McCormick (MKC) Earnings Report: Q2 2015 Conference Call Transcript

The following McCormick conference call took place on July 1, 2015, 07:30 AM ET. This is a transcript of that earnings call:

Company Participants

- Joyce Brooks; McCormick & Company, Inc.; VP of IR
- Alan Wilson; McCormick & Company, Inc.; Chairman and CEO
- Lawrence Kurzius; McCormick & Company, Inc.; President and COO
- Gordon Stetz; McCormick & Company, Inc.; Executive Vice President and CFO

Other Participants

- Ken Goldman; JP Morgan; Analyst
- Alexia Howard; Bernstein; Analyst
- Gordon Stetz; McCormick & Company, Inc.; EVP and CFO
- David Driscoll; Citigroup; Analyst
- Akshay Jagdale; KeyBanc Capital Markets; Analyst
- Jonathan Feeney; Athlos Research; Analyst
- Robert Moskow; Credit Suisse; Analyst
- Eric Katzman; Deutsche Bank; Analyst

MANAGEMENT DISCUSSION SECTION

Joyce Brooks (VP of IR):

Good morning. This is Joyce Brooks, Vice President of Investor Relations. Thank you for joining today's call for a discussion of McCormick's second-quarter financial results and our current outlook for 2015. We started a bit early to coordinate with the General Mills call at 8.30 AM. To accompany our call we've posted a set of slides at IR. McCormick.com.

(Operator Instructions)

As a reminder the conference is being recorded. With me this morning are Alan Wilson, Chairman and CEO; Lawrence Kurzius, Chief Operating Officer and President; Gordon Stetz, Executive Vice President and CFO; and Mike Smith, Senior Vice President, Corporate Finance.

During our remarks we will refer to non-GAAP financial measures. These include adjusted operating income and adjusted earnings per share that exclude the impact of special charges, as well as information in constant currency. A reconciliation to the GAAP results is included in this morning's press release and slides.

As a reminder, today' presentation contains projections and other forward-looking statements. Actual results could differ materially from those projected. The Company undertakes no obligation to update or revise publicly any forward-looking statements, whether as a result of new information, future events or other factors. As seen on slide 2 our forward-looking statement also provides information on risk factors that could affect our financial results.

It's now my pleasure to turn the discussion over to Alan.

Alan Wilson (Chairman and CEO):

Thank you, Joyce. Good morning, everyone, and thanks for joining us. McCormick's second-quarter results demonstrate the effectiveness of our sales and profit growth strategies and continued the momentum that we established in the first quarter.

While sales declined 1% in constant currency we achieved a 5% year-on-year increase. We achieved higher constant currency sales in both our business segments and across geographic regions, a very good performance from our business leaders and employees throughout McCormick .

Based on this broad-based growth and our outlook for the second half of 2015, we reaffirm our projection for 4% to 6% constant currency sales growth for the fiscal year. In fact, this year's pace of acquisition activity gives us more confidence at the upper end of the range.

Special charges, along with currency, lowered our operating income results. However, we grew adjusted operating income in constant currency by 7%. This is an improvement from the first quarter when adjusted operating income in constant currency rose 1%.

As we anticipated, profit growth is improving as our cost savings build and as additional pricing actions go into effect. This improvement supports our reaffirmed outlook for 6% to 7% adjusted operating income growth in 2015 on a constant currency basis.

With a very favorable tax rate variance, second-quarter earnings per share exceeded our expectations. Earnings per share this period was $0.65, and excluding special charges, grew to $0.75 from $0.64 in the year-ago period. In addition to the favorable tax rate, other positive factors included the increase in adjusted operating income, further growth from our joint venture in Mexico, and lower shares outstanding. The CPS result includes the impact of unfavorable currency.

We've raised our latest earnings per share guidance to reflect the net impact of the favorable tax rate in the second quarter and our estimated tax rate for the second half. Aside from this tax adjustment, we feel just as confident in our base business EPS outlook.

Cash flow from our operations remains strong at $186 million supporting our dividend program along with business growth strategies, including acquisitions. I want to recognize McCormick employees around the world for focusing on growth, driving high performance, and engaging in our success.

Next, Lawrence is going to provide an update on each of our two business segments. Lawrence?

Lawrence Kurzius (President and COO):

Thank you, Alan, and good morning, everyone. As Alan indicated, we delivered constant currency sales growth for both our consumer and industrial businesses with particularly good performance in several markets this quarter. Let's start with the consumer business.

Across our entire consumer business, although we reported a sales decline of 3%, in constant currency we achieved a 3% increase. I'll comment first on the strong results in certain international markets and then turn to the U.S. market for more detailed remarks.

China led our consumer business sales growth again this quarter with a double-digit increase in constant currency. We had strong demand for McCormick brand herbs and spices, condiments and seasoning blends driven by our brand building activities, geographic expansion and great in-store execution.

We also grew sales with the introduction of our McCormick brand products into Central China, part of the sale synergies from our Wuhan income Asia-Pacific Condiments acquisition.

In Europe, Middle East and Africa, EMEA, economic and retail conditions remain challenging in parts of the region. However, in constant currency, we had strong volume-driven sales growth this period, particularly in France, Poland and Russia.

In France, we're benefiting from our brand marketing and have expanded to grow brand sales through the discount retailer. Distribution gains are also a primary sales growth driver for our business in Poland and Russia.

And in Australia, consumer sales in constant currency rose at a double-digit rate this period from new distributions and product innovation.

Before moving to the Americas, let's take a look at our line up of new products for the second half in our EMEA and Asia-Pacific regions on slide 7. One of our global initiatives is grilling.

In EMEA we're building out our barbecue products in the UK, France, Poland and other markets with dry seasonings, wet marinades and sauces. And in France, Belgium, Spain and Portugal, recognizing the popularity of burgers, we are introducing restaurant quality burger seasonings in wet and dry sachets.

Our Airplane gelatin in Australia is an iconic brand, with 90% category share, and we are continuing to grow sales with new flavor varieties. Also in this market we will be leveraging the authenticity of our Keene's brand into curry recipe bases.

Let's turn to the Americas. In this region we're making further progress improving the performance of our U.S. consumer business. Consumer interest in flavor, simple and healthy ingredients, and cooking with fresh product continues to drive strong category growth for spices and seasonings, as seen in the latest consumption data, with category sales up 5% in the quarter.

This same data shows that sales of our McCormick brands spices and seasonings rose 1%. This is an improvement compared to a 1% decline in the past 52 weeks. We are definitely heading in the right direction.

For recipe mixes, our next largest category, we continue to gain share. In this latest quarter, the increase was 50 basis points and we marked the 20th consecutive month of share gain. We are achieving this through innovation as well as effective marketing for both new products and core items.

Within the sub segment of taco seasoning mixes we increased share of our McCormick brand's 3 percentage points in the last 52 weeks. And our share of chili seasoning mixes is up 4 percentage points.

We grew share of Zatarain's 5% this quarter versus the year-ago period. Zatarain's' rice mixes are outpacing the category growth rate. And consumption of our frozen entrees rose 4%.

Across all of our U.S. brands we are driving growth through accelerating innovation, building brand equity and through our category leadership at retail. On the innovation front I'll comment on two of our recent launches.

I'm pleased to report that in less than one year, our McCormick skillet sauces have exceeded a 10% share in this growing category, driven by the retail placement we have gained and our marketing support.

The relaunch of our gourmet line began early in 2015 with greater variety; a flavor-seal technology that locks in flavor, color and aroma; and packaging that has a more premium, fresh appearance. In this sub segment of the spice and seasoning category, nearly 80% of retail distribution points are now converted to the new packaging, and we've seen base consumption trends for McCormick gourmet strengthen with consumption up 4% in the second quarter.

This gourmet initiative also helped us expand the number of McCormick brand SKUs on the shelf with existing customers, gain distribution with new customers, and at other customers reduce the number of competitive brands that carry.

For the second half of 2015 we are excited about our innovation plans. These include extending our liquid recipe mixes platform with the introduction of slow cooker sauces. Flavors include smoky barbecue pulled pork and pot roast with caramelized onion and cracked black pepper.

We will introduce additional gluten-free recipe mixes, including beef stew and fajitas, to build off the success of our initial varieties, and kitchen basic stock cubes, a convenient way to boost flavor for soups, stews and risottos, with no MSG or artificial flavors, including a vegetarian variety.

Also in the Americas region our launch plans in Canada include additional skillet sauces, gluten-free recipe mixes and reduced sodium items. And in Latin America we are introducing mustard flavors and barbecue sauces.

A second growth initiative in the U.S. is building brand equity. We had particular success with this quarter with our Grill Mates campaign, including excellent in-store display execution, great new television advertising and a 2015 grilling flavor forecast. Second-quarter sales of Grill Mates grew 9% and we expect to maintain this momentum through the peak grilling season.

Through digital marketing we're connecting directly with consumers. We're moving um the list of go-to places for online recipes. McCormick.com is now in the top 40 recipe destinations, up from 175th in 2012, with 30 million annual visitors and 40 million recipe views. We have the largest online grilling community and are connecting with passionate users of Old Bay, Zatarain's and other distinctive brands.

Behind the scenes we have better alignment of our digital assets not only in the U.S. but all around the world. We continue to strengthen our retail partnerships to drive category growth and engage consumers.

On the last call, Alan discussed a sharper focus on our retail price points and advanced analytic rigor around category management. As we roll this out, several retailers have begun to partner with us on shelf price adjustments, and we're very encouraged by the results for them and for McCormick .

By the end of the third quarter, we will be ready to launch a new, comprehensive category management tool supported by additional internal resources. And we expect these capabilities to accelerate our progress as it relates to pricing optimization. As you would expect, this is an account by account discussion.

As the latest consumption data illustrated, we have reduced the category share decline for our brand but we're not yet where we want to be. I believe we have the right actions and the right team in place to stabilize and then grow our share. In tandem with these actions, we are driving growth for our recipe mixes, as well as niche brands within our U.S. portfolio such as Lawry's, Old Bay, Grill Mates, Zatarain's, Thai Kitchen and now Drogheria & Alimentari.

Before I move to our industrial business, I just want to recognize the great performance of our joint venture in Mexico. Despite an unfavorable currency rate, net income for this business rose 36% mainly due to sales growth and favorable costs.

Turning now to our industrial business, we grew sales for this segment 1% and in constant currency a very strong 7%. These higher sales and our cost-reduction initiatives led to a double-digit increase in adjusted operating income in constant currency. EMEA lead the growth this period with a double-digit constant currency sales increase and volume and product mix up 9%.

This part of our business has had exceptional sales growth for the past three years, as seen on slide 11. Whereas our business with quick-service restaurants has been a challenge in other regions during this period, we are winning in EMEA with product innovation, and for the third year in a row were named new product supplier of the year in this region by a leading quick-service restaurant customer.

We also increased our share of business with quick-service restaurants and are supporting the geographic expansion of those customers. Likewise, we're expanding into new markets along with food manufacturers we supply and, as an example, have broken ground on a new facility in the Middle East.

In the Americas region we're benefiting from an increase in consumer snacking, developing seasonings for snack bars, crackers, chips, and similar products.

At the same time, our customers are moving toward more simple ingredients and our foundation in spices and herbs has us well positioned. In the second quarter we had particularly strong demand from these customers in Latin America with double-digit sales growth in constant currency.

We have a strong base in Mexico and are supporting customer expansion into South America. In Brazil, we cut the ribbon on a small R&D center this quarter to build our expertise in the local flavors.

We also grew year-on-year sales to food manufactures in the U.S. this period and had a solid performance with the sales of branded foodservice products. In addition, we had the benefit of sales from Brand Aromatics acquired early in March. Offsetting a portion of these gains was further weakness in our U.S. sales to quick-service restaurants.

In our Asia-Pacific region, we're pleased to be seeing further recovery in base sales to quick-service restaurants. As in the first quarter, we had an added benefit of innovation and limited time offers and with export sales of products supplied by our facilities in China. Our outlook is for continued improvement through the second half of 2015 for our industrial business in China.

Thank you for your attention. I'll turn it back over to Alan.

Alan Wilson (Chairman and CEO):

Thanks, Lawrence. As Lawrence reported, we're driving solid performance across many parts of our business, demonstrating the effectiveness of our growth strategies and our strong execution. We're making steady progress with our initiatives and encouraged by 2015 results through the first half.

Next, I'd like to provide a few updates from the time of our first-quarter earnings call back in late March starting with acquisition activity. McCormick's business development team is having a busy year with great results.

Back in February, we announced an agreement to purchase Drogheria & Alimentari and completed this purchase at the end of May. In early March we acquired Brand Aromatics.

And about a week ago we signed an agreement to acquire One World Foods, seller of Stubb's, the number one brand of premium authentic barbecue sauce in the U.S. Stubb's products also include marinades, rubs and skillet sauces.

Annual sales of this business are approximately $30 million and are growing at a double-digit rate. Stubb's is a perfect complement to our products, rounding out our range of grilling items under the Grill Mates, Lawry's and McCormick brands. Maintaining the authenticity of this brand, we plan to keep the business headquarters in Austin, Texas.

We expect to maintain a double-digit pace of sales growth near term through expanded distribution, increased household penetration, and innovative flavors. We anticipate significant cost synergies that will deliver at least $10 million of incremental EBITDA by 2017. At an anticipated purchase price of $100 million, we expect Stubb's to be another attractive deal for McCormick .

Along with our efforts to build sales through acquisitions and the innovation and brand marketing activity that Lawrence discussed, employees throughout the Company are making great progress with our efforts to eliminate costs. We reaffirm our goal to achieve at least $85 million in cost savings this year. This will bring our cumulative annual cost savings to more than $400 million since our 2009 launch of McCormick's Comprehensive Continuous Improvement program, CCI.

During the second quarter, we announced additional reorganization plans in the EMEA region. These plans include the transfer of certain additional activities to the recently established McCormick shared services center in Poland.

While we expect to record charges of approximately $25 million related to these actions, there is a very good payback with estimated annual cost savings of $16 million by the end of 2017. We've recently increased our resources to drive our CCI program and expect to continue our track record of productivity improvement throughout the organization.

Let's turn to some recent leadership changes. As announced in early June, we're pleased to have Maritza Montiel and Michael Conway joining our Board. Maritza is former Deputy CEO and Vice Chairman of Deloitte. During her 40 years at the firm, she led a variety of strategic initiatives prior to retiring in mid 2014.

Michael is President of Global Channel Development for Starbucks . He has responsibility for all commercial and business strategy functions and is driving aggressive plans to expand to emerging international markets. Prior to Starbucks , Michael served in leadership roles at Johnson & Johnson and Campbell Soup .

Retiring from our Board is JP Billbery, Chairman, President and CEO of Hershey. He's served as a McCormick director since 2005 and we truly appreciate his participation and contributions to our success.

Turning to our Company leaders, Cile Perich, Senior VP of Human Resources, retired from McCormick after 32 years of exemplary service and seven years as a member of our management committee.

On slide 17, we've listed the current members of the management committee, which now include Lisa Manzone who is promoted to Cile's role, and also Brendan Foley, who joined us from Heinz about a year ago and whose responsibilities have been broadened from head of U.S. consumer business to a North American role.

We also announced in April that Nneka Rimmer has joined the Company, most recently with Boston Consulting Group. Nneka is responsible for shaping overall corporate strategies and working to increase EVA at McCormick . I'm confident that these latest changes will provide strong leadership for our business going forward.

The last topic I want to cover before turning it over to Gordon relates to the healthfulness of spices and herbs. Since it's formation in 2007 the McCormick Science Institute, MSI, has supported scientific research and dissemination of information on the health benefits of culinary herbs and spices. In 2014, MSI, in partnership with the American Society for Nutrition, hosted a summit of researchers, government officials, and health and wellness communicators to discuss the role of herbs and spices in a healthy diet.

This message is beginning to resonate. In May we were pleased to learn that the U.S. Dietary Guidelines Advisory Committee has recommended to the government that the 2015 dietary guidelines encourage use of spices and herbs as a flavor alternative to sodium.

We're optimistic that this change will be made. In addition, Australia's healthy eating pyramid was recently updated and now encourages people to enjoy herbs and spices to flavor food without using salt.

We regard our categories as advantaged, on trend with spicy foods, fresh foods, ethnic cuisine, simple ingredients. This latest health news is just one more reason for consumers to turn to spices and herbs to add flavor.

It's now my pleasure to turn it over to Gordon for a financial perspective on our results and guidance.

Gordon Stetz (Executive Vice President and CFO):

Thanks, Alan, and good morning, everyone. As both Alan and Lawrence indicated, we were pleased with our sales and profit results in the second quarter across our two segments and in both developed and emerging markets.

On a constant currency basis, the underlying growth in sales was very strong at 5%. Our adjusted operating income excludes special charges and rose 1%. But if we also exclude currency, we achieved 7% growth, a sequential improvement from the first-quarter results.

Taking a look at our consumer business, slide 21 shows that we grew second-quarter consumer business sales 3% in constant currency driven by higher volume and product mix. Sales in the Americas rose 2% in constant currency from the second quarter of 2014, with contributions from higher volume and product mix, as well as pricing actions mainly related to honey products in Canada.

As Lawrence described, we grew U.S. sales of recipe mixes, Grill Mates and Zatarain's products. While still a small part of our business, sales in Latin America grew at a double-digit rate this period as we expand distribution across a number of markets from our production base in El Salvador.

In EMEA, consumer business sales in constant currency grew 4% as a result of higher volume and product mix. Distribution gains were a major reason for the increase, with wins in France, Poland, and Russia. Our brand marketing and innovation are additional factors driving sales. And we look forward to including sales of Drogheria & Alimentari in our results starting in the third quarter.

In constant currency we grew consumer business sales in the Asia-Pacific region 7% with a 9% increase in volume and product mix. Our sales in China continued to grow at a double-digit rate year on year.

And Australia also delivered a double-digit increase for the second quarter. We had some further pressure from Basmati rice prices in India, leading to lower pricing for the region this period.

In total for the consumer business, adjusted operating income was $81 million compared to $86 million in the second quarter of 2014. In constant currency adjusted operating income was comparable to the year-ago period, with the impact of sales growth and cost savings offset by the unfavorable impact of material costs, retirement benefit expense and product mix. Also in the second quarter, we recorded about $1 million of transaction costs related to the acquisitions we have announced in 2015.

Turning to our industrial business, we grew second-quarter sales a robust 7% in constant currency from the year-ago period. Pricing actions taken in response to higher material costs and higher volume and product mix each added 3 percentage points, and acquisitions another 1 percentage point of growth.

In the Americas region, sales rose 5% in constant currency, mainly from pricing actions and the addition of Brand Aromatics. Volume and product mix were comparable to the year ago period as increased sales of snack seasonings, particularly in Latin America, and higher sales of branded foodservice products were offset by continued weakness in sales to quick-service restaurant customers.

In our EMEA industrial business we grew sales 12% in constant currency with a 9% increase in volume and product mix. As Lawrence described, we are in our third year of exceptional performance in this part of our business as we support the growth and geographic expansion of leading quick-service restaurants and food manufacturers.

We grew industrial business sales in the Asia-Pacific region 4% in constant currency. In China, we grew through innovation and export. And the recovery continued from 2014 challenges with lower demand for major quick-service restaurants.

Adjusted operating income for the industrial business was $42 million, well ahead of $36 million in the second quarter of 2014. In constant currency the growth was even more impressive at 24%, with the benefit of higher sales and our CCI program more than offsetting the unfavorable impact of material costs and retirement benefit expense.

Let's turn to Slide 31. Across both segments adjusted operating income was $123 million, a 1% increase from $122 million in the second quarter of 2014. In constant currency, we grew adjusted operating income 7%. This is an improvement from the first quarter as increased cost reductions and additional pricing actions are providing a greater offset to material cost inflation.

These same positive factors are impacting gross profit margin. While we were down 50 basis points year on year in the second quarter, this was a better performance than the first quarter. Heading into the second half we expect our cost reduction and pricing activity to continue to improve gross profit margin. However, we now expect gross profit margin for the fiscal year to be comparable to 2014 rather than up slightly.

As a percentage of net sales our selling, general and administrative expense declined 60 basis points, even with the impact of transaction costs related to our 2015 acquisition activity. Special charges of $19 million in the second quarter related primarily to the additional actions planned in EMEA that we announced in April.

Below the operating income line, our effective tax rate was 16% which was below our initial guidance and year-ago quarter due to $13 million of discrete tax benefits recognized in the second quarter of 2015. Based on our current outlook, including these benefits and our projected mix of our business across tax jurisdictions, our estimated effective tax rate for FY15 is approximately 27% compared to our prior guidance of 27% to 28%. This is based on an underlying rate of approximately 29%. Keep in mind that in the absence of any further discrete items we expect an unfavorable variance in the next two quarters, with a tax rate of 29% versus 21.4% in the third quarter of 2014 and 25.9% in the fourth quarter of 2014.

Income from unconsolidated operations rose 19%, led by our joint venture in Mexico which continues to have a strong financial performance, as Lawrence described. This increase is net of an unfavorable currency impact. At the bottom line, adjusted earnings per share for the second quarter of 2015 was $0.75.

As you can see on slide 34, this was an $0.11 year-on-year increase led by the lower tax rate, along with increases in our adjusted operating income, unconsolidated income, and lower shares outstanding.

Turning next to slide 35, we've summarized highlights for cash flow and the quarter-end balance sheet. Our cash flow from operations this period was $186 million compared to $182 million in the first half of 2014.

During the first half of 2015, we used $70 million of cash to acquire nearly 1 million shares of McCormick stock, occurring mostly in the first quarter. Given our activity to date, we continue to anticipate a 1% reduction in shares in 2015. At quarter end we had $46 million remaining on our $400 million authorization. The Board approved a new $600 million share repurchase authorization in March.

During the second quarter we used a combination of cash and short-term borrowings to acquire Brand Aromatics for $63 million and make the initial payment of $49 million to acquire Drogheria & Alimentari. Likewise, we expect to use a combination of cash and short-term borrowings for the acquisitions of Stubb's later this quarter.

Consistent with past practice, we have curtailed our share repurchase activity in order to return to our target debt to adjusted EBITDA level of 1.5 to1.8.

Our balance sheet remains sound. We are generating strong cash flow and we believe we are well-positioned to fund investments to drive growth, including future acquisitions.

I'll wrap up with our latest financial outlook for FY15. We reaffirm our expectation to grow sales 4% to 6% in constant currency. The three acquisitions we have announced should add at least 1% of growth this year, giving us greater confidence in achieving the upper end of our range.

We continued to estimate that currency will reduce our sales growth rate by 5 percentage points in 2015. We reaffirm our expected 6% to 7% constant currency growth for adjusted operating income from a 2014 base of $608 million in adjusted operating income. We continue to anticipate unfavorable currency rates to reduce operating income growth by 3 percentage points.

For operating income on a reported basis, we expect a 4% to 5% decline from $603 million in 2014. This includes a $54 million estimated impact from special charges.

We expect adjusted earnings per share of $3.47 to $3.54. This is a $0.03 increase from the previous guidance, reflecting the latest tax rate estimate. This new range, excluding an estimated $0.12 headwind from currency, is an increase of 7% to 9% from $3.37 in 2014.

On a reported basis, we expect earnings per share of $3.18 to $3.25 compared to earnings per share of $3.34 in 2014. This range assumes a $0.29 impact from special charges.

As you consider the financial projection for the second half versus the year-ago period, keep in mind the projected headwinds from a higher tax rate, unfavorable currency and our plans to increase brand marketing.

These factors are expected to cause a double-digit decline in third-quarter adjusted earnings per share compared to adjusted earnings per share of $0.95 in the third quarter of 2014. However, our projection is to increase fourth quarter adjusted earnings per share from adjusted earnings per share of $1.16 in the fourth quarter of 2014.

For FY15, we continue to expect another year of strong cash flow. This will provide funding for our dividend, our acquisition activity, some debt pay down, and future share repurchase activity.

Let's turn now to your questions and then some closing remarks from Alan. Operator, we're ready for the first question.

QUESTIONS & ANSWERS

Operator:

(Operator Instructions)

You're first question is coming from the line of Ken Goldman with JP Morgan.

Ken Goldman (Analyst - JP Morgan):

Hi, good morning, everybody. The shift to eCommerce in China, it's hurt a lot of consumer companies lately. McCormick seems to be bucking the trend. Just curious the spice and seasoning category is it not being hit by the channel shift as much as others or is McCormick benefiting from that channel shift? I'm curious for your thoughts here because it does seem to be a little bit of an anomaly versus what we're seeing elsewhere.

Lawrence Kurzius (President and COO):

Hi, Ken, this is Lawrence. I'll take this question. We do participate in the eCommerce sector in China but I'll tell you for us it's still developing segment of the market or developing channel just like it is for everyone else. The big difference I think in our business incline afore our consumer segment is that we're a lot less dependent on the modern trade than many of our peer companies.

With the acquisition of Asian Pacific don't it that's we got a strong foothold in the central part of China, great penetration in the more traditional segment of the market, and we're experiencing really broad based growth on both our McCormick brand and acquired brands across China, and we recognize that there's been some slowdown in economic growth in China but our categories continue to do well and our brands in particular had really broad based growth in this quarter and we don't really see any change in that trend.

Ken Goldman (Analyst - JP Morgan):

Thank you, one follow-up. In general you're looking for a nice improvement in the gross margin as the year progresses at least on a year on year basis. I just want to make sure I understand if we had to rank order the factors that are going to help that margin, how much might we attribute to currency versus pricing, just want a little bit more color if possible on what some of those factors might be.

Unidentified Company Representative:

We're looking for sequential improvements in the gross profit margin and it's going to be a combination of CCI, which will be obviously continuing to progress as we go through the year, the pricing actions primarily on the industrial side of the business which as you know those pricing mechanisms get readjusted periodically based on the commodity basket so those will continue to readjust periodically through out the year, and then obviously our fourth Quarter tends to be more heavily weighted to our consumer business so you'll get some benefit of business mix as we approach the Fourth Quarter. Thanks, Gordon.

Operator:

The next question is coming from the line of Alexia Howard with Sanford Bernstein.

Alexia Howard (Analyst - Bernstein):

Good morning, everyone. Can I ask about the trends in operating profit growth on the consumer side? It's been pretty flat for the business as a whole in the last couple of quarters on a constant currency basis.

Are you expecting an improvement going forward and what are the puts and takes and particularly I don't know what you can say about the consumer Americas business but how has that been moving and how is it expected to shape up for the rest of the year? Thank you.

Gordon Stetz (Executive Vice President and CFO):

Hi, it's Gordon. Again what we're expecting the raw material cost pressures as we mentioned in the conference call has been a factor primarily well across both businesses. The consumer business savings are starting to ramp up as we progress through the year, so those benefits we anticipate to be more heavily weighted to the back half of the year.

The operating margins are also being impacted by our brand Marketing expenses so as we mentioned in the call we do have some increase in our brand Marketing expenses, some of this is going to be particularly weighted to Q3 and finally we're looking just for the continued consistency of growth and volume to leverage our scale so again by the fourth Quarter anticipating our guidance anticipates a good fourth quarter for our consumer business particularly the U.S. consumer boy with the combination of CCI, scale, and the timing of our brand Marketing we expect good margin performance by the Fourth Quarter.

Alexia Howard (Analyst - Bernstein):

And just as a quick follow-up. In the U.S. consumer business do you expect the price realization to improve through the course of the second half? Would you expect to get a little bit more of a benefit from year on year pricing being more stable than it has been in the past? Thank you.

Gordon Stetz (Executive Vice President and CFO):

We really haven't taken any pricing in the U.S. consumer business but we do expect a different mix as we're selling more branded items and less of the value items.

Alexia Howard (Analyst - Bernstein):

Great, thank you very much. I'll pass it on.

Operator:

Our next question comes from the line of David Driscoll with Citigroup .

David Driscoll (Analyst - Citigroup):

Great. Thank you and good morning. Wanted just to ask your impressions of the U.S. spices and seasoning category and the market share trends over the course of time and you guys mentioned this in your script but could you just spend a little bit more time on the share declines here and what should we expect going forward?

Is this a multi-year trend where you'll just progress very slowly to try to getting the share declines to stop to get back to neutral and I'm just trying to get your sensitivity on when you see these kinds of share declines how the business wants to respond to it, how significant they are to you.

You got top line growth but share declines are always something that we look at quite closely and I'm trying to get a sensitivity here on your concern level on this and how it should progress forward?

Unidentified Company Representative:

We are obviously very focused on stabilizing and growing share. Our intention is to actually be the driver of growth in our categories. We are seeing share improvement and have for 20 consecutive months in our recipe mixes. We're seeing it in some of our other brands like Zatarain's where we're seeing share improvement and we're seeing share improvement in some of our other Markets.

Our core focus is on the U.S. consumer business where the core spices and seasonings represent a little less than 15% of our total Company sales so I want to keep it in perspective but we are very focused on regaining and driving share in those core items and we think the things that we're doing like working on the pricing of the high price sensitive items at retail is a good mix.

We're helping our retailers in understanding the importance in the profitability of the category and that McCormick drives that profitability so we feel like we're doing a lot of the right things but it is going to take some time.

Lawrence Kurzius (President and COO):

David, this is Lawrence, if I can just add to those comments. We've really been out in front of this since CAGNY in 2014 where really we stepped up and said that we lost some share in both of our core growth platforms in the U.S. to some smaller competitors and put in place some initiatives to tackle it.

I think we did a lot of the heavy lifting last year and we're really actually pleased with our sales progress in both the first quart and the Second Quarter of this year. We aren't gaining share yet in spices and seasonings.

We are and recipe Mitches and really turned out around quite strongly and in portions of our spices and seasonings business we're seeing some great progress. Our gourmet relaunch which is a part of turning around our spices and seasonings category growth is generating greatly results.

We're really winning the grilling season this year and we're confident that we'll do more than just stabilize our share in this segment but that will return to share growth and be the driver of the category in the U.S. We won't be satisfied with our results ourselves until we do.

David Driscoll (Analyst - Citigroup):

Is it still a price gap issue or do you think you have that under control?

Unidentified Company Representative:

I think that we thought about our pricing and really our thinking on pricing has evolved as our understanding of this issue has matured with the greater analytics capability so when we spoke about this at CAGNY in 2014 our focus was on price gaps versus private libel and key competitors and having conversations with retailers about those price gaps with the aim of narrowing them either by reducing the prices on McCormick or frankly by raising the price competitive items that were irrationally priced in some cases below the retailers private label.

But as we've gone through 2014 and developed greater understanding of the pricing dynamics we came to realize that the price gaps actually mattered less than the absolute price points on about a dozen key items so your initiatives this year has been focused more on managing the absolute price points on those key items and it does not involve additional pricing action or promotional activity on our part.

It's really at a way we allocate the promotional spending that we're already doing with the customer to direct it to the most productive place. Finally I think in my prepared remarks I mentioned a comprehensive category Management tool and this is really the next step in our evolution on this to have an even stronger analytic capability that allows us to understand and model the cross-elasticity of the entire category to optimize it for the retailer.

David Driscoll (Analyst - Citigroup):

Very helpful. I'll pass it along, thank you.

Operator:

Our next question is coming from the line of Akshay Jagdale with KeyBanc.

Akshay Jagdale (Analyst - KeyBanc Capital Markets):

Good morning. One quick one just in terms of your guidance for this year, how much of the M & A related charges are included in your constant currency EBITDA or operating in some guidance?

Unidentified Company Representative:

We mentioned about a million dollars related to the consumer acquisitions that is already absorbed in those guidance numbers.

Akshay Jagdale (Analyst - KeyBanc Capital Markets):

Okay, thank you. And just can you talk a little bit more broadly about the consumer environment? Obviously there's been some talk about lower gas prices and consumer spending, we really haven't seen broad data that we look at but how would you characterize the health of the consumer here in the U.S. and maybe talk a little bit about China because all of the indicators that we're seeing point to a little bit of a slowdown there but your business actually doing quite well so can you talk about those two topics broadly? Thanks.

Unidentified Company Representative:

Sure, we're still seeing a bifurcated consumer with some level of growth in premium and our gourmet brand is an example of that and niche categories so there is some growth. We're seeing some recovery in foodservice with people eating out so we are seeing some of those lower gas prices find their way in. On the other hand there is a vast number of consumers who are still stressed economically and so we are competing in the value segment to try to capture that.

In China as Lawrence said there has been some slowdown in economic activity. We're encouraged because we're still pretty broad based. We are in the traditional trade, we have our presence in the modern trade and we're participating in the emerging and fast growing eCommerce but we are still long term believers incline a. We are continuing to make investments there and are bullish on our prospects.

Akshay Jagdale (Analyst - KeyBanc Capital Markets):

Thank you. I'll pass it on.

Operator:

Our next question is from the line of Jonathan Feeney, Athlos Research.

Jonathan Feeney (Analyst - Athlos Research):

Good morning. Thanks very much. I just wanted to understand a little bit about seems like particularly as it relates to EMEA you've come back a few times with some business reviews around these restructuring charges and I guess that it seems to me like maybe you're just trying to get your hands around new cost opportunities that kind of make sense in a changing context whether that's currency or some of the effective currency might have on the market.

Could you tell me about that process a little bit because you've come up with some new charges a couple times now, I guess in the past six months sort of seen more opportunities to take special charges restructurings and maybe where we stand should we expect more of that in the second half of the year, more opportunity to do that? Thanks. Any perspective on that would be great.

Unidentified Company Representative:

Yes, I'll really point to and this is specific to Europe. It's a continuation of the journey of shared service structures and leveraging scale where we have opportunities to do that.

You mentioned a couple of charges, the first charge was primarily our first truly shared service opportunity which we went to Poland with and it was focused primarily in the financial end of things. The current activities are again related to an extension potentially of other activities into those, into the same shared service center, so it's broadening shared service. It's the same journey we've gone on here in the U.S.

The North American initiative that we took more recently was again more of an extension of shared service activity into our North American shared service and also in both cases it's looking at stand up control, faster decision-making and how we can delayer decision-making to be more responsive in a very competitive market.

We do these things very an a lit [oakly] and thoughtfully and to say that we would never do anything again would be a misstatement but at the same time we have to execute what we've already discussed and as a result, we need to get done the charges that we already announced this year and execute against those programs.

Jonathan Feeney (Analyst - Athlos Research):

Okay, thanks very much.

Operator:

Next question is from the line of Robert Moskow with Credit Suisse.

Robert Moskow (Analyst - Credit Suisse):

Hi. Thank you. On gross margin erosion I guess it's kind of hard to see how all this trade activity and pricing actions, why is that not helping you get your gross margin up, like why is the gross margin continuing to erode a little bit? It doesn't appear to be hurting the year but I would have thought by the end of the year maybe do you expect to be back on track in terms of boosting gross Marge anyone.

Unidentified Company Representative:

We expect gross margin as we talked about the impact of raw material costs this year, we said it would hurt us earlier in the year. We're forecasting mid single digit material cost inflation and that was hitting us right away in the beginning part of the year.

The CCI was going to take some time to help us offset that so our expectation is as we progress through the year, gross margin will have a sequential improvement such that by year-end we should see gross margin improvement year on year, so we've got improvement in Q2 versus Q3. We anticipate further sequential, I'm sorry Q2 versus Q1, we expect further improvement in Q3 versus Q2 and then again, improvement in the Fourth Quarter, so it's a function of the timing of raw material costs and the timing of our CCI.

Robert Moskow (Analyst - Credit Suisse):

God en like what's the factor that caused you to have to lower the guidance for the year? What fell below expectations in the first half?

Unidentified Company Representative:

Price realization is the same and CCI savings is the same. It's a tweak on the business mix candidly and the offset was obviously in the favorability of the SG&A but we were up slightly and now we're comparable. It's not what I would call a major change to our full year guidance but in terms of the fundamental of how we see this playing out that has not changed.

Robert Moskow (Analyst - Credit Suisse):

Secondly, on the acquisition of Stubs, is that providing any contribution to operating profit for the year? It's pretty neutral based on acquisition integration costs and the transaction costs that we've already mentioned.

Okay, and then lastly, your biggest customer had been very promotional on its private label side. Has that eased off at all and has that allowed you to compete or to perform better at that retailer?

Lawrence Kurzius (President and COO):

Rob this is Lawrence. I think what you're referring to is actually not private label but it's a control brand that is a McCormick brand that we sell them. They've had a big, that's had a pretty big impact on us in the first part of the year but we do see as they lap the activity that started really last year, that it's backing off considerably.

Robert Moskow (Analyst - Credit Suisse):

Does that mean that it's kind of continuing at a steady State or is it--

Unidentified Company Representative:

Actually the ACV, the large displays is about half its level of the peak, so we're still going to see some year on year comparison but it is greatly reduced from its peak.

Unidentified Company Representative:

It's not steady state.

Robert Moskow (Analyst - Credit Suisse):

So they're merchandising at less. Thanks.

Operator:

Our next question is from the line of Eric Katzman with Deutsche Bank.

Eric Katzman (Analyst - Deutsche Bank):

Hi, good morning, everybody, two questions. On China industrial, is limited time offers that helped you in the First Quarter, did those roll off in the second as you had expected and is that business kind of on track or on plan with what you had thought and then a bigger picture question for Allen.

The companies gotten more aggressive with M & A this year, three deals and the latest one Stubs in barbecue, I think the companies challenge in M & A has been potentially some kind of conflict with industrial customers who may be in the same business. Are you concerned about all of that, any of that or is there still enough runway based on the M & A you see to not have any conflicts arise within your industrial customers? Thank you.

Unidentified Company Representative:

Let me take the industrial question first or the acquisition questions first and I'll have Lawrence talk about China industrial. We always analyze for deals what the competitive overlap is going to be.

We know that we need to be in parts of the categories that are growing faster and we see opportunities for this in this case and in the case of barbecue sauces, we saw very little competitive overlap and we saw the opportunity for us to really participate in more of the premium and higher price part of the category that's growing.

And so, it's a brand that has no high fructose corn syrup and has carved out a very nice free firm all of the stuff that consumers don't seem to want right now so that one fits very well for us and we see some other opportunities like that that don't impact or overlap with our critical customers. So we've expanded our horizons in terms of the kinds of acquisitions that we're considering.

Unidentified Company Representative:

And I'll have Lawrence talk about China industrial.

Lawrence Kurzius (President and COO):

Eric, on our China industrial business, the growth that we're experiencing there partly reflects a recovery of the quick service restaurants and partly reflects a gain in share that we've achieved with those same customers, so while The Limited time offers are important, there's a steady stream of innovation that these customers are doing that cycles through our business continuously and I'd say that the key underlying trend this year has been a recovery in the quick service restaurants themselves and a gain in our share with those customers.

Eric Katzman (Analyst - Deutsche Bank):

Okay, thank you for that.

Joyce Brooks (VP of IR):

I think what we should do since we're coming up on the hour is I'd like to turn it over at this point to Alan for closing remarks and we'll welcome any further questions we'll take those off line.

Alan Wilson (Chairman and CEO):

Thanks for all your questions and participating in the call today. Consumer demand for flavors rising and driving demand for our products. Our geographic presence and product portfolio are expanding and aligned with the move towards health yes, sir eating, fresh ingredients, health anything cuisine and bold taste and we're driving growth through innovation, Marketing and acquisitions.

In 2015 we're seeing benefits of our stepped up cost reduction activity and we'll continue to pursue ways to improve our productivity and profit as we grow the top line. We look forward to reporting to you in our continued progress in the upcoming quarters and we hope everybody goes out and grills on the 4th of July weekend. Have a great weekend.

Joyce Brooks (VP of IR):

Thanks, everyone, for joining us today.