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Kenvue, Inc. (KVUE)

Q1 2024 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Hello and welcome to Kenvue First Quarter 2024 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. [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.

Tina Romani

Head-Investor Relations, Kenvue, Inc.

Good morning, everyone, and welcome to Kenvue's first quarter 2024 earnings conference call. I'm 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 our IR website, investors.kenvue.com.

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. I'm pleased to be here with you this morning to discuss our solid start to the year with Q1 results coming in ahead of expectations.

Earlier this year, I shared with you how we are committed to transform our organization with three clear strategic priorities in 2024: reaching more consumers, freeing up resources to invest for growth, and fostering a culture of performance and impact. Our teams around the world are focused on executing with precision the changes required to bring these three priorities to life. And everywhere in the organization, you start seeing Kenvue shaping up as a different company.

While early in this journey and this transformation will not happen overnight, but this quarter's encouraging performance, the key program initiated throughout the organization and a high level of employee engagement do reinforce my confidence in our ability to deliver the plan this year and deliver our long-term value creation algorithm from 2025 onwards.

The solid financial performance this quarter, beginning with our 1.9% organic growth on top of 11.2% last year reflect the power of the Kenvue portfolio and the quality of our people. As anticipated, volumes are not yet a contributor to our growth with a 3.1% decline versus prior year, and we are not yet where we want to be in Skin Health and Beauty. But, at the same time, we continue to strengthen our leadership positions in Self Care and our innovations are strong contributor to our growth in Essential Health. And we do all of this while exiting TSAs, reinventing our ways of working, freeing up resources to invest behind our brands, and nurturing our new culture of performance and accountability. All of this positions us well for the future.

So let's have a closer look at our progress on each of our three strategic priorities. Beginning with reaching more consumers and starting with our largest segment, Self Care, let me first share with you what we see in the Self Care market. We see consumers continuing to look for science-based efficacious solutions to take care of themselves and their loved ones.

But, this quarter, volumes were affected by two factors. First, the cough, cold and flu season was shorter and slower than last year. And second, we saw some US retailers reducing their inventory levels. These factors will continue to have a meaningful impact on Q2 volumes and in a quarter where we will lap tough compares will mask the underlying strength of our brands.

In this context, our teams delivered outstanding performance. In Self Care, we delivered 4.2% growth on top of 15.3% growth last year and continue to outperform the market owing to the breadth of our portfolio in terms of categories and geographies. In the US, for example, each one of our largest brands grew share during the quarter.

Tylenol, the number one pain care brand in the world, achieved its seventh consecutive quarter of share growth in the US, further widening the spread between us and our next competitor. Regardless of the intensity of the season, our objective is always to advance the category and continue to gain share. And this is what our teams

actively pursued this quarter despite a softer season, with stronger media investment, expanded distribution, and a significant increase in in-store display support.

We also continued to launch category leading innovation. This quarter we launched Tylenol Easy-to-Swallow with GentleGlide technology with the aim at helping approximately 20% of people who hesitate to take a pill.

We are activating the same playbook in allergy. While the category is down so far this year on colder weather and sporadic storm patterns, adult Zyrtec is the only brand in the category increasing penetration and has now been number one in value share for 102 consecutive weeks. Similar to Tylenol, you'll see Zyrtec building on its category leadership ahead of the season with expanded distribution, strengthened in-store execution with a higher number of displays and continued excellence in healthcare professional and consumer engagement activities.

This quarter, we also relaunched Zyrtec Oral Dissolve tablets that melt in your mouth and dissolves in seconds, a strong benefit for consumers in oral antihistamines. And we actively deploy the same recipe in the rest of the world and see the same strong performance in Asia with brands like Tylenol and Motrin growing double-digit in China or in Europe with brands like IMODIUM or MICROLAX in digestive health, and Nicorette in smoking cessation, driving double-digit growth. All of this as a result of the precision in the execution of our brand activation plans by our teams in each market. So, another solid quarter for our Self Care brands.

Next, moving to Essential Health, where we grew 4.9% this quarter on top of 4% last year. The team's focus on executing initiatives to reach more consumers and expand our categories is yielding positive results. In Oral Care, where Listerine is 5 times larger than the next main competitor, we see growth across all regions.

In the US, our scaled business has now delivered more than 63 weeks of continued consumption growth. And we are not stopping there. At CAGNY, I told you about our launch of Listerine Clinical Solutions, our new premium line of alcohol and non-alcohol mouthwash focused on specific health benefits, which is a great example of what we do to expand the categories in which we are leaders. Early reads indicate this innovation already accounts for 0.6% share of the US market and is highly incremental, bringing 72% incremental shoppers to the Listerine brand.

You see us doing the same thing in the baby category. Our global leadership remains strong, with Johnson's Baby and Aveeno Baby as a number one and number two brands in baby toiletries globally. We are now expanding our penetration in children's toiletries, building Aveeno Kids as the fastest growing brand for children in the US. We see an opportunity to develop this new market where we are seeing increased demand. And we will continue to deploy this strategy across the segment with relevant innovation powered by increased investments, precise in-store execution and expanded distribution.

Now moving to Skin Health and Beauty where we saw our business declined 4.5% in the quarter with a 6.9% decline in volume. As we have discussed, stabilizing this business is a key priority for us. In the US, our team is activating a three-pronged approach, increasing in-store presence, elevating consumer and dermatologist engagement, and amplifying innovation. While more work needs to be done and it is too early to see results, I'm encouraged with the progress the team is making against each priority, and I believe we are moving in the right direction.

The US team is laser-focused on 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. For example, the teams have moved quickly to improve the awareness and shopability of Neutrogena Hydro Boost Water Cream, the latest Neutrogena innovation launched last year. New packaging with updated

graphics is underway. Media investments are up nearly 15%. And in-store, we implemented on-shelf signage that more effectively communicates our product's dermatological benefits to shoppers.

As part of our strategy to increase our impact with dermatologists, Kenvue showed up strong at the American Academy of Dermatology Annual Meeting in March, where more than 10,000 dermatologists came together. We presented 22 new pieces of scientific research and hosted a panel moderated by Neutrogena brand ambassador, Jennifer Garner, to showcase our science-led approach to innovation.

We amplified our presence on social media and achieved number one share of voice ahead of all other skin care brands. With a positive showing at AAD, coupled with expanded detailing sales force and a significant increase of our in-practice sampling, we quickly won three points of dermatologist's recommendations for Neutrogena face and moisturizing treatment, regaining our position as the number one recommended brand by dermatologists in this category.

We are also strengthening consumer engagement through compelling and modern marketing campaigns, appealing to young consumers. A good example of this is the activation of our partnership with the Coachella Festival in April, where Neutrogena was the exclusive sun care partner. Beyond offering great sun protection to the more than 650,000 festival goers with over 120 gallons of sunscreen, the Neutrogena team amplified our activation on social media and through influencers earning number one share of voice in the US skin care category during the festival, similar to what we achieved at AAD the month prior.

We are encouraged by the early indication that we are moving in the right direction. That said, we are not where we want to be in terms of market share. The recovery will take time and will not be linear. But, as you can tell, we are laser-focused on executing on our plan to improve our market performance and better reflect the strength of our brands.

To amplify these efforts, during the quarter, we announced decision that will allow us to operate in a more integrated manner. Recruitment for a new global segment leader to be located in the US is underway, and we are in the process of relocating our Los Angeles office to New Jersey, where our brand team will work side by side with R&D to drive innovation, cohesive execution and growth.

Now, moving to our next priority, freeing up resources to invest behind our brands. As discussed with you previously, we continue our journey of transforming Kenvue from a segment of Johnson & Johnson to an independent company focused on accelerating growth. This quarter, we started investing more behind brand activation, where we see opportunities to unlock profitable growth in line with our plan to increase our investment by 15% in 2024.

And we fund these investments with the continued expansion of our gross margins and a transformation of our cost structure as we exit TSAs. I'm pleased with the progress we are making on both fronts. Adjusted gross margin expanded 290 basis points in Q1, adding to our strong track record in this space and freeing up resources to invest into brand activation plans I described earlier.

In parallel, we are taking action to structurally change our cost base, leveraging the unique opportunity we have in front of us as we exit TSAs. You will hear from Paul more details about Our Vue Forward, our program to become a leaner, more agile and fast-moving organization, ultimately, with a lower cost base.

The teams are focused on executing with precision this program that spans over 2024 and 2025. We are at the beginning of this journey, but every day we seek Kenvue transforming a bit more into a company focused on

unleashing the full potential of its portfolio of brands, better positioned to deliver on our long-term algorithm of earnings growth ahead of sales growth and durable cash flow generation.

Which brings me to our third priority, to foster a culture of impact and performance, where we are moving in the right direction, transforming our company operationally and culturally. Starting with strategic alignment, we rallied all Kenvuers behind our three company priorities via robust goal setting process, part of our new approach to performance and pay.

In addition, we clarified responsibilities [ph] and decision rights (00:14:02) throughout the company. We streamlined processes, encouraging faster decision making, improved execution, heightened accountability, and enhanced collaboration.

As we continue our journey to grow Kenvue into the undisputed leader in consumer health, we are intentionally bringing in high-performing external talent. A couple of weeks ago, I was pleased to announce that Russ Dyer will be joining my leadership team as Chief Corporate Affairs Officer, an important leadership role as we continue our journey to grow.

In addition to instilling an owner mindset across the organization to elevate operational performance, we are also committed to operating the business responsibly. With the understanding that human health is inseparably linked to environmental health, during the quarter, we affirmed our commitment to our Healthy Lives Mission, our ESG strategy aiming to advance the well-being of both people and the planet.

And last week, we announced that Kenvue's near-term greenhouse gas emissions reduction targets were validated by the Science Based Targets initiative, and this in less than one year since becoming a public company, demonstrating our team's passion and commitment on this front. We look forward to publishing our inaugural Healthy Lives Mission report in June where you will see how Kenvue is maximizing its impact for good.

So, as you can tell, you are starting to see a different Kenvue in action in 2024. We are off to a good start for the year. Our teams are laser-focused on our three strategic priorities, while making progress on our journey to transform our company, all of which makes us confident in our ability to deliver our plan for the year and execute on our long-term algorithm in 2025 and beyond.

Before I turn it over to Paul, I would like to thank all Kenvuers around the world. Every day they help consumers realize the extraordinary power of everyday care. They embrace change and are actively contributing to our transformation. They are the ones delivering the results I just shared with you, and it is an honor to work alongside such a great team.

And now, over to you, Paul.

Paul Ruh

Chief Financial Officer, Kenvue, Inc.

Thank you, Thibaut, and good morning, everyone. I'd start by echoing Thibaut's sentiment that I am proud of how our teams are coming together. Our colleagues are embracing change, rallying behind our transformation and executing on our strategic priorities, all while delivering strong results this quarter.

Our teams began executing against our first priority: to reach more consumers. Across the portfolio, we deployed more relevant, impactful and distinctive brand experiences. We're beginning to see a difference in how our portfolio is coming to life in-store and with our consumers. Now, this work is just beginning, but we are energized

by the opportunities we see to continue strengthening our relationships with new and existing consumers all around the world.

Which brings me to the next priority: to free up resources to invest more behind our brands. In our press release this morning, we announced that our board formally approved our initiative to build on Kenvue's strength and optimize its cost structure. This initiative is part of our program to optimize the way we work. We call this Our Vue Forward. Thibaut spoke about the unique opportunity we have to reinvent how we work and lower our cost base as we exit TSAs with J&J.

Our Vue Forward equips us to do four things: first, to optimize our geographic footprint, to drive connection, collaboration and synergy across our teams and maximize our shared service hubs; second, to eliminate redundancies across the organization as we broaden spans of control and reduce layers of hierarchy to drive faster decision-making, creativity and innovation and more effective organizational communication; third, to implement new systems and automation to strengthen our capabilities in areas like our ability to uncover and apply consumer insights, improving forecasting, and responding real-time to market dynamics; and finally, to better leverage our procurement partnerships, ensuring we build strategic relationships with our suppliers that are rooted in shared value creation.

As an example, next week, we will bring our top suppliers from around the world together with our team to share knowledge and align on priorities. Our Vue Forward will enable Kenvue to operate more effectively, and ultimately, more competitively. We have already begun to realize efficiencies to support our investments in 2024 and expect the ongoing annualized benefit after full implementation of the initiative to be approximately \$350 million per annum beginning in 2026. This initiative will result in a net reduction to our global workforce of approximately 4%, and we expect to incur restructuring costs totaling approximately \$550 million, split roughly evenly between 2024 and 2025, with a payback period of approximately 18 months.

Importantly, as I am sure you may have the question, there is no change to our capital allocation priorities. Our healthy balance sheet allows for strategic investment in our business for growth, our number one priority, in addition to commitment to a strong dividend, our de-levering program and share buyback to offset dilution.

In this unique moment of transformation, we believe Our Vue Forward will generate the greatest long-term value creation for our stakeholders, accomplishing two goals: reducing our cost base and, as importantly, allowing Kenvue to deploy best-in-class ways of working that move us toward our ambition to become the undisputed leader in consumer health.

This initiative along with continued adjusted gross margin improvement will enable us to fund incremental \$300 million investment behind our brands that we committed to in 2024. As such, there is no change to our adjusted earnings per share guidance. Beyond this year, this initiative will continue through 2025, supporting continued incremental investment behind our brands while staying aligned to the delivery of our long-term algorithm centered around earnings growth ahead of sales growth.

Moving to our first quarter results, which demonstrate progress against our third priority: fostering a culture of performance and impact with heightened accountability. Coming in ahead of expectations, first quarter organic sales growth of 1.9% was strong, particularly when considering our 11.2% organic growth last year.

Momentum in Self Care and Essential Health continued, partially offset by underperformance in Skin Health and Beauty, as anticipated. Value realization contributed 5 points to growth, with approximately 75% carryover and the remaining coming from new value realization primarily outside the US. It's important to note that even as volume

is at the forefront of conversations today, value realization will continue to play an important role in our growth algorithm as the superiority and the efficacy of our products fosters loyalty in our categories and specifically with our brands.

Now, talking about volume. Volume improved meaningfully from fourth quarter trends across all segments, in line with our expectations. Taken together, approximately two-thirds of the 3.1 volume decline is attributable to the expected lapping of a onetime inventory rebuild last year and the impact of retailer trade inventory reduction by some US customers this year. We have continued opportunity here and we expect volume to stabilize and grow in the second half of the year.

Now, let's take a look at our segments. Self Care performance was strong at 4.2% organic growth, on top of 15.3% last year. Notably, we continue to gain share even on strong value realization of 5.6 points. As Thibaut mentioned, this performance reflects not only the diversity of our portfolio and strength across geographic markets, but also consumers' ongoing demand for efficacious health solutions they trust. Volumes were down 1.4 points, driven entirely by the lapping of a large onetime inventory rebuild as retailers replenished supply following the triple-demic last year.

As you consider your models for Q2, in addition to factoring the strong 2023 compare of 14.2%, there are also a couple of unique dynamics to bear in mind. First, in Europe, due to a shorter cold, cough and flu season this year, compared to a more prolonged season last year, we do not expect the same level of replenishment that we saw in 2023.

Second, in Asia Pacific, we do not expect the same level of incidence in China, where we experienced a large surge following the reopening last year. And lastly, in the US, we expect continued trade inventory contraction at some retailers. Given these dynamics alongside this soft start to the allergy season that Thibaut spoke about, we expect growth to be low-single-digit negative in Q2, masking the continued strength of in-market performance we expect to see in the quarter. We remain confident in the underlying strength of the Self Care portfolio and there are no changes to expectations for growth to accelerate in the back half, particularly as we lap easier compares.

Moving to Essential Health where momentum continued. Organic growth of 4.9% was comprised of 6.8 points value realization, partially offset by 1.9 points of volume decline. Similar to Self Care, the strength and diversity of our Essential Health portfolio fueled our growth. Thibaut shared a few examples of how we are driving growth in Oral Care and Baby Care. We are doing the same thing in our women's health businesses across EMEA, LatAm and Asia Pacific.

In India, for example, we are seeing strong growth in our Stayfree brand through consistent efforts in premium product distribution expansion supported by strong media presence, as we build strength in the growing women's health category internationally. Overall, Q1 performance and sequential volume improvement reflect the value of our brands to consumers, and we are confident in our ability to drive growth for the year.

Moving now to Skin Health and Beauty. While Q1 performance is in line with our expectations. As Thibaut discussed, our results do not demonstrate our ambition nor the full potential of our brands. Organic sales declined 4.5%, with 6.9 points of volume decline, partially offset by 2.4 points of positive value realization.

The US Skin Health and Beauty team is heads down focused on stabilizing the business, and we are still a few quarters away from seeing the impact of this work in our results. However, what I am seeing today is a team that is operating differently. As Thibaut mentioned, we are in the process of bringing our US-based teams together

under one roof to drive more collaboration and innovation. We are increasing our engagement with healthcare professionals, with dermatologist recommendations, increasing for Neutrogena Face.

We're also increasing engagement with our customers. For example, last week, we met our customers at NACDS to collaborate on long-term innovation pipelines. Simply put, the teams are executing the plan that we laid out at the start of the year with focus and energy to stabilize the business this year. We are seeing encouraging signs, but we certainly recognize there is more work to do.

Moving to adjusted gross margins. Value realization alongside continued executional excellence in supply chain productivity drove 290 basis points of margin expansion as our teams have accelerated efforts to free up resources and generate the fuel to invest behind our brands. This quarter's strong performance benefited from moderating inflation, which was a slight benefit as market favorability in logistics, energy and agrochemicals outpaced increasing labor pressure alongside slightly favorable currency movements.

We have a strong track record of preserving and expanding gross margin, and you can expect that to continue as we move through 2024 and beyond. At the start of the year, we shared that we expected adjusted gross margin to near 2021 levels or 59%. Given where foreign exchange and net input cost inflation have moved, we now expect to be slightly above this level, though recognizing the environment in terms of inflation and FX continues to be volatile.

Turning to adjusted operating income, first quarter adjusted operating income increased 70 basis points to 22%. This increase is primarily due to strong gross margin, partially offset by incremental stand-alone public company costs that we did not have in the first quarter of last year and increased investment behind our brands.

Let me clarify what we mean when we say increased investment behind our brands. We are referring to advertising investment as well as consumer and product promotion and healthcare professional spend. It is important to note that, similar to our US peers, but different from some of our international peers, our advertising disclosure in our 10-K only represents our pure advertising spend: digital advertising, television, radio and print media. The disclosure does not include other consumer or product promotion or healthcare professional spend. When we speak about our \$300 million incremental investment, we are referring to the increased brand investment across all three categories of spend.

Now, as you think about SG&A for the remainder of the year, given our increased investment behind our brands, it is fair to assume SG&A as a percentage of net sales will be at similar levels as Q1 for the remainder of the year. Interest expense, net for the quarter, was \$95 million, in line with our guidance.

For taxes, the first quarter adjusted effective tax rate was 28.3%. The increase in the adjusted effective tax rate versus the prior year is primarily attributable to jurisdictional mix of earnings, release of prior year tax reserves due to statute of limitations expiring, and negative impact of share-based compensation in the current period. For the full year, we continue to expect an adjusted effective tax rate of 25.5% to 26.5%, which reflects changes in tax laws as well as tax optimization strategies that the company intends to pursue.

And finally, adjusted net income was \$547 million for the quarter. Adjusted diluted earnings per share was \$0.28. On a like-for-like basis, normalizing for interest expense, public company costs, share count and tax rate, earnings per share grew 7.7% versus last year, which brings me to the outlook for the remainder of the year.

We are maintaining our outlook for organic growth in the range of 2% to 4% and 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.

Our outlook balances our solid first quarter, while acknowledging macroeconomic dynamics impacting consumer confidence. Our guidance also considers the possibility for unknowns in our seasonal businesses, including sun, allergy and cold, cough and flu.

As we talked about, Q2 has a few unique dynamics, including strong compares and expected US retailer trade inventory reduction that will impact our results. We continue to expect an acceleration in the back half of the year as compares ease and our plans take hold. All other guidance metrics, which can be found in the slides accompanying our remarks, remain unchanged.

In summary, I would like to leave you with three key takeaways. We had a strong start to 2024. We're executing against our strategic priorities for the year, and we have the right plans, talented people and strategic investments in place to deliver our long-term algorithm.

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. [Operator Instructions] And your first question comes from the line of Andrea Teixeira from JPMorgan. Your line is open.

Andrea Teixeira
Analyst, JPMorgan Securities LLC

Q

Thank you, operator, and good morning, everyone. Thibaut, Paul, you both mentioned that the destocking in the Self Care business will likely continue in Q2 and you gave some color on what to expect in organic sales growth.

But in terms of how we should be thinking across the divisions in terms of the Skin Health and Beauty, is that something we should – I understand that there is still a job to be done and it takes time, and you mentioned, Paul, a couple of quarters or several quarters, I think was the language. But should we expect things to improve sequentially? How we should be thinking of Skin Health and Beauty as we progress? Thank you.

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

A

All right. Good morning, Andrea. And so, many questions in your question. Let me take the first one very quickly. On inventory, we mentioned that we saw an impact of inventory reduction in some US retailers in Q1 in healthcare but across categories, I would say, and we expect this to continue in Q2, but not last beyond Q2 in terms of this...

[Technical Difficulties] (00:32:59-00:33:10)

Operator: Ladies and gentlemen, we are experiencing some technical difficulties. Please standby.

[Technical Difficulties] (00:33:16-00:37:53)

Tina Romani

Head-Investor Relations, Kenvue, Inc.

A

Hi, everyone. Apologies for that. We had some technical difficulties in our room. We will just go back to Thibaut answering our first question from Andrea.

Thibaut Mongon

Chief Executive Officer & Director, Kenvue, Inc.

A

All right. So, Andrea, I was responding to your question, I'm not sure how much you got of my answer. I would start – go back to the beginning. Your question about retail inventory reduction and potential impact in Q2. We saw an impact in Q1 of the retail inventory reduction with some retailers in the US in Self Care, but I would say across categories, and we would expect this impact to continue into Q2 but not last beyond the first half.

Regarding your question on the Skin Health segment and what we should expect moving forward in Skin Health, our diagnostic has not changed. I've always said that a recovery would not happen overnight, would not be linear. We have developed a thoughtful plan. It's a priority for us. Jan and his team in the US are laser-focused on executing this plan with the objective to stabilize the brand in 2024, with improving volumes as the year goes on and deliver growth from 2025 onwards. It's early. It's early. But I'm encouraged, as you heard in my remarks, with what I call the anecdotal evidence that we are moving in the right direction.

We saw this quarter once again that when we activate our brands properly whether it's with dermatologists or consumers, we see a response, a pretty quick response. Now, we know that we will need more of these activities to have an impact at scale on the business and we also know that these activities take time to translate into sales and share gains, but we are definitely hyper-focused on executing the plan in the balance of 2024 to stabilize this business through our focus on in-store presence and prominence, our focus on elevating consumer and dermatologists engagement, and on amplifying innovation.

Tina Romani

Head-Investor Relations, Kenvue, Inc.

A

Thank you, Thibaut.

Andrea Teixeira

Analyst, JPMorgan Securities LLC

Q

Thank you for this.

Tina Romani

Head-Investor Relations, Kenvue, Inc.

A

Operator, we'll take the next question.

Operator: Your next question comes from line of Bonnie Herzog from Goldman Sachs. Your line...

Bonnie Herzog

Analyst, Goldman Sachs & Co. LLC

Q

All right. Thank you. Good morning, everyone. So, I wanted to ask, because we're hearing from some of your peers that they're seeing a step-up in promotional intensity and they're expecting this going forward. So could you talk about what you're seeing in your markets in some of your key categories and if that's consistent and, basically, what your approach will be for the rest of the year? And then, how do we think about this in the context

of robust gross margin delivery in the quarter? And finally, how does that fit into your expectations for continued contribution from net price realization going forward? Thank you.

Thibaut Mongon

Chief Executive Officer & Director, Kenvue, Inc.

A

Yeah. So, what do we see in our categories? We see that our categories continue to be resilient in – and strong. That's probably unique to – linked to the unique nature of the consumer health categories compared to other stable categories you may be familiar with. In our categories, consumers are looking for efficacious solutions at a compelling value proposition. But it is exactly what we offer at Kenvue. If I look at one indicator, which is the penetration of private label in our categories, we don't see that moving around the world. Actually, penetration was down in the US in the most recent read.

It's also linked to the fact that Kenvue brands are strong, typically number one or number two in our respective categories. We offer a very strong value proposition at different price points for different types of consumers. And so, we cater to different needs of different consumers through our portfolio. Now, it's not something we take for granted. Every day, our teams are focused on making sure that we increase the relevancy of our brands with consumers, our credibility with healthcare professionals to maintain our leadership position.

Paul Ruh

Chief Financial Officer, Kenvue, Inc.

A

Let me take the other part of your question. When we think about the impact of promotional spend to gross margin, we always look at all activation and investment with an eye to return on investment. So, when we think about how we deploy our promotional spend as well as for media, we look at how we can maximize the spend in investable propositions.

So, we do balance growth and profitability. In fact, we're very pleased with how our gross margin is evolving so far. I mentioned the 290 basis points of gross margin expansion that comes from both value realization and the excellent work that our supply chain team is doing across the board. And we expect this to continue in the balance of the year.

Operator: Your next question comes from the line of Steve Powers from Deutsche Bank. Your line is open.

Steve Powers

Analyst, Deutsche Bank Securities, Inc.

Q

Yes. Great. Good morning, Paul. Good morning, Thibaut. Thibaut, I wanted to ask about the Our Vue Forward program. It seems like it was really just approved by the board yesterday. So, maybe you could give some perspective on just initial reactions internally across the organization and what steps you've taken to maybe help ensure that this is a program that's viewed as a program of acceleration that people can rally around versus maybe a potential source of disruption. And in that vein, if you could talk a little bit about where you see reinvestment to be prioritized as the savings are realized over the next couple of years that would be great as well. Thank you.

Thibaut Mongon

Chief Executive Officer & Director, Kenvue, Inc.

A

Yeah. So, let me take the first part of your question, Steve, and I'll have Paul answer the second one on the reinvestment. Our Vue Forward has always been a key element of our plan. We see the opportunity of exiting TSAs to not only clone the way the working we had as a division of J&J, but as an opportunity to reinvent our way

of working to make Kenvue more competitive and a company focused on profitable growth. And that's what Our Vue Forward is all about.

We have been thoughtful about putting together a comprehensive program that covers our global operations. As you said, our board formally approved this work this week. And so, today, we are sharing the details with you. We are – everybody at Kenvue is mobilized to transform our company. That's something that we started doing from day one that we are clearly ramping up our efforts in this area as we enter our first full year as an independent company.

And as I said, everybody understands and is excited that the TSA exit is really an opportunity for us to reinvent our ways of working and become more nimble, more agile, closer to the consumer with better defined roles and responsibilities, having our teams co-located for better collaboration, innovation, creativity. And that's what we are all going after through this program.

Paul Ruh

Chief Financial Officer, Kenvue, Inc.

A

Yes. Let me provide some more details about how we're spending the \$275 million both in 2024 and 2025. First, a large proportion is going towards streamlining operations, mostly in our functions, where we're clarifying roles and responsibilities, we're simplifying processes, eliminating redundancies, and the associated costs are primarily related to severance and footprint. A second large bucket is related to the upgrade of our IT infrastructure that will allow us to be more competitive with our peers, allowing for faster and more informed decision making. That is the second part of our investment.

Ultimately, all of these investments position Kenvue to be much more agile at a lower cost of infrastructure and allowing us to be more competitive. I want to reiterate, all of this has been contemplated in our guidance and it bolsters our confidence in to delivering on our long-term algorithm on growing income faster than sales.

Operator: Your next question comes from the line of Nik Modi from RBC Capital Markets. Your line is open.

Nik Modi

Analyst, RBC Capital Markets LLC

Q

Yeah. Good morning, everyone. Thank you. Just a quick clarification in terms of how you over-deliver. Just wanted to make sure I understood exactly what the source of the upside was. And then, Thibaut, I just – when you think about new leadership for Skin Health and Beauty, are there any specific characteristics you're looking for in terms of the new leadership? Just any perspective around that would be helpful.

Paul Ruh

Chief Financial Officer, Kenvue, Inc.

A

Thank you, Nik. Let me take the first one. What drove the outperformance in Q1? Remember, we guided to about flat and the outperformance was driven a little bit by price, a little bit by volume as well. And from a regional perspective, Europe was doing very well, slightly ahead of our expectations. And Essential Health, from a segment perspective, is also performing very well, both in EMEA and LatAm. The rest is performing in our expectations. So pockets of strength across the portfolio as we execute against our priorities.

I'll let you answer the second part of the question.

Thibaut Mongon

Chief Executive Officer & Director, Kenvue, Inc.

A

Yeah. On Skin Health, we have made the decision this quarter to relocate our segment leader position from Asia to the US to work more closely with – again, in the spirit of being co-located with the majority of our teams and foster collaboration and creativity. And as we look for a new leader for this segment, you will see a new leader coming in with an experience in the dynamic skin care category, but also with experience in growing global mega brands because that's what you are talking about when you are talking about brands like Neutrogena, Aveeno, and others that are mega brands present all over the world. So that's what you will see moving forward.

Tina Romani

Head-Investor Relations, Kenvue, Inc.

A

And then, Nik, maybe just to add on, because it's an important point just in terms of Q1's outperformance. Paul talked through some of the unique dynamics. There's also unique dynamics in the second quarter that will absorb some of that. So, overall, for the first half, kind of in line with expectations in terms of performance.

Paul Ruh

Chief Financial Officer, Kenvue, Inc.

A

And for the full year, in line with our expectations as well.

Operator: Your next question comes from the line of Anna Lizzul from Bank of America. Your line is open.

Anna Lizzul

Analyst, BofA Securities, Inc.

Q

Hi. Good morning. Thanks very much for the question. I just wanted to follow up on Bonnie's question. I wanted to ask how you plan to split some of the incremental investment in your brands, maybe between marketing and promotion. And how should we think about a potential increase of promotion or trade spend on price mix as we move through the year? And then in Skin Health and Beauty, how much of the volume weakness was driven by Dr. Ci:Labo in China? Are you beginning to see a recovery there? And how should we think about the volume performance in Skin Health and Beauty by region this quarter? Thank you.

Paul Ruh

Chief Financial Officer, Kenvue, Inc.

A

Thank you for the question, Anna. Let me take the first part and Thibaut with the second one. In terms of how we plan to spend our investments in our brands, remember, we always take a digital first ROI-driven approach. We are on track to investing the \$300 million more that we mentioned on our Q4 earnings. And we began Q1 with a focus on our 15 priority brands, considering what we call investable propositions and those are the ones where we maximize the return on investment. We are increasing investment across a spectrum of activities from in-store activation to media, digital influencers and also HCP endorsement, with a focus to amplify our innovation.

Now, the timing of the payback you may ask may vary. For example, in-store promotion has a more immediate but short-lived payback. And when we think about, on the other extreme, HCP engagement is generally more of a long term, more durable impact. But we're balancing all of those activities focusing on our 15 priority brands and we're encouraged by what we are seeing in Q1. And we'll continue to deploy in the balance of the year to maximize reach and return on investment.

Thibaut, let me pass on the second question to you.

Thibaut Mongon

Chief Executive Officer & Director, Kenvue, Inc.

A

Sure. So, your question on volume in China and Dr. Ci:Labo is a great question because it gives me the opportunity to talk about our China business. I feel that it's not always well understood. So, China grew nicely last year and we saw China continuing to do very well in Q1, growing double-digit. A couple of facts about our business in China. You may recall that China represents approximately 7% of our business. So, it's not an overly developed market for us, ample opportunity for Kenvue to grow in that market.

The other thing is that the majority of our business in China is in Self Care segment. We continue to see the category growing as macro trend in China supports growth, especially with a very ambitious Healthy China 2030 agenda by the China government. We see Chinese consumers continuing to be attracted to science-based efficacious solutions like ours. We are operating in China for many years with a very strong team. We are investing in our Self Care pipeline.

Just a fun fact for you, last year, we launched more innovation in China than we launched in the past 11 years combined in Self Care. And we have a very strong leadership position in that market across analgesics, pediatrics, allergy, antifungals. So, when you hear me talking about our business in China, you see why we are pleased with the performance of our team in China.

Then there is a small part of our business that is not Self Care, that's where Dr. Ci:Labo and other brands are hosted. And here, as everybody else, we saw a deceleration of that part of business. We see the consumer being more cautious. As I indicated at the beginning of the year, we are not investing ahead of the curve in that part of the business. We have not assumed any recovery in the back half of the year in our plan and our outlook for the year. But, as I've always said, we are committed to a long-term prospect in China. And that view has not changed. China is a positive contributor to our growth and we expect it to be the case again in 2024.

Operator: Your next question comes from the line of Filippo Falorni from Citi. Your line is open.

Filippo Falorni

Analyst, Citigroup Global Markets, Inc.

Q

Hey. Good morning, everyone. First a quick clarification. In the Q1 results, in the 1.9% organic, was there any impact from hyperinflationary pricing? Most of your peers have called it out. So, I just wanted to check on that. And then a bigger question. You mentioned Q2, you expect low-single-digit declines in Self Care. Maybe you can give some color for the other segment on expectations as well.

And as you think about the second half, what gives you that confidence that volume will accelerate? Some of it is easy comps, is benefit from your investment action and investment in marketing advertising. Any more color there would be helpful. Thank you.

Paul Ruh

Chief Financial Officer, Kenvue, Inc.

A

Yeah. Thank you for the question, Filippo. Hyperinflation is – particularly in both Argentina and in Turkey represented about 90 basis points in Q1 with no impact to earnings. We are taking the appropriate pricing. That's why there is no impact to earnings. Hyperinflation is expected to have about 50% benefits for the top line for the full year as these 90 basis points in Q1 was particularly high given the compares versus last year.

Do you want to take the second one?

Thibaut Mongon

Chief Executive Officer & Director, Kenvue, Inc.

A

I will take the second one about the unique dynamics of the Self Care segment in Q2. Filippo, there are a few dynamics for you to consider in Q2 as you think about Q2 for the Self Care segment specifically. One, we are going to have difficult compares to absorb. We grew double digit in the second quarter last year. So that will be a strong compare.

The second one is that we do not expect the same seasonal strength that we saw in China in the second quarter when China reopened. We expect continued impact of trade inventory reduction by some customers in the US. And I told you that so far we saw a slow start to the allergy season, which will weigh on volumes in Q2. Having said that, you should also see it as non-operational elements masking the underlying in-market performance of our Self Care business. So that's what is driving our current thinking for Self Care in Q2.

Regarding the back half of the year, we see no change in our expectations for the back half. And that's why we reaffirm our guidance for 2024 this morning. It's going to be a combination of the easier compares, to your point, but also seeing our plans taking hold as we execute against our 2024 priorities.

Operator: Your last question comes from the line of Korinne Wolfmeyer from Piper Sandler. Your line is open.

Korinne Wolfmeyer

Analyst, Piper Sandler & Co.

Q

Hey. Good morning. Thanks for taking the question. I'd like to touch a little bit more on the gross margin. It came in a little bit higher this quarter. I know you talked a little bit about some of the drivers there. Is there any way you can help us quantify the specific drivers and help us better understand which ones are going to be more sticky throughout the course of the year? And then any color on how to think about the cadence of the gross margin throughout the remainder of the year. Thank you.

Paul Ruh

Chief Financial Officer, Kenvue, Inc.

A

Yeah. Korinne, thank you for the question. We're actually very, very proud of the work that the team is doing. Gross margin is a strong muscle for Kenvue and pricing, that is value realization, continues to be a component of our gross margin enhancement along with continuous efficiencies in our operations. The impact of inflation is also moderating with agrochemicals becoming now a tailwind and is still offset by some headwinds in labor and energy.

And we're mindful of the unique dynamics and the volatility that we still see in the commodity market. But we're very confident that we will be reaching, as I said in my prepared remarks, our stated goal of 59% that we had back in 2021 this year. So, we're more optimistic about the gross margin enhancement that will help fuel the brand activation and getting closer to our consumers and customers.

What it means in terms of the cadence of the year, there's always a natural seasonality in our business, but I would – it's fair to assume that our gross margin will be slightly better than we originally anticipated. That will continue to allow to fuel our investments in our brands.

Operator: 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 closing remarks.

Thibaut Mongon

Chief Executive Officer & Director, Kenvue, Inc.

So, thank you, all, for participating on today's call. And apologies again for the technical glitch at the beginning. As you can see, we are pleased with our solid start to the year. As we have discussed, we are committed to continue to transform our organization with our three clear strategic priorities: reaching more consumers, freeing up resources to invest in our brands, and fostering a culture of performance and impact at Kenvue.

So, our teams are all focused on executing with excellence. And we look forward to updating you on our progress throughout the year. Have a great day, everyone.

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

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