AP CAPITAL RESEARCH

M&A Deal of The Week

MARS INC X HOTEL CHOCOLAT

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Executive Summary

M&A DEAL OF THE WEEK

Deal Summary

- On Thursday, 16th November 2023, Mars announced that it would be acquiring luxury chocolate brand Hotel Chocolat (HOTC) for £534 million in an all-cash deal.
- This deal represents a 169.8% share premium of £3.75 per share compared to Wednesday's closing price of £1.39. Shares in HOTC subsequently rocketed up more than 160% in the first half hour of trading after the market opened due to this announcement.
- This acquisition represents an opportunity for Mars to move into the premium chocolate segment. As for Hotel Chocolat, this deal will help them overcome previous supply chain issues and expand further and faster.
- This comes after a 10% fall in YOY revenue (FY2023 ending June) for Hotel Chocolat and a failed joint venture launched in Japan in 2018, leading HOTC to write off nearly £22 million.
- Nestlé made a similar move earlier this year with its acquisition of Brazilian premium chocolate maker Grupo CRM.
- The deal is expected to be completed by the end of January.

Deal Advisors

Mars:
Lead Advisor: Morgan Stanley

Hotel Chocolat:
Lead Advisor: Lazard
Secondary Advisor: Liberum

Key Figures

- Offer premium: 170% [£3.75/share]
- HOTC Market Cap: £505 million
- HOTC EV/EBITDA: 24.3x
- Mars Market Share: 14.4%
- HOTC Enterprise Value: £585 million
- HOTC EPS: -£0.045

Company Information

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Mars Inc

- Founded in 1911, Mars Inc. are the 4th largest private company in the US according to Forbes, and they boast a range of products ranging from pet food to confectionaries such as Celebrations, Whiskas, Snickers and Maltesers. In 2016, they controlled 14.4% of the global chocolate market, making them the largest chocolate company worldwide.
- Mars' main competitors in the global chocolate market are Mondelez and Nestle, which control 13.7% and 10.2% of the global chocolate market, respectively.
- In 2008, they bought chewing gum giant Wrigley from Berkshire Hathaway for $23 billion, adding to their diversified portfolio.
- Their 2023 Revenue is £47 billion, up 4.4% from 2022's revenue of $45 billion, according to Forbes.
- With headquarters in McLean, Virginia, Mars employs over 140,000 in 80 countries worldwide.

Hotel Chocolat

- Founded in 1993 by two entrepreneurs, Hotel Chocolat (HOTC) is a luxury chocolate company that aims to bring affordable, high-quality chocolate to the UK high street. They focus on using less sugar in their recipes, creating a healthier snacking alternative compared to traditional confectionery.
- In recent years, it has attempted to expand into international markets in the US and Japan but with little success, leading to a loss of nearly £22 million from its failed Japan expansion alone. The two founders (Angus Thirlwell and Peter Harris) hold a 54% stake in the company, worth an estimated £288 million.
- In January 2023, HOTC signed a deal to have a 20% stake in a joint venture with Tokyo-based firm Eat Creator, in which they will receive brand royalty revenues and allow them to open 21 Hotel Chocolat branded shops across Japan.
- Hotel Chocolat's current 2023 (FY23 ending June) Revenue was £204.5 million, down 10% from 2022's £226 million.
- EBITDA for 2023 was £24.1 million, down 41% from 2022 EBITDA, which led to a loss of £6.2 million after tax. Their 2023 EPS is a loss of 4.5p per share and a P/E of -81.5x, up from 2022's P/E of -472.6x, when compared to other firms in the chocolate industry, ranks in the 2nd percentile.

Deal Rationale

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New Markets and Segments

- The acquisition will enable Mars Inc. to access new demographics and the premium confectionery market. Considering Mars operates in the low-end confectionery industry (chocolate, gum and confections), diversifying its product range to include premium confectioneries will give it access to a new range of customers, markets and demographics.
- According to Andrew Clark, Mars' Global President of the Snacking division, the strategic rationale for acquiring Hotel Chocolat is that it will fill a gap in their portfolio and allow Mars to compete with Lindt and Godiva in the premium chocolate sector.
- Furthermore, the acquisition will aid in Mars' expansion into the healthier and sustainable chocolate sector, which, over the last decade, has had a significant increase in demand. With the recent acquisitions of vegan and paleo chocolate company Hu from Mondelez and Brazilian premium chocolate company Grupo CRM from Nestle, the acquisition of Hotel Chocolat will help Mars remain competitive in the global chocolate market.
- This acquisition by Mars will allow Hotel Chocolat to grow domestically and internationally, as HOTC have had issues regarding expansion outside of the UK in the past. Hotel Chocolat CEO Angus Thirlwell mentioned supply chain issues as the primary driver of problems. The integration with Mars will significantly catalyse their international presence and allow them to overcome their supply complications.
- Furthermore, the Global Chocolate market is expected to grow at a CAGR of 3.8% per year until 2028, signifying revenue and profitability growth in a fast-growing market.

Deal Rationale

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Results of the acquisition

- Mars will gain a foothold in a new market, and based on their track record of entering new markets, it will quickly expand its market share in the premium chocolate sector, expanding its brand presence. Also, this will help further diversify their portfolio of products.

Risks

- The risk of this acquisition is limited as Mars Inc. is one of the largest private companies in the US, with billions of dollars in assets. Hotel Chocolat only has an EV/Market Cap of 1.16x and a Net Debt of ~£80 million.
- Commodity price risk -> Cocoa prices are up 70% from the previous year, which is impacting Hotel Chocolat as their rising raw material costs are denting their gross margin. A potential risk that Hotel Chocolat brings to Mars' portfolio is that Hotel Chocolat requires a larger percentage of cocoa when compared to other chocolate alternatives.
- Consumer Demand -> The cost of living crisis has impacted many UK households, resulting in consumers weighing more of their disposable income on consumer staple goods over consumer discretionary goods due to the elevated consumer staple prices. Demand for discretionary goods has fallen and is forecasted to remain subdued.

Final Thoughts

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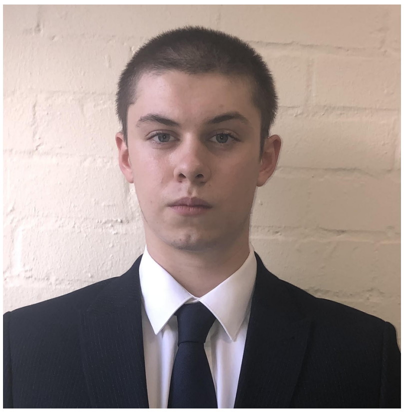
The acquisition of Hotel Chocolat represents an opportunity for Mars to expand their current 14.4% market share into new segments and remain globally competitive. It is also mutually beneficial to both companies as it will give HOTC the resources they require to reach international markets while helping diversify Mars' portfolio of products. Furthermore, the current CEO of HOTC, Angus Thirlwell, remains in his position, which is very beneficial for Mars as they will benefit from someone with decades of experience in the company.

However, given the current cost of living crisis, demand for premium products has fallen as consumers try to reduce unnecessary expenditure, leading to a £6.2 million loss after tax and falling revenues. Furthermore, Mars acquiring HOTC at a price of £3.75 a share (a premium of 170%) represents an overvaluation of almost 70% according to HOTC's intrinsic valuation, meaning that Mars may have quite significantly overpaid for a business that has had YOY falling profits and revenue. Still, it depends on how Mars executes its long-term strategy and growth potential with Hotel Chocolat in international markets.



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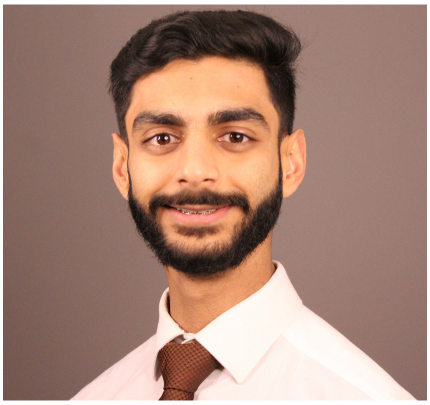

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