Summary

- Shares of National Beverage Are Up Over 100% YTD.
- LaCroix Brand Value Dominates FIZZ's Share Potential.
- Do Comparable Beverage Companies Offer Insight Into a Fair Value for FIZZ.

National Beverage (NASDAQ:FIZZ)

There have been a few articles here on Seeking Alpha discussing the hidden growth potential of the LaCroix brand. Nat Stewart has written about this company multiples times, dating back to 2013, see here and here. His call in 2013, although just a touch early, has been richly rewarded this year with the stock up over 100% ytd.

FIZZ data by YCharts

Interestingly, his last article in August gives a $34 price target for FIZZ with the potential to raise it to $40 if FIZZ isn't acquired in the next 24 months. Given today's stock price of $47, even those price targets look too low.

However, the question we need to ask ourselves is whether the market is already pricing in the future growth potential of LaCroix or its potential as an acquisition target. If those factors are already priced in and neither occur, there could be room to fall in the stock.

I am writing this article because FIZZ provided a good breakdown of their latest sales growth that allows one to more easily estimate the sales of LaCroix and therefore the valuation of the company as a whole.

From FIZZ's latest 10-Q

Net sales for the second quarter of fiscal 2016 increased 9.2% to $178.7 million compared to $163.6 million for the second quarter of fiscal 2015. The higher sales resulted from a 9.6% increase in case volume, which includes 25.3% growth of our Power+ Brands and 2.6% increase in branded carbonated soft drinks. The average selling price was approximately the same for both quarters.

Given these figures, we can estimate roughly that the Power+ Brands division made up approximately 30% of sales in fiscal year 2015 and that ratio has increased to 35% in fiscal 2016. On the other hand, the CSD (carbonated soft drink) segment has declined as a portion of total revenue from 70% to around 65%.

Brand Revenue Split

Growth Rate	2.6%	25.5%
	CSD	Power+ Brands
Fiscal Q2 2015 (163m)	114m	49m
	70%	30%
Fiscal Q2 2016 (178m)	117m	61m
	66%	34%

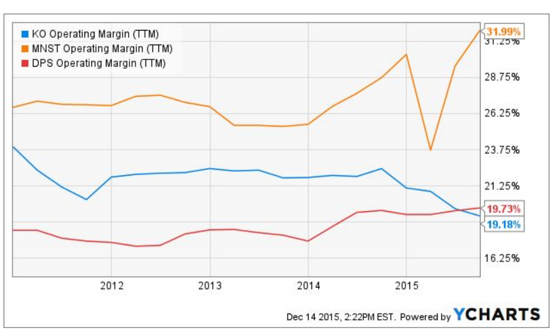
CSD volumes across the industry have declined significantly for the past 10 years. A shift towards "more healthy" options has impacted not only the brand names, but even more significantly, the generic brands, including Faygo and Shasta. This is the result of Pepsi, Coke and others reducing their prices to increase volume, thereby making the price differential less appealing to consumers to trade down to the generic. Cott Industries (NYSE:COT), another generic CSD producer, has over the past years made two major acquisitions (juice and bottled water) to diversify away from its legacy generic CSD brands.

FIZZ is in a similar situation, but offsetting its declining CSD business is the growing LaCroix division. FIZZ does not break out its operating profits among its segments, so the following is an estimate, not an exact science.

FIZZ produced 13% margins in its last quarter and as you can see below (does not include latest quarter's numbers), FIZZ's operating margins have been increasing as LaCroix brand has become a larger portion of the overall revenue pie.

FIZZ Operating Margin (TTM) data by YCharts

If we compare the operating margins of other "branded" beverage, Monster (NASDAQ:MNST), Dr. Pepper Snapple (NYSE:DPS), Coke (NYSE:KO), we see that operating margins range from approximately 20%-30% (MNST being the most profitable of the group at a little over 30%).



KO Operating Margin (TTM) data by YCharts

Economics of scale have a huge impact profitability of the beverage industry. Distribution costs impact both the profitability of the beverage company and its ability to reach a great audience without incurring excessive costs to build out a network of distributors in a new area.

Furthermore, DPS, KO and especially MNST are going to be more profitable due to their "case" mix. MNST sells a higher portion of its products in a single-can version than FIZZ does, thus comparing their profitability profiles is not exactly apples to apples.

However, we can assume that bolted on to a large company with much better economies of scale in both distribution and marketing, FIZZ would exhibit much higher operating margins.

A stab at the stand-alone value of LaCroix might go something like the following. I fully subscribe to the theory that being approximately right is much better than being precisely wrong.

LaCroix Valuation

FIZZ TTM Revenue	$672m
Power+ Brands Revenue	$210m (30% TTM)
Comparable EBIT Margins	30% (MNST, highest among comparable group)
Operating Profit	$60m
Comparable EBIT Multiples	MNST: 34x
Potential LaCroix Valuation	$2B
Legacy CSD Valuation	$0
Total FIZZ Valuation	$2B

Although these numbers are rough and estimates, it is fairly easy to see that FIZZ's share price (current market value around $2B) has probably gotten ahead of itself. Some might argue that their legacy CSD business should have some value, but my experience with Cott Industries is that the generic CSD market is rapidly declining and its ability to earn even its cost of capital may never return, thus my valuation of zero.

There are two additional risk that current FIZZ shareholders must understand at these prices.

First, I have estimated FIZZ's valuation above using one of the most profitable beverage companies in the public markets, but LaCroix is not that company right now and even if Coke or Pepsi would acquire FIZZ, some of that increased value should accrue to the buyer of the asset.

Second, the current owner, Nick Caporella owns over 73% of FIZZ's outstanding shares. His son, Joseph Caporella, is currently the President of the company. There is a distinct possibility that FIZZ will never been sold. This reminds me of Tootsie Roll (NYSE:TR) and its two controlling shareholders, both over 80 (there have been rumors of its sale for at least 10 years). The husband passed away earlier this year, causing the stock to jump 25% in one day only to retreat over the past year as a hope for a sale have faded.

As a standalone company, FIZZ's profitability will never approach that of Monster and therefore the equity valuation should more closely resemble the cash flow that FIZZ can produce and distribute to its shareholder in the future.

Ben Graham once said, "You don't have to know a man's exact weight to know he is fat."

I am unsure on the exact standalone valuation of FIZZ, however, I can be reasonably certain that today's stock price does not offer an adequate margin of safety should a sale not occur in the near future and even if a sale does occur, I question what potential upside is left.