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# Pinnacle Foods, Inc. (PF)

Q2 2015 Earnings Call

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# MANAGEMENT DISCUSSION SECTION

**Operator**: Good morning, ladies and gentlemen, and thank you for standing-by. Welcome to the Pinnacle Foods, Inc. Earnings Call for the Second Quarter-Ending June 28, 2015. This conference is being recorded, and there will be a question-and-answer session at the end of the call.

I would now like to introduce your host for today's conference, Pinnacle's Senior Vice President of Investor Relations, Ms. Maria Sceppaguercio.

Ms. Sceppaguercio, please go ahead.

## Maria A. Sceppaguercio
*SVP-Investor Relations & External Communications*

Thank you, Ray. Good morning, everyone, and thanks for joining us today. Here with me to discuss the results for the quarter are Pinnacle's CEO, Bob Gamgort; and our CFO, Craig Steeneck. Earlier this morning, we issued a press release for the second quarter of 2015. If you haven't received a copy of the release you can get one on our website, at www.pinnaclefoods.com.

Our release and conversation this morning will include results on an adjusted basis. The adjusted basis excludes acquisition, merger and other restructuring charges and other items affecting comparability. The company believes that the adjusted basis provides investors with additional insight into our business and operating performance trends.

While the exclusion of these items is not in accordance with GAAP, we believe that it is the most meaningful comparison and the most appropriate basis for discussion of our performance. Details of the excluded items are included in the reconciliation tables included in our press release and are discussed in detail in our 10-Q, which will be filed next week.

Also reconciled in our release and 10-Q is adjusted EBITDA, which is a non-GAAP measure. We define adjusted EBITDA as GAAP net earnings before interest expense, income taxes and depreciation and amortization, adjusted to exclude items affecting comparability. Other adjusted metrics discussed on the call are calculated using this methodology unless otherwise noted. There are couple of timing factors to keep in mind as we discuss our results for the quarter. First, as we stated in our release the earlier Easter this year early Q2 sales by about 1% reversing the 1% benefit we experienced in Q1. As we expected and discussed last quarter, the bottom-line impact in both Q1 and Q2 was minimal given the ongoing high end promotional environment in several of our Q category.

And second, also discussed on our last call, the timing of our new product launch schedule and related upfront introductory expenses were more heavily weighted this year to Q2 versus Q1. As a result, Q2 was burgeoned by higher introductory cost reversing much of the benefit, we experienced last quarter as expected. As you will recall during the quarter Blackstone sold its last 5 million shares in the secondary offering in May. As a result of this offering, Blackstone no longer beneficiary owns any Pinnacle common stock.

Finally, I'd like to remind you that our discussion this morning may include forward-looking statements, which are subject to the Safe Harbor provisions of the Private Securities Litigation Reform Act of 1995. These statements are subject to a number of risks and uncertainties that could cause actual results to differ materially and the company undertakes no obligation to update these statements based upon subsequent events. A detailed discussion of these risks and uncertainties is contained in the company's filings with the SEC.

With that, I'll hand it over to Bob.

## Robert James Gamgort

*Chief Executive Officer & Director*

Thanks, Maria, and thanks to everyone for joining us today. The second quarter was another good one for us and I'm pleased with the ability of our organization to consistently deliver on expectations, both financial and end market. As you know, the food industry remains growth challenged. Our model targeted sales growth to be in line with our categories, but we continue to over-deliver on that front through solid retail execution and on-trend innovation.

This outperformance is helping us to offset weak overall category performance. And for the quarter, we grew both net sales and composite market share. Our adjusted gross margins for the quarter was down about 25 basis points due entirely to the timing of new product introductory expenses, as Maria referenced, which cost us about 45 basis points.

Inflation exceeded productivity slightly in the quarter, as expected. However, the benefits of higher net pricing and favorable product mix drove the solid gross margin performance for the quarter. We continue to manage our expenses well and benefited from lower net interest expense and a lower effective tax rate. Taken together, all of these factors drove adjusted EPS growth of 9% for the quarter.

Turning to the highlights of the quarter. We grew consolidated net sales 2.3% and North American retail net sales 2%, despite the 1% drag from Easter timing. Driving the growth were the Gardein acquisition and higher net price realization, largely reflecting the impact of select pricing actions on several brands taken in response to protein inflation.

Partially offsetting these positive drivers was lower volume mix, largely driven by Easter timing, and the volume elasticity impact of the pricing. In terms of share, we again outpaced the performance of our categories, growing our composite market share by about 40 basis points in the quarter on the strength of significant share growth from our frozen portfolio.

Six of our eight leadership brands held or grew share in the quarter. As discussed, excluding the timing impact of new product introductory cost, our adjusted gross margin was up about 20 basis points. Productivity totaled about 3.4% of cost of product sold for the quarter, while our input cost inflation totaled approximately 3.6%.

Inflation continue to be driven by high single-digit cost increases in logistics and elevated cost in proteins, which more than offset modest inflation across the balance of our inputs including some items which were deflationary.

SG&A expenses increased less than 2% for the quarter, largely reflecting the inclusion of Gardein and the non-cash impact of the long-term incentive compensation program we established following the IPO.

Net interest expense declined approximately 9% due to last year's deleveraging, while our effective tax rate came in at 35.3% versus 38.1% last year, due to qualifying in 2015 for both the domestic production activity deduction and foreign tax credit. The latter accelerated by the Gardein acquisition. Finally, adjusted diluted EPS for the quarter totaled $0.36, a 9.1% increase versus year ago.

Turning to our segments, starting with Birds Eye Frozen. Net sales were up 9% in the quarter fueled by growth of the Birds Eye franchise and the benefit of Gardein despite the 2% headwind from the timing of Easter. The frozen Leadership Brands portfolio registered strong net sales growth in the quarter and every brand gained market share.

As you know, Birds Eye is our single largest brand with over $1 billion in retail sales. The franchise is anchored in plant-based nutrition, which is growing in popularity. To capitalize on this favorable trend, we continue to leverage Birds Eye health and wellness credentials with innovative new products that satisfied changing consumer needs.

During the quarter, you will recall, that we launched two new Birds Eye platforms, namely, Birds Eye Flavor Full, a line that pairs popular vegetables with on-trend flavors such as buffalo, wasabi and barbecue. And Birds Eye Protein Blends, a line of side dishes that deliver plant-based protein through the power of nutrient-rich vegetables, legume and whole grains.

Both launches are being supported with dedicated TV advertising that began airing in July along with digital and social media featuring our new spokes birds. While still early, both platforms have been met with strong acceptance by retailers and early consumer results are equally encouraging. In fact, our data indicates that both platforms are highly incremental, bringing new users, including millennials to both the category and Birds Eye.

Another important area of focus for us as we're making it easier and more enjoyable for kids to eat vegetables. We have done this over the past few years through multiple partnerships, the most recent of which includes Disney, the partnership for a Healthier America, Celebrity Chef, Melissa d'Arabian and Disney Teen Star, Laura Marano.

In the third quarter we are further reaching moms and kids by introducing a new line of Disney-themed vegetable and pasta side dishes under the Birds Eye Steamfresh brand. The new line features great tasting and nutritious flavor combinations with characters from key Disney properties such as Frozen, Mickey and Minnie and Cars. We will provide more details for you as the launch progresses.

Birds Eye Voila! skillet meals posted another quarter of double-digit consumption growth on the strength of continued distribution gains and expansion of our Voila! Family size line. The business is also benefiting from it's first-ever TV advertising featuring our new sports Birds along with digital and social media campaign. Market share in the quarter advanced more than eight full share points and we plan to continue to drive the growth of this business with incremental activity as the year unfolds.

Turning to Gardein, which you will recall we acquired in the fourth quarter of last year. Gardein builds upon our leadership in frozen vegetables with its unique portfolio of plant-based protein products. This business continue to grow at strong double-digit rate across both the traditional and natural and organic channels, with consumption in the quarter up more than 30% and our market share continuing to advance.

Importantly, Gardein continues to experience significant increases in velocity and distribution across all channels. And as we build awareness for the brand, we expect both to continue to advance meaningfully. To keep up with Gardein's growing demand, we are expanding capacity in our Vancouver manufacturing facility this year, investing about $5 million. We are also pursuing additional capacity expansions here in the U.S.

We continue to believe that plant-based proteins are at the tipping point of becoming mainstream, positioning Gardein, given its superior taste and texture to benefit meaningfully from this growth trend. The Frozen Foundation Brands portfolio declined, largely due to the volume elasticity impact associated with recent pricing actions on a number of brands.

For Hungry-Man, despite the recent pricing, the business continues to perform well. Our new Hungry-Man Selects Chicken & Waffles variety introduced in the first quarter is one of the reasons for that. Our total frozen segment share net 80 basis points for the quarter, with our consumption up 3% in the category composite that was down.

Adjusted EBIT for this segment was down 1.5%, reflecting higher new product introductory costs behind our two new Birds Eye platform, increased investment in consumer marketing and input cost inflation, partially offset by higher sales and productivity savings.

Our Duncan Hines Grocery segment posted a 4% decline in net sales, largely due to heightened promotional intensity in the baking category, which I'll talk about in a moment, and the unfavorable impact of the timing of Easter. In addition, growth of syrups and canned meat was more than offset by lower sales of Wish-Bone and unfavorable foreign currency translation. Our total grocery segment's share declined slightly, with strong market share growth in pickles, syrups and pie fillings, offset by softness in baking, canned meat and dressing.

Turning to baking. Category volume in the quarter continued to be under pressure in part due to the timing of Easter. This was despite category pricing being lower by about 1.5% excluding Pinnacle. Our pricing was up more than 4% in the quarter. Instead of battling strictly on price which tends to drag the category down, we continue to innovate to address some of the category structural issues and capitalize on opportunities resulting from changing consumer preferences.

For example, one headwind that has negatively impacted the category is the decline in household size in America that makes it a less desirable to bake a full-size cake. That's why we and our retailers are excited about the recent launch of the Duncan Hines perfect size platform, a baking kit that is designed specifically for smaller households.

For a perspective, one to two person households have grown to now represent 60% of total U.S. households. Duncan Hines perfect size addresses this demographic shift by providing smaller households a baking option for two to four people. Perfect size kits which come in five varieties, include the cake mix and frosting mix, and a disposable six-inch baking pan. The new line began shipping on July 1st.

Turning to Wish-Bone. The manufacturing startup is now complete and profit continues to track on plan despite some sales softness. As we've discussed previously, we expect this new in-house manufacturing capability to be an enabler to innovation and we are excited about the robust new product pipeline we have ready for early next year. We will share more detail with you at the end of this year.

During the quarter we had a very limited recall of Wish-Bone Ranch Dressing that was produced by Unilever under the co-manufacturing agreement we had with them through mid-May due to mislabeling. Unilever has accepted full responsibility and there is no financial impact to Pinnacle resulting from this recall. Adjusted EBIT for the grocery segment was up 3% largely due to productivity, savings, and favorable timing related to consumer marketing for new products, partially offset by input cost inflation and the sales decline.

Our Specialty Foods segment posted a 4% increase in net sales for the quarter, largely due to the growth of private label canned meat business, while adjusted EBIT advanced 15%, primarily reflecting the growth in net sales and productivity savings, partially offset by input cost inflation.

Before turning it over to Craig, I want to take a moment to comment on the benefit of the investments we made over the past couple of years to build a leading sales organization. You will recall that at the time of our IPO, we had recently transitioned to a hybrid sales structure and which we increased our headquarters' coverage with Pinnacle employee to more than half of our sales.

Since that time, we continue to invest in building capabilities in the area of strategic pricing, analytics, category management, and shopper insights. The 2015 Advantage Group survey of retailers which evaluates manufacturers across a wide range of performance metrics, demonstrates how Pinnacle has improved over the past three years.

Moving from the bottom tier in 2012 to the middle tier in 2014 to the top tier in 2015 with an overall company ranking of seven out of 23 companies and a number two ranking for our personnel. Our enhanced ability to partner with our customers is clearly one of the drivers of our consistent share growth performance.

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

## Craig D. Steeneck

*Chief Financial Officer & Executive Vice President*

Thanks Bob and good morning, everyone. I'll start with our financial results for the second quarter and then we'll then discuss our updated guidance for the full year.

Starting with sales, our consolidated net sales increased 2.3% in the second quarter to $632 million. Reflecting the benefit of the Gardein acquisition and based business results that were essentially even with year ago. Despite the unfavorable Easter timing impact of 1% mentioned earlier.

North American retail sales advanced 2% reflecting a 2.9% benefit from Gardein and higher net price realization of 1.2%. Partially offsetting this growth with lower volume mix of 1.7% driven by Easter timing and unfavorable foreign currency translation of 0.4%.

For our Birds Eye Frozen segment, net sales increased 9.2% despite the unfavorable impact of approximately 2% from Easter timing. This performance reflected a 6.4% benefit from Gardein. Increased volume mix of 1.6% and higher net price realization of 1.2%. Growth of our Leadership Brand portfolio was very strong driven by Birds Eye Voila!, which had – which was up double-digits in the quarter and Birds Eye Vegetables, which benefited from the launch of our Flavor Full and Protein Blends platforms.

For our Duncan Hines Grocery segment, net sales declined 4.1% including the unfavorable impact of approximately 1% from the Easter timing. Higher net price realization of 1.2% was more than offset by lower volume mix of 4.6% and unfavorable foreign currency translation of 0.7%.

From a brand perspective, the net sales decline was driven by Duncan Hines, primarily due to category weakness, and, to a lesser extent, Wish-Bone Salad Dressings. Partially offsetting these declines were higher sales of Log Cabin and Mrs. Butterworth's Syrups and Armour and Nalley's canned meat.

And, finally, for our Specialty Foods segment, net sales increased 4% in the quarter, driven by higher volume mix of 1.8% and increased net price realization of 2.2%. The growth was largely due to higher sales of private label canned meat. It is worth noting that net sales and EBIT for Q3 for Specialty will be under pressure due to comping against last year's large USDA canned meat bid that drove results in Q3 last year.

Turning to gross profit. On an adjusted basis, our gross profit increased 1.3% to $166.3 million in the second quarter. As a percentage of net sales, gross profit declined approximately 25 basis points to 26.3%, due entirely, as Bob mentioned, to the timing of new product introductory expenses that costs us about 45 basis points in the quarter.

Excluding this timing impact, gross margin grew 20 basis points in the quarter due to strong productivity, higher net price realization and favorable mix, partially offset by input cost inflation. For the quarter, input cost inflation totaled 3.6%, primarily driven by high-single-digits logistics inflation and mid-single-digit protein inflation.

Protein inflation for the quarter moderated somewhat versus Q1, and we expect protein costs will continue to moderate for the balance of the year. Manufacturing costs in the quarter were also somewhat elevated due to continued significant growth of Birds Eye Voila! and our new Birds Eye platform innovations, requiring us to add some short term co-pack capacity should meet demand, while we add internal capacity by year-end.

As previously disclosed, we expect second half inflation to be lower than the first half, while the opposite is true for productivity which is expected to accelerate in the second half. This relationship between productivity and inflation will be a meaningful benefit to gross margin in the second half.

Turning to EBIT, excluding items affecting comparability, EBIT advanced approximately 1% to 87 million in the quarter, reflecting an increase in gross profit and a timing of consumer marketing related to new products, which is skewed to the second half. Partially offsetting this growth were higher administrative expenses, driven by increased non-cash stock-based compensation expense, higher depreciation expense and the inclusion of Gardein.

Interest expense for the quarter declined 9.5% to 22.2 million, driven by our debt reduction in 2014 and the related 25 basis point interest rate step down on our term loans. Our effective tax rate for the quarter, again, excluding items affecting comparability, declined to 35.3% versus 38.1% in Q2 last year.

This tax rate favorability reflected that we will begin to qualify in 2015 from both the domestic production activities deduction and foreign tax credit, given the significant roll off of our NOLs. In addition, the structure we used for the Gardein acquisition accelerated some foreign tax benefit into 2015 which was one-time in nature.

Adjusted net earnings increased 9.6% to $41.9 million, or $0.36 per diluted share in the quarter, compared to $38.3 million, or $0.33 per diluted share in the year ago period.

Now, turning to cash flow. Net cash provided by operating activities in the second quarter totaled $53 million compared to $93 million in the year ago quarter. This performance largely reflected higher inventories related to the early receipt of agricultural crops and the pipeline build associated with new products. Both are expected to normalize by the end of the year.

Capital expenditures in the second quarter totaled $21 million compared to $34 million in the year ago period. For the full year, we continue to expect CapEx in the range of $100 million to $110 million, excluding any potential capital this year in the U.S. associated with the Gardein expansion.

Turning to liquidity. At the end of the second quarter, our total debt was $2.3 billion, which includes $1.9 billion in term loans and $350 million in 4-7/8 senior notes. Cash totaled $53 million at quarter-end, bringing our net debt to $2.25 billion and our net leverage ratio to 4.13 times compared to 4.23 times at year-end 2014.

Finally, in terms of our improved outlook for the full year, we now expect diluted EPS in the range of $1.89 to $1.91 versus our previous guidance of $1.86 to $1.91. The new guidance incorporates the following assumptions, input cost inflation of 3% to 3.5%, productivity in the range of 3% to 4% of cost of product sold. Interest expense of approximately $90 million and effective tax rate of approximately 36.5% to 37% versus 38% previously, reflecting the benefit of the foreign tax credit. And a full year weighted average diluted share count of 117.3 million to 117.5 million shares versus a 117 million previously. This increase reflects the impact of a higher share price in calculating diluted shares outstanding and implies a second half share count in the range of 117.4 million to 117.7 million.

With that, I'll turn the call back to the operator and open it up for your questions.

# QUESTION AND ANSWER SECTION

**Operator**: Thank you. [Operator Instructions] And our first question comes from the line of Andrew Lazar of Barclays. Your line is open.

Andrew Lazar
*Barclays Capital, Inc.*
Q

Good morning everybody.

Robert James Gamgort
*Chief Executive Officer & Director*
A

Hi Andrew.

Andrew Lazar
*Barclays Capital, Inc.*
Q

So want to get a just a little bit more clarity on the full year guidance if I could just to make sure I fully understand it. The favorable tax rate now versus prior expectations for the year would seem to account for the majority of the narrowing of the range to the upward portion of the previous range. So, ex that, I guess, on an underlying basis, it's just -- maybe it's a little bit towards the lower end of the range excluding that. So, just trying to get a sense of what that's incorporating? Is it further reinvestment, is it keeping track of what ultimately may occur in, let's say, the baking category as the year progresses? Trying to get a sense of your thinking there.

Robert James Gamgort
*Chief Executive Officer & Director*
A

Sure. We feel great about the performance of our business year-to-date and are confident of our business for the balance of the year. When you think about the upbeat in guidance, obviously it reflects the benefit that you describe combined with that confidence. It also does give us some flexibility in the back half of the year as you point out.

And as an indication sort of the weighting of the fourth quarter, if you take a look at our business that represents about a third of our EBITDA for the year, shows up in the fourth quarter. And as we frequently talk about at this time, we'd like to keep dry powder to be able to be competitive in the fourth quarter as needed.

And we've seen some pressure in the baking category, and we've seen some very aggressive reaction from competitors in that category. So we thought it was in our best interest and then in all of our best interest to be able to be in a position to deliver our EPS at the high end of the range as we talk about, but yet be able to keep some reserve in place to remain competitive if needed in the fourth quarter.

Andrew Lazar
*Barclays Capital, Inc.*
Q

Thank you for that. And then, Birds Eye Frozen, obviously the shipments were very strong in the quarter and a lot of that's I'm assuming some of the new products that were launched and things like that. So I'm just trying to get a sense and make sure that your sense on consumption is matching that or what we need to see obviously in the third quarter, given was it shipments ahead of consumption more just from launching new products or how do we want to think about how it shapes up in 3Q on the top-line?

Robert James Gamgort
*Chief Executive Officer & Director*

A

Sure. Actually, for the quarter, even with a 9% growth in shipments as you point out. Our shipments are very much in line with our consumptions, so if I break it down, of the 9% about 6 points of that 6 of the 9 were driven by Gardein as a comparison to year ago. So that leaves you about 3%, sort of, underlying growth that matches very nicely with our overall frozen segment consumption and what I would point is even embedded in that. Is when you look at the Birds Eye franchise, our consumption in the second quarter was up 6% and so and that's really before the innovation has really hit that we just shift and obviously it doesn't reflect the latest Disney platform that we just talked about today that we're just shipping right now. So our consumption very much supported that shipments strength and I think it's actually sort of, in the early stages of what we expect to see from the impact of the innovation. So we are very bullish on the Birds Eye franchise and our frozen business in total.

Andrew Lazar
*Barclays Capital, Inc.*

Q

Great. Thank you very much.

Robert James Gamgort
*Chief Executive Officer & Director*

A

Sure.

**Operator**: And our next question comes from the line of Farha Aslam of Stephens, Inc. Your line is open.

Farha Aslam
*Stephens, Inc.*

Q

Good morning.

Robert James Gamgort
*Chief Executive Officer & Director*

A

Good morning, Farha.

Farha Aslam
*Stephens, Inc.*

Q

I had two questions. The first one is on your Gardein acquisition. Could you just share with us, kind of, the distribution you've gotten on Gardein? Clearly, that's also really helping us for the frozen division and some color about what growth rates we can expect from that business?

Robert James Gamgort
*Chief Executive Officer & Director*

A

Sure. If you take a look at consumption on Gardein. And we look at two sources for that. We look at traditional MULO channels to IRI and we also look at SPINS data, which gives us view into natural and organic channels. You know, we are seeing growth in IRI channels above 30% and we are actually seeing growth in the SPINS channel above 40%. So great, great, business growth driven by a combination of distribution expansion as well as just velocity and then still at a time when awareness and absolute trial for this business would be on the very low end, so tremendous amount of upside. When we look at distribution, to answer your question specifically, we're in about 85% of the natural channel and we're in about two-thirds – we have some presence in two-thirds of the traditional channel.

And I'd say that when you take a look at the average number of items we have in distribution, it's around 7 in traditional channels. But that's truly an average. We have some retailers where we have 14 or 15 SKUs and we have other retailers where we have just a couple of SKUs.

So we think there is upside on the Gardein business in multiple ways. One is to fill out that distributions. Two-thirds would be on the low end of any of our business – actually, probably, the lowest of any of our businesses that weren't regional in nature. And so we see upside there.

We also see upside in filling up the number of SKUs, and then the big upside in all of this is building awareness trial, which we know will lead to repeat for this category. And that's why we're in investment mode on this business, as we said at the time of the acquisition.

As I talked about it in my section, we're expanding our capacity in the existing plant in Vancouver, and we are in process of identifying opportunities to expand capacity here in the U.S. And so very, very positive momentum on this business and one that we think will continue for years to come.

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**Farha Aslam** Q
*Stephens, Inc.*

And then, when you just look at your other acquisitions, since you've been public as Wish-Bone, has that lived up to your expectations now that you've had it for a while as innovation and industry trends on that salad dressing business?

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**Robert James Gamgort** A
*Chief Executive Officer & Director*

Yeah. I mean, from a profit standpoint, it has lived up to our expectations. From a volume and share standpoint, it's been somewhat below what we expect. And we think the category has been a bit softer, although in the most recent quarter, it looked better. And our share performance hasn't been as good. Now, in 2014, we suggested that was going to happen because we pulled back on some of the very aggressive promotions that were put in place prior to the sale of that business.

But in 2015, we saw some competitive pressure and didn't want to match some of the most aggressive price points. In most recent quarter, our share performance was better, it was nearly flat. If you look at it the food channel, it was flat. And I think our priority has been getting the manufacturing asset up and running which it now is. We're no longer in a co-packing agreement or co-manufacturing agreement with Unilever.

And the big unlock that that creates for us is innovation. And we're going to pull the same playbook we have in Birds Eye and Duncan Hines, in all of our other categories that we talked about which is adding benefits to our products, trading people up, and actually hitting some of the category headwinds directly through innovation. And we got a great innovation pipeline that we're going to be launching in 2016 and we look forward to talking with you about the specifics of that at year end and we think you will be equally excited.

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**Farha Aslam** Q
*Stephens, Inc.*

So, the profits of both have pretty much met your expectation?

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Robert James Gamgort
*Chief Executive Officer & Director*

A

When you say both Wish-Bone and what else?

Farha Aslam
*Stephens, Inc.*

Q

Wish-Bone and Gardein?

Robert James Gamgort
*Chief Executive Officer & Director*

A

Yes, very much. Remember Gardein, we did not have expectations in the way of incremental profitability in the short-term because we set up the time of acquisition, we were going to be investing to expand distribution and also capacity. But from a profit standpoint, we're very much on track with both.

Farha Aslam
*Stephens, Inc.*

Q

Fantastic. And then when you look forward, could you share with us the M&A environment that you're seeing, are you seeing more attractive opportunities in the frozen business or in the dry grocery?

Robert James Gamgort
*Chief Executive Officer & Director*

A

Yeah. Remember we continue to pursue a dual path approach. We review and analyze all of the assets that are formally up for sale, and you're familiar with what those have been and what are out there right now. But I think, more importantly, we've been proactive and continue to be proactive in approaching the strategics for the assets that we know would be game-changers for us. And a lot of those proposals that we put on the table are also tax advantage structures.

So we've said it numerous times. The industry needs to consolidate. We want to be a consolidator in the industry. And although that's been slow to happen, we see the investments made by 3G and the aggressive moves that they are taking and some of the recent interest by activist investors as support for our point of view. And I think, more importantly, we really hope that they serve as a catalyst for additional consolidation.

And, certainly, it has allowed us to dial up some of the conversations that we've had with strategics. It's nice to have a catalyst in the marketplace to sort of accelerate those conversations. I think while all of that is happening, the really important news is the strength of our organic business performance, which is where the great, great majority of our organization is focused continues to be really positive, which enables us to be disciplined and patient in our approach to M&A.

And I think that the macro trends that you're seeing from a consolidation M&A standpoint, and some of these where I would call it external influences into the industry are all moving in our direction.

Farha Aslam
*Stephens, Inc.*

Q

That's helpful. Thank you.

**Operator**: And our next question comes from the line of Chris Growe with Stifel. Your line is open.

Christopher R. Growe
*Stifel, Nicolaus & Co., Inc.*

Q

Hi. Good morning.

Robert James Gamgort
*Chief Executive Officer & Director*

A

Hi, Chris.

Christopher R. Growe
*Stifel, Nicolaus & Co., Inc.*

Q

Hi. I just had two questions for you, if I could. I wanted to get a better sense, Bob, in relation to your kind of holding back some dry powder. Have you used any dry powder yet? Is this more about what may happen later in the year? And I guess the context of my question just will be that, we're seeing promotional spending across a lot of categories actually trend down.

Robert James Gamgort
*Chief Executive Officer & Director*

A

Yeah.

Christopher R. Growe
*Stifel, Nicolaus & Co., Inc.*

Q

So just want to get a better sense of what you're seeing there in general and what you – how you've directed so far?

Robert James Gamgort
*Chief Executive Officer & Director*

A

It's forward-looking dry powder and in our mind is very focused on the fourth quarter, again, because of the impact of the holidays on a number of our categories. Particularly frozen veg and baking and some of the competitive activity that we've seen in response to – I say, in response to the category growth of – in baking, I could argue that it's causing some of the weak category performance in baking. So it's very much forward-looking.

We agree with you in terms of what we're seeing across most of our categories. We're seeing a slight reduction in promotional activity, not a surprise given the inefficiency of promotional spending. And we're seeing a slight but steadily increasing uptick in average price. We've certainly led the way in our categories. When I take a look at for example in the second quarter, if you look at our average price per unit, look at it in syndicated data, we were up over 4% and that's a combination of true pricing and mix as you know the way that IRI looks at it.

And our categories for the first time were up about 1.5%, which is – lags us, but at least it's a step in the right direction. So I would agree with you that across the board we're seeing a moderation of promotional activity and a slight uptick in pricing. But again, a-third of our EBITDA comes from the fourth quarter and we've seen some behavior in critically the baking category that we got to keep our eyes on. We love trading up and innovating but there is a threshold in which we have to defend our turfs and we just want to be ready to be able to do that.

Christopher R. Growe
*Stifel, Nicolaus & Co., Inc.*

Q

Okay. And then, just one other question somewhat related. Your revenue growth in baking mixes and salad dressings, were those down in the quarter, you talked about some pricing being strong and baking mixes in relation to category. Will those two down for you in terms of revenue growth in the quarter?

Robert James Gamgort
*Chief Executive Officer & Director*

A

Yeah. Talking about from a consumption standpoint that we disclosed publicly. But clearly in the second quarter, our revenue was down in baking, if you look at our consumption. In the category in the second quarter was down 10%, which is partly driven by the timing of Easter, which has a disproportionate impact on that category.

But I think really importantly, you take a look at a situation where our pricing was up 4% in that quarter and we see the category excluding Pinnacle, so all the competitors excluding Pinnacle were down about 1.5% and what we're seeing is, it's not nearly an impulse category and if you take pricing down $0.25 on a base caking mix, people don't bake any more. So all you are doing is trading down that revenue on the same time for unit but what I would point out is that's across all of baking and I think that as you know, our strategy has been to be competitive at the low end of baking but emphasize the mid and higher end of baking for all of our innovation and marketing effort and again the numbers prove themselves out. If you look at them on a year-to-date basis. We're up slightly in share on a year-to-date basis. We're down in the classic segment. We're flat in the signature segment and all of our share growth is coming from the Decadent segment. And that really is an important strategy that goes beyond absolute volume and absolute market share. It gets to the area of baking in where it's the most profitable for us and it's the most profitable for our retailers and we also think it plays nicely to the growing consumer trend and we're really excited about the launch of Perfect Size. Just shipping right now that tremendous receptivity from customers and what everybody likes about it is instead of it being another flavor introduction or a novelty-based innovation, it is directly targeted at one of the barriers to baking growth, which is more than 60% of households are one to two people and they don't want bake a full size cake.

So, our approach is to understand what are the barriers and the opportunities and innovate directly against them. And that's priced at the Decadent price point and so again, it trades people up even though it's a tremendous value compared to what they would buy in a bakery and it solves the fundamental needs.

So, it's rough within the baking world if you look at it in aggregate. We love our strategy. It's playing out really nicely from a profit and mix standpoint. But to the earlier question, we have to be very mindful of what some of the aggressive competitive pricing activity is going to be in the fourth quarter and decide where and when we want to match it just to hold their own.

Christopher R. Growe
*Stifel, Nicolaus & Co., Inc.*

Q

Okay. Thanks for all the good color.

Robert James Gamgort
*Chief Executive Officer & Director*

A

Okay.

**Operator**: Thank you. And our next question comes from the line of Bryan Spillane of Bank of America. Your line is open.

**Bryan D. Spillane**
*Bank of America Merrill Lynch*

Q

Hey, good morning everyone.

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**Robert James Gamgort**
*Chief Executive Officer & Director*

A

Hi Bryan.

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**Bryan D. Spillane**
*Bank of America Merrill Lynch*

Q

Bob just wanted to follow-up on your commentary on baking products, baking mix -- maybe baking mixes specifically. Could you just kind of looked at the velocity for the category particularly in baking mixes over the last 52 weeks even -- really the last two years, the velocity. So, just sales per total point of distribution has been declining pretty significantly.

And so is there a risk or is there a possibility that you'll see retailers begin to adjust maybe either just allocation less shelf space, you know taking away some of the extra shelf space around promotional periods and some of the promotional activity you are seeing from some of your competitors kind of a result of trying to sort of keep shelf space where it is? Just trying to get your perspective on that, if you can?

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**Robert James Gamgort**
*Chief Executive Officer & Director*

A

Sure. It's a really unique category in the world of foods and one that's very important for retailers because they know the people who bake also cook and they buy a lots of ingredients and it's a very, very valuable customer for the retailer. So they are equally troubled about the trends and the category and as you might imagine are reacting to it differently, retailer by retailer even by geography.

I think what continues to be proven in this category, is that price promotion, especially at the low end, does nothing for the category and ultimately does very little for the retailer and as a short-term reaction that doesn't really pay off in the longer term. And so our approach has been we know this is an important category for you. We want to innovate and trade people up and we also want to recognize that although you see these velocity numbers that you point look troubling, they're really skewed to the entry level price points in baking and what I would argue is the more commoditized segment.

When you look at the more value added segment in which we are the leader you are seeing very good growth and you are actually seeing very good velocities in there. So I think there is less of a concern about the macro or the total baking section shrinking. I think it's more a discussion about how do you reset that section to take advantage of the trends that I just talked about and if it were to get trimmmed, it's going to get trimmed at the very, very low end of the marketplace which quite frankly we care much less about than we do playing to the higher end.

And again, when you look at interest in baking, it continues to grow with reality TV programs that all the internet excitement around baking that is not translating into the low end of baking mixes because people want to do more and that's why our innovation is focused and that's sort of the interest that we're really capitalizing on.

So, again, it's bumpy when you look at the aggregate numbers it looks really rough and if you are a retailer you'll be troubled by it. But when you peel back to my -- the breakout that I just gave a minute ago and peel out and say what's our performance in classic versus signature versus Decadent, it's proof that our strategy of appealing to a slightly higher end baker, I don't mean that from an income standpoint, I mean it from an interest standpoint.

With value added product that allow to deliver better that people are very responsive to that. We are going to keep working that strategy and again Perfect Size, I think it was one of many innovations to come that suggest that we can do that.

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**Bryan D. Spillane**
*Bank of America Merrill Lynch*

Q

Is it two early yet to determine whether or not perfect size is going to have may be better velocity than the average, and the reason why I ask this is we saw the Coca Cola last night and one of the things they have seen now that they've emphasized smaller packages over the last year especially in the U.S. is that it's actually driving more incidents, higher velocity, I think they have been pleasantly surprised at the list that they have seen.

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**Robert James Gamgort**
*Chief Executive Officer & Director*

A

Sure.

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**Bryan D. Spillane**
*Bank of America Merrill Lynch*

Q

And I am just curious if you've had any chance to observe that yet with Perfect Size?

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**Robert James Gamgort**
*Chief Executive Officer & Director*

A

Very early to tell on that, we gave you the early velocity and early sales information on the Bird's Eye protein blends and flavor full because we had another quarter. So we'll need another quarter and on the next call we can certainly talk about what we're seeing on the end market performance. I can tell you that, the retailer excitement around Perfect Size has been very, very high. And of course, we wouldn't have launched it if we didn't do a ton of consumer testing around it to make sure that it was well received. But you know we have to see how that plays in the marketplace.

But what I will tell you is unique about it is, it delivers a smaller portion size product, but make no mistake, it's a premium product, because what we are offering is a combination of cake mix, frosting mix, and because no one has a six-inch pan in their house that was the big barrier to this idea. We had a put a disposable six-inch pan in the package, lead the convenience, because that you are actually trading people up on a serving basis, which is a really good strategy.

So I think velocity will be A measurable use to evaluate Perfect Size, I think a more important metric will be its incrementality and ultimately the profitability to the retailer. Because that's the mindset we have to get people will think about in baking which is, let's worry less about how many turns, and more about are we driving up the profitability of the segment that lined up with where the consumers want to be, which is more premium products.

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**Bryan D. Spillane**
*Bank of America Merrill Lynch*

Q

All right. Thank you.

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**Robert James Gamgort**
*Chief Executive Officer & Director*

A

Okay.

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**Operator**: And our next question comes from Robert Moskow with Credit Suisse. Your line is open.

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**Robert B. Moskow**
*Credit Suisse Securities (USA) LLC (Broker)*

Q

Hi, thanks.

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**Robert James Gamgort**
*Chief Executive Officer & Director*

A

Hi, Robert.

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**Robert B. Moskow**
*Credit Suisse Securities (USA) LLC (Broker)*

Q

Forgive me if you talked about it already, but the Gardein brand seems to be off to a good start and I wanted to get a sense about your growth expectations for it. How big is it this year, how big do you think for next year? And maybe just me, because I am more aware of it, but -- I seem to be seeing a lot of these brands that are using pea proteins, as a meat substitute, how many competitors do you think you have there and do you see the same – do you see a big influx right now of these types of brands and do you think Gardein is the – where do you think their market share is in relation to them.

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**Robert James Gamgort**
*Chief Executive Officer & Director*

A

Yeah, Gardein is not the largest in the segment. There are some more established, long established brands. They are currently largest, but if you look at the trends they're going in sort of a negative direction and Gardein is obviously growing at as I said before, above 30% in MULO and above 40% in the SPINS natural and organic channel. And we feel to a larger extent that we are really just getting started both in terms of our ability to fill out the breadth of distribution and we have another third of the marketplace right in traditional grocery that has no Gardein in it.

We also in terms of the depth of the distribution as I said before the average number of – the average store has about seven items in distribution but it's heavily skewed by a few that have more than 10, 14, 15 and most that have only a few. So we're just getting started. And then the biggest opportunity is awareness trial and repeat and so yes there is a lot of interest in this category because this is a category that's going to be very big in the future and it's going to be very big for three reasons, health and wellness, but also sustainability versus animal protein and affordability versus animal protein.

And as we said that need has always been there, but the unlock has been, does it taste good? And we think that the big advantage that Gardein has over all of the competitors and believe me we cut all of the competitors before we made the acquisition, and we try every new item that we see pop up on the shelf. Gardein still has a tremendous advantage in terms of taste and texture and we're going to continue to expand that capability into new formats and new flavors and that's the piece that ultimately wins the day in food which it tastes. So we haven't been disclose size of the – the absolute size of business in the world what our growth expectations are, my only comment would be that the numbers that you are seeing right now the plus 30, and the plus 40, we feel like we're just getting started on those. And so that's – that's not a short-term phenomenon, it's something that we believe over the long-term. And as we talked about 2016 guidance we'll give you more color on how we think about Gardein at that time.

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**Robert B. Moskow**
*Credit Suisse Securities (USA) LLC (Broker)*
Q

And Bob did you say that you opened new manufacturing capacity for Gardein recently?

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**Robert James Gamgort**
*Chief Executive Officer & Director*
A

Yeah. What we found is that, they have got a great plant that we acquired up in Vancouver and we saw an opportunity to be able to a combination of some engineering expertise and capital investment to be able to get a nice bump up in output from that existing plant. And that's always the first place you go when you want to expand capacity and one of the concerns that Gardein team had when we started partnering with them is could they feel the growth that they were on with the existing capacity. And so we've been able to alleviate those capacity concerns in the short-term because we want everybody focus on growing this business.

And at the same time we're looking beyond the short-term and we're in serious work being done to expand capacity in the U.S. which would sfill this out nicely, Vancouver's West Coast would be nice to have something more East Coast base in the U.S. and that's underway. And it's honestly in the food industry where we talk about lack of growth. It's really nice to be working on our business where our biggest concern has been capacity expansion and to a degree it's capped some of the growth historically and we're going to make sure that doesn't happen going forward.

And the only other thing I would point out is we say things like Gardein is off to a good start. This business has been running like this for years. We just happen to have the opportunity to partner with them starting in 2014 and be able to continue to feel this momentum, but this isn't short-term phenomenon, this is a long-term phenomenon. They have so much upside in it, which is why we were excited about making that acquisition.

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**Craig D. Steeneck**
*Chief Financial Officer & Executive Vice President*
A

And Rob, we do have $5 million of capital coming into Gardein in the fourth quarter of this year, that's all part of -- in Vancouver all part of our guidance. And with the engineering improvements that Bob talked about plus that 5 million in capital we feel that would adequately allow us to cover Gardien's 2016 needs from the sales perspective.

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**Robert B. Moskow**
*Credit Suisse Securities (USA) LLC (Broker)*
Q

Okay. Thank you.

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**Operator**: And your next question comes from the line of Matthew Grainger with Morgan Stanley. Your line is open.

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**Matthew C. Grainger**
*Morgan Stanley & Co. LLC*
Q

Hi thanks good morning everyone.

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**Robert James Gamgort**
*Chief Executive Officer & Director*

A

Hi Matt.

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**Matthew C. Grainger**
*Morgan Stanley & Co. LLC*

Q

Hi. So, Bob and Craig just I wanted to ask a broader M&A question, I know you are constantly on to look out for a wide range of potential candidate of all shapes and sizes, I mean as you are considering the merits of the larger more transformative acquisition, potentially one structured as an RMT. How do you think about the constraints on the magnitude of synergies you could potentially realize in combining with a much larger sales or asset base in the current – than scale of the current company?

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**Robert James Gamgort**
*Chief Executive Officer & Director*

A

I think I understand the question, let me come at it, and if not please clarify.

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**Matthew C. Grainger**
*Morgan Stanley & Co. LLC*

Q

Sure.

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**Robert James Gamgort**
*Chief Executive Officer & Director*

A

So that we are in the right direction. I think what we are excited from an RMT standpoint, is the fact that we think it makes a lot of these transactions more actionable because one of the biggest objections to the combination is the tax leak as we just talked about before. So RMT from our standpoint is really an enabler to get some of these assets freed up, while because we can relax this constraint that we often hear about tax leakage.

One of the biggest areas of interest for us is to get at the synergies and it's something that we do very, very well and we've evidenced that all the way back to Birds Eye and of course, Wish-Bone even though as we said before we're not as happy with the top-line performance or profit performance is right in line because we've been really good at getting at those synergies.

We see that as one of the biggest points of attractiveness of doing one of these transformational acquisitions because the work that's required to go after synergies, you might as well do it on a larger platform because you get a bigger return for the same amount of time and energy investments that you would on a mid-size or a small size acquisition.

And as we talked about before, we typically pay for our acquisitions through synergies and treat other benefits, revenue upside and that as upside is really above and beyond our case business – business case. So when we take a look at these large transformational RMT, we're confident that they get it there because we know that we can get these synergies and we get them at a much larger quantum and a larger scale versus something that's mid or small size.

Having said that just to put one other point out there, as we told you before, as we keep working these and Craig and I spend a lot of our energy to try to make these happen, we would not pass up on a small or mid-size acquisition that was in our sweet spot. We know that they add a lot of value, look at what's happened with the two that we talked about recently and so we won't pass up on any of those to be able to wait for something that's larger. Does that get at the heart of your question or was there something else that you wanted me to dig in on.

Matthew C. Grainger
*Morgan Stanley & Co. LLC*

Q

No, no. I know it was a little open indeed, but that does help. I think – and I think you touched on this, so I think part of the nature of the question was just that if you're looking at a much larger transformative deal, if the ability of your current infrastructure whether overhead or fixed asset base would have a little bit less flexibility at that point to generate overlap and provide synergies in that sense. And whether there any constrains that we should think about in terms of how much in terms of synergies you might be able to realize?

Craig D. Steeneck
*Chief Financial Officer & Executive Vice President*

A

No Matt, we don't see our infrastructure of any constraint. I mean we have a pool of synergies that we go after on all acquisitions and one of the big transformative ones, first SG&A to bring in line with our infrastructure. And then particularly on a frozen asset, there is absolutely synergy upside on those in terms of production and looking at the manufacturing fees looking at procurement and benefits you can get there and always on logistic side, so I wouldn't say our business is constrained in any regard in terms of future synergies.

Matthew C. Grainger
*Morgan Stanley & Co. LLC*

Q

Okay. Great, thanks. And then just a quick follow-up on Wish-Bone and you may have touched on some of these same issues before but can you just talk a little bit more about the profit outlook and some of the steps you've been able to take to keep their profit expectations on track even as sales have softened. As far as the manufacturing transition and how quickly that plays out? Just any thoughts on how long that process may take to get up toward the run rate EBITDA that you are looking for?

Robert James Gamgort
*Chief Executive Officer & Director*

A

Yeah, I mean we talk about the acquisition. We talk about $65 million in EBITDA in 2016 and that's exactly the track that we are on despite the fact that the top line because of the category in some of the shorter term share performance has been slightly below that. So obviously if we are able to be on track on a bottom line with some softness on the top line, it suggests that we've been even better at the cost side of the business, and that's exactly what happened. And that's not a surprise by the way when we take a look at what we did with Birds Eye, we significantly exceeded the announced synergies, once that we're able to understand the business better and run it more effectively and that certainly been the case on Wish-Bone.

And one other thing to add to that is obviously, when you choose not to replicate some of the most aggressive promotion, it may have some impact on the top-line, but it actually is a positive impact on the bottom line. So that's why all of those different levers that we've been able to pull have kept us right on track with the original EBITDA that we targeted at the time of the acquisition. And then I think we'll get this very excited and I think we'll get you excited as well when we have the chance to talk about it. Now that the manufacturing is up and running, it unlocks our ability to launch innovation. And the way that we're looking at innovation on Wish-Bone is very similar to the way that we look at it, and I'll just use an example, Duncan Hines, what are the category dissatisfiers from a consumer standpoint and how do we introduce products that address those category dissatisfiers, so it's not only good for the brand, but also good for the category. We have some of those in our pipeline that, that we'll be excited to talk to you about.

Matthew C. Grainger
*Morgan Stanley & Co. LLC*

Q

Okay, great. Thanks again.

Robert James Gamgort
*Chief Executive Officer & Director*

A

Sure.

**Operator**: And our next question comes from the line of Michael Gallo with C.L.K. Your line is open.

Michael W. Gallo
*C.L. King & Associates, Inc.*

Q

Hi, good morning.

Robert James Gamgort
*Chief Executive Officer & Director*

A

Good morning.

Michael W. Gallo
*C.L. King & Associates, Inc.*

Q

Two follow-ups, now that you have manufacturing moved over Wish-Bone I was wondering how long is it'll take before we start to see some of those innovations come through, is that something that happened later in 2015 or is that not happened until 2016? And then the second question I had was on the Family rollout at Birds Eye Voila! Obviously expanding your shelf space in the category, I was wondering if you see down the road some opportunities to expand the Family Size and Flavor Full, rice blends and some of you other more traditional Birds Eye products. Thanks.

Robert James Gamgort
*Chief Executive Officer & Director*

A

Yeah. So from a Wish-Bone standpoint we will be selling in the innovation in the late part of 2015 to our customers and we will be shipping that in 2016 and that's why the timing is – once we get to the point where it begins to be out there from a customer standpoint, we are getting ready to ship and then we'll talk to you about that just in advance of our shipment. So that's why we would say we'll be able to show you that and give you more specifics on launch timing et cetera at the end of this year.

With regard to Family Size, Family Size has been a big driver of the Voila! growth and incredibly incremental that was something that surprised us, we first introduced Voila! Typically you see a lot of cannibalization but it was clearly speaking to a different user base because of the incrementality. We've also had good success on Birds Eye on our XLP bag or our large bag. Again in the right SKU is targeting the right family size. And so we do see that as an opportunity as well as different flavors, different more than flavors, different recipe formats that we'll be introducing as well.

So, the good news on Voila! Is again with all of the strength that we demonstrated its household penetration is still relatively low compared to the category and a fraction of what the Birds Eye household penetration is, Birds Eye Vegetable household penetration is. So just by getting Birds Eye users to try more Voila! We still have a significant amount of upside and you've heard us say it before, but we've been bumping up against capacity constraints. And we are in the process of adding even more capacity on Voila! and we continue to get surprised by the significant upside.

Our consumption year-to-date on – in Q2 for example on Birds Eye Voila! was plus 15%, that's consumption, not shipment. And so, that gives you a sense of just how strong this business is and we're trying to invest ahead of it and we continue to be pleasantly surprise by the growth that we're getting. So, lots of opportunity at Viola! and to your point lots of opportunity to expand that pack size into some of our more popular SKUs on the traditional Birds Eye.

Michael W. Gallo
*C.L. King & Associates, Inc.*

Q

Thanks very much.

Robert James Gamgort
*Chief Executive Officer & Director*

A

Okay.

**Operator**: And our next question comes from the line of Eric Katzman with Deutsche Bank. Your line is open.

Eric R. Katzman
*Deutsche Bank Securities, Inc.*

Q

Hi, good morning. I will make this quick. Do you sense that the rest of the industry is also going to have kind of net productivity positive swing in the second half and perhaps that's one reason to be more concerned about the promotional environment in the holiday period?

Robert James Gamgort
*Chief Executive Officer & Director*

A

Good morning. It's hard to know that because you know as we know we have conversations about what you can see from a commodity inflation perspective on a spot basis and we know that people are buying in advance and how closer the P&L becomes incredibly complex. So it's even challenging for us to explain to you guys sometimes how our annual guidance on inflation versus productivity will line up during the quarter. As you point out in our case, productivity was low and inflation was higher in the first half of the year that reverses in the second half of the year. We really have no visibility to see how that flows through to our competitors and therefore that's why this pricing question you're raising here becomes a wild card which is a term that we use and given that we've got such an emphasis on the fourth quarter puts us in a position of using all the levers to our advantage to be able to create some dry powder to be able to react in the fourth quarter because quite frankly we don't know how that flows through everyone's P&L.

Eric R. Katzman
*Deutsche Bank Securities, Inc.*

Q

Okay. Thank you.

Robert James Gamgort
*Chief Executive Officer & Director*

A

Okay.

**Operator**: [Operator Instructions] And our next question comes from the line of David Palmer. Your line is open.

David S. Palmer
*RBC Capital Markets LLC* Q

Good morning, guys.

Robert James Gamgort
*Chief Executive Officer & Director* A

Good morning.

David S. Palmer
*RBC Capital Markets LLC* Q

I have not seen the distribution numbers for Gardein – how is the distribution today? How is it trending perhaps even a percentage of the growth in terms of distribution gain? And do you feel like that distribution upside gives you visibility into the year two growth that we are hoping for?

Robert James Gamgort
*Chief Executive Officer & Director* A

Yeah, I mean very much. We are in about two-thirds of traditional channels with any form of Gardein, so we have significant upside there. We have significant upside in the depth of distribution and in a number of average number of items per store in traditional. And again from a velocity standpoint we are seeing great velocity numbers as well as we expand that distribution.

So when we're driving a 35% -- plus 30% increase in sort of IRI MULO consumption numbers then a 40% increase in sort of the SPINS number, you are getting some of that through distribution gain which you are getting a lot of that through the velocity per store gains, which were a combination of the SKUs moving faster and also getting more SKUs in the store. And that gives us the visibility towards long run rate of growth on Gardein and that's why we are trying to invest ahead of it, both in terms of expanding the plant in Vancouver as well as getting a new set or new platform for manufacturing in the US to be able to fuel that growth. But the consumer interest in this category, it's alignment with long-term trends both in the health and wellness and sustainability perspective, and the profitability from a retailer perspective are all pointing to this being a very, very big category and we like our place in this category. And even though we'll attract more competition no doubt, we like the fact that we are in a first mover advantage with a superior product and that's why we are investing ahead of it.

David S. Palmer
*RBC Capital Markets LLC* Q

Thanks. I just want to do a quick follow-up on that promotional environment. Just – and perhaps you can comment on my thinking, overall it appears that the industry has been easing away from promotions that simply didn't work and now you have a built in leader in this thinking with Kraft Heinz and they're increasingly overlapping with Pinnacle in some of their categories, so perhaps that good news for you from promotion standpoint. But I also wonder if certain categories that are hyper seasonal and are dominated by few players like baking or soup to name another category, are doomed to remain promotional because that prisoner's dilemma situation that you're worried if you don't fire the gun the other guy will and you'll miss this very narrow window for peak sales. What do you think about that?

Robert James Gamgort
*Chief Executive Officer & Director* A

Yes, three points on those. I think one as you are seeing a pull back on the edges of promotion in the industry and you point out accurately that the increase in promotional spending did not deliver a growth increase or volume increase in line with that, so merchandising efficiency was weigh down as we talked about before. So, fairly rational that when you are spending more and getting less at some point you start to pull back.

I think your point about overlap with certain categories where we've seen some of the competitors that you point out pull back on their promotional spending is a net positive. I wish we would overlap more. To be honest with you but there are some overlap but not as much as we would like in those situations, because I think it does lead to more rational behavior. It certainly creates a bit of a gap for some retailers in terms of their profitability when some of those promotional dollars go out the door, but I think it's a good thing for the industry over the long-term.

And then I don't – I'd have to think more about your comment about specific categories and seasonal nature, I think that's less the driver of it, it's more – are you competing on innovation, or do you have nothing else other than price and how much capacity do you have available and when you have excess capacity and no innovation, you almost have no choice but to compete on price, even if it's bad for the category.

When you have been not constrained, but more reserved and more aggressive in taking out capacity like we have and you are innovating to trade people up. You are less dependent on the lower end of the category and price promotion. And so that's why I think you are seeing some different behavior by competitors in the exact same category but I would have to think more about your comment about hyper seasonal business with a smaller set of competitors but that's what's happening in our category.

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David S. Palmer
*RBC Capital Markets LLC*

Q

Thanks very much.

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Robert James Gamgort
*Chief Executive Officer & Director*

A

Okay.

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**Operator**: And I am showing no further questions at this time. I would now like to turn the call back over to Ms. Maria Sceppaguercio for any further remarks.

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Maria A. Sceppaguercio
*SVP-Investor Relations & External Communications*

Thank you, Ray. And thank you all for listening in this morning. I'll be around all day, so give me call if you have any follow-ups. Take care.

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**Operator**: Ladies and gentlemen, thank you for participating in today's conference. This does conclude today's program. You may all disconnect. Everyone, have a great day.