



Tootsie Roll Industries (TR)

Updated August 3rd, 2018 by Josh Arnold

Key Metrics

Current Price: \$29	5 Year CAGR Estimate: 2.3%	Volatility Percentile: 17.5%
Fair Value Price: \$28	5 Year Growth Estimate: 2.5%	Momentum Percentile: 8.4%
% Fair Value: 107%	5 Year Valuation Multiple Estimate: -1.4%	Valuation Percentile: 50.0%
Dividend Yield: 1.2%	5 Year Price Target \$31	Total Return Percentile: 11.0%

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.

Q2 earnings were released on 7/25/18 and results were characteristically weak. Revenue was up 1% and earnings-per-share fell from 18 cents to 16 cents. Management said the slight improvement in Q2 was due to the shifting of sales last year from Q2 to Q3, meaning this year's Q2 would have produced a decline in sales on a normal comparable year. That further implies Q3 is going to be weak as that shift reverses and makes Q3's comparable sales more challenging to reach. In addition, the company continues to struggle with product mix and input costs deteriorating its margins, and we continue to see weak growth ahead.

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

Tootsie Roll's earnings-per-share have been volatile 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. We are forecasting 2.5% annual growth for the next five years, although growth will likely not be linear.

Tootsie Roll will achieve this growth mostly via small amounts of revenue growth driven by product innovation, in addition to its share repurchase program. Tootsie Roll 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 earnings-per-share growth include commodity costs to the downside and acquisitions to the upside. It has been many years since Tootsie Roll completed 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 it has a head start on earnings growth in 2018 in addition to what it can muster from revenue growth and buybacks. Still, margins are a significant concern.

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	28.9	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%

Tootsie Roll's valuation has long been very high despite its growth struggles and that condition persists today. With the price-to-earnings 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. This represents a 1.4% headwind annually to total returns, nearly offsetting projected earnings growth. The payout should see the yield rise from 1.2% today to 1.4%, but this is not an income stock. The 3% annual stock dividend helps but on a cash basis, Tootsie Roll is lacking from a payout perspective.

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

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%

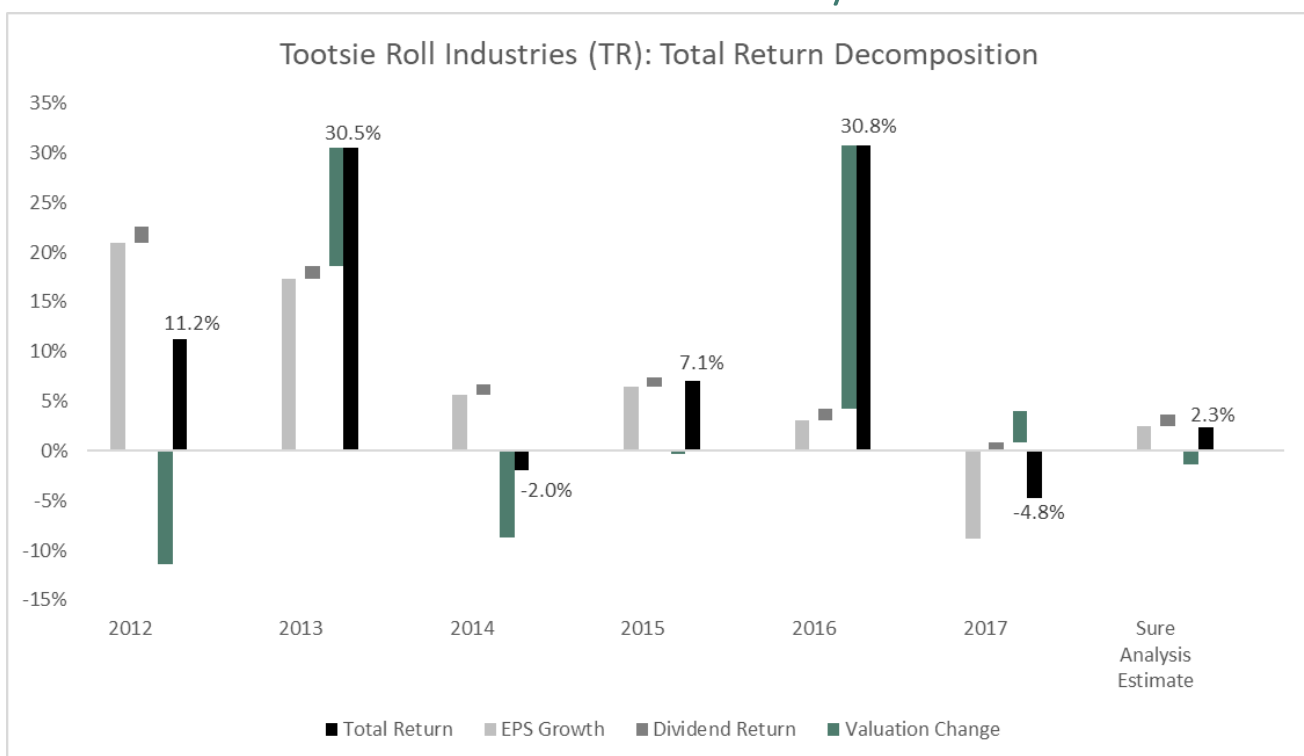
Tootsie Roll's quality metrics have been remarkably stable in the past decade, owed to management's propensity to stick with the status quo instead of chasing growth. Margins have deteriorated slowly in the past couple of years due to higher packaging and commodity costs in addition to more recent pricing 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 measurable. This company is very well-financed and that should not change. We are forecasting the payout ratio to rise slightly in the coming years as dividend growth outpaces earnings growth, but the change is minimal and well within a margin of safety.

The company's competitive advantage is in its core product, the Tootsie Roll, and its lack of direct competition given the uniqueness of the product. Tootsie Roll 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, Tootsie Roll is trading in excess of fair value due to low projected growth. We are forecasting total annual returns of just 2.3%, comprised of 2.5% earnings growth, a 1.2% yield and 1.4% headwind from the valuation drifting lower. Revenue growth and share repurchases should buoy earnings-per-share, 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. Given all of these factors, Tootsie Roll earns a strong sell recommendation from Sure Dividend at current prices.

Total Return Breakdown by Year



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