Company Name: Kellogg
Company Ticker: K US
Date: 2016-11-01
Event Description: Q3 2016 Earnings Call

Market Cap: 26,342.98
Current PX: 75.21
YTD Change($): +2.94
YTD Change(%): +4.068

Bloomberg Estimates - EPS
Current Quarter: 0.881
Current Year: 3.633
Bloomberg Estimates - Sales
Current Quarter: 3099.533
Current Year: 13011.778

Q3 2016 Earnings Call

Company Participants

- John Renwick
- John A. Bryant
- Ronald L. Dissinger
- Paul T. Norman
- Chris Hood
- Maria Fernanda Mejia
- Amit Banati

Other Participants

- Jason English
- Robert Moskow
- Christopher Growe
- Michael Lavery
- Jonathan Feeney
- Bryan D. Spillane
- Alexia Jane Howard
- Steven Strycula
- John Joseph Baumgartner
- Kenneth Bryan Zaslow
- Mario Contreras

MANAGEMENT DISCUSSION SECTION

Operator

Good morning. Welcome to the Kellogg Company Third Quarter 2016 Earnings Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer period. [Operator Instructions] Please limit yourself to one question during the Q&A session. Please note this event is being recorded. Thank you.

At this time, I will turn the call over to John Renwick, Vice President of Investor Relations for Kellogg Company. Mr. Renwick, you may begin your conference call.

John Renwick

Thank you, Gary. Good morning, everyone, and thank you for joining us today for a review of our third quarter 2016 results. As usual, I'm joined by John Bryant, Chairman and CEO, who will give you an overview of our business results and priorities; and Ron Dissinger, Chief Financial Officer, who will walk you through our financial results and outlook.

We're trying something a little new today. We're joined on the phone and in the room by the heads of each of our four regions: Paul Norman, of Kellogg North America; Chris Hood, of Kellogg Europe; Maria Fernanda Mejia of Kellogg Latin America; and Amit Banati of Kellogg Asia Pacific. After John gives some overview comments and Ron runs you through our financials, each of these presidents will walk you through the results, priorities and outlooks for his or her respective businesses one year after our Day at K investor event. We wanted to give you a chance to hear directly from these executives, hence the additional 30 minutes to our call this morning.

The press release and slides that support our remarks this morning are posted on our website at www.KelloggCompany.com. Slide number 3 shows our usual forward-looking statements disclaimer. As you are aware, certain statements made today, such as projections for Kellogg Company's future performance including earnings per share, net sales, margin, operating profit, interest expense, tax rate, cash flow, brand building, up-front costs, investments and inflation are forward-looking statements. Actual results could be materially different from those projected. For further information concerning factors that could cause these results to differ, please refer to the third slide of this presentation as well as to our public SEC filings.

As a reminder, a replay of today's conference call will be available by phone through Tuesday, November 8. The call will also be available via webcast, which will be archived for at least 90 days.

And now, I'll turn it over to John and slide number 4.

John A. Bryant

Thanks, John, and thank you, everyone, for joining us. I'm happy to report Q3 profit and earnings that came in ahead of our expectations. A lower tax rate was part of this over-delivery, but so was broad-based profit margin expansion that exceeded our expectations. Candidly, top-line growth did not come in as we had hoped, and there were specific factors behind that, which we will discuss in a moment. But we do see growth and sequential improvement in many parts of our business.

Behind the numbers, there is great progress being made, not only against our strategy as represented by our 2020 Growth Plan, but also against the key business priorities we laid out for you one year ago at our Day at K investor event. These efforts should continue to yield sequential improvement in our results. We saw it in Q3. And we'll see it again in Q4, finishing the year largely as we originally expected in operating profit, albeit driven more by margin expansion and less by net sales growth.

And this improvement will continue into 2017 as we continue to believe we have the right plans to bring sales at least to flat, and enough productivity initiatives to drive us well on our way to a 350 basis point improvement goal we have set for 2015 to 2018 on a currency-neutral comparable basis, excluding Venezuela.

Today, Ron, the region presidents and I will take you through our results, progress and outlook, and we use as a basis for measurement the priorities we shared with you back at Day at K. I'll start by reminding you of the 2020 Growth Plan, which we unveiled to you at last November's Day at K investor event and which is shown on slide 5.

There are two important points to make here. First, that this Growth Plan is informing our investment decisions and our 2016 priorities were all geared toward delivering on this strategy. As we discuss our progress against our 2016 priorities, we are really discussing our progress against this 2020 Growth Plan.

The second point is that our acceleration of profit margin expansion is by no means a change in strategy. OP margin expansion has always sat front-and-center of our 2020 Growth Plan. And there's more to this profit margin expansion than simply executing initiatives. A couple of months ago, we told you about how we are refreshing our Volume to Value operating model for today's environment. Volume to Value is being embraced and measured throughout the organization. This should give you another reason to believe in our 2018 margin expansion target.

So with that as a backdrop, let's walk through our progress against our strategy. On slide 6, we recount the 2016 priorities we shared with you at Day at K one year ago. Clearly, there is tangible progress being made. We set out to stabilize our four largest cereal markets: U.S., Canada, Australia and the UK. We have invested in food, repositioned Special K, focused our marketing resources behind highest ROI brands and activities. And we have made substantial progress in all but the UK, which is a work in progress.

Expanding Pringles worldwide has been a priority for this year. And in Q3, we continue to see good growth in that brand. Emerging markets have been dramatically scaled up through acquisitions and joint ventures, and we are growing organically in these emerging markets as well.

Enhancing our sales capabilities was another priority, and we've rolled Revenue Growth Management disciplines, processes and tools around the world. We said this was necessary for price realization and we've seen that price realization go from being down slightly in the first half to being flat in Q3, with an expectation of slightly positive price realization in Q4.

Also, regarding sales capabilities, we just announced our biggest-ever acquisition in Latin America, which will not only give us much needed scale in Brazil but also gives us the ability to leverage a very strong reach into high-frequency stores.

Increasing earnings visibility through big productivity and savings initiatives has been a key priority for us this year. And it's already showing up in our results, with Q3 recording yet another year-on-year gain in OP margin. We're delivering on our productivity initiatives. We're shifting our brand-building to higher RIO brands and investments and we're starting to turn around our price realization. So good progress is being made, even if our top-line has not yet reflected it.

With that, let me turn it over to Ron, who will take you through our financial results, progress and outlook.

Ronald L. Dissinger

Thanks, John, and good morning, all. Slide number 7 shows highlights of the financial results for the third quarter. In describing our results and outlook, we will be referring to them on a currency-neutral comparable basis unless otherwise noted. And in many cases, we'll also give you the same metrics, excluding Venezuela. The appendices to our presentation provide you with the detail on our GAAP and non-GAAP performance.

Third quarter net sales decreased modestly and came in short of our expectations, but our operating profit increased, driven by savings from Project K and Zero-Based Budgeting as well as by price increases in Venezuela. This exceeded our expectations and we generated this solid profit growth and margin expansion across all of our regions, making good progress toward our 2018 operating margin expansion goal.

Earnings per share exceeded our expectations, not only because of profit margin expansion but also due to a lower effective tax rate. This performance included $0.04 of currency headwind or about 4 to 5 percentage points of EPS growth impact.

Now, let's turn to slide 8 and the components of the third quarter sales. Our currency-neutral comparable net sales declined in the third quarter. And this included unexpected trade inventory decreases in U.S. cereal and Pop-Tarts, continued softness in UK cereal and a more prolonged transition on shelf for our overall Kasha and Morning Star Farms portfolios.

The good news is we saw growth in several businesses, including U.S. Snacks, U.S. Specialty Channels, Asia Pacific and Latin America, both with and without Venezuela. And we continue to post good growth in Pringles across the globe.

Slide 9 shows our currency-neutral comparable gross profit margin for the quarter. Excluding Venezuela, our gross profit margin was off 60 basis points in the quarter and a bit less for the year-to-date period. Our productivity, Project K and Zero-Based Budgeting initiatives all delivered savings as planned in the quarter. This was most evident in North America, where our gross profit margin improved year-on-year, even despite investment in food, adverse transactional foreign currency impact in Canada and adverse mix in Snacks, driven by softness in our Wholesome Snacks business.

Offsetting this strong North America performance were gross margin declines in our international businesses. These declines were primarily driven by adverse transactional foreign currency impact on dollar-based commodities and other inputs as well as a deflationary retail environment in Europe. But they also reflected adverse country and category mix.

Project K, Zero-Based Budgeting, and the roll-out of Revenue Growth Management are designed to address our gross profit margin performance going forward.

Slide 10 shows the currency-neutral comparable operating margin, excluding Venezuela, for the quarter. And on that basis, operating margin increased by nearly a full percentage point in the third quarter. And by Zero-Based Budgeting and Project K efforts, we generated substantial efficiencies in our SG&A expenses. It's important to note that Q3's margin expansion was broad-based with operating margin up year-on-year in all four of our regions.

Slide 11 shows our cash flow. Our year-to-date cash flow through the third quarter was more than 10% higher than that of the year-ago period, and recall that our first quarter cash flow included the impact of a bond tender offer, which lowered cash flow by $97 million after tax. Importantly, we continued to improve our core working capital as a percent of sales, both sequentially and year-on-year. We're still on track to deliver our targeted $1.1 billion of full-year operating cash flow after capital spending. And full-year capital spending should come in at the low end of our previous guidance range of $525 million to $625 million, reflecting greater efficiency and prioritization of projects.

Slide 12 shows how we expect to end the year, again, on a currency-neutral comparable basis, so that we can move volatility from currency translation and mark-to-market adjustments. We expect sequential improvement in our ex-Venezuela net sales performance in the fourth quarter. The current trends have led us to adjust our outlook, so instead of finishing flat on sales for the year, as was our previous guidance, we now believe sales will be a little less than that, probably down about 1%.

Our operating profit guidance remains unchanged at the high end of the 4% to 6% growth range, excluding Venezuela, thanks to our productivity efforts and our savings performance. We should see our operating margin exceed 15% in 2016, putting us well on the path toward our goal of increasing our margin by 350 basis points between 2015 and 2018.

On earnings per share, we are raising our guidance both on a comparable and currency-neutral comparable basis. This reflects the tax rate favorability we recorded in the third quarter, which should more than offset any increase in our average shares outstanding as we curb share report repurchases in the fourth quarter to fund our acquisition in Brazil.

A couple of words on the financial impact of the Parati acquisition, which we expect to close later this year; net, the acquisition is neutral to our comparable basis earnings per share in 2016, even after the effect of curbing share buybacks in the quarter in order to maintain current debt levels. Integration costs were expected to amount to roughly $0.01 per share in 2016, but this merely puts us at the top end of our previously-announced range of $0.02 to $0.03 for the company this year.

Slide 13 shows some additional elements of our 2016 guidance. And I'll just highlight where there have been changes. First, the currency impact is roughly $0.01 better than previous guidance based on current rates. Our comparable tax rate will now be approximately 25%, reflecting favorability primarily from the adoption the new standard on accounting for stock-based compensation at the beginning of the year.

Share buybacks should be approximately $450 million to $550 million. And, as I mentioned, we're curbing repurchases, for the time being, to fund the acquisition we are making in Brazil. And full-year integration costs are now anticipated to be at the high end of our previous estimate of $0.02 to $0.03, net of tax. And this now does incorporate the roughly $0.01 of closing and integration costs for the Brazil acquisition.

Slide 14 offers a preliminary view of 2017. As we shared with you previously, we are forecasting net sales to be approximately flat to 2017. In effect, this consists of lower volume, offset by higher price mix performance as we employ Revenue Growth Management initiatives and adhere to our Volume to Value principles. This flat outlook is prudent, in our view, even as we strive to do better than flat. Our operating profit should increase at a high single-digit rate in 2017 as our operating margin expansion makes up about half of the remaining basis points of our 350 basis-point challenge through 2018.

As discussed previously, the key drivers of the expansion will be the following: our ongoing 3% to 4% productivity designed to mitigate input cost inflation; Revenue Growth Management to improve our price mix contribution; Project K savings; and Zero-Based Budgeting efficiencies. We believe these initiatives give us good visibility into our margin expansion in 2017 and beyond.

Slide 15 shows our 350 basis point profit margin expansion target through 2018 and shows how this shapes up across our four regions. This is essentially an update of a chart we showed at Day at K last year on the accelerated forward to 2018 from previously 2020. As you can see, we are taking a prudent view towards net sales growth, particularly in the more-developed North America and Europe regions. We believe this is the right way to forecast net sales growth, particularly in the current environment, but we aspire to do better than this. Our operating profit margin expansion skews heavily towards North America and Europe. These are our bigger businesses with strong productivity savings opportunities. In Latin America and Asia Pacific, we will be pursuing similar initiatives, but the impact isn't quite as large as we are still in early stages of scaling up emerging markets in these regions.

Before I pass the call over to the regions, let's briefly take a look at slide 16. This is a recap versus what we shared with you at Day at K focusing on our financial goals. Simply put, in 2016, we're delivering on everything we said we would, with the exception of net sales growth. We are on track to come in at the high end of our operating profit goal and exceeding our goal on currency-neutral comparable earnings per share. We have accelerated our target for operating margin expansion, expecting to reach it two years earlier. We're delivering on our productivity and Project K savings and have expanded our Zero-Based Budgeting program. And we've made acquisitions that perfectly fit our strategic imperatives by being fiscally proven and continuing to deliver strong cash flow to maintain our financial flexibility. So we've made good progress towards our financial goals.

We're now going to turn it over to each of our region presidents, who will give you a closer look at the results, priorities and outlooks for the respective businesses.

We'll start with Paul Norman, our President of North America.

Paul T. Norman

Thanks, Ron. Good morning, everyone. No question that 2016 has been a busy year for us here in North America. Admittedly, the results have been a bit mixed, with top line not recovering as quickly as I had hoped, but profit margin expansion exceeding our expectations. There's been a lot more progress than our top line would suggest.

If we turn to slide 18, we can see the priorities we set out for ourselves for 2016 and shared with you one year ago at the Day at K investor event. Stabilizing our Cereal business was our priority. While the category has held at a 1% rate of decline, this is significantly better than in recent years. We have invested in food. We have prioritized investment behind our core brands. And we've gained share as a result. And we're particularly pleased with how we stabilized Special K.

We also said we have to revitalize our Snacks business. The consumption data shows that our efforts to prioritize investment behind our most important and on-trend brands are working. We're growing our big three cracker brands. We're growing Pringles. And we're growing Rice Krispies Treats. And across our portfolio, consumption is up double-digit in on-the-go offerings.

Frozen and Kashi are still works in progress. Much of the heavy lifting has been done, with packaging overhauls now largely behind us in Frozen, and Kashi's transformation of its portfolio already contributing to stabilization in Cereal. We have plans to stabilize our other Kashi categories, too.

Fuel for Growth refers to all the things we're doing to improve our profit margins; from executing our Project K network restructuring and shared services model, to delivering on Zero-Based Budgeting. We are generating fuel for growth, and you can see it in our increased profit margins this year. We've also launched a more comprehensive approach to Revenue Growth Management, which is already showing positive signs.

So with that as a backdrop, let's discuss each of our North America segments in turn, starting with our 2016 results and then looking ahead to 2017. We'll start with Morning Foods on slide number 19. Morning Foods posted another quarter of solid operating profit growth, with improvements in our margins coming from our productivity efforts under ZBB and Project K. Top line came in a little lighter than we had expected, and this was due to an unexpected reduction in trade inventories. Our cereal consumption was down about 1% and in line with our year-to-date trend. And our Pop-Tarts consumption was actually up about 1%. So shipments clearly lagged consumption in the quarter.

Our underlying progress is clear. We gained 20 basis points of share in Cereal and 50 basis points of share in toaster pastries. Our core six Cereal brands continue to benefit from focused investment, leading our share gain. Year-to-date, Kellogg has most of the highest velocity 2016 innovations in ready-to-eat cereal, maintaining innovation share leadership, led by Special K Nourish, S'Mores and our Finding Dory-licensed cereal.

We executed well during the back-to-school period, which coincided with our Olympics activation. This year's Olympics program generated over 1.8 billion impressions at 30% less cost than our prior Summer Olympics programs. This was driven by a greater focus on social activation. And it demonstrates our new marketing model at work. So we continue to improve the underlying fundamentals on our business.

As we look to Q4, we expect to see Morning Foods sales down slightly again, but down less than we saw in Q3. And we expect to see continued margin expansion, resulting in strong operating profit growth.

Slide 20 offers a few thoughts on 2017 for Morning Foods. We will look to build momentum, expecting to see sequential improvement in top line and another year of strong profit margin expansion. Our plan to achieve this revolves around the four ingredients Craig Bahner outlined a year ago: firstly, ensuring we have food that rocks through great innovation and value-adding renovation against our second priority; brands that matter, namely our core six Cereal brands and Pop-Tarts; thirdly, we will continue to drive excitement through events and properties that drive category engagement and fun in store. Helping this will be the recent completion of a further expansion of our sales force, adding more feet to the street. Fourth and finally, we will continue to expand margins through Project K, ZBB discipline, Revenue Growth Management and a higher return on investment on every marketing dollar we invest. This should keep us on the path towards the 2018 goals that Ron shared a moment ago.

If I were to highlight a couple of examples of initiatives coming early in 2017 on Cereal, I would point to some exciting innovations behind Frosted Flakes and Raisin Bran Crunch as well as a core food improvement initiative on one of our biggest brands, Mini-Wheats. We'll also place continuing focus on driving Special K through the expansion of the [ph] Nourish franchise and the renovation to turn it around (24:24).

On Pop-Tarts, following the success of A&W Root Beer and Orange Crush flavors, we have two new great Dunkin' Donuts-inspired flavors launching in Q1.

Let's now turn to Snacks on Slide 21. We saw strong progress in Snacks in the quarter. We continue to realize strong profit margin expansion, thanks to Project K and ZBB. We had planned to stabilize sales and we did just that. We saw good growth in Q3 by almost all of our focused brands. Let's start with Crackers, where our big three cracker brands, Cheez-It, Club, and Town House continued to collectively grow sales and gain share in the quarter. Pringles also grew consumption in the quarter. Rice Krispies Treats continued to grow sales and share and Nutri-Grain also picked up share.

Single-serve, a key element to our Snacks growth strategy, posted double-digit consumption gains in cookies and cracker caddy packs as well as in Pringles Snack Stacks. Legacy weight management offerings, particularly our Special K bars and Cracker Chips, remained a drag in the quarter, just as we said they would be as we go into more aggressive portfolio actions in early 2017. But even with this drag, the Snacks segment saw good sequential improvement in net sales.

So Snacks is starting to turn the corner for us. In Q4, we expect to see sequential improvement again in net sales to slight growth. With continued Project K and ZBB efforts as well as the work we're doing on Revenue Growth Management, we expect to generate margin expansion and strong operating profit growth, too.

Turning to 2017 on slide 22, for Snacks, our goal next year is to return to top line growth while further improving our margins. Deanie Elsner and her team will continue to drive the agenda they began this year, focusing behind our core brands like Cheez-It, Pringles and Rice Krispies Treats. And they will continue to do this through a combination of more impactful brand-building, innovation and renovation of food and packaging, in-store excitement and small formats to drive consumption in new occasions through expanded distribution.

Initiatives of note coming early next year are new flavors of Cheez-It Duoz and Cheez-It Sandwich Crackers, as well as the launch of a new line of variants under Pringles called LOUD. We will also continue to expand single-serve caddy packs and small format offerings, which we know are highly incremental.

Our other significant goal next year is to stabilize Wholesome Snacks. In the first quarter, we will be executing a comprehensive restage of Special K bars behind new food, packaging and communication, and bringing significant renovation and innovation to Nutri-Grain also.

Revenue Growth Management will be a key element for us in Snacks. We kicked it off with the Cheez-It brand in late 2015 and are still in the process of expanding it across our whole product line. These efforts, along with continued savings from Project K and ZBB, should boost our Snacks margins again in 2017, keeping us well on pace for our 2018 margin goals.

Now, let's turn to our U.S. Specialty Channels business on slide 23. This is a critical business for us when it comes to our strategic priority of winning where the shopper shops. And I'm happy to report that this segment continues to turn in steady growth in sales, margins and operating profit. In Q3, we once again delivered growth in all three of our core channels: foodservice, vending and convenience. We held or gained share in four of seven categories in foodservice, in three of five in vending, and in five of seven in convenience.

This impressive performance was driven by increased distribution, effective promotions around the Olympics, Pringles Summer Jam and a limited-time offering on Pop-Tarts as well as strong innovation performance in K-12, including items like Whole-Grain Rice Krispies Treats and Cheez-Its. Meanwhile, Revenue Growth Management and ZBB continue to improve our profit margins in this important business. And we expect more of the same in Q4, with a strong finish to the year across all channels.

Slide 24 shows some of our expectations for 2017. For Specialty in 2017, Wendy Davidson and her team expect continued top and bottom-line momentum across our channels. We plan to take advantage of category growth trends and to further leverage new food and packaging formats to drive brand ubiquity and reach across our core channels.

We'll leverage emerging channels to test and learn, just as we've been doing this year with Bear Naked custom granola in direct-to-consumer and in partnered innovation with restaurant chains. We'll also continue to generate margin expansion through Revenue Growth Management and ZBB, with [ph] K&A's (29:58) 2018 profit margin goal squarely in our sights. So we expect another good performance from Specialty in 2017.

Lastly, we'll discuss our North America Other segment, which is comprised of U.S. Frozen Foods, Canada, and Kashi and is shown on slide 25. In truth, I'm disappointed with the results of this segment in the third quarter. Canadian results were as we had expected. We experienced adverse volume impact in reaction to our increased list prices and [ph] feature (30:34) prices. These pricing actions were necessary to help offset higher input costs due to significant transactional foreign exchange pressure.

The rest of North America, however, is undergoing big transformations in food, packaging and SKU lineups. We thought these transitions would be fully behind us by Q3, but they are taking longer than we had expected. In Frozen, we recorded good profit margin expansion, but disappointed on the top line. Eggo posted sales growth with particular success in the quarter behind the Disney licensed products, but this was more than offset by the impact of distribution lost on Morningstar Farms as we transitioned over the past few quarters to new packaging.

At Kashi, we're encouraged by the stabilization we've seen in cereal share in measured channels as well as a plus 5% growth in the natural channel. It means our substantial innovation and renovation efforts are starting to take hold and we really haven't turned on broad scale consumer communication yet. So Cereal is on its way, even if it is still down year-on-year. However, Wholesome Snacks is proving to be a much bigger drag on sales than we had anticipated. Consumption has declined sharply as distribution losses have continued; proactive renovation and innovation interventions coming in 2017.

Let's look ahead to 2017 on slide 26. For the North America Other segment, we expect improved sales and profit growth as the Kashi, Frozen and Canadian teams reap the rewards of their work to reset in 2016. Overall, we expect to see top-line growth in this North America Other segment.

Meanwhile, RGM and ZBB, as well as lapping some heavy investment in food, should lift profit margins strongly. This will get us back on track towards our 2018 margin goals. Our Kashi cereal portfolio is poised to return to growth, as distribution has stabilized and our innovation pipeline is strong. The recently launched Dark Cocoa Karma Wheat Biscuit Cereal is going very well. And we have an excellent new GoLean variant coming in January. Acceptance so far from our customers has been strong.

Our largest challenge in 2017 on Kashi will continue to be Wholesome Snacks. We have renovation and innovation coming early in the year, which will significantly change the trend we have been experiencing. However, I doubt we will get the Wholesome Snacks part of this business back to growth on the full year.

In Frozen Foods, our focus is on driving core Eggo with new, taste-oriented communication breaking in January as well as significant renovation with the removal of artificials from all of our waffles in the first quarter. On Morningstar Farms, we are focused on reactivating communication now that the packaging is on-shelf and we have significant innovation building in the first half of the year. Finally, in Canada, we will be lapping our pricing interventions from this year and, as foreign exchange issues moderate, we expect to see a stabilization of sales and a return to margin expansion.

So in summary, there's been a ton of work behind the scenes this year in Kellogg North America, all aimed at getting our portfolio more on trend, enhancing our capabilities and execution and improving profitability. While our top-line growth hasn't consistently reflected these efforts yet, it is coming and we are seeing sequential improvement to go with impressive margin expansion. We are making definitive progress towards the 400 to 450 basis points of operating margin improvement we're targeting through 2018.

With that, let me turn the phone over to Chris Hood, President of Kellogg Europe.

Chris Hood

Thanks, Paul, and greetings, everyone, from here in Geneva. For Kellogg Europe, 2016 will be viewed as a year in which we improved our profitability and got most of our business back on track. We continued to accelerate the growth of Pringles. We returned Wholesome Snacks to growth. We stabilized our Cereal business in most of the region. And we're growing net sales in five of our six geographic clusters. The one exception is UK Cereal, which makes up just over 20% of our total sales. The UK's a market where a sluggish economy and a difficult retail environment have resulted in net price deflation. We've underperformed in our premium adult portfolio, most notably Special K and All-Bran, and this has resulted in sharp sales declines year-to-date in this important market.

But it's important not to overlook the good progress we've made elsewhere in the region. A good way to assess this progress is slide number 28, where we can compare against the priorities we set out for Kellogg Europe in 2016 and shared with you one year ago at the Day at K event. Cereal was stabilizing, with over half of our markets holding or growing share, a significant improvement versus last year.

Needless to say, our primary focus right now and into 2017 will be on stabilizing the UK business and getting Special K back on track. But we are showing improvement in the rest of Europe and that was a priority for this year.

Pringles has been a big success as we acquired this brand in 2012. We're seeing continued high single-digit growth, with broad-based share growth across almost all markets. This marks four years in a row of high single-digit growth in this brand. And we're doing this by strengthening the core of the brand and accessing new occasions in new markets via additional sizes and geographic expansion.

Wholesome Snacks has returned to growth across Europe in 2016, driven by investing in the renovation of Special K bars and innovation like Kellogg-branded fruit and nut bars. Our emerging markets of Russia and Arabia have made substantial progress, despite difficult operating conditions. Our Russian business is up strongly year-to-date and our acquisitions in Egypt, Bisco Misr and Mass Foods, are both growing at a rapid clip as well.

As discussed last year, e-commerce is a big channel for us in Europe. This channel represents over $100 million of our sales and we enjoy share premiums in our categories compared to the total market. And last, we continue to drive transformational change within our cost structure behind Project K, implementation of shared services, getting started with Zero-Based Budgeting where we're about a year behind North America, and implementing Revenue Growth Management to improve net price realization. We've increased our operating profit margin by 70 basis points already this year and by over 400 basis points over the last four years.

So there's good progress being made across Europe on the priorities we established last November. Unfortunately, the growth progress is being somewhat masked by difficult market conditions in the UK on our Cereal business. Looking forward, we expect to stabilize top-line sales and continue to drive strong profit expansion.

Slide 29 discusses our 2016 results and outlook. As you can see, we posted strong profit growth in Q3. Our sales were up slightly, almost solely due to our Cereal business in the UK. In the rest of Europe, we posted sales growth in virtually all of our sub-regions. France Benelux grew high single digits. Southern Europe and the Mediterranean Middle East posted low single-digit growth. And Russia recorded a strong double-digit gain. And we are holding or growing share in over half of our cereal markets, while sustaining strong Pringles momentum.

As we go into Q4, we will work to drive sequential share improvement on our core brands. And we should post another quarter of margin expansion and profit growth. We will finish 2016 with a slight decline in net sales, but significant profit expansion due to all of our productivity initiatives.

Turning the slide number 30, here's how we're thinking about 2017. In combination across Cereal and Snacks, we expect total Europe 2017 sales to be flat to down slightly. We're making good progress on stabilizing our Cereal business in most of Europe. There's already quite a bit of work going on in turning around the UK. We're simplifying and focusing our operations to drive a stronger core business.

We're accelerating the repositioning of the Special K brand behind recently-launched on-trend offerings like Special K Nourish, which has been successful elsewhere in the world. We're crafting a better, more balanced, commercial plan. And we're using Revenue Growth Management to get our prices and pack formats right in order to reverse the deflation that we've been experiencing. With all of these plans, we are expecting sequential improvement on UK Cereal during 2017 with continued decline, albeit at a moderated pace.

Pringles still has plenty of room to grow. Food renovation, commercial innovation and geographic expansion will all continue in 2017, and executing our productivity initiatives will continue to be a focus. Delivering our expected savings from Project K, Global Business Services and Zero-Based Budgeting are all critical to enabling the investment in food renovation and covering Brexit-related transactional currency impact.

In summary, we have more work to do, but we are seeing some green shoots of sales recovery. And we are confident that we can bring stability to our European Cereal business while continuing to grow Snacks. Meanwhile, we'll continue to boost productivity to drive profitable growth, staying on course toward our 2018 operating profit margin goal of 300 to 350 incremental basis points.

With that, let me turn the phone over to Maria Fernanda Mejia, President of Kellogg Latin America.

Maria Fernanda Mejia

Thanks, Chris, and good morning, everyone. Latin America continues to be an important growth opportunity for Kellogg, a key element to the company's 2020 Growth Plan. Our programs are fully aligned to this growth plan and we're prioritizing investment behind markets like Mexico, Caribbean Central America and Andean, strengthening our leadership in cereal while expanding our snacks footprint. And we're building scale in more emerging markets like Brazil. But, as you know, nothing is ever simple in Latin America. We have to manage very carefully through an extremely challenging external environment.

When we met last November during Day at K, we outlined our strategy and key areas of focus for 2016. A year later, I'm pleased to share with you the tremendous progress, as shown on slide 32. Leading category growth is evident from our share growth in many core cereal markets, our record shares in wholesome snacks in Brazil and Colombia and our double-digit growth on Pringles in markets like Mexico. Driving this growth has been innovation. We've expanded our offerings under the Kellogg's parent brand, growing double-digit. And our most recent introductions for Special K Protein cereal and nut bars are exceeding our expectations.

We continue to drive our distribution and sales coverage in high-frequency stores, while improving our in-store execution by tailoring our regional commercial programs by retail environment. And we've continued to increase our supply chain network utilization significantly over the past three years.

We've enabled our innovation platforms, strengthened our packaging capabilities and evolved our business models through partnerships with co-manufacturers, enhancing our speed to market. And we delivered margin improvement through efficiency programs like Project K, [ph] KIM (42:57) and ZBB, all of which are combining with price realization to offset foreign exchange headwinds, so great progress being made across our priorities.

A driver of market expansion will be M&A. And one of the most exciting transformational components of our growth plan can be seen on slide 33. Our recently-announced acquisition of Parati, which we hope to close in the fourth quarter, completely changes the game for us in Brazil, a market where we have been present and where we've been growing for a number of years, but where we've lacked critical scale. With Parati, we more than double our size in the high-growth potential Mercosur region, bringing it from just over 10% of Kellogg Latin America sales to over 25%.

And we substantially increased our overall presence in Snacks, taking it roughly from 20% of Kellogg Latin America sales to about a third. This is a company that plays in attractive categories with strong brands and a track record of growth. It's largely regional, with its foothold in the south, so there is geographic expansion opportunity. Its [ph] strength (44:15) in high-frequency stores will be leveraged across our Kellogg brands.

Slide 34 summarizes our performance in Q3 and our outlook for Q4. After a relatively soft first half, driven by region-wide economic slowdown and FX impact, we returned to growth in quarter three. We saw growth in both Cereal and in Snacks, and the growth was broad-based. Mexico, Mercosur, Caribbean Central America all posted sales growth in the quarter, aided by price realization.

For the region, excluding volatile Venezuela, we've held our share for the cereal category flat year-to-date, with gains in markets like Brazil, Colombia and Puerto Rico. And in the recent periods, we have seen Mexico regain some share it lost earlier in the year. Snacks is showing strong momentum across the region, both on wholesome and salty. Meanwhile, our productivity efforts and price realization are starting to flow through to profit margin, which improved strongly in the third quarter. The team continues to manage well through very difficult economic and currency conditions, and we should not overlook the very good work done to manage through continuous crisis in Venezuela.

We are expecting another quarter of sequential acceleration in net sales in the fourth quarter on improved price realization, stronger commercial plans and relevant innovation across categories hitting the stores and this, despite a difficult economic environment in Brazil. Profit margins in the fourth quarter should continue [ph] to be higher, (46:02) due to price realization and additional efficiencies generated through our recently-launched ZBB initiatives.

On slide 35, we show our priorities for 2017. And everything starts with our largest market, Mexico. The sequential improvements we're seeing in the second half of 2016 will continue into 2017, with exciting innovation to grow consumption in Cereal, continued expansion into the HFS channel, effective brand-building and exciting opportunities behind our growing Snacks businesses. The integration of Parati in Brazil will be executed flawlessly, given our proven success with integrating Pringles several years ago, coupled with our common cultures and complementary businesses.

Revenue growth is critical to driving profitable growth, executing our portfolio by retail environment and implementing the right price and size. Effective promotions, while driving mix, will help us generate sales and profitability. And we'll continue our path towards supply change optimization with step changes ahead.

So in summary, a laser-sharp focus on these priorities should allow us to better manage through current regional volatility and deliver good low single-digit growth and expanded profit margins in 2017. This will put us well on our way toward our 2018 margin expansion target of 100 to 200 basis points.

And with this, I'll turn it over to Amit Banati, President of Asia Pacific, currently in Singapore.

Amit Banati

Thanks, Maria Fernanda, and good morning; well, evening for me from Singapore. We are having a good year in Kellogg Asia Pacific. Our top-line growth has a consistent, led by Pringles and emerging markets, and our joint ventures are also growing strongly. Profit margins have moved higher and we have plans to increase them further. And, most importantly, we have continued to make progress in our key strategic initiatives, and these will make Asia Pacific a sustainable growth engine for Kellogg for years to come.

One slide 37, we show the priorities for Asia Pacific that had been communicated at Day at K last year. In 2016, we continued to make strong progress against our priorities to transform the region. We have a more balanced portfolio. Asia and Africa now account for about 2/3s of the region sales. Snacks now accounts for about 1/3 of the region's sales.

We have made good progress in stabilizing our Australian business, particularly in Cereal, where we are seeing much better category and share trends. Pringles has delivered strong growth in 2016. After two years of double-digit growth in Asia, we have seen growth moderate in 2016, primarily due to challenging market conditions in India in the first half of the year. But we are growing overall and India is recovering in the second half. And in Sub-Saharan Africa, we are seeing strong growth in both our wholly-owned operations and our joint venture in Nigeria.

Slide 38 discusses our quarter three performance and how we see quarter four shaping up. We continued to post increased sales in quarter three, with Pringles and emerging markets driving the growth. We are seeing our Australian Cereal business stabilize in 2016, with improved consumption and share trends in the cereal category. The drivers of improved performance include: our renovation to four-star food of our biggest brand, Nutri-Grain, which is now in growth; the launch of a gluten-free range, which is the number one innovation in the Cereal category year-to-date; and improved execution in store.

Our Pringles business had a strong quarter three, growing sales at a double-digit rate. Growth was driven by distribution expansion in emerging markets and new innovation expanding the Pringles portfolio such as the introduction of [ph] three flavors (50:31) in Korea and the launch of Tortilla across the region.

Emerging markets remain a source of growth for the region, with Sub-Saharan Africa and Southeast Asia key highlights for us in quarter three. Quarter three sales growth was impacted by Korea lapping the year-ago supply disruption of a major competitor. Growth was also impacted by challenging economic and regulatory conditions in India in the first half, and our Snacks business in Australia has remained soft. We have seen sequential improvement in our performance in India and Australia Snacks each quarter. As a result, we expect growth to accelerate in quarter four. This will result in fully outpaced growth in the low single-digit range.

Again, it is important not to forget our unconsolidated joint ventures shown on slide 39. These are a key element of our emerging markets growth strategy. Year-to-date, our joint venture in China and our joint venture and investment stake in Nigeria are both growing at a strong double-digit rate, despite operating in very challenging business environments. When you consider that our share of these businesses net sales is equivalent to roughly half the size of our Asia Pacific region, you can understand how significantly they would add to our overall growth if they were consolidated into our results.

We have strong plans for 2017 represented on slide 40. We will build on our progress on stabilizing our Australian Cereal business. Turning around our Wholesome Snacks business in Australia will be a key priority. We recently launched Special K [ph] Protein bites and Nutri-Grain Edge bars (52:31) and they are both off to a strong start. We have also relaunched the Be Natural brand with new food and packaging.

Emerging markets will continue to be a growth driver across both cereal and snacks. In cereals, we continue to drive category development in emerging markets, and we will also launch wholesome snacks in South Korea and Southeast Asia. We continue to expect strong growth on Pringles behind innovation and distribution expansion in emerging markets as we expand offerings at affordable price points. Small cans now account for 20% of our Pringle sales in the region. 2017 will also see an increased focused on driving operating margin expansion as we roll-out Zero-Based Budgeting and Revenue Growth Management.

In terms of outlook, we expect net sales growth in the low single-digit range for Kellogg Asia Pacific in 2017, with sales from our joint ventures, in effect, bringing that pace of growth much higher. Meanwhile, profit margins should expand, driving higher profit, and putting us closer to our 2018 margin expansion target of 100 to 200 basis points.

And with that, I'll turn the call back over to John Bryant for some final remarks.

John A. Bryant

Thanks, Amit. Let me wrap up with slide 41 and a few key messages I'd like to leave you with today. We are making clear progress toward our priorities. We are doing what we said we'd do, and this will lead to continued improvement in our financial performance. We are disappointed by our recent sales performance, but improving underlying fundamentals points to sequential improvement in Q4 and 2017.

We have unprecedented earnings visibility. That's because of our productivity programs, like Project K and ZBB. It's because of Revenue Growth Management and it's because of a refreshed Volume to Value operating model. And we have increased confidence that we can achieve our goal of raising our operating profit margin by 250 basis points from 2015 through 2018.

I'd like to thank all of our employees for their hard work and dedication. And with that, let's open up the line for Q&A.

Q&A

Operator

We will now begin the question-and-answer session. [Operator Instructions] Our first question comes from Jason English with Goldman Sachs. Please go ahead.

<Q - Jason English>: Hey. Good morning, folks. Thank you for the question. First, real quick housekeeping item, Ron, how was your advertising spend tracking year-to-date just so we can get a bead in sort of underlying SG&A and the efficiency that's being squeezed out there?

<A - Ronald L. Dissinger>: Yeah, first, Jason, let me remind you we're committed to investing in our brands and our food, and we invest at industry-leading levels. And we had very strong pressure in the third quarter as well. The fact is Zero-Based Budgeting highlighted some opportunities for us from an efficiency and an effectiveness standpoint to ensure that we're investing with impact into our business.

For example, we found opportunities in agency fees, so the non-working elements of our brand-building and also in production costs. And, as you know, the model to build brands in the marketplace today certainly is evolving. Now in the third quarter, we saw our brand-building as a percent of sales down about a point. So we did have some money come out, but remember we're investing back into our foods in conjunction with that.

<Q - Jason English>: Okay. Quick follow-up then for Paul, if we still have him on the line; Paul, not unlike the industry at large, we're seeing an algorithm for your growth in North America be accompanied by lower A&P and a bit more pull on the pricing lever. We're starting to see price gaps from private label widening out a bit. How do you guys think about defending against private label encroachment as you're trying to get prices higher, at the same time pulling back on some of the traditional brand-building levers?

<A - Paul T. Norman>: Thanks, Jason. I think it's a good point regarding our private label brands. I mean, our focus is clear on investing in our brands, first and foremost. So you probably heard me say it on several occasions, investing behind our biggest brands, be that our big three crackers, our core six cereals, Rice Krispies Treats, the Eggo brand, the Pop-Tart brand, investing in the food in ways that continuously improve our offerings, sometimes that's removing things people want less of, sometimes that's putting more in what people want more of, like red berries, for example, in Special K. Those are the things that allow branded companies like ours and our big brands to compete and play effectively for consumers' pocketbooks in the marketplace.

So my focus is very much in improving our foods, bigger better ideas, and driving our investment behind those things. Now how you invest, whether it's old school television or whether it's more socially-driven, I think that's what all of us are working towards. So it doesn't mean that you invest like you always did to get the return you always got. You can be more efficient and effective in the ways you go forward.

<Q - Jason English>: Okay.

<A - John A. Bryant>: Jason, if I could just add to that, I think if you look around the world, in general, private label shares are not doing well in our categories. So we're holding our own. In fact, we're doing better than private label in the majority of our categories around the world. I mean, I would strongly disagree with the comment of pulling back on brand-building. We're absolutely committed to brand-building. We spend at industry-leading levels. We can be more efficient at doing it, and that's where the Zero-Based Budgeting benefits are coming through.

And we can change how we spend brand-building to next generation marketing more. That's what Paul was referring to in terms of spending more on digital and less on, say, traditional TV-type advertising programs. So we're absolutely committed to driving strong brands and we think we can do it more efficiently and effectively over time.

<Q - Jason English>: Understood. Thank you, guys.

Operator

The next question comes from Robert Moskow with Credit Suisse. Please go ahead.

<Q - Robert Moskow>: Hi. Thank you. I guess I wanted to take kind of a step back on, John, your international investments. You've made now two more medium-sized, I guess, acquisitions in emerging markets. And I just kind of went back and I looked at the profitability of your international business, and it really has not moved, even if I go back maybe even 13 years. Maybe Europe is a little better, but Latin America way down. The promise of international for Kellogg has been around for a long time, and I was hoping you could kind of take a step back and give us some perspective as to why has it not developed the way maybe you would've hoped over the past 10 years? And so, why double-down on it now to try to reignite it and even in some countries where the visibility, like in Africa, is pretty low?

<A - John A. Bryant>: I think a few things give us great confidence in our ability to grow internationally going forward. One, if you go back to our 2020 growth strategy, emerging market expansion was a big part of that strategy, and you're seeing us make that a reality. We have invested actually in all three of our international regions with emerging market acquisitions or joint ventures in the last year or two years.

We've made significant investments in Nigeria, helping us open up Africa. We've made two acquisitions in Egypt, helping us expand the Mediterranean Middle East region. And we made a very important acquisition in Brazil earlier this year, which transforms that marketplace for us. All these elements help us build a larger emerging market footprint within our company. It's also worth highlighting that Pringles has changed the nature of our emerging markets business from being focused on cereal, to also having the ability to drive snacks expansion.

Pringles has certainly helped us make that a reality within the emerging markets. So as we go forward, we think we are increasingly well-positioned to get better growth, both on the top line and on margin expansion, as you heard from the international area presidents here this morning.

<Q - Robert Moskow>: Could I ask a follow-up? Can you give us an update on the profitability of the Nigerian acquisition? As I look through the JV line, I don't see any profits flowing through. Is there something more to it?

<A - Ronald L. Dissinger>: Rob, it's Ron. The Nigeria investment is making money. There are a number of other things that are flowing through that line, other joint venture investments, including China and a small joint venture in Turkey as well, but we are profitable in Nigeria. And as you heard from Amit, we got very strong sales growth within that market as well.

<Q - Robert Moskow>: Is it meeting its objectives for 2016?

<A - John A. Bryant>: Amit, do you want to talk about the performance of the Nigerian business?

<A - Amit Banati>: Yeah, sure. So we are driving strong double-digit growth on our JV in Nigeria. Despite the economic challenges in the market, margins are largely flat. I think the investment that we made in Multipro, it was a distribution business, so largely local in nature, which has allowed us to continue to hold margins, despite the challenging economic environment. And broadly, seeing very strong growth in the business and are on track with the initial acquisition case.

<Q - Robert Moskow>: Okay. Thank you.

<A - John A. Bryant>: Thank you.

Operator

The next question comes from Chris Growe with Stifel. Please go ahead.

<Q - Christopher Growe>: Hi. Good morning.

<A - John A. Bryant>: Good morning.

<Q - Christopher Growe>: Good morning. I just had two questions, if I could; the first would be in the past, you've given kind of at least a preliminary indication for EPS growth for the coming year. Are there any nuances maybe, Ron, that we should think about for EPS growth for the coming year?

<A - Ronald L. Dissinger>: Well, it's a little early from a currency standpoint, Chris, for us to give guidance on how currencies may impact our business. So that's one thing that we'll need to consider and certainly the impact that Brexit has had on the sterling. The other thing is you heard me communicate on the call here that we expect our tax rate this year to be about 25%. So we'll be lapping that as we move into 2017.

<Q - Christopher Growe>: Okay. And then, just a question for you overall on Revenue Growth Management and the way that we should expect that to kind of feed into revenue growth going forward, is there an immediate effect on volume, maybe a negative effect on volume, for instance, that we're not seeing made up for in the form of higher pricing and mix? Like this quarter, I expected to see price and mix higher. I think in most divisions, actually, it was lower. Is that still to come? Is that the way to look at that?

<A - Ronald L. Dissinger>: Yes. What I would tell you, Chris, is that our Revenue Growth Management work is in its early stages and it's unfolding. We're a bit more developed in some of the U.S. businesses versus our international markets. But where it's progressing well, though – remember what I said in the opening remarks is that we expect, as we go through 2017, 2018, volume to be down and price mix to be improving. Some of this work takes time before you see it unfold within the profit and loss statement. And let me remind you there are a number of different areas that we're taking a look at.

First of all, our trade investment and the efficiency and effectiveness of that trade investment. We're also looking at pack sizes to make sure we have the right pricing structures in pack sizes on shelf, and then we're doing things around mix management. So it takes time to work that from consumer to shelf through the customer and then back into our business. But we'll see that unfold in 2017 and 2018 as well, Chris.

<Q - Christopher Growe>: And has that been in place, [ph] revenue management in North America, throughout 2016 or was (65:06) it phased in through the year?

<A - Ronald L. Dissinger>: Phased in through the year.

<A - John A. Bryant>: I'd say, again, it's still pretty early days for us on Revenue Growth Management. So I think you're seeing better performance in Q3 than the front half of this year. We expect Q4 to be slightly better again, but this is not a sudden shift. This is a build-up over time of the various work we're doing in this area

<A - Paul T. Norman>: I think Deanie highlighted some examples on the last call of how we're beginning to see some improved performance in Cheez-It come through and we are getting the benefits of the work, but we started with Cheez-It. We're now moving across other brands.

<Q - Christopher Growe>: Okay. Thanks for the time today.

Operator

The next question comes from Michael Lavery with CLSA. Please go ahead.

<Q - Michael Lavery>: Good morning.

<A - John A. Bryant>: Morning, Michael.

<Q - Michael Lavery>: You talked at Day at K last year about some of the investing in cookies and the repertoire portfolio and unlocking some of that potential, but it hasn't really been one of the ones you've talked about, the Keebler brand specifically. What's the status there? Is that still something that you see as an opportunity? How do you think about that evolving in your snacks portfolio?

<A - Paul T. Norman>: Thanks, Michael. That's a great question. If you look at the Keebler brand in the third quarter, our sales, our consumption was down about 0.8 of a percent and our share is stable. We reinvested in the brand in about March this year with brand-building advertising and also some food innovation, which is coming through now. And we've seen base sales in the third quarter up almost 6% in the marketplace in the third quarter. And in the more recent data, it's continuing to grow.

So we do have a [ph] tale (66:52) within our cookie portfolio that we're working on, though, specifically, the Keebler brand, we feel good about the Keebler brand. And the team has done a great job. I mean, the brand is stabilizing in consumption, like I say, and we're seeing good baseline sales growth, and a little bit of price from a unit point of view coming through, which is positive. I just didn't mention it today.

<Q - Michael Lavery>: Okay, that's helpful. And then, just a follow-up on wholesome snacks, you talked about that being under more pressure both in the U.S. and Australia. But in Europe, you've cited that as an area of strength. What are some of the differences there? And how transferable are some of the things you're doing in Europe into other markets?

<A - John A. Bryant>: Maybe I'll just talk more broadly about wholesome snacks. I think when we have our food on trend that is in line with the positioning of the brand, we do very well. And it's some of the great work that Chris and the team in Europe have done around relaunching some Special K food that is more on trend with where that brand is going. I think you're seeing some good response.

I think we still have some work to do in some of our markets around the world to ensure that the food really is delivering against the promise of the brand. And we have those plans in place and you'll see more innovation coming out against that in 2017. Paul, do you want to add any comments?

<A - Paul T. Norman>: Yeah, I would say if you look at the U.S. business, Rice Krispies Treats has grown sales and share. Nutri-Grain's hanging in there and growing some share in the category as well. Our drag has been the Special K brand and some of those legacy foods as John mentioned that are probably off trend and more kind of linked towards diet. We have a significant restage coming in Q1 2017, with I think eight new foods around Special K brand and also around the Nutri-Grain brand as we seek to stabilize that part of our business next year overall. So it will take significant investment in food as the starting point to stabilizing that business.

<Q - Michael Lavery>: And just in Europe, did it never really have as much of a diet positioning or does it not have that hole to dig out of? What's working in Europe that's unique?

<A - John A. Bryant>: Let me say some comments and I'll hand it over to Chris. There has been some new innovation. The positioning of Special K in Europe was very much against that traditional weight management positioning, and that is something we're looking to evolve over time. Chris, you want to talk more about the Wholesome Snacks performance in Europe?

<A - Chris Hood>: Yeah, sure. I mean, I think there's some rejuvenation on the Special K bars, as John has referenced, but the other thing that's driving our results in Europe is the introduction of Kellogg-branded fruit and nut bars, which are on-trend, very tasty foods that we launched into the UK this past year and we're now expanding more broadly across Europe. So that's been the other driver.

<Q - Michael Lavery>: Okay. Thank you very much.

Operator

The next question comes from Jonathan Feeney with Consumer Edge Research. Please go ahead.

<Q - Jonathan Feeney>: Thanks very much, guys. Just a quick one; Paul, you talked about you maybe being a little ahead of in Snacking in North America versus where you are in maybe getting Cereal turned around. I'm trying to understand. I've asked this before, years go, but I'm trying to get caught up here. Can you give us a sense of the difference in contribution margins between those two products and if there's there a significant negative profit mix if Snacking does a little bit better than Cereal? And any way of quantifying that both this year and maybe going forward so we can understand what kind of base you're working with as you just get generally more efficient? Thanks.

<A - Ronald L. Dissinger>: Hey, Jonathan. Well, I won't point to specific margin structure of the different categories within the Snacks business or Cereal business. I would tell you, and I mentioned this in the opening remarks, our Wholesome Snacks business has strong margins. And as that business has been soft for us, that's had an impact on our business performance and our gross margin as well. When you look across the Cereal business broadly, our Morning Foods broadly and Snacks broadly, the overall gross margin structures and contribution structures are pretty comparable.

<Q - Jonathan Feeney>: Okay. Thank you very much.

Operator

The next question comes from Bryan Spillane with Bank of America. Please go ahead.

<Q - Bryan D. Spillane>: Hey, good morning, everyone. Just one housekeeping and then just one question; in terms of the revenue guidance change today, just how much was the cereal inventory, the unexpected inventory reductions, have the effect on the revenue guidance? Just trying to get a sense of if that that didn't happen, would you have needed to reduce your revenue outlook?

<A - Ronald L. Dissinger>: This is Ron, Bryan. Looking at the current trends, we probably would have reduced our revenue outlook, but that trade inventory reduction was significant in Morning Foods. There was a big difference between our shipments and our consumption. And from recollection, it was about a half a point or a little bit more within the quarter.

<Q - Bryan D. Spillane>: Okay. And that's now past you, meaning it won't be a drag going forward, right?

<A - Ronald L. Dissinger>: It won't be a drag going forward, and we didn't plan that inventory to come back into the business either. So we took a prudent approach to how we expect the balance of the year to unfold.

<Q - Bryan D. Spillane>: Okay.

<A - Paul T. Norman>: So just to clarify, just to add some more to that, I think our consumption this year on cereal is down about 1%. Our shipments are probably down a couple hundred basis points more than that this year in U.S. So it would be our expectation and so the half point that Ron was referring to before was the total company net sales impact in Q3.

<A - Ronald L. Dissinger>: Yes. That's correct.

<Q - Bryan D. Spillane>: Okay. That's helpful. And then, Ron, I think earlier, maybe on the 2Q earnings call, you talked about Project K delivering about $100 million of savings this year and then ZBB was, I think, $150 million to $180 million. So is that still the range? Has any of that changed for 2016? And then, as we look at 2017, is the incremental impact from Project K and ZBB similar or more or less than this year? Just trying to understand maybe what drives the margin expansion next year if it's different, if it builds differently in 2017 than 2016?

<A - Ronald L. Dissinger>: Absolutely. So let's start first with 2016. Project K is on track and delivering against its financial objectives. We communicated approximately $100 million worth of savings and we're still on track for that number. Zero-Based Budgeting, the latest update I had provided was that our Zero-Based Budgeting savings in 2016 would be in the range of $150 million to $180 million. Now, we are hitting more towards the top end of that range, maybe even a little bit above that range as we look at our most recent outlook for the year. So we're seeing very good performance from Zero-Based Budgeting.

Now, let's move that into 2017. And I did provide an update at the Barclays conference, if you wanted to refer to some charts there, you'd see it on the charts as well. But Project K, balance of the program to hit the $425 million to $475 million worth of savings, so roughly $140 million to $190 million of savings over the next couple years, 2017 and 2018, to hit that range. And we have said that more than half of that savings would come in 2017.

When you look at Zero-Based Budgeting savings and the way we've outlined it, it's roughly a third, a third, a third unfolding in in 2016, 2017 and 2018. So the savings are pretty comparable.

<Q - Bryan D. Spillane>: Okay. That's helpful. Thank you.

<A - Ronald L. Dissinger>: You bet.

Operator

The next question comes from Alexia Howard with Bernstein. Please go ahead.

<Q - Alexia Jane Howard>: Good morning, everyone.

<Q - John A. Bryant>: Morning, Alexia.

<Q - Alexia Jane Howard>: So can I ask just as a follow-up to what Bryan was asking about with the unexpected trade inventory reductions, in U.S. Cereal, was that predominantly driven by reduced shelf space being allocated by the retailers? And I guess within that, is the strategy for 2017 to really focus in your six core cereal brands and maybe to allow shelf space to be reduced on the non-core brands? And do you expect to get back to sales growth in U.S. Cereals in 2017? Thank you and I'll pass it on.

<A - Paul T. Norman>: I'll get that. Hi, Alexia. No, will be the answer to the first part of the question, that it was not linked to any reduction in space by any of our retailers. I think we were carrying maybe a little bit of incremental inventory through the first part of the year and it came out in the third quarter. We're trying to be, as Ron said, cautious and not planning to come back necessarily in the final part of the year. Regarding the core six, our strategy is to drive the core six hard. And that means investment in food. That means investment in great ideas, and that means really working our core assortment across all retail environments extremely hard, so that we get the maximum out of those brands. We also need to turn Kashi back to growth next year as well. If we do those things, I think we can be optimistic about the sequential improvement track in front of us in Cereal as a company and in Cereal as a category back towards flat or better in 2017.

<Q - Alexia Jane Howard>: Great. Thank you very much. I'll pass it on.

Operator

The next question comes from Steven Strycula with UBS. Please go ahead.

<Q - Steven Strycula>: Hi. Good morning.

<A - John A. Bryant>: Morning, Steven.

<Q - Steven Strycula>: I want to follow up on Alexia's question and bring us back to like a bigger picture view on cereal innovation in the category. If we were wanting to clock back a few quarters and think about how you and Mills and a few of the other guys in the industry were thinking about category growth rate at the start of the year, you would have said something about like flat to low single digits, driven by gluten-free, artificial-free, all these different forms of incremental innovation. What do you think, at the end of the day, stopped us short of reaching that goal? Was it food deflation, something in consumer behavior? But bottom line, what do we need to see to bring incremental users to the category?

<A - John A. Bryant>: Maybe I could start and then hand it over to Paul to add any more comments. So I think earlier this year, I was asked if I thought U.S. Cereal would grow in 2016. And I said, yes, I thought we would. And part of that was the improvement we're seeing over the last three or four years in consumption trends in cereal, particularly in our business. And if you look at consumption in 2017, we're going to end up down about 1%. That's actually a significant improvement over prior years, not quite where I hoped we'd get to, but we're certainly trending in the right direction.

Our shipments might end up being 100, 200 basis points less than that because we are expecting a full-year trade inventory reduction in the Cereal business based on what we saw in the third quarter. So I think we're heading in the right direction. Was I a little bit maybe too optimistic we'd get there in 2016, perhaps, but I think as Paul said, we get to 2017, we expect to see the continued improvement. And it's going to come through by engaging consumers with great food, engaging them with the brands, bringing it to life in store, a whole variety of factors that we know historically have driven the Cereal business performance.

<Q - Steven Strycula>: Just to follow up on that. Just wanted to see what is the greatest lift that you're seeing? Give us a tangible example of what really moves the needle most within the Cereal category, whether it's putting ingredient quality back into the box or is it the merchandising or the trade? I know it's probably a little bit of all of this, but what, in your view, when you think reinvesting Zero-Budget Budgeting savings, what gives you that best incremental pop or ROI, so to speak?

<A - Paul T. Norman>: Okay. Well, if you think about Cereal, each brand is different so what makes one brand react might be different from another. We clearly saw a reinvestment in our core foods around, say, Special K red berries, which is a significant part of our lineup. Turn the business back to positive growth on a year-to-date basis this year, K is growing and growing share. We see Rice Krispies do extremely well this year, not because of necessarily innovation or renovation, but because of consumer engagement around recipe usage and versatility and I think that's driving that brand.

Frosted Flakes is another brand that's growing well against teens and tweens this year so and that again I would say is driven by in-store activation behind big properties; properties like Finding Dory or the Olympics event. So it's not the same ingredients behind every brand.

When it comes to ZBB reinvestment, we have put some money back in the business this year. We put it back in our sales force again to drive greater activation right through to the point of purchase. So sometimes, it's behind the brand. Sometimes, it's focusing on getting the assortment right and the perfect shelf at store, and that takes resources at the store level to do that. We did choose to reinvest in Keebler this year, which obviously isn't cereal, but that was a choice coming out of ZBB reinvestment. And we've seen positive returns on that.

So I do think it comes down to core six brands and the one thing we can do better next year, I believe, is get Kashi back to growth. Kashi responds to many needs out there that some of the Kellogg traditional legacy brands can't. It's growing in the natural channel 4% to 5%. We need to get it beyond stable to growth in mainstream measures channels as well next year. We do that plus the core six, I think you'll see the category flatten out and maybe tip into growth.

<Q - Steven Strycula>: Great. Thank you.

Operator

The next question comes from John Baumgartner with Wells Fargo. Please go ahead.

<Q - John Joseph Baumgartner>: Good morning. Thanks for the question. Paul, I'd like to come back to the comment about the prolonged transition on shelf for Kashi. I wonder if you can elaborate a bit in terms of how much is internal execution relative to just a more challenging environment for natural organic overall and maybe what changes you're making from here?

<A - Paul T. Norman>: Thanks, John. That's a great question. Let me start off by saying, in all openness and honesty, I'm disappointed by our performance in Q3. I did expect a little more progress than we got. We started, as you know, 18 months ago, we put our team back out in California. And that team has been extremely focused on getting our food right. So we have completely renovated all of our foods to be Non-GMO Project Verified and about 30% to 40% of our portfolio is now organic. So we've done a lot of the fundamentals of getting the food right, in particular in our biggest business.

We then decided to exit some categories, frozen pizzas for example. And we're getting out of things that we don't think are a good fit for the Kashi brand. And we turned our attention to innovating and renovating aggressively on our Wholesome Snacks business, which, as John mentioned earlier, Wholesome Snacks is again all about getting the food right.

As we look at consumer reaction to Kashi, we're getting good reaction, a lot of positive social reaction to the brand, which means I feel confident about the equity. I think our foods are all getting back on trend. I think, and this is the important bit, you're right. With great execution, which I think we can improve on, we will return this business to growth. So I think there's a journey we're on here and we need to turn up execution because I think all the other elements are coming together.

We have brand new communication about to hit early next year. It would have been great if we could have got that out a bit earlier, but we're getting to where we want to get to. We just need to execute now.

<Q - John Joseph Baumgartner>: Great. Thanks, Paul. And just a follow-up, more broadly in terms of your emerging markets outlook through 2018, you're targeting margin expansion in both Lat Am and AP. Yet, it also sounds as though there's quite a bit of heavy lifting ahead in terms of investments in new and existing territories. Can you speak to maybe where your resources are right now in terms of people investments, brands spending and otherwise relative to target? And what gives you the confidence you can grow margins even as investment increases?

<A - John A. Bryant>: Well, I think as you look around the world, you look at our margin expansion goals, they are more in Europe and North America. So not surprisingly, that's where more of the heavy lifting is from a margin expansion perspective. But even in the emerging markets, we do expect to see margin expansion. We expect to see that because a lot of the initiatives that we have underway. So I'm going to hand it over to Maria Fernanda and to Amit briefly just to talk about some of the things they're doing to drive margins in their regions, starting with Maria Fernanda, then to Amit.

<A - Maria Fernanda Mejia>: Yeah. Thank you, John. So much of our focus around our historical profit margins has been due to investing in emerging markets, investing in Snacks and HFS. I think this year, the focus in moving toward our targets, we are expecting significant productivity progress, as I mentioned, continuing to optimize and streamline our supply chain, focusing on lowering our total delivered costs. Certainly [ph] KIM (83:58) has been quite significant for us, improving our margins in Latin America as well as RGM and ZBB and Project K.

So I think we've demonstrated great discipline in the execution of Project K. And moving forward, we'll transfer that discipline to our ZBB efforts, which we're already starting to see flow through second half of this year, as well as Revenue Growth Management. We talked about several years ago, we set the portfolio right in Latin America. We're focusing our efforts behind those core brands. And looking at total commercial investment through the lens of RGM, I think will help enhance those margins and optimizing our overhead through continued Project K.

<Q - John Joseph Baumgartner>: Thanks, Maria.

<A - John A. Bryant>: Amit, do you want to add anything?

<A - Amit Banati>: Yes. From an Asia Pac standpoint, we're rolling out similar to Latin America, we're rolling out a number of initiatives to drive margin, including Zero-Based Budgeting and RGM, which will enable us to expand margins by around 100 to 200 basis points by 2018, while also providing the fuel to invest behind our 2020 Growth Plan. And as we had outlined in our 2020 Growth Plan, we're focused on [ph] doubling our snacks business in the region, while (85:16) doubling our business in Asia and on scaling up Africa.

<Q - John Joseph Baumgartner>: Okay, thank you.

Operator

The next question comes from Ken Zaslow with Bank of Montreal. Please go ahead.

<Q - Kenneth Bryan Zaslow>: Hey. Good morning, everyone.

<A - John A. Bryant>: Morning, Ken.

<Q - Kenneth Bryan Zaslow>: Just a high-level question on the European margins, there's still to be a fairly wide variance between North America and European margins. Is there an opportunity to actually narrow that gap, even as North American margins go higher and would you expect the cadence of ZBB to accelerate in Europe as well?

<A - John A. Bryant>: Well, let me just say before handing it over to Chris to talk about some of the things we're doing in Europe and great progress in terms of expanding margins over the last few years and how that will progress, let me say that, in general, I think European food companies operate at a lower operating margin than North American food companies. So I [ph] don't (86:12) think that's unique to Kellogg. I think it's pretty standard out there, but, Chris, anything you want to add on the European margin progression?

<A - Chris Hood>: No, I mean, I think we've already said it. I think we've made great progress, 400 basis points over the last four years, another 350 or so over the next few years. And we're essentially following the same playbook that the rest of the company is following around ZBB and RGM as well as some Project K initiatives. So we've got good visibility and we expect to make strong progress.

<Q - Kenneth Bryan Zaslow>: Great. Thank you.

Operator

The next question comes from Mario Contreras with Deutsche Bank. Please go ahead.

<Q - Mario Contreras>: Hi. Good morning.

<A - John A. Bryant>: Good morning, Mario.

<Q - Mario Contreras>: I wanted to ask about the Morningstar Farms business. So I know that you talked about some challenges there in terms of losing distribution. Can you comment a little bit more specifically on what's driving that? Is it that retailers aren't responding to the new packaging or is it just the new packaging isn't available, so they're essentially not taking orders at this time? And then, maybe from a longer-term perspective, this is a pretty on-trend category. Are you expecting a fairly quick return to growth once the packaging situation is resolved? Thank you.

<A - Paul T. Norman>: Hey, Mario. It's Paul here. Yes, let me break this down. We're actually disappointed with the transformation of Morningstar Farms, not from a consumer point of view. We have consumer-validated and qualified packaging that we feel very good about. With any disruptive innovation, sometimes things can get disruptive, and we have not executed through to the shelf at the pace we expected to be able to execute. So I do think this is a case of execution, unfortunately, in the Morningstar Farms business.

If I looked across our business, I look at cereal, I look at snacks, we've seen some very good execution. Kashi would be one area, or Morningstar Farms, where I think we have opportunity to improve. The good news is, like I say, our packaging is consumer-validated.

We are now in a place where our distribution is back to normal and where it needs to be. I have visibility to a great pipeline of news coming early in the year. And we are now completely focused on communication and regenerating trial. There's no issue with the food. There's no issue with consumer. A lot of the food, we just missed it here. And now, we're focused very much on getting back to growth. I foresee growth for Morningstar Farms next year as we go forward.

We did lose one item, which shows through in the numbers, unfortunately negatively, is we did lose a big item in the [ph] top channel, (88:55) one of our best sellers and we're working hard to get that item back in a new organic format. When we get that item back, the [ph] top business (89:04) is big for this business. So we're cautiously optimistic that's coming back as well, and that will be a driver of growth for this business next year.

John Renwick

Operator, I'm afraid we're out of time. So, everyone, thanks for your interest and your questions. And if you have any follow-up questions, please call us in Investor Relations at 269-961-9050.

Operator

The conference is now concluded. Thank you for attending today's presentation. You may now disconnect.