



The Kraft-Heinz Company (KHC)

Updated August 13th, 2019 by Jonathan Weber

Key Metrics

| | | | | | |
|-----------------------------|------|--|-------|---------------------------------|-------|
| Current Price: | \$26 | 5 Year CAGR Estimate: | 12.0% | Volatility Percentile: | 66.1% |
| Fair Value Price: | \$29 | 5 Year Growth Estimate: | 3.3% | Momentum Percentile: | 2.1% |
| % Fair Value: | 88% | 5 Year Valuation Multiple Estimate: | 2.5% | Growth Percentile: | 21.9% |
| Dividend Yield: | 6.2% | 5 Year Price Target | \$35 | Valuation Percentile: | 69.6% |
| Dividend Risk Score: | C | Retirement Suitability Score: | B | Total Return Percentile: | 67.0% |

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 \$32 billion.

The Kraft-Heinz Company has reported its second quarter and earnings results on August 8, the 10-Q was released on August 13. The company reported that its revenues totaled \$6.41 billion during the second quarter, which was 4.2% less than the revenues that Kraft-Heinz generated during the previous year's period. This was still better than what the analyst community had expected, though. During the first half of 2019, Kraft-Heinz' revenues totaled \$12.4 billion, which was down 5% year over year. Currency rate headwinds were a main factor for the company's lower revenues.

Following the disclosure of a massive net loss of \$12.6 billion for the fourth quarter, which was the result of a \$15.4 billion write-down on intangible assets (goodwill) that relates to past acquisitions, Kraft-Heinz reported additional write-downs of \$1.2 billion during the most recent quarterly report. Even though this write-down was much smaller than the previous one, at less than 10% the size, the market reacted very negatively to the renewed charge, sending Kraft-Heinz' shares lower by double digits. Adjusted for this item, which did not impact Kraft-Heinz' cash flows, the company generated EBITDA of \$1.6 billion during the second quarter, and \$3.03 billion during H1. Combined, this is 3.5% less than the adjusted EBITDA that Kraft-Heinz generated during H1 of 2018. Adjusted earnings-per-share (which do not include the impairment charge) totaled \$0.78 during the second quarter, and \$1.44 during the first half of the current fiscal year, down from \$1.89 during the previous year.

Growth on a Per-Share Basis

| Year | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2024 |
|---------------------------|------|------|------|------|------|------|--------|--------|--------|--------|---------------|---------------|
| EPS | --- | --- | --- | --- | --- | --- | \$2.19 | \$3.33 | \$3.55 | \$3.51 | \$2.68 | \$3.15 |
| DPS | --- | --- | --- | --- | --- | --- | \$1.13 | \$2.35 | \$2.45 | \$2.50 | \$1.60 | \$2.00 |
| Shares¹ | --- | --- | --- | --- | --- | --- | 1210 | 1226 | 1228 | 1220 | 1210 | 1160 |

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.

¹ Million shares

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 | 9.7 | 11.0 |
| Avg. Yld. | --- | --- | --- | --- | --- | --- | 2.8% | 2.8% | 2.9% | 4.9% | 6.2% | 5.8% |

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 impairment charges have 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 for Kraft-Heinz' shares 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% | 59.7% | 63.5% |

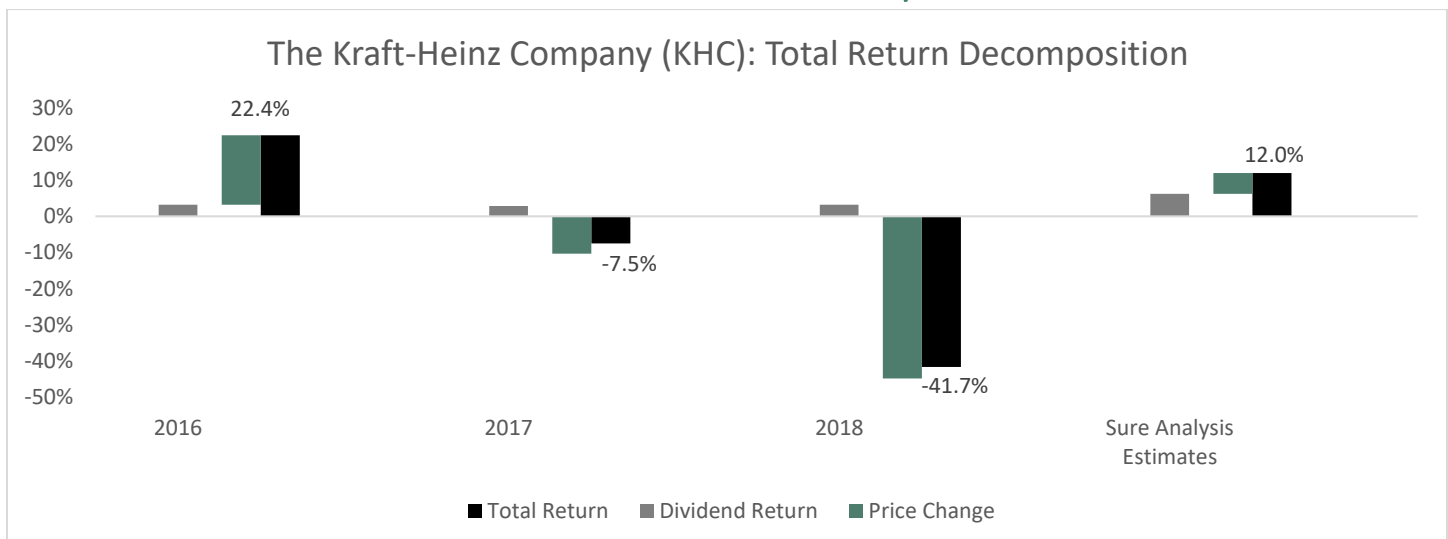
Kraft-Heinz does not have a long dividend history, and after the recent dividend cut, even its short dividend history is not convincing. The dividend looks sustainable at the new, lower level, another cut thus seems unlikely. We are forecasting the payout ratio to rise slightly over time as dividend 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 gotten devastated throughout the last year and are trading close to all-time lows right now. We believe that, thanks to international growth, the company should be able to generate some earnings growth going forward. For those that are not afraid of the risks and the volatility, Kraft-Heinz could be a value play here, trading below fair value and offering a strong dividend yield. We rate Kraft-Heinz a buy 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 | 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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