The Chefs' Warehouse

CHEF : NASDAQ : US$24.05

Buy | US$24.00 Target

Scott Van Winkle, CFA 1.617.371.3759
svanwinkle@canaccordgenuity.com
Mark Sigal 1.617.788.1591
msigal@canaccordgenuity.com

SOFTER Q1 AND TEMPERED GUIDANCE, MAINTAIN BUY AND $24 TARGET

Investment recommendation

We expect that CHEF will deliver an EPS growth CAGR of over 20% over the next few years and has considerable geographic growth and consolidation opportunities to enhance strong organic growth within its existing markets.

Investment highlights

- CHEF reported Q1 results below consensus forecasts as volume softened later in the quarter and dairy deflation tempered revenue growth. Guidance was moderated for F2012 to reflect the Q1 and a customer loss, offset by the benefits of the acquisition of Praml in the Las Vegas market.
- EPS was $0.13 vs. consensus of $0.15 and revenue was $98.1M vs. consensus of $93.3M. On top of the softer trends in March and dairy deflation challenges, Q1 is a seasonally soft quarter.
- While March tends softened, internal growth was 7% and would have been modestly higher if not for deflationary pricing in dairy as the quarter progressed.
- Margins remained strong despite the softening with gross margin up 10 bp to 26.6% and about 50 basis point of leverage was experienced.
- Recently acquired Praml appears to be more profitable than we expected as the implied EBITDA is in line with our expectations while revenue is lower than our initial guess.
- Revenue guidance was increased to a range of $452M-$462M from $450M-$460M, but including the Praml acquisition, the guidance range is down about $10M. EPS guidance is tempered by $0.02 to $0.91-$0.94 from $0.91-$0.96 previously. We will adjust our forecasts for the Q1 trends and acquisition after further follow-up on the quarter and trends.

Valuation

Shares trade at 22x F2013E EPS and about 11x EBITDA forecast, in line with its specialty and natural peers, but the valuation will likely lead to a correction on the softer revenue trends experienced in March, which could be exacerbated by recent insider selling. We maintain our $24 target and expect a correction off of this level today.

VALUATION

Valuation is appropriate, in our view. Shares trade at 22x our 2012 EPS forecast and 11x our forecasted EBITDA. While the valuation represents a significant premium to the traditional food distribution peer group multiples generally in the low teens on forward earnings and 7-8x EBITDA, the valuation is at a slight discount to its best and only real comparable peer from a standpoint of growth, United Natural Foods (UNFI : NASDAQ : $50.30 | Buy). We view UNFI as the best comparison for CHEF given it also enjoys a naturally growing market, superior margins relative to most distributors (yet at 18% UNFI's gross margins are inferior to CHEF at 26%) and is the leader in its segment as is CHEF. We continue to argue that CHEF should trade at a premium to its distribution peers (as UNFI does) given its vastly superior margins, growth outlook and higher returns on invested capital.

We maintain our price target of $24.00, which reflects 11x our 2013 EBITDA forecast and 22x our 2013 EPS estimate, which is consistent with where CHEF currently trades prior to expected share price weakness today and reflect the premium valuations of the specialty food peer group.

Investment risks

Key risks that may impede the achievement of our forecasts and/or price target include the following:

- A rise in commodity prices: While normally beneficial for food distributors, excessive commodity costs, which have been volatile over the last several years, could alter consumption behavior and lower consumer demand. Major products sold that have had their inputs fluctuate greatly are dairy, wheat, flour, and cooking oils. Additionally, rises in fuel costs could negatively impact CHEF's operations.
- Economic sensitivity: Given CHEF's focus on higher end food service establishments, the company is exposures to potential sales volatility as consumer confidence and spending fluctuation. Recent concerns surrounding incremental economic weakness have impacted the performance of the shares.
- Competitive activity: Despite its favorable positioning in specialty foods, competition in the food distribution industry is fierce and CHEF competes with larger food companies with greater resources. Market leaders include Sysco, U.S. Foodservices, Inc and United Natural Foods.
- Market concentration: CHEF operations are concentrated in six markets, leaving the Company susceptible to economic downturns. As of the end of 2010, 66% of CHEF's total sales originated from the New York market.
- Acquisition and integration risk: CHEF has made several acquisitions over its history and it remains a key growth initiative. The specialty foods distribution industry is highly fragmented and the Company has indicated plans for future acquisitions. Future acquisitions could strain management resources; result in sales disruptions or loss of key personnel and the company may not achieve expected cost reductions or distribution gains.
- Product recalls and/or food safety concerns: CHEF products are ingested and any concern about food safety or quality can impair consumer confidence in the brands sold through CHEF. The risk of adverse health impacts is always present.
- Industry regulation: CHEF's line of business is highly regulated at the federal, state and local levels, and its specialty food products and distribution operations require various licenses, permits and approvals. Suppliers are also subject to similar regulatory requirements and oversight. In addition, as a distributor of specialty food products, CHEF is subject to increasing governmental scrutiny of and public awareness regarding food safety and the sale, packaging and marketing of natural and organic products

- Weather: Adverse weather conditions can significantly impact CHEF's ability to profitably and efficiently conduct its operations and, in severe cases, could result in its trucks being unable to make deliveries or cause the temporary closure or the destruction of one or more of its distribution centers.

In addition, we strongly urge investors to review the complete set of risk factors that can be found in The Chefs' Warehouse's most recent regulatory filing.

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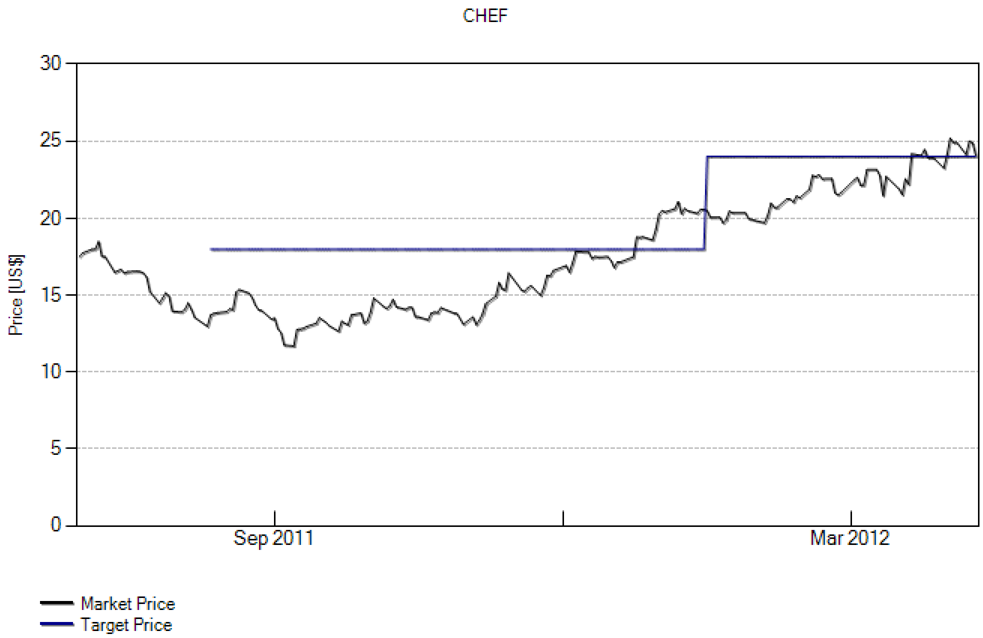
Price Chart:*



	Date	Analyst	Rating	Target Price		Date	Analyst	Rating	Target Price
1)	09/07/2011	Winkle	Buy	18.00	2)	02/09/2012	Winkle	Buy	24.00

*Price charts assume event 1 indicates initiation of coverage or the beginning of the measurement period.

Distribution of Ratings:
Global Stock Ratings
(as of 2 April 2012)

	Coverage Universe		IB Clients
Rating	#	%	%
Buy	503	59.3%	31.0%
Speculative Buy	91	10.7%	73.6%
Hold	232	27.4%	18.5%
Sell	22	2.6%	9.1%
	848	100%	

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Company	Disclosure
The Chefs' Warehouse	1A, 2, 3, 5, 7

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