Corrected Transcript

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CORPORATE PARTICIPANTS

Jeffrey L. Harmening
Chairman & Chief Executive Officer, General Mills, Inc.

MANAGEMENT DISCUSSION SECTION

Unverified Participant

It's my very great pleasure to welcome Jeff Harmening to our Strategic Decisions Conference for the first time. Now, Jeff has been CEO of General Mills since June of 2017 and he joined the company in 1994, serving in many parts of the business, including Big G cereal, Cereal Partners Worldwide, Big G New Enterprises, and Foodservice New Business in both marketing and general management roles.

Now, General Mills has been stepping up its investments in innovation with the percentage of sales from new product introduced over the past year now above 5% globally in fiscal 2019. And the other big initiative recently has been the acquisition of Blue Buffalo in April of last year with the roll [audio gap] (00:00:46) into the pet food shelves of Walmart stores that happened in March of this year.

Here to tell us a little bit more about the company's strategy and outlook, I'll hand it over to Jeff. Thank you.

Jeffrey L. Harmening

Chairman & Chief Executive Officer, General Mills, Inc.

I guess we'll do this from the comfort – the chair is so comfortable, I could just do it from – we'll do it from here. I don't have 20 slides to tell you about the company. I've only got three. And I see a lot of familiar faces in the room, so I'll keep the upfront remarks short and [ph] Alexia (00:01:14), I'll let you ask the questions you want and then any more questions we have from the audience.

But just as a reminder to people, as we think about – our growth strategy is pretty straightforward. We want to compete effectively across all brands in all geographies. And then we want to make sure we accelerate certain parts of our portfolio. And so we have identified four businesses that make up about $4 billion in sales. So, that's Häagen-Dazs ice cream bars, Old El Paso and natural and organic.

And then finally, we said, look, we need to reshape our portfolio for growth. And, obviously, the Blue Buffalo acquisition fits into that. Well, I'm pleased that we made progress on all three of these. There's more to do and we'll certainly talk about that hopefully today. But we feel good about the progress we've made in the U.S. and compete effectively. We're growing share in 7 of our top 10 categories.

So, we feel good about the progress we've made there. There's more work to do in yogurts. There's more work to do in snack bars. But overall, we feel good about our progress. We've accelerated our portfolio. Häagen-Dazs is growing at double-digits in Retail outside the U.S. Snack bars is growing at more than 30% outside the U.S., and so we've made good headway in accelerating our businesses that we meant to accelerate. And then Blue Buffalo is performing well, and I'll talk about that in a minute. So, the first step of our reshaping is going well.

And in fact, today, because Blue Buffalo closes at the end of April, unlike the rest of our businesses which close at the end of May, we thought we'd just give a brief update on Blue Buffalo and what happened in the fourth quarter and where it is for the full year. And in the fourth quarter, we grew our sales at 38% and our operating profit at 82%, which includes purchase accounting. If you back out the purchase accounting, actually 88% growth.

And Buffalo's numbers are roughly in line with what we expected for the end of the year. And as a result, our net sales for Blue Buffalo are up 11% for the year and our segment operating profit is up 11% for the year. And we promised double-digit growth, and we're pleased to say that we're able to deliver that.

And so then finally, I guess what I would say is that we set out three broad priorities for General Mills for fiscal 2019. And we've already said that we're on track to meet or exceed all of these priorities. One was to grow our core business, with top line growth of 0% to 1%. We say we're on track to do that. The second is transition Blue Buffalo effectively. As I just mentioned, we've been able to hit double-digit sales and profit growth, which was our goal coming into the year. And then finally, deliver on our financial commitments. And we've said we'll be at the top range of our guidance on earnings for the year and ahead on earnings per share for the year, and also ahead on free cash flow conversion.

So, we feel good that we've been able to deliver on our core and deliver on Blue Buffalo, and deliver on our financial commitments. So with that, those are my only prepared remarks. And we'll turn it over, [ph] Alexia (00:04:08), to your questions and questions from the audience.

QUESTION AND ANSWER SECTION

Q

Perfect. And if you do have questions for Jeff, as I'm sure you've discovered during the course of the day, there's question cards on your table. We'll collect those up and I will do my level best to work those in as well. So Jeff, just to get things [ph] straight (00:04:23), it's been almost exactly two years since you became CEO at the beginning of June of 2017. Congratulations on the anniversary.

Jeffrey L. Harmening
Chairman & Chief Executive Officer, General Mills, Inc.

A

Yeah. Thank you.

Q

What accomplishments are you most proud of since you took the helm?

Jeffrey L. Harmening
Chairman & Chief Executive Officer, General Mills, Inc.

A

Well, I think one I'm most proud of is something that I don't get asked a lot, but it's really hard to model, but it's the change in culture. And as we think about our business, as we were here a year ago, we missed our third quarter earnings guidance and missed our financial guidance for the year last year, and I'm not a believer that adversity creates character but I think it reveals it.

And I think the fact that we've been able to grow our core this year and grow Blue Buffalo [ph] ahead (00:05:03) from financial commitment says a lot about General Mills and the character. I know it's hard for a lot of you out there to model culture, but it makes a huge difference. And I think what I'm pleased with is we brought in a lot of people from the outside of the organization who have added a lot of value in things like strategic revenue management or global sourcing or E-commerce, or a new Chief Marketing Officer. And we blended that with our internal talent. I'm pleased that we're able to make decisions faster than we were two years ago. We flattened our organization and all the segments now report to me.

I'm pleased that we are able to share ideas better than we have before. We created these accelerate platforms and you can see we're sharing a lot more across boundaries on Häagen-Dazs, on Old El Paso and on bars. For example, we just launched LÄRABAR into the UK and are doing that effectively. And we've taken some advertising from the U.S. and Old El Paso and brought that into the UK.

And you'll see next year, we're leveraging what we do in yogurt. Some of the things we do in France, we're going to leverage that in Canada. So, I'm really pleased with the way the organization has responded, and I think you see them in our growth, in our ability to execute against what we said we're going to do.

Q

Right. Let's dive into Blue Buffalo, which has obviously been big news over the last year. It's now being rolled out more broadly into mainstream channel literally as we speak. Are you able to quantify how big an opportunity that could be for the company over time? And perhaps, go into what you see the risks could be in terms of competitive reactions or perhaps overextending distribution.

Jeffrey L. Harmening
Chairman & Chief Executive Officer, General Mills, Inc.

A

Yes. So, on Blue Buffalo, we're really – I mean, I am thrilled with the Blue Buffalo team, at what we've been able to do this year. We not only hit our sales targets, but also we hit our distribution goal. We said we're going to get to about 65% distribution and we're about 68% as of the end of April. And we've done that pretty seamlessly and through a lot of hard work from the Blue Buffalo team.

And so as we look at the Blue Buffalo business, we've seen a lot of growth. We see a lot of growth ahead for the business. And Jeff Siemon has warned me not to provide forward-looking guidance so I'm not going to do that today. But what I will tell you is that we think we can keep growing our distribution. We're at 65%. There's no reason that we can't eventually get to 80% distribution.

And beyond that, we think we can grow the amount of distribution, the number of SKUs we have in stores. Because we're off to a good start with our Wilderness launch in the Food, Drug, and Mass channel and we're the number one brand in E-commerce and we're the number one wholesome natural brand now in the Food, Drug, and Mass channel and Pet Specialty.

So, we've added a lot of distribution. We think this is the business we can innovate on. Someone called in a question, can we really innovate in the Pet? I think we'll start to show in fiscal 2020 we can innovate in Pet, and I think we'll show that again in fiscal 2021. One of the things we're most excited about is matching General Mills' innovation capability with the pet capability of Blue Buffalo. It's one of the very first things when we took Billy

Bishop through our corporate offices, I think that probably the most excited I saw him was when he saw our R&D capabilities. He said, this is the stuff we can apply to Blue Buffalo.

Q

And were you – as analysts really only see the Food, Drug, and Mass data, which is obviously where you're rolling out at the moment...

Jeffrey L. Harmening
Chairman & Chief Executive Officer, General Mills, Inc.

A

Yeah.

Q

...are you able to give any comments about how things are going on in the E-commerce channel for Blue Buffalo and also in Pet Specialty just so we can get a more all-round view of what's happening?

Jeffrey L. Harmening
Chairman & Chief Executive Officer, General Mills, Inc.

A

Yeah. Sure. Yeah, I will certainly do that. One of the things that is interesting about Blue Buffalo that we find in our other businesses like Cheerios is that great brands travel. You asked about risk in going across channels. What we have found is that in our space, great brands travel. I mean, we sell Cheerios at places like Whole Foods. We sell it in E-commerce. We sell it at Walmart and at Kroger, and it travels well across all the different channels. We're seeing the exact same thing with Blue Buffalo.

And so Blue Buffalo is the number one in the Pet Specialty channel. It's the number one on E-commerce. And our E-commerce business is growing in double digits this year, which is what we expected. Our Pet Specialty business is declining double digits, which is unfortunate. And so it doesn't make us happy but it's declining in line with what we expected it to. And our Food, Drug and Mass business is growing at triple digits, which is also what we expected.

And so one of the things we're pleased is that when you buy a business in a category that you haven't participated in before, you think you understand the category when you purchase it, but it's good to feel a year later that when you look back, yes, we actually did know about the business that we are purchasing in. And it's played out almost exactly as we thought it would.

And I think over time, we'll be able to improve our Pet Specialty business as we're able to innovate specifically for that channel, whether it's through new products or through promotions, much in the same way as we've done in the organic channel with brands like Annie's and LÄRABAR.

Q

Great. Should we switch to the broader industry questions here? In your view, was the focus, the industry focus on cost cutting and zero-based budgeting too extreme over the past few years, and is there a need for reinvestment to drive a recovery in top line growth from here?

Jeffrey L. Harmening
Chairman & Chief Executive Officer, General Mills, Inc.

A

Well, the short answer to the first question is yes. And I mean, it's really hard to really focus on cost and growth at the same time. I mean, you can become more efficient, and we certainly have with our Holistic Margin Management program because it's part of that culture. But when you're doing Holistic Margin Management and you're taking out capacity and you're changing your logistics network and you're doing zero-based budgeting, you're doing all at the same time, it's hard to do all of that and maintain your focus on growth.

And what I feel great about it is our current strategy. We rebalanced the equation. I call it staying in the middle of the boat. We want to stay in the middle of the boat. Yes, we want to grow a little bit faster but we also want to make money while we do it. And that's more in our wheelhouse. And that's why I think you see our percentage of new products coming – our percentage of sales coming from new products has grown to 5% over the last couple of years, because we've invested more time and energy into growth, into new products growth, and less time on the cost cutting side.

Having said, it's also interesting that our Holistic Margin Management at the same time has probably reached record highs. And so we've been able to become more efficient while we've been able to spend more time on growth. And I think that better balance for us right now, I mean, I think it's showing up in our income statement and our results as a company.

Q

If you take a step back, how has the industry structure changed in recent years? Do you think the barriers to entry are as strong as they once were given the emergence of challenger brands and maybe the increased retailer focus on pricing and private label? And what do you think that means for a longer term [ph] earning through this (00:11:39) algorithm across the space?

Jeffrey L. Harmening
Chairman & Chief Executive Officer, General Mills, Inc.

A

Yeah. So I mean, I think the industry has really been dynamic over the last few years and much more dynamic than it has been historically. And certainly, that presents challenges, but I also think it presents opportunities. Because anytime you see change in an industry, there's going to be an area for opportunity. And the three biggest changes we've seen are in the change of consumer food values, a change in the retail landscape, particularly with E-commerce and with discounters. And the third change we've seen – escapes me – oh, it's in the structure, in this focus on cost and how CPG companies have gone to market.

So, those are the three big changes we've seen. And for us, those changes are going on around us. So the question we have to ask ourselves is, how do we adapt to those changes? And General Mills hasn't been around 150 years because it's failed to adapt. It's been around for 150 years because it has adapted. And as we see the E-commerce landscape, I mean, our business, we have a higher share in E-commerce than we do in brick-and-mortar. And it's not an accident. We have the biggest brands plus we've invested behind that.

And the same would be true, as we've seen consumer values have shifted, we've shifted our portfolio. You ask about barriers to entry. I think barriers to entry are less than they have been historically. And on one hand, that's a threat, but it's also a big opportunity. I mean, if you look at our acquisition of EPIC Provisions, which a business we absolutely love, we were able to get that because we're looking outside our four walls for innovation. We set up 301 Inc. which is our internal private equity group to make minority stake investments in businesses, things like

Beyond Meat as a matter of fact and others like Kite Hill and GoodBelly. And so we have about a dozen investments.

And so we're adapting to the external landscape. And so while the barriers to entry may have come down, there's a lot more innovation there has been historically and the only question is, are we going to tap into that? And so far, the answer for us has been, yes, we have. And we think we've got a good line of sight to tap into it in the future.

Q

As you look across your U.S. portfolio, where do you see the biggest growth opportunities and where might you need to be more selective in your resource allocation?

Jeffrey L. Harmening
Chairman & Chief Executive Officer, General Mills, Inc.

A

Yeah. So, I mean, the biggest growth opportunities we see are in the businesses we said we we're going to accelerate, as we said, globally. But that also – a lot of those apply to the U.S. And so Old El Paso, we've been growing at mid-single digits. I'm really pleased with what we've seen of the growth of that business. Totino's hot snacks, we've been growing at mid-single digits and that might be our next billion dollar business. It's been a great growth business for us. And we need to improve our snack bars business. That should be a great growth business for us. It has historically, but it hasn't this past year.

And we think that we can return our yogurt business to growth. We returned to share growth this past year and that's a great moral victory, but we're looking for absolute victories. And our goal is going to be to get our yogurt business back to growth. And we've maintained the growth of cereal while we've done that. And there have been a lot of discussion, if you hear our industry speak, you'd think no one is eating breakfast cereal anymore, but we know we grew breakfast cereal last year. We're on track to grow it this year and we got a line of sight to grow it again next year.

Q

So maybe just taking into some of those categories that you mentioned, what do you think the lessons learned from the experience in yogurt have been so far and how do you see the route to getting the category and your business back on track there, completely back?

Jeffrey L. Harmening
Chairman & Chief Executive Officer, General Mills, Inc.

A

Well, to understate the case, we had a little bit of a rough experience in yogurt for about five years. After growing shares steadily for 35 years, we had to rough 5-year patch. The first lesson learned is that you need to lead innovation. If you're a leader in the category, you need to lead innovation. And whether that's in breakfast cereal or whether that's in yogurt or whether that's in pet food, if you want to be the category leader, you need to lead the innovation. That's what leaders do. And we didn't do that with Greek.

The second lesson is you really need to look around the outside of what's going on like externally and what's going on around you. And part of the reason we formed this 301 Inc., which is our equity firm, internal equity firm, one is to make sure we make investments in businesses that we think might be attractive, but also because it gives us a lens to what's happening externally. And I don't think we saw what was going on with the Greek yogurt fast enough. But I can guarantee you, we do now.

And whether that's in Greek yoghurt or whether that's in bars or what have you, or whether that's in cereal, we see things a lot faster than we did before. So, I think the two lessons for us learned are, one, if you're going to lead the category, and we view ourselves as leaders, then you need to be the first to innovation; and the second is, you need to have your head on a swivel when it comes to innovation and what's going on in the world around you. And what happens within the four walls of General Mills is interesting, but there's a broad world out there and you better be paying attention to what's going on.

Q

And what's your diagnosis around the snack bar segment at the moment? You, obviously, had a big burst of innovation I think as [indiscernible] (00:16:17) snack bars was coming up, which worked very well for a period of time. And now, things seem to be getting tougher. What's the solution there?

Jeffrey L. Harmening
Chairman & Chief Executive Officer, General Mills, Inc.

A

Well, I think it's going to get back to some fundamental innovation. And what I would say is on our snack bar businesses, we have about five snack bar businesses, three are doing pretty well. So, LÄRABAR is growing double digits, EPIC bar is growing double digits. We have a cereal treat bar business that's really growing rapidly. So, those three businesses are good. No one ever asked me about those and so I get that. On Nature Valley, two years ago, we grew it at 8%. This last year, we declined. And Nature Valley, it really is about executing well and about getting back to innovation. I mean, it is the bar that nature intended, it's well-positioned, it's got a great brand equity. And so I'm highly confident we can improve on last year's performance on Nature Valley.

And the one that's really a bit of a trouble for us has been Fiber One. And we're working on fundamentally repositioning that, and we'll certainly talk more about that repositioning at our Investor Day in July and maybe a little bit on our Q4 earnings. But fundamentally, Fiber One used to be a part of about half the diet in the U.S. And now, it's about – 1 point on Weight Watchers. Now, it's a part of about 2% of diets in the U.S. and about 6 points of Weight Watchers. So, we have some work to do on Fiber One.

But Fiber One's a business that we – again, we have led innovation for a long period of time and we didn't do that this last year, but we're going to get back on the horse this coming year.

Q

Okay. What changes are you seeing in the U.S. retailer environment as they wrestle with the duel challenges of online retail, hard discounters out of Europe, and what does that mean for you as a CPG supplier? And maybe linking that to the pricing question, how easy is it to take pricing these days?

Jeffrey L. Harmening
Chairman & Chief Executive Officer, General Mills, Inc.

A

Well, I don't think I've seen a retail environment in food that's more dynamic than the one we see right now for the reasons you just mentioned. Because you see a lot of growth in E-commerce, and whether that's direct store delivery or whether that's stuff delivered through Click and Collect, or whether it's discounters, I think being a retailer in the U.S. now is probably as tough as it ever has been in the food sector. And one of the – so the question is, how do you deal with that?

I think a lot gets made about tensions that might exist between retail and CPG. But our retail customers are all looking for one thing, and that's growth. And so they're looking for the people who can deliver solutions to them, growth solutions to them. And whether that's through your new products or through your data and analytics capabilities, what have you, that's why when I've talked about growing share in 7 out of our top 10 categories, that's really important. Because your customers are looking for people who can help them grow.

And pricing conversations are never easy. I mean, we don't take prices just because we think it's a good thing to do. We take them because we see inflation. And those conversations are always difficult. They're really difficult if you're not helping somebody to grow. If your retail customers are convinced that you're trying to lead their categories and their business back to growth, it's not as if they welcome you with open arms and say, hey, that's great, let's take any prices you want. But the conversations are a lot better if you can assure them that you're plowing those investments back into growing your business and growing their business for them.

Q

Just sticking with the pricing theme, a question from the audience, how closely do you track your pricing to the private label alternative in each of your categories? And are you bumping up against any spread differential issues?

Jeffrey L. Harmening
Chairman & Chief Executive Officer, General Mills, Inc.

A

So, one of the things I'm most proud of is the degree with which we have improved our strategic revenue management capability over the last two years. We've gone from kind of an episodic player in pricing to a full blown global capability. As we look at pricing, I mean, context is everything. And so we certainly look at what's going on in the category around us. And when we talk about private label, we're talking about them as retail brands. We don't even say private label at General Mills, we say retail brands because they are competitors.

And so as we look at it, we look at not only the spread of pricing to the national brand competitors, but what is the spread between us and retail brands. And what's interesting is our prices have gone up over the last year about 2%. Our competitor prices have gone up. And interestingly, the retail brand prices have also gone up. And I'm certainly not going to call on anybody by name or how their prices have gone up, but if you look, the whole industry, the pricing has gone up. And it's gone up because we've all faced the same kind of pressure from input cost, inflation, labor inflation, logistics inflation. So, we track it pretty closely.

Q

One of the things that we've been hearing recently is that retail is maybe becoming more sophisticated around analytics, about optimal shelf space allocations and price elasticity. What does that mean for the category captain role if the retailers are getting those skills and capabilities built up?

Jeffrey L. Harmening
Chairman & Chief Executive Officer, General Mills, Inc.

A

Yeah. I think if you look at retailers in aggregate, it's clear the retail channel, they are driving a lot more innovation through their data and analytic capabilities. And it varies by customer to customer. So, it's certainly not ubiquitous across the channel but certainly, some customers are becoming a lot more sophisticated.

I think that helps companies like General Mills. We've always been very data-driven and we're investing in our data and analytics capabilities as well. And so for us, it's actually helpful to have conversations with retailer where you're feeling like you're talking to them on the same plane. And what they can offer is a lot of information on the customers that go into their stores. What we can offer is a lot of information on how people shop across channels and across categories. Because we participate in 26 different categories here in the U.S., obviously, we're in every retailer. And what a lot of people don't know about General Mills, we also have our own unique data capabilities.

We have three of the top five food websites in the U.S., in BettyCrocker.com and Tablespoon.com and Pillsbury.com. And so we have tens of millions of consumers in the household database. And so we can we can educate our retail customers on what's going on more broadly across channels, because we see what consumer shopping behaviors are more broadly. So, I think as our retail customers increase their level of sophistication about data and analytics, I think it presents an opportunity for those CPG companies who are equally driven by data and analytics.

Q

That actually segues quite well into this question about retailer investments, which I think you just alluded to. Many companies seem to be spending more on retailer investments and a bit less on advertising spend these days. And what do those investments actually buy you? Is it in-store information on consumers in stores? What else does it get you?

Jeffrey L. Harmening
Chairman & Chief Executive Officer, General Mills, Inc.

A

Well, there are certainly some retailers who have become more sophisticated in how they can identify shoppers and shopper behavior, and have marketing work through them. When it comes to the marketing, we've been agnostic for a long time about where our marketing spend takes place. And whether it's on TV or whether it's on Hulu or whether it's through search on Google, I mean, the key for us has always been and will always be, what is the objective you're trying to accomplish and what is the best way to do that?

And I'll give you a couple of examples to just kind of bring that to life. If you talk about cholesterol and Honey Nut Cheerios and you're going to market that to somebody who's 65 years old, I probably wouldn't do that through Hulu. That probably wouldn't be the best use of time. But if you're going to have a coupon in a Sunday newspaper, it probably works. If you're going to invest in Old El Paso to millennials, you're going to do that through recipes. And those recipes are mostly going to be online because the people who are looking for those are 35 years old and they don't have recipe cards sitting on their counter.

And so the way you would do that would be different. The same would be true if you're trying to reach people on Blue Buffalo. When they're trying to compare one dog food to another, they might go through Google search to do that.

And so as we think about our investments and marketing with retailers, we'll look at those with the same eyes as we would the rest of our advertising dollars. And to the extent that advertising through retailers returns the same

ROI and could help us accomplish that objective, we're happy to invest in marketing through our retail customers as long as it's going to build the brand equity.

Q

What are the international sales growth opportunities that you're most excited about today and are there any challenges on the horizon in the international markets that we should know about?

Jeffrey L. Harmening
Chairman & Chief Executive Officer, General Mills, Inc.

A

Yeah. For our global markets, there are certainly plenty of challenges and there are certainly plenty of opportunities. I think for our developing markets, the challenge for us is to maintain our growth rate on the top line, which is kind of mid-single digits this year which I'm pleased with how we're doing; and increase the profitability of those businesses. And we have a line of sight to do both of those things.

Our business in India is growing nicely. Our business in Brazil has returned to growth. We're growing well in Latin America. So on the developing markets, I feel good about how we're doing. And our focus on our platforms, bars and Häagen-Dazs, our global platforms, those are really paying dividends for us. Because those platforms are not only ones where we have a right to win, but they're also profit accretive. And so to the extent that we can grow those, it's actually a form of internal portfolio shaping.

Our toughest market outside the U.S. by far is France. That's the toughest market we compete in. And it's tough because we have a big dairy business in France, because we have Yoplait but we also have Häagen-Dazs, and we see a lot of dairy inflation in France. And France is a tough place to take pricing. And their economy is not on the upswing at the moment, and so probably the toughest market for us outside the U.S. is France.

And it's a big market for us. I don't think it's uniquely tough for us but – and what's interesting is that you might think it would be Brexit – you may think it was Brexit, it would be the UK. Actually, we're growing really nicely and we were growing mid-single digits in the UK. I feel great about our UK business. And we're growing through Häagen-Dazs, we're growing at Old El Paso, we're growing really well in bars in the UK. But for us, it's actually France that's probably the toughest environment for us.

Q

Interesting. Then let's talk about innovation and the pace of innovation and how it's accelerated in the last few years. I think from 3.8% of sales in fiscal 2017 to over 5% globally this year, and over 6% in North America. Are we now at a new normal level? And what level of organic sales growth can that drive over time? And perhaps, most importantly, how can you be sure that you're going to earn an adequate return on those investments and it's not just going to push your margins down?

Jeffrey L. Harmening
Chairman & Chief Executive Officer, General Mills, Inc.

A

Yeah. So on innovation, I'm really pleased with the level of innovation we have right now, particularly with regard to where it was a couple of years ago. And, again, I think there have been two keys for us. One is that focusing more on growth and a little bit less on just cost has been helpful. But we've also changed the way we do innovation. And we're much more intuitive in how we do innovation, and we studied how entrepreneurs do innovation, and we do a lot more innovation like they do.

I can tell you that when we started on Oui by Yoplait, which has been a huge success for us, the initial prototypes of that were not – it was not in a glass jar. It was not called Oui. The texture was not anywhere similar to what it was. But over time, we iterate on that offering and really listened to what consumers wanted and actually made a pretty quick turnaround on that business.

And so as we look at innovation, we're doing it differently and we're focused more on it. And the key to innovation I think is going to be – you're going to have some misses when it comes to innovation. It's inherently more risky. The key is when you have something big, that you really ride it. And we've had that with Oui, we've had that in some of our cereal launches. And when you have something that doesn't work, you call it and you don't throw good money after bad. Because you just realize that innovation is a fundamentally tougher business, but a few successes in innovation pay off wildly. And the key is to make sure you limit your losses on the things that aren't working. But in innovation, you have to make enough bets because some of the things just aren't going to work.

Q

When you talk about it being more entrepreneurial, is it more testing out there in the marketplace more quickly and is it a faster pace of distribution rollout, or just how is it different from the old...

Jeffrey L. Harmening
Chairman & Chief Executive Officer, General Mills, Inc.

A

Yeah. So, the way we would go about it internally is that – and it's really interesting. We actually have a dedicated team of people, so from different functions, marketing and R&D and even finance, and we put that team together, they do nothing but work on new products. And it's an iterative process and so I'll give you an example.

So, the team will come up with an invention in yogurt, let's talk about Oui. They'll go in and try to sell – they'll come up with something and actually go out and try to sell it in store. And nothing brings reality home like actually trying to sell what you're trying to sell. And it's a humbling experience. But then what we're able to do is, based on consumer feedback, we can then go back to our R&D labs and, overnight, change the packaging or change the product or change the name, and then go back out the market the next day and try to sell it again. And we'll find out we've got some things right, we've got some things wrong, then we'll do things overnight and we'll come back the next day and try to do it again.

And so it really isn't a fast rollout of distribution. It's actually failing faster, because you're going to fail if [ph] you do products (00:29:16). The key is to do it fast and cheap. And so through our new methodology, we call it Consumer First design, we're able to fail a lot faster and a lot less expensively, which allows us to succeed faster and less expensively.

Q

Okay. So, the U.S. birth rate seems to be dropping. I think we're at 32-year lows at this point, I think I read this morning. Is this likely to constrain cereal category growth because I think there was a hope that maybe that would pick up over time?

Jeffrey L. Harmening
Chairman & Chief Executive Officer, General Mills, Inc.

A

Yeah. The – so, the – this is where we – the statistics can get you in trouble or lead you to victory. The birth rate is actually declining. But the number of people giving birth is actually accelerating. And then, when you add immigration on top of that, the number of young kids is actually flatter, increasing a little bit. And so, as we look at – and so, I go through all that math only to tell you that I don't think that birth rates or lack of birth rate is going to be a negative on the cereal category. I'm not sure it's going to be a huge tailwind. But I don't think it's going to be a negative either. I think we're in an environment where I would say a few years ago, the number of babies being born and – was lower. And so, that was probably a headwind. So, now, I think we're entering a period for the next few years where it won't be a tailwind, but it won't be a headwind either.

Q

So, just coming back to the North American Retail segment, I think when you actually look at the quarterly results, you've been more successful than other companies and actually realizing price mix improvements over the last year up to 2%, I think, in the last quarter. Do you expect to be able to continue to realize those kind of price increases over time just broadly? And what form might those take?

Jeffrey L. Harmening
Chairman & Chief Executive Officer, General Mills, Inc.

A

Yeah. I think, first, I would go back to something I said earlier. I mean, our ability to do pricing and do it profitably has really improved dramatically over the last couple of years. It's something we're really proud of. But if you look at – but we're not alone in taking our prices up. I think one of the keys has been is, if you look across our different categories, most of our key competitors have raised prices and retail brands have been able to raise prices. So, the environment for pricing has been more conducive because we've all seen the same kind of inflation.

And so, while I'm pleased with our efforts and what we're able to do, I'm not sure that we're unique in our take in pricing. If you look at the last quarter, for example, we had tremendous price mix because we sold a lot more cereal and it was also the key season for brands like Pillsbury. And so, as I look ahead, I'm not sure we're going to see the kind of price mix that we saw in the last quarter, although I think to the extent that there is pricing available, I think we'll be able to get our fair share of it because our capability has improved.

But as I look ahead, I mean, our third quarter was pretty unique and kind of all elements came together. And while I think we'll still be able to generate positive pricing, here, if you look at Nielsen, you would see, for the last quarter, [ph] we've done about (00:32:00) 1% pricing [ph] where it's about 2% (00:32:02) before that. So, as we started to [ph] allow (00:32:06) pricing we've taken before and maybe if we don't see the same amount of mix, I don't know that we'll see the same amount of pricing. But I feel confident in our ability to achieve whatever pricing is available in the marketplace.

Q

Okay. We've heard from some other companies that they're dialing back their investments in the e-commerce channel perhaps because Amazon and others are charging so much for the online shelf positioning. How do you see the e-commerce opportunity, particularly in the pet food area where it's really well developed already?

Jeffrey L. Harmening
Chairman & Chief Executive Officer, General Mills, Inc.

A

Yeah. I mean, there's no question that e-commerce is going to continue to grow. For our food business – human food business [ph] set aside (00:32:40) peppermint and I'll come back to that. For our human food business, it's roughly 3% of our sales here in the U.S. now. As I look over the next five years, e-commerce will certainly account for a fair amount of our growth in the U.S. But it's – do I – but I don't necessarily think it's going to get beyond 10% of our business over the next five years [ph] and just size (00:32:59) that opportunity because we spend a disproportionate time collectively talking about e-commerce. And it's big and it's important and will be a big part of our growth. But that means that 90% will not come from e-commerce. And so, as I think about it, we need to make investments in e-commerce that will help us be successful, but we also have to pay attention in the 90% that will not be e-commerce.

The thing is – the second thing I would tell you is that it's pretty clear in food anyway that there will be a variety of winners in e-commerce. I don't think e-commerce is going to be dominated by one player in – especially in the U.S. market. We see that. And Europe is not dominated by one player. I don't think that's going to be the case in the U.S. We're seeing a lot of competitors, whether it's traditional grocers or whether it's new entrants and just pure play e-commerce. Being successful, I think we're going to see that. I think the implication for us is that we're going to have to be good with multiple customers. It's just not going to be good enough to win with one customer.

In terms of Pet, I think Pet is tailor-made for e-commerce. And whether that's direct-to-consumer or whether that's a click-and-collect model, no one wants to lug 30-pound dog food bags around and especially if you've got two kids with you. So, I think the reason pet food – so much of our sales have now come from e-commerce is because it's a channel that's really made for subscription-based kind of service and people don't want to lug 30-pound dog food bags around. So, I think it really is a channel that is tailor-made for pet food. And we have seen our e-commerce grow 20% this year.

In the last quarter or two, it slowed a little bit, but I think it will pick back up especially now as we're more developed in the food, drug and mass channel because you see a lot of players like Target and Kroger and Walmart and people like that really developing their e-commerce capability. And I think, to the degree we're successful with those customers in that channel and I think we will be, well, I think we'll see our e-commerce business in Pet accelerate actually.

Q

You mentioned the Holistic Management Program earlier and how it's actually developed over time, and it's actually running at a pretty high rate at the moment. Is that current run rate something that can continue over time? Or are you at a peak sort of level right now?

Jeffrey L. Harmening
Chairman & Chief Executive Officer, General Mills, Inc.

A

Well, we've been doing Holistic Margin Management for about 15 years. And every time that we think we've hit a peak or somebody else thinks we've hit a peak, we manage to keep pushing through and doing more. And over that time, we've generated roughly $400 million a year in Holistic Margin Management savings, which is about 4% of COGS. And I don't see a reason why that shouldn't continue. And we generated a little bit more than that this year. And whether we generate a little bit more or less, we'll talk about it in June and when we talk about our guidance for next year. But we've generated about 4% every year through different means for the last 10 or 15 years. And it feels to me like we should be able to continue to do that. And one of the things that create a good environment for Holistic Margin Management is actually growth and change. And to the extent you're growing and changing, you can actually generate more savings from Holistic Margin Management.

Q

A question that's come in, returning to the Blue Buffalo question. What have been the most challenging parts of integrating the Blue Buffalo business for you?

Jeffrey L. Harmening
Chairman & Chief Executive Officer, General Mills, Inc.

A

So, the – it's interesting. When I – when we talked about Blue Buffalo, it's – first of all, it's gone really smoothly and I think because the cultures – the culture of Blue Buffalo and the culture of General Mills are very compatible and I think this element of culture, when you talk about acquisitions, is probably underappreciated and the cultures are very similar. And so, from that standpoint, it's been pretty easy.

The thing I would say is that it's – when we brought it into General Mills, we actually didn't talk about it being in integration. We talked about being in transition. Even in the slides that I have up here, you see it says transition. Blue Buffalo is not integrated. And that was very purposeful because there are some things they've been able to integrate like – our strategic revenue management capability, Blue Buffalo has taken on. Our HMM capability, Blue Buffalo has taken on.

But we haven't actually integrated our sales organization because there are a lot of unique channels to sales. And so, I think we've been – some of our back-office stuff, we have integrated because it made sense. So, it's actually been really, really smooth. If I had an example of a big road bump that we've hit, I would tell you about it because I want to make sure I'm transparent. But we actually haven't had a big road bump because we've been very thoughtful about how we've transitioned. And I think it's been helpful over the last 20 years. General Mills has acquired a lot of national and organic businesses, I think we've learned a lot of lessons over those 20 years. And I'm glad we've learned those lessons because we can apply them as we bought – as we paid $8 billion to buy Blue Buffalo. It's good to learn on the small ones and not the big ones.

Q

And maybe that's a perfect segue into this other question that's come in about Annie's. What's worked? What didn't work as well? What have been the main lessons learned? And how is it doing now?

Jeffrey L. Harmening
Chairman & Chief Executive Officer, General Mills, Inc.

A

Yes. So, with Annie's, I mean, Annie's has been really successful for us. We've doubled the business in the first four years and we actually improved their growth rate from when we acquired them. The – I think the biggest thing we learned on Annie's that we carried over to Blue Buffalo was just the – there were really good marketers of Annie's. Blue Buffalo people are really good marketers and they build great brands. And the first thing – the first rule is respect the brand. People get in trouble when they either don't understand the culture or they don't respect the brand. I mean, you can get by if you stumble on logistics or something doesn't go quite right in your financial integration. But if you screw up a brand, that lasts a long time. And so, one of the things we're very respectful of Annie's and also EPIC and now with Blue Buffalo is very respectful of the people who have built those brands and that's one of the biggest lessons learned.

The other is that we probably integrated Annie's into our logistics network too fast. And if we're able to do that again, I would have done that more slowly because you take a lot of some really small SKUs and you put it into a really big logistics network and it creates a lot of pain in the short term. We did not do that with Blue Buffalo. Frankly, we couldn't. But we also didn't try to. And on Annie's, I think we've got a lot of Annie's right. If we would – if I would have had it to do over again, really, the only thing I would have change I would have probably kept logistics and their network separate from ours [indiscernible] (00:39:00) understood that business a lot better and then I would have integrated it selectively. We applied some of that learning into Blue Buffalo.

Q

So, maybe let's turn to some more organizational questions. How would you describe the main components and objectives of the company's short-term and longer-term incentive plan?

Jeffrey L. Harmening
Chairman & Chief Executive Officer, General Mills, Inc.

A

Yeah. The – well, first, I would say overarching comment, our incentive plans are really well aligned with the incentive of our shareholders, as it should be. And in the short term, our incentives are equally split among our divisions or equally split with sales and profitability. So, if you're in an operating segment, it's equally split on sales and profitability. And when I talk about staying in the middle of the boat externally to all of you, it's the same thing I use internally to our employees. And that means we want to try to grow and we want to try to grow profitably. So, it's aligned to what I tell you all externally. It's really aligned with our metrics internally.

As we look at it over the longer term, there are really two key drivers I think of shareholder value for a food company like ours. The first is sales growth and the second is free cash flow. And if you can grow your top line and you can generate strong free cash flow, your shareholders [ph] are going to (00:40:07) be pretty good. And so for us, these metrics we have for our long term incentive are centered around sales growth but also of free cash flow, which takes into account obviously profitability but also how efficient are you with working capital, and is a leading metric where you look on return on invested capital.

Q

And then sticking with the organizational side of things, have there been any changes to the company's organizational structure over the last few years as the company has pursued cost saving programs over time and how has that affected the business?

Jeffrey L. Harmening
Chairman & Chief Executive Officer, General Mills, Inc.

A

So over the last few years, we have certainly become more efficient in a lot of areas. But one of the things I think is probably underappreciated is we've actually made investments in others. And so while we have cut layers out of the organization and we've taken away our international division, and we had really good people in our international division, but it was costing us time and effort and now that we have all the segments reporting directly on our senior leadership team, we're a lot faster as a company.

But we've also invested in capabilities, so strategic revenue management, e-commerce, that has really shaped our business. We've also brought in a lot – as I said, a lot of people from the outside who had expertise that we really needed and it's been really gratifying to see the impact that they've been able to make internally because, for a while, we didn't – kind of the narrative was that people from General Mills came and they stayed forever and ever. And we still have a lot of people that do that and add a lot of value. But we've been able to bring in expertise that we didn't have and they've integrated very well into the rest of our business.

Q

Are you able to give any sort of example to capabilities that the company didn't have before that through bringing people in from the outside, things have definitely improved?

Jeffrey L. Harmening
Chairman & Chief Executive Officer, General Mills, Inc.

A

Yeah. So, the person who leads our strategic revenue management capability came from a beverage company and they're a lot more sophisticated in their strategic revenue management than we were. And we've been able to bring a couple of more people in externally from other companies who have been more advanced than we are in strategic revenue management. And, importantly, we've paired them with people internally who really know our business well and are very analytically sound. And so, they're able to transfer their knowledge of the business to the new people and the new people have been able to transfer their knowledge of things like strategic revenue management.

We've done the same thing in e-commerce. The person we brought in for our e-commerce came from a clothing company and they've seen a lot more in the e-commerce space than we have. He's seen the [ph] movie (00:42:30) before. And, again, we paired him up with some people internally who know a lot about our business in the food industry so we can transfer that learning back and forth.

Q

Are there any particular pieces of the – I mean, we hear the 10 strategic revenue management a lot, but is it more about the pack sizes or the pricing or the – I mean, what has been the big lessons learned that the industry wasn't really focused on before?

Jeffrey L. Harmening
Chairman & Chief Executive Officer, General Mills, Inc.

A

Yeah. There are a lot of – you could play buzzword bingo...

Q

Sure.

Jeffrey L. Harmening
Chairman & Chief Executive Officer, General Mills, Inc.

A

...when it comes to pricing and strategic revenue management. But, look, there are only about four main components. One of them is everyday price, the other is price pack architecture, the third is trade promotion, and the fourth is mix. Those are the four components. And we call it strategic revenue management to make ourselves sounds smarter, but those are really the four components.

And the key is to have an ongoing capability and play those four different components differently in different categories because you're not going to be able to do the same things in cereal that you are on Old El Paso. You're not going to be able to do it. It's not going to work in the same way in the UK as it is going to work in China, as it's going to work in Brazil. So, the key is to have a common framework across the company we have, but to make sure that you use the levers according to the different businesses and different geographies, so you're specific about how you apply those. And then, it's an ongoing capability. It's actually not more complicated than that.

Q

Maybe I could do the same thing on – you mentioned e-commerce and bringing somebody in from the retail side because they've seen the playbook before. Are you able to give any more color on specifically what is it that they know that CPG companies don't, perhaps aren't just familiar with because it's earlier in the day?

Jeffrey L. Harmening
Chairman & Chief Executive Officer, General Mills, Inc.

A

Well, it's really – e-commerce is really about connecting what consumer do all the way through to their purchase cycle. Again, it's about as straightforward as that. And a lot of times, the CPG company, you have marketing on one side and sales on the other. They're actually merging. And the key to e-commerce is to make sure whatever you're doing on the marketing side flows all the way down through the point of sale, and it really is integrating your marketing. And having seen that before, that can help us understand how to navigate that and structure our organization in the way that we can do that seamlessly.

And that's one of the things about General Mills, about our culture that actually lends itself to something like e-commerce, it's a very collaborative culture. And if you're going to be successful in something like e-commerce, you need to make sure you have marketing and sales and logistics, everybody collaborating. That's one of the keys to this.

Q

Turning on to the more financial side of things. At the end of 2018, you were, I believe, 4.2 times net debt to EBITDA. And that's obviously come down since the acquisition of Blue Buffalo, and you plan to get this down to 3.5 times about a year from now. Will you be looking to do more large-scale deals over time and which areas of focus are you looking for to the M&A side of things?

Jeffrey L. Harmening
Chairman & Chief Executive Officer, General Mills, Inc.

A

Yeah. So, we talked about capital more broadly, I mean our first priority is to make sure we maintain our dividend, and we've done that for over 100 years so we don't take that lightly. The second is to make sure we pay down our debt. We're well on our way to do that. That's why free cash flow conversion is so important and the fact that we're over 100% for this year is as important as well as hitting our financial targets. So as we said at the end of the third quarter, we're well on track to reducing our debt levels at the rate where you suggested, both for this year and for next year.

And that's important because as we look at M&A, the next first priority for us on M&A is to look at divestitures. And we're not divesting because we need to raise cash, because we have plenty of cash. And I say that because we're not just going to give assets away because we need to raise cash to pay down debt or to pay a dividend. We're not in that position. We – even if we don't do any divestiture, we'll continue to pay down debt and to pay our dividend. The reason for us to do – to look at divestitures is because we think there are some businesses where we're just not going to invest enough and will be able to grow those businesses and our resources are going to be better focused on things we think we have a better chance of growing and, again, will give us a better return for our shareholders.

So I've said publicly that we're looking to divest roughly 5% of our business, that's still our target. And people ask, well, what would cause you to change that? Well, if we can't get the value we want. And so we're not going to – I'm not going to be strategically correct and actually pragmatically wrong. We'll divest the businesses to the extent that we see a good financial return and if we don't, we'll come back – I'll come back and tell you we couldn't do it, but it's not to raise cash.

Then you asked about businesses that – on M&A, on the acquisition front, like are our next couple of years really is going to be about paying down debt and paying our dividend and divestitures. Having said that, we'll look at acquisitions the same way we have historically, which is going to be, is there a path to growth? Is there an asset we can grow? And do we think we have a right to win? And that right to win is being able to lend our capabilities. And I know that pet food for many people, when we bought pet food, they're kind of shaking their heads and said, what right do you have to win in pet food? But we have every right to win in extrusion technology. We have every right to win in thermal processing technology. We understand the channels the pet food competes in and humanization of the category is one of the biggest trends. And people talk about treats in pet food as if it's something magical. It's actually pet food speak for snacking which were pretty big.

And so, as we look at acquisitions in the future, we'll look at places where we think we can grow, but also where we have a right to win. And we won't go places where we don't think we have a right to win and having a right to win will mean that we have a chance to be successful and continue to grow it, but it'll probably also mean synergies because if we have a right to win, there's some capability that we can lend to that business already.

Q

Do you target a specific dividend payout ratio or how do you manage the dividend over time?

Jeffrey L. Harmening
Chairman & Chief Executive Officer, General Mills, Inc.

A

We do not target a specific dividend payout ratio. And we've maintained or [ph] grown it (00:48:07) for more than 100 years. I think that's a pretty good record.

Q

Okay. And what are you investing in today that you think will have the biggest payoff over the next five years?

Jeffrey L. Harmening
Chairman & Chief Executive Officer, General Mills, Inc.

A

Well, it's hard to indicate any one thing that's going to have a big payoff for the next five years. I would say we're investing in our business to accelerate growth so in bars and on Häagen-Dazs and Old El Paso, we think they will have a big payoff. But apart from this, if we're going to take a step back, I would say it's continuing to invest in data and analytics. And the key for us there I think is going to be you have to invest in scale to make a meaningful difference. But you also have to be specific about what you invest in so you don't throw away money. You don't say you're going to invest a certain amount of money into digital and analytics, it doesn't make any sense to me. The question is can you do it? Can you invest at scale and can you do it? Things that are specific enough that can help you grow and help you save money. So, I think five years from now, we'll be able to look back and say, yeah, we made some really good investments in data and analytics that are going to help our underlying growth as well as underlying cost structure.

Q

And then just finally to wrap it up with the other items on [indiscernible] (00:49:07) analytics are a big piece of your agenda for the next few years, there are other agenda or items that you'd have that you're personally leading the organization over the next three to five years?

Jeffrey L. Harmening
Chairman & Chief Executive Officer, General Mills, Inc.

A

Well, it's really – the tone gets set at the top of any company. And show me a company with a leader who cares about culture and I'll show you a culture. So, for me, it's about leading intentionally with our culture. And that's one that's going to be an accountable culture but also in a very inclusive culture which I think is important in today's environment. Internally, we call it creating a culture of belonging and that's really important especially as you see divisiveness, whether it's economic or political or religious. We're creating a culture of inclusion which is really interesting. And I think it's helpful to understand that that's what employees are looking for. If you show me a culture that people feel like they can belong, I'll show you a company that can attract great talent, that can keep great talent, and that can get great talent engaged. And when you have that at a company, then your chances of growth are a lot better. It is hard to put that on a spreadsheet, but I can tell you, that is the single biggest contributor of growth. It's going to be a company that is looking for growth and that feel like they belong somewhere and that they're engaged.

Unverified Participant

Great. Thank you very much for joining us today. I really appreciate it...

Jeffrey L. Harmening
Chairman & Chief Executive Officer, General Mills, Inc.

Yeah. Thank you.

Unverified Participant

...and thank you all for being here as well.

Jeffrey L. Harmening
Chairman & Chief Executive Officer, General Mills, Inc.

All right. Thanks.

Unverified Participant

Cheers.