



# J.M. Smucker (SJM)

Updated August 27<sup>th</sup>, 2019 by Eli Inkrot

## Key Metrics

|                             |       |  |       |                                 |       |
|-----------------------------|-------|--|-------|---------------------------------|-------|
| <b>Current Price:</b>       | \$103 | <b>5 Year CAGR Estimate:</b>               | 9.3%  | <b>Volatility Percentile:</b>   | 51.4% |
| <b>Fair Value Price:</b>    | \$110 | <b>5 Year Growth Estimate:</b>             | 5.0%  | <b>Momentum Percentile:</b>     | 57.4% |
| <b>% Fair Value:</b>        | 94%   | <b>5 Year Valuation Multiple Estimate:</b> | 1.3%  | <b>Growth Percentile:</b>       | 38.6% |
| <b>Dividend Yield:</b>      | 3.5%  | <b>5 Year Price Target</b>                 | \$141 | <b>Valuation Percentile:</b>    | 61.8% |
| <b>Dividend Risk Score:</b> | B     | <b>Retirement Suitability Score:</b>       | B     | <b>Total Return Percentile:</b> | 53.0% |

## Overview & Current Events

In 1897 Jerome Monroe Smucker founded a small cider mill in Orrville, Ohio. He used surplus apples, said to be cultivated by Johnny Appleseed, to make cider and apple butter. Since then the J.M. Smucker company has grown into an international powerhouse of packaged food and beverage products including iconic names like Smucker's, Jif, Crisco and Folgers, along with pet food brands like Milk Bone, Meow Mix, Kibbles 'n Bits and 9Lives. The company has a market capitalization of \$12 billion and is on pace to generate ~\$8 billion in sales and earn ~\$800 million this year.

On July 23<sup>rd</sup>, 2019 Smucker's announced a 3.5% quarterly dividend increase from \$0.85 to \$0.88.

On August 27<sup>th</sup>, 2019 Smucker's reported Q1 fiscal year 2020 results for the period ending July 31<sup>st</sup>, 2019. (Smucker's fiscal year ends April 30<sup>th</sup>.) These results include the Ainsworth acquisition (acquired May 14<sup>th</sup>, 2018) along with divestiture of the Company's U.S. baking business on August 31<sup>st</sup>, 2018. For the quarter sales came in at \$1.78 billion, a 6.5% decline compared to Q1 fiscal year 2019, as the divestiture of the baking business had a \$73.1 million negative impact on the top line. Even without this, comparable sales would have been down 4% as the company saw lower pricing in peanut butter and coffee. Adjusted operating income declined 8% to \$290.7 million. Meanwhile, adjusted earnings-per-share declined 11.2% from \$1.78 to \$1.58 for the quarter.

Smucker's also updated its guidance for fiscal year 2020. Sales are now anticipated to come in between -1% to 0% (from +1% to 2% previously), free cash flow is expected to be in the \$875 million to \$925 million range (unchanged) and adjusted earnings-per-share is expected to be in the \$8.35 to \$8.55 range (from \$8.45 to \$8.65 previously). However, keep in mind that this guidance is uniquely adjusted. It includes the expectation of \$7.01 to \$7.21 in earnings-per-share, with -\$0.35 taken away as unallocated losses or gains, \$0.13 added back in for special project costs and \$1.56 for amortization charges. We include the impact of amortization in our earnings expectations, so this guidance implies underlying earnings power of ~\$6.79 to ~\$6.99 this fiscal year (down from ~\$6.90 to ~\$7.09 in our prior report).

## Growth on a Per-Share Basis

| Year                      | 2009   | 2010   | 2011   | 2012   | 2013   | 2014   | 2015   | 2016   | 2017   | 2018   | 2019          | 2024          |
|---------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|---------------|---------------|
| <b>EPS</b>                | \$4.37 | \$4.79 | \$4.73 | \$5.37 | \$5.64 | \$5.35 | \$5.89 | \$6.49 | \$6.97 | \$6.66 | <b>\$6.90</b> | <b>\$8.81</b> |
| <b>DPS</b>                | \$1.45 | \$1.68 | \$1.92 | \$2.08 | \$2.32 | \$2.56 | \$2.68 | \$3.00 | \$3.12 | \$3.40 | <b>\$3.52</b> | <b>\$4.40</b> |
| <b>Shares<sup>1</sup></b> | 119    | 114    | 110    | 106    | 102    | 120    | 116    | 113    | 114    | 114    | <b>114</b>    | <b>114</b>    |

Note that while Smucker's has already completed its 2019 fiscal year, we have elected to present the data above closest to the actual calendar year. Also, the share count increase for 2014 was a result of the Big Heart Pet Brands acquisition.

In the 2008 through 2017 stretch, Smucker's increased earnings-per-share by about 7% annually. Moving forward the company has provided long-term guidance of 2% to 3% sales growth, 5% operating income growth and 8% annual earnings-per-share growth. While we believe this is a great goal, we are hesitant to extrapolate that sort of growth over the intermediate-term and have tempered it slightly to 5% annually. The company has a collection of iconic brands, but many of them are center-isle staples that have been losing popularity as consumers look for fresher, healthier options. Increased advertising spending and moving toward consumer preferences will require significant capital outlays in the

1: In millions.

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years to come. On the positive side, coffee is a strong, sticky segment for the business and Smucker's is working to expand the current iconic lines (think Jif) to more on-trend products like granola bars and on-the-go snacks.

## Valuation Analysis

| Year      | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | Now  | 2024 |
|-----------|------|------|------|------|------|------|------|------|------|------|------|------|
| Avg. P/E  | 12.5 | 13.2 | 16.2 | 16.0 | 18.3 | 19.6 | 20.1 | 21.0 | 17.0 | 16.2 | 15.0 | 16.0 |
| Avg. Yld. | 2.7% | 2.7% | 2.5% | 2.4% | 2.2% | 2.4% | 2.3% | 2.2% | 2.6% | 3.2% | 3.5% | 3.1% |

Over the past decade shares of Smucker's have traded at an average P/E ratio of about 17 times earnings. While we believe this mark is more or less fair, we do caution that it could be overstated should earnings growth continue to stall and have baked in a bit of caution in our estimate as a result, using 16 times earnings as a starting point. With shares currently trading around 15 times earnings, this implies the potential for a moderate valuation tailwind.

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

| Year   | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2024 |
|--------|------|------|------|------|------|------|------|------|------|------|------|------|
| Payout | 33%  | 35%  | 41%  | 39%  | 41%  | 48%  | 46%  | 46%  | 45%  | 51%  | 52%  | 50%  |

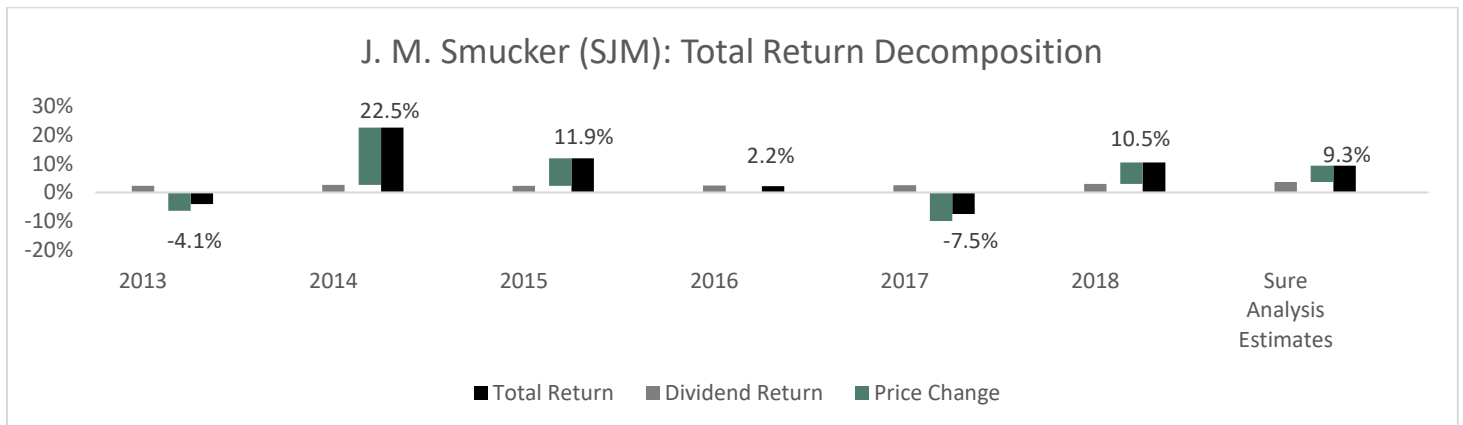
Smucker's iconic brands continue to enjoy recognition, but this competitive position is eroding as consumers look for fresher and healthier alternatives. During the last recession Smucker's held up exceptionally well, growing both earnings and dividends. Our apprehension is not with the next recession, but instead if the company can grow its core brands.

Smucker's acquisitions have levered up the balance sheet. Smucker's held ~\$900 million in long-term debt back in 2009 against ~\$320 million in net profit (2.8x). Today the number is closer to \$5.5 billion in debt against underlying earnings of ~\$790 million per year (~6.9x) with interest payments of ~\$200 million annually. Additionally, \$13.0 billion of the company's \$16.8 billion in total assets are held as goodwill and other intangible assets. The debt is serviceable, the payout ratio is reasonable, and profits are recession resistant, but the safety of the firm is not top-notch in our view.

## Final Thoughts & Recommendation

Shares are down 16% since our last update, while earnings expectations have come down slightly as well. We are forecasting total return potential of 9.3% per annum, stemming from 5% growth and a 3.5% starting yield along with a slight valuation tailwind. While the company has a strong history with a solid dividend and iconic brands, growth prospects are not robust from this point and the company needs to get a better handle on the balance sheet. Moreover, the industry as a whole appears to be facing increasing headwinds. Overall we rate the security as a hold.

## Total Return Breakdown by Year



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1: In millions.

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## Income Statement Metrics

| Year             | 2009  | 2010  | 2011  | 2012  | 2013  | 2014  | 2015  | 2016  | 2017  | 2018  |
|------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Revenue          | 4605  | 4826  | 5526  | 5898  | 5611  | 5693  | 7811  | 7392  | 7357  | 7838  |
| Gross Profit     | 1787  | 1799  | 1845  | 2028  | 2031  | 1969  | 2968  | 2835  | 2836  | 2916  |
| Gross Margin     | 38.8% | 37.3% | 33.4% | 34.4% | 36.2% | 34.6% | 38.0% | 38.4% | 38.5% | 37.2% |
| SG&A Exp.        | 878   | 863   | 893   | 974   | 989   | 1031  | 1510  | 1380  | 1363  | 1509  |
| D&A Exp.         | 182   | 186   | 209   | 251   | 256   | 267   | 430   | 419   | 413   | 446   |
| Operating Profit | 824   | 861   | 867   | 960   | 945   | 830   | 1281  | 1253  | 1266  | 1198  |
| Operating Margin | 18%   | 18%   | 16%   | 16%   | 17%   | 15%   | 16%   | 17%   | 17%   | 15%   |
| Net Profit       | 494   | 480   | 460   | 544   | 565   | 345   | 689   | 592   | 1339  | 514   |
| Net Margin       | 10.7% | 9.9%  | 8.3%  | 9.2%  | 10.1% | 6.1%  | 8.8%  | 8.0%  | 18.2% | 6.6%  |
| Free Cash Flow   | 576   | 212   | 457   | 649   | 577   | 491   | 1260  | 867   | 896   | 781   |
| Income Tax       | 237   | 238   | 242   | 273   | 285   | 178   | 289   | 286   | -478  | 187   |

## Balance Sheet Metrics

| Year                 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014  | 2015  | 2016  | 2017  | 2018  |
|----------------------|------|------|------|------|------|-------|-------|-------|-------|-------|
| Total Assets         | 7975 | 8325 | 9115 | 9032 | 9060 | 16806 | 15984 | 15640 | 15301 | 16711 |
| Cash & Equivalents   | 284  | 320  | 230  | 256  | 154  | 126   | 110   | 167   | 193   | 101   |
| Accounts Receivable  | 239  | 344  | 348  | 314  | 309  | 430   | 450   | 439   | 386   | 504   |
| Inventories          | 655  | 864  | 962  | 946  | 931  | 1164  | 899   | 906   | 854   | 910   |
| Goodwill & Int. Ass. | 5834 | 5753 | 6242 | 6142 | 6123 | 12962 | 12586 | 12227 | 11859 | 13030 |
| Total Liabilities    | 2649 | 3032 | 3952 | 3883 | 4031 | 9719  | 8976  | 8790  | 7410  | 8741  |
| Accounts Payable     | 180  | 235  | 275  | 286  | 289  | 403   | 459   | 477   | 512   | 591   |
| Long-Term Debt       | 910  | 1304 | 2071 | 2018 | 2216 | 6171  | 5430  | 5399  | 4832  | 5911  |
| Shareholder's Equity | 5326 | 5292 | 5163 | 5149 | 5030 | 7087  | 7009  | 6850  | 7891  | 7971  |
| D/E Ratio            | 0.17 | 0.25 | 0.40 | 0.39 | 0.44 | 0.87  | 0.77  | 0.79  | 0.61  | 0.74  |

## Profitability & Per Share Metrics

| Year             | 2009  | 2010  | 2011  | 2012  | 2013  | 2014  | 2015  | 2016  | 2017  | 2018  |
|------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Return on Assets | 6.1%  | 5.9%  | 5.3%  | 6.0%  | 6.2%  | 2.7%  | 4.2%  | 3.7%  | 8.7%  | 3.2%  |
| Return on Equity | 9.6%  | 9.0%  | 8.8%  | 10.6% | 11.1% | 5.7%  | 9.8%  | 8.5%  | 18.2% | 6.5%  |
| ROIC             | 7.8%  | 7.5%  | 6.6%  | 7.6%  | 7.8%  | 3.4%  | 5.4%  | 4.8%  | 10.7% | 3.9%  |
| Shares Out.      | 119   | 114   | 110   | 106   | 102   | 120   | 116   | 113   | 114   | 114   |
| Revenue/Share    | 39.01 | 41.20 | 49.22 | 54.18 | 54.20 | 55.25 | 65.64 | 63.95 | 65.11 | 69.30 |
| FCF/Share        | 4.88  | 1.81  | 4.07  | 5.97  | 5.57  | 4.77  | 10.58 | 7.50  | 7.93  | 6.91  |

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

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