



Tootsie Roll Industries (TR)

Updated November 12th, 2018 by Josh Arnold

Key Metrics

Current Price:	\$33	5 Year CAGR Estimate:	0.9%	Volatility Percentile:	21.2%
Fair Value Price:	\$28	5 Year Growth Estimate:	3.3%	Momentum Percentile:	37.6%
% Fair Value:	120%	5 Year Valuation Multiple Estimate:	-3.5%	Growth Percentile:	16.1%
Dividend Yield:	1.1%	5 Year Price Target	\$32	Valuation Percentile:	24.3%
Dividend Risk Score:	A	Retirement Suitability Score:	C	Total Return Percentile:	6.2%

Overview & Current Events

Tootsie Roll Industries traces its roots back to the late 1890's when its signature product, the Tootsie Roll, was first created. The company has grown into a much wider variety of candy and gum products through R&D and acquisitions, and today sports a market capitalization of \$2.2 billion. Revenue has fallen in recent years but should still clear \$500 million in 2018. Tootsie Roll Industries has increased its dividend for a remarkable 52 consecutive years.

Tootsie Roll reported Q3 earnings on 11/9/18 and results were largely in line with expectations. Total revenue fell 0.4% during the quarter, roughly congruent with the 0.6% year-to-date decline in the top line. Management said timing of certain shipments caused the small revenue decline year-over-year. In general, Tootsie Roll's revenue has been flat year-over-year, and Q3 certainly fit that description. Where the company did see some declines was with margins as it continues to grapple with freight and other costs. Tootsie Roll saw adjusted cost of goods sold move up 150bps to 64% of revenue due to quality improvements in packaging as well as the start-up costs of new manufacturing lines.

Additional freight expense is a common problem among all sorts of companies today due to low trucking capacity, and Tootsie Roll continues to see cost increases as a result. In addition, higher manufacturing overhead costs contributed to lower margins, as did wages and benefits. None of these factors alone contributed significantly to margin deterioration, but together, it caused the company's margins to fall at a time when revenue declined slightly as well.

Further, SG&A costs rose significantly thanks to a one-time charge from the company's deferred compensation program. This was in excess of \$2 million but is not an operational item and thus, we do not believe it will be a recurring problem in the future. However, the company did boost marketing spending during the quarter, which also contributed negatively to operating margins. In total, operating income decline almost 13% but a lower tax rate kept earnings-per-share at 41 cents, a one penny decline from last year's Q3. As a result of a largely in-line Q3 report – excluding the deferred compensation charge – we're reiterating our estimate of \$1.02 in earnings-per-share for 2018.

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	\$1.20
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
Shares	74	73	72	71	70	69	68	66	66	65	64	60

Tootsie Roll should achieve 3.3% forecasted growth moving forward, 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. Influences 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.

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. However, the company does issue a 3% stock dividend each year in addition to the modest cash dividend.

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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	32.3	27.0
Avg. Yld.	1.2%	1.3%	1.2%	1.2%	1.6%	1.0%	1.1%	0.8%	1.0%	1.0%	1.1%	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 at 32.3, we are forecasting a decline back towards the lower end of its historical range at 27 in the next five years. This represents a 3.5% headwind annually to total returns, offsetting projected earnings growth. The payout should see the yield rise from 1.1% today to 1.4%, but this is not an income stock.

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%	36.7%	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%	37%
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%

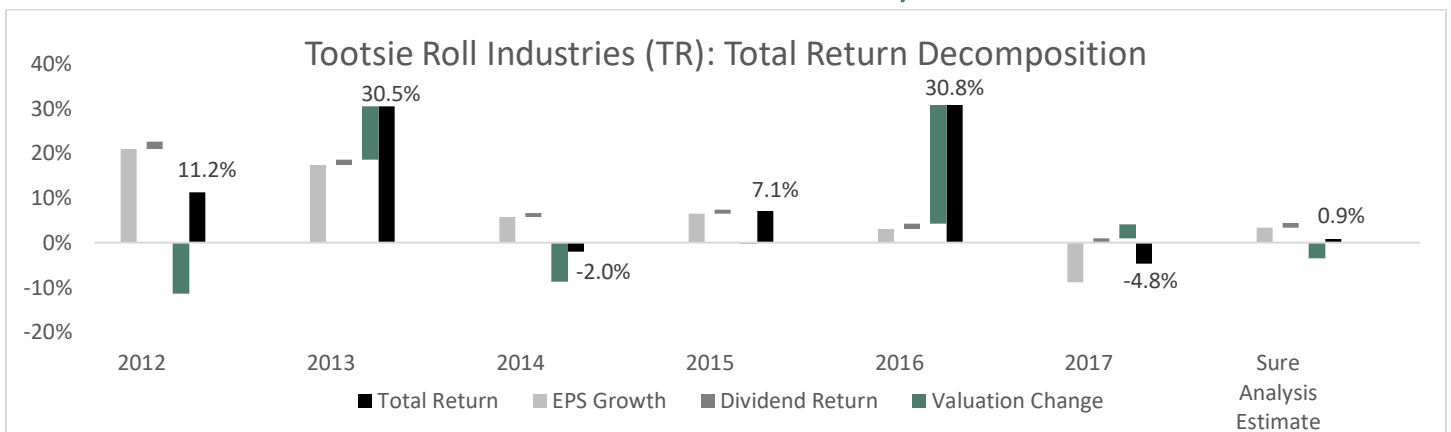
Tootsie Roll's quality metrics have been remarkably stable in the past decade, owed to management's propensity to stick with the status quo instead of chasing growth. Margins have deteriorated slowly in the past couple of years due to higher packaging and commodity costs in addition to more recent pricing 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.

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. This afforded it decent performance during the Great Recession.

Final Thoughts & Recommendation

Overall, Tootsie Roll is trading well in excess of fair value due to low projected growth. We are forecasting total annual returns of just 0.9%, comprised of 3.3% earnings growth, a 1.1% yield and 3.5% headwind from the valuation drifting lower. It is therefore unattractive at this price and would be suitable for investors seeking growth, value or a high current yield. Tootsie Roll earns a strong sell recommendation from Sure Dividend at current prices.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Revenue	496	499	521	533	550	543	544	540	521	519
Gross Profit	162	180	171	166	183	191	202	199	200	192
Gross Margin	32.6%	36.0%	32.8%	31.2%	33.3%	35.2%	37.1%	36.9%	38.3%	37.0%
SG&A Exp.	95	104	106	108	114	119	118	108	107	121
D&A Exp.	17	18	18	19	20	20	21	20	20	19
Operating Profit	67	76	65	58	69	72	84	91	92	71
Operating Margin	13.4%	15.2%	12.4%	10.9%	12.6%	13.3%	15.4%	16.9%	17.7%	13.8%
Net Profit	39	54	53	44	52	61	63	66	68	81
Net Margin	7.8%	10.8%	10.2%	8.3%	9.5%	11.2%	11.6%	12.2%	13.0%	15.6%
Free Cash Flow	23	56	70	34	93	94	78	76	82	26
Income Tax	17	10	20	17	22	24	28	26	31	4

Balance Sheet Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Total Assets	814	838	860	858	847	888	910	909	920	931
Cash & Equivalents	69	91	116	79	64	88	100	126	119	96
Accounts Receivable	31	38	37	42	42	41	43	51	43	47
Inventories	56	56	59	72	62	62	70	62	58	55
Goodwill & Int. Ass.	262	248	248	248	248	248	248	248	248	248
Total Liabilities	179	183	191	192	197	208	219	210	209	197
Accounts Payable	14	9	10	11	9	9	12	11	10	12
Long-Term Debt	8	8	8	8	8	8	8	8	8	8
Shareholder's Equity	635	655	669	666	650	680	691	698	711	734
D/E Ratio	0.01	0.01	0.01	0.01	0.01	0.01	0.01	0.01	0.01	0.01

Profitability & Per Share Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Return on Assets	4.8%	6.5%	6.2%	5.1%	6.1%	7.0%	7.0%	7.3%	7.4%	8.7%
Return on Equity	6.1%	8.4%	8.0%	6.6%	7.9%	9.1%	9.2%	9.5%	9.6%	11.2%
ROIC	6.0%	8.3%	7.9%	6.5%	7.8%	9.0%	9.1%	9.4%	9.5%	11.1%
Shares Out.	74	73	72	71	70	69	68	66	66	65
Revenue/Share	6.67	6.83	7.23	7.49	7.85	7.87	7.98	8.05	7.89	7.98
FCF/Share	0.31	0.77	0.97	0.48	1.32	1.36	1.15	1.13	1.25	0.40

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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