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Pinnacle Foods, Inc. (PF)

Q1 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 First Quarter ended March 29, 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 & Communications, Ms. Maria Sceppaguercio. Ms. Sceppaguercio, please go ahead.

Maria A. Sceppaguercio
SVP-Investor Relations & External Communications

Thank you, Desha. 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 first quarter of 2015. If you haven't received the copy, you can get one on our website, at 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's 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 later today.

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.

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.

Finally, as you will recall, during the quarter, Blackstone sold 14.2 million shares in a secondary offering in March 2015. As a result of this offering, Blackstone's ownership of Pinnacle currently stands at 5 million shares or 4.3% of our shares outstanding.

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 first quarter was a good one for us and I'm pleased with our solid start to 2015. We generated another quarter of market share growth, driven by strength across our Leadership Brands, particularly Birds Eye, and we modestly expanded our gross margin in a quarter in which inflation exceeded productivity as we expected.

We continued to manage our expenses well, including benefiting from the lower interest expense due to last year's exceptionally strong cash flow and deleveraging. All of these drivers combined resulted in EPS growth of 8.3% in the quarter.

As you know, the Easter Holiday was two weeks earlier this year which shifted approximately 1% of sales from Q2 into Q1. As we experienced last year, given the highly promotional environment in the holiday period, the bottom line impact was minimal.

For the second quarter, we expect net sales to be unfavorably impacted by about 1% which is the benefit we experienced in Q2 last year, and again, we expect minimal bottom line impact.

Turning to the highlights of the quarter; we grew consolidated net sales 3.3% and North American Retail net sales 3.6%. The Gardein acquisition was a significant contributor along with higher volume mix and increased net price realization that was largely driven by the timing of new product introductory costs, which I'll explain in a moment.

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, seven of our eight Leadership Brands held or grew share in the quarter.

We expanded our adjusted gross margin by 15 basis points, driven by productivity, favorable product mix, and higher net price realization. These benefits were almost entirely offset by inflation. Our input cost inflation in the quarter totaled about 3.6% of cost of products sold, in line with our expectations. This was driven by significant increases in logistics and proteins.

Our net price realization, our innovation calendar last year was heavily weighted toward the first quarter, while this year, it is weighted toward the second quarter. This timing difference means that our first quarter comparison benefited from lower slotting expense this year, while the second quarter will be burdened by higher slotting expense. This dynamic was responsible for much of the net realized price benefit we reported in the first quarter.

As you know, we took a number of pricing actions late last year and early this year on several Foundation Brands in response to protein inflation, and the volume elasticity impact was essentially in line with our expectations and evident in net sales results for the quarter on the brands with pricing.

Operating expenses in the quarter increased 5%, largely reflecting increased expenses associated with the addition of Gardein, while our interest expense declined 12% reflecting the benefits of last year's deleveraging and exceptional cash flow.

Our effective tax rate for the quarter was 38%. Taken together, the combination of all these factors drove adjusted diluted EPS to $0.39 compared to $0.36 in the year ago period.

Turning to our segments, starting with Birds Eye Frozen; net sales were up 8% in the quarter fueled by the benefit of Gardein as well as higher volume mix and increased net realized pricing. All of the frozen Leadership Brands registered growth in the quarter with particular strength of the Birds Eye franchise which continued to gain market share.

As you know, Birds Eye is our single largest brand with over $1 billion in retail sales. Importantly, in an industry focused on reshaping portfolios to meet the evolving health and wellness needs of consumers, the Birds Eye franchise is anchored in plant-based nutrition, a key health and wellness attribute.

The recent Advisory Committee report to the USDA concluded that fruit and vegetable consumption is the only factor consistently correlated with better health outcomes and is also associated with improving environmental sustainability. Clearly, the opportunity is significant, considering that only one in 10 Americans currently eat the recommended amounts of fruits and vegetables daily.

To continue to capitalize on this opportunity, during the quarter we launched new TV advertising behind Birds Eye and introduced new varieties of Voila! skillet meals. As a result of these actions along with investments we made last year to enhance our position at retail, both Birds Eye vegetables and Birds Eye Voila! grew net sales, retail consumption and market share in the quarter.

In early April, we launched two new Birds Eye platforms, including Birds Eye Flavor Full, a new line that pairs popular vegetables with on-trend flavors such as buffalo, teriyaki and barbecue, creating a great combination of taste and nutrition. We also launched Birds Eye Protein Blends, a new line of side dishes that deliver plant-based protein through the power of nutrient-rich vegetables, legume and whole grain. Both of these new platforms have been met with extremely strong acceptance by retailers, and we are expecting a similar response from consumers.

Turning to Gardein, which you will recall we acquired in the fourth quarter last year. Gardein builds upon our leadership in frozen vegetables and our focus is on leveraging the capabilities of the two organizations to accelerate growth through expanded distribution, marketing and innovation.

Gardein registered very strong growth in the quarter, growing share and expanding consumption by about 30%. As previously communicated, we plan to invest in Gardein to continue to grow the business, including expanding capacity to support the brand's continued growth.

Our seafood business also registered strong growth in the quarter, driven by the earlier timing of Easter and the introduction of Mrs. Paul's and Van de Kamp's flavor encrusted varieties of Tilapia, Cod and Salmon fillet.

Net sales on several other frozen segment brands were down in the quarter as expected due in part to pricing actions we took over the last several months on Hungry-Man and Aunt Jemima breakfast entrées. We introduced a new chicken and waffles variety to our Hungry-Man select line in the first quarter and the item is off to a good start.

In terms of market share, our total frozen segment share advanced 50 basis points for the quarter with our consumption up more than 3% in a category composite that was down slightly.

EBIT for the segment was down 1%, reflecting input cost inflation, particularly in logistics and proteins and higher marketing investment, primarily behind Birds Eye, partially offset by productivity savings and the growth in net sales.

Our Duncan Hines Grocery segment posted a 1% decline in sales despite solid growth of Leadership Brands, largely due to the elasticity impact of Armour and Nalley canned meat pricing actions and lower sales from our Canadian business, including unfavorable foreign currency translation.

The growth of the Leadership Brands was driven by Duncan Hines baking products, Vlasic pickles and our Log Cabin and Mrs. Butterworth's syrups. Wish-Bone also posted a modest increase in net sales for the quarter.

Turning to baking, we continued to outperform the category and the strength of innovation in our tiered pricing strategy, which have enabled us to maintain overall pricing in a category that remains weak and highly promotional.

Our Vlasic pickle business benefited in the quarter from growth of the base business and continued expansion of the Bold & Spicy line introduced last year. In terms of the market share, our total grocery segment share advanced 20 basis points for the quarter, with our consumption down 1% which was better than the performance of the category composite.

Our Wish-Bone integration continues to remain on track and despite sales falling slightly behind our original expectations due to ongoing category softness and promotional intensity, the business continues to deliver the profit metrics we anticipated.

We completed the build-out of the Wish-Bone manufacturing capacity at our St. Elmo facility during the quarter and the manufacturing startup phase is now underway. Unilever will continue to co-manufacture for us through mid-May while going through the startup. As we've discussed previously, we expect this new house – a new in-house manufacturing capability to be an enabler to innovation.

EBIT for the grocery segment was up 4% due to productivity, favorable product mix, and lower marketing spending, partially offset by increased logistics and protein costs as well as a decline in net sales.

Our Specialty Foods segment posted a modest increase in net sales for the quarter, largely due to growth of private label canned meat business, while EBIT advanced 10%, primarily reflecting the growth in net sales and lower amortization, partially offset by higher logistics costs.

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. Starting with sales, our consolidated net sales increased 3.3% in the first quarter to $665 million, reflecting the benefit of the Gardein acquisition, as well as growth in our base business due to strong performance across our Leadership Brands. As mentioned earlier, the earlier timing of Easter favorably impacted net sales by approximately 1% with minimal impact on the bottom line.

North American Retail net sales advanced 3.6%, reflecting a 2.8% benefit from Gardein, higher net price realization of 0.8% due to the timing of new product introductory costs that Bob discussed earlier, and higher volume mix of 0.4%. Partially offsetting this good growth was unfavorable foreign currency translation of 0.4%.

For our Birds Eye Frozen segment, net sales increased 8%, driven by a 5.2% benefit from Gardein, higher volume mix of 1.8%, and higher net price realization of 1%, largely driven by the timing of the new product introductory costs. The earlier timing of Easter benefited net sales by approximately 2%. From a brand perspective, net sales growth for the base business was driven by strength across all of the Leadership Brands.

For our Duncan Hines Grocery segment, net sales declined 1.4% due to lower volume mix of 1.2% and unfavorable foreign currency translation of 0.7%, partially offset by higher net price realization of 0.5%; again, largely driven by the timing of new product introductory costs. Growth across all of our Leadership Brands, particularly Duncan Hines, Log Cabin, Mrs. Butterworth's, and Vlasic was offset by lower sales of our Foundation Brands.

And finally, for our Specialty Foods segment, net sales increased 1.6% in the quarter, driven by higher net price realization of 1.1% and higher volume mix of 0.5%.

Now, turning to gross profit. On an adjusted basis, our gross profit increased 3.9% to $175.2 million in the first quarter. As a percentage of net sales, gross profit advanced approximately 15 basis points to 26.3% due to favorable mix and higher net price realization, despite inflation exceeding productivity in the quarter. Inflation totaled 3.6%, driven by logistics and proteins, while productivity totaled 3% in the first quarter. We continue to expect inflation to be higher in the first half of the year, while productivity, on the other hand, is expected to be higher in the second half of the year. This relationship between productivity and inflation will be a benefit to gross margin in the second half.

Turning for a moment to some specifics on inflation first, our outlook at any point in time will be heavily influenced by the timing of hedging activities in which we engage to achieve pricing certainty. While we track the markets for our inputs daily to make informed decisions about what and when to cover, our objective is to lock in our cost structure and minimize pricing risk and uncertainty.

With that as context, our cost of products sold totals about $1.9 billion annually, with about 2/3 of that or roughly $1.3 billion in ingredients and packaging. The balance is split fairly evenly between manufacturing and logistics, the latter of which is experiencing mid-single digit to high single digit inflation, even after the benefit of lower gas prices. This higher level of logistics inflation is being driven by ongoing capacity constraints in the transportation industry.

Another area of significant inflation for us – this one in the ingredient side – is proteins. These expenses which represent approximately 10% of our input cost basket are primarily concentrated in chicken and beef. Our protein costs were up in the high single digits in the quarter and are expected to remain elevated through the first half of the year before becoming more moderately inflationary in the back half.

We are seeing deflation in several areas, particularly sugar, cocoa, grain-derived inputs and shortening and oils, which collectively represent only about 10% of our input cost basket. This deflation is being more than offset by the significant inflation we are experiencing in the other areas that we just discussed.

Turning to operating expenses; in the quarter, operating expenses increased 5% to $80 million, largely reflecting higher marketing and selling expenses. It is worth noting that several unique items will increase our operating expenses this year, beginning in the second quarter – specifically, non-cash stock-based compensation expense associated with our long-term incentive plan implemented in 2014 will ramp up for the second of three years. This expense is expected to increase by between $3 million and $5 million with about 60% of that increase impacting SG&A.

Another non-cash expense that will increase in 2015 is depreciation and amortization, which we expect to grow by $10 million to $90 million in 2015. This $10 million increase is driven by IT investments and the impact of acquisitions, with about 25% of this expected to impact SG&A.

Beyond these non-cash items, the inclusion of Gardein operating expenses will increase SG&A as will the related marketing and selling investments planned for this new business and our continued investment in the Birds Eye franchise.

Turning back to our results for the first quarter, EBIT, excluding items affecting comparability, increased approximately 3% to $95.5 million in the quarter. Interest expense for the quarter declined 11.8% to $21.5 million, largely driven by the $200 million debt reduction in the third quarter of 2014 and the related 25 basis point interest rate step-down on our term loan.

Beginning in Q2, interest expense will increase slightly due to the interest rate swaps we put in place at the time of the April 2013 refinancing. This impact was built into our full year interest expense forecast of approximately $90 million for 2015.

Excluding items affecting comparability, the effective tax rate for the quarter was 38%, compared to 38.1% in the year ago period. Adjusted net earnings increased 8.4% to $45.9 million or $0.39 per diluted share in the quarter compared to $42.3 million or $0.36 per diluted share in the year ago period.

Now turning to cash flow; net cash provided by operating activities in the first quarter totaled $71 million compared to $94 million in the year ago quarter. This performance largely reflected higher working capital in the first quarter of 2015, due to the timing of sales related to Easter, as well as incremental working capital related to acquisitions.

Capital expenditures in the first quarter totaled $27 million compared to $22 million in the year ago period. For the full year, we continue to expect CapEx in the range of $100 million to $110 million. In terms of liquidity, at the end of the first quarter, our total debt was $2.3 billion, which includes $1.9 billion in term loans and $350 million in 4.875%. Cash totaled $51 million, bringing our net debt to $2.2 billion. Our net leverage at the end of the quarter was 4.18 times.

And finally, in terms of our outlook for the year, we continue to expect diluted EPS in the range of $1.86 to $1.91. This guidance continues to incorporate the following assumptions; input cost inflation of 3% to 3.5%, productivity in the range of 3% to 4% of costs, an effective tax rate of approximately 38%, a full year weighted average diluted share count of approximately 117 million shares, and finally, depreciation and amortization expense of $90 million.

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

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] And our first question comes from Andrew Lazar from Barclays. Your line is open. Please check to make sure your line is not on mute.

Andrew Lazar
Barclays Capital, Inc. Q

Hi, can you hear me?

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

Yes.

Robert James Gamgort
Chief Executive Officer & Director A

Hey. Good morning.

Andrew Lazar
Barclays Capital, Inc. Q

Good morning. I apologize, we have a somewhat of a new phone system here. It's a little confusing. It's a lot confusing for me. But...

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

Don't worry.

Andrew Lazar
Barclays Capital, Inc. Q

So, two questions for me if I could. First would be with respect to gross margin, is there a way to parse out a little bit how much of a positive benefit in the quarter you got on gross margins due to the shift in timing around promotional spending? And the reason I ask is because given some of the commentary on the prepared remarks, trying to get a sense if we should be really thinking about our modeling year-over-year gross margin to be potentially even a little bit down year-over-year kind of in the second quarter before those dynamics you talked about change more favorably in the second half?

Robert James Gamgort
Chief Executive Officer & Director A

Sure.

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

So, Andrew, so first of all, the effect of timing and the moving of sales into the first quarter from the second quarter, I mean, as we said in our prepared remarks there's little effect on gross margin or EBIT for that shift, because particularly around Easter, those are fairly highly promotional sales, so the incremental effect on gross margin is negligible.

The thing that drove the gross margin, the slight improvement in gross margin in the quarter was, number one, our net pricing was positive and we did see productivity being below inflation at 3% productivity and 3.6% inflation. And then we also got some positive vol mix, but the overall effect on gross margin for the Easter shift was relatively inconsequential.

Robert James Gamgort
Chief Executive Officer & Director

A

Right.

Andrew Lazar
Barclays Capital, Inc.

Q

How about the impact on gross margin more from the promotional timing around slotting that helped your net price obviously in the first quarter versus the fact that it will be an impact on the negative side in the second quarter? That's, I guess, what I was getting at.

Craig D. Steeneck
Chief Financial Officer & Executive Vice President

A

Yes. So that difference, Andrew, was about $6 million, so the first quarter was positively impacted by the slotting benefit and that will flip over and you'll see that negative come through in the second quarter. So it's just a timing adjustment from when we launched innovation year-on-year.

Andrew Lazar
Barclays Capital, Inc.

Q

Got it. That's helpful. I was just trying to make sure I'm thinking about gross margin right going forward. And then the second thing is, Bob, I know one of the things you talked about as being one of the bigger wildcards coming into 2015 was kind of obviously the pricing and the promotional environment.

Is there a way to I guess provide a little more color around what you saw from a pricing and promotional perspective, if we kind of take away the benefit again that you've got from the lower slotting versus last year in the quarter? So in other words, it still sounded like it wasn't, I guess overall a negative and I don't know if that was either better than you had anticipated coming into the first quarter or not. I realize it's still pretty competitive in baking, maybe a little less so in frozen vegetables, again, on a normalized basis, is it sort of in line with how you would have expected it to play out so far?

Robert James Gamgort
Chief Executive Officer & Director

A

Yes. It has been. Let me just talk about Q1 for a second and then specifically about Easter, because as you're familiar the timing of Easter is always different year-over-year, so we actually true those two time frames up so that we get a true Easter-to-Easter comparison. So when I look at Q1, we grew consumption nicely about 1.6% in categories were down. I think what's interesting is we had average price increase of about 2.4%, largely mix driven. But we saw our categories with a price increase on average of about 1%, that's not a large number but it's a very positive trend versus what we've seen in the past couple of years.

When I look at Easter, I would say that Easter from a promotional intensity perspective was very reasonable across all of our categories with the exception of baking, and what we saw in baking was some very, very aggressive price competition from the leader in that market. In fact their average price, if you look at it, during the Easter time period was down about 8%. So outside of really what I would say is one category and one competitor, I would say that the environment has become much more reasonable and very consistent with the conversations that we've had about the industry's need to recover some of the inflation that has been apparent over the past number of years, although moderate, was still unrecovered by pricing. So I think it's so far so good in terms of being a rational marketplace.

Andrew Lazar
Barclays Capital, Inc.
Q

Great. Very helpful. Thank you, all.

Robert James Gamgort
Chief Executive Officer & Director
A

Sure.

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

Rachel N. Nabatian
Credit Suisse Securities (USA) LLC (Broker)
Q

Hey, good morning. It's Rachel Nabatian in for Rob Moskow.

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

Good morning, Rachel.

Rachel N. Nabatian
Credit Suisse Securities (USA) LLC (Broker)
Q

So you already kind of started talking about this in the last question but I wanted to know a little bit more about the competitive dynamics within the Easter baking season? And then how your kind of segmentation strategy here helped you navigate through the tough environment?

Robert James Gamgort
Chief Executive Officer & Director
A

Sure. We've gained share in the baking category now, I think, every month for more than a year. And if you look at it on a quarterly basis it's longer than that. And during the Easter baking time period, we lost share for the first time.

And if we take a look at what happened, I think if you drill below the surface, that it's a really interesting dynamic. As I said in a previous question, the number one player in the category dropped their average price by about 8% which we did not match. And not surprisingly they gained share and the rest of the competitors in category including Pinnacle lost share.

I think the unfortunate part about that certainly from a retailer perspective is that that dragged down the category by 7.5% on a revenue basis. And we know that our retailers aren't happy with that performance.

When we look below how we performed on a total basis and break it into the segments that we talked about during our CAGNY Lunch earlier in the year, and we look at Classic, Signature and Decadent. Despite all of that, we actually gained share in the Decadent segment. So really the share loss was at the lower end, and obviously lower profit side of our portfolio.

And what's interesting is when you take a look at the growth in Decadent and the fact that we didn't match on the Classic line, in an environment where our competitor was down 8% our average price was up almost 5% during that time period.

So we're going to continue to stay the course. Our ambition is to drive category growth through innovation and through premiumization of our products and it's not surprising when there's a lot of share loss that somebody might react in a short-term by dropping their price. But there's a limit as far as we will go in terms of dropping our price, because it's not good for our brand and our profitability, it's not good for the retailers either. So we'll stay the course.

Rachel N. Nabatian Q
Credit Suisse Securities (USA) LLC (Broker)

Got it, thank you.

Robert James Gamgort A
Chief Executive Officer & Director

Sure.

Operator: Thank you. And our next question comes from David Palmer from RBC Capital. Your line is open.

David S. Palmer Q
RBC Capital Markets LLC

Good morning. Two questions if I may. First on Wish-Bone; what are the opportunities and challenges you see with that brand as you look at forward? Have you gotten an innovation pipeline teed up there, marketing, perhaps you think the renovation in the future for that brand?

And then just separately you made some comments about inflation protein perhaps weighing on the first half more than the second half. What is going on, curious on the produce side? Is that inflation remaining high due to droughts that are ongoing in California? Thanks.

Robert James Gamgort A
Chief Executive Officer & Director

Sure, Dave. Let me take the first part on Wish-Bone and then I'll turn it over to Craig who can get into more granularity on our inflation situation. When I look at Wish-Bone, as you know, since we've acquired the business we've really been focused on two things; one is getting our manufacturing up and running, to be able to not only realize the significant cost synergies that we've built into our business model but also to unlock inflation.

The previous production facility was a bit outdated and fairly inflexible. And so we needed a combination of increased flexibility as well as profitability to be able to invest back in this business. We've also been very serious about cleaning up promotions. There were a lot of hyper-aggressive promotions in the category and certainly by the brand over the past couple of years that we realize we're very unprofitable and not a good category dynamic either.

And so when I take a look at what's happened I think the category in general is probably more challenged from a growth standpoint that we had originally expected; but our management of the business is pretty much in line with where we have thought. So if you look at the first quarter we had a good January, we had a good March. We had a really poor February, 100% explained by the fact that we did not match a buy one get one promotion in the February of the previous year. And again that's back to understanding efficiency of our promotions and making sure that we're getting some reasonable net price realization across our portfolio.

When we look forward toward innovation, the fact that we just cut the ribbon on the new plant this quarter is a real positive to enabling us to do that. And we'll be able to talk to you about inflation really at year end – I don't mean inflation – about that innovation at year end and give you a sense of not only how we're looking at it from a specifically a Wish-Bone perspective, but how we're using this as an opportunity to target some of the category dissatisfiers that are weighing on the overall category growth. And we see that as an opportunity not only for share growth but in terms of category growth. So we look forward to taking you through that and we're essentially on track.

The last thing I'd point out on Wish-Bone is despite some of the challenges on the top line from the weak category that I talked about and some of the share challenges as we pull back on promotion, the profitability of this business has been right on our acquisition target so we've been able to pull enough of the levers to be able to deliver the profitability despite some of the short-term challenges which is as you know something that we do across our portfolio pretty well.

With that, let me turn it over to Craig. Why don't you take Dave through the inflation perspective?

Craig D. Steeneck
Chief Financial Officer & Executive Vice President

A

Good morning, David. As we said, the inflation for the first quarter came in at about 3.6% and there were couple of items that were on the higher side of that which as we talked about was proteins in the mid-single digits to upper single digits inflation, followed by logistics and to a little bit of a lesser extent, our packaging.

Our input cost basket is enormously diversified and that's a significant advantage for us and we procure very little of our vegetables and any of our input costs from California. So as a result of that, we've seen negligible impact from the California drought and to your specific question on fruits and vegetables, we're seeing low single digit inflation in that category and our input cost basket.

David S. Palmer
RBC Capital Markets LLC

Q

Thank you.

Operator: Thank you. Our next question is from Jason English from Goldman Sachs. Your line is open.

Jason M. English
Goldman Sachs & Co.

Q

Hey, good morning, folks.

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

Good morning, Jason.

Jason M. English
Goldman Sachs & Co.
Q

I guess I'll come back to the two topics being discussed so far – Wish-Bone and baking. Looking at the [ph] standout (33:37) in baking mixes, it was surprising to see that we really didn't get much of a lift despite the holiday timing shift. And I was wondering if there's something going on out there in the marketplace that may explain that, we heard from another company yesterday talking about changing merchandizing policies around Easter. Perhaps that's an issue, I don't really know. I was hoping you could expand on that.

Robert James Gamgort
Chief Executive Officer & Director
A

Yes. I think it's a combination of things that are happening right now. Some of them are short-term, some of them are longer-term. I think from a short-term perspective, especially around Easter – and I think the same is true for the holiday or the fall bake season – is that consumers come to the category at that time with a plan to bake. It's certainly not an impulse item; it's part of the holiday ritual. And a hot price promotion doesn't drive incremental consumption. It just trades down dollars on a category where the units are going to remain relatively stable year-over-year, due to the fact that people come to the category during the holiday season for baking.

We saw this in the fourth quarter where we did not play a very aggressive pricing game and we really were able to gain share and grow consumption, driven by premiumization and innovation, although we saw a lot of price competition in the fourth quarter that dragged the category down.

The exact same thing has happened in the Easter timeframe; as I mentioned, the leader in the category dropped their price by about 8%. So if you're not going to get an elasticity impact on that – on units, by definition it's going to drag the category down and that's exactly what happened. And you can imagine we're having lots of conversations with our retailers, bringing lots of data to the table to show them that this is not a winning strategy, especially during the holiday season where baking is not an impulse item.

We really believe that the keys to driving this category are making sure that we're offering premium products and tiered pricing, because there is a baker out there that is looking for higher quality items and is willing to pay what is actually a fairly small premium in terms of cents – you're talking about $0.25, $0.50 up to $1 or more – but a substantial percent increase versus what's happening right now. They're willing to pay for that on premium products.

The second part of it is innovation. There's been a real, I think, lack of innovation in the category. As we explained to you guys before, our Decadent line, which is probably the most innovative area within the category, has been gaining share steadily at a premium price, and we're looking forward to talking about some of the second half innovation that we have that is yet to be announced to you, although we've had some conversations with our retailers on it, that is starting to go after some of the category issues, particularly around changing demographics.

And what you're seeing is that, baby boomers for example, who are heavy bakers in general, as well as on the opposite, extreme younger households are also very interested in baking. They have a tough time baking for two people because the quantities are too large. And so, we've got some innovation that's targeted solving that need. And I think that's going to bring people back into the category.

So, as I said on one of the previous questions, we're going to stay the course on this one because we know that we've got the right strategy to drive our business as well as the category, and we're not going to get distracted by some of these short-term price issues.

Jason M. English
Goldman Sachs & Co.

Q

Thank you. That's helpful. One housekeeping question, Wish-Bone you mentioned you had net sales growth. We look at the Nielsen data, your salad dressing business is down 9% over the last 12 weeks. So is there inventory movement, is there something off the measured channels that drove that? And then lastly, if you could touch on the M&A environment and I'll pass it on.

Robert James Gamgort
Chief Executive Officer & Director

A

Sure. I'm just looking real quickly. Our consumption number is not negative in the quarter. It's not quite as low as that, but there's always a discrepancy between Nielsen and IRI. There's always some movement between shipments and consumption over time. As I mentioned before in the Q1, consumption is driven 100% by the month of February which was down significantly versus year ago. And if you went back into it, as I said, it really is due to a lapping of a year ago buy one get one promotion that drove lots of volume, but zero profitability that we decided not to match this year.

So I think we're continuing to push forward on Wish-Bone. And the real unlock is the innovation. And then with the innovation, it will enable us to invest the right amount of money in consumer marketing support. Right now, what we're doing is just cleaning up the promotional calendar versus before and starting up the plant. So it's not a lot of levers that we're pulling to drive the top line on this business until we get the innovation and the marketing going.

Operator: Thank you. And our next question comes from Eric Katzman from Deutsche Bank. Your line is open.

Eric Richard Katzman
Deutsche Bank Securities, Inc.

Q

Hey, good morning, everybody.

Robert James Gamgort
Chief Executive Officer & Director

A

Good morning.

Eric Richard Katzman
Deutsche Bank Securities, Inc.

Q

Okay, I guess, Bob, the first question has to do with the frozen case and it just – it seems as if the retailers have a high fixed cost part of the store there and the frozen entrée, the mainstream kind of frozen entrées continue to cede share. So shouldn't we expect from, given Birds Eye's momentum, arguably kind of better results and profits out of that business as this kind of dynamic keeps playing out?

Robert James Gamgort
Chief Executive Officer & Director

A

When I take a look at Birds Eye's performance, especially when you take a look at Birds Eye on their vegetable business as well as Birds Eye on the Voila! business, I think it's performing very well. We're growing share nicely, consumption is up. We just have shipped in the innovation that we showed you guys a couple of months ago. So, none of that innovation that has been well received by customers is showing up in the Nielsen or the IRI numbers yet.

And when I take a look at the Easter timeframe, for example, on Birds Eye, we gained about 50 basis points of share. So, again, nice continual share growth on that business driven in a high quality way, given that our average price per unit, while we were gaining those 50 basis points was up about 3.5%. So I think we're getting a nice balance between getting share growth, while getting net price realization, which is critical. And a lot of that average price increase that you see in your syndicated reports is coming from favorable mix, trading people up to higher ticket, higher margin items.

On the Voila! Business, which is obviously the meals business of Birds Eye, when I look at the Easter time period, we gained almost eight share points, and we're nearly a 40 share now of that category, and that's exceptional growth. And we've been able to get good net price realization on that business as well, because people are buying a higher mix of the big bag. If you look at syndicated data for Easter, you'll see the average price per unit is up almost 8% on Birds Eye Voila!

So market – consumption growth, market share are one important set of metrics that we look at – but I also take a look at profitability and the average net price is another one. And we're really pleased with where that's going with Birds Eye as a total franchise.

Eric Richard Katzman
Deutsche Bank Securities, Inc.

Q

Okay. And then if I could, last question to follow up. Obviously two of your big competitors, Kraft, obviously going to be undergoing a kind of a cultural shift; ConAgra, new CEO. Are you seeing anything, any changes in the market yet that either you're concerned about, or could be beneficial, and then I'll pass it on. Thanks.

Robert James Gamgort
Chief Executive Officer & Director

A

I think it's certainly too early to see any change on Kraft in the marketplace; that deal hasn't closed yet. And I think its business is usual there and obviously in the situation you described with ConAgra, it's very early days there. So there's really no change in strategy as you would expect. I think our retailers in general are a little bit concerned on what they saw for example, from the Heinz acquisition on pullback and promotional spending.

And we've talked about that before when you take a look at the categories in which we overlap directly particularly in frozen that there's a significant pullback in promotional spend, and you guys have reported on that as well, which left a hole in the retailers' bank both in terms of sales as well as profitability. And so they've leaned on other manufacturers to help make that up through growth and we've certainly benefited from that and we will continue to benefit from that. But as we've discussed before, we don't want to just put innovation out there to fill up shelf space. We want to make sure that it's really targeted and have good consumer insight, and also there's only a certain amount of capacity that we leave available. We run a very efficient shop here and so we are not able just to throw new products out there left and right. We continue to benefit from all of these developments in a measured way that balances growth and profitability.

Eric Richard Katzman
Deutsche Bank Securities, Inc.

Q

Okay. Thank you.

Robert James Gamgort
Chief Executive Officer & Director

A

Sure.

Operator: Thank you. And our next question comes from Michael Gallo from C.L. King. 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

Just a couple of questions. Wanted to just dig in on the new advertising at Voila!, I was wondering what kind of consumer responsiveness you've seen to that in terms of consumption and also whether we should think about seeing more TV advertising as we go through the year?

And then also I was wondering on Flavor Full, whether you see it driving an incremental customer to the category that perhaps wasn't buying your products before, whether you see it being used more as a trade up from the basic Steamfresh line? Thanks.

Robert James Gamgort
Chief Executive Officer & Director

A

Yes, I mean, we're really pleased with the overall growth in Voila!, I just talked about the share growth and the consumption growth that we saw during Easter. When I take a look at the first quarter of the year on Voila!, sort of the year-to-date performance from a consumption standpoint, our consumption was up 18.5% on Voila! and our share was up almost eight share points. And that's driven by a lot of what we've been doing over the past couple of years, which is expanded distribution supported by innovation.

Some of the points that Eric was just asking about in terms of the frozen case and retailers interest, they've really been excited about what's happened with Voila! and have given us more space as a result of that, we've earned that space but they've played with us as a partner on that. And the advertising is just sort of the latest accelerator to that and so it's hard to completely tease all of that out. But I can tell you that in aggregate it's all working really nicely.

We're really happy with the campaign. We've kept it primarily focused on Birds Eye vegetables and we'll be able to use that advertising platform to introduce innovation as well. We like the new format and if you've seen it, it has animated birds in there because what we wanted to make sure was that our previous advertising was very engaging by all of the metrics that we used to test consumer advertising and was persuasive, but sometimes it was an issue of brand identification and so what we did is come up with a campaign that could not be misbranded by the consumer and we're happy with the start of that and we'll continue to invest behind that because we get a good ROI.

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

Q

Okay, great. And then on Flavor Full, I know it's early, but do you expect it will drive an incremental customer or more of a trade up from some of your existing customers?

Robert James Gamgort
Chief Executive Officer & Director

A

I think it's going to be a combination of both. I didn't address the incremental or the trade up nature of Birds Eye Voila! We're not seeing tradeoff at all between Birds Eye Steamfresh or Chef's Favorites over the Voila!. We see that as a really different occasion and in many cases, a different consumer. A lot of the growth in Voila! by the way has been on the Family Size, which suggests that you're bringing in the full family into the purchase occasion which is something that most of the complete bag meals have not done because they've been targeted to two.

Very early, we don't have any consumer metrics on Flavor Full, but I think it will be a combination of people trading up as well as bringing new people to the category because we're offering something that's an exclusive. And when you take a look at the frozen vegetable category it has close to a 90% household penetration rate. Birds Eye has about half of that; so any time we bring something that's exclusive to the category by definition we'll be taking people who are category buyers but not Birds Eye buyers into our franchise would want to try that out and hopefully they'll like the product and they'll stick.

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

Q

Great, thanks very much.

Robert James Gamgort
Chief Executive Officer & Director

A

Okay.

Operator: Thank you. And our next question comes from Farha Aslam from Stephens Inc. Your line is open.

Farha Aslam
Stephens, Inc.

Q

Hi, good morning.

Robert James Gamgort
Chief Executive Officer & Director

A

Good morning, Farha.

Farha Aslam
Stephens, Inc.

Q

Just one question and it's a bigger picture question on how you manage your brand portfolio. Now that you've had this brand portfolio for a few years; is there any changes that you feel like you want to make in terms of moving things from Foundation Brands to focus brands and is there something that you're doing as your portfolio gets bigger to ensure that brands don't get lost, that you don't become that standard large food company with some brands that just kind of don't get the attention they need?

Robert James Gamgort
Chief Executive Officer & Director

A

Sure. When we talked about our portfolio management strategy during our IPO, we created this construct of Leadership Brands and Foundation Brands, which is a really simple way of illustrating how we manage our portfolio, but in actuality, it's a lot more granular than that. Instead of it being two broad buckets you'd really look at the way that we manage our businesses on a continuum of opportunity and some of them obviously have more potential for growth due to innovation than others even within the Leadership bucket.

We've added to the Leadership portfolio through the acquisitions of Wish-Bone and Gardein and that really is our focus area, if we were to make – as we make future acquisitions, our goal is to add more to the Leadership side of that portfolio, although we know that number of these acquisitions that we're looking at come with brands but also fall in the Foundation side and we're okay with that.

The whole purpose of this is as you'd pointed out is really making sure that we give the right amount of attention to every brand and the way that we continue to do that is really through our organizational structure. So we have people who're focused against each of these brands, their mandate of what good looks like is different by what we see of the opportunity of each brand, but we have individuals that are being held accountable for the performance of not just the Leadership Brands but also Foundation Brands and it's very important to them individually and to us as a company that each brand gets the right amount of attention and that we manage them for what their maximum potential is.

As we've talked about before, we largely manage the portfolio of Foundation Brands for stability and we take the cash that's generated from that and we invest it into the Leadership side for growth and that's been working although as we pointed out in this quarter, there was some weakness in the Foundation Brands, but it was largely driven by pricing because if you look at that portfolio there's a lot of protein in that side of the portfolio where we experienced significant inflation, so something that was necessary to do and the elasticity impact was very consistent with what we expected.

Farha Aslam
Stephens, Inc.

Q

So that Foundation Brand weakness you think is relatively temporary?

Robert James Gamgort
Chief Executive Officer & Director

A

Well any time you take a price increase you see an immediate elasticity impact and then it typically levels off over time and a lot of that is driven by consumers getting used to new price points but also it depends on what also happens to the direct competitors and given that these are really protein-driven price increases, we've seen a lot of competitive action as well in that because as Craig pointed out on the inflation discussion, protein inflation is significant enough that you really can't absorb it just through productivity. You have to pass some of that on to the consumer and quite honestly the consumer is getting very used to seeing protein price increases across the board, but there's always a short-term impact that we need to work our way through and clearly that happened in the first quarter.

Farha Aslam
Stephens, Inc.

Q

Okay, thank you. That's very helpful.

Robert James Gamgort
Chief Executive Officer & Director

A

Okay.

Operator: Thank you. Our next question comes from Chris Growe from Stifel. Your line is open.

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

Q

Hi, good morning.

Robert James Gamgort
Chief Executive Officer & Director

A

Good morning, Chris.

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

Q

Hi. Just had two quick questions for you. The first one, just to be clear and this is in relation to an earlier question, just the new products that you expect in the second quarter and this shift in slotting fees that will occur, is that mostly in Birds Eye? You've mentioned a couple of there, but is that where you'll see most of that movement?

Robert James Gamgort
Chief Executive Officer & Director

A

Yes, when you take a look at the year-over-year, I was just looking at our comparison of innovation year-over-year, you're going to see that the biggest introductions in 2015 are going to be Birds Eye and it's a combination of the Flavor Full line that we talked about as well as protein.

A year ago a lot of the spending was focused on Duncan Hines in the first quarter of 2014 as well as we had some Wish-Bone items that had been introduced by Unilever but they are spending on slotting bits in the first quarter of last year as well as a few on Hungry-Man. This year most of that spending is really concentrated on the Birds Eye portfolio behind the two introductions that we talked about.

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

Q

Okay, thank you. And then just when you look at new products for any of the divisions, but within the division, are the new products meant to be mix or margin enhancing? Is that a goal of the new products?

Robert James Gamgort
Chief Executive Officer & Director

A

Yes. I mean if you go all the way back to the IPO, all of our innovation is margin accretive and we're in a fortunate position where we have a gross margin that still has opportunity for upside. So we've made significant progress over the past number of years on our margin, largely driven by product mix as well as the fact that in the past couple of years our productivity has exceeded inflation. Going forward, there's still upside and we really view product mix driven through Leadership growing faster than Foundation, as well as, all of our innovation being margin accretive as the opportunity continue to drive not only growth but also profit mix.

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

Q

Okay, thank you for the time.

Robert James Gamgort
Chief Executive Officer & Director

A

Okay.

Operator: Thank you. Our next question comes from Jonathan Feeney from Athlos Research. Your line is open.

Jonathan P. Feeney
Athlos Research

Q

Good morning. Thanks very much.

Robert James Gamgort
Chief Executive Officer & Director

A

Good morning.

Jonathan P. Feeney
Athlos Research

Q

Bob, you said something interesting earlier about consumers, I mean retailers, I'm sorry, not being particularly happy with the declines in category that come from price reductions and it brings up an interesting point, because the commodity picture in a lot of grain-based categories and some others would indicate the need to drive volume through promotion, yet you properly pointed out that in many cases it doesn't drive volume.

So my question is your elasticity across the portfolio still looks excellent, considering even though it's both modest, you grew pricing and volume in the quarter across the portfolio through gaining share. Why wouldn't you and your competitors just take more pricing, particularly considering your capacity utilization is so tight?

And I guess secondly and related to that is how do those conversations go with retailers when you articulate a vision for these categories which is one that's higher price? Do they feel confident that consumers are there and will accept it?

Robert James Gamgort
Chief Executive Officer & Director

A

Yes. You make it sound so easy when you say it that way.

Jonathan P. Feeney
Athlos Research

Q

Yes, absolutely, I've been doing it for years.

Robert James Gamgort
Chief Executive Officer & Director

A

Let me pull that apart because it's a really good question, and there are a number of drivers that lead to this conversation and I really think it's about timing of promotions, and I'll get back to that specifically, about what is the source of price increase and then the last part is that you talk about capacity utilization because all of this is kind of intertwined to come up with a pricing strategy.

First of all, my comment about timing of promotion, when you are promoting heavily based on price during a time period when a category is the destination category, it seems to make sense in the very short-term from a retailer perspective because they're trying to differentiate themselves from the retailer across the street but the reality of it is the consumer is going to buy this category anyway so why trade them down in price? And that's a very, very tough discipline and there's always a retailer who will try to take the leadership position or leadership defined as price leadership position in a category like that. But as we're seeing time and time again in baking during the fall bake period and Easter, the units don't move because it's a destination category that's going to be purchased anyway and it just trades down in dollars.

Now if you promote it during the non-peak season, you probably could drive elasticity a lot higher because it becomes more of an impulse or an unplanned purchase, but that's a tough behavior to try to convince people to do when they're trying to separate themselves from a retailer around the corner.

I think the second part is when you take a look at our price realization or our average price based on Nielsen or IRI in our share growth, we're really happy with that. But what I want to point out is we are not out there just taking price increases. The reason we're getting that price realization is because we're trading people up through innovation to higher value items that offer superior benefit. And there isn't really an opportunity to sit across from a retailer and say, hey, we're just going to take our price up, unless it's a situation like protein where there is a known inflation impact that is hitting everyone.

Our price realization is not driven by just taking our price up, which would be really easy if we could do it. It's driven by working really hard to get the consumers to vote with their dollars for higher benefit items – so Decadent, Chef's Favorites, Family Size on Voila! – that's where we're getting pricing. It's from a higher mix impact on that, not from just an average price increase across the board.

And the last point I would make is your comment about capacity utilization. It's true for us but it's not true for everybody. We've taken a lot of capacity out of our supply chain, which has been a tremendous source of productivity. And I think as a result, enables us to be more thoughtful about not chasing volume because we don't have a lot of excess volume to go out there and chase and so we're willing to kind of hold back on promotions sometimes because we're using our capacity well. There's still way too much excess capacity in this industry and as a result I think there's still too much temptation to chase volume, even at the cost of profitability. So, if that last point weren't true, in fact if everybody were running their supply chains at the level that I think that we're running at, you'd see much less temptation in the industry to chase volume.

Jonathan P. Feeney
Athlos Research

Q

Understood. That's very helpful, Bob, thank you.

Robert James Gamgort
Chief Executive Officer & Director

A

Okay. Sure.

Operator: Thank you. Our next question comes from Kenneth Zaslow from BMO Capital Markets. Your line is open.

Vishal B. Patel
BMO Capital Markets (United States)

Q

Hi. This is Vishal in for Ken.

Robert James Gamgort
Chief Executive Officer & Director

A

Good morning.

Vishal B. Patel
BMO Capital Markets (United States)

Q

I just had one quick question. Hey. You highlighted that you'd be able to do an acquisition, I believe you said three times the size of Wish-Bone. Maybe that was last quarter or a few quarters ago. Could you remind us again maybe what kind of characteristics and criteria that you may be looking for in a transformative acquisition of that size?

Robert James Gamgort
Chief Executive Officer & Director

A

Sure. Let me ask Craig just to clarify that point and then I could talk a little bit about criteria of what we're looking for. That response was directly to if you were looking at a straight up cash acquisition using a combination of cash and debt, how far would you be willing to go and still remain comfortable from a leverage standpoint? So, Craig, why don't you talk through that point, and then I'll come back to criteria.

Craig D. Steeneck
Chief Financial Officer & Executive Vice President

A

Yes. We've made some great progress in de-levering the balance sheet. And as I've said before, our leverage is now below 4.2 times. So what we've said and said publicly and have got a consistent viewpoint with the rating agencies is that we could flex our leverage up, as Bob said, for a cash and debt deal up to 5.5 times. So, we can do an acquisition somewhere between $1.5 billion and $2 billion, that would allow us to stay within that 5.5 times levered.

And relative to criteria, that's been relatively consistent since the beginning, very much North American focused, looking for Leadership Brands like we've done with Wish-Bone and Gardein, opportunities to generate synergies, in either an existing or adjacent categories, so that's been pretty consistent with what it's been from the beginning.

Robert James Gamgort
Chief Executive Officer & Director

A

Yes. And in addition to thinking about acquisitions on sort of a brand basis that meets the criteria that Craig just described using the financial parameters that we just defined for you, we're looking for much bigger opportunities to do something that's in a different type structure. And we've talked in the past about a Reverse Morris Trust, although I would say there are a number of different structures that are sort of evolutions of that. But the perspective is it goes beyond just paying cash and debt. It's more of a merger or a spin opportunity, where the spin company actually has an opportunity to participate in the upside.

That's really the home run scenario that we keep pushing very aggressively towards. And if you think about where we could play really nicely in that, it really is in this frozen space that we've talked about a number of times, where we've seen a lot of weakness in the category in total as well as in our competitors' portfolios. And we've seen real strength in our business and something that we're not only confident we could get significant synergies on, but we're really confident that we could turn the performance of those businesses around.

So, that's really the big game-changer one that we continue to push and that doesn't really get defined or limited by a straight up cash, debt, leverage cap perspective.

Vishal B. Patel
BMO Capital Markets (United States)

Q

Great. Thank you.

Robert James Gamgort
Chief Executive Officer & Director

A

Okay.

Operator: Thank you. And our next question comes from Eric Larson from Janney Capital Markets. Your line is open.

Eric Jon Larson
Janney Montgomery Scott LLC

Q

All right, thanks, everybody. Thanks for taking my question. I know we're running short of time. Two real quick questions, one is technical. On your slotting allowances, the $6 million for getting frozen and protein, that covers the national allowances for those brands, right? It covers your entire ACV?

Robert James Gamgort
Chief Executive Officer & Director

A

Yes, that's full ACV, and it goes beyond those two brands. That's just roughly the shift in spending one quarter to the next. But yes, it would cover everything that we're launching during that time period for full national distribution.

Eric Jon Larson
Janney Montgomery Scott LLC

Q

Okay. And is it more efficient to do multiple brands at a time these days or do the retailers price it by SKU?

Robert James Gamgort
Chief Executive Officer & Director

A

No, this is a negotiation. I think the most powerful thing to do is have great innovation. So if you go in with weak innovation or me-too innovation that's not likely to grow the category, you're likely to be paying more in slotting than you are if you're going in there with something that is viewed as game-changing innovation. Bundling does help because it's very efficient for all parties involved and one that's likely to bring new users into the category. That's viewed very differently.

As we take a look at sort of the center of the store and the top line growth that you've all reported on, our retail partners are really looking for innovation that changes the game, not just flavor addition. And so that's all part of the conversation when you're thinking about what kind of investment you want to make and what kind of investment our retailers want to make when they're viewing innovation.

Eric Jon Larson
Janney Montgomery Scott LLC

Q

Okay, great. Thanks. And then one other quick question. Gardein, we haven't had one question on that this morning...

Robert James Gamgort
Chief Executive Officer & Director

A

Yes.

Eric Jon Larson
Janney Montgomery Scott LLC

Q

...but the consumption was up 30%. Can you give us an idea of – talk a little bit more detail of where you're getting consumption gains, distribution gains, I guess, incremental retail takeaway, repeat purchase type activity because I thought that was an interesting comment.

Robert James Gamgort
Chief Executive Officer & Director

A

Sure. When we take a look at Gardein if we look at two data sources, if you look at the SPINS data source which captures performance in the natural channels where Gardein has been in place for a very long time; business is still growing at about a 25% consumption clip in that channel so that's not distribution driven, although there's some depth of distribution gains there meaning more SKUs going into play.

That's really driven on a velocity basis because that channel has been well covered by Gardein for quite a long time. When you look at traditional IRI MULO channel, it's growing at about a 35% clip year-to-date in consumption and that's driven by really all three, breadth of distribution, depth of distribution as well as velocity. And quite honestly I don't have the breakout of those all in my head right now.

As we're continuing to get more familiar with this business as you can imagine with the kind of performance that's experienced right now, we're taking more of a lighter touch approach and really have focused our energies on how do we support this growth through capacity expansion.

It's something that a company like Pinnacle can bring to a company like Gardein, which is how do you get capacity increases out of your existing manufacturing facilities and then we have our eye towards when do we need to add new incremental production capacity probably at another site.

That's where we spend most of our time, but in the meantime we're digging into a lot of the questions that you're looking at which is trial repeat numbers, where do we think the ultimate universe of distribution could be, and that's all work in progress right now. But very, very encouraging numbers as we point out through the consumption and really a good chunk of that is just driven by velocity which means new people are discovering the product and incorporating it into their lifestyle.

Eric Jon Larson
Janney Montgomery Scott LLC

Q

Okay, thank you very much.

Robert James Gamgort
Chief Executive Officer & Director

A

Sure.

Operator: Thank you. That's all the time we have for questions. I would now like to turn the conference over to Ms. Maria Sceppaguercio.

Maria A. Sceppaguercio
SVP-Investor Relations & External Communications

Thank you. Thanks, everyone, for joining us this morning. We're around today, so if you need anything give me a holler. Thank you for participating.

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