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Mondelez International, Inc. (MDLZ) CEO Dirk Van de Put on Q3 2019 Results - Earnings Call Transcript

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Q3: 10-29-19 Earnings Summary

Press Release *10-Q* *Slides*

EPS of $0.64 beats by $0.04 | Revenue of $6.36B (1.07% Y/Y) beats by $9.17M

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Mondelez International, Inc. (NASDAQ:MDLZ) Q3 2019 Earnings Conference Call
October 29, 2019 5:00 PM ET

Company Participants

Shep Dunlap - VP, IR

Dirk Van de Put - Chairman and CEO

Luca Zaramella - CFO

Conference Call Participants

Andrew Lazar - Barclays Capital

Chris Growe - Stifel Nicolaus

Dara Mohsenian - Morgan Stanley

Ken Goldman - JP Morgan

Steve Strycula - UBS

Jason English - Goldman Sachs

David Palmer - Evercore ISI

Nik Modi - RBC Capital Markets

Robert Moskow - Credit Suisse

Operator

Good day, and welcome to the Mondelez International Third Quarter 2019 Earnings Conference Call. Today's call is scheduled to last about one hour, including remarks by Mondelez management and the question-and-answer session. [Operator Instructions]

I'd now like to turn the call over to Mr. Shep Dunlap, Vice President, Investor Relations for Mondelez. Please go ahead, sir.

Shep Dunlap

Good afternoon, and thanks for joining us. With me today are Dirk Van de Put, our Chairman and CEO; and Luca Zaramella, our CFO. Earlier today, we sent out our press release and presentation slides, which are available on our Web site mondelezinternational.com/investors.

During this call, we'll make forward-looking statements about the company's performance. These statements are based on how we see things today. Actual results may differ materially due to risks and uncertainties. Please refer to the cautionary statements and risk factors contained in our 10-K and 10-Q filings for more details on our forward-looking statements.

As we discuss our results today, unless otherwise noted, we will be referencing our non-GAAP financial measures, which adjust for certain items included in our GAAP results. In addition, we provide our year-over-year growth on a constant currency basis unless otherwise noted. You can find the comparable GAAP measures and GAAP to non-GAAP reconciliations within our earnings release and at the back of the slide presentation.

In today's call, Dirk will give you an overview of our results, as well as progress update against our strategic priorities, then, Luca will take you through the financials and our outlook. We'll close with Q&A.

With that, I'll now turn the call over to Dirk.

Dirk Van de Put

Thank you, Shep, and good afternoon everybody. We are pleased to report another quarter of strong top line growth, continuing the momentum of the first-half of the year. As you know, a year ago we launched our new strategy, which intended to accelerate our growth by focusing on the consumer, driving operational excellence, and building a winning growth culture. Today's results are proof that this strategy is working well, and that we're making progress against our goal to create attractive, long-term sustainable growth. So, let's take a look at the quarter in more detail.

We reported revenue growth of 4.2% in the third quarter, which confirms the strength of our snacking fundamentals around the world, as well as the leadership role that our portfolio of global and local brands plays in snacking. The growth was high quality, and driven by a good balance of volume mix and pricing. It was also broad-based geographically. Our emerging markets grew 6.6% or 5% ex-Argentina, and we are encouraged by what we are seeing in markets such as Russia, India, China, as well as Southeast Asia. Our developed markets grew 2.9%. Europe reported strong volume-driven growth in key markets like Germany and the U.K. And in the U.S., we saw continued revenue growth and share gains, which was driven primarily by biscuits.

Our strategy to invest more in our growth initiatives is paying off, resulting in solid operating income growth. Our adjusted EPS growth was 10% for the quarter, and we're also pleased with our year-to-date cash flow of $1.2 billion. As we look across our business units we're seeing evidence that our strategy is creating the basis for sustainable future growth. This is driven by a renewed focus on the consumer, which is informing everything we do, and it inspires and also motivates our teams. So while the entire organization is focused on driving top line growth, we remain true to our culture of cost discipline so that we can ensure that top line growth generates attractive OI dollar growth.

This focus is leading to impactful growth initiatives across our business in key markets and key channels, as well as on our local and global brands. For instance, we're winning in growth channels in both developed and developing markets. In the U.S., this means capitalizing on growth opportunities like discount and club outlets. While in China we achieved new distribution milestones this quarter, we reached 1.5 million outlets with our biscuit products and one million outlets for our gum. And in ecommerce, another example, this means a continued global expansion through our partnerships with e-tailers and online platforms. Our reported growth in ecommerce for the quarter was 25%.

Another area to highlight are our local jewels, local brands that are also contributing to our growth. A few examples that stood out in Q3 are the Jubilee biscuit brand in Russia, the iconic Prince Polo brand in Poland, and for instance, Biskuat in Indonesia. All these are performing well thanks to renewed investment and focus. A big priority for us this year has been to reinvigorate our marketing approach. One manifestation of that focus is what we call our new marketing playbook that gets to the root of what makes our brand special. Our intention is to drive clarity in brand positioning and consistency in execution. We've applied this playbook to many of our global brands, and we'll be rolling it out across more brands in the future.

As a result of this renewed focus, we're seeing some good examples of brand equity campaigns that enhance our connection with consumers. In the U.K., for instance, where our growth was particularly strong this quarter, our latest edition of the Cadbury Dairy Milk Generosity campaign is performing really well. While we are driving growth, we remain very focused on our operational excellence. For instance, in marketing we've seen solid improvements in our return on investment in digital, while in our supply chain we continue to focus on productivity and process improvements. Good examples here would be the digitalization of our procurement function as well as the reduction of waste in our North American network.

Around the world in our different business units, we are trying to reach best-in-class execution. In EMEA, for instance, we are leveraging our significant sales and distribution capability in key markets like India and Southeast Asia to win in seasonals. As an example, our seasonal gifting offerings performed well during the Hindu celebration of Rakhi in India, or as another example this year, Mid-Autumn mooncake season was particularly successful across Southeast Asia with Kinh Do and even Oreo-branded mooncakes selling really well. Local adaptations of our global brands or the success we're having with culturally relevant seasonal offerings underscore the power of our more locally oriented model.

Another strong example of this is the work we are doing in China with our Stride gum brand. Here our approach is to personalize our marketing to Chinese consumers, and it is working well, helping us win with Gen Z consumers through mainly digital spend. Finally, we continue to make good progress with our more agile innovation approach and our SnackFutures initiative. Our focus is on emerging trends and technologies in wellbeing and premium products. As an example, we've recently reached an agreement with a key supplier to explore the use of cocoa fruit by introducing those parts of the fruit into the food chain that have thus far been discarded. A product using this ingredient was developed in record time and put into the market in a very limited distribution to see how it will perform.

This sort of an approach is very different from the innovation approach that we had in the past. I'm also very proud of the progress we are continuing to make on our sustainable and mindful snacking strategies. Creating durable growth also means looking after our planet and the people who contribute and consume our products. This quarter, we were again recognized by the Dow Jones Sustainability Index, and improved our rating for environmental reporting. This is just one example of how we're brining to life our sustainable snacking strategy, which is our commitment to grow our business the right way.

Another example is how we are using a new methodology focused on science-based targets to help us further reduce our end-to-end CO2 emissions. Finally, I want to mention the work we're doing to respond to the wellbeing needs of our consumers. We are working on offering the consumer the right snacks which can mean different things to different consumers. The options are ranging from smaller portion size formats, what you could call permissible indulgence, to better-for-you products which are made with authentic and simple ingredients or with a particular functional nutritional characteristic. A good proof point was our recent commitment in the U.K. to ensure that all our products that are made for parents to offer to their children are less than 100 calories per serving. I'm quite proud of this move, and know that we will have more to share in the future.

And with that, I will hand it over to Luca.

Dirk Van de Put

Thank you, Dirk, and good afternoon. As you can see on slide nine, we delivered strong performance across a number of key metrics. Our third quarter growth was notable for both its quality, which was broad-based, as well as for the balance of volume and pricing. During the quarter, we drove growth on a variety of fronts. We delivered strong results in three of four regions. Global brands grew mid single digits, while local brands continued to accelerate with growth in line with overall categories, and this growth was high quality, as it was driven by a balance of volume and pricing. Finally, this happened on the back of strong category growth, which we have driven.

We also delivered solid increase in gross profit and OI dollars along with 10% EPS growth. Productivity and cost savings initiatives provided the fewer for approximately $85 million of business investments through the first three quarters. That was cleansing our brands, our go-to-market positions, and saves and marketing excellence for future years. Finally, Q3 marked another good quarter of free cash flow generation, which continues to be a key priority. We generated $1.2 billion through Q3, and are on target for a full-year outlook of $2.8 billion.

Turning to slide 10, our scale, reach, and expertise in emerging markets are clear assets for our company. We continue to drive robust volume-driven grow in key countries like China, India, Southeast Asia, Russia, Mexico, and Africa. In aggregate, emerging markets grew approximately 7%, marking the fifth consecutive quarter of growth greater than 5%. Excluding inflation-driven growth in Argentina, emerging markets grew 5%. Developed markets also performed very well during the quarter with revenue growth of nearly 3% driven by strong volume-driven results out of Europe and North America, where we saw a combination of volume mix and pricing increases.

Now, let's review our profitability performance on slide 11. In the third quarter, we increased gross profit by 2.6%, which in turn translated into solid OI dollar improvement with volume leverage, pricing, and cost savings, partially offsetting investments, primarily in route-to-market capabilities. It is important to note that our profitability results are consistent with our goal of higher quality and sustainable growth. When excluding Brazil, which is dealing with margin headwinds related to supply chain transition and powder beverage category weakness, our business is growing volume mix by more than 2%, growing gross profit dollars faster than revenues, enabling incremental investments across A&C and go-to-market, and growing operating income dollars faster than revenue on a year-to-date basis.

Moving to regional performance on slide 12, Europe delivered another excellent quarter with 5% revenue growth. The U.K. was a standout with double-digit revenue growth in the quarter. Germany, Russia, and the rest of Eastern Europe also posted strong results. Europe continues to demonstrate sales and marketing excellence with particular strengths in our chocolate franchises, where all of our top brands deliver volume and revenue growth. Consistent with Q2, the Philadelphia business turn in very good results, driven by targeted investments, and great sales and marketing execution. Adjusted OI dollar grew by 6% in Europe due to robust sales and volume leverage, alongside ongoing investments, partially offset by higher A&C.

AMEA grew 5.3%, showing continuous trends across much of the region. India grew double-digits behind strong execution, and an attractive market backdrop. We continue to perform well in chocolate, while building out a more meaningful biscuits business that represents a large opportunity for us. China grew just shy of 10%, driven by another well-executed quarter in both biscuit and gum. The team could show the power of our new local first commercial approach that empowers speed, agility, and consumer-centric decision-making. Southeast Asia grew mid-single digits with solid results in biscuits and chocolate. AMEA increased operating income dollars by 10% due to leverage from top line growth, partially offset by continued increases in investment in high growth potential markets.

Latin America grew 4.3% due primarily to inflation-driven growth in Argentina. Revenue declined 1.5%, excluding Argentina. Mexico grew mid-single digits driven by strong execution in candy, while Brazil posted a decline, mostly due to softness in powder beverages driven by category decline and some share losses. We expect to see some volatility in this category in the coming quarters. Adjusted OI dollars in Latin America declined by approximately 13%, primarily due to volume losses in powder beverages, as well as the plant consolidation issues in Brazil that caused additional waste and logistical costs. We are continuing to work through these issues, and expect to see progress in Q4, though still somewhat wins on an absolute basis.

Finally, North America grew 2.5% in Q3, led by another solid quarter in U.S. biscuits. We grew share in biscuits as Oreo, Ritz, and belVita, all delivered strong results. Improved commercial execution and innovation, share gains in alternative channels, and more consistency in supply chain help dye these results. We remain committed to sustaining our improved performance in the region. The North American region grew OI by almost 5% due to effective pricing and waste reduction with pricing and volume mix providing fuel for marketing investments.

Let me spend a moment on categories highlights. Our three snacking categories continue to demonstrate some fundamentals, with total category growth of 4% on a year-to-date basis. We remain encouraged by the health of our categories, and believe they can continue to sustain growth of approximately 3% over the long-term. In many geographies, we were a key driver of the category growth. This includes areas such as U.S. and China biscuits, India, U.K., Russia, and Germany chocolate, and China gum. As we mentioned before, specifically chocolate is benefiting from a prolonged Easter season and the subsequent halo effect on overall consumption. These tailwinds accounts for almost one percentage points of overall category growth. Overall, we held or gain share in 65% of our business, which is consistent with our second quarter and evident of an improving trend over the past year. This resulted in overall flat shares for Mondelez.

Our biscuits business grew 4.1%. Approximately 75% of our revenue grew or held share in this category, including our U.S., China, and India businesses. In chocolate, our business grew 6.4%, approximately 65% of our revenue grew or held share, including the U.K., Australia, and Russia. Gum and candy revenue grew slightly. About 35% of our revenue in this business gained or held share, including strengths in China, France, Brazil, and Russia gum.

Now, turning to EPS on slide 18. Q3 EPS grew 10% in the quarter. This growth primarily reflected operating gains driven by strong revenue results income from the JV equity and the tax benefits in the quarter.

I'll now move on to our free cash flow results on slide 19. We delivered year-to-date free cash flow of $1.2 billion, which is an improvement over the last years through Q3 due to continued progress in our cash conversion cycle, lower cash restructuring, and CapEx. We remain well-positioned to deliver on a full-year target, and feel good about our ability to make improvements over the coming years. I wanted to also mention that we continue to thoughtfully manage our balance sheet, and leverage, and cost of debt. In September, we raised approximately $2.5 billion in new financing at attractive rates to refinance debt matured in late October.

Turning to capital deployment on the next slide, we have returned 2.3 billion to our shareholders through the first three quarters.

Moving to our outlook, we are increasing our full-year organic net revenue growth expectations to 3.5% plus. This reflects our strong year-to-date results, which included the benefit of a longer Easter season. These dynamics do not extend into Q4, and as a result, we are not expecting Q4 growth at the same level as the first three quarters of the year.

We are also increasing our outlook for adjusted EPS growth to 5% to 7%. As a reminder, in Q4 we expect to lap significant favorability in the equity income line related to our JDE investment due to the impact in Q4 of 2018 from an enacted tax rate reduction in the Netherlands. Please note that when estimating adjusted EPS we apply 5% to 7% outlook to the prior year basis of $2.42, then adjust for the expected impact of currency, which we anticipate to be circa $0.14. We expect underlying profit performance to be comparable with the profile so far, where volume leverage upsides and gross profit increases will be partially reinvested in growth initiatives. Additional geopolitical disruptions or other disruptive events, including the hard Brexit are not anticipated within this EPS outlook.

We now expect to spend approximately $1.5 billion for the full-year on share repurchases as we acquire the perfect snack business, and then managing overall leverage thoughtfully. We repurchased a little over 200 million of shares in Q3 to bring our year-to-date amount to more than 1.1 billion, and continue to repurchase shares at current levels. We remain committed to returning meaningful capital to shareholders and share repurchases continue to be an important component of our capital return program. We will continue to operate with a disciplined approach which aims to optimize results for continuing shareholders and allows for flexibility based on market conditions. Finally, our free cash flow expectations remain unchanged.

With that, let's open the line for questions.

Question-and-Answer Session

Operator

[Operator Instructions] And your first question comes from the line of Andrew Lazar with Barclays.

Andrew Lazar

Good afternoon.

Dirk Van de Put

Hi.

Luca Zaramella

Hi, Andrew.

Andrew Lazar

Hi, there. Two questions if I could. First, the updated full-year organic sales guidance of 3.5%-plus, as you mentioned, suggests perhaps a sequential deceleration in 4Q. Can you explain some of the puts and takes on that, particularly in light of the accelerated global category growth, I know you mentioned Easter, but wanted to know if there were some other things playing into that as well? And then second, Mondelez did discuss the challenges in Brazil on the supply chain last quarter. Feels like things maybe got a bit more challenging in 3Q. Could you talk about your visibility there, why you think you've got your arms around it, and perhaps you can parse out how much of the impact of third quarter was really supply chain versus some of the other headwinds in Brazil, like powdered beverages and such? Thanks very much.

Dirk Van de Put

Okay. Well, maybe I'll start with looking at the top line, and then maybe Luca can discuss Brazil. The first thing I would like to say is that the strategy is working well. We are pleased with our progress. We see good momentum in the business; we are delivering on and above our goals. Everything we put in motion a year ago about consumer-centric organization and increasing our speed, execution, and results, it's all working out probably faster than we expected. And in this quarter we saw some quality net revenue growth and also year-to-date as it relates to volume mix and price. The mix between developed markets and emerging markets or between global and local brands as the balance is there.

And the category is strong, as you pointed out, Andrew. In many cases it's driven by us since we play -- we're a major player in the categories. And yes, we do have some challenges in Latin America, but otherwise our overall performance from net revenue through gross profit into OI is a very healthy equation, and it shows that the top line growth we're having combined with the cost discipline is working out for us. We did call up our full-year outlook to 3.5%-plus net revenue growth and an EPS of 5% to 7%. That means that, yes, we expect that Q4 will be a little bit lower. I would say, as you pointed out, Andrew, the first thing to keep in mind is the longer Easter season that we have this year, which will have an effect or lessen -- no affect in Q4, if I can say it like that.

In Q3, we also lapped the heat wave we had last year in Europe which was beneficial to us, so that had a benefit. And so in Q4 we will not see any of these benefits. And overall we feel that our categories are somewhere between 3% to 4% growth, not fully the 4% that we saw in Q4. And we think that the categories will go back to a normal growth rate of around 3%-plus as we've been seeing all the time in reality. As it relates to 2020, we continue to see big opportunities for us to keep on driving the categories to improve our market share and increasing our investment in our brands, in our capabilities, but we have to remain a little bit mindful again about Brexit, which didn't happen this year, but it will have an affect or potential on the first quarter. We'll give you a full outlook on 2020 when we report the Q4 earnings, but I would say, yes, that's the way we're looking at Q4 right now.

So, Luca, may be a bit on Brazil.

Luca Zaramella

Yes, let me maybe just start by saying that Brazil for us is a large and complex market. We have clearly a big portfolio in there that spans pretty much across all the categories that Mondelez competing globally. We have a good set of global and local brands. And as you say, entering Q3 we had a material negative impact that was anticipated for the most part, and this negative impact quite frankly explains the entirety of the profit shortfall that we had in LA in the quarter versus last year. As you said, the issues are two-fold. As we discussed in the last quarter, some plant closures caused transition issues. We ended up line startups that were delayed and we faced extra cost. We ended up scrapping more products than we wanted to. And in addition to that, we had some extra logistics cost. I would say this first issue accounts for pretty much half of the material profit gap we saw in the quarter in LA and in Brazil, as I said.

And the second issue is about powdered beverages, which is a material category for us both in terms of top and bottom line. The category itself is quite challenged at the moment, and our shares of market are declining. The declining trend accelerated a bit in Q3 versus what we saw in the first part of the year. And that resulted in revenue and profit shortfalls, also compounded by the fact that in a declining category and share environment we had to take out some trade stock in the quarter. So we're working on both fronts. And we are making good progress and with our supply chain. But as we said very clearly in Q3, we will still have some impacts in Q4, but the issue should get materially better as we enter 2020.

For PBs, the issue is a little bit more accentuated, and it will take some time for us to address both the category and the share decline dynamics. I would also like to take the opportunity that you provided with your question to reiterate a couple of things. Despite, as I said in my written remarks or recorded remarks, the materiality of the issues in Brazil, and the fact that we are lapping the highest gross margin in Q3 last year, our virtuous cycle is working. GP, NOI are both growing sort of 4% on a year-to-date basis. As I said, when you take out Brazil gross margins, NOI margins are both up on a year-to-date basis. We are delivering the volume leverage and SG&A leverage as we planned.

We continue with cost discipline. I think you see in the quarter a good number for SG&A. That number includes an increase in A&C, but the embedded ZBB behaviors we have are delivering savings. And all of these quite frankly gives me confidence that the model is working, and that we will deliver on our long-term ambition to grow OI and GP more than revenue. So, not ideal what we saw in Brazil in the quarter, but in the big scheme of things when you strip it out I think the model is working and the long-term algorithm we have in mind is safeguarded.

Operator

And your next question is from Chris Growe from Stifel.

Chris Growe

Hi, good evening.

Dirk Van de Put

Hi, Chris.

Chris Growe

Hi. I just had a first kind of high level question. As you think about the strategy and executing your new strategy and your playbook for the business, I'm just curious how that's developing sequentially, so maybe not quarter-by-quarter, but just like, are you moving on to different types of investments, have you made a lot of the initial investment you wanted to make, is this moving more now to marketing new products? Just trying to get a sense of how that's playing into this stronger revenue growth barring some of the unique things that occurred this quarter?

Dirk Van de Put

Yes. Maybe first of all it's a multiyear investment program. We are probably flowing less of our gross profit next year than this year into investments, but we want to keep on increasing our investment year-after-year. And this year, the investment was focused on an increase in our A&C, and increase in route-to-market investments, and to R&D, so innovation. So, Luca was talking about this virtuous cycle, which we want to continue. If I look at what that means for us going forward, I do not expect substantially these investments to change. We do have still areas of the world where we should be putting more and see investment in our brands, particularly the local brands which are accelerating, but they are yet not always on the right level of investment. We still have big route-to-market opportunities, if I think about China, India, where we have to go in third and fourth tier cities. And we for several years we want to be keep on investing, and you can imagine the same for places like Southeast Asia or Africa, where we need to keep on doing that.

And then in R&D, we do want to continue to push on more agility and faster speed, and maybe a little bit less in the years to go forward than we did this year, but it's going to be largely the same three buckets that we are going to invest in. I would also say that apart from increasing our investment, we are also moving more of the investment within A&C into working media. And on top, we are trying to drive the ROI of our marketing spend. We've done things like consolidations of our agency, which drives value and gives us a more consistent quality globally, and we are also working quite hard on our point of sales execution investment, which we will continue next year. So, maybe a long answer to just point out where we are investing and the fact that we see that's continuing, it's working for us, and we feel that there's still a big upside in continuing to do so.

Luca Zaramella

Yes, I --

Chris Growe

Go ahead, Luca.

Luca Zaramella

I will comment for a second. All of this is contemplated in the mid single-digit guidance for OI growth that we gave you at Investor Day and the high single-digit EPS growth that again we gave you at Investor Day.

Chris Growe

Going forward. Thank you, guys. Okay. And just one other question, if I could, which is the pricing is coming through this year, would you say that is offsetting cost inflation? So, if we think about pricing net of costs, your -- that's sort of not a factor on the gross margin here, is that the right way to look at that?

Luca Zaramella

Yes, I think it is. I'm particularly pleased about the fact that our top line is in the quarter off volume enough pricing. I think it varies a little bit by region. Clearly, we see pricing more pronounced in emerging markets and in North America, where the inflationary pressure has been a little bit higher than in Europe. Europe growth is mostly driven by volume. I think you see AMEA with combined strong volume growth and pricing. I'm happy to report clearly that North America has returned to volume growth this quarter.

So, overall, we really like the algorithm. It is more volume-driven in developed markets, where margins are higher, and emerging markets, in relative terms, we see a little bit less volume and more pricing which again we like. So, in the big scheme of things, it is quite balanced and it is offsetting the inflationary pressure. We see quite frankly, though, that is also because we covered our commodity and ForEx exposure quite well. So I don't want to hint to any pricing going into next year, but if we have to mark-to-market, our commodities and ForEx impact would be a little bit higher than what you see in the P&L at the moment.

Chris Growe

Okay. Thank you for the color. That was helpful.

Luca Zaramella

Thank you, Chris.

Dirk Van de Put

Thank you.

Chris Growe

Thank you.

Operator

Your next question comes from Dara Mohsenian with Morgan Stanley.

Dara Mohsenian

Hey, good afternoon, guys.

Dirk Van de Put

Hi.

Luca Zaramella

Hi.

Dara Mohsenian

So first, just a clarification, Luca, on the Brazil issue, this just sounds like it'll linger in Q4, are you expecting a similar magnitude in Q4 relative to Q3, and then it's really next year when you start to see that drag dissipate? And then second, in the U.K., obviously very strong momentum in the quarter, double-digit revenue growth, can you give us a bit more detail on what drove that strength in terms of market share versus category growth? And some CPG companies have noticed a bit of slowdown around the Brexit uncertainty even though it didn't ultimately come to fruition this month. So, have you seen any impact there so far in Q4, expecting any deceleration going forward? Thanks.

Luca Zaramella

Yes, maybe I'll comment on Brazil, a little bit on the U.K., and the impacts in here. So, on Brazil, the biggest impact that's been, you know, actual highest in both Q2 and Q3 that will still be an impact in Q4, but the impact will be substantially lower. Importantly, as we enter next year, the supply chain related issues should be fully solved or almost entirely sold. I think we will still see some issues related to powder beverages and competitiveness of Mondelez in that category. Remember in Q1, it is summertime, and so there is a big consumption. So, there might still be some PB, our powder beverage related issues in Q1.

In U.K., I think we are quite frankly heating on all cylinders, the chocolate category is up, it is on the back of a hot summer last year, and the fact that Q3 was quite hot. So, there was a market de-cap, but importantly we're gaining share. Dirk alluded clearly to, or actually said that in Q3 the execution of Cadbury Dairy Milk and the campaign with Cadbury Dairy Milk Generosity is working very well, and we have seen material share gains. So, we are executing quite well around chocolate, but I would also say, around biscuits, which is the other good category. So, we are very pleased with the execution in that market.

Dirk Van de Put

And I would add that at this stage we cannot talk about any slowdown as it relates to Brexit worries, as the numbers testified. So, we don't see -- at the moment we're preparing for it, of course, but we also believe that our categories, the snacking category is not necessarily going to go big swings up and down as consumer sentiment goes up and down. So, we hope that we will be a little bit protected from big consumer sentiment changes.

Dara Mohsenian

Great. Thanks, guys.

Dirk Van de Put

Thank you.

Operator

Your next question comes from Ken Goldman with JP Morgan.

Ken Goldman

Hey, good afternoon, everybody.

Dirk Van de Put

Hi, Ken.

Luca Zaramella

Hi, Ken.

Ken Goldman

I wanted to -- I know you're not willing to talk about 2020 specifically yet, but you have bought Brexit a couple of times, and I just wanted to ask how you think about either including or excluding any potential impact from Brexit in your guidance, and some companies have said, "You know what, there's no way we can quantify it. So, when we think about the out years, we're just not going to even try." And other companies who said, "No, maybe we should bake in a little bit of risk into our guidance just in case." I am just trying to get a sense of where you guys are on that spectrum, if you even consider that yet?

Dirk Van de Put

Yes, at a larger scale I would say you can say we are really in the first part where we cannot really quantify it, we don't know what type of Brexit it will be. And so, we have not included the larger effect of Brexit into our thinking, but we always include which we will also do for 2020 is the short-term Brexit disturbance that you could have at the borders, where we need to increase our inventories. We need to book more transportation. We need to stock up our raw materials and packaging, and so on. That we have always done, and that we will continue to do, and that's included in our forecast, but if we would be a hard for Brexit with a devaluation of the bounds and a big consumer reaction, that is not included for us.

Ken Goldman

Thank you. And then follow-up is, at Andrew Lazar's conference recently, you talked about Oreo's distribution, not being good enough in U.S. C-stores. I always thought, and I think you guys have always thought, it's a pretty big opportunity that is not necessarily being capitalized on now, but I didn't get a sense of what moves you're making necessarily to improve Oreo in C-stores, whether you're going to use your DSD system to gain distribution and so forth. I just wanted to get a better sense of sort of what the strategy, and maybe some of the tactics are along those lines?

Dirk Van de Put

Yes, first of all, I can say that in the background, there's a lot of work going on as it relates to Oreo in C-stores. It takes a while, we have to test our approach, see if it works. So, next year, we're expecting to make bigger strides as it relates to that. Just to clarify, our DSD does not work in the C-store channel. Obviously it's a system that works in the supermarket channel for us. So, we are not planning at this stage to use our DSD system for that, but we do have the right route-to-market setup, and we are building up the right programs and relationships with the clients, and we're expecting that next year we will show some significant progress.

Luca Zaramella

And I think if you look at the market and share for C-stores, I think we are having not as high as the opportunities yet, but we are gaining sharing in C-stores in biscuits as well.

Ken Goldman

Great, thank you.

Luca Zaramella

Thank you, Ken.

Operator

Your next question comes from Steve Strycula with UBS.

Steve Strycula

Hi, good afternoon.

Luca Zaramella

Hi.

Steve Strycula

So, Luca, a quick cleanup question on the gross margin, excluding Brazil, I think last quarter, you called it out as a $25 million to $30 million profit drag to the line, how should we think about the context specific to Q3? And then I have a revenue question follow-up?

Luca Zaramella

I think it is round about the same number, it is in the ballpark. I think clearly one of the components as I called out it is in relation to PBs, powder beverages, and some de-stocking we had in that category. But when you look at all the numbers excluding Brazil, you really see that the shape of the P&L is good, and as I said, particularly on the year, now we're spending the fact that in Q3 will not be the highest gross margin last year, particularly on a year-to-date basis, you see that virtuous model predicated on volume growth coming into fruition.

Steve Strycula

Great. And then, Dirk, can you walk us through some of the bigger chocolate markets, where Mondelez entered the last few years, but not necessarily has scaled pretty big into specifically China and the U.S.? What's your latest thinking about what the near, medium, and long-term opportunity is for both those markets? Thank you.

Dirk Van de Put

Yes, so both markets are a little bit the same for us. We entered largely from what I would say as an opportunistic approach, trying to carve out as big a niche as we can. That would lead to a market share somewhere between 1%, 2%, may be 3%, best case. We were always aware of that. I would say now that both markets have very significant players here in the U.S. and in China that we would be up against. So, we didn't want to have sort of a major strategy or a major approach. We wanted to just capture the opportunity that we have, largely using Oreo as a brand. So far we have captured what we were planning to get, but we are not planning on pushing that into other brands or a major chocolate approach. We feel that we have other opportunities around the world, which are more -- which are biggest, and give us a better return, and we want to focus on both first before we want to enter those two big chocolate markets around the world, or increase our presence in those two big chocolate markets in China and U.S.

Steve Strycula

Okay. Thank you.

Dirk Van de Put

Thank you, Steve.

Operator

Your next question is from Jason English with Goldman Sachs.

Jason English

Hey, good evening, folks.

Luca Zaramella

Hi, Jason.

Jason English

Jeez, we've covered a lot of ground so far. So I always wanted to -- I guess I'll bring us back to that gross margin question to build off of Steve's prior question. I appreciate that you are up against a larger year-on-year comp, but just looking back over history, your gross margins aren't made meaningfully different between the second quarter and third quarter. Yet this quarter, they sequentially fell by around 90 bips, but it sounds like a fairly comparable Brazil supply chain issue. I'm not trying to make a mountain out of a molehill here, but can you just help us understand a little bit more what the drivers are of that sequential step-down? And how many of them are durable in nature, and which ones may dissipate with time?

Luca Zaramella

Yes. I'm Luca. If you really look at percentages, I think on a year-to-date basis, we are under about 40%. I think we closed last year at 40.2%. So if we really want to dissect to the decimal points, yes, we are few decimal points behind. I don't think, Jason, there is anything structural besides Brazil. And Brazil again, as I dissect the issue, there is part of it that is going to persist to a certain extent into next year, and it is the powder beverage part of it. On supply chain, we should be fixed. I think as you look at all the components of the gross profit delivery, volume leverage is there. I think when you look at the volume mix that is 2%, that is a good number, I think that provides material leverage both into the GP line and the overhead line, and I think we see it coming into fruition.

In terms of pricing, last year, we announced a couple of ways of pricing in the U.S. market, and I think as you look at the biscuit market specifically, you see volume and value going up. In that context, we are gaining share. I think in emerging markets, we clearly have the pricing discipline that is required. And quite frankly, it is a little bit more sophisticated than going out and announcing big price increases. It is leveraging the full array of pricing tools that we have, including previous optimization, promo intensity, price spec architecture, and as I answered before, if I look at the composition of the commodity and ForEx inflation, and the pricing, we have taken business unit by business unit, I think we did a good job in both emerging and developed markets. And productivity, it is a little bit lower than in the past years, not because gross productivity isn't there, it is there, but we are facing a little bit more inflation on the labor front and the logistics costs.

So, as I dissect the gross margin components, and I take myself in a context where I say, "Okay, Brazil is a little bit of an outlier. Do I see us having material issues on price net of commodities, productivity, volume leverage?" The simple answer is "No." I think the one point is mostly attributable to Brazil, it is attributable to the fact that in Q3 last year, the number was higher than the rest of the year, 40% with Brazil embedded into the number, I don't think it is for us something that we should worry structurally about. I think, having said that, we need to continue working well on delivering volume on getting the productivities and pricing in line with inflation we see in the marketplace.

Jason English

Very well, thank you for the fair response. I appreciate it. I'll pass it on.

Luca Zaramella

Thank you, Jason.

Operator

Your next question is from David Palmer with Evercore ISI.

David Palmer

Thanks. Good evening.

Dirk Van de Put

Hi, David.

Luca Zaramella

Hi.

David Palmer

Hi, Dirk. In the past, you've talked about that country level approach to management and one outcome would be that the local powder brands would be getting more marketing support, could you talk a little bit about that, and how's that going, are your country level managers spending more on those local brands as you had planned, and are you getting a return on that investment in terms of accelerated local brand growth? Any numbers on that would be helpful. And I have a quick follow-up.

Dirk Van de Put

Yes. Well, the short answer to your question is, yes, they are spending more on the local brands, and yes, we're getting a return on that, and also, we're seeing an acceleration of the growth. So if I look at our local brands, for instance, in '18 they would have grown around 1%, year-to-date '19, they're growing about 3.5%, and they were even higher in Q3. So we clearly see the effect on our brands and we feel that we're getting a good return. Of course, we want those local brands to grow in line with the markets and they're about there, but there is still we feel the opportunity to keep on investing more. An example would be a brand like Pacific in China, which is very local brand, which is adapted to local flavors, biscuit brands, and it also has a health and wellness connotation. So that plays well, we're revamping LU in Belgium and France. And there's a number of these brands around the world which we think we need to really offer a full portfolio to our consumers. And again, to answer your question, clearly, yes, we have seen very clearly an effect on our local brands and it's working well.

David Palmer

And related to that, I would have thought by now, there'd be more of those bolt-on takes like acquisitions around the world, beginning a wish list, as you get that country level approach, and they're seeing stuff that is more relevant for them in a country level, and then you'd be getting that wish list and would be building up by now and that inorganic growth would be becoming a bigger part of the story. Do you think that that could happen at some point that we start to see more and more bolt-ons as they look to add to the inventory of brands?

Luca Zaramella

Yes, yes. We are constantly evaluating, I would say largely in our bigger markets, what are the opportunities for us to do bolt-on acquisitions. Of course in the first place, we want to invest in our own local brands. But if we see a clear gap in the market and sorting the snacking landscape as we lay it out, and the brands fits their like differences this with recent acquisition of Perfect Snacks here in U.S., protein bar refrigerated largely based on nuts. That is something we don't have growing very fast. So, as we see these opportunities around the world, we are clearly engaging, we try to be disciplined. And so we only will do it when it makes financial sense for us and on top, we see a large runway towards becoming a significant brand. We do not want to buy brands that in the end will not be of significant volume and net revenue to make a difference for us, but yes, again the answer would be yes. And hopefully in the coming quarter, we will see the effect of that.

David Palmer

Thank you.

Operator

Your next question comes from Nik Modi with RBC.

Nik Modi

Thanks. Good evening, everyone.

Dirk Van de Put

Hi Nik.

Nik Modi

Dirk, maybe hi, how are you? Maybe you could just answer two quick ones. The first is just latest thinking on DSD, just wanted to get your latest state of the Union on that. And then the second is, really talking about the breakfast occasion, as well as savory snacking and kind of how your initiatives in those areas are working and what we should be expecting, if you have any big opportunities over the next few quarters? Thanks.

Dirk Van de Put

Okay. Maybe on the DSD, as we said in the past, we think DSD for us is a strength. It allows us to have a better customer service and a fuller presence, if I can call it like that in the store. And we've been very pleased with our performance of our DSD in U.S., and we've seen important market share gains and we're pushing the category. Obviously, the way we think about our DSD system is as we acquire some of these bolt-on brands, we're expecting to bring them over time onto our DSD system. And we've been testing that, we want to test very carefully and we do not want to do it overnight, but some of the tests we've been doing putting some of those new brands on our DSD system have been highly successful. And so as we go forward, you will start to see us putting things like campaigns on our DSD across the U.S., which will be a big boost to the test brand.

So we remain very committed to DSD and we have a clear executional expectation of how DSD will perform for our current brands. But we also see a big opportunity to bring some of our new brands onto our DSD system. As it relates to the breakfast occasion, do you mind repeating what you were alluding to Nik because I didn't fully understand it?

Nik Modi

Yes. I'm just trying to get a sense; obviously those are two important opportunities of growth for the company. So just wanted to understand what your - how those businesses performed this quarter and are there any big initiatives that we should be looking at for the next few quarters?

Dirk Van de Put

Well, the brands that we are positioning on the breakfast occasion is belVita. BelVita is a biscuit that gives you a sort of a slow release of energy, gives you a four hour energy. It's a brand that's performing quite well and it's a mid-single digit growth at the moment, doing quite well particularly in the U.S. Our evolution for belVita is to offer it in more different forums going into a soft cake for instance, going potentially into bars and gradually expand the range of belVita to make it a fuller breakfast offering not only in U.S. but around the world and potentially also take the brand into mid-morning snacking, which could also be very interesting, and I think the brand has a credentials not only from a branding perspective, but also from the active ingredients to make that happen. That's really our focus for the breakfast occasion for us.

Nik Modi

Excellent. Thank you. Okay.

Operator

Your next question is from Robert Moskow with Credit Suisse.

Robert Moskow

Hi. Thank you.

Dirk Van de Put

Hi.

Robert Moskow

I just wanted to -- this year is characterized as one of reinvestment, so I think people are going to look at the SG&A decline as a percentage of sales as a sign that this quarter didn't get the reinvestment as you normally would give to the business, but then again, you've been very clear that ex-Brazil, there was a reinvestment and the model was working. So can you kind of confirm that this missteps in Brazil didn't result in any kind of lower spending elsewhere around the globe that you knew the profit was coming in weak in Brazil, but that maybe - you cut the spending a bit in Brazil, but not elsewhere. And then secondly, a question on powdered beverage is about $400 million in sales that was just my desk estimate here in Brazil.

Dirk Van de Put

So, to your first part of the question, we didn't comp anywhere. Our PB expenses are up materially in Q3 actually more than only year-to-date basis. So, we protected the A&C investment, as these said many times there are a couple of things to bear in mind there. The first one is we are also skewing more towards working media. So that number that on the face of which is high in terms of total A&C is even higher in terms of working media and in the quarter and on a year-to-date basis. And the second element that has to be kept in mind is that management -- certainly management sitting at this table, but also management sitting in the business unit is not getting any past four A&C reductions in terms of incentive. So, if we deliver profit in a quarter through copying A&C, the number is not going count in terms of incentive that we're going to get at the end of the year, and I think that is an important step forward for the past, and the last thing we are going to do is copy and see even in a context where maybe -- we're under a little bit of pressure from a profit delivery.

In Brazil, we did comp some A&C, but it was due to the fact that, we clearly didn't see it working. So, we are not going to be blind and say, yes, let's spend whatever, and no matter what, but I want to reassure that front, we're not going to do anything that we will regret in the medium to long-term. The PB categories in Brazil, it is north of $300 million. As I said, the category is a little bit challenged. We have big brands in there namely, Tang and Clight, and the local brand, which is called Fresh. We are facing a capital pressure point, one it is CSDs are taking share from the category, and the second element -- and so the category is shrinking a bit, and the second element is we are getting pressure from more competitive propositions and low price point propositions for consumers. So we are working on both and there is a more comprehensive plan we have in place for our beverages which hopefully will bring some positives, but I think it will take a little bit of time for that plan to really be in full effect and bring the capital back up and our share back up.

Robert Moskow

Great, Thank you.

Dirk Van de Put

Thank you. I think we can stop the questions here. We are at the top of the hour. So, to wrap it up, our third quarter results, particularly our top line performance demonstrates the continued strength of our core categories and the power of our unique local and global brand portfolio. Our new strategy focused on growth, execution and culture is continuing to drive engagement and results across our business units.

We are encouraged by our early progress against our strategy. We're equally excited about the opportunities that we see ahead of us, particularly for next year, and to increase further the momentum for our company. We see that in the form of expansion into adjacencies, driving market share gains in our existing portfolio, or reinforcing the growth potential of our categories. Our focus going forward remains on continuing to execute against our strategy, and ensuring that the company is well-positioned for sustainable growth and attractive long-term shareholder value creation.

Thank you for dialing in. Thank you for your interest in the company, and talk to you next quarter.

Operator

Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.