Corrected Transcript

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Pinnacle Foods, Inc. (PF)

Q1 2018 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 First Quarter Ended April 1, 2018. 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 Pinnacle Executive Vice President and Chief Financial Officer, Mr. Craig Steeneck, for some opening remarks. Mr. Steeneck, please go ahead.

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

Thank you, Howard, and good morning, everyone. Before we get into the results for the quarter, I want to introduce our new Vice President of Investor Relations, Jennifer Halchak, who is here with us today. Jen joins us from Realogy Holdings, where she was the Senior Director of Investor Relations. She has over 20 years of experience in capital markets, including IR, M&A, and credit analysis. We are very pleased that Jen has decided to join the Pinnacle team and we look forward to having all of you meet her. With us here today, we also have Mark Clouse, Pinnacle's CEO.

With that, I'll turn it over to Jen for a few opening comments.

Jennifer Halchak

Vice President-Investor Relations, Pinnacle Foods, Inc.

Thank you for the warm welcome, Craig. I'm excited to join the Pinnacle team and I look forward to talking with and meeting all of you in the near future. Before Mark begins with his remarks and as my first official duty here at Pinnacle, there are a few housekeeping items to take care of.

First, as a result of the adoption of new guidance related to pension accounting, you may have noticed in the financial tables that accompanied the press release we issued this morning and that you can find on our website, we are now presenting pension benefit in non-operating income, where previously it was a component of gross profit. We have restated our first quarter 2017 P&L to reflect this, moving approximately $500,000 of income between these two lines. The impact is essentially the same for the second, third, and fourth quarters of 2017. We will be filing an 8-K in conjunction with our 10-Q later today to reflect this change with historical periods.

Let me also 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 a 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.

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 on 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, Pinnacle Foods, Inc.

Thanks, Jen, and welcome to the team. And thanks to everyone for dialing in on what we know is a busy day for many of you. Our first quarter shaped up much as we had planned, with a very strong top line sustaining the momentum from 2017 and double-digit growth of adjusted diluted earnings per share, demonstrating our continued ability to sustain top-tier performance and shareholder returns.

We also continued to win in the marketplace, with both strong consumption and market share gains in the quarter, marking our 16th consecutive quarter of composite market share growth. We expect the robust slate of innovation that will hit the marketplace this year across all three of our retail segments will help us continue the momentum.

Lastly, in an industry environment where inflation, particularly as it relates to transportation, remains at some of the highest levels we have seen in recent history, I am very encouraged and confident that between the core productivity programs we have in place, the network optimization program we embarked on in 2017 and select pricing actions that we took both last year and at the beginning of this year, we can expect gross margin growth in the second quarter and in the back half of the year.

Now, let's get to the results for the quarter, starting with some highlights. Net sales grew a strong 1.7% in the quarter, or an even stronger 4.3% excluding the exited Aunt Jemima items, with the earlier timing of Easter contributing approximately 0.8% of growth. This strong performance reflected growth in all three of our retail segments, with the Frozen segment, specifically the Birds Eye franchise, leading the way.

In-markets results were equally as strong, with retail consumption growing 3.5%, or 5.1% excluding Aunt Jemima, and market share expanding 0.4 points. We are committed to continue to lead industry thinking on growth, not only with our world-class innovation, but in our core marketing as well. To that end, today we are announcing that Pinnacle has entered into a first of its kind partnership with Vayner Media to strengthen the effectiveness and efficiency of our consumer relevant content and marketing capabilities.

We'll be talking a lot more about this in the weeks and months to come, but at a high level Vayner will integrate marketing leading expertise in digital and social platforms, including improving the use of data, which will increase ROI and broaden low cost and highly effective marketing opportunities across the portfolio.

The partnership includes members of my team embedded in Vayner and vice versa, and has kicked off with disruptive activations for Vlasic and Duncan Hines, and the early results are very strong. We are very excited about this partnership and continue to look for ways to continue to lead and demonstrate that big iconic brands can win in today's environment.

Our adjusted gross margin, as expected, declined 130 basis points in the quarter. Driving this decline were higher inflation and costs associated with outsourcing some of our innovation, which were partially offset by productivity and net pricing improvements. As we mentioned to you on our fourth quarter 2017 call, we expected this to be the quarter with the tightest spread between productivity and inflation, and it was, as the two factors were each approximately 4% of cost of goods sold. While the relationship between the two should remain tight in the second quarter, we do expect it to improve as the year progresses.

And in terms of the outsourcing costs related to innovation, we would expect these costs to come down over time as we begin to repatriate volume into our network. As a result of these improving relationships, along with the lapping of the discrete items from a year ago, we expect second quarter gross margin to return to growth and for the trajectory to continue throughout 2018 remaining on track with our expectations.

Total operating expenses declined 8% in the quarter, largely representing the planned phasing of marketing spending to better align with our innovation launches over the course of the year. Interest expense in the quarter was slightly below last year and our adjusted effective tax rate declined over 800 basis points to 24.3%. Adjusted diluted EPS advanced 14% to $0.57 in the quarter and we continue to expect EPS for the year in the range of $2.85 to $2.95.

Now turning to our segments. Starting with Frozen, at a high level the Frozen segment had a great start to the year, with net sales advancing 7.5%, or 10.1% excluding the Aunt Jemima exit, with in-market consumption expanding 4.3%, or 7.4% excluding AJ. In terms of market share, performance for the Frozen segment advanced 0.6 point in the quarter, driven by Birds Eye vegetables, which advanced 1.4 points on consumption of 12.2%, and Birds Eye meals, which advanced 1.1 points on consumption growth of nearly 3%.

The strong performance in Birds Eye was driven by both the core business, as well as continued success behind the slate of innovation that we have launched in the past few years, in particular the popular Birds Eye Veggie Made innovation that we launched in 2017. This platform, as you'll recall, uses vegetables in place of starches to create wholesome veggie-rich alternatives for products such as pasta, rice, and mashed potatoes.

In the first quarter, we added to this successful platform with the introduction of Veggie Made fries and tots, which utilize broccoli and cauliflower as a replacement for some of the potatoes. We also expanded our one-of-a-kind Veggie Made pasta lineup, with spaghetti-like offerings that come in a variety of sauces.

As you all know, this strong performance behind Birds Eye is not a one quarter or even one year trend. In fact, if we take Birds Eye veg and look at it on a three-year stack basis, which goes back to when we really started the launch innovation behind the brand, consumption has increased a remarkable 26.3%, driving over 5.5 points of share growth. And we are just as excited as ever about what's to come.

For the remainder of 2018, we continue to expect the Frozen segment to have solid performance on both the top and bottom lines, although second quarter top line growth will not be as robust as it was in the first quarter, given the harder comparable in Q2 and the impact of an earlier Easter this year.

Turning now to our Grocery segment. Net sales for our Grocery segment advanced 0.6% in the first quarter, while retail consumption grew 0.4% and market share was essentially flat to the prior year period. While the earlier Easter was more meaningful for the Frozen segment, it was not as much of a factor in the Grocery segment, specifically in core baking, as the value end of the category came under significant pricing pressure in the quarter. As we have said in the past, we're not going to chase low margin volume.

Looking out to Q2, given the stronger 2017 Easter that the baking category is comping against, we would anticipate some additional top line pressure to persist in Q2. With all that said, we remain very excited about the Duncan Hines Perfect Size for 1 innovation that we launched in 2017 and are following up this year with 13 additional offerings, as well as 11 varieties of our new Perfect Size for 1 frostings and drizzles that allow consumers to easily and fully customize their experience across the line, something that is truly unique to this category.

Coming off a year where Duncan Hines grew household penetration by 3%, Perfect Size for 1 continues to outperform, driving TDP growth of 11% in the quarter for the entire Duncan Hines portfolio. Vlasic pickles also performed well in the first quarter, with consumption expanding 5.5%, driving 0.4 points of share growth. This performance reflects the actions that we took over the course of 2017 to refocus on the core equity of the brand, namely the iconic Stork making crunch and zero calories relevant to millennials through new marketing campaigns and select new items.

As we discussed on our fourth quarter call, we are supporting the momentum behind the brand this year with Vlasic Snack'mms, new innovation that is shipping now and comes in an easy to snack format in four on-trend flavors.

Finally, in the Grocery segment, the refresh of the Wish-Bone business is underway. With new graphics on the bottles and overall optimization of product offerings and simpler, cleaner ingredient lines, we expect the brand to have a very strong presence on shelf. This, coupled with targeted on-trend marketing and a focus on our flagship Italian varieties, we expect the Wish-Bone story to play out in 2018 much as the Vlasic one did in 2017, with sequentially improving trends.

Turning to Boulder, in-market performance for the segment remained very strong, with retail consumption advancing nearly 9%, led by continued growth of gardein, which grew consumption over 55%, and Earth Balance, which was up 22%. This growth was partially offset by lower consumption of EVOL, which was lapping a very strong promotional period in the previous year, and, to a lesser extent Udi's, which is starting to benefit from the consumer trial of the new bread.

While the in-market performance remain very strong, net sales in the quarter expanded by only 0.5%, which largely reflects the impact of higher trade and slotting to support innovation that we are launching across the portfolio this year. In the first quarter, this was largely behind the gardein brand in order to support the bag meals that we launched late in 2017.

Further, now that the Hagerstown facility is up and running, we can really put support behind the base business as well. Also impacting net sales in the quarter, albeit to a lesser extent, were lower retail inventories in the natural and organic channels. However, if we include the month of April, year-to-date shipments and consumption are both strong in the mid-single-digit range and the gap between the two has narrowed considerably.

The launch of the new Udi's bread, while still in the early days, is performing very well. In the most recent period, we are seeing the innovation drive growth within the brand, with the new bread driving a nearly 10 point swing in consumption in total Udi's bread. We're also finding that the new bread is resonating very well with consumers, with satisfaction rates between new and current customers in the high 90% range. Now that the bread has shipped and we've worked through the inventories of the old formula, we are starting to support the innovation with a holistic multi-channel approach with investments across digital, social, shopper, and print.

As we mentioned previously, we expect top line momentum to continue in this segment. However, we continue to expect that margins will be under some pressure in the first few quarters of the year, as they were in the first quarter due to higher new product introductory cost and marketing spend in 2018 versus 2017.

Finally, turning to our Specialty segment. Net sales for Specialty declined 15% in the first quarter, primarily due to the 13% impact of the AJ exit. As we finish lapping the AJ exit, we anticipate the top line of the Specialty segment to return to what it's been in the past, up a little bit in some quarters, down a little bit in others. But given the work we've done to exit low margin businesses over the past year, we would expect adjusted EBIT margins to show good growth.

With that, I'm going to hand it over to Craig.

Craig D. Steeneck

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

Thanks, Mark, and again good morning, everyone. Let me start with the results for the first quarter, and then transition to our outlook for the remainder of the year. Starting with sales, first quarter consolidated net sales increased 1.7%, reflecting strong underlying net sales growth of 4.3%, which includes a lower than expected benefit from the earlier Easter timing of 0.8% due primarily to the baking segment. Partially offsetting this strong underlying growth was the unfavorable impact of the AJ exit of 2.6%.

The Frozen segment advanced 7.5%, which reflects a very strong underlying growth of 10.1%, which includes a 1.6% impact from the earlier timing of Easter. Partially offsetting this growth was a 2.6% impact from the AJ exit. Net sales for the Grocery segment advanced 0.6%, which includes a lower than expected 0.3% benefit from the earlier timing of Easter.

The Boulder segment advanced net sales by 0.5%, reflecting good volume mix, partially offset by in-market support and higher levels of new product introductory costs associated with the robust slate of innovation that we are currently launching in this segment. Finally, net sales of our Specialty segment declined 15%, primarily reflecting the unfavorable impact of 13.1% from the AJ exit.

Turning to adjusted gross profit, our adjusted gross profit declined 3.1%, while the adjusted gross margin decreased 130 basis points, which was largely in line with our expectations. This lower gross margin reflected inflation of 4%, which was largely driven by higher transportation costs, as expected. We expect that transportation and, to a lesser extent, packaging and proteins will remain elevated for the rest of 2018. Also impacting the gross margin in the quarter was the continued impact of outsourcing innovation, primarily in our Frozen segment.

As Mark previously mentioned, we expect to repatriate volume over time and concurrently with improved utilization through our network optimization program. Partially offsetting these drivers was productivity of 4%. We now see both inflation and productivity at the higher end of their respective ranges for this year, as we have more clarity about rising costs and about the delivery of our savings programs. We expect gross margin to return to growth starting in the second quarter and throughout the second half.

Continuing down the P&L, adjusted EBIT increased 1% in the quarter, primarily reflecting the phasing of advertising and marketing spending to better align with our innovation launches that more than offset the decline at adjusted gross profit.

For the Frozen segment, adjusted EBIT increased 11.8%. This performance largely reflects the higher net sales, productivity, and the phasing of marketing and advertising spending, partially offset by input cost inflation. Adjusted EBIT for the Grocery segment decreased 4.3% in the quarter, primarily reflecting input cost inflation and unfavorable product mix, primarily due to the softness of Wish-Bone and the syrup businesses, partially offset by productivity.

Adjusted EBIT for the Boulder segment declined 4.2%, primarily driven by the higher support behind new products and inflation, partially offset by productivity. And finally, adjusted EBIT for the Specialty segment declined 14.2%, largely reflecting the AJ exit, which represented a 17 point headwind in the quarter and inflation, partially offset by productivity.

Adjusted net interest expense for the quarter decreased 1.6%, reflecting the recent refinancing we undertook in the first quarter, as well as the reduction of outstanding indebtedness versus the prior year period. On an adjusted basis, our tax rate came in at 24.3% compared to 32.5% in the year ago period, largely reflecting the favorable impact from the new tax legislation. And finally, adjusted net earnings increased 14.3% in the quarter and adjusted EPS advanced 14% to $0.57 compared to $0.50 in the prior year period.

Now turning to cash flow. Net cash provided by operating activities in the quarter totaled $122 million compared to $63 million in the prior year. This improvement reflects the higher net earnings, the favorable impact of working capital improvements, and lapping the negative impact in the prior year period associated with the refinancing we undertook, specifically the cash settlement of some hedges we had in place.

Capital expenditures in the first quarter totaled $36 million compared to $29 million in the year ago period. And free cash flow in the first quarter increased to $86 million compared to $34 million in the prior year period, largely reflecting the higher cash from operating activities.

Now turning to liquidity. At the end of the first quarter, we had $2 billion in secured loans, $700 million in senior notes, and $78 million in cash, yielding a net leverage ratio of 3.86 times. As we announced back in March, during the first quarter of 2018 we completed the refinancing of our senior secured credit facilities. The refinancing consisted of a new $800 million Term Loan A, a new $1.2 billion Term Loan B, and the upsizing of our revolver to a $300 million five-year facility.

We also used approximately $200 million of cash on hand to pay down debt on the prior term loan. This was once again a significantly oversubscribed transaction that will result in cash interest savings of approximately $50 million over the life of these loans.

Now turning to our outlook for the year. We continue to expect adjusted diluted EPS for the year in the range of $2.85 to $2.95. At the midpoint, this represents growth of 16% versus the comparable 52-week adjusted diluted EPS of $2.50 in 2017. In the second quarter, we expect the year-over-year Easter comparable to be a headwind to net sales, affecting both the Frozen and Grocery segments. Of the $42 million in discrete items that we incurred in 2017, we continue to expect approximately two-thirds to become tailwinds in 2018, benefiting gross margin.

As previously communicated, the favorable spread between productivity and inflation is expected to narrow significantly in 2018 versus prior years. Input cost inflation is still estimated in the range of 3.8% to 4.2%, although it will now be at the higher end of the range.

Productivity for the year, which now includes the residual Boulder acquisition synergies, as well as some early savings from network optimization, is still estimated in the range of 4% to 4.5% of cost of products sold, although will now be at the high end of the range, with second half productivity higher than the first half.

Adjusted net interest expense is still forecasted to be in the range of $123 million to $126 million, although likely at the lower end of that range linked to the previously discussed refinancing. Our adjusted effective tax rate is still estimated in the range of 24% to 25%. The weighted average diluted share count for the year is still forecasted to approach 120 million shares (sic) [121 million shares]. And finally, capital expenditures for the full year are still expected in the range of $155 million to $165 million.

With that, I'll turn it back to Howard to open up the line 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, and welcome, Jen.

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

A

Hi, Andrew.

Andrew Lazar
Analyst, Barclays Capital, Inc.

Q

Hi. Two questions for me. First would be, Mark, can you remind us when the sort of freezer space resets tend to happen at retail? Because I'm trying to think through the sustainability of the trend, the strong trends we've seen at Birds Eye. And just to get a sense of if some of that's happened, how that has played out for the Birds Eye brand and your Frozen business overall?

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

A

Yeah. So, as you know, we've talked a little bit about this before. The resets are a little bit sporadic based on when particular customers look to do that, so traditionally it's been around or post Easter. So you end up with a heavier focus on the core business through the Easter holiday, and then innovation tends to flow in right after that.

I will say there are a couple customers that have pushed that reset window back a little bit later in the year, so we may see a little bit of a sustained build on our innovation as the year unfolds. But the good news is that pipeline that we talked about around Veggie Made is really just hitting the marketplace now and, I believe, will build momentum as we go into the second and third quarter.

Andrew Lazar
Analyst, Barclays Capital, Inc.

Q

Got it. And then, Craig, in thinking about the return to gross margin expansion in 2Q, and then through the remainder of the year, I guess, based on all the factors that play into that, including the reversing of some of the discrete items from last year and such, I think the consensus anyway has full year gross margin expansion maybe somewhere up in the – about 100 basis point expansion or so. And I know you said that the first quarter gross margin contraction was roughly in line with your internal expectation. So trying to get a sense of whether that range seems about right to you based on the factors that you kind of have visibility to today.

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

A

That sounds right in line, Andrew. I mean, as you said, we now know inflation's going to be a bit higher, so we increased it to the top end of that range. So it's going to be north of 4%. We feel rock solid about our productivity and our MVP program, so that's going to be at the higher end of the range at closer to 4.5%. And as you flow out the pricing, the improvement we'll get in mix as we start to in-source a lot of that Birds Eye innovation and, as you say, lapping the one-timers on the discrete items from last year, you'll see a positive flow out in Q2 and each quarter in the back half and you're not far off relative to your full year range.

Andrew Lazar
Analyst, Barclays Capital, Inc.

Q

Thanks very much.

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

A

Thank you, Andrew.

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. I just wanted to inquire a little bit about your relationship with the activist investor in your stock. Have you talked to them recently? Any surprises in terms of looking forward that maybe you haven't been open to. I imagine the answer is no, because, Mark, you've been open to anything and everything that will create shareholder value, I think. But I just kind of wanted to at least poke around a little bit and see if there's anything that we should know about.

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

A

Sure.

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

A

We didn't hear that...

[indiscernible] (00:28:46).

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

A

Thanks, Ken. Yeah, well, as you might imagine, the release of the 13D from Jana, the timing of when that hit put us pretty squarely in our quiet period. So really following today's call, we've got a variety of investor meeting set up. And although [ph] I won't get into (00:29:09) specifics on any individual investor, but what I'll say is we've had historically and continue to expect to have very constructive dialogues with the Jana team.

The board and I are committed to building value for our shareholders. We are, as you say, open to hearing ideas and are happy to listen from all of our investors, but most certainly Jana as well. So I think we look forward to those dialogues in future. But to this point, we've been really focused on finishing out the quarter, getting earnings ready, and from this point now we'll kind of pivot, as we normally do, with a pretty robust agenda of investor meetings and a conference coming up as well.

Kenneth B. Goldman
Analyst, JPMorgan Securities LLC

Q

Thank you for that. And then a follow-up for me. Mark, could you just – I know you said we're going to hear a little more about this later, but the new media partnership, can you give us a little more color as to what it means? What's so differentiated about it that may help you in the future?

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

A

Yeah, sure. And again, we could probably spend the balance of the call on this. But the reality is that, as we all are well aware, the landscape, the consumer dynamics are transforming. And the reality is that our old traditional playbooks that big food and CPG have used in more traditional agency models, they're just not working and they're also incredibly expensive to try to replicate the reach and the impact that we might have been able to get five or 10 years ago. And the other dynamic that I think has evolved as well is over the last several years, there's been a lot of emphasis on the percent of spending in digital, but not necessarily clear on whether that's working or there's a good ROI.

And as we look at it, the key to winning in the marketplace today is this unique intersection of really data management, content creation that's relevant, and placement. And I think that's squarely where Vayner plays. I think it's a unique capability that, quite frankly, if I tried to build it in-house, by the time I got it built, I think the ball will have already moved to the next game.

So what's really different about this is that instead of the kind of traditional model of creating a roster of different agencies to do a lot of different things, we've really created a strategic partnership, where we're embedded within each other's organizations. So I've got folks that are with Gary and his team, folks from his team are embedded in our organization, and that enables us to really be much more nimble and quicker to reaction, because we're all grounded in the right strategy. And so I think this is somewhat indicative of what it's going to take to succeed in the world we're in today.

And as I feel very good about our innovation model and being able to really lead the thinking and how we react quickly in that space, this will bring marketing as another weapon in the arsenal to match with the dynamic of the environment we're in. And I continue to refuse to accept that big brands and bigger food can't win in the environment we're in. But we're going to have to change the way we play and this is an example, among many, that I think we're trying to demonstrate and lead the thinking on.

Kenneth B. Goldman
Analyst, JPMorgan Securities LLC

Q

Thank you.

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

A

Thanks Ken.

Operator: Thank you. Our next question or comment comes from the line of Farha Aslam from Stephens, Incorporated. Your line is open.

Farha Aslam
Analyst, Stephens, Inc.

Q

Hi, good morning.

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

A

Hi, Farha.

Farha Aslam
Analyst, Stephens, Inc.

Q

Could you talk about mix and how it was in the quarter? Was it just the negative mix because of the timing of Easter? And how you plan to manage mix going forward, particularly as you think about your growth brands versus your value brands?

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

A

Yeah. It's a great question and there's a couple of moving parts within it to talk about. But as we mentioned, there's a couple of things that are happening in mix. What I would tell you is the underlying relationship of the strength of our leadership brands versus our foundation brands is a very compelling driver of improved mix over time. What we're dealing with a little bit now that's running through mix is really the impact of outsourcing a fair amount of our innovation. And what that's driving is a shorter-term lower margin on those businesses, as well as some impact within our overall network.

Interestingly enough, though, as we think about this, in many ways this reflects an investment in growth for us, the idea that we can move quicker with innovation where we see opportunities and driving relevance. Even though we don't like the short-term pressure on gross margin, I do like the speed and effectiveness of what we're seeing within our innovation. Veggie Made happens to be one of the bigger drivers.

The other thing that I like about this is that these are controllable variables for us. As we bring this business back into the portfolio, as we continue to optimize the network, we will see that mix impact from innovation mitigating as the year unfolds and at the end of the day, giving us a very compelling $100 million – Veggie Made's $100 million platform already – with margin advantage to the overall portfolio. So I do still see over time mix as a positive contributor. But in this particular window how we've gone after innovation has provided a bit more of a shorter term headwind that we would expect to cycle through as the year unfolds.

Farha Aslam
Analyst, Stephens, Inc.

Q

That's very helpful. And then just following-on on Boulder. You highlighted that you made significant investments to grow. If you look at the year, how should we think about sales and growth for that business?

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

A

Well, I think you start with kind of the underlying in-market results, which continue to be very strong and it's been led fairly consistently by the success of our gardein business, which we're just now beginning to support in a more sustained way from an innovation, as well as a marketing investment, on the heels of Hagerstown coming up and providing us more supply.

I think the halo of plant-based as a consumer trend is also really breathing some life into our Earth Balance business, which you heard me mention earlier has really been on a great roll as well. The Udi's business, which historically has been a little bit of our weaker spot in the portfolio, with the bread launch we're beginning to see significant improvement in that segment, remembering that bread represents about 40% of the Udi's s business.

So as we get bread up and running and in positive territory, and if you look at the April results in particular, you do see bread moving into positive territory. We'll now start to work through the other elements of gluten-free, as we've discussed before, which is frozen pizza, the snacks business, which is under the Glutino brand, and then pasta and meals as a follow-on to that.

Now, to do that, since the acquisition, you may remember, we've added essentially 600 basis points of gross margin to that business. We will invest a little bit back this year as we start the innovation machine back up and doing a little bit of the support behind the businesses in the near-term. A little bit more of that was pronounced in Q1, but I do think you'll see a little bit of pressure on margins in the earlier part of the year and kind of leveling out as we go through the back half of the year, but with the sustained growth and the improving trends in some of those businesses.

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

So, Farha, you should expect the Boulder business to be a mid-single-digit grower. It will be in excess of the portfolio average, obviously, with Frozen being in lockstep with it certainly driven by Birds Eye.

Farha Aslam
Analyst, Stephens, Inc. Q

Great. Thanks for the added color.

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

Thank you, Farha.

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

Jason English
Analyst, Goldman Sachs & Co. LLC Q

Hey, good morning, folks, and thank you for allowing me to ask a question.

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

Hey, Jason.

Jason English
Analyst, Goldman Sachs & Co. LLC Q

Building off Craig's last comment, the Boulder mid-single digits and, Mark, I think you mentioned mid-single-digit growth [ph] you kind of already (00:37:41) back there. As we have thought about the cadence of the year, we were expecting a lot of innovation to be pushed out in the second quarter and that to be a drag on sales that quarter. It sounds like maybe we just got the timing wrong and it could actually be a lot more robust in the second quarter than we had initially expected. Is that fair?

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

A

Yeah. I think the sequence you had a little bit off. I mean, if you think about bread and gardein, which are two of our big sources of innovation this year, through the first quarter it was a pretty steady drumbeat of rolling out. As you get into Q2, I think you'll see a much tighter relationship. In fact, if you were to take – as I've mentioned in my comments, if you look at April, which is not all the way complete yet, but from a consumption and shipment standpoint, it actually trues-up the year as far as relationship between that consumption and shipment line. So that, obviously, implies a nice bounce back in the month of April.

Jason English
Analyst, Goldman Sachs & Co. LLC

Q

And when we dig into your Grocery segment, looking at consumption data, there's been a fair amount of deceleration recently led by both baking and consistent weakness on the salad dressing side. I know you've got some initiatives in salad dressing, but you've had a lot of initiatives over the years and the business has sort of continued to bleed out on you. And I know you've got some new push, but it's kind of round two, where I incrementality to be less on Perfect Size. What are you expecting for those two components of your business? And if it's a return to stability or growth, what's the glide path that really gets us there?

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

A

Yeah. Yeah, great question, two businesses that we're spending a lot of time and focused on. Let me take baking first, because I do think in the world of things we choose to do versus those things that are happening, I think we're much more in control of the trajectory on the baking side. So Duncan Hines, if you look at the last 12 months or so, we continue to feel great about Perfect Size for 1. On a business of this maturity to drive 3 points of household penetration is just a major accomplishment and evidence that we can drive relevance behind some of these iconic brands.

The new news around Perfect Size for 1, we think we also have a continued rhythm behind it that will drive growth, arguably not to the percent changes that we saw last year, but steady contributors to growth. If you remember, a lot of the Perfect Size for 1 flowed in over the course of the year. So as we think about the distribution and the impact of that over the course of 2018, I feel like we will have very good momentum.

In particular what happened in Q1 and what we expect to see a little bit in the April window is that, as we have seen a little bit of this up and down on dysfunctional spending within the lower end of the category, so cake mix, we saw a lot of heavy investment in that space, cake mix as low as $0.59, which is just not an area that we're going to go to. It's just not healthy for the business and it's not worth that reduction in margin to go out and buy the share.

The good news is, as we get through the balance of this year, you will not have that tough comparable. So if you remember, in the fall baking window last year we had a similar situation, where prices were low. So I would expect as the year unfolds to see the innovation pulling Duncan Hines forward and less of any negative comparable based on dysfunctional or lower price. And if pricing moderates, then I would expect us to have even more momentum as we go through the year. So, I guess, net of all that, I would say I feel very good about baking, albeit I would expect April to still look a little tougher in the IRI data.

Wish-Bone, it's a tough category. I mean, the reality is there's a lot of players with the ability for retailers to use that portfolio to drive a lot of fluctuation in pricing, which has been really a big part of the headwinds that we've experienced. I do think, as you mentioned, we have made some moves that, although I think have been helpful, have not been enough. And at the heart of this story is innovation will play a nice contributing role in the portfolio, but we've got to get the core right.

And the good news for Wish-Bone is the Italian and oil-based lines is the place where you have the best health and wellness credentials, and we should have the best opportunity to differentiate as the leader in that space. And so what we've done is really clean up the portfolio, restage the packaging and the marketing to really be far more relevant and focused on where we think the advantages are, including a cleaned up ingredient line that really allows us to tackle that health and wellness permissibility that we think can help.

The bottom line is, we will know a lot more when we get into the Memorial Day window. This category, in many ways, is built heavily on the three holiday drive periods of the summer, how we do in Memorial Day, 4th of July, and Labor Day will really dictate whether or not we're on the right path in making the impact that we need to do. I still believe strongly in the brand. I do believe in our position and our opportunity to stay in a position at least where we're able to return to positive share, but we'll know a lot more when we get through the Memorial Day period.

Jason English
Analyst, Goldman Sachs & Co. LLC

Q

Thanks a lot. Really helpful. Looking forward to seeing next week at your conference.

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

A

Yeah. We'll see you on Tuesday.

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

A

Yeah. We'll see you then.

Operator: Thank you. Our next question or comment comes from the line of Rob Dickerson from Deutsche Bank. Your line is open.

Rob Dickerson
Analyst, Deutsche Bank Securities, Inc.

Q

Thank you very much.

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

A

Hey, Rob.

Rob Dickerson
Analyst, Deutsche Bank Securities, Inc.

Q

Hey. I guess, just kind of a question that follows-up from Jason's question just in terms of baking. Obviously, there's a large competitor that has discussed the potential for a strategic review and maybe divestment. We've just seen pressure within the – mainly the cake mix category over a longer period of time. So, I guess, one is, there seems to be, obviously, a better margin in that business. So is that just more rationale of kind of hold onto it, one?

And then two, if you're getting better growth out of Frozen and now you're going to have the privilege of communicating with Mr. Gary V., I'm assuming that some of the new initiatives, marketing, kind of overall growth push in the business would still kind of weigh more heavily on the more on-trend Frozen piece. So it's, yeah, kind of a roundabout way of asking, do you think that attention and that investment will continue on the baking side or is Pinnacle Foods kind of just going to lean in continually more so on the Frozen side? Thanks.

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

A

Yeah. So I continue to like the composition of the portfolio. I've said this a few times before, which is that in the world in which we live in today, I'd say intuition always suggests that a more linear portfolio is an easier one to manage. But the idea that we've got clear roles that these businesses can play, I think, works to our advantage. And in a world where you have perhaps some headwinds on a business like Wish-Bone, the idea that we can drive relevance and growth on Duncan Hines has been really a key to success of sustaining our performance for such a long period of time. So, although, I would say, if you look at our leadership in foundation brands and how we carve them up, there are a lot of growth opportunities in Frozen and we really do believe we're uniquely positioned to lead that for a variety of reasons.

But I still remain bullish that within the Grocery business, we have brands that can succeed. And again, the idea that Duncan Hines after such a long period of decline in the category, we can use innovation and own a business like Vlasic, where we've used more marketing than innovation to drive the growth, is something that, I think, we will always use prudence in deciding where the next dollar goes. But I do think there will be balance and contribution across the portfolio clearly with a bit of a distortion to the Frozen businesses and the Boulder businesses, but with a clear contributing role from our Grocery portfolio as well.

So, hopefully, that answers the question. And again, a little bit of this is reading the landscape. When we get – you're going to learn in these experiences where some work and some don't. And when they do, you want to be able to fuel that. And when they don't, you want to be able to pivot and adjust appropriately.

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

A

And, Rob, the one big factor too on Duncan Hines is, look, we're not going to play on the low end of the category and chase low margin there. But the Perfect Size for 1 innovation from last year, the new innovation – the 13 new items plus the 11 new items on frosting, is another kind of double down relative to that highly successful platform, which is margin accretive for us. So we'll be able to make improvements there in that decadent size versus the low end.

Rob Dickerson
Analyst, Deutsche Bank Securities, Inc.

Q

Okay, great. Yeah, that's very comprehensive and appreciate it. And then just a quick question. Mark, I think you had mentioned in your remarks earlier that there were slightly lower retailer inventories, natural and organic. I mean, it sounds like maybe that we're past that now. Can you just explain kind of what you meant – said that?

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

A

Yeah. We saw a little bit of inventory reduction in retail, specifically in natural and organic. Those are channels that we're working hard with retailers to ensure that we continue to make them competitive and work on the right programs. But there have been challenges in those segments. I think that translated to a little bit lower inventory position coming out of the quarter. I am really encouraged, though, as I said before, about the bounce back that I've seen in April and the kind of stabilization, if you will, of the relationship with consumption and shipments.

And again, I just would point out, and I know this was a big topic of discussion in the Q4 timeframe, overall on the business for the quarter, we had a very good relationship between consumption and net sales, which was in the 4% to 5% range, which is, I think, a bit of that proof point of those two correlating better over time, even if at any given quarter you may see some ups and downs.

Rob Dickerson
Analyst, Deutsche Bank Securities, Inc.

Q

Okay, great. I'll pass it on. Thanks.

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

A

Thank you, Rob.

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. Thanks for the question. I wanted to ask about the brand investments. And so, obviously, the VaynerMedia deal is the catalyst for the question. So I'm trying to understand, you mentioned that the way CPGs are doing business today is not effective. So what do you mean by effective, right? Because you measure your effectiveness generally through market share and things have been trending really well for a long period of time over there. So does this investment mean that your ability to gain share is better now and the cost of doing that is going to be lower? Is that sort of what you mean by being more effective?

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

A

Yes. I mean, in a nutshell, that's right. I mean, we expect ROIs to improve. It's not a incremental spend. It's really about taking the marketing dollars that we have in place and making them more effective by a metric of ROI. And what I would say is, I think we have done an excellent job in many aspects of this, especially on the innovation side. What I think this recognizes is an opportunity to complement that strong innovation track record with continuing to push for better core marketing and base business initiatives that I think ultimately form the combination that allows sustainability over time. And so we like this relationship.

And what I meant by, kind of, the traditional playbook not working, as we all know, the ability to reach consumers where and with what relevant message is transforming at an incredible pace, along with where they're buying product. And so, the idea that we need to pivot with that or that if you're just running a traditional TV ad, your ability to reach the consumers you really need to influence has gone down in effectiveness or had become significantly more expensive to capture the same reach that you may have had before.

And so, being able to really mine data and then develop the content that's relevant for the channel that you're going to be communicating in, and then placing it in the most efficient vehicle, is really what this relationship is about and where, I think, we could have a great impact without spending more dollars just getting a lot more bang for the buck, if you will, as we go forward.

Akshay Jagdale
Analyst, Jefferies LLC

Q

And just one follow-up. Can you give us some perspective on, if you're leading the charge, it looks like there's only a handful of other companies that are doing something like this. But when I think about in the CPG space who's made bold moves on brand investments, I think of companies that have now combined the promotional dollar spend with the ad dollars spend. Is that something you're also considering or have you given that thought?

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

A

Well, one of the things that we believe this capability is going to be very helpful on is that our retailers are dealing with many of these same challenges of where and how to connect with their consumers. And so the idea that our ability to weave this together as more of a holistic program and to be able to bring some value and insight to our customer partners in a world where there's a lot of dialogue that gets mired in pricing alone, this is a way to talk about a more strategic way to grow the businesses and drive the category. So I think that the idea that your investment should be able to work across both the traditional marketing and the promotional side is absolutely how we're planning to go to market and we see it as an advantage for our retailer partners that we're hoping to also gain benefit from.

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

A

And, Akshay, I think what makes this a bit revolutionary is the fact that we have Vayner employees here in our building with Pinnacle, and we have Pinnacle employees in the Vayner offices. So the connectivity that we're getting with that relationship, I think, has been a bit more forward than others in the space.

Akshay Jagdale
Analyst, Jefferies LLC

Q

Perfect. Thank you. I'll pass it on.

Operator: Thank you. Our next question or comment comes from the line of Robert Moskow from Credit Suisse. Your line is open.

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

A

Hey, Rob.

Robert Moskow
Analyst, Credit Suisse Securities (USA) LLC
Q

I guess, my comment is that this is a lot more boring than the Tesla earnings call, but certainly better results, I guess.

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

Your questions aren't boring.

Robert Moskow
Analyst, Credit Suisse Securities (USA) LLC
Q

Okay. Well, you haven't heard the question yet, so it's going to be kind of boring. But Boulder, I guess, was the thing in my model that was overly optimistic. Your commentary says that mid-single-digit is probably the growth rate that consumption is still at. Can you give me a sense of how much of that is in the Nielsen measured channels and how much of that is kind of in the natural and organic channels that we can't really monitor? And are the growth rates pretty similar by channel or are they different?

And I kind of thought this was going to be a breakout year for Boulder, given the Udi's relaunch and maybe you could have – maybe high single-digit would have been possible based on the fact you were already at mid-single-digit in 2017. So was it wrong to think that the growth rate could accelerate to something higher in 2018 based on the innovation and also the Hagerstown capabilities?

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

Yeah. So let me kind of answer the questions in sequence. So we, generally speaking, it's about 80/20 in measured to unmeasured, and I would say that we do see a bit of variation in the channels, depending a little bit on the channel dynamics themselves. So where the categories are a little bit stronger in some of the traditional retail, we've seen some really positive numbers. And what you would consider to be more of the traditional retail space, I do think there have been some challenges in natural and organic overall that has perhaps mitigated some of the growth rates we've experienced. A lot of incrementality for us on this portfolio is we've been able to drive penetration of gardein and Evol and Udi's into some of those retailers there, where they weren't before.

I think all have led to albeit overall mid-single digit to-date, I do think, though, if you look at consumption, as we talk about it in its later periods, we are pressing on the door of upper single. And I think that a lot of game still yet to be played. We feel great about the plans that we have in place. I think the team is very bullish on the success of the Udi's bread, albeit early. And I hope we do find some upside in some of those areas as the year unfolds.

What's interesting about this dynamic is some of these businesses, we really don't yet have an experience where we're unconstrained on capacity, where we've got the full innovation funnel going and are beginning to invest on the base and the core going forward. So I think we're being appropriately prudent relative to what we're seeing. But certainly our ambition for Boulder is to continue to see acceleration in that business. And again, I think we'll be excited to watch that over the next quarter or two and see how we're doing in a couple of these areas. And I think it's quite possible that we could be pleasantly surprised there.

Robert Moskow
Analyst, Credit Suisse Securities (USA) LLC
Q

Thank you.

Operator: Thank you. Our final question will be taken from Mr. Brian Holland from Consumer Edge Research. Your line is open.

Brian P. Holland
Analyst, Consumer Edge Research LLC

Q

Thanks. Good morning, gentlemen.

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

A

Hey, Brian.

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

A

Good morning, Brian.

Brian P. Holland
Analyst, Consumer Edge Research LLC

Q

In the interest of time and most of my questions have been answered, I'll just ask a sort of brief one here. On the M&A front, obviously, a little bit longer between transactions on your part than maybe some or maybe even you have expected or hoped. I appreciate you're testing a wider net in the Frozen temperature class, but why do you think we're kind of on a stalemate with respect to Frozen consolidation? I mean, is it as simple as valuation or has the improvement in that part of the store, especially relative to broader Grocery, maybe caused some of your competitors in the Frozen category to rethink how they view that part of their portfolio?

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

A

Yeah. Great question. Well, first, let me just start by saying, as we've said all along, we remain very confident and committed to the idea of M&A as an accelerator to our results. I mean, although we feel good about the organic plan that we have, we recognize that this is a muscle that we want to use. And as we've said that, we've talked about where we really think that focus should be. And Frozen consolidation has been and is at the top of that list just because of the nature of that temperature class and what it enables relative to synergy to scale behind it.

I think the reason perhaps it's been a little slower to get to the outcome that we think makes a lot of sense is a couple of factors. One, I think sometimes you need catalyst for action, right? You need something to happen in the clarified strategy. I take the [ph] Reckitt (00:59:24) food business as an example, where one thing needs to happen to kind of enable the clarification or the portfolio optimization. So I think that's part of it. But I do agree with you in a sense that where these may have been businesses and franchises that were leaky buckets for businesses, as the businesses have stabilized at least in the short-term, I think it's become less of a burning platform. I do believe, though, over time it still makes sense for these businesses to be together in some capacity. And I think it is more of a matter of time than an if.

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

A

And then, Brian, we continue to delever the balance sheet, deliver our core plan. The deal flow is still very active. So I think we're doing exactly what we need to do and opportunities will come our way.

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

A

Yeah, agreed.

Brian P. Holland
Analyst, Consumer Edge Research LLC

Q

Appreciate it. Thanks for the commentary. Best of luck.

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

A

Thank you, Brian.

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

A

Thanks, Brian.

Operator: Thank you. I'd like to now turn the conference back over to management for any closing remarks.

Jennifer Halchak
Vice President-Investor Relations, Pinnacle Foods, Inc.

All right, everybody. Thanks for joining us this morning. Tyson and I will be around all day for any follow-up, so we look forward to speaking with you then.

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

Thanks, guys.

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

Thank you, Howard.

Operator: Thank you. Ladies and gentlemen, this concludes today's presentation. Thank you. You may now disconnect. Everyone, have a wonderful day.