



The Hershey Company

**Pre-recorded Discussion of the Hershey Company's Fourth
Quarter 2020 Earnings Results**

February 4, 2021

C O R P O R A T E P A R T I C I P A N T S

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

P R E S E N T A T I O N

Melissa Poole

Good morning everyone, and welcome to the Pre-recorded Discussion of The Hershey Company’s Fourth Quarter 2020 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 February 4. 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 risk 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 risk 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.

Twenty-twenty was a year of unexpected challenges and hardship, but also one that brought opportunity, resilience, and compassion. We are proud to be an important part of comfort and connection in people’s lives. Our portfolio of beloved brands remains extremely relevant with consumers, and our dedicated team, advantaged capabilities, and operational excellence allowed us to create many moments of

goodness for them during these unprecedented times. I want to thank all of our employees across the globe for making this possible by continuing to bring passion, focus, and hard work each and every day.

We had a strong finish to the year, with fourth quarter reported net sales growth of plus 5.7%, an adjusted EPS growth of plus 16.4%, and U.S. confectionery share gains of almost 160 basis points. Despite significant pressures in select parts of our business, we delivered an on-algorithm year in 2020, with reported net sales growth of 2% and adjusted EPS growth of almost 9%.

As we enter a new year, our priorities remain to help ensure the health and safety of our employees, deliver on the needs of our consumers, customers and communities, and advance key initiatives to secure our future and deliver long-term, sustainable shareholder value. We have good momentum heading into 2021. While we anticipate continued volatility in 2021, we have good visibility into a strong start to the year, and we believe we will deliver another year of balanced sales and earnings growth in 2021.

In 2020, we adapted our operating models to prioritize the safety of our employees, execute with excellence, and work with agility to respond to rapidly changing consumer needs. We elevated our social impact and company culture by enhancing community support in a time of need and accelerating our efforts to become an even more inclusive company.

In 2021, we will leverage many of these enhanced models to further optimize speed, agility, and our employee experience. We will focus on maintaining our confectionery momentum by retaining new consumer rituals created during COVID-19 while also working to recapture occasions lost due to social distancing and limited mobility.

We will continue to focus on both portfolio and geographic diversification as we build out our better-for-you snacks business and implement new strategies in our international business for sustainable, profitable growth. We will continue to invest in our capabilities to remain competitively advantaged, to pivot as quickly as the environment and consumers’ behaviors change, and build on our operational excellence.

Finally, we will advance our ESG agenda and further embed and integrate it across our organization to increase our impact and support the long-term sustainability of our business.

Let me discuss the core confectionery business in a little more detail. As we shared last year, COVID-19 has had a positive impact on certain confectionery products and channels while having a negative impact on others. Despite changes to what and where consumers are eating, we have seen our category and our trusted brands remain important, particularly when it comes to celebrating seasons and spending time at home with family. We believe we have a strong and balanced plan to meet consumers’ needs as they change throughout the year. It all starts with robust investment behind our brands.

While 2020 advertising spend was relatively flat in North America due to marketplace media efficiencies and reduced support for brands negatively impacted by COVID-19, 2021 investment is planned to outpace sales growth as we look to maintain our strong 2020 share gains. We plan to support a record number of brands and will continue to leverage our advantaged capabilities to adjust messages, channels, and impressions as needed.

We also have a great lineup of innovation planned for 2021. Our Reese’s Stuffed with Pretzels and Kit Kat Mocha items are already in market, and they provide new textures and flavors for some of our best-selling brands. This spring we are excited to expand our better-for-you confectionery platform with the launch of Kit Kat Thins and our Zero-Sugar and Organic lines. Our sugar free platform has been performing very well and we believe this will enable us to reach more households and provide consumers with

more great tasting ways to enjoy their favorite Hershey brands. And while the Organic chocolate market is small, it is growing rapidly, and we are excited to bring consumers great tasting organic versions of Reese’s and Hershey’s through this targeted launch.

Seasons will remain an important driver of our business in 2021. Twenty-twenty proved how important seasonal celebrations and rituals are to consumers, how creative they are at finding new ways to enjoy them in a safe way, and how important our category and brands are to these celebrations. We continued to leverage our strong consumer insights and deep category expertise to provide consumers with the right products and inspiration to celebrate the holidays in November and December. Our strong execution and tailored media helped drive sales increases across key occasions, from decorating, to baking, to stocking stuffers and gifts.

Hershey holiday retail sales grew 4.8% versus category growth of 0.7%, resulting in a seasonal market share gain of 117 basis points. We expect our strong portfolio of brands and advantaged supply chain execution will enable us to keep this momentum going for Valentine’s Day and Easter.

Easter is our second largest season, and we began shipping in late December. In 2021, Easter is one week earlier than last year, which has historically resulted in slightly lower category sales. Easter is a family-centered holiday rooted in strong at-home traditions, with five of the seven core occasions occurring at home, from baking to filling baskets. These occasions performed well last year during the onset of the pandemic, and we believe they will perform well again this year as consumers are even better equipped to celebrate and shop safely. Given our strong portfolio and execution, we expect to outperform the category for the season.

For both seasons and our everyday business, we will continue to execute an omni-channel strategy to optimize the consumer experience, inspire new ideas, and maximize investment. Our e-commerce net sales now represent approximately 5% of our Company sales after more than doubling in 2020. We expect another quarter of strong growth in Q1 before trends stabilize in Q2 as we begin lapping last year’s significant increases.

Finally, let me touch on pricing. We remain committed to our strategy of smaller, more frequent pricing actions to respond to changes we are seeing in the marketplace and enable strong business reinvestment. We recently communicated updated seasonal pricing to our retailers, impacting approximately 10% of Company sales, beginning with our Holiday 2021 program. As we’ve shared before, these items have not been priced since 2014 to 2015. We expect the changes to flow through in Q4 of this year and Q1 of 2022.

Now, let me provide an update on our snacking portfolio. Skinny Pop had a strong year, with retail sales growth of 10.8% in measured channels, maintaining its number two ready-to-eat popcorn share of 19.5%. Pirate’s Booty also grew in 2020, with retail sales growth of almost 4% in traditional channels. Both brands have new campaigns in 2021 and will continue to focus on core brand velocities and distribution growth.

Our ONE nutrition bar business had a difficult year in 2020, as category trends were significantly impacted by COVID-19. While overall retail sales declined approximately 5% for the year, the brand gained approximately 20 basis points of market share. As we progressed through 2020, some retailers began to shift space from on-the-go nutrition bars to in-home ready to drink protein and powders to align with COVID-19 trends. Based on discussions with retailers, we believe these trends are temporary, and we expect bars to recover as consumer mobility increases. The team is continuing to focus on supporting top SKUs and smart innovation in mini-bars and plant-based bars, so that we are well positioned to grow as trends reverse.

In our international markets, performance remains challenged as COVID-19 restrictions and economic difficulties are negatively impacting the category. Hershey has outperformed the category, with chocolate share gains in all key markets for the year. As I mentioned earlier, we are implementing new strategies in our international markets that we believe are important for our long-term financial objectives. Specifically, in Q4 we made the decision to evolve our go-to-market model in China.

As many of you know, over the past several years we have focused on optimizing our business model to prioritize our chocolate brands, modern and e-commerce channels, and improve profitability. As we have done this, we have continued to evaluate our operations, and the best way we can provide consumers the products they love in the most efficient and effective way.

As a result, we have decided to rely more heavily on utilizing best-in-class, local distributors in China to make our products available to Chinese consumers. This transition will take place after Chinese New Year. While we will remain in many retail outlets in China going forward, we do anticipate sales declines in 2021 as we make the transition. While sales are expected to decline, we do expect stronger profitability from a more efficient operating model, and we believe we can return to sales growth in China in 2022.

Excluding China, we have seen stabilization across markets and expect to grow in 2021. India had a strong finish to the year with fourth quarter reported sales growth of 20%, and we plan to continue expanding distribution to drive additional growth in 2021.

In Brazil, results were hampered by FX, however organic constant currency growth was 4.8% in the fourth quarter.

And in Mexico, despite a challenging retail environment due to COVID and new packaging requirements, organic constant currency sales declines improved versus Q3.

We will continue to adapt our business models and investments to respond to the changes we are seeing in consumer behavior and remain optimistic about the long-term opportunity in these markets.

With that, let me now turn it over to Steve to provide more details of our 2020 financial results and expectations for 2021.

Steve Voskuil

Thank you, Michele, and good morning, everyone.

I want to build on Michele's comments and also convey how proud I am of the way our teams worked together, safely and with integrity, to deliver moments of goodness for our consumers, customers, suppliers, communities, shareholders, and each other.

Our fourth quarter results speak not only to the strength of our brands and our execution, but also the passion and dedication of our teams across the globe. In the fourth quarter, we delivered accelerated reported net sales growth of 5.7%, reflecting continued momentum in our North American confectionery business. North America reported a net sales increase of 8.9% in Q4, driven primarily by volume. This strong performance was ahead of expectations due to our seasonal business, as well as better than anticipated performance within our food service, vending, concession, and specialty retail business.

Within our seasonal business, strong sell through resulted in fewer markdowns and less cannibalization on our everyday business, and we were able to capitalize on marketplace supply chain challenges to capture incremental orders for the holiday season.

In addition, several key retailers requested earlier shipments of Valentine’s and Easter products to ensure they had adequate supply. While these orders shifted from Q1 2021 into Q4 of 2020, we do not expect a material impact on Q1 sales as this shift was offset by additional order strength on Valentine’s and Easter.

Within our non-measured channels, we saw a noticeable improvement in trends versus Q3. While sales declined in the high-single digits, inventory replenishment contributed to our better than anticipated performance. Given that, and the recent spike in COVID-19 cases and associated lockdown measures, Q1 performance in these channels may be lower than what we saw in Q4.

Within our International & Other segment, reported net sales declined 17.3% in the fourth quarter. FX was a 420 basis point headwind. While sales grew in India and in our export business, we saw continued COVID-19 related pressures in Mexico, Brazil, World Travel Retail, and our Chocolate World locations. These results were relatively in line with expectations.

In China, while category sales remain soft, the majority of our net sales decline was driven by the change in the go-to-market model Michele mentioned earlier. Given the seasonally heavy period for the Chinese New Year, the team took a prudent approach to managing orders, inventory, and waste ahead of the transition to minimize risk in Q1.

Overall, we are pleased by the strength of our core business and our meaningful category share gains across segments and markets. This strong sales performance to close the year helped drive margin expansion and business reinvestment and resulted in another quarter of double-digit EPS growth. Q4 adjusted EPS was \$1.49, a 16.4% increase versus prior year.

Adjusted gross margin expanded 50 basis points in the fourth quarter, to 43.9%, led by our North America segment. In North America, gross margins expanded 120 basis points, to 45.9%, as pricing, productivity, and fixed cost absorption were able to more than offset inflation.

Gross margins in our International & Other segment remained pressured due to sales declines across most of our key markets. Recall, Q4 is normally our lowest margin quarter in the International & Other segment due to seasonally driven market and portfolio mix. As a result, sales decline had an even greater impact on gross margins than what we saw in the third quarter, despite comparable net sales declines.

This strong sales and margin performance enabled robust business reinvestment in the fourth quarter to ensure strong seasonal sell through to sustain our everyday U.S. momentum into 2021. In North America, advertising and related consumer marketing spend increased 9.9%, driven by increased investment on our core brands, seasonal products, and our ecommerce business. This increase was consistent with our expectation to grow advertising roughly in line with sales.

In our International & Other segment, we continued to take a disciplined approach to cost management to minimize the profit lost from volume declines in the segment. As a result, advertising and related consumer marketing spend in this segment declined 21.8% in the fourth quarter.

Divisional and corporate expenses were relatively in line with prior year, as reduced travel and meeting costs were offset by increased capability and community investments. Given higher than expected sales and profit in the fourth quarter, incentive compensation came in higher than our previous estimates but was slightly favorable versus prior year.

Fourth quarter adjusted operating profit of \$429 million resulted in an adjusted operating profit margin of 19.6%, an increase of 170 basis points versus the fourth quarter of 2019. Sales growth and gross margin

gains in North America more than offset increased marketing expenses and profit declines in our International & Other segment.

The adjusted tax rate for the fourth quarter was negative 8.1%, a decline of almost 18 points versus the year ago period. Due to unique COVID-19 issues in 2020, many tax credit projects experienced delays over the course of the year resulting in more projects being completed in the fourth quarter than normal. This, in turn, drove a substantial increase in our other expense line for the fourth quarter and a very low tax rate for the quarter. Overall, the net impact of these twoline items was relatively in line with our previous estimate.

Fourth quarter Other expense was \$104 million, an increase of \$69 million versus the prior year period. We remain committed to our capital allocation priorities, reinvestment for growth, dividends, and share repurchases with appropriate leverage.

In the fourth quarter, total capital additions, including software, were approximately \$150 million, bringing the full year investment to \$442 million. This is below our original plan expectations driven primarily by the delays in our supply chain and ERP projects that we spoke about earlier in the year. Overall cost estimates for these projects remain in line with original estimates, and therefore we expect 2021 and 2022 Capex to remain elevated as we complete these strategic programs.

Now, to dividends and share repurchases. In the fourth quarter, we paid \$163 million in cash dividends. We did not complete any repurchases related to stock option replenishment, nor did we repurchase any shares against the \$500 million authorization. Approximately \$260 million remain available under this repurchase program.

While we took a conservative approach to share buybacks in 2020 due to COVID-19, our business and P&L resiliency give us confidence to return to a more traditional buyback strategy in 2021. We are in a strong cash position exiting the year, with balance sheet flexibility to continue investing in our business, pay our dividend, and advance our M&A agenda.

Now, let me share some perspective around our expectations for 2021. As Michele mentioned, we expect volatility to continue in 2021, however, we have good visibility into the first quarter and are confident we can deliver another year of balanced sales and earnings growth in 2021. From a topline perspective, we believe many of the trends we saw in Q3 and Q4 will continue into the first quarter of 2021.

In the U.S., we have good visibility into seasonal orders, and expect continued strong take home chocolate sales and share gains.

As we move through the year, our performance will be impacted by the progression of COVID-19 cases and the vaccine rollout, as well as potential changes to competitive dynamics. For the full year, we do not expect material changes in innovation, promotion, or inventory levels. We do, however, expect inventory to be a tailwind in the first half of the year and a headwind in the second half.

As we shared on our last call, we expect volume to be a larger contributor of overall growth in 2021 compared to the past two years as we lap pricing elasticity and continue to gain share. In January, we communicated price pack architecture changes on part of our seasonal portfolio that will result in approximately 50 basis points of price realization for the year, primarily to be realized in the fourth quarter.

Within our International & Other segment, we expect trends in most markets to be similar to Q3 and Q4 2020 until we begin lapping COVID-19 declines in the second quarter. While we do not expect sales trends to worsen, the magnitude and pace of recovery as we move through the year, remains uncertain.

In China, the changes to our go-to-market model to enhance profitability are expected to have a slight negative impact on overall Company sales growth.

From a gross margin perspective, we expect modest expansion this year driven by productivity, fixed cost absorption, the lapping of incremental COVID-19 incentive costs for 2020, and our operating model change in China. While spot market prices for some inputs including raw materials and freight have risen recently, our proactive approach and robust hedging program enable us to minimize the impact on our P&L this year.

Let me take a minute to discuss cocoa in a bit more detail given some of the more significant changes the market is experiencing this year. First, as we have shared before, we are fully participating in the Living Income Differential for our ongoing and substantial purchases from the 2020 and 2021 Cote d'Ivoire and Ghana crops. This is one of many factors impacting our overall costs. Another key component is supply and demand, not only of overall cocoa beans but also of key cocoa derivatives, including liquor, butter, and powder.

Hershey, like many manufacturers, relies primarily on cocoa liquor and butter to manufacture chocolate. As many of you know, COVID-19 has pressured global demand for chocolate while supply has stayed the same in many markets and increased in others. This has created temporary market opportunities throughout the year and led to declining cocoa butter prices, which softened the impact of the increased investment associated with the Living Income Differential this year.

We expect advertising investment to grow ahead of sales as we lap marketplace efficiencies from 2020, invest to maintain new rituals consumers adopted during COVID-19, and support our strong share gains. Overall divisional and corporate expenses are expected to grow in line with sales, as incentive compensation favorability is offset by capability investments and the return of some travel and meeting expenses in the second half of the year.

We expect our full year 2021 adjusted effective tax rate to be approximately 15% as we plan to continue investing in tax credits. Full year Other expense, which includes our spend on those tax credits, is estimated to be approximately \$125 million to \$135 million.

Finally, interest expense is expected to be roughly \$130 million in 2021. This is approximately \$20 million favorable versus 2020 and driven by planned bond repayments in both February and May. Our capital allocation priorities remain the same, and we will continue to invest heavily behind key initiatives in 2021, including our ERP transformation and supply chain initiatives focused on increasing capacity and agility. We expect full year capital expenditures to be approximately \$550 million.

We look forward to sharing more details on our long-term financial objectives and capital allocation priorities at CAGNY in a few weeks.

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

Michele Buck

Thanks, Steve.

We are excited about the progress we've made and the opportunities we have ahead of us. While 2021 will continue to be uncertain, we remain focused on understanding our consumers' needs and the world around them continuing to be part of important traditions and new occasions and executing with excellence against the things within our control, while building strategies and capabilities for the future.

We have significant investments this year, not only in our brands, but also in technology, supply chain, capabilities across sales and marketing, and our people.

We are advancing our ESG agenda and plan to announce our science-based targets in the next couple of months, continue our cocoa sustainability efforts, announce our deforestation policy, advance our efforts to be a more diverse and inclusive company, and continue to invest in the communities our employees live and work in during these challenging times. I couldn’t be more excited about where we are, and where we are going.

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.