Kraft Union Network

March 24, 2011

Somerdale factory on the auction block/are rising commodity prices the driving force behind Kraft layoffs?

Within days of Kraft CEO Irene Rosenfeld's subbing a UK parliamentary committee (Kraft CEO missing in action as company steps up its vanishing act), it was announced that BNP Paribas is handling the sale of the former Cadbury Somerdale site for real estate development – at a price of GBP 50 million.

Kraft is selling a bit less than a quarter of the total property, including the former factory buildings. According to press reports, this was described as the "developable" part of the property. Apparently neither the factory nor the workers met that criterion.

Outsourcing chocolate/pressure on contract manufacturers in the UK

Kraft is also pressuring workers at the Burton's biscuit factory in Moreton within the framework of a plan already announced by the private equity owners to close the site entirely this year with the loss of 342 jobs. Under license to Kraft, Burton's manufactures all Cadbury chocolate products. The Moreton site produces the new range of Cadbury Crunchie biscuits, Cadbury Turkish Delight biscuits, Cadbury Caramel biscuits and Cadbury Dairy Milk biscuits.

Unite has been contesting the closure, which was announced on January 12 from when it entered into a 90-day 'consultation' period. The union has set up an on-line petition as part of their campaign to fight the closure – click here to support the campaign.

On the same Unite web page you can view a video story from the daily Guardian, where the union's regional industrial organizer Richie James explains how Kraft, citing high cocoa prices, is demanding additional job cuts even before the planned end-of-year closure.

Are commodity prices what's driving restructuring at Kraft?

When the company released its 2010 Q4/annual results in February, the official line was: Operating income in the fourth quarter increased 2.2 percent to $1,240 million, including a favorable impact of 30.4 percentage points from Cadbury, partially offset by a negative 26.9 percentage point impact from Integration Program(2) and acquisition-related costs(3). Currency had a negative impact of 3.1 percentage points. Excluding these factors, the increase in Kraft Foods' base business operating income(1) was primarily driven by lower overheads, higher pricing, and favorable volume/mix. ***These benefits more than offset higher input costs.*** (our emphasis).

In the company's conference call with investors CEO Rosenfeld elaborated on the strong results, stating "In addition, ***despite sharply higher input costs, Europe continued to expand operating margin***."

Moreover,” Kraft said it anticipates net revenue growth of at least 5% during 2011, despite input cost inflation” (to which Kraft is responding by aggressively raising prices).

Restructuring was aggressively pursued in 2009, a year when input prices *fell* substantially from the previous year’s highs. According to the company’s annual report filed with the US SEC, “During 2009, our aggregate commodity costs decreased primarily as a result of lower dairy costs. For 2009, our commodity costs were approximately $150 million lower than 2008, following an increase of approximately $2.0 billion.”

The thousands of job losses that year were programmed years earlier, as part of the plan to feed investors by freeing up cash. From the same year’s annual report: “In 2008, we completed our five-year restructuring program. As part of the program, we announced the elimination of approximately 18,600 positions. As of December 31, 2009, we had eliminated approximately 17,300 of those positions.” No mention of commodity prices here!

A slide from Kraft’s presentation to the “Barclays Capital Back-to-School Conference” (September 9, 2009) lays out the European situation in these terms:

This clearly indicates that the job cuts/restructuring have been programmed over a 5-year + period without regard to fluctuating commodity prices. Further, as Kraft explains in its annual reports, the company hedges many of its purchases through the use of financial derivatives. The net financial impact of the hedging operations, however, is virtually impossible to determine – it’s described as being entered for accounting purposes as part of the “cost of sales”.

While margin/revenue figures have varied over this period, two sets of figures remain constant in their progression: dividends and debt!

At the time of the Cadbury deal, Kraft pledged to squeeze out USD 675 million in cost savings by 2012. They are fighting to meet the target, with a constant eye on operating margins and the all-critical earnings per share. The largest share of the cost savings, USD 300 million, was to be achieved in procurement, manufacturing and logistics – over and above anticipated productivity gains. Cadbury had also in recent years been pushing for consolidating supply chains to raise margins.

Teaming with Cadbury has also raised Kraft's cocoa purchasing clout, gaining it leverage over suppliers. All this should be kept in mind when Kraft sings the high cocoa prices blues.

Teaming with private equity

The Burton's situation represents the convergence of two financial pressure forces on the workers – Kraft, on the one hand, which contracts Cadbury manufacturing to Burton's, and the company's private equity owners.

British private equity investors Duke Street picked up Burton's in 2007 in a secondary buyout from its original private equity owners, HM Capital. In the buyout frenzy of the period, Duke Street reportedly paid some GBP 210 million. HM had bought the company in 2000 for GBP 130 million; they invested nothing while loading it with debt and bleeding it of cash. Two months after Duke Street took charge, the Moreton workers were told that 660 jobs would be cut. The company CEO described this as a necessary measure for "securing the long-term success of the company".

Duke Street continued to run up the debt, breaching its covenant with the lenders who funded the buyout in October 2009. Majority ownership is now shared between buyout giant Apollo Management and a Canadian bank, who converted their junior debt into equity, with Duke Street still holding a share. The deal this time was valued at GBP 331.9 million.

Burton's top management is now staffed by former Kraftys. When Duke Street ceded control, Ben Clarke took over as CEO. Clarke had held top positions at Kraft including area director and vice president of Australia/New Zealand and category director of coffee and confectionery.

In March 2010 Kraft's vice president of international customer development Steve Newiss was appointed to the new job of of chief commercial officer. According to an industry trade report at the time (Burton's Foods hires 'top sales operator in Europe'), "The move comes as Burton's, the UK's second-biggest biscuit manufacturer, announced a "new era" of investment. Newiss is expected to help Burton's grow its portfolio and expand into new markets. He will be responsible for commercial sales activities including customer management, retailer brand, international, category management and sales and operations planning."

Pressure from Kraft to contain input prices is reportedly behind the Burton's decision to outsource its Moreton chocolate refining (which it does for Cadbury) to an unspecified third party.

In the Guardian video, Richie James comments on the financial owners' stewardship of the site – a scene of neglect and devastation which the buyout bosses had pledged to transform into a "center of excellence."

For more on Apollo, and their links with US employee pension funds, see the IUF's [Private Equity Buyout Watch].

Port Elizabeth - South Africa's Somerdale?

In South Africa, where Kraft had secured regulatory approval for the Cadbury acquisition by affirming that there would be no major job losses as a result, FAWU has informed us of company plans to eliminate up to 400 jobs at the Port Elizabeth Cadbury plant.