Company Name: Kellogg
Company Ticker: K US
Date: 2019-02-20
Event Description: Consumer Analyst Group of New York Conference

Market Cap: 20,122.51
Current PX: 57.9864
YTD Change($): +.9764
YTD Change(%): +1.713

Bloomberg Estimates - EPS
Current Quarter: 0.958
Current Year: 4.058
Bloomberg Estimates - Sales
Current Quarter: 3536.615
Current Year: 13817.938

Consumer Analyst Group of New York Conference

Company Participants

- Jonathan Feeney
- Steven A. Cahillane
- Chris Hood
- Fareed A. Khan

Other Participants

- Bryan D. Spillane
- Robert Moskow

MANAGEMENT DISCUSSION SECTION

Jonathan Feeney

Good morning. I'm Jonathan Feeney, Co-Chairman of CAGNY, and it's my pleasure to welcome you to Day 2 of our CAGNY meetings, my 17th. And it's an honor once again to introduce the management team of Kellogg, a longtime sponsor of CAGNY. And with us today, we have their CEO, Steve Cahillane; their CFO, Fareed Khan, their President of North America, Chris Hood; and their Vice President of Investor Relations, John Renwick. Please join me in thanking them for sponsoring a great breakfast once again that many of us look forward to every year, including our families. Thank you.

Under Steve's leadership, Kellogg is clearly putting more resources behind the things that are working. For example, during 2018, they grew the iconic brands like Fruit Loops, doubled distribution of the recently acquired RX, and increased stakes in their West Africa business, so they now boast nearly 20% of sales in fast growing Emerging Markets, quite a transformation. Here to tell you more is CEO, Steve Cahillane. Steve, take it away.

Steven A. Cahillane

Thank you, John, and good morning, everyone. I hope you all enjoyed our breakfast, tried some of our exciting new products from around the world, had your picture taken with Tony and Mr. P. It is really great to be back here at CAGNY, escaping the polar vortex that is Battle Creek, is an additional real positive, enjoying the 75 degrees and sunny is always great, but it's great to be back here a year later to update you on the progress that we're making around Deploy for Growth because we kicked it off a year ago in this very room after I've been with the business for only a short couple of months.

The shame of it is that our stock price doesn't really reflect the progress that we're making. But believe me, this provides great motivation for me and my team, and that's what we're here to talk to you about today, the opportunities that we see in front us. In our short time together this morning, here's what we'd like to do. I'll start with a brief discussion about where exactly we are in our turnaround and how Deploy for Growth is guiding us, how our portfolio has been reshaped for long-term growth.

Chris will then [ph] offer (00:02:30) tangible examples of how we are revitalizing brands and enhancing capabilities for better growth and execution in our key market of North America. Fareed will then put it all together in financial terms with an emphasis on how profit growth will follow this period of increased investment. But first, I have to remind you that certain statements made today are forward-looking statements and that actual results could be materially different from those projected. For information concerning factors that could cause these results to differ, please refer to this scintillating slide behind me.

So a year ago, we told you that our number one priority now that our cost structure had been reduced was to get back to top line growth. It's never easy to reverse a negative multi-year top line trend and particularly [ph] immense (00:03:31) changing food beliefs, a changing media landscape, changing shopper habits, and a very dynamic retailer environment. As I said a couple of weeks ago, this is required altering our mindset, restructuring our organization, rewiring our processes, rethinking every brand, changing how we think about every channel and reorienting our supply chain, and it required a lot of investment.

To be as confident in our future as we are, I believe you have to believe two things. First, [ph] that we're doing (00:04:13) the right things to restore top line growth, that we have the right strategy, that we are indeed shaping the portfolio, and that we're investing in the right places; and the number two thing you have to believe that profit will follow.

We've asked you endure several quarters of substantial investment and we still have a couple more to go. This is right for the long-term. And once these foundational investments are behind us and we shore up what are some short-term margin drags and that the top line momentum that we're seeing continues, then profit and cash flow will indeed follow. That's what we're going to talk about here with you today.

So it makes sense to start with Deploy for Growth, the strategy we introduced to you one year ago. Deploy for Growth guides us on where we'll play and how we'll win. It is understood by our entire organization. It is giving us clear priorities and it is leading us to very deliberate actions. We have made investments and changes in every one of the growth boosters that underpins our Deploy for Growth strategy and it's giving us the confidence to invest in a big way, where we know we can drive sustainable growth. Simply put, Deploy for Growth is the right strategy and it is doing exactly what it was intended to do.

In just a few years and even in the last 12 months, since we were here last, our portfolio has shifted meaningfully toward growth. Most significant is how we've shifted our portfolio towards Emerging Markets. This is where the long-term growth of packaged foods will be most pronounced. In recent years, we have added scale in existing markets and we have expanded into new geographies. We have also expanded beyond Cereal into Snacks, noodles and other categories. We have increased our capabilities and presence in the high-frequency stores or the mom and pops that prevail in these markets. We have catered foods to local cultures and tastes, and launched new pack formats that promote affordability and accessibility.

Today, Emerging Markets represent nearly 20% of our company's net sales. We grew organically in these markets at a high-single digit rate in 2018 with strong growth in both Cereal and Snacks. And on top of that, we consolidated into our results Multipro, the leading packaged foods distributor in Nigeria and a competitively advantaged business that continue to grow at a double digit rate in 2018. So a long-term target of mid-single digit growth, organic growth for Emerging Markets is more than within reach, we're already achieving it. But our portfolio shaping is more than just Emerging Markets. We've used acquisitions and investments to shift our portfolio to growth within each of the other segments shown on this slide. And we're doing the right things to get them on the long-term trajectory shown. So let's review each in turn.

It surprises many to learn that Developed Market Cereal accounts for less than a third of our portfolio today. Many seem to have the impression that this category is in a free fall when in reality it is only declining about 1% to 2% in Developed Markets. The truth is we don't need this segment to be more than flat to down slightly for the total company to grow, and that's a key distinction. History and our playbook, which has worked well recently in Australia and the UK, tell us that we can and will stabilize this business. We're doing the right things to do just that. And Chris will give you some more details in just a moment.

Developed Market Snacks is our largest segment and it's nearly half of our portfolio. This business has undergone a significant transformation in the U.S. with the exit from DSD. This freed up overhead that was only dedicated to a single channel and enabled us to reinvest in brands and capabilities across all channels. As a result, we have revitalized and accelerated our biggest brands. On top of this, we've added the rapidly growing RX brand to our portfolio. We've also expanded our offerings of on-the-go pack formats so important to winning the key occasion of on-the-go in Snacks.

We have work to do on several smaller brands including in Wholesome Snacks, and our proposed divestitures will further focus our portfolio and our resources, but there's no question we are doing the right things to get this business back in growth. In fact, we see no reason why we can't get back to low-single digit growth in our Developed Markets Snack categories maybe even this year.

Developed Markets Frozen Foods is less than 10% of our portfolio. Frozen Foods are on trend with today's consumer and our Eggo and Morningstar Farm (sic) [Farms] (00:10:04) brands have been revitalized via focusing our portfolio, renovating food and packaging, and launching new products. As a result our Developed Markets Frozen Foods business has been growing at a high-single digit rate for us over the last couple of years. We think it's realistic to assume that these categories and brands are settling into a low-single digit growth rate, but we've shown obviously that we're capable of even more than that.

Put [ph] them (00:10:34) all together and you can see why we're confident that our total company portfolio can deliver low-single digit net sales growth over time, and we're almost there. Having stabilized a multi-year decline in 2018, we are confident that we will return to organic growth in net sales this year right out of the gate. Now, don't get me wrong. We are not doing a victory lap here today. Nobody is celebrating this type of growth. We know we have a lot of work left to do. We have more brands yet to revitalize, [ph] think of [ph] our (00:11:18) Wholesome Snack brands, whole snack bars like Nutri-Grain, Special K and Kashi. Think of some of our Cereal brands and even the category, the Cereal category as a whole. But as Chris will show you in a moment, we've got many of our biggest brands fully revitalized. We also [ph] done (00:11:42) enhancing some key capabilities we need to win in today's marketplace. So think e-commerce, think revenue growth management, think pack formats and service levels. We've been honing these capabilities and they're starting to bear fruit.

We're still fine-tuning our organization and processes for better execution. We're breaking down silos for more holistic visibility and we're resourcing our – we're being [ph] sure (00:12:10) about our resource allocation. We're creating better focus against execution and we believe that this will continue to pay off. And we're not done reshaping our portfolio, it wasn't an easy decision to explore a possible divestiture of some of our businesses. We believe that these are great brands, but a divestiture can reshape and further focus our portfolio. We'll also continue to look for bolt-on acquisitions in white spaces and for scale in Emerging Markets.

In short, we'll continue to shift the portfolio ever more towards growth. While there's work yet to do, I think you can see that we're on the right path. We're doing the right things to restore top line growth and you won't have to wait long to see it in our results. But we know clearly that you also have to believe that profit will follow. Let me be very clear on something, we are not seeking growth at any cost. Our goal is to grow both net sales and operating profit. If you think of the progression of our turnaround, it started with a tremendous reduction in our cost structure. We then layered investments on top of it during a period between late 2017 and through the first half of what will be 2019.

We're investing in building a foundation for growth. By that, I mean that we are investing heavily upfront in revitalizing brands, rebuilding a pipeline of differentiated innovation, and enhancing key capabilities. Once your biggest brands are revitalized and you've got the infrastructure set up for your capabilities, this investment diminishes relative to the sales momentum that it creates, thus restoring profit growth.

We have deliberately resisted the temptation to pull back on that investment when budding growth platforms such as new pack formats create temporary additional costs or inefficiencies. We had to create the base of demand first. Now, we can go improve the margins. Chris will talk about what we are doing to shore up margins on certain pack formats in North America. And in Emerging Markets, we're building scale and working to shift our product mix to more premium products. More broadly, we continue to execute new productivity initiatives and we have recently executed revenue growth management measures to help cover underlying cost inflation. So we're always mindful of the importance of profitability and profit growth, and we're closer than you think to getting on track towards balanced top line and bottom line delivery.

Take a look at this slide. Our first two quarters of 2019 will be a continuation of the investment phase that we kicked off in the fourth quarter of 2017, but we're nearing the inflection point, sometime in Q3 when operating profit joins organic net sales in growth. That's only a couple of quarters from. So, yes, profit growth will follow. Now, it's my pleasure to invite Chris up to the stage to bring life to some of these investments around Deploy for Growth. Chris?

Chris Hood

Thanks, Steve, and good morning, everyone. Everything you've just heard from Steve applies to Kellogg North America, and then some. We know that we have the foods, the brands, and the people to grow this business, but we have to make big investments and major changes to get our business back on track. I'm going to give you some tangible examples of what exactly we've been investing in, where we've made important changes and why we're confident that there's good progress being made even if we still have some work to do.

Our first order of business was to revitalize our key brands. So let me take you through what we've done in each of our major categories. In Snacks, we exited DSD to free up resources and we used those resources first to get our big power brands back into growth. And it wasn't just about spending more money, whether it was capitalizing on a unique consumer insights like flavor stacking for Pringles or getting back into the conversation like Cheez-It with its sports sponsorships, or simply adding more fun food like we did on Rice Krispie (sic) [Krispies] (00:17:09) Treats, there was substance behind our marketing.

Look at the growth rates we generated shown on this slide. Pringles soared back into growth. Cheez-It sustained good momentum. And Rice Krispie (sic) [Krispies] (00:17:26) Treats did so well that we're [indiscernible] (00:17:29) allocation in the second half of 2018. Meanwhile, our newly acquired RXBAR brand aggressively expanded distribution into mainstream channels in 2018, bringing its ACV distribution in these channels up to 70% by the fourth quarter, up from less than 30% a year ago, more than double. This launched its first ever national ad campaign, which doubled its unaided brand awareness.

And after a slow start, Pop-Tarts return to growth in the second half of the year on the strength of innovation. These are huge brands for us. In fact, the five brands shown here represent nearly 60% of our measured channel snack sales at retail. That's why getting them back under a strong foundation for growth was absolutely critical. And there's more to come in 2019.

We'll talk about our innovation program in a minute. Hopefully, some of you had a chance to try some of our new products in the breakfast room next door this morning. But before we do that, I'd like to play three ads for you. The first is the ad that we ran for Pringles for the Super Bowl. It's a great example of how we're doing things differently to revitalize our brands. Not only is it built around the compelling consumer insight around flavor stacking, but it was part of an innovative approach that is perfect for today's media landscape. It was a company by customized digital messaging directly to consumers' mobile devices during the big game. This is a glimpse into the capabilities that we're enhancing.

The second is an ad for Cheez-It. I share this ad for Cheez-It with you, one, because it's amusing, but two, because it offers some of our highest ROIs of any brand in our portfolio. And this execution shows how we keep our messaging fresh on a consistent campaign, and the third ad is for our new Pop-Tart (sic) [Pop-Tarts] (00:19:32) Crisps. While, admittedly, this may not be a huge bet for us from a sales standpoint, it does allow us to get the nutritional credentials right and advertise the Pop-Tart (sic) [Pop-Tarts] (00:19:43) Crisps brand again to kids. So we're very excited about that. Can you please run the commercials?

Video Presentation] (00:19:48-00:20:53)

Now, let's talk about Cereal. You all know that the Cereal category has been challenging. Food beliefs have shifted away from low calorie low fat and full on toward protein, and as a result, its highly penetrated category has felt softness in the health and wellness oriented adult segment. The category's 1% decline is not terrible but we have to do better. So in 2018, we set out to do three things: First, to stabilize our key adult brands; second, to continue to drive taste/fun and snacking oriented brands; and, third, to expand in the natural segment

In the adult segment, it was important to stabilize Raisin Bran and Mini-Wheats by amplifying their wellness attributes. It took a little time, but you can see that these brands did stabilize share and return to outright consumption growth in the second half of 2018.

The taste/fun segment is the segment that is growing in the category, partly because it's where most of the innovation and promotion is happening, but also because it benefits the most from increased out of breakfast consumption, mainly snacking. Two of our biggest taste/fun brands, Fruit Loops and Frosted Flakes posted another year of share gains in 2018.

Our core six brands collectively bounced back to share growth in 2018 as a result of all these efforts. We also knew that we had to drive growth in the natural segment. It took some work, renovating our food, launching innovations and strengthening credentials. But Kashi Cereal returned to growth in the second half of 2018 and it's now growing beyond the natural channel, accelerating its growth in the mainstream x-AOC channels and Bear Naked continues to grow in granola as we build brand awareness and launch new offerings.

Now, don't get me wrong; we're not happy with our overall Cereal performance. We still got a lot of work to do both to revitalize the brands in our portfolio and to get the category back to growth. But the brands we revitalized are big and they proved that we can do this. So we are making progress.

Frozen Foods is another area where we revitalized our biggest brands. Eggo's rebound has been well-documented. We took out artificial colors and ingredients. We brought some fun to the category in the form of Disney-shaped waffles and we re-launched Thick & Fluffy as a premium offer. Clearly, this brand is back. Morningstar Farms went through a bit of an overhaul a couple of years ago in portfolio, in packaging, and in food, and it's now focused on what it does best, grilling items. And it's starting to amplify its clean-label and plant protein attributes, and the result has been an impressive turnaround in 2017 and 2018.

Among the most important behind the scene changes and investments we've been making have been around innovation. We've reorganized our structure. We've changed our approach, and we've set very clear priorities. As a result, the quality of the ideas that we are launching is better than ever and speed-to-market is improving. The items that you see on this side are the items that we have launched or are launching in the first half of 2019. It's a great mix of new food forms, premiumized offerings, indulgent items, health and wellness items, pack formats, and even a couple of new brands. The items launched in January are off to a great start even if it's a little early to gauge the scanner data, but a few notable call-outs. Cheez-It Snap'd's terrific food, it already has a velocity that is better than the overall cracker category average, and it only launched at the end of December.

Pringles Wavy is a new food form for the brand and equally delicious. Pop-Tart [Pop-Tarts] (00:25:12) Bites, Pop-Tart (sic) [Pop-Tarts] (00:25:14) Cereal are each recording velocities that exceed their respective category averages, and off the grid waffles is our new entry into the protein segment for frozen waffles. I hope you had a chance to try the Rice Krispie Treat (sic) [Rice Krispies Treats] (00:25:27) Poppers at breakfasts. It's way too early to call success, but I think you'll agree that this is the best line of innovations that we've had in many years, and this should be reflected in net sales this year.

This slide gives you an idea of just how much more net sales we're projecting from year one launches this year than we have in the past few years. You only have to look at the trend we're on to see what an important turnaround this has been for our business. In fact, we're getting our innovation levels back to their highest levels in a long time, and this is one of the key reasons that we are confident that North America can return to growth. So that's what we're doing to revitalize key brands. Now, let's talk about what we're doing to enhance capabilities.

We told you over a year ago that we under indexed on single-serve in our snacking categories. And given how important on-the-go is as an occasion today, we knew that we had to go after it. The chart on the left shows just how much we've accelerated our consumption growth for on-the-go packs especially during the second half of 2018.

The chart on the right shows how our on-the-go items collective share of our categories compares to the share of on-the-go overall in our categories. All right. So it's index fair share. You can see that even after this rapid acceleration we still under index in on-the-go packs, so there's still plenty of opportunity for growth. We've created a stronger on-the-go portfolio and capability, and this has produced a new platform for growth that we expect to be a growth stream for years to come. You could argue that we went after it too quickly, too aggressively, proliferating new pack formats before our supply chain could catch up. This led to higher than expected costs, virtually eliminating the margin on these products.

So now, we have to shore up their margins and as we mentioned in our earnings call a couple of weeks ago, we were already simplifying the portfolio of SKUs which will reduce some complexity and enable the supply chain to keep up. We've implemented price pack architecture changes in order to realize a bit more price for the convenience these pack formats offer, and that should start to improve margins in the first half of 2019. The bigger solves, like setting up centralized packing centers and bringing some of this co-packed volume in-house will start to restore margins in the second half of the year. These pack formats should be margin accretive [audio gap] (00:28:10) obviously right now. But we know [ph] how to build (00:28:13) margin and we're confident that we can do that, and our aim is as we exit in 2019, to have these margins back up where they should be.

We're also investing in improving our service and making aisles more easily shopable. We've expanded our retail sales force to give us more everyday presence in stores and we've invested in technology to boost their capabilities, everything from tracking out of stocks on a real-time basis to dynamic routing for less time in cars and more time in stores. In 2018, we invested in display-ready cases and trays, which helps us and our retail partners get product on to shelves and displays more efficiently. This required some investments but it was the right thing to do for our business. We've invested in racks for Pringles and we've seen impressive lifts in the stores where these have been installed. We've gotten more creative about both cross brand and cross category promotions, as well as partnerships with other consumer staple brands.

And at the 8-K, we discussed the work we are doing to harmonize our Cereal pack sizes. This required packaging investment too, and it will lead to better shopability in the aisle, easier for shoppers to discern between pack sizes and prices, easier for us to promote different combinations of brands and products. These are examples of capabilities that we've had to invest in upfront, but they'll payoff in better sales performance over time.

Finally, let's talk about our portfolio. We've already discussed how we're shifting investment to our power brands and our promising challenger brands. But we've also announced our intention to pursue the divestiture of the brands and categories shown on the slide. These are good businesses and indeed we've seen them respond to brand building investment. They will simply do better in another more focused portfolio where they will get more resources. For us it will give a simpler more focused portfolio and allow us to continue to prioritize investment beyond the focus brands that I've already talked about.

So when you put it all together, we have a North American business that is starting to look substantially different than just a few years ago. From our reorganizational structure, to our go to market, to our portfolio, we're investing in revitalizing power brands and expanding challenger brands and we're enhancing capabilities that will make us more competitive in the marketplace and more efficient internally.

We still have a lot of work to do, a number of additional [audio gap] (00:30:56) need revitalizing, a number of pack formats whose margins need to be shored up. We believe that we can return to organic net sales growth this year in 2019. Even if only slight growth, this would be a great sign of progress for North America.

We're also not losing sight of our margins. We expect to offset the impact of investment and higher input costs with everything from revenue growth management to productivity initiatives to overhead discipline to operating leverage from improved top line and restoring margin in the on-the-go formats. So this puts us on a path for balanced sales and profit growth going forward.

Now, let me turn it over to Fareed to summarize what all of this means financially.

Fareed A. Khan

Thanks, Chris, and good morning, everybody. I keep coming back to this slide because it's so important for understanding where we are in a turnaround and the fact that we're right where we said we'd be and on a path to sustainable top line growth and margin expansion. Our cost structure was lowered meaningfully in the past few years and we're now investing on top of that reduced cost structure, largely in foundational investments that are somewhat upfront in nature and you've heard and seen good examples of those investments today and you've seen how it's starting to restore top line growth to our portfolio, especially on our big brands. But this doesn't mean we're ignoring profitability far from it. With productivity initiatives underway and we've implemented revenue growth management actions and we are very focused on improving the returns on our investments.

We restructured our organization for more efficiency and effectiveness, and our proposed divestiture will simplify and focus our portfolio and resources. And soon, foundational investments will start to diminish and top line growth will start to drive operating leverage. So while we're in an investment phase, the building blocks for profit growth are definitely in place. This slide takes our 2019 guidance and offers some first half versus second half perspectives, because the house will look very different as we mentioned in our Q4 call a couple of weeks ago.

To review, first, our investment both in brand building and capabilities is very front weighted this year, and is largely centered around big innovation launches that Chris described earlier. [audio gap] (00:33:26) a continuation of the investment phase that's been in place since the end of 2017.And, second, we do face some tougher cost inflation comparisons in the first half than in the second half. Our strongest quarter of operating profit growth in 2018 was Q1 when we had some notable cost favorability and we also had some very advantageous commodity hedges come in the first half. And, finally, we'll also lap some discrete tax benefits that we realized last year, mainly in Q1 and Q2.

But let's take a look at what happens in the second half. On net sales, we'll no longer have the incremental benefit of acquisition like we do in the first half but we should see sustained organic growth finishing the year at 1% to 2% growth. That's not far off our long-term algorithm which itself includes future M&A.

Operating profit, we should see a growth, a returned growth. If you do some simple math, you can deduce it'll be roughly in the mid-single digit range; again, roughly equivalent to our long-term target even if margin improvement actions aren't fully completed by that time. And on EPS, we should see a return to growth in the second half as well. The point is we don't have long to go before we start getting back to growth on all three metrics and that starts to get us towards our long-term algorithm. In summary, nothing has changed in the way we view 2019 from a financial perspective.

Not only does profit growth follow our investment, ultimately so will cash flow. For now, it's remaining stable amidst increased investments. Our priority for this cash flow remains the same. Our guardrail is our commitment to remaining investment grade and of course, we recognize that our dividend is inherent feature of our stock and so we remain committed to it as ever.

In 2019, we hope to augment our stable cash flow with proceeds from any potential divestiture. Our plan is to use these proceeds to reduce debt in order to retain financial flexibility for potential acquisitions or for opportunistic share buybacks, such as the buybacks we made in Q4 and even over the last few weeks. And finally, our durable cash flow gives us financial flexibility and this will be augmented by potential divestiture proceeds. This financial flexibility will enable us to remain investment grade while keeping our powder dry for acquisitions and opportunity for share buybacks.

Now, with that, I'd like to turn it back over to Steve for some – I'm not doing well with my page orders here. Okay.

Financial summary. In summary, nothing has changed in the way we view 2019 from a financial perspective. This is exactly when you want your page is to be out of order when you're standing up in front of a big room with smart people.

We are not finished with many of the foundation building investments that are so important for restoring sustainable top line growth. We still have a couple more quarters of this and is already working in that our top line growth is returning. We do have higher cost inflation this year than last year and without as much incremental Project K savings to offset it. But aside from some difficult comparisons in the first half, we believe we had the productivity initiatives and the recently enacted revenue growth management actions to cover it once we get into the second half.

[audio gap] (00:37:10) we're taking decisive actions to restore margins on our growing on-the-go pack formats by the second half. We're building on the good cost structure reduction work we've done in recent years by reorganizing ourselves into a more efficient and effective structure. This is less about savings and more about effectiveness, but we should begin to have a positive impact on execution in 2019. And finally, our durable cash flow gives us financial flexibility and this will be augmented by potential divestiture proceeds. This financial flexibility will enable us to remain investment grade, while keeping our powder dry for acquisitions and/or opportunity for share buybacks.

And with that, I'll turn it back to Steve for some concluding remarks. Thanks.

Steven A. Cahillane

Thanks, Fareed. So, you've seen a little bit into the team dynamic here at Kellogg. Chris Hood is known as one of the biggest practical jokers on the team. I didn't think that would include actually shifting some of Fareed's slides around, but there you have it. So, I would be remiss if I didn't remind you of the kind of company that we are. Through all the changes we're putting ourselves through to turnaround our financial results from organizational change, to process change, to portfolio change, to the investments that we've talked about, we never lose sight of social responsibility. Social responsibility is ingrained in the fabric of this company starting with our founder. We not only view it as the right thing to do, but we know it is really smart business.

As you can see on this slide, we're making a meaningful impact with this work and it's being recognized. We truly want to be a company with a heart and soul, when that is as good to our share owners as it is to our employees, suppliers, customers, and the society and the environment that surrounds us. I don't want this to get overlooked. In fact, what I'd like to do now is share a short video that I think does a good job at capturing this spirit. So, if we could roll that tape, please.

[Video Presentation] (00:39:20-00:41:00)

Great. So let me summarize. Look, I don't need to tell this room that there's a lot of short termism out there. Many investors are focused on the next quarter or two. We all get that, but we can't allow that to distract us. We have to manage this company for the long-term and that's why we're investing in foundational elements of our Deploy for Growth strategy, that's why we're not pulling back investment when cost jump on freight or pack formats or when comparisons get tough on commodities or when a stock market drop in December, affects the accounting returns on our pensions, it's why we're willing to undergo organizational and portfolio changes even while investing in our brands and capabilities.

Our aim is steady growth both in net sales and in operating profit. In other words, balanced and sustainable financial delivery. Our portfolio is being shaped toward that. Our brands are being revitalized right now so they can deliver against that balance. Our capabilities are being honed so that we can deliver that balance, and the green shoots, the signs of progress are undeniable. Look at how we stabilize what had been a multi-year decline in net sales. Look at the improved [ph] consistent (00:42:19) performance we've realized on key brands around the world. Yes, we admit this investment phase is not done yet but it's only a couple of quarters away, and what is a very attractive dividend yield compensates you in the meantime.

The market has reacted very negatively to a near term profit outlook. The company has reacted by buying back stock. And by the way, both Fareed and I have reacted by buying back stock personally because we believe in the future of this business and we believe it's a great investment. So we're managing for the long-term and we like how our turnaround is progressing.

And so with that, I think we still have a couple of minutes for some questions.

Q&A

<Q - Bryan D. Spillane>: Hi. Thank you. Bryan Spillane from Bank of America Merrill Lynch. Two questions related to the back half. One is in terms of the growth expectations that you laid out just earlier, is that inclusive or excluding the Keebler business? And second, if you could kind of quantify how much of a drag that's been. So [ph] excluding (00:43:33) the Keebler business, would it grow even faster organically in the back half of the year?

<A - Steven A. Cahillane>: Yeah. Thanks, Bryan. So I'll start and Fareed can fill in the blanks. Everything that we showed is the portfolio as it exists today. It does not contemplate divestiture that clearly we have announced the intent to do, so everything is in there. In terms of how it will change, as and when we have a transaction to talk about, we'll come in and we'll give you a better insight into exactly what that looks like. You could look at Nielsen data, you could see how the Keebler brands that were talking about divesting are performing relative to the rest of the portfolio. And part of the strategic rationale for doing it as well is focus around those big, poor strategic brands that are growing very nicely in the market today.

I don't know if you want to...

<A - Fareed A. Khan>: I think the only thing I would add is from a top line standpoint, excluding the divestiture, it's a lot more consistent across the quarters than our bottom line. And we spent quite a bit of time on our Q4 call as you know kind of walking through the phasing first half, second half; now it's more on profit and EPS, as top line deliveries will be more stable throughout the year.

<A - Steven A. Cahillane>: Jon?

<Q - Jonathan Feeney>: Thanks. When I look at the long-term algorithm, I'd say, we're starting the second half, I see drivers – I think about mix. I see drivers and people, it's always sort of a [ph] joke, right? Yeah. (00:44:58). As Steve pointed out, people think of Kellogg is it's a cereal company, but one thing about Cereal is it's a super high margin, super iconic brands and much easier to repeat than say, more acquisition dependent, Developed Markets Snacks, and of course they push the little lower margin to get in West Africa and other emerging market. How do you cope with that in terms of your long-term algorithm, what would you say? And am I right about that characterization?

<A - Steven A. Cahillane>: Yeah. Jon, I'll start and, again, if Fareed want to fill in. So what we've laid out is an algorithm in the future that where we say Developed Markets Cereal doesn't have to grow. We can decline by 1%, even 2% and still see a success in our long-term algorithm. Having said that, you're quite right to point out that this is a fantastic category with over 90% household penetration, where the declines are not in free fall, as I've said. And so, this is a category that we would like to see back to growth again and we're working ever so hard to make that happen in Developed Markets.

In Developing Markets, Cereal is growing quite nicely. And so we believe in the category, but from a conservative standpoint, we haven't built into our algorithm anything other than kind of a flattish performance. And when you look at Emerging Markets, you could say, okay, that's margin dilutive to you and it is if you do the math, but every box that we sell in Nigeria is incremental to what happens in North America obviously.

And so we like that type of margin dilution because over time, we're going to continue to build scale in those Emerging Markets, which will come with better margins over time. And in Nigeria, if you look at our total system, margins are actually quite good. We're consolidating Multipro, which is the distributor portion which is a lower margin business. But when you put in the totality of it, we like the Cereal business, we believe in the Cereal business. We're working to turn around the Cereal business, we've done it in other Developed Markets like Australia and the United Kingdom. We need to do it in the United States, but it doesn't have to be in growth for a financial long-term algorithm to be successful.

<A - Fareed A. Khan>: The only thing I'd add is that if you think about the low- to mid-end of our guidance, that's more of an organic view and so that sort of implies there's not a big acquisition out there that this whole thing is predicated on, right, but to get to the higher end, I think more sort of fold-in types of initiative. And the other thing I'll say is that in Emerging Markets, we're very focused now where we're placing our bets. And what you see in those markets, when you scale and you start to have relevant food priced right for the consumer in that particular market, margins will come as well. And so it's not sort of this inherent, reasonably that we can improve margins in Emerging Markets. And the bets we're making are fewer bigger bets on key markets like whether it's Brazil or West Africa, India. And I think – so I just wouldn't expect our Emerging Markets margins not to improve over time with scale.

<Q - Jonathan Feeney>: David?

<Q>: Thank you. The margin improvement that's baked in to the second half guidance, what have to go right to see this happen? And then, please, the focus here is on the single-serve snacks and I'm just very curious as to the steps that have to transpire both in Q1 and Q2 inside of the supply chain in order to deliver the kind of the promised improvement within the margin structure.

<A - Steven A. Cahillane>: Yeah. So, again, I'll start, maybe Chris or Fareed can pick up. We've got a plan for the next, call it, 18 even 24 months around the on-the-go and kind of all new pack formats. That includes everything from revenue growth management, so making sure we're getting the right price for the right package through the right channel in the marketplace; as well as supply chain, which includes everything from bringing in-house to setting up pack centers and so forth. So, it's a comprehensive plan and exists over time.

To answer the question what has to go right, I would say everything has to go right. But we know how to do this particularly on what you can control inside your supply chain and bringing those things in-house. Everything's in motion right now. And so we're confident that we're going to get there.

It's just one of those unfortunate things that you can't flip a switch and just make it happen, it's real change, it's real infrastructure, it's real investment to make those types of changes. But we're confident that we can do it. We know how to do it. It's kind of in the wheel house of our supply chain and things that they can do. So I don't know if...

<Q - Jonathan Feeney>: We still have time.

<A - Steven A. Cahillane>: I think that's probably it.

<Q - Robert Moskow>: Hi.

<A - Steven A. Cahillane>: Before Feeney gives us [ph] up (00:49:39).

<Q - Robert Moskow>: Okay. Rob Moskow, Credit Suisse. For Chris Hood, my understanding is that your Snacks portfolio in U.S. is going to be taking list pricing up and I came up with a number of around 30% of your items maybe. Is that a fair assessment, and how quickly will the consumers see those price increases and what kind of elasticity are you expecting from pricing this year?

<A - Chris Hood>: Yeah. I'm not going to comment on the specific pricing actions that we've taken, but I will say that they're already in the marketplace. So you can even start to see them in the Nielsen data in the month of January. So, in terms of speed and quickness and it was broader than 30% of our line up.

Jonathan Feeney

Well, I think we have to wrap it up there. Please join me once again in thanking the management team of Kellogg for their breakfast this morning and longtime sponsorship.

Steven A. Cahillane

Thank you.

Jonathan Feeney

Thank you.