



GMCR

Snapshot

NEGATIVE



15 AUGUST 2011

Green Mountain Coffee Roasters Inc.

www.greenmountaincoffee.com

Industry	Processed & Packaged Goods
Price	\$103.58 (08/12/11)
Market Cap	15.86 billion
Enterprise Value	16.21 billion
P-E Ratio	100.17
EV/Revenue	7.01
Debt/EBITDA	0.85
Short Interest	14.1%
Days to Cover	6.2

Considerations: ❶ Section 16 filers sold more shares in an eight-day period during August 2011 following the expiration of a lock-up agreement than they had in any other quarter over the last five years. ❷ The elevated volume of shares sold was driven by the sell-through of a significant amount of shares available for sale under 10b5-1 trading plans. ❸ Unusual 10b5-1 activity resulted in the material reduction in beneficial ownership for active executives and directors.

Company Description and Recent Results

- Green Mountain Coffee Roasters Inc. (GMCR) is a leading provider of specialty coffee and coffee makers mainly in North America. The company primarily drives revenues through sales from its Keurig single-cup brewing systems and K-Cup portion packs used in the brewing systems, which combined to comprise roughly 88% of the \$1.36 billion in revenue generated during FY2010 (ended 09/25/10). Keurig brewer and accessory sales increased 67.3% YOY to \$330.8 million in FY2010, while K-Cup portion packs and related royalties increased 96.6% YOY to \$856.4 million. In Q1 CY2011, GMCR signed agreements with Starbucks and Dunkin' Donuts to sell K-Cups portion packs by fall 2011.
- Consolidated revenue increased 126.5% YOY in Q3 FY2011 (three months ended 06/25/11) to \$717.2 million, compared to the sell-side estimate of \$606.7 million. Revenue growth in the third quarter was driven by K-Cup portion pack sales which rose 136% YOY to \$485.4 million. According to the Q3 FY2011 press release, management indicated that in addition to strong consumer adoption of the Keurig brewing system, Q3 FY2011 results benefited from the firm's first-ever significant spring advertising campaign. Gross Margin increased to 36.8% in the third quarter, compared to 34.4% in Q3 FY2010. As a result, non-GAAP diluted EPS rose 184.6% YOY to \$0.37, above the sell-side estimate of \$0.33.

Historically Outsized Sales in Q3 CY2011

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- The magnitude and nature of exercise and sale activity by Section 16 filers appears to contrast with the significant revenue and earnings growth in recent quarters. Specifically, between 08/03/11 and 08/11/11, 10 executives and directors combined to sell 1.3 million shares for a market value of \$130.6 million.
- When excluding historical sales reported by Chairman Robert Stiller, the 765,836 shares sold by nine Section 16 filers during Q3 CY2011 is the largest sales volume for any quarter over the trailing five-year period (see Table I, next page).¹

¹ Dating back to 1994, Chairman Robert Stiller has sold 31.1 million shares, or 68.0% of the 45.7 million shares sold at GMCR. Stiller's significant activity generally creates difficulty comparing abnormal quarterly divestitures. As a result, we excluded his sales to improve our comparability to prior periods.



- Of significance, the market value of shares sold in Q3 CY2011 (\$77.9 million) exceeds the combined market value of sales (\$41.4 million) over the most recent 20 quarters with executive activity spanning Q3 CY2004 to Q2 CY2011. On average, between Q3 CY2004 and Q2 CY2011, executives and directors sold 220,569 shares for a market value of \$2.1 million.

Table 1. Summary of Sales by Section 16 Filers Since Q3 CY2004

Quarter	Shares Sold	Market Value	Mean Sale Price	Quarter	Shares Sold	Market Value	Mean Sale Price
Q3 2011	765,836	\$77,902,517	\$101.72	Q3 2007	0	NA	NA
Q2 2011	100,456	\$6,864,912	\$68.34	Q2 2007	216,032	\$1,129,471	\$5.23
Q1 2011	34,936	\$1,594,459	\$45.64	Q1 2007	210,159	\$882,851	\$4.20
Q4 2010	10,000	\$350,000	\$35.00	Q4 2006	409,192	\$1,534,150	\$3.75
Q3 2010	240,000	\$7,905,886	\$32.94	Q3 2006	159,729	\$455,620	\$2.85
Q2 2010-Q3 2009	0	NA	NA	Q2 2006	207,526	\$645,227	\$3.11
Q2 2009	356,305	\$5,200,038	\$14.59	Q1 2006	0	NA	NA
Q1 2009	303,765	\$3,014,418	\$9.92	Q4 2005	111,392	\$330,713	\$2.97
Q4 2008	371,098	\$3,026,415	\$8.16	Q3 2005	208,714	\$547,700	\$2.62
Q3 2008	0	NA	NA	Q2 2005	479,970	\$1,041,737	\$2.17
Q2 2008	670,867	\$5,828,310	\$8.69	Q1 2005	162,024	\$311,978	\$1.93
Q1 2008	69,461	\$615,573	\$8.86	Q4 2004	20,253	\$36,474	\$1.80
Q4 2007	0	NA	NA	Q3 2004	69,510	\$111,920	\$1.61

10b5-1 Trading Plan Sales Drive Divestiture Activity

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- Several characteristics of the 10b5-1 trading plans appear to be unusual. These include:
 - A high volume of sales in a short period of time;
 - The timing of the plan adoptions; and
 - The rapid sell-through of significant portions of executives' beneficial ownership.
- Discussion with management:** We contacted investor relations at GMCR requesting additional details on the 10b5-1 trading plans, including the duration, shares available for sale, potential price triggers or other automatic trading mechanisms, timing, and estimated divestiture underlying each plan. Suzanne M. DuLong (VP, Investor Relations & Corporate Communications) responded to our inquiry and indicated that information about the specifics of individual 10b5-1 trading plans has not and will not be made public. Additionally we sought clarification on Stiller's Form 144 filed on 08/04/11 disclosing the planned sale of up to 2.0 million shares. Since Form 144 filings are often used to disclose trading plan sales, we inquired whether his sale of



500,000 shares on the same day was under a 10b5-1 plan. GMCR did not comment on whether Stiller's 144 filing was part of a 10b5-1 plan. As a result, our analysis is based on the publicly available disclosures from GMCR.

- **Outsized trading plan sales:** 10b5-1 trading plan adoptions in Q2 CY2011 by several GMCR executives drove historically outsized sales in Q3 CY2011.
 - As illustrated in Table 2 (see next page), nine Section 16 filers sold 755,836 shares for a market value of \$76.9 million under Rule 10b5-1 trading plans in Q3 CY2011. Before Q3, only 54,936 shares were sold historically under 10b5-1 plans at GMCR.
 - Form 4 footnote disclosures indicate trading plans were adopted between 05/04/11 and 05/17/11.
 - As we discuss next, the large sell-through over a short period and material divestiture of equity holdings are 10b5-1 characteristics we associate with increased risk of share-price underperformance.²
- **Timing of plan adoptions:** The timing of 10b5-1 plan adoptions appears associated with GMCR's announcement of a common stock offering on 05/03/11.³ According to a prospectus filed on 05/04/11, executives and directors entered into a lock-up agreement, which restricted the sale of company shares for a period of 90 days after the date of the prospectus.⁴ Furthermore, disclosures in the prospectus indicate that, notwithstanding the lock-up provision, certain executive officers and directors intended to enter into 10b5-1 trading plans. Additional prospectus disclosures indicated trading plan sales in the aggregate will not exceed 5% of aggregate shares beneficially owned by Section 16 filers.
- **Rapid sell-through of plans:** The expiration of the lock-up appears to have triggered a rapid sell through of the plans that were adopted. The most recent proxy filing at GMCR indicates executives and directors owned 18.6 million shares and/or options exercisable within 60 days of the date of record (01/10/11). Based on the prospectus disclosure that trading plan sales will be less than 5% of aggregate holdings, we estimate approximately 929,032 shares are available for sale for Section 16 filers listed in Table 2. In this regard, we estimate more than 80% of shares scheduled for sale (i.e. 80% of the up to 5% of aggregate insider holdings) were divested in just eight days (08/03/11 to 08/11/11).

² Our interest in 10b5-1 sales is heightened when the following characteristics are observed: (1) evidence indicating that the volume of selling under 10b5-1 plans may have been accelerated by embedded share-price triggers, (2) irregular divestiture intervals, (3) irregular numbers of shares divested at each interval, (4) the existence of multiple plans in place at one time or modifications made to existing plans, and (5) material reduction in beneficial ownership over a relatively short period time (i.e., one year or less).

³ <http://investor.gmcr.com/releasedetail.cfm?ReleaseID=574139>.

⁴ <http://sec.gov/Archives/edgar/data/909954/000119312511124788/d424b7.htm>.



Table 2. 10b5-1 Divestitures Reported by Section 16 Filers at GMCR in Q3 CY2011

Name	Position	Date(s)	Shares Sold	Market Value	Sale Price	Initiation Date
Barbara Carlini	Director	08/04/11	108,000	\$11,493,252	\$106.42	05/17/11
Michael Hardy	Director	08/05/11	20,000	\$1,949,606	\$97.48	05/04/11
Howard Malovany	VP/Corporate Counsel/Secretary	08/04/11	78,750	\$8,426,171	\$107.00	05/05/11
R. Scott McCreary	P, SCBU	08/04/11	100,000	\$10,676,800	\$106.77	05/05/11
Hinda Miller	Director	08/04/11	70,000	\$6,484,620	\$108.08	05/05/11
David Moran	Director	08/05/11	10,000	\$985,000	\$98.50	05/05/11
Frances Rathke	VP/CFO/Treasurer	08/05/11	337,500	\$32,692,612	\$96.87	05/04/11
Stephen Sabol	VP, Development	08/03/11	21,336	\$2,287,347	\$107.21	05/04/11
Jules Del Vecchio	Director	08/08/11-08/11/11	20,250	\$1,846,598	\$91.19	05/13/11
Mean/Total			765,836	\$76,842,006	\$101.66	



Material Reduction in Beneficial Ownership

- As illustrated in Table 3 (next page), unusual sales volume during Q3 CY2011 has resulted in a material reduction in equity holdings by active executives and directors. According to data from GMCR's most recent proxy filing (01/24/11) and Form 4 filings, we estimate that beneficial ownership of Section 16 filer sellers in the quarter was reduced by an average of 25.7% as a result of historically outsized sales in a little over a week (between 08/03/11 and 08/11/11).
- Further, five Section 16 filers lowered their equity stake above our 20.0% threshold of concern.
 - Leading divestiture activity is Howard Malovany (VP/corporate counsel/secretary), who reduced his beneficial ownership by 87.6% through the sale of 78,750 shares on 08/04/11 under Rule 10b5-1.
 - CFO Frances Rathke reduced his holdings by 39.3% with the sale of 337,500 shares on 08/05/11. The divestiture by Directors Barbara Carlini (35.8%), Michael Hardy (34.7%), and Hinda Miller (20.9%) also represented a material portion of their beneficial ownership.

(See table, Divestiture of Beneficial Ownership Since 08/03/11, next page)



Table 3. Divestiture of Beneficial Ownership Since 08/03/11

Name	Position	Shares Sold	Shares Owned	Exercisable Options	Divestiture
Barbara Carlini	Director	108,000	0	301,835	35.8%
Michael Hardy	Director	20,000	4,500	53,175	34.7%
Howard Malovany	VP/Corporate Counsel, Secretary	78,750	6,991	82,950	87.6%
R. Scott McCreary	P/SCBU	100,000	107,488	631,277	13.5%
Hinda Miller	Director	60,000	88,452	197,982	20.9%
David Moran	Director	10,000	8,883	154,425	6.1%
Frances Rathke	VP/CFO, Treasurer	337,500	52,693	806,400	39.3%
Stephen Sabol	VP/Development	21,336	13,419	171,698	11.5%
Robert Stiller	Chairman	500,000	16,953,110	804,513	2.8%
Jules Del Vecchio	Director	20,250	265,721	174,675	4.6%
Mean					25.7%

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