Nomad Foods Limited

Third Quarter 2017 Earnings Conference Call

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CORPORATE PARTICIPANTS

Taposh Bari, *Head of Investor Relations*

Stéfan Descheemaeker, *Chief Executive Officer*

Jason Ashton, *Interim Chief Financial Officer*

CONFERENCE CALL PARTICIPANTS

Brian Holland, *Consumer Edge Research, LLC*

William Chappell, *SunTrust Robinson Humphrey, Inc*

Steven Strycula, *UBS Securities, LLC*

Kanika Doyle, *Deutsche Bank Securities*

Jonathan Tanwanteng, *CJS Securities, Inc.*

PRESENTATION

Operator:

Good day and welcome to the Nomad Foods Third Quarter 2017 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.

Taposh Bari:

Thank you, Operator, and thank you all for joining us to review our third quarter 2017 earnings results. With me on the call today are Stéfan Descheemaeker, our CEO, as well as Jason Ashton, our Interim CFO.

Before we begin, I would like to draw your attention to the disclaimer on Slide 2 of our presentation. This conference call may make forward-looking statements that are based, in 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, as well as this slide in our investor presentation which does include 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 as well as in the appendices at the end of the slide presentation that is available on our website.

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Finally, please note that certain financial information within this presentation does represent adjusted figures for both 2016 and 2017. All adjusted figures have been adjusted for exceptional items, restructuring and transaction-related items, and all comments from hereon will refer to those adjusted numbers.

With that, I will hand you over to Stéfan.

Stéfan Descheemaeker:

Thank you Taposh, and thank you everyone for joining us on the call today. We delivered strong third quarter results, highlighted by 5.9% organic revenue growth and 120 basis points of gross margin expansion which resulted in Adjusted EBITDA of €79 million and adjusted EPS of €0.24 per share. Based on our year-to-date performance, we are raising our full-year guidance and now expect 2017 Adjusted EBITDA of approximately €325 million to €327 million.

Q3 represents our third consecutive quarter of positive organic revenue growth and market share expansion for Nomad Foods. These results are a testament to our strategic focus on growing the core of our iconic brands and relentless execution by the entire organization.

Turning to the third quarter highlights, first, we generated another quarter of strong organic revenue growth; second, we continued to expand our gross margins; and, third, we once again deployed capital in an accretive manner. I'd like to spend a few minutes on each of these points beginning with revenues.

Third quarter of organic revenue growth of 5.9%, this positive 2.2% growth that we realized during the first half of the year. Once again, our top line growth was driven by the combination of market share gains and category growth. In Q3 we gained nearly a full percentage point of market share against mid-single digit category growth, resulting in 9% sellout growth for our branded business. Q3 results reflect another quarter of sudden execution, along with category growth that was above average. To put these numbers in context, on a trailing 12-month basis, our category has grown approximately 2% versus our brand sellouts growth of 4%.

Organic growth continues to be driven by our core, which many of you know as must-win battles. This part of our portfolio grew 10% in the quarter. Equally important, we continue to see sequential improving sales trends outside of our core. We experienced strong breadth of growth at the country level with 10 of our 13 core countries, including the U.K., realizing organic revenue growth during the third quarter. It is very encouraging to see our strategy yielding results across most of the markets where we operate.

Sweden, which declined 1% in the quarter, has yet to achieve growth in the country level due to the loss of low-margin industry and private label sales from the factory closure early this year. Nevertheless, we remain optimistic about the long-term growth prospect in Sweden due to its attractive frozen fruits category attributes and our 30% market share in the country which ranks as the second highest of any country in which we operate.

Third quarter gross margin expanded to 120 basis points due to a combination of: one, favorable mix along more profitable core portfolio performed in our highest margin geographies; two, commercial margin improvement from network new management efforts such as promo efficiency and pricing actions; three, we continue to see successful implementation of price increases in the U.K. against foreign exchange region inflation. We continue to view gross margin expansion as a key driver of long-term value and are pleased with the progress we're making today.

Finally, we had another active quarter of capital deployment with the repurchase of approximately 7.1 million shares as part of Pershing Square's sale in September. While this marks the second time this year where we have been opportunistic buyers of our stock, I would reiterate that our willingness to pursue M&A hasn't changed and remains a high priority of cash use.

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Twenty-seventeen has been a good year for our Company and I remain encouraged by prospects for our business into 2018 and beyond.

As the global packaged food landscape continues to evolve, we're fortunate to be operating from a position of strength with healthy category growth and solid execution working in our favor. Our category Savory Frozen Food aligns well with change in consumer preferences and continue to grow across Western Europe. Our iconic portfolio of Frozen Food brands as number one or number two market share position across 85% of our core markets.

Organizationally, we are optimizing the right balance between global and local as we benefit from the financial results of scale in the provisional capabilities of our world-class FMCG company while recognizing that food is local and that regional market expertise and activation is in fact a competitive advantage.

Finally, and most importantly, we're just hitting our stride. As a branded category leader, we have a critical role as category captain in ensuring that we not only sustain but build upon on the growth of the Frozen Food category. We understand that this is a growth initiative that will take time to translate into results, reflecting our long-term commitment to the Frozen category. To that end, we will look to build upon all costs through adjacent innovation along consumer trend-like health and wellness and convenience.

In summary, we're proud of the work that we have accomplished thus far in 2017, but continue to strive for more.

With that, I will hand the call to Jason to review our third quarter results in more detail along with an update on our full-year guidance.

Jason Ashton:

Thank you, Stéfan, and thank you all for joining us on the call today. Third quarter reported revenue increased 4.4% with organic revenue growth of 5.9%. Organic revenue growth was driven by volume and mixed growth of 4.1% and pricing growth of 1.8%. Reported revenue growth was offset by approximately 150 basis points of FX translation.

Slide 4 illustrates the costly progression of our organic revenue growth with an overlay of our core portfolio, or must-win battles, since 2016. We have put momentum in our business and believe 2017 sets the foundation to sustain growth in the years to come.

On Slide 5 we show organic revenue trends across our three largest markets—the U.K., Italy, and Germany—as well as the remaining countries in our portfolio. Each of these groups experienced growth in Q3. As Stéfan mentioned, the U.K. represents one of the notable improvements in Q3 with revenues inflecting to positive 2.5% growth. Performance in the U.K. was driven by continued success in fish fingers and coated fish, as well as the activation of must-win battles across our poultry line earlier this year.

Turning to Slide 6, gross margins expanded 120 basis points to 30.3% with mix, price, and promotions as contributing factors. Mix was driven by category and geographic performance. We also continued to make good progress on net revenue management, which is resulting in better price and promotions net of cost inflation.

On Slide 7 I will review our operating performance during the third quarter. I will skip revenue and gross profit commentary which I just discussed in detail. Operating expenses were up 27% year-over-year, driven by more normalized indirect expenses. The €71 billion of operating expenses we realized in Q3 was slightly better than our expectation of approximately €75 million due to phasing of some expenses into Q4. Within operating expenses, A&P increased 3% and indirect increased 43% year-on-year.

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As we have previously outlined, this year's Q3 indirects reflect a bonus accrual versus last year's Q3 results which included a reversal of the bonus accrual for the first nine months of 2016.

Resulting Adjusted EBITDA was €79 million, representing 17% of revenues. Adjusted EBITDA declined 8% year-over-year, reflecting the aforementioned factors. Depreciation and amortization of €11 million declined to last year due to the closure of our factory in Sweden earlier this year. Adjusted net financing costs were €13 million, down 30% year-on-year, reflecting improved cost of capital over the successful refinancing of our debt in early May.

The effective tax rate was 23%, in line with previous quarters, leading to adjusted EPS of €0.24 for the quarter which grew 9%. This was due to 2% growth in adjusted profit and a 6% year-on-year reduction in our weighted average share count. The Q3 share count fully reflects our 2017 repurchase, but only partially reflects our September 2017 repurchase.

Turning to cash flow on Slide 8, for the first nine months of the year the key drivers in the operating cash flow performance, aside from the EBITDA movement are: working capital, as we had expected, shows an outflow of €25 million in the period, primarily due to the intake of the annual agricultural harvests; pensions and other provision movements provided a net inflow of €2 million; adjusted cap ex, which excludes nonrecurring Findus integration costs of €3 million, increased by €10 million year-over-year, driven by the transfer of production in Bjuv, Sweden to other factories.

Adjusted cash tax paid was €5 million higher than prior year, owing to a change in the phasing of payments. This excludes €19 million of taxes paid related to the previously discussed settlement of one-time legacy tax issues. Restructuring and nonrecurring cash flows of €71 million were largely driven by severance costs associated with the closure of production facilities in Sweden and a further integration of the Findus Group where we are rolling out the Nomad ERP system.

Adjusted cash interest paid decreased €12 million compared to 2016, driven by savings from our debt refinance in May. This delta excludes one-time refinancing fees of €14 million.

We are pleased with adjusted free cash flow delivery of €149 million and operating cash flow conversion of 80% through the first nine months of the year, and remain on track to deliver adjusted free cash flow in excess of €200 million for the year.

Turning to Slide 9, on our updated thoughts on 2017 guidance. Based on our year-to-date results and visibility into the remainder of the year, we are raising our 2017 guidance. We now expect 2017 Adjusted EBITDA of €325 million to €327 million versus the prior range of €320 million to €325 million. Our updated EBITDA guidance represents high single digit growth versus 2016 when excluding three offsetting factors this year: notably, currency translation, an extra trading day in last year's base, and this year's reinstatement of bonuses.

Full-year guidance assumes that organic revenue growth will grow approximately 3% in 2017 versus prior guidance of growth in the low single digits percentage range. We continue to expect free cash flow to be at least €200 million for the year.

I'd like to provide you with a few more thoughts around full-year 2017 guidance, which is based on foreign exchange rates as of November 27, 2017. For both the full-year and the fourth quarter, we now expect organic revenue growth of approximately 3%. Full-year reported revenue is expected to include a 220-basis point offset related to currency translation and the anniversary of a leap year comparison with the FX translation impact to Q4 being approximately 30 basis points.

Gross margin rate is expected to be ahead of 2016 with Q4 showing the greatest year-on-year improvement.

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A&P investments are expected to be comparable to last year. We expect underlying indirect expenses to decline versus 2016, but this will be more than offset by the reinstatement of bonuses.

On cash flow, we continue to expect to generate adjusted free cash flow of at least €200 million. We expect this figure to be offset by €105 million of restructuring and nonrecurring cash charges. Also included is a settlement of legacy tax issues which we continue to anticipate will be in the €30 million to €40 million range.

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

Operator:

Thank you. If you would like to ask a question, please press star, one on your touchtone phone. If you find that your question has already been answered, please press star, two to remove yourself from the queue.

Our first question comes from Brian Holland with Consumer Edge Research.

Brian Holland:

Thanks. Good morning. Congrats on the quarter. Starting with the guidance—obviously not a full flow through of the Q3 beat—I just want to break that apart a little bit and make sure I understand. Did any of the strength in Q3 steal, whether the shipments or anything like that, sort of more discrete that might've stolen from Q4? I mean, does your Q4 internal outlook change at all based on anything we saw in Q3 or are we just kind of staying, I guess, relatively conservative? How would you sort of view that?

Jason Ashton:

I think the only flow through to Q4 was through operating expenses, so operating expenses were lower in Q3 due to the timing, and they will unwind in Q4. That leaves the upside in Q3 coming from better sales and gross margins, which is reflected in the updated guidance.

Brian Holland:

Okay. Got it. Then obviously not expecting it would appear by the guidance, a similar sort of magnitude of organic sales growth, I presume that that's primarily driven by a lap in Germany, etc. Can you just sort of talk about the particular strength in Q3 and why maybe expectations should be—like, why we wouldn't expect that to continue going forward?

Stéfan Descheemaeker:

Yes. I think it's a very good question, Brian. It's very simple. We're gaining market share and we're going to continue to gain market share to make it simple. At the same time—and it's very good news—the industry's doing well. Q3 was a bit, you know, probably on the high side with 4% which is probably lower than the average which is more in the region of 2%. To your point, we're starting to anniversary some more, let's say, less easy comps in Germany. I think the combination of these three things makes it—yes, we're very pleased with what we're doing, very pleased with the Q3 and Q4, but obviously at the same time, yes, the industry's going to really come to a more "normal level."

Brian Holland:

Okay. Last one for me and I'll pass it on is you said Q3, I believe you said the composite categories that you compete in were up 2%. You can correct me if I have those numbers wrong. But can you give us the composition of that growth, how much of that is pricing versus volume, and maybe just a little background there? What's driving the category, is it excitement around stuff that you and maybe others are doing? Is

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it just price driven? Just how we think about that in the sustainability of growth particularly in the frozen door going forward as folks have generally understood that to be a category that's been under pressure for some time in your markets.

Stéfan Descheemaeker:

Actually, Brian, for Q3 it's 4% as opposed to 2%. It's a combination—in all categories—and it's a combination of 3% price and 1% volume where, let's say, the MAP at this stage was volume flat in price, up 2%. That's the one thing.

The second thing is, yes, indeed, why—I mean, is it growing? I think, again, playing the category leader obviously has an impact. When we have some very leading market position in some categories, like fish fingers, for example, in Germany, and then we're growing big time, it has an impact on the industry, so it's a virtuous circle. But these are the marks at this stage.

Brian Holland:

Okay. Thanks. Continue to success, gentlemen.

Stéfan Descheemaeker:

Thank you very much, Brian.

Jason Ashton:

Thank you.

Operator:

Our next question comes from Bill Chappell with SunTrust.

William Chappell:

Thanks. Good morning.

Stéfan Descheemaeker:

Good morning, Bill.

Jason Ashton:

Good morning.

William Chappell:

Can you talk a little bit more not just your top line growth in the quarter, but for the whole category? I'm trying to understand how much of that was volume versus price. Then also kind of what you think as we look to next year on pricing now, I imagine most of the commodity inputs are in, a least for the first half. Are we going to have another round of pricing or would that actually be a headwind for price?

Stéfan Descheemaeker:

Thank you. If you're looking out to 2018, obviously I'm not going to go to any guidance and all these things, but it's very simple; overall, it's as most of the times it's the result of a bit of inflation, but it's quite reasonable, more in some countries than in others, but overall it's still very benign, which is good. In the

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meantime—and you heard us saying that our mission is also obviously to build the growth and to reinforce the growth of the whole industry, so right now it's growing, and we don't see any reason why the industry wouldn't grow on top of obviously on the open market share.

Taposh Bari:

Bill, in the third quarter, the category grew 4%—1% from volume and 3% from price, 4% being roughly double the industry growth rate over the last past 12 months.

William Chappell:

Got it. Just digging into that a little bit, I mean, was that led by meals, fish fingers, vegetables? I mean, was there any one driver or was it kind of across the board?

Stéfan Descheemaeker:

Quite frankly, it was really when you see it, it's really across the board. Obviously, fish fingers—I mean, let's say fish is a big category for us and we've been leading obviously the growth, so that's definitely a big contributor to the growth, but overall, when you see the different categories where we're in, industry is growing, and ready meals and veg and fish.

William Chappell:

Okay. I think probably the most impressive part of the quarter was the turnaround or the growth in the U.K. Can you just give us some more color? Do you feel like as a retail landscape, that's settled down and/or are you just kind of outperforming and kind taking back the share you had lost over the past few years?

Stéfan Descheemaeker:

I think in our market—what we've defined our core business, we are starting to gain market share. It's really the result of a relentless execution, again, focused behind these things, making sure that all the components of our category will be in good shape in terms of packaging, in terms of obviously trade margin in terms of in-store execution, and in terms of quality. Then we've been doing this one by one by one. It was very sequential and well executed and that's why we're doing well.

Is the industry—is retail growing better? I think it has stabilized a bit, but, still, you can see it on people, like Aldi-Lidl, still making some good progress and I don't see any reason why they wouldn't continue that way. So, it's where we are in, which is absolutely fine by us, and we think we can grow across the board within the retail landscape.

William Chappell:

Got it. Last one for me, Stéfan. Why haven't, do you think, made an acquisition this year? Just, there're so many opportunities out there that they seem to be—you now seem to be—the core business is kind of running in the right direction. Is it the sellers are waiting for a higher price, you're focused on bigger deals, just the right thing hasn't come up? I mean, just trying to understand why some things...

Stéfan Descheemaeker:

It's very simple. I mean, we're not going to deviate. We have a series of criteria, which is we want to obviously buy market-leading brands, business with competitive advantage, strong management cash flow, and obviously synergies. So that's the kind of criteria that we are applying right now and we're going to apply. If at some stage there is something we need to announce, we will announce it.

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William Chappell:

Got it. Thanks so much.

Stéfan Descheemaeker:

You're welcome.

Operator:

Our next question comes from Steven Strycula with UBS.

Steven Strycula:

Hi, guys. Congrats on a good quarter.

Stéfan Descheemaeker:

Thank you.

Jason Ashton:

Kind of you to say that.

Steven Strycula:

My question would be just want to drill in a little bit more into the implied guidance for the fourth quarter and to understand what really drove category strength in 3Q. Specifically, you commented that the category is up 4% versus where it has been trending closer to 2%. I want to understand is that more due to the phasing of price increases rolling through across the industry or is it the treatment of private label, is it just anniversaring against easy weather compare? Can you help us unpack that a bit and explain why you're implicitly guiding to a slowdown in 4Q versus 3Q? Then I have a follow-up. Thanks.

Stéfan Descheemaeker:

I think it's a combination of the different points you mentioned, on top of also a bit of weather. You remember that some people were complaining in the ice cream arena that Q3 was difficult for them for weather reasons, and it goes the other way around for us. So that's the key one reason. There was a bit of pricing indeed, and at the same time, indeed, we—and that's more specific to us—obviously we were gaining market share versus last year, especially in countries like Germany. So that's the combination of the different elements where we think, again, we would love to be wrong, but, again, we think the industry is going to go back to something closer to 2%.

Steven Strycula:

Okay. That's helpful. Then as my follow-up, I wanted understand—I think on the last call you highlighted that in terms of cadence, that the fourth quarter would really be the highest absolute gross margin rate of the year which would imply being a fourth quarter gross margin of 31.5% or better. I just wanted to make sure I understand that properly. Then, what is the cumulative synergy realization for the Findus, call it, by 2017 year-end? A lot of people just want to know what is incrementality for 2018. Thank you.

Stéfan Descheemaeker:

Starting with the gross margin then?

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Jason Ashton:

Yes. We continue to expect significantly stronger year-over-year gross margin in Q4 as we previously guided in the last call, and that's due to the following factors: the anniversary of a fall 2016 harvest; some operational supply chain issues, particularly in Sweden; the pricing realization that's coming through in the U.K.; and good momentum on our net revenue management program as the year progresses, which is driving the gross margin expansion in the fourth quarter.

Stéfan Descheemaeker:

Back to your question on synergies, Steven, it's very simple. Bottom line, we remain on plan to realize the synergy of €43 to €48 range by the end of next year. Then, giving a bit of color on '17, which has been an invigorating important integration year, we closed the legacy factory, we repurchased productions throughout our production network, we commenced all European implementation, and also very importantly, we implemented net revenue management across the network, especially in the Findus countries, which, quite frankly, I mean, we're not very advanced from that standpoint, which has been very good for us. Over the last two years, so at this junction everything is very much integrated, so we've been working very hard in '17 and at this stage we've successfully relapsed some savings, actually sooner than originally anticipated. Bottom line, more synergy in '17 and overall the €43 €48 remains obviously the target.

Operator:

Once again, that is star, one to signal on your touchtone telephone.

Our next question comes from Rob Dickerson with Deutsche Bank.

Kanika Doyle:

Good morning. Thank you. This is Kanika Doyle on for Rob. The first question is that there was a pretty sizable step up in organic sales growth in U.K. and other countries in the quarter; is that something that we should view as sustainable performance in the near term over the next couple quarters or was there something in this quarter's results that were more one-time in nature?

Stéfan Descheemaeker:

Let's put it this way, I think a lot of the reason is rather simple. We are in a growth industry, but obviously industry is industry. I don't think you should count on something like 4%. That would be probably a bit premature. Second, is obviously that we're gaining market share. I think these are the two main factors. So, growth in an industry that is growing and we're growing ahead of the industry. From there, obviously you can understand what is sustainable.

Then the last piece is some countries are probably more advanced than others, so U.K. started a bit later than countries like Germany and Italy.

Kanika Doyle:

Okay. Great. Thank you. Given your current category performance combined with your conversations with retailers along with the 2018 innovation pipeline that you have, how do you view your top line growth potential next year?

Stéfan Descheemaeker:

I think from that standpoint I will repeat what I just said is obviously our objective is to gain market share in a category that is growing and obviously more to come during our Q4 announcement.

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Kanika Doyle:

Okay. Great. Thank you.

Operator:

Our next question comes from Jon Tanwanteng with CJS Securities.

Jonathan Tanwanteng:

Good morning, gentlemen; very nice quarter and thank you for taking my questions.

Stéfan Descheemaeker:

Thanks, Jon.

Jonathan Tanwanteng:

Just to add to the prior M&A question, can you give us a bit more color on the pipeline? Do you see more or less opportunity or competition versus three to six months ago and has anything changed in the landscape in terms of valuations and your ability to find or integrate an attractive asset?

Stéfan Descheemaeker:

Let's say six months ago or one year ago I don't think we were looking actively at M&A. I think it would have been a big mistake, by the way. We were looking—the first priority was to make sure that our fundamentals would be restored. At this stage we're looking at a few things. We'll update you when we have something to announce, and, obviously, believe me, we will stay true to our criteria.

Jonathan Tanwanteng:

Okay. Great. Jason, you mentioned roughly 4 million of pushed out expenses into Q4. Any color on that and what was pushed out and why?

Jason Ashton:

Not much color. I mean, there was a small amount of phasing on A&P and both indirects, but nothing too specific.

Jonathan Tanwanteng:

Okay. Great. Finally, maybe it's a bit early, but do you have any preliminary thoughts on the nonrecurring items other than legacy tax issues that may impact your cash flow for 2018?

Jason Ashton:

There will be some nonrecurring payments into 2018. We're still implementing ARP across some of the remaining legacy Findus markets and we have some continuous improvement projects running through the business, but one would expect to be a sizable reduction in this year's nonrecurring cash payments.

Taposh Bari:

Yes. So, Jon, stay tuned. We'll give guidance on our fourth quarter call in March, but as Jason pointed out, we do expect the total cumulative nonrecurring number to come down pretty meaningfully in 2018 versus 2017.

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Jonathan Tanwanteng:

Okay. Great. Just to be clear, are there any other legacy tax issues we should be concerned about?

Jason Ashton:

No.

Jonathan Tanwanteng:

Great. Thank you very much, guys.

Operator:

It appears there are no additional questions at this time.

Stéfan Descheemaeker:

Okay. With that, thank you. As I said, our third quarter result demonstrates another quarter of progression. We have a high-quality portfolio of iconic brands with market leadership positions. We have solid momentum into year and believe we are well-positioned to care momentum into through 2018. I look forward to updating you on our progress when we report fourth quarter and full-year 2017 results in March.

Back to you, Operator.

Operator:

This concludes today's conference. Thank you for your participation. You may now disconnect.

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