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Mondelez International, Inc. (MDLZ)
Earnings Quality Update- 6/21 Qtr.

6- Exceptionally Strong
5- Strong
4- Acceptable
3- Minor Concern
2- Weak
1- Strong Concern
+ quality improving
- quality deteriorating

We are maintaining our earnings quality rating of MDLZ at 2- (Weak).

MDLZ remains on our Top Sell list.

For an explanation of the EQ Review Rating scale, please refer to the end of this report.

Summary

MDLZ reported adjusted EPS of $0.66 the beat forecasts by 1-cent. The company had a higher tax rate vs. the Covid tax breaks of 2Q20, but they guided to a low-mid 20% tax rate and came in at 22.4%. A 1-cent beat is almost a disappointment by itself and MDLZ did not raise its EPS forecast. There were 4-cents of positive FX in the $0.66 too which by itself more than accounts for the beat.

We think investors should be skeptical that in YEAR EIGHT of the restructuring plan, the cost rose from $76 million to $132 million y/y for 2Q21, (also higher than 1Q21 and 4Q20). That was added back in both years for non-GAAP EPS, but what are they still finding to do in the area and how much of management time, travel, and other employee wages that will be ongoing expenses were allocated to this add-back? The higher figure gave MDLZ an extra 3-cents (the total added back was 7-cents). There was also $32 million in accelerated depreciation and write-offs in the quarter that was added back for 2-cents.

Also, investors should question again that MDLZ took $130 million of pricing against only $20 million of cost inflation for a $110 million boost. That was 6-cents in EPS on top of 6-cents in 1Q21. Where we really think this showed up was a 15% boost in Latin American prices in a quarter when FX was very benign. We have noted for years that Latin American pricing is normally eroded by more than 100% from FX losses. In 2Q21, MDLZ's net pricing gain was 12.1% in that region. Assuming that does not continue and MDLZ had merely a 0% pricing gain there vs. its normal loss – this was over 3-cents in EPS (It should be part of the 6 cents already noted.)

- Latin American insanity continues in 2Q21. MDLZ is pointing to its organic growth rate being 4% over the last 11-quarters. Included in that mix are the results from Latin America. This is only about 11% of revenues and yet is it having a profound impact on reported organic growth. The second quarters are most glaring:

	2Q21	2Q20	2Q19
Reported Organic Growth	6.2%	0.7%	4.6%
Growth w/o Latin America	3.6%	2.3%	3.7%
Latin America % Sales	10.9%	10.8%	13.5%

Latin America often posts negative volume growth, but it completely collapsed with the Covid issues in 2Q20 down 18.8%. A big part of the growth in 2Q21 was simply this easy comp:

	2Q21	2Q20	2Q19
Latin America Volume	18.8%	-18.8%	-0.6%

- Latin American pricing is where MDLZ really benefited this quarter. We have written about this continually. High inflation and currency devaluation allow MDLZ to take sizeable price hikes in that region. However, organic growth ignores the FX hit MDLZ is taking. In 2Q21, we think MDLZ took pricing and then did not experience the same level of FX hit.

	2Q21	2Q20	2Q19
Latin America Pricing	14.9%	7.5%	11.5%
FX hit for Latin Am.	-2.8%	-19.4%	-15.7%
Net Pricing	12.1%	-11.9%	-4.2%

This is why we think MDLZ had a windfall gain of pricing-driven growth for Latin America in 2Q21. Adjusted operating income jumped from $19 million with a 2.3% margin to $57

million with an 8.4% margin. We do not believe this level of net pricing will be achieved again and even MDLZ noted it expects higher FX hits for the rest of 2021.

- Trade promotions are returning. These are reported net of sales and reduced pricing gains in 2Q21:

	2Q21	1Q21	4Q20	3Q20	2Q20	1Q20
A/ME/A Pricing growth	1.9%	2.9%	3.8%	2.4%	1.5%	1.3%
Europe Pricing growth	1.2%	0.9%	-0.6%	-0.2%	-0.8%	0.4%
North Am. Pricing growth	0.2%	0.5%	2.1%	2.1%	3.6%	1.2%

- Even with pricing gains exceeding cost inflation, MDLZ continues to see only modest gains in gross margin. The company will argue that it is reinvesting the pricing gains in new volume growth. However, its pricing gains are significantly outpacing cost inflation and customers tend to notice that. Also, MDLZ is forecasting higher impacts of inflation going forward which should pressure margins:

	2Q21	1Q21	4Q20	3Q20	2Q20	1Q20
Price Hikes	$130	$151	$127	$129	$120	$119
Cost Inflation	$20	$49	$121	$63	$102	$108
Net Boost	$110	$102	$6	$66	$18	$11
y/y Gross Margin gain	20bp	0bp	-80bp	20bp	-90bp	-20bp
y/y Oper Margin gain	30bp	140bp	40bp	70bp	-80bp	-20bp

- We were disappointed that Asia/Middle East/Africa volume growth came in lower than 1Q21 even with a very easy comp. We noted previously that MDLZ was excited about stocking new stores in China and India creating higher growth that would eventually need consumer follow-through demand. Yet, we thought it would be stronger in 2Q21 against a -4.8% comp:

	2Q21	1Q21	4Q20	3Q20	2Q20	1Q20
A/ME/A volume growth	5.1%	7.9%	-0.8%	1.8%	-4.6%	0.9%

- Biscuit demand turned negative to -1.4% for the company and fell in North America in 2Q21. It was a tough comp from the start of Covid in 2Q20 and we expected this. But this demand has been declining ever since 2Q20 and is 50% of total sales.

Explanation of EQ Rating Scale

6- (Exceptionally Strong)- Indicates uncommonly conservative accounting policies to the point that revenue and earnings are essentially understated relative to the company's peers. Higher possibility of reporting positive earnings surprises

5 (Strong)- Indicates the company has no areas of concern with its reported results and we see very little risk of the company disappointing due to recent results being overstated from aggressive reporting in recent periods.

4 (Acceptable)- Indicates the company may have exhibited a minor "red flag", but the severity of the issue is not yet a concern. Minimal risk of an earnings disappointment resulting from previous earnings or cash flow overstatement

3 (Minor Concern)- Indicates the company has exhibited either a larger number of or more serious warning signs than companies receiving a 4. The likelihood of an immediate earnings or cash flow disappointment is not considered to be high, but the signs mentioned deserve a higher degree of attention in the future.

2 (Weak) Indicates the company's recently reported results have benefitted materially from aggressive accounting. Follow up work should be performed to determine the nature and extent of the problem. There is a possibility that upcoming results could disappoint as the impact of unsustainable benefits disappears.

1 (Strong Concern)- Indicates that the company's recent results are significantly overstated and that we view a disappointment in upcoming quarters is highly likely

In addition to the numerical rating, the EQ Review Rating also include either a minus or plus sign. A minus sign indicates that our analysis shows the overall earnings quality of the company has worsened since the last review and there is a possibility the numerical rating will fall should the problem continue into upcoming quarters. Likewise, a positive sign indicates that the overall earnings quality is improving, and the company may see an upgrade in its numerical rating should the trend continue.

Key Points to Understand About the EQ Score

The EQ Review Rating is much more than a blind, quantitative scoring method. While we utilize proprietary adjustments, ratios, and methods developed over decades of earnings quality analysis, the foundation of all of our analysis is reading recent SEC filings, press releases, conference call transcripts and in some cases, conversations with managements.

The EQ Review Rating is not comparable to a traditional buy/sell rating. The Rating is intended to specifically convey the extent to which reported earnings may be over/understated. Fundamental factors such as forecasts for future growth, increasing competition, and valuation are not reflected in the rating. Therefore, a high score does not in itself indicate a company is a buy but rather indicates that recent results are a good indication of the underlying earnings and cash generation capacity of the company. A low score (1-2) will likely result in us performing a more thorough review of fundamental factors to determine if the company warrants a full-blown sell recommendation.

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