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MKC - Q4 2015 McCormick & Company Inc Earnings Call

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OVERVIEW:

Co. reported FY15 YoverY constant-currency sales growth of 6% and adjusted EPS of $3.48. 4Q15 YoverY sales growth was 2% and adjusted EPS was $1.18. Expects FY16 constant-currency sales to grow 4-6% and adjusted EPS to be $3.65-3.72.

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PRESENTATION

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

Good morning. This is Joyce Brooks, Vice President of Investor Relations. Thank you for joining today's call for a discussion of McCormick's fourth-quarter and fiscal year 2015 financial results and our outlook for 2016. To accompany our call, we've posted a set of slides at IR. McCormick.com.

(Operator Instructions)

With me this morning are Alan Wilson, Chairman and CEO; Lawrence Kurzius, President and Chief Operating Officer; Gordon Stetz, Executive Vice President and CFO; and Mike Smith, Senior Vice President, Corporate Finance.

During our remarks we will refer to non-GAAP financial measures. These include adjusted operating income and adjusted earnings per share, that exclude the impact of special charges, as well as information in constant currency. Reconciliations to the GAAP results are included in this morning's press release and slides.

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 discussions over to Alan.

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

Thank you, Joyce. Good morning, everyone, and thanks for joining us. As many of you know, we announced back in early December that effective February 1, I'll be transitioning to the role of Executive Chairman, and Lawrence will be promoted to President and CEO. This is the next step in a well-planned succession that we, together with our Board, take a lot of pride in at McCormick.

I'm pleased to be transitioning from my role as CEO at this time. One of my conditions in stepping down was to have the Company in great shape, with strong financial performance and forward momentum. With our 2015 results and accomplishments, and a bullish outlook for 2016, I am very excited about our prospects. Our success is being driven by a clear strategy for growth, a great Board and leadership team, and more than 10,000 highly engaged McCormick employees. I want to recognize and thank our employees around the world for their dedication, efforts, and achievements.

On a personal note, I've enjoyed my many interactions with investors and analysts during my time as CEO, at conferences and one-on-one meetings, and other events. While the main focus of these discussions was your questions about McCormick, I've gotten just as much out of our time together, receiving feedback and gaining industry insights that help to shape our strategy and message. I want to let you know how much I've appreciated your support and perspective.

As I turn it over to Lawrence, I want to assure you that I'm confident in his knowledge, experience, and ability to lead McCormick into the next period of growth, as we continue to build shareholder value. Lawrence?

Lawrence Kurzius - *McCormick & Company, Inc. - President and COO*

Thank you, Alan, for those remarks, and for your confidence. On behalf of McCormick shareholders and employees, I want to recognize Alan for his outstanding leadership as CEO of this great Company. During your time as CEO, we have grown sales by $1 billion to $4.3 billion, completed 11 acquisitions, and expanded our geographic presence, taking our percentage of sales in emerging markets to 17% from 7%.

Since 2007 we have doubled our brand marketing expense, invested in R&D and consumer analytics, and created fuel for growth with nearly $450 million in cost savings led by your comprehensive continuous improvement program that you and Gordon established. Cash flow from operations is now nearly $600 million, up from $225 million in 2007. The stock price has more than doubled, and our quarterly dividend is now $0.43 per share, up from $0.20.

This is an enviable track record. Congratulations. And we look forward to our continued participation in Executive Chairman.

In other leadership news, effective January 1, Malcolm Swift was named President, Global Industrial Segment, and McCormick International, adding responsibility for China to his role. Brendan Foley assumed responsibility for the strategic leadership of our consumer business from me, and was named President Global Consumer Segment and North America. In these roles reporting to me, Brendan and Malcolm will set the strategic and operational goals for our consumer and industrial businesses respectively, as well as assess performance of the segment leaders in each geographic region against these goals. In addition, Brendan will have geographic responsibility for our North American markets, and Malcolm for our international markets.

Let's move next to fourth-quarter performance. Financial results for this quarter demonstrated that consumer demand for flavor is strong and on the rise, and that McCormick has the strategies and the team to drive growth.

We had great performance across both segments, and we're particularly pleased with the progress in our US consumer business. The actions we have underway in 2014 and 2015 have led to improved results, and we have good momentum heading into 2016.

For the total Company, we reported 2% sales growth. In constant currency, we grew sales 8%, with higher volume and product mix in our base business contributing half of this increase. We grew consumer segment sales 6% in constant currency, with about half of the increase from our base business, and half from our acquisitions of Drogheria & Alimentari, and Stubbs.

In the Americas, the constant currency sales increase was 3%, with Stubbs adding about a third of this growth. We were pleased with our results in this period, and the further improvement in our US business.

In this market, year-on-year category growth for spices and seasonings remained robust at 5% in the quarter. At 4%, retail take-away for the McCormick brand was close to the category increase. As seen on slide 7, we have achieved a sequential increase from 2% growth in the third quarter, and 1% in the second quarter.

We had a number of initiatives driving this performance. We launched our digital purity campaign this quarter with the message, pure tastes better, to emphasize to consumers the quality of our products, and we continue to help consumers prepare flavorful, healthy meals at www.McCormick.com, which is now one of the top 50 most visited food and lifestyle sites. Across all of our US websites, we attracted a record 32 million visitors in 2015, up 19% from 2014.

Within the spice and seasoning category is our premium gourmet line. Our 2015 relaunch of this line has been a real success. Since the roll-out of the packaging innovation and new varieties, retail sales are up 5%, and, armed with greater category analytics and insights, we had workshop discussions with our top customers on ways to optimize product assortment, pricing and promotion, for the spice and seasoning category.

For customers that have already taken action based on these discussions, we grew our category share 60 basis points on average during the fourth quarter. At some of these customers, category unit volume was up more than 5%. These are great results for our spice and seasoning business.

Our investment in brand equity building, strong innovation, and this customer interaction with more robust tools, is the way forward for us. As we move into 2016, this work transitions from being a turnaround effort to our everyday approach in building value for our customers, and for McCormick.

As for our next largest US category, recipe mixes, November 2015 capped off 26 consecutive months of share gains in this category. We are driving these gains with brand equity building and product innovation like gluten-free items, skillet sauces and slow cooker sauces. Through these efforts, our branded sales accounted for more than 100% of the category growth in both 2014 and 2015.

Our consumer business team in Europe, Middle East and Africa, EMEA, continues to post impressive results, led by new distribution in Poland. France also contributed to this increase, with higher advertising, including new product support. In 2015, we launched the distinctive line of origin specific Ducros brand black pepper that was just named new product of the year by the French Product Society.

In constant currency, we grew sales in China 5% in the fourth quarter, with some impact from distributors that held back on purchases in anticipation of Chinese New Year promotions in the first quarter of 2016. For the fiscal year, we grew China consumer sales 12% in constant currency. With nearly two months complete, our China consumer business is off to a strong start, and for the fiscal year, we expect to achieve constant currency sales growth in the high single digit to low double-digit range.

We see opportunities for further growth of our consumer business in China, especially with the cross-selling of McCormick brand and WAPC branded products. While we are certainly cautious given the current economic environment, keep in mind that our products are a staple in Chinese cooking, and McCormick has a good penetration in traditional markets and other channels with modern trade accounting for about 20% of consumer sales in this market.

Turning to the industrial segment, our sales growth was particularly strong in the fourth quarter from the year-ago period, up 11% in constant currency. This increase was broad-based, with double-digit growth at each of our three regions. While the addition of Brand Aromatics contributed to this increase, we had exceptional growth in our base business, with sales up 9%. Leading our industrial performance again this quarter, with constant currency sales up 14%, was our team in EMEA. In this region, the greatest growth is with quick service restaurants through product expansion, distribution gains, and their geographic expansion.

In the Americas region, a double-digit constant currency sales increase included 7%, added by our base business. In the US, our branded food service business had a good quarter, and sales to quick service restaurants showed some improvement from prior periods. It is nearly one year since we acquired Brand Aromatics, and we're pleased with the early results from this business.

Mexico also contributed to the increase in this region, with higher sales of snacks seasonings. In Australia, we grew sales of new industrial products that are shipped from this region, mainly to quick service restaurants in the region.

In China, we have seen a turnaround from the year-ago period for our industrial segment. We're also monitoring the macroeconomic impact on this part of our business, heading into 2016. In the fourth quarter of 2015, we had a strong finish to the year with constant currency sales up at a double-digit rate, including some wins for limited time menu items to our quick service restaurant customers. Across both segments, we expected strong fourth-quarter sales growth, and our teams around the world delivered.

Fourth-quarter profit results were generally in line with our outlook for the quarter. On a constant currency basis, we grew adjusted operating income 10%, and on a reported basis, operating income margin rose 70 basis points. The margin increase was led by the performance in our industrial segment, which reached adjusted operating income margin of 11% this quarter, up 350 basis points from the year-ago period.

We're making great progress from our work to shift the portfolio to more value-added products, largely through innovation, and from the addition of Brand Aromatics. Also driving margin improvement are our cost savings efforts, and the benefits of greater scale in our operations, with higher production volume.

Consumer segment adjusted operating income margin declined slightly from the fourth quarter of 2014. We increased brand marketing for this segment 11% this period, to build momentum heading into 2016. This rate of increase was well ahead of our 1% reported sales growth for the segment, and more than accounted for the lower margin, with a 90 basis point impact.

This segment also benefited from our progress with cost savings. As you saw in this morning's press release, and as we guided, adjusted earnings per share was up just slightly from the fourth quarter of 2014, due in part to unfavorable currency rates, and a benefit in the year-ago period from favorable discrete tax items. Overall, we're pleased with these fourth-quarter results and a strong finish to the year.

I'd like to comment next on fiscal year 2015 in total, starting with our top line increase of 6% in constant currency. In our consumer segment, we achieved a turnaround in our base sales in the US, and strong performance in international markets. Industrial sales ended the year up 7% in constant currency, and excluding acquisitions.

In addition, we completed three great bolt-on acquisitions that contributed about 1% to higher sales. China became our number-two market, with robust sales growth of 11% in constant currency. New products launched in the last three years comprised 8% of sales this year. As in past years, this contribution from new products supports our long-term sales growth algorithm, which has one-third of our top line growth coming from innovation.

Health and wellness continues to drive our innovation agenda. In addition to developing winning flavors for our industrial customers, globally, approximately 40% of new products released also had some type of wellness attribute.

In mid-2015, the USDA first recommended spices and herbs as a way to reduce sodium in the diet in recommendations to school nutritionists, and to adults over 65. In early January, this recommendation made its way into the new 2015-2020 dietary guidelines for Americans. This is consistent with the university research study sponsored by the McCormick Science Institute, and great news for McCormick.

We delivered record cost savings of $98 million in 2015, up 42% from 2014. While this provided an important offset to higher material costs, we also increased our investment in brand marketing, with a 6% increase.

Digital marketing is one of our highest-return investments in brand marketing, and in 2015, we continued our shift of marketing spend in this direction, reaching approximately 40% of our advertising spend, up from 10% in 2010. We have established a leadership position in digital and e-commerce, and this was recently recognized by Amazon, which named McCormick supplier of the year for grocery, and by L2, with a number-five ranking of McCormick brand in its Digital IQ Index, number five out of 114 US food brands.

While adjusted earnings per share of $3.48 was a 3% increase from $3.37 in 2014, we had an estimated 5% impact from unfavorable currency rates. We also overcame significant profit pressure this year from mid single digit material cost inflation, and higher retirement expense.

The profit performance for our industrial segment was particularly impressive. In constant currency, adjusted operating income was up 24%, due to 8% higher sales, cost savings, and a shift toward more value-added products, including our Brand Aromatics acquisition.

Adjusted operating income margin ended the year at 9.5%, up from 8.3% in 2014. Our joint ventures achieved great results, led by another year of strong performance from McCormick in Mexico. Sales in local currency for this business rose 11% in 2015. In total, income from unconsolidated operations rose 25%, and accounted for 9% of our net income this year.

Cash flow from operations was also a record, reaching $590 million, a significant increase from the prior high of $504 million in 2014, and driven mainly by working capital improvements. We had good balance in our uses of cash between investments in capital expenditures, acquisitions, share repurchases, and dividends. In November, McCormick's Board approved our 30th consecutive annual increase in the quarterly dividend.

Heading into 2016, we have strong momentum, effective growth initiatives, and a lot of excitement. I'll share our plans and outlook, and Gordon will go into -- more in depth in our financial guidance. We continue to see strong alignment between our business and today's consumers that are seeking bolder flavors, exploring ethnic cuisine, buying more fresh ingredients, focused on wellness, and looking for convenience.

Global category growth for our largest category, spices and seasonings, which accounts for about half of our consumer business sales, remained robust at 7% in 2015, and Euro Monitor projects annual sales growth of 5% globally through 2020. As the largest player in this category in our major markets, McCormick is on the leading edge of these trends with our flavor forecast, our product innovation, and our actions to renovate our core business, such as the 2016 rollout of non-GMO labeling for 70% of our US spices, seasonings, and extracts, and our transition to 80% organic products within our gourmet line.

We expect another year of 4% to 6% constant currency sales growth, with increases in our base business, incremental sales from new products, and a carryover benefit from acquisitions completed in 2015. Our base business will be driven by the category growth of our consumer segment, and increased demand for many of the products we flavor for our industrial customers, such as snacks and beverages. We continue to support the regional expansion of these customers, as well. As an example, a new facility in Dubai will open later this year, to establish a local source of supply in the Middle East.

For our consumer segment we're planning a further increase in brand marketing. Approximately $20 million in support of our business in EMEA, our purity message in the US, and globally our digital programs. Our brand marketing will also build awareness and trial of new products.

Early in 2016, we began the national US rollout of the Herb Grinders we discussed on our October call. We're getting great retail acceptance. Other product introductions in the first half of the year include new Grill Mate items including seasoning blends, marinade recipe mixes, and a new line of liquid 30-minute marinades.

Playing off of our flavor forecast, we're launching four new gourmet healthy blends, such as Citrus Chile Chia. In fact, in 2016, we have a total of 56 new products globally that tie in with the flavor forecast trends that we've identified. And in addition to new Zatarain's seasoned rice mix varieties, we're launching convenient portable rice cups.

In international markets, we're rolling out Thai chili sauce in our squeezable pouch in China, new recipe mix varieties across Europe, great new baking decorations for our Vahine brand in France, and in Canada, consumers will be seeing herb grinders and liquid La Grille brand sauces on retail shelves. We're equally encouraged by a solid pipeline of innovation for our industrial business, much of it in support of large multinational customers. We're also making inroads through new product wins, with some rapidly-expanding restaurant chains.

Going back to the factors affecting 2016 sales growth, I want to also comment on pricing. In 2015, pricing added about 1% to sales. Together with our cost savings, this helped offset a mid single digit increase in material costs.

In 2016, we project low single digit material cost inflation, and plan on pricing to be a primary offset at a 1% to 2% rate, with a rate varying by operating unit. For example, in our consumer business in Canada, we executed a high single digit percentage increase in October to recover both material cost increases and an unfavorable currency impact.

In the US consumer business, we recently announced a 2016 price increase. We leveraged our category management tools with a more data-driven approach to buy item increases. Across this business the average sales impact is a low single digit percentage increase, and we expect minimal volume impact.

Across all of our operations around the world, we believe we have the right actions underway in 2016, innovation, brand building, pricing, with the right tools, and the right team to drive sales growth. Employees throughout McCormick are also working to improve productivity, our fuel for growth. We have targeted another year of significant cost savings in 2016, with a goal to achieve at least $95 million. Work is well underway to deliver this amount, which we expect to lead to higher gross profit margin and higher operating income margin for the year.

However, we operate in what is a still challenging environment for many of our customers. Food retailers in our consumer business and for our industrial business, packaged food and beverage companies, as well as restaurants. Also, we expect some further profit pressure from currency, and as I indicated, material cost inflation.

Excluding the unfavorable impact of currency, at the bottom line, we project a 9% to 11% increase in adjusted earnings per share from $3.48 in 2015. Gordon will provide more details on our outlook. Before I turn it over to him, let me summarize.

Our 2015 results, including the improvements in our US consumer business demonstrates the alignment of our business with today's consumer, and the effectiveness of our strategies. We are excited about our plans and potential for even greater growth in 2016, with new products, incremental marketing, distribution expansion opportunities, and tools for a better retail partnership.

Our acquisition pipeline is strong and we have aggressive cost savings programs underway, and a culture of participation and high performance. McCormick's focus on growth, performance and people is driving success.

It's now my pleasure to turn it over to Gordon. Gordon?

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

Thanks, Lawrence, and good morning everyone. I want to take a moment with McCormick's analysts and investors on the call to also recognize Alan for his strong leadership, his friendship, and his accomplishments as CEO. It's been an honor and a privilege to be CFO during his tenure, and to partner with Alan and the entire executive team, steering our strategy and organization, and delivering high performance. Lawrence, I'm looking forward to working with you when you step into this role on February 1, and that's this Monday, in case you needed a reminder.

Lawrence shared some initial remarks on our fourth-quarter results, and we provided some financial details in this morning's press release and our accompanying slides. Given this background, I'll move through my remarks on the quarter quickly, make a few additional points, and then finish with the details of our 2016 outlook.

On a constant currency basis, the underlying growth in sales was a step up from what we have seen year to date, with an 8% increase that included 3% added by acquisitions. We had a full impact this quarter from Brand Aromatics and Drogheria & Alimentari, and from Stubbs, which was completed toward the end of the quarter.

Slide 16 shows that the base business growth for both the consumer and industrial segments was driven mainly by volume, the result of our product innovation, increased brand marketing, expanded distribution and regional presence, and other business-building work with our customers.

In the consumer segment, we had 3% constant currency sales growth in the Americas, with about a third of the increase from Stubbs. Base business sales growth in this region was led by higher US sales of spices and seasonings, including Grill Mates and our Lawry's brand, as well as gourmet items and Hispanic products. We had good retail sell-through, as Lawrence described, and are encouraged with the trajectory of sales as we head into 2016.

In EMEA, we continued to achieve strong sales performance, up 18% in constant currency. This increase was driven by D&A, which added 11% to sales growth, expanded distribution in Poland, and our performance in France, with new products and brand marketing. In constant currency, we grew consumer segment sales in China 5% as Lawrence described, and Australia had a high single digit sales increase from new distribution and new products in that market.

We indicated last quarter that we were exiting some lower margin product lines in our Kohinoor portfolio in India. In total, the constant currency sales decline in Kohinoor sales lowered our consumer business growth rate in the Asia-Pacific region by 3 percentage points, more than accounting for the volume decline shown on slide 19.

For the consumer segment in total, our fourth-quarter adjusted operating income was down 2% from the year-ago period. In constant currency, adjusted operating income rose 1% from the year-ago period with the impact of sales growth and cost savings more than offsetting the unfavorable impact of material costs and benefit expense.

Turning to our industrial segment, we had excellent results this quarter in both sales and profit, even with unfavorable currency rates. And as Lawrence indicated, this business reached an 11% adjusted operating income margin as the result of our CCI program, scale from higher sales, and shift to more value-added products, including the addition of Brand Aromatics.

On slide 22, sales of Brand Aromatics contributed 4% to our growth in the Americas. Higher base business volume and product mix this quarter, versus the year-ago period, was led by US sales of branded food service products, as well as customized flavor solutions. Mexico also contributed to the increase, with sales of seasonings largely for snack products.

Our industrial business in EMEA capped off an impressive year, with constant currency sales of 14% in the fourth quarter. We are a trusted and valued supplier, supporting the growth and geographic expansion of leading quick service restaurants and food manufacturers in this region.

We grew industrial segment sales in the Asia-Pacific region 11% in constant currency. In China, we are benefiting from further recovery in demand from quick service restaurants, and in Australia, our growth includes new product wins with these customers.

Adjusted operating income for the industrial segment rose 52% from the fourth quarter of 2014. In constant currency, the growth was even greater at 62%, with the factors I already mentioned, as spelled out on slide 25. Across both segments, adjusted operating income, which excludes special charges, rose 6%. If we also exclude the impact of unfavorable currency, we grew adjusted operating income by 10%.

In a turnaround from the three previous quarters, gross profit margin was up year on year in the fourth quarter, with a 30 basis point increase. As we moved into the fourth quarter, we had the full benefit of our cost savings and pricing actions, along with the benefit of higher sales, and higher throughput in our plants. These factors were offset in part by the significant sales increase this period by our industrial segment, which has a lower gross profit margin than our consumer segment.

As a percentage of net sales, our selling, general and administrative expense was down 40 basis points as a result of our cost savings activity, and leverage with higher sales. This includes a 13% fourth-quarter increase in brand marketing from the year-ago period.

Below the operating income line, the tax rate this quarter was 29.9%, a bit above our 29% guidance, and a significant increase from 25.9% in the fourth quarter of 2014, when we had the benefit of discrete tax items. For the 2015 fiscal year, our tax rate was impacted by several favorable discrete items, and ended the year at 26.5%. As we head into 2016, we anticipate a tax rate of approximately 28%.

Despite an unfavorable currency impact for our joint venture in Mexico, income from unconsolidated operations rose slightly this quarter. However, underlying growth remained quite strong with sales for McCormick in Mexico up 10% in local currency.

At the bottom line, fourth-quarter 2015 adjusted earnings per share was $1.18, up $0.02 from the year-ago period, mainly due to higher adjusted operating income, partly offset by the higher tax rate. This result included an unfavorable impact from currency on both consolidated and unconsolidated income.

Turning next to slide 30, we've summarized highlights for cash flow and the quarter-end balance sheet. As Lawrence shared, our year-to-date cash flow from operations was a record $590 million, compared to $504 million in the year-ago period, mainly due to working capital improvements.

In 2015, we returned $351 million of cash to shareholders through dividends and share repurchases. While dividend payments were up 6%, share repurchases were down from 2014, because of our acquisition activity.

Our share repurchases in 2015 contributed to a 1.4% reduction in diluted shares, and we have $567 million remaining on our current $600 million authorization. During the fourth quarter, we completed a previous $400 million share repurchase program, authorized in April of 2013. In the absence of any acquisitions in 2016, we expect to lower our share count by approximately 2%.

During the quarter, we were pleased to complete the issuance of $250 million of 10-year notes at a 3.25% rate, in anticipation of long-term debt that was maturing. At year end, our debt to adjusted EBITDA was slightly above our target range of 1.5 to 1.8, following the financing of our three acquisitions completed in 2015.

Our balance sheet remains sound. We are generating strong cash flow, and we are well-positioned to fund future investments to drive growth.

Building on Lawrence's remarks, I'll wrap up with our outlook for continued momentum in sales and profit growth in fiscal year 2016. We anticipate increases in sales, adjusted operating income, and adjusted earnings per share that are at or above our long-term objectives, excluding the impact of currency exchange rates. Our current projections are based on prevailing rates, and given the level of currency volatility in the market, we will be updating this outlook for you each quarter.

We expect to grow sales 4% to 6% in constant currency. This includes a carryover benefit of 1% to 2% from acquisitions completed in 2015, and higher pricing at 1% to 2%. Based on prevailing rates, we estimate an unfavorable impact from currency of about 4 percentage points, which will lower this range to 0% to 2% on a reported basis.

Excluding the impact of currency, our projected increase in adjusted operating income is 9% to 11%, from adjusted operating income of $614 million in 2015. Currency is expected to lower this range by about 4 percentage points, to 5% to 7%. We expect to drive this increase from higher sales, and at least $95 million in cost savings, savings that include our CCI program, and some carryover benefit from previously announced organization and streamlining actions.

Our guidance also includes plans for an increase in brand marketing of at least $20 million, and our projection for low single digit material cost inflation that we should more than offset with our pricing actions and cost reductions. Our guidance for adjusted earnings per share is $3.65 to $3.72. Excluding the estimated 4 percentage point impact of unfavorable currency rates, this is an increase of 9% to 11% from adjusted earnings per share of $3.48 in 2015. This growth rate is in line with our long-term objective.

Some of the other puts and takes behind this projected growth rate are the favorable impacts of higher operating income, and further reduction of shares outstanding, in the absence of acquisition activity. Expected offsets include the unfavorable currency impact as well as a higher tax rate. Due to the unfavorable impact of currency rates and material cost inflation for our joint venture in Mexico, our 2016 income from unconsolidated operations is likely to be down slightly from 2015.

For the first quarter of 2016, there are several factors that will have an unfavorable impact on our earnings per share. First, we anticipate an impact from currency in the first quarter that could be above the annual estimate, since we will not have yet lapped the larger increases in 2015. Second, we have plans to kick off 2016 with enough spend in brand marketing to support our core business, as well as new product launches.

In addition, we expect a higher year-on-year tax rate. Recall that in the first quarter of 2015, the tax rate was 24.8% as the result of discrete tax items. As a result, EPS in the first quarter of 2016 is expected to be down slightly from $0.70 of adjusted EPS in the first quarter of 2015.

For the fiscal year 2016, we expect another year of strong cash flow. This will provide funding for share repurchases, and the quarterly dividend increase from $0.40 to $0.43 approved by the Board in November.

We also have plans for an increased level of capital expenditures in 2016, of $150 million to $160 million. This is up slightly from our normal run rate of 3% of sales, and includes a larger manufacturing plant in Shanghai, where we have outgrown our current facility. That completes my remarks on our 2016 outlook, so let's open the line for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Our first question is from the line of Alexia Howard with Bernstein. Please proceed with your question.

Alexia Howard - *Bernstein - Analyst*

Can I ask on the US consumer business, it sounds as though it's on a better trajectory, in terms of market share. Does that mean that those smaller brands that have been plaguing you for the last 18 months or so are now, I guess, stabilizing or actually going back? I just want to hear about how things are going on a category management front. Thank you.

Lawrence Kurzius - *McCormick & Company, Inc. - President and COO*

Thank you, Alexia. We think we are making great progress with the improvement actions that we started in the early part of 2014 to build brand equity, accelerate innovation, and to win at retail. We really think that we've gotten a good handle on this. We have worked with our leading customers, with our new tools on both category management, assortment management, and pricing management.

And we think that we've made a great deal of progress, and really have some positive momentum building in this part of our business. In many of the subcomponents of the category, we're clearly gaining share, and with many of the individual customers we're gaining share as well. So we think we turned the corner on the problem, and are in a position to build from a base of strength that's been established by some of the heavy lifting done over the last two years.

Alexia Howard - *Bernstein - Analyst*

Great. As a quick follow-up, it looked as though you had very good net price realization on your US consumer business this time. I'm assuming that was a positive mix shift, with less pressure from the Walmart Fifth Season brand this time around, and yet the profits were only up modestly, and gross margin didn't move too much. Were there other offsets in there, that put pressure on the performance this time around? Thank you, and I'll pass it on.

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

There was no pricing again in the US business that we took this year, so part of it was mix, part of it was some of the noise in the data associated with some of the actions we took with the size of our -- the weighting of some of our products. But generally, we're in a position, as Lawrence said, to be able to execute pricing in that business, as we mentioned in our conference call.

We had some acquisition-related costs in the US consumer side of things, as related to Stubbs. Some of the profit realization was impacted by that, and in total, the gross margin improved.

We are continuing to spend up against our brand. You saw the increase in brand marketing of $9 million in the quarter. That's pretty substantial. So we think that's important, as well to build the business for the future. So that also was impactful on the quarter in terms of profit realization.

Alexia Howard - *Bernstein - Analyst*

Great. Thank you very much and congratulations on the CEO transition. Looking forward to working with you, and great working with you in the past, Alan.

Operator

Our next question is from the line of Robert Moskow with Credit Suisse. Please go ahead with your question.

Robert Moskow - *Credit Suisse - Analyst*

It was really good to see the progress in North America. But you did say that you're going to initiate some pricing for 2016. I think you said very low single digit across. Can you give us a little more color on what parts of the business you're going to implement that pricing on?

And also, talk about -- a lot of grocers I think are worried more about deflation and investors are worried about it too. You seem to still have inflation in your system. How will these pricing actions be in relation to competition?

And then also private label, do you expect your competition in private label to also increase by the same amount? Are they experiencing the same kind of inflation on packaging and materials that you're experiencing? Thanks.

Lawrence Kurzius - *McCormick & Company, Inc. - President and COO*

Sure, Rob. First of all, we have not taken any pricing action in the US for the last two years, while we addressed some of the fundamental challenges in that part of our business. But as we have worked with the price elasticity tools, and have been able to model the category more robustly, we've identified many areas where there are opportunities for us to adjust our pricing.

The price increase that we planned in our US business has really been worked through at quite a granular level on an item-by-item basis. Some items are moving down as well as some items moving up. But the net increase will be in the 1% to 2% range. This has already been taken to our customers, so this is out in the field right now, and we've gotten really no meaningful pushback on it at all.

Our basket of commodities is different than the basket of commodities than most of our peer companies, and there's good cost justification for the increase that we're taking. It's really not around packaging. Packaging's actually a bit of a deflationary mode. It's more around some of our more iconic raw materials.

We believe that the cost pressures around those iconic raw materials, if anything, we're better positioned than our direct competitors on those items, due to our global sourcing capabilities. Our competitors will be feeling that same pressure, as well.

Robert Moskow - *Credit Suisse - Analyst*

That's helpful.

Mike Smith - *McCormick & Company, Inc. - SVP - Corporate Finance*

Rob, this is Mike Smith. We have seen our competitors take pricing already in some cases, and we do think private label will move, also.

Robert Moskow - *Credit Suisse - Analyst*

Very helpful. Thank you.

Operator

Thank you. Our next question is from the line of Akshay Jagdale with Jefferies. Please go ahead with your question.

Akshay Jagdale - *Jefferies LLC - Analyst*

Congratulations again, Alan, on the career and, Lawrence, congrats on your appointment. Looking forward to it. So first question, just a follow-up on commodities. Can you specifically talk a little bit about pepper, and what your expectation is, that's embedded in your overall commodity outlook, as far as pepper goes?

Mike Smith - *McCormick & Company, Inc. - SVP - Corporate Finance*

Akshay, it's Mike Smith again. As you know, the price of pepper has risen over the past five years from about $1 a pound to $5 a pound spot. But we've seen a lot more plantings the last couple years, and we see a stabilization in the price of pepper, as we continue to work with farmers globally to increase acreage, increase yield. Those assumptions are built into our low single digit commodity price increase this year. So we think we've seen the peak. Hopefully longer term, it's a downward trend.

Akshay Jagdale - *Jefferies LLC - Analyst*

Perfect. And then just on North America, you mentioned share gains in the customer accounts, where they've implemented most of the changes you've suggested. What percentage of your sales do those customers account for, roughly? And can you just help us understand the dialogue -- the pushback, perhaps, that you're getting there, and maybe what your argument is, when you do get that pushback?

One of the arguments that we've heard is just generally there's more fragmentation of share across many categories, and that's perhaps driven by consumers wanting more choice and more smaller authentic brands. But would love to know what your category management analysis is telling you, and then if you could give us some sense of the customers that you are seeing success, how much of their portfolio, of your portfolio that represents? That would be great. Thank you.

Lawrence Kurzius - *McCormick & Company, Inc. - President and COO*

Sure, Akshay. I don't want to speak too specifically about any one customer. I will say that the basket of customers that we have approached now is roughly 50% of our -- account for roughly 50% of our volume. And the set of recommendations that we make to those customers are quite extensive.

As a group, some of -- there's quite a span of adoption. So some of those customers have literally taken on our full recommendation, whereas others have cherry-picked it a bit, depending on their strategy. This is going to be an ongoing process, working with these customers to get the recommendations that we think are best for the category, which generally are also the best recommendation for us and the customer, as well, accepted.

And we continue to work with additional customers. This started as an extraordinary effort. It's really become our main way of working in sales. It's just a more fact-based, analytics-based approach to the customer, that the more sophisticated customers in particular appreciate, and they tend to be the larger and faster-growing customers as well. You want to add anything to that?

Akshay Jagdale - *Jefferies LLC - Analyst*

I'll pass it on. Thank you.

Operator

Our next question comes from the line of Chris Growe with Stifel. Please go ahead with your questions.

Chris Growe - *Stifel Nicolaus - Analyst*

I'd like to add my well wishes to you, Alan, and look forward as well Lawrence, to working with you. I just had two quick questions. If you look at the quarter, I'm sorry, for the year, what emerging market growth did you have? If you could give that maybe on an underlying basis. And I was just curious how India and China, maybe this is more of a fourth-quarter question really, influenced that growth rate?

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

On a go-forward basis, we're still robust on China. We know there's a lot of discussion around China. We're obviously very aware of the economic discussion going on there. But our own business, we're anticipating that continues to do well.

India, as you know, we've taken actions to focus more on the branded component of that business. So as we look forward into 2016, we expect India actually to be a drag, as we lap the anniversary of our exit of the broken and bulk rice.

You'll see noise in the Asia-Pacific numbers as we progress through the year, where we'll try and help you understand what's going on in the mix of that business. But again, we anticipate China being a good performer, and India as we have rebased that business, that will be a negative on the sales line.

Lawrence Kurzius - *McCormick & Company, Inc. - President and COO*

Chris, I want to just expand on China just a bit, because it has grown to be such a large contributor to our total business. We're aware of the macroeconomic pressure around the China market, which does make us cautious, but we're also quite optimistic about our business in China. A great deal of the carnage that's happened around us has been more in the modern trade portion of the business. That part of our business is slow, as well, but it only accounts for about 20% of our consumer business in China.

Much more of our business in particular, thanks to the acquisition that we did a couple of years ago, is more directed to the interior, to the smaller cities, and through more traditional trade outlets. So we have continued to experience quite robust growth of our consumer business in China.

For the year, we were up, I think 11% in China in 2015. It was a little bit slower in the fourth quarter, but some of that was some anticipation of the Chinese New Year promotions that were coming beginning in December, which for us is fiscal 2016. I don't want to comment too much on 2016, but our -- the opening of our year in China on the consumer side of our business has been really quite strong.

And I focused my remarks on the consumer side, because for us, China has really become predominantly a consumer business. Years ago, China was more of an industrial business for us, and that's how we got our foothold there. But with the continued growth of our consumer business, and with the addition of the acquisition we did a couple of years ago, that business has now more than started, it's about two-thirds consumer.

Chris Growe - *Stifel Nicolaus - Analyst*

Okay. That's very helpful. Maybe along the same lines --

Lawrence Kurzius - *McCormick & Company, Inc. - President and COO*

I was just there with the China team last week and met with the management over there. Actually Alan and I went over as part of our internal transition communication, and so it gave us an opportunity to meet firsthand with the China team. They continue to be quite optimistic.

Chris Growe - *Stifel Nicolaus - Analyst*

That's great. Thank you for that color. Just a quick follow-up on the acquisition outlook.

Just get a sense of like the pipeline, and really where you're focused today. Are you seeing any opportunities, given some of the macroeconomic uncertainties in emerging markets? Just curious how the pipeline looks here today.

Lawrence Kurzius - *McCormick & Company, Inc. - President and COO*

I'll say we always have an active pipeline of acquisition projects, and we're always in dialogue with some potential targets. And that is the case today, but I really can't say too much more than that.

Chris Growe - *Stifel Nicolaus - Analyst*

Okay. Thank you.

Operator

Our next question is from the line of Brett Hundley with BB&T. Please go ahead with your questions.

Brett Hundley - *BB&T Capital Markets - Analyst*

Good morning, gentlemen. And Alan and Lawrence, congratulations to you both. I don't know what they're doing with all that mayonnaise in Mexico, but it's good to see. Gordon, I have a few questions for you around your cost savings program for 2016, your outlook there.

So I'm curious on how the achievement of your cost savings in 2016 fits into your guidance range. Should we just think about that as in the middle of the guidance range?

And then, as far as thinking about the net benefit to earnings, should I be thinking about something like a net $75 million benefit to earnings, just from taking the $20 million add in spend that you might have on the marketing side, and then you're going to have pricing mostly covering input cost inflation? Is that the right way to think about it?

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

In terms of the program itself and the realization, I would say -- I'd put it this way. In 2016, our anticipation of the use of those benefits is more in line with how we had hoped the program would run, which means we'd have a portion of it read through into reinvestment in the brands, which we indicated we're doing through the up-spend of $20 million plus. It will also blunt partially some of the pricing, and obviously, we have other costs in our system as well, as it relates to salary increases, et cetera, that are built into our forecast.

So I'd just say the combination of all those things end up feeding into the total outlook that we have. I'd prefer not to parse how much of it's going to go to the bottom line, how much is used, but the net-net is obviously an improvement in margin structure that we had hoped that this program would generate, both on the gross and operating income line.

Brett Hundley - *BB&T Capital Markets - Analyst*

And should we still think about a bigger piece of that pie coming from the gross margin line, or would you see more cost benefits in the future coming from the SG&A line?

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

We're still more heavily weighted towards the cost of goods sold as a generator of these savings. But obviously, we continue to look at SG&A and we took actions last year, and we're looking to leverage our SG&A structure as we grow.

Brett Hundley - *BB&T Capital Markets - Analyst*

Okay. And then just a final question from me on the industrial business. Really solid growth during the quarter, a really solid margin. And I wanted to ask a question surrounding either driving margins higher, or sustaining some of the margins that you saw in Q4, just given the growth profile and potential of the top line there. If you can somewhat close the gap on your margins, relative to your consumer business, I think it can really be a positive for you going forward.

And I'm curious on how that margin sustainability, or even growth from here works, whether it's something that's solely related to mix, or if there's some production optimization in there, as well. And I think what I'm really trying to get at here is, when you think about the ingredients industry and the move by a lot of food and beverage companies towards natural, I think it can really help you from a volume standpoint as more and more people use spices and herbs, whether it's for coloring, flavoring, et cetera. But if you could move up the value chain, say from maybe a bulk spice and herb towards an extract or something like that, maybe you can benefit on the price side, and the margin side as well. So I wanted to ask a question about how the growth or sustainability in margin improvement within industrial goes, going forward. Thank you.

Lawrence Kurzius - *McCormick & Company, Inc. - President and COO*

Brett, this is Lawrence. I'll start, and then I'm going to pass this over to Gordon. Some parts of your question, it sounded like you were reading out of some of our internal strategy documents. Certainly, improving the product mix and moving towards flavors and more value-added technically differentiated product is part of the margin equation, and the overall trend in our industry towards more natural, less artificial is an important driver of volume for us, because this is an area where we think that we've got particular expertise.

I think in our remarks, we indicated that about 40% of the briefs that we get from our customers includes some wellness aspect, and this is an area that is an opportunity for us to leverage, and is part of driving our margins higher. There are parts of our business that are higher margin than others, and the flavor end and the more technically differentiated end is definitely where the best opportunities are. Gordon, do you want to elaborate on that?

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

I would just add that obviously the CCI program for the industrial business is designed both to improve margin and to help us reinvest in R&D, to help us drive the mix shift toward a higher margin. So that's part of the equation as well.

Brett Hundley - *BB&T Capital Markets - Analyst*

I'm sorry, but Lawrence, is 11% a high watermark in your opinion?

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

We haven't -- this is Gordon jumping in. We haven't put a boundary on it, candidly. For those of you who have followed us for quite some time, 8% to 10% has been the goal. As we went through periods of high inflation, that gets interrupted, because we have pass-through mechanisms that interrupt that margin improvement, or at least mask the optics of it.

But we're obviously close to that 10%, where we landed here, so it's not as if we put a ceiling on this. It's something that we continue to evaluate, and we'll look forward to improving that even still. But there hasn't been a specific target or ceiling that we put out on that business.

Brett Hundley - *BB&T Capital Markets - Analyst*

Okay. I'll yield the floor.

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

I think with another call coming up at 8:30 we probably ought to end our Q&A there. Lawrence, I know you had some remarks to share. I'll turn it over to you.

Lawrence Kurzius - *McCormick & Company, Inc. - President and COO*

Great. First, I'd like to thank you all for your questions, and to everyone who was on the call today, both the questioners and the listeners, thank you for participating in today's call. Consumer demand for flavor is on the rise. It's driving growth for McCormick. Our geographic presence and product portfolio are expanding and aligned with the move toward healthier eating, fresh ingredients, ethnic cuisine, and bold taste.

This is evident in our 2015 results, and along with our strategies gives us confidence in our 2016 outlook, as we grow our business and build value for our shareholders. I hope all of you who are in the snow impacted areas this weekend cooked a lot of McCormick chili, and a lot of Zatarain's gumbo. Thank you all for your participation on the call.

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

Thanks, Lawrence, and to everyone on the call, if anyone has additional questions regarding today's information, please give us a call at 410-771-7244. This concludes this morning's call.