10 March 2014

SODASTREAM

The Stylish Rebel - Set the Bubbles Free!

USA | CONSUMER DISCRETIONARY | INITIATION

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Your Partner In Finance

Rating: Accumulate

Initiate with Accumulate

Target Price (USD)	**46.0**
Forecast Dividend (USD)	0.0
Closing Price (USD)	40.95
Potential Upside	**12.3%**

Investment Merits

1. Market leader in the high growth market of customizable soft drinks for health and taste reasons with revenue and earnings 3 year CAGR of 39% and 49%

- **SodaStream is a clear global market leader** in a relatively new market category of home soda-making which is rapidly growing.
- **Having a history of 100 years** of soda-making know-how, they are in the frontlines and have been reshaping the drink industry by changing the typical branded drink paradigm in delivery and branding.
- **Market Cap of $820mn,** with revenues of $560mn and net income of $43mn.
- **This potential was verified by a whopping 39% and 49% 3yr Revenue and Net Profit CAGR respectively – *this includes FY13's flat earnings growth!*** As a testament to this powerful growth story, Soda was trading at its peak of $78 and 37x PE as recently as June 2013.

2. Price has been punished due to 4Q13 earnings miss, but earnings CAGR paused not due to revenue drop (i.e. growth story intact), but mgt's strategic move of cutting prices on machines to get them into people's homes. As the business model is the razor and razor blade model – a larger installed base means higher recurring revenue in selling carbon and flavours.

- However, perfect storm of weak US retail sales, logistical issues, currency weakness while making an executive decision to favour sales growth over margins, led to very disappointing Q4 where revenue growth were still in line with target of +26% vs Q412 & +29% FY13 vs FY12 but at the cost of decreased net margins, leading to near zero 4th quarter net income and flat EPS growth in FY13.
- In addition, Coke announced their partnership with Green Mountain coffee to compete in the same space via the "Keurig Cold", to be rolled out in 2015.
- This led to a FY13 revenue of $563m (+26x% vs FY12) but FY13 net income of $42m (zero growth). Company has also guided 1st half continued headwinds of retail sales and FX weakness which will lead to lower single digit growth in FY15. This has caused speculation that the growth story has been majorly impaired. And resulted in a ~48% drop from its 52 week high to $35.

3. If so, margins are expected to improve, as the installed base is growing, thus profitability should return – so long as you get the machine in homes, it is reasonable to assume they will buy higher margin CO2 refills and flavours.

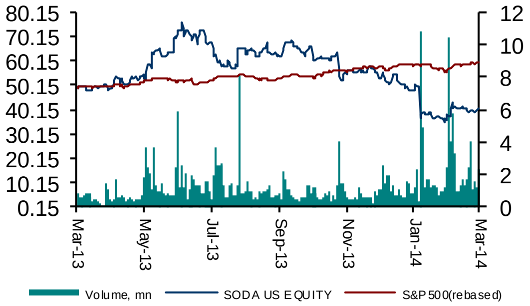
- **Margins are expected to improve** as management rolls out a bevy of top and bottom line strategies for the year. This includes logistical optimization plans, a new primary facility in Israel going live, and an emphatic commitment for price controls.
- **Sales should continue their growth rate on the back of** a continuation of robust additions of brand partnerships, product innovations and geographical expansion.

Company Description

SodaStream engages in the development, manufacture, and sale of home beverage carbonation systems that transforms ordinary tap water instantly to carbonated soft drinks and sparkling water. It offers a range of soda makers; exchangable food-grade CO2 cylinders and refills; reusable carbonation bottles and various flavors. The company sells its products through 60,000 retails stores in 45 countries.

Company Data

Raw Beta (Past 2yrs weekly data)	1.76
Market Cap. (USD mn)	848
Ent. Value (USD mn)	823
3M Average Daily T/O (mn)	1.8
Closing Px in 52 week range	35.27 – 77.80



Major Shareholders	(%)
1. Real Property Invest Ltd	10.1
2. FMR LLC	9.2
3. Tremblant Capital Group	5.5

Valuation Method

Forward P/E

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4. At current price, the downside is priced in, and any sign of returning to profit growth or M&A interest will re-rate the stock – good risk-reward trade.

- **SodaStream used to trade at an average PE of 28x, versus present PE of 20x.** A return to the historical growth story implies more than 40% upside.
- At 20x PE, for a revolutionary company with an incredible 3 year net income CAGR close to 50%, we think downside is limited while waiting on a return to growth or realization of catalysts.

5. High likelihood catalyst in PEPSI or other major drink brand. As Coca-Cola has partnered with Green Mountain (GMCR) to start their version of a home carbonated product, it is likely that PEPSI will need a partner or be left out of the home carbonation megatrend.

- The market seems to think that Coke/GMCR will wipe the floor with SodaStream.
- However, we view this as a potential verification that the home carbonating market is not a fad, but a legitimately growing market. Additionally, this also sets the ball rolling for other major drink brands to join the home carbonation market in which SodaStream is by far the market leader with the biggest global distribution.

How we view this?

- **We believe the growth story is still intact**, riding on megatrends of health, customizable, environmentally friendly consumption, amidst gestation losses while navigating through weak US retail sales to 1H14.
- **Soda will still be the king of carbonation** and there is space in the rapidly expanding market for a Coke/GMCR product which rolls out in 2015. Coke/GMCR activity potentially verifies home soda market is not just a fad.
- **SodaStream used to trade at an average PE of 28x, versus present PE of 20x.** A return to the historical growth story implies more than 40% upside.
- **Possible catalysts are:** successful execution of their logistical optimization initiatives and geographical growth plans, a continuation of the healthy, low-sugar, drink customization megatrend, and a better than expected 1H14.
- **As a bonus, Soda is also a prime potential M&A/partnership target,** as the Coke/GMCR entry into home-soda may trigger other big drink brands to do the same, where SodaStream is the most logical choice. For reference, the market valued Coke's entry into GMCR with a 40% spike in GMCR share price. Additionally, PepsI's takeover of Gatorade (via Quaker Oats) in 2000 was done at 37x PE.

Valuation

- **We liken this investment to a call option**, where downside is possible but limited while there is a better probability of a rerating a year from now, if evidence of net earnings growth or M&A speculation returns.
- **Bullish thesis:** A return back to it's growth story implies a **28x average historical PE, or $56**.
- **Bearish thesis:** The downside is that earnings growth does not recover to historical levels and growth remains at single digits, implying a fair price of $36 pegged to **18x FY14 PE** (at peer average, growing at single digits).
- **SodaStream's case is likely to be between the bullish and bearish thesis.** Taking an average 3 yr earnings growth rate from 2012-2014 (which includes 2 flat earnings years!) of 16%, we estimate fair value at **23x FY14 PE or $46.**
- **… with an addition "call" option!** A joint venture or partnership with major drink brand implies a valuation up to **37x or $71**.

Investment Action

- **We initiate an ACCUMULATE recommendation on SodaStream (SODA) with 12 month target price of $46** (with possibilities to rerate to $56 - $71 when net income shows hints of catching up to revenue growth or on M&A "strike"). This represents a potential 12% from its current price of $41. The target price is based on 23x PE, a 20% discount to it's historical average PE of 28x, to account for the possible impairment to SodaStream's longer term growth rate while still having a solid story. **As an additional bonus: As a potential M&A target,** its M&A valuation is estimated to be 37x FY14 PE, or **$70+**.

SodaStream announced its 4Q13 results on 26 Feb 2014.

Key Financial Summary

FYE Dec	FY11	FY12	FY13	FY14F
Revenue (USD mn)	289	436	563	658
NPAT, reported. (USD mn)	27	44	42	43
NPAT, adj. (USD mn)	27	44	46	47
EPS, reported. (USD mn)	1.34	2.09	1.96	2.02
EPS, adj. (USD)	1.34	2.09	2.21	2.28
P/E (X).	30.9	23.6	20.7	20.3
P/E (X),adj.	30.6	19.6	18.5	18.0
BVPS (USD)	10.91	13.32	15.87	16.30
P/B (X)	3.80	3.71	2.56	2.51
DPS (USD)	0.00	0.00	0.00	0.00
Div. Yield (%)	0.0%	0.0%	0.0%	0.0%

Source: Bloomberg, PSR est.

*Forward multiples and yields are based on current price; historical multiples and yields are based on historical prices

Industry Analysis

Canned Soda Drinks (CSD) shrinking in the US. The overall size of the carbonated beverage market is estimated by SodaStream CEO David Birnbaum to be a massive $260B, or 251 billion litres (Euromonitor 2012) in which SodaStream has an estimated 0.2% and 2% market share of the carbonated soft drinks and sparkling water category. However, **g**lobally, soda drink sales have been shrinking as consumers turn to water, fruit drinks and healthier alternatives. In the US, Soda is still a big market, more Americans drink soda than energy drinks and coffee. From 2001 to 2011, annual soda consumption fell 16% but annual bottled-water consumption soared 56%. North American CSD sales volume dropped 3% in 2013 after falling 1% in 2012. Consumers are choosing more low- and no- calorie beverages, according to the American Beverage Association spokesperson.

Source: Company Presentation, Euromonitor (2012) for beverage consumption

The Big Beverage company results corroborate. PepsiCo, which reported earnings results last week, said carbonated soft drink sales declined by middle single-digit rates in the fourth quarter. Dr Pepper said its carbonated soft drinks were down 2% by volume and 4% by sales. Coke's guidance for diet Coke last quarter was "under pressure".

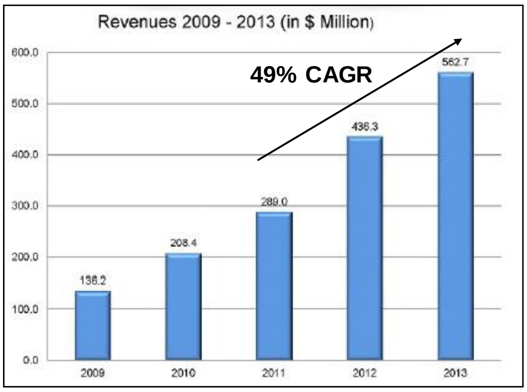
Shifting tastes and drinker's psychology is SodaStream's gain. Soda makers are trying to adapt to changing consumer preferences by marketing "mid-calorie" sodas that have less sugar than regular drinks but eliminate the artificial sweeteners typically used in diet drinks. Slow to the game, a recent study indicates that CSD makers will take 5-10 years to transition into such drinks that suits customer's changing taste, while SodaStream has been capitalizing on this trend for the past few years, as their products targets such consumers. It is apparent that the American consumer is not abandoning "fizz" per se, but they are abandoning calories and potentially cancer causing artificial sweeteners and are moving into alternative drinks. SodaStream allows them to control those calories while customizing taste *levels* while providing the fizz in the realms of all types of drinks, like juices, soda water, seltzer, sodas and alcoholic beverages**! SodaStream is not selling another drink brand; they are selling convenience, sustainability, health & wellness, value for money and personalization that is grounded in a dominant CO2 exchange system.**

Corroborating health megatrend and CSD declining sales esp. in US is the new Mexico sugar tax. According to Barry Popkin, a nutrition and epidemiology professor at the University of North Carolina and author of "The World Is Fat." predicts the new tax — 8 percent on most junk food and a peso-per-liter on sugar-sweetened drinks — will reduce soft drink consumption by 5 percent. That could well be enough to make the policy very attractive to lawmakers and activists in the U.S. This bodes well for SodaStream not only because of their operations in Mexico, but the implications on the Americas' shift in drink habits.

History: SodaStream THEN

Daniel Birnbaum, CEO of SodaStream gives a insightful summary of SodaStream's history and direction in his article in the Harvard Business Review in Dec 23, 2013:

> The basic mechanism for home carbonation was invented in 1903 by Guy Gilbey, a London gin merchant, who created an apparatus to inject pressurized carbon dioxide into water to make sparkling water; flavorings could be added to make different kinds of soda. For 50 years or so the apparatus was used primarily at Buckingham Palace and in other homes for British royalty; then, in the 1970s and 1980s, it became a popular consumer product. At a high point in the 1980s, 40% of British households had a carbonation machine. But over the next 20 years the company, which originally operated as a subsidiary of W&A Gilbey, withered. For a while it was owned by Cadbury Schweppes, which did little to grow a business that could cannibalize its main product line. In the 1990s an Israeli entrepreneur bought the company, and by 2006 it was teetering near bankruptcy. There had been no investment, no product innovation, no international expansion—no growth of any kind.



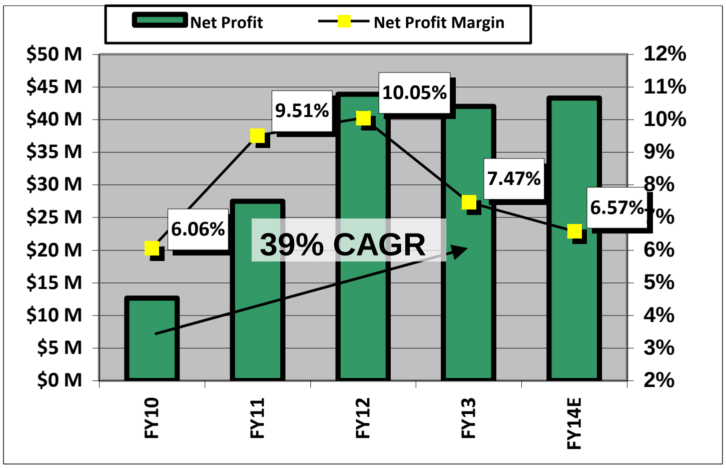
Source: Company Presentation

Yuval Cohen, a private equity investor, then bought over SodaStream in 2007 and installed Daniel Birnhaum (then president of Nike's Israeli business). He continues,

> We transformed our mind-set and our focus from a factory to a consumer-centric organization. Our machine isn't about putting bubbles into water – it's about creating a more economical sustainable, and healthful alternative to regular soft drinks. *We redefined our category*. Instead of winning in "home carbonation," I wanted to grow our share of the $260 billion global soda business. I really liked the idea of competing with Coke and Pepsi. Inside and outside the company, we began talking about a new cola war.

SodaStream NOW

SodaStream, an Israeli Sodamaker manufacturer, is by far the world leader in a relatively new market - home carbonation. It operates in 45 countries (21 direct/24 via distributors) with 60,000 stores (15,000 in US with an estimated 6.5 million active households (~1.3m in US). SodaStream was founded in the U.K. in 1903 and pioneered the world's first home soda maker in 1955. In 2007, Fortissimo Capital acquires Soda-Club (that acquired SodaStream earlier) and SodaStream was listed on NASDAQ in 2010. They have had a longer sales history in Europe and only started selling to US online in 2002. By 2011, their worldwide retail locations surpassed 45,000 including 7,000 in US. **As a testament to being global market leaders in a new, redefined category, they have achieved stunning 3-yr CAGR of 39% and 49% in revenue and net income accordingly. (This is *including* FY13's disappointing results.) They have achieved this without raising any long term debt until recently, with a healthy net cash position of $25M on their balance sheet.**



Source: Company, PSR

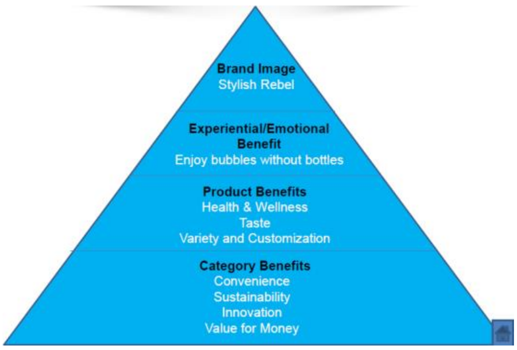
Business Overview

SodaStream manufactures home beverage carbonation systems, which enables customers to easily transform ordinary tap water instantly to carbonated soft drinks and sparkling water. SodaStream develops, manufactures and sell 1) soda makers, 2) exchangeable carbon-dioxide (CO_2) cylinders, and 3) consumables consisting of CO_2 refills, reusable carbonation bottles and flavors. Following a razor & razor blade model, their soda makers are sold at low margin, to encourage an installed base for higher margin recurring income from CO_2 refills and consumables.

Successfully implementation of their strategy involves having a CO_2 retail exchange and distribution eco-system in close vicinity to the consumer. However, CO_2 canisters are considered hazardous and subject to country regulations. In the US, for example, consumption grade CO_2 cylinders are considered hazardous and there can be no transport of them via air or mail. This building of the retail distribution partnerships and CO_2 exchange eco-system is one barrier to entry.

Business Strengths

Clear and compelling consumer benefits – Their products are environmentally friendly, convenient, cost effective, promoting health and wellness, and customizably fun and easy to use. In the United States, estimated cost to a SodaStream customer, excluding the cost of the sodamaker, of sparkling water is estimated to be as little as \$0.25 per liter and of carbonated soft drinks to be \$0.67 per liter, each of which is significantly lower than most bottled or canned sparkling water or CSD. Based on price studies from Euromonitor 2009, Savings are up to 70% for sparkling water and up to 30% for CSD. ROI for the active user is estimated to be within one year.

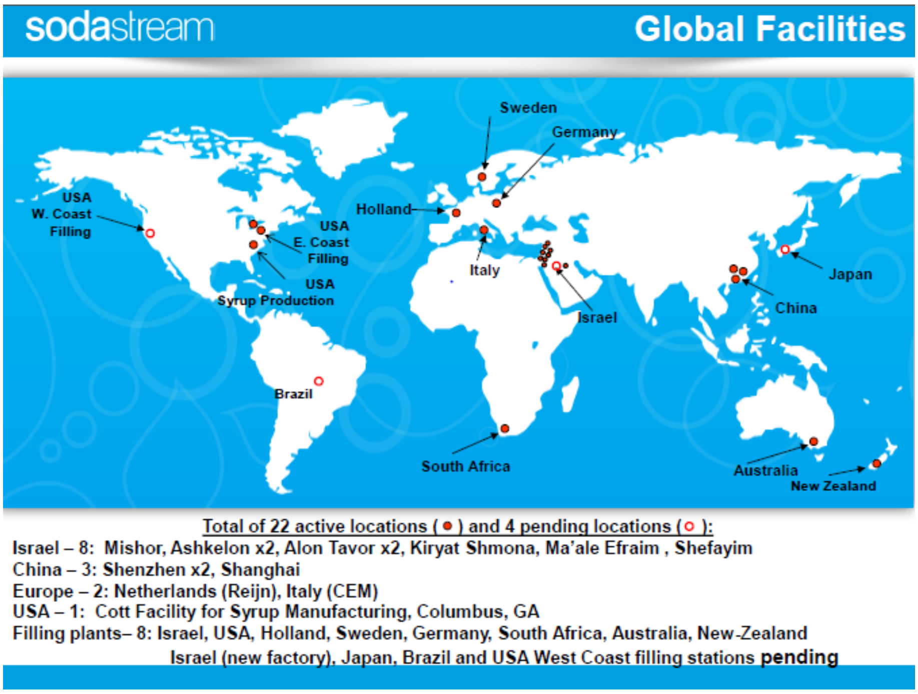


SodaStream's Equity Pyramid
Source: Company Presentation

Promoting health and wellness – Their flavors contain two-thirds less sugars and calories than leading soft drink brands, and one-third less caffeine than popular brands. They do not use high-fructose corn syrup and offer diet versions with Splenda, and without aspartame and saccharin, thus are well-positioned as the consumer is trending against high calorie and artificially sugared drinks, as witnessed by declining sales in canned soda.

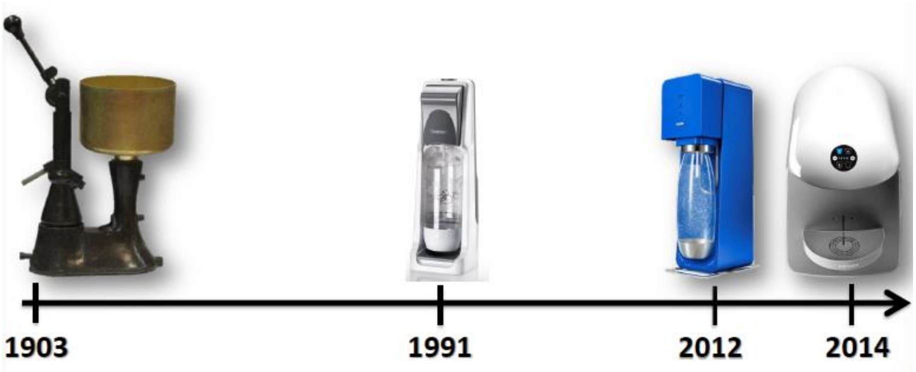
Customizable, fun and easy to use – SodaStream offers more than 100 different flavors, including all-natural versions (including cola and ginger ale) and diet versions. Each member of the family can consume a different flavor, or blend flavors to make new ones and customize the levels of carbonation. The soda makers are quick and easy to use, do not require cleaning and does not even require **electricity**.

Established presence in certain markets. It operates in 45 countries across 6 continents with 60,000 stores (15,000 in US with an estimated 6.5 million active households (~1.3m in US) and has been establishing strong brand recognition among U.S. consumers. In the markets where they operate, they hold the leading market share position. Their global presence and the depth of retailer relationships in key markets allos them to better address consumer preference and to enter new markets more quickly and effectively than many of their competitors.



Source: Company presentation

Innovation. Their ability to bring soda-making into the mainstream through brand marketing, growing retail distribution, increasing brand awareness with reverse logistical know-how for CO2 exchange eco-system, and having designer soda makers won them 23rd place in the world's most innovative companies of 2013 by Fast Company (Feb 2013). They were #1 in the food category. They are not just selling the same old soda from home, they are innovating by introducing the carbonizing of traditional non-carbonized drinks like Kraft, V8, Welch, Kool Aid, and Sunny Delight.



Source: Company Presentation

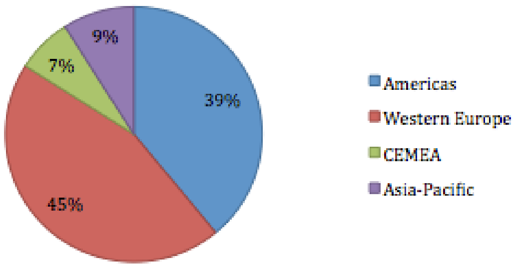
Income model

SodaStream's business model is to increase the installed base of soda makers, in order to generate ongoing demand for higher-margin CO2 refills, carbonation bottles and flavors. When initially penetrating a new market, sales of soda makers typically exceed sales of consumables. Within a few years, as the initial user base grows, unit sales of consumables typically exceed unit sales of soda makers by multples of initial purchases. SodaStream's principle strategies are (1) to grow the installed base through new purchases of our products and (2) to maintain consumer loyalty and "users for life."

For more information about the reengineering of SodaStream ([http://peterspostingblogspot.sg/2013/12/sodastreams-ceo-on-turning-banned-super.html](http://petersposting.blogspot.sg/2013/12/sodastreams-ceo-on-turning-banned-super.html))

SodaStream Snapshot Highlights

- World leader in home carbonation with very little global competition
- Operates in 45 countries, in 60,000 stores
- Installed base of 6.5 million households (1.5 million in US)
- 6 major partnerships (OceanSpray, Kraft, Samsung, EBoose, Campbell's, and Breville)
- FY13 revenue of $563mn, net profits of $46mn
- FY16 targeted revenue of $1000mn
- Sold an equivalent of 4.5 billion cans over the year
- 39% 3yr revenue CAGR, 49% 3yr net income CAGR



Source: Company presentation

- Americas – 39% of Total Revenue (up 87% yoy)
- Western Europe – 45% of Total Revenue (up 26% yoy)
- CEMEA – 16% of Total Revenue (up 16% yoy)
- Asia Pacific – 9% (up 59% yoy)

Getting to speed about SodaStream

SodaStream has been on a phenomenal roll. Following a successful Super Bowl ad campaign, the Israeli sparkling beverage maker reported ~50% sales and net income growth for 2012 and raised guidance for the year ahead. This was on the back of a 3 year sales CAGR of 47%. The market rewarded investors as the stock climbed 40% in the following four months.

A year later, the price crashed into a low of $35 in Feb 2014 from a 52 week high of $75+. The market doubted SodaStream's future prospects because of the following reasons: 1) SodaStream's fourth-quarter earnings significantly decelerated to near zero (causing a full year earnings *growth* to be flat) due to a flat holiday sales season, 2) the challenging holiday season forced the company to decide to either pursue profitability or to aggressively grow its installed base, and 3) soda goliath **Coca-Cola** decided to challenge SodaStream on its own turf by buying a 10% stake in Green Mountain Coffee Roasters to develop their own brand of home-made Coke branded flavors via the *Keurig Cold*, to be rolled out in 2015.

Weakened Outlook for FY14

4th quarter weakness due to logistical issues & weak retail. Management reports that the earnings shortfall was due to lower sell-in prices, higher product costs, a temporary altered product mix and unfavorable currency fluctuation. They have also guided gross margins to be approximately 50% similar to 2013 levels. While majority of Q4 issues have been rectified, main headwinds in 2014 are bigger depreciation (due to expansion) and unfavorable FX movements.

Muted growth FY2014 guidance. Full year revenue growth is 15% and EBITDA growth is approximately 11% over FY13, and net income growth is approximately 3% (due to increased depreciation and a increased tax rate from 10% to 12%). Excluding FX impact, *EBITDA would increase approximately by 25%.*

First quarter is expected to be challenging from both a top and bottom line standpoint due to a combination of soft sales, FX headwinds, and higher A&P expenses from the Super Bowl ad and Scarlett Johansson ambassadorship, as well as marketing investments in Europe.

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Bearish Thesis:

- DIY Sodas are a fad, not a revolution. People will eventually get bored of them. The 4th quarter weakness is not short term. Rapid expansion has execution risks.
- Coke's foray into home sodas will add too much competition.

Bullish Thesis:

- Still managed positive net earnings during 4th quarter retail weakness while lowering starting kit price to goose up sales base. Performed quite resiliently considering they had to repackage 600,000 units.
- Continuation of aggressive growth plans, with acceptable stumbles.
- Their installed base is growing, signaling increased future profit
- A continuing megatrend of healthy, alternative drinks which lends itself well in DIY Sodas.
- Sodastream maintains their position as king of the CO2 exchange
- Coke's foray into home sodas potentially validates that DIY Soda is a growing market, it is not a fad. Hence, there is space for both the Keurig Cold and SodaStream machines.
- Other major F&B players like Pepsi is now under the gun to foray into the home soda market, in which SodaStream would be the premier partner choice due to their undoubted market leadership, established business model and distribution channels.

Thoughts on disappointing Q4 results: Bad, but isn't that horrible

Sodastream, more or less, still hit it's ambitious revenue target of $562m (20% growth), it's their net income target that fell short (flat *growth*).

Assuming a constant currency valuation, adj. net income would have been higher. In FY13, FX had a negative impact on the operating income of approximately $5.8mn. Adjusting for this impact yields 45.9mn net income vs 42.0mn or +4.5% growth yoy instead of -4.2%.

Business model has some resilience. They still managed their net income to stay in the black on large sales despite soft holiday sales, purposeful discounting of unit sales, and a reconfiguration of 600,000 units of finished goods (Mega packs).

People are still buying despite CSD sales decreasing. Major brands like Coke, Pepsi and Dr Pepper Snapple have all reported decreasing sales for their CSD in developed markets, especially in US while SodaStream's sales have increased by 20% in FY13 - this is commendable. Considering their razor and razor blade model, increased revenue and slower net income growth implies that they have been successful in selling more machines, but probably sold less higher margin items like consumables. Machine sales are a precursor to the more recurrent income growth of consumables (CO2 and flavors) and actually bode well to the future. Eventually, when margins recover, net incomes should catch up or exceed revenue growth.

If we tolerate temporary weakness, the company is setting up for future earnings

Operating Growth is still there. Increase in revenues and unit sales in all categories. Given their cheap printer and higher margin cartridge model, CO_2 exchange and flavors indicate recurring income levels, and machine sales indicate future income levels, as more machines with more flavors cause growth in multiples. This potentially explains why the company was willing to sacrifice net earnings for household penetration.

Table 1: Total Growth in Unit Sales

Thousands	Q412	Q413	(%)y-y ch	FY12	FY13	(%)y-y ch
Sodamakers	1111	1542	38.8%	3498	4448	27.2%
CO2 Cylinders	4308	5375	24.8%	16543	21479	29.8%
Flavors	7735	9751	26.1%	28099	34252	21.9%

Source: Company, PSR

Unit sales via segment corroborate their sales numbers. All segments have unit sales increased more than 20%, and the close to 30% FY13 vs FY12 increase in CO_2 cylinders is significant, because it shows people are increasing using the product

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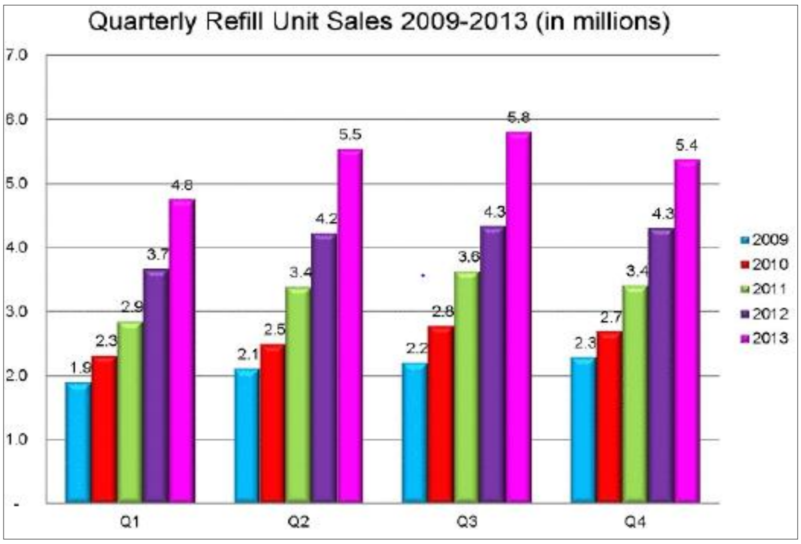


Source: Company presentation

Future income growth looks promising (increasing flavor *and* delivery partners)

Rapidly growing flavors partners: In the last 4 months alone, they have already secured numerous traditionally non-fizzy drink brand to partner them to produce fizzy versions of them. Since October, **in 5 months**, they have secured – Cooking Light, Del Monte, Ocean Spray, Welch, Skinnygirl and most recently, Sunny Delight. Majority are beloved juices to be carbonized which is where consumer sentiment is headed, and Skinnygirl is a modern ***alcoholic*** drink brand. SodaStream is completing *outside* of the CSD category as well.

Growing types of distribution: appliance manufacturer Kitchen Aid is producing soda makers, to be powered by SodaStream. Samsung's has launched their sparkling refrigerator also powered by SodaStream. SodaStream is also in nascent phases of launching SodaStream Professional, designed to compete with traditional soda machines from bigger competitors, to European test restaurants. In early 2013, almost 350 active units were used in European test restaurants. The company's goal is to sell 2000 additional machines in 2014.

Plans to improve gross margins, and sales growth

Company plans to improve margins back to "historical" levels by 2014 by progressively executing a combination of initiatives. On price, they established higher margin thresholds for promotional activity, and will be supporting this with new systems such as central invoicing. On cost, they will be implementing SKU rationalization, design to cost initiatives, a new global procurement department, as well as a West Coast filling station and distribution center for their American business in 2014 which will reduce transportation costs. They will also be expanding into new geographies, including China, and increasing the availability of consumables in existing markets, including the timely penetration into grocery and drug.

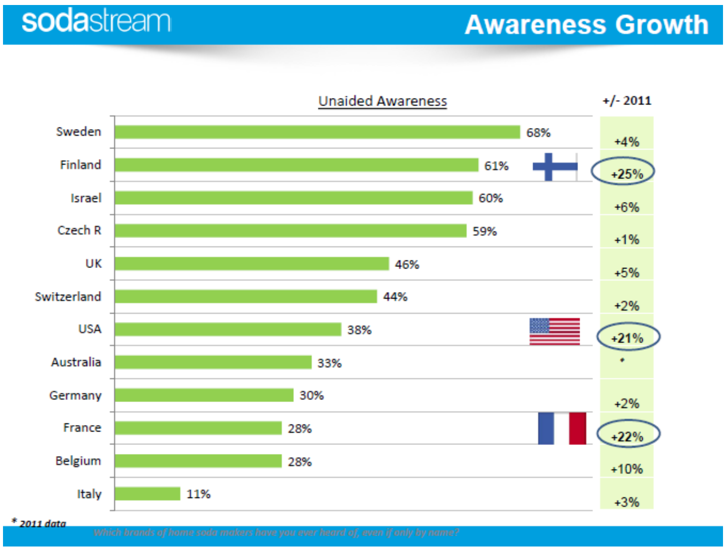
If SodaStream can execute these plans effectively, this will increase both the top and bottom line, and will set up an interesting FY2015 return to improved profitability. However, 2014 seems to be a gestation period to set up for future growth and efficiency. **Investing in SodaStream now is betting on a recovery closer to profitability in 2015 due to the continuation of consumer megatrends, successful execution of multiple sales growth avenues (flavors, delivery and geography) and logistical optimization of a category leader attempting to redefine the market, while patiently waiting out the muted sentiment of a low growth 2014.**

However, is there still room for major growth? The numbers seem to say yes.

The Potential for Growth is hardly over. The "Revolution" is still at infancy.

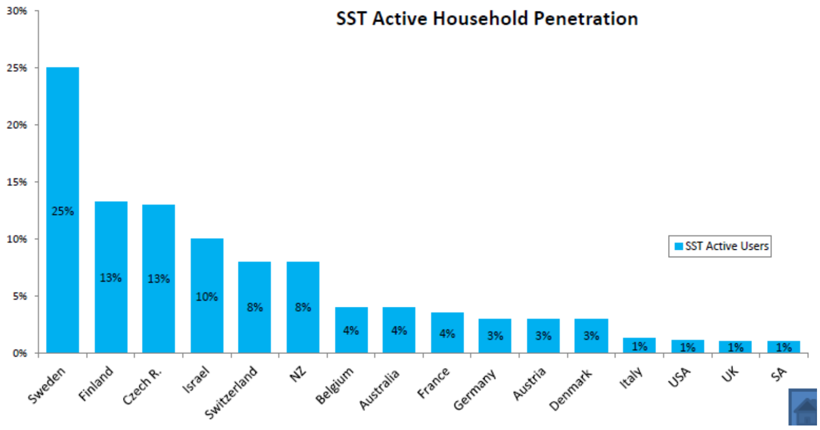
Soda & Sparking Water market is still a big market. According to Euromonitor (2012) for beverage consumption, the carbonated soft drinks market is 220 billion liters and the sparkling water market is 31 billion liters annually. Sodastream's estimated share is only 0.2% and 2% respectively. But this growth potential is understated as it doesn't capture the opportunity to leverage consumers' desire to add bubbles to many of their favourite juice drinks such as Kool-Aid, Crystal Light and Country Time and Ocean Spray.

Awareness rates show potential for growth in the US and Asia. SodaStream re-launched their re-imagined sodamakers (the Pure and the Penguin) in France, Baltic Countries, Italy and Hungary by 2008. This was not too long ago and yet they achieved between 50-68% unaided awareness in these regions. The USA is only at 38%, and Asia is much less than that.



Source: Company Presentation

Home-penetration Rates show even more untapped market potential. A "matured" target would be the whopping 25% household penetration (HHP) in Sweden. Sodastream is targeting at least a 10% HHP in all countries of operation. Hence, there is definitely more room to grow. In addition, management states that in USA there is a "low-hanging fruit" gap of 1-2% household penetration and mid-teens intent to purchase.



Source: Company Presentation

Untapped relative advertising budgets show great potential. Branded drink competition is usually centred on advertising, marketing and distribution to maintain brand equity and drive sales. In 2012, SodaStream's advertising costs were $230mn versus Coke's $9,440mn or less than 3%. This bodes well that product sales have been rapidly increasing despite relatively low A&P. This year, they have started their marketing campaign with a bang, recruiting Scarlett Johansson as their brand ambassador along with a strategically controversial Super Bowl ad campaign.

Reasons SodaStream are market leaders in home carbonation

Barriers to Entry

- First-mover advantage / Brand strength
- CO2 exchange in 60,000 locations and growing
- Expertise in HAZMAT and reverse logistics
- Manufacturing capacity and decades of "know-how"
- Patented leading edge innovation (snap-n-lock, dishwasher-safe, SodaCaps)

Competition.

By far and away, SodaStream is the premier **global** DIY home soda maker. Competition is fragmented, usually isolated to the regions where they operate. Most competition is not on the whole SodaStream value chain but only parts of it.

The Keurig Cold seems to be the only major challenger. But even so, they are not competing with the same technology, making SodaStream the king of CO2 cylinder exchange soda delivery. This implies that there is more space for both competitors. CO2 cylinders allow the DIY customization to leverage on both the health trend with taste customization. In addition, of the two, SodaStream is likely the more cost effective solution to regular club soda / seltzer drinkers.

Insights from Coke's GMCR foray

Is it a guaranteed home-run? Perhaps not.

Shares of the Keurig maker exploded two weeks ago after Coke took a 10% stake in the company, and also agreed to provide its entire brand portfolio for the upcoming Keurig Cold brewing system. However, GMRC is decidedly neither competing with Soda in the CO2 exchange distribution space, nor with the same type of customization and personalization. Keurig Cold uses 2 soda pods - one contains the liquid syrup and the other - a pre-form of carbonation. The pre-measured doses of drink syrup differentiates the Cold with SodaStream. This simply means:

1) You can get Coke in a slightly more convenient but different form which wouldn't be much of an impact to the space SodaStream is operating in as Coke already has 40% of the US soda market and is already readily accessible. Die hard Coke drinkers *already* knew that SodaStream cannot replicate the exact Coke experience. Many SodaStream users also still buy Coke off the shelf as well.

2) This is likely to frustrate bottlers trying to accelerate bottle/can sales, not to mention carrying execution risk.

3) Successful branded drinks like Coke rely on emotional mythology for competitive advantage. Die-hard customers have emotional connections with soda that far exceed the inherent qualities of the soda itself. For these reasons, competition is often centred around advertising and distribution, and rarely on cost competition or product innovation itself.

From this point of view, selling their syrup directly to consumers as this may "pull back the curtain" on their "aura", as well as cannibalize their existing CSD sales. At the same time, using home machines departs from the *classical act* of drinking Coke which is part of the emotional attachment that makes Coke successful. Die hard Coke drinkers still love the idea of drinking those shiny red cans from a 6-pack.

5) Coke is already suffering because consumer tastes have changed. The GMCR partnership will likely add incremental sales, but as demand for Coke falls, so will demand for the Keurig Cold, and more importantly, its appeal.

6) Coke's last attempt to create a miniature soda fountain from the home, the BreakMate, flopped in the early 1990s after great fanfare.

7) SodaStream's modus operandus in brand market is pretty much the opposite, it has spent years building brand equity, branding themselves as "rebellious", modern, earth friendly with innovation in a bottle in a proven system. Who ever thought that you could ever drink sparkling Welch grape juice and save the earth at the same time? For these reasons, it is difficult to estimate how successful the Coke/GMCR partnership will be in wiping the floor with SodaStream. At the very least, there are reasons that both can co-exist in the home soda market. In fact, with a multiple decade lead in *home* soda making, one can make the argument that SodaStream is not quite the underdog in this market space as one would think.

8) Is Coke's foray a validation of the real potential of the home soda market?

Company Valuations

Because we are dealing with a historically high growth company that is trying to redefine its market, but recently stumbled on weak retail sales and questionable logistical decisions. We will outline various bullish and bearish cases to qualitatively estimate potential upsides versus downsides.

Bearish Valuation: 8% longer term NPAT growth

Next years net earnings growth rate is 3%, but revenues are growing at 15%. This impaired rate is more reflective of future prospects and assumes that the longer term net income growth rate falls far from historical levels of 39% CAGR to an estimated 8%. We peg SodaStream's forward PE to 18.1x major drink brand average with FY14 reported EPS of 2.02. This is reasonable because as the major drink brands are having single digit growth and are within the same industry. **We arrive at a target price of $36.**

Bullish Valuation: **back to 20++% NPAT growth**

Company reverts back closer to its historical growth story, after a sleepy 3% FY14 earnings growth, by continuing to redefine their place in the drink industry. Net income growth catches up with or exceeds their est. longer term revenue growth of 23% after FY14 (which is an average of FY13's and FY14's revenue growth). Pegging forward EPS of 2.02 to historical average PE of 28x when their growth story was unabated implies a valuation of $57. Taking a 10% discount to this to account for changed stock market perception due to volatility of great earnings growth one year and flat earnings growth the next and the introduction of a competitor, **we arrive at $51**.

Moderate Valuation: 15% longer term NPAT growth

We think the most likely scenario for net income growth is between the bullish and bearish case. Though FY14 guidance was muted, there are too many numerous growth opportunities, potential to improve margins and catalysts to ignore. Taking longer term earnings growth to be 15% which is also the 3yr CAGR from 2012 to 2014 (which is conservative as it includes 2013 and 2014 reported flat earnings). Pegging valuations to 23x forward PE, an average of the bullish and bearish case, **we arrive at $46.**

… this includes a potential M&A Upside Bonus

Pepsi could be a good fit. There could be many companies interested in buying this company. Pepsi is simply a logical fit. Pepsi had already recently suggested a foray into so-called "at-home" drinks such as SodaStream or Green Mountain's Keurig. PepsiCo CEO Indra Nooyi said on a Feb. 13 conference call that the company sees in-home carbonation as "another distribution channel" for carbonated and sparkling beverages and is "working with multiple people" to be sure it chooses a partner "who we are sure will commercialize" the product.

Buyout Valuation: After Coke purchased 10% of GMCR for 1.25B, GMCR spiked gaining **50%** since the announcement. That increase equates to a $6B change in market cap, meaning the market attributes that much value to GMCR on the major drink brand partnership. By comparison, SodaStream, far and away the market leader in DIY soda, is worth just $844 million, or just about one-seventh of the Keurig Cold's price tag. SodaStream would be arguably more valuable to Pepsi than GMCR is to Coke considering that buying into SodaStream's ready product and distribution channels allows them to get into the home market a year earlier within a proven system.

Historically, Pepsi had bought Quaker Oats (which owns Gatorade) at about 37x PE . **Valuing SodaStream at 37x PE with est FY14 EPS of $2.02 yields a price target of $74.**

Conclusion

- **We believe the growth story is still intact**, riding on megatrends of health, customizable, environmentally friendly consumption, amidst gestation losses while navigating through weak US retail sales to 1H14.
- **Soda will still be the king of carbonation** and there is space in the rapidly expanding market for a Coke/GMCR product which rolls out in 2015. Coke/GMCR activity potentially verifies home soda market is not just a fad.
- **SodaStream used to trade at an average PE of 28x, versus present PE of 20x.** A return to the historical growth story implies more than 40% upside.
- **Possible catalysts are:** successful execution of their logistical optimization initiatives, a continuation of the healthy, low-sugar, drink customization megatrend, and a better than expected 1H14.
- **As a bonus, Soda is also a prime potential M&A/partnership target,** as the Coke/GMCR entry into home-soda may trigger other big drink brands to do the same, where SodaStream is the most logical choice. For reference, the market valued Coke's entry into GMCR with a 50% spike in GMCR share price. Additionally, PepsI's takeover of Gatorade (via Quaker Oats) in 2000 was done at 37x PE.
- **At 20x PE for a revolutionary company with a compelling growth story, that used to enjoy a 50% earnings CAGR before this year's stumble, we think downside is limited while waiting on a return to growth or realization of catalysts.**

Concordantly, like a call option, we see downsides as limited but if certain catalysts materialize we will see major upside movement in prices. Till then, sentiment may not be enthusiastic due to muted company guidance. Investors will have to be patient. **We liken an investment in SodaStream now with a valuation of <u>$46</u> in the one year time frame (23x FY14 PE of 2.02), with an embedded "call" option with possibilities to rerate to valuations between <u>$51 - $74</u> should the company show signs of returning growth, or a major drink brand partners up with them.**

Key upside/ downside risks

Upside Risks:

1) Possible partnership with major drink brand.
2) Better than expected sales or net income numbers in FY14 – any suggestion that growth is returning may cause a rerating.
3) Better consumer retail sentiment in US.
4) The health, customization and alternative drink megatrend continues and accelerates - small improvements in consumer sentiment towards DIY soda making have significant upside impact to top and bottom line.
5) Better than expected execution on their top line and bottom line improvement initiatives

Downside Risks:

1) Changing of government regulations regarding the manufacturing and transportation of exchangeable CO2 cylinders may increase costs or delay entry to a new country.
2) Increases in cost of supply of raw materials: aluminum, brass, CO2, certain plastics and sugars.
3) Disruption of supply chain.
4) Political risks having some of their manufacturing in Israel's West Bank
5) Inability to protect intellectual property rights may permit competitors to more easily compete.

6) Poor execution on cost saving initiatives

FYE Dec	FY11	FY12	FY13
Income Statement (USD M)			
Revenue	**289**	**436**	**563**
EBITDA	**35**	**55**	**64**
Depreciation & Amortisation	6.0	10.1	15.0
EBIT	**28.8**	**44.8**	**48.9**
Net Finance (Expense)/Inc	1.5	0.2	(0.6)
Other items	0.6	(1.1)	(1.6)
Associates & JVs	0.0	0.0	0.0
Exceptional items	(0.1)	0.7	0.0
Profit Before Tax	**30.9**	**44.6**	**46.7**
Taxation	3.4	0.7	4.7
Profit After Tax	**27.5**	**43.9**	**42.0**
Non-controlling Interest	0.0	0.0	0.0
Net Income, reported	**27.5**	**43.9**	**42.0**
Net Income, adj.	**27.5**	**43.9**	**45.9**

* FY14F estimates are from management guidance

FYE Dec	FY11	FY12	FY13
Per share data (USD)			
Diluted EPS, reported	1.34	2.09	1.96
Diluted EPS, adj*	1.34	2.09	2.21
DPS	0.00	0.00	0.00
BVPS	10.9	13.3	15.9

* estimated removal of FX effects on net profit

FYE Dec	FY11	FY12	FY13
Cashflow Statements (USD M)			
CFO			
NPAT	27.5	43.9	42.0
Adjustments	13.6	17.0	30.9
WC changes	(44.6)	(21.3)	(68.1)
Cash generated from ops	(3.6)	39.5	4.8
Others	(4.6)	(2.3)	(0.4)
Cashflow from ops	**(8.2)**	**37.2**	**4.4**
CFI			
CAPEX, net	(21)	(26.8)	(45.8)
Others	(37.8)	17.6	0.5
Cashflow from investments	**(59)**	**(9.2)**	**(45.3)**
CFF			
Share issuance	42.9	0.0	0.0
Loans, net of repayments	(11.2)	(3.9)	15.5
Dividends	0.0	0.0	0.0
Exercise of Options	1.1	2.9	4.2
Others	0.0	0.0	0.0
Cashflow from financing	**32.9**	**(1.0)**	**19.6**
Net change in cash	**(33.9)**	**27.0**	**(21.3)**
Effects of exchange rates	0.0	0.0	0.0
CCE, end	**34.8**	**62.1**	**40.9**

FYE Dec	FY11	FY12	FY13
Balance Sheet (USD M)			
PPE	46.4	76.9	107.1
Intangibles	25.4	42.0	48.1
Associates & JVs	0.0	0.0	0.0
Investments	0.0	0.0	0.0
Others	1.4	2.4	1.5
Total non-current assets	**73.2**	**121.3**	**156.7**
Inventories	76.6	112.7	140.7
Accounts Receivables	78.5	115.5	22.2
Investments	0.0	0.0	0.0
Cash	4.0	62.1	40.9
Others	71.4	0.8	124.5
Total current assets	**230.6**	**291.1**	**328.3**
Total Assets	**303.7**	**412.4**	**485.0**
Short term loans	4.0	0.0	15.5
Accounts Payables	56.6	95.3	100.6
Others	21.5	38.6	31.4
Total current liabilities	**82.0**	**133.9**	**147.5**
Long term loans	0.0	0.0	0.0
Others	2.7	4.0	5.9
Total non-current liabilities	**2.7**	**4.0**	**5.9**
Non-controlling interest	0.0	0.0	0.0
Shareholder Equity	**219.0**	**274.5**	**331.6**

FYE Dec	FY11	FY12	FY13
Valuation Ratios			
P/E (X)	30.9	23.6	20.7
P/E (X), adj	29.9	19.1	18.1
P/B (X)	3.80	3.71	2.56
EV/EBITDA (X), adj.	23.9	17.4	12.9
Dividend Yield (%)	0.0%	0.0%	0.0%
Growth & Margins (%)			
Growth			
Revenue	-	51.0%	29.0%
EBITDA	-	58.3%	16.3%
EBIT	-	55.9%	9.1%
Net Income	-	59.6%	-4.2%
Margins			
EBITDA margin	12.0%	12.6%	11.4%
EBIT margin	10.0%	10.3%	8.7%
Net Profit Margin	9.5%	10.1%	7.5%
Net Profit Margin, adj	9.5%	10.1%	8.2%
Key Ratios			
ROE (%)	3.2%	17.8%	13.9%
ROA (%)	2.5%	12.2%	9.4%
Net Debt/(Cash)	0	(62)	(25)
Net Gearing (X)	0.0%	Net Cash	Net Cash

Source: Company Data, PSR est

Note: Historical Multiples use Historical Price, Forward Multiple use Current Price

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Fig 1: Revenue (Source: Company presentation)

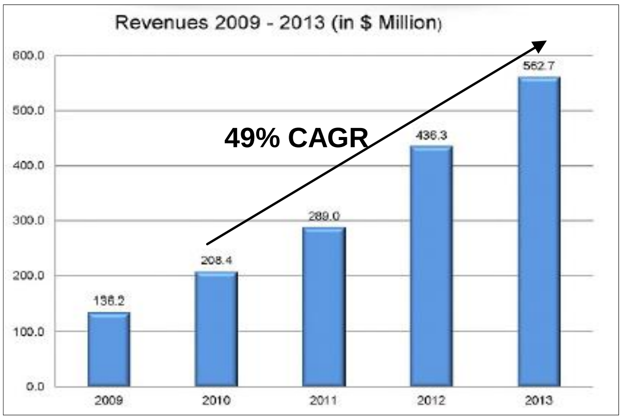

Fig 4: Soda Makers Unit Sales (Source: Company presentation)

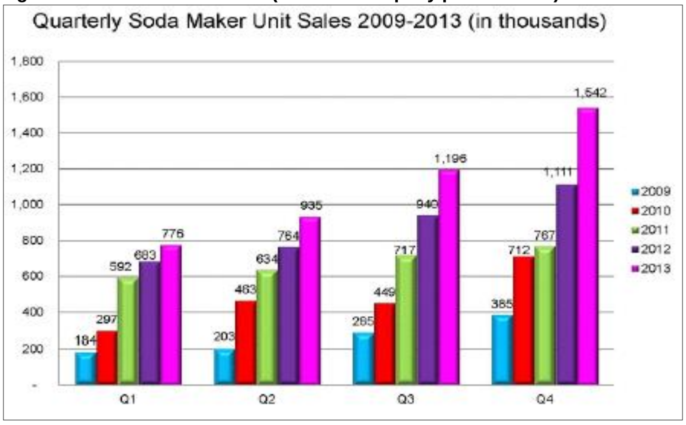

Fig 2: Revenue by quarter (Source: Company presentation)

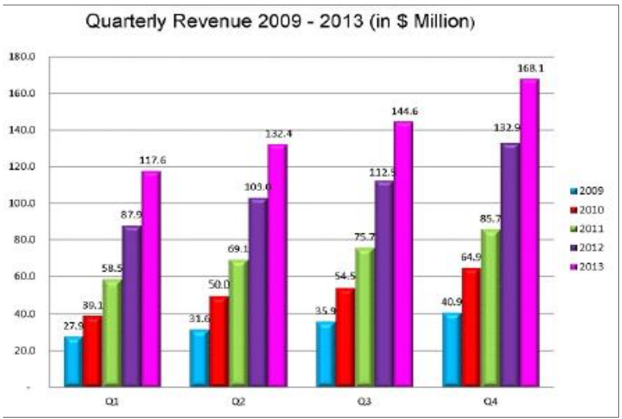

Fig 5: Flavors Unit Sales (Source: Company presentation)

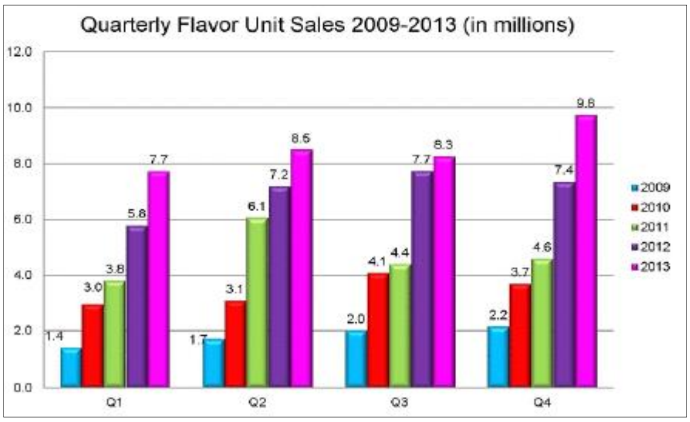

Fig 3: Net Profits (Source: Company, PSR)

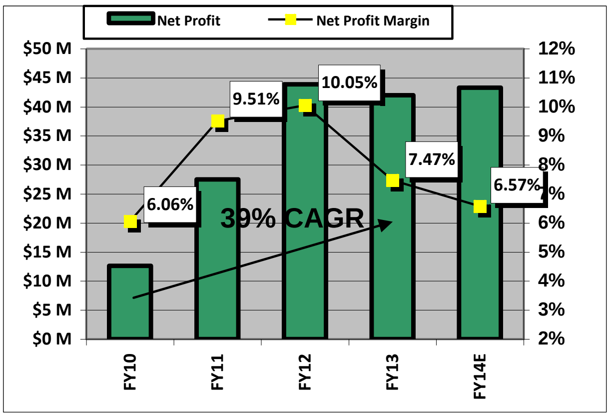

Fig 6: CO2 Refill Unit Sales (Source: Company presentation)

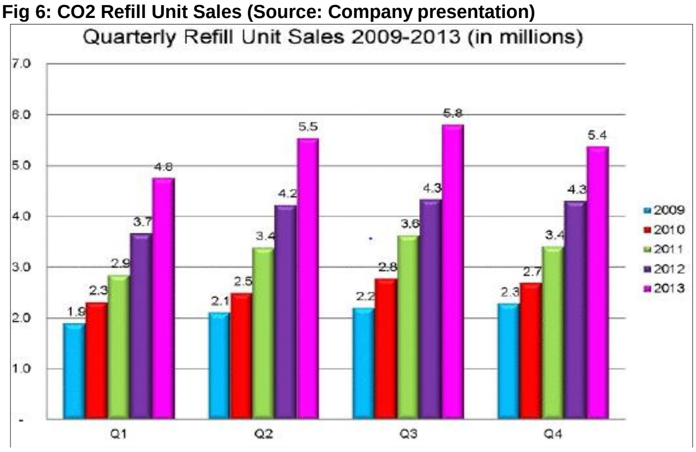

Fig 7: Price vs historical PE chart (Source: Bloomberg)

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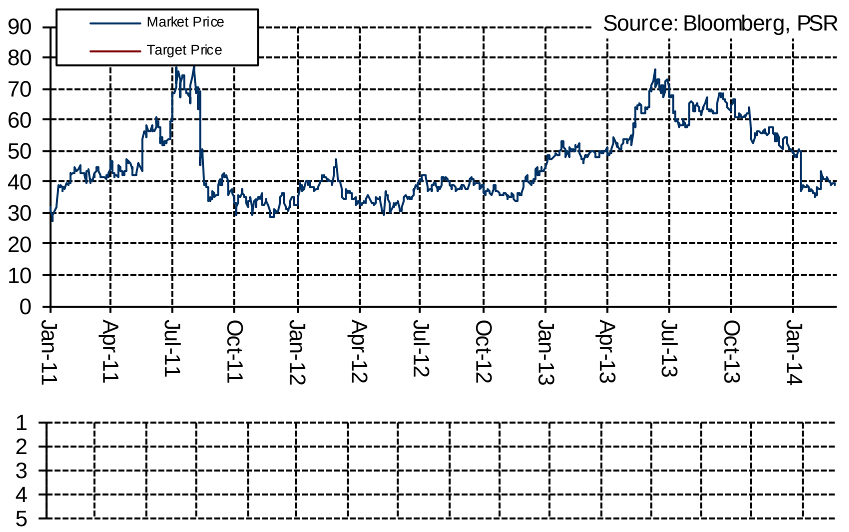
Ratings History



PSR Rating System

Total Returns	Recommendation	Rating
> +20%	Buy	1
+5% to +20%	Accumulate	2
-5% to +5%	Neutral	3
-5% to -20%	Reduce	4
< -20%	Sell	5

Remarks

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