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PRESENTATION

Mark Pogharian - The Hershey Company - IR

I'm Mark Pogharian, I lead the Investor Relations Group at The Hershey Company and we want to thank you for joining us here in New York this morning. I'd like to ask all of you to help me please mute your phones and iPads and computers to keep the noise level down and not have it be a distraction for management and your peers. We have a lot of great materials to cover this morning, but before I turn it over the Michele and Patricia, we need to review my favorite slide.

Let me remind everyone that today's presentation and discussion contains statements which are forward-looking. These statements are based on current expectations, which are subject to risk and uncertainty. Actual results may vary materially from those contained in the forward-looking statements, because of factors stated on this slide, and in our 10-K for 2016 filed with the SEC. Please take a read at this slide and see the appendix at the end of the presentation for a reconciliation of GAAP to adjusted line items.

All right, so we're excited to be here today. As the agenda shows, you will have the opportunity here from CEO Michele Buck, about her vision of the Company and our CFO, Patricia Little, about building shareholder value. By the end of the morning, we believe, you'll feel as good as we do about the opportunities that lie ahead for the Hershey Company. And at the end of the presentation, we'll then open it up for Q&A. We have a quick video to get us started and then Michele will take the podium. Thank you.

(Video Playing)
Michele Buck - The Hershey Company - President & CEO

Good morning to everyone in the room and listening via the webcast. I’m Michele Buck, Chief Executive Officer of The Hershey Company and I’d like to welcome you to our 2017 Investor Update. As many of you know, this is my first official day as CEO and you know when I vision that first day easing into the job, I’m not sure I quite envisioned the second hour would be standing in front of all of you. But nonetheless, I’m really pleased to be here. Seriously, it’s great to see so many familiar faces, have a chance to reconnect with many of you. And also I look forward to meeting many of you who I may not know.

I’ve been fortunate to engage with the investment community for over 10 years and I’ve always enjoyed our discussions on Hershey and the broader CPG industry. Your questions are always thought provoking and your insights are really beneficial. You have my commitment to driving Hershey forward and delivering shareholder value.

I’m honored to be here today as CEO of this special Company. Hershey has great brands, great people, capabilities and processes. Combined, these attributes make a business that over the long term has generated solid returns for our shareholders. I look forward to working with my Executive Team and leaders across the Company to continue to build shareholder value.

This morning, we’ll discuss our vision and priorities as we work to meet the evolving needs of consumers and stay ahead of the trends that are shaping our business. To level-set a bit, Hershey is a snacking Company, with iconic brands that resonate around the world. Annual sales, retail sales of our businesses exceed $7 billion in 2016 -- excuse me net sales. To support these sales, we leverage primarily company-owned facilities and a few co-manufacturers in seven countries. And all this is made possible by our 18,000 remarkable employees around the globe.

Whenever I travel around the world, when I say I work for Hershey, every person I meet gets a big smile on their face and shares a special moment that Hershey played in their lives and I even enjoyed watching all of you enjoy looking at our different products and figuring out which ones you want to try next, as you see the assortment out there. The core of who have been and who we will continue to be in the future is a consumer-centric company that invests in our iconic brands. We have strong partnerships with our retail customers, building solutions to create value in a fast evolving marketplace and we create opportunities to prosper.

Bringing goodness to one another and the world is our North Star, as we deliver the business build for a sustainable future and create a compelling workforce. Our employees are proud to work for a company that does well, while doing good. This harkens back to our founder, who was driven by a sense of community and helping children in need. This spirit is ingrained in our culture. Our employees come to work every day with a sense of purpose, fostered by Milton Hershey values and legacy. As we remind consumers on the back of our classic Hershey bars, every Hershey product you’ve enjoyed has helped support children in need through the Milton Hershey School. Thank you for making a difference.

Our iconic brands have been a consistent driver of growth for us. Over the past five years, they have grown at a CAGR of 4% and gained 1.7 share points within the CMG category. While overall category growth did slow in 2016, these scale brands continued to outperform, growing seven times the category average at 2.8%, resulting in a share gain of over 0.5 points.

Our financial performance over the past five years has been strong, with consistent margin expansion leading to solid shareholder returns. As you can see, the results were balanced and healthy, as our margin expansion did not come at the expense of topline growth. A maniacal focus on supply chain productivity, in addition to price realization has enabled us to expand our already strong operating income margin by 250 basis points and deliver an EPS CAGR of over 9%.

We all know that we’re in a period of unprecedented change. Consumers’ lives are on the go and they’re looking for balanced and increased transparency. Within the business environment, growth has slowed, deflationary pressures are impacting margins and increasing the cost of doing business and competition has intensified. There is a growing bifurcation in North America and developed markets, while emerging markets are seeing a rise in our middle class. The political and regulatory environment across the globe is uncertain and technology is dramatically impacting almost every aspect of our lives. We must and will evolve to keep pace in this rapidly changing world and continue to deliver superior performance. Our vision is to be an innovative snacking powerhouse.
We are currently the Number 2 snacking manufacturer in the US with leading edge capabilities. We aspire to be a leader in meeting consumers' involving snack needs, while strengthening the differentiated capabilities that drive our growth. Importantly, we must continue to honor our heritage, operating with a sense of purpose, while winning with our remarkable people. All of this will enable us to deliver top-tier growth and industry-leading shareholder returns.

We are building from a position of strength, with an advantaged business model that has multiple levers, enabling us to balance economic uncertainty and perform at the top of our peer set. Snacks and confection in particular has high household and channel penetration and are highly impulsive with expandable consumption. Importantly, they are also very profitable for Hershey and for our retailers. We have a portfolio of iconic brands that are responsive to investment and are loved by consumers around the world.

We have a set of differentiated capabilities that when integrated, create advantage in the marketplace. Our strong analytics and insights power our commercial capabilities, all of which are amplified by enterprise connectivity. Holistically, this enables us to drive peer-leading growth, meeting consumers’ needs and partnering with retailers to solve the issues and capture the opportunities of today and tomorrow. So, now let me take you through our action plan.

We continue to believe in our business model of expanding margins to invest for growth. We are in a high-margin, highly responsive category where fueling the topline is a key driver of a healthy P&L. There are three imperatives we will focus on to ensure this Company’s success now and into the future. The first is all about growth, activating and evolving our portfolio. We will reignite our core confection business and broaden participation across snacking to capture new snacking users and new snacking usage occasions.

The second is about reallocating resources, focusing investments to areas with the most profitable growth and increasing the ROI against dollars spent to enable margin expansion. This will provide us with the fuel for our third imperative, investing and strengthening our capabilities and leveraging technology for commercial advantage and growth. This is a differentiator for us.

Let’s first talk about our plans to reignite our profit engine, our core confection business and to expand our breadth in snacking. Globally, snacking is a $1 trillion market with confection representing about 20% of this total. North America is sizable with an expected snacking and confection growth rate of about 2% per year. Emerging markets, like China and India, are less developed but are expected to grow faster in both snacking as well as confection.

Now, I will focus on the US snacking market. As many of you have read, consumers’ consumption habits are changing. Consumers have shifted away from three large traditional meals and have gone to smaller meals, with more snacks in between. This change has impacted where and how consumers shop, as well as the products they buy. As a snacking Company, this creates tremendous opportunity for us.

While the retail box could be choppy from [quad to quad], what’s important on this slide is evidence that consumer snacking behavior continues at the expense of center of plate categories. Importantly, this growth is balanced across the snacking continuum, with both indulgence snacks and more satiating snacks performing well. This growth makes us feel good about our plans and continued collaboration with our retail customers who value the profitable snacking and confectionary categories.

The US snack market is over $100 billion in measured channels and showing solid growth. The category is fragmented with the top five manufacturers representing only 40% of the overall market. We are the Number 2 snacking manufacturer within the snack wheel, with the Number 1 share position in one of its largest categories, candy, mints and gum. And we are committed to growing our presence against other key segments. We’re leading the evolution of snacking merchandising with retailers and providing total snacking landscape insights to best meet consumer needs.

Over our strategic planning cycle, we expect to participate more broadly across snacking via both innovation and M&A. Confection is one of the largest snacking categories and it remains advantaged. It has high household penetration and frequency, channel ubiquity and it’s responsive to investment support. Additionally, there’s a large seasonal component; think Valentine’s, Easter, Halloween Holiday that make this a destination category and thus important to retailers.
The category has grown at a 2.2% CAGR over the past five years, with strong performance during periods of investments and robust innovation. The category faced headwinds in 2016. However, the growth of indulgence snacks, in addition to our consumer research, gives us confidence that this category remains relevant. The plans I'll share with you will reignite confectionery growth in 2017 and beyond.

As you can see, confection is an incredibly important part of our business and always a priority for us. It's who we are and we're able -- we're proud to be able to provide happiness, a little indulgence and great-tasting candy to our consumers. Our marketplace leadership is marked by powerful brands, such as Hershey's, Reese's, Kit Kat, Kisses and Ice Breakers. These five brands alone represent more than $5 billion of retail sales. And these are complemented by a broad and diverse portfolio that delivers against many consumer needs and provides us with competitive advantage in this variety seeking category.

Our portfolio extends across usage occasion, delivering against a variety of needs, highly profitable instant consumables for on-the-go, items to take home and share and products impact types for family celebrations and traditions. Our category is ubiquitous with strong presence not only in traditional channels such as mass and food, but also in channels that many CPG companies do not meaningfully participate. The convenience store, drug, Wholesale Club, Dollar, foodservice and vending channels are key profitable businesses for us. Our growth is overall in line with the trends in these classes of trade.

We are the Number 1 manufacturer in the confectionery space, with a 2-point advantage over our next nearest competitor. We have consistently outperformed our peers and grown our share by almost 2 points over the past five years. Importantly, we have strong share positions across all confectionery segments. Chocolate is almost 60% of the $24 billion CMG category and we have the number one share at almost a 46% share. We also have a solid share in the other sub-segments of CMG, which all have different roles, but collectively are important to our overall leadership.

Given the impulsivity and responsiveness of our category, investing in our brands is a key piece of our business model. We have and will continue to support our brands at levels outpacing that of our peers, with proven results, as scale, strong lift and strong margins result in TV ROIs that are two-times that of the industry.

Now, let me talk to you about the actions we’re taking to reignite our core confection portfolio. We will deepen our engagement with consumers, deliver strategically important innovation for our core brands and bring excitement to the aisle. So why these three initiatives? Well, when you think about deepening consumer connections, it’s about being engaging and top of mind, critically important in this highly impulsive and responsive category.

When it comes to innovation, we know that meaningful launches have historically been a key driver of category growth. These launches provide incrementality to the category by attracting new users and satisfying new usage occasions. We must also ensure consumers' interaction with our products at retail is enjoyable and that our products are easy to find. So we're reinventing the shopping experience in store and continuing to expand our presence online.

We are really proud of some of the work that we've done to closely connect with consumers on social media. As some of you may remember, there were complaints about the shape of our Reese's Christmas trees and whether those trees actually looked like Christmas tree. It began on social media, quickly expanded to digital and yes, TV coverage. Our Reese's brand team engaged on social media, taking leadership of the issue of the witty reply, true to the brand's character. Consumers quickly joined in, sharing their own passion for Reese's and creating their own responses, turning what could have been a negative into an amazing opportunity to delight our consumers.

Another great example of the fun role our brands play in consumers' lives happened last fall. It started with a stolen Kit Kat candy bar and a tweet. A freshman at Kansas State University noticed that someone stole his Kit Kat, but nothing else from his unlocked car, leaving behind this suspicious note. The tweet went viral and national news picked up the story. In less than 48 hours, the Hershey team met the student, filled his car with more than 6,000 Kit Kats and hundreds of students joined in the fun and had a well-deserved break. I think this is a testament to the amazing passion and emotion consumers have for our brands.

We also deepen our brand emotional connections through being a part of special meaningful moments with family and friends. Seasons are an important part of Hershey's business model. For the consumer, they are highly anticipated, cherished special times, centered around traditions.
that are passed on for generations. Each season is a time to connect and celebrate with loved ones. For us, it’s an opportunity for our brands to be a part of that magic and nurture emotional connections that last a lifetime. But there are many times during the year when friends and families gather for meaningful moments. S’mores is a great example.

Over the years, we’ve built this into another season. We began expanding into other occasions last year with Kisses for birthdays, developing unique Kiss birthday items for secondary placement outside the candy aisle. And in 2017, we’ll expand into yet more occasions with an appreciations line under Hershey’s, Reese’s and some of our other brands.

Innovation is an important lever in this variety seeking category, but it’s also hard work. Some of the innovation that we’ve launched over the past several years just hasn’t been as sustainable as we would have liked. We’ve incorporated the learnings from these launches into our current strategy. We’re becoming even more disciplined in our relentless focus on platform innovation, which enable sustainable growth over time and significant extensions to our core.

We are leveraging some of the exciting work from our demand landscape to shape our future innovation and make it more impactful and sticky. We are excited about the innovation we have in the marketplace right now. Hershey’s Cookie Layer Crunch, Reese’s Pieces Cup, KitKat Big Kat and Breath Savers Protect.

But our innovation goes beyond product. At Hershey, we believe our iconic brands are about goodness and about being simple. Goodness is more than just tasting delicious, it’s also pride in our products and what goes in them. This commitment to simple ingredients is part of our heritage. We started making great tasting chocolate in 1894, using a few familiar ingredients we all recognize, like cocoa, milk, sugar and vanilla. We’re continuing that tradition today to ensure current and future generations can enjoy that same pure and simple experience. So let’s take a look at a video that we’re playing online to show consumers where our farm fresh milk comes from.

(Video playing)

Consumers also continue to tell us that their ability to choose is important to them. We are offering more variety across our brands, from single serve to family sharing pack types. We were excited to be the first company to launch SmartLabel, which provides consumers with easy and instantaneous access to detailed information about our products. And this year, we’re launching source map, so they know exactly where ingredients in their favorite Hershey’s products come from.

Now, let’s talk about the shelf. The current shopping experience for candy continues to be challenging. I mean, look at that shelf. With 25% of consumers walking away without buying, because they can’t find what they’re looking for, we have a team of employees dedicated to generating solutions to contemporize our packaging and shelf set to re-engage consumers and improve the experience.

Let me share a great example that is just now hitting the shelves. Shopper insights show that the current laid down package candy section is frustrating to shop and can deter purchases. Hershey’s new standup bags are an evolution to an easily shopped package that looks great on shelf and increases branding. Test results show promising incremental lifts through greater findability. So we’re really excited about the opportunities that this will bring.

The confection category’s advantage purchase dynamics provide opportunity for bricks and mortar retailers to leverage our impulsive, expandable category to grow sales, even as consumers shift some of their purchases to e-commerce. Candy is a fun category and the aisle should elicit feelings of excitement and fun.

Pictured here is an example of Hershey’s new in-aisle strategy that will breathe life into center of store and transform the shopping experience. Initial results are very encouraging. Feedback from our in-store research tells us that this solution drives improvement on all paths to purchase; stopping power, navigation, engagement and conversion.

But this is not a one size fits all solution. We’re currently working with our retail partners on unique solutions that solve their specific challenges on both the confection aisle and other areas of the store, like seasons, the front end for snacks.
We've also responded to the changing retail environment, investing behind our e-commerce capabilities. We've made great progress over the past several years, consistently growing share and achieving channel leadership. We are focused on winning with Amazon and other key omni-channel partners like Walmart, Staples and many more. We are innovating with focused test and learn opportunities and capturing incremental usage occasions through our [Sheft] partnership and expansion into the wedding occasion.

So, now let me show you how we are bringing our growth framework to life with our iconic brands. 2016 was a year of strong growth on our Reese’s franchise, resulting in 52 consecutive weeks of share gains and retail sales growth of 4.7%. Strong TV advertising, social engagement and solid innovation are the formula. The passion Reese’s fans have for the brand led to huge moments of connection via social media, each over 1 billion impressions. The hashtags All Trees Are Beautiful and CUPFUSION contributed to 10% retail sales growth on seasonal shapes and created a frenzy over the new Reese’s Pieces Cup innovation. These are great examples of using connection with our power brands to the consumers.

In 2016, we activated a new campaign against our Hershey’s brand. Results were slow to build, so we quickly made adjustments throughout the year and started to gain traction. We had a record breaking S’mores promotion, with retail sales of $120 million, an increase of more than 5% versus prior year. The expansion of the brand into the birthday and appreciation space presents additional opportunity. Hershey’s Cookie Layer Crunch innovation is off to a terrific start and advertising just began a few weeks ago. Nielsen indicates that its first year of sales could rank it amongst the top 2.5% of new products. We will closely monitor results and track repeat to determine success.

Kit Kat also had a great 2016, growing retail sales nearly 6% and gaining share. Kit Kat success was driven by two key strategies. First, the brand modernized its iconic great positioning to connect to its target consumers. A new advertising campaign features Grammy Award winning artist Chance the Rapper performing a new version of the classic, Give Me a Break jingle, leveraging both traditional and emerging media channels. Strong core brand news with the Big Kat innovation, met a consumer need for Kit Kat lovers who wanted a more substantial eat. The product sales were truly big with nearly $50 million in retail sales in 2016.

Ice Breakers delivered its fifth consecutive year of growth and became the second largest refreshment brand in the US. The Ice Breakers growth model has been driven by product innovation, distribution gains, and new TV advertising. Due to the consumer demand, we increased our gum capacity, which enabled us to drive distribution, resulting in retail sales growth of over $40 million last year, up almost 30% from 2015.

Our Kisses business had a solid year in 2016, growing everyday household penetration with new occasions and driving excitement in store with impactful Olympics packaging and merchandising. We successfully adjusted our media strategy on Kisses, leveraging new analytics to focus TV execution on the important holiday season and moved to a 100% digital model on the everyday business. To Say it With a Kiss social campaign was a big driver of brand growth this year. In addition, our birthday expansion enabled us to secure secondary placement outside confections, driving incremental sales for both us and the retailer.

We also have a portfolio of meaningful brands that enable us to deliver against a broad range of consumer preferences and remain the undisputed leader in the category. We own many forms and ingredient defining brands. When consumers hear Licorice, they think TWIZZLERS; Chocolate and Mint, YORK; Coconut, MOUNDS and ALMOND JOY. These brands are very profitable for us and we are smart with our investments here. We leverage economically efficient ways, like packaging changes, targeted social media executions and packed type extensions to keep these brands fresh, remain relevant with consumers and drive sales.

Now let’s take a look at some of the great advertising that’s driving our growth.

(video playing)

As I mentioned earlier, confection is one of the largest categories within snacking, and we believe strongly in this category. At the same time, we will also pursue opportunities to diversify our portfolio and establish a strong presence across snacking. Our advantaged capabilities are leverageable beyond the confection category and will enable our success across the broader snacking landscape. Our insights and analytics are deep and holistic across the snacking continuum, and in fact across the entire store. We are leading the evolution of snacking merchandising with retailers from the composition of front-ends to the layout of stores.
We can secure ubiquitous distribution and activate in-store leveraging our retail sales force in key channels. This presence is critical to securing merchandising in this highly impulsive competitive category. And, of course, we need to deliver high quality, great tasting products and our R&D team is one of the best at doing this.

There are two key strategies we'll execute to expand our breadth in snacking. First, we'll expand the boundaries of our core confection brands to capture new snacking occasions. And second, we'll continue to increase our exposure into new snack categories, both organically as we did with Reese's snack mix and via M&A, as we've done with both KRAVE and barkTHINS.

There is increasingly a blurring of lines within snacking. We believe there's an opportunity to bridge the gap between savory snacking by expanding the role of our confection brands to deliver enhanced eating experiences and food legitimacy. Our Reese's and Hershey's Snack Mix launched last year is a great example of this. We drove retail sales of over $65 million. We will leverage our new, proprietary to snacking demand landscape to identify additional opportunities. Where there is incrementality to our portfolio and our brands have a high fit, we will extend their reach via innovation, like we did with Snack Mix. For other areas, we’ll leverage M&A to expand our breadth of snacking occasions, like we did with KRAVE.

Our 2017 Hershey's and Reese's Crunchers launch is another example of leveraging our core brands to capture incremental occasions. This we’ll do so by delivering a sweet treat, but with a crunchy texture and a lighter eat. This snack section platform will be available later in the second quarter. We’re also expanding our Snack Mix platform with a new popped version that delivers a lighter eat.

Over the past few years, we entered new categories and new brands, but not always as successfully as we would have liked. We learned valuable lessons that are helping shape our approach to strategic M&A versus organic growth decision. We believe M&A will play an important role in diversifying our portfolio going forward. Some opportunities may focus on smaller but higher growth targets that leverage our advantaged capabilities to scale. Others will enable us to build scale, enhancing our existing capabilities and deliver financial synergies. We have a team dedicated to analyzing the market and identifying attractive targets that deliver on our strategic intent to further diversify the portfolio.

We're really excited about the barkTHINS acquisition that we made less than a year ago. The brand addresses several key consumer trends like premium, high quality simple ingredients and snacking. The integration is complete and we are on track to leverage our scale to grow sales and margins. In 2017, we’ll further expand distribution and increase brand awareness and strength behind sampling and media activation. We've also learned a lot from the BROOKSIDE acquisition. So barkTHINS distribution expansion will be targeted, leveraging analytics to identify the stores with the best consumer fit to ensure success and sustainability.

Meat snacks continues to be a very attractive category with over 3% growth in 2016. KRAVE's culinary inspired flavors and unique texture are bringing new users to the meat snacks category, expanding household penetration. Sales grew over 50% in 2016, resulting in a share gain of 0.7 points. As we build out the brand, we will stay true to the brand equity and more premium positioning. As a result, 2017 distribution may not be at the same level as 2016, but from a long-term brand building perspective, that's the right thing to do.

Our 2017 focus will be on continuing to build brand awareness and trial on our core, and we had launched innovation to reach new consumer usage occasions with our new bars and stick lines which provide meat on the go.

Now, to fuel investments in our business to drive growth, our second key imperative is to be laser focused on ensuring that we allocate our resources efficiently to the areas with the highest potential for profitable growth. This will enable significant margin expansion and positions us in the top quartile related to operating income margin.

Over the next three years, we're expecting about 200 basis points of margin expansion, from 20.4% in 2016 to 22% to 23% by year-end 2019. Four key levers will drive this expansion. First, we’ll reset our international investment, while we still believe strongly that our targeted emerging markets will provide long-term growth. The uncertain macroeconomic environment in many of these markets is expected to continue. As we stated earlier this year, the investments in these international markets need to be relative to the size of the opportunity. We expect that about half of our margin for growth dollar savings will be generated in this business segment.
Next, we'll heighten our SG&A discipline around the organization. Our SG&A as a percent of net sales has been increasing over the past several years and we'll reverse that trend. As I mentioned before, we believe that our brand support model is working. So, it's our expectation that advertising and related marketing expenses will grow roughly in line with sales. Additionally, our retail sales force gives us an advantage in a highly competitive snacking market. I stress these points to emphasize that we believe there are meaningful SG&A improvements we can make without jeopardizing our topline growth.

Third, we'll continue our best in class cost of goods sold optimization. Over the last 10 years, we have expanded adjusted gross margins about 1,000 basis points through pricing and programs like network supply chain optimization and lean manufacturing and we expect this to continue. Finally, we'll streamline our operating model, resulting in faster decision-making, greater agility and taking low value-added work out of the Company.

Now, I'll provide some detail on our plans for our international markets. As a reminder, the International and Other segment has grown at over 4% compound annual growth rate over the past five years and currently represents $900 million in net sales. This segment consists of three pieces. Our global retail and licensing business includes our Hershey's Chocolate World Stores, as well as our very profitable travel, retail and duty-free channels. Many of our core brands can be found in over 80 countries around the world or expat markets. The business here is driven by a few small sales officers who coordinate with distributors where we have no in-country distribution capability. This part of the business also has healthy margins.

Finally, our direct markets include China, Mexico, Brazil and India. In each of these markets, we have in-country manufacturing as well as business offices. These are the markets where we have placed the greatest investment from a marketing and selling function perspective and from which we anticipate the highest long-term growth.

We continue to believe in the long-term growth potential of China, given a large population, positive macro trends, including GDP growth and the entry of a large number of consumers into the emerging middle class. However, Everyday Chocolate is still a small category at about $3 billion, and while we expect growth, it will most likely be slower than we had initially anticipated. As a result, we'll adjust our investments here to the size and pace of the opportunity. Over the next three years, our China business will undergo a transformation with changes across the business and P&L. We expect to streamline and transform the portfolio, simplifying our product mix and eliminating low velocity chocolate items and low gross margin Golden Monkey products.

We will focus our support against Hershey's Megabrand, our largest brand and continue a disciplined test and learn approach with our new snacking and chocolate items in the market. This will ensure that advertising and related marketing investments deliver maximum ROI.

The fastest growing channel in China is e-commerce. Over the last one to two years, it's driven consumer packaged goods growth and it's the area we'll make a big bet on chocolate growth. Our China e-commerce business, though small, posted solid year-over-year growth in 2016 and we expect this to continue in the years ahead. We'll scale our cost structure across the P&L in line with these changes. We'll focus our selling efforts and our advertising in the most critical provinces and the highest growth cities and channels. We'll revise our manufacturing footprint with the goal of increasing capacity utilization and improving efficiencies and we'll adjust our marketing, selling and functional support to align with growth targets. Through pricing mix and manufacturing efficiencies, we plan to reduce our cost of goods sold as a percent of net sales. The sum of these efforts will deliver significant savings, putting us on a path to returning the International and Other segment to profitability.

Though China is where we expect the most improvement, there's also an opportunity in other markets to focus on higher velocity SKUs and a smaller, more leverageable in-country investment. In Mexico, we're driving profitability through implementation of strategic revenue management, which will help optimize pricing and promotion effectiveness. We'll continue to focus support on the Hershey's Megabrand, across chocolate, syrup and beverage categories, as well as the Pelon Pelo Rico brand, the share leader in the spicy sweet segment. We've already made significant improvements in Brazil in a very tough macro environment. We now control our own distribution, which has enabled chocolate market share gains this year, despite the challenging market conditions. Distribution continues to be an opportunity and we will improve profitability by optimizing portfolio mix and balancing our marketing investments.
The focus for our India business is on improving our portfolio mix and transitioning towards higher margin segments, where we have demonstrated success. Examples include Hershey's Syrup, SOFIT Soya beverage, JOLLY RANCHER Hard Candy, all of which are growing, have higher margins than the legacy portfolio and have proven highly responsive to advertising. We are very excited by the recent launch of BROOKSIDE in India. This was a fourth quarter launch, primarily in the modern trade, where we don’t expect much of an impact from demonetization. While small, this launch gives us exposure to a value-added segment with above-average margins for the India business.

While our export markets are already profitable, we are driving a strong profit focus mentality in these markets as well. As a result of these efforts, we are expecting the International and Other segment operating income trend to improve meaningfully in 2017 and to return to profitability as soon as possible. However, the exact timing and implementation of the margin for growth initiative impacts when we get back in the black. More on this as the year progresses.

These margin initiatives will deliver a healthy return to shareholders, but also will importantly fuel investments to activate our brands and evolve our portfolio for growth, which leads to our third major strategy; strengthening our capabilities and leveraging technology for advantaged solutions in the marketplace.

Let me start by taking you through how I think about our capabilities and how they work together to drive competitive advantage at Hershey. At a high level, it’s about having the right data and tools to generate transformational analytics and insights, which when combined with our commercial capabilities, lead to advantaged solutions.

It all begins with data. The world is changing fast and so is the data on which we rely to make decisions. In order to generate insights, we must acquire, integrate and access vast sources of the right data in an effective manner. With this data in hand, we’re able to leverage our advanced analytic techniques, including real time and predictive analytics to generate actionable insights. These insights give us a deep understanding of consumers, our shoppers, our end-to-end supply chain, our retail environment and macroeconomic factors at both a broad and precision level.

One key example of this is our proprietary snacking demand landscape, which I’ll discuss more shortly. These analytics and insights magnify our already advantaged commercial capabilities. Our industry leading mass execution is now complemented with precision execution. Our confection category leadership can be extended across the entire store. Our retail sales force can be dynamically routed to the stores where they can have the greatest impact and be equipped with tools to make the optimal selling decisions.

Our supply chain can benefit from our scale, while also acting with agility on precision opportunities. The foundation of all of these capabilities is enterprise connectivity, enabled by technology, where the right data and insights are available when they are needed. This allows us to deliver advantage solutions to our retail partners, enabling Hershey to win in the marketplace.

Now, let me talk to you about how we will leverage data. An important foundation is replacing our 18-year-old SAP system with SAP’s newest technology S/4HANA. Over the next three years, we will transform our enterprise resource planning systems supporting HR, finance and supply chain, allowing employees to work more efficiently and effectively. Additionally, we’re developing a new platform to integrate our internal data with multiple external sources, including retail sales data, media activity and effectiveness, inventory levels, census data and many more. This data is being structured and harmonized to generate rich, robust insights.

This new platform allows for more granular analytics, empowering our employees with the right information. Our analytically talented teams will receive data and insights based on their specific roles, allowing more time to be focused on higher order thinking and solutions, and ultimately this leads to faster and more effective decision-making to drive value.

We no longer live in a standardized world and we must understand with precision store-level product trends, every aspect of our supply chain and media impact by channel in order to win. Technological advances will support further expansion of real-time and predictive analytics to provide faster, more holistic recommendations to advance our business. Also understanding our shoppers’ changing trip missions and their purchase triggers, both in-store and online allow our marketers and sales teams to design effective solutions.
Finally, we can deliver transformational insights throughout our organization, tailoring the data based on role and need. Our new consumer segmentation will be a key tool in achieving our strategic priorities. Our investment in updating this landscape is a testament to our focus on consumer-driven opportunities to fuel sustainable growth. What’s new and evolving in this key framework is the shift from a heavy focus on a people-based attitudinal segment approach in our past landscape, to a needs-based orientation grounded in consumption occasions going forward. We believe every person’s snacking needs change throughout the day and every day of the week. And I’m sure you can all relate to that. We’ll use this data to focus our product development and our communication action plans.

A second key shift in our landscape is the expansion from previously a focus on only confection to now a view of the full competitive landscape of total snacking, the universe in which our brands truly compete. This provides the strategic guidance to enable our portfolio expansion across snacking and guides the role snack section plays. We’re also leveraging this new landscape to assess M&A opportunities that complement our existing portfolio.

Our commercial capabilities are a critical enabler for us to monetize all of these insights. We are increasingly able to complement our scale model with precision execution. Our collaboration with retailers enables them to solve challenges to deliver their goals across the entire store and is a key competitive advantage for us. The holistic nature of our insights, as well as our ability to execute enables the generation of total store solutions and strategic category planning. Our proprietary in-store retail sales force is key to securing distribution and merchandising in its increasingly competitive environment.

Given the impulsivity of our category, ensuring our product is available and front of mind for consumers is absolutely critical. Our technology investments will enable us to dynamically route our resources for maximum impact. And our large US scale enables us to manufacture and secure distribution across channels and regions with technological advances, enabling us to operate with agility and provide precision solutions. The power in these capabilities is how we leverage them together and action on them in the marketplace for impact. So let me share with you a couple examples.

We know retailers are juggling to satisfy changing consumer needs. Attitudinally, shoppers will say that they want balance, they want the right mix of healthy and indulgent options. A leading retailer, along with several CPG companies, partnered to test a new front-end design, where they shifted the mix and location of checkout items to place a greater focus on healthy options. As Hershey is doing a lot of shopper insights work in this area, we also partnered with that retailer to run a parallel test, using more advanced methodologies. This went beyond normal surveys to capture behavioral patterns and changes.

By utilizing these leading methodologies, Hershey and the retailer discovered that consciously the shoppers’ perceptions did not change, but subconsciously their test check-lane experience was not optimal. Happiness declined and so did sales.

We combined these learnings, along with the precision analytics from our category and sales teams to redirect the rollout and propose an alternative solution to better optimize assortment on the front end. It’s all about providing consumers choice, not limits. Hershey led the post-test refinement to best optimize the test experience, adjusting mix and assortment and our solution is slated to deliver a sales lift of two times the original proposal. This new, more shopper centric mix and layout, is now aligned to increase happiness, sales and profit for the retailer, for Hershey and for all CPG companies with items at checkout.

A second example, we’ve had great success at leveraging store-level data and analytics to transform our planogram capabilities over the past few years and we’ve shared that with you. We’re now advancing this work to apply more broadly across our go-to-market model. We’re leveraging our supply chain, revenue management and in-store retail sales force capabilities for precision execution. Instead of having a national promotion or merchandising priority list, our reps will know exactly which stores to go to and what to execute in each store for maximum top and bottom-line results.

For example, if a Reese’s promotion has outperformed and sold out in its current store -- in a given store, the rep will know in real time and quickly be directed to restock.
Another example, as we’ve added more premium brands to our portfolio, we know that mainstream go-to-market strategy will not work. Through our enhanced data and analytics, we’ve identified those stores where these brands resonate most and have the best long-term sustainability. Additionally, we now have the power to harness the wealth of data our reps can provide about what’s happening in stores. They can quickly snap pictures, document and upload to systems where they’re able to have real-time insights to results. This enables us with a valuable tool to course correct, to leverage as a selling tool with other stores and retailers and increase the ROI of our retail sales team.

And the last example, insights-driven supply chain is using our new harmonized data platform and advanced analytics to track metrics across every single freight lane within our supply chain. This provides visibility in real time into freight move type, by customer, by region, inbound, outbound, by product. These new tools enable us to baseline and track inventory positioning in the supply chain and attack inefficiencies to lower supply chain costs.

As is always the case, we are focused on increasing shareholder value. Everything we organically invest in, acquire or divest, is always done with the best -- with the long-term best interest of the Company and therefore shareholder in mind. And we think one of the best ways to measure the success is looking at net sales growth and operating income margin. It’s our goal to deliver industry-leading performance with top quartile sales growth and margins.

After four-plus years of above-average sales growth marketplace dynamics have changed. In 2015, our sales growth results were impacted by the slowdown in China, as our US net sales increased 2.1% year-over-year in 2015. And as discussed on our fourth quarter conference call, we believe the anomalies related to a shorter Easter and merchandising and display strategies at select customers impacted topline growth in 2016. While it’s a soft start to the year across the total box in 2017, we have confidence in our plans to meaningfully accelerate our sales growth and we expect to be in the top tier of our S&P food group peers.

From a US retail takeaway perspective, versus our S&P food group peers, our performance has been solid over the past four years. And even in 2016, our retail takeaway was top tier. While we strive for an even stronger topline, we’re proud of these results.

We have consistently been able to deliver operating margin expansion with eight straight years of gains. We’ve done this in a high quality and balanced way, while continuing to invest in our brands and consistently delivering top quartile sales growth. And when retail takeaway and sales growth occur, given our scale and leverage in the US, it translates into solid adjusted gross margin and operating income margin expansion.

The Margin for Growth program, combined with our focus on resource allocation and a more nimble and streamlined operating environment, should position us to achieve margins towards the top of the S&P food group.

Our operating income growth has translated into solid adjusted earnings per share diluted growth over the last five years. We are proud of our ability to continue to grow earnings per share in this challenging environment and we believe we are focused on the right things going forward to continue to do this.

Let me now discuss what we think the business can deliver over the long term. We expect to grow our topline in the range of 2% to 4% annually. This is less than our previous target of 3% to 5% and reflects key learnings and the realities of today’s uncertain US consumer environment and macroeconomic challenges in emerging markets. There is no change to our long-term adjusted earnings per share diluted growth of 6% to 8%. This approach gives us the flexibility to make the necessary investments in our brands and capabilities. This model results in consistent earnings stream and strong cash flow generation to support our dividend.

As we execute our Margin for Growth initiatives over the next two years or so, we expect our sales growth to be closer to the lower end of our long-term targets, as we reset some of our investments and focused on the highest — and focus on the highest performing SKUs. During the same period, we also expect our productivity initiatives will kick in and will result in EPS growth towards the upper end of our long-term targets.

Now let me turn it over to Patricia Little, Chief Financial Officer of The Hershey Company who will discuss in a bit more depth our plans to create shareholder value. Thank you.
Patricia Little - The Hershey Company - SVP & CFO

Thank you Michele. Good morning to everyone in the room and everyone on the webcast. It’s a privilege to be here and be part of our Hershey team that has so many opportunities. We have a cadre of experienced leaders and all of us are excited to work with Michele in her new role. I have been with the Hershey Company for almost two years and I’ve been a Board member at another CPG company for almost seven years. I am familiar with the consumer challenges facing the industry. At Hershey, our advantaged category and very profitable North American business distinguish us. I’m committed to long-term value creation, as is our Board of Directors and I look forward to helping the Hershey Company meet its potential.

Let me get started. You have seen this slide a couple of times this morning, it’s our virtuous cycle of creating shareholder value. Simply said, given our scale and leverage, topline growth gives us flexibility to invest in our brands and in our business model. In our business, investing for growth, driving our margins and being thoughtful about our resource allocation are the keys to continuing to deliver shareholder value.

For those of you who are not familiar with The Hershey Company, by the time I’m done, I think you’ll feel as confident as we do that Hershey has a focus on productivity and cost savings to increase both adjusted gross and operating income margin, a commitment to restoring profitability to our International and Other segment, a solid financial position, supported by a strong balance sheet and consistent cash flow generation, and that we’ll use that cash in ways that increase shareholder value.

Over the years, we’ve been very successful in expanding gross margin. We have one of the highest gross margins in the S&P food group and given our brand power, channel mix, and different usage occasions, feel that this advantage is sustainable and can continue to improve over time. We are focused on gross margin, because its strength gives us flexibility to invest in our business model and to expand our operating margin.

Over our strategic planning cycle, we expect adjusted gross margin to increase. We have a strong productivity culture and track record. There are many levers in our operating model, both commercially and through our supply chain. It starts with volume. Our brands respond to marketing investments, enabling us to maximize and leverage our scale and fixed costs. There are also supply chain initiatives that lead to margin expansion through improvements in processes and CapEx investments in new capabilities and technology. While broader snacking margins are less than confectionery, we believe there is still a big CMG opportunity related to product and packed type mix, as well as innovation as a driver of margin. Combined, these initiatives should contribute to gross margin expansion over the long term.

Our gross margin is driven by the scale we have in North America and our very efficient supply chain. We feel very good about our North American manufacturing and distribution footprint and capabilities. The majority of the production here, nearly 85%, is manufactured at seven very large and efficient facilities. Four are in Pennsylvania and one each in Virginia, Tennessee and Illinois. There are also four other facilities that support specific brand or certain packed type needs. The scale of this network results in capacity utilization of about 65%. While we can improve on this number, the challenge of it being materially higher is tied to seasonality, plus the wide variety of flavors, forms and allergens in our product. Our North America profitability shows the power of a supply chain run at scale. Our opportunity in this segment is primarily through process technology, as we expect productivity to broadly offset inflation.

Within our International and Other segment, we have eight manufacturing plants and eight distribution centers supporting about 12% of our total sales. There is a mix of older and newer manufacturing assets, as well as a manufacturing joint venture. As Michel discussed, given the outlook for some of these markets and their role in our portfolio, we see leveraging our modernized facilities and improving capacity utilization in this segment as our primary opportunity to increase adjusted gross margin and an important part of moving this segment to sustainable profitability.

We’re gross margin focused, because cost of goods sold is the biggest cost item on our P&L. In 2016, our total cost of goods sold was about $4 billion. Manufacturing overhead and distribution is about 40% of COGS. This is the portion we derive the majority of our productivity. We continue to target annual productivity and cost improvements of about 3% to 4% of this amount. This is a lever in gross margin expansion, but it also helps us offset normal operating inflation.

In 2016, we stated that productivity would be higher than it has been historically. Specifically, we’re targeting $100 million in annual productivity and cost savings through 2019. We expect about two-thirds of it within cost of goods sold and about one-third in SG&A. Currently, spot prices for some ingredients have trended lower and are likely to be a benefit next year. However, we do have a large input cost basket and some commodities...
like fluid milk don’t have a developed futures market to take long positions. And over the long term, our expectation is for commodity prices to increase, driven by global demand for key agricultural ingredients. We believe our annual productivity program gives us flexibility to deal with this environment. We need to make sure that our business adapts to the inevitable ups and downs in the commodity market and that the health of our P&L is not dependent on a specific commodity price. If we do experience deflation in any given year, we would plan to balance investment opportunities with investor returns.

We’re also proud of our responsible and sustainable sourcing. In 2016, we achieved 60% sustainable cocoa. That’s the equivalent of the total needed to satisfy the production requirements of Hershey’s, Kisses, Kit Kat and BROOKSIDE brands. Our 2017 goal is to procure 75% certified and sustainable cocoa with a target of 100% by 2020, and I’m happy to say that we’re on track. We’re also adding new programs to our Learn to Grow farmer and community investment programs that concentrate on building healthy communities, focusing on education, women’s empowerment and eliminating child labor from our supply chain.

And it’s more than just cocoa. In 2016, we took strong steps to ensure suppliers adhered to the code of conduct. For example, we suspended palm oil purchases from a supplier who did not meet our code, sending a message to everyone that we expect them to honor their sustainable sourcing agreement with The Hershey Company.

We also continue to make progress against our initiatives related to greenhouse gas, water usage, waste and recycling. In December of 2015, Hershey signed the American Business Climate Pledge. Specifically, we’re committing to reduce our environmental footprint across greenhouse gases, water and waste by an additional 25% by 2025. Cocoa is a crop that is highly susceptible to climate change, with increases in temperature and reduced rain fall putting this commodity at risk. We are partnering with other chocolate manufacturers, suppliers, and the World Cocoa Foundation to help cocoa farmers adapt to climate change, as well as take steps, such as reforestation to counteract its effects.

Moving from COGS to cash flow, this is one of my favorite slides. Strong operating cash flow is a hallmark of The Hershey Company. Over the past five years, we’ve averaged over $1 billion per year in operating cash flow and that number is expected to grow. As I mentioned earlier, our highly profitable North America business generates margins and profits that are the envy of the food group. Our focus on overall margins, returning International and Other segment to profitability and lower cash taxes will help set us up for greater operating cash flow in the future.

We consider Hershey to be shareholder friendly, as we’ve returned nearly $5 billion in dividends and share repurchases, excluding options replenishment over the last 10 years. Historically, our dividend has grown in line with our earnings outlook. We continue to expect that to be the case going forward. While our cash flow priorities are relatively unchanged, I’ll review each of them and provide you some context. We continue to have a disciplined capital expenditure investment philosophy. Over the last few years, the industry average for CapEx as a percentage of sales has been about 4%. We were a bit above that in 2014 and 2015, given the CapEx needs of the new facility we built in Malaysia. But in 2016, we were below our 4% target and expect that to be the case over the next couple of years. And note that this forecast includes about $85 million for our multi-year SAP project.

As we think about M&A, we’re particularly interested in companies with accelerating revenue growth within the US $100 billion snack wheel. An ideal acquisition candidate is a brand or a company that complements our strong core confectionery portfolio and our go-to-market capabilities. We have the ability to make any snack to taste good, but we’re brand builders at heart with enormous distribution capabilities. If it adds strength and diversification to our offerings and allow Hershey to satisfy more consumer snacking occasions, then we are certainly interested. Our preference is to seek acquisitions that would be EPS accretive by year two. While this is our objective, for the right strategic acquisition, we would consider accretion farther out.

Over the last few years, we’ve made four acquisitions and by learning from each of them, have improved our M&A due diligence and integration capabilities. We feel good about our approach and can move quickly when the right opportunity arises.

Our next priority is dividends. Historically, our dividend has grown about in line with our earnings. We continue to expect this to be the case. We are targeting at least a 50% payout ratio and absent any large-scale M&A, given our solid cash flow generation, it’s possible the dividend payout ratio could creep a bit higher.
In the event that attractive M&A opportunities don’t present themselves, our next priority is share repurchases. We routinely purchase shares for equity compensation and additionally have $100 million outstanding on our current $500 million buyback. Over the last two years, we’ve bought back nearly $1.2 billion in stock and reduced the share count by 9.6 million shares.

Let me now share some thoughts about our balance sheet and capital structure. Our current net debt to EBITDA is a highly manageable 1.5 times. For purposes of this slide, we define the ratio as gross debt, less cash, divided by adjusted EBITDA. Most of the debt is fixed and we have a solid A/A1 debt rating, given our profitability, cash generation and overall debt position.

Looking more specifically on just our long-term debt, we have about $2.3 billion, nicely spaced out over the next 30 years. It’s up by about $500 million over the last two years, primarily driven by our decision to fund the KRAVE and barkTHINS acquisitions with debt. Given our cash flow generation and capital structure, we were opportunistic last summer and took advantage of a decline in interest rates, in pricing the debt that essentially funded these deals. Additionally, at the end of 2015, we did a debt buyback and reduced some high-coupon liability. Combined these actions allowed us to extend our average maturity from 4.7 years to 10 years. I’m pleased with our work here and that the average interest rate on our long-term debt is 3.5% versus 4.5% a year ago.

Today, our debt to EBITDA is about 1.5 times, and is at the low end of our targeted range, since we prefer to be in the 1.5 times to 2 times range. That range provides us with the ability to consider value creating M&A, while still maintaining our A/A1 debt rating. For the right strategic acquisition, we would consider a debt to EBITDA ratio greater than 2 times.

As we have stated on the fourth quarter conference call just a few weeks ago, our Margin for Growth initiative is a focused program, as well as a change in behavior. We’re instilling an ROI mentality and a culture to ensure that every dollar we spend works as hard for us as it can. When combining all of our productivity and cost savings initiatives, we have a sight-line to $450 million to $475 million in savings over the next three years. Not included in this number are the fourth quarter 2016 savings of about $20 million, which you’ll recall were non-restructure related. Our plan is to invest a portion of these savings back in our business. As we have historically stated and re-articulated today, we believe the CMG and broader snacks category is highly responsive to brand investments that we believe are essential to growth.

Regarding our gross and operating margin, growth is our best source of shareholder value. As Michele outlined, investments are underway in marketing, packaging, aisle reinvention, enterprise connectivity and additional analytic approaches that will enable operational effectiveness and efficiency and will be a differentiator in the marketplace over the next few years.

So the productivity and cost savings provide us with the fuel to invest in both brands and capabilities, while also enabling us to increase operating income margins in both of our segments and to achieve total Company adjusted operating income margin of 22% to 23% by 2019, to keep us in the top tier relative to our peers.

We expect that the majority of the Margin for Growth savings will occur in 2018 and 2019. There’s a lot of complex work to do, impacting facilities, our employees, our processes within both the cost of goods sold and SG&A lines. We’re still working on the timing related to the execution of our plans, and it would be premature to discuss expected savings by year at this point in time. As we finalize and implement our plans, we will communicate our cost savings estimates by year.

We expect a portion of the savings to fall within SG&A, although as Michele has made clear, we are investing in our business model. Given all of these moves, by the end of 2019, excluding advertising and related marketing expense, we expect SG&A as a percentage of net sales to be about a 100 basis points lower than 2016. And this still leaves room for the investments in trade, advertising and consumer marketing, which in total should grow about in line with sales. Depending on the operating environment, in any given year, the increase here could vary by line item.

As part of our savings and margin target, we’re also doing some SKU analysis and looking at velocity thresholds that could result in sales growth at the mid-to low-end of our long-term sales target in 2018.
The charge related to the Margin for Growth program is $375 million to $425 million. The portion of non-cash program costs is expected to be between $200 million to $225 million, with cash cost of $175 million to $200 million. Note that about half of the non-cash charge is related to writing down the book value of Golden Monkey intangibles.

Given these actions, we're also updating our 2017 GAAP earnings per share diluted outlook today. As I indicated earlier, we anticipate that these actions will enable us to improve our international capacity utilization. Our plan is balanced between our existing manufacturing network and co-manufacturers as we aim to minimize our risk, given the challenging macroeconomic environment in some of the countries that we operate. This program touches many line items of the P&L in both of our reporting segments, where we expect margins to expand as we create a more streamlined operating model. As Michel pointed out, we've increased adjusted operating profit margin for eight consecutive years and feel we'll do so as we move forward.

As it relates to long-term targets, we expect investments in North America and international markets to deliver annual constant currency net sales growth of 2% to 4%. A balanced and disciplined approach to brand building and go-to-market capabilities will give us financial flexibility to deliver achievable, consistent and predictable diluted earnings per share growth of 6% to 8% per year. So we remain confident in our future and see a path for continued growth.

In 2017, we have a lot of innovation, in-store merchandising and seasonal plans in place. From a retail takeaway perspective, the entire retail box is softer than we expected to start the year. However, we have good visibility into our Easter orders and sales, which drive our Q1 results.

We feel good about our full-year plans and are happy with the initial results of Hershey’s Cookie Layer Crunch. As always, we’ll provide you with additional information on this and Easter sell through at the end of April, when we report our first quarter results. We continue to refine our marketing mix modeling and expect advertising and related consumer marketing expense to increase in 2017. And as we’ve stated, a few weeks ago, we’re also making investments in other parts of our business.

There is no change to the full year 2017 adjusted outlook we provided on our fourth quarter conference call on February 3. We continue to expect net sales to increase around 2% to 3%, adjusted gross margin expansion of 15 basis points to 25 basis points and adjusted earnings per share diluted growth of 7% to 9%.

I hope you feel as excited and confident about Hershey's future as I do. Thank you very much for your time this morning. And now let me turn it back over to Michel for some closing remarks.

Michele Buck - The Hershey Company - President & CEO

Thanks, Patricia. I hope that you walk away from today's meeting feeling as confident as we do about our consumer-centric business model. Over the long term, our business has delivered sustained results and will continue to do so going forward. And our portfolio of brands and business model has also rewarded shareholders, outperforming the S&P 500 by 1.9 times over the last 20 years.

We are confident in our strong confectionery position in the US and that gives us the flexibility to smartly invest in other snacks. We continue to invest in our brands and in the capabilities that give us competitive edge at retail and with consumers. And our solid financial profile and strong operating cash flow give us many options to grow our business and to reward shareholders. So remember our three key strategies as we believe they will lead to increasing shareholder value.

We have plans to reignite and grow our core confection business and expand further across snacking. We'll expand margins, heightening our focus on resource allocation to provide fuel to the brands that will drive our growth and we'll invest in our brands and expand our capabilities, leveraging technology to provide us with clear commercial advantage.

Thank you very much for your time today, and now we're ready to open it up for Q&A. I'm going to ask Patricia and Mark to join me on stage and then we can get started. We'll take the bulk of your questions, although we do have some of our leadership team here and we'll ask them to help
as needed. For the benefit of everybody in the room and on the webcast, I'd ask that before you ask your question, please state your name and the firm that you represent and I'll have Mark direct the activities.

QUESTIONS AND ANSWERS

Mark Pogharian - The Hershey Company - IR

We'll wait just a minute for our runners with microphones to get positioned and then we'll get started. Just as a reminder, please state your name and firm and direct your questions to Michele and then we'll get started. I think we're ready. David, you want to start us off?

David Driscoll - Citigroup - Analyst

David Driscoll from Citigroup. Two questions, the first one is on this long-term sales growth of 2% to 4%. Could you de-comp that a little bit into what's the contribution from international now expected to be? I think innovation was previously always kind of part of that algorithm, separate from kind of the core growth. So if you could break that down. And then separately, could you just expand a little bit more on your thoughts on gross margin expansion? It looks relatively modest in the guidance. And so I just like to understand the pricing power of the portfolio in your assessment done, what price or mix can do potentially to gross margins over time?

Michele Buck - The Hershey Company - President & CEO

Sure. So as we look as we look at the near-term over the next couple of years, I would say, we believe that we'll have less growth in the international markets than perhaps we've seen in the past. So we're clearly seeing that North America is going to be the biggest driver over that timeframe. As we look beyond the three-year timeframe, clearly I believe international will pick up, as those macroeconomic environments change and we'll start to see some accelerated growth a little bit more than we've anticipated in the near-term. And that's part of why we are saying that in the near term we think we'll be at the low end of our topline range -- on the topline and then in the near-term will be at the higher end on the EPS range, just driven by the mix of business.

From a gross margin perspective, I would say, we clearly believe in the pricing power of these brands. We've seen that over time we have been able to take pricing, especially when we invest behind the brands and have the right programing in place and you will continue to see us achieve that, look at that same type of balance as we've seen in the past, as we look at our total cost inputs and where the business is and determine where we think we can leverage pricing. Strategic revenue management certainly will help us and that's one area we're really focused on, is at a more precision level determining where we have opportunity to take more margin. Patricia, any other thoughts you want to add on?

Patricia Little - The Hershey Company - SVP & CFO

I think that's right. I think that last capability, if I can just add a little bit to that. In the past what we've tended to do is sort of take pricing in big chunks periodically, driven a lot by input inflation. We've done a great job of that cycle really, really well. What we'd like to do is add to our toolbox the ability to tweak our pricing more consistently over time. One way we'll do that is by looking at the effectiveness of our trade promotion spend and making sure that works as hard for us as we can, because that really is part of that algorithm. And we think that's another great place where we're investing in the capabilities of a key driver for something that works really well for us.

Ken Goldman - J.P. Morgan Securities - Analyst

It's Ken Goldman with J.P. Morgan. Patricia, you gave a number 65% for your capacity utilization in North America. And I think you said there is some opportunity to grow that, but maybe not as much as perhaps some people hope. I was struck by the number, because it does seem a little lower than maybe what some of your peers have talked about in recent years. although maybe with their volume declines, it has dropped down to that
level. You talked about the variety of products, allergens, seasonal products as maybe being a little bit of a block in getting that higher. But many companies have allergens and seasonal products and so forth. So I'm just curious if you get that, is there any way to, as we go forward, think about getting a number higher, because it does seem like it is lower than where your peers are, is my first question.

My second question is a little before my time. But one of the first things I heard when I joined this space was that SAP doesn't always go well.

Michele Buck - The Hershey Company - President & CEO
Yes.

Ken Goldman - J.P. Morgan Securities - Analyst
Look at the example of Hershey. So as you implement the next stage of SAP, can you give us some assurances for why this time -- it's been almost 20 years and I think most people in this room are completely different now, but give us some assurance, maybe how it's different and why we should be confident it will work better this time?

Patricia Little - The Hershey Company - SVP & CFO
Let me start with the supply chain question, I'll take a stab at it. But Terry is here and he can fill in the gap. So we have a really good supply chain that runs a lot of product at sort of 24/7 scale. And for that we have enormous capacity utilization. But as you can see by just walking around the lobby out here, we also have a wide variety of products. We have to do changeovers as we change flavors, a lot of allergens related to milk, soy, nuts, peanuts in our products. Those are key allergens for us and they really are engaged. The big allergen risks are really engaged in a lot of our product. So that's really important and we do it right and takes a while to do. And then while a lot of our peers have seasons, I would say that we have a lot of seasons. And so we have to make sure that we have production set up to be within the best freshness codes for our products and then be perfectly ready at our seasons, which requires us have some -- I'd guess I'd say lack of capacity utilization related to that. We do think there are opportunities to improve that and Terry's team has come up with some really smart solutions that allow technology and better aligns different [examples], doing better changeovers more rapidly.

We also have an opportunity, I think, in making sure that we come together, both from a supply chain perspective, as well as from the commercial and Rob Gehring is here, and he is a big part of this. For making sure that our SKUs work really hard for us, there's no reason -- we want to make sure that at the very end of the long tail, where we may be driving some of that changeover time, does that really pay off for us. So we're kind of coming together in the middle of both of those. But we know from benchmarking our peers that for what we run, we're amongst the best in class. The question on -- Terry, do you want to add anything to it?

Terry O'Day - The Hershey Company - SVP, Chief Product Supply & Technology Officer
The only thing I would add is and you touched on it with freshness. So as we've gone to simple ingredients and as we described as ingredients that you can pronounce, that does impact shelf life and it gets -- unfortunately gets shorter. So that really compounds things when we have the seasonality that we do. We can't build well in advance.

Michele Buck - The Hershey Company - President & CEO
Relative to SAP, your second question, I'll start with a couple of thoughts and if Patricia wants to jump in as well. Certainly we understand the magnitude of the change and we're very focused on how we manage that to minimize risk and I'd say there's a couple things we are really doing about that. One is the way that we're implementing the changeover, which much more of a modular approach versus everything changes over one day, and the whole thing can potentially fell apart. So we feel really good about that. And I'd say the second piece is that Terry O'Day is the one who has led our network supply chain work over the years Project Next Century that delivered over 1,000 basis points of gross margin expansion.
There is nobody better to deliver a big capital project, and Terry’s going to be taking the lead on that, in addition to as other responsibilities. And we have a transformation office under Terry that is aligning that along with our Margin for Growth initiatives, just to ensure total thinking and outstanding execution.

Mark Pogharian - The Hershey Company - IR

And I would add to Ken that we did a major SAP upgrade maybe six or seven years ago and everybody at Hershey, except the IT group got a three day weekend when they bought the whole system down and it really went off without a hitch. So I think we have a lot of confidence in the IT group and SAP.

Jason English - Goldman Sachs - Analyst

Thank you for letting me ask a question. Two quick questions, first housekeeping item. You referenced a couple of times sort of the slow start for the industry overall. In the fourth quarter, you mentioned that growth is going to be a little bit more first quarter heavy. Is it fair to say that given the dynamics out there, growth is going to be now be a little bit more even throughout the year, or should we still expect a pretty front-end loaded robust growth figure in the first quarter?

Michele Buck - The Hershey Company - President & CEO

So we still think that we are going to have very solid growth in Q1. We're closely watching what happened with the total box and I'm sure that many of you've seen that or if you haven't seen it yet, you'll see it in the Nielsen data. We know that there are some year-on-year differences relative to holidays et cetera. So I would say the growth will be a little bit less than we might have been anticipating. But we still anticipate it to be a strong solid growth quarter for us.

Jason English - Goldman Sachs - Analyst

And then the bigger picture question. If we take a step back, I think JP brought to the table a lot more focus and emphasis on trying to catch up internationally and really pivot Hershey into more of a global confection growth engine. The message I'm hearing from you and I'm going to oversimplify, but is much more of a refocus on the core market and a pivot to a broader snacking powerhouse, so diversification into adjacencies, et cetera. As we think about how you scaled up, could you give us a sense of what your vision looks like? Right now, you're effectively competing in about a quarter of what that snack wheel is, and you've gone into some adjacent slivers, but they're slivers. [Sticking] to the vision that you're aspiring to, should we or could we expect to see you enter into some of the bigger chunks, the bigger pieces of that snack wheel pie?

Michele Buck - The Hershey Company - President & CEO

So, I think, absolutely if you think about our strategy, job one remains reigniting core confection and that's for sure, you know how big a piece of our business it is, how highly profitable. And as I look at our business model, I think job two is really leveraging that scale we have in the US, because we have tremendous scale benefits across every capability that we have. And so, how do we really continue to leverage that. So would I like to more aggressively expand across total snacking? Absolutely, it is a priority for us, just looking at innovation, where can we innovate with our current brands, where are their M&A opportunities, and we will focus on whatever opportunities we see that makes sense for us strategically, and we will consider small -- high growth opportunities, and if there are any broader opportunities that present themselves, we're constantly evaluating opportunities that can give us that high growth, or it can provide financial synergy and scale.

From an international perspective, I still really believe in the long-term growth that's out there in those markets, with a third of the world's population in some of these emerging markets, I believe it's a place we need to be. I just think that the pacing and over time it is going to be a little bit different versus what we may have thought a few years ago.
Mark Pogharian - The Hershey Company - IR

And Jason, on your first quarter question, just remember too, the net sales will most likely or definitely be greater than retail takeaway in the first quarter, just given the timing of Easter in that. Well, majority of Easter always shifts in the first quarter.

Rob Moskow - Credit Suisse - Analyst

Hi. Thank you. Rob Moskow, Credit Suisse. Outside in the hallway, I think some of the more bolder initiatives that I saw were reimagining the front end of the store for merchandising and the back end of the store, and you are doing some tests with retailers that are pretty impressive. But they are just tests and they look like very expensive merchandising sets for a retailer to take on, and these retailers are under a lot of pressure right now financially. So I guess there's two questions here. What is your expectation in terms of how many retailers would actually do something like this? And secondly, are you seeing more of these retailers going into their own margins to discount prices? It seems to be a trend at Walmart and maybe Target now and others. And how do you expect that to impact your category? Thanks.

Michele Buck - The Hershey Company - President & CEO

Sure. So we have gotten a lot of retailer excitement and interest around our in-store solutions, whether it be on the front end or whether it be in the aisle, and I think one of the things those retailers are looking at as they compete versus e-commerce, how do they make the experience in-store even more engaging. The way that I would see this probably executing is, my guess would be, if you look at every retailer store environment, they have certain percent of their stores that are worth X percent of their total revenue and I would expect that some of those more dramatic opportunities we would see, and what we've heard from them is we would see them be focused primarily in a lot of their big flagships, some of their biggest stores that generate significant revenue. So I don't think that they would do it everywhere, but certainly in those places they see it as a big opportunity.

I look at some of the other categories where there has been evolution like this. If you think about coffee, coffee is always called out as an example of a category that looks very different in-store now than it did, and retailers, especially retailers who are image conscious of bringing in certain type of consumer are very focused on that. So I think it depends. I think there's a breadth question of how broadly it goes, but I would say at this point, if there are enough opportunities and it provides good lift, it's a good investment, we would work in partnership with our retailers to say, hey, there's a certain level of money that if we jointly spend to build the category and how can we leverage that best.

Rob Moskow - Credit Suisse - Analyst

(Inaudible - Microphone Inaccessible)

Michele Buck - The Hershey Company - President & CEO

I'm going to let Rob -- Rob, do you want to handle that? Rob is the Head of -- he's our Chief Sales Officer for the US, and I'll let him take that question.

Rob Gehring - The Hershey Company - Global Chief Sales Officer

And I'll come back to the first one, just a little bit. I believe what we're showing is the hallmark of where it can go, and as I'm in a lot of these conversations with the retailers, they're going to look at how do they scale back to go as broadly as they can. So that decision I think will vary by retailer, and just the ones that I've witnessed. And what they want to do, they want to pick 500 core stores and go the Full Monty, do they want to pick another 1,000 and how can they scale [back], because they have their own brands in those sections too, so when you look at their house brands, it answers a little bit of your second question. They are willing to lean into to sell their house brands by investing in that. So it's something that would be shared as you go across. Mars would pick up theirs. Everybody would pick up their for sure, as a retailer does. They wouldn't expect Hershey to pick up the whole aisle per se.
We just saw some announcements yesterday, I won't pick on any particular retailer, saying they're going to lean in. So we are seeing some lean-ins in different areas where they feel that they can get the return, and I'm also seeing folks get more competitive as e-commerce evolves. So I think we're going to see it by varying degrees, by varying retailers. We're seeing the fragmentation of shopping trips migrate to premium retail and also to the -- I'll say the lower retail, and we're seeing defensive moves by retailers vary. So depending on who they're going to target, if they feel they're losing trips to some of the new entrants that are coming in or versus premium, they're reacting accordingly.

Rob Moskow - Credit Suisse - Analyst
(Inaudible - Microphone Inaccessible)

Rob Gehring - The Hershey Company - Global Chief Sales Officer
It helps us. I would say it depends on the positioning of that retailer, so it helps different retailers in different ways and another retailer in different ways. That makes sense?

Andrew Lazar - Barclays - Analyst
Andrew Lazar, Barclays. Just two things; first, Michele, you talked about some of the issues affecting category growth in 2016. For Hershey specifically, do you have a better sense of how much of it was -- the things you mentioned, shorter Easter, clean floor policy, things like that, versus Hershey maybe not playing as aggressively as you want to in, let's say, the areas where there's more growth, premium, the broader snacking landscape and things like that. So if you have a little bit more of a sense of that, that would be helpful. And then for Patricia, you went through how you're sort of resizing and rescaling the investment in international, based on what the size of the opportunity is closer in. Is there an opportunity -- how much of the infrastructure to support international growth was built at headquarters, in Central PA, that may be -- and is that a part of sort of scaling back some of the international opportunity investment as well? Thanks.

Michele Buck - The Hershey Company - President & CEO
So, as we look at 2016 growth, Andrew, I would say it's a balance of both. So certainly the shorter Easter had an impact on us, certainly we disproportionately have -- we have a disproportionate share of display activity in most retailers. So the pullback in some of those retailers hurt us. At the same time, if I was going to say what else hurt us, I would actually say a part of it was some self-inflicted wounds in terms of there were pieces of our portfolio that we had over extended, and we needed to right size a bit. So we over innovated on sweets a bit. We over innovated on BROOKSIDE a bit, and so we had some adjustments that we needed to pull back, and refocus back to our core, and so that impacted us as well.

There was definitely a big increase in SKUs from health and wellness perspective in 2016, and what I'm feeling better about in 2017 is even though there's growth, I feel like it's getting to a little bit more of an equilibrium, and I think retailers are now taking a really hard look at, okay, they want to have a wide variety of offerings, but what's the velocity across everything that they have, and how do they balance that high velocity of some of the known tried and truth with some of the up and coming new brands they want to offer. Patricia, if you want to talk about the --?

Patricia Little - The Hershey Company - SVP & CFO
Yeah. Great question on where some of the costs related to international reside. Clearly the International and other segment has its cost break-out, but there are certainly costs in our corporate SG&A that support the global nature now of our business, and we are absolutely focused on the costs that reside there in the corporate SG&A as well, and probably we will see the biggest improvement on those a little bit later, because what we have to do is use some of those resources to get the business on the right path. And then as we've done that and it's right sized, I think we'll have -- we have the goal of having much tighter alignment between the needs of those markets and the resources that support them.
Mark Pogharian - The Hershey Company - IR

Alexia?

Alexia Howard - Sanford Bernstein Research - Analyst

So two questions. Alexia Howard from Bernstein. First, so China, you've entered the China market a couple of times in the last decade or two. The business model still seems to be troubled and you're doing a rethink of that. What have you learned from those experiences and what's the path to profitability. I think you had a goal of getting to breakeven in China by 2017, when is the new timeframe for that?

And then the second question is about ingredients. How worried are you, first of all, about the added sugar issue and the fact that that's going to be on pack labeled next year? You've got Nestle saying that they can reduce the amount of sugar somehow through new technology. Are you able to match that? And then also on the simple ingredients that you alluded to, what patterning there is out of vanilla, non-GMO type of angle? Thank you.

Michele Buck - The Hershey Company - President & CEO

So as I look at China, I would say that we have certainly learned a lot through the trials and tribulations. If I look at the business back, Mark, what it would be -- four years ago probably, we had gotten to, I'd say, a reasonable business model where we were getting pretty steady growth and we were bringing our losses down significantly. So the P&L actually looked pretty good. I think as we then went out and went forward with the acquisitions to attempt to broaden our business, the combination of some of the issues that arose from that acquisition, combined with some of the softening in China, at the exact same time created a lot of complexity and difficulty on the business. And I think what you're seeing in our business model and our plans right now is, how do we really go back to the model that we had about four years ago, that really was working to focus on -- focuses on what's important, build scale, to be really smart about our investments, focus on not just the topline, but also the bottom line. And if we do that we believe we can re-pivot. There's also been changes in the marketplace, obviously, where a lot of the growth was in the top-tier cities and now the second and third tier cities are experiencing a lot of the growth and the cost of doing business is more attractive in those markets. So we're taking advantage at the same time to kind of pivot to capture that next wave of growth in some of those provinces and some of those cities with our portfolio.

Second question relative to ingredients, consumers look at our category as a treat and everything that we hear when we talk to them is they expect it to be a treat. So they're not surprised that their -- what the ingredients look like, they're not surprised on the calories, etcetera. It's a part of their daily lives or their consumption that they understand quite well. So, obviously, we're closely monitoring that. Our R&D team is very focused on a holistic plan of how do we provide other choice for consumers. So, for example, we have lots of portion sizes with Kisses that are 25 calories per Kiss. The R&D team is absolutely looking at are there any opportunities to reduce a little bit of the sugar. It's not going to be a huge reduction, because sugar is part of what the product is. So we're very focused, I'd say, on a holistic balanced approach to that.

And from a simple ingredients perspective, anywhere that we can simplify our products, we will. Hershey was a natural. So making sure that we are very focused on milk, sugar, vanilla etcetera. It's something we'll continue to do and make sure we communicate well with consumers. The bulk of our portfolio is actually gluten-free, almost 80% and we have rBST free milk. So we are looking at every ingredient, how we can make it better for consumers.

Chris Growe - Stifel Nicolaus - Analyst

Chris Growe from Stifel. I have just two questions. I want to ask first, when you think about remaining at the lower end of the sales growth range the next several years, next couple of years, what are the main factors that we should be thinking about? Is that SKU rationalization, is that mostly international versus the US? Is there a number you may call out each year and say this sort of dragged on the sales growth?
Michele Buck - The Hershey Company - President & CEO

I don’t know if we will end up calling that out. I would definitely say SKU rationalization, as we’ve mentioned in international is a factor. At the same time, as we are constantly looking at expanding margins, which is critical for our entire business model, any place that we have to simplify our portfolio and make wiser choices in the US are going to be on the docket as well. Patricia, you want to --?

Patricia Little - The Hershey Company - SVP & CFO

I would agree and I really appreciate that the way we’re going about it is led by the sales team and the commercial team to say what makes sense for the whole P&L and that’s making it a very useful exercise. We may have slightly crept into future mini SKUs in the last couple of years.

Chris Growe - Stifel Nicolaus - Analyst

I just had a quick question, if I could, then as well. In relation to lowering the long-term sales growth guidance, but keeping the EPS growth guidance, just curious what makes up the difference in that and just to be clear, is M&A included in that outlook at all?

Patricia Little - The Hershey Company - SVP & CFO

So what makes up the difference is the emphasis that we’ve put in this presentation and you can see it, in things like returning our International and Other segment to profitability to expanding our gross margin and to making sure that all of our parts of our business have an ROI mentality focus. So that would be the gap filler, if you would. And the last part?

Chris Growe - Stifel Nicolaus - Analyst

So that’s M&A included in that outlook?

Patricia Little - The Hershey Company - SVP & CFO

So, no, we would not include M&A, although I would say from just purely from a sales perspective, we’ve done some small M&A, and that’s been part of our algorithm. And so, if we’re talking about the kind of smaller bolt-on acquisitions that we’ve done, I would say that probably speaking that’s in our sales algorithm long term. In terms of something that would be much bigger, obviously it would not.

Matt Grainger - Morgan Stanley - Analyst

Matt Grainger, Morgan Stanley. Just a question on the innovation pipeline. So clearly you’ve gotten assortment in place. This year it’s robust, it takes in some new very relevant directions, but as we think back over the past several years, there were a number of cases where we had very reasonable initial rollout. We expected big things and you had trouble sustaining those sales. So when you look back at those cases, can you generalize about why those launches didn’t last, whether it was competitive A & C support and how you’re adjusting the gating factors for new product launches based on that? And just as a follow-on, how do you plan to judge the success of this year and next year’s innovation? What kind of hit rate are you looking for? What are you looking for before you decide to support it in year two?

Michele Buck - The Hershey Company - President & CEO

So I would say our strategy around innovation is really focused on, we know the best innovation is platform innovation and that platform innovation means innovation that can be extended across brands, or within a brand can be extended either across pack types or with new varieties of ingredients within. And we’re very focused on that and very focused on innovation that is close to the core. So think Big Kat for example. It’s a bigger version of a Kit Kat. We know that those are where we see the most success is in one of those two models. So as I look back over time and say, okay, what
can we do differently, or better, or where did we make a mistake, I would say it's where we didn't follow those principles. So Lancaster Caramel was a new brand. So we needed to create a whole new brand, was the platform big enough to do that, those are the trade-offs I think we always have to make. Innovation is hard, if you think about it, has a repeat -- a good repeat rate is 30%. So, year one you get a lot of triers and you're going have two-thirds of them who become rejecters. So keeping it going, but work is tough, so we're going to be very focused. And I think Cookie Layer Crunch is a platform, we believe, we can build upon. It's early, so I don't want to declare total victory yet, but we believe we can build on. And then we have a couple other platforms that we chose not to talk about, just for competitive reasons that would be coming at the end of the year that we also think are good platform innovation for us.

**Unidentified Audience Member**

Thank you. My first question just on M&A in general, very broad question. Obviously there's consistent speak in the space right now on consolidation for a number of different reasons. We've also seen over the last five years a fairly large-scale consolidation in global coffee. We haven't seen as much in confection. So just kind of broadly speaking, I'm wondering just what your thoughts are on potential for either chocolate or confection consolidation within North America and/or on a global scale over the next couple of years?

**Michele Buck - The Hershey Company - President & CEO**

We don't speculate on M&A consolidation, what could happen in that area. So we're very focused on what do we need to do to drive our business from a marketing, engaging with consumers, innovation, good cost management, investing in capabilities, but unfortunately not something we really going to speculate on.

**Unidentified Audience Member**

I understand. And just a follow-up then. I guess there is a slide you showed that speaks to the broad portfolio of brands. You attempt obviously always try to make all of them fresh. It's easier said than done for some versus others. So if we just look at the past year, some of the larger brands, let's say not Reese's or Kit Kat but others, haven't done as well, let's say TWIZZLERS, per se. With the conversation around SKU rationalization, you're not going to rationalize the TWIZZLERS brand, but other smaller brands that you might consider divesting that relative to history really haven't divested much of the portfolio?

**Michele Buck - The Hershey Company - President & CEO**

Again, I would say, we're really not going to comment on any kind of M&A activity, including divestiture. What I would say is, we believe that the breadth of our portfolio gives us advantage in the marketplace. Obviously, job one is grow the core, because those are the biggest brands with highest profit margin. We very much are focused on portfolio that we believe can give us incrementality. So a BROOKSIDE or a barkTHINS that gets us the premium consumer, some of our tail brands that have very loyal consumers that nothing else. MOUNDS, ALMOND JOY, I think is the biggest coconut snack product in the marketplace. So is a very specific user there. So that's really our focus, is how do we leverage those.

**Unidentified Audience Member**

And just last one on international. Again, there's a slide with expectation, I guess, of some profitability in 2019. Times have changed relative to a couple of years ago. Old target was low-double digit, call it 10% operating profit margin. Is there any color as to what that margin could be over a three-year period of time, is it sub 10%, is it greater than zero, I mean how should we be thinking about that?
Patricia Little - The Hershey Company - SVP & CFO

I think the first thing that we want to focus on is returning it to profitability, because that’s a lot of work, and it’s going to take a lot of change management to get there. And while we do it, I can guarantee you one thing and that’s the world will continue to change. So we’ll need to continue to I think always be adjusting that plan. What we do want is in International and Other segment that balances driving topline growth and contributing outsize to that, but pulling its own way in terms of the EBIT margin. It’s not going to ever be the North America confection business, because I don’t know what could be, but we do want it to have a more balanced place in our overall P&L.

Bryan Spillane - Bank of America Merrill Lynch - Analyst

Bryan Spillane from Bank of America Merrill Lynch. Michele, there was a slide that you presented that showed channel advantages. And I guess it kind of caused me to think about two things. One, a question about just what is it specifically that gives Hershey the advantage. Have you hired sales people, is it the technological advantage, just why is it that you’re advantaged versus other CPG companies? And then second, I guess is you’re thinking about M&A, potentially, you’ve got some other snack companies that are adjusting their distribution model. Kellogg, for instance, is getting out of DSD, partly because they want to invest some money to get into these other channels where they are significantly under present. So as you think about M&A, does this channel advantage sort of influence maybe the scope and types of things you might want to acquire or look at, because you can add that element to a brand or a product that maybe your Company doesn’t have?

Michele Buck - The Hershey Company - President & CEO

So I think about the ubiquitous distribution, ubiquitous availability of snacking, the fact that consumers are looking for snacks in so many different venues and the fact that within our business portfolio that is a way of life for us. I mean, that’s how we think about the category, it’s that how can you grab somebody, especially the instant consumable component of the category and how big and important that is for us. I’d say that’s one of the hearts of the advantages. As I think about our retail sales team and I believe, now more than ever, it’s a key and huge advantage for us, because of what we can power that group with as they go into retail stores in terms of impacting each store on a daily basis with the knowledge that we will have in terms of real-time knowledge of what’s going on, the ability to route, the ability to prioritize by store. I almost feel like we get not totally to DSD-type capabilities, because we’re not delivering product, but close to that. And that’s really where our focus is, is how do we continue to just drive that even harder and get even more out of that investment and we think it gives us a big advantage. Mark, do you want to add anything else?

Mark Pogharian - The Hershey Company - IR

Yes, I mean the only other thing -- and Bryan, you’re familiar with just a lot of our peers, only have exposure to certain channels, where we have such a great mix. We’re not really reliant on any one channel almost, we can take things and with Rob’s team can get anything anywhere and pretty quick.

Bryan Spillane - Bank of America Merrill Lynch - Analyst

And just in terms of M&A, how it factors into your thinking about M&A, is that a variable that we should be thinking about?

Michele Buck - The Hershey Company - President & CEO

I would say it’s a variable in both regard. So, I would say it’s something we think about with some smaller M&A that’s more premium or health and wellness focused in terms of building a stronger core in some of the natural and specialty channels, which are opportunities for us. And so, as we’ve gotten with KRAVE and barkTHINS, there’s a lot of capability in those companies around those costs of the trades. So, we think about it in terms of deeper reach and then we also look at the opposite, which is where there is a product out there in the marketplace that seems to be under-penetrated in some of the categories where we are really big. Again, that becomes our leveraging our distribution scale to build the business, is absolutely one of the biggest value creators that we see as we look at M&A.
Arthur Reeves - Societe Generale - Analyst

Arthur Reeves from SocGen in London. Can we just go back to the factory utilization in the US, 65%, how's that changed over the years, please? And would you look at outsourcing to try and improve that figure?

Michele Buck - The Hershey Company - President & CEO

I'll ask Terry to answer the question about how it's changed. But we use co-manufacturers today as part of our overall supply chain network and we think very tactically, as well as strategically around where we want to put product in our own plants. But we'll go out and do co-man as well. And then sometimes, as we did last year, we repatriate things from co-man. So we're always adjusting that supply chain mix between our product mix, between our own plants and co-manufactures. And then Terry, if you could talk about the --?

Terry O'Day - The Hershey Company - SVP, Chief Product Supply & Technology Officer

So when we started the first initiative in back around 2007, our utilization in the United States was around 40% plus or minus. We ended up closing seven plants, built another one and so that's what's taken us up. The other thing that affects us, we talked about the freshness issue with seasonality. The other thing, as you saw the tail we have. So we have a lot of breadth in our portfolio and not all that equipment is flexible. So, in other words, some of those -- the products we make are on a dedicated line and that also impacts some of our overall utilization.

So when we have talk to outside consulting firms about knowing our portfolio and our seasonality, what is the best you can do and they say, 70% to 75%. So, we still have work to do and we're not satisfied, but we feel pretty good where we're at.

Fintan Ryan - Berenberg - Analyst

Fintan Ryan here from Berenberg. Just two questions, please. First, on the slide that you alluded to your e-commerce platform, could you give us a sense of how big that is in terms of total sales currently, growth rates, and do you have any explicit ambition for e-commerce sales in the midterm? And then secondly, I think one area that wasn't mentioned was around the your premium chocolate brands, I guess, those brands compete with (inaudible). Do you see further development of your premium chocolate portfolio, or you are just going to focus in more mass premium confectionary?

Michele Buck - The Hershey Company - President & CEO

So, first of all, relative to e-commerce, I would say that e-commerce as a percent of our total sales is definitely in the single-digits as a percent of our total. Our biggest focus would be in the US and also in China. Obviously, in China, e-commerce has taken off at an even faster clip than in the US and so, it's actually our biggest channel priority in China and important in the US.

So our business is growing at very high double-digit rate. So it's growing exponentially. What we are seeing is where there are certain categories in the marketplace that have really become staples for consumers from e-commerce perspective, a lot of paper products and commoditized products like that. The growth in food, in particular, in condition distribution foods is a little bit slower. So we think it's high growth, it's important to us, but the opportunities at this point in bricks and mortar are even bigger. So we have a focus on both.

And then the second part of your question, remind me again -- oh, premium. So, clearly, in this market, mainstream chocolate is over 90% of the business, and so that is our first and foremost priority. However, at the same time, we will absolutely look at opportunities to participate in premium. It's highly incremental, it's a highly incremental consumer to our franchise. We're doing that with barkTHINS, we're doing that with BROOKSIDE, we have just relaunched a DAGOBA, one of our premium brands, specifically for Target and have worked in partnership with them. So we'll continue to look at getting a piece of that business, but mainstream chocolate will continue to be our big priority.
Ken Zaslow - BMO Capital Markets - Analyst
Ken Zaslow from Bank of Montreal. Over the last 10 years, Hershey’s actually thought of as a leader in consumer analytics. I’m surprised the need to invest as aggressively in the new analytics. What is the need for the change? Why the need for the change and why doesn’t your analytics evolve with the consumer? Has there been a dramatic change to the responsiveness, to the investment support?

Michele Buck - The Hershey Company - President & CEO
So I would say the acceleration of technology is really what’s causing us to make this big investment. What’s possible today was not possible 10 years ago. So for us to continue to have leading edge capabilities, we need the investment in the base system. And then we’re investing as well in kind of what I’d call the overlay, which integrates and harmonizes all that data, because that’s the key to unlocking it to get those integrated sources of data. So it’s really how much the environment has changed and what’s possible today. I’d say every month or two, I think we understand new things that are possible and we want to be at the forefront of that. It’s a huge enabler and I think can drive significant value for us going forward.

Marshall Jaffe - Neuberger Berman - Analyst
Marshall Jaffe, Neuberger Berman. You make reference to how susceptible the whole category is to impulsivity. As the number of shopping trips to physical stores flattens out or declines, what can you do to compensate for the reduced number of opportunities for impulsivity in those venues?

Michele Buck - The Hershey Company - President & CEO
So we really think broadly about how to capture the opportunities out there. It’s one of the reasons that we’re really looking at aisle reinvention as consumers are looking to that aisle, how do we capture them and make the experience even more engaging in other parts of the stores. E-commerce, obviously, participating in e-commerce and thinking differently about e-commerce, where in e-commerce, it’s really about planned purchase and how do we get our products to be on the list for retailers as they are shopping online. So, kind of shifting the paradigm. We’re also working on some longer-term opportunities that would make our products -- we’ll create a new business model that would make our products even more planned on a routine way going forward for some rituals and traditions, like seasons and holidays. So it’s really shifting our whole mindset, working aggressively with retailers in store where we can, but then shifting how we think about path to purchase.

Mark Pogharian - The Hershey Company - IR
Well, thank you all for joining us here in New York today and on the webcast. I think there are still plenty of samples in bags for you to grab on the way out and we hope you enjoy them. Thank you.