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Annual Food Ingredient Executive Survey

Recipes for Growth – 2007

A “State of the Industry” Survey

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Introduction

An author was introduced with the comment that he was so well known that “he needs no introduction” followed by an unnecessarily long description of the speaker’s achievements. For this survey, each of you who provided the valuable information is one of its authors and while you need no introduction, you deserve a grateful “Thank You” for making this survey possible and a “Welcome” to profit from this presentation. The efforts of the independent firm, Best Vantage, which received and compiled your individual reports confidentially, are greatly appreciated.

The Executive Summary on pages 1 and 2 highlights major elements of the Food Ingredient Industry as they exist today and its prospects for the future, followed by graphic illustrations and comments. Some of these show the challenges and obstacles to solutions. Clearly recognizing problems and stating concerns often helps in seeking solutions on how to deal with them. The responses from the participants strongly indicate a positive business environment and growth for this year and the year ahead, particularly with the developing trend in health, wellness and nutrition – despite the supply chain challenges of rising commodity prices; shortages in fruit, other crops and organic ingredients; the international competition; and global uncertainty in general.

While many of you are familiar with the facts regarding the industry, we think the compilation of all the responses and the comparisons with other participants can be beneficial to you. Our firm, while not consultants, is continuously enhancing our expertise and our perspectives in this industry, and this annual survey keeps us up-to-date, which helps in advising clients and prospects. We are also very pleased to provide you with this service and the reception it has generated.

We hope that we are accomplishing our objective of identifying growth paths and opportunities for acquiring or entering new businesses as well as successful internal expansion and encouraging innovative developments. I will be very pleased to receive questions, comments or suggestions directed to me as follows:

Marco V. Galante (mgalante@jhchapman.com)

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Executive Summary

Growth Paths/Trajectories

➤ Business Environment

The positive response provided by the participants was based on an assessment of the market regarding: market demand, supply chain reliability, raw materials, manpower and capital amongst other key factors.

➤ Growth Perspective for 2008-2009

Sixty-one percent of participants projected growth in excess of 8% annually over the next two years, and all project some growth.

➤ Gross Margin Expansion

Gross margin enhancement was identified as a *very important* growth engine by 50% of respondents, down from 62% in 2006.

➤ International Sales Growth

Sixty-nine percent of respondents rated this either *moderately important* or *very important*. This is up from 50% in 2006.

➤ Product Development: New Ingredients and Applications

Forty-eight percent of respondents identified developing new ingredients and applications as a *very important* strategic objective. This is substantially down from 60% in 2006.

➤ Technical Service / R&D / Marketing and Communications

The relative importance of R&D increased with company size, while that of marketing and communications decreased with the size of the company.

➤ Growth by Acquisition, Joint Ventures and Strategic Alliances

Strategic partnerships remained the preferred win-win relationship for smaller companies, while M&A predominated with company size. Twenty-five percent of the respondents indicated growth by acquisition to be *very important*, an increase from 19% in 2006.

➤ Dominant Development Trends

- Health and wellness
- Obesity management
- Nutrient-based label claims
- Natural and/or organic labels

➤ U.S. Manufacturing Environment

Seventy-nine percent of respondents confirmed that the U.S. provides the most favorable manufacturing environment today, significantly higher than 60% in 2006.

➤ Growth Opportunities

Seventy-one percent of respondents expect to increase their commitment to organic foods over the next two years. Organic, natural and whole foods appear to represent strong growth opportunities.

➤ Challenges

Among food executives, challenging factors include: raw material availability and prices, currency exchange rates, labor costs and regulatory issues amongst others. Additional concerns include:

- Global Uncertainty

Sixty-two percent of respondents considered this factor to be a *moderate to very important* one, an increase from 42% in 2006.

- International Competition

Similarly, 67% of respondents considered this to be a *moderate to very important* challenge to growth, having increased from 44% in 2006.

- Market Environment

Eighty-one percent of the respondents indicated that market demand was a *moderate to very important* challenge to growth, up from 73% in 2006.

- Supply Chain – Issues and Reliability

A new category for the 2007 survey for which the majority of respondents anticipate an increasing reliance upon international raw material sources with tighter supply and ever-increasing demand on transportation.

Concerns about raw material availability and pricing was viewed as a *moderate to very important* challenge to growth by 71% of respondents.

- Regulatory Environment

Respondents voiced a desire for stronger enforcement of quality standards, particularly for imported products, while 63% viewed FDA regulatory policies in a positive light and indicated that such policies improved product development opportunities.

- Environmental Challenge

“Green” issues, agricultural sustainability movements and fuel emissions standards were expected to worsen raw material supply situations for a significant number of respondents.

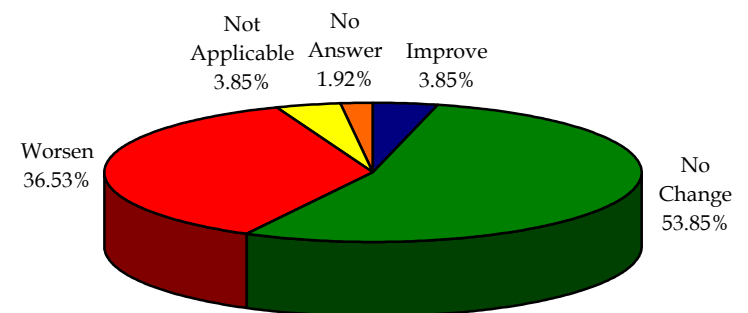


Fig. 1. Anticipated impacts of fuel emissions standards
Q: What are the anticipated impacts of fuel emissions standards on your food ingredient industry sector?

State of the Food Ingredient Industry

During the course of this survey, the food and food ingredient industries were confronted by the following conditions:

1. Rising grain, poultry, dairy and meat prices due to increases in feed prices.
2. Significant diversions of grain (mostly corn) and agricultural land for ethanol production.
3. Major shortages of protein ingredients (dairy and soy based), due in large part to surging international demand in countries with rapidly developing economies.
4. Shortages in citrus and other fruit crops due to inclement weather conditions in California and the southwestern states.
5. Shortages in organic ingredient supplies due to surging demand exacerbated by the entrance of major retailers and their suppliers.

To assess the specifics of the state of the industry, the following conditions were considered:

➤ Raw Material Supply and Pricing

Forty-four percent of respondents rated the 2007 supply situation as *good to excellent*, while 21% rated it as *weak/flat to poor*.

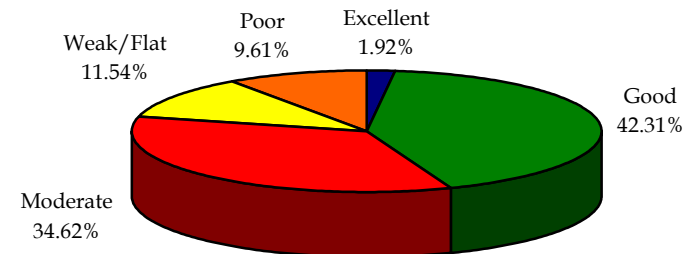


Fig. 2. Business climate rating: raw material supply and pricing
Q: How do you rate the current business climate for your industry according to raw material supply and pricing?

➤ Capital/Funding

In light of the ongoing “financial crisis” in the U.S. and international markets, along with the substantial drop in the exchange rate of the dollar, caution is called for in the interpretation of the survey responses to this particular question.

Sixty-three percent of respondents rated the availability of capital as *good* to *excellent*, while only 8% described it as *weak/flat*.

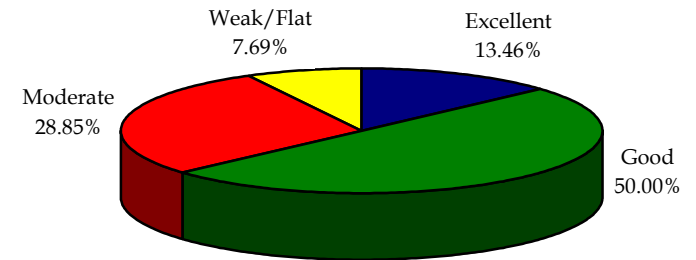


Fig. 3. Business climate rating: availability of capital
Q: How do you rate the current business climate for your industry according to the availability of capital?

➤ Supply of Technical and Professional Manpower

Labor economists have been warning that the U.S. is facing a looming manpower shortage in the technical arena as a result of the retirement of “baby boomers” from the workforce.

This point notwithstanding, the availability of labor manpower was of concern to only 15% of respondents.

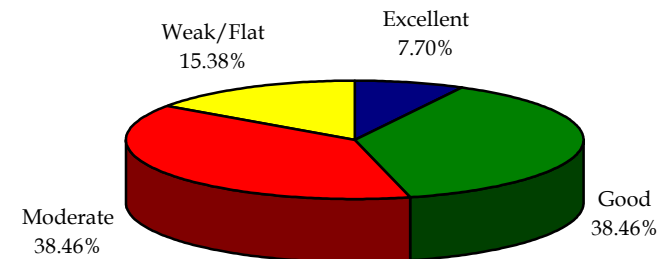


Fig. 4. Business climate rating: supply/quality of manpower
Q: How do you rate the current business climate for your industry according to the supply/quality of technical and other professional manpower?

➤ **Regulatory Environment**

Recent reports suggest a level of dissatisfaction with international food safety standards and enforcements or lack thereof. Notwithstanding, 27% of respondents rated the regulatory environment as *good*, while 21% rated it *weak/flat to poor*.

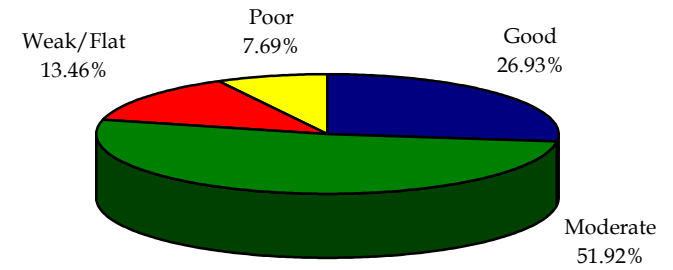


Fig. 5. Business climate rating: regulatory environment
 Q: How do you rate the current business climate for your industry according to the regulatory environment?

➤ **Anticipated Growth Rates 2008/2009**

Sixty-one percent of respondents expected company growth rates in excess of 8% annually during the next two years, a strong contrast to 2006 where only 44% of respondents expected company sales to increase by that amount.

This very optimistic prospect was more evident with the smaller companies (those with less than \$5 million in annualized sales) and declined sharply thereafter as a function of company size.

Eight percent of respondents expected their company sales to grow by less than 4%, in contrast to 24% in the 2006 survey.

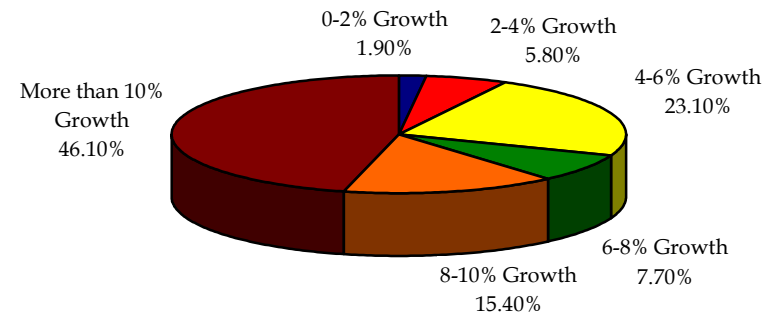


Fig. 6. Expected growth rate over the next two years
 Q: What annual growth rate do you expect your company to achieve over the next two years?

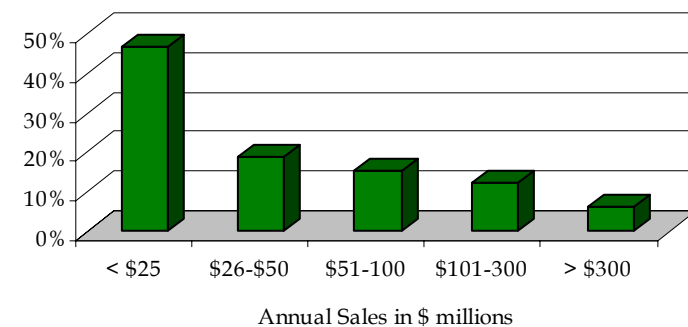


Fig. 7. Respondents projecting annual growth greater than 8% by company revenue

➤ **Business Environment as a Function of Revenue Size and Ingredient Category**

While there was a decrease in the “good to excellent” rating with respect to raw material pricing and sourcing with increase in the company revenue, a more pronounced assessment was evident for the regulatory climate, which became very unfavorable as a function of company size. The availability of capital and funding appear to be most positive for companies within the \$25-300 million revenue level, as shown on Figure 8.

Figure 9 indicates no major differences between categories in perceptions of business climate parameters noted, except for raw material price and availability. All other satisfaction indices were more favorable.

While satisfaction with availability of capital was more evident as a function of company size, satisfaction with the regulatory environment was at its lowest for the food additives and specialty chemical category.

Other cited comments included:

- Availability of source materials (particularly for organic)
- Pricing volatility of raw materials
- Domestic versus foreign sourcing of materials
- Transportation and fuel costs

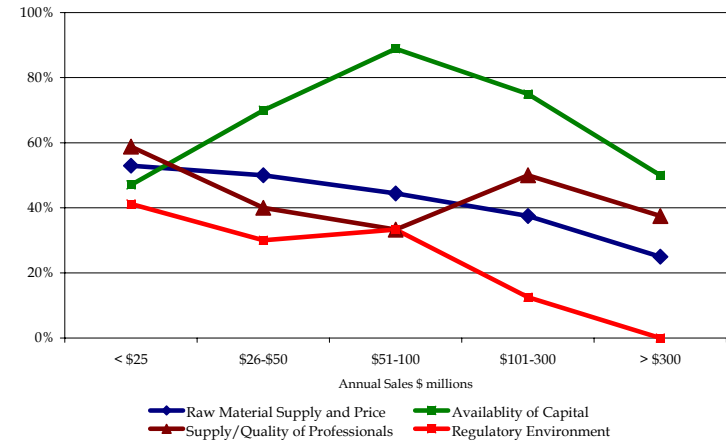


Fig. 8. “Good to excellent” ratings of business parameters as function of company size
 Q: How do you rate the current business climate for your industry according to the following parameters: raw material supply and pricing; availability of capital; supply/quality of technical and other professional manpower; regulatory environment?

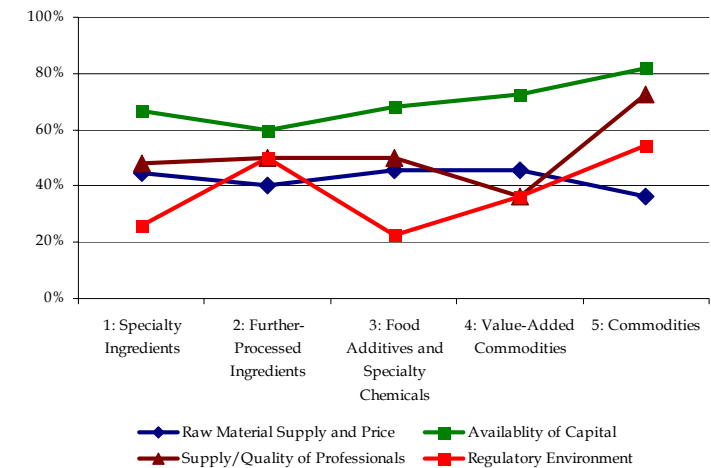


Fig. 9. “Good to excellent” ratings of business parameters as function of ingredient category
 Q: How do you rate the current business climate for your industry according to the following parameters: raw material supply and pricing; availability of capital; supply/quality of technical and other professional manpower; regulatory environment?

Forces for Growth

The objective of this section is to identify the relative balance of factors that impact on growth.

The 2007 survey results indicate a continuing shift away from low-cost commodity to value-added business.

➤ Gross Margin Improvement

Improved gross margins provide companies with the opportunity for future investment.

Eighty-eight percent of respondents identified this as a *very important* to *moderately important* growth factor. Per 2006, this remains a dominant driving factor for growth.

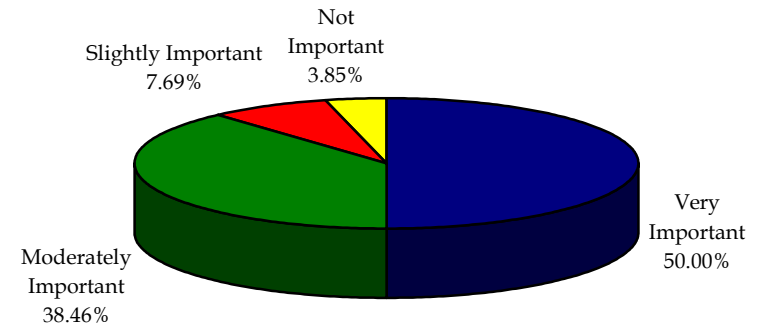


Fig. 10. Gross margin improvement as growth engine

Q: Please assess the importance of gross margin improvement as a "growth engine" to your company today.

➤ Marketing and Communications

While only 23% of respondents consider marketing and communications to be a *very important* growth factor, it represents a positive increase from 15% from the 2006 survey.

Unlike food manufacturers, who understand the power of marketing, it is not clear from these results that the business-to-business supply community has placed adequate importance on marketing and communications as a potential factor for growth.

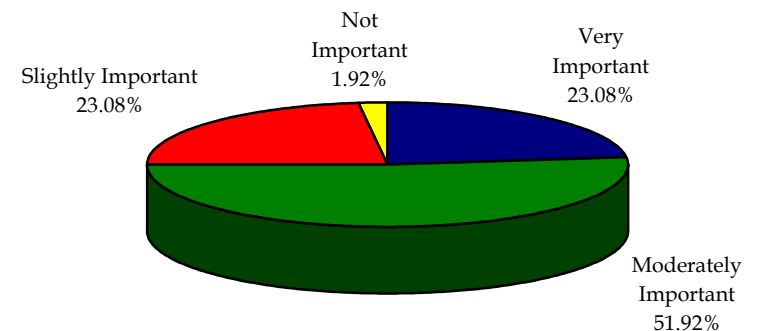


Fig. 11. Enhanced marketing and communications as growth engine

Q: Please assess the importance of enhanced marketing and communications as a "growth engine" to your company today.

➤ **Market Segment Expansion**

Sixty percent of respondents considered market segment expansion to be a *moderately to very important* growth factor for their company.

New business opportunities may be developed through the application of existing ingredients in products within new market segments.

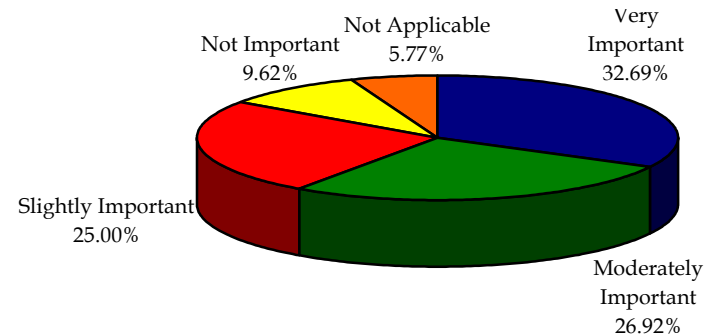


Fig. 12. Expanding ingredient-segment markets as growth engine
 Q: Please assess the importance of expanding ingredient-segment markets as a "growth engine" to your company today.

➤ **Sales Force Expansion**

While not too different than the 2006 survey, only 17% of respondents rated sales force expansion as a *very important* growth factor. However, those ranking this parameter as *not important* declined from 12% in 2006 to 8% for 2007. It is likely that the operative term today is not to "sell harder" but to "sell smarter," given that direct sales remains an expensive sales proposition.

The combined data for marketing, communications and sales force expansion suggest weak support for those elements as potential factors for growth objectives.

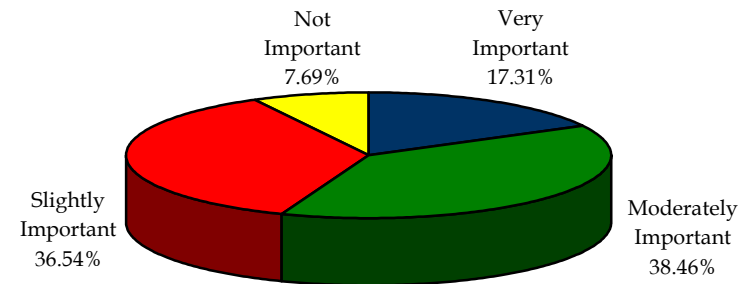


Fig. 13. Sales force growth as growth engine
 Q: Please assess the importance of sales force growth as a "growth engine" to your company today.

➤ **International Sales Growth**

Sixty-nine percent of respondents rated international sales growth as being either a *moderately* or *very important* factor for growth for their company, representing an appreciable increase from the 2006 rating of 54%.

Expanded free trade agreements and the weaker U.S. dollar exchange may be contributing factors to this response.

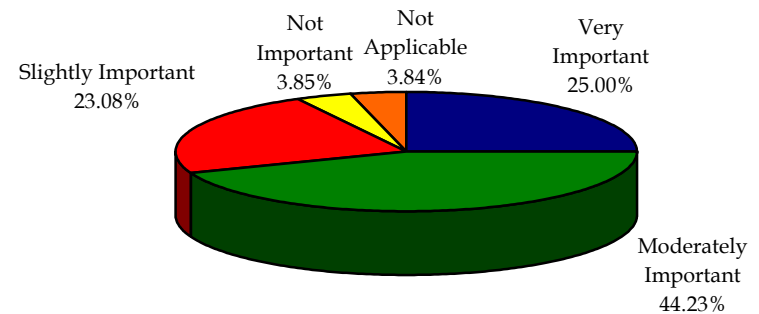


Fig. 14. International sales as growth engine
 Q: Please assess the importance of international sales as a "growth engine" to your company today.

➤ **New Ingredients and Applications**

Forty-eight percent of respondents ranked product development for new ingredients and applications as a *very important* growth factor for their company, significantly lower than the 2006 survey result of 60%.

This is somewhat surprising given that food manufacturers have been outsourcing their product development and technology support needs to the supplier community in ever-increasing numbers.

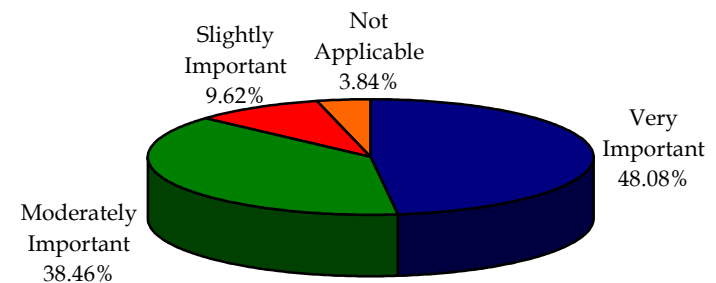


Fig. 15. New ingredients and applications as growth engine
 Q: Please assess the importance of new ingredients and applications as a "growth engine" to your company today.

➤ **Technical Service**

Almost 89% of respondents ranked technical service as *very* to *moderately important*, a substantially higher number than the 58% of the 2006 survey response.

This result reaffirms food companies' increasing reliance upon their suppliers for technical service and product development needs.

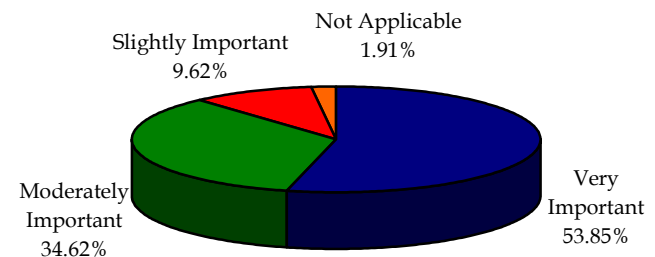


Fig. 16. Technical service/customer interface as growth engine
 Q: Please assess the importance of technical service/technical customer interface as a "growth engine" to your company today.

➤ **Key Growth Forces as a Function of Company Revenue**

While product development as a growth factor becomes more important to ingredient companies with increase in revenue and/or size, marketing and communication appears to become less important in the largest category.

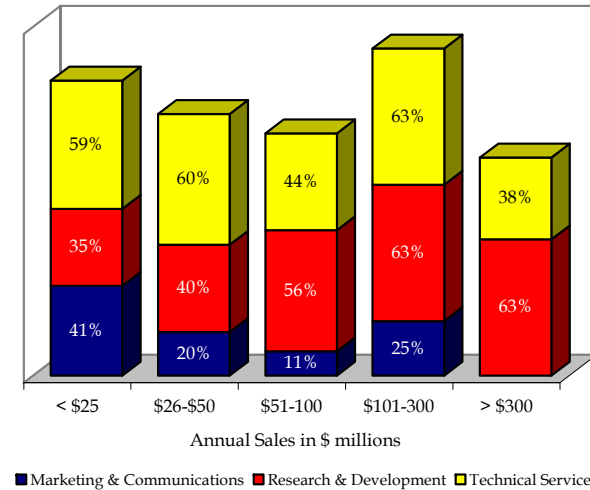


Fig. 17. "Very important" ratings of key growth engines as a function of company size

➤ **Key Growth Factors as a Function of Ingredient Category**

The importance of technical service was dominant for all of five categories. Conversely, marketing scored the lowest importance as a factor of growth for Category 4 (Value-Added Commodities) and Category 5 (Commodities).

The relative importance of product development, technical services, marketing and communications varied considerably among the categories.

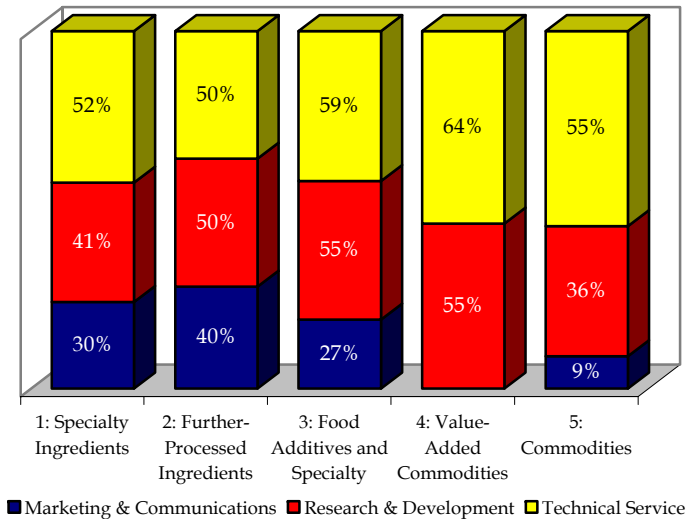


Fig. 18. "Very important" ratings of key growth engines as a function of ingredient category

➤ **Growth Through Partnership and Joint Ventures**

That 15.4% of 2007 respondents rated such relationships as *very important* growth engines, a drop from 19% in 2006, is an indicator of the realities of the challenges of managing such relationships.

For simplicity, partnerships and joint ventures may be viewed as “marriages” requiring elaborate prenuptial agreements. Consequently, these challenging relationships call for ongoing relationship management.

➤ **Growth By Acquisitions**

Growth by acquisition appears to have become more important in 2007. Up from 19% in 2006, 25% of the 2007 respondents indicate that acquisitions represent a *very important* growth force for their companies.

This shift was reinforced by the fact that in 2007 35% of respondents indicated that acquisitions were *not important*, down from 46% in 2006.

➤ **Relative Importance of Growth Factors**

The accompanying graph does not prioritize factors for growth but presents the results as options within a portfolio.

Ninety-two percent of respondents plan to grow organically (from within), 58% through strategic partnerships, 27% through joint ventures, and 39% through mergers and/or acquisitions. Please note that these factors vary in importance subject to the revenue/size of the company.

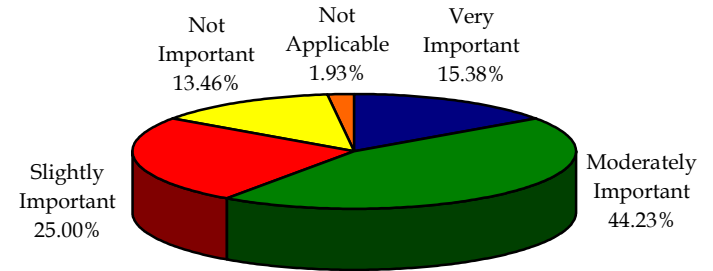


Fig. 19. Importance of growth by partnerships & joint ventures
 Q: Please assess the importance of growth by partnerships & joint ventures to your company today.

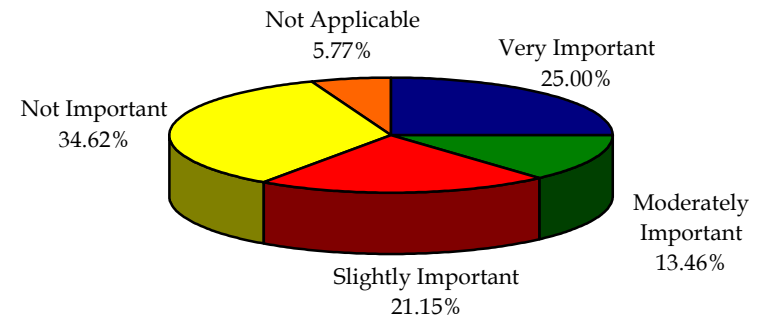


Fig. 20. Importance of growth by acquisition
 Q: Please assess the importance of growth by acquisition to your company today.

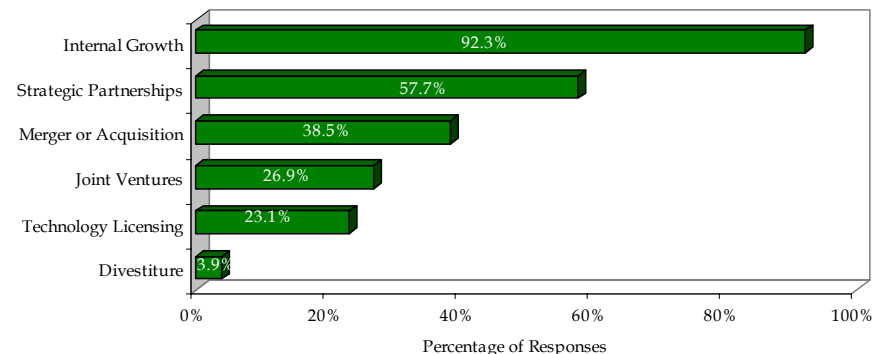


Fig. 21. Sources of growth over the next two years
 Q: How does your company plan to grow over the next two years?

➤ Growth Strategy as Function of Company Size

Similar to the 2006 survey results, in 2007 the preference for smaller companies is for strategic alliances; while that of the larger companies is for mergers and acquisition; and that of middle market entities is a mix of strategic alliances, joint ventures, mergers and acquisitions that are almost on a par with one another.

Smaller companies, for the most part, lack or perceive to lack the required capital resources to actively pursue acquisitions. Conversely, larger companies perceive joint ventures and their management complexities as challenging whereas acquisitions appear to offer the most complex option for growth and management.

Customer demand, improved sales force efficiencies, innovations, and customer acceptance of new technologies are other growth factors cited by respondents.

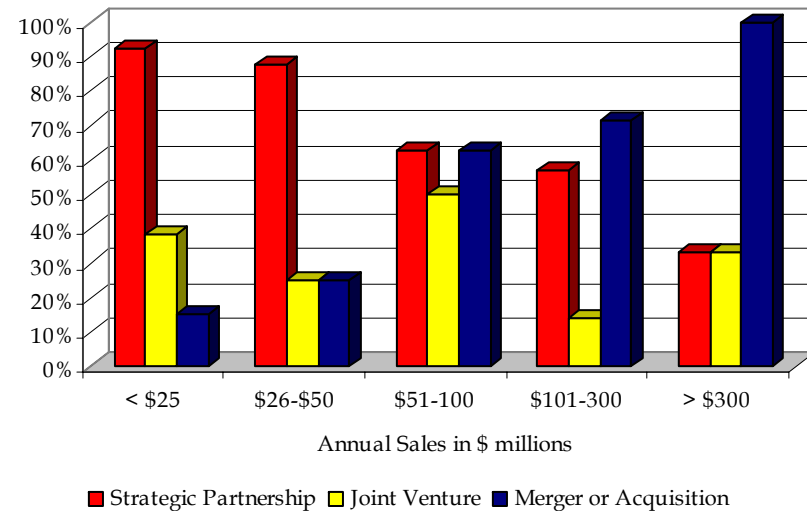


Fig. 22. Company growth strategy by company size

Challenges to Growth

Growth challenges can be:

- Externally Generated – market driven, economic, regulatory, competitive, and customer segmentation
- Internally Derived – market focus, marketing capability, organizational flexibility

External Challenges to Growth

➤ Global Uncertainty

Sixty-two percent indicated that this represented a *very to moderately important* obstacle to growth, considerably higher than the 42% of 2006.

The current climate of surging commodity prices and the plunging dollar exchange rate continue to impact the market.

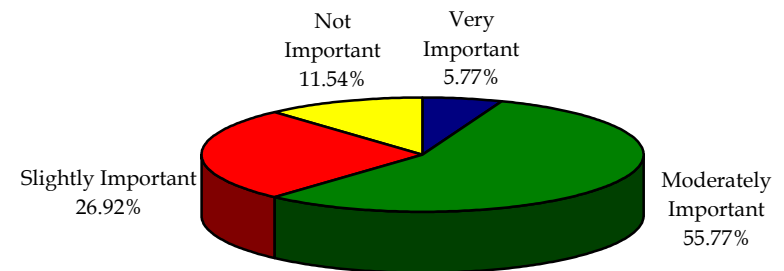


Fig. 23. External challenges to growth: global uncertainty
Q: Please assess the importance of global uncertainty to your company's growth.

➤ International Competition

Sixty-seven percent of respondents recognize international competitors as *very to moderately important* challenges to growth, substantially up from 44% in the 2006 survey.

As the U.S. dollar exchange rate continues to drop, importation of ingredients becomes more expensive.

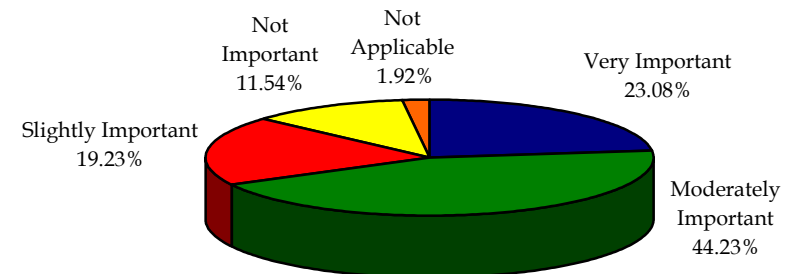


Fig. 24. External challenges to growth: international competitors
Please assess the importance of international competitors to your company's growth.

➤ **Consolidation Environment**

Competitors

Fifty percent of respondents consider the impact of competitor consolidation to pose a *very to moderately important* obstacle to growth, substantially more than the 40% that expressed similar concerns in 2006.

Customers

Conversely, 62% of respondents rated continuing customer consolidation as a *very to moderately important* challenge to growth, a continuing concern reflected by 65% in the 2006 survey.

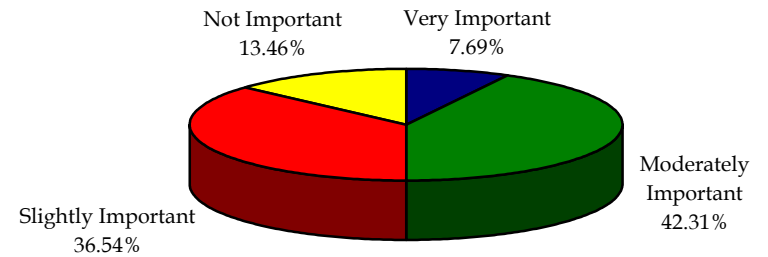


Fig. 25. External challenges to growth: industry consolidation by competitors
 Q: Please assess the importance of industry consolidation (by competitors) to your company's growth.

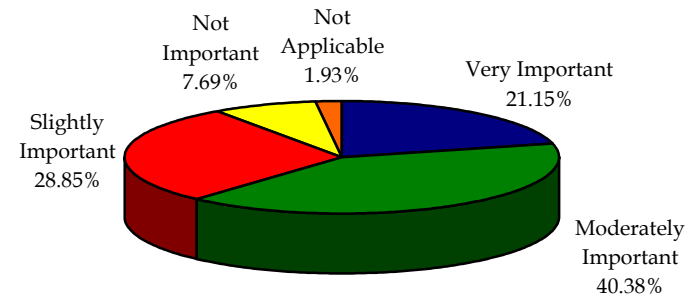


Fig. 26. External challenges to growth: industry consolidation by customers
 Q: Please assess the importance of industry consolidation (by customers) to your company's growth.

➤ **Market Demand**

Eighty-one percent of respondents indicated that market demand posed a *very to moderately important* obstacle to their growth objectives, an increase over the 73% of the 2006 survey.

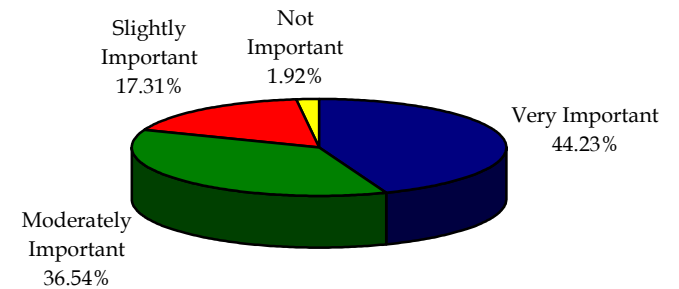


Fig. 27. External challenges to growth: market demand
Q: Please assess the importance of market demand to your company's growth.

➤ **Government Regulation**

Ambivalence toward government regulation by the food and food ingredients industries is a historical cliché, but is it true? While government regulations may appear burdensome to some, suppliers also look to Federal regulations to level the playing field against competitors. Meanwhile, labeling mandates and nutritional claims regulations open new doors to product innovation.

Sixty-five percent of respondents saw government regulation as a challenge to growth, an increase from the 48% in the 2006 survey.

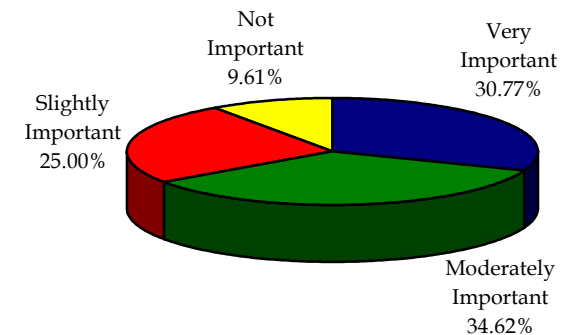


Fig. 28. External challenges to growth: government regulation
Q: Please assess the importance of government regulation to your company's growth.

➤ **Supply Chain Reliability**

This challenge is new to the food ingredient survey.

Seventy-one percent of respondents viewed this challenge as *very to moderately important* for its impact on the growth of their company.

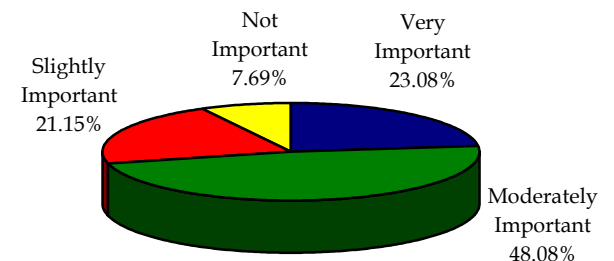


Fig. 29. External challenges to growth: supply chain reliability
Q: Please assess the importance of supply chain reliability to your company's growth.

➤ **Raw Material Prices**

Fully 90% of respondents in this year’s survey portrayed this challenge as *very to moderately important*.

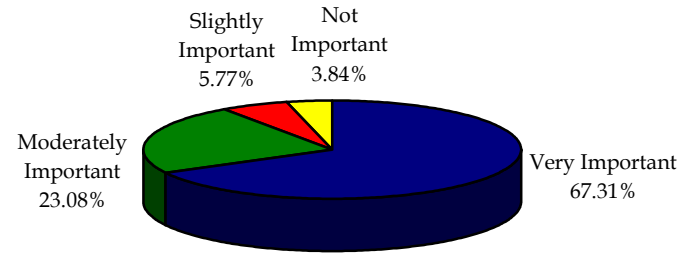


Fig. 30. External challenges to growth: raw material prices
 Q: Please assess the importance of raw material prices to your company’s growth.

➤ **Raw Material Sources**

While 77% of respondents viewed this challenge as *very to moderately important*, of those 40% viewed it as a *moderately important* issue, substantially higher than the 25% expressed in 2006.

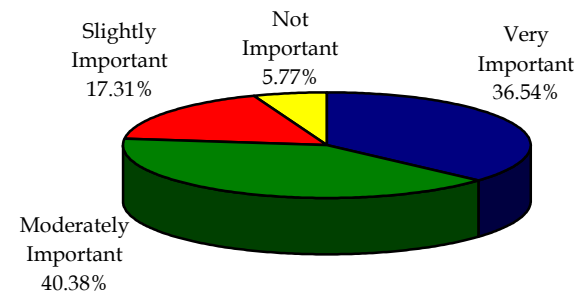


Fig. 31. External challenges to growth: raw material sources
 Q: Please assess the importance of raw material sources to your company’s growth.

➤ **Preferred Supplier Listing Status**

Seventeen percent of 2007 respondents viewed such a listing as *very important*, dropping from 21% in 2006.

It is not clear whether this decline in preferred supplier status is reflective of the respondents’ ability to broaden their customer base or if it is due to their ability to better meet customer expectations.

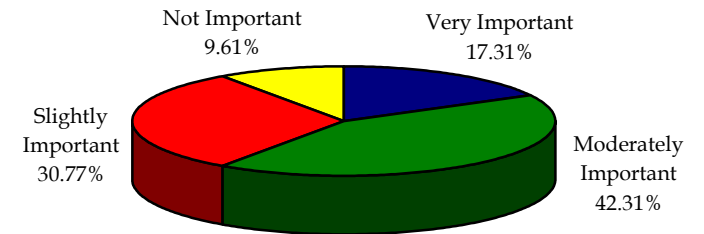


Fig. 32. External challenges to growth: preferred supplier listings
 Q: Please assess the importance of preferred supplier listings to your company’s growth.

➤ **Labor Quality and Cost**

Nineteen percent of 2007 respondents indicated that cost and quality of labor posed a challenge, a moderate increase from the 14% in 2006, while the rating for the *moderately important* parameter remained unchanged.

This response is not reflective of current market sentiment given the looming demographic shortage of talented technical labor in the U.S.

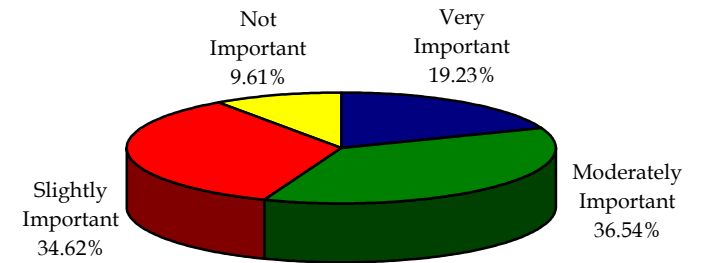


Fig. 33. External challenges to growth: quality and cost of labor
 Q: Please assess the importance of the quality and cost of the labor market to your company's growth.

➤ **Energy Costs**

Seventy-one percent of 2007 respondents cited energy costs as a *very to moderately important* cost factor. There was no statistical change between 2007 and 2006, notwithstanding media reports about the impact of energy costs in 2007 and beyond.

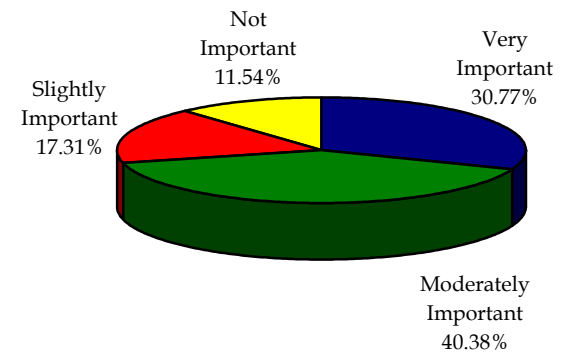


Fig. 34. External challenges to growth: energy costs
 Q: Please assess the importance of energy costs to your company's growth.

Internal Challenges to Growth

➤ **Core Market Focus**

Only 2% of 2007 respondents viewed this as a *very important* challenge to growth, with very little difference to that of the 2006 survey.

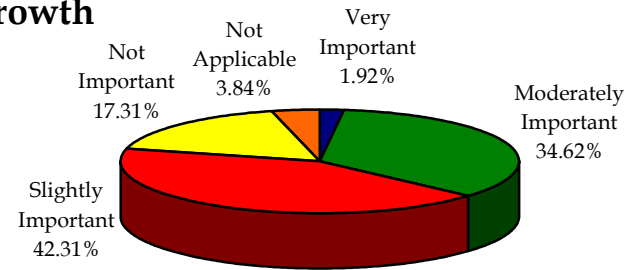


Fig. 35. Internal challenges to growth: lack of core market focus
 Q: Please assess the importance of the lack of core market focus to your company's growth.

➤ **Sales and Marketing Capabilities**

Eighty-one percent of respondents judged sales and marketing capabilities to be *very to moderately important*, higher than the 72% of 2006. This continues to underscore the importance of sales and marketing capabilities.

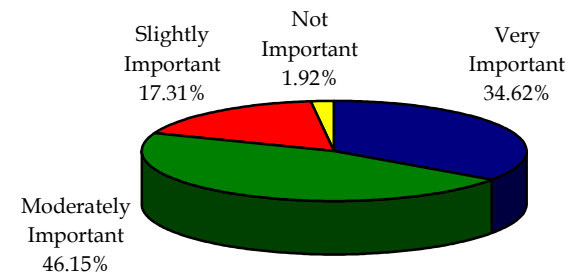


Fig. 36. Internal challenges to growth: sales and marketing capabilities
 Q: Please assess the importance of sales and marketing capabilities to your company's growth.

➤ **Organizational Flexibility**

Sixty-seven percent of 2007 respondents recognized that internal structures and management flexibility were *very to moderately important* keys to growth. This is considerably higher than the 40% indicated in the 2006 survey.

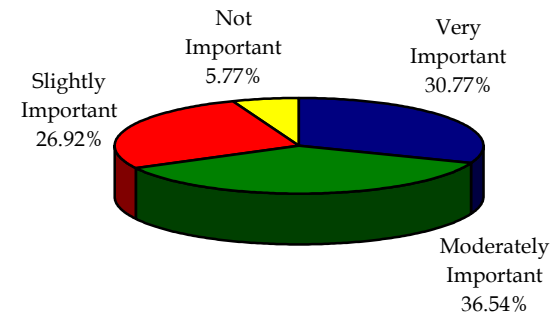


Fig. 37. Internal challenges to growth: structural and management flexibility
 Q: Please assess the importance of structural and management flexibility to your company's growth.

➤ **Availability of Capital and Cash Flow**

Fifty-two percent of respondents viewed this factor as *very to moderately important* in terms of their growth interests. Only 6% of 2007 respondents indicated that capital and cash did not represent a factor in their growth trends.

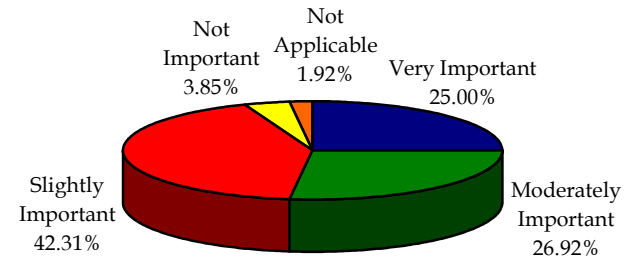


Fig. 38. Internal challenges to growth: capital and cash flow
 Q: Please assess the importance of capital and cash flow needs to your

➤ **Acquisition Targets**

Thirty-five percent of 2007 respondents acknowledged that a lack of acquisition opportunities posed a *moderate to very important* obstacle to growth, an increase from 25% in the 2006 survey and 44% indicated that the availability of acquisition candidates was neither important nor applicable, a decrease from the 62% in 2006.

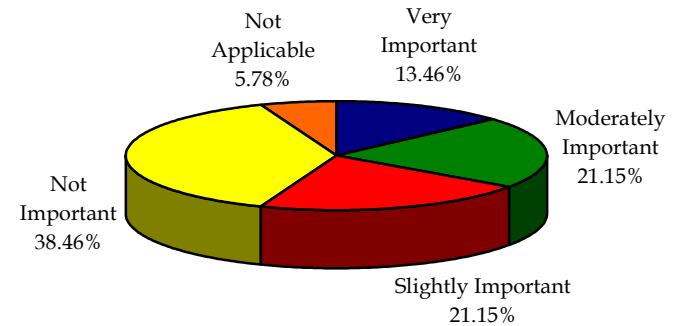


Fig. 39: Internal challenges to growth: lack of suitable acquisitions
 Q: Please assess the importance of the lack of suitable acquisitions to your company's growth.

Growth Strategies: Strategic Alliances and Joint Ventures

External growth options: strategic alliances, joint ventures, and acquisitions.

➤ Strategic Alliances

Fifty-six percent of respondents confirmed their attempt at strategic alliances.

Company Involvement: Strategic Alliances	
Percent involved in one or more strategic alliance	56%
Average number of alliances	2

Respondents identified the benefit of strategic alliances within two broad motivating factors: improved access to resources and new markets.

- Improved access to resources:
 - Enhanced raw materials sourcing capabilities
 - Access to new technologies, equipment and processing capabilities
 - Improved customer knowledge and commitments
- *Improved accessibility to new markets:*
 - Expansion of customer base
 - Improved demand for new products through co-investment
 - Improved market penetration into otherwise weak segments

- One respondent cited “diversified risk and improved flexibility” as an additional benefit.

Other key factors identified by respondents include the need to clearly define:

- The mutual benefits of an anticipated execution
- Structure of the strategic alliance
- Management of cultural differences
- Alignment of external and internal capabilities to ensure appropriate execution
- Tangible and measurable goals

Identified obstacles to strategic alliances included:

- Potential lack of trust between the parties
- Misalignment or wide differences in company cultures
- Difficulty and/or lack of coordination between disparate organizations
- Inconsistent execution, both internally and externally

➤ **Joint Ventures**

Of the three options for external growth, joint ventures proved to be the least popular given the 38% response.

Company Involvement: Joint Ventures	
Percent involved in one or more joint venture	38%
Average number of joint ventures	3

Actual benefits included:

- Access to new technologies
- Improved research capabilities
- Improved raw material supply

External benefit was limited to the potential of expanded market penetration.

Growth Strategies: Mergers and Acquisitions

➤ Mergers and Acquisitions

Fifty-eight percent of respondents indicated their participation or involvement in M&A activity. The results confirm the leading incentives for pursuing growth by acquisition as:

- Access to new products and technologies
- Access to new markets

Motives for pursuing acquisitions differed as a function of company size and primary business.

Market share growth is cited as a very important motive for ingredient companies that post between \$100 and \$300 million in annual sales, but provides considerably less of a motive for those with annual sales less than \$25 million.

Improving economies of scale or achieving critical mass were least cited as motives for acquisitions.

The accompanying chart on the right reflects respondents segregated by ingredient business categories where economies of scale was cited as the leading motive for seeking acquisitions with the exception of Category 2 (further-processed ingredients - mixes and blends).

Other key factors identified by respondents include the challenges of:

- High multiples of EBITDA (reflective of market sentiment)
- The integration of disparate company cultures (the leading factor)

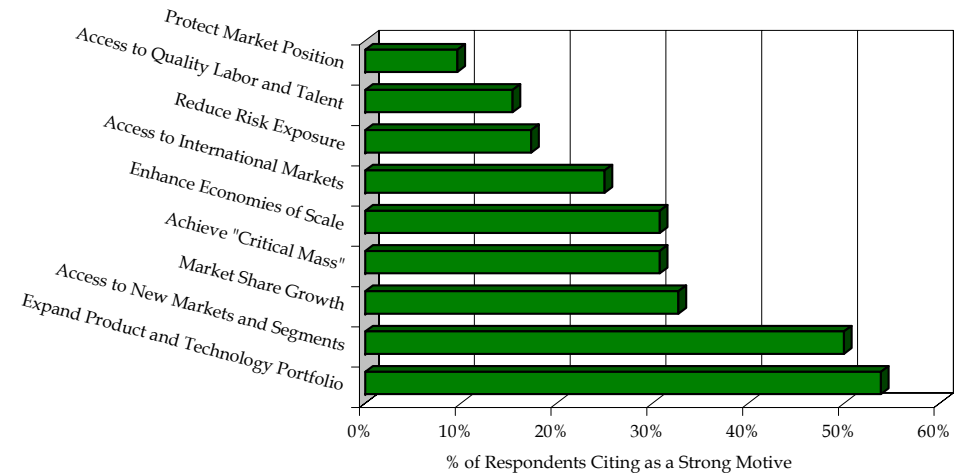


Fig. 40. Motives for pursuing a merger or acquisition
Q: How would you rate relative strengths of different motives for pursuing a merger or acquisition?

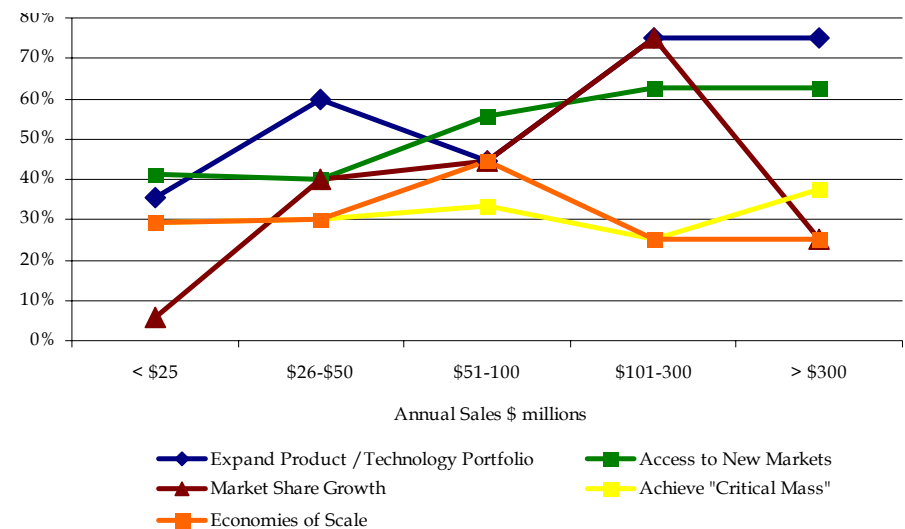


Fig. 41. Motives for pursuing merger or acquisition as a function of company size

Potential benefits included:

Internally:

- Opportunity to integrate best practices
- Enhancement of product portfolio
- Additional manufacturing capabilities and/or capacities
- Better access to capital

Externally:

- Strengthened company relevance to customers
- Access to new markets and new customers
- Potential international expansion and market opportunities

Only 17% of all respondents confirmed that they had been involved in divestitures.

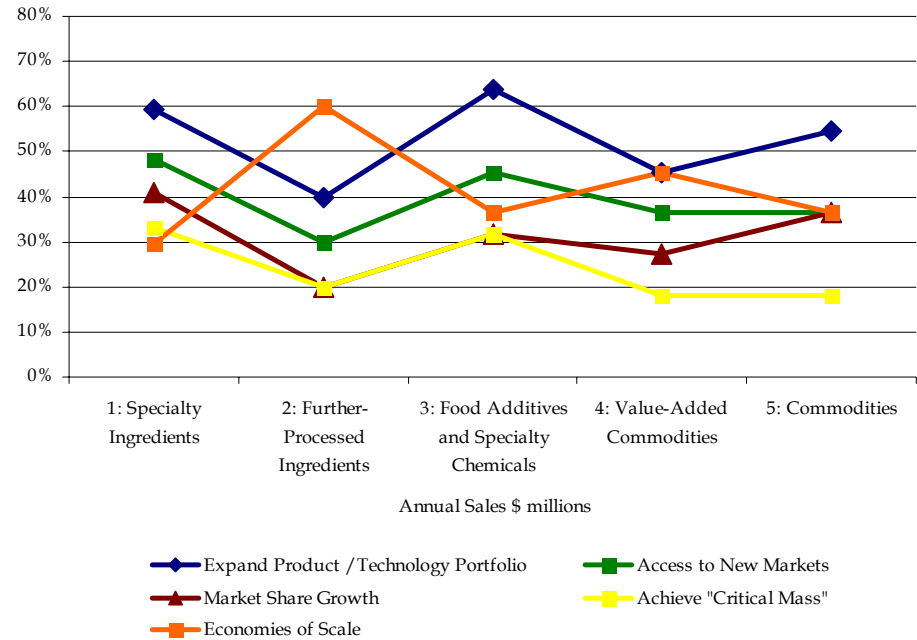


Fig. 42. Motives for pursuing merger or acquisition as a function of ingredient category

The Market Environment

➤ The U.S. Manufacturing Environment

Does the U.S. provide the most favorable manufacturing environment?

Costs of labor, regulations and unfavorable operating overheads have often been cited as reasons for U.S. companies to outsource production to other countries.

Much has happened in the last year – food safety issues with Chinese imports and plunging U.S. dollar values amongst others!

A resounding 79% of respondents agreed that the U.S. does provide the most favorable manufacturing environment. This response is significantly higher than the 60% of the 2006 survey.

Asked which countries or regions provided a better manufacturing environment, only 25% of respondents replied and no one country was particularly significant.

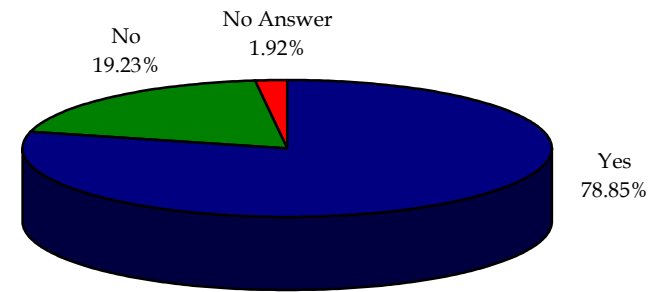


Fig. 43. Ratings on U.S. as a favorable manufacturing environment
Q: Does the U.S. provide the most favorable manufacturing environment?

➤ Food Regulation

In 1992, passage of the Nutritional Labeling and Education Act (NLEA) was vigorously decried by food companies for placing a heavy regulatory and labeling burden on the food industry. Instead, it appears to have provided opportunities for nutritionally-focused new product development and provided an array of innovations for both food ingredient suppliers and food manufacturing companies.

How is food regulation viewed today? Sixty-three percent of respondents confirmed that the FDA regulations improved R&D opportunities, while 35% disagreed.

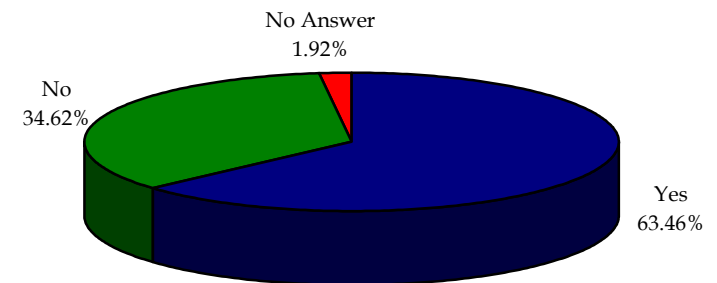


Fig. 44. Ratings on FDA's regulatory policies and R&D opportunities
Q: Are FDA's regulatory policies improving R&D opportunities?

Reasons cited for disagreement include:

- FDA actions over-regulate the market.
- Regulation puts an unreasonable burden of proof on suppliers.
- The FDA makes defensive regulations without fully understanding the challenges facing both manufacturers and consumers.

Supply Chain Management

Supply chain management refers to the control of material supply, the maintenance of its cost effectiveness and quality along every step of the chain (from farm to handling, processing, distribution, and ultimate delivery to the consumer table).

➤ Raw Material Sources

Fifty-two percent of 2007 respondents plan to increase their reliance on international raw material sources, contrasting with 2% that planned to decrease on this reliance.

Key factors identified by respondents that confront the integrity of food manufacturing supply chain include:

Raw Material Integrity

- Quality, integrity and safety of raw materials
- Imports in general, and more specifically from China
- Quality control in China and other overseas suppliers
- Traceability and identity preservation of ingredients through the supply chain

Regulatory Compliance

- The need to improve global safety regulations
- Establishment of affordable quality testing regimens along the supply chain
- Demand for more ISO9000 audits by importers
- Lack of regulatory enforcement outside of the U.S.
- Under-regulation and lack of policing of existing regulations

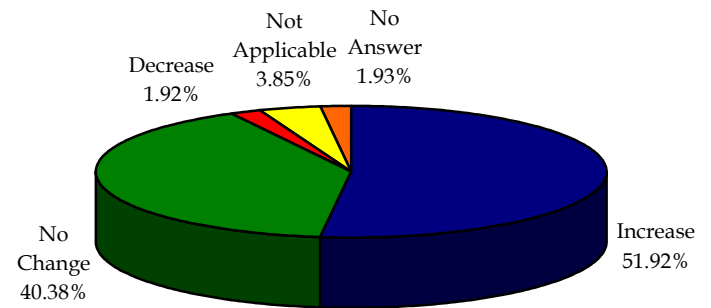


Fig. 45. Anticipated reliance on international sources of raw materials
Q: How does your company anticipate relying upon international sources of raw materials?

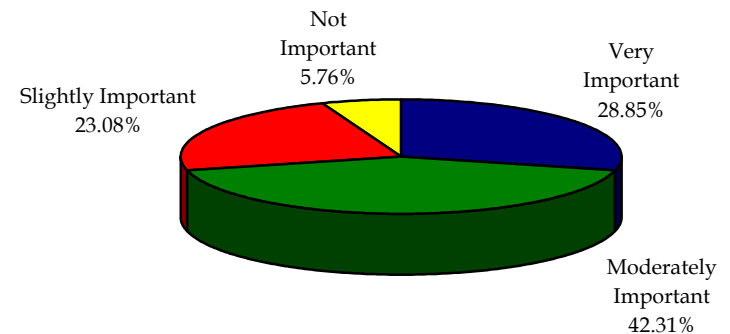


Fig. 46. Internal challenges to growth: supply chain reliability
Q: Please assess the importance of supply chain reliability to your company's growth.

- Cumbersome reporting requirements
- Stricter labeling requirements
- Lack of convictions for criminal fraud

➤ **Transportation Resources**

Forty-six percent of respondents indicated that the availability of transportation resources may pose a challenge to their companies and needs in the future. Those concerns reflect the inflation of fuel costs and the increased demand on international transportation by the developing markets.

The diversion of commodities such as ethanol for non-food uses is also another concern.

➤ **The Environment**

Perceived societal concerns and environmental issues impacting on businesses and their operations included:

- *Water Availability*
Regional differences notwithstanding, competing demands on limited water supplies and environmental controls are seen as worsening issues by 29% of respondents, while only 6% anticipate any improvement.

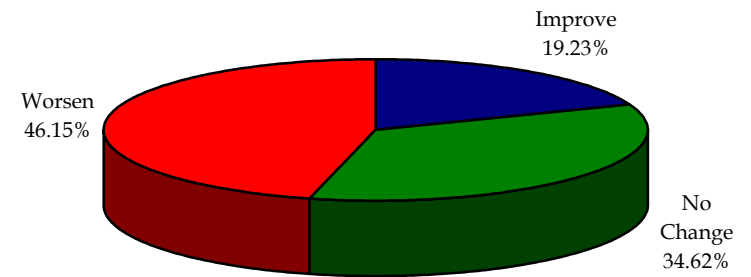


Fig. 47. Ratings on impact of transportation resources on performance
Q: How do you see transportation resources affecting the performance of your industry sector?

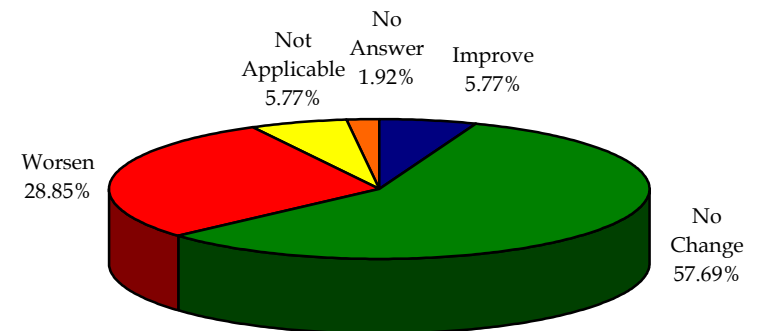


Fig. 48. Ratings on impact of water availability
Q: What are the anticipated impacts of water availability on your food ingredient industry sector?

- *Clean Air Regulation*

A majority of respondents do not expect clean air regulations to negatively impact on their business, while 29% viewed it as a worsening situation, citing the negative health impact of airborne diacetyl, a flavoring compound, as an example.

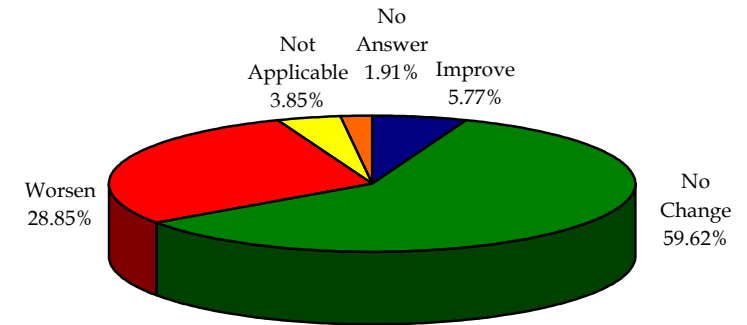


Fig. 49. Ratings on impact of clean air regulations
 Q: What are the anticipated impacts of clean air regulations on your food ingredient industry sector?

- *The "Greening of America"*

Forty-two percent of respondents anticipate that the impact of the "Green" movement will further acerbate food ingredient costs, while 14% view it as an opportunity and trend on which to capitalize.

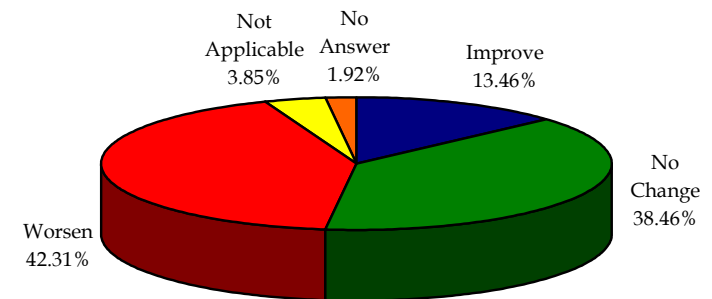


Fig. 50. Ratings on impact of "green" impacts on raw material costs
 What are the anticipated impacts of "green" impacts on raw material costs on your food ingredient industry sector?

- *Sustainable Agriculture*

While this movement is still in its early stages, almost half of the respondents (46%), perceive the impact of this trend to be inflationary for food ingredient costs.

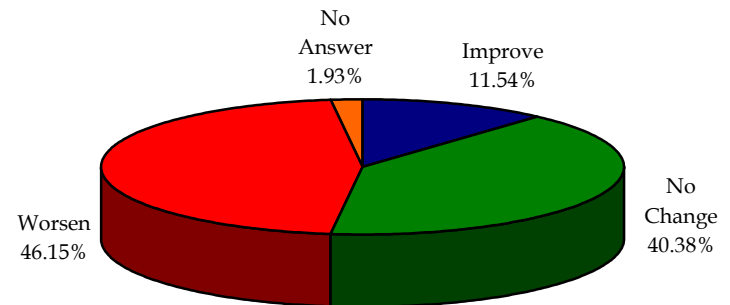


Fig. 51. Ratings on impact of agricultural sustainability issues
 Q: What are the anticipated impacts of agricultural sustainability issues on your food ingredient industry sector?

➤ **Biofuels**

The impact of biofuels on agricultural raw material costs and their ripple effect on grains, meat, poultry and dairy products have strongly resonated in 2007.

This aspect notwithstanding, 60% of respondents foresaw no impact on the economics of the food ingredient industry sector, while 37% believe availability and price of ingredients will be impacted.

➤ **The Export Environment**

The depreciating dollar exchange rate notwithstanding, 33% of respondents anticipate that the food ingredient export environment will improve. This contrasts with 27% who viewed it as worsening, while 39% do not see any change.

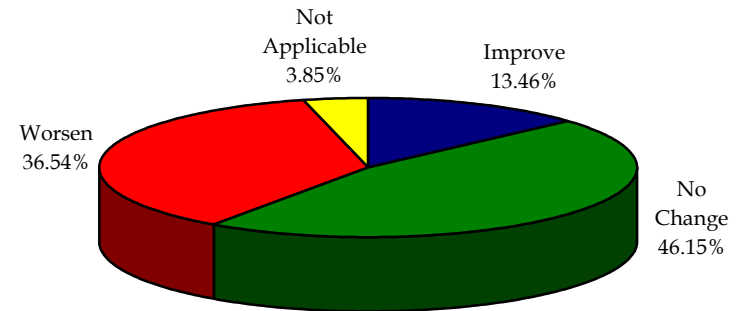


Fig. 52. Ratings on impact of biofuels
 Q: How do you see biofuels affecting the performance of your industry sector?

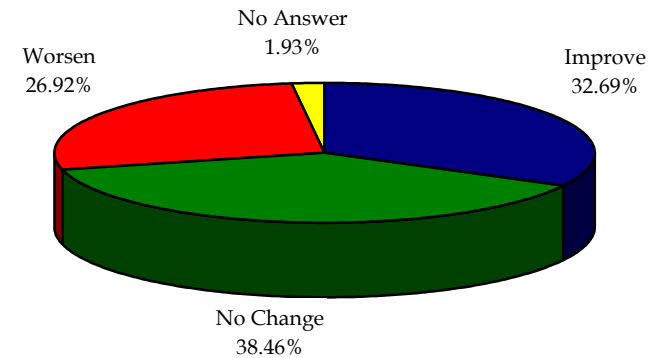


Fig. 53. Ratings on impact of export environment
 Q: How do you see the export environment affecting the performance of your industry sector?

➤ Market Trends

Drivers of Innovation

Key factors identified by the respondents included:

- Nutrition, health and wellness led the list (where aging baby boomers were cited as the driving force)
- Natural, organic and clean label needs and expectations
- The need to continue the development of good-tasting, good-for-you healthy products with a clear, understandable message for the consumers
- Product safety
- The regulatory and legal environment, in part for its stimulus to the development of new products that conform to new labeling regulations
- The development of intellectual property as a competitive point of difference to low-priced ingredient competition

➤ Health and Wellness Trends

The health and wellness trends that will likely dominate the food industry over the next two years, identified by the respondents, include:

Health Specific Foods

- Obesity and weight management
- Cardiac health
- Diabetes
- Joint health
- Brain health
- High blood pressure
- Digestive health
- Anti-aging

Nutrient Related Label Claims

- Fiber
- Omega 3s
- Zero trans fat
- Allergens (“free” thereof)
- Vitamins, minerals and supplements

Natural and Organic Claims

- The increasing demand for organic and all natural labels, inclusive of non-GMO foods

➤ All Natural and Organic

- All things “organic” and their labels are de rigueur
- “All natural” remains attractive notwithstanding its ill-defined description
- The “whole foods” concept gains more support

A 71% majority of respondents planned to increase their company’s commitments to organic foods over the next two years.

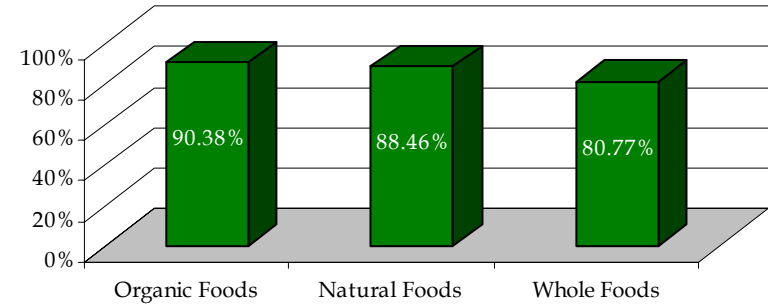


Fig. 54. Perception of growth prospects for organic, natural, and whole foods
 Q: What do you perceive the growth prospects to be for organic, natural and “whole” foods?

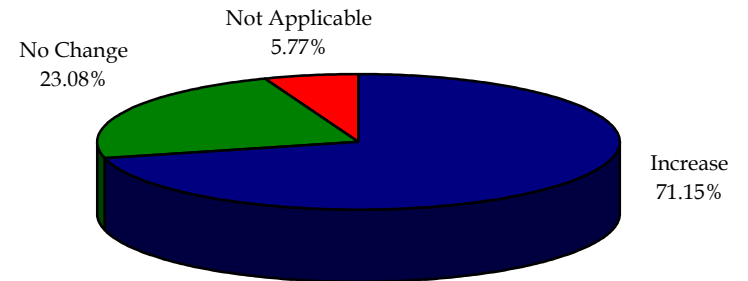


Fig. 55. Anticipated change in commitment to organic foods over the next two years
 Q: How does your company anticipate its commitment to organic foods to change over the next two years?

➤ **The Value Proposition**

This is the need to balance price, quality, product and service. A fit or change in one of those components invariably affects the other.

Respondents were almost equally divided as to which of the three components was the most important.

However, the 2007 results contrasted with those of 2006 as follows:

- Price, at 35% of respondents in 2006, declined to 31% in 2007
- Service increased from 29% in 2006 to 37% in 2007
- Quality remained relatively unchanged

For ingredient category suppliers, it appears that further processed ingredients and food additives & specialty chemicals are the most service-oriented and consequently least susceptible to price pressures.

Quality ranked particularly high for Category 4 (Value-Added Commodities) and Category 1 (Specialty Ingredients), while service mattered the least for those in Categories 4 (Value-Added Commodities) and 5 (Commodities).

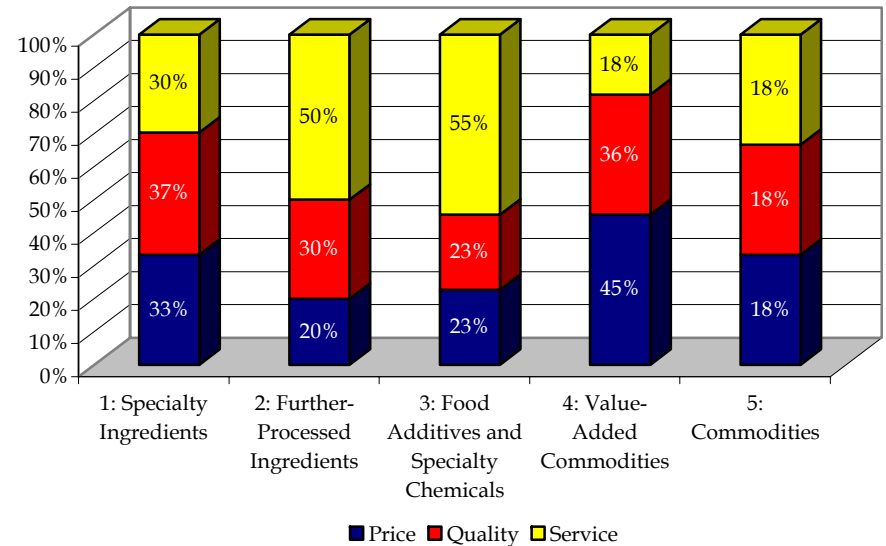


Fig. 56. Selection of attribute as "most important" value component by ingredient category

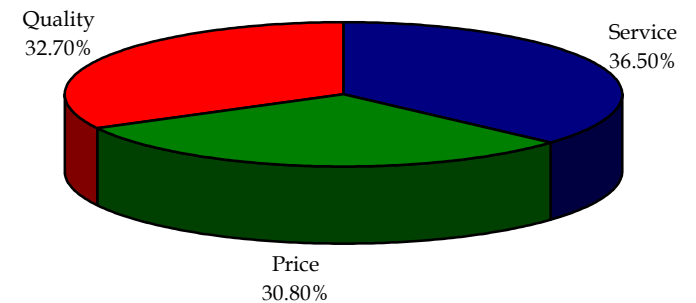


Fig. 57. Greatest concern about the future of the U.S. food industry
Q: What is the single greatest concern you have about the future of the U.S. food industry?

➤ **Customer Relationships**

Forty-six percent of respondents claimed to have improved their relationship with their customers over the past two years. Within the ingredient category it is clear that the most improved relationships were apparent from those categories that had cited service as the most important component of their value proposition.

➤ **Reasons for Improving Relationships**

The need of food manufacturers to outsource more and more of their product development activities was the most commonly cited reason to which respondents attributed their improved working climate with their customers. This was followed by a general recognition of manufacturers’ increased demand for innovation from their suppliers.

Also identified as reasons for improved relationships between ingredient suppliers and their customers were:

- Suppliers now have more proprietary technology or information to offer.
- Manufacturers see more value in their suppliers’ expertise.
- There is an increased willingness by both suppliers and manufacturers to attain mutually beneficial business outcomes (“win-win”).

➤ **Reasons for Worsening Relationships**

Eleven percent of suppliers provided the following reasoning for deterioration in relationships:

- Increasing, and possibly unreasonable, demands placed upon suppliers
- Cost-driven initiatives by manufacturers
- Lack of technical talent (possibly on both sides)

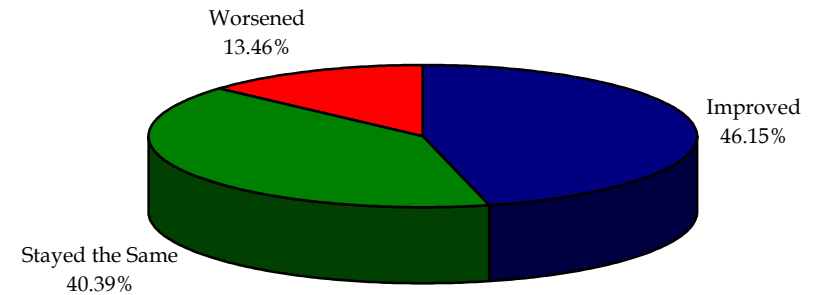


Fig. 58. Change in ability to work with food manufacturers over the past two years
 Q: During the past two years, has the ability of food ingredient suppliers to work with food manufacturers improved, stayed the same, or worsened?

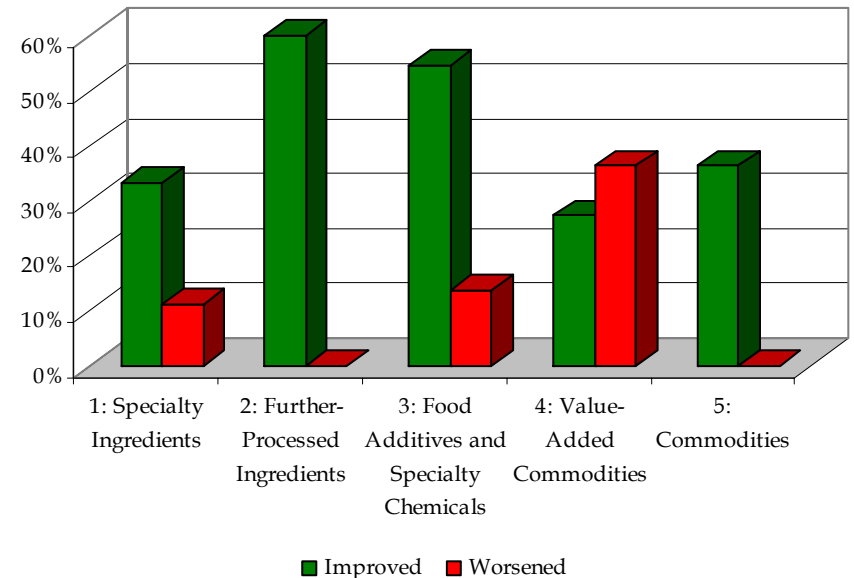


Fig. 59. Ingredient category influence on ability to work with food manufacturers

Appendix

➤ Methodology

One of the predominant trends in the U.S. food industry has been the shift in food R&D capabilities and activities from food manufacturing companies to the food ingredient companies that supply them with goods and services. As such, the authors of this report recognize that the food supplier industry has become a leading indicator and incubator of the fortunes of the food manufacturing industry.

The 3rd Annual Food Ingredient Executive Survey was commissioned by the J.H. Chapman Group, L.L.C., to identify growth trends and drivers within the U.S. food ingredient industry. Only U.S.-based companies or the U.S.-affiliates of foreign-headquartered companies were contacted for this study.

The objectives of this study were to:

1. Establish benchmarks for food ingredient industry innovation.
2. Identify avenues and opportunities for and obstacles to new business growth and development among food ingredient industry.
3. Provide a planning tool for food ingredient company executives.

The web-based survey was designed and conducted by BEST VANTAGE Inc. during Fall 2007. Data was compiled and cross-referenced by ingredient category and company size.

➤ Respondent Profiles

Eighty-three percent of respondents had one of the following titles: owner, president/CEO, executive vice president, general manager. The remaining 17% of respondents identified themselves as vice president or director (marketing, sales, corporate, business development).

➤ Respondent Categories

Food ingredient respondents were categorized by company size and their primary food ingredient categories manufactured. Respondent companies were size-differentiated as follows:

<i>Type of Company</i>	<i>Annual Sales</i>
1. Start-up	Less than or equal to \$25 million
2. Small	Between \$26-50 million
3. Lower middle market	Between \$1-100 million
4. Upper middle market	Between \$100-300 million
5. Large	More than \$300 million

Responding companies were categorized by their primary manufactured ingredients, as reflected by the degree of value addition represented by each category. For examples, "Further Processed Ingredients" (i.e., ingredient blends and pre-mixes) were ranked as a higher "value-added" category ranking than "Food Additives & Speciality Chemicals." However, this ranking system does not necessarily reflect pricing or gross margin profitability for specific ingredients. Respondent

profiles for the 2007 Survey generally mirrored the U.S. food ingredient supplier community.

For the purposes of the survey, ingredients were categorized as follows:

Category	Examples
1. Specialty Ingredients	e.g., Colors; Flavors/Extracts; Herbs; High-Intensity Sweeteners; Nutraceuticals; Peptides/Nucleotides; Specialty Oils; Spices and Seasonings; Sugar Alcohols and Polyols.
2. Further-Processed Ingredients	e.g., Beverage Mixes; Bakery Mixes & Premixes; Cereal Flakes; Bits & Breadings; Cookie Pieces; Fillings & Toppings; Fruit Preparations; Frostings; Whipped Toppings; Glazes; Ice Cream Mixes; Snack & Cereal Pellets; Syrups.
3. Food Additives & Specialty Chemicals	e.g., Acidulants & Phosphates; Antioxidants; Baking Powders; Microbial Cultures & Yeast Ingredients; Dietary Fibers; Emulsifiers; Enzymes; Gelatins; Gums & Hydrocolloids; Modified Milk and Whey Proteins; Polydextrose; Preservatives; Processing Aids; Protein Isolates & Concentrates; Stabilizers; Starches & Maltodextrins.
4. Value-Added Commodities	e.g., Brans and Germs; Cheese and Cultured Dairy Ingredients; Fruits - Dry; Juices and Blends; Nutmeats & Seeds; Vegetables - Fresh, Frozen, Dry.
5. Commodities	e.g., Bulk Sweeteners; Honey; Butter and Margarine; Cocoa Powders; Milk and Whey Powders; Fruit and Vegetable Powders; Oils and Shortenings; Coffee; Salt; Cereal Grains - Wheat, Soy, Corn & other; Legume Flours and Blends.

➤ Respondent Profiles: Responses by Title

Eighty-three percent of respondents represented either the Owner and President/CEO (57%) or Executive VP/General Manager (25%) of their respective company. Sales, Marketing and Corporate Business Development executives comprised an additional 14% of respondents.

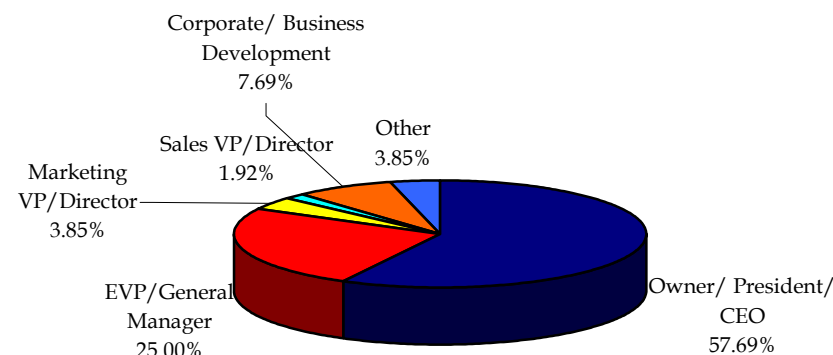


Fig. 60. Respondent profiles: titles/roles

➤ **Respondent Profiles: Responses by Ingredient Category**

Respondents were asked which food ingredient categories best described their companies' primary businesses. The majority of responses were generated by Category 1 (Specialty Ingredients) and Category 3 (Food Additives and Specialty Chemicals), comprising 52% and 42%, respectively. Some overlap between categories was evident.

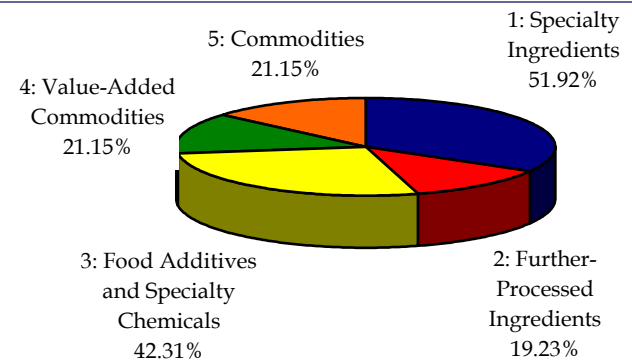


Fig. 61. Respondent profiles: ingredient category
(there is some overlap between categories)

➤ **Respondent Profiles: Responses by Type of Ingredient Company**

Responding companies were also differentiated according to the type of supplier that they represented, as follows: 73% of responses were generated from companies that defined themselves as primary ingredient manufacturers. Twenty-five percent of responses were generated by "Mix or Pre-Blend" suppliers, and 19% of respondents defined themselves primarily as "Distributor/Brokers" of ingredients. Many suppliers classified themselves by more-than one category.

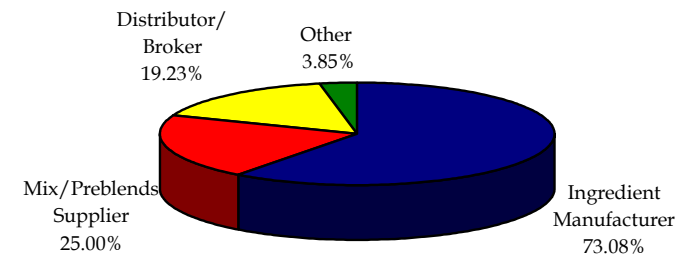


Fig. 62. Respondent profiles: type of ingredient company
(there is some overlap between categories)

➤ **Respondent Profiles: Responses by Company Size**

Company responses were categorized by company size. Start-up and small companies combined generated 52% of all responses. The largest size category of ingredient suppliers (more-than \$300 million in sales) generated 15% of all responses. This distribution approximates the relative size-distribution of food ingredient companies in the U.S.

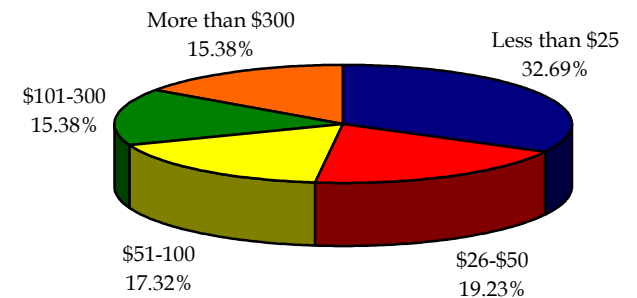


Fig. 63. Respondent profiles: annual company sales (\$ million)

