Barclays Global Consumer Staples Virtual Conference

Company Participants

- Amit Banati, Senior Vice President, Chief Financial Officer, Kellogg Company
- Monica McGurk, Chief Growth Officer, Kellogg Company
- Steven Cahillane, Chairman of the Board & Chief Executive Officer

Other Participants

- Andrew Lazar

Presentation

Andrew Lazar {BIO 1973907 <GO>}

Good morning, we are very pleased to welcome Kellogg's CEO, Steve Cahillane; CFO, Amit Banati; Chief Growth Officer, Monica McGurk; and President of Kellogg North America, Chris Hood to the Barclays Global Consumer Staples Conference. Heading into 2020, Kellogg was at the beginning of shifting its focus from restoring top-line growth in 2018 and 2019 to better balancing top-line growth with profitability and cash flow in 2020 and beyond.

Despite the potential disruption from the pandemic, Kellogg continues to execute well amidst the crisis with clear signs of the underlying businesses in good shape beyond the near-term boost that is increased trial, household penetration and share across its categories as well for Kellogg's growth prospects beyond the crisis, and the company looks to solidify these gains in the second half by reinvesting back in the business behind both its brands and its capabilities. We refer to hearing more about Kellogg and plans to continue the momentum into the second half of the year.

And with that, Steve, I will hand it over to you. Thanks for being here.

Steven Cahillane {BIO 4718688 <GO>}

Thank you, Andrew, and good morning, everyone. The fact that we are on video today and not altogether in Boston is just another reminder of what an incredibly strange year this is. Clearly, the crisis had been disruptive for all of us, but at Kellogg, we are striving not only to execute well through the crisis, but to emerge from it a much stronger company. Not being a quarterly earnings call, today, we're not going to provide any updates for financial performance or outlook, which we discussed on our second quarter earnings call, but we do want to share with you some of the ways in which we are making the most of the situation in order to further solidify our return to balance growth.

So today, I'll discuss how we were on the right track to begin with, how we've executed well through the crisis and how we ended the first half in a stronger than anticipated financial position. I'll point out how we're improving our share position while increasing household penetration and how we're reinvesting more in the second half in order to make sure we are communicating more than ever with consumers who are rediscovering our foods. We're also building on capabilities we know will be crucial for winning in a post COVID world. Monica McGurk, our Chief Growth Officer, will discuss one such capability that has become increasingly important and that's e-commerce; and Amit Banati, our Chief Financial Officer, and Architect of our emerging market strategy, during his time heading up our EMEA region, will discuss how our emerging markets are solid businesses that are getting stronger even amidst formidable external challenges today.

But first our forward-looking statement disclaimer, which you all know very well. So let's talk about some of the ways in which we are working to emerge stronger from this crisis. First, let's remember that we were well on our way to improve the balanced growth even before COVID hit. We launched our Deploy for Growth strategy in 2018 and it was working very well. With progress being made on each of our growth boosters, and each of our Heart & Soul boosters. Importantly, it was driving changes in behavior in big tangible actions along with improved results. You may recall many of these actions from 2019 shown on the left hand side of this slide. So we entered 2020 from a real position of strength.

We entered the year with a stronger portfolio, more geared towards long-term growth. We entered the year solidly back in organic net sales growth, which was our priority last year and most challenging aspect of any return to sustainable earnings and cash flow growth. We entered the year continuing to gradually improve our profitability, something we could give more focus to now that we have that top-line growing again, and we entered the year with a stronger balance sheet after paying down a good portion of the debt taking on to make strategic acquisitions in recent years. Indeed, we entered 2020 exactly where we said we'd be, ready to resume balanced financial delivery, balancing top-line growth with improved profitability and increasing cash flow, and then along came COVID.

The pandemic literally upended our plans, forcing us to go into crisis management mode, but it also created an opportunity to rise to the occasion and to take steps that will make us stronger in the future. It had not taken us off track. In fact, there are aspects to how we've dealt with it that give us that much more confidence in our return to balance growth.

Let's take a look at a few of these reasons for our increased confidence. First, we executed extremely well through the crisis. Our commitment to and investment in employee safety has been a paramount importance and will not abate after the crisis finally subsides, neither will our commitment to and investment in supplying the world with our foods, and we certainly will not stop giving back to our communities to which we've donated nearly $18 million since the crisis began in cash and food addressing hunger relief.

Second, the crisis has come on top of what had already been accelerated sales growth. While there obviously is a temporary element to what we have seen from COVID, it is important to remember that we were on a positive sales growth trend even before the pandemic hit. The crisis far from prompting us to rethink our portfolio had actually confirmed that the reshaping we have done in recent years was well worth it. We have seen accelerated growth rates across all four strategic segments of our portfolio during the first half even as the crisis affected categories and markets differently. This has given up increased confidence in the long-term growth rates we had assumed for each of these strategic segments.

In short, the crisis had accelerated momentum in our business. This momentum is leading to improved financial flexibility. The accelerated top-line growth in the first half experienced across all four of our regions, generated operating leverage and mix that more than offset substantial incremental costs related to safety and increased supply of products. This lifted our gross profit margin and along with having to defer some commercial investment, it's drove outsized operating profit in the first half flowing through to earnings per share.

The first half delivery was strong enough that back on July 30, we not only raised our full-year guidance, but we did so while adding investment in brand and capabilities to our second half plans. This improved P&L performance has flowed through to cash flow, which was additionally helped in the first half by diminished restructuring outlays, good working capital management and the delay of capital expenditure to the second half. In short, our financial flexibility is well ahead of where we had planned it to be.

Here's another reason for our confidence, our improving share position. Recall that in 2018 and 2019, we invested in revitalizing our brand and enhancing our capabilities. This slide shows our improving share performance in our top cereal markets around the world, but we could show you similar performance in other categories in markets around the world as well. In fact, for the first half, we held our gain share in more than half of our largest country category combinations in more than last year. Again, we were on the right track coming into the year and the crisis has highlighted just how much we have increased our competitiveness and improved our execution.

We're also getting into more homes. During the crisis, we have seen sequential and year-over-year increases in household penetration and buy rates in key categories and countries. This slide shows how we are even outpacing most of our categories in increased penetration. The exceptions are portable wholesome snacks due to industry-wide decline in on-the-go food formats and in frozen veg-vegan due to capacity constraints and an already high penetration relative to the category. However, even in these categories like others, we are seeing increased household penetration gains by many of our biggest brands.

Through data and analytics, we know that new and vast users are trying and repeating purchases of our foods across occasions. This is enabling us to tailor our messaging, targeting in outlets accordingly. It's another reason we want to make that reinvestment in the second half and it's another reason we have increased confidence in our longer-term trajectory. We already had a strong second half commercial plan and it just got a lot stronger with this increased reinvestment. This is investment in commercial activity with longer-term implications.

We're entering the refrigerated case of the rapidly expanding market for plant-based meat alternatives with a new sub-brand called Incogmeato. This not only brings our MorningStar Farms brand into another section of the store, but it enables us to better access in expanded consumer base, the so-called flexitarians, and we've modified and amplified our messaging across key cereal brands, reaching out to consumers that have tried our foods, rediscovered our foods or purchase more of our foods in the past few months. With the right messaging at the right time and place, we can convert more consumers to our iconic brands.

We continue to execute well against the Heart & Soul boosters of Deploy for Growth, whose importance has only increased during the crisis. It's not just about the donations, it's also about the culture of our company, how our brands express their values, and the workplace policies we have in place to make our company special. And as we emerge from the crisis, this kind of culture and track record becomes increasingly important to our employees, to our suppliers, to our customers, and to consumers and our share owners. So these are just some of the ways we feel we are ensuring we emerge a stronger company.

Let's get a little more in depth on a couple more areas. The first half is in the area of e-commerce and for that, I'll turn it over to Monica. Monica, over to you.

Monica McGurk {BIO 19711061 <GO>}

Thanks, Steve and hello, everyone. Two years ago, we made the strategic decision to invest in our digital capabilities. We brought in experienced talent from the outside. We invested in tools and capabilities and we launched training in e-commerce and digital across functions. We developed a strategy and approach towards e-commerce that is truly global yet allows for local flexibility and with this infrastructure and strategy in place, our work was paying off ending 2019 with strong growth and solid digital fundamentals in place. E-commerce had already been growing an importance for us every year and then came COVID. We have seen along with everyone else a step change in shopper behavior during the COVID crisis and as a result our e-commerce business has nearly doubled as a percentage of our global retail sales to about 6% in Q2. With the digital resources and fundamentals in place, we were ready for this. COVID simply accelerated our digital growth.

It's a very encouraging sign that we accelerated this e-commerce growth across all four regions. We believe our global platform is one of our key competitive advantages. About 30% of our global e-commerce sales sit outside of the United States. Cereal is well balanced with over 50% of these sales outside of the U.S. and we have a big opportunity in snacks where we get only about 15% of e-commerce sales outside the U.S.

Geographically, we are especially excited about the growth and opportunity we see for e-commerce in our emerging markets. There are also other reasons for optimism. First, we executed well even amidst extreme end-market disruption when manufacturers and retailers alike were struggling to catch up with demand and with customers in some cases, even implying temporary shutdowns and restricting category access to their e-commerce platforms.

Second, our growth has been consistent and diversified across the different types of e-commerce retailers. In every region so far this year, we are delivering double to triple digit growth with omni retailers, peer players and delivery aggregators alike. And last, while many question whether the shift to e-commerce will be sticky or simply a temporary phenomenon, we found our growth accelerating throughout Q2, closing June with our biggest month ever and this came with rising penetration even in markets that entered the crisis with high portions of the business already shifted to the online channel, such as in the UK.

Our better than category penetration of e-commerce channels underscores our advantage. This slide offers our percent of retail sales in selected categories and markets that tend to be bellwethers for our total e-commerce portfolio. You can see that in these categories and markets, our online penetration or ecomm's estimated share of total company sales is higher than that of our categories e-commerce penetration. During Q2, e-commerce penetration levels reached high double digits in many of our markets around the world significantly above pre-COVID levels and here's another sign of strength, we're gaining share in these key categories and markets.

This slide offers a sampling of key markets to give you an idea of how these share gains are not isolated to a particular market or category. In fact, we are outperforming the category in markets that account for 92% of our global e-commerce sales. In about half of our categories, we also have a higher share online than offline meaning this is not simple channel shifting, but true overall growth. It is also efficient growth because of the important role of big brands in the online environment. For us 90% of our global e-commerce sales are generated by our top 20 brands and growth accelerated across all of them during the first half of this year. Of course, all of this is just one aspect of our total e-commerce strategy. We continue to develop exciting direct-to-consumer platforms that allow us to rapidly test and learn and generate valuable data.

Similarly, we are in market with business-to-business platforms that digitize the selling experience for high growth, high frequency stores. By creating this kind of always on access and an improved customer experience, this business to business platform helps us despite COVID based restrictions that prevent our salespeople from physically calling on an outlet. They also drive frequency of purchase and are delivering double-digit improvements in sales value per outlet as well as portfolio penetration. So as I hope you can glean from this discussion, this is not just a story about a channel. E-commerce is a powerful facilitator for our overall business performance and aspect of our overall digital fitness and an indicator of how well-positioned we are to compete in the future.

So in summary, the work and investment we've done around digital capabilities is paying off. If anything, COVID is simply accelerating and accentuating these capabilities. Today, we have stronger than ever data and analytics at just the right time to reach out to households that have reappraised our products during the crisis. Our share gains in key categories and markets give us momentum that we and our retailer partners can build on. In emerging markets, we are just scratching the surface and what we can do to boost e-commerce penetration and growth in our categories, and around the world, we are finding new ways to leverage all these digital capabilities to help our customers grow. It's certainly an exciting time.

And with that, I'll hand it over to Amit.

Amit Banati {BIO 16339861 <GO>}

Thanks, Monica, and hello, everyone. As we've discussed, the key element of shaping a growth portfolio has been our diversification and scaling up in emerging markets. Through acquisitions, partnerships and internal development, we have greatly increased our exposure to the markets that have driven and will continue to drive packaged food growth.

In 2019, emerging markets accounted for more than 20% of our net sales, more than most of our peers. In fact, particularly in the past couple of years, these emerging markets have been a big driver behind our return to net sales growth. This has continued in 2020 with the COVID crisis contributing to an acceleration of our emerging markets growth, especially in cereals. We believe our emerging markets business give us a leg up over time on achieving sustainable top-line growth and as we build for the scale, margin expansion.

Some investors have expressed concern about the potential for near term volatility in these emerging markets, particularly given the COVID related lockdowns and adverse macroeconomic conditions being experienced right now in these markets, and indeed, we did see slowing of our growth in emerging markets during quarter two particularly in our snacks categories, but we see our emerging markets as a source of strength. And while they are being battle tested like never before, you can see that our growth has held up very well this year, especially relative to our peers.

So let's discuss some of the sources of this strength. First is our diversification. From a geographic standpoint, we are fairly well balanced across the key emerging markets sub-regions. Right now, all are facing common headwinds, COVID lockdowns and economic recession, but the degrees of impact can vary greatly and over time they tend to hit headwinds and tailwinds at different times. Importantly, we're also diversified from a category standpoint. For decades, we grew these businesses with just cereal, but this often limited us to modern trade channels and higher income consumers.

Today, we are significantly more diversified. Snacks are led by Pringles, but we also have wholesome snacks in some markets of Asia and Latin America, biscuits in the Middle East, Russia and Brazil, and we have launched more affordable extruded snacks in Africa. These snacks are vital for entering the traditional trade that predominates most of these emerging markets. And we also have noodles, which gives us access to a category more accessible at lower income levels. Most of our noodles are marketed through our partnerships in West Africa and distributed there by Multipro, but outside of West Africa, we have essentially build a Kellogg's branded noodles business from scratch and it is expanding rapidly.

Our next source of strength comes from the work we've done to ladder down the price pyramid ensuring that we have offer affordable price points. This is key to making our products more accessible to more of the population, but it's particularly important during times of economic weakness like we are experiencing now. Many of you have expressed a desire to learn more about our operations in Africa. Indeed, we view our Africa presence as another source of strength. We have had a longstanding stronghold in South Africa where our beloved brands are practically viewed as local brands.

Through acquisitions in Egypt back in 2015, we created a second beachhead in Northern Africa and the Middle East. And then starting in 2015 and expanding in 2018, we established a partnership with Tolaram in West Africa. With these three strongholds, we have on the ground operations in Africa's three largest economies, and can expand across the entire continent. And we're not small here. What was once less than $100 million in annual net sales is today approaching close to $1 billion and its growth prospects are strong.

In addition to geographic presence in key markets, we also have a very strong portfolio. Our foods span categories, occasions and price points, and our brands are well known and leaders in their categories. This is an advantage particularly when selling into the traditional trade. Beyond the obvious growth prospects, we view our operations across Africa as a source of strength for the following reasons. Firstly, our experienced management teams. For instance, our partner Tolaram has been operating in West Africa for four decades managing effectively through every conceivable challenge.

Secondly, the strength of our portfolio, which we'll discuss further in a moment. Thirdly, our local supply chain. These aren't export markets for us. We have modern manufacturing and distribution capabilities on the ground in these markets. And fourth, our go-to-market strength. This is most notable in Nigeria where we have Multipro and we'll discuss that in a in a moment, but we've also been very selective about our route to market and distributor relationships in other markets as well.

Let's explore a couple of these in more details, focusing on West Africa in particular. We talk often about building a competitive mote around our business. This is especially the case in West Africa. Consider the strength of our brands, here, we are leaders in noodles with an 80% market share. We have also expanded rapidly into cereals and snacks with a Kellogg brands as well as some internally developed brands. Through Multipro, we also participate in other large consumer categories, like milk, cooking oil, and pasta.

Our route to market is another competitive mote for us. Multipro is one of the largest distributors for packaged foods in West Africa. Its distribution reach is exceptional and it is a marketing and sampling powerhouse. Because it is the only element of our West Africa operations that fully runs through our P&L, it appears to be a margin headwind, but make no mistake. It is a key driver behind the growth in our high margin but unconsolidated joint ventures and partially owned branded noodles company there.

So our West Africa operations are very strong led by Multipro, and while it certainly isn't immune to macroeconomic challenges, Multipro has a proven ability to manage through them. This year an enormously strong quarter one was followed by challenges in quarter two and COVID related lockdowns, and a pressured economy and while Multipro's sales growth slowed because of these challenges, it only slowed to high single digit growth.

So in summary, our emerging markets businesses are a source of strength for us. We believe we have strengthened them significantly in recent years with reasons to believe they can manage effectively even during times of extreme challenges, like what we are experiencing today. They will be battle tested for sure, but we believe they will emerge from this crisis even stronger.

And now, I'll turn it back to Steve for some final remarks.

Steven Cahillane {BIO 4718688 <GO>}

Thanks, Amit. While COVID seems to be changing everything right now, we had not changed our goal of becoming a stronger, more dependable company. The crisis has been disruptive, there's no doubt about that, but we had good momentum heading into this year, and the crisis has accentuated what it created that momentum in the first place, the strength of our brands and the balance of our portfolio, the flexibility of our supply chain, and the improved agility of our new organizational structures, and the talent of our employees and the execution of enhanced capabilities. We will emerge a stronger company. We've experienced reappraisal by new and vast households. We are increasing brand awareness by not letting up on advertising.

We are revitalizing cereal brands and launching a new plant-based sub-line in Incogmeato. We are optimizing our lineup of SKUs to reduce complexity. We're leveraging our improved and leading capabilities in data and analytics, and in e-commerce. We are strengthening our position in emerging markets. We are bolstering our financial flexibility ahead of our plan and we are more than ever acting as a company with Heart & Soul. So we don't think our trajectory has changed, but what we've done this year certainly gives us ever more confidence in that trajectory to a sustainable and balanced growth.

And with that, we're happy to take your question or two.

Andrew Lazar {BIO 1973907 <GO>}

All right. Thanks, Steve. Yes, we've got it, just a couple minutes here. Maybe I'll start off just a little more broadly. And when we think about how the pandemic maybe has changed anything regarding Kellogg's strategy or portfolio, I'm curious as an example, Kellogg might have been more focused on garnering new households may be pre-pandemic. Now, you've gotten this incredible windfall as the industry has around incremental households, it's kind of like a greatest CPG trial experiment of our lifetime. Does that change the strategy now in terms of moving towards how you convert these consumers right into longer-term repeat buyers versus how you were just trying garner them in the first place?

Steven Cahillane {BIO 4718688 <GO>}

Great. Thanks, Andrew. If anything this pandemic and our strategy, it's like our strategy was built for a moment like this. It was working beforehand, but when you think about what you just talked about households and new households and if you ever had any doubt at all that occasion based marketing and focused on occasions was not the right approach, the pandemic clearly proves it wrong. So you look at just one occasion like morning breakfast at home with family, well that occasion exploded virtually overnight because of the pandemic and our strategy is all about winning through occasions, and so we're purpose-built for this.

When you think about shaping a growth portfolio, Amit just walk through what we've done in emerging markets. The acquisitions and investments that we've made in route-to-market capability and affordability in West Africa and Brazil and others again sets us up perfectly for a recessionary environment because we have the right route to market, we have affordable brands and we have a strong portfolio. You think about the divestiture and how that shaped our portfolio, again purpose-built for this moment. You think about perfect service and perfect store in an environment where service and being on shelf is absolutely critical, the investments that we've made in supply chain and e-commerce that Monica walked through again are purpose-built for the new moment that we're in right now and as the future unveils itself, again focused on service, perfect service in perfect store couldn't be more appropriate, and then finally building world-class brands.

Obviously, consumers are gravitating towards brands that they know, love and trust, and we're doubling down on the investments in some of the most iconic brands in this space. And so all bolstered by our Heart & Soul boosters and our strategy around giving back to communities we believe we are on the right track. We're coming out of this in a much stronger way and it's a horrible thing that the world has to go through this crisis, but we are unapologetically investing in everything that we can to come out of it a stronger company.

Andrew Lazar {BIO 1973907 <GO>}

One very last quick one would be we've all been very focused around the top line opportunity that is brought about by this crisis. I think a lot of food companies are just starting to talk about maybe some of the learnings from the pandemic and thinking about maybe some of the longer-term structural opportunities maybe on the cost side that could come out of this, whether it's travel or global real estate or consulting fees and things of that nature. I'm curious what your viewpoint on this is? Maybe what's some of the learnings while early you're getting from this and maybe how some of this could potentially provide a little visibility as we go into 2021 even in obviously in the context of what will of course be difficult pandemic driven comparisons for everybody?

Steven Cahillane {BIO 4718688 <GO>}

Yes. So we started in this pandemic and I won't rattle from because time, three priorities, keeping our people safe, food flowing through the system and getting back to communities and we quickly added the fourth priority, which is how do we win in this new environment. And a lot of that is the investment that we're making, but a lot is understanding what consumer behavior is going to be and what business operations are going to be in the future and those two things are interrelated, and so everything from like your conference right here, Andrew, with far greater participation even than last year because of the accessibility that not needing to travel gives. The technology that has jumped far into the future creates untold opportunities for running businesses that were almost unimaginable pre-pandemic and so we're studying these things in terms of how we operate our business to be more cost-effective, but engaged way in the future focused on efficiency and effectiveness, and a lot of that will be more affordable and cheaper as cost come out, but also then consumer behavior and how that changes, and those two things are interrelated, because people will be spending more time at home that is undoubtable. So it presented us dual opportunities in how we run our business and how we connect to consumers.

Andrew Lazar {BIO 1973907 <GO>}

Well, I want to thank you Steve, Amit, Monica, Chris. Really appreciate all your help and hopefully, we'll all be doing this in person next year, but until then looking forward to tracking your progress. Thanks again.

Steven Cahillane {BIO 4718688 <GO>}

Thank you. Thanks everybody.