



General Mills (GIS)

Updated September 19th, 2018 by Aristofanis Papadatos

Key Metrics

Current Price: \$44	5 Year CAGR Estimate: 11.0%	Volatility Percentile: 32.6%
Fair Value Price: \$52	5 Year Growth Estimate: 3.2%	Momentum Percentile: 6.3%
% Fair Value: 85%	5 Year Valuation Multiple Estimate: 3.3%	Valuation Percentile: 83.7%
Dividend Yield: 4.5%	5 Year Price Target: \$60	Total Return Percentile: 73.7%

Overview & Current Events

General Mills is a packaged food giant, with more than 100 brands and operations in more than 100 countries. Since it peaked two years ago, General Mills has dramatically underperformed the market, as it has lost 39% whereas S&P has rallied 36%. The main reasons behind this are rising interest rates, the acquisition of Blue Buffalo and the lackluster business performance of the company.

General Mills has not cut its dividend for 118 consecutive years. Thanks to this record, most of its shareholders own the stock for its dividend. However, now that interest rates are on the rise, the dividend of General Mills has become less attractive. The stock has also been burdened by its takeover of Blue Buffalo. As General Mills has a market cap of \$28 billion, its \$8 billion acquisition represents 29% of its market cap. The market is afraid that management does not see promising prospects in the core business of the company while the takeover may prove too large to assimilate.

General Mills has been facing some major challenges in recent years. As consumers have become more health-conscious, the company has failed to grow the sales of its flagship products. Moreover, competition has greatly heated in breakfast products and yogurt while large retailers have been pressuring their food suppliers for lower prices. As a result, General Mills has failed to meaningfully grow its revenues and earnings in the last five years.

General Mills reported its financial results for the first quarter of fiscal 2019 yesterday. The company grew its sales 9% thanks to the acquisition of Blue Buffalo but its organic sales remained flat. Its gross margin shrank from 35.2% to 33.6% mostly due to a charge related to the acquisition of Blue Buffalo, but also due to input cost inflation. General Mills enjoyed a steep decrease in its tax rate, from 30.4% to 22.6%, but its interest expense almost doubled, from \$72 million to \$134 million, due to the major acquisition. Overall, without the steep decrease in the tax rate and the growth of Blue Buffalo, the results would have been dismal. As a result, the stock plunged 8% after the earnings release.

On the bright side, management continues to expect double-digit top and bottom-line growth for Blue Buffalo. The \$30 billion pet food market has grown at a 5% average annual rate in the last decade and has not shown any signs of fatigue. In addition, the yogurt segment, which suffered last year, continues to improve its performance. In the last four quarters, its sales have decreased by 11%, 8%, 5% and 2%, respectively, thus showing signs of stabilization.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	\$1.99	\$2.30	\$2.48	\$2.56	\$2.69	\$2.83	\$2.86	\$2.92	\$3.08	\$3.11	\$3.05	\$3.57
DPS	\$0.86	\$0.96	\$1.12	\$1.22	\$1.32	\$1.55	\$1.67	\$1.78	\$1.92	\$1.96	\$1.96	\$2.08

General Mills has grown its earnings-per-share at a 5.1% average annual rate in the last decade but it has decelerated in recent years and has thus grown its earnings per share at a 2.9% average annual rate in the last five years. Thanks to the growth prospects of Blue Buffalo and the improving outlook of the yogurt segment, we continue to expect approximate 3.2% annual earnings-per share growth until 2024. For fiscal 2019 we have lowered our estimate by 2% due to the poor performance in Q1.

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.

Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	15.2	14.3	14.7	15.1	15.7	17.8	18.6	20.0	20.5	17.0	14.4	16.9
Avg. Yld.	2.9%	2.9%	3.1%	3.2%	3.1%	3.1%	3.1%	3.1%	3.0%	3.7%	4.5%	3.5%

Due to the above-mentioned headwinds, General Mills is trading at a price-to-earnings ratio of 14.4, which is much lower than its 10-year average price-to-earnings ratio of 16.9. As the company is likely to recover in the next five years, the stock is likely to revert to its average valuation level and thus enjoy a 3.3% annual tailwind during this period.

Safety, Quality, Competitive Advantage, & Recession Resiliency

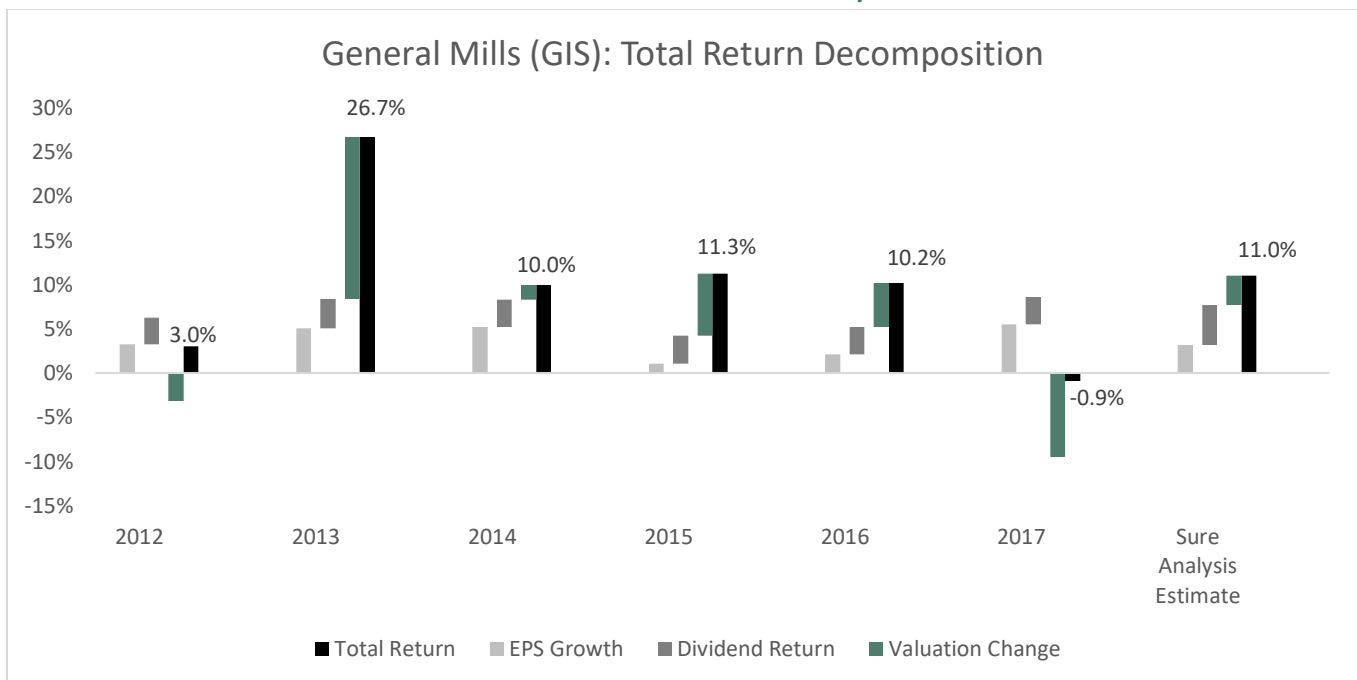
Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
GP/A	29.3%	32.8%	31.9%	28.7%	28.4%	27.5%	27.2%	26.8%	25.5%	24.4%	18.0%	25.0%
Debt/A	69.7%	68.1%	64.6%	67.4%	68.5%	65.5%	75.3%	75.6%	78.5%	79.9%	80.0%	75.0%
Int. Cov.	6.1	7.1	8.0	7.3	9.0	9.8	6.6	8.9	8.7	6.9	5.5	8.0
Payout	43.2%	41.7%	45.2%	47.7%	49.1%	54.8%	58.4%	61.0%	62.3%	63.0%	64.3%	58.3%
Std. Dev.	20.6%	12.5%	12.1%	7.9%	15.8%	11.4%	10.6%	18.9%	15.7%	18.0%	17.0%	16.0%

Due to the acquisition of Blue Buffalo, General Mills has frozen its dividend until it reduces its debt load to a more comfortable level. The stock has proved 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 earnings per share by more than 10% per year from 2007 to 2010. The company is likely to outperform during future economic downturns.

Final Thoughts & Recommendation

Thanks to its dramatic underperformance, General Mills is now trading at an opportune valuation and is offering an almost decade-high dividend yield. The stock 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. 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



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