



Hormel Foods Corporation (HRL)

Updated February 23rd, 2019 by Josh Arnold

Key Metrics

Current Price:	\$43	5 Year CAGR Estimate:	2.0%	Volatility Percentile:	37.8%
Fair Value Price:	\$33	5 Year Growth Estimate:	5.0%	Momentum Percentile:	91.8%
% Fair Value:	130%	5 Year Valuation Multiple Estimate:	-5.0%	Growth Percentile:	34.2%
Dividend Yield:	2.0%	5 Year Price Target	\$42	Valuation Percentile:	14.8%
Dividend Risk Score:	A	Retirement Suitability Score:	B	Total Return Percentile:	8.3%

Overview & Current Events

Hormel Foods was founded back in 1891 in Minnesota. Since that time, the company grown into a \$23 billion market capitalization juggernaut in the food products industry, enjoying \$10 billion in annual revenue. Hormel has kept with its core competency as a processor of meat products for well over a hundred years, but has also grown into other business lines through acquisitions.

Hormel reported Q1 earnings on 2/21/19 and results were largely in line with expectations. Diluted earnings-per-share were down 12% year-over-year, but that was due to the impact of tax reform on the company's Q1 2018 results. Operationally, Hormel looked better.

Total revenue was up 1% thanks to a 1% gain in volume, while pricing and mix had no impact on the top line. By business line, refrigerated products saw total sales up 2% on a 1% volume decline, grocery products saw volumes rise 3% but net sales were up just 1%, Jennie-O Turkey produced flat volume and sales, and the international business saw sales up 2% on a 1% volume increase. Refrigerated products led the way in terms of segment profitability, but overall operating margins were flat at 13% of revenue in Q1. In total, Q1 was largely what was expected of Hormel, and it delivered.

Further, management reaffirmed guidance for fiscal 2019, reiterating its range of \$1.77 to \$1.91 in earnings-per-share. As a result of this, we've left our estimate of \$1.84 for this year unchanged.

Separately, the company announced in late February that it sold the CytoSport business to PepsiCo for a total consideration of \$465 million. The brand, which makes protein powders and Muscle Milk drinks, was non-core for Hormel and produced about \$300 million in revenue annually. We believe the sale price was favorable for Hormel and will provide a sizable injection of cash for the company to pay down debt, buy back shares, or keep for general corporate purposes.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	\$0.63	\$0.76	\$0.87	\$0.93	\$0.98	\$1.12	\$1.32	\$1.64	\$1.57	\$1.86	\$1.84	\$2.35
DPS	\$0.19	\$0.21	\$0.26	\$0.30	\$0.34	\$0.40	\$0.50	\$0.58	\$0.68	\$0.75	\$0.84	\$1.10
Shares	538	534	532	528	526	527	527	528	528	529	530	530

Hormel's earnings-per-share has grown very nicely throughout the past decade, only dipping year-over-year one time in this span, in 2017. There are not many companies that can say that and it has been the result of a steady stream of acquisitions and a bit of organic growth. This has afforded Hormel the ability to drastically raise its dividend as well.

We are forecasting forward earnings growth of 5.0% annually as Hormel should grow more slowly than it has in the past. We see sales growth as the primary driver of earnings-per-share expansion moving forward as fiscal 2018 reiterated that margins can be unpredictable for this business. Hormel will likely continue to buy growth because its legacy businesses are not currently producing it. This strategy has certainly worked in the past. Given the cash inflow from the CytoSport divestiture, Hormel may go after a business that better fits with its long-term plans, although management hasn't said what it plans to do with the proceeds. Certainly, however, Hormel's divestiture of non-core brands affords it the ability to continue to buy growth in the coming years without undue stress on the financials.

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.



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Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	13.0	13.7	15.7	15.6	19.8	21.3	21.6	23.4	21.8	19.3	23.3	18.0
Avg. Yld.	2.3%	2.0%	1.9%	2.1%	1.8%	1.7%	1.8%	1.5%	2.0%	2.1%	2.0%	2.6%

Hormel's price-to-earnings ratio has been volatile in the last decade, sinking as low as 13 in 2009 before rebounding to 23.4 in 2016. It sits at 23.3 now and we believe it will drift lower over time towards its historical mean at 18. That works out to a 5% headwind to total returns over the next five years. Given Hormel's struggles with volume and margins, we believe investors are more likely to reduce the earnings multiple than expand it. At the current multiple, we continue to see significant downside risk to the valuation, and Q1 results reiterate this for us.

We are forecasting a higher yield five years from now as the stock's valuation drifts lower.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	30%	27%	27%	30%	33%	34%	35%	33%	41%	40%	46%	47%

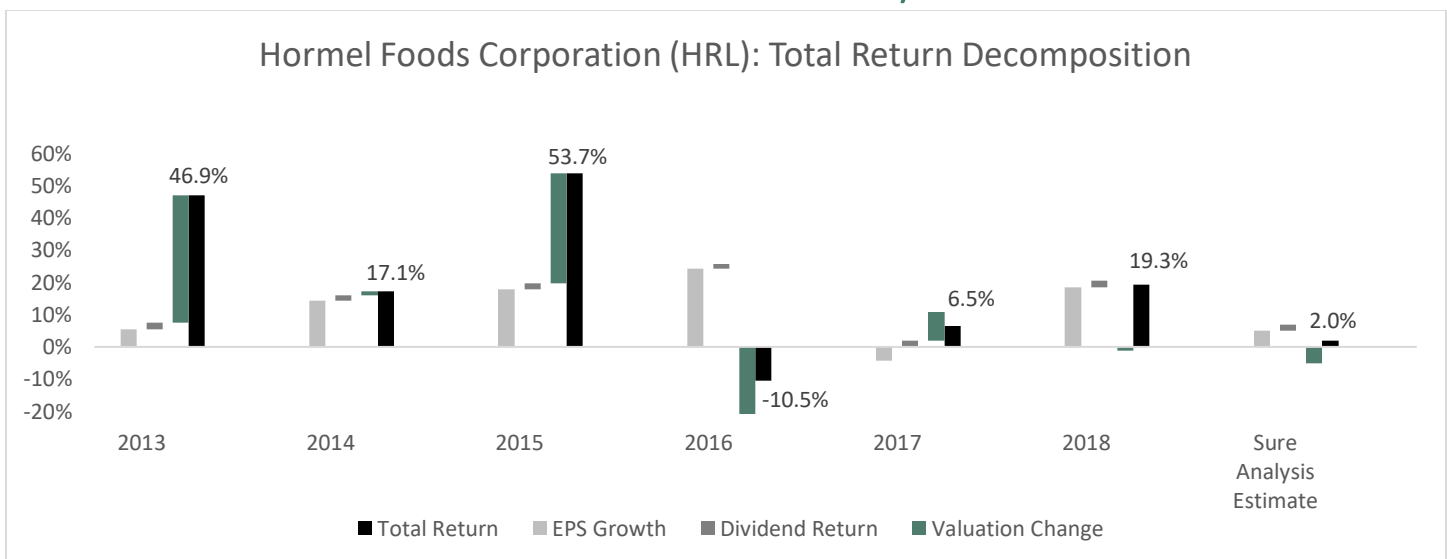
Hormel's payout ratio is just under half of earnings, and we expect that it will remain this way for the foreseeable future. Management is certainly committed to the dividend, but it wants to acquire growth as well, which uses cash.

Hormel's main competitive advantage is its 35 products that are either #1 or #2 in their category. Hormel has brands that are proven, and that leadership position is tremendously difficult for competitors to supplant. In addition, Hormel has a global network of distributors that few food companies can rival. Hormel's earnings-per-share actually grew during the Great Recession while most of the world was in rather dire straits, a testament to the stock's defensive nature.

Final Thoughts & Recommendation

Hormel's recent price action makes the stock look quite overvalued today. The company is in a tough spot as it tries to grow without sacrificing margins. We are forecasting just 2% annual total returns for the next five years, comprised of the 2% current yield, a 5% headwind from a lower valuation and 5% earnings growth. Because of low expected returns, Hormel earns a sell recommendation from Sure Dividend at current prices.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	6534	7221	7895	8231	8752	9316	9264	9523	9168	9546
Gross Profit	1099	1239	1334	1332	1413	1565	1809	2158	2003	1995
Gross Margin	16.8%	17.2%	16.9%	16.2%	16.1%	16.8%	19.5%	22.7%	21.9%	20.9%
SG&A Exp.	567	605	619	606	627	651	744	872	762	838
D&A Exp.	127	126	124	119	125	130	133	132	131	162
Operating Profit	532	633	716	726	785	914	1065	1286	1241	1157
Operating Margin	8.1%	8.8%	9.1%	8.8%	9.0%	9.8%	11.5%	13.5%	13.5%	12.1%
Net Profit	343	396	474	500	526	603	686	890	847	1012
Net Margin	5.2%	5.5%	6.0%	6.1%	6.0%	6.5%	7.4%	9.3%	9.2%	10.6%
Free Cash Flow	462	396	394	385	531	588	848	737	789	862
Income Tax	182	225	240	253	268	316	370	427	432	169

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets	3692	4054	4244	4564	4916	5456	6140	6370	6976	8142
Cash & Equivalents	385	468	463	682	434	334	347	415	444	459
Accounts Receivable	372	431	461	507	552	610	606	591	618	600
Inventories	722	794	886	951	968	1055	993	986	921	964
Goodwill & Int. Ass.	761	771	763	754	1313	1781	2527	2738	3147	3921
Total Liabilities	1568	1647	1585	1739	1599	1844	2138	1919	2036	2537
Accounts Payable	313	361	390	386	387	484	495	482	553	619
Long-Term Debt	350	350	250	250	250	250	435	250	250	625
Shareholder's Equity	2123	2401	2657	2819	3311	3606	3998	4448	4936	5605
D/E Ratio	0.16	0.15	0.09	0.09	0.08	0.07	0.11	0.06	0.05	0.11

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	9.4%	10.2%	11.4%	11.4%	11.1%	11.6%	11.8%	14.2%	12.7%	13.4%
Return on Equity	16.6%	17.5%	18.8%	18.3%	17.2%	17.4%	18.0%	21.1%	18.0%	19.2%
ROIC	13.9%	15.1%	16.7%	16.7%	15.8%	16.2%	16.5%	19.5%	17.1%	17.7%
Shares Out.	538	534	532	528	526	527	527	528	528	529
Revenue/Share	12.06	13.34	14.52	15.30	16.19	17.24	17.12	17.56	17.00	17.55
FCF/Share	0.85	0.73	0.72	0.72	0.98	1.09	1.57	1.36	1.46	1.58

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

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