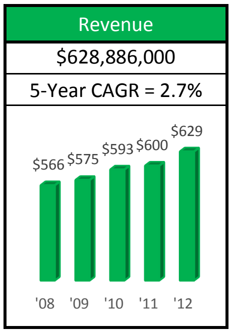
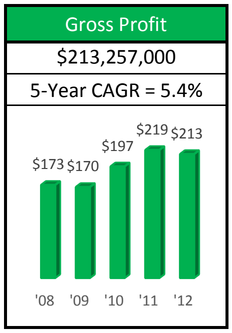
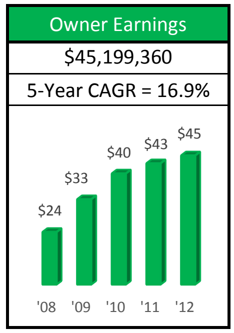
National Beverage Corp
February 21, 2013

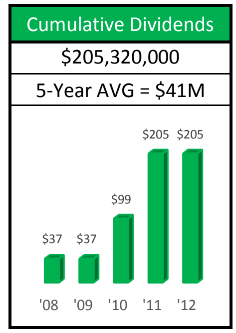
General Overview

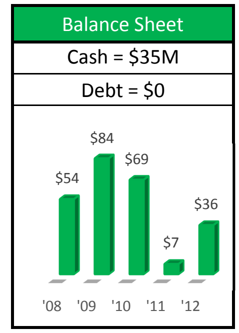
National Beverage Corp (FIZZ) sells a diverse portfolio of flavored beverage products. The company's products include soft drinks, energy drinks and shots, juices, teas, still and sparkling waters and nutritionally enhanced beverages. The company's brands include *Shasta, Faygo, Ritz, La Croix, Rip It Energy Fuel,* and more.











Purchase Logic

FIZZ primarily sells carbonated soft drinks that compete against Coca-Cola and Pepsi. The company differentiates its' business model in two ways: 1) A lower price point, and 2) Distribution through small retailers. The large network of small retailers was built over more than 28 years. The advantage of targeting small retailers is that they are generally less competitive and more difficult to reach than large box stores. In order to establish a relationship with a small retail location, like a mom & pop store or gas station, a sales rep must travel to their location and convince them to purchase the product. A strong customer base is built one store at a time. It is a very difficult way to grow a business, but it has the advantage of being extremely stable because of the fractured customer base. These small stores typically stay customers for a very long time. This brings tremendous stability to FIZZ's income. We purchased FIZZ at a 52-week low and 14x earnings. In the last 5 years the business has paid out roughly 100% of earnings as dividends to shareholders. We were delighted to invest in a company with no debt and a stable 7% dividend yield.

Key Metrics

The key metrics for the business are Revenue, Gross Profit, Owner Earnings, and the Cumulative Dividend. The business factors that drive each of these metrics are described in detail below.

<u>Revenue</u>

FIZZ has a relatively simple business model. The company is a fully integrated beverage producer, meaning it purchases raw materials, produces concentrates, and manufactures the finished products of all the various beverages sold. The company then sells these finish products to retail stores around the country. A relatively simple business.

<u>Gross Profit</u>

The gross profit for FIZZ is the difference between the cost of production and the wholesale price to retailers. The business has maintained relatively stable gross profit margins between 30-33% for the last 10 years. This means that if it costs $4.00 to manufacture a case of beverages the company would sell that case to retailers for $6.00. FIZZ intentionally targets margins in the 30-33% range, which is less than most beverage companies, and competes primarily on price. Due to the relatively stable gross profit margin the gross profits of the business typically grow in line with revenue.

Owner Earnings

Owner earnings are calculated by subtracting all other expenses at the business – which include marketing, advertising, general and administrative expenses and taxes. This metric is ultimately what drives the value of the business and the dividend payouts we receive as business owners.

Cumulative Dividends

FIZZ has allocated roughly 100% of earned income as dividends over the last 5 years. Unlike most companies FIZZ does not have a regularly scheduled dividend, but rather, accumulates cash and then sends out all the excess cash at one time to the owners. This is known as a special dividend. The cumulative dividends are calculated by adding the dividends paid in the current year to all dividends paid out previously – creating a cumulative total. Our calculation shows the cumulative total beginning in 2008.

Historical Performance of Key Metrics

Year	'08	'09	'10	'11	'12
Total Revenue	$566,001,000	$575,177,000	$593,465,000	$600,193,000	$628,886,000
Gross Profit	$172,581,000	$169,855,000	$197,015,000	$218,654,000	$213,257,000
Owner Earnings	$24,211,200	$33,111,040	$40,108,800	$42,867,840	$45,199,360
Earnings Per Share	$0.52	$0.72	$0.86	$0.92	$0.97
Cumulative Dividends	$36,711,000	$36,711,000	$99,006,000	$205,320,000	$205,320,000
Cash	$54,497,000	$84,140,000	$68,566,000	$7,372,000	$35,626,000
Debt	$0	$0	$0	$0	$0

Revenue

In the last 5 years revenue has grown at a rate of 2.7% per year. While this growth rate is not spectacular the stability of FIZZ's business model is unquestioned. The company has increased revenue every year since 2005. We anticipate FIZZ to continue slowly growing the business at a rate between -5% and 8% per year with a 5 year average of 3%.

Gross Profit

Gross profit has compounded at a rate of 5.4% during the last 5 years. This has outpaced revenue due to the change in product mix. In 2008 the gross profit margin was 30% whereas today the gross profit margin is approximately 33%. The increase in margin was due to selling more products, such as energy drinks, with higher margin profiles. Moving forward we anticipate gross profit to move in line with revenue.

Owner Earnings

Over the last decade FIZZ has grown owner earnings at pace of 10% per year. The pleasant disparity between growth in revenue and growth in owner earnings arises from the tight cost controls the business has been implementing every year. In 2004 the company's selling, general, and admin expense was 27% of sales. In 2012 this figured dropped to 22% of sales – allowing the business to increase profitability at a faster rate than income. We have been exceedingly impressed with FIZZ's ability to control costs and increase profits without additional investment into the business. We anticipate owner earnings to grow between -3% and 10% per year with a 5 year average of 5%.

Cumulative Dividend

Since 2008 the company has paid out approximately 100% of earnings as dividends to the owner of the business. However, unlike most businesses that pay regular dividends quarterly, FIZZ typically accumulates cash over a long time period – sometimes multiple years – and then pays out all the excess cash as a special dividend. These special dividends occurred in 2008, 2010, and 2011. Over this time frame the cumulative dividend has amounted to $205 million. To put this in perspective, in 2008 it was possible to buy FIZZ at a price of $8 per share, or $369 million for the entire business. Since that time the cumulative dividends have equaled $4.44 per share or 55% of the original purchase price – and FIZZ has nearly doubled owner earnings during that time frame. An incredible feat.

Summary of Key Metrics

Metric	Expectations
Revenue	Growth ranging from -5% to 8% per year Average of 3% over 5 years
Gross Profits	Growth proportional to Revenue
Owner Earnings	Growth ranging from -3% to 10% per year Average of 5% over 5 years
Cumulative Dividends	Payout ratio of roughly 100% Dividend yield of 7% relative to initial purchase price

The Moat Around The Metrics

The moat around FIZZ's business model stems from three elements working in tandem: 1) Healthy brand names, 2) Low price points, and 3) Strong customer relationships. The various beverage brands sold by FIZZ are well known, especially in the Hispanic and Latino communities, and the strong brand name helps soft drinks like *Faygo* and *Shasta* continue to perform well against the competition. In addition to a portfolio of healthy brand names FIZZ also benefits from being a low cost provider. The profit margins for Pepsi or Coca-Cola products are approximately 60%, or double the profit margin for FIZZ. As a low cost provider FIZZ appeals to cost conscience customers looking to save. And finally, FIZZ has built an outstanding customer network across thousands of stores. Obtaining shelf space at these store locations is very difficult and takes a tremendous amount of time and energy. The customer relationships FIZZ has established over the years are extremely valuable and will likely continue long into the future.

Risks

With a fractured customer base and long history of operational success the risks we've assumed as business owners of FIZZ are low. Below is a list of the potential pit falls we may experience as owners of FIZZ.

Short-Term Risks

- Raw Material Costs. It is possible that the commodity prices for inputs, such as corn, fruit juice, etc. could rise materially in the short-term. Typically when this occurs margins would be temporarily depressed, but the increase in production costs are passed on to consumers and margins are maintained. We view this risk as very low.
    - Low Risk

Long-Term Risks

- Changes in consumer preferences. It is possible that consumers will continue to switch their consumption preferences to beverages that are healthier. FIZZ sells a high volume of carbonated products with high sugar content. In the event that consumers switch to healthier beverages it would have a material impact on FIZZ's future profits. While consumer preferences change from time to time – historically they have been relatively stable over long periods of time. FIZZ also has the ability to change the product mix to beverages with lower levels of sugar to satisfy changing consumer demand (similar to '*Diet Coke'*).
    - Low Risk
- Industry consolidation. FIZZ sells products to a highly fractured customer base that has been consolidating in recent years. As retailers consolidate the purchasing power of these larger chains increases putting pressure on FIZZ's margins. We view this risk as relatively low.
    - Low Risk

Conclusion

National Beverage Corp (FIZZ) sells a diverse portfolio of flavored beverage products. The company sells soft drinks, energy drinks and shots, juices, teas, still and sparkling waters and nutritionally enhanced beverages. In the last 10 years the company has experienced moderate growth in revenue, but much larger growth in owner earnings due to the cost savings realized each year. The income for the business has more than nearly doubled in the last 5 years while simultaneously distributing approximately 100% of earnings to shareholders in the form of special dividends. We believe the company's outstanding profitability will continue long into the future due healthy brand names, lower price points, and strong customer relationships. We effectively paid 14x earnings for the business and will likely realize a 7% dividend yield annual based on special dividend payouts over time.

Works Cited

1) *FIZZ Annual Report - SEC Filing 10-K.* EDGAR, 2012.

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