

Kraft Heinz(KHC)

\$31.24 (As of 01/03/20)

Price Target (6-12 Months): **\$33.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 10/18/19)

Prior Recommendation: Underperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:B

Value: C

Growth: A

Momentum: D

Summary

Kraft Heinz has outperformed the industry in the past three months. The company is gaining from pricing actions and well-chalked strategies to boost efficiency. During third-quarter 2019, prudent pricing actions aided the company's top line. Further, it is on track with plans to boost efficiency in areas such as procurement, manufacturing and distribution. Also, the company has implemented 9 transformational projects to strengthen some of the core areas of the business. On the flip side, the company is struggling with adverse divestiture impacts, which dented the top and bottom line during the third quarter. High input and supply chain costs were also a drag on earnings. These, along with adverse currency movements, and market share and distribution losses in certain categories have been headwinds.

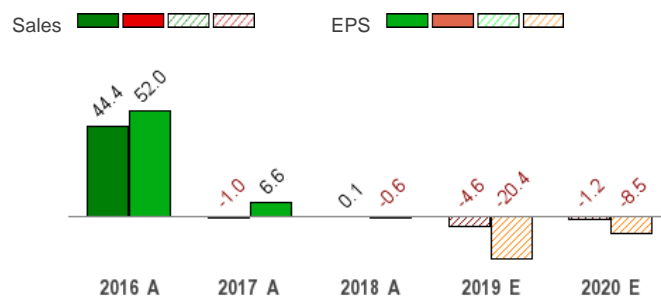
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$48.66 - \$24.86
20 Day Average Volume (sh)	5,328,778
Market Cap	\$38.1 B
YTD Price Change	-2.8%
Beta	0.78
Dividend / Div Yld	\$1.60 / 5.1%
Industry	Food - Miscellaneous
Zacks Industry Rank	Top 38% (95 out of 252)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	30.2%
Last Sales Surprise	-0.3%
EPS F1 Est- 4 week change	-1.7%
Expected Report Date	02/20/2020
Earnings ESP	6.6%
P/E TTM	8.9
P/E F1	12.2
PEG F1	3.3
P/S TTM	1.5

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2020	5,807 E	6,228 E	6,046 E	6,583 E	24,732 E
2019		6,406 A	6,076 A	6,585 E	25,044 E
2018	6,304 A	6,686 A	6,378 A	6,891 A	26,259 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2020	\$0.58 E	\$0.68 E	\$0.62 E	\$0.67 E	\$2.57 E
2019		\$0.78 A	\$0.69 A	\$0.69 E	\$2.81 E
2018	\$0.89 A	\$1.00 A	\$0.78 A	\$0.84 A	\$3.53 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 01/03/2020. The reports text is as of 01/06/2020.

Overview

Headquartered in Pittsburgh, PA, The Kraft Heinz Company (KHC) is one of the largest consumer packaged food and beverage companies in North America. It manufactures and markets food and beverage products like condiments and sauces, cheese as well as dairy, meals, meats, refreshment beverages, coffee, and other grocery products.

Its popular brands include Heinz, Kraft, Oscar Mayer, Planters, Philadelphia, Velveeta, Lunchables, Maxwell House, Capri Sun, and Ore-Ida. Notably, the company generates sales across roughly 190 countries and territories.

Well, the merger of Kraft Foods Group, Inc. ("Kraft") with and into a wholly-owned subsidiary of H.J. Heinz Holding Corporation ("Heinz") was concluded in July 2015. Upon the merger, Heinz was rechristened as The Kraft Heinz Company and H.J. Heinz Holding Corporation was renamed to Kraft Heinz Foods Company. Kraft and Heinz were both pioneers in the food space for more than 100 years.

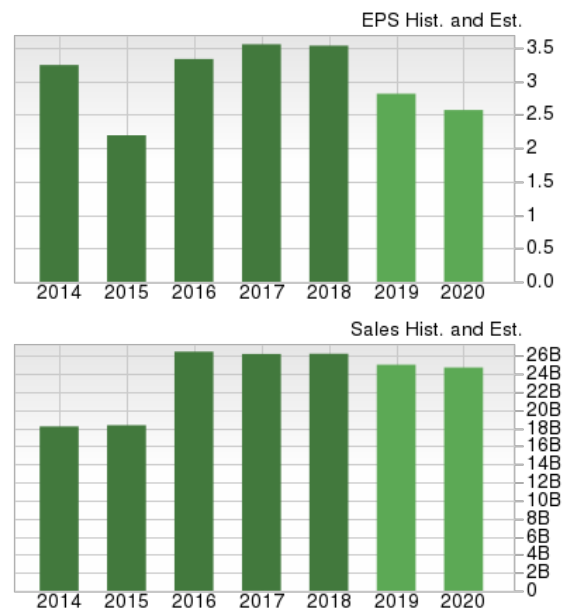
We note that during the third quarter of 2017, management revealed plans to reorganize some of its international businesses for better geographic alignment. These plans included shifting the Middle East and Africa businesses from AMEA segment to Europe, which in turn will form the Europe, Middle East, and Africa (EMEA) segment. The remaining AMEA unit will form the Asia Pacific or APAC segment, which will be a part of the Rest of the World.

Effective first-quarter 2018, Kraft Heinz has three reportable segments defined by geographic region:

United States (69% of the total revenues in FY18), Canada (8.3% of the total revenues in FY18), and Europe, Middle East, and Africa (EMEA; 10.3% of the total revenues in FY18). The remaining businesses are combined and disclosed as "Rest of World" or ROW.

Rest of World (12.4% of the total revenues in FY18) comprises two operating segments: Latin America, and Asia-Pacific (APAC).

On Jan 30, 2019, Kraft Heinz announces the completion of sales of Indian brands namely Glucon-D, Nycil, Complan and Sampriti to Zydus Wellness Limited.



Reasons To Buy:

- ▲ **Pricing Strategies Bode Well:** Kraft Heinz's performance in the third quarter of 2019 gained from pricing actions undertaken in the first half of the year. These actions were mainly undertaken in the United States and EMEA regions as well as in Latin America. The company's top line in the third quarter gained from pricing improvements of 1%. In the United States, pricing improved 1.5%. The EMEA region saw pricing gains of 0.2%, owing to better pricing in the U.K. compared with other regions. In Rest of the World, higher pricing of 0.9% aided organic sales rise, especially in Latin America. The company is on track with implementing pricing actions to mitigate the impacts of cost inflation for certain key ingredients. Such efforts along with other prudent plans to enhance organizational efficiency and capabilities are fueling investors optimism in the stock. Shares of the company have gained 17.4% in past three months, compared with the industry's growth of 4.2%.
- Kraft Heinz is gaining from pricing actions in the U.S. and EMEA regions. Further the company is working toward boosting efficiency in its supply chain.
- ▲ **Efficiency Building Plans on Track:** In order to ramp up overall business, management has laid down certain enterprise transformation strategies. In this context, the company is on track to build efficiency across its supply chain, with particular emphasis on procurement, manufacturing and distribution. Also, the company has implemented nine transformational projects to strengthen some of the core areas of the business. Among them, five projects are directed toward bolstering the top line, two for enhancing operational efficiencies and the remaining for increasing effectiveness. Another important focus-area of the company is its workforce. Management believes that strength in its people plays a key role in realizing the company's strategic goals. As a result, management has undertaken several moves to strengthen the company's leadership.
- In terms of cost savings, the company is increasing visibility and control of its cost components, especially in areas such as marketing and e-commerce. It is also keeping a close watch on investments made for enhancing sales and customer services. Further, the company is in the process of identifying cost-curtailement opportunities across the supply chain. It is also seeking to induce efficiency across operations. The company is on track with examining its SKU's to remove complexities and boost mix. Other productivity improvement initiatives include programs such as zero-based budgeting; modernization and capability building within the manufacturing footprint and building a performance driven culture in the company. A portion of the gains from such initiatives will be re-invested in the business for innovation, brand building and marketing to stimulate top-line growth.
- ▲ **Product Development Efforts:** Kraft Heinz remains focused on improving the performance of three key brands — Heinz, Kraft and Planters — and five global product categories, which are condiments and sauces, cheese, meals, nuts and baby food. Management earlier outlined that the company will make significant investments in marketing, go-to-market capabilities and product development. These capabilities and platforms are expected to further add to the company's gains. Innovations have continued to remain an integral part of the company's growth strategies. The company is on track with identifying areas that hold significant growth opportunities and is accordingly undertaking product development efforts. It is also undertaking efforts to boost the e-commerce channel. In respect of marketing, the company focuses on increasing media spend on flagship brands. Such well-chalked efforts have been aiding growth across several business categories, including condiments and sauces, cream cheese, snacks, desserts and seasonal franchise. In fact, the ketchup category is seeing rapid growth globally.
- Additionally, with growing awareness of the nutritional value of food products, responsible and sustainable sourcing of raw materials has become an important issue for food companies. The importance of using real ingredients and minimal processing in packaged food products is also being emphasized increasingly. As a result, a large number of companies in the food industry are switching or have already switched to the use of cage-free eggs. Kraft Heinz had stated earlier that it plans to switch to 100% cage-free eggs for its North American operations by 2025. Kraft Heinz uses eggs for its sauces portfolio.
- ▲ **Strong Brand Portfolio:** Kraft Heinz is the fifth-largest branded food and beverage company in the world and the third-largest food and beverage company in North America. Globally, the company markets more than \$1 billion brands. The company boasts many iconic brands which enjoy long-standing consumer recognition. Eight of its brands generate more than \$1 billion in sales including Oscar Mayer, Planters, Philadelphia, Velveeta, and Smart Ones.
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Reasons To Sell:

▼ **Q3 Results Fail to Impress:** Kraft Heinz's top and the bottom line declined year on year, during the third quarter of 2019. Adjusted earnings fell 9.2% year over year due to higher taxes and soft adjusted EBITDA. Net sales declined 4.8% to \$6,076 million, which lagged the Zacks Consensus Estimate. The top line included 2% unfavorable impact from divestitures. Organic sales dipped 1.1%. Adjusted EBITDA declined in the said period due to adverse impacts from divestitures, sluggishness in the United States and Canada as well as rise in input and supply chain costs.

Adverse impacts from divestitures, rising costs and currency rate fluctuations weighed on Kraft Heinz's third quarter performance.

Management highlighted that the company's performance was affected by uneven growth across categories and geographies. In fact, the company has been witnessing market share and distribution losses in natural cheese, cold cuts and coffee business in the United States. Also, retail inventory changes led to an adverse 110 basis point (bps) impact on U.S. vol/mix. Further, promotional ventures in Canada have failed to deliver desired growth. Infant nutrition products have been declining in EMEA and China. For the fourth quarter the company expects 50 basis-point headwind from lower retail inventory levels in U.S. business. For 2019, the company expects adverse impacts of 80 bps from inventory declines. Such factors along with continued expectation of adverse impacts from currency rates, divestitures and rising costs are headwinds for the company.

▼ **Rising Costs are a Worry:** For a while, high costs have been a headwind for the company. In the third quarter, net inflation in supply chain costs was less than 1%. Rise in supply chain costs were mainly witnessed in the Rest of the World segment. Further, higher input costs were a drag on performance in Canada. Prior to this, in the first half of fiscal 2019, higher cost scenario mainly emerged from increased fixed costs and supply-chain cost inflation. Management expects such cost-related pressures, especially for commodities, to persist in the forthcoming periods.

▼ **Currency Headwinds:** Kraft Heinz's cross-border presence exposes it to unfavorable currency movements due to the strengthening of the U.S. dollar. During the third quarter, currency movements had an adverse impact of 1.7% on the topline. The same were also a deterrent across the company's Canada, EMEA and Rest of World segments. Prior to this, in the first half of 2019, adverse currency fluctuations weighed on the top line by almost 2.6 percentage points. Management expects unfavorable currency rates to continue to hinder performance in the near term.

▼ **Weak ROE:** Kraft Heinz's trailing 12-month return on equity (ROE) undercuts its growth potential. The company's ROE of 6.2% compares unfavorably with the industry's 10.8%, reflecting that it is less efficient in using its shareholders' funds.

Last Earnings Report

Kraft Heinz Q3 Earnings Surpass Estimate, Sales Lag

Quarter Ending **09/2019**

The Kraft Heinz Company reported third-quarter 2019 results, wherein adjusted earnings per share of 69 cents surpassed the consensus mark of 53 cents. However, the bottom line declined 9.2% year over year on higher taxes and soft adjusted EBITDA.

Net sales declined 4.8% to \$6,076 million, which lagged the Zacks Consensus Estimate of \$6,096 million. Net sales growth included 1.7% and 2% unfavorable impacts of currency and divestitures, respectively. Organic sales dipped 1.1%. Per sources, the company's distribution strategy and weak assortment of products also hurt the top line to some extent.

Report Date	Oct 31, 2019
Sales Surprise	-0.32%
EPS Surprise	30.19%
Quarterly EPS	0.69
Annual EPS (TTM)	3.51

Pricing was up 1%, driven by price improvements in the United States, Rest of World and EMEA markets, and North America. Volume/mix fell 2.1% due to lower shipment in the United States, which offset strength in condiments and sauces.

Operating Highlights

Gross profit of \$1,947 million declined 7% year over year and gross margin contracted 80 basis points (bps) to 32% in the reported quarter.

Adjusted EBITDA was down 7.8% to \$1,469 million in the quarter due to sluggishness in the United States and Canada along with rise in general corporate costs.

Segment Discussion

United States: Net sales of \$4,361 million declined 1.6% year over year. During the quarter, pricing improved 1.5%, owing to better pricing in certain categories. Volume/mix fell 3.1% due to adverse changes in inventory levels and lower retail takeaway in a few categories. However, consumption growth in condiments, sauces and nuts provided some cushion.

The segment's adjusted EBITDA declined 1.8% to \$1,155 million, owing to reduced volume/mix, which more than offset the favorable impacts of positive pricing and the timing of marketing expenses.

Canada: Net sales of \$415 million declined 21.1% year over year, owing to unfavorable impacts of currency and divestitures of 0.8% and 19.8%, respectively. Organic sales edged down 0.5%. Pricing dipped 2.6% due to increased promotional activities and higher cost of cheese. Volume/mix grew 2.1%, owing to growth in products such as cheese and pasta sauce, and improved inventory levels in certain categories. However, lower promotions of macaroni and reduced coffee shipment acted as deterrents.

Segment adjusted EBITDA declined 25.7% to \$107 million due to unfavorable pricing and higher raw material costs.

EMEA: Net sales of \$612 million declined 3.5% year over year, with a 3.9% unfavorable impact of currency. Organic sales inched up 0.4%. Volume/mix was up 0.2% on growth in food services across all regions and favorable timing of shipments in Russia. However, continued softness in infant nutrition remained a drag. Moreover, pricing grew 0.2%, owing to better pricing in the U.K. compared with other regions.

Adjusted EBITDA grew 0.3% to \$165 million on reduced expenses related to supply chain. It also reflects 4.4% loss from unfavorable currency.

Rest of World (comprising Latin America and APAC): Net sales of \$906 million declined 13.3%, with a 10.2% adverse impact of currency and a 3.3% negative impact of sale of an Indian nutritional beverage. Organic sales grew 0.2% on higher pricing of 0.9%, especially in Latin America. Volume/mix declined 0.7% due to softness in infant nutritional products.

Adjusted EBITDA dropped 32.7% to \$100 million, owing to weak organic sales in the Asia Pacific, escalated supply-chain costs and currency headwinds.

Financials

Kraft Heinz ended the quarter with cash and cash investments of \$2,315 million, long-term debt of \$28,112 million, and total shareholders' equity of \$51,804 million.

In a separate press release, the company announced a quarterly dividend of 40 cents per share, which is payable Dec 13, 2019, to shareholders of record as of Nov 15.

Management remains optimistic about turnaround efforts and long-term growth post its improved performance in the third quarter. Going ahead, management intends to increase marketing expenses to boost sales while keeping costs in check, per media reports. This may lift investor sentiment to some extent.

Recent News

Kraft Heinz Completes Sale of Natural Cheese Business in Canada – Jul 2, 2019

Kraft Heinz closed the sale of Canadian natural cheese business to Parmalat. As a result, brands like Cracker Barrel, aMOOza! and P'tit Quebec, as well as a production facility located in Ontario, will now be owned by Parmalat. However, other cheese products and inorganic brands such as Cheez Whiz, Philadelphia and Kraft Singles, which are manufactured in Quebec, will continue to be a part of Kraft Heinz.

Valuation

Kraft Heinz shares are down 27.1% in the trailing 12-month period. Over the same time frame, the Zacks sub-industry and the sector are up 19.1% and 20.9%, respectively.

The S&P 500 index is up 28.4% in the past year.

The stock is currently trading at 12.17X forward 12-month earnings, which compares to 18.39X for the Zacks sub-industry, 19.63X for the Zacks sector and 18.7X for the S&P 500 index.

Over the past five years, the stock has traded as high as 27.47X and as low as 8.63X, with a 5-year median of 20.88X. Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$33 price target reflects 12.86X forward 12-month earnings.

The table below shows summary valuation data for KHC

Valuation Multiples - KHC					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	12.17	18.39	19.63	18.7
	5-Year High	27.47	22.9	22.39	19.34
	5-Year Low	8.63	14.82	16.65	15.17
	5-Year Median	20.88	19.28	19.68	17.44
P/S F12M	Current	1.54	1.74	9.75	3.47
	5-Year High	5.86	2.05	11.03	3.47
	5-Year Low	1.19	1.44	8.02	2.54
	5-Year Median	3.29	1.81	9.78	3
EV/EBITDA F12M	Current	11.39	14.08	34.11	12.66
	5-Year High	33.6	16.59	36.97	12.66
	5-Year Low	9.88	11.67	29.14	9.08
	5-Year Median	15.22	13.26	33.26	10.78

As of 01/03/2020

Industry Analysis Zacks Industry Rank: Top 38% (95 out of 252)



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
Kellogg Company (K)	Neutral
Mondelez International, Inc. (MDLZ)	Neutral
Sysco Corporation (SYF)	Neutral

Industry Comparison Industry: Food - Miscellaneous				Industry Peers		
	KHC Neutral	X Industry	S&P 500	CAG Neutral	CPB Neutral	MDLZ Neutral
VGM Score	B	-	-	B	B	C
Market Cap	38.15 B	4.33 B	23.66 B	16.23 B	14.61 B	78.10 B
# of Analysts	7	3	13	7	5	7
Dividend Yield	5.12%	0.11%	1.79%	2.55%	2.89%	2.10%
Value Score	C	-	-	B	C	C
Cash/Price	0.06	0.04	0.04	0.01	0.00	0.02
EV/EBITDA	-6.81	14.28	13.88	16.37	14.89	21.47
PEG Ratio	3.30	2.36	1.99	2.24	3.21	2.67
Price/Book (P/B)	0.74	3.00	3.36	2.11	11.70	2.91
Price/Cash Flow (P/CF)	7.70	12.77	13.62	13.21	12.77	17.79
P/E (F1)	12.10	18.46	18.74	15.68	19.10	20.48
Price/Sales (P/S)	1.51	1.36	2.67	1.54	1.65	3.04
Earnings Yield	8.23%	5.24%	5.32%	6.39%	5.24%	4.89%
Debt/Equity	0.54	0.62	0.72	1.21	5.37	0.48
Cash Flow (\$/share)	4.06	2.72	6.94	2.52	3.79	3.05
Growth Score	A	-	-	D	B	C
Hist. EPS Growth (3-5 yrs)	NA%	5.08%	10.56%	-2.47%	-0.30%	8.90%
Proj. EPS Growth (F1/F0)	-8.69%	7.85%	7.41%	5.76%	10.26%	7.42%
Curr. Cash Flow Growth	-2.47%	3.82%	14.83%	10.04%	-12.42%	8.30%
Hist. Cash Flow Growth (3-5 yrs)	20.68%	6.91%	9.00%	-0.87%	0.50%	3.23%
Current Ratio	1.00	1.68	1.23	0.87	0.60	0.50
Debt/Capital	35.18%	38.35%	42.92%	54.72%	84.30%	32.64%
Net Margin	-42.85%	2.79%	11.08%	7.62%	2.07%	15.42%
Return on Equity	6.23%	10.61%	17.10%	12.50%	64.48%	13.93%
Sales/Assets	0.25	1.17	0.55	0.47	0.66	0.40
Proj. Sales Growth (F1/F0)	-1.25%	2.51%	4.20%	12.57%	-12.79%	2.51%
Momentum Score	D	-	-	A	A	C
Daily Price Chg	-1.17%	0.00%	-0.61%	-0.86%	-0.12%	-0.17%
1 Week Price Chg	-1.86%	0.14%	0.13%	-2.54%	0.59%	-0.22%
4 Week Price Chg	-0.03%	1.02%	2.60%	15.84%	1.68%	0.80%
12 Week Price Chg	15.96%	5.45%	8.87%	17.60%	2.35%	-2.11%
52 Week Price Chg	-27.87%	23.00%	29.34%	54.64%	48.29%	36.49%
20 Day Average Volume	5,328,778	98,366	1,603,615	5,266,311	1,675,331	5,350,067
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	-1.70%	0.00%	0.00%	0.74%	0.54%	-0.37%
(F1) EPS Est 12 week change	-2.46%	-1.09%	-0.57%	0.51%	0.14%	-1.32%
(Q1) EPS Est Mthly Chg	0.00%	0.00%	0.00%	-1.82%	-7.98%	0.50%

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.

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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	A
Momentum Score	D
VGM Score	B

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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