

Kraft Heinz(KHC)

\$27.42 (As of 02/20/20)

Price Target (6-12 Months): **\$23.00**

Long Term: 6-12 Months

Zacks Recommendation: Underperform

(Since: 02/19/20)

Prior Recommendation: Neutral

Short Term: 1-3 Months

Zacks Rank: (1-5)

5-Strong Sell

Zacks Style Scores:

VGM:C

Value: B

Growth: B

Momentum: F

Summary

Shares of Kraft Heinz have lagged the industry in the past three months. The stock came under pressure, following the company's fourth-quarter 2019 results, wherein both top and bottom lines declined year on year, and sales lagged the consensus mark. Earnings were hurt by lower adjusted EBITDA and high tax rate, while sales continued being hurt by currency headwinds and divestitures. In 2020, management expects EBITDA to be hurt by divestitures, business exits, currency woes, and inflated supply chain costs in Canada and Rest of World along with distribution losses and commodity inflation in the United States. Nevertheless, the company's efficient pricing strategy has been providing some cushion against the aforementioned headwinds. Also, the company is on track with transformation strategies and product development.

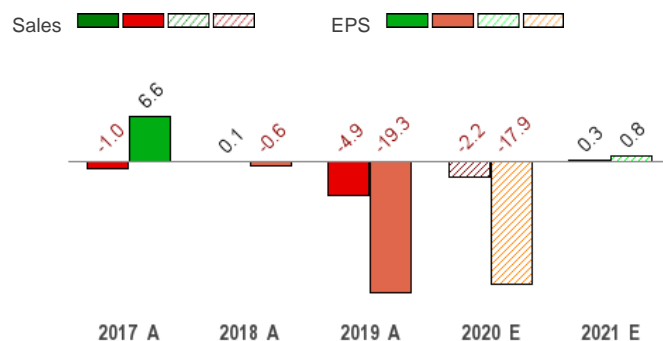
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$48.66 - \$24.86
20 Day Average Volume (sh)	9,881,213
Market Cap	\$33.5 B
YTD Price Change	-14.7%
Beta	0.84
Dividend / Div Yld	\$1.60 / 5.8%
Industry	Food - Miscellaneous
Zacks Industry Rank	Bottom 39% (155 out of 255)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	5.9%
Last Sales Surprise	-0.7%
EPS F1 Est- 4 week change	-8.7%
Expected Report Date	05/14/2020
Earnings ESP	0.0%
P/E TTM	7.8
P/E F1	11.7
PEG F1	3.2
P/S TTM	1.3

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	5,718 E	6,210 E	6,035 E	6,621 E	24,494 E
2020	5,730 E	6,201 E	6,001 E	6,510 E	24,419 E
2019		6,406 A	6,076 A	6,536 A	24,977 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$0.51 E	\$0.63 E	\$0.59 E	\$0.66 E	\$2.36 E
2020	\$0.49 E	\$0.60 E	\$0.55 E	\$0.62 E	\$2.34 E
2019		\$0.78 A	\$0.69 A	\$0.72 A	\$2.85 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 02/20/2020. The reports text is as of 02/21/2020.

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.

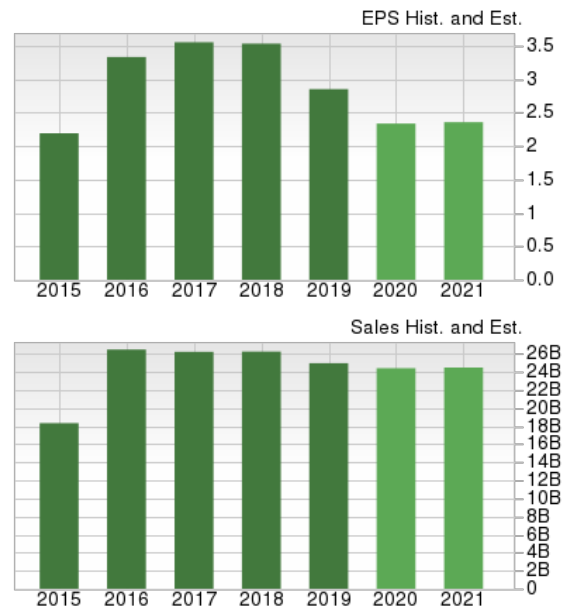
We note that during the third quarter of 2017, management revealed plans to reorganize some of its international businesses for better geographic alignment. These plans included shifting the Middle East and Africa businesses from AMEA segment to Europe, which in turn will form the Europe, Middle East, 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 (71.1% of the total revenues in FY19), Canada (7.5% of the total revenues in FY19), and Europe, Middle East, and Africa or EMEA (10.2% of the total revenues in FY19). The remaining businesses are combined and disclosed as "Rest of World" or ROW.

Rest of World (11.2% of the total revenues in FY19) 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 Sell:

▼ **Q4 Results Fail to Impress, Stock Underperforms:** Shares of Kraft Heinz have declined 10.2% in the past three months against the industry's growth of 3.3%. The stock came under pressure, following the company's fourth-quarter 2019 results, wherein both top and bottom lines declined year over year and the top line lagged the Zacks Consensus Estimate. The company has been witnessing this trend for three straight quarters now. During the fourth quarter, adjusted earnings per share of 72 cents declined 14.3% year over year, owing to lower adjusted EBITDA and elevated tax rate.

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

Further, net sales declined 5.1% year over year to \$6,536 million, lagging the consensus mark of \$6,579 million. Net sales growth included 0.6% and 2.3% unfavorable impacts of currency and divestitures, respectively. Organic sales dipped 2.2%. The company has long been witnessing market share and distribution losses in natural cheese, cold cuts and coffee business in the United States. Also, retailer inventory reductions have been a headwind in the region. Such factors along with continued expectation of adverse impacts from currency rates, divestitures and rising costs are headwinds for the company.

▼ **EBITDA to Remain Pressurized:** Kraft Heinz's adjusted EBITDA has been declining year over year for a while now. In fourth-quarter 2019, the metric fell 6.6% to \$1,564 million, with adverse impacts of 1.3 percentage points from currency movements and a headwind of 1.5 percentage points from divestitures. Apart from this, higher supply-chain expenses in the Rest of World segment along with lower prices in Canada were hurdles, which are likely to persist in the first quarter of 2020. Also, rise in general corporate costs was a drag.

In 2020, management expects divestitures and previously disclosed business exits to weigh on EBITDA by \$110 million. Further, incentive compensation expenses are expected to raise Kraft Heinz's cost burden. Moreover, management expects EBITDA to be hurt by \$150 million from inflated supply-chain costs in Canada and Rest of World along with distribution losses and commodity inflation in some U.S. categories that face intense competition. Finally, adverse currency movements are likely to dent EBITDA by \$60 million.

▼ **Rising Costs are a Worry:** For a while, high costs have been a headwind for the company. In the fourth quarter, rise in supply-chain costs, mainly witnessed in the Rest of the World segment, was a headwind. Further, higher procurement costs were a drag on performance in Canada. In the United States, adjusted EBITDA was somewhat impacted by key commodity cost inflation and increased manufacturing expenses. Persistence of these headwinds is concerning.

▼ **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 fourth quarter, currency movements had an adverse impact of 0.6% on the top line. The same was a deterrent across the company's EMEA and Rest of World segments. 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 5.9% compares unfavorably with the industry's 11.3%, reflecting that it is less efficient in using its shareholders' funds.

Risks

- **Pricing Strategies Bode Well:** Solid pricing initiatives have been aiding Kraft Heinz despite lower volume/mix. In the fourth quarter of 2019, overall pricing was up 2%, driven by price improvements in the United States, Rest of World and EMEA markets. In the United States, pricing improved 3.1%, owing to better prices in certain categories and favorable impact of promotional activities. Within EMEA, better pricing in the U.K. was an upside. In the Rest of World segment, pricing was up 0.7%, especially in Latin America and China. Kraft Heinz has been on track with implementing pricing actions to mitigate the impacts of cost inflation for certain key ingredients.
- **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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Last Earnings Report

Kraft Heinz Q4 Earnings Surpass Estimates, Sales Lag

Quarter Ending **12/2019**

Kraft Heinz reported fourth-quarter 2019 results. Adjusted earnings per share of 72 cents surpassed the consensus mark of 68 cents. However, the bottom line declined 14.3% year over year.

Net sales declined 5.1% year over year to \$6,536 million. Also, the figure lagged the Zacks Consensus Estimate of \$6,579 million. Net sales growth included 0.6% and 2.3% unfavorable impacts of currency and divestitures, respectively. Organic sales dipped 2.2%.

Report Date	Feb 13, 2020
Sales Surprise	-0.66%
EPS Surprise	5.88%
Quarterly EPS	0.72
Annual EPS (TTM)	3.51

Pricing was up 2%, driven by price improvements in the United States, Rest of World and EMEA markets. Volume/mix fell 4.2% due to lower volumes in the United States. Also, volumes in Rest of World segment were down to some extent.

Gross profit of \$2,107 million declined 4.9% year over year and gross margin came in at 32.2% in the reported quarter. Adjusted EBITDA was down 6.6% to \$1,564 million in the quarter due to higher supply chain expenses in Rest of World segment along with lower prices in Canada unit. Also, rise in general corporate costs were a drag.

Segment Discussion

Segment Information

United States: Net sales of \$4,682 million declined 2.7% year over year. During the quarter, pricing improved 3.1% owing to better prices in certain categories and favorable impact of promotional activities. Volume/mix fell 5.8% due to lower distribution in cold cuts and frozen categories along with reduced shipments in a few categories. However, consumption growth in condiments, sauces and foodservice provided some cushion.

The segment's adjusted EBITDA inched up 1.6% to \$1,270 million, driven by higher prices, reduced logistic costs and lower compensation expenses. These factors more than offset the adverse impacts from volume/mix, key commodity cost inflation and increased manufacturing expenses.

Canada: Net sales of \$457 million declined 23.8% year over year, which included unfavorable impact of divestitures to the tune of 21.4% and a favourable currency impact of 0.1%. Organic sales fell 2.5% year over year. Pricing dipped 5% due to increased promotional activities and higher trade expense. Volume/mix moved up 2.5% owing to growth in products such as peanut butter and pasta sauce. However, weakness in coffee and reduced cheese shipment acted as deterrents. Segment adjusted EBITDA declined 26.1% to \$116 million due to unfavorable pricing and higher procurement costs.

EMEA: Net sales of \$689 million declined 0.5% year over year, with a 0.8% unfavorable impact of currency. Organic sales inched up 0.3% year on year. Volume/mix was up 0.2% on growth in food services across most regions as well as condiments and sauces in Russia. However, persistent softness in infant nutrition and lower promotional activities remained a drag. Moreover, pricing grew slightly owing to better pricing in the U.K. Adjusted EBITDA increased 6.3% to \$182 million on higher organic net Sales and lower compensation expenses. It also reflects 1.4% loss from unfavorable currency.

Rest of World (comprising Latin America and APAC): Net sales of \$708 million declined 10.1%, with a 5.2% adverse impact of currency and a 3.3% negative impact of sale of an Indian nutritional beverage. Organic sales declined 1.6%. Pricing was up 0.7%, especially in Latin America and China. Volume/mix declined 2.3% due to reduced shipments across various categories in Australia and New Zealand along with lower shipments in Latin American. Adjusted EBITDA dropped 53.9% to \$60 million due to weak lower volume/mix and escalated supply-chain costs.

Financials

Kraft Heinz ended the quarter with cash and cash equivalents of \$2,279 million, long-term debt of \$28,216 million, and total shareholders' equity of \$51,623 million.

Recent News

Kraft Heinz Declares Dividend - Feb 13, 2020

The company announced a quarterly dividend of 40 cents per share, which is payable Mar 27, 2020, to shareholders of record as of Mar 13.

Valuation

Kraft Heinz shares are down 14.6% in the year-to-date period and 21.6% over the trailing 12-month period. Stocks in the Zacks sub-industry are down 1.8%, while the Zacks Consumer Staples sector is up 0.2% in the year-to-date period. Over the past year, the Zacks sub-industry and the sector are up 12.2% and 10.6%, respectively.

The S&P 500 index is up 4.8% in the year-to-date period and 20% in the past year.

The stock is currently trading at 11.07X forward 12-month earnings, which compares to 18.33X for the Zacks sub-industry, 19.72X for the Zacks sector and 19.31X for the S&P 500 index.

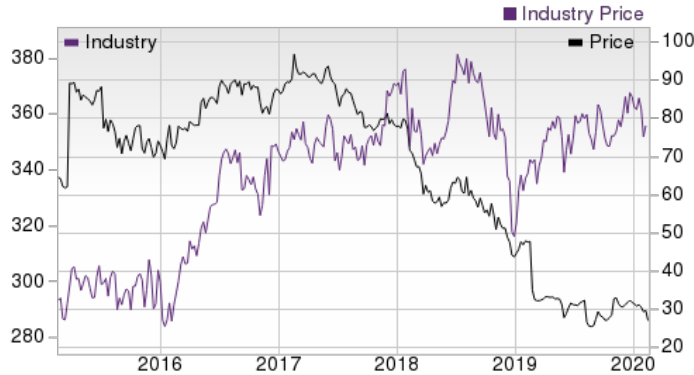
Over the past five years, the stock has traded as high as 27.47X and as low as 8.63X, with a 5-year median of 20.87X. Our Underperform recommendation indicates that the stock will perform worse than the market. Our \$23 price target reflects 9.29X forward 12-month earnings.

The table below shows summary valuation data for KHC

Valuation Multiples - KHC					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	11.07	18.33	19.72	19.31
	5-Year High	27.47	22.9	22.38	19.34
	5-Year Low	8.63	14.82	16.66	15.18
	5-Year Median	20.87	19.19	19.72	17.47
P/S F12M	Current	1.36	1.71	10.05	3.56
	5-Year High	5.86	2.05	11.13	3.56
	5-Year Low	1.19	1.44	8.09	2.54
	5-Year Median	3.29	1.81	9.88	3
EV/EBITDA F12M	Current	11.6	14.08	34.39	12.66
	5-Year High	19.09	16.59	37.23	12.66
	5-Year Low	8.2	11.67	29.38	9.08
	5-Year Median	13.84	13.27	33.58	10.79

As of 02/20/2020

Industry Analysis Zacks Industry Rank: Bottom 39% (155 out of 255)



Top Peers

Conagra Brands Inc. (CAG)	Neutral
Campbell Soup Company (CPB)	Neutral
Flowers Foods, Inc. (FLO)	Neutral
General Mills, Inc. (GIS)	Neutral
Mondelez International, Inc. (MDLZ)	Neutral
Sysco Corporation (SYU)	Neutral
B&G Foods, Inc. (BGS)	Underperform
Kellogg Company (K)	Underperform

Industry Comparison Industry: Food - Miscellaneous				Industry Peers		
	KHC Underperform	X Industry	S&P 500	CAG Neutral	CPB Neutral	MDLZ Neutral
VGM Score	C	-	-	C	B	C
Market Cap	33.49 B	4.27 B	24.34 B	14.54 B	14.40 B	84.60 B
# of Analysts	8	3	13	8	6	8
Dividend Yield	5.84%	0.11%	1.78%	2.84%	2.93%	1.93%
Value Score	B	-	-	B	C	C
Cash/Price	0.07	0.04	0.04	0.01	0.00	0.02
EV/EBITDA	12.62	13.38	14.18	15.28	14.75	19.78
PEG Ratio	3.19	2.51	2.09	2.08	3.17	2.67
Price/Book (P/B)	0.65	2.71	3.30	1.89	11.53	3.10
Price/Cash Flow (P/CF)	8.02	12.70	13.49	11.84	12.59	18.24
P/E (F1)	11.72	17.56	19.28	14.54	18.84	22.10
Price/Sales (P/S)	1.34	1.30	2.68	1.38	1.63	3.27
Earnings Yield	8.53%	5.58%	5.17%	6.89%	5.30%	4.52%
Debt/Equity	0.55	0.66	0.70	1.21	5.37	0.53
Cash Flow (\$/share)	3.42	2.72	7.03	2.52	3.79	3.24
Growth Score	B	-	-	D	C	C
Hist. EPS Growth (3-5 yrs)	NA%	5.54%	10.84%	-2.47%	-0.30%	9.02%
Proj. EPS Growth (F1/F0)	-18.07%	6.84%	7.09%	2.24%	10.14%	8.15%
Curr. Cash Flow Growth	-15.53%	2.50%	6.72%	10.04%	-12.42%	4.99%
Hist. Cash Flow Growth (3-5 yrs)	11.14%	6.70%	8.25%	-0.87%	0.50%	2.73%
Current Ratio	1.03	1.58	1.22	0.88	0.60	0.50
Debt/Capital	35.28%	40.76%	42.37%	54.72%	84.30%	34.82%
Net Margin	7.75%	3.37%	11.56%	7.62%	2.07%	14.96%
Return on Equity	5.93%	10.86%	16.80%	12.50%	64.48%	13.56%
Sales/Assets	0.24	1.15	0.55	0.47	0.66	0.40
Proj. Sales Growth (F1/F0)	-2.23%	2.30%	3.90%	11.19%	-12.90%	2.42%
Momentum Score	F	-	-	F	B	C
Daily Price Chg	0.40%	0.00%	0.01%	0.27%	-0.10%	-0.44%
1 Week Price Chg	-9.00%	0.00%	1.65%	2.32%	-0.49%	1.74%
4 Week Price Chg	-10.63%	-2.07%	0.36%	-8.60%	-2.49%	6.49%
12 Week Price Chg	-9.71%	0.82%	4.39%	2.40%	1.45%	11.97%
52 Week Price Chg	-43.09%	11.88%	15.29%	24.14%	34.71%	21.96%
20 Day Average Volume	9,881,213	134,570	1,992,841	3,809,097	1,452,060	6,792,863
(F1) EPS Est 1 week change	-4.65%	0.00%	0.00%	-4.28%	0.00%	0.70%
(F1) EPS Est 4 week change	-8.69%	-0.11%	-0.02%	-4.42%	-0.11%	1.56%
(F1) EPS Est 12 week change	-10.59%	-0.05%	-0.17%	-3.99%	0.63%	1.19%
(Q1) EPS Est Mthly Chg	-15.52%	-1.49%	-0.48%	-7.67%	-1.72%	-1.71%

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	B
Growth Score	B
Momentum Score	F
VGM Score	C

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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