The Hershey Company

Second Quarter 2023 Earnings Results
Prepared Remarks

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CORPORATE PARTICIPANTS

Melissa Poole, *Vice President, Investor Relations*

Michele Buck, *Chief Executive Officer and Chairman*

Steve Voskuil, *Senior Vice President and Chief Financial Officer*

PRESENTATION

Melissa Poole

Good morning everyone and welcome to the pre-recorded discussion of The Hershey Company's Second Quarter 2023 Earnings Results.

My name is Melissa Poole and I'm the Vice President of Investor Relations at Hershey. Joining me today are Hershey's Chairman and CEO Michele Buck, and Hershey's Senior Vice President and CFO Steve Voskuil.

In addition to these remarks, we will host an analyst Q&A-only session at 8:30 a.m. Eastern on the morning of July 27. A replay of this webcast and our subsequent Q&A session will be available on the Investor Relations section of our website, along with their corresponding transcripts.

During the course of today's discussion, Management will 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. Actual results could differ materially from those projected. 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 that during today's discussion we will 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.

It is now my pleasure to introduce our Chairman and CEO, Michele Buck.

Michele Buck

Thank you Melissa, and good morning everyone.

Our categories continue to perform well as consumer demand for great tasting snacks remains resilient across the globe. We delivered another quarter of strong net sales growth, gross margin expansion and double-digit earnings growth, enabling us to raise our full year adjusted earnings outlook and increase our dividend 15%. New capacity and increased brand investment should enable us to sustain this momentum in the second half as we provide consumers with even more of their favorite snacks for seasonal celebrations, and expand distribution across segments and markets.

Within North American Confectionery, everyday U.S. confection retail sales grew approximately 10% throughout the second quarter. This strength in consumer demand was partially offset by expected inventory headwinds, resulting in mid single-digit organic net sales growth.

Price elasticity increased slightly versus the first quarter, in line with expectations, and remains well ahead of historical levels. We expect elasticities to gradually increase as we progress through the year and enter 2024.

Our summer programs are off to a good start with retail sales for S'mores, Twizzlers and syrup up a combined 11% versus last year behind strong merchandising across channels and increased media investment. Retail sales for gum and mint continue to outperform the broader confection category as mobility increases and workers return to the office.

Hershey refreshment retail sales grew 26% in the second quarter, ahead of the overall refreshment category, resulting in share gains of over 130 basis points. While we are gaining share within the refreshment category, elevated refreshment category growth is a share headwind for Hershey overall given our smaller relative size in the category. This mix impact contributed to more than half of our overall confection category share decline in the quarter. The remainder of our share decline was driven by increased levels of competitive innovation within both the chocolate and sweets categories.

With our increased chocolate capacity this year, and additional co-manufacturing secured within sweets for next year, we can now more aggressively pursue growth opportunities to improve our market share performance. This will include greater levels of innovation, distribution expansion, and targeted increases in promotional activity in 2024 to return merchandising share to historical levels.

We will begin to see some impact from these investments in the second half of 2023, with Halloween retail sales planned to increase double digits versus prior year as we are able to better meet customer demand. Contributing to this was the successful implementation of two new Reese's lines in the first half of this year, and our teams are working diligently to install another line in the fourth quarter. We continue to plan for robust media increases in the second half to support these strong orders so we can maximize unit sell-through on both the seasonal and everyday business.

Now, turning to our North American Salty Snacks segment performance, net sales growth of 6.3% in Q2 was supported by healthy consumer demand but came in below expectations due to execution challenges and promotional shifts into the third quarter.

Hershey Salty Snacks retail sales growth of 9.6% led to share gains of 40 basis points in the ready-to-eat popcorn category and 120 basis points in the pretzel category. Increased media has helped drive higher repeat on both brands while inflation has driven price per transaction up double digits. And despite increased private label activity, household penetration for Skinny Pop and Dot's remains healthy and in line with prior year levels.

As we shared earlier this year, our Salty Snacks business is in the midst of a significant transformation as we integrate and scale the business to support our current and future growth aspirations. In the first quarter we began this journey by integrating our commercial teams and creating new roles to enhance our commercial planning, pricing, innovation and analytics capabilities. We also began work to integrate and optimize the supply chain to improve visibility, resiliency and efficiency. And as we exit this year, we will integrate and significantly enhance our technology platforms as we transition these businesses and plants onto one unified S/4 system.

We continue to believe these investments are critical to execute our growth agenda and drive advantaged competitive positioning in the future. We are pleased with the progress we are making, but with any transformation of this magnitude, we have experienced some execution challenges as we implement new processes with new talent in new roles. In the second quarter this contributed to shipments lagging retail takeaway and a contraction in inventory levels in certain channels. Our teams have already begun implementing solutions to improve our execution in the second half of the year, but we expect larger than normal volatility for the next several quarters as we continue to integrate the businesses and implement the S/4 platform in Q4. Steve will share more details around some of the known impacts to the coming quarters related to this transition.

Reported net sales in our International segment grew high single digits, with balanced price and volume growth. Category trends across markets remain strong, and Hershey continues to gain share by increasing household penetration through innovation and distribution gains. Margins continue to be a bright spot, with segment operating profit margin up 350 basis points in the quarter.

In this dynamic environment, investments in our supply chain, brands, capabilities and people are enabling us to evolve quickly to meet the changing needs of our customers and consumers. Combined with our advantaged categories, iconic brands, and channel and occasion diversification, we are confident we can continue delivering differentiated results in the market.

None of this would be possible without the hard work and dedication of our teams around the world. Thank you for your continued efforts and passion to make us better every day and deliver even more moments of goodness for our consumers.

With that, let me turn it over to Steve to provide more details on our financial results and outlook.

Steve Voskuil

Thank you Michele, and good morning everyone.

We delivered another solid quarter across our three segments with price realization offsetting inflation, productivity enabling margin expansion, and flat volumes excluding the impact of anticipated inventory headwinds. This performance and good visibility into second half programming, pricing, and inflation, gives us confidence to raise our full year adjusted earnings outlook despite rising costs in several key commodities.

Net price realization of 7.7% in the second quarter was in line with expectations. We now expect slightly higher price realization in the second half of the year as our previously announced confection price increase begins to take effect. We continue to expect the majority of this pricing impact to hit in 2024 and help offset anticipated cocoa and sugar inflation.

Volume was a 2.7% headwind, driven by the lapping of inventory replenishment in North America Confectionery in Q2 of 2022, as well as the timing of promotional shipments into Q1 of 2023. Both were in line with expectations. Volume declines of 30 basis points in North America Salty Snacks were below expectations due to a shift in promotional activity into the third quarter, as well as go-to-market execution challenges. The shift in promotional timing was an approximate 30 basis point headwind to overall company results and is expected to be a comparable tailwind to the third quarter. As Michele mentioned, action plans have already been implemented to improve our go-to-market performance in the second half. For the full year, our overall net sales outlook of 8% is unchanged, as incremental pricing is expected to be largely offset by comparable volume declines as elasticities return to historical levels.

Adjusted gross margin increased 130 basis points in the second quarter, as pricing and productivity gains more than offset inflation. This was slightly ahead of our expectations due to favorable logistics and packaging costs. Given this strength, we now expect full year gross margin expansion of approximately 80 to 90 basis points.

Advertising and related consumer marketing increased approximately 15% in the second quarter, with robust investment across segments. Salty Snacks in particular saw a meaningful increase as we launched national campaigns across brands to drive velocity. We continue to expect double-digit increases in brand investment in the second half of the year.

Adjusted operating expenses, excluding advertising spend, increased 4.8% driven by incremental capability and technology investments, as well as compensation and benefits inflation. We expect third quarter investments to accelerate as we continue to advance data and technology capabilities, with expenses projected to increase double digits.

While our full year tax rate and investment tax credit outlook remain comparable to our prior outlook, we saw a sizable shift in timing into the second quarter this year. As a reminder, Hershey invests in renewable energy projects that qualify for federal income tax credits. The majority of our investment expense, as well as the corresponding tax benefit, are recorded when the projects are placed into service. This typically occurs in the second half of the year. This year, a sizable project was placed into service in the second quarter, resulting in a $65 million dollar increase in Other expense in the quarter versus last year, and an adjusted effective tax rate of 8.3%. The net effect of tax and credits was an approximate $0.04 benefit to adjusted EPS. There is no change to our full year outlook for tax.

Sales growth and margin expansion enabled both strong business reinvestment and adjusted EPS growth of 11.7% in the quarter, generating strong cash flow that allowed us to raise our annual dividend by 15%. Capital additions, including software, were $154 million in Q2, supporting our previously discussed capacity expansion projects and ERP implementations. Dividends paid to shareholders totaled $206 million, an increase of 14.6% versus the prior year period.

In the quarter, we closed the acquisition of manufacturing capacity from Weaver Popcorn Inc, a former co-manufacturer of SkinnyPop. These facilities provide more flexibility, agility and resiliency across our growing Salty Snacks supply chain network and enable us to continue supporting the brands' strong growth. The purchase price for these facilities was $165.8 million and was financed with cash on hand and short-term borrowings. Additionally, the acquisition replaces a planned Salty capacity project, so we have trimmed our full year capital spending outlook to $800 to $850 million.

We remain on track to implement S/4 within our Salty Snacks segment in the fourth quarter. As a reminder, we do anticipate some financial impact in the second half due to changes in Salty promotions and inventory levels. In the third quarter, we expect Salty net sales growth of around 20% as we build inventory in advance of the Q4 implementation and realize the benefit of the Q2 promotional timing shift into Q3. In the fourth quarter, we expect double-digit sales declines as we ship below consumption during the transition and execute fewer promotional programs.

I remain confident that our balanced and disciplined approach to investing in our brands, capacity, digital infrastructure, and our people will enable us to create value for all shareholders for many years to come.

With that, I will turn it back to Michele for closing remarks.

Michele Buck

Thanks, Steve.

Business conditions are evolving much as we had expected and we remain confident in our strategy and our ability to deliver on the targets we laid out at our recent Investor Day. Our key commercial, supply chain and workforce initiatives to transform our organization for the next phase of growth remain on track. We are continually evaluating the marketplace and optimizing our go-to-market strategies to respond to changes in the operating environment and remain a category leader.

Thank you for your time this morning. I invite you to listen to our live question-and-answer webcast, which will begin today at 8:30 a.m. Eastern time and will be available at thehersheycompany.com. Thank you.