



# The Kraft-Heinz Company (KHC)

Updated February 26<sup>th</sup>, 2019 by Jonathan Weber

## Key Metrics

<b>Current Price:</b>	\$33	<b>5 Year CAGR Estimate:</b>	12.1%	<b>Volatility Percentile:</b>	37.1%
<b>Fair Value Price:</b>	\$40	<b>5 Year Growth Estimate:</b>	3.3%	<b>Momentum Percentile:</b>	0.9%
<b>% Fair Value:</b>	82%	<b>5 Year Valuation Multiple Estimate:</b>	4.1%	<b>Growth Percentile:</b>	17.1%
<b>Dividend Yield:</b>	4.7%	<b>5 Year Price Target</b>	\$48	<b>Valuation Percentile:</b>	80.2%
<b>Dividend Risk Score:</b>	C	<b>Retirement Suitability Score:</b>	A	<b>Total Return Percentile:</b>	71.6%

## 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 \$42 billion.

The Kraft-Heinz Company has reported its fourth quarter and full year earnings results on February 21. The company reported that its revenues totaled \$6.89 billion during the fourth quarter, which was 0.7% more than the revenues that Kraft-Heinz has generated during the previous year's period. Organic net sales, which adjust for the impact of currency rate changes, as well as for the impact of acquisitions and divestments, were up 2.4% year over year, which is a decent growth rate for a consumer goods company.

Kraft-Heinz disclosed a massive net loss of \$12.6 billion for the fourth quarter, which equates to a loss of \$10.34 on a per-share basis. The massive loss was the result of a \$15.4 billion write-down on intangible assets (goodwill) that relates to past acquisitions. The impairment charge is related to the carrying value of the Kraft brand and the Oscar Mayer trademark. Adjusted for this item, which will not be recurring, and which did not impact Kraft-Heinz' cash flows, the company would have generated EBITDA of \$1.7 billion, which is still down by almost 14% versus the prior year's fourth quarter. Adjusted earnings-per-share (which do not include the impairment charge) totaled \$0.84 during the fourth quarter, which was 6.7% less than the earnings-per-share from the fourth quarter of fiscal 2017.

Kraft-Heinz has cut its dividend by 36% on the day of the fourth quarter earnings release, the new quarterly payout is \$0.40 per share. Kraft-Heinz' share price has reacted very negatively to the bad news of a big net loss and a major dividend cut, shares crashed almost 30% to the lowest level in the last five years.

## Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
<b>EPS</b>	---	---	---	---	---	---	\$2.19	\$3.33	\$3.55	\$3.51	<b>\$3.68</b>	<b>\$4.33</b>
<b>DPS</b>	---	---	---	---	---	---	\$1.13	\$2.35	\$2.45	\$2.50	<b>\$1.60</b>	<b>\$2.00</b>
<b>Shares</b>	---	---	---	---	---	---	1210	1226	1228	1220	<b>1210</b>	<b>1160</b>

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.

*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	---	---	---	---	---	---	18.5	24.9	24.2	12.3	<b>9.0</b>	<b>11.0</b>
Avg. Yld.	---	---	---	---	---	---	2.8%	2.8%	2.9%	4.9%	<b>4.7%</b>	<b>4.2%</b>

The Kraft-Heinz Company's shares traded at quite high valuations during 2016 and 2017. This has not been justified, we believe, as Kraft-Heinz has never been a high-growth company, or a company that deserved a 20+ earnings multiple in the past. The recent huge impairment charge has made investors more wary regarding the company's shares, which is why Kraft-Heinz' shares will likely continue to trade at a huge discount relative to how the company's shares were valued in the past. We nevertheless see some upside potential from here. The low share price has resulted in a very high dividend yield, even after factoring in the recent dividend cut.

## Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	---	---	---	---	---	---	51.6%	70.6%	69.1%	71.2%	<b>43.5%</b>	<b>46.2%</b>

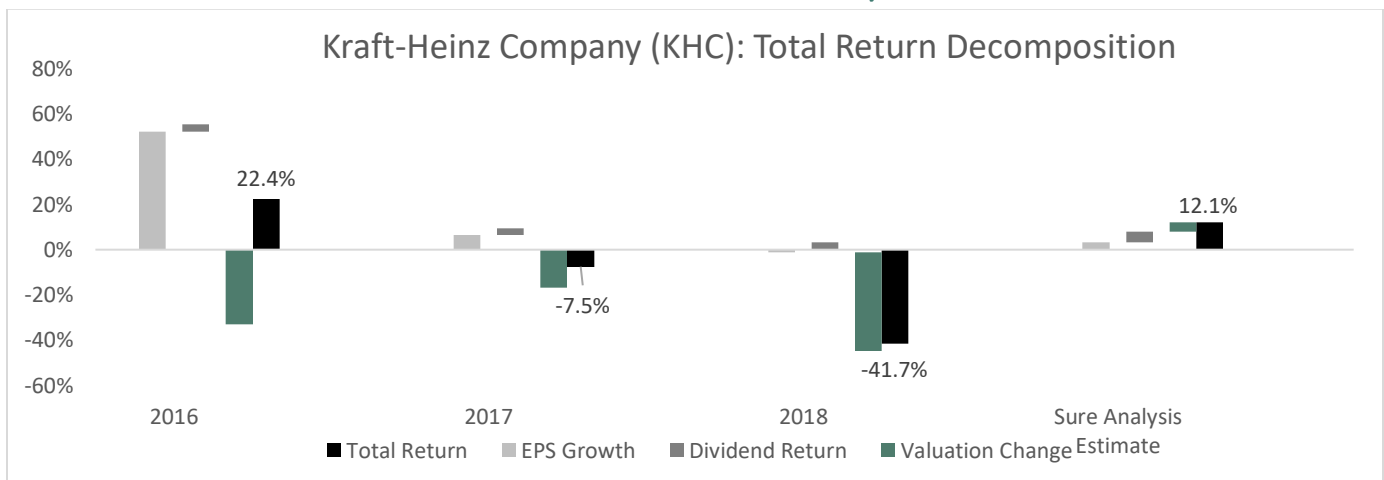
Kraft-Heinz does not have a long dividend history, and after the recent dividend cut, even its short dividend history is not convincing. The dividend looks sustainable at the new, lower level, though, another cut seems unlikely. We are forecasting the payout ratio to rise slightly over time as dividend growth barely outpaces earnings growth.

Kraft-Heinz' brands are strong and recognized by most consumers, and demand for food 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. Kraft-Heinz' brands function as a competitive advantage. Shifting consumer preferences are a headwind for Kraft-Heinz, though, as more consumers chose healthier options of non-processed foods.

## Final Thoughts & Recommendation

Kraft-Heinz' shares have not performed well throughout the last year, and the dividend cut and huge net loss made shares crater to a very low level. Kraft-Heinz was able to grow its sales during 2018, and thanks to international growth the company should be able to generate some earnings growth going forward as well. For those that are not afraid of the risks and the volatility Kraft-Heinz could be a value play here. We forecast 12.1% total annual returns thanks to a combination of value, yield and growth potential.

## Total Return Breakdown by Year



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## Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	N/A	N/A	N/A	18271	18218	18205	18338	26487	26232	26259
Gross Profit	N/A	N/A	N/A	5772	6823	4845	5761	9586	9703	8950
Gross Margin	N/A	N/A	N/A	31.6%	37.5%	26.6%	31.4%	36.2%	37.0%	34.1%
SG&A Exp.	N/A	N/A	N/A	2961	2124	2956	3122	3444	2930	3204
D&A Exp.	N/A	N/A	N/A	428	393	385	740	1337	1036	N/A
Operating Profit	N/A	N/A	N/A	2811	4699	1889	2639	6142	6773	5746
Op. Margin	N/A	N/A	N/A	15.4%	25.8%	10.4%	14.4%	23.2%	25.8%	21.9%
Net Profit	N/A	N/A	N/A	1642	2715	1043	634	3632	10999	-10229
Net Margin	N/A	N/A	N/A	9.0%	14.9%	5.7%	3.5%	13.7%	41.9%	-39.0%
Free Cash Flow	N/A	N/A	N/A	2595	1486	1485	624	1402	-690	N/A
Income Tax	N/A	N/A	N/A	18271	18218	18205	18338	26487	26232	26259

## Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets (\$B)	N/A	N/A	N/A	23.18	23.15	22.95	122.97	120.48	120.23	103.63
Cash & Equivalents	N/A	N/A	N/A	1255	1686	1293	4837	4204	1629	1130
Accounts Receivable	N/A	N/A	N/A	1089	1048	1080	1454	898	1274	2129
Inventories	N/A	N/A	N/A	1928	1616	1775	2618	2684	2815	2683
Goodwill & Int. (\$B)	N/A	N/A	N/A	13.83	13.73	13.64	105.17	103.42	104.27	85.99
Total Liabilities	N/A	N/A	N/A	19607	17961	18582	65080	62906	53991	51724
Accounts Payable	N/A	N/A	N/A	1556	1548	1537	2844	3996	4449	4153
Long-Term Debt	N/A	N/A	N/A	9966	9980	10032	25234	32404	31536	31285
Shareholder's Equity	N/A	N/A	N/A	3572	5187	4365	57685	57358	66034	51785
D/E Ratio	N/A	N/A	N/A	2.79	1.92	2.30	0.44	0.56	0.48	0.60

## Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	N/A	N/A	N/A	7.3%	11.7%	4.5%	0.9%	3.0%	9.1%	-9.1%
Return on Equity	N/A	N/A	N/A	16.3%	62.0%	21.8%	2.0%	6.3%	17.8%	-17.4%
ROIC	N/A	N/A	N/A	10.9%	18.9%	7.1%	1.3%	4.2%	11.7%	-11.3%
Shares Out.	N/A	N/A	N/A	N/A	N/A	N/A	1210	1226	1228	1220
Revenue/Share	N/A	N/A	N/A	30.66	30.41	30.44	23.33	21.60	21.36	21.54
FCF/Share	N/A	N/A	N/A	4.35	2.48	2.48	0.79	1.14	-0.56	N/A

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

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