Corrected Transcript

08-Feb-2024

Kenvue, Inc. (KVUE)

Q4 2023 Earnings Call

CORPORATE PARTICIPANTS

Tina Romani
Head-Investor Relations, Kenvue, Inc.

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

Paul Ruh
Chief Financial Officer, Kenvue, Inc.

OTHER PARTICIPANTS

Steve Powers
Analyst, Deutsche Bank Securities, Inc.

Anna Lizzul
Analyst, BofA Securities, Inc.

Andrea Teixeira
Analyst, JPMorgan Securities LLC

Filippo Falorni
Analyst, Citigroup Global Markets, Inc.

Alec Legg
Analyst, Canaccord Genuity LLC

Navann Ty
Analyst, BNP Paribas Securities Corp.

Peter Grom
Analyst, UBS Securities LLC

MANAGEMENT DISCUSSION SECTION

Operator: Hello and welcome to the Kenvue Fourth Quarter and Full-Year 2023 Earnings Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. 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.

Tina Romani
Head-Investor Relations, Kenvue, Inc.

Good morning, everyone. I am pleased to be joined today by Thibaut Mongon, Chief Executive Officer; and Paul Ruh, Chief Financial Officer.

Before we get started, I'd like to remind you that today's call includes forward-looking statements regarding, among other things, our operating and financial performance, market opportunities and 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've also referenced 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 US GAAP. These non-GAAP financial measures should be viewed in conjunction with the most comparable GAAP financial measures. 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 the IR website.

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

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

Thank you, Tina, and thank you to everyone for joining us today. 2023 was a year of transformational change for our company and for our 22,000 Kenvuers around the world. Our teams accomplished a tremendous amount successfully standing up Kenvue as an independent public company, while continuing to drive profitable growth. While we accomplished a lot in 2023, we know we have areas where we need to increase our focus and improve.

So, as we enter 2024, we have identified three key priorities that will enable our continued transition as an independent company, while continuing to grow the business. This year, we will reach more consumers with a stronger focus on our 15 priority brands, free up resources to invest behind our brands and foster a culture that rewards performance and impact.

In 2023, we delivered on our long-term value creation algorithm centered around profitable growth, durable cash flow generation and disciplined capital allocation. Our 5% organic growth was broad based across all three segments, all four regions, and all eight product categories. Self Care delivered another banner year of 8.4% organic growth, sustaining the momentum we have built over the past several years, resulting once again in strong revenue growth and share gains.

Essential Health grew ahead of our long-term expectations, with 3.6% organic growth, while continuing to execute our strategy to drive gross margin enhancement through successful value realization and premiumization initiatives. And in Skin Health and Beauty, organic growth was 1.8%, less than we expected, mostly due to specific missteps around in-store execution in the US, which we are actively addressing and I will give you more details about that in just a moment.

We continued our successful multiyear program to expand gross margins in 2023 with 30 basis points of expansion through thoughtful revenue management initiatives and relentless supply chain optimization. This further demonstrates that we have the capabilities and strategies in place to drive profitable growth even in a dynamic and uncertain macro backdrop. And finally, we utilized our strong free cash flow to initiate our dividend program, delivering on our commitment of returning cash to shareholders.

Pivoting to Q4 specifically, let's now have a look at the performance of each one of our segments, and

I'll start with Skin Health and Beauty, as our disappointing fourth quarter's performance on top line clearly fell short of expectations both yours and ours. Looking by region is evident where we have strengths to leverage and where we need to improve. EMEA and Latin America ended the year strong. In EMEA, organic growth improved sequentially quarter-over-quarter on positive consumer response to innovation launch earlier in the year.

In Germany, for example, Neutrogena Hydro Boost has fueled growth ahead of the category. In Latin America, where we continued to grow double-digits, Neutrogena Face doubled sales in the quarter, supported by the successful launch of Hydro Boost Refill. In China, weaker consumer demand continued to pressure the overall category and our Skin Care brands.

However, it is our performance in the US that did not meet our expectations. As we've talked with you about, we had an ambitious fourth quarter recovery plan for the US, but frankly, the execution of this plan was disappointing. Restoring Neutrogena to the level of growth we know the brand is capable of is a priority for me and for the team. Over the past several months, I've spent significant time with our team in the US and engaged with our customers and the diagnosis is clear. We know our brand equities are healthy and our products resonate with consumers in the category.

However, we must improve our in-store executional capabilities to drive stronger demand for our brands, better communicate our value proposition to consumers, launch innovation successfully, and finally support our brands with a robust level of marketing investment. In early December, we shared that Jan Meurer, previously our Chief Growth Officer would assume the position of Head of North America. With Jan's deep knowledge of our portfolio and our growth strategy, he has already outlined with his team a focused roadmap that they are executing to strengthen capability and stabilize the business.

Specifically, the recently redesigned North America Skin Health and Beauty leadership team is taking action in three areas. First, we are strengthening in-store presence and prominence through better planning with customers, enhanced packaging that clearly articulate dermatological benefits and more prominent in-store brand activation.

Second, we are enhancing consumer engagement through distinct and consistent brand experiences delivered with the appropriate level of reach and frequency, supported by a revamped marketing effort. And third, we are amplifying innovation through bolstered demand generation activities with consumers and healthcare professionals.

This will not be an overnight shift. It will take time for these actions to generate impact on our results, which we expect to occur in the second half of the year. But we are confident we've correctly diagnosed our weaknesses and are making the necessary changes. Additionally, we believe our strong partnerships with retailers, coupled with increased investment and a higher level of precision in our execution will enable us to stabilize the business in the US and deliver stronger growth in 2024.

So, now turning to the rest of the portfolio. In Self Care, our largest segment, it is a very different picture. We ended the year in line with our expectations, delivering organic growth of 8.4% in 2023, on top of 10.9% growth in 2022. We continued to demonstrate our leadership in the fourth quarter, reading the season accurately and activating our brands with precision.

Adult Tylenol continued to gain share in the US, with 78 consecutive weeks of share growth, even as category volumes declined as expected, with roughly 15% lower incidence levels this cold and flu season compared to 2022. And again, this quarter, we strengthened our leadership positions with relevant innovation, premiumization and leading healthcare professional endorsement. So, looking to 2024, we intend to continue to deploy this winning formula around the world.

And finally, in Essential Health, performance was led by Oral Care and Women's Health, while Baby Care shipments were less robust this quarter. Oral Care grew 8% with organic growth in all regions, including the US, where Listerine, despite being around 5 times bigger than our next competitor, remains the most productive brand in category and has now delivered 21 weeks of double-digit consumption growth. The launch of Listerine Gum Therapy has done extremely well as the largest innovation in the US mouthwash category in 2023, reaching one point of share in under 12 months just for this code and we have great innovation planned in 2024, which brings me to our priorities for this year.

2024 will be our first full year as an independent company, and you will see us starting to operate differently than what we have in the past, which will enable us to unleash the full potential of our portfolio. As I shared earlier, we have three priorities; First, we are going to reach more consumers with a strong focus on our 15 priority brands. We are strengthening our plans to build attractive, consistent brand experiences for our 15 priority brands, which represent two-thirds of our growth. With strong retailer partnership, we will bring to market relevant innovation across our segments, driving mental availability, but also ensuring physical availability where and when our consumers need us.

We are also raising our bar in terms of activation excellence in our focus markets, starting with the US. So, you are going to see our top brands with a higher level of activation in 2024 as we fuel growth. In Self Care, we have strong plans to bring forward science-based category leading innovations to meet the needs of consumers, maintain category leading healthcare professional recommendation and ultimately drive continued share gains.

And in Skin Health, we will stabilize the business in the US with the plan I outlined today. Outside the US, in China, we will monitor consumer sentiment and thoughtfully calibrate our investment accordingly. While in the rest of the world, we will continue to fuel our growth in Europe and Latin America. This requires investment and we have plans to invest more in brand activation in 2024, both with consumers and with healthcare professionals. Continued margin expansion and efficiencies across the business will fuel this investment, which brings me to our second priority, which is to free up resources and invest in our brands.

We expect gross margins to expand at an accelerated pace compared to 2023, which will fund increased investment in our brands. You've heard me say that over the past several years, we have been going to the gym on gross margin. And through this work, we will continue to strengthen this muscle, driving efficiency across our supply chain, managing our mix and implementing thoughtful revenue management initiatives.

In addition, as we exit our transition services agreements with Johnson & Johnson, we are not simply replicating legacy processes, but rather intentionally reinventing our ways of working. This includes implementing modern systems designed specifically to meet the needs of our new company and enable speed, agility, accuracy and a lower cost base.

For example, we are implementing a new integrated business planning process that will improve our demand forecasting capabilities and services levels through better integrating and automating retailer data and demand sensing. This plan will be implemented throughout the next six quarters with the majority occurring this year. All of this will be enabled by our teams around the world, which leads me to our final priority fostering a culture that rewards performance and impact.

In 2024, we are deploying our new Kenvue performance management plan with clear goals and a heightened sense of accountability for every Kenvuer. The plan introduces a new incentive program for all leaders encouraging and rewarding impact on the four drivers of shareholder return, top line growth, margin expansion, earnings growth and free cash flow. Further, we are streamlining decision making across the organization, including in my own leadership team and most importantly, we are creating a culture based on our Kenvue values, where everyone has a strong sense of purpose and belonging, an opportunity to grow and is rewarded for impact.

In closing, we made significant progress in 2023, and while we still have a lot of work ahead of us, our priorities are clear in 2024 and give me confidence in our ability to deliver our plan for the year. I am deeply grateful to our talented teams for their energy and passion to work together as one team to build our new company. It is inspiring to see 22,000 Kenvuers rally behind one purpose helping people realize the extraordinary power of everyday care, and I know they will make us successful this year and into the future.

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

Paul Ruh

Chief Financial Officer, Kenvue, Inc.

Thank you, Thibaut, and good morning, everyone. 2023 was a transformational year where we delivered strong top line, gross margin expansion and robust cash generation, even in the face of a dynamic macro backdrop and significant cost headwinds. I'll start with an overview of results for fourth quarter and the year, then close with our outlook for 2024.

As you heard from Thibaut, fourth quarter performance did not meet our expectations, as in-store execution fell short of plan in the US Skin Health and Beauty business. While we don't expect recovery overnight, I am encouraged by what the new leadership team has accomplished in the past couple of months, diagnosing the issue and putting an action plan in place that is already underway.

Now, getting to results. Fourth quarter organic sales declined 2.4%. It's important to consider our fourth quarter performance in the context of 6.2% organic growth last year, where we experienced outsized growth in Self Care, primarily driven by unprecedented demand for our OTC products. In this context, fourth quarter growth was 3.8% on a two-year stack basis. Value realization contributed 5.8 points to fourth quarter growth, offset by a volume decline of 8.2 points.

Let me deconstruct the volume decline, as there are several unique drivers impacting volume that do not reflect the underlying strength of our brands. First, about three points come from lapping an early and strong cold, cough and flu season that drove double-digit organic growth last year. Further, this year saw a later start to the season, combined with approximately 15% lower incidence levels.

As we've shared previously in parts of our OTC business, volume is characteristically linked to incidence levels, which can go up or down in any given season. For Kenvue, our focus is to be prepared to serve our consumers, while continuing to gain share regardless of what the season may bring, and that is what you saw from us this quarter.

Second 2022 product discontinuations negatively impacted the quarter by about one point. Of note, as of the fourth quarter, we have fully lapped the product discontinuations and do not expect to see an impact next year. Lastly, trade inventory reduction accounted for about one point, as retailers tighten their inventory levels.

In sum, a little over five points of the volume decline is attributed to idiosyncratic elements of the fourth quarter, with the remaining three points mainly attributed to continued softness in China and our underperformance in US Skin Health and Beauty we have discussed. For the full year, net sales grew 3.3% to $15.4 billion. Organic growth of 5% reflects a value realization of 7.7% and a volume decrease of 2.7%, of which, approximately two points is attributed to the 2022 product discontinuations we've discussed all year and the suspension of personal care products in Russia through the first half.

When normalizing volume to exclude these two distinct items, volume was slightly down on nearly eight points of value realization demonstrating the low elasticity of our brands. You also see the power of the portfolio in the fact that private label penetration remained relatively flat throughout the year, even as consumers look to be trending down in other categories. These dynamics give us confidence in our ability to improve volume growth as we progressed through 2024.

Moving to gross margins. Fourth quarter gross margin expanded 220 basis points to 59.5%, and full year adjusted gross margin increased 30 basis points to 58.4%. As we've discussed with you previously, there are some non-recurring items in our results, as we refine our accounting and reporting methodologies to be more comparable to our peers.

Impacts from these refinements were a benefit of approximately 50 basis points in the fourth quarter and 10 basis points for the full year. Inflationary headwinds moderated during the fourth quarter, as positive trends in logistics offset ongoing pressures in energy and wage inflation, while FX continued to pressure gross margin by about a point during the quarter and for the full year.

Turning to adjusted operating income. Fourth quarter adjusted operating income margin expanded 190 basis points and full year adjusted operating income margin was flat. Adjusted operating income margin benefited from the non-recurring items I just spoke about, by about 180 basis points for the quarter and 70 basis points for the year. For taxes, the fourth quarter adjusted effective tax rate was 15.8%. The decrease versus prior year is primarily the result of tax law changes that negatively impacted 2022, the release of tax reserves mostly due to statute of limitations expiring and benefits from effective tax planning.

The full year adjusted effective tax rate was 23.4%. The decrease in the adjusted effective tax rate versus prior year is primarily due to the release of tax reserves. And finally, adjusted net income was $586 million for the quarter and $2.4 billion for the year. Adjusted diluted earnings per share was $0.31 for the quarter and $1.29 for the year, including an approximate $0.03 benefit from the non-recurring items I spoke about.

Turning to cash and capital allocation. For the year, we generated $2.7 billion in free cash flow. It is worth noting that free cash flow benefited from separation-related items and the timing of working capital at the end of the year. During the year, we demonstrated our commitment to disciplined capital allocation as outlined during our IPO. We strengthened our balance sheet, reduced our leverage and returned cash to our shareholders. We have executed on our capital allocation priorities, including a 64% dividend payout ratio and reducing our gross leverage from 2.5 times to 2.2.

As you model 2024, it will be important to consider the working capital timing benefit in 2023, as well as the fact that we will be paying a full year of dividends and have a full year of interest expense, which brings me to the outlook for 2024. First, I want to echo Thibaut's point that we have strong conviction in our ability to execute our plan for the year. We have a clear strategy in place, and in 2024, we are focused on reaching more consumers, optimizing the way we work to invest behind our brands, and rewarding performance and impact.

We will drive efficiencies through further investments in supply chain, technology and a recently implemented integrated business planning process. We will then redeploy the dollars generated from these operating efficiencies into consumer facing brand support. Volume growth and market share capture will be of particular focus for this incremental investment. And finally, we will accelerate the exit of TSAs establishing a new operating infrastructure that meet our needs as an independent company.

In summary, it will be a year focused on enhanced engagement with consumers, while also continuing our transition to a truly standalone entity. In 2024, we expect to achieve organic growth in the range of 2 to 4%. We expect quarterly organic sales growth to improve sequentially, as we progress through the year and as compares ease, and as impacts all of the strategic initiatives that Thibaut outlined begin to materialize.

We expect certain headwinds to continue in the first half of 2024 such as a lower flu season versus last year, softness in China and persistent impacts of in-store issues with our Skin Health and Beauty portfolio. However, as we accelerate investment behind our brands, particularly focused on in-store presence and prominence, enhancing consumer engagement and amplifying innovation, we expect to see growth accelerate as these actions begin to have more of an impact in the second half of the year.

We also think it's prudent to acknowledge that 2024 could be another volatile year, as economic and geopolitical headlines impact consumer confidence. The lower end of our guidance reflects the potential for a weaker consumer and the possibility for unknowns in our seasonal businesses.

Looking to the first quarter, we expect organic growth to be about flat. While we don't plan to guide quarterly as part of our normal practice, given the outsized performance in the first quarter of 2023, which benefited from non-recurring retailer inventory rebuilds, combined with a strong cold, cough and flu season, we thought it would be helpful to provide perspective for Q1.

Moving down the P&L, we expect to maintain a healthy gross margin profile with adjusted gross profit margin expected to be closer to 2021 levels. We expect adjusted operating income margin to be slightly below last year, while the operating efficiencies we spoke about begin to materialize, partially offsetting the increased investment in our brands that includes an approximately 15% increase in our marketing spend, as well as the absorption of a full year of public company costs.

Regarding other guidance items and EPS, at current spot rates, we expect translational foreign currency impact of about 1 point to reported net sales. We expect net interest expense to be approximately $400 million, evenly split across quarters. We expect an adjusted tax rate of 25.5% to 26.5%, which reflects changes in tax laws, primarily the enactment of Pillar Two legislation adopting the OECD's global minimum tax.

Regarding EPS, assuming a full year 2024 weighted average share count of 1.92 billion shares, we expect adjusted earnings per share to be in the range of $1.10 to $1.20. This range assumes about a $0.04 foreign exchange headwind based on current rates. To show a comparable view across years, we've included a slide in our presentation that outlines a rebased starting point for 2024. In other words, a like-for-like view, had we been a public company for the entirety of 2023. This rebased view includes a full year of public company costs, a full year of interest expense, a normalized tax rate and share count. At the midpoint, our earnings per share guidance is about flat when comparing to the rebased 2023 adjusted diluted EPS.

In closing, we are proud of what we achieved in our first year as Kenvue, while also acknowledging challenges within our Skin Health and Beauty business that we have plans in place to improve. As for 2024, our priorities are reaching more consumers, freeing up resources to invest behind our brands and fostering a culture that rewards performance and impact.

Thank you. And with that, we will take your questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. At this time, we will 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. Our first question comes from the line of Stephen Powers of Deutsche Bank. Please go ahead.

Steve Powers
Analyst, Deutsche Bank Securities, Inc.

Q

Yes, thank you and good morning, everybody. Maybe I can start just on the top line. I think just given the momentum that we have exiting 2023, I think some people could look at the call for flat organic in the first quarter, given the comparisons is as ambitious and also the 2% to 4% for the full year as potentially ambitious. So, maybe just a little bit more color on your visibility to that organic forecast and some of the building blocks that we should be looking for as we get into the year.

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

A

Yes, sure. Good morning, Steve. Regarding your question on top line and our ambitions for 2024, we continue to see our categories growing 3% to 4% in 2024 and beyond. Our guidance for 2024 reflects a range of scenarios. It does embed the sequential improvement as we move through the year and as we love the unusual compares of 2023 that we talked about, but also the fact that we expect our increased investment and the plans that I outlined earlier generate impact, especially in the second half of the year. So, that's what makes us confident in our plans for the year.

But we also think it's prudent to acknowledge some of the dynamics at play in 2024, and that's why our guidance also contemplates certain headwinds that could materialize suggests further softness in China, the time it will take to improve in-store execution in Skin, as well as a possibility for unknowns in our seasonal businesses. But I reiterate that we are confident in our plans for the year.

Steve Powers
Analyst, Deutsche Bank Securities, Inc.

Q

Okay. Very good. Very good. And then, maybe this is for Paul on the margin forecast. I guess, just some clarifications that the press release talked about the strong gross margin outlook that you talked about just a few minutes ago as well. And then, but it contemplates 50 basis points of FX headwinds. Just wanted to clarify, is that 50 basis points all within SG&A? And if maybe you can give some color as to the drivers of that transactional headwind in SG&A, number one? And number two, talked about year-over-year rates of increase in advertising. I'm just – I guess I'm a little curious as to where we finished 2023. I don't know if you can share some, like it's going to be in the K, but maybe just give a little color on where advertising finished as a percentage of sales in 2023 and how you expect that to trend into 2024? Thank you.

Paul Ruh
Chief Financial Officer, Kenvue, Inc.

A

Thank you for the question, Steve. Regards to your first part of the question, yes, we're very pleased with our gross margin trajectory as you know, and Thibaut mentioned, we have developed a muscle in terms of continued sustained gross profit margin enhancement. And the FX that I talked about is embedded in gross margin and also in SG&A, but primarily in gross margin.

To your second question, year-over-year rates of advertising, we will disclose advertising in our K, advertising year-over-year versus 2022 was slightly down. But I can tell you that we have very strong plans to increase our advertising. I mentioned 15%, where approximately $300 million more that will fuel the progressive growth enhancement that Thibaut talked about.

Steve Powers
Analyst, Deutsche Bank Securities, Inc.

Q

Okay. Very good. Thank you so much.

Operator: Thank you. Our next question comes from line of Anna Lizzul of Bank of America. Please go ahead.

Anna Lizzul
Analyst, BofA Securities, Inc.

Q

Hi. Good morning. Thanks so much for the question. I wanted to ask on Q4 Skin Health and Beauty. I know you said the volume weakness was mostly driven by US. But can you be more specific on how much of the weakness was driven by China on Dr.Ci:Labo? And are you expecting this to recover in Q1 in terms of your guidance?

And then also in the US on Skin Health and Beauty, in Q3, you had highlighted some innovation in Sun Care for Neutrogena which helped last quarter, but volumes saw a significant deceleration here in Q4. So, in terms of the recovery in distribution, where are you at in your conversations with retailers? Thanks.

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

A

Yeah. Good morning, Anna. So, let me answer your question on Skin Health and where – what do we see in China in the US. So, in China, we saw weak demand for our brands, especially Dr.Ci:Labo due to temporary PR issues that you are familiar with. We believe that these PR issues are dissipating as we speak. But we have – we are going to be thoughtful about continuing to monitor how the categories are doing, how the consumer sentiment is going in China.

And while we are going to see gradual recovery in 2024, we are not contemplating in our guidance a strong recovery, especially in the first half of the year in our Skin Care brands in China. I remind you that China is about 7% of our revenue as a total company that we have, our total portfolio we're represented in China and Skin Health is not the largest part of our portfolio in China.

Regarding the US, we had an ambitious recovery plan in Q4. And as I said in my prepared remarks, we – the outcome of this plan was not what we expected. What's good is that we understand exactly what is going on. Our brands are healthy Neutrogena, for example is the – has a very high penetration in the US. Our online sales are doing well, we grew double-digit on Amazon with a brand like Neutrogena for example. So, what we really need to improve is execution. And Jan and his team are laser focused on improving this execution, and it's going to be broad based if it goes beyond just distribution, but it starts with our in-store presence and prominence.

And here, I'm talking about better on shelf execution, increasing displays, increasing fixtures, updating the packaging where needed to make our range easier to shop, making sure that we have the price pack architecture everywhere, and ultimately making it easier for our customers, for our consumers to shop in-store for their needs.

It's also about engaging with consumers in a bigger way than what we did in 2023. We have industry leading ally on advertising. So, really 2024 is about increasing the reach and frequency of our engagement activities and brand activation activities with both consumer and healthcare professionals. We are going to put more product in the hands, think about samples because we know that once they try our product, they love them.

And lastly, we will deploy innovation at a bigger scale, amplifying our 2023 programs, and we are excited about what we have in the plan for 2024 in terms of innovation and retailers are excited about it as well. So, in a nutshell, it's a heightened focused – heightened focus, more precision around execution, more presence with consumers, amplified innovation. As I said, it's not going to happen overnight. Recovery will not be linear, but we are confident that this stronger plan will help stabilize the business and with, again, a higher level of precision in execution, we expect growth to – in 2024 to definitely be ahead of 2023.

Anna Lizzul
Analyst, BofA Securities, Inc.

Q

Great. Thanks. That's super helpful. And if I can ask a follow-up on Self Care. In Q4, just outside of cold, cough and flu, could you comment on rest of the portfolio? I think you had mentioned last quarter, you were seeing some gains in your other categories or I was wondering, if there are some bright spots there or if they were also somewhat of a drag in the quarter? Thanks.

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

A

Yes, it's a great question because we talk a lot about the season and Paul described really well the dynamics there and how pleased we are with our performance during the season. But the strength of our leadership position doesn't happen by accident. It's outcome of a lot of work that permeates throughout the entire Self Care portfolio, and that's true for analgesics, but it's also true for allergy, for Digestive Health, for Smoking Cessation.

And in other areas of the business, we are very pleased with our performance. We see continued performance in Smoking Cessation, good performance in Digestive Health. Allergy, while we had lower incidences, strong share gains, our innovation like Zyrtec Chewables continues to do very well. So, our strong performance in Self Care is broad based to grow the portfolio.

Anna Lizzul
Analyst, BofA Securities, Inc.

Q

Great. Thank you so much.

Operator: Thank you. Our next question comes from line of Andrea Teixeira of JPMorgan. Please go ahead.

Andrea Teixeira
Analyst, JPMorgan Securities LLC

Q

Thank you, operator. And good morning, everyone. I have a question and a follow-up. Thibaut, can you elaborate more on the time of the displays you just mentioned, the fixtures and the shelf space recovery in the US? In particular, ahead of the spring, I heard that a large retailer is probably moving some of the beauty resets into the summer. Is that impacting your expectations, number one?

And number two, like you had mentioned, you are seeing progress throughout the year, which obviously has to do also with the comps. But is it fair to assume flat to slightly a negative Q1 or first half of the year for organic turning positive, potentially reflecting Q2? And then, the second half of the year is where we should be able to see significant progress on that.

And a follow-up, in terms of the shipments against consumption on POS, I know it's hard to really focus on Nielsen, but unfortunately, that's what we can see in terms of consumption. Should investors expect that, that track channel data will remain weak for most of the first half of the year and should start to see better trends towards June and July, given the resets or you are confident that with the innovation that you called upon, all the work that you have done to simplify the SKUs and also lapping those SKU simplifications, which is probably going to be a tailwind, all else equal. So, should we be seeing slightly better than a progress as you look into the first quarter against fourth quarter?

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

That's a big question, Andrea, so – but it's an important one. So, let me unpack your question in terms of phasing in what we would plan – what we plan to see unfolding in Skin Health and Beauty for the year. First of all, I think the way you are describing the year is directionally correct.

We are not guiding by segment by quarter, but I think the way you described the phasing throughout the year is directionally correct and in line with the way we see it, given the noise you have in the comps, you talked about the impact of discontinuation, the suspension of our sales in Russia in the first half of the year, these are going to be tailwinds for – in terms of growth rate. But we have headwinds like, for example, in Q1, the large replenishment we saw in retailer inventory. Once we got out of the majority of our supply chain issue in the back half of 2022, that's going to be a headwind for us.

So, if – but if you exclude these comps and dynamics, what we are laser focused as an organization is deploying the plan that I just highlighted and making sure that we execute with precision. That does include the stronger presence in-store, but that also includes amplifying our reach to consumers and healthcare professionals and so that's where you will have different phasing of the impact of these different aspects of the plan throughout the year.

I can tell you that we are executing our higher investment plan in terms of media as of January. So, you will see a lag as we all know between the spend in advertising and the consumption that has already started in terms of in-store activation, that will happen throughout the year depending on the rhythm each retailer has.

So, we are laser focused on executing these building blocks. You – I also mentioned that we are doing very well online where the brand experience is very strong and we grew a brand like Neutrogena double-digit. That's something that is not easy for you to track, but that continues to be a source of strength, strength for us. And so, we are laser focused on the tracked channel, if you will, which is what you see and which is where we have the biggest area for improvement.

Andrea Teixeira
Analyst, JPMorgan Securities LLC
Q

And then – that's helpful. If I can squeeze one question for Paul in terms of like the cadence for gross margin. You did call out the TSA, TMA phasing, and I understand it's about a $100 million potential savings. Is that fully included in potentially second half? Should we think about, okay, part of it being factored in this outlook for operating margin being flattish, given all the investments that you're making? So, in other words, whatever you gained this year is going to be reinvested into marketing and the 15% that you called out in A&P. And then, you're still going to have more benefit into 2025, is that the way we should be thinking?

Paul Ruh
Chief Financial Officer, Kenvue, Inc.

A

Yeah, directionally correct, Andrea. Thank you for your question. As you know, gross margin is the result of several elements, including value realization. We have about 60% of the value realization as a carryover from last year, and we will take surgical pricing in different year to another 40%. So, that's one in addition to premiumization and mix, and also the efficiencies that we talked about.

In addition, of course, you have the inflation and Forex impacts, inflation is still positive, but it's coming down. So, you will see a progression – to contribution to gross margin enhancement in terms of that inflation. We are executing TSAs as we speak. Day by day, we're talking about hundreds of TSAs and that impact both our gross profit line and also our operating income line. And those are spread throughout the year, where will you – you will be seeing is the investment starting right out of the gate.

Some of that will take – will bear fruit. Later, if it's more equity advertising or promotional spend will deliver the benefits in the shorter term. So, that's how we see the cadence. So, it's definitely more of a – it's a balance with an enhancements towards the second half and we intend to continue that into 2025. We're not guiding into 2025, but that philosophy of heightened investment should continue beyond 2024.

Andrea Teixeira
Analyst, JPMorgan Securities LLC

Q

Thank you.

Operator: Thank you. Our next question comes from line of Filippo Falorni of Citi. Please go ahead.

Filippo Falorni
Analyst, Citigroup Global Markets, Inc.

Q

Hey, good morning, everyone. I wanted to go back to the question on marketing investment. I think the initial plan was to spend more in 2023, but I think, Paul, you said advertising was slightly down in 2023. So, maybe what drove, I guess, the decline? And then, as you think about the investment into 2024, can you give us a little more concrete examples of where you're spending the advertising by product, by category and your expected ROI on those investments? Thank you.

Paul Ruh
Chief Financial Officer, Kenvue, Inc.

A

Yeah. Let me start with the first part of the question and maybe I'll turn over to Thibaut for the second one. Particularly, the investment in advertising, yes, was slightly down year-over-year and that was primarily the result of a reduction in Asia Pacific, where we did not see investable propositions in – towards the back half of the year. But looking into 2024, investing in our brand is a key priority to further fuel the growth. I mentioned, approximately 15%, it's about $300 million more, we want to start out of the gate. And the most important thing is our philosophy of maximizing ROI is what we are going after. And that it will be applied to all the categories as long as we see those investable propositions and we maximize ROI across the portfolio. Thibaut, anything you want to add?

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

A

Yes. And Filippo, this addition of this overall investment is broad based to activate our brands with consumers and with healthcare professionals. So, I remind you that our advertising line only captures part of our investment to activate our brands, as everything that's related to healthcare professional engagement is not reflected in that line. In 2024, we are going to increase our investment in both areas and we are going to apply this additional investment across our portfolio, but very focused behind our 15 priority brands that I highlighted in my prepared remarks. So, it's a very focused plan that with more fuel.

Behind a philosophy that Paul highlighted of extremely high ROI, we have, I believe, industry-leading ROIs on our marketing investment. This is a capability that we have developed over the years with state-of-the-art analytics systems and capabilities. So, we intend to continue to use this disciplined approach to deploy a higher level of dollars and so that's once again what makes us confident in our ability to deliver the plan we outlined this year.

Filippo Falorni
Analyst, Citigroup Global Markets, Inc.

Q

Got it. Thank you. And then, if I could follow up quickly on the Skin Health and Beauty segment. That is a segment that has been underperforming over the last couple of quarter, you mentioned obviously this quarter the challenges. I guess, can you review a little bit more like what are you changing in the way you manage this business and what gives you the confidence in the improvement as you got through 2024 for Skin Health and Beauty? Thank you.

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

A

Yes, Filippo, what's very clear about Skin Health and Beauty is that the opportunities to improve are really isolated to two areas, two important areas, but two areas. One is the China market and the other one is, I would say, in-store performance in the US. So, our plan is laser focused to improve our performance in these two areas, while we continue to fuel growth in the other areas where it's working well, namely Europe and Latin America.

So, in China, it's not entirely in our hands. And that's why I talked about our position to thoughtfully track how the categories are developing in that market, make sure that we do not invest ahead of the curve to get a strong return. So, we are monitoring consumer sentiment and as we see the right conditions for our Skin Care brand in China, we will invest appropriately.

In the US, in-store, what's different in 2023 – in 2024 compared to 2023 is the higher level of precision in the execution, the heightened focus. I can tell you that many people in the organization are focused on this plan and the plan that Jan, our new leader for North America and his team with the support of the entire organization have put together and started executing as we speak, is very precise, and his heightened focus, increased level of precision and higher level of investment. Again, we would expect this to deliver stronger results, especially in the back half of the year. It's not going to happen overnight, but over time, we are confident that we are going to see the full potential of our brands being unleashed in that market.

Filippo Falorni
Analyst, Citigroup Global Markets, Inc.

Q

Thank you. I'll pass it on.

Operator: Thank you. Our next question comes from Susan Anderson of Canaccord Genuity. Please go ahead.

Alec Legg
Analyst, Canaccord Genuity LLC

Q

Hi. Good morning. Alec Legg on for Susan. A lot of color, so thank you for that. But on the gross margins, you said you expected to get to fiscal 2021 levels. I guess, what are the key drivers of those gains in fiscal 2024 versus 2021? And how should we think about how that progresses through the year? Thank you.

Paul Ruh
Chief Financial Officer, Kenvue, Inc.

A

Yes, thank you, Alec. And it's a great question and one that I'm happy to talk about because this is an area of strength for Kenvue. And we've been on this journey of increasing our margins and enhancing our margins through a complete suite of levers that includes value realization and efficiencies throughout the value chain since 2019. I would actually say that we are managing our gross margin profile in a very competitive way, and I would say above average compared to our industry peers.

If I think about the dynamics of the balance of the year, I would continue to see all those things, continued value realization and mix management, premiumization. We are starting to see some of the tailwinds of inflation now that were previously headwinds, although we still have Forex something that we are mindful of, the efficiencies that we have in place and the discipline that we have in terms of managing that value chain will allow us to continue to in this journey of driving gross margin enhancement.

Alec Legg
Analyst, Canaccord Genuity LLC

Q

Thanks. And then, just a potentially quick follow-up. Are you able to comment on the acetaminophen lawsuit? It seems like the judge had a positive ruling for the defendants. Thank you.

Tina Romani
Head-Investor Relations, Kenvue, Inc.

A

No, we really don't have any update there. We're going through the process to dismiss the MDL. Operator, next question?

Operator: Thank you. Our next question comes the line of Navann Ty of BNP Paribas. Please go ahead.

Navann Ty
Analyst, BNP Paribas Securities Corp.

Q

Hi. Thanks for taking my question. So, we understand low marketing expense drove the underperformance in the product activation, but was there something else such as not the right product display or maybe the packaging not highlighting enough the healthcare recommendations would be helpful to know? And what are the right levels of overall SG&A and maybe R&D to address that? Thank you.

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

A

Yes, Navann. Let me take this one. I think overall, the execution of our recovery plan in the fourth quarter fell short of expectations on a number of elements that I talked about. In a nutshell, it's making sure that our brands are more prominent in-store, easier to shop and supported by the appropriate level of engagement activities, both at the consumer and healthcare professional level.

While all these elements were included in the plan, the level of investment or the precision of the execution was not what we expected and the outcome was not what we expected. Now lessons learned, all these lessons are included in the buildup of the plan for 2024, and that's why you see us in the US executing a plan that is different from what we had in 2023 in these different dimensions. And so, you will see this broad based activation plan put in place.

But I would say if you think about the three priorities I outlined for the company more broadly in 2024, you will see a different Kenvue in 2024 compared to what you saw in 2023 is going to be our first full year as an independent company. And so, you will see, especially our 15 priority brands being activated at a much higher level in 2024 with strong building blocks across these 15 brands and across our three segments, you are going to see us being much more agile and moving with speed and urgency to capitalize on all the opportunities we see in the market and unleash the full potential of our portfolio.

That requires investment, that investment is going to be fueled by the continued and I would say accelerated gross profit margin enhancement that Paul referred to, as we exit our TSAs with Johnson & Johnson, it's also an opportunity for us to reinvent the way we work, work faster, better, make it easier for our teams to operate, but also do it at a lower cost base.

And this combination of expanded margin and efficiencies into the organization is what's going to fuel this investment and allow us to fuel growth in 2024. Now, the year will be a bit noisy for the – due to the compares, unusual compares we have in 2023, but if you look at the underlying strength of the business and the building blocks we have to drive growth in 2024 and profitable growth in 2024 and bring our long-term algo to life, we are confident in our plans.

Navann Ty
Analyst, BNP Paribas Securities Corp.

Q

Thanks very much for your comments. Can I ask actually a follow-up on the litigation? If you can discuss at all the next steps to end the litigation?

Tina Romani
Head-Investor Relations, Kenvue, Inc.

A

Yeah, Navann. Like I said, there's really not much I can share. We're going through the process. Now that the court has granted our motions to exclude, exclude expert testimony, so, we're going through the process through – to allow the court to determine whether the cases are dismissed.

Navann Ty
Analyst, BNP Paribas Securities Corp.

Q

Thank you.

Operator: Thank you. Our final question for the day comes from Peter Grom of UBS. Please go ahead.

Peter Grom
Analyst, UBS Securities LLC

Q

Thanks, operator. And good morning, everyone. I guess, I had a more conceptual question on the guidance. But over time, we've kind of seen some of your staples peers that have underperformed from a top line perspective or a share perspective, they're kind of rejiggering investments to try and fuel growth. In many cases, that coincides with rebasing earnings to set the company up for a stronger growth, not in the current year, but more in future years. Is that what's going on here? Like, has your thought process on the need for investment and innovation evolved versus where we were six, nine months ago? Or has this kind of earnings performance been contemplated for some time?

And then, I guess as a follow-up to Steve's question earlier on the organic growth. Is the flat performance in 1Q a function of weaker category growth and the improvement, just the assumption that the category accelerates or is the underlying improvement, assuming that your performance relative to the category improved substantially? Because it would just deem that if you're kind of exiting the year in more mid-single-digit growth, that that would imply some pretty decent share gains. So, just any color on kind of the share assumptions, would be helpful. Thanks.

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

A

Yeah. To answer quickly your Q1 question, Peter, and we have included in our slide deck, a slide that I think you will find helpful as you model 2024 with all the puts and takes in the different quarters of 2023. You will see that Q1 has a number of items that are going to make the compares very challenging for us.

So, it's really about unique event that happened last year. I talked, for example, about the inventory replenishment. But also the fact that we expect the season to continue to be below last year in, as we exit the winter, similar to what we have seen in Q4 of 2023. So, it's a mix of unique items to what happened at Kenvue last year and a continued lower level of incidence in Q1, similar to what we saw in Q4.

To your broader question about whether or not we are changing our philosophy, I would say our commitment to our long-term algorithm is stronger than ever. Our commitment to deliver strong TSR through a 3% to 4% top line growth year-over-year, growing our earnings faster than share and having a disciplined capital allocation strategy is what we started deploying in 2023. You are going to see as we move through 2024 and 2025 and as we become fully independent and exit our transition service agreements with Johnson & Johnson, you are going to see this long-term algorithm brought to life in a meaningful way.

That was always the plan to make sure that we exit our TSAs and reinvent our ways of working, so we make it fit for purpose for our company with ways of working that fit what we need to be successful as Kenvue, but also do it at a lower base and a combination of this lower cost base and continued improving – improvement in gross margin that we have demonstrated our ability to do for years again in 2023, and we are going to do it again in 2024. This is what brings a fuel to bring more investment to our brands.

There is no limit to our investment in our brands. We are very disciplined in our approach. We go for a return on investment approach. We believe that we have strong investible propositions in terms of building blocks and activities for 2024 as an example. And that's why we feel confident that the higher investment that we mentioned will give us good results in 2024 and beyond.

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

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

All right. So, thank you all for participating on today's call. 2023 was, as we talked about, transformational for Kenvue. I think we have been very clear about our priorities for 2024, reaching more consumers, investing in our brands and foster a culture that rewards performance and impact. So, we look forward to updating you throughout the year as we continue to advance these efforts. And for now, have a nice day and thank you again.

Operator: Thank you. This concludes today's conference call. We thank you for your participation. Have a wonderful day. You may disconnect your lines at this time.