



Lancaster Colony Corporation (LANC)

Updated February 1st, 2019 by Josh Arnold

Key Metrics

Current Price:	\$159	5 Year CAGR Estimate:	-4.6%	Volatility Percentile:	27.2%
Fair Value Price:	\$98	5 Year Growth Estimate:	3.0%	Momentum Percentile:	92.7%
% Fair Value:	144%	5 Year Valuation Multiple Estimate:	-9.2%	Growth Percentile:	11.4%
Dividend Yield:	1.6%	5 Year Price Target	\$128	Valuation Percentile:	7.2%
Dividend Risk Score:	A	Retirement Suitability Score:	B	Total Return Percentile:	1.8%

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 \$4.4 billion market capitalization today on \$1.3 billion in annual revenue. Lancaster Colony makes various meal accessories like croutons and bread products in frozen and non-frozen categories.

Lancaster reported Q2 earnings on 1/31/19 and results were largely in line with expectations. Total revenue increased an impressive 9.4% and even excluding its recent acquisition of Bantam Bagels, revenue was up 7.3%. Lancaster has done a nice job in recent quarters of pushing its better selling products and Q2 showed strength in both of its segments. Retail sales were up 3.9% with a 3.5% organic gain, led by shelf-stable dressings and sauces, caramel dips and frozen garlic bread. Lancaster also benefited from higher pricing. The foodservice segment showed a 16.3% gain thanks to a 12.2% organic sales increase as restaurants are once again buying in force. The Bantam acquisition added a few percentage points of sales growth to the foodservice segment, but the main story is that Lancaster has seen a return to strong demand from its national chain restaurant customers.

Despite the very strong gains in revenue, margins continue to be a problem. Gross profit rose 8.9% during Q2, slightly lower than the pace of revenue growth. Warehousing costs and one-time charges associated with the discontinuation of the Marzetti Simple Harvest line of dips weighed on margins, partially offset by productivity gains. In total, adjusted earnings-per-share increased 8% year-over-year. We're maintaining our estimate of \$5.45 in earnings-per-share for this year as Q2 was in line with our expectations. Revenue growth is continuing at a high rate but margins remain a problem.

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	\$5.45	\$6.32
DPS	\$1.14	\$1.19	\$1.29	\$1.41	\$1.52	\$1.72	\$1.82	\$1.96	\$2.15	\$2.40	\$2.60	\$3.20
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 drop in 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% earnings-per-share growth annually going forward, comprised of low single digit sales and flat margins; Lancaster 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. To be fair, early results for fiscal 2019 are positive and ahead of trend, but we see the risk of volatility to earnings as a key reason for investors to be cautious.

We are forecasting ~3% dividend growth annually for the next five years as Lancaster Colony continues its impressive streak of payouts to shareholders; the payout should crest \$3 per share during the next five years. Lancaster is not an income stock, but it does prioritize growth in the payout each year, and that should continue.

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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	29.2	18.0
Avg. Yld.	3.0%	2.3%	2.4%	2.2%	2.0%	2.0%	2.0%	1.8%	1.6%	1.7%	1.6%	2.5%

Lancaster Colony's price-to-earnings ratio was in excess of 31 last year, but has moved down slightly of late. Although we had previously assigned fair value at around 20 for Lancaster Colony, we are downgrading the company's fair value price-to-earnings ratio to 18 given its recent performance. The stock remains one of the most overvalued in our coverage universe.

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 2.7%. The stock's dividend yield was nearly cut in half from 2009 to 2017 due to a huge rally, 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
Payout	67%	36%	29%	34%	40%	38%	47%	49%	44%	47%	48%	51%

Lancaster Colony's quality metrics are outstanding. It has not 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 moving forward. Gross margins should remain roughly flat as rising freight costs are combated by pricing increases and non-freight cost savings.

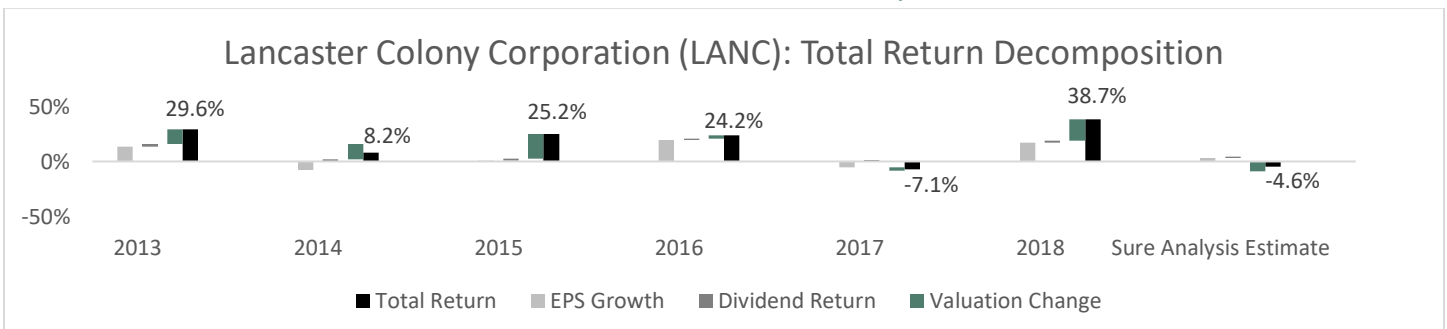
Lancaster Colony's payout should remain where it is today at roughly half of earnings as dividend growth paces earnings growth. Given its Dividend King status, we know the payout is important to management and the dividend is very safe.

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 -2.4% over the next five years. This will be comprised of 3% earnings-per-share growth, the 1.6% current yield and a 7% headwind from the valuation reset. The stock is very unattractive 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. Overall, Lancaster Colony continues to earn a strong 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	1051	1057	1090	989	1014	1041	1105	1191	1202	1223
Gross Profit	215	270	242	223	245	249	258	300	319	304
Gross Margin	20.5%	25.6%	22.2%	22.6%	24.1%	23.9%	23.3%	25.2%	26.5%	24.8%
SG&A Exp.	84	94	95	82	91	95	103	115	144	131
D&A Exp.	22		19	20	20	20	21	24	25	27
Operating Profit	131	177	147	141	154	154	155	185	175	172
Operating Margin	12.5%	16.7%	13.5%	14.3%	15.2%	14.8%	14.0%	15.5%	14.5%	14.1%
Net Profit	89	115	106	96	109	75	102	122	115	135
Net Margin	8.5%	10.9%	9.8%	9.7%	10.8%	7.2%	9.2%	10.2%	9.6%	11.1%
Free Cash Flow	122	95	112	106	108	113	114	129	119	130
Income Tax	48	60	55	49	50	52	53	63	60	39

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets	498	586	622	683	620	639	702	635	716	804
Cash & Equivalents	38	101	132	192	123	212	182	118	143	206
Accounts Receivable		68	64	73	56	58	62	66	70	73
Inventories	103	122	112	110	68	75	78	76	76	91
Goodwill & Int. Ass.	101	99	98	97	96	95	192	189	228	224
Total Liabilities	96	102	105	118	119	110	121	121	140	152
Accounts Payable	41	42	43	41	36	38	39	40	41	58
Long-Term Debt	0	0	0	0	0	0	0	0	0	0
Shareholder's Equity	403	485	518	564	501	529	581	514	576	652
D/E Ratio	0	0	0	0	0	0	0	0	0	0

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	17.5%	21.2%	17.6%	14.7%	16.8%	11.9%	15.2%	18.2%	17.1%	17.8%
Return on Equity	23.4%	25.9%	21.2%	17.7%	20.5%	14.6%	18.3%	22.2%	21.2%	22.0%
ROIC	21.8%	25.9%	21.2%	17.7%	20.5%	14.6%	18.3%	22.2%	21.2%	22.0%
Shares Out.	28.5	28.1	28.2	27.4	27.3	27.3	27.3	27.4	27.4	27.5
Revenue/Share	37.49	37.50	39.36	36.27	37.16	38.12	40.42	43.51	43.80	44.54
FCF/Share	4.34	3.37	4.05	3.89	3.94	4.14	4.19	4.72	4.35	4.72

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

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