Company Name: Hershey
Company Ticker: HSY US
Date: 2019-10-24
Event Description: Q3 2019 Earnings Call

Market Cap: 30594.3295542
Current PX: 145.979995728
YTD Change($): 38.7999957275
YTD Change(%): 36.201

Bloomberg Estimates - EPS
Current Quarter: 1.267
Current Year: 5.756
Bloomberg Estimates - Sales
Current Quarter: 2038.583
Current Year: 7945.5

# Q3 2019 Earnings Call

## Company Participants

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

## Other Participants

- Andrew Lazar, Analyst
- Kenneth Goldman, Analyst
- Jason English, Analyst
- Alexia Howard, Analyst
- Christopher Growe, Analyst
- Robert Moskow, Analyst
- Nik Modi, Analyst
- John Baumgartner, Analyst
- Steven Strycula, Analyst
- David Palmer, Analyst
- Michael Lavery, Analyst
- Kenneth Zaslow, Analyst

## Presentation

### Operator

Good morning, everyone, and welcome to The Hershey Company's Third Quarter 2019 Results Conference Call. My name is Catherine, and I will be your conference operator today. All participants have been placed in a listen-only mode. After the speakers' remarks, there will be a question-and-answer session. (Operator Instructions) This call is scheduled to end at about 9:30 AM, so please limit yourself to one question so we can get to as many of you as possible. Please note, this call may be recorded. Thank you.

I would like now to turn the call over to Melissa Poole, Vice President of Investor Relations. Ms. Poole, you may begin your conference.

### Melissa A. Poole, Vice President of Investor Relations

Thank you, Catherine. Good morning, everyone. We appreciate you joining us for The Hershey Company's third quarter 2019 earnings conference call and webcast. Michele Buck, Chairman of the Board, President and CEO; and Steve Voskuil, Senior Vice President and CFO, will provide you with an overview of our results followed by a Q&A session.

Before we begin, please remember that during the course of this call, we may make forward-looking statements within the meaning of the federal securities laws. These statements are based on our current expectations and involve risks and uncertainties that could differ materially from actual events and those described in these forward-looking statements contained in our 2018 10-K filed with the SEC and today's press release.

Finally, please note that on today's call, 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. Please refer to today's press release for a reconciliation on the non-GAAP financial measures to the most comparable measures prepared in accordance with GAAP.

With that, I would like to turn the call over to Michele.

## Michele Buck, Chairman, President and Chief Executive Officer

Thanks, Melissa. Good morning to all of you on the phone and on the webcast. We are pleased with our third quarter results and the momentum we are seeing on our core business. Investments in our brands and capabilities as well as strong execution are driving solid confection sales and share gains in both our US and international markets.

Our Amplify portfolio continues to deliver mid to high single-digit growth and we continue to execute against our broader snacking ambition with the acquisition of ONE Brands, a portfolio of high growth, better-for-you nutrition bars that enables us to capture incremental consumer occasions. I'd just like to pause briefly and say thank you to all of our employees who work so incredibly hard to deliver today and also to create momentum for our future.

In the third quarter, net sales increased 2.6%. Organic constant currency net sales growth of approximately 1.6% was in line with expectations, driven primarily by pricing in North America and volume growth in international. The net impact of acquisitions and divestitures was 120 basis point benefit driven by our Pirate Brand acquisition, and FX was a 20 basis point headwind.

We had another strong quarter of gross margin expansion that enabled a double-digit increase in brand reinvestment as well as adjusted earnings per share growth of approximately 4%. We remain focused on investing in our brands and capabilities for growth, while also delivering consistent earnings performance over time, something we believe is a differentiator for us and critical to driving shareholder value.

Our key initiatives within our US core confection business continue to perform well and are driving strong retail takeaway and accelerating share performance. For IRI, Hershey candy, mint and gum retail sales increased 2.2% versus prior year in the 12 weeks ending October 13. This resulted in a share gain of approximately 23 basis points. Our $2 billion Reese's brand had another outstanding quarter with retail sales growth of over 6%. Growth was balanced across multiple levers, including, strong advertising, distribution gains, smart innovation, new packaging, seasons and pricing. Reese's Thins is performing well and we are encouraged by the sustainability and incrementality of the launch.

We also relaunched our Take 5 brand under the Reese's umbrella late this summer and early results are strong. As some of you may now, Take 5 is my favorite Hershey candy. So I couldn't be more thrilled to see takeaway up over 50% since the relaunch, and we believe there is more opportunity to capture on this great tasting product.

Reese's along with several of our other brands like Hershey Miniatures, Kisses and Kit Kat are seeing nice lift from our new packaging in the take-home isle. Performance on these improved fags has been consistently trending up since the transition and we are achieving all of our key benchmarks and driving growth both for us and for our retailers. Our Halloween season is off to a solid start and sell-in was strong after a successful 2018 season. The power of our core brands, breadth of our product line up and incremental capacity are enabling us to deliver great assortments and innovative packaging for our consumers. Additionally, this year we have an Adams Family movie partnership that we will leverage to drive shopper engagement via advertising, merchandizing and on-pack promotions for key items.

Our e-commerce confection business continues to perform well with net sales growth of approximately 50% in the third quarter, driven by a strong Halloween sell-in and balanced performance across all fulfillment models. We are measured Hershey share of the chocolate category continues to increase with gains of 610 basis points in the quarter according to third-party sources.

Our pricing initiatives remain on track and are performing in line with expectations. As we have discussed previously, we believe strategic pricing is an important lever for us to enable investment in our brands and capabilities. In 2019, we have invested in capabilities such as media targeting, digital commerce, new business models and supply chain. These capabilities in addition to our brand investments in innovation, advertising, seasons and distribution are driving balanced sustainable growth in the marketplace.

As we look ahead to the rest of the year, we are excited to keep the momentum going with some great activations. Our Ice Breakers brand is partnering with Disney to bring character packaging and high impact merchandising to stores for the highly anticipated release of Frozen 2 next month. This is a great opportunity to capitalize on the cultural momentum of the movie and secure incremental merchandising opportunities in store.

For our holiday program this year, we will build on last year's success by continuing to drive our core and leverage a hero innovation item to secure incremental merchandising and engage with our consumers. This year's item is Reese's Mystery Shapes, which combines the anticipation and surprise at the holidays with the perfect ratio of peanut butter and chocolate that our consumers create during the seasons. It is the first new Reese's holiday shape in 20 years, and it will be available nationwide for a limited time only. And as we announced earlier this year, we will be launching Kit Kat Duos in December. Our supply chain investments in incremental capacity and new production capabilities allows us to bring consumers the crispy, light wafer they love surrounded by dark chocolate on the bottom and mint cream on the top. The launch will be supported with merchandising, national TV and digital media.

Now for an update on our recent acquisitions. SkinnyPop continues to perform very well in the marketplace with retail sales up over 10% in the latest 12 weeks. This growth has significantly outpaced competition resulting in a share gain of 170 basis points in the ready-to-eat popcorn category. So household penetration and frequency has consistently grown this year, a testament to the underlying strength of this brand. We will leverage this strength to continue optimizing placement and facings on shelf as well as secure incremental space for new pack types that meet different consumer occasions. Pirate's Booty performance is improving versus the first half of the year in line with our expectations. In the latest 12 weeks, the business has begun to stabilize and trends are strong where distribution has been maintained. While performance is not yet where we want it to be, we remain confident in the strength of the brand and our visibility into recapturing lost distribution as planograms reset.

Now for a few more details on our most recent acquisition and venture investments. Last month, we closed our acquisition of One Brands, and I am excited to welcome the team to The Hershey family. One is a portfolio of low sugar, high protein nutrition bars with net sales of approximately $100 million. As many of you know, the nutrition bar category is approximately $3 billion and is growing mid to high single-digits. So One portfolio is growing 40% to 50% and has a strong presence outside of measured channels, including a robust e-commerce business. We expect the acquisition to be slightly accretive to earnings in year one and highly incremental through our existing portfolio.

We also announced two minority investments in emerging snacking businesses, Fulfil Holdings and Blue Stripes in August. Fulfil is one of the leading makers of great tasting vitamin fortified, high-protein nutrition bars in the UK and Ireland. And Blue Stripes Cacao Shop offers experiential retail that combines the goodness of cacao with a unique customer experience. This center model provides the company with new avenues for growth through the deployment of small capital investments in disruptive or emerging platforms focused on new occasions, new technologies and new go-to-market opportunities.

Now for an update on our international markets. Constant currency organic sales grew 3.7% in the third quarter and we continue to see strong segment operating income growth of almost 27% as we focus on increasing gross margins and rightsizing our brand and SG&A investments. Our business in Mexico continues to show strong high-single digit growth behind increased distribution and innovation of our Hershey's and Pelon Pelo Rico brands.

In India, we continue to see robust growth of over 16% behind distribution gains and our launch of Hershey Kisses. The Kisses launch remains on track and we plan to expand to additional cities in 2020. And our China business is also growing high single-digits on an organic constant currency basis, driven by improved velocity on our Hershey Bars and region specific flavor innovation, which is driving incremental growth.

In Brazil, our performance has been challenged by a difficult macroeconomic environment and increased competition. While we have invested additional trade to remain competitive, we are also being disciplined about the returns on our investment as we look to balance both the top and bottom line.

In summary, we continue to feel good about the momentum we have across our key strategies and the business results we are delivering. We will continue to invest in our brands and capabilities to take the business to the next level and drive sustainable top and bottom line growth.

I'll now turn it over to Steve, who will provide you with details on our financial results.

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

Thank you, Michele, and good morning, everyone. Third quarter net sales of $2.1 billion increased 2.6% versus the same period last year. The net impact of acquisitions and divestitures was a 120 basis point benefit and foreign currency translation was a 20 basis point headwind. Organic constant currency net sales growth of 1.6% was driven by pricing, which contributed 1.1 points of growth, while volume contributed 50 basis points of growth.

Our 2018 price increase remains on track and as anticipated, the impact increased in the third quarter versus the first half. This was offset by our pricing transition period related to our July 2019 price increase, which executed in line with expectations. We continue to expect minimal full year sales and earnings impact from our most recent pricing action.

Adjusted earnings per share diluted were $1.61, an increase of 3.9% versus the same period last year. This was driven by continued gross margin gains, partially offset by increased brand investment and higher incentive compensation versus prior year.

By segment, North America net sales increased 2.7% versus the same period last year. Price realization was 150 basis point benefit and the net impact of acquisitions and divestitures was also a 150 basis point benefit.

Volume was a 20 basis point headwind and foreign currency exchange was a 10 basis point headwind. North America gross margins expanded 80 basis points in the quarter as favorable commodities and net price realization offset incremental logistics costs. This was slightly higher than our expectations.

Recall in the second quarter, we experienced a gross margin benefit related to external inventory mix and fixed cost absorption, both related to our July price increase. While we expected most of this benefit to reverse in the third quarter as inventory levels normalized, we now expect the majority of the impact to occur in the fourth quarter.

Given this timing shift and the more difficult laps from the year ago period, we expect Q4 gross margin expansion to be less than the third quarter. We continue to be pleased with the underlying momentum in our margin expansion initiatives and the business reinvestment it is enabling.

North America advertising and related consumer marketing spend increased 14.4% in the quarter, driven primarily by advertising. This increase is in line with expectations as we prioritize reinvesting gross margin expansion gains back into our brands to drive growth. As we have shared previously, the dollar spend increase is more meaningful in the second half of 2019 versus the first half, as we are lapping significant media efficiency gains in the year ago period.

Third quarter total International and Other segment net sales increased 1.8%. Volume was a 5.3 point benefit driven by organic growth in our key focus market. Net price realization was a 160 basis point headwind as we invested more in response to increased competitive activity. Foreign currency exchange was a 100 basis point headwind and divestitures were a 90 basis point headwind. Combined organic constant currency net sales in Mexico, Brazil, India and China grew 7.4% versus the third quarter of 2018.

International and Other advertising and related consumer marketing decreased 14% versus prior year, as we continue to right-size investment and increase ROI in China and our regional markets.

Total Hershey adjusted gross profit increased 4.4% resulting in an adjusted gross margin of 44.8%, an increase of 80 basis points versus the third quarter of 2018. This was driven by favorable commodities and net price realization. Third quarter adjusted operating profit of $477 million, resulting in operating profit margin of 22.3%, a decrease of 30 basis points versus the third quarter of 2018 as gross margin gains were offset by incremental brand investments and higher incentive compensation.

Moving down to P&L, interest expense of $35 million decreased $1.5 million versus Q3 last year due to lower short-term interest rates. We expect full year interest expense of approximately $145 million, the high end of our previous range due to our recent acquisition of One Brands.

The adjusted tax rate for the third quarter was 20.1% versus 22.8% in the year ago period. These gains were driven primarily by excess tax benefits from stock based compensation, along with higher tax investment credits. For the full year, we expect an adjusted tax rate of approximately 18.5%.

Third quarter other expense was $18 million, an increase of $5.5 million versus prior year driven primarily by unfavorable pension expense. For the full year, we expect other expense of approximately $70 million to $75 million. This is below our previous estimate as we plan to exercise fewer tax investment credits and is offset by a slightly higher tax rate for the full year. The net impact of these two changes is negligible versus our previous estimates.

For the third quarter of 2019, weighted average shares outstanding on a diluted basis were $211 million, reflecting a slight increase versus the second quarter due to an increased number of stock option exercises in the quarter. The company repurchased $191 million of common shares in the third quarter in connection with the exercise of stock options. The company did not repurchase any shares in the third quarter against our July 2018 $500 million authorization and $410 million remain.

Total capital additions, including software, were $60 [ph] million in the third quarter. For the full-year 2019, we continue to estimate capex of around $350 million. We continue to return cash to our shareholders with third quarter dividends of $158 million. This was our 359th consecutive quarterly dividend on the common stock, a testament to our strong balance sheet and strong cash flow generation.

Before I close, let me provide some additional information on our recent acquisition of One Brands. As Michele mentioned, net sales are approximately $100 million, given our mid-September close, we expect approximately $25 million of sales in the fourth quarter for this acquisition. The margin profile on this portfolio is attractive and we expect it to be slightly accretive to earnings in year one.

Given acquisition related costs, we expect it to be slightly dilutive to reported earnings in the fourth quarter and have a negligible impact to adjusted earnings in Q4. Our focus will be on maintaining the brand's current momentum, continuing to build brand equity and secure incremental distribution and capturing supply chain and procurement synergies.

To summarize for the full year, we expect full year reported net sales to increase to around 2.5%, an increase versus the previous guidance, driven by the acquisition of One Brands. The net benefit from acquisitions and divestitures increases to approximately 1.0 point. Full-year FX impact is anticipated to be slightly negative based on current exchange rates. Full-year reported earnings per share diluted are expected to be around $5.58, relatively flat to prior year.

Full-year adjusted earnings per share diluted are expected to grow 6% to 7% consistent with our previous outlook as the impact of One Brands acquisition has a negligible impact on earnings in 2019.

That concludes my financial discussion. And I'll now turn it back to Michele.

## Michele Buck, Chairman, President and Chief Executive Officer

Thanks, Steve. We remain confident in our strategies and in our ability to deliver our financial commitments for the year. We are pleased with the progress we have made over the past two years, but we continue to operate with a healthy dissatisfaction that drives us to push and elevate the business even further. I continue to be energized by the opportunities presented by this rapidly changing environment and the power of our amazing brands and remarkable people to capitalize on this change to unlock new opportunities for the future. We will continue to focus on delivering today and building for the future in a way that is consistent with our values and purpose.

Steve, Melissa and I are now available to take your questions.

# Questions And Answers

## Operator

(Operator instructions) Our first question today will come from Andrew Lazar with Barclays. Please go ahead.

## Andrew Lazar, Analyst

Good morning, everybody.

## Michele Buck, Chairman, President and Chief Executive Officer

Good morning, Andrew.

## Andrew Lazar, Analyst

Hi there. So I guess, and thinking ahead a little bit, Hershey has already discussed some incremental pricing for 2020, roughly 2% on average. In terms of volume, the SKU rationalization drag I think is behind you at this point. The volume elasticity from the previous pricing, I think it's largely behind you. And obviously Hershey's, you've talked about a stepped up brand investment quite a bit. I do recognize there at least some volume elasticity on the new pricing increase could be a partial offset a little bit on volume going forward. So, I guess, I was hoping if you could just comment maybe even more broadly on how sort of all of these factors are expected to come together, in terms of how we think about volume moving forward. At a high level, it would seem like volume could at least be maybe flattish or given the puts and takes if not a bit better. Or are there discreet, maybe other volume headwinds we should be aware of, maybe it's Easter timing or things along those lines. Thanks so much.

## Michele Buck, Chairman, President and Chief Executive Officer

Yeah, I think if we think about our retail takeaway trends and revenue going forward, I think that there is no reason to expect that the trends wouldn't be similar with what we have been seeing and are seeing here in the back half of this year. I mean, as you think about going from '19 into '20, clearly we will gain a little bit from SKU wrap being behind us. We lose a little bit in terms of Easter and going to a shorter Easter, but net-net, I think those are two of the single biggest changes. You're right that pricing kind of continues at a pretty steady pace. So I think it's fair to assume that the trends would be roughly similar to what we've been seeing here in the back half of the year.

## Andrew Lazar, Analyst

Got it. And those trends in the back half have been around consumption, I think have been, I guess, what you said, today around 2-ish or a little above 2-ish more or less, is that fair?

## Michele Buck, Chairman, President and Chief Executive Officer

Yes, exactly. That's fair. I think we've always said 1.5% to 2% of growth we would get from North America and yes, retail trends -- retail takeaway trends around 2%.

## Andrew Lazar, Analyst

Great. Thank you so much.

## Michele Buck, Chairman, President and Chief Executive Officer

Thanks.

## Operator

Our next question comes from Ken Goldman with J.P. Morgan. Please go ahead.

## Kenneth Goldman, Analyst

Hi, thank you. And Michele, congrats on the added title and responsibilities.

## Michele Buck, Chairman, President and Chief Executive Officer

Thank you.

## Kenneth Goldman, Analyst

I wanted to ask two questions. One, sort of the mechanics of the gross margin impact by the benefit that you got in 2Q was originally expected to reverberate and hit 3Q, now you're mentioning 4Q as the bigger impact. Can you walk through the mechanics of that because to me it was more of a fixed cost absorption benefit. And I just don't understand the timing is delayed by a few months. So that would be helpful. And then I have a follow-up.

## Michele Buck, Chairman, President and Chief Executive Officer

Yeah, I mean, you will --

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

Sure, yeah, happy to take down. The -- as we talked about the second quarter and as you said, Ken, really two pieces there. One, mix driven. We were selling a richer mix for us is instant consumable, that was a benefit for us and then inventory build both ours -- the inventory build in the second quarter and third party inventories. We expected to see more of that inventory come down in the third quarter and we got a little bit of that benefit back probably about a third of what we expected. We expect more inventory reduction in the fourth quarter and that's really the reason for the delay. There is more inventory as we got into the third quarter, both in the third-party and ours and it took longer to bleed it out.

## Kenneth Goldman, Analyst

Okay. Thank you for that. And then my follow-up, Steve, it's only always exciting topic of working capital, but if you look at working capital, forget inventory for a second, because I know there's timing issues there, but looking at your payables, and on a last 12 month basis as percentage of COGS, they've been decreasing for lowest they've been in a few years. Your last 12 month receivables as a percentage of sales at a highest they've been in over a decade. So can you just walk us through what's going on with these items that's running a little bit less favorably for you at least as I look at it and maybe what the opportunity is to turn them around.

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

Yeah, it's a great question. If you look at, say, the pace of the balance sheet and cash flow today, I think net working capital year-over-year through nine months is about a $10 million drag across all three of those components. And if you extract one out of there, so one sort of clouds up the numbers a little bit. It's just a slight positive cash generator year-over-year. But inside that, you're exactly right, we have opportunities to be more efficient on working capital. I think inventory in particular is one that's in our crosshairs here and we think about the future. But we do see the need to be efficient in working capital is one of the sources of funding that helps fund the investment and the other things we want to do with the business. So you can expect, we'll probably talk more about that as we think about 2020 plans and beyond.

## Kenneth Goldman, Analyst

Thank you.

## Operator

We'll now go to Jason English with Goldman Sachs. Please go ahead.

## Jason English, Analyst

Hey, good morning, folks, and thanks for signing me in. I appreciate it.

## Michele Buck, Chairman, President and Chief Executive Officer

Good morning, Jason.

## Jason English, Analyst

Well, good morning. I want to -- I wanted to -- I just come back to the direction of the question that Mr. Lazar was asking in terms of price contribution as we look into next year, but first kind of close out this year. Do you still expect to see roughly 250 bps of price contribution in North America for this fiscal year?

## Michele Buck, Chairman, President and Chief Executive Officer

No, no, -- Jason, fourth quarter, yes. Not for -- the full year was always around more 1.5% because of the time it takes for pricing to build. So we took 2.5% as we mentioned, until that hits fully through the year because of price protection timing, we expected more like 1.5% on the annual basis to even out the year.

## Jason English, Analyst

And that price protection timing, how much longer does it run for? Is it not -- is it not behind us now?

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

Largely behind us as we exit the third quarter, but there is still inventory that will be getting run down in the fourth quarter, some of which was still price protected, but they largely behind us.

## Jason English, Analyst

Right, right. So, I guess, that's the component where I'm just having a hard time bridging because we've got the bracket changes of 50 bps, the gum etc., and sugar confection, we've got to wait out benefit and we should start to see what price protection behind, albeit volume is muted because of the inventory reduction. I would expect to see some of that single-serve pricing come through. I mean, you add all that up and it's a much bigger chunk than say 250 bps in the fourth quarter, what am I missing in the math and maybe what I'm missing is just sort of reinvest, we're seeing you reinvest in SG&A, maybe there's a reinvestment in above the line type investment as well. If you could help me understand that I really appreciate it.

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

I'll take maybe the total P&L side and then we can talk about what (inaudible) to add on the growth line. When you look at the fourth quarter P&L in total, you've got a couple of headwinds. One is the incentives that we mentioned on the call, there was an impact in the third quarter will also be a drag in the fourth quarter. We've got a tax drag in the fourth quarter this year, we've had a lot of our tax planning benefit across the first three quarters. Last year, the fourth quarter was a big tax planning quarter, and so that by itself is order of magnitude an $0.08 drag. So you have those two pieces working again. So we'll have some more DME investment in the fourth quarter, similar to what we saw here. And then that gross margin roughly reversal from the second quarter that Ken talked about just a few minutes ago. So from a total P&L standpoint below sales, there was some of the big drivers driving the -- I'll say deceleration in the fourth quarter P&L. And Melissa you want to add anything on the top line specifically?

## Melissa A. Poole, Vice President of Investor Relations

Yeah, just on the pricing piece. You're right and how you're thinking about the build of last year's and this year is kind of compounding. I guess, the two pieces I would point you to is we did have most of our Halloween business shipped in the third quarter, so that the job we get from that is mostly behind us. So we don't have Halloween pricing in the fourth quarter because we don't really ship too much in the fourth quarter. And then the last piece on price protection. There is still a little bit of price protection for some of the promotional activities of our most recent price increase. So we kind of give in the third quarter would have been more around kind of face volume time to transition to the new prices that everybody gets on everything. In the fourth quarter there is a little bit of promotional activity that we will also deal back. So absolutely right that it should be higher than what it was in -- so far year-to-date and in the third quarter, but I don't know that it's enough to kind of trip you into a pretty significant pop in earnings, given all the point that Steve had walked you through.

## Jason English, Analyst

That's helpful. And that elevated trade in the fourth quarter, would we expect that to persist into next year?

## Melissa A. Poole, Vice President of Investor Relations

No.

## Jason English, Analyst

Great. Thank you so much.

## Operator

We'll now go to Alexia Howard with Bernstein. Please go ahead.

## Alexia Howard, Analyst

Good morning, everyone.

## Michele Buck, Chairman, President and Chief Executive Officer

Hi, Alexia.

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

Good morning.

## Alexia Howard, Analyst

Hi, there. This is probably quite linked I guess to Jason's question but -- and it's again focusing on pricing in North America, but the measured channel pricing was up pretty sharply sort of mid single-digit numbers on the whole portfolio and particularly on chocolate this time around. That's obviously meaningfully higher than the 1.5% price growth that you reported this morning.

Is that just a timing effect, because of the timing of shipments, or are the retailers temporarily increasing the markups on the product, because of the upcoming pricing increases? And similarly the volumes were down only 2.2% in the numbers you reported this morning. And that's a lot better than the mid-single digit declines that we're seeing in measured channels.

So I'm just trying to figure out whether there is something going on in non-measured channels that was better or whether the inventory, some inventory shifts are affecting that if you could maybe speak to that. Thank you very much.

## Michele Buck, Chairman, President and Chief Executive Officer

Sure. So it's not -- it is not a measured channel, non-measured channel. There are couple of different factors going on. So first of all, you're right. Retail takeaway is trending a little bit ahead of shipments in North America and we expected some of this and part of that's tied to the inventory contraction that's associated with our SKU rationalization program.

So we knew that shipments, we have a little bit of a drag there where shipments would be later than takeaway. We also know that as we take price, there is some retailer margin expansion from our price increase, so you do see retail prices go up slightly higher than the Hershey prices. And then some of that is just tied to the timing of that new price increase because, as you know, we've got kind of the two price increases, the one from last year that hit and then the new one where again retail prices will go up before we see that in our data because of how we manage those price increases and allow a buy-in period.

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

I would say, I would add, by the end of the year, we expect those two to tighten up between shipments and takeaway.

## Alexia Howard, Analyst

Great. Thank you very much. I'll pass it on.

## Operator

We'll now go to Chris Growe with Stifel. Please go ahead.

## Christopher Growe, Analyst

Hi, good morning.

## Michele Buck, Chairman, President and Chief Executive Officer

Hi, Chris.

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

Good morning.

## Christopher Growe, Analyst

Hi. And so I have to follow on to Alexia's question there because related to the -- what we're seeing in measured channels the increased level of price realization. We're seeing an equally or a weakening volume performance as well. So I just want to understand how that, maybe from a higher level, how elasticity is playing out for you right now and then how we should read, again, what we're seeing in the measured channel data, which is obviously a increase in pricing, but a much weaker volume performance overall.

## Michele Buck, Chairman, President and Chief Executive Officer

Yeah. So what we're seeing at retail is very consistent with what our models would indicate. We normally see a conversion timeframe when we take price, retail prices up, we see volume go down. Obviously, we do a lot of work with lot of our programing to mitigate some of that volume decline during that conversion time frame to bring back the volume even more quickly, but typically in periods of price increase we do see those volume declines and they are pretty much in line with all of our elasticity models.

## Melissa A. Poole, Vice President of Investor Relations

Just to build on that, Chris, and we can talk with this a little bit more offline because it is -- there is some extra noise in the third quarter, but if you kind of break them into pieces and think about last year's price increase, the prices at retailer are, to Michele's point, pretty much in line with expectations, so they're a little bit ahead of us as retailers are expanding margins, but nothing out of bound by any stretch.

I think a lot of the noise in this quarter, there is some timing in promotional activity where there was some laps and some higher prices on promotion that you're seeing play through and why -- part of why those retail prices are a little bit more elevated in the quarter.

Year-to-date they are pretty much in line with what we're seeing on the P&L, but a little bit of noise in the quarter and then especially this most recent price increase to the timing of the protection causes a pretty big disconnect as they start rising prices, and we don't see that in our P&L right away. So, overall, feeling really good, there where we expected. It's just there's a little bit more noise in this quarter.

## Christopher Growe, Analyst

Okay. And then just a quick follow-on in terms of how that relates to the gross margin. As I think about the fourth quarter, you do have a bit of an easy comparison on the gross margin. Have you given an indication in terms of your pricing in relation to the cost inflation, kind of how that stands today? You talked about input cost being down and then what that would mean for the full year gross margin, and we can kind of imply what that can mean for the fourth quarter?

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

Yeah, I mean, our full-year gross margin guidance isn't changing, we kind of said in the order of 100 basis points up year-over-year, we're just sort of tracking to that. I'd say there's nothing -- nothing new relative to commodities versus price. It's sort of playing out the way we expect that again because we've got the hedging program against some of the commodities that moves out and give some forward visibility. So not a lot of change there. So I don't know if that answers your question.

## Christopher Growe, Analyst

Yes, it does. Thank you.

## Operator

We'll now go to Robert Moskow with Credit Suisse. Please go ahead.

## Robert Moskow, Analyst

Hi, thank you. And I'll second your remarks Michele, on Take 5 expansion.

## Michele Buck, Chairman, President and Chief Executive Officer

Thanks.

## Robert Moskow, Analyst

Yeah. And in my channel checks, what I keep hearing is that actual physical shopping trips to stores are on the rise, which is not what you would expect with the growth of e-commerce and I think that's a positive for your business, more impulse purchases. And then secondly, I saw on the data that it looks like your points of distribution are rising. You didn't really talk about those in your prepared remarks. Can you comment on those two things and would you confirm or not?

## Michele Buck, Chairman, President and Chief Executive Officer

Yeah, I think as you look at the IRI data, it can be -- there is a little bit of noise in that this year because of the -- the stand-up packaging bag transition where we had an overlap of inventories transitioning from the old laid down bags to the stand-up bags. So we are always pushing to drive against distribution, getting additional points of distribution and actually additional disruptive placement in store primarily.

So we did have the -- a program one of our big retailers where we got significantly expanded distribution points around the front end, but -- so it's a little bit of both. We are expanding some distribution with some customer-specific programs, but there's also -- it probably looks a little higher in the numbers in the IRI data and then it actually is just because of that conversion on stand-up bags.

## Robert Moskow, Analyst

Okay. Try to see up. So if there is a -- so net-net, it's a little higher, but it might be temporary or it's, say -- like, how should I --

## Michele Buck, Chairman, President and Chief Executive Officer

Yeah, I would -- I would kind of say, it's higher but not as high as the numbers would show. So there is growth, but it's just not as high as the total IRI look.

## Robert Moskow, Analyst

Okay. And physical ship -- shopping trips to stores, I think IRI also indicates that people are going to stores more frequently.

## Michele Buck, Chairman, President and Chief Executive Officer

Yes. Now we are seeing some good signs there relative to consumers. And I think as consumers are shopping on omnichannel basis, we see them in stores also looking at the retailer's websites whether in-store. So we're seeing a lot more of that versus a net shift.

## Robert Moskow, Analyst

Okay. All right. Very good. Thank you.

## Michele Buck, Chairman, President and Chief Executive Officer

Thanks.

## Operator

Our next question comes from Nik Modi with RBC. Please go ahead.

## Nik Modi, Analyst

Yeah, good morning, everyone. Michele, maybe you can just give us some perspective on some channel dynamics. Maybe just talk about what you are seeing in big box versus -- and the convenience store channel. And then maybe Steve, if you could just address, (inaudible) recently talked about inflation and they cited sugar and milk prices. So just wanted to get your thoughts around that kind of what you guys are seeing and if you're hedged for 2020. Thank you.

## Michele Buck, Chairman, President and Chief Executive Officer

Yeah. So if we look from a channel perspective, we are really seeing growth across most all classes of trade with the exception of drug, which tends to be a little bit soft, particularly given some of the strategies and actions taken, focused in that class of trade. I would say, particular strength in big box for sure in club stores and in the dollar class of trades, but pretty much growth across everything except for drug.

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

And Nick, on the commodity side, obviously, we're watching commodity prices very closely as we put together our plan for 2020. Hedging gives us some visibility. I think probably the biggest takeaway across that group is that as we talked about in the prepared remarks, we've got a tailwind this year on cocoa. But if you look at cocoa prices today versus the last 12 to 24 months, they are higher. And so at minimum, we're not likely to have a tailwind in 2020 that we've been able to enjoy this year on cocoa. Hedging will help to smooth out that transition and we'll give more guidance on commodities in general as we get closer to 2020.

## Nik Modi, Analyst

Great. Thank you.

## Operator

We'll now go to John Baumgartner with Wells Fargo. Please go ahead.

## John Baumgartner, Analyst

Good morning. Thanks for the question.

## Michele Buck, Chairman, President and Chief Executive Officer

Good morning.

## John Baumgartner, Analyst

Wanted to dig into the One Brands acquisition because that nutrition bar space is increasingly crowded. Can you speak a bit to the diligence that went into that and how you're thinking about the competitive tensions there? How do you think One stands out and maybe how you're envisioning growing that business whether it's in distribution channels or different product formats?

## Michele Buck, Chairman, President and Chief Executive Officer

Absolutely. So we continue to be excited with the growth that we're seeing in that snack bar segment. And particularly, if you look across total snack bar and you really dissect that market, you see that the real sweet spot where that has the strongest growth is that high protein and particularly high protein with low sugar. So I think -- I think my first direction would be we kind of dissect within that category to say, where is the sweet spot where we think that there really is growth. And we certainly think that there is room to have a couple of brands that play in that space in the marketplace consistent with other categories

You know what we really liked about it is, it's very consistent and fits right into our stated desire for scaled growing assets in attractive categories to give us access to incremental snacking occasions, high protein, low sugar, it provides on the go convenience. It also gives us a play in the morning snacking occasion, where we are under-developed. We like a lot that business has a strong presence in growth in e-commerce and non-traditional channels, which again provides some incrementality for us. And we certainly like the growth rate that we're seeing on this business.

We think it fits in a nice sweet spot for us in terms of where we can add value because there still as distribution opportunity. So I'd say, job one, as we look at growing the business is securing that incremental measure distribution expansion, continuing to build on the brand equity, we'd like the fact that this asset has good margins that are in line with Hershey margins and that's one thing that's always been important to us, the kind of businesses that we run best. And then of course, we will capture any opportunities for supply chain and procurement synergy.

So, we see it as a platform that has -- our primary focus for growth will be around the close-end for -- at least for the next several years, the close-end driving against the core. So unlike some of the -- perhaps some of the other assets in that space where maybe some of their focus is expanding to a lot of other categories. I think there's a lot of upside within -- expanding within snack bars, but then later some opportunity to take that one trademark more broadly in terms of the platform it stands for.

## John Baumgartner, Analyst

And is it fair to think just given you know-how in the bar business already, that this is something you could repatriate over time internally in-house?

## Michele Buck, Chairman, President and Chief Executive Officer

I mean, we certainly make a lot of bars and that technology kind of slab and slip is something certainly we do well. So, we always taken approach of getting our arms around the business and then looking at how we leverage repatriating for opportunity whenever and if it is appropriate.

## John Baumgartner, Analyst

Okay. Thanks for your time.

## Operator

We'll now go to Steven Strycula with UBS. Please go ahead.

## Steven Strycula, Analyst

Hi. Good morning.

## Michele Buck, Chairman, President and Chief Executive Officer

Hi, Steve. Good morning.

## Steven Strycula, Analyst

So -- I have a question. Michele, could you walk us around the globe, some of your key markets internationally such as Brazil, China, Mexico, just give us a feel for how Hershey's performing versus the competition and whether you're seeing more competitive dynamics or macro acceleration, deceleration, multinational brands versus local? Because you called out specifically Brazil, but it would be helpful to understand the dynamics across, Brazil, China and Mexico. And then I have a follow-up.

## Michele Buck, Chairman, President and Chief Executive Officer

Yeah. I would say across all of our international markets, we are feeling good and performing well in most of those markets, we are gaining share. For some of my highlights in my opening comments, feel particularly good about Mexico where we have strong, very strong growth with a real focus on Hershey's and Pelon Pelo Rico, but we're seeing growth in India, in China.

Brazil is really the market that's been challenged given that combination of macroeconomic as well as some competitive activity around deep discounting where we've just made some choices around investing additionally, but still being very rationale about balanced top and bottom lines. But I feel good growth and good share progress in all the other markets.

## Steven Strycula, Analyst

Okay. And just to clarify, was Brazil more of a multinational or a local competition?

## Michele Buck, Chairman, President and Chief Executive Officer

Yeah. Brazil is more multinational competition.

## Steven Strycula, Analyst

Okay. And then to close out a question on pricing. I know you guys have three levers you pull for pricing this year that are kind of cascading or phasing in throughout the year. And then we have another piece from the price increase announced this summer. So can you help us understand as we go from fourth quarter into the first half of next year, how do we stack pricing on top of pricing? So basically, when does it peak out versus when does it start to kind of like normalized to more moderate rate? Thank you.

## Michele Buck, Chairman, President and Chief Executive Officer

So we will start to see the pricing come into our P&L mostly as we get into Q1 and flow from there. So Q1 should be a little bit higher, but I would expect on an annual basis, you're going to see similar to what we saw with our last price increase of around 2%, that we'll see on an annual basis next year. And it will build -- we won't get from the second price increase any impact this year, but as we go into next year, you'll see that build in the marketplace.

## Steven Strycula, Analyst

Thank you very much.

## Michele Buck, Chairman, President and Chief Executive Officer

It does answer your question?

## Steven Strycula, Analyst

It does. Thank you.

## Operator

We'll now go to David Palmer with Evercore ISI. Please go ahead.

## David Palmer, Analyst

Taking [ph] on 2019 as it's coming to an end here. How do you think this year will shape up versus what you think will be a typical year for your growth in terms of the complexion of the growth? And on the face of it, it looks like there has been some nice pricing gains relative to input inflation even had some pretty clever way of doing pricing with the stand-up bags that wait out there. You're reinvesting heavily in advertising, you're getting some very nice growth out of your Reese's trademark, which is sort of the trademark and growth of your year. So in some ways, it feels like an unusual period in terms of reinvestment room and reinvestment behind what might be your best trademark there and in some ways you might be thinking about a different type of growth going forward, any thoughts there would be helpful.

## Michele Buck, Chairman, President and Chief Executive Officer

Yeah. I guess, as I think about the growth model this year and then the growth model for next year, I would say that there are some similarities and I can call out a few differences. So I think in terms of similarities, pricing certainly this year, pricing will play a key role next year. So I think that's kind of one platform that you could think is, even though taking a little bit differently comparable on a year-to-year basis.

What we don't get into specific guidance, we are continuing to look -- it's our strategy to continue to reinvest and invest in our brands and capabilities and certainly that will be our priority for us next year as it was this year. We always focus on trying to achieve that balance between driving our every day brands and really driving the core brands. So you should continue to expect to see strong support and programming around Reese's.

When you have to build a brand, it's $2 billion in revenue, there will always be a focus on that brand, just because of how big a piece it is as of the portfolio, but also support behind some of our other big brands. We talked about Kit Kat Duos and Kit Kat will certainly be a brand that will have a lot of focus next year as well.

So I think some -- I think a lot of commonality in terms of some of those elements that you called out. I think relative to growth where the biggest differences are is more around the timing of Easter, which is a little bit of a hurt, about 0.5 point for next year, but then the benefit around SKU wrap cycling, which is a help. Did that provide perspective?

## David Palmer, Analyst

Yeah. That's helpful. Thank you.

## Operator

(Operator Instructions) And our next question comes from Michael Lavery with Piper Jaffray. Please go ahead.

## Michael Lavery, Analyst

Good morning. Thank you. Can you just touch on your thinking on the consumer marketing spending, it's obviously up very strongly in the quarter. But looking at the last few years, it's typically been 7%, 7.5% of sales and in 2018 was just a little bit above 6%. Should we expect it to get back up above a 7% level? Or some of the -- is some of the increase this year a little more one-off. Can you just give us a sense of how sticky it is and where your optimal range might be? And maybe just related to that, what were some of the things that changed last year where there were the cutbacks? And what are some of the things that are coming back or new this year in terms of how you are deploying the spending?

## Michele Buck, Chairman, President and Chief Executive Officer

So our kind of stated strategy around marketing investment is to grow in line or slightly ahead of our sales growth, so to grow the dollar investment in line or slightly ahead. There can be some noise around that because sometimes we are able to get efficiencies in how we are buying, and so we can actually get greater impressions than the dollar budget. So it's not always perfect, but I would say that's overall how you should think about it.

When we took our spends back from 7%, 7.5% down to 6%, there were two key places that the spend really came out of. One was, we did start gaining some efficiencies as we started developing some of our creative in-house and also some media efficiencies from very strengthened targeting capabilities. And then we also cut back on some of the smaller emerging brands where we believed that frankly we were over-investing beyond what we should.

As you look at where we are now and the reinstatement of spend, you'll certainly see that in terms of strength behind the core brands, but then also really tapping into unleash some of our smaller brands like a Rolo, Heath, brands that have been around forever, brands that are very stable and with a slight amount of increase in advertising, we can drive some significant growth. So that's, I'd say, where the biggest priority of reinvestment has been.

## Michael Lavery, Analyst

And just when you talk about some of the cuts on emerging brands, could you give any examples of what those might have been?

## Michele Buck, Chairman, President and Chief Executive Officer

Yeah. I would say like, I think Krave would be an example, some of the emerging brands that we have in our Amplify portfolio, some of our snack mixes that were in the warehouse isle under the Reese or Hershey trademark, things like that.

## Michael Lavery, Analyst

That's helpful. Thank you very much.

## Operator

We'll now go to Ken Zaslow with Bank of Montreal. Please go ahead.

## Kenneth Zaslow, Analyst

Hey, good morning, everyone.

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

Good morning.

## Michele Buck, Chairman, President and Chief Executive Officer

Hi, Ken.

## Kenneth Zaslow, Analyst

I just have a one follow-up question here. On the Thins platform, can you talk about how broad that to be to other products? How big you think that could be? It just seems like that's something very similar to the expansion of other products that you have? And are there real opportunity that this can actually become a bigger product offerings? Can you talk about that?

## Michele Buck, Chairman, President and Chief Executive Officer

Yeah. Absolutely. So we feel great, first of all, about Reese's Thins performance in the marketplace. It is on track with our expectations. We are seeing signs of sustainability and incrementality. So certainly, I -- we always look as we develop innovation to see if there is an opportunity to develop the platform and certainly this does feel like one that could cut across multiple brands and that's certainly an opportunity that we are evaluating.

## Kenneth Zaslow, Analyst

Is there -- how big do you think the platform can be? Can you put any -- like parameters around it about which brands it could go to? It just seems like there is a lot that can be happening with this. Can you kind of put some parameters to it? And I'll leave it there.

## Michele Buck, Chairman, President and Chief Executive Officer

Yeah. I mean, I think there are multiple brands it can go to. I think what we always try and focus on with our platform is not spreading it too far, but having it focused on a couple of brands where it really makes the most sense. And clearly if you look at the history of how we've built other platforms in the past and just the size of brands, Reese's, given its size, will definitely be the largest of opportunities, but I do believe that there can be growth beyond that.

## Kenneth Zaslow, Analyst

Great. Thank you.

## Operator

We have no further questions at this time. I would like now to turn the call back to our speakers for any additional remarks.

## Melissa A. Poole, Vice President of Investor Relations

Hey, thanks so much for joining us this morning. The team will be available today and all of next week for any follow-up questions you may have. Thanks so much.

## Operator

This does conclude today's program. Thank you for your participation. You may disconnect at any time.