Q1 2024 Earnings Call

Company Participants

- Amit Banati, Senior Vice President, Chief Financial Officer and Principal Financial Officer
- John Renwick, Vice President, Investor Relations & Corporate Planning
- Steve Cahillane, Chairman, President and Chief Executive Officer

Other Participants

- Alexia Howard, Sanford Bernstein
- Andrew Lazar, Barclays Capital
- David Palmer, Evercore ISI
- Ken Goldman, JPMorgan
- Max Gumport, BNP Paribas Exane
- Michael Lavery, Piper Sandler
- Steve Powers, Deutsche Bank
- Tom Palmer, Citigroup

Presentation

Operator

Good morning. Welcome to Kellanova's First Quarter 2024 Earnings Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session with publishing analysts.

At this time, I'd like to turn the call over to John Renwick, Vice President of Investor Relations and Corporate Planning for Kellanova. Mr.Renwick, you may begin your conference call.

John Renwick {BIO 19769692 <GO>}

Thank you, operator. Good morning, everyone, and thank you for joining us today for a review of our first quarter results, as well as an update on our outlook for 2024. I'm joined this morning by Steve Cahillane, our Chairman, President and Chief Executive Officer; and Amit Banati, our Vice Chairman and Chief Financial Officer.

Slide number 3 shows our forward-looking statements disclaimer. As you are aware, certain statements made today, such as projections for Kellanova's future performance, are forward-looking statements. Actual results could be materially different from those projected.

For further information concerning factors that could cause these results to differ, please refer to the third slide of this presentation as well as to our public SEC filings. A recording of today's webcast and supporting documents will be archived for at least 90 days on the Investors page of www.kellanova.com.

As always, when referring to our results and outlook, unless otherwise noted, we will be referring to them on an organic basis for net sales and on a currency-neutral adjusted basis for operating profit and earnings per share. Also, remember that our 2023 results have been recast to treat the spin-off W.K. Kellogg Co. as a discontinued operation in accordance with applicable accounting guidelines. Those recast statements can be found in our Q4 2023 earnings press release from February 8th of this year.

And now, I'll turn it over to Steve.

Steve Cahillane {BIO 4718688 <GO>}

Thanks, John, and good morning, everyone. Two quarters ago, we became Kellanova, with a more focused and growth-oriented portfolio, a refreshed strategy, more ambitious financial targets, and the continued commitment to deliver long-term value for our shareowners. I'm proud to say that we have continued to deliver solid results, even amidst challenging macro and industry conditions.

Our first quarter was a very strong start to 2024, with better sales growth, profit margins and cash flow, than we had projected, and it was another quarter of on-algorithm performance year-on-year, in fact, at the upper end of our algorithm ranges. We are encouraged by the early signs of headway we are making in the marketplace, including here in the United States, and we continue to deliver strong organic growth in emerging markets.

Put it all together, and you can see why we were able to reaffirm our 2024 guidance today and with an increased level of confidence. But before we dive into the details of our financials and regional performance, let me remind you of a few important drivers of this performance.

First is our strategy, Differentiate, Drive, and Deliver, shown on Slide number 6. Each and every element of this strategy is being addressed and executed, both to deliver our near-term commitments, but also to build for a strong future. The strategy clearly has us further differentiating ourselves as a company, driving the actions that deliver shareowner value.

Then, of course, there is our global footprint, another area of differentiation for Kellanova, depicted on Slide number 7. Our heavy international presence adds diversification and growth, both of which were once again on display in the latest quarter. And this footprint, with its growth orientation and diversification, will remain a key differentiator for years to come. All of this is driving differentiated results.

Slide number 8 shows how our organic net sales growth has remained above our peer group median. Recently, we have benefited in part from our ability to raise prices significantly in markets where the currency has devalued sharply of late, but it is differentiated growth, differentiated from our peers and differentiated from our past, and it does reflect the benefits of our sharpened strategy and our more growth-oriented portfolio. Our portfolio is not only more growth-oriented today, but it is also more profitable.

Slide number 9 shows how our post-spin company's margins are higher than we were as Kellogg Company, even before the pandemic. So, as stated on Slide number 10, we are again reaffirming our full-year guidance, and we are doing so with increased confidence. This increased confidence comes from the over-delivery of our first quarter. It also stems from the fact that a return to full commercial activity is gaining traction, resulting in sequential improvement in key in-market metrics.

A good example is the U.S., where we saw consumption volume and sales improve their trends in March and into April. Meanwhile, category-level elasticities are starting to moderate, which further supports our expectations for stabilizing volumes. We continue to invest in our emerging markets businesses, an important source of our differentiated long-term growth, and we are in the process of adding capacity for our biggest brand, Pringles, in these emerging markets.

We continue to restore and expand margins, progressing ahead of our plan in this area. And finally, we continue to enhance our financial flexibility through increased free cash flow and a deleveraged balance sheet. Meanwhile, we also continue to focus on growing the right way, and Slide number 11 provides just a few examples of our Better Days promise in action during the first quarter.

As always, we had a heavy focus on addressing food insecurity worldwide. But we also know that doing the right thing is good for business, and during the first quarter, we again partnered with customers and leveraged our brands as we supported the communities we serve. We also continue to be recognized for our good work.

So, now let me turn it over to Amit, who will walk you through our financials before I come back and discuss each of our businesses in more detail.

Amit Banati {BIO 16339861 <GO>}

Thank you, Steve, and hello, everyone. Slide number 13 summarizes our key financial results for quarter one. As Steve said, we are pleased to report another quarter of on-algorithm results, and the fact that these results exceeded our expectations gives us even more confidence in our full-year outlook.

Our organic growth in net sales was toward the top end of our long-term target range, with much of this organic growth attributable to pricing to offset currency devaluation. But even outside of that, our sales and volume came in a little better than planned.

On a currency-neutral basis, our adjusted operating profit grew strongly year-on-year. If you normalize the year-ago recast base to also include the pass-through of transition services expenses, this year-on-year growth would still be in the double-digits on a currency-neutral basis, and it was driven by a restoration of gross profit margin that more than covered increased brand-building investment.

Our below-the-line items more or less offset each other, resulting in growth in earnings per share that was similar to the operating profit, and a very good start to the year. Meanwhile, free cash flow is also off to a good start.

Slide number 14 walks you through the major components of our year-on-year net sales growth. As you can see, our 5% organic growth was primarily driven by price mix, which itself was led by revenue growth management actions taken over the past 12 months to cover what had been rising input cost inflation, as well as pricing actions taken more recently in Nigeria to cover currency devaluation.

As expected, our overall price mix growth decelerated sequentially again in quarter 1, and it should continue to do so as the year goes on. Volume declined on elasticity impacts around the world. Sequentially from quarter 4, our overall volume decline was affected by Nigeria experiencing less accelerated orders than last quarter. However, in most of our other regions, we are encouraged by the pace of what we have always planned to be a gradual stabilization and recovery.

Moving along the graph, the small impact from last year's divestiture of our Russia business will continue for one more quarter, as the transaction anniversaries at the start of quarter 3. Foreign currency translation clipped net sales growth by a larger-than-expected 9 percentage points in quarter 1, principally reflecting the Nigerian naira. If exchange rates experienced during quarter 1 were to hold, the full-year's currency impact would be around negative 7%.

Now let's look at gross profit on Slide number 15. As we've discussed previously, the discontinued operations accounting used to recast 2022 and the first three quarters of 2023 takes into account only the expenses associated with our transition services agreement and not the pass-through of those expenses to W.K. Kellogg Co.

Year-on-year, this contributed about 110 basis points of our margin expansion during quarter 1. Currency devaluations affected our country mix, contributing a year-on-year margin benefit in quarter 1 of approximately 170 basis points. But as you can see, even without these recast and country mix impacts, we continued a multi-quarter trend of increased gross profit dollars and improvement in our gross profit margin.

Driving this margin recovery have been a number of factors, including the improved supply environment, a resumed higher level of productivity, and last year's revenue growth management actions against moderating input cost inflation. The fact that this gross margin restoration has continued to run ahead of pace gives us additional confidence in our full-year outlook of more than 35%.

The same holds true for operating profit shown on Slide number 16. This was driven by our top-line growth and recovering gross profit margin, which were enough to fund advertising and consumer promotion that increased faster than net sales. The absence of TSA reimbursement from the year-ago recast base was a year-on-year impact of roughly $45 million at the operating profit line, which explains a little less than 150 basis points of the margin expansion. And the currency-related mix shift had the effect of adding less than 100 basis points of the margin expansion.

Even if we exclude these two factors, we still continue to grow operating profit in dollars and in margin, and quite substantially. Like our gross profit, this operating profit performance was better than expected, another promising sign for the full-year. This strong quarter 1 margin performance lends confidence to our outlook for an operating profit margin of over 14% for the full-year.

Moving down the P&L, we come to our earnings per share walk on Slide number 17. As you can see, all of our EPS growth in quarter 1 was attributable to our growth in operating profit, as below-the-lines items offset each other. Interest expense increased meaningfully year-on-year, reflecting higher interest rates. This was offset by a similar increase in other income, reflecting currency translation gains.

As expected, our effective tax rate came in at about 22.6%, and joint venture earnings and minority interest were collectively about a $0.01 drag on EPS. Our average shares outstanding decreased modestly year-on-year, reflecting share buybacks that we accelerated into the previous quarter.

Let's turn to Slide number 18 and look at our free cash flow and net debt. We're off to a good start on free cash flow, even in what is normally a small quarter for this metric, though some of this is timing-related, specifically the timing of a planned distribution from a post-retirement fund which is expected to be offset later in the year.

Meantime, we've continued to pay down debt, even as we returned sizable cash to shareowners, mostly through our dividend. Our debt leverage remains well below our targeted ratio of net debt to trailing EBITDA of 3x.

On Slide number 19, you can see that we're making no changes to our 2024 financial guidance. For net sales, we continue to expect organic growth within our long-term targeted range, specifically calling for 3% growth or better in 2024. Outside of Nigeria, we still assume that price mix growth will moderate as we continue to lap prior actions, that industry-wide elasticities will fade gradually during the year, and that our return to full commercial activity will result in volume stabilization and improvement as the year progresses.

The exception is Nigeria, where currency-influenced pricing actions have continued, and where we assume we will start to see meaningful elasticity impact on volume. Organic growth, of course, excludes currency translation, which based on exchange rates we saw during quarter 1, would be a headwind of about 7% for the full-year.

For adjusted basis operating profit, we again reaffirm the range of $1.85 billion to $1.9 billion. This incorporates a worsened negative impact from currency translation, which based on exchange rates experienced during quarter 1, would be about negative 2% to 3% for the full-year.

This operating profit guidance still implies continued margin expansion as an improving gross profit margin more than offsets a strong increase in brand investment. In fact, we are taking advantage of our strong quarter 1 to increase our reinvestment in brands and capabilities.

Adjusted basis earnings per share is still expected to be in the range of $3.55 to $3.65. Interest expense for the year now should be around $315 million versus the $310 million we signaled last quarter, and currency translation is running worse than previously expected.

On the other hand, other incomes favorable quarter 1 brings up the full-year, even as remaining quarters are still expected to run at around $15 million per quarter. We also estimate that our effective tax rate will come in below the 23% we previously guided to something more like what we saw in quarter 1, and the collective impact of joint venture earnings and minority interest may continue to run at a similar rate as in quarter 1.

And we are reaffirming our outlook for free cash flow of approximately $1 billion, with year-on-year growth driven by operating profit, and despite capital expenditure temporarily elevated as a percentage of sales for expanded Pringles capacity in emerging markets, as well as usual cash outlays related to our two network optimization projects.

Our strong start to the year across all of these metrics gives us increased confidence in this guidance, while still allowing some room for potential risks, such as further currency devaluations or disruptions in the Middle East, as well as the opportunity to add some investment behind brands and capabilities.

So, in summary, our financial position is solid. We kicked off 2024 with results in the first quarter that were ahead of plan. Our commercial activities are starting to be reflected in improving in-market performance and our profit margins are recovering ahead of pace.

Plus, we continue to address our future margins and return on invested capital, making progress on network optimization projects. All of which gives us increased confidence in the full-year guidance we first provided last August and allows us to increase reinvestment.

Our cash flow and balance sheet are giving us enhanced financial flexibility and we continue to return cash to share owners, not only in the form of the opportunistic share buybacks we made late last year, but also the increase in our dividend that we announced just last week.

And with that, let me now turn it back to Steve for a run through of our businesses around the world.

Steve Cahillane {BIO 4718688 <GO>}

Thanks, Amit. We'll start with Kellanova, North America in Slide number 22. Our organic net sales were flat in the quarter against our toughest comparison of the year. As expected, price mix growth is moderating as we lap last year's revenue growth management actions and last year's relative lack of merchandising activity.

Industry-wide elasticities continue to pressure volume in the quarter, but it is important to note that we again realize sequential moderation in these volume declines and we expect this to continue as our increased commercial activity combines with expected diminishing of elasticities in our categories.

North America's operating profit increased substantially as margins continue to be restored. Half of this year-on-year profit growth can be explained by the year-earlier recast figures not incorporating the pass-through of transition service expenses. The other half of this growth was driven by productivity initiatives and year-on-year improvements in service levels and logistics. So, in spite of soft category demand, North America again delivered financially.

Slide number 23 shows how both our snacks and our frozen businesses lapped strong year-earlier growth through the first half before beginning to lap the category-level rise in elasticities that became more pronounced in the second half last year. Hence, being flattish in quarter 1 was expected for both businesses. Encouragingly, our U.S. categories in-market in quarter 1 showed moderating volume declines as elasticities began to moderate.

Meanwhile, our ramped-up commercial activity is starting to improve our share performance as we had planned. While we returned to merchandising in the second half last year, quality display activity requires lead time, and we are now starting to realize this quality activity with increasing retailer acceptance as we have refined our price points, pack sizes, and merchandising periods and events.

Slide number 24 shows this improvement in two of our most important categories. In both crackers and salty snacks, you can see our upward trajectory in consumption sales and volume, particularly when compared to their respective categories. In salty snacks, Pringles picked up share in March, and in crackers our declines are narrowing rapidly, thanks to increasing merchandising for Cheez-It and share gains by Club and Toasted.

The same is true in our other categories. We gained share in portable wholesome snacks in the first quarter led by Pop-Tarts. Eggo started to narrow its share losses in March on meaningful gains in distribution and MorningStar Farms continues to pick up share.

So, we are gaining traction and we have more building blocks taking shape in the second quarter when we pick up distribution on shelf resets and innovation launches all supported by increased brand investment and merchandising activity. And that's on top of likely easing of elasticities as last year's snap and other government allotments anniversary. So, we fully expect to sustain this improvement in consumption volume and share performance in the second quarter and through the second half.

As indicated on Slide number 25, there is no change in our expectations for North America, only increased confidence. Our increased innovation is beginning to hit the shelves now and our brand-building and merchandising have increased and are of higher quality. Best of all, we're already seeing this activity start to bear fruit in the marketplace. We expect our volume performance in this region will continue to improve as a result.

Meantime, our margins continue to recover ahead of pace and we are seeing early evidence of the post-spin-off benefits of a more focused and agile organization. And I'm just back from the Los Angeles premiere of Jerry Seinfeld's new Netflix movie Unfrosted, which I can tell you is absolutely hilarious. It's a farcical take on the launch of our beloved Pop-Tarts. Only the most iconic brands merit a star-studded movie, so be sure to watch its release tomorrow night on Netflix.

Now let's turn to Kellanova Europe and Slide number 26. This region sustained good net sales growth growing organically by 3% in the first quarter even as it lapped prior year revenue growth management actions. Importantly, we realized a modest sequential improvement in volume performance.

Even excluding favorable currency translation, Europe's adjusted basis operating profit grew by 4% year-on-year despite last year's mid-year divestiture of Russia. Profit margins continue to recover nicely in this business even with significant boosts in brand-building investment.

On Slide number 27, you can see that snacks, which represent over half of our sales in Kellanova Europe, continued to lead our growth in this region during the first quarter. Our snacks net sales grew organically by 4% as they lapped double-digit growth and as we experienced trade inventory timing in certain markets as well as softened demand in Israel which is the lone Middle East market serviced out of Kellanova Europe.

In-market, we saw continued deceleration in retail sales growth for our primary categories on moderating price increases and sustained elasticities. The salty snacks category is growing at low- to mid-single-digit growth rates in developed markets, while sustaining mid-teens growth in emerging markets like Poland and Romania.

Impressively, Pringles has gained share across most markets in the first quarter. In cereal, we remained on a trend of 1% organic net sales growth. We gained share in the growing U.K. cereal market but did see continued category slowing and shifts to private label in many markets in the region.

Slide number 28 reviews the elements to watch for in Europe in 2024. Pringles is poised to sustain momentum as we execute our biggest ever campaigns around football, launch a set of limited edition flavors, and continue our paper-can partnership with a major U.K. retailer, all while we prepare for the launch of Cheez-It starting in the UK in the third quarter.

In cereal, we're excited about the launch of Kellogg's sponsored football camps across the U.K. affiliated with prestigious professional clubs. We're also enthusiastic about building momentum behind innovations like new Choco Corn Flakes and Tresor Brownie. The result will be a seventh consecutive year of organic net sales growth for this region even as we progress on plans for an optimization of our cereal portfolio and pending consultation our manufacturing network.

Now let's look at our emerging markets regions, starting with Latin America on Slide number 29. In the first quarter, Latin America's net sales increased by 5% organically. Price mix growth is moderating as expected as we lap prior year actions to offset high cost inflation. The good news is that volume declines continue to moderate even in spite of the impact of our SKU rationalization and price pack architecture initiatives. Operating profit declined in the first quarter against strong 20% plus year earlier growth.

Slide number 30 shows our Latin American net sales growth by category group. Organic net sales for our snacks business dipped year-on-year due to elasticities in Central America and the lapping of a strong year-ago quarter. However, in-market data indicate that category growth rates for salty snacks generally remain strong and both Pringles and Cheez-It outpaced the category with double-digit consumption growth in Mexico and Brazil.

Our cereal net sales increased by a better than expected 10% in spite of lapping a similarly strong year-ago performance. In-market, the cereal category remains particularly robust in Mexico and Brazil and we gain share in both of those markets. In fact, in Mexico, we recorded our highest share in the past decade through commercial activation of our core brands and expanded distribution.

Slide number 31 reminds you of what to watch for in our Latin America business this year. We expect a seventh straight year of organic net sales growth, with growth in both snacks and cereal. Pringles growth should be sustained by innovation and distribution expansion, and we also expect good growth in cereal. Margins should improve, reflecting price pack architecture and other RGM initiatives, operating efficiencies, and the potential for moderating input cost pressures later this year.

And we'll finish with our EMEA region, starting with Slide number 32. Currency-influenced price increases drove substantially all of the regions' 19% organic net sales growth in the quarter, and this organic growth was more than offset by adverse currency translation.

Nevertheless, our business in Nigeria continues to execute well through this challenging currency environment. It is priced to keep up with parallel market currency rates and has operated very effectively. Up to now, elasticities have remained manageable, though they are now on the rise given the significant pricing we have had to execute.

Stepping back, the short-term challenges are dramatically outweighed by the long-term growth opportunity that this growing market and our advantaged assets provide us. Outside of Nigeria and our joint ventures with Tolaram, our organic net sales declined slightly year-on-year, as it lapped double-digit growth in the year-ago quarter and as demand has been impacted by the heightened tensions in the Middle East.

On a currency-neutral basis, EMEA's operating profit grew by 29%, though the extremely adverse currency translation brings this growth down to 2% in U.S. dollars. Excluding our joint ventures with Tolaram, EMEA's operating profit still grew in the double-digits year-on-year, both with and without currency translation, as margin recovery continues.

On Slide number 33, the magnitude of the currency-driven pricing in Nigeria is reflected in the accelerated organic net sales growth for noodles and other. Pricing has had to continue, and while volume has held up well, some of this is related to timing of advance orders in recent quarters that will likely negatively impact the second quarter, and we also are prudently projecting elasticities to finally rise in this business.

Meanwhile, our Kellogg's noodles in South Africa and Egypt continue to grow rapidly, meaning distribution and share. In snacks, we lapped a notably strong year-earlier quarter, and Pringles is feeling the impact of the conflict in the Middle East. Outside of that sub region, however, our snack sales remained in solid growth, led by Pringles.

In cereal, our organic net sales slipped by less than 1%, despite lapping notably strong growth in the prior year-ago quarter. Category elasticities persist, though we are encouraged by our sales in Australia.

So, for EMEA in 2024, we continue to watch for the elements listed on Slide number 34. This region looks to extend its enviable track record of consistently delivering organic growth. Noodles remains a growth business for us even as we contend with increased pricing and elasticities. We expect to sustain momentum in snacks, led by Pringles, though the Middle East situation may slow its overall growth in the region. And we expect to sustain growth in cereal, led by emerging markets. And EMEA's restoration of profit margins should continue.

So, let me summarize with Slide number 36. We're two quarters past the spin-off, and already the benefits of a more focused, more growth-oriented and more profitable portfolio are on display. We again delivered continued on-algorithm financial performance that tracked ahead of expectations.

Our stronger commercial plans are taking hold, with improving in-market performance that is leading to improving volume performance, and this improvement will continue. We continue to progress ahead of schedule in the restoration of profit margins. All of this enables us to reaffirm our 2024 guidance with an increased level of confidence.

Meanwhile, we continue to take value-creating actions for the future, including, for example, adding much-needed emerging market capacity for Pringles, expanding Cheez-It internationally, and optimizing our global manufacturing network.

Simply put, we have the strategy, the portfolio, the footprint, and the financial flexibility to deliver results consistently, quarter-after-quarter, and create long-term value for our share owners. And as always, the biggest reason for our confidence is the talent and energy of our Kellanova team, who are working hard every day to deliver value for you, our shareowners.

And with that, we'd be happy to take your questions.

Questions And Answers

Operator

(Question And Answer)

We will now begin the question-and-answer session with publishing analysts. (Operator Instructions) As a courtesy to your colleagues, please limit yourself to one question. Our first question today is from the line of gold -- sorry, Ken Goldman of JPMorgan. Please go ahead.

Q - Ken Goldman {BIO 15002920 <GO>}

Hi, good morning, everybody.

A - Steve Cahillane {BIO 4718688 <GO>}

Hi, Ken.

Q - Ken Goldman {BIO 15002920 <GO>}

Hi. Just in scanner data, I know it doesn't cover everything, but and clearly you're able to perform quite well anyway lately. But just noticing that as we've seen for a little while now, private label continues to gain share in both crackers and potato chips, maybe at a little faster rate than they are in most food categories.

So, I'm just curious, as we maybe think about 2Q and 3Q with some of the maybe elasticity fading trends, as you mentioned, maybe some lapping of last year's snap reductions. How do we think about you as a category and private label in the context of that, and maybe some of the competitive trends within there?

A - Steve Cahillane {BIO 4718688 <GO>}

Yeah, thanks for the question, Ken. We don't really see the same thing that you're talking about in terms of private label. It's been a little bumpy, to be honest with you. And if you look back to, say, 2019 all the way through this year, there's no meaningful moves in private label in the categories that you mentioned.

And if you look at PWS, Portable Wholesome Snacks, there might be a little bit more movement there. But I think it's really a story of not much to see there when you take all the noise out, because you do have private label last year, spring a little bit more due to supply disruptions, bottleneck shortages. So, there's some of it's just coming back to where it was. I think equally there is in the non-measured channels, as you said, growing faster.

And so, you can't always look at the syndicated data as a complete proxy for our own top-line performance because of that growth. And the growth in the away-from-home channels as well, which has been very good. So, I think, not to be -- I hope you don't take that as a dismissive comment, but I think it's not as much to see as you might really think as you really analyze the fulsomeness of the data.

Q - Ken Goldman {BIO 15002920 <GO>}

No, it's dismissive of Nielsen, not me. I'll take it that way. But I'm just curious if we can maybe broaden it out a little bit. And thank you for that. Just as you think about lapping the snap reductions, what are your estimates, maybe forgetting what we're seeing in private label, just thinking about it more broadly in terms of maybe the lower income or some of the consumers that are struggling a little bit. Do you expect maybe to see a little bit of improvement, just more on a macro basis as we lap some of last year's trends?

A - Steve Cahillane {BIO 4718688 <GO>}

Yeah, we do, Ken. And you hit it right on the head. The lower income consumers, as you know and have seen, are under a lot more pressure than the balance of the consumers. And that continues. We're probably, as we get in the back half of the year, going to be past the worst of that because of the snap benefits, because of the restoration of having to pay student loans, because of the improving economic environment overall from an employment standpoint and from a wage standpoint.

I think we've seen the last of it. So, we always forecast the elasticities to be the most challenging the first half of the year and to improve in the back half of the year. For us, we're actually seeing a better performance than that. So, if you look at the syndicated data, again, I dismissed it in one hand, but not entirely. You can see that our performance is improving. We're getting back to full merchandising activity, which we said.

So, we're moving from really telling everybody what we're going to do to showing what we're doing. And you actually see that in our improvement. So, we feel much more confident in our volume performance. I'm speaking about North America now, even into the second quarter. And certainly that we see that continuing into the back half of the year. So, overall category, I think, back half of the year improvement for us even sooner than that.

Q - Ken Goldman {BIO 15002920 <GO>}

Helpful. Thank you.

Operator

Our next question today is from the line of Max Gumport of BNP Paribas. Please go ahead. Your line is open.

Q - Max Gumport {BIO 21236637 <GO>}

Hey. Thanks for the question. First, just on the TSA impact, I think we've got the moving pieces now, but it sounds like maybe it was a $45 million to $50 million benefit on EBIT, and then maybe $35 million of that was on the gross profit line. Do I have that right, in terms of the size of the TSA, the reimbursement piece?

A - Steve Cahillane {BIO 4718688 <GO>}

Yeah. Yeah. I think you've got that right. You know, I think, the TSA reimbursement was around $45 million, and that split between gross profit and SG&A is about right.

Q - Max Gumport {BIO 21236637 <GO>}

And then how should we --

A - Steve Cahillane {BIO 4718688 <GO>}

I think, nevertheless, even if you exclude that -- yeah, I think, even if you exclude that, we saw strong double-digit growth in our operating profit. You saw a gross margin. Even if you exclude the TSA as well as the ForEx impact, our gross margins were up 190 basis points in the quarter.

I think from a go-forward standpoint, we'd expect TSAs to continue to be in that range, but starting to ratchet down in quarter 2. As I've mentioned previously, we are transitioning the distribution centers into WKKC. So, that process is underway. It's going really well, so its levels are high as we're doing the transition.

So, as that transition happens through the course of 2024, you'll see some of the TSA costs move directly to WKKC, and so that'll start ratcheting down through the year. And of course, in quarter 4, you'll anniversary that, so that's what's built into the guidance.

Q - Max Gumport {BIO 21236637 <GO>}

Great. Very helpful. And then, Steve, you just touched on this, but over the last several months, we've been hearing more and more commentary of a consumer, particularly a lower-income consumer that is feeling stressed and as a result eating out less, and that's only become more clear through the last several days of restaurant earnings. I think what's not as clear is whether or not we're seeing this result in the shift to food at home. So, I'm just curious what you're seeing on this front and where you think the volume could be going? Thanks very much. I'll leave it there.

A - Steve Cahillane {BIO 4718688 <GO>}

Yeah. I think you're clearly seeing value-seeking behavior and discretionary income, the consumers under the most pressure from a discretionary income standpoint are eating out less. I think that's clear, and they are returning to the at-home channels, but they're still seeking value even among that.

So, you see growth in different channels that better cater or really focus against the value-seeking consumer. You continue to see lower packs seeking price points. And so, we're trying more and more not to vacate those very attractive price points. But yeah, that's exactly what we're seeing. And as I said in the earlier comment, I think in the back half of the year, that pressure will start to abate.

Q - Max Gumport {BIO 21236637 <GO>}

Great. Thanks very much.

Operator

Our next question today is from the line of Alexia Howard of Bernstein. Please go ahead.

Q - Alexia Howard {BIO 15082983 <GO>}

Good morning, everyone.

A - Steve Cahillane {BIO 4718688 <GO>}

Good morning.

Q - Alexia Howard {BIO 15082983 <GO>}

Hi there. So, I think you mentioned at the beginning that the first quarter was coming in a bit better than expected on both the top- and the bottom-line. I'm wondering, therefore, why there wouldn't be a guidance raised at this point, or whether maybe there are things on the table that are still highly uncertain? I mean, we've just mentioned the consumer. Maybe you could just speak to what you see as the key uncertainties as we move through the next few quarters. Thank you.

A - Steve Cahillane {BIO 4718688 <GO>}

Yeah, I think, Alexia, it really comes down to the simple fact it's only the first quarter. So, there's always uncertainty with three quarters to remain. But it really gives us the very strong confidence that we're going to deliver a very good year. And what I mean by that is it allows us to really think about the best levels of reinvestment that we can do.

And I'll give you some examples of that. Root-to-market in Latin America and EMEA continues to be really exciting for us. We're going to invest a little bit more in root-to-market. Everything around digital transformation and artificial intelligence allows us to lean in more than we had planned. We were already leaning in this year in our plans. We can lean in even more on that.

And then brand-building, especially brand-building. I'll give you a real-life example of that. I talked about the Pop-Tarts movie. It really is an exceptional movie. And when a comedic genius and icon like Jerry Seinfeld makes a movie about full feature-length movie about your product with a star-studded cast, it gives you an opportunity that we didn't know about it.

And we're leaning into it. We've got displays going up all over the place. We've got a special pack with Jerry's picture on it. And we've got a 90-second video shot by Jerry that's airing right now. None of that was in the budget. And we were able to lean in, in a meaningful way to really accelerate the Pop-Tarts momentum.

So, we're in that type of position right now. So, there's nothing looming on the horizon that's scaring us. It just allows us to really set up the year for an exceptional performance.

Q - Alexia Howard {BIO 15082983 <GO>}

Great. And can I just follow-up. Your leverage is obviously low at the moment. You've got this transitional services agreement that's going to be fading down. What's your appetite for doing a deal? I know there's a lot of moving pieces right now. Is it too soon to try to replace the sales and EBIT that were lost with the spin-off of W.K. Kellogg? Or are you actively looking at the moment? And if so, I presume it would be in snacking, but would it be domestically or internationally? Just curious.

A - Steve Cahillane {BIO 4718688 <GO>}

Yeah. So, we like the health of our balance sheet without a doubt. Our net debt continues to go down. Our leverage ratios continue to go down. So, we have the capacity to do something if it creates shareholder value. And we're always on the lookout for anything that does create shareholder value.

So, you're right. Snacks is, we talk about being a snacking-led powerhouse. 50% of our business is outside the U.S. So, we could do something domestically or outside. We're not really looking to change -- to proactively change to be more international or more domestic. We would look at the absolute best deal out there. And we have the capacity to do it.

Equally, we're very excited about organic opportunities, which I just mentioned Pop-Tarts, but Cheez-It internationally continues to be a priority for us. Adding Pringles capacity is very much a part of our capital plan this year, building two new factories, one in Latin America and one in Asia. So, we've got good uses for our capital with high ROIs, but M&A could factor into that as well.

Q - Alexia Howard {BIO 15082983 <GO>}

Great. Thank you very much. I'll pass it on.

Operator

Our next question today is from the line of Tom Palmer of Citi. Please go ahead. Your line is open.

Q - Tom Palmer {BIO 18823898 <GO>}

Good morning. Thanks for the question. I wanted to just try to bridge the profit improvement we saw in North America. I think even excluding the TSA contribution that you noted, we'd be looking at almost a 20% increase in operating profit relative to last year's adjusted number.

You know, clearly the positive pricing would seem to have offset the volume declines, but just wondering on other items, it does seem like investments were stepped up, but the cost environment maybe is a bit more favorable. And then kind of how does that cost environment progress as we think about subsequent quarters? Thanks.

A - Amit Banati {BIO 16339861 <GO>}

Yeah, I think very strong performance in our North America business this quarter, so very pleased with that. I think it's all the factors that you mentioned. So, it's the benefit of the revenue growth of actions that we took last year. You know, it's a moderating cost environment, so we're seeing that play out.

I think this quarter, the supply chain performed well. And from a lapping standpoint, this was the biggest lap from the shortages and bottlenecks. So, those were kind of some of the drivers. We continue to expect to see strong profit performance, both growth and operating through the year, probably not at the pace we saw in quarter 1 because we're lapping bulk of the shortages and bottlenecks we lapped. That was predominantly in quarter 1.

And then, some of the mechanical elements, like the currency impact was most pronounced in quarter 1. That'll probably moderate in the rest of the year. I mentioned earlier that we lapped the anniversary, the TSA reimbursements in quarter 4. So, we'd expect continued good performance through the year, but not as pronounced as we saw in quarter 1.

Q - Tom Palmer {BIO 18823898 <GO>}

Okay. Thank you. And then a quarter ago, you guided for all operating segments to report organic sales growth and constant currency operating profit growth in line with their long-term algorithms. Is this still the case, or are there any shifts here, just given the strong start to the year?

A - Amit Banati {BIO 16339861 <GO>}

I'd say broadly in line with what we got. So, no major changes. I think it's coming slightly better than expected. Currency in Nigeria is obviously devalued more than we thought. And the teams there are pricing to recover that. So, some changes, but overall, broadly, I'd say in line with the long-term algo that we had guided to.

Q - Tom Palmer {BIO 18823898 <GO>}

Thank you.

Operator

Our next question today is from the line of Andrew Lazar from Barclays. Your line is open. Please go ahead.

Q - Andrew Lazar {BIO 1973907 <GO>}

Great. Thanks so much. Amit, a lot of discussion on North America profitability, obviously, coming in and far better than most of us had modeled, even adjusting for some of the one-off nature of things. But I assume there was actually also some element of negative fixed-cost absorption in there due to the fact that volume in North America has continued to be on the weaker side.

I guess, how much of a headwind to gross margin might that have been in North America or to overall Kellanova that I would assume would also start to moderate or taper off as volume trends start to stabilize and/or even improve in the back part of the year?

A - Amit Banati {BIO 16339861 <GO>}

Yeah, I think, Andrew, it was a headwind. But like I said, I think the improved supply chain performs more than offset that. So, while the volume line was a bit of a headwind, by far the biggest driver was the lapping of the improved supply chain performance, the improved service levels. And so, I think that's kind of more than offset that. And of course, we'd expect the volume leverage to start improving as the volume (Technical Difficulty)

Q - Andrew Lazar {BIO 1973907 <GO>}

And then quickly, Steve, just we've heard a lot of discussion also in general about just consumers, maybe the lower income consumers obviously reacting to just sort of absolute price points, right, being sort of where they are as opposed to anything having to do with price gaps vis-a-vis private label or anything else.

And sometimes there's an adjustment period here in terms of consumers adjusting their, sort of their reference price points with what they may have equated with a product on promotion prior to the sort of the last two years of inflation and whatnot.

I guess, where do you think the consumer is with respect to adjusting their sort of their reference price points? Do you think they're making some progress on that front? And maybe that's part of what plays into hopefully helping industry volumes in the back part of the year as well. I'm just curious your thoughts on that. Thanks.

A - Steve Cahillane {BIO 4718688 <GO>}

Yeah, Andrew, I think that's exactly right. You know, we talked, I think, in the last quarter and probably the last two quarters about those very reference price points and talking about the consumer will walk by four or five trips and not just be able to accept that new reference price point.

So, I think we're there or thereabouts, probably the seventh or eighth inning, if you like. At the same time, , companies like ours continue to also work RGM initiatives. And it's not shrinkflation. It's making sure that you can hold your margin and hit a price point. And sometimes that means a smaller size.

And so, I think the combination of all of those things working together leads us to believe that the second half of the year is going to be the inflation point for the consumer. And for us, as I said, I think we get there even faster than that because of what we're lapping because we admittedly came back to merchandising activity perhaps later than we otherwise would have knowing what we know today.

But the fact of the matter is we are there now. We are merchandising more effectively. We've got more quality displays. We like our price points. We do like our price points and where they are with consumers. And so, we see all that leading to a better back half of the year, although still not without pressure. So, I don't want to be about it. The consumer is still under a good bit of pressure. But I do think that there is brightness on the horizon.

Q - Andrew Lazar {BIO 1973907 <GO>}

Thank you.

Operator

Next question today is from the line of Michael Lavery of Piper Sandler. Please go ahead.

Q - Michael Lavery {BIO 20141239 <GO>}

Thank you. Good morning. I just want to come back to the big picture outlook for the consumer. And we've touched a little bit already on possibly the food away-from-home shift to food-at-home as a possible tailwind. But I guess, every company is looking for volume improvement in the second half.

Even if you think about food away from home shifts, adding growing the pie, private label momentum is still strong. We hear over and over again about the pressured consumer. Lapping snap kind of puts an incremental negative in the rear view, but doesn't replace it with any new boost.

So, I guess, where does all the volume come from? Do you expect private label share to reverse? Is it just that other competitors in the branded space will feed share to Kellanova? How do we think about how that's meant to unfold?

A - Steve Cahillane {BIO 4718688 <GO>}

Yeah, so I think if you step back and look at everything, I don't think that there has been volume destruction. If there is a caloric reduction in the population, it is quite minimal. And a couple of quarters ago, everybody wanted to talk about the GLP-1 drugs. I think that has faded as well.

So, if you start with the premise that more or less the caloric state remains the same, then the volume goes somewhere. And I think those with the best full commercial activation with brands that matter to consumers are going to be the ultimate winners.

And that's why we're excited about where we are in terms of our ability to reinvest and continue to step up our investment against the consumer and against household penetration and making sure that we're delighting our consumers all along the way because we think the volume potential is still very real and hasn't had any full diminishment, if you like.

Q - Michael Lavery {BIO 20141239 <GO>}

And you've touched in the past on potential consumer adjustments in terms of things like waste reduction and using more leftovers. Is that some of the behavior that might refer to prior norms? Is that some of the things you're counting on as part of the change?

A - Amit Banati {BIO 16339861 <GO>}

Yeah, I think it's interesting because you all on this call and we and all of our peers have been in search of where that volume is, right? And there has been a lot of hypotheses. And I think the fact is, it's probably a lot of things that are hard to measure.

One is managing the household pantry, less leftovers, more creativity. I think all those things have been coming into play. But they are now, if you think about it, they're in the base. You can only work that pantry so long. The pantry is not an infinite supply of stuff in the corners. And so, that's been worked. But I think this new consumer behavior around less food waste and making sure that leftovers are used is probably consumer behavior, as far as we can tell, that will remain.

But again, it's in the base. And so, I think there's a new normal, if you like. Now as the economy improves, if it does improve, if discretionary income keeps growing faster than inflation, you'll likely see a return to kind of the pre-inflationary times as people become a little bit more comfortable. I think that would be a natural outcome. But right now, I think we see the continuation of that behavior, recognizing that it's in the base.

Q - Michael Lavery {BIO 20141239 <GO>}

And just a quick follow-up on LatAm. You called out the performance there of being what it was despite the SKU rationalizations that you've had. Can you just give a sense of maybe the magnitude of what that was? And are there incrementally new ones we should be mindful of modeling ahead, or is this closer to winding down?

A - Amit Banati {BIO 16339861 <GO>}

I think it's largely behind us. And so, yeah. But overall, we're seeing good momentum in our LatAm business, both in Mexico as well as in Brazil.

Q - Michael Lavery {BIO 20141239 <GO>}

Okay, thanks so much.

Operator

Our next question today is from the line of David Palmer of Evercore ISI. Please go ahead.

Q - David Palmer {BIO 6061984 <GO>}

Thanks, good morning. Last quarter, I think you got it to '20 for the year North America snacks, organic sales growth, low-single-digits. Is that still the thinking? And if so, how do you envision price versus volume this year for North America? Just looking at the last four weeks and I know you highlighted the last four weeks. I don't know if that composition is how you're thinking kind of things will play out, but it does look like price per unit is down low-single-digits with volume offsetting that, and not sure how indicative that will be?

A - Steve Cahillane {BIO 4718688 <GO>}

Yeah, David, I think if you look at what's happened the last 18 months, two years, been too much price and not enough volume for obvious reasons. And now, we're seeing -- starting to see the reversal of that in North America.

And as I mentioned several times in the call now, we're seeing a better volume performance. You can see that in the latest published data. We're seeing a gradual recovery in that. And we are very confident in the back half of the year based on what we see right now in terms of our volume performance. So, we like the balance that we see returning to our business and we have a lot of optimism that, that's going to continue.

Q - David Palmer {BIO 6061984 <GO>}

So, do you think this is going to be one where we maybe see volume even stronger than net sales in that division? Is that the kind of year because you're leaning in with high-quality merchandising that's going to lead to some net pricing per unit offset to the volume that you're going to get? Is that fair?

A - Steve Cahillane {BIO 4718688 <GO>}

Yeah, I don't want to go too deep into individual regions and volume price mix beyond what we said. And that is, it's getting a lot better. The volume performance continues to get a lot better. For us, the return to full merchandising activity, which we mentioned several times, is the real driver of that volume recovery.

And we like what we see in terms of that balance. We like what we're seeing with the reinvestments in our brand. We like what we're seeing in terms of our share, improvements in the marketplace, all those things combining to give us the confidence that we've been talking about.

Q - David Palmer {BIO 6061984 <GO>}

Just a follow-up on supply chain was a constraint for the old Kellogg's and Kellanova perhaps more than most companies last year. I know it kept you from doing some of the things you're doing now, the growth spending, but also maybe on productivity initiatives.

Are there certain metrics you could just talk about just year-over-year where you were? It can be the shift on time and in full, but other metrics including productivity quarter -- year-over-year in the quarter that can give us a sense of how much the supply chain is a big helper. Thanks.

A - Steve Cahillane {BIO 4718688 <GO>}

David, I would just say -- I wouldn't say that our supply chain was disadvantaged in the past. What we did say is we were perhaps more conservative than others in wanting to keep our supply fill rates at a very high level, and therefore did not return to full merchandising commercial activation as some of our peers did.

Our supply chain right now is performing at a very high level, like think about pre-pandemic, high watermarks in terms of on time and full. So, that's where we are and that's why we have the confidence.

In terms of productivity, we're back to the type of productivity initiatives that we were pre-pandemic as well. So, that's been very, very positive. We announced worldwide a couple of productivity initiatives that we talked about last quarter that are proceeding very, very well. And so, we like where our supply chain is in North America and we like where our supply chain is globally.

Q - David Palmer {BIO 6061984 <GO>}

Thank you.

Operator

Our next question is from the line of Steve Powers of Deutsche Bank. Steve, your line is open. Please go ahead.

Q - Steve Powers {BIO 20734688 <GO>}

Yes. Hey, good morning, guys. Just a quick one. I guess, a follow-up on that prior line of questioning on North American pricing in combination with Andrew Lazar's question on volumetric leverage. As we think about the benefits of volume leverage throughout the year offset by the price investments that we're seeing, how does that play out on net impact on margins? Is that a net positive and net drag just as we think about the sequential progression?

A - Amit Banati {BIO 16339861 <GO>}

Yes. I think, Steve, there are a number of things playing through in the margin. Like I mentioned earlier, we're confident that our gross margins will be more than 35%. Within that, there are a number of moving parts. Obviously, inflation, which we said and continue -- the guide continues to be neutralish across a number of cost elements. So, that's playing through.

The improved performance of the supply chain is a tailwind this year. I think from a price standpoint, the price mix is obviously moderating. So, I think it's a combination of those factors. We should start seeing some volume leverage as the volume trends improve. But all of that kind of factors in to our expectation that we'd continue to see gross margin expansion, not at the rate we saw in quarter 1, but we'd expect that the gross margins would continue to improve and be north of 35% for the year.

Q - Steve Powers {BIO 20734688 <GO>}

Okay, very good. And Steve, I was hoping you could talk a little bit more about the Cheez-It's expansion overseas. You gave some snippets -- as you went region by region, you gave some snippets about kind of what to watch for, but maybe you could just pull it all together in aggregate and just talk about that initiative and kind of what to watch for in aggregate as you progress through '24, and we start thinking about further progression to '25? Thanks.

A - Steve Cahillane {BIO 4718688 <GO>}

Yes, so we are excited about the Cheez-It and their international prospects. We've got Cheez-It now in Canada, Mexico, Brazil. We're applying those learnings to the launch in Europe later this year, particularly in the U.K. And the U.K. team is very excited about it. The initial research on product and on positioning is very strong.

And so, this is not anything that's going to really affect your models per se, because we're taking it in a very pragmatic way, market by market, continuing to build the playbook. So, each next market is more successful than the one that came before it.

And so, '24 will be the European launch. And then later in '24, we'll talk about additional markets for '25 and beyond.

Operator

Thank you. And I'm afraid we have run out of time for any further questions today. So, I'd like to hand back to Mr.John Renwick for any closing remarks.

A - John Renwick {BIO 19769692 <GO>}

Well, thank you, everyone, for your time and your interest. And if you do have follow-up calls, please do not hesitate to call us. Have a great day.

Operator

This concludes today's conference call. Thank you all for joining. You may now disconnect your lines.