Hormel Foods Corporation (NYSE: HRL)

Sector: Consumer Staples; Industry: Food Products

Target Price	Current Price	52 Week High	52 Week Low	P/E	Market Cap.	Dividend Yield	EPS
$40.21	$34.55	$38	$29.75	22.10	$18.35B	2.14%	$1.57

Business Description

Hormel Foods Corporation is an international manufacturer and marketer of consumer-branded meat and food products. It is divided into five primary segments: grocery products, refrigerated foods, Jennie-O Turkey, specialty foods, and international/other. Among these segments Hormel owns a diverse set of brands spanning different categories and food types; with the consistent factor being value-added protein brands. Hormel sells its products to retail, food-service, and wholesale operations.

Investment Thesis

Guided by its four pillars - global, multicultural, nutritious, and on the go - Hormel makes ongoing strategic acquisitions that broaden its product mix and international presence as well as strengthen its position in the competitive industry of food production. Such investments are supported by strong free cash flows and balance sheet. Its financial strength also allows it to maintain its title as a dividend-aristocrat and provide great shareholder value. Furthermore, Hormel has had a tough year due to the oversupply of turkey, acquisition of Whole Foods by Amazon, and the underperformance of the industry as a whole. Due to the one-off nature of these factors and Hormel's financial strength as well as strategic positioning, we see this as a great discount and buying opportunity.

Industry Trends

The food products industry has been underperforming the consumer staples sector in revenue growth significantly over the 2013-2016 period. As consumer trends move into increased protein consumption and health-oriented foods such as gluten-free, natural, organic, and non-GMO options; large food companies are acquiring health brands to appeal to such an evolving customer base. Furthermore, in order to remain sustainable such companies are employing growth strategies such as acquisitions, expansions of distribution channels, and international ventures.

Valuation Assumptions

Hormel's projected revenue growth of 7.58% into 2018 is a result of the alleviations of many one-off factors that caused the company to have a bad year in 2017. This coupled with its recent strategic investments in companies such as Ceratti in Brazil (Premium deli products company) and Columbus Craft Meats supports its consistent growth of approximately 4.52% into the next five years. Using CAPM, we arrived at a WACC of 7.15%. These assumptions coupled with three other valuations led us to an intrinsic value of $40.21 with a margin of safety of 16.39%.

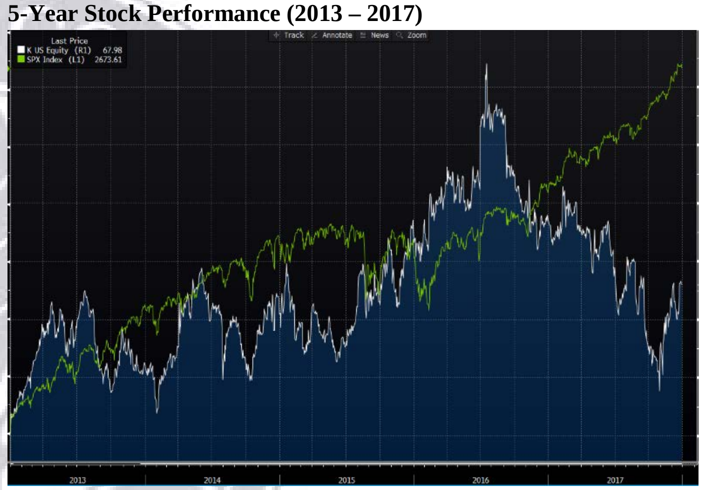
Competitive Analysis

As consumer trends shift into increased protein consumption, most players in the industry are competing in terms of healthy and organic offerings. In order to outperform the competition, large food companies such as Hormel Foods, are making acquisitions of smaller companies with healthy brands in order to appeal to faster growing demands. The major competitors we identified for Hormel Foods are Tyson Foods, Campbell's, and General Mills. Tyson Foods has strong market share in beef, chicken, and pork; however, its hard to differentiate product lines limit pricing power. Campbell's recently disclosed its inability to secure promotional shelf space during the peak of soup season at a major U.S. retailer. The company is also trying to improve the health profile of its offerings, with added costs likely keep margins from increasing. General Mills we saw as too dependent on Walmart (20% of sales), and the company's yogurt lines have been losing share to more on demand Greek yogurt brands. In quantitative terms, we noticed Hormel's outstanding historical return on assets (2011-2016 annual data) compared to such competitors.

Corporate Social Responsibility

Hormel Foods strives to foster a diverse workplace, which is 35% represented by women and 52% by ethnic minorities. In terms of health and wellness, Hormel's partnership with the Cancer Nutrition Consortium (CNC) has resulted in the development of a line of food products (*Hormel Vital Cuisine*) that supports the nutritional needs of patients recovering from cancer and other similar conditions.

5-Year Stock Performance (2013 – 2017)



Competitive Advantages

Hormel owns some of the most well-known food brands. For instance, SPAM is the most popular canned meat product in the US. Skippy is the number #2 peanut butter brand in the US, and Wholly Guacamole has #1 market share in the U.S. The company also has strong financial health (90 H-Score on CompanyWatch Financial Analytics), which allow it to make strategic acquisitions. Hormel also has historically strong return generation (20% five-year average), which we expect to continue, along with the strong financials and strategic acquisitions and international reach.

Investment Risks

Even though Hormel Foods has expanded its lines of products into other non-meat proteins outside of poultry and pork, the company's sensitivity to raw material supply and price fluctuations have not been entirely eliminated. For instance, the oversupply of turkey in 2016 negatively affected the company's top line results. Also, livestock disease could make customers averse to some of the company's core products. Another risk we see for Hormel is possible struggle to increase sales due to increasing center-of-store competition, as the company expands its offerings into shelf-stable products found in the center of stores, such as peanut butter and sports nutrition.

Report prepared by Ana & Bartosz Walas on January 13th, 2018

Sources: Bloomberg, Value Line, Morningstar, CFRA