The Hershey Company (HSY)

Updated November 6th, 2020 by Eli Inkrot

Key Metrics

Current Price:	$150	**5 Year CAGR Estimate:**	3.4%	**Market Cap:**	$31 B
Fair Value Price:	$118	**5 Year Growth Estimate:**	6.0%	**Ex-Dividend Date:**	11/19/20
% Fair Value:	127%	**5 Year Valuation Multiple Estimate:**	-4.6%	**Dividend Payment Date:**	12/15/20
Dividend Yield:	2.2%	**5 Year Price Target**	$158	**Years Of Dividend Growth:**	11
Dividend Risk Score:	B	**Retirement Suitability Score:**	C	**Last Dividend Increase:**	4.0%

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 primarily operates in North America but has international operations as well. The company is headquartered in Hershey, PA and trades with a market capitalization of $31 billion.

On November 6th, 2020 Hershey reported Q3 2020 results for the period ending September 27th, 2020. For the quarter the company generated consolidated net sales of $2.220 billion, representing a 4.0% increase compared to Q3 2019, driven by improvements in price realization and volume. The North America segment (91% of sales) saw a 6.3% gain in revenue. Reported net income totaled $447.3 million or $2.14 per share, a 39% increase, while adjusted earnings-per-share equaled $1.86 compared to the $1.61 in last year's quarter, a 15.5% increase.

Prior to the pandemic Hershey provided a full-year 2020 outlook, anticipating sales to increase 2% to 4%, while adjusted earnings-per-share were expected to be in the $6.13 to $6.24 range. This guidance was withdrawn amid the uncertainty of the pandemic. However, in Q3 2020 a full-year outlook was reinstated. The company now anticipates sales to increase around 1% and adjusted EPS to be in the $6.18 to $6.24 range. We have updated our forecast accordingly.

In addition, Hershey announced a quarterly dividend of $0.804, making it the 364th consecutive dividend paid.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	$2.55	$2.82	$3.24	$3.72	$3.98	$4.12	$4.41	$4.76	$5.36	$5.78	***$6.21***	***$8.31***
DPS	$1.28	$1.38	$1.56	$1.81	$2.04	$2.24	$2.40	$2.55	$2.76	$2.99	***$3.22***	***$4.30***
Shares[1]	227	225	224	224	221	217	212	211	210	209	***210***	***210***

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 8.9% 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 to increasing volumes of its products. Hershey had also been moderately repurchasing its shares over the last couple of years, which has added some additional growth to the company's earnings-per-share. 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 2019 Hershey grew as well, but at a more typical level.

The COVID-19 pandemic is set to test all businesses, but we believe Hershey is set up well for nearly any environment. To this point, recent guidance has been encouraging, with results expected to be up 6.9% to 8.0% this year. We are forecasting 6% annual growth over the intermediate term.

[1] In millions.

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Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	17.9	19.8	20.9	24.2	24.5	23.0	21.9	22.8	18.8	23.2	***24.1***	***19.0***
Avg. Yld.	2.8%	2.5%	2.3%	2.0%	2.1%	2.4%	2.5%	2.3%	2.7%	2.2%	***2.2%***	***2.7%***

During the past decade shares of Hershey have traded hands with an average P/E ratio of about 22 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. However, the security presently trades around 24 times our estimated earnings for this year. If shares revert to a 19 multiple, this would imply a moderate valuation headwind.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	50%	49%	48%	49%	51%	54%	54%	54%	51%	52%	***52%***	***52%***

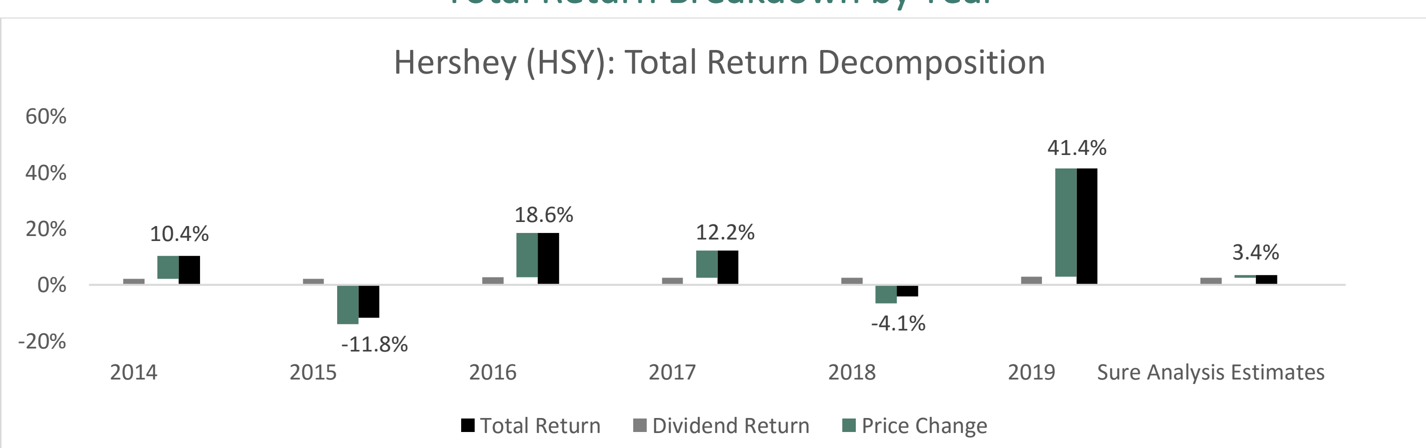
Hershey's dividend payout ratio has moved in a very narrow range throughout the last decade. The company has paid out marginally more than half of its net profits in the form of dividends throughout the majority of those years. The stability of the payout ratio even during the last financial crisis, 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, controlling 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 in lesser times, which is why Hershey is not as 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 slightly since our last report, while earnings expectations have improved. Hershey is a solid company, generating highly attractive earnings and dividend growth in 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 annual return potential of 3.4% per annum - stemming from 6% growth and a 2.2% starting dividend offset by a potential valuation headwind – does not look especially compelling. We are enthused by the quality of the business but believe the valuation could hinder an investment thesis from this point. This view could be too conservative if shares continue to command a mid-20's multiple, but we are not ready to make that speculation. We rate shares as a hold.

Total Return Breakdown by Year



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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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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	5,671	6,081	6,644	7,146	7,422	7,387	7,440	7,515	7,791	7,986
Gross Profit	2,415	2,532	2,860	3,281	3,336	3,383	3,170	3,455	3,575	3,622
Gross Margin	42.6%	41.6%	43.0%	45.9%	45.0%	45.8%	42.6%	46.0%	45.9%	45.4%
SG&A Exp.	1,426	1,478	1,704	1,924	1,898	1,969	1,891	1,885	1,875	1,906
D&A Exp.	197	216	210	201	212	245	302	262	295	---
Operating Profit	989	1,054	1,156	1,357	1,438	1,413	1,278	1,570	1,700	1,717
Operating Margin	17.4%	17.3%	17.4%	19.0%	19.4%	19.1%	17.2%	20.9%	21.8%	21.5%
Net Profit	510	629	661	820	847	513	720	783	1,178	1,150
Net Margin	9.0%	10.3%	9.9%	11.5%	11.4%	6.9%	9.7%	10.4%	15.1%	14.4%
Free Cash Flow	700	240	817	840	474	900	744	992	1,271	---
Income Tax	299	334	355	431	459	389	379	354	239	234

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	4,273	4,407	4,755	5,357	5,623	5,344	5,524	5,554	7,703	8,140
Cash & Equivalents	885	694	728	1,119	375	347	297	380	588	493
Accounts Receivable	390	399	461	478	597	599	581	588	594	569
Inventories	534	649	633	660	801	751	746	753	785	815
Goodwill & Int. Ass.	647	629	803	828	1,151	1,132	1,400	1,295	3,206	3,327
Total Liabilities	3,335	3,526	3,706	3,741	4,103	4,297	4,697	4,622	6,296	6,395
Accounts Payable	411	420	442	462	482	474	523	523	502	551
Long-Term Debt	1,827	1,888	1,907	1,962	2,178	2,421	2,980	2,920	4,458	4,266
Shareholder's Equity	902	857	1,037	1,605	1,455	998	786	915	1,399	1,745
D/E Ratio	2.03	2.20	1.84	1.22	1.50	2.43	3.79	3.19	3.19	2.45

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	12.8%	14.5%	14.4%	16.2%	15.4%	9.4%	13.2%	14.1%	17.8%	14.5%
Return on Equity	62.8%	71.5%	69.8%	62.1%	55.4%	41.8%	80.7%	92.1%	102%	73.1%
ROIC	20.1%	22.7%	23.1%	25.1%	23.3%	14.3%	19.8%	20.4%	24.2%	19.4%
Shares Out.	227	225	224	224	221	217	212	211	210	211
Revenue/Share	24.62	26.45	29.10	31.45	33.01	33.48	34.56	35.16	36.93	29.44
FCF/Share	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.