

FINAL TRANSCRIPT

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KFT - Q1 2007 Kraft Foods Earnings Conference Call

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PRESENTATION

Operator

Good afternoon, and welcome to the Kraft Foods first quarter 2007 earnings conference call. Today's call is scheduled to last about one hour including remarks by Kraft Foods management and a 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 afternoon. Thanks for joining us on our conference call. I am 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 web site, 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, so 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 reconciliation within our news release, and they are also available on our web site.

We'll begin today's call by hearing from Irene who will share her perspectives on our performance in the first quarter. Then Jim will provide an overview of our financials. After that we'll take your questions.

Before we get started I would like to highlight some changes we've made to the earnings release. We've simplified our discussion of the key drivers of organic revenue growth and of operating income and earnings. We want to focus more on the underlying health of our businesses and the factors that are most important to your understanding of our progress against the strategic plan we laid out in February. We hope you find these changes useful and welcome any feedback you have so we can continue to improve our communications.

Now, I'll turn it over to Irene.

Irene Rosenfeld - Kraft Foods - Chairman, CEO

Thanks, Chris. Good afternoon. As we mentioned in our earnings release today, Q1 was a very eventful quarter for Kraft. We became a fully independent company on March 30th. I'm happy to report that the transition has been seamless and our 90,000 employees are eager and energized to write this next chapter in our history. We embarked on our strategic plan to get Kraft growing again and we're making progress. While our I'll share a few examples today, you'll really start to see more evidence in the back half of the year. And most important, our earnings met our expectations. We're on track with our programs and our full year guidance is unchanged.

I'd like to share some thoughts about our results in the quarter and how they position Kraft for the remainder of the year. First, the declines we reported in our earnings and profit margins reflect the necessary planned investments I outlined in February. These investments are targeted at a number of critical areas, all designed to drive consistent, sustainable growth. As a reminder, we're investing in quality, to make our foods truly delicious. Marketing spending to provide the necessary support to our base business. And infrastructure, specifically information systems and expanded distribution in select developing markets.

The second point I want to make is that the early results of these investments in our base business are promising. For example, our investments in quality and marketing support behind our Mac and Cheese business drove double-digit revenue growth

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and over 1 point of share gain year-to-date. We have now launched DiGiorno Ultimate Pizza into 17% of the U.S. So far, results are ahead of expectations as we head into our national launch in June. And we're pleased that Oscar Mayer Deli Creation Sandwiches have had excellent acceptance by the retail trade.

In February I talked about several other initiatives that we're piloting and I'd like to give you a quick update on a few of them. Our Fresh Creations Prepared Salads are being tested in Boston and Denver. We continue to learn and make the necessary adjustments to our launch plans to maximize the potential of this new category in our North American business. We're taking our cheese snacking display test to more than 200 stores, making it easier for consumers to choose Kraft Cheese when they're looking for healthy, convenient snacks. And our wall to wall sales initiative is also gaining momentum. We're now rolling it out to stores that account for about 20% of Kraft's [alt] commodity volume. But we're just getting started.

And while we've had a number of successes to date, we're continuing to address some of the long-standing business challenges that are impacting our growth. First, we're gaining market share in only about half of our U.S. businesses, in particular, cheese, main stream coffee and salad dressing shares fell in the quarter. That's unacceptable and we are working on solutions but it will take some time to get our shares growing more broadly. And while we saw strong results in our international business this quarter, we do have more work to do.

In sum, I'm encouraged by the signs of progress we're seeing in our results, I continue to be confident that we're on the right track in our game plan to return Kraft to consistent, predictable growth but it will take some time.

And now I'll turn the call over to Jim.

Jim Dollive - *Kraft Foods - 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 3.6% in the quarter with more than 1 point of contribution from volume growth and more than 2 points from favorable product mix. Gains in four areas drove revenue growth. New Better For You offerings primarily in beverages, strength in convenient meals, driven by increased marketing support and new products, snacks growth in North America and Europe, and continued momentum in developing markets. Net pricing was relatively flat in the quarter as price increases on several categories were offset by new product support as well as some dealing back to protect promotional commitments through Easter. We expect the contribution from pricing to increase as the year progresses.

Turning to profits, there are three things to note. First, our gross margin was down 60 basis points driven by investments in quality, new product support and the protection of promotional commitments. Second, our operating income margin declined 120 basis points for the reasons just mentioned, as well as incremental investments in marketing, systems capabilities and distribution infrastructure and the higher margins of divested operations. And third, the benefit from share repurchase activity was offset by the increase in our effective tax rate versus 2006. On the quarter, our effective tax rate was 32.3%, as we benefited from full tax consolidation with Altria. For the year, our guidance remains at 35.5%.

Moving on to the [distant] segments, as Irene said, we're beginning to see improved results where we have made investments in our base business and in reframing our categories. At the same time, meaningful challenges remain in a number of businesses. North American beverages is a prime example. Within beverages, organic net revenues grew 3.9% as we benefited from our investment in Better For You and premium products. Product mix was the key driver, contributing 3.5 percentage points, reflected in the success of our powdered beverage sticks including new Crystal Light sticks with anti-oxidants. In addition the launch of Capri Sun with anti-oxidants is off to a good start.

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Finally, coffee growth was driven by our premium products, but this was tempered by share declines in main stream coffee. At the profit line, operating income margin declined 170 basis points as higher grain coffee costs and investments in new products offset solid top line growth.

In North America cheese and food service, organic net revenues were up slightly. Here, cheese revenues grew reflecting solid gains in snacking, topping and spreading cheeses. Sandwich cheese also grew revenues. However, share was down due to heavy branded and private label promotional activity. Partially offsetting the cheese gain was lower food service revenues due to product pruning. Operating income margin was down as we reinvested favorable pricing and mix into a strong, double-digit increase in marketing behind both the base business and new products. While we did lose share of total cheese, we are encouraged by the initial results of our category reframing efforts and expect to see improvement as the year progresses. In fact, our heightened new productivity in cheese should allow us to begin driving both category growth and share gains in the back half of the year.

Moving on to North America convenient meals. Organic net revenues were up nearly 5% driven by three factors. First, we had continued success in the growth initiatives like Oscar Mayer Deli Shaved Meats, Super Premium California Pizza Kitchen frozen [no audio] our quality enhancements in both pizza and mac and cheese drove solid based business growth. Third, we launched DiGiorno Ultimate Pizza and Deli Creation Sandwiches, as part of our strategy to source for the away from home eating occasions. Operating income margin fell approximately 2 percentage points in the quarter, reflecting the impact of divested operations, as well as our investment in product quality, new product support, and increased marketing behind the base business.

On to North American grocery where organic net revenues were flat. Two factors drove these results. First, we continued to see results from new sugar free offerings such as Cool Whip and Jell-O Ready-to-eat Pudding and Pudding Poppers. With it's strong growth, our sugar free refrigerated pudding now represent half of our refrigerated pudding franchise and will be a continued area of focus going forward. These gains were offset by ongoing weakness in salad dressings where revenues were down mid single digits due to category weakness, the lingering softness in [inaudible] salad consumption and continued share losses. We'll share our plans for the [forables] turn around later this year.

Going forward, we're working on ways to contemporize the grocery portfolio with innovations in health and wellness and convenience. But these businesses have been losing share for many years and it will take some time to fix them.

Looking at North America snacks and cereals, organic net revenues were up a solid 4%. In biscuits, new snack products and merchandising gains drove growth in both cookies and crackers. Within that strong performance, Oreo experienced a temporary revenue decline in response to a first quarter price increase. Our main disappointment in this sector was the decline in ready to eat cereal revenues as share losses in kid cereals led to lower volume in the quarter. Operating profit margins in snacks was down slightly. Gains from revenue growth and manufacturing productivity were offset by reinvestments in quality and marketing as well as the impact of the Milk-Bone and Cream of Wheat divestitures. Looking ahead, we expect these same factors to impact the operating income margin of snacks for the remainder of the year.

Now I'll turn to our international businesses which had a good quarter across the board. In the EU, organic net revenues grow about 3%. This was driven by high single digit growth in chocolate, behind new product introductions from Milka, Freia Marabou and Cte d’Or. Going forward, we're excited about the opportunities to continue to build our EU snacks business as we complete the integrate of the UB Iberia biscuit business. By contrast, the EU coffee was essentially flat as heavy promotional activity in mainstream coffee offset gains from our premium products such as Cte d’Or.

Finally, developing markets had another strong quarter. Organic net revenues grew about 9%. Eastern Europe and Latin America led the way with significant contributions from soluble coffee and chocolate in eastern Europe and strong category growth in chocolate and biscuits in Latin America. Going forward, we expect continued strong performance from developing markets as we invest in expanding distribution.

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Finally, on our restructuring program, we spent \$88 million on restructuring activity during the quarter, and continue to forecast \$625 million of cost for the year. Cumulative savings are up to \$615 million, and we continue to expect cumulative savings of \$700 million by year end. Now, we'd be happy to take your questions.

QUESTIONS AND ANSWERS

Operator

Thank you. We will now conduct a question and answer portion of the conference. [OPERATOR INSTRUCTIONS] Our first question is coming from Alexia Howard of Sanford Bernstein. Please go ahead.

Alexia Howard - *Sanford Bernstein - Analyst*

Hello, everyone.

Irene Rosenfeld - *Kraft Foods - Chairman, CEO*

Good afternoon.

Alexia Howard - *Sanford Bernstein - Analyst*

Hi. A couple of quick ones. First of all, I think you mentioned on the last earnings call that pricing was expected to be taken up in the second quarter this year. Are you expecting that to have a marked impact from the operating margins for the entire company as we go through the quarter of the year, the next few quarters?

Irene Rosenfeld - *Kraft Foods - Chairman, CEO*

Well, we have priced a substantial part of our portfolio over the course of the last 12 months. In this first quarter, we spent a fair amount back against some of our new item introductions, as well as to protect our merchandising price points for the Easter holiday, and so we will expect to see greater impacts as we head into the second quarter.

Alexia Howard - *Sanford Bernstein - Analyst*

Okay. Great. And then another -- I guess the second question on just your -- the forthcoming portfolio strategy. It seems as though -- I think I've seen a couple articles recently that you're thinking about focusing on possible acquisitions in eastern Europe and Latin America. I was wondering if you could just give us a bit more color on the type of acquisitions that you're looking at? And then, perhaps on a more direct note, do you have any comments on whether Kraft is considering making a bid to Calgary?

Irene Rosenfeld - *Kraft Foods - Chairman, CEO*

Well, Alexia, as I said on a couple occasions, our plan as we've laid it out is predicated on organic growth, and I feel very confident that we can achieve the targets that we've laid out on that basis. Having said that, we will continue to look at opportunities as they arise, and our focus will be on the opportunity to build scale in international markets, work to gain access to new categories, new capabilities or new technologies, and so that's what I would say at this point.

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Alexia Howard - Sanford Bernstein - Analyst

Okay. Thank you very much.

Operator

Thank you. Our next question is coming from David Adelman of Morgan Stanley.

David Adelman - Morgan Stanley - Analyst

Good morning or good afternoon, rather. Irene, can you talk for a second about quality? You've talked about that as an issue a lot. But could you help us understand, perhaps what percentage of the portfolio has an adequate product quality edge versus competition and where you hope that to be at certain points in the future?

Irene Rosenfeld - Kraft Foods - Chairman, CEO

You know what, I'm not really able to give you a specific number, David. But what I will tell you, that a fairly significant portion of the 3 to \$400 million investment that we have laid out in 2007 is behind quality of a number of our base products. We have been pleased to see the response as we have made some of those investments in products like mac and cheese and pizza, and you'll continue to see progress on a number of others as the year progresses. But we really are making investments across the board.

David Adelman - Morgan Stanley - Analyst

Okay. And then could you comment regarding your share repurchase activity, if any, since the close of the first quarter, when the \$5 billion program became available for your use?

Irene Rosenfeld - Kraft Foods - Chairman, CEO

We ask Mr. Dollive to comment on that one.

Jim Dollive - Kraft Foods - CFO

Hello, David. As we said, we will -- we would be active taking advantage of the opportunity that the distribution of shares afforded us, and we have in fact been in the market doing that. Even though we've been into our earnings period, we have contracted with an outside support group to continue to do that in our behalf. We're not going to get into the specifics of exactly how much we're doing, but we have been active in the marketplace.

David Adelman - Morgan Stanley - Analyst

Okay. Thank you very much.

Operator

Thank you. Our next question is coming from Chris Growe of A.G. Edwards.

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Chris Growe - A.G. Edwards - Analyst

Good evening.

Irene Rosenfeld - Kraft Foods - Chairman, CEO

Hello, Chris.

Chris Growe - A.G. Edwards - Analyst

I just have two questions for you. I guess it's a bit of a follow-up from David, you had mentioned that the bulk of your 3 to \$4 million, or a large sum of that, is going to be in quality upgrades. So was that the main reason for the gross margin pressure in the quarter? Because you had good mix. You had a little bit of price. You had a little more cost saves than I expected.

Jim Dollive - Kraft Foods - CFO

Well, let me grab that one. The gross margin was a couple of things and some of it is the investments we're making in that quality initiative. We also did see during the quarter some higher commodities coming across in certain areas. We've taken pricing, as I said during my comments, to recover that, but we did invest in protecting our promotional programs and that's been the primary driver of the decline in the gross margin.

Chris Growe - A.G. Edwards - Analyst

Okay. And can you quantify the input cost inflation for the quarter, Jim?

Jim Dollive - Kraft Foods - CFO

I don't want to give a specific number. But it's -- well, actually it was on the order of \$100 million. I will give you directional numbers, on the order of \$100 million, and we're seeing it in a couple of different commodities. But I think from a recovery perspective, we're at a much better place than where we've been in the past, and it is our expectation to be able to recover that as the year progresses.

Chris Growe - A.G. Edwards - Analyst

Okay. Thanks for that. And then the last one I had just is on the marketing increase. And again, I had expected a little more of that 3 to \$4 million being more heavily weighted to marketing. Can you give us rough figures for like what marketing would have done in the quarter, perhaps what you expect for the year?

Irene Rosenfeld - Kraft Foods - Chairman, CEO

Well, clarify the comment that I made to David. I didn't say the majority of our 3 to \$400 million. I said it was an important part of it. I want to start there. A big part of it is about marketing and investments behind new initiatives. And, quite frankly, it's a little early for a lot of that to kick in. You would have seen some increase in our A&C investment in this first quarter, but the bulk of that really will play out in the course of the year as we actually bring some of these new items and some of our base advertising campaigns to the marketplace.

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Chris Growe - A.G. Edwards - Analyst

So just a small number here in the first quarter, then?

Irene Rosenfeld - Kraft Foods - Chairman, CEO

Again, it's a contributor to our overall performance in terms of operating margins. But it -- a lot of that is just how it's reported as much as it is the as spent impact on the business.

Jim Dollive - Kraft Foods - CFO

And, Chris, if you look at the [mar] increase during the quarter, the largest single component of that was in fact the marketing spending.

Chris Growe - A.G. Edwards - Analyst

Okay. Well thanks for that. Thank you.

Operator

Thank you. Our next question is coming from Jonathan Feeney of Wachovia.

Jonathan Feeney - Wachovia - Analyst

Good evening. Irene, I want to take -- get a little more into the supply chain here. When you look at the 650 million in cost savings on an annual run rate right now from previously announced restructurings, I guess, 100 basis points of savings for a company that absolutely dominates its -- the segment in terms of sales, and therefore should have -- I would think a ton of efficiencies, especially considering operating at a relatively low margin, it just seems like a low number to me. I guess I'm just wondering, having had some time to take a look at the way Kraft does business and the advantages you have and maybe some overlap, and I know you mentioned wall to wall as sort of a revenue driving strategy, just a better go to market, I mean are there cost savings initiatives that you have in the works, even if they might include some sort of further restructuring?

Irene Rosenfeld - Kraft Foods - Chairman, CEO

Well, you know, I take it -- we will continue to look across our entire business system at opportunities for cost savings. But we have been very active over the last number of years, 5 to 10 years, in fact, in terms of improving the efficiency of our overall supply chain system as we took Kraft out of the consolidation of a number of our selling organizations, as we globalized our procurement organization and our IT organization, so, we've realized a number of the efficiencies that other companies are talking about right now, we've realized those over the course of time. So we will continue to look at those opportunities and we are. But in the near term, I really believe that our selling capability is a source of competitive advantage and that's really our focus, is on how to have a leverage that to help revenue growth.

Jonathan Feeney - Wachovia - Analyst

Okay. And just one other -- it looks like you are increasing advertising/marketing, and I guess if you look at -- it seems like it's been a winning strategy over the years, to not only increase advertising against new products but advertise against the base,

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a number of companies have seen some acceleration in some core, maybe under-advertised products by spending more against it. If you look at Maxwell house, just to give an example, maybe that's an area where there's been a little bit less advertising and that's showing up in the brand right now. I guess, do you have a ad -- relative advertising spending as a percent of sales in mind? What you think is the right one for Kraft? And are there any areas right now within your core that you think specifically are under-advertised?

Irene Rosenfeld - Kraft Foods - Chairman, CEO

I'll take you questions one at a time. I think the first point is, without a doubt we believe that reinvestment in some of our core businesses can generate growth. You will see that playing out over the course of the year. In fact, some of the benefits that we're seeing for example on mac and cheese is not just about the quality investment but it's also then about the marketing investment behind it. And you'll see that play out on a number of our core businesses. So, without a doubt, those investments will be a key part of our growth plan.

Jonathan Feeney - Wachovia - Analyst

And target of relative ad spend, is there one?

Irene Rosenfeld - Kraft Foods - Chairman, CEO

Well, we said in aggregate that we're targeting over time to get our total A&C to about 8 to 9% of net revenue, which we believe will put us at competitive levels. We have not talked specifically about a media target, simply because with the evolving media consumption patterns of consumers, some of that money is not going to be spent on traditional media.

Jonathan Feeney - Wachovia - Analyst

Perfect. Thank you.

Irene Rosenfeld - Kraft Foods - Chairman, CEO

You're welcome.

Operator

Thank you. Our next question is coming from Ken Goldman of Bear, Stearns.

Ken Goldman - Bear, Stearns - Analyst

Questions on innovation and, Irene, you just touched on this a little bit, but three of your biggest categories are cheese, coffee and meat, they're also three of the more fragmented competitive categories in the space, perhaps some would say less -- there's been a little less innovation than they liked to have seen in recent years, and some also have suggested that as these businesses go, so goes Kraft but two of the three I believe lost market share this period. I'm wondering how you think about improving your product quality? Is it across the board in your lines? Is it more in the products that are perceived as premium, like Gevalia, Starbucks? Or is it mainly in the core cheese, meat and coffee product lines?

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Irene Rosenfeld - Kraft Foods - Chairman, CEO

Well, Ken, just as I answered a moment ago, it's really the quality investment is across the line, because we do believe that the opportunity to make our foods truly delicious can benefit all of our businesses. The priority, though, that we have given to a number of our marketing investments is in terms of their ability to over -- to impact the overall business. So the three categories that you've described are three categories that are very much on our radar screen. I'll tell you that we're feeling very good about our performance on our meat business, and in fact, I think that in many respects is a model for what we're looking to do in a number of our core categories, as we think about broadening the frame of reference, reinvesting in quality and investing in marketing support. So that is a key plank of our ability to accelerate growth.

Ken Goldman - Bear, Stearns - Analyst

Thank you.

Operator

Thank you. Our next question is coming from David Palmer of UBS.

David Palmer - UBS - Analyst

Thanks. Irene, you talked about the possibility of a change in the focus for bonus compensation. Since the spin, have you made any changes about how people are going to be paid?

Irene Rosenfeld - Kraft Foods - Chairman, CEO

We have not made any formal changes in that regard, David. We are reviewing some proposals with our Board, and we will make those public as they are approved and we begin to implement them. But our end in mind is to ensure that the performance and the compensation of our top managers is well aligned with shareholder value.

David Palmer - UBS - Analyst

And just a couple category specific questions. Well, actually, first, one on commodity cost, that 100 million directional number you talked about, Jim. That sounds like we're on a run rate to be higher than the 275 million of last year, particularly with the direction we're seeing, I guess, in grains and dairy. Is that a correct characterization? And I guess you're saying that pricing will help you offset it in terms of the margin line going forward.

Jim Dollive - Kraft Foods - CFO

Yes, that is -- that's a good characterization but it's not just the -- I mean the grains and the oils are where the focus is right now. But we're also seeing increases elsewhere, coffee and cocoa have also been higher. The key message and the one you were reiterating there is our ability to recover those costs so that they don't become a factor in the overall performance. And I think that is a fair -- that is a fair statement.

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David Palmer - UBS - Analyst

Regarding the cheese business, there is a lot of discussion in previous calls about your price gap versus private label. In retrospect and seeing some of the performance lately, is it -- is the primary reason that gap getting a little too wide versus private label, that we're seeing some of the weakness?

Irene Rosenfeld - Kraft Foods - Chairman, CEO

No, we actually -- we've got some other issues that are going on in selected marketplaces and we are prepared to address them over the course of the year.

David Palmer - UBS - Analyst

Okay. Thank you very much.

Operator

Thank you. Our next question is coming from Robert Moscow of Credit Suisse.

Robert Moscow - Credit Suisse - Analyst

Good evening. I don't know if you've -- you kind of talked about the 300 to 400 million investment, but can you give us a sense of whether it's loaded in the back half or is it a lot of it coming in the first quarter or how is it spread out overall?

Irene Rosenfeld - Kraft Foods - Chairman, CEO

Robert, it's pretty well spread out over the course of the year, but as you might imagine, some of that investment and the impact of it will lag a little bit. So for example, as we make some of our quality investments, typically it's going to take a two to three month lag before you would -- I'm sorry, a two or three quarter lag before you would necessarily see the impact of that investment. So it just -- the marketplace impact will lag just a little bit.

Robert Moscow - Credit Suisse - Analyst

On the sales, you mean, the sales reaction?

Irene Rosenfeld - Kraft Foods - Chairman, CEO

On the sales reaction.

Robert Moscow - Credit Suisse - Analyst

Okay. And then a second question, quickly. One of the concerns I had had was that there had been a shift in your beverage portfolio, away from powder and into ready to drink beverages, but now with the sticks coming out it seems like powdered is coming back. How is Capri Sun doing and Kool-Aid Jammers, and are you -- and I guess your Fruit H2O acquisition, there wasn't much mention of it today.

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Irene Rosenfeld - Kraft Foods - Chairman, CEO

We're feeling very good about the performance of Capri Sun and our entire kid beverage business. We've launched a number of new products, particularly with anti-oxidants that moms obviously are finding quite desirable and we feel very good about that. We continue to work on challenges, in terms of the opportunities for Fruit 20 and some of our other bottled beverages as we look at opportunities in terms of expanding their distribution.

Robert Moscow - Credit Suisse - Analyst

Are you partnering with anyone to expand distribution for bottled beverages?

Irene Rosenfeld - Kraft Foods - Chairman, CEO

I'm not prepared to comment on that today, but as we've talked about that as an issue and an area of opportunity, we're going to continue to explore a variety of solutions.

Robert Moscow - Credit Suisse - Analyst

Okay. Thank you very much.

Irene Rosenfeld - Kraft Foods - Chairman, CEO

You're welcome.

Operator

Thank you. Our next question is coming from Andrew Lazar of Lehman Brothers.

Andrew Lazar - Lehman Brothers - Analyst

Irene, I wanted to explore just the wall to wall in a little bit more of a granular fashion. I think you said you're seeing in some of the test markets in Tampa like a 50 basis point lift in the sales base from the stores where you've done the wall to wall. I'm trying to get a sense, what's the key driver there? Is it primarily more secondary displays? Is it better out of stock performance? Is one -- or are there other things that come from that that I'm not -- how do we measure, what metric do we use to get us into what's actually driving the 50 basis point improvement?

Irene Rosenfeld - Kraft Foods - Chairman, CEO

I'm not sure we talked specifically about the specific contributions because in any one of these markets obviously it's not necessarily generalizable. But what I will tell you is that the reason that we're seeing a lift, and we believe it has such promise, is because it will impact all of those factors. The relationship with the store manager allows for there to be much more merchandising activity on a more regular basis. It allows us to deal with out of stocks in a more timely fashion. And so, it just all the way around, it allows us, from our perspective, to get some of the benefits that one would have from a store manager relationship that you typically would see on a DSD business with a variety of warehouse products.

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Andrew Lazar - *Lehman Brothers - Analyst*

And then, with I guess the large scale divestitures, seemingly not, I guess, a big part of at least sort of a near term plan as you've talked about, have you employed, I guess internally, a -- kind of a rigorous, I guess for lack of a better term, sort of a brand segmentation type of analysis? Like others that operate in multiple categories, Sara Lee or ConAgra, I'm trying to get a sense of which brands, or when we'll have a sense of which brands or businesses sort of deserve a much greater or disproportionate share of the investments and maybe which ones or which areas are perhaps over-resourced? It would seem like -- I realize the whole scale argument, right, but even within that it would seem like some brands and businesses should play a different role than others and you can't focus on --

Irene Rosenfeld - *Kraft Foods - Chairman, CEO*

I don't want to confuse the statements I've made about our belief that scale can be a competitive advantage because I do believe it can be with the notion that we're not managing the portfolio. There's no question there are some businesses that have a greater ability to contribute and those are the one that's we're giving greater investment to. There are others that play a different role. We have some very high margin, strong cash generating businesses and our opportunity there is to make sure we can continue to protect their margin generation so that we can use that money to reinvest. So those are not mutually exclusive thoughts. We continue to look at the portfolio very rigorously with an eye toward understanding which of our brands best fit into our long-term performance goals.

Andrew Lazar - *Lehman Brothers - Analyst*

Is that something you think, it may be premature, but, that you might be able to sort of report on, kind of going forward? In other words, where you put a greater level of investment, you're seeing this type of lift, where you haven't -- you're not necessarily seeing it fall off that tremendously. It's all about the returns on what you're spending in each area.

Irene Rosenfeld - *Kraft Foods - Chairman, CEO*

I hope you'll see it in our results. So as we make these investments I think it will be clear to you where we're choosing to make some of them. I've certainly signalled a couple of those in February, and I would encourage you to continue to stay focused on what's happening in our cheese business, what's happening in our snacks business, what's happening in our pizza business and our other convenient meals. But I think you -- we'll continue to be able to talk to you about where we stand with respect to the portfolio as our thinking evolves.

Andrew Lazar - *Lehman Brothers - Analyst*

Great. Thanks very much.

Irene Rosenfeld - *Kraft Foods - Chairman, CEO*

You're welcome.

Operator

Thank you. Our next question is coming from John McMillin of Prudential.

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John McMillin - Prudential - Analyst

Hello, everybody.

Irene Rosenfeld - Kraft Foods - Chairman, CEO

Hello, John.

John McMillin - Prudential - Analyst

I don't know if the stock is trading in after hours market but the feedback I've got has been largely positive. Mostly because of the organic sales gain being above my expectation and being kind of towards the high end of your 3 to 4% targeted range. I guess I'm trying to understand the sustainability. One, was an early Easter at all an impact in helping you? Because some other companies kind of mentioned last year that a late Easter hurt them. Were you at all benefited by an early Easter?

Irene Rosenfeld - Kraft Foods - Chairman, CEO

There's no question we feel that we're off to a good start. It's a little hard to quantify the impact of Easter but we believe it would have had some modest positive impact. But we remain confident that the 3 to 4% target that we've laid out for the full year is quite achievable.

John McMillin - Prudential - Analyst

Now, was pass-through a little bit bigger -- in the old days, when you were here at Kraft the first time, it was all about volume and maybe wouldn't have been pleased with the 1% volume gain, a little over 1%. But the -- the price mix was bigger than what I thought. I'm just wondering, to what extent a lot of that was pass-through, or as you indicate, protecting merchandising price points and some kind of shipments ahead of pricing? I guess what I'm really asking, were these sales numbers organic sales numbers in line with your expectations or slightly higher? Because they were slightly higher than ours and I'm just trying to understand the difference.

Irene Rosenfeld - Kraft Foods - Chairman, CEO

Well, I mean, we feel very good about the mix, the performance of mix in driving our overall revenue this quarter. Over time I'm hopeful that we'll continue to see continued contribution from volume. In the short term it's going to be a little bit depressed by some of the pricing actions that we're taking, and we're still doing some pruning in a couple of our core businesses, [inevitably] food service. But over time we're looking to see the combination of volume and mix driving that revenue number and that's what we believe will make it sustainable.

John McMillin - Prudential - Analyst

I wish you told me about that Oscar Mayer Deli Creations before CAGNY so I wouldn't have made my Imus-like statement. But I look forward to eating the product.

Irene Rosenfeld - Kraft Foods - Chairman, CEO

[LAUGHTER] Thanks very much, John.

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Operator

Thank you. Our next question is coming from Edgar Roesch from Banc Of America Securities.

Edgar Roesch - *Banc Of America Securities - Analyst*

Good afternoon. Thanks for taking the question. I guess I wanted to explore mix just a little bit more. I mean, last year you had a lot of SKU reduction and rationalization that helped that mix perform as well as it did. Just wondering if that was much of a contribution at all in this quarter?

Jim Dollive - *Kraft Foods - CFO*

Hi, I'll take that one. Mix certainly did benefit from some of that transition. But if you look at the mix component and in one of the schedules we do revenue, we do show that by segment. It was broad-based. So what we're seeing at the benefit of some of the new product initiatives and some of the other programs we're doing to drive the overall mix of each of the segments.

Edgar Roesch - *Banc Of America Securities - Analyst*

Sounds good. And just one other question on restructuring savings. The 75 million increment in the annual run rate that you achieved during Q1 was a pretty good step-up and accomplished a lot of the step-up that you will for the year. Is it going to be pretty front end loaded this year or was that just a Q1 phenomenon?

Jim Dollive - *Kraft Foods - CFO*

A lot of -- since these are event driven, a lot of it is sequenced by when those particular events unfold. In this case, we had the benefit of some of last year's costs showing up as savings in Q1. So it is -- it does tend to be a bit lumpy. We are on track to hit the cumulative number that we've given for the year. I feel pretty good about that.

Edgar Roesch - *Banc Of America Securities - Analyst*

Okay. Great. And thanks for the new layout on the releases. It's very helpful.

Irene Rosenfeld - *Kraft Foods - Chairman, CEO*

Okay.

Operator

Thank you. Our next question is coming from Kenneth Zaslow of BMO Capital Markets.

Kenneth Zaslow - *BMO Capital Markets - Analyst*

Can you talk about the specific initiatives Kraft is taking to change the direction of mainstream coffee and salad dressings? I think you touched on it for a second in the prepared comments.

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Irene Rosenfeld - Kraft Foods - Chairman, CEO

Well, actually, at this point, Ken, I touched on it only to say they continue to be challenges. As we look at some of the less favorable performances in this quarter, we had a couple of hold-overs from the back of 2006. Those are two of them, and I just want to assure you that we are hard at work in addressing those issues. It will be probably a couple of quarters before we're ready to share with you the solutions to them.

Kenneth Zaslow - BMO Capital Markets - Analyst

Would you share the solutions to the cheese or the cereal or any of that, just any specifics that we could take away? I think those were the weak ones, the salad dressings, cereal, cheese and salad dressings. Any of those that you could give us specifics now? Or no?

Irene Rosenfeld - Kraft Foods - Chairman, CEO

Well, I think, for competitive reasons, as you might imagine, I'm reluctant to share any specifics with you until we have begun to trade release some of these products. So we will certainly talk about them as quickly as we can. I think you've had a bit of a peak under the tent at some of the new items we've got coming out in cheese. We issued a press release about our -- what we're doing in terms of our FMI displays, and I think you'll start to see that we've got an exciting pipeline that will start to hit in late Q2, early Q3, and that's why I feel quite confident that we'll start to see those shares and strengthening in those category performances in the back half of the year.

Kenneth Zaslow - BMO Capital Markets - Analyst

Maybe I'm getting a little too excited about all of this, but if you can get the salad -- these four categories growing, and you're able to put a three plus organic sales growth number up, is there any reason that it wouldn't be incremental, that we could start to see a better growth number than your expected growth going forward? It seems like if you get these right, which are major categories, the top line sales growth could accelerate from current levels, even.

Irene Rosenfeld - Kraft Foods - Chairman, CEO

Well, I -- we certainly feel that we're off to a good start, Ken. But we're only at the beginning of a three-year plan. I've been quite clear in saying there is no quick fix. It's a broad portfolio. I think the early stuff is promising. But these initiatives are in the early stages, and I think as the year progresses we'll have a better sense of how quickly they're catching on.

Kenneth Zaslow - BMO Capital Markets - Analyst

And my last question is, on the pricing power, which category do you think Kraft has a better sense of being able to get pricing power and which categories do you think that you may take a hit on the commodities side?

Irene Rosenfeld - Kraft Foods - Chairman, CEO

Over time our intent is to improve the brand equity of all of our core categories, and I believe we've made some important strides over the last couple of years in terms of just overall closing of the base gaps as well as our investment in quality. So over time we feel very strongly that our intent is to be able to recognize and realize pricing opportunities across the portfolio.

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Kenneth Zaslowsky - BMO Capital Markets - Analyst

There won't be any categories that will lag on the pricing power?

Irene Rosenfeld - Kraft Foods - Chairman, CEO

Well, no. I think we're going to -- there are some that are stronger today, and as we make the necessary investments, they will then be in better position for us to be able to price them. So it will not all happen at once. But over time, our expectation is that by adding value to these core categories, that we will be able to realize the pricing opportunity.

Kenneth Zaslowsky - BMO Capital Markets - Analyst

Great. Thank you very much.

Irene Rosenfeld - Kraft Foods - Chairman, CEO

You're welcome.

Operator

Thank you. Our next question is coming from Eric Katzman of Deutsche Bank.

Eric Katzman - Deutsche Bank - Analyst

Hi, everybody.

Irene Rosenfeld - Kraft Foods - Chairman, CEO

Hello, Eric.

Eric Katzman - Deutsche Bank - Analyst

I guess my first question has to go to the point about kind of inflation and your ability to recover it with pricing. I mean, it's only one or two quarters ago where you were talking about how challenging the business is, and you're not right, and the new productivity is no where close, and yet, today, you sound as if the pricing is a layup, and that you're going to be able to cover the cost, and I'm just really surprised, given how cautious you've been in general since beyond the [Non-Diario] and the CAGNY, that it sounds like you feel pricing is quite doable. I'm kind of wondering why that is, given that the portfolio in the last few years really hasn't shown an ability to price up?

Irene Rosenfeld - Kraft Foods - Chairman, CEO

Well, let me make it very clear. We do not think pricing by any means is a layup. I think what we said earlier is that we believe that we can recover any of the commodity and some of the key input costs through pricing, much more readily than we were able to a couple of years ago. And I think we all feel very, very strongly about that. That doesn't mean that we do not need to make some necessary investments in a number of our core franchises, both in quality, as well as in building brand equity in the form of marketing support, as well as in terms of new product launches to be able to give us the opportunity to really realize the margin opportunity that can come with that.

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Eric Katzman - Deutsche Bank - Analyst

But again, Irene, in the core areas where you mentioned that there's cost inflation, coffee, Folgers is doing extremely well, in grains, you said you took a price increase and you lost volume in Oreo. I assume that was in the Nabisco portfolio. Any time you've taken a price increase in cheese, private label has held back and taken share, and you're telling us that the new product development on that stuff is a ways off. So I guess I just don't see how the two necessary -- I understand longer term, what you're trying to get to, but I'm not sure how shorter term those two go together.

Irene Rosenfeld - Kraft Foods - Chairman, CEO

Well, you know, again, Eric, I think as we start to look through the various categories in the portfolio, an example like Oreo is we did see an impact. There will be a bit of a lag. But we feel that that business will recover in a reasonable time frame. We've got a number of new cheese items, our Live Active line, our probiotics cheeses is coming out in the next couple of weeks. We've got our line of Kraft Selects that is a real premium offering, and we've got a variety of other new products that we believe are the kinds of items that will allow us to be able to add value and then realize the pricing opportunities. So, the ones we're talking about are categories that we feel pretty comfortable, we've got the programming and the necessary investments in place to be able to address them.

Eric Katzman - Deutsche Bank - Analyst

Okay. And then let me just switch subjects here on an area we haven't talked about, which is international. Maybe it's an impact from the United Biscuits acquisition in the EU, but those margins were very low, and I'm kind of surprised, given that you had a currency tail wind that was probably pretty significant on the earnings front, and I think most companies are now talking about Europe at least being a much better environment for branded product. So can you kind of talk a little bit more about why margins were less than 9% there?

Irene Rosenfeld - Kraft Foods - Chairman, CEO

Well, we certainly had some cost challenges in our EU business, which was a big part of the margin impact on the overall category. I think you're aware, green coffee has increased quite a bit and that played a very important role. But, over time, we've continued to look at the opportunity to look more broadly at how we can think about some of these portfolios in a broader way in an effort to be able to capitalize on some of the pricing opportunities that exist, particularly in the higher end of the pricing range in a lot of our core -- in core categories, particularly like coffee, the chocolate business we're seeing some good early success from some of the value added new products that we launched -- that we just launched, and we'll be able to realize the benefit, the margin benefit of that a little bit more over time. So, we did have some challenges in the first quarter, but we really do expect that over time the -- a number of the areas that we're working on are designed to allow us to be able to realize the margin opportunity from some of those categories.

Eric Katzman - Deutsche Bank - Analyst

Was there any United Biscuit mix shift in there? Negative? Or was that --

Irene Rosenfeld - Kraft Foods - Chairman, CEO

Very little.

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Eric Katzman - Deutsche Bank - Analyst

Very little. Okay. Thank you.

Irene Rosenfeld - Kraft Foods - Chairman, CEO

You're welcome.

Operator

Thank you. Our next question is coming from Tim Ramey of D.A. Davison.

Tim Ramey - D.A. Davidson - Analyst

Good afternoon. In the old days, Kraft had a new product development sort of funnel model where you talked about the percentage of sales that could be expected to come from new products. Have you reestablished that, Irene, and can you comment at all on the health of that new product funnel?

Irene Rosenfeld - Kraft Foods - Chairman, CEO

Jim, we've chosen not to use that as a metric, simply because that does not speak to the incrementality of that, and so everybody gets very excited about the fact that they've got a high percentage of new product revenue, and then all of a sudden you discover that your net hasn't -- your net top line hasn't increased. So, that's what we've been forcing the team to think about the aggregate impact of some of these new products. I think the challenge is to -- what's the best way to characterize that in a metric is one that we will continue to work on, because I think it would be helpful for you to have a better sense of how full is the pipeline. But I will tell you that I'm feeling awfully good about where we are, both in terms of our -- the investments that we're making to fix the base, as well as some of the opportunities that we're seeing in terms of broadening our frame of reference.

Tim Ramey - D.A. Davidson - Analyst

Okay. And just to kind of a follow-up on Eric's question a second ago, if you look at this quarter it was in microcosm similar to what's happened over the course of the last six or several years, sales rose, margins declined and investments were made in brands. At some point we've got to see an inflexion point on that. What causes that inflexion point and how close do you think we are to that point?

Irene Rosenfeld - Kraft Foods - Chairman, CEO

I would tell you I think as we've laid out our plan, it's going to take all of 2007 for us to begin to see the inflexion point, because we're making some very significant investments, significant, and I think necessary investments in some of the fundamentals of the business in order to not only get our base shored up in the short term, but importantly to plant the necessary seeds for some of the trajectory changing initiatives over the long-term. So I think some of the margin challenges that you saw in the first quarter are going to be with us for the full year, because of the investments that we're making. But our expectation is, as we head into 2008, as we had laid out, we expect to see our income growth exceed the rate of revenue growth.

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Tim Ramey - D.A. Davidson - Analyst

And just the final question, if we kind of look at \$1.50 or \$1.75, depending on whether we're looking at GAAP or operating, you pay \$1 dividend and you're going to spend a couple of bucks a share in share repurchase in cash each year for the next two years if you fully execute on your 5 billion. Back to that guns or butter question, you seem to be delivering butter. You seem to be delivering shareholder returns in the form of short term cash rather than long-term reinvestment. How would you answer that?

Irene Rosenfeld - Kraft Foods - Chairman, CEO

Well, we're trying really hard to be mindful of the fact that we want to be able to deliver shareholder value while we are investing in the business. And so we will continue to try to strike the right balance there. But at the end of the day, I believe our shareholders are looking for long-term sustainable growth, and the best way for us to do that is to make some of these investments in the near term. Both in the base business, as well as in some of these longer term growth initiatives.

Tim Ramey - D.A. Davidson - Analyst

Thank you.

Operator

Thank you. Our next question is coming from David Driscoll of Citigroup.

David Driscoll - Citigroup - Analyst

Great. Thanks a lot. Good evening, everyone. Irene, I would just like to talk with you about the incrementality idea. A couple of people have asked about new products, they're trying to get more detail. We've heard for quite some time about the bigger, better, new products idea. What I'm very curious about, your take, as you really have gone through the portfolio and talked to the new product teams, how do you guys judge the incrementality of new products you're about to launch? That's kind of question number one. Then, also right within the incrementality question would be the idea that, I assume that people in Kraft have been trying to be incremental with their stuff from day one for years now and it just hasn't been working. As evidenced by the margin declines that we've seen in the business. So really, why do you have confidence here that this is really going to turn around, when so many people have kept trying to do this and it just hasn't been happening?

Irene Rosenfeld - Kraft Foods - Chairman, CEO

I guess I'd give you a couple of thoughts here, David. I think, for starters, one of the reasons for us making the 3 to \$400 million investment is so that we don't have to rob Peter to pay Paul. One of the reasons that some of our new products were not incremental is because we funded them by taking money off of our base business to invest in the new product. I think the example I talked about quite a bit was Tassimo. We had lots of challenges on that business, but in particular, we did -- it did force us to take spending off of our base coffee business, and that didn't serve us well. The second opportunity, though, is to continue to push for more of these ideas to become broader platforms. And as you see some of the items that will be commercialized in the back half of the year, you will see that there is a whole pipeline that comes with them, as opposed to it being a single one-off kind of offering. And I believe those two things together is what will really allow us to have bigger ideas.

And I talked a lot about the things we need to do differently. We've always known what we needed to do. What we've been spending a lot of time doing is talking about how we're going to get it done. And I think that the investment and this focus on

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platforms is really the means by which we can make a lot of our new product ideas much bigger and therefore ultimately more accretive to our overall revenue performance.

David Driscoll - Citigroup - Analyst

Great. Thank you.

Operator

Thank you. Our next question is coming from Eric Serotta of Merrill Lynch.

Eric Serotta - Merrill Lynch - Analyst

Just wanted to touch on the issue of innovation one more time. It was as recent as October, as Eric mentioned, that you guys were talking about the disappointing state of the new product pipeline. You mentioned new products -- Jim mentioned them at several points in the discussion today. Could you give us your assessment as to how far you've come in terms of progress on the pipeline and how much further there is to go before you get it into what you would call a -- the funnel being full?

Irene Rosenfeld - Kraft Foods - Chairman, CEO

I guess I'd start by saying that the whole organization is very actively engaged in this task of reframing our categories, and I'm actually quite pleased by what we're seeing in that regard. We're making some good progress. We've got a number of good initiatives in terms of helping us identify quality upgrades and opportunities to invest, marketing support in a number of our categories that have had some long-standing issues. I think we're making some good progress in terms of broadening our frame of reference in our snacks business and the example I shared at CAGNY in our pizza business.

The reality though is that these new ideas are at various stages of validation with the consumer. And so it's far too early for us to declare a victory. I think the challenge now is how fast can we validate them and then how quickly can we commercialize them, and that will take some time, and that's why I keep suggesting that it will take through the back half of the year for us to really fully see the benefits of a number of these investments.

Eric Serotta - Merrill Lynch - Analyst

Okay. And on another issue, portfolio management, you did stress how you were looking to manage the portfolio within the context of leveraging scale. Have you done any segmentation of the portfolio along the lines of percent of sales or number of businesses that aren't currently generating returns on capital equal to or exceeding their cost of capital? Or is that not a way that you've been -- not a tool that you've been using?

Irene Rosenfeld - Kraft Foods - Chairman, CEO

Well, Eric, I tell you we are using a variety of tools, some of them the ones that you alluded to, all with an eye for identifying how best to manage the portfolio and which are the categories and the brands that we believe can be accretive to our long-term performance, and that will continue to be the framework that we're going to use to assess the future of our various businesses. We're going to continue to evaluate these brands and categories in terms of their fit with our overall performance.

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Eric Serotta - Merrill Lynch - Analyst

Okay. And is that a metric or are some of those metrics around that ones that you could share publicly as the quarters unfold?

Irene Rosenfeld - Kraft Foods - Chairman, CEO

I'd rather not get into the specifics, but I think, as you might imagine, it's the key metrics that really will help us to understand what we see as the long-term potential of these businesses to be accretive to our overall performance.

Eric Serotta - Merrill Lynch - Analyst

Okay. Thank you.

Operator

Thank you. Our next question is coming from Pablo Zuanic of JPMorgan.

Pablo Zuanic - JPMorgan - Analyst

Good afternoon, everyone.

Irene Rosenfeld - Kraft Foods - Chairman, CEO

Hello, Pablo.

Pablo Zuanic - JPMorgan - Analyst

Couple questions, Irene. First of all, regarding the Board of Directors, seems it's been the early changes that you have become the chairperson, should we expect any changes in the makeup of the board over the next 12 months? And related to that, when you talk to the board, how are they supposed to judge you in the near term? What are the metrics they are looking at? When you talk to them, do you tell them, judge me from March now when I started with my new marketing strategy or judge me from June when I joined the Company? The bottom line is you've been at Kraft now for 11 months. Help me understand that part and then I have a follow-up, Irene.

Irene Rosenfeld - Kraft Foods - Chairman, CEO

With respect to the board composition, Pablo, we have made, as part of our preparation for our independent, we made the necessary changes to our board to be able to have the number -- requisite number of independent directors and to be able to back-fill the seats that were vacated by a number of the representatives from Altria. We have appointed two new board members, one of whom we hope to elect at the upcoming meeting -- annual meeting next week, and we are now at our full compliment of independent board members, as well as the compliment that we feel very comfortable operating with. So I feel very good about the board, and I think it's working well together, and I think I feel very good about the support that I've received from them. I would tell you that just like every other employee at Kraft, I need to continue to prove my worth and I intend to continue to stay focused on that. I think some of the programs that we have laid out, and the plans that we've laid out, are designed to ensure that we are delivering shareholder value and that's what the board is very much holding me accountable for.

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Pablo Zuanic - JPMorgan - Analyst

Just to follow up, when you look at some of the initiatives that have been announced. I would argue that somebody might have inherited from Roger or Mary, the cost savings of 1 billion, the company the Roger started, wall to wall is something that Roger started, [inaudible] adjusting merchandise price points is something that Roger is [inaudible], quality initiatives at Tassimo is something that was tried around coffee and that's something that Roger started. Help me understand -- and obviously you are implementing your initiatives, but help me understand what is really new from the Irene Rosenfeld administration?

Irene Rosenfeld - Kraft Foods - Chairman, CEO

Well, at the end of the day, I think the focus is going to be our ability to deliver on our commitments. I think, once again, that's the way that you need to judge us. I feel very good about a lot of the work that was done over the last couple of years. I think it set us up well to be able to build on where we're going. But I think that single biggest opportunity that we have here is not about what needs to get done. That has always been undeniable. It's about going about getting it done. And I'm hopeful that as this year progresses, and as we see the results of over these next couple of years, that our investors will see steady progress in that regard.

Pablo Zuanic - JPMorgan - Analyst

One last one, Irene, if I may. You said before that [inaudible] Oscar Mayer is to follow and obviously you promoted [inaudible] to run North America. You must be very pleased with the performance of Oscar Mayer. From outside, I could make the following comment: The [innovation] of Oscar Mayer in the last five years has been Lunchables. And then, I look at what Sara Lee has done in less than a year, and they've launched Jimmy Dean Breakfast Sandwiches, Breakfast Skillets, Bowls, and I'm certainly other companies in this fashion, they launched package salads and their Hillshire Farm. We have a company with some what less track record and less scale and we've got the [inaudible] Oscar Mayer, and they've done a lot more in a shorter amount of time. So help me understand why is Oscar Mayer such success and what makes [inaudible] so special then?

Irene Rosenfeld - Kraft Foods - Chairman, CEO

I feel very good about our Oscar Mayer business. I think the revenue growth that we saw from our overall convenient meals was about 5%. I think it's a terrific model of what I would like to see across the Company, and a key driver of that performance has been a number of our new products from the Oscar Mayer group, which includes our Deli Shaved Meats, our Deli Creation Sandwiches and we've got a pretty robust pipeline as you'll see as the year unfolds. So I feel very good about the progress that we're making, and as well as the steps we've taken in terms of improving the overall nutritional profile of our Lunchables business, which has contributed to its performance. So I feel very good about where we are. And as I said before, I feel that it is a very good model for what I would like to see happening more broadly across the North American business and around the world.

Pablo Zuanic - JPMorgan - Analyst

Irene, the very last one here, since [inaudible] margins you have said to 7 and 8 should be the inflexion point and we should see an improvement there. When you look at the different levels, what's going to be the main driver? Is it going to be mix? Is it going to be recovering premiums, [inaudible] the brands? Is it going to be the cost cutting? I know it's all of the above, but which would be the main driver would you say that you're focusing on as a way to get margins back up in '08 and after that going forward?

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Irene Rosenfeld - Kraft Foods - Chairman, CEO

I would say our key drivers, Pablo, are volume and mix.

Pablo Zuanic - JPMorgan - Analyst

Thank you very much.

Irene Rosenfeld - Kraft Foods - Chairman, CEO

You're welcome.

Operator

Thank you. We have time for one final question which is coming from Steven Kron of Goldman Sachs.

Steven Kron - Goldman Sachs - Analyst

Great. Good afternoon. Thanks for taking the question. Irene, if I could just go back to the pricing and market share for a second, and certainly should Kraft be successful in driving the innovation in the brand support that you're talking about, no doubt pricing power will improve. As we think about things today, on the one hand you caution us that things will take time, and on the other hand we're looking towards pricing coming up to offset commodity cost inflation at a time when market share in more than 50% of your categories are still eroding. I guess to extend that thought, how are you thinking about the balance of kind of protecting margins versus protecting market share here? And taking that one step further, maybe you could just talk about the pricing strategy? Because it almost seems as though you're taking price to offset commodity costs as opposed to taking price in categories where you feel as though you're further along on the curve in the innovation cycle that can handle the price.

Irene Rosenfeld - Kraft Foods - Chairman, CEO

Well, first of all, Steven, most of the pricing actions that I've described have been announced already. So it's not -- we've taken them. And as we said earlier, some of that -- the impact was offset by some of the precise projection we did for some of our Easter merchandising as well as some of the investments that we made in new products. So, that's pretty much behind us. The opportunity really is the marketing behind those categories that will come out as the year unfolds and that will be the key driver of our ability to regain our share. But our focus is on regaining our share. As I said at the outset, we're not where we want to be. We're not where we intend to be. But some of the challenges, on the share side in particular, are issues that really were lingering from the back half of 2006 and so it will take some time to be able to work -- to be able to launch the solutions that will address those issues.

Pablo Zuanic - JPMorgan - Analyst

Okay. And then just a follow-up, Jim, can you talk a little bit about how you're thinking about kind of the capital structure now that you're kind of free and out of under Altria and talk about leverage and kind of the prioritize the use of cash and capital, be it share repurchases, acquisitions and dividends and things like that?

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Jim Dollive - Kraft Foods - CFO

Well, we really haven't changed dramatically other than how we go about doing it. Because the first priority has been driving the growth, because ultimately that's going to longer term drive shareholder value. We now have the opportunity to be more aggressive on returning cash to shareholders through things like our share repurchase program, and certainly we now have the ability with our balance sheet to take on more leverage to do just that.

Pablo Zuanic - JPMorgan - Analyst

Okay. And if I could, just one last thing, on the margin front, the 120 basis point decline, you touched on marketing, you touched on input cost. You have a systems investments in there as well. Is that the ASP rollout in North America?

Jim Dollive - Kraft Foods - CFO

Yes it is.

Pablo Zuanic - JPMorgan - Analyst

And how far along are we on that investment at this point?

Jim Dollive - Kraft Foods - CFO

That's a multiple year investment. And we'll see most of the step up this year, and then it will be just continuing to spend at sort of an elevated pace for a while.

Pablo Zuanic - JPMorgan - Analyst

Okay. Thanks very much.

Operator

Thank you. I'd like to turn the floor back over to Management for closing remarks.

Irene Rosenfeld - Kraft Foods - Chairman, CEO

Just like to say in sum, this was an eventful quarter for the Company. Our transition to an independent company was seamless. Our people are energized and hard at work to get the Company growing. We met our performance expectations and we're beginning to execute our strategies for long-term growth. I am confident that we're moving in the right direction, and though I'm encouraged by our early progress, as I've said on a couple of occasions, it will take time to restore Kraft to predictable consistent growth. I thank you, and we look forward to updating you in the coming months.

Operator

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

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