THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

MKC - Q3 2014 McCormick & Company Inc Earnings Call

EVENT DATE/TIME: OCTOBER 02, 2014 / 12:00PM GMT

CORPORATE PARTICIPANTS

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

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

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

CONFERENCE CALL PARTICIPANTS

Robert Moskow *Credit Suisse - Analyst*

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

David Driscoll *Citigroup - Analyst*

Akshay Jagdale *KeyBanc Capital Markets - Analyst*

Chris Growe *Stifel Nicolaus - Analyst*

Erin Lash *Morningstar - Analyst*

Eric Katzman *Deutsche Bank - Analyst*

PRESENTATION

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

Good morning. This is Joyce Brooks, Vice President of Investor Relations. Thank you for joining today's call for a discussion of McCormick's third quarter financial results and 2014 outlook.

We've posted a set of slides to accompany our call at IR. McCormick.com. At this time, all participants are in a listen-only mode. A question-and-answer session will follow our remarks.

(Operator Instructions)

As a reminder, the conference is being recorded.

With me this morning are Alan Wilson, Chairman, President and CEO, who will begin with comments on the latest financial performance and outlook and a business update, and Gordon Stetz, Executive Vice President and CFO, who will provide a more detailed review of third quarter results and 2014 guidance.

During our remarks, we will refer to non-GAAP financial measures. These include adjusted operating income and adjusted earning per share that exclude the impact of special charges. A reconciliation to the GAAP results is included in this morning's press release, as well as the slides that accompany this call.

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's now my pleasure to turn the discussion over to Alan.

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

Thank you, Joyce. Good morning, everyone, and thanks for joining us. Our third quarter results included solid sales growth, a significant profit increase, and strong cash flow. This performance demonstrates our progress with McCormick's growth strategies and our ability to deliver shareholder value.

We grew sales 3%, with particularly strong growth in our Consumer business in the Asia-Pacific region, led by a 15% growth in China, and in our Industrial businesses in the Americas region and in Europe, Middle East and Africa, EMEA.

In our Americas Consumer business, we're making steady progress with growth initiatives to build brand equity and strengthen our category leadership. We have the right plan and good momentum.

While Consumer sales in the Americas declined 1% this quarter, that's an improvement from the first half of 2014; and we expect further improvement in the fourth quarter and in 2015.

Gross profit margin increased in the third quarter and a primary driver behind our improvement is Comprehensive Continuous Improvement, CCI. With great work by employees throughout the Company, we now expect our 2014 cost savings from this program to be at least $50 million.

Our Industrial segment has been particularly effective in raising margins year-to-date in 2014. Sales growth, higher gross margin, and our diligent expense management led to a 6% increase in operating income.

Income from unconsolidated operations also had strong profit impacts this quarter, led by our McCormick to Mexico joint venture. Along with 5% sales growth, this business has completed the transition to a new, more efficient production facility, a move that has raised its profitability.

Clearly, earnings per share at $0.94 was ahead of our previous outlook. While we anticipated higher operating income, the tax rate came in well below our projections. Gordon will provide the details on this. Importantly, part of the reduction reflects a continuing benefit on our anticipated tax rate going forward.

In the third quarter, we continued to step up our share repurchase activity and have lowered shares outstanding nearly 2% year-to-date from compared to 2013. This is one use of strong cash flow that McCormick generates.

Our debt leverage is close to our target and we believe we're in a very good position for financing potential acquisitions. Between share repurchases and our dividend payments, we reached $323 million year-to-date in cash returned to shareholders, up 42% from the same period in 2013.

Next I want to provide some general remarks on our latest 2014 financial outlook. Again, Gordon will go into more depth on this topic.

We're maintaining our projected sales growth rate at 3% to 5%. We expect this growth to be driven by product innovation, brand marketing support, certain pricing actions, and in the first half of 2014, incremental sales from WAPC. Sales were up 4% year-to-date, close to the midpoint of this range.

For adjusted operating income, we've moderated our anticipated increase to 4% to 5%. Because we've increased adjusted operating income 8% year-to-date through the third quarter, this implies a flat to slightly down result for the fourth quarter, based on several factors.

First, we're supporting our brands and plan to increase our marketing support by at least $11 million from the fourth quarter of 2013.

Second, we expect the growth of our International businesses to outpace the increase in the US. While this puts pressure on operating income, it creates a favorable tax rate.

And third, we're cautious about the near term demand from quick service restaurants in China and other parts of the Asia-Pacific region.

Taking into account the new operating income range and the favorable tax rate, we've increased our target range for adjusted EPS to $3.30 to $3.37. Overall, we believe this guidance will deliver strong 2014 financial performance.

Let's turn to our business update. We're operating in a dynamic environment, with shifting consumer demographics and preferences, continued economic pressure for many consumers, exceptionally competitive retail conditions across channels, and different choices being made by consumers when they're eating out.

At McCormick, we're adapting our business to address challenges and to identify and pursue emerging growth opportunities, such as the creation of our new Skillet Sauces, funding for digital marketing to connect with consumers, and investments in category management.

Underlying all of our growth strategies is a rising demand for flavor. In a recent US study, at a 90% response rate, taste remains the top factor impacting food and beverage purchases. For our largest growth platform, Spices and Seasonings, the latest Euromonitor projections show a robust 10% average annual growth rate for the next five years.

On slide 7, you can see that a strong increase in Recipe Mix sales is also anticipated. We believe a number of factors are driving this growth. First, the rise of millennial consumers, a group that has strong interest in cooking, much stronger than the baby boomers. In the US, our data shows that both McCormick's gourmet and everyday products are well represented in millennial households.

Second, the influence of ethnic demographics and the exposure each of us has to other cultures and their food. Cuisine-specific, or ethnic fare, now accounts for about 44% of all US flavoring occasions.

Third, the increased connectivity of consumers. They're sharing recipes, meal ideas, and lots of food photos. We have industry-leading digital programs and were recently ranked number five in a Digital IQ survey of 80 packaged foods brands in the US market. And we're number three in a ranking of paid search by ad impressions among the top 50 consumer packaged goods advertisers.

Fourth, there's a measurable shift towards healthier eating in many markets around the world, as consumers turn toward fresh products that are ideally suited to flavor. We're partnering with government agencies and trade agencies to inspire healthy choices among consumers.

And fifth, the rising middle class in emerging markets. While Euromonitor measures herb and spices globally as a $10 billion category, we estimate another $10 billion of product is sold in bulk. This is mainly in emerging markets, where we see consumers gradually converting to the quality and convenience of spices and herbs as packaged foods items.

Let's talk about our progress in driving growth within each of our two segments, starting with our Consumer business. We grew third quarter Consumer business sales 1% in local currency.

As in recent quarters, the performance for this business varied across our geographic regions. The Asia-Pacific region was the strongest contributor, with sales up a double-digit rate. Particularly noteworthy was the 15% sales increase in China. The growth in this market was broad-based, spanning a number of product categories, Spices and Seasonings, Recipe Mixes and Condiments.

Our latest sales results in EMEA were similar to the second quarter, with a low single-digit sales increase in local currency. We're driving sales with pricing actions, product innovation, and expanded distribution, although we continue to experience competitive conditions across the region.

Our latest new product launches include Vahine desert item, Kamis seasonings and Ducros recipe mixes, along with Schwartz brand grinders refillers and Freshlock herbs. And we're supporting our new products along with our core business in the fourth quarter.

Let's turn next to our Consumer business in the Americas. In local currency, third quarter sales in this region declined 1%. This is primarily the result of the unfavorable impact from a shift in US sales between quarters, offset in part by the favorable effect of higher pricing and our initiatives to drive growth.

As I stated earlier, we're making great progress with actions to build brand equity and win at retail. Sales of new products this quarter included Grill Mates Burger Mix-ins, new Perfect Pinch flavors, extra rich vanilla, value sized Grinders, and Zatarain's Recipe Sides.

Retailer acceptance has been strong for our latest introductions, gluten-free recipe mixes and our new skillet sauces. And in early 2015, we'll be relaunching our entire Gourmet line. We'll be differentiating our brand with greater variety, processing methods to include a flavor seal and packaging that has more premium, fresh appearance.

In the third quarter of 2014, we had continued strength with our Recipe Mixes which gained a percentage point of share this period, driven by innovation and brand marketing support. We also had a great grilling season, compared to last year.

Another action underway to strengthen our US brand equity is increased investment in brand marketing, and we're planning an increase of approximately 20% in the fourth quarter. These additional funds will boost our holiday campaigns, with new television ads for Thanksgiving and Christmas. We'll build awareness and trial of the new Skillet Sauces and Gluten-Free Recipe Mixes. We'll drive our quality message and we're supporting the Zatarain's brand.

In addition to building brand equity, we're working to win at retail. We've discussed with you our actions in this area, and let's talk about some of the signs of success.

In our June earnings call, I reported on better alignment of retail pricing between private label, McCormick brand and competitive brands, as well as new distribution for Lawry's and Simply Asia Food brands. In the latest quarter, we've been effective in gaining shelf space for our unique items, like Grinders and Grill Mates, won distribution for our Lawry's brand Hispanic items at two major southeast retailers, and made further progress with retail pricing alignment.

In total, we're targeting category pricing discussions with retailers that represent 60% of ACV. Based on our discussions to date, over half the retailers have accepted our pricing recommendations. Spice and Seasonings is one of the most profitable category for the retailer and our customers want to get it right.

In addition to these bricks and mortar retailers, our e-commerce sales have risen at a high double-digit rate. This performance is a result of our global e-commerce team and dedicated support, such as feature search and recipe marketing.

We recognize it's going to take some time for these actions to fully take hold. However, we are confident that we have the right actions and the right team to deliver improved performance.

Let's move to our Industrial segment. We had another strong quarter for this part of our business. Compared to the year-ago period, sales grew 3% in local currency and adjusted operating income was up 26%.

While we're comparing to a year-on-year profit decline in the third quarter of 2013, on a two-year basis from the third quarter of 2012, adjusted operating income is up 6%.

As in recent periods, our EMEA industrial business led top line growth, this quarter with an 8% sales increase in local currency. This was a combination of pricing actions in response to higher material costs, as well as higher volume and product mix.

We continue to meet increased demand from quick service restaurant customers and participate in the growth of snack seasonings for food and beverage manufacturers. Snack seasonings were a top growth item as well for our Industrial business in the Americas in both the US and Mexico. Largely driven by volume and product mix, sales in this region rose 3% in local currency.

Our quick service restaurant customers in the Asia-Pacific region are currently being impacted by well-publicized supply issues. This is affecting our sales results in the region and has us cautious in our near term outlook, as reflected in our latest guidance.

Wrapping up my update on the Industrial business, we're pleased with the sales and profit results for the segment. We have good long-term momentum and a solid innovation pipeline for further increases in sales and profits.

To summarize, employees throughout McCormick are applying their energy and talent to adapt and succeed in a dynamic environment. I want to recognize and thank them. Through their efforts, we've achieved year-to-date financial results that have us well positioned to deliver record results in 2014.

We believe that McCormick has strong business advantages within the food industry. These include our leading positions in growing markets, a breadth of products from value priced to premium, flavors for all types of eating occasions, market-leading customers, and an expanding geographic presence, our strategic imperatives focused on people, growth and performance are driving our success and designed to build value for McCormick's shareholders. Gordon?

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

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

Let's take a closer look at sales and operating income for each segment. As seen on slide 14, we grew Consumer business sales 1% in local currency. The impact of pricing actions taken in response to higher material costs was offset in part by a slight decline in volume and product mix.

Sales in the Americas were down 1% in local currency, with higher pricing more than offset by a 2% decline in volume and product mix. As Alan indicated, we are pleased with the innovation underway, stepped up brand marketing, and progress with our actions to win at retail. However, in the third quarter we had an unfavorable impact from a shift in sales.

For more than five years, McCormick has offered retailers a holiday display program to encourage early in-store display and merchandising of holiday products. In 2014, we expect another year of strong holiday display activity, although retailer purchases are more skewed toward the fourth quarter than in 2013.

In 2013, holiday display program purchases were more skewed to the third quarter, due in part to a price increase effective in the fourth quarter of 2013. We estimate that this shift had an unfavorable impact of approximately 5% on third quarter 2014 Americas Consumer business sales and expect it to have a positive sales impact in the fourth quarter.

In EMEA, Consumer business sales rose 2% in local currency, mainly due to pricing actions. Volume and product mix was down slightly this quarter, as growth from product innovation and expanded distribution was offset by competitive conditions in this region.

In local currency, Consumer business sales in the Asia-Pacific region rose 11%. The growth this quarter is being driven by our base business, which now includes WAPC.

An 8% increase in volume and product mix reflects 15% growth in China this quarter, with strength in core products along with sales of our squeeze pouch ketchup and other new products.

The higher pricing this quarter comes from India and relates to basmati rice costs. While the impact of this higher pricing was partially offset by lower volume and product mix, the net impact was a double-digit increase.

In total for the Consumer business, adjusted operating income, excluding special charges, was $122 million, a 3% increase from the third quarter of 2013. This increase was mainly driven by higher sales and the benefit of CCI cost savings, offset in part by a $3 million increase in brand marketing support.

As you can see from these results, we are seeing a faster pace of sales growth in international markets. This puts a bit of pressure on our operating income margin for this segment, but has a favorable impact on our tax rate, as I'll discuss in a minute.

Turning next to our Industrial business. We grew third quarter sales 3% in local currency, due to higher volume and product mix and to pricing, as seen on slide 19.

In the Americas region, we grew Industrial business sales 3% in local currency. We had strong demand for snack seasonings in the US and Mexico, including many of the new products that have been introduced by leading food and beverage companies this year.

On the restaurant side of our business, sales of branded food service products increased this quarter, while sales to quick service restaurants remained weak.

In EMEA, our Industrial business team had another quarter of great performance in sales and profit. In local currency, we grew sales 8% by pricing, along with volume and product mix. Demand from quick service restaurants remained strong and we had good sales of snacks seasonings in this market, as well.

In the third quarter of 2014, Industrial business sales in the Asia-Pacific region declined 1% in local currency. This is a slowdown from the growth we reported in the first half of the year. During that period, there was a significant recovery in sales to quick service restaurants in China that had been weak in 2013. However, demand from these customers slowed in this most recent quarter and, as Alan indicated, we are cautious in our near term outlook.

Excluding special charges, adjusted operating income for the Industrial business rose 26%, to $38 million, resulting from higher sales, increased margins within the product portfolio, and CCI cost savings.

While we have more difficult results in the year-ago period and, therefore, a somewhat easy comparison this year, we are ahead on a two-year basis, as stated earlier, and pleased with the progress in our strategies to grow sales and profit for this part of our business.

Looking ahead to the fourth quarter, we do not expect the same rate of operating income growth, since the year-ago comparison becomes more difficult and we are cautious in our outlook for the Asia-Pacific region. As a reminder, adjusted operating income was up more than 50% in the fourth quarter of 2013.

For the total Company, operating income rose 6%, driven by higher sales, CCI cost savings, and more favorable industrial business margins. These same factors also led to improved gross profit margin. And during the quarter, we funded additional brand marketing programs, with a greater investment planned in the fourth quarter.

We reported $2 million in special charges this quarter, with $1 million principally related to the realignment of certain manufacturing operations in the US Industrial business and $1 million related to reorganization activity in EMEA.

Let me discuss this quarter's reduction in the tax rate. In our January 2014 call, we provided you with an initial outlook for a 30% to 31% tax rate this year. This was an increase from a 26.8% tax rate in 2013, and included the estimated impact of a discontinuation of the R&D tax credit, a tax law change in France effective in our FY14, the expected mix of business across tax jurisdictions, and in 2013, we reported favorable discrete tax items.

Last quarter, in our June earnings call, we lowered the projected rate to approximately 29.5% to reflect our latest projection for mix of businesses across tax jurisdictions for the fiscal year, including the faster pace of growth in China and EMEA. We now believe that the tax rate for FY14 will come in at approximately 27%.

This reduction from 29.5% is a combination of three things, an updated mix of business across tax jurisdictions, France released final regulations clarifying the impact of the tax law change, and other discrete tax items.

So what are the implications of this? First, we have increased our projected earnings per share, which I'll discuss shortly. Second, the expected fiscal year tax rate of 27% is now fairly close the 26.8% recorded in 2013. And third, we anticipate a 28% tax rate for the fourth quarter. Keep in mind that this compares to a much lower 24.3% tax rate in the fourth quarter of 2013, which included some discrete items.

Moving on to income from unconsolidated operations, our joint ventures had a strong performance, with income reaching $9 million this quarter. In addition to higher sales, our joint venture in Mexico is settled into its new, more efficient manufacturing facility.

At the bottom line, earnings per share rose to $0.95, excluding special charges. As you can see on slide 27, this was an increase of $0.17, comprised largely of higher operating profit, the favorable tax rate, and increased income from our unconsolidated operations.

Turning next to slide 28. We've summarized highlights for cash flow in the quarter-end balance sheet. Year-to-date cash flow from operations was $276 million, up $48 million from the first three quarters of 2013. This improvement included higher net income and a lower pension contribution in 2014.

During this period, we used $178 million of cash to repurchase 2.6 million shares. At quarter end, we had $181 million still available on our $400 million authorization.

Our balance sheet remains sound. We are close to our target debt level and well positioned to fund investments to drive growth, including acquisitions.

Turning to our 2014 outlook. We continue to expect to grow sales 3% to 5% in 2014 on a currency neutral basis. Keep in mind that this included an incremental impact of WAPC in the first half. Also, we now expect minimal sales impact from foreign currency exchange rates, although rates are still moving quite a bit.

We have moderated our outlook for adjusted operating income. We now expect an increase of 4% to 5% from $591 million of adjusted operating income in 2013. This change reflects an unfavorable impact from the latest business mix projection for the full year, offset in part by our anticipated CCI savings. Our planned increase in brand marketing support remains at least $25 million.

As I indicated in my remarks, this latest projection of business mix has a favorable impact on the tax rate which, together with other tax rate factors, leads us to a higher 2014 earnings per share projection. We have increased our range for adjusted EPS to $3.30 to $3.37, from $3.22 to $3.29. This new range excludes the $0.01 for special charges recorded in the third quarter.

With our year-to-date results, we are on our way toward another year of strong cash flow. As many of you know, we adhere to a balanced use of cash and are committed to returning a significant portion to our shareholders in the form of dividends and share repurchases. In 2014, we expect to use nearly $200 million of cash for dividends and, through share repurchases, to reduce our shares outstanding by approximately 2%.

As I conclude my comments, we look forward to reporting to you on our fourth quarter results in January and providing our outlook for continued growth in 2015. Let's turn now to your questions, after which Alan will provide some closing remarks. Operator, we're ready for the first question.

QUESTIONS AND ANSWERS

Operator

Thank you. We'll now be conducting a question-and-answer session.

(Operator Instructions)

Thank you. Our first question is from the line of Robert Moskow of Credit Suisse. Please proceed with your question.

Robert Moskow - *Credit Suisse - Analyst*

Hello. Thank you. Alan, you mentioned on the call that I think you had flowed through new pricing structures for the category in about half of the retailers, or at least half of the retailers had accepted it. Can you give us a sense of what that means for your pricing in 2015? I imagine it's a positive, but how is it a positive? Does it improve the relative pricing that you have versus competition? And what does it mean to your top line for US Consumer next year?

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

What we're talking about is actual retail pricing, where we're analyzing the category, looking at all the stuff that's there, and getting to the optimum price level for us and our competition. We're looking at things like margin parity, so that we make sure that the retail margins for our products are similar to the retail margins for other people. In some cases, it means raising the price, the retail prices of some of our competition.

The net impact of what that's doing -- and also, one thing I'll also make a point is getting sharper price points on some of the more price sensitive items, from our standpoint. The net impact of that is it's closing price gaps. And we see that as very positive.

Robert Moskow - *Credit Suisse - Analyst*

Okay. And then a follow-up regarding China. I remember last quarter, I think your QSR business had shown some signs of improvement and now you're saying that you're cautious on fourth quarter. What has changed to change your tone? Is there something specific?

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

Well, as we went into last quarter, we were seeing increased foot traffic and some momentum in that business. And then, as you've probably seen from our QSR customers, report of a supply issue which has impacted foot traffic again. We still see that business as being pretty resilient over time, and the Chinese consumers tend to come back. But when they have these well publicized quality issues in the store, it erodes confidence and impacts short-term traffic. And we're seeing some of that, like our customers have reported.

Robert Moskow - *Credit Suisse - Analyst*

Okay. I'll get back in the queue.

Operator

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

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

Good morning, everyone.

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

Good morning, Alexia.

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

Good morning.

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

Can I ask about the US Consumer business? Over the past year, you've had a bit of market share encroachment from private label and also from some smaller brands. Where are you in reversing those trends and how confident are you that the share trends will continue to be fairly decent? Thank you.

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

Thanks. We're seeing some of the impact of the efforts that we've made between a combination of our new products, our category management activities, and frankly, some of those price gaps being closed. So what we've actually seen in the more recent periods, and actually for the year, private label share in spices has not grown in the US. It's been pretty flat. And in more recent periods, we've seen private label share flattening and actually declining a little bit.

The second piece of that is we've actually grown share in the recipe mix category. We're up about a share point, and so we are seeing some of that. The share erosion that we've seen has declined somewhat. We were last year looking at about a point and-a-half of share. Now it's less than a share point. And we're continuing to see momentum. So we're pleased that we have the right plans and the right kinds of activities that are going to continue to build that back.

I'd also remind you that we have a healthy, growing category. So we have not seen the growth rates of category level off at all. And so we're participating in good categories, both in recipe mixes and spices and seasonings.

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

And then as a quick follow-up, you mentioned acquisitions being on the radar screen. Are you continuing to look at fairly small bolt-on acquisitions, mainly in emerging markets, or has your thinking changed on that? Thank you, and I'll pass it on.

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

Thanks, Alexia. We are open and evaluate larger acquisitions. But the ones that we've had the most success with have been the tuck-in acquisitions that we know how to manage, largely in emerging markets, although we have some more developed market candidates, as well.

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

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

Operator

Thank you. The next question comes from the line of David Driscoll with Citigroup. Please proceed with your question.

David Driscoll - *Citigroup - Analyst*

Thank you and good morning, everyone.

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

Good morning, David.

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

Good morning, David.

David Driscoll - *Citigroup - Analyst*

To be totally honest, when I looked at the press release this morning, I thought, wow, this looks fantastic. Then as I get reading it further, guys, it seems more confusing. So a couple of questions here.

The tax rate, you spent a long time on it, but I still don't think I came away with maybe the most important issue here. Is this a sustainable rate for many years to go?

It felt like last year when you gave the initial guidance, there was this massive increase in the tax rate. It was a huge headwind, and it was really a dampening factor on the outlook this year. But lo and behold, here we are, and gosh, it's nowhere near that. So the first question is, what do we do with the tax rate long-term and how do you put some confidence around it?

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

David, this is Gordon. The best estimate I would have on a go-forward basis for the tax rate -- and I have to put two caveats around this, because it's one of the factors that impacted the volatility you've obviously described -- based on current legislation and business mix, the rate that we provided for you for the fourth quarter of 28% would be a reasonable rate.

Now, I appreciate the significant change during the course of the year. That significant change we spoke about is primarily a factor of the legislative environment. And as we started the year, we had rules coming out of France that we thought were going to be a negative impact on that tax rate, and that was going to be a sustainable higher rate. Until the final regulations were published this quarter, and we were able to interpret them more clearly and get advisory input on it. And that became one of the biggest factors in the reversal of that outlook for the quarter.

So I'd say simply at the moment, on current business mix and current legislation, that 28% is probably a good number. But again, it's a volatile legislative environment, and I don't know what different countries or different legislators are going to do as we proceed.

David Driscoll - *Citigroup - Analyst*

Really helpful. Following on this, just wanted to ask about when you take down your operating profit guidance for the year, the growth guidance, does this affect management incentive comp, and if so, how much?

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

We have a mix in our yearly incentive comp that's based partially on EPS, and so there's a positive impact of that, although we look at discrete items and exclude those. And the other part is on what we term as -- we call it McCormick profit. But it's a proxy for economic profit, which is operating income with a charge for working capital. So we do -- it will impact our management incentive comp in a way, in a bit.

David Driscoll - *Citigroup - Analyst*

What I'm really getting after right there, guys, is when we think to 2015, do we think that management comp kind of comes down this year because of the lower op profits and then rebounds next year and it's a factor affecting the algorithm? Or is that -- I'm just running too -- trying to be too specific on something?

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

That's pretty specific. But to recall, last year, a big part of -- because of our results, our bonuses were impacted negatively. And so we're building some of those back as we perform a little better.

David Driscoll - *Citigroup - Analyst*

Last little detail. FX in the fourth quarter, you said for the full year it doesn't matter, but rates have gone crazy. Can you just give us some comment on your fourth quarter FX impact?

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

Certainly there's going to be downward pressure. We haven't quantified the exact impact in the quarter. But I'd say we're definitely going to be experiencing downward pressure, and that's incorporated in the full year guidance that we've given you.

David Driscoll - *Citigroup - Analyst*

Okay. Thank you.

Operator

Our next question is from the line of Akshay Jagdale of KeyBanc. Please proceed with your question.

Akshay Jagdale - *KeyBanc Capital Markets - Analyst*

Hello. Good morning.

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

Good morning.

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

Good morning.

Akshay Jagdale - *KeyBanc Capital Markets - Analyst*

Two questions. First one, just a clarification on what you said on pricing, your pricing strategy in North America. Can you just talk a little bit more about that? Because what if your competitors decide to lower their prices or keep their prices where they are while you're increasing your price point? How should we think about that risk? And so maybe you can just clarify what you said before, because I was a bit confused on that. And then I have a follow-up.

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

To be clear, what we're doing is making pricing recommendations on the category. We can't control what our competition does. Although I will say that what we've seen over history is when we lead in pricing -- and that's our pricing to the retailer -- it takes some time for our competition to follow. Because of our share position, no other competitor is going to lead in pricing.

Until we take pricing, nobody else does. And then they follow it gradually, and we're seeing that impact now from last year's price increase. It just takes a little more time for the others to flow through. If they choose to lower prices or promote heavily and that sort of thing, then we'll adapt and respond, like we always do.

Akshay Jagdale - *KeyBanc Capital Markets - Analyst*

But just to follow up. So the need for this arises from your analysis of the category relative to other categories? And what's the general message that you're sending out to retailers, that prices need to be higher or lower or it's a mixed bag?

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

It's a mixed bag. And frankly, what we're trying to do is help them, as they analyze the category, with competitive prices relative to their competition and looking at the margins they're taking on McCormick items versus competitive items.

Akshay Jagdale - *KeyBanc Capital Markets - Analyst*

Okay. And just a follow-up on your guidance for 4Q. You mentioned the factors that are impacting EBIT growth to be lower now. I'm not clear as to which ones really change.

It seems like the mix impact is pretty significant on EBIT, but is that because you're expecting lower consumer growth now than you did before or higher international sales growth? I'm just not clear which one of those changed to cause that.

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

We're reflecting certainly what we've seen on the international markets and its impact on the margins year-to-date and what we anticipate on a go-forward basis into the quarter. So as we said in the call, we're maintaining the sales guidance, but we're acknowledging that a lot of the sales growth year-to-date has come from the international growth. And that's certainly impacted the margin structure and that's part of it.

It's also acknowledging that we're investing behind our brands, and we're having confidence in the programs that we have in place. We're not going to be pulling back on any of those programs. In fact, we're leaning into those in the fourth quarter. Alan described them to you. So that's a significant increase in Q4 which certainly is going to have an impact near term on the profit, but we think is the right thing long-term for the category.

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

And then the caution that we talked about in China.

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

Right, right.

Akshay Jagdale - *KeyBanc Capital Markets - Analyst*

Okay. Great. I'll get back in --

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

-- on the Industrial segment.

Akshay Jagdale - *KeyBanc Capital Markets - Analyst*

Okay. Thank you.

Operator

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

Chris Growe - *Stifel Nicolaus - Analyst*

Hello. Good morning.

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

Hello, Chris.

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

Good morning.

Chris Growe - *Stifel Nicolaus - Analyst*

I just had two questions for you. And I'm sorry to ask another follow-up on this one. But I just want to be clear on the pricing recommendations that you're changing. Is there any direct benefit to you from these price changes? Or is it more of us getting the prices right to the consumer at retail?

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

It's more about getting the prices right to the consumer at retail.

Chris Growe - *Stifel Nicolaus - Analyst*

That's what I figured. But I wanted to make sure that was clear. Because it was a little confusing. Thank you.

If I could ask about the US consumer performance this quarter, given you had this 5% drag, roughly, from shipment changes year-over-year, would it be fair to say your underlying growth this quarter in US consumer was around 4%, just given the performance that was reported versus the adjustments that came through from the shipment setting?

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

Yes, that's right.

Chris Growe - *Stifel Nicolaus - Analyst*

Okay. That does suggest a marked improvement in the business. That's good.

And then one final question, if I could, maybe to Gordon, on the gross margin. So you had CCI savings coming through. I guess you had some pricing, as well, offsetting cost inflation. So I'm just -- the gross margin was softer than what I expected. Is that more about the business mix shift, or are there any other factors we should be aware of in terms of offsetting inflation or CCI savings, that kind of thing?

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

It's geographic and segment mix.

Chris Growe - *Stifel Nicolaus - Analyst*

Okay. Do you know how much that was in terms of a factor in the quarter on the gross margin?

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

I don't have that quantified in front of me right now, but it would be the significant factor.

Chris Growe - *Stifel Nicolaus - Analyst*

Okay. That's helpful. Thank you for your time.

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

Thanks.

Operator

Thank you.

(Operator Instructions)

The next question is from the line of Erin Lash of Morningstar. Please proceed with your question.

Erin Lash - *Morningstar - Analyst*

Thank you for taking my question. I was curious about the Skillet Sauces, the launch of Skillet Sauces. Obviously, that has been a highly competitive category and one in which several other packaged food firms have entered. And you've talked to the fact that the Spices and Seasonings category growth rates overall remain healthy. I was wondering -- obviously, Skillet Sauces moves you further into that center of the store, packaged food type space. And so I was wondering if you could speak to how your product is differentiated and how you expect to compete in that category.

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

The products that we've launched have been more instead of being more premium, have been more focused on everyday classics with a twist. And so effectively, they're liquid versions of our more popular dry seasoning mixes. And so we think that distinguishes us. We've obviously -- as everything that we do, we test with great flavors. So we believe that's going to deliver.

And just to remind you, we're also in the liquid category already with our Lawry's wet marinades. So while this is a new launch for us and a new category that has been growing, we believe it will help with the category growth rate. We're not going head-to-head with the stuff that's already out there. We've got a different mix of products.

Erin Lash - *Morningstar - Analyst*

Thank you. That's helpful. And then I was just wondering if you could speak a little bit more to the plans for the holiday in terms of how you're maybe positioning your products, if you're positioning your products any differently, given the importance of the holiday season in terms of your overall results.

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

I wouldn't say we're necessarily positioning them differently. But we are, as we always are, very active with display activity to make sure that the stores have the product that they need as the consumers are shopping for the holiday meals. We are continuing to increase our advertising and marketing support behind the products as we go into the fourth quarter, and we're working with retailers to make sure they get those displays up and in the right place so that consumers can find them.

Erin Lash - *Morningstar - Analyst*

Thank you. That's helpful.

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

Thanks, Erin.

Operator

The next question is from the line of Jonathan [Veney] with (Indiscernible) Research. Please proceed with your question.

Unidentified Participant *- - Analyst*

Good morning. Thanks very much.

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

Good morning, Jonathan.

Unidentified Participant *- - Analyst*

So when you communicate this mixed bag on pricing with retailers, are there any units for which you're actually recommending price should go up?

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

That's a -- I would say generally, no. But there are certainly, at least in terms of our products, we're looking at what the right level of pricing to hit the -- for the consumer is, and we're managing gaps.

Unidentified Participant *- - Analyst*

I got you. And you mentioned, you've done a good job maintaining that -- I should say, stopping any kind of encroachment in private label share. When you go through the data with retailers, is there a really big difference? Is it the big difference in velocity between your products and private label that makes it compelling for the retailers? Is that what you lead with? Or is it a difference in absolute dollar margin to the retailer?

What is the bigger factor of those two? Because I know it's a category that you have a unique level of dialogue and frankly, control over, given your manufacturing on both sides, private label and branded, compared to some other food categories.

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

It's more helping the retailer maximize their dollar profit and get the right margin mix for the items. And remember, in our category, it's a fairly small, limited number of items that are duplicated across all the brands. So there's about 15 to 20 items which are duplicated from opening price point to private label and then all the competitive brands that actually matter. And so those we're really working on getting the pricing right.

The broad array of the stuff we offer are the things that are unique to certain times of the year, like poultry seasoning and sage at Thanksgiving and some of the baking items at the holidays. So it's really kind of managing those things that aren't necessarily -- that are duplicated so we get the pricing right, and then all the things that aren't duplicated, making sure the availability is there.

Unidentified Participant *- - Analyst*

Thanks. I guess just one follow-up to that, then. How is it, do you think -- why is it, do you think, that retailers maybe got their pricing a little bit out of whack on some of these products? Do they not understand the consumer? Did the consumer change? I guess any thoughts you had on that.

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

As we talked in some of the earlier calls, we saw a lot of stuff that was coming in through either produce departments or through a DSD supplier that may not have been visible to the center store category managers. And some of that is just bringing that to their attention. Because we're seeing lots of stuff that has just found their way in. And we see it sometimes.

And a couple of the selling stories we're given is to help them understand the impact on their inventory levels for stuff that's not necessarily adding to category growth. So we're kind of telling the whole category story. And that's the role that we can play, given our position.

Unidentified Participant - - *Analyst*

Great. Thank you very much.

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

Thanks, Jonathan.

Operator

Our next question comes from the line of Eric Katzman with Deutsche Bank. Please proceed with your question.

Eric Katzman - *Deutsche Bank - Analyst*

Hello. Good morning, everybody.

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

Good morning, Eric.

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

Good morning.

Eric Katzman - *Deutsche Bank - Analyst*

A couple of questions. Why don't we start out with the advertising spend. It seems like during the year, it's kind of been deferred each quarter to meet up with what your expectation was initially for the full year. So was there something about the product line-up or the landscape that's made so much of the advertising spend fall into the fourth quarter?

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

Typically, the fourth quarter is where we spend the heaviest. And some of that spend is to support new products. And so we've lined up the actual spend with the distribution level of the new products. So there is a piece to that that we've managed.

But by and large, because we do in the US business, and to a lesser extent in our other developed markets, an awful lot of our sales are skewed towards fourth quarter. And the fourth quarter's when we have our highest returns on investment for advertising.

THOMSON REUTERS

Eric Katzman - *Deutsche Bank - Analyst*

Okay. Second, you talked pretty aggressively about the balance sheet and the ability to look for M&A. I know you've been very kind of EVA, or economic profit focused, as opposed to the rest of the world that doesn't seem to even care about that anymore. Seems like it's all about EPS accretion. How are you seeing multiples in your ability to drive economic profit, again in that context?

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

That's always the balance. And we've been pretty disciplined. Through the years, we continue to be pretty disciplined on making sure that we can more than pay back the cost of capital over time for the deals that we make. Certainly, that means that in highly contested deals, we are -- we get bypassed in some cases.

But we've been pretty disciplined. We know what our targets are. We are willing to pay the prices we need to pay. But we also make sure that we know how to get the returns. And we have, as you well know, a pretty good track record on generating the value that we promise.

Eric Katzman - *Deutsche Bank - Analyst*

Okay. And then last question, I guess, is it seems like -- maybe it's 24 hour news these days -- but it seems like the world is, I don't know, aflame in every region. And we don't get great views on your input costs. I think, Alan, you had mentioned to me at one point some concern over pepper cost rising. Are you seeing pressure on some of your crops, and how does that figure into what sounds like basically lower prices at retail for the spice category, led by your discussions?

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

We are seeing some pressure, specifically on pepper, and we're evaluating our plans as we go into next year. We're not making any changes to this year, but we're evaluating how to respond to that for next year. But we're certainly seeing some upward pressure.

It's a pretty volatile world, with everything from political unrest to some uncertain weather. But that's the kind of thing that we've always dealt with. But I will say that we're currently evaluating and setting our -- getting our budgets ready for 2015 and making decisions on how we're going to approach what we do see as some input cost pressure.

Eric Katzman - *Deutsche Bank - Analyst*

Is it -- I'll just last follow-up, but I think it's an important issue. So I read your comments about the category management work with the retailers as essentially being lower price points. If you have somewhat inflationary pressure -- you didn't comment about vanilla or cinnamon -- but does that -- do you have additional productivity savings that can act as an offset to all that, looking into next year, which is -- sounds like it's more relevant to next year, in any case?

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

Yes. And we are continuing to look at and beef up our CCI programs and looking at other ways to help offset some of that inflation and to make sure that we stay within the right gaps that consumers are going to be able to buy our products.

Eric Katzman - *Deutsche Bank - Analyst*

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

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

Thanks, Eric.

Operator

Our next question is a follow-up from the line of Robert Moskow with Credit Suisse. Please proceed with your question.

Robert Moskow - *Credit Suisse - Analyst*

Thanks for the follow-up. Are you able, from an antitrust perspective, to look at spice and seasonings acquisitions domestically anymore, or do you feel more comfortable looking outside that category?

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

We generally are looking more broadly at adjacent categories in the US market. And so that's -- I wouldn't say never that we couldn't, but I will say that most of our targets in the US market are adjacent categories, not directly spice and seasonings.

Robert Moskow - *Credit Suisse - Analyst*

Okay. Thank you.

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

Thanks, Rob.

Operator

Thank you. At this time, I'll turn the floor back to Mr. Alan Wilson for closing remarks.

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

I want to thank everybody for your questions and for being on the call. We recognize that our financial results this quarter were a bit complex and with the tax rate variance, the shift in sales, and special charges. Putting these aside, we want to leave you with a few take-aways.

We're making steady progress to improve the results of our US Consumer business. We're driving increased sales and profits in a number of our international markets, and we continue to invest in our growth and fuel these investments with above target CCI cost savings. This performance has us on track for record sales, profit and cash flow in 2014.

Throughout McCormick, we're executing against our plans that have us well-positioned for the future. Thanks for your time and attention today.

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

Thank you, Alan. I'd also like to add my thanks to those who joined us this morning.

Through October 16, a replay of the call can be accessed by dialing 877-660-6853. The conference ID number is 13588908. You can also listen to the replay on our website later today. Thank you.