TheStreet Transcript

Mondelez International (MDLZ) Earnings Report: Q2 2015 Conference Call Transcript

The following Mondelez International conference call took place on July 30, 2015, 10:00 AM ET. This is a transcript of that earnings call:

Company Participants

- Dexter Congbalay; Mondelez International; VP - IR
- Irene Rosenfeld; Mondelez International; Chairman, CEO
- Brian Gladden; Mondelez International; CFO

Other Participants

- Ken Goldman; JPMorgan; Analyst
- Andrew Lazar; Barclays Capital; Analyst
- Robert Moskow; Credit Suisse; Analyst
- Chris Growe; Stifel Nicolaus; Analyst
- Jason English; Goldman Sachs; Analyst
- Matthew Grainger; Morgan Stanley; Analyst
- Bryan Spillane; BofA Merrill Lynch; Analyst
- Eric Katzman; Deutsche Bank; Analyst
- David Driscoll; Citi Research; Analyst
- Alexia Howard; Bernstein; Analyst
- Ken Zaslow; BMO Capital Markets; Analyst

MANAGEMENT DISCUSSION SECTION

Operator:

Good morning, and welcome to Mondelez International 's second-quarter 2015 earnings conference call. Today's call is scheduled to last about one hour, including remarks by Mondelez management and the question-and-answer session. I'd now like to turn the call over to Mr. Dexter Congbalay, Vice President, Investor Relations, from Mondelez International .

Dexter Congbalay (VP - IR):

Good morning, and thanks for joining us.

With me are Irene Rosenfeld, our Chairman and CEO, and Brian Gladden, our CFO. Earlier today, we sent out our earnings release and today's slides, which are available on our website, mondelezinternational.com.

As you know, during this call, we will make forward-looking statements about the company's performance. These statements are based on how we see things today. Actual results may differ materially due to risks and uncertainties. Please refer to the cautionary statements and risk factors contained in our 10-K and 10-Q filings for more details on our forward-looking statements.

Some of today's prepared remarks include non-GAAP financial measures. You can find the GAAP to non-GAAP reconciliations within our earnings release and at the back of the slide presentation. In addition, please note that our second quarter and first half financials include the results of our coffee business, which we combined with D.E. Masters Blenders effective July 2, to create Jacobs Douwe Egberts.

Separately today via form AK filed with the SEC we provided pro forma non-GAAP financial results that reflect the impact of the coffee business divestiture and other adjustments for 2014 and the first half of 2015, by quarter. As described later, these pro forma adjusted financial results serve as the basis of our updated 2015 outlook.

With that, I'll now turn the call over to Irene.

Irene Rosenfeld (Chairman, CEO):

Thanks, Dexter. Good morning.

We had a strong second quarter. We built on our momentum from the start of the year, continuing to drive top year margin expansion and earnings growth, while also delivering solid organic revenue growth. Specifically, organic revenue grew 4.3%, led by pricing actions to recover commodity and currency-driven input costs.

Adjusted gross margin increased 330 basis points, to 40.2%, driven by record net productivity, as well as 150 basis point benefit from mark-to-market of commodity and currency hedging contracts. We expanded adjusted operating income margin by 270 basis points, to 15.2%, while significantly increasing advertising and consumer support. And adjusted EPS was $0.47, up nearly 38% on a constant currency basis.

Our strong year-to-date results reflect clear progress in the execution of our transformation agenda. Earlier this month, we closed two deals that will enable us to focus even more keenly on snacks. We combined our global coffee business with D.E. Master Blenders, and we acquired the Kinh Do snacks business in Vietnam.

On the cost front, we drove record net productivity in our supply chain and continued to reduce overheads as a percentage of revenue, driven by strong execution of our zero-based budgeting initiative. While continuing to improve profitability, we have also begun to stage the Business for accelerated growth.

In addition to significantly increasing advertising and consumer support, we brought more of our state-of-the-art production lines on stream to drive the growth of our Power Brands and innovation platforms.

Our updated outlook for 2015 reflects the strong year-to-date performance of our ongoing business, as well as the continued progress on our transformation agenda.

These solid results have enabled us to essentially offset the expected dilution related to the coffee transaction, including the near-term impact of stranded overhead costs. As a result, we're increasingly confident in our ability to deliver a 2016 adjusted operating income margin of 15% to 16%.

Before jumping into the specifics of our Q2 performance, let me provide an update on our two recent portfolio actions. Earlier this month we closed our deal to combine our coffee business with D.E. Master Blenders creating Jacobs Douwe Egberts, the world's leading pure play coffee company. The company has revenues of more than 5 billion euros, and market-leading positions in over 18 countries across Europe, Latin America and Australia, as well as a strong emerging market presence.

JDE owns some of the world's leading coffee brands, including Jacobs and Tassimo as well as Moccona, Douwe Egberts, and Pilao. With greater focused and increased scale, JDE will be able to capitalize on the global growth opportunities in coffee, and invest more heavily in innovation, manufacturing, and market development. At closing we received cash of 3.8 billion euros and a 43 1/2% interest in the new joint venture.

These amounts are down somewhat versus previous estimates because we retained our interest in our Korea based joint venture DongSu Foods Corporation. Since we continue to hold that position, this doesn't affect the overall economics of the JDE deal.

As previously stated, we'll use a majority of the cash proceeds to buy back shares. We now anticipate the transaction will be EPS neutral to slightly accretive in 2016, reflecting fewer than expected shares repurchased due to the increase in our stock price, as well as JDE's expected divestitures to satisfy European regulators.

Two weeks ago we also completed the acquisition of a controlling interest in the Kinh Do snacks business in Vietnam. In addition to leveraging Kinh Do's iconic brands and leading positions in biscuits and mooncakes, we'll invest to introduce our Power Brands into their broad distribution network covering 130,000 outlets.

With the completion of the coffee transaction, on a pro forma basis snacks now represent nearly 85% of our revenue, up from 75%. This will enable us to further optimize our capital allocation and focus on accelerating the growth of our key franchises.

As you can see on slide 7, biscuits and chocolate now make up nearly 70% of our revenue, with gum and candy at about 15%. Post Coffee, our beverages segment, is now composed entirely of powdered beverages and will represent about 6% of revenue. Finally, cheese and grocery is about 10% of sales with a little less than half of the business in Europe.

So let's turn to our Q2 performance. We delivered organic revenue growth of 4.3%. Similar to the first quarter, higher pricing drove our top line growth, as we raised prices to recover higher input costs, including the impact of currency.

As we've discussed before, this protects profits and enables us to continue to invest in our brands and innovation platforms. As expected, vol/mix continued to be soft due to elasticity, as well as the impact of a number of strategic decisions we took to improve revenue mix.

In aggregate these strategic decisions were a 60-basis point drag on vol/mix in Q2, and for the full year we expect them to be a 100 basis point headwind. In addition, the shift of Easter-related shipments into Q1 had a negative impact of about 50 basis points.

Finally, to complete our revenue profile, Power Brands grew more than 6.5%. Emerging markets were up nearly 10%, with the BRIC countries also up about 10%. Finally, developed markets grew nearly a point.

Turning now to our results by region. Latin America was up nearly 20% driven by the inflationary economies in Venezuela and Argentina. Brazil was up low single digits, as we priced to recover the inflation impact of a weaker real on input costs. In addition, Brazil slowed sequentially as the weak macro environment led to a significant deceleration in our categories.

As you know, the Brazilian economy has been soft for some time. As a result, we've been closely monitoring and managing inventory levels so that we have no significant destocking surprises. We're pleased that our shares have held up well, and we'll continue to make the appropriate investments to drive further share gains.

That said, Brazil's slowdown is an area we'll continue to watch closely in the second half, as we don't see any short-term catalyst for category improvement.

Our EEMEA region grew 7%. As in the first quarter, this was primarily due to pricing. Our momentum in

Russia continued with revenue up more than 20%. This growth was driven by pricing in response to the sharp devaluation of the ruble. Despite significantly higher prices however, vol/mix was flat as we increased brand support and expanded distribution. Performance was strong across all categories.

Asia-Pacific was up 3%. We were pleased with the performance in China where growth accelerated to more than 20% behind strong execution in both biscuits and gum. India revenue growth was soft due to continued price elasticity in chocolate. India's another market that we're watching closely as we move through the second half. We're keeping a sharp eye on inventory levels as we increase A&C investment to help accelerate category growth.

In North America revenue grew modestly behind improved biscuits growth in the US We expect improved revenue growth in the second half as increased A&C and our new low-cost capacity comes online. Europe was also up modestly. Coffee posted strong growth as we increased trade inventories to ensure a smooth transition to JDE.

As expected, however, Europe's ongoing business remained soft. Similar to Q1, vol/mix was pressured as strategic decisions to improve revenue mix tempered Europe's volumes, especially in chocolate, while the Easter shift also created a 60-basis point headwind.

In addition, chocolate continued to be affected by negative volume elasticity as competitor pricing actions announced earlier in the year are not yet fully reflected on shelf. We anticipate revenue trends in Europe will improve in the second half as price gaps narrow and as our brands benefit from increased A&C support.

Turning to our categories, year-to-date our snacks categories grew about 4.5% globally. Including beverages and cream cheese, our categories were up more than 5%. Our organic growth was about a point below that, again, reflecting the impact of our strategic decisions to improve revenue mix.

While our financial results in the first half were strong, our year-to-date share performance is not where we want it to be. Only 45% of our revenue gained or held share, reflecting some sizable price gaps remaining in our categories, especially chocolate.

Let's take a closer look at each category. The biscuits category grew more than 5.5% year-to-date. Our biscuits revenue growth was solid up nearly 5%, with strong performances in China, Brazil and Russia.

Share performance was also strong with nearly two-thirds of revenue gaining or holding, including increases in both cookies and crackers in the US. Finally, Power Brands grew high single digits year-to-date led by continued strength from Oreo, TUC, Club Social and Barni.

Turning to chocolate, the category grew nearly 5% year-to-date, while our revenue was up only modestly. This was largely due to our performance in Europe, which accounts for about half of our global chocolate revenue. This also affected our share with only about 25% of revenue gaining or holding. Although we typically don't cite short-term data, we are seeing some green shoots in our most recent share performance, reflecting the benefits of selected A&C increases as well as narrowing price gaps.

In the UK for example we captured more than two share points in the most recent four-week period. And in Germany, excluding the impact of some strategic decisions to exit low margin revenue, we increased share through higher marketing support and selective trade investments.

In emerging markets, our year-to-date Chocolate revenue was up mid-single digits. In Russia, chocolate growth was strong, largely due to currency driven price increases, but vol/mix was up as well. Share performance was also strong. In Brazil, year-to-date revenue growth has been solid and we continue to gain share. Although, as I mentioned earlier, the category slowed in Q2 in response to the macro environment.

In India, chocolate revenue was soft, as consumers have been slow to adapt to the higher prices we implemented last year. In each of our key chocolate markets, we expect revenue growth and share performance to continue to improve in the second half, as price gaps narrow further and as we step up A&C investments.

Finally, in Gum and Candy, the category was up less than 2% year-to-date, but our revenue increased over 6.5%, with both gum and candy up mid-single digits, fueled by the launch of Trident in China, and by strong Hall's growth in the US. In sum, we're pleased with our solid top-line growth in the quarter, and with the early indicators of share improvement in response to increased A&C support.

Let me now turn it over to Brian to provide an update on our margin expansion and earnings growth.

Brian Gladden (CFO):

Thanks, Irene, and good morning.

As Irene highlighted, our Q2 results again demonstrate our ability to execute across multiple fronts of our transformation agenda, with great results in reducing costs, expanding margins and investing in growth.

Starting with slide 11, you can see that adjusted gross margin increased 330 basis points in the second quarter, to more than 40%. Productivity drove more than half of the improvement, continuing our momentum from the first quarter and the second half of last year.

In the quarter, we delivered strong net productivity of more than 3% of COGS, or about $175 million, which continues to be a record level of productivity for us, and benchmarks well versus peers.

In addition, mark-to-market contribute 150 basis points to the margin expansion, as we adjusted the value of our currency and commodity positions that don't qualify for hedge accounting. Adjusted OI margin was up 270 basis points, to 15.2%. We took the opportunity to re-invest a portion of the cost savings into additional A&C spending to support top-line growth and market shares.

As a result, A&C spending in the quarter grew double-digits on a constant currency basis, up 60 basis points as a percentage of revenue, to more than 9%. Consistent with our plans to deliver both top tier revenue growth and margin expansion, we'll continue to invest some of the additional cost savings into high ROI initiatives. As a result, we expect A&C spending to continue to increase as a percentage of revenue in the second half.

We'll talk more about this when we present at the Back-to-School Conference in early September. As you can see on slide 12, we expanded adjusted OI margins in all but one region. North America's margin was up modestly, as we re-invested some of the productivity in overhead savings into higher marketing and merchandising support. Margins in Europe, Latin America, and Asia-Pacific were up sharply, driven by strong productivity and overhead leverage, which also fueled increased A&C spending in these regions.

In EEMEA, adjusted OI margin was down 120 basis points as we continued to price to recover currency driven input cost inflation in Russia and the Ukraine. Considering the massive dislocation we saw in these markets in the first months of the year, we have made solid progress here in rebuilding our margins.

Adjusted EPS was $0.47 per share, up nearly 38% on a constant currency basis. Operating gains accounted for $0.06 of the increase, despite the impact of approximately $0.04 of higher A&C spending.

The year-over-year change in mark-to-market accounting accounted for the other $0.06. Below the operating line, lower interest expense and outstanding shares each added $0.02, while a higher tax rate was a penny drag. After accounting for the $0.08 currency headwind, adjusted EPS was still up more than 17%.

On slide 14, you can see that we returned $2.7 billion of capital to our shareholders in the first half. We purchased $2.2 billion of stock, more than 58 million shares, at an average price of a little more than $37 a share.

This increased level of buyback reflects our ability to pull in a substantial portion of our planned buyback related to the coffee proceeds as we leveraged the hedge gains of about $1 billion dollars related to the transaction.

In addition, we increased our share repurchase authorization program by $6 billion to a total of $13.7 billion and extended the expiration by two years through 2018. As a result, we can purchase up to $6.9 billion of stock over the next three and a half years. We also paid nearly $500 million in dividends in the first half.

In addition, last week we announced a 13% increase in our regular quarterly dividend to $0.17 a share, reflecting our continued confidence in delivering on our long-term commitments.

Let's turn to our outlook for the year. Now that the coffee transaction is complete, we'll give you a sense for what to expect for the remainder of the year. As you've seen through the first half, our ongoing business has been performing above our previous outlook. In our updated outlook we continued that momentum.

There's several moving parts and we've provide on slide 15 the key elements of our outlook. To help you determine the appropriate comparative historical financial results to use, earlier today we issued an 8-K with pro forma adjusted financials by quarter for 2014 and the first half of 2015.

The adjustments primarily involved moving our higher margin coffee business out of our reported operating income and reclassifying the after-tax income to below OI using the equity method. This is also how we'll record our portion of the after-tax earnings from JDE going forward.

Let's start with our revenue outlook. For the second half we expect organic growth of at least 3% versus the second half 2014 revenue base of $15.2 billion, which excludes coffee. This target reflects the underlying momentum of our ongoing business, which was up 3.2% in the first half.

So for the full year this implies organic growth of at least 3%. That's up from our previous target of at least 2%, which included coffee for the full year. On an apples-to-apples basis, this is an increase in our revenue guidance.

In addition, we expect a better balance between price and vol/mix in the second half as price gaps narrow, as our share performance improves, as we increase our A&C spending, and as we lap the impact of our strategic decisions to exit lower margin businesses.

Currency, however, will continue to be a sizable headwind. Based on current spot rates especially with the continued weakening of the euro, we estimate currency will have a negative impact of approximately 11 percentage points in the second half.

Turning to margin, in the second half we expect to deliver adjusted OI margin of at least 14%, despite stepping up A&C spending and absorbing a number of headwinds related to the coffee divestiture. That's up from 12.6% in the second half of last year. On an apples-to-apples basis, this reflects a margin upside for our ongoing business, which offsets both the coffee impacts and higher A&C investment.

As I said earlier, we're making good progress in building sustainable momentum in the execution of our supply chain reinvention program and in reducing overheads. Through the first six months we've delivered strong net productivity even before realizing any meaningful benefits from the new state-of-the-art assets that are now coming on stream.

As Daniel Myers discussed at CAGNY, in addition to the four lines that are up and running now in our Salinas, Mexico biscuit facility, in the coming months we have new high-speed and lower-cost production lines being installed in the US, in Europe, in India, China and in other markets.

As expected, we should begin to see the benefits from these new lines in the second half. And yesterday we announce a $130 million investment to install an additional four biscuit lines in Salinas, replacing nine older inefficient lines in our Chicago biscuit plant. We expect these new lines to be on-stream in mid-2016.

In terms of overheads, cost as a percentage of revenue are also down in the first half. In fact, in each of the indirect cost packages we highlighted at CAGNY, we're delivering savings that are on, or better than target, and so we're increasing our cost reduction expectations.

We're also on track with respect to our migration to global shared services, which will simplify and streamline our back office processes and better leverage our scale. Our shared services initiatives will begin to provide savings next year.

Cost reductions in our ongoing business will more than offset the dilutive impacts of three items surrounding the coffee deal. First, the coffee business we divested has a higher margin than our ongoing business. In 2014 the coffee business had an adjusted OI margin of approximately 17%, versus about 13% for the total company.

Second, the divestiture results in some stranded overheads: while the dilutive effect of stranded costs will be more pronounced in the third quarter, this impact is temporary. We expect to fully offset the impacts with additional cost reductions by the end of the year.

Third, and in conjunction with the creation of the coffee JV, we've reclassified after-tax income related to joint ventures in which we have a minority interest from above operating income to below the line to be consistent with how we account for equity earnings from JDE. The largest of these is our Korean coffee-related JV.

Together these three items are expected to pressure margins in the second half by 75 basis points to 100 basis points. Despite these margin impacts from the transaction, we continue to expect adjusted OI margin to expand significantly for the full year.

From a pro forma adjusted margin of 12% in 2014, we expect to deliver pro forma adjusted OI margin of approximately 14% in 2015, excluding a temporary negative impact of 20 basis points to 30 basis points from stranded costs. Importantly, with momentum from our supply chain and overhead cost savings programs, we're increasingly confident in our ability to deliver adjusted OI margin of 15% to 16% in 2016.

Now turning to EPS, we continue to expect to deliver double-digit adjusted EPS growth on a constant currency basis for the full year, versus a 2014 adjusted EPS baseline of $1.75. The margin expansion in our ongoing business is anticipated to drive the bulk of the increase, while lower interest expense and a lower share count are also expected to provide some benefit. These benefits will be partially offset by the dilution related to the coffee divestiture.

We do expect our year-over-year margin and EPS growth to be more fourth quarter-weighted given that in Q3 we'll have a more pronounced impact from stranded costs, from front loading A&C spending, and from an expected year-over-year mark-to-market headwind. Our currency headwind estimate for the year is unchanged at $0.33.

With respect to JDE, to estimate our total adjusted EPS you'll need to be able to estimate the JV's net income. However, since it's a private company that we don't control, disclosure regarding its financial results will be somewhat limited. On slide 20 we have provided a framework for JDE's income statement.

Now looking at how we'll use the cash proceeds from the coffee deal. At closing we received 3.8 billion euros of cash, which we hedged at the time of the agreement in May 2014. So effectively we received approximately $5.2 billion. We're returning about $2.9 billion via increased share buybacks, about $900 million of which we pulled into the first half of the year. We'll deploy the remaining $2 billion over the next 12 months. We'll use approximately $1.6 billion to pay down commercial paper. And we'll use the remaining $700 million for other corporate purposes, including funding the Kinh Do deal.

For your convenience we've summarized the elements of our updated earnings outlook on slide 22. In addition, let me provide you with a few other items to help you update your financial models.

With respect to interest expense, given that commercial paper is a low-cost form of financing, the paydown of $1.6 billion of CP is not expected to have a meaningful impact on our interest expense in the second half. As a result, we still anticipate interest expense to be around $375 million in the back half, and $750 million for the year.

We expect our tax rate to be in the high-teens in the second half, down from a pro forma adjusted rate of nearly 25% in the first half, due to reductions in statutory rates in certain countries. For the year, we expect our pro forma tax rate to be in the low 20's.

We're also increasing our free cash flow outlook for our ongoing business by about $400 million. This is driven by our strong year-to-date margin performance and continued solid working capital management. This increase, however, is more than offset by the divestiture of the coffee business.

So to wrap up, we delivered strong first half results with top tier margin expansion and earnings growth, while also stepping up investments to support future growth and improve market share. Our updated 2015 outlook reflects this momentum, as well as the opportunity to fund additional A&C support, while absorbing the dilutive impact of the coffee transaction. As a result, we're confident we can continue to build upon this momentum and deliver our 2016 adjusted OI margin target of 15% to 16%.

With that, let's open it up for questions.

QUESTIONS & ANSWERS

Operator:

Thank you. Ken Goldman of JPMorgan.

Ken Goldman (Analyst - JPMorgan):

Good morning, everyone. There are some moving pieces within annual guidance. So I'm just hoping maybe you can help us quantify some of the changes on an apples-to-apples basis, excluding coffee. And you gave some of this directionally already. I appreciate that. But just hoping we can get some numbers, I guess, on like-for-like sales, margins? How that guidance is changing?

Brian Gladden (CFO):

Yes, Ken, Sure. There are quite a few moving pieces. I guess I'd start -- clearly, a strong first half by almost any financial metric, and we're ahead of our outlook for the first half on both growth and margins. I guess the simple answer is, we're increasing net organic revenue outlook from 2% plus to 3% plus, and we think that's a prudent increase given what we're seeing in the markets today.

On OI margins, we're still at about 14% for the year, and basically offsetting the dilution in the coffee transaction with underlying margins really improving. So, our year-over-year OI margin improvement is now about 170 basis points. And when you go back to our original outlook, the prior 14% was an improvement year-over-year of 110 basis points.

So, I think that's one of the ways to look at this and feel good about the outlook that we've just given. And then hanging on, obviously, despite the dilution to double-digit adjusted EPS growth at constant currency. Those, I think, are the big elements at a very high level. Happy to get more into the mechanics if you want, but I think those are the headlines.

Ken Goldman (Analyst - JPMorgan):

No, we can follow up after. Thanks very much.

Brian Gladden (CFO):

Thanks, Ken.

Operator:

Andrew Lazar of Barclays.

Andrew Lazar (Analyst - Barclays Capital):

Good morning, everybody.

Brian Gladden (CFO):

Hey, Andrew.

Andrew Lazar (Analyst - Barclays Capital):

If I'm hearing you correctly, it sounds like you've reached a point where you have the margins, flywheel going, so to speak, and are now more comfortable gearing up spending maybe to drive a better balance right between the top-line and margin. So, if I have that right, in light of that, is it too early to talk about what you see as the right longer term EBIT margin? Is 15% to 16% the right level, with upside from there going to the top-line? Is there potentially still more there, even with the increased A&C spending? I'm trying to get a better sense of that, and then I've got a quick follow-up.

Brian Gladden (CFO):

Well, yes. Look, I think, Andrew, we're increasingly confident as we move through the year and see the execution here both in the margins, and I think we feel great about the ability to begin to put some investment on the A&C side, behind growth. I think as we move through the year and, obviously, we'll give you an updated outlook for next year as we get into the first part of the year, will probably give you a sense for where we go from there.

But as we've talked about, there clearly are continued margin opportunities beyond what we see for 2015 to 2016. As we look at the supply chain reinvention and restructuring activities that are going on, we would expect to have further margin opportunities, and I think it really comes down to striking that balance between growth and margin, and we want to retain some of that flexibility to strike that balance, depending upon how the market plays out.

Andrew Lazar (Analyst - Barclays Capital):

Great. And then a quick follow-up. I think on the last call, Irene, you may have talked about raising promotional activity in 2Q, specifically in chocolate in Europe, as the competitor price increases probably wouldn't really hit until the third quarter. And I think the gap between Chocolate category and Mondelez' growth in the quarter was still quite wide. So, I guess I'm just trying to get a sense of, would you have expected better share performance in the 2Q, given some of the additional spending you were going to do? And if so, what caused the gap to still be as wide as it was?

Irene Rosenfeld (Chairman, CEO):

No, actually, Andrew, Q2 played out pretty much as we has expected in Europe. There's no question, we're continuing to feel the impact of having led price. We're seeing volume elasticity and share play out essentially the way we had thought.

And as I mentioned in my script, in the second quarter we did increase some promotional and A&C support in markets like the UK and Germany, and we are starting to see some responses there.

But don't forget that we also -- Europe is really the main place where the strategic decisions have an impact, and that's about a 60-basis point impact to top- line, as well as Europe has a disproportionately large Easter business, and that's about 50 basis points on the top-line. So, the combination of those two things need to be added back to the overall performance.

So net-net we're not entirely pleased yet with our performance in Europe, but it is playing out, essentially, the way we had expected. And we do expect back half to see stronger performance as price gaps narrow, as we start to see our competitor pricing playing through in the marketplace, and as we reinvest some of our savings into more A&C support.

Andrew Lazar (Analyst - Barclays Capital):

Thanks very much.

Dexter Congbalay (VP - IR):

Thanks, Andrew.

Operator:

Robert Moskow of Credit Suisse.

Robert Moskow (Analyst - Credit Suisse):

Thank you. Definitely positive news to know that you feel comfortable re-investing in A&C. I think that there's been several months of conservatism there. Can you quantify how much you're raising that for the year, in dollar terms? And then also, can you give me a sense of like -- there's some geographies that you've talked about where you really are warning that the categories might take a turn for the worse because of macro factors.

And, in the past, I think Mondelez has had trouble bending that trend. I can think of China, a couple years ago, as a point in fact. So, are you going to spend that money to protect and gain share, or are you going to try to drive category growth? And, if so, isn't that a much tougher task?

Irene Rosenfeld (Chairman, CEO):

Actually, Rob, we're not going to provide numbers on our spending for the full year. What we did say, is that we had a significant increase in the quarter. It's actually up double-digits year-over-year. And we're going to continue to strike a balance between places where we want to make sure that we're protecting share until price gaps narrow.

Places like the UK and Germany, but we're also spending money in markets like the US biscuit market. And we were pleased to see, in the second quarter, a change in trend there. That market had been quite slow, and we started to see growth coming back there. So, it will be a balance. The operative thought here is to make sure that we're getting good ROI. But in markets I talked about, Brazil and India, I would say, given the dynamics in Brazil, it's probably going to be much more about share protection.

In a market like India, we are about 65% of the category, and we believe that, therefore, our spending can help to stimulate the consumer acceptance of the higher price points. So it's a balance. But net-net it gives us great confidence that we should see, as we make these investments, we should see improvement in our revenue rate of revenue growth, as well as our share performance.

Robert Moskow (Analyst - Credit Suisse):

Okay. Thank you.

Dexter Congbalay (VP - IR):

Thanks, Rob.

Operator:

Chris Growe of Stifel.

Chris Growe (Analyst - Stifel Nicolaus):

Hi. Good morning.

Brian Gladden (CFO):

Hey, Chris.

Chris Growe (Analyst - Stifel Nicolaus):

Hi. I just had two questions for you, if I could please. I wanted to ask about the gross margin. I think, with some of the disclosure you've given in the release and in the slides, roughly half the benefit came from productivity, roughly half from the mark-to-market.

I'm trying to understand like, from an underlying basis pricing volume, was there a benefit to the gross margin? And then, related to that, productivity savings. When you cite productivity savings, are those inclusive of the Salinas plant, for example? Some of the lines of the future? Are you incorporating that when you talk productivity?

Brian Gladden (CFO):

Yes, Chris, so the two things we talked about, we're not going to fully parse the gross margin for you, but productivity, it ends up being about 180 basis point help in the quarter. We talked about market-to-market 150 basis points. So the two of those are about the number.

The reality is there's some other smaller things moving around. And when you look at price net of commodities within the quarter, we saw positive dollar impact there, but it would've been negative on the margin rate. Not enough price to offset the full impact of commodity inflation in the rate. So that's the dynamic.

We would be in the quarter actually absorbing start-up costs related to the start-up of some of these lines. So for the most part, the new lines would be a headwind to gross margins, a modest one. Not a big one at this point. Okay?

Chris Growe (Analyst - Stifel Nicolaus):

Yes, that's very good color. Thank you. I just have one overall question, maybe a big picture question, Irene. Looking at some of the emerging markets, we've heard some disclosure on India and Brazil, and one in particular that's gotten a lot of interest has been China.

I know you've gone through an issue there a year or 18 months ago. And I just wanted to get a better sense in that market. It sounds like you're watching inventory levels closely. Just how consumption trends are perhaps changing and how consumption overall is holding up in that market?

Irene Rosenfeld (Chairman, CEO):

Well, look, we know that some of our peers have had some challenges. We had challenges of our own as you recall back in 2013, and we very quickly have addressed them. We've taken a number of steps, aside from very closely monitoring inventory versus consumption, as you said. We've invested quite significantly in category growth in biscuits, as well as in our innovation platforms.

So we've invested behind Oreo, behind the launch of Oreo Thins, which has been off to a terrific start. We've seen very nice improvement in our shares as a result of that, and we're seeing the biscuit category is starting to improve after quite some time of being essentially flat. We're also launching our belVita product as we speak, and that will have a nice impact.

So a lot of the good work that's going on in China is our opportunity to control our own destiny by making sure that we have the adequate spending behind our franchises, as well as adequate strong innovation platforms.

On the gum side I'm quite pleased with the performance. Stride continues to do well. We continue to innovate behind that franchise in terms of the launch of bottles and Stride Layers, but we also just recently introduced Trident into the market and it's off to a very strong start. So we're cautiously optimistic.

We're continuing to keep our eye very closely on the dynamic in the market. But I think we've got our hands firmly on the key levers that will help to fuel our business.

Chris Growe (Analyst - Stifel Nicolaus):

And do you see eCommerce sales becoming an issue for consumption and the patterns of consumption for consumers in that market?

Irene Rosenfeld (Chairman, CEO):

I actually don't see it as an issue, I see it as an opportunity. And we're continuing -- we'll be talking about that more at our Back-to-School Conference. We're continuing to see some very nice growth in our eCommerce business, particularly in markets like China.

Chris Growe (Analyst - Stifel Nicolaus):

Okay. Look forward to that. Thank you.

Operator:

Our next question comes from the line of Jason English of Goldman Sachs.

Jason English (Analyst - Goldman Sachs):

I wanted to pick up on some of the questions on chocolate. Irene, you mentioned some optimism on share improvement with price gap scenario in the back half of the year. Can you talk about the progression on price gaps through the quarter and whether or not you've seen some of those narrow into Q end?

Irene Rosenfeld (Chairman, CEO):

Well, without a doubt some of the actions that we took, particularly in Europe and particularly in the UK and Germany, have helped to narrow some of those gaps, as well as we see our competitor pricing coming through in markets like Germany, that also helps to narrow the gap.

So I want to back up a little bit. In aggregate we had very strong performance in our emerging markets, up mid-single digits. The challenge, as I've said, has been in Europe, and again it's in large measure due to the fact that we led pricing, we took some fairly sizable increases in response to both commodities as well as ForEx.

And we do expect improvement in the second half as our competitor pricing comes through and as we start to continue to make investments in A&C.

Jason English (Analyst - Goldman Sachs):

Thanks. That's helpful. And yes, Europe, especially when we strip out coffee, with this AK restatement looks surprisingly soft. Can you talk maybe about the grocery business and its contribution? We've heard a lot on the snack portfolio, not a lot on just the core cheese and grocery business.

Can you talk about how that's performing both in Europe and abroad? And how you're seeing that performance change after the decision to operationally carve it out at least in Europe? I think that was some point last year.

Irene Rosenfeld (Chairman, CEO):

Yes, first, Jason, again, let me remind you, as you look at our Europe, we're not satisfied with our European revenue performance. But remember, it's got an Easter headwind, it's got the impact of some of the decisions we made to improve revenue mix, as well as the elasticity.

So it's got some other factors in there that are causing the overall performance. But that said, we're not pleased with it and we are expecting, given the investments that we're making, as well as the closure of price gaps in the course of the back half. We should see some improvement.

Cheese and groceries is actually performing quite well. The margins are good, the cash flow is good. We had solid growth in the quarter as well as year-to-date. Our Philadelphia brand is performing exceptionally well, it was up high single digits. So we're feeling quite good about that business.

Jason English (Analyst - Goldman Sachs):

That's great. Thanks a lot. I'll pass it on.

Irene Rosenfeld (Chairman, CEO):

Thank you.

Operator:

Matthew Grainger of Morgan Stanley.

Matthew Grainger (Analyst - Morgan Stanley):

Hi. Good morning; everyone.

Dexter Congbalay (VP - IR):

Hey, Matthew.

Matthew Grainger (Analyst - Morgan Stanley):

Hey. Just two questions. Brian, I wanted to follow up on the revenue outlook and some of the potential swing factors there. Obviously, we talked a lot about some of the key emerging markets. But I think you're also moving into a second phase of VVB, which could include some incremental focus on head count. So just curious, are you building in any operational conservatism or expectation of disruption into the second half sales outlook for that reason?

Brian Gladden (CFO):

Look, I think as we look at the top line, it's a prudent plan. I think we've got -- as we called out a couple markets that we have a little bit of concern about. And we've obviously taken a little bit more of a prudent view because of that.

I would also say in general the transformation continues, and whether it's supply chain reinvention and potential challenges that might come as we rationalize our planned footprint, invest in new capacity, or whether it's the broader activities around shared services and the impact that that's going to have, those are things that continue as we move over the next 18 months even 24 months. So clearly those are the two things that I would call out as we think about that revenue guidance of 3% plus.

Matthew Grainger (Analyst - Morgan Stanley):

Okay. But not necessarily something you would call out as being an expected source of near-term volatility?

Brian Gladden (CFO):

No. We're managing it.

Matthew Grainger (Analyst - Morgan Stanley):

Okay. Thanks. And then just, Irene, as we think about the continued volatility in some of your key emerging markets again, could you just remind us where your capabilities stand right now, and what you've done over the course of the past year or two in terms of tracking inventory levels, managing them closely, and being able to quickly respond to any rapid changes that may occur in category growth from here?

Irene Rosenfeld (Chairman, CEO):

Yes, Matthew, as we've shared with you, we've made significant changes in the templates that we use to manage the business as well as the training that we're giving to our colleagues in the individual markets.

And so we've got great visibility. We look at the business on a monthly basis, and we've got the KPIs that are critical to our success. Those are the ones that we're monitoring.

So I feel very good that we've got our finger on the pulse of the business, and we've got much greater visibility into the various levels of demand, as well as the execution against that.

Matthew Grainger (Analyst - Morgan Stanley):

Okay. Great. Thank you both.

Brian Gladden (CFO):

Thanks, Matthew.

Operator:

Bryan Spillane of Bank of America Merrill Lynch.

Bryan Spillane (Analyst - BofA Merrill Lynch):

Hey, good morning, everyone.

Brian Gladden (CFO):

Hey, Bryan.

Irene Rosenfeld (Chairman, CEO):

Hey, Bryan.

Bryan Spillane (Analyst - BofA Merrill Lynch):

Two quick ones for me. First, Brian, on the margin outlook for 2015 for the full year, does it assume that the mark-to-market benefit that you've had year-to-date reverses itself, so it's essentially neutral for the year? Or does it assume that we hang on to some of the benefit for the full year?

Brian Gladden (CFO):

Hard to predict, Bryan. I would say as we think about the second half, it's relatively modest. We see, as we've said, relative to the third quarter we've got year-over-year challenges given some favorability last year. But as we look at the rest of the year, not a big swinger, not a big swinger at this point.

Bryan Spillane (Analyst - BofA Merrill Lynch):

Not a big swinger for the full year or the second half? Because it's had an effect on the first half. That's what I was trying to understand whether or not it's where when we end the year, do we end the year with a mark-to-market benefit that we didn't expect when the year started?

Brian Gladden (CFO):

Yes, I would say we'll have a slight mark-to-market benefit for the total year. Yes.

Bryan Spillane (Analyst - BofA Merrill Lynch):

All right, got it. Thank you. And then the second one. Irene, as you've had the opportunity and made the decision to re-invest some of the margin upside in advertising and in A&C, has the category, the change that you made last year to a more category-led model, has that framework given you more confidence in the ability to invest, where to invest, what to invest in?

Just trying to get a sense for how that has had an impact, or if it has had an impact, on some of the decision-making and the effectiveness of that spending.

Irene Rosenfeld (Chairman, CEO):

Without a doubt, Bryan. Frankly, it's also the answer as a follow-up to Matthew's questions. We're continuing to build capabilities, particularly in our emerging markets. And this category structure is helping to ensure that we transfer the knowledge.

So, without a doubt, I have greater confidence in the launch of belVita in China, because the guy who's launching it actually came out of Europe, where it was a fabulous success. And so, as we look at each of our businesses, the ability to transfer that knowledge is a key driver, not only of the learning, but also of some of the material.

So, I think you'll continue to see us expanding our proven platforms more aggressively as a result of the new model, as well as capturing the learning from one market to the other.

Bryan Spillane (Analyst - BofA Merrill Lynch):

Okay. Thank you.

Operator:

Eric Katzman of Deutsche Bank.

Eric Katzman (Analyst - Deutsche Bank):

Hi. Good morning, everybody.

Dexter Congbalay (VP - IR):

Hey, Eric.

Eric Katzman (Analyst - Deutsche Bank):

A couple of questions. Let's talk about the top-line. Maybe a little bit of a follow-up to Bryan's question. I think, Irene, that you had said or you had thought that the categories were strengthening.

And yet, the data that you show basically says, in sales, total snacks was up 4.4% in the first quarter, and for the year, or year-to-date, it's up 4.5%.

And I assume that there's a fair amount of FX-led pricing going on. So, from a volume/mix perspective, do you still feel that the categories globally are strengthening? Or just maybe you could give a sense there. And then I have a follow-up.

Irene Rosenfeld (Chairman, CEO):

Yes. No, as you can see from our overall results, Eric, the big driver of our revenue is, in fact, pricing and mix. And so, there's no question that volume is not where we need it to be. A big part of the investment that we'll be making, that we've begun to make in the second quarter and we'll be making through the balance of this year is designed to get our volume momentum back.

So we expect -- we had told you that we expected vol/mix in the second quarter to be weak because of the Easter shift, as well as the elasticity's. We should start to see that strengthen in the back half the year.

Eric Katzman (Analyst - Deutsche Bank):

Okay. And then, Brian, can you give some updates on like CapEx, not just this year, but next year? The $1.8 billion that I think you threw out at CAGNY surprised me. And the roughly $1 billion dollars of cash cost for the latest restructuring this year, next year. Are those still like good numbers, or as you've gotten more experienced within Mondelez, are there any changes maybe for the -- on the right side of it?

Brian Gladden (CFO):

Yes. Look, I think we said 5% is the target in the mid-term, given all of the things we're doing with the plants. That's really what the $1.8 billion is. I think as we -- one of the things you saw probably in the deck is that, as we take coffee out that takes about $100 million out. So, the number for the year is still about $1.7 billion.

As I've said, and I think I've said at CAGNY, I mean, this should be the peak year, as a percentage of revenue and on a dollar basis. And we'll start moving down as we move through the execution of the supply chain reinvention activity. So, no real change to that. I think we're being thoughtful. We're adjusting that based on some of the volume trends that you've seen.

In terms of capacity that drives volume, versus investment in productivity programs that may be accelerating some of the productivity opportunities. And that's part of what I think you see play out. On the restructuring, no real change.

We're progressing through that, and that's part of the -- obviously driving some of the overhead savings that you're seeing in the results. And this is, on the restructuring from a cash standpoint, this is the big year, as well. 2015 will be the biggest year.

Eric Katzman (Analyst - Deutsche Bank):

I thought it was, or the last time I asked or we checked, it was like $1 billion this year, or $1 billion next year, and then like $500 million in cash, in 2017. Has that changed a bit?

Brian Gladden (CFO):

It'll be bigger this year, and come down next year. Yes.

Eric Katzman (Analyst - Deutsche Bank):

Okay. Okay. Thank you. I'll pass it on.

Brian Gladden (CFO):

Thanks.

Operator:

David Driscoll of Citi Research.

David Driscoll (Analyst - Citi Research):

Thank you, and good morning.

Irene Rosenfeld (Chairman, CEO):

Hey, David.

Dexter Congbalay (VP - IR):

Hey, David.

David Driscoll (Analyst - Citi Research):

Can you talk a little bit about the pricing dynamic in Latin America? I think pricing here came in well above the foreign exchange effect. This is unusual, at least from my point of view, from a lot of other companies.

We would normally see pricing up to some degree, but it usually never matches the percentages that you see on FX in the impact, because most companies are trying to offset the margin impacts rather than the revenue impacts. Are you getting actual pricing that's just net positive to the margin structure in Latin America?

Irene Rosenfeld (Chairman, CEO):

The answer is yes. There is a timing impact, as you would imagine. And so there's only a -- although I would say we have gotten a lot better about executing pricing actions. We used to price once a year.

Now we're pricing far more frequently, particularly in a number of the more volatile markets. But for the most part, we are pricing to recover our cost increases, and you're seeing that play through in the margins, as well as in the revenue.

Brian Gladden (CFO):

And you would see other quarters where it would be the other way and you got to catch up. That's really the dynamic.

David Driscoll (Analyst - Citi Research):

Okay. So that's -- maybe that's what I'm missing here. So this is -- part of this is a catch-up, versus prior quarters where it just wasn't as good. Would you think that this kind of dynamic that we see today in the second quarter, does it continue in the back half?

Irene Rosenfeld (Chairman, CEO):

Well, again, I think you're going to continue to see us in a number of the markets, particularly Venezuela and Argentina. You're going to see us continue to try to keep pace with the inflationary impact.

In markets like Brazil, we want to just manage the impact of the pricing that we have taken year-to-date, because we still have some sizable price gaps, and we've had a decelerating impact, as I mentioned, on our category performance. So, we're going to monitor that and to make sure we're investing adequately behind the franchises.

David Driscoll (Analyst - Citi Research):

I had a couple little ones here. On FX, your outlook is unchanged, but of course, you had the coffee divestiture, which was European, et cetera. So, why doesn't the FX change post the coffee divestiture? And, also, same question on the tax rate. Why doesn't the tax rate change post the divestiture of this big European business?

Brian Gladden (CFO):

Well, the euro has come down a bit, I think is the offset to the coffee change. That's the dynamic that's playing out. And what was your second question again, David? I'm sorry.

David Driscoll (Analyst - Citi Research):

It's all about like these -- so the tax rate, you've got this big divestiture and the tax rate doesn't change, but I feel like it perhaps should.

Because as you take this big piece out, the residual mix of businesses should cause a change in tax rates as you add them all together. So maybe it's a 2016 or 2017 question. I don't know how, but I feel as if it's something potentially important.

Brian Gladden (CFO):

Yes. I mean, given the exposures of where the coffee business is, I mean, it would have a lower tax rate. So, when you take that out, you expect it to go up a little bit.

What we've got playing out in this outlook is really some specific countries where statutory rates have moved and some discrete items that we see in front of us. So, that's what's keeping it low. Over the longer term, we'll give you visibility to that as we move through the year.

David Driscoll (Analyst - Citi Research):

Last question. Is there a synergy number that you can give us for the new coffee joint venture? Is it significant? And what's the rate of growth that you would expect on this joint venture line going forward?

Brian Gladden (CFO):

Yes, we're not going to get into -- it's a private company. And with our partners, we're not going to disclose a lot about that.

David Driscoll (Analyst - Citi Research):

Thank you.

Operator:

Alexia Howard of Bernstein.

Alexia Howard (Analyst - Bernstein):

Hi, there. Can I ask about India to begin with? You didn't quantify just how much sales were down. I'm assuming that they were down perhaps this time around.

And maybe just a little bit of color on what's happening out there, when it might get back into recovery. And then as a quick follow up, the margin outlook in EEMEA, it was down 120 basis points this quarter. When do you expect the pricing to adjust so that that might turn itself around? Thank you.

Irene Rosenfeld (Chairman, CEO):

Well EEMEA -- a simple answer is, there has been some dislocation with the rapid devaluation of the currencies, and we should start to see that moderate as the year progresses. So that's an easy one. Let's come back to the India question. Let me clarify that. India is growing. It's just growing at a slower rate than it had been.

So I want to be very clear. It's not a problem. It's just we'd like to see it get back up to the high single digit, double digit rates that it had been growing at since we acquired the Cadbury business. There's no question that the actions that we took in response to the devaluation of the rupee, as well as the impact of higher cocoa costs, has impacted the market.

We not only have seen our gaps widen, but we also have crossed some critical price thresholds. And so the intent of our investments back in the chocolate category in India are designed to help to mitigate some of that and help the Indian consumer over the hump. We've also taken a number of steps to help our price pack architecture in the market so that we are covering various points on the price spectrum.

So net-net, India continues to be a market of great importance and interest to us. It's got a nice, growing middle class, very low per capita consumption of chocolate, and we expect it to be a growth engine for the future.

Alexia Howard (Analyst - Bernstein):

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

Brian Gladden (CFO):

Thanks, Alexia.

Operator:

Ken Zaslow of Bank of Montreal.

Ken Zaslow (Analyst - BMO Capital Markets):

Thank you very much for letting me have my question. Let me just ask more of a qualitative question. It was asked a little bit but just trying to get into this idea of the 15% to 16% margin.

After you achieve the 15% to 16% margins, what are the opportunities within your portfolio? Like how will you direct your efforts to reconfigure your operating margins? Is it more of the same? Is there different facilities? Is it different regions? Is it different products? Can you just give us some qualitative view of where you're going to go strategically after you hit the 15% to 16% margins?

Brian Gladden (CFO):

Well, I'll give you a little bit of the dynamics and maybe Irene can answer strategically. As we talked about the restructuring supply chain reinvention, I mean that's an activity that will go through 2018.

So this is one where 15% to 16% is what we're calling for 2016, but the reality is there will be continued cost opportunities and margin opportunities beyond 2016.

As I said earlier, I think we want to maintain the flexibility to balance, really, growth with the margins that we drive in the business. And being able to re-invest is a -- it's nice that we're really getting that opportunity right now to begin to do that.

We expect to do that more. And driving a better balance between top line growth and volume growth, and the quality of that top line, along with higher margins, there's clearly continued opportunity to do that beyond 2015 to 2016.

Irene Rosenfeld (Chairman, CEO):

But Ken, a lot of the productivity, as we shared with you, a lot of the productivity that we're driving as we speak, the record net productivity that we just delivered in this quarter and for the first half is before the impact of our supply chain reinvention investments, which, as we've shared with you, has a sizable impact on variable costs.

In addition, a lot of the tools that are driving that productivity, things like integrated Lean Six Sigma are the tools that will enable us to continue to benefit from productivity as we look ahead.

So we've got good tools in place that should become the foundation for the future performance, and gives us great confidence as we look into 2016 and beyond that our margin performance will continue to be quite strong.

Ken Zaslow (Analyst - BMO Capital Markets):

Do you think that you will -- it seems like there's a long way before you get to your natural limit on your margins. Is that a fair commentary?

Irene Rosenfeld (Chairman, CEO):

Well, I think it's fair to say that we have great visibility to continued improvement in our margins. As we've shared with you, though, we want to continue to make sure, as we think about how much of that will drop to the bottom line, it's all predicated on our balance between our top line and our bottom line. And we'll continue to share that with you as we move ahead.

Ken Zaslow (Analyst - BMO Capital Markets):

Okay. Thank you very much.

Dexter Congbalay (VP - IR):

Operator, that's our last call. This is Dexter. If you have any questions going forward, happy to take them today over the next few days, and thank you for joining our call.

Operator:

Thank you, ladies and gentlemen. This does conclude today's conference call.