



HD Industry Trends And Developments - Food - Canada - Q3 2014

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Key Industry Trends And Developments

Saputo Outlines Plans for Fiscal FY15

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On releasing its FY results in June 2014, **dairy** giant Saputo stated that during fiscal 2015 it intends to continue to improve its efficiencies. In Canada, the **Dairy** Division aims to pursue volume growth in commodity and specialty-type cheeses and in the fluid **milk** category as well as looking for opportunities in the value-added **milk** category, including specialty cheeses. The division will also complete, in the first quarter of fiscal 2015, a project to consolidate distribution activities of the Greater Montreal area into one distribution centre located in Saint-Laurent, Quebec.

On an international basis, the **company** intends to pursue sales volume growth in existing markets as well as develop extra international markets from its **operations** in Argentina. Saputo also intends to accelerate growth in Australia following its **acquisition** of Warrnambool. Indeed, CEO Lino Saputo confirmed that the **company** is examining further possible acquisitions in Australia, the US, Canada and Latin America. In the United States, potential acquisitions could cost less than CAD100mn to as much as CAD4bn. According to Saputo, "The US industry still is very fragmented. So I think there are some great opportunities for us that could be small, medium or large." He added that the **company** may also look for acquisitions in Canada worth around CAD100mn and is eager to add to its new foothold in Australia, where seven or eight players control up to 95% of the **dairy** industry. Due to their growing middle classes, Latin American countries, such as Brazil, are also attractive according to Saputo.

Maple Leaf Streamlines Meats **Business**

In spring 2014, following the **sale** of the Canada **Bread business**, Maple Leaf Foods announced plans to "streamline" its management structure with the goal of improving the profitability of its branded packaged consumer meats **business**. Details of the total numbers of jobs to be cut were not disclosed. According to CEO Michael McCain, "These changes will support that future by consolidating multiple layers of management into a streamlined, responsive and integrated structure."

In June McCain refuted recent press speculation that the **business** was up for **sale**, stating that "We are very committed to the protein **business**. We have another six months to a year of activity and hard work to complete that restructuring journey." The **company** has also introduced a "complete protein snack" in a bid to get more Canadians to ensure they are getting an "adequate amount of complete protein" in their diets.

Saputo in the Market For International Acquisitions

Saputo, one of the top 10 largest **dairy** companies in the world by sales and Canada's biggest, has indicated it will continue its aggressive **acquisition** strategy. In our view, Saputo will likely concentrate on expansion within key Latin America regions such as Brazil and Argentina, along with new interests in Asia following its **acquisition** of a majority **stake** in Warrnambool **Cheese** and **Butter**.

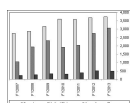
Saputo confirmed in early February 2014 that it had increased its control over Australia's Warrnambool and has reaffirmed that it is still in the market for acquisitions, both domestically and internationally. Saputo, along with rivals Parmalat and Agropur, control more than three quarters of

the Canadian **milk** market. Saputo has announced its intention to consolidate its leading position within Canada, primarily in an attempt to increase its profit margins in the North American region. The **company** is currently implementing a large-scale investment upgrade of its plants and equipment in its Canadian **operations**, and in January, Saputo acquired the fluid **milk** activities of Scotsburn Co-Operative.

Elsewhere, however, Saputo is primarily playing a volume game in order to take advantage of the burgeoning **dairy** industry as quickly as possible. While the **company** takes a large share of its revenues from the US market, the size of the industry means that Saputo is a minority player. The **company** has made efforts to increase its presence in the US **dairy** sector with the **acquisition** of Morningstar Food in 2012 for USD1.45bn. Saputo is, however, the third largest **cheese** producer within the US, and as such will be making attempts to gain market share in the speciality cheeses sector.

Internationally, Saputo is primarily looking to grow via acquisitions. The **company** is already the third largest **dairy** processor in Argentina, and its recent takeover of Warrnambool precursors a move into the highly lucrative Asian **dairy** market. International revenues, however, still account for a very small portion of Saputo's overall revenues, suggesting that there is a great deal more activity left to come.

Could Do More Internationally
Saputo - Revenue By Geographic Region (CADmn)



Saputo has suggested that its primary focus of international expansion is currently Brazil, along with consolidation within Argentina. Brazilian **dairy** production is the fifth highest globally, behind the US, India, **China** and Russia, having doubled within 15 years. The Brazilian **milk** industry is dominated by two entities: **Dairy** Partners of Americas, a partnership between Nestle and Fonterra, and domestic **firm** Lacteos Brasil, which came about from a merger between Laticinios Bom Gosto and Leitbom in 2010.

After these two powers, the Brazilian **dairy** industry is very much fragmented, which allows Saputo considerable scope for acquisitions. The **company** is certainly in a viable financial position to do so. In FY2013, its total debt/ EBITDA ratio stood at 2.0x, even with its high-profile takeover of Morningstar. The **company** has since brought this ratio down to 1.7x; in our view this will likely increase its leverage, following previous years of a well-managed, low debt burden.

Agropur Embarks on **Acquisition** Spree

Canadian **dairy** co-op Agropur embarked on a round of acquisitions during 2013. Following Agropur's merger with local peer Farmers Co-operative **Dairy** in April, the **company** then acquired Nova-Scotia based Cook's **Dairy** a month later followed by British Columbian ice cream maker Coast Mountain **Dairy** in July. The deal allows Agropur to add superior frozen products to its Island Farms **brand**, extending its offering in British Columbia, according to Agropur CEO Robert Coallier. Coast Mountain **Dairy** produces premium ice creams under the Sara's Old Fashioned and Mountain Pride **brand**, as well as an economy line of ice cream and frozen desserts under the Arctic Star **brand**. Cook's **Dairy** has been in operation since the 1920s and produces 2.7mn litres of **dairy** products annually.

In late 2013 Agropur announced a further two acquisitions, firstly purchasing own label and ingredients supplier **M. Larivee International**. Agropur said the **acquisition** would help it build its presence outside Canada. According to Agropur CEO Robert Coallier, "The **acquisition** of MLI goes hand in hand with our desire to develop the export market. MLI's expertise will see us significantly accelerate our development as well as access very promising markets."

This was followed by the **purchase** of Quebec **cheese** manufacturer Fromagerie Damafro. The latter makes a range of **dairy** products, including **cheese**, Greek yoghurt and goat's **milk** and distributes its **cheese** south of the border in the USA.

In March 2014 Agropur announced a merger with local **dairy firm** Dairytown Products. The deal was approved by the producer-members of Dairytown in June by more than a 99% majority, with a turnout of more than 80%. The merger was expected to close at the end of June.

Foreign Companies Looking To Establish And Expand Canadian **Operations**

While the Canadian economy is showing signs of strain, foreign companies appear interested in its longer-term potential, presumably also as an export base for the US. To this end, for example, in July 2013, Spain-based food processing **company** Natra announced plans to establish a new production plant in London, Canada, with an investment of USD15.8mn. The move to develop the new facility, which is expected to create 60 new jobs, is part of the **company's** strategy to cater to the rising demand for its products and increase sales in the North American market. Natra said the 100,000 square foot facility is scheduled to start **operations** by early-2014 and will have an estimated output of 12,000 tonnes.

In a related development, US Del Monte Fresh Produce plans to expand into Canada with the launch of its first fresh-cut processing plant in the country. The **company** intends to open a processing facility in Oshawa, Ontario, by Q4 2013. Del Monte's 108,000-square-foot plant is expected to accommodate 16 trucks simultaneously and also serve as a forward distribution centre for fresh produce.

In late 2013 Canada-based food technology **firm** EnWave signed a collaboration agreement with an option to licence with US-based fish wholesaler Pacific Live LLC. Under the terms of the agreement the Canadian **company** will develop a number of high-value, premium-quality dehydrated seafood products using the **Company's** Radiant **Energy** Vacuum or REV(TM) technology for potential distribution across the American and Asian markets.

At the same time Canada-based Conestoga Meat Packers is increasing the production capacity of its facility in the Kitchener-Waterloo region of Canada by one-third, creating 100 new jobs. The **company** is spending more than USD13.6mn to add 25,000 square feet of cooler space at the plant, where it will place new refrigeration equipment. Conestoga's investment will be part funded by the Southwestern Ontario Development Fund, which has given USD1.4mn towards the project.

Finally, KFC Canada, a subsidiary of US-based fast-food chain KFC, is set to open its new Select restaurant concept in Toronto in December 2013. The food chain expects to attract masses with a menu priced CAD5.99 (US\$6.69), offering a rice bowl, and grilled chicken burritos with cilantro rice and mango salsa. The **company** aims to expand in Canada, according to General manager Nicolas Burquier.

In summer 2014 Canada-based food **company** Dr. Oetker Canada officially opened its new frozen pizza production unit in London, Ontario. The unit, operational since mid-March 2014, will serve as a production centre for the **company's** North American pizza **operations**. The plant is expected to produce up to 50mn frozen pizzas a year for both Canadian and US markets.

Canadian Companies As **Acquisition** Targets

A number of Canadian companies have recently been acquired for foreign players. For example, in November 2013, Spanish food processor Ebro Foods purchased Toronto-based baker Canada **Bread's** pasta and sauce subsidiary Olivieri Foods - owned by Maple Leaf, for about USD120mn. The transaction, completed at the end of 2013, will maximise the **business** value of its fresh pasta **business**, according to President and CEO Richard Lan. Ebro said the **acquisition** will enable the **company** to enter the fresh pasta and sauces segment in Canada through the leading **brand**.

Canada **Bread** is a leading producer and marketer of value-added flour-based products, such as fresh **bread**, rolls, bagels and sweet goods, frozen partially baked or par-baked breads and bagels and specialty pasta and sauces. CEO at Maple Leaf, Michael McCain said the money made from the **sale** will be used in lowering the **company's** debt, reinvesting in its **business** and returning capital to shareholders.

Previously, in October 2013, Maple Leaf Foods' share price increased following the **sale** of its Rothsay rendering **business**. US-based Darling International has acquired Maple Leaf's Rothsay rendering **business** for a consideration of USD645mn. The **sale** includes six rendering facilities situated across Canada in Manitoba, Ontario, Nova Scotia and Quebec and a biodiesel facility situated in Quebec.

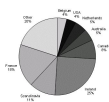
In autumn 2013 Maple Leaf started an auction to sell a majority **stake** in its bakery **business** Canada **Bread Company**. In early 2014 Mexican food giant Grupo Bimbo announced the **acquisition** of Canada **Bread** in a deal worth CAD1.83bn. The **purchase** builds on Bimbo's large US acquisitions in recent years and strengthens its position as the top **bread** maker in North America. The deal was completed in May 2014.

Canadian Investors **Acquire** UK's Burton Biscuits

In November 2013, one of the UK's largest biscuit companies, Burton's Biscuits, was **sold** for around GBP350mn to Canadian pension fund Ontario Teachers' Pension Plan, which also owns Camelot, the operator of the UK's National Lottery.

Burton's, which markets brands such as Cadbury and Maryland biscuits, as well as Jammie Dodgers and Wagon Wheels, recorded revenues of GBP333mn in 2012, with earnings before interest, tax, depreciation and amortisation (EBITDA) of GBP34.6mn. Burton's earnings have grown at a compound annual rate of 14% since 2009, with the **company** also reducing its leverage significantly in recent years. The **company** has recorded sustained recent growth through strong performance of its 'power brands', both domestically and internationally. Though the UK accounts for 85% of Burton's total revenues, its international presence is varied and as such harbours the ability to expand within many geographic markets.

Wide International Presence
Breakdown Of International Revenue (Excluding UK)



Representing the confidence in Burton's, some 30 companies were reportedly interested in the bid. The **purchase** from Ontario Teacher's Pension Plan has fuelled speculation that Burton's could expand its portfolio and manufacturing capabilities within Canada, which currently accounts for about GBP4mn of the **group's** total revenues.

Product Recalls Weigh On Food Industry As Regulators Roll Out New Plan

The Canadian food market has witnessed a number of product recalls in recent months. Not only will this have a negative impact on the performance of the companies in questions, but could also reflect on consumer confidence in the industry as a whole. On the other hand, the timely recall and the investigation by the Canadian Food Inspection Agency could conversely reaffirm consumer confidence.

In May 2013, Canada's government introduced the 'Safe Food for Canadians Action' plan, aimed at further strengthening the country's food safety system, Food **Business** Review reports. Agriculture Minister Gerry Ritz said the plan will aim to tighten regulation, introduce effective inspection, a renewed commitment to service and better information for customers. The Canadian Food Inspection Agency is to launch significant food safety enhancements through the Action Plan over the next two years and will work with consumer groups and industry to develop new regulations to implement the Safe Food for Canadians Act.

Some of the most recent developments in this area include the following:

* In February 2013, Canadian Food Inspection Agency (CFIA) confirmed that Denmark-based **dairy company** Arla Foods had recalled selected Mauri **brand** gorgonzola **cheese**. The recall has been issued amid concerns the **cheese** products may be contaminated with listeria monocytogenes. Shortly prior, the Canadian branch of food retailer Nestle recalled five flavours of its Buitoni pizzas, reported CP24. While the Canadian Food Inspection Agency said there have been no reported complaints in the country, there have been at least two reports in Europe.

* In March 2013, the Sesame Paste Tahina product was recalled by Canadian food manufacturer Clic International. The product has been recalled owing to a threat of salmonella contamination.

* In April 2013, Stuffed Eggplants were recalled by Canadian food **company** Osmat Imports, amid contamination fears. The Canadian Food Inspection Agency (CFIA) has confirmed the recall, stating that there are concerns that the product could be contaminated with Clostridium botulinum.

* Around the same time, the Canadian Food Inspection Agency confirmed that St Thomas Fish Market is recalling jars of bar clams amid concerns about Clostridium botulinum contamination. As of yet, no reported cases of illness have been associated with consumption of these products, and it has been stated that the recall was made voluntarily.

* In July 2013, Canada-based agricultural cooperative Agropur voluntarily recalled its Gorgonzola Dolce **Cheese** because of possible contamination by Listeria monocytogenes. The CFIA is monitoring

the effectiveness of the recall of the product, which was **sold** across Alberta, Manitoba, Ontario and Quebec and possibly in other parts of Canada.

* In August 2013, Canadian food **company** Diwa Products voluntarily recalled its own **brand** grated coconut products amid salmonella contamination concerns. The Grated Coconut originates from the Philippines and has been **sold** frozen throughout Canada.

* In September 2013, Canada-based Ippolito Fruit and Produce issued a voluntary recall of selected spinach brands amid concerns over salmonella contamination. The CFIA confirmed the recall, which applies to specific batches of the **company**'s Frisco's, Queen Victoria and Metro brands. The spinach products are known to have been distributed throughout Ontario and Quebec and may also have been circulated in other regions of Canada.

Interest In Healthy And Environmentally Friendly Alternatives

Demand for healthier food is increasing in Canada - in line with global trends - as consumers try to adopt healthier lifestyles. The government's funding is also forthcoming in this direction, which can be viewed as an effort to boost the Canadian nutritional products industry.

In early 2012, the government announced funding for a national multi-year Healthy Eating Awareness and Education Initiative. The next phase will focus on promoting healthy eating by encouraging consumers to reduce their intake of food and drinks high in calories, fat, sugar and sodium. Healthy eating habits, such as eating more fruits and vegetables, will be promoted through various outreach partnerships, social media engagement and web tools.

In October 2010, a total of 34 food companies including Kellogg's, PepsiCo, Campbell Soup **Company** and Kraft Foods entered into a nutrition initiative - Nutrition Facts Education Campaign - in Canada. The initiative has been developed by Health Canada, the government department dealing with national health policy, and industry association Food & Consumer Products of Canada. The goal of the campaign is to help consumers to understand the nutrition facts table on products; specifically the data on packaging showing the percentage daily value. Minister of Health Leona Aglukkaq said that the information in the nutrition facts table allows Canadians to make healthier food choices. In the first year of the campaign, messaging was placed on more than 300mn units of products.

In a related development, in April 2013, Canadian sea food enterprise, AC Covert Distributor, launched a new **brand**, reports Food **Business** Review. The **brand** Jail Island Seafood, intends to support and improve the fishery industry by donating a percentage of its sales to projects set to develop more eco-friendly and efficient methods of sourcing sea food. The products which will be available exclusively through AC Coverts and its identified distributors are intended to provide 'responsibly caught fresh, local, premium and traceable sea food', according to AC Covert general manager Mike McGlone.

More recently, targeting the wellness trend, PepsiCo Food Canada (comprising Frito Lay and Quaker divisions) launched its new Harvest Crunch Quinoa Granola Bars. The new product, unveiled in August 2013, has been created by Quaker Canada's research and development team as the first quinoa bar to be **sold** at key MGR outlets across the country. Quaker's portfolio of health bars already includes the well-known Harvest Crunch.

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