



# Kellogg Co. (K)

Updated August 28<sup>th</sup>, 2021 by Josh Arnold

## Key Metrics

Current Price:	\$63	5 Year CAGR Estimate:	5.9%	Market Cap:	\$22 B
Fair Value Price:	\$62	5 Year Growth Estimate:	3.0%	Ex-Dividend Date:	08/31/21
% Fair Value:	102%	5 Year Valuation Multiple Estimate:	-0.5%	Dividend Payment Date:	09/15/21
Dividend Yield:	3.7%	5 Year Price Target	\$71	Years Of Dividend Growth:	17
Dividend Risk Score:	B	Retirement Suitability Score:	B	Last Dividend Increase:	1.8%

## Overview & Current Events

Kellogg was founded in 1906, the beginning of what would become a behemoth in the food processing industry. Kellogg has always focused on breakfast, but in recent years the company has also expanded to become an enormous snack producer. The company now derives more than half of its total revenue from non-breakfast categories. Its market capitalization is \$22 billion, and the company produces about \$14 billion in annual revenue.

Kellogg reported second quarter earnings on August 5<sup>th</sup>, 2021, and results were better than expected on both the top and bottom lines. Total revenue was up 3% year-over-year as favorable forex translation was the sole source of revenue growth. The company's organic sales were flat given that the year-ago period saw a surge in at-home demand that has since unwound, which was offset by a recovery in away-from-home channels, as well as positive pricing and mix.

Adjusted operating profit was down -12% year-over-year, while currency-neutral adjusted operating profit was off -15%. The comparable quarter last year saw unrealistic growth that the company was unable to replicate, which saw enormous operating leverage and higher margins as a result. Earnings-per-share declined -8% on an adjusted basis year-over-year and excluding currency translation, adjusted earnings-per-share declined -13%.

The company reaffirmed its guidance for the year and earnings-per-share growth is expected to be 1% to 2%. We've left our estimate for this year unchanged at \$4.10 in earnings-per-share.

## Growth on a Per-Share Basis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
EPS	\$3.38	\$3.37	\$3.77	\$3.87	\$3.53	\$3.72	\$4.04	\$4.33	\$3.94	\$3.99	\$4.10	\$4.75
DPS	\$1.67	\$1.74	\$1.80	\$1.90	\$1.98	\$2.04	\$2.12	\$2.20	\$2.26	\$2.28	\$2.32	\$2.69
Shares <sup>1</sup>	357	361	363	356	350	351	347	344	343	344	341	340

Kellogg's earnings-per-share history is not particularly inspiring as there has been upward movement, but very slowly. It came out of the Great Recession just as well as it went into it but in the years since, we've seen only gradual improvements in profitability. Revenue growth continues to be a problem, although more recent results have improved thanks to a larger focus on snack foods, as well as innovation via product extensions. In addition, Kellogg has not been afraid to purchase growth, such as the wildly successful RXBAR acquisition, which added significantly to the company's top line in 2018 and since. The company's global reach allows it to extend its successes from one side of the globe to the other, as it has with the Pringles brands, among others.

We are forecasting 3% annual earnings-per-share growth going forward, consisting of low single-digit revenue growth as well as some margin improvement from its continued efficiency efforts. Management was upbeat again, but realistic, after the Q2 report, but we see Kellogg as having some additional work to do to continue to boost revenue growth, although progress is being made despite tough comparables for 2021. Currency translation is a constant headwind, not including Q2, but organic growth has been stronger in recent periods. We note that Kellogg will likely have a difficult time growing off a high base that was boosted in 2020 by the pandemic. The current period is favorable for Kellogg given a weak dollar and strong sales tailwinds. If the dollar strengthens, Kellogg will suffer as a result.

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

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We expect the dividend will grow in the low- to mid-single-digit range as Kellogg continues to nurture its reputation as an income stock. Consistent earnings should afford it additional space to boost the payout in the coming years.

## Valuation Analysis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Now	2026
Avg. P/E	15.8	15.3	16.5	16.5	18.7	20.5	17.1	15.4	15.2	16.4	<b>15.4</b>	<b>15.0</b>
Avg. Yld.	3.1%	3.4%	2.9%	3.0%	3.0%	2.7%	3.1%	3.3%	3.8%	3.5%	<b>3.7%</b>	<b>3.8%</b>

Kellogg's valuation has oscillated for much of the past couple of years and today, it is trading for a more normalized multiple, and slightly above our estimate of fair value. We expect the yield to remain around 4% as a result. Kellogg will certainly remain an income stock for the long term, and the current yield offers income investors a value proposition given how low risk-free rates are in the U.S.

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

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
<b>Payout</b>	49%	48%	47%	49%	56%	54%	52%	51%	57%	57%	<b>57%</b>	<b>57%</b>

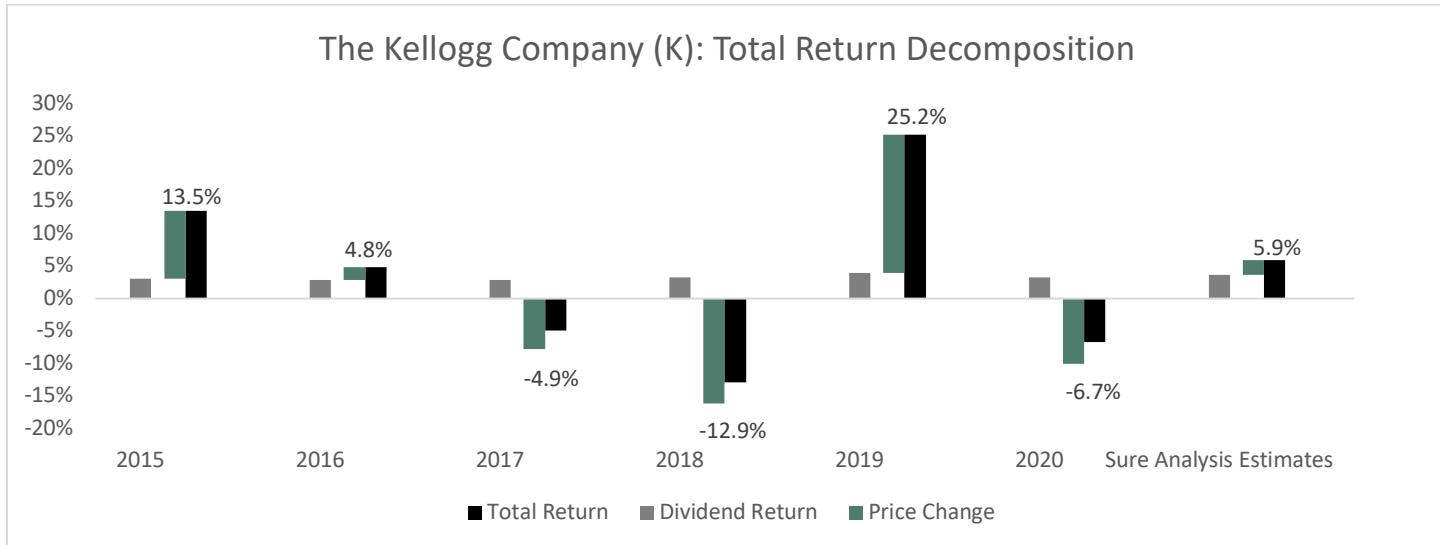
Kellogg's payout ratio is generally close to half of earnings but is above that today. We expect it to remain as such for the foreseeable future given that dividend and earnings-per-share growth should be roughly congruent over time.

Kellogg's recession performance is very strong, as you'd expect from a highly entrenched consumer staple producer. This company should hold up very well during the next recession and the ones that follow. Its competitive advantages include enormous consumer brands with sizable followings and tremendous market shares, in addition to its very efficient global distribution network. Its massive reach allows for extending products across borders with the ease to expand upon proven success of winners. Its innovation labs also continue to produce unique new products. Kellogg is not just a cereal company; it is a truly global powerhouse in the food industry.

## Final Thoughts & Recommendation

Kellogg is trading above our estimate of fair value, with forecasted total returns of 5.9% per annum. Kellogg could achieve these returns via the current 3.7% dividend yield, a small headwind from a lower valuation, and 3% earnings growth. With the recent action in the stock, the valuation has improved slightly, but we're reiterating a hold rating.

## 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>	13,198	14,197	14,792	14,580	13,525	12,965	12,854	13,547	13,578	13,770
<b>Gross Profit</b>	5,152	5,434	6,103	5,063	4,681	4,834	4,699	4,726	4,381	4,727
<b>Gross Margin</b>	39.0%	38.3%	41.3%	34.7%	34.6%	37.3%	36.6%	34.9%	32.3%	34.3%
<b>SG&amp;A Exp.</b>	3,725	3,872	3,266	4,039	3,590	3,351	3,312	3,020	2,980	2,966
<b>D&amp;A Exp.</b>	369	448	532	503	534	517	481	516	484	479
<b>Operating Profit</b>	1,427	1,562	2,837	1,024	1,091	1,483	1,387	1,706	1,401	1,761
<b>Op. Margin</b>	10.8%	11.0%	19.2%	7.0%	8.1%	11.4%	10.8%	12.6%	10.3%	12.8%
<b>Net Profit</b>	866	961	1,807	632	614	699	1,254	1,336	960	1,251
<b>Net Margin</b>	6.6%	6.8%	12.2%	4.3%	4.5%	5.4%	9.8%	9.9%	7.1%	9.1%
<b>Free Cash Flow</b>	1,001	1,225	1,170	1,211	1,138	764	(98)	958	590	1,481
<b>Income Tax</b>	320	363	792	186	159	235	410	181	321	323

## Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
<b>Total Assets</b>	11,943	15,169	15,474	15,153	15,251	15,111	16,351	17,780	17,564	17,996
<b>Cash &amp; Equivalents</b>	460	281	273	443	251	280	281	321	397	435
<b>Acc. Receivable</b>	983	1,179	1,226	1,094	1,161	1,098	1,240	1,153	1,576	1,537
<b>Inventories</b>	1,174	1,365	1,248	1,279	1,250	1,238	1,217	1,330	1,226	1,284
<b>Goodwill &amp; Int.</b>	5,077	7,397	7,418	7,266	7,236	7,535	8,143	9,411	8,437	8,290
<b>Total Liabilities</b>	10,145	12,704	11,867	12,302	13,113	13,185	14,157	14,621	14,250	14,360
<b>Accounts Payable</b>	1,189	1,402	1,432	1,528	1,907	2,014	2,269	2,427	2,387	2,471
<b>Long-Term Debt</b>	6,032	7,902	7,358	7,370	7,745	7,767	8,615	8,893	7,922	7,475
<b>Total Equity</b>	1,796	2,404	3,545	2,789	2,128	1,910	2,178	2,601	2,747	3,112
<b>D/E Ratio</b>	3.36	3.29	2.08	2.64	3.64	4.07	3.96	3.42	2.88	2.40

## Profitability & Per Share Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
<b>Return on Assets</b>	7.3%	7.1%	11.8%	4.1%	4.0%	4.6%	8.0%	7.8%	5.4%	7.0%
<b>Return on Equity</b>	43.8%	45.8%	60.7%	20.0%	25.0%	34.6%	61.4%	55.9%	35.9%	42.7%
<b>ROIC</b>	10.9%	10.6%	16.9%	6.0%	6.1%	7.1%	12.2%	11.7%	8.2%	11.2%
<b>Shares Out.</b>	357	361	363	356	350	351	347	344	343	344
<b>Revenue/Share</b>	36.26	39.44	40.53	40.50	37.99	36.62	36.73	38.93	39.59	40.15
<b>FCF/Share</b>	2.75	3.40	3.21	3.36	3.20	2.16	(0.28)	2.75	1.72	4.32

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

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