CORPORATE PARTICIPANTS

Melissa Poole, Vice President, Investor Relations
Michele Buck, Chairman and Chief Executive Officer
Steve Voskuil, Senior Vice President and Chief Financial Officer

CONFERENCE CALL PARTICIPANTS

Andrew Lazar, Barclays
Robert Moskow, Credit Suisse
Nick Modi, RBC Capital Markets
Jason English, Goldman Sachs
Michael Lavery, Piper Sandler
Ken Zaslow, BMO Capital Markets
Ken Goldman, JPMorgan
Bryan Spillane, Bank of America Merrill Lynch
Chris Growe, Stifel Institutional
David Palmer, Evercore ISI
Steve Powers, Deutsche Bank
Rob Dickerson, Jefferies
Jonathan Feeney, Consumer Edge
Pamela Kaufman, Morgan Stanley
John Baumgartner, Mizuho Securities

PRESENTATION

Operator
Greetings. Welcome to The Hershey Company Fourth Quarter 2021 Question & Answer Session.

At this time, all participants are in a listen-only mode. As a reminder, this conference is being recorded.

I’d now like to turn this call over to your host Ms Melissa Poole, Vice President of Investor Relations for The Hershey Company. Thank you. You may begin.

**Melissa Poole**

Good morning everyone. Thank you for joining us today for The Hershey Company’s Fourth Quarter 2021 Earnings Q&A Session. I hope everyone has had the chance to read our press release and listen to our Pre-Recorded Management Presentation, both of which are available on our website. In addition, we have posted a transcript of the pre-recorded remarks. At the conclusion of today’s live Q&A session we will also post a transcript and audio replay of this call.

Please note that during today’s Q&A session we may make forward-looking statements that are subject to various risks and uncertainties. These statements include expectations and assumptions regarding the Company’s future operations and financial performance, including expectations and assumptions related to the impact of the COVID-19 pandemic. Actual results could differ materially from those projected as a result of the COVID-19 pandemic, as well as other factors. The Company undertakes no obligation to update these statements based on subsequent events. A detailed listing of such risks and uncertainties can be found in today’s press release and the Company’s SEC filings.

Finally, please note we may refer to certain non-GAAP financial measures that we believe will provide useful information for investors. The presentation of this information is not intended to be considered in isolation or as a substitute for the financial information presented in accordance with GAAP. Reconciliations to the GAAP results are included in this morning’s press release.

Joining me today are Hershey’s Chairman and CEO, Michele Buck, and Hershey’s Senior Vice President and CFO, Steve Voskuil.

With that, I will turn it over to the Operator for the first question.

**Operator**

At this time we will be conducting a question-and-answer session.

Our first question is from Andrew Lazar with Barclays. Please proceed with your question.

**Andrew Lazar**

Good morning everyone.

**Michele Buck**

Good morning Andrew.

**Steve Voskuil**

Good morning.
Andrew Lazar

Hi there. I guess my question is it seems like the plan of this year is, is Hershey’s going to look to certainly leverage greater SG&A to more than offset some of the expected gross margin pressure during the year. I guess my question is how does the company balance sort of leaning more heavily on SG&A this year to hit certain targets, including less aggressive marketing spend, albeit in light of capacity constraints? How do you balance that with continuing to lean in on reinvestment to protect as much of the sort of the current momentum and the market share that’s been gained in the last two years, really to benefit the outyears, right, of ’23, ’24 and sort of beyond?

Michele Buck

As you know, we take a pretty balanced approach in terms of focus on delivering the short term as well as making sure that we are building all the capabilities and continued investment to build the long term. So, as it relates to—let me start with some of our SG&A.

We think it’s important to continue to build capabilities. Some of the places that we have been very focused are in the areas of ERP, obviously, so that we can really get a solid foundation of technology that we think will bring us tremendous benefit going forward in the future. We incur a lot of the expense now, and frankly, more of the benefit in the future.

Also, in terms of digital as a big investment area, specifically we’ve had a big focus in advancing our capabilities to deliver more sophisticated targeting and get more efficiency in media. So we believe some of those lean-ins are really important to help us build those capabilities for the future.

As we look at brand investment, as you know we are big believers in our business model that brand investment is key. We have always been very solid spenders, and we continue to believe that. We have moderated some of that spending as we’ve had supply challenges and constraints to make sure that we keep our very strong returns on that investment, so it’s a balancing act. Some of the investments in media have enabled us to get to efficiency so that we are still delivering a pretty strong number of consumer impressions out there. We feel good about where our share of voice is. So, we’re really trying to balance that and say, “Okay, we’ll moderate a bit now in brand investment,” but certainly keep our eye on it as we go forward to make sure that we continue to protect that for the long term.

Andrew Lazar

Right. Thank you.

Michele Buck

Steve, do you have anything to add to that?

Steve Voskuil

No, I think you hit the highlights. We have a compensation reset that happens as we set new targets, and so that gives us a little bit on benefits side to deploy against the things that Michele said.

Andrew Lazar

Right. Then just briefly, Steve, I guess where you say Hershey is right now with respect to sort of retail inventory levels and I guess finished goods inventory as well, relative to where the company might
typically see itself sort of at this time of the year? Just trying to get a sense of what sort of inventory refill opportunity there might be moving forward, obviously as capacity allows. Thanks so much.

**Steve Voskuil**

Sure. As we formed our guidance for next year, we have an assumption inside there that there is an opportunity for some inventory build back into the network. Of course, we’ve also got some inventory building to do on our side, but from a retail distributor standpoint as well and that’s part of our guidance.

**Andrew Lazar**

Okay. Thank you.

**Operator**

Our next question is from Robert Moskow with Credit Suisse. Please proceed with your questions.

**Robert Moskow**

Hi. Thank you for the question. I wanted to get a sense of what you’re seeing from competition. Is your competition facing the same supply chain constraints that you’re facing, and therefore, should we assume that you’re expecting a year of market share gains? Or do you expect to hold share this year? Do you expect them to reduce media as well?

**Michele Buck**

Relative to the competition, yes, we would say everyone in the category seems to be having similar challenges, just as I would say pretty broadly in the industry that’s the case. We anticipate the situation relative to delivering on demand to be about comparable across the competitors.

Relative to market share, we believe that we will hold share this year. As you know, we’ve had some really significant gains over the past two-year period of time. We will have more tepid share performance in the first half of the year, building to a bit more strength in the second half due to laps alone. And relative to share of voice on advertising, we do track that and we feel really good about where we are from an advertising share of voice perspective.

**Robert Moskow**

Okay, great. Maybe a follow-up. Gross profit dollars, for the core business, not including the acquisitions, should we still assume that your gross profit dollars are growing? This is kind of a backhanded way to figure out what kind of gross margin I should expect for 2022.

**Steve Voskuil**

Yes. Gross margin dollars are going to grow. As we talked about in the prepared remarks, from a margin standpoint we expect there to be some dilution comparable to what we saw in ’21. But from a dollars standpoint, yes, up year-over-year.

**Robert Moskow**

Okay. All right, thank you.
Operator

Our next question is from Nick Modi with RBC Capital Markets. Please proceed with your question.

Nick Modi

Thank you. Good morning everyone. Just a housekeeping item and then just a broader question. I was hoping you could maybe just aggregate the shipping days and the elasticity impact that you discussed in the prepared remarks, if there’s any perspective you can give on the magnitude of each.

Then, in the prepared remarks you also indicated you’re looking at historical elasticities when you think about this year, but as we’ve seen across the broader CPG landscape elasticities have been better than expected, so I’m just trying to get clarification. Are you assuming kind of what you’ve seen historically, like pre-COVID? Or if you could just provide some context there.

Michele Buck

Let me start and answer your elasticity question. I’ll give it to Steve to do the disaggregation.

Nick, what we are assuming for this year is historical elasticities. To date on our pricing we have seen a little bit better performance versus historical. As we go into this year, we want to carefully keep our eye on the potential impact of broad inflation on the consumer. We know that there’s been reduction, obviously, in government stimulus and SNAP, and with the inflation across the board it’s just a top of mind watch out area for us, and that’s why we really chose to say historical price elasticities is what we think is a smart and prudent planning move for us.

Steve, do you want to talk about disaggregation?

Steve Voskuil

Yes. Just to break that out a little bit, the shipping days we would estimate to be about a 2 point impact on the quarter. And from an elasticity standpoint, if you kind of took that to the side, if you took the shipping days to the side, pounds were about flat in the quarter, if that helps give you some idea.

Nick Modi

That’s very helpful.

Then, Michele, just one more question. Obviously the issue with out-of-stocks has been a pervasive problem for everyone and labor obviously is a big part of that. Is this one of those scenarios where you just kind of have to manage through it and don’t really have a good handle on when things are going to start getting better? I mean, I guess because it’s so labor dependent.

Michele Buck

Well, I guess what I would say is we have a lot of actions in place to drive continuous improvement relative to our own supply. So certainly yes, there is no certain end state where I can tell you this is where the switch flips. But what I can tell you is we have had numerous programs underway. So first of all we focused a lot on optimizing demand. How do we get the most efficiency out of the capacity we have? By reducing complexity in changeovers, prioritizing SKUs, part of that included working with retailers to double and triple face our core items, which is always a great move because they are very high velocity so that makes a lot of sense.
As it comes to supply, we are continuing to invest in incremental capacity. There is incremental capacity that will gradually come online as we go through this year and also into 2023 and 2024.

We've also made some significant investments in manufacturing labor. Frankly, last year was a real challenge. Our people did real yeoman’s work to just do whatever was needed to produce as much volume as possible, but it really wasn’t sustainable in terms of having a reasonable employee value proposition for those folks. And so we have invested in labor. We won’t get the benefit of that immediately because it takes time to train people, to get them up to speed, to be as efficient as our current workforce, but we do think it’s important and a lot of that really just helps us to manage some of the overtime as well.

So, we do have a lot of activities underway. We think that we will make continuous improvement, but under no circumstances would we really be out of the woods totally; we will continue to have pressure throughout the year. Our goal is just to continue to make improvements.

Nick Modi
Okay. Thanks much. I'll pass it on.

Steve Voskuil
Thank you.

Operator
Our next question is from Jason English with Goldman Sachs. Please proceed with your question.

Jason English
Good morning, folks. Thanks for slotting me in.

Michele Buck
Good morning.

Jason English
Congrats on strong results and some sustained momentum.

The cumulative volume growth in North America over the past two years of, at my calculation roughly 7%, it's obviously a real stand-out here, especially given that it contrasts to what was very little growth before COVID. My question is kind of on that focus. How much of the volume that you picked up during COVID do you think is durable? How much is at risk of leaking back out as we kind of come out the other side of this? What's embedded in your planning assumptions? I know there's a lot there and it's a bit tricky to unravel, but I would love your view on it.

Michele Buck
We've really tried to do a good dissection and deep dive to understand that as best possible, and I would tell you I think there are a number of things going on. First of all, we do know that there are some COVID related impacts. The change in consumer behaviors with consumers spending more time at home has clearly benefited some of our brands and categories because they’re around their homes more to
consume our products and our products are more eaten in those types of environment than out and about in restaurants environments, etc.

I think that based on what we’re seeing in consumer behavior, I think that while more people—and people have become more mobile, there also is a change of behavior that I think is here to stay to some degree, right? People enjoy spending time with their families. They appreciate them more given the COVID situation. They’ve gotten comfortable, some of them, the portion who are flexibly working and want to continue some of that, so I believe that some of that is here to stay.

At the same time, we also did implement a number of new strategies in our business over the years that we think have also helped us. We really tried to do a better job of balancing innovation and the core to get more sustainable growth, and we have seen that that’s had an impact on the business. I think we also think we’ve gotten smarter about pricing where we have multiple levers on list price and price pack architecture that we can utilize. So I guess I’d tell you we believe that there’s part of both of that, so we do think that there is a sustainability, an underlying sustainability. It may not be all of it, but, you know, in addition to us in particular I think the category’s relevancy has just increased during COVID.

Those are some of our thoughts, Rob. I hope that’s helpful.

**Jason English**

That’s helpful.

Sticking on the topic of volume, it looks like your guidance for next year is predicated on fairly firm volume, but you say you’re assuming historical elasticities which should be a net negative drag and maybe some of this COVID stuff comes back out. What are the offsets? Is this like the inventory reload later in the year to catch up? Where are you seeing the offsets of that elasticity?

**Steve Voskuil**

Sure. A couple of things. One, we touched on it earlier, was the inventory, so we are assuming some inventory rebuild with retailers and distributors. That’s a component. Seasons is a component. Seasons worked fantastic this past year. We had another 90% sell-through for Holiday and that will help from an ordering for this year, so we’re leaning into seasons. Then continuing to activate against our brands and go-to-market strategy. A portion of that is innovation. A portion of that is just working with our retail team to make sure we’re bringing new programming that we can support from a capacity standpoint. Those are the biggest factors offsetting the elasticity.

**Jason English**

Understood. Thanks a lot. I’ll pass it on.

**Michele Buck**

Thanks, Jason.

**Operator**

Our next question is from Michael Lavery with Piper Sandler. Please proceed with your question.

**Michael Lavery**
Good morning. Thank you.

Steve Voskuil

Good morning.

Michael Lavery

You mentioned the stimulus benefits and SNAP in particular and clearly there’s some risk there, but can you give a sense of what, if anything, you’re hearing from consumers directly in terms of how they may have reacted with elevated benefits and just how much of your performance could have been driven by that? Because we surveyed consumers; it looks like confections is the category that may have had the least benefit of all. Is that consistent with what you’re seeing? Can you just give a sense of how you think about some of the risk around that?

Michele Buck

We do think that there could have been less benefit. That’s what we’re seeing as well for us, than for others. I do think that’s correct. At the same time, we do know that there’s significant pressure out there and we just want to really keep our fingers on the pulse of it to make sure that we aren’t missing something. Certainly we’re not a category where there’s a big private label component and people can easily just say I’m going to still participate but switch to lower brands. That’s always been a benefit for us during times like this, but we do understand the pressure consumers are under.

Michael Lavery

That’s great color. Thank you.

Then just on some of your outlook where from a planning perspective, can you give a sense of some of the timing you expect for any of the inventory restocking? You touched on the SKU rationalizations. How significant are those? I know you’re swapping them out for higher velocity items. Is that a net positive? Is there timing for that, for anything we should keep in mind from how we think about modeling the year?

Steve Voskuil

Sure. I’d take the first part of that.

If we look at the inventory build, we’re kind of planning it to spread evenly over the year. Obviously it’s gated a little bit by our capacity coming online and so that’s one factor. If I look more broadly at the sale profile for the year, we’ll have more M&A benefit on the top line in the first half of the year, we’ll have more pricing benefit in the top line for the first half of the year, but the inventory build will be spread more evenly.

On the SKU rec side, we see minimal impact from that for the reasons Michele talked about. Where we’ve had to make choices for things we can supply, we been able to gain more pacing and sell more core product, so net-net that hasn’t been a big factor. We have done SKU rec before we got into COVID, just to make sure we were always thoughtful when we did add new innovation SKUs and make sure we had good velocity on those products, so we don’t see a big impact.

Michael Lavery

That’s very helpful. Thank you.
Operator

Our next question is from Ken Zaslow with Bank of America. Please proceed with your question.

Ken Zaslow

Hey, good morning guys.

Michele Buck

Good morning.

Steve Voskuil

Hey Ken.

Ken Zaslow

Just two questions. One is you’re hitting your 9% to 11% EPS growth in a capacity constrained environment with higher labor costs, even with lower ad spending. If you were in a normalized environment, how much incremental EPS growth, or how would you kind of frame the pent-up EPS that may not be in the 9% to 11% as you emerge from the capacity constrained issues?

Steve Voskuil

That’s a tough one to kind of think about because there are so many interconnected variables inside that equation. We’ve got the robust volume which is driving very high utilization on assets, too high to be honest, which is why we’re adding capacity. So you pick up some benefits there, but a lot hangs on that. We’re also with the pricing drop through in response to commodity costs, so that’s a tough one to say. There are too many interconnected components inside the P&L, Ken, to really probably give you a clear answer for that.

Ken Zaslow

Would you think it would be higher or lower? I’ll leave that question and then I have another question.

Steve Voskuil

Sure. Even that’s kind of hard, Ken, because if I start at the very top we would probably not be taking as many price increases as we’ve taken but for the need to cover the costs that we have coming through both commodities and the rest of the P&L, and so even at that very top line level it’s hard to say how the construction then below the rest of the P&L would then flow through.

Ken Zaslow

Okay. Then my second question is with Pirate’s Booty and SkinnyPop, you guys are obviously crushing it on the sales line. What were the key learnings that has changed your acquisition strategy with that, and what are you going to apply to Dots that continues to keep the snacking business at these levels, right?

Your acquisition strategy has clearly evolved into something that has been quite successful. Can you talk about where the evolution has gone and how you apply it to Dots?
Michele Buck

Absolutely. We noted at the beginning of our journey into snacks we had some challenges in some of our first acquisitions and I guess it goes to maybe you kiss a few toads on the way to the prince, but we learned a lot about what we’re good at and what we’re not good at, and we established some principles. One of those principles was there’s a certain size threshold that’s critical for us in order to absorb a business and be able to really build it from there. We’re not good creators of very small businesses and making them big.

We also understand that our business model is all about a high gross margin, of strong gross margin that enables us to invest to grow capabilities and invest in our brands.

We got very, very stringent about those guidelines and those criteria for success. We focused a lot on building capability. Frankly, didn’t have a lot of M&A capability, and so we got a lot smarter about how to do the right due diligence. What were really the key questions we needed to understand? We started to see what we have to know going in, and I think as we did each acquisition we got better at that. So, with Pirate’s Booty and SkinnyPop we got amazing brands. That’s what we’re good at, is really getting a brand that has a strong consumer following. We like to see brands that have tremendous repeat but low household penetration, because that says consumers love them and we can apply our capabilities to expanding distribution and investing to create awareness of the brand.

The other thing we learned was the importance of supply chain. Early on we had some struggles absorbing a lot of these smaller companies who didn’t have their own supply chain. So, thus, you saw when we went forward and bought Dots we decided to buy the co-manufacturer Pretzels Inc. as well.

I think we’ve consistently applied those lessons. As I said, we built a lot of capability and muscle along the way and got better at those key criteria of support of the brand’s margins and the right supply chain.

Ken Zaslow

Great. I appreciate it. Thank you guys.

Operator

Our next question is from Ken Goldman with JPMorgan. Please proceed with your question.

Ken Goldman

Hi. Good morning. Thanks so much.

I just wanted to follow-up on one thing. I know you talked about investing in digital capabilities, and I hear the goal, part of it is advancing targeting and efficiency in media. I guess I’m not quite sure what the mechanics are there and why those efforts would cost a good deal of capital. Maybe I’m digging a little bit too deeply here. I just—those things historically seem to be more about learning, education, hiring consultants to help you, and then capital. I’m just trying to get a sense of connecting the dots there, if I can.

Michele Buck

Sure. One of the things that we have seen has been really critical is what’s the data set. In the past we’ve relied on our own internal data set that we would analyze and do traditional marketing mix modeling kind
of activities, but we’ve really created what we think is a proprietary approach to what we’re doing, investing in other data sources and then integrating them into ours, building the tools that allow us to do that, utilizing the cloud across what we’re doing. So, a lot of that has been investing in those different areas to truly kind of break out in this space.

Ken Goldman

Okay. That’s helpful. Thank you.

I may just be missing it, but I hear that—I see in the press release and in the prepared remarks commentary on strong innovation, I’m not sure I see a list of products that you would consider strong innovation. I can’t recall Hershey ever not listing the new products as the year starts, and I realize this year is a little bit unusual just as last year was. I’m just trying to get a sense of what those new items are that you’re most excited of or for, and how you might qualify them.

Michele Buck

Absolutely. I’d start by saying first, hey, given where we are in a capacity constrained world, our first focus is the core, the core, the core. If we are maxing out capacity with the core, we’re really balancing what’s the right innovation to continue to drive news, but we also want to be very efficient and we just want to maximize throughput.

That said, we do have several items that we are excited about. Reese’s potato chip, KitKat Dark Chocolate with Strawberry, KitKat Hazelnut. We also have, importantly, some really great new pack types.

We’re talked to you about price pack architecture and we’ve put a lot of focus on understanding different consumer occasions and where there was a need or an opportunity for a pack type that best meets that occasion and drives incremental consumption. So we’re really excited about two of those. One is called the Pantry Pack, and think about that as—I’m going to describe it as almost a case of your product or a case pack of your product that’s designed to sit easily either in your refrigerator or in your pantry that you can easily get out multiple units of single-serve product. Then we also have an item that’s called the Super King. You know, we have a standard bar which is a smaller, instant consumable item. We have a King Size bar which is a bigger instant consumable item, and consumers identified interest in a Super King which is an instant consumable pack that has more products and more individual units for sharing. Those pack types have tended to be really great innovation for us over time, highly sustainable.

Ken Goldman

Thanks so much.

Operator

Our next question is from Bryan Spillane with Bank of America. Please proceed with your question.

Bryan Spillane

Hey, good morning everyone. Just a couple of quick ones from me.

First, as we’re looking at the gross margin guidance that you’ve given for ’22, just what do the acquisitions—are the acquisitions accretive, dilutive or neutral to gross margins?
Steve Voskuil

On the gross margin line they’re dilutive. You can get a little sense of that with the new segmentation detail that we provide, particularly dropping those in versus where were before does create some dilution.

Bryan Spillane

Okay. Then I know there’s been a few comments, Steve, that you’ve—questions around just phasing. Could you just help us a little bit with regards to how we should think about the phasing, I guess, of margins through the year. Does pricing help a little bit more later in terms of gross margins? Just any guidance or any color you can provide in terms of how we should be thinking about the phasing of costs over the course of the year.

Steve Voskuil

Sure. Yes, we have—if I go back to kind of first half/second half—I won’t get down to the quarters—we expect to see tougher laps. You know what? More pricing in the first half of the year, but we expect to see probably tougher gross margin in the first half and probably Q2 in particular will be a tough, just looking at the lap that we had last year. We would expect to see gross margins, everything else equal in the plan, gradually improving as we get to the fourth quarter next year.

Bryan Spillane

Okay. Then, Michele, in the prepared remarks there’s a comment around Salty Snacks talking about being in the position, I think, to integrate—more efficiently integrate future acquisitions. Can you just touch on that a little bit, just what that means?

Michele Buck

Yes, absolutely. We’re at a point now where we are continuing to build scale in Salty Snacks. We started with SkinnyPop and Pirate’s Booty. With the Dots business, we have sizeable brands and so we are really looking at what is the optimal way to build the operating model around that entire piece of business? And that includes everything from—obviously right now we’re very focused on integrating Dots and Pretzels Inc., but what’s our end state of from an operating model how we operate, from a supply chain network how we operate. This array of products do not require conditioned distribution so they are very different than our core portfolio, so that’s really the work that we’re talking about there.

Bryan Spillane

Okay, great. Then last one from me. Spillane household is very activated right now around the Cadbury bunny try-outs.

Michele Buck

All right. Love to hear it.

Bryan Spillane

All right. I’ll leave it there. Thanks guys.

Michele Buck
Thank you.

Steve Voskuil

Thank you.

Operator

Our next question is from Chris Growe with Stifel. Please proceed with your question.

Chris Growe

Hi. Good morning. Just to add an editorial remark following Bryan there, we’ve really enjoyed Super King. They’re very dangerous, by the way, but we do enjoy those as well in our household here.

I just had two quick ones. There’s a comment in the prepared remarks about you have pricing coming through but that won’t fully offset cost inflation. You also threw in though some manufacturing investments and that kind of thing. So, I just want to get a sense of how much inflation you have and then will pricing offset inflation but there’s other factors that may weigh on the gross margin. Is that the way to think about it, or do you have any more color on that, Steve?

Steve Voskuil

Yes, a couple of things. In general pricing will offset the majority of our inflation. If I look at our commodity basket, we’ve got the biggest increases year-over-year in places like sugar and dairy and packaging materials and specialty ingredients. We have pretty good visibility into that. We’ve talked in the past about our hedging program and that gives us a pretty good picture.

We’ve also got inflation from a labor standpoint, and as one of the things that Michele said, labor and manufacturing value proposition is one area that we’re leaning in pretty strongly this year. That’s a differential investment than what we’ve done in the past.

So, to answer your question, yes, pricing offsets the majority of the inflationary pieces, but it doesn’t fully offset the additional investment that we’re also making to improve the value proposition for employees.

Chris Growe

Okay. Have you given a level or a range of inflation for the year? Just to get a level set on where you are right now.

Steve Voskuil

Yes, so as we look across, I’ll say the commodity basket but also other sources of inflation, you’re talking mid to high single digits.

Chris Growe

Okay. Thank you.

Then, just to be clear, your capacity that stands today, can you produce enough to meet demand, or are you still using third parties more heavily? Things like that that are going to weigh on the gross margin in addition to other inflation, given the fact that you’re trying to catch up on production here.
Steve Voskuil

Today we don’t have enough capacity to meet all the consumer demand. We’ve had some floor manufacturing lines come online in ’21. We have more in Reese’s and PayDay and Jolly Rancher Gummies that will come online in ’22. But even with that we feel like we’re behind consumer demand.

There is inflation through co-mans and partners in the network. Inflation flows through those lines just like it does from an internal standpoint and so that is a factor. But even as we rotate that outside support into internal production, we’re still going to have inflation on the same labor lines and some of the materials lines.

Chris Growe

Okay, thank you. Then just one thought—I’m sorry. Go ahead.

Michele Buck

I was just going to say and there’s not a lot of material change in our use of co-mans. Some of the items that are in highest demand are items that we uniquely produce. If you think about the uniqueness of some of the forms of some of our big confection items, so while we are trying to use any external co-mans and network as we can, there are some that it’s just not available because of the proprietary nature of our product.

Chris Growe

Makes sense. Thank you.

I just want to follow on Bryan’s question. I think he asked about Dots and I think you mentioned that as dilutive to margin. Is that dilutive to EPS as well? Perhaps you answered that, but I may have missed that.

Steve Voskuil

No. The Dots deal is accretive to earnings in the first year. It’s about a 2-point benefit.

Chris Growe

Okay. Just wanted to be sure on that. Thanks so much.

Operator

Our next question is from David Palmer with Evercore ISI. Please proceed with your question.

David Palmer

Thanks. Good morning. I noticed you’re calling the two segments Confectionary and Salty Snacks. Those are two different parts of that snacking mega segment that you might have shown in a chart years ago, in a past Analyst Day. You don’t say Sweets versus Salty, for example, capturing even more of that. Does that mean that for the foreseeable future those are the two segments that are going to be the company’s focus? If you just kind of roll back the clock, just how did we get here, that Salty is the best adjacent category for Hershey?
Michele Buck

Certainly if you look at our business, these are the largest two areas of our business today and thus from a reporting perspective is exactly where we went to how we segment the business. As you look at some of the bets we’ve placed, I think some of the larger assets, at least on the scale of the acquisitions we’re doing, do tend to be available there. We’ve tended to like many of the assets we’ve seen and the growth there. So that had always been in our eyes early on, was that the two incremental areas of incrementality for us beyond Confection that we were most excited about were ‘salty snacking’ and ‘better for you overall’.

David Palmer

I remember years ago there was some—it didn't always go great with some of the adjacent category acquisitions and there was some talk that you didn't have the—that going into another aisle wasn't always easy.

Could you talk about the capability building that you’ve done in parallel to these growth brands that you’ve acquired that look like they have fantastic momentum, but in terms of the internal workings what have you done to really make sure that you’re going to give us the best growth possible in terms of the salty snack area? Then I’ll pass it on. Thanks.

Michele Buck

Certainly I think if we think about winning in the store, I think we’ve built some scale in the warehouse delivered snack general space. So from a in-store perspective that’s been a key area of focus, but I guess I’d go back to really some of my earlier comments around M&A and where we’ve really built the best capabilities. I think we got very tight about what an asset needs to look like in order for us to—for it to be attractive for us and be a good fit for us, and that’s about it has to start to be—obviously after identifying the two areas of incremental opportunity, it has to be significant scale, $100 million and above, and have strong gross margins because that lets us build the brand.

Go for brands that have very strong repeat, which signifies that they have got a loyal consumer base and there’s a there (phon) there that we can build from, that we can build awareness with consumers through advertising and we can increase distribution and availability. Make sure that we’ve got a good solid supply chain plan because our whole goal is going to be about growth and we have to be lined up to do that.

Then really, given it was a focus, building our talent and our capabilities and our inter-workings and our process. We spent a lot of time on that and getting much more robust in terms of the talent that we’re applying in these spaces. Accountability and ownership across the enterprise, both with our M&A team, with the commercial units that are picking this up, and building a lot of muscle in due diligence and every piece of that, whether it’s legal, whether it is analyzing the business. I think all of those things have been key.

David Palmer

Great. Thank you very much.

Operator

Our next question is from Steve Powers with Deutsche Bank. Please proceed with your question.

Steve Powers
Thanks and good morning. Going back and just to round out the conversation you were having with Jason and others earlier around volume, is what you’re saying that you expect volume in terms of consumption and consumer takeaway to perhaps trend negative year-over-year given elasticities, but that you think your own shipments can remain flat to up given the dynamics that Steve talked about with respect to the seasonal activity and the inventory rebuild? Is that the read, or am I misinterpreting?

**Steve Voskuil**

No, you’ve got it. That's exactly right.

**Steve Powers**

Okay, great.

Then if we could, just because we’re kind of getting a first look at the Salty Snacks business kind of standalone, can we just drill down there maybe and talk a little bit about how you expect that business to shake out, price versus volume, maybe margin progression-wise in 3/22? Anything to call out there as we think about that business standalone?

**Steve Voskuil**

Like the other parts of our business we look at both price and volume, but volume is very strong right now on Skinny, Pirate’s and Dot’s. In some ways we're facing the same challenges that we have on the Confection businesses; we need capacity and trying to solve for capacity to continue to unlock the volume momentum that we’re seeing. That’s probably I would say one of the biggest issues, just like it is for the Confection business right now, but price also plays a role.

**Steve Powers**

Okay. Thanks.

**Operator**

Our next question is from Rob Dickerson with Jefferies. Please proceed with your question.

**Rob Dickerson**

Great. Thanks very much. Just have another question on the salty snacks side. Maybe it’s a bit longer term strategic. Michele, obviously I realize business is doing very well, growth is excellent. Demand, as you were suggesting, cemented your top brands in the segment, it’s very strong. But it’s still obviously a very small piece of your total company, total portfolio, and margins are still a bit obviously lower than your much higher scaled confection business.

If you think forward a few years, is there an argument to be made that maybe there can be some kind of overall margin progression up for Hershey, but that would likely be driven by the salty snack area, just given increased scale, attention, media spend, what have you? I also kind of ask this in the context of kind of where your total company operating margin has been over the prior, call it seven years. Thanks.

**Michele Buck**
We see a lot of opportunity in front of us. As you mentioned, we have been building scale, so you could say that we are subscale but we see tremendous opportunity for efficiencies and synergies as we integrate and gain scale.

As we’ve taken on these businesses, for us job one these are growth businesses. We bought them to accelerate our growth and to participate in high-growth segments that were very appealing to consumers. First and foremost, we wanted to go after that. Then, as you know, it takes some time to get to the right ultimate structure, the right phase of integration and really build towards that efficiency. We’re in the middle of that right now. It will take us a few more years but you see the growth rates from a top line perspective and a lot of the work that we’re doing on the operating model and on the supply chain network are intended for us to drive up the margins to take advantage of the synergy that we think exists.

Rob Dickerson

Okay. Fair enough. Then just quickly, obviously we’re close to Valentine’s Day, smaller holiday for you, Easter if forthcoming and usually large. If we just think year-over-year, I guess just any perspective color in terms of demand you kind of feel so far with conversations with retailers relative to last year, which was obviously strong. Then, are there material differentiating factors in how you would actually provide supply for that season? Versus last year where demand was already high, and you did well and had decent supply. That’s it. Thanks.

Michele Buck

We’re feeling good about both seasons. We see both of them being up versus prior year. We know that for us we had record sell-throughs throughout the seasons and that always leads to a strong season for us the next season, and also, it’s a bit of a longer Easter season and that bodes well for us as well.

We’re focused on working really closely with our retailers to get them the product that they’re looking for, but we are anticipating that we’ll be able to see growth on both those seasons.

Rob Dickerson

All right, super. Thanks so much.

Operator

Our next question is from Jonathan Feeney with Consumer Edge. Please proceed with your question.

Jonathan Feeney

Thanks so much for taking my question. With so many companies really struggling to take pricing, and I measure that in terms of not so much the level of pricing but the adjusted gross margin compared with the apparent elasticity, which in your case you out-gross margined trend year-over-year at negative 40 basis points is all world and the elasticity is limited. What specifically is it do you think about your categories or your company execution, your corporate mindset, that has allowed you to communicate and execute this pricing better than peers in the rest of the industry? I’d just love to hear your perspective on that because I know you’ve invested a lot in the kind of capabilities, not just now but I mean that’s been a buzzword for Hershey for years as far as understanding what the data is telling you about your ability to price. Is it that? Is it the people? What is it?

Michele Buck
I’ll take a crack at a few things. First of all, I think that we all believe that at the root of that is having great brands that consumers see the value in. It’s about the consumer value proposition. It’s one of the reasons that over the years we’ve been such strong believers in investing in our brands, because the more we invest the greater awareness, the greater connectivity consumers have, and with that connectivity they’re more connected to the brands, they don’t want to switch to another brand. I would say fundamentally I think that’s one key thing that’s an advantage for us.

Secondly, we have had great analytics over the years. We’ve always had a big focus on our elasticity models. You know that over time we’ve always focused on pricing pretty aggressively is one of the tools in our toolkit to deliver our P&L and to deliver our business. And I think we just continued to try and take that capability to the next level all the time as we’ve broadened it to, “Okay, we can get the insights on pricing in our category.” Then we started to look at cross-category price elasticity so we could understand any trade-offs that could occur between our category and other categories. Then we started to invest in price pack architecture and look at how could we generate price realization without a list price but by changing the game.

I guess I would say to me at the heart of it are those things, and I wouldn’t underestimate as well the trusting relationships we have with our retailers. We’ve always taken an approach of looking out for what’s best for the category, not being so self-serving and so I think our retailers appreciate that and work really hard with us to get to the right outcomes because of that.

Jonathan Feeney

Helpful. Thank you.

Operator

Our next question is from Pamela Kaufman with Morgan Stanley. Please proceed with your question.

Pamela Kaufman

Hi. Good morning.

Michele Buck

Good morning.

Steve Voskuil

Good morning.

Pamela Kaufman

I wanted to see if you can elaborate on what level of pricing growth is embedded into your guidance for 2022. And in terms of demand elasticity, it seems you experienced some elasticity in Confectionary, but this wasn’t as evident in Snacks. Do you have different expectations for demand elasticity within Salty Snacks versus Confectionary? How will pricing growth vary across the North America segments?

Steve Voskuil

I’ll take the first one. Overall pricing that we’ve assumed in the plan is 5 points to 6 points.
In terms of the difference with the Salty Snacks business, really not a big difference from an elasticity standpoint is the way we look at that and plan for that. Those two are pretty similar.

The last question I might have missed. Was there a third one? Or was that it?

Pamela Kaufman

That was it. Thank you for that.

On media spend, can you elaborate on what your plans are for media investment in 2022? Do you expect it to increase? I know you mentioned that it will be stronger in the back half of the year, but how should we think about it overall? What are some of the key initiatives there?

Michele Buck

So, our dollars will be up slightly for the year in media. More of the increase will come towards the back part of the year as we’re in an increasingly better supply position. There aren’t really a lot of big changes fundamentally in terms of how we’re advertising. We do a significant portion of our spending that is in digital like we have been for many years and so there's not a big shift in how we’re spending the dollars.

Pamela Kaufman

Great. Thank you. That’s helpful.

Operator

Our next question is from John Baumgartner with Mizuho. Please proceed with your question.

John Baumgartner

Good morning. Thanks for the question.

Michele Buck

Good morning.

Steve Voskuil

Good morning.

John Baumgartner

Just building on, coming back to John Feeney’s question and your areas of focus and sort of differentiation. Michele, can you speak to where you feel you are right now on the distribution side? You’ve had quite a bit of success these last few years in terms of gaining new front end displays, modernizing middle of the store and the packaging there, the self-checkouts. At this point, where is your focus regarding those efforts for 2022 and beyond? Where are the opportunities that remain for TDPs and distribution and quality placements from here? Thank here.

Michele Buck
Sure. I think some of the areas of focus for us going forward, self-checkout, queueing lines are a big area of focus. Right now we’re seeing a lot of retailers, given some of the pressure on labor, focusing there.

The other big area and push for us is in what I would call nontraditional channels. We have over the years kind of started distribution in areas like home improvement stores, and as our products have done well there it then gives us the opportunity to expand from having some instant consumable items to putting our take-home portfolio, to even putting seasons during those specific times. Those are the biggest opportunities for focus in ’22.

John Baumgartner

Then I guess related, thinking about distribution internationally, whether it’s Brazil, India, Mexico, you’ve been expanding distribution there as well. How do you think about the opportunities, whether it’s traditional trade, modern trade, what's sort of driving that? Is there a way to think about either ACV penetration or total outlet penetration? How much opportunity is left as you think about sort of reframing international growth going forward?

Michele Buck

Our businesses in most of the international markets—set aside Canada where we’re very developed—we continue to have distribution opportunities. If I looked at Mexico I would say yes, traditional trade is an untapped and an area of opportunity going forward. If I look at the other markets in which we do business, the bulk of the business in India is traditional trade and so there I would call it more just getting broad distribution is the opportunity and building scale, continuing to build scale in areas like Brazil. Western Europe, we’ve had a lot of strength just in getting our brands in distribution across the board in modern trade, in the regular trade there. Great success with Reese. We’re seeding growth in a lot of other countries through our export model, which is really just a distributor model where we get our products on shelf. Again, a lot of that is in either Western Europe or parts of EMEA.

John Baumgartner

Great. Thanks Michele. Thanks for your time.

Michele Buck

Sure.

Operator

We have reached the end of the question-and-answer session, and I will now turn the call over to Melissa Poole for closing remarks.

Melissa Poole

Thank you so much for joining us this morning. I’ll be available throughout the day for any additional questions you may have. Have a great day.

Operator

This concludes today’s conference and you may disconnect your lines at this time. Thank you for your participation.