

Spring 2023 Live Case Study

McCormick & Co.

THE CHALLENGE

Spring 2023 Live Case study focuses on McCormick's competitor response strategy to Kinder's (www.kinders.com) in the market segment of 'Grilling' products.

Kinder's is a family owned privately held business established in 1946 in California as a butcher shop and eventually expanded into catering. Since then, Kinder's has diversified into making grilling-based products like BBQ sauces, marinades, rubs, and seasoning mixes. Kinder's success has been most material in the Spice (grilling) category, where they launched Nationally in 2021 and have quickly risen to #2 in the category with a 20% share of the category (+8 pts) (surpassing the long-standing Weber brand, now only behind McCormick Grill Mates (34% share of the category (-2 pts)). From a regional northern California company Kinder's has expanded their distribution nationwide with their products being available at national retailers Walmart, Albertsons, Costco, Amazon, etc. McCormick has significant presence in the market segment of the grilling category, nevertheless new entrants in a segment/industry can change the competitive dynamics and impact the profitability of current companies. **The executives at McCormick would like you to provide a competitive assessment and recommendations for how to tackle the threat of new entrants in the market segment of grilling spices and blends (exclude BBQ sauces) products. Recommendations maybe with respect to new products, new channels, promotions, digital strategy, etc., while also providing a financial analysis.**

To successfully complete this case, **you should do the following:**

1. Carefully read the information about McCormick provided to you by the executives.
2. Conduct the analysis of all three focus areas below.
3. Research McCormick, Kinder's, spices and condiments industry, market segment of grilling products, distribution channels, American grilling habits and preferences, etc. as needed to conduct your analysis.

1) External Analysis:

- Outline the market for condiments and spices industry in North America (e.g., size, maturity, market share, growth potential, etc.).
- Analyze the recent market trends that are impacting the industry.
- Analyze Americans habits and preferences related to grilling and people's use of spices and flavoring products.
- Apply the Five-Forces Model analysis of industry competition to evaluate McCormick and its top competitors.
- Use other external strategic analysis tools covered in the course if applicable (e.g., PESTEL, industry key success factors, strategic group mapping, industry evolution).

2) Internal Analysis:

- Discuss McCormick's and Kinder's competitive advantage and disadvantages in the market segment of grilling products.

- Explain any unique market positioning that McCormick and Kinder has over its rivals.
- Apply internal strategic tools covered in the course (e.g., value chain analysis, resource-based view, SWOT, financial analyses, vision-mission-objectives, core competencies, balanced scorecard, and transitory rather than sustained competitive advantage).

3) **Financial Analysis:**

- Estimate the cost to develop and implement your strategy for the next three years.
- Provide revenue projections for the next 3 years for the proposed strategy.
- Provide projected income statements combining revenue and cost projections from the previous two bullets.

Information from the Executives of McCormick & Co.

About

McCormick & Company, Incorporated is a global leader in flavor. As a Fortune 500 company with over \$6 billion in annual sales across 170 countries and territories, we manufacture, market, and distribute spices, seasoning mixes, condiments, and other flavorful products to the entire food industry including e-commerce channels, grocery, food manufacturers and foodservice businesses. Our most popular brands with trademark registrations include McCormick, French's, Frank's RedHot, Stubb's, OLD BAY, Lawry's, Zatarain's, Ducros, Vahiné, Cholula, Schwartz, Kamis, DaQiao, Club House, Aeroplane and Gourmet Garden. Every day, no matter where or what you eat or drink, you can enjoy food flavored by McCormick.

Founded in 1889 and headquartered in Hunt Valley, Maryland USA, McCormick is guided by our principles and committed to our Purpose – To Stand Together for the Future of Flavor. McCormick envisions A World United by Flavor where healthy, sustainable, and delicious go hand in hand.

Our Purpose and Our Vision

Our Purpose is "To Stand Together for the Future of Flavor."

Our Vision is "A World United by Flavor—where healthy, sustainable and delicious go hand in hand." We believe flavor's greatest potential lies ahead. Flavor is foundational to our food and our shared future. Flavor has untapped potential to enhance our health, our communities, and our planet in ways that taste great. We stand with our employees, creating great places to work that offer opportunities for all. We stand with the communities where we work and grow, partnering to ensure they can thrive for generations. We stand with our consumers, using flavor to bring people together across the table and across the world. We stand with our customers through innovating new products that make good food taste great while contributing to happier, healthier lives.

Business Segments

We operate in two business segments, consumer, and flavor solutions. Demand for flavor is growing globally, and across both segments we have the customer base and product breadth to

participate in all types of eating occasions. Our products deliver flavor when cooking at home, dining out, purchasing a quick service meal, or enjoying a snack. We offer our customers and consumers a range of products to meet the increasing demand for certain product attributes such as clean-label, organic, natural, reduced sodium, gluten-free and non-GMO (genetically modified organisms) and that extend from premium to value-priced. Consistent with market conditions in each segment, our consumer segment has a higher overall profit margin than our flavor solutions segment. In 2021, the consumer segment contributed approximately 62% of consolidated net sales and 75% of consolidated operating income, and the flavor solutions segment contributed approximately 38% of consolidated net sales and 25% of consolidated operating income.

Consumer Segment. From locations around the world, our brands reach consumers in approximately 160 countries and territories. Our leading brands in the Americas include McCormick, French's, Frank's RedHot, Lawry's Cholula Hot Sauce and Club House, as well as brands such as Gourmet Garden and OLD BAY. We also market authentic regional and ethnic brands such as Zatarain's, Stubb's, Thai Kitchen, and Simply Asia. In the Europe, Middle East and Africa (EMEA) region, our major brands include the Ducros, Schwartz, Kamis and Drogheria & Alimentari brands of spices, herbs and seasonings and an extensive line of Vahiné brand dessert items. In China, we market our products under the McCormick and DaQiao brands. In Australia, we market our spices and seasonings under the McCormick brand, our dessert products under the Aeroplane brand, and packaged chilled herbs under the Gourmet Garden brand. Elsewhere in the Asia/Pacific region, we market our products under the McCormick brand as well as other brands. Approximately two thirds of our consumer segment sales are spices and seasonings and condiments and sauces. Within the spices and seasoning category, we are the brand leader globally and a category leader in our key markets. In the condiments and sauces category, we are one of the brand leaders globally and in the U.S. There are numerous competitive brands of spices and seasonings, and condiments and sauces in the U.S. and additional brands in international markets. Some are owned by large food manufacturers, while others are supplied by small privately-owned companies. In this competitive environment, we are leading with innovation and brand marketing, and applying our analytical tools to help customers optimize the profitability of their sales of these categories while simultaneously working to increase our sales and profit. Our customers span a variety of retailers that include grocery, mass merchandise, warehouse clubs, discount and drug stores, and e-commerce retailers served directly and indirectly through distributors or wholesalers. In addition to marketing our branded products to these customers, we are also a leading supplier of private label items, also known as store brands. In our businesses in China and India, foodservice sales are managed by and reported in our consumer segment.

Flavor Solutions Segment. In our flavor solutions segment, we provide a wide range of products to multinational food manufacturers and foodservice customers. The foodservice customers are supplied with branded, packaged products both directly by us and indirectly through distributors, apart from our businesses in China and India, where foodservice sales are managed by and reported in our consumer segment. We supply food manufacturers and foodservice customers with customized flavor solutions, and many of these customer relationships have been active for decades. Our range of flavor solutions remains one of the

broadest in the industry and includes seasoning blends, spices and herbs, condiments, coating systems and compound flavors. In addition to a broad range of flavor solutions, our long-standing customer relationships are evidence of our effectiveness in building customer intimacy. Our customers benefit from our expertise in many areas, including sensory testing, culinary research, food safety and flavor application. Our flavor solutions segment has several competitors. Some tend to specialize in a particular range of products and have a limited geographic reach. Other competitors include large publicly held flavor companies that are more global in nature, but which also tend to focus on providing integrated solutions extending beyond flavor using other functional and nutritional ingredients.

Raw Materials The most significant raw materials used in our business are dairy products, pepper, capsicums (red peppers and paprika), onion, vanilla, garlic, and salt. Pepper and other spices and herbs are generally sourced from countries other than the United States. Other raw materials, like dairy products and onion, are primarily sourced locally, either within the United States or from our international locations. Because the raw materials are agricultural products, they are subject to fluctuations in market price and availability caused by weather, growing and harvesting conditions, market conditions, and other factors beyond our control. We respond to this volatility in several ways, including strategic raw material purchases, purchases of raw material for future delivery, customer price adjustments and cost savings from our Comprehensive Continuous Improvement (CCI) program. In addition, we rely on third-party transportation providers to deliver raw materials as well as our product to our customers. Reduced availability of transportation capacity due to labor shortages, primarily as a result of the COVID-19 pandemic, has caused an increase in the cost of transportation for us and our suppliers.

Customers Our products are sold directly to customers and also through brokers, wholesalers and distributors. In the consumer segment, products are then sold to consumers under a number of brands through a variety of retail channels, including grocery, mass merchandise, warehouse clubs, discount and drug stores, and e-commerce. In the flavor solutions segment, products are used by food and beverage manufacturers as ingredients for their finished goods and by foodservice customers as ingredients for menu items, as well as provided to their own customers for use in dine-in and take-out eating occasions, all to enhance the flavor of their foods. Customers for the flavor solutions segment include food manufacturers and the foodservice industry supplied through a variety of channels including directly and indirectly through distributors, wholesale foodservice suppliers and e-commerce. We have many customers for our products. Sales to one of our consumer segment customers, Wal-Mart Stores, Inc., accounted for approximately 11% of consolidated sales in 2021 and 2020 and 12% of consolidated sales in 2019. Sales to one of our flavor solutions segment customers, PepsiCo, Inc., accounted for approximately 11% of consolidated sales in 2021, 2020 and 2019. In 2021, 2020 and 2019, the top three customers in our flavor solutions segment represented between 48% and 52% of our global flavor solutions sales.

Our Acquisitions

In August 2017, we completed the acquisition of Reckitt Benckiser's Food Division (RB Foods) from Reckitt Benckiser Group plc. The purchase price was approximately \$4.2 billion. The iconic brands we acquired from RB Foods included French's, Frank's RedHot and Cattlemen's, which are a natural strategic fit with our robust global branded flavor portfolio. We believe that these additions moved us to a leading position in the attractive U.S. Condiments category, while providing significant international growth opportunities for our consumer and flavor solutions segments.

On November 30, 2020, we completed the purchase of the parent company of Cholula Hot Sauce (Cholula) from L Catterton. The purchase price was approximately \$801 million, net of cash acquired. Cholula, a premium Mexican hot sauce brand, is a strong addition to McCormick's global branded flavor portfolio, which broadens the Company's offering in the high growth hot sauce category to consumers and foodservice operators and accelerates our condiment growth opportunities with a complementary authentic Mexican flavor hot sauce. At the time of the acquisition, annual sales of Cholula were approximately \$96 million. The results of Cholula's operations have been included in our financial statements as a component of our consumer and flavor solutions segments from the date of acquisition.

On December 30, 2020, we completed the purchase of FONA International, LLC and certain of its affiliates (FONA), a privately held company. The purchase price was approximately \$708 million, net of cash acquired. FONA is a leading manufacturer of clean and natural flavors providing solutions for a diverse customer base across various applications for the food, beverage and nutritional markets. The acquisition of FONA broadens our value-add offerings with products that are highly complementary to our existing portfolio. By combining the portfolios and infrastructures, we have added manufacturing capacity as well as greater scale and expect to accelerate our global flavor growth. At the time of the acquisition, annual sales of FONA were approximately \$114 million. The results of FONA's operations have been included in our financial statements as a component of our flavor solutions segment from the date of acquisition.

Financial Highlights

Results SINCE 2016

% Represents 5-Year Compound Annual Growth Rate

DELIVERING ON OBJECTIVES		Consumer Segment
<i>Generated Fuel for Growth</i>	<i>Achieved Top-tier Performance</i>	
\$170 M INCREASE IN CASH FLOW FROM OPERATIONS	8% NET SALES ¹	8% NET SALES ¹
210 BPS ADJUSTED OPERATING MARGIN EXPANSION ¹	11% ADJUSTED OPERATING INCOME ¹	10% ADJUSTED OPERATING INCOME ¹
>\$580 M CUMULATIVE COST SAVINGS ACHIEVED	10% ADJUSTED EARNINGS PER SHARE	8% NET SALES ¹
		13% ADJUSTED OPERATING INCOME ¹

¹Net sales, adjusted operating income and adjusted operating margin are stated in constant currency. The reported amounts are consistent with those in constant currency other than the 5-year compounded annual growth rate for adjusted operating income for the Flavor Solutions segment, which reflects a 1% unfavorable impact from foreign currency.

Financial HIGHLIGHTS

For the year ended November 30 (in millions except per share data)	2021	2020	% Change
Net sales	\$6,317.9	\$5,601.3	12.8%
Gross profit	2,494.6	2,300.4	8.4%
Gross profit margin	39.5%	41.1%	
Operating income	1,015.1	999.5	1.6%
Operating income margin	16.1%	17.8%	
Net income	755.3	747.4	1.1%
Earnings per share—diluted	2.80	2.78	0.7%
Cash flow from operations	828.3	1,041.3	-20.5%
Dividends paid	363.3	330.1	10.1%
Dividends paid per share	1.36	1.24	9.7%

We are providing below certain non-GAAP financial results excluding items affecting comparability. The details of these adjustments are provided in the Non-GAAP Financial Measures within Management's Discussion and Analysis in the Company's Form 10-K.

	2021	2020	% Change
Adjusted gross profit	\$2,505.6	\$2,300.4	8.9%
Adjusted gross profit margin	39.7%	41.1%	
Adjusted operating income	1,101.5	1,018.8	8.1%
Adjusted operating income margin	17.4%	18.2%	
Adjusted net income	823.9	762.7	8.0%
Adjusted earnings per share—diluted	3.05	2.83	7.8%

Financial results for the third quarter ended August 31, 2022

- Sales increased 3% in the third quarter from the year-ago period. In constant currency, sales increased 6% driven by growth in both the Consumer and Flavor Solutions segments. Both comparisons include a 1% unfavorable impact from the divestiture of the Company's Kitchen Basics business.

- Operating income was \$235 million in the third quarter compared to \$265 million in the year-ago period. Adjusted operating income was \$239 million compared to \$272 million in the third quarter of 2021.
- Earnings per share was \$0.82 in the third quarter as compared to \$0.79 in the year-ago period. Adjusted earnings per share was \$0.69 as compared to \$0.80 in the year-ago period.
- For fiscal year 2022, McCormick reaffirmed its sales, operating income, and earnings per share outlook.

Lawrence E. Kurzius, Chairman and CEO states that “During the third quarter, supply chain challenges continued, and recovery of certain constrained materials has taken longer than expected. We continued to incur elevated costs to meet high demand in some parts of our business, while in other parts of our business, where demand has moderated, we are experiencing lower operating leverage. Across the supply chain, we remain focused on managing inventory levels and eliminating inefficiencies, though the normalization of our supply chain costs is taking longer than expected, pressuring gross margin. Over the coming months, we will be aggressively eliminating supply chain inefficiencies. Importantly, as we had expected in the third quarter, we began to recover the cost inflation that had been outpacing our pricing actions and other levers. We expect this will continue into next year as we plan to fully offset inflation over time.

"We remain confident that the strength of our business model and the value of our products and capabilities position us well for the long-term and will allow us to successfully navigate this dynamic global environment. We continue to capitalize on the long-term consumer trends that have accelerated since the beginning of the pandemic, including the sustained shift to cooking more at home, increased digital engagement, clean and flavorful eating, and trusted brands."

Consolidated Income Statement (Unaudited)

(In millions except per-share data)

	Three months ended		Nine months ended	
	August 31, 2022	August 31, 2021	August 31, 2022	August 31, 2021
Net sales	\$ 1,595.6	\$ 1,549.4	\$ 4,654.8	\$ 4,587.6
Cost of goods sold	1,028.9	949.8	3,004.7	2,795.9
Gross profit	566.7	599.6	1,650.1	1,791.7
Gross profit margin	35.5 %	38.7 %	35.4 %	39.1 %
Selling, general and administrative expense	328.1	327.3	1,010.6	1,005.2
Transaction and integration expenses	—	1.3	2.2	27.0
Special charges	3.4	5.8	38.0	20.6
Operating income	235.2	265.2	599.3	738.9
Interest expense	37.9	33.9	104.7	103.3
Other income, net	77.4	3.5	89.9	12.0
Income from consolidated operations				
before income taxes	274.7	234.8	584.5	647.6
Income tax expense	59.3	31.5	115.4	135.5
Net income from consolidated operations	215.4	203.3	469.1	512.1
Income from unconsolidated operations	7.5	9.1	27.2	45.8
Net income	\$ 222.9	\$ 212.4	\$ 496.3	\$ 557.9
Earnings per share - basic	\$ 0.83	\$ 0.79	\$ 1.85	\$ 2.09
Earnings per share - diluted	\$ 0.82	\$ 0.79	\$ 1.83	\$ 2.07
Average shares outstanding - basic	268.3	267.4	268.1	267.2
Average shares outstanding - diluted	270.2	270.0	270.4	270.0