The Hershey Company

Third Quarter 2022 Earnings Results
Prepared Remarks

November 3, 2022

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 Third Quarter 2022 Earnings Results.

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

In addition to these remarks, we will host an analyst Q&A-only session at 8:30 a.m. Eastern on the morning of November 4. 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.

Third quarter results came in ahead of expectations, as our increased brand investments and improved supply chain performance helped support resilient consumer demand and drive category growth across business segments.

Marketplace share and gross margin trends both improved versus the second quarter, and we have strong momentum exiting the year. Given our performance to date and visibility into the fourth quarter, we are raising our net sales and earnings outlook for the year. Net sales growth of 15.6% in Q3 was balanced with all segments delivering double digit organic growth driven by both price and volume gains.

In the North America Confectionery segment, net sales growth of 10.4% was led by strong gains in our chocolate brands. Hershey chocolate retail sales grew 12.6% in the third quarter, resulting in a segment share gain of over 100 basis points. This was a 125-basis point improvement versus the second quarter share performance, bringing our category leading chocolate share to 47% in Q3, an increase of 150 basis points versus pre-pandemic levels.

With improved supportability and a 25% increase in advertising, Reese's retail sales grew over 16% in the third quarter. A big thank you to our teams across the organization who have worked tirelessly to install new lines, reconfigure existing lines, and optimize our offerings and investment to maximize output and get more Reese's on the shelves for our consumers to enjoy. Next week our latest Reese's innovation, Reese's Big Cup stuffed with Reese's Puffs Cereal, will be available at stores nationwide to satisfy your next Reese's craving.

PayDay also experienced outsized growth in the third quarter enabled by incremental capacity. Our teams have done a phenomenal job capitalizing on this supply chain investment with higher levels of advertising support, new pack sizes, and incremental distribution to deliver retail sales growth of over 35% in Q3.

Our Sweets and Refreshment business grew double digits in the third quarter, with 10% retail sales growth and a share improvement of about 85 basis points versus the second quarter as our teams made significant progress addressing our Mints manufacturing challenges.

Innovation continues to perform well, and advertising support increased versus first half levels with improved on shelf availability.

Overall advertising levels on our confection brands increased meaningfully in the third quarter, with strong double-digit gains in consumer impressions as we seek to return to more historical levels of support behind improved inventory levels.

Promotional activity also returned to more normalized levels in the third quarter, with incremental investments supporting higher levels of quality merchandising in store and online compared to the first half of the year. We expect this to continue in Q4 and into next year.

Before I provide updates on our other segments, let me share a recap of our Halloween season and expectations for the Holiday season and everyday trends as we close the year. Preliminary results indicate a strong Halloween season, with participation and spend both above pre-pandemic levels. Candy category retail sales are estimated to have grown double-digits this year, with Hershey Halloween retail sales growing high single-digits, both in line with our expectations. We believe we are well positioned for a great Halloween next year, given our high sell-through this year and additional capacity coming online to support more growth.

We anticipate this category momentum to continue into the Holiday season, and product is already out in stores and selling well. We have a great lineup of products this year and our Retail teams are already busy building amazing displays across stores in America to generate excitement and capture incremental purchases. We expect category and Hershey performance during the Holiday season to be comparable to what we saw during Halloween.

Everyday trends are also expected to remain healthy as we exit the year, but with growth levels moderating as consumer behaviors continue to evolve in response to high inflation. We are continuing to prioritize brand and supply chain investments to capture additional opportunity if current trends sustain.

Now, shifting gears to our North America Salty Snacks segment, where performance continued to shine with over 20% organic sales growth and strong category shares gains in the quarter. SkinnyPop ready to eat popcorn retail sales grew over 20% in the third quarter, resulting in a 120 basis points category share gain, while Pirate's Booty grew over 14%.

Dot's pretzels grew over 34% and gained another 200 basis points of share within the pretzel category on top of a 260-basis point gain during the same period last year. Dot's core products remain strong, and we have an exciting new Cinnamon Sugar limited time flavor hitting stores now that will help generate even more consumer interest and in store merchandising. Despite higher retail prices, our Salty Snack volume trends have remained incredibly resilient and consumer units grew over 7% during the quarter, well ahead of category averages as our brands continue to grow households and frequency.

While a smaller part of our portfolio, our Baking products continue to perform well and maintain the majority of consumers and occasions gained during COVID-19. Sales for our baking chips, cocoa and syrup products grew over 7% in Q3, and are now approximately 25% higher than the same period pre-pandemic as consumers continue to spend more time at home baking sweet treats for family and friends.

This broad-based growth was seen across classes of trade in the U.S., with double digit sales growth in the convenience, mass, club, and dollar class of trades and high single-digit sales growth in food and drug. While inflation has driven some changes in consumers shopping behaviors, including channels shopped and pack sizes purchased, our products have remained a key component of consumer baskets.

Within our International segment, all markets grew double digits despite increasing FX headwinds. Reported net sales in India grew approximately 29%, Brazil and Mexico each grew about 11%, and our export markets and world travel retail businesses combined grew over 15%. Strong category demand, combined with continued distribution gains and consumer relevant innovation drove growth across markets. We continue to make focused capital investments to support growth in our strategic markets that will support incremental capacity in Mexico, Brazil, and select export markets.

This hard work and performance has been recognized across the globe, with our Latin American team winning two Cannes Lions awards for our HerShe campaign, our Brazil teams securing its best ever ranking on the *Great Place to Work* list within the Mid-Multinationals sector, and our team in India winning over 20 external awards for excellence in marketing, supply chain, packaging, and leadership. I couldn't be prouder of our teams across the globe for their continued passion, hard work, and exceptional results.

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

Steve Voskuil

Thank you, Michele, and good morning, everyone.

We delivered another strong quarter with net sales, gross margin, and earnings per share performance, all exceeding our expectations. Sustaining topline momentum drove adjusted operating income growth of nearly 10% in the third quarter despite broad based inflation and continued supply chain disruptions.

Organic, constant currency net sales increased 11.8% in the third quarter driven by balanced growth across all segments. Net price realization contributed 7.7 points of growth, as expected, while volume growth was stronger than planned, contributing an incremental 4.1 points of growth. Higher volumes were driven by resilient price elasticities, a 2-point benefit from earlier seasonal shipments, and an approximately 1-point benefit from continued inventory replenishment.

As a result of the strength in consumer demand in the third quarter and visibility into the fourth quarter, we are increasing our full-year net sales guidance to approximately 14% to 15%. We expect price elasticities to moderate in the fourth quarter as consumer demand is expected to slow but remain favorable to historical levels.

Adjusted gross margin in the third quarter was 42.5%, a decrease of about 180 basis points versus the prior-year period. As expected, broad-based supply chain inflation, labor investment, higher supply chain costs to support sustained consumer demand, and unfavorable mix continued to pressure margin, partially offset by net price realization and volume growth. While our gross margins continue to lag prior-year levels, we are pleased with the improvement in trends and expect the sequential improvement to continue into Q4. For the full year, we expect adjusted gross margin to decline approximately 120 basis points versus last year.

As supportability improved in the third quarter, advertising and related consumer spending increased 5.4%, with consumer impressions up double digits versus the prior-year period. Brand investment remains a critical driver of growth, and we plan to continue increasing advertising levels in the coming quarters behind our improved capacity and supply chain performance.

Corporate expenses increased 20.9% in the third quarter driven by capability and technology investments and higher incentive, compensation, and benefits costs. I'm excited to share that we successfully deployed the Company's new ERP system in Mexico during the third quarter, with the business resuming normal operations faster than anticipated. The teams are now pivoting their efforts to deploying this capability and lessons learned to our Salty Snacks business towards the end of next year, with the U.S. and Canada businesses to follow thereafter.

The adjusted effective income tax rate was 15.9%, an increase of 120 basis points versus prior year, driven by higher utilization of capital losses in the prior-year period, as well as the timing of renewable energy tax credits. We now expect the full year adjusted effective tax rate to be approximately 14% to 15%. This is slightly lower than our previous outlook driven by increased visibility into renewable energy projects to be completed this year. As a result of the expected higher tax credits and slightly higher pension costs of about $10 million, Other expense is now estimated to be about $205 million for the full year.

Interest expense was approximately $35 million in the quarter, an increase of approximately $5 million due to increased debt related to the financing of the Dot's and Pretzels' acquisitions. Our full year interest outlook is now approximately $135 million to $140 million, reflecting higher interest rates on our outstanding commercial paper.

Despite tax and non-operating headwinds, strong net sales growth drove adjusted EPS of $2.17, an increase of 3.3% versus the prior year. Based on this strength, we are raising our full year adjusted earnings per share guidance to 14% to 15%, while simultaneously increasing investments in people, capabilities, and technology to drive future growth.

Balanced top and bottom-line growth drove operating cash flow of about $450 million in the third quarter, bringing our year-to-date total to $1.6 billion, an increase of over 10% versus prior year. In the third quarter, total capital additions, including software, were approximately $120 million, bringing year-to-date investment to $360 million. For the full year, we expect a capital investment of about $600 million, consistent with our previous guidance.

Within the third quarter, two new Reese's lines came online to support strategic forms and packs, including incremental capacity for smaller, opening-price point multi-packs. Our new Gummy capacity also came online producing its first salable case of Jolly Rancher Gummies within the quarter. This critical capacity will allow us to unlock growth in the Gummy segment through JR Gummies and the recent launch of Twizzler Gummies, which will be in stores nationwide beginning in November.

As we invest for future growth, we are also focused on reducing costs, preserving resources, and ensuring good stewardship. This year, we are installing digital capabilities to enable real-time energy and water management through monitoring systems across our plants, which are expected to reduce energy intensity by about 10% over the next three years. This investment will help reduce our greenhouse gas emissions, and advance us towards our science-based targets, while also providing a return on investment.

Before we wrap this morning, I want to touch on 2023. Our key financial planning assumptions remain unchanged from what we shared in July. We continue to expect pricing to be a large contributor to net sales growth and help offset high single-digit cost inflation across commodities, packaging, logistics, wages, and other general operating expenses. While we expect the operating environment to remain dynamic into 2023, we also expect to enter next year with strong momentum and believe we are positioned to deliver a year of strong top and bottom-line growth.

While 2022 is a strong year for capital investment, we are currently expecting another significant stepup in 2023 as we invest differentially in core Confection capacity, Salty Snack supply chain optimization, and supply chain resilience. We believe this investment is critical to achieving our vision to be a leading snacking powerhouse and look forward to sharing more details with you next year.

I am confident that our iconic brands with leading positions in Confection and now Salty Snacks, our consumer-led strategies, and our advantaged business model will deliver differentiated results in 2023. It's this operational excellence that provides us with the financial flexibility to meet the needs of today, while simultaneously investing for future growth, even in an inflationary period.

As I look to the future, I am excited about the investments we are making in capacity, flexibility, and digital infrastructure, in addition to our people and ESG agenda to realize our vision to be a leading snacking powerhouse. It's this balanced, disciplined approach that will create differentiated, long-term value for our consumers, customers, employees and ultimately, our shareholders.

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

Michele Buck

Thanks, Steve.

Our performance gives us confidence that we have the right strategies, investments, and execution to continue delivering advantaged marketplace performance and meeting the needs of our stakeholders over the long-term. We remain steadfast in our commitment to investing not only in our brands and with our customers, but also in our people, our communities, and in our sustainability initiatives so that our business thrives for years to come.

Thank you for your time this morning. I invite you to listen to our live question and answer webcast, which will begin today at 8:30 a.m. Eastern Time and will be available at thehersheycompany.com. Thank you.