



Tootsie Roll Industries (TR)

Updated April 18th, 2018 by Josh Arnold

Key Metrics

Current Price: \$30	5 Year CAGR Estimate: 2.0%	Quality Percentile: N/A
Fair Value Price: \$28	5 Year Growth Estimate: 2.5%	Momentum Percentile: N/A
% Fair Value: 109%	5 Year Valuation Multiple Estimate: -1.7%	Total Return Percentile: N/A
Dividend Yield: 1.2%	5 Year Price Target: \$31	Valuation Percentile: N/A

Overview & Current Events

Tootsie Roll Industries (TR) traces its roots back to the late 1890's and its signature product, the Tootsie Roll. The company has grown into a much wider variety of candy and gum products through R&D and acquisitions, and today sports a market cap of just over \$2 billion. Revenue has fallen in recent years but should still clear \$500 million in 2018.

TR's recent Q4 report looked much like its other earnings releases in recent years, characterized by flat revenue and flat earnings. The company's controlling family hasn't chased growth the way that most companies do and thus, while revenue has drifted lower over time, EPS has struggled to move higher. A lower tax rate did help enormously in Q4.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	\$0.52	\$0.73	\$0.74	\$0.62	\$0.75	\$0.88	\$0.93	\$0.99	\$1.02	\$0.93	\$1.02	\$1.15
DPS	\$0.24	\$0.24	\$0.25	\$0.26	\$0.33	\$0.27	\$0.28	\$0.25	\$0.34	\$0.34	\$0.36	\$0.44

TR's EPS has bounced around in the past decade but over time, the trend is clearly higher. The company's performance during the Great Recession was actually fairly strong given that it sells discretionary items, but growth has been hard to come by. We are forecasting 2.5% annual growth for the next five years, although growth will likely not be linear.

TR will achieve this growth mostly via small amounts of revenue growth driven by product innovation, as well as its share repurchase program. TR has broadened its assortment in recent years to spinoffs of its core brands in candy and gum in addition to gradual increases in volume for its existing lineup. Changes to EPS growth include commodity costs to the downside and acquisitions to the upside. It has been many years since TR did a large acquisition but management has shown it is willing and able to do so when the time is right. This year will be helped along by a lower tax rate as well, so TR has a head start on EPS growth in 2018 in addition to what it can muster from revenue growth and buybacks.

The dividend should continue to grow in the low single digits as growth in the cash dividend has never really been a priority for management; this is not a stock to buy solely for dividend growth or current yield.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	36.5	24.9	27.6	35.2	27.5	30.3	27.5	29.5	33.1	27.6	29.4	27.0
Avg. Yld.	1.2%	1.3%	1.2%	1.2%	1.6%	1.0%	1.1%	0.8%	1.0%	1.0%	1.2%	1.4%

TR's valuation has long been very high despite its growth struggles and that condition persists today. With the PE multiple near 30, we are forecasting a slight decline back towards the lower end of its historical range at 27 in the next five years. The reason is that TR's growth numbers simply don't justify anything close to its current valuation, but investors have assigned TR sky-high multiples for many years, perhaps waiting for a potential sale of the company. This would represent a 1.7% headwind annually to total returns, nearly offsetting TR's projected EPS growth.

The yield should move up a bit as the valuation declines while the payout rises in the coming years, producing a 1.4% yield against the current level of 1.2%. Again, this is not a high-income or high-growth dividend stock, so the payout is likely not why investors buy it. TR does pay a 3% stock dividend each year that can be sold to create a higher dividend, but on a cash basis, TR is somewhat lacking as a dividend stock despite its Dividend King status.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	32.9%	36.3%	33.1%	31.5%	33.6%	35.5%	37.3%	37.1%	38.6%	37.3%	37.0%	37.0%
Debt/A	22%	22%	22%	22%	23%	23%	24%	23%	23%	21%	21%	21%
Int. Cov.	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Payout	45%	33%	34%	42%	45%	23%	30%	31%	33%	37%	35%	38%
Std. Dev.	42.5%	24.3%	19.3%	26.2%	18.8%	20.4%	17.6%	21.3%	21.3%	17.0%	20.0%	22.0%

TR's quality metrics have been remarkably stable in the past decade, owed to management's propensity to stick with the status quo instead of chasing growth. Margins have deteriorated slowly in the past couple of years due to higher packaging and commodity costs in addition to more recent pricing pressure from retailers, but the damage has been limited. Its balance sheet is very clean as its only debt is in trade payables that carry no interest and thus, its interest coverage is not meaningful. TR is very well-financed and unless it completes a sizable acquisition, that won't change.

We are forecasting the payout ratio to rise slightly in the coming years as dividend growth outpaces EPS growth, but the change is minimal and well within a margin of safety. TR's competitive advantage is in its core product, the Tootsie Roll, and its lack of direct competition given the uniqueness of the product. TR also enjoys relationships with a robust lineup of distributors and retailers, meaning it isn't beholden to a small concentration of customers. This afforded it decent performance during the Great Recession despite the fact that it sells discretionary items.

Final Thoughts & Recommendation

Overall, TR looks like it is trading in excess of fair value due to low projected growth. We are forecasting total annual returns of just 2%, comprised of 2.5% EPS growth, a 1.2% yield and 1.7% headwind from the valuation drifting lower. TR's revenue growth and share repurchases should buoy EPS but this is not a growth stock. Given its valuation, it is also not a value stock and with a yield just over 1%, it also doesn't qualify as an income stock. It is therefore unattractive at this price and wouldn't be suitable for investors seeking growth, value or a high current yield. Those wanting to own TR should wait for more favorable prices as the total return outlook from here is unattractive.

Total Return Breakdown by Year

