

Freshpet, Inc.

# House Training: looking to accelerate penetration but margin story working

Reiterate Rating: BUY | PO: 75.00 USD | Price: 69.54 USD

## Margin progress is reassuring as inflation eases

Freshpet (FRPT) reported 1Q23 sales in-line with BofAe and better on adjusted EBITDA of \$3.0mm vs our (\$0.9mm) estimate. FRPT's reiterated FY23 sales and EBITDA outlook offers some reassurance that the year is progressing as planned and that new capacity in their Ennis, TX plant is helping keep pace with demand. Upside vs Street estimates on gross margin reflected an improvement of 200bps to input costs, 80bps to quality control costs and +60bps to logistics costs as pricing catches up to easing inflation.

## Overhead absorption key to delivering FY23 guide

With the Ennis plant supporting what should be volume-weighted growth in 2H23 we expect fixed cost absorption will help deliver meaningful margin expansion in the back-half of the year. Still, progress will be lumpy as FRPT laps 15pts of price and \$15-20mil of pipeline fill. We expect 2Q will see a sequential step-down in gross margin as FRPT incurs higher logistics costs to fill their Texas distribution center with rolls from Pennsylvania and note about half of the lapped pipe-fill will land in 4Q alone.

## Watching household penetration; Buying rate still strong

At 9.6mil households, 1Q penetration slowed to +7% YoY from +16% YoY in 4Q despite a \$4.4mm step-up in advertising, likely unsettling some investors. Mgmt. remained optimistic however, noting the buying rate grew +28% YoY in 1Q and up from +14% last quarter as high-income households purchased more, offsetting the attrition largely seen in lower-income households. Ultimately, we view the skew in FRPT's consumer base as favorable in the long-term, establishing a foothold among more resilient pet parents.

## Reiterate Buy rating and \$75 PO

We lower our 2Qe sales by 3% to \$185mil and adj. gross margin by -100bps to 38.5% reflecting higher logistics costs. We lower SG&A however, to reflect better overhead absorption which gets us to \$3mil of adj. EBITDA vs our prior \$1.2mil. For FY23e, we maintain sales of \$754mil and adj. EBITDA of \$55mil as dollar sales and margins ramp through the year. We reiterate our Buy rating and \$75 PO based on our DCF model, reflecting a 29x target CY24e EV/EBITDA, up 4x from our prior target as higher net debt from the convertible issuance impacts valuation. In our view, the higher multiple is warranted by the stability provided by the debt to achieve FY27e EBITDA targets, partially offset by a murkier near-term profit outlook.

Estimates (Dec) (US\$)	2021A	2022A	2023E	2024E	2025E
EPS	(0.69)	(1.29)	(0.93)	0.73	1.41
GAAP EPS	(0.69)	(1.29)	(0.93)	0.73	1.41
EPS Change (YoY)	-762.5%	-87.0%	27.9%	NM	93.2%
Consensus EPS (Bloomberg)			(0.59)	0.06	0.73
DPS	0	0	0	0	0
Valuation (Dec)					
P/E	NM	NM	NM	95.3x	49.3x
GAAP P/E	NM	NM	NM	95.3x	49.3x
Dividend Yield	0%	0%	0%	0%	0%
EV / EBITDA*	90.6x	157.8x	57.9x	26.1x	18.4x
Free Cash Flow Yield*	-9.7%	-8.2%	-5.8%	-3.7%	-2.6%

\* For full definitions of *IQmethod*<sup>SM</sup> measures, see page 4.

09 May 2023

### Equity

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### Stock Data

Price	69.54 USD
Price Objective	75.00 USD
Date Established	17-Apr-2023
Investment Opinion	C-1-9
52-Week Range	36.02 USD - 73.22 USD
Mrkt Val (mn) / Shares Out (mn)	3,328 USD / 47.9
Average Daily Value (mn)	52.49 USD
BofA Ticker / Exchange	FRPT / NAS
Bloomberg / Reuters	FRPT US / FRPT.OQ
ROE (2023E)	-4.4%
Net Dbt to Eqty (Dec-2022A)	-12.3%
ESGMeter™	Medium

ESGMeter is not indicative of a company's future stock price performance and is not an investment recommendation or rating. ESGMeter is independent of BofA Global Research's equity investment rating, volatility risk rating, income rating, and price objective for that company. For full details, refer to ["BofA ESGMeter Methodology"](#).

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Timestamp: 09 May 2023 05:05AM EDT

# iQprofile<sup>SM</sup> Freshpet, Inc.

## iQmethod<sup>SM</sup> – Bus Performance\*

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Return on Capital Employed	-3.9%	-5.3%	-2.9%	2.5%	4.1%
Return on Equity	-5.3%	-6.8%	-4.4%	3.3%	5.4%
Operating Margin	-5.8%	-8.7%	-5.1%	4.3%	6.4%
Free Cash Flow	(321)	(273)	(194)	(124)	(86)

## iQmethod<sup>SM</sup> – Quality of Earnings\*

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Cash Realization Ratio	NM	NM	NM	2.5x	2.4x
Asset Replacement Ratio	10.6x	6.7x	3.6x	3.7x	3.5x
Tax Rate	NM	NM	NM	5.0%	5.0%
Net Debt-to-Equity Ratio	-9.1%	-12.3%	18.3%	26.4%	28.3%
Interest Cover	-8.6x	-10.0x	-17.4x	NA	NM

## Income Statement Data (Dec)

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Sales	425	595	755	953	1,204
% Change	33.5%	39.9%	26.8%	26.3%	26.2%
Gross Profit	162	187	240	373	494
% Change	22.0%	15.5%	28.2%	55.5%	32.4%
EBITDA	35	20	55	121	172
% Change	-6.9%	-42.6%	172.7%	121.4%	41.9%
Net Interest & Other Income	(3)	(5)	(2)	0	(1)
<b>Net Income (Adjusted)</b>	<b>(30)</b>	<b>(59)</b>	<b>(45)</b>	<b>35</b>	<b>68</b>
<b>% Change</b>	<b>-831.9%</b>	<b>-100.3%</b>	<b>24.6%</b>	<b>NM</b>	<b>93.7%</b>

## Free Cash Flow Data (Dec)

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Net Income from Cont Operations (GAAP)	(30)	(59)	(45)	35	68
Depreciation & Amortization	30	35	65	56	71
Change in Working Capital	(27)	(49)	(7)	(30)	1
Deferred Taxation Charge	NA	NA	NA	NA	NA
Other Adjustments, Net	27	31	31	25	25
Capital Expenditure	(322)	(230)	(238)	(210)	(250)
<b>Free Cash Flow</b>	<b>-321</b>	<b>-273</b>	<b>-194</b>	<b>-124</b>	<b>-86</b>
<b>% Change</b>	<b>-183.5%</b>	<b>15.0%</b>	<b>29.1%</b>	<b>36.0%</b>	<b>31.1%</b>

## Balance Sheet Data (Dec)

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Cash & Equivalents	73	133	215	92	63
Trade Receivables	35	58	72	90	83
Other Current Assets	43	72	66	72	71
Property, Plant & Equipment	584	801	1,057	1,323	1,644
Other Non-Current Assets	50	63	61	61	61
<b>Total Assets</b>	<b>784</b>	<b>1,125</b>	<b>1,472</b>	<b>1,638</b>	<b>1,923</b>
Short-Term Debt	1	2	2	2	2
Other Current Liabilities	58	88	83	90	96
Long-Term Debt	6	4	395	395	450
Other Non-Current Liabilities	0	0	0	0	0
<b>Total Liabilities</b>	<b>65</b>	<b>94</b>	<b>480</b>	<b>487</b>	<b>548</b>
<b>Total Equity</b>	<b>720</b>	<b>1,032</b>	<b>992</b>	<b>1,152</b>	<b>1,375</b>
<b>Total Equity &amp; Liabilities</b>	<b>784</b>	<b>1,125</b>	<b>1,472</b>	<b>1,638</b>	<b>1,923</b>

\* For full definitions of iQmethod<sup>SM</sup> measures, see page 4.

## Company Sector

Food Producers

## Company Description

Freshpet Inc. is a pet food company offering pet owners fresh, minimally processed, meat-based products. Through an end-to-end refrigerated supply chain, Freshpet sells its products to North American and European retailers across multiple channels such as grocery, mass, specialty, natural, etc., through company-owned branded refrigerators that replace standard shelving in the pet aisle or an end cap of a retail store. FRPT generated \$595m in net revenues and \$20m in adjusted EBITDA in 2022.

## Investment Rationale

Our Buy rating is based on our view that FRPT is in a solid position to meet 2025 financial targets of \$1.25bn net revenues and 11m households supported by pet food industry tailwinds, strong consumption growth rates, and retailer interest.

## Stock Data

Average Daily Volume

754,809

## Quarterly Earnings Estimates

	2022	2023
Q1	-0.40A	-0.52A
Q2	-0.45A	-0.42E
Q3	-0.39A	-0.17E
Q4	-0.06A	0.17E

## Price objective basis & risk

### Freshpet, Inc. (FRPT)

Our \$75 PO is based on our DCF model and reflects a target CY24e EV/EBITDA multiple of 29x, justified by potential for margin upside vs 2027 targets and having ample cash at their disposal to do so. This multiple sits above with General Mills' Blue Buffalo deal transaction of 25x. We believe this multiple is warranted given above-average growth and the lower EBITDA base, noting guidance reiteration helps clear some of the murkier near-term profit outlook visibility. Our DCF model uses a WACC of 7.9% and a terminal growth rate of 3.5%.

Upside risks to our PO are: faster-than-expected distribution gains at retailers, faster-than-expected consumer adoption of products, and higher-than-expected efficiencies from new capacity coming online.

Downside risks to our PO are: capacity coming online takes longer than expected, which could constrain sales targets, inflation and supply costs are higher than expected, competition impedes FRPT household penetration.

## Analyst Certification

I, Bryan D. Spillane, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

### US - Consumables Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
<b>BUY</b>				
	BellRing Brands Inc	BRBR	BRBR US	Bryan D. Spillane
	Coca-Cola Europacific Partners plc	CCEP	CCEP US	Bryan D. Spillane
	Constellation Brands	STZ	STZ US	Bryan D. Spillane
	Coty Inc.	COTY	COTY US	Anna Lizzul
	e.l.f. Beauty	ELF	ELF US	Anna Lizzul
	Freshpet, Inc.	FRPT	FRPT US	Bryan D. Spillane
	JM Smucker Company	SJM	SJM US	Peter T. Galbo, CFA
	Keurig Dr Pepper	KDP	KDP US	Bryan D. Spillane
	Kraft Heinz Company	KHC	KHC US	Bryan D. Spillane
	Lamb Weston Holdings Inc	LW	LW US	Peter T. Galbo, CFA
	Mission Produce Inc.	AVO	AVO US	Bryan D. Spillane
	Mondelez International	MDLZ	MDLZ US	Bryan D. Spillane
	Monster Beverage Corporation	MNST	MNST US	Peter T. Galbo, CFA
	PepsiCo	PEP	PEP US	Bryan D. Spillane
	Philip Morris International	PM	PM US	Lisa K. Lewandowski
	Pilgrim's Pride Corp.	PPC	PPC US	Peter T. Galbo, CFA
	Sovos Brands, Inc.	SOVO	SOVO US	Peter T. Galbo, CFA
	The Coca Cola Company	KO	KO US	Bryan D. Spillane
	The Duckhorn Portfolio, Inc.	NAPA	NAPA US	Peter T. Galbo, CFA
	The Hershey Company	HSY	HSY US	Bryan D. Spillane
	The Procter & Gamble Company	PG	PG US	Bryan D. Spillane
	The Vita Coco Company, Inc.	COCO	COCO US	Bryan D. Spillane
	Thorne HealthTech, Inc.	THRN	THRN US	Bryan D. Spillane
<b>NEUTRAL</b>				
	Altria Group	MO	MO US	Lisa K. Lewandowski
	Celsius Holdings Inc	CELH	CELH US	Jonathan Keypour
	Colgate-Palmolive Company	CL	CL US	Bryan D. Spillane
	Conagra Brands, Inc.	CAG	CAG US	Peter T. Galbo, CFA
	Estee Lauder Companies Inc.	EL	EL US	Bryan D. Spillane



**US - Consumables Coverage Cluster**

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
	General Mills	GIS	GIS US	Bryan D. Spillane
	Kellogg	K	K US	Bryan D. Spillane
	Kimberly-Clark	KMB	KMB US	Anna Lizzul
	Oatly Group AB	OTLY	OTLY US	Bryan D. Spillane
	Utz Brands	UTZ	UTZ US	Peter T. Galbo, CFA
	Zevia PBC	ZVIA	ZVIA US	Bryan D. Spillane

**UNDERPERFORM**

	Beyond Meat Inc.	BYND	BYND US	Peter T. Galbo, CFA
	Brown-Forman Corporation	BFB	BF/B US	Bryan D. Spillane
	Cal-Maine Foods, Inc.	CALM	CALM US	Peter T. Galbo, CFA
	Campbell Soup Company	CPB	CPB US	Peter T. Galbo, CFA
	Canopy Growth	YWEED	WEED CN	Lisa K. Lewandowski
	Canopy Growth	CGC	CGC US	Lisa K. Lewandowski
	Church & Dwight	CHD	CHD US	Anna Lizzul
	Clorox	CLX	CLX US	Anna Lizzul
	Cronos Group	YCRON	CRON CN	Lisa K. Lewandowski
	Cronos Group	CRON	CRON US	Lisa K. Lewandowski
	Dole plc	DOLE	DOLE US	Bryan D. Spillane
	Herbalife Nutrition Ltd	HLF	HLF US	Anna Lizzul
	Hormel Foods Corp.	HRL	HRL US	Peter T. Galbo, CFA
	McCormick & Co.	MKC	MKC US	Peter T. Galbo, CFA
	Molson Coors Beverage Company	TAP	TAP US	Bryan D. Spillane
	Olaplex	OLPX	OLPX US	Jonathan Keypour
	Tyson Foods, Inc.	TSN	TSN US	Peter T. Galbo, CFA

**IQmethod<sup>SM</sup> Measures Definitions****Business Performance**

Return On Capital Employed

Return On Equity  
Operating Margin  
Earnings Growth  
Free Cash Flow

**Quality of Earnings**

Cash Realization Ratio  
Asset Replacement Ratio  
Tax Rate  
Net Debt-To-Equity Ratio  
Interest Cover

**Valuation Toolkit**

Price / Earnings Ratio  
Price / Book Value  
Dividend Yield  
Free Cash Flow Yield  
Enterprise Value / Sales

EV / EBITDA

**Numerator**

NOPAT = (EBIT + Interest Income) × (1 – Tax Rate) + Goodwill Amortization

Net Income  
Operating Profit  
Expected 5 Year CAGR From Latest Actual  
Cash Flow From Operations – Total Capex

**Numerator**

Cash Flow From Operations  
Capex  
Tax Charge  
Net Debt = Total Debt – Cash & Equivalents  
EBIT

**Numerator**

Current Share Price  
Current Share Price  
Annualised Declared Cash Dividend  
Cash Flow From Operations – Total Capex  
EV = Current Share Price × Current Shares + Minority Equity + Net Debt + Other LT Liabilities  
Enterprise Value

**Denominator**

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill  
Amortization  
Shareholders' Equity  
Sales  
N/A  
N/A

**Denominator**

Net Income  
Depreciation  
Pre-Tax Income  
Total Equity  
Interest Expense

**Denominator**

Diluted Earnings Per Share (Basis As Specified)  
Shareholders' Equity / Current Basic Shares  
Current Share Price  
Market Cap = Current Share Price × Current Basic Shares  
Sales  
Basic EBIT + Depreciation + Amortization

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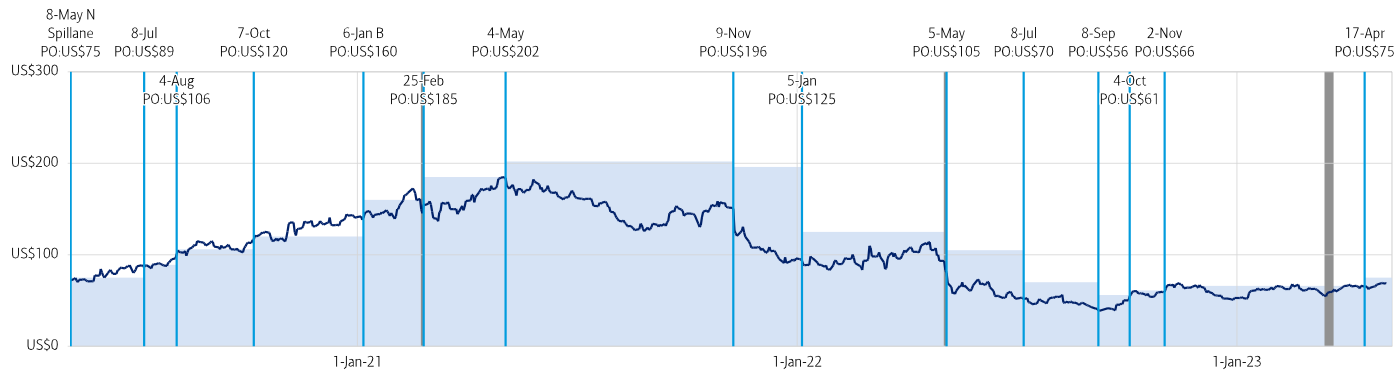
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### Freshpet, Inc. (FRPT) Price Chart



FRPT — Restricted PO  
 B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of a date no more than one trading day prior to the date of the report.

### Equity Investment Rating Distribution: Food Group (as of 31 Mar 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships <sup>R1</sup>	Count	Percent
Buy	30	43.48%	Buy	18	60.00%
Hold	19	27.54%	Hold	11	57.89%
Sell	20	28.99%	Sell	10	50.00%

### Equity Investment Rating Distribution: Global Group (as of 31 Mar 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships <sup>R1</sup>	Count	Percent
Buy	1869	53.01%	Buy	1030	55.11%
Hold	827	23.45%	Hold	476	57.56%
Sell	830	23.54%	Sell	389	46.87%

<sup>R1</sup> Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster <sup>R2</sup>
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

<sup>R2</sup> Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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