Nomad Foods Limited

Second Quarter 2018 Earnings Conference Call

August 9, 2018

CORPORATE PARTICIPANTS

Taposh Bari, *Head of Investor Relations*

Stéfan Descheemaeker, *Chief Executive Officer*

Samy Zekhout, *Chief Financial Officer*

CONFERENCE CALL PARTICIPANTS

Bill Chappell, *SunTrust Robinson Humphrey, Inc.*

Robert Moskow, *Credit Suisse*

Steve Strycula, *UBS Securities, LLC*

John Baumgartner, *Wells Fargo*

Rob Dickerson, *Deutsche Bank Securities*

Jon Tanwanteng, *CJS Securities, Inc.*

PRESENTATION

Operator:

Good day, ladies and gentlemen, and welcome to the Nomad Foods Second Quarter 2018 Earnings Conference Call. Today's conference is being recorded.

At this time, I would like to turn the conference over to Taposh Bari, Head of Investor Relations. Please go ahead, sir.

Taposh Bari:

Great, thanks so much. Thank you all for joining us to review our second quarter 2018 earnings results. With me on the call today are Chief Executive Officer Stéfan Descheemaeker and Chief Financial Officer Samy Zekhout.

Before we begin, I would like to draw your attention to the disclaimer here on Slide 2 of our presentation. This conference call may make forward-looking statements that are based on our view of the Company's prospects at this time. Actual results may differ due to risks and uncertainties, which are discussed in our press release, our filings with the SEC, and this slide in our Investor Presentation which includes cautionary language.

We will also discuss non-IFRS financial measures during the call today. These non-IFRS financial measures should not be considered a replacement for and should be read together with IFRS results. Users can find the IFRS to non-IFRS reconciliations within our earnings release and in the appendices at the end of the slide presentation available on our website.

Lastly, please note that certain financial information within this presentation represents adjusted figures for 2017 and 2018, and that all adjusted figures have been adjusted for exceptional items, restructuring, share-based payment and acquisition-related items, and that all comments from hereon will refer to those adjusted numbers.

With that, I will hand the call over to Stéfan.

Stéfan Descheemaeker:

Thank you, Taposh, and thank you, everyone, for joining us on the call. Earlier today, we reported solid second quarter results, which further reinforces our commitment to driving sustained shareholder value through a combination of organic growth and disciplined M&A.

During the second quarter, we reported organic revenue growth of 1.3%, 80 basis points of adjusted gross margin expansion before the mix effect from M&A, adjusted EBITDA of €89 million and adjusted EPS of €0.28 per share, representing 22% growth versus the prior year. Strong year-to-date performance, visibility into the rest of the year and the closure of the Aunt Bessie's acquisition are leading us to raise our guidance. For the year, we now expect EBITDA in the range of €365 million to €370 million and EPS in the range of €1.14 to €1.17 per share. This represents estimated EPS growth in the range of 15% to 18% versus the prior year.

Turning to Slide 4, the underlying drivers of second quarter performance were very much a continuation of what we have seen now for the past 18 months. Organic revenue growth of 1.3% was driven primarily by price, as volumes were held back by two discrete factors: an earlier Easter which shifted approximately 1% of growth from Q2 to Q1, and unseasonably warm temperature across most of Europe. Despite these factors, organic revenue growth for Q2 was squarely within our low single-digit organic revenue growth algorithm, reflecting the strength of our business model and solid execution by the team. Adjusted second quarter EBITDA of €89 million euro was driven by better than expected gross margins and the phasing of operating expenses. Samy will cover both in more detail in his remarks.

Moving on to M&A, we're making good progress on both of our recent acquisitions. Goodfella's, which we closed in late April, has performed well in the three months since we acquired the business, and as I mentioned, we closed on Bessie's just a few weeks ago. We have a robust plan and are excited to integrate both teams into our organization. The acquisitions of Goodfella's and Aunt Bessie's advances the scale and breadth of our European portfolio, which is anchored by the iconic Birds Eye brand. The U.K. has had one of the strongest organic growth profiles in our portfolio in both Q2 and the first half, reinforcing our confidence in this large and strategic growth market. Furthermore, we believe the sum is greater than the parts and integration will enhance the whole of our U.K. operations in the coming years.

Turning to Slide 5, as most of you know, much of our financial success can be attributed to improved execution and renewed focus around our core. During the first half of 2018, we reinforced our market leadership in frozen fish by launching our new Captain campaign in several countries in Q1, and following up with our Crispiest Ever Fish Fingers in Q2. These investments have paid off with sales of fish fingers and frozen fish, our two largest Pan-European sub-categories, of 4% and 5%, respectively, through the first half of 2018.

Renovation is an ongoing discipline that we will continue to stress in the coming quarters and years, given our desire to raise the bar even further on our core SKUs. With that said, you will begin to see a greater balance between renovation and innovation beginning the second half of 2018. Our innovation agenda will build on the strong foundation we have created through relentless focus on our core categories. Taking vegetables as an example, our brands have strong market share positions across their respective countries. However, the majority of leadership in the vegetable category today is still within frozen peas and spinach, which combine to account for more than 50% of our vegetable business. While we also sell a range of mixed vegetables, we believe we have an opportunity to leverage our brand and unique capabilities to significantly expand this part of our portfolio.

Slide 5 illustrates some of the most exciting vegetable innovations that we plan to bring to market in the back half of this year. Included on this slide are: Veggie Power, an exciting new twist on vegetables boosted with healthy grains; Pulses, a breakthrough blend of ready-to-cook vegetables, high in protein and fiber, and a great alternative to canned vegetables; PEASE, a new line of plant protein products launching in Sweden; and Veggie Bowls, a range of modern vegetable-based, single-serve meals. You've heard us say that we believe that frozen food has more to offer as a category. Q3 marks an exciting new chapter for our Company as we begin to pursue exciting white space opportunities that we see in the market.

Slide 6 gives you a little more flavor for what to expect from us on the innovation front. We recently began the activation of Veggie Power in Portugal as part of a multi-country launch. We'll be rolling this line out to a few other markets, notably, Germany in the third quarter. The early reads in Portugal are very encouraging and set a strong precedent for other countries to deliver against. As you can see, we have an exciting slate of new and on-trend product introduction in the second half of this year, with much more to come in 2019, so stay tuned.

To summarize, we are pleased with the progress which we're making against our strategic agenda with the first half of the year now complete. Through the first six months of 2018, we've reported organic revenue growth of 2.1%, Adjusted EBITDA growth of 14% and EPS growth of 31%. These figures are tracking ahead of initial 2018 guidance that we provided back in March. With that said, there is still work to be done. We have an exciting and ambitious agenda ahead of us in the second half between the integration of two acquisitions and the launch of our exciting innovation pipeline. We've been working hard to get to this point and look forward to continuing the momentum that we have demonstrated for the past seven quarters.

With that, I will hand the call over to Samy to discuss our financial results in more detail. Samy?

Samy Zekhout:

Thank you, Stéfan, and thank you all for your participation today.

Turning to Slide 7, I will provide more detail on our key second quarter operating metrics, beginning with revenues, which increased 6.6% to €488 million euro, driven by 1.3% organic revenue growth and 6.4 percentage points from the recent acquisition of Goodfella's, which we closed on April 23. Foreign exchange translation offset revenue growth by 1.1 percentage point.

As Stéfan mentioned, organic revenue growth of 1.3% was primarily driven by prices, as volumes were impacted by the shift of Easter into Q1, and unseasonably hot temperatures throughout the quarter. Once again, the U.K. was a key driver of growth, up 3.6% in Q2. This marks the fourth consecutive quarter of organic revenue growth in this market, which is being fueled by strong execution of must-win battles and distribution gains. Other key contributors during the quarter were Germany and France, both of which grew 4%, and Norway up 8%. Sweden declined 4%, reflecting our continued focus on driving improved EBITDA and margins in this large and under-earning market. The team has made good progress against their plans this year, margins have improved significantly, and the Company remains on track to rebuilding its economic model in what is one of the fastest and most attractive frozen food countries across our network.

Moving on to adjusted gross margins, which were flat versus last year at 31.5%, but expanded 80 basis points before the effect of mix from the Goodfella's acquisition. Gross margins were ahead of our expectation, mainly due to promotion optimization and favorable procurement benefits. Overall, legacy gross margins were helped by 70 basis points from mix, 100 basis points from price and promotion, and were offset by 80 basis points from higher cost of sales and 10 basis points from FX translation. M&A mix was an 80-basis-point offset to adjusted gross margins for the legacy business. We continue to expect gross margins to be in the range of 30% to 31% range in the second half, driven primarily by M&A mix, given Goodfella's lower gross margin profile.

Moving down through the rest of the P&L, adjusted operating expense increased 2% year-over-year, with operating expenses in A&P declining 1%, due primarily to phasing out of Q2 into Q3, and indirect expenses increased by 4% due to the acquisition of Goodfella's. Adjusted EBITDA was €89 million euro, representing a 12% increase versus the prior year. Adjusted EBITDA margin expanded 90 basis points to 18.2% for the quarter. Adjusted EPS was €0.28 euro cents for the quarter, an increase of 22%, reflecting higher EBITDA, lower interest expense and share repurchase in the prior year.

Turning to cash flow on Slide 8, we generated €104 million euro adjusted free cash flow throughout the first six months of the year, which equates to operating cash flow conversion of 70%. Factors contributing to free cash flow through the first half of 2018 are as follows: Adjusted EBITDA of €192 million euro, which grew 14% year-on-year; working capital was a €48 million offset due to a combination of phasing and acquisitions; capex was €9 million during the quarter, beating last year, due to the anniversary of machinery and equipment purchases related to the Findus integration; cash taxes were €9 million; and finally, cash interest and other were €22 million. In summary, we remain committed to generating strong free cash flow and expect cash flow conversion to be close to our long-term annual target range of approximately 90% by year end.

Turning to Slide 9, on 2018 guidance, which is based on foreign exchange rate as of August 8, 2018. Based on our year-to-date performance, visibility into the rest of the year and the recently closed acquisition of Aunt Bessie's, we are raising our full year 2018 guidance. As a result, we now expect 2018 Adjusted EBITDA in the range of €365 to €370 million euro and adjusted EPS in the range of €1.14 to €1.17 per share. When translated into U.S. dollars, the currency in which our shares trade, adjusted EPS guidance equates to a range of $1.32 to $1.36 US dollar per share.

Full year guidance continues to be based on an underlying assumption of low single-digit organic revenue growth. Based on current exchange rates, we expect FX translation to represent approximately 50 basis points of drag on reported revenue in the third quarter and 90 basis for the full year. Our updated full year guidance includes expected contribution from both Goodfella's and Aunt Bessie's. And for the year 2018, we expect both businesses combined to contribute approximately €150 million in revenue and €20 million of EBITDA. For Aunt Bessie's, this implies €60 million of revenue and €10 million of EBITDA for what will, effectively, be six months of ownership during 2018. For Goodfella's, our guidance continues to assume €90 million of revenue contribution and €10 million of EBITDA for the eight months of ownership during 2018. On operating expense, we expect a significant increase in A&P in Q3 due to the phasing out of Q2. Based on the timing of expenses and the seasonality of the two acquisitions, we expect second half EBITDA growth to be heavily concentrated in the fourth quarter.

That concludes our remarks. I will now turn the session over to Q&A. Thank you. Operator, back to you.

Operator:

Thank you. Ladies and gentlemen, if you would like to ask a question, please press star, one on your telephone keypad. If you're on a speakerphone, please pick up your handset and make sure your mute function is turned off to allow your signal to reach our equipment. Once again, that's star, one.

Our first question will come from Bill Chappell with SunTrust.

Bill Chappell:

Thanks. Good morning.

Stéfan Descheemaeker:

Good morning.

Samy Zekhout:

Good morning.

Bill Chappell:

Stéfan, could you just talk a little bit more—I guess, trying to understand the new product launches and some of the recent acquisitions, I guess why you've chosen kind of these markets for the launches first. Then, on the acquisitions so far, it's all really come in the U.K., and so just trying to understand, as you look out on the pipeline going forward, is there a reason why it's been more and more U.K.-based or are there other opportunities outside the U.K.?

Stéfan Descheemaeker:

Okay, let me start with the product launches. As I mentioned, we started in Portugal. It's very simple. Portugal is a great country, it's one of our best countries. It's also representative of what the other countries could do, so it's a good pilot for us, and so it gives a very good signal to the other countries what they could do with the product. So, that's as simple as that. More fundamentally, what happens is, you know, what you see, what you do is—you're presenting the different NPD's, so the new products to the different countries, and you see the kind of appetite they have, obviously, for one versus the other, based, obviously, on the must-win battle, as well. That's very much an opportunistic process, but at the same time also very disciplined, so it's interesting to see how it works, but it's working well.

Back to M&A, Bill, I'll be very simple. What we do is—obviously, we're very disciplined in terms of where we want to invest, and then the rest is—as usual in M&A, it's opportunistic. In other words, when the guys are ready, obviously, it's something we can do. So, we've worked very hard and for a long time behind these two targets, among others. There are other targets in other countries, but these two came to the market at some stage. The good news is we are definitely the consolidator of the frozen food industry, and so somehow, naturally, a lot of these deals will come to us first. That's the great news. But, we will not limit ourselves to the U.K. However, U.K. is a great market for us. It's very well managed by Wayne Hudson. The U.K. execution is very good. So, they can digest both, you know, the focus behind must-win battles, and at the same time, obviously, the execution of these two countries. As an example, today, actually, we had the presentation of the products from the Aunt Bessie's guys, so very interesting. They fully understand the must-win battle concept and I'm very confident it's going to go well.

Bill Chappell:

Got it, thanks. Samy, just to follow-up, I think at the end you said that EBITDA growth would be more weighted towards the fourth quarter versus third. I think I understand the rational behind that, but can you just give me a little bit more color?

Samy Zekhout:

Yes, it's primarily driven by the fact that we are going to step up our investments in A&P. There's a pretty significant phasing from Q2 into Q3, which is, effectively, bringing Q3 down, and Q4 is coming across as a very strong contributor over the second half. And plus the fact that, particularly, Aunt Bessie's is starting to contribute, particularly, in the second half, towards the end of the year, given the fact that this is a seasonable business, as well.

Bill Chappell:

So, you'll have some of the revenue from these new product launches, but just it'll be heavily supported with marketing this quarter versus the fourth quarter?

Samy Zekhout:

Yes, there will be increasing support behind the products, but behind, as well, the base business, we're going to be launching the Captain campaign, as well, over Q3, which has been reflected in the A&P spending, and plus the fact that, as I had mentioned, there is a factor of seasonality that will help disproportionate Q4 versus Q3, as well, with Aunt Bessie's.

Bill Chappell:

Got it. Thanks so much.

Stéfan Descheemaeker:

No problem.

Operator:

If you find that your question has been addressed, it's star, two to remove yourself from the queue.

We'll now hear from Robert Moskow with Credit Suisse.

Robert Moskow:

Hi, thank you. Just for a little bit of context for those of us who are kind of new to the name, the EBITDA guidance raise year to date, is that exclusively for the impact of the acquisitions or has there been any change this year for the base business, as well, and then I'll have a follow-up? Thanks.

Samy Zekhout:

It's reflecting—we clearly had raised our guidance last time to, let's say, bring the range towards the higher end of the range, and then now, what we've done is we've added only Aunt Bessie's to the total.

Robert Moskow:

Okay, all right, good. Then, regarding the innovation that you're launching, can you give us a sense of, like, are there competitive products similar to these already on the market in Portugal or in your other markets? How new is this to the consumer? We're familiar with a lot of these ideas just watching the U.S. competitors, but I'm not sure how the European consumer views these kinds of things. What's really breakthrough for the European consumer?

Stéfan Descheemaeker:

Robert, it all depends on the countries. Some countries are very much at the vanguard of food, and I would take the example of the Nordics, probably even ahead of what the U.S. is doing, where others—for example, Portugal, the Veggie Bowls, it's very new for them, it's very new. So, most of the time we are the vanguard, but at the same time private label is there and sometimes they are also doing very well. We're also starting this PEASE thing, as you know, which is plant protein based on peas. It's great, but we're not the only ones, but we definitely believe that we have more than the right to play on this category given our credentials, obviously, in vegetable, and more specifically in peas, which is great. So, I would not say that we are always number one, and I don't think we want to be the guys starting everything, but when we see that there are some very solid trends coming in, then we need to move fast, and that's exactly what we're doing.

Robert Moskow:

Okay, and this is just an execution kind of question, but the bowls themselves, like the materials you're using, are you using plastic or are you using paper? I know environmentally conscious consumers prefer paper.

Stéfan Descheemaeker:

It's a good question. More specifically, the bowls in Portugal, they are plastic at this stage, because it's easier, but we're working on two different avenues. One is can we obviously improve the recyclability ratio in terms of plastic, that's one thing, and we're making great progress. As you know, most of the time, by the way, when you see all packaging with Birds Eye, with Iglo, with Findus, we have a lot of—it's paper-based, which obviously is great. It used to be very boring, and then we can see that people little by little started to understand, yes, by the way, it's good for the planet. So, it's doing well. There is definitely an awareness of what we need to do. We also have given ourselves, by the way, in terms of recyclability, some very good targets for the future, and that's going to be part of it.

Robert Moskow:

To what degree does the consumer pay attention to that in your markets?

Stéfan Descheemaeker:

In some countries again, Robert, I mean, in some countries, they're literally paranoid about it, and I would say the more north you go, the more paranoid they are, and south, it's the other way around, but it's moving fast, it's moving fast, so I can see that—the countries in Southern Europe are catching up. I think it's becoming more—it's a very solid trend overall. So, sustainability is really something that is absolutely fundamental for us and we definitely believe it's also going to become a competitive advantage, and from that standpoint, again, frozen food, as you know, is really, really well positioned in terms of waste, in terms of packaging, in terms of nutrition, so we're ticking all the right boxes.

Robert Moskow:

Okay. Thanks very much.

Stéfan Descheemaeker:

You're welcome.

Operator:

Our next question will come Steve Strycula with UBS.

Steve Strycula:

Hi, good morning. So, two-part question. The first part would be on the two acquisitions that you've recently done. You clearly are building scale in the U.K., your largest region already. So, my question centers on how do we think about what is duplicative assets layering on top of one another, in sense of an overlap, whether it's plant, supply chain, and how does this impact your route to market? How do you think about scaling when you already have an infrastructure in this country? That would be question one, and then I have a follow-up.

Stéfan Descheemaeker:

Okay. So, let me start with that question, I would put it that way, from the supply chain standpoint, so the plant standpoint, there is no duplication, very simple. A fish factory is not a Yorkshire pudding factory, I can tell you, it's totally different, and so there is no way you can duplicate. What you can do, though, is not so much the hard synergy thing, but you can bring best practice. I'm a firm believer that synergies do not only come from hard synergies and duplication, but also by checking the yields, checking who is best-in-class, and then bringing the best practice from one country or from one plant to another. But, that's for the supply chain side.

Then, in terms of over it, and obviously, you know, the over it part, that's exactly what we're doing right now. We're working with the U.K. team, and we definitely have to work—we have to make sure that we're going to make one integration instead of two, and that's going to be, obviously, much faster, much easier for us, and definitely we need to start from a blank piece of paper and then determine exactly how many people we need now, given the different ranges we have. Then, I'll let you imagine, in terms of obviously go-to-market, there are definitely synergies. The way, you obviously, you can present yourself to the retailers is much better when you come in with a full range, between, obviously, the Aunt Bessie's products, the Goodfella's products and the Birds Eye products. So, there are some duplications in hard synergies, that's things we like, that's mostly at the indirect level. You have a bit of costs, but limited, I must admit, to indirect costs. Then, the rest is really, again, back to the market, so trade terms, net revenue management. These kind of things, we definitely believe where we have made a lot of progress over the last few years, as you know, and these are these are the kinds of things we want to bring to Aunt Bessie's and to Goodfella's.

Steve Strycula:

Okay, great. Then, for the follow-up, I just wanted to get a little bit of clarity, Stéfan. You're lapping some pretty difficult compares in the back half, but I also appreciate that your business is accelerating and improving from both distribution and sales velocity. Is there one quarter in particular that you think is maybe more challenging from either a weather compare or a sell-in that you're lapping that we should keep in mind?

Stéfan Descheemaeker:

I wouldn't say so. I think we're going to stick to—we're sticking to our low single-digit targets, that's 2.1% at the end of H1, and that's our target and our guidance for the full year. So, nothing in particular to mention. By definition, you have the weather, but the weather is part of the business.

Steve Strycula:

Okay. All right, thank you, I'll pass it along.

Operator:

We'll now hear from John Baumgartner with Wells Fargo.

John Baumgartner:

Good morning, and thanks for the question. Samy, I wanted to come back to the gross margin for a minute. It was pretty strong, especially given, I guess, the perceived dilution from Goodfella's. So, just wondering if you could maybe detail it a bit more in terms of any factors that came in stronger than expected relevant to the timing issues, and then should we still think about a 30% to 31% range for gross margin in 2018 in totality?

Samy Zekhout:

Yes, let me give you just some perspective there, which is the fact that upside in the Q2 gross margin came from lower promotional expense, I mean, given the hot weather across Europe, that was clear, and the half-point gross margin benefit is from some procurement timing which we're not repeating into half two. We have at the same time a negative mix from acquisition in half two. We guided you through the impact of Goodfella's. That's what's creating, let's say, guidance of—we are delivering a strong margin, a pretty strong margin over the first half, and about 30% to 31% over half two. That's how it works.

John Baumgartner:

Okay. Then, Stéfan, just thinking more through the acquisitions, Goodfella's and Aunt Bessie's, you mentioned some of the synergies there, but as you kind of think about the back half of 2018 and first half of '19 for Goodfella's and Aunt Bessie's, where should we be looking for the first phases of the synergies being realized? Is it more on the trade promotion side, is it more on the opex line? I guess, how would you compare the synergy opportunities between Aunt Bessie's and Goodfella's?

Stéfan Descheemaeker:

Usually, what's happening is you're going to start first to make sure that you're going to have one single team and, obviously, all the savings that come with it, and that should be fully integrated by, let's say, starting January 2019. So, that's one thing. The little, let's say, procurement synergies will already be implemented by that time. Then, the question of trade terms and net revenue management, by definition, it takes always more time, because you have to do this in synch with additional A&P to make sure that your message is consistent to the trade. The message to the trade is, yes, we're coming with a superior consumer proposition, and at the same time we have a good position with you to have conversations about trade terms and net revenue management, and that takes, obviously, much more time. So, in other words, I would say, particularly, the hard synergies will come first, the soft synergies will come later.

John Baumgartner:

Okay, and then in terms of the timing, you're thinking more phasing, larger synergies coming through in 2020 versus 2019 at this point?

Stéfan Descheemaeker:

It's '19 and '20, both, yes. It's going to come in the course of, let's say, second half of '19 and into the course of '20.

John Baumgartner:

Great. Thanks for your time.

Stéfan Descheemaeker:

Following the normal calendar with the trade.

John Baumgartner:

Right, right. Thanks, Stéfan.

Stéfan Descheemaeker:

You're welcome.

Operator:

As a reminder, that's star, one for questions. We'll go to Rob Dickerson with Deutsche Bank.

Rob Dickerson:

Great, thank you so much. Just to return to the question regarding the back half of the year and kind of cadence, volumes, pricing, I'm just trying to get a better understanding of why, or let's say how Q3 and the back half would be a bit different than what we're seeing in Q2. I just ask because, obviously, the heat in Western Europe is well documented—I just got back from there and it's still hot, people are still complaining—and we saw a decent amount of pricing in the quarter. It seems like some of that was due to a reduction in promotional expense, which helped gross margin. As you get into Q3, it sounds like you're going to now promote that back to try to lift the volume as you also face a tougher volume compare. So, I'm just trying to get a sense, basically, strategically, as we think about the back half, are we thinking it's still likely now more volume heavy versus pricing heavy, which is a reversal from Q2, and part of this is really driven by just what's happened with the heat? I'll start there.

Samy Zekhout:

Yes, maybe I'll take that one Stéfan. The one thing that's important on this is the fact that from a promotion standpoint, it's not just the promotion, but overall it's A&P, and if you look at, let's say, Q4, for instance, is going to be the highest quarter for A&P, which we have never reached there, and Q3, we have the highest growth year-on-year. So, it's a shift, on the one hand, of Q2 into Q3, driven by the point you were making earlier, but at the same time there's, as well, new initiatives, there's the launch of the Captain campaign and there's the integration of all the businesses that we have that are clearly creating the differentiation between the two quarters versus the first half, and then the other point is—I mean, September is our biggest month, I mean, in Q3.

Overall, that gives you enough color commentary to get the perspective of both quarters, but, usually, you know, we said that in the past, I mean, we don't provide quarterly guidance, we tell you to look at the business for the total year, and first half and second half, which you are commenting there, but I think the comment on A&P is probably going to give you enough guidance, let's say, to understand how it works.

Rob Dickerson:

Okay. I'm just looking, really, for more color with respect to kind of volume performance, right? Look, it's been very hot, and, obviously, inverse correlation between heat and frozen fish sticks sales, and ice cream is doing well, it's still been hot. So, in terms of profitability and how you manage the business, is it you kind of try to promote less if you think the heat is a headwind, it's not worth fighting against, but as you get into the back half of the year, kind of that promotional spend now lifts more than it naturally would, or it would just be normalized relative to the year ago, and I understand everything that's happening with new initiatives. I'm just trying to focus on the weather piece, really.

Stéfan Descheemaeker:

The good news is, structurally, September is always, by nature, the biggest month of Q3, because it's back-to-school, the big back-to-school month. It's hasn't proven yet that it's going to be equally hot. So, that's one thing. Second, when it's so hot at this stage—the good news is also that Q2 most of the time is the smallest, you know, is the smallest quarter, by definition, because it's really summertime, and we don't promote that much, anyway, during this time. So, that's the good news. We're going to start back to Q3. I would put it that way. Looking backward now, look at Q2, Q2 was hot overall, May and June were hot, and we've managed to demonstrate—we've managed to come up with growth at the right margin.

Samy Zekhout:

The one thing I would add is that just shows, actually, the dynamic aspect of the management of our business, which is we adapt our business to the market condition, as well, and we are really doing everything we can to maximize the return on our trade and promotion investments, and it makes more sense, frankly, to invest at a time the market is more, let's say, conducive to growth.

Rob Dickerson:

Okay, makes sense. Okay, then, just quickly on Aunt Bessie's, can you just quickly repeat for me—I didn't hear it—the EBITDA contribution for the year?

Samy Zekhout:

The EBITDA contribution for the year is going to be €10 million and €60 million revenues.

Rob Dickerson:

Got it, okay, and then you said approximately, I think, €0.04 in EPS contribution. Is that slightly higher than you may have thought upfront? The reason why I ask is I feel like when you announced Aunt Bessie's, we could kind of back into a pretty decent assumption from margin what maybe EBITDA would be. It seems like it's a little bit better than we thought, and it also seems like the EPS could be a little bit better given the timing of the deal. It's not year one, it's really just kind of half the year. So, just kind of giving any color as to how Aunt Bessie's is now versus when you first looked at it. Thanks.

Samy Zekhout:

So far—I mean, the one element that's important is it is a seasonal business, so there's, effectively, a higher concentration towards the second half of the business, but the point is, where we have to address your question specifically, is what you get from us now is very much consistent with what we have guided you through. The acquisition economics have been reflected so far. We're just in the process of integrating the business, and the €60 million revenue and €10 million EBITDA is very much consistent with the acquisition economics that we have been sharing with you at the time we announced.

Rob Dickerson:

Okay, great, and then quickly, just more kind of big picture for you, Stéfan. Obviously, your kind of top four markets have been driving the impressive top line growth over the past, call it six, you know, quarters. With the new introduction of, I guess, PEASE more in the Nordic area, how are you thinking strategically internally kind of as we look out into '19? Have we now officially started kind of the strategic push into some of those underperforming markets that you didn't really focus on upfront in the must-win battles and hopefully it's more of a balanced push, or do you continue to think that the likes of U.K., Italy and Germany would be kind of the majority of the top line driver? Thanks.

Stéfan Descheemaeker:

Let me start, to your point, very much from a macro standpoint, let me start with the algorithm that we put together. This category can and will generate something like 1% plus per annum and we believe we have what it takes to do a bit more than that, given market share. We're grabbing market share ahead of this. So, hence, obviously, the low single-digit revenue growth algorithm that we've put together. At the same time, when you see progression of the different countries, I would put it that way, '17 was very much Germany and Italy contribution, and still doing well, by the way, and '18 is really now—I mean, U.K., you remember was a bit behind the curve and we always told you it's coming, it's coming, and there are some reasons for this, because the ratio of must-win battles versus the rest was lower, so for various reasons, and also they had to take a lot of price, successfully, by the way, and so they're doing well. So, that's really 2018, and at the same time, you know, we have a series of countries, like Austria and Netherlands, that we tend to probably not mention systematically, but they're doing extremely well. I think the good news is also we have seen some gaps, like, for example, in the Nordics, in terms of gross margin, in terms of EBITDA, that we believe that we have a key difference in terms of gross margin and EBITDA margins versus other countries. We don't believe it is structural, so it's a great opportunity for us in the coming years to make up the difference with these countries.

So, to you point, you obviously have to make sure that you have your must-win battles per SKU and per range, but you also have your must-win countries and you have to manage the whole thing, and the good news is we still have a lot of differences. We love differences, because it's an opportunity, obviously, to close these differences.

Rob Dickerson:

Super. Thank you so much.

Stéfan Descheemaeker:

You're welcome.

Operator:

Thank you. We have one additional question from Jon Tanwanteng with CJS Securities.

Jon Tanwanteng:

Good morning, gentlemen, and thank you for taking my questions.

Stéfan Descheemaeker:

Hi, Jon.

Jon Tanwanteng:

How are you doing? Stéfan, I know you've probably thought about this a lot, but can you give investors a bit of reassurance that your investments in innovation won't result in the kind of attrition in the core businesses that happened on your predecessors, maybe what were the major factors that happened last time around and how are you avoiding them this time?

Stéfan Descheemaeker:

Yes, I've given it some thought, Jon, thank you very much. You're right, you're right, by the way. You may remember two, three years ago that somehow the word "innovation" was a bad word, and we did that with a purpose. We thought that the first thing we had to do was to restore the foundations behind our key SKUs, and so that's why it was all about renovation, and that's really the essence of a brand business, you need to make sure that your core SKUs are going to be ahead of the curve, and they were not. So, all the effort was really behind renovation. Now that we have done this, it's not that we're now going to stop renovation, but we have some algorithm, as well, which is how many SKUs do we need to renovate on a yearly basis, and at the end of the day it'll be every five years, where do we need to stand with the renovation. So, with that, we don't lose that focus, but, obviously, it's also generating some resources that we can further develop behind innovation.

Back to innovation, though, the big difference with, you know, probably, something like four years ago, is we're going to be very disciplined. It's going to be all about the must-win battles. So, that's very, very important. When you see the new innovation in terms of fish, it's all about fish, it's about natural fish, it's about prepared, and the same thing with vegetables. So, it's very, very, very different. At the same time, we're not going to risk the whole thing by thinking that innovation is going to cover something like 20%, 30% of the additional sales. It should be still something like less than 10% of the net sales, given the methodology that we all apply in the last two years.

So, that's a very, very different context. We're very mindful of this must-win battle focus. We're also very mindful of making sure that all the existing products are going to be renovated on a regular basis, and that's what we're going to do. We're going to also go to fewer renovations, by the way, with bigger innovation, instead of going to something which is way too fragmented.

So, that's a long answer, Jon, but it's a key question, indeed.

Jon Tanwanteng:

Great, thanks for the color. I think you've mentioned in the past that both Goodfella's and Aunt Bessie's were more under-invested from an A&P standpoint. The A&P that you're spending in the second half to get those businesses ramped up, is that more representative of a normalized rate or is it more intense than it should be and you'll ramp it back down? How should we think about that as we head into the back of this year and into next year?

Stéfan Descheemaeker:
You should probably take into consideration for phasing within the existing business more than anything else. So, we still need to prepare the A&P plans for Goodfella's and Aunt Bessie's. Once it's ready, obviously, we'll start to invest. You may remember, the way we consider the must-win battles, it took a bit of time and probably it was a bit difficult in terms of patience, but we always said that we need to be ready, must-win battle by must-win battle, before reinvesting, and so that's exactly what we're doing right now with the teams. We are adjusting exactly what the must-win battles are, and then we have 360 approach, including obviously A&P. Once it's ready, packaging-wise, in-store (inaudible), quality, and obviously the mixes, then we can reinvest, but it takes a bit of time. It's always frustrating, but that's life, and that's what we've been doing in '15, '16, '17, and we also have learned that you need to do that in a very disciplined way, otherwise it's not going to work.

Jon Tanwanteng:

Got it, and my final question. Samy, did you quantify how much A&P you pushed out from Q2 into Q3? Can we get that number?

Samy Zekhout:

Yes, it's about €5 million.

Jon Tanwanteng:

Five million. Great, thank you so much.

Operator:

Thank you. I'd like to turn the conference back over to Stéfan for any additional or closing comments.

Stéfan Descheemaeker:

Thank you very much, and thank you for all of you. We're pleased by our second quarter results, which demonstrate the strength of our business model and execution by the team. So, first half results are tracking ahead of the guidance that we provided at the start of the year, as well as ahead of the long-term growth algorithm that we provided at CAGNY. We have an exciting and ambitious agenda on plan for the second half of the year and look forward to updating you on our progress when we report our third quarter results in November.

Operator:

Thank you. Ladies and gentlemen, that does conclude today's conference. Thank you all again for your participation. You may now disconnect.