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FlowersFoods

A BROKEN BUSINESS MODEL

BEST IDEA: SHORT FLOWERS FOODS (FLO)

August 9, 2016

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*ANSWERED AT THE END OF THE CALL

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HEDGEYE CONSUMER STAPLES BEST IDEAS LIST

LONG LIST		TRADE	TREND	TAIL
1) CAG	ConAgra Foods	✓	✓	✓
2) WFM	Whole Foods Market	✓	✓	✓

LONG BENCH	
GIS	General Mills
PEP	PepsiCo
THS	Treehouse Foods

SHORT LIST		TRADE	TREND	TAIL
1) FLO	Flowers Foods	X	X	X
2) KR	Kroger	X	X	X
3) SVU	SUPERVALU	X	X	X
4) CPB	Campbell Soup Co.	X	X	X

SHORT BENCH	
NUS	Nu Skin
HAIN	Hain Celestial

Bench = timing is not right, or research is in progress.

KEY POINTS

1

THE CORE BUSINESS IS STRUGGLING IN ITS CURRENT STATE

In the baked goods category, where the shelf-life is three to seven days (FLO runs at a three day), the DSD model is the only alternative. Unfortunately, the consolidation of retailers over the last 20 years has made this form of delivery very unprofitable for the distributors. Now, given the growing number of SKUs in the FLO's portfolio it is getting increasingly difficult to execute, causing a slowdown in volumes.

2

THE CURRENT BUSINESS MODEL IS BROKEN

Given the dynamics, FLO has had to alter its business model to improve profitability, which is now being tested in the court of law. The intense scrutiny of the business model will prove that it is not a viable way of doing business in its current state. In addition, this could also lead to further scrutiny around the company's accounting policies from the SEC. Two other potential issues that could come up are revenue recognition and allowance for doubtful accounts.

3

CHANGES TO THE MODEL HAVE DEVASTATING CONSEQUENCES

Historically the company has always settled its misclassification suits "on the courthouse steps." In June, the judge in the Rehberg v. Flowers case put the company in a very precarious position – settle or go to trial. The company can't settle because it would be so damaging to the way they operate today. Trial appears to be imminent. The chances of the company winning appear slim and will likely be demoralizing to the company. There are multiple paths this can go, none of which are a positive for FLO.

DATA SOURCE: HEDGEYE.

COMPANY OVERVIEW

COMPANY OVERVIEW

Company Overview

- Flowers Foods (FLO) is a producer, marketer and distributor of bakery products in the United States.
- FLO's origins date back to 1919, they later went public in 1968 trading as an OTC stock, and then in 1982 got listed in the NYSE.
- FLO operates through two business segments:
    1. Direct-Store-Delivery (DSD): 84% of sales
    2. Warehouse Delivery: 16% of sales
- FLO has grown successfully through M&A and organic expansion, expanded their network to improve their coverage of the U.S. population from 38% in 2003 to 85% as of 2015.
- This aggressive growth would not have been possible if not for their DSD system, which allows them to push much of the cost to run a route onto the independent operators (IO) who run the routes.
- The company currently has 5,100 independent distributors who own the rights to their respective routes, FLO has 600 company-owned routes which are available for sale and an additional 230 company-owned routes which are not available for sale, for a total route count of 5,930.
- FLO's largest headwind outside of the fundamental business are the misclassification allegations they face in 23 different cases, which we will delve into much deeper during this presentation.

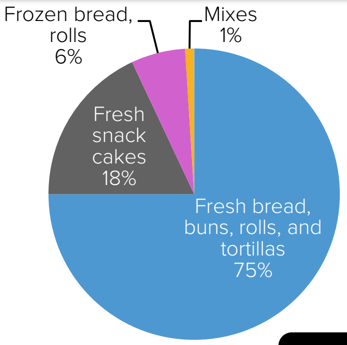
Management Team

- **President and CEO: Allen Shiver**
    - Joined FLO in 1978, has been in current position since May 2013
    - He has served various positons across the company, including CMO and COO
- **EVP and CFO: Steve Kinsey**
    - Joined FLO in 1989, has served in current position since May 2008
    - Has served in the past as Corporate Controller and Director of Tax
- **EVP, Secretary and General Counsel: Stephen Avera**
    - Joined FLO in 1986 has been in current role since May 2008
- **EVP and COO: Bradley Alexander**
    - Joined FLO in 1981, named EVP and COO in July 2014
- **President, Flowers Bakeries: D. Keith Wheeler**
    - Joined FLO in 1988, named to current position in July 2014

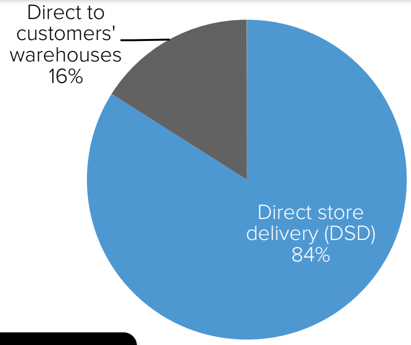
DATA SOURCE: COMPANY FILINGS, HEDGEYE.

FLO BUSINESS BREAKDOWN

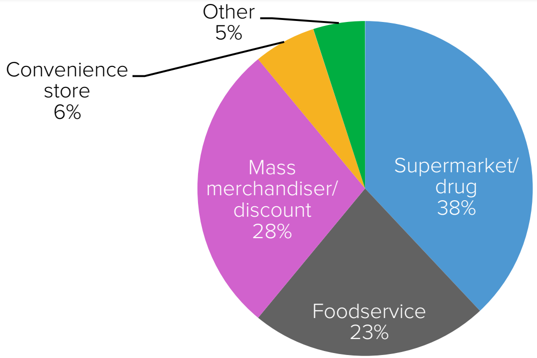
Product Mix



Distribution

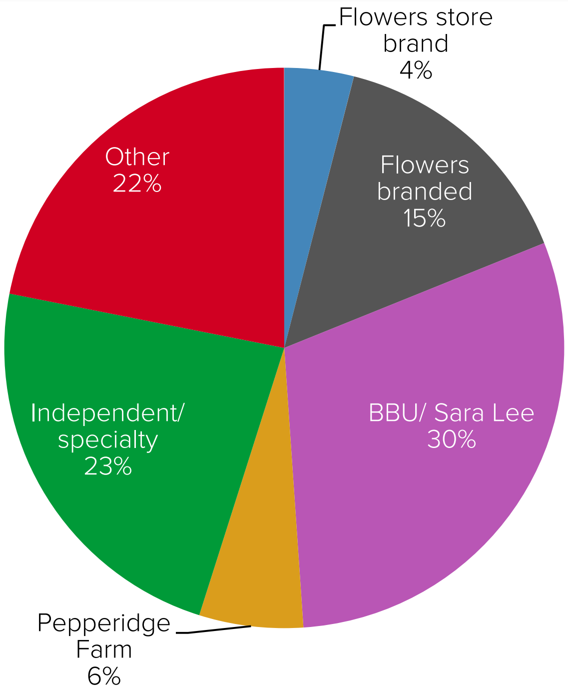


Sales Channels



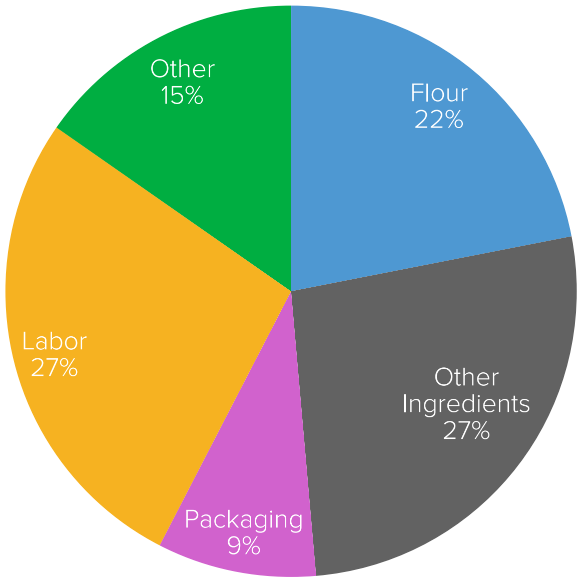
FLO BUSINESS BREAKDOWN (CONT'D)

Brand Share



*Breads, Buns, Rolls updated Q4 2015. IRI total US Census Region MultiOutlet data 52 weeks ending 1/03/16; chart data should not be used for historical comparisons because of changes in geographic definition.

COGS Breakdown



M&A DRIVEN GROWTH

February 2006, FLO acquired Derst Baking Co. for an undisclosed amount. Derst employed 475 people operating 165 DSD routes serving SC, GA and north FL

August 2008, FLO acquired Butterkrust Bakery, a frozen and non-frozen bakery and dessert products for $91.3mm

October 2009, FLO acquired Leo's Foods, a maker of tortillas for an undisclosed amount

July 2012, FLO acquired Lepage Bakeries for $370mm, expanding geographical reach in New England and NY

July 2013, FLO acquires Aryzta Buns and roll business in Modesto, CA for $10.4mm

September 2015, FLO acquired Dave's Killer Bread for $275mm

2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016

August 2008, FLO acquired Holsum Bakery for $150mm, Holsum had two bakeries in Arizona

May 2009, FLO acquires GIS's fresh bread mixes business with a facility in Cedar Rapids, Iowa for $8.3mm

May 2011, FLO acquired Tasty Baking Co. for $148mm, Tasty had 740 employees and 413 IO's

July 2013, FLO acquired the assets and operations of Hostess' bread business for $355mm

October 2015, FLO acquired Alpine Valley Bread Co. for $120mm

DISTRIBUTION REACH

- FLO has significantly grown their reach from 38% of the U.S. population in 2003 to approximately 85% at the end of 2015
- FLO operates 39 bakeries and 10 warehouse distribution centers
- This growth, as previously shown, has been heavily driven by M&A
- The recent acquisition of Dave's Killer Bread (DKB) for instance expanded their geographic reach into the Pacific Northwest

DATA SOURCE: COMPANY FILINGS, GOOGLE MAPS.

COMPETITIVE LANDSCAPE

TWO KEY TENETS TO THE FUNDAMENTAL STORY

Retailer Consolidation

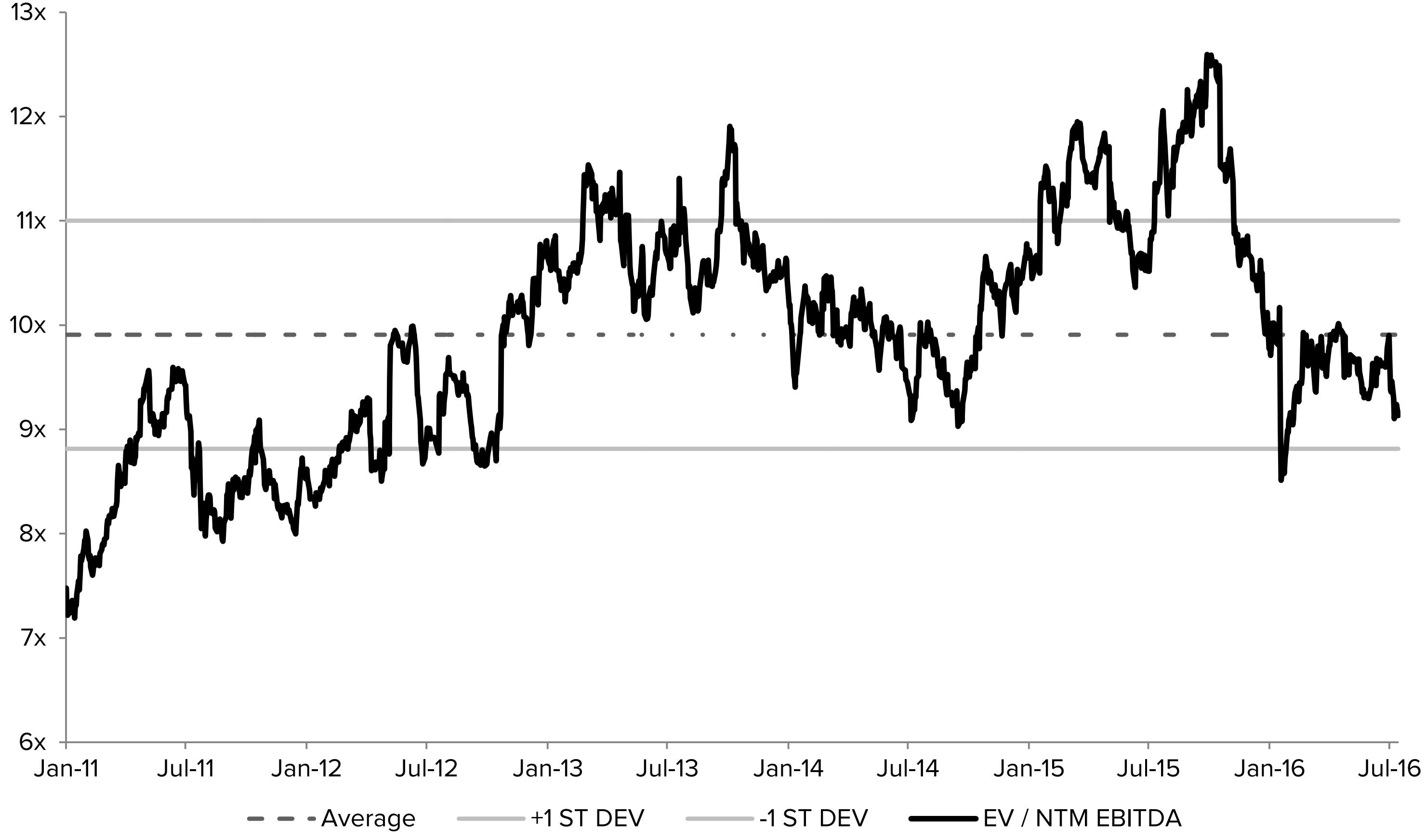
- The consolidation of food retailers has had ripple effects across the food supply chain and the baking segment is no exception
- Back in the mid 1980's when the independent operator model was conceived, it was a great business opportunity for IO's, they had the ability to network with independent stores and grow the value of their routes and increase their income
- Now with so few independent retailers the ability to do so is near impossible
- And even worse for the IO's is that they have nearly no ability to choose pricing, product or sometimes even time of delivery, this is all driven from the corporate level (yes we know this sounds like they are employees, we will get to that later)

Bakery Competition

- Hostess' bankruptcy in January 2012 significantly changed the baking industry landscape which shifted sales to the remaining competitors
- Flowers was the beneficiary of some Hostess bread assets, most notably *Wonder*. Acquiring them in July 2013, and re-introducing them to the marketplace at the end of 3Q13
- Flowers Foods holds the number two market position in bakery, Bimbo is currently number one with Pepperidge Farm (Campbell's) coming in third
- Store brands have been a relatively consistent threat to sales over the last five years, which account for approximately 26% of the dollar sales and 39% of the unit sales of the retail fresh packaged bread category

DATA SOURCE: COMPANY FILINGS, HEDGEYE.

5 YEAR VALUATION TREND

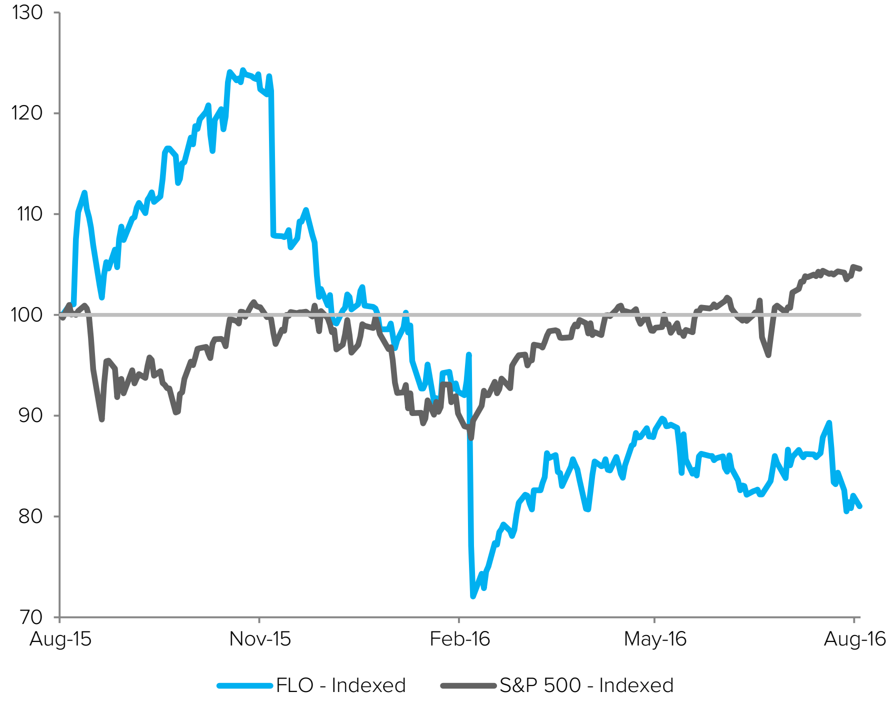


- FLO is currently trading slightly below its five year average EV / NTM EBITDA multiple which is roughly 10x, at 9.53x
- Given the deteriorating fundamentals alone, we see the ability for this stock to trend lower, yes it is “cheap” versus 12 months ago, but it’s not cheap relative to its longer term history
- And with the potential of the entire operating model of the company changing, the business would be a far less appealing investment

PRICE PERFORMANCE VERSUS THE S&P 500

TRADING WELL BELOW THE MARKET IN BOTH TIME PERIODS

1 Year Performance



3 Year Performance

DATA SOURCE: FACTSET, UPDATED ON 8.8.16.

"A material negative change in our relationship with the independent distributors, litigation or one or more adverse rulings by courts or regulatory or governmental bodies in various jurisdictions regarding our independent distributorship model, including actions or decisions that could affect the independent contractor classifications of the independent distributors, or an adverse judgment against the company for actions taken by the independent distributors could materially and negatively affect our financial condition, results of operations, and cash flows."

-Flowers Foods (FLO) 2015 10-K

MISCLASSIFICATION ALLEGATIONS

BACKGROUND ON THE DSD SYSTEM AND HOW WAGE AND HOUR MISCLASSIFICATION SUITS CAME TO BE

The Creation of the DSD Route System

- Earlier in its history, Flowers' delivery drivers were employees. In the 1980's, Flowers adopted a model that privatized its routes, which it sold to independent distributors (IO's). According to Flower's most recent 10-K (filed Feb 2016), the DSD segment currently relies on 5,100 IO's to deliver food in their geographic markets.
- Distributors pick up product from Flowers' warehouses and deliver them to customers in a defined territory. Distributor's job duties include delivering products to customers, restocking and organizing shelves, and removing stale product.
- Distributors buy routes from Flowers (or on the open market), typically financing them through the company. Distributors build equity in their routes as they pay down the note over time.
- They can also gain equity through growing sales in their territory, which is very difficult presently as most sales increasing are achieved through new store openings in your territory, which is out of your control.
- Most distributors lease a truck owned by Flowers in order to make deliveries. When Flowers decides to exit a territory or cease using independent distributions in that area, Flowers buys back the distribution rights.
- Flowers treats its distributors as statutory employees for FICA withholding and unemployment tax purposes. The IRS views the distributors as employees because distributors have no investment in a "facility," which does not include a truck or a route.

Wage and Hour Misclassification Suits

- According to an analysis prepared by NERA Economic Consulting, businesses settled 613 wage-and-hour lawsuits between January 2007 and March 2015 (an average of 75 per year), for a total of $3.5 billion.
- The number of wage-and-hour class actions settled increased from about 20 in 2007 to peak at over 100 in 2011 and 2012 (when distributors filed the class action against Flowers).
- The average settlement value is $6.9 million and the median settlement value is $2.2 million over this eight-year period.
- NERA found that the average and median settlement amount per class member was $5,742 and $2,576, respectively.
- The most frequent targets of wage-and-hour class actions are financial services/insurance, retail, and food and food services industries.
- The average settlement value for wage-and-hour cases against businesses in the food and food services industries was approximately $7 million in 2014-15. "facility," which does not include a truck or a route.
- If the higher range of these averages applied to FLO, then the settlement would be $29.3 million (5,100 distributors x $5,742). Based on the number of lawsuits, the potential settlement of all class actions would be higher -- $161 million (23 class actions x $7 million).
- We have reason to believe a more accurate estimate would be $510 million to $900 million, which we will go into more detail throughout the presentation.

ALLEGATIONS THEY FACE

- These lawsuits generally allege that Flowers misclassified its distributors as independent contractors when they are actually employees under state labor laws.
- The actions allege that Flowers sets the pricing, policies, and procedures for sales to retailers. According to the plaintiffs, Flowers dictates the products delivered and the delivery schedule, instructs distributors how products are to be stocked and displayed in stores, and requires distributors to use Flowers' computer system to log deliveries.
- The distributors allege that contrary to Flowers' representations, distributors do not have discretion to use their judgment to manage their businesses and increase profitability.
- According to the lawsuits, most drivers work more than 40 hours per week (often in the 50-60 hour range). And from talking with distributors it is often even longer, causing unsafe driving occasions.
- By classifying the drivers as independent contractors, the lawsuits allege, Flowers avoided paying drivers' overtime wages and deducted administrative and warehouse fees from the drivers' compensation.

DATA SOURCE: SHOOK HARDY & BACON, HEDGEYE.

TIMELINE OF THE REHBERG CASE

September 12, 2012: Complaint alleging the distributors of Flowers' Jamestown subsidiary were misclassified as independent contractors.

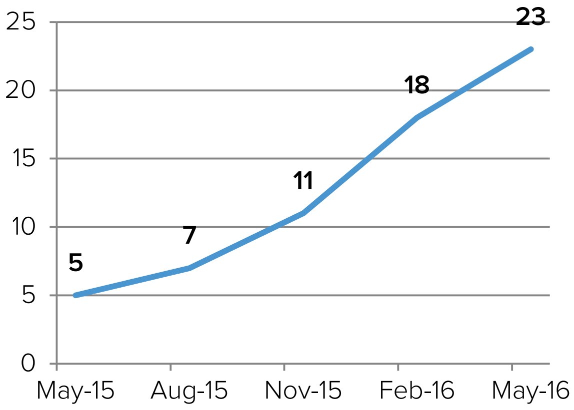
March 22, 2013: the court conditionally certified a collective action under the federal Fair Labor Standards Act (FLSA), finding the members "were together the probable victims of a single decision, policy, or plan."

February 12, 2016: The district dismissed Flower's motions for summary judgement, assuring that the litigation will continue to move forward. In so doing, the court ruled that releases of liability signed by former drivers when they sold their distributorships back to the company did not waive their claims.

June 9, 2016: The court urged the parties to attempt to settle the class action through mediation. Judge Max O. Cogburn, Jr., noted that "plaintiffs have raised substantial issues concerning wage and hour laws which, if proven in trial, could result in an award of back pay and other damages."

July 27, 2016: Plaintiffs file for motion for pretrial conference call. The plaintiffs claimed in their motion "to date, there is no agreement on a resolution of this matter and no further mediation sessions are scheduled." They went on to state they "have no intention to continue the mediation process given the lack of progress over the course of three full days of mediation in June and July."

of Lawsuits Filed



**For more detail on the case please request our FLO White Paper*

REHBERG CASE UPDATE

- June 9, 2016 The court urged the parties to attempt to settle the class action through mediation.

- Judge Max O. Cogburn, Jr., noted that "plaintiffs have raised substantial issues concerning wage and hour laws which, if proven at trial, could result in an award of back pay and other damages."

- However, Judge Cogburn pointed out to the plaintiffs that while this outcome would be favorable, "such a determination could, going forward, well result in loss of their investment in the distributorships and lower pay for hourly work."

- **Judge Cogburn also pointed out to Flowers that an unfavorable determination "could mean not just a monetary loss, but a loss of a business model, which, with the exception of this and sister litigation, has apparently worked well for this company and maximized sales of product."**

- Judge Cogburn encouraged the parties to "engage an appropriate neutral expert on structuring distributorship agreements to aid in the process."

DATA SOURCE: SHOOK HARDY & BACON, HEDGEYE.

RECENT DEVELOPMENTS IN OTHER CASES

- August 27, 2014 - The US Court of Appeals for the Ninth Circuit reversed the grant of summary judgement that FedEx drivers were employees as a matter of law under California's right-to-control test.
- The appeals court instructed the district court to enter summary judgment for the plaintiffs on the question of employment status.
- FedEx settled with ~2,000 drivers in California for $227mm and continues to fight similar litigation all over the country.
- March 2015 - Federal District Court Says Uber Drivers are Employees for Purposes of Summary Judgment.
- Bimbo lost lawsuit in Maine in early 2014 for treating distributor and fill-ins different as in hourly pay and offering benefits.

Flowers sets the pricing, policies and procedures for sales to retailers, IO's have no control, this business model can't exist in today's current retail environment.

DATA SOURCE: SHOOK HARDY & BACON, HEDGEYE.

IS FEDEX A PROPER PRECEDENT?

- Litigation against FedEx alleging that it misclassified its drivers as independent contractors suggests that the Flowers litigation is likely to settle for a significant sum and require substantial changes to the distribution model.
- Important to note, unlike the Flowers litigation, the FedEx misclassification lawsuits were eventually placed before a single judge.
- Similarly, the claims against FedEx alleged that FedEx had broad authority to dictate the way drivers carry out their jobs and, by classifying drivers as independent deprived them of benefits and forced them to cover business expenses.
- The plaintiffs alleged that they had to obtain FedEx-branded trucks, uniforms and scanners among other conditions they had to agree to in contract.
- The plaintiffs also alleged that they did not receive overtime compensation or receive compensation for missed meals and rest periods.
- The Ninth Circuit found that the level of control FedEx exercised over its drivers made them employees. “The operating agreement grants FedEx a broad right to control the manner in which its drivers perform their work,” wrote U.S. Circuit Judge William A. Fletcher. “Accordingly, we hold that plaintiffs are employees as a matter of law.”
- FedEx recently settled this misclassification lawsuit with California 2,000 delivery drivers for $226.5 million with each class member receiving over $100,000 (FedEx also paid $37.2 million in lawyer fees for the drivers). FedEx and drivers in 20 other states also have a $240 million settlement in June 2016 pending court approval
- In the midst of the litigation, FedEx moved to an independent distribution model that relies only on incorporated entities that operate multiple trucks and routes, they call these entities “Independent Service Providers” (ISPs).
- Flowers could take a similar approach, which would reduce, but not eliminate, the risk of future misclassification litigation.
- FedEx was much closer to the change of their distribution model than FLO currently is, it remains a very large question whether or not FLO is capable of executing this change in their model given the currently very fragmented IO network they have.

Additional thought: A *Washington Post* article explored the value of FedEx’s ISP model. A full-time unionized UPS driver starts at a base salary of $39K a year, with regular raises up to $52K, which also increases to over $80K for most drivers factoring in overtime pay, and drivers receive full benefit packages and job protection. FedEx drivers, on average, may receive between $30K and $35K per year, with few benefits and little job security.

DATA SOURCE: SHOOK HARDY & BACON, WASHINGTON POST, HEDGEYE.

FLOWERS POTENTIAL SETTLEMENT

At this point a large cash settlement to distributors is inevitable in our eyes, it is the question of what will be required to happen with their distributor model that remains.

Pay Damages – FedEx Example

- The way we see it, the FedEx route is the easy way out of this case, but not the one with a higher probability
- If FLO goes the FedEx way they will be required to pay a big settlement and be required to rework their distribution network in a way that they are working with registered entities that hire multiple drivers and treat them as employees
- **Estimated Settlement: $510 million to $900 million**
- FLO will also most likely experience disruptions in the business due to the magnitude of the changes required
- This large payment will require debt which will add interest to the P&L hampering profitability
- Settling one case does not guarantee the settlement of the rest in similar fashion given all the cases are in different courts

Pay Damages and Buyback Routes

- A.k.a the death blow scenario
- Litany of changes to Balance Sheet, Income and Cash Flow Statements
- Buy back routes
- Buy back trucks
- Remove distributor notes receivable from BS
- Eliminate distributor territories held for sale
- Pay settlement
- P&L faced with ongoing costs of distributors being employees
- **Total estimated one-time costs $0.9 to $1.4 billion**

DATA SOURCE: HEDGEYE.

BUT THEY CAN NEVER LOSE...

- FLO has always had a never lose attitude, always able to settle on the courthouse steps
- This scenario is what they have feared most, being cornered by multiple governing bodies; Courts, Department of Labor, and potentially the SEC
- We are aware that they settled a case California out of court but the terms of the settlement are unknown
- The possibility of more cases coming to the surface is nearly certain
- DOL could provide an overarching crack down on FLO and the IO distribution model more broadly
- Additionally, the SEC may catch wind of some lackluster accounting (in our opinion) and dig deeper into the company

DATA SOURCE: HEDGEYE.

BROKEN BUSINESS MODEL

COSTS WILL INCREASE DRAMATICALLY

City, State	Price	Gross Sales /yr	Average Sales /wk	Gross Commissions /yr	Avg. Commission	Avg. Weekly Overhead	Yearly Overhead	Actual Net Income	Weekly Net	Selling Ratio
Pine Hurst, NC	$ 150,000	$ 494,832	$ 9,516	$ 90,060	18.2%	$ 390	$ 20,280	$ 69,780	$1,342	15.8x
Gastonia, NC	$ 199,000	$ 584,012	$ 11,231	$ 105,122	18.0%	$ 188	$ 9,776	$ 95,346	$1,834	17.7x
Columbia, SC	$ 189,000	$ 651,144	$ 12,522	$ 112,648	17.3%	$ 551	$ 28,652	$ 83,996	$1,615	15.1x
Myrtle Beach, SC	$ 240,000	$ 771,524	$ 14,837	$ 138,103	17.9%	$ 486	$ 25,272	$ 112,831	$2,170	16.2x
Pageland, SC	$ 140,000	$ 436,852	$ 8,401	$ 75,575	17.3%	$ 479	$ 24,908	$ 50,667	$ 974	16.7x
Perry, GA	$ 175,000	$ 574,860	$ 11,055	$ 105,200	18.3%	$ 240	$ 12,480	$ 92,720	$1,783	15.8x
Jacksonville, FL	$ 239,000	$ 630,084	$ 12,117	$ 110,265	17.5%	$ 357	$ 18,564	$ 91,701	$1,763	19.7x
Chambersburg, PA	$ 159,900	$ 420,212	$ 8,081	$ 75,638	18.0%	$ 203	$ 10,556	$ 65,082	$1,252	19.8x
Hillview, KY	$ 99,000	$ 593,871	$ 11,421	$ 106,564	17.9%	$ 601	$ 31,252	$ 75,312	$1,448	8.7x
Boone, NC	$ 159,000	$ 577,200	$ 11,100	$ 107,360	18.6%	$ 550	$ 28,600	$ 78,760	$1,515	14.3x
Boone, NC	$ 169,000	$ 588,484	$ 11,317	$ 111,812	19.0%	$ 476	$ 24,752	$ 87,060	$1,674	14.9x
Santa Barbara, CA	$ 199,000	$ 595,712	$ 11,456	$ 119,142	20.0%	$ 288	$ 14,976	$ 104,166	$2,003	17.4x
Irvine, CA	$ 210,000	$ 565,552	$ 10,876	$ 121,836	21.5%	$ 502	$ 26,104	$ 95,732	$1,841	19.3x
Claremont, FL	$ 275,000	$ 946,504	$ 18,202	$ 148,198	15.7%	$ 701	$ 36,452	$ 111,746	$2,149	15.1x
Wilmington, NC	$ 115,000	$ 419,224	$ 8,062	$ 78,605	18.8%	$ 231	$ 12,012	$ 66,593	$1,281	14.3x
Orlando, FL	$ 160,000	$ 513,734	$ 9,880	$ 79,357	15.4%	$ 336	$ 17,472	$ 61,885	$1,190	16.2x
Charleston, SC	$ 169,900	$ 598,832	$ 11,516	$ 113,778	19.0%	$ 169	$ 8,788	$ 104,990	$2,019	14.8x
West Ashley, SC	$ 260,000	$ 776,190	$ 14,927	$ 141,654	18.2%	$ 494	$ 25,688	$ 115,966	$2,230	17.4x
Indian Trail. NC	$ 109,000	$ 442,520	$ 8,510	$ 86,188	19.5%	$ 419	$ 21,788	$ 64,400	$1,238	12.8x
Kennesaw, GA	$ 125,000	$ 694,364	$ 13,353	$ 90,277	13.0%	$ 300	$ 15,600	$ 74,677	$1,436	9.4x
Fayetville, NC	$ 185,000	$ 842,260	$ 16,197	$ 128,048	15.2%	$ 345	$ 17,940	$ 110,108	$2,117	11.4x
Kitty Hawk, NC	$ 165,000	$ 602,524	$ 11,587	$ 125,216	20.8%	$ 948	$ 49,296	$ 75,920	$1,460	14.2x
Chesapeake, VA	$ 198,000	$ 677,092	$ 13,021	$ 128,048	18.9%	$ 332	$ 17,264	$ 110,784	$2,130	15.2x
Charlston, SC	$ 140,000	$ 657,540	$ 12,645	$ 118,357	18.0%	$ 358	$ 18,616	$ 99,741	$1,918	11.1x
Maryville, TN	$ 185,000	$ 642,835	$ 12,362	$ 128,567	20.0%	$ 369	$ 19,188	$ 109,379	$2,103	15.0x
Lexington, SC	$ 210,000	$ 756,288	$ 14,544	$ 121,006	16.0%	$ 338	$ 17,576	$ 103,430	$1,989	14.4x
Virginia Beach, VA	$ 147,000	$ 447,772	$ 8,611	$ 89,554	20.0%	$ 302	$ 15,704	$ 73,850	$1,420	17.1x
Charlotte, NC	$ 168,000	$ 461,656	$ 8,878	$ 86,424	18.7%	$ 285	$ 14,820	$ 71,604	$1,377	18.9x
Philadelphia, PA	$ 140,000	$ 416,000	$ 8,000	$ 74,880	18.0%	$ 180	$ 9,360	$ 65,520	$1,260	17.5x
Average	**$ 175,166**	**$ 599,299**	**$ 11,525**	**$ 107,499**	**18.1%**	**$ 394**	**$ 20,474**	**$ 87,026**	**$1,674**	**15.4x**
Min	**$ 99,000**	**$ 416,000**	**$ 8,000**	**$ 74,880**	**13.0%**	**$ 169**	**$ 8,788**	**$ 50,667**	**$ 974**	**8.7x**
Max	**$ 275,000**	**$ 946,504**	**$ 18,202**	**$ 148,198**	**21.5%**	**$ 948**	**$ 49,296**	**$ 115,966**	**$2,230**	**19.8x**

Additional Cost Avg.	**$104,415,641**
Total @ $600 /week	**$159,120,000**

- To the right we have provided stats for 29 routes that are available for sale, pending or sold from routesforsale.net
- Weekly overhead costs vary greatly based on size and age of route, where the newest route owners pay more because of increases in rent, miscellaneous fees and higher vehicle lease expenses
- As your territory note and truck payment gets towards the end, or at the end the cost obviously goes down
- From speaking with numerous people and gathering the data available, we have determined that $600 per week, per distributor is a fair estimate for overhead across the distribution network
- **Using this as a proxy we have come up with an estimate of additional cost that will hit FLO's P&L of $160 million per year, or 4.0% of sales if they are required to reclassify their IO's as employees**

DATA SOURCE: ROUTESFORSALE.NET, HEDGEYE.

WHAT HAPPENS IF THE COMPANY HAS TO BUY BACK ROUTES

Buy Back Routes		
Branded DSD Sales	$	641.70
Independent Distributors		5,100
Average Weekly Sales (AWS)	$	40.11
Cost To buy Back All Routes	$	401.06
Cost per Route	$	0.07
Cost to Buyback IO Routes	$	344.93
- Distributor Notes	$	168.00
Net Additional Liability	**$**	**176.93**

Balance Sheet Adjustments		
Reduction in Assets		
Distributor Notes Receivable Goes Away	$	(168.00)
Eliminate Distributor Territories Held For Sale	$	(44.59)
Potential Liability Additions		
Liability to Buy Back Routes	$	344.93
Liability to Buy Back Trucks	$	255.00

Estimated One-Time Expenses		
Buy back Routes	$	176.93
Buy Trucks @ $50k each	$	255.00
Settlement Fee (Low End - $100k per)	$	510.00
Settlement Fee (High End - $150k per)	$	900.00
Total one Time (Low End)	**$**	**941.93**
Total one Time (High End)	**$**	**1,331.93**

DATA SOURCE: COMPANY FILINGS, HEDGEYE.

END RESULT

LOW MARGIN, DEPLETED P&L

- To the right we have displayed our attempt at re-casted financials for FLO
- We have added additional employee costs to cover overhead that IO's currently pay as 4.0% of sales
- Eliminated interest income as distributor notes receivable would no longer exist
- Added additional interest expense to account for $1bn in debt to finance settlement and buybacks at an interest rate of 4.75%
- Making IO's employees although detrimental to the business model near-term may be their best bet to put this all behind them forever.
- This business' margins would be cut by ~400bps and would no longer trade in the neighborhood of its current multiple

($'s in millions)	1Q16	2Q16E	3Q16E	4Q16E	2016E	1Q17E	2Q17E	3Q17E	4Q17E	2017E
Total Revenues	**$ 1,204**	**$ 935**	**$ 936**	**$ 888**	**$ 3,963**	**$ 1,227**	**$ 953**	**$ 954**	**$ 905**	**$ 4,039**
YoY Change	*5.1%*	*5.2%*	*5.7%*	*3.4%*	*4.9%*	*1.9%*	*1.9%*	*1.9%*	*1.9%*	*1.9%*
Total Cost of Sales	621	484	493	464	2,062	635	492	492	469	2,088
Gross Profit	**$ 583**	**$ 451**	**$ 443**	**$ 424**	**$ 1,901**	**$ 592**	**$ 461**	**$ 461**	**$ 436**	**$ 1,951**
Gross Margin	*48.4%*	*48.2%*	*47.3%*	*47.7%*	*48.0%*	*48.3%*	*48.4%*	*48.4%*	*48.2%*	*48.3%*
SD&A	445	339	335	325	1,443	454	346	341	331	1,471
D&A	43	32	32	34	142	44	33	33	34	145
New Employment Expenses		37	37	36	110	49	38	38	36	162
Income from Operations	**$ 95**	**$ 42**	**$ 39**	**$ 29**	**$ 206**	**$ 46**	**$ 44**	**$ 49**	**$ 34**	**$ 173**
Operating Margin	*7.9%*	*4.5%*	*4.1%*	*3.3%*	*5.2%*	*3.7%*	*4.7%*	*5.1%*	*3.7%*	*4.3%*
Interest Expense	9	7	7	7	30	9	7	7	7	30
~~Interest Income~~	~~(6)~~	~~(5)~~	~~(5)~~	~~(5)~~	~~(21)~~	~~(6)~~	~~(5)~~	~~(5)~~	~~(5)~~	~~(21)~~
Additional Interest		12	12	12	36	12	12	12	12	48
Pre-tax Profit	**$ 86**	**$ 24**	**$ 20**	**$ 11**	**$ 140**	**$ 25**	**$ 25**	**$ 30**	**$ 15**	**$ 95**
Tax Rate	35.7%	36.0%	36.0%	36.0%	35.8%	36.0%	36.0%	36.0%	36.0%	36.0%
Tax Expense	31	9	7	4	50	9	9	11	5	34
Net Income	**$ 55**	**$ 15**	**$ 13**	**$ 7**	**$ 90**	**$ 16**	**$ 16**	**$ 19**	**$ 10**	**$ 61**
EPS	**$0.26**	**$0.07**	**$0.06**	**$0.03**	**$0.43**	**$0.08**	**$0.08**	**$0.09**	**$0.05**	**$0.29**
Consensus Estimate		$0.26	$0.25	$0.22	$1.01	$0.31	$0.27	$0.26	$0.23	$1.07
Difference		(72.1%)	(75.5%)	(84.9%)	(57.7%)	(75.6%)	(71.0%)	(65.0%)	(79.6%)	(72.7%)
EBITDA	**$139**	**$75**	**$71**	**$63**	**$347**	**$90**	**$78**	**$82**	**$68**	**$318**
EBITDA Margin	*11.5%*	*8.0%*	*7.6%*	*7.1%*	*8.8%*	*7.3%*	*8.2%*	*8.6%*	*7.6%*	*7.9%*

FlowersFoods

IO'S RUNNING LOW ON PATIENCE

DISTRIBUTOR DISCONTENT IS WIDESPREAD

"Was just told I could put my Christmas fruit cake display out…after the holidays"

"My contract says 10%…but the way Flowers pays you who really knows what you are getting, I think they just make stuff up to try to pay you as little as possible…the best thing with Aunt Millie's when was with them they paid you 23% on premium and 18% on private label and it was strictly off your invoices…you could bring home your invoices, put in a spreadsheet and know exactly what your settlement check was going to be…I am regretting leaving them to come back to Flowers…but there were a lot of factors"

"So two reasons why Flowers is pushing DOT stuff. Perhaps 1 or both are objective.

1) By making us interstate it would shield them from overtime lawsuits as interstate drivers are exempt from overtime.
2) A discount on insurance as well as possible kick backs based on number of people signed up. Just my 2 cents"

DATA SOURCE: FACEBOOK, HEDGEYE.

JOB POSTINGS TELL A DIFFERENT STORY

Prospective Distributors

compensation: **$13.50/hr**
employment type: **full-time**
We are currently recruiting Prospective Distributors for Flowers Baking Company of Thomasville, LLC in the Dothan, AL market. The Prospective Distributors will work on an assigned sales route in accordance with the company's merchandise program and standards. The position requires interaction with customers at stores and warehouses.

Flowers Baking Company of Thomasville, LLC is a subsidiary of Flowers Foods, one of the top packaged bakery foods companies in the U.S. Flowers' brands include Nature's Own (the #1 bread brand in the U.S.), Wonder, Sunbeam, Tastykake and Cobblestone Bread Co.

Position Responsibilities:
* Build and establish a relationship with customers.
* Increase current sales.
* Review the route weekly to identify problems and discover additional opportunities. Identify ways to increase the sales of products, build the brand, obtain additional shelf space and improve the positioning of the products.
* Limit the percentage of stale products to established levels.
* Actively seek and update knowledge of the competition, including pricing, products, space and position.
* Learn how to operate a hand-held computer scan gun and use daily.
* Make safety in the job a top priority at all times.
* Learn the product freshness code system and never leave out-of-code product at an account.
* Check assigned truck prior to loading. Keep it clean and in good repair. Use proper lifting techniques at all times and secure load to prevent product damage. Maintain accurate vehicle records and practice defensive driving.
* Maintain a professional personal appearance, including hygiene and grooming.

Skill Set For Success in This Role:
* Route delivery and route sales experience is a plus, but not required.
* Previous experience with a hand-held scanner.
* Natural ability to connect with various types of customers and ability to sell the company's multiple product lines.
* Ability to lift, maneuver and move an average load of 75lbs to/from warehouse to truck and to/from truck to customer service area.
* Ability to lift, stoop and bend to dismantle stacks of product and transfer product to customer shelves at a height of 1-7 feet. Lifting from various positions, on the average 25lbs or more. When necessary, exert force to lift, maneuver and move an average load of 255lbs.
* Color vision and near vision required to distinguish product date codes.
* Must have good written and oral communication skills. Able to read and comprehend English paperwork and signs. Practice necessary safety procedures, defensive driving and proper lifting.
* High School Diploma or equivalent.
* Have/maintain a valid state driver's license, a documented safe driving record and a current DOT certification OR able to become DOT certified. Must be able to operate assigned company truck.

In order to expedite the application process, use the following link to apply:

https://www.teamambassador.com/Job.aspx?id=00004WVP

If above link does not work, go to www.teamambassador.com to review open positions.

Ambassador is an Equal Opportunity Employer. All qualified applicants will receive consideration for employment without regard to race, color, national origin, religion, sex, disability status, protected veteran status, or any other attribute protected by law.
Principals only. Recruiters, please don't contact this job poster.
do NOT contact us with unsolicited services or offers

DATA SOURCE: CRAIGSLIST.COM, HEDGEYE.

NOT ALL ROUTES ARE CREATED EQUAL

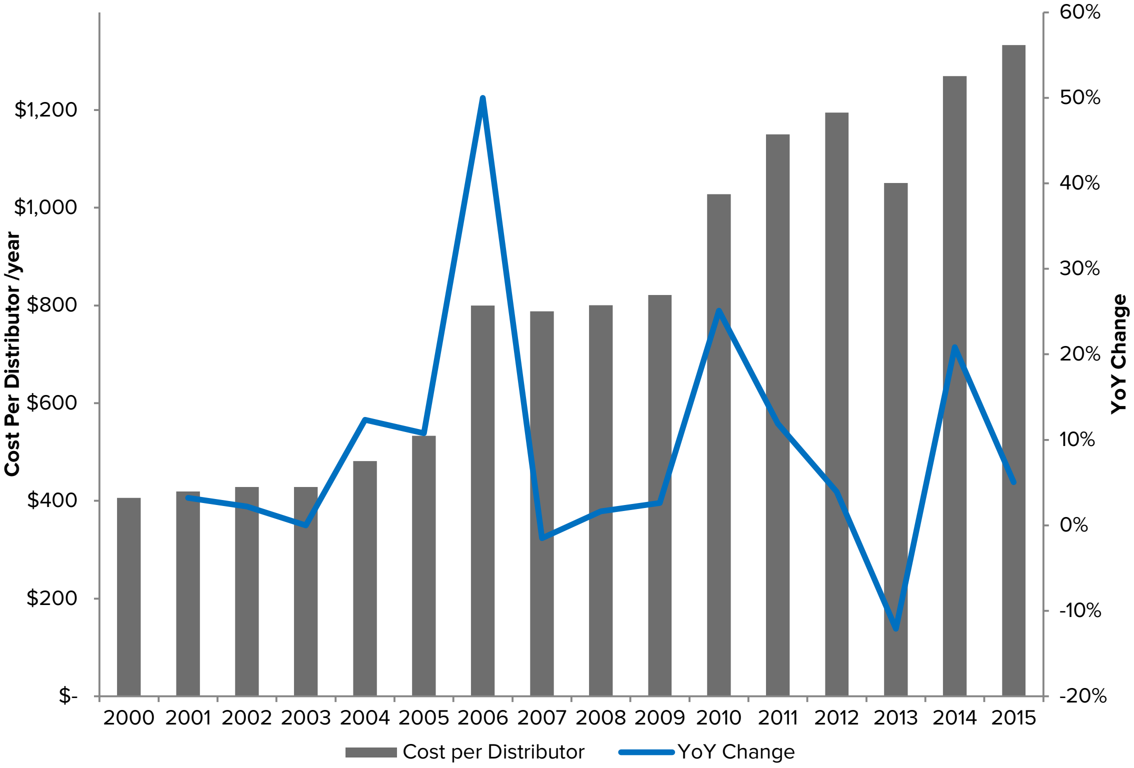
- Not all routes are profitable
- Flowers provides Development Allowances to make some routes profitable, in order to entice drivers to take the route
  - These routes were still valued at 10x sales even though they were losers
- More often than not, FLO ends up buying these route as they are very hard to sell
- Chain grocery stores and consolidation have really changed the business, there is little ability to grow your route with independent grocers, you are dependent on the opening of big retailers, and even then if your route gets too big, Flowers will buy it back, re-size it, and then sell it back. This initiative of FLO makes it difficult to build equity value in your route
- Private label a loss leader used to cover plant overhead and maintain relationships with retailers, often creates headaches for distributors as they barely break-even on this product
- WMT mandatory morning meeting “it’s good industry practice” says FLO management. Does that sound like independence?
- IO’s often forced to drive long hours causing unsafe working conditions. There are multiple reports of accidents on the job, especially while driving.

DATA SOURCE: HEDGEYE.

MISCELLANEOUS CHARGES CHARGED TO IO'S

- There is a litany of miscellaneous charges that IO's have to fund on a daily basis, that FLO is missing out on:
  - Truck lease/insurance
  - Truck maintenance, gas and oil
  - Home office expenses
  - Tolls
  - Depreciation of truck if owned
  - Amortization of territory costs
  - Loan interest
  - Expense of personal car for call backs instead of using trucks
  - Computer and hand-held
  - Cell phone

Yearly Hand-held Charge Per Distributor



NOTES FROM MEETING WITH THE FORMER CFO

Jimmy Woodward

Jimmy M. Woodward, was the Senior Vice President and Chief Financial Officer of Flowers Foods from September 2002 through September 2007. Previous to that role Mr. Woodward served as Vice President and Chief Financial Officer from November 2000 until September 2002. He also served as Vice President and Chief Financial Officer at Flowers Industries from March 2000 to March 2001, as treasurer and chief accounting officer of Flowers Industries from October 1997 to March 2000, and as assistant treasurer of Flowers Industries for more than five years prior to that time.

Notes From Conversations with Jimmy

We had the pleasure of speaking with the former CFO of FLO, Jimmy Woodward (started with FLO in 1986 and retired in 2007) and he was able to shed light on the issues at hand. Important to note that Jimmy volunteered to testify for the distributors and against Flowers in the Rehberg case.

- Jimmy started off our conversations with a view inside the walls of Flowers, describing the culture as “cult” like and “the biggest private public company”
- On multiple occasions Jimmy tried to bring up the issues at hand, calling the IO model a “labor strategy,” which did not sit well with the rest of the executive team
- Jimmy estimated that average driver turnover when he was there was around 30%, this was a job to these people, just a way to make ends meet.
- Jimmy especially dislikes the rejiggering of routes, saying if a store opens in your area, that is great for you, if one closes, that is the risk of running your own business, FLO muddies the waters by getting involved and changing the borders of your routes to try to make everyone as even as possible
- Everyone on the executive team knows that these drivers are working more than 40 hours a week and not getting paid overtime, which is a core reason they set up the program in the first place!
- If there is an analysis of the facts by a court or government agency it is virtually certain the drivers would be found to be employees
- The concept of independent distributors delivering to independent grocery stores does not exist anymore
- These lawsuits would happen all the time but were settled on the courthouse steps “sign this release and go away”
- Flowers has no fallback position, they cant afford to lose this case, their business model could implode
- Way too many brands on the truck, drivers can’t handle the workload, fundamental slowdown
- Hearing from multiple sources that FLO Corporate members are going around to different distributors and asking them to sign an addendum to their contract in exchange for $1,000

POTENTIAL ACCOUNTING ISSUES

ACCOUNTING MAY NOT BE THEIR STRONG SUIT

Potential Accounting Issues as Told by Jimmy Woodward

“The Company started the distributor program with the drivers classified as independent contractors for all purposes (labor law, tax and financial reporting). Therefore, it seemed appropriate, upon sale of a territory to a driver, to debit notes receivable and credit income.

A year or two later, the Company changed the treatment of the drivers to a "statutory employee" under IRS rules. For tax purposes, the drivers do NOT have an investment in a "facility" per IRS regulations. The ownership of a truck cannot be considered a "facility" and the intangible geographic route is not a facility per IRS interpretation. At that time, as a statutory employee, the Company began to calculate a FICA wage under Revenue Ruling 73-260, collect the employee FICA portion weekly from the driver, match the employer portion of the FICA, and submit to SSA. Also, a statutory employee requires payment by the Company of state and federal unemployment tax, and the Company must issue a Form W-2 annually to each driver reporting the FICA wages and tax withheld. The driver does not pay self employment tax.

The company continues to record the sale of the route for financial reporting as noted above.

After years of considering this issue, it seems to me that since (1) the driver is a "statutory" (by law) employee for FICA and SUTA/FUTA, (2) since the Company is generally the sole buyer and reseller of any open routes upon departure of a driver for any reason and therefore no cash comes to the Company from an external source , (3) the Company records sales at an amount equal to the selling price of the product to the retailer, and (4) the Company records the product price discount given to the distributor as a selling expense akin to compensation…etc.…maybe the Company should not record the initial transaction as a "sale" for financial reporting purposes. That would result in no note receivable, etc.

The Company is not going to do this because it would impair their position for labor issues that the driver has purchased an asset, the territory, and is independent.”

Flowers Foods

MULTIEMPLOYER PENSION PLANS

THE FINANCIAL ISSUES FACINGS MPP'S

A ONE-TWO PUNCH

The one-two punch to MPPs is the **combination of the drop in the value of the pension funds as a result of market losses** and **a reduction in the number of employers contributing to the fund due to bankruptcies and mergers.** As a result, a smaller pool of companies has fewer resources to fund the pension obligations of a large number of workers.

1. MPPs worked in a growing economy, as the firms that contributed were profitable and the market rose. Over time, pools of assets replaced contributions as the primary source of pension fund income. **MPPs lost significant value as a result of investment losses in 2008, as much as 20% to 30%.** Roughly two thirds of plans (about 1,000) were placed in either endangered or critical status.

2. Since the financial crisis, many employer participants merged or filed for bankruptcy. In addition, unionized employment has fallen. **As a result, MPP obligations fall on the backs of a smaller pool of employers.** Some large plans have lost thousands of contributing employers over the last two to three decades.

    — Employer contributions are generally based on hours worked by active workers. Over the last three decades, the proportion of active to inactive participants in MPPs has flipped. **In the 1980s, three-quarters of participants were active and one-quarter of participants were retired. Today, about 60% of MPP participants are inactive. This results in a smaller contribution pool to fund the pensions of a larger proportion of retirees.**

DATA SOURCE: HEDGEYE.

MULTI-EMPLOYER PENSION PLAN

CHALLENGES FACING EMPLOYERS WITH MPPS

The Next downturn In Asset Performance - Can you imagine what these things will look like post the next downturn, which pick your time frame 0-24 months away? Milliman data showed that every 4% decline in asset returns pushes the funding status down by 15-20% (insane sensitivity). The next 10yrs, based on the Asness/CAPE suggest that returns will be ~0.5% + inflation (~1.5%), so call it +2%/yr, on average, for the next decade. **These plans will see their funding ratios drop by 20-30% in this scenario, i.e. an 80% funded plan today will drop to 50-60% funding within just a few years, just as the number of inactive (retirees) begins to go parabolic.**

Impending Failure of the PBGC Backstop - PBGC, created in 1974 by the Employee Retirement Income Security Act (ERISA), provides an insurance backstop to plans whose employers or industries become unable to support the promised benefits. If an MPP becomes insolvent, then the PBGC loans money to the plan to pay benefits, and pension payments must be reduced to the extent that they exceed the PBGC's statutory maximum. PBGC predicts that its MPP insurance fund will collapse by 2025, possibly sooner. **The Government Accountability Office (GAO) found that if a major MPP becomes insolvent, the PBGC would exhaust the insurance fund within two or three years.**

"Last Man Standing" Rule - When a withdrawing employer fails to pay its full withdrawal liability due to reasons such a bankruptcy or going out of business, the responsibility for the unfunded liabilities of the departing employer shift to the employers that remain active in the plan. **As a result, the remaining employers are forced to pay the pension obligations of many people ("orphan employees") who never worked for the company and may have worked for a competitor or in a different industry.**

Withdrawal Liability - The amount of withdrawal liability is an estimate of the employer's proportionate share of the plan's unfunded vested liabilities.

DATA SOURCE: HEDGEYE.

FLO'S POTENTIAL LIABILITY

SOMETHING WORTH NOTING

	Stated Withdrawal Liability or Previous Payment	# of Employees	Payment/Employee	FLO Employees	Assumed Withdrawal Liability
UPS (NETTI Fund)	$841,000,000	10,200	$82,451	1,150	$94,818,627
UPS (Central States)	$6,100,000,000	64,015	$95,290	1,150	$109,583,691
SYY	$245,000,000	9,446	$25,937	1,150	$29,827,440
KATE	$19,100,000	365	$52,329	1,150	$60,178,082
YRCW	$10,000,000,000	32,000	$312,500	1,150	$359,375,000
Albertsons	$510,000,000	6,600	$77,273	1,150	$88,863,636

Average:	**$123,774,413**
Ex. YRCW Avg.	**$76,654,296**
Minimum	**Maximum**
$29,827,440	$359,375,000

Liabilities	$ in Billion	% of TEV
Fair Value Of Total Debt	$1.1	22.4%
Contractual Obligation to buy Routes/Trucks	$0.7	14.1%
Net Deferred Tax Liabilities	$0.2	3.9%
Withdrawal Liabilities	$0.1	2.6%
Total Liabilities	**$2.0**	**42.9%**
Equity Value	**$3.7**	
Total Enterprise Value (TEV)	**$4.7**	

- Minor issue right now for the company, but not something they can really afford to get out of.
- Per these precedent cases, FLO's withdrawal liability is in the neighborhood of $75 million to $100 million, this is not to say that they have to pay this amount, or will pay it anytime in the future, but it does mean they will be stuck in these plans which have rising costs which could increasingly negatively impact the P&L over time
- By implementing this IO model were they avoiding MPPs and now it is coming back to bite them?
- Whole point of IO model seems driven to prevent employees from unionizing to keep down costs to continue to grow the business
- FLO wouldn't be as big or as profitable as they are now if they had union drivers
- Would they have to put their employees into MPP as employees and union members?

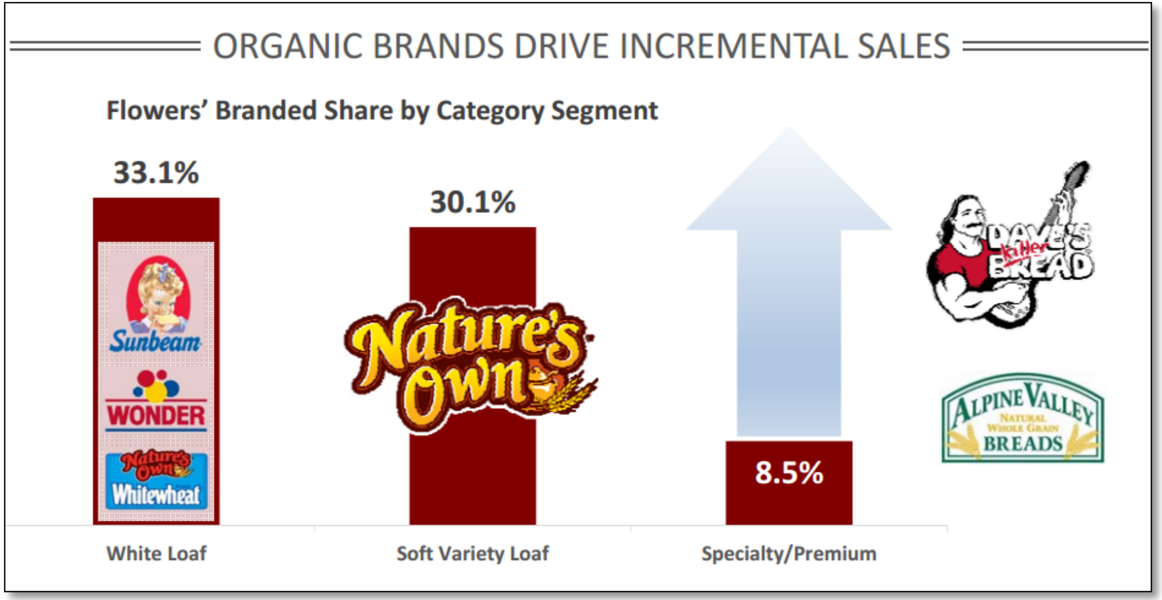
DATA SOURCE: COMPANY FILINGS, HEDGEYE.

FlowersFoods

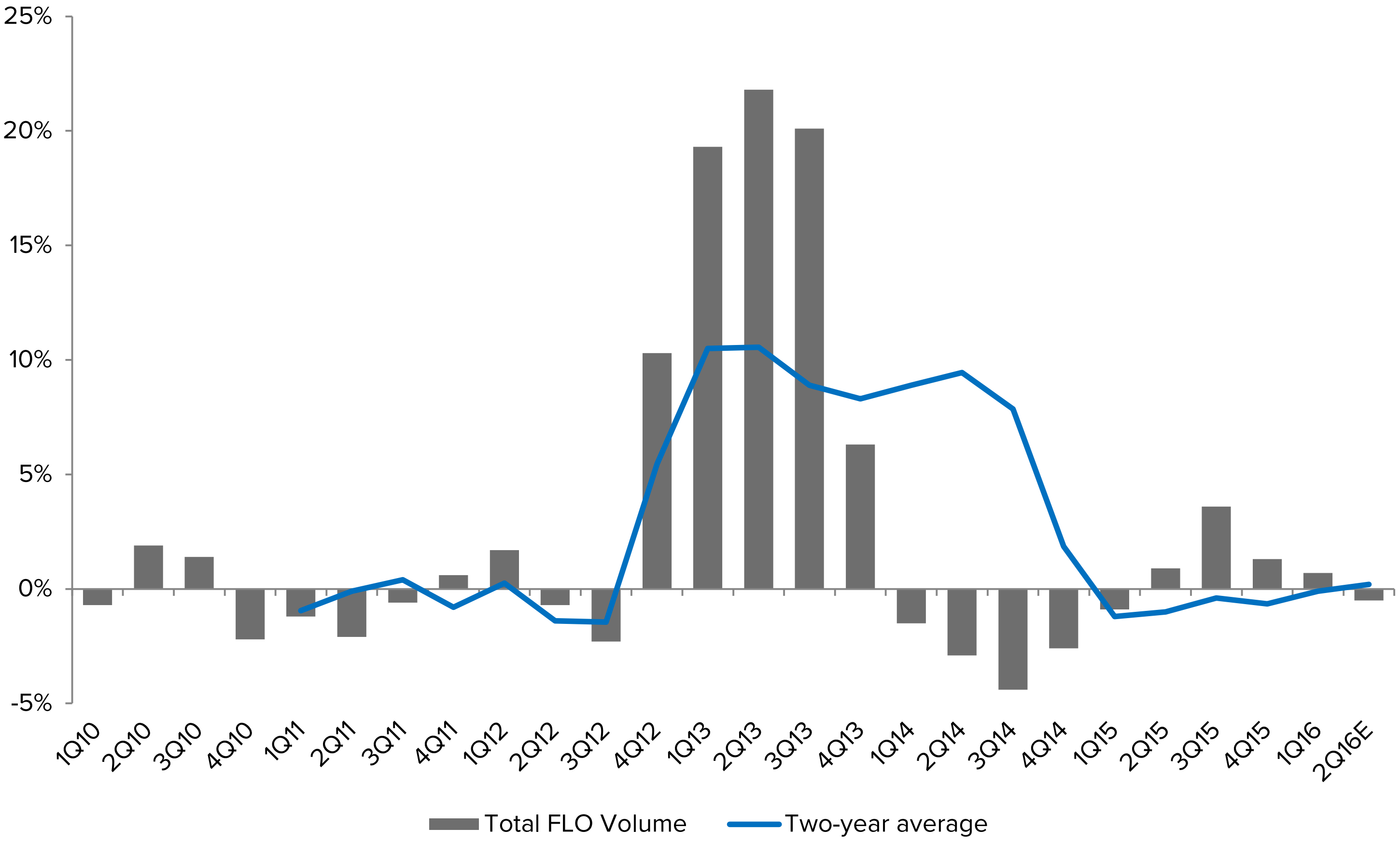
FUNDAMENTALS DETERIORATING

FRAGMENTED BUSINESS

- Overload of brands causing slowdown
- Increase in private label is unprofitable for distributors, it is a loss leader
- Organic brands driving incrementality, but they are slowing down operations and complicating processes for IO's
- Additionally, organic brands are certainly popular in core geographic markets, but it is tough to sell a $5 to $6 loaf of bread at Walmart.



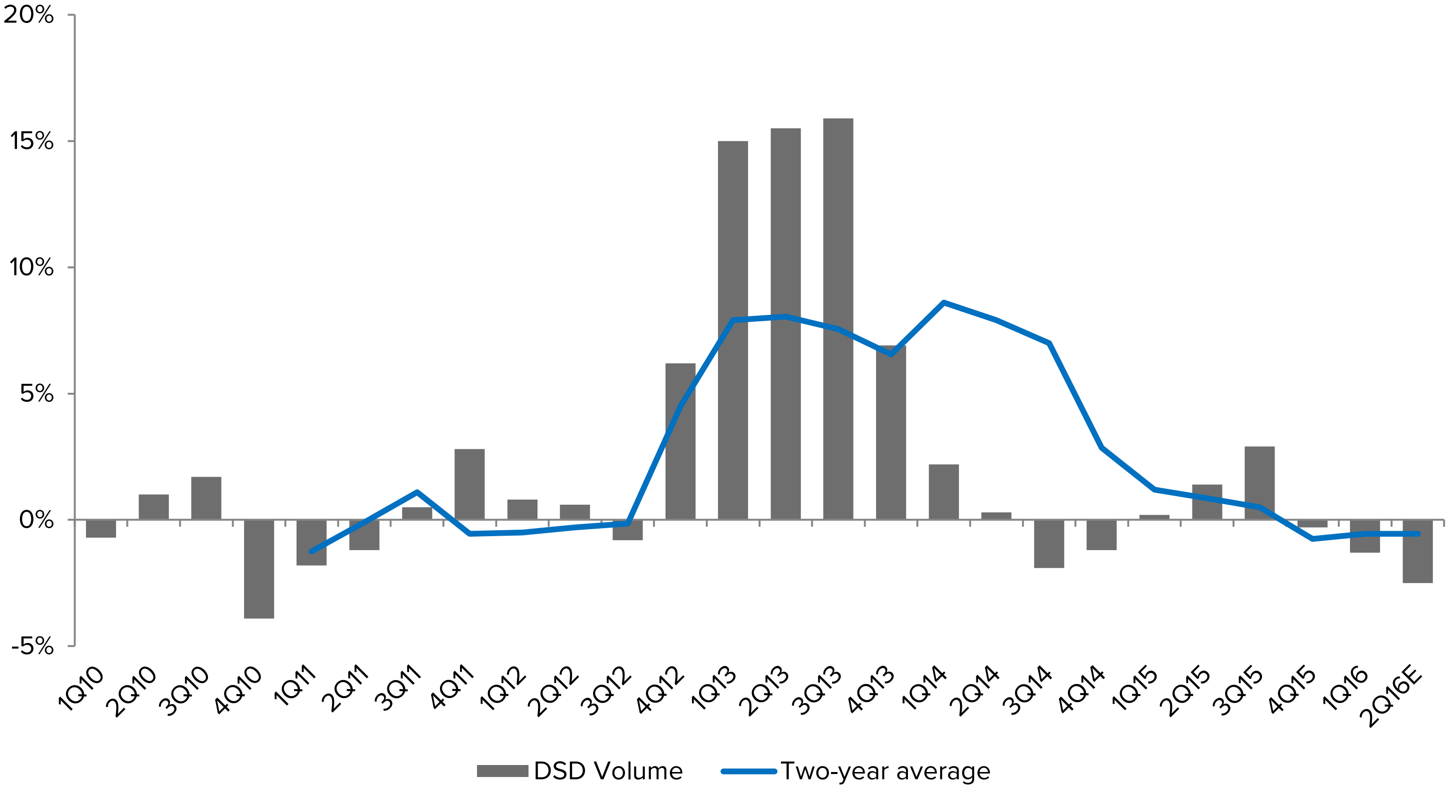
CONSOLIDATED FLO VOLUME GROWTH



- Coming into 2Q16 and the back half of the year, FLO begins to face tougher comparables, the toughest one coming in 3Q16
- The large 2013 increases are due primarily to the gains in the marketplace as a result of the Hostess Brands exiting the market back in November 2012

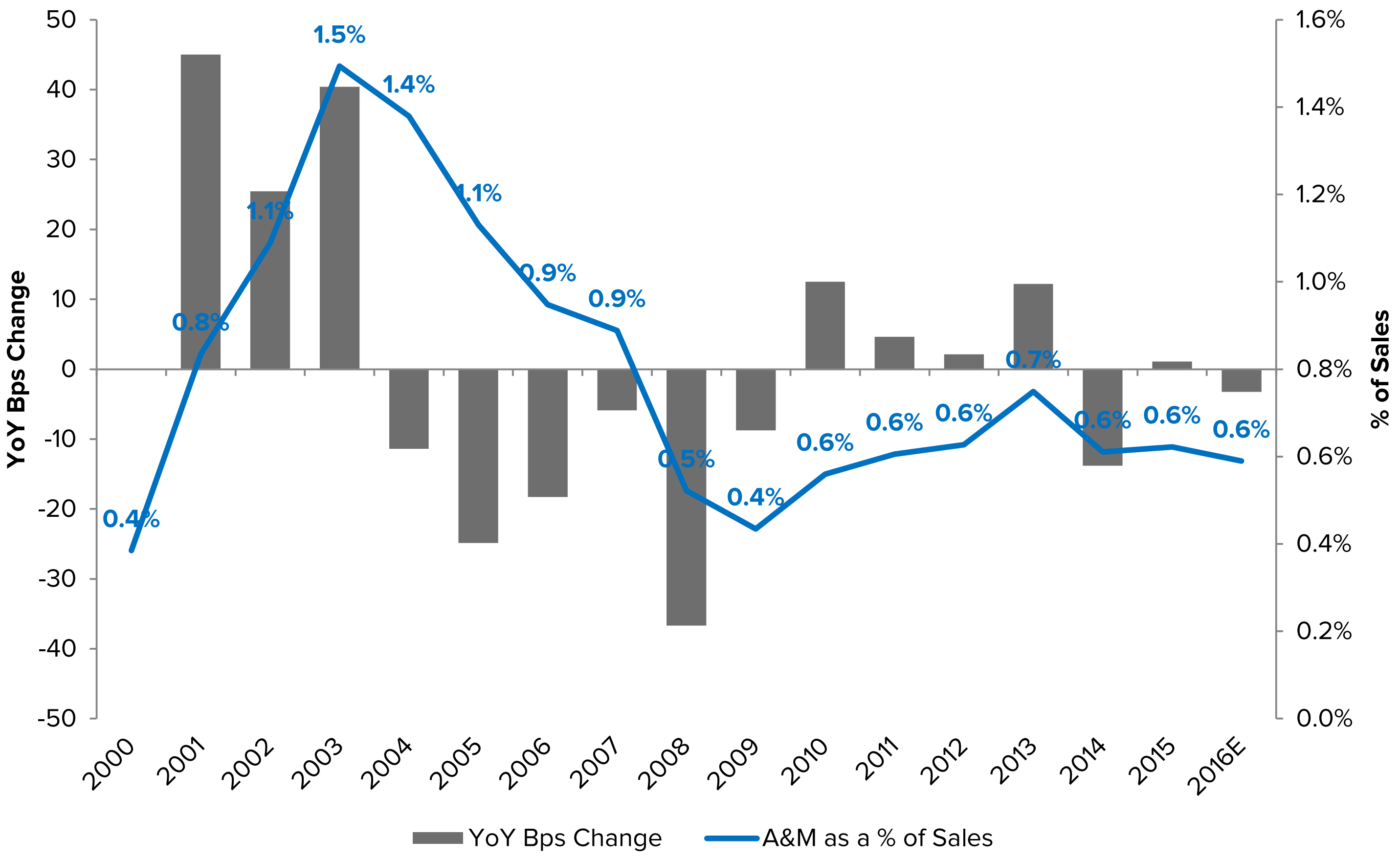
SLOWDOWN BEING LED BY THE DSD SEGMENT

NOT A GOOD SIGN



- These IO's have no incentive (and frankly ability) to grow the business further given the constraints that corporate places on them
- This coupled with the proliferation of brands in their system, is causing rifts between the distributors and management
- Unsatisfied workers that are not incentivized properly will have little interest in growing the business just to pad the wallets of management and shareholders

A&M AS A % OF SALES

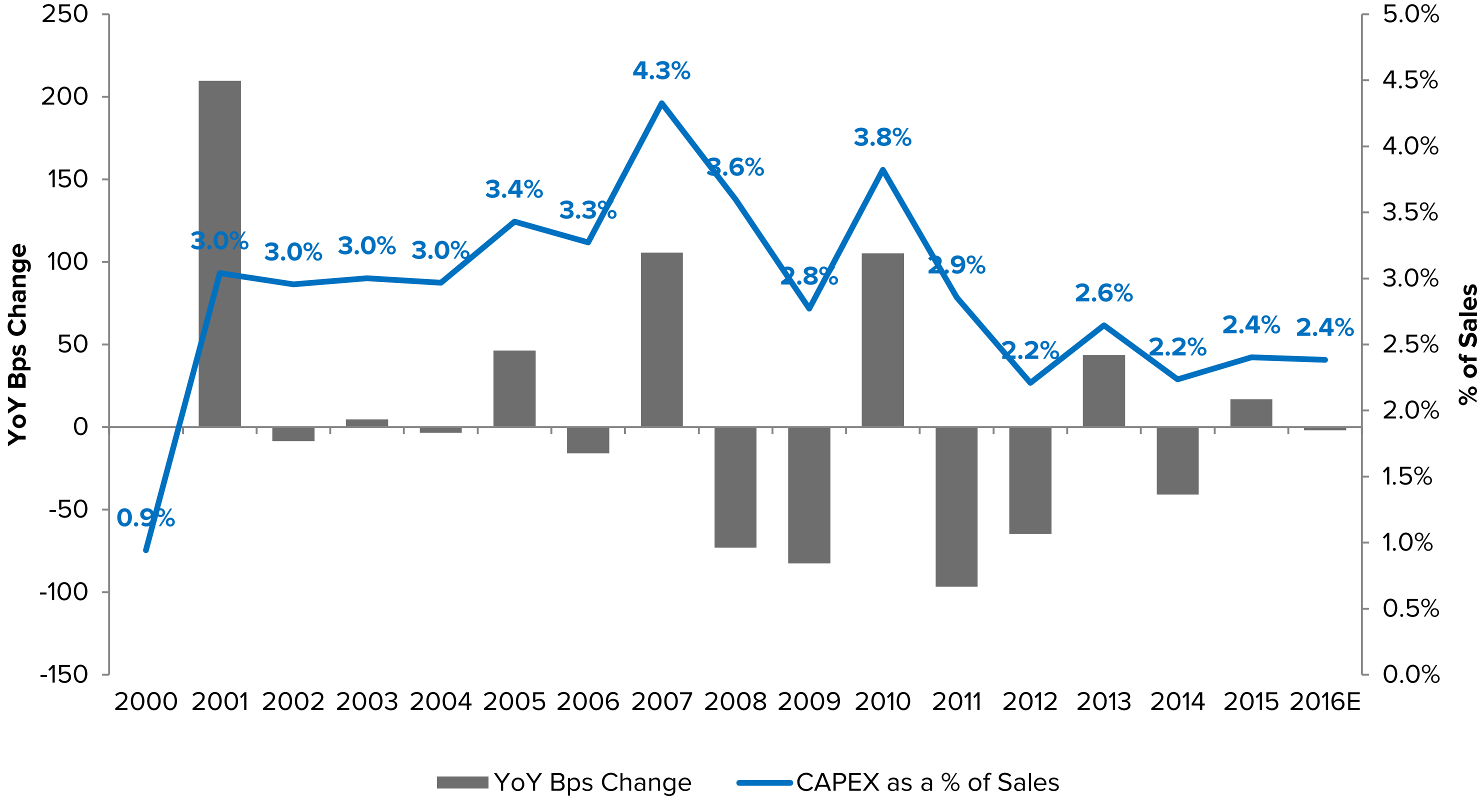


Well off peak of the early 2000's, but has held steady in the better part of the last 10 years. Besides being hit with the general slowing center of store, the bread category is as steady as they come, requiring little advertising.

DATA SOURCE: COMPANY FILINGS.

CAPEX AS A % OF SALES

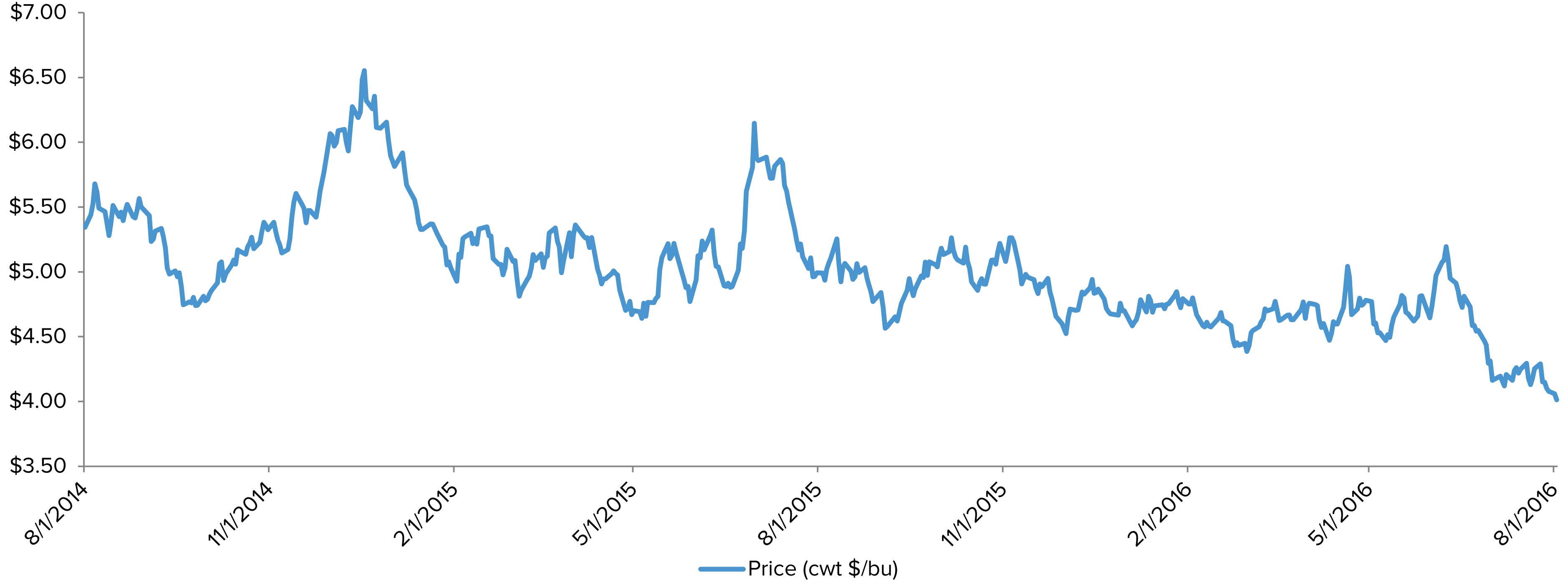
IN A STEEP DECLINE SINCE 2007



- Using the midpoint of managements guidance ($90 - $100 million) and the consensus estimate for sales, we arrive at a flat YoY comparison for CAPEX as a % of sales at 2.4%

DATA SOURCE: COMPANY FILINGS, FACTSET, HEDGEYE.

WHEAT HISTORICALLY DEFLATIONARY



WHEAT HAS BEEN A TAILWIND TO EARNINGS

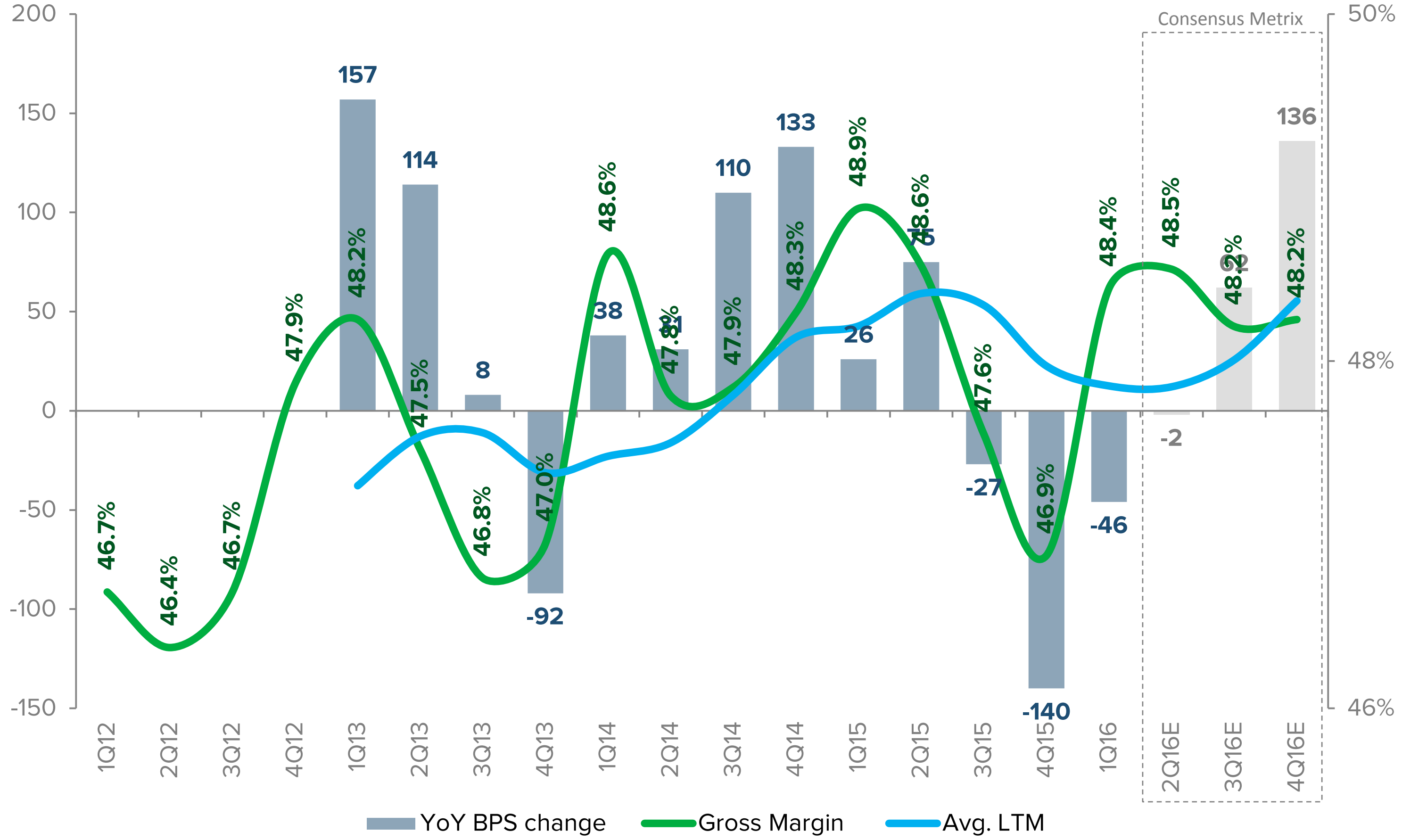
Flour is roughly 22% of total COGS and roughly half of ingredient costs, making it a major driver of the commodity basket. Other commodities include; eggs, soybean oil and natural gas.

DATA SOURCE: FACTSET.

Flowers Foods

MARGIN ANALYSIS

GROSS MARGIN



- Lower input costs benefit margins by approximately 110bps in 1Q16, while higher workforce costs and increased outside purchases resulted in overall gross margins to be down -46bps to 48.4% of sales

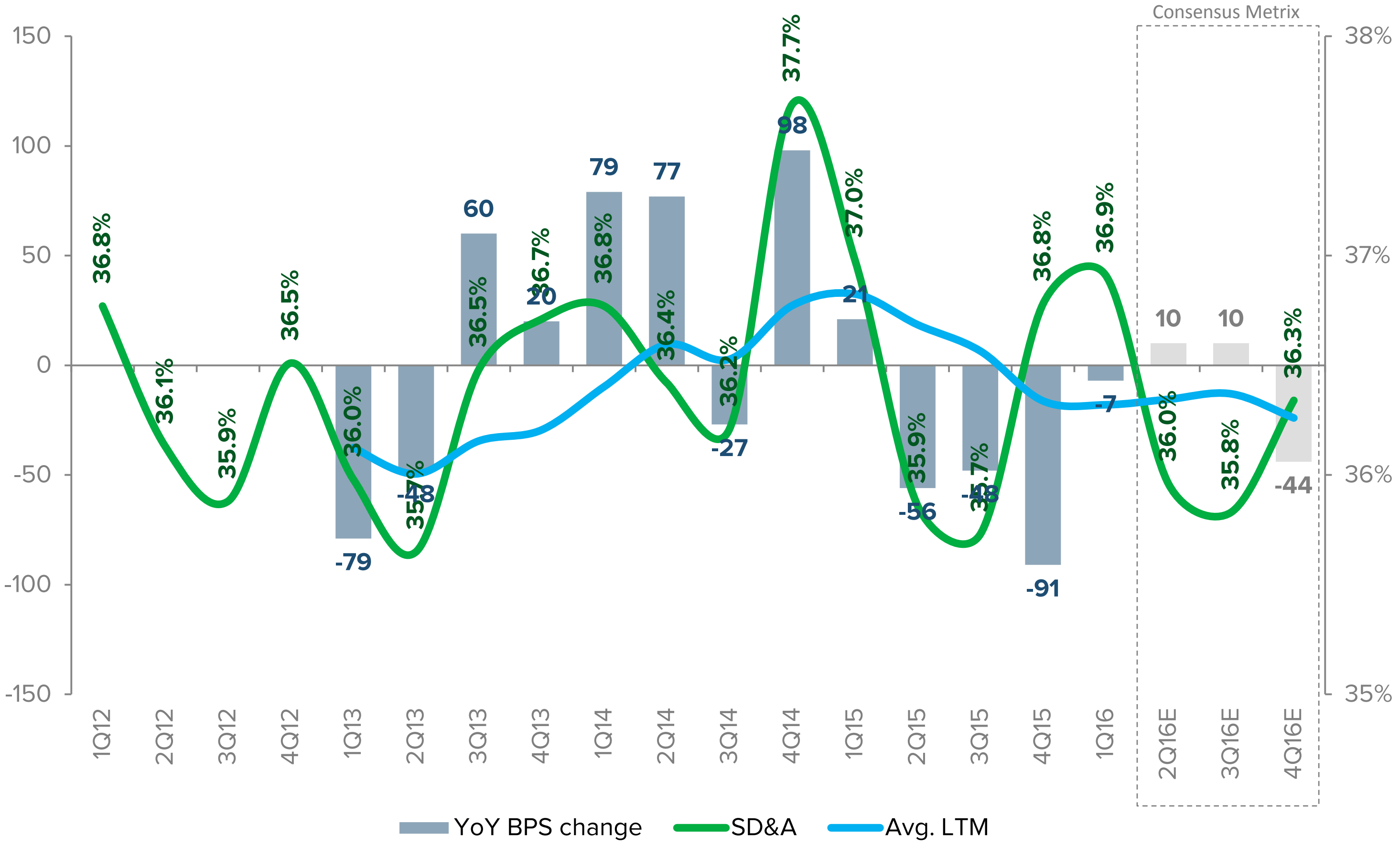
- Going back to the steep decline in 4Q15, gross margins were down -140bps to 46.9%

- Acquisitions negatively impacted gross margins by roughly 80bps in 4Q15 and 30bps in FY2015 as a whole

- The impact from acquisitions is primarily a result of increased purchases from outside products (products from co-manufacturers)

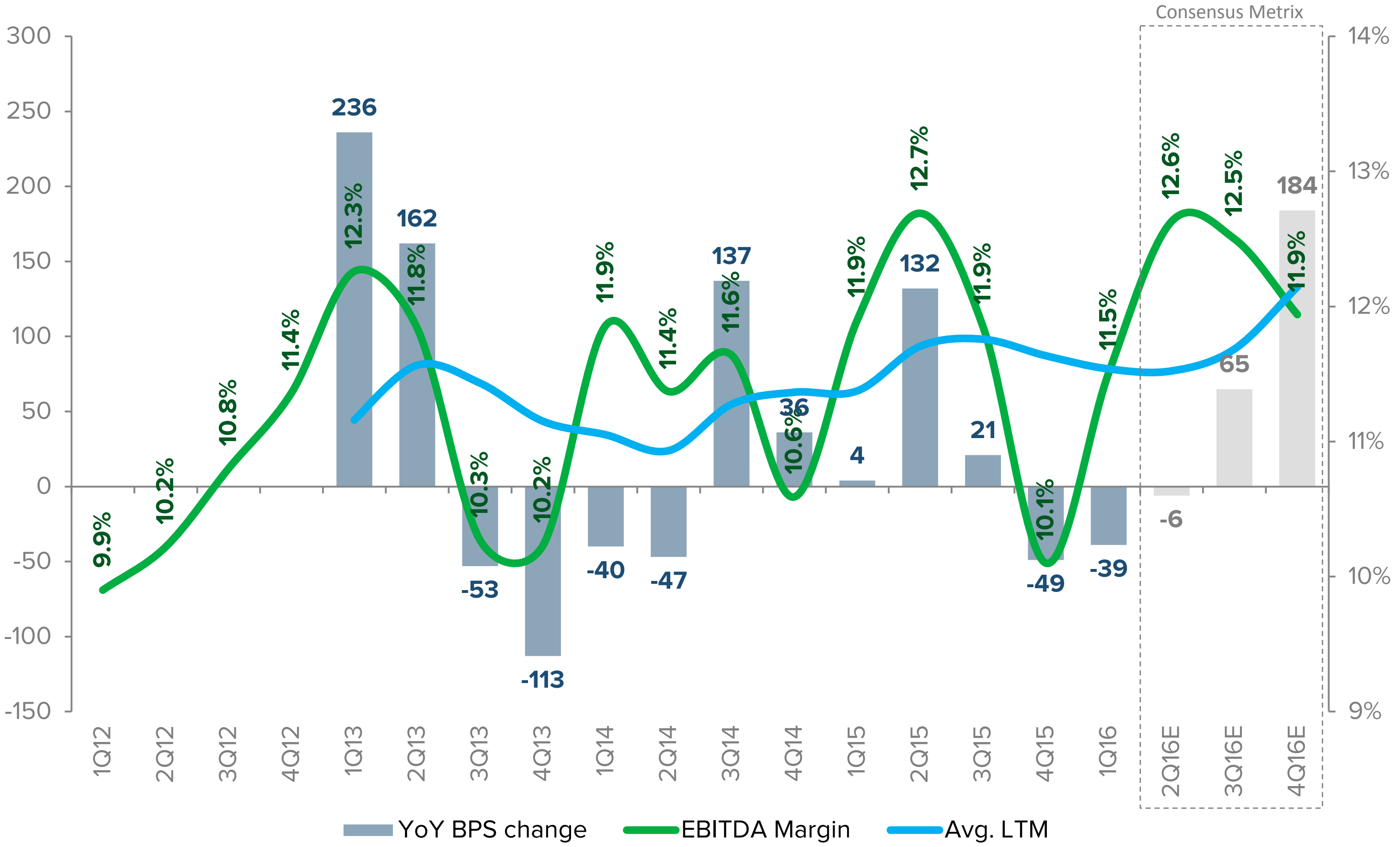
DATA SOURCE: COMPANY FILINGS, CONSENSUS METRIX.

SD&A AS A % OF SALES



- SD&A costs were down 10bps to 36.9% of sales in 1Q16, as higher marketing and legal costs were more than offset by lower distribution fees as a percent of revenue
- This dynamic was driven in part by DKB and Alpine being distributed primarily through warehouse
- Notably, in 2014 SD&A costs rose 98bps YoY to 37.7%, driven by increased distributor discounts and higher workforce related costs
- Decreased volume in both businesses was also a drag

EBITDA MARGIN

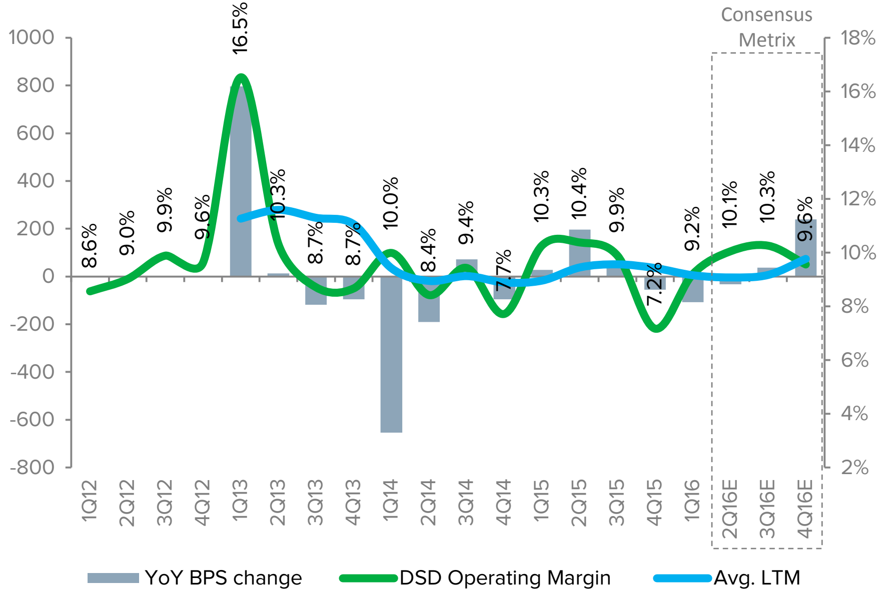


- FLO has been gradually improving their Adjusted EBITDA margin over the last five years
- Most recently, in 1Q16, EBITDA as a percent of sales declined -40bps due to soft volumes, capacity constraints and start up costs, which more than offset the deflationary commodity pricing
- They have stated a goal of getting to between 12% and 14%
- They plan to do this by eliminating unproductive promotional activity and increasing price realization
- Increasing market share, leveraging technology and manufacturing efficiencies will also be large contributors
- We view near term consensus estimates as overly optimistic, given current market conditions and distributor sentiment

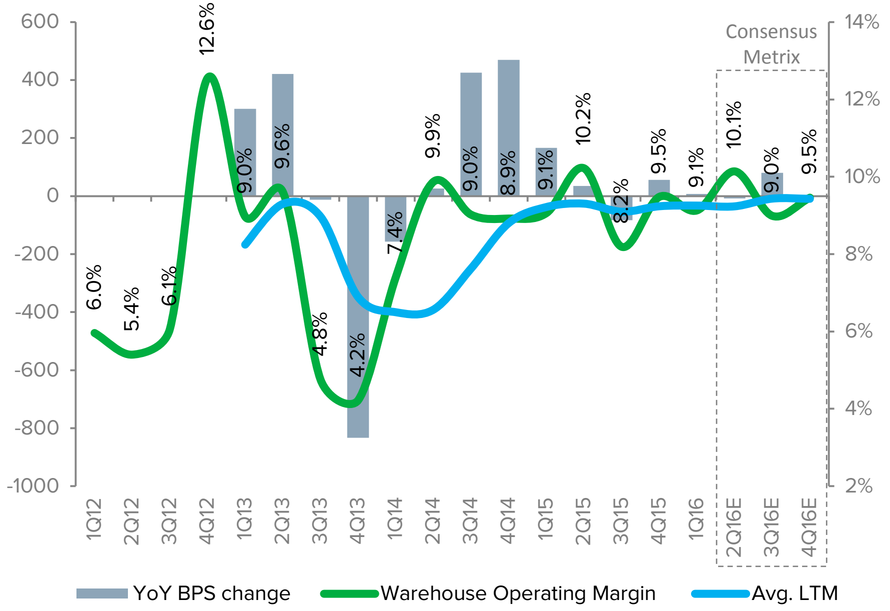
DATA SOURCE: COMPANY FILINGS, CONSENSUS METRIX.

OPERATING MARGIN

DSD



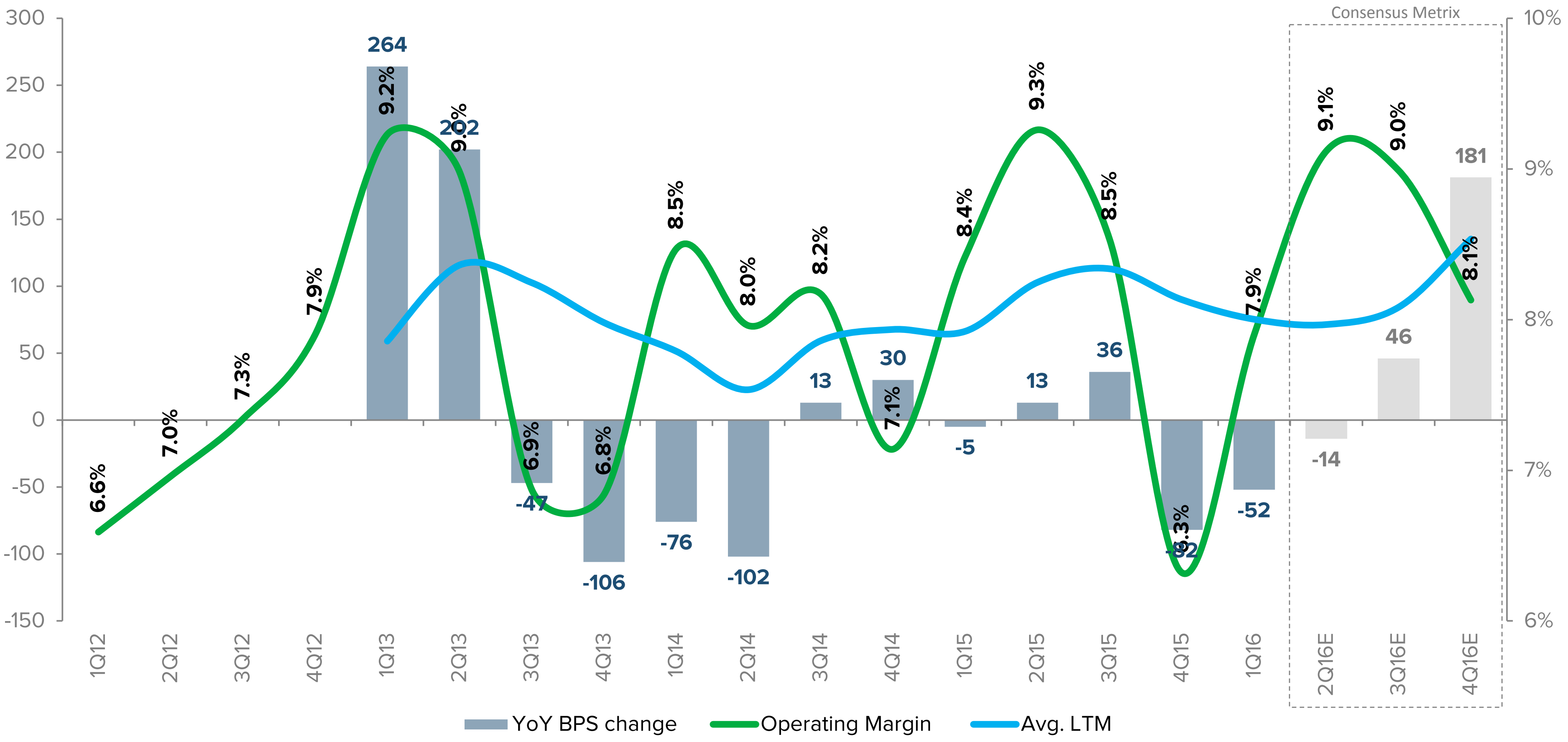
Warehouse



THE UPSWING IN MARGINS SEEMS UNATTAINABLE

Looking out to the remainder of 2016, consensus estimates are projecting some decent growth, that seems unrealistic from where we are standing. And if they are able to achieve them, distributors are likely to feel the pain

CONSOLIDATED OPERATING MARGIN



DATA SOURCE: COMPANY FILINGS, CONSENSUS METRIX.

FlowersFoods

VALUATION

FLO'S LONG-TERM GROWTH PLAN & GUIDANCE

FLO's Long-Term Goals

Grow Sales 2% to 4% (excluding future acquisitions)

- Grow volumes in expansion markets (e.g. Midwest, Northeast, West Coast)
- Grow sales in under-developed segments (e.g. Organics, Breakfast)
- Improve price/mix with increased focus on promotional efficiency

Grow EPS 8% to 10% (excluding future acquisitions)

- Leverage sales growth
- Achieve EBITDA margins 12% to 14%
- Reduce stales
- Execute initiatives to improve efficiencies and reduce costs
- Reduce debt and interest expense

Current 2016 Guidance

Sales Guidance = $3.986 to $4.080 billion

- Increase of 5.5% to 8.0% over fiscal 2015
- Acquisitions to contribute 5.2% to 5.7% to overall increase
- Core and expansion markets to contribute 0.3% to 2.3% of sales growth

EPS Guidance = $1.00 to $1.06 per share

- EBITDA margin expansion driven by improved efficiencies, cost structure leverage
- Guidance now incorporates accretion from ASR

Additional Color

- D&A = $145 to $150 million
- Net interest expense = $10 to $11 million
- Updated tax forecast = ~35.5%
- CAPEX = $90 to $100 million

COMPANY DASHBOARD

Worst case scenario upon adverse legal settlement

Flowers Foods, Inc. **$17.89**

EARNINGS AND VALUATION SUMMARY

(FY ends Dec.)	NTM	2016E	2017E	2018E
Hedgeye EPS	$0.24	$0.43	$0.29	$0.29
% Chg YoY		-53.3%	-32.6%	0.0%
Consensus	$1.05	$1.00	$1.08	$1.20
% Chg YoY		8.9%	7.7%	11.2%
Variance %		-57.1%	-73.1%	-75.8%
P/E	73.5X	40.6X	60.7X	60.7X

SUMMARY FINANCIALS

(Consensus in mm)	NTM	FY2016E	FY2017E
Sales	$4,011.0	$3,985.8	$4,070.3
% Chg YoY		5.5%	2.1%
EBITDA	$494.6	$481.0	$503.6
% Chg YoY		9.1%	4.7%
EBITDA Margin*	12.3%	12.1%	12.4%
EV/EBITDA	9.6X	9.9X	9.5X

VALUATION

Stock Price	$	17.89
Shares Outstanding		207
Market Cap	$	3,700.3
+ Net Debt	$	1,065.1
+ Preferred Equity	$	-
+ Minority Interest	$	-
Enterprise Value	**$**	**4,765.4**
NTM EBITDA	$	494.6
NTM EV/EBITDA		9.6x
NTM EPS	$	1.05
NTM P/E		17.1x
1X Turn	$	2.39
Upside/Downside		13.4%

INVESTMENT POSITIVES

1) Market leading brands
2) #2 market share in bread category

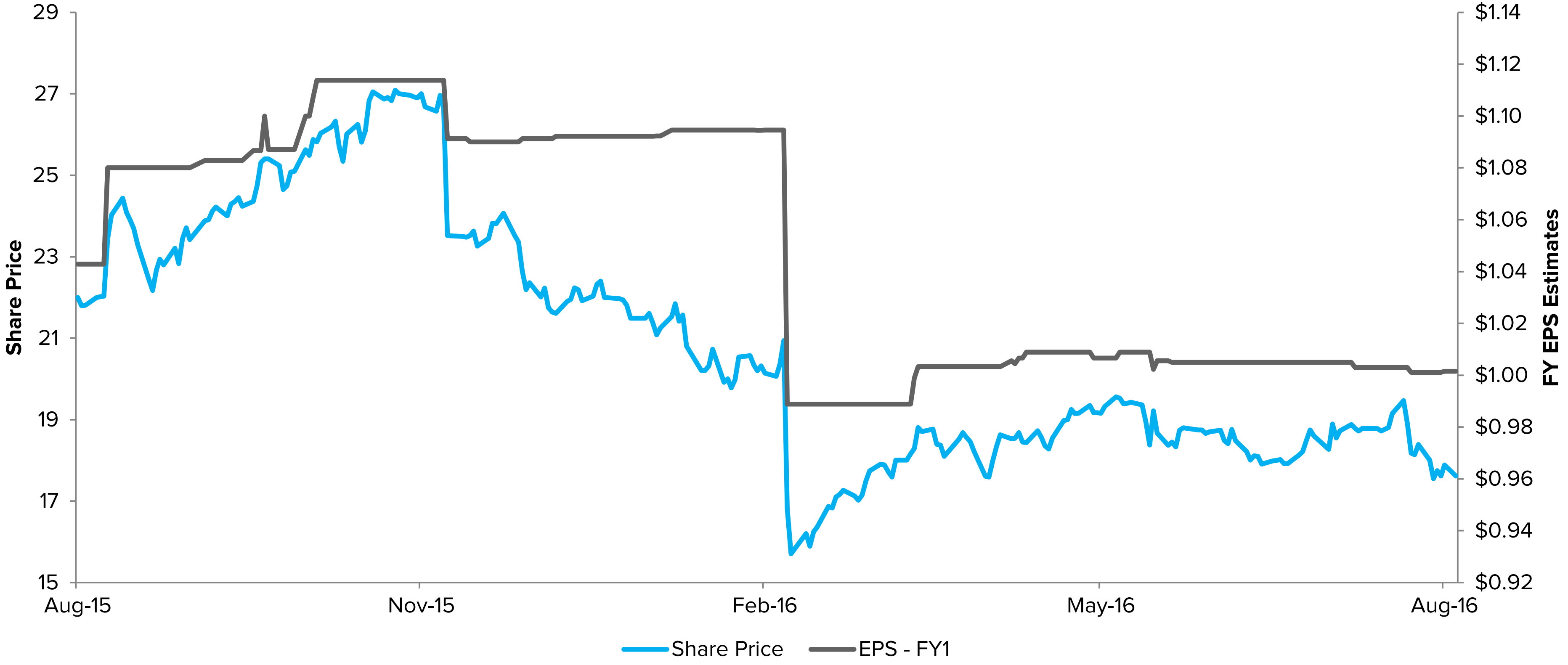
INVESTMENT NEGATIVES

1) Misclassifation lawsuits
2) Deteriorating business fundamentals
3) Brand overload

Source: FactSet, Company Filings.
*Consensus EBITDA Margin

I YEAR EPS REVISIONS VS. STOCK PRICE

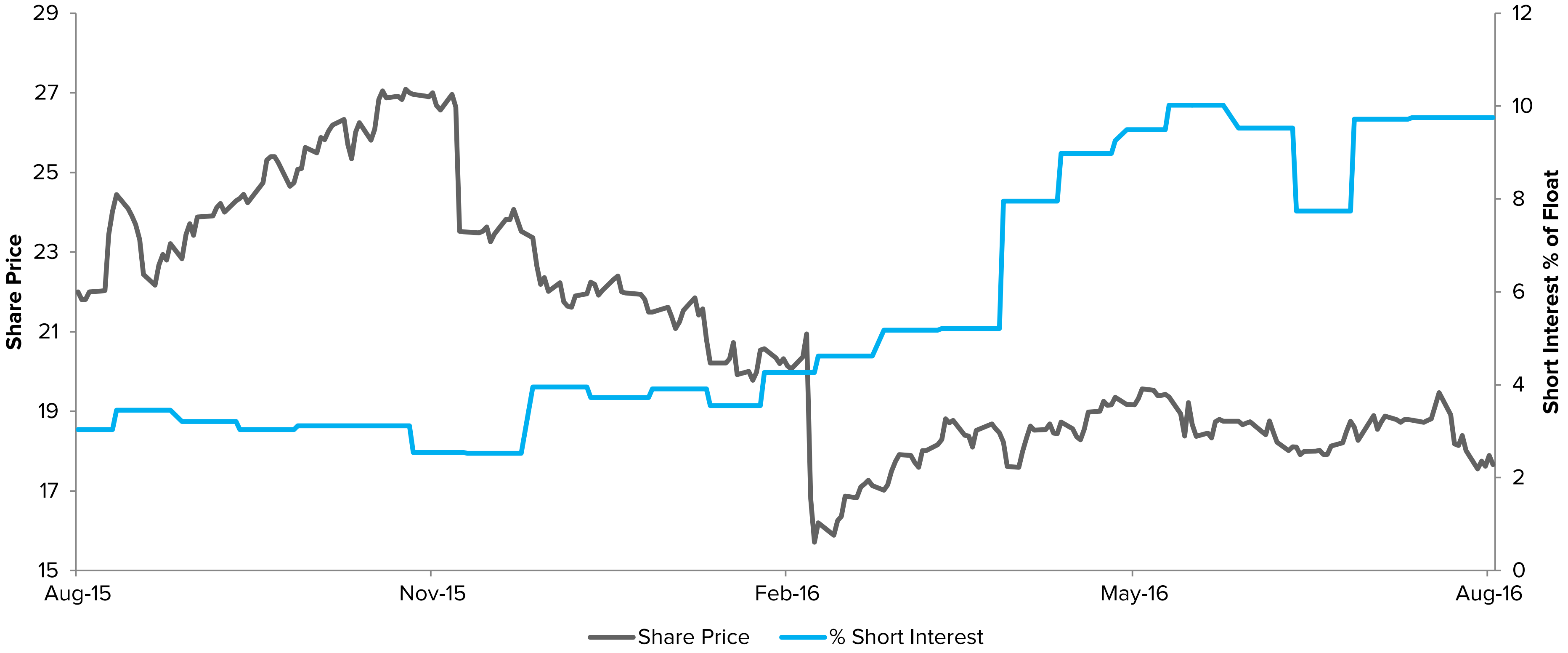
IF THEY LOSE IN COURT, THIS IS NOWHERE NEAR A FLOOR



DATA SOURCE: FACTSET, UPDATED ON 8.8.16.

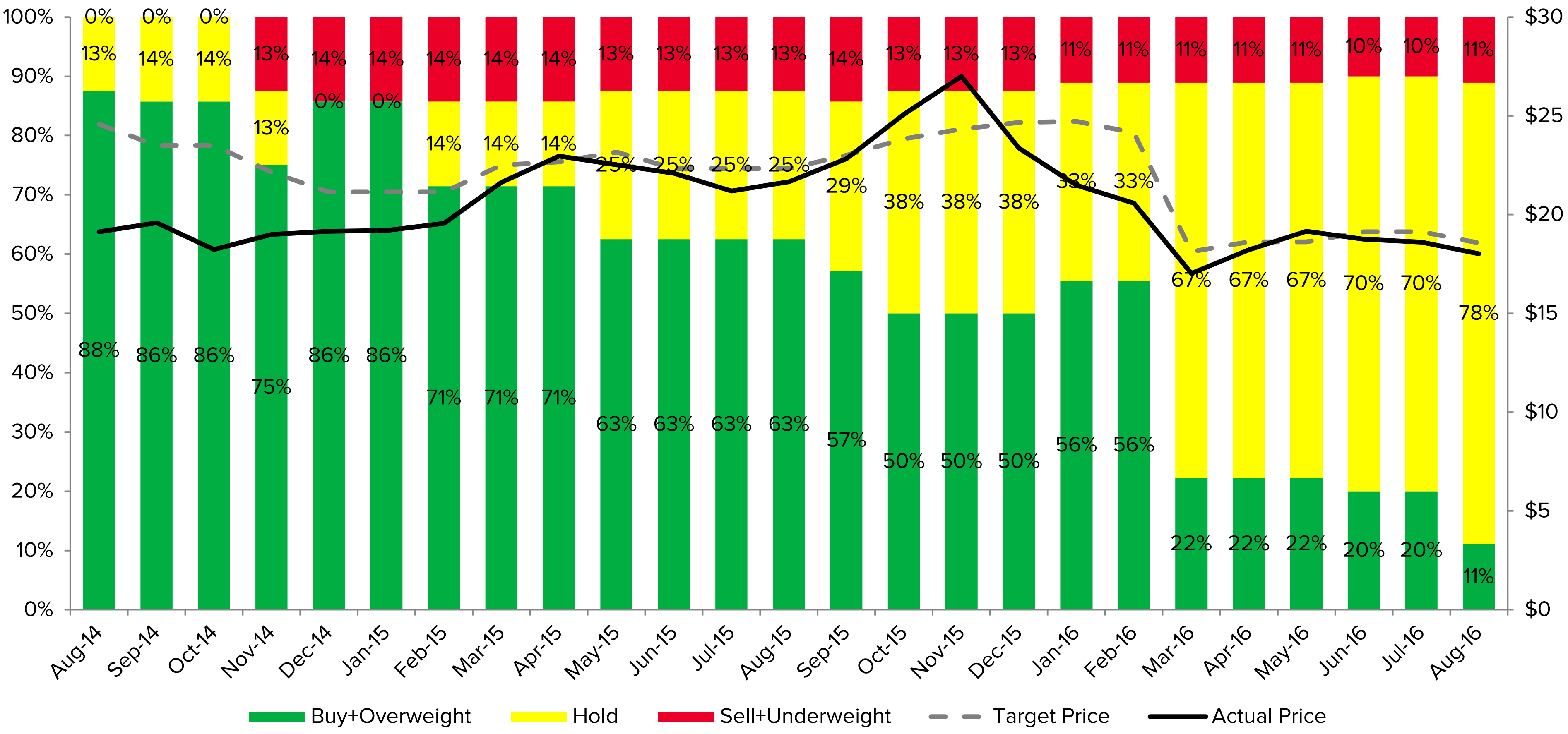
SHORT INTEREST

RISING STEADILY WITH THE NUMBER OF LAWSUITS FILED



DATA SOURCE: FACTSET, UPDATED ON 8.8.16.

ANALYST RATINGS



PUBLIC COMPANY COMPARABLES

Company Name	Price	Diluted Shares Out.	Equity Value	Enterprise Value	LTM Sales	Gross Margin	EBITDA Margin	NTM EV/ EBITDA
FLO	$17.89	207	$3,700	$4,765	$3,837	48.4%	12.1%	9.5x
GIS	$70.55	597	$42,104	$50,992	$16,563	36.8%	22.0%	14.2x
K	$82.71	350	$28,949	$36,850	$13,136	39.2%	19.0%	14.3x
CAG	$46.31	439	$20,316	$25,091	$11,643	27.5%	17.7%	12.3x
SJM	$155.23	116	$18,073	$23,393	$7,811	38.9%	22.4%	13.2x
CPB	$61.32	309	$18,926	$22,228	$7,967	37.3%	22.3%	12.2x
PF	$49.67	118	$5,860	$8,889	$2,869	29.8%	20.7%	13.0x
THS	$100.08	57	$5,676	$8,522	$4,476	19.7%	20.4%	11.5x
LNCE	$34.33	96	$3,285	$4,667	$1,717	35.4%	13.7%	13.1x
Mean						33.1%	19.8%	13.0x
Median						36.1%	20.6%	13.1x

DATA SOURCE: FACTSET, CONSENSUS METRIX.

VALUATION MATRIX

NTM EV/EBITDA Multiple

EBITDA	7.5x	8.0x	8.5x	9.0x	9.5x	10.0x	10.2x	10.4x	10.6x	10.8x	11.0x
$296	$5.57	$6.28	$7.00	$7.71	$8.43	$9.14	$9.43	$9.72	$10.00	$10.29	$10.57
$302	$5.78	$6.51	$7.24	$7.97	$8.70	$9.43	$9.72	$10.01	$10.30	$10.60	$10.89
$308	$6.00	$6.75	$7.49	$8.23	$8.98	$9.72	$10.02	$10.32	$10.61	$10.91	$11.21
$314	$6.23	$6.98	$7.74	$8.50	$9.26	$10.02	$10.32	$10.63	$10.93	$11.23	$11.54
$320	$6.45	$7.23	$8.00	$8.77	$9.55	$10.32	$10.63	$10.94	$11.25	$11.56	$11.87
$326	$6.69	$7.47	$8.26	$9.05	$9.84	$10.63	$10.95	$11.26	$11.58	$11.89	$12.21
$333	$6.92	$7.73	$8.53	$9.34	$10.14	$10.95	$11.27	$11.59	$11.91	$12.23	$12.56
$340	$7.16	$7.98	$8.81	$9.63	$10.45	$11.27	$11.60	$11.93	$12.25	$12.58	$12.91
$346	$7.41	$8.25	$9.08	$9.92	$10.76	$11.60	$11.93	$12.27	$12.60	$12.94	$13.27

BEAR	BASE	BULL
-69%	-42%	-26%

IT'S HARD TO BE OPTIMISTIC ABOUT THE FUTURE FOR FLO

Downside scenario supported by depleted P&L due to major distribution model restructuring. We see little to no upside at current valuation levels given the aforementioned litigation and general deteriorating business fundamentals

DATA SOURCE: HEDGEYE.

SUMMARY OF OUR THOUGHTS

Key Points

1. Fundamentally FLO's business faces challenges the way it is today
2. Retailer and supplier consolidation as created increasingly competitive operating environment
3. Misclassification allegations could be detrimental to the business
4. Margins and earnings would be drastically reduced if required to change business model

Risks To The Short

1. The #1 risk is that the misclassification lawsuits that are currently pending, were to fall in FLO's favor entirely, that would be the end to our short call
2. Although commodities are favorable now, increases in key commodities such as wheat, eggs, soybean oil and nat. gas would effect margins negatively
3. Center of store recovers dramatically and people start to buy bread at an increasing rate

DATA SOURCE: HEDGEYE.

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