Pinnacle Foods Inc.

Moderator: Jen Halchak
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7:30 a.m. ET

Jen Halchak: Good morning, everyone. As we outlined in our earnings call announcement, today's comments will focus on Pinnacle's 2018 second quarter results and will not include a Q&A session.

For information regarding the pending acquisition of Pinnacle Foods by Conagra Brands, please refer to Conagra's S-4 filing, which was filed on July 25th 2018.

Let me also remind you that as usual, our release and remarks this morning will include our results on an adjusted basis. The adjusted basis excluded 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 in our press release and are discussed in detail in our 10-Q, which will be filed this morning.

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

(Mark Clouse): Good morning, everyone, and thanks for joining. Our second quarter, like the first, shaped up much as we had planned and in what remains a very competitive environment we grew the top line one percent in the quarter, excluding the impact of Easter phasing, which resulted in a market share that was flat from prior year.

In fact, if you look at the business on a year-to-date basis, net sales excluding the (AJ exit) are up two percent and we've grown share two-tenths of a point.

Importantly, we continued to deliver excellent top line results on our largest franchise, Birds Eye vegetables, as well as in key growth areas in our Boulder portfolio. In the quarter, we also expanded adjusted gross margin by 140 basis points and grew adjusted EBIT by nearly six percent.

While the industry environment isn't without its challenges – specifically regarding inflation, and in particular, transportation – we are pleased with our continued ability to navigate these challenges and deliver strong bottom line results.

Year-to-date, while holding gross margin even with prior year, we have delivered EPS growth of 13 percent.

Our full year EPS guidance – which we reaffirm today – represents year-over-year growth of 16 percent at the midpoint and would be the sixth consecutive year of delivering double digit increases of EPS. That is truly a testament to the dedication of all of our employees over the years.

Now, let's get into the second quarter segment results, starting with frozen. At a high level, the frozen segment continued its strong growth trend, even when we consider the unfavorable phasing of Easter, with net sales advancing 4.3 percent in the period.

This translated to strong in-market performance, with consumption also expanding 4.3 percent and market share advancing three-tenths of a point in the quarter – driven by Birds Eye vegetables which grew market share 1.5 points on consumption of 9.5 percent.

The strong performance in Birds Eye was led by the slate of innovation that we have launched in the past few years. In particular, the popular Birds Eye Veggie Made platform that launched in 2017 and now includes Veggie Made Pasta, Fries & Tots, Mashed and Riced Cauliflower and Mashed Sweet Potato.

While barely a year old, the Veggie Made platform is already $100 million business at retail, with eight percent household penetration and a runway too triple in size over the next several years.

While the frozen segment overall had another solid quarter, we did see continued heightened competition in the frozen meals category.

The good news is that this category is now growing at a healthy clip, and with a differentiated position, Pinnacle brands will continue to play a leading role in ensuring the category continues to grow in a way that everyone wins – the consumer and the retailer.

Turning now to our grocery segment. Net sales for our grocery segment declined seven percent in the second quarter, with retail consumption down 5.5 percent and market share off slightly.

Duncan Hines came under pressure in the second quarter as both the phasing of Easter as well as lapping of an exceptionally strong period in 2017 weighed on the brand.

We have also experienced continued competitive pricing in our base baking businesses. As we have said before, we will not chase low margin volume and this was the strategy we continued to execute in the second quarter.

While the base Duncan Hines business was under pressure in the quarter, Perfect Size for One remains a compelling and disruptive snacking platform. Evidence by strong consumption and the attraction of competitive (entrance) into the space.

As we lap the strong growth from last year's initial introduction of the product of the product, we feel good about the nearly 40 percent growth year to date.

However, given the new competition, we are looking at our offerings to ensure we have the right mix and we are activating additional marketing strategies to support the continued leadership of our first to market innovation.

An area we are very pleased with is the progress we have made with Vlasic. Pickles are continuing to respond to new marketing with consumption growing 2.2 percent and market share up slightly.

As we've spoken about before, Vlasic is a great example of how renovation of an iconic brand of an iconic brand can really work. It's also great example of how renovation of an iconic brand can really work.

It's also a great example of the effectiveness of our partnership with Vayner as a social media campaign that was created to bring back the Vlasic Stork and was geared toward millennials proved to be highly successful and provided good lift to the brand and the markets where the campaign ran.

In terms of Wishbone, the story is mixed. As we continue to work through the refresh we improved our performance during Memorial Day with the best volume growth in the entire category but returned toward a decline during the

July 4th period following aggressive competitive pricing and the erosion of some distribution on the tail of the business.

The positive news in velocities are up as we optimize our portfolio and continue to drive the brand refresh. We're not satisfied with the performance to date but continue to believe a simplified portfolio, cleaner ingredients, and a balanced approach on pricing will stabilize the business.

So looking forward, although we expect trends to improve the reality of strong comps that some of the brands have in the segment, particularly Duncan Hines, and some of the work that we'll still have to do on Wishbone we expect the grocery segment to remain under some pressure for remainder of the year.

Although, certainly not at the level we saw this quarter. Turning to Boulder, net sales in the quarter increased five percent and in market performance for the segment remain strong with retail consumption advancing over seven percent, led by the continued strength of Gardein which grew consumption 38 percent in the quarter.

And Earth Balance, which was up 15 percent. Also in the quarter we saw Udi's turn to positive consumption growth led by the new bread that we launched at the beginning of 2018.

We have focused our efforts on renovating and innovating our gluten free businesses starting with our bread offerings. We're pleased to report that the launch of the new Udi's bread is performing very well.

During the most recent period, our frozen gluten free bread offerings grew nearly five percent at retail, which is a 12 point swing in consumption and is the main driver behind Udi's returning to consumption growth.

We are continuing to support this new bread with marketing in order to drive trial and awareness and in the third quarter we'll be launching additional varieties. As previously mentioned, our focus is not just on bread.

We will also be renovating our gluten free pizzas and granolas in the third quarter as well as introducing new flavors in the back half of the year.

We continue to believe there is strong growth potential in the gluten free category and we remain committed to our strategy of renovating and innovating within our core categories and delivering the no compromise gluten free experience consumers are looking for.

We also remain excited about the new innovation we've launched behind Gardein and Evol. Namely our Gardein skillet meals and our Evol bowls that deliver specific ingredient bundles tailored to healthy lifestyles, which have started to ship and will help to drive continued growth in the back half of the year.

Finally, turning to our Specialty segment. Net sales for Specialty were flat in the second quarter but were up two percent excluding the net impact of the (A.J.) exit. As we are now finished lapping the (A.J.) exit, we anticipate the top line in the Specialty segment to remain stable.

However, given the work we've done to exit low margin business over the past year, you should expect adjusted EBIT margins to show good growth. Before turning it over to (Craig), let me share a few comments on the industry and our recent news.

Everyone who follows this space, including those of you on the call, know we have often talked about the power scale in consolidation in our industry, especially in the frozen aisle.

I also believe, given the current industry back drop, this has never been more true, which is why we are truly excited about the announced acquisition of Pinnacle by Conagra Brands.

During this process, we have spent a lot of time with the Conagra team, and it was clear that we shared their conviction, that the opportunity to combine these two great companies is not only logical and synergistic but also creates a combined business that is positioned to lead and thrive in our industry.

When we think about the power of this combination, we see it coming from three key opportunities. The first is the portfolio. The complimentary nature of the brands and their consumer relevance creates an incredible platform to win in frozen, center of store, and snacking.

I firmly believe that our combined innovation pipeline and capabilities to deliver what the consumer's looking for can set the standard for the industry. Second are the synergies. We talk a lot about unleashing our brands potential at Pinnacle, and to do that, we have to drive profitability and wisely invest in our brands.

The clear synergy opportunity of this combination will help both of those objectives. Finally, there's the culture. I believe that Pinnacle has created something powerful in our industry.

This is an organization that is lean but capable, high-speed but disciplined, and truly gets that sustainable performance comes from focus and striking the balance of cost reduction and growth.

I believe this is the same culture that Conagra has been building and should make this integration highly affective. I would like to congratulate the over 5,000 employees at Pinnacle for building such a fantastic company and for continuing to demonstrate the power of the Pinnacle playbook.

This playbook has created a total shareholder return, in excess of 275 percent, since our IPO in 2013. We are excited about bringing that playbook and our passion for winning to the next chapter of the journey with Conagra. With that, I'm going to hand it over to (Craig).

(Craig): Thanks, (Mark), and good morning, everyone. Let me provide some additional color on the results of the second quarter. Net sales for the quarter were $742 million which was down about half a percent year over year but up 1.1 percent, excluding the timing of Easter.

As (Mark) mentioned, frozen continue its great start to the year and Boulder built on its momentum. Adjusted gross profit increased 4.6 percent, and adjusted gross margin expanded by 140 basis points.

The improvement was primarily driven by the lapping of last year's Aunt Jemima recall and exit and corresponding discreet items, though we did see some pricing benefit in the quarter as well.

As they did in the first quarter, inflation and productivity essentially offset, as both approached 5 percent of cost to goods sold. Looking forward, we continue to see clear drivers that will support gross margin expansion in the back-half of 2018, albeit, in a very challenging environment.

We will benefit from the lapping of last year's discreet items, and we are also getting selective pricing, particularly in our frozen segment. We also expect continued repatriation of outsourced innovation, to modestly contribute to the margin expansion.

With that said, while we continue to execute well on our elevated level of productivity programs, we also believe that the inflationary pressures affecting the entire industry, particularly transportation, will remain higher.

So we expect the gap between these two measures. These two measurements will remain closer than originally planned. But as you know, we have always proactively managed SG&A and other line items, making the appropriate trade offs in order to provide some essential support for our brands while still delivering our bottom line commitments.

So with positive gross margin and aggressive cost management, we remain confident in our EPS target for the year.

Continuing down the P&L, adjusted EBIT increased 5.7 percent to $120.7 million, pretty much entirely reflecting the higher adjusted gross profit and partially offset by higher marketing expense that was more in line with our average historical spend.

For the frozen segment, adjusted EBIT increased 32.2 percent in the quarter, largely reflecting the lapping of the discreet items, as well as productivity and higher net sales partially offset by inflation which was primarily related to higher transportation costs and higher outsourcing costs.

Adjusted EBIT for the grocery segment decreased 16.7 percent, reflecting higher input cost inflation, particular transportation costs, (negative) product mix, and lower net sales. Partially offset by productivity.

Adjusted EBIT for the (Boulder) segment increased 4.5 percent in the second quarter, primarily reflecting productivity, and partially offset by input cost inflation.

As we mentioned previously, while we expect top-line momentum to continue in this segment, given the higher new product introductory cost and marketing spend in 2018 versus 2017 – we would expect margins to remain under pressure for at least another quarter.

And finally, adjusted EBIT for the specialty segment more than doubled, reflecting the lapping of the (discrete) items and productivity, partially offset by input cost inflation.

Adjusted net interested expense in the second quarter of $28.4 million, was essentially flat with the prior year period, largely reflecting the lower overall debt balance in 2018. The flat adjusted interested expense in the quarter, particularly in a time of rising interest rates, is a testament to our ability to manage below the line items in a proactive manner.

However, I'd note that with the May 2018 (extinguishment) of the 4 and 7/8th that were due in 2021, a slightly higher percent of our total debt is now exposed to floating interest rates.

The adjusted tax rate for the second quarter declined to 23.3 percent, compared to 26.2 percent in the prior year – reflecting the impact of U.S. tax reform enacted in December of 2017, and a one-time adjustment to income tax liabilities that benefit the adjusted ETR by about 120 basis points.

Adjusted net earnings in the second quarter increased 12 percent, to $70.8 million, compared to $63.2 million in the year-ago period. Reflecting the favorable adjusted gross margin and tax rate. And finally, adjusted diluted

EPS increased 11.3 percent, to 59 cents compared to 53 cents in the prior year period.

Turning now to cash flow – the second quarter proved to be a really good quarter of cash generation. Net cash provided by operating activities increased to $93.2 million in the second quarter of ’18, compared to $57.4 million in the year-ago period.

For the first six months net cash provided by operating activities increased to $214.8 million compared to $120.3 million in the year-ago period – largely reflecting the higher net earnings and favorable working capital.

Capital expenditures in the second quarter totaled 24.5 million, compared to 20.1 million in the year-ago period. And free cash flow in the second quarter increased to 69 million, compared to 37 million in the prior year period – largely reflecting the higher cash from operating activities.

Now turning to liquidity, at the end of the second quarter we had $2.2 billion in secured loans, $350 million in senior notes, and $80 million in cash. The (end of year) net leverage ratio of 3.82 times.

And finally in terms of our outlook, as (Mark) previously mentioned and as you likely saw in our press release – we reaffirmed (full) year 2018 adjusted EPS guidance of $2.85 to $2.95. Given the pending opposition by Conagra, that is the only guidance that we will be providing today.

That concludes our remarks on the second quarter. We know that those of you listening to the prepared remarks are accustomed to a more interactive dialogue on the results, as we are.

But we hope you can appreciate that because we are in the midst of a public transaction, our disclosure going forward will be limited to what we have discussed today. Thank you for listening, and with that I’ll turn it back to (Jen).

(Jen): Thanks for joining us this morning, and please reach out to me or (Tyson) if we can provide clarification on any of today’s material.

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