

Cadbury
Moderator : Mr Todd Stitzer
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15h00

Operator: Good day and welcome to the Cadbury's Interim Management Statement conference call. For your information today's conference is being recorded. At this time I would like to turn the call over to your host today, Mr Todd Stitzer. Please go ahead sir.

Todd Stitzer: Hello everyone and welcome to our Trading Update conference call. I am Todd Stitzer, Chief Executive, and I am joined today by our Chief Financial Officer, Ken Hanna. The purpose of today's announcement is to update you on trading and other important developments and, from a trading perspective, we had another good quarter with revenues ahead by 6%. We continue to make good progress on our Vision into Action cost reduction program and, following a review of our structure, we are today announcing major changes to our organisational structure to further streamline the management of our business. The significant additional savings generated by these changes further underpin the delivery of our 2011 mid-teens margin goal.

I would like to make a few brief comments on each of these in turn, starting with our trading performance. Revenues were 6% ahead in the third quarter bringing our year-to-date growth to 7%. The key highlights of the quarter were an excellent performance from all our business in Britain where revenues were ahead by 10% and continued double digit growth from our emerging market businesses were nearly all performed strongly and each of our categories, chocolate, gum and candy, also performed well supported by our sustained investment in innovation and marketing.

Looking briefly at each of our regions, Britain, Ireland, Middle East and Africa was up by 10%; within that as already mentioned Britain was up by an exceptional 11% driven by a significant recovery in our candy business after the floods in our Sheffield factory last year. A strong innovation program and increased marketing also assisted in this excellent result. Key product launches included a new range of Cadbury Dairy Milk Bars, Cranberry Granola and Apricot Crumble and the re-launch of Wispa.

In Europe revenues were up 4% with good performance in gum despite difficult market conditions. The integration of Intergum in Turkey is progressing well with positive market share and revenue trends. Revenues in the Americas were ahead 7% reflecting good growth in South America and the US partly offset by a weaker performance in Canada. Our US candy business performed well driven by Swedish Fish and Sour Patch Kids, and we are continuing to develop long term plans to grow the market and capture further share in US gum after strong growth in the last 5 years. In Asia Pacific revenues were up 2%. Within that confectionery was ahead by 5%, while beverages revenues fell by 5%. Confectionery growth was strong across our key emerging markets, notably in India and South East Asia.

Looking to the year as a whole, the guidance we gave at the half year results is unchanged. Overall our revenue performance remains robust despite the weaker economic backdrop. We continue to experience weak conditions across most of Europe but this is being more than offset by strong growth elsewhere and we are confident that successful price realisation will allow us to recover the average 5% to 6% increase in raw material costs we have experienced during the year despite the phasing impact of higher inflation in the second half. This means that the benefits of our cost cutting program and operational leverage will drive a good improvement in our operating margins and important first year down payment on our 2011 mid-teens margin goal.

Let me now turn to the non trading topics covered in the statement today. In terms of our VIA cost reduction program we are announcing a number of further initiatives which will deliver cost savings starting from 2009. All in all the initiatives we have announced over the last year account for around 60% of our total planned Vision into Action cost savings. New initiatives include the reconfiguration of our chocolate supply chain in Australia and New Zealand combined with a major rationalisation of the SKU's sold in that market place. In our half year results we said that in order to underpin the delivery of our margin goals we were reinforcing our focus on costs, pricing, organisation structure and business portfolio.

Accordingly, today, we are announcing important changes to our management structure which further streamlined the organisation while, at the same time, strengthening our focus on globally-led categories. We are removing the regional operating structure, allowing the operating units which are centred around our focus market to work more closely with the centre and our category leadership team. Given our move over the past 18 months to aggregate these smaller units into larger commercially cohesive clusters, we no longer need the regions. Around 250 people, including a number of senior managers, will be leaving the business as a result and we expect the changes to deliver significant cost savings in 2009. As we said at the half year, the costs will be funded from our existing restructuring program.

So, in summary, our revenue momentum remains robust, despite the more challenging economic backdrop and we continue to aggressively execute our Vision into Action cost reduction program. In 2008, given the combination of good top line momentum, increased price realisation and cost cutting, we continue to expect a successful outcome for the year in line with the guidance we gave at our half year results in July.

Looking further forward into 2009, while we do not expect to be immune from any further deterioration in the world economy, we operate in resilient category with a strong business model, not only in relation to the products we sell but also in the way we finance the business with long term and committed facilities. As we said in July, we will be facing higher commodity headwinds in 2009 which we currently estimate to be in the 6%-8% range and we are seeking to increase our price realisation further in order to recover these higher costs. The organisational changes announced today will not only generate significant cost savings to underpin our margin goals from 2009 onwards, but are importantly also designed to speed up our decision-making processes and further improve the quality of our commercial execution.

So we are off to a good start with our Vision into Action program. We are well positioned to make further progress and we are confident that we can reach our goal. Thanks for your attention and now Ken and I will be happy to take your questions.

Operator: The question and answer session will be conducted electronically. If you would like to ask a question, please press the star or answer key or the digit 1 on your telephone keypad. Please ensure that mute option on your telephone is switched off to allow your signal to reach our equipment. We will take questions in the order received and will take as many as time permits. If you find that your question has been answered, you may remove yourself from the queue by pressing *2. Once again, please press *1 to ask a question.

We shall take our first question from Warren Ackerman of Dresdner Bank. Please go ahead.

Warren Ackerman: Hi Todd, hi Ken. This is a follow-up really from this morning. I have just been thinking about the changes. I am just wondering about the organisational changes. I mean obviously we are going to have to restate our numbers and obviously you are talking about

simplifying the business and taking out 250 people so we are going from sort of four divisions back to seven which, perhaps naively, seems as though it's adding a layer effectively. Can you maybe just sort of walk us through – I don't think we really went through it in much detail this morning about how that pans out. That's the first one. The second one is, did you say this morning that on the price increase in chewing gum in the US, the 8% that Wrigley had followed or hadn't followed? I didn't quite get what you said on that.

Todd Stitzer: Okay, well, on the second we said we hadn't observed that so we don't actually know, one way or the other. We make these decisions independently of competitors so we haven't seen any evidence of that at this point. As it relates to the organisational changes, going from four to seven but eliminating in essence a filter between the centre and the seven business units makes it simpler and more transparent to understand what's going on in a much faster manner and it also eliminates a layer of cost. So there are regional headquarters with staff and people who analyze what happens in the business units but then, you know, pass those analyzes and numbers on to the centre but we are just going to eliminate that process and deal with it. The region certainly added value from 2003 to 2004-5, but the strength of the underlying business unit is the strength of the company and therefore we are just going to relate to them directly. Separately, about a year and a half ago, we introduced category management into the system and now each of the BU heads will join me with the category heads on the executive committee so that commercial decisions can be made by all the people who have a stake in it quite quickly.

Warren Ackerman: Okay, you say things like you are speeding up decision-making and simplifying – can you give us some colour on how that actually pans out? Obviously the 250 people leaving is significant in itself but fast decision-making, more in-market fusion, better alignment, you know, how material could this be?

Todd Stitzer: Well it literally saves one level of conversation in making a decision. If you talk directly to the business unit about exactly what they want to do in the market as opposed to talking to the person who supervises the person who ... I mean that's basically it. Just speeds it up.

Operator: Thank you. Ladies and gentlemen, as a reminder, if you would like to ask a question please press *1 on your telephone keypad.

Todd Stitzer: Okay, are there any further questions?

Operator: We have a question from Chris Pelinsky from Jennison. Please go ahead.

Todd Stitzer: Hi Chris.

Operator: My apologies, we now have Jonathan Feeney from Wachovia. Please go ahead.

Jonathan Feeney: Hi. You guys mentioned that commodity prices remain in line with expectations – I'm just wondering if you could walk us through what your significant commodity inputs are and what they are doing individually this year?

Todd Stitzer: Yes, well, our four big commodities are not in order but sugar, cocoa, oil and milk. They are the four big confectionery input costs and they have been up – the 5%-6% increase in 2008 was a number we actually highlighted a year ago, in our quarter three 2007 numbers – there has been a few ups and downs across the year but it has remains within the 5%-6% range. Clearly we hedge some of these commodities. We do not publicly discuss our hedges. They are

commercially sensitive. So the hedging does disguise, if you like, some of the ups and downs and it sometimes, most times screens out the peaks and troughs so it allows us to price accordingly. So clearly looking at the spot rates doesn't tell you the whole picture. On a hedge to hedge basis we are up 5%-6%. The biggest increase in '08 was milk and that's what we said a year ago and that's still the case.

Jonathan Feeney: Thanks, and could you talk a little bit about the commodity inputs that go into your gum lines, specifically the sugar free gums?

Ken Hanna: Well, a variety of products, various products that we buy around the world, obviously gumbase, polyols, they are all, many of them are influenced by oil and the oil impact on packaging as well.

Jonathan Feeney: Thank you.

Operator: Thank you. We are taking the next question now from Pablo Zuanic of JP Morgan. Please go ahead.

Pablo Zuanic: Hello everyone and sorry to ask the question again that I asked in the morning but, in discussion with John and other investors, I think what I heard from some investors after your conference call, there was some confusion in my opinion and just so we can understand better, you might want to do it in this forum also – there was some confusion from the comment you made in the morning that you want to try it to push the operating to realise price increases of 6%-7% next year which is again apparently in line with what you have done in '08 and one would say “why not” right and the bears could say “well, there's 6-8% cost inflation, there is a weaker

consumer environment, you have this landscape" so one could say is that realistic? But, at the same time, you talk about price increases only to really offset cost inflation based on the market given 6%-8% cost inflation on a base of £1.6m, you will only need about a 2% price increase. So I guess I just want you to really go over that in more detail. Is there a disconnect; does that mean that you need 6%-7% price increases to achieve your margin expansion goals in '09? What he said is wrong and in reality you only need a 2% price increase to offset cost inflation and the rest from operating leverage, but just to understand why you talk so much about the 6%-7% price increase in the morning if, at the end of the day, really the realisation goal is only about 2% and the rest I guess goes to promotions and marketing. I think it is good to verify that as I think there was quite a bit of confusion from my discussions with investors.

Ken Hanna: I'll jump in here Pablo. It's Ken here. The 6%-7% was in relation to several markets, one of them being US Gum for example. The 6%-7% will not be an average across the board. You know we deal in 85 countries of which 25-30 are very significant so there's ups and downs across the board. Getting 6%-7% headline price increase from every single market on every single product is impossible. The only number we quoted was 8% on US Gum and there's lots of ups and downs. Even in a chocolate market we might get, for example, a good price increase on moulded chocolate and no price increase on gifted products or seasonal products. It's give or take so the 6%-7% is what we've challenged some of our major markets to go in some product lines; it is not an average. Now, clearly, we have to go for a higher number or mathematically it's not going to wash. You have to go for a higher number to cover your input cost pressures and, by the way, you shouldn't just assume pricing is required to cover the 2% of commodity cost pressures. We've got, whatever the number is, 4% or 5%, 3%-5% on our payroll costs which is to cover all of our inflation on our cost base. So it is a target to go for in certain markets; do not take it as the price increase across the board. That is as clear as we can be.

Pablo Zuanic: Okay, that is very useful and then, if I may, and again maybe this is for Todd and correct

me if the whole process here is wrong, but when investors and people look at markets emerging and the impact on your business in '09 or 2010, people normally talk about chocolate but most of the focus has been on gum and I think that I could argue that the impact could be greater on chocolate, your chocolate business and the reason I say that is because gum is quite consolidated with you and Wrigley, but on the other hand chocolate is rather fragmented and Mars obviously have a lot more room to grow in terms of market share than say Wrigley. So if I am thinking of U.K. where Wrigley's dominance in gum in Germany and Mars obviously in chocolate is not, one would think that those two countries are markets where your margin potential is low, so would it be fair to say that that merger is a bigger challenge for your chocolate business than for your gum although it is for both as I understand?

Ken Hanna: In the market where we are strong in chocolate we are generally number one and Mars is number two by quite some way. They have indicated a strategy of keeping their chocolate and gum and candy businesses separate, so I mean we will literally be competing against the same Mars chocolate business that we compete against now pretty successfully – increasingly successfully. So I don't think in the markets where we are strong it is that big of a stretch to think that we'll continue to compete strongly and well. I think in developing markets where one or other of us has gotten there first, I think that's where there will be a different sort of a context.

Pablo Zuanic: Thanks and the last one for me – when we look at the innovation chocolate in the third quarter in Portugal and the UK, is it fair to say that we are entering a phase where the larger part of the innovation is only coming from chocolate and that we went for three or four years when there was a lot of innovation in gum and made acquisitions in the US, obviously innovation will continue in gum and candy but it seems to me that there is to be an opportunity there in chocolate and that's what we are beginning to see, or not really; it's really across the board?

Ken Hanna: We operate a total confectionery model. I mean we have big innovation plans in all of our categories in different markets at different times which is one of the attractive things about our business model. So I think we have worked very hard and I think you have heard us say that our chocolate business, I mean our first focus when we combined with Adams, was to bring the Adams business back to a very productive business model. It took us two and half years to do that, a year really before we were scheduled to do it we turned our focus on chocolate, we said that we would make our chocolate model more productive a year and a half ago in the middle of June of '07. You are starting to see the benefits of us focusing on our chocolate model and making it as productive and innovative and focused as our gum model is and I think, as you see us get up to speed on these various sectors of our business, you are going to see a business model and innovation-driven, market-driven model similar to gum, because that's what we are focused on.

Pablo Zuanic: Okay and my last one Ken, if I may, and this is the very last one. When I look at your profit margins in America, can you comment how the US and other margins would compare with the Latin American margins or are they similar?

Ken Hanna: They are reasonably similar; they are reasonably similar in North and South America. They are, and clearly next year you will see it when we represent our numbers into different business units and you'll get more transparency.

Pablo Zuanic: Thank you.

Operator: Thank you. We will take the next question now from Rajeev Bhaman of Oppenheimer. Please go ahead.

Rajeev Bhaman: Hello. I was just wondering if these dislocations in the financial market have had any impact on your financing costs in the near term?

Ken Hanna: Rajeev, the quick answer is no, they have not. We have got 60%-odd, 65% of our debt fixed and we have been able to draw down a revolver that we negotiated about a year, eighteen months ago, a year ago at pretty advantageous rates and the banks have clearly honoured that, so it has not affected the 2008 estimate which is 6% interest rates.

Rajeev Bhaman: You wouldn't expect it to have any impact in the months to come?

Ken Hanna: Well, we have got some debt maturing in 2009. We have got to replace that. You might be sitting here today and think that spreads are going up but LIBOR is going down. I don't think it's going to be material but it's very early for me to predict what the cost of refinancing debt will be next summer.

Operator: Thank you. As a final reminder ladies and gentlemen, if you would like to ask a question please press *1. As we have no further questions, I would like to hand the call back over to you gentlemen for any additional or closing remarks. Thank you.

Todd Stitzer: Well, thanks everyone for your interest in the company and just to say we participate in a resilient category with a strong business model. I think our third quarter results are a reflection of that. We are by no means immune from the global economic circumstances but we think we have a better than even chance of sorting our way through it because of the shape of the model and the participation. So, thanks for your time, and we look forward to seeing you soon.

Operator: Thank you. That will conclude today's conference call. Thank you for your participation ladies and gentlemen.