

Kraft Union Network

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There's always something going on at Kraft Foods...
Kraft to split itself in two

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Kraft CEO Spent Billions Preparing to Dismantle

By PAUL ZIOBRO, DAVID KESMODEL and JOANN S. LUBLIN

Irene Rosenfeld, chief executive of Kraft Foods Inc., is best known for her epic battle to take over Cadbury PLC, during which she faced down Kraft shareholder Warren Buffett and weathered an outburst of British nationalism.

After Thursday, it's more likely that she'll be remembered for assembling a behemoth with \$50 billion in annual sales in order to split it in two.



We believe scale will be an increasing source of competitive advantage both in confectionary and in the food industry at large.

Irene Rosenfeld, January 2010,

Taking our performance to the next level requires a bold new approach: creating two great companies that can optimize value by focusing on their unique drivers of success.

Irene Rosenfeld, August 2011

The deals never stop at Kraft foods. On the road to moving from “one of the world’s largest food and beverage companies” to a “global snacks powerhouse”, Kraft in 2007 paid USD 7.2 billion, to acquire Danone’s European biscuit operations, borrowing cash it didn’t have. Kraft steadily raised dividends while closing over 35 factories and eliminating over 20,000 jobs, squeezing out cash through closures, spinoffs and outsourcing. Cost-cutting, layoffs and divestitures fueled more dividend increases and paved the way for even more debt to power the USD 19.5 billion cash-and-share acquisition of UK-based Cadbury in 2010.

“Scale”, “supply chain leverage” and marketing “synergies” were the rationale for the Cadbury deal, trotted out in innumerable press releases and conference calls with investors.

Synergy and scale yielded to “focus” on August 4 this year, when Kraft announced it would split the corporation into 2 independent publicly traded companies, both headquartered in North America: “A high-growth global snacks business with estimated

revenue of approximately \$32 billion and a high-margin North American grocery business with estimated revenue of approximately \$16 billion. The company expects to create these companies through a tax-free spin-off of the North American grocery business to Kraft Foods shareholders. Global snacks will consist of the current Kraft Foods Europe and Developing Markets units as well as the North American snacks and confectionery businesses. The North American grocery business would consist of the current U.S. Beverages, Cheese, Convenient Meals and Grocery segments and the non-snack categories in Canada and Food Service.” (source: Kraft press release)

According to Kraft, this was *a/ways* the plan: On August 4, The Financial Times reported CEO Rosenfeld saying “... that she and the board had been considering the split since 2007 when it acquired Danone’s LU cookie business. Rather than being an about-face, the move was a ‘validation’ of the company’s strategy.”

In the investor call following the announcement of the split, Rosenfeld said "There's not a lot of overlap in selling and distribution between our two businesses." This much is true: there were never many “synergies” to be gained from the Cadbury deal, whose logic was always purely financial. The distribution and marketing run primarily through



September 8, 2011 – BCTGM members at the Kraft bakery in Richmond, Virginia hold an informational picket in support of BCTGM members in Norcross, Georgia whose jobs were transferred to a non-union third party operation run by Excel, the US subsidiary of Deutsche Post/DHL.

distinct channels: In North America, snack products are primarily delivered direct-to-store, grocery products from warehouses. Kraft has been steadily outsourcing its warehousing and logistics systems without waiting for alleged “synergies” from the Cadbury deal (see Kraft Foods cutting jobs and stealing severance pay from BCTGM members <http://cms.iuf.org/?q=node/1098>). And ongoing restructuring and outsourcing of Kraft’s European logistics have scarcely been constrained by low growth in North American groceries. As part of the cost-cutting program following the Cadbury acquisition, for example, hundreds of Kraft employees in France were transferred to FM Logistic earlier this year.

Splitting the Brands

Snack Foods

Oreo, Chips Ahoy, Fig Newtons, SnackWell's, Nilla wafers, Mallomars

Nabisco crackers including Ritz, Triscuit, Teddy Grahams, Honey Maid, Premium saltines, Planters nuts, Cheese Nips, Easy Cheese, Wheat Thins, Nutter Butter

Toblerone chocolate, **Milka** candy bars, **Cadbury**, Green and Black's

Trident/ Dentyne gum


Halls

Sour Patch Kids, Swedish Fish

Tang

Lu biscuits

Jacobs coffee

 = 'power brand' with revenue over USD 1 billion – note the two coffee brands on both sides of the split!



Grocery Division North America

Kraft macaroni and cheese

Stove Top stuffing

Kraft, Velveeta and Cracker Barrel cheese

Philadelphia cream cheese

Maxwell House coffee

Kool-Aid and Capri Sun drinks

Deli brands including **Oscar Mayer**, Louis Rich, Lunchables, Deli Creations, Claussen pickles

Jell-O

Cool Whip

Miracle Whip

Bull's Eye barbecue sauce, A-1 steak sauce, Grey Poupon mustard

Vegemite

Kraft has discarded the language of “size” and “scale” for the language of “focus”, confirming that *the logic of the split is purely financial*, not operational, i.e. the same opportunistic logic which drove the Cadbury acquisition. Apart from doping the share price of the newly independent snacks company, there is nothing that Kraft can't do equally well, or equally poorly, as a single company – including letting the market value its shares based on performance.

Kraft claims the split is tailored for two distinct groups of investors: those seeking higher returns through rising stock valuation will have the candy, crackers cookies and gum snacks division (with coffee thrown in for Europe!); the cash-rich, higher-margin grocery business is for investors looking for steady dividends.

Bloomberg

PepsiCo Poised for 49% Gain Imitating Kraft Breakup: Real M&A

September 21, 2011, 4:46 PM EDT

By Duane D. Stanford, Devin Banerjee and Tara Lachapelle

Sept. 21 (Bloomberg) -- PepsiCo Inc. shareholders stand to reap a 49 percent gain if Chief Executive Officer Indra Nooyi splits the soft drinks business from snack foods, joining a wave of breakups from Kraft Foods Inc. to Tyco International Ltd.

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Cycles of Empire

Kraft is not alone in splitting or seeking to split into two. French-based hotelier Accor, driven by two private equity funds which had ramped up their stake in the expectation of driving up share prices and then cashing out, last year split its voucher business from the slower-growth hotel operation (see Demerging Accor – less than the sum of its parts? On the IUF’s Private Equity Buyout Watch

http://www.iufdocuments.org/buyoutwatch/2010/05/demerging_accor_less_than_the.htm l#more). In the foods sector, Sara Lee has pursued the same strategy. PepsiCo

informed the authors of the Bloomberg article above that “The combination of our snack and beverage portfolios creates significant value for our shareholders through synergies driven by a common customer base and distribution platform, supplier leverage and shared infrastructure.” At the same time, the company is fuelling speculation by publicly musing on the possibility of a Kraft-style split.

The spin cycle is endless. Kraft sold cereal maker Post Foods (number 3 in North America) to Ralcorp for USD 2.7 billion in 2008 to raise cash for acquisitions. Ralcorp, having failed to sell it to other food companies or to private equity funds, announced on September 19 that it would split itself into two companies... in order to “unlock value for shareholders.” Post will do the branded products while Ralcorp will focus on private label production.

Edward Jones analyst Jack Russo, quoted by Bloomberg, says “*You go through these cycles where you build empires and you break them apart. We’re going through a cycle where the investment bankers are convincing companies smaller is better and the sum of the parts is worth more than the whole.*”

The bankers

Investment bankers have been feasting on an endless round of Kraft deals ever since Kraft was spun off from Altria in 2007. According to a Reuters article published on January 19 last year (“Sweet fee prize for Kraft and Cadbury bankers”

<http://uk.reuters.com/article/2010/01/19/uk-cadbury-fees-idUKTRE60I48N20100119>)

7 banks “will split an estimated fee pot of around \$100 million for advising on Kraft Food Inc's takeover of Cadbury PI, giving merger bankers their first big pay day of 2010 as they look forward to an increase in deal activity.” On the Cadbury side, Goldman Sachs, Morgan Stanley and UBS split an estimated USD 50-56 million, while Kraft advisors Lazard, Citygroup, Centerview and Deutsche Bank shared between 53 – 58 million. Additionally, a group of 9 banks pocketed USD 26-32 million for arranging the USD 9 billion bridge loan that funded the cash-and-share purchase.

The Wall Street Journal has identified two of the gang which helped Kraft swallow Cadbury and are now advising the company on how to spit it out tax-free: Centerview Partners and Goldman Sachs (Kraft Breakup: Big Win for the Bankers <http://blogs.wsj.com/deals/2011/08/04/kraft-breakup-big-win-for-the-bankers/>). The WSJ refers to the third member of the advisory troika, Evercore, as a “serial breakup artist.”

Clearly, financial “advisors” stand to benefit enormously from positioning themselves in the endless deal cycle. These are the same people who issue the “buy”, “hold” and “sell” calls.

Fast-moving consumer goods, fast-moving investors

Ownership of Kraft stock is similar to that of other large US-based food and personal product companies, with roughly three-quarters of the shares held by large institutional investors (pension funds, mutual funds, banks, insurance companies etc.). Kraft's share ownership in comparison with its peers, however, shows an exceptionally high degree of concentration among the largest shareholders. Over the past half year, and the past three months in particular, the five largest shareholders have (with the exception of Warren Buffet's Berkshire Hathaway, who famously called the Cadbury deal “dumb”) have been increasing their share of the company.

Equity Ownership KFT

Funds		Institutions					
Name	Ownership Trend Previous 8 Qtrs	Shares	Change	% Total Shares Held	% Total Assets	Date	
Capital Research Global Investors	Premium	110,830,154	13,117,647	6.30	1.52	06/30/2011	
Berkshire Hathaway Inc	Premium	99,467,624	-5,746,960	5.66	6.69	06/30/2011	
State Street Corp	Premium	85,877,461	5,952	4.84	0.52	06/30/2011	
Capital World Investors	Premium	73,120,321	11,857,000	4.16	0.88	06/30/2011	
Vanguard Group, Inc.	Premium	64,409,176	275,611	3.66	0.35	06/30/2011	
BlackRock Institutional Trust Company NA	Premium	41,266,528	-381,387	2.35	0.37	06/30/2011	
Wellington Management Company, LLP	Premium	39,144,090	124,321	2.23	0.49	06/30/2011	
Franklin Mutual Advisers, LLC	Premium	28,037,319	-2,586,263	1.59	2.97	06/30/2011	
Invesco Advisers, Inc	Premium	24,423,419	510,957	1.39	0.67	06/30/2011	
Pershing Square Capital Management, L.p.	Premium	22,230,989	-8,276	1.26	12.23	06/30/2011	
Total: Top 10 Top Institutions	Premium	588,807,081	17,168,602	33.44			

Source: <http://investors.morningstar.com/ownership/shareholders-overview.html?t=KFT>, viewed September 30, 2011

Comparison with the figures from close 2010 in the following chart shows the trend.

Top Institutional Holders* (Shares in Millions)		
Name	Shares*	% of KFT**
Berkshire Hathaway Inc.	105.2	6.0%
Capital Research Global Investors	97.7	5.6%
State Street Global Advisors (U.S.)	83.9	4.8%
Vanguard Group, Inc.	62.5	3.6%
Capital World Investors	60.3	3.4%
BlackRock Institutional Trust Company, N.A.	55.0	3.1%
Wellington Management Company, LLP	43.2	2.5%
Franklin Mutual Advisers, LLC	35.5	2.0%
Invesco Advisers, Inc.	26.2	1.5%
Jennison Associates, LLC	22.8	1.3%

*As of December 31, 2010 per 13F filings
**Based on shares outstanding as of January 31, 2011

Stock markets have become increasingly volatile as shares trade hands with increasing rapidity, high-speed trading increasingly dominates and institutional investors like pension funds struggle to keep their portfolios “balanced” in response to huge market swings. Over and above this growing volatility, “activist investors” flash across the

turbulent investment stratosphere like moneyed meteorites, blazing in their pursuit of quick gains and then disappearing (cash in hand) as they enter the atmosphere.

As the war for Cadbury heated up, short-term traders and hedge funds acquired as much as 40% of the company. When the deal closed, short-termers owned some one third of Cadbury stock, including a 3.4% stake belonging to Nelson Peltz’s Trian hedge fund.

Pelz had earlier staked out a large position in Kraft beginning in 2007, eventually winning two seats on the board. By the end of the second quarter last year, Trian had dumped all its Kraft stock, only to begin building a second large stake in the company this year. Lured by steady cash flow, Trian has been an active investor in food companies like Heinz, taking stakes, shaking up boards, squeezing out gains through dividends and share buybacks and then cashing out, leaving the workers to inhabit the wreckage. In parallel with Trian’s return, Pershing Square Square Capital Management had pushed its share in Kraft to 1.3% by the middle of this year..

On August 5, the Wall Street Journal linked the timing of Kraft’s August announcement of the breakup to pressure from these two leading “activists” (Activists pressed for Kraft spinoff

http://online.wsj.com/article/SB10001424053111903454504576487720348267828.html?mod=WSJ_Deals_MIDDLETopStories), stating that Trian had signaled its intention to publicly demand a split in September.

The outlook

Inside Kraft, some executives thought the company was spending too much money to market and advertise its slower growing grocery business, said another person familiar with the matter. Separating grocery would allow it to be run on a cash-flow basis and operate more like H.J. Heinz Co., Campbell Soup Co. (CPB) and Kellogg Co. (K), with a focus on cutting costs.

Kraft Foods Chief Rosenfeld Says More Acquisitions Possible After Spinoff
Bloomberg, August 4, 2011

<http://www.bloomberg.com/news/2011-08-04/kraft-foods-to-spin-off-north-american-grocery-business-retain-snack-unit.html>

“...The Northfield-based company's all-American brands have stalled and can no longer depend on the families that made Kraft Macaroni & Cheese and Jell-O pantry staples to buy them at a pace and price that will satisfy shareholders. Instead, Kraft will create a new snack-driven company that will rely on customers in places like India and Brazil to buy Cadbury chocolates and Oreo cookies. It will then manage the cash-focused grocery company for margins and shareholder dividends.

Kraft jettisons U.S. brands so global snack biz can fly higher

<http://www.chicagobusiness.com/article/20110806/ISSUE01/308069982/kraft-jettisons-u-s-brands-so-global-snack-biz-can-fly-higher>

Because Kraft's financial reporting presents consolidated accounts for the grocery and snack products, there is a huge element of guesswork in imagining the capital structure of the two newly-independent companies. One analyst quoted in the Bloomberg article cited above "... estimated that the snack business would be valued at a multiple of 13 times earnings before interest, taxes, depreciation and amortization, while the grocery business would be valued at about 8 times Ebitda."

Kraft's insistence that they are not "abandoning" US consumers and that they will continue to invest in innovation etc. in the grocery business rings hollow in the light of past performance. Production of "iconic American brands" like Fig Newton cookies has long since been outsourced to Mexico. Investment at Kraft, as a percentage of the company's gigantic cash flow, has been declining steadily. Outsourcing and relentless cost-cutting in both snacks and grocery have substituted for investment, and earnings per share – the key criterion for investors in the company's stock - has only been boosted through regular selloffs. Without the sale of Post (2008) and the frozen pizza business (2010) to Nestlé, market analysts would have been screaming for even more blood, despite the fact that Kraft remains consistently profitable. Financial markets demands more and more.

In 2006, with USD 55.54 billion in assets, capital expenditure at Kraft was USD 1.16 billion. In 2009, after acquiring Lu, assets stood at 66.72 billion but capital expenditure was a paltry 1.33 billion. In 2010, the year they bought Cadbury, assets amounted to

95.21 billion, capital expenditure was 1.66 billion. In North America, no one can remember when Kraft last made a major investment in plant or equipment. Spending on research and development (“Kraft will continue to invest in our iconic brands”) has also lagged consistently behind both revenue growth and growth in assets. Kraft net revenues increased by some 27% in 2010 over the previous year: while 2010 saw an absolute increase in r&d as a result of the Cadbury deal, the percentage increase was on the order of 22% - far below sales growth.

Kraft bought Cadbury, not for its European operations, which also confront the same investor impatience with low-spending recession-strapped consumers as the North American grocery business, but as a platform for expanding snack food operations in countries like India and Brazil. In India, following the Cadbury acquisition, Kraft is promoting sales of its Oreo biscuits, yet production is entirely outsourced to a third party manufacturer - Bector Food Specialties’ in the northern state of Punjab – which doesn’t employ a single permanent worker. (<http://cms.iuf.org/?q=node/1033>) Kraft foods has no manufacturing operations in the country, nor has it announced plans to invest in facilities of its own. At the same time, Kraft continues its relentless cost-cutting in Europe, where Belgian workers at the chocolate factory in Halle are opposing plans to shift production eastwards and eliminate substantial numbers of jobs (‘Belgian’ chocolate in Europe fares no better than “iconic American brands’ in the USA). This is the operational model for the “focused” snacks company to emerge from the breakup.

Health and safety: the price of squeezing more out of less

On June 30 this year, the US Occupational Safety and Health Authority (OSHA) listed Kraft Foods as a “severe violator” of workplace safety standards as a result of a fatal crushing accident at a Chicago Nabisco facility.

In September, OSHA again cited Kraft for 12 “serious” violations concerning chemicals and other hazards at the Oscar Mayer facility in Madison, Wisconsin.

“OSHA’s inspection identified deficiencies in the company’s process safety management program, a detailed set of requirements and procedures employers must follow to proactively address hazards associated with processes and equipment that involve large amounts of hazardous chemicals. Nine of the serious violations involve failing to comply with the requirements of the process safety management standard.

“The three remaining serious violations involve failing to provide guardrails to protect workers from fall hazards, comply with the ‘lockout/tagout’ standards for the control of hazardous energy and provide proper machine guarding. A serious violation occurs when there is substantial probability that death or serious physical harm could result from a hazard about which the employer knew or should have known.

“Northfield, Ill.-based Kraft Foods Inc. has been inspected by OSHA more than 100 times nationwide in the past five years, including eight times at the Madison facility. Additionally, Kraft was cited in 2002 for process safety management violations and failing to control hazardous energy after a worker died following exposure to anhydrous ammonia in 2002.”

(http://www.osha.gov/pls/oshaweb/owadisp.show_document?p_table=NEWS_RELEASES&p_id=20733)

Sorting out the debt: size matters

Since Kraft has regularly taken on huge debts to finance its acquisitions, a substantial portion of revenue has to be used to finance interest on borrowed money. Kraft’s credit rating is currently just a notch above “junk” status, meaning that interest is high, including the cost of borrowing to finance short term operations like managing inventory, taking supplies etc. (so-called “commercial paper”).

“Bondholders are trying to determine how Northfield, Illinois-based Kraft will manage \$23.4 billion of long-term debt as it separates its divisions making Velveeta cheese and Oscar Mayer hot dogs for US consumers to focus on selling Oreo cookies and Cadbury chocolates worldwide”, Bloomberg reported on August 9 (Kraft must slash debt to avert downgrade”, <http://gulfnnews.com/business/retail/kraft-must-slash-debt-to-avert-downgrade-1.849008>)

“Most of the debt isn't going to be able to travel to the new company, so they're probably going to have to put some new debt on the grocery business,” said Joel Levington, a managing director of corporate credit at Brookfield Investment Management in New York.”

Just how much debt is dumped on the newly independent grocery division will go a long way to determining just how much harder Kraft workers are squeezed, over and above the current cost-cutting and dividend gouging. Bondholders aren’t the only ones who should be concerned: revenue in = interest out is not a formula favoring workers.

“By repaying the \$6.2 billion of debt the company has coming due in the next year, Kraft’s international snacks business could have debt of 4.3 times Ebitda, a “crossover-type” ratio straddling investment-grade and junk, Mui wrote.

“That compares with leverage of 3.98 times as of June 30, Bloomberg data show. A total of \$11 billion of debt reduction would result in leverage of 3.5 times Ebitda and likely prevent a downgrade, he said.

“Nestle SA, the world's largest food company, has 1.25 times more debt than Ebitda and ratings of Aa1 from Moody's and AA at S&P, while leverage at PepsiCo, which is rated Aa3 by Moody's and A at S&P, was 2.2 times last quarter, Bloomberg data show.”

Another expression of the debt burden on revenue/profits – and on workers – is the interest coverage ratio, the percentage obtained by dividing earnings for a given period before interest and taxes (EBIT) by interest expenses. The lower the ratio, the greater the interest squeeze; a higher ratio means a greater revenue buffer. At the end of 2006, Kraft's interest coverage ratio stood at 7.58; by the end of 2010, it was 3.95 – a 91% increase in the interest burden. By comparison, snack food competitor PepsiCo, which borrowed heavily last year, saw its interest coverage ratio go from 21.36 to 10.12 – indicating heavy borrowing but a greater capacity to buffer their margins, permitting big dividends against which Kraft's performance is automatically benchmarked.

What next?!

Kraft has given itself one year to prepare the split and bring it to market. CEO Rosenfeld has “not ruled out” acquisitions in either of the two divisions, but, as we have seen, cash flow at the company is under pressure from both investors and creditors (in the form of interest). If, as is likely, a disproportionate amount of the current debt is lodged with the grocery division, there will be even greater pressure to divest. The scramble for cash leaves virtually all of the company's current grocery brand portfolio potentially up for sale in order to launch the split, reward investors and prepare the next move...



In both the new companies, therefore, workers can anticipate continued attacks on pensions, jobs, employment rights and bargaining. Ensuring union successor clauses guaranteeing maintenance of terms and conditions in any company sold is an absolute union imperative. Kraft's strategy relies on squeezing dividends out of Kraft grocery, and growing the share value of the snacks company through Increased outsourcing/contract manufacturing and casualization. International trade union resistance is essential.



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