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Kraft Heinz Co (KHC) CEO Miguel Patricio on Q3 2019 Results - Earnings Call Transcript

Oct. 31, 2019 1:12 PM ET4 comments | 3 Likes
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Q3: 10-31-19 Earnings Summary

Press Release *10-Q* *Slides*

EPS of $0.69 beats by $0.15 | Revenue of $6.08B (-4.74% Y/Y) misses by $-58.72M

Earning Call Audio

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Kraft Heinz Co (NASDAQ:KHC) Q3 2019 Earnings Conference Call October 31, 2019 8:30 AM ET

Company Participants

Christopher Jakubik - Head, Global IR

Miguel Patricio - CEO & Interim President, U.S. Zone

Paulo Basilio - Global CFO

Conference Call Participants

Alexia Howard - Sanford C. Bernstein & Co.

Andrew Lazar - Barclays Bank

Jonathan Feeney - Consumer Edge Research

Robert Moskow - Crédit Suisse

Bryan Spillane - Bank of America Merrill Lynch

John Baumgartner - Wells Fargo Securities

Steven Strycula - UBS Investment Bank

Laurent Grandet - Guggenheim Securities

Operator

Good day. My name is Joelle, and I will be your operator today. At this time, I would like to welcome everyone to the Kraft Heinz Company's Third Quarter 2019 Earnings Conference Call. I will now turn the call over to Chris Jakubik, Head of Global Investor Relations. Mr. Jakubik, you may begin.

Christopher Jakubik

Hello, everyone, and thank you for joining our business update. We'll begin today's call with an overview of our third quarter and 9-month results as well as an update on our path forward from Miguel Patricio, our CEO; and Paulo Basilio, our CFO, and then we'll open the lines for your questions. Please note that during our remarks today, we will make some forward-looking statements that are based on how we see things today. Actual results may differ due to risks and uncertainties, and these are discussed in our press release and our filings with the SEC. We will also discuss some non-GAAP financial measures during the call today. These non-GAAP financial measures should not be considered a replacement for and should be read together with GAAP results. And you can find the GAAP to non-GAAP reconciliations within our earnings release.

Now let's turn to Slide 3, and I'll hand it over to Miguel.

Miguel Patricio

Thank you, Chris, and hello, everyone. On our previous call, I promised to be candid with you from the start and to update you on our progress along the way. I also highlighted some potential risks to the second half performance. 3 months on, and we are getting to deeply understand our business. That business is on a better footing because we are increasing visibility and control of our costs. The team is making excellent progress and we are gaining confidence in our path forward. We are not where we believe we can be, but we are excited with the evolution we had in the third quarter and what we have ahead of us. This comes from directing our efforts to 3 work streams: stabilizing the business as we execute to the 2019 plan; setting our near-term transformation in motion; and establishing a true north through our enterprise strategy work. As we committed to you earlier, we will give you a detailed plan coming out of the enterprise strategy work early next year. But we do want to share the progress we have made and set early high-level observations with you today.

In terms of delivering our 2019 plan and how we are running the business day-to-day our performance improved from the first half of the year, and we are seeing signs of continuous improvement taking hold. As I said on our last call, my #1 focus is our people and developing the team because it's our people that will deliver continuous improvement and the turnaround of Kraft Heinz. Since our last call, we have made a number of moves to enhance our leadership team, both at the global level and within business units. For instance, I named Nina Barton to a new role, Chief Growth Officer, where in addition to leading the development of our enterprise strategy, Nina has responsibility for overall channel growth, global e-commerce and digital, innovation, marketing services and R&D.

In Finance, our need is to move with speed and have in place proven well-respected leaders that know the business from the start. With that, I'm delighted to have Paulo Basilio back to the position of Global CFO and also Andre Maciel to be our Head of the U.S. Finance, a job he held for the first few years following the merger. To build morale and ensure a high level of engagement, I have held 9 town halls and put out roughly 20 internal videos to shine a spotlight of activities that employees across the world, across Heinz, are doing to address the company. In this past month, we held a global Kraft Heinz Meal Packathon where employees from 15 locations across 9 countries got together with Rise Against Hunger to pack 1 million meals for children in need. Not only we reached the target, but we overdelivered by packing more than 1.2 million meals. And although we have still a lot to do to build our bench strength, in terms of recruiting, I'm very encouraged by the number of people we've seen that want to be part of our turnaround.

Results-wise, organic net sales growth was up slightly on a sequential basis. And year-on-year, adjusted EBITDA was down roughly 4.5% in Q3 on a constant currency basis versus 16% in the first half. Pricing is coming through and inflecting from negative to positive in both United States and EMEA, with overall elasticity in line with our expectations. Net inflation in our supply chain costs falling from 3.3% in the first half of the year to below 1% in the third quarter, marking the first quarter since 2017 that we have been seeing stability on the cost side. And we began to lap stepped-up marketing and e-commerce spending and investments in sales and customer service from the previous year. In addition, we are seeing significant positive momentum where we have something to say, and this includes mid-single-digit retail takeaway in our U.S. condiments and sauces, cream cheese, snacks, desserts and seasonal franchise. In ketchup, specifically, we are getting great traction around the world behind our Heinz 150th anniversary, including our first-ever global Heinz campaign featuring pop music star, Ed Sheeran. And our total U.S. sauces business, which includes ketchup, mustard, mayo, Miracle Whip, salad dressings and pasta sauce, has continued to build momentum since 2017.

Brazil is growing double digits in both retail and foodservice channels, and we are seeing solid growth of 14% in our China soy sauce business.

At the same time, we are still far from where we should be. While overall performance is improving, our numbers are still negative versus the prior year, and our performance remains uneven across categories and across geographies. This includes ongoing share and distribution losses within our natural cheese, cold cuts and coffee business in the United States, lower-than-anticipated promotional lifts in Canada, ongoing infant nutrition declines in both EMEA and China as well as increasing supply chain costs in our Rest of the World segment.

To change our trajectory, we must improve our execution around the category, brand and sales initiatives by making critical fixes and closing any capability gaps; and drive greater efficiency in our supply chain across procurement, manufacturing and distribution. So while we have been working hard to finish the year in a much better place than we started, we have also been investing a lot of energy in our future. We are developing 9 transformational projects that touch the core areas of our company to improve our capabilities and make us a more efficient company. Our teams are making rapid progress understanding root causes, defining what needs to be done and already taking some actions that will benefit 2020.

The nine projects currently underway includes 5 projects focused on top line, 2 projects focused on operational efficiencies and 2 projects focused on organizational effectiveness.

Slide 10 shows our list of projects and the scope of each, but let me provide some examples to illustrate. In marketing, we are defining the framework and optimal marketing spend, both by brand and by working/nonworking allocations. And so far, we identified the opportunity to reallocate a substantial amount of dollars to work in [indiscernible] 2020 as well as redirect dollars disproportionately towards support of our flagship brands. Based on this alone, we will see a significant percentage increase in media spend and an even greater increase for the brands that are the biggest drivers of our profitability. Around our innovation efforts, we are revamping our product development process so we can be faster and more consumer-centric with our new products. And we are evaluating shifting innovation support to fewer, bigger, better initiatives, launches that promise to be more incremental to our base. As a result, in 2020, we will reduce the number of projects being launched by half and better align our post-2020 pipeline with our enterprise strategy.

In sales, the work is concentrated in 3 areas. First, strengthening day-to-day execution through ways of working and timing of our planning process to tighten the connectivity between sales, our category teams, and more importantly, with our retail partners. Second is developing a road map for price, mix, promotion and trade improvements. And third is developing a channel strategy, to better define roles and priorities for each part of the portfolio, by channel and by customer. In supply chain, we have several projects underway that collectively can deliver significant efficiencies to help offset inflation with the goal of funding our long-term strategy. A key driver of this will be examining every SKU, cutting anything with a negative margin, and in the process, removing complexity from the system to boost productivity and improve mix. Based on our work to date, we see scope to rationalize a significant portion of the SKUs in our U.S. business and with minimal impact on profits. There is also more work being done elsewhere, including the transformation of our financial planning and forecasting that Paulo is heading up.

Taking a step back, I think it's important to recognize here that even though we are putting things in motion now, the purpose of all these projects is to lay a foundation that will support us for the long run.

Finally, regarding the long term, in the third quarter, we initiated and we are on track with the development of our enterprise strategy. We are developing a much better understanding of the consumer with a view to the future. We are setting our strategic direction, where we believe we can drive the greatest growth and returns by brand, by category, by geography and by channel with the full support and participation of our Board. And we are assessing how best to organize ourselves against our biggest opportunities. There is still much work ahead of us, but we remain confident in our ability to launch our enterprise strategy and share it in detail with you early next year. Personally, I'm encouraged and excited at how our people are embracing change, their desire to get better through new ways of doing things and to move with speed. After all, these are the key ingredients to building a continuous improvement mindset. And as I said on the last call, one of our key principles and goals for the company going forward is not only to identify the new investments needed to grow both the top line and the bottom line, but keeping expenses under control and using that capital to support those investments.

With that, I will turn over to Paulo to discuss where we are and where we expect to go from here on the financial front.

Paulo Basilio

Thank you, Miguel, and good morning, everyone. I will start with a quick overview of our third quarter performance, which showed both sequential improvement versus the first half as well as the beginning of business stabilization. Our top line improved versus the first half, with organic net sales down 1.1%. Pricing turned from negative in the first half to positive in the quarter. This was driven by realization of the pricing actions we announced in the first part of the year in the United States and EMEA as well as ongoing pricing to offset inflation in Latin America. Vol/mix was lower versus the prior year as we are lapping the strong gains in the prior year and continue to see unfavorable changes in retail inventory levels versus the prior year. In Q3, retail inventory change resulted in a negative 110 basis point impact to U.S. vol/mix. That translated into a roughly 80 basis point decline versus the prior year for total Kraft Heinz results. And for the fourth quarter, I will note here that we currently expect a roughly 50 basis point headwind from lower retail inventory levels for our U.S. business.

With respect to profitability, EBITDA is beginning to stabilize. Constant currency adjusted EBITDA in Q3 was down 4.6% versus the prior year. And this includes a roughly 1.5 percentage point negative impact from divestitures. Excluding these factors, the reduction in EBITDA was driven by a mix of negatives and positives. On the positive side, we are getting supply chain costs under control in the U.S. EMEA returned to EBITDA growth on a constant currency basis. And we had favorable timing of marketing and selling expenses in the U.S. versus the prior year. At the same time, supply chain costs were still negative year-on-year on a global basis in Q3, driven by higher supply chain losses in the Rest of the World markets. A combination of lower pricing and higher input costs led to another weak performance versus the prior year in Canada, and both of these need to be fixed going forward.

Finally, at adjusted EPS, Q3 results were better than we anticipated 3 months ago. This is mainly due to a combination of a better-than-expected outcome in other income and expenses due to favorable FX gains, favorable order income that we do not expect to repeat, lower-than-expected interest expense as a result of successful refinancing as well as more favorable discrete items in the tax line. With respect to our effective tax rate, we are now expecting a rate in between 19% and 20% for the full year versus the 21% expected previously, which brings me to our financial outlook and near-term expectations.

On a personal note, it was an honor when Miguel and the Board asked me to step back into the CFO role here at Kraft Heinz. Much has changed since I last held it. As Miguel has been saying, this period calls for new thinking and new ways of doing business. One area that I believe must be of greater focus is the company trajectory in gross profit. As mentioned, we are revisiting the efficiency in many areas of our supply chain, the effectiveness of our programming, our profitability at an SKU level, as well as product mix to create a better port sales. In the process, the elimination of ink to volume made paper organic net sales in the near term. In addition, key commodity inflation and price volatility in both cheese and meats is likely to remain a challenge in both Q4 and into next year.

While we are implementing pricing in both these areas, reaction in the market remains unclear at this point. So as always, we will need to balance market share, distribution and profitability.

And finally, please note that the divestitures we closed earlier this year will and unfavorable currency may continue to temper our reported results in the near term. At EBITDA, we are focused on continuous improvement with the goal of stabilizing constant currency adjusted EBITDA, excluding divestitures on a year-on-year basis. As mentioned, our visibility on net inflation within our supply chain is improving. We also have significant scope to drive the business forward through greater investments in media that we are determined to make happen. So far, we have been encouraged by our ability to find and fund efficiencies to help offset inflation and to help fund those investments in [indiscernible]. That said, we are still defining our interest price strategy and finalizing our broader ambition to see if more will be needed.

So far as guidance goes, we continue to think it would not be productive for the organization to provide specific point-estimate financial guidance. I will tell you, however, in recognizing that we are still at early stages, it would be prudent to expect year-on-year top and bottom line performance in Q4 to be generally similar to what we saw in Q3. And from an earnings per share perspective, while we have delivered better-than-expected income and expenses below adjusted EBITDA, we still expect these items to be unfavorable on a year-on-year basis in the fourth quarter. Collectively, we expect these below-the-line items to negatively impact EPS by up to $0.10 versus the prior year in Q4.

Now before we move to Q&A, there is another area I think is important to address in terms of progress to date, where we currently stand and where we go from here, and that is our capital structure. Here, we have been making significant progress against our balance sheet priorities, and we believe they have strong credit momentum to build on. From the merger to the end of 2018, we diligently reduced gross debt by $2.4 billion. In Q3, we announced an additional $2.3 billion of cash-funded debt take-out that was enabled by a combination of divestiture proceeds and solid cash generation. And along the way, we have taken a number of actions to put our patience in an overfunded stock and have prefunded most of our post-retirement benefit obligations. As a result, we have minimum future contribution requirements going forward. Also in Q3, we undertook a successful leverage near to $3 billion refinance that further strengths our liquidity. We have a strong investor participation in our offering that we think reinforced investor confidence. And this refinance gives us significant flexibility through 2025, especially given the fact that we currently have no commercial paper outstanding and a $4 billion revolving credit facility that has never been drawn. Refinancing our debt as well as establishing our long-term strategy are critical steps to defining how we will continue to deleverage our company and maintain our investment-grade status.

Now we would be happy to take your questions.

Question-and-Answer Session

Operator

[Operator Instructions]. Our first question comes from Alexia Howard with Bernstein Research.

Alexia Howard

So obviously, this was a pretty encouraging quarter relative to the first half of the year. Investors that I speak to are very keen to know about what the path forward is to stabilization. We don't need to worry about 2020 at this point. But as you look out to the fourth quarter, I think Paulo alluded to this, are you expecting to see a similar pattern to what we saw this quarter in terms of broadly stable or maybe slightly down top line and something broadly in line with the fairly modest declines in EBITDA that you saw this time around?

Paulo Basilio

Alexa, thanks for the question. This is Paulo. So as we're sitting here, as well, when we see our Q4 results, we expect very similar year-over-year performance versus -- as we saw in Q3 versus prior year, both in sales and EBITDA. And this is pretty much driven by, we have divestitures, FX, higher commodity costs that we expect in Q4, and we'll be lapping a strong vol/mix comp, mainly in U.S. And in the positive side, we're going to have all the results from the price actions that we're taking. And the best -- better visibility in cost and net inflation. So we are expecting pretty much in sales and EBITDA similar year-over-year performance as we saw in Q3. And below the line, we are expecting roughly $0.10 -- up to $0.10 headwind versus prior year. So pretty much that's how we're seeing Q4 performing in this year.

Alexia Howard

Fantastic. And given the comments on the uses of cash and the leverage and the investment-grade rating that you made at the end of the prepared remarks, should we assume that, at least for the time being, there are no plans to cut the dividend? Or is that something that we'll have to wait for the Investor Day early in 2020 to get confirmed?

Paulo Basilio

So Alexa, first of all, I think investment-grade status for us is -- continues to be very important. We've just declared the dividend, as you saw. And again, we are in a very solid position in terms of liquidity after the recent refi we did and also in the cash flow generation that would allow us to reduce our leverage over time. But now we are going to a very deep strategic review of the business, understanding how we're going to see the future performance of the company. And in this analysis, in this review, a capital structure is going to be a very important chapter. So we expect to come back to the market with our full view and full picture of how we're expecting the company's performance, the company's strategy for the future, including capital structure at the beginning of next year.

Operator

Our next question comes from Andrew Lazar with Barclays.

Andrew Lazar

Miguel, you discussed a little bit about your desire or the plan to move the organization more in the direction of a continuous improvement, productivity sort of mindset from what I think you described as more integration-led cost-savings programs that we all kind of know proves less sustainable. I realize you're probably not in a position yet to fully size this sort of opportunity. But I guess, do you see any structural reason that would preclude KHC from driving similar levels of sort of ongoing productivity as peers, let's say, as a percent of cost of goods. And the reason I ask is because I presume this is where it can be quite helpful in terms of funding the media spend investment that you mentioned today on the call, other things, inflation and such that come up all in the context of managing EBITDA to be more stable within the confines, I guess, of a constrained balance sheet. So perhaps, any color on that you can provide would be helpful.

Miguel Patricio

Andrew, thank you very much for your question and I think we think alike. From day 1, when I looked at the past and I saw that there was a pretty big deterioration of gross profit because of decrease of COGS, we made -- we defined supply as a big area for improvement for 2 reasons. First, because we had pretty big disruptions in the past with our customers for -- because of low service levels. But second, because COGS has been increasing in our company. And I do not see a reason for that. I think that if we changed the mentality to the company for a mentality of continuous improvement, if we invest on that, on people, in our factories, in our way of thinking on believing if we change the mentality from basically cost-cutting into continuous improvement, I think we can do it and we should do it. And as you said, I see it as a great source of -- for investment in the business. I was very glad to see that in this quarter we could stabilize cost of goods sold. And this is big for us. We are all relieved with that. It's just the first step. Everything to be proved, but the first step was good and gives us a lot of faith, a lot of hope that we are in the right direction.

Operator

Our next question comes from Jon Feeney with Consumer Edge.

Jonathan Feeney

You mentioned -- Miguel, you mentioned in your remarks, capability gaps. And I thought that was an interesting way of putting it. Could you be more specific about the kind of capabilities where you see gaps that need to be funded? Like is it something different than we all think about media spend, we think about product quality, as things that pay off right now? Are there big structural investments as far as generating insights where you feel like there are gaps that require investment? If so, like, where specifically? And maybe related to that, the SKU reduction, is there anything related to like new insights, new capabilities that, that would now would be the time to look at reducing SKUs in North America? It seems to me like -- I don't know, that seems to be something where I think Kraft Heinz has been great at taking a look at where SKUs don't make sense and focusing. So what -- maybe what insights related to that drove that decision?

Miguel Patricio

Thank you, Jonathan. Specifically, let me start specifically with the SKUs that you are mentioning, and then I go -- I'll tell you overall my point of view about that. I think we -- the company has been on a frenzy of innovation in the last 2 to 3 years and trying through launching new products to compensate the decline in net sales. We have not been successful on that. We really have not been successful on that. Yes, we brought a lot of complexity to the system but this innovation was not translated into additional sales. It was very cannibalistic and brought much more complexity. And as a consequence, a lot of supply chain losses and lower margins. Many of this innovation was done through third-party manufacturers. So of course, that's, for me, when I arrived and with fresh eyes, I asked the obvious questions and one of them is, let me understand profitability by SKU, let me understand volume by SKU, and there's a big tail of SKUs that, yes, actually, with a negative margin or are not important at all, very, very small or both. And that can just generate a lot of complexity in the system. And so yes, we are going to reduce this, we are going to reduce.

We have to have the discipline that, at the same time that we innovate and we put new products in the market we have to have the discipline to clean the tail of low margin, negative margin or a low volume, very low volume, that are really not [indiscernible] just creating more complexity in the system. And this is a capability. So going back to your point about capabilities. I think that innovation is an area that we have to increase, we'll have to improve dramatically. There are other areas that I think that we have to improve our capabilities. And -- but I think that innovation is one that I'm very focused on. It is a big driver for growth for the future, has to be especially in the food industry, but we have to do bigger innovation. We have to do fewer innovation. We have to do bolder innovation. We have to do profitable innovation and has to be incremental instead of doing everything and old products innovating and vouching and throwing new products in the market that will not really generate extra profitability to our company.

Operator

Our next question comes from Robert Moskow with Crédit Suisse.

Robert Moskow

A couple of questions. One is, Miguel, on the slides, you focused a lot on giving us a plan for 2020 but I kind of thought that investors were looking for like a 3-year plan or something of a longer-term nature. Are you going to give us kind of a ramp of what those next 3 years might look like when you give us the review?

And then secondly, a more detailed question. In your conversations with customers, have you found that customers are giving you any kind of insight on their perception of Kraft versus your peers? My perception is that Kraft has had some pretty rigid structures in terms of pay-for-performance with customers, and maybe that led to some of the disputes that you've had in the past. Is there any insight you can give us in that regard?

Miguel Patricio

Yes. So two very different questions. Let me answer first the first one, Robert. I'm working at the same time in the -- well, in delivering the results for 2019 on building the budget for '20 and on the future, right? For 2020, I need the strategy, but this -- 2020 is going to be more about continued stabilization. And then this is what I aim, is that 2020 is a year that we stabilize the business and that we build the foundation for growth in 2021. So the answer to you is yes, when we present the strategy that we are working on, that is going to be a long term with a long-term view. So we -- our 3-year plan will be addressed. Regarding customers, yes, I've been talking to customers and learning a lot from them. And I can tell you that their biggest concern is what you call the disputes and then that translates into service levels. So we had problems in the past, several problems in different types of products with our service level. And that although we haven't had any big problem this year, so we are in a much better year in terms of service level, there are still scars from the past.

And then when they remind us of all the problems that we had in the previous years in terms of service level, they questioned that if this is sustainable or not. They also -- so this, I would say, that is -- their number one concern, really, service level. But they're also concerned about planning and strategy. So we need to be better on our planning with them and adapt our planning cycle to their planning cycle. I think there's a big opportunity to do that, and we are going to address that. At this moment, because of the way we are planned -- that we plan on our budget cycle that doesn't tie with their budget cycle, the feeling I have is that we are always late and the feeling that they have is the same. The other part is related to strategy that they want to see us communicating to them and teaching them and is training them in a more strategic way on a long term. And then I would put a fourth point that the -- that is about execution, that we can have better execution in their stores. So I would say that these are the four items that we -- that I'm -- when I think about customers that I'm focused on, really, service level, planning, strategy and execution.

Operator

Our next question comes from Bryan Spillane with Bank of America.

Bryan Spillane

So I think about the follow-up on Andrew's question about -- so, I guess, supply chain opportunities or opportunities within COGS and maybe, Paulo, if you could help us sort of get a little bit of a bridge. If we go back to EBITDA for fiscal '17 and then compare it to where we are the last 12 months, there's an EBITDA decline of about $1.6 billion or so. And can you give us a little -- a bridge of kind of what the drivers were that got us from there to here? And I guess what's really underneath the question is just trying to understand how much of it was items that were outside of the company's control and then items that are sort of within the control and are potentially addressable?

Paulo Basilio

Sure. So thanks for the question. When you go back from our peak 2017 margins. And again, when you bridge these two, let's say, our last 12, as I said, pretty much we have two big drivers, two big areas of decline, right? 60% of the decline roughly is coming from gross margin. And this -- you could split this in mainly the inflation we have in our supply chain with not enough initiatives to offset that; investments that we had in service level for the customers; an unfavorable product mix that we saw in the launch of the business, and this is part of the type of incrementality, the innovation that we had that Miguel was talking about. And also, the fact that with all of this inflation and not enough savings or efficiency initiatives to offset that, we were slow in moving our prices. So I think this is pretty much 60% of the gap. The other 30% of the gap is driven by SG&A. So 60-plus around gross margin, 25% to 30% around SG&A. 70% of that was pretty much commercial investments we made. We had international go-to-market initiatives, new areas inside the company like digital and also additional market investments that we put that is -- because of our fragmentation of innovation, ended up going too much to nonworking piece to support the innovation pipeline.

And the remaining, also we have like of 30% of the 25% from the SG&A is pretty much lapping bonds accrual that we didn't have in 2017. So a 6% gross margin, 30% SG&A, with 70% of this 30% coming from these commercial investments that we made that we are assessing now. The other 30% of the 25% decline, driven by bonds that we didn't have in 2017. I think it's -- on that, I think it's -- and we, internally here, and myself specifically, we reflect a lot about this, the performance and the root cause of this performance. And we had big leaks of key learnings here and things that we're going to go after and things that came from the outside. That's pretty much at the base of all these initiatives, near-term projects that we have. But at the end of the day, pretty much we were not kind of fast enough to move from that first initial integration stage to build this organic growth plan for the company. In a moment that the industry had a lot of big transformations, right, both from the customers' lens, from the retailers' lens.

So I think that was the combination of the things that I think drove our past three years' performance down. But now I think the offense is that we built these work streams with Miguel to address those things through -- again, we had a lot of costs inside the business. And now we are reassessing each of them the ability for us to get back them to be able to help to fund all the investments that we are identifying as opportunities in the business. And what we can share also here is that so far, we found a lot of opportunities to invest, as Miguel was saying, behind media, behind higher support from a more concentrated set of innovation. And so far, we were able to find the sources inside the company to fund those investments. Again, of course, we are still working on the strategy and later price, that we expect to find more areas of opportunity and also more areas of savings to support potentially those investments.

Operator

Our next question comes from John Baumgartner with Wells Fargo.

John Baumgartner

Miguel, I'd like to come back to the innovation approach. Because when you speak to the fewer, bigger, better ideas, I'm curious as to how you think about the capabilities there. Because those are, as you say, bets which may or may not work out. So can you speak to where the company stands right now and its ability to identify the idea that could become successful, big bets, because the company has pursued this for the last couple of years of very limited success. And I guess my follow-up would be, what's changing or what still needs to change in terms of the capacity there?

Miguel Patricio

Okay. So a very good question. And I'll tell you, I think that there's a fundamental change that -- or we need to do a fundamental change in the company, from a company that was much more focused on today and probably pursuing a strategy that was more focused on inorganic growth to a company that needs to pursue organic growth and needs to understand the future better than anybody else. That's a big change. You need to change, you need to put first the mindset in a direction.

Second, really a strategy, where do we think that the growth is going to happen? So we need to transform this company into a much more consumer-driven company in a much more looking-forward type of company rather than just operating the present. It's not either one or the other. We need to do both. And I think that we can and we should do both. So as a consequence, I think that the innovation was we did a lot of plan extensions. We were relying too much on things that were not really incremental and we need to do more things in areas that we believe are going to grow. The last call, I gave the example of

Boca, and I think is a good example. We were the first company introducing veggie burgers 15 years ago. But because we didn't have a good vision about how the world would progress, Boca has not been a focused brand. And as a consequence, we never really took advantage of everything that is happening in this area.

So understanding the future, understanding the consumer, I think, is the way to go. Of course that -- for that, we will need much more better insight, much better creativity. We'll need a more united R&D. So we didn't have a Head of R&D. R&D was in all departments of the company. We are now unifying R&D in the company, having one head of R&D. We are defining our strategy. We also appointed a Chief Growth Officer. Pull things into this direction, right. Hopefully, I was -- I gave you the answer you were expecting, John. I don't know if you want to ask anything else related to that.

John Baumgartner

No, No. I guess, maybe just as a follow-up in terms of rebuilding the R&D pipeline. How long does it take to really kind of get the ideas going, kind of getting the pipeline full again? Is this like a five year plan? Is it a three year plan, how do you think about that?

Miguel Patricio

So on that, we also have to work on process to speed up innovation. In my previous world, in my previous role and previous company, we reduced the development of products from a 2-year to 6 months by changing process methodologies, basically introducing the agile type of building innovation. We're going to do the same here. So we need to be much faster. And that is also what I previously said, John, that in 2020, needs to be a year of stabilization to give us the time to be working on the pipeline for the future, for the years to come. What we have in the pipeline for 2020, it's still, of course, not under the strategy that we are going to present to you at the beginning of the year. During 2020, we will have to define and develop the pipeline for the future.

Operator

Our next question comes from Steve Strycula with UBS.

Steven Strycula

Miguel, I have a quick follow-up to Alexia's question, and I appreciate you haven't fully ironed out the Board plan at this point in time. But can you help investors at least think through the obvious and, more importantly, the less obvious implications of the dividend policy as you think forward? That would be helpful. And then I have a quick follow-up.

Miguel Patricio

Can you help me giving you exactly what you have in mind, Steve? I want to address your question in the right way.

Steven Strycula

Sure. Yes. So when I have conversations with investors, we receive the puts and takes of whether the company has excess capital to really pay out at the levels that they do today. And how do you think about some of the considerations of, if you have fewer brands in the portfolio moving forward, or the priority is to paying down debt? So to sum up, the question would really be, what are the very obvious considerations of keeping it versus not keeping it? And then what would be some of the unintended consequences that maybe most investors might not see from our vantage point?

Paulo Basilio

This is Paulo. Let me try to address how we're thinking about that. So in the cash flow information, and I know that we're going to see these later in our Q. In -- for example, in Q3, we generated a free cash flow to equity after CapEx of $860 million. So sufficient to pay the dividend at roughly below $500 million. But the important thing here is that now, what we are doing that, as Miguel mentioned, we are discussing the future of the company, the strategy of the company, how we're going to, where are we going to invest to grow the business for the next 3 to 5 years. And developing this plan, for sure, as you can imagine, like capital structure is a key chapter of this as I said. And for us, being an investment-grade company is -- remains very, very important. So our time line here is that we are going to develop our strategic plan, we are going to set our future expectations for our performance, addressing our portfolio, our categories, our brands, our regions and also our capital structure to support that and share with the market early next year.

Miguel Patricio

Steven, just repeating what Paulo said. I think that when we define our strategy, we'll define what are the areas that we think that we can have substantial growth. What are the areas that we don't think we can have substantial growth but can generate very good cash to support the growth? And what are the areas that our products or categories that actually could have a better fit with somebody else. And I think that with this in mind, we can identify categories that we can have divested in the future.

Steven Strycula

And then a quick follow-up related to innovation, Miguel. What's your personal philosophy or strategy as you think about the patience to seed and build growth and, call it, longer-term categories? They might not be very large today, but might be the future of, call it, the portfolio or areas that could be a few hundred million dollar brands. So I guess to sum up, the question would really be, how does a company that's so ZBB focused think about immediate return on investment versus necessarily seeding and needing to grow for the longer term?

Miguel Patricio

And now I think that your question is very important, but let me tell you that, yes, I love ZBB. I really do. In my previous company, I worked for 22 years and I learned to love ZBB. But for one reason, because ZBB was a big lever or made it possible to grow the business throughout the year. So when I look at ZBB, I look at it as a discipline to make things every day better, so we can free up resources to invest in other products. I don't look at ZBB as a way to basically cut costs and cut costs. I see it as a way to do things better every day and have -- the consequence of that is to be more efficient and to free up resources to invest in the business.

But addressing your second point about how are you going to invest in things that today are small, and tomorrow can be big, are you going to have that discipline? I think that question is very, very important. I think companies tend to invest on what's big and not what it will grow, and I think we need to do both. And then we really need to understand what will grow and bet on it. It may be smaller today, but you need to have the patience to nurture these categories, these products, these brands to be big one day. I'm looking at this right now, not only brands but also channels that today may not be so representative, but have a great potential for the future. So I tend to agree with you, and I don't think that, that has to do with ZBB. It's just the opposite. I think that ZBB will free up resources to invest in these categories.

Operator

Our final question comes from Laurent Grandet with Guggenheim.

Laurent Grandet

Yes. Thanks, Miguel, for sharing in details your progress. Very insightful, thank you. Actually, I do have two quick ones. I mean, first is other income. Could you please explain what is in the other income line this quarter? As you'd explained, about half of the beat in the quarter are about $0.08 in our math. And then more on the Plasmon business in Italy. Could you please explain why you changed your position in regards to the divestiture? And it will be interesting for us, I mean, in understanding the rationale here, I mean, as we further assess, I mean, other possible, I mean, the right opportunities for you?

Paulo Basilio

Thanks for the question. This is Paulo. So let me -- again, I'm going to -- I'm not going to comment on the consensus expectations for other income. But at the level of our other income, it was very similar to the levels that we had in prior year, pretty much the same type of level. Versus our expectations, it was a little bit better and pretty much driven by three factors. It's the first one, we had better return to the capital markets from our investments. We had some gains in hedging positions and also favorable FX in the balance. So this is pretty much how we -- how this other income line performed versus our internal expectations. So for Q4, to give a little bit more color here, we're expecting the other income to go down by around $20 million. It's part of the -- versus -- go down $10 million versus prior year. That's part of the headwind that we disclosed below the EBITDA lines. About divestitures, Miguel, would you want to comment?

Miguel Patricio

Yes, sure. No, I wanted to tell you about baby food, that I think it's -- we have a business that if you look at -- in baby food, if you look it individually at the countries where we have baby food, it's not very meaningful. We have baby food in a lot of countries, in Russia, in China, in Australia, in Italy, in U.K., in New Zealand, in Canada, in Colombia, in Mexico, all tiny business. Maybe the biggest one is in Italy. But all very tiny business. But when you put them together, it's $0.5 billion business, it's sizable. We are declining in the majority of these countries. And I tell you, I think that is basically because it's not very important in each one of the countries and also because we really do not have expertise, really expertise, big expertise on baby food.

And if you look at the countries individually, we don't even have the scale, I think, to have this expertise. Now with the changes that we made in structure, with the appointment of Rafael as our Zone President International when we put Latin America, Asia Pacific and Europe together, then he will have all this business or basically all this business together and becomes meaningful in his portfolio. He will put a team working on baby food. Understanding what moves baby food, understanding these sites, understanding the trends, understanding the needs of the moms and the babies that, because of scale, we didn't have today in each one of these countries. So it's a good example of capabilities that we have to build that by changing structure, we can get there. So that would be my comment about baby food.

Operator

Thank you. This concludes today's question-and-answer session. I would now like to turn the call back over to Chris Jakubik for any further remarks.

Christopher Jakubik

Well, thanks, everyone, for joining us this morning. For the analysts that have follow-up questions, both myself and Andy Larkin will be available. And for members of the media that have follow-up questions, Michael Mullen will be available to take your calls as well. Thanks very much, and have a great day.

Operator

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