

Snyder's Lance (LNCE)

Valuation		Multiples	2016	2017	2018
Price	\$29.96	FV/Revenue	1.8x	1.7x	1.7x
Shares outstanding	96	FV/EBITDA	13.3x	11.1x	10.8x
Equity value	\$2,871	FV/EBIT	19.6x	15.3x	13.8x
Cash	(41)	P/E	29.9x	18.3x	17.3x
Debt	1,404	P/FCF	26.1x	16.3x	16.0x
Firm value	\$4,234	FV/FCF	38.5x	24.1x	23.5x

Snyder's Lance (LNCE) represents a compelling opportunity to buy a simple, predictable cash flow business that is on the brink of transforming from a small niche consumer packaged goods manufacturer into a low-risk rollup vehicle that will benefit from revenue growth and margin expansion, on a similar base of invested capital and will become a meaningful potential takeout candidate for conglomerated food.

Business Description:

Snyder's Lance ("Lance") is at the beginning stages of becoming a snack-food roll-up. I deliberately use the word rollup rather than platform because of all of the risks that the word entails. However, I believe that acquiring recipes and manufacturing prowess are less difficult to integrate than acquisitions in other industries. With the exception of Post – ConAgra whose problems were significant and predictable, food acquisitions have generally gone well given the limited changes in industry structure and limited variance of business model that present challenges in other industries.

The Company is currently a rollup of three, 100 year-old companies, that on their own produce strong free cash flow. Lance and Snyder's of Hanover merged in a merger of equals in 2010, and over the past 6 years have sold their private label capabilities, using the proceeds to add brands and manufacturing capability, capped with their acquisition of Diamond Foods in February 2016. The result is a Company with a widespread manufacturing network and advanced capability, an enviable national distribution network that is attractive to subscale brands, and reach that is newly international.

The Company categorizes its revenue into four categories. Branded, which includes the Core and Allied Brands, (listed below) and represents 70% of revenue; Partner Brands, which are owned by other owners, but pay for distribution through LNCE's distribution system, and account for 15% of revenue; Culinary, which is mostly the legacy Diamond Foods nuts business, that accounts for 10% of revenue, and Contract Manufacturing, whose customers include Mondelez, Unilever, and General Mills, which accounts for 5% of revenue.

Brands:

1. **Snyder's of Hanover:** Market leading pretzel brand
2. **Lance:** Market leading sandwich cracker
3. **Cape Cod & Kettle:** #2 and #3 brands in the kettle chip category. One from Diamond the other from legacy Lance, a major source of synergies moving forward
4. **Diamond:** #2 provider of culinary nuts. 50% of the business is pure commodity to culinary kitchens and industrial customers. 50% is retail, which in other businesses (MKC has a significantly higher gross margin
5. **Pretzel Crisps:** #2 provider of deli crisps
6. **Late July:** #2 provider of organic tortilla chips

7. **Pop Secret:** #2 provider of microwave popcorn (Neck and neck with Orville Redenbacher)
8. **Emerald:** #4 provider of snack nuts. (Significant opportunity)

Fifty percent of sales are sold through 3rd party direct to store distributors who then sell to grocery stores, convenience stores, and mass merchandisers like Walmart and Target. The remaining 50% of the business are direct sales to the Club channel that includes Costco and Sam's.

Trends: Current consumer behavior is supportive of snacking. In 2011, the average number of snacks consumed daily was 2.6, while 41% of people snacked over 3 times a day. At the BMO conference in May 2016, the Company reported that in 2015, over 60% of people now snack over 3 times a day. While this is great for the category, there may be a natural limit to how much more this can expand further. Within snacking, indulgence and wellness are growing more quickly than general snacking.

Management: I believe in evaluating management on the basis of what their company needs and what the industry needs rather than how well they can talk to the street (unless their business relies on access to the capital markets). With Snyder's Lance becoming a roll-up vehicle, the ability to appropriately value, acquire, and integrate are the most important skills. Lance has demonstrated the ability to hit or exceed synergy targets on its major acquisitions over the past 5 years and in listening to the Company's management, they are intimately familiar with the discrete steps required to integrate Diamond Foods – to a level that is uncommon amongst senior management I've spoken to in the past. While their ability to appropriately value is still unsettled, I believe they have the skill set to integrate, using data from their distribution relationships, already in a preferred position to acquire, and are likely the right management team for the task in front of the Company.

In May, the company's CFO decided to retire, effective at the end of the year. The length of runway before retirement is an indicator that the departure is on good terms and I believe that no change in guidance or strategy should be expected and that the board will seek to attract a candidate with a similar skill set.

Why Cheap? The Company's stock has traded down over the past six months for two reasons that I believe will prove temporary.

1. **Walmart:** The Company's largest customer reduced inventory in the 3rd, 4th, and 1st quarter as part of its Clean Stores initiative. Sales should normalize to Walmart in the 2nd and 3rd quarter as inventory is worked through.
2. **Snyder's of Hanover:** The pretzel category weakened considerably during the end of 2015 and into the 1st quarter of 2016 with customers leaving the category for popcorn and flavored tortilla chips. Lance has innovated in the category, with pretzel poppers, pretzel sandwiches, organic, and additional flavors, and is backing up the innovation with advertising and promotional spending that has begun to turnaround the brand during Q2'2016.

I believe both of these issues are of the type that will occur in running a consumer packaged goods company, but that because Snyder's is smaller than Conglomerated Food, the issues with one customer and with one brand have a more significant financial impact. Despite these bumps, cash flow generation is still strong at the Company. I believe that the brand managers in the Company will manage the issues over the medium term and that normal growth will return.

Thesis: While most stocks that have undergone a major acquisition are evaluated on the basis of whether the sum of the two companies is greater than the parts. I believe in its current form, the market believes Snyder's Lance is less than whole, and that the combination will result in less than the parts. Even

without the purchase of Diamond Foods, Snyder's Lance had an enviable portfolio of brands, good distribution, and leading manufacturing capability that would have translated into margin expansion, and above average FCF conversion. With the addition of Diamond I believe the Company will prove to be stronger, with significant synergy realization, and an acceleration of "organic" revenue growth and margin expansion on the back of a high quality asset base.

1. **Over the past 5 years, Snyder's Lance has invested heavily in its manufacturing capability.**

Last 5 years/Gross PPE	1.5x
Gross PPE	741
Last 5 years capex + net assets from acquisition	(1,095)
Capital Expenditures	(336)
Net Assets from Acquisitions	(759)

Which has resulted in a superior cash flow generating business.

<u>Name</u>	<u>Capex actual/rev</u>	<u>Capex actual/pp&e</u>
Snyder's-Lance	2.9%	9.4%
Mondelez Intl A	5.0%	16.5%
Hain Celestial Group	2.5%	18.6%
TreeHouse Foods	2.4%	6.5%
J&J Snack Foods	5.4%	29.8%
ConAgra	3.4%	16.8%

Additionally, their contract manufacturing revenue is derived by providing processes where others lack the technical knowhow rather than mundane tasks where others don't have capacity. As the Company introduces new products, it will displace the 5% contract manufacturing revenue that has an estimated 2000 bps lower margin than the Core Brand offering which should propel margins past their 10% EBIT margin goal.

2. **The Company's long term growth rate of 3-5% will prove conservative.** Even fully penetrated CPGs like Coca Cola, achieve 4% annual growth through a mix of price and volume increases. In the case of Snyder's Lance, the Company has limited international exposure and will be able to use Diamond Foods base to expand legacy Snyder's Lance brands in Europe. The Company has cut their expected growth for this year to 0-2% given the problems in the first quarter, and the bar is now set low for them to beat as they reaccelerate growth to their long term model.
3. **The Company has multiple levers to pull to achieve synergies after the purchase of Diamond Foods that will add \$75mm to EBIT.** 30mm of the synergies are on track to be realized by the end of the first year, and those number assume no revenue synergies.
4. **Despite levered to 3.8x, the Company is still able to achieve investment grade interest rates on its bank debt and can delever regardless of whether synergies are realized.** Furthermore,

while the Company expects to delever during 2016 and be under 3x levered by the end of 2017, I expect the Company to continue use its free cash flow to acquire, stay near the top end of its targeted range of 2.5-3.0x, but to have much greater earnings.

Free option: As the Company grows in size it will become an excellent merger candidate for Mondelez, Pinnacle Foods, Kellogg, Unilever, or General Mills. These companies are focused on health and wellness, trade at a similar multiple, do not have a significant presence in the chip aisle, and are big enough that Snyder's Lance wouldn't move the needle pre Diamond Foods acquisition, but does now.

Risks:

1. Diamond Foods nuts business introduces commodity variability that impacts revenue and EBITDA that may take time for the street to understand.
2. A majority of the Company's debt is floating rate. While I believe the Company will seek to substitute the floating for fixed rate, the price for which it does may impair FCF
3. Any time a CFO leaves a company, the guidance is in doubt. While in this case, all signs point to a friendly retirement, and therefore a CFO who may jumped on a grenade and already set guidance low, the new CFO may want to kitchen sink the guidance to make his job easier moving forward.
4. Another brand or customer could falter.

Deserved Valuation: Based strictly on current assets, I believe the stock is 30% undervalued on a cash flow basis. By 2018, the cash flow generation should create the ability to acquire at least 10% more in equity value, if the Company were to only buy their own equity, while any synergistic acquisitions could create substantially more value. Base Case PT ~\$40.