Q2 2021 Earnings Call

Company Participants

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

Other Participants

- Alexia Howard
- Bryan Spillane
- Chris Growe
- Eric Larson
- Jason English
- Laurent Grandet
- Michael Lavery
- Rob Dickerson
- Robert Moskow
- Steve Powers

Presentation

Operator

Good morning. Welcome to the Kellogg Company's Second Quarter 2021 Earnings Call. All lines have been placed on mute to prevent any background noise. 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, Gary. Good morning, and thank you for joining us today for review of our second quarter 2021 results as well as an update regarding our outlook for the full-year 2021.

I'm joined this morning by Steve Cahillane, our Chairman and CEO; and Amit Banati, our Chief Financial Officer. Slide number 3 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 this presentation as well as to our public SEC filings.

This is a particular note during the current COVID-19 pandemic when the length and severity of the crisis and resultant economic and business impacts are so difficult to predict. A recording of today's webcast and supporting documents will 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 an organic 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. I hope you and your families are doing well. There is no question that we're still managing through a pandemic. In this environment, keeping employee safe remains job number one and aiding our communities is more important than ever. We also continue to supply the world with food, though this remains challenging as the pandemic persists. A reacceleration of COVID cases has brought on new restrictions causing temporary shutdowns of production in some countries. Meantime, we and the vendors that supply us are having to manage through bottlenecks and shortages of materials, labor and freight all created by demand supply imbalances that are also pushing up costs.

So 2021 is shaping up to be anything but business as usual, and I'm extremely proud of how our organization continues to persevere and succeed in such challenging conditions. I'm also pleased with how well we continue to execute against our strategy deploy for balanced growth, which is depicted on Slide number 6. From a business perspective, demand in eating occasions at home remained elevated in quarter two, but they are gradually shifting as consumer mobility returns. In the second quarter, this was reflected in an as forecast continuation of decelerating at home demand growth as measured by two-year compound annual growth rates in our cereal and frozen categories around the world.

We also saw signs of gradual recovery in away-from-home channels in an on-the-go snacks and pack formats. These channels grew year-on-year and better than forecast even if they remain below 2019 levels. Our deploy for growth boosters are working effectively from focusing on ever-evolving occasions to leveraging our reshaped portfolio, to driving momentum in our world-class brands, and to investing in our supply chain to better serve our customers. Our Better Days boosters with further our ESG efforts continue to work effectively as well.

A few Better Days highlights our shared on Slide number 7. During the second quarter, we continue to progress toward our ongoing Better Days commitments. This Slide calls out a few of our actions and achievements of the quarter. The key message is that this remains a critical element of our strategy, a clear focus of management, and a part of the DNA of Kellogg company.

And we turned in another quarter of strong business performance in the second quarter as discussed on Slide number 8. Overall, at-home demand remained elevated and we saw continued recovery in our away-from-home channels. Most encouraging has been the momentum demonstrated by key long-term growth engines for us. Our world-class snacks brands sustained their momentum with many continuing to outpace their respective categories. Our plant-based protein business is continuing to show strong growth. Our emerging markets businesses sustained their rapid growth and continued to excel even amidst challenging business conditions. Meanwhile, we continue to manage through the global supply challenges I referred to earlier, even as we continue to bring on our plan capacity increases.

From a financial standpoint, our second quarter continued the balanced delivery that we returned to in 2020. Specifically, comparing to pre-COVID 2019, we realized another quarter of strong organic top-line growth and operating profit growth, as well as improved cash flow generation. We are affirming our full-year guidance today. Like so many others, we are currently facing increased cost inflation and supply hurdles, and that is factored into our second-half assumptions. Nonetheless, the business is showing good momentum. And just as we work through these challenges in the second quarter, we're confident we can work through them in the second-half as well.

Let me now turn it over to Amit, so he can take you through our financial results and outlook in more detail.

Amit Banati {BIO 16339861 <GO>}

Thanks, Steve. And good morning, everyone. Our financial results for the second quarter are summarize on Slide number 10. It was another strong quarter, best viewed on a two-year basis because of the unusual period we were lapping from last year. On an organic basis, we nearly matched last year's unusually high net sales, generating 4.5% growth on a two-year compound annual growth rate or CAGR basis. This came in better than expected. Thanks to an impressive momentum in emerging markets and faster improvement than expected in our away-from-home channels.

Currency neutral adjusted basis operating profit declined against last year's exceptional quarter when it grew 27% despite losing about 8 points to divestiture impact. Excluding those divested businesses from the 2019 base, our operating profit in quarter two this year grew at a two-year CAGR of about 8%. This is strong growth that indicates underlying margin expansion. Currency neutral adjusted basis earnings per share declined as it lapped last year's outsized growth, but it grew about 9% on a two-year CAGR basis excluding the divestiture impact on operating profit. And cash flow was again stronger than anticipated for the quarter. And while it lapped last year's unusually high level, this cash flow was again higher than that of quarter two of 2019.

So, on a two-year basis, we saw another quarter of good top-line growth, margin expansion and conversion of profit into cash flow. That's the kind of balance we strive for. Let's examine these results in a little more detail. We will start with net sales on Slide Number 11. Net sales remain strong despite tough comparisons. Volume declined against last year's double-digit surge while remained up on a two-year basis even despite and as expected reversal of shipment timing from quarter one in North America. Price mix was again an important driver. Once again, most of this price mix growth came from revenue growth management initiatives implemented in all four regions. Mix was only slightly positive, as a mix shift towards snacks was partially offset by resume mix shift towards Multipro, our West African distributor business.

Our two year organic net sales CAGR was 4.5% in quarter two, a very strong performance. Rounding out net sales, foreign currency translation was again positive in quarter two. As we look to the rest of the year, we assume continued deceleration in at-home demand with moderation and away-from-home declines being more modest due to the mix of our channels. We've seen this reflected in our two year CAGRs from quarter one to quarter two, and we expect this deceleration to continue into quarter three and quarter four. And based on where ForEx rates are right now, we would expect to see a less positive impact on net sales in the second-half.

Moving down the income statement. Slide number 12 shows two important drivers of our profit margin performance. As you know, our gross profit margin in quarter two was lapping outsized operating leverage in quarter two 2020, when our plans ran flat-out, producing only a limited lineup of SKUs. But importantly, our gross margin in quarter two as in quarter one increased from 2019 levels. Productivity and price realization drove this two-year improvement more than overcoming high cost inflation, labor and freight disruptions, COVID related costs and a mix shift towards emerging markets. So this two year improvement is very encouraging.

As we'll talk about in a moment, we expect to see more pressure on gross margin in the second-half than we did in the first-half, reflecting the current operating and cost environment. Operating profit margin remained higher than quarter to 2019 as well. This reflects the gross margin performance and good discipline on overhead. Brand building investment while up double digits against last year's delays was up more modestly versus two years-ago. As we look to the second-half, our SG&A expense may provide some offset to the gross margin pressure. SG&A expense in the second-half should moderate year-on-year, not only because of last year's back weighted brand building particularly in quarter four, but also because of lapping last year's incentive compensation. This could be partially offset by a gradual resumption of travel and related activities as economies reopen.

Moving down the P&L, let's turn to Slide number 13. During quarter two, interest expense decreased year-on-yea on lower debt, and this decrease will continue for the remainder of the year with quarter four additionally lapping the $20 million debt redemption costs we recorded last year. Of note, during the quarter, we issued our first ever sustainability bond, which was very well received. Other income increased modestly year-on-year to a level that is a little higher than we would expect for the remaining quarters, owing to favorability in various nonpension items. Our effective tax rate of 22.6% was essentially in line with our full-year forecast rate.

JV earnings and minority interest together were roughly in line with last year and average shares outstanding decreased year-on-year, reflecting the impact of quarter one's buybacks. We still expect full-year average shares outstanding to be around 0.5% lower than 2020. Let's now discuss our cash flow and balance sheets shown on Slide number 14. Year-to-date, our cash flow remains below last year's unusually high level as expected, but well above that of the first-half of 2019. This two-year increase is driven by our improved operating profit and improved cash flow conversion. We finish the first-half ahead of our expectations for cash flow. And as we look to the rest of the year, cash flow should remain below last year's COVID related levels, but still well above 2019. Meanwhile, our balance sheet remains solid. Net debt remains roughly even with last year and lower than each of the prior two years, even despite our increase in cash return to share owners in form of resumed share buybacks and increased dividend. So our financial condition is quite strong.

Slide number 15 shows where our results stand after the first six months of 2021. Obviously, we've had a good year so far, producing strong and balanced financial results on a two-year basis and staying modestly ahead of our own internal forecast. This strong start is although more important when you consider just how much more challenging the business environment has gotten lately.

Now, let's discuss our full-year guidance shown on Slide number 16. As Steve mentioned, we are affirming our overall guidance. Within that guidance, we are raising our net sales guidance. We are now calling for organic growth of flat to up to 1%, which is a bit higher than our previous guidance for flat, reflecting our business momentum particularly in emerging markets. This equates to almost 3% growth on a two year CAGR basis. Volume will continue to lap last year's large gains, but price mix will remain positive as we execute revenue growth management actions to cover higher input costs.

Our guidance for currency neutral adjusted operating profit is unchanged, still calling for a year-on-your decrease of about 1% to 2%, equating to almost 4% growth on a two year CAGR basis, excluding the divestiture impact. This reflects our stronger-than-expected quarter two profit and raised full-year net sales outlook, balanced by increased cost pressures and operating challenges that make us a bit more cautious about the second-half. Specifically, we have the productivity and revenue growth management actions in place to continue to cover high market driven cost for commodities and freight. However, the economy wide supply chain challenges that Steve mentioned are impeding production and shipping and creating incremental operating costs as well, particularly in quarter three. Because of this, we now expect gross profit margin to finish 2021 slightly below 2019 levels or well above 2019 in gross profit dollars. We're also affirming our guidance for 1% to 2% growth in currency-neutral adjusted earnings per share, which equates to almost 5% growth on a two-year CAGR basis. And we continue to look for cash flow to finish the year in the range of $1.1 billion to $1.2 billion. This outlook balances the momentum in our business with the challenging operating environment and balances our margin protection actions against heightened cost pressures.

To summarize, we remain in strong financial condition, and we remain solidly on track for continued balance financial delivery on a two-year basis.

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

Steven Cahillane {BIO 4718688 <GO>}

Thanks, Amit. Before we get in each of the four regions, let me start off by highlighting the strength of some of our most important growth drivers. The first is Pringles shown on Slide number 18. This $2 billion global retail sales brand continues to perform well around the world. Here in the United States, it continue to outpace the category on consumption growth using a two-year CAGR to eliminate uneven comparisons. It's also outperforming the category on household penetration gains since the pandemic. And around the world, we are seeing similar momentum. We're seeing growth in original and core flavors. We're seeing incremental growth from innovations like Scorchin and Sizzl'n.

Equally impressive has been Cheez-It, another world-class brand shown on Slide number 19. This $1 billion retail sales brand continues to perform well in the U.S. Its two year CAGRs remain well ahead of the categories growth and its household penetration has grown in contrast to the rest of the category. Meanwhile, our launches of this power brand in the Canada and Brazil are off to strong starts.

Let's not overlook two other world-class snack brands. On Slide number 20, we can see the continued strength of Pop-Tarts and Rice Krispies Treats. Together, these two power brands represent $1 billion in measure channel retail sales in the U.S. alone. You can see from the Slide that they are in terrific shape as well. Their consumption has continued to outpace the portable wholesome snacks category on a two year CAGR basis. And these brands have added household since the pandemic, whereas the overall category has not.

Plant-based protein and our leading MorningStar Farms brand is another growth driver that is performing very well. As shown on Slide number 21, this $400 million retail sales brand continues to show strong consumption growth on a two year CAGR basis, and it's continue to add to its household penetration. A key advantage of MorningStar Farms is the breadth of its offerings across product types. And in Q2, we continue to see double digit two year CAGRs across segments like chicken, appetizers, breakfast meat and sausages. We continue to innovate against this brand, including its sub-brand Incogmeato, which continues to add distribution and share and is proving to be incremental to the MorningStar Farms franchise. MorningStar Farms growth has bumped up against our capacity at various times in the past year, even as it has faced numerous new entrants into the category. This is creating a lot of excitement in the category and we are pleased with our momentum and prospects.

And of course there's Eggo shown on Slide number 22. This $900 million retail sales brand continues to perform well in the U.S. as indicated by its strong two year compound annual growth in consumption and by its better than category performance on household penetration. Meantime, the brand continues to grow on a two year basis in Canada and Mexico as well.

Our emerging markets are another key growth driver for us. And as you can see on Slide number 23, they have actually accelerated their growth over the past couple of years. As we've discussed many times, this is a testament to our geographic footprint, our portfolio of foods and brands, our local supply chains, our go-to-market and our experience management teams. As you can see from the chart, we continue to record impressive growth in these markets in Q2, even in-spite of challenges related to COVID. We grew strongly in Africa, Asia, Latin America and Russia. And we continue to grow in cereal, snacks and noodles. Emerging markets represent more than 20% of our net sales, and are expected to remain an important growth driver for a long time to come.

So, some of our portfolios most important growth drivers are very clearly showing good momentum and have only strengthened over the past year. And these aren't small businesses even just the one I discussed here collectively represent more than half of our company's net sales.

Let's now discuss each of our regions. We'll start with North America on Slide number 24. We sustain net sales growth on a two year basis in North America even if that growth rate was held back by the pandemic's negative impact on away-from-home channels and on-the-go pack formats. Moreover, versus last year, our volume in Q2 was not only lapping last year's double-digit surge, but also felt the impact of our previously discussed shift of shipments into Q1 and resultant trade inventory coming out as expected during Q2.

Importantly though, we realized good price mix growth driven by revenue growth management actions. And our overall sales growth was supported by good underlying consumption trends. We outpaced four of our six primary categories on a two year compound annual growth basis with our two-year consumption growth accelerating sequentially from Q1 in five of our six categories. And as we discussed on the past few Slides, this strong performance is being driven by many of our biggest brands. So the underlying fundamentals look good.

On operating profit, remember that we were lapping a year-ago quarter in which operating profit grew 36% excluding divestiture impact and unusually strong quarter elevated by at-home demand outsized operating leverage and delayed brand investment during the height of the pandemic. On a two year CAGR basis though, you can see we continued to generate good operating profit growth driven by top-line growth productivity and price mix. These have been able to offset the impacts of extremely high cost inflation this year as well as the frequent shortages of materials freight and labor, which are most pronounced in North America.

Let's take a closer look at our category groups in North America. Slide number 25 shows that our net sales for snacks in North America continue to grow both on a one-year and a two-year CAGR basis, despite declines in away-from-home channels and many on-the-go foods and pack formats.

U.S. consumption remains solid on a two-year CAGR basis, outpacing all three of our snacks categories and led by power brands. In crackers, we outpaced the category on a one year and two year CAGR basis, led by continued strength in Cheez-It and Club. In salty snacks, we outpaced the category on a one year and two year CAGR basis as well due to continued strength in Pringles, particularly its core four flavors, its new scorching innovation and multi packs.

And in portable wholesome snacks, we are seeing brands like Pop-Tarts and Rice Krispies Treats hold up very well on a two year CAGR basis, while also starting to see signs of recovery in our more on-the-go oriented brands like Special K Nutri-Grain and RXBARs. In North America cereal shown on Slide number 26, organic net sales were off slightly on a two year CAGR basis due to declines in away-from-home channels. We also saw the impact of being capacity constrained on certain brands. In the U.S., the categories consumption was flat on a two year CAGR basis in Q2. And after being down about 1% in Q1, we improved the flat in Q2, keeping up with the category on that basis.

Frosted Flakes accounted for most of the share decline related to pulling back on brand building and merchandising since Q4 last year, as we work to maintain service levels and add capacity planned prior to the pandemic. Unfortunately, our capacity expansion has been slowed by current supply shortages, and by a recent fire in one of our facilities. This will delay our return to normal commercial activity unaffected brands. In the meantime, our business continues to progress well. We continue to lead the category and share of innovation, and we are seeing better performance in wellness oriented brands, like Raisin Bran, Special K, Kashi and Bear Naked.

And on Slide number 27, we can see that our two frozen businesses plant-based foods and frozen breakfast also continue to grow on a two year CAGR basis, even despite capacity limitations and declines in away-from-home channels. We've already discussed both of our key brands in frozen MorningStar Farms plant-based foods and Eggo from the griddle foods, both continue to generate strong consumption growth on a two-year CAGR basis and both are poised to sustain growth.

And before we move on from our discussion of North America, we should touch on our U.S. away-from-home business on Slide number 28. The Slide shows rolling two year average growth rates in our net sales over the past few quarters in these channels. As restrictions eased and consumer mobility increased, we saw gradual recovery get underway in these channels. It remains to be seen whether this trajectory will continue given recent pandemic developments. So our North America region continues to perform well even as we work to catch up to demand and work our way through industry-wide shortages of freight, labor and materials.

Now let's take a look at Europe shown on Slide number 29. Kellogg Europe posted its 15th consecutive quarter of organic growth, a remarkable track record of consistency in this market. Volume had to lap a year-ago surge, but we sustained good price mix growth driven by RGM actions. And on a two-year CAGR basis, you can see that we remain in strong net sales growth with this growth being driven by both snacks and cereal. Importantly, we also continue to perform well in market. Retail scanner data indicate only modest sequential deceleration of category and Kellogg consumption grows on a two year CAGR basis. On that two year CAGR basis, we kept up with the salty snacks category with particular recent strength in France and Spain. Our consumer promotion around the Euros soccer tournament was our biggest summer promo ever for Pringles.

In cereal, our two year growth has outpaced the category in most markets led by key brands like Crunchy Nut in the UK, and Tresor and Extra in continental Europe, and Coco Pops and Coco Krispies more broadly. Europe's operating profit lapped a year-ago quarter in which operating profit grew more than 35% when it was elevated by at-home demand, outsized operating leverage and delayed brand investment during the height of the pandemic. Nevertheless, on a two year CAGR basis, we grew our profit at a double-digit rate in Q2. So clearly, Kellogg Europe continues to perform very well.

Moving the Latin America in Slide number 30. Latin America had a notably strong quarter. It grew organic net sales by 9% on top of last year's 14% gain, resulting in strong double-digit growth on a two year CAGR basis. Volume had to lap last year's 11% surge, and this was felt primarily in cereal. But we sustain strong price mix growth, driven by RGM actions across the portfolio and markets. The result was a year-on-year net sales growth in all sub-regions and as shown on the Slide sustain momentum on a two year CAGR basis.

Scanner data do indicate a gradual slowing of at-home demand, which for us manifest itself in cereal. Nevertheless, our two-year CAGRs for consumption remains strong in our key cereal markets with Kellogg exceeding category growth rates particularly for big brands like Corn Flakes and Fruit Loops.

Similarly, Pringles, outpaced two year CAGRs for salty snacks categories in key markets and is gain share on a one year basis in our biggest markets Mexico and Brazil. Meanwhile, our Parati business in Brazil continue to post strong consumption growth and increased share in biscuits. While operating profit had to lap a near doubling in the year earlier quarter, it was still up strongly on a two year CAGR basis despite high cost there were heightened further by adverse transactional currency exchange. We clearly are performing well in this region. And while we are somewhat cautious about decelerating at-home demand and further regulatory pressure in the second-half, this year is certainly shaping up to be a good one for Kellogg Latin America.

And we'll conclude our regional discussion with AMEA on Slide number 31. AMEA produced another quarter of exceptional organic net sales growth, both on a one year and two year CAGR basis. Both volume and price mix contribute to the strong year-on-year growth. Geographically, the growth was broad-based and driven by emerging markets. It was led by double-digit gains in Africa. Within Africa, we experienced notably exceptional growth in Nigeria. Our business there has been dependably in growth for a long time, and it's recent acceleration and momentum has been impressive. Meanwhile, we also generate good growth elsewhere in Africa and in the Middle East. We generated double-digit organic net sales growth in Asia as well, and the gains were broad-based across markets like India, Japan, and Korea, and the growth came from both snacks and cereal. Even in developed market Australia, our sales were roughly flat against last year's surge. AMEA's operating profit growth was also outstanding in Q2, growing 25% year-on-year. So AMEA continues to demonstrate strong momentum. And while we would not expect it to keep up this exceptional rate of growth, it is very clearly a dependable growth driver for us.

Allow me to wrap up with a brief summary on Slide number 33. We have completed another quarter of strong execution and performance, capping a first-half that featured the following: underlying business momentum driven by our biggest brands; unlocking capacity, so we can resume full commercial activity in certain products; sustained growth momentum in emerging markets; leveraging enhanced capabilities from data and analytics to innovation to ESG; strong cash flow and balance sheet, providing financial flexibility and increased cash to share owners; a continuation of balanced financial delivery and an affirmation of our full-year guidance, as top line momentum helps offset the impact of higher cost pressures and global supply chain obstacles.

As I mentioned earlier, the current business environment is anything but business as usual. In addition to the challenges of ensuring our employee safety, we and the entire economy are wrestling with tight supply of materials, freight and labor, as well as the related rise in their costs. We manage through this environment very effectively in the first-half and we have firm guidance today with confidence that we will continue to manage through it in the second-half. We remain as convinced as ever that we are stronger today as a company.

So before closing, I want to thank our Kellogg employees for their dedication and hard work, and what have been incredibly challenging circumstances.

And with that, we'd be happy to take any questions you might have.

Questions And Answers

Operator

(Question And Answer)

We will now begin the question-and-answer session. (Operator Instructions) Our first question comes from Bryan Spillane with Bank of America. Please go ahead.

Q - Bryan Spillane {BIO 2147799 <GO>}

Hey. Good morning, everyone.

A - Steven Cahillane {BIO 4718688 <GO>}

Good morning, Bryan.

Q - Bryan Spillane {BIO 2147799 <GO>}

So I guess my question is around the commentary just around the rising costs and some of the supply chain issues like sourcing materials in North America. And so my question is, in terms of mitigating that you've taken some actions in the second half to begin to try to mitigate. But I guess as we go forward, how should we think about, how much of this maybe leaks into the first half of next year? And are there other incremental actions, whether it's pricing or productivity that you might have to take in order to sort of stay on top of this as we move beyond this current fiscal year?

A - Steven Cahillane {BIO 4718688 <GO>}

Yeah, thanks for the question, Brian. And you hit on some of the most important activities. And we always like to say that our first line of defense against something like this is productivity, right. So we've been working hard at productivity and looking for every area where we can be more efficient. And then RGM, obviously everything about RGM and the capabilities we've been building is very important right now, because the surge in inflation that we're all seeing, which is clearly industry-wide is --I am not telling anybody anything they don't know is quite significant.

And on balance, probably the most we've seen in nearly a decade. And so all these things are going to be very important, but we're going to continue to invest in our brands, because as you've heard me say before, we can go to the trade and talk about rising commodity prices, and all these things which are very factual. But the more we spend against our brands in terms of innovation and making sure that they pull off the shelf, the more we earn the right, to have those discussions with our retailers as it moves into the future into '22, it's hard to say how long this persists. It's very pervasive. There's certain things that are clearly going to unwind containers will eventually find their rightful places on the world, labor shortages should mitigate. But it's hard to predict and we're planning for an ongoing challenging cost environment well into next year. Amit, I don't know if you have anything.

A - Amit Banati {BIO 16339861 <GO>}

I think, just to build on what Steve said, if you look at our inflation, it came in higher than what we had expected in the second quarter. I think we kind of closed the first half at around mid-single-digit rates of inflation, and I think as we look to the second half, we expect that to accelerate to high single-digits. I think, as you'd have seen in our quarter two results, we're seeing strong price mix come through globally. So across all our markets, and that will continue to be an emphasis in the second half as well. We are taking a revenue growth management actions and you'll starts -- and you will continue to see the impact of that in the second half as well.

And then I think just from a margin standpoint, like I mentioned our outlook now for the year is that our gross margin will be slightly below 2019 levels, but I think it's important to note that our gross profit dollars will be higher than in 2019.

Q - Bryan Spillane {BIO 2147799 <GO>}

Okay. Thanks, Steve. Thanks, Amit, appreciate the color.

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.

Q - Alexia Howard {BIO 15082983 <GO>}

Hi there. So just a couple of questions. On the production and shipping issues, is that really just speaking to the fire and perhaps labor problems on the cereal side of the business in the U.S.? Or is it more broad-based? And would we expect more out of stocks to happen as a result of that? And then I have a follow-up.

A - Amit Banati {BIO 16339861 <GO>}

I think Alexia, this is Amit here. It's broad based, and I think everyone seeing it. If you kind of look at labor shortages, there are widespread shortages of labor particularly here in the U.S. and that's impacting the freight market. We've seen the spot market in the freight significantly up due to a shortage of drivers. It's impacting our operation in our factories in terms of just labor, and it's impacting the entire supply chain. So, we are seeing it in our suppliers as well.

So it is broad-based. And then when you look internationally COVID is raging in some emerging markets and so you've seen COVID restrictions kick-in, and a couple of our facilities have been impacted because of COVID restrictions, so broad-based.

Q - Alexia Howard {BIO 15082983 <GO>}

Great. I really appreciate it. And just a really minor follow-up. Are you able to quantify the currency impact on EBIT and on operating profit and earnings per share for the full year? Just so that we have an idea of what guidance implies.

A - Amit Banati {BIO 16339861 <GO>}

Yeah. I think, it's hard, I mean, it's hard to kind of forecast exchange rates. I think if you look at where the rates are today, you'd say that, it's about a 2% on the EPS from our ForEx standpoint. It's about 1% to 2% on a net sales basis.

So that's kind of the -- if you look at just where rates are today.

Q - Alexia Howard {BIO 15082983 <GO>}

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

Operator

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

Q - Rob Dickerson {BIO 19993946 <GO>}

Great. Thank you so much. So just a question around emerging markets. Stevie, you've said, it's about 20% of the business; obviously we've seen some nice pricing already come through there, even though it looks like currencies hasn't been a headwind. So I'm just curious kind of net-net within kind of the broader emerging market platform you have, has the strategy just been you hope that volumes essentially can remain somewhat steady, as you get through that back half of the year, while pricing still elevate and maybe there were just some pricing opportunity, I think that you had spoken to kind of coming out of Q1? Then I have a quick follow-up.

A - Steven Cahillane {BIO 4718688 <GO>}

Yes, thanks for the question, Rob. Obviously, we're very pleased with the emerging market performance in the first half. It was surprisingly strong. I mean I say that because, as Amit already mentioned and as everybody knows COVID really is raging in many of these parts of the world. But I think our strength there really comes down to the execution of our strategy which starts with the affordability pyramid, which we've talked about in the past, our portfolio is much more affordable today than it has been in years, it's much more locally relevant in terms of the foods that we bring to market.

And so that's allowed us to weather what is a very uncertain environment in many of these markets. We also have a very advantaged position in some of these markets If you think about our West African Nigerian business, our strength and route to market through our multi pro distributor allows us to mean to operate and in this very challenging environment. The Parati acquisition in Brazil gave us strong route to market. So the focus on route to market and affordability has allowed us to weather this very challenging, and in fact be very successful in the first half of the year.

We're cautious going forward, we wouldn't expect this type of elevated performance to continue and we say that just because of the level of uncertainty around COVID, around potential disruptions. We have had some factory disruptions in the emerging markets in the past quarter. We can't guarantee that won't happen again. And so it's with some degree of just caution that we look forward relative to the performance that we had in the first half of the year.

Q - Rob Dickerson {BIO 19993946 <GO>}

All right. Great. And then just to focus on North America for a minute obviously the price mix is already coming through nice in Q2, I'm assuming some of that is more mix driven relative pricing you've already taken. So as I think kind of on the go forward in the back half, always kind of of what you did in Q2 is that let's say one of their proxies or what you might be able to put up in price mix.

And then secondly, it's just on the tonnage side, obviously came off a bit in Q2 I realized you're being a bit cautious on how that plays out given period home deceleration potential. But at the same time it seems like maybe your portfolio should be a little bit better insulated by relative to others on the volume side, in the back half, given you don't have extremely tough comparison, and also because you kept some of the on-the-go exposure. So kind of two parts pricing, and then tonnage expectations. And that's it. Thanks.

A - Amit Banati {BIO 16339861 <GO>}

Yeah. So just starting with the pricing, we saw like I said around 4% price mix in the first half and it was across all our markets, both in the U.S. and in the international markets. And, it was a more price than mix in the first half and we'd expect that to continue in the second half, and you'd -- we'd expect to continue to execute our revenue growth management actions.

Q - Rob Dickerson {BIO 19993946 <GO>}

Great. And then just on the volume side, just kind of thinking about portfolio construct and elasticity et cetera?

A - Steven Cahillane {BIO 4718688 <GO>}

Yes. So we feel pretty good about the volume side of the equation, but we're also continuing to focus on the balance of price mix. As you think about our various categories, obviously the second quarter was the really big lap when it comes to tonnage, and then the back half of the year becomes less so.

Q - Rob Dickerson {BIO 19993946 <GO>}

All right. Thanks, Steve.

Operator

The next question is from Michael Lavery with Piper Sandler. Please go ahead.

Q - Michael Lavery {BIO 20141239 <GO>}

Good morning. Thank you. You've passed your two toughest comps for organic growth and averaged around a 2% organic growth lift in the first half despite that. And I know you've raised the guidelines -- the guidance for top-line expectations. But it certainly would point to a deceleration you've called out some of the COVID uncertainty, especially in emerging markets. But what are the real key drivers there that make you think this will slow down so much on the second half?

A - Steven Cahillane {BIO 4718688 <GO>}

Yeah, Michael. Thanks for the question. I think, obviously if you just reflect back in the last 18 months, there was a time when many companies weren't giving guidance, and we've tried to be as transparent as we possibly can all throughout this. We're clearly pleased with the first half of the year, we're pleased with the top line performance. But as we look to the second half of the year, we did slightly raise the guidance that we have for the top line.

But again the types of performances we've had in emerging markets have been quite elevated, and we're trying to do a center cut down the middle of the fairway. Do we hope to do better? We certainly always hope to do better. But we're trying to give the best possible outlook that we can give what is still an incredibly uncertain environment. I mean just a few weeks ago, you wouldn't have forecasted the type of delta variant and pandemic disruptions that we're seeing again in North America.

Q - Michael Lavery {BIO 20141239 <GO>}

So apart from some of this uncertainty and the especially COVID and/or emerging market related, there's not a specific headwind to watch out for it's just recognizing some of those moving parts.

A - Amit Banati {BIO 16339861 <GO>}

Yes. The only other thing I'd say is that at-home demand is decelerating, right? We saw that from quarter one into quarter two. So if you look at our two year CAGR it was 6% in quarter one, it's 4.5% in quarter two. So you are seeing the deceleration of demand at-home. So that's built into our outlook as well that we'd continue to see that.

Now I think to Steve's point is right, depending on how the pandemic plays out and the twists and turns, it's hard to forecast that.

Q - Michael Lavery {BIO 20141239 <GO>}

Thanks for the color.

Operator

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

Q - Laurent Grandet {BIO 19930531 <GO>}

Yes. Thanks for the opportunity. Actually, a question about your manufacturing facilities and you mentioned on two things. First, in the U.S. cereals and you had some issues there. So just wanted to understand what is the midst possibility in terms of sales you occurred in the second quarter and how long do you think that will last? And then I mean you mentioned in your remarks as well and you have to shut down some facilities I mean in emerging country. So like to understand what -- where that is and what it is? And if there is additional risk coming into the third quarter? Thank you.

A - Steven Cahillane {BIO 4718688 <GO>}

Yeah, Laurent, thanks for the question. I'd say, the supply disruptions that we're seeing are the same things that many in the industry are seeing, everything from a shortage of labor, which is quite challenging, shortage of even things like pallets. So the whole supply chain was disrupted and much of that you can point to China went into lockdown obviously very early in the pandemic and was the first out, recovered quite quickly and sucked up a lot of resource. And it's really created supply and balances throughout the world that everybody has had to deal with, and we've had to deal with inside North America. During that time, we're also adding capacity. We've successfully added capacity throughout the world we had, what we call a vertical startup of our Pringles line in Poland which was done very successfully.

So we have been able to add capacity in some areas in North America, it's been a little bit slowed because of some of these supply disruptions. And so we haven't been able to get the level of capacity as quickly as we would want. But it's all in our outlook. So as we talk about the second half of the year, and what we expect in the second half of the year, we're doing our best to forecast these types of disruptions, and this type of slowed activity relative to a non-pandemic world.

Q - Laurent Grandet {BIO 19930531 <GO>}

Yes. Can you specify, I mean, the manufacturing facility that just to close in which countries and what type of business you have to close that in emerging market.

A - Amit Banati {BIO 16339861 <GO>}

Yeah, I think Malaysia has seen a spike in the delta variant in the last few weeks and we have a manufacturing facility there in Malaysia Pringles. So production there was impacted, but the teams have done a remarkable job to get us back up and running. But we did see some disruption in the quarter. And South Africa again, we've got a manufacturing location there, and there were some civil strife and so that impacted production. But I think it's just a -- with the COVID restrictions and with COVID continuing to rage in many of these markets, we see these supply restrictions and restrictions on movement coming through.

Q - Laurent Grandet {BIO 19930531 <GO>}

Okay, thank you very much. Very I'll pass it on. Thank you.

Operator

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

Q - Chris Growe {BIO 4034432 <GO>}

Hi. Good morning.

A - Steven Cahillane {BIO 4718688 <GO>}

Good morning, Chris.

Q - Chris Growe {BIO 4034432 <GO>}

Hi, just had a question for you on North American cereal. Obviously, it sounds like capacity is still a bit of an issue there, so I'm just curious how your share performed Frosted Flakes? That sounds like that's the one that's really causing the issues, and then what do you think you can get that back to a more normal promotional environment, I guess, for that brand?

A - Steven Cahillane {BIO 4718688 <GO>}

Yes. Chris, thanks for the question. Off the top of my head, Frosted Flakes did make up probably more than half of our share loss, and much of that was still not getting back to the levels of commercial activity that we would like. And so we've talked about in the back half of the year, getting that going again. I did mention a fire in one of our facilities, that will affect Frosted Flakes as well as some of our other brands. But the team is the team is working very, very swiftly and quickly to get that back up to speed.

So we're not -- you've heard me say in the past, we're not happy about losing share in U.S. cereal. We believe, it's not going to be a long-term or continuing trend, but we've got work to do to get there. The other thing I'll just remind everybody is, obviously we've got a lot of other businesses besides U.S. cereals, an important business for us, but it is less than 1/5 of our total global portfolio.

Q - Chris Growe {BIO 4034432 <GO>}

That's good point there. I had one quick follow-up for Amit if I could please, which is last quarter like you had indicated you're pretty well hedged on your input cost. Could you give us an update on that? And if I could just add a bit of follow up. The inflation you're seeing right now is this on primarily on inputs where you're not hedged, is that what we're seeing some of the incremental inflation come through?

A - Amit Banati {BIO 16339861 <GO>}

Yeah. So I think in our hedging we're almost now fully hedged for the year, as you'd expect at this time of the year. So I think from a hedging standpoint, standpoint for the year for '21 we're almost fully hedged.

I think in terms of inflation, we've seen a little bit of inflation on our commodities, but I think the area that's turned inflationary is packaging, on flexible scans, so that has turned inflationary since our last outlook. And then I think the comment I made earlier around freight, we're seeing freight rates continue to rise. And more importantly, there are widespread shortages. And so just securing the supply of freight is coming at much higher rates than what we had expected. And so, I think those are the areas that we are seeing higher costs come through. And then the other one which is hard to forecast is just the labor shortages, and that's kind of through the supply chain. So those are the areas that we're seeing higher cost come through.

Q - Chris Growe {BIO 4034432 <GO>}

Okay. That's very helpful. Thanks for your color and time today.

Operator

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

Q - Robert Moskow {BIO 6299775 <GO>}

Hi, I have a couple questions. The first is, if your sales do over deliver in the back half, because COVID end up maybe benefiting you more than you think. Would those incremental sales still be profitable or are they much less profitable because the cost to deliver is really high. So, that's the first thing. And then the second question is, North

America snacks decelerated to 2% on a two-year CAGR in the quarter? I think your snack peers are growing at a stronger rate than that. Were you surprised by that the amount of decel did something hold it back in the quarter?

A - Steven Cahillane {BIO 4718688 <GO>}

Yes. So Rob, I'll start and Amit can add color. On the first question, I would say, if you look at our first half performance, obviously a strong top line helped us mitigate very inflationary environment. And I think that's illustrative of any over-delivery we would -- it's always going to be profitable, but there's clearly a cost Challenge. And I think Amit pointed out in his prepared remarks, when we look at margins, we're still looking at 2019 as a decent base year, and it's likely will come in slightly below that, but the gross profit dollars will be significantly greater.

And so, that's the way we think we're always looking for profitable sales but clearly there's a lot of cost challenges. We'll try and deliver the best possible P&L shape that we can, and obviously profitable sales are clearly continue to be important.

A - Amit Banati {BIO 16339861 <GO>}

And I think just on your U.S. snacks question, if you look at our first half, the two year CAGR is around 4%, I think between the quarters, between quarter one and quarter two there was some shipment timing. And also these -- remember these numbers include the away from home channel as well which continues to be impacted. I mean, it's moderating, but it's still below 2019 levels. So I think from a overall consumption standpoint, we're pleased with the consumption that we're seeing and the momentum that we are seeing in our snacks brands in the U.S.

Q - Robert Moskow {BIO 6299775 <GO>}

Okay. Well, thank you.

Operator

The next question is from Eric Larson with Seaport Research Partners. Please go ahead.

Q - Eric Larson {BIO 1507483 <GO>}

Yes, thank you everyone. Thanks for taking my question. I have two real quick questions. The first is, thank you for the framing all your big brands and the size of those brands and the household penetration. The question I have on that is, you showed the incremental household penetration since COVID, but you don't really give the overall ACV penetration and some of these brands are international. So it's hard for us to measure some of that. But can you make a case here for continued distribution gains just part of your overall revenue growth basis?

A - Steven Cahillane {BIO 4718688 <GO>}

Yeah, Eric, thanks for the question. I think, obviously we all look at the syndicated data, and it is limited to mostly developed markets, less so in developing markets. And distribution opportunities remain important for us. Obviously very important, and are different based on the maturity of the brands. And so if you look at our ACV distribution for our snacks and cereal business in the U.S., obviously very high.

And then we'll look to add weighted ACV distribution as we look to launch new innovations, and we track that very closely. And so, it's a clear important metric for us. And then with respect to -- what was the second part of the question, oh, penetration, yes, so, we're looking at categories for us that are already very highly penetrated.

And so if you look at the penetration gains we've had, we did see penetration gains across our portfolio in our developed markets. And we saw even more of that COVID lifts coming from buy rates though. And so increased household penetration is important. But obviously, looking at buy rates is equally if not more important when you're talking about categories, which are already quite highly penetrated like U.S. cereal and U.S. snacks.

Q - Eric Larson {BIO 1507483 <GO>}

Okay. Thanks. And then my second question is you showed the gradual improvement in your eating away from home sales, and in the industries that you compete in, and I know you have large exposure to universities and hotels, et cetera. Can you give us -- can you frame us where you are over or under-indexed in your eating away from home channel penetration? So that as these economies -- as the economy reopens et cetera, we know where you have your best leverage in your food service sales.

A - Steven Cahillane {BIO 4718688 <GO>}

Yes. So Eric, I'd say, we're seeing all of it come back but at different rates. We're over index really in travel and lodging, schools, convenience stores. And they're coming back at different rates. So C-Stores are coming back faster. Schools, we'll see right now, schools are starting in many parts of the world, and what happens there remains to be seen, but it looks like it will be coming back. Travel and lodging coming back slower, and particularly business travel.

But then, you obviously see leisure travel, and the airline starting to fill up planes again. So that seems to be coming back as well. And so it's very uneven but by and large coming back as we said. Now as I said earlier, there's still a degree of uncertainty based on what's happening with the pandemic right now, and it's still below 2019 levels. So not yet close to where we were pre-pandemic.

Q - Eric Larson {BIO 1507483 <GO>}

Okay, thank you.

Operator

The next question is from Steve Powers with Deutsche Bank. Please go ahead.

Q - Steve Powers {BIO 20734688 <GO>}

Hey, sorry, thanks a lot for squeezing me in. I guess the question I have and you've talked about it a bit, but I'm just -- I'm still trying to better understand how much of the implied second half deceleration is, is really just prudence on your part because of the uncertainty you talked about versus things you have firmer line of sight to. Because as you talked about the first half versus '19 was about 5%, some deceleration 1Q to 2Q, but we also had some shipment timing in there so maybe not as stark as it looks. But the back half has implied essentially at 1% two years versus '19. So it's a pretty stark deceleration. And again I'm just trying to figure out how much of that you actually have some line of sight to versus things that you're just pumping the brakes on just from an expectation standpoint. Thank you.

A - Steven Cahillane {BIO 4718688 <GO>}

Yeah. Thanks, Steve, I'd say, again very pleased with the first half performance. As we think about the second half performance, as Amit mentioned, we are seeing decelerating at home demand. And so we've taken that into account. We've also taken to account the strong delivery in emerging markets, and the likelihood that continuing that type of performance would be great. But obviously we're trying to be prudent, and we're trying to be cautious based on supply disruptions that we have seen in the first half that could happen again in the second half.

And as I said before, of course, we aim to over deliver, we hope to over deliver, but we're trying to take a prudent approach given the degree of uncertainty that we still see and the trend in deceleration that -- that is in fact real. And again we hope to over deliver, but this is what we felt was a pretty transparent and fair bit of guidance.

Q - Steve Powers {BIO 20734688 <GO>}

Okay. Thank you very much.

A - John Renwick {BIO 19769692 <GO>}

Operator, I think we have time for one more.

Operator

And that question is from Jason English with Goldman Sachs. Please go ahead.

Q - Jason English {BIO 16418106 <GO>}

Hey. Thanks, guys. I guess like if you want to come at the implicit growth challenges in the back half but I think we've beat that horse pretty aggressively. So let me zoom in a little bit into the U.S. frozen business or North America frozen business. I guess I'm surprised you Steve, you showed in your prepared remarks a slide showing a two year stack growth on MorningStar Farms it's slowing. And this quarter, you delivered shipments for frozen that are only marginally above where you were in 2019, based on the decline that you posted the organic sales decline this quarter.

So it begs the question of what's happening there. I would have thought that would be a growth engine with accelerating momentum not deceleration. It's just a sign that maybe incognito and your efforts in MorningStar Farms are beginning to fall flat.

A - Steven Cahillane {BIO 4718688 <GO>}

No, Jason. Far from it. MorningStar Farms continues to be a very exciting category for us, a very exciting brand for us. Underlying consumption is strong on a one-year and two year basis. And incognito, to put it in perspective, incognito entered a category, the refrigerated category which is very exciting, incredibly competitive with lots of entrance coming in, and it's growing share and distribution as we speak. If you look at the last year -- last four week syndicated data, it's over a two share right now.

And so would we like to be at even higher than that, of course, we would, but it's a very competitive category. MorningStar Farms is the leader in the category. And again, underlying two-year stacked consumption is very good. So we stand by the performance of MorningStar Farms what the team is doing. And far from falling flat, I think it's doing quite well, strong growth beyond burgers as well in chicken and others. So is it shipment timing or something else that's driven such a weak sales quarter?

A - Amit Banati {BIO 16339861 <GO>}

Yes, I think that's shipment timing, I mean the overall consumption remains strong, and then I think within the shipment you've got the away from home as well dynamic playing through. So -- but when you kind of look at retail consumption it's strong.

Q - Jason English {BIO 16418106 <GO>}

Got it. Well, thanks a lot guys. And congrats on a good quarter. I'll pass it on.

A - Steven Cahillane {BIO 4718688 <GO>}

Thanks, Jason.

A - Amit Banati {BIO 16339861 <GO>}

Thanks, Jason.

Operator

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

A - John Renwick {BIO 19769692 <GO>}

Thanks everyone for your interest. And if you do have follow-up questions, please do not hesitate to call us.

Operator

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