Corrected Transcript

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Pinnacle Foods, Inc. (PF)

Q2 2016 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 ended June 26, 2016. This conference is being recorded, and there will be a question-and-answer session at the end of the call.

I'll now introduce your host for today's conference, Pinnacle's Senior Vice President of Investor Relations, Ms. Maria Sceppaguercio. Ms. Sceppaguercio, please go ahead.

Maria Sceppaguercio
Senior Vice President, Investor Relations, Pinnacle Foods, Inc.

Thank you, Ashley, and good morning, everyone. Thank you for joining us today. Earlier this morning, we issued our press release for the second quarter of 2016. If you haven't received a copy of the release, you can get one on our website. As you know, since our last earnings call in April, Mark Clouse joined Pinnacle on May 23rd as CEO, and he had the opportunity to meet with a number of you at our welcome reception the following day.

Mark is here with me today to discuss our results for the quarter as is Craig Steeneck, our CFO, who many of you know quite well. As you likely know, earlier this week, we announced that we successfully repriced the $550 million term loan related to the Boulder Brands acquisition. The repricing enabled us to capitalize on the improved interest rate environment since the time of the acquisition earlier this year, and will result in approximately $10 million in interest expense savings over the life of the loan. Craig will take you through more specifics shortly.

As usual, our conversation this morning will include our 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 trend. While the exclusion of these items is not in accordance with GAAP, we believe it is the most meaningful comparison and the most appropriate basis for discussion of our performance. Detail of the excluded items is included in the reconciliation tables in our press release and discussed in detail in our 10-Q, which will be filed shortly.

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 Mark.

Mark A. Clouse
Chief Executive Officer & Director

Thanks, Maria, and thanks to everyone for joining us. It's a pleasure to be here today to discuss our terrific results for the second quarter. Before getting started, I'd like to spend the moment sharing my initial perspective on Pinnacle, now that I've been in the CEO role for about two months.

As many of you know, Pinnacle is a unique company with a highly talented and experienced team, executing a proven playbook for delivering sustained results. The marrying of speed of execution with the operating excellence has served the company well. This combination has resulted in consistent market share growth and gross margin expansion, leading to strong EPS performance since the IPO. Add to that list, excellent cash flow and smart capital allocation, including making three acquisitions, all while maintaining a very lean overhead structure.

In a nutshell, this is the Pinnacle playbook. To say that I've been impressed in my short time here would be an understatement. I believe the quality of the second quarter results we will discuss here today is a great example of the tremendous power of this playbook and the focus of the team, even during a period of significant change.

In the coming weeks and months, I look forward to engaging with analysts and investors to share my thoughts about the further potential, I believe, exists at the company. Rest assured, what has made Pinnacle a great investment since our IPO will remain very much intact and will be the foundation upon which we build. As you know, our portfolio has evolved important capabilities, that have strengthened the business, have been added over the past few years.

One of the distinguishing characteristics of Pinnacle is our platform for acquisitions, along with our integration expertise and our ability to quickly delever post-acquisition. A strategy to continue to drive the core business and add more through acquisition has created significant value at Pinnacle and you should expect us to continue to do both moving forward.

We will be presenting at the Barclays Conference in Boston in early September and actively meeting with investors for the balance of the year. We are also planning an Investor Meeting before year end. Over the balance of the year, I look forward to sharing the key plans for driving the next chapter of value and unlocking the full potential of Pinnacle Foods.

Now, let's turn to the quarter. In terms of some highlights, net sales advanced almost 20%, driven by the benefit of the Boulder Brands acquisition and improving growth of 1.6% for North America Retail. This was partially offset by anticipated softness in our Specialty segment.

North America Retail composite market share advanced for the ninth straight quarter, with Pinnacle consumption up 2.3% and a category composite that declined. This outperformance drove a 70 basis points increase in composite market share for the quarter, with 12 of our 14 businesses gaining or holding share in the period.

We expanded our adjusted gross margin by an impressive 260 basis points in the quarter, fueled by productivity totaling 3.9% of cost of products sold, which outpaced modest input cost inflation of 1.5%. Also benefiting adjusted gross margin performance in the quarter was favorable net price realization and mix, along with the benefit of the Boulder acquisition.

Below gross profit, total operating expenses increased 31%, reflecting the addition of Boulder Brands and a double-digit increase in marketing investment on the base business, particularly for Wish-Bone, and, to some degree, Hungry-Man.

Net interest expense was also up considerably due to the Boulder Brands acquisition, and, to a lesser extent, the 25 basis points interest rate step-up on pre-Boulder term loans. And finally, adjusted diluted EPS advanced 16.7% to $0.42 for the second quarter, versus $0.36 in Q2 last year.

Now, turning to our segments. The Birds Eye Frozen segment delivered a very strong quarter, with net sales advancing more than 6% and adjusted EBIT up almost 25%. In addition, retail consumption was up 6.4% in a category composite that was flat, resulting in composite market share growth of a 120 basis points.

Importantly, each of the segments' eight brands gained or held market share in the quarter. The Birds Eye franchise, Gardein and Hungry-Man led to net sales and consumption growth for the segment, with existing businesses and recent innovation performing well. From a market share standpoint, Birds Eye Voila! and Birds Eye vegetables advanced 310 basis points and 190 basis points, respectively, in the quarter, while Gardein advanced 400 basis points on a strength of a 35% increase in retail consumption.

During the quarter, we introduced four new varieties for each of Birds Eye Protein Blends side dishes, Flavor Full vegetables, and Disney-themed side dishes for kids, while distribution was expanded for the four premium varieties of Voila! launched in the back half of 2015 and the four new varieties of Hungry-Man Selects introduced in Q1.

Heading into the important holiday season later this year, we feel really good about the momentum we have behind our Birds Eye franchise and we're confident in our plan to continue to drive growth for the balance of this year and next.

Our strategy and strong execution on this business has allowed Birds Eye over the last few years to transform not only frozen vegetables and meals but also, to some degree, the entire frozen aisle. We expect to expand our leadership in these categories with an accelerated pace of consumer-driven and category-expanding Birds Eye innovation, marketing and retail execution. We welcome the renewed interest in the category, and, as the leader, we expect to benefit the most from it.

The adjusted EBIT growth of approximately 25% for the Frozen segment in the quarter reflected the benefits of the increase in net sales and productivity in excess of inflation, partially offset by a double-digit increase in marketing investment.

Now, on our Duncan Hines Grocery segment, we registered a significant sequential improvement in trends in the second quarter, with net sales down less than 3% and adjusted EBIT up 1%. This performance was primarily driven by improvements in Duncan Hines baking products, Wish-Bone salad dressings, and Armour canned meat, partially offset by our Canadian business and Vlasic pickles.

Market share for the segment was even with year ago, as retail consumption declined approximately 3% in line with the category composite. Four of the segment's six businesses gained or held market share for the quarter, including baking, which was up 50 basis points, and salad dressings, which was positive in the month of June, resulting in flat share for the quarter.

In the baking segment, our premium portfolio continued to perform well, driven by our Duncan Hines Perfect Size platform and an improvement in trend for the lower-priced segment of the business. To continue to drive performance at the premium ends of the categories during the quarter, we expanded the Perfect Size platform to include three new varieties, namely Key Lime Pie, Chocolate Dream Pie, and Cheesecake.

We also entered the gluten-free segment of the category with two new Duncan Hines Decadent varieties, namely Chocolate Lovers Brownies and Vanilla Cream Cake. Our market share for this premium segment continue to be strong in the quarter with consumption up 15%, driving a full share point increase.

The improvement that we're seeing at the low end of the category reflects our stepped-up focus on fundamentals, including retail merchandising and smart price gap management. Our market share for this lower-priced segment turned positive in the month of June, and continues positive into early July.

The rollout of our new Wish-Bone E.V.O.O and Ristorante Italiano platforms continue to build momentum in the second quarter, with retail ACV reaching approximately 75%. Market share advanced 60 basis points in the month of June, which drove share in line with year ago for the quarter.

We supported the brand during the quarter with consumer marketing and in-store shopper marketing programs to drive awareness and trial of the new items, which are proving to be highly incremental to the category.

Adjusted EBIT for the Grocery segment advanced 1%, reflecting productivity that offset input cost inflation, partially balanced by the double-digit increase in marketing investment, primarily behind Wish-Bone. Net sales and adjusted EBIT for our Specialty Foods segment were under pressure for the quarter as we expected, primarily reflecting lower sales of private label canned meat due to a heightened competitive bidding environment for the USDA stew business.

We continue to expect the Specialty segment to remain under pressure for the balance of the year. Our focus remains on driving the higher-margin segments with the best ROIs in our portfolio, while we continue to optimize Specialty costs.

Turning to Boulder Brands, Boulder had a good second quarter, contributing a $123 million in net sales and $17.2 million in adjusted EBIT for the quarter. The adjusted EBIT performance reflected improved input cost inflation and better than planned supply chain productivity. From an adjusted EPS standpoint, after giving effect to acquisition-related interest expense and the impact of Boulder's higher effective tax rate, the business contributed $0.02 in the quarter.

Retail consumption for the business was even with year ago in the quarter, with trends improving for the Smart Balance brand. Excluding Smart Balance, retail consumption for Boulder was up 4.3%. The integration of the business continues to proceed well and is on track with our acquisition plan. As previously discussed, getting Boulder onto our systems to enable one order, one invoice and the related improved visibility to the business is planned for August 1, which will represent a key executional milestone in the integration.

Another important area of opportunity that we anticipated at the time of the acquisition is achieving the benefits of SKU rationalization project. Next month, we will be communicating the specifics of the program with our retail partners, and we'll be working with them to ensure a smooth process. Once that communication takes place, we will be in a position to share some specifics of the program with you. As communicated previously, the impact has been built into our guidance for this year, and our outlook for growth for the Boulder business remains very much intact.

In terms of synergies, we continue to expect to achieve the two-year savings of $30 million that we communicated at the time of the acquisition and now have some initial visibility to incremental savings beginning in late 2017. We'll provide more on that as plans firm up and visibility strengthens.

With two quarters now under our belt, albeit with much work remaining to achieve our acquisition model commitments, we are highly confident that we will exceed the EBITDA target we initially communicated due to higher than planned base business performance, including strong supply chain productivity results.

And with that, I'll hand it over to Craig.

Craig D. Steeneck
Chief Financial Officer & Executive Vice President

Thanks, Mark, and good morning, everyone. I'll start with the results for the quarter, and then, transition to our full-year outlook.

Starting with sales, our consolidated net sales increased 19.7% in the second quarter to $756.4 million, representing a 19.4% benefit from the Boulder Brands acquisition and higher net price realization of 1.3%, partially offset by lower volume mix of 0.9% and unfavorable FX of 0.1%. Net sales for North America Retail increased 1.6% in the quarter, reflecting higher net price realization of 1.4%, including the impact of modestly higher new product introductory expenses and favorable volume mix of 0.3%. This was partially offset by unfavorable foreign currency translation of 0.1%.

Our Birds Eye Frozen segment delivered another strong quarter, with net sales increasing 6.1% fueled by higher volume mix of 3.6% and increased net price realization of 2.5%, despite higher new product introductory expenses behind new items in the Birds Eye Flavor Full, Birds Eye Protein Blends, and Birds Eye Disney-themed platforms.

Net sales for Duncan Hines Grocery segment declined 2.7% due to lower volume mix of 2.9% and unfavorable FX of 0.3%, partially offset by increased net price realization of 0.5%. Net sales for the Duncan Hines baking products were down modestly in the quarter but strengthened sequentially versus the first quarter, reflecting improved volume across the baking portfolio and the continued benefit of new premium-tier products.

Net sales for Boulder Brands totaled $123 million in the quarter. Retail consumption continued to advance versus prior year for the Glutino, Udi's, Earth Balance, and EVOL brands, with trends behind Smart Balance continued to show improvements.

Lastly, net sales for our Specialty Foods segment declined 7.9% in the quarter, reflecting lower volume mix of 8.2%, partially offset by higher net price realization of 0.3%. The private label canned meat business, as expected, continued to put pressure on the segment due to a heightened competitive bidding process for the USDA stew business.

Now turning to adjusted gross profit, adjusted gross margin advanced approximately 260 basis points in the quarter to 28.9%. This strong performance was fueled by productivity savings of 3.9%, favorable net price realization and improved mix, as well as the inclusion of Boulder Brands. Modest input cost inflation of 1.5%, partially offset these positive margin drivers.

Adjusted EBIT advanced approximately 32% to $150 million in the quarter, driven by the strong growth in gross profit, partially offset by a double-digit increase in marketing investment for the base business as well as the inclusion of Boulder Brands.

Interest expense for the quarter increased to $35.5 million, largely driven by the additional debt issued to finance the Boulder Brands acquisition, and, to a lesser extent, the impact of previously communicated 25 basis points interest rate step-up on the pre-Boulder term loans.

Earlier this week, the company has successfully repriced our $550 million term loan issued in connection with the Boulder acquisition. I'll provide details on this transaction shortly. Our effective tax rate in the quarter, excluding items affecting comparability, increased to 37% versus 35.3% in the year-ago period, mostly driven by the higher tax structure of Boulder Brands.

Adjusted net earnings increased 19.2% to $50 million compared to approximately $41.9 million in the year-ago period. Adjusted EPS advanced 16.7% to $0.42 per diluted share, compared with $0.36 per diluted share in the year-ago period.

Now, turning to cash flow. Net cash provided by operating activities in the quarter totaled $88 million, compared to $53 million in the prior year. For the six-month period, net cash from operating activities increased $41 million to $165 million, compared to $124 million last year. Capital expenditures in the second quarter totaled $26 million, compared to $21 million in the year-ago period.

As we have previously discussed with you, we continue to expect to invest approximately $30 million in our new Gardein facility in Hagerstown, Maryland to expand capacity for this rapidly growing brand. We firmly believe that the plant-based proteins are at the tipping point of becoming mainstream, positioning Gardein to benefit meaningfully from this growth trend.

Given the favorable interest rate environment, we are now planning to finance a portion of this $30 million expansion and a Birds Eye capacity project through capital leases. As such, the cash requirement associated with our capital program this year has been reduced to a forecasted range of $115 million to $125 million, versus our previous range of $135 million to $145 million.

Now turning to liquidity, at the end of the second quarter, our total debt was $3.2 billion, including $2.5 billion of term loans, $350 million of 4.875% senior notes and $350 million of 5.875% senior notes. Cash totaled a $129 million, bringing our net debt to $3.1 billion and our net leverage ratio down to 4.6 times.

Getting back to our repricing of the $550 million Boulder acquisition term loan, this transaction reduced the LIBOR spread on the loan by 25 basis points to LIBOR plus 275 basis points. It also reduced the LIBOR floor to 0, which was previously set at 75 basis points. This repricing is expected to reduce our interest expense by approximately $10 million over the life of the loan. In 2016, the benefit is expected to be less than $1 million. We expect the transaction to result in minimal one-time expenses this year, which will be treated as an item affecting comparability.

Before turning to our outlook for the year, let me provide an update on Boulder Brands. We continue to expect Boulder Brands to contribute net sales in the range of $460 million to $480 million, reflecting only 49 weeks that Boulder will be consolidated with Pinnacle. It also reflects the anticipated impact of SKU rationalization efforts that are critical to synergy capture and building the foundation for accelerated growth. The impact of this effort has been incorporated into our second half plan and is likely to become visible in our retail consumption results beginning in Q3.

As Mark discussed, our synergy outlook over the 2016 and 2017 period remains very much intact, and we have growing confidence that beyond these first two years, we will drive incremental synergy versus the acquisition model, with some modest savings already identified for early 2018. The important one order, one invoice milestone will be key to strengthening our visibility into the business and estimating the magnitude of the opportunity in the post-2017 period.

Our outlook for Boulder Brands adjusted EBITDA growth over the 2015 to 2017 period has increased considerably, as Mark mentioned, primarily due to higher than planned base business performance, including strong supply chain productivity results. Specifically, we now expect EBITDA growth to approach 65% between the 2015 to 2017 period versus the original target of 50%. This view assumed Boulder over delivers the acquisition model in both 2016 and 2017, which is reflected in the updated guidance for 2016 we provided today.

Specifically, we now expect adjusted diluted EPS for Boulder to be in the range of $0.07 to $0.08 for the year versus our previous outlook of about a $0.05. Recall that this outlook includes the impact on base business of the higher tax structure of Boulder Brands. Finally, one-time integration costs for Boulder are estimated to approximate $30 million and will be treated as an item affecting comparability.

And finally, in terms of our outlook for the year. Adjusted diluted EPS is now expected to be in the range of $2.10 to $2.15, up from our previous guidance range of $2.08 to $2.13. Input cost inflation for the year is now expected at the low end of our 2% to 3% range, including Boulder Brands, and we continue to expect second half inflation to be higher than first half.

Productivity continues to be estimated in the range of 3.5% to 4% of cost of goods sold, including Boulder Brands' organic cost savings, however excluding acquisition synergies. We continue to expect second half productivity to be higher than first half.

Interest expense continues to be estimated at approximately $140 million, including the 25 basis points interest rate step-up on pre-Boulder term loan and the repricing, both of which I spoke to earlier. Our effective tax rate outlook, excluding items affecting comparability, continues to be estimated at or slightly above the company's 2015 effective tax rate of 36.6%.

This outlook is due to the higher effective tax rate for the Boulder business and results in a $0.02 to $0.03 EPS headwind in 2016, which is accounted for in the guidance for Boulder for the year. The weighted average diluted share count for the year is now estimated to be modestly above 118 million shares. FX is expected to continue to be less of a headwind in 2016, with the impact estimated at about $0.01.

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

QUESTION AND ANSWER SECTION

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

Andrew Lazar
Barclays Capital, Inc.

Q

Good morning, everybody.

Maria Sceppaguercio
Senior Vice President, Investor Relations, Pinnacle Foods, Inc.

A

Good morning, Andrew.

Mark A. Clouse
Chief Executive Officer & Director

A

Hi, Andrew.

Andrew Lazar
Barclays Capital, Inc.

Q

Hi. Two questions for me, I guess. First, would be – one of your larger competitors in baking mixes is obviously detailed a new strategy around its portfolio segmentation and includes sort of baking mixes in a grouping of businesses that'll be more focused obviously on returns, profitability versus, let's say, outright growth. So, I guess, I'm curious just your thoughts on potentially the impact that could have on, sort of, the category, which I know has been a little less rational in certain regards, and more importantly, if you've seen anything yet in terms of changes in marketplace dynamics from that, or if it's too early yet? And then, just a follow-up.

Mark A. Clouse
Chief Executive Officer & Director

A

Sure. I think it doesn't change our strategy. I mean, our play on Duncan Hines, as we've talked about in the past, has been to establish a stronger presence in the premium upper tier of the segment, where we've been focusing a lot of our attention on innovation and bringing relevance back to the section, and I see no reason that the role of any competitor would change our position there.

I think as you work through those tiers into the lower end, one of the actions that you probably noticed in our results this quarter, especially in the month of June, was a very focused effort on making sure that all of our fundamentals are really in place. That's both execution at retail as well as what I would call smart price gap management. And we're not going to chase unprofitable volume, but I do think given the significance where it's almost half of the business for us in the lower end, we've got to make sure that we're always positioned competitively.

And that will – again, that's an ongoing evaluation. So, as dynamics may change in the category, certainly, we would evolve with that. Our goal is not to again lower prices and drive unprofitable volume. But, I don't think it'll have a material impact. We still believe that there is opportunity in this category to bring relevance. The other area that we focused on a bit this quarter is we begin to kind of look for opportunities to do that, was adding the gluten-free variance, which I think will have a very good impact in results, as we broaden usage and continue to reach as many customers as we can.

Andrew Lazar
Barclays Capital, Inc.

Q

Yeah. Thanks for that. I mean, I'm hoping, obviously, that maybe it'll bring a little bit more rationality to the lower end, which I know has been difficult for all. But, we'll see how it plays out. And then, just sort of with respect to gross margin, I think, Craig, I think last quarter, you talked about gross margin expansion being probably stronger in the second half of the year than in the first in terms of the cadence. Obviously, it came in a lot greater in terms of the expansion year-over-year in the second quarter than we had modeled. Does that cadence still hold, meaning gross margin expansion could still be greater in the second half than the first half in light of what we saw the gross margins do in the second quarter?

Craig D. Steeneck
Chief Financial Officer & Executive Vice President

A

Yeah. Andrew, the guidance that we gave, we'll expect inflation to be higher in the second half than the first half. Certainly, the inflation number at 1.5% did come in a little bit lower than our expectation. And also as we said, productivity is going to be greater in the second half than the first half. So, that's the whole story. So, the gap between productivity and inflation will narrow a bit in the second half.

I mean, a lot of the improvement, or a big portion of the improvement, coming in the quarter was Boulder. The core fundamental business there and supply chain productivity was a bit above our expectations. So, I think everything for the year is intact. You see from our guidance, we've lowered the inflation estimate to the low end of the range and kept productivity in the sweet spot, where we continue to be, I think, excellent operators in the past.

Maria Sceppaguercio
Senior Vice President, Investor Relations, Pinnacle Foods, Inc.

A

The one thing that I would add to that, Andrew, is that it's really important that it was mentioned in our press release was that, for the quarter, the base business was a significant contributor to the gross margin performance, I mean, it drove most of it. Boulder was incremental, and that was great. The margins were good, but the base business had a really good quarter from a gross margin standpoint.

Andrew Lazar
Barclays Capital, Inc.

Q

Great. Thank you.

Operator: Thank you. Our next question comes from Farha Aslam of Stephens, Inc. Your line is open.

Farha Aslam
Stephens, Inc.

Q

Good morning.

Mark A. Clouse
Chief Executive Officer & Director

A

Good morning.

Maria Sceppaguercio
Senior Vice President, Investor Relations, Pinnacle Foods, Inc.

A

Good morning, Farha.

Farha Aslam
Stephens, Inc.

Q

First question is on the Birds Eye business, and Mark, you referred to the frozen category, we're just ahead of that key fall season. Could you share with us how the retailers are approaching that frozen vegetable aisle differently perhaps this year than past years?

Mark A. Clouse
Chief Executive Officer & Director

A

Well, I think one of the things that we're definitely seeing is, I would call it, an increasing or building level of confidence in this category as being an opportunity for growth. And I think over the last couple of years, we've demonstrated a great potential in bringing focus to the section but also providing meaningful innovation across a variety of different fronts. And I think what you're seeing is a kind of a believability now of the proposition, that's lending itself to us being able to create more incremental opportunities and continue to drive both our performance as well as improving the category.

And with that, I think has come some renewed competitive interest which, I think, for us is the clear leaders, we do welcome that. I think it'll bring more attention to the category and bring more interest into the section, and I think we're well-positioned to win in that scenario. So, we're feeling really good about that. And I think retailers are coming along with us on it and working with us to make sure that we get the most out of that section.

Farha Aslam
Stephens, Inc.

Q

And just continuing on a follow-up to that vegetable category, are you seeing a focus on innovation, how are you seeing kind of pricing and promotions as you head into that key fall period?

Mark A. Clouse
Chief Executive Officer & Director

A

I think there's always a good mix. If you look at the course of the year, what you'll see is a bit of an ebb and flow over the year where innovation plays a bigger role in one season. You'll see a little bit stronger performance around the core business through the holiday where a lot of traditional meal, traditional recipes are a major focus. But, we see good performance on both.

And so, I think as you go into the season, this has not been a business that has been aggressively driven on lower price points or high levels of merchandise volume. And I believe we will continue to see that trajectory maintained. Again, we're going to make sure that by customer, by store, we're positioned well competitively, but I think you'll generally see it moving on some of the newest flavors and then just core consumption through that key holiday window.

Farha Aslam
Stephens, Inc.

Q

That's helpful. Thank you.

Mark A. Clouse
Chief Executive Officer & Director

A

Great.

Operator: Thank you. Our next question comes from Brian Holland of Consumer Edge Research. Your line is open.

Brian P. Holland
Consumer Edge Research LLC

Q

Thank you. Good morning.

Mark A. Clouse
Chief Executive Officer & Director

A

Hi, Brian.

Brian P. Holland
Consumer Edge Research LLC

Q

So, a quick question, when we look at the EPS beating the guidance for the back half of the year, the number came up, you beat by $0.03, the number came up $0.02 for the back half of the year. I'm wondering if – I know marketing was up double-digits for you in the second quarter, marketing spend. And I'm curious whether or not that math changed for you guys as you sort of started to flow through the upside you've seen in the first half of the year. And if we – if maybe embedded in this guidance is increased marketing support in the back half of the year, how to think about that if at all?

Mark A. Clouse
Chief Executive Officer & Director

A

Right, Brian. Yeah. I think you'll see that commitment continuing paired with again, of course, the very strong delivery of gross margin improvements. So, you'll see that nice balance, I think, continuing of some increase in investment. And again, I think, we'll look for continued opportunity to fuel some of the areas of the business that are performing well, while also making sure that we're competitive throughout the year.

We feel great about the back half plan. I think we're positioned well. And, again, we're building confidence in a variety of different areas where we've kind of proven, especially as we've exited Q2 that we can drive the business in a few areas. And again, always paired with that cost discipline and that margin delivery that we've committed to. But, I'll think you'll see that trend continue through the back half of the year and position us well from both the competitive standpoint as well as, like as I said, continuing to fuel some of the momentum on the business.

Brian P. Holland
Consumer Edge Research LLC
Q

Thank for that. Switching over Wish-Bone, so you reiterated again today the incrementality of the new product introductions into the category. When we look at the scanner data, it's not quite as clear if we kind of isolate the new product and then look at the legacy products. It seems to apply some cannibalization. Obviously, there is a positive mix benefit, so we're seeing points of distribution come down for the legacy products. We're seeing deceleration. So, again, I don't know, maybe there's something that we're missing there and not counting, but if you could may be walk us through how you think about that.

Mark A. Clouse
Chief Executive Officer & Director
A

Right, Brian. Yeah. So, clearly, there would be some planned cannibalization with the launch. But I think part of what you're seeing right know is related to a customer service issue that we had on one particular size of the business. That happened to coincide in the same window that we're really building inventory on the new items and that slowed down the distribution growth in the month of June. I think you will see that accelerate and pick back up as we're fully through that customer service issue, fully shipping, the sizes that were the issue and I think you'll see a heightened level of incrementality as we go forward and that continued incremental benefit and mixed benefit that you're describing. So, there was a little bit of noise there that weakened a bit of the performance on the incrementality size. But I think we're – we are through that and we will continue to see that build I think in the months ahead.

Brian P. Holland
Consumer Edge Research LLC
Q

Thank you. Appreciated.

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

Jason English
Goldman Sachs & Co.
Q

Hey. Good morning, folks.

Mark A. Clouse
Chief Executive Officer & Director
A

Hi, Jason.

Maria Sceppaguercio
Senior Vice President, Investor Relations, Pinnacle Foods, Inc.
A

Good morning, Jason.

Jason English
Goldman Sachs & Co.
Q

Thank you for the question. Craig, question for you on cash flow. You gave us a free cash flow figure for the full year, I think, at that CAGNY lunch. Sounds like you've got some moving pieces with CapEx moving lower, and, obviously, nice cash from op so far this year. Where do we stand in terms of full year cash outlook? And also, where do we stand in terms of CapEx, is it fair to take your new number and just flop off $30 million as we look into next year or given the capital leases, does that sort of move around a bit?

Craig D. Steeneck
Chief Financial Officer & Executive Vice President

A

Yeah. So, I mean, the guidance we gave relative to the cash flow for the year at CAGNY is obviously very much intact. We're delighted with the performance to-date. We continue to drive nice improvement in working capital. We took the opportunity with these capital leases where the inherent interest rate in them was in the low-2%s to be able to defer out $20 million of cash into next year and beyond. So, that was just a smart financial decision.

So I feel really good about the cash flow for this year. We're right on plan to the first six months. We'll get some improvement because of the CapEx movement. And as you look to next year, as we've stated all along, our CapEx is in the 3% to 4% of net sales range. So, the base business is a little bit north of $100 million.

We've taken selective opportunities in the past, like with the Wish-Bone acquisition to be able to capture some synergies, with the Gardein acquisition to be able to put CapEx into expansion propositions. And we'll continue to do that as we look into the next year and beyond.

Jason English
Goldman Sachs & Co.

Q

Thank you. I guess, I wasn't really probing on whether or not intact, I guess, I was trying to get to the point of shouldn't it be going higher, your free cash flow outlook, given lower CapEx?

Craig D. Steeneck
Chief Financial Officer & Executive Vice President

A

Yeah. It will go up dollar for dollar for the improvement in the CapEx.

Jason English
Goldman Sachs & Co.

Q

Got it. Cool. One more question, and I'll pass it on. Great progress on the profitability of Boulder in results here. Now, you sat with the business for a while. I'm curious, are there any sort of structural reasons why this business maybe can't get to a similar level of profitability from margin perspective as the rest of your retail business?

Craig D. Steeneck
Chief Financial Officer & Executive Vice President

A

I think it will over time, Jason. I mean, clearly, the Boulder cost structure, when you look at SG&A and the complexity that they had in the supply chain, had an EBITDA level in the low-teens. We've gotten the synergies in SG&A so far this year. The base business is performing better. We feel really good about the synergies as you look beyond 2017 into 2018 on supply chain. So, it's certainly going to move a lot closer to Pinnacle. Will it fully get there by the end of 2017? Probably not, but a year or two beyond that, perhaps.

Jason English
Goldman Sachs & Co.

Q

Super helpful. Thank you very much.

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

Christopher Growe
Stifel, Nicolaus & Co., Inc.

Q

Hi. Good morning.

Maria Sceppaguercio
Senior Vice President, Investor Relations, Pinnacle Foods, Inc.

A

Good morning, Chris.

Mark A. Clouse
Chief Executive Officer & Director

A

Hi, Chris.

Christopher Growe
Stifel, Nicolaus & Co., Inc.

Q

Good morning. I just had two questions. The first one, the Birds Eye division, Birds Eye brand had obviously a, say, great performance in the quarter. And part of that business is benefiting as well from some disruption on the – from large suppliers on the private label side. So you had great market share growth. Is that something you expect to continue into the third quarter or some business you're picking up or phases you're picking up? Just want to get a sense of how that could continue to benefit the company.

Mark A. Clouse
Chief Executive Officer & Director

A

We definitely had a very strong quarter on both the Birds Eye base vegetable business as well as Voila! which is doing extremely well also. And when you look at what we launched in the Q2 as far as innovation goes relative to a very strong support plan in the back half, I expect to continue to see positive performance. I think within the competitors, it is a bit of a mixed bag.

But I think really the driver of our performance has been much more the combination of really effective innovation as well as good fundamentals on the business. And I think we've still got runway on this business as we go forward. And, again, as I said, I think, we're seeing partnership in the retail environment continue to grow as they see it as an opportunity as well. And I think that's going to bode well for both the share position as well as the category dynamic.

Christopher Growe
Stifel, Nicolaus & Co., Inc.

Q

Okay. And just a second follow-up question. There was a comment, and I think it was in two different divisions of new product introductory costs. I just want to get a sense of how that could be weighing on sales, certainly a profitability and how that maybe could be relieved in the second half of the year? Was that a meaningful factor for 2Q or some we could consider for the second half?

Craig D. Steeneck
Chief Financial Officer & Executive Vice President

A

I mean, certainly, much more substantial in the first quarter Chris, as we talked about, when we launch a lot of the incremental slotting behind Wish-Bone. There was some small slotting increment year-on-year in Q2 as we put some Birds Eye platforms out there in addition to Duncan Hines Perfect Size, but not a meaningful drain negative comp. And the second half historically doesn't have a significant level of slotting. So, you shouldn't expect material movement in the back half.

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

Okay. Thank you for your time.

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

Thank you, Chris.

Mark A. Clouse
Chief Executive Officer & Director
A

Thanks, Chris.

Operator: Thank you. Our next question comes from Evan Morris of Bank of America. Your line is open.

Evan Morris
Bank of America Merrill Lynch
Q

Good morning, everyone.

Mark A. Clouse
Chief Executive Officer & Director
A

Hi, Evan.

Maria Sceppaguercio
Senior Vice President, Investor Relations, Pinnacle Foods, Inc.
A

Hi, Evan.

Evan Morris
Bank of America Merrill Lynch
Q

Hi. Just getting back on Boulder for a second. I think last quarter, you had said that it was little too early – I maybe paraphrasing, too early to raise guidance, and now we move into this quarter and you've raised the guidance. I know you talked more broadly about the upside opportunities over the next couple of years. I guess, just more specifically, what did you see or what materialized in 2Q that led you to increase the outlook? And are any of those factors given that happened earlier in the year, any of those factors in place, like why shouldn't it continue to lead to upside throughout the year?

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

Yeah. So, Evan, at the end of the first quarter, obviously, we had only owned the business for two-and-a-half months. We felt a high level of confidence as we articulated that we could get or we could see our way through the cost savings in SG&A and supply chain. I think what allowed us to be able to take up the guidance is we generated a very strong Q2, with a little bit lower input cost inflation and higher productivity on the base business.

And we see no reason that those factors are not going to continue to the back half, that's why we took up the guidance specifically relative to Boulder.

Mark A. Clouse
Chief Executive Officer & Director

A

And one thing, Evan, that I would say as well as we mentioned earlier, we've got a pretty significant event that's happening in August and getting all of the business on one invoice, which is going to help us, I would say continue to add transparency to the business as well as get through a major executional milestone. And I think as we come into the third quarter, we're going to continue to evaluate that and certainly, we continue to push on a variety of drill sites, but I do think there's a certain amount of confidence that will be built after we get through that executional element and I think we'll continue to update you as we see where we now have clear pictures and where opportunity might reside.

Evan Morris
Bank of America Merrill Lynch

Q

Okay. And just a question there, the increase in guidance, the $0.02 to $0.03, was that more forward looking about what you see for the back half like you said or was that really the upside that you saw in the 2Q based on the stronger base business, better productivity, that kind of stuff?

Craig D. Steeneck
Chief Financial Officer & Executive Vice President

A

I mean, a combination of both, but mostly the raise accounts for the better performance in the second quarter. A lot of it on Boulder, obviously, on inflation productivity, as Maria said before, the gross margin expansion. The base business in the second quarter was exceptional. And the dollar for dollar rise is the result of the Boulder performance, and we're making sure we're going to be competitive in the back half on the base business in terms of marketing, in terms of promotion, Birds Eye, Wish-Bone, Duncan Hines, et cetera.

Evan Morris
Bank of America Merrill Lynch

Q

Okay. And then, just a quick one for Mark. I know it's still early days, but as you're kind of looking at the business and looking at just the landscape out there, assets, valuations, have the M&A priorities for Pinnacle changed at all? Is it a greater focus on leveraging on the Boulder platform now for the faster growing segments or doing something large scale? Can you talk about sort of how this evolves?

Mark A. Clouse
Chief Executive Officer & Director

A

Yeah, sure. Well, I think, as I said earlier, it will remain a priority and focus for us, because I do think one of the real competitive advantages that Pinnacle has is this tremendous platform, lean costs, very, very strong and nimble in execution. And I think one of the things that we are learning with the Boulder business is that platform can apply to both iconic brands as we tended to do in the past as well as faster growth businesses.

So I don't think it fundamentally changes our strategy, but it builds confidence that I think we have the opportunity to apply it in both kind of where we've been, which certainly has created a tremendous amount of value, and we would continue to see consolidation as an opportunity, while also looking at additional ways to build out the scale in Boulder on health and wellness where we believe we can apply a similar playbook with some slightly different muscles, but able to still unlock value on that front as well. Does that help?

Evan Morris
Bank of America Merrill Lynch

Q

Yeah, yeah. It does. Thank you, all. I'll pass it along.

Operator: Thank you. Our next question comes from Michael Gallo of C.L. King. Your line is open.

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

Q

Hi, good morning.

Maria Sceppaguercio
Senior Vice President, Investor Relations, Pinnacle Foods, Inc.

A

Good morning, Mike.

Mark A. Clouse
Chief Executive Officer & Director

A

Hi, Mike.

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

Q

My question – just bigger picture question for Mark on the Birds Eye business. You've had sustained growth, and you really demonstrated tremendous growth in these categories over the last couple of years. Seems to me there's still a lot of small brands in the retail aisle where there's three, four, five different brands and be it frozen peas or carrots, et cetera. I was wondering whether you see increased retail momentum to want to have the more comprehensive offering, which should allow you to continue to take shelf space as some of that might get rationalize over the coming years. Thanks.

Mark A. Clouse
Chief Executive Officer & Director

A

Yeah. Mike, I think that's a very fair observation and one that we would agree with. I think the opportunity to really redefine the aisle where we have clearer destinations for both the base business as well as the innovation and the new platforms that we've been adding, I think has been a key to unlocking this growth; and then, really changing the dynamic in the section.

As time goes on, I think our ability as always is the case in frozen, space is a premium. And so our ability to really help retailers optimize that category and be clear on the segmentation while eliminating redundancy I think will be part of our strategy going forward. And I agree with you. I think there's still a significant amount of runway ahead given what we proven. And it's important to remember this has really just been about a 24-month journey on Birds Eye. I mean, we have a lot of opportunity that we still see out in front of us in the pipeline, as well as ideas and plans for further growth as we go forward. So I would agree with your observation, and I think that should be part of what we're doing as leaders in the category.

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

Q

Thanks very much.

Operator: Thank you. Our next question comes from Ken Zaslow of Bank of Montreal. Your line is open.

Kenneth Bryan Zaslow
BMO Capital Markets (United States)

Q

Hey. Good morning, everyone.

Mark A. Clouse
Chief Executive Officer & Director

A

Hi, Ken.

Kenneth Bryan Zaslow
BMO Capital Markets (United States)

Q

Just a couple of quick follow-ups. One is, in terms of the increase in the Boulder Brands accretion for this year, is that implied that you're pulling it forward or the entire Boulder Brands accretion is higher than you expected?

Craig D. Steeneck
Chief Financial Officer & Executive Vice President

A

The latter. In my comments in the speech, we said at the time of the acquisition that we felt we could increase the EBITDA in the business by 50%. It was trending around about $60 million, $62 million; we thought we could add $30 million to it. We now think that we can – instead of 50% accretion, look at 65%, which would mean we can bring the Boulder EBITDA to a little bit north of $100 million.

And as articulated, we see it in 2016 and we see it in 2017 and that's really on the strength of the base business, incremental supply chain productivity, better management of costs. We feel really good about the synergies and are starting to get incremental line of sight to the synergies, back half of 2017 into 2018.

Kenneth Bryan Zaslow
BMO Capital Markets (United States)

Q

In August, once – you're going to even get another level of clarity that there seems to be maybe some built-in conservatism on top of that as well, is that a fair – that's what sounds like what Mark you said.

Mark A. Clouse
Chief Executive Officer & Director

A

I don't know that I would say conservatism, what I would I say with 100% increased our visibility. I mean, we're on top of it now, we're operating Boulder as a separate segment. They are on separate systems. We're bringing them on to our systems this weekend. Once we get through that integration or that milestone, that's a big piece of the integration formula that we have and that will do nothing but increase our visibility. I'm not sure if that that necessarily translates into dollar for dollar increase in our guidance, but it all certainly heightened our visibility.

Kenneth Bryan Zaslow
BMO Capital Markets (United States)

Q

My second question is when you guys came out with the IPO, I think you guys had a dividend yield of 3% to 4% focus. You guys are now kind of I've got low-2%. Is there – and now you also got CapEx or readjusted your cap spending, why is there not an initiation to actually increase your dividend as well, am I missing something?

Craig D. Steeneck
Chief Financial Officer & Executive Vice President

A

Well, Ken, what we said at the IPO in relation to putting out a yield was that we had a target of having our dividend be 50% of net income and we have kept to that over the three years that we've been public. We have a board meeting come up in a couple of weeks, that's where will be determined the new year dividend rate, but we've stuck steadfast to this 50% of net income roll as opposed to trying to chase yields which obviously has got fluctuation with the stock price it associated with.

Kenneth Bryan Zaslow
BMO Capital Markets (United States)

Q

Okay. And then, Mark, my last question is, now that you have been there for a couple months, what do you want to accomplish and what type of imprint do you actually want to have on this company? Is it just kind of keeping in the direction, the boat going in the right direction and just you're going along with it? Or is there something that you would like to add value and enhance something at Pinnacle and can you talk about that?

Mark A. Clouse
Chief Executive Officer & Director

A

Yeah. Certainly, more clarity will come over the months ahead as we lay out kind of the next chapter of the strategy. I guess, the best way I would describe it is, I think there is a tremendous foundation here. There's no question that the playbook kind of as advertised I've been able to validate in the first few months that I've been here. And I think that platform has really served the business well in a very active time, a lot of consolidation and a lot of integration.

I think, as we go forward, I don't think I would expect a hard left or right turns strategically. But what I do think we can do and what my goal and the entire team's goal is, is to kind of take those areas to the next level. So, finding ways in which we've done a great job optimizing the pieces. How do we look at the pieces together and really drive value as a portfolio as we now have a different portfolio than we had before? How do we look for growth as a better contributor for us going forward? All of those elements, I think will be woven into what I would call the next generation or the evolution.

And as far as an imprint, I think being able to continue to move on this strategic journey but to accelerate and ramp up the input from it while still utilizing M&A as an aggressive part of our plan I think is a great kind of summary of where I expect to go. Now, clearly, the proof will be in the details. And as we go forward, we certainly plan and are confident that we can layout what those areas of focus will be and why that's a credible next step and one that we think we can take the business to the next level.

Kenneth Bryan Zaslow
BMO Capital Markets (United States)

Q

Great. I appreciate it.

Mark A. Clouse
Chief Executive Officer & Director

A

Thank you, Ken.

Maria Sceppaguercio
Senior Vice President, Investor Relations, Pinnacle Foods, Inc.

A

Thanks, Ken.

Operator: Thank you. Our next question comes from Eric Larson of Buckingham Research. Your line is open.

Eric Larson
The Buckingham Research Group, Inc.

Q

Okay. Thank you. Good morning, everyone. And nobody has said this yet, but I will. Congratulations on a great quarter.

Mark A. Clouse
Chief Executive Officer & Director

A

Thank you, Eric.

Maria Sceppaguercio
Senior Vice President, Investor Relations, Pinnacle Foods, Inc.

A

Thanks, Eric.

Eric Larson
The Buckingham Research Group, Inc.

Q

Yeah. Just a couple really quick questions. I want to drill down on your free cash generation, which is really superb right now, and you lowered your CapEx by, on average, about $20 million. Craig – this one is for Craig, is that – that's not a deferral, it's coming in lower this year, but you'll have to add to next year. And do you have enough capacity to support kind of your strong kind of revenue growth outlook kind of across your portfolio today?

Craig D. Steeneck
Chief Financial Officer & Executive Vice President

A

Yeah. I think the right way to look at it, Eric, is when you put these capital leases in play, we've taken $20 million of cash out of this year, and deferred that for multiple years over the next four years, five years. And, yeah, I mean, that does not affect in any way shape or form our ability to be able to service the business. As you see, we're adding CapEx behind Gardein, which has got great growth potential. We've added some capacity in Birds Eye. So, there's absolutely no constraints in terms of making sure that capital is supporting the growth.

Eric Larson
The Buckingham Research Group, Inc.

Q

Okay, okay. Good. Then, another quick question, maybe you can address this. I started – in Walmart, I started seeing some shelf sets for some very key Boulder brands, Udi's, Glutino, I'm not sure if I saw EVOL or not, and I know that Boulder did not have Walmart distribution when they were a standalone public company. Can you talk about some of your distribution gains at Boulder, and what that might mean going forward?

Mark A. Clouse
Chief Executive Officer & Director

A

Well, Eric, we did have distribution in Walmart on several of the brands. What I will say though is as we brought the businesses together, our executional focus, and I'd say executional consistency has improved. So, part of what you may be seeing is a ramped up level of in-store focus and in-store oversight, that's helped to create the stronger presence and a little bit of the cleaned up sets. But, there has been a meaningful business there at

Walmart, but again, I do think the benefit of us working the portfolio collaboratively with our broader portfolio is that we're going to be able to bring more executional focus there in Walmart and all the retailers for that matter.

Eric Larson
The Buckingham Research Group, Inc.

Q

Okay, okay. Good. And then, just a final question which can have an impact on frozen pricing throughout the year. Last year, we had a very large vegetable crop. We seem to have gotten – you seem to have gotten through that in the last year pretty well. This year, I would assume the crops are also pretty substantial. Can you talk where the harvest is this year and what that might mean for the next 12 months going forward?

Mark A. Clouse
Chief Executive Officer & Director

A

Yes. Excellent observation, Eric. So, yeah, last year was one of the best crop seasons we've had over the last 10 years.

Eric Larson
The Buckingham Research Group, Inc.

Q

Yeah.

Mark A. Clouse
Chief Executive Officer & Director

A

Very much focus obviously on peas and corn and green beans and carrots which we formed internally. It's still a bit early in the process, but so far so good. I mean, I wouldn't say it's necessarily at 100% of the level of last year, but we're also having a very good – weather has been very supportive, and we expect another good crop year for this year. Once again, we'll benefit 2017 and beyond.

Eric Larson
The Buckingham Research Group, Inc.

Q

Okay. I'd rather see the crop a little shorter than longer, but, okay, that's just a biasness on my part. But anyway, thank you. I'll pass it on.

Mark A. Clouse
Chief Executive Officer & Director

A

You got to farm when the sun is shining.

Eric Larson
The Buckingham Research Group, Inc.

Q

Yes.

Operator: Thank you. I'm not showing any further questions in queue at this time. I'd like to turn the call back over to Ms. Sceppaguercio for any further remarks.

Maria Sceppaguercio
Senior Vice President, Investor Relations, Pinnacle Foods, Inc.

Thank you, everyone. Appreciate your support and dialing in this morning. I know it's a busy day for everyone. I will be around. So, if you have any questions, give me a call.

Operator: Thank you. Ladies and gentlemen, thank you for participating in today's conference. This concludes today's program. You may now disconnect. Everyone have a wonderful day.