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The Hershey Company

Fourth Quarter 2022 Earnings Results
Prepared Remarks

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CORPORATE PARTICIPANTS

Melissa Poole, *Vice President, Investor Relations*

Michele Buck, *Chairman of the Board, President and Chief Executive Officer*

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 Fourth Quarter 2022 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 2. 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.

In 2022, The Hershey Company delivered one of its strongest years in history despite record inflation, continued supply chain disruptions and macroeconomic uncertainty for many consumers. It took tremendous hard work, perseverance and agility from every one of our employees and partners, and I couldn't be prouder of what they've accomplished or more excited for what lies ahead. We expect to deliver another year of strong sales and earnings growth in 2023, as we invest in our amazing portfolio of brands, additional capacity and capabilities.

We achieved a milestone in 2022, exceeding $10 billion of net sales, led by double-digit organic sales growth across our segments and the addition of more great tasting snacks to our portfolio. While high inflation contributed to our sales growth, we were also able to grow volume, a testament to our brands and execution in a volatile market.

Despite capacity constraints, Reese's retail sales grew 10.5% for the year, its second consecutive year of double-digit growth. Since 2018, Reese has gained nearly $1 billion in retail sales, representing nearly a quarter of total chocolate category growth during that period, and while capacity constraints impacted our ability to fully capture consumer demand, we were able to maintain our share lead versus the number two competitor in the confectionery category.

With the addition of Dot's Pretzels and Pretzels Inc. to the portfolio, our Salty Snacks segment now represents approximately 10% of Company net sales. Organic growth for the year was 18.7%, with nearly half the gain driven by volume growth as our brands reached even more households and delivered against more consumer occasions.

Within our International segment, net sales growth of over 16% was broad-based, led by combined growth of 20% in our key markets of Mexico, India and Brazil. The team continued to make huge strides optimizing the portfolio mix and cost structure to deliver operating income gains of over 45%, resulting in a full year operating profit margin of 12.6%.

Despite varied supply chain obstacles during the year, the team delivered a record year of production and significantly improved output and inventory levels over the course of the year.

While we spent a lot of time focused on execution, we also continued to advance work on capabilities critical to our growth ambitions, and will continue to do so in 2023. Key priorities this year include increasing advertising on key Confection and Salty Snacks brands, adding capacity on our fastest growing brands, including Reese's and Skinny Pop, transitioning all of our Salty Snacks brands onto our new ERP platform and readying for the 2024 U.S. Confection implementation, and adding talent within our Salty Snacks segment to scale up capabilities to support the businesses' robust growth.

As we look ahead, we remain confident in our expectation that we will deliver a strong year on both the top and bottom line.

Across markets and products, consumer demand has continued to pace ahead of our expectations. While more than half of U.S. consumers indicate inflation is having a major impact on their grocery shopping, many are spending more as they cut back on dining out. In addition, our largest categories, Chocolate and Salty Snacks, rank as two of the top three resilient treats that consumers are not willing to forgo. Chocolate moments are such a heavily integrated part of consumers' weekly routines, from rewarding moments to stress relief to self-care, and everything in between, that they indicate they would rather cut back on other expenses to make room for chocolate because they love it so much and it's affordable. Salty snacks are another regular companion that consumers are hard-pressed to cut back out of their grocery budget. Not only are they affordable compared to other expenses, but they are key parts of both parents' and kids' daily routines.

As a result, we believe snacks and confection trends will continue to pace ahead of other food categories, and our planned increases in advertising levels, supported by higher production capacity, are expected to further bolster Hershey's growth and help offset price elasticity.

Advertising levels are planned to increase double-digits, with nearly half of this increase dedicated to our largest confection brands and occasions, including Reese's, Hershey's and Seasons. Key white space growth opportunities including gummies and better-for-you will also receive greater levels of support this year. Salty Snacks will see a meaningful increase in investment this year as we look to deepen consumer engagement and build brand equity for these fast-growing brands. Over the past three years, retail sales for Skinny Pop, Pirate's Booty and Dot's have more than doubled.

Points of distribution have increased by 70% and households buying have increased 40%, bringing household penetration to 25%. With this greater scale comes an opportunity to activate greater levels of media to continue building brand equity and maintain our top line momentum.

Based on our 2022 performance and incremental capacity available in 2023, we anticipate that Seasons will be an important driver of our growth this year. Valentines is off to a great start and all signs point to continued consumer enthusiasm for the Easter season.

Within our International markets, we will continue to expand distribution in India and Mexico on our core Hershey products and local jewels, and strengthen our Reese's brand equity in select markets. The teams will also build on recent innovation successes, bringing differentiated offerings in Latin America and Europe, and expand our Hershey campaign 'celebrating inspirational women' across the globe.

To support this growth and enable greater efficiencies and stronger resilience, we will continue to make meaningful, but disciplined, investments in our supply chain network. In 2023, we will add capacity for our largest and fastest growing brands. This will enable us to increase overall production capacity, improve service levels, and insource production to help improve profitability. As we invest for growth, our teams continue to remain focused on enhancing our manufacturing network to optimize output, margin, utilization rates and service levels. We look forward to sharing a bit more about these strategies and investments at our Investor Day in March.

We are also making incremental investments within our supply chain to support our ESG agenda. Our primary focus remains on cocoa, with progress on increasing sourcing visibility, expanding child labor prevention, monitoring and remediation programs, forest protection, as well as planned investment in an innovative program to improve farmer incomes and strengthen economic resilience. We look forward to sharing more about these important initiatives in the coming months.

We remain relentlessly focused on investing in the necessary capabilities, talent and infrastructure to sustain differentiated performance for years to come. We have a portfolio of amazing brands, an advantaged financial structure, and a talented team of individuals whose passion for excellence and transformation is surpassed only by their commitment for achieving it in the right way.

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

Steve Voskuil

Before we delve into Q4's financial performance, I, too, would like to take a moment to thank our teams for a milestone year. In 2022, we had four consecutive quarters of exceptional growth across our financial metrics. For the full year, we reported net sales growth of 16.1%, adjusted gross profit dollar growth of 14.5%, adjusted earnings per share growth of 18.5%, and operating cash flow growth of 11.8%. This is an outstanding performance.

In the fourth quarter, net sales grew 14%. Organic constant currency net sales growth of 10.7% was balanced across segments. Net price realization contributed 8.5 points of growth, in line with expectations. Volume contributed an additional 2.2 points of growth, driven by continued strength in consumer demand across segments.

Adjusted gross margin increased 20 basis points to 43.7%. Net price realization and higher volumes drove these gains and offset broad-based cost of goods sold inflation, higher labor and manufacturing costs, and unfavorable portfolio mix. This was ahead of expectation, driven by the top line outperformance and an improvement in supply chain execution.

For the full year, adjusted gross margin declined 90 basis points. Approximately 50 basis points of this decline was driven by mix related to the private label portion of our recent pretzel's acquisitions. Excluding the impact of acquisitions, adjusted gross margin declined approximately 40 basis points. While down versus 2021, I'm proud of our teams' efforts and swift actions taken throughout the year to navigate a difficult operating environment and deliver differentiated performance versus the rest of the industry, behind both price realization and volume gains.

Advertising and related consumer spending increased 3.3% in the quarter, driven by higher levels of media on Reese's and Jolly Rancher brands as new capacity came online. Corporate and divisional expenses increased 15.4%, driven by incremental capability and technology investments, an increase in non-income tax reserves and cycling a favorable benefit accrual from the prior year period.

The adjusted tax rate for the fourth quarter was negative 6.5%, a decline of 870 basis points. This was driven by higher renewable energy tax credits versus the prior year period, which in turn primarily drove an increase in other expenses of about $40 million versus the same period last year.

We are pleased by the strength of our core business and improving trends in profitability as we exit the year. This strong sales performance to close the year resulted in another quarter of double-digit adjusted EPS growth, increasing 19.5% versus prior year.

In the fourth quarter, total capital additions, including software, were nearly $160 million, bringing the full year investment to approximately $520 million. Certain capital projects experienced equipment delays related to broader supply chain challenges that lowered the projected spend for the year. In the fourth quarter, we paid $207million in cash dividends, totaling over $775 million in cash returned to shareholders in 2022, an increase of 13% versus the prior year.

As we look forward to this year, we expect continued strength in net sales growth, with reported net sales projected to grow 6% to 8%. Price is expected to be the largest contributor to growth, with volumes projected to be flat to slightly down for the year, as higher levels of advertising and increased capacity help offset price elasticities. Price realization is expected to skew slightly towards the first three quarters of the year as we begin lapping in-pricing in Q4.

In aggregate, inventory levels are relatively healthy, and we do not expect material changes to retail inventory in 2023. We do, however, expect a slight net sales headwind of about one point related to inventory, as we lap last year's significant confection replenishment and deplete internal inventory levels within our Salty Snacks segment in the fourth quarter as we transition ERP platforms.

From a profitability perspective, we expect gross profit dollars to increase high-single-digits and gross margin to expand approximately 40 to 50 basis points in 2023. Net price realization and higher levels of productivity are expected to offset continued cost of goods, labor, packaging and logistics inflation. While we expect full year expansion, we do expect gross margin declines in the first quarter as we lap a timing benefit related to inventory valuation in the prior year period.

Strong gross profit growth fuels the rest of our P&L, beginning with reinvesting in our brands. Brand reinvestment is a critical growth lever in 2023, and advertising and related consumer spend is expected to increase low double-digits versus prior year as we increase advertising on core confection and salty brands.

Strong sales and margin performance also enables investment in capabilities, technology and our workforce. These investments are expected to partially offset favorability in incentive compensation. Combined, operating expenses, including divisional and corporate expenses, are anticipated to grow by mid-single-digits in 2023.

Below operating profit, we expect our full year 2023 adjusted effective tax rate to be approximately 15% to 16%, which assumes fewer renewable energy tax credits versus 2022. Other expense, which includes our spend on those tax credits, is also expected to be lower, though partially offset by higher pension cost of approximately $15 million. In aggregate, other expense is expected to be in the range of $190 million to $210 million. Finally, interest expense is expected to be $145 to $155 million, which reflects the higher interest rate environment.

Reinvesting in our core business is one of the best ways we can deploy capital and is a key growth enabler for us. Capital investment this year is expected to be between $800 and $900 million, with at least 60% of this spend focused on core capacity expansion. Late last year, we announced three new projects, a chocolate-making facility and line expansion in Hershey, Pennsylvania, and a line expansion at our plant in Robinson, Illinois. These projects will expand our capacity of Reese's, Hershey's and Mounds/Almond Joy, and are expected to be operational in 2024. An additional 20% of our spend is focused on digital infrastructure and capabilities, including the upgrade and implementation of our ERP system, along with projects focused on improving productivity.

We are looking forward to sharing more details on our long-term objectives and capital allocation priorities at our Investor Day in a few weeks.

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

Michele Buck

Thanks Steve.

As we continue to drive the business, we remain as passionate as ever about leading the right way and deepening the trust and relationships we have with all of our stakeholders, including our consumers. We are honored to have been recognized last month on the annual ranking of America's Most JUST Companies by JUST Capital and media partner CNBC. We are particularly proud that Hershey was ranked number one by customers in the Food, Beverage and Tobacco industry. 2023 marks the Company's fourth consecutive year on the list, moving up 26 spots from 2022.

Before I close, I want to reiterate my appreciation and pride in my colleagues across the Company who delivered fantastic results and are now focused on another successful year ahead.

With that, 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.