Freshpet, Inc. (FRPT)

Baird Facts

Please refer to Appendix - Important Disclosures and Analyst Certification.

Price ($) (5/6/20): 74.84  
52WK H-L ($) : 81 - 36  
Market Cap (mil): 2,799  
Shares Out (mil): 37.4  
Float (mil): 15.0  
Avg. Daily Vol (mil): 0.53  
Dividend ($) : 0.00  
Yield (%): 0.0

Rating: Outperform  
Suitability: Higher Risk  
Price Target ($) : 90  
L-Term Rev. Gr Rate Est: 20%  
L-Term EPS Gr Rate Est: 30%  
Debt/Cap: 0.0%  
ROE: NM  
EV/EBITDA(FY21E): 42.1x

Price Target ($) : 90  
L-Term Rev. Gr Rate Est: 20%  
L-Term EPS Gr Rate Est: 30%  
Debt/Cap: 0.0%  
ROE: NM  
EV/EBITDA(FY21E): 42.1x

FY Dec 2019A 2020E 2021E
Q1 (0.10)A (0.10)A
Q2 (0.16)A (0.08)E
Q3 0.08A 0.07E
Q4 0.12A 0.17E
Total (0.04)A 0.08E 0.53E

EPS (Net): Our EPS estimates assume FRPT will be able to utilize cumulative NOLs to avoid paying taxes.

Headquartered IPO/Founded:  
Secaucus, NJ 2014/2006

Management  
CEO: Billy Cyr  
COO: Scott Morris  
CFO: Dick Kassar

Revenue Profile

Company Description

Founded in 2006, Freshpet pioneered the concept of “fresh food” for pets in North America and currently provides fresh, all-natural, refrigerated pet foods and treats across a number of retail channels (mass/grocery, club, natural, pet specialty, online). As such, Freshpet is a true “category creator,” one that is disrupting the $30B-plus North American pet food industry with an innovative/differentiated offering that is positioned at the intersection of two key secular trends – growing pet humanization and increased consumer focus on health and wellness. The company’s first-mover status, in-house “know-how,” and unique retail distribution model (products available in >21k company-owned refrigerators across all major retail channels) represent significant competitive advantages and barriers to entry, which should provide a solid foundation for profitable growth over the next several years.

Revenue Profile

Prior Period Store Locations 10,836 13,386 15,015 16,609 18,004 19,499 21,570 22,570
New Store Locations, Net 2,550 1,629 1,594 1,385 1,485 2,071 1,090 1,600
End of Period Store Locations 13,386 15,015 16,609 18,004 19,499 21,570 22,570 24,170
% change y/y 23.5% 12.2% 10.6% 8.4% 8.3% 10.6% 4.6% 7.1%

Grocery 6,130 6,881 7,953 9,056 10,129 11,315 12,065 13,120
Mass / Club 3,045 3,555 3,814 3,930 4,184 4,837 5,187 5,667
Pet Specialty 3,979 4,294 4,530 4,630 4,783 4,963 4,838 4,878
Natural 242 279 312 388 423 465 480 505
Total 13,386 15,015 16,609 18,004 19,499 21,570 22,570 24,170

Source: Company Reports, Baird Estimates
Competition
Mass/grocery dry/wet pet food brands (Nestle Purina, Mars Petcare, Big Heart Pet Brands, Rachael Ray Nutrish, etc.), pet specialty dry/wet pet food brands (Blue Buffalo, Nutro, Taste of the Wild, Wellpet, Natural Balance, Champion Pet Foods, etc.), emerging pet specialty fresh/frozen/raw pet food brands (Nature’s Variety, Primal, Stella & Chewy's, etc.), and store brand/private label pet food alternatives (Simply Nourish at PETM, Pure Balance at WMT, 4Health at TSCO, Whole Paws at WFM, etc.)

Quick Summary
FRPT remains a rare breed. FRPT’s 1Q results were fine, and the company reaffirmed its top-line guidance while trimming FY20 adjusted EBITDA plan by ~8% to account for incremental revenue growth supporting investments. Beyond the numbers, FRPT’s successful defense of their dominant competitive position and improving leverage to digital grocery disruption represent durable positives not to be overlooked from this report. Bottom line, the key pillars of this rare consumer staple growth story remain very much intact.

Investment Thesis
- Freshpet is a true “category creator” disrupting the North American pet food industry. Founded in 2006, FRPT is pioneering the concept of “fresh food for pets” in North America and currently provides fresh, all-natural, refrigerated pet foods and treats across a number of retail channels (mass/grocery, club, natural, pet specialty, online) in the $30B-plus North American pet food market. As such, FRPT is a true “category creator,” one that is disrupting the industry with a unique and innovative offering that holds powerful appeal for consumers, retailers, and (in our view) investors alike. With company-owned coolers in over ~21k retail locations and the only coast-to-coast refrigerated distribution network in pet, FRPT enjoys significant “first mover” competitive advantages and stands on the cusp of a multi-year cycle of robust top- and bottom-line growth.
- Living at the intersection of two powerful secular trends. Big picture, we continue to believe FRPT is uniquely positioned to benefit from two powerful secular trends in CPG – the humanization of pets and the desire for fresh, all-natural foods. When combined with rising Millennial/Gen Z pet ownership, the business is also poised to enjoy a natural demographic tailwind as FRPT over-indexes to these cohorts.
- The path to $1B in revenue by 2025. Based on the aforementioned secular and demographic trends, management believes the addressable household opportunity for the brand currently stands at 20M "Prime Prospects" – nearly triple the 7.5M TAM identified in 2016. Management has utilized several approaches to assessing the businesses longer-term opportunity. The results all point to a similar conclusion – a market opportunity >$1.7B at retail by 2025 (or ~$1B in wholesale revenue). Management’s $1B revenue target is predicated on adding 5M U.S. households to the franchise (vs. ~3M today). While media investments will remain a key driver of customer acquisition (leveraging proven strategies plus new tests), FRPT is also focused on converting “aware, non-user” households through ongoing product innovation and expanding accessibility/availability (via multi-fridge stores, ecommerce/digital).
- Capacity expansion plans ramping. Kitchens 2.0 is on track for 3Q20 production and the planning process for Kitchens 3.0 (which will be located in Ennis, TX) is already kicking into gear. Expected to start production sometime in 2022, phase 1 of this new facility will cost ~$300M for ~400k sqft and bring ~$300M in production capacity. We estimate phase 2 could cost another ~$160M for ~200k sqft and ~$400M of additional capacity (assumes more efficient lines). All told, K3.0 should bring an incremental ~$700M of production capacity to FRPT by 2025.
- Significant profitability growth on tap. Despite increased media spend and some expense pull-forward related to future capacity, G&A leverage is expected to result in 2020 adjusted EBITDA growth >50% (well ahead of >26% sales growth). Looking to 2025, while structural improvements in adjusted gross margin will largely be offset by mix, G&A leverage is expected to result in ~25% adjusted EBITDA margins (vs. 2020E’s ~14%).
- Price target rationale. Our $90 price target reflects a blended NTM multiple of ~5x/~22.5x on FY25E sales/EBITDA discounted back at ~10%. Given FRPT’s potential to deliver outsized sales and profit growth, we believe these target multiples are justified given BUFF’s takeout multiples of ~6x/25x TTM sales/EBITDA.

Risks & Caveats
- Managing rapid growth. Freshpet’s growth strategy must be carefully managed (e.g., ensuring retail partner buy-in, launching effective/successful new products, driving customer adoption and purchase velocity, containing fridge opening/production operating costs) in order to achieve sales/margin targets and appropriate returns on capital. Ongoing fridge growth and new product launches could also cannibalize existing sales and damage the company’s overall operating results.
- Concentration of retail customer base. A significant portion of Freshpet’s sales currently come from several key retail accounts, including Walmart, Kroger, and Target. As a result, FRPT’s operations are more susceptible to the pet category management actions and purchase behaviors across these key retailers than the operations of more diversified pet food manufacturer competition.
- Key person risk. CEO Billy Cyr, COO/President Scott Morris, and the broader FRPT senior leadership team have been and will continue to be instrumental to FRPT’s growth, continued financial performance, retail relationships, and expansion strategy. Any departures from or disruption to this management team could adversely impact the company’s strategy and growth prospects.
- Vendor/supply chain risk. FRPT’s ability to manage commodity/input costs (most notably chicken, but also beef) and produce/deliver pet food products at the highest levels of quality (e.g., close to human-grade, free from bacterial contamination) remains a significant driver of FRPT’s success (as well as key risk) longer term.
- Increased competition. Expansion of large players (Mars Petcare, Nestle Purina Pet, Hill’s, Blue Buffalo, etc.) into the fresh/refrigerated/raw/frozen pet food category, as well as efforts on the part of small/upstart pet food competitors in growing market share, launching innovative products and/or increasing promotional pricing, could adversely impact Freshpet’s sales and/or margins.
Changes in U.S. consumer spending and pet ownership trends. Any abrupt change in U.S. consumer spending or pet-related trends (e.g., pet ownership rates, pet food purchase tastes, etc.) could have a material impact on Freshpet’s ability to deliver sales and margin growth.
Appendix - Important Disclosures and Analyst Certification

Approved on 07 May 2020 12:40EDT/ Published on 07 May 2020 12:45EDT.

Rating and Price Target History for: Freshpet, Inc. (FRPT) as of 05-06-2020

1 Robert W. Baird & Co. Incorporated makes a market in the securities of FRPT.
2 Robert W. Baird & Co. Incorporated and/or its affiliates managed or co-managed a public offering of securities of Freshpet, Inc. in the past 12 months.
3 Robert W. Baird & Co. Incorporated and/or its affiliates have received investment banking compensation from Freshpet, Inc. in the past 12 months.

Appendix – Important Disclosures and Analyst Certification
Robert W. Baird & Co. Incorporated ("Baird") and/or its affiliates expect to receive or intend to seek investment-banking related compensation from the company or companies mentioned in this report within the next three months. Baird may not be licensed to execute transactions in all foreign listed securities directly. Transactions in foreign listed securities may be prohibited for residents of the United States. Please contact a Baird representative for more information.

Investment Ratings: Outperform (O) - Expected to outperform on a total return, risk-adjusted basis the broader U.S. equity market over the next 12 months. Neutral (N) - Expected to perform in line with the broader U.S. equity market over the next 12 months. Underperform (U) - Expected to underperform on a total return, risk-adjusted basis the broader U.S. equity market over the next 12 months.

Risk Ratings: L - Lower Risk – Higher-quality companies for investors seeking capital appreciation or income with an emphasis on safety. Company characteristics may include: stable earnings, conservative balance sheets, and an established history of revenue and earnings. A - Average Risk – Growth situations for investors seeking capital appreciation with an emphasis on safety. Company characteristics may include: moderate volatility, modest balance-sheet leverage, and stable patterns of revenue and earnings. H - Higher Risk – Higher-growth situations appropriate for investors seeking capital appreciation with the acceptance of risk. Company characteristics may include: higher balance-sheet leverage, dynamic business environments, and higher levels of earnings and price volatility. S - Speculative Risk – High growth situations appropriate only for investors willing to accept a high degree of volatility and risk. Company characteristics may include: unpredictable earnings, small capitalization, aggressive growth strategies, rapidly changing market dynamics, high leverage, extreme price volatility and unknown competitive challenges.

Valuation, Ratings and Risks. The recommendation and price target contained within this report are based on a time horizon of 12 months but there is no guarantee the objective will be achieved within the specified time horizon. Price targets are determined by a subjective review of fundamental and/or quantitative factors of the issuer, its industry, and the security type. A variety of methods may be used to determine the value of a security including, but not limited to, discounted cash flow, earnings multiples, peer group comparisons, and sum of the parts. Overall market risk, interest rate risk, and general economic risks impact all securities. Specific information regarding the price target and recommendation is provided in the text of our most recent research report.

Distribution of Investment Ratings. As of April 30, 2020, Baird U.S. Equity Research covered 724 companies, with 59% rated Outperform/Buy, 40% rated Neutral/Hold and 1% rated Underperform/Sell. Within these rating categories, 12% of Outperform/Buy-rated and 4% of Neutral/Hold-rated companies have compensated Baird for investment banking services in the past 12 months and/ or Baird managed or co-managed a public offering of securities for these companies in the past 12 months.

Analyst Compensation. Research analyst compensation is based on: (1) the correlation between the research analyst's recommendations and stock price performance; (2) ratings and direct feedback from our investing clients, our institutional and retail sales force (as applicable) and from independent rating services; (3) the research analyst's productivity, including the quality of such analyst's research and such analyst's contribution to the growth and development of our overall research effort; and (4) compliance with all of Baird's internal policies and procedures. This compensation criteria and actual compensation is reviewed and approved on an annual basis by Baird's Research Oversight Committee. Research analyst compensation is derived from all revenue sources of
the firm, including revenues from investment banking. Baird does not compensate research analysts based on specific investment banking transactions.

A complete listing of all companies covered by Baird U.S. Equity Research and applicable research disclosures can be accessed at http://www.rwbaird.com/research-insights/research/coverage/third-party-research-disclosures.aspx. You can also call 800-792-2473 or write: Robert W. Baird & Co., Equity Research, 777 E. Wisconsin Avenue, Milwaukee, WI 53202.

**Analyst Certification**

The senior research analyst(s) certifies that the views expressed in this research report and/or financial model accurately reflect such senior analyst's personal views about the subject securities or issuers and that no part of his or her compensation was, is, or will be directly or indirectly related to the specific recommendations or views contained in the research report.

**Disclaimers**

**Baird prohibits analysts from owning stock in companies they cover.**

This is not a complete analysis of every material fact regarding any company, industry or security. The opinions expressed here reflect our judgment at this date and are subject to change. The information has been obtained from sources we consider to be reliable, but we cannot guarantee the accuracy.

**ADDITIONAL INFORMATION ON COMPANIES MENTIONED HEREIN IS AVAILABLE UPON REQUEST**

The Dow Jones Industrial Average, S&P 500, S&P 400 and Russell 2000 are unmanaged common stock indices used to measure and report performance of various sectors of the stock market; direct investment in indices is not available. Baird is exempt from the requirement to hold an Australian financial services license. Baird is regulated by the United States Securities and Exchange Commission, FINRA, and various other self-regulatory organizations and those laws and regulations may differ from Australian laws. This report has been prepared in accordance with the laws and regulations governing United States broker-dealers and not Australian laws.

**Other Disclosures**

The information and rating included in this report represent the research analyst's views based on a time horizon of 12 months, as described above, unless otherwise stated. In our standard company-specific research reports, the subject company may be designated as a “Fresh Pick”, representing that the research analyst believes the company to be a high-conviction investment idea based on a subjective review of one or more fundamental or quantitative factors until an expiration date specified by the analyst but not to exceed nine months. The Fresh Pick designation and specified expiration date will be displayed in standard company-specific research reports on the company until the occurrence of the expiration date or such time as the analyst removes the Fresh Pick designation from the company in a subsequent, standard company-specific research report. The research analyst(s) named in this report may, at times and at the request of clients or their Baird representatives, provide particular investment perspectives or trading strategies based primarily on the analyst’s understanding of the individual client’s objectives. These perspectives or trading strategies generally are responsive to client inquiries and based on criteria the research analyst considers relevant to the client. As such, these perspectives and strategies may differ from the research analyst's views contained in this report.

Baird and/or its affiliates may provide to certain clients additional or research supplemental products or services, such as outlooks, commentaries and other detailed analyses, which focus on covered stocks, companies, industries or sectors. Not all clients who receive our standard company-specific research reports are eligible to receive these additional or supplemental products or services. Baird determines in its sole discretion the clients who will receive additional or supplemental products or services, in light of various factors including the size and scope of the client relationships. These additional or supplemental products or services may feature different analytical or research techniques and information than are contained in Baird’s standard research reports. Any ratings and recommendations contained in such additional or research supplemental products are consistent with the research analyst’s ratings and recommendations contained in more broadly disseminated standard research reports. Baird disseminates its research reports to all clients simultaneously by posting such reports to Baird’s password-protected client portal, https://bol.rwbaird.com/Login("BairdOnline"). All clients may access BairdOnline and at any time. All clients are advised to check BairdOnline for Baird's most recent research reports.

After research reports are posted to BairdOnline, such reports may be emailed to clients, based on, among other things, client interest, coverage, stock ownership and indicated email preferences, and electronically distributed to certain third-party research aggregators, who may make such reports available to entitled clients on password-protected, third-party websites. Not all research reports posted to BairdOnline will be emailed to clients or electronically distributed to such research aggregators. To request access to Baird Online, please visit https://bol.rwbaird.com/Login(RequestInstLogin or contact your Baird representative.

**Dividend Yield.** As used in this report, the term “dividend yield” refers, on a percentage basis, to the historical distributions made by the issuer relative to its current market price. Such distributions are not guaranteed, may be modified at the issuer’s discretion, may exceed operating cash flow, subsidized by borrowed funds or include a return of investment principal.

**United Kingdom (“UK”) disclosure requirements for the purpose of distributing this research into the UK and other countries for which Robert W. Baird Limited holds a MiFID passport.**

The contents of this report may contain an “investment recommendation”, as defined by the Market Abuse Regulation EU No 596/2014 (“MAR”). This report does not contain a “personal recommendation” or “investment advice”, as defined by the Market in Financial Instruments Directive 2014/65/EU (“MiFID”). Please therefore be aware of the important disclosures outlined below. Unless otherwise stated, this report was completed and first disseminated at the date and time provided on the timestamp of the report. If you would like further information on dissemination times, please contact us. The views contained in this report: (i) do not necessarily correspond to, and may differ from, the views of Robert W. Baird Limited or any other entity within the Baird Group, in particular Robert W. Baird & Co. Incorporated; and (ii) may differ from the views of another individual of Robert W. Baird Limited.