



Stock Pick of the Week: Cal-Maine Foods (CALM)

Our stock pick this week produces possibly one of the most inelastic goods in history. A company that provides a product that is always in demand is often a great investment, but it can be an even better investment when the demand for the product is actually growing. Our stock pick of the week is fresh egg producer Cal-Maine Foods (CALM), the leading egg producer in the United States. Cal-Maine receives our Very Attractive rating.

Steadily Growing Business Market

Cal-Maine owns well-known brands such as Egg-Lands Best, Land O' Lakes, and Farmhouse eggs. The company provides specialty eggs, including nutritionally enriched, cage free, organic, and brown eggs. Over the past few years, diets in the United States have begun focusing on high protein items, and eggs are known to be one of the best sources of protein. According to the American Egg Board, per capita consumption of eggs has grown by 1% compounded annually since 2008. This steady increase bodes well for Cal-Maine.

Impressive Results in 2014

When Cal-Maine reported fiscal 2Q15 operations in December, the company's showed progress on the top and bottom lines. Sales for the quarter were up 7% over the previous year and operating income up 36%. Some of this increase can be attributed to the decline in corn prices. As corn prices fluctuate, Cal-Maine's feed expenses will vary as well. Barring a drastic increase in corn prices, the company should be able to manage costs effectively.

These recent results are another signal that Cal-Maine is successfully riding an uptrend in egg demand. Over the past four years, Cal-Maine has maintained after-tax operating profit ([NOPAT](#)) right around \$61 million, but in 2014 profit growth returned to the company. NOPAT increased 64% over 2013, and Cal-Maine's return on invested capital ([ROIC](#)) jumped from 13% to 19%.

Cal-Maine also has an impressive balance sheet, with only \$58 million in [total debt](#) (3% of market cap) and has generated \$62 million in [free cash flow](#) on a trailing twelve-month basis. If management can continue growing revenues, keeping costs in line, and increasing profitability, Cal-Maine has great upside. As an added bonus, Cal-Maine pays out dividends that provide a 3% yield. With low debt and positive free cash flow, Cal-Maine should have no problem continuing this cash distribution.

California Legislation News Provides Entry Point

The reason for disappointment in the company's 2Q15 earnings in December was the California Proposition 2 going into effect beginning 2015. This proposition and related state rule requires better cages for egg-laying hens and that any eggs imported into or produced in California must abide by these requirements.

Cal-Maine's CEO Adolphus Baker noted that this proposition would negatively impact the egg production landscape through the country in 2015, but that the company expected to be able to mitigate any risk and still expects favorable results in 2015. However, this announcement sent the stock price tumbling 22% over the past month. As the largest producer of eggs in the country with healthy free cash flow, we believe that Cal-Maine is in a position to handle the slowly changing landscape. As happens often during earnings announcements, this reaction is overdrawn to the downside.

Long-Term Portfolio Asset

Cal-Maine is positioned to grow with the continued growth the American egg market and economy. Buying this company after the recent share price decline is a no-brainer given how undervalued this drop has left CALM's stock.

At its current price of ~\$35/share, Cal-Maine has a price to economic book value ([PEBV](#)) ratio of 0.8. This ratio implies the market expects Cal-Maine's NOPAT to permanently decline 20% from current levels. This seems very pessimistic given the steadily growing demand for eggs over the years.

If Cal-Maine can only [grow NOPAT by 7% compounded annually for the next 10 years, the stock is worth \\$48/share today](#) — a 37% upside. Throw in the dividend yield and it's worth even more in your portfolio long-term.



Kyle Guske II contributed to this report.

Disclosure: David Trainer and Kyle Guske II receive no compensation to write about any specific stock, style, or theme.



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