Company Name: Kellogg
Company Ticker: K US
Date: 2019-02-07
Event Description: Q4 2018 Earnings Call

Market Cap: 19,328.04
Current PX: 55.697
YTD Change($): -1.313
YTD Change(%): -2.303

Bloomberg Estimates - EPS
Current Quarter: 1.087
Current Year: 4.297
Bloomberg Estimates - Sales
Current Quarter: 3497.000
Current Year: 13724.625

Q4 2018 Earnings Call

Company Participants

- John Renwick
- Steven A. Cahillane
- Fareed A. Khan

Other Participants

- David Cristopher Driscoll
- Dara W. Mohsenian
- Eric J. Larson
- Robert Moskow
- Michael S. Lavery
- Steven Strycula

MANAGEMENT DISCUSSION SECTION

Operator

Good morning. Welcome to the Kellogg Company Fourth Quarter 2018 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] Thank you.

At this time, I will turn the call over to John Renwick, Vice President of Investor Relations and Financial Strategy (sic) [Corporate Planning] (00:42) for Kellogg Company. Mr. Renwick, you may begin your conference call.

John Renwick

Thank you, Gary. Good morning and thank you for joining us today for a review of our fourth quarter and full year 2018 results. I'm joined this morning by Steve Cahillane, our Chairman and CEO; and Fareed Khan, our Chief Financial Officer.

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 performance 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. A replay of today's conference call will be available by phone through Thursday, February 14. The call will also be available via webcast, which will be archived for at least 90 days. As always, when referring to our results and outlooks, we will be referring to them on a currency-neutral, adjusted basis unless otherwise noted.

And now, I'll turn it over to Steve and slide number 3.

Steven A. Cahillane

Thanks, John, and good morning, everyone. Our fourth quarter came in as we had indicated, completing a very important year for Kellogg Company. We launched Deploy for Growth, a strategy that gives us very clear priorities and has resulted very quickly in tangible, often bold actions, for pivoting us back to growth.

Our portfolio is more shaped toward growth today. We acquired RX in late 2017, and in 2018, we expanded its distribution, doubled its small brand awareness, and extended its product line. This is a new growth platform for us. In early 2018, we increased our stakes in our West Africa operations, moving emerging markets up to almost 20% of our company's sales. Emerging markets will be a growth driver for years to come, and in 2018, we accelerated our organic growth in these markets to a high single-digit rate.

We also invested heavily in our brands and capabilities in 2018. Our brand-building investment was increased at a high single-digit rate in 2018, and it was invested behind better commercial ideas at higher ROIs. We're not just spending, we're revitalizing brands, and even launching some new ones. We also invested in capabilities from ecommerce and digital social marketing to new pack formats, to execution in high-frequency stores. All of these are investments in building a long-term foundation for growth.

We're seeing progress in the forms of better net sales and consumption performance around the world. This wasn't easy and it wasn't inexpensive. As we said before, the heaviest lifting, the heaviest investment is when you are trying to reverse a trend. For us, this was a multiyear trend in declining organic net sales.

Take a look at slide number 4. It is the delta between the prior years' sales declines and 2018 stabilization that offers the best indication of how this investment in portfolio shaping is working. Reversing a stubborn trend is incredibly difficult. It has required altering our mind-set, restructuring our organization, rewiring our processes, rethinking every brand, and changing how we think about each channel and reorienting our supply chain. That's why swinging to even flat organic growth is such a good sign. And we're not done yet.

Our guidance for 2019 incorporates a plan to continue increasing our investments through the first half. This, on top of some unfavorable cost comparisons with last year, means operating profit will decline in the first half before returning to growth in the second half. This translates into flat operating profit for the year, but it drives a solid return to organic net sales growth almost immediately.

Further down the P&L, while earnings per share will be down in 2019, they will be down because of lapping 2018's first half tax benefits and because of the accounting impact of weak financial markets last December, not because of anything related to our operating performance. The reason we're willing to continue investing in this turnaround is because we are confident it's working.

Slide number 5 summarizes how we're investing, particularly in the first half. First, we'll continue to reshape our portfolio in 2019. In West Africa, we'll leverage the competitive advantage that our Multipro distributor gives us, growing our presence in cereal, snacks and noodles. We'll continue to invest in RX's expansion because it gives us a new growth platform that goes beyond the [ph] base bars (05:16) and possibly even beyond the United States.

We're also investing in new brands that fill in white space for us such as in the areas of natural foods and digestive health. We're in the process of divesting our cookies, fruit snacks, pie shells and ice-cream cones businesses in order to help us focus resources. The outcome of all these actions is a more focused growth oriented portfolio.

Second, we'll continue to revitalize brands in 2019. The brands shown on this page all generated improved or growing consumption in share in 2018 as we ramped up investment behind better ideas. This is true revitalization. Look what we've done with Pringles and its Flavor Stacking campaign in the U.S. and its Soccer campaign in Europe or with Cheez-It and Rice Krispies Treats both with innovation and single serve offerings. Eggo now has a stronger premium offering. Kashi cereal is back in growth and Bear Naked has become the number one granola brand in the United States. And brands like Crunchy Nut and Extra have been revitalized in Europe. Consumers are rediscovering the benefits of cereal brands like Raisin Bran and Mini-Wheats. We've got even bigger plans for these and other brands in 2019.

And third, we'll continue to enhance capabilities in 2019. We've invested in and improved our innovation capabilities and pipeline, and in 2019, we have our strongest innovation pipeline in years, much of which hit the shelves in January and are off to strong starts. We've also been investing as you know in new pack formats, particularly around on-the-go offerings that can meet a growing occasion for us and one that we still under-index in our categories. Our ecommerce business is growing, and we are developing capabilities to keep up with the growth and set us up for sustainable growth well into the future. We'll continue to invest in all of these key strategic capabilities in 2019 because we know they can give us a leg up in the marketplace.

We even have changed our organizational structure to execute these capabilities better than ever. So, the first half of 2019 will be a continuation of our investment phase, and it will produce further improvement in organic net sales growth and consumption. We'll come out of this investment phase with a streamlined and more growth oriented portfolio, a set of revitalized brands, both power brands and challenger brands, a stronger innovation pipeline and more competitive capabilities for today's marketplace. By the second half of 2019, you'll start to see investment increases moderate and profit growth return to sustainable levels.

Let me now turn it over to Fareed to walk you through what all this means. Fareed?

Fareed A. Khan

Thanks, Steve, and good morning, everybody. Q4 results came in largely as we had indicated. We faced our toughest ex-DSD impact comps of the year on top line, and we continue to invest in brands and capabilities, not to mention continued temporary cost inefficiencies on our drive to expand on-the-go pack formats and channels as we've discussed on previous calls.

Slide 6 reviews our net sales performance. Two acquisitions accounted for six points of growth for the year. These were Multipro, the West Africa distributor we consolidated in May, and RX which we acquired in October of 2017. Both these businesses continued to grow sales at strong double-digit rates, right through Q4, and going forward, RX will be fully in our organic results and we'll have four months of Multipro in the acquisition line before it too goes into organic results. On an organic basis, our sales were off slightly for the quarter and flat for the full year.

This is an important improvement from declines we experienced in the last few years, particularly when considering the absorption of a mechanical negative 1% impact from the DSD exit. Specifically, this is the SKU rationalization and the elimination of the price premium we used to charge for DSD services. And keep in mind that while there was no such mechanical DSD impact in this year's Q4, we were comparing against strong ex-DSD impact growth performance in 2017's fourth quarter. In fact, as we pointed out previously, we faced significant tougher comps across our businesses in the second half than in the first half as we lapped last year's second half acceleration in Frozen Foods, European Pringles and ex-DSD U.S. Snacks.

An element to point out within sales is our price mix. As you can see, it's stabilized in Q4 as we got past the DSD impact and as we executed Revenue Growth Management actions late in the quarter. This total price mix line should continue to gradually improve going forward. And finally, on currency, after a net weakening of the U.S. dollar in the first half, the dollar strengthened meaningfully in the second half giving us a negative impact for the year.

Let's turn to our gross profit margins on slide number 7. Once again, we split our gross margin performance into three buckets because we think this is helpful for understanding and forecasting the various puts and takes. We'll start with the biggest bucket on the slide, the year-on-year mechanical impacts. First, as discussed previously, the DSD impact has been running about negative 125 basis points before lapping during Q3, and second, the Multipro impact which started during Q2 was about negative 130 basis points to 140 basis points during each of its full quarters of Q3 and Q4. We've got another full quarter of Multipro impact coming in Q1 of this year and a partial quarter in Q2. So, this bucket remains predictable with no surprises.

The next bucket is the growth-related impact. As you recall, this is the bucket that became a meaningfully negative impact starting in Q2. Driving most of this year-on-year impact were two mix shifts that we've discussed with you previously. First, we saw accelerated growth in our emerging markets businesses, which don't yet have the scale of developed markets and, therefore, carry lower percent margins at this time.

Second is the mix shift towards channels and pack formats especially on-the-go pack formats that we aggressively expanded in 2018 despite extra costs and distribution inefficiencies that this created. Right through Q4, we saw the benefits of this expansion in the form of new distribution, in-store placement that drives acceleration in on-the-go consumption growth, and in the second half, significantly outpacing our snacks categories. This is a new platform for us for growth.

This growth-related bucket will gradually stabilize over the course of 2019. The mix shift towards emerging marks will persist, and that's fine. This growth is not cannibalizing any of our other businesses and as we grow scale and shift our mix towards more value-added products, we'll improve our emerging markets margins over time. For on-the-go and other pack formats, we're already working on reducing inefficiencies and incremental costs. We are adjusting our lineup of SKUs and we're working with co-packers to establish centralized packing centers and we are bringing some of our co-pack volume in-house, but this will take some time.

Lastly, but very importantly, is our bucket of ongoing input costs net of productivity. Throughout the year, our productivity and Project K savings as well as very effective commodity hedges were able to offset the margin impact of higher transportation, packaging and other costs. Looking ahead, costs for freight, packaging and various inputs are projected to remain inflationary. And with very favorable hedges now rolling off, this inflation will be even higher for us in 2019 especially in the first half. We managed it well in 2018 and we've executed Revenue Growth Management actions in several countries to help cover it as we progress through 2019.

Let's turn to slide 8 to round out the rest of the P&L. Operating profit was up slightly in 2018, and down slightly in the fourth quarter because of the growth-oriented cost that weighed on gross profit but also because of our increased investments in brands and capabilities. Starting in Q4 2017, we have used the elimination of declining ROI DSD overhead to fund a ramp-up in brand building investment and investments in capabilities. Brand-building alone increased at a high single-digit rate in 2018, a sizable dollar investment that's already starting to revitalize key brands as Steve mentioned.

Earnings per share increased in 2018 thanks to U.S. Tax Reform and some discrete one-time benefits, mainly in the first half of the year. Interest expense increased because of debt added to cover our additional stakes in West Africa. Other income declined because of our decision to mitigate future risk by reducing our pensions expected rate of return. And shares outstanding came down modestly as we had mostly refrained from buybacks during Q1 through Q3 on the heels of our RX and West Africa acquisitions.

So in what was truly a year of investment, we grew net sales, operating profit, and earnings per share in 2018. And even as we ran into some unexpected costs in the second half, we resisted the temptation to pull back on this investment because our priority was to improve our top line performance and because this investment was working.

We'll conclude our discussion of 2018 by turning to cash flow in slide number 9. As we'd often point it out, our cash flow is extremely durable. It's held steady first through incremental cash outlays related to Project K and other product initiatives, and then in 2018, through increased cash outlays for growth initiatives mainly in the areas of capacity and technology.

We also, you'll recall, made a voluntary cash contribution to our pension funds increasing their funded levels, and we again improved our core working capital which came down by 50 basis points as a percentage of sales on good payables management. This durability and good working capital management is important as we ramp up capital expenditures further in 2019 around growth-oriented investments and more on that in a moment.

So, let's now turn our attention to 2019, starting with slide number 10. This is a slide we've shared with you on a couple of occasions because it's useful context for how we see our progression financially. In 2018, or really Q4 of 2017, we pivoted from a period of cost reduction focus to a focus on returning to sustainable growth. This requires an investment phase, spanning 2018 and into 2019 in which we shape our portfolio, revitalize our brands, and develop and hone capabilities. We're building on a foundation that can produce sustainable profitable growth over time.

Slide 11 is yet another slide we shared at Day@K only updated with some actual figures for 2018 and specific guidance for 2019. It too provides important context. The slide shows a gradual improvement in the balance between net sales and operating profit performance, and we're right on track with this plan. As we told you back in November, we expect our organic basis net sales to improve further in 2019 moving into growth, while increased investment will hold operating profit relatively flat again. As time goes on, our increases in investment moderate as our top line sustains momentum, moving operating profit back into growth. In fact, this starts as early as the second half of this year.

Slide 12 gives you a lot more detail about how we're thinking about our 2019 outlook. It's important to reiterate that our outlook on all of these metrics does not reflect any potential divestiture. That sale process is well underway and we believe we could have a transaction completed sometime in the second quarter.

However, until we know the transaction's true shape and size so to speak, we won't offer guidance on P&L impacts or cash proceeds at this time. What I can tell you is our plan for the proceeds remain to pay down debt for future acquisitions and/or share buybacks, and of course, as with any carveout of a business or businesses, there will be some appropriate business alignment activity. We'll keep you posted as the divestiture process progresses.

For now, we'll discuss our outlook with the assumption that we own these businesses all year. Our net sales growth guidance includes a couple of points from the four incremental months of acquired sales of Multipro, which we consolidated in May of last year. It also includes improved organic growth up 1% to 2% year-on-year led by our RX in emerging markets as well as improvements across our portfolio and regions. Recent Revenue Growth Management actions should create a better balance between price mix and volume growth.

Operating profit is flat because of the increased investment both in terms of increased advertising and overhead as well as costs related to our efforts to expand on-the-go and other pack formats. The latter will become less of a profit impact as the year goes on as we've discussed earlier.

Earnings per share will be down year-on-year because of lapping 2018's discrete tax benefits and because of a sharp decline in other income as pension income and other items are negatively affected by last year's downturn in the financial markets especially in December. As a result, the other income line could be down as much as $60 million to $70 million year-on-year.

And we're looking for cash flow to remain even with last year, and this is despite an increase in capital expenditures we invest behind capacity and technology with an emphasis on growth plus the extra months of Multipro. Specifically, capital expenditure will increase by about $50 million year-on-year to roughly $600 million to $630 million range or roughly 4% to 5% of net sales. This is another example of investing now for sustained growth over the long-term.

We don't normally give quarterly guidance, but we're facing an unusual shape to our year-end 2019 and we want to make sure you understand why. Slide 13 illustrates, without numbers, the basic shape of our likely quarterly phasing for operating profit in 2019 relative to what we saw in 2018. We don't anticipate any big differences in organic sales performance between the first half and the second half as heavier innovation calendar in the first half is balanced with Multipro being in organic sales in the second half.

However, we do see two elements creating a lighter operating profit performance in the first half versus the second half, the timing of investment and the timing of cost pressures. First from an investment standpoint, we do have a heavier innovation launch plan in the first half of 2019 than we did in 2018, including new brands. So our brand building investment increases much more in the first half as we support these launches. Additionally, many of the investments and capabilities that we launched in Q3 and Q4 of 2018 will continue into the first half of 2019.

And second, there are some timing differences in our costs. Our underlying cost inflation will be higher in 2019 as incremental Project K savings and COGS moderate this year, and as we roll off some very favorable hedges. In addition, there's much more year-on-year pressure in the first half related to last year's favorability on savings and cost which even contribute to Q1 being by far the biggest profit growth quarter of the year in 2018. We have good productivity management programs in place this year, and we've taken Revenue Growth Management actions to improve price realization. We don't expect to fully cover underlying cost inflation during the first half of the year.

And finally, there's a gradual ramp-up on margin improvement actions for our new pack formats as we discussed. We have a lot of actions underway to reduce the near-term drag on margins from some of our new pack formats and channels including the on-the-go items. As I mentioned earlier, some of these actions, many of which will take longer to put in place, and probably won't start to have a positive impact until the second half.

One more thing to keep in mind and it's not in our currency-neutral guidance, but foreign currency translation is another factor you should consider in the phasing because based on where exchange rates are now, you'd expect a much more negative impact on sales and profit in the first half than in the second half. So, our net sales aren't back weighted, but our profit is because of how year-over-year comparisons, our investments, our costs and our margin improvement plans play out this year.

From an earnings per share standpoint, there's one more timing factor and that's our effective tax rate comparisons depicted on slide number 14. We have talked about this before. In 2018, our underlying corporate rate reset lower thanks to U.S. Tax Reform. That will translate into an ongoing rate for us of close to 21%. However during 2018, we also realized some discrete tax benefits on top of the U.S. Tax Reform reduction. Always difficult to predict the timing, those benefits were particularly pronounced during Q1 and Q2. And this means lapping extremely low tax rates in the first half.

So putting it all together, the front-weighted investment and cost pressures and the year-on-year differences in tax rate in Q1 and Q2, we would expect to see a sharp double-digit decrease in EPS in the first half with the first quarter down much more than the second, and then we'll return to growth in both operating profit and EPS in the second half.

So, that's a detailed preview of how we see 2019 shaping up financially. It's another investment year, and it does have some timing elements that weigh down earnings early in the year. But we like the foundation we're building, and you'll start to see more balanced P&L growth in the second half.

So with that, let me turn it back to Steve to walk you through our businesses.

Steven A. Cahillane

Thanks, Fareed. One of the most important signs that Deploy for Growth is working is the fact it improved organic net sales performance in all four of our regions as shown on slide number 15. This means that the investments and changes we are making in reshaping our portfolio, revitalizing key brands, and developing capabilities are taking place all over the globe, and it's working.

It's clearly working in our international businesses. We returned to strong growth in Europe and in Latin America, and we accelerated our organic growth in Asia Pacific. We did this through a combination of stabilizing developed cereal markets, improving the growth of Pringles, and expanding other snacks brands and products in tune with local cultures and tastes, and more affordable pack formats.

As we build up our scale and portfolios in emerging markets, these regions become that much more important to our growth algorithm, and something we're very proud of are our recent acquisitions in promising emerging markets businesses that complement our own. Witnessed the transformative impacts of our acquisitions in Egypt, our Parati acquisition in Brazil, and our investments in West Africa.

Our investment and hard work is starting to take hold in North America too. We narrowed our decline in 2018 and very nearly got back to flat if you exclude the roughly 1.5 points of mechanical impact from our mid-2017 exit from DSD. We've got big brands back in growth. We've restored our innovation pipeline, and we're reducing complexity through a reorganization and a proposed divestiture. Make no mistake, we're not yet where we need to be, but we are clearly making progress.

So, let's take a closer look at each of these regions and their underlying businesses. We'll start with North America. In North America Snacks, sales declines moderated in 2018, so only a slight decline excluding the negative DSD impact. And as suggested on slide number 16, there were some very clear signs of progress. The exit from DSD unlocked brand investment for our major brands and also enabled us to extend support to more brands in the portfolio. And the brands that we supported did very well. Pringles accelerated its consumption growth in 2018 as did Cheez-It and Rice Krispies Treats. As we look to 2019, these brands should benefit from our strongest innovation lineup in years, many of which launched in January and are off to very good starts.

Elsewhere in our snacking portfolio, RX sustained its strong momentum, as I mentioned earlier, and we are excited about the prospects for this business, which still has so much runway. We'll continue to expand its distribution, brand awareness and product line in 2019, and we'll also make further progress on other natural brands like Pure Organic bars and Bear Naked Bites.

On this slide, you can see the sharp acceleration we drove in on-the-go offerings, especially in the second half of 2018. We've talked a lot about the extra cost this on-the-go expansion added in 2018, but we were willing to absorb these costs temporarily in order to make good on a strategic priority of boosting our offerings for this important occasion. And as you can see, we are driving strong demand in building a platform for growth. Expect to see these pack formats continue to outpace our categories in 2019, even as we take steps to shore up their margins. So, snacks is on its way back to sustainable growth, and we would expect growth in 2019 excluding any divestitures.

Now, let's turn to cereal in North America on slide number 17. The overall U.S. cereal category moderated its decline in 2018, as did we. And if you exclude the impact of Honey Smacks whose supply chain disruption kept it off shelf for most of the second half, we held share in the United States, we also gained share in Canada in 2018.

There is also a progress behind this result. We know that when food beliefs change, what always brings this category back to stabilization or growth is amplifying its wellness attributes, especially in the adult segment. Kellogg did more of this in 2018 and these efforts were effective in stabilizing key brands like Raisin Bran and Mini-Wheats. Expect more of this wellness emphasis in our innovation and communication in 2019, including the launch of a new brand that plays squarely in digestive health.

Meantime in the taste/fun segment, which grew for the category in 2018, we continue to innovate and this resulted in share gains for our key Frosted Flakes and Froot Loops brands. Expect this to continue in 2019 with a strong lineup of new products hitting the shelves now and communication that also taps into the rapidly growing portion of cereal consumption that is out-of-breakfast or snacking.

And we're particularly excited about the progress we've made on Kashi cereals. While we had been performing well in natural channels for some time, Kashi consumption in the x-AOC measured channels turned positive in 2018 thanks to strong innovation and effective messaging. Innovations like Kashi by Kids and new offerings under the Go-Lean line are gaining traction. As you can see, this turnaround was especially pronounced in the second half, so Kashi carries some good momentum into the new year, and we have great plans for 2019. Meanwhile, we also grew consumption for our rising granola brand, Bear Naked, and we have innovation coming for that brand in 2019 as well.

Finally, as we discussed at our Day@K event, we are embarking on an ambitious plan to harmonize pack sizes and make the cereal aisle that much more shopable. Where we've done this, most recently in Europe, we see improved results. This work will be executed across the first half of 2019. We'll give you more details on all of these plans at CAGNY. I wouldn't count on growth for North American cereal in 2019, but we will continue to moderate its decline getting back to where it's stable long-term trend.

Now, let's turn to slide number 18 and our North America Frozen Foods business. Consumer trends towards convenient meal preparation have had a positive impact on Frozen Foods categories, and we've raised our game in both of our key Frozen brands. Eggo's consumption and share growth accelerated in 2018 on a strong core and the success of our relaunched premium Thick & Fluffy line as well as continued success with Disney-shaped waffles. This was all supported by effective media. Morningstar Farms consumption also accelerated in 2018 as we refocused on our core offerings renovating our food for even cleaner label and honing our message around plant-based protein.

So even though consumption growth moderated in the second half as we lapped 2017's market acceleration, we have some momentum going into 2019. And in 2019 you can expect to see us continue to fuel these great brands with investment in innovation, renovation and brand communication. The results should be another year of growth for

Frozen Foods.

Now let's discuss Europe shown on slide number 19. Europe returned to growth in 2018 led by Pringles whose double-digit net sales growth was broad-based with strengths in all sub regions. We ran an extremely successful campaign during the World Cup in the summer and sustained the brand with new pack formats and effective media. The brand grew share in seven of our eight major markets. Clearly, this brand has been revitalized and in 2019 we'll continue to support it with innovation and new commercial initiatives.

We've also made good progress on cereal in Europe. Cereal net sales declined only modestly in 2018 cutting in half its 2017 decrease and improving our share performance in key markets across the region. Most notable were our share gains in the difficult UK and France markets. In fact, we grew cereal share in the UK for the first time in several years, a testament to our ability to run our playbook and stabilize highly penetrated cereal categories.

We revitalized Special K in key markets with a new campaign called #PoweringYou. We have rejuvenated brands like Extra and Crunchy Nut in the granola segment and we have launched a new natural brand called [ph] WK Kellogg (31:37). We'll continue to run this playbook in 2019.

I would also point out the success Kellogg Europe has been having in emerging markets. We recorded another year of double-digit growth in Russia in 2018, growing share in cereal, salty snacks, and biscuits, and there's so much opportunity to expand further into markets in adjacent central Europe in 2019.

We also generated strong growth in the Middle East and Northern Africa in 2018, both in cereal and snacks. These businesses will be shifting over to our Asia-Pacific region in 2019 with strong kudos to the Kellogg Europe team for the expansion they have made in this promising region. So Europe enters 2019 in a much stronger position, poised for another year of growth.

Now let's turn to Latin America on slide number 20. Latin America had a fantastic 2018. Its net sales bounced back to growth growing more than 7% on an organic basis. Leading the way was Mexico which has now recorded 11 consecutive quarters of currency neutral net sales growth. This momentum has been driven by strong execution in cereal which accelerated its consumption growth in 2018 gaining two points of share.

Across the region in fact our cereal sales grew at a mid single-digit rate in 2018, an impressive positive swing. Our snacks net sales in Latin America grew at a similar mid-single digit rate. Pringles led the way with notable gains in Mexico and Caribbean Central America. And Parati has truly transformed our business in Brazil. Not even a disruptive trucker strike and volatile political climate could take this business off its double-digit growth trajectory in 2018. Latin America in 2019 will continue executing its strategy and sustaining its momentum in these key markets.

Rounding out our international businesses, let's discuss our Asia-Pacific region shown on slide number 21. Multipro, the distributor portion of our partnership in West Africa continues to grow at a double-digit clip. This business has enormous potential for growth, and we are very pleased with its momentum, its competitive advantage, and what it can do for other Kellogg brands in West Africa.

But Asia-Pacific in 2018 also accelerated its growth on an organic basis, specifically the region's organic net sales growth was 5%, a marked acceleration from 2017's growth. This was led by cereal whose broad-based growth accelerated in 2018. Our cereal business held share in a stabilized Australian market, gained share in markets like Japan and Korea, and continued to generate double-digit net sales growth in emerging markets like India and Southeast Asia. In snacks, Pringles accelerated its net sales growth to almost 6% in 2018, and we continue to expand wholesome snacks across the region with great success in newly launched markets like Korea.

As I mentioned, this region is being renamed AMEA to reflect the shift from our European region of our Middle East, North Africa and Turkey businesses. This unites all of our businesses in Africa and the Middle East under one regional management team which offers obvious benefits of scale and resource allocation.

We should see continued expansion throughout Africa in 2019 led by Multipro and augmented by expansion of other products such as our launch of noodles in South Africa. In Asia, we will drive continued broad-based growth in cereal and Pringles, and in Australia, the region's most developed market, we expect continued stability or even slight growth.

So we expect another year of good growth in this region in 2019.

So allow me to summarize with slide number 22. Deploy for Growth isn't just words on a piece of paper. It is setting clear priorities for us, and it is driving us to tangible and often bold actions. We are in an investment phase, but this isn't simply investing to drive near-term growth. This investment is reshaping our portfolio to one that is more focused and more geared towards growth. This is investment in revitalizing brands, from big brands that are being reformulated and repositioned to our own challenger brands that are just building awareness. And this investment is in capabilities, from pack formats that can win important consumer occasions to a better process and pipeline of innovation, from more effective digital and social media, to getting ahead in e-commerce.

We're not apologetic about this investment or the fact that it is holding down profit for a couple or more quarters because we know that this investment is building a stronger foundation for future growth, growth that is profitable and growth that is sustainable. And it's working. You saw this in our improved net sales performance in 2018, in our improved consumption trends and the improved ROIs we're realizing on our brand building investment. So, good progress in 2018 and more to come in 2019.

As always, I'd like to take this opportunity to sincerely thank our employees who are working so hard to make all this happen.

And with that, we'd be happy to take any questions that you might have.

Q&A

Operator

We will now begin the question-and-answer session. [Operator Instructions] Our first question comes from David Driscoll with Citi. Please go ahead.

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

<A - Steven A. Cahillane>: Good morning, David.

<Q - David Cristopher Driscoll>: I actually want to slip in two questions. One is a small one on pensions. Fareed, can you walk us through just kind of the mechanical impact here? You noted the big decline in December, but then as equity markets rebound, it feels like there is no recognition of that. Is it because it gets marked only at the end of the year and you kind of have to live with that through all of 2019? And then I have a more substantial follow-up for Steve.

<A - Fareed A. Khan>: You're exactly right, David. It's a point in time calculation, and essentially what it is, the value of the pension assets declines because of the market decline, or – the estimates for the return on those assets while we brought them down in 2017 from 2016 to de-risk the pension, it's still at the same level at 2018. The other factor I'd point to too that plays into this is rising interest rates and that impacts it as well. So what you have is a pretty significant mark-to-market decline for pensions, and that flows through into earnings per share.

As I mentioned, that's about a $60 million, $70 million headwind going to next year. But it's all non-cash. It's basically an accounting estimate point in time, and as markets recover, you would see assets come up again. Again, just for those who aren't familiar, it's a large pension plan. We've frozen a lot of the key elements. It's very well funded, and we've been making moves to de-risk it with the pension contribution that we made last year.

<Q - David Cristopher Driscoll>: Steve, my other business question is just about the single-serve snack opportunity. It's something like $100 million hit that you took maybe for this investment in 2018, maybe a similar amount in 2019. I'm more interested on what's the size of the prize. So your margins are impacted right now, but I just don't think that we have a good handle on where the margins for the single-serve businesses can go.

And then what's the size of revenues or just is there any way that you can dimensionalize why you're putting so much effort into this in terms of a profit opportunity somewhere down the road? Is this going to be worth $300 million, $400 million, $500 million in profits to Kellogg as you really establish the single-serve business? Thank you.

<A - Steven A. Cahillane>: Yeah, thanks for the question, David. I think what I would start with is as we think about occasions and focusing more on occasion-based opportunities, we clearly underindex in on-the-go pack formats and on-the-go channels, on-the-go occasions. And so that's why we initially started to spend a lot more time and focus, because it's incremental growth opportunities for us. And as we pointed out last year, obviously it came with some pain in terms of it being margin dilutive and even sometimes almost net no margin, but over time, we see a clear path towards margin accretion. And so you should see these pack formats over time really towards the back half of this year being margin accretive whereas up to this point they've been margin dilutive.

But we see it as a big opportunity because it is highly incremental if not completely incremental. It drives more usage of our brands, and therefore more awareness, more brand health, and so overall points to a very large opportunity that up to this point the company had just not focused on. And so we went at it fast and hard last year, but we've got good plans in place that we started last year that continue to this year that over time, particularly as we get to the back half of this year, we'll see these pack sizes, these pack formats in these channels becoming much more accretive whereas in the back half of last year, obviously, they were more of a hurt.

<Q - David Cristopher Driscoll>: Thank you.

Operator

The next question comes from Dara Mohsenian with Morgan Stanley. Please go ahead.

<Q - Dara W. Mohsenian>: Hey. Good morning.

<A - Steven A. Cahillane>: Good morning.

<Q - Dara W. Mohsenian>: So, Steve, my question is really around the cost of top line growth. So if you look at 2019 guidance, you're only assuming 1% to 2% organic sales growth. That's coming despite two years of investment beginning in 2018 and that's at the low end of your long-term range. So I get your point on the call that it's progress, but it still seems like a pretty muted top line payback relative to a substantial reinvestment versus what we were thinking six months ago.

So I guess what gives you confidence that this is enough to drive a top line turnaround to a sustained level in line with your long-term goals and you won't need even more investment beyond 2019, which could basically pressure your ability to hit the long-term profit and EPS algorithm goals in order to get back to that long-term top line goal. Thanks.

<A - Steven A. Cahillane>: Yeah, great. Thank you for the question. I think I'd just reiterate the comment I made in the prepared remarks around, it's really the delta between a mid single-digit decline getting back towards growth. And so it is a difficult thing to do. You see a lot of companies try and not really be able to revitalize brands and turn what are longer term declines into growth. And so we're very encouraged by what we've seen in terms of the delta disappearing and getting back to flat, and we're confident that we've got the right plan in place in 2019.

The other thing I would tell you in terms of the investments that we're making particularly in the first half of this year, we're very confident because a lot of it is based on new, exciting innovation that we're bringing into the marketplace.

If you go into the market right now, you'll see big exciting things like Cheez-It Snaps, Rice Krispie Treats Poppers, Pringles Wavy's, Pop-Tarts Bites, all off to good starts, all supported. And these are big brands that already have obviously powerful equities. And so you invest behind those with new food formats and fun and exciting commercial ideas, they have good returns.

In cereal, we launched Pop-Tarts cereal, again leveraging a very strong core equity. That's off to a good start. And so the early signs of what we're seeing in terms of our new investments in the beginning of this year gives us encouragement that builds on the excitement we saw last year in bending that trajectory from what was a negative decline into positive. And so I fully appreciate that there's doubting Thomases and we have to show you. We have to show investors. But we are running our plan. We're confident in our plan, and the number one objective to get back to the longer-term algorithm is getting that top line back to sustainable growth and we feel like we have the plan in place to make that happen.

<Q - Dara W. Mohsenian>: Okay. And as you look beyond 2019, just to follow-up, it doesn't sound like there are big areas of reinvestment that you might need beyond 2019 like the on-the-go area this year, because I'm just trying to put it in context if I go back over a longer period of time, much of which wasn't under your tenure, but if I go back five or six years, we've really seen [indiscernible] (45:01) come down significantly as a percent of sales. So I'm just trying to understand if sort of this 2019 base really gives you what you need going forward or if there could be other big areas of investment beyond 2019.

<A - Steven A. Cahillane>: We feel like we're at a very reasonable level of investment for us going forward. And you'll see us turn our attention ever more to ROIs to getting the most that we possibly can out of the investments that we're making. It's a new world obviously with digital, social, and so forth, and so that's part of maybe the decline over the years.

But we do feel like we're at a good level of investment right now. We took bold moves obviously to get us back to where we are today, and we feel comfortable that we've got the right levels. You'll see us allocate that and reallocate that over time, but in terms of a headline number, we feel pretty comfortable we're in a good place.

<Q - Dara W. Mohsenian>: Thank you.

Operator

The next question comes from Eric Larson with The Buckingham Research Group. Please go ahead.

<Q - Eric J. Larson>: Yes. Good morning. Thank you for taking my question. This may be for either – it's probably Steve, I'm not sure who will answer it. But when you take all of your puts and takes on your operating profit margins, when we look out and this will be including the mix with Multipro, et cetera. When we look at 2020 which I guess would be the year that we should be looking for a more normalized adjusted operating profit margin, what should that margin look like on an apples-to-apples basis?

<A - Steven A. Cahillane>: Yeah, I'll start and leave it over to Fareed. We're not obviously giving – we gave 2019 guidance, so I'd be cautious about going all the way to 2020 guidance. But as you think about the way that we've constructed this year and obviously some significant headwinds, many of which are mechanical in the first half of the year and then in the back half of the year, we get to something much closely – much more closely resembles our aspirational algorithm, and so we'd enter 2020 with that kind of tailwind momentum. And so, Fareed, I don't know if you want to build on it.

<A - Fareed A. Khan>: What I would say is we're still confident in our long-term algorithm that we put out several times. And if you look at the shape of 2019, we went in some details kind of outlining where that is and you look at sort of how the year progresses and what that means for our exit rate from 2019. That should give you a little bit of confidence as well. And the main thing is returning businesses to top line. We'll have a more focused portfolio. We'll have more targeted brand investment. And a lot of this innovation is going to be accretive. We'll be addressing some of those single-serve dynamics as we've talked about. And then in the backdrop, we still have very strong growth rate consistently in our emerging markets. And then you'll see there as we build scale, as we have more relevant local foods, as we're bringing more value to the market, that that will improve as well.

So we've got the benefits of scale. You've got some very specific timing things that you can see playing out in 2019. And then sort of the underlying economics of – as we build scale in emerging markets. So again those things together give us confidence in the algorithm we put out there.

<Q - Eric J. Larson>: Okay. Thanks. That's helpful. And then just a quick follow-up question. It's related to what David was asking on the pension fund. So when you look back over the – and it's been pretty consistent for the last x number of years. You have been making fairly significant voluntary cash contributions to the pension, which has done a pretty good cash usage. Are we getting to a point where the pension fund is funded to the point where those voluntary contributions can actually start receding a bit? I mean how should we think about that?

<A - Fareed A. Khan>: Yeah, so it's a large pension plan as I've talked about. It's frozen. At least the key elements have been frozen both in North America and in Europe. So, that helps sort of contain the obligations.

It's about 91.4% funded, so well-funded, and we've been making contributions towards it. As we made those contributions like we did with some of the cash proceeds we received from U.S. tax reform, we also have changed the asset allocation mix to begin to de-risk it as well and accompanying that was lowering our expected return on assets, which start in 2018 and also come into 2019.

And so, what you'd expect from all of that [ph] you get (49:50) de-risk plan, well-funded, a pivot to de-risk the returns and we, unfortunately, just given the timing of December and what the markets were doing, there's an accounting EPS impact that will go into next year. But, again, that's non-cash. That's point in time, and I wouldn't view that as sort of anything that would fundamentally shift the quality of the program that we have already.

<Q - Eric J. Larson>: Okay. Great. Thanks.

Operator

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

<Q - Robert Moskow>: Hey. Thank you. Fareed, I was hoping you could help me bridge the net income to cash flow for 2019, because it – there's just something missing there, and the cash flow seems very low. If you start with adjusted net income of maybe $1.4 billion, even when I take into account higher CapEx spending, it's just hard to get down to the $950 million of free cash flow. And I want to know, is there something else in there, especially, given the fact that you say that working capital should be a source of cash. What else gets us that low to $950 million?

<A - Fareed A. Khan>: Yeah, I think we've got durable cash flow as we've talked about. Our CapEx up a little bit year-over-year, and the mix of that CapEx is shifting more towards capacity and growth to support what we're seeing happening in the business. So, CapEx is going to be up a little bit. But, essentially, the other moving parts are pretty straight forward.

So, from an operating profit perspective, we're forecasting about flattish. There'll be lower tax benefits going into 2019 versus 2018 both from a combination of tax reform, as well as the discrete items that we've had. And then, offsetting some of that was the pension contribution we made last year, so...

<Q - Robert Moskow>: Fareed, maybe I could bridge it a little differently, though. Because if you start with $1.4 billion of net income, you take the D&A, you add that back, you subtract the CapEx, you'd still be quite a bit higher than the $950 million that you're guiding to, so there must be some other non-cash income in the net-income-level number or some kind of tax-related issue that gets you lower to $950 million and maybe this needs to be taken offline, but it...

<A - Fareed A. Khan>: Yeah, that might be better, but I mean those like I said, we've sort of outlined the key moving parts. There are some pretty major year-over-year tax rate differences. Our base rate for 2018 is going to be 16.5% and your outlook for 2019 will be quite a bit higher. So, there might be some of those dynamics going on, but it might be better offline. But, again, nothing that I would point to and say it'd be unusual we haven't talked about on the call.

Operator

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

<Q - Michael S. Lavery>: Thank you. Good morning.

<A - Fareed A. Khan>: Good morning.

<A - Steven A. Cahillane>: Good morning.

<Q - Michael S. Lavery>: You talked about some new brands launching. And, obviously, typically those cost more than extensions or innovation under any current brands. Can you give a little more color on what some of those might be or what categories and why you thought it would make sense to pursue a new brand approach?

And then, some of these presumably white space opportunities, did you also look at M&A as an alternative? And how did you think about that comparison?

<A - Steven A. Cahillane>: Yeah, Michael. Thanks for the question. We're doing a combination of all the above that you just mentioned. So, some of the things that are more capable of moving the needle, if you like, are the ones that I mentioned that are big brand related like Cheez-It Snap'd, Rice Krispies Poppers and so forth, but there's also some very interesting white space that we're launching into this year.

One of those is around digestive health and we're launching a brand called Happy Inside, which we're excited about and we're going to learn as we launch this. It does require investment, but we also felt that it was such a unique space that the launch of a new brand versus extending one of our existing brands into that space was more appropriate.

We also scanned the horizon and looked at from an M&A perspective, is there somebody in that space? And the net of all those things led us to believe that Happy Inside as a new launch, a new brand, was the best alternative for us. We also have a product called joyböl, which is a softer launch which is really about hyper convenience as a major trend, and one of the occasions that we talk about is the desk-fest occasion, which is, think about really everybody, but particularly millennials, who are on-the-go who tend to put their snack or breakfast in a knapsack, go to work, and then have it on the breakfast – or have it at their desk.

So joyböl is another new brand we're launching into that space. Some of the same reasons we just didn't feel like an extension of one of our existing brands was as relevant to launching a new brand. So we'll do a combination of all of the above, extending our brands where we feel like they have a right to play and a right to win, and it actually reinforces the core equities of those brands versus diluting those brands. And so that's one of the prisms that we look towards brand extensions.

White space where we have the opportunity to launch a new brand with appropriate levels of investment behind, and then M&A, which you saw us do most recently in this same type of space with RX which filled a big white space opportunity for us where we felt like the launch of our own brand would be far too expensive and extending our own existing brands into that space wouldn't be as successful as acquiring RX. So look for us to do all of the above, but those are two examples of launching new brands to answer your question.

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

Operator

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

<Q - Steven Strycula>: Hi. Good morning, and congratulations on turning Kashi cereal around. It's a nice improvement.

<A - Steven A. Cahillane>: Thank you.

<Q - Steven Strycula>: As we think about the revenue bridge from where you tracked in fourth quarter to where you're going at midpoint of next year, can you walk through a few of the pieces that start to enter the comp base and how they help you scale the reported consolidation of the results, particularly Multipro and RXBAR? I know those are much faster growing. And then what does that imply for the base business?

<A - Fareed A. Khan>: Yeah, it's Fareed. So we sort of talked about the organic growth rate 1% to 2%. We see sort of the larger developed markets, North America, Europe, being in slight growth, and in North America, we've gotten through the DSD. We've gotten through the pricing dynamics. So there's more of a clean base there. The investments that we've been making around our big brands, we're seeing good performance. We're seeing that momentum building. And an overlay to that are some of the innovations that Steve talked about. So the snacks portfolio had some nice momentum building. And then we see sequential improvement in cereal, and if you look at 2018 versus 2017, there was some improvement, and we expect that to continue.

May not be all the way to growth, and then some of the other businesses that we mentioned, Frozen performing strongly, on-the-go, and convenience really helping some of our Specialty Channels. And then Kashi as you noted, some nice improvements in part of that business with RTEC. A similar story where there's been really good Pringles momentum in 2018. We really benefited from football. But we also have some gaming and other things going on there. So we do see Europe in growth.

And then in our emerging markets, which is becoming a larger part of our portfolio, Australia which is a big market in the Asia Pacific, nice progression there particularly in the cereals category. And then we're seeing strong double-digit growth in a lot of the markets.

Again, we're placing fewer bets really building scale in high potential growth markets like Brazil, in India, certainly in West Africa as you've seen. So you should have mid single growth rates in Latin America, in Asia, slight growth in North America and Europe. And that gets you pretty solidly in the range that we gave. But, again, the momentum that we're seeing in some of these big brands and some of these big categories whether it's RX or in the core is what gives us confidence behind those numbers. So hope that helps.

<Q - Steven Strycula>: That's very helpful. And then any language around RXBAR or Multipro's contribution? And then I'll pass it along. Thank you.

<A - Fareed A. Khan>: Just that great businesses. They've been growing at double-digit growth rates. A lot of potential in both in slightly different ways. RX obviously expanding its distribution base. Also, some extensions into nut butters, RX Kids that have been progressing well, and Multipro, we view West Africa as just a terrific long-term bet and it's a proven business model, phenomenal distribution reach in that market.

And it's going to benefit from just fundamental demographics, rising incomes, and we've seen that business go through ups and downs of whether it's energy prices or transitions, but it's a very strong, very stable business, and so we see that momentum continuing. And again, you have large businesses growing at double-digit growth rates, so obviously those are very accretive to the overall top line results.

John Renwick

I think we are at 10:30, operator. So at this point, we have to wrap it up.

Operator

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

John Renwick

Thanks, everyone, for your interest. I'm around all day. Thank you.

Operator

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