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The Hershey Company

Fourth Quarter and Full Year 2023 Earnings Conference Call
(Prepared Remarks)

February 8, 2024

CORPORATE PARTICIPANTS

Melissa Poole, *Vice President, Investor Relations*

Michele Buck, *Chief Executive Officer and Chairman*

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

PRESENTATION

Melissa Poole

Good morning, everyone, and welcome to the pre-recorded discussion of The Hershey Company's Fourth Quarter 2023 Earnings Results.

My name is Melissa Poole and I'm the Vice President of Investor Relations at Hershey. Joining me today are Hershey's Chairman and CEO, Michele Buck, and Hershey's Senior Vice President and CFO, Steve Voskuil.

In addition to these remarks, we will host an analyst Q&A-only session at 8:30 a.m. Eastern on the morning of February 8. 26. A replay of this webcast and our subsequent Q&A session will be available on the Investor Relations section of our website, along with their corresponding transcripts.

During the course of today's discussion, Management will make forward-looking statements that are subject to various risks and uncertainties. These statements include expectations and assumptions regarding the Company's future operations and financial performance. Actual results could differ materially from those projected. The Company undertakes no obligation to update these statements based on subsequent events. A detailed listing of such risks and uncertainties can be found in today's press release and the Company's SEC filings.

Finally, please note that during today's discussion, we will refer to certain non-GAAP financial measures that we believe will provide useful information for investors. The presentation of this information is not intended to be considered in isolation or as a substitute for the financial information presented in accordance with GAAP. Reconciliations to the GAAP results are included in this morning's press release.

It is now my pleasure to introduce our Chairman and CEO, Michele Buck.

Michele Buck

Thank you, Melissa, and good morning, everyone. Thank you for joining us today.

We executed well in the fourth quarter, and we're encouraged by the resilience of seasonal tradition and the consumer response to innovation in our categories, despite sustained macroeconomic headwinds impacting consumer behavior. As expected, October and December delivered strong seasonal sales, yielding Halloween category growth of 7.6% and Holiday category growth of 3.3%, versus last year. This seasonal strength helped us to return to share growth within the chocolate category, with gains of 10 basis points in the quarter.

We operate in resilient categories and we have a long history of successfully adapting to periods of rapid change and uncertainty. This period of historically high cocoa and sugar prices, while challenging, is no different. While cocoa is expected to limit earnings growth this year, we believe our business strategies will enable us to grow our categories and profitably expand market share over time.

We have been preparing for opportunities that could be seized post S/4 implementation and salty snacks integration, and we are accelerating a number of these initiatives that improve our agility and enhance our end-to-end connectivity. We are pleased with the enhanced insights and efficiencies our recent technology investments have enabled and we will continue to prioritize cost structure optimization moving forward. We remain confident in the long-term potential of our business and we believe these actions will position us well to help offset some of the macroeconomic challenges we are facing and deliver balanced top and bottom line growth over the coming years.

Moving now to our Q4 results, overall marketplace food volume trends in the fourth quarter were comparable to Q3, with continued strength in non-measured channels and a slight deceleration in sales growth as price realization moderated.

Hershey chocolate retail sales growth outpaced the category in Q4, with solid measured channel growth of 2.9%, as category price elasticity continued to outperform broader food and improved in the fourth quarter. Seasonal traditions were a key driver of this performance, with Hershey outpacing category growth in both Halloween and Holiday. We are also encouraged by the improvement in our everyday chocolate share following the launch of Reese's Caramel. Our largest innovation of the year is off to a great start and outperforming Reese's with Pretzel's, our last scale launch prior to capacity constraints. As some of you may have seen, Reese's will return to the Superbowl this weekend and our teams have done a fantastic job leveraging this event to drive consumer engagement and incremental in-store merchandising.

Our refreshment business continues to perform well, with double-digit retail sales growth in both gum and mints outpacing the category and resulting in share gains of approximately 45 and 215 basis points, respectively.

While our sweets share declined slightly, growth was solid and up mid-single-digits in the fourth quarter. Our teams have a robust calendar of incremental innovation, distribution and merchandising activations planned for 2024, supported by significantly more capacity. We will share more details later this year about some of our exciting second-half sweets innovation.

Shifting now to salty snacks, net sales were below expectations in the fourth quarter, driven by continued softness within the ready-to-eat popcorn category. Skinny Pop declines slightly outpaced the category, consistent with expectations, driven by reductions in advertising and merchandising to ensure strong customer service during our S/4 implementation. Share trends improved in December as media and in-store promotions were reactivated. While we expect current category trends to continue through the first half of 2024, we remain optimistic about the long-term opportunity and are excited about our teams' investments and activations to drive growth in the second half of the year.

Dot's Pretzels had a strong quarter, with gains in distribution and velocity driving a 50-basis=point increase in pretzel category share.

For the first time, you will see joint merchandising activations across our confection and salty snacks businesses this year, driving scale across some of our largest properties, including March Madness and Fall Football. We are excited to leverage the breadth of our portfolio to secure impactful merchandising in-store and meet even more consumers' snacking needs for these key events.

We had a strong quarter within our International segment, driven by double-digit growth across Latin America and World Travel Retail, and more than 50% growth in Europe, driven by our Reese's expansion. India performance was in line with expectations, growing high-single-digits in the quarter. In Mexico, we saw decelerated growth in the chocolate and spicy candy categories to more historical levels in the second half of 2023. Our brands have continued to outperform, with share gains in both categories in the fourth quarter. As we look to 2024, we expect on-algorithm growth of mid-single-digits within our International segment, with household penetration, distribution and innovation gains partially offset by declines driven by our discontinuation of a dairy beverage product line in Mexico.

In '24, despite the challenging cost backdrop, we are continuing to prioritize brand investment, with media spend expected to grow in line with sales. In addition, we have enhanced our media targeting for our largest brands, which will enable us to increase consumer reach at an even greater rate for more incrementality and stronger ROIs.

Turning to the outlook, for the full year we expect net sales growth of approximately 2% to 3%, consistent with current trends. Our North America Confectionery and International segments are expected to grow in line with our long-term algorithm, while North America Salty Snacks segment sales are expected to be in line with or slightly ahead of 2023 levels, with trends improving sequentially throughout the year as popcorn category sales stabilize.

As many of you know, cocoa is trading at historic highs and have risen significantly since our last call. We have a strong track record of managing through volatile and inflationary environments, and we have very good visibility into '24 cocoa and other key ingredient costs.

We remain committed to our long-term strategy of pricing to cover raw material inflation and we expect several points of price realization this year. Despite expected operating profit margin declines this year, we remain ahead of pre-COVID levels. 2023 operating profit margins came in ahead of expectations due to incremental price realization and favorable industry packaging and logistics costs. Importantly, we were able to achieve multi-year margin expansion without sacrificing brand investment, with advertising, people and capability investments all up double-digits since 2019. The returns on these investments continue to lead the industry and remain an important part of our long-term growth strategy.

As is always the case, we are monitoring many factors to inform the go-forward strategy, pricing and investment decisions that we believe will best position us to capture share and drive growth for '25, and beyond. We are actively evaluating price pack architecture opportunities to help ensure we have the right offerings and price points to meet consumers' changing needs, and will share more about the opportunities we see later this year.

Given the rapidly evolving environment, we have accelerated several initiatives and opportunities that we highlighted last spring at our Investor Day, to drive efficiencies and fuel investment in capabilities for future growth. We are in a strong position to increase productivity across the business by leveraging our insights and investments in S/4 and other technology platforms in 2024, and beyond. We expect to see savings in both supply chain procurement and manufacturing, as well as SG&A, driven by automation, process optimization and operational synergies across our business segments. While this will be a multi-year journey, our teams are off to a great start, and we are excited by the organizational unlock this will enable, in addition to the cost savings that we will secure.

Additionally, given the confidence we have in our long-term business opportunities and the strength of our balance sheet, we are doubling our share buybacks for this year and increasing our dividend an additional 15%.

With that, let me turn it over to Steve for some additional perspective on our financial results and outlook.

Steve Voskuil

Thank you Michele, and good morning, everyone.

For the full year 2023, we executed against our long-term strategies and demonstrated our agility in a dynamic and challenging environment. We reported 7.2% net sales growth, adjusted gross profit dollar growth of 10.4%, and adjusted earnings per share growth of 12.6%.

In the fourth quarter, we delivered reported net sales growth of 0.2%, while organic constant currency net sales declined 0.1%, slightly below our expectations. The North America Confectionery segment performed largely as expected, reporting an organic net sales increase of 2.1%. Volume declined 5.1% in the quarter, as strong seasonal and non-measured channel growth was offset by price elasticity declines within our everyday business. As Michele noted, organic, constant currency net sales for our International segment increased 8.3%, as volume improved sequentially, as expected.

Organic, constant currency net sales for our North America Salty Snacks segment declined 24.6%, reflecting an approximate 16-point headwind from the planned inventory drawdown following the Q4 ERP implementation, which we expected. However, the base business decline of high-single-digits reflects softness in the ready-to-eat popcorn category, compounded by fewer planned promotional programs as we emerged from the ERP transition, in part offset by incremental club distribution for Dot's. We have good visibility to increased levels of distribution and merchandising, and believe this, in addition to higher levels of media and innovation, will drive sequential improvement in retail trends as we progress through 2024.

Moving down the P&L, adjusted gross margin increased 50 basis points in the fourth quarter, as pricing and productivity gains, coupled with favorable manufacturing and logistics costs, more than offset inflation. This was ahead of expectations due to incremental productivity savings, as well as lower freight and warehouse costs.

Advertising and related consumer marketing increased 5.8% in the fourth quarter. Adjusted operating expenses, excluding advertising and related consumer marketing spend, increased 3.7%, driven by elevated investments in capabilities and technology, as well as higher labor and benefit costs.

The adjusted tax rate for the fourth quarter was negative 3.8%, an increase of 270 basis points versus the year-ago period. This increase was primarily driven by fewer renewable tax credits in the quarter versus the prior year, as credits were realized earlier in 2023, as compared to 2022.

While Q4 net sales growth was limited by consumer behavior changes and planned Salty Snacks segment inventory declines, price realization, productivity and strong cost management allowed us to sustain business investment and deliver adjusted earnings per share of $2.02 in the quarter.

Capital additions, including software, were $223 million in Q4, supporting our previously discussed capacity expansion projects and ERP implementations. As several capacity projects reach completion in the first half of '24, we anticipate capital spending as a percentage of sales to return to historical levels as we exit the year. Total capital investment this year is expected to be between $600 million and $650 million.

There is no change to our capital allocation priorities, including reinvestment for growth, steady dividends growing in line with earnings, and share repurchases. In the fourth quarter, dividends paid to shareholders totaled $238 million, an increase of 14.9%, versus the prior year period. In 2024, our dividend increase will reflect a planned shift to earlier in the year, to the first quarter, from the third quarter in prior years. The Company has $370 million remaining under the May 2021 $500 million share buyback authorization, and in December 2023, the Board of Directors authorized an incremental $500 million.

Now I'll share a few more details on the incremental cost savings opportunities we have identified, enabled, in part, by our technology and organization investments over the past 18 months.

Our Advancing Agility & Automation, or "AAA" initiative, will provide fuel for investment and generate net run-rate savings of approximately $300 million, pre-tax, by 2026. Approximately 70% of these savings are anticipated to come from SG&A, with the remainder from cost of goods sold. For 2024, we are targeting $100 million in cost savings, with $90 million coming from SG&A. When modeling, keep in mind that savings will build over the course of the year. Estimated cash costs in 2024 are projected to be $110 million.

Total three-year costs are projected to be between $200 and $250 million, including approximately $25 million of non-cash costs. Estimated costs will include investments that advance digitalization and end-to-end connectivity, and enhance our agility and flexibility to respond quickly in an increasingly dynamic marketplace. This program is incremental to our previously communicated $400 million supply chain productivity initiative.

Now, let me share some perspective on 2024. As Michele mentioned, we expect organic net sales growth within our North America Confectionery and International segments to be in line with our long-term algorithm. North America Salty Snacks segment sales are projected to be slightly below long-term algorithm, with growth rates improving once we begin lapping the onset of the popcorn category softness in the second half of 2023. Our full year net sales outlook of 2% to 3% growth is primarily driven by price realization, with volume expected to be flat to slightly down.

We expect some headwinds to persist in the first half of the year, including consumer pressures related to the loss of SNAP benefits, the loss of merchandising at a key retailer, and continued high raw material costs. We also expect a slight headwind from a shorter Easter season, which we plan to offset with a more robust innovation calendar, increased media reach, distribution gains and price realization. In the second half of the year, we will begin to lap consumer behavior and merchandising changes, but expect more muted seasonal growth, based on difficult laps and slightly lower sell through in '23.

We remain on track to implement our upgraded ERP system in several markets, including the U.S., Canada and select international markets, in early Q2. We anticipate an approximate 3- to 4-point benefit to net sales growth in Q1, as we build inventory in advance of the implementation. We expect this inventory build to largely reverse in Q2.

From a profitability perspective, we expect gross profit dollars to decline low-single-digits and gross margin to contract by approximately 200 basis points. Historically high cocoa prices and elevated sugar costs, along with incremental labor inflation and negative product mix, are expected to more than offset net price realization, supply chain productivity and incremental savings from the AAA initiative.

We will continue to invest across our brands, with advertising and related consumer spend planned to increase in line with sales. Incremental SG&A productivity, including AAA initiative savings, along with lower incentive compensation, are expected to lower divisional and corporate expenses by 3% to 4%.

We expect our full year 2024 adjusted effective tax rate to be approximately 13%, which reflects incremental returns on our existing strategies. Other expense, which includes our spend on tax credits, is expected to be $220 million to $230 million. Interest expense is expected to be $165 million to $175 million, which reflects the higher interest rate environment. Given the valuation contraction we have experienced, our strong balance sheet, and our confidence in future business performance, we are planning for share buybacks to rise in our capital allocation priorities. We currently project shares outstanding to be approximately 1% lower for the year.

Additionally, we expect some volatility in our results related to the S/4 implementation, so we thought it would be helpful to provide some insight into first-half and second-half expectations.

Relative to gross margin, we expect more contraction in the first half of the year, as productivity will be skewed to the second half of the year due to the S/4 implementation. In addition, we are lapping approximately $15 million to $20 million of incremental costs in the Salty Snacks segment in the second half. Marketing spending, S/4-related costs and incentive/benefits costs are expected to be front-half loaded, while the timing of renewable tax credits are expected to normalize, creating a headwind to earnings in second quarter and tailwind in the second half of the year. Combined, we expect this to result in a double-digit adjusted EPS decline in the first half and a comparable increase in the second half as we exit the year.

We look forward to sharing more details about the power of our insights-driven strategies, as well as updates on innovation, merchandising and consumer activation across our categories at CAGNY in a few weeks.

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

Michele Buck

Thanks, Steve.

To close, I want to start by saying that I am tremendously proud of what our teams have accomplished over the last year to advance our innovative portfolio and build a stronger, more resilient business for the long term. Our goal as we move through 2024 and beyond is to ensure that we continue to advance and evolve our strategies, maximize the opportunity to grow our categories, expand our margins and enhance our long-term returns.

As the environment remains dynamic, we will continue to prioritize cost structure optimization to strengthen our financial core. We are confident in the actions we are taking to drive efficiencies and enhance our capabilities, and wholeheartedly believe that these actions will help us increase the productivity of our business.

I want to thank everyone again for joining this morning and encourage you to listen to our live question-and-answer webcast, which will begin at 8:30 a.m. Eastern Time today, and will be available at thehersheycompany.com. Thank you for your continued support and interest in Hershey.