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# EDITED TRANSCRIPT

MKC - Q2 2014 McCormick & Company, Inc. Earnings Conference Call

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## OVERVIEW:

Management discussed 2Q14 results, reporting EPS of \$0.64 on sales growth of 3% vs. 2Q13. Guidance was for 2014 EPS of \$3.22-3.29 on sales growth of 3-5% vs. 2013.



## CORPORATE PARTICIPANTS

**Joyce Brooks** *McCormick & Company, Inc. - VP of Investor Relations*

**Alan Wilson** *McCormick & Company, Inc. - Chairman, President and CEO*

**Gordon Stetz** *McCormick & Company, Inc. - EVP and CFO*

## CONFERENCE CALL PARTICIPANTS

**Ken Goldman** *JPMorgan - Analyst*

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## PRESENTATION

**Joyce Brooks** - *McCormick & Company, Inc. - VP of Investor Relations*

Good morning. This is Joyce Brooks, Vice President of Investor Relations.

Thank you for joining today's call for a discussion of McCormick's second-quarter financial results and 2014 outlook. We have posted a set of slides to accompany our call at [ir.mccormick.com](http://ir.mccormick.com).

At this time all participants are in a listen-only mode. A question-and-answer session will follow our remarks.

(Operator Instructions).

As a reminder the conference is being recorded. With me this morning are Alan Wilson, Chairman, President and CEO, who will begin with comments on the latest financial performance and a business update, and Gordon Stetz, Executive Vice President and CFO, who will provide a more detailed review of second-quarter results and our latest financial guidance for 2014.

As a reminder, today's presentation contains projections and other forward-looking statements. Actual results could differ materially from those projected. The Company undertakes no obligation to update or revise publicly any forward-looking statements whether as a result of new information, future events or other factors.

As seen on slide 2, our forward-looking statement also provides information on risk factors that could affect our financial results. It is now my pleasure to turn the discussion over to Alan.

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**Alan Wilson** - *McCormick & Company, Inc. - Chairman, President and CEO*

Thank you, Joyce. Good morning, everyone, and thanks for joining us.

Our second-quarter results included solid sales growth and strong cash flow as well as earnings per share that exceeded the outlook that we shared with you in March. While the results varied by region, the overall performance demonstrated progress with McCormick's growth strategies and gives us increased confidence in our ability to deliver our 2014 financial outlook.

We grew sales 3% in local currency. Both our consumer and industrial businesses contributed to this increase. Growth in our international markets was particularly strong including incremental sales from WAPC, an acquisition that we completed in May of 2013.

We also drove international sales with pricing actions and with higher volume and product mix driven by product innovation, distribution expansion and brand marketing support. In our America's consumer business sales declined this quarter due to competitive pressure that began to impact our US results in 2013. Also we are comparing to robust year-on-year sales growth of 5% in the second quarter of 2013 for our America's consumer business.

We are addressing the competitive environment in this market and I will provide an update later in my remarks. We improved gross profit margin in the second quarter by 60 basis points with our Comprehensive Continuous Improvement program, CCI, which is generating cost savings throughout the Company. In addition, our industrial business team increased margins in the product portfolio this period.

Sales growth, higher gross margin and our diligent expense management led to a mid-single-digit increase in operating income. While the increase in operating income was in-line with our expectations for the quarter, we exceeded our earnings-per-share projection. This was a result of a lower tax rate and our share repurchase activity.

The reduction in shares outstanding through the first half is tracking at the upper end of our 1% to 2% target for 2014. We maintain strong cash flow this quarter with a year-to-date amount of nearly \$50 million from a year-ago period.

Through the first half we have returned \$223 million to shareholders in the form of dividends and share repurchases, a 22% increase from the first half of 2013. As Gordon will discuss in more detail, we are reaffirming our fiscal year 2014 outlook to grow sales 3% to 5% and deliver earnings per share in a \$3.22 to \$3.29 range.

Let's turn to a business update for each of our two segments, consumer and industrial. Our consumer segment is meeting the increased demand for flavor when preparing meals at home. In category growth for our two primary categories, spices and seasonings and recipe mixes, remains strong.

The latest Euromonitor 52-week data shows global sales of spices and herbs up 5.2% and recipe mixes up 3.3%. For McCormick's consumer business we grew sales 4% in the second quarter and 6% year to date. This builds upon our year-on-year sales increase of 5% in the first half of 2013.

However, the performance across our various regions was mixed with the international businesses leading the increase in this most recent quarter. I will comment first on our top contributor, the Asia-Pacific region, and follow with comments on growth in the Europe, Middle East and Africa region, EMEA, and then discuss progress with our actions to improve results in the Americas region.

In the Asia-Pacific region, the incremental impact of WAPC drove much of the growth along with the underlying increases in China. For WAPC, it has been one year since we completed this acquisition and we are extremely pleased with the results. The integration has been smooth and both sales and profit are exceeding our targets for this business.

We are just in the early innings of gaining sales synergies between our WAPC bouillon products in central China and McCormick branded products along the coastal regions. Our base consumer business in China also achieved double-digit growth this period continuing the momentum from previous quarters. We have achieved great distribution and consumer acceptance for our new 13 spice blend and our squeeze pouch ketchup.

Ketchup is a leading retail item for us in China and sales of the squeeze pouch are outpacing sales of our bottled ketchup and largely incremental to the category. With this rate of growth and strong performance China is on track to be our second largest country this year in terms of annual sales when both consumer and industrial businesses are included.

Our sales performance in EMEA was a positive with a 7% increase. In local currency sales rose 2% driven by pricing actions. Our volume and product mix were down this period with some initial reaction to the price increase.

We are also operating in some difficult retail environments such as the United Kingdom. In these markets our brand support and product innovation are vital to driving sales. We launched a number of new products in the first half and are supporting these with incremental brand marketing driving awareness and trial.

We are encouraged by the initial response to a number of these items including flavor shots. Looking ahead to the second half, our team in EMEA has additional products poised for launch that include Vahine dessert items, [Hammonds] seasonings and Ducros recipe mixes.

On slide 6 we show two Schwartz brand items that we will introduce to UK consumers, a no-mess grinder refill pouch and a line of freshlock herbs. This freshlock range extends to the UK, a proven product in France that answers the consumer demand for freshness with a vacuum-sealed package.

Let's turn next to our consumer business in the Americas. In local currency second-quarter sales in this region declined 4%. This decline compared to a strong year-on-year sales increase in local currency of 6% in the second quarter of 2013.

As we have discussed, we are addressing some competitive inroads which began to impact our US business in 2013. In this latest period we had continued pressure from some smaller brands in the marketplace largely focused on certain product groups within our spices and seasoning category. And while our category share was down, the percentage decline was less than it was in late 2013.

We are taking aggressive actions to strengthen our brand equity and to win at retail. These actions are building as we progress through 2014. And we recognize it will take more than one or two quarters before these actions gain traction and help return to growth in this market.

While we would like to see more rapid results we are making steady progress in building brand equity. We introduced a number of new products in the first half that included Grill Mates steakhouse burger seasonings, value-sized Grinders and Lawry's oven fry mixes. Distribution targets have been met and we are pleased with the initial consumption data.

We increased brand marketing support in the first half with spice superiority and product quality messages and completed the redesign of our Grill Mates website for this summer's grilling season. Our latest ROI metrics show positive returns in TV, print, PR and digital. This gives us confidence in the efficacy of additional investments that we are making in 2014 to build brand equity.

Our new products and brand marketing have led to recent share gains in the recipe mix category. We also had good growth with our Hispanic items and Kitchen Basics brand this quarter.

As for winning at retail, we've completed the realignment of our sales organization. We are using insights and analytics to set a gold standard for organizing the retail spice set. And we are having a more strategic dialogue with our customers on category management.

Spice and seasonings is one of the most profitable categories for the retailer and these customers want to get it right. We are being aggressive, not only sharing our category management story but demonstrating our superior quality.

Through the first half these conversations have led to some early wins that include better alignment of retail pricing between private label, McCormick brand and competitive brands. In addition, we have gained new distribution for Lawry's and Simply Asia Foods brands and won the supply of private label from a competitor.

So with the progress underway what should you expect from our Americas consumer business in the second half? First, greater brand support.

In the US we are planning an increase of at least \$10 million in 2014. Through the first half the increase has only been \$3 million. In the second half we plan to direct our incremental support toward everyday cooking, new holiday advertising, superiority and quality messages and the launch of FlavorPrint, our personalized recipe engine.



We have a number of new products entering the marketplace. Our greatest emphasis will be on two of these.

The first is gluten-free recipe mixes, which had an accelerated launch this past April. And second, McCormick skillet sauces and flavors like fajita with roasted chili, garlic and lime. These flavors leverage mainstream family favorites with a bit of a twist.

Both the gluten-free items and skillet sauces are designed to build upon our momentum in the recipe mix category. We are already gaining good retail acceptance of these new products and anticipate strong consumer trial and repeat purchases.

Again improved results for our consumer business in the Americas are going to take some time but we have had initial progress with the actions that we have underway. I will turn next to an update on our industrial business.

We are pleased with our second-quarter results for the industrial business, particularly the significant increase in operating income and operating income margin. We recognize that this performance compares to a year-on-year profit decline in the second quarter of 2013. However, if we look back two years to the second quarter of 2012, industrial operating income is up 10% and the operating income margin, at 8.6% in the latest quarter, is up 70 basis points from two years ago.

As with the consumer business the performance varied by region. In the Americas we grew sales of branded food service products while sales to other food manufacturers were stable and sales weakness continued with quick service restaurants. The net impact was a decline of 1% in local currency.

Heading into the second half we are encouraged by our innovation pipeline which is more robust than a year ago. Customers continue to place an emphasis on health and wellness in their innovation. With our foundation in herbs and spices we believe McCormick is well positioned.

2014 is on track to be another excellent year for our industrial business in EMEA. Excluding any currency impact we had a strong 12% sales growth this quarter driven by expanded distribution, new products, particularly with quick service restaurants.

Improvement in industrial sales in China continued this quarter with an 18% increase in local currency. This growth rate compares to weak demand from quick service restaurants in the first quarter of 2013 that related to concerns about avian flu and poultry menu items. Across all three regions we are encouraged by our industrial business outlook for the second half and believe that we will deliver strong sales and profit growth in 2014.

To summarize, across all of our businesses our financial results through the first half have us well on our way toward meeting our 2014 objectives. We've increased confidence in our financial outlook for the year and we are encouraged by the longer-term prospects for growth at McCormick.

We believe that we are well positioned with leading positions in growing markets, a breadth of products from value priced to premium, flavors for all types of eating occasions, market-leading customers and an expanding geographic presence. We are increasingly focused on the alignment of our corporate social responsibility efforts with our business objectives and strategy recognizing that these efforts are tied to our business success.

In the latest Newsweek Green Ranking, McCormick was listed in the top 10 among the 500 US companies included in this assessment of corporate sustainability and environmental performance. We are proud of this recognition and are pursuing opportunities for further improvement.

Across the Company we are bringing focus, setting priorities and directing our resources based on McCormick's strategic imperatives with a focus on people, growth and performance. Together we believe that these imperatives will drive our success and lead to greater value for McCormick's shareholders. Gordon?

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**Gordon Stetz** - *McCormick & Company, Inc. - EVP and CFO*

Thanks, Alan, and good morning, everyone. As Alan has described our second-quarter financial results included solid sales growth in many parts of the business, greater-than-expected earnings per share driven by our growth strategies along with a favorable tax rate and share repurchase activity and excellent cash flow.



I'll begin with a closer look at sales and operating income for each segment. Let's start with the consumer business.

As seen on slide 12, we grew consumer business sales 4% in local currency. In the second quarter of 2014 sales from WAPC accounted for 6 percentage points of the increase and higher pricing contributed 3 percentage points. These were offset in part by a 5% decline in volume and product mix.

In local currency this compares to a 5% year-on-year sales increase in the second quarter of 2013 which had no impact from acquisitions. In the Americas region sales were down 4% from the year-ago period in local currency. A 2% increase in pricing following a late 2013 pricing action was offset by lower volumes and product mix.

In comparison, consumer sales in this region rose 5% year on year in the second quarter of 2013 from the second quarter of 2012, an increase mainly attributable to higher volume and product mix. As Alan described, competitive inroads have affected our US consumer business and we have actions underway to drive performance.

Along with early indications of improvement the category growth remains healthy for spices and seasonings and recipe mixes based on the latest consumption data. To a lesser extent we had some second-quarter impact from a later start to the grilling season and the timing of our trade promotion activity, which will be more skewed toward the second half.

In Europe, the Middle East and Africa, EMEA, we grew consumer sales 2% in local currency as a result of higher pricing. Volume and product mix declined this quarter due in part to the pricing actions and the difficult retail environment in markets like the UK.

In the preceding quarters we had better results from this region and have continued to invest in brand marketing and product innovation to drive sales of our brands. We expect to see improved performance with these initiatives and as consumers adjust to higher pricing.

In local currency consumer business sales in the Asia-Pacific region rose 76%. The addition of WAPC accounted for 70 percentage points of the growth. We grew sales of the base business 6% and China led this growth with a 23% sales increase mainly from new products and expanded distribution.

For the Kohinoor brand in India, sales rose slightly in local currency with significantly higher pricing offset by lower volume and product mix in the second quarter. Operating income was \$86 million for the consumer business, down 2% year on year. Higher brand marketing support and an unfavorable business mix reduced operating income this period offset in part by the favorable impact of higher sales and CCI cost savings.

We also had a favorable comparison in the year-ago period to \$4 million of transaction costs related to the acquisition of WAPC that were recorded in the second quarter of 2013. Turning to our industrial business, we grew second-quarter sales by 3% in local currency due to both pricing and higher volume and product mix as seen on slide 17. In the Americas region industrial sales declined 1% in local currency.

Demand from quick service restaurants remained weak in this market through the second quarter. We continue to work with our customers to draw restaurant traffic by developing flavors for new menu items.

For the second quarter branded Food Service sales rose and sales to food manufacturers were relatively even with the year-ago period. In EMEA, our industrial business achieved another quarter of strong sales growth with a 12% increase in local currency. This follows a similar growth rate in the first quarter of 2014 reflecting continued success with product innovation and distribution gains, largely with quick service restaurants as well as higher pricing and response to material cost increases.

In the second quarter of 2014 we grew industrial business sales in the Asia-Pacific region by 10% in local currency. This is also the same rate of growth we had in the first quarter of 2014.

Volume and product mix in China continues to improve as this market recovers from the sharp year-ago decline as Alan described. Operating income for the industrial business rose 26% to \$36 million resulting from higher sales, increased margins within the product portfolio and CCI cost savings.

While we had difficult results in the year-ago period and a bit of an easy comparison this year, we are pleased with our profit growth and the margin expansion driven by our growth strategy. For the total Company operating income rose 5% as a result of higher sales, improved industrial business product margins and our CCI cost savings. These same factors also improved gross profit margin by 60 basis points.

And during the quarter we funded additional brand marketing programs with more investment planned in the upcoming quarters. The tax rate this period was favorable at 28.5% compared to 29.6% in the year-ago period. The tax rate that we now expect for the fiscal year is approximately 29.5%.

This is below our initial estimate for 2014 of 30% to 31% and reflects our latest projection for a mix of business across tax jurisdictions for the fiscal year. Income from unconsolidated operations was up slightly with strong performance from our joint venture in Mexico.

We reported earnings per share of \$0.64. This was an 8% increase from \$0.59 in the year-ago period and driven by higher operating income, the lower tax rate and lower shares outstanding.

Let's turn next to some highlights for cash flow and the quarter-end balance sheet as summarized on slide 26. Cash flow from operations was \$182 million through the first half, up \$49 million from the first half of 2013. This improvement included a lower pension contribution in 2014.

During this period we used \$126 million of cash to repurchase 1 million shares and at quarter end we had \$234 million still available on our \$400 million authorization. Our balance sheet remains sound. We are close to our target debt level and well positioned to fund investments to drive growth including future acquisitions.

Turning to our 2014 outlook, we are reaffirming our projections for sales growth, operating income and earnings per share. At the top line we still expect to deliver 3% to 5% sales growth on a currency-neutral basis driven by increased volume, higher pricing and in the first half, the incremental impact of WAPC.

As we have indicated we have reached our first-year anniversary for this acquisition at the end of May. We continue to expect currency to reduce sales by approximately 1 percentage point in 2014 based on prevailing exchange rates. We reaffirm our outlook for growth of 6% to 8% in operating income when compared to \$591 million of adjusted operating income in 2013.

This projection includes the benefit of CCI cost savings that are expected to reach at least \$45 million for 2014 and an increase in brand marketing support of at least \$25 million. And we are reaffirming our earnings-per-share projection of \$3.22 to \$3.29.

With the reduction in our tax rate to approximately 29.5%, we have greater confidence in reaching the upper end of this range in 2014. Even at 29.5% the expected 2014 rate is still an increase from the 2013 rate of 26.75%.

On slide 28 we show the impact of this tax rate variance and \$0.01 in special charges on our EPS growth rate. Together these variances have an unfavorable impact of 4 percentage points on the 2014 projected EPS growth rate.

With our first-half results we are on our way toward another year of strong cash flow. As many of you know we adhere to a balanced use of cash and are committed to returning a significant portion to our shareholders in the form of dividends and share repurchases.

In 2014 we expect to use nearly \$200 million of cash for dividends and through share repurchases to reduce our shares outstanding by 1% to 2% this year. As I conclude my comments we are confident in our ability to deliver on our 2014 financial objectives and look forward to reporting on our progress in the upcoming quarters.



Now let's turn to your questions after which Alan will provide some closing remarks. Operator, we are ready for the first question.

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## QUESTIONS AND ANSWERS

### Operator

Thank you. (Operator Instructions). Ken Goldman, JPMorgan.

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### Ken Goldman - JPMorgan - Analyst

Hi, thanks for the question. Alan, your Nielsen numbers, they showed a decline but not to the degree you reported domestically. So I guess I am curious if you can help us understand that disparity a bit.

Gordon talked about a later grilling season, so I'm curious if it was a shipment timing issue or maybe a channel issue or a non-measured? You are maybe doing a little bit less impressively than measured, I'm just trying to understand that dynamic a bit better.

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### Alan Wilson - McCormick & Company, Inc. - Chairman, President and CEO

It's pretty hard to calibrate all the different sources of information. We use IRI and we have a custom database. So from our outlook -- I'll talk more generally without trying to get into specifics of the data as to what is happening.

From our view what we saw was less of a decline in share than we saw in the fourth quarter of last year. Partly we think that some of our efforts at retail are starting to have an impact. It's going to take some time and we expect that we will win.

But in terms of getting to the data specifics it's really hard for us to get. There was a later start to the grilling season. The weather was not favorable for grilling.

We are expecting a pretty good grilling season as we go through the summer. And we are planning to extend it through the third quarter and even through Labor Day and to tailgate season.

So we are pretty encouraged. Most of our new products are going to hit in the second half of the year. And we are pretty excited about those as well.

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### Ken Goldman - JPMorgan - Analyst

Thank you. And then if I can ask one more.

Gordon, we are seeing a good number of packaged food companies thinking about rationalizing production and overhead in the US. Even Mills, which has an ongoing cost savings program, just like yours, I think, is going this route.

So curious if you guys are considering going down this road? Or if you are comfortable with your cost structure I guess at the moment?

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### Gordon Stetz - McCormick & Company, Inc. - EVP and CFO

You always need to challenge yourself to be competitive. And that is a whole nature of the CCI environment. And the idea behind the program, as you know, Ken, when we developed it a few years ago was to keep looking at those opportunities on a go-forward basis and you can never stop.



I will calibrate it a bit, though, in that if you recall a few years ago in the North American businesses in particular we did some significant rationalization in particular on the consumer side where we did reduce a number of plants. And therefore our footprint is pretty consolidated here in the US in our consumer business.

In the industrial side our plants tend to be more specialized for customer service needs. And having said that we constantly look at our network and the best way to organize ourselves. So we still look for these opportunities all the time.

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**Alan Wilson** - *McCormick & Company, Inc. - Chairman, President and CEO*

And we have adjusted our SG&A and headcount for the volumes that we have seen both in manufacturing as well as in our headquarters.

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**Operator**

Alexia Howard, Sanford Bernstein.

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**Alexia Howard** - *Sanford C. Bernstein & Company, Inc. - Analyst*

Good morning, everyone. Can I just ask for a little bit more granularity on the share losses? Could you remind us is it concentrated in a particular region with a particular type of retailer, is it private label you are losing share to or value brands or premium brands and do you know which consumer segments you are losing share to?

Is it a Hispanic group, is it millennial consumers or older consumers? Just a little bit more detail on how you are seeing the development of those share changes. Thank you.

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**Alan Wilson** - *McCormick & Company, Inc. - Chairman, President and CEO*

It has changed a bit in the more recent periods. Private label is more flat. We have one larger branded competitor and that competitor is relatively flat.

And so what we are seeing is very small inroads from a number of small and regional competitors that are gaining one-tenth of a share point, or 0.2 of a share point. Their overall share base is still less than 1% or 2% I think as I looked at the most recent period. And of the 10 brands that gained share, no one other than McCormick by the way, our core A-Z actually gained a slight bit in the most recent period, but nobody had more than 2% share in all of that.

So what's happening is the consumer and the retailers are pretty fragmented. And some of that is on the value end, some of that is on the premium end. We compete across both of those segments.

And so we've got different tactics that we are using to compete with the super premium and in some cases even bag spices that are finding their way into measured markets. And then on the premium with what we are doing with our innovation.

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**Alexia Howard** - *Sanford C. Bernstein & Company, Inc. - Analyst*

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



**Operator**

Robert Moskow, Credit Suisse.

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**Robert Moskow - Credit Suisse - Analyst**

Hi, thank you. Gordon, I was trying to reconcile the guidance. With the operating income being up 6% to 8%, the tax rate down, share count down, we are getting a number that seems to go beyond the high end of your range for EPS at \$3.29.

I just want to make sure I am doing this right. So is the 6% to 8%, are we supposed to reduce that for currency or is that 6% to 8% absorbing the currency?

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**Gordon Stetz - McCormick & Company, Inc. - EVP and CFO**

It's getting pressure from currency. I would say that. But I don't want to be more specific than that.

Obviously currency is going to put some pressure on that number. The other thing on the operating income line as you heard Alan talk about is we are supporting our business in the back half of the year. We have spent year to date \$11 million in advertising promotion and we said at least \$25 million in the back half, so that's going to be a factor impacting those numbers as well.

And then just to help calibrate the tax rate, that tax rate, unfavorability as you know is very much weighted towards the back half of the year. So that is also something else needs to be factored in because that all starts to occur. I think our last year's rate for the second half was a little north of 25% and at 29.5% that is quite a drag on the EPS in the back half of the year.

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**Robert Moskow - Credit Suisse - Analyst**

Okay, Gordon, I get that but just to be more clear, your sales guidance is in constant currency. So I know what to do with that, and you have a 1% hit for 4x on the top line. Is it also a 1% hit on the operating income line, does it flow through and is the 6% to 8% ex-currency or not?

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**Gordon Stetz - McCormick & Company, Inc. - EVP and CFO**

The 6% to 8% is not ex-currency, that is all-in. So it would reflect whatever pressure that currency drops through the bottom line. And generally it is not a one-for-one relationship but there is certainly a negative hit on that 6% to 8% from currency.

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**Robert Moskow - Credit Suisse - Analyst**

All right, I got it now. So, last question.

In fourth quarter that is your biggest quarter especially in the US for seasonal reasons. Are your market share -- do you expect your market share to be down again in fourth quarter in the US, Alan, or are you going to have lapsed those market share losses by that time? And therefore we can expect kind of a normal growth pattern for fourth quarter?

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**Alan Wilson - McCormick & Company, Inc. - Chairman, President and CEO**

We expect to stabilize and start to grow our share. But certainly in the fourth quarter we think we will have lapped the impact in share from last year.

**Robert Moskow** - *Credit Suisse - Analyst*

Okay, so you would expect like a pretty good seasonal time period this year. Have you gotten initial sell-in already for how much inventory your customers are looking at for the seasons?

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**Alan Wilson** - *McCormick & Company, Inc. - Chairman, President and CEO*

Yes, we are selling in right now. The display programs are the easiest things for us to track.

The turn orders are little more difficult. But we are encouraged by what we are seeing with our holiday sale-in at this point.

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**Robert Moskow** - *Credit Suisse - Analyst*

Great. Thank you.

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**Operator**

David Driscoll, Citigroup.

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**David Driscoll** - *Citigroup - Analyst*

Great, thank you, and good morning. I want to go back to the question that Rob was asking a moment ago about the guidance. I'm going to try it a different way, though.

So if all of the numbers are unchanged except we have a nice lower tax rate, 100 basis points of tax if I go from the midpoint of what the prior range was to the new one, that's worth like \$0.05. So the other observation is that the segment results are coming in, especially this quarter, weaker than what we had modeled.

So is it fair to say that within this range of operating income of 6% to 8% that you now towards the lower end of this and then the tax comes in to give you the confidence to reiterate the range? Is that a correct way to look at these pieces of guidance?

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**Gordon Stetz** - *McCormick & Company, Inc. - EVP and CFO*

Certainly from the operating results from the quarter we had puts and takes. We had the strong growth in international markets and then we had obviously the US consumer results that you saw as we reported.

It is too early for us to be that specific. I think all we are saying at this stage is really that we acknowledge that the tax rate is more favorable so that gives us more confidence in the upper end of the range.

As we progress through the year I think our statements around that operating income range we can firm those us up as we see the traction in the US consumer business and how the programs are playing out as we progress through the year.

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**David Driscoll** - *Citigroup - Analyst*

All right. I guess I was hoping that you might give me confidence that you actually can hit the upper end of that operating income. Because of course the second-quarter numbers would maybe give most people the opposite impression given the decline in consumer which is obviously very concerning.

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**Gordon Stetz** - *McCormick & Company, Inc. - EVP and CFO*

Well we certainly are encouraged as you heard in Alan's comments by all the programs and activities that we have lined up for the back half of the year. So I don't want to convey that we don't believe we are able to certainly return to a growth mode in that business. But at the same time as you know the third and fourth quarters start to be the biggest parts of our year so we just have to see how it plays out for the rest of the year.

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**David Driscoll** - *Citigroup - Analyst*

Okay, last question just on the tax rate. This is a little specific so apologies for it but it is important.

The lower tax rate, is it a function of specific discrete benefits, or would you describe this as more of a mix issue? Because obviously when you have the US business underperforming it fundamentally has a mix effect on the tax rate. But I would like to understand the difference between the discrete benefits and the mix issue.

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**Gordon Stetz** - *McCormick & Company, Inc. - EVP and CFO*

Yes, there are some minor discrete benefits and the vast majority of the adjustment reflects the mix of the geographies across tax jurisdictions.

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**David Driscoll** - *Citigroup - Analyst*

Okay, thank you.

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**Operator**

Jonathan Feeney, Athlos Research.

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**Jonathan Feeney** - *Athlos Research - Analyst*

Good morning, thank you very much. A couple of questions.

First, on WAPC benefits, as you lap closing the transaction May 31, do you anticipate still getting distribution benefits? And as we go forward will that be reported -- it won't be reported separately, but is that going to lift the same-store results of the business? Is WAPC growing on a same-store basis right now?

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**Alan Wilson** - *McCormick & Company, Inc. - Chairman, President and CEO*

Yes, WAPC is growing at a same-store basis and we do expect that to continue. It's continuing to expand both geographically and in penetration.

And the other thing that we are working and starting to do is to develop some synergies between our core selling force in the coastal regions where they will sell more of the WAPC items and the WAPC sales force which will sell more of the McCormick items in the central regions. So we are encouraged by the growth rates there and pretty bullish on that business.

**Jonathan Feeney** - *Athlos Research - Analyst*

Thanks, Alan. And one other thing.

I wanted to follow-up on, you made a comment in your prepared remarks about being pleased with the ROI you are getting in the ad spending in media spending you're doing in, I think that was the US market you're referring to. Could you give us more clarity on how you measure that and if you are getting positive ROIs does that mean we will see more spending in the US market to sort of turn things around second half of the year?

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**Alan Wilson** - *McCormick & Company, Inc. - Chairman, President and CEO*

Yes, that's exactly what we have said as well. The way we measure that is with a classic marketing mix and we are looking at the impact on that marketing in the short term.

Where we are spending our money is about half in TV, half in digital and PR and so we are encouraged by what we are seeing. What you will see in the back half is additional support for our big programs like holiday, fall cooking and also some digital initiatives that will help to drive some of our new product sales.

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**Jonathan Feeney** - *Athlos Research - Analyst*

Great. Thank you very much.

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**Operator**

Andrew Lazar, Barclays.

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**Andrew Lazar** - *Barclays Capital - Analyst*

Good morning, everyone thanks for the question. Alan you talked about the market share losses in the core spice and seasoning business not being as significant as they were compared to the fourth quarter. How did they compare sequentially versus the first quarter?

Because I think as of the last conference call you had certainly sounded a relatively optimistic tone at least from an early days preliminary perspective on the reaction to some of the things you were trying to do in the marketplace. And in this call obviously you are suggesting making progress but of course still have a ways to go. So I'm trying to get a sense if anything has changed from the first quarter and if so what led to that.

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**Alan Wilson** - *McCormick & Company, Inc. - Chairman, President and CEO*

No, I wouldn't say that anything has changed from the first quarter. The share results are pretty similar.

I will say that if there's anything there is a little bit of optimism because we grew share in recipe mixes and have started to see some growth there. But I wouldn't say that there is a dramatic change from the first quarter.

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**Andrew Lazar** - *Barclays Capital - Analyst*

Okay. And then in terms of seasonal sell-in and such, I guess the last year or two, I may have it wrong, you have pushed forward or pulled forward the timeframe in which you will sell-in a lot of the seasonal displays. Because you have found that the sooner those get in-store the more folks are charged up around the seasons and end up coming back and such.



Is that a program that you are staying with around the timing and for those reasons? Or is there related change based on the last year or so?

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**Alan Wilson** - *McCormick & Company, Inc. - Chairman, President and CEO*

We still have the holiday program, which we have had for a think about eight or nine years now which is to get the specific displays into stores as early as possible. Obviously year on year we have a lot of fluctuation based on the timing that some specific large customers take their holiday shipments.

Sometimes they will be in the third quarter, sometimes they will be in the fourth. Last year because it was also combined with a price increase we had a fairly heavy buy-in on that and saw the impact in the third quarter and then the resulting hangover in the fourth.

But we are still offering that program. We don't think it will be as significant this year as it was last year when we were having a price increase.

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**Andrew Lazar** - *Barclays Capital - Analyst*

Got it, right in terms of the shift between --

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**Alan Wilson** - *McCormick & Company, Inc. - Chairman, President and CEO*

In terms of the shift between quarters. Yes, we expect it to be -- and this year actually does look like more of a normalized pattern. And we are seeing some of that with our shipments in the second quarter versus the third that are going to be closer into consumption.

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**Andrew Lazar** - *Barclays Capital - Analyst*

Thanks, and very last thing, this updated or ideal shelf set, gold standard shall set, are there certain -- what are the certain time frames in which your sales team is able to get this sold-in and more importantly that those shelves would get reset? Are there certain one or two time frames through the course of your fiscal year where you can really expect once they are sold-in for them to start actually happening in-store?

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**Alan Wilson** - *McCormick & Company, Inc. - Chairman, President and CEO*

Yes, most customers have their own timing so there's not a specific time across the country where that happens. Some customers reset -- generally most customers will want to reset prior to the fall specifically in our category.

But we are cutting in new items in January and we are cutting in new items in June. So it's hard to say that there is a specific time for that.

But where we are we are seeing progress in helping customers understand that this is a very profitable category for them, that our interests are really aligned and the more they sell premium branded products the higher the level of their profit. And that we bring consumers to the shelf and that is the thing that we are working with them on.

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**Andrew Lazar** - *Barclays Capital - Analyst*

Thanks very much.

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**Operator**

Eric Katzman, Deutsche Bank.



**Eric Katzman** - *Deutsche Bank - Analyst*

Hi, good morning. I have two questions.

First, top-line related to focus on EMEA for a second. It sounds like the industrial side of things continues to go well there. But it almost sounds like from your comments around the UK, which is such an important market for you, that things have gotten a little bit worse.

Is that accurate? And if so, what are the plans to try to improve the UK?

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**Alan Wilson** - *McCormick & Company, Inc. - Chairman, President and CEO*

The UK market is a specifically tough market and there's been a lot of press on the large customers there and some of their challenges. Specific to what we are doing in our business, it's very similar to what we are doing in the US with new products and with supporting our brands with advertising.

In the short term what we saw was a fair amount of competitive activity in the recipe mix category in the UK. We are responding pretty aggressively with that with our own promotional plans.

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**Eric Katzman** - *Deutsche Bank - Analyst*

All right. So then to kind of switch over, I think you have been calling for somewhat inflationary trends in your more esoteric input cost base for a bit, but can you update us on that? Is there any more concern?

It seems like there is just generally a little more inflation than everybody expected. And then related to that, you took the price increase last fall. I think in retrospect you said maybe it wasn't the right thing to do, or the right time.

And given all the competition even with input cost pressure, are you unlikely to take pricing on the consumer side going into 2015?

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**Alan Wilson** - *McCormick & Company, Inc. - Chairman, President and CEO*

Yes, we are not anticipating any near-term pricing, any new near-term pricing in our consumer business at this point. We may have some adjustments in our industrial business to reflect changes in commodity costs but we are not anticipating near term that we will be doing that.

There is some upward cost inflation specifically in commodities like pepper and vanilla and we are working with our CCI programs to help to try to offset those. Obviously if it gets excessive then we will readjust our thinking but certainly we are not anticipating anything before the end of 2014.

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**Eric Katzman** - *Deutsche Bank - Analyst*

Okay. Gordon, just remind me, what inflation level are you assuming for the year again?

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**Gordon Stetz** - *McCormick & Company, Inc. - EVP and CFO*

We said it was in the low single digits, 2% to 3%.

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**Eric Katzman** - *Deutsche Bank - Analyst*

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

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**Operator**

Akshay Jagdale, KeyBanc.

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**Akshay Jagdale** - *KeyBanc Capital Markets - Analyst*

Good morning. A couple of questions just on the end demand and what you see as it relates to your consumer business. Because I think you get some good readthroughs on what is happening with package food customers and then QSR.

So the first question is, in the US can you talk a little bit about the innovation pipeline for your packaged food customers as you see it? I think a little bit ago you had said you were pretty optimistic about that pipeline and it doesn't seem to have played through.

So perhaps you could just give us your perspective on what has happened there with a little bit of history as to why it hasn't played through, if I'm correct about that. And then the second question is on just the state of demand, or state of things in the QSR segment in China, if you can help us understand from your perspective where we are relative to all the issues that have taken place from a food security perspective. So, those are my two questions.

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**Alan Wilson** - *McCormick & Company, Inc. - Chairman, President and CEO*

Yes, sure. On US foods we are seeing a bit of a mix with our customer base. Our snack customers are continuing to do pretty well and continuing to innovate and we are seeing that reflected.

Our packaged food customers are struggling with core volume and part of the way that they are trying to overcome that is with new product innovation that we are working with them on. So what we have with packaged foods, or with our consumer food manufacturer customers so far, in the US at least, is relatively flat. Snacks up, core process foods kind of down a little bit.

And new product not quite offsetting those. We have a stronger innovation pipeline this year than we had at this time last year, so we continue to have a good outlook on that.

Obviously as customers adjust their thinking and focus more on promotional spending or on driving different core products they may change that but our innovation pipeline is stronger this year than last year in our US business. In China what we are seeing is a recovery in QSR driven I think a lot by our customers having an increased frequency of promotions and limited time offers to bring consumers back to the stores.

They have historically been pretty resilient and they are obviously up against some weaker comparisons from last year. But we are encouraged by what we are seeing with both new product activity in China as well as the increased foot traffic that they're getting to the stores and we are seeing a renewed confidence in new store openings there as well. So we are optimistic on the outlook there.

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**Akshay Jagdale** - *KeyBanc Capital Markets - Analyst*

And just one India, if I can. I know it's a smallish percentage of your overall business, but it's one of those rare things where you acquire a business and it doesn't go as well as you planned.



So can you just give us a sense of where we are in that process and if and when the distribution gains will again start to take effect? Because the way I understand what's going on is you bought the business, there has been some obviously commodity-related inflation that you are passing on and you don't have the -- or your distribution gains have paused for now and then you're also recalibrating your product mix, right?

The whole idea there is to do recipe mixes and other things such as that and the McCormick brand using this distribution. So just give us a longer term where are we in the journey with this acquisition and your expectations there.

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**Alan Wilson** - *McCormick & Company, Inc. - Chairman, President and CEO*

Yes, we think India is a longer-term play. We have made good progress in stabilizing our supply chain and in continuing to drive distribution.

Obviously the significant inflation we have seen in the price of basmati rice has impacted our volumes there. We are again taking the philosophy that we generally take in a market like this that we pay as we go.

So as the business earns its ability to invest then we will make the investments. And so we are focused now on driving profitability in the business. And we are also introducing the new products but more on driving the profitability of the business.

We still believe as India develops, in modern trade, as the infrastructure develops that it will be a very good market for us. It has taken a little more time than we anticipated as we went into it.

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**Akshay Jagdale** - *KeyBanc Capital Markets - Analyst*

Perfect. Thank you. I will pass it on.

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**Operator**

(Operator Instructions). Chuck Cerankosky, Northcoast Research.

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**Chuck Cerankosky** - *Northcoast Research - Analyst*

Good morning, everyone. And looking at your guidance you are talking about an incremental brand marketing spend of least \$25 million. Gordon, did I hear you say \$11 million of that increase was in the first half already?

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**Gordon Stetz** - *McCormick & Company, Inc. - EVP and CFO*

That's correct.

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**Chuck Cerankosky** - *Northcoast Research - Analyst*

Okay, now does that \$25 million include consumer promotion activity, or is it strictly more of what we would call advertising?

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**Gordon Stetz** - *McCormick & Company, Inc. - EVP and CFO*

The bulk of it is weighted more towards consumer-facing advertising. Any traditional promotional around price, etc. would be between gross and net. So that's primarily -- that's not primarily, that is consumer facing increases.

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**Chuck Cerankosky** - *Northcoast Research - Analyst*

So from promotion expenditures would be in addition to it?

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**Gordon Stetz** - *McCormick & Company, Inc. - EVP and CFO*

Yes. That would be in addition.

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**Chuck Cerankosky** - *Northcoast Research - Analyst*

And how do you expect that to track this year? The promotion?

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**Gordon Stetz** - *McCormick & Company, Inc. - EVP and CFO*

From a year-over-year basis not too differently but as you heard in my remarks and some of Alan's remarks, some of it is weighted a bit more towards the back half of the year.

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**Chuck Cerankosky** - *Northcoast Research - Analyst*

All right. Thank you.

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**Operator**

Ken Goldman, JP Morgan.

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**Ken Goldman** - *JPMorgan - Analyst*

Thanks for the follow-up. I don't think anyone had asked this yet, so forgive me if they had. But Alan, you talked a little bit about working with customers to get the price gap right between branded and private label.

I'm just curious whether this gap had grown to an unusually wide level and you're just sort of getting back to normal, or whether the gap that historically existed maybe didn't function as effectively as it used to? So curious if you are just going to narrow it to a range that is smaller than usual, or just sort of get back to normal? And maybe I'm not even reading that right at all I'm just curious how you think about that?

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**Alan Wilson** - *McCormick & Company, Inc. - Chairman, President and CEO*

That's actually a really good question. The gap itself hasn't changed that much. It does over periods where we tend to lead with pricing and private label takes a little bit longer to catch up and as do our competitors.

So we tend to see a three- to six-month gap and that. The impact that we are dealing with right now is more where some customers have chosen to take price threshold movement not necessarily a percentage gap but more price threshold.

So for instance they may have crossed from \$2.97 to \$3.09, which is a more significant impact for customers. So we are working to also get price points right so that we maximize the volume and the profit for the customers.



The percentage gaps haven't changed that much over the last seven years. They do from time to time but it's not anymore significant. In fact what we've seen in the most recent periods is a little more aggressive pricing on private label than we have seen on the brands, so by aggressive I mean the price gaps have narrowed a little more.

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**Ken Goldman** - *JPMorgan - Analyst*

Great, thanks very much.

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**Operator**

Thank you. I will now turn the call back to Alan Wilson for closing remarks.

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**Alan Wilson** - *McCormick & Company, Inc. - Chairman, President and CEO*

I want to thank everyone for your questions and for participating in today's call. As I wrap up, I would like to recognize Chuck Langley, President of our Global Industrial Business.

As previously announced Chuck's retiring at the end of June following a 38 year at McCormick. Under his leadership annual sales of our industrial business have exceeded \$1.5 billion and profits are up nearly 40% in the last five years. I want to thank Chuck for his service, his dedication and his contributions and I wish him all the best.

McCormick's 2014 fiscal year is on track to be a record year in sales and profits. Our strategic imperatives around people, growth and performance are driving sales, delivering CCI cost savings and generating higher profits and strong cash flow.

We bring the joy of flavor to every day at McCormick and we believe that we are well positioned for future success. Thank you.

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**Joyce Brooks** - *McCormick & Company, Inc. - VP of Investor Relations*

Thanks, Alan. I would also like to thank those on this morning's call. Through July 10 a replay of the call can be accessed by dialing 877-660-6853 and the conference ID number is 13581413.

You can also listen to a replay on our website later today and if you have any additional questions regarding today's information you can reach us at 410-771-7244. This concludes this morning's call.

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