

Company Name: Kellogg  
Company Ticker: K US  
Date: 2020-02-06  
Event Description: Q4 2019 Earnings Call

Market Cap: 21744.7538475  
Current PX: 63.75  
YTD Change(\$): -5.41  
YTD Change(%): -7.822

Bloomberg Estimates - EPS  
Current Quarter: 1.012  
Current Year: 4.025  
Bloomberg Estimates - Sales  
Current Quarter: 3350.833  
Current Year: 13356.588

## Q4 2019 Earnings Call

### Company Participants

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

### Other Participants

- Steve Powers, Analyst
- Jason English, Analyst
- Rob Dickerson, Analyst
- Laurent Grandet, Analyst
- Bryan Spillane, Analyst
- Ken Goldman, Analyst

### Presentation

#### Operator

Good morning. Welcome to the Kellogg Company's Fourth Quarter 2019 Earnings Call. (Operator Instructions) Please note that this conference is being recorded. And at this time, I will turn the call over to John Renwick, Vice President of Investor Relations and Corporate Planning for the Kellogg Company. Mr. Renwick, you may begin your conference call.

#### John Renwick, Vice President of Investor Relations & Corporate Planning

Thank you, Gary. Good morning, and thank you for joining us today for a review of our fourth quarter and full year 2019 results, as well as our initial outlook for 2020. I am 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, February 13th. 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.

Additionally, please note that when we discuss the impact of last July's divestiture, we would be referring only to the absence of the divested businesses net sales and profit. And now, I'll turn it over to Steve.

#### Steve Cahillane, Chairman and Chief Executive Officer

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Thanks, John, and good morning, everyone.

2019 is now in the books and we're pleased with the progress we made. We stayed on strategy and on plan all year long and we did what we said we would do right through Q4. And this was in spite of significant changes in investments made throughout the year, all aimed at building a solid foundation for steady, dependable financial delivery.

The primary goal of 2019 was to return to organic net sales growth and we did that. In fact, Slide number 5 shows that we sustained our accelerated growth right through the fourth quarter. For the quarter and for the full year, this was our best organic net sales growth in several years, and this return to organic net sales growth is the strongest evidence that our Deploy for Growth strategy is working. We grew in all four quarters with full-year growth in all four regions. We utilized revenue growth management to restore positive price realization in all regions, and we improved our end-market performance in key countries and categories.

Even as we were delivering on our 2019 plans, we were busy driving important changes intended to build a foundation for the future. Some of these changes and investments are shown on Slide number 6. We significantly restructured our organization in 2019, starting with North America at the beginning of the year, followed by corporate and then the international regions. With reduced layers and fewer business unit silos, we can now assess resource allocation more holistically and make faster decisions.

From a portfolio standpoint, we divested four businesses in a single transaction. This divestiture improves our portfolio's underlying growth rate and its profit margins, while enabling our organization to sharpen its focus on our core businesses. We also enhanced our financial flexibility by using the divestiture proceeds to pay down \$1 billion of debt. And from an investment standpoint, we continue to expand and build scale in emerging markets.

In addition to growing our existing businesses, we rapidly built up distribution of Kellogg noodles in Africa. We established local production of Pringles for the first time in Africa and Latin America, as well as noodles in Egypt and South Africa, and we shifted production of cereal in Brazil to a new, more efficient facility.

There was some upfront capital and cost related to these moves, but they will facilitate profitable growth well into the future. All of these business and portfolio realignment actions were large and important, and they contribute greatly to the foundation we are building. It's also important that we delivered the results that we had guided to. Amit will go into more detail in a moment, but I want to emphasize that our return to dependability starts with doing what we said we do and this includes delivering on our financial guidance.

We plan to sustain this dependable performance in 2020, including a more balanced financial delivery. Again, Amit will walk you through the specifics in just a moment, but the key elements of this balanced plan are depicted on Slide number 7. First, we plan to continue to grow our net sales organically in 2020 in the 1% to 2% range that we think is sustainable. It should feature a little more balance between volume and price mix, and again, it should be broad-based and it should be led by our biggest, most differentiated brands.

Second, we plan to improve our underlying profitability, swinging to operating profit growth excluding the divestiture impact. We'll continue to gradually improve our gross profit margin as we continue to reutilize revenue growth management, generate productivity savings in our supply chain, and complete the restoration of on-the-go margins. We'll also continue to manage our overhead tightly.

Third, we will increase our investment behind our brands. Some of this increase is related to specific pullbacks we had to do in the first half of 2019, such as when we paused RX advertising during its supplier related recall and paused investment in U.S. cereal as we harmonized pack sizes. And most of the increase is around new opportunities. For example, our launch of Incogmeato ready-to-cook meat alternatives, and our Pringles and Pop-Tarts commercials during the Super Bowl.

In U.S. cereal, we're not just lapping the harmonization-related pullbacks, we are going all-in on a comprehensive plan. And internationally, there are other promising product launches and expansions. These are all unique opportunities and we are reinvesting the profit of a 53rd week this year to help offset this increase in investment. And finally, we'll continue to enhance our financial flexibility, not only by improving our cash flow, but also by using that cash flow after

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dividends for paying down debt. In short, we're planning for a more balanced delivery with prudent forecasts as we build a foundation for sustainable growth.

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

## **Amit Banati, Senior Vice President, Chief Financial Officer**

Thank you, Steve, and good morning, everyone.

Our quarter four and full year 2019 results are summarized on Slide number 9. We finished 2019 with a quarter four that again featured sequential acceleration in organic net sales growth and sequential improvement in gross profit margin. It also featured increased investment in A&P and effective overhead management. Excluding the year-on-year impacts of the divestiture, we delivered another quarter of operating profit growth and we delivered good cash flow. All-in, it was a solid finish to the year.

The results were obviously affected by the divestiture which closed at the end of July. The absence of these businesses' results in quarter four had a negative impact on reported net sales and it more than offset our base business growth in operating profit and earnings per share. We'll go into more detail on net sales and operating profit in a moment.

Our earnings per share finished in line with the year-ago fourth quarter as the negative impact of the divestiture was offset by base business profit growth and favorability in some items below operating profit. Interest expense decreased in quarter four as expected, owing to using divestiture proceeds to pay down debt.

Other income in quarter four was similar to recent quarters in absolute dollars, but year-on-year, it was very favorable because of lapping the impact of the quarter four 2018 soon in financial markets, which impacted our insurance investments.

Our effective tax rate benefited from a modest tax benefit. Our cash flow was also affected by the divestiture, specifically by almost \$500 million. As discussed previously, this was not just the absence of the divested businesses' profits, this impact also included upfront costs and working capital timing differences, as well as most significantly taxes on the divestiture proceeds. Remember, the proceeds are not in the cash flow, but the taxes, some \$255 million, are included in the cash flow. Excluding this divestiture impact, our base business cash flow was quite stable. It's important to note that we finished 2019 on our guidance for each of the four guided metrics, who's only change during the year had been to incorporate the divestiture.

As Steve mentioned, we are aiming for improved predictability and dependability, and we demonstrated that in 2019 even despite reorganizations, investment shifts and some near-term macroeconomic challenges, particularly in the second half.

Let's now go into more detail. We'll start at the top of the P&L with net sales growth and Slide number 10. We continued to post strong organic net sales growth coming in at 2.7% in the quarter and bringing our full year growth to 1.9%, the high end of our guidance range. Once again, all four regions grew net sales organically in quarter four. Importantly, we continued to realize price reflecting revenue growth management actions and we saw in quarter four, a much better balance between price mix and volume, both of which grew more than 1% year-on-year.

Among our categories globally, snacks again led the organic net sales growth in quarter four, increasing in all four regions. Frozen foods had its best quarter of growth of the year and noodles and other products continued to post solid growth. Cereal sales were flat in the quarter on continued international growth and a meaningful moderation in North America's decline.

In its first full quarter out of our results, the divestiture negatively impacted net sales growth by about 5.5%. For the full year, its impact was directly offset by the positive acquisition impact of consolidating Multipro, our West Africa distributor, which anniversaried back in quarter two. Lastly, after running negative all year, currency translation was neutral in the fourth quarter. It finished the year as a negative 1.7% impact.

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Now, let's turn to our gross profit margin on Slide number 11. Our goal this year was to sequentially improve gross profit margin performance every quarter, and that is exactly how it played out. Looking at the buckets we have been using to explain this improvement, let's start with the mechanical impact of acquisitions and divestitures. The consolidation of Multipro created a headwind until it anniversaried during quarter two, and then the divestiture created a small tailwind beginning in quarter three. No surprises here, and we'll have this divestiture tailwind for two more full quarters as well as a month in quarter three.

Next, the ongoing bucket remained modestly negative. This is our input costs net of any productivity and savings. There was no major changes in our underlying cost inflation rate, though we had expected to see at least a little moderation which didn't materialize. And while cost inflation should moderate in the aggregate during 2020, there are some inputs that has sugar, potatoes and various types of packaging that have done more inflationary. And lastly, there is the growth-related bucket which continued to moderate during quarter four as we had anticipated. We still had some negative country and category mix shifts and we did have start-up costs on new plants. However, we were able to offset much of this with price realization and sequential restoration of margins on our on-the-go pack formats. We expect this bucket to continue to get less negative over the course of 2020 as we get past plant start-ups and other costs, and as productivity programs gain traction.

On SGA expense, we continue to realize benefits related to organizational restructurings dating back to early in the year. Partially offsetting this overhead favorability in quarter four was an increase in A&P investment. Not only was some of this increase related to shifts from prior quarters, but we also elected to add investment during the quarter. The result of our good organic net sales growth, moderating gross margin decline and year-on-year decrease in overhead was another quarter of growth in operating profit before the impact of the divestiture.

So to wrap up 2019's financial results, let's turn to Slide number 12. We returned to organic net sales growth, which was our top financial priority, and it's important to see that we grew in all regions and across most of our important brands and categories. We made steady sequential improvement in gross profit margin performance each quarter as planned, and we'll continue to make progress in this important area.

We invested in the future. We invested in capacity, primarily in fast growing emerging markets, but also for certain foods and pack formats in developed markets. We invested in innovation, and while our brand-building levels were lower in the quarters that lapped 2018's large infusion of incremental investment, we supported our key brands all year, increasing A&P year-on-year in the fourth quarter. We delivered on our guidance for net sales, operating profit, earnings per share and cash flow, and we strengthened our balance sheet using the proceeds of the divestiture to pay down debt. This gives us added financial flexibility.

Now, let's turn to 2020 with our initial guidance shown on Slide number 13. As Steve mentioned, we believe we have a prudent outlook that delivers balanced financial results, while providing the flexibility we need to step up investment behind some specific opportunities and to contend with some less favorable macro environments. We expect organic net sales growth to continue to run in the 1% to 2% range. Some businesses will do better than they did in 2019, while some will lap unusually strong performances of 2019, and others like Brazil and Nigeria will continue to face challenging macro conditions in the near term. On the whole, this growth rate represents solid sustainable performance.

Excluded from the organic growth of course is the impact of the divestiture. The absence of those divested businesses negatively impacts net sales by about 4 percentage points in 2020. The organic growth also excludes the benefit of a 53rd week at the end of 2020, which based on prior experience, typically amounts to about 1.5 percentage points. Currency-neutral adjusted operating profit is expected to decline by about 4% as the absence of the divested businesses has a mechanical impact of approximately negative 6%, more than offsetting a return to operating profit growth for our base business. This base business growth includes a sizable increase in investment in brands and initiatives, which is only partially covered by the benefit of a 53rd week.

This projected underlying growth in operating profit, even with the increased investment, is a big positive swing from 2019 and right in line with our plan for steady, gradual improvement. Currency-neutral adjusted EPS is expected to decline by 3% to 4%. Again, growth in the base business is more than offset by the roughly 5% negative impact of the

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divestiture after considering the divestiture's full-year benefit on interest expense from using the proceeds to pay down debt last year.

Below the operating profit line, the various items are fairly mixed. Interest expense will be lower because of a full year of debt reduced by the divestiture proceeds. And other income will be higher because of the positive impact on pension assets of last year's strong financial markets, though partially offset by our recent decision to reduce risk in our pension portfolio and decrease our expected return on assets.

On the other hand, our effective tax rate will be higher, mainly due to lapping 2019's discrete benefit, and our average shares outstanding will likely drift higher as we prioritize debt reduction over share repurchases. And finally, cash flow should increase strongly to roughly \$900 million to a \$1 billion. This is close to our base business -- base businesses' normal run rate, even less, even after the absence of our divested businesses' cash flow.

There are a couple of factors that definitely alter the shape of our quarters this year. The first is the year-on-year impact of the divestiture, in other words, the impact of the absence of the divested businesses' net sales and operating profit. This is shown on Slide number 14. Remember, the divestiture had seven months of impact in 2020 as opposed to only five months in 2019. And it also includes the highly seasonal Girl Scouts business which happens almost entirely in the first quarter of the year. That's why you'll see a much larger year-on-year impact in quarter one. Then the second quarter should be similar to what we saw in quarter four, and quarter three only has four weeks of impact as the divestiture lapse at the end of July.

The second factor to consider is timing of investment. As mentioned, we are increasing investment meaningfully in 2020, even reinvesting the extra profit from our 53rd week to help fund it. There are some good reasons why the bulk of this year-on-year impact is heavily weighted to the first two quarters. First, there are some businesses that are lapping deliberate pullbacks. For example, U.S. cereal had its pullback last year in quarter one and quarter two, during the pack size harmonization. RX had to pull back during the first half following its supplier related recall. Second, there is simple calendar timing, for instance, Pringles and Pop-Tarts Super Bowl ads obviously had to be in quarter one. And our initial launch of Incogmeato meat alternatives is scheduled for late quarter one and early quarter two. So the divestiture impact and the investment increases are first-half weighted. And then there is the 53rd week which only benefits quarter four.

So to wrap up our financial section, we feel good about our improved financial results in 2019 and we enter 2020 in solid financial condition and with plans for continued gradual improvement in 2020. Our goal is steady dependable financial delivery and we are clearly on the right track.

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

## **Steve Cahillane, Chairman and Chief Executive Officer**

Thanks, Amit. Let's begin with North America in Slide number 16. North America continued to show improvement in Q4 completing a year of progress emits tremendous change, both to our portfolio and to our organizational structure.

On the face of the P&L, the results get a little drowned out by the absence of our recently divested business. The impact of the divestiture was about 9 percentage points on net sales. We grew sales organically in North America by more than 1% in the fourth quarter and slightly for the full year. Both time periods represented North America's best organic net sales growth performance since 2012.

It all starts with consumption, and you can see on the slide that we improved consumption growth significantly in 2019 right through the fourth quarter. This growth was across most of our categories. It was led by our biggest most differentiated brands and it reflected gains in our core product lines as well as incremental innovation. We also grew net sales organically in our away from home channels in both the quarter and full year aided by good consumption growth across most of our key categories in the food service and convenience channels.

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From a profit standpoint, results are better than they look as the mechanical impact of the absence of our divested businesses more than offset operating profit growth in our base business in quarter four. And this underlying profit growth included a strong year-on-year increase in A&P. So even as we worked to restore top line growth in North America, we continue to make progress in improving our underlying profitability and investing for the future.

Now let's discuss each major category in a little more detail. We will start with snacks, our largest category in North America on Slide number 17. As you can see, we recorded another quarter of solid organic net sales growth in this business. And just as it has been all year, it was driven by consumption in each of our three categories. This was led by the power brands that we revitalized in 2018, but was also driven by our most successful class of innovation launches in many years, and other brands that we began to revitalize in 2019.

In crackers, we continued to outpace the category on the strength of Cheez-It, whose double-digit growth this year came equally from the core line-up and from this year's sensational innovation platform, Snap'd. Importantly, we also returned the Club cracker brand to growth as well. We expect to continue to grow in crackers in 2020. Yes, comparisons will be tougher, but we have strong commercial plans and we'll also have added capacity for supply constrained Snap'd.

Pringles continued to grow consumption in the fourth quarter despite lapping a notably strong year-ago performance. Our new Wavy line has been incremental and we also continue to grow our on-the-go pack formats including immediate consumption and multi-packs. We have strong plans for this brand in 2020 and we got them kicked off last weekend with our new ad during the Super Bowl. So even with a recent price increase to cover sharply rising potato and packaging costs, we are confident we can continue to grow Pringles.

Finally, in portable wholesome snacks, we had another good year and quarter. Rice Krispies Treats is a powerhouse brand whose growth accelerated in 2019 from -- both from core growth and innovation. Pop-Tarts bounced back to growth in 2019 and we extended our brand revitalization efforts to include Nutri-Grain, which also grew consumption. So North America snacks is in good position to sustain its growth.

Let's now turn to cereal in Slide number 18. As you can see, our net sales declines moderated meaningfully in the -- in the fourth quarter as we returned to full commercial activity. We've talked previously about our decision to take a big bang approach to our pack-size harmonization last year as opposed to a more gradual less disruptive approach.

We do not regret it. Our shelf is immensely more shoppable and we can cross-promote brands that we couldn't previously. While it meant not being able to fire on all cylinders for a couple of quarters, it's behind us. In the fourth quarter, we made our best progress yet towards stabilizing this business.

In the quarter, our consumption declined by less than 1%, compared to our full year consumption being down almost 3%. That's a significant moderation. We again grew share in the taste-fun segment with consumption and share growth accelerating behind Frosted Flakes and its Mission Tiger campaign, as well as growth in brands like Froot Loops, Corn Pops, and Krave, where we ramped up our commercial activity. In health and wellness, our new Special K campaign and positioning went on air late in the third quarter and we saw the brand's declines moderate further in the fourth quarter, helping slower declines in this segment overall.

Our all-family segment is the one where we haven't yet made progress. This is principally due to Mini-Wheats, which not only lapped good growth in the year-ago third and fourth quarters, but we didn't fully return to advertising inactivity behind that brand in quarter four choosing instead to ensure our recent production shifts were on solid footing. We expect that brand's performance to improve in 2020 as we return to full support.

I recognize we talk a lot about our snacks, frozen foods, and emerging markets businesses, and for good reason, but we never lose sight of the fact that cereal is incredibly important to us and it is our legacy. In 2020, we'll be executing a full year of commercial activity, investing behind a plan that we feel very good about. It's a plan that includes more innovation, more brand building, and more exciting in-store activity. I want to emphasize our confidence in our ability to perform much better in 2020. Make no mistake, with respect to cereal, we are in it to win it.

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Let's complete our North America discussion with frozen foods on Slide number 19. It was another quarter of good performance. MorningStar Farms, our leading brand of frozen plant-based meat alternatives, built on its accelerated growth. Consumption in the fourth quarter increased again at a double-digit rate, again gaining share. Impressively, this accelerated consumption and share growth has been driven across product segments as you can see on the slide.

Clearly, the breadth of our product line, along with strong brand communication, is working and we're expanding distribution. And as we discussed, we'll enter the ready-to-cook category late in first quarter 2020 with the MorningStar Incogmeato line. We should also note the growth we've generated in food service in K through 12 schools. So obviously, we're excited about our MorningStar Farms business.

In frozen breakfast, our core Eggo from the griddle business, which encompasses frozen waffles, pancakes and French toast, grew consumption slightly year-on-year in the quarter and by almost 2% for the full year. That growth has been led by innovation in the French toast and pancake segments as well as sustained momentum for Eggo's premium Thick & Fluffy Waffles sub-line, which grew by nearly 30%. Kashi has also accelerated its growth in this category as we pursue a natural and organic occasion. Overall, including all subcategories, our frozen breakfast consumption declined as expected, but this reflected our continued phasing-out of certain non-core products. As we invest behind the momentum and expansion of MorningStar Farms and sustained steady growth in Eggo, we expect continued growth in North America frozen foods in 2020.

Now let's discuss our international businesses, starting with Europe on Slide number 20. We had another very good year in Europe, and the fourth quarter was our ninth straight quarter of organic net sales growth in this region, a region with some very mature markets and challenging retailer environments. Leading our growth has been Pringles, which finished with high single-digit consumption growth in the quarter and full year. It grew throughout the region led by double-digit gains in markets like the UK and Spain. Driving this growth has been a promotional program targeted toward gaming, a new innovation platform featuring Asia-inspired rice infused crisps and continuing to expand our on-the-go pack formats. We have big growth to lap for Pringles in 2020, but our commercial plans are strong, and we're executing well.

We also had a good year and a good fourth quarter in cereal. Region-wide, our cereal consumption returned to growth in the second half of 2019, led by good growth in taste brands like Crunchy Nut, Coco Pops and Tresor. New packaging and positioning has returned Special K to growth in the UK, giving us confidence in executing similar programs elsewhere in 2020.

We're especially pleased with our performance in the UK overall. In that market, we grew consumption by almost 2% for the year and more than 5% in the fourth quarter. So we've got good reasons to believe we can be at least stable on cereal in Europe in 2020. We made some progress on transforming wholesome snacks in 2019 with good performance by Rice Krispies Squares in the UK, innovation on our Extra brand in France, and the expansion of the Kellogg's master brand in Italy. There is still more work to do and we have good plans for continuing to stabilize this business in 2020.

Within Europe, we do have an emerging market and that is Russia and Central Europe. In Russia, in 2019, we generated strong double-digit consumption growth in cereal, gaining share behind Krave and our local brand, as well as the launch of Extra brand Granola. We also continued to expand Pringles in Russia, growing consumption at a double-digit rate and gaining share.

Meanwhile, we continue to expand into Central Europe. So we have good reasons to be confident in top line growth again in Europe in 2020, and with enhanced revenue growth management and a reorganization that we executed in 2019, we have room to increase investment in 2020 and still deliver margin expansion.

Let's turn to Latin America in Slide number 21. We continued to grow organic net sales in 2019, though reported net sales were affected by the divestiture. For our Latin America business, 2019 was a year of momentum, transition and economic challenges. Though momentum was principally in Mexico, in this key market, we continued to drive consumption and share growth in 2019 and we did it in all three major categories as shown on the slide.

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We have strong commercial plans again in 2020 giving us confidence that we can sustain momentum in this important market. The transition was in Central America, where we are changing distributors, and in Brazil, where we are transforming our supply chain. Specifically, we started up our first local production for Pringles in Brazil and we moved our cereal production out of Sao Paulo into a new modern plant on Parati site in Sao Lourenco. All of these actions have strong long-term benefits, but they did result in incremental costs and temporary supply chain -- supply constraints during quarter three and especially quarter four. These issues move behind us during 2020. And then there were the economic challenges. In Puerto Rico our biggest market in our Caribbean and Central America sub-region, economic softness continues to affect all categories.

Meantime, Brazil is seeing softness across categories as well. While our growth in Brazil has been slowed by these conditions, we have been able to sustain consumption growth in our key categories, including cereal, cookies, salty snacks and powdered drinks. So while the economic challenges may persist into 2020, we like how we are positioned in these markets. 2019 was not a typical year for Kellogg in Latin America, and we expect to be back in growth in both top line and bottom line in 2020.

We'll finish our business update with our fastest growing region AMEA shown on Slide number 22. We finished 2019 with very strong organic net sales growth in AMEA right through the fourth quarter. Our Africa strategy continued to play out with a first full year of Multipro in our results as well as the realignment of our Middle East, North Africa and Turkey businesses into AMEA and the rapid expansion of a new Kellogg's branded noodles business. This paid off in strong growth.

We saw good results in Pringles, particularly in the Middle East and we started up local production of that key brand in South Africa. Though slowed during the year by challenging macroeconomic conditions, Multipro continued to generate strong growth almost (inaudible) competitive note of this business and the multi-decade experience of our partners in managing through often volatile conditions in West Africa. We also generated good growth in Asia, driven by both cereal and Pringles. Consumption growth for Pringles was broad-based in 2019, including the fourth quarter. In Cereal, growth was aided by share gains in several markets. And in Australia, our developed market in this region, we returned to consumption growth in cereal in 2019, even accelerating growth during the fourth quarter. We also saw a good consumption and share gains in Pringles.

So even with some economic related slowdown in West Africa, our fundamentals are in place for continued growth in AMEA in 2020. We did incur incremental costs during the fourth quarter, some of which was related to production start-up for Pringles, but we would view these costs as temporary and AMEA should be back in profit growth in 2020.

Let's wrap up with a brief summary on Slide number 24. As discussed many times, our primary objective for 2018 and 2019 was to return to top line growth as this is the hardest and most essential element of returning to sustainable, consistent profit and cash flow growth, and we achieved this. We stabilized our organic net sales in 2018 and we accelerated it to solid growth in 2019.

Now in 2020, our goal is to grow both net sales and operating profit, leaving aside the negative mechanical impact of our divestiture. There are good reasons to be confident we can do this. First of all, our portfolio is more geared toward growth today than it was even a couple of years ago. Second, we're not only seeing multi-quarter momentum in organic net sales growth, but it's been broad based in all regions and improving across major product groupings. Third, we've improved our execution with a realigned organization, enhanced capabilities and improved service. Fourth, we're gradually improving our profitability. And finally, we're investing in promising opportunities leaning into incremental investment in a year that has a 53rd week.

Returning to balanced growth isn't just words on paper. We're moving to the next phase of our Deploy for Growth strategy and financial operating model, focusing the organization more on profit and cash flow metrics, and we've made changes to our incentive compensation programs as well. We are building a foundation for growing sales, profit and cash flow dependably for a long time. 2019 was an excellent start and 2020 will improve on it.

As always, I'd really like to thank our organization. We couldn't do any of this without the skill and dedication of our associates.



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Bloomberg Estimates - EPS  
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And with that, we'll open it up for your questions.

## Questions And Answers

### Operator

(Operator Instructions) Our first question comes from Steve Powers with Deutsche Bank. Please go ahead.

### Steve Powers, Analyst

Yes. Hey, thanks guys. Good morning. So...

### Steve Cahillane, Chairman and Chief Executive Officer

Good morning, Steve.

### Steve Powers, Analyst

Look, you've been investing a lot in the business over the past 12 plus months as you discussed and momentum has definitely improved. I guess despite that, and despite the reinvestment of the extra week this year, you're guiding underlying performance only low single-digit profit growth without any further top-line acceleration. And I guess, the question of the day really is, is that -- how do we think about that? Is that conservatism on your part? Is the cost of doing business really just that high? And either way, what do you think it will take to inflect that profit growth a bit higher ahead of top line growth as you go forward through 2020 and beyond?

I'm not sure what underlying productivity is expected to run at. Maybe that's part of the solution. But just how do we think about the rate of further improvement '20, '21 plus? Thank you.

### Steve Cahillane, Chairman and Chief Executive Officer

Great. and thanks for the question, Steve. I think we would consider the guidance that we're giving prudent. but I'd also underline that our swing back to profit is really a 4 point swing ex to divestiture. So from a base business perspective, from a minus 2 to a plus 2, we think is meaningful improvement. And as we mentioned during the prepared remarks, from a top line perspective, it's the best performance we had in 2019 at plus 1.9% since 2012. So that's quite a long period of time, and we're guiding towards continuing that with 1% to 2% top-line growth based on substantial reinvestment in the business against terrific opportunities that we see.

And so we feel that's prudent, but we'll be very pleased with continuing that top-line momentum which is broad based and across many categories. And so we think, it's on strategy, it's on plan. We continue to show good progress against our portfolio. The reorganizations are behind us. Our service levels are improving, we're lapping some very good innovation from this year, we've got very good revenue growth management, productivity plan is in place, our emerging markets continue to perform very well. And so we're pleased with where we are as we end 2019.

We think 2020 will be a continued year of good positive momentum and again a four point swing in operating profit as well as continued positive momentum in the top line is what we're shooting for.

### Operator

The next question is from Jason English with Goldman Sachs. Please go ahead.

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## Jason English, Analyst

Hey, good morning, folks.

## Steve Cahillane, Chairman and Chief Executive Officer

Good morning, Jason.

## Jason English, Analyst

Thank you for slotting me in. Two questions, if I may. First, you made reference to a comprehensive program to rejuvenate your North America cereal business. Can you give us some more context around that?

## Steve Cahillane, Chairman and Chief Executive Officer

Yes, I will, Jason. Thanks for the question. I'm not going to give a lot of detail, obviously, because for competitive reasons, but the whole price package transformation that we underwent last year, as I said, was a big bang that's behind us now. And so we enter the year in good shape. And if you look at it from a segment perspective, the taste-fun segment, we did well on in 2019 and we've got good momentum. You'd look at things like our Mission Tiger program complete with a college football bowl game continues to show good momentum, Froot Loops as well, Krave, Corn Pops showing good momentum. And so that's been good.

Our new Special K program is actually mitigating the big declines we've seen in Special K, in fact cutting that in half against a more simple program focused on the food and focused on the wellness. It's really in our all-family segment with Frosted Mini-Wheats and Rice Krispies, where we have the big -- we just haven't fixed yet and we own that and we have to get to it. Now with Frosted Mini-Wheats, we see good promise in front of us. We know that we held back on a lot of promotional activity last year based on some supply constraints we had as we were realigning our network. We know that brand responds when we've got good ideas against it. So as we look at the three segments that we compete in, as I said, we're in it to win it, and we see 2020 as a much better year for us in cereal.

## Jason English, Analyst

Okay. Thank you. My second question, more holistically, just looking at the shape of your P&L. You're already the lowest margin, large cap packaged foods company out there by a fairly substantial delta, and your guidance suggests that that delta is going to widen even further next year with the overall margin compression at EBIT. You said, you thought, 1 to 2 was a durable growth rate for this business. Can you give us your prospect on what you think a durable margin is for this business? Because I still am a bit confound, I look at your portfolio and it seems like you're operating categories that generally offer good profit margins and you're operating with brands at price points that should also afford good profit margins. It's not coming to the surface of your P&L.

## Steve Cahillane, Chairman and Chief Executive Officer

Thanks, Jason. I think it's an excellent question. I'll start and happy to let Amit chime in as well. What we've said all through the course of this year is we're aiming for margin expansion as we reinvest in the business and return to top-line growth, and you saw that. You saw a sequential improvement in margins across the course of the year, including into the fourth quarter, and our aim is to continue that margin expansion as we go through 2020. And we're constructively dissatisfied as to where we are. So we do believe we've got ongoing opportunities to improve on that.

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We're coming off of a lot of transformation work that address many of the costs in not only our North America business, our European business as well. And as we continue in 2020, we'll continue to look for opportunities to expand margin and always relentlessly look at our cost base. Amit do you want to...

## **Amit Banati, Senior Vice President, Chief Financial Officer**

Yes. I think just to build on what Steve said, I think from a -- if you start kind of with the gross margin, our goal for 2020 would be to stabilize gross margin. I think, we see the input costs moderating in 2020 and would expect to offset that through a combination of pricing, as well as our savings program. So from a gross margin standpoint, the goal would be to stabilize our gross margin going forward.

I think, as we mentioned in our prepared remarks, we are planning to increase investment meaningfully next year behind opportunities that we see in 2020 from a brand building standpoint. And those are opportunities that we'd like to invest in to continue to drive the momentum in the top line. From an SG&A standpoint, that's something that we're always working on. We've initiated a number of initiatives to realign the business post the divestiture, and you're seeing the benefits of that come through on the P&L. And then from an emerging market standpoint, I think, we're making good progress on the gross margins. Scale in emerging markets -- as the scale in emerging markets improves, the significant margin come through on those businesses, or I'd say we'd expect to improve our margins in every region over time.

## **Operator**

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

## **Rob Dickerson, Analyst**

Great. Thank you. It's question number three on the margin side. So you just said, it seem -- it sounds like your expectation is to stabilize gross margin in 2020 where ex-Keebler, you're calling organic sales growth 1, 2, op profit around 2. So maybe there is some hopeful sequential improvement in operating margin. It sounds like, as you get through the year, just given first half investment, etc.. So when you say weeks, again you're doing that sort of growth in the top line. Does that mean that you actually plan to increase your overall investment in advertising and brand support? Or is it more of a reallocation? And I just ask because as Jason alluded to kind of your operating margin structure relative to other peers, so to speak, is a little bit lower, obviously that's given mix, what have you. But on an advertising basis and brand support, it's not as if Kellogg historically was one that was like massively underinvesting. So yes, short question is basically, will you increase your actual dollars in that investment to get to a point to hopefully improve your margin over time, I guess, driven by volume leverage? Thanks.

## **Steve Cahillane, Chairman and Chief Executive Officer**

Yes. Thanks for the question, Rob. The simple answer to that is, yes. We plan on increasing our brand building investment to continue to drive our growth. We said we're going to reinvest the 53rd week, we're going to do more than that. And so you could see the incremental investment above the 53rd week being a 53rd week plus, that and a little bit more. And we're committed to doing that, because you see, when you look at the brands that were -- we've revitalized and we've invested in, have really responded and done very well. And so Cheez-It and Cheez-It Snap'd, Rice Krispies Treats, Pop-Tarts, all showing terrific momentum in the marketplace. I mentioned cereal, we've got a job to do there, it doesn't come for free. And we're pleased with early indications that we're seeing around our taste-fun brands as I've said. Europe, when we look at Europe and the opportunities we have there, we see good momentum despite a challenging macroeconomic environment in many of those countries. So we see the ability to get very good ROIs on our investment.

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And the final thing I'll tell you is, our MorningStar Farms business continues to do very well as I mentioned in the prepared remarks. But with the launching of new sub-brand called Incogmeato, now I'm not going to get into exactly, but we're spending against that obviously for competitive reasons, but we're not going on buying something, we're investing in a brand new launch which we're going to be in it to win it and we're going to spend against it, and we see that as a very big opportunity.

We've got terrific food, we're excited to have you tried at CAGNY when we're all there. So we're very excited, enthusiastic and committed to that launch, and we think that the investment plan that we have, the incrementality behind it will pay-off and pay-off well into the future, because again, what we're looking for is long-term, sustainable growth that's balanced, that continues our top line, continues margin expansion and gets us again this 4-point swing in 2020 which is the beginning of what we see as long-term dependable performance.

### **Rob Dickerson, Analyst**

Okay, great. And then just a quick follow up on free cash flow. I think you said you now have a little bit more financial flexibility, but at the same time pulling back a bit on repurchase activity and focusing on deleverage. Is there is a rationale just you'd like to have a bit more or -- little bit clean every balance sheet, a little bit more firepower and flexibility going forward on the acquisition front and there is really not a lot of net near-term benefit, let's say, vis-a-vis acquisitions to be buying back stock? That's it. Thank you.

### **Amit Banati, Senior Vice President, Chief Financial Officer**

Yes. I think, that's right. I think we are using the free cash flow to pay down our debt next year and create flexibility for us going forward.

### **Rob Dickerson, Analyst**

Thank you.

### **Operator**

The next question is from Laurent Grandet with Guggenheim. Please go ahead.

### **Laurent Grandet, Analyst**

Yes, hi. Good morning, Steve and Amit. I'd like to dig more a bit on the top-line guidance. Organic top-line guidance is disappointing, I mean where you're finishing the year at plus 1.9%, almost 2% I mean this year. So -- I mean, in 2019, sorry. On the divestiture, you did, I mean, our fullest performing business, I mean, we were expecting more than the 2%, I mean, growth in 2020. So what is surprising also is that in all your businesses, when you highlight what you -- what to watch in 2020, it seems everything is going in the right direction. So what makes you so pessimistic in a way and is there anything we missed there? So that's my first question. Thank you.

### **Steve Cahillane, Chairman and Chief Executive Officer**

Thank you, Laurent. I wouldn't call it pessimistic guidance. I'd characterize it as prudent guidance. And again, I'd just remind everybody that it's been since 2012 since we performed the way that we performed in 2019 with plus 1.9%. And so, obviously we've got some big hurdles that we'll be lapping. All of the successful innovations that we had in

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place this year that drove that performance, we'll have to anniversary. Now we're confident we'll be able to do that, but we want to be prudent in how we think about that. We also have challenging macroeconomic conditions in certain markets like Brazil and potentially West Africa and so forth. So do not get us wrong. We plan on continuing our momentum and investing in the earlier momentum and we would hope to continue that momentum and do better, but we feel based on long-term history and that we anniversary in potential macroeconomic condition, so 1% to 2% is prudent.

### **Laurent Grandet, Analyst**

Yes. And actually my second question what is exactly about Brazil and Nigeria. You mentioned in your prepared remark, I mean, some softness are coming from those two regions. Could you please elaborate and give us a bit more color there and in term of magnitude and what to expect?

### **Steve Cahillane, Chairman and Chief Executive Officer**

Yes. So in -- if I start with West Africa, we definitely saw a slowdown, a macroeconomic slowdown and you saw it in some of our peers' results and so forth. We're still performing very well. So high single-digits -- coming out of the fourth quarter and we plan on continuing that. That's not the same as double-digits, but high-single digits in a market where there is some turbulence, we think, is quite good. Brazil, obviously same type of macroeconomic conditions, consumer sentiment and so forth that's affecting consumer goods in general.

Now we continue to perform well. Our cookies, crackers are biggest -- our biggest categories continue to perform well and we continue to gain share. So we don't see a reason for worry, but we see a reason for prudence. We're also very pleased about the supply chain changes that we made in Brazil. We moved, as I said, a very old cereal plant in Sao Paulo to a brand new production facility and lines in Parati. We opened our first Pringles production line in Latin America also in Parati, a wonderful, world-class facility. So there is a lot of reasons to be positive about those two markets. But again, emerging markets are volatile by nature, and we just want to ensure that we're prudent in our approach.

### **Laurent Grandet, Analyst**

Thank you very much. I pass it on. Thank you.

### **Operator**

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

### **Bryan Spillane, Analyst**

Hey, good morning, everyone.

### **Steve Cahillane, Chairman and Chief Executive Officer**

Hey, good morning, Bryan.

### **Bryan Spillane, Analyst**

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Just two -- I guess, two items that I just wanted to get a better understanding of that are kind of flowing through for 2020. One is, the incremental investments, are those one-time in nature? Or is it sort of rebasing higher your A&C investments? And then the second related, just thinking about the operating income, is stranded overheads. I think my recollection of the Keebler divestiture, was that the stranded overheads would not really be mitigated much in fiscal '20 because you've got the -- the TSA agreement and maybe that becomes more of a fiscal '21. So if you can give us an idea of on the stranded overhead, just again remind us the size and then the pacing of mitigating that?

### **Steve Cahillane, Chairman and Chief Executive Officer**

Yes, thanks for the question, Bryan. I'll start and let Amit take the second one. So you can think of some of this in terms of the marketing investment being one-time in nature, right? So Incogmeato will launch in a lonely launch once the RX recall that we're lapping. So there is a bit of one-time in the 53rd week you can think is particularly a one-time event in nature, and obviously we'll continue as we go throughout the year to be agile and how we think about investments required. But I would look towards 2020 as not being a rebase necessarily as being opportunistic investments against really interesting categories that we're competing in. You want to take the second one, Amit?

### **Amit Banati, Senior Vice President, Chief Financial Officer**

Yes. Just on the stranded costs, so obviously we've already initiated actions in terms of realigning the organization and we've seen some of the benefits come through in '19 and we'd expect to continue to see some of that come in 2020. However, we are a TSA as well, and that TSA, we expect to run through the course of 2020. So some of that, once we come off the TSA, would be -- addressing that would fall more in 2021. So it's a mixed bag.

### **Bryan Spillane, Analyst**

Is an order of magnitude with more of the recapture of stranded overheads fall in the '21 versus '20 in terms of what's remaining?

### **Amit Banati, Senior Vice President, Chief Financial Officer**

I'd say it's balanced, but there would definitely be some impact in 2021 once we come off the TSA and deal with those stranded costs. That will definitely be 2021, but we are also addressing stranded costs in 2020 and some in '19 already, So it's mixed.

### **Bryan Spillane, Analyst**

Right. Okay, great. Thanks for that color. We'll see you see in Florida.

### **John Renwick, Vice President of Investor Relations & Corporate Planning**

Operator, we only have the time for one more question, and it has to be short.

### **Operator**

And that question comes from Ken Goldman with JPMorgan. Please go ahead.

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## Ken Goldman, Analyst

I'll make it very short. Can you give us a...

## Steve Cahillane, Chairman and Chief Executive Officer

Thanks.

## Ken Goldman, Analyst

Quick update. I know -- hi, everybody. I know you talked a little bit about RXBAR, but Steve, can you give us a quick update on whether its distribution has recovered to the extent you had hoped a few months ago? And if not, what's going on there? Thank you.

## Steve Cahillane, Chairman and Chief Executive Officer

Yes, thanks for the question, Ken. A simple answer to that is yes. So it's recovered to its previous highs and in fact expanding beyond that. And there's a lot of really exciting innovations coming, that will expand distribution RXBAR Minis, for example, you can find in the Club channel right now, RX Oats continues to expand its distribution. Now we're focusing on advertising and velocities and getting that brand back to its momentum. And if you look at the latest Nielsen data, you can see that it's bouncing back, it's bouncing back nicely. We're really proud of the team there and really encouraged by the momentum that we see in the business and the potential that we see in the business.

## Ken Goldman, Analyst

Thanks so much.

## Operator

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

## John Renwick, Vice President of Investor Relations & Corporate Planning

Thanks everyone for your interest. And please do not hesitate to call us today.

## Operator

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

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