# Bull & Bear Bulletin

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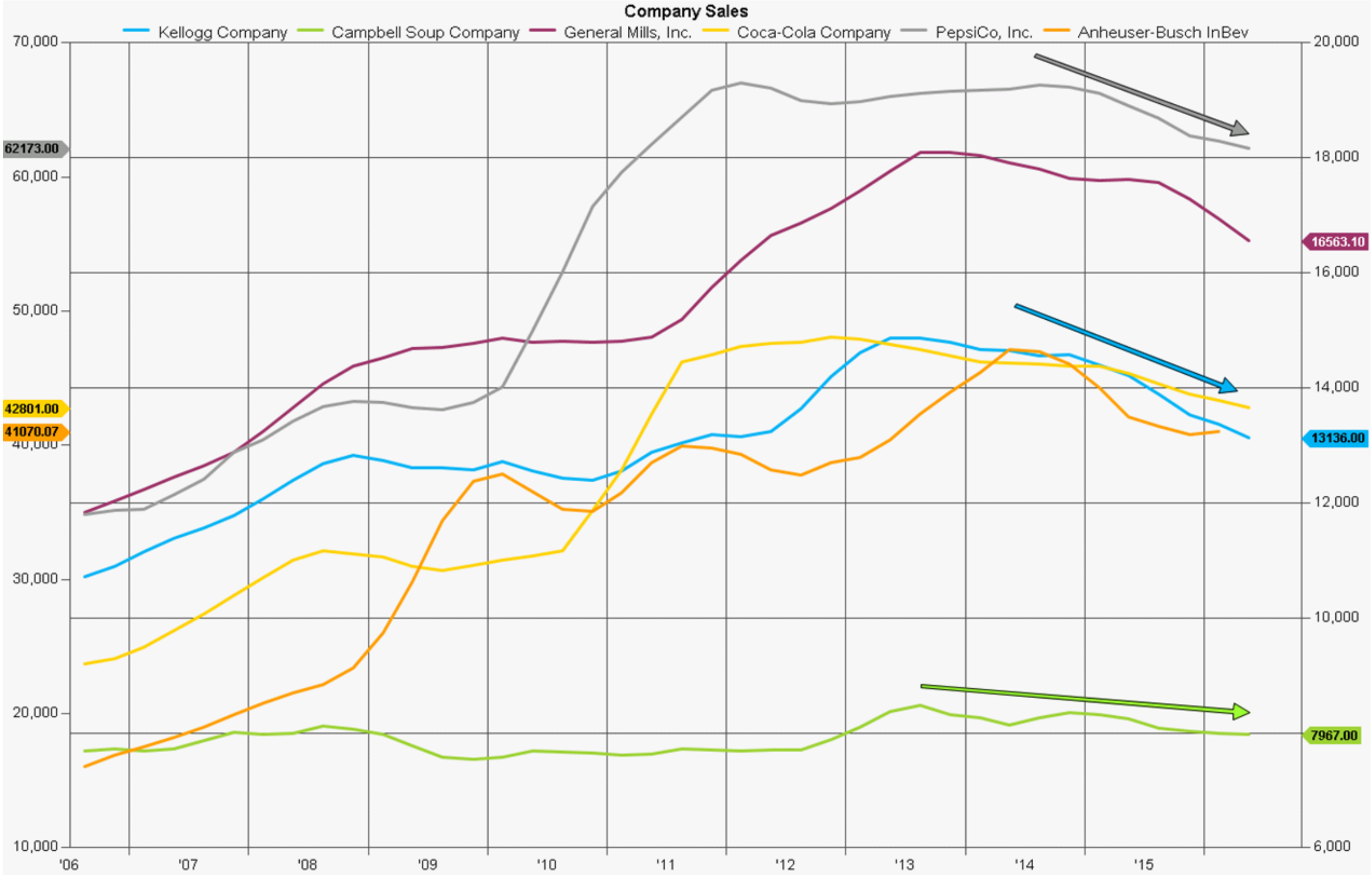
## Is More, Better?

Which of the following quotes is more accurate: "Many hands make light work" or "Too many cooks in the kitchen spoil the broth"? Both sayings reflect people coming together, but each results in a different conclusion. In business, mergers and acquisitions (M&A) refer to the joining of two companies. The goal of M&A is to create synergy within the new company, which usually means reducing costs and maybe even creating revenue generating opportunities. When "Too many cooks are in the kitchen," processes may become overly complex or unprofitable and layoffs follow. Recently, there has been significant M&A activity in food manufacturing, leaving many to believe there's more to follow. As investors, we need to look at similar previous transactions to identify investing opportunities and possible pitfalls. Luckily, the healthcare industry just went through the hottest year in M&A history and may provide a good starting point for analysis.

Just six years ago, the healthcare industry was highly fragmented and resources were scarce for small providers. New reporting demands (e.g., measurable performance changes via data analytics) of the HITECH Act of 2009 provided among other things a catalyst to merge different medical services to meet capital intensive software requirements. Larger networks acquired low volume, rural providers and niche services such as ambulatory care or biotech developers. In 2010, only 913 healthcare related M&A transactions (valued at $206 billion) occurred but, in 2015, 1,498 transactions (valued at $563 billion) were completed. As new business segments were added and growth was achieved through innovation, some networks flourished while others like Community Health Systems (CHS) have not. CHS just posted a $1.43 billion loss this month, as a write-off for struggling acquisitions. CHS pointed to smaller, underperforming, specialized, rural providers as the source of this problem and is looking to divest twenty-two of them in the near future.

Like the healthcare industry, food manufacturing is now fragmented between legacy brands and small, agile companies. Legacy brands dominate the distribution channels and are household names, but they now struggle to meet the millennial generation's tastes and concerns (e.g., social responsibility and natural/organic ingredients) that new brands can meet. As depicted in the graph below, you can see legacy brands' sales starting to decline in late 2014, but that has provided a catalyst for M&A in food production. On July 2, 2015, Kraft and Heinz (now Kraft Heinz) merged under the leadership of Warren Buffett and 3G Capital, a private equity firm. Thus far, cost reduction (zero based budgeting) has been highly successful, but revenue growth is still illusive. In July 2016, Mondelez International, a previous spinoff of Kraft, offered to acquire Hershey for $23 billion at a 20% premium, but the deal fell through. In the same month, Danone purchased the niche, organic company WhiteWave (products include Silk, Horizon Organics and Alpro) for $12.5 billion at a 22% premium.

This wave of M&A in food manufacturing hasn't had enough time to play out yet. As consumers' tastes change, the question remains whether long standing food companies will be able to efficiently meet the new demands. So far, Kraft Heinz has been an example of "Many hands make light work," but the unsuccessful Hershey-Mondelez deal may point to future uncertainty. Only time will tell in this battle of the Bull and the Bear.



*Source of Chart: FactSet*

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