

Kellogg Company (K)

\$69.14 (As of 01/09/20)

Price Target (6-12 Months): **\$73.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 04/10/19)

Prior Recommendation: Underperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

4-Sell

Zacks Style Scores:

VGM:D

Value: C

Growth: C

Momentum: F

Summary

Kellogg's shares have outperformed the industry in the past six months. The company has been gaining from an impressive organic sales trend. During the third quarter, organic sales improved 2.4%, backed by broad-based growth and improved price realization. Additionally, the company has been benefitting from a strong brand portfolio, supported by prudent buyouts as well as presence in emerging nations. However, the company's third-quarter performance were hurt by the divestiture of the cookies, fruit snacks, pie crusts and ice-cream cones businesses. Consequently, revenues and earnings fell year on year. For 2019, the company expects the divestiture to adversely impact the top line by almost 2-3%. The same is also likely to exert pressure on the bottom line. Moreover, rising input costs and currency volatility are threats.

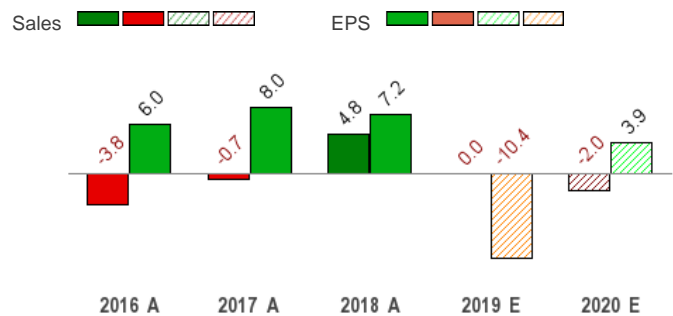
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$70.00 - \$51.34
20 Day Average Volume (sh)	1,448,838
Market Cap	\$23.6 B
YTD Price Change	-0.0%
Beta	0.53
Dividend / Div Yld	\$2.28 / 3.3%
Industry	Food - Miscellaneous
Zacks Industry Rank	Top 41% (104 out of 254)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	13.2%
Last Sales Surprise	0.1%
EPS F1 Est- 4 week change	-0.1%
Expected Report Date	02/06/2020
Earnings ESP	0.0%

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2020	3,311 E	3,287 E	3,382 E	3,322 E	13,270 E
2019	3,522 A	3,461 A	3,372 A	3,185 E	13,544 E
2018	3,401 A	3,360 A	3,469 A	3,317 A	13,547 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2020	\$1.00 E	\$0.97 E	\$1.05 E	\$1.01 E	\$4.03 E
2019	\$1.01 A	\$0.99 A	\$1.03 A	\$0.85 E	\$3.88 E
2018	\$1.19 A	\$1.14 A	\$1.06 A	\$0.91 A	\$4.33 A

*Quarterly figures may not add up to annual.

P/E TTM	17.6
P/E F1	17.2
PEG F1	3.8
P/S TTM	1.7

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 01/09/2020. The reports text is as of 01/10/2020.

Overview

Headquartered in Battle Creek, MI, **Kellogg Company (K)** manufactures and markets ready-to-eat cereals and convenience foods (including cookies, crackers, toaster pastries, cereal bars, fruit-flavored snacks, frozen waffles and veggie foods), and savory snacks. The company has a balanced portfolio of cereal and snack products.

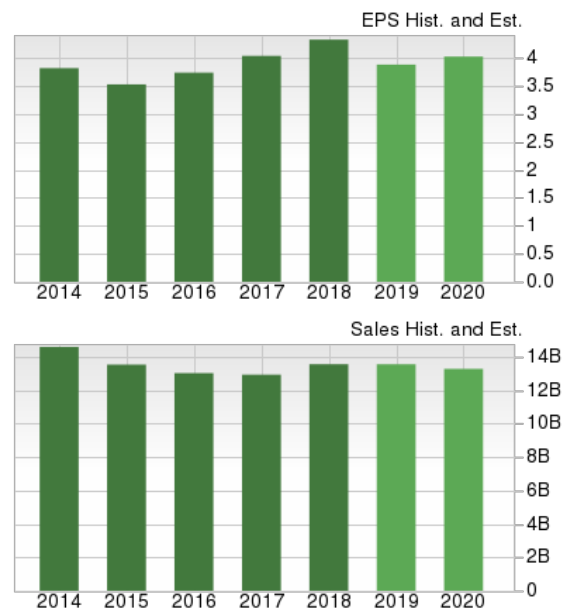
Kellogg's products are manufactured in 20 countries and marketed across 180 nations. Principal markets for the products offered include the United States and United Kingdom.

We note that earlier the company reported results under seven segments namely; U.S. Snacks, U.S. Morning Foods, U.S. Specialty Channels, North America Other, Europe, Latin America and Asia Pacific. The U.S. Snacks unit includes items such as crackers, cookies, cereal bars, savory snacks and fruit-flavored snacks. The U.S. Morning Foods unit consist of mainly cereals and toaster pastries. U.S. Specialty Channels consists of food away from home channels, including food service, convenience, vending and food manufacturing. Further, the North America Other unit includes U.S. Frozen, Kashi, Canada, and RX operating segments. The remaining segments are based on geographical locations, namely; Europe, Latin America and the Middle East and Northern Africa.

Concurrent to its fourth-quarter 2018 results, Kellogg unveiled some changes related to its segments for 2019. As part of its efforts to reorganize its North America region, the sub divisions – U.S. Snacks, U.S. Morning Foods, U.S. Specialty Channels and North America Other – have been removed.

Further, the company has transferred its Middle East, Turkey and North African businesses from Kellogg Europe to Kellogg Asia-Pacific. Kellogg Asia-Pacific has been rechristened as Kellogg Asia, Middle East & Africa. As per these changes, the company now reports its quarterly outcomes under four segments, namely; North America, Europe, Latin America and the Asia, Middle East & Africa or AMEA region.

In 2018, the company generated sales of \$13.5 billion (64.1% from North America, 17.7% from Europe, 11.2% from Asia-Pacific and 7% from Latin America).



Reasons To Buy:

▲ **Robust Organic Sales Trend:** Kellogg's organic sales have been rising for a while. During the third quarter of 2019, the company's organic net sales moved up 2.4% to \$3,416 million, backed by broad-based growth and improved price realization. Moreover, organic sales had improved across the company's regional segments. Prior to this, organic sales had improved 2.3% and 0.3% in the second and the first quarter, respectively. Moreover, management expects organic sales to rise 1-2% in 2019. Such upsides along with prudent buyouts, growth in emerging regions and efforts to enhance efficiency have boosted investors' optimism. Shares of the company have gained 26.6% in the past six months compared with the industry's rise of 4.3%.

Kellogg boasts robust organic sales trend. Further, the company is on-track with building brands and expanding presence in the emerging regions.

▲ **Lucrative Buyouts:** In line with the strategy to diversify its organic offerings, Kellogg acquired protein bar maker, Chicago Bar Company, in 2017. Chicago Bar Company makes RXBAR, which is considered the fastest growing nutrition bar brand in the United States. RX now forms part of Kellogg's organic revenues. Additionally, the company's Pringles buyout has been lucrative. Moreover, with the Pringles deal, Kellogg transformed itself from what was essentially a large U.S. snacks business to a true global snacks player. Also, the consolidation of Multipro, a Nigerian food distributor, was an upside to the company's performance in 2018 as well as in the first half of 2019. Markedly, these acquired businesses are expected to continue supporting the company's business. Kellogg also continues to expand its acquired brands through new product introductions.

▲ **Growth Efforts on Track:** Kellogg's productivity saving initiatives, have been on track. In this respect, the company is striving toward building a better cost structure. We note that the company successfully completed the Project K program. Savings from this program are being invested in brand-building initiatives, improve logistics, sales capabilities and innovation.

Further, the company is on track with deploy for growth strategy, and is accordingly undertaking efforts to restructure portfolio. As part of portfolio restructuring efforts, the company completed the sale of certain snacks, cookies, crusts and ice cream businesses. Though this divestiture is likely to weigh on the company's results in the near term, such efforts are likely to aid focusing on other lucrative business platforms and achieve greater efficiency. Moreover, the divestitures have helped the company to reduce debt and improve its financial position.

▲ **Strong Brand Portfolio:** Kellogg boasts a legacy of over 100 years built on solid product portfolio and brand identity in both cereals and snacks. Its portfolio consists of strong brands such as Pringles, RXBAR, Bear Naked, Cheez-It, Rice Krispies Treats among many others. The company's frozen foods brands like Morningstar Farms and Eggo have also been depicting strong growth. In Jun 2012, the company acquired Procter & Gamble's snack unit, Pringles, which is now its second-largest brand. Kellogg is also dedicated toward augmenting its portfolio through adding more products under existing brands, innovation and marketing initiatives. The company currently spends a high percentage of profits on brand building. In this respect, it invests in efforts such as digital media, consumer promotions and traditional advertising. It is also investing in in-store capabilities like increasing the sales forces of its struggling businesses, such as cereals.

▲ **Expansion into Emerging Markets:** Kellogg is rapidly building its business in the emerging markets of Asia, the Middle East and the African (AMEA) regions. The Pringles acquisition has also opened up growth opportunities in these fast-growing nations. Moreover, the company is undertaking efforts to expand business in the emerging markets of Brazil, Russia, West Africa and Central Europe. Management expects emerging markets to be a solid growth driver in the forthcoming periods.

Reasons To Sell:

▼ **Divestiture Weighs on Q3 Performance, Outlook Dismal:** Kellogg's third-quarter 2019 performance was dented by divestitures. The company delivered net sales of \$3,372 million, which slipped 2.8% year over year. The downside can be attributed to currency woes as well as impacts from the divestiture of the company's cookies, fruit snacks, pie crusts and ice-cream cones businesses. Absence of the divested businesses dragged sales by about 4%, and also exerted pressure on the company's North American Unit. Additionally, the divestiture affected the company's bottom line performance, which declined 2.8% year-on-year.

Adverse impacts from divestitures and currency rates as well as rising input costs were headwinds for Kellogg in third-quarter.

For 2019, the company expects divestitures to adversely impact the top line by almost 2-3%. The same is also likely to exert pressure on the company's bottom line. Adjusted operating profit (at cc) is expected to decline 4-5%. Consequently, Kellogg envisions adjusted earnings to drop 10% (at cc).

▼ **Elevated Costs:** Kellogg has been struggling with rising input costs. During the third and the second quarter of 2019, high input costs weighed on the company's bottom line. In the third quarter, adjusted operating profit also fell almost 5.7% year over year, thanks to cost inflation, increased investments, currency headwinds and adverse divestiture impacts. Also, the company's adjusted earnings declined 1%, at constant currency, owing to higher costs. Looking into the segments, high input costs were a drag on the company's European and Latin American operations. Persistence of such rising cost trends are a threat to the company.

▼ **Currency Headwinds:** Kellogg's solid international presence keeps the company exposed to risks associated with overseas operations. Volatile currency movement is one such risk. Incidentally, the U.S. dollar strengthened significantly in the second half of 2018, which served as a headwind for Kellogg's performance in 2018. Also, adverse currency rate was a drag on performance during the first, the second and the third quarter of 2019.

▼ **Food Industry Headwinds:** The food industry is grappling with stiff competition and aggressive promotional environment. The company faces intense competition from other food companies on the grounds of quality, prices and availability. To meet such competitive pressure effectively, Kellogg may have to lower prices or indulge in marketing activities to maintain market share. Additionally, since the company operates in a highly regulated nutritional food space, its products are frequently inspected by government agencies. Moreover, nutritional products usually have a lower shelf life which requires products to move off the shelves rapidly, to prevent expiry.

Last Earnings Report

Kellogg's Q3 Earnings & Sales Top Estimates, Decline Y/Y

Kellogg Company reported third-quarter 2019 results, wherein adjusted earnings of \$1.03 per share beat the Zacks Consensus Estimate of 91 cents. However, the bottom line fell 2.8% year over year, due to impacts from divestitures and currency headwinds. On a constant-currency (cc) basis, adjusted earnings fell nearly 1% to \$1.05 due to escalated costs.

The company delivered net sales of \$3,372 million, which slipped 2.8% year over year, though it surpassed the consensus mark of \$3,368 million. The year-over-year downside can be attributed to currency woes as well as impacts from the divestiture of the company's cookies, fruit snacks, pie crusts and ice-cream cones businesses. Absence of the divested businesses dragged sales down by about 4%. Sales dropped 1.5% to \$3,416 million at cc. Further, organic revenues moved up 2.4% to \$3,416 million.

Adjusted operating profit fell 5.7% to \$444 million, thanks to cost inflation, increased investments, currency headwinds and divestiture impact. The metric dropped 4.4% to \$450 million at cc.

Segment Discussion

Sales in the **North America** segment amounted to \$2,059 million, down nearly 6% due to divestiture impacts. Sales grew marginally on an organic basis, courtesy of favorable price realization and continued consumption gains in five out of six major categories. Adjusted operating profit declined approximately 6% at cc.

Revenues in the **Europe** segment totaled \$527 million, down 1% year on year due to unfavorable currency movements. Nevertheless, sales rose about 4% at cc, backed by enhanced in-market performance. Pringles sustained its momentum in key markets, on the back of efficient brand-building efforts, innovation and new pack formats. Adjusted operating profit fell around 5% at cc as elevated costs and intense promotions more than offset lower restructuring charges related to Project K.

Revenues in **Latin America** totaled \$244 million, up about 2% year on year. Sales grew approximately 5% at cc, driven by broad-based growth in snacks and cereals. Adjusted operating profit fell roughly 5% at cc, due to higher distribution and input costs.

Revenues in the **Asia, Middle East & Africa** segment totaled \$542 million, up 6% year over year. Sales improved about 8% at cc, backed by strength in Africa and the Middle East. Further, Kellogg witnessed growth in snacks, noodles and cereal. Adjusted operating profit improved 18% at cc.

Other Financials

Kellogg ended the quarter with cash and cash equivalents of \$453 million, long-term debt of \$7,683 million and total equity of \$3,288 million.

Year to date, the company has generated cash from operating activities of \$925 million.

2019 Guidance

Kellogg is on track to focus on core growth areas, evident from its reshaped portfolio. Further, the company remains focused on rejuvenating key brands through innovation and brand-building efforts.

That said, sales in 2019 are expected to grow 1-2% at cc and on an organic basis. Further, adjusted operating profit (at cc) is expected to decline 4-5% due to divestiture impacts.

Kellogg envisions adjusted earnings to drop 10% at cc compared with 10-11% decline projected earlier. The expected year-over-year decline is accountable to divestiture impacts and other factors.

Quarter Ending **09/2019**

Report Date	Oct 29, 2019
Sales Surprise	0.11%
EPS Surprise	13.19%
Quarterly EPS	1.03
Annual EPS (TTM)	3.94

Recent News

Kellogg Declares Dividend – Oct 18, 2019

Kellogg's board approved a dividend of 57 cents per share, payable on Dec 16, 2019, to shareholders in record as on Dec 2, 2019.

Kellogg Completes Selected Businesses Sales to Ferrero – Jul 29, 2019

Kellogg announced that it has completed the divestiture of certain cookies, pie crusts, fruit and fruit-flavored snacks, and ice cream cones businesses to Ferrero Group. The divested businesses were a part of the company's North America snacking business.

Valuation

Kellogg's shares are up 18% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Consumer Staples sector are up 12.9% and 16.8% over the past year, respectively.

The S&P 500 index is up 24.4% in the past year.

The stock is currently trading at 17.15X forward 12-month earnings, which compares to 18.25X for the Zacks sub-industry, 19.75X for the Zacks sector and 18.81X for the S&P 500 index.

Over the past five years, the stock has traded as high as 22.71X and as low as 12.45X, with a 5-year median of 16.77X. Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$73 price target reflects 18.11X forward 12-month earnings.

The table below shows summary valuation data for K

Valuation Multiples - K					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	17.15	18.25	19.75	18.81
	5-Year High	22.71	22.9	22.39	19.34
	5-Year Low	12.45	14.82	16.65	15.17
	5-Year Median	16.77	19.19	19.75	17.44
P/S F12M	Current	1.78	1.73	9.83	3.49
	5-Year High	2.28	2.05	11.03	3.49
	5-Year Low	1.32	1.44	8.02	2.54
	5-Year Median	1.77	1.81	9.78	3
EV/EBITDA F12M	Current	13.17	14.08	34.12	12.66
	5-Year High	14.21	16.59	36.97	12.66
	5-Year Low	10.39	11.67	29.14	9.08
	5-Year Median	11.94	13.26	33.27	10.78

As of 01/09/2020

Industry Analysis Zacks Industry Rank: Top 41% (104 out of 254)



Top Peers

B&G Foods, Inc. (BGS)	Neutral
Conagra Brands Inc. (CAG)	Neutral
Campbell Soup Company (CPB)	Neutral
Flowers Foods, Inc. (FLO)	Neutral
General Mills, Inc. (GIS)	Neutral
J & J Snack Foods Corp. (JJSF)	Neutral
Nomad Foods Limited (NOMD)	Neutral
TreeHouse Foods, Inc. (THS)	Underperform

Industry Comparison Industry: Food - Miscellaneous				Industry Peers		
	K Neutral	X Industry	S&P 500	CPB Neutral	GIS Neutral	THS Underperform
VGM Score	D	-	-	B	B	B
Market Cap	23.58 B	4.32 B	23.94 B	14.36 B	31.68 B	2.61 B
# of Analysts	6	3	13	5	7	5
Dividend Yield	3.30%	0.11%	1.78%	2.94%	3.74%	0.00%
Value Score	C	-	-	C	A	A
Cash/Price	0.02	0.04	0.04	0.00	0.02	0.02
EV/EBITDA	14.62	14.41	13.97	14.72	13.05	16.97
PEG Ratio	3.83	2.29	2.03	3.16	2.20	1.78
Price/Book (P/B)	7.17	2.90	3.33	11.50	3.95	1.45
Price/Cash Flow (P/CF)	11.74	12.94	13.73	12.56	12.28	6.80
P/E (F1)	17.23	18.35	18.79	18.78	15.43	17.57
Price/Sales (P/S)	1.72	1.35	2.64	1.62	1.89	0.51
Earnings Yield	5.83%	5.21%	5.32%	5.33%	6.47%	5.68%
Debt/Equity	2.45	0.62	0.72	5.37	1.37	1.29
Cash Flow (\$/share)	5.89	2.72	6.94	3.79	4.26	6.83
Growth Score	C	-	-	B	C	C
Hist. EPS Growth (3-5 yrs)	3.43%	5.08%	10.56%	-0.30%	2.82%	-10.27%
Proj. EPS Growth (F1/F0)	3.70%	8.40%	7.49%	10.26%	5.41%	11.16%
Curr. Cash Flow Growth	6.86%	3.82%	14.83%	-12.42%	5.47%	-61.72%
Hist. Cash Flow Growth (3-5 yrs)	1.17%	7.12%	9.00%	0.50%	1.32%	10.92%
Current Ratio	0.80	1.65	1.23	0.60	0.61	1.49
Debt/Capital	71.00%	38.35%	42.99%	84.30%	57.73%	56.27%
Net Margin	5.35%	2.79%	11.08%	2.07%	12.62%	-7.65%
Return on Equity	42.47%	11.60%	17.16%	64.48%	27.33%	5.80%
Sales/Assets	0.76	1.17	0.55	0.66	0.55	0.92
Proj. Sales Growth (F1/F0)	-2.03%	2.51%	4.20%	-12.79%	2.14%	1.17%
Momentum Score	F	-	-	A	D	D
Daily Price Chg	0.36%	0.00%	0.53%	0.57%	-1.13%	-0.45%
1 Week Price Chg	-1.68%	-0.64%	-0.30%	-2.08%	-2.35%	0.10%
4 Week Price Chg	4.46%	1.25%	1.92%	-0.19%	1.39%	-7.40%
12 Week Price Chg	11.14%	4.28%	6.54%	-0.71%	-1.10%	-14.63%
52 Week Price Chg	18.61%	16.88%	22.58%	38.11%	26.46%	-17.62%
20 Day Average Volume	1,448,838	108,515	1,580,816	1,770,589	3,923,731	390,556
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	-0.07%	0.00%	0.00%	0.04%	0.67%	0.00%
(F1) EPS Est 12 week change	-0.81%	-0.77%	-0.50%	0.34%	0.81%	-7.06%
(Q1) EPS Est Mthly Chg	-2.13%	0.00%	0.00%	0.08%	-5.23%	0.00%

Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	C
Growth Score	C
Momentum Score	F
VGM Score	D

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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