

NYSSA Student Research

Industry: Food Processing

This report is published for educational purposes only by students competing in the NYSSA Investment Research Challenge™.

Tasty Baking Company

March 16, 2007

Ticker: TSTY (NASDAQ)
Price: \$8.82 (close 3/15/2007)

Recommendation: SELL
Price Target: \$6.60



www.tastykake.com

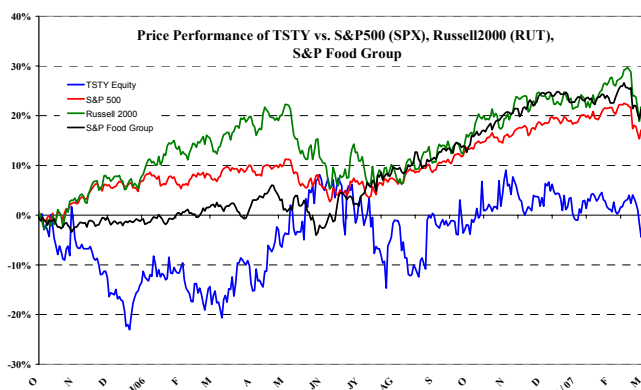
Earnings/Share

	Mar.	Jun.	Sept.	Dec.	Year	P/E Ratio
2005A	\$0.06	\$0.11	\$0.04	\$0.02	\$0.23	31.9x
2006A	0.12	0.14	0.06	0.19	0.51	17.3x
2007E	0.12	0.14	0.07	0.09	0.42	21.0x
2008E	0.12	0.14	0.07	0.09	0.42	21.0x

Highlights

- Sell recommendation based on valuation concerns.** Our two-stage, discounted cash flow to equity (DCF) model, based on a cost of equity of 8.74% and a terminal growth rate of 3%, yields a twelve-month target price for the Tasty Baking Company (TSTY) of \$6.60. This is a discount of 25.2% to the current price of \$8.82. We believe that justifying the current price requires unreasonable assumptions for its cost of equity and/or the long-term growth rate.
- Limited growth potential.** The company has encountered difficulty enhancing its brand equity, expanding beyond its core-Philadelphia market, and upgrading its outdated manufacturing facilities. We believe that these factors, compounded by a shrinking core market and a declining demand for traditional snack cakes, the company's main product, inhibit TSTY's growth potential.
- Cash-poor financial conditions.** The company is neither cash-rich nor a strong generator of cash flows, placing its growth plan at risk. Adding to its cash flow challenges, it must confront an increasing debt burden and an under-funded pension.
- Brand equity problems and demand challenges.** The results of our telephone survey of TSTY and its products, in which we called a random sample of over 3000 residences in the mid-Atlantic region, its core distribution area, reveal brand recognition and brand equity problems. They indicate that 75.5% of the respondents had not heard of the name, "Tastykake." In addition, 76.5% of Tastykake consumers identify its products as "junk" food. This leaves TSTY vulnerable to intense price competition. A face-to-face interview with a long-time independent sales distributor of the company's products supports these findings.
- Weak insider support.** The top four officers currently hold only about 198,000 of the 8.22 million shares outstanding, which we interpret as the management's lack of confidence or lack of interest in the company's future performance. The misaligned interests of the top management and shareholders do not instill confidence in the stock.

TEAM C



Market Profile	
52 Week Price Range	\$6.97-9.97
Average Daily Volume	6,665
Beta	0.70
Dividend Yield	2.27%
Shares Outstanding	8.22m
Market Capitalization	\$72.5m
Institutional Holdings	67.2%
Top Management Holdings	2.4%
Book Value per Share (mrq)	\$5.94
LT Debt to LT Capital Ratio	27.4%
Return on Equity (ttm)	10.2%

Source: Reuters and Bloomberg, as of March 15, 2007

Important disclosures appear at the back of this report

Investment Research Challenge™ is a trademark of The New York Society of Security Analysts, Inc.
©2006 The New York Society of Security Analysts, Inc.

Investment Summary

We initiate coverage of Tasty Baking Company (TSTY) with a SELL rating. Our analysis leads us to a twelve-month target price of \$6.60, a discount of 25.2% to the current market price of \$8.82. We conclude that justifying the current price requires unreasonable assumptions for its cost of equity and/or the long-term growth rate.

Valuation

We use three valuation methods. Our model of discounted cash flow to equity (DCF), based on a cost of equity (COE) of 8.74% and a terminal growth rate of 3% per year, yields a target price of \$6.60. In addition, our dividend discount model (DDM) produces a target price of \$4.40. Volatile EPS growth also calls into question the valuation based on current P/E ratios. These results indicate that the stock is significantly overvalued.

Limited Potential for Growth

Our main concern, supported by a number of observations, is with TSTY's limited long-term growth potential. Its ten-year historical compounded annual growth rate (CAGR) for gross sales is 2.34%, and is comparable to the five-year average annual projected growth rate of 1.90% for the bread and bakery products industry. We find it hard to envision a dramatic increase in the consumption of these products, especially non-nutritious bakery goods, among increasingly health-conscious consumers. As evidence, fourth-quarter volume for 2006 declined by 17% compared to fourth-quarter volume for 2005. While this decline is attributable in part to a 20% price increase on its products, it is also direct evidence of the challenges that TSTY faces. Moreover, TSTY's long-term marketing and distribution prospects are unimpressive. The company is a small, regional player in the Philadelphia area with limited brand recognition beyond it. Past attempts to expand outside of its traditional core market, such as into New York City or California, have not been successful.

As a response to these challenges, TSTY has undertaken a strategic growth initiative. The plan went into effect in 2003. It includes a new marketing campaign, the adoption of an enterprise resource planning (ERP) system for manufacturing, and a long-term strategy to replace aging plants. We feel that these are necessary steps if TSTY is to be a successful, long-term player in the market for snack cakes. However, without an influx of cash, an almost-immediate improvement in brand equity, and a near-term upgrade in manufacturing facilities, we doubt whether the company can generate sufficient cash to finance the plan, especially in light of an increasing debt burden and an under-funded pension, part of which has been financed recently by taking on more debt. Considering these constraints, we think our long-term revenue growth rate of 3% is generous.

Figure 1: 5-year TSTY Daily Stock Price History



Source: Reuters

Cash-Poor Financial Conditions

In our view, TSTY's financial condition is cash-poor. Its income statement reveals that profit indicators are below the averages of the peer group. Its three-year average gross profit margin of 0.71% is far below the peer group average of 2.62% for the same period. Furthermore, TSTY operates in a highly competitive and mature industry that is predicted to grow by less than 1.90% over the next five years. The competitive nature of this industry is further evidenced by the bankruptcy filing of one of TSTY's major competitors, Interstate Bakeries, producer of the popular Hostess, Dolly Madison, and Wonder Bread brands, in September of 2004. Adding to TSTY's hurdles, the company faces rising fuel and commodity costs. This will only exacerbate what has been an uninspiring and volatile EPS growth rate. Its historical average EPS growth, from 1997 through 2006, is -17.3%, and during our coverage period, EPS fluctuates from \$0.23 in 2005 to \$0.51 in 2006 before falling to estimated values of \$0.42 for 2007 and 2008 (as shown in the table at the top of this report). The balance sheet reveals a large under-funded pension and post-retirement benefits of approximately \$26 million. Although the company has frozen the defined benefits plan, the under-funded position will continue to be a drag on cash flows, as witnessed by the need to take on \$5.3 million in additional long-term debt to finance a mandatory one-time pension payment in 2005. At approximately \$12,000, there is not much cash on the balance sheet. Although TSTY shows positive cash flows from operations, these cash flows are mostly offset by negative cash flows from investing and financing. These negative cash flows stem from the capital intensive nature of the business and the ongoing repayment of existing debt.

Brand Equity Problems and Demand Challenges

A rising health consciousness among consumers is a major challenge for the industry, and TSTY is no exception. The results of our survey of TSTY and its products, in which we called a random sample of over 3000 residences in the mid-Atlantic region, its core distribution area, reveal brand recognition and brand equity problems. Our original field research indicates that 75.5% of the respondents had not heard of the name, "Tastykake." It also shows that Tastykake consumers do not consider the company's products as healthful, with 76.5% of them classifying the food as "junk" and a nearly identical percentage identifying them as "high in calories and fat." Moreover, the aging and declining population base in TSTY's core market only compounds the demand challenges that it faces. The outcome is often intense price competition, marked by deep discounting to stimulate sales, a problem to which TSTY is vulnerable because its outdated manufacturing facilities prevent it from being a true low-cost producer. In fact, its efforts in 2006 to raise revenue by raising price by 20% were more than offset by declines in volume, precisely the expectation in a price-elastic environment. A face-to-face interview with a long-time independent sales distributor of the company's products supports these findings

Weak Insider Support. The chair of the board of directors, CEO, CFO, and the chief marketing officer, the top four positions in the company, hold a total of approximately 198,000 of the company's 8.22 million shares outstanding. We interpret this as a schism between the interests of top management and those of shareholders, calling into question confidence in the company's future performance. We believe that this vulnerability places the company's stock price at risk.

Conclusion

We conclude that TSTY is an unattractive investment at current price levels. Not only does our DCFE model indicate an overvalued stock, but our research suggests that the company faces significant hurdles that will be difficult to overcome in the next twelve months. Its cash-poor financials, rising debt burden, under-funded pensions, low brand equity, outdated manufacturing facilities, lack of pricing power in a declining market, volatile EPS growth, and questionable upper-management support move us to place a SELL recommendation on the stock.

Valuation Analysis

We value Tasty Baking Company (TSTY) using three different approaches: discounted cash flow to equity (DCF), dividend discount model (DDM) and relative valuation (RV). The DCF and DDM models yield respective price targets of \$6.60 and \$4.40 and support the conclusion that the company's current stock price of \$8.82 is significantly overvalued. Volatile EPS growth also calls into question the valuation based on current P/E ratios.

Discounted Cash Flow to Equity (DCF)

Our two-stage DCF model yields a price target of \$6.60, a discount of 25.2% to the current market price of \$8.82 (as of March 15, 2007). The valuation is a direct result of the company’s limited growth potential and inability to address a weak financial position, in spite of its recent restructuring efforts.

Our DCF model consists of two stages. The first stage reflects the estimated impact of the ongoing strategic growth plan, and the second stage incorporates our analysis of TSTY’s long-term growth potential. We believe management’s current efforts to increase brand equity, deliver product innovation, and drive operational efficiencies will deliver slightly higher than historical gross sales growth, and maintain current levels of COGS and SG&A expenses over the next few years. However, we do not believe that this short-term growth can be sustained in the long run. The company’s financial position is weak, its manufacturing facilities are outdated, and its under-funded pension and healthcare liabilities are significant.

We project a short-term growth rate in gross sales of 3.50% for 2007 through 2011, and estimate the terminal growth rate to be 3%. The short-term growth rate of 3.50% is based on a three-year CAGR (under current management) in gross sales of 2.25% and a moderate increase in sales from the additional advertising, entry into new markets, and new supply chain technology. In estimating the long term growth rate, we consider two factors: historical firm growth and future industry growth. The average projected growth rate for the bread and bakery industry from 2007 through 2011 is 1.90% (see Appendix O). The company’s historical gross sales compounded annual growth rate (CAGR) from 1996 through 2006 is 2.34%. Excluding 2006, in which the company experienced a decline in top-line sales of 3.62%, the CAGR is 3%. As a result, we assigned a terminal growth rate for TSTY of 3%, which we consider to be the highest attainable long-term growth rate.

We make various accounting adjustments in projecting TSTY’s long-term financial position. These adjustments include the following: removing of restructuring charges; maintaining ongoing pension expense at 2005 levels; and sustaining capital expenditures based on the 2005 ratio of CAPEX to gross sales (see Appendix I). We feel that these adjustments provide higher long-term growth for TSTY than what may be attainable, given its recent history of volatile growth, restructuring charges, and ongoing need for capital expenditures. Figure 2 provides a summary of our DCF analysis, with our twelve-month price target of \$6.60 (see Appendix H).

Figure 2: DCF Summary

Fiscal Year	Stage 1: 2007-2010					Stage 2: after 2011
	2007	2008	2009	2010	2011	2012
Gross Sales	277,288	286,993	297,038	307,434	318,194	327,740
Net Income	3,478	3,436	3,513	3,379	3,706	3,712
add: Depreciation (no amortization reported)	7,108	7,484	7,869	8,273	8,699	6,948
Interest expense	1,532	1,585	1,641	1,698	1,758	1,811
Tax rate	35%	35%	35%	35%	35%	35%
add: Interest expense*(1-tax rate)	996	1,031	1,067	1,104	1,143	1,177
less: Change in working capital	(183)	(16)	(18)	(17)	(17)	(3)
less: CAPEX	5,882	6,087	6,301	6,521	6,749	6,948
Free Cash Flow to Firm (FCFF)	5,883	5,879	6,165	6,253	6,815	4,892
less: Interest expense*(1-tax rate)	\$996	\$1,031	\$1,067	\$1,104	\$1,143	\$1,177
add: Net proceeds from debt	(2682)	(2885)	(3077)	(3347)	(3400)	-
Free Cash Flow to Equity (FCFE)	2,206	1,964	2,022	1,801	2,273	3,715
Average common shares outstanding	8,255	8,274	8,293	8,312	8,331	8,350
FCFE per share	0.27	0.24	0.24	0.22	0.27	0.44
Terminal value beyond 2011	-	-	-	-	-	7.75
Discount factors	0.92	0.85	0.78	0.72	0.66	0.66
Present value (PV) of FCFE per share	0.25	0.20	0.19	0.16	0.18	5.10
Sum of PV FCFE per share						6.07
12-Month (March 2008) Price Target						6.60

Source: Company 10-Ks, Student Estimates

Our DCF sensitivity analysis (see Appendix J) shows that justifying the company’s current stock price would require an unrealistic terminal growth assumption, an unreasonable cost of equity, or both. With our

estimate for the cost of equity of 8.74%, a terminal growth rate of greater than 4.5% is required to justify the current market price of \$8.82. With our assumption of terminal growth of 3.0%, an unrealistically low cost of equity of less than 7.5% is needed to justify the current market price. We do not believe either scenario is plausible.

Dividend Discount Model (DDM)

Using the current dividend payout ratio of 60% and our terminal growth rate of 3%, we arrive at a target price of \$4.40. However, the dividend payout history of TSTY does not instill confidence in this estimate. From 1997 through 2002, for example, the company declared a quarterly dividend of \$0.12 per share. Beginning in February of 2003, it reduced the dividend to \$0.05 per share, where it has remained. During the past four years, these constant dividends of \$0.20 per year represent payout ratios of 39%, 89%, 131%, and 69%, respectively, illustrating TSTY's volatile earnings and unreliable payout policy.

Relative Valuation

The current P/E ratio of 26.7 (as of March 15, 2007), based on trailing twelve-month EPS, after adjusting for a one-time options grant of \$1.6 million (i.e., "Keystone option"), is comparable to that of its peer group, ranging from 22.2 to 33.4. The peer group consists of Interstate Bakeries, Flowers Foods, J&J Snack Foods, Lance, and George Weston Ltd. These are direct competitors of TSTY, with a market capitalization of less than \$2 billion (see Appendix L). The forward P/E ratio of TSTY is 21.0, which is also comparable to that of its peer group, ranging from 15.2 to 23.6. However, TSTY's historical P/E ratios have been volatile and unpredictable. During the past ten years, the P/E ratios, after adjusting earnings for one-time charges and non-recurring events, have ranged from 6.8 to 55.9. During the past three years, they have ranged from 26.7 to 55.9. Owing to the volatility in TSTY's earnings, these wide-ranging P/E ratios do not instill confidence in the relative valuation. They also call into question the validity of the comparison based on current P/E ratios.

Cost of Equity (COE) Determination

We estimate TSTY's cost of equity (COE) by using the capital asset pricing model (CAPM). Based on a risk-free rate of 4.54% (as of March 14, 2007), a risk premium of 6.00%, and a blended beta of 0.70, we compute a cost of equity of 8.74% (see Appendix D). We confirm that our CAPM COE is within an acceptable range by employing two other models: the Fama-French three-factor model and the synthetic cost-of-debt-plus-risk-premium method.

In estimating the CAPM COE, we use a blended beta based on three estimates: unadjusted, adjusted, and levered. Instead of singularly relying on a statistical estimate of beta, which is known to be susceptible to the estimation window and the data frequency, we use a blended approach. The blended beta of 0.70 is an average of the three estimated betas. The unadjusted beta of 0.55 is based on a five-year weekly regression with the S&P 500 representing the market's returns (see Appendix E). The adjusted beta is 0.70 ($= 0.34 + 0.677 \times \text{unadjusted beta}$), which takes into account empirical evidence that most companies' betas tend to move toward one. The levered beta of 0.84 takes into account the capital structure of the firm.

We confirm our estimate of COE with two additional approaches: Fama-French three-factor model and the method of summing the synthetic cost of debt with a risk premium. The Fama-French three-factor model uses size, the price-book ratio, and the market beta. It provides COE estimates ranging from 7.80% to 14.74% (Appendix G). The sum of the synthetic cost of debt and the risk premium adds a 3% risk premium to the cost of debt of 9.04%, as measured by Moody's synthetic bond rating (the 3% risk premium is generally considered to be appropriate for a manufacturer like TSTY). It gives a COE estimate of 12.04% (see Appendix G). Our use of the COE of 8.74% represents our effort to be as optimistic as possible.

Business Description

Tasty Baking Company manufactures, co-packages, and distributes baked goods. Established in 1914 by Philip J. Bauer and Herbert T. Morris, it is one of the oldest and largest independent baking companies in the U.S. The company is headquartered in Philadelphia, and has manufacturing facilities in both Philadelphia and Oxford, Pennsylvania. The company was previously listed on the New York Stock Exchange (NYSE) and is currently listed on the National Association of Securities Dealers Automated Quotation (NASDAQ) since October 21, 2005, under the ticker symbol "TSTY."

Product Lines

Tasty Baking Company manufactures over 100 varieties of baked sweets under the Tastykake brand name. These products include Cupcakes, Donuts, Honey Buns, Juniors®, Kandy Kakes®, Krimpets®, Kreamies™,

Pies, Sensables™, Snak Bars. TSTY also manufactures a separate private label brand exclusively for its top customer, Wal-Mart. TSTY's relatively new sugar-free product line, "Sensables™," has been comparatively successful, accounting for 2% of net sales in 2005. Three new products were added to the Sensables line in the beginning of 2007: Banana Chocolate Chip Cookie Bars, Cream-filled Koffee Kake, and Cream-filled Vanilla Cupcakes.

Geographic Presence and Distribution Methods

The company employs three methods of distribution: direct store delivery (DSD), non-route distribution, and internet and telephone sales. Product sales through DSD are conducted by independent sales distributors who purchase the right to distribute in certain core routes. These routes are located in the states of Delaware, Maryland, New Jersey, New York, Ohio, Pennsylvania, and Virginia. In addition to core routes, TSTY has expanded via non-core routes to other states, including Connecticut, Florida, Georgia, Massachusetts, and New Hampshire. Non-route sales occur through major grocery chains that have centralized warehousing facilities throughout North America. Its top twenty customers account for 56.7% of net sales for 2006, with Wal-Mart representing 18.4% of net sales.

Strategic Growth Plan

After a restructuring phase from 2001 through 2003, a new management team instituted a strategic growth plan in 2003, putting into effect the "five pillars" of transformation: build brand equity; deliver product innovation; grow core routes; grow new markets; and drive operational excellence.

One of the key pillars of the plan is "to build brand equity through increased advertising and consumer marketing."¹ TSTY began the "Now that's Tasty!" campaign in 2004, which included radio and billboard advertising, and in the first quarter of 2007, it will be advertising on television in its core markets. Another pillar TSTY proposes is "to deliver product innovation to drive consumer excitement in the Tastykake brand."¹ To implement this plan, TSTY has introduced more than fifty new products in the past three years, such as "Sensables" and "Dublicious." TSTY also aims to increase its market reach by growing core routes through its direct store delivery (DSD) system and expanding non-core routes through third-party distributors. Finally, TSTY has implemented an enterprise resource planning (ERP) system to reduce unit costs.

We believe that these pillars are critical to TSTY's future growth. However, we are concerned that TSTY's current financial condition will constrain management's ability to implement effectively these initiatives. To overcome the limited brand equity beyond its core markets, as evidenced by our original field research (see Appendices M and N), TSTY needs to commit significant financial resources to its marketing strategy. In addition, TSTY's reliance on discounts and allowances to grow core routes limits the positive financial impact that accompanies new business. The same holds for non-core business, in which it faces margin pressures from non-core customers, such as the large mass merchandiser, Wal-Mart. Furthermore, to achieve the operating efficiency needed to compete cost-effectively, TSTY requires major capital expenditures, including a new manufacturing facility. To conclude, while we believe the strategic growth plan is an important step forward for TSTY, we do not believe its current financial resources are sufficient to support it.

Weak Insider Support

The company's current financial condition helps to explain, at least in part, our belief that top management's support for the company appears to be weak. This does not instill confidence in the stock. We base this on the fact that, as of March 15, 2007, TSTY's top four officers own only 198,328 shares of the 8.22 million shares outstanding, and none of them has reportedly purchased any shares since March of 2006. The holdings are as follows: J. Ksansnak, Chair (40,000); Charles Pizzi, President and CEO (80,136); David Marberger, Senior Vice President and CFO (37,586), and Vincent Melchiorre, Senior Vice President and Chief Marketing Officer (40,606).²

Original Field Research Results

The company needs to drive its revenue growth through building its brand equity and developing new products to grow its consumer base. To investigate the demand for TSTY's products and the reach of the company's brand name, we performed original field research. It reveals that TSTY suffers from both brand image and recognition problems. Working with an independent sampling organization, Genesis Sampling Systems, we conducted a survey of 3206 residences in the mid-Atlantic region, TSTY's core market. Of the

¹ 2005 Tasty Baking Company 10-K

² Source: Reuters and Bloomberg

400 individuals who agreed to participate, 302, or 75.5%, stated that they are unaware of Tasty Baking Company and its products. Among the respondents who are aware of the Tastykake brand, an overwhelming majority, 70.5%, preferred the products of TSTY's major competitors: Entenmann's, Hostess, and Little Debbie. In addition, 75.5% of the respondents agreed with the statement, "Tastykake is high in calories and fat," illustrating the company's challenge in overcoming current consumer trends toward healthful eating. These results suggest that TSTY does not have the brand equity and product offerings to drive revenue growth (see Appendix M).

A face-to-face interview with a long-time independent distributor of TSTY's products in a demographically diverse area of the mid-Atlantic region supports these findings. He has experienced a significant decline in sales after the recent price increase in 2006; disappointing results with the new products; and low brand recognition. He also indicated that TSTY's recent efforts to strengthen its core routes have had no impact on his business. He further stated that his sales have declined by 20% since the 1980's (see Appendix N).

Industry Overview and Competitive Positioning

Industry Outlook

The U.S. bread and bakery industry is highly competitive. In particular, sweet baked goods are price-elastic: changes in sales volume are sensitive to changes in price. The industry also faces an income-inelastic demand: units sold do not rise in proportion to increases in income. In addition, changing consumer trends and disposable income levels are affecting consumer demand. Sophisticated consumers are becoming increasingly selective, demanding nutritious and healthful choices among sweet baked goods.³ The industry is attempting to respond to these trends by offering a variety of new products that contain less sugar, fat, and other ingredients viewed as unhealthy. As a result, we believe success in the industry necessitates nimble and efficient production lines to drive new products, minimize unit costs, and build strong brand equity to expand the consumer base. We believe that TSTY, with an aging and inefficient manufacturing base and a limited brand equity, is not well positioned in the competitive landscape.

The overall outlook for this industry is stable for 2007, but slow growth is expected over the next five years at an average rate of 1.90% (see Appendix O). We foresee that shifting consumer demand away from the industry's traditional products will exert downward pressure on revenue growth. Individual consumption of sweet baked goods is not predicted to grow significantly because of changes in consumer preferences toward more healthful products. As a result, firms in the industry will not grow without expanding their existing consumer base and nimbly introducing new, differentiated product lines. In addition, variable energy and input costs are expected to increase the uncertainty over the profitability of many firms.

Competitive Landscape

The overall industry is fragmented. Several large companies with a variety of national brands and economies of scale coexist with smaller, regional players, such as TSTY. In the snack food market, TSTY's direct competitors include McKee Foods, Interstate Bakeries, and George Weston Limited. In 2005, the Tastykake brand recorded sales of \$65.5 million in snack cakes sold through mass merchandisers, supermarkets and drugstores. This ranks fourth behind the well-known Little Debbie line of McKee Foods, with \$251.1 million, and the nationally recognized Hostess brand of Interstate Bakeries, with \$144.2 million (see Appendix P). In the overall bread and bakery product-manufacturing industry in the US, TSTY is estimated to have a less than 1% market share.

This competitive landscape poses a particular challenge to TSTY. Our SWOT analysis indicates that with an outdated manufacturing base and limited brand recognition, the company is likely to grow more slowly than companies with nimble and efficient production lines and successful national brands (See Appendix Q). For example, the well-known Little Debbie brand is nationally recognized, reaching all of North America. The Hostess brand, enjoying the same national recognition, has enabled Interstate Bakeries to successfully introduce 100-calorie snack cake packs, while the Entenmann's brand realized positive revenue growth for George Weston in 2006, even with a price increase.

The competition does not end with nationally recognized brands. For example, Lance, with a similar regional reach as TSTY but with greater pricing power, realized revenue growth of 10.7% in 2006, well above TSTY's revenue shortfall of 3.6%. Another regional competitor, Flower Foods, with newer and more efficient bakeries than TSTY, enjoyed a higher gross profit margin in 2006, recording 4.3% compared to TSTY's 1.5%. Furthermore, regardless of brand recognition and manufacturing efficiency, future profits are likely to be pressured by increasing sales to powerful mass merchandisers, such as Wal-Mart, which

³ S&P industry survey on foods and nonalcoholic beverages

command lower-than-average prices. In conclusion, it does not appear that TSTY is well positioned in this competitive landscape. Its low brand equity limits its pricing power, reducing its ability to generate revenue growth. Our original field research also supports these findings (see Appendix M).

Financial Analysis

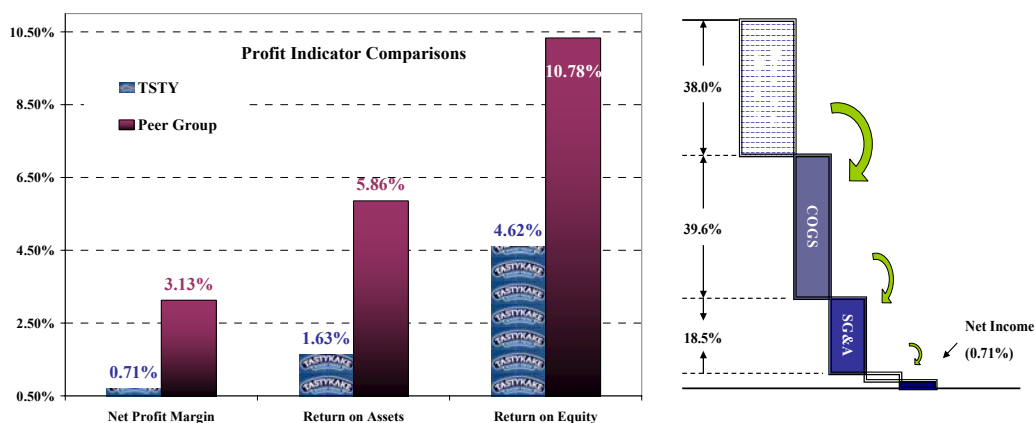
Tasty Baking is at a critical juncture. We believe it cannot compete successfully long term without improving its brand equity and upgrading its outdated manufacturing facilities, each of which requires a significant commitment of financial resources. Our analysis indicates, however, that TSTY does not generate sufficient cash flows on its own to support such a commitment.

Earnings

The income statement reveals that the strategic growth plan has had a positive impact on gross and net sales growth, cost of goods sold, gross margins, net income, and EPS during the past three years. The compounded annual growth rates (CAGR) for gross and net sales over the last three years are 2.3% and 1.8%, respectively. Cost of goods sold (COGS) has decreased from 43.4% of gross sales in 2003 to 38.6% of gross sales in 2006. The gross margins improved from 27.2% in 2003 to 34.4% in 2006. Net income has grown from a loss of \$2.36 million in 2003 to \$4.20 million in 2006, and when adjusted for non-recurring one-time charges and expenses, net income in 2006 was \$2.73 million (see Appendix R). Earnings per share (EPS) have grown from a loss of \$0.29 per share in 2003 to \$0.51 per share in 2006, and when adjusted for the “Keystone option” of \$1.6 million, EPS in 2006 was \$0.33 per share.

Although management has seen growth in revenue, gross margins, and EPS during the past three years, the company’s profit indicators have remained below industry standards. After adjusting the financial statements for non-recurring one-time charges and expenses, TSTY has a three-year average net profit margin of 0.71%, return on equity of 4.62%, and return on assets of 1.63%. These profit indicators are well below our industry peer group medians of 3.13% for net profit margin, 10.78% for return on equity, and 5.86% for return on assets (see Figure 3 and Appendix L).

Figure 3: Profit Indicators and Components of Gross Sales



Source: Reuters, Bloomberg, Student Estimates

The low profit indicators are mostly attributable to high selling, general, and administrative (SG&A) costs, and high levels of discounts and allowances, as shown in Figure 3 above. The SG&A costs in the past three years have averaged 18.5% of gross sales, and discounts and allowances have averaged \$102 million (38.0% of gross sales). Large discounts and allowances are required to finance TSTY’s core route business, with most of the discounts and allowances being used as incentives for the independent sales distributors. The company also must commit to high-profile marketing and new product development strategies, resulting in significant SG&A expenses. These strategies are essential to overcome TSTY’s limited brand recognition outside its core-Philadelphia market and to meet the demands of health-conscious consumers. Consequently, the high SG&A expenses and discounts and allowances mostly offset the moderate improvements in revenue growth and operating efficiencies during the past three years. The result is low net income and low profit margins as compared to industry peers and historical performance.

Cash Flow

The company operates in a capital-intensive industry. In the past three years, TSTY has spent an average of \$7.0 million on property, plant, and equipment out of \$10.7 million in cash flows from operations (after removing a one-time \$5.3 million pension expense in 2005). The company's high dividend payout and debt payments, averaging \$1.6 million and \$3.4 million, respectively, during the past three years, leave little room for major capital expenditures, such as the upgrading the outdated manufacturing facilities. A conservative estimate of the upgrade, for example, is \$50 million, much greater than the company's cash position.⁴

Balance Sheet

The company's weak balance sheet further exacerbates its ability to generate significant cash flows. At the end of 2006, TSTY's cash balance was \$12,000, with the three year average of \$157,000. More importantly, TSTY has significant debt, pension, and post-retirement liabilities. In 2006, TSTY's long-term debt stood at \$18.3 million; its pension liability was \$19.8 million; its post-retirement liability equaled \$6.0 million; and its accrued payroll and employee benefits amounted to \$6.6 million. In 2006, these long-term liabilities, amounting to 39.4% of TSTY's total assets and 91.6% of its equity, are among the highest in its peer group, which includes the bankrupt Interstate Bakeries (see Appendix L).

In conclusion, our financial analysis shows that TSTY has had recent success with the strategic growth plan, but it still lacks the financial resources needed for long-term growth.

Investment Risks to Sell Recommendation

Although we believe that our fundamental analysis is compelling, with major indicators pointing to a SELL recommendation, we identify five investment risks to our position:

Highly effective marketing campaign. A highly effective marketing campaign might stimulate sales and expand the customer base, spurring gross sales growth above our short-term growth estimate. As a result and all other things held equal, our valuation of \$6.60 would be too low.

New and appealing product line. If TSTY produces one or more new product lines, beyond its current product mix, that strongly appeal to new trends in consumer tastes, then revenue growth could be above our short-term expectation of 3.50%. In turn, this could mean that TSTY's EPS growth may be greater than our estimates, which would support a price higher than our target.

Significant improvements in productivity. If management uncovers new ways to enhance productivity, such as through advancements in enterprise resource planning (ERP) or the upgrading of its manufacturing facilities, then TSTY would realize lower unit costs. All else being equal, this would enhance margins and ultimately EPS growth, making our estimate too conservative. It is unlikely, however, that significant productivity improvements can be realized within the next twelve months because implementing these changes and realizing their benefits may take several years.

Acquisition of Tasty Baking Company. We believe that TSTY's lack of brand recognition alone makes the company an unattractive acquisition target. However, if TSTY is acquired, whether on friendly or hostile terms, the acquisition price may still be at a premium to the current market price. A larger, more efficient manufacturer than TSTY may acquire TSTY at a premium, for example, for its strong, historical presence in the Philadelphia area. In addition, TSTY may be strategically acquired by a private equity firm or a hedge fund for similar reasons.

Market inefficiency: Although TSTY's performance has improved since 2003, the company is not cash-rich, does not have a strong cash flow, has low brand recognition, has outdated manufacturing facilities, has low pricing power, and is operating in a mature and highly competitive market. In addition, its stock has weak upper-management support, is thinly traded – an average volume of 6,665 per day (0.08% of shares outstanding) – and lacks broad analyst coverage. Nonetheless, the desire of investors to at least hold the stock, perhaps because the one analyst who covers it has a “buy” recommendation on it, or because some investors feel that the relative valuation is attractive, might support the price beyond our expectations.

⁴ Brubaker, Harold. “Tasty Baking seeks to upgrade manufacturing operations”. Philadelphia Enquirer. May 11, 2006

In conclusion, the investment risks to our sell recommendation are not insignificant. We believe, however, that at least a significant improvement in brand recognition and an upgrade in manufacturing facilities together will be necessary to drive the stock price significantly higher than our twelve-month estimate, an outcome to which we assign a low probability.

Order	Appendix Title	Page
Appendix A	Pro-Forma Income Statement	11
Appendix B	Pro-Forma Balance Sheet	12
Appendix C	Pro-Forma Statement of Cash Flows	13
Appendix D	Cost of Equity (COE) Calculation	14
Appendix E	Blended Beta Calculation	14
Appendix F	COE Computation Using the Synthetic-Cost-of-Debt	15
Appendix G	Fama-French Three-Factor Model	15
Appendix H	Detailed Discounted Cash Flow to Equity (DCF) for TSTY	16
Appendix I	Two-stage DCF Assumptions and Valuations	17
Appendix J	DCF Sensitivity Analysis	18
Appendix K	Dividend Discount Model (DDM) Valuation	18
Appendix L	Relative Valuation	19
Appendix M	Poll Questions and Results	20-22
Appendix N	Interview with Independent Sales Distributor	23
Appendix O	Industry Growth Outlook	24
Appendix P	Top 5 Snack Cake Revenues	24
Appendix Q	SWOT Analysis	24
Appendix R	Adjusted Income Statement	25

Appendix A: Pro Forma Income Statement

\$ in Thousands except for per share data

	2001	2002	2003	2004	2005	2006(U)	2007E	2008E	2009E	2010E	2011E	Terminal
Revenue												
Gross sales	255,336	255,504	250,648	259,029	277,967	267,911	277,288	286,993	297,038	307,434	318,194	327,740
Less discounts and allowances	(89,091)	(93,241)	(91,519)	(99,968)	(105,694)	(100,196)	(103,718)	(107,352)	(111,109)	(114,998)	(119,023)	(122,594)
Net Sales	166,245	162,263	159,129	159,061	172,273	167,715	173,570	179,641	185,928	192,436	199,171	205,146
Cost of sales	103,297	111,187	108,689	103,693	111,690	103,495	109,846	113,690	117,669	121,788	126,050	129,832
Depreciation	7,204	6,807	7,148	7,711	6,503	6,566	7,108	7,484	7,869	8,273	8,699	9,146
Gross Margin	55,744	44,269	43,292	47,657	54,080	57,654	56,616	58,467	60,390	62,375	64,422	66,168
Selling, general and administrative	44,008	45,941	48,149	45,751	50,990	52,290	50,151	51,907	53,723	55,604	57,550	59,276
Interest expense	1,103	1,066	909	1,254	1,370	1,480	1,532	1,585	1,641	1,698	1,758	1,811
Gain on sale of routes	-	-	(1,077)	(75)	(97)	-	(98)	(101)	(105)	(109)	(112)	(116)
Gain on determination of option	-	-	-	-	-	(1,600)	-	-	-	-	-	-
Other income, net	(1,190)	(1,165)	(873)	(1,129)	(922)	(1,088)	(1,130)	(1,170)	(1,211)	(1,253)	(1,297)	(1,336)
Restructure charge (income), net of reversals	1,728	6,341	(71)	9	71	-	-	-	-	-	-	-
Net Expenses	156,150	170,177	162,874	157,214	169,605	161,143	167,409	173,395	179,587	186,001	192,647	198,613
Income (loss) before provision for income taxes	10,095	(7,914)	(3,745)	1,847	2,668	6,572	6,161	6,246	6,342	6,434	6,524	6,533
Federal	3,286	(11)	(3,089)	147	(108)	1,882	2,156	2,186	2,220	2,252	2,283	2,286
State	(90)	(316)	709	80	33	394	370	375	380	386	391	392
Deferred	579	(3,246)	997	377	900	89	157	249	229	417	142	142
Total provision for (benefit from) income taxes	3,775	(3,573)	(1,383)	604	825	2,366	2,683	2,809	2,829	3,055	2,817	2,821
Change in accounting principle for start-up costs												
Net Income (Loss)	6,320	(4,341)	(2,362)	1,243	1,843	4,206	3,478	3,436	3,513	3,379	3,706	3,712
<i>Net income growth:</i>	<i>-32.74%</i>	<i>-168.69%</i>	<i>45.59%</i>	<i>152.62%</i>	<i>48.27%</i>	<i>128.23%</i>	<i>-17.32%</i>	<i>-1.19%</i>	<i>2.21%</i>	<i>-3.79%</i>	<i>9.68%</i>	<i>0.15%</i>
Average common shares outstanding	7,834	7,974	8,100	8,137	8,155	8,236	8,255	8,274	8,293	8,312	8,331	8,350
Net Income Per Share (EPS):												
Basic	0.79	(0.54)	(0.29)	0.15	0.23	0.51	0.42	0.42	0.42	0.41	0.44	0.44
Diluted	0.78	(0.54)	(0.29)	0.15	0.23	0.51	0.42	0.42	0.42	0.41	0.44	0.44
<i>Diluted EPS growth:</i>	<i>-25.00%</i>	<i>-169.23%</i>	<i>-46.30%</i>	<i>151.72%</i>	<i>53.33%</i>	<i>122.05%</i>	<i>-17.51%</i>	<i>-1.42%</i>	<i>1.98%</i>	<i>-4.01%</i>	<i>9.43%</i>	<i>-0.08%</i>

Source: Company 10-Ks, Student Estimates

Appendix B: Pro-Forma Balance Sheet

\$ in Thousands except for per share data

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007e	2008e	2009e	2010e	2011e	Terminal
ASSETS																	
<i>Current Assets</i>																	
Cash and cash equivalents	234	749	373	722	311	367	282	146	208	251	13	23	16	15	85	108	168
Receivables	16,963	18,661	21,215	19,683	20,772	22,233	20,881	19,503	20,049	18,389	17,769	17,769	17,769	17,769	17,769	17,769	17,769
Inventories	2,856	3,296	4,707	4,506	5,931	8,412	6,777	5,730	5,412	6,472	6,926	6,926	6,926	6,926	6,926	6,926	6,926
Deferred income taxes	2,505	2,069	2,022	2,418	2,483	3,055	5,214	3,902	3,280	2,127	3,040	3,513	3,172	3,026	2,976	3,145	3,166
Prepayments and other	221	173	296	87	1,036	1,101	2,941	3,271	1,092	1,769	1,414	1,782	1,845	1,909	1,976	2,045	2,107
<i>Total Current Assets</i>	<i>22,779</i>	<i>24,948</i>	<i>28,613</i>	<i>27,416</i>	<i>30,533</i>	<i>35,168</i>	<i>36,095</i>	<i>32,552</i>	<i>30,041</i>	<i>29,008</i>	<i>29,162</i>	<i>30,013</i>	<i>29,728</i>	<i>29,645</i>	<i>29,732</i>	<i>29,994</i>	<i>30,136</i>
<i>Property, Plant and Equipment</i>																	
Land	1,267	1,098	1,098	1,098	1,098	1,098	1,098	1,098	1,033	1,433	1,433	1,433	1,433	1,433	1,433	1,433	1,433
Buildings and improvements	27,366	28,012	30,066	32,696	34,054	37,103	37,832	40,288	41,327	42,282	43,110	45,266	47,529	49,905	52,400	55,020	57,772
Machinery and equipment	110,716	120,153	128,199	136,601	143,151	146,023	152,689	158,286	166,449	136,392	124,501	147,301	155,005	163,112	171,642	180,619	190,066
<i>Total Property, Plant and Equipment</i>	<i>139,349</i>	<i>149,263</i>	<i>159,363</i>	<i>170,395</i>	<i>178,303</i>	<i>184,224</i>	<i>191,619</i>	<i>199,672</i>	<i>208,809</i>	<i>180,107</i>	<i>169,044</i>	<i>194,000</i>	<i>203,967</i>	<i>214,450</i>	<i>225,476</i>	<i>237,073</i>	<i>249,270</i>
Less accumulated depreciation and amortization	98,376	105,501	110,971	110,937	118,488	124,523	129,529	136,156	143,774	113,859	103,660	110,768	118,252	126,121	134,394	143,093	152,239
<i>Total Net Property, Plant and equipment</i>	<i>40,973</i>	<i>43,762</i>	<i>48,392</i>	<i>59,458</i>	<i>59,815</i>	<i>59,701</i>	<i>62,090</i>	<i>63,516</i>	<i>65,035</i>	<i>66,248</i>	<i>65,384</i>	<i>83,231</i>	<i>85,714</i>	<i>88,329</i>	<i>91,082</i>	<i>93,980</i>	<i>97,031</i>
<i>Other Assets</i>																	
Long-term receivables from indpt. Sls. Distrbrs.	10,288	11,233	10,851	10,682	9,652	10,201	10,095	11,253	11,185	10,700	10,960	10,839	10,987	10,934	10,884	10,921	10,913
Deferred income taxes	10,236	11,060	10,453	10,909	8,533	7,382	8,230	9,267	10,337	13,251	4,596	9,136	9,317	9,328	9,126	8,301	9,041
Spare Parts Inventory	2,780	2,426	2,665	2,930	3,406	3,633	0	0	0	0	0	0	0	0	0	0	0
Miscellaneous	374	891	771	375	253	50	768	1,792	2,100	2,190	1,380	1,380	1,646	1,822	1,828	1,773	1,690
<i>Total Other Assets</i>	<i>23,678</i>	<i>25,610</i>	<i>24,740</i>	<i>24,896</i>	<i>21,844</i>	<i>21,266</i>	<i>18,375</i>	<i>21,288</i>	<i>23,314</i>	<i>26,051</i>	<i>17,746</i>	<i>21,355</i>	<i>21,951</i>	<i>22,083</i>	<i>21,837</i>	<i>20,994</i>	<i>21,644</i>
TOTAL ASSETS	87,430	94,320	101,745	111,770	112,192	116,135	116,560	117,356	118,390	121,307	112,292	134,599	137,393	140,058	142,651	144,968	148,811
LIABILITIES																	
<i>Current liabilities</i>																	
Current obligations under capital leases	587	544	326	196	217	240	176	634	713	534	327	477	537	518	478	467	495
Notes payable	0	900	1,200	750	2,200	3,900	4,500	4,900	2,700	631	631	0	0	0	0	0	0
Accounts payable	3,964	4,346	4,204	4,121	5,386	5,307	6,074	9,261	7,173	3,934	3,875	3,964	4,102	4,246	4,394	4,548	4,685
Accrued payroll and employee benefits	5,608	6,817	6,687	5,882	6,888	6,209	6,480	6,013	7,146	6,810	7,444	6,861	7,101	7,350	7,607	7,873	8,109
Other accrued liabilities	925	1,827	92	321	368	379	981	2,280	3,307	3,734	5,349	3,130	3,560	3,816	3,918	3,955	3,676
<i>Total current liabilities</i>	<i>12,616</i>	<i>14,463</i>	<i>12,782</i>	<i>12,993</i>	<i>15,059</i>	<i>16,886</i>	<i>20,628</i>	<i>24,419</i>	<i>23,272</i>	<i>19,372</i>	<i>19,791</i>	<i>16,397</i>	<i>17,466</i>	<i>18,094</i>	<i>18,563</i>	<i>19,009</i>	<i>19,130</i>
Long-term obligations under capital leases, less current portion	1,133	587	261	4,060	3,843	3,600	3,486	4,705	4,159	534	208	208	208	208	208	208	208
Long-term debt	5,302	7,773	13,500	17,000	13,000	11,000	9,000	8,113	9,000	22,558	18,177	19,131	20,072	21,009	21,864	22,837	23,787
Accrued pensions and other liabilities	11,203	11,772	12,683	13,950	11,729	11,507	15,669	19,938	23,824	24,599	19,781	19,781	19,781	19,781	19,781	19,781	19,781
Postretirement benefits other than pensions	18,267	18,129	18,161	18,328	18,388	18,077	16,684	16,718	16,747	16,955	6,065	14,634	14,224	13,725	13,120	12,354	13,611
TOTAL LIABILITIES	48,521	52,724	57,387	66,331	62,019	61,070	69,035	74,937	77,603	84,018	64,022	70,351	71,750	72,817	73,536	74,188	76,517
SHAREHOLDER'S EQUITY																	
<i>(Common stock, par value \$0.50 per share, and entitled to one vote per share)</i>																	
Authorized 15,000 shares, issued 9,116 shares	3,645	4,559	4,558	4,558	4,558	4,558	4,558	4,558	4,558	4,558	4,559	0	0	0	0	0	0
Capital in excess of par value of stock	29,743	29,338	29,762	29,779	29,742	29,389	29,433	29,393	29,292	28,910	28,951	28,951	28,951	28,951	28,951	28,951	28,951
Retained earnings	22,265	24,788	27,023	27,969	32,352	34,839	26,622	22,641	22,261	22,472	25,028	25,028	25,028	25,028	25,028	25,028	25,028
TOTAL SHAREHOLDER'S EQUITY	38,908	41,596	44,358	45,422	50,173	55,065	47,525	42,419	40,787	37,289	48,270	64,249	65,643	67,240	69,115	70,780	72,293
TOTAL LIABILITIES AND SHAREHOLDER'S EQUITY	87,429	94,320	101,745	111,753	112,192	116,135	116,560	117,356	118,390	121,307	112,292	134,599	137,393	140,058	142,651	144,968	148,811

Source: Company 10-K, Student Estimates

Appendix C: Pro-Forma Cash Flows

\$ in Thousands

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007e	2008e	2009e	2010e	2011e	Terminal
Net Income (Loss)	6,306	6,048	5,729	4,702	8,144	6,320	(4,341)	(2,362)	1,243	1,843	4,197	3,478	3,436	3,513	3,379	3,706	3,712
<i>Adjustments to reconcile net income (loss) to net cash provided by:</i>																	
Depreciation	7,268	7,215	6,650	7,016	7,759	7,204	6,807	7,148	7,711	6,503	6,566	7,108	7,484	7,869	8,273	8,699	9,146
Gain on sale of routes	-	-	-	-	-	-	-	(1,077)	(75)	(97)	(48)	(98)	(101)	(105)	(109)	(112)	(116)
Pension and SERP expense	-	-	-	-	-	(217)	5,866	2,190	2,449	130	(78)	35	35	35	35	35	35
Deferred taxes	(346)	(388)	501	(908)	2,317	579	(3,246)	997	377	900	2,198	157	249	229	417	142	142
Restructure payments and reclassifications	-	-	-	-	-	(877)	(1,207)	(2,525)	(1,347)	(861)	(247)	-	-	-	-	-	-
Gain on termination of Keystone option	-	-	-	-	-	-	-	-	-	-	(1,600)	-	-	-	-	-	-
Other	754	864	1,227	1,286	(2,154)	352	(611)	(594)	(41)	(473)	544	-	-	-	-	-	-
Net Cash Flows from/for Operating Activities	15,837	12,568	8,433	15,499	13,198	10,904	10,115	7,860	14,871	(176)	12,114	10,680	11,103	11,540	11,996	12,470	12,920
Proceeds from independent sales distributor loan repayments	3,804	3,368	3,229	4,021	4,065	3,495	3,987	3,540	3,691	4,080	3,772	3,814	3,779	3,827	3,855	3,809	3,817
Purchase of property, plant and equipment	(12,535)	(10,528)	(11,328)	(14,038)	(8,116)	(7,314)	(5,359)	(6,676)	(9,295)	(5,896)	(5,906)	(5,882)	(6,087)	(6,301)	(6,521)	(6,749)	(6,948)
Loans to independent sales distributors	(3,030)	(4,320)	(2,853)	(3,856)	(3,039)	(4,043)	(3,881)	(3,628)	(3,785)	(3,465)	(3,537)	(3,537)	(3,537)	(3,537)	(3,537)	(3,537)	(3,537)
Proceeds from Keystone option	-	-	-	-	-	-	-	-	-	-	1,600	-	-	-	-	-	-
Other	114	56	44	50	40	46	(46)	(414)	(403)	(619)	(347)	(347)	(347)	(347)	(347)	(347)	(347)
Net Cash Flows from/for Investing Activities	(11,647)	(11,424)	(10,908)	(13,823)	(7,050)	(7,816)	(5,299)	(7,031)	(9,710)	(10,542)	(4,321)	(5,952)	(6,192)	(6,357)	(6,550)	(6,824)	(7,015)
Dividends paid	(3,465)	(3,544)	(3,749)	(3,755)	(3,760)	(3,833)	(3,876)	(1,619)	(1,623)	(1,632)	(1,640)	(2,087)	(2,062)	(2,108)	(2,028)	(2,224)	(2,227)
Payment of long-term debt	(6,876)	(1,646)	(1,573)	(3,154)	(10,196)	(3,217)	(2,117)	(1,402)	(1,467)	(3,720)	(4,915)	(3,635)	(3,826)	(4,014)	(4,202)	(4,373)	(4,567)
Net increase (decrease) in short-term debt	(700)	900	300	(450)	1,450	1,700	600	400	(2,200)	(2,069)	-	-	-	-	-	-	-
Additional long-term debt	7,000	3,500	7,000	6,000	6,000	1,000	-	-	2,000	16,590	-	954	941	938	854	973	950
Other	-	161	122	16	-	-	-	-	-	-	-	50	30	-	-	-	-
Net Cash Flows from/for Financing Activities	(4,041)	(629)	2,100	(1,327)	(6,506)	(3,032)	(4,901)	(995)	(5,099)	10,761	(8,031)	(4,718)	(4,917)	(5,184)	(5,375)	(5,623)	(5,845)
Net Increase (Decrease) in Cash	149	515	(375)	349	(394)	56	(85)	(166)	62	43	(238)	10	(7)	(1)	70	23	60
Cash, beginning of year	85	234	748	373	705	311	367	312	146	208	251	13	23	16	15	85	108
Cash, end of year	234	749	373	722	311	367	282	146	208	251	13	23	16	15	85	108	168

Source: Company 10-K, Student Estimates

Appendix D: Cost of Equity Calculation

To determine the cost of equity, we use the Capital Asset Pricing Model (CAPM). We calculate the cost of equity by using a blended beta of 0.70, expected market risk premium of 6%, and the ten-year Treasury yield of 4.54%, as of March 14, 2007.

CAPM Cost of Equity Calculation	
Blended beta	0.70
Expected market risk premium (Rm-Rf)	6.00%
Risk-free rate (10-year Treasury yield)	4.54%
k (COE using CAPM)	8.74%

Source: Bloomberg, Student Estimates

Appendix E: Blended Beta Calculation

I. Adjusted Beta Determination

To estimate the blended beta, we regress the historical market returns of TSTY against the ten-year and five-year monthly and weekly returns of both the S&P 500 and the Russell 2000. Our beta is considered significant if the probability value from the regression is less than 0.05. The results are listed below:

Adjusted Beta Determination					
	Time	Beta	P-value	Coefficient of Determination (R ²)	Significant?
S&P 500	10-year Monthly	-0.07	0.704195938	0.0012	No
	5-year Monthly	0.29	0.382161143	0.0132	No
	10-year Weekly	0.29	0.001500039	0.0191	Yes
	5-year Weekly	0.55	6.57919E-05	0.0589	Yes
Russell 2000	10-year Monthly	0.06	0.656495949	0.0017	No
	5-year Monthly	0.14	0.55550356	0.0060	No
	10-year Weekly	0.24	0.001747872	0.0185	Yes
	5-year Weekly	0.40	0.000214949	0.0508	Yes

The S&P 500 five-year weekly estimation yields the most significant coefficient and the highest R-squared. The beta from the regression is 0.55.

II. Levered Beta Determination

The levered beta seeks to incorporate the financial leverage of the firm into the computation of beta. The levered beta is determined first by adjusting the industry beta using the industry debt-to-equity (D/E) ratio:

$$\text{Unlevered Beta Industry} = \text{Industry Average Beta} / [1 + (1 - \text{Industry Avg tax rate}) * (\text{Industry D/E ratio})]$$

Using “food processing” industry averages, the unlevered industry beta is:

$$0.61 = 0.72 / [1 + (1 - 0.1960) * (0.2239)]$$

The unlevered industry beta is then adjusted for TSTY’s debt-to-equity ratio:

$$\text{Levered Beta for TSTY} = \text{Unlevered Beta for Industry} * [1 + (1 - \text{TSTY's tax rate}) * (\text{TSTY's D/E ratio})]$$

The levered beta for TSTY is $0.84 = 0.61 * [1 + (1 - 0.35) * 0.59]$.

III. Adjusted Beta Determination

The adjusted beta accounts for the observation that most betas regress towards 1. The equation is as follows: *Adjusted beta = Unadjusted beta * (0.067) + 1.00 * (0.33)*. Using the S&P 5-year weekly regression beta of 0.55, the calculated adjusted beta is: $0.55 * (0.67) + 0.33 = 0.70$. The adjusted beta for TSTY is 0.70.

We take the average of the three betas -- *unadjusted beta (0.55)*, *levered beta (0.84)*, and the *adjusted beta (0.70)* -- to determine the blended beta of 0.70.

Source: Damodaran Online, Value Line, Bloomberg, Student Estimates

Appendix F: COE Computation Using the Synthetic-Cost-of-Debt-Plus-Risk-Premium Method

Because TSTY has not issued bonds, but uses term loans, mortgage loans, and other credit facilities for its debt financing, we use a synthetic bond rating to determine our cost of debt. Moody's calculates TSTY's bond rating to be in the B2/B range, highly speculative. Using a corporate bond spread of 450 bps over the ten-year Treasury yield of 4.54%, results in a cost of debt of 9.04%.

Reuters Corporate Spreads for Industrials						
Rating	1 Year	2 Year	3 Year	5 Year	7 Year	10 Year
Aaa/AAA	0.05%	0.10%	0.15%	0.22%	0.27%	0.30%
B2/B	5.25%	5.50%	6.00%	5.00%	4.50%	4.50%

Synthetic Cost of Debt + Equity Risk Premium	
10-year Treasury yield	4.54%
Basis point spread for 10-year B2/B	4.50%
Synthetic cost of debt calculation (10-year + spread)	9.04%
Equity risk premium above synthetic cost of debt	3.00%
k (COE=cost of debt + equity risk premium)	12.04%

Source: Moody's, Reuters, Student Estimates

Appendix G: Fama-French Three-Factor Model

The Fama and French three-factor model is used to derive an appropriate discount rate based upon a stock's relation to the historical excess returns of the S&P 500, size factor (Small-minus-Big, *Smb*), and value factor (High-minus-Low, *Hml*). The regression then yields three beta values for each category: market, *Smb*, and *Hml*, and an alpha for the company. These estimates are then used to compute the expected return given the current values of the three factors. The equation for this model is: $r_i = \alpha + \beta(R_m - R_f) + \beta(Smb) + \beta(Hml)$.

Our analysis yields a matrix of discount rates as follows:

Fama-French Three-Factor Model					
		Yearly Average of University of Chicago's Research on Security Prices (CRSP) Data			
		1-year	5-year	10-year	15-year
Years of Regression	20-year	14.74%	12.00%	9.48%	7.80%
	15-year	10.23%	8.78%	6.60%	4.70%
	10-year	8.39%	7.34%	4.32%	1.49%
	5-year	-5.93%	-8.48%	-8.43%	-7.71%

The highlighted has the most significant beta estimates and R-squares.

Source: University of Chicago, Kenneth French Data Library, Student Estimates

Appendix H: Discounted Cash Flow to Equity (DCF) for TSTY

Income Statement								
Fiscal Year	2005	2006E	2007E	2008E	2009E	2010E	2011E	Terminal
Operating Revenues	172,273	167,715	173,570	179,641	185,928	192,436	199,171	205,146
less operations expense	162,680	155,785	159,997	165,597	171,393	177,392	183,600	189,108
less depreciation	6,503	6,566	7,108	7,484	7,869	8,273	8,699	9,146
less restructure charge (income), net of reversals	71	-	-	-	-	-	-	-
Operating Income	3,019	5,364	6,465	6,560	6,667	6,771	6,872	6,892
less interest expense	1,370	1,480	1,532	1,585	1,641	1,698	1,758	1,811
less gain on sale of routes	(97)	-	(98)	(101)	(105)	(109)	(112)	(116)
less other income, net	(922)	(1,088)	(1,130)	(1,170)	(1,211)	(1,253)	(1,297)	(1,336)
Earnings Before Income Taxes	2,668	4,972	6,161	6,246	6,342	6,434	6,524	6,533
less provisions for income taxes	825	2,375	2,683	2,809	2,829	3,055	2,817	2,821
Net Income	1,843	2,597	3,478	3,436	3,513	3,379	3,706	3,712

Statement of Cash Flows								
Fiscal Year	2005	2006E	2007E	2008E	2009E	2010E	2011E	Terminal
Net Income	1,843	2,597	3,478	3,436	3,513	3,379	3,706	3,712
add depreciation	6,503	6,566	7,108	7,484	7,869	8,273	8,699	9,146
add deferred income taxes	900	2,198	157	249	229	417	142	142
add change in working capital	(187)	(391)	(183)	(16)	(18)	(17)	(17)	(3)
add other expenses	(9,235)	1,144	120	(51)	(52)	(56)	(61)	(78)
Cash Flow from Operations	(176)	12,114	10,680	11,103	11,540	11,996	12,470	12,920
add capital expenditures (CAPEX)	(5,896)	(5,906)	(5,882)	(6,087)	(6,301)	(6,521)	(6,749)	(6,948)
add other expenses	(4,646)	1,585	(70)	(105)	(57)	(29)	(75)	(67)
Cash Flow from Investing Activities	(10,542)	(4,321)	(5,952)	(6,192)	(6,357)	(6,550)	(6,824)	(7,015)
Dividends	(1,632)	(1,640)	(2,087)	(2,062)	(2,108)	(2,028)	(2,224)	(2,227)
Payment of Long-Term Debt	(3,720)	(4,915)	(3,635)	(3,826)	(4,014)	(4,202)	(4,373)	(4,567)
Shortage	(16,070)	1,238	(994)	(978)	(784)	(784)	(950)	(890)
Retained Earnings	211	2,557	1,391	1,375	1,405	1,352	1,483	1,485
Incremental LT Debt/ Proceeds from LT Debt	16,590	-	954	941	938	854	973	950
Long-Term Debt	22,558	18,177	19,131	20,072	21,009	21,864	22,837	23,787
Incremental Share Equity from New Shares	(3,709)	8,424	40	37	1	-	-	-
Shareholders Equity	37,289	48,270	49,701	51,112	52,518	53,870	55,353	56,837
Net Proceeds from Debt	10,801	(4,915)	(2,682)	(2,885)	(3,077)	(3,347)	(3,400)	(3,618)
Net Proceeds from Equity	(93)	(159)	40	37	1	-	-	-
Cash Flows from Financing Activities	9,076	(6,714)	(4,729)	(4,911)	(5,183)	(5,375)	(5,623)	(5,845)

Discounted Cash Flow Valuation								
Fiscal Year	2005	2006E	2007E	2008E	2009E	2010E	2011E	Terminal
FCFE = CFO - FCInv + Net Borrowing	83	2,878	2,047	2,025	2,106	2,098	2,247	2,287
less difference in depreciation & CAPEX in terminal year								(2,198)
add net proceeds from debt in terminal year								3,618
Terminal Value after 2011								64,572
Shares Outstanding	8,155	8,236	8,255	8,274	8,293	8,312	8,331	8,350
FCFE/Share	0.01	0.35	0.25	0.24	0.25	0.25	0.27	7.73
Discount Factors			0.92	0.85	0.78	0.72	0.66	0.66
Present Value (PV) of FCFE/Share			0.23	0.21	0.20	0.18	0.18	5.09

Sum of PV FCFE per share as of Year-end 2006 **6.08**

12-Month (March 2008) Price Target **\$6.60**

Source: Student Estimates

Appendix I: Two-stage Discounted Cash Flow to Equity (DCF) Assumptions and Valuation

DCF Key Assumptions

Risk Free Rate (Rf): 10-year Treasury yield of 4.54%
 Market Risk Premium (Rm – Rf): 6%
 Cost of Equity (COE) k: 8.74%

Two-stage Discounted Cash Flow to Equity (DCF) Assumptions						
	Stage 1: 2007-2010					Stage 2: after 2011
Fiscal Year	2007	2008	2009	2010	2011	2012
Operations Efficiency Ratio	92%	92%	92%	92%	92%	80%
Revenue Growth	3.50%	3.50%	3.50%	3.50%	3.50%	3.00%
Discounts & Allowances (% of Sales)	37%	37%	37%	37%	37%	37%
Annual Capital Expenditure	5,882	6,087	6,301	6,521	6,749	6,948
Equity Dilution	0.23%	0.23%	0.23%	0.23%	0.23%	0%
Dividend Payout Ratio	60%	60%	60%	60%	60%	60%
Annual Long-Term Debt Due for Repayment	20%	20%	20%	20%	20%	20%
Long-Term Debt to Total Capital	40%	40%	40%	40%	40%	40%
Discount Factors	0.92	0.85	0.78	0.72	0.66	0.66

Accounting Assumptions:

- 1) Discounts and allowances based on five-year historical average.
- 2) COGS is a two-year average reflecting the lower COGS as a percent of sales due to increased operating efficiencies.
- 3) Depreciation is a five-year average of depreciation expense as a function of total property, plant, and equipment.
- 4) SG&A expense is a five-year average.
- 5) Restructuring charges not included in projections.
- 6) Pension expense is capped at 2005 level due to difficulties in determining future pension expenses (corridor method).
- 7) Land was capped at 2005 figure.
- 8) Buildings and Improvements – ten-year CAGR of 5%.
- 9) Machinery – nine-year CAGR of 5.23% due to large write-offs in 2005.
- 10) 2006 sales were adjusted for 53-week year.

Source: Student Estimates

Appendix J: Discounted Cash Flow to Equity (DCF) Sensitivity Analysis

The sensitivity analysis below shows the different target prices for TSTY based on different terminal growth rates and different costs of equity (COE).

DCF Target Price as of January 2008							
		Terminal Growth Rate starting 2012					
		2.00%	2.50%	3.00%	4.00%	4.50%	5.00%
C O E (k)	6.50%	8.79	9.75	10.98	14.92	18.37	24.12
	7.00%	7.88	8.64	9.58	12.40	14.66	18.04
	7.50%	7.14	7.75	8.49	10.60	12.18	14.40
	8.00%	6.53	7.02	7.62	9.25	10.41	11.97
	8.74%	5.79	6.16	6.61	7.77	8.56	9.57
	9.00%	5.56	5.91	6.31	7.36	8.06	8.93
	9.50%	5.18	5.47	5.81	6.68	7.24	7.92
	10.00%	4.84	5.10	5.39	6.11	6.57	7.12
	10.50%	4.55	4.77	5.02	5.63	6.01	6.46

Source: Student Estimates

Appendix K: Two-stage Dividend Discount Model (DDM) Valuation

Dividend Discount Model (DDM) Valuation								
Fiscal Year		Stage 1: 2007-2010					Stage 2: after 2011	
		2006	2007E	2008E	2009E	2010E	2011E	2012E
Dividends		1,640	2,087	2,062	2,108	2,028	2,224	2,227
Average common shares outstanding		8,236	8,255	8,274	8,293	8,312	8,331	8,350
Dividends per share		0.20	0.25	0.25	0.25	0.24	0.27	0.27
Terminal value after 2011		-	-	-	-	-	-	4.65
Discount factors		-	0.92	0.85	0.78	0.72	0.66	0.66
Present Value (PV) of FCFE per share			0.23	0.21	0.20	0.17	0.18	3.06

Sum of PV FCFE per share **4.05**

12-Month (March 2008) Price Target **\$4.40**

Source: Student Estimates

Appendix L: Relative Valuation

TSTY vs. Peer Group Valuation									
Ticker	Company Name	Market Cap (in millions)	P/E (ttm)	Forward P/E	Long Term Liabilities to Assets	Long Term Liabilities to Equity	3-year Avg. Net Profit Margin	3-year Avg. ROA	3-year Avg. ROE
TSTY	Tasty Baking Co.	72.46	26.73 *	21	39.39 %	91.63 %	0.71 %*	1.63 %*	4.62 %*
IBCIQ.PK	Interstate Bakeries Corp	198.66	-	N/A	50.90 %	-265 %	-5.43 %	-12.12 %	-12.09 %
FLO	Flowers Foods Inc	1,774.73	22.22	21.14	17.48 %	28.26 %	3.71 %	6.49 %	10.09 %
JJSF	J&J Snack Foods Corp	715.64	24.06	21.93	5.57 %	-100 %	5.62 %	8.96 %	11.71 %
LNCE	Lance Inc	617.89	33.44	23.56	13.91 %	25.44 %	3.13 %	5.86 %	10.78 %
WN.TO	George Weston Ltd	16,563.04 **	16.46	15.19	48.90 %	1.77 %	1.84 %	2.95 %	13.23 %
Peer Group: Baked Goods	Peer Average/Mean	796.65	19.24	20.46	21.97 %	-77.83 %	1.77 %	2.43 %	6.65 %
	Peer Median	703.10	22.22	21.54	15.70 %	-37.28 %	3.13 %	5.86 %	10.78 %
	Peer Standard Deviation	624.94	12.37	3.65	19.93 %	138.38 %	4.25 %	8.41 %	10.55 %
	Peer High	1640.00	33.44	23.56	50.90 %	28.26 %	5.62 %	8.96 %	13.23 %
	Peer Low	140.38	-	15.19	5.57 %	-265 %	-5.43 %	-12.12 %	-12.09 %

* Using adjusted earnings per share (EPS) P/E

**Adjusted for Canadian Dollars

Source: Reuters, Bloomberg, Student Estimates

Appendix M: Telephone Survey Poll Questions and Results

Q1. In what year were you born?

- 1977-1989
- 1962-1976
- 1947-1961
- 1946 or earlier
- Refuse to answer

Q2. We know that this is an obvious question but we must ask it anyway, what is your gender?

- Male
- Female

Q3. What is the range of your current household income: under \$50,000, between \$50,000 and \$100,000, between \$100,000 and \$150,000 or over \$150,000?

- \$0 - \$50,000
- \$50,000- \$100,000
- \$100,000- \$150,000
- \$150,000 +
- Refuse to Answer

Q4. Of the following brands, which have you heard of: Little Debbie, Entenmann's, Hostess, or Tasty Kake?

- Heard of Tastykake
- Has not heard of Tastykake
- Refuse to answer

If yes to "Tastykake" then continue

If no then end Survey – "I'm sorry but we're conducting a poll about Tastykake. Thank you for your time. Have a good evening."

Q5. Which of these brands do you buy most frequently, Little Debbie, Entenmann's, Hostess, or Tastykake?

- Little Debbie
- Entenmann's
- Hostess
- Tastykake
- None
- Refuse to answer

Q6. Have you purchased Tastykake products in the past 3 months?

- Yes
- No
- Don't Know
- Refuse to answer

Q7. *If yes to question 6*, how many times have you purchased Tastykake in the past 3 months?

- 1-3
- 4-6
- Less than 6
- Refuse to answer

[CONTINUED ON NEXT PAGE]

Please let me know if you agree or disagree with the following statements:

Q8. Tastykake is a Junk Food

- Agree
- No Opinion
- Disagree

Q9. Tastykake is a Health Food

- Agree
- No Opinion
- Disagree

Q10. Tastykake is a Snack Cake

- Agree
- No Opinion
- Disagree

Q11. Tastykake is high in calories and fat

- Agree
- No Opinion
- Disagree

Q12. Tastykake is unhealthy for you

- Agree
- No Opinion
- Disagree

Q13. Tastykake does not have any health conscious products

- Agree
- No Opinion
- Disagree

Q14. Tastykake is an impulse buy.

- Agree
- No Opinion
- Disagree

Q15. Where would you most likely look to purchase Tastykake; at a supermarket, at a convenience store, at a gas station, or at a mass merchandiser (e.g. Wal-Mart/Target/Costco)?

- Supermarket
- Convenience Store
- Gas Station
- Mass Merchandiser (e.g. Wal-Mart/Target/Costco)
- Other
- Refuse to answer

[END POLL - *Thank you very much*]

[CONTINUED ON NEXT PAGE]

Independent Poll Data Statistics

Total number of participants (includes non-consumers)	400
Total number of completed polls (TSTY consumers)	98
Total number of completed polls (Non-TSTY consumers)	302
Non-TSTY consumers out of total number of participants	75.50%

Response to Agree, Disagree, No Opinion Questions

	# of respondents that agreed	Percent which agreed (%)	# of respondents that disagreed	Percent which disagreed (%)	# of respondents that had no opinion	Percent which had no opinion (%)
Tastykake is a junk food	75	76.53	21	21.43	2	2.04
Tastykake is a health food	9	9.18	85	86.73	4	4.08
Tastykake is a snack cake	93	94.90	1	1.02	4	4.08
Tastykake is high in calories and fat	74	75.51	10	10.20	14	14.29
Tastykake is unhealthy for you	51	52.04	38	38.76	9	9.18
Tastykake does not have any health conscious products	31	31.63	32	32.65	35	35.71
Tastykake is an impulse buy	60	61.22	33	33.67	5	5.10

Response to Brand Purchased Most Frequently

Brands	# of respondents	Percentage
Entenmann's	30	30.61%
Hostess	3	3.06%
Little Debbie	29	29.59%
Tastykake	26	26.53%
None/refuse to answer	10	10.20%

Age Category of Respondents

Years of Birth	# of respondents	Percentage (%)
Before 1946	18	18.37
1947-1961	35	35.71
1962-1976	26	26.53
1977-1989	16	16.33
Refuse to Answer	1	1.02
Blank	2	2.04
Total	98	100

Appendix N: Distributor Interview

The following is an interview with an anonymous owner-operator/distributor for Tasty Baking Company with many years of experience in a geographic location that has a wide variety of demographic characteristics:

Q1: Could you describe for me your role in the distribution of Tasty Baking's products?

A: Sure. I sell the Tastykake product line in my geographical area to supermarkets, chain stores and independent grocery stores. After I distribute the Tastykake product line, I then derive my main source of income from commission-based sales.

Q2: You say that your main source of income is based on commission, how has the recent price increases affected your business?

A: It has really had a negative impact on my business. It seems like every time we raise prices, sales seem to drop a bit. In lower income neighborhoods especially, competitors like Little Debbie who have been selling their product for \$0.25 a package are really tough to beat considering Tastykake's average price is \$1.19. When I started many years ago, I used to take in 20% more per month than I do now, and that's without adjusting the prices for inflation!

Q3: Tasty Baking prides itself on having a strong brand, do you agree with this statement?

A: Yes. In their prime market near Philly it's strong. However, in the New York area things get tough. I have always been a little frustrated that we can't crack into this market more. Also, people are moving away from Philly and the core market is shrinking, so they really need to do something as far as advertising goes in order to hold onto their market share even in this core region.

Q4: Besides building brand equity, one of the other pillars of the Strategic Transformation Plan is product innovation. How are people taking to the new product lines?

A: I have been disappointed over the past couple of weeks. They just launched a new product line for the *Sensables* brand with coupons and other types of promotions. But, people haven't seemed to take to it well. *Doublicious* does fairly well in the more affluent areas because it yields a premium price. Overall, I don't think that Tasty does well with advertising and marketing with regards to the launch of new products. They tend to release a new product, see how it does, end up not getting behind it much with advertising, and then it slowly gets pulled off the shelf even though it may have been a decent product.

Q5: The third pillar of the Strategic Transformation Plan is to grow core routes. How has Tasty Baking helped you to expand your business?

A: They really haven't helped me much. I didn't even know that one pillar was to expand core routes because even talking to other distributors I haven't heard much. However, I know that they tried to expand outwards to chain stores like Kroger's. They don't talk much to us about this.

Q6: Do you see any potential for expanded growth outside, and in some cases inside Tasty Baking's core markets?

A: I think there is room for expansion in both, but I don't think we know how to market our products properly. The best example of this is the one I mentioned earlier about our new products. I haven't seen any one product that has stood out and done very well over the last couple of years. Also, they have wanted for years to break into the Big Apple and they just can't seem to do it. It must be frustrating for management. Even just a small percentage of the market share would give us a boost. However, we do well in inner cities. At least 50% of my sales come from areas that have large concentrations of well-fair; so there is some room for improvement in the right areas, it's just difficult to penetrate them.

Q7: What are some of the major challenges, pertaining to growth, that you currently see the company facing?

A: The market is getting older and more health conscious. These are not good things for people in the Sweet & Baked Goods Industry. The market is tough and shrinking. So, part of the challenge is finding something new to penetrate the new markets.

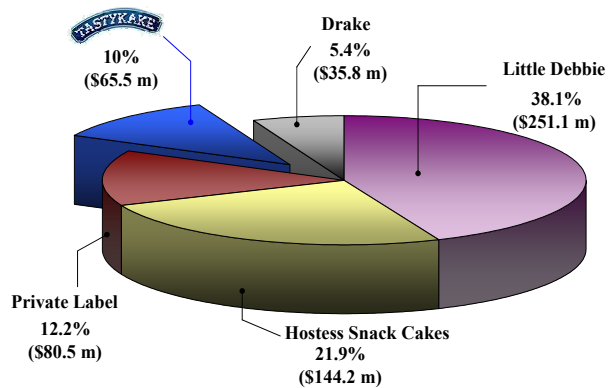
Appendix O: Industry Growth Outlook

Year	Revenue (\$ in millions)	Growth %
2007	36,058.40	2.6
2008	36,553.50	1.4
2009	37,458.70	2.5
2010	37,990.70	1.4
2011	38,598.50	1.6

Source: IBISWorld

Appendix P: Revenues Share for Top 5 Snack Cake Brands

Rank Brand	Dollar Sales (in millions)	% Change	Dollar Share	Dollar Share Change vs Year Ago
Little Debbie	\$251.1	-2.1%	38.1	+0.2%
Hostess Snack Cake	144.2	-9.6	21.9	-1.7
Private Label	80.5	+2.3	12.2	+0.6
Tastycake	65.5	+2.1	10.0	+0.5
Drake	35.8	-2.1	5.4	0.0
Total Category*	\$658.3	-2.6%	100.0	0.0%



*Including brands not shown

Source: Information Resources, Inc., Total Sales for US Supermarkets, Drug Stores, and Mass Merchandisers. Calendar year, 2005

Appendix Q: SWOT Analysis

Strengths	Weaknesses
<ul style="list-style-type: none"> ◆ Strong consumer base in Philadelphia ◆ New management and strategic growth plan ◆ Recent implementation of ERP system ◆ Direct Store Delivery (DSD) 	<ul style="list-style-type: none"> ◆ Lack of pricing power ◆ Difficulty expanding beyond Philadelphia ◆ Weak brand recognition and brand equity ◆ Outdated manufacturing facility ◆ Large underfunded pension
Opportunities	Threats
<ul style="list-style-type: none"> ◆ New product development and innovation ◆ Successful expansion into new markets ◆ Come to a solution on outdated plant problem ◆ New marketing strategy 	<ul style="list-style-type: none"> ◆ Competitors increase market share in TSTY's core market ◆ Manufacturing facility requires sudden large cash investment ◆ Changing consumer preferences towards healthier eating ◆ Sweet baked goods, TSTY's main product, are price elastic

Appendix R: Adjusted Income Statement

\$ in Thousands except for per share data

	1998	% G.S.	1999	% G.S.	2000	% G.S.	2001	% G.S.	2002	% G.S.	2003	% G.S.	2004	% G.S.	2005	% G.S.	2006(U)	% G.S.
REVENUE																		
Gross sales	228,453	100%	226,350	100%	249,691	100%	255,336	100%	255,504	100%	250,648	100%	259,029	100%	277,967	100%	267,911	100%
Less discounts and allowances	(77,724)	-34.02%	(75,689)	-33.44%	(86,813)	-34.77%	(89,091)	-34.89%	(93,241)	-36.49%	(91,519)	-36.51%	(99,968)	-38.59%	(105,694)	-38.02%	(100,196)	-37.40%
Net Sales	150,729	65.98%	150,661	66.56%	162,878	65.23%	166,245	65.11%	162,263	63.51%	159,129	63.49%	159,061	61.41%	172,273	61.98%	167,715	62.60%
<i>Net Sales Growth</i> Gross Sales Growth:	<i>0.96%</i>	2.88%	<i>-0.05%</i>	-0.92%	<i>8.11%</i>	10.31%	<i>2.07%</i>	2.26%	<i>-2.40%</i>	0.07%	<i>-1.93%</i>	-1.90%	<i>-0.04%</i>	3.34%	<i>8.31%</i>	7.31%	<i>-2.65%</i>	-3.62%
Cost of sales	93,234	40.81%	95,697	42.28%	105,036	42.07%	103,297	40.46%	111,187	43.52%	108,689	43.36%	103,693	40.03%	111,690	40.18%	103,495	38.63%
Depreciation	6,650	4.17%	7,016	4.12%	7,759	4.35%	7,204	3.91%	6,807	3.55%	7,148	3.58%	7,711	3.69%	6,503	3.61%	6,566	2.45%
Gross Margin	50,845	33.73%	47,948	31.83%	50,083	30.75%	55,744	33.53%	44,269	27.28%	43,292	27.21%	47,657	29.96%	54,080	31.39%	57,654	34.38%
Selling, general and administrative	43,007	18.83%	39,724	17.55%	37,211	14.90%	44,008	17.24%	45,941	17.98%	48,149	19.21%	45,751	17.66%	50,990	18.34%	52,290	19.52%
Interest expense	745	0.33%	1,124	0.50%	1,540	0.62%	1,103	0.43%	1,066	0.42%	909	0.36%	1,254	0.48%	1,370	0.49%	1,480	0.55%
Other income, net	(1,607)	-0.70%	(1,281)	-0.57%	(1,421)	-0.57%	(1,190)	-0.47%	(1,165)	-0.46%	(873)	-0.35%	(1,129)	-0.44%	(922)	-0.33%	(1,088)	-0.41%
Net Expenses	142,029	62.17%	142,280	62.86%	150,125	60.12%	154,422	60.48%	163,836	64.12%	164,022	65.44%	157,280	60.72%	169,631	61.03%	162,743	60.75%
Income (Loss) Before Provision for Income Taxes	8,700	3.81%	8,381	3.70%	12,753	5.11%	11,823	4.63%	(1,573)	-0.62%	(4,893)	-1.95%	1,781	0.69%	2,642	0.95%	4,972	1.86%
<i>Provision for (benefit from) income taxes:</i>																		
Federal	2,229	0.98%	3,114	1.38%	2,562	1.03%	3,286	1.29%	(11)	0.00%	(3,089)	-1.23%	147	0.06%	(108)	-0.04%	1,882	0.70%
State	241	0.11%	319	0.14%	(270)	-0.11%	(90)	-0.04%	(316)	-0.12%	709	0.28%	80	0.03%	33	0.01%	298	0.11%
Deferred	501	0.22%	(908)	-0.40%	2,317	0.93%	579	0.23%	(3,246)	-1.27%	997	0.40%	377	0.15%	900	0.32%	63	0.02%
Total Provision for (Benefit from) Income Taxes	2,971	1.30%	2,525	1.12%	4,609	1.85%	3,775	1.48%	(3,573)	-1.40%	(1,383)	-0.55%	604	0.23%	825	0.30%	2,243	0.84%
NET INCOME (LOSS)	5,729	2.51%	5,652	2.50%	8,144	3.26%	8,048	3.15%	2,000	0.78%	(3,510)	-1.40%	1,177	0.45%	1,817	0.65%	2,729	1.02%
<i>Net Income Growth:</i>	<i>-28.37%</i>		<i>-1.34%</i>		<i>44.09%</i>		<i>-1.18%</i>		<i>-75.15%</i>		<i>275.50%</i>		<i>133.53%</i>		<i>54.38%</i>		<i>50.17%</i>	
AVERAGE COMMON SHARES OUTSTANDING	7,804		7,823		7,823		7,834		7,974		8,100		8,137		8,155		8,236	
NET INCOME PER SHARE (EPS)																		
Basic	0.73		0.72		1.04		1.03		0.25		(0.43)		0.14		0.22		0.33	
Diluted	0.73		0.72		1.04		1.03		0.25		(0.43)		0.14		0.22		0.33	
<i>Diluted EPS Growth:</i>	<i>-28.74%</i>		<i>-1.58%</i>		<i>44.08%</i>		<i>-1.32%</i>		<i>-75.59%</i>		<i>-272.78%</i>		<i>133.38%</i>		<i>54.03%</i>		<i>48.69%</i>	

Adjustments

- 1) Removed restructuring charges in '05, '04, '03, '02, '01, '99
- 2) Removed gain on sale of routes '05, '04, '03
- 3) Removed option grant in 2006

Source: Company 10-K, Student Estimates

Disclosures:

Ownership and material conflicts of interest:

The author(s), or a member of their household, of this report holds a financial interest in the securities of this company.

The author(s), or a member of their household, of this report knows of the existence of any conflicts of interest that might bias the content or publication of this report. The conflict of interest is...

Receipt of compensation:

Compensation of the author(s) of this report is not based on investment banking revenue.

Position as a officer or director:

The author(s), or a member of their household, does serves as an officer, director or advisory board member of the subject company.

Market making:

The author(s) does not act as a market maker in the subject company's securities.

Ratings key:

Banks rate companies as either a BUY, HOLD or SELL. A BUY rating is given when the security is expected to deliver absolute returns of 15% or greater over the next twelve month period, and recommends that investors take a position above the security's weight in the S&P 500, or any other relevant index. A SELL rating is given when the security is expected to deliver negative returns over the next twelve months, while a HOLD rating implies flat returns over the next twelve months.

Disclaimer:

The information set forth herein has been obtained or derived from sources generally available to the public and believed by the author(s) to be reliable, but the author(s) does not make any representation or warranty, express or implied, as to its accuracy or completeness. The information is not intended to be used as the basis of any investment decisions by any person or entity. This information does not constitute investment advice, nor is it an offer or a solicitation of an offer to buy or sell any security. This report should not be considered to be a recommendation by any individual affiliated with NYSSA or the NYSSA Investment Research Challenge with regard to this company's stock.
