



# The Kraft-Heinz Company (KHC)

Updated August 19<sup>th</sup>, 2020 by Jonathan Weber

## Key Metrics

<b>Current Price:</b>	\$36	<b>5 Year CAGR Estimate:</b>	5.9%	<b>Market Cap:</b>	\$43B
<b>Fair Value Price:</b>	\$34	<b>5 Year Growth Estimate:</b>	3.0%	<b>Ex-Dividend Date:</b>	08/27/20
<b>% Fair Value:</b>	104%	<b>5 Year Valuation Multiple Estimate:</b>	-0.9%	<b>Dividend Payment Date:</b>	09/25/20
<b>Dividend Yield:</b>	4.4%	<b>5 Year Price Target</b>	\$40	<b>Years Of Dividend Growth:</b>	0
<b>Dividend Risk Score:</b>	D	<b>Retirement Suitability Score:</b>	C	<b>Last Dividend Increase:</b>	-

## Overview & Current Events

Kraft-Heinz is a processed food and beverages company which owns a product portfolio that includes food products such as 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, orchestrated by Warren Buffett's Berkshire Hathaway and 3G Capital. Kraft-Heinz is headquartered in Chicago, IL.

The Kraft-Heinz Company reported its second quarter earnings results on July 30. The company reported that its revenues totaled \$6.7 billion during the quarter, which was 4% more than the revenues that Kraft-Heinz generated during the previous year's period. This was slightly better than what the analyst community had expected. Kraft-Heinz' organic sales were up by 7%, which compares favorably to the analyst estimate. The very solid revenue growth pace was partially caused by stockpiling during the pandemic, it is not likely that revenues will continue to rise at this pace.

Kraft-Heinz generated earnings-per-share of \$0.80 during the second quarter, which easily beat the consensus estimate. Earnings-per-share were up slightly versus the previous year's quarter when the company generated earnings-per-share of \$0.78. The earnings-per-share performance was better compared to the previous quarters, which management touts as a sign of stabilization. Kraft-Heinz has also announced that its deleveraging strategy was on track. The company plans to reduce its debt further, while maintaining its dividend at the current level. The coronavirus crisis is not hurting the company's operations so far, but even before the crisis, an earnings decline was expected, which has not changed.

## Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
<b>EPS</b>	---	---	---	---	---	\$2.19	\$3.33	\$3.55	\$3.51	\$2.85	<b>\$2.65</b>	<b>\$3.07</b>
<b>DPS</b>	---	---	---	---	---	\$1.13	\$2.35	\$2.45	\$2.50	\$1.60	<b>\$1.60</b>	<b>\$1.60</b>
<b>Shares<sup>1</sup></b>	---	---	---	---	---	1210	1226	1228	1220	1230	<b>1230</b>	<b>1200</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 positive returns, though. In Kraft-Heinz' case there are several avenues for growth the company can pursue.

The first factor is international expansion. Market penetration in many emerging countries is not very high. These markets are huge and they are 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, which results in a positive outlook for Kraft-Heinz' international business. Another factor for earnings growth is margin expansion, as Kraft-Heinz' management is experienced in cutting costs. We thus believe that margins will remain high, and possibly rise further over the coming years. Last but not least, Kraft-Heinz should benefit from debt reduction that results in declining interest expenses. On the other hand, changing consumer behavior is a headwind for Kraft-Heinz, mainly in the US, which is why we believe that earnings will not grow at a rapid pace, rather relatively slowly.

<sup>1</sup>In Millions

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	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	---	---	---	---	---	18.5	24.9	24.2	12.3	11.2	<b>13.6</b>	<b>13.0</b>
Avg. Yld.	---	---	---	---	---	2.8%	2.8%	2.9%	4.9%	5.0%	<b>4.4%</b>	<b>4.0%</b>

Kraft-Heinz' shares traded at quite high valuations during 2016 and 2017. This was not justified, we believe, as Kraft-Heinz has never been a high-growth company, or a company that deserved a 20+ earnings multiple. The impairment charges in the recent past 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. Our fair value earnings multiple is not very high, and we believe that shares are trading relatively close to that level right now. The dividend is at an above-average level of more than 4% right now.

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

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	---	---	---	---	---	51.6%	70.6%	69.1%	71.2%	56.1%	<b>60.4%</b>	<b>52.1%</b>

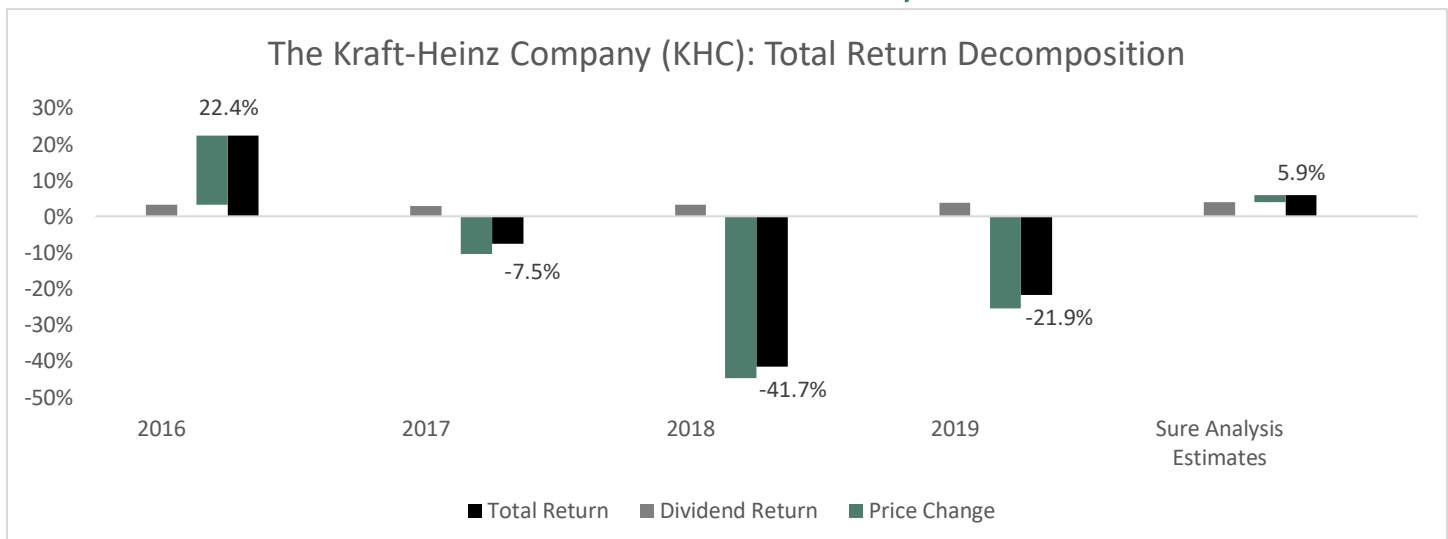
Kraft-Heinz does not have a long dividend history, and after the recent dividend cut, even its short dividend history is not really convincing. The dividend looks sustainable at the current level, another cut thus seems unlikely. We are forecasting the payout ratio to decline over time as earnings should rise in the long run.

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 companies. Kraft-Heinz' brands function as a competitive advantage. Shifting consumer preferences are a headwind for Kraft-Heinz, though, as more consumers chose healthier options such as non-processed foods.

## Final Thoughts & Recommendation

Kraft-Heinz' shares' performance over the first half of 2020 was very solid, as shares are up 10% year to date. We believe that, thanks to international growth, the company should be able to generate some earnings growth in the long run, but Kraft-Heinz will never turn into a high-growth company. Due to a mediocre total return forecast, and due to the fact that Kraft-Heinz trades slightly above fair value right now, we rate the stock a hold.

## Total Return Breakdown by Year



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## Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
<b>Revenue</b>	17,797	18,576	18,271	18,218	18,205	18,338	26,300	26,076	26,268	24,977
<b>Gross Profit</b>	6,020	5,763	5,772	6,823	4,845	5,761	9,146	9,033	8,921	8,147
<b>Gross Margin</b>	33.8%	31.0%	31.6%	37.5%	26.6%	31.4%	34.8%	34.6%	34.0%	32.6%
<b>SG&amp;A Exp.</b>	3,063	2,937	2,961	2,124	2,956	3,122	3,527	2,927	3,190	3,178
<b>D&amp;A Exp.</b>	354	364	428	393	385	740	1,337	1,031	983	994
<b>Operating Profit</b>	2,957	2,826	2,811	4,699	1,889	2,639	5,619	6,106	5,731	4,969
<b>Op. Margin</b>	16.6%	15.2%	15.4%	25.8%	10.4%	14.4%	21.4%	23.4%	21.8%	19.9%
<b>Net Profit</b>	3,534	1,775	1,642	2,715	1,043	634	3,596	10,941	(10,192)	1,935
<b>Net Margin</b>	19.9%	9.6%	9.0%	14.9%	5.7%	3.5%	13.7%	42.0%	-38.8%	7.7%
<b>Free Cash Flow</b>	380	2,263	2,595	1,486	1,485	624	1,401	(693)	1,748	2,784
<b>Income Tax</b>	1,112	1,101	811	1,375	363	366	1,333	(5,482)	(1,067)	728

## Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
<b>Total Assets (\$B)</b>		21.5	23.2	23.2	22.9	122.9	120.5	120.1	103.5	101.5
<b>Cash &amp; Equivalents</b>		-	1,255	1,686	1,293	4,837	4,204	1,629	1,130	2,279
<b>Accounts Receivable</b>		903	1,089	1,048	1,080	1,454	898	1,274	2,129	1,973
<b>Inventories</b>		1,943	1,928	1,616	1,775	2,618	2,684	2,760	2,667	2,721
<b>Goodwill &amp; Int. (\$B)</b>		13.9	13.8	13.7	13.6	105.2	103.4	104.3	86.0	84.2
<b>Total Liabilities</b>		4,951	19,607	17,961	18,582	56,760	62,906	54,022	51,686	49,701
<b>Accounts Payable</b>		1,447	1,556	1,548	1,537	2,844	3,996	4,362	4,153	4,003
<b>Long-Term Debt</b>		-	35	9,966	9,980	10,032	32,404	31,503	31,168	29,244
<b>Shareholder's Equity</b>		16,588	3,572	5,187	4,365	57,685	57,358	65,863	51,657	51,623
<b>D/E Ratio</b>		0.00	2.79	1.92	2.30	0.38	0.56	0.48	0.60	0.57

## Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
<b>Return on Assets</b>	---	---	7.3%	11.7%	4.5%	0.9%	3.0%	9.1%	-9.1%	1.9%
<b>Return on Equity</b>	---	---	16.3%	62.0%	21.8%	2.0%	6.3%	17.8%	-17.3%	3.7%
<b>ROIC</b>	---	---	10.9%	18.9%	7.1%	1.2%	4.0%	11.7%	-11.3%	2.4%
<b>Shares Out.</b>	---	---	---	---	---	1210	1226	1228	1220	1230
<b>Revenue/Share</b>	30.11	31.43	30.66	30.41	30.44	23.33	21.45	21.23	21.55	20.41
<b>FCF/Share</b>	0.64	3.83	4.35	2.48	2.48	0.79	1.14	(0.56)	1.43	2.27

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

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