Food Safety Due Diligence

Considerations for Investors

TriVista

Investments in the Food & Beverage sectors have helped many private equity investors realize sizeable returns. However, investment professionals must keep Food Safety regulations and compliance top of mind during due diligence and post transaction to preserve capital and mitigate risk.

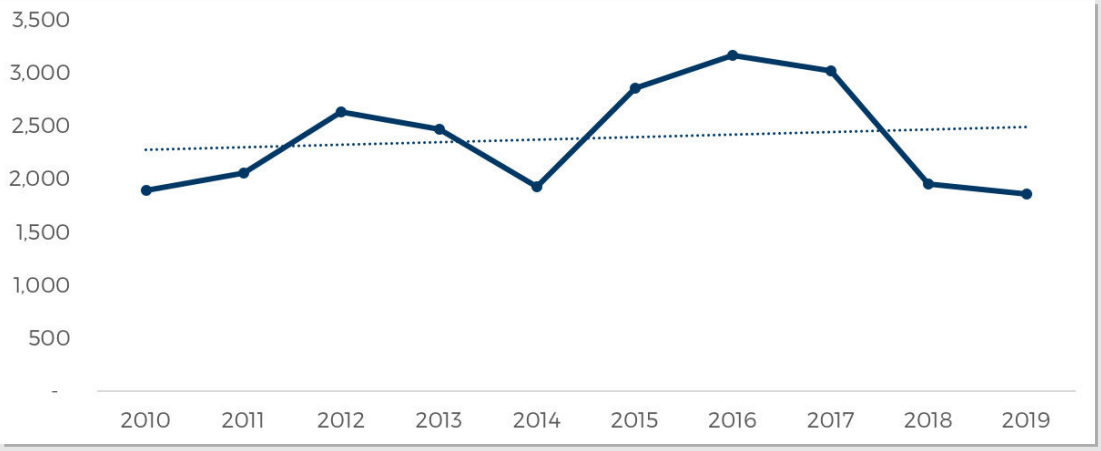
Private equity investment activity in the Food & Beverage sectors continues to increase substantially, particularly in the middle market. Entrepreneurs seeking growth capital and liquidity have presented investment opportunities that are ripe for investors, while also allowing for ample exit opportunities to larger funds and strategic buyers. However, investments in the Food & Beverage sectors come with unique risks that are not encountered in traditional manufacturing and distribution environments.

FOOD SAFETY DUE DILIGENCE

Conducting Food Safety Due Diligence is one component of a broader diligence effort. In addition to conducting traditional Operational Due Diligence, investors need to understand that there are critical elements of a comprehensive Food Safety Program that must be assessed, including Product Safety, Regulatory Compliance, Management Commitment, and the target's company-wide Food Safety Culture. While an operation may have various food safety certifications, these auditing schemes tend to focus on documentation without considering other, more comprehensive elements to product protections. Food Safety Programs must be well-developed and compliant, and a top-down Food Safety culture that fosters employee empowerment can lead to effective implementation of those programs. It is recommended that trained experts be retained to evaluate the application of the Food Safety and Compliance Programs as an independent review of adherence to industry best practices.

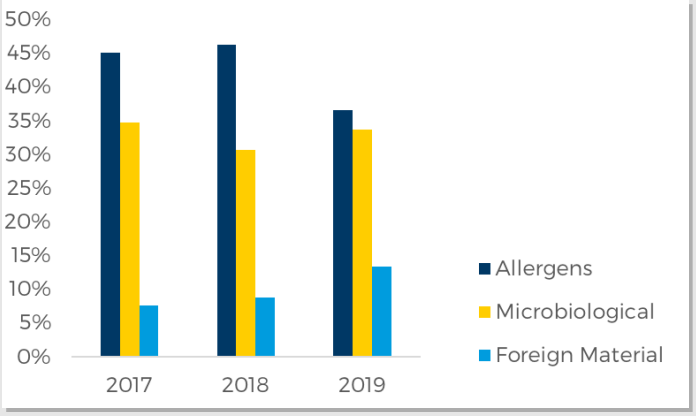
Determining early-on whether or not a target company is compliant with the FDA, USDA, state or other international industry regulations is critical to mitigating downside risk. While no production facility is ever deemed "perfect," it is important that investors consider gaps that exist in the target company's Food Safety Program. Additionally, it is essential to understand the potential liability and probability of a product recall or regulatory sanctions – either of which could dramatically impact an investment. Mapping out a post-close risk mitigation and improvement plan that can be shared with management will ensure timely closure of critical corrective actions and demonstrate to management the investors' commitment to Food Safety and Compliance.

FDA Food Product Recalls



Source: FDA Enforcement Reports (www.fda.gov)

Primary Drivers of FDA Recalls '17 to '19



Food Safety Due Diligence Checklist:

- **Good Manufacturing Practices** (GMPs)
- **HACCP** (Hazard Analysis & Critical Control Points)
- **Microbiological Programs**
- **Allergen Control**
- **Foreign Material Control**
- **Sanitation**
- **Supply Chain Management**
- **Traceability & Crisis Management**
- **Food Defense**
- **Plant Infrastructure & Equipment Conditions**
- **Pest Control**
- **Corrective & Preventative Action Program**
- **Personnel Training**
- **Regulatory Communications**
- **Third-Party Audits**

FDA: FOOD SAFETY MODERNIZATION ACT

The FDA's Food Safety Modernization Act (FSMA) should be of critical concern to private equity investors active in the Food & Beverage space. Since being signed into law in 2011, FSMA has been rolled out in stages. However, Food & Beverage operations have struggled to interpret and implement the new regulations, and many are still not compliant. FSMA compliance extends outside of the boundaries of the US, and several countries around the world have adopted similar regulations. Mid-market and small-cap companies may be at a significant disadvantage with the regulatory compliance movement, since they often lack the basic science and technological expertise to stay out in front of the changes required.

GLOBAL SUPPLY CHAIN

In addition to ensuring an operation is in regulatory compliance and has a robust Food Safety Program in place, there are supply chain and ingredient factors that must be assessed. Certain ingredients and finished products have inherent risks, and with so many ingredients being sourced internationally, regulators have been paying increased attention to both intentional and unintentional adulteration of these ingredients. For example, a Foreign Supplier Verification Program (FSVP) must be in place for FDA-regulated products. This program places responsibility on US food importers and manufacturers to assess and mitigate the risks involved with their imported ingredients.

> The United States imports about 15% of its overall food supply. But this increasingly globalized and complex marketplace has also placed new challenges on our food safety system" — FDA, 2019

POST-TRANSACTION PORTFOLIO COMPANY OVERSIGHT

Assessing a company's current programs and implementation does not always ensure future adherence or commitment to a comprehensive and effective program. To that end, private equity investors should also consider the management of Food Safety and Compliance Programs post-close.

Investors should monitor performance, and the management of Food Safety Programs should be regularly scrutinized, especially with respect to changing regulations. Investors must empower management teams to invest time, money, and resources into their Food Safety infrastructure, which may require capital expenditures and external advisory services.

Food Safety is a constantly evolving field that needs to be regularly monitored and re-assessed to ensure effectiveness. Staying ahead of the curve will guarantee that risk has been mitigated and that the organization is adequately positioned to prevent recalls or other costly regulatory and compliance issues.

FOOD SAFETY AT EXIT

The final consideration for private equity investors investing in the Food & Beverage sectors is the impact Food Safety can have on the exit process. Investing in the right resources during an investment hold period should net tangible results. While it would be difficult to estimate the net positive impact of a robust food safety program on enterprise value, having a plan in place to tackle every element of Food Safety should enable a faster deal process, higher likelihood of close, and potentially higher exit multiples.

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