Mondelēz Union Network

November 2016

What's driving Mondelēz?

Mondelēz is a particularly aggressive employer because of its strategic reliance on high and unsustainable levels of debt for funding top management and large shareholders at the expense of investment in building a sustainable food business. Because of its precarious financial structure and strategy, Mondelēz relies on short-term fixes and aggressive cost cutting to boost margins rather than increasing sales volume and investing in innovation. But costs cannot be endlessly cut before they endanger the business as a whole.

Mondelēz has the high levels of debt typical of a leveraged buyout, a model which has also been adopted by Kraft Heinz, with the same results. Mondelēz has simultaneously loaded up on debt to boost (on paper) its return on equity while funding share buybacks and dividends. The high debt ratio leaves the company, and its workers, highly vulnerable to changes in interest rates, sales income, currency fluctuations, recalls, etc. – anything which can result in pressure on cash flow.

Increasing debt

Over the last three years the company's long term debt to equity ratio has been growing, bringing with it increasing risks to the business and workforce as Mondelēz struggles to meet principal and interest on its borrowing. Mondelēz has been so far able to meet its obligations only through refinancing the debt thanks to record-low interest rates and one-off cash injections that require regularly selling off profitable parts of the business. By increasing its debt as a percentage of equity, Mondelēz' ability to cover its interest expenses has been questionable at least once in the past 3 fiscal years –notably in FY 2013 when its interest coverage ratio was 1.495. The interest coverage ratio expresses the company's ability to meet its borrowing costs i.e. the degree of strain with which a company can pay interest expenses on outstanding debt. A ratio below 1.5 is dangerous ground; a ratio of one would mean insolvency, where all cash coming in goes out as interest.

What might happen for a highly leveraged company like Mondelēz if interest rates increase? Or sales dipped? Or they were hit by a rise in commodity prices and ingredients? How would it cover its interest payments? The business and the workforce are highly vulnerable to sudden shifts in the business environment.

Another way to look at this is Mondelēz' difficulty meeting its short-term obligations with its short-term assets (i.e. cash). Mondelēz' current and quick ratios, metrics indicating ability to pay short-term obligations, for the past 5 fiscal years have largely been below 1. A metric below 1 can indicate a lack of ability to pay short-term obligations. However, Mondelēz has positive cash flow and available bank lines (not shown on the company's balance sheet), which represent accessible cash for the company to pay its short-term obligations. Without these bank lines, Mondelēz could be in short-term trouble. And its ability to keep these borrowing lines open depend in part on a healthy cash flow.

Declining market share

As a result of poor management and short-term business direction, Mondelēz has seen declines in market share. As reported in 2015, "while in a fast growing category, [revenue] growth has been completely missing on an as reported basis from continuing operations. As the company has focused on boosting margins through pricing and cost reduction, it has lost market share."[1] In 2016, Mondelēz has lost market share in chocolate. As one of the less profitable companies in the industry, it can't sustain rising cocoa costs as long as its competition. It has therefore passed the increased costs onto the consumer and become less competitive. In the case of Toblerone in the UK, however, Mondelēz chose to cheapen its product instead of increasing prices. It met consumer backlash as a result.

A better path forward for Mondelēz and its workforce

Is there a better path forward for Mondelēz that will benefit both the company and its workforce? We believe there is. Increased investments in research, innovation and expansion into product categories that reflect shifts in consumer demand towards healthy and organic foods would be beneficial to growing Mondelēz. Mondelēz has announced that it aims to derive 50% of its revenue from *wellbeing* snacks in 2020. *To achieve this goal, Mondelēz would need to increase spending on R&D at least to the % of net sales it comprised before the spin-off in 2012—1.96%.* As long as it is scrambling for cash and constantly looking for quick fixes to fund inflated shareholder returns, this will be difficult to achieve.

Mondelēz should also focus on improving earnings quality long-term. High-quality earnings mean that the reported earnings for a particular period should (1) represent the underlying economics of the business and (2) be both persistent and predictable.[2] Mondelēz has done

[1] Source: http://m.foodbusinessnews.net/articles/news_home/Business_News/2015/03/Mondelez_gaining_momentum.aspx?ID=%7B33382E07-D904-4729-BDA8-58CA882D59E3%7D&p=1&cck=1

[2] Source: http://www.investopedia.com/university/accounting-earnings-quality/earnings2.asp

neither of these in its persistent use of non-Generally Accepted Accounted Principles (GAAP) metrics since its inception, which have largely misled investors and artificially propped up the company's financial results by removing numerous "standard costs of doing business, especially for an international company like Mondelēz. Perhaps, most misleading is Mondelēz' removal of currency rate fluctuations from 'Organic Net Revenue' given that 76% of sales [were] generated outside of the U.S. in 2015."[3]

Finally, cost-cutting at Mondelēz achieved new levels in 2016. Mondelēz has promised to deliver additional supply-chain 'productivity' and other cost savings to ratchet up margins and deliver still more cash to eager shareholders. At the Consumer Analyst Group of New York (CAGNY) conference in spring 2016, Mondelēz announced plans to reduce capital investment by a significant percentage over the next three years, in line with the direction established by Kraft before the company was split. Despite the company's desire to deliver increased productivity, over the medium-long run cuts in capital expenditures will lead to productivity declines.

Slashing investment in its workforce is a dead end for Mondelēz as well as a catastrophe for workers. Over the past three years, the company has shown declining productivity as a result of its lack of capital investment. Mondelēz should be investing rather than endlessly cutting costs.

It is more important than ever that Mondelez' workforce stay united and organized in the face of a company looking to generate profit by selloffs and improvised cost-cutting rather than investing wisely in its workforce and business. The IUF Mondelez Union Network was created to help Mondelez workers stay united and organized. Contact your IUF affiliate to get more involved and affiliates please contact Sarah.Meyer@iuf.org for more information.

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[3] Source: http://seekingalpha.com/article/3963526-numerous-issues-around-mondelez-international