



## **PROMAR CONSULTING CASE STUDY**

**Attracting Japanese F&B FDI:  
Separating the wheat from the chaff**



Promar Consulting is Asia's preeminent business development and research consulting firm specializing exclusively in assisting food, drink, agricultural and fishery organizations to capitalize on market opportunities and resolve ongoing business issues

## SERVICES

Market research and business development

New product development

M&A (Target identification and CDD)

Regular market intelligence

Regulatory analysis

Economic & policy analysis

Promotion strategy & coordination

## INDUSTRIES

Grains and oilseeds

Fruits and vegetables

Meat and dairy

Packaged foods

Beverages

Ingredients

Seafood, fish, & fisheries

Food packaging & distribution

Agro-chemicals, fertilizer, & seeds

Biotech and biofuels

Water and irrigation

## REGIONS

Japan

China

East Asia

South and Southeast Asia

Oceania

North America

Latin & South America

EU

Russia and CIS

MENA

Sub-Saharan Africa

## SPECIFIC INTEREST

- Government agencies** seeking to attract Greenfield investment from the Japanese F & B sector
- Investors** seeking to understand the dynamics of the Japanese sector
- Input suppliers** seeking to understand their Japanese customers
- Firms** that want to enter the Japanese F & B market

## GENERAL INTEREST

- F & B firms** that want to benchmark themselves against domestic and international peers.
- Specialized research and advisory firms** seeking partners for Japan-focused research
- Generalist research and advisory firms** seeking partners who specialize in F & B

**CLIENT**

A state-level government office in one of the world's largest commodity producing countries.

**ISSUE**

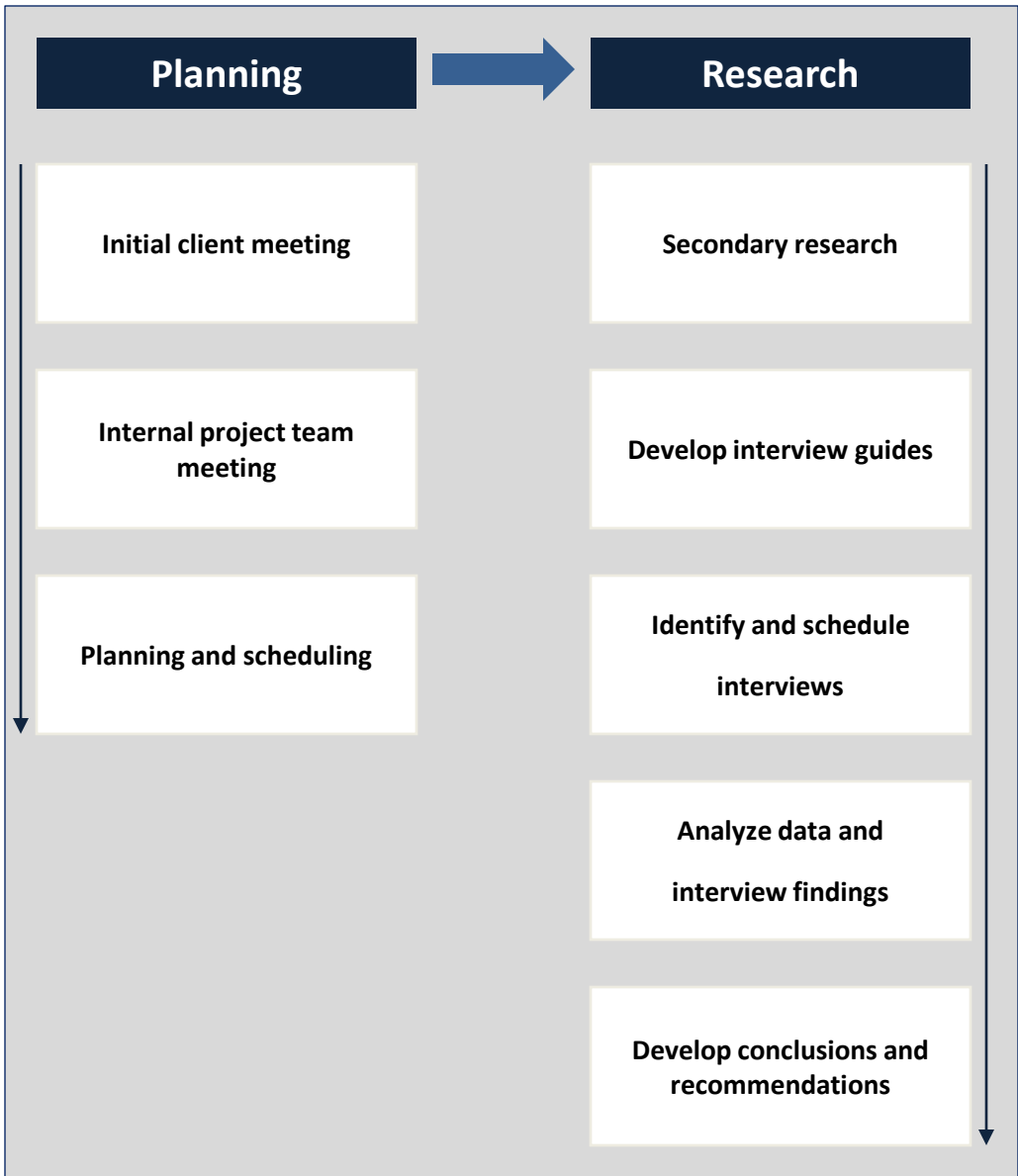
From the early 1990s until around 2003, State X attracted Japanese F & B investments at a rate of around one major project per year. Since then, however, investment flows had stopped. Efforts to revive them by the state were unfocused and had thus failed to correct the situation. Some firms contacted were not a fit product-wise, while others were not in a financial position to make an investment

**SOLUTION**

Promar focused on developing a clear methodology for identifying companies that included benchmarking of financial performance, assessing input needs and strategy, and interviewing executives to determine their criteria for selecting an overseas investment destination.

**RESULT**

Promar advised the client in a number of different areas and provided a list of recommendations, including promoting industry clustering in the state and developing a better roadshow that was tailored to each individual company.



While recognizing that each engagement presents unique situations and needs, Promar’s baseline approach follows the diagram found to the left.

For this particular project, Promar focused first on understanding the financial condition of listed Japanese F & B firms and developing a set of basic indicators that we could use to separate the strong from the weak. To this end, we calculated sector and sub-sector benchmarks to measure each firm against, using basic growth indicators and financial ratios, such as debt-to-equity, EBIT, and ROA. We allowed firms to fall below the benchmark by only one measure; if they failed to meet two or more, they were eliminated from consideration., unless there was a compelling reason for the firm to remain, like particularly strong revenue growth or appealing work capital, for example.

Our initial list reduced, we then eliminated firms that did not have input needs that matched what the client state could provide. This yielded a final group of companies, whose executives and key decision-makers we interviewed to understand their investment strategies, in general, and opinion on State X as a investment destination, more generally.

The following case study represents a highly-condensed version of the final report we provided to the client but retains the essential components to the study, which were to:

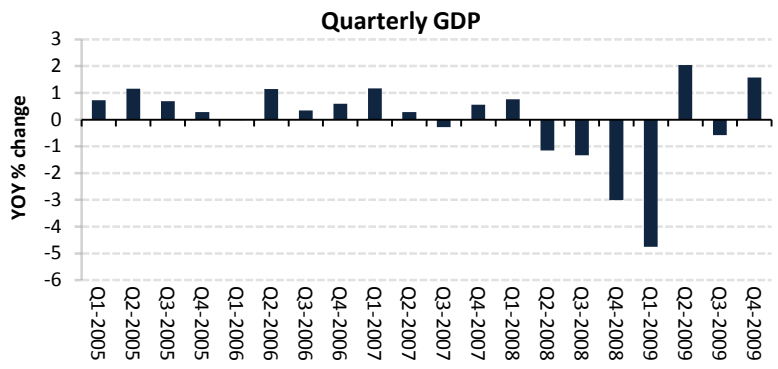
- ❑ **Educate** the client on key trends affecting Japan’s F & B sector
- ❑ **Analyze** Japanese F & B investment patterns and criteria for making investment decisions
- ❑ **Benchmark** individual firms against their peers to separate the financially-strong firms from the weak
- ❑ **Identify** firms with the strongest potential for investing in State X
- ❑ **Provide** recommendations for selling those firms on investing in State X

This case study is organized along those objectives. The outline is as follows:

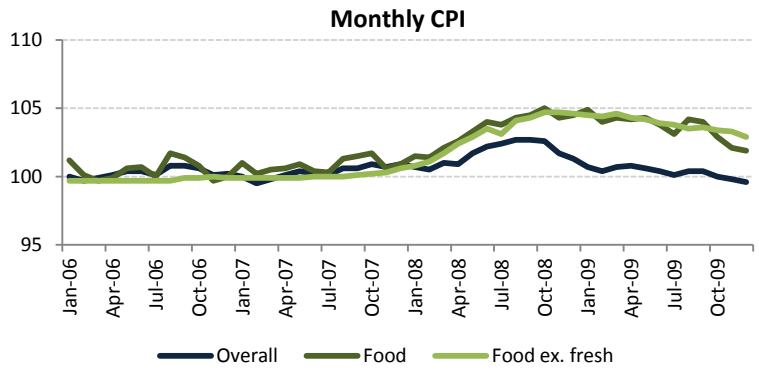
Section 1: Factors affecting the sector	<ul style="list-style-type: none"><li>• Economic indicators</li><li>• F &amp; B sector trends and impacts</li></ul>
Section 2: Japanese F & B sector Outward FDI Trends	<ul style="list-style-type: none"><li>• Historical FDI outflows</li><li>• Firm-level investment priority criteria</li></ul>
Section 3: Financial benchmarks	<ul style="list-style-type: none"><li>• 5-year trend in 8 basic benchmarks</li><li>• Summary analysis</li></ul>
Section 4: Sample firm analysis	<ul style="list-style-type: none"><li>• Bourbon</li><li>• Nisshin Seifun                      Hokuto</li></ul>
Section 5: Selected recommendations	<ul style="list-style-type: none"><li>• Promote clustering</li><li>• Develop a tailored roadshow</li></ul>

## **SECTION 1:**

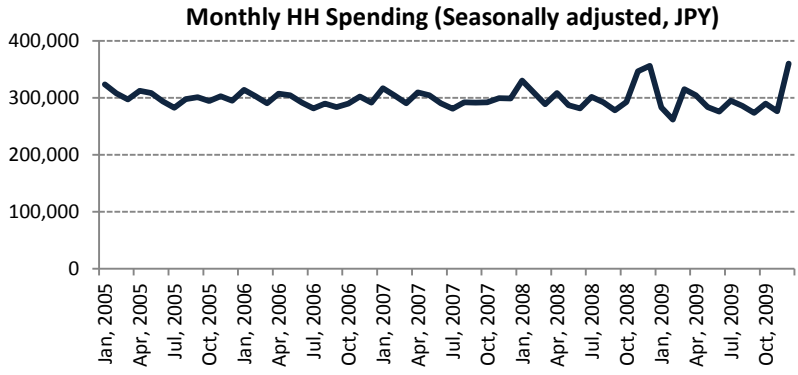
## **FACTORS AFFECTING THE SECTOR**



- ❑ Japan’s so-called “Lost Decade,” an era of low or anemic growth that began after the bursting of the bubble in the early 90s, dragged on for much longer than 10 years.
- ❑ Following the onset of the GFC, the economy contracted in four consecutive quarters, from Q208 to Q109.
- ❑ An apparent recovery in Q209 was cut short by a return to negative growth in Q3, but the economy did resume expanding in Q4 on stronger exports.



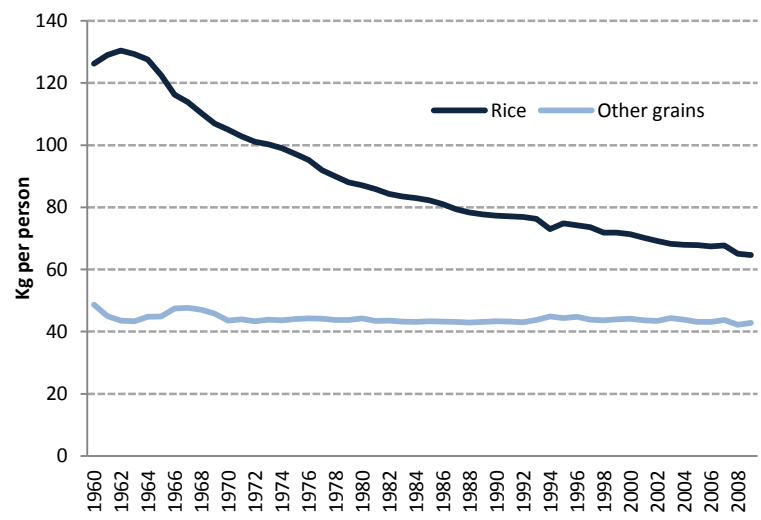
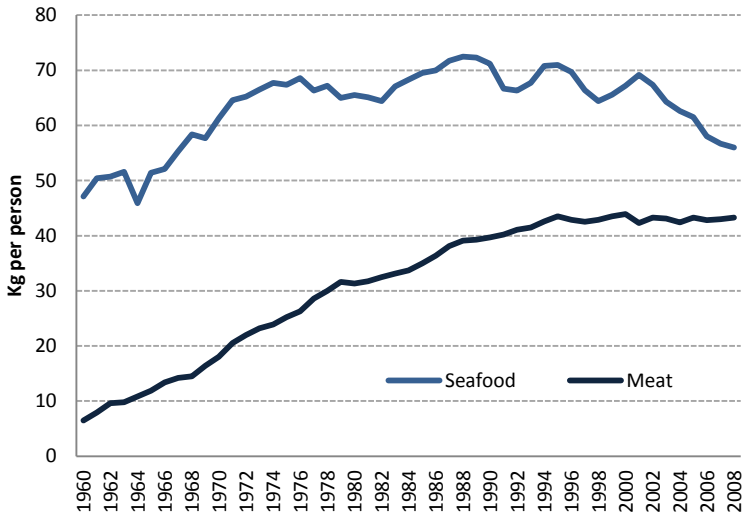
- ❑ Japan has been in and out of deflation throughout the course of the “Lost Decade,” despite BOJ efforts to re-flate the economy through QE and other measures.
- ❑ By forcing the country to import inflation, the commodity price spike accomplished what the BOJ couldn’t, but that effect was short-lived and deflation returned towards the end of 2009.



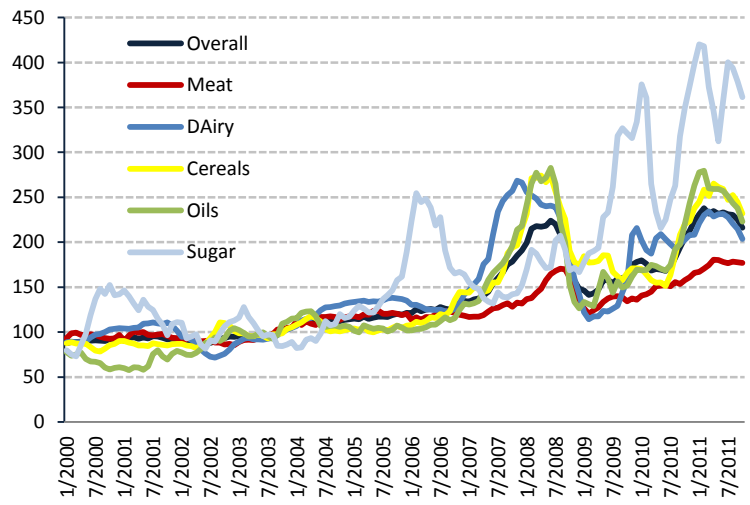
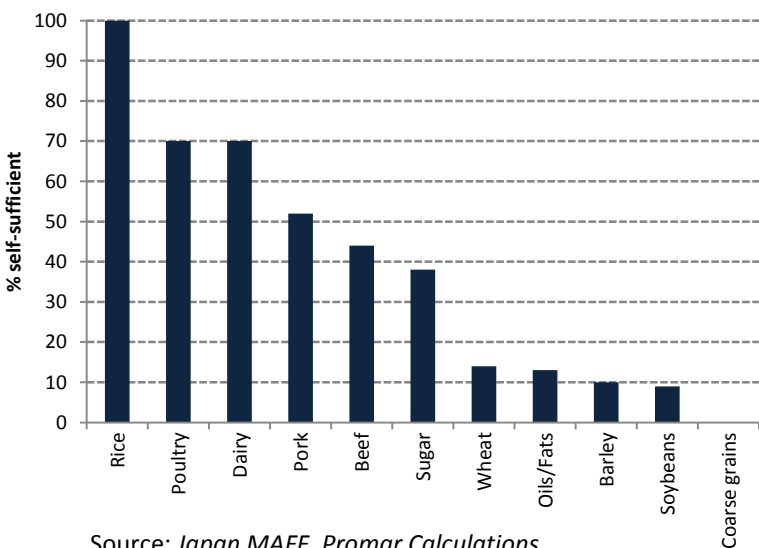
- ❑ Although Japanese consumers are among the wealthiest in the world, HH spending/final consumption has always lagged the US and other developed countries as % of GDP; in 2008, it was 58% of GDP versus 70+% in the US
- ❑ Consumption patterns may have changed somewhat, but overall spending has remained more or less that same over the past decade.



**Demand for traditional food is declining in favor of Westernized food habits....**



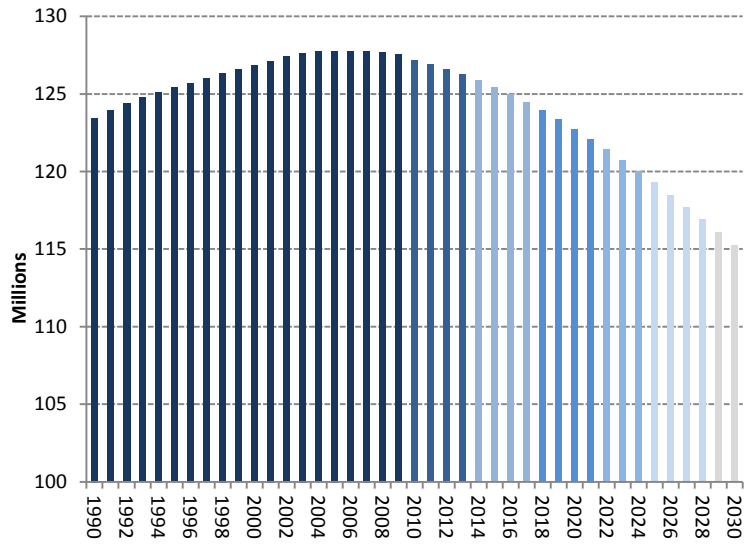
**Making the country more reliant on imports and thus more exposed to int'l prices**



Source: Japan MAFF, Promar Calculations

Source: FAO Food Price Index (2002-04 = 100)

The population is shrinking and....

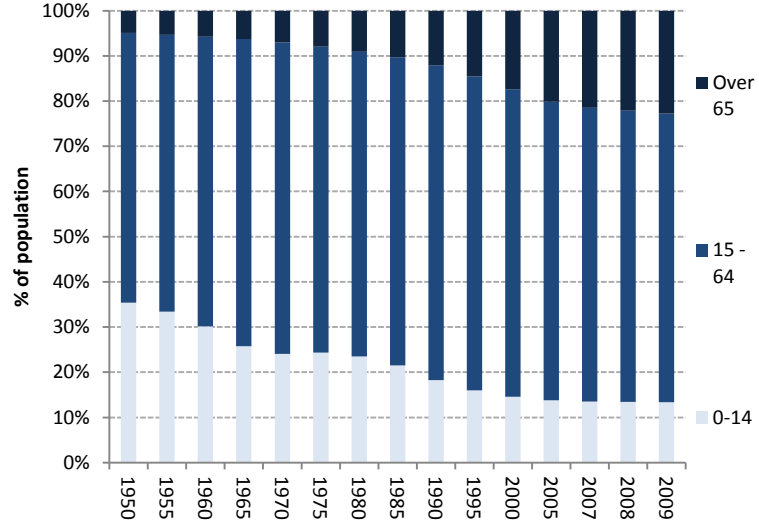


❑ Japan’s population peaked somewhere around 2005/06 and has now entered period of slow decline that will see the total fall to under 115 million by 2030.

❑ It is not alone in facing this trend, but unlike the US or other aging societies, Japan does not accept large numbers of immigrants and political considerations make it unlikely to do so in the future.

❑ For the F & B sector, a shrinking population generally means a shrinking overall market. For some products, this trend has been compounded by a concurrent drop-off in demand, as is the case with beer and which explains why those firms have been the most aggressive in pursuing overseas acquisitions.

... aging at the same time



❑ With birth rates below replacement levels not only do populations shrink, but they age. Japan already has the largest group of 65+ citizens as a percentage of total population and because of the long average life spans, that figure will only continue to rise.

❑ Senior citizens tend to eat less than they did when they were younger, so the larger the portion of the market made up by senior citizens, the smaller that market becomes.

❑ However, a graying population is expected to increase demand for some products, particularly functional foods, which older consumers will seek out to stem the effects of aging.

## **SECTION 2: JAPANESE F&B SECTOR OUTWARD FDI TRENDS**

Cumulative Outward FDI from the Japanese Food Sector by Cases and Value: 1989-2004					
	World	Asia	North America	Europe	Oceania
Total # of cases	1,158	598	337	98	87
Total Value (100 mil JPY)	30,674	4,527	7,845	14,235	2,912
Avg. investment size (same)	26.5	7.6	23.3	145.3	33.5

Source: Japan Ministry of Finance, JETRO, Promar Consulting calculations.

Notes: All figures in 100 mil JPY. "Asia" includes East Asia, China, and Southeast Asia; North America includes the US and Canada. Europe includes both Western and Eastern Europe; Oceania includes Australia, New Zealand, and the Pacific Islands. Prior to 2005, outward FDI by sector was only available on a regional rather than country-level basis.

- ❑ Over half the cases of outward FDI from the Japanese F & B sector were in Asia, but just 15% of the total value. Investments into developed markets, like N. America and Europe, tended to be larger and rarer cross-border M&A transactions, while investments into developing Asia tended to be more frequent and of the Greenfield variety, mainly because of lower start-up costs and lack of serious M&A targets (at the time).
- ❑ The trend towards larger cross-border M&A transactions accelerated in the 2005-08 period (not shown), primarily as Japanese brewers and other large firms in the sector sought out established businesses that could provide immediate growth outside of the stagnant home market. Besides the brewers, firms such as Kagome, Japan Tobacco, Mitsui, and Nissui, among others, completed large takeovers during this period.
- ❑ Investments into China—or investments elsewhere to serve the Chinese market—have drawn most of the outward FDI from Japan's F&B sector over the past 10 years. Considering the strong trading relationship country X has developed with China, this was initially viewed as a positive development for its potential investment destination, but Promar research revealed this not to be a deciding factor.

		Priority Criteria for Japanese Food Companies Investing Abroad				
		China	Southeast Asia	US	EU	Country X
Greater importance ↓ Lesser importance	Large market	✓	✓	✓	✓	
	Stable raw material supply	✓	✓	✓	✓	✓
	Low labor costs	✓	✓			
	Ease of exporting to Japan or third country (distance mainly)	✓	✓			✓
	Food culture similar to Japan or large Japanese community	✓	✓	✓		
	Political or legal need to be on the ground	✓	✓			

❑ Looking at the table above, you can see that Country X (in region X) faces a number of roadblocks for attracting Japanese investment. Even the one area where it is normally perceived to be **strong, stability of raw material supply**, has come into question of late because of volatile production levels for key commodities (hence the circle above).

❑ **Labor costs**—and past problems with **labor unions** experienced by other Japanese firms—and the country's **small market** also raise red flags for the executives of firms Promar interviewed. On the latter point, the need to find growth outside of the stagnant home market means that small populations and the low limits they impose on growth prospects make a market like country X unattractive.

❑ Executives also stressed that they already have strong, stable relationships with Country X's commodity suppliers, so they **don't see a political or legal need** to be on the ground for reasons of contract enforcement or otherwise. This is in contrast to countries like Thailand and Indonesia, where legal institutions can be weak and ineffective, necessitating an in-country presence and this Greenfield investment in production.

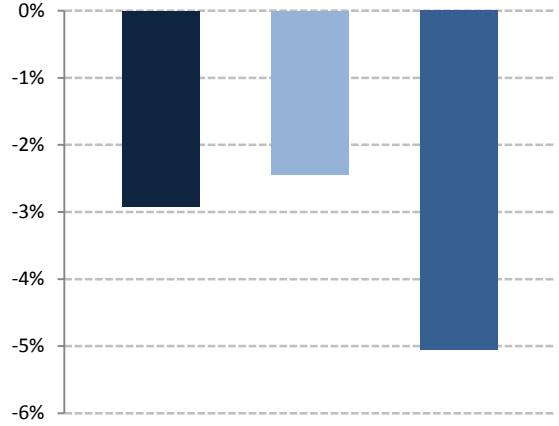
## **SECTION 3:**

## **FINANCIAL BENCHMARKS**

All F&B
  Meat & Dairy
  Manufacturers

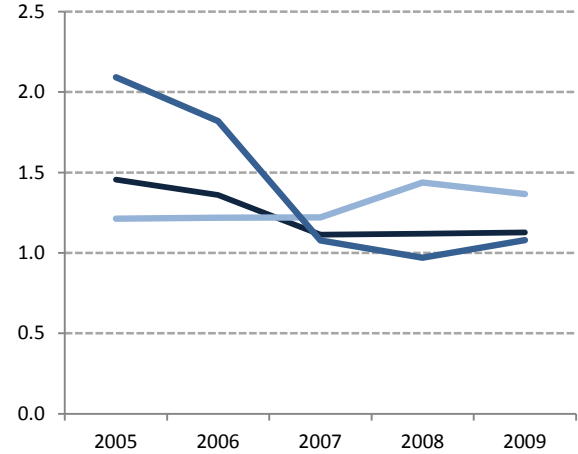
**Growth: negative**

Revenue CAGR (2005-09)



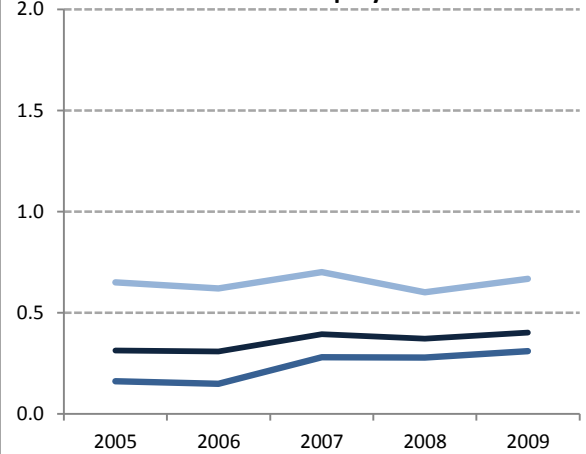
**Liquidity: weakened**

Current Ratio

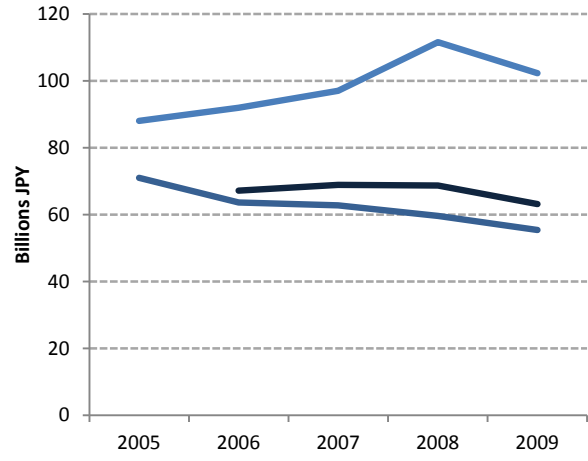


**Solvency: stable**

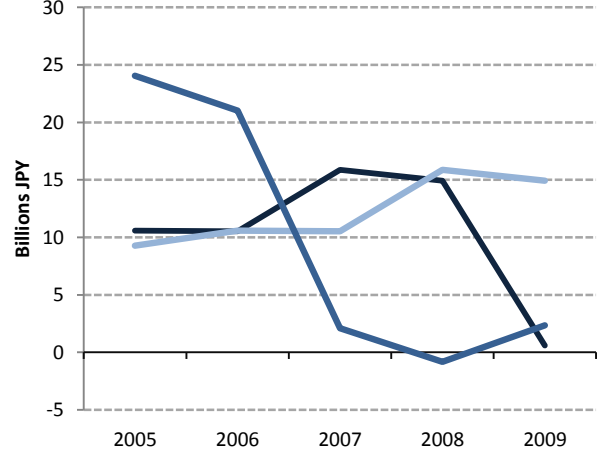
Debt-to-equity



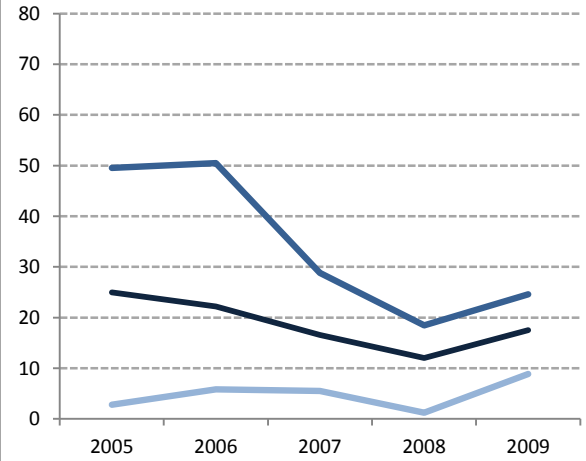
**Revenue per employee**



**Working Capital**



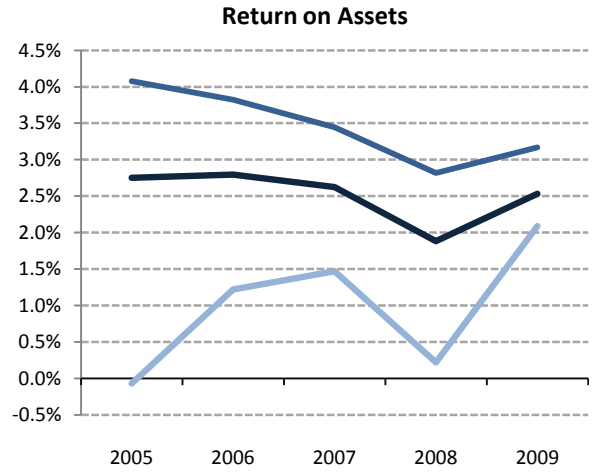
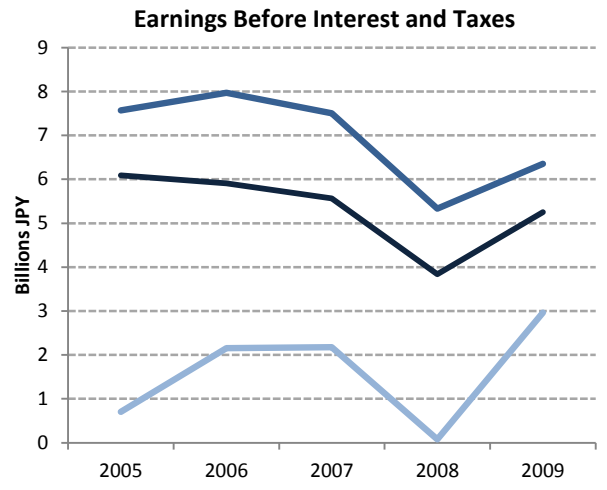
**Interest Coverage Ratio**



Source: Nihon Sangyou-betsu Zaimu Data Handbook, Promar Calculations

All food Meat & Dairy Manufacturers

Profitability: recovering (for now?)



**Growth.** The food sector as a whole has contracted significantly over the past five years on poor economic conditions, changing dietary habits, and as Japan found itself increasingly subject to rising international commodity prices. Average firm revenue across a sample of 84 listed F & B firms remained below 2002 levels as of the end of 2009. We expect a modest recovery coming out of the GFC, and there are still pockets of potential growth within the sector, but in general there's not much upside considering the shrinking and aging population.

**Liquidity.** There has been a steady deterioration in current assets, while current liabilities, on average, are more or less unchanged from 2005. Trade receivables have been down across the board, as has cash and deposits, presumably as firms draw down on reserves to cope with poor sales.

**Solvency.** Debt levels have never been high in the sector, as evidenced by the relatively low historic debt-to-equity ratios, but shirking profits have narrowed interest coverage ratios considerably. Because debt levels have been so low and stable, however, the rebound in profits in FY09 helped to improve interest coverage.

**Profitability.** As international commodity prices have softened over the last year, firms' profitability has been able to recover despite continued negative revenue growth. Sector-wide, COGS fell 6.5% in FY09 from the previous year, while revenue fell by only 4.4%. Looking forward, we believe that the current downturn in major commodity prices will prove temporary and COGS will increase again in 2010, or soon thereafter, and particularly for meat & dairy and confectionary firms, the latter of which relies heavily on fats and oils, flour, and sugar as inputs.

Source: Nihon Sangyou-betsu Zaimu Data Handbook, Promar Calculations



**SECTION 4:**

**SAMPLE FIRM ANALYSIS**

## Overview

<b>Main business</b>	Confectionary
<b>HQ</b>	Niigata prefecture
<b>Largest shareholders</b>	Founding family
<b>Oversees operations</b>	China
<b>No. of employees</b>	3,895 (full-time)

	Bourbon	Manufacturers	Food Sector
<b>Revenue (2009)</b>	¥ 101.3	¥ 73.0	¥ 109.8
<b>Revenue CAGR (05-09)</b>	4.1%	- 5.1%	-2.9%
<b>Current ratio</b>	1.28	1.08	1.13
<b>Working capital</b>	¥ 6.0	¥ 2.4	¥ 0.6
<b>Debt-to-equity</b>	0.21	0.31	0.40
<b>Interest coverage</b>	46.9	24.6	17.5
<b>EBIT</b>	¥ 2.2	¥ 6.4	¥ 5.3
<b>ROA</b>	0.7%	3.2%	2.5%

\* Currency figures in billions JPY

## Summary

Bourbon began, under a different name, as a chewing gum and candy company in the 1920s. Over time, however, it moved into the biscuits and cookies business and now that business line, along with rice crackers, account for the majority of firm revenue. Firm has recently expanded into the functional foods segment and gained FOSHU certification from the Japanese MHLW for a cocoa product, but revenue from this segment remains marginal.

## Input needs

Firm's five main input needs are: flour, sugar, dairy ingredients, palm oil, and –a recent addition–fruits. Palm oil is sourced from Malaysian refiners, while the sugar and dairy products are primarily Australian and New Zealand in origin. Management has recently called on the procurement division to look into moving downstream into production, though the project is already behind schedule and could take years to complete.

## Financial strength

Firm has achieved growth despite its near-total reliance on the home market and with rising, flour, sugar and dairy input costs. The pace of fixed asset investment has run ahead of profits, dragging down ROA. However, firm has low levels of debt and strong working capital.

## Investment potential

For now, the firm is trying to get its assets under control and increase efficiency. Because Greenfield investments are capital intensive, firm would not consider an investment in State X in the near future. If industry clustering in the state, achieved sufficient scale it would consider an investment down the road.

Executives noted that they already have a good relationship with input suppliers from country X and thus do not see a pressing need to be on the ground to secure supplies.

## Overview

<b>Main business</b>	Processed foods, milling
<b>HQ</b>	Tokyo
<b>Largest shareholders</b>	Nippon Life Insurance, Yamazaki Baking
<b>Oversees operations</b>	US, Canada, Thailand, China
<b>No. of employees</b>	5,200

	Nisshin Seifun	Manufacturers	Food Sector
Revenue (2009)	¥ 466.7	¥ 73.0	¥ 109.8
Revenue CAGR (05-09)	2.9%	- 5.1%	-2.9%
Current ratio	3.11	1.08	1.13
Working capital	¥ 118.7	¥ 2.4	¥ 0.6
Debt-to-equity	0.04	0.31	0.40
Interest coverage	127.2	24.6	17.5
EBIT	¥ 24.87	¥ 6.4	¥ 5.3
ROA	3.6%	3.2%	2.5%

\* Currency figures in billions JPY

## Summary

Nisshin Seifun began as a wheat milling co., but flour and pre-mixes have come to represent less than half of revenue as the co. has moved into processed foods., which includes a range of pastas and pasta sauces, ready-to-eat meals, frozen foods, and instant noodles. The group also includes a pet food business, along with health care products and pharmaceuticals.

## Input needs

Firm's single largest input is wheat. It purchased 5.5 million tons last year from the US (58%), Canada (24%), and Australia (18%). US wheat is mostly for milling, while Canadian durum is for pasta production, and Australian wheat is used for Japanese-style noodles and instant noodles.

Other needs include starch (firm would not discuss procurement), tomatoes, and edible oils like palm and soybeans. Tomatoes are mainly sourced in Thailand and China, although domestic-allyproduced sauces generally use Japanese tomatoes.

## Financial strength

Firm exceeds the benchmarks for all basic measures used for this report. It has had strong (for Japan) revenue growth, has almost no debt to speak of, and is sitting on significant cash reserves.

## Investment potential

Firm is, in every respect, a perfect match for state X. Its need what the state can supply, it is in the middle of an ambitious overseas expansion, and it is financially-strong. However, executives told Promar that labor costs are too high in the state, the local market is not large enough, and there are alternatives in the region if it were to make an investment, particularly for processed and frozen foods.

The only scenario under which firm would consider an investment would be if it attracted an agglomeration of Japanese noodle markers to function as a ready-made customer base.

## Overview

<b>Main business</b>	Mushrooms/cultivation
<b>HQ</b>	Nagano
<b>Largest shareholders</b>	Institutional investors (50.49%)
<b>Oversees operations</b>	USA, Taiwan
<b>No. of employees</b>	807

	Hokuto	Manufacturers	Food Sector
<b>Revenue (2009)</b>	¥ 45.9	¥ 73.0	¥ 109.8
<b>Revenue CAGR (05-09)</b>	5.0%	- 5.1%	-2.9%
<b>Current ratio</b>	0.52	1.08	1.13
<b>Working capital</b>	-¥ 9.0	¥ 2.4	¥ 0.6
<b>Debt-to-equity</b>	0.20	0.31	0.40
<b>Interest coverage</b>	66.7	24.6	17.5
<b>EBIT</b>	¥ 8.0	¥ 6.4	¥ 5.3
<b>ROA</b>	14.4%	3.2%	2.5%

\* Currency figures in billions JPY

## Summary

Firm was est. in 1964 and began as a trading house specializing in packing materials. That business has been left behind, for the most part, and firm now derives almost all revenue from the cultivation and sale of branded mushrooms. In FY 09, it's total mushroom output was 62,000 tons, with Brown Beech variety accounting for half that figure, with the remaining 50% divided between King Trumpet and Maitake.

## Input needs

Mushroom cultivation does not require specific inputs, per se, except for the maitake variety, which grows on oak wood. High-quality water and compost or soil are a must, however. Although there is not a compelling input-related story to sell firm on state X, the strength of the state's agriculture sector and horticulture production could prove attractive.

## Financial strength

Firm has posted strong results in each of the last five years, with the most recent year, FY09, being its best yet. EBIT beats the food sector average and ROA is 5x the food sector benchmark.

Firm has taken on higher amounts of short-term debt in the last three years, which has hurt working capital, but we see little risk in this regard as the firm has a strong cash position and reduced debt in FY09.

## Investment potential

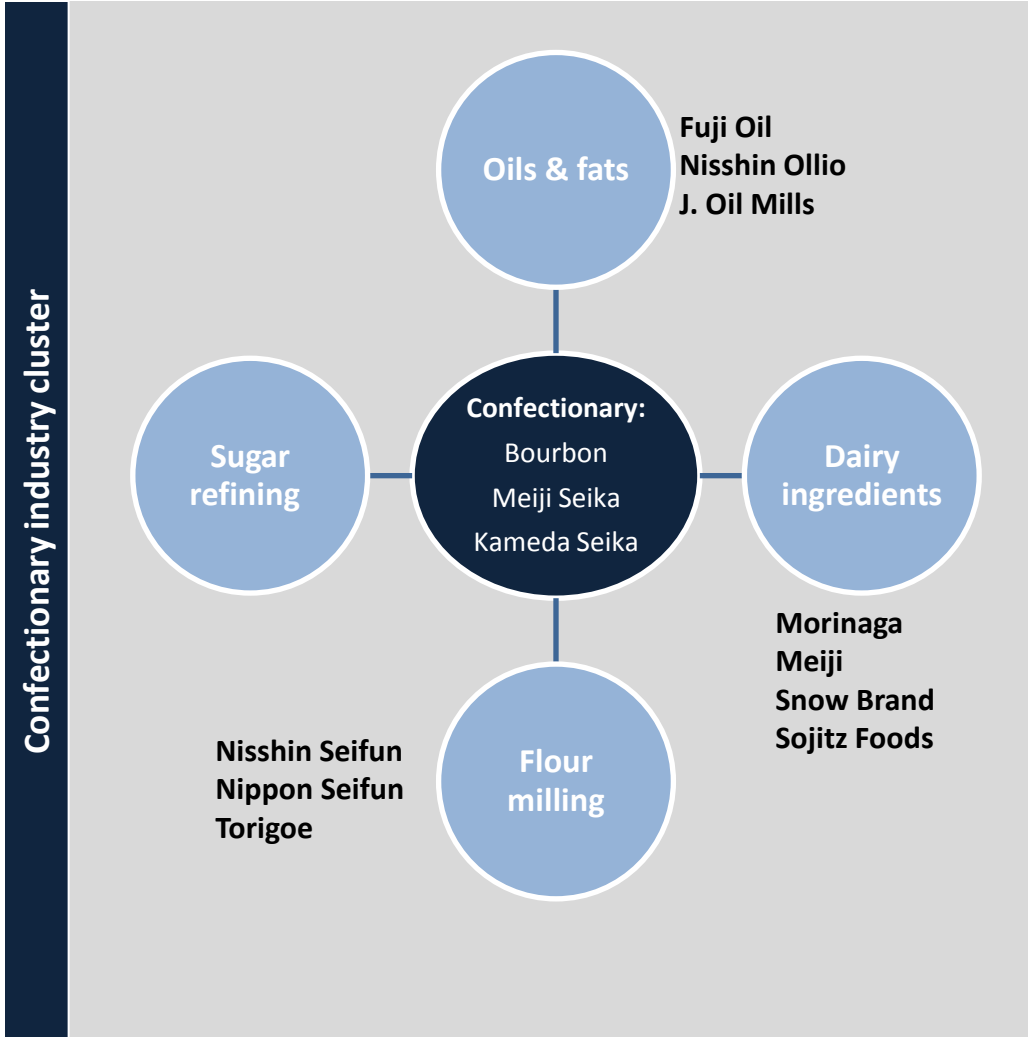
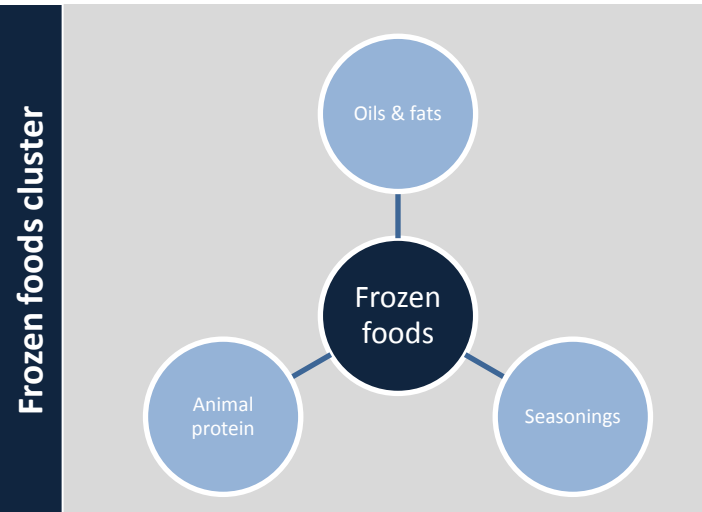
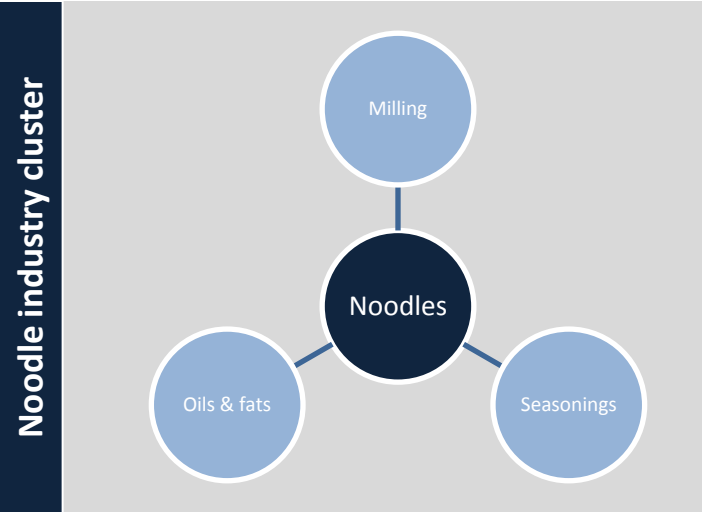
Near-term potential is low, according to firm's executives, who said that they are focused on expansion in the US and Taiwan (as a stepping stone to mainland China). They also voiced concerns about the stability of the water supply in State X, echoing a concern we have heard regularly in interviews.

However, the firm will eventually look to SE Asian markets for growth and when it does, and if State X government can ensure stable water supplies, it would consider the state as a potential export platform.

**SECTION 5:**

**SAMPLE RECOMMENDATIONS**

State X will need to take a different approach because of its perceived shortcomings as an F&B sector investment destination. One possible option is to pursue a clustering strategy whereby the State X government chooses one F&B industry to champion, and thereby attracting complimentary investment from supporting industries. Three examples are provided below; we believe that, considering the type of commodities State X and adjacent states produce, the confectionary industry could prove the most attractive.



To date, State X’s trade and investment office has taken a somewhat unfocused approach to selling Japanese companies on the benefits of making Greenfield investments in the state. This project represents the first step in remedying that issue in that it has identified the most promising firms to approach. The next step, selling these firms on the benefits, requires a more tailored approach than used in the past. In practice that means addressing the specific needs and concerns of each firm within the context of a general pitch on State X. For a possible structure to such a presentation, we present the following example.

### Sample Outline for Roadshow Presentation

