Company Name: Kellogg
Company Ticker: K US
Date: 2019-08-01
Event Description: Q2 2019 Earnings Call

Market Cap: 21665.8220557
Current PX: 63.6300010681
YTD Change($): 6.62000106812
YTD Change(%): 11.612

Bloomberg Estimates - EPS
Current Quarter: 0.982
Current Year: 3.835
Bloomberg Estimates - Sales
Current Quarter: 3324.929
Current Year: 13407.563

Q2 2019 Earnings Call

Company Participants

- John Renwick, Vice President of Investor Relations and Corporate Planning
- Steve Cahillane, Chairman of the Board and Chief Executive Officer
- Amit Banati, Senior Vice President, Chief Financial Officer

Other Participants

- Michael Lavery, Analyst
- Tim Ramey, Analyst
- Tom Palmer, Analyst
- Chris Growe, Analyst
- Robert Moskow, Analyst
- Jason English, Analyst
- Laurent Grande, Analyst
- Rob Dickerson, Analyst
- Bryan Spillane, Analyst
- Steve Strycula
- Andrew Lazar, Analyst
- John Baumgartner, Analyst

Presentation

Operator

Good morning. Welcome to the Kellogg Company Second Quarter 2019 Earnings Call. (Operator Instructions) At this time, I will turn the call over to John Renwick, Vice President of Investor Relations and Corporate Planning for Kellogg Company. Mr. Renwick, you may begin your conference call.

John Renwick, Vice President of Investor Relations and Corporate Planning

Thank you, Gary, and good morning everyone. Thank you for joining us today for our review of our second quarter 2019 results and an update of our full year 2019 outlook. I'm joined this morning by Steve Cahillane, our Chairman and CEO and Amit Banati , our Chief Financial Officer.

Slide number 3 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 this third slide of the presentation as well as to our public SEC filings. A replay of today's conference call will be available by phone through Thursday, August 8. 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 outlook unless otherwise noted, we will be referring to them on a currency neutral basis for net sales and on a currency neutral adjusted basis for operating profit and earnings per share. And now I will turn it over to Steve.

Steve Cahillane, Chairman of the Board and Chief Executive Officer

Thanks, John and good morning everyone. In a business turnaround, there is nothing more important, -- to continuously report back to our share owners that we are executing our strategy as planned and that we are delivering our results as planned and that's exactly what I had the opportunity to do here today.

There is no more compelling evidence of this than in our organic net sales growth, which is shown in slide number 5. Ever since we pivoted in Q4 2017 from our cost reduction phase and into and invest for growth phase, we have been committed to and demonstrating a gradual improvement in organic net sales growth.

This is absolutely critical for long-term profit growth. It has required heavy lifting, we had to exit DSD and free up resources .We had to revitalize brands through repositioning and investment. We had an innovation pipeline that had to be refilled. And we had to shift our portfolio to faster growth categories and markets. And it's working. Q2 was the purest example of this with organic net sales growth of more than 2% and it's not just that this is our best organic growth since 2016 or even since 2012 if you exclude the inflationary benefits of Venezuela in prior years, it's the fact that this growth was broad based with all four regions in growth. It's the fact that our enhanced capabilities in revenue growth management are yielding improved price realization in a year of notably high cost inflation.

It's the fact that our innovation launches are off to a great start and it's the fact that we are holding or gaining share in more of our categories than before. And what may be a surprise to many of you, it's the fact that we can post this kind of growth for the total portfolio even in a quarter when our closely watched US cereal business declined meaningfully amidst a pack size harmonization. This organic net sales growth is the truest sign that we're making strong progress in deploy for growth. But it's not only sign of progress in Q2. Slide number 6 shows some more elements that you should be aware of.

First, we've continued to reshape our portfolio. Just this week, we closed on the divestiture of our cookies, fruit snacks, pie crust and ice cream cones businesses. It's never easy saying goodbye to colleagues, but these brands are going to a more suitable home and Ferrero is truly a world-class organization.

For us the closing of this divestiture means we now have a portfolio that is more focused on our most advantaged brands and categories with a better growth profile and higher profit margins. Meanwhile, we continue to expand in emerging markets, particularly through snacking not only because of successful acquisitions and partnerships, but also from geographic and product line expansion. We posted another quarter of good growth in Russia, we grew double digit again as we expand in West Africa and the Middle East and we continue to grow strongly in Brazil, led by our parity business.

Second, we've seen improved in-market performance in developed markets as well. In particular, we are pleased to see the momentum in key snack brands that we knew we had to revitalize, we'll talk more about these later. Third, our improved innovation pipeline is bearing fruit as we told you our net sales from newly launched products in 2019 will be the highest in at least four years. But more importantly they're doing well, particularly on new food platforms like Cheez-It Snap'd. Fourth, we've continued to grow on the go offerings, remember this was a key priority for us as we take advantage of this growing occasion. We had another strong quarter of consumption growth in key US snacks categories and we continue to use single serve to reach affordable price points in emerging markets.

Fifth, we've realized price as I mentioned, this was important in an environment where we are facing our highest cost inflation in years, but it also gives you a read on how much we've improved our capabilities in revenue growth management.

And lastly, we've realigned our business I touched on this earlier, but it bears repeating, because this isn't easy. Extracting stranded costs requires a complete re-arranging of organization and processes and you should feel good that we are proactively and immediately addressing this. We also took the opportunity to restructure our European business, both should add to the agility and speed we have been seeking to enhance. So another eventful quarter with continued progress.

The profit will follow, particularly as we get past the initial heaviest investments as we start to surmount our accelerated cost inflation in challenging cost comparisons, but we're building for the long term and we like where we're headed. With that let me turn it over to our new CFO, Amit Banati who will take you through our financial results and outlook in more detail. Amit.

Amit Banati, Senior Vice President, Chief Financial Officer

Thanks, Steve and good morning everyone. First, let me start by saying that it's an honor and privilege to be here today on my first earnings call as CFO. I look forward to working with you all.

Our Q2 and first half results are summarized on slide number 8. Context is important here. Since late last year we've been telling you how 2019 would play out. We said that organic net sales growth would improve gradually as revitalized brand sustain momentum as price realization improves and as Multipro anniversaries and starts to contribute to organic growth. That is certainly playing out as Steve just discussed.

We said the gross margin would be down year-on-year, especially in the first half, owing to tougher input cost comparisons and the fact that our On the Go pack format margins remain a year-on-year negative until major corrective actions kick in during the second half. But we told you we'd see gradual sequential improvement in gross margin and that's exactly what we saw again in quarter two. We said that the result of these factors would be year-on-year decreases in operating profits during the first half, returning to growth in the second half, excluding any divestiture impact.

If anything, our operating profit declined less than expected in both Q1 and Q2, affording us the ability to better balance what was already a back-weighted plan. And we noted particularly difficult year-on-year comparisons for tax rate during the first half, further, adding to this first half, second half disparity on earnings per share. And again through the first half we are actually a little ahead of our EPS expectations.

Finally, on cash flow, we said that we would likely be flat year-on-year before any divestitures or related business realignment charges and outlays. Through the first half we are ahead of last year on cash flow. So our Q2 and first half results are clearly in line with our stated plan and they give us increased confidence in our full year outlook.

Let's now go into a little more detail. I'll start at the top of the P&L, with net sales growth and slide number 9. Steve covered this pretty well already pointing out that this Q2 performance was our best organic growth in some time. I'll just point out a few other items to consider as you model us. One, the organic growth was broad-based. As already mentioned, we generated organic growth in all four regions. Among our categories globally, snacks led the growth, but we also grew in frozen and in noodles. Cereal was down, mainly because of our US business but it continue to grow in emerging markets. So we feel pretty good about our foundation for growth.

Two, we have executed revenue growth management actions across the globe and across categories over the past two to three quarters, including in quarter two. So there is a near-term relationship between the decline in volume and our positive price mix. We would expect them to balance out a bit as we get into the second half. Three, Multipro's consolidation which we treat like an acquisition from a reporting standpoint anniversaried on May 2nd during Q2. So that is now in our organic basis net sales. Starting in Q3, we will start to see the impact of our divestiture, which depending on seasonality will reduced reported net sales by roughly 4 to 5 percentage points in Q3 and Q4.

And four, currency translation has been more negative than we anticipated, though this pressure should moderate a bit in the second half as we start lapping last year's US dollar appreciation. To wrap it all up and we are up 1.3% year-on-year on an organic basis through the first half, which should give you confidence in our full-year forecast for net sales growth of 1% to 2% both on a currency neutral basis and on an organic basis.

Now let's turn to our gross profit margin on slide number 10. As we have communicated previously, we expect our gross margin to decrease year-on-year in 2019 but for this decline to moderate as the year goes on. That's what happened in Q2 when our gross margin decline moderated from Q1's decline. Let's look at each of the three buckets, we've been using to explain this margin pressure.

The first is mechanical. About 40 basis points of this decline was simply the mechanical impact of consolidating Multipro for one month in the quarter in April, in which we were not yet lapping the consolidation last year. As we get into the second half, our divestiture provides a small positive benefit.

The next bucket is what we call growth-related. As in recent quarters, this bucket was negative year-over-year. Once again, most of the growth-related impact in quarter two was related to the mix and cost impact of our shift towards emerging markets and notably toward On the Go pack formats in our North America snacks categories. As you know, we have taken some steps to mitigate this impact such as SKU rationalization and revenue growth management and we did see sequential improvement. But the bigger thrusts [ph] such as centralized packing centers and repatriating some co-pack volume don't begin to yield benefits until the second half. That's why we expect to see less negative impact to this overall growth-related bucket in Q3 and maybe even a positive swing by the fourth quarter.

The final bucket is what we call ongoing. As we've discussed previously, we not only have higher input cost inflation in this year, but we also comparing against notably favorable hedges last year, especially in the first half. This too is a pressure that is expected to moderate slightly each quarter. Again, none of this is new news. And we expect continued sequential improvement in gross margin performance.

Multipro's negative mechanical impact is behind us and will be replaced by modestly positive mechanical impact of our recent divestiture. The revenue growth management actions that commenced in quarter four 2018 have been fully implemented and actions to restore profit margins on our On the Go pack formats are well underway and input cost inflation gets slightly less negative.

Now let's move below the operating profit line turning to slide number 11. As we have discussed previously, we faced some headwinds on these below-the-line items in 2019, particularly in the first half. So that's what we saw again in quarter two. Interest expense, for example, was a modest year-on-year headwind because the year ago quarter did not have a full three months of borrowings for our additional stakes in Nigeria.

Other income is down year-on-year as we had indicated because of the impact on pension expense, mainly due to a pension asset base that declined sharply with the financial markets last December. Once again, the biggest year-on-year headwind was on tax rate. Our effective tax rate in Q2 and in Q1 was in line with our full year guidance of approximately 21%. However, because of a sizable discrete benefit in the year earlier quarters this was a significant drag on EPS in both Q1 and Q2. This becomes less of a headwind in the second half. So again, none of this is new news and it's coming through as anticipated.

Before we get into our guidance for the year, let's discuss our recently completed divestiture shown on slide number 12. With the completion of the transaction, we continue to forecast a net negative impact on our full-year 2019 operating profit of about 4% to 5% from the absence of the divested business. As you know, we sold these businesses for $1.3 billion, or roughly $1 billion net of taxes.

As previously disclosed, we are using the net proceeds to reduce debt and we recently announced a tender offer for this purpose. This reduces our leverage and enhances our financial flexibility. Though the cost of the tender will largely offset the savings on interest expense this year. More important than how this transaction impacts our 2019 P&L is what it does for our overall growth and margin profile going forward for our overall growth and margin profile going forward, not only were these lower growth and lower margin businesses for us, but we can now focus more attention and resources on our best categories and brands.

So let's move to our 2019 full-year outlook and guidance which is shown on slide number 13. We are making no changes to our full-year guidance for net sales, operating profit and earnings per share and updating our cash flow guidance for the divestiture impact. Let's take a look at each currency-neutral net sales are still expected to be 1% to 2%. Just as we guided last quarter, in effect, the five months of divestiture in the second half offsets the four months multiple acquisition in the first half. Meanwhile organic net sales growth is still forecast to be 1% to 2% as well. Currency neutral adjusted operating profit expectations continue to be in the negative 4% to 5% range as we communicated last quarter because our operating profit finished ahead of our first half outlook.

We can now re-balance what had been a [ph] backwardated plan .This includes adding back investment to quarter three that was delayed from the first half as we brought on additional capacity and work through organizational changes and the divestiture and currency neutral adjusted EPS is still expected to be down 10% to 11% with debt redemption costs in Q3 largely offsetting interest savings. So no change to our full-year P&L guidance just increased confidence based on first half performance and clear or visibility on the recently closed divestitures impacts .

Slide number 14 looks at our cash flow guidance, from a cash flow perspective you may recall that last quarter we told you it was too early to call, given the uncertainties around the timing of our divestiture, the transition services plan and business realignment to address stranded costs. Now with the benefit of the divestiture transaction has been closed. We have increased visibility into cash flow expectations for the full year. From an accounting standpoint $1.3 billion of gross proceeds from the divestiture will show up outside of cash from operating activities, but the taxes paid on those proceeds are in cash from operating activities, that's approximately $260 million.

We'll also have the absence of the divested businesses cash flow for the remainder of the year and we will incur upfront cash costs related to the transaction and business realignment and restructuring. The net of all of this is that cash flow in 2019 temporarily dips to about $0.5 billion. The key thing to note is that the outlook for cash flow for our base business has not changed meaningfully. If anything, we are tracking towards the higher end of our previous base outlook range. Thanks to discipline on working capital and prioritization of capital expenditure.

At this point, we'll run through each of our businesses. Before I turn it back to Steve, it makes sense for me to go ahead and take you through our performance in AMEA.

Our Asia-Pacific, Middle East and Africa business is shown on slide number 16. AMEA had a particularly strong quarter in addition to one month of Multipro acquisition benefit, the region posted its strongest organic growth in a long time, up nearly 9% year-on-year. Multipro's continued growth had a lot to do with this as it became part of our organic growth in May. This business again posted double-digit growth in the quarter. Even more important for AMEA in the quarter was our Snacks growth led once again by sustained momentum and Pringles. This brand gained share collectively across the region and its net sales increased at a strong double-digit rate, led by growth in the Middle East, North Africa and Turkey sub region as well as in more developed markets like Australia and South Africa.

Cereal, sales were up across the region with the exception of Australia where shipment timing resulted in net sales being off slightly, but consumption remained in growth in Australia. Outside of Australia, our cereal net sales growth was broad based with growth in markets ranging from Japan and Korea to India and Southeast Asia. Importantly, in a rising cost environment, our price realization in AMEA was strongly positive in the quarter, reflecting good execution of revenue growth management so we saw good overall momentum in AMEA in the first half and we expect good growth in the second half as well. Let me now turn it back to Steve who will walk you through our other regions.

Steve Cahillane, Chairman of the Board and Chief Executive Officer

Thanks, Amit. Continuing with our international businesses. Let's discuss Europe shown on slide number 17.

Europe continued to grow in Q2 it's seventh consecutive quarter of year-on-year net sales growth and its growth was fairly broad-based across the region, even despite some developed markets with challenging retailer environments growth was led by momentum in Pringles whose consumption growth remained particularly strong in the UK and France benefiting from our Rice Fusion innovation and an effective commercial program around electronic gaming. This growth more than offset modest declines in wholesome snacks and cereal. Wholesome snacks, you'll recall is a business we set out to transform this year following a declining trend, while sales were flat in Q2 they are up year-to-date and innovation is performing well. So we like where this business is heading , particularly around Rice Krispies Squares. In Cereal, we continue to make sequential progress with only a small net sales decline in Q2 and even a return to growth in the key UK market.

Consumption in that Cereal market and across the region is stabilizing. Europe in Q2 also featured in another key element of our strategy. Growth in emerging markets. We recorded another quarter of double-digit growth in Russia and we continue to expand elsewhere in Central and Eastern Europe. So another solid quarter for Europe.

Latin America posted another quarter of net sales growth. As shown on slide number 18, growth in the quarter was led by serial who sales remain strong and was again led by continued momentum in Mexico consumption and share. We continue to execute well in this key market. Our Parati business continues to perform well, despite market softness in Brazil, we gained share in biscuits, and other key categories and we generated strong price realization. We couldn't be more pleased with the synergy progress we're making, both on the selling and the supply chain fronts. Pringles continues to outpace the category in Mexico.

However, we saw continued decline in Argentina related to economic and currency weaknesses and some temporary softness in Caribbean, Central America related to economic conditions and a distributor transition, but the brand remains in very good shape in most of the region. Profit was pressured a bit in the quarter by input costs, transactional foreign exchange and investment in capabilities, but we feel good about how this region is performing particularly on the topline.

So we expect continued growth in Latin America in the second half. Let's now turn to North America and slide number 19. It's not a small thing that we can show you net sales growth in our biggest region after several quarters in which improvement was masked by DST price adjustments, a product recall and even shipment versus consumption timing. We're past all that and what you're seeing in Q2 is the underlying growth showing through.

Some important elements to note about this net sales growth, first, shipments were right in line with consumption this suggest that last quarter's imbalance was really just one of timing. Second, price realization came through price mix was up nearly 3% year-on-year in North America, reflecting a full set of revenue growth management actions we started implementing in late 2018 in order to offset some of the accelerated cost inflation we are experiencing. T

Third, we grew even though our highly visible cereal business did not. This is true of net sales and consumption in the quarter and shows just how important our growing Snacks and Frozen businesses are to our North American portfolio.

And fourth, we're generating growth in our specialty channels. We are competing well in key categories, channels and customers. And there is plenty of opportunity here as we lean into putting our brands in key consumer occasions.

North America's profit remained pressured as expected by higher input costs and continued if moderating drag from On the Go pack formats and other mix shifts. However, North America's Q2 sales performance should give you the clearest sign yet that our strategy is working in this key market, just as it is internationally. We've launched better innovation, we've revitalized key brands, and we've executed revenue growth management actions. And we've done all of this amidst a major reorganization and divestiture.

Let's discuss each major category in a little more detail. We'll start with Snacks on slide number 20. Once again we generated strong growth in our five biggest snacks brands, the brands we revitalized with increased investment last year, an innovation that is shaping up to be our biggest launch here in a long time. The US consumption growth is shown on this slide. Cheez-It posted another quarter of double-digit consumption growth. The brand's core SKUs are growing and its on-the-go offerings are growing.

A highlight for the brand has been the success of our exciting new platform, Cheez-It Snap'd whose velocities are just as good as the overall brand and showing strong signs of sustained growth. Pop-Tarts is also sustaining its double-digit consumption growth in quarter two. This brand continues to grow its base business paired with a very successful innovation Pop-Tarts Bites, whose velocity is even exceeding that of the overall brand. Rice Krispies Treats returned to double-digit consumption growth aided by core SKUs and new poppers innovation.

Added capacity has been a key enabler as we are no longer supply constrained. Pringles continued its growth in consumption, even as it laps strong year ago gains. Growth has been aided by expansion of On the Go pack formats and our new wavy innovation. And RX has surged back into strong double-digit consumption growth restoring its distribution. These aren't just any brands. Collectively, they represent over 60% of our US measured channel consumption for snacks, a figure that goes up to nearly 75% when we exclude our now divested cookies and fruit snacks categories. So clearly, we have our North America snacks business in very good shape.

Let's now turn to cereal and slide number 21. As we've discussed previously, our pack-size harmonization was a strategic priority this year for what it does for making our aisle more easily shopable for enabling us to cross promote our brands and for revenue growth management. We knew it would create some disruption for us in the first half, though for competitive reasons we couldn't talk too much about it publicly, particularly since it involved pulling back on promotional activity. It did impact consumption during the first half.

On this slide, you can see how our promotional activity had to be pulled back in Q1 for our Taste-Fun segment brands, which were in the first wave of harmonization. In Q2, their activity stabilized and their consumption improved led by our key Taste-Fun brands, Frosted Flakes and Froot Loops. At the same time during Q2, you can see how we pulled back on promotion behind our Adult and All-family brands. A more recent four-week data show that we are already starting to restore normal activity.

The good news is that this is now behind us. As we get into the second half, we have a return to more normal brand building and in-store promotional activity and we like our plans. Frosted Flakes gets a new media campaign at the Special K. Honey Smacks re-launches with new food and new Pop-Tarts cereal gets expanded distribution. And we are relaunching Kashi Go and continuing to support Raisin brand. So we expect to see the declines in net sales moderate for North America cereal in the second half. And we will finish with frozen foods on slide number 22.

This business posted solid net sales growth in Q2 led by our veggie foods business. MorningStar Farms grew consumption in measured channels despite lapping a notably strong year ago performance, while also continuing to expand in unmeasured specialty channels. In Q2, we accelerated growth on our Chick and breakfast meat portfolio supported by increased media. This year's innovation, including the first ever Vegan Cheezeburger, as well as mini Corn Dogs and popcorn chicken offerings demonstrate how we are extending into more consumer occasions, from center plate options to snacking.

We fully understand the opportunities and dynamics emerging in this category and we are very excited about what we have in the innovation pipeline. Meanwhile, Eggo also grew consumption and net sales in Q2, despite tough comps. Growth in this strong brand has been aided by recent premium launches in French toast, as well as a new high protein offering in waffles called Off the Grid. In specialty channels, our new Confetti Eggo Innovation drove share gains in our K-12 school segment. So we feel good about our frozen business as well and expect to see continued growth in the second half.

So let's summarize on slide number 24. We are on strategy, deploy for growth, had us thinking differently, and investing differently. We have today a much different portfolio than we did, even just a couple of years ago, one that is shaped more toward growth. We have revitalized our Snacks brands and we continue to expand in rapidly growing emerging markets. We are doing what we said we would do. We're also on plan. Let me re-emphasize the point I made earlier. The deploy for growth and the investments behind it were intended to bring us back into organic net sales growth. As you can see on this slide, it's clearly working.

We're seeing a return to organic growth in each of our four regions. And the profit and cash flow will follow. Our top line is back in growth. We have realized price. We are addressing costs that have weighed down our gross profit margin and we expect to see continued sequential improvement in that key metric. We are now lapping the strong ramp-up of investments that started in late 2017 and we are so important for revitalizing key brands and enhancing capabilities.

We'll have a divestiture impact that will mask some of this improvement but our underlying profit performance will improve. And with this improvement will come higher operating cash flow and return on invested capital. We are also strengthening our balance sheet by using the divestiture proceeds to reduce debt. In closing, I want to be sure to thank and praise our employees. It has been a period of incredibly heavy lifting and their expertise, hard work, passion and creativity, are what is turning around this great company.

And with that, we're happy to take your questions.

Questions And Answers

Operator

(Operator instructions) Our first question comes from Michael Lavery with Piper Jaffray. Please go ahead.

Michael Lavery, Analyst

Good morning. Thank you.

Steve Cahillane, Chairman of the Board and Chief Executive Officer

Good morning, Michael.

Michael Lavery, Analyst

Could you just touch on how conservative you think your full year guidance might be. You mentioned obviously that it was -- your first half was ahead of expectations. But you also touched on some spending shifts. How should we think about -- are you airing on the conservative side in the second half? And also what if anything -- are you factoring in for your assumptions on something like Brexit?

Steve Cahillane, Chairman of the Board and Chief Executive Officer

Great, thank you for the question, Michael. I would not characterize our guidance for the back half of the year as conservative. I would characterize it as prudent. And it was always back weighted if you'll recall. So there is a significant shift in our profile from the first half to the second half. What gives us confidence is the return to organic net sales growth across all four regions and the fact that the investments that we put in place are working.

We did have a lot of disruption in the first half that we were anticipating. So if you think about what we've achieved despite a divestiture, despite a major reorganization in both Europe and North America, we are very proud and pleased with the performance of our people. But it gives us the ability to look at the second half and some of the investments that we didn't put in Q2, we are putting into Q3 to sustain the momentum but we believe it gives us a very good chance to achieve exactly what we said we would achieve but I wouldn't characterize it as conservative, I would say it's straight down the middle.

Then in terms of Brexit, obviously Brexit is -- it's still out there. We can't predict any better than anybody else exactly what will happen. There is a new Prime Minister, who seems very committed to Brexit and we continue to make the type of contingency plans that we've talked to in the past, but nothing new to report on that matter.

Michael Lavery, Analyst

Okay, thank you very much.

Operator

The next question comes from Tim Ramey with Pivotal Research Group. Please go ahead.

Tim Ramey, Analyst

Good morning. Thanks so much. I know the debt will be going down as a result of the divestiture but have you modeled what that should do to debt to adjusted EBITDA?

Amit Banati, Senior Vice President, Chief Financial Officer

Yeah. So I think you know, firstly a couple of comments on that. One is the tender -- so from a 2019 standpoint, the tender costs will offset the interest savings. So from a P&L standpoint we expect it to be net neutral. I think from a debt-to-EBITDA level, it will get us in the four range.

Tim Ramey, Analyst

Terrific, thanks so much.

Operator

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

Tom Palmer, Analyst

Good morning, it's Tom Palmer on for Ken. Thanks for the question. You had a sizable step-up in price mix this quarter versus last quarter. It didn't really seem to translate in full to the gross margin line as much as the magnitude of the step-up might have suggested. Why was this and should we expect a clear flow-through of this pricing to the margin line, as we progress through the year?

Steve Cahillane, Chairman of the Board and Chief Executive Officer

Yeah, thanks for the question, Tom. I'll start and then Amit can build on it. We are still -- the things that we've talked about in the past in terms of input costs and a strong inflationary environment, as well as mix continue to be the issues that we're facing. And as we've talked, we're going to see sequential improvement as we go throughout the quarters with the best performance in gross margin being in the fourth quarter and then entering into 2020. And so that hasn't really changed all that much.

We've had to shift some of our CapEx investments into capacity and away from On the Go, just as we stay agile and pivot based on strong demand in things like Rice Krispies Treats and Cheez-It and so forth to make sure we have the right levels of capacity. But you will see -- continue to see sequential improvement in the gross margin as we've discussed as we -- as we get into the back half of this year and into 2020.

Amit Banati, Senior Vice President, Chief Financial Officer

No, I think Steve you've covered it. I think the mechanical impact as I mentioned in my prepared remarks will turn favorable as we get into the back half. So that drag goes away. And then I think you know some of the actions we will have better comps versus a year ago and then some of the actions on the On the Go formats, such as the repacking centers, et cetera will come into play in the second half. So I think the combination of all of that will result in an improving trend in gross margins as we go through the year.

Tom Palmer, Analyst

Okay. And just to follow up on that and thank you for the color. A quarter ago you said you expected to exit the year with year-over-year gross margin growth. Is that still the case?

Amit Banati, Senior Vice President, Chief Financial Officer

Yeah, I think that would still be our expectation. I think you know, we remain on track with our major initiatives.

Tom Palmer, Analyst

Okay, thank you.

Operator

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

Chris Growe, Analyst

Hi, good morning.

Steve Cahillane, Chairman of the Board and Chief Executive Officer

Good morning, Chris.

Chris Growe, Analyst

Hi, I just had a question for you. As you look at the cereal promotional activity for your business obviously it was up and down and down during most of the first half. I'm just curious to know your expectations for the category. And does the category need to improve or do you expect the improvement to come from, say, market share gains, you think that's like a normal operating environment for your business.

Steve Cahillane, Chairman of the Board and Chief Executive Officer

Yeah, thanks for the question, Chris. Clearly, we did an awful lot in the price package harmonization efforts in the first half of this year, a very consequential redo of our price package architecture. And as I mentioned in my prepared remarks, we couldn't really talk too much about this and tip our hand in terms of, you're not going to go public and say, we're going to stop promoting. The category is currently running at about minus 1%. I think that's a reasonable forecast. We have been losing share as we've gone through this price package harmonization because of our significant pullback on promotions as we went through it. We are not in the shared donation business.

So we would expect to be back exactly where we would like to be, which is at a minimum growing with the category or staying right at the category at a minimum. But what I would tell you is just to kind of re-emphasize, despite the challenges and headwinds in the US cereal, the fact that North America was able to post a solid 1% growth despite this, we're very proud of the team and what they've gone through and what they did to deliver that type of result. And I think it really again shows the strength of the Snacks portfolio, the Frozen portfolio, the Specialty portfolio and the different balance they were achieving in North America and indeed around the world.

Chris Growe, Analyst

Thank you for that. I just had one other question. You've talked about pushing some investment into the second half of the year, we had modeled some in the first quarter, they have kind of got pushed to the second quarter, it sounds like some of that is getting pushed to the third quarter now. Do you have any frame of reference for how big that might be? And I guess really where that's focused as we have lots of interest.

Steve Cahillane, Chairman of the Board and Chief Executive Officer

Not really a frame of reference, but I think the focus would be on Q3 because it's about what we've heard from the first half of this year into the second half. We've got really good momentum in the top line. We definitely plan on sustaining that. So from a brand building standpoint, we'll be looking at the third quarter as a good opportunity to take some of that shift from the first half of the year.

Chris Growe, Analyst

Okay, thank you.

Operator

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

Robert Moskow, Analyst

Hi, thanks. I had a question about the transition services guidance here and how it continues into 2020. Amit, does that mean that you're getting TSA income in 2020 and that will continue, or does that phase out eventually in 2020 and create more dilution in 2020? I'm trying to -- I know we have dilution this year. I'm just trying to figure out how much to expect in next year and how it relates to that transition services?

Amit Banati, Senior Vice President, Chief Financial Officer

Yeah, so as I mentioned in my prepared remarks we forecasted a negative 4 to 5 full year OP impact, operating profit impact, as a result of not having the divested brand profits for 5 months. This impact may seem a little high but remember this was a very well integrated business and much of the indirect expense stays with us during the initial transition period, before we can start reducing that trade. We're not going to give guidance on 2020. There will be an impact, neck in 2020. But we are working through that as we finalize the TSA agreements.

Robert Moskow, Analyst

Okay. One quick follow-up. Promotional spending on cereal, you say you want to put it back to normal, will that put any pressure on your margins in the second half?

Steve Cahillane, Chairman of the Board and Chief Executive Officer

No, I wouldn't expect that puts pressure on our margins. There is a lot of noise in the first half because again it was such a consequential redo of our price package architecture. But you can think about us getting back to normal competitive levels and obviously for competitive reasons, we're not going to get into great detail around exactly what we're going to do.

Robert Moskow, Analyst

Okay. Thank you.

Operator

Excuse me. The next question comes from Jason English with Goldman Sachs. Please go ahead.

Jason English, Analyst

Hey, good morning folks. Real quick housekeeping, I missed your answer to how much income you're generating on TSAs per Rob's question?

Amit Banati, Senior Vice President, Chief Financial Officer

Yeah. So I think -- like we said for this year, right, the overall impact would be 4 to 5 on operating profit dilution of 4 to 5 and that includes whatever benefits we're getting from the TSA this year.

Steve Cahillane, Chairman of the Board and Chief Executive Officer

Which are very small.

Jason English, Analyst

Okay, so they're negligible. The TSAs are negligible. All right. And going back to another question in terms of the cadence of investment, I know last year was framed as an investment year, this year was framed again it's an investment year to get the top line working. Congrats on getting the top line working by the way, it's great to see the sequential improvement and building momentum there. I just, it's unclear to me where the investments are, with SG&A coming in substantially lower than last year and the same thing last year we had SG&A coming in light. What's driving the SG&A efficiency? What's happening with your brand marketing expense and where is this investment going into?

Steve Cahillane, Chairman of the Board and Chief Executive Officer

Yes, thanks, Jason. I'd say a couple of things. First, we are lapping a significant step up that started in the back half of 2017. And as I've said in the past, we feel pretty good about where we are from a brand building investment as a percentage of sales and will remain agile and we'll do the things necessary to put the right level of pressure behind the brands, but remember we're lapping a significant double-digit increase from 2 years ago and so that's got something to do with the SG&A efficiencies. We've also got a reorganization that's coming through. We've got overall really good zero overhead growth practices and good strict, we've good disciplines around overall cost. And so that's driving good SG&A efficiency. And as I said, some of it is deferred into the 3rd quarter as well, but if the question is do you have enough brand building and how do you like where you're at. I think we can point to our organic sales growth in all 4 regions and say that doesn't happen by accident, obviously it happen because we put the right capabilities in place, we put good pressure against good commercial ideas in place and you're seeing the type of results flow through on Cheez-It on Pop-Tarts on Pringles and RXBAR and so we'll continue in that vein.

Jason English, Analyst

Okay, thank you.

Operator

The next question comes from Laurent Grande with Guggenheim. Please go ahead.

Laurent Grande, Analyst

Yes, hi, good morning everyone and welcome Amit. Well just to pursue a bit on the last question, so you had actually ___1:01:23____ I mean the momentum building for brands like Pringles, Cheez-It and some others. What are the key drivers of that momentum in your view. I mean is it execution, more marketing, did you gain in penetration or repeat purchase? I'd like to understand this better to better assess the sustainability of that momentum. Please. Thank you.

Steve Cahillane, Chairman of the Board and Chief Executive Officer

Yeah, Lauren. Thanks for the question. I would say it's all of the marketing mix coming together in a really meaningful way underpinned by excellent execution. So if you take a couple of examples of that. Pringles in Europe, we are lapping the World Cup from 2 years ago, it would take a very good commercial idea to make that come to life and they came out with Rice Fusion as an innovation and gaming as a commercial idea and executed incredibly well and lapped growth, on growth and talking about lapping strong double-digit growth. Cheez-It in the United States.

You have Snap'd as a terrific innovation backed with very good commercial ideas coming through and you know and it's the right brand building that supporting those brands as well as innovation and then the On-the-Go offerings, which we always said, we're very under-indexed in, so it's targeting new channels in new occasions with the right commercial idea is the right innovation all bolstered by strong execution.

And so, we've done that in a lot of our portfolio and much of it is showing through in all 4 regions. We recognize, we still have work to do. The number one item under construction is US Cereal, but we're taking a meaningful and purposeful approach to that through the price package architecture and approaching it the same way that we've approached all those other big brands that I just mentioned.

Laurent Grande, Analyst

Thank you.

Operator

The next question is from Rob Dickerson with Deutsche Bank. Please go ahead.

Rob Dickerson, Analyst

Great, thank you. So just quick question on trajectory of the North America organic sales growth into the back half. I guess, obviously, while we appreciate the result in Q2 was great, right year-over-year. I think we do need to note that the year-ago compare was obviously materially, a little bit easier in Q2 relative to Q1. So as we get into Q3, right. If you have a little bit more brand support, maybe a little bit more innovations being pushed are kind of back on track in Cereal, so to speak. Like is the -- should we all be thinking that this kind of 1% or low-single digit positive growth trajectory should continue into the back half in North America or should we also be taking under consideration just kind of what the compares are relative to Q2. And that's it.

Steve Cahillane, Chairman of the Board and Chief Executive Officer

Yeah. Thanks for the question. We're not going to give any guidance on the regions. And I would just re-emphasize that we have a lot of confidence in our 1% to 2% reaffirming that top line guidance, we feel very good about the North American business, what's happening in Snacks, what's happening in Frozen, the RTEC we're past the big disruptions in the first half. And so we feel confident that the North American team is delivering and feel very confident that they'll continue to deliver.

Rob Dickerson, Analyst

All right, great. Thanks, Steve.

Steve Cahillane, Chairman of the Board and Chief Executive Officer

Thanks, Rob.

Operator

The next question is from Bryan Spillane with Bank of America. Please go ahead.

Bryan Spillane, Analyst

Hey, good morning everyone. Just 2 questions, I guess relative to cash flow. One is just the base business outlook for this year is now at the high end. So $1 billion and I know there's a lot of sort of transient issues that will knock that down for this year, but is that $1 billion still a decent sort of baseline that we should think about as we're looking forward. And I guess, second to that, just I don't know if I saw it or not, but just how CapEx changes now with the divestitures?

Steve Cahillane, Chairman of the Board and Chief Executive Officer

Yeah. So I think. I think that the $1 billion, is a good baseline and going forward, and I think on CapEx you that we do the ongoing prioritization of CapEx that you would expect us to do, I think, Steve mentioned, we think good demand in some of our, in some of our areas, and so we are prioritizing capacity to service the demand, but nothing really significant in change from a CapEx standpoint.

Bryan Spillane, Analyst

Okay, thank you.

Operator

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

Steve Strycula

Hi, good morning. So question on 2 of your larger acquisitions from the past 2 years in Multipro and Parati. How do we think about what Multipro is growing and it was only a month of inclusion organic sales calculus, but it appears like that must be growing at least 20% percent right now. And then what is really the strategy for growing Multipro and Parati in the respective markets that would be helpful.

Steve Cahillane, Chairman of the Board and Chief Executive Officer

Thank you. Yeah, I'll start and turn it over to Amit who obviously is close to Multipro as you can get. We're not strip out guidance or our results on those, but we're talking about strong double-digit growth. And what it really unlocks the similarity between Parati and Multipro is, it really gives us access to a broad based distribution with affordable locally relevant foods that resonate with the consumers there allowing us to build our portfolio on top of that. So that's the similarities between those two.

And the other similarities are both outstanding countries to be in Nigeria, with 200 million consumers growing middle class, vibrant economy and Brazil obviously also a very, very attractive emerging markets. So we like both of those acquisitions. We think both acquisition -- we don't think we are confident in both acquisitions, we'll continue to do well. They have done well. I don't know if there's anything you want to add?

Amit Banati, Senior Vice President, Chief Financial Officer

Yeah, just to give you a little bit more color on Multipro. I think if you kind of step back and look at it at our Africa strategy we decided the top 3 economies in Africa, Nigeria, South Africa and Egypt and we've made investments in all 3, that places us really well in terms of the Africa opportunity going forward. So I'd start with that, I think you know within Nigeria which is the largest economy in Africa we've made a number of investments. So Multipro is the distribution arm and the activation arm, we've also made an investment in Dufil, which is a leading food company in Nigeria. It's the number one player in Noodles which is the number one package foods category in that country and we have close to an 80 share in Noodles.

We've also set up a joint venture for Cereal and Snacks. We've launched Kellogg range of Snacks. We've put in a new manufacturing facility in Nigeria and that's off to a very strong start. We see a big opportunity on snacks in that market. The Snacks category is still forming and again we are well placed with the distribution that Multipro brings as well as our global snacks portfolio to shape that category in the next decade. So Multipro is one element, a critical element of our overall win in Nigeria and win in Africa strategy.

Steve Strycula

Great, thank you .

Operator

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

Andrew Lazar, Analyst

Good morning. I know we're running tight on time. So maybe just quickly Steve, if you could just remind me, because I know you've probably explained it before, just the benefits that you anticipate coming from the cereal pack harmonization, is it top line benefits, is it profitability, is it to the change the relative price points relative to sort of competitors or is it -- and is it part of the revenue growth management benefits that you're seeing or is it really completely separate from that. Thanks so much.

Steve Cahillane, Chairman of the Board and Chief Executive Officer

Yeah, thanks for the question, Andrew. I'd tell you a couple of things. It's really, it's starting with the consumer-first approach and aisle shopability and shelf shopability. Prior to the transformation, we had a very large number of different sized SKUs could not ship on the same pallets, could not display on the same pallets and looked awkward on the shelf next to each other. So, it allows for cross brand promotion, allows for better shopability. Yes, there is a benefit in the factories obviously, when you take out complexity in the number of SKUs, clearly that's in there. So there is a lot of meaningful benefits that accrue to the moves that we've made, but it really starts with the consumer first approach to making our brands simpler to shop.

Andrew Lazar, Analyst

Thank you.

Steve Cahillane, Chairman of the Board and Chief Executive Officer

Operator, I think we have time for one more question.

Operator

And that question will come from John Baumgartner with Wells Fargo. Please go ahead.

John Baumgartner, Analyst

Good morning, thanks for fitting me in. I wanted to come back to price mix and promotion in North America. I understand the moving parts around the cereal business but promo levels are also down across pretty much all the main categories in the portfolio and that's kind of in the trend for the past year or so. So how much of that movement in promo outside of cereal should we consider as kind of the new normal, given the revenue management activities, versus I guess how much of it is just still more kind of programming and timing related?

Steve Cahillane, Chairman of the Board and Chief Executive Officer

Yeah, John, thanks for the question. I think you probably should think about a lot of it being timing related. I wouldn't point to any meaningful change in the competitive landscape in North America in any of our categories. We are happy that we're seeing stronger base sales that's coming from the brand-building investments to good innovations, the momentum in the brands, and we have a brand -- a number of brands that are growing double-digits, obviously the retailers happy with that, consumers happy with that, we're happy with that allowing for that base business to continue to grow. But I wouldn't point to any significant change in the competitive landscape. We're just, we're feeling very good about where our brands are relative to the momentum, particularly in Snacks and Frozen and a clear understanding, a very clear-eyed understanding of what we need to do in US cereal to get to a better place as well.

John Baumgartner, Analyst

Okay, and then Steve, just on that the positive 3% price mix in North America for Q2, can you give any clarity there on how that splits out between price and mix? I mean is the mix a tangible benefit at this point in time?

Steve Cahillane, Chairman of the Board and Chief Executive Officer

Yeah, I think we're just looking that up. I think it's across, it's across price mix pretty even.

Amit Banati, Senior Vice President, Chief Financial Officer

Fairly balanced between price and mix.

John Baumgartner, Analyst

Great, thank you.

Operator

This concludes our question-and-answer session and the conference is also now concluded. Thank you for attending today's presentation. You may now disconnect.