Lancaster Colony Corporation (LANC)

Updated August 25th, 2018 by Josh Arnold

Key Metrics

Current Price:	$154	**5 Year CAGR Estimate:**	-2.8%	**Volatility Percentile:**	27.3%
Fair Value Price:	$105	**5 Year Growth Estimate:**	3.1%	**Momentum Percentile:**	79.2%
% Fair Value:	147%	**5 Year Valuation Multiple Estimate:**	-7.5%	**Valuation Percentile:**	6.6%
Dividend Yield:	1.6%	**5 Year Price Target**	$122	**Total Return Percentile:**	2.1%

Overview & Current Events

Lancaster Colony has been making food products since 1969 after shifting away from housewares. The move has afforded the company some meaningful growth in the past five decades and the stock sports a $4.2 billion market capitalization today on $1.3 billion in annual revenue as a result. Lancaster Colony makes various meal accessories like croutons and bread products in frozen and non-frozen categories.

Lancaster Colony reported Q4 earnings on 8/23/18 and results were strong. Total sales increased 6% to a record $308 million on strong foodservice sales. That segment saw growth of nearly 12%, driven by higher pricing and promotions the company ran with national restaurant chain customers. The retail business was up less than 2%, continuing a years-long trend for that segment. Gross profits were up only 5% against a 12% gain in revenue as Lancaster Colony continues to struggle with freight and input costs. Indeed, we've reduced our estimates for gross margins for 2019 and beyond as a result. Consolidated operating margin fell 80bps in Q4 as lower gross margins weighed. In total, higher sales helped push earnings-per-share up from $1.04 to $1.18.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	$3.18	$4.07	$3.84	$3.51	$3.99	$3.69	$3.72	$4.44	$4.20	$4.92	***$5.15***	***$6.00***
DPS	$1.14	$1.19	$1.29	$1.41	$1.52	$1.72	$1.82	$1.96	$2.15	$2.30	***$2.40***	***$2.90***
Shares	28.5	28.1	28.2	27.4	27.3	27.3	27.3	27.4	27.4	27.5	***27.5***	***27.8***

The company's earnings-per-share growth has been spotty as its revenue tends to ebb and flow with restaurant traffic. It recovered nicely from the Great Recession but the cut to 2008 earnings was very steep. In addition, declines in earnings-per-share are common and thus, the multiple that should be assigned should reflect that risk going forward.

We are forecasting 3.1% earnings-per-share growth annually going forward, comprised of low single digit sales and flat margins. Lancaster Colony does not buy back stock. The company's average revenue growth has been and should remain in the low single digits, but keep in mind the possibility for earnings volatility going forward - there will be years where it dips and other years where it may rise rapidly, as it did in 2018. Organic growth has been a problem for Lancaster Colony, but it does complete sizable acquisitions regularly. Recent results suggest organic growth will continue to be a struggle. Q4's results in the foodservice segment are atypical and thus, we are not changing our outlook as a result.

We are forecasting 4% dividend growth annually for the next five years as Lancaster Colony continues its impressive streak of payouts to shareholders; the payout should approach $3 per share during the next five years.

Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	11.8	12.8	14.2	18.6	18.6	23.5	24.5	24.3	31.2	31.4	***29.9***	***20.3***
Avg. Yld.	3.0%	2.3%	2.4%	2.2%	2.0%	2.0%	2.0%	1.8%	1.6%	1.7%	***1.6%***	***2.4%***

Lancaster Colony's price-to-earnings ratio was in excess of 31 last year and it is only slightly lower than that today at 29.9. We are forecasting a 7.5% headwind to total returns over the next five years as the valuation should come back in line with historical norms around 20; the stock looks significantly overvalued today.

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

Due to a forecast decline in the valuation and thus, the stock price, we are expecting the yield to climb back to more normalized levels at 2.4%. The stock's dividend yield was nearly cut in half from 2009 to 2017 due to a huge rally in the stock, but that situation should be rectified by a declining multiple and rising payout in the coming years.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
GP/A	20.5%	25.6%	22.2%	19.7%	21.0%	23.9%	23.3%	25.2%	26.5%	24.8%	***25.0%***	***25.0%***
Debt/A	19%	17%	17%	17%	19%	17%	17%	19%	20%	20%	***20%***	***18%***
Int. Cov.	113	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	***N/A***	***N/A***
Payout	67%	36%	29%	34%	40%	38%	47%	49%	44%	47%	***47%***	***48%***
Std. Dev.	32.3%	19.3%	29.5%	16.7%	17.9%	20.1%	18.4%	23.0%	23.5%	23.5%	***23.5%***	***23.5%***

Lancaster Colony's quality metrics are outstanding. It hasn't had any debt to speak of since 2009 apart from trade payables, which amount to about 20% of its total assets; we expect this will continue. Gross margins should remain roughly flat as rising freight costs are combated by pricing increases and non-freight cost savings.

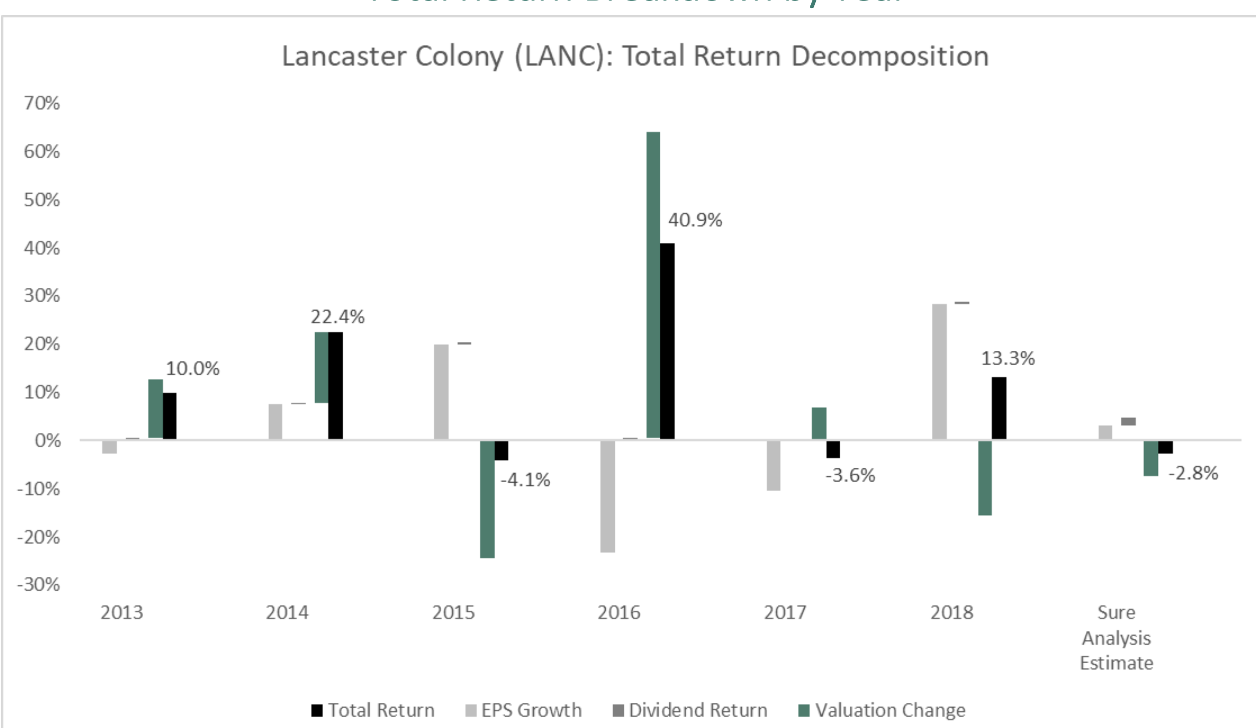
Lancaster Colony's payout should remain where it is today at 47% of earnings as dividend growth outpaces earnings growth. Given its Dividend King status, we know the payout is important to management; its dividend is very safe.

Lancaster Colony's competitive advantage is in its leadership position within the niche categories in which it competes. The company goes after accessory categories like bread, dressings and croutons where competition tends to be lighter. It also has strong distribution partnerships with companies like Wal-Mart and McLane Company, a major restaurant distributor. Its recession performance track record is spotty because it is reliant upon restaurant traffic, something that suffers mightily during times of economic stress. This can be seen in its trough 2008 earnings-per-share number.

Final Thoughts & Recommendation

We expect Lancaster Colony to provide shareholders with total annualized returns of -2.8% over the next five years. This will be comprised of 3.1% earnings-per-share growth, the 1.6% current yield and a 7.5% headwind from the valuation reset. The company is very unattractive here as it is well in excess of fair value. Investors seeking income should wait for a better price with a higher yield, and those seeking growth or value should simply look elsewhere; we rate it a sell.

Total Return Breakdown by Year



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