Company Name: Kellogg
Company Ticker: K US
Date: 2017-09-06
Event Description: Barclays Global Consumer Staples Conference

Market Cap: 23,413.94
Current PX: 67.84
YTD Change($): -5.87
YTD Change(%): -7.964

Bloomberg Estimates - EPS
Current Quarter: 0.941
Current Year: 3.979
Bloomberg Estimates - Sales
Current Quarter: 3206.786
Current Year: 12693.125

Barclays Global Consumer Staples Conference

Company Participants

- Andrew Lazar
- John A. Bryant
- Adrienne Deanie Elsner

MANAGEMENT DISCUSSION SECTION

Andrew Lazar

We're pleased to welcome again the Kellogg Company to our Global Consumer Staples Conference. In what has been an unrelenting center store malaise, I believe Kellogg has demonstrated a willingness to make some tough decisions that will ultimately lead to a more balanced approach to growth and creating shareholder value.

In this vein, we believe the company's decision to exit its U.S. Snacks DSD business was seen by many as bold and a strategic decision that will not only shape the company moving forward but perhaps serve as a case study for the packaged food industry for years to come.

With this in mind, we find it notable that to-date key milestones in the transition process have come through with little variance from management's initial expectations with the company reaffirming its top line guidance last quarter. Ultimately, we believe this provides further visibility to Kellogg's 18% operating profit margin target by 2018 with fuel for reinvestment.

With us today to further discuss Kellogg's strategy are CEO, John Bryant; as well as President U.S. Snacks, Deanie Elsner. I'll turn it over to you, John. Thanks for being here.

John A. Bryant

Okay. Thank you, Andrew. It's pleasure to be here this morning. As Andrew said, I have Deanie here with me. Unfortunately, Fareed Khan, our CFO, was unable to make it today because of a family emergency. So, I'll cover both the front section and the back section of the presentation, and Deanie will talk about what we're doing to transform U.S. Snacks.

Before we get started, I want to draw your attention to our forward-looking statements disclaimer. The company will make a number of forward-looking statements today. Obviously, we're exposed to a variety of risks. What might turn out might be something different to what we expect. Please take a moment to read this and review our public filings as well for more information on these risks.

In terms of the agenda today, I'm going to talk about how we're transforming the Kellogg Company. Deanie is going to go through the biggest area of transformation in our company, which is actually U.S. Snacks. Then, I'll come back and talk about our financial outlook and financial performance.

Before we get started, some things were working well at the Kellogg Company and some things are not going as well as we would like. What's working well is, very strong productivity programs that's driving strong profit growth, operating margin expansion and cash flow generation. That's what working well. What we're not happy with is our top line performance. And that's our area of focus and I'm going to talk today about what we're going to do to drive business back to top line growth and how we're transforming the business to help make that a reality.

Four key areas to talk about. First, having on-trend food and packaging. There's been a number of changes in the beliefs around health and wellness for the U.S. consumer over the last few years. Unfortunately, some of those changes were unhelpful to some key brands that we have. And stabilizing and getting those key brands back to growth is a critical element to driving long-term growth for the Kellogg Company.

Secondly, we're increasing our exposure to snacking in our portfolio. Every generation in the U.S. is snacking more than the prior generation. We see that not just in the U.S. but around the world. As we become more of a snacking company, we need to be within the arm's reach of desire. We need to be ubiquitous. That means we need to be available in a lot more channels than where the Kellogg Company has historically operated. So, we're investing in high frequency stores, especially channels here in the U.S., and we're getting ready for the impact of e-commerce on the retail environment.

And then finally, we're setting ourselves up to even more growth in the emerging markets. We've made several investments over the last few years. There's no question that the emerging markets is the defining event in our lifetimes in the food industry, is a macro mega trend that will continue to provide growth for large food companies like Kellogg.

We'll look at each of these, starting with Special K and the impact of changing beliefs around health and wellness. The decline in Special K has essentially been equal to the total decline of the Kellogg Company over the last few years. So, if we stabilize Special K actually, you see the company has slight growth. What's happened here? Across the 2000s, we saw tremendous growth from Special K behind a weight management positioning supported by low-fat, low-calorie foods. Unfortunately, consumers don't want to count calories anymore and fat is no longer as negative as it once was. So, we had to change the positioning of Special K from weight management to inner strength.

From programs like Drop a Jean Size to programs like we have now in the U.S. called #OwnIt. At the same time, we've had to renovate the foods. Some of the Special K foods like Special K Cracker Chips have largely declined in the marketplace.

Other businesses like the [ph] Calcio (04:30) actually can continue to do well under the current definition of health and wellness. And we've launched new foods like Special K Nourish with more evident fruits, nuts, and grains. Stabilizing and driving Special K back to growth is priority number one for our company, and that's where our focus is. This has been a big area of change for the company. And we've demonstrated that we can do this.

Kashi is another brand that's been challenge in recent years [ph] according to the (04:54) definition of natural – and discussion of what we meant, to have natural foods. We have renovated this portfolio extensively, and we've seen this business return to consumption growth here in the front half of this year.

In particular, if we look at cereal, we're growing Kashi Company cereal sales in the natural channel mid-single digits here so far this year. We're gaining share in the natural channel and we're gaining share in the traditional channels as well. And we have a range of wholesome snacks around nut butters. They're doing extremely well in the marketplace that's also driving additional growth.

The key here is getting on-trend food and packaging. As we do this in the company, we see the business respond. The company is undergoing the largest renovation program in our history across multiple brands, reducing sugar and salt those sorts of items adding items of benefits, and gaining back that simple natural foods as the core of our portfolio. This is critical as we drive our long-term growth.

The second big change is how we reshape the portfolio. You know us as the largest cereal company in the world, also the second largest cookie cracker company, and second largest savory snacks company. In fact, our snacks sales today are roughly the same size as the total sales of the company back in 2000. And snacks represent just over half the total company sales. And what has transformed our snacks business has been the Pringles acquisition. Pringles has been growing 6%, 7%, 8% a year since the date of acquisition and we're still in the early days of the growth story around Pringles. We're under-indexed in certain channels in the U.S. We're under-indexed in single-serve within the Pringles business. We think, we have significant opportunity and runway for continued growth.

And then the other big transformation going on in our snacks business is the DSD exit. It was about setting up that business for long-term growth, I'll let Deanie talk about that here shortly. As we become more of a snacks company, we need to be within arm's reach of desire, we need to be ubiquitous, and so, we're driving our growth into other channels. In the emerging markets, that's high frequency stores, mom-and-pop stores. Here in the U.S., it's convenience channel, vending channel, et cetera. So, a significant growth across those channels.

But also, we've recognized that e-commerce is going to transform the retail environment over the next decade. We're seeing it around the world. We're rapidly approaching the situation where over half our sales in China are direct-to-consumer, where we have markets in Europe with over 10% of our sales going through click and collect type programs or buy online, pickup in store programs. And while e-commerce in the U.S. is only around 2% of the food industry, it is growing significantly. Our e-commerce business grew 70% in Q2 in the U.S., and will continue to grow over the next few years.

So, preparing ourselves for that change, being in a position to win in the e-commerce environment is a big part of our strategy. It's worth pointing out that where we go through click and collect programs in Europe, our market share is generally higher and our margin is also very good as well.

The fourth area is the emerging markets. We talked a lot about organic sales growth as a company. A lot of the moves we've made in the emerging markets are not showing up in that metric. The acquisitions that have happened last year or two are they're unconsolidated joint ventures or unconsolidated investments.

To give you a sense of the size and scale of the investments that we have made; we've sold about 80% more volume, tonnage, kilos this year. 80% more this year than we did five years ago in the emerging markets. Big investments here include buying the largest cookie cracker company in Egypt, buying a leading cereal business in Egypt, buying a leading regional cookie cracker player in Brazil and making a significant investment in Nigeria.

I'll give you a sense of the scale and size of Nigerian business, some of the largest food businesses in Nigeria. Several hundred million dollars in sales depending upon where the exchange rate is from day-to-day, and it's growing around 20% to 35% a year. So, if we were to consolidate that business, it will obviously impact dramatically the overall growth algorithm of the company.

So, we're positioning ourselves here to continue to grow in the emerging markets. Add all that together and you'll get our 2020 Growth Plan, our four key drivers of growth as well as our commitment to productivity and driving margin expansion. You've seen this plan before. It hasn't changed, but we are delivering on it and we are transforming the portfolio of the company to set ourselves up for long-term growth.

A big part of that is unlocking the growth potential in our U.S. Snacks business. Big part of making that a reality is a decision around DSD, a difficult decision to make for a company like Kellogg but absolutely the right decision to make.

I'll hand over to Deanie to take you through that transformation.

Adrienne Deanie Elsner

Thanks, John. Good morning. In order for Kellogg to achieve growth, U.S. Snacks has to grow. In order for Kellogg to get to global snacking powerhouse, U.S. Snacks must grow. I'm less interested in that and more interested in the fact that we have a right to grow. We compete in categories that are the biggest and fastest growing in the U.S. market today. The snacking category today is just over $90 billion, growing at about 4%. It is on path to growth to about $100 billion by 2020. Consumers are snacking more. They're snacking more frequently and often substituting snack for meals.

So, we're in the right space in terms of consumer trends. We've got incredibly strong big differentiated brands that have a point with consumers that is tremendously relevant. What's even more important is they are largely advantage in a marketplace in that, they source a lot of their volume from outside of the categories they compete in and they are largely unique in the marketplace and un-substitutable.

We have a track record for innovation success. We historically have punched above our weight in terms of innovation share versus our share in the marketplace. And really importantly, Kellogg has a vast amount of first-party data. We've invested in first-party data for years behind our loyalty program that enables us to have a bird's eye view of consumer unlike anything we've seen so far and that combined with our advanced analytics begins to get the underpinnings of new capabilities that enable us to compete in the marketplace differently.

So, you have to ask the question. Why aren't you growing? Two reasons, one, it's the Special K reason that John cited. Special K has been a very large [ph] disproportional (11:25) loss in the snack portfolio over the last four years. But then importantly, many of our assets, many of our resources have been tied-up in the route-to-market called DSD. And so, we've been inflexible in terms of how we can reallocate those resources to drive a differentiated position in the marketplace. 18 months ago, we literally laid out the roadmap for the U.S. Snacks business. It was three major phases. The first step was to refocus the organization to get costs under control, to restructure our networks so we could pull out unutilized and unnecessary capacity, to launch ZBB and pull costs in and, importantly, to drive revenue growth management to bring some discipline to our pricing practices.

At the same time, we made the decision to distort our resources and shift our investments behind the biggest, most high-priority brands in our portfolio. The good news is that's behind us, and it worked. 2016 was the best result snacks business delivered in the last four.

In fact, the back half, third quarter and fourth quarter last year, we delivered top line – trifecta: top line growth, volume growth, and operating margin growth. And so, we proved that this works. That's important because it lets us set the company up going forward.

Second phase is the transform phase. This is really where our decision to exit out of DSD becomes the biggest part of this phase, but it's not the only part. The other parts of this phase really is reinventing marketing as we know it today, getting to a more agile allocation of marketing, moving towards a new playbook and setting up a new sales organization that is a non-DSD sales organization so that we move the back part of our roadmap, which is about accelerating growth.

This is where it gets fun. This is where you start get into joint value creation with your customer, looking at an end-to-end supply chain that includes your customers so that you can get after shared value of removing barriers and investing more aggressively in your business.

Today, we live in the transform phase, but I want to give you a little bit of dimension around why the refocus stage was so important and why we feel confident coming out of the refocus stage. Three big reasons, our marketing ROIs historically above benchmark externally continued to grow last year. Now, they continue to grow because we pulled down costs, we got smarter about how we allocated our media, and we focused on new vehicles that got to consumers in a more relevant ways.

What's important is we also, for the first time in many years and with one brand first time ever, began to advertise new brands. Now, when you do that, you would expect your ROI to come down because it's just almost impossible for your ROIs to be as strong as your arsenal of brands that you have historically talked about, but that wasn't the case. Those brands responded well, our strong brands got stronger, and our ROIs increased. That means we're on the right path.

Second, innovation. We've historically punched above our weight in terms of innovation. On average, our share of innovation is about 2x our share in market. So, we've been successful at doing this, but last year, we built a new infrastructure by which to look at white space opportunities and, in fact, our index in innovation share increased and widened. And so, we felt good about the infrastructure we've built there.

And then, finally, I told you we distorted across our priority businesses. Four priority businesses, those businesses grew at 1.7 times faster than the categories they competed in. So, for these reasons, it gives us confidence that we can shift to the next part of this equation and begin to find a better way to reallocate our costs contained today in the distribution method to drive more investees behind our brands.

Now, the biggest most visible part of our transform phase and the thing that gets a lot of questions and talk time is our exit out of DSD. So, let me kind of center you again on why we're doing what we're doing. It would be a mistake to look at this as a cost play, a onetime cost benefit that we can't continue. It was not the reason we went down this path. If you think about DSD, we have a sales organization that goes in and literally writes the orders for the stores in-store. We have a distribution organization that receives those orders and distributes the product in the back of the stores. And then, we have a merchant [ph] size being (15:50) part of the organization that goes in, pulls the product out, puts it on shelves and builds displays. That's DSD. That's the part of the route-to-market that we have made the decision to exit.

In making that decision to exit, we made it for really three very big reasons. One, you would be in DSD if your product was fragile, if it was so high velocity moving that you had to be in the service-to-shelf or if it had a short shelf code that doesn't exist in the categories we compete in today. None of those attributes exist.

Two, our customers have gotten tremendously sophisticated in terms of their distribution systems, their pricing decisions, their shelving decisions, and their display decisions. The need to have a DSD in doing that for them actually becomes more of a cash flow challenge for them than a benefit.

And three, maybe most importantly, the consumer is shifting the way she shops today. She is fragmenting her purchases across channels, and many channels that she is going to, we don't service with DSD. So, for us, to unlock those resources, to refocus against our brands was one of the most important things we could to transform this business.

Now, the good news is of the stage gates in this project, we are through the majority of the difficult stage gates. We've negotiated with our customers one by one. We've agreed to terms on how we're going to readjust the price when they do the cost to serve in-store. We've also agreed on assortments. We've also agreed on the SKU rationalization, and we began to do the SKU rationalization within our organization. And we have made the shift out of DSD and today, we are 100% warehouse-distributed.

It's important to note though, because we are warehouse-distributed and we're out of DSD doesn't mean all of our customers have transferred over to this new route-to-market completely. Although, they are shipping in-store, some of our big customers have not changed the assortment on shelf. Some of our customers have pulled back on merchandising.

And so, I call this as kind of our ugly period. If there's a period where things look really bad, it's the month of August because, we exit our DSD at the beginning of the month. We exit our merchandise at the beginning of the month. We shift to a new warehouse model. And we have not yet completed the shift all the way through to our customer on shelf and training them how to now manage the shelves that we are no longer shelving. So, that's why we're in hypercare. Hypercare is really us continuing to manage through this process so that come Q4, we are fully out. We are fully up and running and we begin to shift to the new model.

Now, I know you want us to tell you exactly what to expect next. I need to remind you, there's no playbook for what we've just done. Nothing exists and even though I've read one, two, three DSD easy as can be, it's not the case. This has been a complex project, difficult to manage. What you can expect though is a slightly smaller, more focused business that is stronger and more profitable.

Why is it slightly smaller? Because, we have rationalized our SKUs. We have pulled back on merchandising literally from the end of May until the third week of August. You will see our displays down tremendously. You will see our average price up. You will see our weeks of merchandising down because we couldn't risk disrupting this shift and drive merchandising in-store. So, we chose to pull back as did our customers. That's what's showing up in the numbers today.

We also pulled products off our shelf while we reset the prices. And so, that's what's going on to the numbers today. That's going to get us to less of a tail to deal with as of front half of 2018. That's going to get us to less secondary and tertiary displays.

Ultimately, what that gets us to is, a less complex portfolio that is actually more focused and more scaled on primary displays. That is a smaller, more focused organization. Our businesses will be stronger though, because we're increasing our investments. We've got a scaled route to market to take advantage of the worldwide strength of the Kellogg warehouse and we've got stronger retailer margins. What that means is, you're going to see a bigger, stronger in-store presence and stronger tentpole events for our retailers, bigger events overall. Ultimately, we will have a more productive shelf. We'll have higher moving velocity SKUs that will drive more top-line sales, that will be more profitable and drive stronger shares. That will come next year.

It will be more profitable, because you will see our overheads expand, our profit margins expand as a result of pulling away from overheads. But that's even after we've transferred dollars to our retailer to manage the cost of doing business inside their store today, that's after we've increased our investment in our portfolio, and that's after we've put more feet on the street to manage the sales for this organization longer term.

What that's going to mean for us long-term is that our margins get to be the average KNA, North American average in totality. That's what we're committing to today, literally, a roadmap of margin expansion over a three-year period when you begin to wrap up this roadmap of cost-cutting, getting smarter about our supply chain, and moving out of DSD.

We are committing today that we will be at the North American average by 2018 or within 2018 and that we can count on. So, we enjoy now the most profitable position that Kellogg U.S. Snack business will ever be in, and we've set ourselves up for growth. It gets me to the next leg of this journey, which is really the accelerate leg. This is – although, the refocus and the transform was fun, now, it really gets fun.

We've got five platforms that will help us drive our growth going forward. First, you will see us increase our brand investment going forward significantly on our key priority brands. We will also build new ways of doing marketing, and I'll talk at length about this, because this is going to be a true competitive advantage for us going in the marketplace.

We will shift more towards customer value creation as our retailers are under as much pressure as we're under to drive top-line. They're looking for partners. They can partner with them in different and unique ways and lever tremendous data and analytical advantage. We'll talk about that. You'll see us push hard into channel expansion, because this is where, if you're a snacking company, you have to be. Consumers [ph] are going (22:42) across all of our channels to purchase our brands. And if we are not represented in those channels, we do not get the opportunity [ph] to be purchased (22:52). And then, finally, I will discuss how we're going after end-to-end in a much bigger way, both upstream for us as well as for our customers.

Let me start with the increase in brand investment. We've talked about the fact that you will see a double-digit increase in our brand investment from today going forward. It's a known commodity for us because of all the work we did last year. We know our brands are highly responsive to investment. And so, we will invest behind aggressively Cheez-It, Rice Krispies Treats, and Pringles. But, historically, that's where we would stop, because we didn't have the money to move on beyond that. Now, we will increase our investment on those brands.

We will get to optimal investment levels on brands like Keebler, brands like Nutri-Grain, brands like Special K, and we will begin to invest for the first time in parts of our portfolio that we've had to ignore, because they've been too small. What happens when you ignore brands is, consumers forget about them.

So, although we won't have big splashy campaigns, we will find ways to activate brands like Famous Amos that is growing tremendously well, and Murray and Mother's out in the West Coast and to drive some awareness for those brands in-store with our consumers.

It's not just that we will be present or investing more in these businesses, we will also invest smartly in these business, as you will see us expand our digital footprint. Next year, we will spend more than 65% to 70% of our spend in digital and social. That's incredibly important, because today that's how consumers are engaging with brands, and brands that are not well represented there are brands that risk becoming irrelevant. The industry benchmark for digital and social is about 45% to 48%, so, we'll be well ahead of those benchmarks.

What's important about how we spend is the fact that we're developing the communication streams and the engagement within the environment. This isn't a campaign that we develop for TV and we're trying to translate into digital and social. These are campaigns and communication mods that are being developed in that environment, so they drive even stronger relevance.

And if that weren't enough, we're now going back and across the board with better first-party data to understand our consumers or developing new campaigns on Cheez-It, Pringles, and Rice Krispies Treats, and we're moving to master campaigns on umbrella brands where the brand really has tremendous equity and we activate by segments like Keebler as well as Special K. So, you will see us repositioning and talking to consumers in a new way on all of these business and that will start at the back half of this year and into next year.

I read an interesting article over the weekend that said, today marketers are dealing with anywhere from 10 to 50 times more data today than they were 3, 5 and 10 years ago. Imagine that. 10 to 50 times more data. So, any company that wants to try to reinvent and transform in this environment must do it within the world of developing new capabilities for marketing, because if you don't, your current capabilities, your current models, your current processes are not set up to even digest and help provide direction for the data that's available today.

Now, I talked about the fact that Kellogg sits on a vast amount of first-party data. It's great data. It's great, it's data that's deep and broad that gives you great perspective on your consumer. By matching that data with third-party data externally, all of a sudden we have a data lake that gives us tremendous insights. We're developing capabilities in three very big and important ways to help us transform our way of doing business in marketing.

First, I will talk about how we're doing that for innovation and shopper, then I'll talk about how we're going to do that for targeting and then, last I'll talk to you about the capability we're building for an optimization of returns on investments going forward. So, let's first talk about occasion-based demand landscapes.

Think about an environment where you get to see real-time the consumers that you define as the most important in your portfolio, the occasions that they purchase and consume your product in all of your competitive products both in your current categories, as well as the adjacencies. You understand their [ph] needs space (27:20) and what drives them and you understand that when they move from a consumer and walks to the front door of a retail outlet, they become a shopper on a mission. We have developed a real-time data-driven demand landscape that lets us understand with precision the white-space opportunities in terms of size, in terms of attributes required to compete in that space, and importantly in terms of the competitive landscape that exists in that space, both inside your categories and outside.

What this enables us to do with tremendous precision is define exactly what it's going to take to win in that environment. In addition, it gives us tremendous insights, real-time insights, behaviorally, about how consumers navigate that space.

Finally, from a shopper's standpoint, it enables us to see where those consumers are shopping and what mission they are shopping against. So, now we built a capability that transcends from our marketers to our sales organization, insight-driven, opportunistically-sized areas where we can go after for white-space growth. We built this last year and this is in large part why we've seen the increase and the widening gap on our innovation. We will continue to use this in terms of our innovation and shopper programs going forward.

Second, mass precision targeting capability. Again, based on our first-party data. Most brands managed two to three different targets, women 25 to 54, young men 15 to 18, they have some large demographically-defined group. The problem with that is, consumers today expect to be dealt with individually. They want to know that you understand them exactly and your brand message is relevant to what they are doing in their lives. And so, today, in the snacks businesses across all of our brands, we on average, are managing anywhere from 15 to 25 different targets. We're doing this by getting to a scaled level of consumers – of light consumers, so we can talk to them about our brand messages in a way that's compelling and relevant.

Imagine a Cheez-It, if you were a Cheez-It user, but you've never used our product, that's more like a chip it's called Grooves. It's a new product we launched four years, it's been growing consecutively for four years. Now, we know you're a salty snack user, you use Cheez-It, you love Cheez-It, but you've never tried Grooves. We now can deliver a message directly to you and in some cases incentive to go try a new product in our portfolio. That's the mass precision we now have available to us that we're using.

What that gets us is tailored consumer experience that drive brand relevance. And brand relevance in this country trumps every single time, because these are brands that are such high-velocity brands, incredibly important capability that we've built.

Third, real-time optimization. We can now, between our trade and our marketing, look at dynamic scenario planning that enables us to simulate what are the best places to spend our money. Once we do that, we can optimize real-time makeshift between the vehicles within a brand, between the standby brand, or between marketing and trade. Ultimately, our ambition is to get to more predictive analytics that help us fill in the gaps as we ask the questions. But that's the real-time optimization.

So, this capability building for us, moving into a world that is being driven by millennials, is dependent on your ability to digest an action big data are true advantages in the marketplace that will help us move towards growth in terms of top-line.

Equally, we can apply our data footprint to creating joint value for our customers. Similarly, we can do data-driven analytics to identify the biggest steps we have at any one retailer between a brand, a format, a size or a combination of brands [indiscernible] (31:32) in store. This now enables us to cross over in terms of cross-category promotions in a way we've never been able to do, because remember, we're one route to market. Prior to this, we weren't one route to market. So, it was very difficult to line up those DSD deliveries with the warehouse deliveries and get them all brought together in store.

Now, with one route to market, data informed analytics and precision focused big bets, we now the capability to be much more prescriptive about what will work and what won't work and get after priority brands in a much bigger way activation in-store. It also enables us to get after in-store reinventions, aisle reinvention.

Today, center of the store represents about 75% of a retailer's profitability. We can now find ways to bring consumers down the aisle and help stores navigate this new space. And, finally, unique shopping experiences by tying our brands to what's relevant externally and bringing that to life in store.

The fourth leg of this is, channel expansion and pack-formats. I have said, since I've been with the company for the last two years. The biggest opportunity Kellogg has is to move from a pantry pack orientation to a single serve orientation. And, in fact, across every one of our categories, we under develop in terms of single serve to a category with the exception of cracker. So, across every category, improving our formats and making them available across channels will be growth upside for us.

Crackers have sourced tremendously from a salty category over indexed for crackers, but versus the salty category, we only index at about a 30 mark – 30 index. And so, what that means is by getting the right message to the right consumer and the right brand, with our single serve, we can actually drive more activation and that's what you're seeing across the board.

Finally, end-to-end supply chain finding mutually beneficial ways to maximize the value wheel with our customers to create joint value, improve profitability, and barrier restrictions will enable the entire supply chain upstream to work better.

So, in conclusion, we are on the path the U.S. roadmap laid out almost 18 months ago. We are in the transformed phase and we've made great strides in that space. We are moving towards the accelerate phase and there's upside for us to drive this business for growth, especially on the brands we have to ultimately deliver sustainable sales and profit growth.

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

John A. Bryant

Great. Thank you, Deanie. So, in terms of the financial update, we are reaffirming our 2017 guidance here this morning. This is the same slide we showed back on our Q2 conference call. Obviously, the top-line is adversely impacted by the DSD transition, both the disruption from that as well as the price concessions as activity moves from our company to our retail partners.

[ph] As you (34:27) look at this guidance, if you say there's a little bit of risk here anyway, you'd say the risk is on the top-line. [ph] Our rollout (34:33) today has us hitting this guidance. We have absolute line of sight there and we believe in that. But if we were a little bit softer than this guidance, we still have the productivity visibility with the operating profit and the EPS.

We're only managing the business just to manage a weak top-line. We want to drive the business back to top-line growth. That comes out of fixing brands like Special K and Kashi. You're seeing the progress there increasing our portfolio, orientation towards snacking and emerging markets, and driving availability in multiple other channels where consumers are looking for our foods. We believe all of this combine can drive the business back to low-single-digit sales growth and that's what we're focused on achieving as a company. In addition to that, we plan to continue to drive margin expansion. Project K will deliver additional savings through 2018-2019.

Remember, the operating profit impact from the DSD transition is relatively profit neutral in 2017. Actually, a lot of the benefit will come through in 2018 and 2019. And we're still in the early stages of zero-based budgeting, the second year in North America, the first year in international. So, continued productivity visibility will help us drive a 350 basis points of margin expansion from 2015 to 2018. We're tracking in line with achieving that outcome.

Now, one thing to remember about 2018 is, we have an unprecedented level of accounting changes, lease accounting, revenue recognition accounting, pension accounting, et cetera. Most of those have very little impact on us, but pension accounting will have an impact. Pension accounting does not impact our EPS, but it changes the geography within the P&L.

The result of that is some line items that move from above operating profit to below operating profit, which will bring operating profit down across all these years by about 150 basis points to 200 basis points. So, it's a step-down in operating profit. And again, no impact to EPS, just a geography change in the P&L. No change in numbers you're used to looking at historically.

That strong operating profit drive, the growth drive, net income growth which drives cash flow generation. Our uses of cash, first priority is the dividend. We have a 50% payout ratio. We have a dividend yield of 3.3% or thereabouts and a key element of holding the Kellogg's stock as we drive that net income growth, we drive our cash flow growth which should continue to grow our dividend over time.

And our goal for cash flow is that basically we have about 100% conversion versus net income. We've been absorbing a lot of restructuring cash flow charges over the last few years and still converting our cash flow at around 100% net income. And then, we've been doing that by reducing core working capital. As we go forward, we expect less restructuring cash flow impact and probably a little bit less core working capital benefit.

Second priority is M&A. We're focused on making acquisitions in the intersection of emerging markets in snacks, in an intersection of developed markets and health and wellness. And then, we'll balance that with share buybacks and debt reduction to ensure we maintain an investment grade balance sheet.

Of course, there's more to Kellogg Company [ph] than just our (37:32) financial results. This is also the heart and soul of the company why we exist. Issues like Hurricane Harvey, a great example of the Kellogg Company sending food down to people who needed the most. We've given away nearly 2 billion servings of food globally over the last three to four years, and we'll continue to make those sorts of programs and also nurturing our planet with sustainability programs. We have a commitment to reduce greenhouse gas emissions across the end-to-end supply chain from the farm to the consumer's home by 50% by 2050. We have five-year goals getting us there that has us working with a target of 0.5 million farmers around the world to implement climate smart agricultural practices.

So, if you look at the Kellogg Company, we're committed to driving top-line growth. We're committed to increasing our operating margins. And we're committed running the company with the intent and spirit of our founder, Mr. Kellogg, to give back to the communities and society in which we operate in.

So, thank you. I think we have time, Andrew, maybe for one quick question.

Q&A

<Q - Andrew Lazar>: [indiscernible] (38:32). I guess, John, I'll start off with more of a macro question in the food space, there's a lot of concerns out there on many of the news items that we've seen. Last week, in particular, we heard of one company that had failed to reach an agreement with a large customer on promotional activity. We heard similar things from another company out of Canada. You had mentioned some things a quarter ago with Pringles in Europe. I'm sure these sorts of things go on back and forth between manufacturers and retailers non-stop, most of the time, we don't know about it.

It does seem like we've had a couple of higher profile ones that have kind of been – become – the management teams have felt the need to sort of discuss with the investment community a bit more. Is that something that you feel like there's been some really dramatic change in that regard? We know the retail partners are under a lot of stress as well or maybe you can put it in perspective for us.

<A - John A. Bryant>: Yeah. Great question, Andrew. I don't think it's a dramatic change. [ph] There's certainly always (39:27) been conversations between retail partners and manufacturers on margin and supporting programs. And as high discounters impacted certain markets around the world and as e-commerce impacts markets around the world, we do see some [indiscernible] (39:42) retail put more pressure on margin.

And the result of that is, we work together with our retail partners so we can both win the marketplace. And, at times, [ph] you take a bus stop (39:50). At times, you take a customer dispute. We had one earlier in the year in Europe around Pringles. Pringles declined pretty significantly in the first half of the year. It's back to growth here in the back half of the year. The right long-term solution is to work with the retail partners. But if you have to take the dispute, you take the dispute and you move forward.

Andrew Lazar

Okay. Why don't we do this? Let's take more in the breakout. Thank you very much for being here. Please join me in thanking, Kellogg.

John A. Bryant

Thank you.