Trend of the Year: Investing in start-ups
Emerging brands are capturing the attention of hungry investors.
FoodBusinessNews.net, 12/19/2016
by Monica Watrous

Emerging brands are capturing the attention of hungry investors.

KANSAS CITY — Good Culture, a maker of organic cottage cheese, and Tio Gazpacho, a ready-to-drink soup company, are among brands that recently secured strategic investments from 301 INC, the business development and venturing unit of General Mills. The fund was launched last year to invest in and help build promising new food and beverage start-ups. Kellogg Co. and Campbell Soup Co. have since launched venture funds, too.

It's one way in which the industry is adapting to changes in the marketplace. The largest food manufacturers in the United States have ceded market share to small and medium-size competitors while growing revenue at a fraction of the rate — 1.8% compared with 11% to 15%, according to a report published by A.T. Kearney and The Hartman Group.

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The high cost of acquisitions is driving top companies to create seed funds in order to get on the ground floor of food and beverage start-ups. Such initiatives position companies to take advantage of consumer trends with a lower entry cost.

"We are seeing companies invest a lot earlier into smaller firms," said Randy Burt, a partner with A.T. Kearney.

In addition to helping brands expand distribution, 301 INC leverages the resources and capabilities within General Mills to accelerate new product development.

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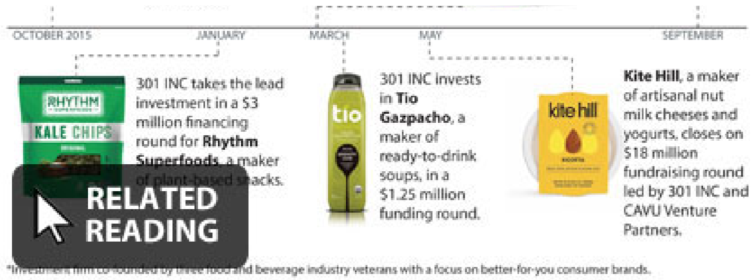

"It's one of many opportunities in terms of what we're doing on operation and supply chain and product quality and sourcing and marketing and communications; all of those things are part of a pretty vast toolkit that we can tap into because we have access to those things at General Mills," said John Haugen, vice-president and general manager of 301 INC. "But what really triggers all of that is the relationship we build with our portfolio brand, and it really is incumbent upon how we work with them to define that…

John Haugen, vice-president and general manager of 301 INC

"We don't run their business. We don't tell them how to run their business. We work with them to understand their business and how they run it and ask, 'What are some resources we can bring to help you do that?'"

Los Angeles-based Good Culture introduced its cottage cheese varieties nationwide at the beginning of the year and is growing rapidly with help from 301 INC.

"What's great about the 301 INC team is they are very much in the trenches with us," said Jesse Merrill, co-founder and chief executive officer of Good Culture. "They have robust capabilities across many different functions. We don't have a dedicated sales force within General Mills, but when we need assistance, they're certainly there, and we can tap their shoulder and get help as needed. They help us a lot in the R.&D. space, in manufacturing, they helped us conduct consumer research. They're very helpful both from a strategic perspective but also executional, which is really nice."

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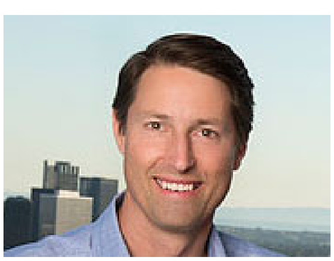
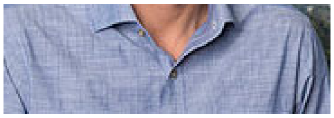
Good Culture also received a strategic investment from CAVU Venture Partners, a fund launched this year by three food and beverage industry veterans with a focus on better-for-you consumer brands. CAVU's investments have included Bai, Health-Ade Kombucha and Chef's Cut Real Jerky.



"One of the things that I see too often is a lot of entrepreneurs are getting capital, but they're not getting smart capital," said Clayton Christopher, co-founder and partner of CAVU Venture Partners. "A lot of the firms out there pride themselves on being good at picking winners, whereas we pride ourselves on building and creating winners."

CAVU Venture Partners seeks investments in early- to mid-stage companies with $50 million in revenue or less. In late April, CAVU announced a $4 million investment in High Brew Coffee, an Austin, Texas-based ready-to-drink cold brew coffee brand, which also landed a distribution deal with Dr Pepper Snapple



Clayton Christopher, co-founder and partner of CAVU Venture Partners

Group.

Launched in 2014, High Brew Coffee grew 270% in its first year and is set to grow another 200% this year, said David Smith, founder and c.e.o. of High Brew Coffee. The shelf-stable ready-to-drink beverages are distributed in 14,000 retail outlets and available in such flavors as Mexican vanilla, salted caramel and dark chocolate mocha.

"We're big believers in the cold brew coffee category, that it's here to stay," Mr. Christopher said.

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A common link among new food and beverage start-ups is a passion for improving the food system and protecting the planet. Back to the Roots, an Oakland, Calif.-based maker of organic breakfast cereal, earlier this year expanded its crowdfunding campaign on CircleUp into a $10 million Series A funding, led by Acre Venture Partners, the venture capital arm of the Campbell Soup Co. Campbell earlier this year announced the $125 million investment fund, which is managed externally by independent partners.

"A lot of our brand is built on this idea of knowing where your food comes from and working directly with farmers," said Nikhil Arora, co-founder of Back to the Roots. "That's what inspires us, that we can walk down a grocery store … for every category, how can we make packaging more sustainable, the branding more authentic and expressing our values? The main thing is the ingredients and really focusing on this idea of radical transparency and simplicity. There's a lot ahead of us."

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Beyond Meat, El Segundo, Calif., aims to reduce global meat consumption by 25% by 2020, with the goal to improve human health, positively impact climate change, conserve natural resources and improve animal welfare. The company makes plant-based meat substitutes that have the taste and texture of animal protein. All products are made with soy or pea protein and contain no gluten, dairy, trans fats, cholesterol or bioengineered ingredients. Beyond Meat is a portfolio company of 301 INC.

“There has been a perception around plant-based meats, that they aren’t sufficient, and that’s completely wrong — they are in fact extremely important as an overall healthy diet,” said Ethan Brown, c.e.o. of Beyond Meat. “The whole ethos of the company is to create a product that is completely indistinguishable from animal protein. We’re not there yet, but every day we do get closer and we do know that scientifically it’s possible.”

Tyson Foods, Inc., Springdale, Ark., acquired a 5% stake in Beyond Meat in October.

Another start-up with a similar mission is Kite Hill, a Hayward, Calif.-based maker of premium nut milk cheeses and yogurts, which closed on an $18 million funding round in May led by 301 INC and CAVU Venture Partners.

“There were areas where we believed both CAVU and 301 could bring operational expertise to the table, and I think that was instrumental in our deciding to partner with them as a part of this most recent round,” said Matthew Sade, c.e.o. of Kite Hill.

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Combining traditional cheese-making techniques with a proprietary almond milk formulation, Kite Hill produces a range of products, including four artisanal nut cheeses, two cultured cream cheese-style spreads, two varieties of frozen ravioli and seven flavors of cultured yogurt.

“Usually if you say ‘vegan’ and ‘cheese’ in the same sentence, you’re going to get a dirty look from people,” Mr. Haugen of 301 INC said. “There has not been a product that’s delivered on taste.”

He added, “There are a lot of people who are not vegan but who are still looking for specific occasions to reduce or avoid animal protein. People who are flexitarians, lessitarians… I think it’s absolutely tipping right now.”

Plant-based food and beverage brands have generated much attention from the investment community recently. In August, Powerplant Ventures, a venture fund established to partner with such businesses, announced the closing of a $42 million fund with the goal to support emerging plant-centric companies and brands. Included in Powerplant Ventures’ current portfolio are Hail Merry, Rebbl, Thrive Market, TerraVia, Hampton Creek, Treasure8 and Juicero.

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“It’s very well known that we as Americans are eating differently,” said Jon Sebastiani, founder and c.e.o. of Sonoma Brands, a consumer products incubator and venture fund launched earlier this year. “We’re not eating meals as regularly as we once did, and we’re snacking throughout the day. The term snacking is being redefined every year.”

In March, Sonoma Brands made its first investment, taking the lead in a minority funding round for Dang Foods, a Berkeley, Calif.-based pioneer in bringing a coconut chip snack product to market. This year, the company added a line of onion chips.

“When we make an investment like we did into Dang Foods a few months ago, it’s not just our capital that fuels the growth of the company; we’re literally going to join them in sales and marketing and operations and finance,” Mr. Sebastiani said. “The stage of investments we’re making — which is earlier stage, meaning revenues are generally around $10 million — most of the time the founders of those companies are still wearing every hat. They’re the chief marketing officer, the chief operating officer, they’re doing everything…

“At the end of the day, all the way through the lifecycle of the business, the founder is really the most passionate, most important sales person that a company will have. If that founder has an authentic story, meaning they created the company out of something authentic and real to them, that’s a value-add.”

“Food is the new tech” is a refrain uttered often that appears to be becoming truer as more small business venture capitalists, incubators and accelerators focused on food and beverage continue to emerge. One such company is Food-X, a business accelerator that every quarter selects 10 companies to invest in and mentor through the difficult and challenging start-up process.

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Andrew D. Ive, managing director of Food-X, sees the increased interest in food and beverage start-ups as being primarily consumer driven.

“Two decades ago, consumers and producers were focused on the lowest cost calories and getting foods rich in various carbohydrates and proteins at the least possible price,” he said. “What has happened in the past 10 years is consumers have become more conscious of the decisions they are making around food. Therefore they are more discriminating in terms of what they buy and what they consume. This consumer-driven awareness is driving what retailers are stocking and merchandising. This, in turn, is affecting the supply chain in terms of consumers looking for more local, sustainable and artisanal products.

“The large food companies are seeing this and are getting in on the act. They are becoming more aware of the shifting consumer choices.”

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In June, Kellogg Co. announced the launch of eighteen94 capital (1894), a $100 million venture capital fund to invest in start-ups pioneering in food ingredients, packaging and technology.

"As consumer preferences move toward more diverse tastes and trends, the pace of innovation in the packaged food industry continues to intensify," said Gary Pilnick, vice-chairman of Kellogg. "By investing directly in the most promising entrepreneurs and ventures, we can increase greatly our access to game-changing ideas and trends that could become significant sources of growth for us. At the same time, we will be providing these companies with essential growth capital and access to Kellogg resources and expertise, which will help drive their ideas and businesses. It's truly a win-win."

It is difficult to imagine a more powerful indicator of the dynamism and promise of the food and beverage industry than the emergence of venture capital funds targeted specifically at the sector. Recognition of this potential extends beyond the investment community.

With the industry's largest and more mature companies seeking new avenues for growth, many have established such venture funds in pursuit of innovation and to avoid the high multiples involved in acquiring such businesses as Annie's and Applegate Farm later in their development.

Beyond the high cost of acquisitions, there are other reasons why venture capital investing has become a preferred avenue toward innovation in food and beverage. Most notably, the process allows manufacturers to test new product concepts outside of their higher-equity stables of brands, brings less risk to the innovation process and may ultimately lead to less expensive acquisitions.

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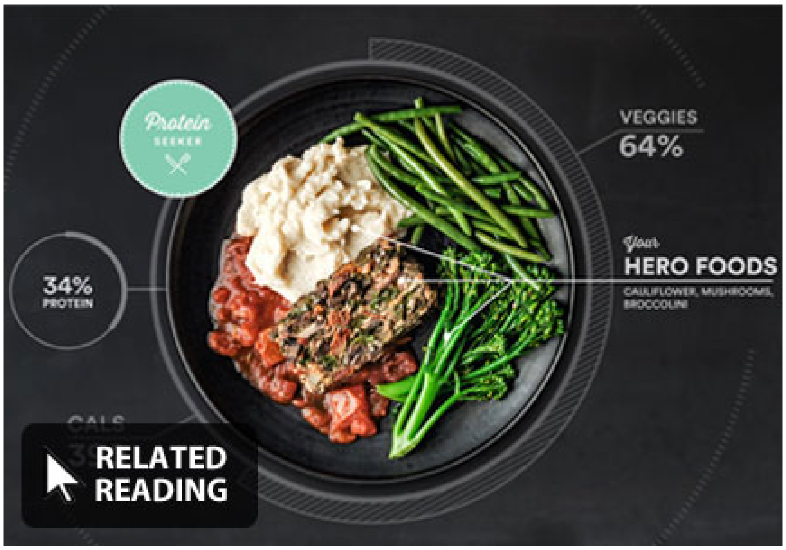
Food and beverage companies active in the venture capital market include Nestle S.A.; The Coca-Cola Co.; General Mills, Inc.; Kellogg Co. and others. In some cases, the creation of a fund may reveal the pursuit of strategic shifts. For example, Tyson Foods, Inc., one of the world's largest meat protein providers, recently created Tyson Ventures L.L.C., a $150 million fund that will focus on opportunities in alternative proteins, food waste and food insecurity and improving the supply chain through technology.

The fund's first investment was a 5% stake in Beyond Meat, a California manufacturer of meat-free burgers and single-serve meals. The move may be viewed as recognition by Tyson Foods that the greatest future growth in protein lies beyond its core markets for chicken, beef, pork and prepared meals.

The Campbell Soup Co. entered into a partnership with Acre Venture Partners earlier this year to create a $125 million fund. Denise Morrison, president and chief executive officer of Campbell Soup, said about the company's participation in the fund that defining the future of food requires new approaches and new business models.



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The fund reinforced Ms. Morrison's statements when Campbell Soup invested in a personalized nutrition meal delivery service called Habit (see related story on Page 36). What stands out about the investment is how it differs so widely from Campbell Soup's current business mix. Habit uses personalized data generated from a number of indicators, including DNA testing, to create customized meal plans. As part of the program, Habit will prepare the customized meals and deliver them as well.

The venture fund approach also suggests a belief that new brands may incubate more effectively in small, nimble businesses versus under the stewardship of the largest consumer packaged goods companies. A study published earlier this year by the consultancy A.T. Kearney highlighted how small- and mid-size food and beverage companies have seen sales increase at the expense of the industry's 25 largest companies. The top 25 food manufacturers in the United States, which include companies with annual revenues of more than $4 billion each, have ceded 300 basis points to small- and medium-size competitors since 2012 and have grown revenue at 1.8% compared with 11% to 15% for smaller companies, according to the report.

A similar study published by the market research firm I.R.I. in partnership with the Boston Consulting Group shows small companies, those with less than $1 billion in sales, and mid-size companies, those with sales between $1 billion to $5 billion, accounted for 46.4% of total C.P.G. sales in 2015, a 2.7% gain since 2011. The gain translates into an $18 billion shift in the $670 billion C.P.G. market during the past four years, according to the study. The shift has taken place as more niche companies are establishing themselves in specific categories as viable competitors to some of the largest C.P.G. companies.

Whether any of the early-stage investments prove scalable and brings the growth companies are seeking remains to be seen. A great positive is that so many companies are willing to embrace ideas and approaches outside of their traditional business models. It shows an openness that is required to identify ideas that may be considered truly innovative.