Amid turmoil, Big G still making dough

By MATT McKINNEY, Star Tribune
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It seems only logical that a food company such as General Mills would suffer in this year of rising food and energy costs.

Just as it costs more to heat your home and stock your pantry, it costs Big G more to make a Cheerio and to ship it to market. And yet, except for a slide late last year that lasted halfway into January, General Mills stock has gone on a healthy tear, now trading at all-time highs around $67 a share.

The stock is what long-term investors dream of: a largely unblemished upward climb over decades.

And so far, the Golden Valley-based company has managed to avoid the pitfalls of other food companies. Last week, ConAgra Foods cut its earnings forecast to something slightly less than the June estimate of 26 to 28 cents a share. The reason: higher costs have shredded profit in the company's consumer foods segment, especially cooking oils, table spreads, frozen foods and popcorn. Shares slid 7 percent the day of the announcement.

And even Austin, Minn.-based Hormel Corp., which had managed to cope with rising corn and feed costs, finally succumbed to the high prices last month. Its stock is off 15 percent since mid-May.

Is General Mills, which reports first-quarter numbers Sept. 17, headed for its own hiccup? Analysts don't seem to think so.

The company holds the No. 1 or No. 2 position in a broad cross-section of shelf-stable and refrigerated and frozen food brands, with the top-selling dry dinner mixes, fruit snacks and refrigerated dough. It owns strong brands such as Wheaties, Cheerios, Nature Valley Granola Bars, Pillsbury, Yoplait and Progresso Soups. The company has also escaped some of the pain of the meat industry, where skyrocketing feed costs have made it nearly impossible to sell pork, beef and chicken at a profit.

And it's been buttressing strong growth at home with large jumps abroad. Its most recent fiscal year ended with sales of $13.65 billion, a 9.7 percent gain over the previous year. Earnings grew 13 percent, to $1.3 billion. And its international segment, although not the largest piece of the company, grew by 21 percent.

Citigroup, which has had a "buy" rating on General Mills shares since January, once again recommended the stock last month in a note covering some of the best performers in the food industry.

And Rick Shea, a former food company executive who runs Shea Marketing and Consulting in Chanhassen, said the company's struggles with ingredient costs and energy may be easing as commodity prices fall back from their highs.

Food companies can bat down costs in three ways, Shea said. The first, raising prices, was how General Mills managed about 70 percent of its cost inflation over the past 12 months, including last year's "Right Size, Right Price" initiative that shrank cereal boxes, making the product more expensive per ounce.

That's a simple, if risky, maneuver to wrestle with rising costs. The more complicated one has seen the company embark on a top-to-bottom search for ways to save money in its operations. Distribution, shipping and manufacturing costs all have gone under a microscope, and in some cases employees have been let go.

For example, an Old El Paso plant in Poplar, Wis., was closed and the work shifted to another facility, with 113 employees getting severance checks. The company also exited the frozen waffle business, closing the 111-employee plant in Allentown, Pa. A frozen dough plant in Trenton, Ohio, was closed, with 470 employees let go. And just last month, General Mills sold its Pop Secret popcorn business to Diamond Foods for $190 million.

And there's marketing and advertising, an area that has had aggressive spending this year. The company reported a 13 percent gain in marketing investment in its fiscal year ended May 25, the biggest jump in that area in at least five years.

"One of General Mills' strengths is [that] they have critical mass," Shea said, adding that the company can circulate ads that promise a few dollars off to anyone who buys 10 General Mills products. Some customers will do that, because there's such a wide variety of products to choose from.

"It's called pantry-loading. General Mills, Kellogg's, Kraft -- the larger companies with big portfolios of products can do that," Shea added.

The other side of this has been the consumer, ever more wary of spending money on gasoline and eating out. That's been a boon to discount supermarkets and a bust for casual-dining restaurants.

"A lot of people are not eating out as much," said Tim Kenyon, senior market analyst at GfK Custom Research in New York, which recently published a study about consumer food behavior. And not everyone's buying the cheapest food on the supermarket shelf, meaning generics won't make as much headway on the name brands in General Mills' portfolio, he said.

"They may actually be willing to spend a little more on the nicer products because they know they're not going out as much."

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