



Rating  
**Hold**

North America  
United States

Consumer  
Food

Company  
**Smucker**

Reuters: SJM.N    Bloomberg: SJM UN    Exchange: NYS    Ticker: SJM

Date  
11 July 2018

## Company Update

Price at 10 Jul 2018 (USD)	109.14
Price target	100.00
52-week range	131.53 - 99.99

## HQ Visit Takeaways

### Time spent with new executives helped our understanding of SJM's positioning

Yesterday, we hosted an investor trip to Smucker's headquarters in Orrville, OH. Management in attendance included President & CEO Mark Smucker, CFO Mark Belgya, and new business heads Joseph Stanziano (Coffee), Tina Floyd (Consumer Foods), and David Lemmon (Pet Food & Snacks). Given the recent executive changes, we found the time spent with marquee senior management very helpful in understanding the company's current position and outlook. Topics of discussion included the sale of the U.S. baking business, increased investments for growth in the form of greater emphasis on narrower platform focuses, Canadian tariffs, K-cup margins, relationships with large retailers and the Amazon Effect from a pet food category perspective, and the current M&A landscape.

### Tweaking estimates off baking divestment & potential Canadian tariff headwind

Before Monday's announcement of the U.S. baking business sale to Brynwood Partners, we assumed an EV/EBITDA multiple of 10.5x, an estimated transaction value of \$660m and after-tax cash proceeds of ~\$625mm. By our math, the \$375mm transaction value implies a multiple of ~7.5x U.S. baking's 2018 EBITDA of ~\$50mm, or an EBITDA margin of ~13.5%, reflecting the business's declining volumes and #3 market share position owing to the category's high level of trade and Smucker's lack of investment in its baking brands. Sales to Canada account for ~\$500mm of total company annual sales, of which ~55% is produced in the U.S., representing a ~\$275mm exposure to Canadian tariffs ranging from 2%-10% on a variety of American consumer goods categories imported into the country. We're estimating the rough volume impact to Smucker's FY'19 international segment sales to be ~\$10mm. Our total company organic growth estimate is now 1.1% vs. 1.2% previously (vs. guidance of 2%), and our net sales growth estimate is now 8% vs. 8.1% previously (vs. implied guidance of ~9% excluding baking). Given the lower-than-expected selling multiple and potential cash proceeds on the U.S. baking divestment and, to a lesser extent, potential tariff-related headwinds, we are reducing our FY'19 estimate by a total of \$0.10 to \$8.25. We note our FY'19 EPS estimate excludes the gain from investment on the U.S. baking business.

### Conversations with management were productive, but remain sidelined

We came away from our discussions with management feeling incrementally positive with respect to the company's brand support and platform innovation strategy, but potential near-term headwinds from the industry's weakened pricing ability, the company's reliance on the consumer response to its innovation, and potential incremental pet food competition keep us on the sidelines.

### Valuation & Risks

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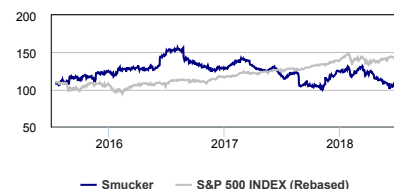
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#### Key changes

TP	97.00 to 100.00	↑	3.1%
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Source: Deutsche Bank

#### Price/price relative



Performance (%)	1m	3m	12m
Absolute	6.5	-12.3	-4.6
S&P 500 INDEX	0.5	5.2	15.1

Source: Deutsche Bank

**Valuation & Risks:** We apply a ~30% discount to the current group multiple, in line with market valuation, against our 24-month forward EPS estimate (including amortization). Given near-term risks to the top line and overall brand investment needs, we find it fair to apply a larger discount than the stock's historical ~10% discount to peers. Upside risks include higher-than-expected cost savings from current initiatives, category share gains from brand support or innovation, lower-than-expected input costs and accretive M&A. Downside risks include increased category competition, reinvestment needs, input cost volatility, and M&A integration.



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## Highlights from the HQ visit

### Sale of U.S. Baking

- Extremely high levels of trade in the category
- Didn't spend behind it over past two years
- Competitors spent on trade while SJM did not, hitting SJM baking volumes
- Brands in declining category are likely getting 7.5x to 9x EBITDA right now
- Didn't want to hang onto baking and wait for higher value
- Business has a fairly low cost basis
- Baking was only 5% of SKUs
- Company will treat the gain from sale as part of adjusted EPS, but will be a headwind next fiscal year
- Company doesn't think that the value of the baking business is indicative of current CPG valuations

### Growth platforms and investment/spending

- Smucker continues to focus on coffee, pet, and snacking categories
- Crisco would be logical next sale (not in these categories), but business has good profits
- Overall, the company's ROIC is not where management wants it to be but they think that will change as they invest up for growth
- Because of higher spending this year, company has more flexibility in their spending (more online this year) and can adjust as the year plays out
- \$50mm behind Jif Power-Ups and 1850 innovation
- \$30mm on growth platforms like Cafe Bustelo, Uncrustables, etc.
- FY'19 spending on innovation will be 1H-heavy given innovation platforms
- 1850 launch: expect double-digit growth rate in first couple of years, hoping to take share from other non-SJM brands, \$50-75mm would be considered a huge launch
- Promotional activity: don't see anything specific right now for this time of year but things will heat up heading into BTS

### Canadian Tariffs

- July 1st: 2%-10% tariffs went into effect, 55% of Canadian business sales is sourced from U.S., total business is \$500mm



- Will try to price to offset but could be tough vs. local players, will impact SJM (volume pressure) but company thinks it stays within guidance ex-the baking divestiture

#### Cost inflation

- Seeing 5-year lows in coffee prices - Brazil's huge crop has helped but that cycle can change
- Cost inflation up overall: Pet exposed to plastic, steel, wheat
- Freight peaked for SJM but fundamental pressures remain

#### K-Cups

- Margins aligned with rest of coffee business, reinvesting and paying off
- Keurig pushing on entry level machine side and helps SJM (expansion of household penetration)
- K-cup margins were aligned with segment but then they went down as more competition entered, SJM was being squeezed, others were under renegotiation, fewer restrictions on SKUs and channels now, more freedom to operate
- This team is more focused, and focused on "hot" and getting brewer down to a more affordable rate, they want to have a more mainstream consumer in the system
- Went from \$0.75/cup to \$0.50
- 1/3 of cups consumed could be on a Keurig brewer, most consumers still want K-cups

#### Shift in focus over the years

- Richard and Tim Smucker decided that they needed to branch out from being a fruit spread business - they were good at understanding and managing brands, not just single-category specialists, looked to be brand managers in pet and coffee
- Re-innovation: company realized that it was too line-extension focused and wasn't investing enough behind brands, so they've increased their innovation rate, consumer focus is key
- Now, more platform-focused and will invest more behind bigger bets, so to speak
- Company will be changing some compensation metrics next year: rolling periods, capital-return focus

#### Corporate governance

- Rights changes were good governance, was going to expire next year
- Did not change time-phased voting of 10-to-1, which rewards long-term shareholders that have been holders longer than 4 years



## Pet

- Premium pet growing well online and in mass/WMT
- Pet is largest center store category (\$30bn)
- Fragmented, lower private label penetration, growing
- With BHPB acquisition, they didn't see the growth online and deceleration of specialty pet stores, there were many external forces that they didn't see that contributed to the deceleration
- WMT pet rep said that they like that Nutrish and Nature's Recipe brands both growing and can co-exist
- Pet innovation pipeline great this year, good next year, but they need to sustain it in out years - this is the challenge - they think there's a ton of white space with legacy brands
- Core competencies: relationships with customers and trust is high, ability to implement (acquisitions, execution), ability to create and nurture emotional bonds with consumers
- Change at WMT: pricing is more difficult to get, but the old handshake and accommodation with SJM still exist
- Retailers are pushing harder on pricing, but can still get it - helps to be a large player as retailers trust brands
- SJM has larger presence globally, and is the closest to having a global supply chain
- 50% of nature's recipe online is on subscription

## Online/Amazon supply chain

- Minimized Advertised Pricing (MAP): Amazon wants it more and wants CPG companies to enforce it more
- They rely on their algorithm but they're tweaking that to an extent
- Can't lose share online as SJM is building this area
- "We are all trying to figure out what the mix of customers will be"

## Acquisition targets and integration

- Kind Bar - "saturated U.S. market, growth slows, going to international for growth"
- RXBAR - "what's the end game, how far can they take it?"
- Need to focus on customer centricity, opportunities
- Have passed, or have been passed, on some smaller deals but they were simply outbid, which wasn't a bad thing
- On pet, they felt comfortable with valuation given synergies, but they now need to deliver on synergies - have to be careful right now as there's a bunch of cash out there in the category



- Large scale consolidation possibility: "It depends", some cases create short term value but long term destruction
- CAG and PF looks like it might make sense given growth and consumer learnings and category overlap
- Scale - just matters to have enough scale in categories that they compete and the right portfolio mix
- Larger companies even if scaled like KHC likely have better access to capital
- Over time, synergies likely come down as companies become more efficient

#### Cost savings

- Mostly supply savings
- Potential media spend
- Multiple areas for ZBB spending in phases - implemented travel and leisure
- Expecting flat gross margin this year driven by green coffee prices and Keurig contract, so mostly 1H-heavy



Figure 1: J.M. Smucker Quarterly Income Statement

Fiscal Year End April (US\$m)	2017	JUL	OCT	JAN	APR	2018	JUL	OCT	JAN	APR	2019E	2020E	2021E
		1Q18	2Q18	3Q18	4Q18		1Q19E	2Q19E	3Q19E	4Q19E			
<b>Sales</b>	\$ 7,392	\$ 1,749	\$ 1,924	\$ 1,903	\$ 1,781	\$ 7,357	\$ 1,985	\$ 2,020	\$ 2,020	\$ 1,919	\$ 7,944	\$ 7,953	\$ 8,105
Cost of Goods	4,524	1,099	1,177	1,172	1,107	4,554	1,245	1,236	1,243	1,192	4,917	4,902	4,976
Cost of Goods / Sales (%)	61.2%	62.8%	61.2%	61.6%	62.1%	61.9%	62.7%	61.2%	61.6%	62.1%	61.9%	61.6%	61.4%
YY Δ COGs / Sales (bps)	(80 bps)	242 bps	78 bps	3 bps	(37 bps)	70 bps	(10 bps)	(0 bps)	0 bps	(0 bps)	(1 bps)	(26 bps)	(25 bps)
<b>Gross Profit</b>	<b>2,868</b>	<b>650</b>	<b>746</b>	<b>732</b>	<b>675</b>	<b>2,803</b>	<b>740</b>	<b>783</b>	<b>776</b>	<b>727</b>	<b>3,027</b>	<b>3,051</b>	<b>3,130</b>
Gross Margin (%)	38.8%	37.2%	38.8%	38.4%	37.9%	38.1%	37.3%	38.8%	38.4%	37.9%	38.1%	38.4%	38.6%
YY Δ Gross Margin (bps)	80 bps	(242 bps)	(78 bps)	(3 bps)	37 bps	(70 bps)	10 bps	0 bps	0 bps	0 bps	1 bps	26 bps	25 bps
Selling, Distribution, & Administrative	1,598	401	415	383	379	1,578	455	470	435	432	1,792	1,798	1,847
SG&A / Sales (%)	21.6%	22.9%	21.6%	20.1%	21.3%	21.4%	22.9%	23.3%	21.5%	22.5%	22.6%	22.6%	22.8%
YY Δ SG&A / Sales (bps)	(31 bps)	54 bps	(3 bps)	(70 bps)	(40 bps)	(17 bps)	(4 bps)	170 bps	140 bps	127 bps	111 bps	6 bps	17 bps
Total Expenses	1,598	401	415	383	379	1,578	455	470	435	432	1,792	1,798	1,847
<b>Operating Profit</b>	<b>1,271</b>	<b>249</b>	<b>332</b>	<b>348</b>	<b>296</b>	<b>1,225</b>	<b>285</b>	<b>314</b>	<b>341</b>	<b>295</b>	<b>1,235</b>	<b>1,253</b>	<b>1,283</b>
Operating Margin	17.2%	14.2%	17.2%	18.3%	16.6%	16.7%	14.4%	15.5%	16.9%	15.4%	15.5%	15.7%	15.8%
YY Δ Operating Margin (bps)	111 bps	(296 bps)	(76 bps)	67 bps	77 bps	(54 bps)	14 bps	(170 bps)	(140 bps)	(127 bps)	(110 bps)	20 bps	8 bps
Amortization	207	52	52	52	52	207	56	56	56	56	222	223	227
<b>Operating Profit, excluding Amortization</b>	<b>1,478</b>	<b>301</b>	<b>383</b>	<b>400</b>	<b>348</b>	<b>1,432</b>	<b>341</b>	<b>369</b>	<b>397</b>	<b>350</b>	<b>1,458</b>	<b>1,475</b>	<b>1,510</b>
Operating Margin, excluding Amortization	20.0%	17.2%	19.9%	21.0%	19.6%	19.5%	17.2%	18.3%	19.6%	18.3%	18.3%	18.5%	18.6%
YY Δ Operating Margin, excluding Amortization (bps)	125 bps	(286 bps)	(78 bps)	63 bps	77 bps	(53 bps)	(0 bps)	(163 bps)	(136 bps)	(130 bps)	(111 bps)	20 bps	8 bps
Interest Expense	163	42	42	43	47	167	54	54	54	54	217	213	197
Interest Income	-	-	-	-	-	-	-	-	-	-	-	-	-
Interest Expense, Net	163	42	42	43	47	167	54	54	54	54	217	213	197
Other Income (Expense)	10	(3)	3	(4)	3	(1)	-	-	-	-	-	-	-
Pretax Income	1,325	256	344	353	304	1,264	287	315	343	296	1,241	1,262	1,313
Income Taxes	432	84	115	69	84	352	70	77	84	73	304	309	322
Tax Rate (%)	32.6%	32.9%	33.3%	19.7%	27.6%	27.9%	24.5%	24.5%	24.5%	24.5%	24.5%	24.5%	24.5%
<b>Net Income, excluding Amort. &amp; Extraordinary Items</b>	<b>\$ 893</b>	<b>\$ 172</b>	<b>\$ 230</b>	<b>\$ 284</b>	<b>\$ 220</b>	<b>\$ 911</b>	<b>\$ 217</b>	<b>\$ 238</b>	<b>\$ 259</b>	<b>\$ 224</b>	<b>\$ 937</b>	<b>\$ 953</b>	<b>\$ 991</b>
Extraordinary Items / Other	(301)	(45)	(35)	548	(34)	434	(40)	(40)	(40)	(40)	(160)	(160)	-
Net Income, GAAP	592	127	195	831	186	1,345	177	198	219	184	777	793	991
<b>EPS, Excluding Extraordinary Items</b>	<b>\$ 6.49</b>	<b>\$ 1.21</b>	<b>\$ 1.72</b>	<b>\$ 2.13</b>	<b>\$ 1.60</b>	<b>\$ 6.65</b>	<b>\$ 1.54</b>	<b>\$ 1.72</b>	<b>\$ 1.91</b>	<b>\$ 1.60</b>	<b>\$ 6.77</b>	<b>\$ 6.91</b>	<b>\$ 7.36</b>
<b>EPS, Excluding Extraordinary Items &amp; Amortization</b>	<b>\$ 7.69</b>	<b>\$ 1.51</b>	<b>\$ 2.02</b>	<b>\$ 2.50</b>	<b>\$ 1.93</b>	<b>\$ 7.96</b>	<b>\$ 1.91</b>	<b>\$ 2.09</b>	<b>\$ 2.28</b>	<b>\$ 1.97</b>	<b>\$ 8.25</b>	<b>\$ 8.39</b>	<b>\$ 8.89</b>
Basic EPS, GAAP (Reported)	\$ 5.11	\$ 1.12	\$ 1.71	\$ 2.32	\$ 1.64	\$ 11.79	\$ 1.55	\$ 1.74	\$ 1.92	\$ 1.62	\$ 6.84	\$ 6.98	\$ 8.89
Diluted EPS, GAAP (Reported)	\$ 5.10	\$ 1.12	\$ 1.71	\$ 2.32	\$ 1.64	\$ 11.78	\$ 1.55	\$ 1.74	\$ 1.92	\$ 1.62	\$ 6.84	\$ 6.98	\$ 8.89
Shares Outstanding (Basic - GAAP)	116	114	114	114	114	114	114	114	114	114	114	114	111
Shares Outstanding (Diluted - GAAP)	116	114	114	114	114	114	114	114	114	114	114	114	111
Depreciation & Amortization	419	106	102	104	101	413	111	111	111	111	445	445	454
EBITDA	\$ 1,690	\$ 355	\$ 434	\$ 452	\$ 397	\$ 1,638	\$ 397	\$ 425	\$ 452	\$ 406	\$ 1,680	\$ 1,698	\$ 1,737

Income Statement (YY %)													
Sales	(5.4%)	(3.7%)	0.5%	1.3%	(0.1%)	(0.5%)	13.5%	5.0%	6.1%	7.8%	8.0%	0.1%	1.9%
COGs	(6.6%)	0.2%	1.8%	1.3%	(0.7%)	0.7%	13.3%	5.0%	6.1%	7.8%	8.0%	(0.3%)	1.5%
Gross Profit	(3.4%)	(9.6%)	(1.5%)	1.2%	0.8%	(2.3%)	13.8%	5.0%	6.1%	7.8%	8.0%	0.8%	2.6%
SG&A	(6.7%)	(1.4%)	0.4%	(2.1%)	(2.0%)	(1.2%)	13.3%	13.3%	13.5%	14.2%	13.6%	0.4%	2.7%
Operating Income	1.2%	(20.3%)	(3.7%)	5.2%	4.7%	(3.6%)	14.6%	(5.4%)	(2.0%)	(0.5%)	0.8%	1.4%	2.4%
Pretax Income	2.1%	(21.0%)	(3.9%)	3.0%	1.1%	(4.6%)	12.2%	(8.5%)	(3.0%)	(2.5%)	(1.8%)	1.8%	4.0%
Net Income, excluding Extraordinary Items	3.4%	(21.0%)	(4.1%)	21.9%	7.8%	2.1%	26.2%	3.7%	(8.8%)	1.7%	2.8%	1.8%	4.0%
EPS, excluding Extraordinary Items	6.9%	(23.0%)	(2.2%)	25.7%	9.3%	2.5%	27.3%	0.4%	(10.6%)	(0.3%)	1.8%	2.1%	6.5%
EPS, excluding Extraordinary Items & Amortization	6.3%	(19.0%)	(1.6%)	25.0%	9.1%	3.5%	26.1%	3.7%	(8.8%)	1.7%	3.5%	1.8%	6.0%
Shares Outstanding	(2.8%)	(2.5%)	(2.5%)	(2.5%)	(1.1%)	(2.2%)	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	(1.9%)
Dividend per Share	11.9%	4.0%	4.0%	4.0%	4.0%	4.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%

Source: Deutsche Bank estimates, company data



# Appendix 1

## Important Disclosures

\*Other information available upon request

Disclosure checklist			
Company	Ticker	Recent price*	Disclosure
Smucker	SJM.N	109.14 (USD) 10 Jul 2018	6, 9

\*Prices are current as of the end of the previous trading session unless otherwise indicated and are sourced from local exchanges via Reuters, Bloomberg and other vendors. Other information is sourced from Deutsche Bank, subject companies, and other sources. For disclosures pertaining to recommendations or estimates made on securities other than the primary subject of this research, please see the most recently published company report or visit our global disclosure look-up page on our website at <https://research.db.com/Research/Disclosures/CompanySearch>. Aside from within this report, important risk and conflict disclosures can also be found at <https://research.db.com/Research/Topics/Equities?topicId=RB0002>. Investors are strongly encouraged to review this information before investing.

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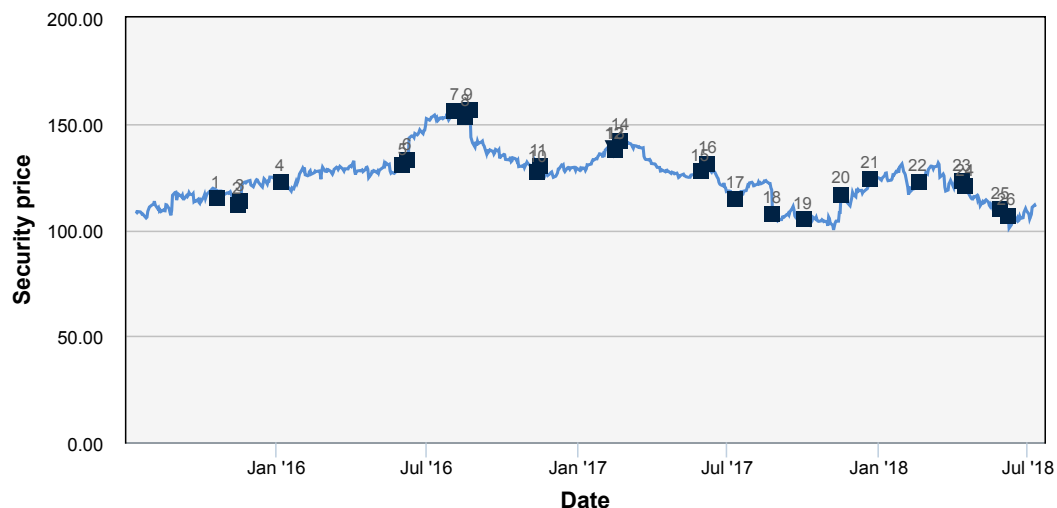
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The views expressed in this report accurately reflect the personal views of the undersigned lead analyst(s) about the subject issuer and the securities of the issuer. In addition, the undersigned lead analyst(s) has not and will not receive any compensation for providing a specific recommendation or view in this report. Rob Dickerson



Historical recommendations and target price. Smucker (SJM.N)

(as of 07/10/2018)



Current Recommendations

- Buy
- Hold
- Sell
- Not Rated
- Suspended Rating

\*\* Analyst is no longer at Deutsche Bank

1.	10/21/2015	Buy, Target Price Change USD 126.00 Eric Katzman, CFA**	14.	02/22/2017	Hold, Target Price Change USD 143.00 Kanika Goyal, CFA
2.	11/16/2015	Buy, Target Price Change USD 125.00 Eric Katzman, CFA**	15.	05/31/2017	Hold, Target Price Change USD 140.00 Kanika Goyal, CFA
3.	11/19/2015	Buy, Target Price Change USD 130.00 Eric Katzman, CFA**	16.	06/08/2017	Hold, Target Price Change USD 135.00 Kanika Goyal, CFA
4.	01/07/2016	Buy, Target Price Change USD 137.00 Eric Katzman, CFA**	17.	07/12/2017	Hold, Target Price Change USD 131.00 Kanika Goyal, CFA
5.	06/03/2016	Buy, Target Price Change USD 143.00 Mario Contreras**	18.	08/25/2017	Hold, Target Price Change USD 120.00 Kanika Goyal, CFA
6.	06/09/2016	Buy, Target Price Change USD 152.00 Mario Contreras**	19.	10/02/2017	Hold, Target Price Change USD 114.00 Kanika Goyal, CFA
7.	08/05/2016	Buy, Target Price Change USD 162.00 Mario Contreras**	20.	11/17/2017	Hold, Target Price Change USD 116.00 Kanika Goyal, CFA
8.	08/18/2016	Buy, Target Price Change USD 165.00 Mario Contreras**	21.	12/22/2017	Hold, Target Price Change USD 130.00 Stephen Powers
9.	08/23/2016	Buy, Target Price Change USD 162.00 Mario Contreras**	22.	02/19/2018	Hold, Target Price Change USD 134.00 Kanika Goyal, CFA
10.	11/14/2016	Buy, Target Price Change USD 150.00 Mario Contreras**	23.	04/13/2018	Hold, Target Price Change USD 133.00 Matt Fishbein
11.	11/17/2016	Buy, Target Price Change USD 147.00 Mario Contreras**	24.	04/17/2018	Hold, Target Price Change USD 126.00 Matt Fishbein
12.	02/15/2017	Downgraded to Hold, Target Price Change USD 145.00 Mario Contreras**	25.	05/29/2018	Hold, Target Price Change USD 118.00 Matt Fishbein
13.	02/17/2017	Hold, Target Price Change USD 142.00 Kanika Goyal, CFA	26.	06/07/2018	Hold, Target Price Change USD 97.00 Kanika Goyal, CFA





### Equity Rating Key

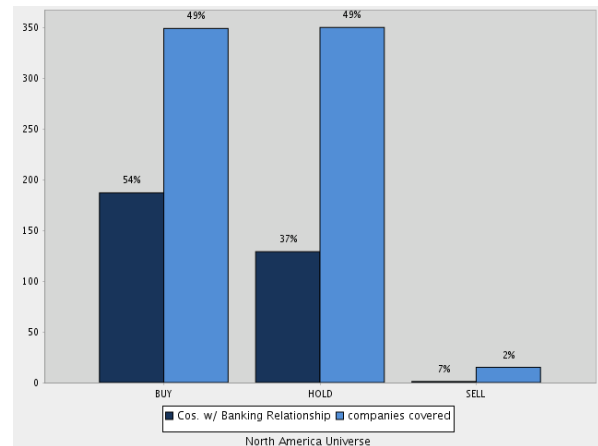
**Buy:** Based on a current 12- month view of total share-holder return (TSR = percentage change in share price from current price to projected target price plus pro-jected dividend yield ) , we recommend that investors buy the stock.

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**Hold:** We take a neutral view on the stock 12-months out and, based on this time horizon, do not recommend either a Buy or Sell.

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### Equity rating dispersion and banking relationships





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