Q1 2020 Earnings Call

Company Participants

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

Other Participants

- Alexia Howard, Analyst
- David Driscoll, Analyst
- David Palmer, Analyst
- Ken Goldman, Analyst
- Michael Lavery, Analyst
- Robert Moskow, Analyst

Presentation

Operator

Good morning. Welcome to the Kellogg Company's First Quarter 2020 Earnings Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be the question-and-answer period. (Operator Instructions) Thank you. Please note, this event is being recorded.

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 {BIO 19769692 <GO>}

Thank you, operator. Good morning, everyone, and thank you for joining us today for a review of our first quarter results as well as our outlook for 2020. I'm joined this morning by Steve Cahillane, our Chairman and CEO; and Amit Banati, our Chief Financial Officer.

Due to the pandemic and measures to stay safe, we are calling in from multiple locations and even time zones. So hopefully, technology will carry the day and we'll all hear each other clearly throughout the call.

Slide number three shows our 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, May 7th. The call will also be available via webcast, which can be archived for at least 90 days on the Investor page of kelloggcompany.com. 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'll turn it over to Steve.

Steven Cahillane {BIO 4718688 <GO>}

Thanks, John, and good morning, everyone. Obviously, these are unprecedented times and our hearts and thoughts go out to the families affected and lives disrupted by the coronavirus pandemic. And I sincerely hope you and your families are staying healthy and safe.

Today, we'll share with you what we're doing to keep our employees safe and the market supplied with food and how we are giving back to the community. These are the priorities right now. Obviously, it has been nothing close to business as usual over the past few weeks and is not likely to be business as usual for some time. That said, we're pleased with the direction our business was going prior to the crisis and we're proud of the work we've done to manage the business during the crisis.

Today, we'll discuss how the crisis has impacted our results and give you a sense of how we think the rest of the year could play out. And we'll reassure you that while managing through this crisis, we are also taking prudent steps to ensure stable and dependable performance now and in the future.

So, let's discuss our priorities during the crisis, starting with Slide Number 5. Our first priority, of course, is to keep our employees safe. We acted quickly to protect our employees, taking a global crisis management approach. We invested in incremental safety supplies, personal protection equipment and cleaning protocols across our facilities. We took measures like temperature checks and social distancing protocols in our plants and distribution centers.

We provided recognition bonuses and enhanced benefits like leave policies for our plant and distribution center employees. We implemented travel and meeting restrictions followed by work-from-home policies, investing in technology to make this possible. I meet daily with my leadership team to monitor, assess and make timely decisions and we are having regular worldwide updates via video conferences with all employees. Safety will continue to be our highest priority.

Our next priority has been to ensure we are supplying food to the marketplace as captured on Slide Number 6. As a food manufacturer, we have a unique role and responsibility during this crisis. Our beloved foods and brands are sought by consumers worldwide, making it so important for us to find ways to get our products to them.

Fortunately, governments have established that food is designated as an essential service and we are collaborating closely with them. As a result since late February, we've been able to run our plants at full capacity in most markets around the world, increasing production by focusing on key items. We are working closely with our retailers to get them what they need.

We've invested in additional warehouse space, redeployment of inventory and increased access to transportation. We've deferred certain commercial activations and product launches, and we've invested in technology to support critical business and finance systems. I couldn't be more proud of the way our supply chain has responded to these challenges. It hasn't been easy. This is what required a lot of extra planning, problem solving and investment and execution.

Another priority during the crisis has been aiding our communities, as depicted on Slide Number 7. We pride ourselves for being a company with heart and soul and we have stepped up our giving during this crisis, helping our food bank partners and neighbors in need during this pandemic.

Local governments have specifically called out food security as a top priority in their fight against COVID-19. And so aligned with our Kellogg's Better Days program to address food insecurity around the world, Kellogg and our charitable funds have donated more than $10 million so far in food and funds to fund global COVID-19 food relief efforts.

Around the world, we are donating to everything from local food banks and school feeding programs, to childcare centers, hospitals and senior care centers. All of this is completely consistent with Kellogg's heritage and values, which makes this company truly special.

So let's turn to Slide Number 8 and put this into the context of business performance and financials. Prior to and during the accelerated global spread of the coronavirus, our base business is performing very well. We accelerated our organic net sales growth, even excluding the estimated impact of the pandemic in March and we have continued to make progress toward offsetting mix headwinds and sequentially improving our gross profit margin.

And as promised, we had boosted our brand-building investment behind targeted brands and categories around the world. We feel as strongly as ever that our Deploy for Growth strategy is working. Then, of course, the crisis hit and redirected our focus and plans. You've all seen the scanner data notably for the United States and Western Europe, which showed a sharp acceleration in consumption growth, beginning around the first and second weeks of March.

Since that time, we have been focused on producing and shipping food. Most of our plants have ramped up their production, while in some emerging markets, restrictions and logistical challenges prevent us from running at full capacity. While shipments have accelerated so has our investment in our plants for safety and for our employee appreciation and benefits. And in our logistics for incremental warehouse space and transportation.

From a brand investment standpoint, many of our second quarter commercial activities as well as product launches have been delayed to the third and fourth quarters. So where does this put us for the rest of the year? How long the crisis persists? And how quickly we can return to business as usual, operations and commercial activities is obviously unknown at this point.

So far in quarter two, we're seeing elevated, a slowing at-home consumption, partially offset by severe softness in away-from-home channels, a slowing in certain emerging markets, high investment and utilization in our supply chain to get food to the marketplace and less commercial activation and innovation activity, as we and our customers focus on getting food on the shelf.

Obviously, the third and fourth quarters are harder to predict. For now, though, we are prudently assuming economic softness and investment shifts to create a profit offset to the first half. Beyond the factors we cannot control, we are prepared to weather the crisis. Our employees are engaged and working to stay safe. We are supplying the market as best we can and our financial health is solid.

We're also taking a very close look at our plans in the event of a prolonged global economic slowdown. We've studied what worked well and we did not, in past recessions, and how this one could be different for the globe and for our portfolio. We strongly believe that our Deploy for Growth strategy with its focus on occasions, growth portfolio, world-class brands and service has us well prepared for making any necessary adjustments.

So with that, let me turn it over to Amit, who will take you through our financial results and outlook in more detail.

Amit Banati {BIO 16339861 <GO>}

Thank you, Steve, and good morning, everyone. Clearly, our financial results and outlook have been affected by the pandemic. So, I'll do my best to sought through the financial puts and takes.

Slide Number 10 outlines our financial approach since the crisis began. Employee safety is the top priority and we have invested in this area, in safety supplies, temperature checks and incremental cleaning protocols. Additionally, we invested in information technology to facilitate working remotely. To supply the market with food, we've had to increase production quickly, focusing on priority SKUs, and rewarding our people with bonuses and benefits. In addition, we've invested in logistics to get food to our customers as quickly as possible. We've also worked to ensure financial flexibility.

As you know, we had already been focused on reducing our debt leverage this year. And this becomes even more important in an environment of economic recession and volatile financial markets. We continue to have good access to commercial paper markets and we have built up our cash balances around the world. We've also been proactive about locking into lower interest rates, reducing our long-term cost of debt.

Meanwhile, we remain committed to investing in the future. The crisis has forced us to defer some commercial activity and investments to the second half. But excluding the divestiture, we did increase our brand-building year-on-year in quarter one, mostly before the crisis really hit us in March.

Now turning to Slide Number 11, let's look at our financial results for the quarter. Obviously, there are a few moving parts. So, I'll do my best to bucket them. First, our base business continues to perform very well. Even before and excluding the pandemic impact, our organic net sales growth was strong, even ahead of our expectations.

We were also making progress toward our 2020 objective of stabilizing gross profit margin in spite of accelerated mix shifts towards emerging markets. And importantly, we had kicked off the incremental advertising and promotion investments that we had announced a few months ago.

The second major factor is something that was already behind us, our divestiture at the end of July 2019. As we had indicated previously, quarter one is the seasonal outlier for the divested business, owing to its Girl Scouts cookies. So in Q1, the divestiture impacted our year-on-year net sales growth by negative 9% to 10% and our operating profit growth by about 12%.

The next factor is the pandemic. The surge in demand for packaged foods from increased at-home consumption started in early March. This probably contributed approximately half of our organic net sales growth in quarter one. The additional sales growth drove profit growth at lower margins due to increased costs and investments around safety, logistics and IT, as well as decisions made that affected our base business. As you know, the crisis did trigger a sharp strengthening of the US dollar against key foreign currencies, creating a much larger-than-expected negative impact on our reported results.

Lastly, on earnings per share, we saw the expected pension expense benefit from a higher year-on-year pension fund asset valuation at the beginning of the year. And while our decision to prioritize debt reduction did decrease our interest expense as planned, our shares outstanding did float higher. The result of all of these is an earnings per share that came in well ahead of pace, but that we feel is largely timing related as we'll discuss in a moment.

Importantly, our cash flow is also well ahead of pace, which is important, as we prioritize financial flexibility going into an economic slowdown. So the results are affected by the pandemic and other factors, but we'll walk you through them in a bit more detail.

Let's start at the top of the P&L, with net sales growth on Slide number 12. On organic basis, net sales growth surged to 8% year-on-year in the quarter. We estimate that the pandemic impact drove about half of this growth, suggesting our base business grew at a rate of about 4%. In other words, even excluding the pandemic impact, our base business was accelerating a growth sequentially yet again. Volume growth surged to more than 8%, led by the pandemic-related orders, as well as by a particularly strong quarter of Multipro, the distribution portion of our business in West Africa.

This mix shift towards Multipro is a big reason our price mix was slightly negative in the quarter. In fact, while the mix for the total company was negative, pricing remained positive. Our organic net sales growth was across all four regions and across all four category groups within each region; snacks, cereal, frozen foods and noodles and other.

The divestiture impact we already discussed. Now that we have past lapping Girl Scout season, this divestiture impact will be less negative. With quarter two's impact looking like 2019's quarter four negative 5% to 6% impact and quarter three, only a partial quarter of impact, more like negative 1% to 2%. As I mentioned, currency also turned more negative on us in quarter one, as the dollar strengthened against key currencies as the pandemic hit. Based on forward rates, we can expect this to be even more of a headwind going forward.

Now let's turn to gross profit margin on Slide Number 13. As we've discussed previously, our goal is to continue to sequentially improve gross profit margin, finishing 2020 at a stable level year-on-year. This requires offsetting underlying input cost inflation, as well as some natural mix shifts in our portfolio, most notably a mix shift towards emerging markets. And within those markets, towards the distribution arm of our operations in West Africa. These mix shifts are not a concern, as they do not cannibalize any of our Developed Markets businesses.

To offset the impact, you know that we've been working on several levers; price realization through revenue growth management, productivity through a variety of initiatives, building scale in emerging markets and addressing margins in specific product lines, most notably on the Go pack formats.

While Q1 was anything but business as usual, we did continue to make progress in this area. As you can see, our gross profit margin was nearly flat year-on-year, aided by the absence of the divested businesses as well as the actions I just listed. Some of this progress was offset by input cost inflation. Remember, we are hedged out most of the year and costs and investments related to safety and cleaning, employee benefits, food donations and logistics during the pandemic.

This crisis will create some variability around gross profit margin as we incur incremental production and incremental costs, but we will continue to make progress towards our full-year goal.

Let's turn to cash flow and capital structure on Slide Number 14. As shown on the slide, our cash flow was strong in quarter one, up significantly year-on-year despite the absence of businesses we divested last July. Some of this was timing from quarter four and some of it was inventory depletion and delays of capital investment during the pandemic. But it also reflects strength in our underlying profit performance, good working capital management and reduced cash outlays related to restructurings.

The next chart on the slide shows our net debt position. You can see that a combination of last year's divestiture proceeds and durable cash flow have enabled us to pay down debt and carry higher than usual cash balances. In fact, you will see that our cash position was over $1 billion at quarter end. This is simply a proactive approach to financial flexibility in an uncertain operating environment.

Our liquidity is good. In addition to our high cash balances, we retain good access to commercial paper. And we have $2.5 billion of back-up funding facilities. We are in solid financial shape with sufficient flexibility.

Let's now discuss our full-year outlook, starting with Slide Number 15. Our outlook really should be viewed in three time periods. First, there are the actual results of quarter one. Clearly, these results came in better-than-expected, both because of how our underlying business was performing and because of the surge in at-home demand brought on by the pandemic.

Next, there is quarter two. The pandemic has obviously persisted and so far in April, we have seen continued elevated levels of at-home assumption. There may be less net sales lift as consumption growth has moderated, even as food away-from-home channels remain very soft. We should see positive operating leverage from running our plants at high utilization, partly offset by incremental labor and logistics costs to do so.

And then there is quarter three and quarter four, the second half of the year. Of course, no one knows how long the pandemic and related lockdown will persist. At this time, the best we can do is prepare for a correction, back to normal rates of consumption in developed markets, albeit with away-from-home channels that will take some time to recover. In addition, we'll have increased brand-building and other investments that have been delayed from the first half and we have to be ready for potential softness in emerging markets, which tend to be more vulnerable to recessionary impacts and whose currencies have already weekend. In fact, we saw slowdown in currency devaluation in certain emerging markets already in late Q1. So, we expect to see a shift to sales and profit into the first half and out of the second half.

You'll see on Slide Number 16 that we are firming our full-year guidance today. We think this guidance is the prudent way to plan right now as we manage through the crisis. Organic net sales growth will slow in the second half. The question is how much, and whether it slows enough to offset the unusually strong growth of the first half.

Currency-neutral adjusted basis operating profit has the additional variables of shifting investment from the first half and our desire to retain some flexibility to invest more in business opportunities as they present themselves. Because net sales and profit are now first-half weighted and well ahead of our full-year pace through quarter one, it would suggest some bias to the high-end of our currency-neutral sales and profit guidance ranges.

As you would expect, however, this guidance does not include two uncertain elements. First, it does not include any major supply or economic disruptions. This would be something like a plant or warehouse shutdown related to the pandemic. Or it could be any significant macroeconomic volatility beyond what we've already experienced. We are in unprecedented times, and we can only guide based on what we know right now.

And second, remember that all of our guidance is on a currency-neutral basis. The pandemic and oil shocks triggered a marked strengthening in the US dollar against major foreign currencies late in quarter one in both emerging and developed markets. This impacted growth in net sales, operating profit and EPS growth by negative 1% to 1.5% in the quarter. And that's really only reflected less than a month of impact. A full quarter of these exchange rates would have had that much more negative impact. Obviously, we can't predict where the dollar will go from here, but this can give you an idea of the magnitude of this recent currency moves.

And with that, let me turn it back to Steve, for a review of each of our major businesses.

Steven Cahillane {BIO 4718688 <GO>}

Thanks, Amit.

Eventually, this crisis will pass and we are doing everything we can to ensure that we emerge right where we thought we'd be. Our strategy is working, even as we have to modify commercial activities and what has been essentially a supply-driven market in recent weeks. In addition, we're doing a lot of thinking and analyzing about how the crisis is generating trial and reappraisal of some of our brands and foods, including, for example, ready-to-eat cereal.

Let's begin with North America and Slide Number 18. Last July's divestiture is what pulled down adjusted basis, net sales and operating profit by roughly 14% each. Excluding that, this region posted very strong growth in net sales and operating profit. North America had recorded organic net sales growth through the February period against year earlier growth and was on its way to a good first quarter with another quarter of sequential acceleration.

Then came March, when the stay-at-home mandates went into effect and we saw a market acceleration in this growth. In the end, we estimate that this pandemic-related surge in demand accounted for about 0.75% of our North American regions organic net sales growth in Q1. Our consumption growth well outpaced our net sales growth in March and the quarter overall, suggesting meaningful depletions of retailer inventories.

Not everything has seen a lift during the pandemic. Our business in Foodservice, vending and convenience stores experienced sharp and sudden net sales declines in March, as schools and restaurants closed and travel came to a halt. And that softness continues.

Nonetheless, the accelerated net sales growth drove up operating profit in our base business, which excludes the impact of divestiture. And this was despite increased brand-building investment in the base business and incremental costs and investments related to keeping employees safe and enabling our supply chain to keep up with demand.

Let's take a quick look at each of our three major category groupings in North America, starting with our largest, snacks, on Slide Number 19. This is the business affected by the divestiture. But on an organic basis, its net sales rose almost 11% year-on-year. Snacks organic growth was already strong going into March, driven by solid commercial programs and here-to-support [ph] for Cheez-It Snap'd, and then the business got an extra boost from accelerated consumption growth. During March, US consumption for our crackers jumped almost 40% year-on-year and our salty snacks and portable wholesome snacks were both up nearly 30%.

This consumption growth has been broad-based across our portfolio of brands. From an occasion standpoint, we have seen less lift for on-the-go items and more growth for pantry packs, which makes sense. We feel good about the positioning and strength of our North America snacks business as we work daily to keep up with demand.

Now, let's turn to North America cereal and Slide Number 20. Here too, we saw market acceleration in US consumption growth in March, plus 43% year-on-year. Beneath that category-wide and portfolio-wide acceleration were the early stages of our step-up in brand building investment. It's too early to see the results of these efforts, particularly during March's acceleration. But we're pleased to see share growth in the Taste/Fun segment. Importantly, cereal is one of the food categories whose consumption has remained at very elevated levels, even after the couple of weeks of consumer stock-ups. An interesting thing to watch will be how this stock up and elevated consumption is driving trial and reappraisal of this category.

Take a look at Slide Number 21. US household penetration data showed that our cereal brands collectively gain more than 3 points of penetration in March versus February and did this against all cohorts, whether by age group, income level or households with or without kids. As I mentioned, this is something we're studying closely and looking to build upon. We know that our cereals are getting into the pantry and that they're getting consumed. They are iconic brands, great food, versatile across occasions and a great value for money. Consumers rediscovering these benefits could be very positive for this category and we plan to seize this opportunity.

Now, let's turn to our North America Frozen Foods business and Slide Number 22. Our Eggo brand have been generating strong consumption growth and share gains through February and then saw its US consumption accelerate to over 45% in March. The same is true for Morningstar Farms in our frozen veggie business. This on-trend brand was already showing strong double-digit momentum in consumption in the US, and then it's consumption growth shoot up to over 66%. As our retail partners work to keep shelves filled, many have delayed resets. So, we have delayed the first wave of our launch of Incogmeato, the Morningstar Farms sub-line of refrigerated meat alternatives.

Instead of launching the burger products at the end of Q1, we now plan to launch them along with the previously planned sausage products sometime later this year. North America had an unusual month, to say the least, and this unusual environment continues. We've shifted investment out of the first half, given the current situation and into the second half. And for now, we remain focused on supplying the market with food and keeping our people safe. It will be some time before condition stabilize. Nonetheless, we feel good about the underlying direction of this business and the years delivery just got much more front-weighted to the first half.

Now, let's discuss our international businesses, starting with Europe on Slide Number 23. Europe got out of the gates strongly in 2020, reporting solid organic net sales growth through our February period, both in snacks and cereal. With the pandemic stock-ups and elevated consumption in March, it got an additional lift, probably accounting for half of its growth in the quarter. Interestingly, the lift was far more pronounced on cereal than it was on snacks. Probably because the foods consumers were most stocking up on were meal related. But it could also have to do with the fact that Pringles had such strong momentum already.

Regardless, the quarter began and finished with growth across the region. In cereal, we generated particularly promising consumption, share and penetration gains through February in the United Kingdom and equally strong momentum in Russia. And Pringles recorded notably strong consumption in Germany, Spain and Russia. We still have some work to do on our smaller wholesome snacks businesses. But overall, Kellogg Europe has good underlying fundamentals.

We do expect much of this quarter one growth to reverse itself in the second half. The cancellation of major sporting events has taken away large promotional activities for us, starting in the second quarter and we are having to revise commercial plans, particularly around Pringles. Meanwhile, we have to be wary of the currency and economic impacts on markets like Russia, and the likelihood of prolonged softness in away-from-home channels. So, this is the region with the most substantial shift in delivery to the first half, but that shouldn't take away from what is a very strong performing region for us.

Let's now turn to Latin America and Slide Number 24. Latin America is a business that underwent some transition last year, and we are pleased to report that it continues to progress well on its distributor transitions and its ramp-up of new cereal and Pringles production facilities in Brazil.

Latin America's organic net sales growth pre-pandemic was quite strong, as was its consumption growth, notably for Pringles in Mexico and Brazil. Then like our other regions, albeit a bit later in the month, Latin America saw a surge in net sales in March, amidst the pandemic stay-at-home guidelines. The lift was probably about a fourth of Latin America's organic net sales growth in the quarter.

The uplift in March was more pronounced in cereal than it was in snacks, similar to what we've seen in Europe and has continued in April. Amidst an uncertain economic environment, we have a Latin American business that is managing well through the challenges.

And finally, we'll discuss EMEA shown on Slide Number 25. This region's organic net sales growth was exceptional, led by Africa. Multipro experienced a notably high-double digit gain, accompanied by strong growth in our Middle East, North Africa and Turkey sub-region and an encouraging share gain in South Africa. From a pandemic standpoint though, EMEA had less of a net positive impact than our other regions. We saw a sizable net sales lift in developed markets like Australia, Japan and South Africa, particularly in cereal.

However, we experienced production and distribution challenges in emerging markets, mainly in Asia and Africa. So for the quarter, the pandemic impact on net sales was probably less than a fourth of the region's overall organic growth. And it also added to costs. These challenges have actually gotten more severe in the second quarter, with certain plants in the region only able to produce at partial capacity according to local restrictions and distribution challenges in other markets.

In addition, Multipro is experiencing a meaningful slowdown already in the second quarter, feeling the economic impacts of the pandemic, the oil shock, retail closures and soft demand for non-food products that it distributes for other companies. So while temporary and partially offset by good growth elsewhere in the region, EMEA may see some pressure on its sales and profit during the remainder of the year. Nevertheless, this business is operating well and has outstanding growth prospects, once we emerge from this pandemic and related economic slowdown.

Let's wrap up with a brief summary on Slide Number 27. None of us has ever seen the likes of this pandemic. It has left us in a state of uncertainty, with a continuous flow of heartbreaking infection statistics and also heart rendering acts of courage and selflessness. We can only hope that this crisis passes quickly and that we can all get on with our normal lives.

As a company, we can only manage through the crisis in the right way, keeping our employees safe, supplying food to customers and consumers and giving back to our communities. I think we're managing these priorities well. And we feel good about our underlying business. We got off to a good start to the year even before COVID-19, sustaining our top line momentum, progressing towards stabilization of gross profit margin, investing in key brands and delivering strong cash flow.

We are confident that when the crisis abates, we will be on solid footing to resume with our strategy and plans. From a financial standpoint, our earnings are now more weighted towards the first half than originally planned, as the crisis has shifted sales into the first half and deferred investments to the second half. That's a better shape from a planning stance, even if the second half business environment is anything but clear.

Meantime, with economic recession looming, we are making sure that we have solid financial flexibility. We may be managing through an unprecedented crisis, but we remain committed to our strategy. As the world emerges from this crisis, you can be sure, we will continue to build our plans around a balance between sales growth, profit growth and cash growth over time. Always looking to make our brands and our company stronger.

In closing, I want to thank our employees for their dedication and hard work. There is nothing normal about the situation in which we find ourselves today and our employees have risen to the challenge, taking the extra steps necessary to keep each other safe, to supply the world with food and to give back to our communities. I could not be more proud to be a part of this great company.

And with that, we'll open it up for your questions.

Questions And Answers

Operator

We will now begin the question-and-answer session. (Operator Instructions) Our first question is from Michael Lavery with Piper Sandler. Please go ahead.

Q - Michael Lavery {BIO 20141239 <GO>}

Good morning. Thank you.

A - Steven Cahillane {BIO 4718688 <GO>}

Good morning, Michael.

Q - Michael Lavery {BIO 20141239 <GO>}

Can you touch on the promotional environment and trade spending and how much, if any benefit, are you getting? Clearly, there is such a strong consumer demand. It doesn't seem like the time-to-price promote. Are you -- do you have flexibility around that? And then, if so, how much of that just gets deferred or is there an opportunity for calendar year savings to come from that?

A - Steven Cahillane {BIO 4718688 <GO>}

Michael, thanks for the question. A couple of things I would tell you. First off, for competitive reasons, we don't talk about promotional activity. But what I can tell you is in the first quarter because the pandemic hit so late, it was really a normal environment in terms of pulling back of promotions, not executing commercial activities and so forth. Obviously, that changes as we get into the second quarter, which is why we're saying that the second half of the year will have some of the deferred investments from the first half of the year. But the first quarter looked a little bit more normal through really the first -- completely normal through the first two months. And it was really the last two weeks of March that saw the incredible changes, which was really too late to change the commercial activities that we had in place.

We did increase brand building in the first quarter, again, for the same reasons, we committed to doing that. So January and February, we were seeing good organic growth, good commercial activation, good pull-through from our programs, but obviously, everything changed once the pandemic hit.

Q - Michael Lavery {BIO 20141239 <GO>}

Okay. Thank you very much.

Operator

The next question is from David Palmer with Evercore ISI. Please go ahead.

Q - David Palmer {BIO 6061984 <GO>}

Thanks. Good morning. A question on how you think things are really going to be impacting your business ongoing into '21? If you were to think pre-COVID about '21 earnings and then now after the crisis, how are you looking at that year differently than you did before, in terms of say, earnings power? I would imagine that you're going to have some opportunities to do some brand-building investments this year that you might not have had. There might even be some positives in terms of the ongoing restaurant declines into that year, but obviously, you noted some other weaknesses out there like emerging markets and they have a negative hangover. So, any thoughts about broad strokes impacts to '21 beyond? Thanks.

A - Steven Cahillane {BIO 4718688 <GO>}

Yeah, David. Thanks for the question. Right now during this pandemic, we're really focused on employee safety, supplying food to the marketplace and aiding our communities when they need it most. This has created an opportunity to invest in our business in the second half. How that affects 2021? It's far too early to tell. But we do see opportunities where our products are getting into homes, penetration is going up, consumption is going up.

So, we're going to continue to invest in our brands, invest in our people, invest in our business, invest in our company, all with the goal of coming out of this pandemic with a stronger company than we go into it. But it's far too early to really talk about what the 2020 environment might look like.

Q - David Palmer {BIO 6061984 <GO>}

Okay. Thank you.

Operator

The next question is from Ken Goldman with J.P. Morgan. Please go ahead.

Q - Ken Goldman {BIO 15002920 <GO>}

Hey. Good morning, everybody. I'm wondering if you can help us -- I know it's not easy, but maybe estimate the dollar cost of your direct COVID expenses, things like bonuses, cleaning, et cetera and how that looks heading into 2Q? And I'm really curious how much of that is one-time versus ongoing? Because very clearly, I think, across the board versus what some people expect in a month ago in food, maybe the flow through from sales to EBITDA has been a bit more restrained than what some people had modeled a few weeks ago.

Obviously, efficiency efforts are put on hold. It's critical to produce volume with, I guess, less regard than usual for margins. But I do think investors are sort of asking for a better sense of how much of these current incremental costs are truly one-time and fade, as we get into the back half versus things that are going to be ongoing for a little bit? I know it's a hard question to answer, but at least, with the visibility you have so far, I think it would be useful perhaps.

A - Steven Cahillane {BIO 4718688 <GO>}

Yeah, Ken. Thanks for the question. Obviously, there are one-time direct costs that hit us, as we started to prepare ourselves for the pandemic, things like employee bonuses and benefits to our heroes on the front line to make sure that they're safe and that they're being rewarded for what they're doing for their communities and for our customers and so forth.

Warehouse and logistics costs, obviously, going up when you're -- when you see demand spikes like this, you have to invest to make sure that our customer service is as high as we can possibly make it and a shout out to our customers. I mean the environment and customers in the way that they've leaned in and almost -- what I call the esprit de corps among the whole industry has been really inspiring to tell you the truth.

And then safety. Just safety protocols that are different than what they've been, PP equipment and so forth, operating in environments with social distancing, changing the way the shifts go in and out. All these things are costs that many will be one-time in nature, as and when this pandemic is over, when a vaccine is in place, when we're back to a normal environment site.

So to be a little bit more direct with your question, you can think about roundabout $10 million in the first quarter for us in direct costs related to the things that I just described. Obviously, that was the end of the -- just the end of the first quarter, so that will be higher in the second quarter. And so that's the way we're looking at it. We're not going to make any compromises. We'll make the right level of investments to keep our people safe. That's the most important thing.

A - Amit Banati {BIO 16339861 <GO>}

I think if I could just add from a ForEx standpoint, most of the transactional ForEx we were covered. So, I think from a transactional standpoint, the impact of ForEx was limited. However, from a translation standpoint, as you well know, the dollar strengthened sharply and that was right towards the end of the quarter. So, that's something that we'd expect to have more of an impact as we go through the year.

Q - Ken Goldman {BIO 15002920 <GO>}

Yes. That's helpful. Can I ask you a very quick follow-up? I think, Amit, you had said that you are assuming that in the second half, away-from-home is weaker still, but food-at-home is just back to normal. So first, is that correct? And second, I'm not sure why that would be the case, I guess. It feels a little conservative to me to assume that away-from-home is weaker but food-at-home is just back to normal. Wouldn't it maybe stand to reason that food-at-home would be a little bit better, if people are eating at home a little more?

A - Amit Banati {BIO 16339861 <GO>}

I think it's fair to assume that foodservice was taking longer to ramp back up. So, I think that's an assumption going into the second half. I think, emerging markets, we are starting to see softness in the emerging markets. So, there is an assumption that emerging markets in the second half would be impacted and that there'll be a moderation in the at-home consumption.

Now, things are uncertain. So it's hard to -- we've done a range of scenarios and it's hard to kind of pinpoint on one particular assumption, but that's -- those are the headline assumptions that we've used as we've looked at the second half.

Q - Ken Goldman {BIO 15002920 <GO>}

Okay. Thanks so much.

Operator

The next question is from David Driscoll with DD Research. Please go ahead.

Q - David Driscoll {BIO 3978440 <GO>}

Good morning.

A - Steven Cahillane {BIO 4718688 <GO>}

Hey, David.

A - John Renwick {BIO 19769692 <GO>}

Good morning, David.

A - Amit Banati {BIO 16339861 <GO>}

Hey, David.

Q - David Driscoll {BIO 3978440 <GO>}

I want to follow up -- great. I want to follow up on Ken's second question. I think this is the big one. In the second half of the year when you say there is the give back, I mean it really does seem that in-home consumption is up. It's going to stay up at some level versus whatever the baselines were for 2020, including the second half. Why is it that you think that profits are going to be so much lower that you are just keeping the guidance consistent?

I mean, I guess I just want to say it directly. Are you just trying to take a conservative approach because it's just so hard? Because it really feels like, on balance, your foodservice business in these away-from-home channels are a smaller portion. If your at-home consumption is elevated in the second half, you should have a net positive. But it could just be -- you don't really know when you're taking a conservative view, but I'd really like to test the strength of your conviction on that comment.

A - Steven Cahillane {BIO 4718688 <GO>}

Yes, David. Thanks for the question. And I think I wouldn't disagree with anything that you're saying. But the real answer is who knows. Who knows how long this change persists and the magnitude of it? And so I think we can be -- characterize as taking a prudent approach here. And we think prudence in this very uncertain environment is the right way to go.

And I'll give you really four reasons why we're thinking about this. One is what I just said. The environment is incredibly uncertain. In fact, most companies are actually withdrawing guidance because of this uncertainty and we're affirming guidance. The second is lost activities in the second quarter and third quarter. So, you have things like the European Championship in Europe, which is a big event for Pringles. That's not going to happen. You have the lag impact of investments that we're going to make in the second half that are not in the first half. So, there is a big shift from the first half to the second half in investments. And there is some volume that's going to come out in the second half because these promotional activities around sports and other things are not going to happen.

The third is emerging markets slowdown. We're already seeing it in large markets like Nigeria where we have a big business. You think about oil-based economies and nobody ever imagined oil would be where it is right now. Well, that's going to impact these economies. And so we think we can manage through it. We've got the right playbook. We've been here before. But it's going to have an impact. Emerging markets are going to slow down.

And then finally, and you touched on this. We will have the flexibility to reinvest in the business to make this company stronger and stronger and come out of this pandemic with very good share positions, very high brand equity scores, people who we've invested in and just a better company. And so we think that this is the right approach. I'd like to think we get some credit for affirming guidance and not withdrawing it, but we think this is the right approach, a prudent approach and the right approach for us.

Q - David Driscoll {BIO 3978440 <GO>}

Can I just do a quick follow-up on your SKU counts? And are you taking this opportunity to reduce your SKUs, and will this have any significant impact on the business going forward?

A - Steven Cahillane {BIO 4718688 <GO>}

Yeah. David, the answer to that is yes. We need our plants to operate at the highest potential possible in terms of throughputs. So, that's meant really focusing on core SKUs. And if you look at the syndicated data and you look at things like, just take ready-to-eat cereal, you look at blue box Frosted Flakes, you look at red box Froot Loops, you look at orange box, Frosted Mini-Wheats. Brands are doing very well and growing, and we're really focused on them.

Core items and Cheez-It, same thing. How this manifest itself post-crisis? We will see. But I would suspect that -- this is not giving 2021 guidance. But I would suspect, in 2021, grocery stores, retail outlets will probably have less SKUs than they had going into the pandemic, but we'll just have to wait and see.

Q - David Driscoll {BIO 3978440 <GO>}

Thank you.

Operator

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

Q - Robert Moskow {BIO 6299775 <GO>}

Hi. Thanks. I think the guidance implies a stronger North America performance this year than you previously expected. And I think that that's rational. I hope I'm correct because the offset is really in the emerging markets and maybe a little bit of Europe. So, I just want to sure make I'm right on that.

And also when you mentioned these channels that are declining like foodservice, C-store travel, is that about like 10% or 15% of North America? Is that a fair assessment?

And then the last question was, you mentioned some inventory de-loading at retail. Is it possible that, that comes back in 2Q as a benefit? Thanks.

A - Steven Cahillane {BIO 4718688 <GO>}

Yeah. Thanks for the question, Rob. First off, North America, the answer is yes. They are performing at a very high level and driving a lot of excellent performance. As I mentioned in the prepared remarks, Europe is really the business that was benefited from the first half and because of Euro Championship and other things I mentioned will not have the same strength in the second half. And then, obviously, the other two regions are very emerging market focused. And I just talked you through some of the concerns around emerging markets. So, you've got that right. In terms of the away-from-home business in North America, well, let's talk globally. It's about 8% to 10% of our business globally, foodservice, vending, C-stores, college, university, schools. Obviously, this business was obviously significantly impacted as everybody knows. And how that comes back, when that comes back, how quickly it comes back, we'll just have to see.

The teams have done a phenomenal job at things like delivering food to children who are out of school. And so they're very hard at work at doing community-based things, but the business has really dramatically changed as you know. In terms of North America though, it's less than 15% of North America business. Internationally, it's less significant. It's kind of less than 5%, that channel, of our international businesses.

Q - Robert Moskow {BIO 6299775 <GO>}

And the retail inventory de-loading?

A - Steven Cahillane {BIO 4718688 <GO>}

Yes. Sorry. So, yeah, if you look, obviously, our consumption dramatically outpaced our shipments. And so you can think about inventory in the system being down, how quickly we can rebuild inventories will be a function of what happens with ongoing consumption and right now we're seeing consumption continue quite strong. So the ability to rebuild inventories again will have to wait, as we just continue to run flat out to supply the demand that's right in front of us.

Q - Robert Moskow {BIO 6299775 <GO>}

All right. Well, the Moskow family is going through a box of cereal every two days. So --

A - John Renwick {BIO 19769692 <GO>}

Step it up, Rob.

A - Steven Cahillane {BIO 4718688 <GO>}

We appreciate it. Thanks, Rob.

Operator

The next question is from Alexia Howard with Bernstein. Please go ahead.

Q - Alexia Howard {BIO 15082983 <GO>}

Good morning, everyone.

A - Steven Cahillane {BIO 4718688 <GO>}

Good morning, Alexia.

A - Amit Banati {BIO 16339861 <GO>}

Good morning.

Q - Alexia Howard {BIO 15082983 <GO>}

So the question I have is around the share trends in US cereal. And it looks as though, as the pandemic accelerated, you lost some ground there. And I'm just curious about whether that's capacity constraints or pricing dynamics or whether you are trying to make that or you hope to make that up over the next few weeks and months.

And then just the second question is a quick follow-up. You mentioned in the prepared remarks that you've been studying what worked in previous recessions and what might be different this time. I'd love any sort of color, commentary you've got on what those insights were and how you think you might be different? Thank you.

A - Steven Cahillane {BIO 4718688 <GO>}

Yeah. Thanks, Alexia. So starting with the cereal and share question. Right now, we're really in a supply-driven market, but we have lost share. And so, admittedly, that's the case. What's happened, though, as you think about the demand that this pandemic has created, it's really been -- especially, most recently, if you look at the Nielsen, which characterizes the Taste/Fun, the kids segment, driving the category. Secondarily, the all-family segment, slightly behind that and trailed by the adult segment.

And so the structural makeup of our portfolio is what's creating that share loss because it's happening in the adult segment, which is up less than the rest of the categories. We're making progress and gaining share in the kids segment, brands like Frosted Flakes and Froot Loops. And so we're not -- as you've heard me say in the past, we're not in the business of donating share. But right now we're doing everything we can to satisfy the orders that are coming in. And so we'll stay mindful of the health of our brands. That's what I talk about investing in our brands and making sure that we come out of this stronger then when we went into it. And so that's kind of the case with US ready-to-eat cereal.

In terms of the recessions, in a softer economic environment, which, obviously, we just saw the results or the GDP numbers yesterday, the just heartbreaking unemployment figures that continue to come out in the United States, 30 million people unemployed, just shocking numbers. And so we're preparing ourselves. And so some of the learnings from past recessions are; entry-level price points are important. Family size is important. Being mindful though of continuing to invest in your brands is really important because it's about value for money and maybe one of the most important things is don't stop innovating.

And so some of the mistakes made cross categories in recessions is a hunkering down mentality, which takes away brand-building and slows up on innovation. And people still want good news, people want fun. They want to try things in an affordable way. And our brands are iconic. They bring joy. And so we'll be bound and determined to continue to invest to innovate. But to be very mindful of the price-value relationship and making sure that people understand how economic, for example, ready-to-eat cereal is in terms of a meal solution, it's an incredibly economic way to feed your family.

Q - Alexia Howard {BIO 15082983 <GO>}

Great. Thank you very much. I'll pass it on.

A - John Renwick {BIO 19769692 <GO>}

Operator, we're going to have to cut it there. We gave a few extra minutes because of the technical delays upfront. But thank you, everyone, for your interest. And if you do have follow-ups, please, by all means, give me a call. Thanks for your participation.

A - Steven Cahillane {BIO 4718688 <GO>}

Thanks, everybody.

Operator

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