Cadbury Schweppes Interim Management Statement
3pm Analyst and Investor Conference Call Transcript
10th October 2007

Todd Stitzer, Chief Executive Officer:

Good morning ladies and gentlemen if you're in the States and if you're in the UK good afternoon. Thanks for joining me and Ken to discuss the announcement we released earlier today. Given the breadth of the announcement my opening comments will be slightly longer than usual. As always we'll be happy to take your questions after the comments.

Our announcement today updates the market on progress since our June 19th investor seminar and our August interim results announcement. In short there has been significant strategic and operational progress. We've continued to work on separation to create two strongly managed value creating businesses. We're making good, early progress on our cost reduction programme in confectionery and have announced a further restructuring in Americas Beverages. Operationally the confectionery business is performing very strongly while the beverages business continues to outperform a very difficult US beverage market. I'll focus most of my remarks on the trading update and the progress we're making on our cost reduction programmes but first I'd like to briefly cover the separation and management changes.

Let me start with separation. At the end of July we announced that we were extending the timetable for a sale to allow the bidders to complete their proposals against the backdrop of a more stable credit market. Credit markets have failed to improve materially since that time and therefore we've been focusing on getting the business ready for a de-merger. The Americas Beverages business will be listed on the New York Stock Exchange and the de-merger will be via a share distribution to existing share owners. Given the many rulings and approvals required we don't expect to be able to complete the separation before the second quarter of 2008. We will be shortly filing a draft Form 10 with the SEC and more information will be provided as a part of that filing.

Turning now to management changes. As we move towards separation we're also making two important leadership announcements. Sir John Sunderland, our chairman has previously indicated to the board his intention to retire in 2008 after 40 years of service. He has since stated his commitment to stay with the company through the separation process. One of his key areas of focus will be the creation of two strong boards for the two new businesses. We're also announcing that Larry Young will lead the separated Americas Beverages business. Larry is steeped in the beverage business, he has very strong operational credentials and has already played a pivotal role in the successful delivery of our vision of a fully integrated beverages business in the Americas. Gil Cassagne who many of you also know is leaving the business for personal reasons to pursue other interests and our good wishes go with him after 25 years of outstanding contributions to our beverage business.

Now I'd like to move to our more immediate agenda, current trading and the progress we're making on our cost reduction programme. On June 19th we laid out our Vision into Action plan for our confectionery business, a plan which called for 4-6% revenue growth on an annual basis and a goal of mid-teens margins by 2011. On June 19th we weren't able to give you much detail on our cost reduction initiatives because they had not been announced internally. Since then however we have been able to make significant progress and have recently announced a number of important initiatives. Taken together these initiatives would lead to a reduction in 2,500 roles or around a third of our planned confectionery head count reduction and deliver a significant proportion of our expected central, SG&A and supply chain savings.

What you'll see from today's announcement is first that we're making good, early progress on addressing the right sizing of our central overheads post separation. Second that in three of our four regions we've announced important reorganisations which significantly reduce overheads through clustering of commercial units and de-layering; and third that we've announced proposed major reconfigurations of our chocolate manufacturing in Britain and our candy supply chain in Asia Pacific. In both these cases manufacturing is being concentrated in scaled centres of excellence.

As described on June 19th and again in our announcement, SG&A reductions will begin to deliver benefits from 2008 while the proposed supply chain configuration benefits would reduce costs from 2009 onwards. The timing of savings can be explained by the complexity of legislatively required consultation with our employees, the construction in Poland of receptor factory sites and the subsequent transfer of machinery and equipment from our Somerdale plant in the UK to Bournville and Poland.

In beverages as we move toward a possible de-merger we are today also announcing a further restructuring of that business as we see additional opportunities to simplify the structure and drive the benefits of our fully integrated beverages model. We expect the beverages restructuring to deliver £35 million of savings in 2008.

Moving finally to current trading, we have had a very strong quarter in the confectionery business with like for like revenues up by 10% bringing our year to date revenue growth to +7%. Overall while we had the benefit of the post recall bounce back in Britain, this was broadly offset by a number of factors, most notably the adverse impact of a flood at our very large Sheffield candy factory. All of the regions did well. BIMA or Britain, Ireland, Middle East and Africa was ahead by 12%, Europe by 10% and the Americas by an impressive 14%. Asia Pacific was ahead by 2%. Our strong revenue growth was driven by another excellent performance in gum around the world and improved results in chocolate despite a difficult quarter in Australia where structural changes in the retail market continue to prove challenging and where we also withdrew from a low margin co-packing contact, a subject we discussed in the start of 2007. In gum our US business did particularly well gaining share in a market which showed double-digit growth in the quarter. Elsewhere we were pleased to see the successful launch of centre-filled gum move share ahead in two of our important markets. Our chocolate performance was boosted by a particularly good quarter in Britain where we benefited from the bounce back from a very depressed Q3 in 2006 when we suffered from the combination of a product recall and hot summer weather.

In Americas Beverages our revenues were ahead by 3% on a like for like basis with good results from our bottling operations offset by a weaker performance from US CSD concentrate sales. While we continue to grow share the CSD market in the US did not have a good quarter and was not helped by the wet and cold summer weather. While our core four non-CSDs did well boosted by good results from Snapple, our launch of Accelerade has been very disappointing with revenues well below expectations despite a significant marketing and launch investment.

There has been much comment about the continuing increase in the price of food commodities in recent months. We've seen further increases in both our confectionery and beverages costs, most significant has been the escalation in liquid milk prices in the last three months. While we don't expect this to have a material additional impact in 2007 we expect our commodity input costs to be around 5-6% higher for both confectionery and beverages in 2008. We are in the process of implementing price increases in most of our markets to offset these increases. In Americas Beverages while the business has good revenue momentum, the consolidation of bottling acquisitions coupled with the investment in Accelerade is impacting margins. Although we earn around 40% of our confectionery profits in the final quarter of the year, given the strong performance so far this year we do enter the fourth quarter with increased confidence.

Since our interim results in August we have been intensely focused on preparing for a de-merger and progressing our cost reduction plans. I'm very pleased to be able to report today that in so doing we have not lost our operational focus and have continued to maintain strong revenue momentum in confectionery. Trading in Americas Beverages has been more challenging given the difficult market conditions of course a focus on the sale and de-merger and we are certainly disappointed by the poor performance of Accelerade. We will as usual provide an update on trading, margins and the outlook for the full year at our pre-close announcement in December.

Ken and I will now be happy to take your questions.

Bill Leach, Neuberger Berman:

Just in terms of your margin guidance I wasn't quite clear where we are now. The last statement you said was that margins probably would not improve and now that you're putting beverages back in, are we looking at margins actually going down this year?

Ken Hanna, Chief Financial Officer:

On a Cadbury Schweppes consolidated basis you need to think about Bill we're including some more bottling acquisitions so there will be a dilutive impact from the additional bottling acquisitions and an extra three months of BG plus the launch costs of Accelerade.

Bill Leach:

So if we look at the ongoing confectionery business would margins be flattish this year?

Ken Hanna:

We've not changed our guidance since the interims and we're not planning to do so. What we are saying is that we are getting good revenue momentum, getting some price increases and we've still got 40% of the year to go and we'll update everyone on December 11th.

Bill Leach:

As you're probably aware the Hershey Trust made a statement yesterday regarding discussions they had with you. Would you care to comment on that?

Todd Stitzer:

Bill, we are very focused on transforming our business through de-merger and delivering margins and continued good revenue growth, so we don't have a perspective on what they've said and wouldn't care to comment.

Todd Duvick, Bank of America:

I had a couple of questions on the fixed income side. First of all I think you said in the trading update that you now have 50% of the debt at fixed rate as opposed to 75% previously so that in my mind indicates that you've got more flexibility. Is it still true that through the de-merger that your plans are that no debt will travel with the Americas Beverage business?

Ken Hanna:

We haven't finally decided yet. The long term debt that we have secured has been secured under the covenant of Cadbury Schweppes so we are still thinking that through but what we have said is that the good cash flow characteristics of the beverage business on a standalone basis will encourage us to look at appropriate or different leverage levels for that business. Just to recap the reason that our fixed elements come down from 75% a year ago to 50% now was two fold really, in anticipation of separation we obviously didn't issue some long term pieces of paper in the early part of this year and we've just spent in the region of £300 million on the acquisitions that have closed in the last few months so obviously that generates an increase in the short term element of our funding.

Todd Duvick:

I think previously you have stated that following the de-merger or following the separation of the Americas Beverage business you would continue to target a credit rating that is as high or higher than your current credit rating?

Ken Hanna:

For confectionery only, Cadbury plc as we're now calling it, we're not changing the guidance, that is correct. We gave you that back in June, BBB+ target credit rating.

Todd Duvick:

Finally with respect to any debt pay downs in the remaining confectionery business, how would you get the cash for the transaction or should we look for colour on that from the Form 10 filing?

Ken Hanna:

I think you should wait for the Form 10 filing.

Jonathan Feeney:

Todd, if you can give us a little bit more detail about your vision for the de-merger here. When you say second quarter of '08, would you want to have sold the entire beverage business out from under Cadbury plc or would it be sufficient to you to have sold a part of it as is customary with a lot of these split ups that have happened in the US markets before?

Todd Stitzer:

The vision is a true, total de-merger and what the means is that Cadbury Schweppes share owners would get a share of a beverages company and a share of a confectionery company. There's no 20% spin option, there's no piecemeal separation, it literally splits into two companies with two boards of directors, two public company listings.

Jonathan Feeney:

If I could follow up on Todd's earlier question, do you have guidance for what the target capital structure would be for the beverage business?

Ken Hanna:

No we don't. It's our intention to leverage the beverage business appropriately to its cash flow characteristics, i.e. it can take a substantial amount of debt but I think we need to wait until the debt markets settle down before we come off the fence on this one, but it is our intention to do that and therefore generate some return of capital to shareholders.

Jonathan Feeney:

Just finally, Todd, you touched a little bit on the linearity of margin expansion but you did target a third of head count and I know that's just targeted and it's not executed yet but could we say when you have got that third of head count executed that would be about a third of your margin expansion target?

Todd Stitzer:

I'm not sure I would do that. There's a mix of activities that are happening. We said that we would have meaningful margin progression in 2008 and we stick by that. We said we'd deliver 100 basis points of margin growth across '08 and '09 from central costs and we'll do that, so I think dividing it up into thirds probably isn't exactly right.

Mike Caputo, Cramer Rosenthal:

Can you give a little more colour on Accelerade, what exactly went wrong and what kind of financial impact it had on margins and where do you go from here with that product?

Todd Stitzer:

Well, it's a great product concept, a patented long energy burning product. I'm afraid we had some recipe problems at the outset that complicated production. We got to market a bit later than we wanted to. The syncopation of that and our marketing and launch plans just didn't work the way we hoped they would. Americas Beverages has been extremely good at innovation over the last three or four years, I'm afraid this one just hasn't gone as well as a number of others have done in the past, so I think we shared in the release today that the launch costs were about £6 million. We clearly have further investments in July, August and September and Ken and I are reviewing with the Americas Beverages team whether or not this is a viable proposition or not and we'll update the market in December when we give our trading update then.

Mike Caputo:

Can you quantify how much it impacted margins for the beverage business or not?

Todd Stitzer:

I think the total cost we've invested so far this year will be around £20-30 million so we'll give you a sense of how that impacts margins in December.

Andrew Wood, Bernstein:

Three questions, the first is on the timing of the de-merger. I understand you've been working on this on a dual track for the last six months now yet you're still guiding that you need at least another six months to get this through. Are you just being prudent here? Can you be more aggressive? Is there any way of getting this done sooner than the second quarter of next year bringing it forward? You've got Coke and Pepsi at all time highs, this is the right time to do it. Second, it's to do with the guidance on margins, I'm going to follow up on Bill's question from earlier. We do know what your underlying guidance is for confectionery is pre-M&A, pre-forex and so on so if you strip out all of the bottler acquisitions and so on, what is your guidance now for your beverage business now that it's back consolidated within Cadbury. The third question is you mentioned this morning that the commodity impact was going to be about 5-6% in 2008. I was just wondering if you could put a pound figure on that just so we can conceptualise exactly what it is. Thanks.

Ken Hanna:

The timing of the demerger is very complicated. We've taken the view that it would be best to do this on the back of audited 2007 actuals, so obviously that takes some time. That's number one, number two it does require some SEC and IRS approvals that do take quite a lot of time and it's a little bit bureaucratic, and trust me, we would like to get it done as quickly as possible and we think Q2 is really the most realistic time. Just on commodities, it would be between £80-90 million, that is for confectionery only and for beverages it's the same number of 5-6%, that would be between £40-50 million. Let's go back to beverages, on beverages there are two things that you need to think about. One is obviously the acquisition of BG and other bottling acquisitions and the other is we would say the one-off impact of Accelerade. Whatever we decide to do on Accelerade in '08 we certainly won't lose £20-30 million, so our base business is making progress but we have a negative from Accelerade and we have a negative from BG.

Andrew Wood:

So ex-M&A you're still going to have margins down in Americas Beverages, is that what you're saying?

Ken Hanna:

We're not guiding to margins at this stage Andrew. The business will make progress in 2007 but we're not guiding to margins on the beverage business.

Jeff Kanter, UBS O'Connor:

A question for you Todd, what's going to be the composition of the board? How big is it going to be? Who's going to be the chairman? Perhaps I missed that, could you give a little insight? I'm more concerned with the ongoing confectionery business.

Todd Stitzer:

We said today that Sir John will supervise the creation of two new boards, and there will be a new chairman. He already has a process underway to identify that chairman. You saw today in the announcement that we have one recent retiree, another to retire in March. It's possible that certain of the existing board members might shift to beverages, not absolutely clear on that but there clearly is some shifting that will need to go on. Now the Cadbury Schweppes board is probably a bit too large for a standalone confectionery board in numbers and I'm sure he's taking that into consideration with his non-executive colleagues as well.

Jeff Kanter:

But a chairman has not been named, is that correct?

Todd Stitzer:

That's correct.

Jeff Kanter:

And is the inclination to promote an insider or an outsider to that position?

Todd Stitzer:

Again that's with the nominations committee and the chairman so I honestly can't comment on it right now.

Jeff Kanter:

Just getting back to the spin. Did you say in your prepared remarks that as we move toward a possible de-merger, yet I'm reading everything and hearing the

Q&A that you're clearly going to spin this off and kind of any sale is off the table. Is that correct?

Todd Stitzer:

We are absolutely focused on a de-merger and there are no sale discussions underway.

Thomas Russo, Gardner Russo Gardner:

What is the restriction against the spun off beverage business in turn being acquired if it were by an outside party at a later date? What is the restriction on timing of such an event if any?

Todd Stitzer:

There's none that we know of.

Thomas Russo:

In the Journal this morning there was discussions about the chocolate category and the interesting share loss Hershey experienced, and the share gains that Mars has experienced. I wondered if you could speak to your portfolio and the impact this dynamic has had on your chocolate market shares in the US?

Todd Stitzer:

Well, we don't have very much chocolate share in the US. It might be 1%. Green & Black's is growing in the United States and hopefully adding to our small 1% share but that's not a major focus of our commercial life.

Thomas Russo:

Then lastly in the UK gum wars, I didn't hear any specific comments but I'm late to the story so I just go back and listen or any colour on your own launch and what competitive reaction did that trigger?

Todd Stitzer:

The UK gum market as a whole is currently up about 17%. Our share has been consistently over 10% and continues to be so. Our second wave went out in July with Raspberry Peach Splash and soccer ball shaped bottles. It's doing fine, we'll be well ahead of our plan and expectations for the year. Wrigley certainly has responded incredibly competitively with both innovation and advertising and promotion, the market growth shows it.

Paul Flood, CREF:

You gave revenue numbers but could you talk a little bit about the forex impact on the business, at least on the top line?

Ken Hanna:

All the numbers we've quoted here are on constant currency, but there was more of an impact in the first half because the dollar had weakened against Sterling in the second half of ’06, but there should be a 5% or 6% impact of currency on the full year numbers, roughly 5% or 6%.

Ends