General Mills (GIS)

Updated May 2nd, 2018 by Aristofanis Papadatos

Key Metrics

Current Price:	$44	**5 Year CAGR Estimate:**	11.0%	**Quality Percentile:**	N/A
Fair Value Price:	$52	**5 Year Growth Estimate:**	3.2%	**Momentum Percentile:**	N/A
% Fair Value:	85%	**5 Year Valuation Multiple Estimate:**	3.3%	**Total Return Percentile:**	N/A
Dividend Yield:	4.5%	**5 Year Price Target**	$61	**Valuation Percentile:**	N/A

Overview & Current Events

General Mills is a packaged food giant, with more than 100 brands and operations in more than 100 countries. It generates 65% of its sales in North America. Since it peaked almost two years ago, General Mills has dramatically underperformed the market, as it has lost 40% whereas S&P has rallied 22%. The main reasons behind the vast underperformance are rising interest rates and the acquisition of Blue Buffalo.

General Mills has paid dividends for 118 consecutive years. Thanks to this exceptional record, most of its shareholders own the stock for its dividend. However, after several years of record-low interest rates, the Fed has begun to aggressively raise them since early last year. Consequently, the dividend of General Mills has become less attractive, as investors can now find decent yields elsewhere.

The other factor that has burdened the stock is the takeover of Blue Buffalo. As General Mills has a market cap of $28 B, its $8 B acquisition represents 31% of its market cap. Consequently, the market is afraid that this takeover will be too large for General Mills to assimilate. Moreover, General Mills will be a different company after such a major acquisition.

The company also greatly disappointed investors in its last earnings report. While it beat the analysts' estimates on both lines, it reduced its EPS guidance for this year from $3.17 to $3.08 due to higher costs of raw materials and higher freight costs. Investors should note that General Mills has failed to meaningfully grow its revenues and earnings in the last five years due to a series of headwinds. As consumers have become more health-conscious lately, they are less attracted by the flagship products of the company. Moreover, competition has greatly heated in breakfast products and yogurt. Furthermore, the large retailers have engaged in a price war and have thus begun to exert pressure on their suppliers for lower prices. All these factors have taken their toll on the margins of the company in recent years.

On the bright side, thanks to the products of Annie's, General Mills has great growth potential in the organic market. In fact, the company expects to surpass the $1 B threshold in organic sales next year. Nevertheless, as this segment generates only 5% of its total sales, it is not sufficient to move the needle in its overall results. However, General Mills has even more promising prospects in the pet food market thanks to its takeover of Blue Buffalo. This $30 B market has grown at a 5% average annual rate in the last decade and has not shown any signs of fatigue. Therefore, it is likely to keep growing for years. Thanks to the strong brand of Blue Buffalo, this acquisition is a great vehicle for General Mills to return to its growth trajectory.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	$1.76	$1.99	$2.30	$2.48	$2.56	$2.69	$2.83	$2.86	$2.92	$3.08	***$3.08***	***$3.61***
DPS	$0.79	$0.86	$0.96	$1.12	$1.22	$1.32	$1.55	$1.67	$1.78	$1.92	***$1.96***	***$2.08***

General Mills has grown its EPS at a 5.8% average annual rate in the last decade but it has decelerated in recent years and has thus grown its EPS at a 2.7% average annual rate in the last five years. Thanks to the growth prospects of Blue Buffalo and the efforts of General Mills to retrieve its yogurt market share, the company is likely to grow its earnings by about 4.0% per year on average over the next five years. However, as the stock will dilute its shareholders by 4% to raise $1 B for its acquisition, its EPS are likely to remain flat next year. Therefore, the company is likely to grow its EPS by about 3.2% per year on average over the next five years.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	16.5	15.2	14.3	14.7	15.1	15.7	17.8	18.6	20.0	20.5	***14.3***	***16.8***
Avg. Yld.	2.7%	2.9%	2.9%	3.1%	3.2%	3.1%	3.1%	3.1%	3.1%	3.0%	***4.5%***	***3.4%***

Thanks to the record-low interest rates that prevailed until 2016, General Mills enjoyed a markedly rich valuation in 2015 and 2016. However, due to the above-mentioned headwinds, the stock has now passed to the other extreme and is trading at a P/E of just 14.3, which is much lower than its 10-year average P/E of 16.8. This equates to a 3.3% annual tailwind from valuation multiple gains if General Mills' valuation mean reverts in this time period.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	25.6%	29.3%	32.8%	31.9%	28.7%	28.4%	27.5%	27.2%	26.8%	25.5%	***23.9%***	***25.0%***
Debt/A	66.1%	69.7%	68.1%	64.6%	67.4%	68.5%	65.5%	75.3%	75.6%	78.5%	***76.0%***	***75.0%***
Int. Cov.	5.3	6.1	7.1	8.0	7.3	9.0	9.8	6.6	8.9	8.7	***8.0***	***8.5***
Payout	44.9%	43.2%	41.7%	45.2%	47.7%	49.1%	54.8%	58.4%	61.0%	62.3%	***63.6%***	***57.6%***
Std. Dev.	17.8%	20.6%	12.5%	12.1%	7.9%	15.8%	11.4%	10.6%	18.9%	15.7%	***18.0%***	***16.0%***

Due to the acquisition of Blue Buffalo, General Mills has announced that it will freeze its current dividend until it reduces its debt load to a more comfortable level. On the other hand, due to the rising interest rates and the resultant plunge of the stock, its dividend yield has climbed to a decade-high level of 4.5%. Moreover, the stock has proved markedly resilient during recessions thanks to the strength of its brands. In the Great Recession, while most companies saw their earnings collapse, General Mills grew its EPS by more than 10% per year from 2007 to 2010.

Final Thoughts & Recommendation

Thanks to its dramatic underperformance, General Mills is now trading at an opportune valuation and is offering a decade-high dividend yield. Therefore, it can offer an 11.0% average annual return over the next five years thanks to 3.2% EPS growth, a 4.5% dividend and a 3.3% annualized gain from P/E expansion. In addition, the company is highly recession resistant and has an exceptionally low stock price standard deviation. General Mills is a buy at current prices for conservative investors looking for a higher yield and double-digit expected total returns.

Total Return Breakdown by Year