PRESCIENCE POINT
CAPITAL MANAGEMENT

The Middleby Corporation

NASDAQ: MIDD

TARGET PRICE: $26.91

The Middleby Corporation (MIDD) is a debt-fueled roll-up that has used M&A to mask deteriorating organic growth and weak cash flow pre-COVID-19. Consensus expects record profitability and margins in FY 21 despite restaurants permanently closing doors at a record pace, over-levered chains cutting unit growth & capex, and large franchisee groups teetering on bankruptcy. Add a flood of used equipment hitting the market soon and MIDD finds itself in a treacherous downward spiral. As net debt hovers near all-time highs and profits face unprecedented hurdles, MIDD won't be able to acquire itself out of its problems. Shares are down >50% YTD and are likely to get cut in half again.

DATE OF REPORT
04/15/20

SHARE PRICE
$54.00

AVG DAILY VOLUME
1.3M

MARKET CAP
$3.0B

NET DEBT
$1.8B

Prescience Point Research Opinions:

- **Demand for MIDD's equipment enters a vicious downward spiral as purchases disappear & used equipment floods the market:** MIDD had been struggling from lower capex and pushed out projects from its large chain restaurant customers since at least Q3 19. In fact, a few large franchisee groups were flirting with bankruptcy pre-COVID-19. Now, as record numbers of restaurants close permanently (National Restaurant Association estimates it will be at least ~15%) and major chain customers halt unit growth and cut capex, demand is disappearing. Moreover, even in the off-chance restaurants stage a "V" shaped recovery, a flood of lightly used equipment about to enter the market will wreak havoc on pricing and demand for MIDD products.

- **Channel checks reveal commercial foodservice equipment purchases are down as much as 85% and some distributors are trying to put inventory back to MIDD:** In conversations with MIDD's customers/distributors and competitors, we were told foodservice equipment purchase activity was down as much as 85%, a stark contrast to consensus at -8% for FY 20. In addition, a large commercial foodservice distributor and one of MIDD's biggest customers indicated they were working to see how much equipment they could return!

- **Pre-COVID-19 MIDD was able to hide deteriorating organic growth and low-quality M&A with acquisition accounting:** For years, MIDD has been making successively larger but lower quality acquisitions to obfuscate deteriorating and negative organic growth, a classic red flag of desperation. Negative pro forma growth in FY 19 implies revenue from recent targets deteriorated after they were acquired. As demand disappears and leverage hovers near all-time highs, MIDD's debt-fueled roll-up strategy is set to implode.

- **Sell-side expectations for record profit and margins in FY 21 will be impossible to achieve, shares have over 50% downside:** Despite these unprecedented hurdles, consensus still expects MIDD to post record profit and margins in FY 21; this is unachievable. Even if the economy has a "V" shaped recovery, we are doubtful the restaurant industry will fully participate given the damage already done. Moreover, even if restaurant demand sees a "V" shaped recovery, MIDD won't participate in it, as restaurants delay capex, grapple with heavier debt loads and lost revenue, and used equipment sales eat into revenue. Not to mention, margins at MIDD's largest and most profitable business (Commercial Foodservice) have declined for three years in a row. Simply, if MIDD can't expand margins in one of the largest economic expansions on record, how will it do so against the most challenging fundamental backdrop we've ever seen. We value Middleby's shares at $26.91, implying 50% downside.

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Executive Summary

Prescience Point is short The Middleby Corporation (NASDAQ: MIDD) as the Company is a debt-fueled roll-up that has used M&A to mask deteriorating organic growth and weak cash flow pre-COVID-19. Consensus expects record profitability and margins in FY 21 despite restaurants permanently closing doors at a record pace, over-levered chains cutting unit growth & capex, and large franchisee groups teetering on bankruptcy. Add a flood of used equipment hitting the market soon and MIDD finds itself in a treacherous downward spiral. As net debt hovers near all-time highs and profits face unprecedented hurdles, MIDD won't be able to acquire itself out of its problems. Shares are down >50% YTD and are likely to get cut in half again.

Middleby is heavily exposed to quick-and full-service restaurants, retail outlets, and hotel kitchens. The Company generates over two-thirds of its revenue from commercial kitchen and foodservice customers. In addition, the Commercial Foodservice segment is Middleby's most profitable business. The remaining one-third of revenue comes from the sale of residential kitchen equipment and food processing equipment for protein and bakery production.

Middleby is best described as a levered roll-up. Since FY 01, the Company has made more than 90 acquisitions. However, M&A activity started to pick-up dramatically around FY 13, right as organic growth peaked. Since, Middleby began making successively larger but lower quality acquisitions to hide deteriorating and negative organic growth, a classic red flag of desperation. Indeed, cumulative adjusted free cash flow has been negative every year since FY 13 but the Company has been able to use acquisition accounting to flatter metrics. Moreover, Middleby's Commercial Foodservice margins (it's largest and most profitable business) have declined for three consecutive years.

In FY 18, Middleby spent a record ~$1.2 billion on M&A most of which related to the acquisition of Taylor Company for $1.0 billion (3.2x sales), its largest and most expensive acquisition ever. However, negative pro forma growth in FY 19 suggests revenue from these deals (including Taylor) deteriorated after they were acquired by Middleby.

Since at least Q3 19, Middleby has talked about pressure from large restaurant chains lowering capex and pushing out projects. Shelter-in-place restrictions across the US have made the situation so dire, we believe the restaurant industry may be severely impaired. Indeed, the National Restaurant Association estimates at least ~15% of restaurants will close permanently within the next month. Major customers have already made announcements to halt unit growth and curb capex. Not to mention, a few over-levered large franchisee groups were already flirting with bankruptcy pre-virus. Our conversations with Middleby's competitors, customers/distributors, and end-users suggest current equipment sales are down as much as 85% and will likely remain under significant pressure for the remainder of the year. In addition, the record number of bankruptcies will prompt a flood of gently used equipment into the market, exacerbating weakening demand and pricing pressure on equipment manufacturers. In addition, Middleby's historical growth lever, M&A, will be handicapped as the recent record M&A pushed leverage near all-time highs.

Despite these unprecedented hurdles, consensus still expects Middleby to post record profit and margins in FY 21. Simply, we think this is unachievable. Even if the economy has a "V" shaped recovery, we are doubtful the restaurant industry will fully participate given the unprecedented damage already done. Moreover, even if restaurant demand sees a "V" shaped recovery, Middleby won't participate in it, as restaurants delay capex, grapple with heavier debt loads and lost revenue, and used equipment sales eat into revenue. Using more realistic FY 21 EBITDA estimates, we value Middleby's shares at $26.91, implying 50% downside.

Consensus "V" Shaped Recovery with Record Profit & Margins in FY 21 is Implausible

Consensus currently expects FY 20 revenue to decline high-single-digits with a slight rebound in FY 21. In absolute terms, that implies Middleby's FY 21 revenue will be slightly above what it generated in FY 18. These expectations are implausible because even if the economy and the restaurant industry had a "V" shaped recovery in FY 20, Middleby wouldn't participate as restaurants delay capex, grapple with heavier debt loads and lost revenue, and used equipment sales eat into revenue.

Keep in mind, Middleby's customers were already slowing capex and pushing out projects before COVID-19. Several large franchisee groups were also on the brink of bankruptcy pre-COVID-19. We believe the restaurant industry could be severely impaired as at least ~15% of restaurants are expected to close permanently within the next month, which could prove conservative. Even after restrictions are lifted, consumer behavior is likely to change from lingering virus fears (especially for those most at risk) meaning restaurant traffic will remain below pre-virus levels.

Our discussions with industry experts including competitors, distributors, and restaurant operators suggest foodservice equipment sales are currently down well over 50.0% (in some cases as much as 85%) and are expected to remain depressed throughout the year. Moreover, certain distributors discussed exploring the used equipment market for the first time in years as a lot of gently used equipment floods the market due to a record number of restaurant bankruptcies. In short, **the growth outlook for Middleby was bad pre-virus and now it's even worse.**

Revenue Expectations are Too Optimistic

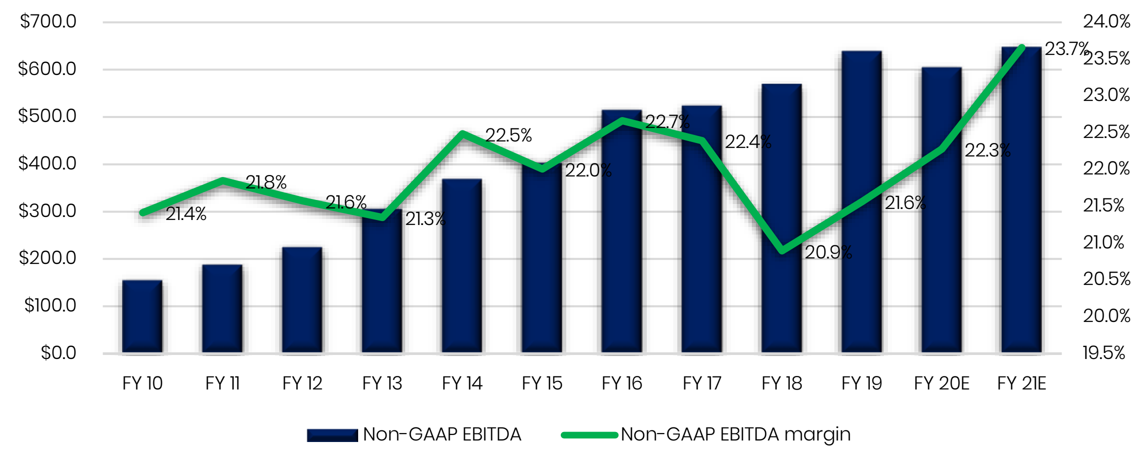
Source: November 2019 Investor Presentation, Consensus estimates

Despite FY 19 EBITDA and EBITDA margin missing expectations, consensus expects FY 20 EBITDA to only be down slightly with margin improvement and FY 21 EBITDA to eclipse FY 19 levels and margin to accelerate at the fastest rate in over a decade (140 basis points) to record profitability. These estimates will be nearly impossible to achieve and anchor on unwarranted optimism about a "V" shaped recovery. Simply, how can

Middleby report record EBITDA and EBITDA margins when at least 15% of restaurants have closed doors permanently and margins in its largest and most profitable business were deteriorating pre-COVID-19?

Record Profitability in FY 21 is Unrealistic

($ in millions)



Source: November 2019 Investor Presentation, Consensus estimates

We present two alternative scenarios to consensus:

- **Base Case:** In our Base Case, we estimate FY 20 revenue will decline ~25.0%, significantly worse than consensus, but slightly better than our due diligence that suggests foodservice equipment sales are currently down more than 50.0% with an estimated FY 20 exit-rate of minus 15.0%. We estimate FY 21 revenue to pick-up slightly with 3.0% growth. Moreover, we estimate FY 20 and FY 21 EBITDA margin to be flat with FY 19 at 21.6%, which is slightly below peak margins from a few years ago.

- **Bear Case:** In our Bear Case, we estimate FY 20 revenue will decline ~33.0% with a slightly larger rebound in FY 21 of 5.0% growth. In addition, we estimate FY 20 EBITDA margin will decline 150 basis points to 20.1%, slightly below trough profitability in FY 18, and FY 21 EBITDA margin will be flat.

Prescience Point Estimates			
(in millions)	FY 19	FY 20E	FY 21E
Consensus			
Revenue	$2,959.4	$2,711.0	$2,735.0
Year-over-year	*8.7%*	*(8.4%)*	*0.9%*
EBITDA margin	21.6%	22.3%	23.7%
EBITDA	$638.2	$604.0	$647.0
Prescience Point Base Case			
Revenue	$2,959.4	$2,231.7	$2,298.7
Year-over-year	*8.7%*	*(24.6%)*	*3.0%*
EBITDA margin	21.6%	21.6%	21.6%
EBITDA	$638.2	$481.3	$495.7
Prescience Point Bear Case			
Revenue	$2,959.4	$2,004.4	$2,064.6
Year-over-year	*8.7%*	*(32.3%)*	*5.0%*
EBITDA margin	21.6%	20.1%	20.1%
EBITDA	$638.2	$402.2	$414.3

Source: Consensus estimates, Prescience Point estimates

Even if The Economy Had a "V" Shaped Recovery, The Restaurant Industry Wouldn't Fully Participate as Stimulus Won't Be Enough and Will Create Unintended Consequences

Government stimulus packages will certainly alleviate some of the near-term cost pressures restaurant owners face but it's not enough to save the industry from undergoing a significant transformation. Specifically:

- **At least ~15% of US restaurants are expected to close permanently:** Discussed herein, almost 15% of US restaurants are expected to close permanently and we anticipate this number to grow in the coming months. In some cases, stimulus measures were maybe too late and/or restaurant owners were operating on too thin of margins. Regardless, stimulus packages may provide restaurant owners/employees money for basic living expenses but it likely won't bring back these restaurants.

- **Most of the revenue loss is permanent:** We agree that there will be some pent-up demand for dining out when shelter-in-place orders are lifted. However, it will only compensate for a fraction of the lost revenue while restaurants were closed.

- **Stimulus packages won't cure virus fears:** Candidly, it doesn't matter how much money the government is willing to hand out, it won't cure COVID-19. Consequently, many consumers, particularly those most at risk, may not dine-out even when shelter-in-place orders are lifted. It's difficult to quantify this risk, but until there is a readily available vaccine and/or widely accepted therapeutic treatments, we believe store traffic will be below pre-virus levels.

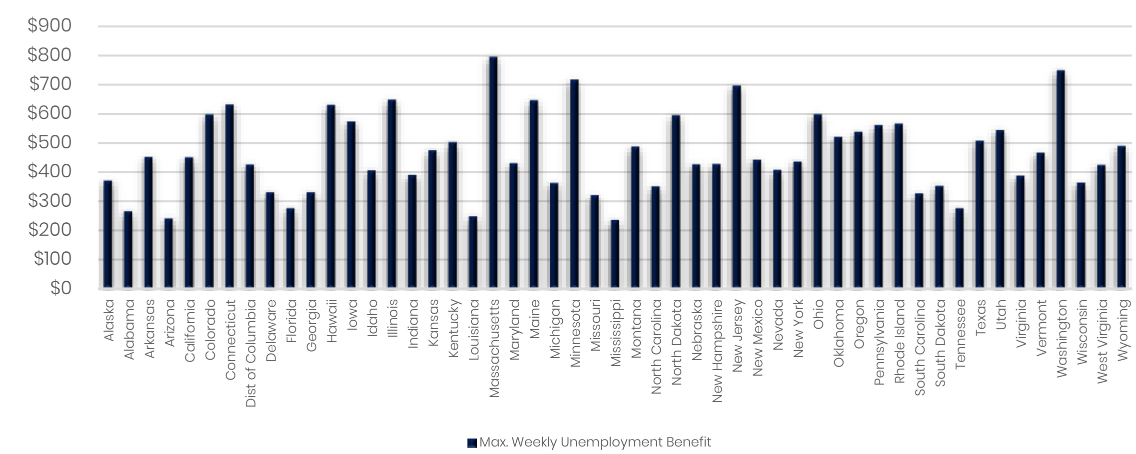
- **Quarantine may alter eating habits:** After weeks of quarantine and cooking meals at-home, we believe there is a real possibility of consumer behavior changes in favor of at-home meals that are healthier and/or cheaper than dining-out.

Collectively, we believe the items above suggest (1) the number of US restaurants will shrink by at least 15%, (2) the restaurants that do survive will broadly be in a worse financial situation than pre-virus due to permanently lost revenue, (3) store traffic will remain below pre-virus levels and may take much longer to ramp-up than expected (i.e. no "V" shaped recovery for restaurant traffic/sales). As a result, restaurants will have to push out capex decisions including expensive remodels and equipment replacements and slow or even indefinitely stop unit growth to shore-up extended balance sheets. All of which pose serious risks to Middleby's core business.

Unintended consequences: Federal unemployment benefit incentivizes hourly workers to not go back to work

In the Coronavirus Aid, Relief, and Economic Security Act ("CARES Act"), under Federal Pandemic Unemployment Compensation ("FPUC"), states will administer an additional $600 weekly payment for individuals who are collecting regular Unemployment Compensation.[1] For context, this equates to an additional $15/hour for a 40-hour work week. The average maximum unemployment benefit across the US is $464/week. So, recently laid-off or furloughed individuals could receive an unemployment benefit as high as $1,064/week ($53,200/year annualized) or $26.60/hour.

Avg. Maximum Unemployment Benefit is Only $464/week, FPUC will Double Paychecks

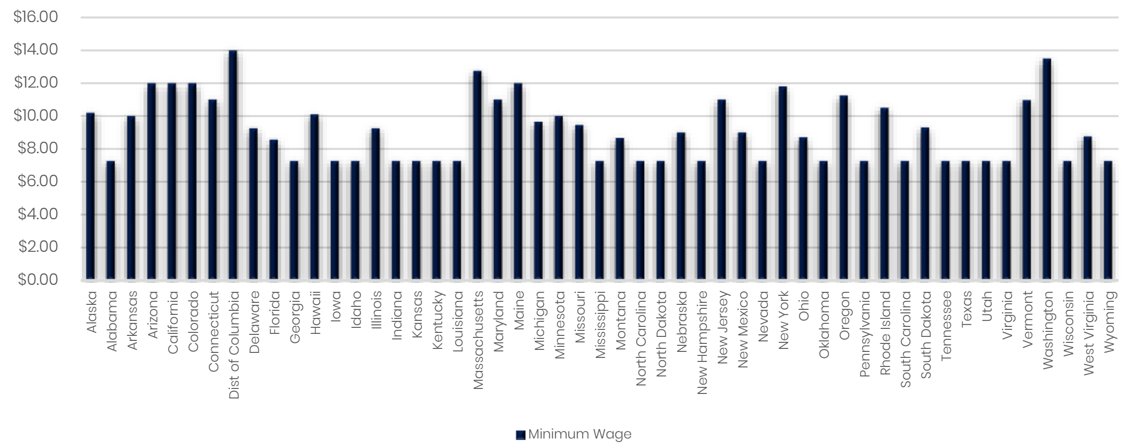


Source: https://fileunemployment.org/unemployment-benefits/unemployment-benefits-comparison-by-state/

Indeed, not all individuals will receive the maximum unemployment benefit. In fact, we estimate most hourly workers will not, as the average minimum wage across the US is only $9.12/hour.

[1] The FPUC benefit payments will end after payments for the last week of unemployment before July 31, 2020.

Avg. Minimum Wage is Only $9.12/hour, FPUC will More Than Double Paychecks of the Lowest Earners



Source: https://www.dol.gov/agencies/whd/mw-consolidated

However, individuals that previously earned less than $15/hour will see their income at least double while on unemployment due to the additional FPUC stimulus. In addition, part-time individuals that earned greater than $26.60/hour but worked less than 40-hours/week could also earn more while on unemployment. Essentially, any individual that earned less than $26.60/hour on average (based on a 40-hour work week) will be making more money on unemployment than if they went back to work.

We believe this is currently an underappreciated but enormous near-term risk for employers that recently had to lay-off or furlough employees. While consensus (and certainly the current Administration) are adamant about a "V" shaped recovery once the economy re-opens, we remain skeptical. While the additional money under FPUC will undoubtedly assist individuals to meet their most basic needs (i.e. food, rent, utilities, etc.), it may actually hinder near-term growth as many hourly-wage individuals are currently incentivized to not go back work.

Consequently, businesses that rely heavily on hourly-wage employees may have incredible difficultly immediately re-hiring previously laid-off or furloughed employees. For purposes of this report, we are specifically focused on the restaurant industry, but the impact will be widespread across industries (e.g. hotels, retail, casinos, gig economy, etc.). Indeed, FPUC has created an unintended catch-22 for operators:

- Open business with inadequate staff levels (if that's possible) = less efficiency, reduced hours, limited offerings, etc.: Restaurants that depend on hourly-wage employees may not be able staff locations appropriately because the new unemployment economics incentivize individuals to not work. Inadequately staffed restaurants may have to reduce hours of operation, limit menu items/offerings, and/or take a host of other growth prohibitive actions to operate understaffed.

- Pay a premium to properly staff restaurant = lower profitability: In order to be appropriately staffed, operators may have to pay an hourly premium to incentivize individuals to come back to work immediately. In the near-term, this would weigh heavily on profitability.

In some cases, we anticipate unit economics will be so poor under either scenario that business operators may not even want to re-open until after the FPUC rolls-off at the end of July. In addition, both scenarios play out negatively even if store traffic returns to pre-virus levels immediately after shelter-in-place orders are lifted. As discussed, we believe that level of traffic is highly unlikely.

Restaurant traffic in China appears weak even after quarantines were lifted

It's not a perfect corollary but looking at China post-quarantine suggests restaurant traffic and general consumer consumption is still under pressure and below pre-virus levels. On 04/04/20, the South China Morning Post ("SCMP") highlighted that even though the lockdown was lifted, shops, bars, and restaurants remained empty in Beijing.

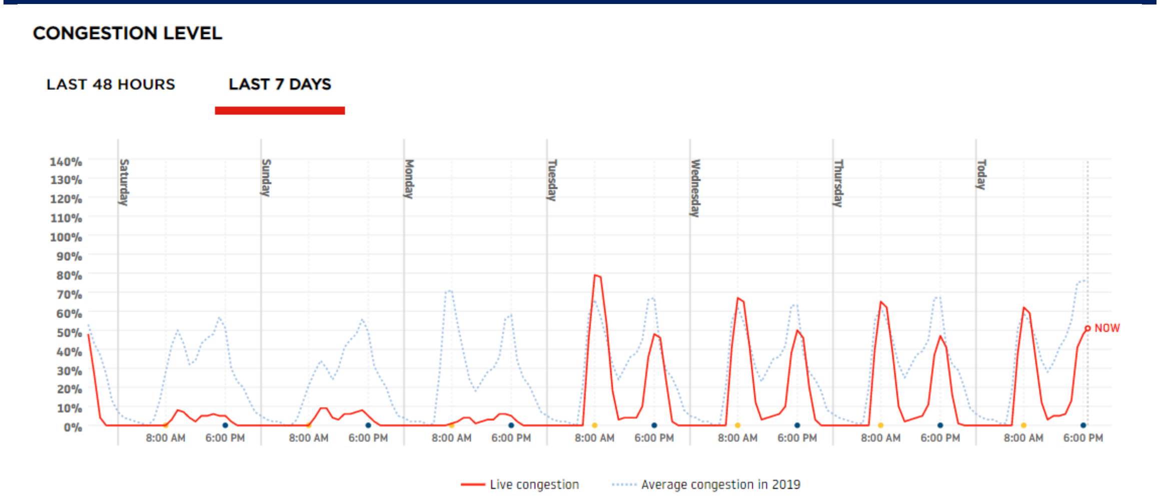
> *Many restaurants, cafes and pubs remained closed in the city, where vigilance remains high about a second wave of infections. Among those that were open, there were few customers to be seen. (South China Morning Post, 04/04/20)*

In addition, it appears there may be change in consumption behavior in favor of home cooked meals to save money.

> *The nearly two month-long lockdown has changed the consumption behavior of Chinese residents, many of whom have turned to home cooking to cut their spending. (South China Morning Post, 04/04/20)*

While SCMP may be anecdotal, real-time Beijing congestion levels appear to corroborate lower consumer activity. As seen below, congestion levels during the week have returned to normal but weekend congestion remains well below 2019 averages, implying people are going to work but still significantly limiting recreational activity.[2]

Beijing Weekend Congestions Levels Have Not Returned to Normal After Quarantine



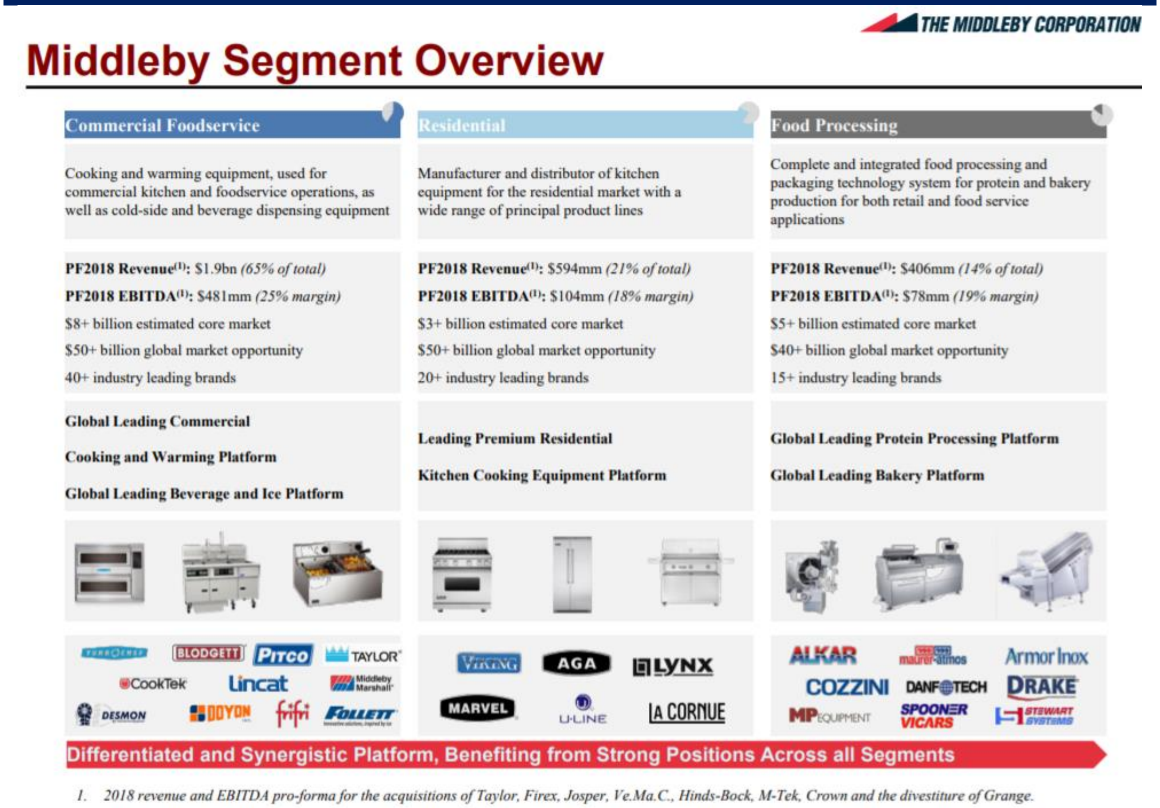
Source: https://www.tomtom.com/en_gb/traffic-index/beijing-traffic/, as of 04/10/20

[2] Monday, April 6th, was a Chinese national holiday.

Restaurant Industry Severely Impaired From COVID-19; Commercial Foodservice Equipment Purchases Down as Much as 85%

Middleby is heavily exposed to quick-and full-service restaurants, retail outlets, and hotel kitchens. The Company generates over two-thirds of its revenue from commercial kitchen and foodservice customers. In addition, the Commercial Foodservice segment is Middleby's most profitable business. The remaining one-third of revenue comes from the sale of residential kitchen equipment and food processing equipment for protein and bakery production.

Sales to Commercial Foodservice Customers Account for 2/3 of Revenue & Have the Highest Margins



Source: June 2019 Investor Presentation

One of Middleby's largest customers said commercial foodservice equipment orders are down as much 85%

During the course of our research, we spoke with several industry experts including Middleby's foodservice equipment competitors, customers/distributors, and franchisee operators that purchase/use Middleby products. Across the board, we were told current purchase activity is down over 50.0% and in some cases as much as 85.0%. Moreover, the current purchase activity is primarily disposables, cold storage (e.g. freezers), and some replacement parts, not cooking and warming equipment (e.g. ovens, fryers, etc.).

> "We are operating at about 15% capacity right now, we're seeing about 15% of normal volumes right now. So, a really really deep hit."

Source: Executive, Commercial Foodservice distributor & Middleby customer

On 03/27/20, the National Restaurant Association ("NRA") published the results of a survey illustrating the dire status of the restaurant industry. The key takeaways are:

- **More than 50% of restaurants are currently closed, at least ~15% expected to close permanently:** 3% of operators have permanently closed their restaurant. Given there are more than 1.0 million restaurant locations in the US, we estimate this equates to ~30,000 restaurants.[3] In addition, another 11% of operators anticipated closing permanently within the next 30 days (i.e. over 100,000 restaurants). 44% of operators have temporarily closed their restaurant.

3% of Restaurants Have Already Closed Permanently with Another 11% Expected within 30 Days

Source: [National Restaurant Association]

We asked an executive at a large commercial foodservice distributor about the NRA's estimates and they replied:

[3] https://www.restaurant.org/research/restaurant-statistics/restaurant-industry-facts-at-a-glance

> "It's going to be a **disaster** for the industry…many customers have already notified us that they will not come out this…[NRA's 15% estimate for permanently closed restaurants] is an extremely optimistic number, I think **it will be significantly more than 15.0%.**"

Source: Executive, Commercial Foodservice distributor

- **Lost revenue will be massive and lead to unprecedented layoffs:** In just the last three weeks of March, aggregate restaurant sales declined by ~50.0% equating to $25.0 billion and more than 3.0 million restaurant employees were laid off.

In the Last Three Weeks of March Restaurants Sales Declined by 50% = $25B in Lost Sales

Source: [National Restaurant Association]

- **Total March sales could be down 60% and April will be even worse:** The NRA estimated total March restaurant sales could be down 60.0% or $45.0 billion. Moreover, April might be worse, and sales could be down over $60.0 billion.

Total March Losses could be $45B & April Losses Could be over $60B

Source: [National Restaurant Association]

The implications of global shelter-in-place restrictions have had devasting and unprecedented consequences on the restaurant industry. In addition, it's exposed the fragility of many over-levered restaurant operators without enough liquidity. Major restaurant chains have balked at rent payments, unit growth plans have been shuttered, and unfortunately, millions of employees have been furloughed or laid off. We don't believe these issues get resolved instantaneously nor will the industry have a "V" shaped recovery once the shelter-in-place orders are lifted. Recall, an estimated ~15.0% of restaurants have already closed permanently, and the final tally could be much higher.

Massive influx of used foodservice equipment will wreak havoc on pricing and demand for new equipment

In addition, we believe there is an underappreciated second derivative effect from record restaurant bankruptcies that will have an immediate and huge negative impact on commercial foodservice equipment volumes and pricing. An executive at one of Middleby's largest customers put it this way:

> "A lot of our customers will go under and you will see a **flood of used equipment** that is relatively new hit the market, there will be a drop in demand for new product and new equipment...We are positioning ourselves to get into the used market...Not only am I **not going to be purchasing from them [Middleby] at the prior levels, but I will start purchasing their [Middleby] products used** from bankrupt and liquidating customers and then resell it at a fraction of the cost."

Source: Executive, Commercial Foodservice distributor & Middleby customer

Major Customers are Halting Unit Growth & Large Over-Levered Franchisee Groups Flirt with Bankruptcy

While Middleby's customer base is highly diversified, it regularly includes a slide highlighting its "Premier" customers in its Investor Presentations. Many of these "Premier" customers have already made announcements about halted unit growth and capex.

MIDD's "Premier" Customers are Heavily Impacted by the Recent Shelter-in-Place Orders

Source: November 2019 Investor Presentation

- **Cheesecake Factory suspends new unit growth and won't pay rent:** In its FY 19 10K, Cheesecake Factory had originally guided for unit growth to accelerate in FY 20 with as many as 20 new restaurants. However, in a Press Release in late March, the Company announced it had curtailed its planned unit growth and was evaluating additional measures to further preserve financial flexibility.

In another Press Release, the Company indicated it was not planning to pay rent on its leases for the month of April.

- **Darden deferring capex including new store openings:** In its Press Release on 04/07/20, Darden announced it was deferring nearly all of its capital spending including opening new restaurants.
- **YUM! Brands allowing US franchisees to defer all capital obligations for remodels/new units:** In its Press Release on 03/25/20, YUM! Brands (i.e. KFC, Pizza Hut, & Taco Bell) announced it was allowing US franchisees to defer all 2020 capital obligations for remodels and new unit development through the end of the year.

These are only a few of many examples. Most of the companies above provided a public COVID-19 business update but some deferred discussing guidance until CY Q1 20 results were reported. As a result, we expect more similar announcements in the coming weeks as public companies start to report results.

Second largest US franchisee defaulted earlier this year (pre-COVID-19) and could file for bankruptcy

NPC International, Inc. ("NPC") is the second largest US franchisee and the largest Pizza Hut and Wendy's franchisee, operating 1,231 Pizza Hut and 392 Wendy's restaurants, with annual revenue of approximately $1.6 billion. In September 2019, Moody's downgraded NPC's corporate family rating to Caa1 from B3 due to continued weak operating performance, persistent cost and margin pressure, high leverage, weak interest coverage with high capex requirements, and pressured liquidity. For the twelve-month period ended 06/25/19, NPC's net debt to EBITDA was over 7.0x.

> *The downgrade of the CFR to Caa1 reflects NPC's continued weak operating performance with persistent cost and margin pressure," stated Adam McLaren, Moody's Senior Analyst. High leverage and weak interest coverage, along with elevated capital expenditure requirements have pressured the company's liquidity. (Moody's Press Release, 09/13/19)*

In February 2020, Bloomberg reported NPC was exploring restructuring options including a bankruptcy filing due to "debt struggles amid relentless competition." Moreover, NPC had recently defaulted on ~$800.0 million of debt after skipping loan payments. It's important to point out that **NPC was struggling pre-COVID-19, its dire situation has only gotten worse**.

> *NPC International Inc. is exploring restructuring options including a bankruptcy filing as the company saddled with $1 billion of debt struggles amid relentless restaurant competition…The operator of about 1,600 restaurants, including Pizza Hut and Wendy's brands, recently defaulted on about $800 million of debt after it chose to skip loan payments. (Bloomberg, 02/19/20)*

Fourth largest US franchisee is over-levered and cutting capex to pay down debt

Carrols Restaurant Group, Inc. ("TAST") is the fourth largest US franchisee and the largest Burger King franchisee. Carrols operates 1,034 Burger King restaurants and 65 Popeyes restaurants. On its Q4 19 Earnings Call, Carrols indicated it was going to "aggressively" reduce capex to generate cash and de-lever the balance sheet. Indeed, Carrol's FY 20 net debt/EBITDA is 6.3x.

> *[We] decided to reset our growth and capital allocation strategy in 2020 to prioritize organic sales and margin improvement within our current restaurant portfolio and to* ***aggressively reduce our capital spending*** *in order to generate free cash flow and de-lever our balance sheet…In total, we expect to*

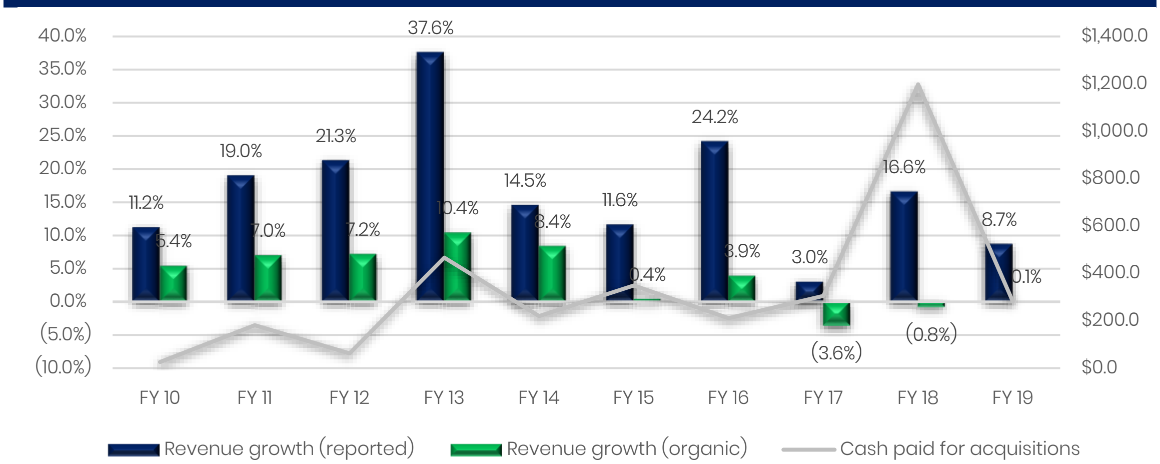
reduce our net capital expenditures in 2020 to approximately $55 million to $65 million. This compares favorably to our net capital expenditures of about $100 million in 2019. (TAST CEO Mr. Daniel T. Accordino, [Q4 19 Earnings Call](), 02/25/20) [emphasis added]

NPC and Carrols are both illustrative and cautionary tales about the dangers of too much leverage on too thin of margins in an increasingly competitive market. It remains to be seen how damaging the shelter-in-place restrictions will be on their respective operations, but it could be disastrous. At a minimum, kitchen upgrades/spending for their stores will be pushed out indefinitely.

M&A Obfuscates Poor Organic Growth & Weak Cash Flow; Roll-Up Strategy Will Be Limited for the Foreseeable Future

Middleby has always been acquisitive. Since FY 01, the Company has made more than 90 acquisitions. However, M&A activity started to pick up dramatically around FY 13 which interestingly coincided with peak organic growth. Since FY 13, organic growth has consistently trended lower while nearly all reported growth came from M&A.

Since FY 13 MIDD Used More M&A to Offset Deteriorating Organic Growth

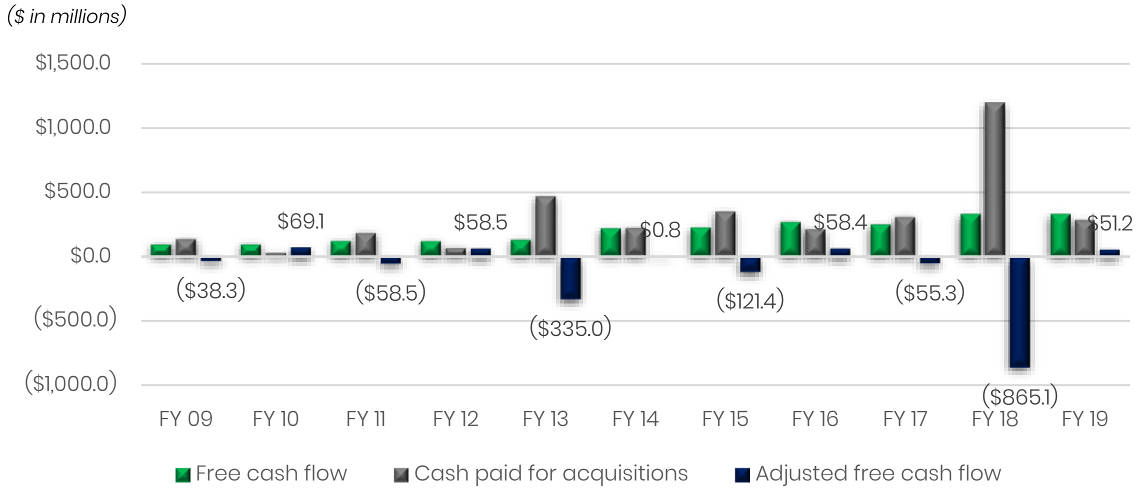


Source: Company 10Ks, 10Qs

In addition, M&A has obfuscated Middleby's true underlying earnings power and free cash flow. Highly acquisitive companies can report flattering cash flow metrics given the inherent nature of acquisition accounting. Working capital (i.e. inventory, receivables, payables, etc.) acquired via M&A is recorded in cash from operations, while the cash paid for the acquisition is reported in cash from investing activities. So, if the target operated with positive working capital (i.e. inventory + receivables > payables), the acquiror's cash from operations would increase without a corresponding cash outflow for the acquired assets. Consequently, these mechanics can provide an unsustainable boost to cash from operations and free cash flow without any improvement in the acquiror's underlying/organic business. As a result, we use adjusted free cash flow to assess a highly acquisitive company's earnings quality and the performance of acquisitions post-integration.[4]

[4] Adjusted free cash flow = cash flow from operations - capital expenditures - cash paid for acquisitions

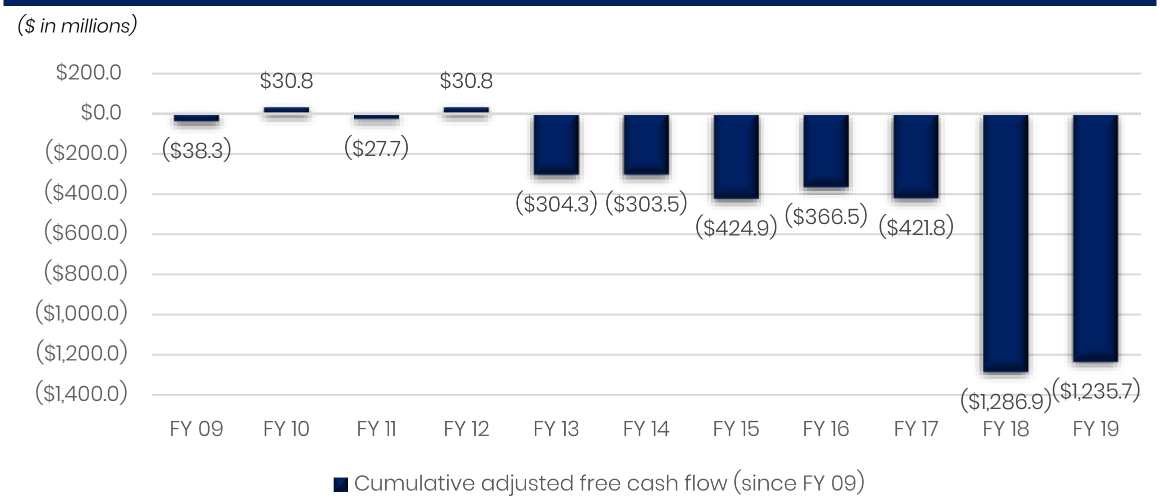
Adjusted Free Cash Flow More Negative Than Positive Implying Poor Cash Conversion from M&A



Source: Company 10K & 10Q filings, Prescience Point calculations

While a large drop in FY 18 adjusted free cash flow would be expected due to the size of the Taylor acquisition, cumulative adjusted free cash flow has been negative since FY 13 and generally became successively more negative each year. At a minimum, we believe earnings quality and cash conversion is much weaker than it appears. Given Middleby does not provide granular detail on post-M&A cash flow, we believe certain acquisitions may (1) have significantly lower cash conversion than Middleby and/or (2) be materially underperforming.

Cumulative Adjusted Free Cash Flow Negative Since FY 13

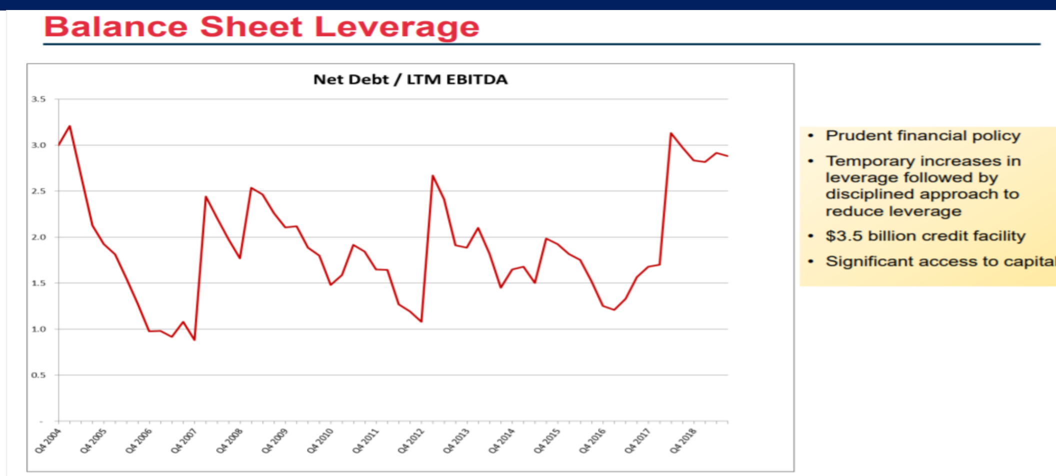


Source: Company 10K & 10Q filings, Prescience Point calculations

Middleby's leverage has ebbed and flowed over the years between 1.0x and 3.0x EBITDA. Historically, the Company would lever-up for M&A and then focus on paying down the debt to repeat the cycle. Middleby's credit facility limits leverage to a maximum of 4.0x, which may be adjusted to 4.5x with certain qualified acquisitions.

> *Satisfy certain financial covenants: (i) a minimum Interest Coverage Ratio (as defined in the Amended Facility) of 3.00 to 1.00 and (ii) a maximum Leverage Ratio of Funded Debt less Unrestricted Cash to Pro Forma EBITDA (each as defined in the Amended Facility) of 4.00 to 1.00, which may be adjusted to 4.50 to 1.00 for a four consecutive fiscal quarter period in connection with certain qualified acquisitions, subject to the terms and conditions contained in the Amended Facility.* ([FY 19 10K])

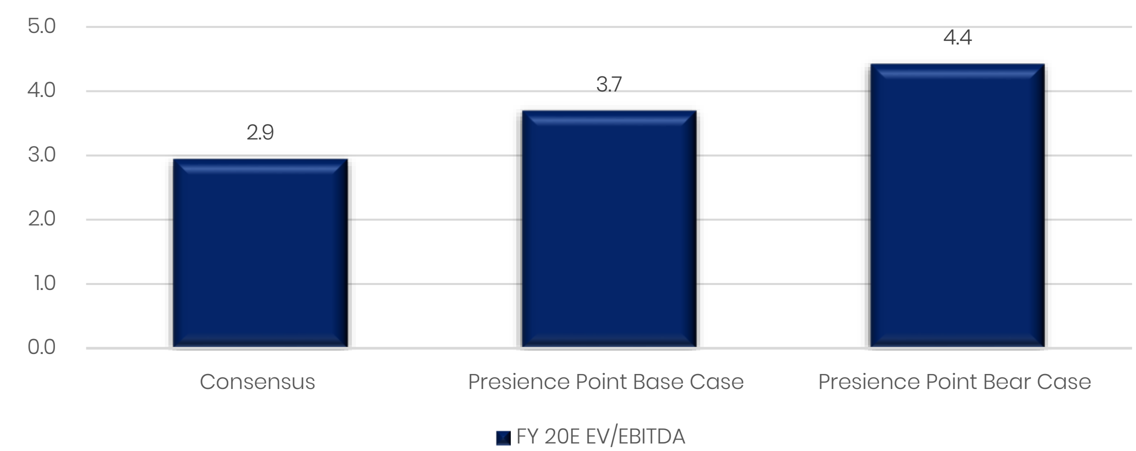
Leverage will Limit/Prevent Large M&A



Source: November 2019 Investor Presentation

While the recent market turmoil could create some attractive acquisition opportunities, we believe Middleby will be somewhat limited in its ability to capitalize on lower multiples. In Q2 18, Middleby made its largest and most expensive acquisition (Taylor Company for $1.0 billion or 3.2x sales) putting it near the top end of its leverage range at nearly 3.0x LTM EBITDA. Moreover, anchoring on LTM EBITDA could materially understate Middleby's true leverage. Our Base Case FY 20 EBITDA estimate implies a leverage ratio of 3.7x and our Bear Case implies a ratio of 4.4x.

Pro Forma Leverage Ratios Near Covenant Thresholds



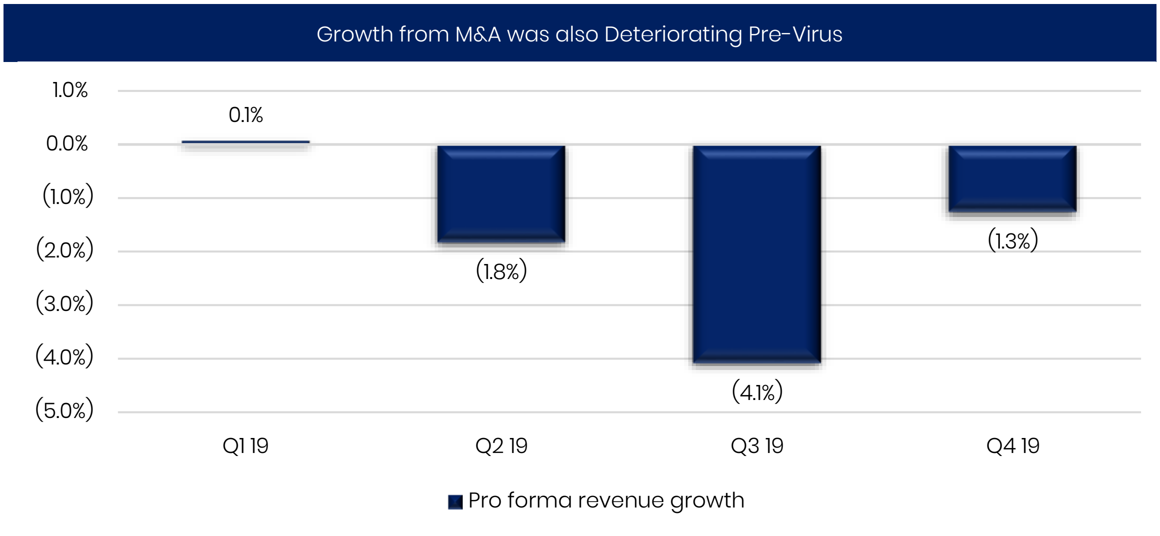
Source: [November 2019 Investor Presentation]

Negative Pro Forma Growth Implies Revenue from M&A Deteriorated Post-Acquisition

Middleby doesn't provide great granularity or specific commentary on acquisition performance once a target has been consolidated. However, buried deep in the footnotes of its 10Qs and 10Ks, Middleby discloses pro forma revenue which we can use to assess aggregate performance of acquired companies. The Company's pro forma results assume acquisitions made in the current and prior year were all completed on the first day of the prior fiscal year. For example, pro forma results for Q3 19 assumed the 2018 acquisitions of Hinds-Bock, Ve.Ma.C, Josper, Firex, Taylor, M-TEK and Crown and the 2019 acquisitions of EVO, Cooking Solutions Group, Powerhouse, Ss Brewtech and Pacproinc were all completed on December 31, 2017 (the first day of FY 18).

> *In accordance with ASC 805 "Business Combinations", the following unaudited pro forma results of operations for the nine months ended September 28, 2019 and September 29, 2018, assumes the 2018 acquisitions of Hinds-Bock, Ve.Ma.C, Josper, Firex, Taylor, M-TEK and Crown and the 2019 acquisitions of EVO, Cooking Solutions Group, Powerhouse, Ss Brewtech and Pacproinc were completed on December 31, 2017 (first day of fiscal year 2018). (Q3 19 10Q)*

The rapid deterioration of pro forma growth throughout FY 19 implies revenue from acquisitions declined post-deal close and raises a red flag about whether Middleby overpaid for recent deals. Recall, the Taylor acquisition in Q2 18 for $1.0 billion was the largest and most expensive at 3.2x sales. At a minimum, we believe aggregate M&A since FY 18 significantly underperformed initial expectations.



Source: Company 10Ks, 10Qs

Commercial Foodservice Customers Were Pushing Out Orders Pre-Virus, Now It Will Only Get Worse

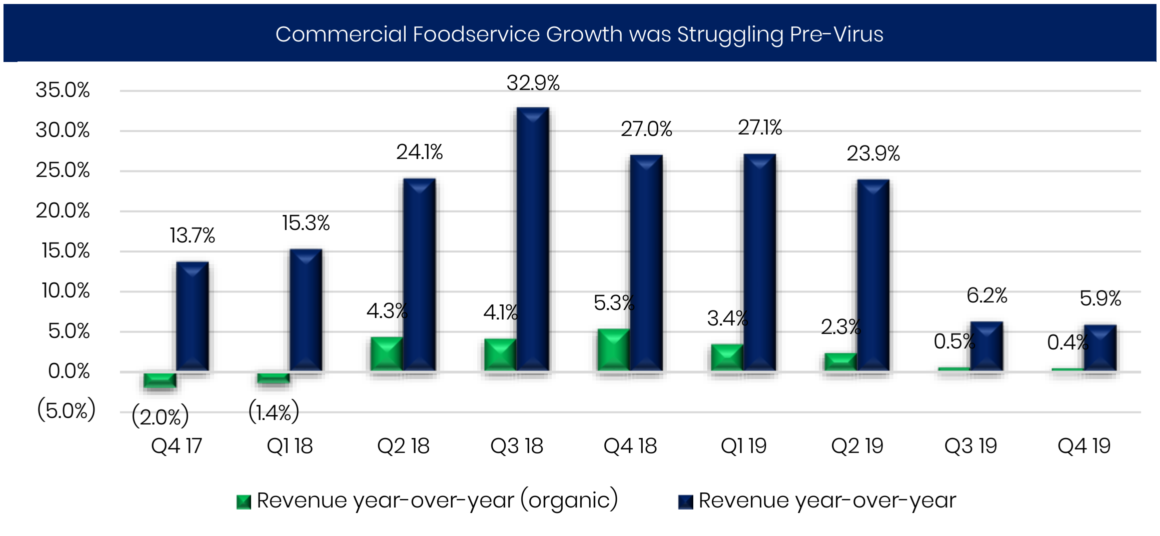
Middleby's reported and organic revenue growth were already significantly slowing before COVID-19. In fact, Middleby talked about rollouts from major restaurant chains failing to materialize as early as Q3 19.

> ***Major rollouts by used restaurant chains are continuing to take longer to materialize**, which is leading to lower-than-expected organic revenue growth. I expect these challenging market conditions to remain in the fourth quarter and could potentially impact Q1 -- we look forward to improving organic revenue performance as we progress through 2020. (CFO Mr. Brian E. Mittelman, Q3 19 Earnings Call, 11/06/19) [emphasis added]*

In Q4 19, Middleby continued to indicate lower spending from its largest restaurant chain customers negatively impacted growth.

> *At our Commercial Foodservice segment, **lower spending across the industry, particularly at our largest restaurant chain customers** continue to impact revenue growth. (CEO Mr. Timothy Fitzgerald, Q4 19 Earnings Call, 02/26/20) [emphasis added]*

Since customer purchase activity was significantly slowing pre-virus, it's hard to believe customer purchases will have a "V" shaped rebound post-crisis. To the contrary, we anticipate remodels, upgrades, and new builds get pushed out even further or cancelled all together as restaurants grapple with less traffic, lower sales, and heavier debt burdens.



Source: Company 10Qs and 10Ks

Recently increased Asia Pacific/China exposure will negatively impact FY 20 results

In Q4 19, Asia accounted for 10.0% of revenue, the highest level since at least 2017. In addition, on its Q3 19 Earnings Call, Middleby highlighted it was "expanding" its China operations with the opening of a new factory that came online in November 2019.

> *We are also expanding our China operations with the opening of a new factory coming online this month. This facility will allow us to increase capabilities and operate at a higher capacity with greater efficiency. We will also be able to deliver product quickly in the region and sharpen our focus on local growth in the Asian region. We'll be adding a number of new products for the local market in 2020 and offering solutions for specific chain customers expanding into the Asian market. (CEO Mr. Timothy FitzGerald, Q3 19 Earnings Call, 11/06/19)*

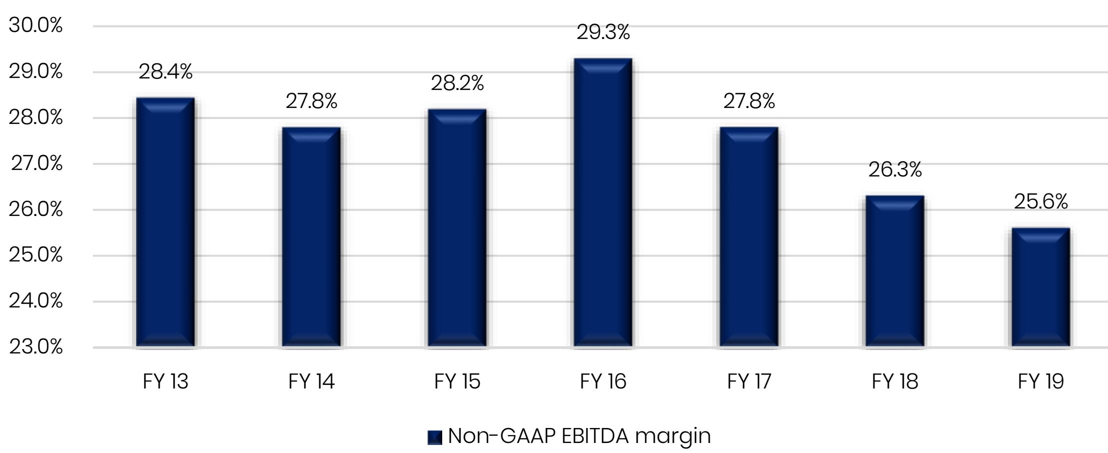
Given much of China was under quarantine during Q1 20, we anticipate the recent expansion will be a headwind to near-term performance. In addition, recent commentary and traffic trends imply the underperformance may persist into at least Q2 20.

Recent Expansion in China May Weight on Near-Term Results

Source: [November 2019 Investor Presentation]

Commercial Foodservice is Middleby's most profitable segment with the highest margins. However, Commercial Foodservice profitability has been steadily deteriorating in each of the last three years. Recall, consensus expects FY 20 and FY 21 EBITDA margin to expand. **If Middleby can't expand Commercial Foodservice margins in one of the biggest economic expansions in history, how will it achieve record profitability when the restaurant industry is facing unprecedented closures and major chains were already pushing out projects pre-virus?**

Commercial Foodservice EBITDA Margin Has Been Deteriorating Since FY 17



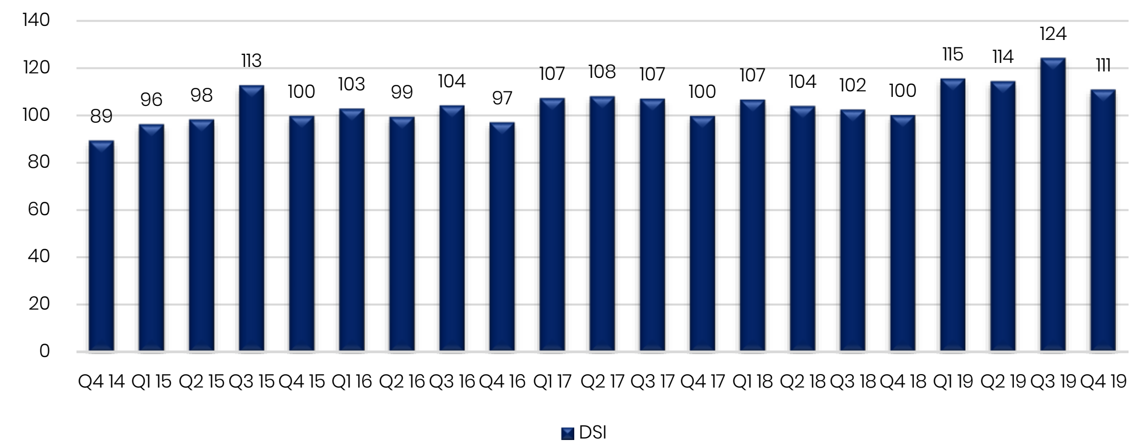
Source: Company 10Qs and 10Ks

Bloated Balance Sheet Inventory an Incremental Headwind to Profitability; Full Channel May Exacerbate Lower Revenue

In Q4 19, DSI increased 10.9% year-over-year to 111 days, well above normal levels. Middleby did not discuss Q4 19 inventory levels but attributed the spike in Q3 19 to (1) purchasing in advance of potential price increases expected from tariffs, (2) building to mitigate risk around fulfilment rates, and (3) lower than anticipated sales.

> *Significant increases in inventory in the first half of the year have negatively impacted cash flows during the nine-month ended September 28, 2019. The increases are attributable to various factors including purchasing in advance of potential price increases expected from tariffs and building to mitigate risk around order fulfillment rates. Inventory levels also have been impacted by lower than anticipated sales levels.* (*Q3 19 10Q*)

DSIs Near Peak Highs



*Source: Prescience Point calculations. DSI = average inventory / COGS * days in the period*

Discussions with Middleby's customers/distributors indicated channels are full, purchase activity will slow going forward, and inventory may get put back to Middleby

We spoke with executives at some of the largest distributors of commercial foodservice equipment in the US including some of Middleby's biggest customers and the takeaways were ominous. One executive estimated that their stocking levels are "normal to slightly above normal right now" but would get "cut in half" over the coming months as restaurants go out of business and halt capex. The executive also indicated their purchase activity going forward would be much slower as demands drops and they keep less stock. In fact, the distributor said they even wanted to **put inventory back to Middleby**.

> "We're cutting our stocking levels in half. As we see demand dropping, we're cutting them in half. And we are working with our suppliers **to see what we can return**. At a bare minimum I can tell you we are not going to be purchasing anything soon…**we have excess inventory levels** and we have to see it go down before we hit that re-order point."

Source: Executive, Commercial Foodservice distributor & Middleby customer

As we discussed earlier, distributors are also exploring the used equipment market for the first time in years as a lot of gently used equipment floods the market due to a record number of restaurant bankruptcies. **Combine Middleby's bloated balance sheet inventory with cuts to distributor inventory levels and increased competition from lower priced used inventory and it's a disaster for demand.**

Valuation: Shares Have 50.0% Downside

Middleby's shares currently trade near the low-end of its peer group range at 7.8x FY 20 EV/EBTIDA and 7.3x FY 21 EV/EBITDA. While its gross margin and adjusted EBITDA margin are in-line with the peer group average, Middleby is less diversified than its peers and is a lot more dependent on restaurants and commercial kitchens. Arguably, two of the most negatively impacted end markets due to shelter-in-place restrictions.

Company Name	Ticker	Share Price	Market Cap.	E/V	FY 19 Gross Margin	FY 19 Adj. EBITDA Margin	EV/EBITDA FY 20E	EV/EBITDA FY 21E	P/E FY 20E	P/E FY 21E
($ in millions, except share price)										
Barnes Group Inc	B	$41.29	$2,051.1	$2,792.0	36.7%	23.0%	9.3x	8.3x	14.2x	12.4x
Colfax Corp	CFX	$23.15	$2,658.3	$4,908.7	42.4%	23.2%	9.2x	8.3x	12.5x	10.7x
Dover Corp	DOV	$87.70	$12,444.5	$15,127.6	36.9%	20.5%	11.6x	10.9x	15.3x	14.1x
Illinois Tool Works Inc.	ITW	$155.92	$48,587.2	$54,368.2	42.0%	27.1%	16.1x	14.6x	23.1x	20.2x
John Bean Technologies Corp	JBT	$79.47	$2,452.6	$3,112.3	30.8%	15.0%	11.4x	10.7x	18x	16.1x
Lincoln Electric Holdings Inc	LECO	$76.61	$4,512.8	$5,061.4	33.4%	15.6%	11.8x	10.7x	17.8x	15.3x
Nordson Corp	NDSN	$144.92	$8,181.8	$9,200.3	54.3%	26.7%	15.5x	14.2x	23.4x	20.7x
Enpro Industries, Inc	NPO	$41.53	$837.9	$1,374.0	33.5%	14.0%	8.9x	7.8x	17.8x	15x
Pentair Plc	PNR	$32.23	$5,294.5	$6,241.1	35.6%	19.9%	11.5x	10.8x	14.1x	12.9x
Wabco Holdings Inc.	WBC	$135.13	$6,898.4	$6,863.2	29.6%	13.5%	14.7x	13.3x	21.2x	22.7x
Welbilt, Inc.	WBT	$4.92	$633.8	$1,907.4	35.7%	18.0%	9.2x	7.9x	17.2x	9.2x
Max			$48,587.2	$54,368.2	54.3%	27.1%	16.1x	14.6x	23.4x	22.7x
Avg.			$8,595.7	$10,086.9	37.3%	19.7%	11.7x	10.7x	17.7x	15.4x
Min			$633.8	$1,374.0	29.6%	13.5%	8.9x	7.8x	12.5x	9.2x
Middleby Corp	MIDD	$54.00	$2,941.5	$4,720.2	37.3%	21.6%	7.8x	7.3x	9x	8.4x

Source: Thomson Reuters

Middleby's EV/EBITDA multiple has contracted significantly but remains above trough levels. We posit the current outlook is as bad as we've ever seen for the restaurant industry. For our Base Case, we used Middleby's current EV/EBITDA multiple. However, for our Bear Case we used a slight discount from current levels as our Bear Case EBITDA would put Middleby in a significantly more precarious debt situation.

EV/EBITDA has Pulled-In but Still Above Trough Levels

Source: Thomson Reuters

We value Middleby based on FY 21 non-GAAP EBITDA. We think this is most appropriate as many investors may give companies a pass on FY 20 given the unprecedented impact from COVID-19. Our two scenarios are:

- **Base Case:** In our Base Case, we estimate FY 20 revenue will decline ~25.0%, significantly worse than consensus, but slightly better than our due diligence that suggests foodservice equipment sales are currently down more than 50.0% with an estimated FY 20 exit-rate of minus 15.0%. We estimate FY 21 revenue to pick-up slightly with 3.0% growth. Moreover, we estimate FY 20 and FY 21 EBITDA margin to be flat with FY 19 at 21.6%, which is slightly below peak margins from a few years ago.

- **Bear Case:** In our Bear Case, we estimate FY 20 revenue will decline ~33.0% with a slightly larger rebound in FY 21 of 5.0% growth. In addition, we estimate FY 20 EBITDA margin will decline 150 basis points to 20.1%, slightly below trough profitability in FY 18, and FY 21 EBITDA margin will be flat.

Base Case & Bear Case Valuation on FY 21 EV/EBITDA			
(in millions, except share price)	Consensus	Base	Bear
FY 21 non-GAAP EBITDA	$647.0	$495.7	$414.3
EV/EBITDA multiple	7.4	7.4	6.5
Enterprise value	$4,786.44	$3,667.12	$2,692.63
Less: debt	($1,873.1)	($1,873.1)	($1,873.1)
Add: cash	$94.5	$94.5	$94.5
Equity value	$3,007.8	$1,888.5	$914.0
Shares outstanding (diluted)	55.7	55.7	55.7
Share price	$54.00	$33.90	$16.41
Current price	$54.00	$54.00	$54.00
Downside risk	--	***(37.2%)***	***(69.6%)***

Source: Consensus estimates, Prescience Point estimates

Based on our probability weighted blended price target, we value Middleby shares at $26.91.

MIDD Shares have 50% Downside	
Base Case price target	$33.90
Probability	60.0%
Bear Case price target	$16.41
Probability	40.0%
Blended price target	$26.91
Current price	$54.00
Downside risk	***(50.2%)***

Source: Prescience Point estimates

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