

The Kellogg Company (NYSE: K)

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We are overweight Kellogg's 3.4%, 2027 notes. After exiting the Direct-Store-Delivery (DSD) segment of their business in mid-2017, Kellogg has become increasingly profitable & competitive within the consumer staples industry. As part of the company's Project K, operating margins increased by 900 bps from Q1 to Q4 of 2017. This increase in profitability has allowed Kellogg to not only retain robust cash flows, but also become acquisitive by buying smaller companies such as Parati and RXBar to diversify its portfolio of products. Meanwhile, key competitors GIS, SJM, & CPB have seen stagnant or precipitously decreasing margins. Ultimately, we believe that Kellogg's 27's have stronger upside to main competitors. As a diversified company with snack brands such as Pringles, Kellogg is better positioned vs. pure-play single-segment peers such as GIS. Trading 15-20 bps wide, Kellogg should tighten to its competitors by continuing to improve its bottom line, increasing sales in Latin America, and stabilizing breakfast foods sales in Europe. Thus, given the attractive wide spread between Kellogg and its peers, increasing brand diversification, and growth opportunities ahead, we think the company's 27's will trade closer to par.

Capitalization Table

The Kellogg Company Capitalization Table									
Type of Debt	Rate (%)	Maturity	Debt Outstanding (\$MM)	% of Gross Debt	xLTM Adj. EBITDA	Market Value	Price	Yield	xLTM Adj. EBITDA
Commercial Paper	1.150%		\$ 486.0	5.5%		\$ 486.0	\$ 100.00	1.15%	
Total Secured Debt			\$ 486.0	5.5%	0.20x	\$ 486.0			0.20x
Senior Note	3.250%	5/21/2018	\$ 400.0	4.5%		\$ 400.1	\$ 100.03	2.73%	
Senior Note	4.150%	11/15/2019	\$ 500.0	5.7%		\$ 511.4	\$ 102.29	2.69%	
Senior Note	4.000%	12/15/2020	\$ 850.0	9.6%		\$ 871.9	\$ 102.58	2.98%	
Senior Note*	1.750%	5/24/2021	€ 500.0	6.9%		€ 524.6	€ 104.92	0.19%	
Senior Note	3.125%	5/17/2022	€ 358.0	4.1%		€ 358.1	€ 100.02	3.06%	
Senior Note*	0.800%	11/17/2022	€ 600.0	8.3%		€ 608.4	€ 101.40	0.47%	
Senior Note	2.750%	3/1/2023	\$ 211.0	2.4%		\$ 204.2	\$ 96.79	3.40%	
Senior Note	2.650%	12/1/2023	€ 600.0	6.8%		€ 583.8	€ 97.30	3.14%	
Senior Note*	1.000%	5/17/2024	€ 600.0	8.3%		€ 600.8	€ 100.13	0.95%	
Senior Note*	1.250%	3/10/2025	€ 600.0	8.3%		€ 604.5	€ 100.75	1.11%	
Senior Note	3.250%	4/1/2026	\$ 750.0	8.5%		\$ 716.0	\$ 95.47	3.88%	
Senior Note	3.400%	11/15/2027	€ 600.0	6.8%		€ 573.8	€ 95.64	3.93%	
Senior Note	7.450%	4/1/2031	\$ 625.0	7.1%		\$ 801.3	\$ 128.21	4.51%	
Senior Note	4.500%	4/1/2046	€ 650.0	7.4%		€ 642.3	€ 98.81	4.53%	
Total Senior Notes			\$ 8,347.2	94.5%	3.63x	\$ 8,512.8			3.70x
Total Debt			\$ 8,833.2	100.0%	3.63x	\$ 8,998.8			3.70x

*Notes are denominated in EUR and are converted to USD for debt calculations.

Kellogg has \$400 million of 3.250% senior notes slated to mature in May of 2018. Because Kellogg typically allows similar sized & purposed notes, such as a prior \$400 million 2017 note, to mature, we expect this maturity to be paid off. As a result, *we predict leverage will decrease to 3.27x*, which will allow the company to issue new notes in the future.

Market Data

Bond Maturity: 11/15/2027

Rating: Baa3/BBB-

Price: \$95.788

Coupon: 3.4%

YTW: 3.926%

Call Date: 8/15/2027

Call Price: \$100

Total Debt (MM): \$8,444.3

Liquidity (MM): \$2,886

LTM EBITDA: \$2,434

Debt/EBITDA: 3.63x

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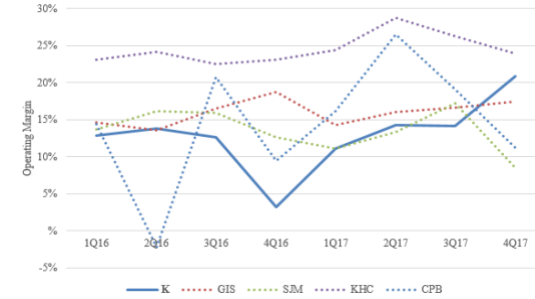
- Competitive Moat** versus food packaging peers
- Risks** to our long position in Kellogg's 27's
- Relative Value:** Z-spread & comparable analysis
- Market Data:** Kellogg & Industry Performance
- Summary Model**

Competitive Moat

Increasing Profitability: Exiting DSD

Kellogg's mid-2017 elimination of direct-store-delivery (DSD) from its business has been favorable for its bottom line. Through management's "Project K," the company has seen savings of almost \$300 million in SG&A expense from fiscal year 2016-17. In comparison, CPB, KHC, & GIS all have seen decreases in operating margins while K's have increased.

Figure #1: K's Improved Operating Margin vs. Peers



Source: Bloomberg Terminal & MFIF Analysts

Entering New & Emerging Segments

Kellogg's new portfolio of products has provided the company an upside advantage against its peers. As the consumer staples industry shifts towards healthier products, Kellogg has followed suit with consumer trends. By purchasing RXBar, Kellogg adds approximately \$120 million in annual revenue and fuels the company for future growth within the nutrition bar industry. In addition, the acquisition of Parati tripled K's size in Brazil, and allows for large upside growth in the Latin America region. While Kellogg has made strategic investments in new & emerging segments, its competitors are investing large amounts of capital into matured industries. For instance, key competitor CPB bought-out Snyder-Lance for \$4.9 billion, but the pretzel industry only accounts for roughly 16% of snack production revenue (IBISWorld). Thus, as sales stagnate in developed products & markets, Kellogg's investments set the company up for a positive outlook as consumer preferences change.

Risks

- Large presence in breakfast foods segment poses future challenges with growth
- Inability to further decrease costs would be unfavorable to Kellogg's bottom line & cash flow
- Acquisitive nature of business increases leverage
- Buyout of Parati and RXBar are significant investments that have not fully been proven
- Emerging market uncertainty in Latin America region (Venezuela & Brazil)

Company Information

Figure 2: K Equity Chart (1Y)



Source: Bloomberg Terminal

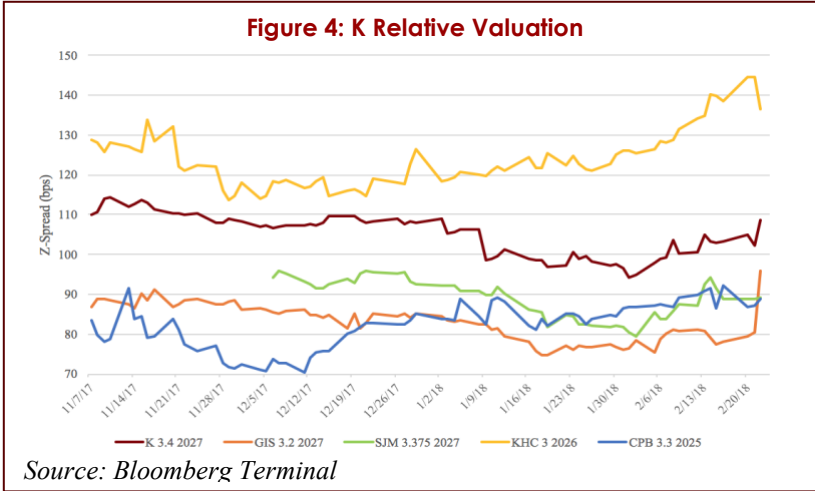
Figure 3: K 27s Z-Spread



Table 1: Equity & Debt Holders

Top Equity Holders		Top Debt Holders	
Kellogg W.K. Foundation	19.50%	State Farm	2.69%
Capital Group Companies	7.68%	Vanguard	2.21%
KeyBank	7.46%	Lincoln National	1.85%
BlackRock	7.14%	Allianz SE	1.78%
Vanguard	6.53%	New York Life	1.64%
State Street	3.24%	TIAA-CREF	1.51%
State Farm	3.24%	Aflac Group	1.36%
Sun Life Financial	2.37%	Prudential	1.16%
American International	2.16%	BlackRock	1.14%
FMR LLC	1.81%	Ameriprise Financial	1.13%

Relative Value



As a relatively new issuance, Kellogg's 27's have traded wide to both SJM and GIS's 27's. This is largely applicable to investor uncertainty over growth guidance in Europe. However, as Kellogg continues to implement measures that increase the company's bottom line, we expect the bond to trade tighter to SJM and GIS. Additionally, K's acquisitive past has provided the company stronger growth opportunities versus its peers. If new investments such as RXBar and Parati add their expected revenue values, K's 27's will trade in the sub-100 bps range. In addition, we expect KHC's 26's to trade wide to its peers given that the company has been unable to revamp its portfolio and decrease leverage.

Looking forward, we expect K's 27's to trade 15-20 bps tighter. *If operating margins in 2018 are analogous to Q4's 20.8%, which reflected over a 500 bp increase QoQ, the bond should tighten.* In comparison, key competitors GIS & CPB are less likely to tighten and trade within the 90-95 bps range. For GIS in particular, management has failed to diversify the company's brands into new emerging trends, which has caused sales to decline. Thus, we see strong upside with K's 27's and believe that current spread is not truly reflective of the company's full potential.

Competitor Analysis

Table 2: Competitor Financial Performance & Health

(LTM, \$ MM)	K	GIS	SJM	KHC	CPB
Revenue	\$12,923.0	\$15,567.7	\$7,359.6	\$26,232.0	\$7,858.0
LTM EBITDA	\$2,427.0	\$3,100.6	\$1,340.0	\$7,809.0	\$1,718.0
EBITDA Margin	18.78%	19.92%	18.21%	29.77%	21.86%
FCF	\$1,145.0	\$2,266.4	\$901.7	\$(690.0)	\$933.0
Debt/EBITDA	3.63x	2.99x	3.72x	4.04x	2.06x
EBIT/Interest	8.64x	8.50x	6.25x	5.49x	12.50x
Liquidity	\$2,886.0	\$3,798.1	\$1,726.2	\$5,629.0	\$2,045
Moody's Rating	Baa3	Baa2	Baa2	Baa3	A3
YTW	3.926%	3.780%	3.828%	4.116%	3.547%

Source: Bloomberg Terminal & MFIF Analysts

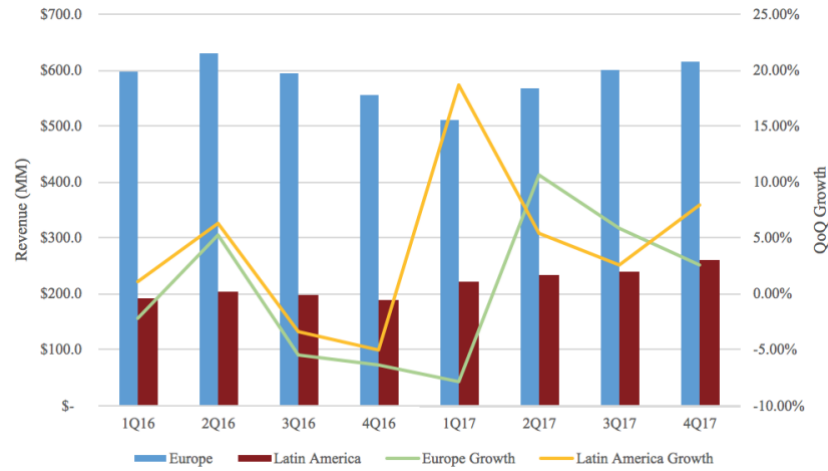
Table 3: Moody's Packaged Food Rating Methodology

Criterion	Weight	K	GIS	SJM	KHC	CPB
Total Sales	20%	A	A	Baa	A	Baa
Geographic Diversification	12%	A	A	Ba	Aa	Baa
Segment Diversification	12%	Baa	Baa	Baa	Aa	Baa
Market Share	7%	Ba	Ba	Ba	Ba	Ba
Category Assessment	7%	Baa	Baa	Baa	B	Baa
Profitability	7%	Baa	A	A	Aa	A
Financial Policy	14%	Ba	Baa	Baa	Baa	Baa
Debt/EBITDA	7%	Ba	Baa	Ba	Ba	A
RCF/Net Debt	7%	Ba	Baa	Baa	B	Baa
EBIT/Interest Expense	7%	A	A	Baa	Baa	A
Grid Indicated Rating	100%	Baa3	Baa1	Baa2	Baa3	Baa1

Source: Moody's Corporation & MFIF Analysts

Kellogg & Industry Data

Figure #5: Kellogg Latin America Growth & European Sales Stabilization

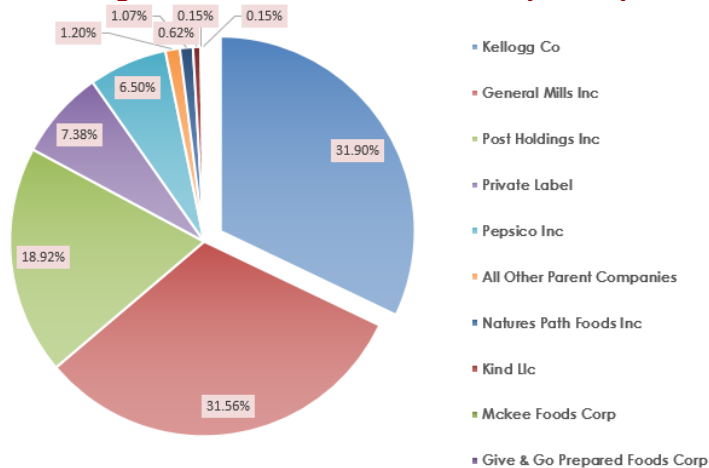


Source: Bloomberg Terminal, Company 10-K Filings

Throughout fiscal 2017, Kellogg experienced substantial growth in its Latin America region. This is attributable to the Parati acquisition and strong growth in Mexico. Furthermore, we expect additional revenue increases of 15% in 2018 as the Caribbean segment should rebound from the devastating effects of Hurricanes Maria & Irma. As well, the growth of the Parati business should also propel the region to new revenue highs.

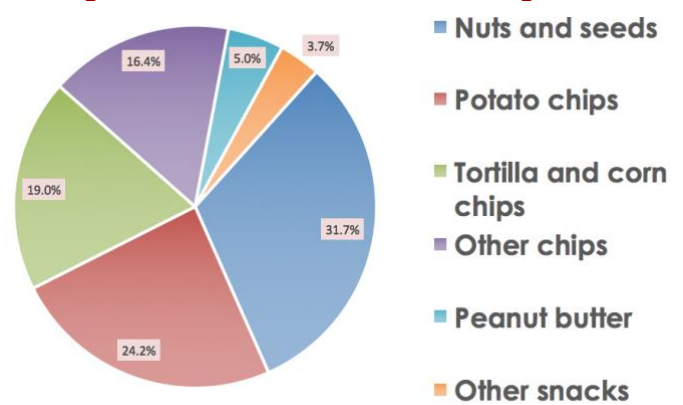
Analyzing Europe, Kellogg experienced a precipitous decline in sales in late 2016 & early 2017. This was due to a price dispute with customers over the repackaging of Pringles products. However, after the negotiations were settled, sales stabilized through the end of 2017.

Figure #6: Cold Cereal Market Share (FY 2017)



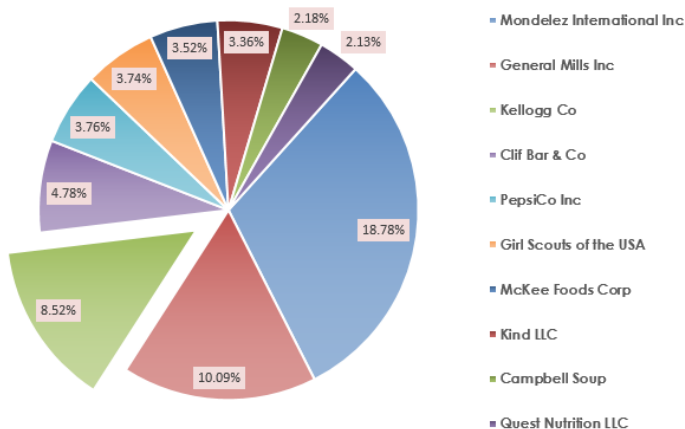
Source: Bloomberg Terminal & IRI Data

Figure #7: Snack Production Product Segmentation

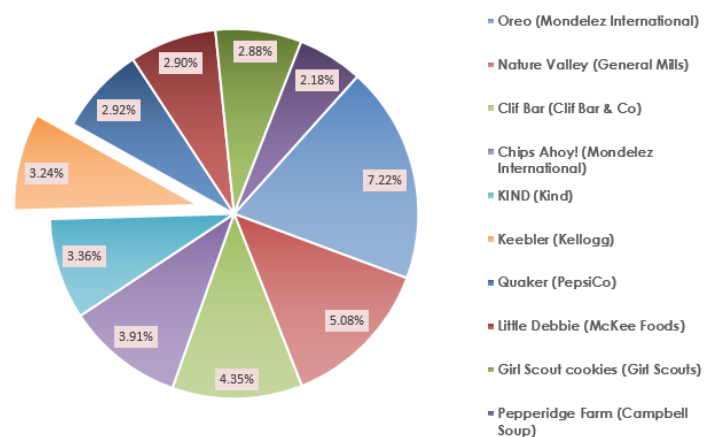


Source: IBISWorld Reports

Figures #8 & 9: Market Share Available for Parati & RXBar in Snack Bar & Biscuits Segment



Source: Bloomberg Terminal



Source: Bloomberg Terminal

Kellogg Company (K)

Summary Model

	2016	2017	1Q18E	2Q18E	3Q18E	4Q18E	FY18E	FY19E
Revenues:								
U.S Snacks	\$ 3,198	\$ 3,067	\$ 758	\$ 787	\$ 752	\$ 716	\$ 3,013	\$ 2,985
% growth	-1.1%	-4.1%	-3.0%	-2.0%	-1.0%	-1.0%	-1.8%	-0.9%
U.S. Morning Foods & Kashi	\$ 2,931	\$ 2,778	\$ 682	\$ 645	\$ 678	\$ 637.3	\$ 2,642	\$ 2,642
% growth	-2.0%	-5.2%	-5.2%	-4.9%	-4.5%	-4.9%	-4.9%	0.0%
Europe	\$ 2,377	\$ 2,291	\$ 517	\$ 572	\$ 611	\$ 626	\$ 2,326	\$ 2,212
% growth	-4.8%	-3.6%	1.0%	1.0%	2.0%	2.0%	1.5%	-4.9%
North America Other	\$ 1,598	\$ 1,616	\$ 401	\$ 399	\$ 428	\$ 420	\$ 1,648	\$ 1,648
% growth	-5.3%	1.1%	2.0%	2.0%	2.0%	2.0%	2.0%	0.0%
U.S. Specialty	\$ 1,214	\$ 1,249	\$ 406	\$ 282	\$ 296	\$ 294	\$ 1,278	\$ 1,297
% growth	2.8%	2.9%	2.7%	2.1%	2.2%	2.2%	2.3%	1.5%
Latin America	\$ 780	\$ 955	\$ 255	\$ 269	\$ 276	\$ 298	\$ 1,098	\$ 1,216
% growth	-23.2%	22.4%	15.0%	15.0%	15.0%	15.0%	15.0%	10.7%
Asia Pacific	\$ 916	\$ 967	\$ 245	\$ 250	\$ 268	\$ 258	\$ 1,022	\$ 1,042
% growth	-0.3%	5.6%	5.7%	5.2%	5.5%	6.2%	5.6%	2.0%
Total	\$ 13,014	\$ 12,923	\$ 3,263	\$ 3,204	\$ 3,310	\$ 3,250	\$ 13,027	\$ 13,043
% growth	-3.8%	-0.7%	0.3%	0.5%	1.1%	1.3%	0.8%	0.1%
COGS	\$ 7,742.0	\$ 7,420.0	\$ 1,837.9	\$ 1,786.5	\$ 1,832.8	\$ 1,797.4	\$ 7,254.6	\$ 7,188.7
SG&A	\$ 3,360.0	\$ 3,076.0	\$ 717.9	\$ 704.9	\$ 728.1	\$ 715.0	\$ 2,866.0	\$ 2,869.4
D&A	\$ 517.0	\$ 481.0	\$ 120.0	\$ 120.0	\$ 120.0	\$ 120.0	\$ 480.0	\$ 506.5
Other Operating Expenses								
Operating Income	\$ 1,395.0	\$ 1,946.0	\$ 587.4	\$ 592.8	\$ 628.9	\$ 617.5	\$ 2,426.5	\$ 2,478.1
Net Interest Expense	\$ 406.0	\$ 256.0	\$ 68.0	\$ 68.0	\$ 68.0	\$ 68.0	\$ 272.0	\$ 272.0
Other Non-Operating Expense	\$ 62.0	\$ 16.0	\$ 4.0	\$ 4.0	\$ 4.0	\$ 4.0	\$ 16.0	\$ 16.0
EBT	\$ 927.0	\$ 1,674.0	\$ 515.4	\$ 520.8	\$ 556.9	\$ 545.5	\$ 2,138.5	\$ 2,190.1
Taxes	\$ 233.0	\$ 412.0	\$ 118.5	\$ 119.8	\$ 128.1	\$ 125.5	\$ 491.9	\$ 503.7
Income (loss) from Affiliates	\$ (1.0)	\$ (7.0)	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Minority Interest	\$ 1.0	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Net Income	\$ 694.0	\$ 1,269.0	\$ 396.8	\$ 401.0	\$ 428.8	\$ 420.0	\$ 1,646.6	\$ 1,686.4
EBITDA Reconciliation								
Net Income	\$ 694.0	\$ 1,269.0	\$ 396.8	\$ 401.0	\$ 428.8	\$ 420.0	\$ 1,646.6	\$ 1,686.4
(+) Net Interest Expense	\$ 406.0	\$ 256.0	\$ 68.0	\$ 68.0	\$ 68.0	\$ 68.0	\$ 272.0	\$ 272.0
(+) Taxes	\$ 233.0	\$ 412.0	\$ 118.5	\$ 119.8	\$ 128.1	\$ 125.5	\$ 491.9	\$ 503.7
(+) Other Operating Costs	\$ 62.0	\$ 16.0	\$ 4.0	\$ 4.0	\$ 4.0	\$ 4.0	\$ 16.0	\$ 16.0
Operating Income	\$ 1,395.0	\$ 1,953.0	\$ 587.4	\$ 592.8	\$ 628.9	\$ 617.5	\$ 2,426.5	\$ 2,478.1
(+) DD&A	\$ 517.0	\$ 481.0	\$ 120.0	\$ 120.0	\$ 120.0	\$ 120.0	\$ 480.0	\$ 506.5
EBITDA	\$ 1,912.0	\$ 2,434.0	\$ 707.4	\$ 712.8	\$ 748.9	\$ 737.5	\$ 2,906.5	\$ 2,984.7
(+) Other 1x Costs	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
EBITDA Adjusted	\$ 1,912.0	\$ 2,434.0	\$ 707.4	\$ 712.8	\$ 748.9	\$ 737.5	\$ 2,906.5	\$ 2,984.7
% growth	17.7%	27.3%	46.5%	24.6%	26.3%	-6.2%	19.4%	2.7%
Free Cash Flow								
Adjusted EBITDA	\$ 1,912.0	\$ 2,434.0	\$ 707.4	\$ 712.8	\$ 748.9	\$ 737.5	\$ 2,906.5	\$ 2,984.7
Capex	\$ 507.0	\$ 501.0	\$ 126.5	\$ 124.2	\$ 128.3	\$ 126.0	\$ 505.0	\$ 505.6
Cash Interest	\$ 406.0	\$ 256.0	\$ 68.0	\$ 68.0	\$ 68.0	\$ 68.0	\$ 272.0	\$ 272.0
Cash Tax	\$ 233.0	\$ 412.0	\$ 118.5	\$ 119.8	\$ 128.1	\$ 125.5	\$ 491.9	\$ 503.7
Gross FCF	\$ 766.0	\$ 1,265.0	\$ 394.3	\$ 400.8	\$ 424.5	\$ 418.0	\$ 1,637.6	\$ 1,703.3
Working Capital	\$ 205.0	\$ 186.0	\$ 47.0	\$ 46.1	\$ 47.6	\$ 46.8	\$ 187.5	\$ 187.7
Net FCF	\$ 561.0	\$ 1,079.0	\$ 347.4	\$ 354.7	\$ 376.8	\$ 371.2	\$ 1,450.1	\$ 1,515.6