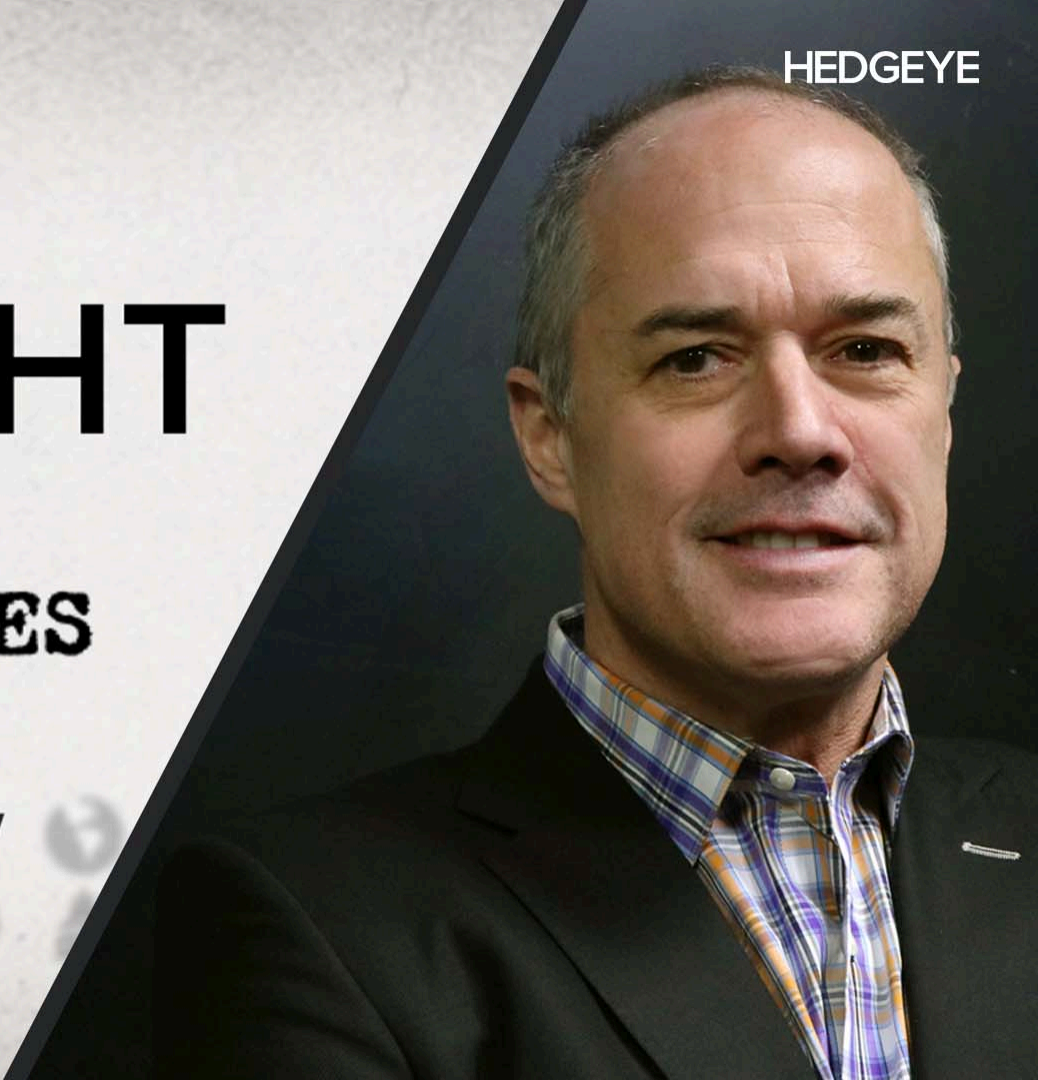
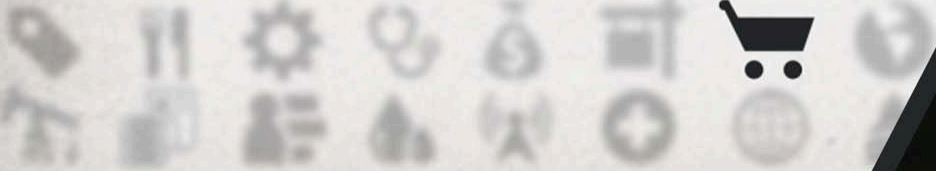


SECTOR SPOTLIGHT

CONSUMER STAPLES



DISCLAIMER

DISCLAIMER

Hedgeye Risk Management is a registered investment advisor, registered with the State of Connecticut. Hedgeye Risk Management is not a broker dealer and does not provide investment advice for individuals. This research does not constitute an offer to sell, or a solicitation of an offer to buy any security. This research is presented without regard to individual investment preferences or risk parameters; it is general information and does not constitute specific investment advice. This presentation is based on information from sources believed to be reliable. Hedgeye Risk Management is not responsible for errors, inaccuracies or omissions of information. The opinions and conclusions contained in this report are those of Hedgeye Risk Management, and are intended solely for the use of Hedgeye Risk Management's clients and subscribers. In reaching these opinions and conclusions, Hedgeye Risk Management and its employees have relied upon research conducted by Hedgeye Risk Management's employees, which is based upon sources considered credible and reliable within the industry. Hedgeye Risk Management is not responsible for the validity or authenticity of the information upon which it has relied.

TERMS OF USE

This report is intended solely for the use of its recipient. Re-distribution or republication of this report and its contents are prohibited. For more details please refer to the appropriate sections of the Hedgeye Services Agreement and the Terms of Use at www.hedgeye.com

PLEASE SUBMIT QUESTIONS* TO

QA@HEDGEYE.COM

**ANSWERED AT THE END OF THE CALL*

KEY THEMES

1

M&A A POSITIVE – HAS ZBB GONE TOO FAR?

It's rare to go a month or even a week without hearing a rumor about a large M&A deal in the consumer staples space. Accordingly, M&A has to be considered when making investments in the sector. A great example of this is our long GIS, PF and HRL calls, sales are not great at the companies, but the prospect of M&A and the different ways they can go about it are too good to pass up. All this M&A and the involvement of 3G in the industry has brought on a new way of doing business. Zero Based Budgeting (ZBB) has ravaged the industry with many companies going through multiple cost savings programs over the last few years. With the spending so goes the sales, as categories across the store have slowed. As an example, GIS flat out admitted to cutting too far in certain areas and falling short of expectations because of it in their most recent quarterly earnings call.

2

REFLATION TRADE HAS A LONG RUNWAY

The investor community has largely gathered around the thought that we will begin to see deflation easing and a turn towards modest inflation in the middle of 2017. The better food retailers (COST & WFM) and distributors (USFD & SYY) have benefited in part to this thought process. With that being said we believe this idea is still lacking true conviction/implementation as only a small set of commodities have started to show a strong bottoming. CPI – Food at Home notched its 13th consecutive month of deflation in December, which is six months longer than the average deflationary period going back to 1959. We anticipate a further acceleration in these shares as the reflation trade commences.

3

IMPLICATIONS OF THE TRUMP ADMINISTRATION

Top of mind is the Border Tax Adjustment/Tariff that could be implemented, lower corporate tax rate and the repatriation of overseas cash. The lower corporate tax rate is a clear gain for most companies we cover given the high taxes that are currently levied against them, we look at WFM with a tax rate of 39% to be a big beneficiary. The border tax adjustment is something that if implemented would negatively effect retailers (COST for example) the most given the amount of goods that are imported. We have been speaking extensively with our team in Washington and believe there is a low probability that a border tax is implemented given the negative implications for the US consumer. Additionally, Pence loves free trade, so could be a beacon of hope for the National Retail Federation, who is lobbying hard against border taxes.

HEDGEYE CONSUMER STAPLES IDEAS LIST

LONG LIST

- 1) **WFM** Whole Foods Market
- 2) **COST** Costco Wholesale
- 3) **USFD** US Foods
- 4) **GIS** General Mills
- 5) **PF** Pinnacle Foods
- 6) **HRL** Hormel

TRADE TREND TAIL

TRADE	TREND	TAIL
-	✓	✓
-	✓	✓
-	✓	✓
-	✓	✓
-	✓	✓
-	✓	✓

LONG BENCH

- PEP** PepsiCo
- CAG** ConAgra Foods
- SJM** J.M. Smucker Co.
- TWNK** Hostess Brands
- PFGC** Performance Food Group

SHORT LIST

- 1) **HAIN** Hain Celestial

TRADE TREND TAIL

TRADE	TREND	TAIL
X	X	X

SHORT BENCH

- NUS** Nu Skin
- KR** Kroger

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

M&A LANDSCAPE

Announced Date	Target	Acquirer	Enterprise Value (EV)	Enterprise Value /	
				Revenue	EBITDA
12/30/2016	Hill & Valley	J&J Snack Foods			
12/2/2016	Victoria Fine Foods	B&G Foods	\$70	1.71x	7.78x
11/28/2016	Snyder's-Lance Specialty Nuts	Blue Road Management			
11/22/2016	Bai Brands	Dr Pepper Snapple	\$1,700	4.00x	21.25x
9/26/2016	Frontera Foods	ConAgra	\$109		
9/21/2016	ACH Foods	B&G Foods	\$365	1.66x	9.36x
7/7/2016	WhiteWave	Danone SA	\$12,054	2.93x	22.20x
7/5/2016	Hostess Holdco	The Gores Group	\$3,290		
5/23/2016	Spicetec Flavors (ConAgra)	Givaudan SA	\$340		
5/18/2016	Justin's	Hormel	\$286	2.86x	
1/13/2016	Sunny Delight Beverages	Brynwood Partners	\$195	0.46x	
1/6/2016	EPIC Provisions	General Mills			
11/24/2015	Boulder Brands	Pinnacle Foods	\$959	1.90x	23.50x
11/16/2015	thinkThin	Glanbia	\$217	2.58x	
11/2/2015	ConAgra Private Brands	Treehouse Foods	\$2,700	0.75x	9.00x
10/28/2015	Diamond Foods	Snyder's-Lance	\$1,914	2.21x	17.80x
9/10/2015	Alpine Valley Bread	Flowers Foods	\$120	1.33x	
9/3/2015	Green Giant (General Mills)	B&G Foods	\$765	1.31x	7.85x
8/12/2015	AVB Inc. (Dave's Killer Bread)	Flowers Foods	\$275	1.67x	
8/7/2015	Wallaby Yogurt	WhiteWave Foods	\$125	2.78x	
6/10/2015	Vega	WhiteWave Foods	\$550	5.50x	
6/9/2015	Garden Fresh Salsa	Campbell's	\$231	2.31x	
5/26/2015	Applegate Farms	Hormel Foods	\$775	2.28x	
3/25/2015	Kraft	Heinz	\$54,810	3.00x	15.00x
2/3/2015	Big Heart Pet Brands	J.M. Smuckers	\$5,800	2.52x	12.89x
11/14/2014	Garden Protein	Pinnacle	\$154	2.69x	
10/14/2014	So Delicious	WhiteWave Foods	\$195	1.70x	
9/8/2014	Annie's	General Mills	\$821	3.95x	27.37x
		Mean		2.37x	15.82x
		Median		2.29x	15.00x
		Min		0.46x	7.78x
		Max		5.50x	27.37x

Data Source: FactSet, Hedgeye.

Potential Deals

Acquirer



Target



CHOBANI™



Mondelēz International



Potential Targets



Mondelēz International



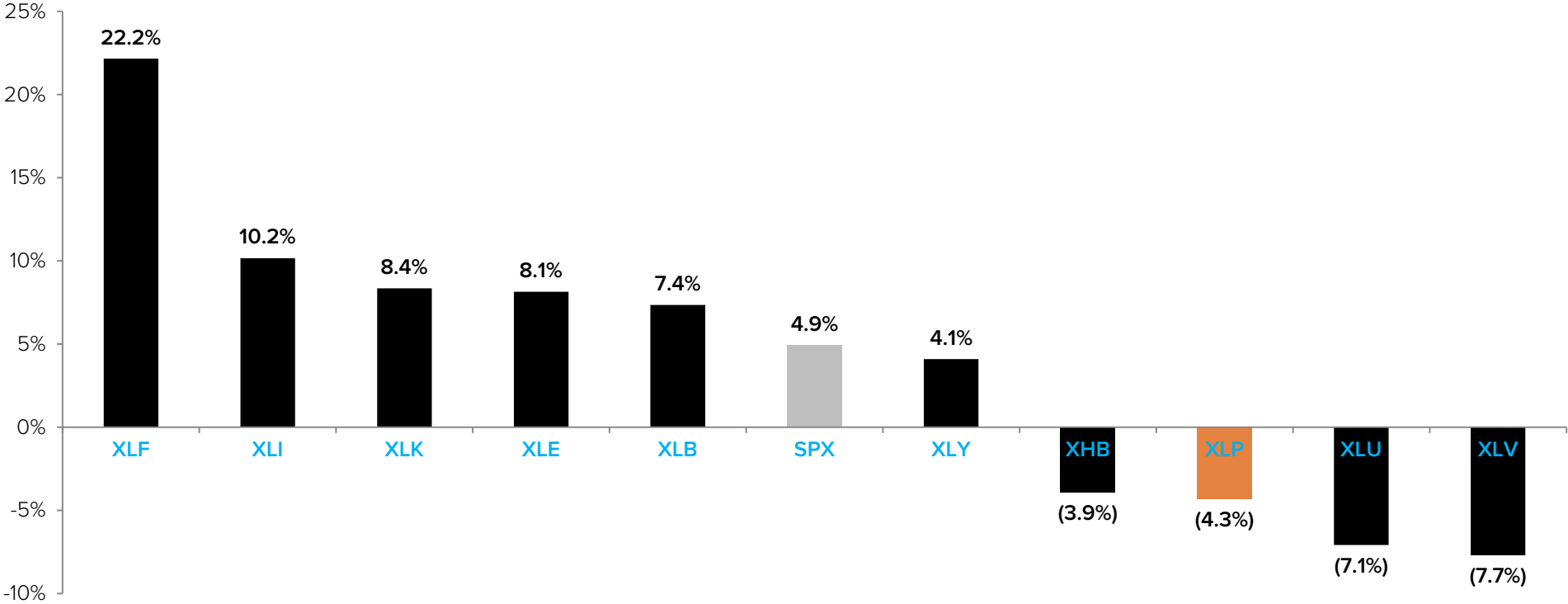
Amplify SNACK BRANDS



CHOBANI™

XLP VERSUS THE MARKET – LAST 6 MONTHS

SECTOR PERFORMANCE: LAST 6 Months



XLP VERSUS THE MARKET - YTD

SECTOR PERFORMANCE: YTD



U.S. DOLLAR INDEX CORRELATION TO RELATIVE S&P SECTOR PERFORMANCE

Daily U.S. Dollar Index Correlation to Relative S&P Sector Performance

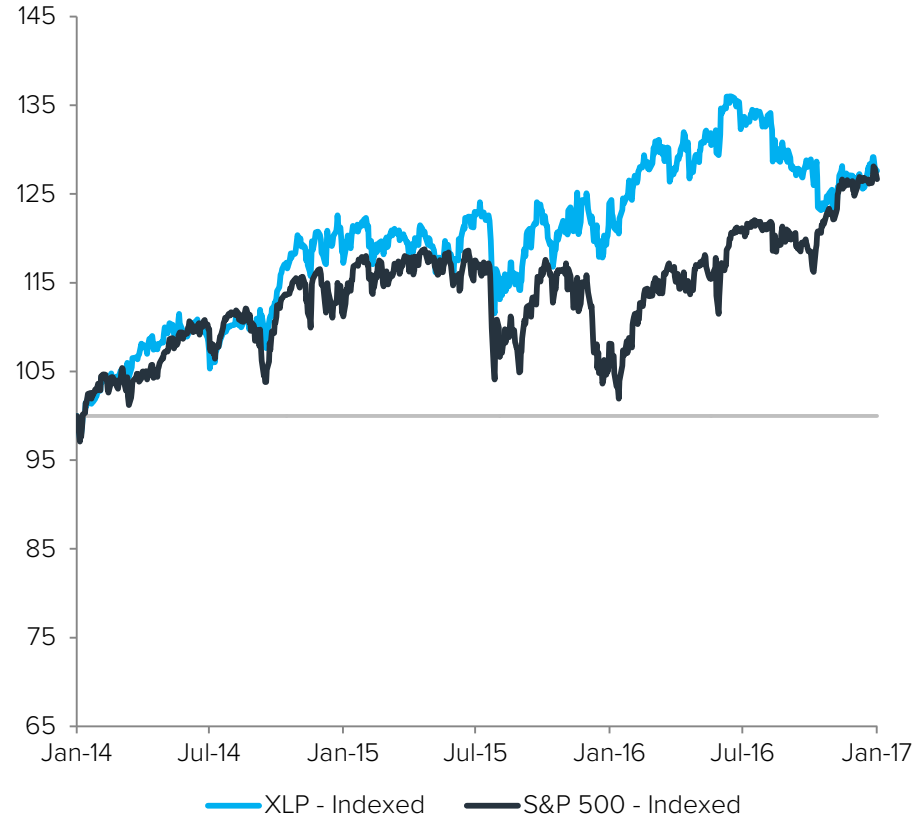
S&P 500 Sectors (GICS Level I Composites)	1-Mth	3-Mth	6-Mth	1-Yr	3-Yr
S&P 500 Financials	0.73	0.85	0.95	0.87	0.03
S&P 500 Industrials	-0.50	0.45	0.81	0.69	-0.46
S&P 500 Energy	0.83	0.61	0.75	0.41	-0.92
S&P 500 Materials	-0.77	0.07	0.33	0.00	-0.84
S&P 500 Information Technology	-0.89	-0.63	-0.03	0.49	0.81
S&P 500 Consumer Discretionary	-0.93	-0.10	-0.23	-0.52	0.78
S&P 500 Telecom Services	0.75	0.70	-0.51	-0.55	-0.50
S&P 500 Utilities	0.53	-0.60	-0.84	-0.74	-0.02
S&P 500 Real Estate	0.60	-0.62	-0.91	-0.84	0.27
S&P 500 Health Care	0.57	-0.57	-0.91	-0.82	0.55
S&P 500 Consumer Staples	-0.09	-0.76	-0.92	-0.78	0.44
DXY Performance	-2.14	1.69	4.71	0.49	23.01

XLP VERSUS THE MARKET

1 Year Performance vs. S&P 500

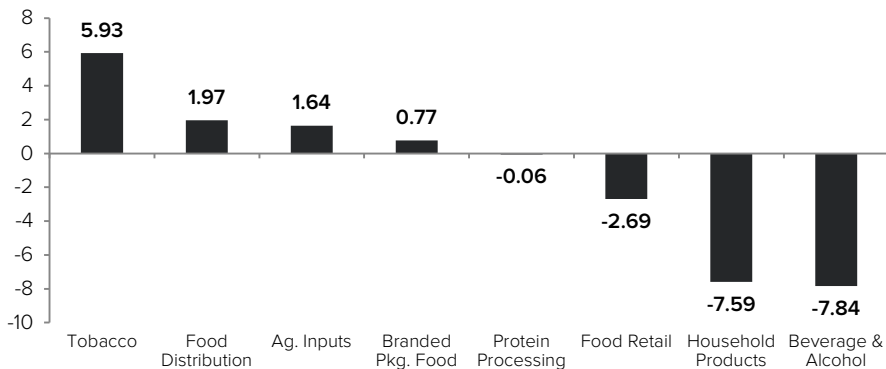


3 Year Performance vs. S&P 500

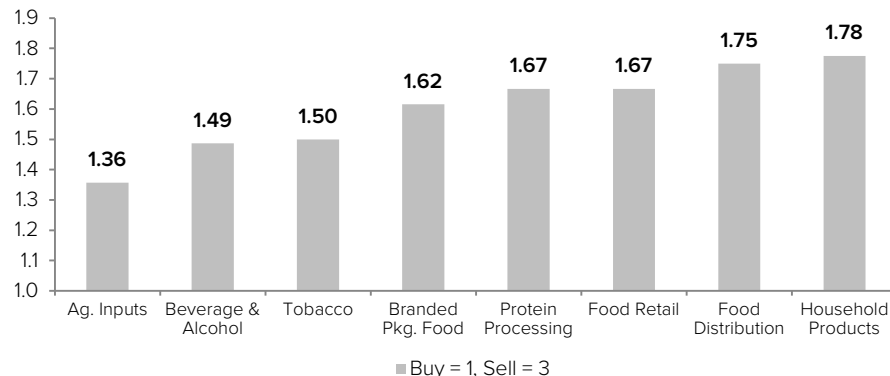


CONSUMER STAPLES MACRO TRACKER

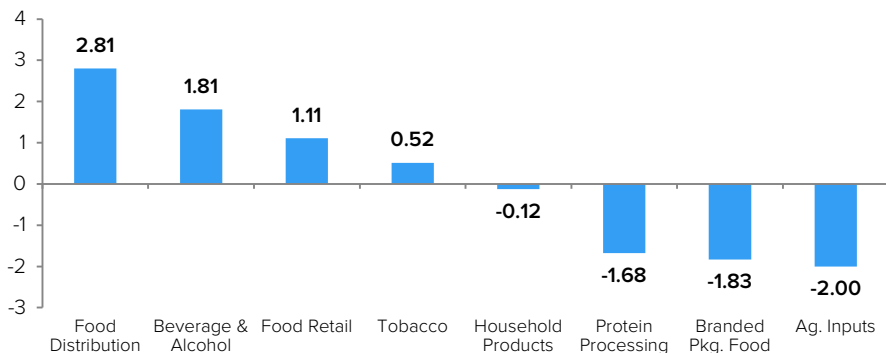
6 Month Price Change



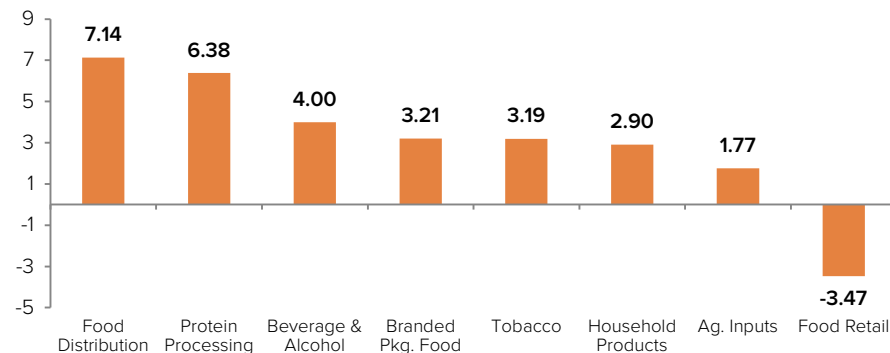
Analyst Rating



6 Month NTM Revenue Revision Trend

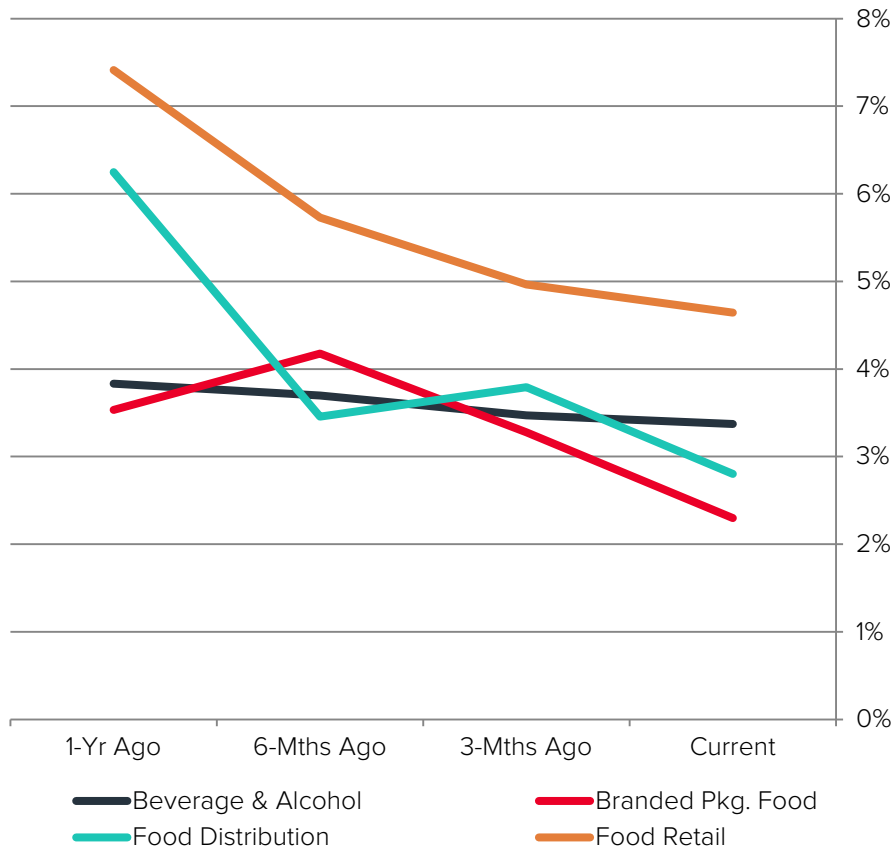


6 Month NTM Earnings Revision Trend

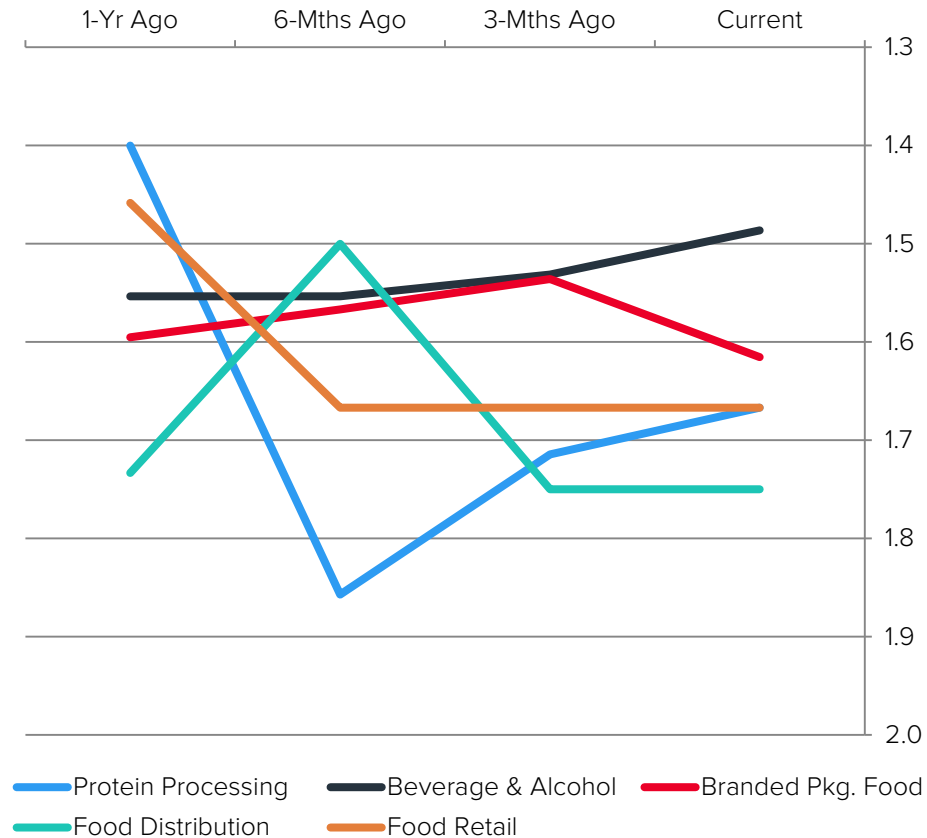


SENTIMENT TREND

Sub-Sector Median Short Interest

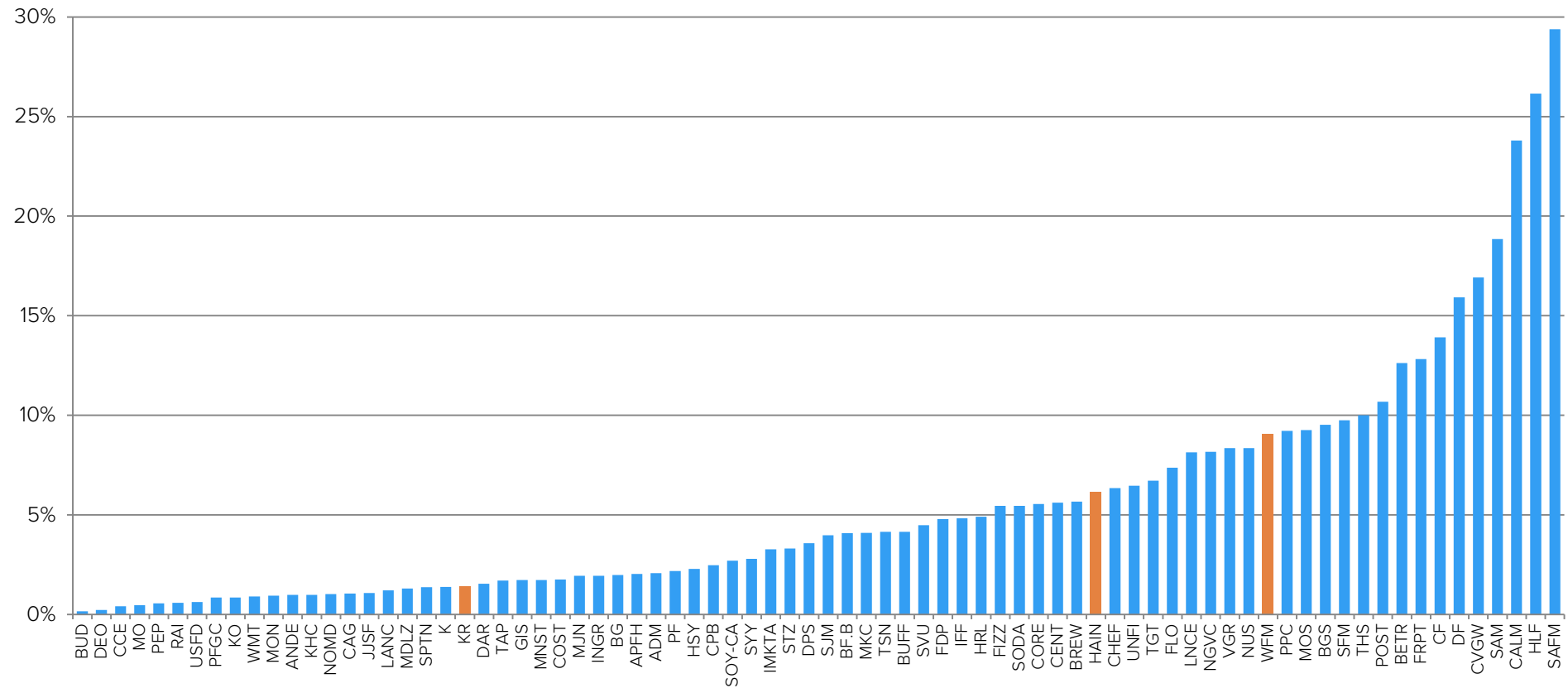


Sub-Sector Median Analyst Rating



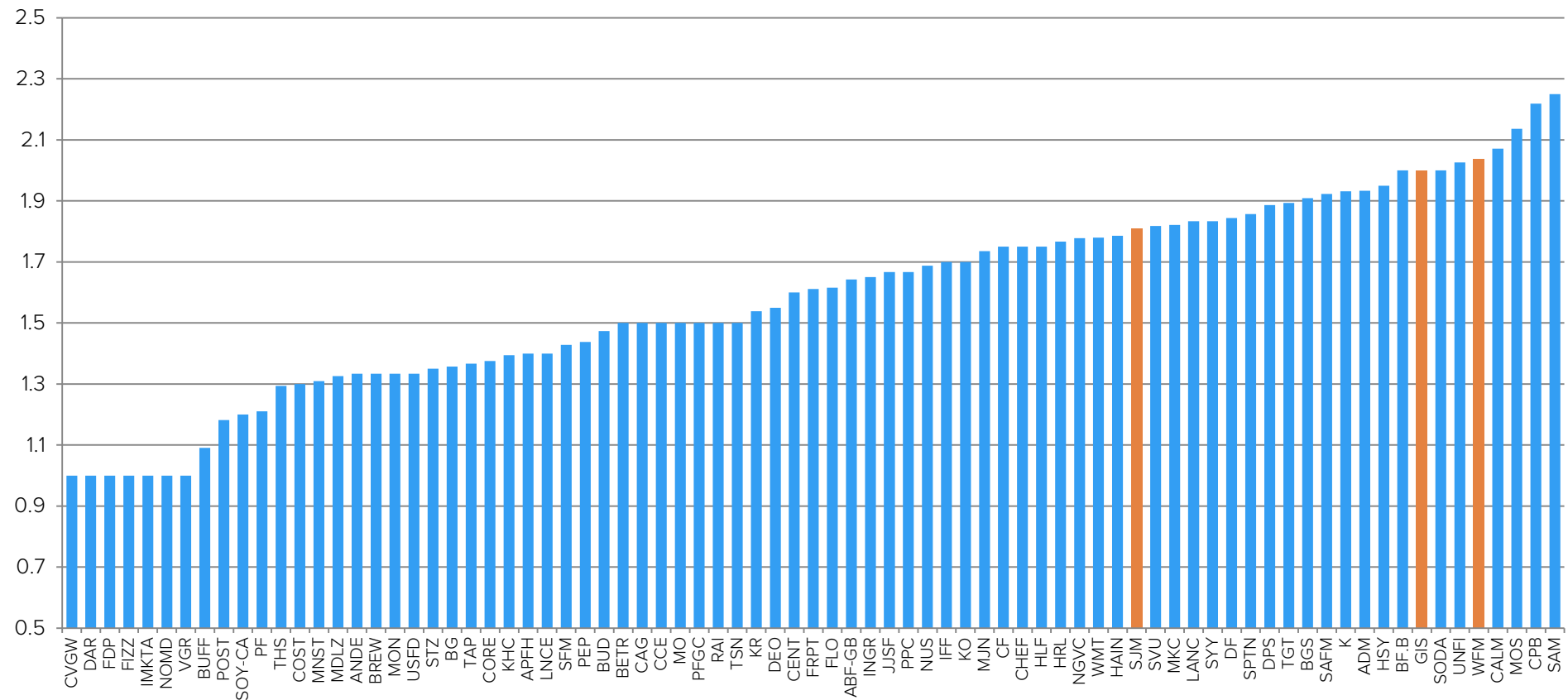
SENTIMENT TRACKER: SHORT INTEREST

Short Interest



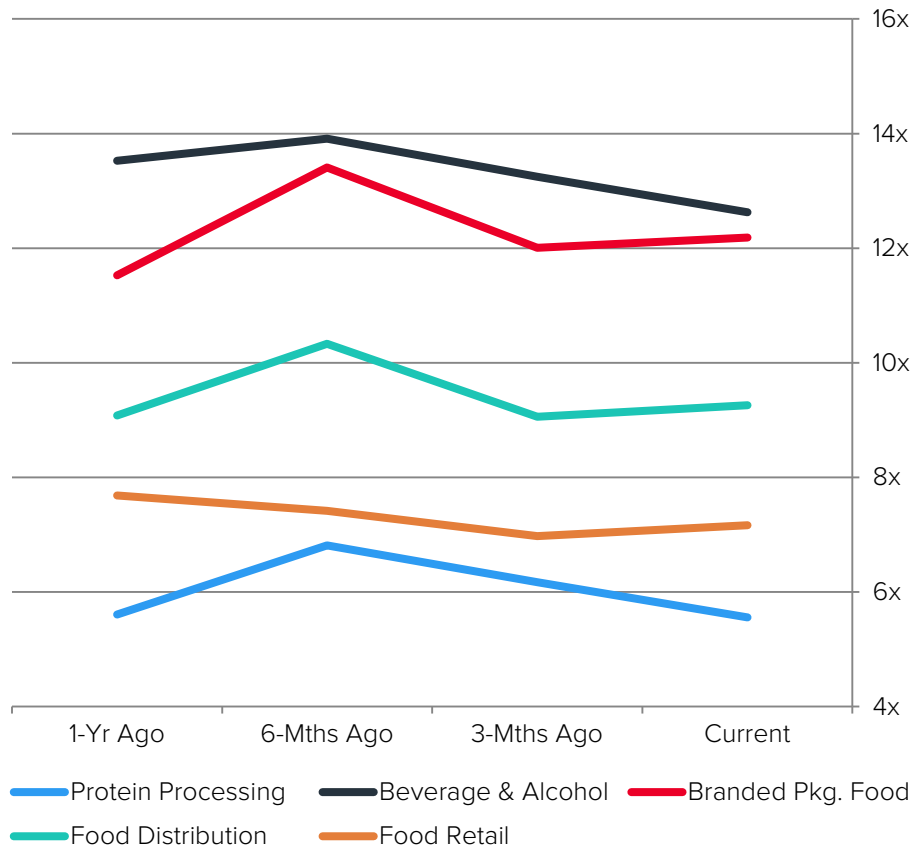
SENTIMENT TRACKER: ANALYST RATING

Analyst Rating

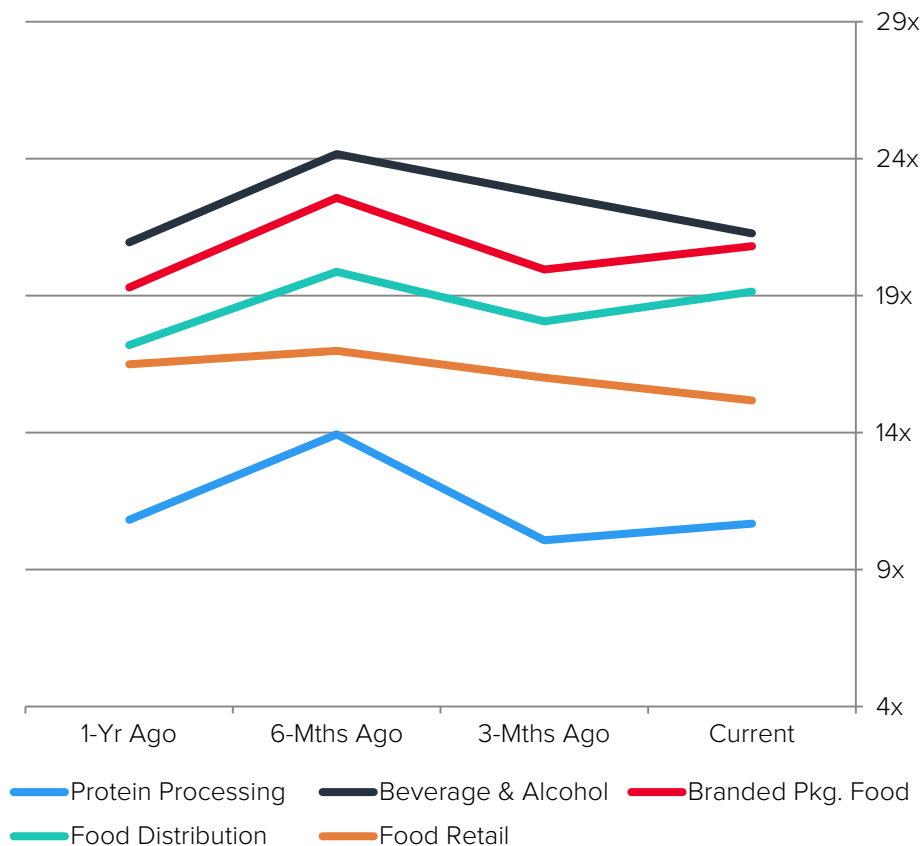


VALUATION TREND

Sub-Sector Median EV / NTM EBITDA

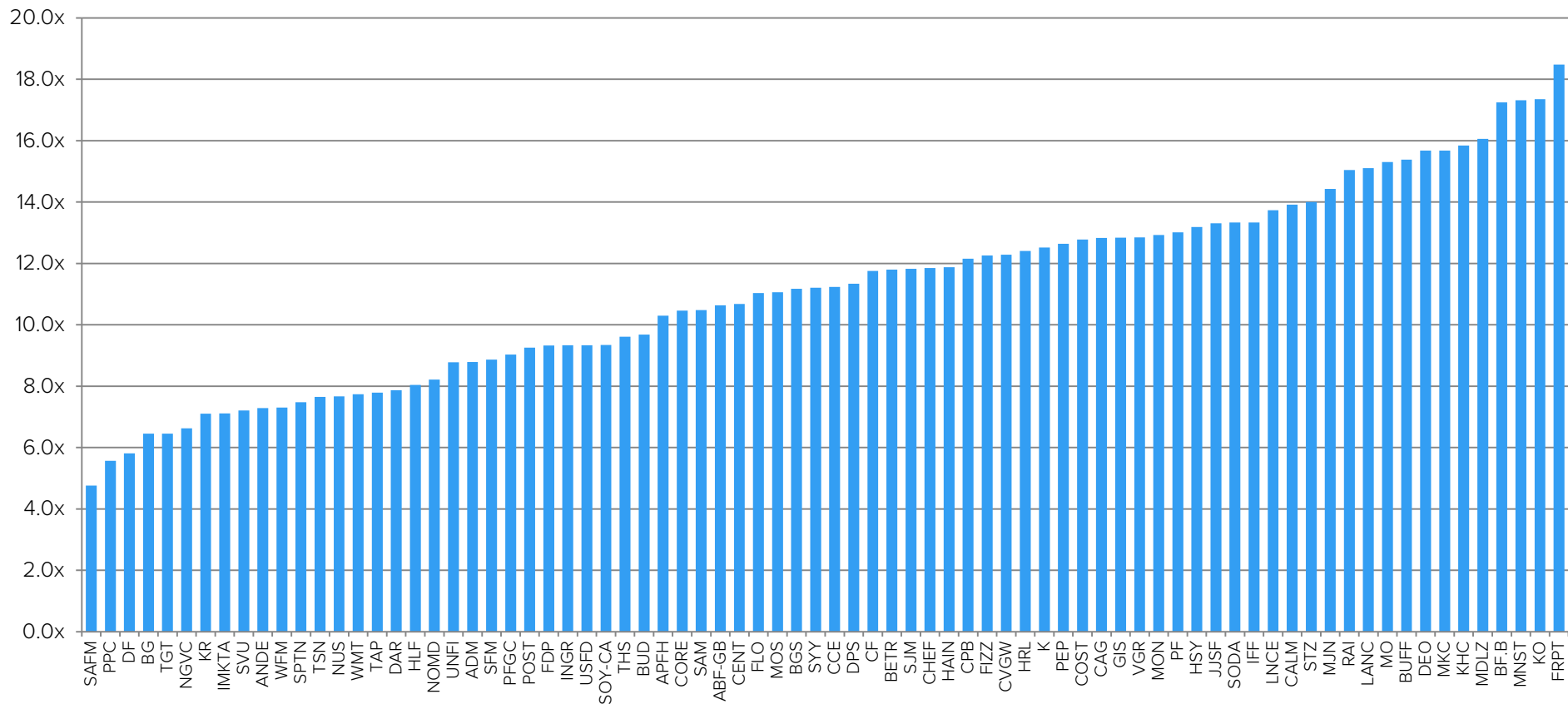


Sub-Sector Median P/E - NTM



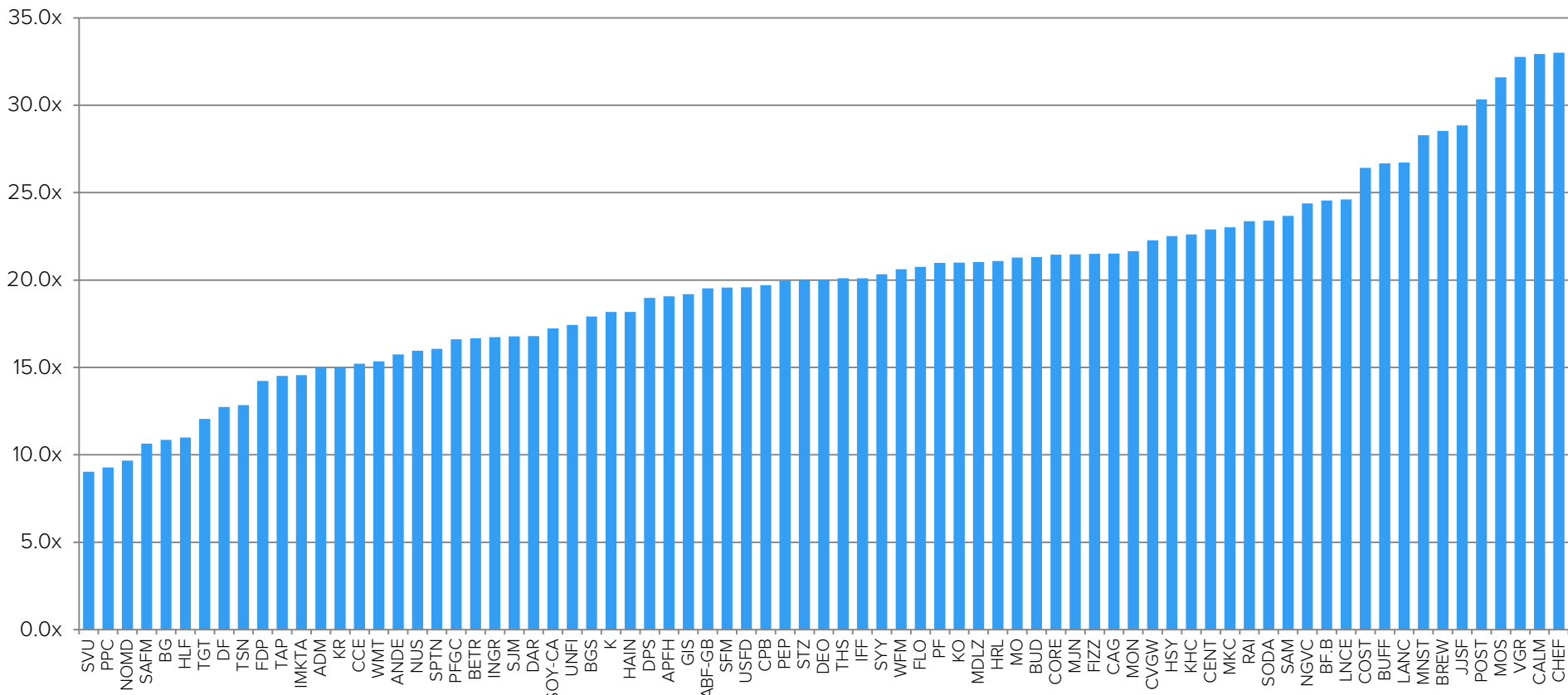
SENTIMENT TRACKER: EV / NTM EBITDA

EV / NTM EBITDA



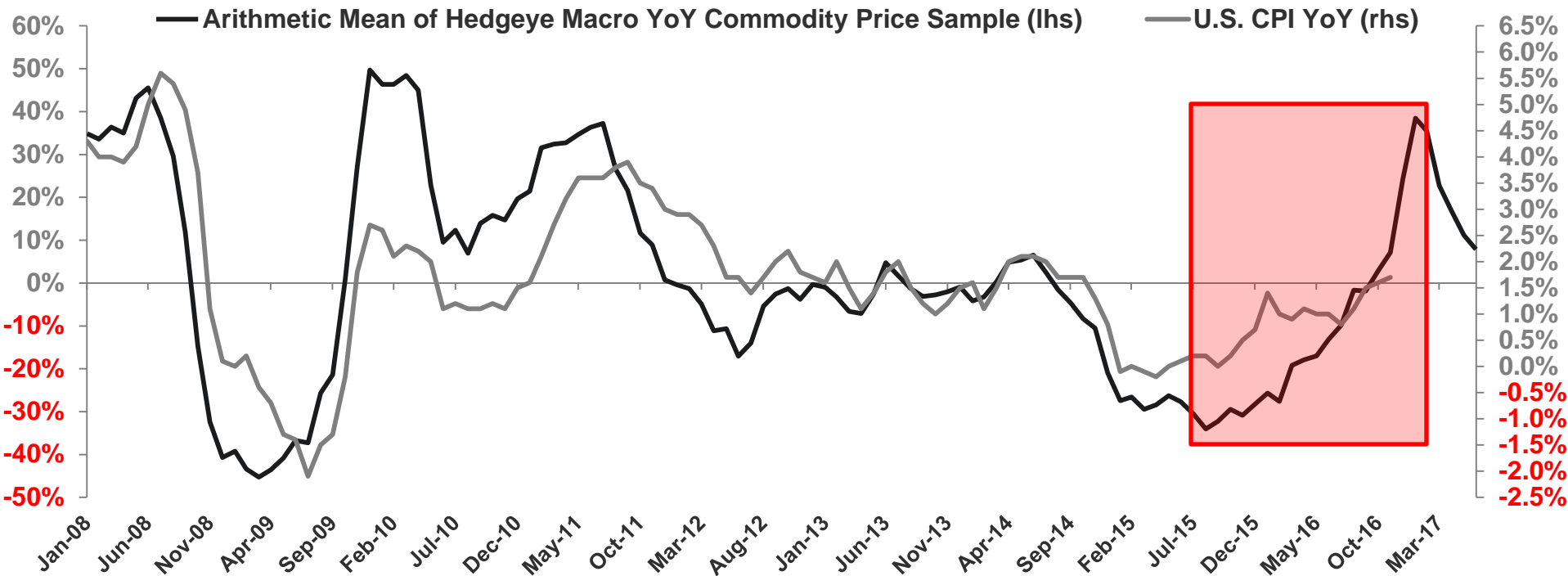
SENTIMENT TRACKER: P/E – NTM

P/E - NTM



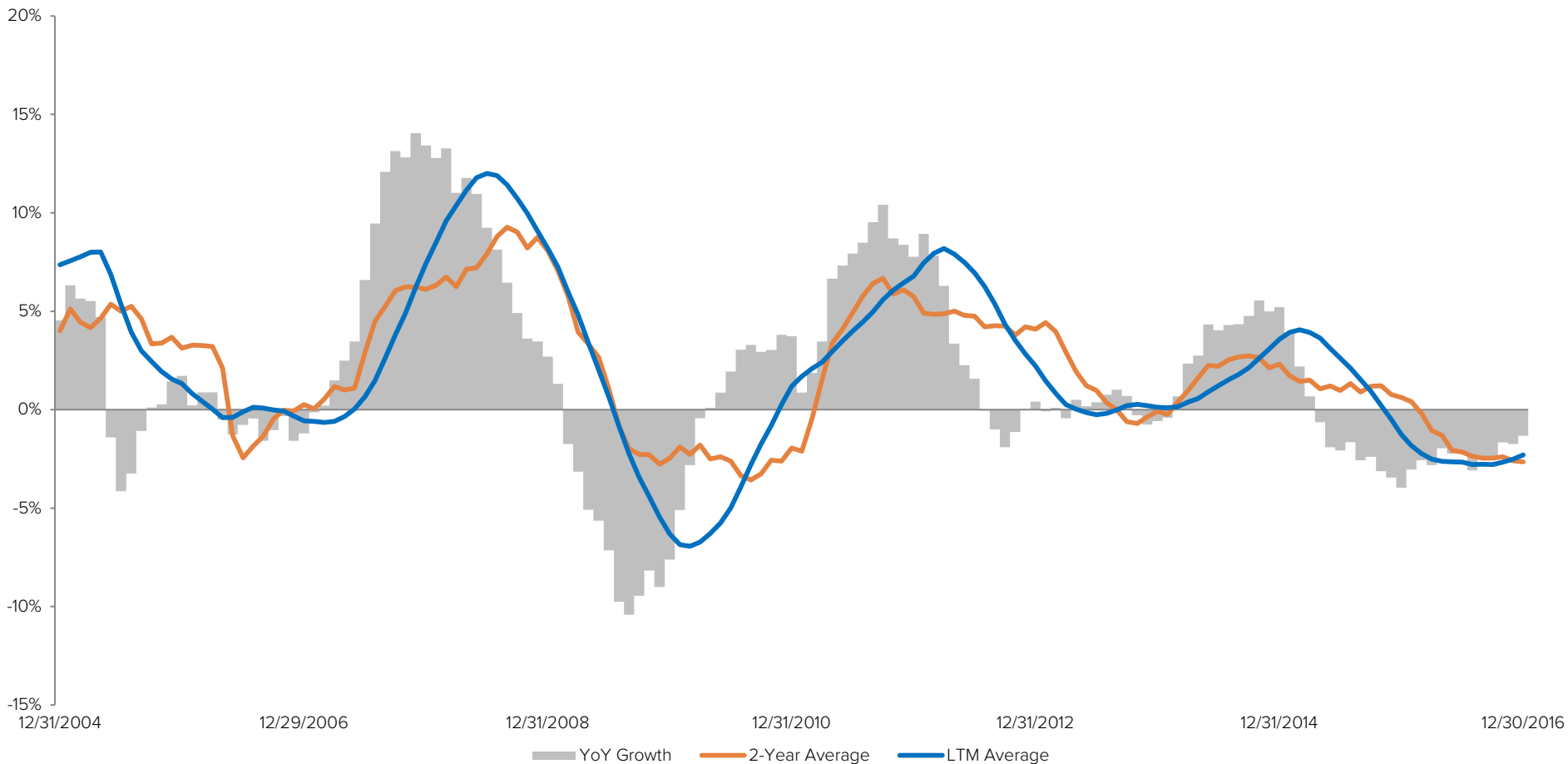
#REFLATION'S PEAK: KEY PROPRIETARY COMMODITY PRICE SAMPLE

THE Y/Y GROWTH RATE IN OUR COMMODITY PRICE SAMPLE, WHICH HAS BEEN A GOOD PREDICTOR OF CPI, CLEARLY PEAKS ON A SECOND DERIVATIVE BASIS IN Q1 OF 2017 BEFORE EASING INTO Q2.

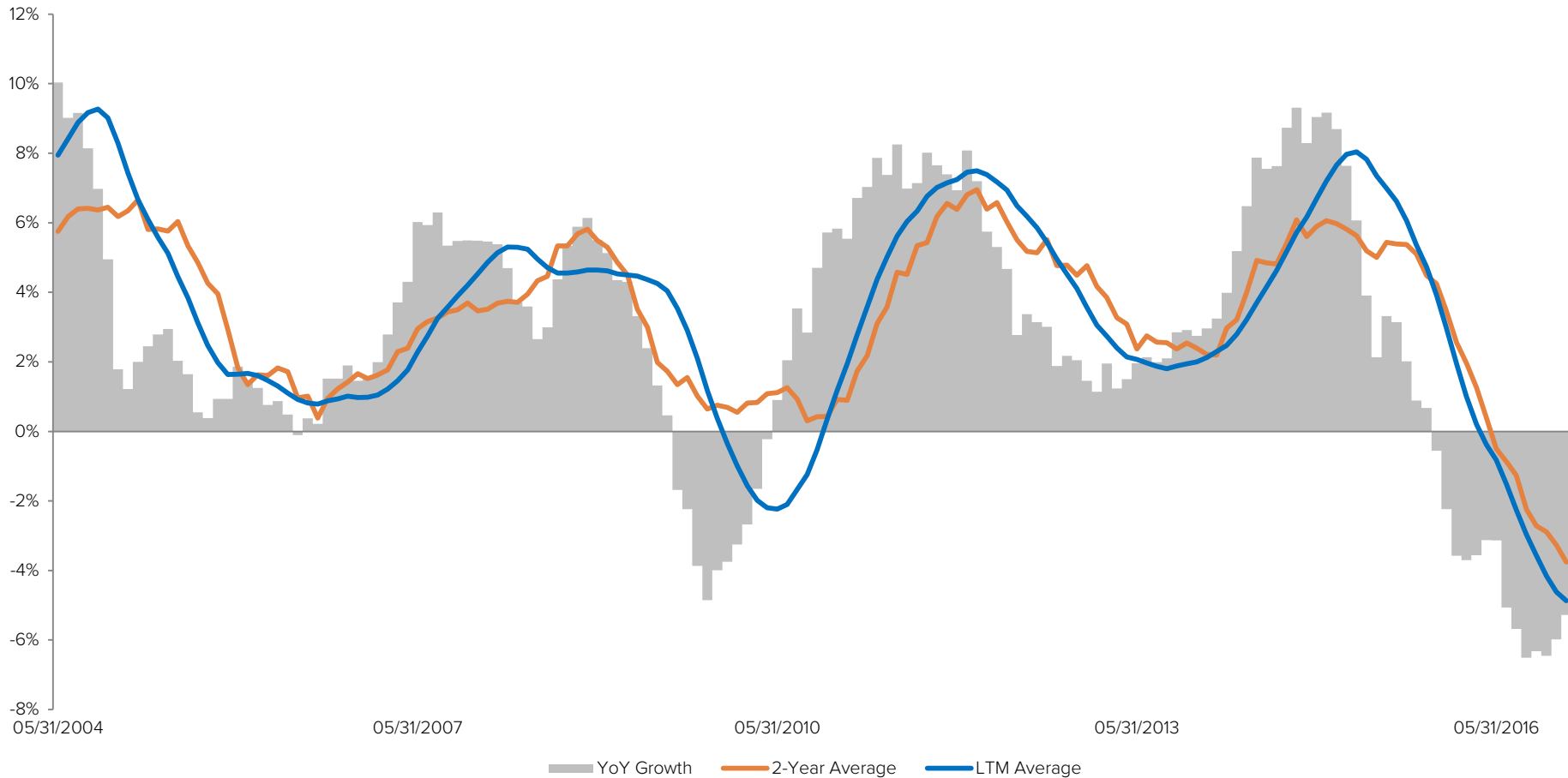


The Hedgeye Macro commodity price sample includes the CRB Index, CRB Raw Industrials Index, Brent Crude Oil and the UN Food and Agriculture Price Index. YoY deltas are calculated from monthly averages. Forward estimates assume no change to current monthly averages.

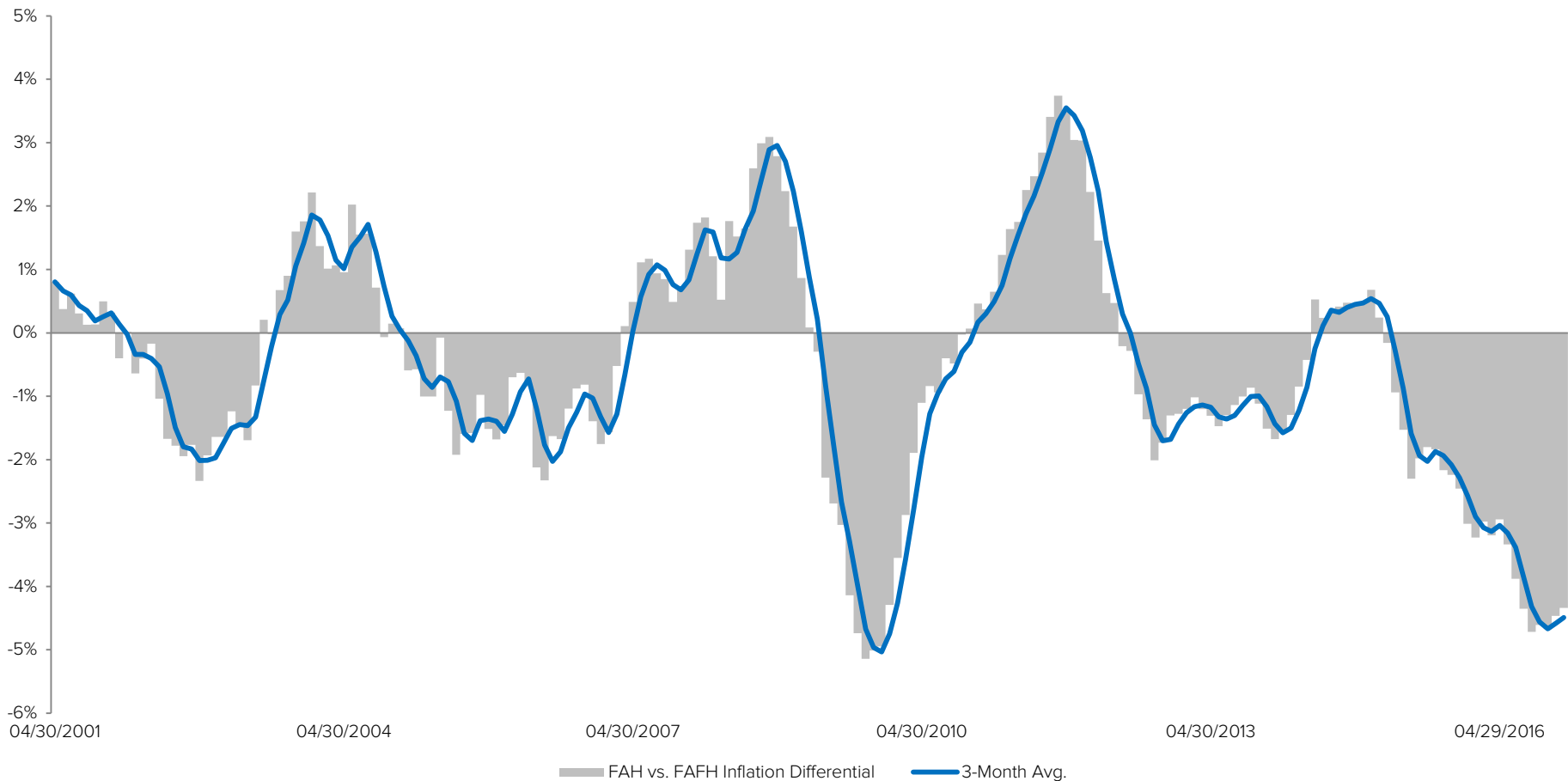
CPI – DAIRY AND RELATED PRODUCTS



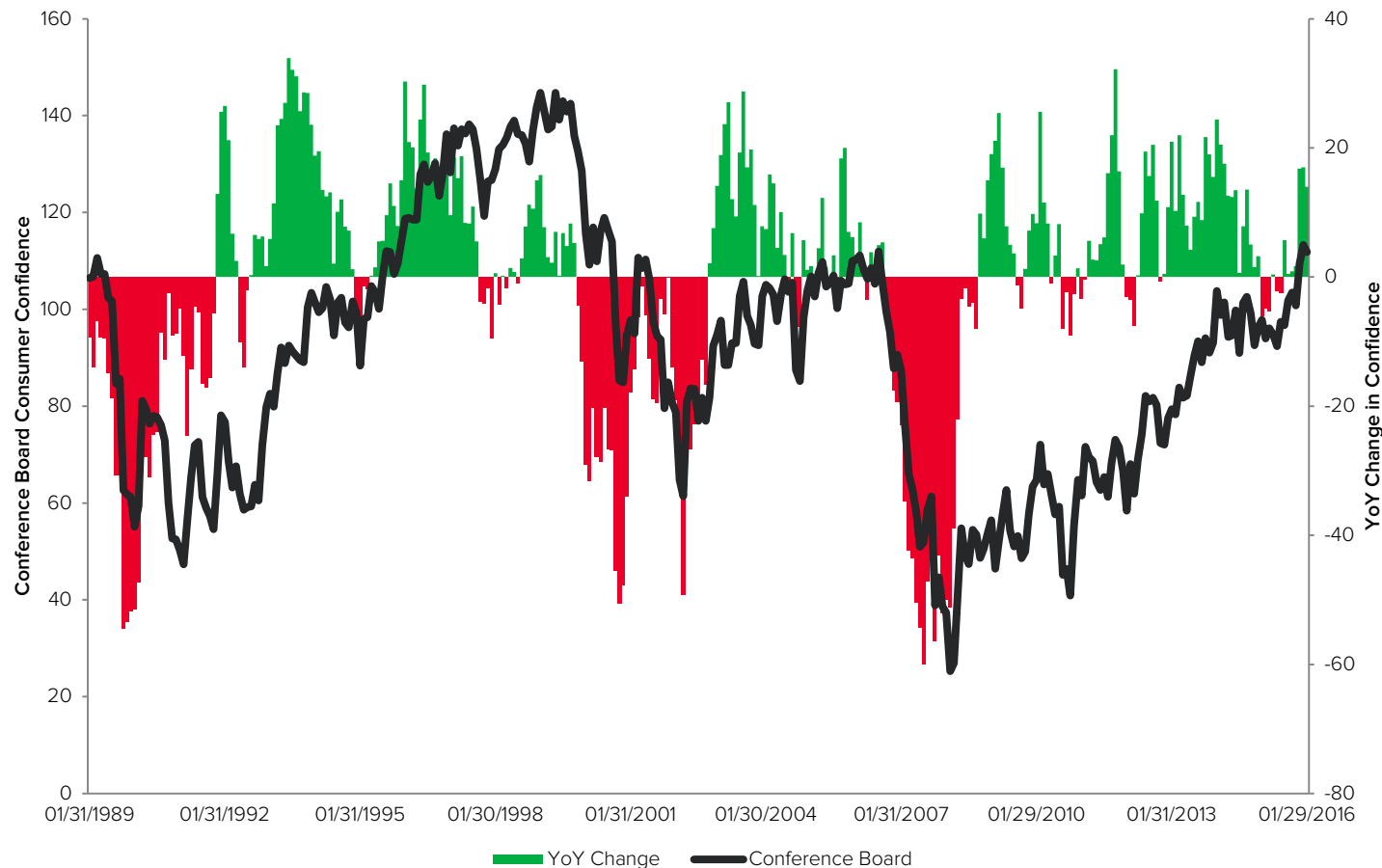
CPI – MEATS, POULTRY, FISH AND EGGS



FAH VS FAFH INFLATION DIFFERENTIAL



CONFERENCE BOARD CONSUMER CONFIDENCE



- The post election surge in consumer confidence is being driven by optimism for the economy and job/income prospects.
- Going forward throughout the year consumer confidence will be dictated by the extent of the realization of expected benefits.
- For now, we anticipate this optimism will be 'pre-spent' with a portion going to restaurant spending.



A CUT ABOVE

BEST IDEA: LONG U.S. FOODS (USFD)

January 19, 2017

KEY POINTS

1

MARGIN EXPANSION THROUGH MULTIPLE AVENUES

Pruning low margin distribution agreements and growing their private label sales have been two major initiatives to improve the profitability of the Company. Strategic national chain exits occurred from 2Q14 through 2Q16, while at the same time they have been growing the penetration of private brands which have expanded from 30% of sales in 2010 to 33% in 2016. These core initiatives, coupled with further penetration of customers' menus, and technological enhancements to improve USFD operations, as well as those of their customers, are meaningful contributors to the growth in profitability.

2

GROWTH WITH INDEPENDENTS AND HEALTHCARE SEGMENT

One of USFD's biggest advantages is their positioning within the restaurant industry, dedicating themselves heavily to the independent and regional operators versus large/lower margin national chains. In addition to the profitability difference, the independents are faring better from a sales growth perspective than national chains, making it a stronger customer base. USFD's growth in the healthcare segment is also notable; with the recent signing of a deal with Brookdale Senior Living, they continue to expand in this channel.

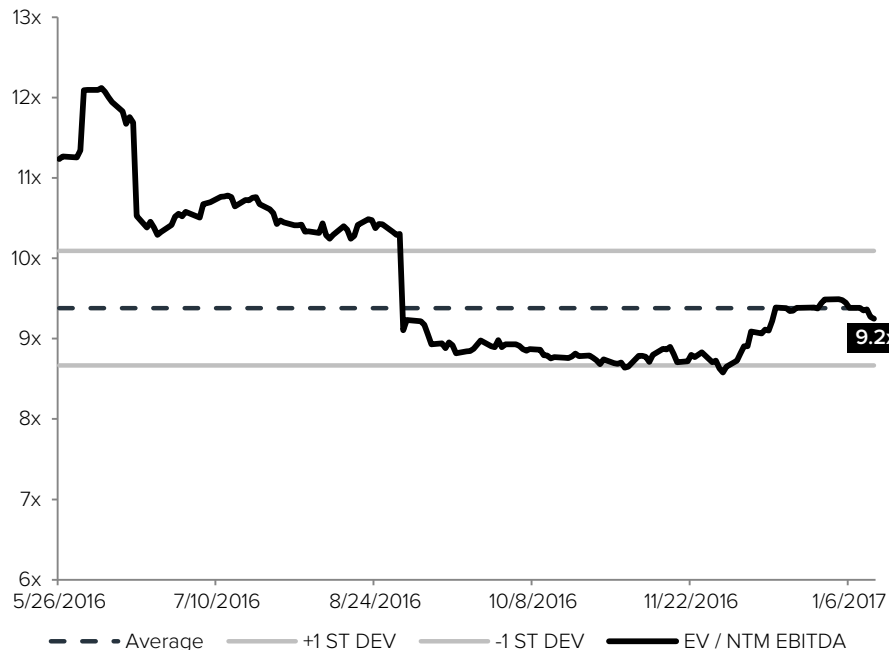
3

DEBT BURDEN IMPROVING, ALLOWING FOR MORE M&A

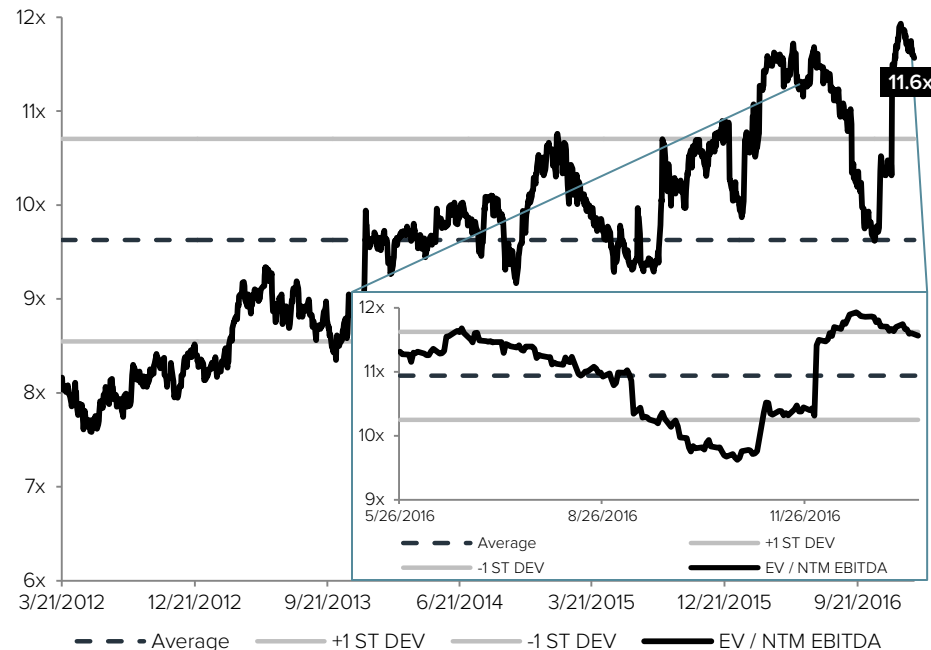
Pre-IPO net debt/EBITDA was 5.3x, USFD used all of their \$1.1 billion in IPO proceeds to lower their leverage, and have renegotiated many of their terms putting them in a much better financial position. As of the latest quarter they are down to a leverage multiple of 3.8x. Tuck in acquisitions are going to continue to be a major factor for both top line growth and profitability, of which they have done five in roughly the last year with a combined run rate of \$450-\$500 million in net sales. In our opinion a major deal looms in the industry, that will create a more formidable #2.

USFD VALUATION TREND VERSUS SY Y

USFD Valuation Trend – Since IPO



SY Y Valuation Trend – 5 year



USFD VALUATION HAS TRAILED OFF SINCE POST-IPO HIGHS

USFD is trading greater than two turns below SY Y (its most formidable competitor), and interestingly they both traded down in a similar fashion since USFD's IPO until SY Y's recent spike, as deflation ran rampant across the industry. We believe the discounted trading level is justified to some extent for the time being given the large insider ownership that will likely lead to selling over time, SY Y's better balance sheet and SY Y's sheer size, standing out among other reasons. But looking past that, USFD boasts far better growth prospects given their focus on independent restaurants. With those factors in mind we expect the valuation gap to close over time.

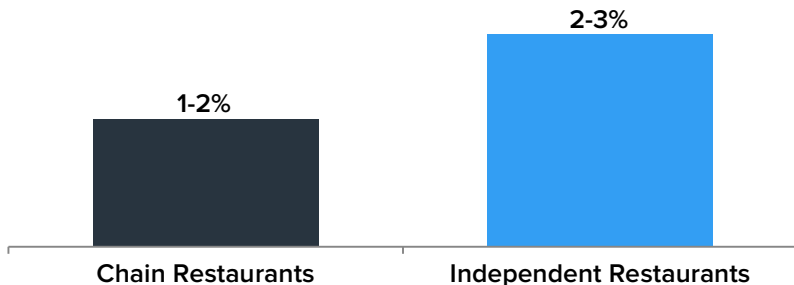
GROWTH SKEWS TOWARDS INDEPENDENT OPERATORS

INDEPENDENTS APPEAR TO BE TAKING SHARE

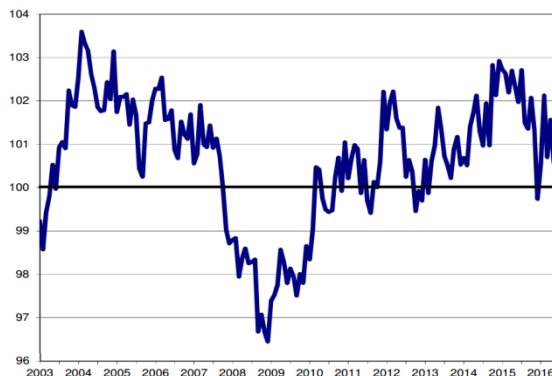
“There is more growth in the total restaurant sector than in the chain restaurant numbers tracked by Black Box Intelligence, suggesting other players such as independent operators and smaller regional chains may be growing faster and taking away share from the chains.”

- Sarah Atkinson Higgins
Senior Director, Marketing & Communications
TDn2K

Projected Real Sales Growth

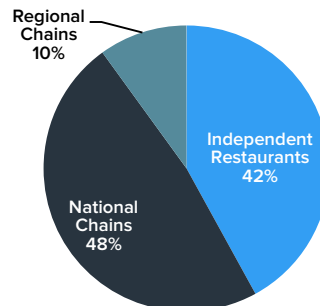


Restaurant Performance Index



Source: NRA; Values Greater than 100 = Expansion; Values Less than 100 = Contraction

2015 Industry Sales of \$162 Billion



- In Technomic's latest update regarding their outlook of the restaurant industry released on 11/29/16, Joe Pawlak, Technomic Managing Principal stated, *“Consumer economic uncertainty, value issues, and undifferentiated positions are putting strains on many full service chains. However, independents seem to be holding their own as consumers are gravitating to these establishments due to their unique offerings, local orientation and strong value propositions.”*
- “The best friends of distributors are the independents because they are a much more profitable business for the distributors,” says Technomic's Goldin.
- “Selling to a chain, distributors are lucky to get 10 percent margins. Selling to an independent, they are more likely to get 20 percent margins.”

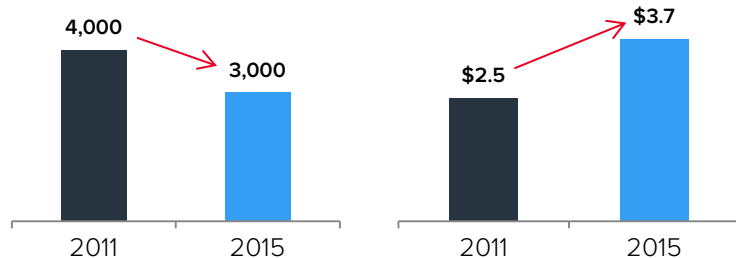
E-COMMERCE & SUPPORT SERVICES

“MADE EASY”...TO IMPROVE THE CUSTOMER EXPERIENCE

- The Company sees significant growth in e-commerce and the adoption of mobile technology by foodservice operators, and believes that investing in these capabilities will give them a competitive advantage.
 - Their e-commerce tools and mobile solutions make it easier for customers to conduct transactions with USFD, subsequently increasing customer adoption and loyalty.
 - USFD’s mobile and e-commerce platforms allow customers to easily place orders, track shipments, view product information, and verify orders once they are delivered.
- The Company is increasing sales force efficiency through e-commerce offerings.
 - Net sales dollars per sales associate increased by over 30% from 2012 to 2015 (\$4 million to \$5.4 million).
 - In fiscal 2015, \$15B in net sales were generated through USFD’s e-commerce platforms, representing 67% of total sales compared to 52% in fiscal 2011. Comparatively, e-commerce accounts for only 8% (2Q16) of Sysco’s sales.
 - Percent of sales from e-commerce to independent restaurants has risen from ~8% in 2011 to ~51% in 2016.
- Product Innovation: USFD supports their industry-leading product innovation with high-impact nationwide launches via Scoop.
 - Over 400 product launches
 - Majority of products featured are private label brands
 - \$1.2 billion in cumulative new sales
 - 3 Scoop launches per year (20-25 items per launch)
 - Over 50% customer trial, with a 7% prior customer retention rate

Number of Local Sellers

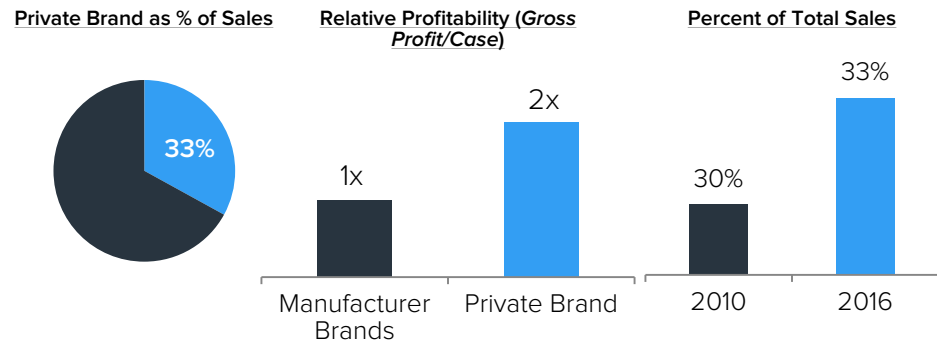
Average Route Size (\$M)



PRIVATE LABEL ADVANTAGE

Private Brand Penetration

- USFD's private brand program includes an extensive and growing assortment of over 14,000 products across more than 20 brands, contributing \$7.3B (32%) in net sales in fiscal 2015 (private brands products had represented ~30% of total sales in both 2015 and 2014).
- The Company's private label lineup has grown by approximately 1,200 products since 2013.
- Despite already having an extensive private brand lineup, the Company still sees this as a significant growth opportunity.
 - Their private brand products typically have higher gross margins compared to similar brand-name offerings.
 - USFD's private brand products are generally priced below comparable manufacturer brands.
- The Company plans to drive private brand growth through center-of-plate and produce penetration, seller penetration, specialists deployed in field, stock-yards expansion, produce logistics, and acquisitions.



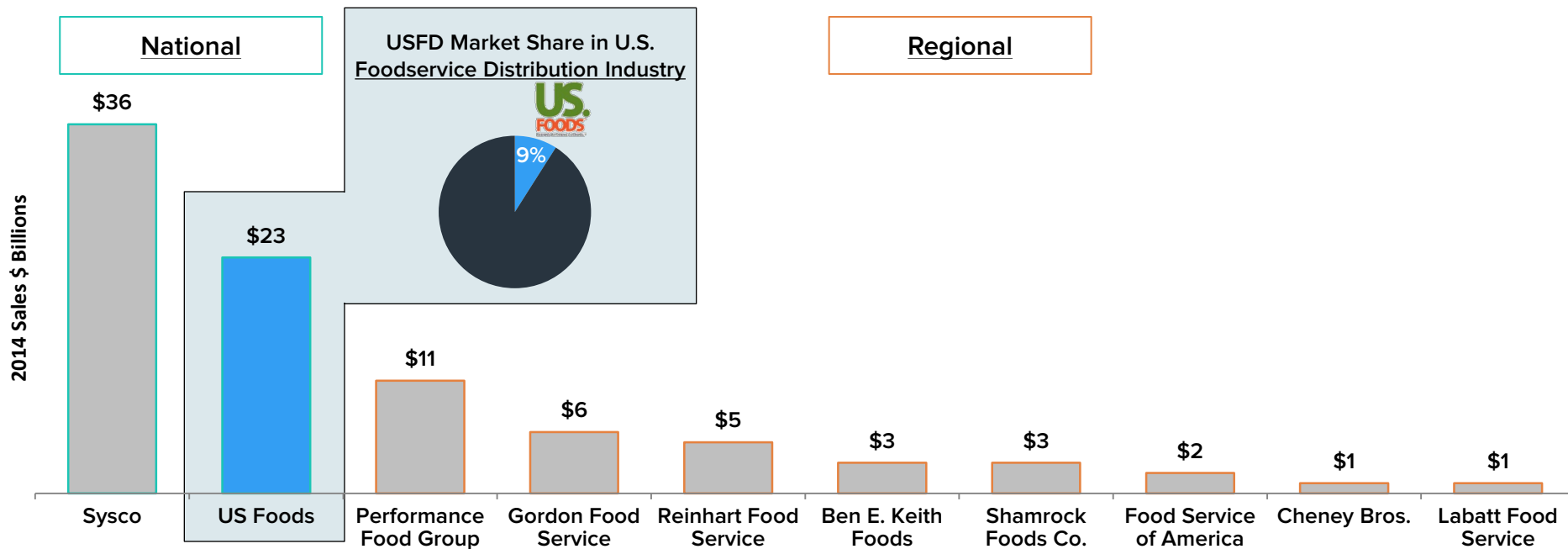
Key Product Differentiators

- USFD's "Serve Good" initiative includes products that are responsibly sourced or contribute to waste reduction.
- These products are developed with suppliers that are verified by third-party certifiers, including:
 - The American Humane Association
 - The Marine Stewardship Council
 - The Global Aquaculture Alliance
 - The Fishery Improvement Project
 - The U.S. Department of Agriculture
 - The Non-GMO Project
 - The Biodegradable Products Institute
- **Fun Fact:** US Foods was the first foodservice distributor to nationally launch a grass fed, all-natural, hormone free, minimally processed beef burger, further differentiating itself from competitors.



FRAGMENTED INDUSTRY

U.S. Broadline Sales of Top 10 Foodservice Distributors

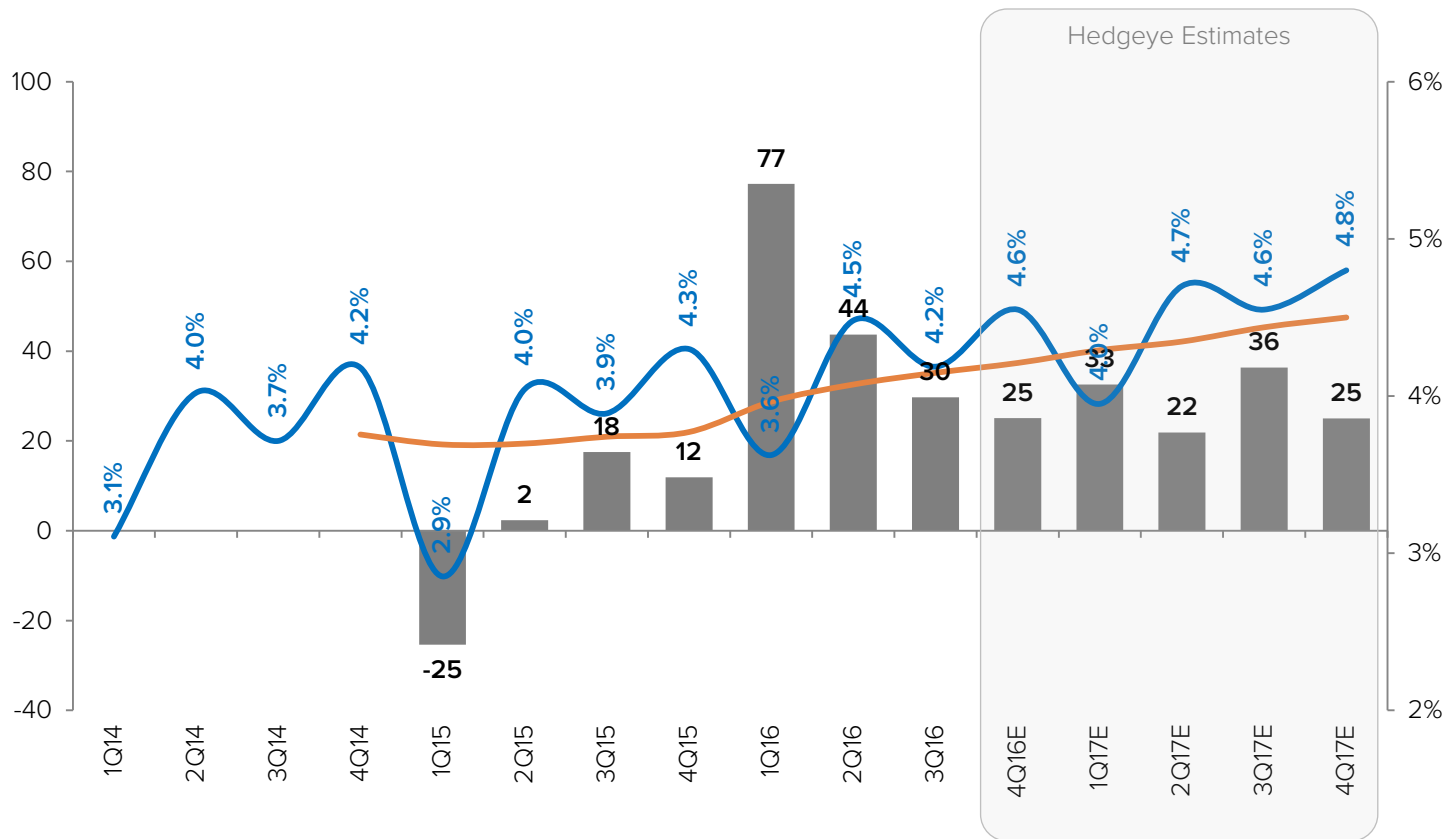


ROOM FOR CONSOLIDATION

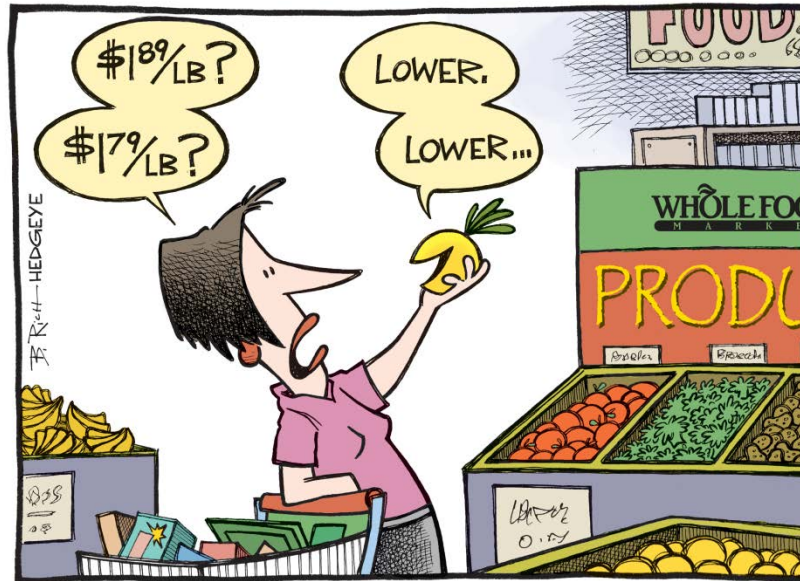
The foodservice distributor industry is a very fragmented one, with over 15,000 local and regional distributors, cash & carry and club store competitors. There is ample room for consolidation, which USFD has already contributed to on a smaller scale with five deals in roughly the last year, with an estimated net sales run-rate of \$450 million to \$500 million.

USFD ADJ. EBITDA MARGIN

■ YoY Bps Change — Adj. EBITDA Margin — LTM Average



- Adjusted EBITDA dollar growth is projected to grow 7 – 10% mid-term



THE RETURN TO WHOLE

THE SEARCH FOR REVITALIZATION IN AN EVER-CHANGING LANDSCAPE

BEST IDEA: LONG WHOLE FOODS MARKET (WFM)

September 15, 2016

WFM KEY POINTS

1

INITIATIVES TO OFFSET SOME OF THE MACRO ISSUES

Unlike other companies in the supermarket space, WFM is taking on the macro challenges head on. Until recently, the company never really had to refine their business much because of their industry leading business model. Now the competition is coming from a number of different sources, forcing them to improve their business model. Ultimately, this will prove to be a winning strategy. To that end, WFM is currently working through a \$300 million cost savings program and has a number of initiatives underway across the enterprise to refine and improve their operating performance.

2

THE ORIGINAL NATURAL & ORGANIC STORE IS HERE TO STAY

WFM was the first mover in its category and still has an industry leading position, but as others have come in, they have been forced to pivot to stay relevant. Gone are the times of charging consistently higher prices to capture industry leading margins. As natural & organic has gone mainstream, WFM's advantage of being the only place to get those products drifted away. They are now faced with intense competition from both direct competitors and more conventional food retailers which they are not used to, forcing them to rework their business to remain competitive. WFM's brand is still one of the best in the business and we are confident given the initiatives underway they will re-accelerate market share growth in their segment.

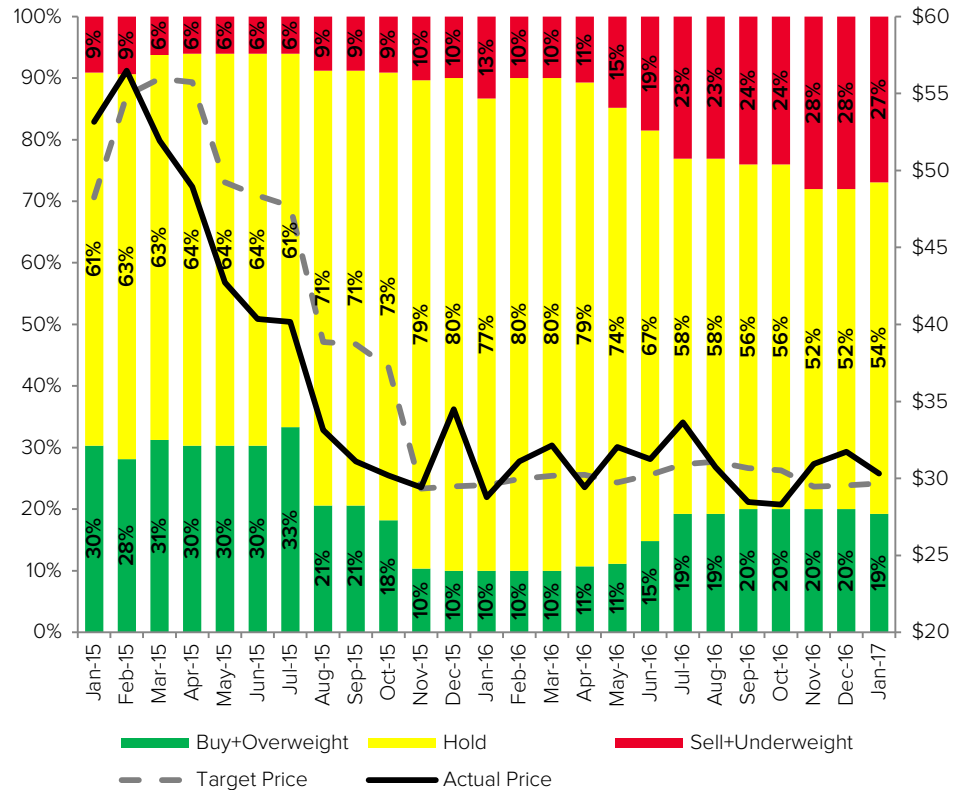
3

PLAYING THE DEFLATION CYCLE

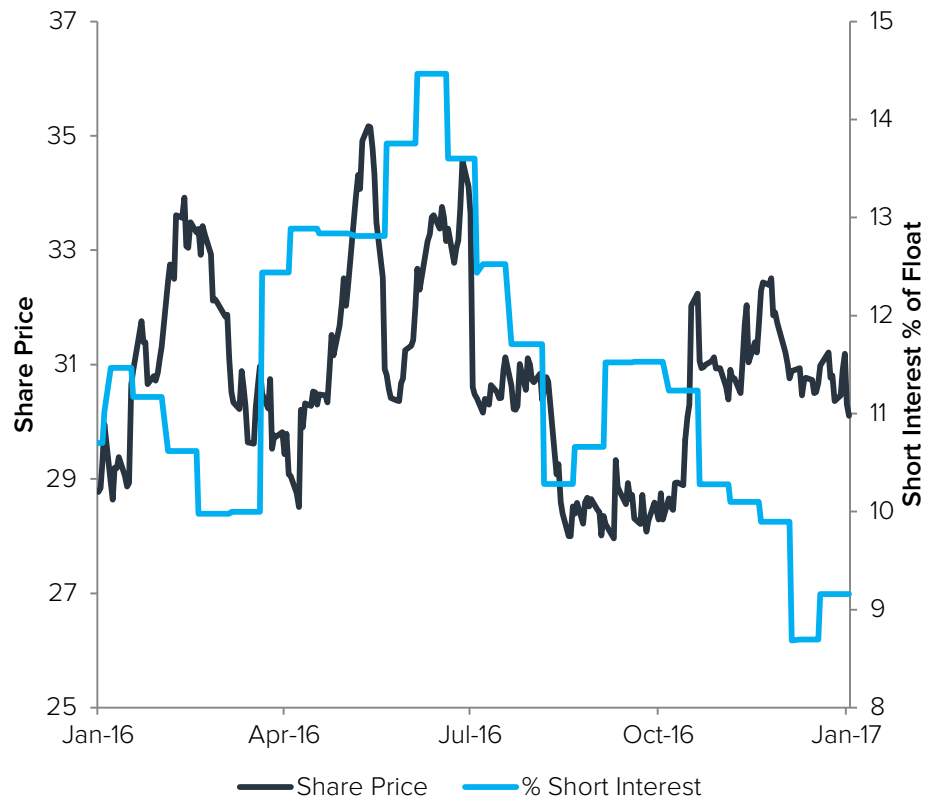
We have a tendency to be early with some of our calls as we like to think of stocks over a longer duration. WFM will likely be one of those calls. Currently the street hates WFM and the sector in general. Depending on your investment style, that is usually the best time to build a long position. Over the past 50 years, looking at food at home inflation there have been 6 periods of deflation (excluding the current) lasting approximately 7.2 months. The current deflationary cycle has lasted 8 months so we are past an average downturn. As we approach calendar 4Q16, it looks like early 2017 could be the inflection point in the turn from deflation to inflation and also the sentiment on WFM.

SENTIMENT = VERY NEGATIVE

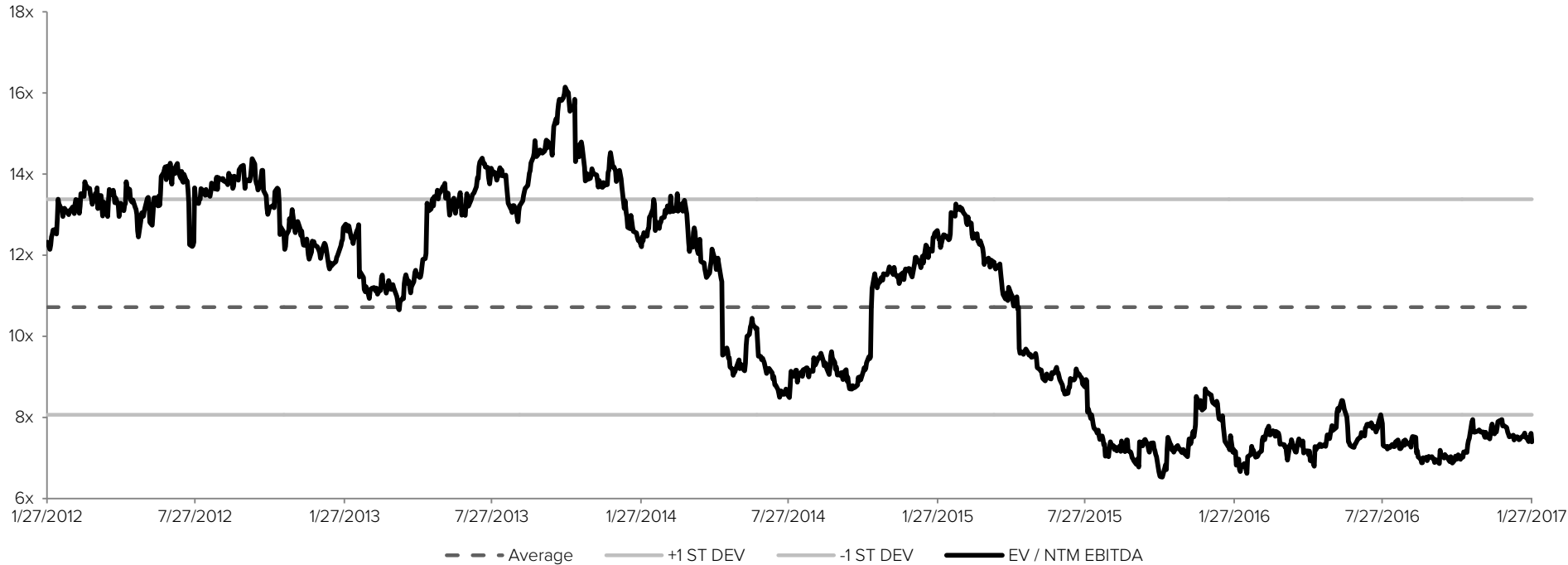
Sell-Side Ratings



Short Interest



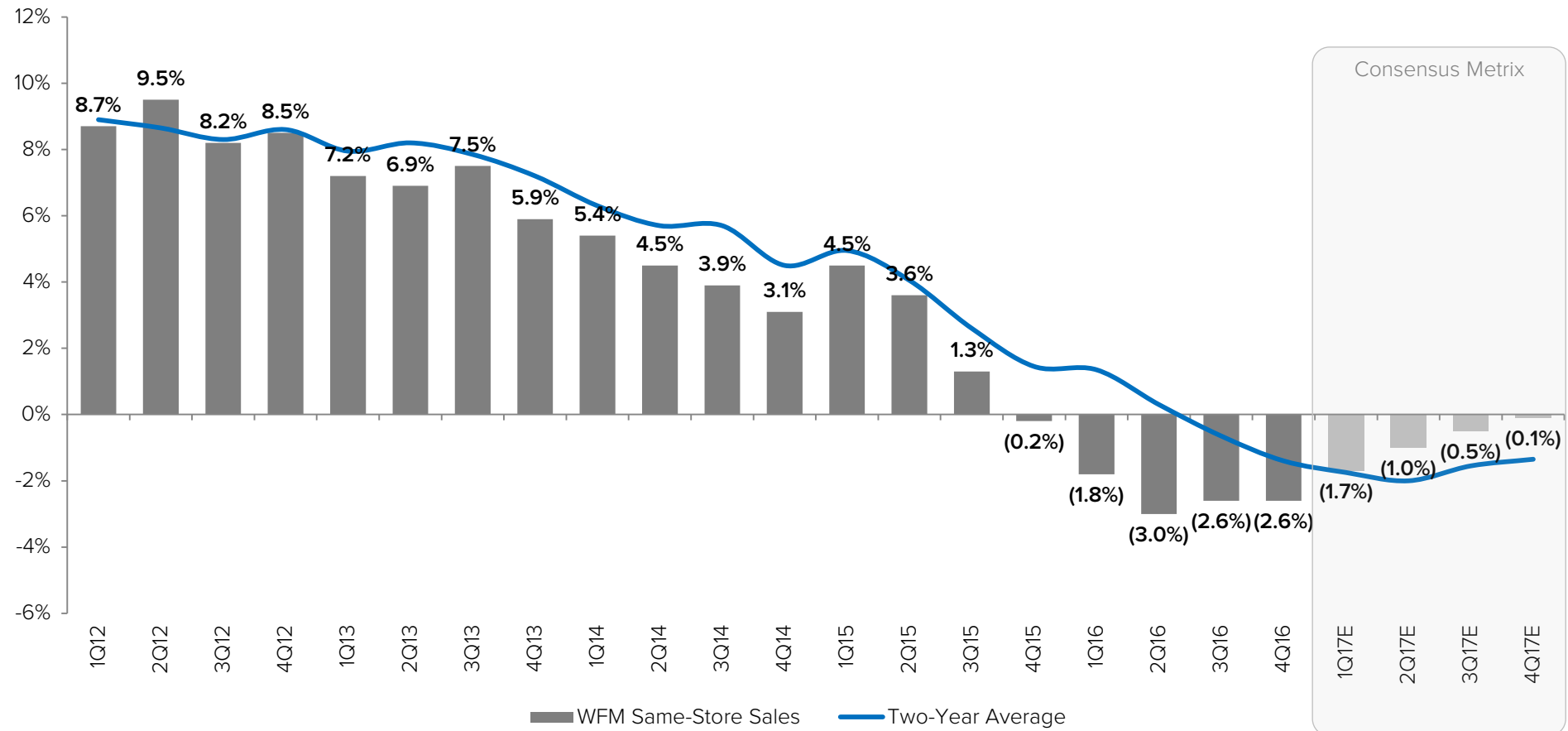
WFM 5 YEAR EV / NTM EBITDA



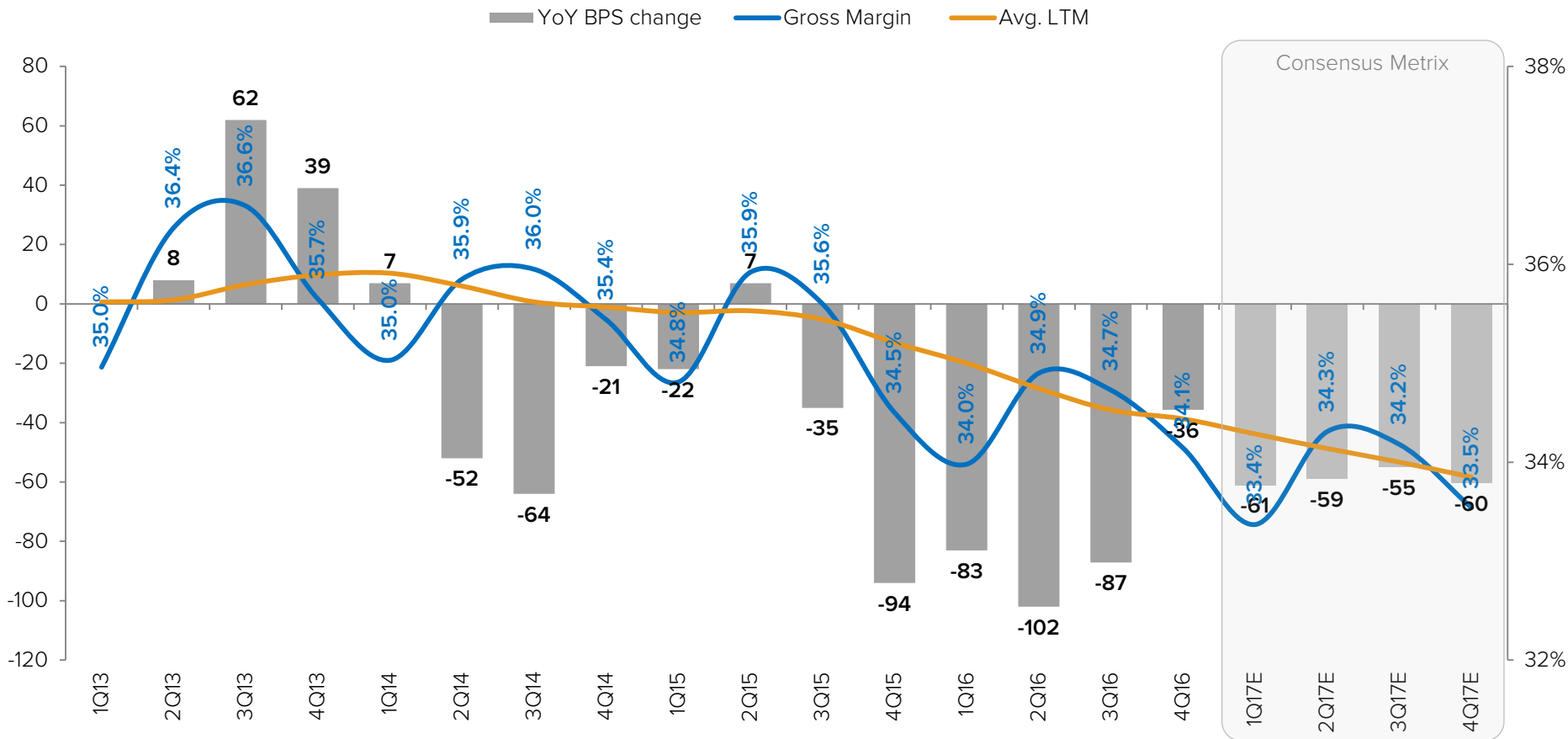
WFM IS CURRENTLY TRADING GREATER THAN 1 STD BELOW ITS 5 YEAR AVERAGE

The lowest WFM has traded on an EV / NTM EBITDA multiple basis is just under 4.0x at the end of 2008. This business has grown since then and has a more robust capital structure, the likelihood of a dividend cut is minimal, although they are faced with a notion that natural and organic has gone mainstream, and they are not the only game in town. Right now at 7.4x it is trading at the same level it was at the end of 2009.

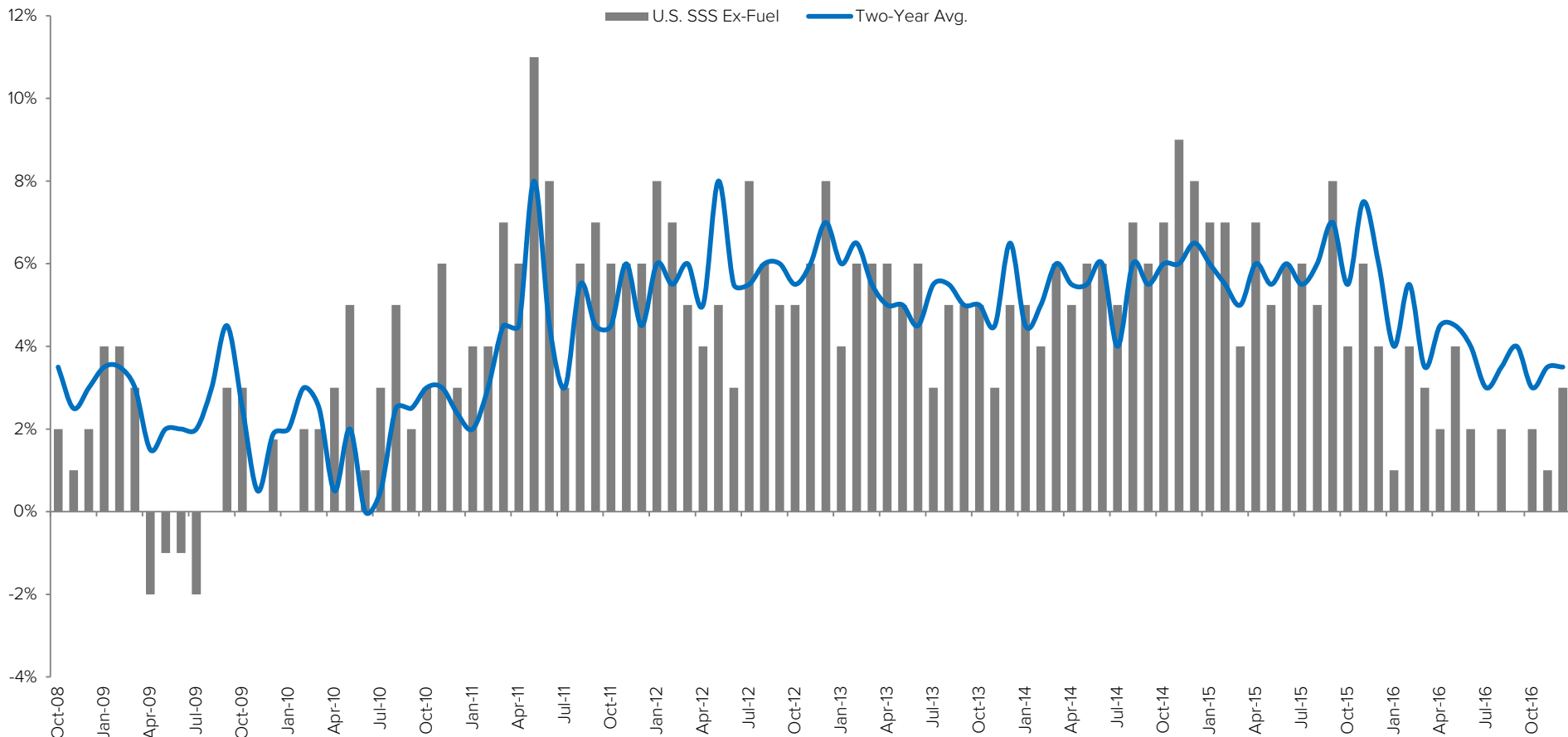
WFM SAME-STORE SALES



WFM GROSS MARGIN



COST – SAME-STORE SALES U.S. EX. FUEL & FX



FOR MORE INFORMATION, CONTACT US AT:

SALES@HEDGEYE.COM

(203) 562-6500