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Pinnacle Foods, Inc. (PF)

Q3 2017 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 Incorporated Earnings Call for the Third Quarter ended September 24, 2017. This conference is being recorded, and there will be a question-and-answer session at the end of the call.

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

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

Thank you, Howard. Good morning, everyone, and thanks for joining us today. Earlier this morning, we issued our press release for the third quarter of 2017, which is available on our website. As we expected and discussed last quarter, several of the discrete items related to our Aunt Jemima recall and business exit along with the carryover impact of the accelerated manufacturing investments we implemented last quarter were again headwinds in our third quarter results. As we did last quarter, we will walk you through these impacts so that you'll have a sense of our underlying performance, and we'll also discuss the future benefits of the accelerated manufacturing investments.

Over the past few months, a series of natural disasters occurred that unfavorably impacted our results in Q3. We will discuss these impacts with you as well and what you can expect in Q4. During the quarter, we took a noncash trade name impairment charge of $39 million to write-down the carrying value of five Foundation brands. This impact is included in our GAAP results, but excluded from our adjusted results.

Here with me today to discuss our results in the quarter and our outlook for the year are Pinnacle's CEO, Mark Clouse, and our CFO, Craig Steeneck.

Before turning the call over to Mark, let me remind you that, as usual, our release and 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 trends.

While the exclusion of these items is not in accordance with GAAP, we believe that it is a meaningful comparison and an 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.

In addition, 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.

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

Mark A. Clouse

Chief Executive Officer & Director, Pinnacle Foods, Inc.

Thanks, Maria, and thanks to everyone for dialing in. As Maria referenced, we have a lot to talk about again in this quarter. At a higher level, much like last quarter, we posted very strong in-markets results, and the fundamentals of the business remain on track.

Before discussing our underlying fundamentals, I want to review the discrete items, which are now largely behind us. All of the actions associated with these efforts have been completed, and we expect the final residual impact to waterfall through the P&L in Q4.

For the quarter, the total cost to gross margin of the discrete items was $15 million. For the full year, this cost is now expected to be $7 million higher than we were anticipating due to two drivers. The first driver is unanticipated AJ recall expenses totaling $3 million, primarily related to greater than expected return volume and some penalties incurred in foodservice accounts.

The second driver reflects an incremental $4 million of strategic investments, mostly a slower start-up at our Jackson facility. Craig will provide more details and the related benefits shortly.

As you well know, these decisions were not without some pain in 2017, but we continue to believe that these were the right long-term decisions for the business and expect much of these costs to serve as tailwinds in 2018. In addition, and more importantly, we remain confident in the strength of our underlying fundamentals, which we believe is clearly evident in the reported consumption and share data.

Finally, before turning to the fundamentals, as we outlined in our press release this morning, hurricanes Harvey and Irma also had an unfavorable impact on our results in the quarter, primarily by delaying shipments. These delayed shipments, mostly in Frozen are expected to benefit sales in Q4 and importantly, this is reflected in our October results. However, higher freight rates from the storms in the last few weeks of the third quarter are expected to continue throughout the balance of the year.

Now turning to the fundamentals. Starting with our top line, our net sales were up a strong 3.1% excluding the discrete items in the residual Boulder impacts as well as the estimated impact of the hurricanes. In the food industry environment increasingly struggling to find growth, we are pleased with our strong underlying top line performance. In-market performance was even stronger with our consumption versus year ago up 3.5% in the quarter and an even more impressive 5.2%, excluding Aunt Jemima. This exceptionally strong performance reflected growth across all three retail segments. Composite market share across the portfolio continued to grow, registering a 0.7 point increase in the quarter and marking our 14th consecutive quarter of share growth.

Our adjusted gross margin was down 130 basis points in the quarter, reflecting the 150 basis-point headwind from the discrete items and hurricanes referenced earlier. Our modest underlying gross margin growth was driven by productivity at 4.1% of cost of products sold and acquisition synergies that continue to track slightly ahead of plan, along with some modest net realized pricing. Inflation, which was a more meaningful 3.4% this quarter served as a partial offset as did unfavorable mix.

Total operating expenses declined 9% in the quarter, primarily reflecting higher marketing spending in support of our innovation platforms, more than offset by lower SG&A overhead expenses resulting from synergy capture, aggressive cost management and lower performance-based compensation. Interest expense in the quarter declined approximately 20% while our adjusted effective tax rate declined to 31.7%.

Adjusted diluted EPS advanced 9% to $0.58 in the quarter even after giving effect of the impact of the discrete costs and hurricanes, which totaled approximately $0.09 in the quarter. We continue to expect EPS for the year at the low end of our guidance or $2.55, and we continue to believe that the 2018 will – that 2018 will play out essentially in line with our long-range plan.

Now turning to our segments. I'll start with Frozen. At a high level, Frozen had a great quarter from a market share and retail consumption standpoint, but net sales lagged due to the discrete items and hurricanes driving some shipment timing that is expected to reverse in Q4. In fact, our Frozen shipments in October excluding Aunt Jemima are estimated to be up approximately 5% versus a year ago and we expect a strong Q4 for the segment. In terms of market share, performance for the Frozen segment advanced 0.6 share point in the quarter driven by Birds Eye vegetables, which advanced 2.1 share points on consumption growth of almost 13% and Birds Eye meals, which advanced 1.3 points on consumption growth of 8%.

Our multiyear innovation agenda behind our Birds Eye franchise has resulted in significant share growth of both our core businesses and new platforms. In fact, since 2013, market share has advanced 6.1 share points for Birds Eye Veg and 14.1 share points for Birds Eye meals, which now holds a 42% share of the bagged meal category.

Earlier this year we launch five new Birds Eye platforms including three veggie made offerings, which are vegetable made lines that mimic pasta, rice and mashed potatoes with significantly less carbs and a full serving of vegetables. These products are resonating with both consumers and retailers and driving significant incrementality. In addition, during Q3, we launched Hungry-Man handfuls, a forward line items of hand held pocket meals that are twice the size of the leading brand.

We also continue to expand our retail distribution for the Frozen segment, posting a 7% increase in TDPs for the quarter or 10% growth excluding the impact of the AJ exit, fueled by a double-digit increase for the Birds Eye franchise and a more moderate increase for our Hungry-Man business.

Turning to our Grocery segment. Third quarter was a good one for Grocery. With strong net sales and continued strong in-market performance, momentum behind Duncan Hines continued in Q3 with the brand posting another quarter of double-digit sales growth fueled by the significant success of Perfect Size for 1.

The new 18-item line addresses a number of previously unmet category and consumer needs, including portion control, individuality and convenience, to name a few. Distribution for the new line, which is now at 75% ACV has proven to be highly incremental, supporting the 14% increase in retail distribution Duncan Hines achieved in the third quarter. Our Armour business also posted double-digit net sales growth in the quarter, which is higher than what you would have seen in IRI or Nielsen because our net sales included some shipments to FEMA for relief efforts.

Net sales for Vlasic were also strong in the quarter reflecting the benefit of the Q2 launch of Vlasic Purely Pickles. On the other hand partially offsetting this growth were lower sales for primarily Wish-Bone salad dressings due to aggressive competitive pricing.

Strengthening Wish-Bone will require a more balanced attack, including focusing on base business improvement and strengthening the brand's core equity in the Italian segment as well as through innovation such as our healthy oils platform.

In-market performance for the Grocery segment was strong, with retail consumption advancing 2.3% in the quarter in a category composite that was up about 1%. This performance drove a market share gain for Grocery of 0.2 share point largely driven by Duncan Hines and Armour, partially offset by declines for Wish-Bone and pie fillings.

Supporting the consumption and share growth for Grocery was continued distribution expansion, up 2% in the quarter led by double-digit growth for Duncan Hines and more moderate growth for Armour and syrups.

Now, turning to the Boulder segment. This segment had an exceptionally strong quarter. Net sales advanced 9% driven by underlying growth of 15%, partially offset by a 6% decline from both the UK business wind down and SKU rationalization program that we implemented in the second half of 2016. Driving the underlying net sales growth for the segment were double-digit increases for gardein, Earth Balance, and Evol.

gardein strength reflects the benefits of our new Hagerstown facility and higher marketing spending now that we have capacity to support demand. The strength of Evol reflected continued distribution expansion, while Earth Balance continued to benefit from the growing interest among consumers for plant-based offerings.

Net sales for Udi's on the other hand declined due to a proliferation of new competitive entrants into the gluten-free bread category, which continues to enjoy double-digit growth. We continue to believe that the single biggest opportunity for Udi's is eliminating the compromise for gluten-free, which we believe can dramatically change the relevance and usage of gluten-free items.

Udi's has developed and is readying for launch early next year, a good gluten-free bread product that is tested in parity would regular bread with a broader set of no compromise offerings in the pipeline.

In-market performance for Boulder remained strong with retail consumption up 10% despite the SKU rationalization program. Market share for Boulder was even with the year ago primarily reflecting the impact of the SKU rationalization in categories that continue to grow rapidly.

Finally, turning to our Specialty segment. Net sales were again significantly impacted by the Aunt Jemima exit, which accounted for more than 13 percentage points of the segment's 17% net sales decline. The underlying sales decline of 4% was driven by the previously disclosed gardein private label business exit and lower sales of food service, both of which significantly benefited specialty margins in the quarter.

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

Craig D. Steeneck

Chief Financial Officer & Executive Vice President, Pinnacle Foods, Inc.

Thanks, Mark, and good morning, everyone. Let me restart with the results for the quarter, and then transition to our outlook for the remainder of the year. Net sales for the third quarter decreased 1.2% to $750 million, reflecting strong underlying growth of 3.1%, more than offset by the impacts of 2.8% from the AJ exit, which included an additional $3 million of recall expenses in the quarter as well as 0.8% from the Boulder UK wind down and SKU rationalization and an estimated 0.7% from the hurricanes.

Driving the underlying net sales growth was higher volume mix of 2.5%, favorable net price realization of 0.5% and 0.1% benefit from current foreign currency translation. Net sales for our Frozen segment declined 4.1% in the quarter entirely reflecting the combined unfavorable impacts of the AJ exit of 2.8% and the hurricanes impact of 1.3%.

The underlying flat net sales in the quarter was due to favorable net price realization of 0.2% and a favorable foreign currency translation of 0.3%, offset by lower volume mix of 0.5%, including the unfavorable shipment timing Mark referenced earlier.

Our net sales for our Grocery segment increased a strong 4.4% in the quarter, fueled by volume mix growth of 3.9% and a favorable net price realization of 0.5%, largely reflecting lower new product introductory costs versus year ago.

Net sales for the Boulder segment increased a very strong 9.3% in the quarter fueled by volume mix of 12.7% and net price realization of 2.6%. This was partially offset by a 6% impact from the exit of the Boulder UK operations and SKU rationalization program.

Finally, net sales for our Specialty segment declined 17.2% primarily due to the 13.3% impact from the Aunt Jemima exit, lower volume mix of 3.6% primarily due to the previously disclosed exit of the gardein private label business and lower net price realization of 0.3%.

Now turning to adjusted gross profit. Our adjusted gross margin in the quarter declined 5.4% or 130 basis points to $216.7 million or 28.9% of net sales compared to $229.1 million or 30.2% of net sales in the year-ago period. The adjusted gross profit in the quarter was again under pressure due to the expected costs associated with the AJ exit and accelerated manufacturing investments albeit higher than we anticipated.

For the quarter, these discrete costs totaled $15 million. Gross margin was also unfavorably impacted by approximately $4 million from the hurricanes, reflecting some delayed shipments along with elevated logistics costs. The latter of which we expect to continue throughout the balance of the year. Taken together, these events adversely impacted gross margin in the quarter by 150 basis points.

Benefiting gross margin in the quarter were strong productivity at 4.1% of cost of goods sold and $2 million of Boulder synergies, partially offset by inflation of 3.4%, which included an overall increase in logistics costs due to higher freight costs.

Let me take a moment to provide some additional detail behind the impact to gross margin of the discrete items in the quarter and the drivers of the $7 million we expect in incremental full-year expense. The AJ recall, which is entirely behind us now ended up costing an incremental $3 million in the quarter due to greater than expected return volume and penalties incurred in our foodservice accounts. This brings the cost of the recall to $12 million for the year.

The strategic manufacturing investments, including the investments made at our Jackson facility post the Q2 shutdown totaled $11 million in the quarter, including approximately $4 million of incremental costs due to a slower than anticipated startup in Jackson following the upgrades we made.

At the same time, we experienced less waterfall expense in Q3 than we had anticipated, which will now move into the P&L in Q4. For the year, strategic manufacturing investments, including those of the Jackson facility are expected to total $19 million versus the $15 million previously expected.

On a year-to-date basis, the discrete items have totaled $35 million, and we expect the final $6 million to flow through the P&L in Q4. For the year, the total cost of the program, including the impact of the AJ exit is expected to be $41 million. We recognize that the price tag of the discrete items has increased from our previous estimates by approximately $7 million, all due to the incremental [ph] recall (19:20) costs and slower start-up discussed earlier. While we are not pleased with the increase in these costs, we remain steadfast in our conviction that accelerating the strategic investments into 2017 was the right business decision as we strengthen our quality and capabilities across our Frozen network and positioned ourselves to begin realizing efficiencies earlier than we would have otherwise.

In terms of the return that we expect on the discrete items, which obviously excludes the AJ recall, we estimate the following. The AJ exit will provide a mix benefit to total Pinnacle gross margin of approximately 25 basis points on a go-forward basis with little impact on the bottom line.

The accelerated strategic manufacturing investments are expected to have a meaningful positive impact to our go-forward productivity, driving savings above the 4% of cost of products sold for the foreseeable future. This is well above our previously stated long-term productivity target of 3% to 4% and represents significant savings over the next several years, consistent with our long-range plan and a driver of our stated 300 to 400 basis points margin improvement by 2019.

Adjusted EBIT declined 3.1% in the quarter to $130.4 million, largely reflecting the impact of the discrete items and hurricanes as well as higher marketing spending, partially offset by lower overhead expenses resulting from the synergy capture, aggressive cost management and lower performance-based compensation.

For the Frozen segment, adjusted EBIT declined 17.7% to $52.5 million in the quarter. This performance was impacted by $9 million of discrete costs associated with the AJ exit and accelerated manufacturing investments as well as an estimated $2 million impact from the hurricanes. Also impacting the quarter was input cost inflation and higher marketing spending, primarily behind Birds Eye Innovation, partially offset by productivity.

Adjusted EBIT in the Grocery segment advanced 4.7% to $58 million in the quarter despite a $2 million unfavorable impact from the hurricanes due to the benefits of sales growth, productivity and Boulder synergies, partially offset by higher marketing spending and input cost inflation.

Adjusted EBIT for the Boulder segment increased nearly 50% to $18.6 million, reflecting the benefits of the acquisition synergies, productivity and the strong topline growth of the segment. Partially offsetting these drivers were input cost inflation and less than $1 million of discrete items.

Finally, adjusted EBIT for the Specialty segment declined 21.3% to $7.3 million, largely reflecting $4 million of discrete costs in the quarter, along with input cost inflation, partially offset by productivity. Excluding the discrete impact of $4 million, adjusted EBIT advanced more than 20% and margins grew significantly, reflecting our strategy of focusing on higher-margin businesses in this segment.

Interest expense for the quarter decreased by approximately 20%, reflecting the term loan refinancing we completed in the first quarter of this year as well as a reduction of our outstanding indebtedness versus the prior-year period.

Our adjusted effective tax rate in the quarter, excluding items affecting comparability came in at 31.7% compared to 36.4% in the year-ago period, largely reflecting the benefits of the new accounting treatment for stock-based compensation and an adjustment to our income tax liabilities, partially offset by unfavorable state tax legislation.

Finally, adjusted net earnings increased 10% to $69 million compared to $63 million in the prior year, while adjusted diluted EPS advanced 9% to $0.58 compared to $0.53 in the year-ago period.

Now turning to cash flow. Net cash provided by operating activities in the quarter totaled $58 million compared to $75 million in the prior year. For the nine-month period, net cash provided by operating activities totaled $179 million compared to $240 million in the year-ago period, largely reflecting the working capital build associated with the company's robust innovation agenda in 2017 and the cash impact of the AJ exit.

Capital expenditures in the third quarter totaled $21 million compared to $16 million in the year-ago period. Free cash flow in the third quarter decreased $37 million compared to $59 million in the prior-year period, largely reflecting the lower cash from operating activities.

Turning to liquidity. At the end of the third quarter, our total debt was $3 billion, including $2.3 billion secured term loan and $700 million of senior notes. Cash totaled $131 million, bringing our net debt to $2.9 billion and our net leverage ratio to 4.21 times.

And finally, in terms of our outlook for the year, for the full year, we have maintained our guidance for adjusted diluted EPS in the range of $2.55 to $2.60, and we continue to expect to be at the low end of the range. The benefit of the 53rd week is still expected to add approximately 1% to full year net sales and $0.03 to adjusted diluted EPS. This impact will be spread across all four segments in the fourth quarter of 2017.

Input cost inflation is now estimated to be approximately 3%, reflecting higher than previously expected transportation expense. Productivity for the year is now estimated to slightly exceed 4% of cost of products sold. In addition to the productivity, we expect Boulder Brands acquisition synergies of slightly more than $15 million this year. These synergies will benefit both gross margin and SG&A overhead.

For perspective, through the first nine months, we have realized $14 million of acquisition synergies. Adjusted net interest expense is now forecasted at approximately $121 million. The adjusted effective tax rate for the year, including the benefit of the change in tax treatment for stock-based compensation is now estimated to be approximately 32.5%. The discrete items that continue to impact the third quarter are expected to impact fourth quarter adjusted diluted EPS by approximately $0.03.

The weighted average diluted share count for the year continues to be approximated at 120 million shares. And finally, capital expenditures for the year are now estimated to be approximately $100 million, which excludes the $37.5 million acquisition of the frozen warehouse and packaging facility in Beaver Dam, Wisconsin.

With that, I'll turn the call back to Mark for some concluding remarks.

Mark A. Clouse

Chief Executive Officer & Director, Pinnacle Foods, Inc.

Thanks, Craig. Before moving to questions, I thought I'd share just a few summary thoughts. First, the in-market strength that we have consistently demonstrated and more recently accelerated, points to a very healthy underlying business that is resonating with consumers and our retail partners. We are pleased with these results, and believe we're just getting started.

Second, although our gross margin in Q3 was below our expectations, we expect the trajectory of gross margin to improve in Q4, providing confidence in our outlook for 2018 and our margin target for 2019 and beyond.

And finally, given all of these drivers, we continue to navigate a challenging environment quite well, enabling us to deliver our forecasted adjusted EPS growth this year of 19%.

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

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Our first question or comment comes from the line of Andrew Lazar from Barclays. Your line is open.

Andrew Lazar
Analyst, Barclays Capital, Inc.
Q

Good morning everybody.

Mark A. Clouse
Chief Executive Officer & Director, Pinnacle Foods, Inc.
A

Hi, Andrew.

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

Good morning, Andrew.

Andrew Lazar
Analyst, Barclays Capital, Inc.
Q

Hi. I guess, as we think about your target for outsized gross margin expansion in 2018, I was hoping maybe we could just go through like a couple of the – sort of the puts and takes or the headwinds and tailwinds even just kind of bucket them a little bit, even though I know you're not giving specific 2018 guidance at this point. I would think on sort of the headwind side, you've got whatever inflation hits you, the lapping of the 53rd week, any impact from acquisitions and divestitures and such, [ph] and in terms of (28:58) missing anything.

And then obviously the tailwinds piece, you've got the incremental ongoing productivity, the incremental Boulder synergies, the reversal of the Aunt Jemima recall and strategic investment, which I think, you said this year now will total about $41 million. And then, you won't have I would assume a repeat of some of the incremental hurricane costs, which, I think were $4 million in this quarter, but I must have missed – I forgot what it would be for the whole year.

But I'm trying to get a sense of if that captures a lot of what we should consider, and also what maybe the incremental Boulder synergies are likely to be next year in terms of what impacts gross margin?

Mark A. Clouse
Chief Executive Officer & Director, Pinnacle Foods, Inc.
A

Okay. Let me try to -

Andrew Lazar
Analyst, Barclays Capital, Inc.
Q

Yeah.

Mark A. Clouse
Chief Executive Officer & Director, Pinnacle Foods, Inc.
A

I think you've got most of the pieces in place. So the way we think about it is the underlying plans that we had built for the 300 to 400 basis-point target by the end of 2019 included a contribution from our productivity initiatives. And that we remain very much intact and on pace to deliver. That is built heavily on the concept of both doing what we've been doing, which is really optimizing our assets and our manufacturing facilities well, while also adding this kind of what we call horizontal approach where we're looking for scale, including the network optimization work. And some of the manufacturing investments that we've been able to accelerate into this year are going to help us get to those savings, and it's great to have those behind us as we give into 2018.

So that's really the first and the most material building block. The second is really around the synergy capture and the overall improvement of the Boulder business, and you've got those numbers about right, I'll let Craig reference a little more detail here in just a second. And the third bucket is its mix and price. And as you suggested, we know it's a very difficult environment relative to getting pricing through, relative to – although there is some increase in inflation that's enabling us to take some pricing, but I think we'll be watching that very closely. At the end of the day, as we look at those underlying fundamentals, we still feel very good on the premise that we put in place to deliver the upside.

I think the tailwinds then that will be coming out of 2017 fall into a couple of buckets, and let me just kind of clarify a couple of the pieces. The pieces that are clearly tailwinds for us as we go into next year is going to be lapping the recall of the business, and that was about $12 million of the $41 million that we've described.

The exit of the AJ business, well, about a quarter of the residual sales piece, but as far as a margin impact, it will be beneficial to us as we go into next year and that will be the tailwind as well.

The strategic investments, many of those are going to enable us to accelerate our productivity agenda, while also the one-time nature of some of those costs will be tailwind. So I'd say a portion of that will serve us tailwinds, well not 100% of that. So that really gives you kind of a lay of the land and why we've got great confidence in being able to deliver the commitments while seeing a little bit of a different phasing relative to how 2017 is played out into 2018.

I think the hurricane component of it, the sales piece of it will neutralize as we go through the fourth quarter. Quite frankly, we've already seen the majority of that in October relative to the disparity in Frozen between consumption and shipments. The logistics costs will be a little bit of that inflation that we're talking about, that we do expect to continue through the year. So again, I think a big part of the hurricane impact will neutralize, but while we'll see some of those logistics cost continue.

Craig, maybe you can talk a little bit about the synergy and phasing of that.

Craig D. Steeneck
Chief Financial Officer & Executive Vice President, Pinnacle Foods, Inc.

A

Yeah. So, look, I think Andrew, Mark hit on the big topics. Just to reiterate on the hurricanes had an adverse effect in Q3 on the top line, that will reverse in Q4, there's a little bit of that holds – negative effect holds for the year. That's entirely on logistics cost where we saw almost a 7% inflation in Q3. And certainly, a lot of headlines and articles in The Wall Street Journal, the freight environment is getting a lot tighter, and you should expect to see mid-single-digit inflation for the balance of this year and into next year.

On the synergies, the original acquisition synergies from the Boulder acquisition were put at $30 million. By the end of this year, we will realize slightly above that, 31-ish million dollar or so. And there is some incremental $4 million to $5 million that will flow through 100% into cost of goods for next year.

And then lastly, just on the equation between productivity and inflation, we certainly expect our productivity number will be north of 4%. We're delivering some of that now with the strategic investments we've done this year. You'll see 4%, as religion, going forward and then early indication relative to inflation for next year, we've upped the increased – inflation increase to this year to 3%. Again, a lot of that driven by freight. You can expect certainly north of 3% for next year, somewhere between 3%, 3.5% for our overall portfolio.

Mark A. Clouse
Chief Executive Officer & Director, Pinnacle Foods, Inc.

A

And Andrew, maybe just one closing thought on it. As you strip away the discrete items in the hurricane in the quarter, we were up about 20 basis points versus a year ago in gross margin. And clearly, that's a bit below where we would have wanted to be. And a lot of that has to do with the inflation, the productivity relationship we saw in the quarter. The good news is we did get pricing into the quarter, and we would expect that to continue as we go forward. As tough as it is, we're seeing our way forward to being able to be selective and picking the right spots where we believe it's justified.

And so as you think about the balance of the year and going into next year, you're going to see momentum building in the fourth quarter. We still expect to be round about the flat gross margin for the year versus a year ago, including all of the discrete items, and then momentum building as we go into 2018 clearly and staying on track for our longer-term goals.

Andrew Lazar
Analyst, Barclays Capital, Inc.

Q

Got it. Great. That's really helpful for breaking that out. Thank you.

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

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

Q

Hi. Good morning.

Mark A. Clouse
Chief Executive Officer & Director, Pinnacle Foods, Inc.

A

Hi, Chris.

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

Q

Hi. I just want to ask you first, if I could, when I go through the different divisions and I know there's a lot of noise like hurricanes and that kind of thing.

But I say think about consumption versus shipments, you had very strong consumption, we can see that in the data, you had some sort of shipment effects that worked against you. Broadly, was consumption – was above shipments. And is there any kind of beyond the hurricane, any benefit to Q4 for consumption catching up to shipments?

Mark A. Clouse
Chief Executive Officer & Director, Pinnacle Foods, Inc.

A

Yeah. So if you take – one of the things that is always tricky in these quarter-to-quarter conversations, certainly the hurricane is the main story, and that's primarily sitting in our Frozen business. And as I said earlier, the good news is we're seeing a very strong October out of the gate.

In particular, on our Birds Eye business where you see a lot of that variation between consumption and shipments residing, so I think that will normalize as you put October into the mix. But if you look at it year-to-date and you say, okay, how does this look overall?

Through the first three quarters, you're really within a couple of points of difference between consumption and shipments with October in place and that kind of true-up of the timing related to the hurricane. We're pretty close. And I think as you see the year finish, we don't expect a material difference relative to consumption and shipments.

We did a little better in Q2 with some pipeline related to the innovation in Frozen, we had the hurricane this quarter and now you're going to roll-in through October where you see that coming back. And as the year finishes out, we expect that to be a pretty neutral driver relative to the performance.

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

Q

Okay. Great, thank you, and just a quick follow-up. You've had a really strong performance in the Grocery division, Duncan Hines doing very well. For example, some other pieces of business doing well.

Should we expect – can I keep your foot on the accelerator there from like a new product and marketing standpoint? It was a higher rate of growth than I expected in the quarter, can that continue at roughly that rate?

Mark A. Clouse
Chief Executive Officer & Director, Pinnacle Foods, Inc.

A

Yeah. I think the answer is yes. I mean, the reality is that we're really just getting started on a couple of those platforms. The two, I would say kind of shining stars in Grocery this quarter was the continuation of Duncan Hines and the majority of that growth is coming from the successful launch of Perfect Size for 1, which I think has done a tremendous job in addressing some of the barriers that existed in the baking category whether it's portion control, convenience or just variety and personalization, it's done a great job achieving that.

And that business, we've been building steadily distribution, we've got a great pipeline behind it and we feel very good about what that will do for that franchise going forward. I think the other nice bright spot in the Grocery division was the turnaround and improvement in Vlasic.

And that's really a combination of getting the base business fundamentals right. So improved marketing, a great social program – media program that's worked very well, some very smart innovation around Purely Pickles, which allows us to provide a healthier option, a cleaner label or a cleaner ingredient option at a line price with the rest of the business.

And we've cycled through some of the innovation from the prior year years that we have been losing up to this point. And it has put us back on a positive trajectory. So we feel good about that playbook going forward with Vlasic.

And quite frankly, we're going to apply those learning's as we tackle Wish-Bone, which I think is the place where we've got some more work to do. I do think it needs to be – this kind of as I mentioned earlier, a balanced attack of really focusing on building the base equity and credentials around Italian, which is where we lead and then adding great innovation like the healthy oils platform.

So I do feel very good about the trajectory of Grocery, and I believe that can continue going forward.

Craig D. Steeneck
Chief Financial Officer & Executive Vice President, Pinnacle Foods, Inc.

A

And Chris, as we noted in our press release, we had three brands that had net sales growth in the quarter of an excess of 10%, Duncan Hines, Vlasic and Armour. Armour clearly aided by the hurricanes and some of the shipments we did there. So, look, we expect robust performance going forward. 4% is probably a tad aggressive relative to each quarter for the balance of this year and into next year.

Mark A. Clouse
Chief Executive Officer & Director, Pinnacle Foods, Inc.

A

Yeah.

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

Q

Understood, yeah. Thank you for the color.

Operator: Thank you. Our next question or comment comes from the line of Akshay Jagdale from Jefferies. Your line is open.

Akshay Jagdale
Analyst, Jefferies LLC

Q

Good morning.

Mark A. Clouse
Chief Executive Officer & Director, Pinnacle Foods, Inc.

A

Good morning.

Akshay Jagdale
Analyst, Jefferies LLC

Q

Thanks for taking the question. So, just want to ask about sort of amplifying the playbook. There's a lot of noise this quarter, but if you take a step back, it seems like on the sales side, you are starting to see signs of an acceleration in growth. So, maybe you can give us your perspective on where you are on each of the sort of – you've got the sales side and then you've got the costs side. It looks like you're lagging a bit on the costs side given the timing of this AJ exit, et cetera and how it's playing through.

So, when you think about your strategic initiatives and amplifying the playbook, maybe you can just tell us how you feel, now you're a little bit or as you're into your strategy and what you're seeing. It looks like organic growth is picking up and I was...

Mark A. Clouse
Chief Executive Officer & Director, Pinnacle Foods, Inc.
A

Yeah, yeah.

Akshay Jagdale
Analyst, Jefferies LLC
Q

...particularly interested in your comment on gluten-free, which pretty early to make that comment I would say. So maybe you can give us some insights there. Thanks

---

Mark A. Clouse
Chief Executive Officer & Director, Pinnacle Foods, Inc.
A

Sure. Yeah, I think clearly, there's noise in the quarter and I think stripping that away and really looking at the underlying fundamentals is very important in understanding trajectory going forward. And I would say that we feel very good on both of those key building blocks. I think from the cost standpoint, the productivity has been very strong, consistent.

If anything, we've been able to accelerate some of the drivers underneath that with network optimization and the strategic investments, the acquisition of the Beaver Dam facility for frozen vegetables, these are all great moves that our key and essential for us driving that agenda.

We talked a little bit earlier about the environment on pricing, and we know that will be challenging but we have a good track record of being able to execute and certainly as a nice segue into the growth standpoint, always easier to have those kind of strategic conversations on price when you're bringing innovation and news to your categories and driving growth on the business.

And to your point, I do think we see a lot of positive indicators on in-market sales. There's no doubt that we've now been able to string together a several-year growth agenda on Birds Eye. Our stack growth is quite impressive, fueled by innovation, but also strong baselines.

And the good news is as we go through 2017, we're now seeing the category respond to that and bringing growth back with increasing demand for vegetables. We feel great about that trajectory going forward.

I think in our Grocery businesses, we've done some renovation work, no question about it, and we're seeing the fruits of that labor with strength in Duncan Hines improvement in Vlasic, stabilization I'd say on the [indiscernible] (42:54) business and some work to do on Wish-Bone.

And then finally, I'll just conclude with the – you mentioned gluten-free. But what I would say is overall on the Boulder business, this was a really strong quarter for us. The ability to see us begin to cycle through the tailend of the SKU rationalization, get the market back or the focus of the marketing team and the organization on a balanced approach of continued cost savings, but also growing the business with the Hagerstown facility up and running and gardein, you see tremendous runway ahead on that business.

Good to see Meatless Mondays in New York City, for those of you that are there, that's a good – that bodes well for the gardein business, but also strength on Earth Balance, which is our complementary brand on plant base, all feeling really good. The disruption expansion on Evol is – continues to really demonstrate that there is a demand for a more premium, but clean ingredient label frozen meal and we are doing quite well on that front as well.

And then the one weakest spot in the portfolio from a performance standpoint is Udi's, but the strength in gluten-free remains a very strong. And I think as we've said all along, the key breakthrough for us on Udi's, we'll be able to achieve this goal of no compromise. And we're going to start that journey as we transition out of the year into next year with a gluten-free bread that truly is no compromise.

And we'll share more details as we get closer to the broader launch. But I feel very good about that as well as the pipeline we have, another critical, no compromise items that will touch snacking, frozen pizzas and pasta as well. So all good news ahead, I think, relative to where we are on the Boulder business and I think that collectively does allow us to feel good about that second key building block of accelerating profitable growth as we go forward.

Akshay Jagdale
Analyst, Jefferies LLC

Q

Thanks a lot. I'll pass it on.

Operator: Thank you. Our next question or comment comes from the line of Ken Goldman from JPMorgan. Your line is open.

Kenneth B. Goldman
Analyst, JPMorgan Securities LLC

Q

Hi. Thank you. Good morning.

Mark A. Clouse
Chief Executive Officer & Director, Pinnacle Foods, Inc.

A

Hi, Ken.

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

A

Hi, Ken.

Kenneth B. Goldman
Analyst, JPMorgan Securities LLC

Q

Hershey this morning said that improving customer service levels is an "overall theme" in the industry between retailers and manufacturers. I think they were suggesting it was getting bigger. Is this something you're seeing as well? The reason I'm asking is we have noticed that some bigger customers in the food industry, Walmart and Kroger in particular, they have been getting or at least trying to get stricter on fulfillment rates for these food companies in general. And I'm sure beverage and HPC as well.

I guess, I'm just curious if you've experienced any incremental pressure from your customers in this regard? And if so, whether you see it as a, I guess, potentially incremental headwind for you ahead?

Mark A. Clouse
Chief Executive Officer & Director, Pinnacle Foods, Inc.

A

Yeah. Well, clearly, there is a strong orientation to being able to manage inventory levels and service in a balanced way. So the ability to meet the demands of customers while also managing inventory at a reasonable level is something that we're always focused on as our retail partners. And so the emphasis on making sure that we're not only managing appropriately on the costs side, but also the capacity side to make sure we're able to serve where we have growth.

Let's take Birds Eye, for example. The acquisition of the Beaver Dam facility is a great opportunity for us to both improve efficiencies but also to give us more flexibility in being able to meet the growth rates and the demand on this business. So although I would agree that it is a – it is continuing to get a heightened level of focus, I think it's always been a big part of how we've laid out our strategic plan and tried to get the balance right between making sure that we've got the capacity we need to meet those service levels while we continue to be pragmatic about the costs and inventory levels that we're managing.

Craig D. Steeneck
Chief Financial Officer & Executive Vice President, Pinnacle Foods, Inc.
A

Yeah, and Ken, what I would add is customer service has always been an enormously important metric that customers view manufacturers for. I think where it's kind of ramping up a bit is, now, there's delivery time so they want full customer service, in delivery windows consistently being delivered. So that's where you're seeing a little bit more pressure, not only on the service level, but a full suite of service and logistics being a component of that.

Mark A. Clouse
Chief Executive Officer & Director, Pinnacle Foods, Inc.
A

Yeah, and certainly through a window like we've been in with the number of natural disasters we've navigated and some of the investments that we've made, there clearly has been pressure on that this year as we've navigated through the year. But I think many of the moves that we're making and the investments that we're taking are going to better position us for that in the future going forward.

Kenneth B. Goldman
Analyst, JPMorgan Securities LLC
Q

Thank you for that. Any chance I could ask a quick follow-up, Maria, just to clarify one thing?

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

Sure. Go ahead. Go ahead.

Kenneth B. Goldman
Analyst, JPMorgan Securities LLC
Q

Thank you. On the gross margin side, just trying to bridge the gap between sort of what you've thought the impact of the discrete items would be in the third quarter and what actually happened? Obviously, we can get pretty close where you didn't expect the $4 million in hurricane expenses, so that's one item.

But I think you previously were suggesting or saying that most of the $13 million costs for Aunt Jemima and accelerated investments would be – would take place in the third quarter. I'm really just trying to get a sense – or if you have an exact number, how many millions of dollars between AJ and accelerated investments were incremental in reality in 3Q versus your expectation? And maybe you said this in your prepared remarks I only heard total of your numbers, so apologies if I missed it. But do you have a number, that would be super helpful I think for some people.

Mark A. Clouse
Chief Executive Officer & Director, Pinnacle Foods, Inc.
A

Right. So let me try to give it to you because it is a couple different pieces that are in the puzzle. First, let me just start with obviously the hurricane impact would not have been something that was anticipated, and that was about $4 million impact in our gross margin in the quarter. On the discrete items, we had a couple of moving pieces, right?

So we had, as Craig laid out earlier, we had about $3 million that was worse on the recall. And that was really driven by the fact that we had more volume in the network than we had anticipated as we brought it back and a lot of that residing in distributors. It's a little harder to get that exact number right. The good news is we're 100% done with that. And we also had some penalties associated with foodservice, where – as we were not able to meet our contractual obligation, not able to find other supplier in the market, that increased the penalties than what we had expected. And that's the $3 million, and that all came in the third quarter and impacted the business.

On the strategic investment side, you had a couple of puts and takes. So as we said, we were about $4 million unfavorable and will be for the year versus the $15 million that we had originally expected to the $19 million, and that really recited around the startup associated with the Jackson facility. That was partially mitigated by the waterfall that we had anticipated for the total manufacturing or strategic investments where we had a little bit of that costs move from Q3 into Q4.

So, at the end of the day, I think the biggest delta in the – for the quarter was the hurricanes, but also several million in relationship really to the recall, added expense and that the investments was kind of neutralized based on the timing. And again, well, the good news is the variability of these items are now locked down. So what we're projecting in the Q4 hard and fast numbers, and we've got that were you'll see about $0.03 left in the...

Craig D. Steeneck
Chief Financial Officer & Executive Vice President, Pinnacle Foods, Inc.
A

Q4.

Mark A. Clouse
Chief Executive Officer & Director, Pinnacle Foods, Inc.
A

...Q4.

Kenneth B. Goldman
Analyst, JPMorgan Securities LLC
Q

Thanks so much.

Operator: Thank you. Our next question or comment comes from the line of David Palmer from RBC Capital Markets. Your line is open.

David Palmer
Analyst, RBC Capital Markets LLC
Q

Thanks. Good morning. Could you talk about your anticipated evolution of CapEx as a percent of sales kind of out-years and beyond – 2018 and beyond? And also touch on how plant capacity might cause some sales acceleration in some pockets?

I asked partly because we're seeing gardein in the Nielsen data, it's up 50% or so in the last 12 weeks and that's an acceleration and presumably that's because you upped the capacity with the Hagerstown plant.

Mark A. Clouse
Chief Executive Officer & Director, Pinnacle Foods, Inc.
A

Yes.

David Palmer
Analyst, RBC Capital Markets LLC
Q

And I know you're doing something similar with Birds Eye, with Beaver Dam. So I'm wondering if there might be some boost here to sales and then, of course, you have your other growth brands, so any help on this would be super. Thanks.

Craig D. Steeneck
Chief Financial Officer & Executive Vice President, Pinnacle Foods, Inc.
A

Yes. So David, for the year, our CapEx number we've come down to is $100 million, which is consistent, where that has been kind of historically, that's around 4% of net sales. At a recent conference, we said there would be – to exactly to your point, there would be a little bit of a step up in capital in 2018, and that was really associated with the capital necessary to get the Beaver Dam facility 100% for Birds Eye vegetables up and operational.

For 2018, specifically, we're now thinking that number is going to be a little bit less than the 6% that we've put out there, probably in the upper 4s, or may mid-5s, something like that 4.5% to 5% of CapEx for next year. And then after that, it will return to round about 4% of net sales going forward.

And I think you hit upon the point, we put CapEx into Hagerstown. That was in the early part of the first year and last year. Now we have the facility up and functioning and now you can see we've kind of unleashed gardein, we're getting outsized growth there. We'll put the capital into Beaver Dam next year. That'll take probably a little bit longer most of the year next year and then you'll see us be able to kind of accelerate not only growth, but margin on the Birds Eye franchise as we get that facility operational.

Mark A. Clouse
Chief Executive Officer & Director, Pinnacle Foods, Inc.
A

Right. As you might imagine, part of that benefit comes from the balance that we strike between co-manufacturing and internal manufacturing while also supporting the growth agendas that we have on both of those businesses.

David Palmer
Analyst, RBC Capital Markets LLC
Q

Thank you.

Operator: Thank you. Our next question or comment comes from the line of Tim Zaslow (sic) [Ken Zaslow] (53:27) from the Bank of Montreal. Your line is open.

Ken Zaslow
Analyst, BMO Capital Markets (United States)
Q

Hey. Good morning, everyone.

Mark A. Clouse
Chief Executive Officer & Director, Pinnacle Foods, Inc.
A

Good morning.

Ken Zaslow
Analyst, BMO Capital Markets (United States)
Q

So, when I put it all together, so you have a lot of onetime costs in 2017 going back and forth. When you look at 2018 on a dollar profit basis, is your gross profit dollar and your operating profit dollar higher, lower or in line with your original expectations before all the noise?

Mark A. Clouse
Chief Executive Officer & Director, Pinnacle Foods, Inc.
A

I would say generally in line.

Craig D. Steeneck
Chief Financial Officer & Executive Vice President, Pinnacle Foods, Inc.
A

In line, yeah.

Ken Zaslow
Analyst, BMO Capital Markets (United States)
Q

On a dollar basis, right?

Mark A. Clouse
Chief Executive Officer & Director, Pinnacle Foods, Inc.
A

Yeah.

Ken Zaslow
Analyst, BMO Capital Markets (United States)
Q

What you're going to bring to the bank on a gross dollar basis would be and the operating profit dollar basis would be the same.

Mark A. Clouse
Chief Executive Officer & Director, Pinnacle Foods, Inc.
A

Yes. Generally speaking, yes.

Ken Zaslow
Analyst, BMO Capital Markets (United States)
Q

Okay. My second question is just on the business, what are your key initiatives that you're going to do to help that Wish-Bone business, and how does that kind of fare over the next year?

Mark A. Clouse
Chief Executive Officer & Director, Pinnacle Foods, Inc.
A

Yeah. So it's clearly a significant focus for us as we get all of our 2018 plans in place. I think – again, I would put it into three big buckets that are going to be our key actions. The first bucket is really strengthening the base. And I think if there's a lesson here learned that we talked a little bit earlier about what Vlasic is that although innovation will play important roles, it's really important that we've got strong base business support as well and that we've got that formula and the competitive nature of it right, so that when you're dealing in a competitive environment like we are in salad dressings, we're not always, is dependent on price points in the marketplace.

So, you're going to see a significant focus back on the base business where we're going to be looking at everything from the product, the package, our support levels, usage strategies. A lot of, I think, very strong tools that we can step up our support on, that will help really – help us win in that core Italian space. You will see us continue to maintain our focus on innovation, primarily around our healthy oils platform. So we have E.V.O.O. in the marketplace as well as Avocado oil that we launched this year that will play an important role and needs to be continue to be part of the formula.

And I think the third focus area is going to be around really driving scale at the key seasons. I think one of the realities of salad dressings is that winning those key summer seasons around the Memorial Day, 4th of July, Labor Day where we've got meaningful scale in our portfolio, we can do a better job of bringing that to bear and strengthening our program around winning those key holidays.

So those are the three areas that we're going to be really focusing on going forward. And I think we can have a significant impact on the business, not unlike what we've experienced in working through the turnaround of Vlasic.

Ken Zaslow Q
Analyst, BMO Capital Markets (United States)

And then just the final question. Just what's your CapEx for next year, did you give tax rate for next year?

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

No.

Mark A. Clouse A
Chief Executive Officer & Director, Pinnacle Foods, Inc.

No. Obviously clearly, Ken, relative to gross margin everything else, we'll be giving full year guidance when we report our year-end results at the end of February, it will have everything in there. There's no doubt that there was kind of a bit of a one-time benefit in the tax rate this year from changing accounting on stock comp, so we'll have to get ahead around that for next year.

Ken Zaslow Q
Analyst, BMO Capital Markets (United States)

Great. I appreciate it.

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

Jason English Q
Analyst, Goldman Sachs & Co. LLC

Hey, good morning, folks. Thank you for squeezing me in.

Mark A. Clouse
Chief Executive Officer & Director, Pinnacle Foods, Inc.
A

Hi, Jason.

Jason English
Analyst, Goldman Sachs & Co. LLC
Q

I kind of want to come full circle to the very first question back to gross margin outlook for next year and weave in some of the extra data points you've given throughout the Q&A. At a recent conference, you showed your bar chart for gross margin expectations indicating flat this year, which you're kind of committed to today. It also seems to suggest roughly 260 basis points of gross margin expansion next year, which is a big number.

If we walk through the puts and takes that kind of Mr. Lazar laid out earlier, mathematically, it implies that you need almost 5% of COGS productivity and that's before contemplating any sort of price mix benefit or other leakage. Now historically, there is other leakage you're leaking out roughly 80 to 100 basis points of margin per year on these sort of simple mathematical bridges that we have.

Assuming that continues, you've kind of suggests you need A, that 5% COGS productivity and maybe some incremental benefit of price mix to the tune of 100 bps. A, does that kind of make sense from a mathematical perspective? And B, in context to the environment that's out there right now, how can we get comfort or confidence that you'll be able to realize that sort of price mix benefit next year?

Mark A. Clouse
Chief Executive Officer & Director, Pinnacle Foods, Inc.
A

Yeah. So I think, Jason, the way we're kind of putting this all the puts and takes together is we're working through those moving parts now. I think there's no question that we expect to have a good trajectory in gross margin next year. And then as we lap some of the one-timers and as we work forward on the core plan that we had, we do expect to be very clearly in positive territory.

I'm hesitant to get into specific targets relative to that. I do think you're right to say though there are a couple of variables that are headwinds that we've got to navigate, I think looking at the inflation, managing pricing, really understanding the phasing of the productivity that we would have originally laid out, all of those things I think need to be worked through relative to where we expect to be. But what I would tell you that in general terms, I think you will see a very strong 2018 ahead. I think you'll see continued confidence building relative to proof-points across the P&L and ultimately, on track to the targets that we laid out for the end of 2019.

And again, as we try to do the best we can, we'll give you more granularity as we get closer, as we get into the guidance for next year, we'll try to be as helpful as possible in laying out all those pieces. But I think the building blocks that we're describing – described earlier and that we're talking through now, those are all the right blocks, we just got to really work through exactly how that will ripple through the P&L fully as we get into the 2018 planning and guidance.

Jason English
Analyst, Goldman Sachs & Co. LLC
Q

And this has been a good year for innovation for you guys, some really great successes, and congrats for that. And clearly it's contributed not only to top line, but presumably to some mixed benefits as well.

Mark A. Clouse
Chief Executive Officer & Director, Pinnacle Foods, Inc.

A

Yeah.

Jason English
Analyst, Goldman Sachs & Co. LLC

Q

It's always hard to comp a good year how are you feel about your ability to comp a good year? And can you give us a bit more sneak peek in terms of what you have staged? We heard the gluten bread thing, I'm sure that's going to help [ph] foodies (01:00:26) but not sure it's really and even moving for the company in aggregate.

Mark A. Clouse
Chief Executive Officer & Director, Pinnacle Foods, Inc.

A

Yeah.

Jason English
Analyst, Goldman Sachs & Co. LLC

Q

So we'd love just more color around that.

Mark A. Clouse
Chief Executive Officer & Director, Pinnacle Foods, Inc.

A

Well, I think if you kind of work your way through the portfolio, I guess, let me just start with, I feel really good about the innovation pipeline that we have for next year. As we've said on multiple occasions, I believe that runway on Birds Eye is strong as the results have been. We're just getting started. As we've said before, there's a lot of great platforms that we can build out like Veggie Made, which we're really happy with the success and the results so far in that space. We also see new occasions that we can move into and building the continued strength we have in meals as well as other day parts where we and expand. And so I feel very good about that trajectory on Birds Eye going forward.

I think we've got a lot of runway ahead on Perfect Size for 1 and what we've built there is a platform. I think you'll see some complementary items on some of the other brands within Grocery that are exciting. We also – one of the businesses that it's in a really competitive space now, which is Hungry-Man, which sits in frozen meals space. We just launched handfuls, which is a really good product, very relevant for that consumer. It's a pocket meal that's about twice the size of the leading competitor, which is, needless to say, a key attribute of Hungry-Man. And that's just going to be – that's just launching now, so we'll have that going forward.

But perhaps what I'm most excited about, although I would say I anticipate the Udi's bread launch to be bigger than what you might have suggested, what I'm really excited is Boulder back on both feet focused on the future and growth. I think you're going to see some really strong ideas and innovation, having capacity back on gardein is quite exciting, we've been relatively dormant on innovation in that business for several years, we're going to be able to get that machine rolling in the 2018 as well. So, although I think we've had some really significant wins this year, I think we've got a very healthy pipeline for next year as well.

Jason English
Analyst, Goldman Sachs & Co. LLC

Q

Okay. Very good, guys. Thank you.

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

Brian P. Holland
Analyst, Consumer Edge Research LLC

Q

Thanks. Good morning, everyone.

Mark A. Clouse
Chief Executive Officer & Director, Pinnacle Foods, Inc.

A

Hey, Brian.

Brian P. Holland
Analyst, Consumer Edge Research LLC

Q

So, I'll just get out of here with one question for you this morning. But thinking about the M&A landscape, you've had a competitor – larger competitor on the Frozen side, making acquisition recently some of the larger competitors in packaged food continue to be pretty specific from a parameter looking at Health & Wellness, better-for-you, et cetera, which is obviously on your radar post-Boulder Brands.

So, I'm just wondering – and obviously we've seen some better trends overall in Frozen as a lot of the relevant brands have seen some reinvestment. So I'm just wondering with that as context whether the tone or is there more or less engagement as you discussed sort of acquisitions with counterpart.

And then maybe just as a side off of that, given the strength of Birds Eye, given the more capacity that you're being into support brands like gardein and you're finally outside of the portfolio rationalization or the SKU rationalization efforts within Boulder. Assuming that maybe you couldn't do some of the deals that maybe some people were thinking about 12 months ago – even six months ago, how do you think about the expandability of your brands and your ability to play in adjacent categories such that you can leverage these into categories that you might have otherwise look to acquire into? Is that the feasible opportunity for you in anyway? And just your comments there'd be helpful.

Mark A. Clouse
Chief Executive Officer & Director, Pinnacle Foods, Inc.

A

Yeah. It's interesting question. I think first, let me just talk a bit about the landscape for M&A. Our strategy and our readiness remains very much intact. And you should trust the fact that as opportunities present themselves, we're going to look at them seriously. We're not afraid of the multiples, if the economics make sense, we're not going to overpay for something, that is discipline is important. And as we've said many times, no deal is better than a bad deal.

But I think the reality is that as much as the premise that we have suggested that further consolidation is likely, it's just a matter of timing. And when the sequence of these events occur, but we remain very confident that there are assets that will be available, that will be active and that can continue to contribute to the benefit of this great platform we're building here and being able to expand that and add scale.

At the same time, I would just reiterate that always, I think, the strength of our business and the company is the fact that we are not dependent on M&A to deliver the commitments that we're making, and that we see them as accelerators. And as part of that, we continue to look for consumer spaces where our brands could be relevant or bring news and innovation.

So, certainly, we're working kind of both sides of the fence, looking for where M&A makes sense while also continuing to look for the expandability of our brands, which we do have a lot of confidence in.

Birds Eye certainly one of them, but there are many other businesses, a lot of the Boulder Brands, we talked a lot earlier, have a lot of runway into these consumer spaces whether it'd be plant-based or gluten-free or just Clean Convenience in general. So I think both sides are worthy and I think you'll see us continuing to be aggressive on both fronts.

Craig D. Steeneck
Chief Financial Officer & Executive Vice President, Pinnacle Foods, Inc.

A

Brian, everything that we've said relative to our M&A strategy with North America focused, number one and two brands, we've loved the Frozen space for a long time way before other people thought it was a good space...

Mark A. Clouse
Chief Executive Officer & Director, Pinnacle Foods, Inc.

A

Frozen before.

Mark A. Clouse
Chief Executive Officer & Director, Pinnacle Foods, Inc.

A

...center of the store. And look, with the acquisition of Boulder and the brands that we have in there, we are moving towards internally developing things on our own. But as we continue to serve that Health & Wellness space, there are clearly plenty of opportunities in there.

So the concepts that we have, the ideas that we have, they all still hold true. The balance sheet will be de-levered by the end of the year, and nothing has changed in that regard.

Brian P. Holland
Analyst, Consumer Edge Research LLC

Q

Thanks, gentlemen, I appreciate the commentary. Best of luck.

Operator: Thank you. Unfortunately, we do not have any further time for questions this afternoon. I'd like to turn the conference back over to management for any closing remarks.

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

Okay, thank you, Howard. Thank you all for listening in. Sorry, we went a few minutes over. We hate to do that to you, but we wanted to try to get as many questions as we could. I am around all day today, so don't hesitate if you want to follow-up with me.

Take care. Have a good day.

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