

Trading Update
Morning Conference Call and Q&A Transcript
18 June 2009
Todd Stitzer (TS), Andrew Bonfield (AB), John Dawson (JD)

TS Good morning everyone, and welcome to our trading update conference call. I'm Todd Stitzer, CEO, and I'm joined by Andrew Bonfield our CFO, and John Dawson, our IR Director. The purpose of today's trading statement is to give a brief update on performance since our interim management statement in April, and provide you with some up to date technical guidance. The introduction should last around five minutes, and then we can turn over to Q&A.

As you will have seen from our announcement, we have today confirmed that we have built on our good first quarter performance, with improved trading in April and May. We expect to deliver growth and cost efficiencies for the year, and we reconfirmed our guidance for 2009. Let me outline our category progress, and then briefly review our performance by business.

I am pleased to say that gum and candy revenues improved in April and May after a slow start to the year, compared to a strong first few months in 2008. While some of this improvement can be attributed to the non recurrence of the de-stocking we saw right at the start of the year, there were positive developments in many of our businesses, particularly in a number of developed markets. At the same time growth in chocolate remained robust, continuing its solid revenue performance in Q1.

Turning to our business units, our Britain and Ireland business sustained its strong performance, owing to the excellent growth in the UK, which offset tougher trading in Ireland. Cadbury UK continued to gain share in seasonal chocolate products, due to a very successful Easter, which lasted into April, but also in standard products, helped by the continued success of Wispa and our new bitesize peanuts, raisins and clusters packs.

Conditions in Europe, however, remain challenging. Gum and candy category growth has been weak in France and Spain, although we have gained share in gum year to date in those markets. In Russia challenges with our distribution network continue to hold back our revenue growth.

Our Middle East and Africa business grew well, with a strong performance in South Africa and improved growth in Nigeria.

Turning to Asia, the pace of growth of our business there has been very satisfactory, led by strong revenue growth and continued market share gains in India.

Our Pacific business benefited from good seasonal chocolate shares [meant 'sales'] in Australia, and an improved candy performance from the recent Sansei acquisition in Japan. The re-launch of Cadbury Dairy Milk in Australia is now underway, although it is very early days to comment on results.

Revenue in North America continued to recover from the impact of de-stocking in the US early in the first quarter, and underlying market growth there has remained positive. In Mexico growth has slowed from the high levels achieved in 2008, in part reflecting a small negative impact from the swine flu situation.

South America continued its good progress, with some favourable market share developments in Brazil, and strong growth in base brands such as Trident and Halls across the unit.

Overall our guidance for revenue and margin for the full year is unchanged; having said that it's worthwhile explaining the expected differences between the two halves of the year. Looking at revenues, as expected, the slower start to the year will hold back growth somewhat for the first half. The second half should be stronger as we expect to deliver further growth, underpinned by new product launches. While our margin guidance is unchanged for the year, the first half margin improvement is expected to be higher than for the year as a whole, reflecting the impact of re-phasing some of our market investment for the second half to support the new product launches I just referred to.

Now, I would like to turn to Andrew, who will review technical guidance.

AB Thank you Todd, and good morning everybody. I only have three points to make today. Firstly you will be pleased to know that our technical guidance for input costs, price realisation, restructuring costs, interest rates, tax rates, depreciation and capital expenditure are unchanged from those included in our full year's results statement for 2008, and the first quarter IMS in April. On raw materials in particular, whilst some raw materials are marginally cheaper, we remain in the 6% to 8% input cost increase range that was disclosed in February, albeit at the lower end. You may remember that on the first quarter call we mentioned the negative mix effect at the gross margin level of chocolate and candy relative to gum. I'm pleased to say that we have seen some favourable purchase price variances, which we expect will offset the negative mix impact at the half year. This improvement compared to our previous expectations underpins the slightly higher margin growth now expected in the first half. In addition price realisation has remained good, with no major attrition on the recent price increases implemented to cover the cost inflation.

Secondly, on foreign exchange translation and its impact on our revenue and operating profit. As you know the impact is impossible to predict with certainty, and you will have your own house views on the projected rates for the balance of the year. That said, assuming exchange rates remain unchanged for the balance of the year from those as of 11th June, we would expect an increase in net revenue of around 5%, and in underlying operating profit of around 6% for the full year. The increase for the first half is expected to be 10% and 14% respectively. The change from our previous guidance reflects the strength of sterling and the Venezuelan Bolivar where, as required by international accounting standards, we are now using the parallel rate rather than the official exchange rate.

Finally, let me point out that the full income statement for the first half of 2008 is attached to our press release as an appendix to aid the comparison of half year on half year performance.

Now let me hand it back to Todd for a summary.

TS Thanks Andrew. So, let me summarise by stating that our early progress has continued into the second quarter, with our business units focused on delivering market share gains and efficiency improvements. As a result we reconfirm our full year guidance for revenue growth around the lower end of our 4% to 6% goal range, and to make good progress toward our goal of mid teens margins by 2011. Our half year results for 2009 will be announced on the 29th of July. We appreciate your attention. And now Andrew, John and I would be happy to take your questions.

MF (Member from the floor) Morning, it's Polly Barclay from Cazenove. Just on the pull forward of the margin phasing to the first half, could you just explain what has changed on the purchase prices since you talked of a second half weighting due to the mix effect of the soft start of gum at the time of the Q1 IMS? And will these purchase price improvements continue to benefit in the second half?

AB Yes, the real benefit has been mainly in milk prices, and it's not in the UK; it's actually in some of the international businesses that have been sustained through most of the first half of the year. And that is giving us a favourable PPV. Obviously at the time of the April call it was a little bit early to call that for the first half. Overall, based on our expectations, and as we all know, commodity prices are hard to predict at the best of times - if we could do that I wouldn't be here, I would actually be trading - our expectation still puts input cost inflation around 6% to 8% range; so probably at the bottom end of that range, as I mentioned in my comments. So, I think expectation is okay for the first half, some favourability on PPV; I would be reluctant to call that for the full year at this point in time.

MF Julian Hardwick, RBS. The Q1 we saw a number of one off factors which muddied the waters. Is it fair to say the Q2 picture is a much cleaner one, or are there any special effects that you would like to draw to our attention as having impacted the sales development in Q2?

AB Well, as it relates to Q2, no. I think we commented upon the de-stocking that occurred early in the first quarter. That significant one off has not reoccurred, and we are basically focused on executing against the plans that we had in place as it relates to marketplace performance.

MF And secondly, Venezuela doesn't feature in my model at the moment; can you tell me how big your sales are there?

AB Yes, the impact on currency is about a third of the 6% we're talking about...sorry, 4% at sales level and about 6% at profit level versus our previous guidance; it's around about a third of that in total. Our business there was around about a £70 million business; that has been cut by approximately two thirds because of the use of the parallel rate. The reason why we're using the parallel rate is we no longer have access to the official currency exchange because of reclassification as our product from consumer staples out of that classification. So, we are no longer able to gain use of the official currency, so we have to use the parallel rate, and that is required by IAS. And you will see other companies having done that. The reason why we've called it out in particular is given the overall currency impact the vast majority is really the dollar and the euro. This would normally have probably just flown under the radar screen, but it is about a third of the impact that you mentioned.

MF Jeff Stent from Citi. Could you talk about Trident Layers please?

TS That is a product concept that we've been working on as an innovation, and I would rather not talk about the details, to be perfectly honest.

MF Alan Erskine, UBS. Can you give us a feel for how you think your market share has progressed through the second quarter in aggregate? And secondly, just more generally, as you strive towards to mid teens margin target how important is it to you that as you get there you at least maintain your market share?

TS It's tough to call global market share on aggregate since Euro Monitor only publishes it sometime in July for the prior year. But the sense that we have is we have had significant market share gains in the UK, of around 300 basis points. In France our market share, despite a difficult market, is back up close to 51%. In Spain, similarly, we've had excellent performance. In Mexico we've had excellent performance. In India we've had 40 basis points of market share gain in recent quarter. The US is off about 60 to 70 basis points through the first five months. All in all we're quite happy with the market share performance that we have delivered in the first five months. It's our goal to deliver sales, market share and margin growth; that is what our teams are challenged to do. I think we did that in 2008,

and we are focused on trying to do that in 2009. So far there is nothing to say that won't be accomplished. I know good business people constantly balance market share and margin and revenue growth accomplishment. Our goal is to do it all, and we are still in touch with that goal.

MF Have you any visibility on what you think A&P as a percent of sales will do for the year as a whole?

TS I think that we said our goal is to continue to invest in marketing; I don't think I would want to call the year as we speak, although our goal is to continue to invest.

MF Alex Smith, Nomura. Just a point of clarification. I think you said your market guidance is unchanged; can we interpret that to mean that you are happy with the consensus number, which I think you sent around of about 70 basis points in constant currency? And secondly, just on the top line guidance; can I again confirm that the mix in that in terms of volume versus price, I think in the past you said that was predominantly price driven, volumes expected to be flattish for the year? Is that still what you're looking for?

AB Yes to both questions. Yes, our margin guidance remains unchanged, and we are comfortable with consensus of around 70 basis points or so. And on sales guidance, yes, most of it will be price led for the year. And we hope volumes to be around flattish. Obviously we are going to be running a little bit against headwind in the first quarter where they were down 3%, of which 2% was due to the de-stocking impact. That is broadly that guidance hasn't changed.

MF Is it at all possible to say anything about pricing for next year or maybe in the fourth quarter? If you look at cocoa prices they seem to be higher than they were last year. Maybe other things are looking more favourable, but in the past you've obviously had to take price up in the fourth quarter; is that something that might be different this year?

AB It's too early yet to make final calls on pricing for 2010. Obviously we are going through our planning processes at the moment and looking at obviously all input costs for 2010, and that's part of the analysis that we will go through and come up with pricing decisions in consultation with customers at the appropriate time.

MF Pablo Zuanic, JP Morgan. In last year's IMS you were more [unclear] in terms of numbers; you talked about being ahead of 7% sales growth, and this year there is no mention of that. Can you at least validate that you are happy with the consensus of 3.1% for the first half? And related to that just give us a bit more colour in terms of actual sales growth in non-seasonal chocolate in the UK? Comment on US trends in terms of takeaways; you said that takeaways in the first quarter were 0%, down 6 because of the de-stocking, but 0% in terms of takeaways. What happened with takeaways in the second quarter? And just remind us why you said that in France and Spain gum, apparently according to Nielsen, is down close to 10%.

JD I'll start on the takeaways issue. What we said at the time of the Q1 results for North America as a whole was that the performance of the business adjusting for de-stocking was flat, and that included obviously gum and candy and, to a certain extent in Canada, chocolate. So, it was across the whole piece that you saw that performance, rather than specifically in gum. Clearly the Halls element of it was a reasonable factor as well as the de-stocking which we talked about. If you look at the underlying takeaway from stores, the consumer off take, if we look particularly at gum, the statistics that we saw for the first quarter have indicated around 2% to 3% value growth in the category. And our performance we judged adjusting for de-stocking in gum was probably a little bit below that but reflecting a

modest, as Todd indicated, loss of share. But that was the indications that we gave at the time of our Q1 results.

TS Non seasonal chocolate in the UK has been quite robust, driven by both Wispa and by the launch of our bitesize products, chocolate covered peanuts, raisins and clusters. Our market share in non seasonal is up in the 250 basis points range; quite healthy. So, we really had a doubly successful first five months of the year with very strong seasonal performance and very strong standard performance. On France and Spain it is true that the gum category is off in the sort of 10% range, but as I think I said in my remarks, our gum share in both places is performing well; we are taking disproportionate share from our competitors and we are focused on doing better than the market in a difficult circumstance. We are not doing better than the market, but we are improving our performance month on month as we focus on execution in the market place. As it relates to sales in the first half, we make our first half sales announcement on July 29th. I think you can assume that our sales are rateably improving in line with market perceptions in the first half. So, we're comfortable that we are in line with full year guidance, and we will update you at the half.

MF Just to follow up, when people talk about Mars and Wrigley and the idea and benefits of selling chocolate and gum together, I really wonder about the decision in your case of having launched gum in the UK, and not, for example, having launched chocolate in Brazil. The reason I say that is in the UK you have 25%-30% share, Wrigley 90% in gum, that was a formidable competitor. In Brazil you have 70% share in gum and your competitors, Kraft Nestlé, in chocolate it is a more fragmented category. So, I would have thought that, if it's true that selling chocolate and gum together makes sense, you would have had a lot more leverage doing this in Brazil as opposed to launching gum in the UK, where your share is still pretty small. Any thoughts on that?

TS I think those are very valid strategic considerations, so I completely agree. There are other strategic considerations, however, in terms of the relative impact of competition against particular competitors. So, if we were seeking to impact profit pools of a particular competitor, doing that in Brazil isn't quite as effective as doing it in the UK. So, that would have been probably the single most important determinate of why we chose one over the other. And I think we continue to focus on the UK; it's our biggest chocolate business with the biggest confectionery sales force in the market. We have further innovations to go in the UK and we are committed to seeing out the investment.

MF Sara Welford, Bank of America Merrill Lynch. In Europe you've obviously eluded to the gums markets being down in France and Spain; can you clarify, have there been any changes in trade behaviour, or is it just consumer behaviour that is affecting this? And secondly, to clarify on your share performance in North America; versus Q1 can you say has the loss of share actually worsened or have you made a bit of a comeback? And finally are you willing to give any more of a sort of slightly more quantitative picture for Q2? You obviously had volumes that were down in Q1; are you willing to say whether your volumes were flat or better than flat in Q2?

TS As it relates to European gum and market behaviour, I would say it's largely impacted by the consumer. Clearly retailers in Europe, big box retailers are competing with big box hard discounters, and there is a competition going on there. We are trying to increase our access in hard discounters. But I really do think it's the consumer; it's not the retailer. We have strong positions in almost all the retailers. We've had tough but fair conversations with them about promotional support, so I think it's the consumer. As it relates to North America I would say there has been about a 10 to 20 basis point share drift in North American gum. There has been a positive drift upward in North American candy. I think our market share will be in the 33%, 34% range on gum until the second half when we have some fairly significant innovation. So, I think that's the comment on North America. As it relates to a

quantitative picture for Q2 we issue our results for the first half on July 29th, and that is when we will be able to be more forthcoming about the numbers around it.

MG Pierre Tetner, Oddo. I would like to come back to the previous question. Are you seeing during the last two months some difference in terms of consumer behaviour between North America and European behaviour? Are you seeing more US consumers coming back to chocolate consumption compared to Spanish, French or other European countries?

TS Well we don't have a big chocolate business in North America; we have a reasonable chocolate business in Canada. As an overall matter, things are slightly more positive in the US than they are in Europe right now. The gum category, which is the category we participate in the most in the US, is up 3% to 4% as compared to a gum category that is down 8% to 10% in Europe. I think there have been some upticks in consumer visits to convenience stores, the price of gas has been down for the last five or six months, I think you are seeing signs that the consumer is somewhat more vibrant in North America than in Europe. That would be my view.

MF My second question is concerning retailers. Are you benefiting from some rationalisation of the shares with some retailers focusing on the main leaders? Did you lower consumer trends during the past few months? Are there any significant moves or changes from retailers in terms of relationships with confectionery business companies?

TS I would say not really.

MF John Cox, Keppler. Just to start with on the commodities, it seems that you are saying that actually the commodities are maybe easing somewhat, but when I look at the prices of cocoa and sugar in particular that still seems pretty high and maybe hasn't come off as much as I anticipated for this year. I'm wondering if you can just give some more colour on that. You say de-stocking has been completed; would you say that is an accurate statement regarding the North American market, that that process is finished? I think a lot of people would say this whole thing about de-stocking in America in the food sector was a bit of a red herring; but you seem to be saying that this de-stocking process has come to an end. And a third question, just going into Europe and the move to the hard discounters in potentially France and Spain and the category being off, is it because you are actually seeing a shift into private label, where you guys are obviously are not in terms of gum in France and Spain? Or is it a case of now you are actually negotiating with these guys and you are thinking that we can offer them more promotion potentially and that should get the whole thing going? Or would you say the down 10% you talk about has basically gone to private label and that is really the issue? Because I was under the impression there wasn't really any private label gum to speak of. And I want a bit more colour on the dynamics there.

AB On commodities obviously we don't necessarily purchase everything in the spot market, so spot prices aren't necessarily an indication of where we have hedged some of those commodity prices. PPVs are a reflection of what our expectations were for the year in our calculation of our standard costs versus what we are actually paying. So, it is hard to just refer to commodity prices. But you are correct, cocoa has fluctuated and it's still higher than it was last year, and sugar is higher. But that is not necessarily the prices which we've been using for calculating our cost of goods. On the hard discounters in France and Spain I would just make the point that there actually isn't probably much private label penetration at all, so the actual market is down, as Todd mentioned, by about 8% to 10% in Europe gum market; and that is not because of private label, it is just really declining consumer consumption that is impacting that.

TS On the de-stocking point, I think completely finished is a difficult statement for anybody to ever make, but I would say it is largely completed in the context of people pulling

down their days of stock in the North American market. So, I don't think it was a red herring; I think it was an actual phenomenon. I don't think there is any re-stocking at this point, but I think retailers who are good at managing their business have decided they want to manage their business for cash reasons at a lower level of stocks. If consumer velocity increases, which happens when economies look better and consumers feel more confident, then it is conceivable that inventory might tick up a little bit again because they don't want to lose that extra sale from having not enough stock. I think at the moment people are being careful. So, I would say it is in relative equilibrium for the moment in North America. Just another comment. Andrew is absolutely right; the penetration of private label in chewing gum is not very much at all. You do have this dynamic where the big box retailers in Europe have decided to compete with the hard discounters by offering their own value lines, and the hard discounters have decided they will compete by offering certain branded products accessed to their formally not very branded format. So, you have an interesting competitive dynamic where each of the channels is seeking to imitate the other to attract the other's customers, and we are maintaining our position in big box retailers because there isn't any private label gum, and we are actually getting access to hard discounters because they want our number one and number two brands. So, once it works through the system we'll actually end up with greater availability in more retail outlets in France and Spain, which is a good thing.

MF A couple of follow ups on that. I would have assumed that the hedging would have dropped off by now if you'd typically hedged forward 12 months, 18 months on the cocoa. Is there a risk that as the hedging drops off maybe into H2, and if the cocoa prices remain the same, this will have a negative impact going forward? In France and Spain, it is very interesting what you are saying there, I'm just wondering, you are not cutting the list price for gum; you are basically offering more in terms of promotion, as you say, this dynamic rather than cutting the list price. Is that a correct assessment? And the second thing is on the gum being down so much, is it really just the macro economic situation, and I think you guys have said it before, if people aren't really travelling they are not buying gum, whereas they would still veg at home and munch chocolate. Is that a correct assessment?

AB Let me come back to you on commodities. Our expectation, as I mentioned in my comments, is the guidance we gave at the beginning of the year overall of 6% to 8% remains, and we expect to be at the lower end of that 6% to 8%. We don't disclose our hedging policies because they are commercially sensitive, but based on what we're seeing and where we are today, based on cover we have and also our expectations we have for prices for the remainder of the year, we are comfortable with that guidance.

TS And to the question about promotional strategy, clearly coming up with interesting consumer and retailer promotions is a traditional and far better way of managing the pricing and competitor dynamic than cutting list prices. So, as I think Andrew has said, we've had pretty good productivity on price realisation across our markets. We have also been thoughtful about our promotional strategy to maintain a competitive position. And that would be a reflection of the share gains that we've had. This is one of the fundamentals of life in the consumer products business, and I think we're managing it reasonably well. As it relates to gum activity versus chocolate, I think our view would remain as you stated, life still for consumers is particularly hunkered down, they are spending more time at home with brands that they are more familiar with, the traditional brands, and I think they are travelling less, so they are consuming less gum on the run, as it were. But I think that is loosening up, firstly in North America to some extent. And I think we're confident that the category will resume growth in Europe. Gum penetration and frequency of consumption in Europe is far lower than it is in the United States and Latin America, and we think there are still many opportunities there.

MF Charlie Mills, Credit Suisse. Could you give us some form of quantification of this phasing in the marketing? How much might marketing be down in the first half?

AB Broadly, if you look at the structure of our P&L, around 45% of our sales in the first half and 55% in the second half. If you look last year I think we actually spent 55% of our marketing budget in the first half and about 45% in the second, it will be more evenly phased across the year this year. So, marketing spend will be broadly in line with the full year spend as a percentage of sales in the first half.

MF Thanks. And is there any particular regional spread that is worth highlighting when we see your divisional margins when you report in July?

AB I think we will see improvements in many of the regions as we go through the period, in line with our expectations for what they are able to do for the full year. We'll probably see the European business struggling the most, as you would expect, with the downturn in sales in those areas. That really will be the regional focus for margins.

JD Just to be clear on the marketing topic. The phasing, as Andrew said, is to have marketing roughly split equally first half, second half. The percentages that will result from that, it will be slightly higher as a percentage of sales in the first half than the second on that basis, but much closer to the average than it will be last year. Last year I think we had 11.8%, if memory serves, in the first half of last year, and less than 10% in the second half, giving the average of 10.8. This year you're looking at it being closer to the average in both halves. The pound spend, at this early stage, being indicatively 50/50; but obviously that can vary.

MF Martin Dolan, Execution. I wonder if you can give us an update on Vision into Action, particular on how many actual plants you've closed in the first half. And also give us the number of exit run rate of factories for the group as a whole going out of the first half?

JD We haven't given the details of the exact phasing of different plant activities that we're doing through our Vision into Action programme for some very important reasons, which are internally focused. It wouldn't be appropriate for us to comment on that in too much detail. What we've said as a result of the overall Vision into Action programme is that we will reduce our number of plants by around 15%. Now, obviously we have divested the Australia beverages business and a number of other things, and therefore the headline figure that we originally talked about when we announced the programme in 2007 has moved. As a result of all the initiatives we're doing we should have around 60 facilities globally at the end of the programme, at the end of 2011. We have announced a number of consultations in March, two to be precise, one in Spain and one in Turkey. Those are examples of the activities we are undertaking. But to go into any more detail just wouldn't be appropriate, so please forgive us for reserving the right to do these things quietly.

MF How many factories have you got right now?

JD It's a good question. We'll come back to you. It's close to 70.

TS It's 68 I think.

JD Sounds about right.

MF Charles Pick, Finn Cap. In reference to the emerging markets growth, 6% in Q1, is it possible to give any pointers for April and May just to see how it differed? And secondly, reference the phasing in of new product launches in the second half, is it possible to give any sort of quantities or loose qualities to the impact of those likely phases in terms of growth rate to sales?

TS I would say emerging markets growth in the second quarter has been better than in the first. I wouldn't want to characterise it any more than that, but it has been very good and it continues to strengthen. As it relates to innovation, I think we are going to have innovation in both the third and the fourth quarters, and it will be in chocolate and in gum and candy. So, we have a fair amount of innovation. Quantifying the phasing of it is a detail, we wouldn't necessarily share out.

MF Pablo Zuanic, JP Morgan. Is it true to say that EBIT margins in Britain and Ireland three or four years ago were about 400 to 500 basis points higher? And if that is true, most of the margin compression was related to share losses to Galaxy mostly, and now you are recovering shares, why aren't margins already back there?

AB We will give you the margin numbers in approximately one month's time, and that will be able to answer your question. Obviously margins have improved in the UK, but most of that is related to SG&A and A&P action, rather than actual improvements in cost of goods. Obviously the UK has had pressure from sterling, a relative devaluation of sterling, and also input costs impact the chocolate business in particular, and cocoa is obviously a key component of that. The other point to note is B&I also has our Irish business, and our Irish business has been suffering from probably almost the perfect storm in that it is a euro denominated business, as the euro has strengthened against sterling we actually export product from Ireland into the UK, and at the same time we also import a large number of countlines from the UK into Ireland, and you also have the Northern Ireland border trading position. So, the Irish business has been suffering over the past couple of years. So, that will have a negative impact on the overall B&I margin as we look into the first half of the year.

TS Ladies and gentlemen, thanks so much for your interest in Cadbury plc and for your time this morning. Andrew, John and I look forward to seeing you personally at our half year results announcement and continuing the dialogue. Thanks so much and have a great day.