



# Lancaster Colony Corporation (LANC)

Updated February 12<sup>th</sup>, 2024, by Josh Arnold

## Key Metrics

|                             |       |                                            |       |                                  |                       |
|-----------------------------|-------|--------------------------------------------|-------|----------------------------------|-----------------------|
| <b>Current Price:</b>       | \$194 | <b>5 Year CAGR Estimate:</b>               | 6.5%  | <b>Market Cap:</b>               | \$5.4 B               |
| <b>Fair Value Price:</b>    | \$183 | <b>5 Year Growth Estimate:</b>             | 6.0%  | <b>Ex-Dividend Date:</b>         | 03/01/24 <sup>1</sup> |
| <b>% Fair Value:</b>        | 106%  | <b>5 Year Valuation Multiple Estimate:</b> | -1.2% | <b>Dividend Payment Date:</b>    | 03/29/24              |
| <b>Dividend Yield:</b>      | 1.9%  | <b>5 Year Price Target</b>                 | \$244 | <b>Years Of Dividend Growth:</b> | 61                    |
| <b>Dividend Risk Score:</b> | A     | <b>Retirement Suitability Score:</b>       | B     | <b>Rating:</b>                   | Hold                  |

## Overview & Current Events

Lancaster Colony has been making food products since 1969, after shifting away from housewares. The move has afforded the company some meaningful growth in the past five decades and the stock has a \$5.4 billion market capitalization on \$1.9 billion in annual revenue. Lancaster Colony makes various meal accessories like croutons and bread products in frozen and non-frozen categories. Lancaster also has one of the best dividend increase streaks in the entire market, with more than six decades of consecutive increases.

Lancaster posted second quarter earnings on February 1<sup>st</sup>, 2024, and results were mixed. The company posted earnings-per-share of \$1.87, which was 22 cents better than expected. Revenue was \$486 million, up 1.8% year-over-year, and missing estimates by more than \$7 million. However, that was a record level of sales.

Retail segment net sales were up 2% to \$264 million. Volume was down 1.9%, but saw favorable pricing actions.

Foodservice segment net sales were up 1.5% to \$222 million despite deflationary pricing. Volume was up 4.6%, driven by higher demand from national chain restaurant accounts, along with volume growth for branded foodservice products.

Consolidated gross profit was 19% of sales, attributable to favorability in pricing net of commodity costs, as well as cost savings initiatives. Partial offsets to those factors included higher labor costs and higher depreciation expense. Operating income was up 28.1% to a Q2 record \$66 million. Higher SG&A expenses partially offset growth in gross profits. Net income was \$52 million.

We move our expectation for earnings-per-share in fiscal 2024 to \$6.30 after Q2 results.

## Growth on a Per-Share Basis

| Year                      | 2014   | 2015   | 2016   | 2017   | 2018   | 2019   | 2020   | 2021   | 2022   | 2023   | 2024          | 2029          |
|---------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|---------------|---------------|
| <b>EPS</b>                | \$3.69 | \$3.72 | \$4.44 | \$4.20 | \$4.92 | \$5.46 | \$4.97 | \$5.05 | \$4.38 | \$4.76 | <b>\$6.30</b> | <b>\$8.43</b> |
| <b>DPS</b>                | \$1.72 | \$1.82 | \$1.96 | \$2.15 | \$2.40 | \$2.55 | \$2.75 | \$3.00 | \$3.15 | \$3.40 | <b>\$3.60</b> | <b>\$4.82</b> |
| <b>Shares<sup>2</sup></b> | 27     | 27     | 27     | 27     | 28     | 28     | 28     | 28     | 28     | 28     | <b>28</b>     | <b>28</b>     |

The company's earnings-per-share growth has been spotty as its revenue tends to ebb and flow with restaurant traffic. It recovered nicely from the Great Recession, but the drop in 2008 earnings was very steep. We note the COVID recession saw Lancaster's retail and foodservice diversification come into its own as foodservice demand essentially disappeared.

We are forecasting 6% earnings-per-share growth annually ahead, comprised of low single-digit sales and growing margins over time, with the caveat that margins are generally volatile. Lancaster does not buy back stock. The company's average revenue growth has been and should remain in the low single-digits, but keep in mind the possibility for earnings volatility going forward - there will be years where it dips and other years where it may rise rapidly, as it did in 2018, and again in 2019. Organic growth has been a problem for Lancaster Colony, but it does complete sizable acquisitions regularly. After a decline in earnings in 2020, Lancaster has failed to get back near its prior highs in terms of earnings. We believe the company has a very strong chance to set record earnings again in 2024.

<sup>1</sup> Estimated date

<sup>2</sup> Share count in millions

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We are forecasting modest dividend growth annually for the next five years as Lancaster Colony continues its impressive streak of payouts to shareholders; the payout could be \$4.82 per share in five years. Lancaster is not a strong income stock, but it does prioritize growth in the payout each year, and that should continue. The company raised the dividend in November 2023 for the 61<sup>st</sup> consecutive year, a streak we expect to continue indefinitely.

## Valuation Analysis

| Year      | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | Now  | 2029 |
|-----------|------|------|------|------|------|------|------|------|------|------|------|------|
| Avg. P/E  | 23.5 | 24.5 | 24.3 | 31.2 | 31.4 | 28.8 | 30.0 | 35.0 | 29.4 | 42.2 | 30.8 | 29.0 |
| Avg. Yld. | 2.0% | 2.0% | 1.8% | 1.6% | 1.7% | 1.6% | 1.8% | 1.7% | 2.4% | 1.7% | 1.9% | 2.0% |

The stock's price-to-earnings ratio has spent the past few years around 30, but given the company's exposure to restaurants, we see fair value at 29 times earnings. Today, shares trade for 30.8 times our fiscal 2024 earnings estimate, so we see it as slightly overvalued.

We see the yield remaining about where it is today given the forecasted moves in the valuation, earnings, and payout. Lancaster's current yield is better than the S&P 500.

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

| Year   | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | 2029 |
|--------|------|------|------|------|------|------|------|------|------|------|------|------|
| Payout | 38%  | 47%  | 49%  | 44%  | 47%  | 47%  | 55%  | 48%  | 72%  | 71%  | 57%  | 57%  |

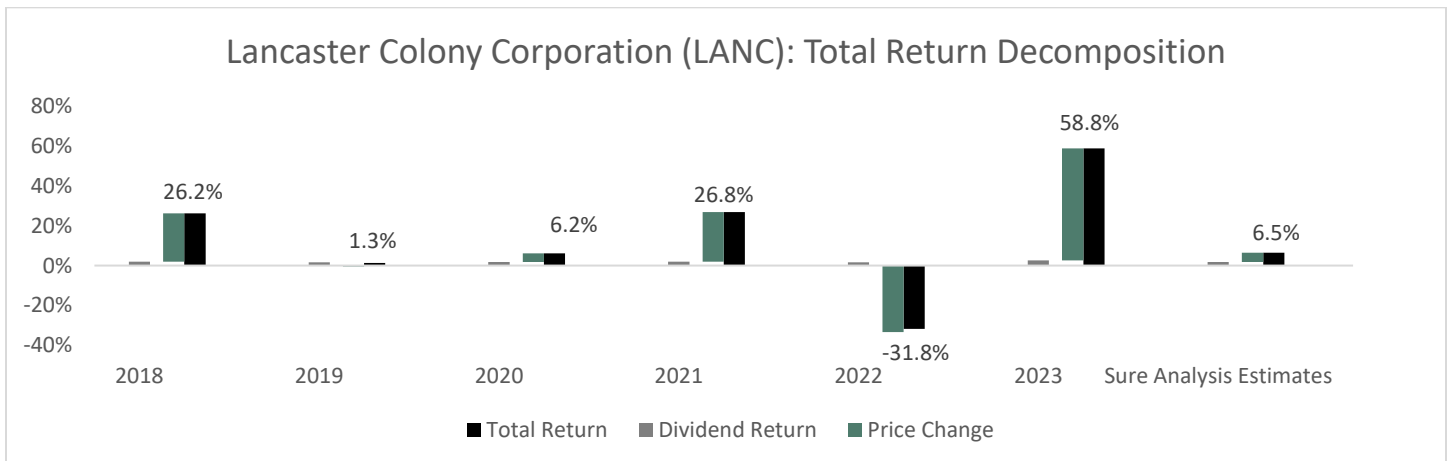
Lancaster Colony's payout should remain near where it is today as dividend growth roughly matches earnings growth. Given its Dividend King status, we know the payout is important to management and the dividend is very safe.

Lancaster Colony's competitive advantage is in its leadership position within the niche categories in which it competes. The company goes after accessory categories like bread, dressings, and croutons where competition tends to be lighter. It also has strong distribution partnerships with companies like Walmart and McLane Company, a major restaurant distributor. Its recession performance track record is spotty because it is reliant upon restaurant traffic, something that suffers mightily during times of economic stress and input cost inflation.

## Final Thoughts & Recommendation

We forecast Lancaster Colony to provide shareholders with total annualized returns of 6.5% over the next five years, comprised of 6% growth, a 1.9% dividend yield, and a small headwind from the valuation. We're moving the stock from buy to hold after Q2 results, as projected returns have fallen.

## Total Return Breakdown by Year



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## Income Statement Metrics

| Year                    | 2014  | 2015  | 2016  | 2017  | 2018  | 2019  | 2020  | 2021  | 2022  | 2023  |
|-------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| <b>Revenue</b>          | 1,041 | 1,105 | 1,191 | 1,202 | 1,223 | 1,308 | 1,334 | 1,467 | 1,676 | 1,823 |
| <b>Gross Profit</b>     | 249   | 258   | 300   | 319   | 304   | 326   | 358   | 387   | 356   | 389   |
| <b>Gross Margin</b>     | 23.9% | 23.3% | 25.2% | 26.5% | 24.8% | 24.9% | 26.8% | 26.4% | 21.2% | 21.3% |
| <b>SG&amp;A Exp.</b>    | 95    | 103   | 115   | 143   | 130   | 150   | 181   | 205   | 212   | 222   |
| <b>D&amp;A Exp.</b>     | 20    | 21    | 24    | 25    | 27    | 32    | 38    | 45    | 46    | 51    |
| <b>Operating Profit</b> | 154   | 155   | 185   | 176   | 174   | 176   | 177   | 181   | 144   | 166   |
| <b>Operating Margin</b> | 14.8% | 14.0% | 15.5% | 14.6% | 14.2% | 13.5% | 13.3% | 12.4% | 8.6%  | 9.1%  |
| <b>Net Profit</b>       | 75    | 102   | 122   | 115   | 135   | 151   | 137   | 142   | 90    | 111   |
| <b>Net Margin</b>       | 7.2%  | 9.2%  | 10.2% | 9.6%  | 11.1% | 11.5% | 10.3% | 9.7%  | 5.4%  | 6.1%  |
| <b>Free Cash Flow</b>   | 113   | 114   | 129   | 119   | 130   | 127   | 88    | 86    | -30   | 136   |
| <b>Income Tax</b>       | 52    | 53    | 63    | 60    | 39    | 45    | 42    | 43    | 23    | 32    |

## Balance Sheet Metrics

| Year                            | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021  | 2022  | 2023  |
|---------------------------------|------|------|------|------|------|------|------|-------|-------|-------|
| <b>Total Assets</b>             | 639  | 702  | 635  | 716  | 804  | 905  | 993  | 1,101 | 1,090 | 1,113 |
| <b>Cash &amp; Equivalents</b>   | 212  | 182  | 118  | 143  | 206  | 196  | 198  | 188   | 60    | 88    |
| <b>Accounts Receivable</b>      | 58   | 62   | 66   | 70   | 73   | 76   | 87   | 98    | 135   | 115   |
| <b>Inventories</b>              | 75   | 78   | 76   | 76   | 91   | 86   | 85   | 122   | 145   | 158   |
| <b>Goodwill &amp; Int. Ass.</b> | 95   | 192  | 189  | 228  | 224  | 279  | 274  | 267   | 241   | 213   |
| <b>Total Liabilities</b>        | 110  | 121  | 121  | 140  | 152  | 179  | 210  | 258   | 246   | 251   |
| <b>Accounts Payable</b>         | 38   | 39   | 40   | 41   | 58   | 77   | 71   | 110   | 115   | 112   |
| <b>Long-Term Debt</b>           | ---  | ---  | ---  | ---  | ---  | ---  | ---  | ---   | ---   | 0     |
| <b>Shareholder's Equity</b>     | 529  | 581  | 514  | 576  | 652  | 727  | 783  | 843   | 845   | 862   |
| <b>LTD/E Ratio</b>              | ---  | ---  | ---  | ---  | ---  | ---  | ---  | ---   | ---   | 0     |

## Profitability & Per Share Metrics

| Year                    | 2014  | 2015  | 2016  | 2017  | 2018  | 2019  | 2020  | 2021  | 2022  | 2023  |
|-------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| <b>Return on Assets</b> | 11.9% | 15.2% | 18.2% | 17.1% | 17.8% | 17.6% | 14.4% | 13.6% | 8.2%  | 10.1% |
| <b>Return on Equity</b> | 14.6% | 18.3% | 22.2% | 21.2% | 22.0% | 21.8% | 18.1% | 17.5% | 10.6% | 13.0% |
| <b>ROIC</b>             | 14.6% | 18.3% | 22.2% | 21.2% | 22.0% | 21.8% | 18.1% | 17.5% | 10.6% | 13.0% |
| <b>Shares Out.</b>      | 27    | 27    | 27    | 27    | 28    | 28    | 28    | 28    | 27    | 27    |
| <b>Revenue/Share</b>    | 38.12 | 40.42 | 43.51 | 43.80 | 44.54 | 47.49 | 48.53 | 53.31 | 61.02 | 66.32 |
| <b>FCF/Share</b>        | 4.14  | 4.19  | 4.72  | 4.35  | 4.72  | 4.60  | 3.21  | 3.14  | -1.10 | 4.94  |

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

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