



COMPANY UPDATE / ESTIMATE CHANGE

Key Metrics

SJM - NYSE (as of 2/17/17)	\$135.95
Price Target	NA
52-Week Range	\$121.79 - \$157.31
Shares Outstanding-Basic (mil.)	116.4
Market Cap. (\$ mil.)	\$15,829
3-Mo. Average Daily Volume	968,114
Institutional Ownership	80%
Total Debt/Total Capital (1/17)	41%
ROE (TTM ended 1/17)	12%
Book Value/Share (1/17)	\$62.20
Price/Book Value	2.2x
Annual Dividend & Yield	\$3.00 2.2%
EBITDA Margin (TTM ended 1/17)	21%

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

	2016	Prior 2017E	Curr. 2017E	Prior 2018E	Curr. 2018E
1Q	\$1.60		\$1.86	A	
2Q	\$1.91		\$2.05	A	
3Q	\$2.05		\$2.00	A	
4Q	\$2.23	\$1.77	\$1.74		
Year	\$7.79	\$7.70	\$7.65	\$8.15	\$8.05
P/E	17.5x		17.8x		16.9x

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

Revenue (\$ mil)

	2016	Prior 2017E	Curr. 2017E	Prior 2018E	Curr. 2018E
1Q	\$1,952		\$1,816	A	
2Q	\$2,078		\$1,914	A	
3Q	\$1,974		\$1,879	A	
4Q	\$1,808	\$1,898	\$1,821		
Year	\$7,811	\$7,545	\$7,430	\$7,625	\$7,575

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 — Neutral-2

3Q Results Were A Bit Light, In Our View

- **SJM's fiscal 3Q results were slightly disappointing, in our view.** Net sales for the quarter ended 1/31/17 fell 5%, greater than the street consensus expectation of a 3% decline. Contributing factors included the impact of the divested U.S. canned milk business, lower coffee volume, and lower net price realization in the coffee and pet food segments. Excluding the impact of the divested milk business, 3Q net sales would have declined 3%.
- **Earnings were about as expected.** Adjusted gross margin (excluding nonrecurring items) was flat with the year ago level. Adjusted operating margin declined 30 basis points. Adjusted earnings per share (also excludes amortization) were \$2.00 compared to \$2.05 in the year ago period. This compares to our estimate of \$2.02 and street consensus of \$2.00.
- **Guidance was trimmed a bit.** Net sales for all of FY17 (April period end, leaving only the 4Q to come) are expected to decline 5%, whereas previous guidance called for a 2-3% decline. Adjusted EPS guidance changed little due to expectations of cost containment and a slightly lower tax rate.
- **There were no major news items covered by the press release or related conference call, in our view.** As is tradition, management will present at the widely followed Consumer Analyst Group of New York (CAGNY) conference this week, where it plans to discuss longer term strategies and initiatives in more detail. We will consider information covered at that conference when contemplating our investment view.
- **We maintain our Neutral rating on SJM based on valuation and current conditions within the business segments.** While near-term results could be challenged (including an expected EPS decline in the current quarter), we generally like the longer term. We will monitor conditions and look for a more attractive entry point for potential investments.

**Note Important Disclosures on Pages 7-8.
Note Analyst Certification on Page 7.**

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

	Three Months Ended			Nine Months Ended		
	1/31/17	1/31/16	% chg.	1/31/17	1/31/16	% chg.
U.S. Retail - Coffee	\$537.6	\$575.5	(6.6%)	\$1,602.7	\$1,726.6	(7.2%)
U.S. Retail - Consumer Foods	517.3	569.8	(9.2%)	1,611.6	1,796.0	(10.3%)
U.S. Retail - Pet Foods	550.9	570.9	(3.5%)	1,601.4	1,687.5	(5.1%)
International & Foodservice	273.0	257.7	5.9%	792.8	793.5	(0.1%)
Total Net Sales	1,878.8	1,973.9	(4.8%)	5,608.5	6,003.6	(6.6%)
Cost of Products Sold	1,155.9	1,210.1	(4.5%)	3,420.0	3,723.8	(8.2%)
Gross Profit	722.9	763.8	(5.4%)	2,188.5	2,279.8	(4.0%)
Selling, Distrib. & Admin. Exp.	337.2	381.1	(11.5%)	1,056.3	1,158.5	(8.8%)
Amortization	51.7	52.2	(1.0%)	155.2	158.2	(1.9%)
Impairment Charge	75.7	0.0		75.7	0.0	
Special Project Costs	18.0	41.4	(56.5%)	66.8	94.9	(29.6%)
Other Operating Exp. (Inc.)	2.6	(29.2)		(0.3)	(31.0)	
Operating Income	237.7	318.3	(25.3%)	834.8	899.2	(7.2%)
Interest Expense, net	(40.3)	(43.6)	(7.6%)	(122.8)	(130.6)	(6.0%)
Other Income (Expense)	0.2	0.6		4.5	(0.9)	
Earnings Before Taxes	197.6	275.3	(28.2%)	716.5	767.7	(6.7%)
Taxes (Benefit)	63.0	90.0	(30.0%)	234.6	270.0	(13.1%)
GAAP Net Income	\$134.6	\$185.3	(27.4%)	\$481.9	\$497.7	(3.2%)
GAAP Diluted EPS	\$1.16	\$1.55	(25.3%)	\$4.14	\$4.16	(0.5%)
Reconciliation to Non-GAAP N.I.:						
Income Taxes	63.0	90.0		234.6	270.0	
Amortization	51.7	52.2		155.2	158.2	
Unalloc. Derivative (Gain) Loss	(0.8)	(6.7)		5.7	(2.7)	
Cost of Prod. Sold - Special Projects	0.5	3.1		4.8	9.2	
Impairment Charge	75.7	0.0		75.7	0.0	
Other Special Project Costs	18.0	41.4		66.8	94.9	
Pretax Income, exclud. Special Items	342.7	365.3	(6.2%)	1,024.7	1,027.3	(0.3%)
Adj. Taxes	109.9	119.3	(7.9%)	335.5	361.3	(7.1%)
Non-GAAP Net Income	\$232.8	\$246.0	(5.4%)	\$689.2	\$666.0	3.5%
Non-GAAP Diluted EPS	\$2.00	\$2.05	(2.7%)	\$5.92	\$5.56	6.3%
Non-GAAP Diluted EPS (excluding gain on divestiture) ~	\$2.00	\$1.91	4.4%	\$5.92	\$5.42	9.0%
Avg. Diluted Shares Outst.	116.5	119.7	(2.7%)	116.5	119.7	(2.6%)
As a % of Net Sales:			bp. chg.	bp. chg.		
Gross Profit	38.48%	38.69%	(22)	39.02%	37.97%	105
Selling, Distrib. & Admin. Exp.	17.95%	19.31%	(136)	18.83%	19.30%	(46)
Operating Income	12.65%	16.13%	(347)	14.88%	14.98%	(9)
GAAP Net Income	7.16%	9.39%	(222)	8.59%	8.29%	30
Non-GAAP Net Income	12.39%	12.46%	(7)	12.29%	11.09%	120
Segment Profit Margins:						
U.S. Retail - Coffee	32.03%	33.81%	(178)	33.23%	31.79%	144
U.S. Retail - Consumer Foods	23.04%	22.66%	39	21.69%	20.92%	76
U.S. Retail - Pet Foods	22.93%	21.72%	121	22.67%	21.08%	158
International & Foodservice	16.67%	18.98%	(231)	17.24%	17.72%	(48)

~ In 3Q of FY16, SJM had a \$0.14 per share gain on the sale of its U.S. canned milk business. Above, we present non-GAAP EPS both including and excluding this gain.

Source: Company reports and Hilliard Lyons estimates

Note: April fiscal year

Additional 3Q discussion. In the U.S. Retail Coffee segment, 3Q sales declined nearly 7% while profits dropped 12%. This reflected lower net price realization (a price hike came too late in the quarter to have a material impact) and lower volume for the *Folgers* brand. Business was encouraging for the *Dunkin' Donuts* (bagged and K-Cup offerings) and *Cafe Bustelo* brands. Segment profit margin declined 180 basis points in the quarter.

The U.S. Retail Consumer Foods segment posted a 9% sales decline and an 8% drop in profits. These declines largely reflected the past divestiture of the U.S. canned milk business. Excluding that business in both periods, net sales dropped 2% and segment profit rose an impressive 26% in the quarter. This reflected lower manufacturing overhead, higher net pricing, and reduced marketing expense. The *Uncrustables* frozen sandwich product line continued to perform well despite tough comparisons. Segment profit margin, excluding the divested business—rose 510 basis points.

In the U.S. Retail Pet Foods segment, sales declined about 4% yet segment profit rose 2% as the sales decline was more than offset by synergy realization and lower marketing expense. The segment had lower net price realization for the quarter, as the industry remained highly competitive. The *Nature's Recipe* premium dog food product line benefited from greater distribution and the *Kibbles 'n Bits* brand had a volume gain. The pet snack segment was down. Segment profit margin rose roughly 120 basis points.

Sales from the International and Foodservice segment increased 6% but profits fell 7%. The sales gain reflected higher volume and the profit decline reflected a write-off in the period that related to the disposal of some assets. Segment profit margin declined 230 basis points compared to one year ago.

Non-GAAP diluted EPS for the 3Q period were \$2.00 compared to \$2.05 in the year ago quarter. The year ago figure was boosted by \$0.14 from a gain related to the sale of the canned milk business. Excluding that item, the year ago period produced non-GAAP EPS of \$1.91. On this measure, the recent 3Q produced a 4% gain in EPS, as noted in Exhibit 1.

Financial condition. The balance sheet remained in good shape, in our view. As of January 31, 2017, total cash and equivalents were \$139 million. Receivables and inventories were at sufficient levels, in our view. Total debt was \$5.087 billion, or 41% of total capitalization. There has been some debt pay down during FY17; at the end of FY16 (April period end), total debt was \$5.430 billion. Shareholders' equity was \$7.241 billion at the recent period end.

For the nine-month period, net cash provided by operations was \$794 million. After capital expenditures of \$136 million, free cash flow was approximately \$658 million. During the period, the company spent \$200 million on debt reduction and \$252 million on dividend payments.

For the trailing twelve-month period, EBITDA (earnings before interest, taxes, depreciation & amortization) of \$1.587 billion led to a leverage ratio of approximately 3.2x, down from 4.1x shortly after the Big Heart acquisition last year.

Outlook. Management updated FY17 financial guidance, which essentially represents views on the current 4Q. Management noted key factors were slightly lowered expectations for the coffee and food segments. Annual guidance for net sales was reduced (expected decline of 5% versus the previous view of a 2-3% drop), while the range for adjusted EPS was trimmed modestly (upper end of range lowered by \$0.05). Our adjusted EPS estimate, excluding nonrecurring items and amortization expense (largely from the Big Heart acquisition), is \$7.65, down a modest \$0.05 from our previous figure. Management's guidance was refined at \$7.60-\$7.70.

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 FY17 EPS estimate of \$7.65 equates to roughly \$6.45 including amortization expense. After capital expenditures of about \$240 million, FY17 free cash flow is projected at \$950 million to \$1 billion. In FY16, free cash flow was \$1.256 billion.

We have also made minor adjustments to our FY18 outlook. These include a \$50 million reduction to our sales projection to \$7.575 billion and a \$0.10 reduction to our EPS estimate (excluding amortization expense) to \$8.05.

Valuation. SJM shares are trading at 17.8x our FY17 adjusted EPS estimate of \$7.65. Including amortization expense in the methodology (most earnings figures from our covered companies include amortization expense), the current stock price represents 21.1x an estimated FY17 EPS figure of \$6.45, subtracting annual amortization of \$1.20 per share related to the Big Heart Pet Brands acquisition in March 2015. We believe comparing SJM's current 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:

- Relative to the current 21.1x multiple on our FY17 EPS estimate including amortization expense, we note SJM traded at 22.1x our FY16 EPS estimate roughly one year ago.
- The 21.1x multiple on our FY17 EPS estimate including amortization expense compares to a 19.6x multiple for the S&P 500 and a 22.5x multiple for the S&P Consumer Staples sector using an earnings time frame similar to SJM's FY17 (April fiscal year).
- The 17.8x multiple on our adjusted FY17 EPS estimate excluding amortization expense is above the mid-point of a broad historical range we estimate at 12x-20x (adjusting past EPS figures to exclude amortization expense).

On an Enterprise Value-to-EBITDA basis, SJM shares are trading at 12.2x our estimated FY17 EBITDA figure of \$1.710 billion. Over the past ten years, we believe the trailing EV/EBITDA median multiple for SJM has been 10.5x.

Opinion. We like SJM's operating history, the 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 *Uncrustables* frozen sandwich line, which could add to future growth.

For now, we believe SJM shares are fairly priced given near-term sales growth prospects are below historical averages (we project only 2% growth in FY18) and EPS are a bit pressured by lower net price realization and other factors. We believe a Neutral rating is most appropriate at this time. If the share price retreats further and the valuation contracts, we could become more positive on the stock, assuming no related weakness in company fundamentals. Also, given that the current 4Q is likely to produce an EPS decline (on an apples-to-apples basis in terms of adjustments/inclusions/exclusions), and that further discussion of the FY18 environment could come at the CAGNY conference this week, we prefer to be on the sidelines at this time.

We continue to like the longer term outlook more than the short-term view. Key factors include a potential rebound in net price realization in certain segments, potential operating margin improvement, debt reduction, share repurchases, and annual dividend increases. In addition, 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 and expect free cash flow to exceed \$1 billion in a typical year.

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. These 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; relationships with retail trade customers, particularly SJM's larger accounts; potential future acquisitions; and the global economy.

The continued integration of Big Heart Pet Foods, purchased in March 2015, is a key investment factor, in our view. Also, if SJM continues on an acquisition strategy, this could lead to risks such as cost of acquisitions, general balance sheet impact, and integration of acquired operations.

Labor contracts are another consideration. Recently, about 28% of SJM's employees were covered by union contracts at 10 facilities. Three contracts expired and were renewed in FY16, covering about 11% of SJM's total employees.

There were recently just over 116 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 2**Consolidated Statements of Income**

(figures in millions except percentages and per share data)

	<u>FY18E</u>	<u>% chg.</u>	<u>FY17E</u>	<u>% chg.</u>	<u>FY16</u>
U.S. Retail - Coffee	\$2,175	3.1%	\$2,110	(5.8%)	\$2,239
U.S. Retail - Consumer Foods	2,155	1.7%	2,120	(6.6%)	2,270
U.S. Retail - Pet Foods	2,180	1.2%	2,155	(4.2%)	2,250
International & Foodservice	<u>1,065</u>	1.9%	<u>1,045</u>	(0.7%)	<u>1,052</u>
Total Net Sales	7,575	2.0%	7,430	(4.9%)	7,811
Costs of Products Sold	<u>4,605</u>	1.4%	<u>4,540</u>	(6.3%)	<u>4,843</u>
Gross Profit	2,970	2.8%	2,890	(2.6%)	2,968
Selling, Distrib. & Admin. Exp.	1,485	7.6%	1,380	(8.6%)	1,510
Amortization	200	(3.8%)	208	0.0%	208
Impairment Charge	0		76		0
Special Project Costs	0		90		
Other Operating Exp. (Inc.)	<u>50</u>		<u>40</u>		<u>104</u>
Operating Income	1,235	12.7%	1,096	(4.3%)	1,145
Interest Expense, net	(154)	(6.7%)	(165)	(3.5%)	(171)
Other Income (Expense)	<u>4</u>		<u>5</u>		<u>4</u>
Earnings Before Taxes	1,085	15.9%	936	(4.3%)	978
Taxes	<u>358</u>	17.7%	<u>304</u>	5.3%	<u>289</u>
GAAP-based Net Income	<u>\$727</u>	15.1%	<u>\$632</u>	(8.3%)	<u>\$689</u>
Non-GAAP Adjustments:					
Income Tax Expense	358		304		289
Amortization	210		208		208
Unallocated Derivative Loss (Gain)	5		6		(12)
Impairment Charge	0		76		0
Costs of Products Sold - Special Costs	10		5		12
Other Special Project Costs	<u>85</u>		<u>90</u>		<u>136</u>
Pre-tax Income, Adjusted	1,395	5.6%	1,321	(0.1%)	1,322
Income Tax Expense, Adjusted	<u>460</u>		<u>429</u>		<u>391</u>
Net Income, Adjusted	<u>\$935</u>	4.8%	<u>\$892</u>	(4.3%)	<u>\$931</u>
Avg. Diluted Shares Outst.	116.1	(0.4%)	116.6	(2.4%)	119.5
Non-GAAP EPS, diluted, as reported	<u>\$8.05</u>	5.3%	<u>\$7.65</u>	(1.9%)	<u>\$7.79</u>
As a % of Net Sales:		bp. chg.		bp. chg.	
Gross Profit	39.21%	31	38.90%	90	37.99%
Selling, Distrib. & Admin. Exp.	19.60%	103	18.57%	(76)	19.34%
Operating Income, GAAP-based	16.30%	155	14.75%	9	14.66%
Net Income, GAAP-based	9.60%	109	8.50%	(31)	8.82%
Net Income, Adjusted	12.34%	34	12.00%	8	11.92%
Tax Rate, Adjusted	33.00%	50	32.50%	292	29.58%
Dividend Data:	FY18E		FY17E		FY16
Dividends Paid During FY	\$3.21		\$2.92		\$2.65
Dividend Payout Ratio	40%		38%		34%

Note: FY16 EPS includes \$0.14 per share gain on the sale of U.S. canned milk business.

Source: Company reports and Hilliard Lyons estimates

Note: April fiscal year

Additional information is available upon request.

Prices of other stocks mentioned – Dunkin Donuts - DNKN - \$55.01

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

Rating	Hilliard Lyons Recommended Issues		Investment Banking Provided in Past 12 Mo.	
	# of Stocks Covered	% of Stocks Covered	Banking	No Banking
Buy	36	30%	17%	83%
Hold/Neutral	76	62%	7%	93%
Sell	10	8%	0%	100%

As of 6 February 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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