Company Name: Kellogg
Company Ticker: K US
Date: 2015-05-05
Event Description: Q1 2015 Earnings Call

Market Cap: 22,504.02
Current PX: 63.18
YTD Change($): -2.26
YTD Change(%): -3.454

Bloomberg Estimates - EPS
Current Quarter: 0.954
Current Year: 3.595
Bloomberg Estimates - Sales
Current Quarter: 3478.154
Current Year: 13812.889

Q1 2015 Earnings Call

Company Participants

- Simon D. Burton
- John A. Bryant
- Ronald L. Dissinger
- María Fernanda Mejía

Other Participants

- Eric Richard Katzman
- Kenneth B. Goldman
- Andrew Lazar
- Christopher R. Growe
- David H. Hayes
- Bryan D. Spillane
- David Cristopher Driscoll
- John J. Baumgartner
- David S. Palmer
- Kurt A. Feuerman

MANAGEMENT DISCUSSION SECTION

Operator

Good morning. Welcome to the Kellogg Company First Quarter 2015 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 Simon Burton, Kellogg Company Vice President of Investor Relations. Mr. Burton, you may begin your conference.

Simon D. Burton

Thanks, Gary, and good morning, everyone, and thank you for joining us today for a review of our first quarter 2015 results. I'm joined here today by John Bryant, Chairman and CEO; Ron Dissinger, Chief Financial Officer; and Maria Fernanda Mejía, President of Kellogg Latin America. The press release and slides to support our remarks this morning are posted on our webpage at www.kelloggcompany.com.

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, upfront 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 second 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, May 12. The call will also be made available via webcast which will be archived for at least 90 days.

And now I'll turn it over to John.

John A. Bryant

Thanks, Simon, and thank you everyone for joining us. We're pleased to have announced today results for currency-neutral comparable net sales, operating profit, and earnings per share that were ahead of our expectations. We saw good net sales growth in international business and improving trends in several of our developed market businesses in North America.

As you know, we've invested in various revenue driving initiatives around the world and we've seen improving sales trends. Specifically, we posted strong double-digit net sales growth in Latin America in the quarter. We posted low-single-digit net sales growth in Europe. And Asia-Pacific region posted mid-single-digit net sales growth due to double-digit growth in the Asian business. And we saw improving trends in our developed Cereal business in the U.S., category trends improved and our Kellogg brands gained share.

As we mentioned at the CAGNY conference, we'll be doing a lot of work over the last year on Project K, our efficiency and effectiveness initiative. We're on track to generate savings and to invest in the business to drive profitable net sales growth. Specifically, we're focused on three main areas of opportunity. We're investing where the shoppers shop. We're investing in our food. And we're increasing our investment in the high-growth emerging markets.

Let's start with a discussion of in-store execution. The first area of investment we're focused on is the warehouse sales force in the U.S. We've made a significant investment in this area in 2014 and we're investing more in 2015. Their focus is on selling promotions, gaining share of the shelf, maximizing distribution, and increasing the speed to shelf for new products.

The second area of investment is the DSD sales team. The benefits we get from this investment build over time and we've always seen improved in-store display activity in the channels serviced by DSD.

The third area of investment is in emerging markets where we've invested in our coverage of high-frequency stores in both Asia and Latin America. We are pleased with the progress we've made so far. We have more to do, although we've already seen improved results.

Let's turn to slide five and the second area of focus, increased investment in our food. First of all, we have started some broad initiatives in the U.S. Cereal business this year, including the Origins program, which is similar to one that was successful in Europe. This program includes new food and support which stresses the simplicity and goodness of the new products.

We've also got some great new snacks coming. In the U.S., we have renovated our Special K bars to include more visible ingredients, and we are launching Special K Chewy Nut bars, which include simple ingredients preferred by consumers. We've launched a variety of new mueslis in a number of countries which are off to a good start, and we have plans to launch granolas and mueslis in other parts of the world. And very importantly, we've also done a lot of work with our Kashi business in North America.

We have great brands in both Kashi and Bare Naked. We have a dedicated team in California, and they're making progress across three priorities. First, they're designing and launching a portfolio of innovative plant-based foods that deliver powerful uplifting health. Second, they are engaging with customers and partnering to develop new and exciting programs targeted at food-forward consumers. And finally, they are developing stronger marketing plans using more of a storytelling model rather than a traditional advertising model.

Finally, for Project K, let's turn to slide six and the investment we are making in the emerging markets. We have a strong team across the international businesses. Within these regions, we have targeted various initiatives. In Asia and Latin America, we are focused on increasing our penetration of high-frequency stores. We've driven strong sales growth in the Pringles business in emerging markets over the last three years, and we've recently opened a new plant in

Malaysia.

In addition, we recently invested in a large biscuit manufacturer in Egypt, and our joint venture in China continues to perform well. These are all initiatives designed to increase our rates of profitable sales growth and return us to our long-term model. It's early in the process, but we're seeing good sales growth in our international regions and we're confident that we'll achieve additional growth as we execute these programs.

Now I'll turn it over to Ron.

Ronald L. Dissinger

Thanks, John, and good morning, everyone. Slide seven shows the financial results for the first quarter. Reported net sales declined by 5% primarily due to international currency devaluations. Currency-neutral comparable net sales decreased slightly. We had good growth in all of our international regions and results improved in several developed businesses in North America. This quarter's improving trends were the result of new product introductions and brand building initiatives in each of the regions and investments we've made with savings from Project K.

Reported quarterly operating profit was $384 million and included a charge for the capitalized portion of our pension mark-to-market at year-end 2014 as well as Project K costs in the first quarter. Currency-neutral comparable operating profit decreased by 1.9% in the quarter, better than our expectations. Comparable earnings per share which exclude integration costs, mark-to-market adjustments, Project K costs and other items that affect comparability were $0.98 per share in the first quarter, again ahead of our expectations.

These results include $0.06 of currency headwind in the quarter, so currency-neutral comparable earnings increased by 3% to $1.04 per share including a lower-than-planned tax rate resulting from some discrete items. So our results in the first quarter were ahead of our expectations and were in line with our guidance for the full-year.

Slide eight shows the composition of the first quarter sales growth. Currency-neutral comparable revenues for the first quarter declined by 0.3% reflecting an overall improvement in trends. Comparable volume decreased by 0.7% in the quarter. We saw volume growth across our international regions driven by both Cereal and Snacks offset by results in our North America business. Price and mix increased by 0.4% and the impact of currency translation decreased sales growth by 4.7% in the quarter as many currencies depreciated against the U.S. dollar.

Slide nine shows our currency-neutral comparable gross profit and gross margin for the first quarter. Quarterly gross margin remained unchanged at 37.9%, which was broadly in line with our expectations. Productivity improvements and savings from Project K supply chain initiatives offset inflation and factory distribution costs and investments in our food. As expected, commodity and packaging costs were net deflationary and we are currently approximately 85% covered.

Let's turn to slide 10 which shows the currency-neutral comparable operating profit performance for each of the regions in the first quarter. North America's operating profit decreased by 8%; this was primarily driven by lower sales and investment in our U.S. sales force as well as re-establishing our Kashi business in California. Europe's operating profit increased by 13% in the first quarter driven by the region's sales growth and net deflation in cost of goods sold including savings from Project K. Operating profit increased by 5% in Latin America in the quarter. Strong sales growth included increases in volume and price actions to offset inflation. In addition, we invested in brand-building activities to support new product launches and drive market penetration. Operating profit decreased by 3% in the Asia-Pacific region. While we had solid sales growth in the quarter, we are investing in capabilities and brand building for growth in our emerging and developing markets within the region.

Slide 11 shows our year-to-date cash flow. Our results for cash flow were in line with our plan and we continue to expect approximately $1 billion of cash flow for the full-year, although currency has become more of a headwind to our outlook for both earnings and cash flow.

Operating cash flow after capital expenditure was $12 million, which was driven primarily by the timing of an interest payment and an increase in cash costs in the first quarter associated with Project K. In fact, those two items and the impact from foreign currency translation accounted for much of the decline. Capital spending for the quarter was $83 million and we are on track with investments for the year. Share repurchases in the first quarter were $285 million, and we reduced our average share count by 1.4%. And dividends paid in the quarter were $174 million. So total cash returned to shareowners was more than $450 million.

Now if you'll turn to slide 12 you'll see that our guidance for 2015 has not changed. As always, sales, operating profit, and earnings per share guidance is currency-neutral comparable, excludes the items that affect comparability as detailed in our notes. As we told you last quarter, this guidance includes realistic assumptions regarding the competitive environment and the growth of our businesses in developed markets in 2015.

We continue to expect that net sales will be approximately flat for the year. We also continue to expect some net deflation in cost of goods sold and slight improvement in gross margin. We are approximately 85% covered for the year on commodity and packaging costs, and productivity savings should be between 3% and 4% of cost of goods sold, in line with our long-term goals. And in addition to this, we expect to see incremental savings from Project K. We expect that operating profit will be down between 2% and 4%. Remember, this includes a negative three point to four point impact from the annual rebasing of incentive compensation costs. And we continue to expect that brand building will increase the rate faster than sales.

We're also maintaining our guidance for currency neutral comparable earnings per share of $3.74 to $3.82, or a range between flat and down 2%. The expectations for sales, operating profit, and earnings per share exclude the impact of last year's 53rd week and the impact of foreign currency translation. Our original expectations for the impact of currency translation was $0.15 per share, but we now estimate the impact could be as much as $0.24 per share. We still expect the tax rate to be between 27% and 28%. And interest expense is expected to be between $215 million and $225 million.

Cash flow after capital spending should be approximately $1 billion, which includes total incremental cash costs of $350 million for Project K. This also includes the incremental capital expenditure required by the project. So cash flow for the full year excluding Project K should be between $1.3 billion and $1.4 billion. We continue to expect that total capital spending will be in the range between 4% and 5% of sales, including approximately one point of sales for incremental capital related to Project K. And we still expect that we will repurchase between $700 million and $750 million of shares during the year.

Slide 13 shows our full year EPS walk. Remember that this outlook could be affected by any significant currency devaluations that occurred during the year, such as in Venezuela. Costs associated with the integration of Pringles and the recent acquisition in Egypt are expected to be between $0.04 and $0.06 per share, and we expect that incremental savings from Project K will be between $90 million to $100 million for the full year, approximately two-thirds of which will come from cost of goods sold. As we mentioned last quarter, pre-tax P&L costs related to the project are estimated to be between $400 million and $450 million or approximately $0.80 to $0.90 per share for the year, approximately 75% of which will be in cost of goods sold.

And our current outlook for second quarter earnings per share is that they will account for approximately one-quarter of our estimate for the full year. Currency impact we expect in the second quarter is also approximately one-quarter of our estimate for the full year.

And with that, I'll turn it back over to John.

John A. Bryant

Thanks, Ron. And now let's turn to slide 14 and the U.S. Morning Foods business. First of all, I'd like to welcome Craig Bahner to the role of President of Morning Foods. Craig joins us most recently from Wendy's. Before that, he worked for a number of years at P&G, and we look forward to having him as an important part of the team.

I'd also like to congratulate Paul Norman on being named President of Kellogg North America. I'm sure you'll all agree that there is no one better than Paul for this role.

Now onto the Morning Foods business where comparable net sales declined by 2.9% in the quarter. This represents an improvement from the performance we saw last year. Category trends improved, and Kellogg brands gained 30 basis points cereal category share in the quarter. We saw a mid-single-digit increase in in-store displays, and we activated strong commercial plans. In addition, our innovation launches performed well in the quarter. Raisin Bran Cranberry, Special K Protein and the Disney Frozen themed Cereal are all doing well. And we had approximately 44% share of innovation in the quarter. In addition, we have the Avengers themed cereal and support coming in the second quarter.

So overall, we were pleased with the results in the Morning Foods business in the first quarter. The team has done a great job, trends generally improved, and we started to see the benefit where we have invested. As we discussed with you at the CAGNY conference, improvement will be a process, but we're encouraged by the results so far this year and expect gradual progress as we move through 2015 and into 2016.

Let's turn to slide 15 and our U.S. Snacks business. Comparable net sales declined by 1.1% in the first quarter. The decline in sales in the cracker category was led by the Special K Cracker Chip business. We have redesigned the food and the packaging, and the consumer communication begins in earnest in the second quarter. Velocity has improved, but we continue to be affected by prior distribution losses.

Sales in the cookie business declined in the quarter due in part to the performance in our Right Bites 100-Calorie Packs. This was a result of trends in weight management foods and a majority of our 2015 cookie innovation launches at mid-year.

Sales in the wholesome snack business also declined in the quarter; however, we saw good performance from Rice Krispies Treats. Consumption of Special K bars declined due to distribution losses, but velocity improved. And the new bars that we introduced in December of last year got off to a good start. And we have more new products coming in the category.

The Pringles brand posted flat net sales in Q1 against high-single-digit comparisons last year due to the launch of Pringles Tortillas. So we continue to face some challenges in our U.S. Snacks business, but we're seeing some success and we've already made changes, and we have some more to come. As I said before, improvement will take some time and will be progressive. However, we're focusing our investment to drive improvement in 2015 and into 2016.

Let's turn to slide 16 and the U.S. Specialty segment. Net sales in the Specialty Channels business declined by 2.5% in the quarter. The primary cause of the decline was a distributor in the convenience channel who decreased levels of inventory significantly during the period; however, we do see strong underlying consumption.

In the convenience channel, we increased share in the cracker, wholesome snack, cookie, and salty snack categories in the quarter. Consumption of Pringles grew at a strong double-digit rate. The team expects full year net sales and operating profit growth in 2015 with the performance in the first quarter due primarily to the timing of sales.

Slide 17 shows the performance of the North America Other segment which now includes the U.S. Frozen Foods, Kashi, and Canadian businesses. Net sales declined by 6.1% in the first quarter. We saw good consumption in the Frozen Foods business in the quarter, although net sales declined due in part to supply disruptions from last year's limited recall of our MorningStar Farms product. This was related to an industry-wide issue with a supplier of cumin. It is worth noting that we are back in supply now specifically the Eggo franchise posted consumption growth, higher rates of penetration and share gains in the quarter.

Now turning to the Kashi business. Net sales declined as velocities stabilized, but were impacted by last year's distribution losses. We plan to rebuild distribution over time with new innovation. And finally, net sales for the Canadian business also declined in the first quarter, this was largely due to the timing and phasing of activity.

Now let's turn to slide 18 and our European business. Comparable net sales in the region increased by 1% in the quarter due to double-digit growth in the Pringles business and good growth in Northern Europe and Russia. Sales in the Cereal business declined in the quarter due to the timing of promotions and weakness in the Special K brand, although results were in line with our expectations. As is the case in many parts of the world, we have a lot planned for the Special K brand in the region in the next few months. We have newly-renovated food going into the market in April and new packaging and support schedule for the summer. We recently launched muesli in Germany. [ph] We brought (22:08) distribution in the first quarter and early results have been good and the Coco Pops products that we launched recently in the U.K. is also off to a good start. As I mentioned, we saw double-digit net sales growth in Pringles in the quarter, which was driven by good promotions and new flavors, and we're launching Tortillas Pringles in the second quarter. So the European business had a good quarter exceeding our expectations. We have a range of activity planned for both Cereal and Snack businesses over the remainder the year and we expect continued good results from the region as a result.

Now I'll turn it over to María Fernanda for a discussion of our Latin American business.

María Fernanda Mejía

Thanks, John, and good morning, everyone. I'm excited to be here today to talk about the great business we have in Latin America and to give you some insights as to why we're so optimistic regarding our potential. I'll begin with an overview of the region then I'll share our operating model and strategy and I'll close with highlights of how we're bringing all the elements of the strategy together.

So let's start with slide 21 and some background about our region and the opportunities we have. As you can see, there's a large consumer base, 40% of whom are under the age of 20 and the population is urbanizing with a rising middle-class. However, despite this dynamic environment, consumers in the region retain their tradition, their sense of community and family, and their optimism. As you might imagine, this changing environment presents some challenges but also some great opportunities.

Slide 22 shows the composition of Kellogg business in Latin America. Our business is largely in Cereal, although we have a good core wholesome snack business, and the acquisition of the Pringles brand gave us a meaningfully-sized salty business as well. We have a significant core business in Mexico, which along with rest of Latin America performed well in the first quarter and we also have growing businesses in attractive areas of the region and in growing categories and segments in those areas.

Now let's turn to slide 23 and one of our competitive advantages our brands. Around the region, we have a stable of well-known global brands that consumers love. The consumer base in our region appreciates quality products and Kellogg is one of the most trusted brands in Latin America. Consumer awareness of our brands is high and our products have some of the highest category and segment shares in the region and the brands are expandable as we've seen with our success in the wholesome snack category. We've also targeted geographic expansion with Pringles and the recent introduction of our Kellogg parent brand.

Now let's turn to slide 24. As you can see, we have more than 55% cereal category share across the region. Our wholesome snack business holds approximately 24% share and is made up of snacks sold largely under our cereal brand name such as Special K, Zucaritas, All-Bran and now Kellogg. And finally, you can see that our salty snack business holds only a 1.3% share across the region, although net sales have grown significantly since the acquisition of Pringles. As a result, we see great potential across all of our categories. However, despite the great positioning, three years ago we identified some opportunities to expand the business even further. These opportunities were unleashing the potential of the region, growing in all segments of the Cereal business and in high-growth areas of the region expanding into high-frequency stores and better leveraging our supply chain.

So now let's look at slide 25 and the discussion regarding how we've addressed these opportunities. We implemented a new regional, multi-functional category organization and we reorganized our businesses into regional hubs which provided increased scale and improved speed to market. We began developing our plan not only focused on our consumer but also on our shopper, who can oftentimes be different than the consumer and the regional environment in which these shoppers were shopping. And we elevated our engagement with our customers. We have focused on increasing the efficiency and effectiveness of our organization. For example, we are delivering pan-regional innovation and commercial program. We're better leveraging total commercial investments to win with shoppers where they shop and we've moved from a manufacturing organization to a supply chain organization focused on optimizing asset utilization and improving gross margin.

As a result, we're executing Project K. We're reducing our cost structure and we're eliminating complexity in the portfolio and fueling our growth. And we will continue to drive underlying productivity and improved profitability. Also, we've made great progress in building a strong organization. These are all major undertakings and the entire team in Latin America has done an amazing job implementing these changes to our structure while remaining focused on generating profitable sales growth.

So how has all this played out in recent years? If you'll turn to slide 26, you'll see some of the recent successes we've had as a result of the changes we've made to our operating model and strategy. The rate of net sales growth improved as we progress through 2014 and year-on-year net sales grew at a double-digit rate in the first quarter of 2015. And importantly, volume increased by more than 4% as a result of good innovation and strong in-market activity and we're confident we'll see good rates of net sales growth across the remainder of the year. We've also seen the benefit of the work we've done in gross margin expansion in recent years, we focused on our large businesses and have achieved margin expansion in both the Mexican and the pan-regional Cereal business.

Now let's turn to Slide 27 and more detail regarding our strategy in the region. There are five interrelated parts. First, as I mentioned, we have a large and growing Cereal business in the region and continuing to drive category growth is one of our main priorities. We're also focused on the snack categories and on driving increased consumption across the portfolio. Next, while our program of innovation and renovation has been successful, we can always improve. Speed to market is critical and we've made good progress streamlining the process. We're also committed to winning where people shop and we're increasingly focused on high-frequency stores. This is a channel where between 50% and 70% of retail sales in the traditional food basket are made where the majority of our shoppers shop and where affordable products are a requirement. We're executing Project K in the region, this means optimizing our supply chain network, developing a footprint that will serve our future growth and generating the flexibility to increase investment in the business.

And finally, we're constantly striving to develop our people, improve their performance and provide them with exciting opportunities. We've taken big strides in this area and have what I believe is a world-class team dedicated to constant improvement.

Now let me give you more detail on our investment in pan-regional innovation. How we're excelling at in-store execution and our work in high-frequency stores. Let's start with innovation on slide 28. We significantly increased the number of pan-regional introductions which has increased the efficiency of our investments. We re-launched Choco Krispis in 2014 which drove an increase in volume and share in the Andean and Central American regions. We restaged Special K as well and gained share in core countries of the region. And we also launched a full line of muesli granola cereals and bars branded with the Kellogg's brand. We've had some real successes with pan-regional innovation so far and we're really looking forward to continued progress.

Now let's turn to slide 29 and detail regarding the Pringles business in our region. We've increased net sales in U.S. dollars by more than 10% since the acquisition in 2012. Growth in local currencies was significantly greater. At the time we acquired Pringles, we saw Latin America as one of the areas with the most opportunity for expansion. As you can imagine, we're attacking this growth potential as quickly as possible by increasing distribution and driving significant innovation. Latin America has certainly been a success story for Pringles over the last few years and we expect continued strong growth in 2015 and beyond.

Now turning to slide 30. Our efforts on high-frequency stores have been focused in three areas; optimizing our route to market to enhance our reach principally in mom-and-pop stores, developing the right portfolio for this channel and getting the right visibility in these stores. As you can see on the slide, we've developed a range of inexpensive, smaller-serve products which are available to our shoppers in high-frequency stores. There are two million high-frequency stores in the region and we have a goal of increasing our coverage of these by approximately 50% this year. Having said that, we do have continued opportunities to increase the coverage even further in future years.

Slide 31 details the program design to improve the visibility of Kellogg product in high-frequency stores, ensuring all our products are displayed, visible, and accessible to our shoppers. The program includes an ideal store initiative which leverages stores' real estate to promote the Kellogg brand and build engagement with shoppers and store owners. This program is a pan-regional initiative and sales at these stores have increased at a double-digit rate and they've gained share. And our goal for 2015 is to have many more of these stores in place by the end of the year.

And on slide 32 you can see that we have more to come. We have more innovation, as I've mentioned, including Kellogg parent brand launches in various parts of the region. We're continuing to invest further in the expansion of high-frequency stores. And finally, we have significant commercial activations planned. You can see on the slide that we're proud sponsors of the Copa América soccer tournament going on this summer in Chile. We have full home-to-store support plan and expecting great results.

So let's turn to slide 33. I'm sure you'll agree we have an exciting opportunity for the years ahead. We've never been better positioned to grow given the dynamic categories where we participate with our leading brands. A renewed strategy and focused initiatives all with the objective of driving long-term profitable growth and we focused on the organization. And I'd like to end by thanking the Latin America team for their leadership and commitment to our collective success.

And now I'll turn it over back to John.

John A. Bryant

Thanks, María Fernanda. Now let's turn to slide 34 and our Asia-Pacific business. The Asia-Pacific segment posted an increase in comparable net sales of 4% in the first quarter. We posted double-digit growth in Asia as a result of double-digit growth in India, Japan, and South Korea.

In India, we saw growth in our core brands and in new smaller-sized packs designed to make our products more affordable. We have completed construction at our new plant in India and the facility has started production to service the increasing demand in the country. Sales declined in the Australian business due to weakness in the Cereal and Snack businesses. However, we are launching a range of innovation including granola, muesli, gluten-free, and on-the-go offerings. The Pringles business posted good sales growth with results exceeding our expectations. We ran a muesli promotion in Australia, Southeast Asia and Taiwan, which drove sales at a double-digit rate during the activation period.

So we had another good quarter in this region driven by strong growth in our Asian business. As you might imagine, we continue to expect growth from the region for 2015.

Please turn to the summary on page 35. Our results for sales, operating profit, and earnings per share were all ahead of our expectations in the first quarter. We saw sales growth in Europe, Latin America, and Asia-Pacific. And we saw improving sales trends in our U.S. Cereal business, and our Kellogg brands gained share.

The Project K initiative continues to go well. We are investing the savings in areas designed to drive profitable sales growth and we're starting to see the results. Obviously, our investment program is a process and the benefits will build over time. Improvement in our results will also build, and we know that there's no quick fix. However, we are very encouraged by some of the early signs of success we've already seen and by the plans we're making now for future periods.

Now I'd like to end, as always, by thanking our employees around the world. It's all their hard work that is allowing us to build a foundation for growth in 2015 and beyond.

And with that, I'll open it up to questions.

Q&A

Operator

We will now begin the question-and-answer session. [Operator Instructions] At this time, we will pause momentarily to assemble our roster. The first question comes from Eric Katzman with Deutsche Bank. Please go ahead.

<Q - Eric Richard Katzman>: Hi. Good morning, everybody.

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

<Q - Eric Richard Katzman>: Happy Cinco de Mayo. I guess my question has to do with kind of the Project K savings versus the advertising and promotional spending. I don't remember you quantifying either, so I'm kind of wondering if you can do that. And it looked like in one of the slides, I think, it was slide 10, that the spending behind the brands was mostly in Latin America and Asia. Is that right? And should that kind of broaden out as the year progresses?

<A - Ronald L. Dissinger>: Eric, it's Ron. So in terms of the Project K savings, recall, for the year, I said that the savings were in the range of $90 million to $100 million. And that's relatively pro rata across the course of the year, a little bit lighter in the first quarter. In terms of our investment in brand building, you know we have good investment levels behind our business across the globe. We didn't invest – or we did invest a little bit heavier in our international regions. Our sales, or brand building as a percent to sales, were comparable to last year. So good pressure in the business. As we move through the second and third quarter as well, we have innovation coming out, and our brand building levels will be up year-over-year to support the commercial programs and the innovation.

<A - John A. Bryant>: So, Eric, if I could just add on to that as well. As we think about reinvesting the Project K savings, we are reinvesting the savings in a number of areas in our business. Some of the money is going into getting food that's even more on trend with changing consumer needs. Some is going into our sales capabilities, both in the U.S. as you've seen with the warehouse and DSD system, but also with the sales force that supports high-frequency stores in a number of the emerging markets.

Quite frankly, as we look at brand building, we have a high level of brand building as a company. We spend about twice the amount of advertising as the average food company. So we feel like we have fuel in the engine there. We believe we're going to get the best return by investing more to enable us to get growth through additional capabilities such as sales and by making sure we have food that's absolutely on trend with changing consumers' needs.

<Q - Eric Richard Katzman>: Thanks for that. I'll pass it on.

Operator

The next question comes from Ken Goldman with JPMorgan. Please go ahead.

<Q - Kenneth B. Goldman>: Hey. Good morning, everybody.

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

<Q - Kenneth B. Goldman>: Your main competitor in U.S. cookies and crackers, they talked recently about large customer reverting to more of an EDLP strategy, which is leading to fewer, I guess, display opportunities for the category. Is that something that you guys have experienced as well? I mean, I'm looking at your U.S. Snacks numbers. They seem okay, but I'm just curious for what your thoughts are there?

<A - John A. Bryant>: We do see customers from time to time changing their merchandising plans. I think we had a large customer that probably did somewhat adversely impact us in that area as well. And obviously we worked with that customer to ensure that jointly we're building our categories over time. And so I think we'll have better programs as we go forward. And the thing about our U.S. Snacks business, we're essentially on plan coming through the first quarter. The first quarter is our toughest comp for our U.S. Snacks business. A lot of innovation in Snacks this year was actually in the middle of the year so we do expect our sales trend to improve as we go through the year.

<Q - Kenneth B. Goldman>: Thank you. And then if I can ask another quick one. John, you asked about, or you talked rather about the inventory issue with the c-store customer. We've been seeing some signs of convenience stores maybe clearing out a little bit of shelf space for more, I guess, health and wellness oriented products or perceived to be health and wellness. Is this what you think partially drove the de-load, because that will reduce your shelf space or was it more just a normal course of business type of reduction that happens from time to time?

<A - John A. Bryant>: No, Ken, I don't think it's adversely impacted our shelf space. It was more a case of retail holding more inventory than they thought appropriate and it came out significantly here in the first quarter.

<Q - Kenneth B. Goldman>: Great. Thanks very much, John.

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

Operator

The next question comes from Andrew Lazar with Barclays. Please go ahead.

<Q - Andrew Lazar>: Morning, everybody.

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

<Q - Andrew Lazar>: John, you talked about the cereal category improving. I'm trying to get a sense of what you see driving that in your expectations for the category overall for this year. And then in Cereal, your share of innovation you marked at 44% and your displays were up mid-single-digits. I'm trying to get a sense of how those metrics compare to maybe what they might have been, let's say, over the course of 2014?

<A - John A. Bryant>: Great. Thanks, Andrew. On the category, we are seeing the trends improved. We're down around 2% to 3% in the first quarter, which is better than last year so it's very dangerous to predict what a category is going to do, but I'd say it's going to be down in that low-single-digit sort of range for the year. What we're seeing in our business is stronger performance. Seven of our 10 largest brands under the Kellogg brand gained share in the quarter and the Kellogg brand itself gained about 30 basis points of share. If you look at why some of our business is doing better, Froot Loops grew about 6% and that's being driven by some great advertising programs behind evening consumption, et cetera. The Raisin Bran business is up about 7%. Rice Krispies is up 4%. In case of Raisin Bran, we have some innovation but also some very on-trend advertising as well.

We are seeing improved distribution and merchandising from reinvesting back into our U.S. sales force. Displays are up in Q1 last year. Quite frankly, we were down in Q1 last year, so part of it is the comp as well that's helping us there, and 44% share of innovation is a sort of share of innovation that we'd like to see in our U.S. Cereal business, but not what we had necessarily last year, so I think we are seeing some good performance within the Cereal business, particularly across the legacy Kellogg brands.

<Q - Andrew Lazar>: Great. Thanks very much for that.

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

Operator

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

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

<A - Ronald L. Dissinger>: Good morning, Chris.

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

<Q - Christopher R. Growe>: Hi. I had two questions, if I could. I wanted to ask first from a bigger picture standpoint, John, in relation to improving sales trends and a stronger first quarter performance, especially on the profit side, what does that mean for Kellogg for the year? Is it that you can reinvest more heavily now? Are there areas that this gives you more flexibility to invest in? I'm just curious how to look at the year if the sales trends keep improving the way they are?

<A - John A. Bryant>: Well, I think we've had a good start to the year. And as we said in the press release, we beat our internal expectations in Q1. It is one quarter in the year though, so I think it's appropriate for us to say that we're still on track from a full-year perspective and so it would be too early for us to start thinking about reinvest or other alternatives. So I think it's a good start for the whole year. We have expectations of sales being relatively flat; we achieved that in the first quarter, which is actually our toughest comp so we're feeling good about where we are.

<Q - Christopher R. Growe>: Okay. And just a question relation to Europe; a pretty strong profit performance, certainly, and Pringles obviously did well, it sounds like. I'm curious how the base Cereal business performed, especially in the developed markets and then the emerging market piece of Europe, how that performed as well?

<A - John A. Bryant>: So if you look within Europe, we did have good growth in Pringles, as you said. Cereal sales were down in the quarter, though that's actually is an improving trend in line with our expectations, so we're seeing some good progress there. And if you look within Europe, we actually saw some growth on a consolidated basis in Northern Europe, France, and Benelux, U.K., Ireland, and Southern Europe down very slightly, low-signal-digits in the quarter. We had some good growth in the emerging markets, particularly in Russia, even though it's a tough environment we actually saw some good growth in Russia in the quarter as well.

<Q - Christopher R. Growe>: Okay. Thank you for the time.

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

Operator

The next question comes from David Hayes with Nomura. Please go ahead.

<Q - David H. Hayes>: Good morning, all. If I can just touch base on international. There's two things actually, just following up on that Pringles comment in Europe. I'm just wondering whether you can talk about the capacity that came on stream or that did come on stream for Pringles in the first quarter and, therefore, whether some of that improved performance, that double-digit performance is due to that capacity now being there and, therefore, effectively do you expect that to continue as a trend through the year? And then secondly, if I can, sorry, just as María is there, I just wonder if we can catch up on where we are with regulation in Mexico. Clearly, this time last year, there was some negative impact with the effect of the [ph] shipping (45:42) tax. I just wonder whether there is any more news flow or noises around whether that could be repeated again or elsewhere in the region if there's any risk of that happening. Thanks very much.

<A - John A. Bryant>: Thank you. So I'll start with the Pringles question and then hand over to María Fernanda to talk about the regulatory environment in Latin America. On Pringles, we do have the benefit of our plant in Poland coming up last year. So it's helping us supply the market this year. And we're still essentially in a situation where we're selling every can we can make as a company. We have a new plant in Malaysia coming up this year. That will be a bit of a slower start for us because it's a totally new facility in Malaysia. But we are looking to get some capacity out of it, it might help drive our Asia-Pacific business.

On a global basis, we grew Pringles around 7%, 8% in Q1 which is similar to what we're seeing growth over the last couple of years. So I think we're seeing very good ongoing trends and really we are just constrained by how quickly we can bring capacity on. And María Fernanda, do you want to talk about Mexico?

<A - María Fernanda Mejía>: Sure. Thanks for the question, David. Regarding the Mexico tax first, last year we believe the team did a really great job in predicting the impact of the Mexico tax through the good use of insights and analytics. We did see an impact in volumes particularly in the first half of 2014, but through the implementation of very strong consumption building and category program, we saw the elasticity improve through the back half of 2014 and certainly through the first quarter of 2015 where in Mexico we saw great volume recovery. As far as what we're seeing in the region from a regulatory standpoint, obviously we meet all government and regulatory requirements, and we're constantly tracking and evolving – the requirements and the evolving consumer preferences.

In the region, cereal, a bowl of cereal with milk fruit still provides a very nutritious breakfast offering when we compare it to other local offerings in the marketplace. So I think we should congratulate the Mexico team for a job well done in managing a challenging situation for us through the first half of 2014.

<Q - David H. Hayes>: Okay. Thanks, guys. Thank you.

Operator

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

<Q - Bryan D. Spillane>: Hey. Good morning, everyone.

<A - Ronald L. Dissinger>: Good morning, Bryan.

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

<Q - Bryan D. Spillane>: John, we've talked in the past about the snack bars, Kashi, and Special K businesses really being the principal drags on performance over the last I guess year or two. And I guess listening to their prepared remarks this morning it didn't sound like you've yet got much benefit from those three areas really improving. So I guess, A, is that correct? And B, I know you've got a lot of prescriptive actions in place to try to turn those. Should we expect may be to see some movement on that as we move through the balance of this year?

<A - John A. Bryant>: Thanks, Bryan. Great question. So let me just clarify one thing, on Kashi, the Kashi wholesome snack bars actually grew in the first quarter, which is a sign of the strength of the brand, particularly when you have great food going up against it. On the Special K business, if you look at some of the softness in consumption we've had in our U.S. Snacks business, it does largely come down to Special K. But there's some good news in there. So if we look within wholesome snacks, Special K bars is a primary source of weakness within that category for us. We've come out with new Special K bars here at the beginning of the year. We've lost some distribution and some retailers but we've maintained the distribution, the velocity is up strong, which would suggest that we've got good food that's delivering upon the promise of Special K. And we have more innovation coming in behind Special K in the middle of the year.

If you come to crackers, similar story. We've renovated the Special K Cracker Chip offering. We've lost some distribution on those products, but where we've maintained the distribution, the velocity is up strongly again, which also suggests we have some great food out there. So I think what we're seeing is a transition, the good news is where the food's in play we're seeing good velocities. Now our job is to rebuild the distributions based on having great food in the marketplace.

<Q - Bryan D. Spillane>: Thanks, John. And just fair to say that the upside in the quarter wasn't really a function of a contribution from those actions yet, that's still something you're expecting further out in the future?

<A - John A. Bryant>: I think that's fair. We're essentially on plan in our U.S. Snacks business in the first quarter. I think the upside had more to do with some great performances in the international businesses and seeing better trends come out of our U.S. Cereal business.

<Q - Bryan D. Spillane>: Okay, great. Thank you.

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

Operator

The next question comes from David Driscoll with Citigroup. Please go ahead.

<**Q - David Cristopher Driscoll**>: Thank you, and good morning.

<**A - John A. Bryant**>: Good morning, David.

<**Q - David Cristopher Driscoll**>: Just wanted to follow up on your U.S. Snack comments, John. I think you said to another question that you expected this to sequentially improve. However, when we look at the U.S. Nielsen data, what we're seeing, though, would be the opposite. We're seeing snack information from Nielsen kind of weakening materially. Cookies look double-digit negatives on both volumes and sales and certainly issues on the snack bars. So is second quarter actually a – you really expect a sequential improvement in U.S. Snacks?

<**A - John A. Bryant**>: David, there's a couple of factors driving that. If you look at the consumption data versus the shipment data, there's two reasons for differences there in the first quarter. One has to do with strong growth in the non-measured channel right. I realize that Nielsen covers most of the business but there are some large customers and meaningful channels that are not inside that data as we're seeing some very good growth in those businesses. Secondly, a lot of what's happening is driven by the phasing of innovation year on year. So last year innovation went out in the first quarter, this year innovation for Snacks is much more mid-year.

And what's happening there is we'll see that innovation go in Q2, that will give us more of a consumption drive and a little bit more of a shipment drive too as we fill the pipelines for that innovation. Last year innovation went in, in the first quarter which means that supplies usually ships in Q4 and so we actually burn through inventory in Q1. We get good consumption coming from behind that innovation in Q1 last year. So a little bit of a timing issue within the year that's driving what you're seeing there. We do expect better results, I would caution on some of the April data because the shift of Easter can distort one week versus another but we do expect to see improving consumption trends in our Snacks business over time

<**Q - David Cristopher Driscoll**>: Thanks for clearing that up. Just one other thing for me, Project K, the savings plan there versus kind of what we're seeing at ZBB savings from the Heinz and Kraft. John, how do you and your team benchmark Kellogg? And have you gone far enough to reduce costs with the Project K plan?

<**A - John A. Bryant**>: So historically when we've benchmarked the company to our peers, we've actually come with a little bit leaner, quite frankly, than a lot of our peer group. Clearly, as we have a new model with the 3G model and Kraft and Heinz, we're going to watch that closely and learn and reapply what works. But we're not going to blindly follow those actions. As you think about our business, we're doing Project K, reinvesting for growth. As we talked about at CAGNY, we only need low-single-digit growth to drive mid-single digit operating profit and we believe that's the right way to sustainably grow and drive these businesses over time. So to answer your question, we continue to look, to learn but we're going to drive Project K for now and then see if more ideas come to us based upon what we see in the marketplace.

<**Q - David Cristopher Driscoll**>: Thank you, John. I'll pass it along.

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

Operator

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

<**Q - John J. Baumgartner**>: Good morning. María, just wanted to come back to the growth opportunity in Latin America given that, I guess, the sales growth we've seen has been largely price-based. I think the last year where Kellogg really had steady volume growth maybe five or six years ago. So what's been holding back consumption there? And is there a target that you're maybe looking at in terms of what normalized volume growth could be as Pringles ramps up? And then with the timing, when you think that can be achieved? Thank you.

<A - María Fernanda Mejía>: Thanks, John. It's a great question. As we shared with you earlier in the presentation, we've made some pretty important structural changes to better address the growth opportunities in Latin America and they're quite simple. First is high-frequently stores. Traditionally, we've had pantry size boxes of cereal going through most of our direct accounts. 50% to 70% of all food sales go through HFS, as I mentioned earlier, only 20% of cereal sales and for us, less than 20% of our snacks. So that is the biggest opportunity. To be able to drive volume growth, John, in HFS, we need to have the right size, the right pack, at the right affordable price and that's what we've now put in through the core of our cereal brands to address high-frequency stores. And as we ramp-up Pringles, having Pringles also in affordable sizes for high-frequency stores, is going to be absolutely critical.

<Q - John J. Baumgartner>: So your view is more of a price-point issue as opposed to just changing consumer consumption trends over the years?

<A - María Fernanda Mejía>: I think so. I think it's making sure that our products are affordable and accessible where consumers and shoppers shop every day in our region.

<Q - John J. Baumgartner>: Thanks, María.

Operator

The next question comes from David Palmer with RBC Capital Markets. Please go ahead.

<Q - David S. Palmer>: Thanks. Good morning, guys. First to follow up on gross margins. Using that guidance on a year-over-year basis currency-neutral, it looks like you'd be expecting gross margins to be flat to up for the remainder of the year. If that is about right, and I think you said the Project K savings timings would only be a little bit more favorable in the last three quarters, is the rest of that input cost easing? Any color on that would be helpful.

<A - Ronald L. Dissinger>: Yeah, so you're right. Our gross margins were flat in the first quarter, and we have said guidance for the full year is that our gross margin will be up slightly. Project K was a little bit lower in the first quarter versus how it will play out over the next three quarters. And our rate of productivity savings in the balance of the business, so excluding Project K, also gets a little bit better as we go through the balance of the year, David. So that contributes to slight gross margin improvement as well.

<Q - David S. Palmer>: Great. And then just to follow up on Kashi, where are you on the product renovation side with Kashi going to GMO-free and perhaps the broadening of the organic line? Thanks.

<A - John A. Bryant>: We're making good progress on Kashi. As you mentioned, we are renovating some of our core foods today. The good news is that we have a strong team in place in California, and we are making progress both on the renovation front, which we expect to have for Kashi largely this year, but also on the innovation front, bringing new foods to market. If you look at what's happened to Kashi, we have seen a significant loss of distribution over the last year, but our velocities are stabilizing. And as we bring in new innovation mid-year, we expect to start to improve our distribution as we go forward. So mechanically, we're going to see a decline in Kashi this year. That's really a loss of past distribution as opposed to a weakness in the underlying brand or foods. And as we start to rebuild through innovation, I think we'll start seeing the business return to growth. That's probably more a 2016 discussion than a 2015 discussion. The good news as we go talk to retailers about the innovation of what we're doing on the brands, there's real excitement about what we're doing, and we're seeing improving support from retailers as well as we go forward.

<Q - David S. Palmer>: Thank you.

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

Operator

The next question comes from Kurt Feuerman with Alliance. Please go ahead.

<Q - Kurt A. Feuerman>: Good morning. I have a quick comment and then a question. As a portfolio manager who speaks to many managements in many sectors, I'm struck by how positive you are on this call and how informative the call is for, I think, everyone else whose asked the question so far as a sell-side analyst. Yet the company is struggling so seriously. And only 14% of these sell-siders recommend the stock. That's one of the lowest ratios of any company that's listed. Here's my question. It's probably a better question for the board of directors than for senior management, but here it is. How does management justify its lack of urgency and direction in light of continued lackluster results since the current CEO came in? This is, to me, especially relevant in light of the Heinz, Kraft transaction, and the fact that 3G – one of the reasons 3G chose Kraft was specifically management's willingness to merge. So the question is, is the company hiding behind its poison pill which is the foundation stake?

<A - John A. Bryant>: Kurt, thanks for the question. We are executing the largest restructuring program in the company's history, taking out a very large amount of cost and reinvesting that back in the business to drive long-term growth. You're seeing that through our investments back in sales capability, investments in our food, and you're seeing our top line trend starting to improve with growth across our international businesses and better trends in some of our U.S. businesses. So we're on track with our plan to return to sustainable growth over time, and we believe that's the best way to create value for shareholders.

<Q - Kurt A. Feuerman>: Right. But let me just follow up. We know that you're doing that, but it's not providing results that are as good as some of your competitors. And it's certainly not enhancing shareholder value. So if you look at just yourself versus General Mills, since you became CEO, I believe your earnings are up 8% if you earn [ph] 355 (60:24) this year, which is the midpoint of your guidance. Whereas, General Mills earnings would be up – earnings per share would be up 30%. And just on shareholder value, would you consider merging with another company if that was in the best interest of shareholders?

<A - John A. Bryant>: Kurt, we always will do what we think is the best way to create shareholder value and we are [ph] – and our belief is (60:49), driving exactly like programs to achieve that outcome and that's what we're absolutely focused on as a company. I think you're seeing improving trends in this quarter and that's our goal as we go forward. So I appreciate the question.

<A - Simon D. Burton>: Gary, I think we better wrap it up, please, if we can.

Operator

This concludes our question-and-answer session. I'd like to turn the conference back over to management for any closing remarks.

Simon D. Burton

That's it. Thank you. We'll be around to answer questions over the next day or two if anybody has follow ups. Thanks.

Operator

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