



Kellogg (K)

Updated April 30th, 2018 by Josh Arnold

Key Metrics

Current Price: \$59	5 Year CAGR Estimate: 13.7%	Quality Percentile: N/A
Fair Value Price: \$75	5 Year Growth Estimate: 5.2%	Momentum Percentile: N/A
% Fair Value: 79%	5 Year Valuation Multiple Estimate: 4.8%	Total Return Percentile: N/A
Dividend Yield: 3.7%	5 Year Price Target: \$96	Valuation Percentile: N/A

Overview & Current Events

Kellogg was founded in 1906, the beginning of what would become a behemoth in the food processing industry. Kellogg has always focused on breakfast but in recent years, has also expanded to become an enormous snack producer. Its market cap is north of \$20B and it is due to produce more than \$13B in revenue this year.

Kellogg's recent Q4 report was decent as revenue was up almost 4% and comparable earnings were up 5.5%. The company's move out of the direct store delivery model has been lengthy but is beginning to pay off in the form of lower overhead costs, which improves margins. Its snack brands are largely making up for weakness in its core cereal markets, but overall, Kellogg is having difficulty growing. It is combatting this with product innovation, with mixed results.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	\$2.99	\$3.16	\$3.30	\$3.38	\$3.37	\$3.77	\$3.87	\$3.53	\$3.72	\$4.04	\$4.43	\$5.70
DPS	\$1.30	\$1.43	\$1.56	\$1.67	\$1.74	\$1.80	\$1.90	\$1.98	\$2.04	\$2.12	\$2.16	\$2.56

The company's EPS history isn't particularly inspiring as we've seen upward movement, but very slowly. It came out of the Great Recession just as well as it went into it but in the years since, we've seen only gradual improvements in profitability. Revenue growth continues to be a problem, although more recent results have improved thanks to a larger focus on snack foods as well as innovation via product extensions. Finally, Kellogg hasn't been afraid to go out and purchase growth, such as the wildly successful RXBAR acquisition. The company's global reach allows it to extend its successes from one side of the globe to the other, as it has with the Pringles brands. We are therefore forecasting 5.2% annual EPS growth going forward, consisting of low single digit revenue growth, a small tailwind from buybacks as well as some margin improvement from its continued efficiency efforts.

Likewise, we expect the dividend will grow in the low to mid-single digits as Kellogg continues to nurture its reputation as an income stock. Stronger EPS growth should afford it additional space to boost the payout in the coming years.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	17.0	14.5	15.7	15.8	15.3	16.5	16.5	18.7	20.5	17.1	13.3	16.8
Avg. Yld.	2.6%	3.1%	3.0%	3.1%	3.4%	2.9%	3.0%	3.0%	2.7%	3.1%	3.7%	2.7%

Poor investor sentiment has caused Kellogg's P/E multiple to decline significantly of late as it is expected to produce materially higher earnings this year while the stock is at a multi-year low. This has created a situation where the stock looks to be trading well below fair value and as a result, we expect the P/E multiple to rise materially from the current 13.3 to nearly 17 in the years to come. Kellogg's fundamentals have improved over recent years and while it certainly is no growth stock, the current valuation prices in a lot of negative sentiment.

That has also pushed the yield all the way up to 3.7%, which is well in excess of its historical norms. The combination of a rising valuation as well as the slow-growing dividend should produce a much lower yield in five years, more in line with its historical yields in the high 2% range. Kellogg will certainly retain its income stock status but today's yield nearing 4% is rather extraordinary and should be rectified when the valuation returns to more normalized levels.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	41.9%	42.9%	43.1%	39.0%	38.3%	41.3%	34.7%	34.6%	36.5%	38.9%	39.2%	41.0%
Debt/A	87%	80%	82%	85%	84%	77%	81%	86%	87%	86%	86%	86%
Int. Cov.	6.3	6.7	8.2	6.1	6.1	12.1	4.9	4.4	3.3	7.5	8.0	8.5
Payout	43%	45%	47%	49%	48%	47%	49%	56%	54%	52%	49%	45%
Std. Dev.	23.6%	21.1%	9.3%	13.9%	12.3%	13.8%	14.5%	13.7%	13.9%	16.3%	16.0%	15.5%

Kellogg's quality metrics have been very stable for a long time, owed to its business model that moves slowly. Debt financing has remained steady in the high 80% range and we expect that will continue, while rising margins and profitability allow for slightly better interest coverage; Kellogg's financials certainly are not a concern at this juncture. We see the payout ratio declining slightly over time as the dividend's growth is outpaced by EPS growth.

Kellogg's recession performance was very strong, as you'd expect from a highly entrenched consumer staple producer. This company will hold up very well during the next recession and the ones that follow. Its competitive advantages include enormous consumer brands with sizable followings and big market shares in addition to its very efficient global distribution network. Its massive reach allows for extending products across borders with ease to expand upon the proven success of winners and its innovation labs continue to produce unique new products. Kellogg is not just a cereal company any longer; it is a truly global powerhouse in the food industry.

Final Thoughts & Recommendation

Kellogg looks like a very compelling buy here. The stock is trading well under fair value and we are forecasting total annual returns of 13.7% going forward. Kellogg will achieve these returns via the current 3.7% yield, a 4.8% tailwind from a higher valuation and 5.2% EPS growth. Kellogg represents a unique combination of a very high current yield, decent growth prospects and an exceedingly cheap valuation by historical standards. Additionally, the company exists in an extremely slow changing industry and is remarkable for its stability. Kellogg today is a rare lower risk, higher reward investment.

Total Return Breakdown by Year

