Hormel Foods Corporation (HRL)

Updated September 3rd, 2020 by Josh Arnold

Key Metrics

Current Price:	$51	**5 Year CAGR Estimate:**	0.3%	**Market Cap:**	$27.7 B
Fair Value Price:	$35	**5 Year Growth Estimate:**	6.0%	**Ex-Dividend Date:**	10/10/20[1]
% Fair Value:	147%	**5 Year Valuation Multiple Estimate:**	-7.4%	**Dividend Payment Date:**	11/17/20[2]
Dividend Yield:	1.8%	**5 Year Price Target**	$46	**Years Of Dividend Growth:**	54
Dividend Risk Score:	A	**Retirement Suitability Score:**	B	**Last Dividend Increase:**	10.7%

Overview & Current Events

Hormel Foods was founded back in 1891 in Minnesota. Since that time, the company has grown into a $27+ billion market capitalization juggernaut in the food products industry with 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 54 consecutive years.

Hormel reported third quarter earnings on August 25th, with results coming in about as expected on the top and bottom lines. Volumes in Q3 were up 4%, with organic volume rising 3%. Organic revenue was up 2%.

Grocery Products revenue was up 7% to $581 million, Refrigerated Foods revenue rose 5% to $1.36 billion, Jennie-O Turkey sales declined -4% to $287 million in a return to weakness for that segment, while the International segment was up 2% to $151 million. US net retail sales were up 19% and foodservice net sales declined -19%.

Operating margin was down 70bps year-over-year to 10.5% of revenue, but was ahead of consensus. Diluted earnings-per-share came to 37 cents, which was flat to the same period last year

Cash flow from operations soared 59% to $330 million, which was aided by an increase in accounts payable and a reduction in inventory. The company also said it expects capex to be $350 million this year, and incremental supply chain costs of $80 to $100 million.

Management guided for Q4 to be similar to Q3, and our expectations of earnings-per-share for this year remains unchanged at $1.65 after Q3 results.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	$0.76	$0.87	$0.93	$0.98	$1.12	$1.32	$1.64	$1.57	$1.86	$1.74	***$1.65***	***$2.21***
DPS	$0.21	$0.26	$0.30	$0.34	$0.40	$0.50	$0.58	$0.68	$0.75	$0.84	***$0.93***	***$1.19***
Shares[3]	534	532	528	526	527	527	528	528	529	544	***550***	***580***

Hormel's earnings-per-share has grown nicely throughout the past decade, only dipping year-over-year twice in this span. Relatively consistent results have come from a steady stream of acquisitions and a bit of organic growth. This has afforded Hormel the ability to consistently raise its dividend as well. We note that 2020 is slated to be the third decline in earnings in this period.

We are forecasting forward earnings growth of 6% annually as Hormel could grow more slowly than it has in the past. We see sales growth as the primary driver of earnings-per-share expansion moving forward as recent results continue to show that margins and volumes can be unpredictable for this business. Hormel will likely continue to buy growth

---

[1] Estimated date
[2] Estimated date
[3] Share count in millions

because its legacy businesses are not currently producing it outside of extraordinary circumstance early in 2020. 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 its financials.

Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	13.7	15.7	15.6	19.8	21.3	21.6	23.4	21.8	19.3	24.2	***30.9***	***21.0***
Avg. Yld.	2.0%	1.9%	2.1%	1.8%	1.7%	1.8%	1.5%	2.0%	2.1%	2.0%	***1.8%***	***2.6%***

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 a staggering 30.9 now and we believe it will move meaningfully lower over time towards our fair value estimate of 21 times earnings. That works out to a -7.4% annual headwind to total returns over the next five years as the stock is more expensive now than it has been in the past decade. Given Hormel's struggles with volume and margins, we believe investors are much more likely to reduce the earnings multiple than expand it further. At the current multiple, we continue to see significant downside risk to the valuation, and Q3 results reiterate this for us. We are forecasting a significantly higher yield five years from now as the stock's valuation could move meaningfully lower.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	27%	27%	30%	33%	34%	35%	33%	41%	40%	48%	***56%***	***54%***

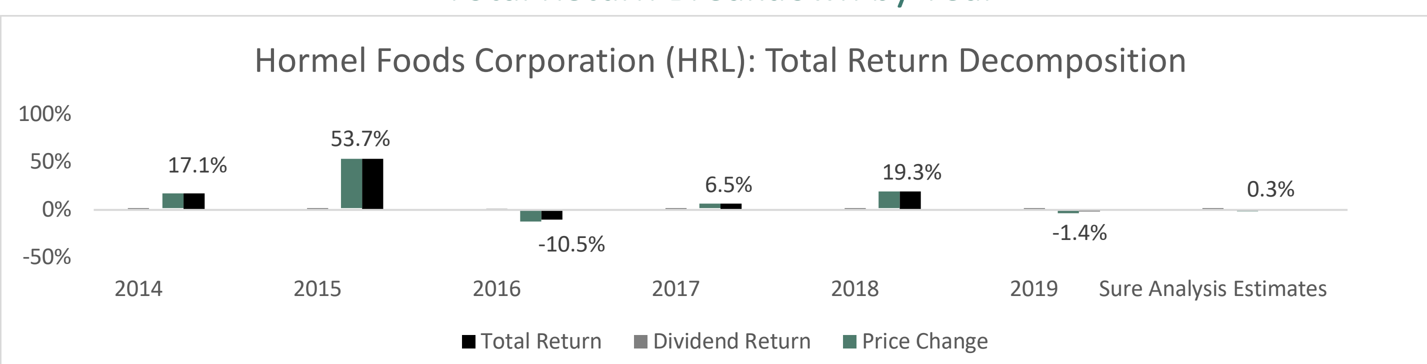
Hormel's payout ratio is just over half of earnings, and we expect that it will remain this way for the foreseeable future. Management is certainly committed to the dividend, but it wants to acquire growth as well, which uses cash.

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 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, which isn't working. We are forecasting essentially no annual total returns for the next five years, comprised of the modest yield, a sizable headwind from a lower valuation, and 6% earnings growth. As a result of these factors, this Dividend King continues to earn a sell rating from Sure Dividend at current prices.

Total Return Breakdown by Year



Click here to rate and review this research report. Your feedback is important to us.

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.

Hormel Foods Corporation (HRL)

Updated September 3rd, 2020 by Josh Arnold

Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	7221	7895	8231	8752	9316	9264	9523	9168	9546	9497
Gross Profit	1239	1334	1332	1413	1565	1809	2158	1997	1979	1885
Gross Margin	17.2%	16.9%	16.2%	16.1%	16.8%	19.5%	22.7%	21.8%	20.7%	19.8%
SG&A Exp.	605	619	606	627	651	744	872	759	841	728
D&A Exp.	126	124	119	125	130	133	132	131	162	165
Operating Profit	633	716	726	785	914	1065	1286	1237	1138	1157
Operating Margin	8.8%	9.1%	8.8%	9.0%	9.8%	11.5%	13.5%	13.5%	11.9%	12.2%
Net Profit	396	474	500	526	603	686	890	847	1012	979
Net Margin	5.5%	6.0%	6.1%	6.0%	6.5%	7.4%	9.3%	9.2%	10.6%	10.3%
Free Cash Flow	396	394	385	531	588	848	784	813	852	629
Income Tax	225	240	253	268	316	370	427	432	169	231

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	4054	4244	4564	4916	5456	6140	6370	6976	8142	8109
Cash & Equivalents	468	463	682	434	334	347	415	444	459	673
Accounts Receivable	431	461	507	552	610	606	591	618	600	574
Inventories	794	886	951	968	1055	993	986	921	964	1042
Goodwill & Int. Ass.	771	763	754	1313	1781	2527	2738	3147	3921	3516
Total Liabilities	1647	1585	1739	1599	1844	2138	1919	2036	2537	2183
Accounts Payable	361	390	386	387	484	495	482	553	619	590
Long-Term Debt	350	250	250	250	250	435	250	250	625	250
Shareholder's Equity	2401	2657	2819	3311	3606	3998	4448	4936	5601	5921
D/E Ratio	0.15	0.09	0.09	0.08	0.07	0.11	0.06	0.05	0.11	0.04

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	10.2%	11.4%	11.4%	11.1%	11.6%	11.8%	14.2%	12.7%	13.4%	12.0%
Return on Equity	17.5%	18.8%	18.3%	17.2%	17.4%	18.0%	21.1%	18.0%	19.2%	17.0%
ROIC	15.1%	16.7%	16.7%	15.8%	16.2%	16.5%	19.5%	17.1%	17.7%	15.8%
Shares Out.	534	532	528	526	527	527	528	528	529	544
Revenue/Share	13.34	14.52	15.30	16.19	17.24	17.12	17.56	17.00	17.55	17.42
FCF/Share	0.73	0.72	0.72	0.98	1.09	1.57	1.45	1.51	1.57	1.15

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