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WK Kellogg Co (KLG)

Q1 2025 Earnings Results Prepared Management Remarks

CORPORATE PARTICIPANTS

Gary Pilnick
Chairman and CEO, WK Kellogg Co

David McKinstry
Chief Financial Officer, WK Kellogg Co

Karen Duke
Vice President | Investor Relations

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Vice President | Investor Relations

Good morning and thank you for listening to WK Kellogg Co's prepared remarks for first quarter 2025. I am joined this morning by Gary Pilnick, our Chairman and Chief Executive Officer; and Dave McKinstry, our Chief Financial Officer.

Slide 2 shows our forward-looking statement disclaimer. As you are aware, certain statements made today, including projections for the company's future performance, are forward-looking statements.

Actual results could differ materially from those projected. For further information concerning factors that could cause these results to differ, please refer to the disclaimer slide in our earnings presentation, as well as disclaimers and risk factors noted in our SEC filings.

As we discuss our results today, unless noted as reported, we'll be referencing the respective non-GAAP financial measure which adjusts for certain items included in our GAAP results.

You can find definitions of each non-GAAP measure and GAAP to non-GAAP reconciliations within our earnings release and in the appendix to the slide presentation.

I will now turn the call over to Gary.

PRESENTATION

Gary Pilnick
Chairman and CEO, WK Kellogg Co

Thanks Karen, and good morning, everyone. Thank you for joining us.

Today I will discuss our first quarter financial results and in-market performance, including the impact of the operating and macroeconomic environment. I will also share an update on our strategic priorities.

I will then turn the call over to our Chief Financial Officer, Dave McKinstry, who will provide additional detail on our Q1 performance and updated 2025 guidance.

We are in a challenging operating environment and the business did not perform as we had expected when we entered the year. We have revised our outlook for the year accordingly.

We will discuss the quarter in more detail in a moment, but let's start with how we are thinking about the business on a longer-term basis as we focus on executing our strategy and creating sustainable value for our stakeholders.

We continue to be on track with our long-term plan, including executing our strategic priorities. Our Supply Chain Modernization program and the separation from Kellanova continued to progress as planned. This is important for the business as we continue to work to create a platform for growth by transforming our capabilities and investing in scalable infrastructure. On top of that, we are activating the elements of our Cereal Growth Framework.

These strategic priorities all come together to deliver our long-term financial model of stable topline and outsized margin improvement, while positioning us for the future.

Zooming back in, during the quarter, we observed consumers placing even greater emphasis on health, which fueled growth in health-forward segments of the category, an acceleration of a key trend we highlighted at CAGNY.

This is a trend we have already begun planning to activate against, and we are excited about the health-focused initiatives we have planned for the back half of the year. While this was certainly a headwind for the quarter, we believe it should be a long-term tailwind as we move forward.

We view the increased focus on health as a great thing for the category and WK. We introduced the SPOONS framework at CAGNY, which expresses key health credentials for cereal, such as simplicity, protein and fiber. As we noted, SPOONS certainly applies to health and wellness brands, but equally applies across our entire portfolio. In the back half of the year, we're bringing SPOONS to life through new media campaigns on our mainstream brands, and relaunching Kashi. We have the focus and agility to elevate our business, including meeting evolving consumer needs and putting the commercial support behind it.

Now, let's look at our Q1 results and updated 2025 outlook on slide 4. This was a challenging quarter, and again, our results did not meet our expectations.

As a result, we are updating our 2025 outlook. We now expect organic net sales to be down approximately 2% to 3% and Adjusted EBITDA growth to be approximately flat to down 2% year over year.

Our updated Adjusted EBITDA growth guidance now includes a modest impact relating to tariffs, which Dave will cover in more detail in a moment. The majority of our food is produced and sold in the U.S., however, like other modern supply chains, we have raw materials and finished goods that naturally flow across borders. The majority of this production is covered through the USMCA and is not subject to tariffs at this time. The global trade environment continues to evolve, and we will closely monitor the situation and evaluate mitigation strategies should things change.

Turning to our quarterly results, Q1 organic net sales declined 5.6% vs the prior year. As noted on our Q4 call, our Q1 sales delivery was impacted by an approximate 2% headwind due to the timing of shipments related to Easter and the lapping of a large retailer promotion. Dave will cover more of this shortly. Our decline in the quarter was also driven by weaker than expected consumption trends.

Gross margin in the quarter was 29.4% and EBITDA margin was 10.8%. Let's turn to slide 5 to discuss category trends and our performance.

The metrics we discuss today for our U.S. business reflect Circana's tracked coverage within its Mulo+ with convenience domain. This expanded database provides broader coverage of the category.

As we step back, the category in the U.S. and Canada continues to provide the stable backdrop we need to execute our strategy. Within the category, we've seen a shift, most notably towards health, which I touched on earlier, but also towards value and omni channels, as consumers look to optimize budgets. Health-forward brands led the category in share growth within the quarter.

Now let's turn to the category and our in-market performance. For the quarter, U.S. Cereal category dollar sales declined 0.8%, with volume declining low single digits.

In the U.S., in-market dollar sales for WK, were down 4.5% and we ended the quarter with share of 25.4%, a decline of 100 basis points versus the prior year. Consumption trends were impacted by the rapid growth of health and wellness brands in the category, as well as distribution gains from a competitor reentering the market.

Granola, natural and organic cereal, and health-forward cereal brands, experienced double-digit growth in the quarter, while our N&O brands did not participate in this growth at nearly the same rate, and we continue to be impacted by the performance of Special K.

For the quarter, Canada in-market dollar sales were down 5.5%, and we ended the quarter with a 37.6% share position, a 160-basis point decline versus the prior year. Importantly, in-market performance in Canada was impacted by our PPA transition, which resulted in less promotional activity compared to the prior year. We expect that this PPA initiative will be completed in Q2, allowing us to return to a normalized level of promotion.

Now, let's turn to slide 6 to review how we are already executing and evolving our cereal growth framework that we outlined at CAGNY.

The team continues to execute against this framework, which includes driving demand on our core business, delivering exciting innovation, targeting higher growth areas of the category, and expanding our presence in new channels and formats.

As we look ahead, we are amplifying our efforts across three key areas: value, e-commerce, and health.

First, value has been outperforming traditional channels, as consumers look to optimize their spending in the current environment. We have been pursuing distribution opportunities here and have already secured a number of new agreements to expand distribution with key retailers.

We are also increasing our promotional investment to enhance consumer value across key channels. These investments have been deployed where we see the highest potential return.

Second, e-commerce is another area that is growing in the category. During the fourth quarter and into Q1, we have been investing to elevate our presence in e-comm, and we've seen promising early results with in-market consumption growing 8% during the first quarter. We expect this trajectory to continue as velocities improve and we realize the full benefit of our investment.

Finally, as consumers increase their focus on health, we too are accelerating our health-focused initiatives. We are reallocating some of our media spend to reinforce key health credentials across our portfolio, and we recently activated a refreshed commercial plan for Kashi, which has just started to hit the market.

Now, let's take an even closer look at how we are activating commercially to elevate our portfolio with health-focused consumers.

At CAGNY, we highlighted our intention to invest behind communicating key health credentials inherent to cereal. Our SPOONS framework brings to life what we know to be true for cereal, much of which is often misunderstood, or otherwise goes unrecognized. It is the collective impact of these messages that we believe can influence perspectives and drive behaviors.

The good news for us is that consumers are already heading in this direction, prioritizing quality ingredients and functional health, without compromising taste.

Today, we will focus on three key areas of SPOONS that we are amplifying in the marketplace.

First, simplicity. Many of our cereals start with just four simple ingredients before adding vitamins and minerals. We are launching a new media campaign and updating front of pack claims to share this message, featuring key brands such as Frosted Flakes, Corn Flakes, and Rice Krispies.

Second, protein. Kashi is one of the pioneer N&O brands, which offers great tasting food, high quality ingredients and inherent health benefits – exactly where you want to be within this current consumer landscape.

Prior to the spin, it was managed separately within the broader Kellogg Company and often deprioritized. Now, as part of WK, we have simplified recipes, improved supply, and profitability of the brand portfolio has improved. We are now shifting our focus to demand generating activities, and increasing commercial support to levels that the brand has not had in years.

Representing approximately 50% of the franchise is Kashi Go, which we are now relaunching with new food, an improved packaging design, and a larger pack size offering. Kashi Go now delivers consumers the unique benefit of 10 grams of protein and 10 grams of fiber, with single digit sugar. This is the type of food that should resonate well with our health-focused consumers.

Third, speaking of fiber, cereal is the number one source of fiber for kids, and we know many people don't get enough of this essential nutrient. Many of our cereals provide an excellent source of fiber, and we are bringing that message to life through a new multi-brand campaign launching later in Q2.

You can see how these consumer trends and our activities behind them would serve as a tailwind for our topline performance going forward.

Turning to slide 8, our key strategic priority of modernizing our supply chain is on schedule and on budget. Workstreams are progressing as planned. We have contracts in place for a significant portion of our capital costs, and we recently completed the initial installation of new packaging equipment in our Battle Creek plant.

As we have said, we are investing up to 500 million dollars to optimize and consolidate our network, enhancing efficiency and reliability, which will drive the bottom line and enable the top line. Importantly, we remain on track to deliver our margin expansion of approximately 500 bps as we exit 2026. We're encouraged by the fact that the same economics that we announced at the time of the spin-off are still true today, nearly two years later.

Before I turn it over to Dave to share more detail on our first quarter results, I want to take a moment to highlight a significant milestone for our company.

Turning to slide 9. Since spin, we have been separating just about every aspect of our business from Kellanova, and during the first quarter, we successfully transitioned to our own ERP system and have now fully exited the major elements of our TSA.

As we have separated, we have invested in building our own operating infrastructure across the company and are already laying out the roadmap and workstreams to continue to optimize our

operating systems. We also remain on track to separate and fully operate our dedicated warehouse network. We expect to complete that by mid-year.

Lastly, while separating, we are creating scalable infrastructure that allows us to begin preparing for driving value through inorganic growth such as licensing, distribution, partnerships and M&A, which we discussed during CAGNY, and described as our platform for growth.

This has been a tremendous body of work and I want to take a moment to thank the WK team, as well as the Kellanova team, for their superb execution and partnership. We are excited to start using the new systems and tools that will enable quicker and better decision making today and tomorrow.

I'll turn it over to Dave to walk through our Q1 financial performance and 2025 outlook.

David McKinstry
CFO, WK Kellogg Co

Thank you, Gary.

Now, looking at our results on slide 11, organic net sales for the first quarter were \$667 million, down 5.6% versus the prior year. Price realization was up 3.0%, as we finish up the lapping of our PPA initiative, which was offset by volume declines of 8.6%

As we previously noted on our Q4 earnings call, organic net sales in the quarter were negatively impacted by a reduction in retailer inventory, driven by the timing of Easter and the lapping of a large retailer promotion, which equated to an approximate 2.0% headwind.

And as Gary previously mentioned, consumption trends were impacted by a heightened consumer focus on health, as well as distribution gains associated with the reentry of key competitor.

Turning to profit, Adjusted EBITDA for the first quarter was \$72M, a 4% decrease versus the prior year, which was primarily driven by lower sales volume.

Turning to slide 12, I will now focus on our operational highlights. Gross margin for the first quarter was 29.4%, a 20-basis point increase versus the prior year, which resulted from continued efficiency improvements in our supply chain.

Adjusted EBITDA margin in Q1 was 10.8%, a 20-basis point improvement versus last year, with the gross profit impact of lower sales being largely offset by a reduction in SG&A.

Looking at the below line items, interest expense in Q1 was \$3 million and other income was \$5 million.

Let's turn to slide 13 to cover cash flow and the balance sheet.

First quarter net cash flow from operations was negative \$2 million due to 2024 incentive compensation, which gets paid out in Q1, and core working capital timing. Additions to properties were \$60 million in the first quarter and reflect investments related to exiting our transition services agreement and our supply chain modernization initiative. Free cash flow for the first quarter was negative \$62 million.

As a reminder, for the full year we expect to invest ~\$200 million in our supply chain modernization initiative, ~\$60 million of TSA exit spend, and ~\$70 million of base capex, with our total spend being more weighted towards the back half.

Turning to the balance sheet, we ended the first quarter with \$597 million of debt and cash and equivalents of \$27 million, resulting in net debt of \$570 million. This was an increase of \$75 million vs last quarter and was driven by the step up of investments I just mentioned.

As a result, we ended the quarter with net leverage of 2.1x, and expect to end the year with approximately 2.6x leverage as we increase our investment spend in line with our long-term plan.

Let's turn to slide 14 to discuss our 2025 outlook. As Gary mentioned earlier, based on the weaker than expected consumption trends in Q1, we are lowering our full-year 2025 guidance, we now expect organic net sales to be down approximately 2% to 3%.

We expect our net sales trajectory to sequentially improve from Q1, driven by three key items:

First, distribution gains. We have new distribution hitting market right now across key retailers, with added gains coming in Q3 and Q4.

Second, increased investment in promotional activities. Since spin, we have continued to improve our promotional ROI, giving us confidence to increase activity more broadly across channels. This increased investment reflects a strategic reallocation of the 53rd week profit, which is being redirected from other brand investments to drive greater impact.

Third, we expect our investment in communicating health benefits to consumers to have a long-term positive impact, starting immediately with the Kashi Go restage, which is being executed in the market today.

Our revised Adjusted EBITDA growth guidance of approximately flat to down 2% reflects the impact of lower net sales including the associated leverage impact, which is partially offset by SG&A efficiencies. We expect to sustain these efficiency improvements over the long term.

Based on the operating leverage impact, we expect gross margin for the full year to be relatively flat vs the prior year, with Q2 being most pressured as we adjust manufacturing plans to bring inventory back in line. Similar to our net sales trajectory, we also expect sequential improvement in gross margin in the back half of the year.

Our EBITDA guidance also reflects our current tariff exposure on ingredients that are imported into the U.S. Based on the tariffs currently in place we expect this impact to be between \$2 - \$4M for the full year. We continue to monitor the situation and this impact could change should there be any new tariffs imposed or a change to existing tariffs.

Longer term, we remain on track with our supply chain modernization initiative and delivering approximately 500 bps of margin expansion as we exit 2026.

I'll now turn it back to Gary for closing remarks.

Gary Pilnick

Chairman and CEO, WK Kellogg Co

Thanks, Dave.

While it's not the start to the year that we planned for, I hope you can hear that we are advancing with urgency and purpose to meet the evolving needs of our consumers within this challenging environment.

We are also advancing our strategic priorities that will make us a stronger business into the future. Our supply chain modernization program, along with the investments we are making to build a platform for growth, positions us to create significant value over the long term. The execution of these initiatives is a top priority and remains on track.

We are operating in a category that our founder created and is at the intersection of value, nutrition and taste. What we call affordable, healthy, joy, all of which motivate today's consumers. And we have the right brands, and we have the right team to continue executing our strategy.

Finally, I want to thank our employees for their unwavering dedication and continued efforts to make us a stronger company. It's been an incredible journey since spin, and I am excited to keep moving forward together.