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MKC - Q3 2012 McCormick & Company, Inc. Earnings Conference Call

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OVERVIEW:

MKC reported 3Q12 sales growth of 9% in local currency, operating income of \$144m and EPS of \$0.78. Expects FY12 sales growth to be 9-11% in local currency and EPS to be \$3.03-3.08. Expects 4Q12 EPS to be \$1.10-1.15.



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PRESENTATION

Joyce Brooks - *McCormick & Company, Inc. - VP of IR*

Good morning. This is Joyce Brooks, McCormick's Vice President of Investor Relations. Thank you for joining today's call to review the Company's third-quarter financial results and 2012 outlook. We've posted a set of slides to accompany today's call at our website, IR. McCormick.com.

At this time, all participants are in a listen-only mode. A question-and-answer session will follow our remarks. (Operator Instructions). As a reminder, the conference is being recorded.

With me on today's call are Alan Wilson, Chairman, President and CEO, and Gordon Stetz, Executive Vice President and CFO. Alan is going to comment on our third-quarter 2012 results and share our latest progress with key growth initiatives, along with remarks about the current business environment. Gordon will provide a review of our third-quarter financial performance and discuss our 2012 financial guidance. After that, we look forward to discussing your questions and closing remarks from Alan.

As a reminder, today's presentation contains projections and other forward-looking statements. Actual results could differ materially from those projected. The Company undertakes no obligation to update or revise publicly any forward-looking statements, whether as a result of new information, future events or other factors.

As seen on slide two, our forward-looking statement also provides information on risk factors that could affect our financial results.

It is now my pleasure to turn the discussion over to Alan.



Alan Wilson - *McCormick & Company, Inc. - Chairman, President, CEO*

Thanks, Joyce. Good morning, everyone, and thanks for joining us. Our third-quarter financial results demonstrate the effectiveness of McCormick's growth initiatives even in a challenging environment. Measured in local currency, we grew sales 9%, increased operating income 12% and achieved a 13% increase in earnings per share.

Through the first three quarters, we have generated \$256 million of cash flow from operations and are on track to exceed \$400 million for the fiscal year.

Our strategy to grow sales and profit by investing in the business and fueling these investments with CCI, our Comprehensive Continuous Improvement program, provides the framework for our progress. And employees throughout the Company are doing exceptional work and a key ingredient of success, our power of people.

As an example, we now expect to exceed \$50 million in cost savings from CCI, a 25% increase from our initial goal of at least \$40 million in cost savings during 2012. We regard this program as particularly important in a period of time when material costs remain volatile. This quarter, we were pleased to report a 50 basis point improvement in gross profit margin following a number of quarters when margins have been under pressure.

While difficult economic conditions in many of our markets persist, we're making excellent progress with our growth initiatives in three areas -- product innovation, brand marketing support and acquisitions.

Let's start with some remarks on consumer business innovation, where we are building on our global growth platforms, as well as innovating behind our brands that are regional leaders. Following the launch of 200 branded consumer products in 2011, we are on track to launch close to 250 new items this year.

In the US, new McCormick recipe mixes are allowing consumers to easily prepare wholesome, traditional meals for their families. Our Zatarain's Frozen Meals for Two has helped drive a 9% sales increase year to date for the brand. Grill Mates blends, marinades and barbecue sauces are behind an 8% year-to-date sales increase. And in the fourth quarter, we will be introducing Hispanic rice mixes, frozen Simply Asia entrees and a holiday multipack of small-sized extracts.

In Latin America, we've developed and introduced value-priced condiments that are helping to drive a 9% increase in our consumer sales in El Salvador throughout the first three quarters. And in Canada, we've gained strong retail acceptance for 37 new products and expect sales of our 2012 new products to be double the sales of new products introduced in 2011.

Moving to Europe, the Middle East and Africa, consumers are under pressure and seeking ways to economize. During this period, differentiated new products are more important than ever. Building on our global platform of recipe mixes, we are having particular success with Bag'n Season in France and the UK, Slow Cookers and limited-edition varieties. Likewise, innovation behind our spice and seasoning platform include grinders and, across multiple markets, new Recipe Inspirations.

For consumers who want to prepare great desserts at home, we continue to expand our Vahine brand product offerings.

In the Asia Pacific region, we are expanding our recipe mix platform in China. Earlier in the year, we launched a line of family classics with flavors such as Kung Pao Chicken and Honey Pork Ribs, followed more recently by World Flavor varieties. Australia's introductions include Naturals recipe mixes, as well as Recipe Creations and marinades.

Our industrial teams have been equally active with innovation. Demand for healthier products remains a great opportunity for McCormick to provide customized flavor solutions for numerous food categories, snack chips, crackers, cereals, side dishes and menu items, beverages, chicken and sandwiches. Recently, we completed a study to track the success of the flavors that we develop for customer products, comparing the performance of our flavors with flavor varieties supplied by a competitor for the same salty snack cereal or cracker brands.



The three examples on slide seven are representative of what we see across a number of examples. The McCormick flavored products are outselling. Clearly, we are providing flavors preferred by consumers, as we continue to invest in our technical innovation capabilities with the ribbon-cutting in August for a new facility in Mexico, new flavor labs in the US and more recently in the UK, and our new technical innovation Center in Hangzhou, China, due to open by year end.

Brand marketing support is another key growth initiative. While we expect to increase our spending this year by at least \$15 million, we are also reallocating funds to reach consumers in new ways. A portion of funds are being directed toward a value message behind our brands with coupons, features and in-store displays. In fact, our US retail displays for the holiday period are going in even earlier during this fourth quarter, and we have a strong ad campaign planned behind new Thanksgiving advertising.

We are also adapting to reach consumers where they are spending their time, which is increasingly on the Internet, as shown on slide eight. In 2012, we expect our digital marketing to reach 12% of our total brand marketing support, triple what we were spending just two years ago.

We are working to connect with consumers at every stage of what we call the flavor life cycle, from inspiration with a recipe idea to getting our product on the shopping list and helping with meal preparation and finally sharing success with family and friends.

In addition to our Facebook fans for brands like Grill Mates, Zatarain's and Old Bay, we are excited about our presence on Instagram and Pinterest to support our gourmet consumers. Pinterest is now the third largest social media site after Facebook and Twitter and provides an opportunity for consumers to become engaged with our brands in more authentic and compelling ways.

The third growth initiative I want to touch on is acquisitions. Acquisitions completed in 2011 are contributing meaningfully to our 2012 sales growth at a 6% rate year to date. The addition of Kamis and Kohinoor have expanded our emerging-market presence, and through the first three quarters, sales in emerging markets accounted for 14% of total McCormick sales.

I reported last quarter that these integrations were complete, and we are now achieving some early wins. Kamis is currently tracking ahead of plan due in part large part to our business in Russia. Russia comprises nearly 20% of the Kamis business, and we've grown sales 44% from the year-ago pre-acquisition period in this market. Our business there is supported by distribution facilities and a local sales team. As the third largest spice and seasoning business in Russia, with a category share of approximately 10%, we are further expanding our distribution in this fragmented market.

Turning to India, we are realigning our Kohinoor distribution network by retail channel rather than geography, to build focus on modern trade, traditional trade and food service. This is patterned after a similar alignment that met with great success in China. And in the US, we continue to build retail distribution for Kitchen Basics products.

About a month ago, we announced our latest acquisition agreement, this time in China. We've agreed to purchase 100% of the assets of Wuhan Asia-Pacific Condiments, WAPC, for approximately \$141 million. This price is about 12 times the multiple of EBITDA. With annual sales of roughly \$115 million, WAPC manufactures and markets two leading brands of bullion in central China. Sales are growing at a double-digit rate with a network of distributors that supply traditional markets as well as modern grocery stores. This business is an excellent fit with our current business in China. It extends our product portfolio of spices, seasoning blends and sauces to bullion. And WAPC's geographic strength in central China complements McCormick's existing strength in China's coastal regions.

We regard WAPC as a great follow-on to our acquisitions of Kamis and Kohinoor in 2011. We are building out our emerging-market presence through acquisitions that have been in the \$100 million to \$200 million range. As we execute our emerging-market strategy, we are maintaining our financial discipline and acquiring established brands that are immediately accretive to earnings when costs to close the deal are excluded.

We're well on our way toward reaching the goal that we set in April, for sales in emerging markets to reach 20% of total sales by 2015. Let me turn it over to Gordon now for more insight into our third-quarter financial results and our latest 2012 guidance. Gordon.



Gordon Stetz - *McCormick & Company, Inc. - EVP, CFO*

Thanks, Alan, and good morning, everyone. As Alan indicated, we continue to operate in a challenging environment, one that has demanded adaptability, resourcefulness and the talents of McCormick employees across the Company. Our financial results are a testament to their accomplishments.

Alan provided some of the headline results for the third quarter, 9% sales growth in local currency, a 12% increase in operating income, a double-digit increase in earnings per share and strong cash flow.

I'd like to begin with a closer look at each of our two segments, starting with our consumer business. As seen on slide 12, we grew consumer business sales 12% in local currency. In a period of increased pricing, we are maintaining our volume and product mix and had another strong contribution from our 2011 acquisitions this period.

In the Americas region, we grew third-quarter consumer business sales 5% in local currency. As seen on slide 13, sales from Kitchen Basics added 1% to our growth this period. Pricing was up 5% as a result of an increase taken in the fourth quarter of 2011 and a more recent price increase on pepper.

For the third quarter of 2012, volume and product mix were about even with the year-ago period. As a reminder, in the third quarter of 2011, we estimated that customers purchased approximately \$10 million of product in advance of a price increase, shifting sales into the third quarter of 2011 from the fourth quarter of 2011. Excluding this impact, third-quarter 2012 volume and product mix were up approximately 3% year on year, a solid growth rate being driven by the new product activity and brand marketing support that Alan discussed.

In Europe, the Middle East and Africa, EMEA, we grew consumer sales 22% in local currency. This increase was attributable to sales of Kamis, our acquisition in Poland, which was still incremental in this quarter. For the base business, a slight increase in pricing was offset by a decline in volume and product mix. Difficult conditions persist in much of Europe, where consumers are facing uncertainty and economic pressure. In this environment, we are working to drive growth with differentiated new products and our brand marketing support.

Consumer business sales in the Asia Pacific region rose 69% in local currency. Kohinoor, our acquisition in India, added 55% to third-quarter sales. The base business grew 14%, mostly from volume and product mix.

Following a strong start to the year and a more modest increase in the second quarter, sales rebounded this period, illustrating the quarter-to-quarter variability we've seen in this region, which is due in part to the timing of holiday seasons and marketing programs.

Our consumer business in China drove this quarter's increase, and sales there are up 20% year-to-date in local currency.

Across all three regions, third-quarter consumer business operating income was \$109 million, up 8% from the prior year, driven primarily by sales growth. Pricing actions, together with our CCI costs savings, continued to provide an offset to the impact of higher material costs.

Let's turn now to our industrial business, and start with a review of our sales performance. For this segment, we grew sales of 6% in local currency, with most of the increase related to pricing taken in response to increased material costs.

On slide 18, industrial sales in the Americas rose 7% in local currency, due primarily to pricing actions. During the third quarter, we grew sales of seasonings and flavors to a number of food manufacturers and also increased sales of branded items to food service distributors. However, we saw lower demand for our products sold to quick-service restaurants.

In EMEA, our industrial business achieved another consecutive quarter of strong sales growth in the third quarter. We grew sales 11% in local currency, with a 7% increase in volume and product mix. Demand from quick-service restaurants remains robust, and we are meeting this demand with products supplied from our operations in the UK, Turkey and South Africa.



In contrast to the consumer results in the Asia Pacific region, this was a somewhat weak quarter for the industrial business there, with sales in local currency down 4%. This compares to 17% year-on-year sales growth in local currency for the third quarter of 2011.

In 2012, we have been impacted by a lower level of promotional activity behind some of the quick-service restaurant items we flavor in this region.

In the Asia Pacific region and across our other two regions, our industrial teams are working to partner with our customers to drive their growth through new product development.

Operating income for the industrial business was \$35 million in the third quarter, an increase of 27% from the year-ago period, which reflect higher sales, CCI-related cost savings and operating expense leverage. In addition, our customer pricing is better aligned with our current material costs than in the third quarter of 2011, when we were getting pricing actions in place in response to significant material cost increases.

Across both segments, we grew third-quarter operating income 12% to \$144 million, mainly due to higher sales and our CCI program. Gross profit was 40.1% this period compared to 39.6% in third quarter of 2011, a 50 basis point improvement. This reflects the favorable sales mix in consumer and faster growth of the consumer segment versus the industrial segment.

And as mentioned, for each of these two segments, we are offsetting higher material costs with pricing actions and CCI cost savings.

Also affecting operating income was our selling, general and administrative expense, which was down 20 basis points as a percent of net sales in the third quarter. Brand marketing spending this period was about even with the year-ago period. This follows a 27% increase in the third quarter of 2011.

For the full year, we expect our brand marketing support to be up at least \$15 million. This is just an increase of a few million dollars in the fourth quarter, given what we have spent year-to-date. This fourth-quarter 2012 increase builds upon a \$10 million increase in the fourth quarter of 2011.

Moving below operating income, our tax rate for the third quarter was 25% compared to the prior-year period at 26.8%. This year-on-year tax rate variance added about \$0.02 of the earnings per share increase in the third quarter of 2012.

In the third quarter of 2011, we had the benefit of discrete tax items. In the third quarter of 2012, we repatriated \$70 million of cash from foreign subsidiaries. Due to the mix of foreign earnings that related to this cash, the repatriation resulted in foreign tax credits in the US. Versus our underlying tax rate for 2012, the impact of these tax credits added about \$0.04 to earnings-per-share. We expect the tax credits to add \$0.02 to earnings-per-share in the fourth quarter of 2012 versus our underlying tax rate. We currently expect the fourth-quarter tax rate to be approximately 27%.

Income from unconsolidated operations continues to lag the year-ago result, with \$5.5 million achieved in the third quarter of 2012 compared to \$6.8 million in the year-ago period. Although the decline has moderated from the first half of 2012, it is still due in large part to the exchange rate between the Mexican peso and the US dollar, not only in the translation of earnings from our McCormick-to-Mexico joint venture, but in the transaction impact for the purchase of soybean oil.

We now expect income from unconsolidated operations for the full year to be down approximately 20% year on year. At the bottom line, we reported earnings per share of \$0.78, a 13% increase from \$0.69 in the third quarter of 2011. Of the \$0.09 increase, higher operating income was the primary factor behind our profit growth, followed by the favorable tax rate, as shown on slide 25.

Let's turn next to our cash flow and August 31 balance sheet. Year-to-date, cash flow from operations was \$256 million compared to \$86 million in the first three quarters of 2011. The improvement was led by a much lower increase in inventory for the first three quarters of 2012 than in the first three quarters of 2011. Year-to-date in 2012, we used \$98 million of cash to repurchase roughly 1.8 million shares. At quarter end, we had \$171 million still available on our \$400 million authorization.



Our balance sheet remains strong. We have maintained our debt level through 2012 and plan to pay down approximately \$50 million in the fourth quarter. In 2013, we expect to balance of the use of cash for the acquisition of WAPC in China with our share repurchase program.

As a final topic, I want to review our latest 2012 guidance, as shown on slide 27. With strong sales results through the first three quarters, we reaffirm our expectation to grow sales 9% to 11% in local currency for the fiscal year. Based on prevailing foreign currency rates, we are still estimating an unfavorable currency impact of 2% for the year.

At the operating income line, we are reaffirming a 9% to 11% increase. We have increased our guidance for earnings per share to a range of \$3.03 to \$3.08, reflecting the impact of the foreign tax credits. This is a \$0.02 increase from the prior range of \$3.01 to \$3.06, and indicates our outlook for the fourth-quarter EPS is a range of \$1.10 to \$1.15.

While the impact of the foreign tax credits versus our underlying rate is about \$0.06, we are adding just \$0.02 to reflect a more conservative view of the fourth quarter given the global economic environment and continued volatility in material costs, as well as an opportunity for additional investment in brand marketing support.

As a reminder in updating your models, keep in mind that we recorded acquisition-related transaction costs in the fourth quarter of 2011 that lowered earnings per share by \$0.05, and we expect to have a \$0.02 benefit from foreign tax credits in the fourth quarter of 2012.

To summarize, we were pleased with our third-quarter performance and expect record financial results in 2012. While we maintain a cautious outlook based on the global economic environment, we are excited about our growth initiatives and the enthusiasm and energy of McCormick employees around the world.

Thank you for your attention, and now let's turn to your questions. Operator.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Chuck Cerankosky, Northcoast Research.

Chuck Cerankosky - Northcoast Research - Analyst

Good morning, everyone. In looking at the QSR business in Europe versus North America, one is weaker, one is stronger; yet the economies both have a fair amount of consumer stress. Can you give us some insight on that difference?

Alan Wilson - McCormick & Company, Inc. - Chairman, President, CEO

I think part of what has gone on there is that we've gained a little bit of share in the European business. Our share is relatively flat in the US business. So I think -- I wouldn't necessarily -- and I'd say the same thing about Asia -- that I wouldn't necessarily draw an inference into the performance of that channel based on our results, because there is a lot of things that move back and forth based on what items we supply and what the customers are promoting and what share we've gained.

Chuck Cerankosky - Northcoast Research - Analyst

All right. And then looking at the underlying tax rate, Gordon, you are comparing that \$0.04 favorable variance to the underlying tax rate. Is that suggesting something in the low 30s?



Gordon Stetz - *McCormick & Company, Inc. - EVP, CFO*

As we indicated for Q4, we expect it actually to be below 30%, more in the range of 27%. You are saying -- oh, you're asking about the underlying tax rate. I apologize. The underlying tax rate would be about 30%.

Chuck Cerankosky - *Northcoast Research - Analyst*

All right. That's helpful. Thank you.

Operator

Alexia Howard, Sanford Bernstein.

Alexia Howard - *Sanford Bernstein - Analyst*

Good morning, everyone. Can I ask about some trends that we've been seeing in the consumer takeaway data? It looks as though in spices and seasonings in the US, there has been a bit of encroachment from private-label dollar and volume share. Could you just tell us a little bit about what's going on there with respect to price gaps to private label, private label promotional activity? And do you expect that kind of environment to persist going forward? Thank you.

Alan Wilson - *McCormick & Company, Inc. - Chairman, President, CEO*

I think it is going to be a challenging environment going forward. But as we look at it, the four-week data is pretty skewed, because it can be based on what we are promoting and when we are promoting it. And certainly, what you are talking about is a factor in the four-week period.

As I look at it over the year, we've actually seen a more aggressive price change with private label than we have necessarily with the brand. And actually we've grown share over the 52 weeks, all channels, all outlets, with McCormick brands versus private label.

The price gaps had closed pretty significantly; what we saw in the four-week was probably some promotional activity that would suggest about 3% price impact from private label and about 5% from the brand.

Alexia Howard - *Sanford Bernstein - Analyst*

Okay, great. And just a quick follow-up. The industrial business in Asia Pacific, you mentioned adverse promotional activity. Again, do you think that is likely to persist, or was it really just affecting this quarter?

Alan Wilson - *McCormick & Company, Inc. - Chairman, President, CEO*

I think we will still see some impact of that. And what it is is that customers are focused on promoting some items that we don't supply. So that is certainly a piece of it. It is not necessarily a drop in their promotional activity.

I'd also take you back to we had very, very strong results in the fourth quarter of 2011 in that business. We were up 16% in volume. And so I think it is a little bit of they are focused on some other stuff and we are up against a fairly tough comparison, and the pipeline and some new products that were launching in fourth quarter last year.



Alexia Howard - *Sanford Bernstein - Analyst*

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

Operator

Thilo Wrede, Jefferies & Company.

Thilo Wrede - *Jefferies & Company - Analyst*

Gordon, if I understood you right, you are lowering the underlying guidance for the year by \$0.04, offset by the tax benefits you are getting. Are there any particular parts of the business or any particular geographic regions that give you that cause for caution?

Gordon Stetz - *McCormick & Company, Inc. - EVP, CFO*

No, I'd just go back to my comments in the call, which relates just to the general economic environment we are operating in. Obviously, we can all read the headlines and see where there is stress around the world, in particular Western Europe, where the consumer is still being impacted by the economic environment.

Additionally, we did point to the potential for us to reinvest in the brand, as well. And finally, as you heard Alan talk about, there are some tough comparisons, in particular on the industrial side, that we're up against in Q4 on the Asia Pacific business, where we were up 16% in the prior year.

Thilo Wrede - *Jefferies & Company - Analyst*

So does the economic slowdown that we read about in China and Brazil and so on, does that give you any particular concern? Are you already seeing an impact on your business from that?

Alan Wilson - *McCormick & Company, Inc. - Chairman, President, CEO*

Our consumer business in China is performing very well, as we continue to grow our distribution and gain share there. So that is performing well.

We are seeing some slowdown on the industrial side, which we've seen over the last several months. But again, it is a factor of what the customers are promoting versus what we are necessarily supplying. And that's a piece of it.

We are cautious in Europe, and have seen some additional pressure there. Although we think we've got the right plans in terms of our new products and our promotion plans and then building for a good holiday finish.

I would highlight again what Gordon already said, is that we are going to continue to invest in advertising. And a part of that conservative guidance in the fourth quarter is behind our investment spending.

Thilo Wrede - *Jefferies & Company - Analyst*

Okay. And then last question I had for you. It seems like the growth of modern trade in India might accelerate, given the regulatory changes there. Is that something that would be particularly beneficial for you?



Alan Wilson - *McCormick & Company, Inc. - Chairman, President, CEO*

Yes, we believe that is very beneficial for us, because our products -- even though we cover the traditional trade as well as the modern trade there, our products are really geared for convenient, packaged, safe items. So we do benefit as modern trade expands.

Thilo Wrede - *Jefferies & Company - Analyst*

Okay, that's all I had. Thank you.

Operator

Chris Growe, Stifel Nicolaus.

Chris Growe - *Stifel Nicolaus - Analyst*

I just wanted to clarify then on a follow-up comment there to Thilo. In the fourth quarter, you've called out roughly \$15 million of incremental marketing for the year. Are you saying you could go over and above that if you see the opportunity in the quarter? Or is your incremental investment you are talking about that \$15 million?

Gordon Stetz - *McCormick & Company, Inc. - EVP, CFO*

The current guidance would indicate that we would be up at about \$15 million, would be an incremental 2 within the quarter, with the potential for us to spend more if we determine we think it would be an effective spend.

Chris Growe - *Stifel Nicolaus - Analyst*

And that is part of the conservatism for the fourth quarter? Is that -- I'm just trying to understand.

Gordon Stetz - *McCormick & Company, Inc. - EVP, CFO*

That is part of it as well, yes.

Chris Growe - *Stifel Nicolaus - Analyst*

Okay, yes. And then I just wanted to ask as well, you took your CCI cost-saving amount up for the year. Did that come through the business already? Do you expect that to come? So is there an improving outlook for that? I guess I would also like to ask, is that more SG&A-related? The SG&A was a little lower than I thought this quarter.

Alan Wilson - *McCormick & Company, Inc. - Chairman, President, CEO*

It is pretty consistent delivery as we progress through the year, Chris. And it is a function -- it is really as we progress through the year more visibility into the projects and the timing of their execution. So it is pretty even as it relates to the year and the quarters.

I'd say because of the fourth-quarter size, we tend to incur more of the benefit just by virtue of the amount of production and materials that flow through our facilities. It still is skewed towards the cost of goods sold line, and it's about 80% -- 75%, 80% do relate to our cost of goods sold, while the remainder is in SG&A.



Chris Growe - *Stifel Nicolaus - Analyst*

Okay, thank you. And then I have one final one. That was in the third quarter, have you said or could you say how much the benefit to consumer operating profits came from the acquisitions?

Alan Wilson - *McCormick & Company, Inc. - Chairman, President, CEO*

Within the quarter itself, we don't get into that level of detail. But I can say we are pleased, we're on track. Relative to the initial accretion that we've given, all the acquisitions have been pretty much performing in line. So I'd use that prior guidance as a gauge. And as you know, we start to anniversary those acquisitions in the fourth quarter.

Chris Growe - *Stifel Nicolaus - Analyst*

Yes, that's correct. Thank you.

Operator

Eric Katzman, Deutsche Bank.

Eric Katzman - *Deutsche Bank - Analyst*

Two questions. I guess first one on the top line. I guess you indicated that about half of the local currency growth is acquisition related, and half is price. Is that correct?

Alan Wilson - *McCormick & Company, Inc. - Chairman, President, CEO*

Yes, Eric, that is correct. So of the 9%, it roughly breaks down into half price, half acquisition, with some (multiple speakers) volume mix on that.

Eric Katzman - *Deutsche Bank - Analyst*

I guess because -- you've done a great job of introducing new products in various niches across the industry, as well as geographically. And so you highlighted them so much, Alan, I assume that they are performing at least in line with your expectations on a global level. But does that mean that there is some decent elasticity on the core, given the 4% to 5% pricing?

Alan Wilson - *McCormick & Company, Inc. - Chairman, President, CEO*

I would also remind you that we had the buy-in in advance of the price increase last year. So if you -- and it's hard to gauge that. But if we took that out, we would have more substantial volume impact in the quarter.

So we feel pretty good about what our new products are doing for us, and they are going to hit what we expect them to. I would say we still are under pressure with volumes as the consumer is under pressure. So we are seeing some level of that elasticity that we always see.

Eric Katzman - *Deutsche Bank - Analyst*

Again, from a broader top-line perspective, some of the companies that have reported recently have talked about improving, let's say, volume growth across a number of categories. Do you kind of echo that sentiment, Alan, or are you more cautious?

Alan Wilson - *McCormick & Company, Inc. - Chairman, President, CEO*

I think the volume trend in our category is a little stronger than the 52-week and a little weaker than the 12-week in the latest. And you can't gauge that much for it. We feel like in the fourth quarter, at least in the US, that we are set up for very good execution against last year.

Now, last year, as we saw, was pretty weak in December from a takeaway standpoint. So what we are gauging is what do we ship in in the fourth quarter. But we feel like we are well-poised. We've got good display activity, things are going in and so we are pleased with how we are set up. And the thing that we are watching is what the consumer takeaway ends up to be.

Eric Katzman - *Deutsche Bank - Analyst*

Okay, thanks for that. And last question to -- I guess to the -- Gordon, to the tax issue, I'm not even sure I know how to ask the question, let alone whether I will understand the answer. But I thought that when you repatriate cash, which was, I think, one of the points you made in the text, that when you repatriate cash, that generally elevates your tax rate. And yet you are saying it is kind of repatriating cash and getting a credit, and therefore the tax rate is lower. How is all that working?

Gordon Stetz - *McCormick & Company, Inc. - EVP, CFO*

It's the complexities of the foreign tax credit calculation, the relationship of US earnings to non-US earnings, calculations of the characterization of those earnings and earnings in profit pools, foreign exchange rate relationships at the time. So it would take a lot of time, but that is, in a nutshell, what it all boils down to.

Eric Katzman - *Deutsche Bank - Analyst*

I knew I wouldn't understand (laughter). Okay. Maybe we'll follow up off-line. Okay, thanks.

Operator

Ken Goldman, JPMorgan Chase.

Ken Goldman - *JPMorgan Chase - Analyst*

You have some insight into some broader trends in US food consumption, just based on your relationship with some of your customers in the food manufacturing side. We are starting to hear some companies, as Eric said, talk about some volume improvements, at least less pressure on that end.

Can you give us some general insight into what you are seeing across food manufacturing? Without mentioning companies in particular, of course. But just is it sustainable? Is it something that people are talking about, just building on easier comps? Do a lot of your customers -- are they starting to feel better about things? Or is it a little bit of a let's wait and see how we go and not get too excited yet? I'm just curious, based on your particular vantage point, what you're seeing out there across food.



Alan Wilson - *McCormick & Company, Inc. - Chairman, President, CEO*

I think the general consensus that we are hearing is people are seeing some recovery in volumes and some moderation of cost increases. Not that they are going lower, but that they aren't going up as high as they have in the past.

What we are seeing from a new product activity standpoint is that our customers are focused on bigger, fewer new products, as opposed to a steady stream of the base hit. So I think -- which would tell me that they are feeling more confident in that.

And so I think, again, going back to what we were dealing with at this time last year, which was significant commodity inflation and pricing, the commodity inflation is not as high as it was, and so we expect that we should see the ability for the consumers to buy a little more and not have that sticker shock. Because I think what we saw early in the year was a little bit of the sticker shock, people living out of their pantries, and I think kind of the general impression is that things are improving a bit.

Ken Goldman - *JPMorgan Chase - Analyst*

Okay, that's helpful. And then you seem to be doing well in China on the consumer side at a time when many consumer companies aren't. And I'm sure it's partially because spices are more of a staple, but partially because of your strong execution, too.

Can you just talk a little bit about what you are seeing in the Chinese economy overall? There have been a lot of consumer companies, not just in food, citing those tough trends there, like I said. I'm just interested in your views and maybe whether if there is a slowdown in China, does that affect your plans in any way, or is it just more full steam ahead for you?

Alan Wilson - *McCormick & Company, Inc. - Chairman, President, CEO*

I think the long-term growth rate of China is going to be good and positive and is going to be an important part of our business, as well as for a lot of people's business. We are seeing a general slowdown and some impact with consumer confidence I think in China.

What we are seeing in our consumer business is that we are continuing to gain share and increase our distribution. So we are offsetting some of those trends by driving our business. We've increased our advertising there. We are increasing our new product activity. And so I think we are offsetting some of that.

But I think there is a general slowdown that we've seen over the last, say, nine to 12 months in China. But I think the long term -- my long-term view on China is it is going to continue to grow and be a great market for us. That is why we are making the investments we are making with the Wuhan Asia-Pacific Condiments business. But we are also investing in our facilities. We are in the process of completing a new technical center and a plant expansion. So we are pretty bullish long-term on China.

Ken Goldman - *JPMorgan Chase - Analyst*

Thanks a lot.

Operator

Akshay Jagdale, KeyBanc Capital Markets.



Akshay Jagdale - KeyBanc Capital Markets - Analyst

Good morning. Just one clarification on your guidance. So you didn't change your EBIT guidance. Right? A lot of the noise is just below the line, correct?

Gordon Stetz - McCormick & Company, Inc. - EVP, CFO

We reaffirmed operating income growth at 9% to 11%. That is correct.

Akshay Jagdale - KeyBanc Capital Markets - Analyst

Okay, good. Can you just talk a little bit more in depth about what is going on in India? And you mentioned your experience in China helping with that. So specifically, did you expect to make this change in your go-to-market strategy, I guess, when you made the acquisition or have things changed? Just give us a little bit more color on why you think that is the right idea.

Alan Wilson - McCormick & Company, Inc. - Chairman, President, CEO

We were pretty regionally focused. And what we are seeing as the modern trade starts to grow in India, and from some of the earlier comments, we expect that could accelerate.

But the activity that we have focused on the geographies, we felt like we were missing some opportunities. This is a model that we had in China. So as we went into the acquisition, we did expect to make this change. And what we are talking about is a change from focusing on geographies to organizing our sales by channel. So we did expect to make that change. It is early in making that, but we are very confident that is going to be the right move for us, and especially as modern trade grows.

Akshay Jagdale - KeyBanc Capital Markets - Analyst

That's helpful. And just back to China, I may have missed some of your comments, but your industrial business saw a slowdown, and that was related to quick-serve and partly China. Is that right?

Alan Wilson - McCormick & Company, Inc. - Chairman, President, CEO

That's correct.

Akshay Jagdale - KeyBanc Capital Markets - Analyst

But your consumer business in China did pretty well, right?

Alan Wilson - McCormick & Company, Inc. - Chairman, President, CEO

Yes, that is correct.

Akshay Jagdale - KeyBanc Capital Markets - Analyst

So overall, we saw the last couple of quarters the industrial business was really hitting on all cylinders. Is there any trade-off between sort of away from home and at home going on in your opinion, in terms of consumer spending?



Alan Wilson - *McCormick & Company, Inc. - Chairman, President, CEO*

I'm not sure I would draw necessarily that trend at this point. It is something that we watch, but I don't know that we've seen a measurable enough impact to really say that at this point. I think it is more the internal work that our teams are doing in the consumer business there.

Akshay Jagdale - *KeyBanc Capital Markets - Analyst*

Great. I'll pass it on. Thanks a lot.

Operator

(Operator Instructions) Robert Moskow, Credit Suisse.

Robert Moskow - *Credit Suisse - Analyst*

Just curious about the comment about reinvesting into advertising. It sounds like you want to reinvest a little bit more than the \$15 million that you targeted for the year.

But for the incremental dollar of reinvestment, Alan, would you -- is that the best place to put it, or is it in India or Poland? And are there places to put it in those two markets. If you had the incremental dollar to put it in there, what kind of activities would you put it in in those two markets?

Alan Wilson - *McCormick & Company, Inc. - Chairman, President, CEO*

For short-term investments, media either, digital or TV -- or TV or where we have the opportunity to spend. We seem to be -- we tend to be more developed in our developed markets in being able to do that. Our programs are set and it's easy to add more incremental in either the EMEA region or in the US for that to be effective. And in the smaller markets or in the newer markets, we are less positioned with programs that we can pull the trigger on on the short term.

Long term, by the way, we are investing in Poland. We are -- we are investing in India as well. But for the short term, we tend to focus more on our developed markets.

Robert Moskow - *Credit Suisse - Analyst*

Okay, I think I get that. And then a follow-up. Your guidance says that because of the tough global environment, you want to be a little more cautious in your guidance here, I guess. Your organic sales here have been outstanding all year. And this quarter, your volume mix would have been up 3%, pricing up 4.5%, if not for the pull-forward. So what is to be cautious about?

Alan Wilson - *McCormick & Company, Inc. - Chairman, President, CEO*

Just pointing back to some of the comments we made earlier, in particular, we are up against some comparisons in the industrial side in Asia Pacific that is creating some level of caution for us as we head into the fourth quarter. And again, we are still looking at a world in which we see consumer stress and uncertainty, and that always gives us a moment to pause. And I guess I'll just point finally to the comments earlier on the potential to reinvest.

Robert Moskow - *Credit Suisse - Analyst*

Okay. Gordon, just so we get a top line right for fourth quarter, because of the pull-forward last year, your volume mix was only up about 1%. So for fourth quarter this year, should we take the full shift and assume that you have a 2% easy comp or -- I think 2% or 3% easy comp in fourth quarter on volume mix?

Gordon Stetz - *McCormick & Company, Inc. - EVP, CFO*

Certainly the fact that it was pulled in would give us an easier comp versus the prior year, because of that \$10 million. That would be as it relates to the US consumer.

The other things that I would suggest that we need to keep in mind as well is we are going to anniversary the acquisitions. We do have continued pressure from FX. And we are starting to anniversary the price increases from last year in certain markets. So I would also have that in mind as well.

Robert Moskow - *Credit Suisse - Analyst*

So the pricing won't be quite as robust as it was year to date.

Gordon Stetz - *McCormick & Company, Inc. - EVP, CFO*

That is correct. Because if you recall, part of the whole reason for that \$10 million shift is we started to implement that in the fourth quarter of last year.

Robert Moskow - *Credit Suisse - Analyst*

Okay. So should we think in terms of the mix of this, more volume than price in fourth quarter or maybe even?

Gordon Stetz - *McCormick & Company, Inc. - EVP, CFO*

You would certainly expect a little bit of both. But relative to prior quarters -- or this quarter, I should say, you would expect some more volume.

Robert Moskow - *Credit Suisse - Analyst*

Thank you.

Operator

Ann Gurkin, Davenport & Company.

Ann Gurkin - *Davenport & Company - Analyst*

Good morning. Just following up on the repatriation of cash. Why now? Is there a change in potential acquisitions or can you help me understand the timing of that?



Gordon Stetz - *McCormick & Company, Inc. - EVP, CFO*

We are constantly evaluating our capital structure, Ann, and opportunities for us to improve our overall cost of capital. And as a result of that, as we evaluated and looked at future cash needs and the current programs we have here in the US, we felt now was a good time to pull some of that cash back.

Ann Gurkin - *Davenport & Company - Analyst*

Okay. As we think about next year, can you comment on expectations for input costs, commodity costs, anything we should watch out for?

Alan Wilson - *McCormick & Company, Inc. - Chairman, President, CEO*

We certainly expect commodity costs to be up, and we are putting our budgets together now, so it's kind of early. But we would expect something in the low single digits in terms of cost of goods inflation.

Ann Gurkin - *Davenport & Company - Analyst*

Okay, great. And third, just curious -- consumer behavior in the US, are you seeing any changes in impulse purchases? Any change in consumer behavior?

Alan Wilson - *McCormick & Company, Inc. - Chairman, President, CEO*

I wouldn't say anything dramatic. We saw the real short-term issue in the first part of the year, but I don't think we are seeing any major trend changes at all.

Ann Gurkin - *Davenport & Company - Analyst*

Thank you very much.

Operator

Chuck Cerankosky, Northcoast Research.

Chuck Cerankosky - *Northcoast Research - Analyst*

Somebody asked about the inflation outlook for COGS. But any other thoughts about the volatility of raw material product supplies over the next couple quarters?

Alan Wilson - *McCormick & Company, Inc. - Chairman, President, CEO*

We are watching that all the time, because, as you know, we are sourcing from some potentially volatile areas of the world. We don't see anything that would suggest that we are going to have major supply disruption.

But we are always managing that, and staying -- trying to stay ahead of that, as we always do, with our global sourcing team. So we make decisions on bringing and more inventory when we expect something to happen or we expect a weather event that may cause some change in yields. So we are always monitoring that. But we don't see anything immediately that is going to be a major impact.



Chuck Cerankosky - *Northcoast Research - Analyst*

And Gordon, the press release mentioned a reduced investment in working capital this quarter versus a year ago, but your inventories are still at a strategically built-up level, I would gather, that \$628 million.

Gordon Stetz - *McCormick & Company, Inc. - EVP, CFO*

Clearly, last year, we were building inventory for, as you recall, two primary reasons. One was the impact of price on the purchase of raw materials, and the other was a strategic inventory build as well.

We don't reveal specifically our position, but we still have a view on that. And as a result, we do carry some strategic inventory. But that -- you build and then you maintain or you roll a little off or you add a little bit to it. So year on year, the growth rate is not as dramatic, obviously.

And if you look at the increase of the inventory versus prior year, about half of it after you adjust for FX is going to be related to the acquisitions we did in the fourth quarter of last year. And the rest of it would be price and some -- what is left of whatever the strategic inventory build was.

Chuck Cerankosky - *Northcoast Research - Analyst*

That's helpful. Great. Have a good -- good luck in the fourth quarter.

Alan Wilson - *McCormick & Company, Inc. - Chairman, President, CEO*

Thanks, Chuck.

Operator

Andrew Lazar, Barclays Capital.

Andrew Lazar - *Barclays Capital - Analyst*

Good morning, everybody. Just wanted to ask a quick question about the frozen space. It's an area overall that has been, the last couple of years, a pretty rough place. It's a pretty fragmented space. It has been pretty price-competitive. And again, I'm talking about broadly speaking across the frozen space.

But you've had some -- obviously come up with some interesting entries here of late, obviously, in some of the key niches in which you operate. So I'm just trying to get a sense of what you see as the opportunity there, at least for you, because that seems to buck the trend a little bit of -- the broader trends we've seen in this space overall.

Alan Wilson - *McCormick & Company, Inc. - Chairman, President, CEO*

What we are trying to do is deliver the core products that we -- that make sense for us, in a frozen format that makes -- that gives the consumers convenience and value. We are not trying to be 10-for-10s on frozen lasagna or anything like that. We are really niche-focused on the specialty items that we have, like Thai Kitchen and Zatarain's, that we believe we can make a difference in.

So by staying focused that way, we are kind of going against those trends. We recognize we have to continue to innovate and bring new products and keep that fresh. But that is our strategy in frozen. It is not to be a 30% supplier or 30% share. It is really to augment those regional businesses that we have.

Andrew Lazar - *Barclays Capital - Analyst*

As you see it, in those sort of subsegments of sort of the frozen space, if we were to look at the data that we have access to, I assume we would see growth rates and whatnot that look, I guess, perhaps very different than one would see if you just look at the overall -- the broader frozen entree category or something like that. Is that a fair statement?

Alan Wilson - *McCormick & Company, Inc. - Chairman, President, CEO*

That's correct. And just to put it in perspective, our size in frozen would probably be a rounding error in a lot of those big companies. It is a pretty small business. It's good for us, it's great for Zatarain's, but it is pretty small relative to the overall category.

Andrew Lazar - *Barclays Capital - Analyst*

The whole scheme of things. Okay, thanks very much.

Operator

Thilo Wrede, Jefferies & Company.

Thilo Wrede - *Jefferies & Company - Analyst*

Just had one quick follow-up. I think in the press release and also in your prepared remarks, you talked about the innovation in Europe and how that will help to counter the negative economic trends there. Does that mean that the innovation is geared more towards value products, and if that is the case, what impact would that have on margins?

Alan Wilson - *McCormick & Company, Inc. - Chairman, President, CEO*

It is actually a combination of things. It is -- we've got a pretty good stable of dessert products with Vahine in France. And then a lot of what we're doing, both in France and the UK, is launching against some of our global platforms. So we launched, for instance, Grill Mates in the UK. We have launched Recipe Inspirations across Europe and Bag'n Season across Europe. So it really is bringing our product platforms, much actually less value-focused than product innovation -- or than -- it is more about product innovation than it is about value in those markets.

We still have the value items that we are advertising, but it is more around the value of the cost of the meal, as opposed to we are going to try to sell stuff really, really cheap.

Thilo Wrede - *Jefferies & Company - Analyst*

So even in a difficult economic environment, the approach is still, if you have the product on the shelf, it should sell, and you don't need to do anything in particular to push these products?

Alan Wilson - *McCormick & Company, Inc. - Chairman, President, CEO*

We still have a level of promotional activity, and we have been promoting especially behind our Recipe Mix, our dry seasoning mix items, in those markets. But our product innovation isn't necessarily geared to value.

Thilo Wrede - *Jefferies & Company - Analyst*

All right. Thank you, Alan.

Operator

Jonathan Feeney, Janney Montgomery Scott.

Jonathan Feeney - *Janney Montgomery Scott - Analyst*

Good morning. Thank you. I just had a detailed follow-up about the Asia Pacific industrial business. You've gotten a lot of questions about that. Could you refresh my memory or our memory about how the product actually works or how the revenue actually works?

Do you -- I saw the press release about the sort of -- the slowdown in the promotion of certain items by a customer. But is -- do you get paid as products ship typically, even in an overseas industrial business, where there might be some inventory taken on by the customer? What is the lag from the time people are eating a delicious McCormick-enhanced food-service product to the time it hits McCormick's revenue? Thanks.

Alan Wilson - *McCormick & Company, Inc. - Chairman, President, CEO*

Our revenue cycle is pretty much we bill it as we ship it. So it is not necessarily delayed. It's pretty much the same that we do around the world. So if there is -- but also, the use-up on the kinds of products -- our industrial business in Asia is predominantly a quick-service restaurant, condiment or breading business. And so as we ship it, it gets used up pretty quickly in the restaurants.

Jonathan Feeney - *Janney Montgomery Scott - Analyst*

Okay. And so it really -- there doesn't really tend to be a customer inventory issue?

Alan Wilson - *McCormick & Company, Inc. - Chairman, President, CEO*

No, I don't think so at all. The only place that could even happen is where we are shipping, for instance, a breeder to a chicken supplier that could end up in inventory there. But from our revenue standpoint, as we ship it, we would bill it.

Gordon Stetz - *McCormick & Company, Inc. - EVP, CFO*

These tend to be our higher turn items in our portfolio.

Jonathan Feeney - *Janney Montgomery Scott - Analyst*

Great. Thank you very much.



Alan Wilson - *McCormick & Company, Inc. - Chairman, President, CEO*

Great. I want to thank everybody for your questions and for participating in today's call. McCormick has a great portfolio of products across our business segments. We've got operations around the world that bring our passion to flavor to customers and consumers globally. In a difficult environment, we have a strategy that is achieving growth and building value for our shareholders.

Joyce Brooks - *McCormick & Company, Inc. - VP of IR*

Thank you, Alan. I'd like to add my thanks to those who participated on today's call. Until October 4, you may access a telephone replay of the call by dialing 877-660-6853. The account number for the replay is 309, and the ID number is 399044. You can also listen to a replay on our website later today.

If anyone has additional questions regarding today's information, you can reach me at 410-771-7244. This concludes today's call.

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