20-Jul-2023

Kenvue, Inc. (KVUE)

Q2 2023 Earnings Call

Copyright © 2001-2023 FactSet CallStreet, LLC

CORPORATE PARTICIPANTS

Tina Romani
Global Head of Investor Relations, Kenvue, Inc.

Thibaut Mongon
Chief Executive Officer & Director, Kenvue, Inc.

Paul Ruh
Chief Financial Officer, Kenvue, Inc.

OTHER PARTICIPANTS

Anna Lizzul
Analyst, BofA Securities, Inc.

Filippo Falorni
Analyst, Citigroup Global Markets, Inc.

Andrea Teixeira
Analyst, JPMorgan Securities LLC

Peter Grom
Analyst, UBS Securities LLC

Jason English
Analyst, Goldman Sachs & Co. LLC

Steve Powers
Analyst, Deutsche Bank Securities, Inc.

Navann Ty
Analyst, BNP Paribas Exane

Jeremy Fialko
Analyst, HSBC

MANAGEMENT DISCUSSION SECTION

Operator: Greetings and welcome to the Kenvue Second Quarter 2023 Earnings Conference Call. At this time, all participants are in a listen-only mode. The question-and-answer session will follow the formal presentation. [Operator Instructions] As a reminder, this conference is being recorded. It is now my pleasure to introduce your host, Tina Romani, Head of Investor Relations for Kenvue,. Thank you. Tina, you may begin.

Tina Romani
Global Head of Investor Relations, Kenvue, Inc.

Good morning, everyone. Joining me on the call today is our Chief Executive Officer, Thibaut Mongon, and our Chief Financial Officer, Paul Ruh. Please note that today's call will include forward-looking statements regarding, among other things, our operating and financial performance, market opportunities, and our growth.

These statements represent our current beliefs or expectations about future events and are subject to various risks, uncertainties, and assumptions that could cause our actual results to differ materially. For information regarding these risks and uncertainties, please refer to our earnings materials related to this call posted on our website and our filings with the SEC.

During this call, we will also reference certain non-GAAP financial information. The presentation of this non-GAAP financial information is not intended to be considered in isolation or as a substitute for financial information presented in accordance with GAAP. A reconciliation of these items to the nearest US GAAP measure can be found in this morning's press release and our presentation available on our IR website.

Copyright © 2001-2023 FactSet CallStreet, LLC

With that, it's my pleasure to turn the call over to Thibaut.

Thibaut Mongon

Chief Executive Officer & Director, Kenvue, Inc.

Thank you, Tina. Good morning and thank you for joining our second quarter earnings call and our very first as a public company. Our recent IPO marked an important and exciting milestone in Kenvue's history. Over the last 135 years, we have established ourselves as the world's largest pure-play consumer health company. And now as a standalone company, we are looking forward to building on our strong heritage and continuing to deliver on our purpose to realize our extraordinary power of everyday care.

Before we begin, as you may have seen this morning, Johnson & Johnson announced their intended next step in the separation of Kenvue. At this point, we are very limited on what information we can provide other than what has been made public. And as a result, we will not be able to discuss any further details at this time. What I can tell you is that we are ready to take on the next phase in our journey to becoming a fully independent company.

For today's call, I'll begin with an overview of our second quarter results. Paul will then take you through a more detailed view of our Q2 financials and 2023 outlook. And then Paul and I will be happy to answer any questions you may have.

But first, let me begin with our strong results this quarter. With over $4 billion in net sales, Q2 was one of the strongest quarters in our 135-year history and certainly the strongest since the beginning of our business transformation in 2019. Organic sales grew 7.7%, bringing our first-half organic growth to a very strong 9.4%. Similar to Q1, our growth was broad-based across all segments of our portfolio and across all geographic regions.

So this quarter was yet another proof point showcasing the power of our portfolio. Our three segments did well. We saw double-digit growth in Self Care, continued recovery in Skin Health and Beauty, and growth ahead of our long-term expectations in Essential Health. Further, we delivered balanced growth across all geographic regions, with North America contributing about half of the growth, with all other regions representing the remainder.

There were several portfolio highlights in the quarter, but let me focus your attention on a few standouts. In Pain and in Cough and Cold Care, we saw higher incidence rates drive continued demand for our leading brands such as Tylenol, Motrin, and our other brands in these need states. Across our Self Care portfolio, we see innovation, premiumization, and healthcare professional recommendations all fueling market share growth for many of our brands.

In Skin Health and Beauty, our performance in sun care showed the power of our brands as we see continued recovery after a period of disruption. Innovation, improved supply, and strong commercial execution contributed to sustained market share growth for Neutrogena Sun this season.

In Essential Health, our Listerine mouthwash superiority claim over dental floss is being deployed around the world, and our Listerine Gum Therapy product in the US is ranked number one [ph] new code (00:05:32) in the mouthwash category this quarter. And we continue to see the power of BAND-AID where consumer-led innovation and strong customer partnerships delivered another strong quarter. BAND-AID was also recognized in the quarter as America's Most Trusted Brand for 2023 by Morning Consult, and this is the second year in a row that BAND-AID has earned the top spot.

With the macro environment continuing to be challenging, consumers are increasingly more choiceful with their purchase decisions. In the consumer health space, though, they turn to brands and products they know and trust,

Copyright © 2001-2023 FactSet CallStreet, LLC

and we have many of those brands in our portfolio. We see this playing out in the value-volume dynamics of Kenvue this quarter.

While value represented 9.4 points of growth, volumes only declined 1.7 points. And excluding the impact of our own intentional decisions, like portfolio rationalization or suspension of our personal care business in Russia, volumes were about flat this quarter. Important to note that we delivered this exceptionally strong first half of the year in part thanks to the investments we have made in our supply chain, building capacity and resiliency. While service levels will continue to be a focus area for us, we have made significant progress that has allowed us to capitalize on and deliver against the unique demands of the first half of the year.

Regarding our margins, they continue to be healthy fundamentally when excluding non-operational impacts such as FX of standard company costs. Inflationary pressures, though moderating, continue to be meaningful. But this quarter, again, we used a combination of strategic value realization, both price and mix, and productivity initiatives in our operations to offset a significant portion of these costs, which Paul will get into in just a moment.

So net, a strong quarter showing the power of our world-class portfolio of category-leading brands that includes many of the most recognizable household names across consumer health, which brings me to Kenvue's greatest source of competitive advantage. With a sole focus on consumer health, every day our 22,000 Kenvuers are committed to delivering science-based innovative solutions that increase relevancy with consumers and strengthen credibility with healthcare professionals.

These relationships have been cultivated over decades through innovations supported by rigorous science, based on our vast clinical research capabilities and meaningful cross-category consumer insights. As a result, brands across our portfolio have a long history of recommendations by healthcare professionals and are often the number one most recommended brand in their respective categories, which ultimately fosters lifelong loyalty to our brands, loyalty that is passed down from generation to generation.

Our first-half results exemplifies this loyalty and consumers' desire for our efficacious products. While consumers may be trending down in more discretionary and traditional staple categories, we have not seen this dynamic in our portfolio. Consistent with what we have seen historically during times of challenge and uncertainty, private label penetration for our categories remains stable on a global basis this quarter.

Our first-half results also reflect the unique opportunity we have to expand usage occasions across the spectrum of consumer health. There is no limit for consumers to take care of their own health, and for Kenvue, there is no limit to finding new ways to help consumers take care of their health. The categories in which we operate tend to be undiagnosed, undertreated, and underpenetrated.

Using sun care, for example, since we are in the middle of the summer season, it's estimated that one in five Americans will develop skin cancer in their lifetime. Yet today, a majority of Americans do not use sunscreen on a regular basis. At Kenvue, we want to understand why that is, what are the barriers to adoption. That's tremendous opportunity for us to leverage our extensive capabilities and consumer insights to develop innovative new products to better serve the needs of our consumers. So, with this in mind, this year in the US, we launched Neutrogena Purescreen+ Mineral UV Tint in four shades that blends smoothly to complement skin tones. Our new products are up to 30% [ph] less whitening (00:10:07) than the leading mineral sunscreen, which is one of the biggest frustrations consumers have.

Innovation like these have huge share gains through better customer retention, increased consumption, and attraction of new consumers to the brand, all driving the strength we saw in the quarter for Neutrogena sun care.

Copyright © 2001-2023 FactSet CallStreet, LLC

That's what makes this consumer health space very attractive, the infinite ability to expand usage occasions and give consumers around the world new opportunities to take care of their health.

Now, let me take a moment to speak to the strength and agility of our operating model that supported our results. Since 2019, we have made tremendous strides in removing complexity, streamlining our organizational and operational footprint, and simplifying our portfolio while investing in digital and omni-channel capabilities that position us well for the future.

Today, we have a resilient portfolio with iconic brands well-balanced across categories and geographic markets. Our model is designed to drive synergies across our portfolio from shared consumer insights, go-to-market strategies, operation, marketing, innovation, and so on. While we set our strategy and allocate resources at the segment level, all three segments are focused on one single and cohesive end market, consumer health.

Take products for children as an example. You'll see products leading in Self Care with Children's Tylenol, in Skin Health with Neutrogena or Aveeno Sun for kids, or in Essential Health with Johnson's Baby or BAND-AID. But it's one consumer, one penetration, one understanding of the interaction between child and parents that allow us to present ourselves as a preferred partner for everything you need for children's health.

And the same applies to the rest of the portfolio. This dynamic is a critical component in understanding the strengths of Kenvue. In addition, being a pure-play consumer health business both drives efficiency across areas like R&D and advertising, and also affords us agility and flexibility. We saw this agility in action this quarter with the Kenvue teams delivering strong performance on multiple fronts, including responding to unprecedented demand for Self Care brands.

So as you can see, our second quarter results are emblematic of the power of our portfolio. In a dynamic macroeconomic environment, we delivered strong top line with operationally healthy margins and solid earnings per share, all of which supported the initiation of a first quarterly dividend as Kenvue of $0.20 per share.

Now, looking to the back half of 2023. This year has for sure been an incredible journey for Kenvue so far. But we have a lot to look forward to, with the full-year organic growth expected to be between 5.5% and 6.5%. Paul will take you through the assumptions embedded within our full-year outlook, but I wanted to take a moment to acknowledge the consumer landscape.

It continues to be uncertain, and we anticipate market volatility will continue, including in the incidence level for the upcoming winter season. In this environment and building on the unique nature of the consumer health space, we as Kenvue will continue to stay focused on what we do best, delivering superior, science-backed, efficacious health solutions to serve the needs of our 1.2 billion consumers around the world who know and trust our brands.

In Self Care, we will deliver a consistent cadence of [ph] innovation in marketing (00:13:49) programs to drive growth on our priority brands. You may have seen we just launched Tylenol Precise, where we leverage in Self Care our extensive Skin Health expertise to develop a maximum strength topical pain treatment with rapid absorption in an instantly pleasing next level experience.

For me, this is another great example of what we mean by the power of the portfolio with synergies across segments delivering innovative health solution. Within Skin Health and Beauty, while we expect continued progress on distribution point recovery in the US through the third quarter, we are planning to return to a normal cadence of innovation with a strengthened and more resilient supply chain and reactivation of marketing campaigns to continue to build momentum in our brands.

Copyright © 2001-2023 FactSet CallStreet, LLC

And within Essential Health, we expect science-backed claims and innovation launches to drive category essentiality and relevance, their effective execution while strengthening brand equity in priority markets. So as you can tell, a lot to look forward to in the back half of the year.

So in closing, as the largest pure play consumer health company in the world and with unparalleled depth and breadth of our portfolio, we offer a one-stop solution for retailers positioning Kenvue as a preferred partner of choice for retailers who want to become a destination for everyday care.

This quarter was another strong illustration of the resilience of our categories and the strength of the Kenvue operating model. None of this would be possible without the passion, commitment and honest mindset demonstrated by our amazing team of 22,000 Kenvuers who work every day to help consumers realize the extraordinary power of everyday care.

I want to acknowledge and recognize them here as we start our journey as a standalone company. To summarize, we feel confident about the future of this business with the strength of our brands, the power of our portfolio, and our competitive advantages which, we believe, will enable us to consistently deliver a strong performance over time and drive long-term value for all our stakeholders.

With that, I'll turn it over to Paul.

Paul Ruh

Chief Financial Officer, Kenvue, Inc.

Thank you, Thibaut. And good morning, everyone. I am pleased to be co-hosting our first earnings call to report on a strong quarter, our first after our successful IPO. I'd like to echo Thibaut's acknowledgment of the passionate and talented team we have here at Kenvue.

The team's execution on our proven strategies yielded a strong and broad-based sales growth, with healthy underlying margins, despite navigating a continued significant inflationary pressure and a challenging macro backdrop. I couldn't be prouder of what this team has delivered in the first key steps of our journey as a public company.

Now, getting into the quarter, we had a strong and balanced quarter with every segment and geographic region contributing to our 5.4% reported growth and 7.7% organic growth. In terms of the drivers, value realization, which is comprised of price and mix, represent of 9.4 points of growth. Approximately 60% of the value realization growth was driven by carryover of actions in the back half of last year with the remainder driven by incremental actions in the first half of 2023. Notably, even with 9.4 points of value realization, volume remained strong with only a 1.7-point decline which includes the impact of intentional strategic portfolio rationalization initiatives and the decision to suspend the sale of personal care products in Russia which we are anniversarying this quarter. If not for these delivered reductions, volume would have been about flat, exemplifying the resilience of our brands.

By segment, sales growth had another strong quarter with the segment gaining share globally driven by increased consumption across all new states and priority brands driving 14.2% organic growth. Value and volume were both strong at 10.6 points and 3.6 points, respectively. In addition to broad-based strength across the colds, cough, and flu categories globally, our new first-to-market vaping cessation indication in the UK is driving consumption in Nicorette, and Digestive Health grew with strong Imodium consumption globally. On allergy, we were very pleased with the performance of our largest brand, ZYRTEC, which continued to gain share in the US this year though we saw lower incidences this season.

Copyright © 2001-2023 FactSet CallStreet, LLC

Moving to Skin Health and Beauty. Organic growth of 3.4% was comprised of 6.6 points of value realization with 3.2 points of volume decline. It's important to note that volume includes intentional strategic portfolio rationalization initiatives and the decision to suspend the sale of personal care products in Russia. Excluding this impact, volume was up low-single digits, demonstrating the healthy underlying demand for our Skin Health brands.

We're pleased with the recovery we're seeing in the business and expect gradual improvements to continue as we restore supply, regain points of distribution with retailer floor resets coming this fall, and support our healthy brand equities through innovation and premiumization. This quarter's strength in sun care is a great example of our ability to grow and gain share when we have a full portfolio on shelf supported by innovation, premiumization, and media support.

Next, moving to Essential Health. Organic growth was 3.8% comprised of 10.7 points of value realization and 6.9 points of volume decline, primarily due to competitive market dynamics particularly in Asia.

Similar to Skin Health, it's important to note that excluding intentional strategic portfolio rationalization initiatives and the decision to suspend the sale of personal care products in Russia, volume was only down mid-single digits. With a healthier core portfolio, the business is focused on strengthening brand relevance through innovation-driven brand differentiation and premiumization.

Overall, our second quarter results are indicative of the leadership positions we hold across the growing consumer health categories in which we operate. The resiliency we've seen this quarter and since our transformation efforts began in 2019 give us confidence that the investments we're making in our technology and digital capabilities to modernize our supply chain, product innovation pipeline, R&D, and our strategic marketing are working and position Kenvue well to drive sustainable growth over the long term.

Now, turning to gross margins. Excluding amortization, adjusted gross margin was 57.5%. We continue to face significant though moderating inflationary pressures during the quarter. Through value realization and supply chain productivity improvements, we were able to successfully offset the majority of these headwinds. In parallel, gross margin was negatively impacted by transactional foreign currency fluctuations of approximately 100 basis points and other non-operational costs related to building of standalone infrastructure. Our teams are focused on identifying and actioning productivity initiatives that will mitigate these headwinds.

Moving to adjusted EBITDA margins. Adjusted EBITDA margin was 24.5% and reflects the impact of the forex headwinds I just mentioned and incremental costs of being a standalone public company. In Q2, our standalone public company costs were approximately $50 to $60 million, which reflects a front-loading of these costs. Acknowledging the complexities of standing up a company of our size and scale and that there is more work ahead over the coming two quarters, we expect these costs to remain elevated as several investments are concentrated upfront in the process. However, we expect these costs to decrease and be offset by other productivity efforts over time, remaining in line with our initial expectations.

Turning to taxes. As can be expected, there are several unique items impacting our second quarter effective tax rate with our IPO in May. On a reported basis, our tax rate is approximately 32.7%. And on an adjusted basis, our Q2 effective tax rate is 30%. The primary drivers for this higher tax rate versus last year are, first, higher [indiscernible] (00:22:40) taxes, net of foreign tax credit; and second, less favorable discrete benefits in 2023 as compared to 2022 related to share-based compensation, law changes and prior-year items; and third, the recording of a valuation allowance on our ability to utilize foreign tax credit assets in Q2 of 2023.

Copyright © 2001-2023 FactSet CallStreet, LLC

And finally, our adjusted net income was $581 million and adjusted diluted earnings per share of $0.32. All in, we are proud of what we delivered in our first quarter as a public company. Strong and balanced top line with fundamentally healthy margins. As we look ahead, we remain committed to investing in our business for the long term with an eye towards delivering attractive total shareholder returns in a balanced way, which brings me to our capital allocation philosophy.

We have a proven track record of generating robust, durable cash flow north of $2 billion per year historically, which gives us the flexibility to pursue our balanced capital allocation strategy. This is comprised of four pillars: number one, responsibly invest resources in our iconic brands to drive profitable growth; two, return cash to shareholders through dividends; three, de-lever, a reliable cash flow gives us the flexibility to prudently de-lever and reduce interest rate expense at the appropriate time; and number four, assess potential inorganic tuck-in growth opportunities that strengthen our position as a leader in consumer health, and we've already begun executing on this strategy with this morning's announcement that our board of directors declared a third quarter dividend of $0.20 per share.

The decision by our board reflects the confidence we have in our ability to deliver profitable growth over the long term while returning cash to shareholders and their commitment to our balanced capital allocation strategy.

Now, let's get into our 2023 outlook starting with the top line. Reflecting our strong first half, we expect full year net sales growth to be between 4.5% and 5.5% and organic growth to be between 5.5% and 6.5%. At current spot rates, we expect an approximate 1 point negative impact of foreign currency fluctuations for the full year.

A few other items to keep in mind as you model the remainder of the year, it's important to consider our strong performance in the back half of 2022 as we improved service level over that period. Further, our first half 2023 results benefited from a couple of onetime-in-nature dynamics that we would not expect to continue in the second half.

First, our Q1 results were supported by higher than normal inventory replenishment primarily in Self Care and Skin Health and Beauty. This was a result of our retail customers exiting Q4 with lower than average inventory levels, generating outsized orders during the quarter as they looked to restock.

Second, globally, there has been an exceptionally strong cold, cough, and flu season throughout the first half of the year. While we will be operationally ready for any level of seasonal demand, our outlook contemplates more normal incidence rate levels this coming winter.

With regards to interest, we expect reported net interest expense to be approximately $270 million and approximately $300 million on an adjusted basis.

Moving to taxes. With regards to the full year, we expect a reported effective tax rate of 34.5% to 35.5%. On adjusted basis, we expect the range to be between 24.5% and 25.5%. The higher rate versus prior year is primarily driven by jurisdictional mix of earnings and less favorable discrete benefits in 2023 as compared to 2022. On the bottom line, we expect full year adjusted diluted EPS to be in the range of $1.26 to $1.31. This range assumes a full year 2023 weighted average share count of 1.855 billion shares.

As we look to the back half, we continue to operate in a challenging environment with ongoing pressures from labor costs, raw materials, packaging and foreign exchange volatility. While our guidance reflects a variety of scenarios, we remain focused on the things that we can control, and we'll utilize the levers within our operating

Copyright © 2001-2023 FactSet CallStreet, LLC

model to mitigate these headwinds. As we have done over the past several years, I'm confident in our proven ability to navigate uncertain operating environments, leveraging the power of the portfolio and the expertise of our teams.

Now, I'll turn it back to Thibaut for some closing remarks.

Thibaut Mongon
Chief Executive Officer & Director, Kenvue, Inc.

Thank you, Paul. Again, we are pleased with the strength of our second quarter results and our first quarter as a publicly traded company. This quarter highlighted our unique model as the world's largest pure-play consumer health company, building on clear sources of competitive advantage to deliver robust financial performance. And now, let's open up for Q&A.

QUESTION AND ANSWER SECTION

Operator: At this time, we'll be conducting a question-and-answer session. In the interest of time, we ask that you limit yourself to one question and one follow-up to allow for as many questions as possible. [Operator Instructions] One moment please while we poll for your questions. Our first question comes from the line of Anna Lizzul with Bank of America. Please proceed with your questions.

Anna Lizzul
Analyst, BofA Securities, Inc.

Q

Hi. Good morning and thank you for the question. You mentioned innovation several times on the call and you've previously shared that Kenvue has launched over 100 new product innovations each year since 2020 and they've comprised about 10% of net sales each year. Are you on track for product innovations to contribute to a similar amount to net sales this year? And also, what gives you confidence in the coming quarters that consumers are still willing to spend on higher priced innovation and consumer health when we have seen some greater trade down within some categories in [ph] HPC (00:29:29)? Thank you.

Thibaut Mongon
Chief Executive Officer & Director, Kenvue, Inc.

A

Yes. Good morning, Anna. Thank you for your questions. Yeah, as you're rightly pointed out, innovation is a big part of our model at Kenvue. That's what we have been doing historically, and that has been our history of 135 years with very -- many first market innovation. And we definitely intend to continue on this trajectory. I talked in my prepared remarks about the number of examples of innovation we launched this quarter and they have been well-received.

And we are excited about what is in the pipeline and what we are about to launch in the market in the back half of this year across all three segments. I would remind you that for us, innovation means not only new products, but also it can be a new claim or a new clinical data that allows us to give consumers and healthcare professionals another reason to use our brands. So, yes, we are pleased with the health of our innovation pipeline and the impact it has on our business.

Regarding your second question, regarding the consumer confidence, while you may have seen in, I would say, more traditional stable categories some downgrading happening in some geographies, at Kenvue, we don't see

Copyright © 2001-2023 FactSet CallStreet, LLC

this dynamic happening in our portfolio. You saw that excluding our own intentional discontinuations, our volumes were flat in the second quarter. And despite strong value realization, you remember that we saw the same thing happening in the full year 2022. So what we see is that even in this more dynamic environment, consumers remain focused on their health and well-being. They want to take control of their own health and they are looking for trusted products, solutions and brands that have been in their household for years, for decades, sometimes for generations. And as you know, many of these brands are in the Kenvue portfolio. So that what makes us confident in the fact that our brands will continue to be the go-to brands for consumers around the world.

Anna Lizzul
Analyst, BofA Securities, Inc.

Q

Thank you. And just as a follow-up, in terms of distribution, are you happy right now with your distribution with various retailers like Walmart, Target in the drug channel? Do you see any areas where you might be underpenetrated or any potential categories where you can expand distribution with certain retailers either domestically or internationally?

Thibaut Mongon
Chief Executive Officer & Director, Kenvue, Inc.

A

Yeah. I would tell you that domestically and internationally distribution is always an opportunity for all of our portfolio of brands. It's something that we continuously work on with our retail partners around the world across the portfolio. Following the period of disruption we had in the part that particularly hit our Skin Health and Beauty segment and some part of Essential Health segment, we are focused on recovering distribution points. I am pleased with the progress we have made so far, but I would expect a continued recovery in distribution points in the back half of the year. But beyond this specific event, distribution is something that we always work on with our retail partners, yes.

Anna Lizzul
Analyst, BofA Securities, Inc.

Q

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

Operator: Thank you. Our next questions come from the line of Filippo Falorni with Citi. Please proceed with your questions.

Filippo Falorni
Analyst, Citigroup Global Markets, Inc.

Q

Hey. Good morning, guys, and congrats on reporting the first quarter as a public company. I have two questions on top line. The first as a total company level, just how are you thinking about the evolution of price and volume in the second half of the year and whether you have additional pricing action that you're contemplating?

Thibaut Mongon
Chief Executive Officer & Director, Kenvue, Inc.

A

Yes. Good morning, Filippo. Thank you for your question. So, regarding the back half of the year, I would remind you a couple of things. First of all, we are going to comp a higher base than we had in the back half of 2022 as we started recovering service levels.

Second, we had in the first half of 2023 two items that we would not expect to repeat in the back half of the year. The first one is the fact that in the first quarter we saw retailers restocking our products significantly knowing that

Copyright © 2001-2023 FactSet CallStreet, LLC

they had exited 2022 with extremely low inventory levels. The second thing is that we have seen very strong incidence in the past winter season. For this coming winter season, we are planning with more normal season. So, that's what we expect in – for the back half of the year. The back half will continue to see a mix of value realization and volume. Distribution gains will play a role. We talked about it a minute ago. Value rate realization, price and mix will continue to play a role as well with targeted price actions to cover continued elevated input costs, but also premium innovation, innovative solutions and favorable mix. So, all of that will – leads to our guidance of an organic growth comprised between 5.5% and a 6.5% growth.

Filippo Falorni
Analyst, Citigroup Global Markets, Inc.

Q

Got it. Thank you. And then just a follow-up and a second question, particularly in Self Care, as you mentioned, very strong cough and cold season, you're expecting a more normal one. Are you – do you think there was also a little bit of pull-forward in demand in the first half of the year? As you think about the second half, have you contemplated maybe like a bit more destocking at the retailer, but also at the consumer level embedded in your guidance for the Self Care segment particularly?

Paul Ruh
Chief Financial Officer, Kenvue, Inc.

A

Filippo, good morning. This is Paul. Thank you for the question. We did not see a pull-through. Our inventory -- retail inventory and all inventory are in balance. And in the case of Self Care, seasonalities are normalizing as – that's what we have contemplated in our forecasts. So, we do not see a pull-forward in demand for second year. Expect a normalized season in the balance of the year.

Filippo Falorni
Analyst, Citigroup Global Markets, Inc.

Q

Okay. Thank you, guys. [indiscernible] (00:37:19)

Operator: Thank you. Our next questions come from the line of Andrea Teixeira with JPMorgan. Please proceed with your questions.

Andrea Teixeira
Analyst, JPMorgan Securities LLC

Q

Thank you. Good morning. I just want to follow up a bit on the commentary regarding the consumer environment and just see if you can speak to the consumer behavior towards the end of the quarter, if you're still seeing, in general, consumers being not on trading or how you're seeing price elasticity coming along. And then also, as you just mentioned, regarding the cold season, but any word on how we should be thinking of puts and takes of retail inventory, pantry inventory, and consumer demand. Thank you.

Thibaut Mongon
Chief Executive Officer & Director, Kenvue, Inc.

A

Yeah. Andrea, thank you for your questions. So as I mentioned, we live in the consumer health space which might behave in a different manner compared to other consumer staple categories. Our world is really about bringing efficacious solutions to cater for real needs of consumers around the world. So, we are [indiscernible] (00:38:34) discretionary categories, and we have very strong portfolio of brands that are very often synonymous with our categories.

Copyright © 2001-2023 FactSet CallStreet, LLC

So, when we – when you combine these two factors, you see that consumers continue to be focused on their health and wellness. They want a trusted solution, trusted product that they know, that they trust, that are recommended by the healthcare professionals, that they have seen in their household for a very long time. These are the brands we are talking about with Kenvue.

I'll give you a couple of proof points. If you look at our key segments of Self Care and Skin Health and Beauty, again excluding the intentional discontinuations we made ourselves, volumes are up in both segments.

Another proof point is the fact that we don't see private label penetration – we see private label penetration stable this quarter, which is in line with the history of private label. We have seen that -- in the past, even when times are tough, private label penetration does intend to fluctuate very much.

And the last proof point I would give you is what we are seeing as we speak in the summer season in sun care where our Neutrogena range is doing extremely well. We are market leader in the US. We have premium positioning. We launch premium innovation. All of that is extremely well-received by consumers and we are gaining share in the US with Neutrogena [indiscernible] (00:40:31). So, we are aware of consumer dynamics. We make sure that our products are accessible at different price points to cater for different needs of different consumers, that we are also very confident in the robustness of our portfolio and our ability to serve consumers with a product and solutions they need. That's what we have been doing for 135 years, and that's what we intend to continue to do.

Andrea Teixeira
Analyst, JPMorgan Securities LLC

Q

Thank you. Just a follow-up, if I may, in terms of like the other categories that are not so health-oriented, for example, Listerine and some of the other categories within adhesives and wound care, is that applied to that as well?

Thibaut Mongon
Chief Executive Officer & Director, Kenvue, Inc.

A

So in Essential Health, as Paul mentioned, we are pleased with the performance of this segment at 3.8%, 10.7% of value realization. When you exclude discontinuations, it's mid-single-digit volume decline. I would say volume held up pretty well in this area. Wound care had another good quarter with strong customer partnership, good innovation with Band-Aid. And Listerine is – we are pleased with the performance of gum therapy products which in the US which is a number one new code in the US this quarter.

The Listerine Gum Therapy gives you four times healthier gums in three weeks. And consumers are responding very well to this offering. We saw softness in the category in Asia. But we continue to gain share there. So, that's how I would summarize the performance of Essential Health.

Andrea Teixeira
Analyst, JPMorgan Securities LLC

Q

Thank you, Thibaut. I'll pass it on.

Operator: Thank you. Our next questions come from the line of Peter Grom with UBS. Please proceed with your questions.

Copyright © 2001-2023 FactSet CallStreet, LLC

Peter Grom
Analyst, UBS Securities LLC

Q

Thanks, operator. And good morning, everyone. So I was actually hoping to get some more color on the gross margin performance. So I know you mentioned headwinds from FX, stand up costs and inflation, but value realization was strong and you also mentioned productivity in the tailwind. So can you maybe just help bridge the decline in the quarter which I think was a bit weaker than we were expecting?

And then a second part to this question as we look through the balance of the year, is there any color you can share on these moving pieces and how maybe specifically we should be thinking about gross margin progression? Thanks.

Paul Ruh
Chief Financial Officer, Kenvue, Inc.

A

Yeah. Good morning, Peter, and thank you for the question. We are, in fact, navigating a volatile environment for a couple of years now, but I am actually very proud of the way we have been doing it consistently with our experience. In the case of the quarter, we still see some elevated inflation and transactional forex was also a headwind.

However, we have an arsenal of tools to be able to offset partially the gross margin pressures, particularly we use supply chain efficiencies and we constantly do that as part of our discipline. Premiumization, innovation in RGM and value realization as Thibaut -- is a big component of course.

As we look into the second half of the year, we believe that these levers will continue to be utilized. We have, as I said, a continuous arsenal of ideas that we put in place in terms of total end-to-end network optimization. And of course, the carryover of the pricing that we have put in place will help us offset the still inflationary yet diminishing commodity headwinds. We feel very good about our ability that we have demonstrated to maintain very healthy gross margins.

Peter Grom
Analyst, UBS Securities LLC

Q

No, that's super helpful. And then maybe shifting gears to China. I would just be curious kind of what you're seeing in that market, how did performance in the quarter prepare or compare versus your expectations.

And I guess maybe, specifically, as you move through the quarter or around the exit rate, are you seeing any signs of improved demand that gives you confidence that there could be better performance on the horizon or would you expect trends to remain choppy there for a period of time?

Thibaut Mongon
Chief Executive Officer & Director, Kenvue, Inc.

A

Yeah. Maybe I can take this one. We have been in China for a very long time as a business, have myself lived for many, many years in Asia. So, you are not in Asia or in China for the short-term. And I can tell you that we are positive about long-term prospects of our business in China.

When I look at our performance in China this quarter, I think it's another great example of the power of the Kenvue portfolio. I can tell you that we grew double-digit in China this quarter, strong performance in our Self Care segment. We see softness in other categories, but it's something that we anticipated. We have never been

Copyright © 2001-2023 FactSet CallStreet, LLC

in the camp of those who thought that China will recover overnight. Unfortunately, we have been proven right, and we would expect a slow recovery in these categories that – where we see softness today.

But we are very confident in the ability of these markets to continue to deliver performance. And we see that again in this quarter with double-digit growth, and that's the power of the Kenvue business model and Kenvue portfolio.

Peter Grom
Analyst, UBS Securities LLC Q

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

Operator: Thank you. Our next questions come from the line of Jason English with Goldman Sachs. Please proceed with your questions.

Jason English
Analyst, Goldman Sachs & Co. LLC Q

Hey. Good morning, folks. Thanks for [ph] slotting (00:47:19) me in and I'll echo some of the others. Congrats on your first quarter as a public company. I got a couple of questions. First, let's pick up kind of where you just left off on geography. You mentioned China have double-digit. I think APAC sales overall were only up [ph] 1%, 3% (00:47:33). So, what was the offset?

And then as we look at EMEA, you started the year really strong with 9.3% growth, and it slowed to around 3.5% this quarter, despite what looks like it should have been a pretty moderating or much less [ph] onerous (00:47:47) FX headwind. Can you unpack that performance there as well? Thanks.

Thibaut Mongon
Chief Executive Officer & Director, Kenvue, Inc. A

All right. Hey, Jason. Thank you for the question and thank you for your thanks for the strong quarter we delivered. So, in Asia, we see competitive dynamics. We see category dynamics happening that had a negative impact on parts of our business in the second quarter. I mentioned the mouthwash category where we see decline in both China, Japan, and other parts of Asia. We are gaining share in China and Japan, but the categories are suffering as we speak. India had a soft quarter, and emerging markets in general, we saw softness there. So, that's for Asia.

For EMEA, we are very pleased with the performance of our business in Europe, Middle East, and Africa. Across our portfolio, we see our brands doing well, strong demand for products in both Self Care and Skin Health, with obviously opportunities in some places as always, but overall pleased with the performance of our European region this quarter and this first half.

Jason English
Analyst, Goldman Sachs & Co. LLC Q

Okay. Good to hear.

[indiscernible] (00:49:30)

Jason English
Analyst, Goldman Sachs & Co. LLC Q

Copyright © 2001-2023 FactSet CallStreet, LLC

...oh, sorry go ahead.

Paul Ruh
Chief Financial Officer, Kenvue, Inc.

A

Sorry, Jason. You're right about the headwind. It's still persistent of – yet moderating, the Forex, but important thing is the underlying strength of the business is there. And also, we had – we continued to see elevated incidences of flu that we even saw that in the second quarter. So it's more the core that we feel very good about and moderating effects pressures.

Jason English
Analyst, Goldman Sachs & Co. LLC

Q

And let's pull on the thread of elevated flu incidences. Since you've IPOed, lots of conversations with investors, and one consistent question or area of concern to most investors is whether or not you're going to enter a Self Care slump, right? We had sort of twin engines or twin tailwinds behind this business with COVID and then this nasty cold and flu season lifting big parts of your business.

Is it reasonable to expect that there will be a Self Care slump? In other words, a period where your business is likely to contract as these [ph] tailwinds stay (00:50:32)? Or is there reason to believe that you can have durable growth? And if so, what are those reasons?

Thibaut Mongon
Chief Executive Officer & Director, Kenvue, Inc.

A

Yeah, that's a very good question, Jason. That's a question that we are facing every day to plan for our operations. Our guidance of 5.5% to 6.5% growth, organic growth for the full year takes into consideration [ph] our (00:50:57) current thinking, which is to have the normal season. So, we do not expect to have as big of an incidence as we had last winter season. We will be ready from an operational point of view to respond to any seasonal demand, but from a planning perspective, we were not planning with such a high season.

Having said that, and I think the second quarter is a good example of that, our Self Care segment comprises more need states than just cough and cold or analgesics. And you saw this quarter our order need states, like smoking cessations with Nicorette, like digestive health with Imodium, or like allergy where, despite a slightly slower level of – lower level of incidence, we continued to gain share in the US with both ZYRTEC and Benadryl, all of these – all those segments are doing well. So, we are very pleased with the performance of this segment and very confident in the continued performance of the segment.

Jason English
Analyst, Goldman Sachs & Co. LLC

Q

Understood. Thank you, all.

Operator: Thank you. Our next questions come from the line of Steve Powers with Deutsche Bank. Please proceed with your questions.

Steve Powers
Analyst, Deutsche Bank Securities, Inc.

Q

Hey. Good morning, everybody. Thank you. You've spoken to this a little bit, but I just wanted to kind of round it all out. Within Skin Health and Beauty, and Essential Health, the growth in both segments came in slightly below

Copyright © 2001-2023 FactSet CallStreet, LLC

external forecasts. So, I was hoping you could put a bit more definition around how they compared to your internal forecasts? I mean, you've spoken to the Asia issues in Essential Health, but just more broadly.

And then, I was also hoping you could just clarify for us exactly when you expect to fully cycle the portfolio rationalization headwinds that are impacting both the segments. And if possible, just within the context of that 5.5% to 6.5% organic growth call for the year, talk a bit about how you expect the three segments to contribute to that on an annual basis, to give us a little bit more perspective on how the second half is likely to shake out.

Thibaut Mongon
Chief Executive Officer & Director, Kenvue, Inc.

A

Yeah. Steve, three questions. So, let's [indiscernible] (00:53:37) handle them one by one. Let me first maybe talk about – start with the last one on – as you know, we don't give guidance by segment. It's a reminder that really we – the portfolio is very important. And we gave you several examples in this call again on the importance of seeing Kenvue as one portfolio, focused on consumer health.

Your second question on anniversarying the discontinuation. As you heard from Paul, we are anniversarying our decision to suspend sales of personal care products in Russia this quarter. And regarding the other discontinuations of [ph] goods (00:54:27) that we are talking about, most of them were, I think, in last year, when we discontinued slower-moving [ph] goods (00:54:36) to free up capacity in our supply chain.

Having said that, we will continue to remain focused on the velocity of our [ph] goods (00:54:50) to make sure that our portfolio is as productive as possible. That's one of the [ph] tenets (00:54:57) of our partnership with our retailers, to make sure that we continuously work with them to optimize our assortment and make sure that our assortment is as productive as possible for them and for us.

So on the Skin Health and Beauty, and Essential Health segment, I would say that when you take out the impact of discontinuation and that's what many not have been fully reflected in external forecast, I feel very good about the underlying strengths of brands and of our equities across our portfolio. If you look at Skin Health and Beauty, with volume at low single-digits this quarter, with strong value realization, with some room to go in terms of distribution points in the US specifically, that makes us very confident in the future of this business.

Steve Powers
Analyst, Deutsche Bank Securities, Inc.

Q

Okay. Very good. Thank you. And if I could, just on the topic of investment levels, just curious for a little bit more additional perspective now that you've been operating independently. Just your comfort with planned investment levels and, to some extent, where you expect to prioritize those investments over the balance of the year.

Paul Ruh
Chief Financial Officer, Kenvue, Inc.

A

Steve, thank you for the question. Nothing has changed in terms of our investment philosophy as we are now an independent company versus before. What we strive to do is maximize return on our investment, and we continue to invest solidly in our brands, whether it is through advertising, through healthcare professional representations, promotional impact. So we balance all of that in the most effective way that maximizes the return on our investment. So we're very encouraged by the performance and we will continue to fuel the growth of our brands through a balanced investment approach.

Copyright © 2001-2023 FactSet CallStreet, LLC

Steve Powers
Analyst, Deutsche Bank Securities, Inc.
Q

Thank you very much.

Operator: Thank you. Our next questions come from the line of Navann Ty with BNP Paribas. Please proceed with your questions.

Navann Ty
Analyst, BNP Paribas Exane
Q

Hi. Good morning. Can you discuss and tell us more about the supply chain improvements that benefited the second quarter? And do you expect them to benefit the rest of the year? My second question is, and apologies if I missed it, can you detail the breakdown of pricing versus mix within the 9% value realization? And just a third one, if you could comment on Kenvue recent dialogue with J&J regarding monetizing the stake in Kenvue with the – has there been any change? Thank you.

Thibaut Mongon
Chief Executive Officer & Director, Kenvue, Inc.
A

Okay. So, on the price mix question, we don't disclose the mix between the two. On the supply chain improvement, whether we expect some benefits in the balance of the year, the answer is absolutely yes. We have invested in the more capacity and more resiliency of our supply chain. We continue to do that. As a result of that, we have significantly improved our service levels across the portfolio.

Are we fully where we want to be? Not yet. So it will continue to be a focus area for us to improve service levels. But we are pleased with the progress so far. And we would expect the back half of the year and beyond to continue to benefit from these investments we have made in our supply chain in terms of capacity, resiliency, automation all working in the right direction. That will also include – that also includes even stronger partnerships with our retail partners to do some joint business planning and make sure that we get the right signal demands to make sure that we operate our supply chain efficiently, but making sure that we have always products available on shelf for consumers when they need us.

Paul Ruh
Chief Financial Officer, Kenvue, Inc.
A

And, Navann, on your question about the split from Johnson & Johnson, at this point, you all saw that Johnson & Johnson has announced their intention for the next step of the separation of Kenvue. Unfortunately, we're very limited on the information that we can provide other than what has already been made public. I can tell you that we're fully ready. We've been operating independently, and we're very excited about the future.

Navann Ty
Analyst, BNP Paribas Exane
Q

Thank you.

Operator: Thank you. Our final questions will come from the line of Jeremy Fialko with HSBC. Please proceed with your questions.

Copyright © 2001-2023 FactSet CallStreet, LLC

Jeremy Fialko
Analyst, HSBC

Q

Hi. Jeremy Fialko, HSBC. Hey, thanks for fitting me in late in the call. Two questions on advertising and promotion. So, the first one is, could you give a bit more color on what your advertising spend did in the quarter, the extent to which it was up, and also whether it was [ph] up as a (01:00:48) percentage of sales? And then if you could talk a little bit about your plans for advertising spend in the second half of the year.

And then the second question related to that is, have you seen any change in competitive behavior? Can you give examples of where you are seeing your competitors put more into advertising or more into trade promotion as the raw material prices in some areas start to ease? Thank a lot.

Thibaut Mongon
Chief Executive Officer & Director, Kenvue, Inc.

A

Yeah, Jeremy, thank you for your question. I will not comment on what other companies are doing. We live in a competitive environment. What I would tell you is that we continue to invest behind our brands. Remember that our business model relies on demand generation, delivered through different means. One is direct-to-consumer demand-generation activities. Another big part of our model relies on the healthcare professional recommendation. And so on both fronts, we continue to invest. We are on track with our investments and we intend to continue to invest to that level.

We do not disclose advertising at a quarter level. We'll disclose it on a full-year basis. But you should always remember that for Kenvue, advertising expenses is only one part of our demand-generation model. Another part and important part is linked to healthcare professional recommendation. But we are absolutely committed to invest behind our brands, that what we have been doing in the first half and we intend to continue to do it in the back half of the year.

Jeremy Fialko
Analyst, HSBC

Q

Okay. Thanks very much.

Thibaut Mongon
Chief Executive Officer & Director, Kenvue, Inc.

A

Thank you, Jeremy.

Operator: Thank you. We have reached the end of our question-and-answer session. I would now like to turn the floor back over to Thibaut Mongon for any concluding comments.

Thibaut Mongon
Chief Executive Officer & Director, Kenvue, Inc.

So thank you for this good conversation. And thank you, everyone, for participating in today's call. Once again, as you heard from Paul and I, we are very pleased with the strong results we achieved and our teams achieved around the world this quarter. They reinforce the power of our iconic brands, the strength of the Kenvue operating model. So, very strong debut for Kenvue as a newly publicly traded company and we look forward to connecting with all of you again and keeping you updated on our continuous progress on future earnings calls. So, have a great day and thank you, everyone.

Copyright © 2001-2023 FactSet CallStreet, LLC

Paul Ruh
Chief Financial Officer, Kenvue, Inc.

Thank you.

Operator: This concludes today's conference. Thank you for your participation. Have a wonderful day. You may now disconnect your lines.

Disclaimer
The information herein is based on sources we believe to be reliable but is not guaranteed by us and does not purport to be a complete or error-free statement or summary of the available data. As such, we do not warrant, endorse or guarantee the completeness, accuracy, integrity, or timeliness of the information. You must evaluate, and bear all risks associated with, the use of any information provided hereunder, including any reliance on the accuracy, completeness, safety or usefulness of such information. This information is not intended to be used as the primary basis of investment decisions. It should not be construed as advice designed to meet the particular investment needs of any investor. This report is published solely for information purposes, and is not to be construed as financial or other advice or as an offer to sell or the solicitation of an offer to buy any security in any state where such an offer or solicitation would be illegal. Any information expressed herein on this date is subject to change without notice. Any opinions or assertions contained in this information do not represent the opinions or beliefs of FactSet CallStreet, LLC. FactSet CallStreet, LLC, or one or more of its employees, including the writer of this report, may have a position in any of the securities discussed herein.

THE INFORMATION PROVIDED TO YOU HEREUNDER IS PROVIDED "AS IS," AND TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, FactSet CallStreet, LLC AND ITS LICENSORS, BUSINESS ASSOCIATES AND SUPPLIERS DISCLAIM ALL WARRANTIES WITH RESPECT TO THE SAME, EXPRESS, IMPLIED AND STATUTORY, INCLUDING WITHOUT LIMITATION ANY IMPLIED WARRANTIES OF MERCHANTABILITY, FITNESS FOR A PARTICULAR PURPOSE, ACCURACY, COMPLETENESS, AND NON-INFRINGEMENT. TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, NEITHER FACTSET CALLSTREET, LLC NOR ITS OFFICERS, MEMBERS, DIRECTORS, PARTNERS, AFFILIATES, BUSINESS ASSOCIATES, LICENSORS OR SUPPLIERS WILL BE LIABLE FOR ANY INDIRECT, INCIDENTAL, SPECIAL, CONSEQUENTIAL OR PUNITIVE DAMAGES, INCLUDING WITHOUT LIMITATION DAMAGES FOR LOST PROFITS OR REVENUES, GOODWILL, WORK STOPPAGE, SECURITY BREACHES, VIRUSES, COMPUTER FAILURE OR MALFUNCTION, USE, DATA OR OTHER INTANGIBLE LOSSES OR COMMERCIAL DAMAGES, EVEN IF ANY OF SUCH PARTIES IS ADVISED OF THE POSSIBILITY OF SUCH LOSSES, ARISING UNDER OR IN CONNECTION WITH THE INFORMATION PROVIDED HEREIN OR ANY OTHER SUBJECT MATTER HEREOF.

The contents and appearance of this report are Copyrighted FactSet CallStreet, LLC 2023 CallStreet and FactSet CallStreet, LLC are trademarks and service marks of FactSet CallStreet, LLC. All other trademarks mentioned are trademarks of their respective companies. All rights reserved.