

Mossberg's Investor Digest

Best Idea Profile

Smart Balance (Nasdaq: SMBL)

DESCRIPTION:

Headquartered in Paramus, NJ, Smart Balance is the second largest marketer of buttery spreads in the United States. Products are marketed to grocery, mass merchandise and convenience stores under the brand names Smart Balance and Earth Balance and sold at a slight premium (about 10%) compared to the rest of the category. Buttery spreads (Approximately 75% of sales) is by far the most developed product. The company has also introduced peanut butter, cooking oils, mayonnaise, popcorn and dairy products.

KEY INVESTMENT CONSIDERATION:

Dominate brand in a category with secular growth

– Consumers are placing greater emphasis on eating healthy. According to the International Foods Information Council, the number one health concern among consumers is heart health. Based on this concern, the healthy premium category of spreads has grown 60% from 2002 to 2007 and comprises approximately 18% of the spreads market. Smart Balance, which accounts for approximately 70% of the healthy premium category, has been largely responsible for the category growth. Since 2005, SMBL sales have grown at a CAGR of 31%. Sales grew 26% in 2008.

(Nasdaq: SMBL)

Investment Data (as of 5/15/09)

Recent Price	\$7.71
52-Week Range	4.58 - 9.45
Fiscal Year End	December
Dividend	N/A
Yield	N/A
Shares Outstanding	62.6 MM
Average Trading Volume (3 mos)	621
Market Capitalization	482 MM
Cash	8.1 MM
Long Term Debt	69 MM
Enterprise Value (EV)	542 MM
LT Debt/ Equity	0.2
Tangible BV/ Share	N/A
TTM Revenue	234 MM
P/ Revenue	2.0x
TTM EPS	-0.07
P/ EPS	N/A
Adjusted EBITDA	26.9 MM
EV/ TTM EBITDA	20x

Exclusive license and patent protection gives competitive advantage – About ¾ of the company's products used proprietary technology that enhances good-to-bad cholesterol ratios and still tastes good.

Virtual business model requires limited capital to support growth

– The company outsources its manufacturing and distribution and has limited need for capital expenditures. The company has already made infrastructure investments; IT infrastructure, systems, etc. required to quadruple the size of the business without the need for significant capital spending. In addition, there is significant leverage in this business model. There are only 60 employees in the company and management claims they only need to grow to 75 to 80 people to support twice as much revenue.

Betting on the Jockey

– Steve Hughes, the company's Chairman and CEO, along with other members of the management team, have an impressive track record of building and turning around brands in the consumer packaged food and beverage industry. Steve's track record includes leading the Healthy Choice brand from zero to \$1 billion in sales, turning Tropicana's US business around, doubling Tropicana's sales from \$1 billion to \$2 billion (ultimately sold to Pepsi for 3.3 billion), and increasing Celestial Seasonings from \$80 million in sales, which was ultimately sold to Hain for \$387 million in three years.

VALUATION:

The company is investing considerable sums in brand advertising, \$40 million in 2008 and \$50 million is expected during 2009. With this level of investment, profitability levels are near breakeven to a slight loss, making it impossible to value the stock based on a multiple of earnings. Based on an adjusted EBITDA (adjusted for stock options)/to Enterprise value of 20x, it appears the stock is fully valued. However, the company is growing at an aggressive rate and entering new categories with significant market potential. Small, fast growing companies in the food business typically don't last long as independent companies. Based on management's past track record, the company could be sold to a larger company at a much higher valuation.

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