



Anthony Ariciaga
Equity Analyst
Ariciaga95@gmail.com
11/7/2018

Kevin Lo
Equity Analyst
<Email>
11/7/2018

McCormick & Co.

NYSE: MKC

BUY



Recommendation: BUY

Intrinsic Value: \$177.12

Investment Thesis

We believe that McCormick & Company is a buy because their recent acquisitions to expand its product line and global market share have yet to be fully realized in its stock price.

Executive Summary

McCormick & Company, Inc. has performed seven acquisitions since 2015. Their latest acquisitions of RB Foods has yet to be fully realized in their stock price. Which is why we recommend a buy action while MKC price is at 148.50; this presents us with a 19.24% gain. By pursuing our recommendation, the portfolio will have a consumer staple that will prepare it for any possible downtrend of the market.

McCormick & Co Inc- Adjusted					Key Stats	
In Millions of USD 12 Months Ending	FY 2014 11/30/2014	FY 2015 11/30/2015	FY 2016 11/30/2016	FY 2017 11/30/2017		
Revenue	4,243.20	4,296.30	4,411.50	4,834.10	Current Price	148.5
Gross Profit	1,730.20	1,741.30	1,832.00	2,031.10	Market Cap	19,546,000,000
Operating Income (Loss)	608.20	617.50	665.90	801.70	Sector	Consumer Staples
Pretax Income (Loss), Adjusted	559.60	565.30	614.10	694.10	Industry	Packaged Foods
Pretax Income (Loss), GAAP	554.40	496.20	589.20	594.80	52-Week High/Low	93.70 - 148.58
Net Income, GAAP	437.90	401.60	472.30	477.40	P/E	30.53
					Beta	0.67

Company Overview

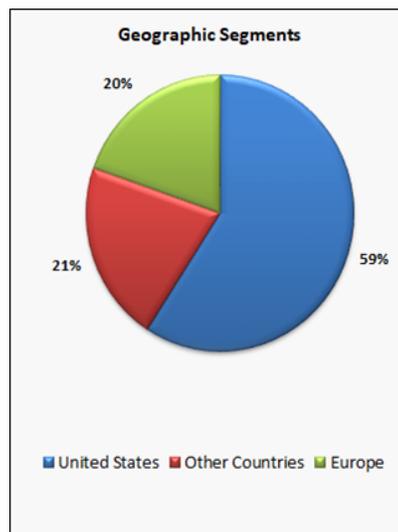
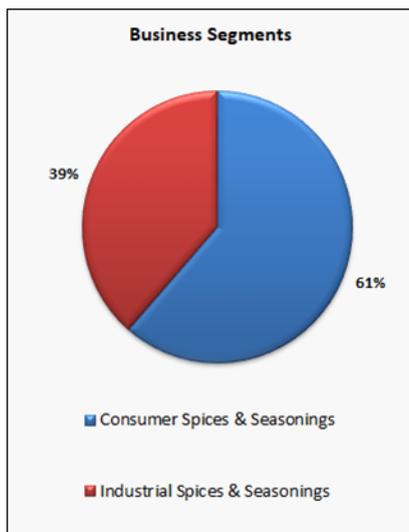
McCormick is a global leader in flavor. The company manufactures, markets, and distributes spices, seasoning mixes, condiments, and other flavorful products to the entire food industry- retailers, food manufacturers, and foodservice businesses. They operate in two business segments, consumer and industrial. The company's distribution channels reach consumers in 140 countries and territories with its 250+ brands of spices. They are an established company that has built its relationships among food manufacturers and foodservice customers for decades.



Catalyst

- **1) Diversifying its product width through acquisitions, thus allowing them to reach new markets**
 - Since 2014 McCormick has made acquisitions of smaller brands with market shares in a non-targeted geographic regions.
 - Acquisitions include Giotti for \$127 million (Italy), Kamis S.A for 291 million (Poland), and majority stake in Kohinoor Specialty Foods India for \$115 million (India). They have also purchased smaller companies in Mexico and Australia.
 - On top of acquiring, they bought one of their biggest and widely known competitors, RB foods.
- **2) Comprehensive Continuous Improvement (CCI) Program**
 - Since 2013 McCormick & Co has had a continuing initiative to improve productivity and reduce cost throughout the organization. The program helps offsets higher material cost and enables higher operating income.
 - Has helped with all acquisitions since 2013
 - Approximately \$100 each year from cost savings. Gross profit margin increased approx. 300 bps since 2013.
- **3) Per Capita Disposable Income**
 - As McCormick grows and realizes the benefits of the acquisition, revenue will increase. As revenue increases, the amount of disposable income increases. MKC will then use that income to continue its expansion of acquiring shares in emerging markets and continue its strategy of placing itself as leaders in the global market.

Company Overview – Let's Dig a Little Deeper



McCormick & Co. has made drastic changes to expand its products globally by acquiring smaller brands in uncharted areas across the world. The push to expand its brand globally is a result of the company coming to terms that the U.S market is mature and that McCormick needs to expand its presence to emerging and developing markets. As seen in the graph to the left, approximately 41% of its sales come from international areas. The percentage of sales has kept constant throughout the past 4

years, as seen in the graph below, but the dollar amount has increased by approximately \$100 million since 2014. With acquiring international businesses, McCormick has simultaneously managed to increase its international sales while also increasing domestic sales through new product exposure to domestic consumers. With changing consumer taste towards more exotic and different types of foods, McCormick's strategy fits well with the changing consumer environment within the U.S (*IBIS World*).

McCormick & Co Inc/MD (MKC UN) - By Geography				
In Millions of USD except Per Share 12 Months Ending	FY 2014 11/30/2014	FY 2015 11/30/2015	FY 2016 11/30/2016	FY 2017 11/30/2017
Revenue	4,243.2 100.0%	4,296.3 100.0%	4,411.5 100.0%	4,834.1 100.0%
United States	2,357.5 55.6%	2,438.1 56.7%	2,565.3 58.2%	2,859.6 59.2%
Other Countries	954.9 22.5%	954.5 22.2%	950.2 21.5%	1,022.9 21.2%
Europe	930.8 21.9%	903.7 21.0%	896.0 20.3%	951.6 19.7%
North America	—	—	—	—

Starting in 2013, McCormick & Co. has made efforts to cut down on cost. Within the spice, sauce, and condiment industry, most cost come from raw material and processing. McCormick and its peers incur most cost from raw materials and processing because the goods that they sell do not require a lot of adjustment, so their overall expenses are heavily weighed in the early stages of production for their goods. As mentioned earlier, McCormick implemented their CCI program in 2013 to reevaluate where they source and process their goods. The goal of this project was to get rid of unnecessary cost and have a competitive edge over its peers when it came producing a high gross profit. As seen in the chart below, McCormick gross margin has increased 162 basis points since the implementation of the CCI program. In dollar terms, their gross profit has increased by \$365 million.

(\$ millions)	2013	2014	2015	2016	2017	2018	2019	2020
Gross Profit	1,665.80	1,730.20	1,741.30	1,832.00	2,031.10	2,509.86	2,760.85	2,985.35
% Margin	40.40%	40.78%	40.53%	41.53%	42.02%	44.00%	44.00%	46.00%

The cost saving actions by McCormick has allowed them to realize higher profits while also having the ability to allocate their cash flow to more important matters. According to management and Bloomberg analyst, the implementation will be fully realized in 2020. There is a DCF model in the appendix for reference.

Industry

Porters Five

Threat of new entry - High

The barriers to entry for the Seasoning, Sauce, and Condiment Production industry are low and depends on the economies of scale of production the entrant is pursuing. The leading challenge new entrants experience is the well-entrenched position of industry's larger players. If the entrant aims to compete against the mid - to - large sized producers then they will have to secure enough capital to invest heavily in facilities. However, new entrants are able to establish themselves by focusing mostly in the low-priced, non-branded segment.

Buyer Power - Moderate

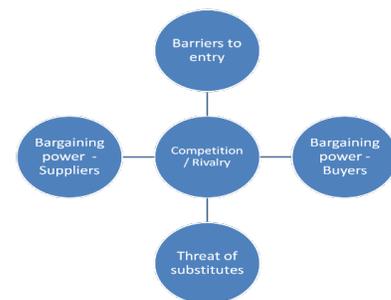
Product differentiation is quite low. Perceived quality determines the price consumers are willing to pay. Price sensitivity occurs and varies on branding and the perceived quality for the product.

Supplier Power - Moderate

Supplier power is dependent and is maintained with strong relationships. Guaranteed high-quality ingredients and the ability to secure prime grocery stores and shelf space sets market leaders from the new entrants

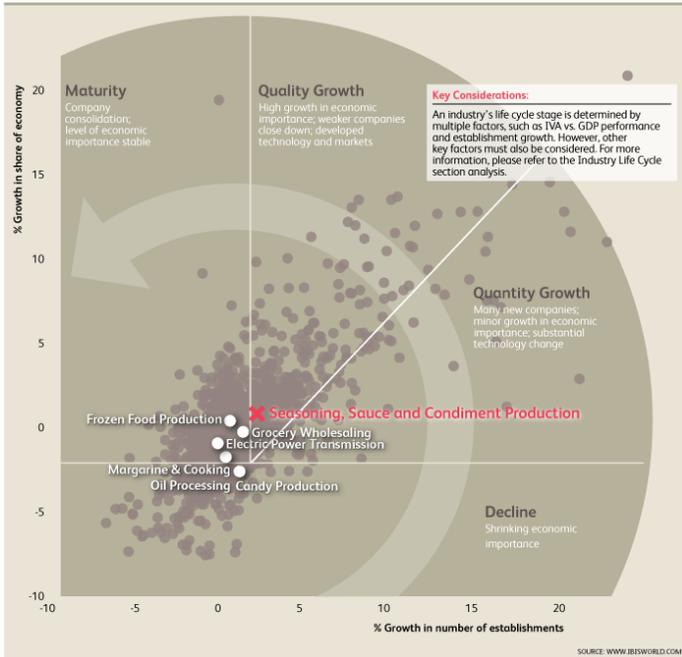
Threat of Substitution- High

Threat substitution arises from rival products. Because products differentiation is almost nonexistent, firms have to new innovate new ways to brand and market their products.



Competition- high

Based on these five forces, high threat of new entry, moderate buying power, moderate supplier power, high threat of substitution makes it difficult to survive in this industry. However, a big company like McCormick, has many of these risks mitigated due to its entrenched position in the industry.

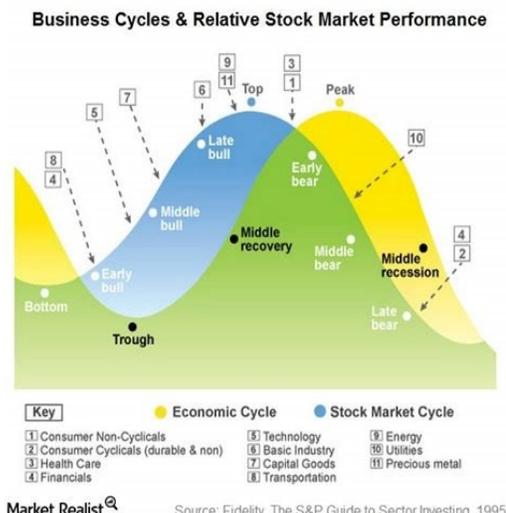


The Seasoning, Spice, and Condiment Production industry is in the mature stage of its life cycle. Over the 10 years to 2023, the Industry Value Added (IVA) is forecasted to increase at an annualized rate of 2.4%. The industry’s products are widely accepted in consumer markets and most are considered household staples.

As employment outlook for Americans look promising and household disposable income is expected to continue rising consumers are anticipated to dine-out at restaurants more frequently, strengthening demand from foodservice establishments. New product introductions that incorporate spices and spicy flavoring are expected to continue to drive industry revenue growth over the next five years (particularly hot sauce).

As a result, industry revenue is forecast to rise at an annualized rate of 1.9% to reach \$23 billion over the next five years to 2023.

Economic Outlook



McCormick & Co. is a company that tend to do well regardless of the cycle in the economy. In a down or a rising economy, people need to eat. The amount that people will spend on food will change, but putting spices on their food remains and sauces on their food remains constant. McCormick also has the advantage of adapting to changing consumer environments with easily being able to change the type of products they supply to meet the demand of consumers. Beyond future economic condition, adding McCormick to our SMIF portfolio aligns with what we mentioned in the SMIF economic outlook. As a team, we decided that we need to position our portfolio to be more defensive. As we enter a stage in the cycle where the market is becoming volatile and less confident, the SMIF team felt that moving to more cautionary securities such as the

consumer staple, McCormick & Co would be optimal.

Valuation and Recommendation

When comparing to its peers, McCormick has the financial edge in return on equity and higher gross margins. Although smaller capital compared to its two main competitors, McCormick has the potential to make major shifts in its operations in the next upcoming years. Its main competitor is Kraft Heinz, who as of recently, beat in market share for spices, sauces, and condiments. If McCormick continues their aggressive trends, the total market share and financial status within the Industry will be dominated by McCormick.

FYE 2017 (USD Denominated)	McCormick (10.8%)	Kraft Heinz (10.3%)	Unilever (3.9%) (EU Market)
Market Capitalization	19.32 Billion	63.89 Billion	155.41 Billion
Stock Price (last close)*	143.46	50.73	--
P/E*	30.20	15.12	21.74
Revenue	4.83 Billion	6.38 Billion	60.68 Billion
Net Income	173.50 Million	630.00 Million	6.84 Billion
Gross Margin	41.58	36.99	43.13
ROE	31.84	16.73	40.38
ROA	8.67	8.66	10.37



McCormick & Co. stock price has increased by approximately 50 points in the past year. The increase is a result of the recent shifts that McCormick has done to expand its brand and cut down on cost. It also helps that McCormick has beat earnings for the past two year and has also increased their dividend every year for the past five year. Some might say that the

stock price is at its highest point, but we believe that the stock still has room to grow. Many of the acquisitions still have yet to be realized and according to management, they do not expect the acquisitions to be completely realized still 2020. Given the McCormick has cut down on cost, has a long standing reputation, and has the largest market share, they look like a strong candidate to pay off its debt and move in a positive in the near future.

Overall, given the SMIF economic outlook and financial condition of McCormick, the purchase of MKC will be a great addition to the SMIF portfolio.

Risk

- Laws and regulations
 - The Food industry is susceptible to any regulation or laws that may be passed. An example would be any import laws that could impair the company from acquiring raw materials. There are many possibilities for McCormick to receive an impactful loss. The food industry is generally subject to risks posed by food spoilage and contamination, product tampering, product recall, and consumer liability claims
- Damage to the brand name
 - The rising popularity of social networking and other consumer-oriented technologies has increased the speed of information dissemination (whether or not accurate) and as a result, negative, inaccurate, or misleading posts or comments on websites may generate bad publicity that could damage the company's reputation.
- Risks with Raw Materials
 - As a manufacturer, McCormick, must acquire their raw materials to supply their orders to customers. McCormick has a plethora of brands which require a vast amount of raw materials that need to be acquired. Some of these raw materials include: pepper, dairy products, garlic, vanilla, capsicums, onion, wheat flour, and rice. If certain countries that supply certain materials were to suffer severe weather disasters, the price will be effected drastically.
- If consumers decide to buy private label or competitor's brands or satisfactory

Appendix

(\$ millions)	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Revenue	4243.2	4296.3	4411.5	4834.1	5704.238	6274.662	6489.883	6712.485676	6846.735	6983.67
YOY Growth %	3%	1%	3%	10%	18%	10%	3%	3%	2%	2%
COGS	2513	2555	2580	2803	3194.37328	3513.811	3504.537	3624.742265	3697.237	3701.345
% of Revenue	59%	59%	58%	58%	56%	56%	54%	54%	54%	53%
Gross Profit	1730.2	1741.3	1832	2031.1	2509.86472	2760.851	2985.346	3087.743411	3149.498	3282.325
% Margin	0.407758	0.405302	0.415278	0.42016094	0.44	0.44	0.46	0.46	0.46	0.47
Operating Cost	1122	1123.8	1166.1	1229.4	1426.0595	1568.665	1622.471	1678.121419	1711.684	1745.918
% of Revenue	26%	26%	26%	25%	25%	25%	25%	25%	25%	25%
Operating Income	608.2	617.5	665.9	801.7	1083.80522	1192.186	1362.875	1409.621992	1437.814	1536.407
YOY Growth %	6%	2%	8%	20%	35%	10%	14%	3%	2%	7%
Taxes	158.132	166.725	173.134	208.442	281.789357	309.9683	354.3476	366.5017179	373.8318	399.4659
Tax Rate %	26%	27%	26%	26%	26%	26%	26%	26%	26%	26%
NOPAT	450.068	450.775	492.766	593.258	802.015863	882.2174	1008.528	1043.120274	1063.983	1136.941
Depreciation & Amortization	84.864	85.926	88.23	145.023	114.08476	125.4932	129.7977	134.2497135	136.9347	139.6734
% of Revenue	2%	2%	2%	3%	2%	2%	2%	2%	2%	2%
Increase (Decrease) Capital Expenditures	127.296	128.889	132.345	193.364	228.16952	250.9865	194.6965	201.3745703	273.8694	279.3468
% of Revenue	3%	3%	3%	4%	4%	4%	3%	3%	4%	4%
Changes in NWC	42.432	-128.889	-88.23	-193.364	-57.04238	-125.493	-194.696	-134.2497135	-205.402	-139.673
% of Revenue	1%	-3%	-2%	-4%	-1%	-2%	-3%	-2%	-3%	-2%
Unlevered Free Cash Flow	365.20	536.70	536.88	738.28	744.97	882.22	1138.33	1110.25	1132.45	1136.94
YOY Growth %	0%	47%	0%	38%	21%	26%	21%	27%	24%	25%

Free Cash Flow at Year 5	1132.45	Shares Outstanding	121.8 M
WACC	7%	DCF Estimated Value Price per Share	177.12
Perpetuity Growth Rate	2%		
Perpetuity Value at End of Year 5	22649.00	Current Price	146.85
Current Enterprise Value	18236.9	Consensus Price Target	127.09
		DCF Estimated Upside	21%

Disclosure

This report is provided for information only and is not an offer or a solicitation to deal in securities or to enter into any legal relations, nor an advice or a recommendation with respect to such securities. This report is prepared for general circulation. It does not have regard to the specific investment objectives, financial situation and the particular needs of any recipient hereof. You should independently evaluate particular investments and consult an independent financial adviser before dealing in any securities mentioned in this report.

The information or views in the report ("Information") has been obtained or derived from sources believed by SMIF to be reliable. However, SMIF makes no representation as to the accuracy or completeness of such sources or the Information and SMIF accepts no liability whatsoever for any loss or damage arising from the use of or reliance on the Information. SMIF and its connected persons may have issued other reports expressing views different from the Information and all views expressed in all reports of SMIF and its connected persons are subject to change without notice. SMIF reserves the right to act upon or use the Information at any time, including before its publication herein.

Except as otherwise indicated below, (1) SMIF, its connected persons and its officers and

Appendix
