

The Hershey Company(HSY)

\$132.87 (As of 03/12/20)

Price Target (6-12 Months): **\$140.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 11/21/19)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

2-Buy

Zacks Style Scores:

VGM:C

Value: C

Growth: B

Momentum: D

Summary

Hershey's shares have outpaced the industry in the past year. The company has been gaining from prudent buyouts and pricing strategies. These upsides drove fourth-quarter 2019 performance, with the top and the bottom line rising year over year. Markedly, the Pirate's brand buyout boosted sales. Management expects acquisitions, especially One Brands, to favorably impact the top line in 2020. Additionally, the company is on track with product launches under some of its key brand banners. Also, efforts to accelerate its business in key markets like China, India, Brazil and Mexico bode well. However, increased advertising and marketing costs were a drag on the company's performance in the quarter. Persistence of such headwinds remains a threat. Also, volatile currency movements are likely to be a concern.

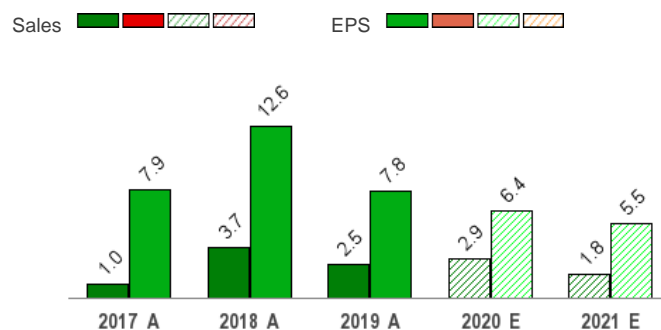
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$162.20 - \$108.95
20 Day Average Volume (sh)	1,204,923
Market Cap	\$27.9 B
YTD Price Change	-9.6%
Beta	0.11
Dividend / Div Yld	\$3.09 / 2.3%
Industry	Food - Confectionery
Zacks Industry Rank	Top 15% (38 out of 253)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	3.2%
Last Sales Surprise	0.0%
EPS F1 Est- 4 week change	-0.0%
Expected Report Date	04/23/2020
Earnings ESP	1.6%
P/E TTM	23.0
P/E F1	21.6
PEG F1	2.7
P/S TTM	3.5

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	2,127 E	1,858 E	2,255 E	2,141 E	8,361 E
2020	2,064 E	1,825 E	2,212 E	2,123 E	8,217 E
2019	2,016 A	1,767 A	2,134 A	2,068 A	7,986 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$1.78 E	\$1.42 E	\$1.83 E	\$1.44 E	\$6.49 E
2020	\$1.66 E	\$1.29 E	\$1.81 E	\$1.40 E	\$6.15 E
2019	\$1.59 A	\$1.31 A	\$1.61 A	\$1.28 A	\$5.78 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 03/12/2020. The reports text is as of 03/13/2020.

Overview

Founded in 1894 and based in Hershey, PA, **The Hershey Company** (HSY), is the largest chocolate manufacturer in North America as well as a global leader in chocolate and non-chocolate confectionery. In addition, Hershey manufactures pantry items like baking ingredients, toppings and beverages; and gum and mint refreshment products; snack bites and mixes, as well as spreads.

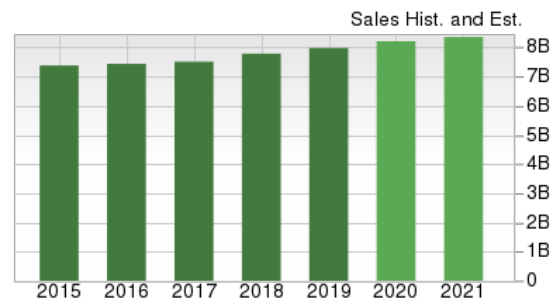
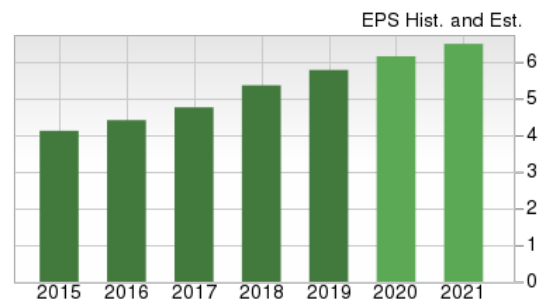
Hershey's operating segments comprise geographic regions — **North America** (contributed 88% to 2019 net sales) as well as **International and Other** (12%). International and Other segment includes operations in China, Mexico, Brazil, India and Malaysia, as well as export to markets in Asia, Latin America, Middle East, Europe, Africa and other regions).

The company's portfolio in North America includes a wide range of products, which are marketed and sold under brands like Hershey's, Reese's and Kisses, along with other popular chocolate and non-chocolate confectionery brands like Jolly Rancher, Almond Joy, Brookside, barkTHINS, Cadbury, Good & Plenty, Heath, Kit Kat, Lancaster, Payday, Rolo, Twizzlers, Whoppers and York.

In North America, the company also provides premium chocolates through Scharffen Berger and Dagoba brands. Further, it offers Ice Breakers mints and chewing gum, Breathsavers mints and Bubble Yum bubble gum as part of gum and mint products. Hershey's pantry and snack items include baking products, toppings and sundae syrups sold under the Hershey's, Reese's and Heath brands, as well as Hershey's and Reese's chocolate spreads, snack bites and mixes, Popwell half-popped corn snacks, baked and trans fat free Pirate's Booty snacks and other better-for-you snack brands such as Oatmega among others.

In the International and Other regions, Hershey produces and sells the same brands. It also provides other brands, which are marketed regionally. These include Pelon Pelo Rico confectionery products in Mexico, IO-IO snack products in Brazil, and Nutrine and Maha Lacto confectionery products and Jumpin and Sofit beverage products in India.

The company manufactures and markets several products through licensing agreements with Kraft Foods Ireland (York, Peter Paul Almond Joy and Peter Paul Mounds), Cadbury U.K. (Cadbury and Caramello) and Nestle (Kit-Kat and Rolo).



Reasons To Buy:

- ▲ **Gains From Buyouts:** Hershey has been undertaking buyouts to augment portfolio strength as well as boost revenues. In fact, net impact from buyouts and divestitures boosted sales growth by 2.2 points during the fourth quarter of 2019. Gains from the Pirate's brand acquisition supported the top line in the said quarter. The company acquired Pirate Brands in September 2018 to bolster its snacking business. Additionally, the company has been gaining from Amplify Snack Brands, which was acquired in January 2018, to expand in the snacking category. In earlier developments, the acquisition of New York-based barkTHiNS (April 2016) premium chocolate snacking brand has been aiding the company's better-for-you snacks portfolio. The SkinnyPop buyout has also been driving growth in the ready-to-eat popcorn category. Notably, retail sales in this category increased more than 13%, resulting in category share gain of 170 basis points (bps) during the fourth quarter. In August 2019, the company announced minority investments in Fulfill Holdings and Blue Stripes, whose business is likely to ramp up in the snacking arena.

Hershey has been undertaking buyouts to augment portfolio strength as well as boost revenues. Also, the company regularly brings innovation to its core brands to meet consumer demand.

Another significant addition to the company's better-for-you snacking business is ONE Brands, LLC. The buyout was completed in September 2019 is bolstering the company's nutrition bar category. Markedly, One Brand grew 35% in traditional measured channels along with added strength in other channels like e-commerce. In fact, ONE brand is expected to leave a positive impact of roughly 1 point on net sales in 2020. Gains from acquisitions along with prudent pricing strategies and other growth efforts have been fueling the stock. Shares of Hershey have gained 20.4% in a year, outpacing the industry's growth of 11.4%.

- ▲ **Solid Q4 Results & Optimistic View:** Hershey delivered fourth-quarter 2019 results, with the top and the bottom line increasing year over year. Moreover, earnings beat the Zacks Consensus Estimate. While earnings gained from higher sales, sales were backed by improved price realization and acquisitions. Further, organic sales rose 1.9% at cc on efficient pricing in the United States and volume increases in international markets. Additionally, adjusted gross margin improved on the back of favorable commodities and price realization.

Hershey is focused on achieving its financial goals, making core brand investments and generating balanced growth. The company expects net sales to rise in the range of 2-4% for 2020. Buyouts and divestitures are expected to make nearly 1.0 point positive impact on the top line. Further, the company envisions adjusted EPS for 2020 in the range of \$6.13-\$6.24. This view indicates a rise of 6-8% from the reported figure in 2019.

- ▲ **Strong Brand Portfolio & Focus on Innovation:** Hershey is the largest producer of quality chocolate products in the United States. It markets some of the world's leading brands which enjoy widespread consumer acceptance. The company is also a global leader in sugar confectionery products, which is attractive category as confectionery products are easily available, affordable and highly indulgent, thus making the industry almost recession resistant. Hershey's core brands — Hershey's, Reese's, Hershey's Kisses, Jolly Rancher, Brookside, Sofit and Ice Breakers — have been growing strongly on the back of advertising investments, in-store merchandising, and programming and innovation.

In fact, Hershey regularly brings innovation to its core brands to meet consumer demand and needs that are not addressed by its current portfolio. In this respect, it is optimistic about its Kit Kat Duos innovation along with expansion plans of THiNS platform. Further, the company expects to launch York THiNS and Reese's white THiNS by March. Earlier, it also relaunched the Take5 brand under the Reese's banner. The launch of Kisses brand in India is also reaping benefits. Previously, management had stated that Hershey's Gold and Reese's Outrageous, launched in 2018, are doing well. An important strategy of the company is to create a unique and holistic portfolio for every season, which can meet consumers' seasonal shopping needs.

- ▲ **Efforts to Boost Efficiency & Pricing Strategies:** Hershey focuses on optimizing its portfolio in order to deliver increased profitability. In this respect, the company's SKU rationalizing efforts have been fruitful. In addition, the company gained from its Margin for Growth multi-year program. This program is intended to improve overall operating margin through supply chain optimization, streamlining the operating model and reduction of administrative expenses. These moves are anticipated to boost efficiency, leverage global shared services and common processes and increase capacity utilization. Additionally, the company has undertaken strategic pricing initiatives to improve mix. Notably, net price realization benefited Hershey's top line by 3.6 points in the quarter under review.

- ▲ **Gaining Traction in Key Markets:** Keeping in mind its weak international presence, Hershey is accelerating its business in key markets like China, India, Brazil and Mexico where consumer spending growth is positive. Hershey is slowly activating its five core brands in these markets. Constant-currency organic sales in Mexico, Brazil, China and India increased 6% in the fourth quarter of 2019. The company is optimistic about strength in its base business and in-store activations in China. In fact, management stated that it plans to add additional manufacturing capacity and resources to boost growth in the region. Moreover, Hershey is encouraged to bring new innovations and business model in Brazil and Mexico during 2020.

Reasons To Sell:

▼ **High Advertising, Marketing & Selling Costs:** Total advertising and related consumer marketing expenses increased 2.1% in the fourth quarter, due to increased advertising spending in North America. Excluding this, the company's selling, marketing and administrative expenses increased 6.4% due to higher incentive compensation and advertising expenditure. Moreover, increased incentive compensation exerted pressure on the company's adjusted operating margin, which declined 90 bps in the said quarter. Persistent rise in such expenses is likely to dent the company's performance in the forthcoming periods.

Currency had an adverse impact of nearly 10 bps on the company's top-line growth in the fourth quarter of 2019.

▼ **Currency Headwinds:** Hershey remains exposed to volatile currency movements despite a low international presence. Markedly, currency had an adverse impact of 0.1 points on the company's top-line growth in the fourth quarter of 2019. In the International and Other segment, currency headwinds hurt net sales by 0.1 point. Unfavorable currency fluctuations are expected to have a negative impact on sales in 2020.

▼ **Lower International Presence:** Approximately 88% of the company's revenues was generated in North America (U.S. and Canada) in 2019. Markets outside this region form a lower proportion of the company's top-line. Though the company is accelerating investments in the overseas markets, competitors like Mondelez International have a stronger presence outside North America.

▼ **Soft Macroeconomic Environment:** The North American food industry is experiencing changes in consumer preference (for example, shift toward products with less artificial sweeteners, sodium and saturated fat), changes in consumer dynamics, demographic shifts, and also a spending shift toward lower-priced products.

Further, Hershey is dependent on consumer discretionary spending environment, which is affected by the general macroeconomic conditions like consumer confidence and employment levels. In Europe, the economic/political conditions have become challenging post Brexit.

▼ **Stiff Competition:** Hershey operates in highly competitive markets, along with several global multinational, national, regional and local firms. The company has some competitors, which are big entities with considerable resources and significant international operations. Well, Hershey competes on the basis of product innovation, product quality, price, efficacy of marketing and promotional strategies and the ability to cater to consumer preferences among other things.

Of late, the company also witnessed heightened competition from other snack items, which in turn puts pressure on the confectionery category.

Last Earnings Report

Hershey's Q4 Earnings Beat Estimates, Sales Up Y/Y

The Hershey Company delivered fourth-quarter 2019 results, with the top and the bottom increasing year over year. Moreover, earnings beat the Zacks Consensus Estimate. The quarterly results gained from acquisitions and improved price realization.

Earnings & Revenue Discussion

Adjusted earnings per share (EPS) of \$1.28 surpassed the Zacks Consensus Estimate of \$1.24 and rose 1.6% year over year. The upside can be attributed to higher sales.

Consolidated net sales of \$2,068.1 million rose 4% year over year. The Zacks Consensus Estimate was \$2,067 million. Price realization drove sales growth by 3.6 point. Buyouts and divestitures had a net favorable impact of 2.2 point on the top line. However, currency translations and volumes had a negative impact on sales by 0.1 and 1.7 points, respectively.

Margins in Detail

Adjusted gross profit that amounted to \$898 million, rose nearly 6.4% year on year. Adjusted gross margin expanded 90 bps to 43.4%, backed by favorable commodities and net price realization.

Selling, marketing and administrative costs increased 6.4% during the quarter. Advertising and related consumer marketing expenses rose 2.1% due to increased advertising spending in North America.

Adjusted operating profit amounted to \$370.5 million, up 0.4% from the prior-year quarter's figure. However, adjusted operating margin declined 70 basis points to 17.9% as gains from improved gross margin were offset by increased incentive compensation.

Segmental Update

North America (the United States and Canada) net sales improved 3.8% year over year to \$1,812.7 million. Markedly, price realization and net impact of acquisitions as well as divestitures boosted the unit's sales by 4.0 and 2.5 point, respectively. However, volumes dented the unit by 2.7 point. Income in the segment rose 7% to \$519.8 million on the back of favorable gross margin.

Net sales in the **International and Other** segment rose 5.8% to \$255.4 million. Volumes and net price realization drove the unit's sales by 5.7 and 0.6 point, respectively. Foreign currency made unfavorable impact of 0.5 point. Combined net sales in the company's focus market that includes Mexico, Brazil, China and India increased nearly 5.3%. Excluding currency headwinds from currency rates and divestitures, net sales from these markets increased nearly 6%. Segment income came in at \$14.1 million in the quarter, up 67.9% year over year. The upside can be attributed to improved gross margin and stronger volumes along with efficient marketing strategies.

Financials

Hershey ended the quarter with cash and cash equivalents of nearly \$493.3 million, long-term debt of \$3,530.8 million and total shareholders' equity of \$1,745 million.

In a separate press release, Hershey declared quarterly dividend payouts of 77.3 cents per share for its common stock and 70.2 cents for Class B shares. These are payable on Mar 16, 2020 to shareholders of record as on Feb 21.

Details on 2020 Guidance

Hershey expects net sales to rise in the range of 2-4% for 2020. Buyouts and divestitures are expected to make nearly 1.0 point positive impact on the top line. Also, unfavorable currency fluctuations are expected to have a negative impact on sales growth.

Further, the company envisions adjusted EPS for 2020 in the range of \$6.13–\$6.24. This view indicates a rise of 6-8% from the reported figure in 2019.

Quarter Ending **12/2019**

Report Date	Jan 30, 2020
Sales Surprise	0.04%
EPS Surprise	3.23%
Quarterly EPS	1.28
Annual EPS (TTM)	5.79

Recent News

Hershey Concludes Buyout of One Brands - Sep 23, 2019

Hershey concluded the previously announced acquisition of ONE Brands, LLC, which is a manufacturer of a line of low-sugar, high-protein nutrition bars.

Valuation

Hershey's shares are down 9.6% in the year-to-date period and up 20.4% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Consumer Staples sector are down 12.6% and 22.8% in the year-to-date period, respectively. Over the past year, the Zacks sub-industry was up 11.4%, while the sector declined 15.2%.

The S&P 500 index is down 23% in the year-to-date period and 12.5% in the past year.

The stock is currently trading at 21.35X forward 12-month earnings, which compares to 19.11X for the Zacks sub-industry, 17.16X for the Zacks sector and 15.84X for the S&P 500 index.

Over the past five years, the stock has traded as high as 27.02X and as low as 16.46X, with a 5-year median of 21.15X. Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$140 price target reflects 22.5X forward 12-month earnings.

The table below shows summary valuation data for HSY

Valuation Multiples - HSY					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	21.35	19.11	17.16	15.84
	5-Year High	27.02	24.52	22.38	19.34
	5-Year Low	16.46	15.67	16.66	15.18
	5-Year Median	21.15	18.01	19.65	17.42
P/S F12M	Current	3.38	2.18	8.58	2.91
	5-Year High	4.2	2.74	11.13	3.44
	5-Year Low	2.35	1.63	8.09	2.54
	5-Year Median	2.84	2.07	9.87	3
EV/EBITDA F12M	Current	17.25	11.51	33.36	12.34
	5-Year High	18.02	12.26	37.22	14.18
	5-Year Low	11.28	7.36	29.4	9.08
	5-Year Median	13.27	9.47	33.65	10.82

As of 03/12/2020

Industry Analysis Zacks Industry Rank: Top 15% (38 out of 253)



Top Peers

Conagra Brands Inc. (CAG)	Neutral
Campbell Soup Company (CPB)	Neutral
General Mills, Inc. (GIS)	Neutral
Mondelez International, Inc. (MDLZ)	Neutral
The Simply Good Foods Company (SMPL)	Neutral
HOSTESS BRANDS (TWNK)	Neutral
Kellogg Company (K)	Underperform
TreeHouse Foods, Inc. (THS)	Underperform

Industry Comparison Industry: Food - Confectionery				Industry Peers		
	HSY Neutral	X Industry	S&P 500	MDLZ Neutral	SMPL Neutral	TWNK Neutral
VGM Score	C	-	-	C	F	D
Market Cap	27.87 B	1.79 B	17.38 B	68.08 B	1.49 B	1.43 B
# of Analysts	7	5	13	8	3	5
Dividend Yield	2.33%	0.00%	2.51%	2.40%	0.00%	0.00%
Value Score	C	-	-	C	C	B
Cash/Price	0.02	0.08	0.05	0.02	0.04	0.17
EV/EBITDA	16.02	16.74	10.90	16.44	23.66	11.93
PEG Ratio	2.70	2.82	1.54	2.25	NA	NA
Price/Book (P/B)	15.90	2.00	2.35	2.49	1.26	0.90
Price/Cash Flow (P/CF)	17.10	19.89	9.60	14.67	22.68	12.34
P/E (F1)	21.60	17.06	13.98	17.84	17.06	15.54
Price/Sales (P/S)	3.49	3.09	1.89	2.63	2.69	1.57
Earnings Yield	4.63%	5.88%	7.07%	5.60%	5.88%	6.40%
Debt/Equity	2.02	0.58	0.70	0.53	0.54	0.62
Cash Flow (\$/share)	7.77	1.10	7.01	3.24	0.69	0.89
Growth Score	B	-	-	C	F	D
Hist. EPS Growth (3-5 yrs)	9.03%	9.03%	10.85%	9.02%	NA	NA
Proj. EPS Growth (F1/F0)	6.45%	15.79%	5.99%	7.85%	63.69%	15.41%
Curr. Cash Flow Growth	9.40%	10.15%	6.15%	4.99%	10.26%	19.10%
Hist. Cash Flow Growth (3-5 yrs)	7.63%	5.50%	8.52%	2.73%	NA	5.50%
Current Ratio	1.05	2.75	1.24	0.50	2.67	2.83
Debt/Capital	66.93%	36.60%	42.57%	34.82%	35.02%	38.17%
Net Margin	14.40%	9.68%	11.64%	14.96%	4.96%	6.95%
Return on Equity	73.68%	7.14%	16.74%	13.56%	5.64%	4.44%
Sales/Assets	0.99	0.48	0.54	0.40	0.41	0.30
Proj. Sales Growth (F1/F0)	2.89%	6.26%	3.54%	2.34%	63.84%	9.62%
Momentum Score	D	-	-	D	C	F
Daily Price Chg	-10.69%	-5.21%	-10.03%	-9.23%	-5.21%	-5.69%
1 Week Price Chg	8.54%	-0.16%	-0.67%	5.42%	-20.67%	-0.16%
4 Week Price Chg	-16.61%	-18.18%	-28.22%	-19.52%	-37.04%	-18.18%
12 Week Price Chg	-9.41%	-24.94%	-25.63%	-13.85%	-44.20%	-24.94%
52 Week Price Chg	20.38%	-9.28%	-16.72%	0.34%	-21.57%	-6.42%
20 Day Average Volume	1,204,923	1,204,923	3,061,271	10,074,150	1,400,088	1,318,914
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	-0.72%	0.00%
(F1) EPS Est 4 week change	-0.03%	-0.09%	-0.32%	-0.80%	-0.09%	-6.38%
(F1) EPS Est 12 week change	0.46%	0.46%	-0.65%	-0.22%	17.52%	-4.86%
(Q1) EPS Est Mthly Chg	-0.12%	-0.12%	-0.62%	-0.90%	1.30%	-33.52%

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	C
Growth Score	B
Momentum Score	D
VGM Score	C

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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