

Kraft Heinz	
Ticker Site BiG	KHC
Ticker BiGlobal Trade	KHC
Ticker BT24	KHC
Ticker BiG Power Trade	KHC
P/E Ratio 2019E	11,00
P/BV Ratio	0,72
EV/EBITDA	-

Source: Big Research;

Price and Performance (Values in USD)	
Price	30,52
52 week high	64,99
52 week low	26,96
YTD	-29,1%
Average daily volume (un)	10.699.121
Market Capitalization (mn)	37.233
Beta	0,88
Dividend	2,50
EPS	-8,36

Source: BiG Research;

Analysts Consensus (last 3 months)	
Buy	2
Hold	17
Sell	4

Source: BiG Research;

Financial Data	
Sales (USD mn)	26.268
EBITDA (USD mn)	-9.237
Number of Employees	38.000
ROA	-9,1%
ROE	-17,3%
D/E	0,60
Dividend Yield	5,24%

Source: BiG Research;

Notes:

All quotes were updated in Bloomberg at 10h20 of July 3rd, 2019.

Relevant Information:

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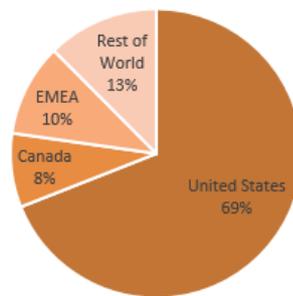
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Kraft Heinz (Ticker: KHC)

Description

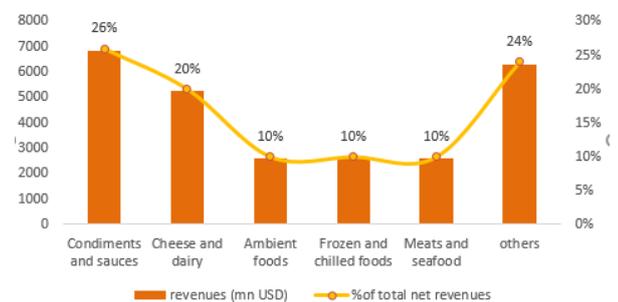
Kraft Heinz is one of the biggest companies in the food and beverage market. In 2015 Kraft foods Group merged with Heinz Holding Corp and renamed to Kraft Heinz Company. Until 2015 Heinz was controlled by Berkshire Hathaway and 3G Global. The company is present in more than 190 countries and their main products are condiments and sauces, cheese and dairy, meals, refreshment beverages, and coffee are sold under the name of brands such as Heinz, Kraft, Oscar Mayer, Philadelphia, Velveeta, Lunchables, Planters, Maxwell House, Capri-Sun, Ore-Ida, Kool-Aid, Jell-O. Kraft Heinz sold in 2018 USD 26 bn being Walmart its biggest customer representing 21% of the net sales of Kraft Heinz. The company has 38 thousand employees and a market capitalization of USD 37.98 bn.

Revenue per segment (% of total)



Source: Company's data

Revenues & % of total revenues by category



Investment Thesis

Kraft Heinz has some of the most recognizable brands in the market especially in the sauce and condiments category. The stock has been penalized by its SEC probe and its impairment losses in some brands and business unit, having a P/E of 11.2x vs 20.2 peer's average and it has been reflected with YTD of -27.7%, being trading at its lowest values since Kraft merged with Heinz so the stock may have a recover in the short term. Nevertheless, revenues have been more or less flat in terms of growth (see graph in the "income statement" separator) in the past three year and in the long term the company doesn't have a clear outlook regarding the growth so in the long term we do not see major opportunities for Kraft Heinz.

Environmental, Social, and Governance (ESG)

Kraft Heinz pledged since the baseline to fulfill until 2020 certain criteria regarding their production facilities such as reducing by 15% greenhouse emissions, energy consumption, water consumption, and solid waste sent to landfill. Regarding palm oil plantations (one of the main raw materials), with the increase in the demand for palm oil, also came increase in the threats to environment. In this chapter, Kraft Heinz belongs to the Roundtable on Sustainable palm oil.

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Investment Case

Impairment losses: In 2018 the company recognized a USD 15.4 bn impairment in goodwill in some of their biggest brands such as Kraft, Oscar Mayer, and Velveeta. These impairments were due to errors in the calculations in the impairments testing's in the 4Q '18. These errors were found in the calculations of projected cash flows and allocation. The impairment loss resulted in a loss of USD 10.2 bn in 2018.

Company's strategy/ New CEO: In the 25th of June, Kraft Heinz's new CEO started its mandate following Bernardo Hees. It is not expected to see a disposal of any brand or also a major acquisition. Instead should be expecting to continue to have a particular attention to costs so it can free some money for developing new products and marketing as well. The new CEO has a policy of following the zero-base budgeting. The intention is not to cut costs but to keep an eye on them, so it can maximize its margins.

Dividend: in 2019 the company cut its quarterly dividend by 36% to USD 0.40, totalizing an annual dividend of USD 1.60, given that the company seeks to have space to improve growth and returns overtime and implement a payout level that can both grow over time with EBITDA growth and accommodate additional divestitures. Nevertheless, Kraft Heinz still delivers a 5.25% dividend yield which is much higher than most of its biggest competitors (MDLZ 1.9%; NES 2.4%; GIS 3.7%).

Evolv Ventures: With Evolv ventures Kraft Heinz explores its growth approach of start developing disruptive digital business models and fuel growth for the company. For that created a tech and entrepreneurial team in San Francisco and Chicago, and a USD 100 mn venture fund in which have opened a digital hub. In 2018 the company acquired Wellio (see more in M&A section), an AI food tech company.



Bernardo Hees, current CEO

Management

Bernardo Hees is the current CEO and has been in Heinz Company since 2013 then becoming the CEO of Kraft Heinz since the merger of Kraft with Heinz. In 2019 he will leave its position. His predecessor is Miguel Patricio, a Portuguese manager, who was already an advisor since May 2019. Before joining Kraft Heinz, Miguel was Chief of Special Global Projects and Marketing at AB InBev. He also held several senior positions in many different multinationals as The Coca-Cola Company, Johnson and Johnson, among others. In 2017 Mr. Hees made USD 4.2 bn of which USD 1 mn in base salary, USD 2.73 mn in stock awards, and USD 0.47 mn in other compensation.



Miguel Patricio, successor CEO

Relative Valuation

Name	Country	Market Cap (mn)	Currency	P/E 2019	P/E 2020E	EV/EBITDA	EV/Sales	YTD	Div. Yield	NetDebt/EBITDA	Margin EBITDA
KEURIG DR PEPPER INC	UNITED STATES	41.863	USD	24,4	21,2	23,5	5,6	16,1%	3,5%	6,7	23,6%
NESTLE SA-REG	SWITZERLAND	304.564	CHF	23,5	21,6	15,2	2,9	28,2%	2,4%	1,7	19,3%
MONDELEZ INTERNATIONAL INC-A	UNITED STATES	79.152	USD	22,0	20,4	21,5	3,5	37,3%	1,9%	4,4	16,4%
KELLOGG CO	UNITED STATES	18.152	USD	13,9	13,2	13,3	2,2	-6,5%	4,2%	4,3	16,3%
CAMPBELL SOUP CO	UNITED STATES	12.239	USD	16,0	15,7	14,7	2,1	23,2%	3,4%	6,5	14,3%
UNILEVER PLC	BRITAIN	141.556	Gbp	22,4	20,4	9,8	2,8	23,1%	2,7%	1,5	28,1%
GENERAL MILLS INC	UNITED STATES	32.235	USD	16,0	15,7	14,9	2,8	37,5%	3,7%	4,5	18,6%
KRAFT HEINZ CO/THE	UNITED STATES	37.233	USD	11,0	10,6	-	3,2	-29,1%	6,7%	-	-32,5%
Average exc. Kraft Heinz				19,7	18,3	16,1	3,1	22,71%	3,12%	4,2	19,51%

Source: BiG Research

2018 was a tough year for Kraft Heinz and that translated to its multiples. Kraft Heinz P/E is 11x way below its peer's average of 19.7x due to the impact of the SEC investigation and impairments in the stock price. It has a dividend yield of 5.24% vs 3.12% average of its peers.

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Income Statement (USD mn.)	2017	2018
Condiments and sauces	6519	6830
Cheese and dairy	5476	5254
Ambient foods	2608	2627
Frozen and chilled foods	2608	2627
Meats and seafood	2608	2627
Others	6258	6304
Net Revenues	26076	26268
COGS	17.043	17.347
SG&A expenses	2927	3205
Goodwill impairment losses	0	7008
Intangible assets impairment losses	49	8928
Operating Expenses	20.019	36.488
Operating Profit	6.057	(10.220)
Interest expense	1.234	1.284
Other expense/(income)	(627)	(183)
EBT	5.450	(11.321)
Taxes	(5.482)	(1.067)
Net Income *	10.941	(10.192)
Earnings per share	9	(8)

*less net income attributable to noncontrolling interests

Source: Company's data

Free Cash Flow (USD mn)	2017	2018
Operational Cash Flow	501	2.574
Operating Profit	10.932	(10.254)
Depreciation and amortization	1031	983
Goodwill and Intangible impairment loss	49	15.936
Taxes	(6.495)	(1.967)
Change Working Capital	(3.364)	(2.063)
Others	(1.652)	(61)
Investment Cash Flow	1.177	288
Capex	(1.194)	(826)
Acquisitions	0	(248)
cash receipts on sold receivables	2.286	1.296
Others	85	66
Financial Cash Flow	(4.221)	(3.363)
Long term Debt change	(1.145)	277
Short Term Debt change	(206)	(429)
Dividends payment	(2.888)	(3.183)
Others	18	(28)
Change in free cash flow	(2.486)	(633)
Cash and equivalents at end	1.769	1.136

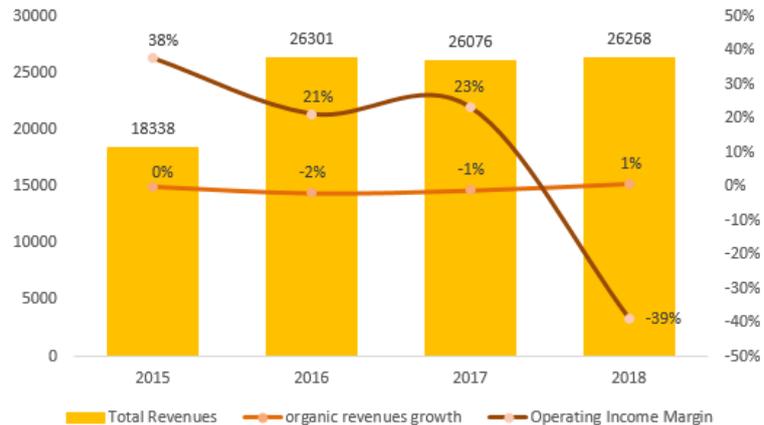
Source: Company's data

Balance Sheet (USD mn.)	2017	2018
Assets	120.092	103.461
Cash & Equivalents	1.629	1.130
intangible assets	59.432	49.468
Goodwill	44.825	36.503
Receivables	1.274	2.129
Inventories	2.760	2.667
Property Plant & Equipment	7.061	7.078
Other Assets	3.111	4.486
Liabilities	54.016	51.683
Short term Debt	462	21
Current portion of LT debt	2.733	377
Long term Debt	28.308	30.770
Payables	4.362	4.153
Deferred income tax liabilities	14.039	12.202
Other liabilities	4.112	4.160
Total Shareowner's Equity	66.070	51.775
Total Equity and Liabilities	120.092	103.461

Source: Company's data

Income Statement

Products' categories presented in this Income statement are the ones that from all categories represented in 2017 and 2018 more than 10% of sales individually. In 2018 revenues grew 1% from USD 26 bn in 2017 to USD 26.2 bn. Net income suffered a major loss, in 2017 net income (after noncontrolling interests) was USD 10.9 bn and in 2018 USD -10.2 bn. This loss was mainly due to the recognition of impairment losses in goodwill and intangible assets of USD 15 bn in their Kraft, Oscar Myer brands, Canada retail, and US refrigerated. These impairments resulted in a net loss attributable to common shareholder of USD 12.6 bn and a diluted loss per share of USD 10.34.



Source: Company's data

Free Cash Flow

Regarding the free cash flow, in 2018 operational cash flow increased significantly from USD 501 mn to USD 2.6 bn mainly driven by an increase of impairment losses of USD 15 bn (the free cash flow statement was made according indirect method). The investment cash flow decreased to USD 288 mn vs USD 1.7 bn in 2017 due to the acquisition of all the outstanding equity interests of Cerebos for USD 248 mn (see more in the M&A section), and a reduction in the cash receipts on sold receivables, the name given to the method Kraft Heinz uses to have liquidity securitizing accounts receivables, from USD 2.3 bn to USD 1.3 bn. The Financing activities verified an outflow of USD 3.36 bn (vs USD 4.22 bn in 2017) with the increasing in dividends paid, USD 3.2 bn vs USD 2.9 bn, payment of short-term debt of USD 429 mn and issuance of long-term debt of USD 277 mn.

Balance Sheet

As for the balance sheet, total debt decreased 1% from USD 31.5 bn to USD 31.16 bn mainly due to a big reduction in short term debt and current portion of LT debt. However, net debt increased to USD 30 bn vs USD 29.8 in 2017. In 2018 Kraft Heinz had a SEC probe regarding its accounting practice that resulted in a USD 25 mn increase in its products sold costs that reflected in inventories. For 2019 the company's strategy goes by reinforcing its balance sheet.

Guidance

As for 2019, Kraft Heinz expects to have a growth in organic revenues with a 3-4 pp negative impact from divestitures and currency headwind. Also, the company expects to have an adjusted EBITDA of USD 6.3 bn to USD 6.5 bn. Regarding Adjusted EPS, the expected value is to be held back approximately USD 0.25 compared to 2018. The Capex estimate for 2019 is USD 800 mn.

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▲ Main segments & categories

Kraft Heinz operates in several countries and organizes its segments in four different territories. In each segment the brands that the company sells are not the same and the products they sell of each brand may also differ from segment to segment. So, the segments can be described as follows:

U.S. (USD 18.1 bn sales (-1% growth); 69% of total revenues; 29% Op income margin):

The Us segment, which is the most relevant in revenues for the company sells mainly brands such as: Kraft, Oscar Mayer, Heinz, Philadelphia, Lunchables, Velveeta, Planters, Maxwell House, Capri Sun, One Ida, Kool Aid, and Jell-O.

Canada (USD 2.2 bn sales (-0.2% growth); 8% of total revenues; 28% Op income margin):

In this segment, some of the brands that are produced and sold are Kraft, Cracker Barrel, Heinz, Philadelphia, Maxwell House, Classico, McCafe, P'Tit Quebec, Tassimo.

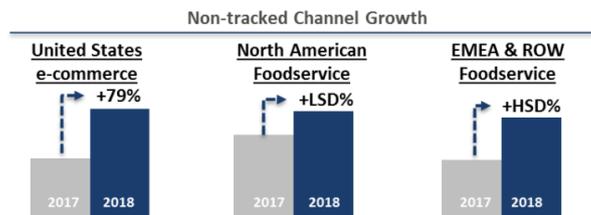
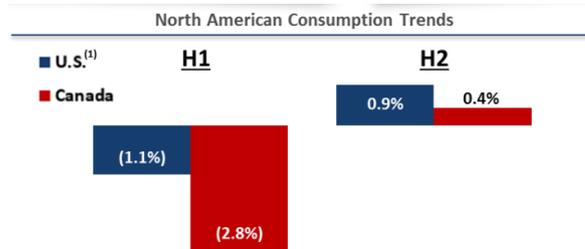
EMEA (USD 2.7 bn sales (+5% growth); 10% of total revenues; 27% Op income margin):

Previously was separated between Europe and AMEA being joined in the first quarter of 2018 to create EMEA. Some of the brands that are sold in this segment are Heinz, Plasman, Pudlizki, Horig, HP, Kraft, Benedicta, and Karvar Cevitam.

Rest of world (USD 3.2 bn sales (+20 growth); 12% of total revenues; 20% Op income margin):

This segment includes two territories, Latin America and Asia Pacific (APAC). Some of the brands that are sold are: Heinz, ABC, Master, Quero, Kraft, Golden Circle, Wattie's, Glucan-P, and Complian.

Nevertheless, it is possible to identify and categorize its products in the following categories, being the following the ones that contributed to more than 10% of the total net revenues of the company:



Source: Company's data

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▲ M&A

Cerebos pacific Limited: This is an Australian food and beverage company that manufactures products such as gravies, sauces, instant coffee, salt, herbs and spices, and tea that has mainly operations in Australia and New Zealand with several local brands. Kraft Heinz acquired all of the outstanding equity interests in this company for USD 244 mn.

Primal Kitchen: In January 2019 Kraft Heinz completed the acquisition of Primal Kitchen which is a better-for-you brand focused on condiments, sauces and dressings such as mayonnaise, Salad dressings, and avocado oil, this is a growing company in the healthy snacks category and other. This brand will be integrated in Springboard, a platform created by Kraft Heinz to join brands that will disrupt the food industry, but will still operate autonomously and keep their leadership team. The acquisition was made for USD 200 mn.

Wellio: Kraft Heinz announced in November 2018 that was acquiring Wellio which is a San Francisco based AI food tech company. Wellio is still on beta phase (user acceptance test) tech provides elements of personal nutritionist, chef, and shopper combined to deliver an on-demand dinner solution that seeks to give its customer the best solution for a meal that includes fresh ingredients, less food and packaging waste, cost efficiency, scanning of ingredients, and inclusion of less processed food. With this acquisition, Kraft Heinz manages to fuel their digital ambition and with the AI platform of Wellio create food related solutions in unique ways.

▲ Risks

Consumer tastes: Consumers tend to be more demanding in what they buy since health concerns are more discussed. Therefore, consumers are changing their eating and drinking habits to healthier options. For this reason, and with more measures as taxes applied to these type of products, the company's revenues would decrease, and costs increase, reducing its margins. In line with this risk is the capacity of the company to innovate and create new products that meet the consumer's needs.

Brand image: Following the investigation on the accounting policies of Kraft Heinz taken by the SEC (resulted in a correction of costs and inventories of USD 25 mn). Although this had no major impact in the results of the company, this has an influence in the brand's name within its customers.

Impairments: Kraft Heinz has a large amount of goodwill and intangibles (85% of assets) due to its highly diversified portfolio of brands. In 2018 the company reported USD 15.4 bn in impairment losses mainly in its Kraft and Oscar Mayer brands which impacted significantly its results with a negative operational income of USD 10.2 bn and a negative net income of USD 10.1 bn in 2018.

Dividend cut: As stated in the "investments case" separator, the company cut its quarterly dividend by 36% to USD 0.40 in the 4Q of 2018. There is a risk that the company may need reduce again its dividend to invest more in the business but for now the company hasn't made an outlook about the growth of the dividend.

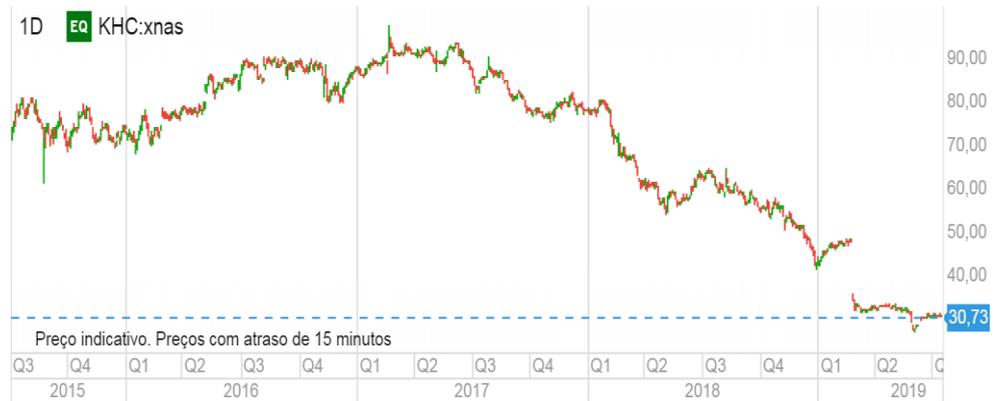
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Graph

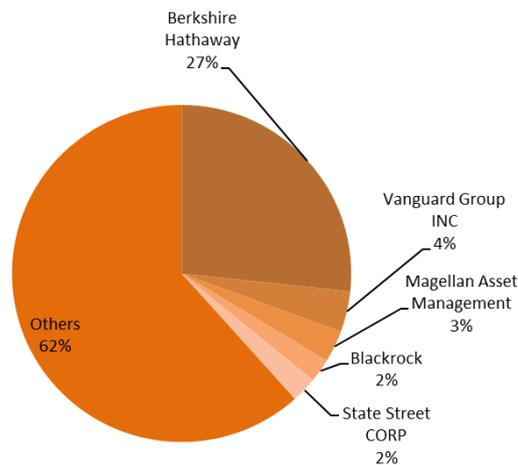


Source: BiG Global Trade

Calendar

1st of August 2019: Earnings results

Shareholder



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 - Accumulate, expected absolute return between +5% and +15%;
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