



### COMPANY UPDATE / ESTIMATE CHANGE / PRICE TARGET CHANGE

#### Key Metrics

SJM - NYSE (as of 8/24/17)	\$107.51
Two Year Price Target	\$130.00
52-Week Range	\$106.93 - \$143.68
Shares Outstanding-Basic (mil.)	113.5
Market Cap. (\$ mil.)	\$12,202
3-Mo. Average Daily Volume	979,430
Institutional Ownership	65%
Total Debt/Total Capital (7/17)	42%
ROE (TTM ended 7/17)	12%
Book Value/Share (7/17)	\$61.07
Price/Book Value	1.8x
Annual Dividend & Yield	\$3.12 2.9%
EBITDA Margin (TTM ended 7/17)	21%

#### Adjusted EPS FY 4/30 (excludes nonrecurring items and amort.)

	2017	Prior 2018E	Curr. 2018E	Prior 2019E	Curr. 2019E
1Q	\$1.86		\$1.51	A	
2Q	\$2.05	\$2.10	\$1.89		
3Q	\$2.00	\$2.20	\$2.24		
4Q	\$1.80	\$2.01	\$2.15		
Year	\$7.72	\$7.90	\$7.79	\$8.35	\$8.25
P/E	13.9x		13.8x		13.0x

Note: EPS figures exclude nonrecurring items and amortization expense.  
Quarterly figures may not add to annual figure due to rounding.

#### Revenue (\$ mil)

	2017	Prior 2018E	Curr. 2018E	Prior 2019E	Curr. 2019E
1Q	\$1,816		\$1,749	A	
2Q	\$1,914	\$1,925	\$1,900		
3Q	\$1,879	\$1,908	\$1,886		
4Q	\$1,784	\$1,817	\$1,815		
Year	\$7,392	\$7,450	\$7,350	\$7,600	\$7,500

**Company Description:** Established in 1897, The J.M. Smucker Company is a leading marketer and manufacturer of consumer foods, beverage products, and pet food/snacks in North America. Its portfolio of food & beverage brands includes Smucker's, Folgers, Dunkin' Donuts (packaged coffee), Jif, Crisco, Pillsbury, R.W. Knudsen, Hungry Jack, Café Bustelo, Martha White, Sahale Snacks, and Bick's. The Pet food/snack portfolio of brands (from the purchase of Big Heart Pet Brands in March 2015) includes Meow Mix, Milk-Bone, Kibbles 'n Bits, and 9Lives.

## The J.M. Smucker Company

SJM — NYSE — Long-term Buy-2

### Lower Fiscal 1Q Results

- **Fiscal 1Q results were below expectations.** Net sales for the quarter ended 7/31/17 declined 4% to \$1.749 billion compared to the street consensus expectation of flat sales. Gross margin declined due to an unfavorable impact of increased costs and pricing. Adjusted earnings per share, excluding amortization, were \$1.51 compared to \$1.86 in the year ago period. The street consensus expectation was \$1.63 and our estimate was \$1.59.
- **Contributing factors in the period were basically anticipated.** The quarter was expected to produce a double-digit percentage EPS decline due to higher marketing spending, unfavorable price/cost dynamics in the coffee and pet segments, and a tough comparison to year ago results (a 17% EPS gain). The consumer foods segments was a bit below our expectation, but not to an alarming degree, in our view.
- **We expect double-digit earnings growth in the 2H of FY18.** This is based on gross margin improvement as the year unfolds (projected up for the year) and continued cost containment. For all of FY18, management lowered its EPS guidance by about 1% from its previous view. Our updated outlook for FY18 includes a small increase in EPS.
- **We have a more favorable view of FY19 and beyond.** Although SJM's segments are currently in highly competitive environments, we consider the company well-positioned with a strong portfolio of brands and the financial wherewithal to invest in those brands to maintain or grow share over time.
- **Our two-year price target is lowered by \$10 to \$130 per share.** SJM shares are trading at 13.8x our FY18 EPS estimate (excluding amortization and nonrecurring items). This is below an 18.5x figure one year ago and a ten-year average forward multiple of 16.4x. Our outlook assumes negligible EPS growth this year, improving to upper single-digit growth in subsequent years. We assume some valuation expansion from the current level. Our Suitability rating remains 2.

**Note Important Disclosures on Pages 8-9.  
Note Analyst Certification on Page 8.**

**Exhibit 1****Consolidated Statements of Operations** (figures in millions except percentages and per share data)

	<b>Three Months Ended</b>		<b>% chg.</b>
	<b><u>7/31/17</u></b>	<b><u>7/31/16</u></b>	
U.S. Retail - Coffee	\$481	\$513	(6.3%)
U.S. Retail - Consumer Foods	492	537	(8.3%)
U.S. Retail - Pet Foods	522	520	0.4%
International & Away From Home	254	246	3.3%
Total Net Sales	<u>1,749</u>	<u>1,816</u>	(3.7%)
Cost of Products Sold	<u>1,087</u>	<u>1,093</u>	(0.6%)
Gross Profit	662	723	(8.4%)
Selling, Distrib. & Admin. Exp.	350	356	(1.6%)
Special Project Costs	27	22	22.1%
Amortization	52	52	(0.4%)
Other Operating Exp. (Inc.)	<u>(1)</u>	<u>(1)</u>	
Operating Income	234	294	(20.4%)
Interest Expense, net	(42)	(42)	1.2%
Other Income (Expense)	<u>(3)</u>	<u>1</u>	
Earnings Before Taxes	189	253	(25.4%)
Taxes (Benefit)	<u>62</u>	<u>83</u>	(25.4%)
GAAP Net Income	<u>\$127</u>	<u>\$170</u>	(25.4%)
GAAP Diluted EPS	\$1.12	\$1.46	(23.5%)
<b>Reconciliation to Non-GAAP Net Inc.:</b>			
Income Taxes adjustment	62	83	
Unall. Derivative (Gain) Loss	(13)	(8)	
Amortization	52	52	
Impairment Charge	0	0	
Cost of Products Sold - Special	1	4	
Other Special Project Costs	<u>27</u>	<u>22</u>	
Pretax Income, exclud. Special Items	256	324	(21.0%)
Taxes (Benefit)	<u>84</u>	<u>106</u>	
Non-GAAP Net Income	<u>\$172</u>	<u>\$217</u>	(21.0%)
<b>Adjusted non-GAAP EPS</b>	<b><u>\$1.51</u></b>	<b><u>\$1.86</u></b>	(19.0%)
Avg. Diluted Shares Outst.	114	117	(2.5%)
<b>As a % of Net Sales:</b>			<b><u>bp. chg.</u></b>
Gross Profit	37.86%	39.80%	(194)
Selling, Distrib. & Admin. Exp.	20.02%	19.61%	42
Operating Income	13.37%	16.18%	(281)
Non-GAAP Net Income	9.81%	11.96%	(215)
<b>Segment Profit Margins:</b>			
U.S. Retail - Coffee	25.75%	33.86%	(811)
U.S. Retail - Consumer Foods	22.52%	20.74%	178
U.S. Retail - Pet Foods	18.84%	23.52%	(468)
International & Away From Home	15.08%	16.06%	(98)
Total	21.23%	24.61%	(338)

Source: Company reports

Note: April fiscal year

**1Q FY18 results.** The U.S. Retail Coffee segment faced challenges in the quarter, as expected. 1Q sales declined 6% (about as we expected) while profits dropped 29% (more than we anticipated). This reflected lower volume (primarily *Folgers*) and higher commodity prices. Higher net price realization did not help much. Business remained encouraging for the *Dunkin' Donuts* and *Café Bustelo* brands. Segment profit margin declined over 800 basis points in the quarter.

The U.S. Retail Consumer Foods segment posted an 8% sales decline and roughly flat profits. This reflected lower volume (including the *Crisco*, *Pillsbury*, and *Smucker* brands), but beneficial impacts of reduced marketing expenses and higher net pricing. The *Uncrustables* frozen sandwich product line continued to perform well despite tough comparisons. Segment profit margin rose nearly 180 basis points.

In the U.S. Retail Pet Foods segment, sales were about even with the year ago figure, while profit dropped 20% due to lower net price realization, higher product costs, and increased marketing expense. Segment profit margin for the quarter was down roughly 470 basis points.

Sales from the smaller International and Away From Home (formerly titled Foodservice) segment increased 3% and profits declined 3%. The sales gain reflected higher volume and higher net price realization. Profits, however, were impacted by higher commodity costs, construction of a new production facility, and overall unfavorable foreign currency exchange. Segment profit margin declined about 100 basis points compared to a year ago.

Share repurchases helped the EPS calculation. Non-GAAP net income fell 21%, while EPS dropped 19% due to a 2.5% decline in the weighted average share count. Non-GAAP diluted EPS for the 1Q period were \$1.51 compared to \$1.86 in the year ago quarter. The street consensus expectation was \$1.63.

**Financial condition.** The company's balance sheet is solid, in our view. As of July 31, 2017, total cash and equivalents were \$183 million. Receivables and inventories were at sufficient levels, in our view. Total debt was \$4.944 billion, or 42% of total capitalization. One year ago, total debt stood at \$5.351 billion. Shareholders' equity at the recent quarter end was \$6.931 billion.

**Wesson oil to join the portfolio.** On 5/30/17, SJM announced an agreement to acquire the *Wesson* oil brand from Conagra Brands. The *Wesson* brand is considered a complement to SJM's *Crisco* brand. The all-cash transaction was valued at \$285 million, before an expected tax benefit valued at \$45 million. SJM management expects *Wesson* to add about \$230 million in annual sales, \$30 million in EBITDA, and \$0.10 in EPS in the first full year under SJM ownership. The \$285 million purchase price represented 9.5x EBITDA prior to the tax benefit. Including that benefit, and expected synergies, the multiple is expected to drop to about 5.0x. The deal is subject to customary closing conditions and regulatory approvals. We will incorporate *Wesson* in our financial model for SJM when the transaction becomes official.

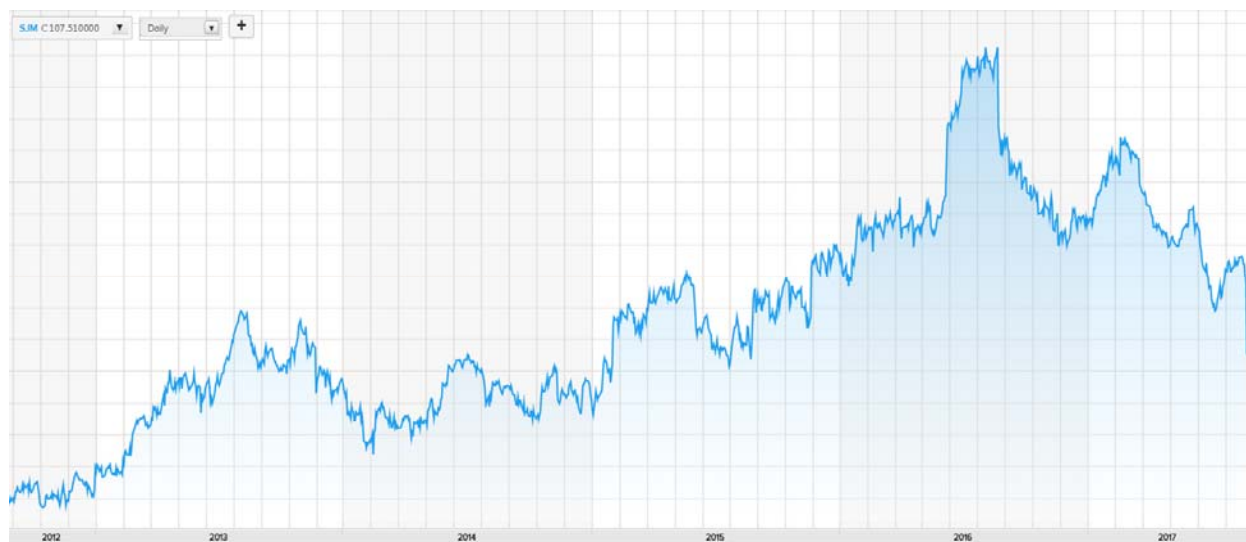
**Outlook.** Management updated its FY18 financial guidance, with key factors being lower net price realization in the coffee segment, continued cost containment, and higher gross margin for the year. Annual guidance included a slight decline in net sales, adjusted gross margin improvement of 50-75 basis points, and higher operating margin after the impact of synergies and cost reduction initiatives. Reflecting share repurchases, non-GAAP EPS are expected in a range of \$7.75-\$7.95, a reduction of \$0.10 on the lower and upper end of the range. The mid-point of this guided range represents 2% growth from FY17 EPS.

We have updated our FY18 outlook. Our net sales estimate is \$7.350 billion, down \$100 million from our previous figure. After updates to various line items and our share count assumption, our non-GAAP EPS estimate is \$7.79, or \$0.11 below our previous figure of \$7.90. After planned capital expenditures of about \$310 million (above FY17's figure of \$192 million), FY18 free cash flow is projected at \$775 million. In FY17, free cash flow was \$867 million. We also made slight reductions to our FY19 estimates, in what we view as a conservative act.

Our presentation of EPS is consistent with the methodology used by the company, that is, excluding amortization expense. However, for valuation purposes, we also consider the more conservative approach of including amortization expense (mostly related to the acquisition of Big Heart Pet Brands in March 2015). Our new FY18 EPS estimate of \$7.79 equates to roughly \$6.61 including amortization expense.

## Exhibit 2

### SJM - 5 Year Share Price History (through 8/24/17)



Source: Thomson Reuters Eikon

**Valuation.** Recent share price weakness (including a near 10% drop yesterday following 1Q results) has resulted in an attractive valuation, in our view. SJM shares are down approximately 16% for the calendar YTD period and down 24% for the past twelve months. Based on the current price, the shares are trading at 13.8x our FY18 adjusted EPS estimate of \$7.79. Including amortization expense in the methodology (most earnings figures from our covered companies include amortization expense), the current stock price represents 16.3x an estimated FY18 EPS figure of \$6.61, subtracting annual amortization of \$1.18 per share related to the Big Heart Pet Brands acquisition in 2015. We believe comparing SJM's commonly presented and discussed price/earnings multiples to historical figures has some limitations due to changing methodologies behind EPS figures (perhaps a mix of the two methodologies—with and without amortization expense). However, we note the following:

- The 14.6x multiple on trailing EPS excluding amortization expense compares to a comparable figure of 18x one year ago and an approximate 19x average figure over the past ten years.
- The 13.4x multiple on our projection of forward EPS excluding amortization expense is near the lower end of an historical range we estimate at 12x-19x (adjusting past EPS figures to exclude amortization expense).
- The current 16.3x multiple on our FY18 EPS estimate including amortization expense compares to 18.5x our FY17 EPS estimate one year ago and 20.2x our FY16 EPS estimate two years ago.
- The 16.3x multiple on our FY18 EPS estimate including amortization expense compares to forward multiples of 19.2x for the S&P 500 and 19.7x for the S&P Consumer Staples sector.
- On an Enterprise Value/EBITDA basis, SJM is trading at just under 10x our estimate of forward adjusted EBITDA. This is near the low end of a recent historical range we estimate at 9x-13x.

**Opinion.** We like SJM's extensive operating history, diverse product portfolio, and seasoned management team. In time, we believe the Big Heart pet food business can become more of a growth vehicle for the company and a meaningful cash flow generator, particularly with some improved industry dynamics, greater distribution, and fully realized synergies. In addition, a new manufacturing facility is planned for the fast-growing *Uncrustables* frozen sandwich line, which could add to growth in the consumer foods segment. Finally, we would not be surprised to see one or more acquisitions over the next few years.

The coffee business is a good cash flow generator, in our view, but profits can be volatile over the short-term due to fluctuations in commodity costs and pricing decisions implemented by SJM management. It is also quite competitive at this time. However, we like the combination of a mainstream brand (*Folgers*) and smaller growth-oriented brands (*Café Bustelo* and *Dunkin' Donuts*).

We are also mindful of the "investment year" represented by FY18, as the company injects money back into the business to boost innovation, add capacity in certain product lines, and improve its overall competitive position. This should have a limiting impact on 1H profits, in our view, with the 2H outlook notably better. Beyond that, we feel good about the company's prospects in FY19 and beyond.

Longer term, earnings growth could potentially come from factors such as improved volumes, market share gains, product development/brand extensions, operating margin improvement, debt reduction (lower interest expense), and share repurchases. Also, we expect annual dividend increases, with declarations around July of each year (a 4% raise was announced last month). We consider the balance sheet solid and note management's recent comment that it was "aggressively pursuing a variety of growth opportunities." We project long-term annual EPS growth in the upper single digit percentages.

**Rating and price target.** We rate SJM shares Long-term Buy. We consider the company a high achiever, with notable histories of both organic and external growth. Given some expected near-term earnings pressure, but a more favorable outlook over the next few years, we believe our Long-term Buy rating is most appropriate. Our two year price target is \$130 per share, a decline of \$10 from our previous figure. This adjustment is based on a slightly lower future EPS assumption. We still assume negligible EPS growth in FY18 and mid to upper single digit growth in FY19 and FY20. Our target is based on a price/earnings multiple of 14.3x applied to a FY20 EPS estimate of \$9.10; both of these figures are below our previous assumptions. The assumed 14.3x multiple is above the current depressed multiple of 13.8x based on our FY18 EPS estimate, but is still well below the historical average.

**Suitability.** Our Suitability rating on SJM is 2 on a 1 (most conservative) to 4 (most aggressive) scale. Contributing factors in determining our Suitability rating include the company's debt level (particularly following the March 2015 acquisition of Big Heart Pet Brands), market capitalization, liquidity/trading volume, diversity of revenues, the industry in which the company operates, the company's competitive position within the industry, and the company's long-term earnings and dividend history.

**Risks.** There are numerous factors that could affect operations of The J.M. Smucker Company. A recent factor is the company's relationship with its retail partners (in a dynamic food retailing industry) as it relates to unit volumes and pricing. Other factors include changes in consumer demand for the company's products; product competition, including private-label; price competition; volatility of commodity markets (green coffee beans, wheat, soybean oil, milk, peanuts, sugar, etc.); labor relations; extreme weather conditions or occurrences; crude oil price trends and the resulting impact on transportation, energy, and packaging costs; the ability to implement price changes in response to rising input costs; the success and costs of introducing new products; the impact of potential food safety concerns; risks associated with potential growth of international operations such as exchange rate fluctuations and geopolitical risks; potential future acquisitions; and the global economy.

Labor contracts are another consideration. Recently, about 30% of SJM's employees were covered by union contracts at 11 facilities. One contract expired and was renewed in FY17, representing about 8% of SJM's total employees.

There were recently just under 114 million common shares outstanding and there is only one class of stock. Shareholders are typically entitled to one vote per share held; however, shareholders who have owned the stock for approximately four years are entitled to ten votes per share held on certain matters, including major issues such as a potential merger, consolidation, or liquidation of the company.

**Exhibit 3**  
**Consolidated Statements of Income**

(figures in millions except percentages and per share data)

	<b>FY19E</b>	<b>% chg.</b>	<b>FY18E</b>	<b>% chg.</b>	<b>FY17</b>	<b>% chg.</b>	<b>FY16</b>
U.S. Retail - Coffee	\$2,110	2.9%	\$2,050	(2.8%)	\$2,109	(5.8%)	\$2,239
U.S. Retail - Consumer Foods	2,100	2.9%	2,040	(2.2%)	2,085	(8.1%)	2,270
U.S. Retail - Pet Foods	2,170	0.5%	2,160	1.1%	2,136	(5.1%)	2,250
International & Away From Home	<u>1,120</u>	1.8%	<u>1,100</u>	3.5%	<u>1,062</u>	1.0%	<u>1,052</u>
Total Net Sales	7,500	2.0%	7,350	(0.6%)	7,392	(5.4%)	7,811
Costs of Products Sold	<u>4,575</u>	1.8%	<u>4,494</u>	(1.4%)	<u>4,557</u>	(5.9%)	<u>4,843</u>
Gross Profit	2,925	2.4%	2,856	0.7%	2,835	(4.5%)	2,968
Selling, Distrib. & Admin. Exp.	1,470	2.6%	1,433	3.0%	1,391	(7.9%)	1,510
Amortization	215	2.4%	210	1.3%	207	(0.3%)	208
Impairment Charge	0		0		133		0
Special Project Costs	0		0		77		136
Other Operating Exp. (Inc.)	<u>30</u>		<u>50</u>		<u>(4)</u>		<u>(32)</u>
Operating Income	1,210	4.0%	1,163	12.7%	1,032	(9.9%)	1,145
Interest Expense, net	(160)	(5.3%)	(169)	3.6%	(163)	(4.6%)	(171)
Other Income (Expense)	<u>5</u>		<u>4</u>		<u>10</u>		<u>4</u>
Earnings Before Taxes	1,055	5.7%	998	13.6%	878	(10.2%)	978
Taxes	<u>346</u>	5.7%	<u>327</u>	14.2%	<u>286</u>	(1.1%)	<u>289</u>
GAAP-based Net Income	<u>\$709</u>	5.7%	<u>\$671</u>	13.3%	<u>\$592</u>	(14.0%)	<u>\$689</u>
<b>Non-GAAP Adjustments:</b>							
Income Tax Expense	346		327		286		289
Amortization	215		210		207		208
Unallocated Derivative Loss (Gain)	0		0		27		(12)
Impairment Charge	0		0		133		0
Costs of Products Sold - Special Costs	10		16		6		12
Other Special Project Costs	<u>75</u>		<u>85</u>		<u>77</u>		<u>136</u>
Pre-tax Income, Adjusted	1,355	3.5%	1,309	(1.5%)	1,329	0.5%	1,322
Income Tax Expense, Adjusted	<u>444</u>		<u>429</u>		<u>433</u>		<u>391</u>
Net Income, Adjusted	<u>\$911</u>	3.5%	<u>\$880</u>	(1.7%)	<u>\$896</u>	(3.8%)	<u>\$931</u>
Avg. Diluted Shares Outst.	110.5	(2.2%)	113.0	(2.7%)	116.1	(2.8%)	119.5
<b>Non-GAAP EPS, diluted, as reported</b>	<b><u>\$8.25</u></b>	5.9%	<b><u>\$7.79</u></b>	<b>1.0%</b>	<b><u>\$7.72</u></b>	<b>(1.0%)</b>	<b><u>\$7.79</u></b>
<b>As a % of Net Sales:</b>		<b>bp. chg.</b>		<b>bp. chg.</b>		<b>bp. chg.</b>	
Gross Profit	39.00%	14	38.86%	50	38.35%	36	37.99%
Selling, Distrib. & Admin. Exp.	19.60%	10	19.50%	68	18.81%	(52)	19.34%
Operating Income, GAAP-based	16.13%	31	15.82%	187	13.95%	(71)	14.66%
Net Income, GAAP-based	9.46%	33	9.13%	112	8.01%	(80)	8.82%
Net Income, Adjusted	12.15%	17	11.98%	(14)	12.12%	20	11.92%
Tax Rate, Adjusted	32.75%	0	32.75%	18	32.57%	299	29.58%
<b>Dividend Data:</b>	<b>FY19E</b>		<b>FY18E</b>		<b>FY17</b>		<b>FY16</b>
Dividends Paid During FY	\$3.31		\$3.12		\$2.92		\$2.65
Dividend Payout Ratio	40%		40%		38%		34%

Note: EPS figures exclude amortization expense.

Note: FY16 EPS includes \$0.15 per share gain on the sale of U.S. canned milk business and a \$0.42 per share nonrecurring tax benefit.

Source: Company reports and Hilliard Lyons estimates

Note: April fiscal year

*Additional information is available upon request.*

Prices of other stocks mentioned: Dunkin Brands Group - DNKN - \$52.47  
Conagra Brands Inc. - CAG - \$33.23

### **Analyst Certification**

I, Jeffrey S. Thomison, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject company(ies) and its (their) securities. I also certify that I have not been, am not, and will not be receiving direct or indirect compensation in exchange for expressing the specific recommendation(s) in this report.

### **Important Disclosures**

Hilliard Lyons' analysts receive bonus compensation based on Hilliard Lyons' profitability. They do not receive direct payments from investment banking activity.

### **Investment Ratings**

**Buy** - We believe the stock has significant total return potential in the coming 12 months.

**Long-term Buy** - We believe the stock is an above average holding in its sector, and expect solid returns to be realized over a longer time frame than our Buy rated issues, typically 2-3 years.

**Neutral** - We believe the stock is an average holding in its sector, is currently fully valued, and may be used as a source of funds if better opportunities arise.

**Underperform** - We believe the stock is vulnerable to a price set back in the next 12 months.

### **Suitability Ratings**

**1** - A large cap, core holding with a solid history

**2** - A historically secure company which could be cyclical, has a shorter history than a "1" or is subject to event driven setbacks

**3** - An above average risk/reward ratio could be due to small size, lack of product diversity, sporadic earnings or high leverage

**4** - Speculative, due to small size, inconsistent profitability, erratic revenue, volatility, low trading volume or a narrow customer or product base

<b>Rating</b>	<b>Hilliard Lyons Recommended Issues</b>		<b>Investment Banking Provided in Past 12 Mo.</b>	
	<b># of Stocks Covered</b>	<b>% of Stocks Covered</b>	<b>Banking</b>	<b>No Banking</b>
<b>Buy</b>	38	30%	11%	89%
<b>Hold/Neutral</b>	77	61%	8%	92%
<b>Sell</b>	11	9%	0%	100%

*As of 9 August 2017*





Note: Price targets accompanying Buy ratings reflect a one year time period while price targets accompanying Long-term Buy ratings reflect a two to three year time period.

### Other Disclosures

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