GAAP-uccino

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Background and Business

Background and Business

- Green Mountain Coffee Roasters (GMCR) is headquartered in Waterbury, VT
- GMCR was founded in 1981 as a small café in rural Vermont where it roasted and served premium coffee
- GMCR soon began distributing coffee to restaurants, supermarkets, convenience stores, and specialty food stores primarily in the northeastern U.S.

Sources: GMCR 10-K for FY 2010, http://investor.gmcr.com/background.cfm, GMCR 10-K for FY 1997

Background and Business

- During the 1990s the majority of GMCR's revenues were derived through its wholesale coffee business with the balance coming from retail and catalog sales
- GMCR benefited from the growth in the specialty coffee segment of the coffee industry during the 1990s
- From 1991 to 2000 GMCR's revenues grew 25% a year
- From 2000 to 2005 growth slowed to 14% a year

Sources: GMCR 10-K for FY 1997, Capital IQ

Background and Business

- In 1998, Keurig, which had developed a single-cup brewing machine for the office market, partnered with GMCR to manufacture and sell Keurig's patented K-cups
- Keurig introduced its single-cup brewing system to home users in 2002. During that same year GMCR acquired 42% of Keurig for $15M
- GMCR acquired the remainder of Keurig in June 2006 for $104M

Sources: GMCR 10-K for FY 2006; GMCR 8-K filed on May 22, 2006; GMCR 10-K for FY 2002

Background and Business

- Since the Keurig acquisition in 2006:
  - GMCR business evolved to a razor / razor blade model
    - Sell the brewer (razor) at or near cost
    - Sell the K-cup (razor blade) at a high margin
  - GMCR grew Keurig through direct sales and by license agreements with Tully's, Timothy's, Diedrich and Van Houtte
  - GMCR revenues have grown at a 57% CAGR from 2006 to 2010
  - GMCR has sold over 13 million single-serve brewers and over 9 billion K-cups
    - Approximately 96% of Keurig brewers shipped in fiscal 2010 were sold to the At-Home channel

Sources: GMCR 10-K for FY 2010, GMCR quarterly and annual SEC filings

Background and Business

- Keurig offers an array of different At-Home brewers

Keurig® At-Home Brewers

MINI Plus (B31)
$99.95

Elite (B40)
$119.95

Special Edition (B60)
$149.95

B155
$249.95

Platinum (B70)
$179.95

Keurig Brewed® Technology

MR. COFFEE®
$79.95

MR. COFFEE®
$89.95

Cuisinart
$199.95

Breville
$249.95

Source: http://www.keurig.com/shop/brewers/single-cup-coffee-makers

Background and Business

Owned Brands

Green Mountain Coffee
Tully's Coffee
Van Houtte Café
Timothy's World Coffee
Diedrich Coffee
Coffee People
Café Escapes
revv
Donut House collection by Green Mountain Coffee
Donut Shop Coffee
Barista Prima Coffeehouse
Brûlerie St. Denis
Les cafés Orient Express coffee
Brûlerie Mont Royal
Green Mountain naturals

Licensing/Manufacturing Agreements

Newman's Own Organics
Celestial Seasonings
Emeril's Original
Caribou Coffee
Twinings
Wolfgang Puck
Gloria Jean's Coffees
Folgers Gourmet Selections
Millstone Coffee Company
Bigelow
Kahlúa
Dunkin' Donuts
Swiss Miss
Tazo

Source: GMCR presentation on August 10, 2011

Background and Business

Fiscal Year Ending Sept. *millions $*	2008	2009	2010	2011E	2012E
Total Revenue	492.5	786.1	1,356.8	2,701.3	4,345.8
Growth y/y	*46.5%*	*59.6%*	*72.6%*	*99.1%*	*60.9%*
COGS	318.5	540.7	931.0	1,780.2	2,824.8
Gross Profit	174.0	245.4	425.8	921.1	1,521.0
Gross Margin %	*35.3%*	*31.2%*	*31.4%*	*34.1%*	*35.0%*
Total SG&A	129.4	169.0	253.2	504.0	835.4
Operating Income	44.7	76.4	172.6	417.1	685.6
Operating margin %	*9.1%*	*9.7%*	*12.7%*	*15.4%*	*15.8%*
Net Interest and Other	(5.9)	(5.4)	(5.6)	(30.3)	(31.9)
Pre-Tax Profit	38.7	71.0	167.0	386.8	653.7
Income Taxes	15.0	27.1	61.7	143.7	242.0
Non-GAAP Net Income	**23.7**	**43.9**	**105.3**	**243.1**	**411.7**
Non-GAAP EPS	**$0.21**	**$0.36**	**$0.76**	**$1.61**	**$2.59**

Source: Historical data as per GMCR SEC filings and earnings reports; forward estimates represent consensus estimates as per Bloomberg as of October 13, 2011. Note that Non-GAAP results exclude acquisition-related transaction expenses, legal and accounting expenses related to the SEC inquiry, foreign exchange impact, and non-cash items such as losses incurred on the extinguishment of debt and amortization of identifiable intangibles (GMCR began excluding amortization of intangibles from Non-GAAP earnings in FY 2010).

Background and Business

Market Valuation

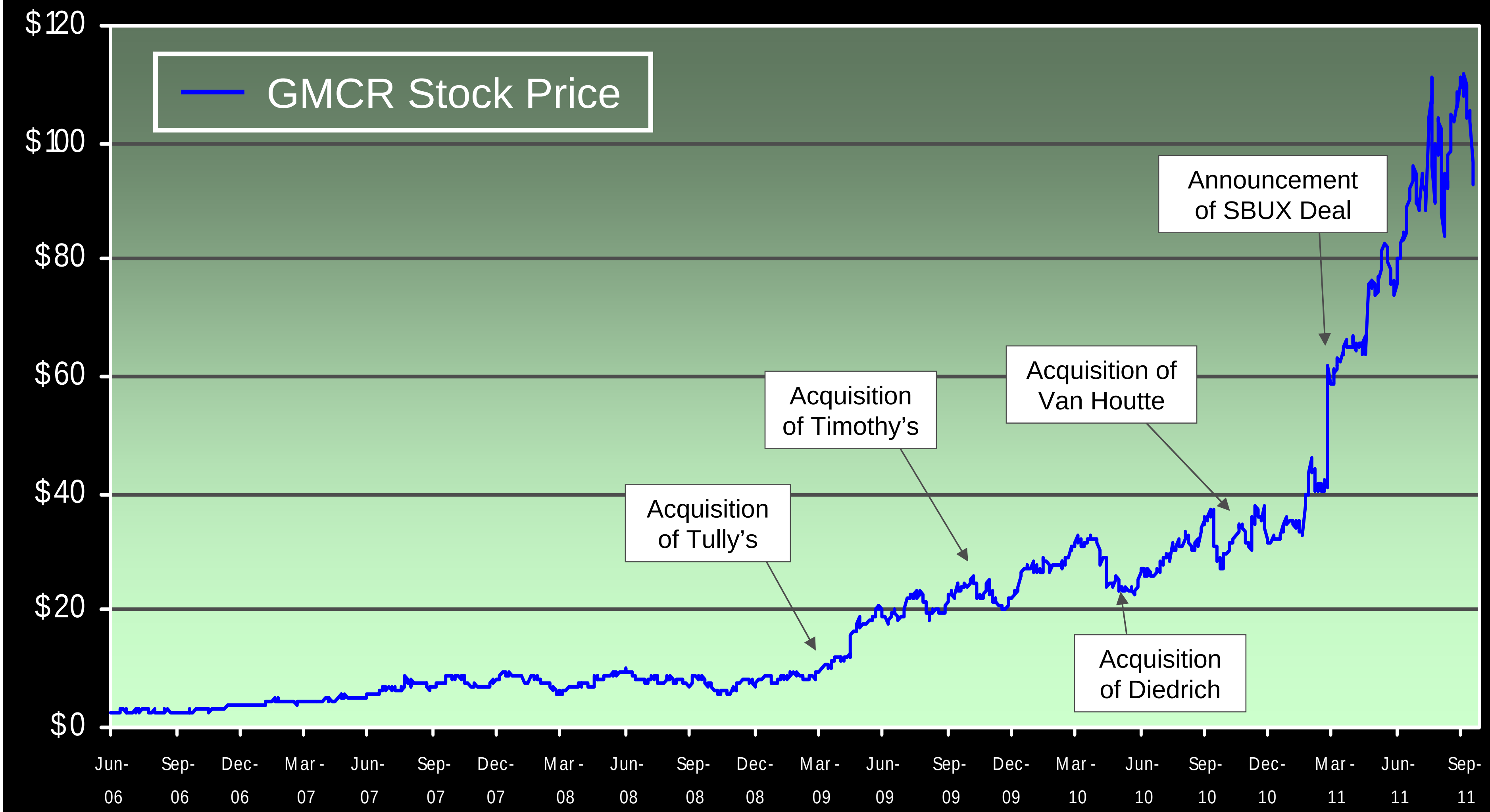
Stock Price	$92.09
Diluted Shares Out.	158.8
Market Cap	$14,621
Net Debt	315
Enterprise Value	$14,936

Valuation Multiples (1)

	$	*Multiple*
Revenue 2011E	$2,701	*5.5x*
Revenue 2012E	$4,346	*3.4x*
EBIT 2011E	$434	*34.4x*
EBIT 2012E	$697	*21.4x*
EPS 2011E	$1.61	*57.2x*
EPS 2012E	$2.59	*35.6x*

1. Bloomberg consensus estimates as of October 13, 2011. Market valuation metrics as of October 14, 2011.

Background and Business



Sources: Thomson Reuters; GMCR FY2010 10-K, GMCR 10-Q for 3Q 2011

Bull Case

Bull Case

- The GMCR growth story is still in the early innings
  - There are 64 million households that drink 2+ cups each day
  - If GMCR captures 1/3 of that market = 21 million brewer installed base
  - Current installed base is 7.5 million (as of May 2011), therefore the installed base could nearly triple from here

Source: SunTrust Robinson Humphrey research note published May 6, 2011

Bull Case

- GMCR still has room to expand distribution
  - Retailers will commit additional space to brewers and K-cups going forward
- GMCR will experience margin expansion
  - Additional infrastructure spend in 2012 will be key to greater K-cup profitability
- The installed base of brewers will increase from having recognized brands like Starbucks and Dunkin Donuts available in the Keurig system
  - Partnerships mitigate competition risk

Sources: Janney Capital Markets research notes and SunTrust Robinson Humphrey research notes

Bull Case

- GMCR can earn $8-10 per share

Target Market (Homes that brew 2+ cups/day)	64M
Keurig Share of Target Market	33%
Fully Penetrated Installed Brewer Base	21M
Average Daily K-cups Per Brewer	2.00
Days/Year	365
Annual K-cup Consumption	15,558M
Profit Per K-cup	$0.15
Annual K-cup Profit (EBIT)	$2,352M
Annual K-cup Profit (After Tax and Interest)	$1,440M
Shares Outstanding	160M
Long Term EPS (At Home Sales)	$9.00

Source: SunTrust Robinson Humphrey research note published July 21, 2011. Assumes $30M interest expense, 38% tax rate, and 160M shares.

Bull Case

- GMCR is currently capacity constrained:
  - "We are definitely being stretched…. demand is definitely stretching our ability to supply. And we've not quite caught up with that demand curve yet." (1)
  - "As we have continued to add portion pack production capacity in Q3, we were able to fulfill customer demand that had pent-up in the system over the prior two quarters." (2)
  - "We continued to also experience spot outages of portion packs with our customers." (2)

1. Larry Blanford, GMCR CEO – GMCR Q1 2011 earnings call on February 2, 2011
2. Larry Blanford, GMCR CEO – GMCR Q3 2011 earnings call on July 27, 2011

Bull Case

- GMCR claims to be a technology company
  - "We are a technology company with a host of patents" (1)
  - "I would define our company today as really a single serve beverage company that is sitting on top of this magnificent technology, call it disruptive technology platform" (2)
- Jim Cramer called GMCR an "ETF on the rapid-growing single-serve market" (3)
- "We are the iPod of coffee" (4)

1. Fran Rathke, GMCR CFO – conference on March 15, 2011
2. Larry Blanford, GMCR CEO – conference on August 10, 2011
3. http://www.madmoneyrecap.com/madmoney_nightlyrecap_110629_3.htm
4. Greenlight conversation with GMCR management

Market Opportunity

GMCR Has Reduced Transparency

Metric	GMCR Q3 2008 [1]	GMCR Q3 2011 [2]
Coffee	• Total pounds shipped • Pounds shipped by channel (including supermarkets, resellers, convenience stores, office coffee services, food service, and consumer direct)	• None
K-cups	• K-cup units shipped system-wide • GMCR brand K-cup units shipped and implied K-cup units shipped by licensees	• Net sales ($) of K-cups
Brewers	• Keurig brewer units shipped, rounded to nearest thousand • Brewers shipped to At-Home and Away-From-Home channels	• Keurig brewer units shipped, rounded to nearest hundred thousand • Keurig brewer units and implied brewer units shipped by partner brewer manufacturers • Net sales ($) of brewers and accessories

1. GMCR 10-Q for Q3 2008 and GMCR Q3 2008 earnings release
2. GMCR 10-Q for Q3 2011 and GMCR Q3 2011 earnings release

Market Opportunity

- The opportunity is smaller than the bulls believe
  - The addressable market is smaller
  - The penetration is greater
    - Estimated installed base of >10.5M household brewers (1)
    - 20,000 retail points of distribution (2)
    - 15,200 supermarket points of distribution (2)
  - The attachment rate, or estimated daily K-cup consumption per brewer, is smaller and declining

1. Greenlight estimate through June 30, 2011
2. GMCR presentation given at conference on August 10, 2011 (data as of June 2011)

Market Opportunity

- Keurig already has widespread distribution and brand awareness
- GMCR claims the addressable market is the 90 million households that own a coffee maker (1)
- However, only about 70% of the addressable market are regular coffee drinkers (2)
- Keurig is an aspirational product priced above the premium end of the market

1. GMCR presentation given at conference on August 10, 2011
2. GMCR presentation given at conference on August 11, 2010 (64M households drink 2+ cups of coffee per day of the 90M with a coffee maker)

Keurig Brewers Are Expensive

- Price-points start at $80

Keurig® At-Home Brewers

MINI Plus (B31)
$99.95

Elite (B40)
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Cuisinart
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Breville
$249.95

Source: http://www.keurig.com/shop/brewers/single-cup-coffee-makers

Keurig Brewers Are Expensive

- Traditional brewers are much cheaper (prices start at $20)

GE 5-Cup Digital
$19.46

Mr. Coffee 12-cup Programmable
$24.88

GE 12-Cup Gourmet
$39.88

Faberware 12-cup Programmable
$59.88

Source: Various retailers including Bed Bath & Beyond and Walmart

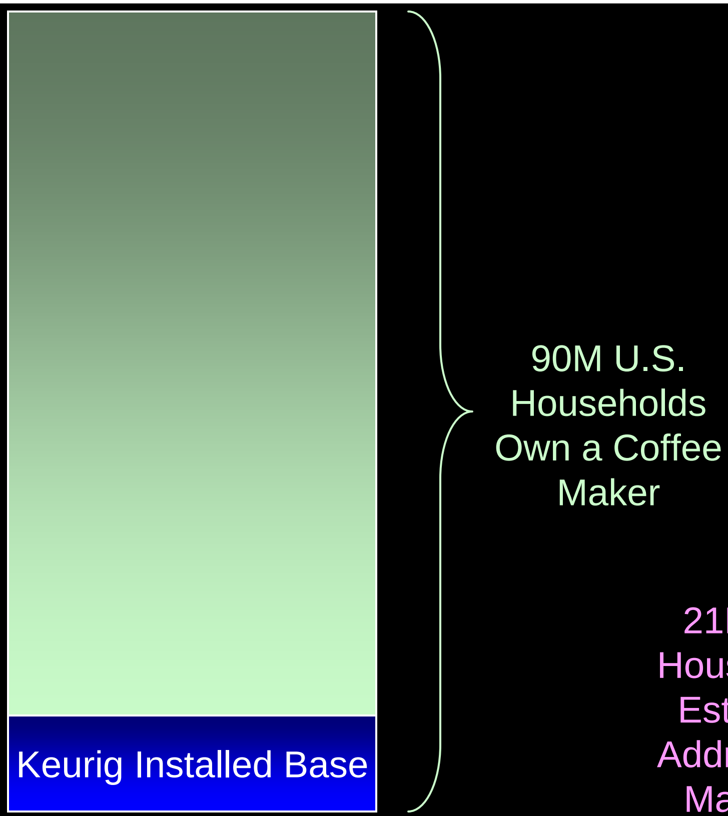
K-cups Are Expensive

Brand	Price $	Servings	*Per Serving*
Drip - Lower End			
Folgers : Custom Roast Ground	$8.86	270	3.3 ¢
Folgers : Medium Classic Roast	$10.78	270	4.0 ¢
Maxwell House : Daily Brew Ground	$7.48	270	2.8 ¢
Maxwell House : Tassimo Classic Roast	$10.78	270	4.0 ¢
Drip - Higher End			
Dunkin Donuts : Ground Coffee (40 oz)	$21.73	113	19.2 ¢
Dunkin Donuts : Original Blend	$24.35	113	21.5 ¢
Starbucks : Sumatra (1 lb)	$14.95	45	33.0 ¢
Starbucks : Breakfast Blend (1 lb)	$11.95	45	26.3 ¢
K-cup - Lower End			
Folgers : Black Silk Dark Roast	$11.28	18	62.7 ¢
GMCR : Breakfast Blend	$16.28	24	67.8 ¢
Tully's (GMCR) : Kona Blend	$11.99	18	66.6 ¢
GMCR : Donut House Regular	$11.99	18	66.6 ¢
K-cup - Higher End			
Barista Prima (GMCR) : Coffeehouse Blend	$14.99	18	83.3 ¢
Café Escapes (GMCR) : Chai Latte	$12.99	16	81.2 ¢
Dunkin Donuts : Original Blend	$11.99	14	85.6 ¢

Source: Greenlight pricing checks at various retailers including Bed Bath & Beyond, Amazon.com, Walmart, and Starbucks.com

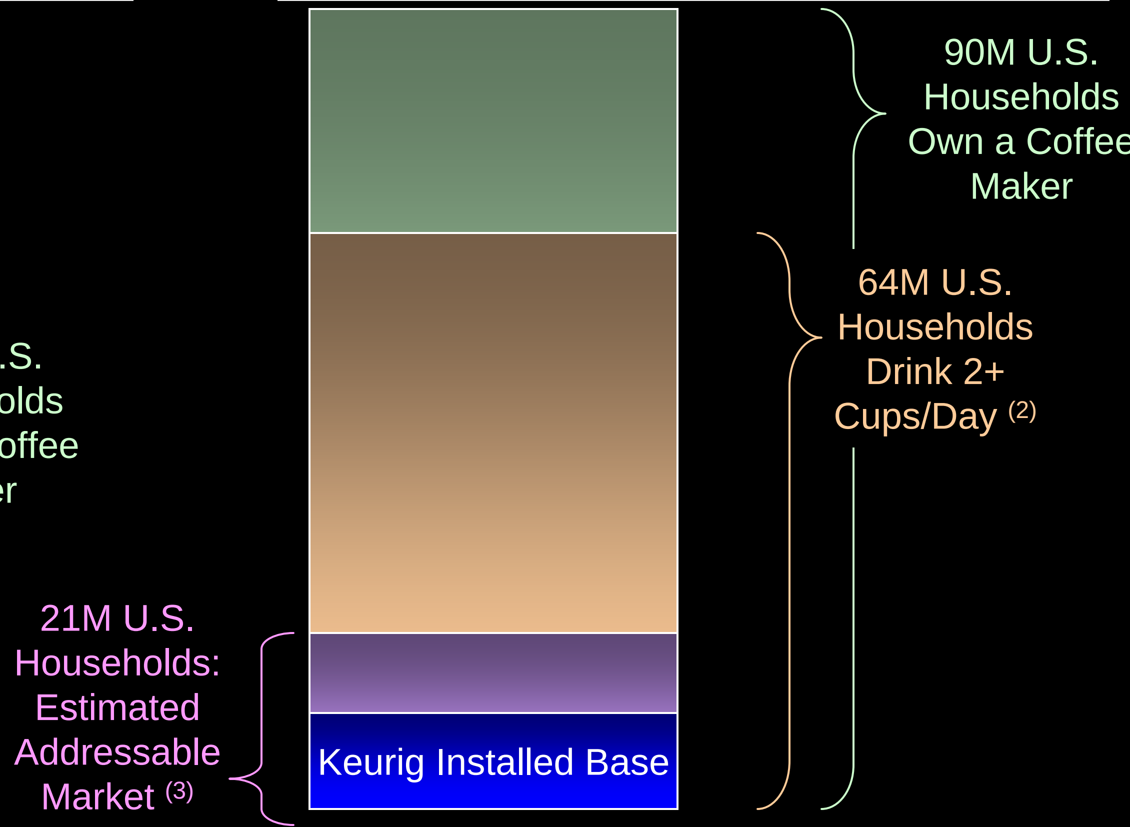
Brewer Penetration

What GMCR Says About Penetration (1)



Keurig Installed Base is 7M-9M
(8% -10% penetrated into the 90M)

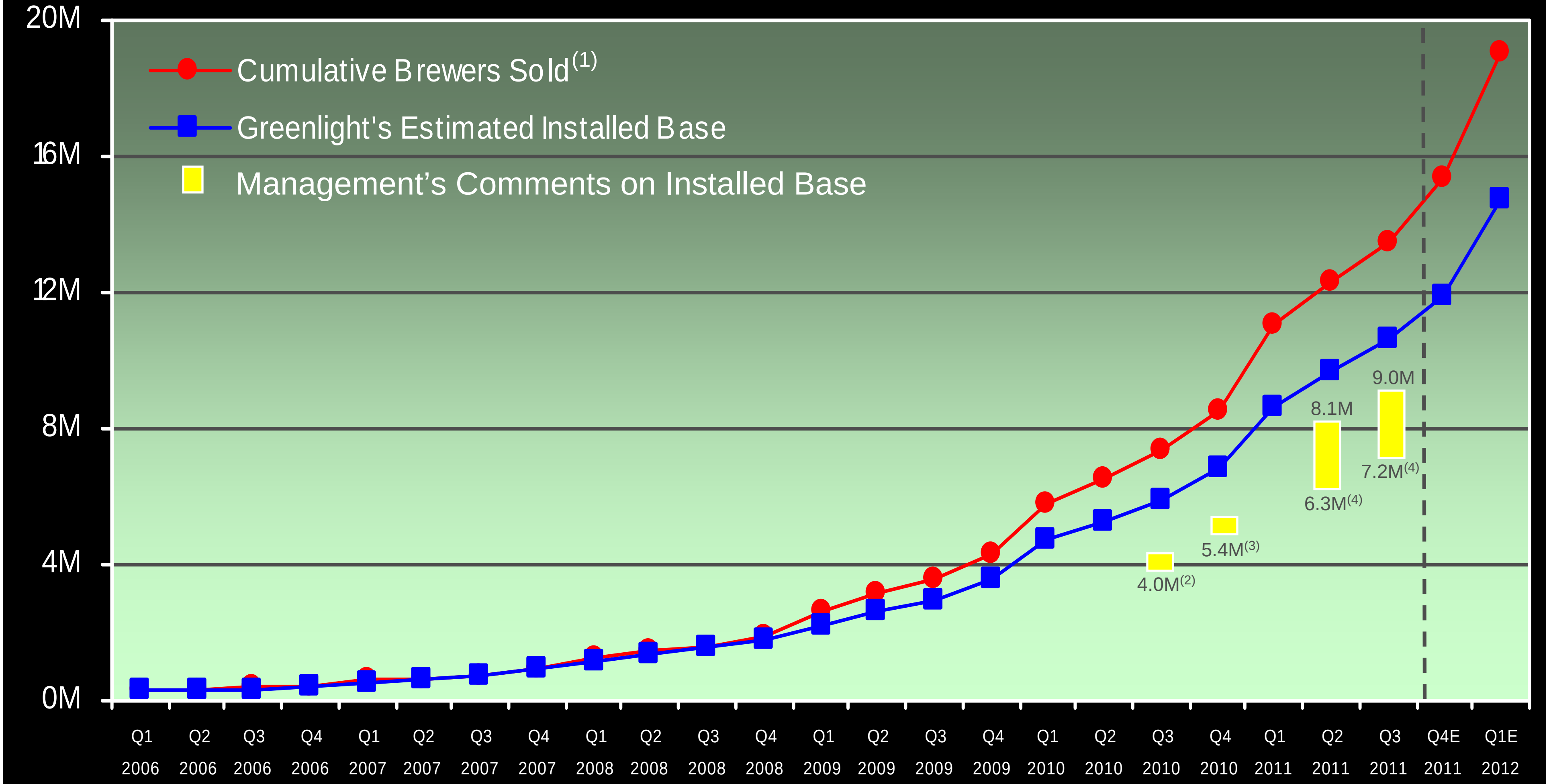
A More Realistic View



Keurig Installed Base is >10M (4)
(~50% penetrated into the 21M)

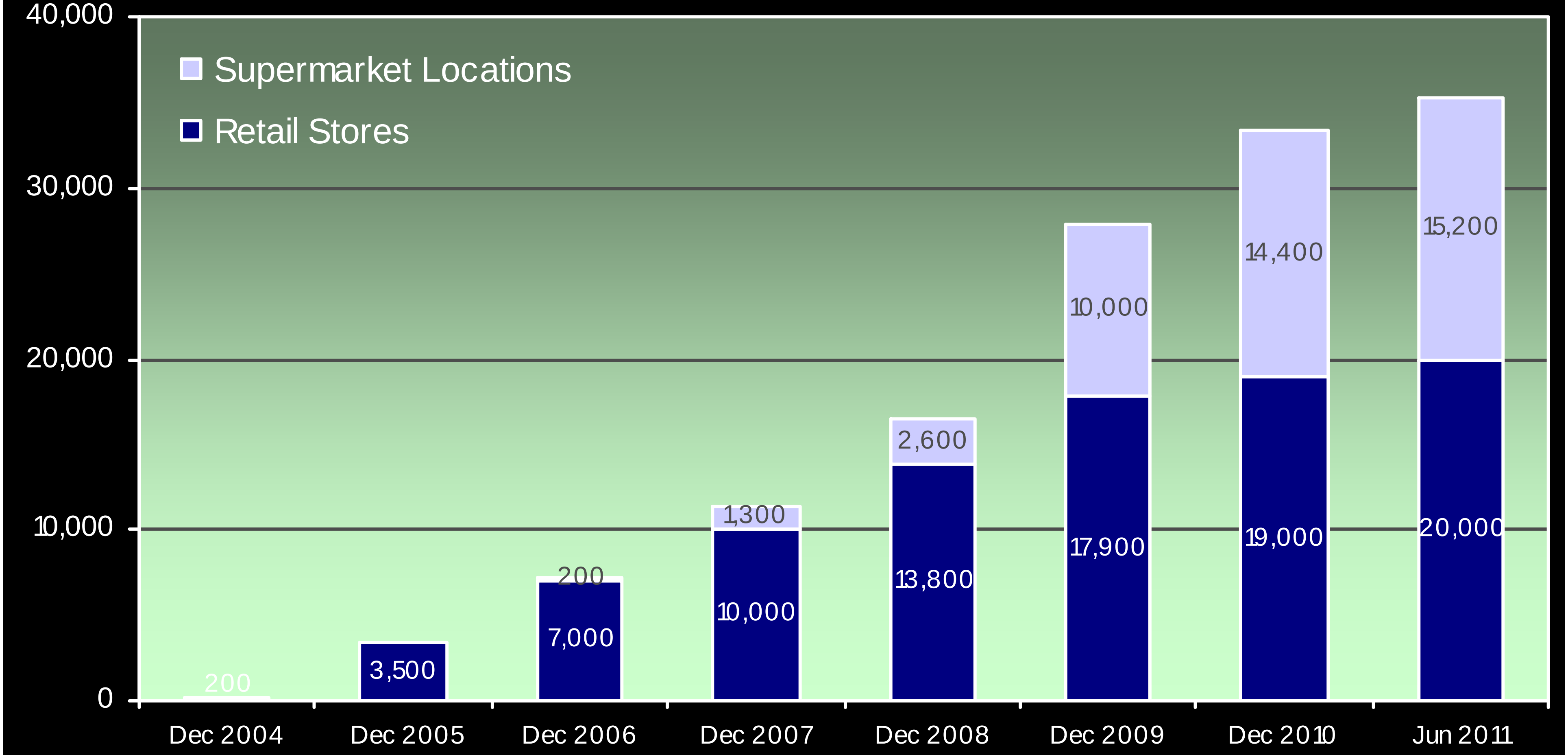
1. GMCR presentation given at conference on August 10, 2011
2. GMCR presentation given at conference on August 11, 2010
3. SunTrust Robinson Humphrey research note published July 21, 2011 (“If we assume that only 1/3 of [the 64M] households would be willing to buy a Keurig machine due to higher price points, the total available market is roughly 21mm homes.”)
4. Greenlight estimate through June 30, 2011

More Penetrated Than GMCR Says



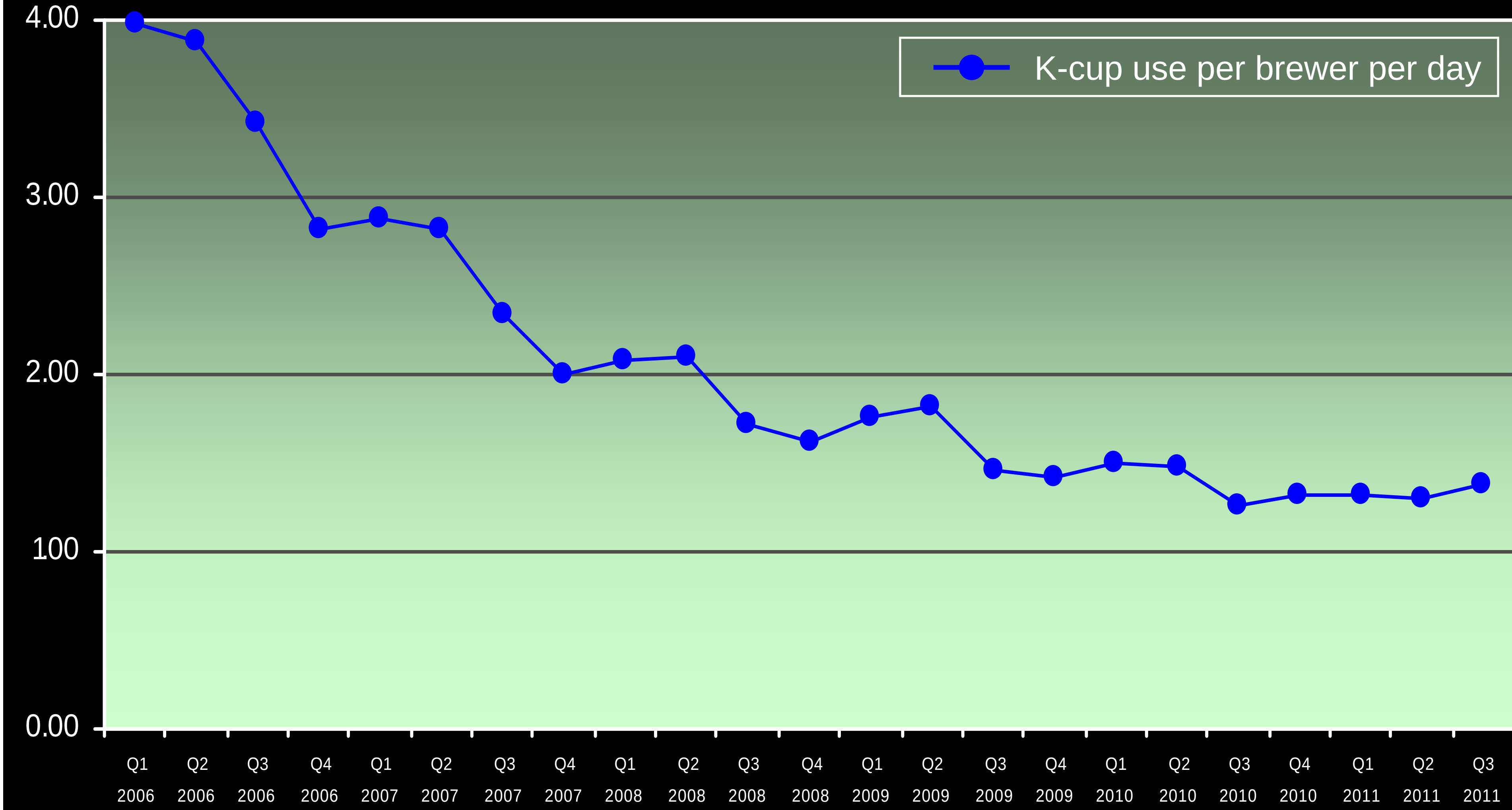
1. Q1 2006 – Q3 2011 based on GMCR earnings releases and SEC filings; Q4 2011 and Q1 2012 based on Greenlight estimates
2. GMCR presentation at conference on August 11, 2010 (approximately 4.5% of the 90M households with a coffee maker use a Keurig brewer)
3. GMCR Q4 2011 prepared remarks ("Keurig brewers now are in approximately 6% of the estimated 90 million U.S. households with a coffeemaker")
4. GMCR Q3 2011 Earnings Call (installed base is at 8-10% penetration, up from 7-9% penetration, of the 90M households that have a coffee maker)

Door Growth Has Slowed Substantially



1. GMCR presentation given at conference on August 10, 2011 (approximate totals based on company estimates)

K-cup Historical Attachment Rate



Source: Greenlight estimates

GMCR CEO on K-cup Attachment Rate

Q: Have you noticed any change in the attachment rates going up, down or are they remaining somewhat stable?

A: I think what we've indicated going forward because we are really focused on driving dollars going forward and we will continue to see new beverages at new price points. And we are just think that looking at dollars sold at portion packs is the best way to look at our overall progress. And we are not going to, going forward, report on consumption per brewer. Again, we are trying to encourage also multiple brewers in every household. We would love for households to have a brewer in the kitchen, a brewer in the office, a brewer in their weekend getaway whether it is a houseboat or a cottage. And our objective here is overall share of household coffee and more broadly, non-carbonated beverage consumption. And the brewer consumption per brewer is not particularly important, it is the overall portion packs sales and our share of household that we're focused on.

Source: GMCR Q1 2011 Earnings Call on February 2, 2011. Emphasis added.

Starbucks Deal

Starbucks Deal Structure

- SBUX deal announced on March 10, 2011
- SBUX K-cups to be sold in grocery stores soon and in SBUX stores next year
- Agreement is non-exclusive and “multi-year”
- It does not apply to GMCR’s next generation brewer

Source: Greenlight conversations with GMCR and SBUX representatives

Starbucks Deal Structure

GMCR Sells a SBUX K-cup **"*Licensing*"**	**SBUX Sells a SBUX K-cup** **"*Contract Manufacturing*"**
• GMCR buys roasted coffee from SBUX • GMCR packages it into a SBUX K-cup • GMCR sells into the retail channel • GMCR pays SBUX a royalty	• SBUX buys and roasts the coffee • SBUX delivers the roasted coffee to GMCR • GMCR packages it into a SBUX K-cup • SBUX sells into its CPG channel • SBUX pays GMCR packaging costs + manufacturing fee

Source: Greenlight's understanding based on conversations with representatives from GMCR and SBUX

Starbucks Deal Structure

- We believe SBUX and GMCR have approximately $0.22 in operating profit per K-cup to split:

Per K-cup Economics	Licensing	Contract Manufacturing
Retail Sales Price per K-cup	$0.85	$0.85
Retail Markup	$0.23	$0.23
% retail price	*27.0%*	*27.0%*
Wholesale Revenue	$0.62	$0.62
Revenue to Fulfillment Company	$0.02	N/A
Net Revenue to Selling Company	**$0.60**	**$0.62**
Coffee from SBUX (coffee & roasting)	$0.16	$0.16
Packaging	$0.15	$0.15
Total COGS	$0.31	$0.31
Gross Profit	$0.29	$0.31
Gross Margin %	*48%*	*50%*
Operating Expenses	$0.07	$0.09
Operating Profit To Split	**$0.22**	**$0.22**

Source: Greenlight estimates

Smucker's Deal Implies Manufacturing Fee of ~$0.06

Retail Sales Price per K-cup [1]	$0.63
Retail Markup	$0.15
% retail price [2]	*24.5%*
Revenue to Smucker's	$0.47
Coffee & Roasting Costs [3]	$0.10
Packaging Costs [3]	$0.12
Total COGS	$0.22
Gross Profit	$0.25
Operating Expenses [4]	$0.08
Operating Profit Before Manufacturing Fee	$0.17
Operating Profit After Manufacturing Fee	$0.11
Operating Margin % [5]	*24%*
Estimated Manufacturing Fee to GMCR [6]	**$0.06**

1. Based on current retail pricing of Folgers and Millstone K-cups
2. As per grocery industry due diligence specific to Smucker's branded K-cups
3. Greenlight estimates
4. Based on Smucker's corporate SG&A expense as a percent of sales of approximately 17%
5. Smucker's commented on 2/17/2011 that K-cup margins were above SJM overall margins of ~16%, but not above coffee segment margins of ~29%
6. Greenlight estimates this manufacturing fee based on Smucker's commentary related to its K-cup operating margin range. In addition, the $0.06 fee is consistent with prior royalty payments received by Keurig from licensees manufacturing K-cups.

Starbucks Deal Structure

- GMCR has said it is indifferent if SBUX or GMCR sells the K-cups [(1)]
- GMCR has said the SBUX deal is most like the Smucker's deal [(1)]
- SBUX should make the majority (~ 2/3) of the profits
- Smucker's and SBUX deals should be less profitable than GMCR current brands on a per K-cup basis
- Smucker's and SBUX deals aren't entirely incremental
  - They could cannibalize existing higher margin K-cup sales

1. GMCR Q2 2011 earnings call on May 3, 2011 and Q3 2011 earnings call on July 27, 2011

Business Quality

Is GMCR a Great Business?

- GMCR has not generated free cash flow

millions $	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010	YTD 2011
Cash Flow from Operations	$12.8	$29.8	$1.9	$38.5	($10.5)	$174.7
Capital Expenditures	($13.6)	($21.8)	($48.7)	($48.3)	($118.0)	($175.5)
Acquisitions	($101.1)	$0.0	$0.0	($41.4)	($459.5)	($907.8)
Free Cash Flow	($101.8)	$8.0	($46.8)	($51.2)	($588.0)	($908.6)
Cumulative Free Cash Flow	($101.8)	($93.9)	($140.6)	($191.8)	($779.8)	($1,688.4)

Source: GMCR 10-K's for 2010, 2009, 2008. GMCR 10-Q for Q3 2011. Note: YTD 2011 represents 39 weeks ended June 25, 2011.

Is GMCR a Great Business?

- “We expect that most of our cash generated from operations will continue to be used to fund capital expenditures and the working capital required for our growth over the next few years.”

Source: GMCR 10-Q for Q3 2011, p.39

Returns on Capital Investment – Bull Case

2013 Bull Case EPS [1]	$4.00
Shares	160.0
Implied Net Income	640.0
Estimated Net Working Capital [2]	1,120.0
Acquisitions [3]	1,409.1
Net Fixed Assets as of Q3 2011	499.1
CapEx in Q4 2011 [4]	162.0
CapEx in FY 2012 [4]	740.0
Total	3,930.2
Return on Invested Capital	*16.3%*

1. SunTrust Robinson Humphrey research note published September 13, 2011; Janney Capital Markets research note published September 22, 2011
2. Assumes net working capital required is equal to 20% of FY2013 revenue (using consensus estimates from Bloomberg as of October 13, 2011)
3. Represents purchase price of Tully's, Timothy's, Diedrich, and Van Houtte in aggregate
4. Assumes the mid-point of GMCR capital expenditure guidance

Business Quality

- Historical and intermediate-term cash flow is poor
- Return on capital even in a bull scenario is merely adequate
- It is difficult to justify current super-premium multiple (36x FY2012 EPS estimates)

Competition and Patents

Competition – Bull Case

- Competition is limited and K-cup patent cliff is not meaningful
  - The growth of the Keurig brewer installed base should continue as there is a diminishing competitive threat from Tassimo, Senseo, and Nestle [1][2]
  - The only meaningful coffee brands that GMCR does not have in its portfolio are Maxwell House (i.e., Kraft) and Peet's [3]
  - Private label represents only 10% of coffee sold at retail [4]
  - There are barriers to entry:
    - There is a significant technology and capital requirement to produce K-cups on a large scale [4]
    - New entrants will have a difficult time securing shelf space in FY '13 (after K-cup patents expire) [1]

1. Janney Capital Markets research note published May 9, 2011
2. SunTrust Robinson Humphrey research note published May 6, 2011
3. SunTrust Robinson Humphrey research note published July 21, 2011
4. SunTrust Robinson Humphrey research note published September 13, 2011

The Patent Issue

- GMCR’s Razor/Razor Blade Model depends on making high margin profits from selling K-cups
- At issue: the pending expiration of the key patents preventing others from selling K-cups for use in Keurig machines

Patent Discussion

What GMCR Says In SEC Filings	**What GMCR Tells Analysts**
The two principal patents associated with our current generation K-cup portion packs will expire in 2012, and we have pending patent applications associated with this technology which, if ultimately issued as patents, would have expiration dates extending to 2023. (1)	*Q: Clearly the patents roll off in a year, and there might be some kind of me-too type products out. How do you see that evolving?* A: With respect to our patents and intellectual property, we have a broad portfolio of patents on portion packs, on brewers, on the system of the – of both portion packs and brewers. And certainly to the extent that any other product might infringe on our intellectual property, we take that very seriously and we would, in fact, rigorously defend our intellectual property. (2)

1. GMCR 10-K for FY2010, p.10
2. GMCR CEO Larry Blanford, Q3 2011 conference call on July 27, 2011

The Reality of GMCR's Patent Position

- GMCR wants everyone to believe that the patent situation is under control
- However… GMCR will no longer be able to rely on the two patents after September 16, 2012
  - Competitors will be able to produce K-cups

Competition Expected In September 2012

- Both patents (patent 5,325,765 and patent 5,840,189) are set to expire
- Any aspect of the K-cup that was revealed in either patent falls into the public domain
- Competitors will also be free to develop their own improved versions of the K-cup, taking the core concept from these patents but then altering, for instance, the design of the filter or the materials used to make the cup itself
- Competitors will also be able to advertise their K-cups as being compatible with the Keurig system

Source: Professor of Law.

The Patent Issue

- GMCR has been aware of the looming patent problem for years
- We believe it has embarked on a multi-pronged strategy to attempt to maintain its position
  - Overpay to buy their licensees back via acquisitions
  - Partner with other coffee brands
  - Attempt to patent minor improvements to the K-cup
  - Introduce a new brewer that uses a different patented portion pack.

GMCR Acquisitions of Licensees

	Tully's	Timothy's	Diedrich	Van Houtte
Acquisition Date [1]	Mar 27 '09	Nov 13 '09	May 11 '10	Dec 17 '10
Acquisition Price [1]	$40.3M	$155.7M	$305.3M	$907.8M
Revenue [2]	$30.4M	$43.7M	$86.5M	$443.0M
Multiple (EV/Revenue)	*1.3x*	*3.6x*	*3.5x*	*2.0x*
EBITDA [3]	n/a	n/a	$7.4M	$91.6M
Multiple (EV/EBITDA)	n/a	n/a	*41.3x*	*9.9x*
Approx.% of system-wide K-cups [4]	3%	12-13%	12-13%	< 12%
Allocation of Price to Goodwill [1]	$25.8M	$69.3M	$217.5M	$472.3M
Allocation of Price to Intangibles [1]	$12.4M	$98.3M	$100.2M	$375.1M
Allocation of Price to GW & Int.	$38.2M	$167.6M	$317.7M	$847.4M
% of Purchase Price	*95%*	*108%*	*104%*	*93%*

1. GMCR FY2010 10-K, GMCR 10-Q for 3Q 2011
2. Tully's: http://investor.gmcr.com/releasedetail.cfm?ReleaseID=466783.
   Timothy's: Estimate based on GMCR disclosure that Timothy's contributed $37.9M of revenue in FY 2010 (GMCR 10-K for FY 2010), grossed up to full year.
   Diedrich: TTM as of March 3, 2010 (See DDRX 10-Q for period ended March 3, 2010 and DDRX 10-K for FY ended June 24, 2009).
   Van Houtte: TTM as of Aug 21, 2010 (See GMCR Sep 14, 2010 presentation at http://investor.gmcr.com/events.cfm).
3. Diedrich: TTM as of March 3, 2010 (See DDRX 10-Q for period ended March 3, 2010 and DDRX 10-K for FY ended June 24, 2009).
   Van Houtte: TTM as of Aug 21, 2010 (See GMCR Sep 14, 2010 presentation at http://investor.gmcr.com/events.cfm).
4. Greenlight conversation with GMCR management

GMCR Acquired Diedrich

- GMCR revalued Diedrich's Assets

Diedrich Acquisition Price [1]	$305.3
Allocation of Purchase Price to Goodwill [1]	$217.5
Allocation of Purchase Price to Intangibles [1]	$100.2
Implied Value of Diedrich Stockholder Equity	($12.4)
Diedrich Total Stockholders' Equity [2]	$16.2
Revaluation of Diedrich's Book Value	($28.6)

1. GMCR FY2010 10-K, p.F-26
2. Diedrich 10-Q for the period ending 3/3/2010

Re-estimation of Van Houtte Goodwill

- In the December 2010 quarter, GMCR's allocation of the Van Houtte purchase price to goodwill was $418.6 million
- In the March 2011 quarter, GMCR re-estimated the allocation of the Van Houtte purchase price to goodwill to $472.3 million
  - A re-estimation of $53.7 million

Sources: GMCR 10-Q for Q1 2011 and GMCR 10-Q for Q2 2011

Summary of Acquisitions

- GMCR eliminated the licensees by buying them
- The most valuable asset the companies had was the license to make K-cups
- The licenses had limited value, as they would not be needed after the GMCR patents expire
- GMCR paid high prices to avoid having to compete with licensees post patent expiration
- The licensees roasted coffee and packaged their own K-cups, so they should have had similar fixed investment to GMCR
- The very high allocations to Goodwill raise suspicion about subsequent earnings quality

Brand Partnering

- To mitigate the threat of competition GMCR has partnered with multiple brands

- GMCR has, in effect, attempted to transition itself into the low-cost manufacturer of K-cups, which makes it a manufacturing company rather than a technology company

Brand Partnering

- Brand partnering could cannibalize higher profit GMCR K-cup sales with lower profit brand partner K-cup sales
- Contract manufacturing is a capital intensive, low multiple business
- Still does not prevent K-cup competition post patent expiration

The Patent Issue

- GMCR is attempting to patent minor improvements to their K-cup, unsuccessfully so far
  - Fluted filter vs. the original filter with smooth sides and conical shape
    - The Patent Office rejected this patent application because of “obviousness”
    - GMCR recently had this sent back to the Patent Office. GMCR will likely spend 3-12 months defending this long-pending patent application.
  - Even if GMCR does succeed here, it is irrelevant because anybody can make a K-cup for the installed base of Keurig brewers after September 2012
  - GMCR would need to convince their customers that a fluted K-cup filter makes a better cup of coffee than a smooth K-cup filter

Source: Professor of Law.

Next Generation Brewer?

- GMCR is attempting to introduce a new brewer that uses a different, patented K-cup
  - The new brewer appears to be higher end and is not meant to replace the current installed base (1)
  - On December 17, 2010, Keurig filed a new patent application that discloses a way to use “sonic energy” to drive and control the brewing process (2)
  - The next generation brewer clearly uses a different K-cup; in this example it would require a sonic receiver (2)
  - This may or may not be their next generation brewer

US 20110151075A1

(19) **United States**

(12) **Patent Application Publication** (10) **Pub. No.: US 2011/0151075 A1**

Peterson (43) **Pub. Date: Jun. 23, 2011**

(54) **BEVERAGE FORMATION APPARATUS AND METHOD USING SONIC ENERGY**

(75) Inventor: **Peter Peterson**, Waterbury, VT (US)

(73) Assignee: **Green Mountain Coffee Roasters, Inc.**, Waterbury, VT (US)

(21) Appl. No.: **12/971,535**

(22) Filed: **Dec. 17, 2010**

Related U.S. Application Data

(60) Provisional application No. 61/284,477, filed on Dec. 18, 2009, provisional application No. 61/335,083, filed on Dec. 31, 2009.

Publication Classification

(51) **Int. Cl.**
A47J 31/00 (2006.01)
A23F 5/10 (2006.01)

(52) **U.S. Cl.** **426/238**; 99/295

(57) **ABSTRACT**

Apparatus and method for forming beverages using a beverage cartridge and sonic energy. A cartridge may include a sonic receiver, such as a feature that extends into an interior space of the cartridge and is arranged to receive a sonic emitter that introduces sonic energy into the interior space. The sonic receiver may be excited by sonic energy, which causes the sonic receiver to itself introduce sonic energy into the cartridge.

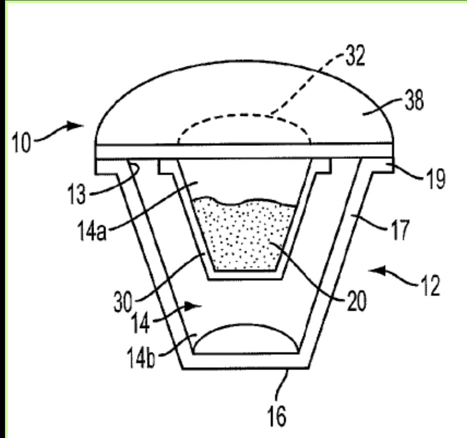


FIG. 1

1. SunTrust Robinson Humphrey research note published September 13, 2011
2. US Patent Application filed December 17, 2010

Patent Issue – New Brewer Platform

- GMCR hinted it would replace the brewer ecosystem
  - "As we are thinking about the future and the new platform, we are envisioning that the new platform would exist for some time with our current platform." (1)
  - "If you want to come into the system, how comfortable are you investing in your R&D, CapEx, go to market and that might eventually be obsolete?" (2)

1. Larry Blanford, CEO on Q1 2011 earnings call dated February 2, 2011
2. Fran Rathke, CFO at conference on March 15, 2011

Patent Issue – New Brewer Platform

- GMCR recently changed directions:
  - While the company remained tight lipped on the specifics of the next gen platform, it does see it as a parallel platform, not a replacement for the “classic” version. We expect the product to be focused on the high end of the market with limited distribution for the next year or two. (1)
- The goal of the new system is to have a new portion pack that would extend patent protection until 2021

1. SunTrust Robinson Humphrey research note published September 13, 2011

Problems With New Brewer Platform Plan

- Why would a consumer abandon the soon-to-be open Keurig platform to “upgrade” to a new closed platform that offers less product choice and enforces GMCR’s monopoly pricing?
- Offering a new brewer system with new portion packs invites the consumer to consider competitive products
- “Launching a new incompatible brewer system would be a significant risk for the company.” (1)

1. Professor of Law.

Patent Issue

- Conclusion:

This is a Razor / Razor Blade Model where GMCR will lose its ability to monopoly price its razor blade next September

Private Label Competition

- Major retailers want private label K-cups
- Kroger, Safeway, Super Value, HEB, Wegman’s and Costco have indicated they would be interested, as soon as a private label manufacturer can produce a K-cup with a filter
- Sturm (Treehouse) can enter the market with minimal capital investment
    - Sturm already produces filter-less K-cups
    - Sturm has production lines that can be easily modified

Source: Private label food & beverage industry expert

Private Label Competition

Private label K-cup penetration could exceed private label coffee penetration today because of the price differential

- "The penetration level in private brands of the entire coffee business is between 10 and 11%. It's been staying about there. But Sturm feels that the potential penetration level of single serve coffee is so much greater than it is for the standard business because the price differentials are going to be huge."
- "I would say that a 20% penetration level would not be a bad number."

Source: Private label food & beverage industry expert

Potential Branded Competition

KRAFT

Peet's Coffee & Tea

MARS incorporated

Nestlé

Maxwell House GOOD TO THE LAST DROP!

PREMIUM Sara Lee

Competing Single Serve Systems

TASSIMO (KRAFT)	NESTLE NESCAFE	NESTLE NESPRESSO
		
Tassimo Suprema **$139.99**	**Nescafe Dolce Gusto** **$219.99**	**Nespresso Pixie** **$248.95**
FLAVIA (MARS)	**SENSEO (SARA LEE)**	**COFFEE BEAN & TEA LEAF**
		
Flavia Fusion **$124.99**	**Senseo Supreme** **$139.99**	**CBTL kaldi** **$179.95**

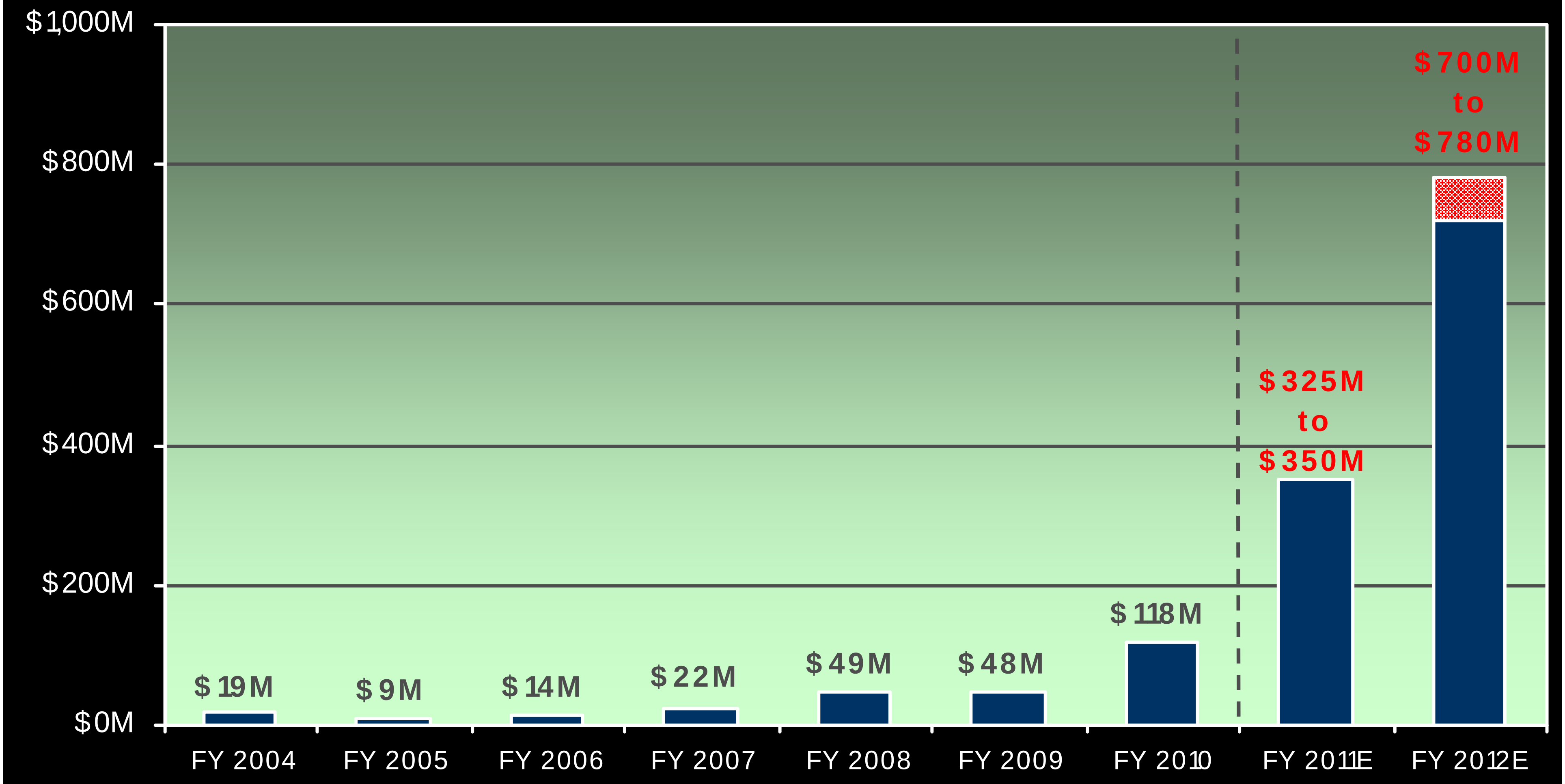
Revisiting the $9.00 Estimate

	Bulls' Estimate [1]	Adjusted Estimate
Fully Penetrated Installed Brewer Base	21.3	21.3
Average Daily K-cups per Brewer	2.00	1.25
Private Label Penetration	0%	20%
Average GMCR Daily K-cups per Brewer	2.00	1.00
Days/Year	365	365
Annual GMCR K-cup Consumption	15,558	7,787
Profit per K-cup [2]	$0.15	$0.12
Annual K-cup Profit	$2,352	$934
Long Term EPS	$9.00	$3.50

1. SunTrust Robinson Humphrey research note published July 21, 2011. Assumes $30M interest expense, 38% tax rate, and 160M shares.
2. $0.12 average profit per K-cup calculated by applying the bull's estimate of $0.15 profit per K-cup to GMCR K-cups (estimated 70% share) and Greenlight's estimate of $0.06 profit per K-cup (i.e., manufacturing fee) to non-GMCR K-cups (estimated 30% share).

Capital Expenditure Forecast

GMCR Capital Expenditures



Source: GMCR 10-k's for 2010, 2009, 2008, 2007 and 2006, and GMCR 10-Q for Q3 2011, p.39, "We currently expect to invest approximately $325.0 million to $350.0 million in capital expenditures during fiscal 2011. For fiscal 2012, we currently expect to invest approximately $650.0 million to $720.0 million in capital expenditures. In addition, as the Company secures new production facilities for future growth it may incur additional capital expenditures in the range of $50.0 million to $60.0 million in fiscal 2012."

Capital Expenditures

Millions (except per dollar data)	FY 2007	FY 2008	FY 2009	FY 2010	*FY 2011E*	*FY 2012E*
Estimated GMCR K-cup Units Sold [(1)]	359	579	1,056	2,290	4,751	8,041
Change in K-cup Units	104	220	477	1,234	2,461	3,290
Capital Expenditures for Fixed Assets [(2)]	$21.8	$48.7	$48.3	$118.0	$234.4	$313.4
Incremental K-cup Units per Dollar of CapEx	4.7	4.5	9.9	10.5	10.5	10.5
Midpoint of GMCR's CapEx Guidance [(3) (4)]					$337.5	$740.0
Unexplained CapEx					**$103.1**	**$426.6**

1. Greenlight's estimate excludes K-cups manufactured by licensees
2. GMCR 10-K for 2010, 2009, and 2008. For 2011 and 2012 estimates, based on GMCR growth and prior level of capital efficiency.
3. http://investor.gmcr.com/releasedetail.cfm?ReleaseID=594488. "Capital expenditures for fiscal 2012 in the range of $650 million to $720 million. In addition, as the Company secures new production facilities for future growth it may incur additional capital expenditures in the range of $50 million to $60 million in fiscal 2012."
4. "The majority of our anticipated 2011 CapEx is related to capacity required to support growing demand for K-cup portion packs." (Larry Blanford, Q1 2011 earnings call on February 2, 2011). "We expect the majority of our $650 million to $720 million in planned 2012 capital expenditures will go to scaling our portion pack production capacity" (Larry Blanford, Q3 2011 earnings call on July 27, 2011).

Capital Expenditures in FY 2011

millions $	Total Cost
K-cup Processing Equipment (1)	$95.0
Rack Systems	$4.0
Facilities Upgrade	$10.0
Factory Expansion	$12.5
Van Houtte Related CapEx (2)	$30.0
Total Estimated Capital Expenditures	**$151.5**
Midpoint of GMCR's CapEx Guidance (3)	$337.5
Unexplained CapEx	**$186.0**

1. Greenlight estimate based on incremental production requirements and assumes packaging lines producing on average 500 K-cups/ minute and 70% utilization rate. Processing equipment price based on conversations with packaging equipment provider.
2. GMCR Q1 earnings call, “We've added $30 million to our estimate for fiscal '11 CapEx due to the acquisition of Van Houtte.”
3. http://investor.gmcr.com/releasedetail.cfm?ReleaseID=594488.

Capital Expenditures in FY 2012

millions $	Total Cost
K-cup Processing Equipment (1)	$111.0
New Portion Pack Equipment (1)	$22.0
Rack Systems	$6.0
Facilities Upgrade	$15.0
New Factory	$50.0
Factory Expansion	$25.0
Coffee Brewer Tooling in China (2)	$30.0
Business Systems (3)	$50.0
Total Estimated Capital Expenditures	**$309.0**
Midpoint of GMCR's CapEx Guidance (4)	$740.0
Unexplained CapEx	**$431.0**

1. Greenlight estimate based on incremental production requirements and assumes packaging lines producing 700 K-cups / minute and 70% utilization rate. Processing equipment price based on conversations with packaging equipment provider.
2. Based on conversation with coffee brewer manufacturer and assumption that tooling is for approximately 10 million units of brewer production for next generation brewer.
3. Based on conversation with industry expert who stated that a full ERP implementation would cost ~$100 million and take 2+ years.
4. http://investor.gmcr.com/releasedetail.cfm?ReleaseID=594488.

Capital Expenditure Conclusions

- Capital spending is growing much faster than the business
- Capital intensity should be getting more efficient as the company achieves scale
- The gap is so large and insufficiently explained that it raises questions about what is being capitalized and casts doubt on the business model

Review of Recent Reported Results

Quarterly Income Statement

	Fiscal Quarters						
millions $	Q1 2010	Q2 2010	Q3 2010	Q4 2010	Q1 2011	Q2 2011	Q3 2011
Total Revenues	345.2	322.0	316.6	373.1	575.0	647.7	717.2
Cost of Goods Sold	249.6	214.1	207.7	259.6	430.6	404.8	453.1
Gross Profit	95.6	107.9	108.9	113.4	144.4	242.9	264.1
Gross Margin %	*27.7%*	*33.5%*	*34.4%*	*30.4%*	*25.1%*	*37.5%*	*36.8%*
Total SG&A	69.3	59.8	62.7	61.3	100.5	109.3	132.2
Operating Income	26.2	48.0	46.2	52.1	43.9	133.6	131.9
Operating margin %	*7.6%*	*14.9%*	*14.6%*	*14.0%*	*7.6%*	*20.6%*	*18.4%*
Net Interest and Other	(1.2)	(1.0)	(1.5)	(2.0)	(2.8)	(17.5)	(11.8)
Pre-Tax Profit	25.1	47.1	44.7	50.1	41.1	116.1	120.1
Income Taxes	10.0	18.1	16.4	17.2	15.0	44.1	43.8
Non-GAAP Net Income	15.1	28.9	28.3	32.9	26.1	71.5	75.7
Non-GAAP EPS	**$0.11**	**$0.21**	**$0.21**	**$0.24**	**$0.18**	**$0.48**	**$0.49**

Source: GMCR SEC filings and earnings reports. Note that Non-GAAP Net Income is net of income to non-controlling interest in Q2 2011 and Q3 2011.

Operating Expenses in March 2011 Quarter

- GMCR completed its acquisition of Van Houtte on December 17, 2010
- Van Houtte's operating expenses (which include Selling and Operating Expense and General and Administrative Expenses) ran at approximately 40% of net sales

	Yr Ended	Yr Ended	Yr Ended	52 Wks
thousands $	3/29/08	3/28/09	4/3/10	9/25/10
Total Revenues	370,370	361,465	381,034	416,557
Total OpEx	153,652	154,642	156,389	163,657
% sales	*41.5%*	*42.8%*	*41.0%*	*39.3%*

Source: GMCR 8-K filed March 3, 2011 (EX-99.2, EX-99.4)

Operating Expenses in March 2011 Quarter

- Van Houtte contributed $100.5 million to GMCR's net sales in the March 2011 quarter [1]

millions $	Dec FY 2010	March FY 2010	June FY 2010	Sep FY 2010	Dec FY 2011	March FY 2011
Total GMCR Revenues	345.2	322.0	316.6	373.1	575.0	647.7
Total Non-GAAP Operating Expenses	69.3	59.8	62.7	61.3	100.5	109.3
Operating Expenses as % of sales	*20.1%*	*18.6%*	*19.8%*	*16.4%*	*17.5%*	*16.9%*

- GMCR's operating expenses as a percentage of sales fell even though GMCR added Van Houtte's high cost structure business

1. http://investor.gmcr.com/releasedetail.cfm?ReleaseID=574139

Operating Expenses in March 2011 Quarter

- When asked about this discrepancy, GMCR's CFO refused to disclose Van Houtte's operating expenses
  - "It turns out they just spend less than we thought." (1)
- Van Houtte's June 2011 Quarter operating expenses were $38.1 million (2)
- GMCR increased its purchase accounting goodwill calculation in the March 2011 Quarter by $53 million

1. Fran Rathke at GMCR equity road show on May 5, 2011
2. GMCR 10-Q for Q3 2011

Revenues in June 2011 Quarter

- GMCR June 2011 Quarter revenue was $717 million, which included $485 million of K-cup sales (1)
  - $100 million higher than GMCR's revenue guidance of $602 - $617 million, given on May 3, 2011 (2)
  - $108 million higher than consensus estimates (3)
  - $70 million, or 11%, higher than March 2011 Quarter revenue, despite seasonality (4)

1. http://investor.gmcr.com/releasedetail.cfm?ReleaseID=594488
2. http://investor.gmcr.com/releasedetail.cfm?ReleaseID=574139
3. Thomson Reuters consensus estimates as of July 26, 2011
4. GMCR 10-Q for Q2 2011

Revenues in June 2011 Quarter

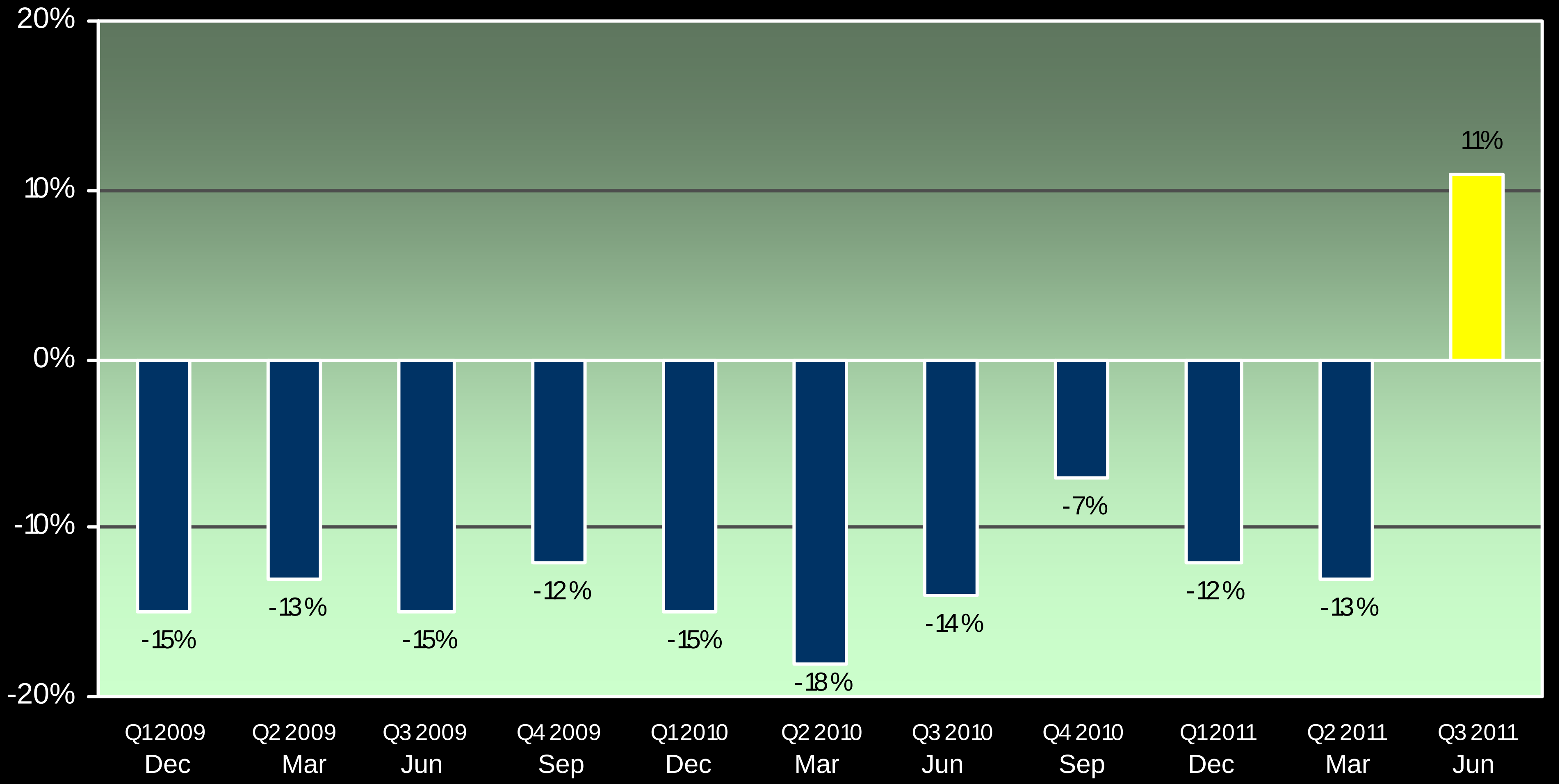
- All upside was due to higher K-cup sales
- Historically K-cup sales have been predictable
  - Installed base X attachment rate (seasonally adjusted) X days

Units in millions	Dec FY 2010	March FY 2010	June FY 2010	Sep FY 2010	Dec FY 2011	March FY 2011	June FY 2011
Estimated Installed Brewer Base(1)	4.7	5.3	5.9	6.8	8.6	9.6	10.6
Predicted Attachment Rate (2)	1.54	1.58	1.27	1.24	1.31	1.30	1.10
Predicted K-cup Units	666	764	690	775	1,034	1,142	1,058
Actual Attachment Rate	1.51	1.49	1.26	1.33	1.33	1.30	1.39
Actual K-cup Units (3)	650	720	683	832	1,046	1,145	1,346
Difference in K-cups	(16)	(44)	(7)	57	12	3	288
Surprise (percentage)	*-2%*	*-6%*	*-1%*	*7%*	*1%*	*0%*	*27%*

1. Greenlight estimate
2. Predicted attachment rate calculated by applying a constant year over year change in attachment rate (-13%) to the year-ago period's actual attachment rate
3. GMCR stopped providing K-cup units data after Q4 2010. Q1 2011 – Q3 2011 K-cup units are Greenlight estimates based on management's comments on quarterly earnings calls of approximate percentage growth in K-cup units.

Year over Year Change in Attachment Rate

- June Quarter surprise – dramatic change in attachment rate



Source: Greenlight estimates

Revenues in June 2011 Quarter

- GMCR CFO stated that management was "surprised to the upside on the strength of the portion pack (K-cup) sales." (1)
- GMCR ascribed the $100 million revenue outperformance to a combination of four factors (1)
  - Continued strong consumer adoption of the Keurig Single-Cup Brewing system coming off a holiday season
  - Higher advertising and retail merchandising
  - Catch-up from prior periods (i.e., more K-cups sold in the June quarter as a result of adding additional capacity and filling pent-up customer demand from December and March quarters)
  - Pull-forward from future periods (i.e., more K-cups sold in the June quarter as a result of retailers purchasing K-cups in advance of a K-cup price increase that took effect at the end of the June quarter)

1. GMCR Q3 2011 conference call on July 27, 2011

SEC Inquiry

SEC Inquiry

- On September 20, 2010, the staff of the SEC's Division of Enforcement informed the Company that it was conducting an inquiry and made a request for a voluntary production of documents and information
- <u>Based on the request, the Company believes the focus of the inquiry concerns certain revenue recognition practices and the Company's relationship with one of its fulfillment vendors</u>
- The Company, at the direction of the audit committee of the Company's board of directors, is cooperating fully with the SEC staff's inquiry

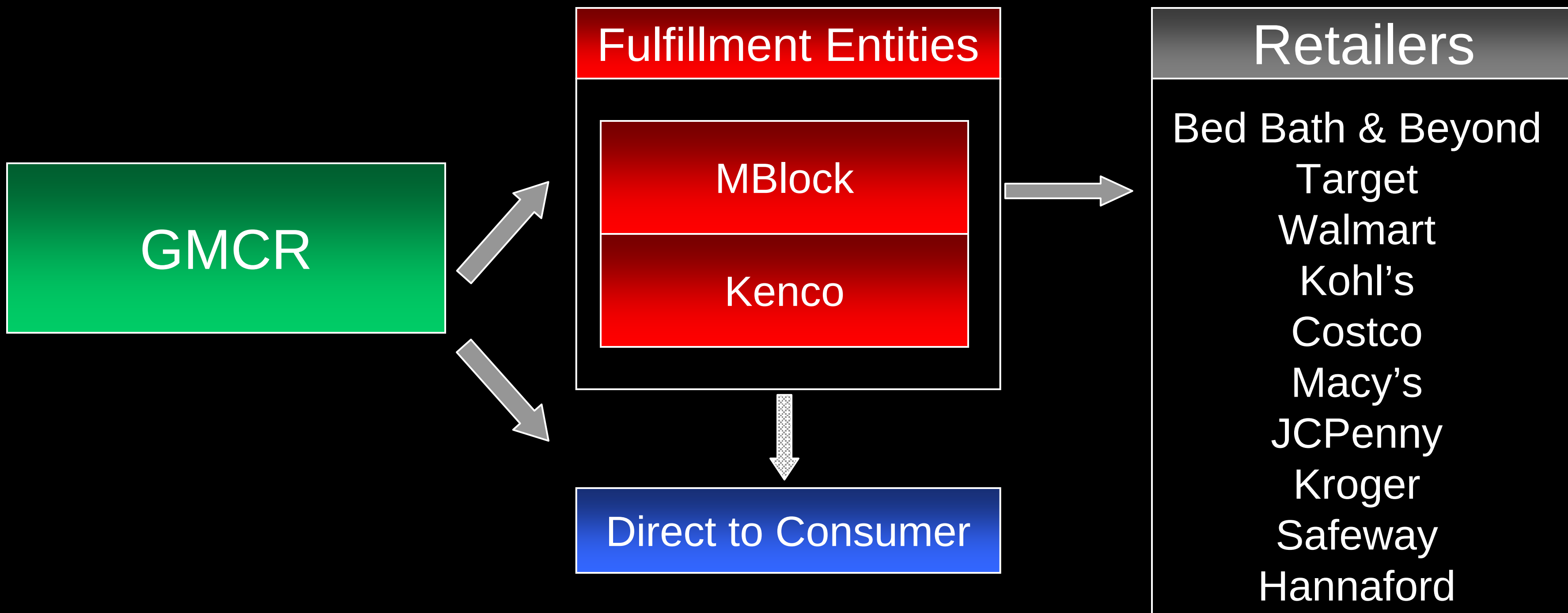
Source: GMCR 8-K dated September 28, 2010. Emphasis added.

SEC Inquiry

- Internal investigation exonerated the company
- Company made relatively minor accounting restatement and signaled the problem is behind them
- SEC inquiry remains open
- We believe there may still be a material issue

SEC Inquiry

- Sales and Distribution



Source: Greenlight’s understanding of business organization from GMCR’s 10-K, conversations with management, and investor presentations

SEC Correspondence

- SEC asked GMCR to file MBlock agreement
  - We note your disclosure regarding the importance of your relationship with MBlock & Sons, Inc., the order fulfillment entity through which the company makes a majority of the at-home orders for the Keurig business unit's single-cup business sold to retailers. Please tell us how you concluded that filing your contract documentation would not be required to comply with Item 601(b)(10) of Regulation S-K. The same comment applies to your single order fulfillment partner in Canada and your sole manufacturer in China.

Source: SEC letter to GMCR dated March 2, 2011 "Comment 9." Emphasis added.

GMCR’s Response

- In analyzing its contractual relationships with third parties, <u>the Company has evaluated its contracts with each of its fulfillment partners and its manufacturer in China and concluded that such contracts are not material for purposes of Item 601 of Regulation S-K</u>.
- As disclosed in the Fiscal 2010 Form 10-K, MBlock performs an administrative function in processing the majority of sales orders for the Company’s at-home single-cup business with retailers in the United States.
- *These fulfillment entities do not sell the Company’s products but rather receive and fulfill sales orders and invoice retailers and maintain the Company’s inventory. The Company notes that even though approximately 43% of its consolidated net sales were processed by MBlock in fiscal 2010, the substance of MBlock’s relationship with the Company is administrative and procedural and not as a purchaser or consumer of the Company’s products.*

Source: GMCR response letter to SEC dated March 29, 2011 “Response to Comment 9.” Emphasis added.

What GMCR Said in 2009

- We rely on a single order fulfillment company, MBlock & Sons, Inc., to process the majority of orders for our At-Home (AH) single-cup business sold through retailers. <u>We sell a significant number of brewers and K-cups to this third party fulfillment company for re-sale to certain retailers</u>.
- Receivables from this company were approximately 51% of our consolidated accounts receivable balance at September 26, 2009. Accordingly, we are subject to significant credit risk regarding the creditworthiness of this company. [(1)]
- Revenue from wholesale and consumer direct sales is recognized upon product delivery, and in some cases upon product shipment. [(2)]

1. GMCR 10-K for FY 2009, p.12 (Risk Factors)
2. GMCR 10-K for FY 2009, p.32 (Revenue Recognition Policy)

SEC Inquiry

- MBlock remains very material to GMCR
- GMCR is by far MBlock's biggest relationship
- MBlock former workers felt like they worked for Keurig
  - "It was more like I was working for Keurig than I was working for MBlock… I really never even had a boss while I was at MBlock."
- Nature of the "unusual" relationship
  - When Keurig came to visit MBlock, "they were not treated like clients as the other customers were…. It was so weird."
  - "They treated all the other customers like clients. Not Keurig."
- SEC is right to demand disclosure of the material agreement between the two companies

Sources: Former MBlock workers

Results of Field Research

Field Interviews - Background

- It was difficult to understand how GMCR sold the extra $100 million of K-cups in the June 2011 Quarter
- It was alleged in a class action lawsuit filed earlier this year (1):
  - "CW1 [Confidential Witness One] indicated that GMCR improperly recognized revenue on 150 truck loads of product that was shipped to MBlock during the quarter ended December 26, 2009. This former GMCR manager stated that he/she and other Company employees, including the Company's global transportation manager, were unable to locate the requisite paperwork, including purchase orders, material requisition orders, or product shipment authorizations, traditionally used by GMCR to validate the sale.
  - Specifically, CW1 indicated that because there was no order for those products, no payment was ever made on the 150-truckload shipment. In addition, the order was not listed on the Company's production forecast schedule and employees who worked under CW1 not only saw the trucks go out, but visited MBlock and saw its warehouses filled to the rafters with K-cups. CW1, who estimated that the value the revenue recognized on the foregoing improperly recorded transaction to be between $7.5 and $15 million dollars…"

1. Horowitz v. Green Mountain Coffee Roasters 7/12/11 (p.19)

Field Interviews - Background

- In an effort to determine whether the recent strong results were driven by similar behavior, we interviewed several former GMCR and MBlock workers
- The workers tell consistent stories and paint an unflattering picture of the companies
- The research shows that Green Mountain and MBlock are potentially engaged in a variety of shenanigans that appear designed to mislead auditors and to inflate financial results

Field Interviews – Summary Findings

- Both GMCR and MBlock use sub-standard IT systems. Important functions including inventory management are performed in Excel spreadsheets which are easy to change, provide non-standardized analysis, and are prone to material error.
- Suggestions to improve operations through the use of technology are met with resistance inside both organizations
- The Accounting Department at GMCR uses many temporary workers and makes extensive use of college “co-op” students instead of hiring full time accountants
- Former workers believe that though no reason was given, they were fired for asking too many questions

Field Interviews – Summary Findings

- Bonuses were based on overall K-cup production, rather than on total revenue/sales
  - This has led to excess production and related inventory and spoilage problems
- There is a lot of cross-shipping. Product is transferred from one facility to another, often multiple times
  - PeopleSoft function to fulfill orders from multiple locations was never implemented
  - Deliberate overproduction of K-cups and refusal to ship from multiple locations gave cover for a “shell game that Green Mountain was playing across all its facilities.”
  - “We would do more transferring of inventory than we physically did shipping… Keurig would ship stuff to themselves, I mean truckloads of stuff they’d ship [from MBlock] to themselves.”

Sources: Former GMCR / MBlock workers

Field Interviews – Summary Findings

- Peculiar relationship between GMCR and its distributors
  - "It was clear that Keurig and Green Mountain control MBlock."
  - "Nobody in that warehouse can tell you what is MBlock's, what is Keurig, what is Green Mountain's, nobody can tell you that. I honestly don't think the owner of MBlock can tell you that."
- Odd material movements at distributors
  - Kenco trucker allegedly reported delivering merchandise to Kenco, picking it up later on, sealing the truck, and delivering it 10 bay doors down at the same warehouse

Sources: Former GMCR / MBlock workers

Field Interviews – Summary Findings

- Excess production…
  - "… he was the manager of demand planning. And consistently, his e-mails would talk about how far over the demand forecast actual production was."
- Led to a significant problem with expired coffee
  - MBlock received truckloads of expired coffee directly from Green Mountain
  - Channel checks have identified significant amounts of retail product with short shelf-life, and at times even expired product
  - "These plant managers just kept on saying they have space taken up by the inordinate amount of expired coffee."
  - "I would have to say at least one third of their warehouse is more than likely expired coffee in all the warehouses."

Sources: Former GMCR / MBlock workers; Greenlight channel checks

Field Interviews – In Their Own Words

- Irregularities during external inventory audits at MBlock
  - Prior to the inventory audit, "We would remove product and preload trailer trucks to ship to retailers because we didn't have room on the floor. Then we'd load more product on trailer trucks to nowhere to move it off the floor."
  - The warehouse was partially cleared prior to an audit, leaving a skeleton inventory of ~50%. Inventory was loaded onto trucks, which sat in the docks and was never counted. Sometimes after the audit, the product would simply be moved back into the warehouse.
  - Immediately prior to an audit, 500,000 brewers were inventoried and processed as an order for QVC. The brewers were never shipped, and after the audit, the inventory was restocked.

Sources: Former GMCR / MBlock workers

Putting It All Together

Putting It All Together

The Bull Case Is Frothy

- GMCR has grown rapidly
- The market is smaller and more penetrated
- Legitimate growth is already slowing
- Attachment rates matter and they are falling
- A more realistic assessment of potential earnings is closer to $3.50 than $9.00 and at that point GMCR should garner a market multiple rather than a premium valuation

Putting It All Together

The Patent Expiration is a Real Problem

- Fighting the patent office, creating new products and buying back licensees have mixed costs and benefits
- The “classic” system will become an open system in September 2012
- GMCR will lose its opportunity to monopoly price the “razor blades”

Putting It All Together

The March Quarter Was a Big Surprise

- Margins expanded dramatically as Van Houtte "just spen[t] less than we thought"
- GMCR sold 1.3 million brewers, which exceeded market expectations by about 300,000 brewers (1)
- This was the quarter where the former MBlock worker described the 500,000 brewers that were not to be inventoried

1. Janney Capital Markets research note published on May 9, 2011

Putting It All Together

The March Quarter Was a Big Surprise

- Management clearly stated that they did not pull forward any sales
  - Q: Just want to make sure I understand, not the seasonality but whether, how much sales actually might have been pulled forward in response to the spring merchandising. I think on brewer sales it looked like the NPD data was running at about a plus-60% or so rate, and I think your brewers sales in the quarter were up over 80?
  - A: First of all one of the things to be cautious about is the NPD database does not reflect all of our customers. In fact several of our customers are not included in that base so you can't really make those direct comparisons from one base to the other. We did not pull forward any sales at all…. I think that is just the nature of the acceleration of adoption of the product is really with what we are seeing, there is no pulling forward of shipments to do anything, other than react to the demand [1]
- The day after the earnings announcement and call, GMCR’s stock appreciated 19.4%[2]

1. GMCR Q2 2011 earnings call on May 3, 2011
2. Bloomberg

Putting It All Together

The March Quarter Was a Big Surprise

- Concurrent with their earnings release GMCR announced it would sell 7.1 million shares in an equity offering (1)
  - Ultimately GMCR issued 10.1 million shares in the offering, raising $689 million on May 11, 2011 (2)
  - Certain stockholders sold an aggregate 410,456 shares in the offering (3)
    - Robert Stiller (Chairman) sold 310,000 shares
    - Larry Blanford (CEO) sold 51,573 shares
    - William Davis (Director) sold 40,000 shares
    - David Moran (Director) sold 8,883 shares

1. GMCR 8-K filed May 3, 2011
2. http://investor.gmcr.com/releasedetail.cfm?ReleaseID=576447
3. Thomson Reuters

Putting It All Together

Questionable Business Practices

- Reduced and ever-changing transparency and disclosure
- Aggressive acquisition accounting
- Unexplained levels of capital spending
- Peculiar relationships with quasi-captive distributors
- Puzzling behavior uncovered by field research
- Poor financial controls and ongoing SEC inquiry

Putting It All Together

- Evaluation of Disclosure Controls and Procedures
  - Under the supervision of and with the participation of management, including the Company's Chief Executive Officer and Chief Financial Officer, the Company conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended, as of March 26, 2011. <u>Based on that evaluation and the material weaknesses referenced above, the Chief Executive Officer and Chief Financial Officer have concluded that the Company's disclosure controls and procedures were not effective as of March 26, 2011.</u>

1. GMCR Q2 2011 10-Q. Emphasis added.

Putting It All Together

- PricewaterhouseCoopers LLP opinion
  - We do not express an opinion or offer any other form of assurance on management's statement referring to the Company's plan for remediation of the material weaknesses in internal control over financial reporting. [1]

Auditors Are Distancing Themselves From Management

1. GMCR 10-K for FY 2010

Putting It All Together

- GMCR has relied on a high share price to raise capital
  - GMCR raised $689 million on May 11, 2011 (1)
    - Issued 9.48 million shares in a public equity offering and 608K shares in a private placement to Luigi Lavazza S.p.A.
  - GMCR raised $250 million on September 28, 2010 (2)
    - Sold 8.57 million shares of its common stock to Lavazza
  - GMCR raised $387 million on August 12, 2009 (3)
    - Sold 17.25 million shares in a public equity offering

1. http://investor.gmcr.com/releasedetail.cfm?ReleaseID=576447
2. GMCR 8-K filed on September 28, 2010
3. GMCR 8-K filed on August 12, 2009; GMCR 10-K for FY 2009. Note that shares sold are adjusted for subsequent 3 for 1 stock split.

Putting It All Together

- Insiders have been Sellers

Name	Title	Amount Netted
Robert Stiller	Chairman	$77.0M
Larry Blanford	CEO	$12.2M
Fran Rathke	CFO	$32.2M
Howard Malovany	General Counsel	$7.7M
Scott McCreary	Officer	$10.5M
Stephen Sabol	Officer	$2.3M
Michelle Stacy	Officer	$1.4M
Barbara Carlini	Director	$11.3M
Hinda Miller	Director	$7.3M
Jules Del Vecchio	Director	$4.5M
William Davis	Director	$2.5M
Michael Mardy	Director	$1.8M
David Moran	Director	$1.6M
Total		**$172.3M**

GMCR Insiders Have Netted ~$172 million in 2011

Source: Thomson Reuters

Putting It All Together

How to Assess GMCR's Value

- Given the large number of warning flags, it might not make sense to accept the income statement at face value
- "Follow the money"

GMCR has not had much free cash flow and says it won't have much for the next few years

The End