



Hormel Foods Corporation (HRL)

Updated February 18th, 2021 by Josh Arnold

Key Metrics

Current Price:	\$47	5 Year CAGR Estimate:	3.1%	Market Cap:	\$25.4 B
Fair Value Price:	\$39	5 Year Growth Estimate:	5.0%	Ex-Dividend Date:	04/08/21 ¹
% Fair Value:	122%	5 Year Valuation Multiple Estimate:	-3.9%	Dividend Payment Date:	05/16/21 ¹
Dividend Yield:	2.1%	5 Year Price Target	\$49	Years Of Dividend Growth:	55
Dividend Risk Score:	A	Retirement Suitability Score:	B	Last Dividend Increase:	5.4%

Overview & Current Events

Hormel Foods was founded in 1891 in Minnesota. Since that time, the company has grown into a \$25+ billion market capitalization juggernaut in the food products industry with about \$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 55 consecutive years.

Hormel reported first quarter earnings on February 18th, 2021 with results coming in mostly in line with expectations. Total sales were up 3% year-over-year to a record of \$2.5 billion. The gain was due to pricing and mix, which more than offset a -1% decline in volume, which came to 1.2 billion pounds.

Pretax earnings fell -5% during the quarter to \$277 million, as operating margin declined from 11.8% of revenue to 10.9%. Diluted earnings-per-share fell -9% to \$0.41 against the year-ago period. Operating free cash flow was a bright spot, up 27% to \$165 million.

Hormel also announced it struck a deal with Kraft Heinz to acquire the Planters snack nut portfolio for \$3.35 billion in cash. The deal is expected to provide Hormel with a \$560 million tax benefit, for a net price of \$2.79 billion. The portfolio produced \$1 billion in sales in 2020 and should reach Hormel's long-term organic growth target. Hormel expects Planters to be accretive from a margin perspective starting in 2022 and expects to see synergies of \$50 million to \$60 million annually to be realized by 2024. The transaction should close in Q2 of 2021.

Hormel's CEO said he was "increasingly optimistic" about generating sales and earnings growth this year and guided for \$1.70 to \$1.82 in earnings-per-share, which does not include the expected impact from the Planters acquisition. Given that acquisitions generally cost the acquirer in the short term, as well as taking into account the guidance range, we've reduced our estimate of earnings-per-share by a nickel for this year to \$1.75.

Growth on a Per-Share Basis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
EPS	\$0.87	\$0.93	\$0.98	\$1.12	\$1.32	\$1.64	\$1.57	\$1.86	\$1.74	\$1.66	\$1.75	\$2.23
DPS	\$0.26	\$0.30	\$0.34	\$0.40	\$0.50	\$0.58	\$0.68	\$0.75	\$0.84	\$0.93	\$0.98	\$1.25
Shares²	532	528	526	527	527	528	528	529	544	548	552	570

Hormel's earnings-per-share has grown nicely throughout the past decade, only dipping year-over-year three times 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 see 2021 as a return to growth.

We are forecasting forward earnings growth of 5% 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 Share count 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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because its legacy businesses are not currently producing it outside of extraordinary circumstance early in 2020. This strategy has certainly worked in the past, and Planters is yet another example.

Valuation Analysis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Now	2026
Avg. P/E	15.7	15.6	19.8	21.3	21.6	23.4	21.8	19.3	24.2	28.4	26.9	22.0
Avg. Yld.	1.9%	2.1%	1.8%	1.7%	1.8%	1.5%	2.0%	2.1%	2.0%	2.0%	2.1%	2.5%

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 26.9 now and we believe it could move meaningfully lower over time towards our fair value estimate of 22 times earnings. That works out to a -3.9% annual headwind to total returns over the next five years as the stock remains quite expensive. 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 first quarter results reiterate this for us, as volumes and margins both fell again. We are forecasting a higher yield five years from now as the stock's valuation could continue to move lower.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	27%	30%	33%	34%	35%	33%	41%	40%	48%	56%	56%	56%

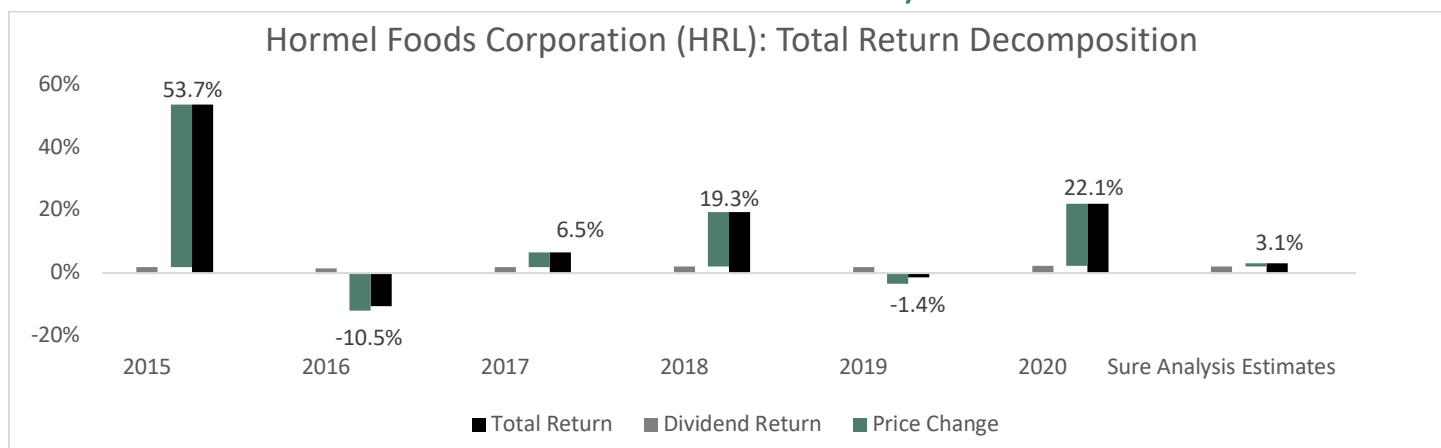
Hormel's payout ratio is just over half of earnings, and we expect that it will remain this way for the foreseeable future. Management is certainly committed to the dividend, but it wants to acquire growth as well, which uses cash.

Hormel's main competitive advantage is its ~40 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 looks quite overvalued today in our view, despite the stock being flat since our last update. The company is in a tough spot as it tries to grow without sacrificing margins, which simply isn't working, as seen again in Q1. With the valuation still very elevated and margins struggling, we see just 3.1% total annual returns for Hormel, and rate the stock a sell despite its exemplary dividend history.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue	7895	8231	8752	9316	9264	9523	9168	9546	9497	9,608
Gross Profit	1334	1332	1413	1565	1809	2158	1997	1979	1885	1,826
Gross Margin	16.9%	16.2%	16.1%	16.8%	19.5%	22.7%	21.8%	20.7%	19.8%	19.0%
SG&A Exp.	619	606	627	651	744	872	759	841	728	761
D&A Exp.	124	119	125	130	133	132	131	162	165	206
Operating Profit	716	726	785	914	1065	1286	1237	1138	1157	1,065
Operating Margin	9.1%	8.8%	9.0%	9.8%	11.5%	13.5%	13.5%	11.9%	12.2%	11.1%
Net Profit	474	500	526	603	686	890	847	1012	979	908
Net Margin	6.0%	6.1%	6.0%	6.5%	7.4%	9.3%	9.2%	10.6%	10.3%	9.5%
Free Cash Flow	394	385	531	588	848	784	813	852	629	761
Income Tax	240	253	268	316	370	427	432	169	231	206

Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Assets	4244	4564	4916	5456	6140	6370	6976	8142	8109	9,908
Cash & Equivalents	463	682	434	334	347	415	444	459	673	1,714
Accounts Receivable	461	507	552	610	606	591	618	600	574	702
Inventories	886	951	968	1055	993	986	921	964	1042	1,073
Goodwill & Int. Ass.	763	754	1313	1781	2527	2738	3147	3921	3516	3,689
Total Liabilities	1585	1739	1599	1844	2138	1919	2036	2537	2183	3,478
Accounts Payable	390	386	387	484	495	482	553	619	590	645
Long-Term Debt	250	250	250	250	435	250	250	625	250	1,304
Shareholder's Equity	2657	2819	3311	3606	3998	4448	4936	5601	5921	6,426
D/E Ratio	0.09	0.09	0.08	0.07	0.11	0.06	0.05	0.11	0.04	0.20

Profitability & Per Share Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Return on Assets	11.4%	11.4%	11.1%	11.6%	11.8%	14.2%	12.7%	13.4%	12.0%	10.1%
Return on Equity	18.8%	18.3%	17.2%	17.4%	18.0%	21.1%	18.0%	19.2%	17.0%	14.7%
ROIC	16.7%	16.7%	15.8%	16.2%	16.5%	19.5%	17.1%	17.7%	15.8%	13.1%
Shares Out.	532	528	526	527	527	528	528	529	544	548
Revenue/Share	14.52	15.30	16.19	17.24	17.12	17.56	17.00	17.55	17.42	17.58
FCF/Share	0.72	0.72	0.98	1.09	1.57	1.45	1.51	1.57	1.15	1.39

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

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