WK Kellogg

NYSE: KLG

April 19, 2023

Buy Recommendation

TEXAS A&M UNIVERSITY

Company Overview

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Creation of WK Kellogg

Timeline of spinoff:

June 2022: The company announced it would split into three parents (cereal, snacks and plant food)

December 31, 2022

February 2023: Company announced that only splitting into two, with plant-based food remaining part of Kellanova (parent)

October 2, 2023: Company officially spinoff and trades on the NYSE as KLG while its parent still trades as K under a new name: Kellanova

December 31, 2023

Who keep What?

Parent Company, Kellogg (now called Kellanova) will keep snacks and plant food, and international cereal

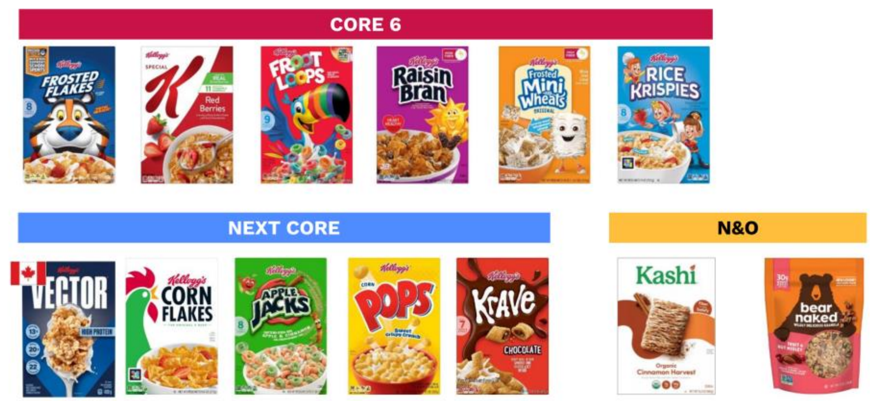
WK Kellogg will obtain all North American cereal brands from Kellogg

% of business each cereal makes up:

70% from the core 6

15% from the next core

15% from the N&O



Who Keeps What?

Pre-Spin
(Kellogg Company)
Multiple brands*, competing priorities

Cereal

Today
(WK Kellogg Co)
Singular focus on cereal

Cereal

Basic Company Data

Key Financial Stats

Market Cap: 1.6B	2023 Revenue: 2.8B
Enterprise Value: 2.0B	2023 EBITDA: 332M
LTM EV/EBITDA: 6.2x	2023 Net Debt/EBITDA: 1.3x
P/E: 14.7x	Beta 5Y: N/A

Thesis

Market View

- The market is not overall optimistic about WK Kellogg
- Various reason cited included declining cereal industry, which created doubt about the company's ability to increase sales
- They also expressed doubt about the company's ability to reach 500bp of EBITDA margin withing the near future
- Rising company debt also has analyst worried

"Although we expect EBITDA Margin Expansion, we aren't yet comfortable with the **company's outlook for 500 basis points over the next three years, debt is expected to rise over the next two years**, and the **cereal category has been declining** for a long time"

- Brandon Cohen, JP Morgan Securities LLC, who rated the stock as **NEUTRAL**

"...we would note a still **weak volume outlook** to start the year, **negative free cash flow** and the **need for share gains in a declining category** as potential causes for concern when evaluating KLG over the near to medium term"

-Andrew Lazar, Barclays who rated the stock as **NEUTRAL**, with potential downside of **– 19.4%**

My View

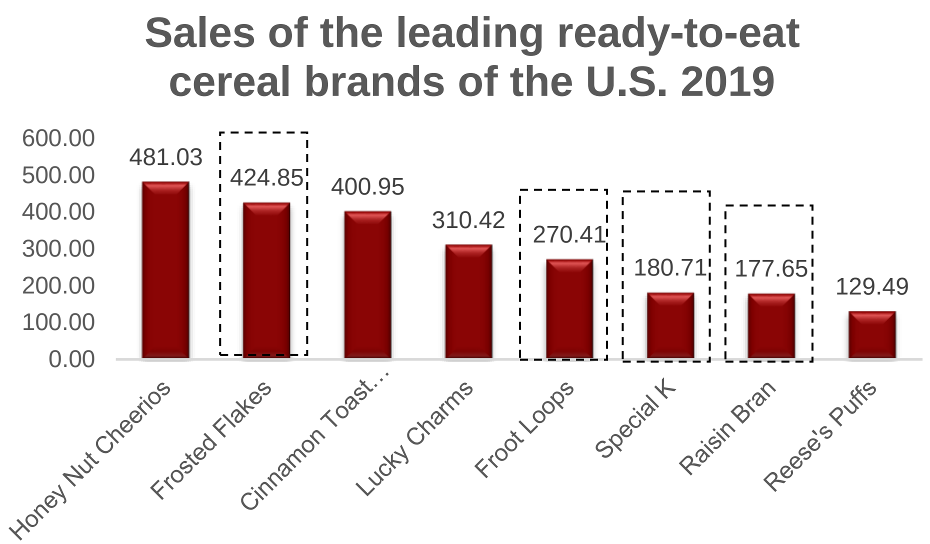
- Despite a declining cereal industry, the company has a terrific portfolio of cereal brands on par with its biggest competitors, General Mills, who has a market cap far greater than WK Kellogg
- WK Kellogg as a standalone cereal company has a proven track record of its brand's value, as seen with a ROIC significantly higher than even its biggest competitor, General Mills
- WK Kellogg also has new avenues to grow revenue as a mid-term goal in a declining industry, such as repurposing cereal as snacks to eat through the day, as well as develop new healthier cereals to keep customers around
- Even in the worse case scenario (company can grow revenues through the methods mentioned above), the company simply needs to lower production costs to realize its objectives (grow EBTIDA margins 500bps by the next year or so, pay attractive dividend, keep net debt/EBITDA to 2.5x or below)
- The company also has a well-incentive and competent management teams who has so far beat company expectations significantly

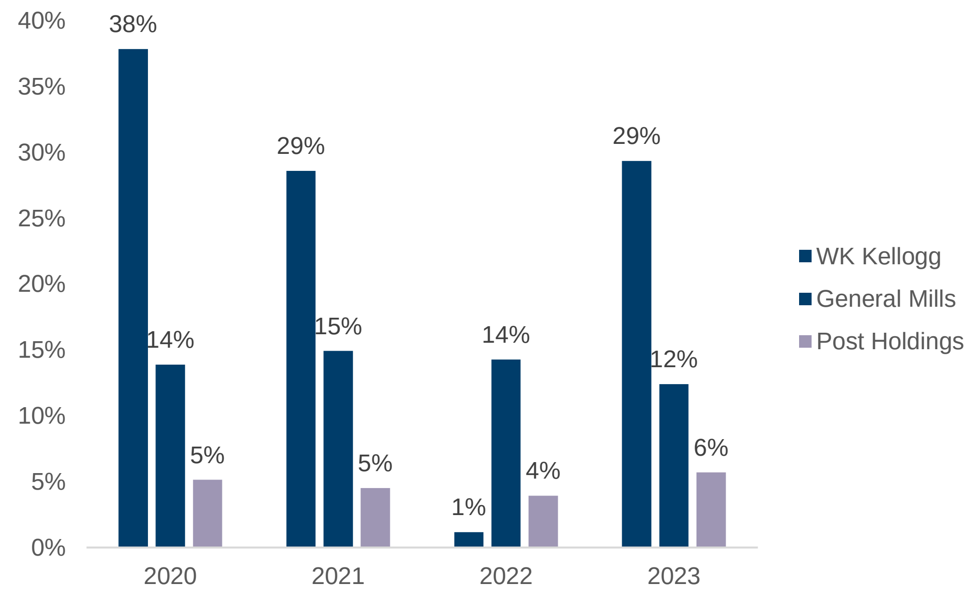
This provides us with the opportunity to generate alpha!!

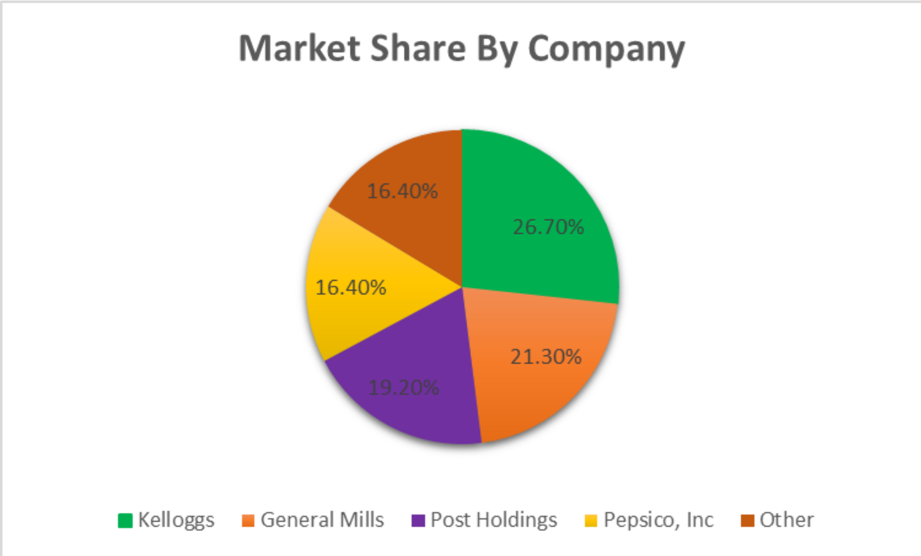
A Solid Company in a Declining Industry

Leading with the Advantage

- When WK Kellogg broke off from its parent, it started with a huge advantage through some of America's most popular cereal brands, many of which compete with popular cereal brands made by General Mills
- Kellogg's Cereal Brands owned the highest share of the market, according to IBIS World
- More importantly its cereal brands achieved ROIC far above its peers, even before spinning off in October 2023
- Higher input costs, plus a plant fire and strike from the latter part of 2021 that affected the first quarter of 2022, lowered ROIC in 2022







CapIQ Statistia (BakeryandSnacks.com), IBIS World

Finding New Opportunities

2024 Front Half Plan to Drive Revenue

"This plan has 3 elements: driving the premium segment…The next element of our innovation is expanding the appeal of our existing brands with brand extensions…And finally, we continue to expand in occasions with the launch of mini snacks."

Doug Vandevelde, Chief Growth Officer

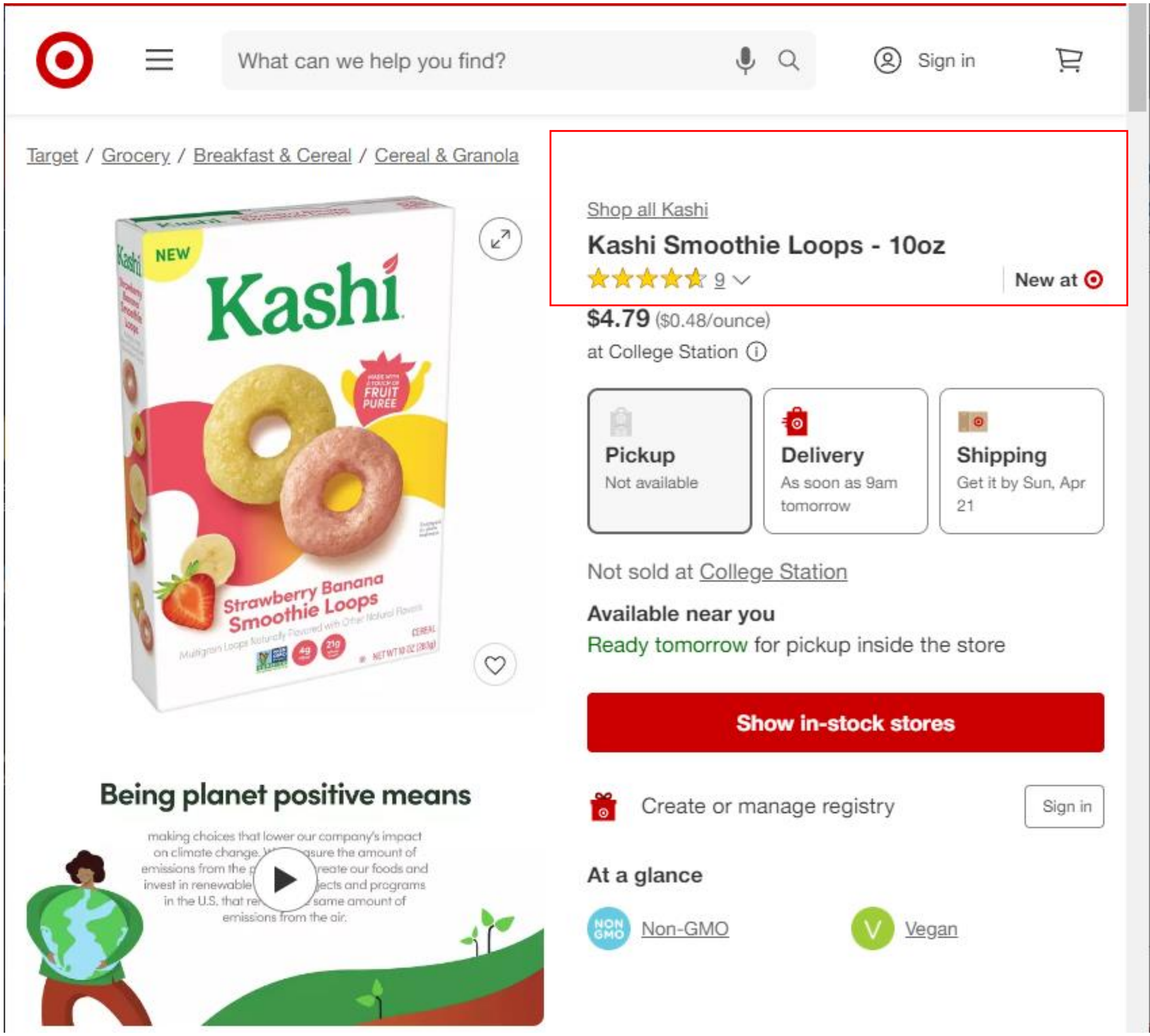
Healthy Cereal (Premium)

- Company's 2024 plan is to introduce new types of cereal
- They will all be premium cereal
  - Eat you Mouth Off (Zero Sugar, High Protein)
  - Special K (Zero and High Protein)
  - Extra ("Taste Premium Brand, a legacy European Brand" as noted in the Investor Presentation Day)

"The premium segment in cereal is **growing** as consumers are showing their willingness to pay more for value-added benefits" – Doug Vandevelde, Chief Growth Officer

Brand Extension

Newly Developed Kashi Flavor Cereal!!



Snacking

- Another key area highlighted by management is the eating of cereal outside of breakfast, a growing trend especially popular among younger generations
- Studies have found that those who eat cereal as a snack often eat unhealthy cereals, and WK Kellogg has some of the most popular unhealthy cereals
- When it comes to eating cereals for a snack, taste is #1, not health

"'Snacking is another of those new occasions where we see considerable opportunity for **growth in our category and in our share**...There are approximately 800 snacking opportunities per year per person...'" - Mr. Vandevelde, Chief Growth Officer [quote taken from foodbusinessnews]

Mintel Research:

- Research from Mintel suggests that 43% of US eaters eat cereal as a snack at home, although 89% of them still eat it for breakfast
- Younger generations primarily responsible for this trend
- 49% eat it as a guilt-free treat
- 9 in 10 (about 86%) cereal eaters eat it without milk
- Despite trends towards "healthier cereal" (29% of people say they try to eat less sweet cereal), these same people (30%) put taste over nutrition
- 80% consider taste first for cold cereal while 77% for hot cereal
- 40% of cereal eaters said that cereal should be easy to carry around

Improving EBITDA Margins Through Operational Efficiency

Focused Operation Improvement to Expand EBITDA margins

- Seeing the value of Kellogg’s North American cereal in the past, with its sole focus now on cereal, it has a significant advantage over other cereal makers
- While management’s mid term goal is to grow revenue, its short-term goal is to reduce costs through production efficiency
- This involves consolidation and finding the most efficient factory/method to produce their cereal
- This involves taking on debt to fund the 450 to 500 capex over the next two years (2024 to 2026)
- Ultimately the company want to achieve EBITDA margins growth of 500bps from its current margins of 9% by 2026

CFO David McKinstray Investor Day:

- “Moving from maintain to modernizing our supply chain, including our manufacturing facilities.”
- “Over the next 2 years, we will invest 450 to 500M in modernizing our supply chain”

Examples of Company Operational Efficiencies from CFO Investor Day:

- The company is expanding their Canadian plant in Bellville, Ontario (increase size and number of production lines) since it’s the most efficient low-cost plant
- Consolidating production lines from 3 lines in 3 facilities to 2 lines to the 2 best facilities (in terms of cost and efficiency)

Will these Operational Efficiencies Work?

Implementing IWS at inefficient factories:

- WK Kellogg want to improve its existing through making existing factories more efficient, in addition to just moving them to efficient factories
- In the news recently, due to government incentives, WK Kellogg decided to keep their Battle Creek, Michigan
- This would result in WK Kellogg missing out on 20M in savings, which the government would try to compensate through grants
- WK Kellogg decided to train its employees using Kellogg's Integrated Work Systems
- This will help bring down the 20% inefficiency gap between its most and least efficient factories
- More importantly, the results of IWS already have been successfully implemented at WK Kellogg's Canadian plant, one of its best plants (cost and efficiency)

Case Study: P&G's Integrated Work System (IWS), developed with EY:

Two key objectives of IWS

Zero Loss – Defeating 8 types of loss:

- Overproduction
- Waiting
- Motion
- Transportation
- Defects
- Over-processing
- Inventory
- Non-utilized talent

100% Employee Ownership:

- Its every employee's job to remove losses

Results of the P&G and EY Collab:

- 10-year partnership and 15B in savings
- They have also put IWS into 400 smart factories in other countries
- P&G have won many awards, such as Supply Chain Master from Gartner, and Supplier of the Year from Walmart

"We received incentives from the state of Michigan and reached an agreement to implement Kellogg Integrated Work Systems or KIWS and the plant. These work systems **have already been deployed in our most efficient facilities."** – David McKinstray, CFO

"KIWS creates a standard for work that is **integrated across our supply chain.** Think about this as a **blueprint** for how we get work done." – David McKinstray, CFO

"We've expanded the building footprint and will animate new production line at this plant, increasing production at **one of our lowest cost, most efficient facilities.**" – David McKinstray, CFO, regarding the Belleville Plant in Canada

"This project [referring to company's announcement] would result in two of the three lines currently operational in Battle Creek to be idled and the decision was largely due to the **significantly lower cost to manufacture cereal in Belleville**, as well as that facility's **superior operating efficiency**, enabled by h**igh-performing work teams**."

- Brief Written to MBDP written by WK Kellogg regarding their rationale in moving its production to Belleville, Canada

"The MEDC has been working with the company to find a path forward to capture some of that investment [450-500M investment in all the company's plants] at its **Battle Creek facility which is one of the company's highest-costing and least efficient manufacturing locations.**" – Brief written to the MBDP regarding the state of its Michigan Plant

Incentivizing Management

Stock Awards Vastly Exceed Salary

Executive Stock Ownership Guidelines

In order to preserve the linkage between the interests of our NEOs and those of Shareowners, NEOs are expected to establish and maintain a significant level of direct stock ownership. Our current stock ownership guidelines (minimum requirements) are as follows:

Chief Executive Officer	6x annual base salary
Other Named Executive Officers	3x annual base salary

Named Executive Officer	2023 Post Spin Off Base Salary
Gary Pilnick	$1,000,000
David McKinstray	$500,000
Douglas VanDeVelde	$550,000
Bruce Brown	$455,000
Sherry Brice	$400,000

A significant amount of management's compensation comes from shares awarded for performance!!

Major Incentive to Deliver Value Through Cash Awards

Uses Annual Incentive Plan (AIP)

Annual Cash Incentives

Annual cash awards granted under the AIP are designed to support our pay-for-performance culture and are based on a combination of business and individual performance. For 2023, the potential AIP payouts were based on achievement of performance goals and could range from 0% to 200% of target, based on a combination of pre-Spin Off performance at Kellogg Company as noted in Chapter 2 and post-Spin Off performance at WK Kellogg. Because the Spin Off completion date occurred during the fiscal year, the target bonuses as a percent of salary were prorated for the NEOs to reflect their pre- and post-Spin Off compensation levels. The following chart summarizes the AIP target bonuses for 2023.

	Target Bonus % of Base Salary			
Named Executive Officer	Q1-Q3 (Pre-Spin)	Q4 (Post-Spin)	Aggregate 2023	2023 Target Bonus $
Gary Pilnick	95%	110%	99%	$987,397
David McKinstray	50%	80%	57%	$287,397
Douglas VanDeVelde	60%	65%	61%	$336,856
Bruce Brown	50%	65%	54%	$244,516
Sherry Brice	45%	60%	49%	$194,959

Expectations of Cash Awards through AIP; we will see how well management does two slides from now!!

Management gets Cash Award (Through AIP) to Meet EBITDA Margin Goals

Based on the business performance tiers below for our NEOs (assuming the annual Net Sales target was achieved), the AIP payout would be calculated as follows:

Tier	Minimum EBITDA Delivery for 2023 ($ millions)	WK Kellogg 4Q Payout Factor
1	252.0	Target
2	253.6	125%
3	256.2	150%
4	261.3 and higher	200%

WK Kellogg's business performance exceeded the 2023 forecast and plan provided by management at the WK Kellogg Investor Day on August 9, 2023, and the third quarter earning conference call on November 8, 2023. Based on actual 2023 standalone adjusted EBITDA performance of $258 million and achievement of the 2023 standalone adjusted Net Sales equal to $2.739 billion, EBITDA performance achieved was in the high range of Tier 3 in the table above, resulting in a payout factor of 150% for the fourth quarter, prior to any adjustment for individual performance. The WK Committee determined this as the appropriate payout for the fourth quarter based on our 'pay for performance' strategy and the period of time WK Kellogg operated as an independent company.

- This part of the DEF 14 filed showed that the company incentivized management to meet its EBITDA goals. As seen above, management went above and beyond the target set by the company, achieving a third-tier status, resulting in a payout 150% above its salary.
- This gives shareholders confidence that management has the incentive to continue growing EBITDA and EBITDA margins through the operational efficiencies described in previous slides, as well as drive revenue growth later

How Much did Management Actually Get Awarded Using AIP?

Historical Success in 2023

Individual performance is recognized under the AIP by applying an adjustment to the NEO's full year business performance factor, which adjustment can be upward (up to a maximum of 60%) or downward, depending on the individual's performance. The actual percent of the AIP target paid to our NEOs each year can range from 0% to 200% of the target opportunity.

The WK Committee considered individual performance in 2023 and awarded AIP payouts based on performance of 40% above the business performance factors for each NEO, consistent with the terms of the AIP. The AIP bonus payout for each of the NEOs was as follows:

Named Executive Officer	% of AIP Target(1)	2023 AIP Payout ($)(2)
Gary Pilnick	155%	$1,526,611
David McKinstray	150%	$431,575
Douglas VanDeVelde	165%	$555,800
Bruce Brown	147%	$358,696
Sherry Brice	158%	$308,265

(1) The aggregate 2023 AIP Payout Factor percentage represents ~75% of the Kellogg Company payout factors in "Pre-Spin Off Decisions by Kellogg Company" and ~25% of the WK Kellogg payout factor for the fourth quarter of 2023, adjusted based on individual performance.

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- Executives get compensated if they go above 40% of the stated performance goal
- Management here all exceeded this 40% minimum

This is why their cash awards through the AIP program exceeded expectations in 2023!!

One-Time Retention Equity Grants

One-Time Retention Equity Grants in Connection with the Spin Off

On November 13, 2023, WK Kellogg entered into retention agreements with each of our NEOs, pursuant to which each NEO received a one-time grant of RSUs that will cliff vest on the third anniversary of the grant date, subject to the NEO's continued service and compliance with the terms of the retention agreement, including confidentiality, non-competition, non-disparagement and non-solicitation restrictive covenants. This one-time grant was aligned with market norms for similar spinoff transactions and will not be considered part of each NEO's ongoing annual long-term incentive grant. This grant is intended to further align each NEO's interests with those of our Shareowners by increasing the NEO's personal financial stake in the success of WK Kellogg, supporting retention of key talent over our three-year strategic horizon, and recognizing the NEOs for successfully establishing WK Kellogg as an independent, publicly-traded, company. The terms and conditions associated with the grant include forfeiture of the award in the event of any voluntary resignation, including retirement, prior to the three-year cliff vesting, as well as standard release and other restrictive covenants.

Named Executive Officer	Grant Date Fair Value[(1)]
Gary Pilnick	$3,960,096
David McKinstray	$960,098
Douglas VanDeVelde	$750,080
Bruce Brown	$750,080
Sherry Brice	$750,080

(1) These one-time RSU awards made in connection with the Spin Off were granted on November 13, 2023 and cliff vest on November 13, 2026, subject to their terms and conditions. These grants are not considered part of the NEOs' ongoing annual long-term incentive grants.

- The company also gave its executive team this one-time retention equity grant to tie more of management's net worth to the company, as well as encourage management to stay with the company to achieve its three-year objectives
- Therefore, this should encourage shareholders as management works to achieve its desired EBITDA margins

Valuation

Reducing Production Costs by 1% YoY can Achieve Management Goals

Drivers	2021	2022	2023	2024	2025	2026	2027	2028
Increase Revenue by GDP given it's a mature industry				-1%	-1%	-1%	-1%	-1%
COGS as a % of Revenue	77%	77%	73%	72%	71%	70%	69%	68%
SG&A as a % of Revenue	22%	21%	24%	22%	22%	22%	22%	22%
Tax Rate	24%	4%	24%	24%	24%	24%	24%	24%
Dividend				4.00%	4.00%	4.00%	4.00%	4.00%
NET DEBT / EBITDA			2.5x	2.0x	2.0x	1.9x	1.5x	1.1x
EBITDA Margins			8%	11%	12%	13%	12%	13%
EBITDA			221	300	325	349	373	396

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Comparable Analysis

Comparable Analysis	Ticker	Market Cap (B)	LTM EV/EBITDA	LTM P/E	NTM Forward P/E (CapIQ)
Post Holdings	POST	6.4B	10.4x	22.8x	19.14x
General Mills	GIS	39.0B	11.3x	15.9x	15.08x
Kellonova	K	19.0B	13.0x	24.7x	15.54x
WK Kellogg	KLG	1.6B	6.2x	14.7x	12.48x
Average		21.5B	11.6x	21.1x	16.6x
Median		19.0B	11.3x	22.8x	15.5x

Discounted Cash Flow Analysis

Discounted Cash Flow Model

Income Statement	2021	2022	2023	2024	2025	2026	2027	2028
Net Sales	2460	2695	2763	2735	2708	2681	2654	2628
COGS	(1884)	(2064)	(2009)	(1962)	(1915)	(1869)	(1824)	(1779)
SG&A	(539)	(556)	(662)	(606)	(600)	(594)	(588)	(582)
Operating Profit	37	75	92	167	193	218	242	266
Income taxes	(52)	1	(35)	(51)	(55)	(59)	(63)	(68)
NOPAT	(15)	76	57	117	138	159	179	198
D&A	68	68	66	70	69	69	68	67
Changes in NWC	(86)	(69)	272	(1)	(6)	(6)	(6)	(6)
Additions to Properties (Part of Capex)	(75)	(71)	(150)	(167)	(167)	(167)	(80)	(79)
Unlevered FCF	64	142	(299)	21	47	67	174	192
Discount Period				1	2	3	4	5
Discount Rate at: 10%				0.91	0.83	0.75	0.68	0.62
PV of Unlevered FCF				19	39	51	119	119
EBITDA			221	300	325	349	373	396

Terminal Value - Exit EBITDA Multiple	
EV/EBITDA	10.4x
Terminal Value	4120.5
PV of Terminal Value	2558.5
Sum of PV of FCF	346.5
Implied Enterprise Value	2905.0
Add: Cash	89.0
Subtract: Total Debt	(517.0)
Implied Equity Value	2477.0
Shares Outstanding	85.8
Implied Share Price	28.87
Current Share Price (3/26/2024)	18.88
Upside/Downside	53%

Sensitivity Table

	28.87	6.4x	8.4x	10.4x	12.4x	14.4x
Discount Rate	8%	19.46	25.74	32.03	38.31	44.60
	9%	18.40	24.40	30.41	36.41	42.41
	10%	17.40	23.14	28.87	34.60	40.34
	11%	16.45	21.93	27.41	32.89	38.38
	12%	15.55	20.79	26.03	31.27	36.51

	Low End	Median	High End
Share Price Range	21.93	28.87	36.41
Current Share Price (3/26/2024)	18.88	18.88	18.88
Share Upside	16%	53%	93%

Risks

Risks

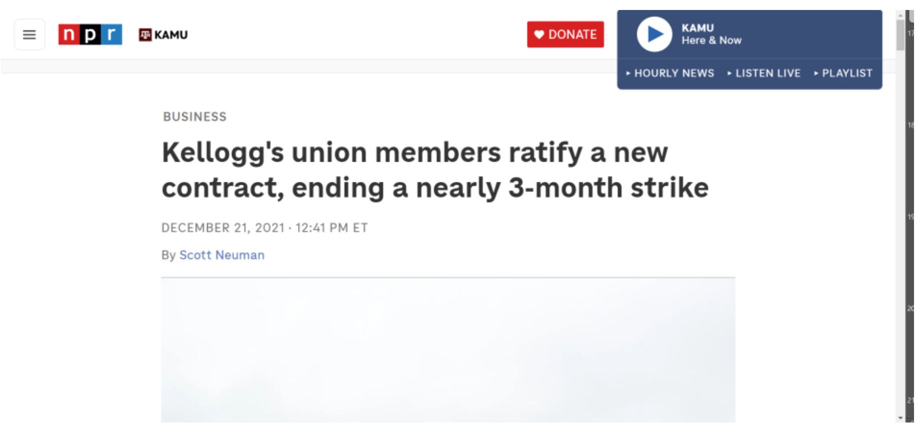
Threat of Unions to Company Cost Cutting Measures

- The company has recently faced off with unions in October 2021 over terms and conditions related to payment and benefits
- In the situation, the union successfully negotiated pay raises and benefits for the 1400 workers, such as not allowing plants to shut down for two years (until October 2026) and increases in pensions
- The agreement to not shut down makes sense, given the company announcement in September 2021 to ship jobs to their Canadian factory to cut costs by 20M
- Situations such as these could raise costs and hinder company production progress if something like happens again

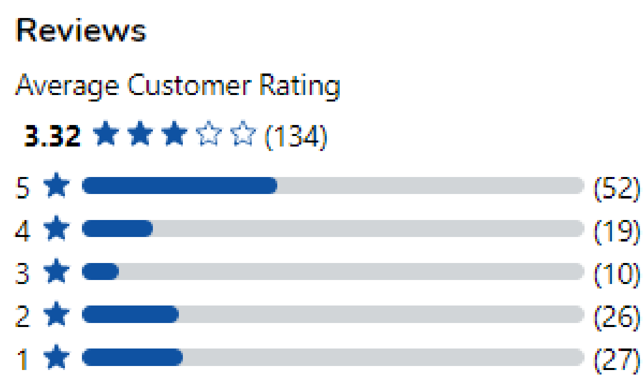
The Company's New Cereal Brands May Not Succeed

- As part of the company's plan, in addition to leverage their existing brand of cereals and applying them to snack occasions, the company also has been working to develop new cereal that target markets focused on health
- This includes the new Kashi Smoothie Cereal, as well as their Eat Your Mouth Off Cereal (Zero Sugar, High Protein, Low Carb)
- However, the Eat Your Mouth Off Cereal has been a major flop, as seen below
- According to Kroger, the cereal had an average rating of 3.32 stars out of 5 stars (134 people total reviewed it)

Snapshot of NPR Headline of Company Strike



Distribution of Ratings



Appendix

Appendix (Why the Company ROIC Terrible in 2022)

Inflationary pressures. Events such as the COVID-19 pandemic have resulted in certain impacts to the global economy, including market disruptions, supply chain challenges, and inflationary pressures. Like the rest of the industry and economy, the Company experienced a sharp increase in input costs beginning in 2021, ranging from ingredients and packaging to energy, freight, and labor. The increase in input costs has persisted through our fiscal year 2022 and into our fiscal year 2023. The Company mostly offset the dollar impact of this input-cost inflation through the execution of productivity initiatives and the implementation of revenue growth management actions to realize price. In addition to input-cost inflation, the industry and economy also experienced widespread bottlenecks and shortages of labor and materials, creating substantial inefficiencies and incremental costs. For the Company, these inefficiencies and costs had a significant impact on profit margins in the first half of 2021. In the second half of 2021, the bottlenecks and shortages were supplanted by a significant Company-specific interruption in production, first because of a fire that temporarily shut down one of our U.S. plants, and then by a three-month labor strike in all four of our U.S. plants. The fire and strike combined to negatively impact results through depleted inventory, lost net sales, lost fixed-cost absorption, and incremental costs during the second half of 2021 and into the first quarter of 2022, though such negative impacts were partially offset by curbed commercial investment and reduced overhead.

Company Overview

Business Description

- Cheniere Energy, Inc. is an energy infrastructure company headquartered in Houston that specializes in LNG liquefaction and regasification
- Cheniere Energy, Inc. is the largest producer of LNG in the United States
- Operates the Sabine Pass LNG facility as well as the Corpus Christi LNG facility
- Over 3,070 cumulative LNG cargoes have been produced and exported from their LNG facilities, and they have been delivered to 39 markets around the globe

Historic Stock Price

Facilities and Pipelines

- The Sabine Pass Liquefication facility has been in service since 2016 and has a production capacity of ~30 mtpa
- The Corpus Christi Liquefication facility has been in service since 2019 and has a production capacity of ~15 mtpa
- The Creole Trail Pipeline connects the Sabien Pass LNG facility with several interstate gas pipelines
- The Corpus Christi Pipeline connects the Corpus Christi LNG facility with several interstate and intrastate natural gas pipelines
- Cheniere has an equity investment in the Midship Pipeline, which connects gas production from the Anadarko Basin to Gulf Coast and Southeast markets

Key Stats

Market Cap: 40.9B	LTM Revenue: 24.5B
Enterprise Value: 67.5B	LTM EBITDA: 21.0B
LTM EV/EBITDA: 3.2x	Net Debt/EBITDA: 1.1x
P/E: 3.4x	Beta 5Y: 0.97