The Hershey Company

Fourth Quarter 2022 Earnings Results
Q&A Session

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Robert Moskow, *Credit Suisse*

Ken Goldman, *JPMorgan*

Bryan Spillane, *Bank of America*

Michael Lavery, *Piper Sandler*

Cody Ross, *UBS*

Chris Growe, *Stifel*

Nik Modi, *RBC Capital Markets*

Jason English, *Goldman Sachs*

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PRESENTATION

Operator

Greetings, and welcome to the Hershey Company's Fourth Quarter 2022 Question-and-Answer Session.

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

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

Melissa Poole

Good morning, everyone. Thank you for joining us today for The Hershey Company's Fourth Quarter 2022 Earnings Q&A Session.

I hope everyone has had the chance to read our press release and listen to our pre-recorded Management remarks, 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. 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 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

Thank you. At this time, we will be conducting the question-and-answer session.

Our first question comes from the line of Andrew Lazar with Barclays. Please proceed with your question.

Andrew Lazar

Thanks so much. Good morning, everybody.

Michele Buck

Good morning, Andrew.

Steve Voskuil

Good morning.

Andrew Lazar

Hi there. I guess just one for me. I'm trying to get a better sense of how you're thinking about elasticity for '23, versus what you saw in '22, which was very little, and what percentage increase in capacity are you expecting for this year, and I guess I ask because, you know, if elasticity were to stay as benign as it has been and you ramp some capacity, I'm trying to get a sense of whether it could render your flat to slightly down volume outlook for the year somewhat conservative or if continued capacity constraints limit the potential for top line upside from here.

Michele Buck

Yes, thanks, Andrew. As we look at price elasticities, we are assuming that they will be closer to last year than they were to historic, but not quite as good as last year, and as we look at our capacity, we will have low-single-digit increases in capacity, which do give us some ability to flex with demand as we see it.

Steve, anything else?

Steve Voskuil

No, that's spot on.

Michele Buck

Yes.

Andrew Lazar

Excellent. That's it. Thank you so much.

Michele Buck

Thanks, Andrew.

Operator

Thank you. Our next question comes from the line of Robert Moskow with Credit Suisse. Please proceed with your question.

Robert Moskow

Hi, thanks, and congrats, everyone, for such a great year. I wanted to know if the guidance for '23 is more aggressive than normal. Like, you normally start the year rather conservative, but this year you're guiding above your normal algorithm, and I want to know if you could kind of isolate what the key drivers are and why you've raised it compared to three months ago. Maybe drilling down, it looks like gross margin is coming in better than you thought, maybe you can explain why. Then, also, on market share, are you expecting market share gains in Confectionary in '23? Thanks.

Steve Voskuil

Sure. Do you want me to start with that one?

Michele Buck

Yes, go ahead, Steve.

Steve Voskuil

Yes. So, just on the big movers on the top line, obviously price driven, and we have good visibility into that, we saw that effect be part of the driver for the fourth quarter performance, and so we see that carrying forward, especially through the first three quarters of next year, and we do have elasticity factored in, as Michele said in the last question. Our planning isn't quite down to the levels of historic elasticity, but it probably looks more like last year, to see it sort of drop further through the P&L. We do see some benefit from the gross margin side as we see more stabilization and the pricing coming down and some cost efficiencies, and a return to more historic levels of productivity. Now, we still have to reach for more productivity, but at least this year we're starting to see something that we hadn't seen in the last two years. So, those are some drivers through the P&L that far.

On the market share side, yes, we do expect to have positive market share next year. I think that's one that we're disappointed about this year and want to see turn the other direction next year.

Michele Buck

Yes, and some of that market share will be helped by the incremental marketing investment, as we've taken that up, as we have additional capacity online, and certainly the additional capacity, as well. As we think about the pacing of the market share, you should think about it relative to the beginning part of the year will be slower and we won't see those declines probably till we get into the spring, but once we hit the spring, that will really kick into gear. We know that we had some lost opportunity this year around Seasons, that we weren't able to fulfill totally all of the orders, and then, also, a little bit of a mix impact from refreshment being a late rebounder given social behaviors, but we think that'll neutralize going forward.

Robert Moskow

Okay, makes sense, and just one follow-up. On the gross margin side, are your costs, like, inflation costs, coming in better than you thought, or is this really just productivity is accelerating more than you thought?

Steve Voskuil

Yes, it's probably more on the productivity side. We have pretty good visibility into the COGS costs, and with the hedging program and so forth, particularly on commodities. We're still expecting high-single-digit year-over-year inflation through commodities and a lot of the materials items, and mid-single-digits on things like labor and logistics and other supply chain costs. I don't think those assumptions have changed much from our outlook, but probably a little bit more productivity.

Robert Moskow

Great. Thank you.

Michele Buck

Thanks.

Operator

Thank you. Our next question comes from the line of Ken Goldman with JPMorgan. Please proceed with your question.

Ken Goldman

Hi, thanks. You're guiding to a gross margin around 44.5% next year. I'm just curious, for this coming year, what do you see as, I guess, "normal" level, if there is such a thing in this kind of environment. I guess, more specifically, if you can grow your gross margin by a healthy amount in an inflationary environment, is there any reason it can't ultimately get back to 45% or above?

Steve Voskuil

Sure. Yes, I mean, our model is growing gross margin every year. That would be the goal. That's really part of the growth algorithm. We've had two years where that's been a challenge. We see that now turning for 2023, and really getting back on the algorithm. I would like to say it's price- and inflation-agnostic in terms of the strategy. How we get there will change based on the external environment. But, yes, we do see restoring to gross margins that we had in the past and, frankly, continuing to drive that forward.

Ken Goldman

Then, how do we think about the breakdown of sales growth and operating margins by segment in 2023? You gave a little bit there, but are there any unusual items we should be aware of for either of these segments, just as we consider our models, maybe drivers that aren't necessarily apparent at first glance?

Steve Voskuil

Yes, the only things that are unusual or different, if I kind of go to Salty, and we mentioned some of this in the remarks, Salty is going to have strong top line, we're expecting that. We're also expecting to see gross margin improvement year-over-year. We saw some of that in the fourth quarter, finally seeing pricing catch up in that business a little bit to inflation, but still some room to grow, but we'll see some reinvestments below that. So, we're going to activate more against the brands next year, we're going to do some capability investments between the lines to really scale up the infrastructure, and part of that infrastructure is the ERP transition that we talked about in the prepared remarks, but that's probably the area of IT. Strong sales growth, some gross margin improvement, less drop-through to up margin that we might see in a normal year on the back of those capability investments. Other than that, I think the other segments are probably pretty traditional in terms of their growth characteristics.

Ken Goldman

Thank you.

Operator

Thank you. Our next question comes from the line of Bryan Spillane with Bank of America. Please proceed with your question.

Bryan Spillane

Thanks, Operator. Good morning, everyone.

Michele Buck

Good morning.

Bryan Spillane

My question is just around the advertising and consumer spend investments. I guess I have two questions. One, in the prepared remarks, one of the things you talked about investing in is workforce, so I wanted to just understand, is that, like, more merchandisers and people in the field, or something else, and then—maybe I'll start with that, and then I had one other follow-up.

Michele Buck

As we look at some of the investments that we're making in our employee base, clearly, one of our key strategic goals this year is really to integrate and scale our Salty business, and so we are adding some incremental talent there to really make sure that we have the right skillsets and that we have all the employee base and talent needed to do that heavy lifting in the work, some of that also around improving our planning systems, some of the things that when you buy a smaller company, we need some more sophisticated capabilities. Then, obviously, given a lot of the work across the business on supply chain, where we are continuing to invest to build capacity and resiliency in the network, we have made investment in supply chain talent, as well.

Bryan Spillane

Okay, but it's not specifically adding merchandisers or more people, frontline sales people?

Michele Buck

Oh, no. No.

Bryan Spillane

Okay, okay. Then, the second just was related to kind of the thinking behind the double-digit increase in advertising and consumer spend. Is that partly sort of a function of just inflation has been so persistent? Obviously, you've got price increases on your own product lines, but consumers are just seeing—you know, have seen a lot of inflation across a lot of consumables. If you're going to have that level of pricing, you really need to advertise in order to sort of make sure consumers stay engaged, because you're going to have to start making some choices, or was there something else that kind of drove the decision or the need to increase advertising at that rate?

Michele Buck

Yes, absolutely. You know, our long-term model, we believe in advertising. We've seen the impact and the returns that we get on advertising in terms of having very strong ROIs, so we take a very data-based approached to media spending and we invest where we see that incremental profitable growth. Over time, we do know that that advertising builds consumer connectivity and we know that that consumer connectivity is part of what helps us to have the elasticities that we do. People are connected to our brands, and during the tough times, we know that that connectivity leads to them continuing to buy. So, yes, it is important during an inflationary time, and we've done statistics over that analysis to validate that.

Then, as you know, we reduced spend last year, really due to capacity constraints, and we did see an impact in demand on several of our brands, and so those are really the priorities where we are reinvesting this year, and we're also investing in some of our white space opportunities, like Gummies and better-for-you to strengthen the business, as well as our Salty brands, where we're really in a major growth mode, gaining household penetration, gaining market share, and we want to continue that momentum.

Bryan Spillane

Right. Thanks, Michele.

Michele Buck

Sure.

Operator

Thank you. Our next question comes from the line of Michael Lavery with Piper Sandler. Please proceed with your question.

Michael Lavery

Thank you. Good morning.

Michele Buck

Good morning.

Steve Voskuil

Good morning.

Michael Lavery

I just want to start by following up on the spending. Could you give us a sense—I recognize last year, you adjusted spending to match or better align with the capacity limitations, but would this year be restored levels to sort of the optimal targets, or do you still see that ramping into next year, as well? I'm just trying to understand the sense of—if you'll be back on your sort of steady run rate or kind of ideal level, or if we're not even quite going to be there yet until maybe 2024?

Michele Buck

Yes, I mean, we are always looking at the returns that we're getting on our spending and making decisions as we go forward based on that. We think that we're in a reasonable zip code. I think we've said before that we don't think we have to go back up to the very highest levels that we were at historically. We've done a great job over time getting a lot of efficiency, getting very tight in our targeting, so that we're getting even greater returns, but I wouldn't also commit that this is the high mark above which, you know, we're not going to move above. We're still probably not quite back to exactly the point we want to be.

Michael Lavery

Okay, that's really helpful. I just want to unpack a little bit more, if we can, a comment you made in the prepared remarks about Seasons being a growth driver. You said it's off to a great start. Obviously, last year, it went really well, as well. So, just would love to understand a little bit better how that unfolds and how have you been thinking about that.

Michele Buck

Yes, we continue to anticipate very strong growth in the Seasons. We've continued to see that in the category. Consumers, during the past several years, have even dialed up their interest in Seasons. It is a strong part of our portfolio. It's a place where we do very well. It's a place where there's a lot of emotional connectivity. If there's an anchor event, people want to participate in those anchor events with the brands that they love, and so we think that there's opportunity. We had some missed demand that we weren't able to fully fulfill because of capacity, and we're going to be in a much better position this year to be able to more fully capture that opportunity. Now, the first part of the year, as I mentioned earlier, from a share perspective, we won't be as strong as we anticipate that we will be for the Seasons towards the back part of the year.

Michael Lavery

Okay, great. Thanks so much.

Operator

Thank you. Our next question comes from the line of Cody Ross with UBS. Please proceed with your question.

Cody Ross

Good morning, and thank you for taking our questions. I just want to go back to the last question on volume and perhaps unpack cadence throughout the year. You have increased capacity for Seasons coming on, but you're also lapping the over-shipment in the first half this year. Can you just unpack a little bit how you expect volume to progress throughout the year, understanding that you expect for the full year it to be flat to slightly down? That's my first question. Thank you.

Michele Buck

Steve, can you talk about that?

Steve Voskuil

Yes. Going into the first part of the year, Seasons, we've already identified the volume and shipments there, so, yes, as Michele said, we still—we're dealing with some capacity constraints leading into Seasons in the front part of the year. When you look at the year overall, we're not expecting any big material differences by quarter for volume.

Cody Ross

Okay, that's helpful, and then just one last question on capital allocation here. You're at the low end of your leverage target over the long term. Are you beginning to look at making additional acquisitions or perhaps return more cash to shareholders in the upcoming years? Thank you.

Michele Buck

Well, I'd just say job one right now for us is integrating the amazing acquisitions that we bought, SkinnyPop, Pirate's and Dot's, and we're investing to leverage their full potential. However, we do always continue to be in the market looking at assets that can continue to advance our strategy, expand our portfolio appropriately into high-growth consumer demand segments, and we certainly do have a lot of balance sheet flexibility to be able to do the right M&A if it becomes available.

Steve Voskuil

That's right, and I would say, more broadly, from a capital allocation standpoint, no major changes. We definitely want to be giving back cash and repurchasing shares, that's part of our strategy. That puts good tension on the internal investments and M&A to make sure we're getting the best returns, and so that's an area we'll continue to monitor. We've got a lot of Capex this year, and so that's one thing that we're taking into consideration as we look at the overall balance of capital allocation.

Operator

Thank you. Our next question comes from the line of Chris Growe with Stifel. Please proceed with your question.

Chris Growe

Hi, good morning.

Michele Buck

Good morning.

Steve Voskuil

Good morning.

Chris Growe

Hi, and thanks for the question. First, if I could, a bit of a follow-on to an earlier question, but, in particular, in the Salty Snacks Division, with the margin being so strong in the fourth quarter and reaching over 20%, was there anything unique to the quarter? I certainly heard about investments you want to make both internally in advertising throughout 2023. I guess I just want to understand how you expect the margin to fair throughout the year. Does margin expand, but just not to the level which it did here in the fourth quarter?

Steve Voskuil

Yes, we're really pleased with the fourth quarter finish, and probably two things drove that. One, we did have easier laps in the fourth quarter, and then, second, as we said earlier, we are seeing pricing catching up a little bit more to some of the inflation that we saw over the course of the year, so we got a little bit of a benefit of that, as well. As we look to margins for that business going forward and into next year, we want to—again, on the gross margin line, expect to see some continued advancement. We have a lot of plans still to optimize that business, and we've talked before about streamlining the back office, streamlining the supply chain network, better integrating all of that with our existing Hershey systems, and so forth. In fact, we'll talk more about that when we get to our March investor conference and spend some time on that. But, have aspirations to continue to see that profile up over the course of the year, but as Michele said, we are going to reinvest some of that back between the lines to accelerate top line, to invest behind the brands, and then on the capabilities investments, like ERP. But, I would say the key takeaway is we have still have high margin aspirations for that business as we look forward over the next couple of years.

Michele Buck

And most of those will occur over the longer term. We don't expect significant margin expansion or margin expansion in '23.

Steve Voskuil

Yes.

Chris Growe

Okay, that's helpful, thank you, and then just a quick follow-up, if I could, to understand how inventory will fair through the year. You talked about depleting some inventory late in the year as you move to the new ERP system. Should inventory grow through the year and then you deplete it, or does it hold this level and it just goes lower as you kind of move that inventory out? Have you built it already, I guess is the question, or do you expect to build more?

Steve Voskuil

We haven't built it all already. There might be some build, not that material. I mean, there's a limit to how much Salty inventory we can build. But, as we said, when we get to the fourth quarter, we expect a pretty significant depletion, and that's really just to allow the cutover between systems. So, on a net/net basis, that will look like a negative for the year for that business. We would expect to see that come back next year, probably, with a strong start to the year.

Chris Growe

Okay. Thanks so much for your time.

Steve Voskuil

Sure.

Operator

Thank you. Our next question comes from the line of Nik Modi, with RBC Capital Markets. Please proceed with your question.

Nik Modi

Yes, thank you. Good morning, everyone. Michele, I was hoping you could just comment on fill rates, kind of where you guys are now versus kind of where you'd like to be. I know things are below where they have been historically. Just curious, is that just a function of capacity, or if there's also a labor component to that? Then, I had a bigger picture question.

Michele Buck

I would say our fill rates are much better than where they were. There's been some significant improvement versus last year, as we've been able to invest in capital and get additional capacity on the ground, and, really, there's minimal impact from labor, it was really largely very much tied to capacity. Now, we did staff up in labor to enable us to be able to obviously execute against the capacity and the incremental lines, but we're seeing less network disruption than we've seen in the past, not all the way back to the perfect situation it was before the pandemic, but it's certainly improved.

Nik Modi

Great, thanks for that color, and then just the bigger question is—you know, look, these categories, especially on the Chocolate and Confectionary side, I think, clearly, we can see a renaissance, and maybe we can attribute some of that to COVID, but I'm just curious, like, what does your research, your internal research say about what's actually going on with the consumer in these categories, because I think we can all agree the underlying trend rate has been much better than I think anyone would have expected a couple of years ago?

Michele Buck

Well, certainly, we know that snacking has been on the rise, has continued to be on the rise as a consumer behavior pre-pandemic, and also post-pandemic. We know that there still is a bit more at-home behavior versus folks cutting back on going to restaurants, and, certainly, that's a benefit across packaged goods snacking. We also know, based on our insights, that consumers are interested in snacking, and particularly in Confection and Chocolate, on two diametrically kind of opposed parts of their emotional state. One is when they are incredibly happy and it's a treat time and they want to treat themselves and the other is when there are down times and they want a bright spot, but they do view these categories, especially Chocolate, as a part of kind of emotional wellness, what it does and how it makes them feel.

Then, of course, I think, the more that we interact with consumers—and this really hasn't changed over time—consumers have emotional connectivity to our brands. Our brands are more than just about the products, they are about the moments of connection. Many of them are used in special times. We get letters all the time with people talking about the special role that some product played in their life, they remember when they were with a friend experiencing it or with their kids in the Seasons, and I think that continues to be timeless, and perhaps has even dialed up a bit since the pandemic.

Nik Modi

Great. Thanks for that color.

Operator

Thank you. Our next question comes from the line of Jason English with Goldman Sachs. Please proceed with your question.

Jason English

Hey, good morning, folks. Thanks for slotting me in. My apologies. I didn't get a chance to go through all the prepared remarks. We had a lot going on this morning. I apologize in advance if I ask redundant questions. Two quick things. First, the capacity expansion. You gave some quantification for the year. What's the cadence? When should we expect to see that capacity coming online?

Steve Voskuil

Yes, it's going to be coming online throughout the year. Again, this further fits into a broader discussion we've had on capacity expansion, I think, we've talked in the past. If you look at the 2020 to 2024 period, we're looking at a 15%-ish increase in capacity off the network. So, what we're going to see in 2023 is going to be a low-single-digit contribution towards that goal, and I would kind of think about it coming in ratably over the course of the year.

Jason English

Okay, and the elevated Capex, it sounds like it's a long slog. Should we expect this elevated level to continue into next year, and maybe the year beyond, as well?

Steve Voskuil

Yes, not at this level, but I would say at least for 2024, we will have some amount of elevated Capex. We'll still be finishing off the ERP program and still probably having some tail investments from a capacity standpoint. So, those are the two things I would point to. On the Capex, as we talk about all the time, the majority of that Capex is targeted on capacity expansion, and if you click into that, a large portion is driven by the recent fantastic growth we've had there. Reese's capacity and network expansion has improved significantly, but we still have opportunities, some on Reese's and some on other brands, to unlock more efficiency and capacity. So, that capacity expansion, plus the ERP investments, that will eventually drop out, are the two kind of biggest components of the Capex right now.

Jason English

Understood, and last question for me. I've always considered your European venture to be a bit opportunistic, it's a small taxable export business, yet recently you've kind of carved it out as a standalone business with a designated head. Does this signal anything in terms of your strategic intent on expansion in Europe?

Michele Buck

No, not at all. In reference to any of the talent changes that we made, they were really in the course of just normal development and expansion for people to get new opportunities. Europe continues to be small, we continue to feel that we are making great strides and seeing a lot of growth there, but there is no strategic change in our approach to that market at all.

Jason English

Understood. Thank you.

Operator

Thank you. Our next question comes from the line of 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

Can you talk about your key innovation plans for '23, and how are you thinking about the drivers of top line growth between innovation versus existing brands, where you've been capacity constrained?

Michele Buck

Sure. Innovation continues to be an important part across our portfolio and we have several items that are launching this year that we think will generate a lot of consumer excitement and merchandising. If we look at our core Confection business, the highlights there would be Reese's stuffed with Reese's puffs. We have a limited edition, which is a Reese's Creamy, and then a Reese's Crunchy product. So, a line of limited editions that let consumers pick their favorite, which texture they like. Then, we have an exciting new KISSES flavor, that is called Milcolicious (phon), which is KISS filled with a milk chocolate filling. On our Salty business, we launched a limited time edition this year, a Dot's cinnamon sugar flavor, and so folks will see that in the market as it's been very successful. So, those are probably the highlights with some of the biggest innovations.

We continue with our strategy that we employed several years ago, that's really helped to accelerate our top line growth, which is, while innovation is important and we will support innovation across the board for news and excitement, we really don't want to stray away from a primary focus on our core. Our core, our brands that are sustainable, they have been out there for a long time, consumers love them. The velocities on them will always be stronger than innovation. So, across our entire portfolio, driving our core is job one, and then using innovation for news and excitement.

Pamela Kaufman

Great, thank you, and just in terms of your organic growth outlook for 2023, how are you thinking about the growth between North America Confectionary and Salty Snacks, and maybe if you could just touch on some of the key growth drivers behind the Salty Snacks business for '23?

Michele Buck

Let me talk about some of the growth drivers and then let me have Steve talk a little bit about the other part of your question.

As we look at Salty Snacks, we will be, as Steve mentioned, investing in marketing to really continue to expand those brands and businesses, and continue our growth in household penetration. So, that is clearly an investment that will drive growth. We continue to have some level of distribution upside, especially on Dot's. On Dot's, we saw distribution upside, as well as increased item counts in 2022, and we'll see some of that growth continue as we go through '23. Once we get beyond that, we think we'll then start to be going more to velocity increases and price pack architecture opportunities. So, those are some of the biggest ones. Investments in SkinnyPop, in advertising, as well, will continue to unlock growth potential. I think those are some of the biggest growth drivers across the Salty business.

Steve Voskuil

Yes, just at a very high level, from a Confection standpoint, we're expecting high-single-digit top line, price being the primary driver there, and as we talked about earlier, Seasons, underneath that Seasons, and then media investment behind the brands are going to be big components of that. On the Salty side, double-digit growth, which is what we should expect from that business. Price there, as well, but also volume, and, again, as we said, there, too, we're investing behind the brands. We have some distribution opportunities, as Michele mentioned. On the International side, solid mid-single-digit performance on the back of distribution, volume, some pricing, as well, and some innovation. So, at a high level, those are sort of the big targets.

Pamela Kaufman

Thank you.

Operator

Thank you. Our next question comes from the line of Chris Carey with Wells Fargo Securities. Please proceed with your question.

Chris Carey

Hi, good morning, and thank you for the question.

Michele Buck

Good morning.

Chris Carey

Steve, you gave good information on gross margin ranges for the year, a little bit on cadence with the Q1, and the impacts of inflation. It's just striking to see high-single-digit commodities in terms of just labor, which is in this dynamic of sticky inflation that we're seeing across the staples landscape, but you clearly have good visibility into that outlook. I guess what I'm wondering is—this is going to be, probably, a volatile environment for inflationary drivers, namely, commodities, over the next year, and I'm just trying to frame, if there is a change in the commodity outlook, is that something that changes your own outlook, or are you so locked in on costs at this point that it's, "No, we have good visibility on the year and we're fairly locked in, and that's really more of a consideration a year from now," something like that, and I have a quick follow-up?

Steve Voskuil

Sure. In general, we have pretty good visibility, I would say, across COGS and commodities. I'd say the hedging program gives us some of that visibility. The caveat is that, if you look at the last two years, where we've been bitten in some cases, has been the things that we don't hedge and have been volatile, things like packaging and resins and specialty ingredients, and so forth, dairy even in some spots. Those are ones that, I think, we keep an eye on. Movement of some of those, material movements can move the needle. We saw some of those material movements in the last few years. I think our expectation is some of that will settle down, and with that settling down and our visibility into the rest of COGS—I agree with you it's still potential for volatility, but we feel we sort of picked the guidance range to try to accommodate most of that volatility.

Chris Carey

Okay, that makes sense. One quick follow-up, and perhaps something that's even better suited to the Investor Day coming up, but this confidence on long-term margin improvement, and then, clearly, we saw an inflection in the Snacks business today, with positive commentary on the medium term in that business, so when you think about that long-term margin, between the Confection and Snacks side, do you have any sense of what would be driving that between those segments, or is this just more of a holistic target for the organization over time? Thanks so much.

Steve Voskuil

Yes, that is a great one for the Investor conference, but I will say our expectation is we want to see margin improvement across all parts of the business, all segments. We've seen a lot of improvement in International in recent years, but we have the same expectation that that's going to continue, also, and that we're going to optimize and grow, but grow in a sustainably profitable way there. Salty, probably expectations, given the capital that we've deployed in those acquisitions, and the opportunity we touched on, things like private label and the impact that still has on the business as we look to the future, you know, opportunities to extract more margin out of that business, and always on the Confection side, we want to have a model that drives margin accretion.

Chris Carey

Okay. Thanks for the insights.

Operator

Thank you. Our next question comes from the line of David Palmer with Evercore ISI. Please proceed with your question.

David Palmer

Thanks. I have a question on gross margin in this latest quarter, especially versus the third quarter. The reason I'm asking for color about what might have been your biggest unlocks that fourth quarter is because, one, on a multi-year basis, it looks like pricing was rather similar to the third quarter, yet your year-over-year margin trend improved, and that fourth quarter was actually higher than it was in the fourth quarter of 2019. So, any color about unlocks and gross margin would be helpful.

Steve Voskuil

Yes, I think the biggest driver that we touched on, we did have some better productivity, dropping through supply chain efficiencies that had ramped up, and as Michele said, we're not all the way back in terms of that supply chain efficiency, but we did see an uptick in the fourth quarter, and then I'd say the volume growth on the elasticity side helping, and dropping some fixed cost absorption through the P&L, as well. Those are probably—if I was to point to just a couple of things, those are the ones I'd point to.

David Palmer

And just a big picture question, one I've been thinking about. During this COVID era, clearly, at-home snacking did well, and you guys have made your own thunder with S'mores and your Seasons, and you seem to have pretty good visibility into what you're doing each year in Seasons, and so it looks like you're poised to have a pretty good 2023, but I'm wondering, as you just think about the overall energy for at-home snacking as an occasion, do you have a view about whether that can sustain in terms of it's growth rate. I wonder about this not just for Hershey, but for other companies, as well. Any comments there would be helpful. Thanks.

Michele Buck

Sure. So, let me start by saying, as much as we have benefited on our take-home business with at-home snacking, our instant consumable business has also been quite strong. We've really seen growth across all three segments of our business, even take-home and instant consumable. We don't expect that we're going to lose volume on those segments going forward, so we don't see a reversal in the trend, but we would say that growth may moderate. We would expect it to moderate a little bit versus where it's been as consumers just shake out into their normal ongoing behavior.

David Palmer

Thanks.

Operator

Thank you. Our next question comes from the line of Steve Powers with Deutsche Bank. Please proceed with your question.

Steve Powers

Yes, hi, good morning. I want to go back to the two topics you talked about already, the A&P investments and the workforce investments, just a little bit drilling down into those. On the A&P side, any notable phasing of the incremental spending that you're planning, and if so, just the drivers of that phasing, if you could. Then, on the workforce side, Michele, you walked through a number of priorities, especially on the Salty side, and I think they make sense and they're, frankly, intriguing. I guess the question is where are you with those hires? Is that something that we should anticipate you kind of have in the near-term pipeline and the investments show up early in the year and carry forward, or is it something that builds and the spending progressively layers on as the year goes on, just where you are in making those hires that you talked about earlier? Thank you.

Michele Buck

As we look at the investments in marketing spending, you should think about the Confection investments being fairly stable throughout the year. On Salty, our investments will be more front loaded during the year, because of the—towards the end of the year is when we're doing the S4 conversion, so we're really going to drive the volume harder at the beginning, and those investments, harder at the beginning of the year. SG&A spend, we will see that across the quarters, and especially beginning in Q1.

Steve Powers

Okay. Thank you very much.

Operator

Thank you. Our next question comes from the line of Max Gumport with BNP Paribas. Please proceed with your question.

Max Gumport

Hey, thanks for the question, just one for me, and it's on gross margins. You expect gross margins to be up 40 to 50 basis points year-over-year in 2023, given net price realization and higher levels of productivity, which are expected to offset inflation, but it sounds like 1Q '23 gross margins will be pressured due to lapping a timing benefit related to inventory valuation last year. I'm trying to get a sense if you close frame the magnitude of that 1Q '23 impact. Thanks.

Steve Voskuil

You're exactly right, for quarter one, that will be our most pressured gross margin quarter. In fact, I expect we'll be still down year-over-year for the first quarter because of those laps. I don't know that I'll get as specific as the guidance for that, but you're exactly right, that'll be our most pressured gross margin quarter.

Max Gumport

Great. I'll leave it there. Thanks very much.

Steve Voskuil

Thank you.

Operator

Thank you. Our next question comes from the line of John Baumgartner with Mizuho Securities. Please proceed with your question.

John Baumgartner

Good morning, and thanks for the question.

Michele Buck

Good morning.

Steve Voskuil

Good morning.

John Baumgartner

First off, Michele, in Confection, you're bringing more capacity online, you're increasing brand spending, as well, but how are you thinking about in-store activation at this point? I think, going back pre-COVID, there was an increased focus in the aisle with the King size and some different shelf sets, and then you moved to the checkout lines and you were taking some shelf space from magazines and non-consumables. So, When we think about 2023, and I guess even beyond at this point, what are the levers you see as most impactful from here? Where can you still benefit from activation going forward?

Michele Buck

We are always looking to optimize across the entire mix of levers that we have to drive activations. Managing the shelf distribution, shelf space is always a priority. There were some areas, as we were lighter on capacity, where we were unable to fill some of those distribution needs, so we see some of that ahead of us as an opportunity, as we have improved service. We talked a little bit earlier about the marketing spending, where we had to pull back again because we were lighter on capacity, so reinstating that, we know that there's a very strong return on that. Reinvesting in the front end, retailers are always looking at how they optimize front end space, and so we partner with them, and we continue to see opportunity there. As we look at our in-store promotional spending, we do believe that getting visibility and display in-store is important to our business. That said, our promotional spending is below COVID levels and we've seen that we've continued to be able to drive the business where those promotional levels are today, so that's not a key priority to reinstate back to the past.

John Baumgartner

Okay, thanks for that. Then, Steve, on the Salty Snacks margin, there was a lot of noise this year. You mentioned the catch-up on pricing. You had the warehousing in Q4. You had some reduced promo and advertising spending. As we think about the sequential increase in margin from Q3 to Q4, is it possible to bucket those tailwinds across the different elements, or maybe what do you think the underlying run rate is for segment margin exiting '22, is it mid-teens, is it high-teens? I'm just trying to think about the moving pieces versus the structural improvements there thus far. Thank you.

Steve Voskuil

Yes, it's a fair question, there have been a lot of movements across the quarters. Think about run rate in the mid-teens. That's probably a good baseline to operate from. There'll still be movement across the quarters, probably, especially as we look to the back half of this year, with that ERP transition that we talked about. As we get further into the year, we'll give more color to some of that variability, but if you think about mid-teens, that's probably a good starting spot.

John Baumgartner

Okay. Thank you very much.

Operator

Thank you. Our next question comes from the line of Jonathan Feeney with Consumer Edge. Please proceed with your question.

Jonathan Feeney

Good morning, and thanks very much. It's been about 15 points or so over the past two years of pricing and I was wondering if you could characterize—I know it's data-driven, but I wonder if you could characterize how much of that was driven by this narrative about rising costs, and if costs continue to moderate, or even decline, should we expect some—is the expectation from the retailer that some of that pricing goes away if costs go down, or has this just all been a change in the conversation to, you know, let's work together to grow the category? I'm just curious about how much risk you have if costs, in fact, start to moderate or decline. Thank you.

Steve Voskuil

Sure.

Michele Buck

We always work together with retailers to try and maximize category growth, that is our fundamental premise, especially being leaders in all of the categories that we are in. If the category is growing, we feel really good that we will benefit from that growth. Historically, there hasn't really been a move in the category to execute price declines or price rollbacks. As prices have gone up, they have tended to stick in the marketplace, as a matter of principle, of how the category dynamics have worked.

Jonathan Feeney

Okay, thank you.

Michele Buck

Then, what we really try and do is to leverage some of that favorability in price in our holistic model to reinvest for growth, whether that's reinvesting in capabilities to get smarter about managing the shelf with the retailer, helping them to find new points of interruption, or whether that is incremental consumer investment.

Jonathan Feeney

Makes sense. Thank you.

Steve Voskuil

Thank you.

Operator

Thank you. Ladies and gentlemen, that concludes our question-and-answer session. I'll turn the floor back to Ms. Poole for any final comments.

Melissa Poole

Thank you so much for joining us this morning. We will be available for any follow-up questions you have. Have a great day.

Operator

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