



The Kraft-Heinz Company (KHC)

Updated November 2nd, 2018 by Jonathan Weber

Key Metrics

Current Price:	\$56	5 Year CAGR Estimate:	9.5%	Volatility Percentile:	22.0%
Fair Value Price:	\$60	5 Year Growth Estimate:	3.3%	Momentum Percentile:	6.4%
% Fair Value:	93%	5 Year Valuation Multiple Estimate:	1.4%	Growth Percentile:	16.4%
Dividend Yield:	4.5%	5 Year Price Target	\$71	Valuation Percentile:	77.3%
Dividend Risk Score:	B	Retirement Suitability Score:	B	Total Return Percentile:	65.1%

Overview & Current Events

Kraft-Heinz is a processed food and beverages company whose product portfolio includes condiments, sauces, cheese & dairy, frozen & chilled meals, and infant diet & nutrition. The company was created in 2015 in a merger between Kraft Food Group and H. J. Heinz Company. Kraft-Heinz is headquartered in Chicago, IL, and is currently valued at \$68 billion.

Kraft-Heinz reported its third quarter earnings results on November 1. The company generated revenues of \$6.4 billion, an increase of 1.6% compared to the prior year's quarter. Management has stated that the top line turnaround was possible thanks to higher sales volumes and a shift in its product mix to higher-priced goods. Margins were under pressure due to supply chain inflation and higher wages. Earnings-per-share came in at \$0.78 for the quarter, a decline of 6% year-over-year. Kraft-Heinz generated EBITDA of \$1.62 billion during Q3, which compares favorably to \$330 million in interest expenses and \$630 million in quarterly dividend payments. During the first two quarters of 2018 Kraft-Heinz' dividend was not covered by free cash flows, which totaled \$1.21 billion (including sales of receivables), whereas dividend payments totaled \$1.26 billion during that time frame. Kraft-Heinz' weak cash generation was founded on a built-up of trade receivables over the coming quarters. It is unlikely that this trend will continue forever, which is why cash flows will likely be stronger going forward.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	-	-	-	-	-	-	-	\$2.19	\$3.33	\$3.55	\$3.75	\$4.41
DPS	-	-	-	-	-	-	-	\$1.13	\$2.35	\$2.45	\$2.55	\$3.05
Shares	-	-	-	-	-	-	-	1210	1226	1228	1230	1230

The Kraft-Heinz Company does not have a long history in the form it currently exists in, which is why we are not able to provide much data. The two companies that merged to create Kraft-Heinz both have a long history, though. As a food and beverages company, Kraft-Heinz is not operating in a high-growth industry. The company therefore will, in all likelihood, not be able to generate enormous growth rates going forward. Even in a low-growth industry companies can generate solid returns, though. In Kraft-Heinz' case there are several avenues for growth the company can pursue.

The first is international expansion. Market penetration in many emerging countries is not high. These markets are huge and growing relatively quickly. Due to steadily rising disposable incomes in countries such as China and India, more consumers have the means to purchase consumer goods from Western companies such as Kraft-Heinz.

Another factor for earnings growth is margin expansion. Kraft-Heinz' management is experienced in cutting costs. Kraft-Heinz is headed by Bernardo Hees and Alex Behring, two 3G Capital managers that are famous for their cost-cutting expertise. Kraft-Heinz should be able to generate some additional margin growth over the coming years.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	-	-	-	-	-	-	-	18.5	24.9	24.2	14.9	16.0
Avg. Yld.	-	-	-	-	-	-	-	2.8%	2.8%	2.9%	4.5%	4.2%

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Kraft-Heinz' shares trade at marginally below 15 times this year's expected net earnings. We believe that shares are slightly undervalued right here. Shares of Kraft-Heinz should not trade at a high-teens or higher valuation, though, the high multiples during 2015-2017 were primarily driven by the fact that interest rates were very low, which resulted in a lot of demand for dividend-paying stocks. This will normalize as interest rates increase.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	-	-	-	-	-	-	-	4.7%	8.0%	8.1%	9.0%	11.0%
Debt/A	-	-	-	-	-	-	-	52.8%	52.5%	45.0%	42.0%	40.0%
Int. Cov.	-	-	-	-	-	-	-	1.8	5.4	5.5	6.0	7.0
Payout	-	-	-	-	-	-	-	51.6%	70.6%	69.1%	68.0%	69.2%
Std. Dev.	-	-	-	-	-	-	-	18.2%	13.6%	13.5%	17.0%	16.0%

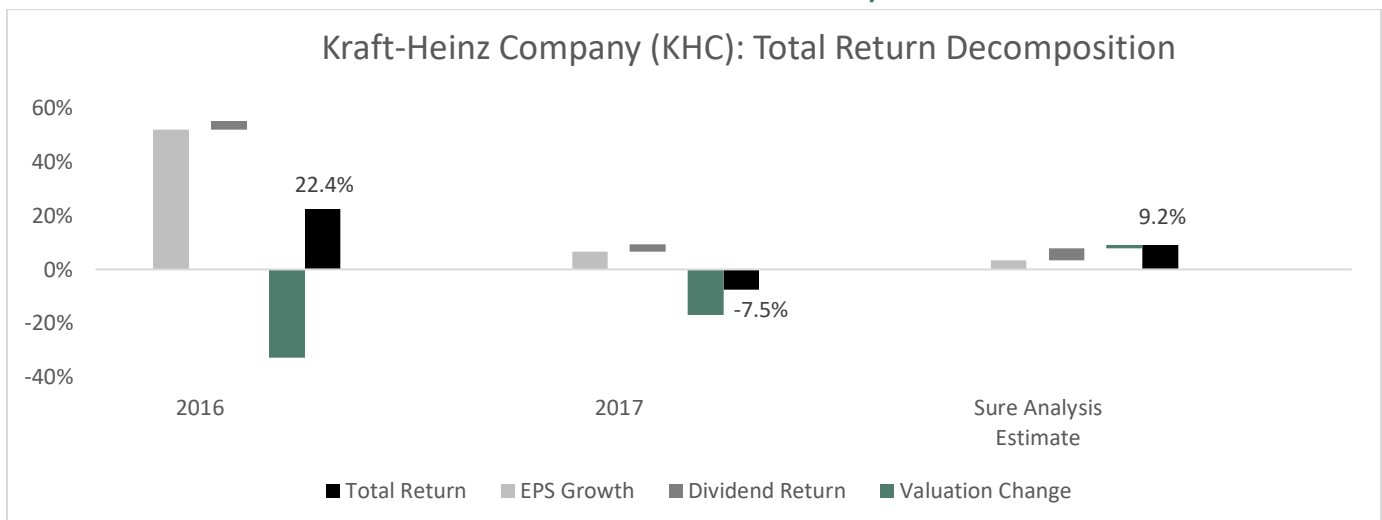
Kraft-Heinz has a large asset base, although most of those assets do not consist of material items like plants, buildings and machines, but of intangible assets and goodwill. These two items make up \$103 billion of the company's \$120 billion in assets. Their size can be explained by the fact that the company was recently established in a huge merger. When we adjust for these two items, Kraft-Heinz' gross profits to tangible assets ratio is very compelling, at roughly 53%.

Kraft-Heinz' balance sheet holds a sizeable amount of debt, but due to a solid interest coverage ratio and a non-cyclical business the company is not overleveraged. Kraft-Heinz should reduce its debt levels going forward, as higher interest rates make refinancing more expensive. Kraft-Heinz' brands are strong and recognized by most consumers, and demand for its products is not cyclical or dependent on economic conditions. Kraft-Heinz therefore should be able to remain profitable in economic downturns, as do most consumer staples. The brands function as competitive advantages.

Final Thoughts & Recommendation

Kraft-Heinz is not active in a cyclical industry. The company has managed to produce higher revenues during Q3, despite currency headwinds. Cash generation at Kraft-Heinz is not strong, which is primarily due to an increase in the company's working capital. We believe that this is only temporary, and that cash flows should therefore grow going forward, to fall more in line with the net profits that Kraft-Heinz earns. Kraft-Heinz could produce solid total returns going forward, which is why shares are a buy for those that seek exposure to the space and that are not afraid of the debt levels.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Revenue	N/A	N/A	N/A	N/A	18271	18218	18205	18338	26487	26232
Gross Profit	N/A	N/A	N/A	N/A	5772	6823	4845	5761	9586	9703
Gross Margin	N/A	N/A	N/A	N/A	31.6%	37.5%	26.6%	31.4%	36.2%	37.0%
SG&A Exp.	N/A	N/A	N/A	N/A	2961	2124	2956	3122	3444	2930
D&A Exp.	N/A	N/A	N/A	N/A	428	393	385	740	1337	1036
Operating Profit	N/A	N/A	N/A	N/A	2811	4699	1889	2639	6142	6773
Operating Margin	N/A	N/A	N/A	N/A	15.4%	25.8%	10.4%	14.4%	23.2%	25.8%
Net Profit	N/A	N/A	N/A	N/A	1642	2715	1043	634	3632	10999
Net Margin	N/A	N/A	N/A	N/A	9.0%	14.9%	5.7%	3.5%	13.7%	41.9%
Free Cash Flow	N/A	N/A	N/A	N/A	2595	1486	1485	624	1402	-690
Income Tax	N/A	N/A	N/A	N/A	811	1375	363	366	1381	-5460

Balance Sheet Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Total Assets (\$B)	N/A	N/A	N/A	N/A	23.18	23.15	22.95	122.97	120.48	120.23
Cash & Equivalents	N/A	N/A	N/A	N/A	1255	1686	1293	4837	4204	1629
Accounts Receivable	N/A	N/A	N/A	N/A	1117	1074	1101	903	789	944
Inventories	N/A	N/A	N/A	N/A	1928	1616	1775	2618	2684	2815
Goodwill & Int. (\$B)	N/A	N/A	N/A	N/A	13.83	13.73	13.64	105.17	103.42	104.27
Total Liabilities	N/A	N/A	N/A	N/A	19607	17961	18582	65080	62906	53991
Accounts Payable	N/A	N/A	N/A	N/A	1556	1548	1537	2844	3996	4449
Long-Term Debt	N/A	N/A	N/A	N/A	9966	9980	10032	25234	32404	31536
Shareholder's Equity	N/A	N/A	N/A	N/A	3572	5187	4365	57685	57358	66034
D/E Ratio	N/A	N/A	N/A	N/A	2.79	1.92	2.30	0.44	0.56	0.48

Profitability & Per Share Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Return on Assets	N/A	N/A	N/A	N/A	7.3%	11.7%	4.5%	0.9%	3.0%	9.1%
Return on Equity	N/A	N/A	N/A	N/A	16.3%	62.0%	21.8%	2.0%	6.3%	17.8%
ROIC	N/A	N/A	N/A	N/A	10.9%	18.9%	7.1%	1.3%	4.2%	11.7%
Shares Out.	N/A	N/A	N/A	N/A	596	599	598	1210	1226	1228
Revenue/Share	N/A	N/A	N/A	N/A	30.66	30.41	30.44	23.33	21.60	21.36
FCF/Share	N/A	N/A	N/A	N/A	4.35	2.48	2.48	0.79	1.14	-0.56

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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