



# Hormel Foods Corporation (HRL)

Updated May 30<sup>th</sup>, 2021 by Josh Arnold

## Key Metrics

<b>Current Price:</b>	\$49	<b>5 Year CAGR Estimate:</b>	2.3%	<b>Market Cap:</b>	\$26 B
<b>Fair Value Price:</b>	\$39	<b>5 Year Growth Estimate:</b>	5.0%	<b>Ex-Dividend Date:</b>	07/09/21
<b>% Fair Value:</b>	127%	<b>5 Year Valuation Multiple Estimate:</b>	-4.7%	<b>Dividend Payment Date:</b>	08/16/21
<b>Dividend Yield:</b>	2.0%	<b>5 Year Price Target</b>	\$49	<b>Years Of Dividend Growth:</b>	55
<b>Dividend Risk Score:</b>	A	<b>Retirement Suitability Score:</b>	B	<b>Last Dividend Increase:</b>	5.4%

## Overview & Current Events

Hormel Foods was founded in 1891 in Minnesota. Since that time, the company has grown into a \$26 billion market capitalization juggernaut in the food products industry with about \$10.6 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 second fiscal quarter earnings on May 20<sup>th</sup>, 2021, with results coming in ahead of expectations on both the top and bottom lines. Total revenue was \$2.6 billion, which was up nearly 8% from the year-ago period. Volume was down -3% to 1.2 billion pounds, but better pricing helped drive the top line higher. Q2's revenue number was a record.

The Refrigerated Foods business saw volume rise 3%, and total sales soar 17%, while segment profit was up 32%. The segment saw a massive recovery in the foodservice business, as well as growth in retail and deli brands. Lower operating costs helped drive segment profit higher as well.

The Grocery Products segment saw volumes decline -14%, while total sales fell -8%, and segment profit declined -23%. The pandemic-boosted comparables from last year's Q2 proved too much to match, and the segment saw more normalized results, as expected.

Jennie-O produced weak results once more, as its strength in 2020 has proven fleeting. Volume declined -3% in Q2, while revenue was up slightly, but segment profit fell by more than half due to a huge increase in feed costs. Finally, the international business saw flat volumes, but a 17% gain in revenue that helped drive a 6% gain in segment profit.

Operating margin was 11.1% of sales, which was off 100bps from the year-ago period, due to higher raw material and feed costs. We've left our estimate for this year at \$1.75 following Q2 results as strength and weakness roughly offset each other in the most recent quarter.

## Growth on a Per-Share Basis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
<b>EPS</b>	\$0.87	\$0.93	\$0.98	\$1.12	\$1.32	\$1.64	\$1.57	\$1.86	\$1.74	\$1.66	<b>\$1.75</b>	<b>\$2.23</b>
<b>DPS</b>	\$0.26	\$0.30	\$0.34	\$0.40	\$0.50	\$0.58	\$0.68	\$0.75	\$0.84	\$0.93	<b>\$0.98</b>	<b>\$1.25</b>
<b>Shares<sup>1</sup></b>	532	528	526	527	527	528	528	529	544	548	<b>552</b>	<b>570</b>

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

<sup>1</sup> Share count in millions

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because its legacy businesses are not currently producing it outside of an 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	28.0	22.0
Avg. Yld.	1.9%	2.1%	1.8%	1.7%	1.8%	1.5%	2.0%	2.1%	2.0%	2.0%	2.0%	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 28 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 mid-single digit 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 half 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%

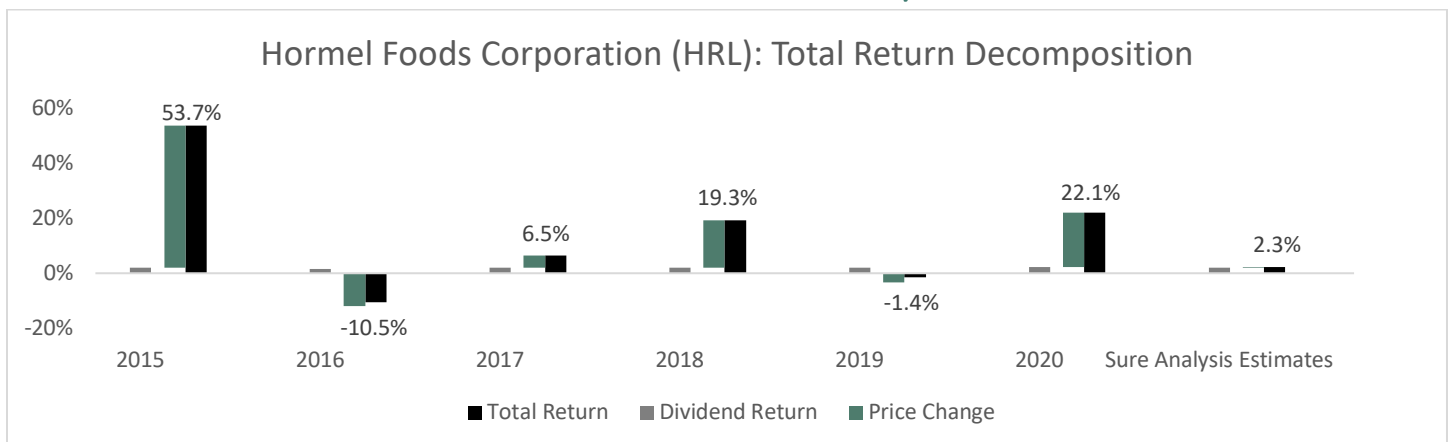
Hormel's payout ratio is just over half of earnings, and we expect that it will remain this way for the foreseeable future. Management is certainly committed to the dividend, but it wants to acquire growth as well, which uses cash.

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 company's defensive nature.

## Final Thoughts & Recommendation

Hormel looks quite overvalued today in our view, despite the stock being roughly 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 Q2. With the valuation still elevated and margins struggling, we see just 2.3% 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
<b>Revenue</b>	7895	8231	8752	9316	9264	9523	9168	9546	9497	9,608
<b>Gross Profit</b>	1334	1332	1413	1565	1809	2158	1997	1979	1885	1,826
<b>Gross Margin</b>	16.9%	16.2%	16.1%	16.8%	19.5%	22.7%	21.8%	20.7%	19.8%	19.0%
<b>SG&amp;A Exp.</b>	619	606	627	651	744	872	759	841	728	761
<b>D&amp;A Exp.</b>	124	119	125	130	133	132	131	162	165	206
<b>Operating Profit</b>	716	726	785	914	1065	1286	1237	1138	1157	1,065
<b>Operating Margin</b>	9.1%	8.8%	9.0%	9.8%	11.5%	13.5%	13.5%	11.9%	12.2%	11.1%
<b>Net Profit</b>	474	500	526	603	686	890	847	1012	979	908
<b>Net Margin</b>	6.0%	6.1%	6.0%	6.5%	7.4%	9.3%	9.2%	10.6%	10.3%	9.5%
<b>Free Cash Flow</b>	394	385	531	588	848	784	813	852	629	761
<b>Income Tax</b>	240	253	268	316	370	427	432	169	231	206

## Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
<b>Total Assets</b>	4244	4564	4916	5456	6140	6370	6976	8142	8109	9,908
<b>Cash &amp; Equivalents</b>	463	682	434	334	347	415	444	459	673	1,714
<b>Accounts Receivable</b>	461	507	552	610	606	591	618	600	574	702
<b>Inventories</b>	886	951	968	1055	993	986	921	964	1042	1,073
<b>Goodwill &amp; Int. Ass.</b>	763	754	1313	1781	2527	2738	3147	3921	3516	3,689
<b>Total Liabilities</b>	1585	1739	1599	1844	2138	1919	2036	2537	2183	3,478
<b>Accounts Payable</b>	390	386	387	484	495	482	553	619	590	645
<b>Long-Term Debt</b>	250	250	250	250	435	250	250	625	250	1,304
<b>Shareholder's Equity</b>	2657	2819	3311	3606	3998	4448	4936	5601	5921	6,426
<b>D/E Ratio</b>	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
<b>Return on Assets</b>	11.4%	11.4%	11.1%	11.6%	11.8%	14.2%	12.7%	13.4%	12.0%	10.1%
<b>Return on Equity</b>	18.8%	18.3%	17.2%	17.4%	18.0%	21.1%	18.0%	19.2%	17.0%	14.7%
<b>ROIC</b>	16.7%	16.7%	15.8%	16.2%	16.5%	19.5%	17.1%	17.7%	15.8%	13.1%
<b>Shares Out.</b>	532	528	526	527	527	528	528	529	544	548
<b>Revenue/Share</b>	14.52	15.30	16.19	17.24	17.12	17.56	17.00	17.55	17.42	17.58
<b>FCF/Share</b>	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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