

Kellogg Company (K)

\$53.56 (As of 03/23/20)

Price Target (6-12 Months): **\$45.00**

Long Term: 6-12 Months

Zacks Recommendation: Underperform
(Since: 02/11/20)

Prior Recommendation: Neutral

Short Term: 1-3 Months

Zacks Rank: (1-5)
4-Sell

Zacks Style Scores:

VGM:D

Value: D

Growth: D

Momentum: A

Summary

Kellogg's shares have declined year to date. The company's fourth-quarter results were hurt by the divestiture of the cookies, fruit snacks, pie crusts and ice-cream cones businesses. Sales slipped 2.8% year on year. For 2020, management expects the divestiture to adversely impact sales by almost 4%. The same is also likely to exert pressure on earnings. Apart from this, rising input costs and currency volatility are threats to its performance. Further, macroeconomic challenges in Latin America are a concern. Nevertheless, the company has been benefiting from robust organic sales trend. During the fourth quarter, organic sales improved 2.7%, backed by improved price realization and product mix. Also, it has been benefitting from strong brand portfolio, supported by prudent buyouts and presence in emerging markets.

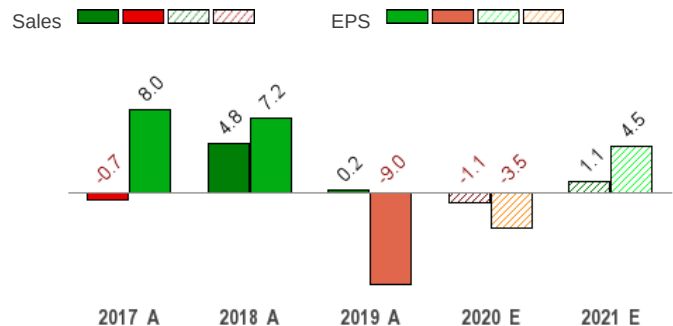
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$71.05 - \$51.34
20 Day Average Volume (sh)	3,163,150
Market Cap	\$18.3 B
YTD Price Change	-22.6%
Beta	0.66
Dividend / Div Yld	\$2.28 / 4.3%
Industry	Food - Miscellaneous
Zacks Industry Rank	Top 39% (100 out of 254)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	5.8%
Last Sales Surprise	0.8%
EPS F1 Est- 4 week change	-3.0%
Expected Report Date	05/07/2020
Earnings ESP	1.7%
P/E TTM	13.6
P/E F1	14.1
PEG F1	3.1
P/S TTM	1.4

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	3,356 E	3,347 E	3,447 E	3,350 E	13,584 E
2020	3,288 E	3,298 E	3,381 E	3,443 E	13,433 E
2019	3,522 A	3,461 A	3,372 A	3,223 A	13,578 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$0.95 E	\$0.99 E	\$1.08 E	\$1.01 E	\$3.97 E
2020	\$0.89 E	\$0.90 E	\$1.00 E	\$0.99 E	\$3.80 E
2019	\$1.01 A	\$0.99 A	\$1.03 A	\$0.91 A	\$3.94 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 03/23/2020. The reports text is as of 03/24/2020.

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.

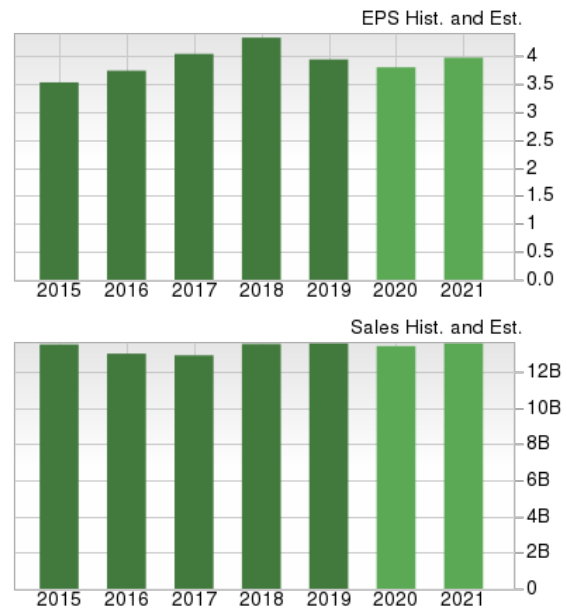
Kellogg's products are manufactured in 20 countries and marketed across 180 nations. Principal markets for the products offered include the United States and United Kingdom.

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 2019, the company generated sales of \$13.6 billion (61.8% from North America, 15.4% from Europe, 6.9% from Asia-Pacific and 15.9% from Latin America).



Reasons To Sell:

▼ **Soft Q4 Performance, Outlook Dismal:** Kellogg delivered net sales of \$3,223 million, which slipped 2.8% year over year when it reported fourth-quarter 2019 results. The downside can be attributed to 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 6% in the fourth quarter and also exerted pressure on the company's North American unit. Additionally, adjusted operating profit fell 6.8% year over year during the fourth quarter. Further, the divestiture affected the company's bottom-line performance.

Adverse impacts from divestitures and currency rates as well as rising input costs are headwinds for Kellogg.

For 2020, the company expects divestitures to affect the top line by almost 4%. The same is likely to exert pressure on the company's bottom line. Adjusted operating profit (at cc) is expected to decline 4%. Consequently, Kellogg envisions adjusted earnings to drop 3-4% (at cc). Shares of the company are down 22.3% year to date, whereas the industry declined 28.2%.

▼ **Macroeconomic Headwinds in Latin America:** Kellogg witnessed certain macroeconomic headwinds in Puerto Rico, Argentina and Brazil along with the transition of distributors in Central America during the fourth quarter. Notably, revenues in Latin America totaled \$233 million, down 1.6% year on year. Persistence of such headwinds may pose a threat to the company's Latin America business in the future.

▼ **Elevated Costs:** Kellogg has been struggling with rising input costs. During the fourth quarter, results were impacted by cost inflation to some extent. Looking into the segments, high input costs dented the company's Latin American operations. Although management expects some moderation in input costs in 2020, commodity costs like sugar, potatoes and packaging are likely to remain high.

▼ **Currency Headwinds:** Kellogg's solid international presence keeps the company exposed to risks associated with overseas operations. Volatile currency movement is one such risk. Notably, adverse currency rate hurt the company's top line in 2019. Moreover, the headwind exerted pressure on Kellogg's bottom line to some extent in the year. Persistence of such headwind is a threat to the company.

▼ **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.

Risks

- **Robust Organic Sales Trend:** Kellogg's organic sales have been rising for a while. During the fourth quarter of 2019, the company's organic net sales moved up 2.7% to \$3,224 million, backed by improved price realization along with better volume mix. Notably, organic sales improved across all regional segments. Prior to this, organic sales had improved 2.7%, 2.3% and 0.3% in the third, the second and the first quarter, respectively. Moreover, management expects organic sales to grow 1-2% in 2020.
- **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 one of 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. Markedly, with the Pringles deal completed in June 2012, Kellogg transformed itself from what was essentially a large U.S. snacks business to a true global snacks player. Also, the consolidation of Multipro (completed in May 2018), a Nigerian food distributor has been yielding. 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 in July, 2019. 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. Kellogg is also dedicated toward augmenting its portfolio through adding more products under existing brands, innovation and marketing initiatives. The company has been focused on investing in brand-building efforts. In this respect, it invests in digital media, consumer promotions and traditional advertising. Kellogg has also been enhancing its in-store capabilities like increasing sales force of its struggling businesses.
 - **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. Recently, Kellogg setup local manufacturing unit for Pringles brand in Africa and Latin America. Also, the company started production of noodles in Egypt and South Africa. Further, the company is undertaking other 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.
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Last Earnings Report

Kellogg Q4 Earnings Top Estimates, Sales Decline Y/Y

Kellogg Company reported fourth-quarter 2019 results, with earnings and sales surpassing the Zacks Consensus Estimate. However, the topline declined year over year due to impacts from the divestiture of the company's cookies, fruit snacks, pie crusts and ice-cream cones businesses.

Q4 in Detail

Adjusted earnings of 91 cents per share were flat year over year. Moreover, the metric beat the Zacks Consensus Estimate of 86 cents. Reduced net interest expenses and increased other income were offset by the absence of results from divested businesses. On a constant-currency (cc) basis, adjusted earnings came in at 99 cents per share that were in line with the year-ago quarter's figure.

The company delivered net sales of \$3,223 million, which slipped 2.8% year over year. Nevertheless, the figure surpassed the consensus mark of \$3,198 million. The year-over-year downside was caused by 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 6%. Sales dropped 2.8% to \$3,224 million at cc. Further, organic revenues moved up 2.7% to \$3,224 million.

Adjusted operating profit fell 6.8% to \$403 million, as improvement in the base business was more than offset by the impact from absence of the divested businesses. The metric dropped 6.9% to \$403 million at cc.

Segment Discussion

Sales in the **North America** segment amounted to \$1,894 million, down 7.3% due to divestiture impacts. Sales inched up more than 1% on an organic basis, courtesy of continued consumption gains in categories like Cheez-It, Pringles, Rice Krispies Treats and Pop-Tarts among others. Moreover, adjusted operating profit declined 5%.

Revenues in the **Europe** segment totaled \$526 million, up 2.9% year on year. Further, sales rose more than 3% on organic basis, backed by sustained momentum in snacks category, especially Pringles brand. Adjusted operating profit improved 15% at cc on increased sales and better profit margins.

Revenues in **Latin America** totaled \$233 million, down 1.6% year on year. Sales were marginally higher on an organic basis. The company witnessed certain macroeconomic headwinds in Puerto Rico, Argentina and Brazil along with the transition of distributors in Central America.

Nevertheless, continued consumption growth in cereal, salty snacks, and portable wholesome snacks across Mexico along with stabilization in the Andean markets and market share gains in major categories across Brazil bode well. Notably, the company started ramping up its new production facility in Brazil during the quarter. Adjusted operating profit fell roughly 21% at cc, due to higher costs and impact of absence of the divested businesses.

Revenues in the **Asia, Middle East & Africa** segment totaled \$570 million, up 8.4% year over year. Sales improved about 8% on organic basis, backed by strength in Africa and Asia. However, adjusted operating profit declined 7% at cc.

Other Financials

Kellogg ended the quarter with cash and cash equivalents of \$397 million, long-term debt of \$7,195 million and total equity of \$3,314 million.

For 2019, the company generated cash from operating activities of \$1,176 million.

2020 Guidance

That said, sales in 2020 are expected to grow 1-2% on an organic basis. Further, adjusted operating profit (at cc) is expected to decline 4% due to divestiture impacts.

Kellogg envisions adjusted earnings to drop 3-4% at cc. The expected year-over-year decline was caused by divestiture impacts.

Quarter Ending **12/2019**

Report Date	Feb 06, 2020
Sales Surprise	0.79%
EPS Surprise	5.81%
Quarterly EPS	0.91
Annual EPS (TTM)	3.94

Recent News

Kellogg Declares Dividend – Feb 21, 2020

Kellogg's board approved a dividend of 57 cents per share, payable on Mar 16, 2020, to shareholders in record as on Mar 3, 2020.

Valuation

Kellogg's shares are down 22.6% in the year-to-date period and 5.5% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Consumer Staples sector are down 28.3% and 30.9%, respectively in the year-to-date period. Over the past year, the Zacks sub-industry is down 20%, while the sector declined 24.9%.

The S&P 500 index is down 28.2% in the year-to-date period and 18.3% in the past year.

The stock is currently trading at 13.93X forward 12-month earnings, which compares to 12.96X for the Zacks sub-industry, 14.21X for the Zacks sector and 13.75X 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 Underperform recommendation indicates that the stock will perform worse than the market. Our \$45 price target reflects 11.7X 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	13.93	12.96	14.21	13.75
	5-Year High	22.71	22.9	22.37	19.34
	5-Year Low	12.45	12.96	14.21	13.75
	5-Year Median	16.77	19.1	19.66	17.42
P/S F12M	Current	1.36	1.19	7.01	2.5
	5-Year High	2.28	2.05	11.16	3.43
	5-Year Low	1.32	1.19	7.01	2.5
	5-Year Median	1.77	1.81	9.89	3
EV/EBITDA F12M	Current	13.58	13.78	34.16	12.28
	5-Year High	14.21	16.59	37.75	12.64
	5-Year Low	10.39	11.67	29.77	9.09
	5-Year Median	12.05	13.27	34.04	10.8

As of 03/23/2020

Industry Analysis Zacks Industry Rank: Top 39% (100 out of 254)



Top Peers

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
B&G Foods, Inc. (BGS)	Underperform
TreeHouse Foods, Inc. (THS)	Underperform

Industry Comparison Industry: Food - Miscellaneous				Industry Peers		
	K Underperform	X Industry	S&P 500	CPB Neutral	GIS Neutral	THS Underperform
VGM Score	D	-	-	B	C	A
Market Cap	18.34 B	2.74 B	15.21 B	12.95 B	28.66 B	2.16 B
# of Analysts	8	3	13	6	8	6
Dividend Yield	4.26%	0.16%	2.82%	3.26%	4.15%	0.00%
Value Score	D	-	-	B	C	B
Cash/Price	0.02	0.05	0.07	0.00	0.02	0.09
EV/EBITDA	12.34	10.55	9.67	12.48	12.30	26.75
PEG Ratio	3.28	2.24	1.37	2.61	1.95	2.90
Price/Book (P/B)	5.53	1.64	1.99	5.18	3.65	1.18
Price/Cash Flow (P/CF)	9.98	9.54	8.15	11.32	11.09	6.25
P/E (F1)	14.77	12.64	11.83	15.89	13.66	15.27
Price/Sales (P/S)	1.35	0.89	1.60	1.56	1.71	0.45
Earnings Yield	7.09%	7.34%	8.21%	6.29%	7.32%	6.55%
Debt/Equity	2.30	0.60	0.70	1.97	1.47	1.23
Cash Flow (\$/share)	5.36	2.68	7.01	3.79	4.26	6.13
Growth Score	D	-	-	C	D	B
Hist. EPS Growth (3-5 yrs)	3.41%	5.54%	10.85%	-1.52%	2.74%	-10.02%
Proj. EPS Growth (F1/F0)	-3.55%	7.02%	4.20%	17.47%	7.45%	5.02%
Curr. Cash Flow Growth	-9.43%	3.82%	5.93%	-12.42%	5.47%	-1.33%
Hist. Cash Flow Growth (3-5 yrs)	-0.49%	5.64%	8.55%	0.50%	1.32%	5.96%
Current Ratio	0.72	1.58	1.23	0.61	0.64	1.50
Debt/Capital	69.71%	38.43%	42.57%	66.31%	59.59%	55.14%
Net Margin	7.07%	3.90%	11.57%	17.46%	12.68%	-7.61%
Return on Equity	41.84%	10.86%	16.74%	50.69%	26.40%	6.26%
Sales/Assets	0.75	1.15	0.54	0.64	0.55	0.87
Proj. Sales Growth (F1/F0)	-1.07%	0.33%	2.76%	-12.23%	2.16%	-10.79%
Momentum Score	A	-	-	A	A	A
Daily Price Chg	-4.03%	-3.18%	-3.98%	-5.23%	-11.41%	-3.16%
1 Week Price Chg	-12.33%	-6.99%	-16.96%	-8.08%	-0.21%	4.02%
4 Week Price Chg	-16.96%	-27.60%	-36.64%	-10.60%	-11.99%	-12.86%
12 Week Price Chg	-22.13%	-28.15%	-37.10%	-12.83%	-10.35%	-20.19%
52 Week Price Chg	-5.49%	-22.58%	-28.90%	12.15%	-7.46%	-40.04%
20 Day Average Volume	3,163,150	211,499	4,200,337	4,631,216	8,249,651	724,904
(F1) EPS Est 1 week change	-0.44%	0.00%	-0.16%	3.45%	2.93%	0.00%
(F1) EPS Est 4 week change	-3.02%	0.00%	-1.37%	6.64%	2.67%	-0.13%
(F1) EPS Est 12 week change	-7.05%	-2.34%	-2.41%	6.53%	1.94%	-5.04%
(Q1) EPS Est Mthly Chg	0.32%	0.00%	-1.16%	9.36%	7.51%	9.29%

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	D
Growth Score	D
Momentum Score	A
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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