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MKC - Q1 2017 McCormick & Company Inc Earnings Call

EVENT DATE/TIME: MARCH 28, 2017 / 12:00PM GMT

OVERVIEW:

MKC reported 1Q17 adjusted EPS of $0.76. Expects FY17 constant currency sales to grow 5-7% and adjusted EPS to be $4.05-4.13.

CORPORATE PARTICIPANTS

Kasey Jenkins

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PRESENTATION

Kasey Jenkins

Good morning. This is Kasey Jenkins, Vice President of Investor Relations. Thank you for joining today's call for a discussion of McCormick's first quarter financial results and our current outlook for 2017. To accompany our call, we've posted a set of slides at ir.mccormick.com.

We will begin with remarks from Lawrence Kurzius, Chairman, President and CEO; and Mike Smith, Executive Vice President and CFO, and then open the line for questions. (Operator Instructions) We also have Joyce Brooks of McCormick Investor Relations on the call.

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. Reconciliation 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 discussion over to Lawrence.

Lawrence E. Kurzius - *McCormick & Company, Incorporated - Chairman, CEO and President*

Thank you, Kasey. Good morning, everyone. Thank you for joining us. McCormick's first quarter results were a solid start to the year, delivering operating income and earnings per share growth, margin improvement and higher sales. We executed against strategies which will drive strong results as we go through the year.

Starting with our top line for the first quarter. We grew sales 4% in constant currency from the year-ago period. Sales from our acquisitions of Gourmet Garden, Cajun Injector and Giotti added 3 percentage points of the increase. The remaining 1% constant currency sales growth was led by our industrial business this period, which delivered solid sales growth from our foodservice brands and customized flavors in the Americas and quick service restaurants in the Asia/Pacific region. Consumer segment sales, excluding acquisitions, were comparable to the year-ago period. We had strong sales momentum in China, offset by the impact of weak U.S. food industry trends during the period and a challenging retail environment in the U.K.

We increased our gross profit margin 30 basis points year-on-year. This improvement was the result of cost savings from our Comprehensive Continuous Improvement program, CCI, and shifts in our portfolio to more value-added products. We grew first quarter adjusted operating income 8% from the year-ago period on a constant currency basis, led by the higher sales, increased gross profit margin and reduction in our selling, general and administrative expenses, despite increased brand marketing. Both segments achieved an increase in operating income and higher operating income margins. At the bottom line, adjusted earnings per share of $0.76 was an increase of 3% from the $0.74 in the first quarter of 2016. This includes the unfavorable impact of currency.

For fiscal 2017, we reaffirm our plans to deliver constant currency growth of 5% to 7% for sales, 9% to 11% for adjusted operating income and 9% to 11% for adjusted earnings per share. Each of these growth rates is at or above our long-term constant currency objectives.

I'd like to turn now to a business update. Let's begin with the consumer segment and start with our observations about market conditions in the U.S. As has been widely recognized by food analysts and investors, U.S. consumer purchases for center-of-store food were soft in the first quarter, especially in February. This is based on retail consumption reports for the period, which showed a measurable year-on-year deceleration across many categories. While retail sales growth of spices and seasonings exceeded the performance of most center-of-store categories, continuing to display its relative strength, our category was impacted by the industry slowdown as well.

We believe that this short-term slowdown can be attributed to a confluence of factors, including unseasonable weather, a late Easter and the timing of income tax refund payments, which are likely temporary. In fact, a few weeks into our second quarter, we have seen an uptick in our sales of U.S. consumer products. Our outlook for U.S. sales of spices and seasonings for the balance of the year remains strong and unchanged from our prior projections.

Taking a closer look at the first quarter, our customized IRI consumption data indicated strong category dollar growth for spices and seasonings at 6%. During the same period, retail sales of McCormick branded spices and seasonings grew 4%. The IRI data showed pricing was 4% for both the category and McCormick, with underlying volume growth of 2% for the category and flat for McCormick. Both of these growth rates, for McCormick and the category, were lower than in past quarters and coincide with the general weakness in center-of-store food categories.

Within our spice and seasoning sales in the first quarter, we experienced particular weakness in Hispanic items and attribute this in part to the timing impact of a late Easter in 2017. In the same period, we had areas of strength, and the most notable was our exceptional sales growth of Gourmet Garden products. This product line continues to build momentum in the U.S., with first quarter consumption growth up over 25% from the year-ago period.

In measured channels, McCormick U.S. branded share declined 90 basis points this quarter. This overstates our share loss as we continue to achieve strong growth in unmeasured channels. These are retail channels not captured in Nielsen or IRI data and not in the IRI consumption data I shared. In the first quarter, we had double-digit sales growth with club and e-commerce. We estimate that these unmeasured channels added another approximately 1.5 percentage points to our retail sales growth for spices and seasonings.

Looking ahead to the balance of the year, we expect our strong performance from unmeasured channels to continue. We also expect a benefit from the reversal of the timing issues I mentioned. For our consumer business in the Americas, we're confident in our outlook for a number of other reasons.

First, we have had strong retail acceptance on new products, including Lawry's brand products, and the expanded distribution for our Gourmet organic line. Beyond spices and seasonings, we're gaining distribution with new Zatarain's items and Kitchen Basics Organic and Bone Broths. We expect continued strength for the sales of Gourmet Garden products. We have strong marketing plans. We successfully executed against our pricing initiatives during the first quarter, and importantly, our products remain well aligned and on trend with consumer demand for flavorful, healthy eating. We look forward to sharing more about our growth plans at next week's Investor Day at McCormick.

As we look outside of the Americas, we are experiencing various retail conditions across our top markets. We grew sales in China at a double-digit rate in constant currency. The growth was broad-based across our different brands and channels, including e-commerce. And we expect this performance to continue throughout 2017.

In the U.K., a challenging retail environment has persisted, and we've been impacted by a large retailers' reduction of shelf space for food products. Given these conditions, it is particularly important to keep our brands relevant through marketing and innovation. We've invested in marketing with the launch of our purity campaign in the U.K. Our latest new product launches in Europe include a gluten-free line of recipe mixes in the U.K. and the introduction of Thai Kitchen products in France.

Sales across the consumer segment were up 2% over the year-ago period in constant currency. With the benefit of higher sales and our CCI-led cost savings, we grew first quarter adjusted operating income 5% in constant currency. Adjusted operating margin for this segment expanded 45 basis points from the first quarter of 2016.

Turning to our industrial segment. We had excellent performance starting at the top line with 6% constant currency sales growth. In the Americas, we grew sales of our branded foodservice business at a double-digit rate with a benefit from expanded distribution as well as pricing. We are also seeing continued momentum and double-digit growth in sales of savory flavor products from our 2015 Brand Aromatics acquisition. Across our broad industrial portfolio in the Americas, we are executing against a new product pipeline of on trend and better for you products. We are particularly excited about the increased customer demand for organic Seasoning Blends for snacks.

In Europe, the Middle East and Africa, EMEA, incremental sales from our Giotti acquisition contributed double-digit sales growth to the first quarter of 2017. Our integration of Giotti is progressing well. This increase in sales was offset in part by the impact of our decision in late 2016 to exit a low-margin business from our South African operation. We drove sales in the Asia/Pacific region mainly in China and Australia with new products and promotional activities of quick service restaurants.

In addition to the industrial segment's overall 6% constant currency sales growth, our cost reduction efforts and our portfolio shift to more value-added products drove an 18% constant currency increase in adjusted operating income. Adjusted operating margin for this segment expanded 67 basis points from the first quarter of 2016. We are continuing to shift our product portfolio for the industrial segment to more value-added products through innovation and acquisitions.

Let me summarize by restating that our first quarter financial results across both our consumer and industrial segments were a solid start to 2017. We have confidence in our fiscal year outlook for our growth plans for brand marketing, innovation across both our consumer and industrial segments and opportunities to expand distribution. We're balancing our resources and efforts to drive sales with our work to lower costs and are on track to achieve approximately $100 million in 2017 cost savings led by our CCI program. Around the world, McCormick employees are driving momentum, and I thank them for their effort and their engagement.

It's now my pleasure to turn it over to Mike.

Michael R. Smith - *McCormick & Company, Incorporated - CFO and EVP*

Thanks, Lawrence, and good morning, everyone. I'm going to discuss our first quarter results, followed by comments on our current 2017 financial outlook. We started the year with an increase in adjusted operating income and adjusted earnings per share that was in line with our expectations and a more modest increase in sales, as we had indicated in our first quarter outlook.

Let's turn right to our top line results as seen on Slide 11. On a constant currency basis, we grew sales 4%. The incremental impact of acquisitions completed in 2016 and in early 2017 was 3%. The other 1% was driven by the pricing actions we took in response to higher material costs, offset partially by lower volume in the consumer segment.

On Slide 12, consumer segment sales in the Americas rose 2% in constant currency, with Gourmet Garden and Cajun Injector contributing 3%. During this period, as Lawrence commented, we were impacted by weaknesses across the U.S. food industry in many center-of-store categories. In particular, Hispanic sales were weak, partially due to timing issues such as a late Easter. As we had previously indicated, our plan pricing actions in the U.S. were successfully implemented midway through the quarter.

In EMEA, constant currency sales were down 5% from a year ago. The largest decrease was in the U.K., where a challenging retail market continues to adversely impact sales. This included a reduction in the number of Schwartz brand products by a large U.K. retailer, which has been rationalizing its portfolio to gain space for general merchandise. In France, our sales of Vahiné homemade dessert products were also impacted by the late Easter.

We grew consumer sales in the Asia/Pacific region by 13% in constant currency. Sales from Gourmet Garden added 4 percentage points of this increase. In China, we grew constant currency sales at a double-digit rate driven by holiday promotions as well as e-commerce growth, which offset a sales decline in India. The India decline results from our prior decision to discontinue certain low-margin Kohinoor products and the associated sell-off of that discontinued inventory in the first quarter of 2016.

For the consumer segment in total, our first quarter adjusted operating income rose 4% to $98 million. In constant currency, adjusted operating income rose 5% from the year-ago period, with the impact of sales growth and lower expenses, including CCI-driven cost savings, more than offsetting higher material costs and an increase in brand marketing in this period.

Turning to our industrial segment, we had excellent results in this quarter in both sales and profit. Starting with sales growth, in constant currency, we grew sales 6% with increases in each of the 3 regions. Adjusted operating income was up 18% in constant currency driven by higher sales, a shift to more value-added products and the impact of our CCI program.

On Slide 17, we grew Americas sales 3% in constant currency, led by pricing actions as well as double-digit sales growth of savory flavors and branded foodservice products, which was partially offset by lower sales to quick service restaurants. Sales of Giotti contributed 14% to our 13% constant currency growth in EMEA. Discontinuation of a lower margin business was partially offset by solid pricing-led sales growth with packaged food companies. We grew industrial segment sales in the Asia/Pacific region 10% in constant currency. As Lawrence indicated, both our China and Australia operations had higher sales to quick service restaurants in the region, benefiting from new products and promotional activities.

Adjusted operating income for the industrial segment ended the quarter up 10% at $40 million. In constant currency, the growth was even greater at 18% with the factors I already mentioned and as spelled out on Slide 20. We also increased marketing for this segment in support of our branded foodservice business. Those of you who follow us closely know that the industrial segment tends to have some quarter-to-quarter profit volatility, largely attributable to customer activity, including new product launches, limited time offers and other promotions. Following an exceptionally strong first quarter, we are projecting adjusted operating income growth for this segment to slow in the second quarter. For the fiscal year, we expect both an increase in adjusted operating income and improved margins versus 2016.

Across both segments, adjusted operating income, which excludes special charges, rose 5% in the first quarter from the year-ago period. If we also exclude the impact of unfavorable currency, we grew adjusted operating income by 8%, even with an increase in brand marketing. Gross profit margin was up year-on-year as well, with a 30-basis-point increase. This improvement was the result of CCI-led cost savings and favorable mix. As a percentage of net sales, selling, general and administrative expense was down 20 basis points, including a $3 million increase in brand marketing. Excluding this increase, we had lower expenses during the period, which included CCI-led cost savings.

Below the operating income line, the tax rate this quarter was 27.8% compared to 26.9% in the year-ago period. We continue to expect the rate for the full year to approximate 28%. As a result of unfavorable currency, income from unconsolidated operations declined 17% to $7 million. This currency impact masked a strong underlying sales performance led by our joint venture in Mexico, which grew sales at a double-digit rate in local currency. We are also pleased with the performance of our Eastern joint venture in India, which is delivering growth in sales and profit. Based on prevailing currency rates, we now expect a mid- to high single-digit decline in 2017 income from unconsolidated operations. At the bottom line, first quarter 2017 adjusted earnings per share was $0.76, up from $0.74 for the year-ago period mainly due to higher adjusted operating income. This result included the unfavorable impact from currency on both consolidated and unconsolidated income.

On Slide 25, we've summarized highlights for cash flow and the quarter-end balance sheet. Through the first quarter, cash flow from operations was $44 million compared to $79 million in the year-ago period. A slight increase in net income was offset mainly by the timing of income tax payments and incentive compensation payments related to 2016's financial performance. We returned $142 million of cash to shareholders through dividends and share repurchases and used $30 million for capital expenditures this period. At the end of the first quarter, $244 million remained on the current $600 million share repurchase authorization. Our balance sheet remains strong, we are generating strong cash flow and we are well positioned to fund future investments to drive growth.

Let's move now to our current financial outlook for 2017 on Slide 26. Our strong outlook for the year is unchanged except for the impact from special charges related to the organization and streamlining actions we have underway. Our 2017 projection of special charges has increased to approximately $11 million from $4 million. At the top line, we reaffirm our plan to grow sales 5% to 7% in constant currency, which includes the incremental impact of approximately 2% from acquisitions completed in fiscal year 2016 and Giotti, acquired in December 2016. We anticipate a combination of pricing at higher volume and product mix to contribute 3% to 5% of growth. Including the estimated impact of currency, we project sales growth of 3% to 5% in 2017.

On a constant currency basis, we continue to expect to increase adjusted operating income 9% to 11% from adjusted operating income of $657 million in 2016. Currency is expected to lower this range to 8% to 10%. We plan to drive this increase with higher sales and at least $100 million in CCI-led cost savings. With this fuel for growth, we plan to also fund a high single-digit increase in brand marketing.

We reaffirm projected adjusted earnings per share of $4.05 to $4.13. Excluding the estimated 2 percentage point impact of unfavorable currency rates, this range remains an increase of 9% to 11% from adjusted earnings per share of $3.78 in 2016. In the second quarter of 2017, we expect adjusted earnings per share to be comparable to $0.75 of adjusted earnings per share in the second quarter of 2016.

Keep in mind that we had a very low tax rate in the second quarter of 2016 at 23%, which is below our outlook of 28% for fiscal year 2017. In addition, the impact of unfavorable currency exchange rates is particularly high in the second quarter of 2017. This impact is not only translation but also transactional, which places pressure on our gross margin in the second quarter. We are also planning additional investments in our brand marketing.

As a final remark on our outlook, we are on track for another year of strong cash flow for fiscal year 2017 with higher adjusted net income and actions underway to improve our working capital.

That completes my remarks. So let's turn now to your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question is from the line of Alexia Howard with Bernstein.

Alexia Jane Burland Howard - *Sanford C. Bernstein & Co., LLC., Research Division - Senior Analyst*

So a couple of questions. First of all, on the share losses in measured channels, is there -- is that still share losses to smaller brands in other parts of the store? Or is it private label? And is it likely to get any better?

Lawrence E. Kurzius - *McCormick & Company, Incorporated - Chairman, CEO and President*

Alexia, this is -- we lost through measured channels about 0.9 of a share point. And as we mentioned on the call, we think that, that overstates our actual loss because of the strength that we experienced in the unmeasured channels. But regarding the measured channels in particular, we think that we've actually been quite effective in our responses to the smaller competitors. We've made our brands more relevant. We bought the most successful of them, frankly, the Gourmet Garden business. And so we think that we've done a pretty good job of dealing with the smaller competitors. I don't want to leave out Hispanic brands also, where we've had quite a strong response with our branded products with the launch of items like the Lawry Casero range and the continued expansion of our El Guapo in the truly heavily Hispanic-targeted stores. I'd say that right now, private label is the bigger issue, particularly on a dollar share basis. Part of it is something that we've created ourselves. A great deal of our category management effort has been directed towards changing the price structure of the category and encouraging retailers to take higher pricing on private label. And you're seeing that coming through in the data, where private label dollar growth is very strong over and above the unit growth. I don't want to lose track of the fact that about half of the reported private label growth is actually not true growth, but it's the conversion of a controlled brand by one of the major retailers from a branded item to their private label and a reclassification of those sales in the data.

Alexia Jane Burland Howard - *Sanford C. Bernstein & Co., LLC., Research Division - Senior Analyst*

Great. Can I just have a quick follow-up on the transactional effects of FX? Where -- could you just describe where those are happening just so that we can understand from which region to which region are some of these things being shipped and sold.

Michael R. Smith - *McCormick & Company, Incorporated - CFO and EVP*

Sure. This is Mike, Alexia. Well, obviously, last year with Brexit happening in June, we saw a large decrease in the euro and the pound, and actually a lot of currencies, like the peso, after that. So if you go back to last year, remember the first 6 months of last year, we had margin expansion in the -- between 70 and 130 basis points. It became a little bit more challenging in the second 6 last year as some of those currency rates went against us. And you're seeing that, really, the biggest impact for us in the first half of this year is in the second quarter. And if you look at the currency charts, you can see that very clearly. We see that trend going for us in the second 6 of this year. So you're seeing really a timing issue between the 2 years.

Operator

Our next question comes from the line of Robert Moskow with Crédit Suisse.

Robert Bain Moskow - *Crédit Suisse AG, Research Division - Research Analyst*

I wanted to know -- I agree with your comments that first quarter had probably some transitory issues related to center-of-store slowdown. But when I compared the retail growth rate that you cited for your category in first quarter, at 6%, and I think it was only 5% in the fourth quarter. And then for your McCormick products, I think it was 4% in both when you brought it all in together, including Hispanic and club. So is the consumer slowing down in the category in first quarter compared to fourth or not? Because I think the numbers you provide indicate that it really wasn't quite so bad.

Lawrence E. Kurzius - *McCormick & Company, Incorporated - Chairman, CEO and President*

Well, I think that you're referring to dollar growth. And there's quite a bit more pricing in the second -- sorry, in the first quarter than there was in the fourth quarter. And so I'm going to go to your -- go to the second part of your question, which is, do we see the consumer slow down -- do we see a consumer slowdown in the first quarter? And absolutely, yes. And it's across the whole center of the store, I mean, everybody has published on this. And the Nielsen data that is out there shows that the center of store had quite a strong slowdown, especially going into February. That impacted the spice category. Our relative strength was still good compared to other categories, but there was certainly an impact on the offtake.

Look, we expected our Q1 sales growth to be the lowest sales growth quarter for us in 2017. We only had a partial quarter of the pricing, so there was that impact on dollar sales. Most of our distribution wins come on stream later in the year. And we had some known losses last year that we knew were going to flow into this year, like the U.K. distribution loss. I know that's not U.S., but I'm talking at the total company level right now. And I mean, we didn't talk about it on the call and it was factored into our expectations for the quarter, but we've had 1 day less because last year was leap year. And while that's a small thing, it's still a percentage point. What we didn't anticipate was the slower industry sales in the U.S., which as we discussed on the call, we think are really due to transitory factors. We don't see anything in our data going into March, and I know we're getting into second quarter here. But we don't see anything in our data going into March to suggest the slowness that we saw in January and February is continuing. And for the reasons that we gave on the call, we think that it is transitory. And the timing of tax payments, I think Lent had a big impact on us. Our business has a very high index to Hispanic consumers, who are more Catholic. The later Easter made all of Lent fall outside of the quarter. And we're certainly seeing the reversal of that in March. And then just the weather that was out of sync with the season, or it was just very warm and that discourages consumption of the kind of cold weather items that normally we sell a lot during that time of the year, chili, gravy and all of the things that go along with that.

Robert Bain Moskow - *Crédit Suisse AG, Research Division - Research Analyst*

Okay. And maybe a question for Mike. When I look at your back half implied EPS guidance now, I think it implies some pretty strong double-digit earnings growth off of what was a pretty tough third quarter, anyway. So what's driving that strong earnings growth? Is it going to be the full impact of the pricing? Is there an incremental benefit in terms of restructuring savings because of these new special charges? Is that helping also?

Michael R. Smith - *McCormick & Company, Incorporated - CFO and EVP*

Yes. Well, I think what you're seeing, back -- I mean, the main thing is back to the transactional, the timing of the second -- first 6 versus the second 6. We really got hit in the second quarter pretty hard compared to last year. And that was the biggest gross margin increase last year at 130 basis points. We're also seeing CCI really is more backloaded this year than in the past. We've got a lot of great projects to get to our $100 million and actually hope to exceed that. We've expanded this program globally. So you will see additional savings in the latter part of the year. Plus pricing, and we've talked about the U.S. a lot, but also some of our European operations do price in the second quarter range, so we get the full impact in the second 6 there, too.

Operator

Our next question is from the line of Dave Driscoll with Citigroup.

Cornell R. Burnette - *Citigroup Inc, Research Division - VP and Analyst*

This is Cornell Burnette in with a few questions for David. Great. I just wanted to know if you could impact perhaps what the timing of the Easter shift meant to the top line in the first quarter. And then what would that imply for 2Q?

Lawrence E. Kurzius - *McCormick & Company, Incorporated - Chairman, CEO and President*

I don't want to try to quantify that. But there's no doubt that there was an impact on our business as a result of that. Some -- on our core McCormick business, we index strongly to the Hispanic consumer, our Lawry's brand index, very strongly to the Hispanic consumer. And a portion of our Lawry's range is actually specifically targeted to them. Hispanics tend to be more Catholic than general population, and have -- the Lenten timing has a bigger impact on us as a result. Also our Zatarain's products, which are also heavily influenced by the Lenten timing, were impacted in this period as well. It's just unfortunate that Lent literally started on the first day of March, and so it completely fell outside of our quarter. And that does have an impact in both shifting consumption and in shifting retailers' purchases in anticipation of that consumption. I'm not ready to quantify it, but we believe that it was pretty real.

Michael R. Smith - *McCormick & Company, Incorporated - CFO and EVP*

And I'd say -- I'd go to our yearly guidance of 5% to 7% and assume that the rest of the quarter should be around that range. First quarter, we came at 4%, slightly below that 5%. So you can assume the second would be in that range.

Cornell R. Burnette - *Citigroup Inc, Research Division - VP and Analyst*

Okay, very good. And then can you just talk a little bit, it seems like the Asia/Pacific segment in consumer did some really nice things there. I think China was particularly strong for you. And I just was wondering if you can describe what's going on in that market and kind of how -- what's driving some of the strength there and how sustainable that is going forward.

Lawrence E. Kurzius - *McCormick & Company, Incorporated - Chairman, CEO and President*

Well, in particular for us, China's growth was strong and broad-based. And this continues, really, a long-term trend there. There's not any particular news about it. We have had a long run of high single-digit, low double-digit growth in China that has continued to this day. And we could see a long runway of growth in that market. Our brands are gaining share in all of the categories that we compete in, in China. We've got continued strong growth of new placements and distribution. And on top of that, e-commerce is developing as a strong growth channel for us in China. Last year, our e-commerce business in China was up over 100%. And it is also up over 100% year-to-date this year.

Operator

Our next question is from the line of Andrew Lazar with Barclays.

Andrew Lazar - *Barclays PLC, Research Division - MD and Senior Research Analyst*

With all of the, I guess, all the variables that you've highlighted that impacted volume in the Americas consumer segment in the quarter, I guess I'm just trying to get a better sense of whether you can parse out volume elasticity and whether that was more or less in line with your expectations, given the recent pricing actions. Because it's obviously hard to tell from our perspective, given all the impacts that hit volume in the quarter.

Lawrence E. Kurzius - *McCormick & Company, Incorporated - Chairman, CEO and President*

Andrew, we just took that pricing in January. And so it's really too soon to read that through with the consumer. We don't have any reason to believe that what we modeled and expected is any different than what we were actually realizing in terms of elasticity. And remember, most of the price increase that we took was directed towards vanilla, which was commodity-driven. We've certainly gone up, but so has everyone else. Whether branded or private label, vanilla beans are over $200 a pound and everybody's got to price accordingly. So the elasticity would really be whether people stop using vanilla at all. I think we'll have a better read on that in a few months, particularly as we get past the Easter baking season, we'll have a better sense of that. Right now, the demand for vanilla is pretty much what we expected it to be. And we did expect an elasticity impact due to the size of the increase that we took. Is that getting at your question?

Andrew Lazar - *Barclays PLC, Research Division - MD and Senior Research Analyst*

Yes. No, that's helpful, I appreciate that. And then your comments about, obviously, just what you're seeing at least thus far in March in terms of center store for your category on consumption is certainly encouraging, I think, given some of the broader industry concerns that we saw earlier in the year. Is your sense, Lawrence, that the broader center store is kind of seeing maybe some of that sort of relative rebound from January and February in consumption as well? Or is your sense that maybe something in your core spice and seasonings category is a little bit different and more favorable than maybe the rest of the sort of store?

Lawrence E. Kurzius - *McCormick & Company, Incorporated - Chairman, CEO and President*

Well, certainly we're seeing it in our products and in our category. And I would, and I'm really taking a bit of a guess here, but I would guess that the same is true for other categories as well, to the extent that whether Lent, tax refund timing impacted the center of the store, and that's kind of the underlying reason for the slowdown in our area, I would think that the reversal of that, that we're experiencing would hold true for others. I'll also say that our industrial -- in our industrial business, the demand from -- for flavors from our consumer packaged goods customers has remained -- is really strong. And so I would say that bodes well as well.

Operator

Our next question is from the line of Evan Morris with Bank of America Merrill Lynch.

Evan Benjamin Morris - *BofA Merrill Lynch, Research Division - VP in Equity Research*

Just when I look at how 1Q played out, when you gave guidance here, you said that EPS was going to be kind of flattish year-over-year. And one of the variables was a planned increase in marketing expense. We didn't, I guess, really see any sort of follow-through or benefit on the top line, given some of the factors that you talked about. So if we think about 2Q and the guide for flat again, is there a need now to have to raise or spend more on marketing than initially planned because you didn't get any kind of lift or real return in 1Q? Or is that Q2 guide for flat EPS really all gross margin and tax rate-related?

Lawrence E. Kurzius - *McCormick & Company, Incorporated - Chairman, CEO and President*

No, I'll start this, and then I'll pass it over to Mike. But I mean, we did have a modest increase in marketing spend in the first quarter, and we expect -- actually, we expect a greater increase in marketing spend in the second quarter of the year. And I wouldn't characterize that as not giving us a lift. It does not -- I mean, the A&P spend and the sales don't happen simultaneously. I think we feel pretty good about the return that we get on our investment from marketing spend. We have an expectation about strong growth, and we're leading into that growth with our spending. And I think we'll continue to do so as we go through the year. Really, we plan a pretty good increase in our investment behind our brands for the year as a whole, and we believe that, that's part of what drives our growth. Mike, do you want to take...

Michael R. Smith - *McCormick & Company, Incorporated - CFO and EVP*

Yes, I think the thing to consider, too, is second quarter, where Easter is now, the investment spend in A&P is up a bit. It's on our full year guidance, but it's really focused -- we have a big increase in working media as we activate media, digital against Easter. So that's where you'll see a lot of focus in Q2.

Evan Benjamin Morris - *BofA Merrill Lynch, Research Division - VP in Equity Research*

Okay. And then just on the U.K., some of the weakness there, and you talked about one of the retailers taking away some shelf space. Is that going to continue to be a headwind? Is that now done and behind? And what's sort of your outlook or expectation for the U.K. consumer business for the balance of the year?

Lawrence E. Kurzius - *McCormick & Company, Incorporated - Chairman, CEO and President*

That is really the story in the U.K., Evan, is that one retailer. It's a very concentrated market, so the customers are large, and they all matter. And it has a big impact not just on our U.K. business, but it's big enough that it impacts our EMEA business as a whole. The change in shelf space and items in distribution at that retailer really occurred during the fourth quarter of last year. And so that's an unfavorable comparison that we're going to carry for that region for the whole year. We'll also say that, that's really baked into our thinking when we said 5% to 7% constant currency. We've got a great story in other markets and in other customers in that market. We continue to invest in marketing in the U.K. even with this change because it's important to show both that customer and the other customers in the market, and frankly, the consumer, the relevance and importance of our brands. And we're leaning in there with A&P and also with new product launches, like the gluten-free recipe mixes that we're launching in the U.K. Mike, do you want to say anything else...

Michael R. Smith - *McCormick & Company, Incorporated - CFO and EVP*

No, you covered everything great. It's okay.

Operator

Our next question is from the line of Rob Dickerson with Deutsche Bank.

Robert Frederick Dickerson - *Deutsche Bank AG, Research Division - Research Analyst*

Just a couple, hopefully easy, questions. The first one is just on acquisitions. It seemed like with the 3% growth year-over-year in net sales, I guess that's approximately, let's call it, a $30 million contribution to the top line. Is there any way to give me kind of incremental color on what the operating profit contribution was?

Michael R. Smith - *McCormick & Company, Incorporated - CFO and EVP*

Generally, we say in the first year of an acquisition, between integration costs, things like that, they're pretty flat from an operating profit perspective. So Giotti, for example, we bought that in mid-December, so you won't see much impact from that. You'll see actually -- one of the things you'll see in the first 2 quarters is a lot of integration costs. And that does speak to the second half strengthening, too, as another factor. Gourmet Garden, we're very happy with that business. And we don't disclose separately the impact there, but it definitely is positive.

Robert Frederick Dickerson - *Deutsche Bank AG, Research Division - Research Analyst*

Okay. And then just on the unconsolidated line, I think you used to be comparable for the year, now you're down a bit. Is that just noise essentially? Is that FX-related? Or is there something else we should be aware of?

Michael R. Smith - *McCormick & Company, Incorporated - CFO and EVP*

Yes, definitely, it's FX-related, Rob. The peso, which is very volatile, as you know, has gone against us, actually the last 2 years. But our underlying results from a sales perspective in our Mexican joint venture are excellent.

Robert Frederick Dickerson - *Deutsche Bank AG, Research Division - Research Analyst*

Okay, cool. And then just in capital allocation, obviously your leverage is still low. You like to do acquisitions. But just in terms of buyback, I don't think there's a target for the year. Is expectation, as cash flow builds throughout the year, that we should be baking in some type of buyback, I mean, just considering, I don't know, let's call it, the past 5 years or 4 years, you've been spending, I don't know, about $200 million a year? Is that probably about the same for this year?

Michael R. Smith - *McCormick & Company, Incorporated - CFO and EVP*

Yes, I mean, at the rate we're buying, you're right. You'd hope that, obviously, our first use of cash is really to go after the acquisitions and our pipeline is robust, so -- but in the lack of acquisitions, we would look at doing another buyback of some sort probably mid- to late year.

Operator

Our next question comes from the line of Ken Goldman with JPMorgan.

Thomas Palmer - *JP Morgan Chase & Co, Research Division - Analyst*

It's Tom Palmer on for Ken. I just had a quick question on the consumer Americas side. When we look at the sales headwinds in the first quarter compared to the robust sales trends we saw late last year, do you think selling ahead of the price increase might have pulled volume, just looking in arrears? Or because it was a mid-quarter increase, do you not really think that was a factor?

Lawrence E. Kurzius - *McCormick & Company, Incorporated - Chairman, CEO and President*

I don't think that it was a factor. I think you're exactly right that we took the pricing mid-quarter precisely to make sure that, to the extent there was any kind of prepurchases by customers, that it would wash itself out. But importantly, we also had -- the primary item that we took the increases on in the U.S. were vanilla. And we put vanilla on allocation to our customers partly to manage the -- any kind of a forward buy. We did not want to -- in the face of a strongly rising commodity, we did not want to sell out our inventory at a below-market price. So I think we managed that pretty well. I don't think that, that is what happened. I think that what we really saw was slow consumption in January and in February that washed through.

Thomas Palmer - *JP Morgan Chase & Co, Research Division - Analyst*

Okay. And just a quick one, I know we've asked about this in past quarters, but just wanted to circle back. I mean, we still see in like Nielsen scanner data, weaker sales trends on the gourmet side. Is that still something that, on your end, you're seeing more robust sales trends there? Or was there a bit of a slowdown here in the first quarter there?

Lawrence E. Kurzius - *McCormick & Company, Incorporated - Chairman, CEO and President*

Well, during the transition from organic -- to organic, we did have some disruption at the shelf, which we have worked through. Then on the tail end of that, we had a lot of heavy promotion by a couple of retailers of their organic private labels. That really related not so much to their desire to be competitive in the spice category but more to a total store promotion on natural and organic items to be competitive with the natural food channel. And there was some irrationally low pricing on organic items through the December and January period, in particular. We've seen that go back to normal. And we're optimistic that we're going to see better trends on our gourmet business. In addition, we had a lot of new placements and expanded distribution on gourmet that really comes on a little bit later in the year as the retailers go through their shelf reset cycles. So our outlook for gourmet, particularly as we lap that transition period from a year ago, is actually quite positive. And we believe the conversion to organic was absolutely the right thing to do.

Operator

Our next question is from the line of Jonathan Feeney with Consumer Edge Research.

Jonathan Patrick Feeney - *Consumer Edge Research, LLC - Senior Analyst*

I guess, first, a follow-up, and then a bigger question. My first question is a follow-up on Evan's question. I'm not sure -- I don't think brand marketing was up double digit this quarter. It seems like, I think, you told us it was up $3 million or something and that gets to like mid-single digits. Can you kind of correct me on what's going on with brand marketing and how that worked in this quarter? And secondly on Easter, back in 2014, it was almost the exact same Easter split. Ash Wednesday, I think there was 4 less days, but it was almost the same thing. Ash Wednesday, I think, was March 5 in 2014 versus having been much -- like February 10 the year before. You didn't talk about Easter shift in that call. It was asked in the Q&A. And I'm just wondering, maybe some of these new acquisitions gives it a more impact of Easter. But any color you can give us. I know you didn't want to specifically quantify it. But any color you can give us on maybe there's innovation around fish boils or something like that, that's made the business a little bit more Lent and Easter-heavy, for future modeling purposes.

Michael R. Smith - *McCormick & Company, Incorporated - CFO and EVP*

Jonathan, this is Mike. On your first question, we didn't say brand marketing was up double digits. It was up $3 million, as you alluded to, in the first quarter. And we see...

Jonathan Patrick Feeney - *Consumer Edge Research, LLC - Senior Analyst*

I'm sorry, I meant in the prior year. That was going to kind of be the plan, wasn't it, from the guidance?

Michael R. Smith - *McCormick & Company, Incorporated - CFO and EVP*

Yes, we were hopeful. I mean, we did really hit the U.K. hard, as Lawrence mentioned, with purity. With some of the timing, as we said, around Easter, we made some decisions there to focus it on where it could be most effective.

Lawrence E. Kurzius - *McCormick & Company, Incorporated - Chairman, CEO and President*

The second part, on the impact of Easter and Lent, we're talking about it in the context of one of the factors that influenced the slowness in January and February, not just for us but for the industry as a whole. The timing of Lent versus last year, we believe, is one factor. But I'm certainly not saying that it's the only factor. And I think we're all looking for the reasons why that period was slow. It does seem that there were some events that would have created a shift versus prior year, timing of Easter being one. Weather being yet another. And I don't want to underestimate the impact that the change in U.S. income tax refund policy has had, pushing those refunds later for, especially for consumers at the lower end of the economic spectrum, who tend to spend those refunds, they're often -- that's their earned income credit comes back to them, those go into regular household consumption. And I think it has the same kind of impact as a change in SNAP payments.

Operator

The next question comes from the line of Brett Hundley with the Vertical Group.

Brett Michael Hundley - *The Vertical Trading Group, LLC, Research Division - Research Analyst*

Just 2 questions for you, the first on raw materials. You guys are reiterating an expectation of mid-single-digit increase in raws for 2017. And I know we've all seen headlines on vanilla and garlic. I think you guys have made comments in the past that you would expect to see vanilla and garlic cycle off as the year progresses. And I don't know if that's still the case. And so when you reiterate a mid-single-digit increase, are you maybe seeing things go from a plus 4% to a plus 5%? Or a plus 4% to a plus 6%? Or do you see things staying relatively stable still at this point? And if things are shifting a little bit within that mid-single-digit increase, is there any incremental pricing that would be required? Or would you just hope to drive more cost saves, as I think you mentioned, Mike? Any color there would be helpful.

Lawrence E. Kurzius - *McCormick & Company, Incorporated - Chairman, CEO and President*

Brett, this is Lawrence. I'm going to start, and then I'm going to pass it to Mike. But we are not indicating any cycling off in the second half for vanilla. Now garlic is an annual crop, and so there'll be a new crop midyear, and we will hope -- we are hopeful that, that's going to take some of the pressure off of garlic, and we may see that one cycle down a bit. But the outlook for vanilla, which is the major impact item, is for it to be strong. We had actually hoped for some relief from the new crop. You may or may not have seen in the news that there was a large tropical cyclone in Madagascar that struck the vanilla-growing areas at a very inopportune time. And so -- Madagascar produces about 85% of the world's vanilla crop. The estimates right now are that 20% to 30% of the crop was lost as a result of the cyclone. So we see this high vanilla pricing continuing certainly well into 2018. So I just wanted to address that part of it.

Michael R. Smith - *McCormick & Company, Incorporated - CFO and EVP*

Yes, vanilla is grown over a 2- to 3-year cycle, so it doesn't have a quick bounce back like garlic, which is an annual crop. I'd just kind of say, to your range question, I'd still stick with the mid-single-digit range. I mean, with buying crops from 80 different countries, there's always something up and something down. And cinnamon might be going up and pepper might be going down, but generally, mid-single digits is still where we stand for the whole commodity base.

Brett Michael Hundley - *The Vertical Trading Group, LLC, Research Division - Research Analyst*

Okay, I appreciate the clarity there. And then my last question is just, well, it's on the consumer, the U.S. consumer set. And I know that the issue that's affecting you in the U.K. is completely different from what I'm about to ask. But I think that the issue in the U.K. really stems from the Aldis and the Lidls of the world. And what I wanted to ask you about the U.S. is as you see the greater proliferation of Aldi, and then Lidl coming on to the U.S. market I think summertime here, especially on the East Coast, it looks like is where they're targeting, which is obviously a highly populous area, do you have any expectations of existing grocers here in the U.S. trying to beef up private label or become tougher on pricing in order to compete with the potential proliferation of additional discounters here? And can you talk about how you position yourselves in that environment and also just the growing importance of brand marketing as something like that happens as well?

Lawrence E. Kurzius - *McCormick & Company, Incorporated - Chairman, CEO and President*

Sure, Brett. That's a very broad set of questions. But I will start by saying that the discounters you named are important customers of ours in Europe that we are engaged with and do business with. Aldi has been in the U.S. for many years and has some several thousand stores here and is a customer as well. And we would expect with the entry of Lidl to this market and our existing relationship with them that they will be a customer as well. I certainly think that all of the traditional retailers and mass merchants have their attention quite firmly focused on the entry of these competitors into the market. And they're all preparing their response to them. And I think that this will continue to add to the kind of the competitive robustness of the U.S. market. I think that, frankly, as much as the traditional retailers are challenged, I think this is a huge challenge to the dollar channel, which has been in existence for many years. And for U.S. consumers, it's filled a similar niche.

Michael R. Smith - *McCormick & Company, Incorporated - CFO and EVP*

But Brett, to your point, too, it'd be important for branded food companies to really focus on effective media spending but also innovation. And that's where we've been driving over the last couple of years, to really drive innovation in our brands across the whole business.

Operator

Our last question today comes from the line of Akshay Jagdale with Jefferies.

Lubi John Kutua - *Jefferies LLC, Research Division - Equity Associate*

This is Lubi filling in for Akshay. Most of my questions have been asked already. But maybe I can get your thoughts on M&A. So I know you've recently completed a few smaller deals. But can you just comment on how we should think about your appetite for additional deals going forward and maybe how you would characterize the current pipeline and valuations?

Lawrence E. Kurzius - *McCormick & Company, Incorporated - Chairman, CEO and President*

Well, I'll say a few words about this. First of all, it's part of our growth algorithm that 1/3 of our growth comes from base business, 1/3 comes from innovation and 1/3 from acquisitions. And so we would continue -- I would expect -- you should expect to see a continued stream -- it's a lumpy stream because there has to be a willing seller, but a continued stream of bolt-on acquisitions. As we have said over the last couple of years, we've broadened our lens to include both consumer flavor businesses and industrial flavor businesses. And so over the last -- both last year and, really, already this year, really, Giotti was a 2017 deal, we've acquired an industrial flavor business in addition to some consumer businesses. I think you can look forward to the same. We also are considering larger assets. Those are going to come at an even less regular interval, but we continue to consider larger assets as well.

Lubi John Kutua - *Jefferies LLC, Research Division - Equity Associate*

And then just in terms -- so in the industrial segment, I think you mentioned in your prepared remarks that you saw double-digit growth in the branded portfolio. Can you maybe just expand a little bit on what drove that, and then how you see those trends sort of playing out for the balance of the year?

Lawrence E. Kurzius - *McCormick & Company, Incorporated - Chairman, CEO and President*

Specifically in the U.S. branded foodservice business, we have had some strong distribution gains. We have a strategic partnership and category captaincy with one of the major foodservice distributors. And that's driving a lot of sales growth for us.

Operator

Thank you. At this time, I will turn the floor back to Lawrence Kurzius for his closing remarks.

Lawrence E. Kurzius - *McCormick & Company, Incorporated - Chairman, CEO and President*

Great. Well, thanks, everyone, for your questions and for participating on today's call. As I said, we expected Q1 sales growth to be the lowest quarter for us in 2017 for the reasons that we discussed. For the rest of the year, particularly in our Americas consumer business, we expect strong sales growth for the reasons we gave in the prepared remarks. We have strong acceptance of new items, expanded distribution on our gourmet range, plus we're lapping the transition on that range from last year, continued strength on Gourmet Garden. The pricing actions, and this is true for the whole company, not just our U.S. business, have been completed. Our marketing plans are strong. And importantly, our products remain well aligned with what consumers choose to eat. Taste continues to rank #1 in what consumers use in making their decisions about their food purchases. We're aligned with today's move towards more healthy, flavorful foods, and we're confident in our growth plan. With our steadfast focus on growth, performance and people, we're well positioned to deliver strong financial results and shareholder value in 2017.

Kasey Jenkins

Thank you, Lawrence, and thanks to all for joining us today. If anyone has any additional questions regarding today's information, please give us a call at (410) 771-7140. This concludes this morning's conference call.