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Pinnacle Foods, Inc. (PF)

Q4 2016 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, ladies and gentlemen, and thank you for standing by. Welcome to the Pinnacle Foods Inc. Earnings Call for the Fourth Quarter and Full Year ended December 25, 2016. 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, Pinnacle Foods, Inc.

Thank you. Good morning, everyone, and thanks for joining us bright and early today. We hope the early time slot this morning worked out for many of you participating at the CAGNY Conference this week. Earlier this morning, we issued our press release for the fourth quarter and full year 2016, which is available on our website. In addition, earlier this month, we issued a press release announcing the details of our new segment structure, which we indicated previously was under review following the Boulder Brands acquisition in early 2016.

The principal changes include the following. We will now report four segments; Frozen, Grocery, Boulder, and Specialty. gardein moved out of the previous Birds Eye frozen segment and into the new Boulder segment. Smart Balance moved out of the previous Boulder Brands segment and into the new Grocery segment. Canada moved out of the previous Duncan Hines grocery segment and into the new Frozen segment. In addition, all Canadian businesses of gardein and Boulder Brands are consolidated with the Canadian businesses of legacy Pinnacle in

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the new Frozen segment. All the U.S. foodservice and private label businesses of gardein and Boulder Brands are consolidated with the legacy Pinnacle foodservice and private label businesses in the Specialty segment.

The Q4 and full year results we reported this morning and will discuss here today reflect this new structure and are consistent with the historical financials we provided in the referenced press release, which is also available on our website. In Q1, we will transition our IRI reporting to be consistent with our new structure, which will include the businesses from the Boulder Brands acquisition. Our press release this morning and our comments here today are consistent with the manner in which we reported this information throughout 2016.

Finally, in early February, we refinanced our senior secured credit facilities in a significantly oversubscribed transaction that meaningfully lowered our interest expense, extended our maturity profile, and enhanced our financial flexibility. This press release is also available on our website and the lender's presentation associated with the transaction was filed with the SEC.

In a related transaction in connection with the refinancing, we terminated our interest rate swap contracts and replaced them with new ones carrying lower rates. This action further reduced our interest expense beginning in 2017, more on that shortly.

Here with me to discuss the results of the quarter and year, as well as our outlook for 2017, are Pinnacle CEO, Mark Clouse; and our CFO, Craig Steeneck. 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 in a meaningful comparison and appropriate basis for a discussion of our performance. Details of the excluded items are included in the reconciliation tables in the press release and are discussed in detail in our 10-K, which will be filed later today.

Before turning in over to Mark, I'd like to remind you that our discussion this morning may include forward-looking statements which are subject to the Safe Harbor provisions of the Private Securities Litigation Reform Act of 1995. These statements are subject to a number of risks and uncertainties that can cause actual results to differ materially and the company undertakes no obligation to update these statements based upon subsequent events. A detailed discussion of these risks and uncertainties is contained in the company's filings with the SEC.

With that, I hand it over to Mark.

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

Thanks, Maria, and thanks to everyone for dialing in so early this morning. As I wrap up my first fiscal year as CEO of Pinnacle, I'm delighted to report that we did so in a high-quality way and, perhaps even more importantly, we have a high degree of confidence in our outlook for another strong year in 2017.

Turning to a quick recap of the full year highlights for 2016, starting with the Boulder Brands acquisition. This acquisition was flawlessly integrated into the business within seven months, and acquisition synergies anticipated at the time of the transaction were delivered in 2016 and are tracking on plan for 2017. In addition, as communicated previously, we've identified an incremental $4 million to $6 million of synergies that are expected to

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benefit 2018. All-in, our original synergy forecast of $30 million has grown to $34 million to $36 million through 2018.

In addition, by bringing Boulder Brands into our successful MVP program, we have also made significant progress in driving ongoing efficiencies, which contributed to the business, doubling the EPS contribution in 2016 that we anticipated at the time of the acquisition. Another highlight of the year was successful marketplace performance. For the fifth consecutive year, we outpaced the performance of our categories, growing retail consumption of the legacy Pinnacle business by 2.7% in a category composite that was down. This strong performance, which was fueled by our Frozen segment and Birds Eye in particular, drove composite market share growth of 70 basis points.

We expanded our adjusted gross margin by approximately 120 basis points for the year, reflecting growth from the base business, fueled by the ongoing success of our productivity program and higher net price realization, as well as the benefit of the Boulder Brands acquisition. Modest input cost inflation and select business investments were partial offsets to these growth drivers.

We also continued to tightly manage our SG&A overhead expenses, which were slightly above 9% of net sales for the year, as expected, due to the higher overhead structure of the Boulder business. Interest expense, as expected, advanced to approximately $139 million, largely due to the financing associated with the Boulder Brands acquisition, while our adjusted tax rate was even with a year-ago at 36.6%. All of these factors taken together, resulted in a 12% increase in adjusted diluted EPS to $2.15 in 2016, placing us at the high-end of our guidance range.

Finally, our cash flow generation was outstanding in 2016, with net cash provided by operating activities totaling $488 million and free cash flow totaling approximately $387 million. Our consistent ability to generate strong cash flow enables us to use debt to make acquisitions and quickly pay it down. We've done this consistently after each of our acquisitions, including reducing our total leverage ratio this past year to 4.19 times versus 4.8 times at yearend 2015 pro forma for the January 2016 Boulder Brands acquisition.

Before turning to our segments, I'd like to provide some context on our strong Q4 performance. Specifically, our in-market results exceeded our expectations, particularly through the critical holiday season. This led to a higher overall top-line, but less favorable mix, given the seasonal demand for lower margin core vegetables at a time when competitive intensity was below what we had expected. This performance, along with tight SG&A management, drove EPS at the high-end of our guidance, albeit at a slightly lower gross margin than expected.

As we head into 2017, all aspects of our margin agenda remain on track and I would expect the composition of our performance to be more in line with our historical results, specifically, modest top-line growth, strong margins, tight SG&A management, double-digit EPS delivery, and strong cash flow performance.

Turning now to the segments, I'll cover the full year results, and Craig will discuss the fourth quarter details and our guidance for 2017. So, for the year, our Frozen segment continued to perform very well, with net sales growth of 5.6% and adjusted EBIT up 12.3%. The exceptional performance of our Birds Eye franchise and continued strength of Hungry-Man drove the growth, supported by double-digit retail distribution expansion for this segment. Lower sales of seafood, Aunt Jemima breakfast products, and Lender's bagels were partial offsets.

The strong Birds Eye momentum reflected broad-based growth across the franchise, with both the base business and innovation driving results. During the year, we launched 16 new Birds Eye varieties behind the flavorful protein blends and Disney-themed platforms. In the fourth quarter of 2016, we also launched in the limited

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distribution two new platforms, namely Birds Eye Veggie Made Rice side dishes and Birds Eye Signature Skillet Meals. Both new platforms are off to a good start and will be expanded nationally in the first half of this year. To ensure the continued momentum of the Birds Eye franchise, we are also launching five new platforms in 2017. We'll provide more detail on these as the year unfolds.

The continued strength of Hungry-Man was driven by solid base business performance and the addition of 12 new varieties during the year, 10 of which were new premium tier Hungry-Man Selects. In-market performance for the Frozen segment was also exceptionally strong, with retail consumption advancing 5.5% for the year and an impressive 9.5% for the month of December, with both periods fueled by the Birds Eye franchise. Similarly, market share for the Frozen segment advanced 1.2 share points in both periods.

Heading into 2017, although we expect another strong year for our Frozen segment, we do expect a slower start, given the exceptionally strong December consumption results we achieved and the shift of Easter from the first quarter to the second quarter. This unfavorable Easter timing is expected to most significantly impact the Frozen segment, given the nature of its portfolio. The 2016 12% growth and adjusted EBIT for the Frozen segment reflected the benefits of the net sales increase and strong productivity, partially offset by input cost inflation and investment behind the conversion to new Birds Eye stand-up packaging for our Steamfresh production lines.

Turning now to our Grocery segment. Net sales for Grocery increased 6.3%, largely reflecting the addition of the Smart Balance brand from the Boulder Brands acquisition and, to a much lesser extent, continued strength of Armour canned meat. From an in-market performance perspective, the Grocery segment outperformed our categories, which were under pressure in 2016, resulting in our holding composite market share for the year. Our Wish-Bone brand turned in a solid second half and a very strong December, as expected, following the introduction of the Wish-Bone E.V.O.O. and Ristorante Italiano premium-tier platforms introduced in the second quarter.

On the other hand, the Duncan Hines business was under pressure from continued category weakness and a heightened promotional environment in 2016, albeit somewhat improved in the second half of the year. Vlasic pickles and Mrs. Butterworth's syrup also posted modest year-over-year declines.

In 2017, we are expanding our Wish-Bone healthy oils platform, with the February launch of Wish-Bone avocado oil salad dressing in three varieties, adding to our presence in the premium segment of the category with on-trend healthier oils. We are also adding a new variety to our Ristorante Italiano platform.

Turning for a moment to our Duncan Hines baking business. As you know, the baking category has faced a number of structural challenges, including the decline in household size and consumer concerns regarding portion control, as well as aggressive competitive pricing at the low end of the category. Our strategy continues to be focused on innovating at the premium higher end of the category, rather than battling strictly on price at the low-end.

While Duncan Hines net sales and retail consumption were down for the year, we achieved a slight market share gain. This relative outperformance reflects the success of our premium-tier Perfect Size platform, which addresses both the decline in household size and portion control concerns. To continue the momentum of Perfect Size, we are launching Duncan Hines Perfect Size for one, a new 18 variety platform that is bringing unique innovation to the category. The line with varieties across all day parts is made with real, simple ingredients providing consumers an ultra-convenient solution that is baked in a coffee mug in the microwave in one minute. This new line, which will be available broadly by Q2 of 2017, has received significant retailer support and is expected to be highly incremental to Duncan Hines and the category.

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Finally, adjusted EBIT for the Grocery segment advanced 12.1%, largely reflecting the sales growth, strong productivity, and favorable margin mix resulting from the inclusion of the Smart Balance brand. Partially offsetting these positive drivers was input cost inflation. Before getting into the details of the new Boulder segment, let me provide some perspective on the Boulder Brands acquisition and the results it generated in 2016.

Net sales, as expected, totaled $470 million and the EPS contribution from the business came in well ahead of our initial acquisition forecast. The net sales performance included the anticipated impact from the SKU rationalization program we implemented in the third quarter of 2016. This program, which was designed to establish a strong foundation for the acquired business, eliminated approximately half of the SKUs, but less than 10% of net sales and minimal profit.

In-market retail consumption for the old Boulder segment, adjusted for the SKU rationalization effort, was up 5%, excluding Smart Balance. Including Smart Balance, retail consumption was even with a year-ago. We are now seeing the impact of the SKU rationalization program in the consumption data, particularly for our gluten-free brands. We expect this impact to be evident into the third quarter of 2017, as we lapped the previous strategy involving SKU proliferation and unprofitable retail distribution expansion.

Net sales of the new Boulder segment, which now includes the U.S. retail business of Udi's, Glutino, EVOL, and Earth Balance, as well as out of gardein, totaled $365 million for the year. Segment net sales of approximately $42 million in 2015 reflected the results of the gardein business.

Net sales for gardein continued to grow at a strong double-digit rate in 2016. To keep up with this growing demand, we are bringing new capacity online this quarter at our Hagerstown, Maryland plant that we acquired in August of 2015. We continue to believe that the growth of plant-based proteins represents a very significant opportunity, and gardein is poised as the leader in this space to benefit meaningfully. Adjusted EBIT for the Boulder segment totaled approximately $47 million in 2016 compared to the approximately $3 million in 2015, which reflected the results of the gardein business now included in the segment.

Turning to our Specialty segment. Net sales for Specialty increased 4.3%, reflecting the addition of the acquired Boulder Brands foodservice and private label businesses and growth of the gardein businesses now included in the segment. Partially offsetting these drivers were lower sales of private label canned meat.

As we've discussed with you previously, due to the heightened competitive bidding environment for the USDA stew business, our focus has shifted to optimizing Specialty's cost structure rather than chasing very low margin businesses. As a result, we expect some top-line pressure to continue into 2017, particularly in Q1, as we lap our last USDA stew bid of 2016. Nevertheless, we expect Specialty margins to improve versus year-ago throughout 2017. Adjusted EBIT for the Specialty segment of $35 million in 2016 was essentially even with year-ago, primarily reflecting the benefit of the Boulder acquisition offset by input cost inflation and lower margins in several of the legacy Specialty businesses.

To summarize, our overall results in 2016 were strong and we delivered performance for the fourth consecutive year that exceeded our long-term algorithm. Our results reflected a solid core business fueled by innovation and market share growth. Gross margin expansion and a continued lean overhead structure, all accelerated by the benefit of the Boulder Brands acquisition.

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Importantly, we also set the stage for another above-algorithm year in 2017, with expected EPS growth of 20% at the midpoint of our guidance range, including about $0.05 contribution from the new accounting treatment for stock-based compensation.

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 start with the results for the fourth quarter of 2016, as well as some full year highlights, and then transition to our outlook for 2017. Starting with sales, in the fourth quarter, our consolidated net sales increased 18.8% to $858.5 million, reflecting a 17.3% benefit from the Boulder Brands acquisition and higher volume mix of 2%, partially offset by lower pricing of 0.5%.

Our Frozen segment delivered another very strong quarter, with net sales increasing 7.8%, fueled by higher volume mix of 6.3% and a 2% benefit from the Canadian businesses of the Boulder Brands acquisition, partially offset by lower net realized price of 0.5%.

Net sales for the Grocery segment increased 7.1%, reflecting a 9.7% benefit from the Boulder Brands acquisition, partially offset by lower volume mix of 2.3% and lower net price realization of 0.3%. The acquisition benefit was due to the Smart Balance brand moving into this new Grocery segment.

The Boulder segment registered net sales of $97.4 million in the fourth quarter, compared to $11.8 million in the year-ago period, driven by the Boulder Brands acquisition and higher volume mix of 21.5%, which reflected the results of gardein.

Finally, net sales for our Specialty segment increased 4.1%, driven by the 9.6% benefit from the addition of the acquired private label and foodservice businesses of Boulder Brands, partially offset by lower volume mix of 4% and lower net price realization of 1.5%.

Now turning to adjusted gross profit. Adjusted gross profit in the fourth quarter increased 19.5%, with gross margin advancing 20 basis points. As Mark indicated previously, the margin came in lower than we expected due to significantly higher volume during December of our seasonally promoted products, particularly Birds Eye core vegetables.

For the full year, we delivered strong margin expansion of 120 basis points and we remain firmly committed to growing gross margin by 300 to 400 basis points through 2019.

Adjusted EBIT grew 19.6% in the quarter to $182.5 million, largely driven by the growth in gross profit. Interest expense for the fourth quarter totaled $35.6 million versus $22.4 million in the year-ago period, largely driven by the additional debt issued to finance the Boulder Brands acquisition and, to a lesser extent, the 25 basis point interest rate step-up on the pre-Boulder term loans.

Our effective tax rate in the quarter, excluding items affecting comparability, came in at 36.3% compared to 36.6% in the year-ago period. Adjusted net earnings increased 13.3% to $93.5 million compared to $82.5 million in the year-ago period, while adjusted diluted EPS advanced 12.9% to $0.79 compared to $0.70 in the year-ago period.

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On a full year basis, adjusted diluted EPS advanced 12% to $2.15 a share versus $1.92 in 2015. This growth included strong results from the Boulder Brands acquisition, which contributed approximately $0.11 of adjusted diluted EPS for the year, double the $0.05 we anticipated at the time of the acquisition.

Turning to cash flow, net cash provided by operating activities in the fourth quarter totaled $248 million compared to $162 million in the year-ago period, reflecting the growth in net earnings and a significant reduction in working capital. For the full year, net cash provided by operating activities totaled $488 million.

CapEx for the fourth quarter was even with year-ago at $24 million, and for the year CapEx declined $7 million to $101 million. As previously communicated, we also financed approximately $18 million of CapEx through capital leases to take advantage of the favorable interest rate environment during the year. Free cash flow at $223 million was up nearly $85 million versus Q4 last year. And on a full year basis, free cash flow grew more than $120 million to approximately $387 million.

Now turning to liquidity, at year end, our total debt was $3.2 billion, including $2.5 billion of senior secured loans and $700 million of senior notes. Cash totaled $353 million, bringing our total net debt to $2.9 billion and our net leverage ratio to 4.19 times.

Before turning to our guidance for 2017, let me provide some perspective on the refinancing that we completed earlier this month. Given the favorable term loan market and the current uncertainty regarding the interest rate environment, we refinanced our three term loans in what turned out to be a significantly oversubscribed transaction. That meaningfully reduced our interest expense, extended our maturity profile and enhanced our financial flexibility moving forward. Cash interest savings associated with the refinancing are estimated at approximately $50 million over the seven-year life of the new term loan, with approximately $22 million occurring in the next three years.

In addition, in a related transaction, we terminated the interest rate swaps we had in place and added new contracts at significantly favorable rates, fixing two-thirds of our variable rate term loan debt for 2017. This transaction resulted in incremental cash interest savings of approximately $23 million over the next three years. Taken together, total cash interest savings are estimated at approximately $73 million over the seven-year life of the new term loan, with about $45 million benefiting the next three years. We estimate that the one-time cash costs associated with above transactions will total approximately $34 million and will be treated as an item affecting comparability when recorded in Q1 2017.

As a result, our net interest expense outlook for 2017 has improved to approximately $123 million, pending final review of the non-cash deferred financing charges. We will update our outlook on the non-cash effect of these actions on our Q1 2017 earnings call.

And finally, in terms of our outlook for 2017. Starting with adjusted diluted EPS, taking into account the aforementioned refinancing actions and including the $0.05 benefit we expect from the change in tax treatment on stock-based compensation expense, we now expect adjusted diluted EPS in the range of $2.55 to $2.60 a share. At the midpoint of this range, this represents growth of 20% versus the $2.15 we delivered in 2016.

The impact of a later Easter in 2017 is expected to shift approximately $15 million of net sales and about $0.01 of adjusted diluted EPS from Q1 to Q2. We expect the lion's share of this impact to affect the Frozen segment and, to a lesser extent, the Grocery segment, due to the seasonal nature of those portfolios. Three extra weeks of Boulder Brands ownership added $22 million in net sales across the four segments and about $0.01 in adjusted diluted EPS in the month of January 2017.

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The benefit of the 53rd week to the entire company, including Boulder Brands, adds approximately 1% to the full year net sales and $0.03 of adjusted diluted EPS. This impact will be spread across all four segments during the fourth quarter of 2017. Input cost inflation for the year is estimated in the range of 2.5% to 3%. Productivity for the year is estimated in the range of 3.5% to 4% of cost of products sold. In addition, we expect Boulder Brands acquisition synergies of approximately $15 million that will benefit both gross margin and SG&A overhead expenses.

As previously mentioned, our outlook for interest expense, excluding items affecting comparability, has improved to approximately $123 million for the year, pending the aforementioned deferred financing review of non-cash charges underway.

The estimated tax rate for the year, including the benefit from the new accounting standards for stock-based compensation, is estimated at approximately 35%, with minimal impact expected in the first quarter and a meaningful benefit expected in the second quarter due to the first-ever vesting of awards in the company's long-term equity incentive plan established following the IPO.

The weighted average diluted share count for the year is expected to approach 120 million shares, and capital expenditures for the year are expected to be in the range of $120 million to $130 million, within our target of 4% of net sales.

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

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] And our first question comes from the line of Ken Goldman of JPMorgan. Your line is now open.

Kenneth B. Goldman
Analyst, JPMorgan Securities LLC

Q

Hi. Thank you. Mark, at the Investor Day, I think it's fair to say your tone was excited, right, about the potential for near-term M&A. Would you describe your outlook where your tone has changed at all? I realize we on the outside are not necessarily known for our patience, but I think some investors were hoping for a deal to be done, maybe almost expecting one soon after the Investor Day. So I just kind of wanted to get an update on your thoughts.

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

A

Yes, Ken, fair question. I would say my excitement and commitment to M&A as part of the strategy of the company remains very high. I think what I continue to be excited about is the fact that we're taking all the right actions to position the company to be ready, which is really what the message I was trying to land in December, especially as you look at where we landed on debt exiting the year and the position that we're in in the completion of the integration of Boulder. So I think – I would also say, I think that there will be movement in the industry this year. And I think with the optionality we have on both the health and wellness side, as well as on the iconic brand side, we're feeling great about the platform we've built, the position we're in, and the readiness that we have.

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So, I think as far as putting a calendar or a timeline to it, we have been very effective at being disciplined in our process and making sure that as we look at potential opportunities we're really clear on, are these accretive? Are they within or adjacent to our categories? Do they give us ones or twos in the categories, so we have good sustainability? And can we integrate them relatively quickly and move forward? And those criteria will remain the same, and I can just give you great confidence that we're vigilant and on the path, but I think, again, we've got to make sure that at the same time we're doing the right things to make the right choices for the future.

And again, underpinning all of it, and this is a message that we hit on in December and I think has been another one of the foundational pieces of the business, is we feel great about the organic plan of the business and having that strength gives us the opportunity to really be thoughtful about the next choice, but trust, we're ready and we're in a good position.

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

A

And, Ken, what I would add is, look, we've spent a lot of time getting the balance sheet ready for the future. We've delevered to below 4.2 times. We've refinanced all the variable rate term [ph] date (32:46) and modified the swaps. We've renegotiated the credit agreements, so we have a very flexible credit agreement going forward, which will be beneficial for M&A. We have a delevered balance sheet. We've got the capacity now if we were to move up to 5.5 times leverage, which is what our stated kind of top end of the range would be, to be able to do a $2 billion acquisition. So, certainly the balance sheet and cash flow is ready to go whenever the right deal comes up, as Mark said.

Kenneth B. Goldman
Analyst, JPMorgan Securities LLC

Q

That's helpful. A very quick follow-up from me. I realize you're not giving explicit quarterly guidance, but for the first quarter of 2017, you did talk about the impact of Easter. You highlighted maybe some weakness in Specialty versus some other quarters. Is the message really that you're just trying to give a bit of help in a more general sense or are you trying to be more specific that maybe the Street's estimate of, I think, $0.49 for the quarter is a little bit aggressive?

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

A

Well, Ken, I think the message we're trying to deliver is that there's quite a few moving parts in Q1. So, as we said in the scripted comments, we do expect a little bit of a slower start in Frozen, given strength of the consumption in December, also with the shift of Easter into Q2. All of that, more affecting the Frozen businesses.

Now, on the other side, though, we also have an extra three weeks of the Boulder business and a very strong pipeline on our Grocery portfolio. So I guess what I would say is the net or the balance of that is, we would expect Q1 to perhaps look a little more like our historical delivery, where we have modest top-line, we have a strong gross margin, good solid management, tight management of SG&A, and overall very good EPS.

Craig, anything to add on the...

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

A

Ken, what I'd say is, look, we feel highly confident about everything that we articulated relative to the gross margin agenda. So, productivity we feel good about. It's fairly evenly balanced throughout the year. We've put our

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inflation estimate out there at 2.5% to 3%, highly confident that productivity will be greater than inflation every quarter in the year. Everything that we drive in terms of margin-accretive innovation will continue. We'll try to eke out a little bit on net price realization including trade optimization as the year progresses. And then the overweighting of our leadership brands versus foundation brands, that will continue, and you'll see a robust return to margin improvement throughout the year.

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

So, I think if you take the net of that and you look at Q1, you know there will be a little bit of pressure there on the top-line, but I think good underlying fundamentals is the way I would say.

Kenneth B. Goldman
Analyst, JPMorgan Securities LLC Q

Thank you, both.

Operator: Thank you. And our next question comes from Bryan Spillane of Bank of America Merrill Lynch. Your line is now open.

Bryan D. Spillane
Analyst, Bank of America Merrill Lynch Q

Hey. Good morning, everyone.

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

Hi, Bryan.

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

Hi, Bryan.

Bryan D. Spillane
Analyst, Bank of America Merrill Lynch Q

Hey. So two quick ones for me. One just a follow-up to Ken's question on the M&A. Has the sort of uncertainty about tax policy and just government policy in general had any effect in your view on movement or is there a little bit of just sort of holding back in terms of that just because there's some uncertainty with regards to that? Then I have a second question.

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

No, I don't think so. I mean, certainly there's a lot of speculation on several of these variables. But the reality is, I think there continues to be an underlying momentum around the potential for further consolidation. And I think relative to this year and as we think about going forward, I'm not going to speculate on any particular companies, but I do think we will continue to see opportunities emerge this year, because I think it's part of where value creation can come from.

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And certainly from our standpoint, we remain very aggressively postured on that front, because we see the far bigger benefit of being able to better lever our platform as something that would certainly out-weigh what might be some of the nuances of how policy may evolve or change. So certainly, we'll be aware of it, but it's not slowing us down strategically, and I don't think it's slowing down a lot of the other players as well.

Bryan D. Spillane
Analyst, Bank of America Merrill Lynch

Q

All right. That's helpful. Thank you. And then just second question with regards to the full year for 2017. You've got good productivity, you've got an extra week in the fourth quarter. You have a lot more – I don't know – resources, I guess, to spend in this year to try to drive some more sales growth. So could you just kind of talk about, are you doing anything extra in 2017 to drive organic sales growth, given the resources you have, than maybe a normal year, just simply because you've got some extra sort of cushion to spend?

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

A

Bryan, I don't think philosophically we're going to change our approach to investment. I think we're very clear that what we want to be driving is profitable growth. We want to make sure that we kind of pay as you go as we validate strong ROIs. As we have said before, I do think as you look at the portfolio and as we talk about opportunity areas where we may have innovation, and we have a lot of exciting platforms coming out this year, I would think, and you should expect us to invest appropriately behind those businesses, we will continue to remain vigilant on the competitive front. If we feel we need to do the right things to protect our franchises, we will. And certainly, we will continue to try, as we always do, to create the right flexibility in our business to be able to make those decisions as the year unfolds. But I don't think you'll see a concerted effort to spend more in 2017, much more about us doing it behind the big initiatives and platforms we have or addressing particular competitive threats where we may have them.

Bryan D. Spillane
Analyst, Bank of America Merrill Lynch

Q

Thanks.

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

A

And, Bryan, we certainly feel with our 20% increase in EPS at the midpoint of the guidance range we've put out, we've taken that all into consideration. We've put in the $0.05 for the tax treatment on stock comp. We've put in improvement in the interest expense and interest rate from the refinancing. We've built in extra week in the fourth quarter. So that's all-in and incorporated into our guidance at plus 20%.

Bryan D. Spillane
Analyst, Bank of America Merrill Lynch

Q

Thanks, guys.

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

A

Okay. Thanks, Bryan.

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

A

Thank you, Bryan.

Operator: Thank you. And our next question comes from Andrew Lazar of Barclays. Your line is now open.

Andrew Lazar
Analyst, Barclays Capital, Inc.

Q

Good morning, everybody.

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

A

Good morning, Andrew.

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

A

Hi, Andrew.

Andrew Lazar
Analyst, Barclays Capital, Inc.

Q

Hi. I guess more of a high level question, but in the Grocery business, that's one that's been declining on an organic basis for some two years or so. I guess, what do you think are the elements of stabilizing the top-line in this business in the context of the multiyear gross margin targets? How do you think about, I guess, the required volume from this business to achieve the margin expansion target? And if your modeling continued volume declines, I guess, how do you think about offsetting the volume deleveraging that comes from that business? Thanks so much.

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

A

Okay. Thanks, Andrew. Well, certainly when you look at the Grocery business, the first thing that I would just say is that it is a portfolio. So you've got a pretty broad range of brands in there, and we know that some of the businesses and categories are a bit more challenged than others. So part of what we have been doing very effectively, I think, over the last couple of years is really focusing on where you can drive momentum and driving those businesses, while we look at what the right ways are to optimize some of the other businesses. So, if you think about, let's call it, the best moves so far in Grocery, I'd point to a couple of things.

One is, as we've looked at some of the categories that are challenged, we've continued to trade consumers up to more premium and higher margin parts of the business. So even though you may be dealing with some volume declines, the mix in some of these brands are in the portfolio is helping us continue to drive our margin agenda. You see that on the Duncan Hines business, and with the new launch of Perfect Size for one, we're really putting additional momentum and support behind that strategy.

I think on Wish-Bone, the same thing. Trading up to healthier oils with the original launch of E.V.O.O. and now the launch of avocado oil gives us a great critical mass now of higher margin, more premium products within a challenged category. And I think that core strategy of being able to find the right ways to bring news and relevance, and doing it in a margin-accretive way, is one of the important elements of navigating this category.

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I think the second thing is, and I've talked about this a couple times before, you're going to see, I think, a more concerted and deep-dive effort in making sure that we really understand all of the levers on these brands, making sure we are spending our trade in the most efficient way, making sure that our marketing is as hardworking as possible, and that we're spending it on the right things. So, I do think even where we are challenged, we have some opportunities to stabilize the businesses and create a little bit more predictable performance.

Now, all of that wrapped up, I think, is what we do to really work the brands in the businesses. In the backdrop, you heard me talk a little bit in December about this idea of vertical and horizontal costs. So, while we do that, we also need to cast that into a strategic plan with a proper amount of sensitivities on where the volumes will go and really make sure that we're looking across the portfolio at our network and optimizing it to get the best value and the best cost out of it, as well as looking at the individual facilities where we're making these products and making sure that we're staying on top of the optimal cost structure to run the volumes against the ambition or the plans that we have.

So, I think it's really a combination of those two things together, optimizing our execution and running the portfolio with good innovation, while looking at the supply chain and network behind it to really make sure that we optimize both those horizontal and vertical costs.

Andrew Lazar
Analyst, Barclays Capital, Inc.

Q

Great. Thanks very much for all that color.

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

A

Yeah.

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

Farha Aslam
Analyst, Stephens, Inc.

Q

Hi. Good morning.

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

A

Hi, Farha.

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

A

Good morning, Farha.

Farha Aslam
Analyst, Stephens, Inc.

Q

To think about the SKU rationalization that you started at Boulder, where are we in the process? And could you share with us some color on kind of the natural brands, EVOL, Udi's, gardein, what kind of growth should we expect from those brands?

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

A

Yeah. Well, let me give you – it's a good question. Let me give you kind of maybe a broader point of view on Boulder, and I'll try to hit each of those pieces as we kind of go through it. So, I think the headline for us is that we continue to feel very good about this business. We delivered the top-line in 2016 of $470 million. But more importantly I think than that is, we're starting to get a better sense of the potential of these brands. And as I kind of work through that portfolio, let me just start with the plant-based proteins and spreads, which continues to have significant momentum in demand. And with the strength of the gardein and Earth Balance brand, we feel very good about their ability to lead this trend that I believe is only going to build speed going forward.

And if you look at the results on the gardein business to-date, you see consistently we've been growing in the higher double digits and continue to do that. Our biggest challenge, as you know, has been to fuel that demand with supply. So, we're quite excited about Hagerstown opening up here very shortly and being able to use that as a tool to really ramp-up our support. Remember, the gardein business today is still at a very, very low household penetration, and with that growing demand from consumers, I think we're set up in a really positive way for that to be a growth engine.

I think the second big bucket is gluten-free, and I guess what I would start with there is a lot of discussion and debate around whether gluten-free as a category was a fad, was it going to fade. And I'm happy to tell you that as you look at the underlying dynamics in gluten-free, you continue to see very strong double-digit top-line, whether you're looking at IRI or whether you're looking at Mintel, you see very positive momentum, albeit down from where it was a year or two ago, but certainly very meaningful growth. I think in our particular case, this is where a lot of the SKU rationalization has been anchored. So, you are seeing a weaker performance out of our gluten-free businesses.

It's also a place where I would say the transition of the integration, which, as you know, sometimes creates a bit of a lull on the promotion and innovation side, has probably been most pronounced, because it's also the most competitive space right now within all of our Boulder businesses. So, as we come through the first half and as we work through SKU rationalization, which is really through Q3 – and just as a reminder, it was about half the SKUs, but below 10% of the revenue, and even less of the profit. So as we come through that, I think you should expect to see momentum building, especially on our gluten-free businesses, as we see some very compelling innovation and programming behind those businesses as we go into the back half and out of the year.

And then the final piece of the business is EVOL, which is very much about clean ingredients in Frozen, and I would tell you right now it is our fastest-growing business within Boulder. It is a combination of the fact that that transparent ingredient line and the relevance of that being moved into mainstream location and broader distribution is working very effectively. So I would expect to continue to see that business growing very quickly through the balance of 2017. So, a little bit of a broader answer, but maybe that helps everybody get a flavor for where we are on Boulder and how we're seeing the business unfolding into 2017.

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

A

And, Farha, with the re-segmenting that we did, the new Boulder segment, as we move forward into 2017, will have all of the brands that Mark just mentioned together in one unit. So the gluten-free piece, the plant-based protein with gardein, and EVOL will all be together in Boulder. So you'll be able to see full P&L associated with that.

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Farha Aslam
Analyst, Stephens, Inc.

Q

That's very helpful. And just as a quick follow-up on the Birds Eye brand. You noted that competition was less than you anticipated in that holiday period. What is your anticipation about competition for that brand going forward?

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

A

Well, I think what we would say is, we certainly take all of our competitors seriously. And I think as you look at competition in frozen veg and you look at some of the two-year kind of stacked trends and the comparables that they're going to be lapping, I would expect some positive performance there. And I think our strategy, though, will remain very much the same, where we will have the right balance between really staying on task and driving the long-term vision.

You heard us talk about five new platforms coming in the spring around the Birds Eye business to continue to fuel the overall movement from base just playing core to added value, trading consumers up, adding margin into the category and relevant news, building off of the successes we've had there, while also remaining very focused on store-by-store, customer-by-customer, making sure that we're in a competitive position.

So, I guess what I would say is, I would certainly expect that competition to continue to build and be there. And again, given what that underlying trend is, I think there's some positive opportunity. But I also think we remain in a very strong position as the leader in this category and we'll continue to operate and play that way.

Farha Aslam
Analyst, Stephens, Inc.

Q

That's helpful. Thank you.

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

Jason English
Analyst, Goldman Sachs & Co.

Q

Hey. Good morning, folks.

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

A

Hey, Jason.

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

A

Good morning.

Jason English
Analyst, Goldman Sachs & Co.

Q

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Thank you for letting me ask a question. Certainly, a nice refreshing message from you guys in context of what we've been hearing down here in sunny Florida at CAGNY so far [indiscernible] (50:11). I wanted to build off a couple of Farha's questions.

So first, I appreciate the color, the context and flavor you've given us on all the brand segment. Can you give us some numbers just to make sure expectations are in the right place? Any sense of the magnitude top-line erosion we should brace for until we get to the third quarter and come out the other side of SKU rationalization?

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

A

Well, I think the overall – so if you look at the more recent trends in Boulder and you take all of the components together, we're still in positive territory. Again, I'm talking new – Jason, I'm talking new segment now, so that has Smart Balance in the out and in the Grocery business. I know that can be a little bit confusing as we think about that. But within the overall Boulder business, if you look at the last 13 weeks or so, we remain in positive territory.

I think in general terms, that's where I would say we should expect to remain going forward. As you know, our longer-term ambition is to grow those accelerate brands that are in our portfolio, which is primarily the Boulder businesses plus Birds Eye, at a rate well above the averages of the company. But I do think as we navigate these first three quarters, I think you're going to see more modest growth.

Now, within the portfolio, what should you expect? I think there will be some stronger brands and some weaker performances in the near term. As I alluded to, although I feel really good about the category trends in gluten-free, I do think some of the greatest pressure, because of the combination of where the SKU rat is really focused in, where there is a lot of competitive proliferation right now, I do think you'll see gluten-free as probably the toughest comparables in the group, but I think the balance of the strength in some of the other pieces of the business, especially as Hagerstown begins to come online, I think you'll still see us in what I would call modest top-line with growing momentum as we go through the year and as we cycle out. Does that help a little bit more?

Jason English
Analyst, Goldman Sachs & Co.

Q

It helps a lot more. I appreciate that. And one more question on the Birds Eye side. I think I heard you say five platforms of innovation behind Birds Eye. If I'm wrong on that, I appreciate the correction.

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

A

No, you're correct.

Jason English
Analyst, Goldman Sachs & Co.

Q

Good. Good. So my question is, what does the platform mean to you? Are we talking new flavors, new forms, new occasions? Can you give us some context in terms of how outside of the core portfolio these platforms may be? And also, I appreciate why you don't want to give details yet, you want to give details as you're closer in launch. But can you give us a sense of sort of cadence? Because five seems like a lot in terms of platforms.

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

A

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It is, but I will tell you that we continue to believe that there is a potential for more material transformation in the category. As we still look out across frozen veg, you see a significant amount of redundancy, whether it's between – I've got five corns or four green beans, do I really need that many, to what I would call some me-too products that have followed us, that probably aren't at the right quality and probably not as necessary. So we continue to believe that there is opportunity for us to source space here. When we talk about platforms, what we're really talking about is the combination of a clear benefit with multiple SKUs around it, and it can be anchored in a particular occasion.

So if – let's take something like Birds Eye Signature Skillets that we launched at the end of 2016, or our [ph] Ricer (54:04) product that we launched at the same time. We would consider those platforms, right? You've got a handful of SKUs. You've got a really clear benefit in occasion that you're going after. And as how they will sequence, one of the things that's really been effective, and I think would make a lot of sense to you from a retailer standpoint, is this is not a category that's going to go through three, four resets a year. It goes through really one reset.

And so, as you line up your innovation, you really need to be in a position, even though you may be able to add a SKU or two, like we did at the end of the year, you really want to get your innovation locked and loaded ready to go around April. That's when the retailers change their sets and we want to make sure that we're there to set the full category for the balance of 2017 with our innovation in it.

Jason English Q
Analyst, Goldman Sachs & Co.

Got it, super helpful. Thank you, guys. I'll pass it on.

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

Okay. Thanks, Jason.

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

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

Hi. Good morning.

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

Hi, Chris.

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

Good morning, Chris.

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

Hi. Just had two questions for you. I want to make sure I understood on the gross margin improvement that you expect just going forward over the next three years. Is that mostly driven by – and I'm now thinking about 2017 –

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kind of the gap between productivity and cost inflation? Are there other kind of discrete benefits coming through maybe around Boulder that are helping drive the gross margin higher this year as well?

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

A

Yeah. So, let me kick it off and then Craig will – ask Craig to provide a little bit of color as well. But, Chris, if you go back to the presentation in the December timeframe and you remember how we laid out the gross margin journey, we basically said there's there big pillars of this, right? There is the MVP productivity pillar, there is the Boulder future contribution pillar, and then there is the NRP and mix.

And what we said was on orders of magnitude, we didn't give specific contribution, but the biggest contribution would really be from our MVP and cost program. Our next would be the contribution from Boulder. And albeit in an environment we're in today, a bit smaller contribution from pricing and some steady contribution from mix.

In addition – so that's – and generally, that's the flow that we would expect to happen over the three-year horizon that we've talked about. I think the one addition to 2017 that adds a little bit of momentum to that is the year two synergies on Boulder, and I'll let Craig kind of give you the lay of the land on that. But that's why you see a little bit of benefit from there. But generally, pretty steady across that framework that we created and walked through in December.

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

A

Yeah. So, Chris, what I would add to that is, look, if you're looking for 300 to 400 basis points over the next three years, that's an average of 100 to 130 basis points per year. What we talked about in December was that the 2017 year would be a bit outsized relative to that pace and, as Mark articulated, a big factor on that is, we generated $15 million of synergy benefit from the Boulder integration in 2016. Most of that was SG&A.

As you move and you turn the clock to 2017, we're going to generate an incremental $15 million, and that's split more evenly, say, 50-50 between gross margin and SG&A. So, you're going to get a bit of an additional kicker on the synergies and gross margin. And then as you start to roll out all of our MVP programs and the Pinnacle playbook against the Boulder base business, as we saw in 2016, you're going to continue to get improvement on Boulder for 2017.

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

A

I think, Chris, it's important that we don't – as we've talked before, giving greater levels of specificity in certain time periods on gross margin is probably not the most prudent way to manage the business. As you know, there will be things that will need some flexibility to make decisions on as we go along, but the general underlying fundamentals of our margin agenda, I think, very much in line with how Craig laid them out is how we're thinking about it.

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

Q

Okay. That was very helpful. Thank you for the color there. Just a quick follow-up to make sure I understand. You had a strong December period exit in the year for some of your core frozen vegetables, and it's something you expect to have a little bit of a softness to start the year. Is that just due to – were there inventory considerations there or just the [indiscernible] (58:56)?

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

A

Well, yes. Certainly, not retail or our inventory, but consumers and the consumption that occurred in that period of time really was a significant month. And so, we did a really – a nice job around the program. And as I said, little lighter competition than we had expected, which resulted in one of the higher growth rates that we've seen on the business, lapping a relatively high growth rate.

So I think what we're seeing is consumers that purchase quite a bit of core veg in December, and as we've seen January unfold, we've seen a little bit of softness. Now, I would say, though, that that softness is pretty industry-wide in January, very warm month, some other contributing factors that were there.

So I think what we're just suggesting is our shares continue to look really good, all the things that you'd want to see underlying health of the business, but probably a little bit softer start in January than we expected. We do see some stepping up in February. And again, the challenge will be of Easter later. So we'll just have to kind of navigate this quarter. And as I said before, the good news to that is, we've also got, I would say, one of the more robust grocery pipelines that we've had in a long time, and we will also be benefiting from three additional weeks on the Boulder business.

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

Q

Okay. Thank you so much for the time.

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

A

Thanks, Chris.

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

Kenneth Bryan Zaslow
Analyst, BMO Capital Markets (United States)

Q

Hey. Good morning, everyone.

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

A

Hi, Ken.

Kenneth Bryan Zaslow
Analyst, BMO Capital Markets (United States)

Q

Most questions have been asked, but I just wanted to touch on Wish-Bone. What's your ambition for that? I mean, it sounds like you are getting more success with E.V.O.O. and Ristorante Italiano. And in progression of this, have you found that the success with these products, that's giving you more confidence to go even further and deeper with this? Can you just talk about the long-term strategic initiatives with this business?

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

A

Yeah, absolutely. Well, let me just start by saying, we are very happy with the performance of E.V.O.O., but we do need to recognize that this is a highly competitive category. Lot of years in being a part of this segment and I know how quick the response is and how on top you have to be both the innovation and the base business side. And so, that's really going to be our strategy.

It's a combination of driving good fundamentals on the business. That means making sure that we're positioned well for key salad seasons, that we get good, strong usage strategies in place, that we have the right partners working with us to create more total solutions, and then use our innovation platforms really to help trade consumers up, bring some profitability, and really drive against very highly relevant spaces that are unique and new.

So I think, although we feel great about the innovation, it's important to remember, this is not an easy category and taking your eye off the ball on the base business at any point in time has to be part of our agenda as well.

Kenneth Bryan Zaslow
Analyst, BMO Capital Markets (United States)

Q

Great. Thank you.

Operator: Thank you. And that concludes our question-and-answer session for today. I'd like turn the conference back over to Ms. Sceppaguercio for closing remarks.

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

Thank you. I will be around all day today to take any additional questions that any of you may have. We're trying to be – keep tight on time, given we know you're all busy down there at CAGNY. So call me during the day when you have a chance, if you have any questions that we just couldn't get to in the hour. Thanks and have a good day, guys.

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

Thank you.

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

Thanks.

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

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