Intersection Investing: A Better Approach

It's common to hear both investors in the food sector and food companies planning M&A or innovation strategy speak in terms of a particular macro-trend. The strategic rationale for an investment, acquisition or innovation is explained in terms of being "on trend" with macro forces like "The 19 minute lunch hour," "The rise of private label" or to "Go organic." Based on these trends, many merchant bankers and consultants generate long lists of investment opportunities for their clients.

We won't. In IAP's view, the strategic rationale behind generic, single-trend investing, M&A or innovation is roughly at the level you remember from late-night college bull sessions about "The meaning of life:" clichés are filling in for broader insight and experience.

Intersection Investing

How can a food company do better in pursuing an M&A or innovation strategy? At IAP, we help clients pursue what we call an "Intersection Investing" strategy.

What is an intersection investing strategy? The intersection investing approach starts with macro trends like those above, but it then insists on a second level of disciplined focus – a coherent intersection between a macro trend and a second, more specialized characteristic or a unique capability. In other words, IAP believes that no particular trend is your friend: only trends that intersect another axis – capability – generate truly compelling investment opportunities. Why this extra layer of investment discipline from the outset? *Because the long-term challenge of the food sector is to deal simultaneously with rapid industry change and fierce competition*. There hasn't been a true "Blue Ocean" option in food business strategy since humans became omnivores. Therefore, IAP suggests that whether you're conducting a general search, evaluating a specific firm, or wondering about a particular investment, don't ask, "Is this target on trend?" Instead, imagine an old-fashioned treasure map, and ask, "Does X – an intersection of trend and unique competitive capability – mark the spot?"

Sustainable Trends versus Fads

The first question we get when we introduce the intersection investing concept is, "Great, but how do you tell a sustainable trends from a short-lived fad?" The answer is to look at the underlying drivers. Is this *only* about food, or does the food trend reflect deeper and longer-lasting macro factors like demographic change or a new technology? Fads, in other words, are usually confined to the food sector only, and don't have much outside support.

"No Carb" - Not a well-grounded trend

Gelatin "salads", for example, were all the rage at dinner parties in the 1950s (think celery-flavored gelatin, congealed with chopped celery, pimento olives and cheese: yum!). Then came fondue in the 1970s (not just cheese – meat boiled in oil, too!). More recently we saw "No Carb" offerings take off and then fade away. These phenomena were fickle consumers meeting marketing dollars. As you'll see from the following example, *real* trends in the food business reflect broader and deeper societal changes.

An Example: Axis One

Let's look at a specific example. Anyone who hasn't been trapped in a salt mine for the last few years knows that Hispanics make up an increasingly important part of the U.S. market for everything. After all, Latinos now make up 16% of the U.S. population. Nevertheless, the latest data on the Hispanic market retain power to surprise:

1) **It's big**. By 2015, Latino buying power will reach $1.5 trillion. Put this in perspective: if the U.S. Hispanic market were detached from the rest of the country, it would be one of the G20, or top twenty economies in the world[1]; its per capita income would be higher than three out of four of the much-vaunted BRIC countries.[2]

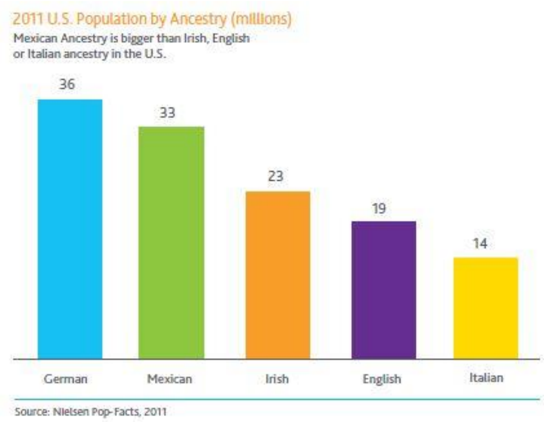
2) **It's growing.** Between now and 2050, the total U.S. population is expected to grow by 42%. In that period, the U.S. White, non-Hispanic population will grow by only 1%. The U.S. Hispanic population? It is estimated to grow by 167%.[3]

[1] According to the CIA World Fact Book, 2011 Hispanic buying power was $1.11 billion, which would place it 11th on the list of G20 countries, ahead of Turkey, Australia, Argentina, Saudi Arabia and South Africa.
[2] According to the U.S. Census Bureau, in constant 2009 US dollars, Hispanic per capita income is beneath that of Russia, but above that of Brazil, India and China.
[3] See Nielsen "The Hispanic Market Imperative", Q-2 2012.

3) **It's getting richer.** Despite the recession, U.S. Hispanic households that earn more than $50,000 are growing faster than total national households. Consider Hispanic income growth versus the averages from 2000 to 2011:

2000 to 2011 Percent US Household Income: Latino Growth is Loco		
Household Income	US Total	Hispanic
<25k	-17%	-19%
25-34.9k	-13%	-10%
35-49.9k	-6%	0%
50-74.9k	0%	10%
75.99.9k	16%	31%
100k+	49%	71%
Source: US Census Bureau		

4) **It's sustainable.** This is no fad. Hispanic population growth can be confirmed as a sustainable trend in two ways. First, its growth is organic: even if immigration completely ceased tomorrow, the Hispanic market will keep growing due to higher birth rates. Second, the Latino population is exhibiting more cultural persistence than past waves of immigrants to America. Modern technology, ease of travel across international borders, and what sociologists call "retro acculturation"[4] are combining to mean that U.S. Hispanics are not shedding their culture and blending into the American mainstream in the same manner as past waves of immigrants.[5] In other words, Hispanic culture will evolve, but Latinos will remain a distinct subset of the U.S. population for the foreseeable future. And by the way, Americans of Mexican ancestry now outnumber those of Irish, English or Italian ancestry.



Axis Two, or Completing the X

OK, you're sold: Hispanic products are not merely a niche or a fad, they're part of a growing opportunity *for some firms*. Which ones,

[4] Retro-acculturation is commonly defined as "the practice of adult Hispanics wanting to learn or improve their Spanish, learn more about their family histories and to take ownership of Hispanic cultural practices". For example, according to Nielsen, 37% of Hispanic adults who spoke English mostly when they were young children indicated that they learned enough Spanish to become bilingual. The majority expressed a desire to read, watch and listen to more Spanish language media in the next five years. See: http://www.hispanicmarketadvisors.com/articles/retro-acculturation_process.html

[5] US census data show that 72% of intermarried parents (with one Hispanic and one non-Hispanic partner) classified their children as Hispanic in 2011, compared to only 35% who did so in 1991.

however? If you've followed our argument so far, you know that compelling macro data *alone* doesn't mean that an Hispanic opportunity makes sense for *your* firm, and you shouldn't use it as the sole basis of an investment decision.

To be truly compelling, an Hispanic opportunity must intersect with something else either in the outside world or for your company. That "something else" might be a specific attribute of a product or service, or it might be another trend a target firm somehow taps.

For example, we recently worked with a firm producing unique, all-natural lactose-free and sugar-free treats. The younger characteristics of the Hispanic market hold an obvious attraction for U.S. treat-makers, but it was the other intersections that made this firm a compelling investment opportunity.

IAP was able to point out, for example, that though Hispanics were not this company's current focus, it was ideally placed to break into the Latino market. The case for that opportunity was grounded in some lesser-known dietary and medical data about the U.S. Hispanic population:

1) Lactose intolerance varies greatly worldwide, but one key variable is ethnicity. According to the U.S. National Institute of Health, as much as 50% to 80% of the U.S. Hispanic population may be lactose intolerant.[6] This number may be overestimated somewhat by self-diagnosis, but nevertheless, 77% of Latinos who believe that they are lactose intolerant take steps to reduce or limit the amount of dairy in their diet.[7]

2) Compared to non-Hispanic white adults, the risk of diabetes is 66% higher among U.S. Hispanics generally, with the disease rising even higher in some sub-categories (for example, among Mexican Americans diabetes was 87% higher, and among Puerto Ricans it is 94% higher than the norm).[8]

3) Sadly, diabetes tends to strike Hispanics at younger ages than the non-Hispanic white population, and the likelihood of the disease increases with age. Hispanic women born in 2000 have a 52.5 percent risk of developing diabetes in their lifetime while Hispanic men have a 45.4 percent risk. That compares to a 31.2 percent risk for non-Hispanic white females and 26.7 percent risk among non-Hispanic white males and a 49.0 percent and a 40.2

[6] See http://www.aafp.org/afp/2002/0501/p1845.html and http://www.statisticbrain.com/lactose-intolerance-statistics/
[7] See: http://hispanic-marketing.com/bl/demographics/new-research-finds-latinas-with-lactose-intolerance-manage-by-avoiding-dairy/
[8] CDC "National Diabetes Fact Sheet, 2011.

percent risk among African American women and men respectively. [9]

In short, this firm, with unique lactose and sugar-free treats, appealing to all ages but especially to kids, lay at the center of the X. They were not merely "on trend" because they sold a product that appealed to kids. Their unique attribute of being all-natural but lactose and sugar-free put them literally and figuratively in "the sweet spot," at the intersection of both a macro trend and unique, value-added capabilities within that trend. In other words, the firm could *harness a change in the industry and had a distinctive competitive advantage*.

The Bottom Line

IAP believes that food and beverage businesses must simultaneously cope with rapid industry change *and* fierce competition. Trend-chasing investments, M&A or innovation tactics only address industry change, and don't always address the competitive aspect. If you insist on an intersection investment strategy from the start, your firm will be on trend *and* in a far better position to compete and succeed when the deal is done.

IAP focuses solely on the food and beverage industry. We'd welcome a chance to discuss what an intersection investment strategy might look like for your firm, whether in the Hispanic market, engaging other macro trends, or leveraging the unique capabilities of your firm as our point of departure.

Insight Advisory Partners advises companies in the food industry across all aspects of corporate and financial strategy including strategic growth initiatives, capital raising strategies, acquisitions and divestitures, retained search, due diligence, pre-and post-merger integration, turnarounds and financial restructurings.

For more information please visit us at www.insightadvisorypartners.com or call 312.399.3627.

[9] CDC: Fact Sheet "Prevalence of Diabetes among Hispanics In Six U.S. Geographic Locations"