

The Hershey Co (HSY)

Earnings Update

Hold | Outperform

William Errett | February 14, 2024



Overview

Summary

Hershey's is a chocolate and other candy and snacks company that we added to our portfolio at the end of 2023. Hershey's has a wide moat with cost advantages that stem from the immense amount of volume that they produce each year as well as Intangible Assets that come from their iconic brand names such as Hershey's Chocolate and Reese's peanut butter cups.

Hershey's missed on revenue by 2.5% and beat on Earnings by over 3%. The revenue miss was primarily due to volume pressure and the beating in earnings was indicative of cutting costs during the quarter more than expected. Revenue for the quarter increased by 0.2% to \$2.7 Bn. 6.5% of this growth came from price increases across all product categories, there was also an average decline in volumes of 6.6% for the year. On a segment basis for the year North America Confectionary increased 2.1% in revenue, 7.2% was driven by price increases and a 5.1% decrease in volumes. North America Salty Snacks decreased by 24.6%, driven by a 1.5% price increase and 26.1% volume decline. And finally International grew 12.7% off 6.0% in price increases and 2.3% volume increases as well as 4.4% from favorable exchange rates.

Gross Margin was 42%, which was down 1% from the prior quarter 4. Operating profit finished at \$464 Mn which represented an operating margin of 17% which was down 2% from the previous quarter, this was primarily due to SG&A expansion. Net income finished at \$349 Mn which had a net margin of 13% which was also down by 2%. Earnings per share declined by 10% during the quarter as well.

Revenue for the year increased by 7.2% to \$11.1 Bn. 8.3% of this growth came from price increases across all product categories. There was also an average decline in volumes of 1.3% for the year. On a segment basis for the year North America Confectionary increased 6.9% in revenue, 9% was driven by price increases and a 1.9% decrease in volumes. North America Salty Snacks increased by 6.1%, driven by a 5.4% price increase and 70bps of volume growth. And finally International grew 11.2% off 4.7% in price increases and 3.1% volume increases as well as 3.4% from favorable exchange rates.

Hershey's guidance came below expectations. They are guiding for roughly 3% revenue growth, however, due to margin compression they expect earnings per share to be flat for the year. However, this is considering large one-time costs that they will undertake to reduce their workforce. Overall, this will impact the company by almost \$0.50 on their earnings for the year. And considering that this will lower costs for the business and provide easy comps for 2025 I expect the same 5-year CAGR for Earnings of 6%. This weak guidance is mostly due to a strained customer and the need for price increases due to the price of cocoa increasing.

Due to the small margin of safety of this business going into a level of uncertain growth for the business and having just added this to our portfolio I recommend that we hold the business. This is based on an average growth rate of 6.5% and a midline exit multiple of 24x earnings.

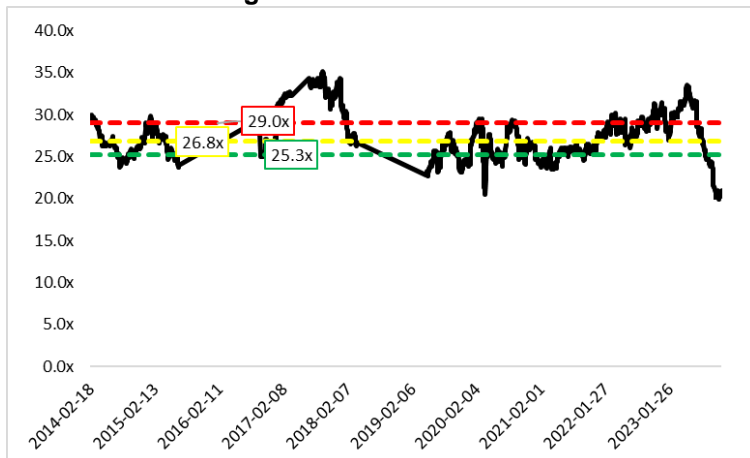
IOFS

Hershey's is almost a perfect IOFS company, the only metric that they fail is Capital Expenditures as a percentage of net income, which finished at 31.6%. Otherwise, I believe that the strong gross margins show Hershey's ability to pass on commodity inflation of cocoa to the consumer. This allows me to be relaxed and not worry about how the business will respond to record cocoa prices going forward.

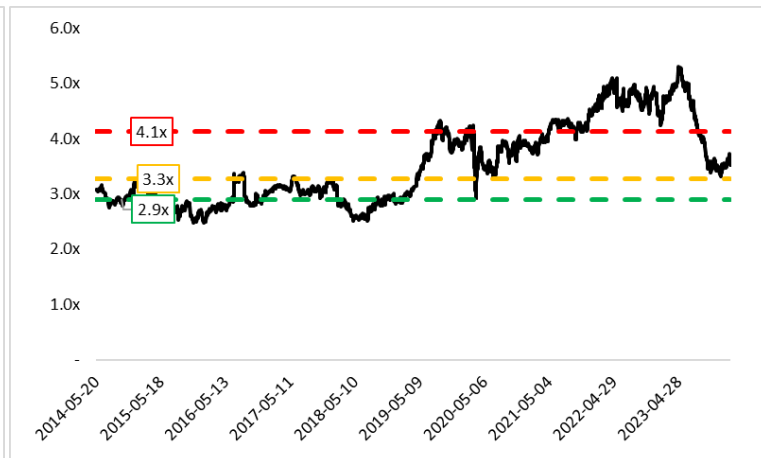
	2014-12	2015-12	2016-12	2017-12	2018-12	2019-12	2020-12	2021-12	2022-12	2023-12
IOFS										
Revenue	\$ 7,422	\$ 7,387	\$ 7,440	\$ 7,515	\$ 7,791	\$ 7,986	\$ 8,150	\$ 8,971	\$ 10,419	\$ 11,165
Gross profit	\$ 3,336	\$ 3,383	\$ 3,170	\$ 3,455	\$ 3,575	\$ 3,622	\$ 3,701	\$ 4,049	\$ 4,499	\$ 4,998
Operating Income	\$ 1,438	\$ 1,413	\$ 1,278	\$ 1,570	\$ 1,700	\$ 1,717	\$ 1,810	\$ 2,047	\$ 2,263	\$ 2,561
Net Income	\$ 847	\$ 513	\$ 720	\$ 783	\$ 1,178	\$ 1,150	\$ 1,279	\$ 1,478	\$ 1,645	\$ 1,862
EBIT	\$ 1,394	\$ 983	\$ 1,191	\$ 1,211	\$ 1,557	\$ 1,533	\$ 1,648	\$ 1,927	\$ 2,057	\$ 2,324
EBITDA	\$ 1,605	\$ 1,228	\$ 1,493	\$ 1,473	\$ 1,852	\$ 1,824	\$ 1,943	\$ 2,242	\$ 2,436	\$ 2,324
Dividend Yield %	1.96	2.5	2.32	2.24	2.57	2.03	2.07	1.76	1.66	2.39
Gross Margin	45.0%	45.8%	42.6%	46.0%	45.9%	45.4%	45.4%	45.1%	43.2%	44.8%
Operating Margin	19.4%	19.1%	17.2%	20.9%	21.8%	21.5%	22.2%	22.8%	21.7%	22.9%
Net Margin	11.4%	6.9%	9.7%	10.4%	15.1%	14.4%	15.7%	16.5%	15.8%	16.7%
SG&A/ Gross Profit	56.9%	58.2%	59.7%	54.6%	52.4%	52.6%	51.1%	49.4%	49.7%	48.8%
Capex/ Net Income	43.8%	69.6%	37.4%	32.9%	27.9%	27.7%	34.5%	33.6%	31.6%	0.0%
Dividend Payout ratio	184.8%	103.8%	71.9%	69.6%	49.4%	54.8%	51.6%	48.0%	48.7%	49.2%
Shares Outstanding	224.8	220.7	215.3	213.7	211.0	210.7	209.4	207.8	206.6	205.5
Returns %										
ROE	55.4	41.8	80.7	92.1	101.8	73.3	64.4	59.2	54.3	50.3
ROIC	26.5	19.2	19.3	24.4	25.5	21.2	22.9	21.3	20.5	22.2
ROCE	36.5	28.8	35.3	34.1	35.5	26.9	24.7	25.4	26.4	28.0
ROA	15.4	9.4	13.2	14.1	17.8	14.5	14.8	15.1	15.4	16.3
Leverage & Liquidity										
LT Debt	1542	1557	2347	2061	3254	3715	4272	4398	3639	3789
ST Debt	636	863	633	859	1203	732	508	942	1447	1025
PF Stock	0	0	0	0	0	0	0	0	0	0
Leases*7	0	0	0	0	0	233	290	254	223	0
Pension SF	#CALCULATION?									
Cash	\$ 375	\$ 347	\$ 297	\$ 380	\$ 588	\$ 493	\$ 1,144	\$ 329	\$ 464	\$ 402
Obligation Ratio (1)	2.1x	4.0x	3.7x	3.2x	3.3x	3.6x	3.1x	3.6x	2.9x	2.4x
Cash/ Revenue	5.1%	4.7%	4.0%	5.1%	7.5%	6.2%	14.0%	3.7%	4.5%	3.6%
Per Share Data										
Revenue	\$ 33.01	\$ 33.48	\$ 34.56	\$ 35.16	\$ 36.93	\$ 37.90	\$ 38.92	\$ 43.18	\$ 50.44	\$ 54.32
Earnings	\$ 3.77	\$ 2.32	\$ 3.34	\$ 3.66	\$ 5.58	\$ 5.46	\$ 6.11	\$ 7.11	\$ 7.96	\$ 9.06
Dividends	\$ 2.04	\$ 2.24	\$ 2.40	\$ 2.55	\$ 2.76	\$ 2.99	\$ 3.15	\$ 3.41	\$ 3.87	\$ 4.46
Book Value	\$ 6.58	\$ 4.60	\$ 3.70	\$ 4.34	\$ 6.67	\$ 8.33	\$ 10.73	\$ 13.38	\$ 16.10	\$ 20.05
Tangible Book Value	\$ 1.38	\$ (0.62)	\$ (2.90)	\$ (1.80)	\$ (8.62)	\$ (8.34)	\$ (5.94)	\$ (10.55)	\$ (7.78)	\$ (2.33)

Valuation

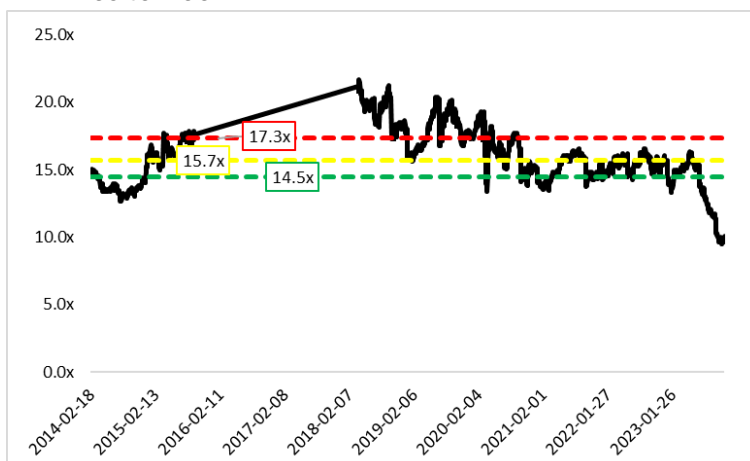
Price to Earnings



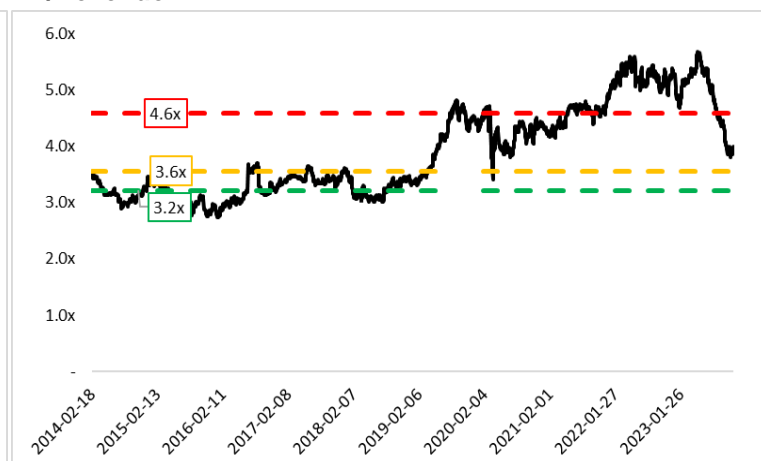
Price to Sales



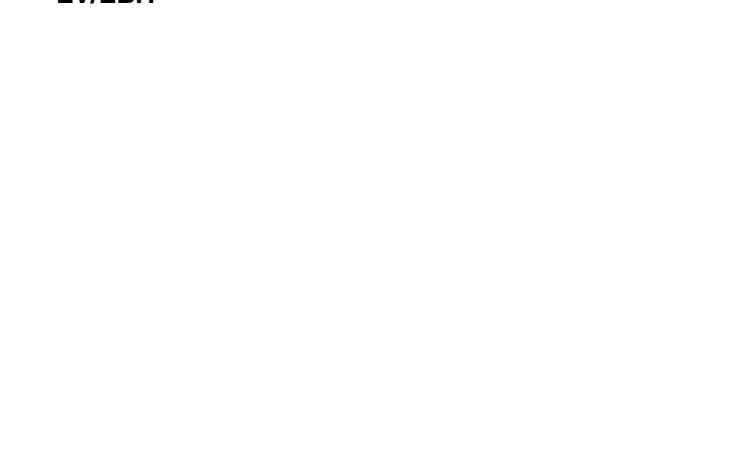
Price to Book



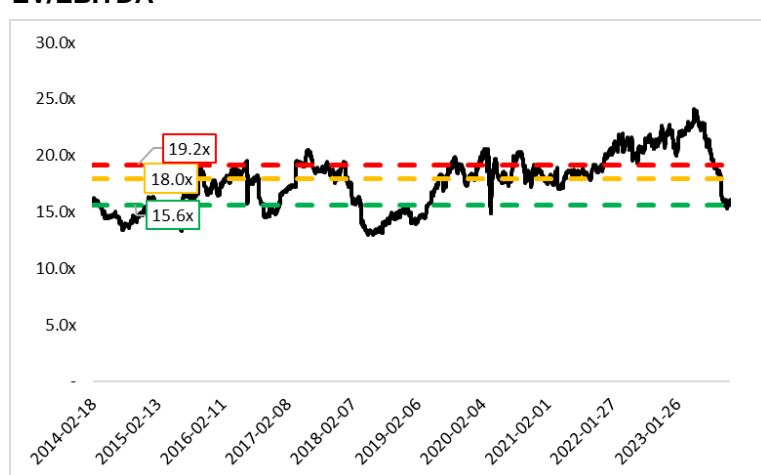
EV/Revenue



EV/EBIT



EV/EBITDA



When looking at several of Hershey's valuation metrics it is clear to see that they are trading at an almost unprecedented discount to what they usually do. This is partially due to lower expected short-term performance; however, we are long-term investors, we saw this as a great opportunity to buy a great wide-moat business.

For my valuation I used average growth rates of 6.5% and exit multiples ranging from 21x earnings to 27x earnings. This gives expected present values for the business ranging from \$185 a share to \$220 a share, giving a positive margin of safety and an outperform rating.

Ticker: HSY Price: \$191.21 5 Year EPS Model											
							P/E	Total Return Price	PV	5 YR Return	Annual Return
Bear		<u>Current</u>	<u>2024</u>	<u>2025</u>	<u>2026</u>	<u>2027</u>	<u>2028</u>	21.0x	\$260.37	\$164.63	36.2%
	EPS	\$9.06	\$8.88	\$9.77	\$10.26	\$10.77	\$11.31	24.0x	\$294.29	\$185.69	53.9%
			-2%	10%	5%	5%	5%	27.0x	\$328.20	\$206.75	71.6%
Base		<u>Current</u>	<u>2024</u>	<u>2025</u>	<u>2026</u>	<u>2027</u>	<u>2028</u>	21.0x	\$285.40	\$177.21	49.3%
	EPS	\$9.06	\$9.06	\$10.15	\$10.86	\$11.62	\$12.43	24.0x	\$322.69	\$200.36	68.8%
			0%	12%	7%	7%	7%	27.0x	\$359.98	\$223.52	88.3%
Bull		<u>Current</u>	<u>2024</u>	<u>2025</u>	<u>2026</u>	<u>2027</u>	<u>2028</u>	21.0x	\$312.34	\$193.94	63.4%
	EPS	\$9.06	\$9.24	\$10.53	\$11.48	\$12.52	\$13.64	24.0x	\$353.27	\$219.35	84.8%
			2%	14%	9%	9%	9%	27.0x	\$394.20	\$244.77	106.2%

