Mead Johnson Nutrition Company (MJN) Earnings Report: Q1 2016 Conference Call Transcript

The following Mead Johnson Nutrition Company conference call took place on April 28, 2016, 09:30 AM ET. This is a transcript of that earnings call:

Company Participants

- Kathy MacDonald; Mead Johnson Nutrition; Investor Relations
- Kasper Jakobsen; Mead Johnson Nutrition; President and CEO
- Michel Cup; Mead Johnson Nutrition; EVP and CFO

Other Participants

- David Driscoll; Citi Research; Analyst
- Matthew Grainger; Morgan Stanley; Analyst
- Rob Moskow; Credit Suisse; Analyst
- Josh Levine; JPMorgan; Analyst
- Amit Sharma; BMO Capital Markets; Analyst
- Pablo Zuani; Susquehanna; Analyst
- Bryan Spillane; BoA Merrill Lynch; Analyst
- John Baumgartner; Wells Fargo Securities, LLC; Analyst
- Jason English; Goldman Sachs; Analyst
- Mario Contreras; Deutsche Bank; Analyst

MANAGEMENT DISCUSSION SECTION

Operator:

Welcome to the Mead Johnson Nutrition first-quarter 2016 earnings conference call.

(Operator Instructions)

As a reminder, this conference is being recorded for replay purposes.

I would now like to turn the conference over to Kathy MacDonald, Vice President, Investor Relations. Please proceed, Kathy.

Kathy MacDonald (Investor Relations):

Thank you, Operator. Good morning. Thank you for joining Mead Johnson’s first-quarter 2016 conference call.

With me today are Kasper Jakobsen, our Chief Executive Officer; and Michel Cup, our Chief Financial Officer.

Earlier today, we issued our earnings release and financial reference slides, which are available on our website.
As we start, let me remind everyone that our comments will include forward-looking statements about our future results, including statements about our financial prospects and projections, commodity costs, currency fluctuation, pricing, taxes, capital spending, depreciation and amortization, new product launches, private quality, other growth initiatives and market conditions that constitute forward-looking statements for purposes of the Safe Harbor provision under the Private Securities Litigation Reform Act of 1995.

A more detailed explanation of our forward-looking statements will appear in the materials posted on our website in connection with today’s conference call.

Keep in mind that our actual results may differ materially from expectations as of today due to various factors, including those listed in our annual report on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K. In each case, as filed with or furnished to the Securities and Exchange Commission and our earnings release issued this morning, all of which are available upon request or on MeadJohnson.com.

Today’s comments will include discussion of non-GAAP financial measures. A reconciliation of these measures to comparable GAAP measures appear in the morning’s earnings release posted on our website. In addition, any forward-looking statements represent our estimates only as of today and should not be relied upon as representing the estimates as of any subsequent date.

While we may elect to update forward-looking statements at some point in the future, we specifically disclaim any obligation to do so even if our estimates change.

I will now turn the call over to Kasper.

Kasper Jakobsen (President and CEO):

Thank you, Kathy. Good morning to all of you. Thank you for joining our call.

Let me begin by summarizing our first-quarter performance before I then expand on the headlines with additional detail from each of our recording segments. My comments will focus on strategy and top-line performance. Michel will then follow up with additional financial analysis and elaborate on profitability and cash flow.

Except where I note otherwise, I will be referring to non-GAAP results.

At our investor day in October of last year, we laid out a three-year plan for value creation. We noted at the time that 2016 would be a year of transition. During our year-end earnings call, I identified three key milestones we’ve used to monitor our progress against this plan.

Firstly, a return to constant-dollar sales growth, with the first step being sequential sales growth from fourth-quarter 2015 to first-quarter 2016. While today, we are announcing constant-dollar sales in the first quarter rose 1.5% above the prior quarter.

Secondly, we said we would deliver on our first-year commitments to reduce our overall operating expense base. And in the first quarter, our Fuel for Growth initiative delivered $20 million in expense reductions versus the prior year’s first quarter. And we are well on our way to achieve our annual savings target.

Thirdly, and finally, we said we would invest a portion of our operating expense savings to fund key growth initiatives both above and below the net sales line. In the first quarter, we continue to make strong investments in support of our strategy, especially in China. I will expand on this a little later this morning.
Turning now to our first-quarter 2016 results. First-quarter sales came in as expected at $962 million. As anticipated, this represented a sequential improvement in constant dollars over our fourth-quarter 2015 number. This is our second successive quarter of sequential improvement in our underlying business following the difficult second and third quarters of 2015.

Also as anticipated, our financial results were adversely impacted by currency movements to the tune of 600 basis points. Compared to the same quarter of prior years, sales were 6% lower in constant dollars, driven by 8% lower volume, while pricing contributed 2 percentage points of growth.

The unfavorable year-over-year comparison was mainly driven by tough base comparisons in our two largest markets. And affecting the quarter itself are significantly reduced shipments to Venezuela.

Given the large adverse currency impact, I am pleased with the Company's continued earnings power. Gross margin for the quarter remained slightly better than 64%, and our EBIT margin was above 25% as our cost reduction initiatives began to take hold.

Investment in advertising and promotion represented 15.8% of sales for the quarter. This was similar to the levels seen through the second half of 2015. Non-GAAP earnings per share for the quarter were $0.87. Michel will discuss how the most recent devaluation in Venezuela impacted our GAAP earnings.

Elaborating on the sequential improvement in sales against the prior quarter, improvements in Asia and Latin America were key drivers of growth. I know you are all watching our performance in China closely, so I want to let you know that, sequentially, we saw a high single-digit percentage improvement in constant-dollar sales in the world's biggest market. Simultaneously, we saw weaker sequential performance in our North American and Europe segment. I will expand on this in just a moment.

Let me now briefly discuss progress against some of our major value-creating strategic initiatives. And let me begin with our growth initiatives before I then address cost reductions and investment optimization.

As you know, last year we began the expansion and transformation of our China brand portfolio to allow us to better meet consumer needs and participate in growing market segments and channels. In late March, we announced the imminent introduction of Enfinitas, a best-in-class premium brand into the China market. I will return to this topic later.

In China, we also are making good progress with our Enfamil branded line of fully imported products. And as we closed the quarter, these accounted for fully 45% of our sales in mainland China.

Outside of China and Southeast Asia and Latin America, we continued investment in our Enfamil franchise, promoting the benefits of our new plastics packaging and refill system. This is the same system many of you will know from retailer shelves here in the United States.

And domestically, in the United States, we are continuing to invest in our liquids portfolio, a category segment where we have historically underperformed. Our objective is to secure our fair share of this highly profitable market segment.

Our determination to establish a segment for nutritionally fortified toddler milks in North America is also undiminished. Enfagrow remains a critical part of our growth strategy, and we remain excited about its potential.

Still in the United States, we have begun a test to see how we can leverage big data analysis and our substantial database capability to more precisely target consumers with relevant products and messages. To test this, we have introduced Enfamil Enspire, a new product deploying the same science used in our China Enfinitas products into limited retail distribution. We anticipate learning a great deal from this test, and the initiative demonstrates our commitment to innovating our business model over time.
Let me now turn to our effort to optimize our expense base. Our Fuel for Growth initiative is essential to our ability to sustain investments in growth while generating shareholder value to EPS growth over time.

In the first quarter, we began to see the impact. We aim to reduce non-A&P operating expenses by at least $120 million over a three-year period. We are making good progress against this target, and, in the first quarter, reported SG&A expenses alone were 16% lower than a year earlier.

We also continue to evaluate opportunities to accelerate or enhance our cost reduction plan. During the coming quarter, we anticipate making progress in our review of advertising and promotion expenditure and other investments in demand creation. We believe new approaches to media and the ongoing conversion to digital will allow for greater efficiency of spend in the mid- to long-term.

But given our substantial investment in new product introductions, we do not expect this initiative to translate into lower A&P percentages until towards the end of this year.

I will now discuss in more detail the performance of each of our reporting segments beginning with the North America and Europe segment.

Overall, sales in this segment were less strong than the first quarter on both the sequential and year-over-year basis. Measured against the same quarter of 2015, constant-dollar sales were weaker by 1% from volume, and foreign exchange represented an additional headwind of 2 percentage points.

The start to the year in our US business was affected by market share losses from the highs we saw in the middle of 2015.

On a positive note, we believe the strengthening labor market and workforce participation rates have caused the rise in breastfeeding rates to level off over the last four months or so. We are, of course, very focused on what we can control, and we are constructing remedial plans to strengthen our market share in the United States, including through pricing actions.

In Europe and Canada, I am delighted to report that we are already enjoying record high market shares. As a consequence, we are seeing strong growth both sequentially and year over year. In both geographies, we are executing our strategies extremely well, demonstrating that when we do so, we can grow our business even in relatively mature markets.

Let me now turn to Latin America. In constant dollars, and excluding the impact of Venezuela, Latin America rose over the prior quarter and was 7% higher compared to a year ago. However, when including the impact of suspended shipments to Venezuela, constant-dollar sales were lower by 6%. Foreign exchange represented an additional significant headwind of 16%, and improved pricing of 7% was insufficient to fully offset this impact on reported sales. Across the whole region, we are seeing economies impacted by weaker commodity prices and, in several cases, political uncertainty.

Though both countries are still recovering from currency depreciations, stronger business performance in Mexico and Colombia helped somewhat mitigate the impact of the economic recessions in Brazil and Venezuela. We have previously described how we have chosen to make only limited shipments to Venezuela, as we are constrained by our limited access locally to hard currency. We are very keen to help alleviate the acute product shortage in Venezuela and restore supply, and we are working with the government to find a solution. But until one is found, we expect very limited sales in Venezuela.

Brazil is going through a well-publicized economic recession. The impact on consumer and business confidence is manifesting itself in softer demand for discretionary items. And we are feeling the impact most acutely within our children's category. Our infant formula sales are holding up relatively better. We remain excited about the country's long-term potential, but we do not anticipate a substantial
improvement within this year.

As mentioned, we enjoyed a strong start to the year in Mexico, where our modifier brands recovered somewhat from the weakness in mid-2015. Our infant formula and toddler business gained market share in the first third quarter as new packaging and revised messaging behind an improved formulation resonated with consumers.

Though I recognize we can’t quantify the extent to which Colombia may be benefiting from informal parallel exports to neighboring Venezuela, we believe increased market share is the main driver very strong double-digit sales growth there.

And finally, our business in the Caribbean and Central America grew by high single digits over the prior year’s same quarter. In most of these markets, we transact in dollars, and, hence, the reason remains a stabilizing factor in an inherently volatile segment.

I turn now to our Asia segment. As mentioned in my global overview, we saw a strong single-digit sequential improvement in constant-dollar sales in Asia. China grew faster than the segment as a whole, but Thailand and Malaysia also improved over the previous quarter.

Despite our strong sequential improvement, year-over-year sales comparison was unfavorable.

Volume was lower by 9%, mainly reflecting the fact that we have still not returned to the year-ago sales levels in China and Hong Kong. Price was in line with the prior year, with improved product mix offsetting the impact of added promotional activity. In Thailand and Malaysia, the sequential comparison was helped by nonrepeating retailer inventory reductions referenced in our fourth-quarter earnings call.

Malaysian consumers appear to be adjusting spending habits in response to the VAT introduction and currency-related inflation of 2015. Consequently, we expect more stable performance from Malaysia going forward.

The Thai economy remains relatively weaker, and we are a little more cautious about a rapid turnaround there. We are maintaining investment levels and in fact seeking to strengthen our position in anticipation of an eventual recovery in economic growth. Inherently, Thailand is a great market for us, and we have a very experienced team on the ground. Longer-term, I am confident in our prospects there.

In Vietnam, we’ve seen opportunities to improve our execution. The market somewhat underperformed against our expectations in 2015 and in the most recent quarter. But our team is focused on the right issues and putting in place plans to strengthen performance in the second half of the year.

Because our business in Indonesia is relatively small, we don’t often talk about our performance in this large market. However, over the last 12 months we’ve developed a more focused geographic strategy for the country. And our improved focus appears to be helping. Sales grew strongly in the first quarter both sequentially and year over year.

It is clear that we would like to build a bigger business in this high-potential market, but we remain realistic about our scale and the challenges to realizing our ambition organically.

Let me close on China. The China market continues to evolve quickly, and we are still assessing the full impact of recent changes to duty structure and regulatory frameworks. Over the last year or so, I have repeatedly stated my belief that regulatory changes were afoot in China. A more even-handed duty structure is, in my mind, likely to be just the first of several important changes being driven by the Chinese government.

The focus remains on consumer safety. And a requirement that all infant formula in children’s products
regardless of sales channel be registered in China is a key part of the government’s efforts to safeguard the consumer. We are supportive of these efforts to protect consumers by ensuring products and labels meet Chinese standards regardless of how and from where they are sold.

Before I discuss the performance of our China business, I want to remind you of the broad China strategy we laid out for you more than a year ago. We promised we would reshape our product portfolio to better satisfy consumers’ preference for imported premium products. And once we had the right portfolio, we would then commit the resources to strengthen our performance in higher-growth sales channels.

Since then, we’ve introduced a fully imported line of our Enfamil-branded products. And after the close of the first quarter, we introduced a new product offering into the highest-priced market segment. Enfinitas, as we have aptly called this new offering, contains our best science and was developed incorporating understanding gained from our extensive studies of breast milk, nutrition and metabolism.

In addition to our long-proven, industry-leading levels of DHA and AHA, the products contain boosted levels of lactoferrin and fat globular membranes, ingredients closely associated with both neural and immune system development.

Though this new technology is costly, we believe Chinese parents will once again confirm that they are willing to invest in their child’s future.

We now have the right portfolio to win with both consumers and retailers. Helped by our recent introductions, baby stores became our largest sales channel in the latest quarter. And both this channel and the e-commerce channel grew in excess of 20% over the same quarter of last year.

And despite cannibalization from our imported line, sales of our locally manufactured product line appear to have stabilized in response to a stronger defensive start and increased promotional competitiveness. I know you all share my interest in the price promotional environment China. Let me give you my perspective.

It’s clear to us that some competitors pushed sales aggressively in the fourth quarter of 2015 and, as a result, are now providing additional discounts to clear inventory overhang from distributors and retailers.

Though we will of course act to protect our market share, we take a different approach. We simply do not believe Chinese consumers are significantly motivated by lower prices, even though retailers may well be. Rather, Chinese consumers are amongst the world’s most discerning, and they continue to show a willingness to pay for superior quality and nutrition. This is evidenced by the continued shift towards higher-price segments.

Our view is supported by the fact that, sequentially, price impact was a positive contributor to our growth in China in the latest quarter, the positive effect of product mix more than offsetting the effect of promotional spend. In response to the successful execution of our strategy, our performance in China improved substantially over the prior quarter, with constant-dollar sales as mentioned showing a high single-digit percentage improvement.

Commenting now on our outlook for the full year 2016, I reiterate that Company guidance for model sales growth between 0% and 2%. Based on current exchange rate assumptions, we expect this to translate into an unfavorable sales comparison in US dollars of between 4% and 6%. As advised in our January call, we expect to deliver 9% to 12% growth in constant-dollar EPS. Based on this, we also reiterate our guidance for full-year non-GAAP EPS between $3.48 and $3.60.

I will not hand over to Michel, who will provide additional details on our financial performance. I will then return with a few summary remarks before we take your questions. Michel, over to you.
Michel Cup (EVP and CFO):

Thank you, Kasper. Good morning, everyone.

Today I will discuss the Company's first-quarter 2016 financial results. I will then briefly highlight EBIT results by segment and wrap up with a cash flow analysis and summary of our full-year guidance. Unless otherwise noted, my comments will be on the non-GAAP financial results. References to currency impacts or the effects of currency fluctuations January 3 to the impact on the translation of local currency financial statements into the United States dollars.

Let me start with sales. As shown on slide 3, on a sequential basis, from the fourth quarter of 2015, constant-dollar sales grew by 1.5%. Nearly all of our large markets grew sequentially, and most notably China. When you review the five-quarter sequential trend, sales were strong within the first quarter of 2015 and started to decline in the second quarter.

As 2015 progressed, we invested to protect competitiveness, launched new products and were able to stabilize sales in the fourth quarter. In the first quarter, we continued to invest. We rolled out new innovations and selectively increased prices in some markets to compensate for the continued currency devaluations.

Consistent with my stated expectation last quarter, I would like to remind you that the second quarter of 2016 year-over-year comparison will continue to be tough on a constant-dollar basis, although we should see an improvement in the second-quarter performance.

First-quarter sales on a reported basis were 12% below and constant-dollar sales were 6% below the prior quarter. Adverse foreign exchange rate contributed a 600-basis-point decline.

Slide 4 summarizes the impact of foreign exchanges on sales and EPS. The US dollar continued to be strong in the first quarter of 2016, and its effect on the translation of local currency negatively impacted all reporting segments.

The first-quarter decline of 6% was the same percentage as both the third and the (technical difficulty) quarter of 2015. Half of the negative currency impact in the first quarter were from the Chinese renminbi, the Mexican peso and Argentinian peso. The balance of the adverse foreign exchange impact was widespread across the regions.

We continue to expect an approximately 6% adverse foreign exchange impact on sales for the full year 2016. I will address the foreign exchange impact in the EPS guidance section as well.

I will now move to the factors that impact our gross margins on slide 5. Gross margins was 64.1% in the first quarter of 2016. This was a similar margin percentage to the first quarter of 2015 and in line with our expectations for the full year.

Sales impacted from positive mix and pricing was offset by higher trade investment, resulting in a slight gross margin decline. Manufacturing conversion costs negatively impacted margins due to lower volume absorption and higher costs of innovation and inflation.

Low dairy costs was the largest benefit to our gross margin in quarter one, and more than offset higher conversion costs and other commodity increases. We expect to see dairy benefits in the second quarter.

As you can see, we continued to deliver productivity savings within our cost of goods sold. Our supply chain team has already secured commitments for nearly 90% of our 2016 productivity goals.

Moving to operating expenses, I will start with advertising and promotion investments on slide 6. A&P
was 15.8% of sales in the first quarter, compared to 13.2% in the prior-year quarter. This was an increase of 11% on a constant-dollar basis. The criminal investments were mainly to support our key China initiatives. Historically, the Company had a lower A&P spending in the first quarter of the year.

Since our China fully imported port line was launched in the middle of last year, we continued strong investments in the first quarter of 2016, especially for television, digital and e-commerce media. Additionally, we supported the investment of new innovation rollouts in selected markets.

With the April 2016 launch of our super-high premium product, we expect A&P as a percentage of sales to be high in the second quarter. As you can see on the slide, when we launched the China fully import product in the second quarter of 2015, our total A&P as a percentage of sales went up significantly. We can expect that in the second quarter of 2016 as well.

Turning the slide 7, the increase in A&P was offset by a reduction in selling, general and administrative expenses. This is in line with the strategy we outlined at investment day, that 2016 would be the year of transition with a focus on investments.

On a constant dollar basis, SG&A was 10% lower than the first quarter of 2015. Approximately $20 million of the SG&A reduction is attributed to our Fuel for Growth initiative, which I will address on the next slide.

Slide 8 shows that our Fuel for Growth initiative had a strong start in the first quarter. On a constant-dollar basis, we delivered cost reduction of 10% for the first quarter of 2015, especially in our support functions.

While we have made some reductions in the regional offices, about three-quarters of the reduction was from corporate headquarter functions, which decreased by approximately 30% on a like-for-like constant currency basis. Of the corporate headquarter reductions, more than half was from outside services, and the balance were personnel related. To date, we have secured over 90% of our planned 2016 reductions.

And we are ahead of schedule. At the same time, we constrain sales forces and distribution spending to remain relatively flat to prior year on a constant-dollar basis.

Turning now to slide 9 for a discussion of EBIT. Let me start with the analysis per segment.

In the first quarter, Asia delivered an EBIT of $169 million, a decrease of 22% on a constant-dollar basis. An incremental 5% decrease came from the adverse foreign exchange impact largely driven in the Chinese renminbi, [sibat] and the Malaysian ringgit. The Asia EBIT margin at 33.8% improved 390 basis points compared to the fourth quarter of 2015, yet was 600 basis points lower than the first quarter of 2016. The main year-over-year drivers were lower sales and increased channel investment and promotional activities.

Investments continue throughout the Asian region to support our innovation launches. The most significant investments were in China, including competitive price promotions on the locally manufactured products and investments for the fully imported product line.

Latin America delivered an EBIT of $41 million in the first quarter, a decrease of 11% on a constant-dollar basis. The EBIT decline was due to lower sales mainly in Venezuela. Yet, the decline was somewhat offset by lower A&P investments. Excluding the impact of the Venezuela business, the Latin America EBIT on a constant dollar basis increased 22% compared to prior year.

For the segment, adverse foreign exchange impacted EBIT by 18%, largely from the Mexican peso. On a reported basis, EBIT was 29% lower than prior year. The Latin America EBIT margins was 25.5% for the first quarter 2016, compared to 28% for the same quarter last year. The 250-basis points decline was from
lower sales mainly in Venezuela, somewhat offset by lower A&P and sales force for spending.

For the first quarter, North America and Europe EBIT was $82 million, an increase of 9% on a constant dollar basis. EBIT margin of 27.2% was 190 basis points better than the prior-year quarter. Despite lower sales, gross margin remains strong from the dairy benefit. Within operating expenses, reductions in the SG&A were selectively invested to support new product innovations, while a portion of the savings (technical difficulty) EBIT margins. As mentioned on the Fuel for Growth slide, corporate and other delivered significant benefit to EBIT.

For the total Company, the first-quarter EBIT of $244 million was 10% below the prior-year quarter on a constant dollar basis. Adverse exchange nearly doubled the impact, resulting in a reported EBIT down 19%. The decline was due to lower sales somewhat offset by improved operating expenses.

The EBIT margin of 25.4% of sales was 200 basis points lower than prior quarter. The first-quarter 2015 EBIT of 27.4% was high due to underspending on A&P. As 2015 progressed, A&P increased and annual 2015 EBIT came in at 24.1%.

I will now address our financial results from EBIT to net income on slide 10.

The increase in interest expense reflects the full quarterly impact of the November 2015 $1.5 billion notes. The significant portion of the proceeds from the notes were used to finance the accelerated share repurchase program. As a reminder, 10.7 million of shares -- of stock were received from the fourth quarter. The balance of shares will be delivered at the end of the agreement, which is scheduled to conclude in the second quarter of 2016.

Our non-GAAP effective tax rate, or ETR, was 23.2% for the first quarter of 2016, compared to 22.5% in the prior-year quarter. First-quarter 2015 rates was lower as a result of a more favorable geographic earnings mix that did not prevail for the full year. Non-GAAP EPS for the first quarter was $0.87.

Let me summarize our financial results by addressing the changes to EPS on slide 11. In the first quarter, non-GAAP EPS declined $0.12 on a constant-dollar basis versus the prior quarter. Sales unrelated gross profit negatively impacted EPS by $0.16. The increase in A&P was offset by Fuel for Growth savings. The ASR delivered $0.03 benefit net of higher interest expense. Half of the $0.12 decline in non-GAAP EPS on a constant dollar was a result of the temporary suspension of shipments to Venezuela in the first quarter of 2016. Foreign exchange adversely impacted EPS by $0.10.

Let me address specified items. Since we took a significant specified charge in the first quarter, let me briefly explain what drove the Venezuelan change noted on slide 12. In March 2016, the Venezuelan government changed the exchange rate system from a three- to a two-year structure. There were two significant impacts to our business.

First, the CCOG rate was eliminated. This was the rate we previously used to translate our net monetary assets of our Venezuelan subsidiary. As a result, we adopted the floating rate now call DCOM. For reference only, the most recent CCOG rate was 13.5. And the DCOM rate at the end of the quarter was approximately 273 and continued to devalue in April.

The remeasurement impact from adopting the DCOM rate was a $32 million loss impacting monetary assets.

Second, as the DCOM rate also impacts the translation of our local earnings to US dollar, our future results for Venezuela business are impacted. This triggered an impairment review of Venezuela’s long-lived net assets.

Following that process, we concluded there was a $46 million impairment of our long-lived assets. Due to
the Venezuelan change, Fuel for Growth and pension remeasurement charges, specified items for the first quarter was $0.48 per share. Including these specified items, GAAP EPS was $0.39.

Turning to a high-level overview of cash movement, on slide 13, the cash balance of $1.7 billion as of March was similar to the year-end balance. Cash from operating activities was lower than the prior-year period. Cash flows reflected lower sales and the negative impact from other working capital. An end-user item on this chart is the size of a foreign exchange impact on cash. This was mainly due to the adoption of the new exchange rate and the remeasurement of our monetary assets in Venezuela.

In summary, the cash generated from operations this quarter was used to pay dividends and capital commitments. For the full year, our capital spending goal remains about 4% of sales.

To summarize our annual guidance on slide 14, we expect full-year 2015 constant dollar growth in the range of 0% to 2%. We continue to anticipate tough comparisons for the first half-year 2016. And we do not expect to report positive revenue growth of the same quarter of prior year until the second-half 2016.

We reaffirm our 2016 non-GAAP EPS guidance in a range of $3.48 to $3.60. Primarily due to the first quarter of charges related to Venezuela, full-year specified items are now expected to be $0.57 per share. Therefore, our updated 2016 GAAP EPS is expected in the range of $2.91 to $3.03. GAAP EPS will change as a result of future market-to-market pension adjustments which we cannot estimate at this time.

This concludes my discussion on our first-quarter financial results. Thanks again for your time this morning, and I will now turn the call back to Kasper.

**Kasper Jakobsen** (President and CEO):

Thank you, Michel.

Before we take your questions, let me briefly summarize our key messages.

Firstly, we are satisfied with the sequential improvement in constant dollar revenue.

Secondly, we are pleased with the improvement we are seeing in China, and we remain focused on the successful execution of our previously outlined China strategy.

Thirdly, we do not underestimate the challenges we are facing in an uncertain global economic environment. Despite these challenges, we believe the balance within our global portfolio will allow us to complete 2016, which we have often referred to as the year of transition as planned.

We are therefore reiterating our prior guidance for modest full-year constant dollar sales growth between 0% and 2%. We are confident that sequential constant dollar sales for the first half of 2016 will be stronger than the second half of prior year. And within 2016, sales in the second six-month period will be stronger than the first half of the year.

For the year, we expect foreign exchange to adversely affect translation into our reporting currency by 600 basis points. We are also confirming unchanged non-GAAP EPS guidance of $3.48 to $3.60.

I will now have the call over to our operator, who will assist us in opening the lines for questions. Operator, I hand the call back to you.

QUESTIONS & ANSWERS

**Operator:**

(Operator Instructions)
David Driscoll, Citi.

David Driscoll (Analyst - Citi Research):

I wanted to ask about the super-premium product launches, starting with the China Enfinitas product, and just to hear a little bit more about the reception from the mom and baby stores. Shelf space -- is it incremental to the existing shelf space you have in there? And then just some comments on what we should expect on the pacing of (technical difficulty) in China. And (technical difficulty) limited launch and test (technical difficulty)? Suppose I heard you (technical difficulty) something like that was slightly (technical difficulty).

Kasper Jakobsen (President and CEO):

Well, let me just begin by saying the production in China is really proceeding (technical difficulty) very early days yet. We (technical difficulty) our first initial (inaudible) didn't happen until the middle of the (technical difficulty) has been very favorable, and we (technical difficulty) that require additional shelf space (technical difficulty) into the retail channel in China. So, I would -- we are (technical difficulty) by what we (technical difficulty). (technical difficulty) in China. (technical difficulty) we want (technical difficulty) into giving forecast and expectations by a (technical difficulty).

(technical difficulty)

Operator:

Matthew Grainger, Morgan Stanley.

Matthew Grainger (Analyst - Morgan Stanley):

I just wanted to -- thanks -- I wanted to ask about Enfinitas as well. Could you talk a bit more about the formulation and its uniqueness relative to what's currently on the market? Is the value proposition here driven by the ingredients, or is it really the proprietary combination? And I guess what I'm curious is how quickly do you think fast followers can try and incorporate similar benefits into their products?

And just related, from a margin perspective given the price point, is the expectation that once you hit scale that margins can ultimately be accretive to your overall Asia region or China business?

Kasper Jakobsen (President and CEO):

Yes, I think the whole product bundle is quite unique. We -- as you know, we have a large ongoing effort underway within the Company to continually enhance our understanding of breast milk in particular and how we can incorporate the latest science associated with breast milk in enhanced form, in some cases, into formulas.

We have acted on some of that. We have raised the levels, as I mentioned, of lactoferrin, which is naturally present in very low levels in all -- in most formulas. I shouldn't say all, but most. And we have incorporated elevated levels as well -- significantly elevated levels of milk fat globular membranes, which is just what it says it is. Both of these ingredients are closely associated with physiological development, either neuro or immune system development of -- for infants.

The second ingredient is in somewhat scarce supply in the world. And we believe that, though people can talk about it, it will take some time for people to get to the levels we are at. But, most importantly, I think it's understanding of how the ingredients work. And then we've incorporated that into quite unique packaging in the marketplace as well and then backed it with our advertising and digital capabilities.

So we are excited about it. I guess we feel like we've got quite a unique package, which is one of the
reasons we’ve delayed the entry. We wanted to make sure we had the right package. And I don't know if Michel wants to comment on margins. Do you want to add something, Michel?

**Michel Cup** (EVP and CFO):

Yes. The question of margin accretion -- I think, as Kasper said, we are in the process of rolling out. That's our current focus we are investing in very strong. So to drive there and have the right level of distribution and to ensure that moms enter the (inaudible). Over time, we expect to see the return on these investments, but definitely not at the beginning.

**Matthew Grainger** (Analyst - Morgan Stanley):

Okay. Alright. Thanks.

**Operator:**

Rob Moskow, Credit Suisse.

**Rob Moskow** (Analyst - Credit Suisse):

A couple questions about the guidance. First on FX, I think last quarter you called out $0.40 of headwind. And I don't think I heard it called out on this call. The revenue guidance hasn't changed for FX. And I guess I'm a little surprised. Most of your peers are experiencing lighter headwinds. I just wanted to know what the update is on that.

And then secondly, your comments about the market in China and inventory -- or efforts to promote away inventory that's on the shelves, is it pretty much the same kind of conditions you saw in fourth quarter, or have things gotten a little worse in first quarter? How would you characterize it? Thanks.

**Kasper Jakobsen** (President and CEO):

Well, let me start with addressing the inventory situation. I would say that the promotional environment is certainly not getting better. And I think there is a -- it would appear that some people are dealing with a fourth-quarter/first-quarter dynamic. I am very happy with where our inventory levels are. And I think we've -- our team on the ground has managed that quite well.

I think what we've said before, which maybe I should've said in response to Matt's question as well, is that we feel pretty good about our ability to sustain the margins in China at or around the same level as they are today, as we see the ability of a favorable product mix as having the ability to offset any additional pressure there might be to increase promotional competitiveness.

**Michel Cup** (EVP and CFO):

Let me address the FX question you had. A couple of points. I think you are aware that we operate in 50 countries, so two-thirds of our revenue in EBIT is exposed to foreign currency fluctuations. And as I highlighted also last year, part of that is hedged for a certain period.

The second point I would like to make is there is below that an improvement, but you still see a significant fluctuation of some currencies. Which reminds me -- on the Chinese renminbi, mid April, where you saw a significant change again, and that is impacting our business as we speak.

I think you know we have seen a -- in Q1, we delivered our reported sales of the decline of 6% in line with our expectations. So as it stands of today, and if we could lock in the whole year as of today, which we can't do, we would see some benefits of a couple of things I would say on EPS.
Rob Moskow (Analyst - Credit Suisse):

Okay. But you say part of it was hedged. Did you -- the part that was hedged, is that -- were you leaving some money on the table, so to speak? Did that work against you now?

Michel Cup (EVP and CFO):

When I gave the guidance of $0.40 in January, I included the hedged position that we had at that point in time.

Rob Moskow (Analyst - Credit Suisse):

Okay. So is it still $0.40 or is it different?

Michel Cup (EVP and CFO):

Could you repeat your question?

Rob Moskow (Analyst - Credit Suisse):

Is the headwind still $0.40 or is it different?

Michel Cup (EVP and CFO):

I haven't changed guidance, so -- I haven't changed guidance. $0.40 is still included.

Rob Moskow (Analyst - Credit Suisse):

Okay. All right. Thank you.

Operator:

Ken Goldman, JPMorgan.

Josh Levine (Analyst - JPMorgan):

This is Josh Levine on for Ken. I just had a question actually on Fuel for Growth. You said that it drove about $20 million in the first quarter, which you said was attributed mostly to cutting out some services and overhead. Both of those sound like sustainable savings levels. Is it right to assume that level continues through the year? And obviously you have guided to $60 million of savings. That would imply obviously you would beat that number. I'm just -- I guess can you just help us on the pacing there?

Thanks.

Michel Cup (EVP and CFO):

I think that's a good question. Because if you would do your math, as we noticed earlier, we would have $60 million in savings this year. If you will take $20 million times four, you had $80 million.

I would put some cautiousness in there. I think there is a certain fluctuation, especially if you do a quarter-on-quarter comparison, especially in the area of third-party services.

Having said that, I am very encouraged by the fact that we secured 90% of the $60 million, and I indicated that we had are ahead of our plan. And as Kasper also indicated, we are continually going through a review which we disclose more about by the end of the second quarter, on which additional -- actions we see that we potentially could accelerate.

Josh Levine (Analyst - JPMorgan):
Got it. Thanks. And then just on A&P spending, you said that it would be -- 2Q levels would be higher than 1Q, which I guess is similar to last year. But just from a year-over-year basis, how is that -- how should we think about that for 2Q?

And then just a larger question, you typically advertise ahead of product launches and ahead of innovations. But I guess how do you think strategically about when you ramp down that spending? Just as we think about when you can let the returns on that market investment fall to the bottom line. Thanks.

Michel Cup (EVP and CFO):

Well, as Casper also indicated, don't expect a significant drop in the first half-year. We will continue to invest, like I said in my earlier comments, especially in Q2. And you might see some lower A&P expenditures more towards the end of the year.

Kathy MacDonald (Investor Relations):

Great. Operator, please move to the next call.

Operator:

Amit Sharma, BMO Capital Markets.

Amit Sharma (Analyst - BMO Capital Markets):

Kasper, you talked about baby stores in China are now your biggest or largest channel. Could you just define for us what is the size of the opportunity? And as we become even bigger in that channel, are you fully incorporating the mix benefit of having a larger presence in that channel?

Kasper Jakobsen (President and CEO):

I think we are incorporating the benefits. We are certainly thinking about it. As you know, we talked quite a bit about the fact that last year we were caught in the second and third quarters with a bit of a mismatch between our product offerings and, frankly speaking, both the consumer preference and the channel preference in China.

We have now addressed that. And we feel very good about the product portfolio we have in place now. And we are beginning to see the returns of that. We've seen a pretty quick improvement in our performance in baby stores. We think there are -- still are opportunities to expand distribution over time, and we are doing that in a considered and gradual fashion.

And, likewise, there are opportunities in e-commerce as well. But why we are expanding in those channels and we are growing strongly in those channels, we, just like everybody else I think are seeing an erosion of sales in the more traditional channels like supermarkets, for instance. But I think we are doing our best to incorporate these things into our overall forecasting, which obviously underpin our guidance.

Amit Sharma (Analyst - BMO Capital Markets):

And is the promotional environment any different in baby channels versus supermarkets?

Kasper Jakobsen (President and CEO):

No. I wouldn't say so. I think it's fairly consistent.

Amit Sharma (Analyst - BMO Capital Markets):
Got it. Thank you.

Operator:
Pablo Zuanic, Susquehanna.

Pablo Zuanic (Analyst - Susquehanna):

Two questions. One, when you talk about the sequential improvement in your sales growth in the -- compared to the third quarter and compared to the fourth quarter, how does that compare with the market? I'm just trying to get an understanding of how are you growing versus the market. That's the first question.

And the second question regarding the new regulations -- I understand it's difficult to make judgments and some of them are still not clear. But in terms of the changes that the positive list announcement implies for gross board of trade, are you seeing any crackdown or slowdown in terms of parallel imports? Thanks.

Kasper Jakobsen (President and CEO):
Pablo, I take it your second question is directed particularly at China. Is that right?

Pablo Zuanic (Analyst - Susquehanna):

Yes; that's right.

Kasper Jakobsen (President and CEO):

Okay, okay. Well, I think we are satisfied with the progress we are making vis-a-vis the market outside of the United States. I did highlight in my prepared remarks, Pablo, that we have clearly lost some market share in the United States and --

Pablo Zuanic (Analyst - Susquehanna):

No, I'm sorry, Kasper. I don't mean to interrupt, but my questions both were related to China. I'm sorry. Thanks.

Kasper Jakobsen (President and CEO):

Both of them were related to China. Okay. Well, we feel that the -- our performance vis-a-vis the market in China in the first quarter was favorable vis-a-vis where we began at the beginning of the quarter.

And with regards to the regulatory framework, we welcome the new set of regulations, and we think it's a very positive step by the government to continue to regulate our product category, which is -- which carries inherent risks to consumers if not regulated. So we are very encouraged by what we have seen.

Those of you who have been on calls with us before know that I've been expecting this for quite some time. So I think it was inevitable. I think it is going to act to constrain some of the cross-border trades, particularly the cross-border trade which is not organized and not complying with Chinese regulations, whether that be from an ingredient, quality or labeling perspective.

Pablo Zuanic (Analyst - Susquehanna):

And just a quick follow-up on last one, regarding Enfamil, the imported range, I understand the benefits when you launched it in the summer last year. And obviously doing well; 45% of your sales. But what are all your price point customers? When I see a [$2.75] R&B for Enfamil, it looks pricey compared to a lot
of our imported products there. Is that an issue and does that price may need to come down in the future. Thanks. And that's all.

**Kasper Jakobsen** (President and CEO):

Well, you are quite right that it is priced above many other imported products. But I think it speaks to the strength of our brand equity in China. And I think the fact that we are able to grow that product line so strongly, I think, supports my assertion that Chinese consumers are fundamentally far more concerned with quality and safety of their nutrition than they are with the cost of it. And if you can give them a premium-quality offering, they are willing to pay what it takes.

**Kathy MacDonald** (Investor Relations):

Operator, please move on to the next call.

**Operator**:

Bryan Spillane, Bank of America.

**Bryan Spillane** (Analyst - BoA Merrill Lynch):

Just one question. Can you just give us some sense for -- as you are in China specifically, as you've been expanding the distribution of the imported product, is there any pipeline fill? So are you -- is sales growth now a little bit ahead of consumption because you are filling pipeline? And I guess as we model going forward with more new product coming into the markets, how should we think about sales versus consumption?

**Kasper Jakobsen** (President and CEO):

I think you can assume that it is mostly consumption-based. Most of the distribution builds that we experienced happened late in the second and third quarters of last year.

**Bryan Spillane** (Analyst - BoA Merrill Lynch):

So we are seeing -- the sequential improvement you have seen in sales is also reflective of a sequential improvement in consumption as well?

**Kasper Jakobsen** (President and CEO):

We are satisfied. It's real, so to speak.

**Bryan Spillane** (Analyst - BoA Merrill Lynch):

Okay. Thank you.

**Operator**:

John Baumgartner, Wells Fargo.

**John Baumgartner** (Analyst - Wells Fargo Securities, LLC):

Kasper, wondering if you can speak a bit to the competitive environment in North America. Is it your sense that this is also some of the dairy cost deflation being realized, or is it more maybe just product and innovation-based where you have kind of followed behind?

And then with your A&P being down for the quarter in Q1, should we expect greater brand support investments coming through to help out volumes as 2015 unfolds?
Kasper Jakobsen (President and CEO):

I think we fell a little bit behind on innovation. I think most of you might have listened or read Abbot's earnings call. And I commend them. They've done a great job on their non-GMO line. We are clearly catching up, but catching up quite fast in that area. And we will expect to complete the catch-up, so to speak, later in the year.

It's the nature of the US market that market share tends to oscillate. But, over time, the two biggest players in the marketplace are in fact quite stable in the ability to hold onto market share over time. We go through periods -- we had a very good period in the first half of last year where we gained substantial market share. And then we gave up some as we exited the year. We are suffering a little bit with that right now. But I am very confident in our ability to, shall we say, restore equilibrium. We have shown again and again that we can do that, and as has the other major player here. So we will get it back.

John Baumgartner (Analyst - Wells Fargo Securities, LLC):

And then are you just seeing any unusual price discounting based on the dairy cost deflation at this point?

Kasper Jakobsen (President and CEO):

No. I don't see that.

John Baumgartner (Analyst - Wells Fargo Securities, LLC):

Okay. Fair. Thank you, Kasper.

Operator:

Jason English, Goldman Sachs.

Jason English (Analyst - Goldman Sachs):

I guess I will pick up where we just left off on the last question, Kasper, you are sort of describing North America actions forward as one of innovation. But I think in prepared remarks, you referenced exploring some remedial pricing actions. Can you elaborate a little on that?

Kasper Jakobsen (President and CEO):

Well, I think we always -- we are always looking to optimize our value equation in every market we compete in. And I do believe that there's probably opportunities to adapt our value equation in the US in a favorable direction. So we will look at it on a product-by-product basis and make sure we optimize our pricing.

Jason English (Analyst - Goldman Sachs):

Okay.

Kasper Jakobsen (President and CEO):

I didn't mean to imply that we imagine pricing going down.

Jason English (Analyst - Goldman Sachs):

Yes, that's kind of the interpretation I had, so I appreciate the clarification on that.
Kasper Jakobsen (President and CEO):
I'm sorry. I probably was unclear in my communication then.

Jason English (Analyst - Goldman Sachs):
No, I think was sort of vague, which is why I jumped to the bad side of the conclusion. So thank you for the clarification on that one.

And then I want to come back to Pablo's question earlier. You are referencing or foreshadowing more regulatory changes on the comp. We have obviously had a lot of regulatory changes in terms of registration, labeling requirements, duty changes, et cetera.

But one of his questions was have you seen an impact yet in terms of the illegitimate trade flow into the market. I was hoping you could expand on that. Have you seen any impact, or is still hopeful thinking that the more change -- or belief that more change will be necessary from the government before we can actually start to stymie that flow?

Kasper Jakobsen (President and CEO):
No, we've seen an impact almost immediately. Let me -- rather than talk about other people's business, let me perhaps talk about my own business. So we've seen an impact on our Hong Kong business. It is clear that checks at the border between Hong Kong and mainland China has been tightened quite substantially. And there are now efforts underway to collect duty on products shipped into the free trade shows.

It is still somewhat inconsistent with how duty collection and the new regulations are being implemented. The speed of implementation between different ports in China have varied quite a bit at the moment, as one would expect. But we are definitely seeing -- what shall we say -- unofficial flows of products becoming more difficult. Now, that, of course, is an opportunity for the products that we bring into China in a more orderly fashion. So we are also seeing a corresponding benefit to our fully imported line, and that is definitely helping the growth of that line.

Jason English (Analyst - Goldman Sachs):
Thank you. That's good to hear. Out of respect for time, I will pass it on.

Kathy MacDonald (Investor Relations):
Operator, we have time for one more call, so this next one is the final one.

Operator:

Eric Katzman, Deutsche Bank.

Mario Contreras (Analyst - Deutsche Bank):
This is Mario Contreras on for Eric. Good morning. I wanted to ask about Venezuela. Obviously a number of your CPG peers have deconsolidated their business there. So I wanted to ask if you could quantify the potential EPS risk if you guys were to have to do the same. And then maybe that aside, should we anticipate similar top-line headwinds for the next few quarters just in terms of the reduced shipments?

Michel Cup (EVP and CFO):
First of all, let me say that in all the non-GAAP guidance as well as the sales guidance that we have given you, we have taken into account the deterioration of Venezuela. So that's very important to note.
If you look at it from -- the question on deconsolidation, I think we still see opportunities there, as Kasper indicated, going forward. We are in discussions with the government to see what are actions we could take. We had some shipments, but very, very small in the first quarter. And I think we have some -- we see, for the near future, still an opportunity to further develop the business back to where it was at a certain point of time. So that's the reason why we don't want to consolidate -- deconsolidate at this point of time.

**Mario Contreras** (Analyst - Deutsche Bank):

But is there any way that you could quantify the risk if you were to be in that situation, or is it just premature to do that?

**Michel Cup** (EVP and CFO):

No. I think if you look to the impairment from the balance sheet perspective, the monetary and the non-monetary assets, clearly I think the -- we took the majority of the risk out of the balance sheet. That's one. From an operational point of view, I think I see limited risks that could impact our EPS going forward.

**Mario Contreras** (Analyst - Deutsche Bank):

Okay. Thank you.

**Kasper Jakobsen** (President and CEO):

Maybe in closing -- Operator, just before we close the call, let me take the opportunity just to clarify the ambiguous statement I made on pricing in the US. We in fact have announced that we are taking selective price increases on some product lines already which will be effective later this quarter. So I apologize if I was not clear about that.

So with that, I think we will sign off for today. Thank you very much for joining the call. Kathy?

**Kathy MacDonald** (Investor Relations):

That's it. Thank you very much for participating on our first-quarter conference call. Operator, I will leave you to close out the call.

**Operator:**

This concludes the presentation.

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