



# Hormel Foods Corporation (HRL)

Updated May 31<sup>st</sup>, 2019 by Josh Arnold

## Key Metrics

<b>Current Price:</b>	\$40	<b>5 Year CAGR Estimate:</b>	1.6%	<b>Volatility Percentile:</b>	28.5%
<b>Fair Value Price:</b>	\$32	<b>5 Year Growth Estimate:</b>	4.0%	<b>Momentum Percentile:</b>	69.9%
<b>% Fair Value:</b>	126%	<b>5 Year Valuation Multiple Estimate:</b>	-4.5%	<b>Growth Percentile:</b>	36.2%
<b>Dividend Yield:</b>	2.1%	<b>5 Year Price Target</b>	\$38	<b>Valuation Percentile:</b>	20.0%
<b>Dividend Risk Score:</b>	A	<b>Retirement Suitability Score:</b>	B	<b>Total Return Percentile:</b>	11.8%

## Overview & Current Events

Hormel Foods was founded back in 1891 in Minnesota. Since that time, the company grown into a \$21 billion market capitalization juggernaut in the food products industry, enjoying nearly \$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. The company sells its products in 80 countries worldwide, and its brands include Skippy, SPAM, Applegate, Justin's, and more than 30 others. In addition, Hormel is a member of the Dividend Kings, having increased its dividend for 52 consecutive years.

Hormel reported Q2 earnings and while results were decent enough, guidance for the rest of the year was weak. Total revenue came in at a new Q2 record of \$2.3 billion, an increase of 1% year-over-year. Three of the company's four segments posted sales increases, but the company did face some headwinds.

African swine fever in China began to impact global hog and pork markets, which led to significantly higher input costs for Hormel. In response to this, Hormel increased pricing across its Grocery, Refrigerated, and International segments.

In addition, the company's Jennie-O Turkey segment continues to struggle due to volume and plan startup costs. The company is investing in the weakest of its segments to boost results, and management expects production and efficiency increases later this year. Hormel also boosted promotional activity for Jennie-O to boost volumes.

Finally, the company finalized the sale of CytoSport and used the proceeds to pay down debt and build its cash position. The company said it would use its stronger balance sheet to grow through acquisition and capacity expansion.

Management slightly lowered its guidance for this year from \$1.77 to \$1.91 to a new range of \$1.71 to \$1.85; we've lowered our estimate from \$1.84 to \$1.75 in sympathy thanks to margin headwinds and relatively weak volume.

## Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
<b>EPS</b>	\$0.63	\$0.76	\$0.87	\$0.93	\$0.98	\$1.12	\$1.32	\$1.64	\$1.57	\$1.86	<b>\$1.75</b>	<b>\$2.13</b>
<b>DPS</b>	\$0.19	\$0.21	\$0.26	\$0.30	\$0.34	\$0.40	\$0.50	\$0.58	\$0.68	\$0.75	<b>\$0.84</b>	<b>\$1.10</b>
<b>Shares</b>	538	534	532	528	526	527	527	528	528	529	<b>530</b>	<b>530</b>

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 4% annually as Hormel should grow more slowly than it has in the past. We note this is a slight downgrade from our prior forecast of 5% growth, and it is due to margin headwinds presented in Q2. We see sales growth as the primary driver of earnings-per-share expansion moving forward as Q2 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. 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	<b>22.6</b>	<b>18.0</b>
Avg. Yld.	2.3%	2.0%	1.9%	2.1%	1.8%	1.7%	1.8%	1.5%	2.0%	2.1%	<b>2.1%</b>	<b>2.9%</b>

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 22.6 now and we believe it will drift lower over time towards its historical mean at 18. That works out to a 4.5% headwind to total returns over the next five years. Given Hormel's struggles with volume and margins, we believe investors are much 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 Q2 results and guidance 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%	<b>48%</b>	<b>52%</b>

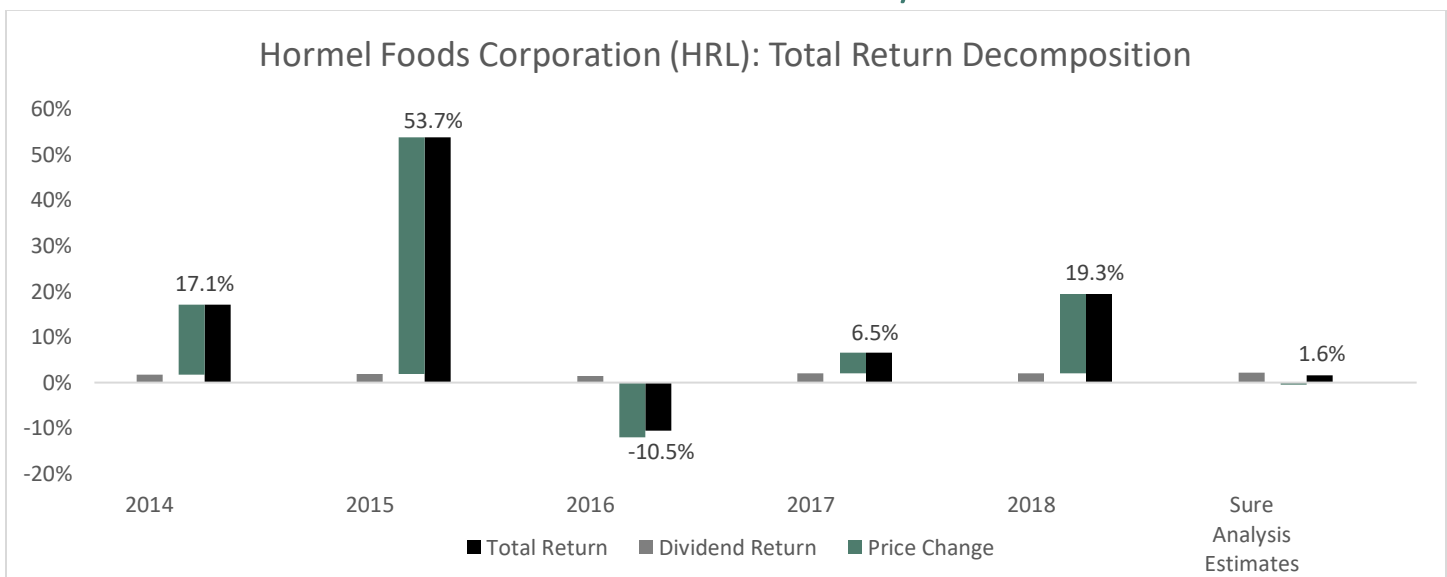
Hormel's payout ratio is just under half of earnings, and we expect that it will remain this way for the foreseeable future. Management is certainly committed to the dividend, but it wants to acquire growth as well, which uses cash.

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 1.6% annual total returns for the next five years, comprised of the 2.1% current yield, a 4.5% headwind from a lower valuation and 4% earnings growth. Because of low expected returns, this Dividend King 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
<b>Revenue</b>	6534	7221	7895	8231	8752	9316	9264	9523	9168	9546
<b>Gross Profit</b>	1099	1239	1334	1332	1413	1565	1809	2158	2003	1995
<b>Gross Margin</b>	16.8%	17.2%	16.9%	16.2%	16.1%	16.8%	19.5%	22.7%	21.9%	20.9%
<b>SG&amp;A Exp.</b>	567	605	619	606	627	651	744	872	762	838
<b>D&amp;A Exp.</b>	127	126	124	119	125	130	133	132	131	162
<b>Operating Profit</b>	532	633	716	726	785	914	1065	1286	1241	1157
<b>Operating Margin</b>	8.1%	8.8%	9.1%	8.8%	9.0%	9.8%	11.5%	13.5%	13.5%	12.1%
<b>Net Profit</b>	343	396	474	500	526	603	686	890	847	1012
<b>Net Margin</b>	5.2%	5.5%	6.0%	6.1%	6.0%	6.5%	7.4%	9.3%	9.2%	10.6%
<b>Free Cash Flow</b>	462	396	394	385	531	588	848	737	789	862
<b>Income Tax</b>	182	225	240	253	268	316	370	427	432	169

## Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
<b>Total Assets</b>	3692	4054	4244	4564	4916	5456	6140	6370	6976	8142
<b>Cash &amp; Equivalents</b>	385	468	463	682	434	334	347	415	444	459
<b>Accounts Receivable</b>	372	431	461	507	552	610	606	591	618	600
<b>Inventories</b>	722	794	886	951	968	1055	993	986	921	964
<b>Goodwill &amp; Int. Ass.</b>	761	771	763	754	1313	1781	2527	2738	3147	3921
<b>Total Liabilities</b>	1568	1647	1585	1739	1599	1844	2138	1919	2036	2537
<b>Accounts Payable</b>	313	361	390	386	387	484	495	482	553	619
<b>Long-Term Debt</b>	350	350	250	250	250	250	435	250	250	625
<b>Shareholder's Equity</b>	2123	2401	2657	2819	3311	3606	3998	4448	4936	5605
<b>D/E Ratio</b>	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
<b>Return on Assets</b>	9.4%	10.2%	11.4%	11.4%	11.1%	11.6%	11.8%	14.2%	12.7%	13.4%
<b>Return on Equity</b>	16.6%	17.5%	18.8%	18.3%	17.2%	17.4%	18.0%	21.1%	18.0%	19.2%
<b>ROIC</b>	13.9%	15.1%	16.7%	16.7%	15.8%	16.2%	16.5%	19.5%	17.1%	17.7%
<b>Shares Out.</b>	538	534	532	528	526	527	527	528	528	529
<b>Revenue/Share</b>	12.06	13.34	14.52	15.30	16.19	17.24	17.12	17.56	17.00	17.55
<b>FCF/Share</b>	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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