

Consumer Staples

Daniel Junghans,
junghan2@msu.edu

Recommendation: Hold CALM

We look to increase our position of CALM if the stock drops below \$35 and subtract if the stock rebounds to \$43. We like Cal-Maine Foods' domination in the shell egg production sector because there is a moderate barrier to entry that is increasing. However, we are still concerned with new state regulations requiring major investments in new property, plant, and equipment. Also, COVID-19 continues to threaten supply chain disruptions in the sector. Based on this we have a neutral view for the semester based on how the stock price moves.

Key Investment Highlights

Revenue decreased due to low selling prices.

For the first quarter of fiscal 2021, Cal-Maine Foods had \$292.8 million dollars in sales and had a net loss of \$19.4 million dollars. In the previous quarter, they had \$453.33 million dollars in sales and a net income of \$60.46 million dollars. The large disparity in revenue is largely due to an increase in COVID-19 purchases and seasonal demand in fiscal 2020. Over the first quarter, market prices for eggs remained volatile and decreased overall compared to the previous quarter. The supply of eggs has declined dramatically, and Cal-Maine Foods believes that demand will improve as food service sales return to pre-quarantine levels.

A growing number of states are passing laws regarding the amount of space given to chickens.

During 2020, Cal-Maine Foods continued its efforts to position itself as a leader in cage-free eggs. An increasing number of states including Michigan, California, Washington, Oregon, Massachusetts, and Rhode Island have all passed new laws requiring that eggs come from chickens that are cage-free or have a minimum space requirement. These laws will come into effect sometime between January 2022 and January 2026. In response to new cage-free demand and new regulations, Cal-Maine Foods has invested \$371.7 million dollars in facilities, equipment, and other related operations to increase cage-free production. For the first quarter of fiscal 2021 they purchased \$25.3 million dollars in property, plant, and equipment compared to only \$23.7 million dollars last year.

Potential Companies

Inter Parfums, Inc. (IPAR). This company has extreme asset efficiency (ROA: 7.4%) and is very liquid (Current Ratio: 3.11) compared to the rest of the sector. IPAR is a potential investment because it has consistently grown revenue over the past 5 years and continues to expand its portfolio of brands.

Tootsie Roll Industries, Inc. (TR). Like IPAR, this company uses its assets efficiently (ROA: 6.7%) and is more liquid (Current Ratio: 4.44) than the rest of the industry. Tootsie Roll Industries owns some of the most iconic candy brands in the world and is one of the largest candy producers. This company's financial status may make it a great investment.

e.l.f Beauty, Inc. (ELF). This cosmetic company has an above average asset efficiency (ROA: 4.0%) and is moderately liquid (Current Ratio: 2.59) compared to the consumer staples sector. ELF's diverse product line and financial success could make this company a solid investment for the portfolio.

Hostess Brands, Inc (TWNK). This company is moderately liquid (Current Ratio: 2.83) and its asset efficiency (ROA: 2.1%) is about average for the sector. Hostess is one of the oldest and biggest packaged food companies. The history of financial success for this company makes it a very good potential company for the portfolio.

Farm production costs decreased for the first quarter of fiscal 2021.

During the first quarter of fiscal 2021, farm production costs per dozen eggs produced went down by 4.3%. This can largely be attributed to lower feed costs during the quarter. In fiscal 2020, feed costs represented 55.4% of the production costs for Cal-Maine Foods. According to the USDA, current supplies of corn and soybeans are favorable. Because of this, Cal-Maine Foods believes they will have sufficient supply of both grains for the next fiscal year. Despite USDA reports, COVID-19 still causes supply chain uncertainty and price volatility.

Sector Overview

Cal-Maine, Inc. engages in the production, packing, grading, and sale of fresh shell eggs. The focus of this industry is raising chickens for egg production. Cal-Maine, Inc. is headquartered in Jackson, Mississippi with locations in Alabama, Arkansas, Florida, Georgia, Kansas, Kentucky, Louisiana, Mississippi, North Carolina, Ohio, Oklahoma, South Carolina, Tennessee, Texas, and Utah. Their growth strategy is focused on remaining a low-cost provider of shell eggs and increasing acquisitions of cage-free producers to meet customer demand and adapt to new regulations. Their different egg segment sales have performed as seen below.

Sector Analysis

Cal-Maine is the largest producer of shell eggs in the United States and makes up 15.6% of the industry. Conventional egg sales were \$155.4 million dollars making up 54.3% of egg revenue. Specialty egg sales were \$129.2 million dollars for the quarter making up 45.2% of shell egg revenue. Year to date revenue for the chicken egg production industry in the United States is \$8.66 billion dollars. Industry revenue in 2020 has increased 11.28% from the previous year. The chicken egg production industry is expected to experience mild revenue growth due to upward pressure on egg prices and an increase in per capita egg consumption. An investing opportunity may arise from a rapid increase in the price of eggs.

Positive & Negative Catalysts

A positive catalyst for this stock is next quarter's earnings. 2nd quarter fiscal 2021 earnings for Cal-Maine Foods will be announced on 01/04/20. The next catalyst is rising egg prices. Historically, egg prices are usually at their lowest during the fourth and first fiscal quarters due to seasonal demand.

One major risk associated with Cal-Maine Foods is chicken feed price volatility. As of now, feed prices are stable and have gone down, but a COVID-19 supply chain disruption could cause feed prices to become volatile and rise. Food service egg demand has also not recovered to pre-COVID-19 levels, leading to another major risk. COVID-19 may continue to

suppress food service demand even though some restaurants have resumed limited service.

What to Watch – Next

Current analyst estimates expect sales to exceed \$330 million dollars for this upcoming quarter. We believe that increased seasonal demand and rising egg prices will make this target attainable. Low and stable feed prices will also aid Cal-Maine Foods in reaching this goal by lowering their cost of production dramatically. The stock price has dropped a significant amount since the past quarter, falling by 13%. If Cal-Maine surpasses this quarter's sale and meets revenue expectations, the stock will likely see a small increase (\$1-\$3).

Final Take

Recommendation: Hold Cal-Main Foods, Inc. shares unless the stock price drops below \$35.00 (buy) or if the stock price rises above \$43.00 (sell). The future stock price for Cal-Maine Foods is highly uncertain due to the market price of eggs remaining volatile and COVID-19 continuing to threaten supply chain disruptions. Because of this, I believe holding Cal-Maine Foods will add the most value to the portfolio. Additionally, we should closely watch new state regulations and be ready to sell some of our position in Cal-Maine Foods.