ConAgra Foods: Anatomy of a Merger

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Banquet ® , *Chef Boyardee* ® , *Egg Beaters* ® , *Healthy Choice* ® , *Hebrew National* ® , *Hunt's* ® , *Marie Callender's* ® , *Orville Redenbacher's* ® , *PAM* ® , *Peter Pan* ® , *Reddi-wip* ® , *Slim Jim* ® , *Snack Pack* ®. If you recognize any of these names, you've tasted ConAgra Foods products, and perhaps have them on your pantry shelf. ConAgra Foods was one of the largest packaged foods companies in North America, with its products found in almost all American households. In addition, ConAgra had a large commercial foods business, supplying global restaurants and food service operations.

Largest packaged food producer in North America. This is what ConAgra became when in purchased Ralcorp in January 2013. While the title of largest producer was a big step forward, ConAgra had faced problems since the acquisition was made – reduced profitability, lower earnings per share and an extraordinarily high increase in debt.

The Industry

ConAgra is part of a large, competitive food manufacturing industry. Major players in the industry include General Mills, Kraft, Kellogg, Nestle, and Schwann Food Company. As the economy recovers and consumers have more disposable income, ConAgra can expect to benefit through greater volume and potentially more demand for its premium products. There is a consumer trend toward healthier, organic and non-GMO foods and smaller portions. Buyers may become more willing to pay a premium for organic and health foods products. Industry growth rates ranged from 2.2% to 5%, depending on the specific segment (frozen and packaged foods, cakes and pastries, frozen pizza and cookies, crackers and pasta.

The industry was mature, indicating future low but stable growth, with higher growth in organic and health foods segments. For example, General Mill's brand, "Annie's" grew 20% from 2013 to 2014. See Exhibit 1 for ConAgra's financial statements. The food industry underperformed relative to the S&P 500, but outperformed the consumer staples group in 2014.

Add industry analysis (Daniel)
Add ratio analysis of competitors to exhibits

ConAgra Foods

ConAgra began as a Midwestern flour-milling company, initially incorporated as a Nebraska corporation in 1919 and were reincorporated as a Delaware corporation in December 1975. The firm has expanded its food business, largely through acquisitions of packaged food brands, and divesting dehydrated and fresh vegetable operations, packaged meat and cheese operations and poultry, beef and pork businesses. The firm, headquartered in Omaha, Nebraska, had 32,800 employees, primarily based in the US.

ConAgra unveiled "Recipe for Growth" in 2012, the firm's strategic roadmap for its operations. The firm had five areas of focus for its business: Core, International, Private Brands, People and Citizenship. Acquiring Ralcorp Holdings, Inc., a private brand food manufacturer, in January 2013 was considered to be an important step in the Recipe for Growth. With this acquisition, ConAgra became the largest private brand packaged food business in North America. Research and development was an important part of the firm's growth, with expenses of $103.5 million, $93.1 million, and $86.0 million in 2014, 2013, and 2012, respectively.

ConAgra's 2014 annual report stated that its goals were:

- Growing branded and private branded portfolios through innovation
- Creating a more customer-focused company, becoming a strategic partner and influence for the branded needs of the firm's customers.
- Establishing and further developing qualities that differentiate ConAgra from other food companies, and expanding product markets.
- Implementing high-impact marketing programs.
- Improving spending effectiveness, enterprise business planning and pricing analytics.
- Achieving cost savings targets create an organization that will drive productivity, total delivered cost and customized solutions
- Reducing selling, general and administrative costs.

After the Ralcorp acquisition, for financial reporting purposes, ConAgra divided into three divisions: Consumer Foods, Commercial Foods and Private Brands.

Consumer Foods

This segment included branded foods sold in grocery and convenience stores.. Food products include full meals, entrees, condiments, sides, snacks, and desserts, including frozen, refrigerated and stable temperature foods. This includes international sales of consumer food products. Major brands included: *Alexia*®, *ACT II*®, *Banquet*®, *Blue Bonnet*®, *Chef Boyardee*®, *DAVID*®, *Egg Beaters*®, *Healthy Choice*®, *Hebrew National*®, *Hunt's*®, *Marie Callender's*®, *Odom's Tennessee Pride*®, *Orville Redenbacher's*®, *PAM*®, *Peter Pan*®, *Reddi-wip*®, *Slim Jim*®, *Snack Pack*®, *Swiss Miss*®, *Van Camp's*®, and *Wesson*®. The Alexia brand provided ConAgra's foray into frozen meals using natural foods. However, the brand was the subject of a class action false advertising lawsuit for allegedly labeling its products "all natural" when chemicals were present.

Commercial Foods

Commercial Foods included commercially branded and private branded food and ingredients, which are sold primarily to commercial, foodservice, food manufacturing, and industrial customers. The segment's primary food items were frozen potato and sweet potato items and a variety of vegetable, spice and frozen bakery goods which are sold under brands such as *Lamb Weston*® and *Spicetec Flavors & Seasonings*®.

Private Brands

Private Brands included private branded and customized food items sold in various retail channels, primarily in North America. Products included hot and ready-to-eat cereal; snacks; condiments; bars and coordinated categories; pasta; and retail bakery goods. A significant portion of 2014 results came from the newly acquired Ralcorp businesses. ConAgra's largest customer was WalMart, which accounted for 17% of total revenues.

Private Brands vs. Name Brands

Add a section about the merits of branded vs. generic

Mergers and Acquisitions in AgriBusiness

Add section on specific M&A activity in this area

ConAgra's Acquisitions Strategy

Although Ralcorp was by far one of ConAgra's largest acquisitions in January, the firm purchased (or sold) the following:

- Purchased assets from Harlan Bakeries acquired in September 2013 including machinery, operating systems, warehousing storage and other assets associated with making pies, pastry shells and cakes.
- Purchased P.F. Chang and Bertolli brands frozen meal business, acquired in August 2012.
- Sold Medallion Foods, a small snack business in April 2014.
- Sold assets of Lightlife, a plant protein business, in September 2013 to Brynwood Partners.
- Joint venture with Cargill and CHS Inc. to create Ardent Mills, a flour milling operation that included ConAgra's milling and Horizon Milling, owned by Cargill and CHS.

The Ralcorp Acquisition

In January 2013, ConAgra purchased Ralcorp for $5.07 billion. If Ralcorp's cash was subtracted from the purchase price, the net price was $4.75 billion. Ralcorp manufactured private brands of products such as ready-to-eat and hot cereals, nutritional and cereal bars, snack mixes, cookies and crackers, snack nuts, peanut butter, jellies, syrups, dressings, frozen griddle products, frozen pre-baked products, dry pasta and frozen pasta meals. The acquisition was funded with existing cash, a senior, unsecured term loan, new senior notes and common stock. Ralcorp's financial statements prior to its acquisition are contained in Exhibit 2. ConAgra's estimate of the fair value of Ralcorp's assets is contained in Exhibit 3. Information about companies comparable to ConAgra is contained in Exhibit 4.

Acquisition Challenges

ConAgra's integration of its Ralcorp acquisition was not going well. In addition to decreases in Consumer Foods volumes, unrelated to the Ralcorp acquisition, ConAgra noted "challenges" in its Private Brands profitability. According to ConAgra's 10K report, "We anticipate fiscal 2015 to be a year of stabilization and recovery. We plan to benefit from stronger underlying operations, generate sizeable productivity and administrative savings and continue to realize substantial synergies from the Ralcorp transaction." The profitability "challenges" were reflected in a steep drop in earnings per share from $1.85 in 2013 to $0.70 in 2014. In fact, in 2014, the Private Brands division went from a $123.1 million operating profit in 2013 to a $375 million loss the following year. Profits in Consumer Foods were also down from $1,000.2 million in 2013 to $899.4 million in 2014. Profits in the Commercial Foods increased from $731.3 million in 2013 to $774.6 million in 2014.

Integrating Ralcorp resulted in ConAgra's revamping its entire supply chain network and reducing selling, general and administrative expenses, with special attention paid to rightsizing manufacturing assets and optimizing dry distribution and mixing centers. This was expected to cost $325 million, $76.6 of which was non-cash charges. In 2014 ConAgra recognized $83.7 million of these changes and $28.4 million in 2013.

SG&A expenses were $2.77 billion in 2014, an increase of $530.5 million compared to the prior year. ConAgra attributed the increase to the SG&A from Ralcorp's businesses along with charges of $75.7 million, related to intangible asset impairments primarily from the Chef Boyardee brand, a decrease in advertising expenses of $48.9 million but an increase in wages of $63.7 million. From Ralcorp, changes included $605.4 million for impairment of goodwill and other intangible assets in the Private Brands segment, expenses of $94.1 million from the firm's restructuring plan, $53 million to support the integration of the Ralcorp business, and transactions costs of $20.1 million to form Ardent Mills.

Capital Structure Changes

ConAgra primarily used short-term debt to finance ongoing operations, including seasonal working capital needs. The firm had a $1.5 billion revolving credit facility, used primarily as a backup for its commercial paper. As of the end of fiscal year 2014 in May 2014, ConAgra had zero borrowings under the facility. ConAgra was in compliance with the facility's covenants, including having debt of less than 70% of its capital base and fixed charges coverage greater than 1.75. At fiscal year-end, ConAgra had $137 million in commercial paper, down from the peak of $395 million earlier in the fiscal year.

Long-term debt was used to finance base working capital needs and long-term assets. The Ralcorp acquisition also meant acquiring a substantial amount of debt. In 2013, ConAgra issued senior notes for $3.975 billion; issued additional senior unsecurred notes of $716 million in exchange for senior notes issued by Ralcorp, assumed senior Ralcorp notes for $460.7 million and borrowed $1.5 billion under a new term loan facility. This loan, due in 2018, carried an interest rate of LIBOR plus 1.75%. The $3.975 billion in debt was issued in four tranches: 1.4% senior notes for $750 million due in January 2016, 1.9% senior notes for $1 billion due in January 2018, 3.2% senior notes of $1.225 billion due in January 2023, and 4.6% senior notes for $1 billion due January 2043. The $716 million in senior notes consisted of 4.95% notes with a principal amount of $282.7 million due August 2020 and $433.3 in 6.625% senior notes due August 2039.

ConAgra repaid $612 million in debt in 2014 and planned further debt repurchases for 2015. ConAgra's bonds are rated BBB-, as low as a rating can be without being classified as junk, or below investment grade bonds. The firm stated in its 2014 annual report that it was committed to maintaining an investment grade bond rating. ConAgra's long-term contractual obligations are detailed in Exhibit 4. The weighted average interest rate on long-term obligations was 4.2%. Details about ConAgra's long-term debt are in Exhibit 5.

ConAgra has a share repurchase program, and 2.9 million shares of stock were repurchased for $100 million in 2014.

ConAgra did not have a stellar credit rating credit history, particular in comparison to its competitors. (See Exhibit 6). In fact, ConAgra was rated at the bottom in most categories.

What Next?

ConAgra clearly had problems, both in its acquisitions integration, its acquisition strategy and its capital structure choices. Was ConAgra's assessment of Ralcorp's value correct? What range of values might be feasible for Ralcorp? What can ConAgra do to improve is far-below-average credit performance?

Exhibit 1 – ConAgra's Financial Statements
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Exhibit 2 – Ralcorp's Financial Statements
Place IS/BS/CF here

Exhibit 3 – Fair Value of Ralcorp Assets
In Millions, as of January 29, 2013

Assets Acquired	**Fair Value**
Cash and cash equivalents	$320.7
Other current assets	899.0
Current assets held for sale	14.1
Property, plant and equipment	955.9
Goodwill	4,360.6
Brands, trademarks and other intangibles	2,152.7
Other assets	27.7
Non current assets held for sale	57.2
Total assets acquired	**$8,787.9**
Liabilities Assumed	
Current liabilities	$616,2
Current liabilities held for sale	4.6
Noncurrent liabilities	3,097.2

Noncurrent liabilities held for sale	0.1
Total liabilities assumed	**$3,718.2**
Net assets acquired	**$5,069.7**

Note: Assets held for sale is comprised of Medallion Foods, a snack foods subsidiary of Ralcorp that was sold for $32 million in April 2014.

Exhibit 4

Comparable Company Trading Multiples

Company Name	TEV/Total Revenues LTM - Latest	TEV/EBITDA LTM - Latest	TEV/EBIT LTM - Latest	P/Diluted EPS Before Extra LTM - Latest	P/TangBV LTM - Latest	NTM TEV/Forward Total Revenue (Capital IQ)	NTM TEV/Forward EBITDA (Capital IQ)	NTM Forward P/E (Capital IQ)
Kellogg Company (NYSE:K)	2.1x	18.1x	26.3x	50.8x	NM	2.19x	12.03x	17.94x
General Mills, Inc. (NYSE:GIS)	2.5x	13.3x	15.9x	29.1x	NM	2.54x	12.77x	19.22x
Campbell Soup Company (NYSE:CPB)	2.2x	12.3x	15.4x	20.0x	NM	2.27x	11.93x	20.06x
Kraft Foods Group, Inc.	3.4x	27.0x	32.6x	54.9x	NM	3.35x	16.21x	27.74x
Mondelez International, Inc. (NasdaqGS:MDLZ)	2.6x	16.7x	21.0x	30.2x	NM	2.79x	15.70x	23.21x
Dean Foods Company (NYSE:DF)	0.3x	10.1x	31.0x	NM	4.9x	0.30x	6.78x	18.96x
The Hershey Company (NYSE:HSY)	3.0x	13.4x	15.5x	24.6x	NM	2.89x	12.69x	21.59x
McCormick & Company, Incorporated (NYSE:MKC)	2.7x	16.1x	18.1x	24.6x	NM	2.67x	15.56x	22.73x
The J. M. Smucker Company (NYSE:SJM)	3.3x	16.5x	21.6x	32.6x	NM	2.40x	11.66x	18.99x
Hormel Foods Corporation (NYSE:HRL)	1.6x	12.8x	14.5x	23.9x	7.5x	1.57x	12.69x	23.31x

Exhibit 5 – ConAgra's Contractual Obligations

Payments Due by Period (millions)

Contractual Obligations	**Total**	**Less than 1 year**	**1-3 Years**	**3-5 Years**	**After 5 Years**
Long-term Debt	$8,658.8	$76.3	$1,023.7	$3,137.1	$4,421.7

Capital Lease Obligations	79.1	8.9	15.4	10.5	44.3
Operating Lease Obligations	524.0	91.4	150.2	107.0	175.4
Purchase Obligations*	2,409.8	2,027.8	139.3	67.8	174.9
Notes Payable	141.8	2,346.2	1,328.6	3,322.4	4,816.3
Total	$11,813.5	$2,346.2	$1,328.6	$3,322.4	$4,816.3

***** Includes open purchase orders and agreements, some of which are legally binding.

Exhibit 6			
ConAgra's Long-term Debt			
	May-14	**May-13**	**May-12**
4.65% senior debt due January 2043	937	1000	—
6.625% senior debt due August 2039 (including Ralcorp senior notes)	450	450	—
8.25% senior debt due September 2030	300	300	300
7.0% senior debt due October 2028	382	382	382
6.7% senior debt due August 2027	9	9	9
7.125% senior debt due October 2026	372	372	372
3.2% senior debt due January 2023	1225	1225	—
3.25% senior debt due September 2022	250	250	—
9.75% subordinated debt due March 2021	196	196	196
4.95% senior debt due August 2020 (including Ralcorp senior notes)	300	300	—
7.0% senior debt due April 2019	500	500	500
1.9% senior debt due January 2018	1000	1000	—
LIBOR plus 1.75% term loans due January 2018	900	900	—
2.1% senior debt due March 2018	250	250	—
5.819% senior debt due June 2017	500	500	500
1.3% senior debt due January 2016	750	750	—
1.35% senior debt due September 2015	250	250	—
5.875% senior debt due April 2014	—	500	500
2.00% to 9.59% lease financing obligations due on various dates through 2029	79	77	106
Other indebtedness	86	80	73
Total face value of debt	8737	9292	2939
Unamortized fair value adjustment of senior debt in connection with Ralcorp	155	162	—
Unamortized discounts/premiums	(46.5)	(57.5)	(59.8)
Adjustment due to hedging activity	7	9	18

Unamortized fair value adjustment of senior debt in connection with Ralcorp	155	162	—
Unamortized discounts/premiums	(46.5)	(57.5)	(59.8)
Adjustment due to hedging activity	7	9	18
Less current installments	(84.2)	(517.9)	(38.1)
Total long-term debt	8768	$ 8887	$ 2859

Exhibit 7

ConAgra and Peer Credit Health

Source: Capital IQ

Company Name	Overall	Operational	Solvency	Liquidity	S&P Issuer Credit Rating Foreign Currency LT Rating
The Hershey Company (NYSE:HSY)	1	1	2	2	A
Hormel Foods Corporation (NYSE:HRL)	1	2	1	1	A
General Mills, Inc. (NYSE:GIS)	2	1	3	3	BBB+
McCormick & Company, Incorporated (NYSE:MKC)	2	2	1	4	A-
The J. M. Smucker Company (NYSE:SJM)	2	3	2	2	BBB
Campbell Soup Company (NYSE:CPB)	3	2	3	4	BBB+
Mondelez International, Inc. (NasdaqGS:MDLZ)	3	3	2	3	BBB
Dean Foods Company (NYSE:DF)	3	4	4	1	BB-
Kellogg Company (NYSE:K)	4	4	3	3	BBB+
Kraft Foods Group, Inc.	4	4	4	2	NR
ConAgra Foods, Inc. (NYSE:CAG)	4	3	4	4	BBB-

Key: 1 = Above Average, 2 = Average, 3 = Below Average, 4 = Bottom

Teaching Note
ConAgra Foods: Anatomy of a Merger

Case Summary:

ConAgra Foods (CAG) is a packaged foods company, selling brands that can be found in 99% of American households. ConAgra has the largest private brand packaged food business in North America and a strong commercial and food services business. CAG's purchase of Ralcorp, which packages private brand products such as cereal, snack foods, sauces, pasta, breakfast foods and prebaked dough products caused CAG to move from one of the largest to the largest private brand food company. The Ralcorp purchase followed a string of acquisitions, including the P.F. Chang and Bertolli frozen meal business, Kangaroo Brands' pita chips, Odom's Tennessee Pride breakfast foods, Del Monte Canada, Marie Callender brand, National Pretzel Company and an equity interest in Agro Tech Foots Ltd. The Ralcorp purchase was financed primarily with debt, and acquisition which had a significant impact on CAG's capital structure. This case will evaluate the purchase of Ralcorp, including issues of acquisition strategy, valuation, debt financing, and changes in capital structure.

Learning Objectives:

Learning objectives for students include:

- Using discounted cash flow and comparable multiples to value an acquisition target
- Determining an appropriate discount rate for a large company acquisition of a smaller target
- Assessing the success of an ongoing acquisition strategy, including comparing pre-acquisition goals with post-acquisition integration.
- Determining the pros and cons of various methods of financing an acquisition and assessing ConAgra's choice to finance this acquisition with debt.
- Assessing the immediate impact and potential future impact of increasing debt in the capital structure.
- Evaluating ConAgra's free cash flows and its choice of using its free cash flows to make acquisitions.

Research Methods

The case was researched using publicly-available sources, including ConAgra's 10K statements, various financial data bases and financial press articles.

Opportunities for Student Analysis

As a comprehensive case, students could provide a great deal of analysis. However, the instructor could limit the analysis by telling students to focus on valuation or financing or strategy, rather than all three areas. Case discussion questions revolve around valuing Ralcorp and making an appropriate financing choice for the acquisition, and evaluating ConAgra's long-term acquisition strategy. Students could do the following quantitative analyses:

1. Discounted cash flow valuation of Ralcorp. The case would provide historical financial statements and free cash flow would be forecasted using historical percentages.
2. Determine an appropriate weighted average cost of capital to use in finding the present value of the free cash flows. Finance theory says that it is appropriate to use the risk (beta) of the target and the capital structure weights and cost of debt of the acquiring company. These calculations are complicated by the fact that the acquisition is large enough to impact the current capital structure of ConAgra.
3. Value Ralcorp using comparable company multiples provided in the case.
4. Value the synergies of the Ralcorp acquisition, with information about synergies provided in the case, based on ConAgra's SEC filings concerning the acquisition.
5. Determine valuation differences created by each acquisition financing choice, including debt, equity, or a combination of debt and stock to purchase a company.

In addition to the quantitative analysis, students can explore qualitative issues such as evaluating ConAgra's long-term acquisition strategy, the costs and benefits of taking on significant debt, how and why a company should spend its free cash flow, and how acquisitions can be integrated into the acquiring company.

Discussion Questions

1. What does a ratio analysis show about ConAgra's strengths and weaknesses?

Need to download ratios and then analyze.

2. Analyze ConAgra, post acquisition, using Porter's 5 Forces framework.

3. Evaluate the Ralcorp acquisition, using discounted cash flow and multiples analysis. What conditions need to be present or assumptions need to be made in order to justify the price that ConAgra paid?

4. What synergies were present or expected in the Ralcorp acquisition? How might ConAgra have been expected to integrate Ralcorp into its existing operations? To answer this, look at ConAgra's operating expenses, selling, general and administrative expenses and margins to see the impact Ralcorp had on the firm. If ConAgra is able to return to its pre-acquisition margins, what impact could this have on its stock price?

5. ConAgra had a dramatic change in its capital structure, taking on a very significant amount of debt to purchase Ralcorp. Evaluate this decision. Is this an amount of debt that ConAgra can handle, or is this likely to constrain its future operations or impair its acquisition strategy?

6. The industry section in the case notes consumer trends toward healthier, organic foods. ConAgra moved in the opposite direction by selling Lightlife and had difficulty with its Alexia "all natural" brand. Should ConAgra re-explore the trend toward organic and health foods? If so, how?

7. What could ConAgra do to improve its current very poor credit status, when compared to its peers?