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RESEARCH GROUP

BOULDER BRANDS | BDBD

INVESTMENT RESEARCH REPORT

"Between a Rock and a Hard Place"

DOWNGRADING PRICE TARGET

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Prescience Point Comments on Boulder's Earnings

High Risk of Covenant Breach Signals Need for Equity Capital; Critical Questions Remain Unaddressed

Prescience Point wants to update its readers with our thoughts on Boulder Brands' (Nasdaq: BDBD) latest earnings report. With the stock having fallen 28% since we initiated the company at Strong Sell on February 26th, despite the company reporting that it, "*Delivers 35% Net Sales Growth & 15% Organic Net Sales Growth in the (4th) Quarter*," and "*Increases 2013 Outlook*," we suspect that the market has already seen through the charades. However, we thought we'd piece together the remainder of the puzzle for investors with our own observations.

We are downgrading our price target from $4.00 to $3.00 on the risks of a convent breach and likelihood of an imminent, highly dilutive equity capital raise.

Boulder Stays Quiet on the Patent Expiration Topic

In our report, we pointed out that the most significant risk facing the company is the looming expiration of the key set of patents that prevent competitors from selling HDL-raising margarine spreads, which the Smart Balance and Earth Balance businesses have relied upon since 1996. We believe the expiration of these patents in April of 2015 will result in a crippling of the company's ability to generate the cash flows necessary to service its debt. While the company said absolutely nothing to address these concerns, it is keenly aware of the urgency to forestall the day of reckoning.

We point readers to Boulder's cash flow statement, where it is disclosed that patent/trademark defense costs quadrupled from 2011 to 2012, growing from $1.1 to $4.4 million – and with good reason. Boulder understands the market positions of both Smart Balance and Earth Balance are based on the existence of these patent protections: According to Boulder's 2012 10-K, "*Approximately 47% of our sales in 2012 were dependent upon this licensed, patented technology.*" As such, the company ought to vigorously defend this intellectual property.

On September 7, 2011 Boulder filed suit against some of the biggest names in food manufacturing – including Nestle, Kellogg and Unilever – for infringing on Patents No. 5,843,497 and No. 6,630,192. The company alleges, "*All of these infringing acts severely undermine Plaintiffs' significant investment in the inventions of the Patents-in-Suit, all to the Plaintiffs' detriment.*"

Cash flows from investing activities	2012	2011	2010
Acquisitions, net of cash and cash equivalents acquired	(126,910)	(66,112)	(2,000)
Purchase of property and equipment	(8,032)	(4,771)	(1,348)
Patent/trademark defense costs	(4,387)	(1,139)	(106)
Net cash (used in) investing activities	(139,329)	(72,022)	(3,454)

If Boulder has spent $4.4m to defend its IP, we can assume the competitors it has accused of infringement are spending similar sums to defend themselves and their products in question. Boulder's competitors are likely ready and waiting to begin marketing their products using the exact benefit claims (currently protected by its family of patents) Boulder has relied on in building the Smart Balance and Earth Balance brands. We believe that beginning in April 2015, Boulder's competitive position will come under attack, resulting in a deterioration in its revenues and margins, and its ability to service its debts.

Boulder Dances Around Earth Balance's Performance

In our report, we informed our readers that Boulder's recent segment reorganization in October 2012 appeared to be an attempt to conceal declining growth of certain brands, particularly Earth Balance. In its Q4'2012 pronouncements, management stated that Earth Balance continues to "*perform well*" with "strong *consumption*" trends; but, a careful analysis of management's change in language around the issue points to a different reality, and we believe corroborates our thesis.

> Q3'12: "*Earth Balance continues to perform well with strong consumption trends of approximately plus **26%** across all channels at natural, conventional and club.*"
>
> Q4'12: "*Earth Balance continues to perform well with strong consumption trends of approximately **16%** across to all retail channels in geographies and we really compete a natural conventional grocery Canada and club with Earth Balance*."

And there it is, in plain sight – if consumption trends are a proxy for product sales, management has admitted to a decline in the growth rate of Earth Balance sales.

On the Q4'2012 conference call, one analyst asked the management for an indication of what 'inning' (a baseball analogy) of the growth cycle Earth Balance is in. The CEO's response, below, appears convoluted and left us with the impression that Boulder does not have a clear roadmap for the future of its Earth Balance brand.

> "*Again, we're everywhere plant based is a question or concern. I mean, we really think that Earth Balance has – we haven't -- we kind of did the Smart Balance category expansion. We did spreads, we did mayonnaise, we did peanut butter. Well, we're just starting to learn, I think next week at Expo you will be -- you will be pretty impressed by these Earth Balance vegan snacks and the early movement of these is -- this is looking to be our fastest starting new product launch. So we think that Earth Balance and now you kind of follow the oil, follow the plant based, can play in snacks. We think we can create some very unique products there. There is no question that the natural, ancient grain, snack arena is one of the hottest categories. We think Earth Balance can play there. We also think that there are other categories that we're currently in that could be of interest. I mean, we think the sprouted breaded category is interesting, where the brand can play there. So, I think what you'll expect to see is potentially not the pace of the number of introductions that we're going to see under Glutino and Udi's, because we're trying to fill up that footprint quickly. But I think you're going to see us tackle a major category here on Earth Balance*."

Overall, our view is that weakness in the Earth Balance and Smart Balance brands is to persist. To illustrate, consider that management talked about the launch of a "*Space Saver package*" for Earth and Smart Balance. The Space Saver package, described as a solution to address "*limited space in store and warehouse*," appears to be a reaction from customers to shrink Boulder's product placement at the retail level. Nonetheless, management did its best to spin the Space Saver package as a positive development by calling it "*an ingenious move*," and to expect future "*distribution gains*."

Boulder Dodges Specifics RE Revenue Recognition Policies;

Draws SEC Scrutiny of Segment Revenue Grouping

In our report, we pointed out that management has made frequent changes to its accounting for sales discounts and allowances, and that we would give them the benefit of the doubt in favor of a suitable explanation. We were disappointed with management's terse response that Boulder's "*policy forms the best practice in the industry and has have consistently applied the policy since adoption*." We had hoped they would provide more specifics regarding why they chose to move from expensing to crediting income for portions of the sales discounts in Q2/Q3'11, only to reverse back to expensing later.

The SEC has also given attention to Boulder's revenue reporting disclosures, but with a focus on holistic reporting matters. In a recently filed comment letter, the SEC asked Boulder to justify how it reports its segment revenues in light of the disclosure requirements of FASB ASC paragraph 280-10-50-40. (We note this was a similar request from the SEC to one received by Green Mountain Coffee in May 2012.)

The exchange between the SEC and Boulder follows:

> ***SEC****: Discussion in the Business section of your filing indicates that you sell a variety of different products. In view of this, explain to us how you have considered the disclosure requirements of FASB ASC paragraph 280-10-50-40.*
>
> **Boulder Response**: The Company advises the Staff that it has assessed whether or not to include quantified disclosure of revenues for each of its product lines in "Note 3. Summary of Significant Accounting Policies - Segments" on the basis of similarity of products and services pursuant to ASC 280-10-50-40. The Company refers to its product lines in the Business section in order to help investors understand the wide range of products the Company sells (approximately 600 different SKU's).
>
> The Company offers its customers a variety of sales and incentive programs, including discounts, allowances, coupons and slotting fees, which are recorded as a reduction of gross sales and are not specifically identified or tracked by SKU. As a result, the Company has not provided quantified disclosure of net sales by SKU because it does not track net sales by SKU. Rather, the Company tracks net sales by reportable segment. As of September 30, 2012, the Company's operations are comprised of two reportable operating segments: Natural and Smart Balance. The Company believes that its current disclosure of net sales by reportable segment meets the requirements of ASC 280-10-50-40 because its reportable segments are themselves major categories of products.

We find it concerning that Boulder does not track its discounts, allowances, coupons and slotting fees by SKU. By all means, Boulder should have the processes in place to do this.

And, investors should carefully consider Boulder's continued financial control issues associated with primary brands. Boulder states in its recently filed 10K (p. 44), "*In making our assessment of disclosure controls and procedures and of changes in internal control over financial reporting as of December 31, 2012, we have excluded the operations of Udi's. We are currently assessing the control environment of this acquired business*." Likewise, Glutino was also being excluded from the assessment of the adequacy of internal controls through mid-year 2012 according to the Q2'12 10Q (p. 19).

Low Quality Cash Flow and Mysterious "Deferred Revenue" Signals Problems

We note that management was generally mum on the topic of cash flow in its earnings press release and on the conference call. We believe we know the reason why – because it's struggling to generate it. The company reported in its annual report that it generated $27.6m of cash from operations. However, we note that a majority of this cash flow came from a large Q4 swing in the Accounts Payable and Accrued Expenses account, which through the first 9 months had accounted for a cash drain of $2.6m.

2012 Full Year Cash Flow Statement

	2012
Cash flows from operating activities	
Net income (loss)	$ 4,203
Adjustments to reconcile net income (loss) to net cash provided by operating activities:	
Depreciation and amortization of intangibles	13,451
Amortization and write-off of deferred financing costs	4,078
Deferred income taxes	(6,137)
Excess tax benefit from stock-based payment arrangements	(2,204)
Stock-based compensation	11,513
Goodwill impairment	—
Changes in assets and liabilities:	
Accounts receivable	(4,016)
Income tax receivable	—
Inventories	(2,660)
Prepaid expenses and other assets	(1,078)
Prepaid taxes	(17)
Accounts payable and accrued expenses	10,478
Net cash provided by operating activities	27,611

First 9 months of 2012

	2012
Cash flows from operating activities	
Net income	$ 462
Adjustments to reconcile net income to net cash provided by operating activities:	
Depreciation and amortization of intangibles	9,427
Amortization and write-off of deferred financing costs	3,157
Deferred income taxes	(2,548)
Excess tax benefit from stock-based arrangements	(1,186)
Stock-based compensation	8,474
Changes in assets and liabilities:	
Accounts receivable	(2,247)
Inventories	(291)
Prepaid expenses and other assets	(2,529)
Prepaid taxes	(5,108)
Accounts payable and accrued expenses	(2,654)
Net cash provided by operating activities	4,957

The tables below show the biggest drivers of the account increase. Cash inflows rose from a near doubling in cash generated from an increase in the Accrued Trade Spend account in Q4'2012, relative to the first nine months of 2012. We also note that management continues to move toward greater account obfuscation in its disclosures. Boulder is now booking a Deferred Revenue account, something it has never done in past filings and that stands in odds with the accounting of its competitors (including Hain Celestial, Annie's, Lifeway Foods, WhiteWave Foods, and J&J Snacks), none of which reports this account.

Acct's Payable/Accrued Expenses 9/30/12

	September 30, 2012
Accounts payable	$ 19,847
Accrued trade spend	4,980
Accrued marketing	4,926
Current portion of contract payable	1,375
Accrued restructuring	2,707
Accrued incentives	2,818
Accrued legal fees	2,451
Accrued freight	1,562
Accrued commission	1,194
Accrued payroll-related	2,591
Accrued other	4,915
Total	$ 49,366

Acct's Payable/Accrued Expenses 12/31/12

	December 31, 2012
Accounts payable	$ 21,390
Accrued trade spend	8,067
Deferred revenue	4,351
Accrued incentives	4,280
Accrued legal fees	3,371
Accrued payroll-related	3,264
Accrued marketing	3,226
Accrued restructuring	2,279
Accrued other	10,364
Total	$ 60,592

Deferred revenue is recognized when a company collects cash upfront for a product or service it has yet to perform. The idea of a food producer taking payment for product upfront seems questionable. Food product producers like Boulder are typically credit extenders: They typically deliver their products first and wait to be paid by grocery stores, as opposed to getting paid in advance. To be clear, this is a possible sign that Boulder is offering significant discounts to customers willing to pay upfront, and we expect this to manifest as margin erosion in the coming quarters. Furthermore, a willingness to accept deep discounts in favor of pulling in cash to pay down debt indicates Boulder may have attempted to bolster the appearance of its financial solvency as portrayed by its year-end financial statements.

We also found that Boulder went from disclosing the "Accrued Freight" amount in the previous quarter, to omitting it in favor of burying the details in "Accrued Other," something warranting further investigation. Our evaluation of Boulder's disclosures on shipping and handling costs is presented in the table below. We observe that shipping and handling costs are falling as a % of overall net sales and as a % of reported selling expenses, and that these costs have not been growing as fast as total net sales or selling expense in the past two years. A review of recent management commentary reveals no explanation that would lead us to conclude that Boulder has extracted significant selling expense savings. (Most of management's recent emphasis has on reducing cost of goods sold.) So, we are left wondering about the disconnect and what it implies about Boulder's reported sales growth.

Boulder's Shipping and Handling Costs Out of Sync with Growing Sales
$ in millions

	2010	2011	2012
Total Net Sales	$241.9	$274.3	$369.6
% growth	*1.0%*	*13.4%*	*34.8%*
Selling Expense	$19.7	$23.2	$30.7
% growth	*12.1%*	*17.8%*	*32.3%*
% of sales	*8.1%*	*8.5%*	*8.3%*
Shipping and Handling Cost	$15.9	$17.3	$22.3
% growth	*22.3%*	*8.8%*	*28.9%*
% of sales	*6.6%*	*6.3%*	*6.0%*
% of Selling Expense	*80.7%*	*74.6%*	*72.7%*

Note: Boulder includes shipping/handling costs within selling expenses.
Source: Boulder Financials

In sum, we believe Boulder's real free cash flow is much lower than a cursory glance at Boulder's financial statements would indicate; and, we believe it will prove impossible for Boulder to hit its free cash flow guidance of $15-20m. CFO Christine Sacco guided investors to expect 2013 free cash flow to be in this range upon being pressed by an analyst on the Q4'12 conference call.

In the table below, we illustrate our estimate of Boulder's true free cash flow, which takes into consideration an adjustment for the mysterious deferred revenue account and increasingly large expenditures related to patent defense. Given that management has indicated 2013E CapEx of $27 - $29m, the CFO's estimate implies cash flow from operations (CFFO) will be approximately $48 - $53m next year, a figure that appears entirely far-fetched in relation to previous years' figures (which have shown a trend of deterioration).[1]

[1] We should qualify our analysis by stating that if management ramps up sales on a deferred revenue basis, it is possible for them to show outsized gains in CFFO and free cash flow, given that deferred revenue is added to CFFO. However, should they choose to do so, we are likely to see substantial margin deterioration and no concurrent increase in top-line sales.

Boulder's Adjusted Free Cash Flow Figures

$ in millions

				2013E BDBD Guidance(1)		
	2011	**2012**	**Adjusted 2012**	**Low**	**--**	**High**
Reported Cash From Operations	$29.2	$27.6	$27.6	--	--	--
Deferred Revenue Adjustment	--	--	($4.4)	--	--	--
Adjusted Cash from Operations	**$29.2**	**$27.6**	**$23.2**	**$48.0**	**--**	**$53.0**
CapEx (2)	($4.7)	($8.0)	($8.0)	($28.0)	--	($28.0)
Patent Defense Costs (3)	($1.1)	($4.4)	($4.4)	($5.0)	--	($5.0)
Adjusted Free Cash Flow	**$23.4**	**$15.2**	**$10.8**	**$15.0**	**--**	**$20.0**
% of Sales	8.5%	4.1%	2.9%	3.3%	--	4.3%

(1) Free cash flow guided on Q4 conf call by the CFO of $15-$20m implies $48-$53m of cash from ops.

(2) Midpoint of 2013 CapEx guidance.

(3) Assumes similar patent defense costs for 2013.

To be clear, we believe management's guidance is aggressive; and as discussed in the next section, Boulder has set investors up for material harm if the company does not deliver on these numbers. In the sections that follow we further break down the implications of management's CapEx guidance and elaborate on the escalating costs that will be necessary to drive any revenue growth in 2013.

Boulder's Guidance for CapEx Signals Need for Equity Capital

In the Q3'12 earnings release, Boulder guided that CapEx in 2013 would be approximately $13 million, primarily for margin improvement projects and capacity additions for the gluten-free business. Fast forward a bit more than 3 months later, and its view on CapEx requirements has shifted dramatically: According to Boulder's Q4'12 earnings release, management now believes CapEx will be $27 – $29 million to fund the consolidation of five Udi's facilities into one gluten-free "center of excellence" and the Company's efforts to automate the production of gluten-free bread. Commenting further on the call, Boulder said, "*We believe this new facility will be the largest most sophisticated gluten free bakery in the world. We expect this project to be completed this fall and it will allow us to keep up with the strong demand in our gluten free business as we plan to stay ahead of the growth curve.*"

But, where is the cash going to come from for this ambitious plan? We believe that, absent tremendous luck and perfect execution, it will come from a highly dilutive equity raise.

Boulder's cash flows have declined in each of the past few years. Assuming its CFFO holds steady at $27m in 2013 (we believe this is overly optimistic, with our base case projection being $22m in 2013 CFFO), and Boulder spends $29m on CapEx and $4 - $5m on patent defense costs, Boulder would drain the majority of the cash on its balance sheet. Perhaps Boulder anticipates using its revolver to fund the CapEx? We note management did not change its estimated interest expense of $19m for the year (despite claiming debt pay-down of ~$8m), indicating this is a possibility – at least at first, until they approach the breach of Boulder's max CapEx covenant…

Boulder's increase in its CapEx program puts it right on the verge of violating a debt covenant that limits its CapEx spend. Per Section 8.23 of Boulder's Credit Agreement,

> *Capital Expenditures. Neither the Parent nor any Borrower shall, nor shall it permit any of their respective Subsidiaries to, incur Capital Expenditures in an amount in excess of $12,000,000 (the "Maximum Cap Ex Amount") in the aggregate during any fiscal year; provided that if the Parent, the Borrowers and the Subsidiaries expend less than the Maximum Cap Ex Amount in any fiscal year the Maximum Cap Ex Amount for the next succeeding fiscal year of the Parent, the Borrowers and the Subsidiaries (but only the next succeeding fiscal year) shall be increased by (i) the excess of the Maximum Cap Ex Amount for the preceding fiscal year over the amount actually expended by the Parent, the Borrowers and their respective Subsidiaries during such preceding fiscal year (the "Carry Forward Amount") and (ii) the Available Basket Amount.*

And, as summarized in Boulder's 2012 10-K,

> *The terms of the Credit Facility require us and our subsidiaries (on a consolidated basis and subject to certain customary exceptions) to meet the following financial covenants….We are also limited to spending not more than $12 million of capital expenditures per year with any unexpended amounts carried over to the next twelve months*

Boulder has neither notified investors of any waiver of this covenant, nor has it filed any amendment to the credit agreement that would signal approval from its lenders; based on our read of the credit agreement, Boulder has left itself with little wiggle room; if it does not deliver on its outlandish cash flow forecast ($45-55m CFFO), management's CapEx plan will put the company in breach of this covenant. The Credit Agreement defines such a covenant breach as an Event of Default, which at the lenders' requests triggers an acceleration of Boulder's loans, with any amounts outstanding (principal and interest) immediately due. Boulder does not currently have the financial resources to deal with such an acceleration (which, were it to occur, could end up equating to a death spiral), indicating that underlying management's guidance for $27 - 29m in CapEx spend is a potential intent to raise equity capital. An equity raise would remove the noose, enabling the company to pay down a portion of its loan and to fully fund its CapEx program; and, a better leverage profile (subsequent to a raise) would allow Boulder to refinance any remaining amount owed to its creditors.

In summary, Boulder has guided for 2013 CapEx to be $27 - 29m. The company will have to deliver on its cash flow forecasts to fund this level of CapEx without breaching the financial covenants it is bound by. We believe it will fail in doing so and that management has left itself with no margin for error. **We believe they understand this, and our only conclusion is that Boulder intends to blind side investors with a dilutive equity offering**.

Should Boulder Footnote its "Raising Revenue Guidance" with "And Dramatically Increasing Costs"

Like any good growth story spun by an aggressive management team, a carrot has been dangled, with the pot of gold at the end of the rainbow just around one more corner. Boulder is no exception to the rule. In raising revenue guidance for 2013, Boulder's CFO noted at the very end of the pitch that, "*We expect a number of items to impact our sales and costs throughout 2013 and as a result, we expect our sales and related profits to be backend loaded. Specifically with our Natural segment, we expect sales will build throughout the year as we deliver on the distribution gains we have in our pipeline and expand retail presence of our brands. From a cost perspective, we expect the associated slotting cost to be leveraged in the second half as sales build*."

Management had little more to say on the topic of slotting fees, one of the costs they will bear to reach the consumer to generate these incremental sales; revenue growth can come at a big cost, as food producers try to claw for shelf space in an increasingly cluttered product category such as gluten-free. We applaud some of the other analysts for pointing this out and pushing management into an admission that slotting fees will increase materially in 2013. Commenting on the current quarter impact and future impact of slotting fees, the CFO stated, "*I would say the impact of this quarter was not significant in relation to other quarters. Slotting for 2013, agreed there is going to be --we're going to have distribution gains, we're*

anticipating in natural as we said." Afterward, the CEO chimed in with more nebulous commentary by saying, "*We're going to probably see a 3 or 4 step up in slotting total*."

We hope management accounted for these increasing costs in their revenue guidance, as the slotting fees should be netted against gross revenues. In the table below, we illustrate Boulder's old vs. new guidance. We note that management has now decided to stop talking about Cash Operating Income in favor of EBITDA and Adjusted EBITDA. We also note that management's guidance incorporates up to $7.0 million for other items, which could be continued restructuring charges, or something else management is spending on, but not disclosing to investors.

Boulder's New Guidance Reconciliation

$ in millions

	Prior Guidance as of 11/8/12			New Guidance as of 2/28/13		
	Low	--	High	Low	--	High
Sales	$440.0	--	$450.0	$450.0	--	$460.0
Gross Margins	*42.0%*	--	*44.0%*	*42.0%*	--	*44.0%*
EBITDA (COI)	$70.0	--	$75.0	**$72.0**	**--**	**$77.0**
Margin	*15.9%*	--	*16.7%*	*16.0%*	--	*16.7%*
Expected EBITDA				$64.0	--	$69.0
Incremental Stock Comp (1)				$1.0	--	$1.0
Other Items not specified				$7.0	--	$7.0
Adjusted EBITDA				**$72.0**		**$77.0**

(1) Change in company guidance from 11/8/12 to 2/28/13

EBITDA = NI before net interest expense, taxes, D&A

Adj EBITDA = EBITDA adjusted for stock comp expense, purchase acct'g adjustments, restructuring, acquisition, integration and certain other items

Analysts Still Asleep at the Wheel

Based on a time-consuming, critical analysis of Boulder's earnings release and call, SEC comment letter, and recent 10-K filing, we believe Boulder is increasingly distressed. In contrast, sell-side analysts quickly issued their reactions to Boulder's earnings just one day after the release, advocating the recent quarter to be a success and recommending the stock as an attractive buy. We believe their lack of deep-dive analysis may be driven by the likelihood of an imminent capital raise, as discussed in the preceding section.

BMO, in a 1-page note commented, "*The 30% decline in BDBD stock over the past three days creates an attractive buying opportunity. Notwithstanding soft – albeit likely conservative – sales and earnings guidance, underlying consumption trends in the gluten-free and plant-based portfolio remain solid.*"

The analyst at William Blair was also quick to offer his opinion, yet was at a complete loss to explain why Boulder's stock price had been depreciating – even after he cut his own earnings estimate for 2013! He commented, "*Given fourth-quarter results modestly above consensus expectations and higher 2013 sales and EBITDA guidance, it is not immediately clear to us why the stock exhibited such volatility—to the upside and eventually to the downside—in today's trading*." Yet, in further comment, he maintained his former 2013 EBITDA projection and set his 2013 EPS projection at $0.34c. It must have slipped his mind to mention that he trimmed his December 2012-issued 2013 EPS projection of $0.38c. Perhaps the linkage between future earnings and stock price has escaped this analyst.

RBC's analyst commented that Boulder remains a "*Top Pick for 2013*" and that his Boulder thesis *"remains very intact*." However, the analyst quietly cut his price target by $1 to $15.00 per share, and believes the 2013 EPS target should be lowered due solely to higher stock compensation, depreciation, and amortization expenses. We are baffled by his lack of consideration for declining Smart Balance and Earth Balance sales, which should be primary inputs in reducing earnings estimates.

Conclusion: Downgrading Price Target, Major Concerns Not Resolved

Most of the major concerns addressed in our initial report have yet to be addressed by management, and as a result we believe the risk profile of Boulder's equity remains elevated, and not priced-in at Boulder's current valuation. The gravest concern is the patent expiration in 2015, which is clearly on management's mind, as illustrated by a dramatic increase in Boulder's patent defense costs in 2012. Furthermore, concerns about the company's frequent shifts in revenue recognition, and specifically in sales discounts and allowances, remain unresolved. A recently released comment letter from the SEC also indicates that Boulder's revenue segments could be on the regulator's radar. In light of our observation that the segment reorganization is obscuring the growth decline in Earth Balance, we believe the SEC comments have real merit.

We believe the company's reported cash flow from operations has declined in quality, and that its sources of cash flow indicate it may have presold product at aggressively discounted prices to bolster the appearance of financial solvency, as conveyed by its 2012 financial statements. The majority of the company's 2012 cash flows came from a sudden and large reversal in the Accrued Expenses and Accounts Payable account; it was also largely bumped due to an increase in Accrued Trade Spend and the mysterious appearance of a Deferred Revenue account (for the first time in the company's history). We believe that by taking on deferred revenue, the company may have aggressively discounted its products to generate cash and pay down debt in Q4, in an effort to bolster the appearance of financial solvency as conveyed by its year-end financial statements. We believe these clues indicate further troubles lie ahead for Boulder.

Boulder's guidance for an increase in its CapEx program puts the company right on the verge of violating a debt covenant that limits its CapEx spend, indicating a high likelihood the company will blind-side investors with a dilutive equity raise. In summary, Boulder has guided for 2013 CapEx to be $27 - 29m. It is impossible for the company to spend this amount without delivering on its cash flow guidance, which we believe an outlandish probability. Should it not, we believe it will be in breach of a financial covenant that limits the company's CapEx spend. The company does not have the resources to deal with an Event of Default, which would likely result in an acceleration of any amounts due. An equity raise would enable the company to pay down a portion of its loan and fully fund its CapEx program; and, a better leverage profile (subsequent to a raise) would allow Boulder to refinance any remaining amount owed to its creditors. A dilutive equity raise appears to be management's only option should it follow through on its CapEx guidance.

Sell-side analysts are still too bullish, with 2013 earnings estimates that have significant room to drop. It appears that analysts rushed to Boulder's defense, potentially without even reviewing the company's annual report. We believe they are more focused on the potential fee pool from a potential equity deal, than on engaging in a deep-dive analysis of Boulder's financial accounts and looking into any of the potentially crippling risk factors we have identified. However, we applaud several analysts for challenging management on the topic of slotting fees for 2013, which are set to rise considerably, and could pressure Boulder's ability to convert its incremental revenue boost into hard profits.

Prescience Point downgrades its target price from $4.00 to $3.00. We believe an analysis of the recent quarterly earnings release, conference call, and annual report validates our thesis that there is more to Boulder than meets the eye; the company appears to be experiencing financial struggles as it contends with increasingly saturated product markets and an increasingly price competitive environment. At the current stock price Boulder continues to trade at an unjustified premium to its food producing peers, indicating that investors have yet to price in the multitude of risk factors likely to lead to a future that looks far different than that conveyed by the sell-side pitch. As discussed, we believe management's ambitious consolidation project and back-half loaded 2013 sales guidance do nothing more than punt future disappoints into the next couple quarters. <u>In the absence of an equity raise, we fear a terminal price target of **zero** as an increasingly possible outcome</u>.