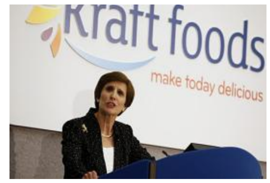
Kraft Union Network

March 28, 2012

There's always something going on at Kraft Foods…

$22M in compensation for Kraft's Rosenfeld



March 23, 2012 | By Emily Bryson York | Tribune reporter

Kraft Foods CEO Irene Rosenfeld took home nearly $22 million salary, stock and option awards during 2011, according to documents filed the Securities and Exchange Commission Friday afternoon.

The compensation package includes, in addition to the USD 1.5 million in salary, a cash incentive of $4.2 million, $7.8 million in stock and 276,373 in assorted compensation including use of the company plane.

On February 26, Kraft announced that Executive Chairman John Cahill, who joined Kraft in January to oversee the financial engineering of the company's split into two separate entities later this year, would receive USD 6 million in compensation for 2012. Cahill brings to Kraft his long experience of splitting and draining companies of cash to reward top management and shareholders at PepsiCo and private equity operators Ripplewood Associates (see More than a hint of the future… in Kraft Union Network December 9, 2011). Cahill changed jobs in time to miss the fallout over the collapse of Ripplewood-owned Hostess Brands, the largest industrial baker in the US, which filed for bankruptcy in January this year. When the Kraft split is finalized later this year, Cahill is expected to stay on as non-Executive Chairman of the grocery division.

Rosenfeld's 2011 compensation increased by 14% over 2010. Executive pay at Kraft is growing faster by far than any relevant financial indicator.

What else is going on at Kraft, besides the recently announced elimination of 1,600 jobs in North America?

Kraft debt to 'migrate'

Kraft Foods' CEO Discusses 2011 Results - Earnings Call Transcript

February 21, 2012 | about: KFT

Chief financial Officer David Brearton, speaking at the February 21 investor call (http://seekingalpha.com/article/380821-kraft-foods-ceo-discusses-2011-results-earnings-call-transcript), confirmed that Kraft's enormous debt would be put on the grocery division as Kraft takes a "clean sheet approach as we set up lean corporate structures". They call this 'migration':

“Let me preempt the likely questions about which entity, global snacks or North American grocery, will benefit from the savings associated with these activities. The answer will be both. Much of the cost will be borne by Kraft Foods, as we reported today, with benefits shared across the 2 entities as we set up each organization. These actions are necessary for separation but also for each company to achieve peak performance.”

“Between now and the transaction date, we'll also set up the capital structures for each company. It involves *migrating debt* [our emphasis] to North American grocery…

“I know there are some concerns on how our free cash flow was pacing during 2011[but] our cash generation did indeed come back into line. It was essentially flat with 2010 despite the high commodity environment.

“Total debt was down more than $4 billion from March 2010. And *we're also taking actions to create flexibility to migrate debt down to the North American grocery company* [our emphasis]. In January of this year, we issued $800 million of floating rate notes that will be redeemed at the earlier of the time of the spin date or 18 months. And we'll communicate news as we execute our debt migration plans between now and the transaction date.”

In other words, Kraft’s “clean sheet” approach is not quite so clean. The company failed to increase cash flow (the CFO concedes it was flat), and they’ve gambled on refinancing part of the debt through new floating rate bonds. The debt will “migrate” to grocery. Nothing here explains how both “entities” will benefit from the presumed cost savings. On the contrary, *new costs* will fall on that part of the current operation where sales growth is slowest, the new North American grocery business.

Kraft’s debt burden is also heavier than Brearton indicates. Kraft’s debt-to-equity ratio, though high, is not out of line with industry standards in these debt-inflated times. But interest coverage at Kraft, the ratio analysts use to determine the part of company revenue devoted to servicing debt, *is considerably* higher than for its peers. The lower the interest coverage ratio (a ratio of one would indicate insolvency), the greater the strain on cash flow - and on workers:

	Dec 31, 2011	Dec 31, 2010	Dec 31, 2009	Dec 31, 2008	Dec 31, 2007
Debt to equity	0.76	0.80	0.73	0.91	0.77
Debt to capital	0.43	0.44	0.42	0.48	0.43
Interest coverage	3.90	3.95	4.40	3.85	6.04

http://finapps.forbes.com/finapps/jsp/finance/compinfo/Ratios.jsp?tkr=PEP, consulted on March 27, 2012

The figures show that Kraft’s debt payment situation in fact deteriorated over 2011, that 2011 marked a deterioration with respect to 2010, and that the overall situation is considerably more strained than it was in 2007 – when Kraft launched the acquisition binge which has now culminated in splitting the company.

For purposes of comparison, here are the figures for the US consumer goods industry as a whole:

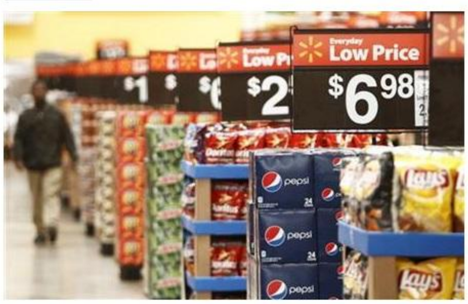
Interest Coverage, Comparison to Industry

Kraft Foods Inc.[1]	3.90	3.95	4.40	3.85	6.04
Industry, Consumer Goods	–	10.10	8.21	18.08	17.82

At the end of 2011, interest coverage at snack food rival PepsiCo was 11.3. To a far greater extent than for the consumer goods sector or at its closest competitors, a big piece of Kraft's enormous cash flow – the part that isn't transformed into dividends and executive compensation – is drained away as interest. When the two businesses separate, the grocery division will have about half the sales revenue of the snacks division, yet will be called upon to sustain an even heavier burden of interest on debt than the businesses support today as one company. This translates into additional pressure on Kraft workers.

Wal-Mart's price push tests manufacturers' prowess

Recommend | Sign Up to see what your friends recommend.



Tweet 2
Link this
Share this
Digg
Email
Print

Related Topics
Business »

Stocks

By Martinne Geller and Jessica Wohl
NEW YORK/CHICAGO | Tue Mar 6, 2012 7:05pm IST

"Wal-Mart is pushing its grocery suppliers harder to offer consistently low prices, instead of timed promotions or "rollbacks." That means food companies are unlikely to be able to pass through more price increases and will be forced to pull other levers, such as cost-cuts to protect margins or product innovation to drive sales."

http://in.reuters.com/article/2012/03/06/usa-consumer-walmart-idINDEE8250BS20120306

The investor call shows that Kraft grew revenue in 2011 at the expense of volume, and admits to losing market share in some key product areas. The strategy of raising prices, however, may have reached its limit. With the US still mired in massive unemployment, retailers are becoming more aggressive, with Wal-Mart in the lead.

"We want to work with vendors on that to see if we can take a price lower and leave it there permanently," Wal-Mart chief financial officer Charles Holley told reporters last month. "The price image for a customer is very important." Where Wal-Mart leads, other retailers follow.

“I think we reached the wall in terms of raising prices. Consumers can’t take any more,” said Edward Jones analyst Jack Russo, citing recent Nielsen data showing correlations between price increases and declines in sales volume.

The grocery division, Rosenfeld emphasized at the February 27 investor call, “Will generate substantial cash flow. This cash can be returned to shareholders in the form of a highly competitive dividend payout and a growing dividend over time while continuing to fuel the virtuous cycle.” But some investors are worried that shares in Kraft are expensive for what they’re delivering, with future earnings and dividend growth potentially constrained by difficulties in raising prices to grow revenue.

This presents a dilemma for shareholders, as the Reuters article explains: “With many consumer goods stocks trading at a premium to the broader market, analysts say the risk is on the downside… Consumer staples companies that make up two Standard & Poor’s indexes – the S&P 1500 Packaged Foods & Meats index and the S&P 1500 Household & Personal Products Industry Group index – trade at nearly 16 times expected earnings, while companies in the S&P 500 index trade at 12.8 times expected earnings.

“A lot of these companies are going to have to get back to basics and not raise prices much,”, Russo told Reuters in the article cited above, “and if they want to grow sales they’re going to have to do it through innovation, or being razor-sharp on pricing.”

Innovation costs money – money which has been pledged to shareholders. That leaves cost-cutting. One way to cut costs is is by cutting back on product lines, which Executive Vice President and President of Kraft Foods North America W. Anthony Vernon described to investors as a “Real opportunity” on the February call “About 40% of this [‘selective product pruning’] will occur in Foodservice with the rest spread out among the other business units. We expect this pruning to modestly temper organic revenue growth this year by about 2 points in North America and about 1 point for Kraft Foods overall.”

Financial analysts Jefferies estimated the damage as more serious, advising clients in a downgrade note which sent Kraft’s share price into a spin that fewer Kraft products on retailers’ shelves could knock some 5% off of the growth in earnings per share this year (Costs, spin-off to hurt Kraft Foods in 2012: Jefferies)

Investors, nonetheless, are betting on a huge immediate payout from the split. Institutional investors have increased their holdings in Kraft, and now account for a greater percentage of the shareholders than they did 7 months ago.

Ownership of Kraft shares remains extremely concentrated. Here are the top ten shareholders:

Equity Ownership KFT

Funds | **Institutions**

Name	Ownership Trend Previous 8 Qtrs	Shares	Change	% Total Shares Held	% Total Assets	Date
Capital Research Global Investors	Premium	98,585,754	-805,000	5.58	1.64	12/31/2011
State Street Corp	Premium	88,591,641	54,508	5.01	0.58	12/31/2011
Berkshire Hathaway Inc	Premium	87,034,713	-2,711,995	4.92	4.92	12/31/2011
Vanguard Group, Inc.	Premium	67,966,414	1,503,091	3.84	0.40	12/31/2011
Capital World Investors	Premium	56,342,321	-8,014,651	3.19	0.74	12/31/2011
BlackRock Institutional Trust Company NA	Premium	44,493,941	2,962,648	2.52	0.42	12/31/2011
Wellington Management Company, LLP	Premium	27,908,743	-3,416,915	1.58	0.41	12/31/2011
Franklin Mutual Advisers, LLC	Premium	24,736,727	137,724	1.40	2.97	12/31/2011
J.P. Morgan Investment Management Inc.	Premium	23,642,119	2,464,300	1.34	0.82	12/31/2011
Pershing Square Capital Management, L.p.	Premium	21,160,759	-4,022,574	1.20	10.16	12/31/2011
Total: Top 10 institutions	**Premium**	**540,463,132**	**-11,848,864**	**30.58**		

Source: http://investors.morningstar.com/ownership/shareholders-overview.html?t=KFT, viewed March 27, 2012

Investor eyes are on the split – and not much beyond. The Jefferies analyst quoted in the article cited above said "The company will benefit in the long term [from declining earnings in 2012] as the slow earnings growth will create easy comparisons and set up Kraft for a strong performance in 2013 after it splits.

This is the essence of financial engineering: easy comparisons.

Kraft workers necessarily take a longer view.

Cash at Kraft is under pressure from interest charges, the commitment to raise dividends and constraints on the price increases which have sustained revenue growth. Outsourcing, not something Kraft executives like to stress in investor calls, will accelerate in both the grocery and snacks divisions, where alongside "iconic American brands" like Fig Newtons made in Mexico, there's now "Belgian chocolate" made in Slovakia and Lithuania. Easy comparisons of operating margins invite attacks on wages and pensions, key "variable costs". Procter & Gamble, the world's largest consumer goods company, has upped the ante in the competitive layoff competition by recently announcing the elimination of 5,700 jobs, a move which financial analysts welcomed gleefully. Where Kraft management sees "real opportunity" in reducing the product portfolio, Kraft workers will be confronting closed production lines and shuttered factories. They can prepare for tough bargaining as the company advances towards splitting itself in two.

BUSINESS | Updated March 22, 2012, 1:39 p.m. ET

What's a Mondelēz? A Krafty New Name for Snack Maker

Article | Stock Quotes | Comments (39)

Save | Recommend 405 | +1 2 | Tweet 319 | A A

By JULIE JARGON

Will Kraft by another name taste as sweet?

Kraft Foods Inc., KFT -0.26% purveyor of such storied brands as Ritz crackers, Oreo cookies and its eponymous macaroni and cheese, is betting on a more obscure formulation for the name of the global snacks business it plans to spin off later this year.

Mondelēz International Inc., (pronounced mohn-dah-LEEZ), the new moniker announced Wednesday, is a portmanteau meant to evoke the idea of a "delicious world." "Monde" comes from the Latin word for "world," and "delēz" is a "fanciful expression of 'delicious,'" Kraft executives explain.

Not in Webster's Dictionary

The 'definitions' for two new corporate monikers.

Mondelēz [mohn-dah-LEEZ]

n. [<Lat. Mundus + slang] The new name of Kraft Foods snacks business; pronounced similar to Condoleezza Rice. Kraft says 'Monde' derives from the Latin word for '*world*,' and '*delez*' is a fanciful expression of '*delicious*.'

AbbVie [Abb-vee]

n. [ME abbod + <Lat. Vi] The new name of Abbott Laboratories pharmaceutical business. The company says '*Abb*' connects the new company to Abbott and '*Vie*' is

"It's quite a job for a single word to capture everything about what we want the new global snacks company to stand for," Kraft's Chief Marketing Officer Mary Beth West said in a statement announcing the new name. Mondelēz is "interesting, unique and captures a big idea."

What else is going on? Kraft has found a name for the snack division. Shareholders will decide in May whether it truly evokes the idea of a delicious world.