Company Name: Hershey
Company Ticker: HSY US
Date: 2019-07-25
Event Description: Q2 2019 Earnings Call

Market Cap: 31079.8083379
Current PX: 148.850006104
YTD Change($): 41.6700061035
YTD Change(%): 38.879

Bloomberg Estimates - EPS
Current Quarter: 1.635
Current Year: 5.748
Bloomberg Estimates - Sales
Current Quarter: 2127.846
Current Year: 7951.385

Q2 2019 Earnings Call

Company Participants

- Melissa Poole, Vice President of Investor Relations
- Michele Buck, President and Chief Executive Officer
- Steven Voskuil, Senior Vice President and Chief Financial Officer

Other Participants

- Andrew Lazar, Analyst
- Ken Goldman, Analyst
- David Driscoll, Analyst
- Jason English, Analyst
- Bryan Spillane, Analyst
- Alexia Howard, Analyst
- Robert Moskow, Analyst
- Chris Growe, Analyst
- David Palmer, Analyst
- John Baumgartner, Analyst
- Ken Zaslow, Analyst
- Steve Strycula, Analyst
- Michael Lavery, Analyst

Presentation

Operator

Good morning, everyone, and welcome to The Hershey Company's Second Quarter 2019 Results Conference Call. My name is Katherine, 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 A.M., 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 now like to turn the call over to Melissa Poole, Vice President of Investor Relations. Ms. Poole, you may begin your conference.

Melissa Poole, Vice President of Investor Relations

Thank you, Katherine. Good morning everyone. We appreciate you joining us for The Hershey Company's second quarter 2019 earnings conference call and webcast. Michele Buck, 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 of 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, President and Chief Executive Officer

Thanks, Melissa, and good morning to all of you on the phone and webcast. First, I'd like to start by giving a special welcome to Steve. He joined the company following our last call, and he has been a great addition to the executive leadership team. Some of you have already had the chance to meet Steve, and he and I look forward to visiting with more of you in the coming months.

Now on to business. We are pleased with our second quarter results and the momentum we are seeing behind our key initiatives for this year. Our balanced plans and capability investments are enabling us to deliver accelerated sales growth and differentiated earnings performance. We are maintaining our market share leadership in our profitable U.S. confection business and driving incremental profitable sales with our snacking and international portfolios, both of which continue to perform well. These have been and continue to be the strategic priorities of our business.

And I'd like to take a minute to thank my colleagues across the business for their contributions to the strong quarter. As we look to the back half of the year, we remain confident in our ability to deliver our financial commitments for the year. In the second quarter, net sales increased 0.9% in line with our expectations. Organic constant currency net sales growth of approximately 1.8% was driven by pricing and the launch of key innovation including Reese's Thins and the Reese's lovers, as well as our new packaged candy bags.

The net impact of acquisitions and divestitures was a 60 basis point headwind as the Tyrrells and Shanghai Golden Monkey divestitures offset our Pirate Brands acquisition. The majority of the impact of these divestitures has been realized and we expect the net impact of M&A to be a benefit for the remainder of the year. Foreign currency exchange was a 30 basis point headwind in the second quarter.

We had another strong quarter of gross margin expansion, which enables brand and capability investments as well as robust earnings growth. While some of our second quarter margin and earnings gains were timing related, the underlying trend remains solid. This strong gross margin expansion of almost 200 basis points drove second quarter adjusted EPS growth of 14.9%. Steve will share more details around second quarter gross margin performance as well as our expectations for the rest of the year.

As we have previously discussed, price realization is a strategic focus area for us. The price increase we announced last summer remains on track and the final portion is implementing now as we execute our Halloween program. Additionally, last week, we announced a new price increase on our confection instant consumables business. These products represent roughly one-third of our overall sales, and they were priced high single digits contributing to an estimated 2 points of pricing to our overall portfolio.

Consistent with previous practices, we will have a transition period for our retailers to adjust to these new prices and we do not expect a material sales or earnings impact in 2019 from this pricing action. We anticipate category retail prices for these impulse items to begin to increase in the second half of the year. These actions reinforce our commitment to a more agile approach to pricing strategy that protects our advantaged margin structure while enabling continued investments in our brands and capabilities to drive category growth.

Other key initiatives on our U.S. confection business are also progressing well and on track. Retail takeaway was slightly ahead of our expectations coming out of Easter, due to accelerated activation of our Reese's lovers in and out promotion. For IRI, Hershey candy mint and gum retail sales increased 1.9% versus prior year since the Easter season ended. This was in line with overall category growth of 1.9% resulting in flat share. This growth was led by our powerful Reese's franchise, which grew 12% during the time period behind our new packaged candy bags, our Reese's Thins innovation and our Reese's lovers instant consumable promotion. Our new packaged candy bags are on shelf at all major retailers and we are pleased with the increased branding and improved shoppability that we are seeing to date.

We are also excited by the response we are seeing from increased media and some of our smaller iconic brands. These profitable brands are a tremendous asset for us that deliver unique consumer proposition and incrementality to our portfolio. We are leveraging our new media capabilities both for content as well as targeting and increased investment to drive growth on many of these brands.

Over the past year and a half, we have increased support on our Almond Joy, Mounds, York, Payday and Twizzlers brands. Our strong gross margin performance has enabled us to support additional brands, Heath and Rolo in the second quarter. Early results are encouraging, with our Heath brands growing 37% and our Rolo brands growing over 7% over the last four weeks.

While not all of this growth is incremental, having more brands in our portfolio stay relevant with our consumers and growing is critical to our overall category leadership. Our e-commerce business continues to perform well with second quarter net sales growth of over 60%. Customer specific data as well as industry reports indicate that our growth is consistently outpacing competition by 10 basis points to 15 basis points in 2019.

As we look to the second half of 2019, we expect to build on last year's seasonal success with solid performance in Halloween and Holiday. Additional Kit Kat capacity is further enhancing our assortment bags for Halloween and enabling our Kit Kat Mint Duos innovation that will launch towards the end of the year.

Now for an update on our Amplify and Pirate Brands acquisition. Per IRI, Skinny Pop ready-to-eat popcorn grew approximately 10% in the second quarter, resulting in a share gain of over 100 basis points. We continue to focus on expanding distribution and optimizing our shelf placement, which is leading to consistent gains in household penetration.

As we discussed on our April call, Pirate's Booty sales performance has declined recently due to distribution losses at a few key retailers and the lapping of some significant promotional activity from prior year. The distribution of losses occurred during the sales transition, but we remain confident that trends will improve in the second half as planograms reset and year-over-year promotional activity normalizes. Retail sales trends for the latest four weeks are already improving versus the last 12 weeks, and we expect that that will continue to improve.

Now for an update on our international business. Constant currency organic sales grew 8.3% in the second quarter and we continue to demonstrate disciplined investment resulting in segment operating income growth of 32% versus prior year. In Mexico, we grew our net sales high single digits in the second quarter behind continued strength in our core chocolate business and the launch of a new Pelon Pelo Rico flavor.

In Canada, our Reese's brand eclipsed Kit Kat and is now the number one brand. Our Reese's brand is also seeing great momentum in the UK, recently receiving the Gold IPM Award for best new product launch for our Easter Reese's creme egg. We will continue to focus on our core brand equities to drive profitable sales growth in the second half and beyond. To wrap up, we have good momentum across all of our key strategies with strong financial results in the second quarter. We will continue to invest in our brands and our capabilities to take this 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.

Steven Voskuil, Senior Vice President and Chief Financial Officer

Thank you, Michele . Good morning, everyone. Before I get started, I'd like to take a few minutes to say how excited I am to be part of the Hershey team. Hershey is a great company with strong brands, leading market positions and a balanced approach to profitable growth. I have been energized by the talented team here and their passion for innovation, growth and transformation. I look forward to partnering with Michele, our Board and the whole team to achieve our strategic vision and delivered strong and sustainable shareholder return.

Now on to the financial results. Second quarter net sales of $1.8 billion, increased 0.9% versus the same period last year. Organic constant currency net sales growth of 1.8% was driven by net price realization of 1.2 point and volume growth of 60 basis points. The net impact of acquisitions and divestitures was a 60 basis point headwind and foreign currency translation was a 30 basis point headwind. These results were all in line with expectations. Adjusted earnings per share diluted were $1.31, an increase of 14.9% versus the same period last year. This was driven primarily by gross margin expansion and was ahead of expectation, driven by two key factors related to the price increase we announced last week.

First, a few select customers increased inventory on our most profitable items in anticipation of a price increase, while total retail inventory levels were not up significantly from prior year, we benefited from positive mix for the quarter. Second, we increased internal inventory levels to support more demand from our retailers in the coming weeks as we transition to the new prices, which resulted in favorable fixed cost absorption. About 90 basis points of our gross margin expansion in the second quarter can be attributed to these two factors, and is expected to be offset in the second half, primarily Q3, as internal and external inventory levels normalize. We are pleased with underlying momentum against our margin expansion initiatives, the business reinvestment it is enabling and the balanced top and bottom line growth it is driving.

By segment, North America net sales increased 0.5% versus the same period last year, driven by pricing, which contributed 1.5 points of growth in the quarter. Volume was a 50 basis point headwind, the net impact of acquisitions and divestitures was a 30 basis point headwind, and foreign currency exchange rates were a 20 basis point headwind. These results were in line with expectations.

North America gross margins expanded 180 basis points in the second quarter. As I mentioned, about half of this was driven by favorable product mix and fixed cost absorption related to the price increase we announced last week, and is expected to reverse in the second half, primarily Q3. The remaining 90 basis point expansion was consistent with our expectations and was driven by favorable commodities, price realization from our July 2018 price increase in improved ways as we continue to execute our SKU rationalization program.

These factors are expected to continue contributing to solid underlying growth margin expansion in the second half, though will be partially offset by the reversal of Q2 gains from product mix and fixed cost absorption, as well as some additional supply chain costs associated with fully integrating Pirate Brands into our operations.

North America advertising and related consumer marketing spend increased 2.7% in the quarter, driven primarily by advertising. We expect dollar investment to continue to accelerate as we move through the year due to the lapping of last year's media efficiency gains and increased investment in our confection brands. Second quarter, total International and Other segment net sales increased 3.9%, driven by volume gains of 960 basis points. This was partially offset by a 320 basis point headwind from divestitures, 130 basis point headwind from net price realization, and a 120 basis point foreign currency exchange headwind.

Organic constant currency net sales in our focus markets, Mexico, Brazil, India and China, grew 5% versus the second quarter of 2018. The International and Other advertising and related consumer marketing increased 38% versus prior year. Most of this increase is driven by increased investments to support Ramadan in EMEA, our India Kisses launch and timing of consumer marketing spending.

Total Hershey adjusted gross profit increased 5.3% resulting in an adjusted gross margin of 46.5%, an increase of 200 basis points versus the second quarter of 2018. As mentioned, approximately half of this expansion was driven by favorable product mix and fixed cost absorption that are expected to reverse in the second half. The remainder was driven by favorable commodities, price realization from our July 2018 price increase and efficiencies from our SKU rationalization initiative.

Given the progress we have made year-to-date, and our visibility into the second half, we now expect full year gross margin to increase approximately 100 basis points. Second quarter adjusted operating profit of $370 million resulted in operating profit margin of 20.9%, an increase of 150 basis points versus the second quarter of 2018. Gross margin gains and continued SG&A discipline were partially offset by incremental advertising on our confection brands.

Moving down the P&L, interest expense of $34 million decreased $1 million versus Q2 last year. Full year 2019 interest expense is now expected to be in the $140 million to $145 million range, due to lower interest rates. The adjusted tax rate for the second quarter was 14.8% versus 16% in the year ago period. These declines were driven primarily by valuation allowance releases and excess tax benefits from stock based compensation, partially offset by fewer tax credit investments.

Second quarter other expense was $13 million, a decrease of $8 million versus prior year due to fewer tax credit investments. We now expect our full year 2019 tax rate to be approximately 18% versus our previous estimate of 17%. However, we also expect our full year other expense to decline to $80 million to $90 million as we expect fewer tax credit investments. The net impact of -- to the full year of these two changes is expected to be negligible versus our previous estimate.

For the second quarter of 2019, weighted average shares outstanding on a diluted basis were approximately $211 million. This is a slight increase versus the first quarter, due to an increased number of stock option exercises in the quarter. The company did not repurchase any shares in the second quarter against our July 2018 $500 million authorization, and $410 million remained. The company repurchased $56 million of common shares in the second quarter in connection with the exercise of stock options.

Total capital additions, including software were $176 million in the second quarter. For the full year 2019, we estimate CapEx to be towards the high end of our $330 million to $350 million range. As a percent of net sales, this remains slightly higher than our long-term target as we continue to implement our new ERP system and invest in core capacity. We continue to return cash to our shareholders with second quarter dividend of $149 million. This was our 358th consecutive quarterly dividend on the common stock. Additionally, this morning, we announced a 7% dividend increase, a testament to our solid balance sheet and strong cash flow generation.

To summarize, for the full year, we expect full year reported net sales to grow around 2%, the midpoint of our previously communicated range. We continue to anticipate approximately a 0.5 point net benefit from acquisitions and divestitures, and the full year FX impact to be negligible based on current exchange rates. Full year reported earnings per share diluted are expected to be around $5.58 comparable to prior year. We expect full year adjusted earnings per share diluted growth of around 6% to 7%, the top half of our previous range.

As we look to the second half, we want to highlight a few areas where we expect trends to very versus the first half. Underlying gross margin is expected to continue to build as pricing builds. However recall, we expect approximately half of the Q2 expansion to reverse in the second half, primarily Q3. Advertising and related consumer marketing expense is expected to grow more in the second half than the first half as we lap media efficiencies from last year, as well as increased support on our core confection brands.

Given current sales and EPS guidance, compensation is anticipated to be a headwind in the second half of 2019 versus the second half of 2018. Due to timing of tax strategies, we expect the second half net tax impact to be unfavorable versus prior year. For the full year, we continue to expect a slight benefit to EPS from tax.

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

Michele Buck, President and Chief Executive Officer

Thanks, Steve. We've had a strong start to the year. The actions we are taking to drive core confection momentum to capture growth via incremental portfolios and regions, and to invest in our brands and capabilities, will continue to drive this business forward. We have a portfolio of beloved brands and amazing team of individuals that are excited and proud to come to work every day. And we remain focused on achieving balanced sales and earnings growth to continue delivering peer-leading shareholder returns.

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

Questions And Answers

Operator

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

Andrew Lazar, Analyst

Good morning, everybody, and welcome, Steve.

Steven Voskuil, Senior Vice President and Chief Financial Officer

Thank you.

Melissa Poole, Vice President of Investor Relations

Good morning, Andrew.

Michele Buck, President and Chief Executive Officer

Good morning.

Andrew Lazar, Analyst

Hi. As you noted consumption in North America was a bit above shipments organic growth, and I assume some of that was certain things like SKU rationalization and such. But I guess with SKU rationalization, I think you expected to moderate some in the second half, and pricing expected to build, and certainly a greater level of innovation that will hit as well.

Given some of the, I guess, under shipment, if you will in 2Q relative to takeaway, I guess why wouldn't organic sales in North America not necessarily keep, let's say, a similar level of momentum as we have seen more recently? And then just, I may have missed it, but the incremental pricing that you've announced, is that all list pricing or similar to last year's pricing where it was a mix of all of the various revenue management levers? Thank you.

Michele Buck, President and Chief Executive Officer

Thanks, Andrew. It's Michele. Hey, so let me get your first one, your second part of your question, first. The incremental pricing is indeed all list pricing. So that's a pretty simple one.

Andrew Lazar, Analyst

Yes. Thank you.

Michele Buck, President and Chief Executive Officer

As we look at our consumption and our sales, let me start with, as we told you in the past on a full year basis, we always expect our net sales and our takeaway to be relatively in line. But we continue as we have in -- had in the past again this year to have some volatility from a quarter to quarter basis.

I guess the easiest way that I would advise you to think about it is, if you looked at our takeaway trends, first half, second half, and you see that basically on our CMG business, we were up first half about 2.6%, but we all know that about a point of that was driven by Easter. If you take the first half minus the Easter bump, we expect that same underlying trend to continue in the back part of the year. So we think we're going to have -- continue to have pretty solid takeaway on a full year basis.

There are several puts and takes as you look at the net sales piece relative to a little bit less SKU rat in the second half, but at the same time we are -- we have a bit of a harder lap as we lap some of those seasons, and as you recall, how strong seasons were in the back half of the year, last year, some inventory related things in the second quarter, but by full year end, we think it will level out as it has in the past.

Andrew Lazar, Analyst

Great. Thanks very much.

Operator

We'll now go to Ken Goldman with JP Morgan. Please go ahead.

Ken Goldman, Analyst

Hi. Good morning.

Michele Buck, President and Chief Executive Officer

Hi, Ken.

Ken Goldman, Analyst

You said you don't expect a material sales impact from the new pricing action this year, but I think, I also heard you say that category retail prices for these impulse items will increase in the second half of the year. So I wanted to reconcile this a little bit if I could. Are your customers taking up their pricing before you are? If so, why you're protecting your pricing? I just wanted to clarify, when you expect wholesale and retail net prices to rise, and if they're in synchronicity with each other?

Michele Buck, President and Chief Executive Officer

So, we do expect that we will see some impact at retail on the everyday business, particularly in the fourth quarter. But as you know, as you look at the back half of our year, we are heavily weighted towards seasons. So seasons is a much bigger piece of the portfolio than the everyday piece. So we expect we'll see some there, but we also do some price promotion protecting, so, many of our retailers have price promotions, trade promotions that they have booked that we've committed to six months out, sometimes slightly more, and we do price protect those promotions when we go out with our pricing action. So that's why you don't see the full impact. Again, we believe the impact will not be material to us.

Ken Goldman, Analyst

But will the increased retail prices, and maybe you're saying that, there really won't be because they will be dealt back. So I just want to understand, will that potentially lead to a situation where you're not getting the pricing yet, but retail prices are going up and therefore your volume could get hurt because of some elasticity trends. Again, I guess I just want to make sure I'm understanding all the puts and takes here from a net pricing perspective.

Michele Buck, President and Chief Executive Officer

There is a little bit of impact there, but it's minimal. And all the pricing is baked into the guidance.

Ken Goldman, Analyst

Okay. I'll let it go. Thanks so much.

Operator

And we'll now go to David Driscoll with Citi. Please go ahead.

David Driscoll, Analyst

Thank you, and good morning, and welcome, Steve. So nice to have you on the call. Nice quarter to join the company. Yes, I break it too [ph]. Can you talk a little bit about the pricing and the impact on the king-size bars. I think as we understand it, the king-size bars will break the $2 price point that will be over $2, and this may cause some down-trading.

So just kind of building on Ken's question, just trying to understand the impact of the price increase here and how it affects the loose bar portfolio? Is this something where -- can you just walk us through these impacts as I find it kind of complicated? King-size is always such an important component of your loose bar business. So profitable. So it forces some down-trading to the standard bar. Walk me through the impact on how you see the price increase playing through on this issue?

Michele Buck, President and Chief Executive Officer

So, David, we've pretty sophisticated price elasticity modeling that we do. Whenever we take any price action, including this one, that model takes a look at the impact of crossing key price thresholds. It also takes a look at the relationship between regular counts, the single bar and the king-size because there's an impact there. It looks at other competitive items in the marketplace and any impacts there. So all of that is taken into account as we do those elasticity models that help us to predict the conversion curve.

And then we also take a look at that, and in some cases, if there is an area where we think we need it, part of our total pricing action could include some level of reinvestment in trade on specific areas to either maintain the current price point. We certainly also reinvest in advertising, because we know back from the past, if we take pricing and at the same time reinvest, that also helps to accelerate the conversion curve. So, we believe all that is taken into account as we do the analysis, and you're right though on some of those businesses, some of those -- you do hit some of those issues, but we think that's fully taken into account in our plans for the marketplace.

David Driscoll, Analyst

One quick follow-up on your comment on Reese's. We also understand that the Reese's lovers promotions was very successful, but ironically, the criticism that I heard was that it was such a good product, people were disappointed, the retailers are disappointed, they couldn't reorder it. Can you give us some thoughts as to what you do with something like this that's gone this well? Is there any thought to making any part of that promotion and every day part of the line-up or you just repeat the promotion sometime in the future? How do you think about that?

Michele Buck, President and Chief Executive Officer

So, David, it's certainly a great problem to have, and we will evaluate all of those things. Interestingly, there is sometimes a good thing to have something consumers love and they look forward to seeing it return to the marketplace. And I think, frequently, we found that that's a really good strategy to employ. It was a great in and out promotion, and we could do it again in the future. So we'll be evaluating those options -- all options to determine whether something like that should become permanent or we just leverage it to keep news and excitement, which is key in this category.

David Driscoll, Analyst

Thank you so much. I'll pass it along.

Michele Buck, President and Chief Executive Officer

Thanks.

Operator

(Operator Instructions) Our next question comes from Jason English with Goldman Sachs. Please go ahead.

Jason English, Analyst

Hey. Hood morning, folks. Thank you for sliding me in. I guess I want to come back to the price increases as well, and focus a little bit more on what's different this time. Looking back at some of the last time -- the last pricing cycles, particularly on single-serve, arguably they were all cost justified and we don't certainly see kind of what the cost justification is for this magnitude of pricing in single-serve. So, question number one is, are we missing some sort of cost pressure out there that necessitates this price? And if not, without the cost pressure, how might this be different? Do you expect to have to deal back more, to reinvest more, to keep retailers happy, or do you expect the relationship of retailers to be very similar to what we've seen in the past cycles?

Michele Buck, President and Chief Executive Officer

So thank you for the question. As we shared we've evolved our pricing approach from one in the past that was very much -- much more constant and commodity driven to much more of a strategic pricing capability where we think strategically across the portfolio, where we have opportunity on an ongoing basis, more than versus that kind of episodic approach. But we approach it in much the same way as we have in the past in terms of how it gets impacted and executed through retail, and I wouldn't anticipate that we would see any type of different scenario versus other times when we've priced instant consumables in the marketplace. We haven't priced that part of the portfolio for probably more than five years and we expect to see similar results based on what we've seen in our elasticity models.

Jason English, Analyst

That's helpful. Thank you. And looking back to the 2014 hike or even the 2011, is the buy-in period -- the protection period was eight weeks in duration for both of those cycles, and it effectively caused a deferral of the P&L flow through benefit by one quarter. So you announced in July last time by the fourth quarter, we actually saw material flow through of price benefit. You're suggesting this time will be different, at the same time, you're saying it's kind of consistent. So what's the disconnect there? Why shouldn't we be expecting a more material benefit coming in the fourth quarter?

Michele Buck, President and Chief Executive Officer

I mean, we expect that we will see some impact in Q4, but we don't view that impact to be material, and I think some of that will be associated with what -- some of that varies on how much we see relative to what kind of inventory position people are carrying, and how that kind of flows through.

Melissa Poole, Vice President of Investor Relations

Yes, Jason, it's Melissa. I mean I think the one piece that we didn't talk through that was a little different than the last time is we did have retailers kind of building inventory on these tax before we announced. So there is a little bit more inventory in the marketplace at those old prices. So we will take a little bit longer to cycle through that just because of speculation was out there in advance. So that is a little different from the last time.

Jason English, Analyst

Okay. Very good. Thank you.

Michele Buck, President and Chief Executive Officer

Thanks.

Operator

We'll now go to Bryan Spillane with Bank of America. Please go ahead.

Bryan Spillane, Analyst

Hey. Good morning, everyone.

Michele Buck, President and Chief Executive Officer

Good morning.

Bryan Spillane, Analyst

So just -- I guess a question first, just about Reese's Thins. It's been in the market now for, I guess, almost two months, and so any sort of takeaways in terms of how that's performing in the market, better or worse than expectations, and kind of how you're thinking about that for the balance of the year?

Michele Buck, President and Chief Executive Officer

So Reese's Thins is performing well. It is exactly in line with our expectations. We are feeling good about not only the trial, but also the repeat, which is strong and building. And we believe that based on what we're seeing to date, it will be a sustainable item for us and that we may be able to extend further off that platform.

Bryan Spillane, Analyst

So, I guess, following up on that, just in terms of extending off of that platform, is that possible to go with Thins across some other brands, maybe as we look into next year?

Michele Buck, President and Chief Executive Officer

Yes, well, we don't want to make any firm commitments on our future innovation plans. I think we clearly look at a platform, an idea like that is something that really can be a platform that can be expanded, and if you look at how we've run platforms in the past, many times it is a basic idea that we take across brands and just allows us to get scale for merchandising, et cetera.

Bryan Spillane, Analyst

Okay, great. Thank you.

Michele Buck, President and Chief Executive Officer

You're welcome .

Operator

Our next question comes from Alexia Howard with Bernstein. Your line is open.

Alexia Howard, Analyst

Good morning, everyone.

Michele Buck, President and Chief Executive Officer

Hi, Alexia.

Alexia Howard, Analyst

Hi, there. Can I ask about -- you've made a couple of comments about the popcorn brand earlier. I'm curious about the pricing on the Skinny Pop line. It seems to have come down fairly sharply in the last, I guess, three quarters or so. The rest of the category doesn't seem to have followed. I'm wondering if there is -- what the competitive dynamics were? What the thinking behind that was? And whether you anticipate needing to continue with that -- those kind of pricing strategies going forward? Thank you.

Michele Buck, President and Chief Executive Officer

So one of the things we love about Skinny Pop and believe is the key part of the business prop is the premium pricing that we have on that brand. We are delighted that we're continuing to see really strong growth overall, strong retail growth in the double-digit range, which to us would suggest that the price volume piece is working, though this is a brand where given the channel dynamics.

We can see bigger swings on promotional pricing impact in the marketplace just given how that product skews by class of trade. For example, there is a bigger club business on Skinny Pop than we're used to seeing in the rest of our portfolio and that can drive bigger swings there. So I wouldn't be concerned about it relative to that, that we are looking to change the pricing strategy on that brand.

Alexia Howard, Analyst

Okay, thank you. And just as a quick follow-up, I mean you've made a number of diversifying snacking acquisitions of late. Are you still very actively looking for more opportunities to do that? Thank you, and I'll pass it on.

Michele Buck, President and Chief Executive Officer

Yes, I believe that M&A is a key component of our growth algorithm and of our strategic vision for the company, and we continue to stay very active in the market, investigating categories and assets. As you know, it's all about finding the right one. But you can expect to continue to see us be focused on further expanding the portfolio.

Alexia Howard, Analyst

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

Operator

(Operator Instructions) Our next question comes from Robert Moskow with Credit Suisse. Please go ahead.

Robert Moskow, Analyst

Hi. Thanks for the question. Steve, I hate to be the one to greet you with an accounting question, but you're CFO. So the benefit you had in second quarter from the inventory build, -- that relates to inventory in your own inventory, right? It hasn't shipped out the door yet?

Steven Voskuil, Senior Vice President and Chief Financial Officer

Yes, there are two parts that we talked about on the call. The one is retailers, our distributors built some inventory, and that doesn't benefit us from fixed costs, but the mix that they built it in gave us a favorable mix impact. And then we built a bit of our own inventory, because we build our inventory at this time of the year anyway for Halloween, but beyond that, we built some more in anticipation of the price increase, and that's the portion that drives a fixed cost absorption benefit, as we put those costs in inventory until it bleeds out in the third quarter.

Robert Moskow, Analyst

So I understand, like your volume was down in North America in the quarter, but retailers were building up inventory, so does that mean, it would have been worse if they hadn't been building up inventory?

Steven Voskuil, Senior Vice President and Chief Financial Officer

In total, inventories for retailers didn't build. I say built -- it may built some in anticipation of the price increase, if they are more profitable brands that we touched on. In total, they weren't up. And so, I don't know if that comes around...

Michele Buck, President and Chief Executive Officer

The accounting impact has more to do with our internal inventory than external inventory.

Steven Voskuil, Senior Vice President and Chief Financial Officer

That's right.

Robert Moskow, Analyst

Okay. Well, then the next question is, if it hasn't been shipped yet, how do you accrue for inventory benefit on that kind of volume? Is it like you just get better rates on your labor or better rates on your (inaudible) commodities like -- it seem to me, you wouldn't enjoy that benefit until it actually shipped to a customer, but maybe I just don't understand the accounting?

Steven Voskuil, Senior Vice President and Chief Financial Officer

Yes. You are getting more efficiency in your plans, by running more volume, and then it goes into the inventory, so off the P&L into the inventory, until it comes back when you do the sale.

Robert Moskow, Analyst

Okay. All right. Thank you.

Operator

Our next question comes from Chris Growe with Stifel. Your line is open.

Chris Growe, Analyst

Hi. Good morning.

Melissa Poole, Vice President of Investor Relations

Good morning, Chris.

Michele Buck, President and Chief Executive Officer

Good morning.

Chris Growe, Analyst

Hi. I just had a question for you in relation to the price increase. Obviously, it's well-validated by competitors taking prices up to. I guess, I'm just curious with input costs down, are you getting much push back, say, from retailers on this pricing strategy associated at this time, when input costs are more favorable?

Michele Buck, President and Chief Executive Officer

So our retailer conversations around pricing has gone well so far. The retailers know and appreciate that we continue to invest in our brands that we provide a lot of investment to drive category growth in terms of our category management, and other investments with the customer and we really jointly work together to drive revenue growth and profitable growth, which benefits all of us. So at this point in time, we're feeling good. As you know the category has priced. So it's been a category initiative and we're feeling good at this point.

Chris Growe, Analyst

Okay. And then just a question for you, you talked about second half North American sales growth rate, largely in line with the first half, I think ex the Easter benefit. And if I understand that right, you're going have pricing coming through at least at that level. You've got marketing up and new product pipeline looks pretty solid. It would seem volumes could grow in the second half of the year, although I don't think that's what you were implying. So I'm just trying to understand those -- that factor and how that could affect your second half growth rate?

Michele Buck, President and Chief Executive Officer

Sure. So as we think about the back part of the year, I did mention that some of the lapse were a little bit tougher for us as we look at the back half given the trends we had in seasons. There is also a bit of pipeline fill that we had in the second quarter from our new products. If you think about the new products we had though in the marketplace, we had the new packaged candy bags, we had Reese's Thins, we had Reese's lovers. Reese's lovers actually hit the market a little sooner than we had anticipated to hit in Q2, we thought more of it was going to hit in Q3. And so those things come out of our numbers in the back half of the year.

And then if you think overall about the business, we are increasing our DME spend, and we'll have impressions up similarly to the first half of the year, but it's going to cost us a little bit more on that just because we're lapping some of the efficiencies that we realized as we brought some of our accretive production in-house year ago. Hope that helps.

Chris Growe, Analyst

It does. Yes. Thanks so much for that.

Operator

Our next question comes from David Palmer with Evercore. Please go ahead .

David Palmer, Analyst

Thanks. Just a little bit of a follow-up on Chris' question on volume in your return on advertising. This summer is the summer of Reese's, and you've already been spending back in the quarter on advertising. It sounds like, it's going to be doing even more in the next quarter or two with the benefit of the pricing behind you. So I guess the question is about volume, it's been tough to grow for a lot of players in the instant consumables area. What makes you think or how confident are you that you're going to get a volume response from this advertising in the second half? And I guess, it doesn't seem like that's baked into the numbers. So how are you going to be judging this return on investment? Thanks.

Michele Buck, President and Chief Executive Officer

So, generally, as we price, we expect to see a dip in volume. That's just how the conversion works. So, the first year of pricing, you take the drop in your volume and then the consumer kind of converts and gets used to it. Certainly, we try to accelerate that conversion curve by spending in to advertising, which we have found to help really drive that conversion curve to be a bit stronger than it otherwise would. So that's really what's occurring when you think about that, because our last year price impact is really what's hitting the marketplace this year, just as this year's price impact primarily comes into the marketplace in 2020.

David Palmer, Analyst

So perhaps safer to say that you would be hoping to see a volume response as the year progresses, and perhaps that exit rate on volume is going to be how you judge this advertising push?

Michele Buck, President and Chief Executive Officer

Yes, I would say that, yes, that progresses getting better piece towards the end would be how we judge it. Yes.

David Palmer, Analyst

Okay. Thank you very much.

Operator

We'll take our next question from John Baumgartner with Wells Fargo. Go ahead.

John Baumgartner, Analyst

Good morning. Thanks for the question. Michele, just wanted to touch on the international business. I mean, the focus markets are growing mid singles, but that's a slowdown from last year, especially in India. So, how much of that do you saw -- would you say is just harder comps relative to anything incremental on the competitive front or on the consumer side? And then, I guess, secondly, the non-focus markets, export markets, I mean there are still an appreciable part of the business, and your growth seems to be accelerating. So just what's driving that pickup up, and how do you think that the export business is fitting in strategically over the longer term for you?

Michele Buck, President and Chief Executive Officer

Yes, absolutely. So if you think about our international strategy, certainly we believe international is an important part of our business model, and we will be continuing to focus on profitable growth across the key markets. The way we think about that business, we have scaled businesses in Canada, Mexico and Brazil. We have a very highly profitable export business, just because we don't have those fixed costs of feet on the ground as we export, but we found that to be a very viable piece of our business model, and actually growing increasingly across the board. Particularly, we've seen a lot of strengths for the Reese's brand in the UK with very limited investment on our part.

And then the place that we're really placing bigger bets for the future are in China and India, the big emerging markets that have so much potential growth. And we're excited about those opportunities. So yes, I would say the slowdown in the top line growth is really a factor of -- as we build scale, the same kind of growth just off a bigger base starts to drop down. But we're feeling really good about the performance in across all those markets. They've been hitting expectations. India, we launched Kisses. Feel good about what we're seeing there, and about expanding that opportunity. So yes, we're feeling good about that piece.

John Baumgartner, Analyst

Great. And just a follow-up on the pricing. Just to be clear, it sounds like the second round of pricing you're taking is going to be in excess of commodity inflation. So should we be thinking about a benefit, net of inflation for next year on your margins, or are you going to spend that back elsewhere in the business? Just to be clear on that.

Michele Buck, President and Chief Executive Officer

So, we definitely are -- run our business model in a way that we try and make sure that we are balancing, pricing, margin expansion overall through smart cost management to enable reinvestment back into the brand. So, you know that we have a pretty active commodity management, hedging program. We try and look at what that outlook looks like, look at all the other cost factors and cost elements in the cost bucket, and just keep trying to net ahead in terms of pricing where we think it makes sense that where there is realization opportunities, smart cost management and then investing back in. So it's really kind of a -- it's a holistic approach to looking at the P&L versus just zeroing in on any one line here.

Steven Voskuil, Senior Vice President and Chief Financial Officer

Yes. And I'd say the key is the proactive past year. So we're not ready to talk about 2020, yes, but certainly having the pricing in place will be a good way to start the year.

John Baumgartner, Analyst

Okay. Thanks a lot for your time.

Operator

We'll now go to Ken Zaslow with BMO. Please go ahead.

Ken Zaslow, Analyst

Hey. Good morning, everyone.

Melissa Poole, Vice President of Investor Relations

Good morning, Ken.

Michele Buck, President and Chief Executive Officer

Good morning.

Ken Zaslow, Analyst

Just two questions. First is on the smaller brands like the Rolo, the Heath, what have you done differently with them is just activating marketing, what other brands have you not touched yet that maybe in the potential? And then I have a follow-up.

Michele Buck, President and Chief Executive Officer

So, yes, I would say primarily marketing. So on those smaller brands over the years, we have seen evidence where a packaging upgrade on the graphics can have a nice impact on those businesses, given they don't have a lot of support when consumer goes to the shelf, and you really refresh the package. So we've done that on several of the brands, definitely unlocking them through advertising as if we haven't talked to consumers and then they start to hear about those brands from an advertising perspective. We definitely see a lift there.

And I would say that is the primary activation. We have hit most of the smaller brands. There are a few that -- I would say there is a couple more that we will consider investing in going forward. I can think of three. I don't know if I want to really talk about what those are for competitive reasons, but there are a couple more that we would consider some minor investing. But I would say the ones that you've seen this year including down the Heath and Rolo, you should think about those as the more sizable ones for which we would see the bigger impacts.

Ken Zaslow, Analyst

And then my follow-up, I think you said it earlier that you lost distribution in some of the -- one of the acquisition, I know which one, was that part of the plan going into that, and what are the plans to regain the distribution back?

Michele Buck, President and Chief Executive Officer

So, it was on Pirate Brands. As part of the transition it was one of those elements where -- yes, a distribution was lost, a retailer, a couple of retailers that shouldn't have been. As we took over the business, our sales team quickly went in and got the buy-in to get that distribution back. It just takes a little time, because you can't actually get the distribution on shelf until the customer has a planogram reset lined up, and the next planogram resets were in the fall. So, September-October time frame, we expect to start to see that distribution come back. We have the commitments that it will come back. So it really wasn't about not deserving the space, it was more of an integration hiccup. And we feel really good about the velocities we're seeing, where we haven't lost distribution, we are very high single-digit velocity gains on Pirates.

Ken Zaslow, Analyst

And it is more distribution gains across the US ACD [ph] or are you there and you decided to execute now? And I'll leave it there. Thank you.

Michele Buck, President and Chief Executive Officer

No, I think there is more opportunity in distribution across the US.

Ken Zaslow, Analyst

Great. Thank you very much.

Operator

And we'll now go to Steve Strycula with UBS. Please go ahead.

Steve Strycula, Analyst

Hi. Good morning.

Steven Voskuil, Senior Vice President and Chief Financial Officer

Good morning.

Steve Strycula, Analyst

Michele, quick clarification question for you. The price increase that you talking this year, meaning July 2018, that is going to be a contribution of our 1.5% for full-year pricing. But on an annualized basis, it's 2.5%. So there is a phasing effect. My understanding is from what you're saying on today's call, is that the go forward price increase is closer to 2%, but with no phasing. So we should think about it being a clean 2% for next year. That's the first part of my question.

Michele Buck, President and Chief Executive Officer

Yes, that's generally fair way to think about.

Steve Strycula, Analyst

Okay. And then the second piece a little bit on the strategy. The way I understand it to simplify the math is that North America breaks down a third center store, a third front-end store, and a third seasonal, and it sounds like you took pricing across two of those pieces of the third, meaning, one third is left untouched. Can you speak a little bit about what's happening in that portion of your business and how we think about, when might be appropriate times to also kind of monetize the pricing opportunity?

Michele Buck, President and Chief Executive Officer

So, yes, part of seasons, we have done some small pricing action. So generally we priced pretty broadly across the portfolio. We haven't taken as much on the sweets part of our business, but we have had some increase in seasons as part of our broader increases. So, at this point, I can't tell you that there is a -- we don't talk about our future plans around pricing, but we do feel like we've taken some there, and on an ongoing basis, we're just going to constantly evaluate the entire portfolio and look at when and where we think there is opportunity for greater price realization.

Steve Strycula, Analyst

Okay. Thank you, and congrats on a good quarter.

Michele Buck, President and Chief Executive Officer

Thank you.

Operator

Our final question today comes from Michael Lavery with Piper Jaffray. Please go ahead.

Michael Lavery, Analyst

Good morning. Thank you.

Michele Buck, President and Chief Executive Officer

Good morning.

Michael Lavery, Analyst

Just back to the international business, can you maybe give us a sense of the margin progression there and sort of what inning we're in? Obviously divesting Golden Monkey is a big help and you've done quite a bit to really improve the profile there, the trajectory of margin expansion has obviously been really strong. But now, what's the kind of the runway ahead over the last four quarters more indicative of what we should expect or is there still some big step-ups to come?

Michele Buck, President and Chief Executive Officer

I wouldn't expect a big step-up. Certainly, we're going to continue as we do everywhere to look at every line item on our P&L and continue to look at opportunities to improve margin because that's just a piece of who we are as a company. But I think the really big step-ups have been taken.

Steven Voskuil, Senior Vice President and Chief Financial Officer

Yes, I'd agree. And going back to the earlier question, now it also matters the mix between the export countries and the ones that we have feet on the ground, and that the feet on the ground, will have an impact on how that margin progresses as well.

Michael Lavery, Analyst

That's helpful. And is pricing a meaningful component of what you can push there too or is really the pricing focus just North America?

Michele Buck, President and Chief Executive Officer

So we have always had a very active pricing component in those markets. As you know there are economic volatility components in those markets, there are forex, et cetera. So we do continue to price in part of where -- why our margins are, where they are, is some of the pricing there, but it does vary by market, and given they are smaller piece, we just don't talk overtly about that on the call.

Michael Lavery, Analyst

Okay. Thank you very much.

Operator

We have no further questions at this time.

Michele Buck, President and Chief Executive Officer

Thanks, everybody. I'll be around today to answer any follow-up questions you have.

Operator

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