FINAL TRANSCRIPT

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KFT - Q2 2007 Kraft Foods Earnings Conference Call

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PRESENTATION

Operator

Good morning and welcome to the Kraft Foods second quarter 2007 earnings conference call. Today's call is scheduled to last about one hour, including remarks by Kraft Foods management and the question and answer session. (OPERATOR INSTRUCTIONS)

I will now turn the call over to Mr. Chris Jakubik, Vice President of Investor Relations for Kraft. Please go ahead, sir.

Chris Jakubik - *Kraft Foods - VP, IR*

Thank you and good morning. Thanks for joining us on our conference call. I'm Chris Jakubik, Vice President of Investor Relations. With me are Irene Rosenfeld, our Chairman and CEO; and Jim Dollive, our Chief Financial Officer. Our earnings release was sent out earlier today and is available on our website Kraft.Com.

As you know, during this call, we may make forward-looking statements about the Company's performance. These statements are based on how we see things today so they contain an element of uncertainty. Actual results may differ materially due to risks and uncertainties. Please refer to the cautionary statements and risk factors contained in the Company's 10-K and 10-Q filings for a more detailed explanation of the inherent limitations in such forward-looking statements. Some of today's prepared remarks will exclude those items that affect comparability. These excluded items are captured in our GAAP to non-GAAP reconciliations within our news release and they are also available on our website.

We'll begin today's call by hearing from Irene who will share her perspective on our second quarter. Then Jim will provide an overview of our financials, after that we'll take your questions. With that, I'll hand it over to Irene.

Irene Rosenfeld - *Kraft Foods - CEO*

Thanks, Chris. Good morning, everyone, and thanks for joining us. Overall, I'm pleased with the progress we made in the past few months, both in terms of our second quarter financial results and perhaps of greater importance, in how we're implementing the transformation plan we laid out in February. Today, I'm even more confident that our plan is sound and that it's execution will enable us to restore Kraft to reliable growth. I say that for three reasons.

First, our early investments have produced sequential top line improvement. We had solid revenue growth in all major geographies. Second, while our market share and profit margins are clearly not yet where we want them to be, we are increasingly confident that the actions we're taking will lay the foundation for improved results. And third, we're taking other significant actions to further enhance shareholder returns.

Let me provide more details starting with the positive impact on our results from our early investments. In North America we delivered sequential revenue improvement from quarter one to quarter two. That performance was driven by some focused differentiated new products and incremental marketing investments in powdered soft drinks, pizza, and Oscar Meyer. In January, we launched Crystal Light with enhanced benefits like immunity, energy, and hydration, these helped to drive trademark sales up 47% in the quarter.

We introduced DiGiorno Ultimate Pizza to you in February. It's now the hottest thing in frozen pizza representing one-third of all new product sales in the category through June, driving DiGiorno's revenue growth of 12%, and that's even before our national advertising began last week. We have increased confidence that our new Oscar Meyer deli creations sandwiches have the potential to be $100 million platform and highly incremental to our base business. These sandwiches are a great example of our ability to leverage the power of our broad portfolio to better compete with foodservice offerings.

In the EU, reinvestment in our core coffee and chocolate brands has resulted in stepped up organic revenue growth, and in developing markets, our new products, supported by a significant increase in marketing, delivered double digit growth. Net, we feel good about both our sequential growth from the first to second quarter and our 3.9% organic revenue growth for the first half of the year. We'll also continue to improve our sales execution and in store presence. We're seeing higher revenue growth in the rollout markets for our wall to wall sales initiative in North America. In Q3, wall to wall will be in stores that accounts for about 35% of Kraft's all commodity volume. We have, however, slowed the pace of expansion as we refine our sales rep training for maximum effectiveness and we expect to complete our rollout by mid 2008.

Despite this early progress on a number of fronts we have not made progress on market share. Through the second quarter, we're gaining market share in less than half of our U.S. businesses. The investments we are making in the back half will fuel both our top line momentum and improve our share. We now see a much more robust pipeline of new ideas across the Company, new products, new packages, and new advertising campaigns, which make us confident to invest at the high end of the 300 to $400 million range. Importantly, about half of our investment dollars will go to fix key laggards, including our mainstream coffee business in the U.S., North American cheese, and snacks. In coffee, our mainstream brands continue to lose share. Later this quarter, we launch a new higher quality Maxwell House with 100% Aravica beans in a new consumer preferred package.

In cheese, we are not yet comfortable that we've added enough value to our portfolio to manage through record dairy prices. We have a number of key initiatives in the back half to improve share. These include Live Active probiotic cheeses, premium Kraft Single select and a new advertising campaign, for base Kraft Singles.

In snacks our growth lags that of the broader snacking world. In the back half, we will launch a robust new product pipeline, invest in higher marketing spending, and rollout a new Planters campaign to step up our performance. The balance of our spending will go to accelerate new product and marketing activities in high impact categories like convenient meals where we'll continue to build on the strong first half momentum. This higher investment coupled with the fact that approximately three quarters of our incremental spending will occur in the back half of the year, gives us confidence that our share trends will improve especially in the fourth quarter. Consequently, we are raising our organic revenue guidance to 4% plus for the full year.

Let me now turn to our margin performance. As you know, we had expected margins to decline this year, given our growth investments, but higher than expected input costs will place even greater pressure on our margins in the back half of the year. That said, we are at the start of a three year plan. 2007 is a building year, one which will lay a strong foundation for our future growth. We are committed to investing now because it is essential to driving the accelerated volume growth and stronger product mix that will leverage our overhead costs and improve margins over time. While making these investments in the business, we are taking other significant actions to enhance shareholder returns.

Last month, we announced our plans to acquire Danone's global biscuit business. This is a major strategic action that will give us a platform for greater scale, faster growth, and better margins in our international business. On Monday, Danone reported strong first half biscuit growth, further evidence that this acquisition will be an important contributor to our growth strategy. We are not finished reshaping our portfolio. We continue to evaluate our existing brands in the context of our new framework and we'll divest those businesses that don't fit our long term growth plan. We will of course share those decisions with you at the appropriate time.

We're also making better use of our balance sheet capacity. Not only through acquisitions but by executing the $5 billion share repurchase program we announced in February. In fact during the second quarter we repurchased almost 4% of our outstanding shares for $2 billion.

In sum, I'm encouraged by the early progress in our transformation plan. We're doing what we said we would do and we are seeing signs that our investments and efforts will pay off. Of course there's much more to do but I remain confident that we're on the right track, and I look for accelerated momentum in the back half of 2007, and now I'll turn the call over to Jim.

Jim Dollive - *Kraft Foods - EVP, CFO*

Thanks, Irene, and hello, everyone. Before I begin, please keep in mind that unless otherwise noted, my comments will exclude the items affecting comparability that were highlighted in our press release. Now let's get into the numbers starting with sales.

Our organic net revenues were up a solid 4.1% in the quarter. We delivered gains from product mix across most businesses, the result of several new product initiatives and reinvesting in marketing to support our base business. We've begun to see the effects of recent price increases in several categories with net pricing up 1.7 percentage points in the quarter. Volume was down in the second quarter. We have solid gains internationally and in some North American businesses. But these gains were offset by ready to drink bottled beverage weakness, further portfolio pruning in foodservice, and our North American grocery business reflecting both a shift in Easter timing to Q1 versus Q2 last year and continued share challenges in salad dressing.

Turning to profit and earnings, I want to emphasize three points--First, our gross margin was down 130 basis points because higher input costs and our investments in product quality more than offset our gains from pricing and productivity. As Irene mentioned, we anticipate that this will be the case for the balance of the year and therefore we expect lower gross margins in the second half of 2007. Second, our operating income margin declined 210 basis points year-over-year. This includes the gross margin impact as well as increased overhead costs and the higher margins of previously divested operations. Our overhead costs were higher due to our planned incremental investments in marketing, systems capabilities, and distribution infrastructure as well as the absence of last years $18 million gain on the sale of a facility. Third, below the line, we benefited by roughly $0.02 from our share repurchase activity and by $0.01 from a decrease in our effective tax rate versus 2006.

In the quarter our effective tax rate was 32.5% including the positive resolution of some outstanding tax items as well as a change in our mix of earnings by country. As a result for the year, our guidance for taxes is now 33.5% versus our earlier forecast of 35.5%. On the share repurchase front as Irene mentioned, during the quarter, we repurchased 3.7% of our outstanding shares for $2 billion and we intend to continue repurchasing our stock under our current $5 billion repurchase authorization. I'll take a few minutes now to share some highlights of our business segments.

As Irene said we're beginning to see improved results where we have made incremental marketing investments in our base business and in new products that are helping to reframe our categories. At the same time, significant challenges remain in select businesses. We will begin to address these with a number of our second half growth initiatives. I'll start with North American beverages where our focus on health and wellness and premium offerings is paying off.

Organic net revenues grew 4.3% this quarter. This increase was driven by our Crystal Light powdered beverage sticks and Capris Sun ready to drink pouches with antioxidants and functional benefits. Strong growth in Starbucks Premium Coffees and the successful restaging of Tassimo with marketing targeted at a narrower user base of coffee Aficionados. At the profit line, operating income margin increased 130 basis points. The first time margin has been up in beverages in five quarters as the benefits of product mix and pricing more than offset higher grain coffee and packaging costs. Going forward, we will make further improvements in beverages by investing in Maxwell House product quality and packaging as Irene discussed earlier. We expect these actions will begin to halt the longstanding trend of market share declines in the coffee category.

In North American cheese and foodservice, organic net revenues were up 3.3% due mainly to price increases to offset higher dairy costs. 2007 is shaping up to be the year with the highest dairy commodity costs ever. Because of this run up, we recently increased our list prices in cheese for a second time this year, generally between 5 and 12% effective July 9. We expect the cheese will remain a tough competitive environment. Our share of total cheese is down year-to-date; however despite higher costs in the back half of the year, we will fund the necessary investments to improve our share position and plant the seeds for future growth. Our plans include a number of new products and significant increases in advertising and consumer and promotional spending across the line. Operating income margins in cheese and foodservice were down 370 basis points in Q2. We expect them to be down in the balance of 2007 as well. The factors driving both Q2 results and the balance of 2007 are higher input costs and the normal impact of price elasticity on volume and funding for our growth initiatives.

Moving on to North American Convenient Meals. Organic net revenues were up more than 5% driven by successful new product platforms and investments in marketing and quality that are capturing quick meal eating occasions. Irene has already told you about the success of DiGiorno Ultimate and deli creations. I'd also add that our deli shaved meat platform grew 37% in the quarter and now exceeds $300 million on an annual basis and California Pizza Kitchen grew over 20% in the quarter. Operating income margins fell in the quarter negatively impacted by two factors--Higher input costs including investments in quality and new capacity and higher overhead costs driven by incremental marketing investments. Going forward, we expect convenient meals to continue with strong revenue growth in the back half of 2007, and margin performance should progressively improve over the course of the year as launched costs moderate.

On to North American Grocery, where organic net revenues were down 1.8% due to lower volumes, over half of which reflects the shift in Easter timing. As for the overall business, we continue to see strong momentum behind new, better for you products such as sugar free Jell-O Ready-to-Eat Pudding Poppers, however these gains were offset by ongoing weakness in portable and spoonable salad dressings. We'll have new product news and incremental marketing later this year as we contemporize our salad dressing business but these businesses have been losing share for many years and it will take some time to fix them.

Looking at North American Snacks and cereals, organic net revenues were up 3.7% with contributions from volume, mix, and pricing. Three highlights here drove growth in the quarter. First, strong product mix in cookies driven by gains in 100 calorie packs. Second, volume gains in Ready-to-Eat cereal from a rebound in kids cereals driven by new products and renewed marketing support on our sensible solution offerings. And third, strong growth in bars behind the launch of Nabisco 100 calorie bars.

Operating income margins fell 60 basis points due to our Milk Bone and Cream of Wheat divestitures. Excluding the effects of divestitures the benefits of product mix and manufacturing productivity were partially offset by higher overhead costs driven by incremental advertising and consumer spending. For the remainder of the year, we expect our strong new product line-up across the snacks business will result in stepped up organic revenue growth. Now, I'll turn to our international business which had another good quarter across-the-board.

The EU continued its return to moderate growth, increasing organic net revenues by 2% driven by volume and mix gains in coffee and chocolate. Several factors contributed to the coffee and thus the EU success. We saw gains across the EU in Tassimo due to our successful restaging with new marketing programs and new product launch s including Latte Machiato. We executed successful promotions for Jacobs in Germany and for Kenco in the United Kingdom and we increased A&C launching a new campaign for Carte Noire in France. Chocolate revenue also continues to be up as we introduced new products and reinvested A&C behind premium end offerings under the Cote d'Or, Toblerone, and Milka brand name.

Biscuits, soon to be our third core EU growth category contributed 7.4 percentage points to reported net revenue growth. The United biscuits businesses are performing ahead of our expectations driven by global biscuit brands including Oreo. EU operating income margins declined 100 basis points. Here, the benefits of improved product mix were more than offset by higher promotional and advertising spending. Also, last year included the $18 million one-time gain on the sale of a facility I mentioned earlier. Looking ahead we'll continue to invest to improve our coffee and chocolate businesses, and we're excited about the opportunities to accelerate the growth in our EU snacks business once we finalize the acquisition of the Danone biscuit business.

Finally, developing markets delivered another consecutive quarter of solid growth with organic net revenues up double digits. This was due to strong gains in Eastern Europe, Middle East, and Africa, and Latin America including gains in Russia behind both Jacob's coffee and Alpen Gold chocolate and in Brazil, Argentina, and Venezuela from new products and increased marketing support.

At the operating income line, margin was essentially flat. The benefits of higher pricing and improved product mix were offset by higher input costs and higher overhead driven by investments in marketing. Going forward, we expect continued strong performance from developing markets as we invest in marketing support and expand distribution.

And finally, a comment on our restructuring program. In short, savings are coming in faster than we expected. Cumulative savings are up to $660 million. We now expect cumulative savings to reach $725 million by year-end, up from our earlier expectation of $700 million.

On the cost front, we spent $245 million year-to-date. Due to the timing of activities, we now expect total cost of 575 million for the year down from our earlier expectation of $625 million.

Irene Rosenfeld - *Kraft Foods - CEO*

Thanks, Jim. In sum, during our first few months of independence we made good progress in our plans to transform Kraft. Results from our early investments are promising. We had strong revenue growth in all major geographies for the first time in a long while. We have a stronger pipeline of competitively advantaged products that will be launched over the balance of this year and into 2008. We are pricing to recover the majority of input costs. We are delivering faster savings under our restructuring program and we are looking at additional opportunities to reduce administrative overhead. We are making the necessary investments for long term growth and have maintained our full year $1.75 to $1.80 EPS guidance. We would now be happy to take your questions.

QUESTIONS AND ANSWERS

Operator

Thank you. We will now conduct the question and answer portion of the conference. (OPERATOR INSTRUCTIONS) Your first question is from Kenneth Zaslow with BMO Capital Markets.

Kenneth Zaslow - *BMO Capital Markets - Analyst*

Good morning, everyone.

Irene Rosenfeld - *Kraft Foods - CEO*

Good morning.

Kenneth Zaslow - *BMO Capital Markets - Analyst*

Irene you touched on the idea of divestitures and the possibility of that. Can you just lay out the criteria by which you would think about divestitures, what type of businesses would you think, I know you can't give us the exact business but what type of criteria would you be using?

Irene Rosenfeld - *Kraft Foods - CEO*

Well, Ken, we're continuing to evaluate all of our brands and categories in the context of the framework that I laid out in February and we would divest those businesses that don't fit our long term growth plan. And so we're looking at their potential to be able to grow and to be accretive to our performance over the long term.

Kenneth Zaslow - *BMO Capital Markets - Analyst*

Okay, and second question is in terms of the cheese category, can you talk a little bit about the premium to private label and how that is relative to history and how that's going to change the market share dynamics going out?

Irene Rosenfeld - *Kraft Foods - CEO*

Well, we feel very good about our price gaps as we stand here to date. They're much lower than they were a year ago, but I would tell you that our performance is not just about price gaps. We have some work to do I believe in terms of improving the overall value of our offerings and that's what the focus of some of the investments that we're making is on.

Kenneth Zaslow - *BMO Capital Markets - Analyst*

Great. Thank you.

Operator

Thank you. Your next question is from David Palmer with UBS. Please go ahead.

David Palmer - *UBS - Analyst*

Thank you. Share trends in the measured channels as you noted have been fairly dismal lately and it appears that pricing at least in the last month is showing some acceleration and just broadly net revenue per volume is going up in many of your categories. You talked about pricing but could you be more specific about perhaps how much more pricing we would see in your numbers in the second half of the year and what impact do you see that having on your share trends? Thanks.

Irene Rosenfeld - *Kraft Foods - CEO*

Well, David, as you know, pricing accounted for about 1.7 points of our revenue growth in this quarter and as we go forward, we expect that it will play a greater role as we see more price realization. What I have to say is I feel very comfortable that the businesses that we are pricing are showing some strong performance even in the face of the pricing actions and as a result of that, that's given us confidence to raise our revenue guidance for the balance of the year.

David Palmer - *UBS - Analyst*

One follow-up unrelated question about wall to wall. You said you're up to about a third of your stores with wall to wall and you're slowing that deployment a bit for training. Could you perhaps talk about where it's been around for a little while, what benefits you are seeing in those stores, what learnings that you have in terms of what you're increasing in terms of the training?

Irene Rosenfeld - *Kraft Foods - CEO*

Well, we continue to be very excited about wall to wall and the entire initiative. I think it's actually one of our best examples of the opportunity to turn our scale into a competitive advantage. We are seeing higher revenue in our rollout markets and so I continue to be encouraged about the long term possibilities. I suggested that we hoped to see as much as 0.5 a point of revenue growth over the long term and I think we're on track to deliver that. The intent though in making sure that we get the training right is that we are asking our reps to take on a broader portfolio and we are confident that they can do that but we want to make sure as we roll this out that we get it absolutely right and so we expect to be at about 35% by the end of this quarter as I said and we will complete the rollout by mid 2008.

David Palmer - *UBS - Analyst*

So pretty even rollout from here with the remaining 65% by quarter?

Irene Rosenfeld - *Kraft Foods - CEO*

I would say this is a classic case where I think we need to just go a little slower to go faster but the net of it is a very significant initiative and I believe it has the potential to be an important contributor to our long term revenue growth.

David Palmer - *UBS - Analyst*

Thank you very much.

Irene Rosenfeld - *Kraft Foods - CEO*

You're welcome.

Operator

Thank you. Your next question is from Andrew Lazar with Lehman Brothers.

Andrew Lazar - *Lehman Brothers - Analyst*

Good morning.

Irene Rosenfeld - *Kraft Foods - CEO*

Good morning, Andrew.

Andrew Lazar - *Lehman Brothers - Analyst*

Irene, if we think about the lower forecast tax rate for the full year and some other things below the line, it looks like that adds whatever it is, $0.05 or a little more at least to my estimate for the year, yet obviously not changing earnings guidance because of a number of things you're doing around reinvestment. I'm trying to get a sense, of that amount that I've discussed, how much of that is covering incremental input costs which have obviously been a lot more onerous than anybody could have forecast versus the incremental marketing side because I think most had already been looking for probably the high end of your 300 million to 400 million reinvestment anyway so is the majority of that going towards the input costs or truly incremental marketing about that?

Jim Dollive - *Kraft Foods - EVP, CFO*

Andrew, I'll take that, thank you. Clearly, we are seeing a benefit from the lower tax rate this year and that does give us both the ability to help manage the total P&L, to continue to do the investments that we said we would do against the business and we feel terrific about where we are in that. As you look at that gain, it's kind of split about half and half between how much more is going into the marketing program and how much more is helping support the rest of the P&L.

Andrew Lazar - *Lehman Brothers - Analyst*

Okay, and then with respect to the biscuit acquisition, just a follow-up on that one. As we think about the need for scale, in your business internationally and even in Western Europe, they must certainly bring some of that, is your thought does this bring frankly, as you think out a couple of years, does this bring enough scale or is there probably still more that you need to think about or look at doing or does this give you a sense that we're done for awhile on the scale play in Western Europe?

Irene Rosenfeld - *Kraft Foods - CEO*

Well, I think it's a terrific first start for a couple of reasons. It gives us another core category in Western Europe which gives us the potential to be able to invest in infrastructure. I think it helps to improve our margins there and I feel very good about where we are in terms of our net position in that geography. The other benefit as you know is about its ability to help our position in developing markets and in that part of the world, we're going to continue to look at opportunities to improve our scale. It's obviously got terrific population in GDP growth and I believe particularly with our strong biscuit position that we have an excellent platform from which to build.

Andrew Lazar - *Lehman Brothers - Analyst*

Thanks very much.

Operator

Thank you. Your next question is from Terry Bivens with Bear Stearns.

Terry Bivens - *Bear Stearns - Analyst*

Good morning, everyone.

Irene Rosenfeld - *Kraft Foods - CEO*

Good morning, Terry.

Terry Bivens - *Bear Stearns - Analyst*

One quick one and then a more broad one. Jim, probably for you. To what extent did you offset higher cheese cost with sales of some of your inventory into the wholesale market? Was that meaningful?

Jim Dollive - *Kraft Foods - EVP, CFO*

No, not really.

Terry Bivens - *Bear Stearns - Analyst*

Okay, and I guess the broader one for you, Irene, you're the first company I can remember that has attracted investors as disparate as Warren Buffett, Carl Icon and Nelson Pelts, now there has been some publicity around the latter there, Mr. Pelts. Have you met with him yet and if so, is it just a coincidence that you're now mentioning words like divestiture and it seems to be a slightly more aggressive posture towards share repurchase, if you could address that?

Irene Rosenfeld - *Kraft Foods - CEO*

Well, we are continuing to evaluate our portfolio as I said. When I rooted out the strategy at CAGNY, Terry, I made it clear that that was not a Safe Harbor for all of our businesses and we continue to look at them within the context of the framework that we laid out and I think the question I'm asked most frequently by our investors is what about divestitures and so I think it's important to just be explicit about how we're thinking about that. Obviously, we will share decisions on that subject with you as those actions are completed, but it's not a change in our position. It's really just a clearer articulation of how we're thinking about it.

Terry Bivens - *Bear Stearns - Analyst*

Okay, thanks very much.

Irene Rosenfeld - *Kraft Foods - CEO*

You're welcome.

Operator

Thank you. Your next question is from David Adelman with Morgan Stanley. Please go ahead.

David Adelman - *Morgan Stanley - Analyst*

Good morning.

Irene Rosenfeld - *Kraft Foods - CEO*

Good morning, David.

David Adelman - *Morgan Stanley - Analyst*

Irene, first as a follow-up on the divestiture issue. Could you help us understand the percentage of the portfolio perhaps that you'd consider being subject to divestiture? I think in the past the Company has talked about upwards of 5% of sales. Are you now looking at something that's potentially demonstrably larger than that and is the potential of negative business system leverage a serious consideration as you look at potential divestitures?

Irene Rosenfeld - *Kraft Foods - CEO*

Well, actually, David I would say at this point we're looking at something considerably smaller than that. I think we've got a lot of our major activity behind us. We will continue as I've said to look at individual categories and make those decisions and clearly to the extent that they create some overhead issues, we will deal with those as part of our overall assessment of the opportunity, I think we will continue to look at the reshaping of the portfolio but our focus really is on generating organic growth and following the four strategies that we laid out.

David Adelman - *Morgan Stanley - Analyst*

Okay and then let me ask you a second question Irene about the U.S. market share trends. I would imagine when you came back to Kraft, you envisioned, I would assume that a year into your tenure, there would be better market share momentum than there currently exists and I'm curious, you've highlighted a number of problem categories that need to be addressed but is there a more sort of overarching observation you can make about some of the issues the Company faces, not necessarily on a category by category basis to position itself to be able to generate consistent composite market share growth? Thanks.

Irene Rosenfeld - *Kraft Foods - CEO*

Well, David, as I said at the outset and it is part of the reality of timing, we expect, we've always expected our results to improve in the back half of 2007, partly because that was where the bulk of our spending was going to hit and that was when many of our new products were going to hit. We have a much stronger pipeline in the back half of 2007 than we did a year ago and I feel good about that.

Having said that I am disappointed in our North American particularly U.S. market share performance. Some of those issues though are some businesses that have been issues for quite some time and I think that the difference here is that we are facing those issues and we're dealing with them. I've talked about some of the actions that we're taking on cheese, on coffee, on snacks, and even pizza which has some very very strong revenue growth, we are year-to-date losing share in that business and we expect that we will see recovery in the back half. So I don't feel good about our share performance. There's no question that it's not where we want it to be, but we do expect to see overall improvement in the second half especially Q4 as our new items hit and we benefit from the incremental spending that is yet to come.

David Adelman - *Morgan Stanley - Analyst*

Okay, thank you.

Irene Rosenfeld - *Kraft Foods - CEO*

You're welcome.

Operator

Thank you. Your next question is from Chris Growe with A.G. Edwards.

Chris Growe - *A.G. Edwards - Analyst*

Good morning.

Irene Rosenfeld - *Kraft Foods - CEO*

Good morning.

Chris Growe - *A.G. Edwards - Analyst*

Hi, just had a question for you to clarify a statement, I think Jim had made. Your gross margin was down 130 basis points in Q2. Am I correct in the way that you characterize the second half of the year that could be worse than you saw in the second quarter due to input cost inflation on the gross margin side?

Jim Dollive - *Kraft Foods - EVP, CFO*

Yes. I'll take that, Chris, and that's exactly what I was indicating is as we look at these rising commodity costs, they will peak later in the year, not earlier in the year. That said, we are recovering a larger percentage of our input costs than we have in the past and we feel terrific about that but as Irene mentioned the portfolio just isn't where we need it to be in terms of our ability to fully recover those costs. Just to continue for one other thought, the easier thing would be for us to cut the marketing support and do other things and that's not something we're willing to do.

Chris Growe - *A.G. Edwards - Analyst*

Okay, and then if you look at the increase in your total spending, you're now $400 million at the high end of your range and that's up from wherever you were expecting it before, is that increase Irene more marketing or is it more about the quality upgrades if you will in R&D type components of your spending?

Irene Rosenfeld - *Kraft Foods - CEO*

Actually, Chris, about a third of it is investments in quality and about two-thirds of it is in marketing and infrastructure.

Chris Growe - *A.G. Edwards - Analyst*

And that comment if I'm correct, you're talking about the increment from where you were before; is that correct?

Irene Rosenfeld - *Kraft Foods - CEO*

That's correct. That's not the total.

Chris Growe - *A.G. Edwards - Analyst*

Okay, sure, and then just one point, one question to clear it up here on volume. Being down roughly 1% in the quarter and there's some numbers there that are probably pushing that a little lower but with the market share weakness, it would seem like with more aggressive pricing your volumes could weaken. I know there's some programs in place to try and improve that but should we be looking for weaker volumes in the second half of the year because of the price realization that's coming through?

Irene Rosenfeld - *Kraft Foods - CEO*

No, actually, we've said volume is still not where we want it to be. It's actually a combination of factors. The biggest is our continued pruning in foodservice which is still a head wind for us, represented about 1.5 point on the sector in the quarter so it's an issue. We continue to have some chronic problems in a couple of core categories that we are addressing but we do expect to see volume improvement in the back half driven by the programming that we've put in place, and as I said before, I actually feel encouraged by the fact that our volume has held up reasonably well on those businesses that we've priced, so we do expect to see some volume recovery in the back half of the year and I believe the programming that we've got in place will be a key part of that.

Chris Growe - *A.G. Edwards - Analyst*

Okay, great. Thank you.

Irene Rosenfeld - *Kraft Foods - CEO*

You're welcome.

Operator

Thank you. Your next question is from Jonathan Feeney with Wachovia Capital. Please go ahead.

Jonathan Feeney - *Wachovia Capital - Analyst*

Good morning. Thank you. Irene, I wanted to I guess talk about your philosophy around acquisitions. Clearly, your Danone acquisition adds some nice solid overlap for you in scale building but I don't know if it did a tremendous amount as far as accelerating your top line potential. Would you consider acquisitions probably globally that would accelerate your top line? Or is that not a priority of yours right now?

Irene Rosenfeld - *Kraft Foods - CEO*

Well first of all, Jonathan, reiterate the fact that our plan is predicated on organic growth and the guidance that we've laid out there is really predicated on our belief that the strategies that we've laid out can help to accelerate growth in our core categories and I think we're starting to see some early impact of those, of that thinking and those investments. Having said that, we will continue to look for opportunities to expand our footprint as well as to accelerate growth, and certainly the Danone Biscuit is a part of our overall desire to accelerate growth and as I mentioned their first half revenue was up about 5% and we believe that that can definitely be accretive to our performance and particularly as we start to look at some of the synergy opportunities. We will continue to look for opportunities to add-on businesses that we think can further help to accelerate our growth. Okay, and secondly, when you think about wall to wall, I know, could you talk about what the deliverables are as far as I know it's not something that's being looked at as a way to reduce costs across your sales and marketing organization. A year from now, let's say wall to wall is half or more of your stores. What can we look for as specific evidence that that program is working and is transforming your U.S. performance in a way that's meaningful for investors? Well, I'll tell you what the criteria are for our guys. It is going to be accelerated revenue growth and stronger share performance and those are very clear and simple metrics. They all understand exactly what they are looking to do and as I mentioned the early results in the rollout markets are encouraging. But importantly--.

Jonathan Feeney - *Wachovia Capital - Analyst*

On those two metrics?

Irene Rosenfeld - *Kraft Foods - CEO*

On those two metrics but importantly we're only in less than 35% today. We will be up to 35% by the end of the quarter. So it's going to take a little bit of time until we see that performance more broadly across the portfolio, but we certainly believe that this is an important enabler to our acceleration of our overall top line growth.

Jonathan Feeney - *Wachovia Capital - Analyst*

Thanks, and just finally to follow-up on Terry's question a little bit, given there's been a ton of news about all these celebrities buying stock, what is your philosophy on sort of soliciting input from shareholders about the future direction of Kraft? I know, I think you were deliberate in being somewhat hesitant to reveal who you've met with and who you haven't but maybe short of that you can share with us your sort of philosophy about getting that kind of input from shareholders.

Irene Rosenfeld - *Kraft Foods - CEO*

Well, Jonathan, over 100% of our shares have actually traded since the spinoff, and so critically important that I continue to stay in touch with our investor base and I will continue to do so. I think it's very helpful to understand how they feel about our overall strategies and to make sure that they understand the context and the progress that we're making so it's an important part of my ability to be able to return Kraft to reliable growth.

Jonathan Feeney - *Wachovia Capital - Analyst*

Okay. Thanks very much.

Irene Rosenfeld - *Kraft Foods - CEO*

You're welcome.

Operator

Thank you. Your next question is from Eric Serotta with Merrill Lynch. Please go ahead.

Eric Serotta - *Merrill Lynch - Analyst*

Good morning.

Irene Rosenfeld - *Kraft Foods - CEO*

Good morning, Eric.

Eric Serotta - *Merrill Lynch - Analyst*

A couple quick housekeeping questions and a follow-up. First of all, Jim, the tax rate obviously for the year came in lower, is going to come in lower than your guidance. You'd previously talked about '08 going up to I think 37%. Do you still stand by that or is there potential upside from lower tax rate in 2008?

Jim Dollive - *Kraft Foods - EVP, CFO*

Sure. Obviously we are benefiting this year from the resolution of those items I mentioned as well as the mix in countries. We really haven't updated our guidance yet for 2008. Previously we said it was going to be around 37%. Rest assured we are actively pursuing those programs we think will help reduce our long term tax rate and it's really just too early now for us to make any committment on that.

Eric Serotta - *Merrill Lynch - Analyst*

How much of the reduction in the tax rate for '07 was attributable to discrete items like the tax rate, like the audit resolution and how much related to country mix and the like?

Jim Dollive - *Kraft Foods - EVP, CFO*

A little more than half was related to the resolution of some of those specific tax items.

Eric Serotta - *Merrill Lynch - Analyst*

Okay, and then Jim, did I hear you, I guess I don't remember whether it was Jim or Irene who made the comment but did I hear it correctly that about three-quarters of the incremental marketing and quality spending will occur in the second half?

Irene Rosenfeld - *Kraft Foods - CEO*

Yes, that's what I said, Eric.

Eric Serotta - *Merrill Lynch - Analyst*

Now that's three-quarters of of the 400 million?

Irene Rosenfeld - *Kraft Foods - CEO*

Yes.

Eric Serotta - *Merrill Lynch - Analyst*

Okay, looking at that, that would obviously imply that you spent about 100 million in the first half, an incremental 100 million and when I look at the overall SG&A line for the first half, it was up about 340 million or so, so I'm just wondering what some of the drivers were behind the increase in the non-quality marketing portion of SG&A and I realize that even a portion of the $100 million investment is coming in the COGS line, so I guess why was SG&A up, why was SG&A eX-marketing up so much and what's your outlook for the second half?

Jim Dollive - *Kraft Foods - EVP, CFO*

Let me grab that one, Eric. Obviously, we are looking at -- when you look at that line on our P&L it does show a fairly sizeable increase. The largest single component of that increase particularly in the second quarter was our marketing investment and our investment in some other growth initiatives, about 40% of the total change. There are some structural changes that you're seeing in that number. It's a combination of both currency implications as well as the addition of the UB Iberia business that we acquired back in the beginning of the fourth quarter last year. That's about 30 to 35% of the total change, and then we did have recognized in there that $18 million gain from the prior year, that's about another 10% of the change in the quarter, so there's a lot of things in there that drive it. Some structural but the more important one, the most significant one is the investment we're making in our business.

Eric Serotta - *Merrill Lynch - Analyst*

Just lastly, do you see the potential for some structural cost savings on the overall overhead line, on the overall overhead that falls within the SG&A line as we get into the second half and into calendar '08?

Irene Rosenfeld - *Kraft Foods - CEO*

Well, Eric, as we mentioned we're very pleased with the progress we're making against our overall restructuring plan and we are delivering greater savings at a faster pace than we had anticipated. We're going to continue to look at opportunities to drive our administrative costs down and I am hopeful that as we continue to look at opportunities to simplify the organization that we will find some additional opportunities for overhead savings.

Eric Serotta - *Merrill Lynch - Analyst*

Great. Well, good luck. Thank you very much.

Irene Rosenfeld - *Kraft Foods - CEO*

Thank you.

Operator

Thank you. Your next question is from Eric Katzman with Deutsche Bank. Please go ahead.

Eric Katzman - *Deutsche Bank - Analyst*

Good morning, everybody.

Irene Rosenfeld - *Kraft Foods - CEO*

Good morning, Eric.

Eric Katzman - *Deutsche Bank - Analyst*

A few questions, I guess first one, follow-up on Terry's question earlier. Isn't the problem really that the government wants their pound of flesh when it comes to divestitures, so if you're going to get rid of let's say Maxwell House as Pelts is rumored to propose, I mean, huge earnings dilution so unless you really get the sense that you can't fix that business, otherwise, it just doesn't make much sense. Isn't that fair given the tax basis of those assets?

Irene Rosenfeld - *Kraft Foods - CEO*

Yes. In fact that's why divestitures is not a major part of our plan. I feel very comfortable that we have the ability to better leverage the breadth of our portfolio and that's a critical piece of our strategy going forward. I think our scale can be a competitive advantage but having said that to the extent that we have businesses that we don't believe can be accretive over the long term, we are better to put our investments elsewhere and obviously we will consider all opportunities to do that to be able to maximize shareholder value and the tax implications is an important consideration in that equation.

Eric Katzman - *Deutsche Bank - Analyst*

I don't understand why people just get so fascinated with the idea of getting out of a business when it will be hugely dilutive but anyway, let's move on. Just in reference to the the three categories where they are big and your share is under pressure, in Maxwell House odds are it's not going to be easy because you're going up against Procter and Folgers to the extent that they still care about food or beverages. Snacks you got a lot of competition obviously with PepsiCo and others, but it would seem that the one area where you can from a competitive standpoint where you should win is cheese because that's largely private label. So I guess it used to be that anybody who is going to progress at Kraft had to fix or grow cheese. What do you think is just the long term problem there?

Irene Rosenfeld - *Kraft Foods - CEO*

I actually don't think there's a long term problem. I think the issue has been we have been far too focused on commodity costs and price gap as our lever and the reality is it's a growth category, consumers around the world are eating more and more cheese and we're not participating, and so as I said before, I'm not yet comfortable that our pipeline on cheese is robust enough in general and certainly to handle these record high dairy costs, but we are about fixing it. It's just going to take us some time because there's just not enough in the pipeline. We've got a couple of good items coming out in the back half. I've talked about the Live Active product, our Kraft Singles Select product, we've made some changes in our advertising agency that I think will lead us to a stronger program for our base singles product but net-net, we need to get some more innovative products coming out and it will take us some time to do it but clearly cheese is one of those categories where we have the right to win and we will.

Eric Katzman - *Deutsche Bank - Analyst*

Okay and then two quick follow-ups for Jim. Jim, I think previously when you talked about the restructuring, the cash costs have been about 1.1 billion over the life of the programs. Did that change with today's adjustments?

Jim Dollive - *Kraft Foods - EVP, CFO*

We're looking at that. We are running slightly favorable on some of our cash costs just as we're seeing the efficiencies in the total program, but for clarification, we spent about 900 million on cash so far, what we said was the total 3 billion had somewhere in the order of 1.9 billion as a cash component but I think we're going to see some favorability around that.

Eric Katzman - *Deutsche Bank - Analyst*

Okay, and then lastly, did you quantify the gross margin impact from input costs versus the benefit on price?

Jim Dollive - *Kraft Foods - EVP, CFO*

We really haven't gotten into the specifics of how each of the components drive into that. The simple answer is that the gross margin is under pressure because of the rapid increase in the commodity cost.

Eric Katzman - *Deutsche Bank - Analyst*

Okay. So most of -- even with the pricing, the input costs are still overwhelmingly hitting you?

Jim Dollive - *Kraft Foods - EVP, CFO*

I wouldn't call it overwhelmingly. We are pricing to recover the majority of our input costs but we're not there yet in terms of 100%.

Eric Katzman - *Deutsche Bank - Analyst*

Okay, thank you.

Operator

Thank you. Your next question is from Alexia Howard with Sanford Bernstein. Please go ahead.

Alexia Howard - *Sanford Bernstein - Analyst*

Hello, there.

Irene Rosenfeld - *Kraft Foods - CEO*

Good morning.

Alexia Howard - *Sanford Bernstein - Analyst*

I just wanted to talk a little bit about the strategy going forward on Tassimo. It was obviously the write-off in Q4 of last year. It sounds as though you've still got a fair amount of marketing investment going in there. Maybe you could just talk about how much of the downturn in margins in North American beverages over the last few years has been to do with the Tassimo launch and what is the plan going forward? Is it more of a milking strategy at this point, is it -- how are are you thinking about the strategy as we go from here?

Irene Rosenfeld - *Kraft Foods - CEO*

Actually, Alexia, we continue to believe that Tassimo is an important growth engine for us as we go forward. In fact, the fact that we've chosen to go to a more targeted strategy particularly in North America is paying dividends on the bottom line and it's one of the factors that contributed to our strong performance in our beverage segment so I believe that the targeted strategy is paying dividends. We actually expect our Tassimo platform to grow about 70% this year, but we're focused on the right people. We're not trying to appeal to the mass market. It's about targeting coffee Aficionados. We've got some exciting new products in the EU like Latte Macchiato and that's performing quite well for us. We've got some new advertising that is coming out in the back half of the year and actually I'm quite encouraged by the program that is setting up for our Christmas season this year.

Alexia Howard - *Sanford Bernstein - Analyst*

Thank you.

Irene Rosenfeld - *Kraft Foods - CEO*

You're welcome.

Operator

Thank you. Your next question is from David Driscoll with Citigroup Investments. Please go ahead.

David Driscoll - *Citigroup Investments - Analyst*

Hi, good morning, everyone.

Irene Rosenfeld - *Kraft Foods - CEO*

Good morning, David.

David Driscoll - *Citigroup Investments - Analyst*

Just first a comment, Irene. There is, in the old days we had some nice presentation slides that had a tremendous amount of information on it. You guys had stopped doing that when you came on board and I would just say that there's a lot of questions that are being asked today that would have been answered through those slides. If at all possible if you reinstitute those that would be very helpful. Now on to a couple questions here. Jim, can you tell us what was the market share change for Kraft Top 25 U.S. OCI categories? As you recall that was a metric that you used to give out quite frequently.

Jim Dollive - *Kraft Foods - EVP, CFO*

David, we don't have that. What we're really looking at right now is how we're doing in our Top 30 or so categories in the U.S. on a trailing 52 week basis, and as Irene said in her opening comments, we're still not growing share in more than half of them. We're still slightly under half.

Irene Rosenfeld - *Kraft Foods - CEO*

David, we're choosing to look at the top revenue contributors because what I found before, the Top 25 is an important metric but the fact was they were growing and we had a leaky bucket. So I think the relevant consideration is what percent of our revenue is growing and as I mentioned, less than half of our revenue is growing share, and that is unacceptable. We expect to see that number go considerably North over time and in fact, we should see some improvement in the back half of this year particularly in the fourth quarter.

David Driscoll - *Citigroup Investments - Analyst*

Next question would be Jim, can you just give us what the estimate for commodity cost increases is? I don't actually think you said the number on the call. If I missed it I apologize.

Jim Dollive - *Kraft Foods - EVP, CFO*

No, we didn't give a specific number on the commodity cost. We're actually trying to get away from giving that specific number. As I said earlier, what's really important here is the net of how we're doing from a total recovery perspective and we're actually in better shape now than we've been previously.

David Driscoll - *Citigroup Investments - Analyst*

All right. Well, that leads to the next question. Irene, on pricing, we've heard a lot of different companies talk about the environment for actually realizing a price increase is quite good right now. Would you echo those comments and what other color can you give to us about the ability to pass through those price increases?

Irene Rosenfeld - *Kraft Foods - CEO*

Well, David we've priced about 60% of our North American portfolio in the last 12 months and as we mentioned earlier, I expect to see even more realization of that pricing in the back half of the year, so we believe that we will be able to recover a significant portion of our input costs through the pricing actions we've taken. Having said that, it's more than we've been able to do in the past but it still is not sufficient to offset the entire impact.

David Driscoll - *Citigroup Investments - Analyst*

Jim, just one last question, following up on Eric's question on the 2008 tax rate. Given that you guys are fully separated right now, I understand that you may not have completed your '08 plans but the 37% tax rate is enormously higher than where you are right now. Why would anybody believe that that tax rate is a realistic tax rate for '08 given what we're seeing this quarter?

Jim Dollive - *Kraft Foods - EVP, CFO*

Well, remember, in the current year, we continue to have some benefit of our association with Altria, and that is enabling us to get a benefit versus what it will be on a fully stand alone basis. 2008 is our first full year independence.

David Driscoll - *Citigroup Investments - Analyst*

So then you're really sticking to your guns that 37 might be the appropriate rate at this point?

Jim Dollive - *Kraft Foods - EVP, CFO*

Well, we're just not updating the guidance. We are actively looking at programs that are going to help us bring that down but we're just not ready to commit to anything at this time.

David Driscoll - *Citigroup Investments - Analyst*

Okay, I understand. Thanks a lot, everybody. Good luck.

Irene Rosenfeld - *Kraft Foods - CEO*

Thanks, David.

Operator

Thank you. Your next question is from Ann Gurkin with Davenport. Please go ahead with your question.

Ann Gurkin - *Davenport - Analyst*

Good morning. I think you said you all put a price increase through on cheese. Have you protected the retailer for a specific period of time?

Irene Rosenfeld - *Kraft Foods - CEO*

Yes, we have.

Ann Gurkin - *Davenport - Analyst*

Can you give me that time frame?

Irene Rosenfeld - *Kraft Foods - CEO*

Well, basically we told you we took a pricing action earlier in the year and then we took another one effective July 9, and so we are getting ourselves through the 4th of July holiday.

Jim Dollive - *Kraft Foods - EVP, CFO*

And the effective date is the date after the deal protection.

Ann Gurkin - *Davenport - Analyst*

Great, and then for the back half should we look for operating margins on the cheese and foodservice segment to be down like what we saw in the second quarter?

Irene Rosenfeld - *Kraft Foods - CEO*

Yes. I think it's as you heard Jim say, we expect it will get somewhat worse before it gets better as the higher input costs flow their way through the P&L, particularly in the third quarter.

Ann Gurkin - *Davenport - Analyst*

Okay, great. Thank you.

Irene Rosenfeld - *Kraft Foods - CEO*

You're welcome.

Operator

Thank you. Your next question is from Pablo Zuanic with JPMorgan. Please go ahead.

Pablo Zuanic - *JPMorgan - Analyst*

Good morning, everyone. Just a couple of questions for Jim first, and then a couple ones for you, Irene. On the cheese side, Jim, can you give us some sense in terms of economics? If cheese is up 50%, how much of a price increase you need to fully offset that, or if you want to think in terms of cents, but what color you can give there would help.

Jim Dollive - *Kraft Foods - EVP, CFO*

Obviously, cheese is just a percentage of the total cost profile, so when you have an increase in cheese, the revenue increase needed to cover that is significantly less, and I'm not going to get into the specific dynamics there because then I'd have to get into the P&L structure and the cost component on cheese.

Pablo Zuanic - *JPMorgan - Analyst*

Okay. And now when I look at the marketing expenses, one-third going in the first half, was that the plan all along or did you have to delay some of them in the second quarter because of the higher input cost?

Irene Rosenfeld - *Kraft Foods - CEO*

No, actually, I would say it was the plan in the sense that we understood that a number of the new items and some of the marketing ideas that this spending is going to go against would not be ready until the back half and that's one of the reasons I've been saying all along that we expected to see stronger recovery in the back half, and so that's the reason for the spending coming more sharply in the back half than it has so far.

Pablo Zuanic - *JPMorgan - Analyst*

Okay, and just to follow-up on that Irene, if you can tell us when you look at the five divisions in the U.S., which ones are more advanced in terms of the innovation pipeline, in terms of the marketing programs, and which are behind? Can you give us some color there, shades of our progress there?

Irene Rosenfeld - *Kraft Foods - CEO*

I certainly can, Pablo. I think it should be somewhat clear from my remarks I feel very good about our progress on powdered beverages. We're beginning to see some progress on coffee and I think we're addressing an issue that's been longstanding so I feel good about beverages. I feel very good about our position in convenient meals. On the top line we've got some work to do there in terms of margins which will recover as the year progresses. So I think beverages and convenient meals are our strongest performers and have the strongest pipeline.

The balance of our sectors, particularly cheese, snacks, and grocery are the areas that we continue to have some issues but rest assured, we are on top of what those key issues are. It's just going to take somewhat longer for us to be able to address some of them but the progress will accelerate in the back half, as I've said three quarters of our spending is yet to come. We do have a stronger new product pipeline across-the-board which you'll have much more visibility to as these products come out into the marketplace. I expect to see better pricing realization and all of which will, I believe will lead to improved share as well as volume performance.

Pablo Zuanic - *JPMorgan - Analyst*

And one last one if I may. In terms of thinking about commodity exposure, private label exposure, the (inaudible) or the feedback is that we get a lot of commodity type products and obviously you're addressing that through innovation, but for me the definition of a commodity type category is where private label penetration is high. So I look at for example, Heinz, frozen potatoes almost 28, 30% private label market share but Oneida is able to get about 70, 80% premiums to private label and I look at the Planters Snacks and the premium to private label is 5 to 7%. So I'm just trying to get an idea when I think of nuts, hams, cheese, which are so-called commodity type categories, do you see room there to significantly improve premiums from where they are right now through innovation or is there something structural that doesn't make the premiums possible in some of your other products?

Irene Rosenfeld - *Kraft Foods - CEO*

Well, I know I actually think that the opportunity we have is to be able to get stronger volume performance from the premiums that we have. I think over time, clearly as we add more value to a number of our products particularly in cheese and nuts as you suggest, that will help us, but the real opportunity we have is to be able to generate stronger performance and particularly stronger share performance with the gaps that we have today and that will hinge entirely on our ability to restore brand equity to a number of these iconic brands and to innovate with value-added products and that's really what our investment plan is focused on.

Pablo Zuanic - *JPMorgan - Analyst*

And just a last one, any update on the search of a Marketing Officer -- Marketing Director?

Irene Rosenfeld - *Kraft Foods - CEO*

Yes, we are continuing to search. It's a critically important role for us particularly as I'm looking to place much more emphasis on the consumer and the quality of our marketing. We've been actively engaged in an external search and I expect to make an announcement later this quarter.

Pablo Zuanic - *JPMorgan - Analyst*

Thank you.

Chris Jakubik - *Kraft Foods - VP, IR*

Operator, we can take one more question.

Operator

Thank you. Your final question is from Steven Kron With Goldman Sachs.

Steven Kron - *Goldman Sachs - Analyst*

Two questions and they both turn out to be follow-ups here, back just on the cheese business. You mentioned lower price gaps versus last year. You've spent some on innovation and I think you shared that at CAGNY, yet obviously share as you've commented on is down so it begs the question, is the absolute price at this point a bit more important than the gap itself to the consumer and I can't help but think that recent pricing actions just furthers that price point in a category that seems to be obviously a bit more commoditized to the consumer?

Irene Rosenfeld - *Kraft Foods - CEO*

Well, again, Steven, I think we have to stop talking only about price gaps as the root of our issues. There's no question that we're not happy with our share performance on cheese. We do feel that our price gaps for the most part are in a reasonable place, and so I don't believe that that is the solution to our long term opportunity. The issue is really about the quality of our pipeline and the ability to introduce value-added new items, and that's what we've got the team focused on. So I don't think it's about price gaps. Certainly, getting better price realization and seeing how the marketplace reacts in general to these higher input costs will be important and may create some relative dislocation in our position but I feel generally quite good about where our pricing position is on cheese. The issue is the ability of the portfolio to add enough value to be able to be distinguished and competitively advantaged.

Steven Kron - *Goldman Sachs - Analyst*

Okay, that's a good segue into the next question which is Irene, just trying to get a bit of perspective maybe a status update a little bit different from a prior question as it relates to innovation in the U.S. And particularly the speed to market if I recall, if I think back to CAGNY, there was a whole host of pipeline of new products that you were very excited about and it kind of feels like things are a little bit more back end loaded than perhaps I would have thought and we're talking about '08 and I understand that this is an evolving process, but can you maybe talk about your level of satisfaction with the speed to market with some of this innovation?

Irene Rosenfeld - *Kraft Foods - CEO*

Well, I think we're making good progress. We're not exactly where we need to be but I will tell you over the coming weeks we will be talking at the back-to-school conference about a number of our new items and we're just beginning to present them to the trade so I come back to the point I knew that it was going to take us some time in 2007 to get this pipeline jump started and that's why we've been talking about the fact that we expect to see stronger acceleration in the back half. Having said that, our early investments are already showing some results, so it will take us some time as we've said particularly on some of the longstanding issues in some of our core categories, those are a little harder to fix and we are in the process of doing that and we will lay those out as we commercialize them in the marketplace, but I will tell you overall, I think the organization is responding very well to the overall charge of moving faster, of being bolder, of taking some actions, of testing and learning and I'm seeing examples across the Company of progress there and it will be more visible to you as these new products begin to come out in the back half of the year.

Steven Kron - *Goldman Sachs - Analyst*

Thanks very much.

Irene Rosenfeld - *Kraft Foods - CEO*

You're welcome.

Chris Jakubik - *Kraft Foods - VP, IR*

Okay, thank you. For those people with the media who have additional follow-up questions, please feel free to call Claire Regan at 847-646-4538 and for analysts and investors who have follow-up questions please feel free to call me after we hang up. So thank you very much and have a good day.

Operator

Thank you. This concludes today's Kraft Foods conference call. You may now disconnect.