Company Name: Kellogg
Company Ticker: K US
Date: 2018-02-21
Event Description: CAGNY Investor Conference

Market Cap: 23,829.87
Current PX: 68.9225
YTD Change($): +.9425
YTD Change(%): +1.386

Bloomberg Estimates - EPS
Current Quarter: 1.072
Current Year: 4.429
Bloomberg Estimates - Sales
Current Quarter: 3275.067
Current Year: 12979.700

CAGNY Investor Conference

Company Participants

- Unverified Participant
- Steven A. Cahillane
- Fareed A. Khan

MANAGEMENT DISCUSSION SECTION

Unverified Participant

We can make our way to our seats. We're ready for day two of CAGNY. So our next presentation this morning is from Kellogg's, and before I introduce CEO and President (sic) [Chairman] (00:17), Steve Cahillane, I'd like to thank Kellogg's for treating us for breakfast this morning. Breakfast with Kellogg's is a long-standing and much anticipated tradition each year. So we're pleased to have Steve Cahillane back here at CAGNY and for the first time as CEO of Kellogg's. Alongside Steve today are CFO, Fareed Khan; and VP of Investor Relations, John Renwick. In his brief tenure at Kellogg's, Steve has brought new energy to the organization. We look forward to hearing more about his impressions of the company and his plans going forward.

Steve, I'll turn it over to you.

Steven A. Cahillane

Good morning, everyone. I hope you enjoyed our breakfast. I also hope that while you were eating some of our delicious foods, you were noticing some new ideas, some willingness to try new things and glean new insights from new places. I am very excited to be here and I'm delighted to finally get a chance to meet you in person and to talk about our business.

Before we start, I have a few words from our lawyers. Slide number 2 shows our usual forward-looking statements disclaimer. As you are aware, certain statements made today such as projections for Kellogg Company's future 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 this slide as well as to our public SEC filings.

As I've said previously, there has been nothing I've learned in my first 100 days that has in any way changed my view that this is an incredible company that has every right and every ability to thrive for the next 100 years. I believe that our company has a number of structural advantages. Food beliefs and trends come and go, but our foods and brands are timeless. They're made with the highest-quality ingredients. They feature enduring attributes like taste, convenience, nutrition and affordability. They can be adapted to new trends as well as to local tastes and cultures around the world. And our brands are beloved. In fact, they're in most homes every day.

Kellogg Company also has a special culture, one that insists on adhering to its core values like respect and ethics, like accountability and a hunger to learn. It is committed to social responsibility just as it is passionate about our brands and winning in the marketplace. And I really like the size of our business, big enough to benefit from scale, but small enough to really wrap your arms around.

We are in categories that have meaningful synergies with each other. We're on sound financial footing with a reduced cost structure in categories that are profitable, and with the cash flow that is strong and dependable. Simply put, we have the financial flexibility to invest in growth. And we truly are committed to getting back to growth. As we'll discuss today, we think we have better ideas, ideas that are more exciting to the consumer. We have a 2018 budget that provides for a ramp-up in investment and we're investing these funds in growth platforms, some existing and some new.

So today, I'd like to briefly remind you of the foundation we are starting from, as we embark on our return to growth. And then I'll walk you through how we see our current growth trajectory. Then I'll explain deploy for growth, how we will reorient ourselves against key growth elements that can help us exceed our current trajectory. Fareed will put it all together from a financial perspective and then I'll come back and wrap up with some closing thoughts.

So let's start with our foundation for growth. Just look at the brands we have in our portfolio. They are big. They're repertoire brands enjoyed by households week after week. They're recognized and easily expanded into markets around the globe. They respond well to innovation and to brand building, and they are profitable both for us and for our retail partners. They have, can and they will grow.

These brands and our foods have a proven ability to participate in megatrends and to pivot when these trends shift. A current and vital megatrend we are all observing is health and wellness. Definitions of health and wellness constantly evolve, and Kellogg Company has always been there with foods and brands that stand for health and wellness. So we can play in emerging health and wellness trends. We know that. Quite simply, this company has a heritage of health and wellness, and it is important – it is as important for us today as it has been over the course of the past 100-plus years.

Another megatrend that we're all seeing is snacking. It often surprises people that through innovation and acquisition, we now derive more than half of our portfolio from the snacks category and this doesn't even include the fact that nearly a third of cereal consumption is now outside of breakfast and consumed primarily as a snack. So can we play in snacks? Absolutely, we can. We're in fact already today predominantly a snack company.

Another element that gives us a solid foundation, our global presence. This gives us access to more areas of growth. This gives us the opportunity to share successful ideas across markets. Yes, our business is still weighted towards big developed markets, markets like the United States, the UK, Canada and Australia. But we have a large long-standing and growing presence in so many other markets including the developing markets and emerging markets that offer the best prospects for long-term growth.

I think our emerging markets presence has been somewhat overlooked. Not only are we growing our emerging markets presence organically, but we scaled it up significantly in recent years through acquisitions and joint ventures. Pringles added to our presence in numerous markets. We made two acquisitions in Egypt. We tripled our scale in Brazil with the acquisition of Parati. Since 2012, when we announced our plan to double our emerging markets business by 2020, we have increased this volume by nearly 85% including our share of the joint ventures. That's a huge difference, but it's not just their size that we have increased. Our growth profile has been improved by shifting our emerging markets portfolio beyond cereal and towards snacks, which are growing even faster in these markets.

In 2012, snacks represented less than 20% of our emerging markets volume. In 2017, snacks were more than 40% of our volume excluding joint ventures. Our bigger presence in snacking gives us that much more growth potential in these vitally important markets. Emerging markets are an important component of our current growth trajectory, and we have made decisive moves in this area. So we have a very strong foundation for growth.

Now, let's turn to what we call our current trajectory for growth. Let's view this by breaking down our portfolio into four segments that each have very different growth dynamics. Developed Markets – Cereal is big and it is profitable, and we recognize that we have to stabilize it which is exactly what we're doing. Developed Markets – Snacks is our largest segment and it's starting to return to growth as we emerge from the DSD transition in the United States. Developed Markets – Frozen is growing rapidly as it hits on so many of today's consumer trends. And Emerging Markets today is bigger and faster-growing segment than it has been in the past.

Let's take each of these in turn. Let's start with the bucket most people think of first when they think of Kellogg and that's Developed Markets – Cereal. It may surprise some of you that this represents less than a third of our business today. Population growth is slow in these markets, and ready-to-eat cereal is a highly penetrated category. So it tends to grow only slightly over time, moving through cycles, triggered by changes in food beliefs and levels of innovation. In recent years, consumer trends away from low-calorie, low-fat definitions of weight management and towards high protein and prepared meals have put Developed Markets – Cereal on one of its cyclical downturns.

This has pulled down the so-called adult health and wellness segment of this category, and we over-indexed in that segment. And frankly, we haven't done enough to keep the consumer engaged. But we have every reason to be confident we will stabilize our Developed Markets – Cereal sales. We stabilized three of our core four markets in 2017. We did this through relevant food news, coupled with effective brand building and tying it all together with strong in-store execution. There is no reason we cannot do even better going forward. We have stronger innovation and renovation planned. We are expanding eating occasions, like the snacking occasions where cereal has shown that it has relevance. And we're influencing food beliefs, instead of just reacting to them, with a strong push now behind digestive health. It's not unreasonable to expect this portion of our portfolio to be somewhat flat over time, up slightly in some years and perhaps down modestly in others. Even if it can't consistently decline slightly, we could still deliver top line growth.

Now, let's talk about what is in fact our biggest bucket and that's Developed Markets – Snacks. This represents nearly half of the company's total sales. You are all aware of the snacking megatrend and we are fortunate to play in its growing categories. Our sales have been down in recent years, owing primarily to Special K and the shift in consumers' weight management definition. Additionally, we were underinvested in brand building in the United States, as most of our P&L was tied up in an expensive DSD system that served only one channel. But we're poised to get back to growth in the near term. Pringles is growing – grows consistently in these markets and there is so much more we can do with pack formats, in-store racking, innovation, and fun brand building ideas like flavor stacking.

Our transition out of DSD in the U.S. allows us to shift our resources into demand driving brand building. This means more support for power brands like Cheez-It and Club crackers, Rice Krispies Treats and Pringles, but it also means support for other brands like Keebler, Nutri-Grain and Famous Amos. And now, we have RXBAR in our portfolio. This is a brand that has barely scratched the [ph] service (12:04) in terms of distribution. And we look at this business as a new entrepreneurial growth platform for us. So, as you think about Developed Markets – Snacks, it should not be hard to envision a current trajectory of plus 1% organic growth over time.

First of all, our categories are growing at least at this rate. Secondly, through additions like RXBAR and subtraction like our SKU rationalization, we have a stronger portfolio of brands today than we have had in recent years. And finally, thanks to the DSD transition, we are moving investment to optimal levels.

Next is Developed Markets – Frozen. This is predominantly our U.S. frozen foods business, and it represents just under 10% of our total company sales. This business declined for a couple of years, as we pruned its portfolio and revamped its packaging, But it rebounded to growth in mid-2017 and momentum built up through the second half of the year propelled by the removal of artificial colors and ingredients from Eggo, innovation launches around Disney shapes, and emphasis on core drilling items in our MorningStar Farms business. We're seeing very strong growth in consumption, share and net sales for both MorningStar Farms and Eggo. And we have every intention and opportunity to continue to innovate and renovate emphasizing simple ingredients, the versatility of our foods and plant protein.

So it's actually a bit conservative to assume a current trajectory of only a low-single-digit organic growth rate over time. Obviously, we will strive to grow faster than that just as we are in fact experiencing today.

Finally, we've got our Emerging Markets, which represent nearly 15% of our total company sales excluding our joint ventures. These are markets with the strongest population growth rates, rising disposable incomes, and pronounced snacking trends. In the past, our portfolio in these markets was almost solely focused on one category, ready-to-eat cereal, and we lacked the scale and economics to make these markets a true growth driver for us. In recent years though, we have been building scale and presence particularly in snacking. As a result, we've been able to grow organically in recent years despite difficult macro conditions.

Pringles has momentum as we enter new markets and as we launch new food pack and formats. We're using the Kellogg master brand to launch granola and wholesome snacks in Asia and Africa. We've built a stronger Middle East foothold through our cereal and biscuits acquisition in Egypt, and we're integrating and growing Parati, which triples our size in Brazil and gets us into the biscuit category. So it's reasonable to assume an organic growth trajectory in the mid-single digits for our wholly-owned Emerging Markets business, the precise results we achieved in our latest quarter. And remember, this doesn't even include our joint ventures, which are growing at a very strong double-digit growth rate.

So if you take these four portfolio segments and make even conservative assumptions for each, you can get to about 1% growth following 2018 that is flattened by the impact of our DSD transition. That's how we see our current trajectory. Maybe a little bit more, maybe a little bit less, but roughly 1%. But we're clearly not satisfied with this. And as we step back and assess the business over the past few months, it became clear that there is an opportunity to do even better.

We're going to bring the same relentless focus to a growth agenda that we brought to reducing our cost structure in recent years, and we're going to deploy our resources behind growth via investment, via M&A, and via improved capabilities and execution. We call this deploy for growth, and it is what can take us from the current trajectory to a long-term growth rate in the 1% to 3% range.

So let's now talk about deploy for growth and how it can deliver more growth than our current trajectory. Choosing where to play and how to win is the essence of any strategy. Our 2020 growth plan has served us well so far, and it has led to some important strategic moves in recent years. But now, it's time to evolve our strategy to drive more focus on growth, more focus on execution and on investing where the growth is. But before I talk about what we'll do differently, let me point out what in fact does not change. Our vision and our purpose don't change. They absolutely capture what we are all about. Our heart and soul pillars remain the same. And our financial guideposts don't change. Growing sales and share, expanding our operating profit margin and delivering top-quartile total shareholder returns remain vitally important.

What does change are our growth pillars. What we formally refer to as win in breakfast becomes win through occasions. Breakfast is a key occasion clearly, but so is late night snacking and on-the-go meal replacement and a snack-as-a-meal accompaniment. Emerging markets engine becomes shape a growth portfolio. Emerging markets are no less a priority for us as we've already discussed, but there are more pockets for growth out there and we had the chance to shift our portfolio to more of them.

Creating world-class marketing gets elevated to a strategic priority. Across all of our categories, we have the opportunity to improve the way we build and market our brands. Win wherever the shopper shops becomes deliver perfect service and perfect store. This is intended to emphasize and specify the executional elements we need to focus on.

Let's take each of these in turn. First, we have to shift our mindset away from categories and products in occasions. This is the way the consumer thinks. This is the way the consumer behaves. This company's roots are in the breakfast occasion, and so many of our products and categories were developed with breakfast in mind. But winning through occasions means delivering the right food in the right packaging, at the right time for any particular occasion. In effect, we've been moving beyond breakfast for some time, but we have a lot further that we can go.

For instance, visit a consumer's home, be it in Mexico, in Korea or even right here in the United States and cereal is just as apt to be consumed in the evening as a snack as it is in morning – as it is during the morning at breakfast. By focusing on the occasion, we can better meet the needs of that consumer. Another example, Pringles are beloved by all, but while a large can might be perfect for at-home grazing, a small immediate consumption Grab & Go can might be more suitable for a consumer looking for something to accompany their sandwich.

When we know the occasion, we can renovate or innovate the food accordingly. We know that getting the food right for current and future consumer trends is essential. And from my observations so far, we've been pretty good at it. This slide shows just a few of the recent examples. Whether it's renovation or innovation, this must continue to be a focus for us, always keeping the consumer occasion front and center.

We also know that getting the pack format right is critical for winning the occasion. That's why we've been hard at work at building capability and capacity for new pack formats, such as single serve, immediate consumption, freshness and, in some markets very importantly, affordability. This chart shows that we've made progress on single serve, but that we still strongly under-index our categories in this regard. So there's really plenty of opportunity for growth going forward.

And in addition to helping us reach consumers in all new occasions, these single serve and immediate consumption pack formats are ripe with revenue growth management opportunities. Whether it's renovation or innovation, whether it's on food or pack formats, you can expect us – you can expect to see us getting more aggressive on innovation going forward. It may not be in the number of launches as proliferation can sometimes be short-term oriented without helping long-term results. It's going to be about the quality of the innovation – differentiated, new, on trend and delightful for our consumers.

And this slide shows where we're focused. We're already moving in this direction. On hyper-convenience, think of some of the new pack formats we've launched lately or even try our new [ph] Joyable (21:59), which is in our breakfast room and is in test right now. For digestive wellness, look at what we're trying out with Special K probiotics just hitting shelves now. For strength and energy, think of what we can do with RXBAR. And in next generation natural, we can continue to stretch our portfolio of brands and new ingredients and markets.

I wish I could share more with you today, but much of what we're working on is in early stages and has not been announced yet to the trade. Some of it will launch in 2018, but there will be still more coming after that.

On top of innovation, we'll be investing resources behind our best ideas and brands. By this, I mean investing where the growth is. We're already moving in that direction. We're adding capacity for Pringles in Brazil because growth in the America served region is outstripping our supply. We see growth in U.S. snacking categories, so we've exited DSD to free up resources that can be used to ramp up investment in the innovation and brand building that drives those categories. It starts with momentum brands like Cheez-It and Rice Krispies Treats, and it extends further to our other brands.

Frozen foods are on trend right now both from the perspective of convenient meals and plant-based protein. We've got both. And as we've invested, we've seen our growth momentum build. Bear Naked hits a granola trend, and we've been investing in the offering and distribution of this wonderful brand which has now become the number one granola brand in the United States.

We're also pushing into whitespace opportunities. For instance, we're launching wholesome snacks in Asia and Africa because there is an emerging consumer opportunity opening up for these kinds of products. When we invest behind our best ideas and brands, we improve our growth trajectory. We see M&A as being another important way that we can shift our portfolio's growth profile and move our long-term growth rate higher.

Our most likely hunting grounds are the ones you've seen from us in recent past – health and wellness in developed markets, and snacking in emerging markets. A few recent examples are right here on this slide. We're incredibly excited, as I've already mentioned, to have RXBAR as a new growth platform. It's growing rapidly on its own and now it has Kellogg resources at its disposal, resources around R&D, marketing and distribution. And think about opportunities like expanding this brand internationally or adding similarly new emerging brands into this business and letting it work its entrepreneurial magic.

Parati is almost fully integrated and we're now looking to expand its reach within Brazil. But think about how Parati can serve as a foundation for other snack brands we can bring into the region. Our joint ventures in West Africa and China are expanding rapidly improving the reach and awareness of our brands in a region with a large and largely untapped consumer base. These JVs are not consolidated into our results today, but they certainly are a key part of our emerging markets expansion. We have developed a strong M&A capability and we see bolt-ons, whitespace opportunity and emerging markets expansion as promising ways to improve our portfolio's growth profile.

Next, we're focused on the execution of truly world-class marketing. World-class marketing starts with deep, relevant and actionable insights. If you want to see this at work, look no further than what we did with Pringles around the Super Bowl just a few short weeks ago. This started with a sound consumer behavioral insight that only with Pringles can a consumer stack different flavored crisps to create an entirely different taste and experience. This insight was turned into a big 360-degree marketing effort that of course included a TV commercial spot during the Super Bowl, but also included impactful social and digital components including links to purchase online and enabled us to execute true in-store theater for the shopper.

In this day and age, it's increasingly less about the ad itself, it's all about the conversation and that starts with great insights turned into great ideas. These efforts created 2.5 billion impressions and created a conversation about a new way to use this wonderfully unique brand. Pringles consumption jumped 12% year-on-year during the week leading up to the Super Bowl and sustained similar growth the week after it.

Let's run the Super Bowl commercial in case you missed it.

[Video Presentation] (27:21-27:50)

Wow. Through Kellogg's Family Rewards, Kellogg's has established a large database of consumers who share their preference and purchase information with us, which we have integrated into our media buying. We have robust analytics around consumer behaviors enabling us to target our message like never before. Among the things this enables us to do is taking great ideas and customizing them for specific audiences and occasions.

This Rice Krispies Treats digital video execution is an example of world-class marketing. We designed custom versions of Rice Krispies Treats creative to be triggered depending on what the consumer search for on YouTube. There were fully 110 versions of the creative. The results were good enough that we ran it for three quarters and developed excellent learnings around how to tailor creative messaging at scale. Rice Krispies Treats grew consumption and share in 2017, and that growth has in fact accelerated in recent weeks.

We can also use ideas to revive conversations about brands. Take our oldest brand Corn Flakes. In 2017, our UK team created a whole new conversation around it. There was no food news, there was just an idea about getting people to remind themselves why they fell in love with this brand in the first place. It started a simple digital content, expanded into a 360-degree activation, and blossomed into full social media conversation. It drove reconsideration, and it proves the brand and the food are relevant today if properly presented to consumers. This is world-class marketing in today's world and the result was double-digit consumption growth for the brand.

Let's run the commercial.

[Video Presentation] (29:57-30:279)

Double-digit growth for a brand as old as Corn Flakes. World-class marketing also means tapping into cultural trends in creative ways. When Eggo waffles became a fixture on the hit show Stranger Things, we quickly leveraged the resultant consumer engagement both online and offline. It sparked conversations and it prompted consumers to reconsider a long established brand in new and very contemporary ways. And this is contributing to Eggo's double-digit consumption growth, again highlighting that we have brands and foods that are relevant to today's consumers. And when we drive reconsideration in creative ways, we can drive growth.

Let's turn to another strategic priority, delivering perfect service and the perfect store. As customers drive to reduce inventories and drive efficiency, they are raising their game and therefore ours. We welcome this, as it is in both of our interest to get better and better. Our move out of DSD was a great example of how we are changing our game. It puts all of our U.S. businesses on a single, more efficient warehouse distribution system, which allows us to improve our service levels. Retailers are rightly demanding better service and we are rising to the challenge. Because to get to the aspirational perfect store, we have to get to the aspirational perfect customer service, and we've been busy on this front.

Project K realigned our network, and now we're in the process of modernizing and digitizing our plants. We've been smoothing out our end-to-end supply chain, taking steps to improve our S&OP process, get better at integrating important demand signals, and even trimming our line-up of SKUs. We have a program called Ingredients for Growth that helps us at finding efficiencies with our retail partners. Much has been made publicly of customers' insistence on higher service levels. Let me be very clear here. We welcome their higher standards. We work closely with them to find ways to get better and better so that neither of us ever misses a potential sale.

If we get the service right, we can get the store right. And on that front, we're getting more ambitious and creative about our aisles. With Pringles for example, we're installing gravity-fed racks that transform the look and accessibility of that brand's shelf space. We're also exploring new ways to rack and display cereal. Both are in either test or early rollout, but the consumption lifts we're seeing from them are impressive. This is another example of how we are thinking differently.

And around the world, we're investing in bigger more eye-catching displays to create in-store theater that is irresistible to the shopper. And in the U.S. with the exit from DSD, we can now do more cross-category promotions and displays than ever before, another big change toward perfect store. Perfect store can take many shapes depending on the channel. New channels are emerging, and we have been building our capabilities and presence in these channels – high frequency stores in the emerging markets for instance and vending around the world, and of course e-commerce.

Global e-commerce sales grew by more than 40% year-on-year for us in 2017. It's a channel that we can win in because with our big brands and the capabilities we are investing in, we can reach the coveted first page more frequently than others can. Our growth can be attributed to many things including the ones shown on this slide. Category leadership, we work with our partners to shape our categories. CPG partnership, we work with high penetration, non-competing CPG brands that complement our product offering across both cereal and snacks.

Enhancing capabilities, we've created a global e-commerce team and we've resourced customer service teams with e-commerce expertise across marketing, category management and commercial sales. We've invested in improving our digital shelf, and we're exploring supply chain and packaging efficiencies in partnership with global e-commerce retailers. And occasion-led events, events play a pivotal role in e-commerce and we have been honing our ability to amplify these events with our retail partners. These are investments and capabilities that are only just starting to pay off for us.

It goes without saying that to execute all this at a world-class level, we also need world-class people, tools and technology. In other words, we need to invest in capabilities and in building a high performance culture.

Let me give you a few quick examples of this kind of thing and what we're already doing. We are now more sharply differentiating the performance and rewards of our associates. This year, we moved to a five-point scale for employee performance ratings from what was a three-point scale. And we drove a forced distribution to ensure that we made the tough choices around performance differentiation. It wasn't easy, but it is necessary.

We are realigning compensation, for example changing the bonus weighting to shift more towards net sales for much of the organization and shifting everyone to bonus metrics more closely aligned to their particular area of the organization.

On competencies, we're focusing on leadership and we're also zeroing in on commercial capability, where it needs to be, where we are now and what we need to change. And we're doing it quickly. Like many others, we are focused on the digital transformation occurring outside and what we need to do there for inside Kellogg. A big piece of that is harnessing all the information we have into meaningful insight and clear actions. And we're using technology to re-imagine how we work, whether that is in our plants, with our sales teams or with our employees as they're learning new skills for the future.

So there's a lot going on behind the scenes to take us from the current trajectory, which gets us back to slight net sales growth to something a little bit better than that, something in the 1% to 3% range. Before we get to the rest of the P&L, let me emphasize that all of these changes and even their promising early results are already visible. You already see us investing where the growth is. Of course, there are still some brands that we have to stabilize. Special K is the primary example, but we're taking a holistic global approach to our portfolio and investing behind the best ideas in the fastest growing segments. You're already seeing a higher level of brand building investment. We kicked that off in a big way in Q4 when we boosted brand building by more than $50 million year-on-year. Much of it was U.S. Snacks plant step-up behind its DSD exit, but funding went to promising new ideas around the globe as well. In the first half of 2018, we'll increase brand building by another $50 million year-on-year. We're not spending for the sake of spending. We're investing behind promising high ROI ideas.

You'll see more differentiated innovation coming from us, bigger ideas that can break through in the marketplace. Special K probiotics is an example of a bold bet on influencing food beliefs. You'll see more growth out of our emerging markets. We've been building scale and shifting the portfolio mix towards snacking. These markets are clearly a priority for us and you can expect to see us continue to look externally for ways to shape our portfolio. This might be bolt-on acquisitions, somewhere in the cross-section of health and wellness in developed markets and snacking in emerging markets. They can fill in whitespace opportunities for us and they can help us grow. You'll also see a more balanced financial model coming from us.

And to discuss that, I'll now turn it over to Fareed.

Fareed A. Khan

Good morning, everybody. Thanks for joining us. As Steve said, we're seeking a balance in our financial delivery, a balance between improving profitability and investing in growth. We think that's the best way to drive consistent above-peer average total shareholder return. Growth is what we're after, but we need productivity to fund the necessary investment and we need execution to make that investment yield growth.

From a standpoint of capital allocation, our priorities don't change. We know our dividend is a key feature of our stock and we'll continue to target something like a 50% payout. Bolt-on acquisitions will be important for us in pursuit of scale in some markets and also filling in whitespace in others. We've had a good track record on these and we'll continue to look for promising opportunities always with discipline.

Share buybacks will continue to be utilized to offset any potential dilution from options exercises or other equity-based compensation, but we can also use this lever opportunistically to return cash to shareholders and we will remain investment grade. This acts as our guardrail. So simply put, that's our financial philosophy.

We remain on sound financial footing. We're very well positioned for the future. And despite the well-documented industry conditions with a slow top line growth for Kellogg and our entire peer group, our earnings and cash flow have been durable. By reducing our cost structure through bold initiatives, we've been able to post strong EPS growth. I'll come back to some of these cost reduction issues in a moment.

By reducing working capital, we've been delivering durable cash flow results even as we absorb substantial cash outlays related to Project K restructuring initiatives and elevated capital expenditures related to growth, for example adding capacity to our Pringles platform globally. So we're in a very strong financial footing, and this gives us the financial flexibility we need to both invest in growth and return cash to shareholders.

As a result of these efforts, we have a meaningfully reduced cost structure as we move into the future. The size and scope of our cost reduction initiatives require considerable focus in several areas as we've discussed. First, Project K realigned our supply chain network. It created a shared services model, thinned out layers of management and got us out of a declining ROI DSD system in the United States.

Zero-based budgeting reduced our operating expenses and added strong discipline in cost management. And even on brand building, we weeded out non-working expenses and low ROI activities. We were conscious of the fact that accounting standard changes related to pensions recast our operating profit margins lower. But when you break down the components of our operating profit margin, the biggest difference is our brand building as a percent of sales. This is related to the mix of our business, all of which are extremely responsive to brand building.

Going forward, we need to continue our cost discipline, while ensuring we are coming up with the big ideas that will return us to grow. Our operating margin goal was never intended to be a ceiling. We'll continue to look for new sources of productivity on a never-ending quest for efficiencies, margin expansion and fuel for growth. Our margin expansion may be more gradual in coming years than the step changes we've made in the last few, but it will continue.

Now, let me give a brief overview on our outlook for 2018 that we shared in our Q4 earnings call. We'd characterize 2018 as a transition year, not because of its results, because of what we're completing this year. We're completing the actions behind our ambitious Project K restructuring program, while beginning plans around the next set of cost reduction opportunities. In U.S. Snacks, we're transitioning to life after DSD. This includes a full year of the adjusted list price and SKU rationalizations, and it includes a ramp-up in brand building behind our key brands as we discussed.

We'll also be increasing brand building levels in other businesses as well. This varies by brand of course, but it's a meaningful increase year-on-year even outside U.S. Snacks. We'll be integrating and growing our latest acquisition, RXBAR, while completing the integration of Parati in Brazil and building on its growth and synergies. We'll be investing to sustain the rapid growth of our joint ventures in Africa and China. And we'll be leveraging a newly issued U.S. tax reform putting its benefits to work for us and our customers.

Despite being a transition year, we expect to deliver results that are by no means pedestrian. Net sales should be flat excluding currency even as we absorb the wraparound impact of our DSD-related SKU rationalizations and price adjustment. Importantly, we expect to see good improvement in our underlying performance. Margin expansion should be strong as we realize most of the remaining savings from our productivity initiatives, which more than offset our first half ramp-up in brand building. And adjusted EPS should grow strongly due to operating profit growth, plus the benefit of U.S. tax reform. We've already been seeing increase – we've already been increasing the earnings power of the company and we'll do it again in 2018 despite being a transition year in so many ways.

So let's look beyond 2018. If you take our reduced cost structure and our financial flexibility and you combine it with net sales growth that Steve discussed, you come up with a long-term P&L algorithm like the one shown on this slide, 1% to 3% NSV growth, which comes from organic growth augmented by M&A activity; 4% to 6% operating profit growth, which comes from operating leverage, continuous productivity and synergies related to acquisitions; 6% to 8% EPS growth with below-operating profit leverage held back only by funding acquisitions.

And with dividend yield, we can target a very healthy dependable TSR in high-single digits or low-double digits. Again, this isn't guidance or a specific target, it's a reasonable path to the kind of growth we expect to generate sustainably over time. We're a stronger company today on sound financial footing with the opportunity to get back to sustainable top line growth. This can create a dependable, above-median TSR over time.

And with that, let me turn it back over to Steve.

Steven A. Cahillane

Thanks, Fareed. Before I wrap up and how we plan to deploy for growth, I wanted to emphasize something equally important, our values as a company. We view social responsibility being a leading corporate citizen as doing the right thing each and every day. It's part of our culture, it's part of our heritage. And this kind of social responsibility is becoming increasingly important to our shareowners, our customers and our consumers. So you can be sure that even as we deploy for growth, we will not lose sight of this.

Now to quickly wrap up, I have emerged my first 100 days all of the more convinced that this is a special company. Our heritage, our foods, our brands and our people give us a foundation for growth, a right to win in the marketplace. We've also made some key strategic moves. We've reduced our cost structure, we've built capabilities, we've exited DSD in the U.S. to free up brand investment, and we've built scale in emerging markets.

Now, we're going to put the same focus on growth that we put on reducing our cost structure in recent years. We're deploying for growth in a more focused way with more focus on execution, winning through occasions, shaping our portfolio against pockets of growth, creating truly world-class marketing holding ourselves to the highest standard, and delivering that aspirational perfect service to our customers each and every day, and therefore achieving the perfect store. I'm sure you'll agree our plan is pragmatic and there's nothing pie in the sky about our outlook.

At the same time though, let me be clear, it is inspiring and energizing for our organization. It puts us on the right track towards steady, dependable, profitable growth, and we are very excited about the future.

So with that, we'll close and happy to take questions.

Q&A

<A - Steven A. Cahillane>: [ph] David (47:08)?

<Q>: Great. Thank you. Good morning. Steve, wanted to just maybe ask you a little bit more about the dichotomy between investments in brand building and top line versus the need to see margins at this company approach much closer to the peer group average. After the pension accounting adjustments, you're substantially away from where the peer group is. I feel like your presentation was very heavily weighted towards brand building and getting it back on track. But I'd really like to get your sensitivity to where the margins are and really the – how much your focus really will be to improve the margin profile of Kellogg?

<A - Steven A. Cahillane>: Thank you, [ph] David (47:47). We believe the most important thing we need to do is return the company to top line growth. That's our sustainable future getting there. The company has done a very good job at addressing the cost structure and taking cost out and improving and growing margin, and that's why our 2018 – in 2018, we will achieve that 350 basis points post accounting adjustment. And going forward, we will continue to improve on margin – we'll continue to grow our operating profit margin that will be a goal. But the most important word is and. We have to do both, we have to grow our top line by investing and we have to continue to grow our operating profit margin, and we see a path for that. We see opportunities to continue to do that. It will not only expand our operating profit margin, but give us the fuel to invest in our brands to grow. The long-term algorithm that Fareed showed as something that we believe is attainable and achievable, that drives double-digit TSR performance for us because it focuses on both. If we don't get the top line back in growth, we can grow our OP margin, we want to create the right value for shareholders. So it's about and. It's about doing both.

<Q>: Thank you. [ph] Ken (48:55)?

<Q>: Hi. One of the changes you made to the slides is, you changed – I forget the previous one, but you made it into deliver perfect service and store. And you mentioned that a couple of times. Is there a particular challenge that Kellogg has had in getting product to stores on time, getting the right service there? If so, how much of an issue was it, how much will it cost you to get it there to the place you want it to be? And I guess I'm just curious how much of this was driven by some of the Walmart and Kroger decisions that have been made lately?

<A - Steven A. Cahillane>: Thank you. No, we do not have a particular problem anywhere. This is driven by opportunity to continuously improve and get better. We came out of DSD and into the warehouse system last year with flawless execution and very high marks from our customers. And it just pointed out to us the continued opportunity to raise our game. And when you get to the right – when you get to that perfect service level, you develop a whole new dialog with customers, it's about value creation, it's about joint business planning, that's about how you grow categories, not swap share back and forth, but grow categories and then grow within that.

And so it's really born of looking at customers and seeing and understanding what they need, and where our strategy overlaps with their strategy is really creating that in-store theater, that in-store delight that moment where the shopper sees the brand and it's in stock and perfectly merchandised. That's a win for both of us. So it's not born of a problem, it's born of an opportunity. And we really aim to win at retail and we know we have to do that through customers. We know one of the most important things to customers is getting that service level at a very high level.

Unverified Participant

Okay. With that, I think we're ready to move into the breakout. Please again join me in thanking Kellogg for both breakfast and the presentation session.