Kraft Union Network

May 2, 2011

Post-Cadbury global cost-cutting offensive intensifies

On March 16, Kraft nonchalantly announced – in violation of the prescribed procedure - the closing of its Madrid Business Center with the elimination of 70 jobs. Spanish unions are questioning whether Kraft was less than rigorous in its "due diligence" when it contracted branded cheese production at Quesería Menorquina to the now-bankrupt Nueva Rumasa. Also in March, Kraft announced that merchandising (retail distribution and promotion) jobs formerly performed by Johannesburg Cadbury employees would now be assigned to a dedicated contractor employing disposable workers on a casual basis. This follows the planned elimination of 400 FAWU jobs at the company's Port Elizabeth Cadbury plant – which the union is challenging as a violation of the understanding Kraft gave the regulatory authorities as a condition for the takeover in South Africa.

On April 2, UK Cadbury workers who remain in the final salary pension scheme (Cadbury had already closed it to new employees) were given an ultimatum: "voluntarily" opt out of the scheme or face a 3-year pay freeze. Kraft management, in a by now familiar pattern, explained that they had "overlooked" the details of the pension scheme when they executed the Cadbury takeover…

Kraft is racing to realize by year's end the promised USD 675 million in cost-savings it promised investors when it organized the Cadbury deal. Nearly half of these savings were to be achieved in manufacturing, procurement and logistics, where they are now accelerating (see Are commodity prices to blame for restructuring and layoffs at Kraft?).

But these new targets are superimposed on a cost-cutting imperative which is deeply embedded in Kraft's pre-Cadbury structures and operations. For many years prior to the Cadbury acquisition, Kraft had been struggling to reconcile sluggish growth in highly-competitive markets with investors' (and top management's) growing financial appetites. The solution at Kraft has been to feed the demand for shareholder value by funding "bolt-on" expansion through debt, leading to further reductions in capital expenditure, r&d etc – the ultimate drivers of long-term growth. Kraft workers worldwide are bearing the costs of this "borrow to grow" strategy. (True, CEO Rosenfeld had to settle for a smaller bonus this year for missing some 2010 targets after getting total compensation of USD 26.3 million for swallowing Cadbury...)

With revenues of $37 billion, Kraft Foods Inc. is one of the world's largest food and beverage companies.

Kraft 2008 Fact Sheet

The combination of Kraft Foods and Cadbury creates a global powerhouse in snacks, confectionery and quick meals.

Kraft 2009 Fact Sheet

Kraft Foods is a global snacks powerhouse with an unrivaled portfolio of brands people love.

Kraft 2010 Fact Sheet

In the space of thee years, Kraft's self-presentation has gone from describing itself as a food and beverage company to asserting its identity as a "global snacks powerhouse". More than the periodic brand portfolio reshuffling, the change is due to the assimilation of the Danone Europe biscuits and Cadbury purchases. Snacks and confectionery have completely eclipsed the US Grocery division, which formerly accounted for the largest single contribution to net revenue. According to the Kraft February 22, 2011 CAGNY Conference presentation they now make up 75% of the portfolio and, more importantly, account for 90% of growth as well as the largest share of revenue. The profit center and driving force has shifted dramatically. And the most rapid growth is in developing markets, which was the logic of the Cadbury deal:

While still hugely profitable – the basic truth for any union going into collective bargaining or fighting off a pension attack – this structural reorientation (from food/bev to snacks "powerhouse") has involved a heavy price. Key financial indicators indicate the extent to which margins have been won at the expense of investment in research, plant and equipment, and the "people" to which Kraft regularly invokes their appreciation and dedication (which doesn't stop the company from throwing them on the trash heap). For year, Kraft has relied on ruthless cost-cutting to boost its margins.

Capital expenditure has steadily shrunk over the past 5 years, whether measured against cash flow or total assets. In 2006, with total assets of USD 55.54 billion capex stood at USD 1.16. It inched up to 1.33 billion in 2009 (pre-Cadbury), against an increase in assets to 66.7 billion. At the close of 2010, with assets at 95.2 billion, capex was a mere 1.66 billion. Measured against the huge adrenaline rush of free cash flow (the growth of which was diverted into executive bonuses, buybacks and dividend hikes), the decline in spending on the company's future is even more dramatic. Free cash flow measured 2.55 billion in 2006 and 3.75 in 2009 (the comparison for 2010 is less relevant because cash flow declined under pressure to pay down debt from the Cadbury deal, but the capex against cash flow is still low).

Operating margins actually *declined* between 2006 (12.4%) and 2010 11.5%), after hitting 13.4% in 2009l. For each of the years 2006-2010, Unilever and PepsiCo, competing in the same product categories, turned in consistently better results.

Kraft's percentage return on assets, a favorite ratio of financial analysts, for the years 2006-2010 were 5.51, 3.81, 4.60, 4.53, and 4.32. The comparable benchmark figures for PepsiCo are 18.85, 16.34, 14.29, 14.92, and 9.27. Unilever, which disposed of some three-quarters of its brand portfolio over the past decade under consistent pressure from financial markets, bested Kraft by some 50% for each of these years but 2010, when results disappointed and the company again came under financial market pressure.

Financial analysts view these figures and draw one conclusion: Kraft has too many assets and too many employees. To boost margins and earnings per share (EPS), the recipe is more selloffs, more outsourcing, more disposals.

This is the message of the recent investor downgrades from e.g. Morgan Stanley and JP Morgan.

Investor impatience and ongoing struggles to reduce the company's burden of debt it took on for the big deals, will undoubtedly be reflected in the activity around Kraft's May 5 quarterly results announcements and conferencing. Workers, unlike investors and those who run companies as if the quarterly report counted more than long-term profitability and investment in the future, are already feeling the squeeze.

In addition to supply chain and manufacturing consolidation, another round of precipitous disposals may be in the works (since there are no easy "bolt-ons" looming in the near-to-medium future). In two key years following major acquisitions (2008 and 2010), Kraft has shown a huge leap in *earnings from discontinued operations*. These were USD 381 million in 2007, leaping to 1.21 billion in 2008 (post-Danone), sinking to 218 million in 2009 and rising to 1.64 billion in 2010. The 2010 figure should be measured against pre-tax 2010 earnings from *continuing operations of 3.64 billion* – a performance which is clearly not sustainable.

In its rush to meet investor appetites, Kraft has thrown a number of valuable brands and companies into the wastebasket rather than patiently invest and build. The bargain-basement disposal of the North American pizza business to Nestlé is not the only hasty move which, following Warren Buffet, could be qualified as "stupid". The Stella d'Oro story is an object lesson.

In 2002 Kraft bought Nabisco, and with it specialty US biscuit maker Stella D'Oro, originally with an eye on challenging other up-market bakery specialists. Kraft began by investing in new equipment and production lines in the Stella plant in Illinois. But Kraft succumbed to the pressure for "shareholder value". The company abandoned its investment, scrapped the newly updated plant, and sold on the remaining Stella operation. Analysts were pleased – this was in the early days of "downsize and distribute" and Kraft was learning to financialize. Shortly after the Stella sale, Kraft announced a 23% increase in quarterly earnings and the elimination of an unspecified 8,000 jobs worldwide

Stella D'Oro was sold off to a private equity fund who plundered the cash, destroyed the company and shuttered the union factory before selling on the brand (the full story is

detailed on the IUF's Private Equity Buyout Watch here). By reducing investment and then disposing of the company on the cheap, Kraft missed out on the "biscotti boom" which has accompanied the explosive growth of specialty coffees and coffee outlets. And Kraft missed out on the coffee boom in developed markets, despite having some of the world's largest selling coffee brands, by treating the brands as cash cows to simply plunder.

There is an alternative to "borrow to bolt-on" at Kraft. The alternative to disposable jobs and slash and burn is long term growth through patient investment and unionized workplaces. Unions will have to defend this alternative while mobilizing against the relentless global cost-cutting. That will require building a path to corporate management based on global union recognition and global rights.

Download the campaign poster here!