

February 6, 2014

## **SodaStream: Why the Fizz Just Went Out of the Short Position**

After a year which promised hyper-growth, but delivered somewhat less than spectacular earnings, SodaStream (NASDAQ:SODA) ended trading yesterday at a 52 week low -- but now everything has changed.

The news of the day in today's market is the 10% investment of Coca Cola in Green Mountain Coffee, with the goal of establishing a definitive market for single serve cold beverages. After hours, the market reacted as though it was SODA's "Uh-Oh" moment ... But really?

### **The thin line between competition and proof of concept**

While Citron does not hold itself out to be a beverage analyst, we think it fair to state that Coca Cola understands this competitive space better than anyone. So what does this mean for SodaStream?

### **The Perfect Storm**

Short-sellers ought to look at yesterday's news as the perfect storm of bad news.

- The stock has closed at a 52 week low
- Short interest is near its 52 week high. As of Jan 15, 2014, it was [8.7 mm shares](#) or 42% of the outstanding -- that's 54% of the float.
- The story has completely changed -- and it will take years to disprove the thesis

## Enter Pepsi



It is an understatement to say that Coke vs Pepsi is a pre-eminent corporate rivalry. Every credible news source would call this the greatest corporate rivalry in the history of business.

<http://money.cnn.com/gallery/news/companies/2013/03/21/greatest-business-rivalries.fortune/2.html>

<http://www.dailyfinance.com/photos/50-greatest-business-rivalries-of-all-time/>

Every business school in the world uses these two companies as exhibits #1 and #2 when discussing competition.

This is no 3-rounder for flyweights, either; it's a 15 round heavyweight bout.

Coke has Minute Maid, Pepsi has Tropicana.

Coke has Powerade; Pepsi has Gatorade.

Coke has Sprite; Pepsi has 7-UP

Coke has Dasani and SmartWater; Pepsi has Aquafina

Coke has Odwalla; Pepsi has Naked Juice ... it goes on and on.

Gee, do you think there's a pattern here?

These two giants have been playing "Prisoners Dilemma" – Fortune 100 version – for years. Now Coke has made their move into the at-home beverage market. What are the chances Pepsi won't respond?

The idea isn't even all that new. BusinessWeek had it 8 months ago:

<http://www.businessweek.com/articles/2013-06-06/two-reasons-for-pepsi-to-think-twice-about-sodastream>

Only problem was, the stock was nearly double its current price, and they were talking about 100 per share for SODA.

What is Pepsi going to do? Unless they believe that Coke is **DEAD WRONG** -- they have no choice: Hello SodaStream!

## Adding a little “fizz” to the story:

While we don't by any means predict a deal this rich, it only shows the danger of the short position as of this game-changing deal from this morning forward.

- SODA has 20.7 million shares outstanding and a current market cap of \$725 million. Coke paid \$1.25 billion for a 10% stake in GMCR. If Pepsi were to pay \$1.25 billion to invest in SODA, they **would be paying \$60 per share and could buy all of SodaStream.**
- GMCR has 148.9 million shares (before considering the Coke investment). It gained \$36.45 after hours, adding \$5.43 billion in market cap, despite core GMCR earnings being not that good. So if you attribute all of this gain in market cap to the Coke investment and the prospect of the Keurig Cold, which does not even exist, you have the Keurig Cold being worth \$5.43 bn.
- If SODA were to be worth this amount (despite being well further down the path and having the distribution network etc.), **SODA shares would be valued at \$262 per share. If they only got 50% credit for the GMCR uplift in value, SODA shares would be worth \$131 per share**

This reminds Citron of the moment two years ago when Apple announced its entry into the streaming music space. At the time the leader was Pandora. On the day of the announcement Pandora stock dropped 17% ... but it is now over 350% higher.

Remember this moment?

<http://www.hypebot.com/hypebot/2012/09/pandora-stock-drops-in-wake-of-news-apples-coming-music-service-.html>

## That dangerous line between competition and proof of concept

Pepsi has no place else to turn. Not only is SodaStream the leader in make-it-at-home cold beverages, they have other advantages:

-  SODA has a brand in the industry for homemade cold and carbonated beverages.
-  They are currently the only player in this space of any consequence
-  They have a substantial global footprint (the non-North America market is more than 50% of their revenues)
-  SODA already has built and earned a distribution network. It has a presence in many of the major retailers and also has an effective network for the distribution and refilling of the Carbon Dioxide canisters, which are the key to the machine.

The difference between SODA as a product and other consumable food is that the CO<sub>2</sub> canisters are not just one-time use and throw away, but they need to be refilled to keep things economical. And they have the logistical support for this.

## SODA has already begun establishing significant strategic relationships: (2013 to date)

-  Welch's Juice Drinks on Jan, 29, 2014:  
<http://sodastream.investorroom.com/2014-01-29-SodaStream-and-Welchs-Announce-a-Partnership-to-Bring-Together-Homemade-Bubbles-and-Welchs-Juice-DrinkS>
-  Updated Ocean Spray on Nov 13, 2013:  
<http://sodastream.investorroom.com/2013-11-18-Cranberries-Meet-Bubbles-SodaStream-Launches-Ocean-Spray-Co-Branded-Flavors-with-a-TV-Commercial-Featuring-the-Popular-Ocean-Spray-Veteran-and-Rookie-GrowerS>
-  Del Monte on Nov. 12, 2013:  
<http://sodastream.investorroom.com/2013-11-12-Del-Monte-and-SodaStream-Announce-a-New-Series-of-Fruity-Flavors-for-the-SodaStream-Home-Carbonation-System>
-  Cooking Light on Oct. 24, 2013:  
<http://sodastream.investorroom.com/2013-10-24-Cooking-Light-and-SodaStream-Join-Forces-to-Offer-Delicious-Naturally-Sweetened-Flavors-for-the-SodaStream-Home-Soda-Making-System>
-  KitchenAid on June 17, 2013:  
<http://sodastream.investorroom.com/2013-06-17-KitchenAid-Enters-Home-Soda-Category-in-Collaboration-with-SodaStream>
-  Ocean Spray on Feb. 27, 2013  
<http://sodastream.investorroom.com/2013-02-27-SodaStream-and-Ocean-Spray-Announce-Partnership-to-Bring-Homemade-Sparkle-to-Cranberry-Juice-Flavors>
-  SODA's partnership with Samsung on refrigerators:  
<http://sodastream.investorroom.com/index.php?s=43&item=101>

These partnerships demonstrate substantial IP value here in addition to the base business and the SodaStream brand. More importantly, note the collaboration with Ocean Spray, already a major collaborative partner with Pepsi:

<http://www.zacks.com/stock/news/67995/Pepsi-Gets-Juicier-With-Ocean-Spray>

## So What if We Are Wrong, And Pepsi Does Nothing?

First, the shorts will have to go to bed every night hoping that tonight is not **the** night of the news (we have been there before and it is not fun – you really have to do your homework, and even then...) Moreover, you are not short a company that is going to 0 or a company that just thought about entering the do-it-yourself cold beverage business. They are a substantial force in that business, and they built it on their own, a significant achievement.

SODA has a market cap of \$725 million as of the close of trading after hours. It has \$20 million of net cash (\$40 million of cash and \$20 million of debt). For this, you get a company which did \$562 million in revenue in 2013, up 29% from their 2012 sales levels. The company had 2012 EBITDA of \$56 million and had exceeded that through 9 months in 2013, with full year estimates of \$70 million for 2013.

If Pepsi were to invest in SodaStream or buy it outright, they are not just buying a concept. For 2014, SodaStream projects \$666 million in sales (18.5% growth) with \$79 million in EBITDA. These estimates are the lowered numbers: they are adjusted down for the Q4 warning on January 13<sup>th</sup>.

Revenue was modestly below expectation (\$562 million vs. estimates of \$565 million), however they had significantly lower profitability (adjusted net income of \$52.5 million vs. expectations of \$66 million)

Additionally, the company has been subject to various anti-Israel boycotting campaigns, which has hurt the image slightly. We consider this to be mostly empty noise, and not impactful of future valuation. Defenses of the company are already appearing in the press. But regardless, there is unlikely any financial impact longer term, especially if they draw a large partnership or buyout offer.

How much more negative can things get? The low analyst target is Stifel at \$34.



## Conclusion

Who knows how this plays out? Did Coke just waste its money? It is not for Citron or any other analyst on the Street to guess this one. We can only assume that the people at Coke have done their research before spending \$1.6 billion, plus shouldering the brand reputation risks. In the meantime, we believe that SodaStream should be able to attract a perma-bid until we get commentary or action out of Pepsi.

**Cautious Investing to All – on Both Sides of a Deal.**