The Hershey Company (HSY)

Updated August 16th, 2019 by Eli Inkrot

Key Metrics

Current Price:	$156	**5 Year CAGR Estimate:**	0.8%	**Volatility Percentile:**	22.7%
Fair Value Price:	$108	**5 Year Growth Estimate:**	6.0%	**Momentum Percentile:**	98.9%
% Fair Value:	145%	**5 Year Valuation Multiple Estimate:**	-7.2%	**Growth Percentile:**	54.2%
Dividend Yield:	2.0%	**5 Year Price Target**	$144	**Valuation Percentile:**	9.5%
Dividend Risk Score:	C	**Retirement Suitability Score:**	D	**Total Return Percentile:**	8.5%

Overview & Current Events

The Hershey Company, founded in 1894, is a chocolate and sugar confectionary products manufacturer that sells major brands such as Hershey's, Reese's, Kisses, Cadbury, Ice Breakers, Kit Kat, Almond Joy, Jolly Rancher, Twizzlers, Heath and Milk Duds. Hershey operates in North America as well as internationally. The company is headquartered in Hershey, PA and trades with a market capitalization of $33 billion.

On July 25th, 2019 Hershey reported Q2 2019 results for the period ending June 30th, 2019. For the quarter the company generated consolidated net sales of $1.767 billion, representing a 0.9% increase compared to Q2 2018 as net price realizations and volumes were both higher during the period. The North America segment (89% of sales) saw a 0.5% gain in revenue. Reported net income came in at $312.8 million or $1.48 per share, representing a 37% increase. On an adjusted basis, earnings-per-share came in $1.31, a 14.9% improvement compared to the year ago period.

Hershey also updated its full-year 2019 outlook. For the year the company now anticipates sales increasing 2% (from a 1% to 3% range previously). Reported earnings-per-share are expected to be in the $5.54 to $5.66 range, while adjusted earnings-per-share are now expected to increase 6% to 7% (at the higher end of 5% to 7% previous guidance).

In addition, Hershey announced a quarterly dividend of $0.773, representing a 7.1% increase and the 359th consecutive dividend paid on the common stock.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	$2.17	$2.55	$2.82	$3.24	$3.72	$3.98	$4.12	$4.41	$4.76	$5.36	***$5.68***	***$7.60***
DPS	$1.19	$1.28	$1.38	$1.56	$1.81	$2.04	$2.24	$2.40	$2.55	$2.76	***$3.09***	***$3.80***
Shares[1]	228	227	225	224	224	221	217	212	211	210	***211***	***205***

Hershey has recorded both strong and consistent growth over the last decade, with earnings-per-share growing every year since 2008. Since 2007 the earnings-per-share growth rate has come in at an average of 7.2% per annum.

Hershey's earnings-per-share growth stems from several factors. The first one is organic revenue growth, which Hershey has managed to achieve despite the public becoming more conscious about healthy eating habits over the last decade. The company has also been able to improve its margins throughout the last decade. Hershey owns well-recognized brands, so pricing increases have not been a headwind as it relates to increasing volumes of its products. Hershey has also been repurchasing its shares relatively consistently over the last couple of years, which has added some additional growth to the company's earnings-per-share, above the already solid net earnings growth rate. In 2018 Hershey's earnings-per-share growth was above the long-term average, but that is primarily due to the impact of a lower tax rate and the effect of the Amplify acquisition, which was responsible for the majority of the company's revenue growth. In early 2019 Hershey has been able to grow its top line as well, but not at an overly strong pace. We believe that Hershey has the potential to grow by 6% annually over the intermediate-term.

Since 2008 Hershey has raised its dividend right around 10% annually. Moving forward we would expect this rate of growth to slow somewhat, and track earnings-per-share growth closely.

1: In millions.

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.

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Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	16.9	17.9	19.8	20.9	24.2	24.5	23.0	21.9	22.8	18.8	***27.5***	***19.0***
Avg. Yld.	3.2%	2.8%	2.5%	2.3%	2.0%	2.1%	2.4%	2.5%	2.3%	2.7%	***2.0%***	***2.6%***

During the past decade shares of Hershey have traded hands with an average P/E ratio of about 21 times earnings. While we believe a premium multiple is warranted, we are more cautious – using 19 times earnings as a starting place – given the reduced growth expectations. With shares up meaningfully as of late, now trading around 27.5 times our estimate of this year's earnings, this could imply a substantial valuation headwind in the years to come.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	55%	50%	49%	48%	49%	51%	54%	54%	54%	51%	***54%***	***50%***

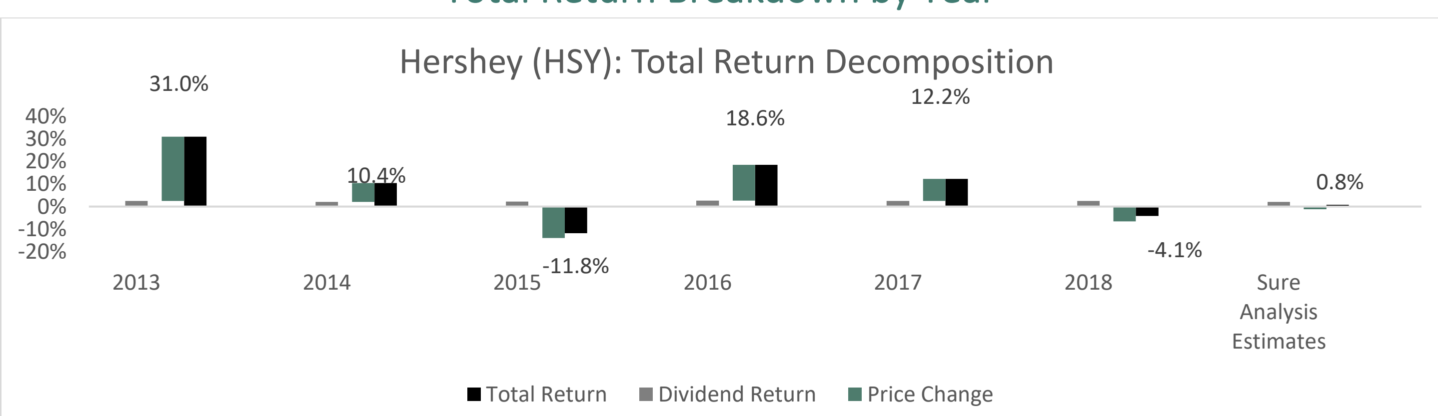
Hershey's dividend payout ratio has moved in a very narrow range throughout the last decade. The company has paid out marginally more than half of its net profits in the form of dividends throughout the majority of those years. The stability of the payout ratio even during the last financial crisis, coupled with the fact that the payout ratio is not overly high on an absolute basis, makes us believe that Hershey's dividend is relatively safe.

Hershey is one of the top chocolate and confectionary companies in the world, and it controls iconic brands that are ubiquitous to consumers. Competition is not a terrific problem for the company, but if customers became more health-conscious, that could hurt the growth rate for the whole industry. Customers do not tend to cut back on chocolate when the economy is weak, which is why Hershey is not vulnerable to recessions. During the last financial crisis – an especially severe recession – the company managed to increase both its profits and its sales, although the dividend was frozen.

Final Thoughts & Recommendation

Shares are up 21% since our last update, while earnings expectations are more or less unchanged. Hershey is a top chocolate company, and it has generated highly attractive earnings and dividend growth during the past. On top of that, Hershey is not especially vulnerable to recessions, which makes the company's shares a viable choice for risk-averse investors. However, the total return potential of just 0.8% - stemming from 6% growth and a 2% starting dividend offset by a potential -7.2% valuation headwind – does not look compelling. We are enthused by the quality of the business, but believe the valuation will significantly hinder an investment thesis from this point. This view could be too conservative if shares continue to command a high-20's multiple, but we are not ready to make that speculation and rate shares a sell.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	5299	5671	6081	6644	7146	7422	7387	7440	7515	7791
Gross Profit	2053	2415	2532	2860	3281	3336	3383	3170	3455	3575
Gross Margin	38.7%	42.6%	41.6%	43.0%	45.9%	45.0%	45.8%	42.6%	46.0%	45.9%
SG&A Exp.	1209	1426	1478	1704	1924	1898	1969	1891	1885	1875
D&A Exp.	182	197	216	210	201	212	245	302	262	295
Operating Profit	844	989	1054	1156	1357	1438	1413	1278	1570	1700
Operating Margin	15.9%	17.4%	17.3%	17.4%	19.0%	19.4%	19.1%	17.2%	20.9%	21.8%
Net Profit	436	510	629	661	820	847	513	720	783	1178
Net Margin	8.2%	9.0%	10.3%	9.9%	11.5%	11.4%	6.9%	9.7%	10.4%	15.1%
Free Cash Flow	920	700	240	817	840	474	900	744	992	1271
Income Tax	235	299	334	355	431	459	389	379	354	239

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets	3675	4273	4407	4755	5357	5623	5344	5524	5554	7703
Cash & Equivalents	254	885	694	728	1119	375	347	297	380	588
Accounts Receivable	410	390	399	461	478	597	599	581	588	594
Inventories	520	534	649	633	660	801	751	746	753	785
Goodwill & Int. Ass.	697	647	629	803	828	1151	1132	1400	1295	3206
Total Liabilities	2915	3335	3526	3706	3741	4103	4297	4697	4622	6296
Accounts Payable	288	411	420	442	462	482	474	523	523	502
Long-Term Debt	1542	1827	1888	1907	1962	2178	2421	2980	2920	4458
Shareholder's Equity	720	902	857	1037	1605	1455	998	786	915	1399
D/E Ratio	2.14	2.03	2.20	1.84	1.22	1.50	2.43	3.79	3.19	3.19

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	11.9%	12.8%	14.5%	14.4%	16.2%	15.4%	9.4%	13.2%	14.1%	17.8%
Return on Equity	84.0%	62.8%	71.5%	69.8%	62.1%	55.4%	41.8%	80.7%	92.1%	102%
ROIC	18.7%	20.1%	22.7%	23.1%	25.1%	23.3%	14.3%	19.8%	20.4%	24.2%
Shares Out.	228	227	225	224	224	221	217	212	211	210
Revenue/Share	23.14	24.62	26.45	29.10	31.45	33.01	33.48	34.56	35.16	36.93
FCF/Share	4.02	3.04	1.05	3.58	3.70	2.11	4.08	3.46	4.64	6.03

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

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