Stock Spotlight: General Mills

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Leading the Pack

You may see online ads about “hot stocks” that are about to grow 10-fold in high-risk industries like young pharmaceuticals or autonomous drone companies. However, the intrinsic value of these are questionable, and, too often, they are more bark than bite. We believe the true high-potential stocks hide in the dark reaches, waiting for our in-house analysts to lead the expedition to discovery.

At first blush, General Mills (GIS) seems to be a run-of-the-mill Consumer Staples company, specifically within the Packaged Food Products industry. They are a major player, but cereal; frozen dough; and granola bars are not particularly special. However, earning returns above the market benchmark is always exciting, and this is exactly what GIS has been doing.

Qube’s analysts have the keen senses to identify overlooked securities by their distinctive markings: deep value along with catalysts. GIS was plucked out of our universe last summer and, after in-depth analyses, our research team identified a few company-specific attributes which the market has yet to spot.

Waking a Sleeping Giant...

GIS was held by Qube in years prior; however, we were unimpressed with the management at the time. Tides began to shift when Jeffrey Harmening took over as the CEO in 2017. Harmening sports an impressive resume:

- Harvard MBA,
- VP of Marketing for Cereal Partners Worldwide (a joint venture with Nestle to sell cereal abroad) from 2003 to 2007,
- President of General Mills’ Big G cereal division from 2007 to 2011,
- Executive of the European division of Cereal Partners Worldwide from 2012 to 2014,
- And, lastly, the Executive Vice President and Chief of Operations of the US Retail Segment for General Mills.

It is plain to see that Harmening is well-versed in the General Mills business—not just in the US, but overseas as well.

During his first presentation, he discussed four main growth priorities:

1. **Grow cereal globally**
2. **Return US yogurt and China to growth**
3. **Invest in differential growth (organic foods)**
4. **Sustain the current business with appropriate investments**

In the five short years since his appointment, Harmening's vision has yet to come to fruition. His focus, along with the focus of many other CEOs, shifted to mitigating COVID, inflation, and supply chain difficulties. But the true benefit of his leadership is evident when we read between the lines. The previous CEO was averse to change and did not understand the necessary steps to fuel growth. Harmening, on the other hand, has identified weak spots and is taking action to combat them.

Don't Judge a Cereal Box by Its Cover

The average consumer may only associate General Mills with cereal, but this beast is much more than that. In terms of simplicity, GIS is a leading American producer of packaged consumer foods, including but not limited to: breakfast cereals, snacks, baking mixes, canned soups, ice cream, and yogurt. You may not notice, but you likely come across countless GIS products every grocery trip.

For a long time, the market had written off GIS as a large food packager with no growth opportunities in sight—an unremarkable creature. However, our research team was able to dig up GIS's new potential: organic pet food. The most important of Harmening's contributions came in 2018, when GIS acquired **Blue Buffalo,** a premium American pet food brand consisting of chicken, lamb, and fish.

This acquisition opened the pet food segment for GIS. Organic pet food sales are currently being fueled by a number of factors: the humanization of pets, the rise in millennial pet owners, and the increasing number of baby boomers becoming empty nesters (and going on to fill their homes with furry companions).

Past Performance

As seen on the following page, Consumer Staples (purple) and General Mills (darker blue) have outperformed the S&P500 (light blue) over the last 12 months. We believe that the positive investor sentiment for Consumer Staples is two-pronged:

1. The industry is non-cyclical.
2. The industry is inflation defensive.

GIS is considered **non-cyclical** because its products are necessities (i.e., consumers will purchase them regardless of the economic environment). This consistent stream of revenue provides investors a haven—relative to other sectors—during times of economic slowdown, such as the one we are experiencing now.

Additionally, due to the necessary nature of its products, Consumer Staples offer a partial **defence to inflationary pressures.** By passing along the price increases to consumers, companies in the Consumer Staples industry are more attractive than companies in industries that see a reduction in demand when prices increase.

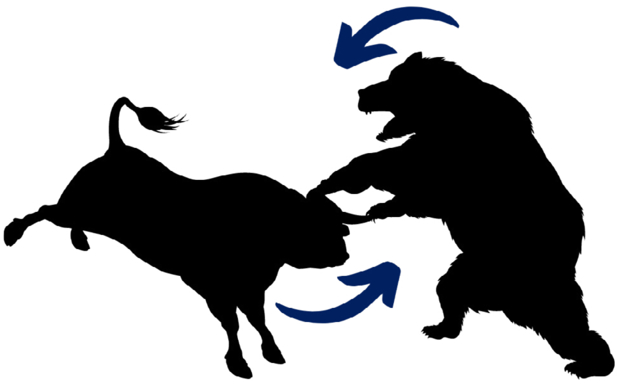
Ultimately, the Consumer Staples industry is well-positioned in the current economic environment relative to other sectors. Further, the graph above indicates that GIS has outperformed **both** its industry and the greater market over the last year.

A Company With Teeth

So how does GIS set itself apart from its industry? In terms of operations, this behemoth specializes in **acquiring, divesting, and restructuring** to maximize both organic and inorganic growth. In other words, GIS is focused on adding synergistic brands and tweaking its current offerings in order to better serve the consumer.

Our research team interprets GIS as **bullish** in the long term for four main reasons:

1. Shareholder reward
2. Versatile management
3. Lower investment risk
4. The emerging trend of organic pet food



Here is one easy way to remember the difference between bull and bear markets: Bulls thrust their horns **upward** when they attack, whereas bears will swipe their claws **downward.**

Qube purchased GIS on August 12, 2021, for an average price of $59.1664. As of May 31, 2022, price appreciation totalled 18.24%, along with 3 dividend payments summing to $1.53/share, which is an additional 2.59% return.

In other words, Qube clients have enjoyed a **total return of 20.83%,** while the greater market (S&P500) has returned a humbling -7.37% over the same time period.

Dividends Ahead

Qube focuses on finding undervalued securities. This strategy generates most of our return, however it is not the only way to be rewarded for holding a security.

One key aspect of valuation for the research team is a **company's dividend.** As a research analyst, it is vital to understand when a dividend is healthy and warranted, and when it is a sign of weak management with no growth opportunities. Fortunately, GIS's dividend is the former.

A **dividend** is money paid to a company's shareholders from its profits.

Dividends are often expected from large and mature Consumer Staples companies; however, GIS's current dividend is especially attractive due to its historical performance. Believe it or not, GIS has distributed a cash dividend to shareholders for the last **120 years.**

We have even seen it increase each year over the last decade. The dividend is so healthy that our model implies that GIS is fair valued even if the dividend grows at -0.7% for the next 10 years. Yes, GIS could **reduce** its dividend payout, and it would still be worth its share price today. But this seems unlikely given that the dividend has room to grow and that management rarely trims it.

The market is underestimating the value of this shareholder reward. Our research team is a fan of this dividend payout mainly because it provides our clients with a return while we wait for the market to figure out the valuation we already recognized.

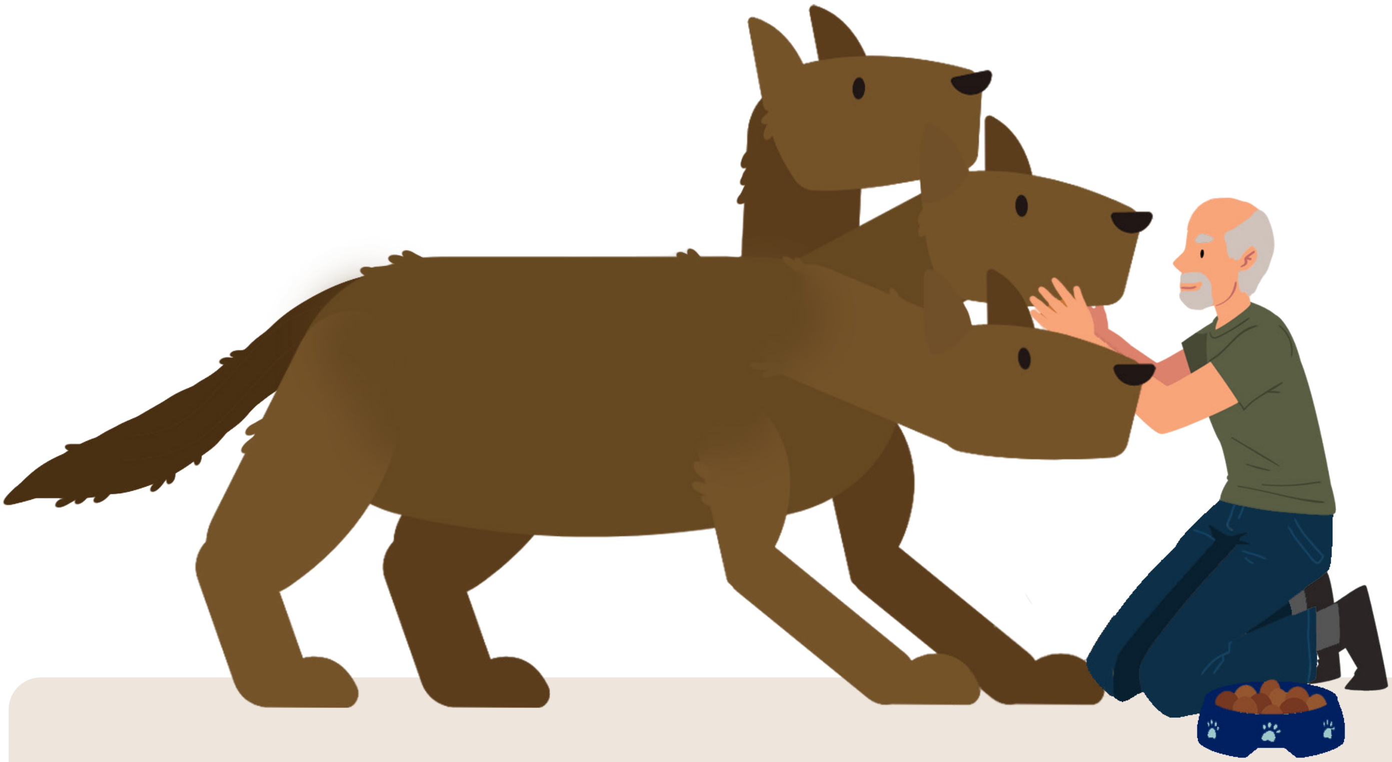
Barebones Beta

After thorough research, analysts discovered that one of the most attractive qualities of GIS is its low-risk business. Furthermore, GIS is mature, non-cyclical, essential to life, non-seasonal, cost-advantaged, and large—all of which contribute to a **low beta.**

GIS carries a beta of 0.5, insinuating that a 1% price change in the market would theoretically lead to a 0.5% change in the GIS stock price. In other words, GIS' stock price is not volatile, which helps us and our clients feel less stress during large macroeconomic headwinds.

Beta is a risk measure that represents the price change of a stock relative to the price change in the overall market.

Our research team expects additional stability from the current inflationary environment as consumers will deviate from expensive, organic goods and buy more of GIS' low-priced products.



In Conclusion...

General Mills is a long hold, and, after multiple reviews, our research team maintains confidence in it. The recent entry of organic pet food into General Mills' portfolio should boost revenue for years to come. General Mills further committed to this new segment by purchasing the pet treat brands Nudges, Top Chews, and True Chews from Tyson Foods in 2021.

If there was any doubt what this foray can do for GIS, the current market size for global pet food ingredients is approximately USD $41Bn and expected to reach USD $77Bn by 2030. This represents a 7.2% compound annual growth rate (CAGR). General Mills historical 10-year sales CAGR is only 2.0%, meaning this pet food should spark growth. In other words, we expect GIS to grow faster than their historical benchmark. We anticipate this increased revenue combined with the low beta will provide a steady, smooth upward lift to the share price.

This creature is awakening from its deep sleep, shaking the grogginess from its many heads: a new industry segment, investment in organic products, forward-thinking leadership, and increasing dividends, just to name a few. Any one of these factors alone would be enough to at least pique the interest of inquisitive investors. But combined, they make General Mills a formidable beast which we expect will continue to provide returns, both in share appreciation and dividends.

Qube is one of the rare firms that has a dedicated in-house research team, and their extensive analysis assures us that we make it matter for our clients. If you want to learn more about our stock selection process and how we anticipate returns, email our team at info@qubeinvest.ca or give us a call at (780) 463-2688.