

## Kraft Foods Group

## This Was the Rorschach Test of Quarters -- Staying Neutral as Uncertainty Still Reigns

**Neutral**

KRFT, KRFT US

Price: \$44.57

Price Target: \$47.00

Kraft reported 3Q12 yesterday and provided sufficient fodder for a variety of interpretations to be made. Bulls can point to an improving gross margin and solid organic sales growth excluding SKU pruning. Bears can point to the inventory load and the muted 0.4% sales growth figure ex-pruning. Our view is that while the quarter was probably more or less in line with expectations, we find it difficult to draw solid conclusions given how many moving pieces were floating around. This uncertainty, plus the fact that the Street is already well ahead of guidance for next year (we think the \$2.70 consensus may need to come down), lead us to maintain our Neutral rating.

- **What the bulls may have seen.** 1) The top line beat, up 3.0% versus the Street's 1.6% forecast. 2) The gross margin was much better than expected, at 33.3% excluding hedging gains versus last year's 30.9%. 3) Guidance was maintained for next year, suggesting that management's visibility remains clear. 4) Volume and pricing rose simultaneously. 5) The quality of the quarter seemed solid, with ad spending and the SG&A margin up.
- **What the bears may have seen.** 1) The top line was up only 0.4% excluding pruning. 2) The gross margin was helped a great deal – though the amount is unclear – by the trade load. 3) Commentary about 4Q12 was not necessarily positive, with management pointing to tough comps, the flip side of the inventory load, more product pruning, and higher costs.
- **What we saw.** We appreciate that fundamentals were okay during the period, but they were not great and we still are unsure if Kraft can drive sales growth as high as it wants without pruning even more items. (We do not necessarily agree with the company that voluntary SKU pruning should be excluded from sales growth numbers, even if that pruning is broad in nature.) Overall, the organic top line of 0.6% excluding the load was just so-so in our view. Yet as for the gross margin, even if one penalizes KRFT the full \$40MM in costs for the inventory load that the company cited, the margin still rose by a lot, so this is a positive indicator. In all, we see both sides to the story at this point and there remains so much uncertainty and complexity to numbers (the company could not provide guidance for the quarter that is nearly half over) that we think both the bulls and bears have valid arguments when analyzing the quarter.
- **Reducing estimates slightly.** Our 2013 and 2014 EPS estimates drop slightly to reflect what may be slightly greater cost headwinds next year than we initially modeled (on a variety of line items).

## Kraft Foods Group, Inc. (KRFT;KRFT US)

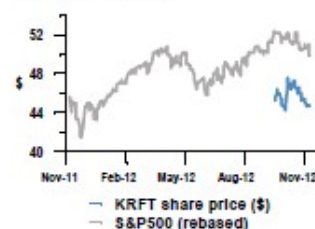
FYE Dec	2013E (Prev)	2013E (Curr)	2014E (Prev)	2014E (Curr)
EPS Reported (\$)				
Q1 (Mar)	0.61	0.69	0.66	0.73
Q2 (Jun)	0.68	0.74	0.80	0.85
Q3 (Sep)	0.76	0.64	0.84	0.72
Q4 (Dec)	0.59	0.57	0.67	0.64
FY	2.64	2.63	2.95	2.93

Source: Company data, Bloomberg, J.P. Morgan estimates.

## Food Manufacturing and Retail

J.P. Morgan Securities LLC

## Price Performance



	YTD	1m	3m	12m
Abs	-1.2%	-4.3%	-1.2%	-1.2%
Rel	-12.1%	-0.1%	-0.7%	-11.8%

## Company Data

Price (\$)	44.57
Date Of Price	07 Nov 12
52-week Range (\$)	48.00 - 42.00
Mkt Cap (\$ mn)	26,385.44
Fiscal Year End	Dec
Shares O/S (mn)	592
Price Target (\$)	47.00
Price Target End Date	31 Dec 13

## See page 4 for analyst certification and important disclosures.

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