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Private Equity Challenge – The Simply Good Foods Company

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Abstract

Four students collaborated on an Investment Committee Paper outlining a proposal for the leveraged buyout of Simply Good Foods Company, a company specializing in nutritious and convenient food options. The project features a well-crafted value creation plan and capital structure, resulting in a projected Internal Rate of Return (IRR) of 24% and a Money Multiple of 4.5x over a seven-year period. The document also encompasses individual contributions, covering areas such as market analysis and internationalization strategy, financial modeling, valuation and returns, as well as an analysis of M&A landscape and its alignment with selected exit strategy.

Keywords: Private equity, Leveraged buyout, Simply Good Foods, Acquisition

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Group Part – Investment Committee Paper Summary

1. Company Profile

Headquartered in Denver, United States, The Simply Good Foods Company (SMPL) is a leader in the fast-growing nutritional snacking sector, developing and selling nutritional packaged food and beverages. The origins of the company go back to 1989, when Atkins Nutritionals Inc. was founded, by Dr. Robert Atkins. SMPL was incorporated in 2017, from a combination with Conyers Park Acquisition Corporation. In 2019, the firm acquired Quest Nutrition LLC and, nowadays it operates under the Atkins and Quest brands. It is physically present in the US, where, besides its headquarters, it operates four offices & storage buildings, two R&D labs, and two distribution centers and it hires 260 employees. The 3% of the company's FY2022 revenue that relates to international is mainly from Australia and New Zealand.

1.1. Product Portfolio

Under Atkins' brand, the company sells approximately 96 products in 6 different categories of weight management, namely bars, food & meals (e.g.: frozen pizza), treats, shakes, protein chips, and keto treats. Quest is a sports/protein-focused nutritional snacking brand that markets around 69 diverse products under 11 categories including protein bars, chips, powder, cookies, hero bars, frosted cookies, frozen pizza, protein shakes, cheese crackers.

1.2. Business Model

Sourcing. The firm uses some core ingredients for manufacturing and packaging its products, including soy, nuts, dairy, protein, fiber, and cocoa, as well as some materials such as flexible film, cartons, tetra paper and corrugation. These are sourced from a limited number of third-party suppliers, a fraction of which are international companies. For certain supplies, the company establishes direct purchasing agreements with suppliers, under which the contract manufacturers source ingredients for production.

Manufacturing. As mentioned above, manufacturing is assigned to contract manufacturers, regularly audited, and then it generally acquires the finished goods whose price includes all the packaging and ingredients used as well as an agreed-upon tolling charge for each item produced.

Storage & Distribution. The finished products are then weekly shipped either directly to both leased storage and distribution centers, directly from the contract manufacturer to the customer, or available in the storage units for customer pick-ups. This step of the supply chain is also assured by and contracted from third-party providers.

Customers. The majority of its revenues are generated from a limited number of retailers, the main three being Walmart (31% of sales in FY2022), Amazon (13% of sales in FY2022) and Target (10% of sales in FY2022). E-commerce players, besides Amazon, include Atkins and Quest's websites and other platforms of brick-and-mortar customers. Regarding channel split, Atkins sold approximately 81% in mass retail and stores, 12% in e-commerce, and 7% in other channels, whereas Quest sold 69%, 21% and 10%, respectively.

Consumers. Atkins has historically targeted older and more rural buyers that engage in a self-directed low carbohydrate diet. Quest, as a protein-focused brand, targets younger buyers, mostly female, who pursue an active lifestyle and wish to replace meals, engage in a nutritional diet, and gain strength. To attract additional purchasers, the company has used a consumer-focused approach, through coupons, advertising, influencers, and online resources.

1.3. Management Team

The company is managed by a new strong management team, with years of experience in the industry. Geoff Tanner has been the CEO since July 2023 and previously, he played executive roles at large players such as The J.M. Smucker Co., Big Heart Pet Brands, and Del Monte Foods. Shaun Mara has been SMPL's CFO since October 2022 but had previously been CFO of Atkins Nutritionals, Inc., as well as CFO at Dean Foods. Jeremy Ivie holds another key position as Chief Product Technology Officer, having substantial knowledge of Quest and Atkins products as he took leadership positions in R&D at both companies.

1.4. Historical Financials

In 2020, SMPL acquired Quest Nutrition LLC to leverage consumer trends favoring healthier dietary choices, positioning the company to capitalize on the burgeoning demand for nutritious and delectable products (The Simply Good Foods, “Acquisition of Quest Nutrition”). Between 2017 and 2022, the company experienced strong growth at a +25% CAGR, boosted by Quest's inclusion. Atkins grew to +8%, Quest at +44%, and the International segment at +5%.

Despite COVID-19 challenges, the company's revenue remained stable due to health trend preferences and recommendations from health institutions (Barrea et al., “Dietary Recommendations for Post-COVID-19 Syndrome”), particularly regarding post-COVID-19 diet habits. The gross margin declined from 41% to 38% in 2022 due to pandemic disruptions affecting operations and maintaining costs. The pandemic significantly disrupted traditional business operations, causing supply chain disruptions, reduced consumer demand, and limitations on physical selling points such as stores, offices, or distribution centers (OECD, “COVID-19 and the Retail Sector”). Operating Income rose from 6% to 17% in 2022, driven by increased investments in selling & marketing and higher administrative costs. These augmentations were strategic moves by the company to bolster its market presence, expand revenues, and enhance brand recognition. Adjusted EBITDA stability indicated consistent operating cash, though 2020 declined due to Quest's integration.

Assets surpassed liabilities, highlighting an asset-light strategy post-Quest. Liabilities have been reduced since 2020 improving ratios such as Net Debt/Adj. EBITDA, enhancing debt management despite a 2020 downturn. Equity notably surged during the historical period, mainly due to increased paid-in-capital and retained earnings resulting from Quest's integration and enhanced company`s performance.

The Free Cash Flow (FCF) reported on the Cash Flow Statement (CFS) is largely influenced by financial cash flow due to negative trends in investment cash flows in recent years. Despite a substantial investment of almost $1 billion in 2020, the company managed an FCF ranging from -€28m in 2017 to €105m in 2022. Conversely, investment cash flow remained negative owing to significant investments made by the company, including initiatives like business combinations and the acquisition of Quest.

2. Market Overview

The global snacking market has been one of the fastest-growing industries over the last few years. Benefiting from a more modern lifestyle where people prefer to eat snacks in place of meals, the market became extremely relevant, reaching a value of over $584 billion and it is projected to grow at a CAGR of +5.3% until 2029 (Fortune Business Insights, "Snack Food Products"). Hidden within this market is a niche that is growing at an even higher CAGR: the nutritional snacking market (often referred to as the healthy snacking market). With a historic CAGR of +11.3% from 2013 to 2020 alone, the global market has developed in a short period and reached a market value of over $91 billion in 2022. This market will reach a value of $ 158 billion by the year 2030, maintaining a yearly growth rate of +7% in the process (Grand View Research, "Healthy Snacks Market"). SMPL operates primarily in this dynamic fast-growing nutritional snacking market. Driven by people's lifestyles and habits, such as making sugar-free, vegan, and overall healthier and more environmentally friendly products available to people, SMPL has the right response to customer and market needs.

In terms of product segmentation, the nutritious snacking market can be divided into 4 main categories: sweet and salty snacks, protein bars, RTD shakes, and confectionery market. One of the largest shares of SMPL's turnover comes from the market for protein bars and sweet and salty snacks market. The sweet and salty market size amounted to approximately $75 billion in 2022 and will reach $112 billion by 2030 with a CAGR of +6% (Grand View Research, “Healthy Snacks Market”). RTD shakes stand out as the fastest-growing segment. Supported by a huge post-pandemic fitness wave and many influencers promoting these meals, the market is expected to grow at a CAGR of +8.1 % to reach $2.65 billion by 2030 (Globe Newswire, “RTD Shakes Market”). Closely related to the segment of RTD shakes are protein bars market. Currently, the vegan trend is dominating the product offers in this market and sets it up to an estimated CAGR of +6.3% until the year 2030 (Market Research Future, “Protein Bar Market”). The fourth segment is the confectionary snack market, which is experiencing significant growth due to a rising trend in obedience. With products like sugar-free confectionary targeting this demographic, the niche is expected to grow at a CAGR of +5.5% until 2029, nearly doubling its current market share of $2.5 billion. (BlueWeave, Sugar-Free Confectionery Market). Taking a closer look into the geographical segmentation, the market share is led by North America with 36%, closely followed by Europe (30%) and Asia Pacific (23%). Africa and South America remain smaller markets now (combined 11%), as they are often limited by the high prices for healthy snacks and the limited availability due to missing supply chains into these regions which are the two biggest threads now to the industry (MRFR, “Global Healthy Snacks Market). SMPL sells mainly in North America (97 % of net sales), where it has a market share of approximately 6%. There is another large market that overlaps with the nutritional snacking market, which is the weight management market. As of 2022, the market was valued at $ 143 billion, with a projected CAGR rate of +9.9% through 2030. Led by a share of 75%, diet products are the unmatched market leader (Grand View Research, “Weight Management Market”). SMPL and similar companies in the nutritional snacking industry can seize opportunities in the growing weight management market by offering customized snacks for specific customer groups, catering to the unique needs of each segment.

2.1. Benchmark Analysis

The considered group of peers for SMPL are Glanbia, Hain Celestial, Pilgrims, Hostess, John B & Sanfilippo, and Tree House, which are mainly companies from North America. From a two-dimensional perspective regarding the business size and the broad portfolio, SMPL is in the upper range of these two measures compared to its competitors. Along with its product offering SMPL offers almost 170 products. In view of the sales of the benchmark, approximately 80% of the net sales come from North America, while international sales account for 20%. Similar to SMPL, most competitors distribute their products through retail stores, and the largest customers are Walmart and Amazon. In a financial comparison, SMPL recorded the highest 5-year average sales growth among its competitors (+19.7 percentage points), even if growth fluctuated greatly over the period analyzed. In terms of adjusted EBITDA margin, the company was more profitable than its competitors (+5.8 percentage points compared to the 5-year average). The capital expenditure (CAPEX) / depreciation & amortization (D&A) ratio of SMPL increased in the last five years, from 22.8% to 30.3% in the last fiscal year. This data indicates that SMPL has been depreciating and amortizing its assets faster than its investments. However, despite this unencouraging trend, SMPL performs far better than its peers in this metric, except Glanbia, which managed to cut the ratio by almost half. The cash conversion cycle (CCC) of SMPL has increased from 55.9 in the last five years to 64.6 in the last fiscal year. This reduced cash conversion performance indicates growing inefficiencies in its income generation activities and the use of the working capital.

3. Investment Thesis & Value Creation

SMPL consolidated a set of characteristics that makes it an attractive target for this proposed leveraged buyout (LBO). Firstly, it is a market leader in the nutritional snacking category, one of the fastest-growing segments within the food & beverages industry and it is strategically positioned in that market by managing two brands that target complementary and loyal customers. Additionally, its light-asset business model with low CAPEX requirements allows the firm to keep sustainable cash flows and strong financials – namely high revenue growth and profitability - and focus on its Intellectual Property assets to safeguard and enhance products' value. The company's commitment to product excellence is further strengthened by its in-house R&D efforts, dedicated to creating and evaluating new products, flavors, and packaging innovations. Finally, the Quest acquisition was successful, as they doubled the target size and deleveraged – from a 4.1x to a 1.5x Net debt/Adj. EBITDA - within 2 years, which provides some comfort in terms of another large acquisition being a potential strategy for value creation.

3.1. Value Creation

The strategy to maximize SMPL's market presence revolves around three key areas. Firstly, it focuses on international expansion achieved through an M&A deal, that broadens the company's market reach and allows synergies to be leveraged from the acquired entity, in terms of brand recognition mainly. Secondly, the strategy entails the development of a key strategic segment. This is pursued through an M&A deal targeting a company to create a buy-and-build strategy to improve the company presence and impact over the segments. Lastly, the strategy involves operational enhancements, such as improving the cash conversion cycle, thereby aiming for efficiency improvements within the company's operations.

The selection of the target companies was guided by key drivers that significantly influenced the decision-making process. Firstly, the nature of the target company's business model played a pivotal role. John B. shares a partial asset-light operational model like SMPL, streamlining the integration of financials. Meanwhile, Grenade UK, being smaller in size, offers SMPL an opportunity to increase Grenade's growth due to brand recognition that allows the company to access a better and larger network of suppliers, customers, and consumers without extensive financial commitments.

Secondly, the targeted markets of these companies were crucial considerations. Grenade operates in a geographically distinct market, offering SMPL an entry point into Europe with existing operational facilities. Conversely, John B. is mainly focused on nuts, in terms of distribution of revenues and having acquired targets in that segment. However, the nuts segment has not been demonstrating an attractive revenue growth, thus, the Snack & Trail mixes segment could be an opportunity for SMPL to build on and enhance profitability and growth. Given SMPL's robust financial standing compared to its peers, the strategic focus of these acquisitions aims for profound strategic impacts rather than solely financial gains.

John B. Sanfilippo & Son, Inc., recognized as a prominent and expanding figure in the snack food industry, particularly renowned for the Fisher® brand, specializes in processing, packaging, and promoting a diverse range of nut and snack products. Conversely, Grenade UK is a potentially prominent sports nutrition brand focusing on weight-loss products. As an adept buyer, SMPL possesses the capabilities to significantly enhance Grenade UK's growth in its niche, making it an ideal fit for acquisition.

4. Business Plan

Initially, the business of SMPL was projected on a stand-alone basis, focusing on specific revenue segments (Atkins, Quest, and International), costs, margins, and various other financial indicators. Subsequently, each target of the M&A strategies was forecasted independently, integrating them into a unified business plan that delineates the financial forecast comprehensively, and inputting it into the final LBO.

Developing the business model involved crafting two distinct scenarios: a stable base case forecast and an investment case that factored in higher growth potentials, amplified capital infusion, or riskier yet potentially more lucrative strategies. To facilitate comparison, all financials of the targets were calendarized to align with SMPL's fiscal year, accounting for differences in fiscal years across entities. Furthermore, it was assumed that a seven-year holding period would be ideal to allow for the comprehensive implementation of strategies aimed at maximizing profit potential.

The acquisition of both targets is anticipated to take place in late 2023, with the integration of their financials into SMPL's financials expected by 2024. The acquisition prices with fees (4% from the acquisition price) for each target were $1,032,045 thousand for John B. Sanfilippo & Son, Inc. and $163,725 thousand for Grenade. The add-ons are anticipated to strengthen revenue growth and facilitate the company in reducing specific fixed costs by leveraging economies of scale. With an expanded stakeholder network, the company foresees solidifying its financial stability throughout the holding period, substantially enhancing its growth trajectory. Contrarily to acquiring a better-margin target, which is a challenge as SMPL has already very healthy profitability margins, the major M&A strategy, the buy-and-build of John B., focus on acquiring a non-optimally performing target, which, in this case, one segment will be expanded and improved.

The primary financial enhancements for the targets primarily stem from operational enhancements within the businesses. SMPL, being an experienced and well-performing entity, offers valuable insights into cost efficiency and overall margin expansion for the targets. Grenade experienced slight improvements, notably in COGS reducing from 64.4% of revenues in 2023 to a stabilized 61% in 2029. Additionally, reductions were seen in SG&A, dropping from 14% to 12.5% of revenues, along with an improved CCC from 55 days down to 42 days.

However, these advancements were limited as SMPL lacks experience in this market segment. For John B., improvements were concentrated in segments where SMPL's expertise lies, in Trial & Snack Mixes. COGS/Revenue notably improved from 79.1% in 2023 to 60% in 2032, approaching SMPL's margin. CCC also improved from 89 days to 78 days mainly due to better inventory management, aligning with SMPL's efficient practices.

5. Valuation and LBO

Business valuation, the process of estimating the economic worth of a company, is pivotal for strategic decision-making in operations such as purchasing, selling, merging, or seeking financing. For our evaluation of SMPL, we utilized three core valuation methodologies: Discounted Cash Flow (DCF), Comparable Transaction Analysis (CTA), and Comparable Company Analysis (CCA), grounding our assessments in intrinsic and relative values.

For DCF the weighted average cost of capital (WACC) was utilized to discount the Unlevered Free Cash Flow (UFCF). In this process, debt and equity were considered at 25.7% and 74.3%, respectively, rendering a WACC of 7.86% for SMPL. The terminal value represented 71,3% and was calculated using the Gordon Growth Model, which considers a steady growth rate. For this, a conservative growth rate of 2% was used. In the end, the DCF approach yielded an EV of $3,602 million and a 15.5x EV/Adj. EBITDA.

Next, the CTA was employed, which assesses a company's worth based on similar transactions within the market. The most recent transactions were scrutinized and involved companies with similar financial performance and geographic reach, within a three-year time frame. From the median of the EV/EBITDA multiples, an EV of $2,645 million and a 11.4x multiple were obtained.

The third method, the CCA, compares the subject company to its industry peers. This method provides a market-based direction to valuation by aligning the firm's metrics with those of peers already trading in the stock market. Guided by criteria like industry, size, geography, and financials, a list of comparable companies was curated, ending up with median EVs ranging from $2,692 million to $3,163 million and multiples from 11.6x to 17.5x on EV/Adj. EBITDA and EV/EBIT, respectively.

Each of these methods brings unique insights to the valuation process. The DCF focuses on the company's inherent financial health and prospects. The CTA offers market context based on recent comparable transactions, and the CCA gives a real-time perspective of market sentiment. The combination of these methods anchored our valuation in both fundamental financial analysis and market dynamics. This approach culminated in an overall valuation wherein we averaged the results from these methodologies. The output yielded a comprehensive, adjustable, and accountable valuation of SMPL. The finalized valuation gave a median EV of $2,986 million, an EV/Adj. EBITDA multiple of 12.9x and an EV/EBIT multiple of 17.0x. This multifaceted approach to valuation underscored the complex dynamics of the financial market, the company's financial performance, and positioning, providing insights into its worth.

5.1. LBO

To accurately represent the uses of the model and their influence on the overall financial framework, a weighted average multiple was calculated, based on the estimated combined EBITDA of SMPL, John B., and Grenade, all of which are included in the LBO. The aim was to align the capital structure with the financing sources associated with the respective targets. This calculation resulted in an entry multiple of 12.4x, reflecting the impact of these acquisitions on the overall capital structure. The result of these calculations generated an entry purchase price of $4,178 million for SMPL, additional costs estimated at 4% of the EV are expected. These include fees for investment banks (about 2-3%) and due diligence advisors, along with consulting fees (another 2-3%). As such, the total investment, the total sources and uses, amounts to $4,412 million, financed through a mix of debt (51.7%) and equity (48.3%).

The debt component is projected to be 6.8x the total Adj. EBITDA, comprised of term loans A to C, with maturity times of seven, eight, and nine years, respectively, as well as the stretched-on debt with maturity of 5 years. These maturities are comparatively shorter due to stricter lending practices. Corresponding interest rates are set at the three-year swap rate plus a 3.5% to 5% spread, setting the term loans from A to C, at 8%, 8.5%, and 9.0%, respectively, offering higher coverage and mirroring the current interest environment. Additionally, there is a stretched senior debt of $700 million, which will be used for the targeted acquisitions. Considering the higher risk, this debt has an interest rate of 9.5%.

On the other side, the total equity amounts close to $2,131 million, divided mostly between the FRI (Fixed Return Instrument), with a multiple of 6.0x out of the total 6.3x, and Ordinary Equity. The FRI, valued at $2,027 million, is subject to a PIK-interest setup at 10.0%. Ordinary Equity includes a sweet equity component that is not fully realized until 2029, amounting to 20% of the ordinary equity. The sweet equity, as a general practice, equals double the total yearly management compensation, although in SMPL's case was considered only one year, equaling around $21 million. The gradual vesting of this equity incentivizes management to stay committed to the company through the duration of the investment period.

5.2. Returns

The planned investment in SMPL is projected to yield a money multiple of 4.5x along with an IRR of 24.0%, with the anticipation of an exit in 2029, marking a 7-year holding period. The anticipated exit EV is predicted to be around $10.759 million, considering the Adjusted EBITDA of $866 million generated in the terminal year 2029, and multiplying this with the exit multiple of 12.4x, as no multiple arbitrages were considered.

Diving deeper into the components of this exit value, according to the exit waterfall breakdown, we have net debt sitting at negative $582 million, and total equity at $11,341 million. In terms of institutional investor gains, the total investment amounts to $2,110 million. The return on this investment is expected to be impressive, with an IRR of 24.0%, a 4.5x money multiple, and total proceeds approximating $9,519 million. For management, the total investment would be around $21 million, but the windfall is substantial – with an IRR of 82.2%, a 66.7x money multiple, and proceeds reaching $1,392 million. The projected Adjusted EBITDA of $911 million in 2029 also stems from two crucial business segments: Grenade and John B.

6. Exit strategy

Four different exit options were studied, two of them being highlighted and recommended, considering each one's feasibility and perspective of higher returns for investors. The first one, the sale of the full company, was one of the most attractive. It would encompass an acquisition from a large conglomerate of brands looking for an opportunity to add additional brands to its portfolio and leveraging from the higher-growth segment of nutritional and healthy food and beverages to further expand the company and strengthen its market position. Despite being a very attractive exit option, as usually large conglomerates have the resources to acquire the full company, it may take longer to close due to strategic due diligence and regulatory approvals. Some potential bidders include Nestlé and PepsiCo, both with over $200 billion of market capitalization. In the past, PepsiCo acquired Quaker, an oats brand, for a total of $13.4 billion, which is a similar-sized target to SMPL at exit. The second strategy to be considered is the sale of separate brands to several strategic buyers. This strategy, even though could be more complex due to synergies between brands and regarding the timing and the management of sale processes in parallel, would allow for a larger number of potential bidders. One potential option would be to sell both Quest and Atkins due to size to Mondelez International to leverage the recent acquisition of Clif bar, one of SMPL's competitors, sell John B. Sanfilippo to General Mills, allowing for an increased market share in the nuts business, and sell Grenade to Glanbia to further strengthen the position in the UK and European market in the nutritional snacking sector. The secondary sale and an Initial Public Offering were not so highly recommended, the first one mainly due to the size of the business and the second due to risks, complexity, and costs associated.

7. Due Diligence

For the proposed acquisition of SMPL to proceed, a thorough DD process should be devoted to addressing four key risk areas around the add-on targets, operational adjustments, and financial dependence. With the primary emphasis on commercial due diligence, consideration will also be given to financial, legal, and technical aspects.

The first point to consider under the commercial due diligence would be the shift in the top management team of SMPL in 2022. This poses a high challenge in maintaining effective collaboration due to potentially different strategic priorities. This may cause the employees to face integration problems, leading to uncertainties in operational conduct. Another area for improvement is SMPL's high concentration of sales to a limited number of retailers, accounting for a significant portion of its net sales. Moreover, these relationships involve "at-will" contracts with no fixed recurring or minimum purchase requirements, subjecting the sales directly to market performance. The size of the account also exposes the company to demands for lower prices and preferences for private labels over SMPL's branded offering. Similarly, the company's supply chain is also limited to a few selected suppliers for its core ingredients and a restricted number of manufacturers. This keeps the company vulnerable to supply chain fluctuations. Another key risk is the new market entries through M&A. Expansion into new markets, such as Europe, requires in-depth due diligence and can distract from the core business. Moreover, M&A brings with them uncertainties such as intense competition, financial constraints, and valuation risks. Due diligence revealed additional risks, such as the company's susceptibility to changing consumer preferences and the imperative for expansion into new markets. All these factors must be weighed before SMPL's acquisition.

Individual Part – Tomás Dias

Valuation

1. Valuation Methods

The complex process of estimating the economic worth of a firm or organization is known as business valuation. This critical procedure is used to determine a firm's intrinsic or fair market worth, assisting owners in critical decision-making processes such as purchasing or selling a company, obtaining cash, or merging with another company. A variety of elements are considered throughout the valuation process, including the company's assets, liabilities, past, present, and forecasted financial performance, as well as industry trends.

A company's value can be determined by applying particular, predefined metrics, such as EV/Revenue, EV/EBITDA, EV/EBIT, and P/E ratios, and by comparing it to similar businesses. The concept of this strategy is that similar assets should be assigned similar valuations. Professionals commonly identify comparable organizations by researching comparable public corporations (Comparable Companies Analysis) and prior transactions (Comparable Transactions Analysis).

On the other hand, evaluating a company's worth exclusively on its inherent value, as determined by the present value of its anticipated future cash flows, is called Discounted Cash Flow analysis, which is one of the most commonly used methodologies. Furthermore, the evaluation of "Value" includes both Equity Value and Enterprise Value. The value of all assets owned by a corporation that is available to equity investors, such as common shareholders, is defined as equity value. Enterprise value, on the other hand, denotes the value of the company's core assets, which are purely tied to its essential business activities and are available to all investors, including stock and debt holders. The following sections will dive into the complexities of the most common valuation methodologies, giving insight into the extensive process of evaluating a company's worth, and the overall methodologies and values obtained for the valuation of Simply Good Foods (SMPL).

1.1. Comparable Company Analysis and Comparable Transactions Analysis

Comparable Transactions Analysis (CTA) serves as a pivotal method within the realm of relative valuation, offering a nuanced approach to understanding a company's worth based on comparable transactions. The primary distinction lies in its reliance on real-world transactions, aiming to determine the value assigned to a company by scrutinizing prices paid in analogous deals. Stringent criteria, encompassing factors such as geography, industry, size, and financials, are applied to establish a meaningful comparison. Notably, the temporal element is introduced to ensure that the selected transactions are temporally proximate, avoiding distortions arising from distant market conditions (A. Damodaran, 2012).

The construction of the valuation Peer Group forms a critical step in the CTA process. This involves meticulous selection, considering the geographical and industry relevance, size congruence, and financial parameters, such as deal size and EBITDA. Once the Peer Group is defined, attention turns to extracting pertinent factors from the income statements of these comparable companies. These factors are then meticulously compared with capital market information or enterprise value, resulting in key ratios. These ratios, often encapsulated by metrics like EV/Sales and EV/EBITDA, are subsequently applied to the target company under evaluation.

Despite CTA's advantages in offering insights grounded in actual transaction data, it is not without drawbacks. Its susceptibility to business cycles and market conditions introduces volatility, potentially leading to distorted valuations. Furthermore, CTA's short-term focus may not capture the long-term trajectory of a company's development.

In the course of this research, five transactions within companies of the sector were taken into consideration. Specific requirements were set, focusing on companies with comparable geographies, which ranged from the USA to Greece, Italy, and Sweden, with similar financial performances, and a reasonable three-year time horizon, with the latest transaction dating to April 2020. The chosen time frame, aimed at prioritizing more recent transactions, is perceived as more beneficial for the analysis. Among the transactions, some were deemed valuable but less accurate due to factors such as deal size, such as the acquisition of Gastronomica Roscio, an Italian manufacturer of chilled and frozen meals, being lower than the market value of Smart Foodservice Stores LLC. Additionally, certain transactions were considered less precise due to differences in business models, as exemplified by the acquisition of Vivartia Holding S.A., which has a broader business plan and also focuses on other sectors.

These transactions, along with those detailed in the appendix, were identified as the most pertinent for analysis. However, it's crucial to acknowledge the challenges faced in information collection, owing to a limited number of recent transactions in the sector and a lack of detailed data. Subsequent to the selection of these transactions, the EV/EBITDA multiples were collected and analyzed, which generally yields better estimates than EV/EBIT (E. Lie and H. Lie, 2019). Looking at the range, this multiple was very consolidated, with a minimum of 10.0x and a maximum of 12.5x, which translated into an estimated Enterprise Value ranging from $2,320 million to $2,900 million. The median multiple derived from this distribution was then calculated, yielding a valuation multiple of 11.4x. This multiple corresponds to an enterprise value of $2,645 million, providing valuable insight into the potential market valuation for SMPL.

CCA, as the counterpart to CTA, shifts the focus to examining the current stock prices of comparable companies. This method aims to unravel the hypothetical value a target company would command if publicly listed, drawing comparisons with counterparts already trading in the stock market. Criteria for comparability, including geography, industry, size, and financials, remain integral in selecting companies for the CCA. CCA boasts advantages such as the availability and recency of data, relying exclusively on listed companies, for this case.

The valuation Peer Group in CCA is crafted based on these listed companies, allowing for real-time market data updates. Within CCA, metrics like EV/Sales and EV/EBITDA emerge as go-to measures, with EV/EBITDA particularly valued for its resilience against divergent accounting standards and reflection of operating cash flow. While CCA offers a market-based, up-to-date valuation method, challenges still exist (E. Lie and H. Lie, 2019).

The reliance on market conditions exposes CCA to potential distortions during market irrationality, especially for smaller market capitalization companies or those with limited free float of shares. Additionally, finding suitable listed peer companies, especially in niche markets, may lead analysts to loosen search criteria, introducing potential selection bias. Despite these challenges, CCA stands out for its quick calculation of fair value and relative simplicity.

To perform the Comparable Companies Analysis for Simply Good Foods, a meticulous process was employed in which seven companies were initially identified. These companies aligned closely with the industry, product offerings, and key financial parameters of SMPL. The initial focus was on nutritional snacking and weight management sectors, chosen for their relevance as reference points for the valuation approach applied to the company in question, SMPL. The comparison was conducted at a granular level, scrutinizing factors such as business models and end-products, spanning categories like nuts, sweet and salty, chips, and protein bars, with the main goal of finding companies as similar as SMPL.

The finalized list of comparable companies included Post Holdings, Hostess Brands, The Hain Celestial Group, TreeHouse Foods, Pilgrim's Pride Corporation, John B. Sanfilippo & Son, and Glanbia. However, following a rigorous assessment of EV/Adj. EBITDA multiples for the year 2022, it was carefully decided to exclude TreeHouse Foods and Pilgrim's Pride Corporation from the Comparable Companies Analysis. This strategic refinement, by removing outliers well below averages for that year, ensures a more accurate and insightful evaluation tailored to the specific nuances of the industry and Simply Good Foods' positioning within it.

Looking at the Peers Summary, throughout the CCA, 4 multiples were calculated. They ranged from P/E ratios, EV/Revenue, EV/EBITDA, and EV/EBIT, which were all calculated both for the last twelve months (LTM) and for the last five years' average (L5FY). Out of these options, only four were considered for the entire valuation of Simply Good Foods, being both EV/EBITDA LTM and L5FY average, as well as both EV/EBIT LTM and L5FY average.

In terms of EV/EBITDA, but more specifically EV/Adj. EBITDA for the last five years gave a median multiple of 11.6x and a mean multiple of 11.7x, which corresponded to an overall Enterprise Value of $2,692 million. In comparison, EV/Adj. EBITDA for the last twelve months had a median multiple of 13.6x, and a mean multiple of 13.0x, which represented an implied EV of $3,163 million. Additionally, EV/EBIT for the last twelve months and for the last 5 years gave a median multiple of 16.2x and 17.5x, respectively. This then corresponded to an implied EV of $3,023 million for the last five years' avg. and an EV of $2,790 million for the last twelve months.

<u>1.2. Discounted Cash Flow Analysis</u>

The most discernible difference between relative and intrinsic valuation approaches lies in the fact that the latter forms an asset's worth based on its future cash flow projections, not on its perceived market value. To determine this value, the anticipated business growth is taken into account, as well as profitability margins, and investments in new business assets. The two foremost methods used in intrinsic valuation are the Dividend Discount Model (DDM) and the Discounted Cash Flow Model (DCF). For instance, the DCF approach considers a corporation's operational and non-operational investments, deducting the value of outstanding debts to yield the ultimate estimation of Equity Value. In contrast, the DDM concentrates on assigning value to a company's equity by discounting its anticipated dividend payments.

In Simply Good Foods' case, the Discounted Cash Flow Analysis was the chosen approach. The DCF analysis is a key part of the Enterprise Value (EV) methodologies, which espouses the principle that all providers of capital, both equity and debt holders, are entitled to the cash flows of the firm. This approach necessitates an accurate forecast of an enterprise's financial performance, from which the relevant Unlevered Free Cash Flow (UFCF) can be deduced. For these calculations, the following formula was used:

$$FCF = EBIT\ (1 - Tax\ rate) + D\&A - \Delta NWC - CapEx$$

Subsequently, these UFCFs are discounted utilizing the weighted average cost of capital. The WACC epitomizes the return expectations of both equity and debt capital providers, reflecting the diverse risks linked to both forms of financing. For the WACC calculation, the following formula was utilized:

$$WACC = k_E \left(\frac{Equity}{Equity + Debt}\right) + k_D\ (1 - Tax\ rate) \left(\frac{Debt}{Equity + Debt}\right)$$

Debt and Equity were considered to be 25.7% and 74.3%, respectively, translating into a WACC of 7.86% for Simply Good Foods Co. In this model, the cost of equity is mainly retrieved using the Capital Asset Pricing Model (CAPM), where $k_E = r_f + MRP \times \beta$. The Risk-Free Rate within CAPM symbolizes what an investor could earn on a government bond that's safe and denominated in the same currency as the organization's cash flows. Considering that SMPL is from the United States, the 10-year U.S. Treasury rate was used, resulting in a risk-free rate of 2.98%. The Market Risk Premium indicates the excess return of the stock market where the company operates, over that of safe government bonds, which returned a value of 5.96% using *Statista*. The Leveraged Equity Beta (LEB) represents the relative volatility of a company compared to the general market, considering both inherent business risks and the risks derived from leverage. In determining the cost of equity for a company, a standard approach might involve using the company's historic LEB. Yet, a more refined method, which is commonly employed, involves comparing the LEB of similar companies in the same industry and then de-levering it to separate the intrinsic business risk. Subsequently, to account for the increasing risk brought about by shifts in the capital structure, the de-levered Equity Beta is re-levered, pertaining to the organization's existing, planned, or ideal capital structure. The value used for the unlevered beta of the industry was 0.75, which then, re-levered, increased to 0.95. Using the above formula, the cost of equity was then calculated to be 8.67%. Looking at the cost of debt, using the already mentioned risk-free rate, a 21% tax rate, and a 7% interest rate, the post-tax cost of debt was calculated to be 5.51%. Once the WACC was calculated, it was then possible to discount the unlevered free cash flows of the company in each year to obtain their present value.

The latter stage of the DCF valuation process focuses on the terminal period, particularly on determining the terminal value (TV). Unlike the forecasted period, during the terminal period, the growth rate and discount rate remain constant indefinitely (T. Koller, M. Goedhart, and D. Wessels, 2005). In the current practice, the Gordon Growth Model (GGM) was utilized to calculate the TV, using the following formula:

$$Terminal\ Value = \frac{FCFn \times (1+g)}{(WACC - g)}$$

The Gordon Growth Model assumes perpetual growth, suggesting that the company will continuously generate cash flows at a stable rate (A. Damodaran, 2012). The exit multiple approach, on the other hand, assumes a scenario akin to relative valuation, where the company's worth would be a multiple of a particular market metric at the time of sale. The GGM is typically favored by academics, while practitioners lean toward the exit multiple approach.

Computing the TV is crucial, as it usually represents 60-80% of the company's total worth (Gordon, 1959). The growth rate is also one of the most considerable influencers of the TV when applying the Gordon Growth Model, so it's appropriate to use realistic assumptions for this rate. It is often assumed in practice that the company will grow at a rate equivalent to the country's economy forever. However, such an assumption may not be valid if one considers an infinite time horizon, as this would imply that the company might eventually exceed the size of the entire economy, an unrealistic prospect. When the long-term GDP growth of a country is highly uncertain or its government is troubled, the validity of the Gordon Growth Model comes into question. In such scenarios, the exit multiple approach could be more suitable. For SMPL's case, a growth rate of 2% was utilized. The last step in a DCF valuation involves discounting the terminal value at the WACC and incorporating this discounted value into the present value for the entire projected period. When adding all the present values of the free cash flows, this resulted in a value of around $1,035 million, representing 28.7% of the total EV. When discounting the TV at the WACC, this resulted in a value of $2,568 million, accounting for 71.3% of the total EV. Combining these two values, resulted in an overall Enterprise Value of $3,602 million and an implied EV/Adj. EBITDA multiple of 15.5x. Finally, a sensitivity analysis was carried out for the firm's valuation and the consequent EV/Adj. EBITDA multiple by fluctuating the WACC discount rate, from 6.9% to 8.9%, and the terminal growth rate, from 1.0% to 3.0%. The evaluation showed that these values intensified with a rise in the terminal growth rate and contracted with a surge in the discount rate.

1.3. Entry Multiple

In summarizing the valuation process, various methodologies, including the DCF, CTA (Comparable Transaction Analysis), and CCA (Comparable Company Analysis), were utilized. Each method offers unique insights into the company's value, and when combined, they provide a comprehensive and reliable assessment. For this combination, we used six metrics from these three methods and then calculated an average of the median Enterprise Value.

The DCF valuation method involved the discounting of projected cash flows and the expected terminal value (TV) at the end of the forecast period. The various parameters such as Weighted Average Cost of Capital (WACC) and growth rate, which influenced the TV, were meticulously calculated. This provided an in-depth exploration of the company's inherent financial strength and future potential by considering aspects such as growth rate, margin profitability, and investments in the business. The median EV obtained from this method was $3,602 million, which translated into a 15.5x EV/Adj. EBITDA multiple.

Concurrently, in the CTA method, there was a focus on examining similar recent market transactions to Simply Good Foods. This analysis included several evaluation metrics, however, the one being used was EV/EBITDA, with an implied EV of $2,645 million, and a multiple of 11.4x. This approach provided a complementary perspective that reflected the current market performance and investor sentiment, giving contextual guidance to the valuations.

The CCA method uses a comparative approach wherein Simply Good Foods is compared to its industry peers to align the firm's metrics with those of the comparable companies. This reality check offers valuable insights, which help refine and adjust the initial assumptions and projections. Among the four lines used were EV/Adj. EBITDA, for the last twelve months and the last 5 years average, with an EV of $3,163 million and $2,692 million, respectively. This translated into a median multiple of 13.6x and 11.6x, respectively. The other two lines used were EV/EBIT, as well both for the last twelve months and the last five years' average. Respectively, this resulted in an EV of $2,790 million and $3,023 million, and consequent multiple of 16.2x and 17.5x.

By integrating the outputs from the DCF, CTA, and CCA methodologies, an inclusive valuation was formulated. This multi-faceted approach led to the derivation of averages that grounded the final valuation in both fundamental financial analysis as well as market conditions. This process, therefore, provided a robust, justifiable, and well-informed valuation of the company's worth. Thus, the overall valuation process was thorough, flexible, and responsive to the complexities of the financial markets and the company's operational environment. Calculating the median averages, this resulted in an Enterprise Value of $2,986 million, an EV/EBITDA multiple of 12.9x, and an EV/EBIT multiple of 17.3x. Moreover, the approach involved calculating a weighted average multiple based on the estimated combined EBITDA of SMPL, John B., and Grenade. This calculation aimed to align the capital structure of the model with the financing sources associated with the respective targets. By factoring in the impact of these acquisitions on the overall capital structure, an entry multiple of 12.4x was determined. This method was utilized to accurately represent the funding origins of the targets and their influence on the overall financial framework within the model.

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