

Nomad Foods

Nomad Foods Limited

Second Quarter Earnings Call

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CONFERENCE CALL PARTICIPANTS

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PRESENTATION

Operator:

Good day and welcome to the Nomad Foods Second Quarter Earnings Call. Today's conference is being recorded. At this time I'd like to turn it over to Paul Kenyon. Please go ahead.

Paul Kenyon:

Good morning, good afternoon, everyone. Before we start I would, as always, draw your attention to the disclaimer on Slide 2. I do not propose to read it through, but ask that you do so in your own time. With that, I will hand you over to Stéfan. Stéfan?

Stéfan Descheemaeker:

Thank you and good morning, good afternoon, everyone and thank you for joining us on our second quarter 2016 results call. As you just heard, I'm joined today by Paul Kenyon, our CFO. I will start by saying that we continue to see some early positive results of our strategic (phon) execution. Our focus remains on 12 categories and discipline integration of Findus, and it's paying off.

We have three priorities in 2016: firstly, stabilizing sales by progressively slowing the rate of decline at the top line through the balance of the year; secondly, delivering on our synergy commitments from the Findus deal; and thirdly, pursuing consolidation of the European Frozen category. So, I'm going to take each of these points in turn.

So, firstly, I was really pleased to see a further slowing of the rate of decline in sales in the second quarter. We have now halved (phon) the rate of decline since the bottom of our—in Q3 in 2015 with only the early stages of our new strategy reaching the consumer. We look forward to the remainder of the year where we see the strength continuing as more elements of the new strategy line in the market. All

Teams are highly focused on what they can do to support the must-win battles ahead of the strategy rollout and have been extremely creative in refreshing all the advertising with up-to-date logos and pack (phon) shots.

As I noted in my comments last time, we have succeeded in reintroducing the Captain in six markets by the end of the first quarter, utilizing previous copy, and the response has been uniformly positive with increased levels of awareness amongst all consumers and improvements in the base rate of sales. As a result of this success, we've elected to reschedule the launch of the new Captain advertising to early 2017 and instead prioritize the launch of the new Vegetable copy from the third quarter of this year.

The must-win battles are the heart of our strategy, and while the vast majority have yet to be activated, we are beginning to see some encouraging signs. At the Q1 call I commented on the Italian Sofficini savory pancake business, which was reported by the oven crispy coating product renovation launch, backed by focus promotions reports and I'm pleased to report that this must-win battle remains in double-digit growth year-on-year for the first half of 2016.

In Germany, I highlighted fish recipes as a must-win battle on our last call, supported by the launch of a new variant plus advertising in free-gift promotion. Here we have again seen a year-on-year increase in quarterly sales, delivering first half growth of those products of 6.7%.

Another key must-win battle for the Group is Fish Fingers which saw a sales increase of 5.2% against Q2 last year. This was driven by the UK where we have adopted a more technical (phon) approach to promotion activity and Germany where we have additional promotion activity in two of our largest customers as we continue to refocus on our core product offering.

Moving on to margin performance, Adjusted EBITDA margin was 2.2 higher year-on-year, although I would caution that this was significantly impacted by our decision to delay advertising investments into the second half of the year behind new or refreshed copy. Cash conversion was also strong during the quarter and we remain on track to deliver the €200 million pre-restructuring and nonrecurring cash commitment in 2016.

Turning to our second priority, the integration of Findus continues to be a key focus and we have delivered approximately €9 million in run rate synergy so far and our integration process remains on track. This equates to around €2.25 million in the second quarter and €3 million year-to-date. As a reminder, our overall targets remains to deliver between €43 million and €48 million in 2018.

Our factory rationalization initiative is proceeding and we have successfully concluded the consultation process in Sweden. This project involves a very complex product transport process, covering over 400 SKUs, and while production has already started to transfer to all the sites in the Group, we now expect that the Bjuv site to cease operations in the first half of 2017, slightly later than originally anticipated, and Paul will update you with the timing implications of that change in his presentation. I'm pleased to say that we have now restored normal service levels in Sweden and the business delivered year-on-year growth in Q2 on the back of strong demand in the Food Service and Private Label businesses.

As a reminder, as I mentioned in my Q1 comments, we have generated some operation issues from the former owners of Findus, most notably regarding product supply in Sweden, which had negative impacts on sales during Q1. The total financial impact of those supply challenges in our Swedish business has amounted to around €8 million so far this year.

Regarding our third priority, we continue to see further acquisition opportunities and we believe we are well-positioned to execute both, both on synergistic acquisitions in European Frozen, as well as broader strategic transactions globally as a means of delivering value for our Shareholders.

With that, I will hand it over to Paul who is going to cover the financials in more detail.

Paul Kenyon:

Thank you, Stéfán, and good morning, good afternoon, everyone. Before turning back to the presentation, please note that the financial information represents pro forma as adjusted figures for 2015 and as adjusted figures for 2016. All figures have been adjusted for exceptional items, restructuring, and transaction-related items and all of my comments from hereon will refer to those as adjusted numbers.

Turning to Slide 5, we thought that it would be helpful to continue to fill in the quarter-on-quarter growth for the Group that we originally published as part of the CAGNY presentation. As you can see, with a 3.8% decline, the second quarter shows a step up in the rate of improvement quarter-on-quarter versus that seen over the prior two quarters where the decline slowed at about 1% each quarter from an 8% decline in the trough of Q3 2015 to a 7% decline in Q4 and a 6% decline in Q1 2016.

As Stéfán noted in his comments, we have succeeded in halving the rate of decline over the last three quarters and our expectation remains that we will continue to see a progressive improvement in the rate of decline through the balance of the year as the various elements of the new strategy start to impact the markets from the newer refreshed creative work airing from the third quarter onwards, or granted by the implementation of the new promotional tactics to the launch of the first wave of core renovation projects in the autumn cabinet reset, which will mainly impact sales in the fourth quarter.

Turning to Slide 6, we show the year-on-year performance for the second quarter of 2016. Net revenue was down €32.1 million or 6.6% year-on-year. Adjusting for currency impacts and the exit from Russia, the like-for-like decline was 3.8%, a 2.3% improvement on the rate of decline in the first quarter. As has been the case in the past few quarters, the decline in sales was driven by the Group's three largest markets, namely the UK, Italy, and to a lesser extent, Germany, although each of these markets again shared reduced rates of decline year-on-year compared to the prior quarter.

Gross profit declined €8.8 million, driven primarily by lower sales volumes. Gross margin improved by 0.2 percentage points, driven by a favorable pricing year-on-year, lower levels of trade promotions, and a reduction in input costs. A&P investment was €12.1 million, lower as the Group re-phased advertising spend to align with the anticipated launch of the new advertising from the third quarter onwards. Indirect costs were €2.1 million lower year-on-year due to synergy realization and the benefits from the Group's Lean Reorganization program.

The effective tax rate for the quarter was 23%, consistent with Q2 2015. Earnings per share increased by one euro cent year-on-year due to the increase in profit.

Slide 7 contains the comments that I have just made, so I will not repeat them here.

Turning to Slide 8, I will give a little more color on the sales performance. Adjusting for the exit from Russia and the slight weakening in the sterling and Norwegian krone rates gives a like-for-like sales comparator of €473.9 million. As I said a moment ago, the majority of the decline is concentrated in the UK, Italy, and Germany, so I will focus my comments on those markets.

The UK business declined 5.4% on a like-for-like basis in the quarter, an improved performance compared with the declines in both Q1 of this year and Q4 2015. The overall UK grocery market remains extremely challenging, with the frozen sector in decline. The top four retailers remain highly focused on price to regain the loyalty of value-seeking consumers for whom the hard discount has represented very real alternatives, with both Aldi and Lidl enjoying double-digit growth.

The UK business has taken active steps to enter new channels to reduce its reliance on the top four, which now accounts for 67% of the UK business, down from 69% in 2015, and to take a more balanced approach to in-store promotional participation. The UK Team reset base pricing on the Core portfolio to align with retailer strategies and this has been well-received by our trade partners. However, as we have said before, the UK remains the most difficult market given the structural changes underway in the grocery channel.

Italy was again the largest driver of the overall sales decline with a drop of 8.1% year-on-year, but this is an improvement on the decline seen in the last two quarters. As we've commented before, the economy and consumer confidence remain extremely fragile in Italy, which has impacted the Frozen Food market as a whole, with a 2.2% decline seen in the quarter, while Private Label grew by 2% in the same period. We continue to have an ongoing issue with hake fillets, which are still impacted by the industry-wide raw material shortage, and as a result, declined year-on-year. Excluding the impact of this, the must-win battles platforms are showing encouraging growth rates of 2.4%.

Within that, Sofficini pancakes continues to perform strongly in Q2 and Fish Fingers continue to consolidate thanks to the Captain Findus media support. Furthermore, we have seen good development in Peas, Soups, and Recipe Fish, all of which have benefited from stronger media promotion focus.

Germany declined by 3.9% year-on-year, which was a significant improvement versus the 9.2% decline seen in Q1. The market also declined by the same amount. The must-win battle strategy is starting to show positive results with both Fish Fingers and Fish Recipes showing growth rates year-on-year at 22% and 5.5% respectively, supported by a 360 degree marketing campaign. As I mentioned in Q1, our Vegetable sector continued to be impacted by private label competition, where the level of product differentiation is lower. A complete overhaul of the Vegetables assortment with supporting media campaign is planned for launch in Q4 2016 to combat this.

The results in the quarter were again influenced by the continuation of the customer specific issue, which resulted in no shipments being made for the second consecutive quarter. Although we believe that we have recouped some of the lost sales as loyal consumers have purchased our products in alternative retailers. The issue has been settled now and shipments restarted as of the beginning of July with a more favorable business model under smaller assortment.

The last bar shows the net impact of the remaining countries totaling €2.3 million. Included within this is growth in Sweden, driven mainly by the industrial and food service channels, offset by declines in Norway where strong price competition continued on natural fish for Netherlands, where aggressive pricing of private label continues, and Austria where the bankruptcy of a customer at the end of 2015 has impacted overall volumes.

Turning to the margin performance on Slide 9, we analyze the gross profit movement over year by key driver. Excluding the impact of exit markets and FX rates, our like-for-like gross profit comparator is €143.7 million. Working across the page from this gross profit comparator, volumes were down slightly less than net sales on a like-for-like basis, driving a reduction in gross profit of €6.4 million. The business also saw negative mix in the quarter, which impacted gross profit by a further €6.2 million. This was driven by the continuation of the hake fillet shortage in Italy which is an attractive business for the Group, coupled with the growth of industrial and food service channels in Sweden and Norway which typically deliver lower-than-average margins.

Pricing and promotional spend was €11.1 million better year-on-year, driven by the effect of implementing price increases to offset raw material inflation. Performance was also boosted by lower promotional spend, in part, due to the Group's net revenue program, but also impacted by specific issues in Sweden as a result of the product supply issues; Germany, as a result of the customer-specific issues, and Italy as a result of the shortage of hake.

Cost of goods inflation reduced gross profit by €2.6 million, driven by weakening of the euro against the US dollar, the operational issues in Sweden, and lower volumes which drove lower fixed cost recoveries. This was, in part, offset by lower distribution costs and favorable buying prices across the whole portfolio.

Turning to Slide 10, to the EBITDA bridge, the like-for-like EBITDA decline was driven by the impact of lower gross profits which has been more than offset by savings in advertising and promotional spend since the Group re-phased advertising investment to align with the anticipated launch of the new and/or refreshed copy. Indirects were also slightly lower year-on-year, driven by the reasons I highlighted earlier.

In terms of EBITDA margin performance, the business saw a 2.2 percentage point improvement year-on-year, driven by the delayed phasing of advertising this year.

Turning to Slide 11, we show the year-on-year performance for the first half of 2016. Net revenue was down €55.8 million, or 5.3% year-on-year. Adjusting for currency impact, the exit from Russia, an additional trading day in Q1 2016 due to the leap year, and the business acquisition of La Cocinera in Spain, the like-for-like decline was 5%. As has been the case in the past few quarters, the decline in sales was driven by the Group's three largest markets, namely the UK, Italy, and Germany, although each of these markets showed a reduced rate of decline year-on-year compared to the second half of 2015.

Gross profits declined €20 million, driven primarily by lower sales volumes. Gross margin declined by 0.3 percentage points, driven by an adverse mix and the dilutive effect of the La Cocinera acquisition, partly offset by favorable pricing, lower trade terms investment, and a reduction in input costs.

A&P investment was €15 million lower, as the Group re-phased advertising spend to align with the anticipated launch of the new or refreshed advertising from the third quarter onwards.

Indirect costs were €3.8 million lower year-on-year due to synergy realizations and the benefits from the Group's Lean Reorganization program. The effective tax rate for the first half of the year was 23%, consistent with the first half of 2015. Earnings per share decreased by two euro cents year-on-year due to the decrease in profit.

Slide 12 contains the comments that I have just made, so I will not repeat them now.

Slide 13 shows the pro forma as adjusted cash flow. The key drivers in the operating cash flow performance, aside from the EBITDA movement, are working capital, which showed an inflow of €13 million, primarily due to the usual rundown of inventory levels ahead of the agricultural harvests in Q3. The inflow was lower than the comparable period in 2015 as credits of balances were lower due to the advertising phasing change year-on-year. Capital expenditure continued to run us about €6 million per quarter as the Group again maintained tight controls of investment levels following the conclusion of the manufacturing footprint review.

Tax paid has decreased by €11 million due to refunds of tax in Germany and Italy of €3 million and €2 million, respectively. We also have lower phasing of payments in the first half of 2016 versus 2015. Our expectation for cash taxes in 2016 remains in the low €30 million, equivalent to an effective cash tax rate of around 19%. Restructuring and nonrecurring cash flows in the first half of 2016 of €32 million were largely driven by costs associated with the integration of the Findus Group, the implementation of the Nomad strategy, and the restructuring programs in a number of the Group's factories.

The operating cash flow conversion year-over-year for the first half was 99.5%, which was slightly ahead of the prior year and taking into account seasonal fluctuations which align to our strategic target of around

90%. The free cash flow pre restructuring and nonrecurring costs delivery of €140 million is consistent with our €200 million annual target.

To help those of you that are new to the Company, I should mention that we typically see cash outflow in the third quarter due to the annual agricultural harvests, which fall during that period. It is difficult to give precise guidance due to the fact that harvest quality and quantity can vary significantly year-on-year, on which subject unpredictable weather in 2016 has adversely impacted both our spinach and pea harvests. As a result of this poor weather, we now expect our harvest yields to be lower than previously anticipated; however, we are confident that we have enough peas and spinach in stock to minimize the impact of this on our customers and consumers, although we do expect some excess costs to hit our P&L associated with the factory efficiencies resulting from the poor harvests.

LTM, or rolling 12-month operating cash conversion, was lower than our typical level at 76% of pro forma as Adjusted EBITDA due to the dilutive impact of the Legacy Findus business. Our net leverage ratio was 3.6 times, which is 0.4 times lower than the December 2015 ratio of 4.0 times, driven mainly by an FX translation driven decrease in gross debt of €36.3 million and an increase in net cash of €87.5 million.

In terms of our cash guidance of €200 million pre-restructuring and nonrecurring, as Stéfan noted in his comments, we remain on track to deliver against that commitment. In terms of the restructuring and nonrecurring cash flows, the rephrasing of the product transfers from the Bjuv site may delay some of the restructuring cash flows associated with our project into 2017 and we will update you when the Product Transfer program is finalized. As a reminder, our guidance for restructuring and nonrecurring cash flows for 2016 is €120 million of which €50 million—5-0—relates to the Bjuv factory closure.

To help you in modeling the P&L, as Stéfan reiterated, our ambition is still to progressively slow the rate of decline in sales as we stabilize the business. We expect gross margins to hold up broadly in line with last year, with synergies in tight control of trade spend, offset the cost issues in Sweden inherited from the previous owners, and the expected incremental charges associated with the poor pea and spinach harvest. We still expect A&P spend to be broadly in line with 2015 levels while indirect costs are expected to be lower year-on-year as a result of synergy delivery, augmented by lower bonus levels due to the operational issues described above.

Translation impacts of currency are estimated to reduce EBITDA by around €10 million in 2016, assuming a rate of 117 (phon) for the balance of the year, leaving Adjusted EBITDA broadly flat versus 2015.

Lastly, I have had a number of questions regarding the impact of Brexit on the business and thought it would be helpful to repeat my comments here. There is obviously a translation FX impact as our UK earnings are worth less in euro terms based on current rates and I have just quantified that impact for you. There is also a transactional FX impact on raw material purchases, although this was hedged for the balance of 2016. In 2017, we will see an impact due to the depreciation of sterling versus the euro in the US dollar and the UK Team are currently assessing opportunities to pass this on to the consumer. Lastly, in the event of tariffs being imposed between the UK and the EU, it would be relatively simple to eliminate the current product close between our European factories and the UK by making a modest investment in our lowest of (phon) plant to make the UK self-sufficient.

With that, I will now hand you back to Stéfan.

Stéfan Descheemaeker:

Thank you, Paul. So, in summary, while the commercial market environment has remained challenging in Q2, we continue to believe that we have the right actions in place to stabilize the business and we are seeing some encouraging early signs that those strategies are working and expect to continue the progressive improvement seen in the second quarter.

As I said earlier, I'm encouraged that we have managed to half the rate of decline from bottom in Q3 of last year and are making steady progress on synergy delivery. The capability of the business on the cost and cash disciplines remains strong and we remain optimistic that we will be able to stabilize the sales line whilst maintaining a strong track record of margin and cash delivery.

The Nomad Team is coming together well and I'm extremely pleased with the level of collaboration across all of our businesses, as well as the determination of all our employees to deliver flawless execution of our strategy.

With that, I will turn the session over to Q&A. Operator, back to you.

Operator:

Thank you. If you would like to ask a question, please signal by pressing star, one on your telephone keypad. If you are using a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. Again, that is star, one, to ask a question. We'll take our first from Steve Strycula with UBS.

Steven Strycula:

Hey, guys. Nice revenue quarter. So, quick question for you on the revenue piece and then I have a margin question. So, for the revenues, you mentioned that we should continue to see sequential revenue improvement as we move through the balance of the year. I guess I would like to see you comment on twofold. First, talk about what proactively we should see, like underlying improvements in your businesses across key markets, stuff that is within your control; and then, secondarily, we'd like to hear what, like, nonrecurring headwinds are going away and should be no longer part of the revenue drive for the business, like the bankruptcy in Austria or factory service levels. Thank you.

Stéfan Descheemaeker:

Okay. So result we'll be able to see—and please, Paul, complement to what I could say—proactively across the board. As we said repeatedly, we have only started all the must-win battles and when you think about these must-win battles, which represent about 75% of all our business, you have different stages. You obviously have the promotion stage, you have the, let's say, the copy stage—and you heard that we're really going to start intensively in Q3. You have the renovation, which already have started, but it's really going to hit Q3, Q4, and then Q1 and later on in 2017; and obviously, as I said, the packaging side, which is really starting to impact again positively in the business start in Q3, Q4. So that's really under our control.

Just to give you an example, we're going only (phon) to start in the UK, so UK, for various (phon) reasons a bit more complex, is really starting a bit later than, for example, Germany. So that is really across—it's really under our control. What we have seen, let's say, basically must-win battle by must-win battle where we're activating the must-win battle, it's working. So that's pretty good.

The nonrecurring, let me take them one by one. We should see already in terms of supply in Italy. We had a hake shortfall, so it should really start Q3, Q4 to get back on track. Not on any recurring industry (phon), to your point, is the bankruptcy of one of the smaller change throughput (phon), which was around 5% of our business—5% of market share as well by the way—and so really starting next year, it should be a much easier comp for the Austrian business, which, by the way, is doing well.

So, that's—and obviously the service level in Sweden, at the end of the day, when you see—you can see our resilience (phon) of businesses because despite, quite frankly, during Q1, early Q2, some rather low

level of service, we've been able to manage the business in a very professional way. So now we're back on track, and as you have seen, and also despite the emotions caused by the closure of the Bjuv plant in Sweden, Sweden's from the top line level is delivering a very solid performance.

So that's—Paul, any complementary comments?

Steven Strycula:

Yes. No. That was real...

Paul Kenyon:

Just one. Sorry. Carry on.

Steven Strycula:

No. Go ahead, Paul. Please explain a little bit more and then I'd also like to hear any kind of sales velocity comments that you're seeing from some of these new recent must-win battles? Like, Stéfan how have your conversations evolved with retailers over the past year as you kind of correct some of the decisions that were made under the old strategy, and how are the retailers receiving the conversations and are they actually changing how they manage your product on the shelf space and where your placement is?

Stéfan Descheemaeker:

Okay. So maybe I will cover that piece and then, Paul, you will obviously complement what I said. In terms of sales velocity, again, it's a question, Steve, of common sense. All the retailers—and it's a growing trend—like simplicity, so they want to make sure that the shelves are not cluttered and that they have the right SKUs. So instead of coming with new initiatives, new, let's say, new product developments starting from a very low baseline, focusing obviously on the SKUs that work, which is somehow the essence of the must-win battle, is obviously something that is music to their ears, and that's what we've seen. Obviously negotiation with the retailer is always a process, as you know; it's always a battle, as always, but we've seen already despite a very difficult 2015, what we've seen is, yes, they like what they see, they like the simplicity, and they like the focus.

Paul Kenyon:

Okay. Then just to come back on your point about headwinds in the sales line, Steve, I think, being honest, with the European grocery channel as competitive as it is, we're always going to see small players fall out of the market, so you've got a kind of steady drip of those. We manage our business very carefully to make sure we don't get a big hit from it, but there are smart retailers who are either being taken over or falling over. You probably get one per half year, maybe two.

I guess the other comment I would make is, inevitably, we are in difficult discussions with at least one retailer across our whole European business at any one time. That's just the nature of the industry and it's part of normal business. It's unusual to be out of supply for two quarters as we were in Germany, but every so often you have to make a stand to manage your business in the right way. So I think those things I would characterize as part of normal course of business. A couple of the others we've called out probably aren't, so it's unusual for us to be in short supply across the industry as we are in Italy at the moment, and as I commented in our first quarter results call, we have set up a new supply, which will come online in the second half. So that probably is more unusual.

The other unusual one, obviously, is being off promotion in Sweden in the second quarter, which was a direct consequence of our announcement of the closure at the Bjuv plant. So, clearly that would be more one-off in nature because we don't regularly close plants.

So hopefully that gives you a bit more color behind the kind of headwinds we faced.

Steven Strycula:

Okay. Great. One last question and then I'll pass it on. Just wanted to get understanding; I think just to be clear, the EBITDA in euros for year-on-year is going to be roughly flat from the adjusted baseline pro forma of last year; is that correct? Two, can you kind of talk about the A&P spend shift that you guys are talking, discussing? What is the magnitude into the back half? I know you said A&P is going to be flat year-over-year, but just talk about the nature of the shift and how should we think about A&P spend going forward? Thanks.

Stéfan Descheemaeker:

My suggestion, Paul, if you could take the EBITDA question and then together we will cover the A&P shift.

Paul Kenyon:

Sure. So, yes, Steve, as you will recall in the revised 2015 pro forma numbers we put out in the Q1 results, we delivered €331 million of EBITDA, post currency, and that would be our current expectation for this year.

On A&P, the precise number we have re-phased—you know, we've spent €15 million—1-5—less in the first half of 2016 than we did in 2015. That was a decision that was subject to a lot of debate in the business, but it was felt that we needed to wait for the good copy and also to keep our pounder drawing (phon) until we had new products and new promotional tactics to advertise behind. So we felt that we would get a better bang for our buck by waiting until Q3, Q4 when we had a more complete strategy to invest behind.

But, Stéfan, perhaps you would like to build on that?

Stéfan Descheemaeker:

Yes. To be very clear, obviously there is no pushback from the center to spend less in terms of A&P, so it's really—we want to make sure that we're going to spend the right amount of money behind the right copies, so that's that. In the meantime, which is also an ongoing process, by the way, we keep optimizing the A&P, the nonworking side. We've just closed a deal with Zenith that will also obviously improve the nonworking side of A&P. But the number of GLPs (phon) is obviously very crucial for us and it's really one of the cornerstones of these must-win battles. So in each and every must-win battle over time needs to receive the right number of GLPs to obviously feed (phon) so it'll grow (phon) in the future.

Operator:

Again, that is star, one for questions. We'll move to our next from Jon Tanwanteng with CJS Securities.

Jonathan Tanwanteng:

Hi, Stéfan, Paul. Thanks for taking my questions. Aside from the currency impact, have you seen any other demand impact from Brexit and are you making any changes to how you purchase and process Fish in response to that, the currency headwinds there?

Stéfan Descheemaeker:

At this stage, no, we're not changing anything, so, quite frankly, the currency thing is more driven by—in terms of fish, by the way, it's more driven by the dollar, so it's not changing anything. We're not changing anything in terms of policy. It's mostly T-12 (phon) anyway.

Besides that, obviously, as Paul mentioned, in the future, we're going to adopt the UK more and more, so as to become some sort of less dependent upon obviously the currency impact, especially at the transformation level. Paul, anything else?

Paul Kenyon:

No. I mean, I think if I look at the pound/euro rate, it's—I've been in the business four and a bit years now and what I've seen rates range between 116 and 145, so we're still in the kind of range we've experienced and we didn't decide to move production when it was at 116. I think if we see sterling has settled at a much lower rate on a sustainable basis, that might change our thinking, but I think we'd like to see how things play out. The UK Government hasn't yet invoked Article 50. There seems to be plenty of time before that happens, so I think we'd like to see how the negotiations between the relevant governments pan out before we start moving production around. But we obviously keep it under constant review.

Jonathan Tanwanteng:

Okay.

Stéfan Descheemaeker:

Yes. The good news is that, let's say, footprint-wise we're reasonably well hedged between the different sides, between continental Europe and UK.

Jonathan Tanwanteng:

Okay. Great. Given the issues with currency, perhaps a more adverse harvest and various supplier retailers' issues, what's offsetting that and giving you the confidence in being able to deliver on that €200 million free cash flow target?

Stéfan Descheemaeker:

Well, there is a thing (phon). Let me start, Paul, and then obviously you will complement it. Synergies is one; obviously big, great focus behind indirect; but also, you may have seen that at the gross margin level, on this (phon) review program is starting to generate some very interesting results. Yes, little by little, as we said, moving from minus 8 to minus 6 to minus 3.8 to obviously an improvement in Q3, Q4, all these things obviously will—I mean, are making us more confident to hit a target that was mentioned by Paul.

Anything else, Paul?

Paul Kenyon:

Yes. I mean, I think we've always called out that the cash generation from the Legacy Findus business was at a much lower than the old Iglo business. While it's early days, we are working very hard to improve debt to management inventory control, and as you can see from the cap ex line, we really have a very, very rigorous control of cap ex, which is a discipline we've had in the old Iglo business for years. So I think we see still a route to deliver the €200 million and that's why we reaffirmed it today.

Jonathan Tanwanteng:

Great. One more for you, Stéfan; can you talk a bit more about the prospects for M&A today? Are they better or worse than they were in the previous couple of quarters and what have you seen change in that environment?

Stéfan Descheemaeker:

Again, at this stage, no, I will first and foremost—I will focus really behind Frozen Food in Europe. Let's say priority number one—and for the right reasons for us—was really first stabilize the sales line, the synergies. Now we're starting to get the—we're focusing more and more behind what could happen—and what we've seen is at least at the bolt-on level, there is a series of potential targets that could be available in the coming, let's say, quarters or years. Obviously—and you may know that I've spent a bit of my life in M&A—you need to be true (phon) to do this, so it's an unpredictable process, but at least we're starting to obviously to be more focused and be more proactive.

But, let's say—let's, again, focused on Frozen Food at this stage and I will cover the Non-Frozen Food later. On the Frozen Food you can see that you still have a lot of categories and countries where there are some opportunities for us, and we like it to complement to—when we have two must-win battles or three must-win battles in a country, to come up with a fourth one with the same kind of cost structure makes a lot of sense, and we're demonstrating with Findus that, yes, we can move obviously this margin from a reasonably low level to a level that is becoming acceptable to us.

That's that kind of model we like, moving from a pre-acquisition of something like—I'm just making it up, you know; don't take this as an indication—but 9 times EBITDA to something like 5.5, plus acquisition is a kind of deal that makes a lot of sense and we think that some, let's say, mid-size deal, that might be—it'll be available (phon) in the coming quarters and years.

Back to other bigger things, again, we're going to need to remain very disciplined. We've repeated the investment criteria that we set for ourselves in the past, starting from a very strong, obviously, position and Iglo was a great position, not a dominant position but definitely a leadership position, which was great; great people. So potentially, some, obviously, similar routines (phon) with Frozen Food might be helpful, synergies potential, very strong brands, so that's the kind of thing that we see. We're not going to lose sight, but obviously it's also which is (phon) something which is outside Frozen Food, but that could become available as well in the future.

Jonathan Tanwanteng:

Great. Thank you very much.

Operator:

We'll take a follow-up from Steve Strycula from UBS.

Steven Strycula:

Hey, guys. Just a quick follow-up. Stéfan, I would like to hear your thoughts given your background and your experience in revenue management. How those initiatives are tracking; what stage are you in, in terms of building a Revenue Management Team internally? At what point—I know it takes time to implement revenue management, but what could it do at what point, like is it a 2017 catalyst for the Company, is it 2018? How should Investors kind of think about that?

Then a follow-up question for Paul. On EBITDA margins, looking forward to next year, if you just exclude synergies, which will obviously be a benefit for the Company, is there an opportunity on a like-for-like basis to just make the business standalone basis more profitable from a margin perspective? Thanks.

Stéfan Descheemaeker:

So, to be very clear with your question, it's 2017; it shouldn't be 2018. So we definitely—we're starting to see some results already in 2016, but we're just scratching the surface at this stage. But 2017 should be definitely an important year.

Now, so back to revenue management, as such, revenue management is a very generic term that includes many different components. I would just limit myself to three at this stage. Each and every country within the Nomad Foods scope will receive targets in terms of conditionality. So, obviously, the more conditional it is, the better it is in terms of trade terms with the retailers. That's one thing. You have very different situations from one country to another, from one retailer to another, so it's really something—it's something that is something we need to develop year-after-year. So that's one thing.

Second is obviously to make sure we have retailer-by-retailer store-by-store—the must-have assortments. It could be must-have assortments for the hypermarkets, it could be for supermarkets, it could be for convenience. So, but that's the kind of discipline that's going to be ours (phon) and we have the data that proves this.

Last, but not least—and it's really going to hit positively the results in 2017—is when you go through the daytime, you need to have the right transparency for this. You'd be surprised by the number of promotions that are just useless and sometimes even negative for both, and for both the retailers and for us. So this is something that we're tracking. We bring the right level of visibility right now. We're investing behind this with some service providers and then, again, we're going to provide—to come up with targets country-by-country.

So that's the kind of program starting 2016, generating results over the early 2016, but bigger—I mean, more to expect in '17, '18, '19.

Paul Kenyon:

Then taking your question on EBITDA margin, Steve, I mean, obviously we have a well-honed continuous improvement program that rolls over year through our supply chain. Stéfan has just talk to the net revenue management and then he talked earlier to our efforts to squeeze the maximum benefit out of A&P. I think in organic terms, x synergies, whatever we throw off, we would much rather at this stage reinvest into A&P because we think with the must-win battle concept we have something that really could drive sustainable progress for the Company, and I guess we would prefer to invest more behind that to give it a real chance of success than drop it to the bottom line at this point.

But, Stéfan, you may want to build on that.

Stéfan Descheemaeker:

Well, I think you mentioned all the right things. That's why we said, obviously we want to see progress behind indirect; that's very clear. But within A&P, obviously you need to make the difference between the nonworking cost, and on that one we'll keep the same kind of discipline, but at the same time, we need to reinvest behind our brands, behind our must-win battles, and, yes, I think, obviously a number of GLPs per category, that's pretty fundamental and so we still have some further investments to make, to make sure that we have the right level, and we're not going to compromise on that.

Operator:

We'll take our next question from Brian Holland with Consumer Edge Research.

Brian Holland:

Thanks. Quick housekeeping question, if I could just start. Just thinking about the back half of the year briefly—and I apologize if you've addressed this earlier—we're looking at sequential improvement. Can you kind of help us think about the cadence for that? You've got easier comps in the back half, you've obviously got some staggered initiatives rolling in and benefiting. If we think about the kind of sequential improvement we've seen about the last three quarters, is it the same kind of pace of improvement? Are there reasons why it should be slower or maybe accelerate faster?

Stéfan Descheemaeker:

I will pass this question to my CFO, Paul.

Paul Kenyon:

Thanks, Stéfan. Yes. I mean, we've always said it was difficult to predict precisely how fast the new strategy would impact given the range of markets and the range of products in the must-win battle categories. Clearly we've delayed advertising spend in the second half of the year to ensure that we really get more for the bang and it's very difficult to predict how fast those products in those markets will respond. So I guess we were heartened to see that in Q2 where we've managed to get old copy of the Captain back on air with refreshed logos and refreshed pack shots that we have seen a bit of a pickup in the business, over (phon) rates of improvement. So I think our ambition is still to deliver quarter-on-quarter improvements.

While I understand the point people make about soft comps, it's easier to lose consumers than gain them in this channel in Europe, so I wouldn't underestimate the challenge we face in getting the business back to stable, but currently we feel in reasonable shape after Q2.

Brian Holland:

Got it. Thank you. Then if I could just circle back on your M&A comment, you've obviously talked about—and I appreciate that you're focusing on the day-to-day and where your priorities are with stabilizing the core and integrating Findus—but, again, looking forward on the M&A, and you've sort of talked about Europe. I guess, can we just maybe get some commentary about the North American market; how you're thinking about that? I know it's been out there as a potential for you. I know it may be a longer-term initiative, but maybe how you would think about that or prioritize in continuing to roll up (phon) Europe, which seems like it may be a smaller opportunity as opposed to maybe building a platform in North America. So if you could maybe provide any updated thoughts you have about that.

Stéfan Descheemaeker:

Okay. Let me—number one, Food overall and Europe and North America, the Food market is reasonably fragmented and I think we could say the same for North America. So, as a result, starting from strong platform and, obviously, a bolt-on acquisition process later on should create value. So there are obviously other categories that we should contemplate in North America. I don't think we should limit ourselves to Frozen Food because quite frankly the Frozen Food synergies between North America and Europe are quite limited. Obviously you have best practice, and some scale, but very limited. So that shouldn't be the criteria. So the criteria remains the same and then we know that we have some interesting targets. Same thing: starting from very strong brands.

Obviously if you're starting from a new category, you need to make sure that you have the right management, something we narrated (phon), and at the end of the day, with Iglo and with Findus, but definitely with Iglo as a starting point, and, obviously, a market where we have a leading position. So, with that, I don't think you can afford to go to something which is too small in the US because if it's too small, as such, probably even starting from the right starting position, reasonably leading position that something—the kind of things we had with Iglo.

So, don't expect something like a bolt-on in the US or necessarily something in Frozen Food, but expect something that responds to the same criteria as the one that we had described and used for Iglo. But there are different categories that fit the bill.

Operator:

At this time I'd like to turn it back to Management for any additional or closing remarks.

Stéfan Descheemaeker:

Okay. So, with that, again, as you said, let me finish by—thank you all for attending the call today. While I take encouragement from progress made on implementing our strategy so far, as Paul said and as I said, there is still much to do and we remain focused on the key objectives for the year. First, is to stabilize the top line; secondly, to deliver the predicted (phon) synergies; and thirdly, pursuing a highly synergistic deal in European Frozen. So, Paul and I look forward to seeing many of you in the US in the coming weeks, in Boston most specifically.

With that, I wish you a good day and hand back to the Operator.

Operator:

That concludes today's conference. We thank you for your participation. You may now disconnect.