Nomad Foods Limited

First Quarter 2019 Earnings Conference Call

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CORPORATE PARTICIPANTS

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CONFERENCE CALL PARTICIPANTS

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Robert Moskow, *Credit Suisse*

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PRESENTATION

Operator:

Good day and welcome to the Nomad Foods First Quarter 2019 Earnings Conference Call. Today's conference is being recorded.

At this time, I would like to turn the conference over to Taposh Bari. Please go ahead.

Taposh Bari:

Thanks, Amanda, and thank you all for joining us to review our First Quarter 2019 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 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, and this slide in our investor presentation which does include cautionary language.

We will also be discussing 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.

Please note that certain financial information within this presentation represents adjusted figures for 2018 and 2019. All adjusted figures have been adjusted for exceptional acquisition-related share-based payment and related expenses, as well as non-cash foreign exchange gains or losses. All comments from hereon will refer to those adjustment numbers.

Finally, users should be aware that 2019 figures have been presented in accordance with IFRS 16, which is the new standard for leases. As such, certain financial measures may not be directly comparable to 2018 figures. That being said, we have disclosed the impact of this change in the press release where the impact on comparability has been deemed material.

With that, I will hand you over to Stéfan.

Stéfan Descheemaeker:

Thank you, Taposh, and thank you all for joining us on the call today. Earlier today we reported first quarter 2019 earnings results and reiterated our full-year Adjusted EBITDA guidance. We're pleased to have begun 2019 with a strong start and are on pace to deliver against our long-term growth algorithm for a third consecutive year.

Highlights from the first quarter include organic revenue growth of 0.9%, representing a ninth consecutive quarter of growth, despite the shift of Easter sales into Q2. Adjusted gross margins of 30.9% with 60 basis points of growth in the base business offset by 150 basis points of acquisition mix. Adjusted EBITDA of €122 million, which grew 18% year-on-year and adjusted EPS of €0.40 per share, representing growth of 14%.

First quarter performance was underpinned by many of the same drivers as in the past, notably investments in our brands and solid growth from our core categories. During the first quarter we achieved strong revenue growth, navigated higher fish prices, advanced our innovation strategy, and strengthened our balance sheet to fund future growth.

Organic revenue growth of 0.9% was driven by strong execution in a number of markets, notably the U.K. and Austria, which each grew 4%, and the Netherlands which posted a growth of 11%. First quarter organic revenue growth was led by price which contributed growth of 4.1%. Partially offsetting this growth was a 3.2% decline in volume, which was impacted by a later Easter this year.

As you know, we have raised price in response to higher raw material costs which we experienced this year, mainly in fish. So far, we have navigated the environment well by remaining laser-focused on executing our growth model. We continue to invest in our brands with the majority of our resources focused on our core categories, which, once again delivered solid growth of 3.3% in Q1.

Success in our core portfolio continues to be a result of efforts at both a global and local level. Fish, our largest global category, delivered another strong quarter with fish fingers and coated fish posting 3% and 4% growth, respectively. As expected, sales of peas declined in Q1 due to last year's poor harvest which limited supply in the marketplace. That said, we were successful in replacing lost peas volumes with growth in other areas of our vegetable portfolio, notably SteamFresh in the U.K.

Strong growth in our core global SKUs were complemented by several local success stories. These include poultry in the U.K., ready meals in Germany, and minestrone in Italy. As a reminder, local core categories combine to represent roughly half of our core portfolio. This group of categories grew an impressive 5% during the first quarter, demonstrating the ability of our regions to execute both centrally-led and country-specific initiatives.

Turning to innovation, we advanced our strategy in Q1 with the launch of Green Cuisine, a range of plant protein products in the U.K. This launch adds yet another dimension to our growing U.K. portfolio, which has gone through significant transformation over the past two years between an impressive turnaround in its base business and the integration of two complementary acquisitions. Green Cuisine marks our second plant protein launch in the past year and follows the introduction of PEASE, our sub-brand of plant protein products launched last year in the Nordics.

PEASE has performed well in its first few months in the market, driving 30% growth in our Swedish Vegetarian portfolio. It has also attracted new users into the category with very positive feedback from both consumers and retailers. Both PEASE and Green Cuisine are our pea-based innovations and build on our brand’s strong heritage and expertise in this high-protein crop. We look forward to providing you with an update on Green Cuisine in the coming quarters after we build distribution and begin to support this new range of products with a multi-channel advertising campaign this summer.

Finally, we strengthened our balance sheet to support future growth and this includes M&A. As you know, the packaged food space is going through a period of significant change and dislocation. This has, in turn, created a number of unique opportunities for us. We’ve been looking for a while and are currently evaluating a number of interesting opportunities. We’re not going to comment on specifics but rest assured that we’re committed to making the right deal at the right time that is in the best interest of our shareholders.

Our recently enhanced balance sheet provides us with the capacity and flexibility to drive value through accretive acquisitions, and we look forward to providing details when we have more news to share.

Before turning the call over to Samy, I would like to highlight a couple of new and exciting products and marketing campaigns being rolled out in the market. On Slide 5 you can see two current examples. The first on the left is Artisan, one of our largest product launches in 2019. Artisan is a new range of coated fish that will provide retailers and shoppers with a complementary dimension to our existing portfolio of frozen fish products. This innovation leverages key food trends such as Artisan breads and seeded inclusions, while still delivering the great taste, convenience, and value that our brands are known for.

We will be supporting Artisan with an exciting new media campaign featuring our Captain, who now finds himself on land, exploring a local artisan market. Artisan is currently being distributed across a handful of markets and, as I mentioned, will be one of our big bets in 2019, along with plant protein and modern vegetable launches.

On the right-hand you can see the Goodfella’s brand reboot, which we recently introduced in the market in April. We’ve applied our growth model across all aspects of the brand by changing the packaging design, upgrading product quality and launching a new multi-channel campaign celebrating the heritage of this strong brand. The new campaign titled Made with Respect introduces a new lead character, the godmother, who serves as the matriarch of the family and is the ultimate judge of Goodfella’s product quality. This reboot marks an exciting new era for the Goodfella’s pizza brand and will help support our longer-term strategy of growing sales with a stronger gross margin profile.

To conclude, the year is off to a strong start. First quarter marks our ninth consecutive quarter of organic revenue growth, and based on performance during the month of April, we feel very good about our ability to build on our momentum into Q2. We are firmly on track to execute our growth plans for the year, are making good progress on our recently acquired businesses, and are eager to continue to add more complementary assets to our portfolio in due course.

With that, I will hand the call over to Samy to discuss the financials and guidance in more detail. Samy?

Samy Zekhout:

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

Turning to Slide 6, I will provide more detail on our key first quarter operating metrics, beginning with revenues which increased 15% to €618 million, driven by 0.9% organic revenue growth and 13.8 percentage points from the acquisitions of Aunt Bessie's and Goodfella's. Gross margin was 30.9%, declining 90 basis points year-on-year. Base business gross margins expanded 60 basis points, driven by volume mix and price and promotions, which more than offset COGS inflation. Acquisition mix negativity impacted gross margins by 150 basis points.

As we had anticipated, first quarter base business gross margin was affected by two timing factors unique to Q1 versus the rest of the year. First, we realized the full benefit of price increases, but only a partial impact from raw material inflation in the first quarter. This will normalize at the beginning of Q2. Second, the shift of Easter and related promotions moved from Q1 into Q2, given the timing of the holiday versus the prior year.

Moving down to the rest of the P&L, adjusted operating expenses increased 9% year-over-year, primarily due to the inclusion of acquisitions. As a percentage of revenue, adjusted operating expenses improved to 13.8% from 14.5% in the prior year, reflecting acquisition synergies, expense discipline, and phasing. First quarter adjusted operating expenses were approximately €5 million lower than we originally expected due to the timing of some media activities moving into subsequent quarters. Within operating expenses, A&P increased 6% and indirect expenses increased 11%.

Adjusted EBITDA was €122 million and, as expected, included a €4 million benefit related to IFRS 16, the new standard on lease accounting effective this year. Excluding this benefit, Adjusted EBITDA grew a healthy 14% versus the prior year.

Adjusted EPS was €0.40 for the quarter, an increase of 14%, reflecting underlying EBITDA growth, higher finance costs, and lower effective tax rate and a higher share count as a result of the equity offering. IFRS 16 did not have a material impact on EPS during the first quarter.

Turning to cash flow on Slide 7, we generated €93 million of adjusted free cash flow during the quarter, an increase versus the €82 million generated in the same period last year. In an effort to increase our organizational focus and accountability on cash, we have made the decision to redefine our cash KPI with a priority now on free cash flow as both an absolute metric and relative to adjusted profit.

Factors contributing to first quarter adjusted free cash flow included, Adjusted EBITDA of €122 million; working capital outflow of €11 million; capex of €6 million; cash taxes were €4 million, lower than the €11 million adjusted P&L tax, due to the timing of tax payments; and, finally, cash interest and other was €8 million, also lower than P&L finance costs, due primarily to the non-cash impact of IFRS 16 on the P&L. We're pleased with the amount of cash that we generated in Q1.

As you know, we also raised €343 million of equity in a transaction that closed on March 22. Accordingly, we ended the first quarter with €753 million of cash on hand and net leverage in the high-2s. We believe this level of leverage provides us with the necessary resources and flexibility to pursue our strategic growth ambitions, which include organic growth as well as the acquisition of food companies where we can unlock value.

With that, let's now turn to Slide 8 to review our 2019 guidance, which is based on foreign exchange rates as of May 7, 2019. For the full-year 2019 we are reiterating Adjusted EBITDA guidance of approximately €420 million to €430 million, which assumes organic revenue growth at a low-single digit percentage rate.

Given the recent equity offering which resulted in the Company raising €343 million in capital and issuing 20 million new shares, we now expect adjusted EPS to be in the range of €1.18 to €1.22 per share. This assumes a weighted average share count of 192 million for the year. This compares to our prior guidance of €1.28 to €1.32 which assumed 176 million shares outstanding.

To help you with your models, there are also some quarterly movements in the remaining periods of the year that I would like to highlight. Starting with revenues, as you know, Easter fell three weeks later this year versus last, resulting in approximately 1.5 points of revenue growth moving out of Q1 and into Q2. As a result, we expect Q2 organic revenue growth to be higher than in Q1. We expect some incremental contribution of revenues in Q2 from Goodfella's and Aunt Bessie's, albeit significantly less than we experienced in Q1 as we begin to anniversary the Goodfella's acquisition which closed during Q2 of last year. As a reminder, Aunt Bessie's closed on July 2 last year.

Moving on to gross margin, with the shift in Easter timing I mentioned earlier, it's important to note that Easter period tends to carry a higher level of promotions, which now shift into Q2 versus Q1, and will have an adverse impact on Q2 gross margins. Further, keep in mind that we face an uneven gross margin comparison in Quarter 2 and 3 of this year. Recall that we scaled back promotions during the second quarter of last year given an unseasonably hot start to the summer. As you may recall, Q3 gross margins were negatively impacted by a poor harvest. As a result, we expect gross margin to decline year-on-year in Q2 and increase year-on-year in Q3.

Finally, there was approximately €5 million of A&P spend which shifted out of Q1 into the rest of the year, mostly into Q2. Taking all of these factors into consideration, we expect Q2 Adjusted EBITDA to be relatively unchanged versus the prior, followed by double-digit growth in Quarter 3 and Quarter 4.

That concludes our remarks. I will now 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 signal by pressing star, one on your telephone keypad. If you're using a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. Again, press star, one to ask a question. We'll pause for just a moment to allow everyone an opportunity to signal for questions.

We'll take our first question from Jon Tanwanteng with CJS Securities.

Jonathan Tanwanteng:

Good morning, gentlemen. Thank you for taking my questions and excellent quarter.

Stéfan Descheemaeker:

Good morning.

Samy Zekhout:

Good morning, Jon.

Jonathan Tanwanteng:

Good morning. Could you tell us if the guidance that you've provided on the EBITDA includes all the IFRS benefits this quarter and moving forward?

Samy Zekhout:

Yes, it does.

Jonathan Tanwanteng:

Okay. How much is that expected to be over the next several quarters?

Samy Zekhout:

It's €15 million for the year.

Jonathan Tanwanteng:

Okay. Great. Thank you. Then can you give us an update on the use of proceeds from your recent equity raise; is it purely for M&A, or are there other uses for investments that you're planning? Any color there would be helpful.

Samy Zekhout:

We effectively have been raising the equity and are now sitting on €753 million in cash, and we intend to use that to, let's say, to invest in deals to come, and we will be selecting those deals on the basis of the financial return that they will deliver.

Jonathan Tanwanteng:

Okay. Great. Could you also just comment on the IPO of Beyond Burger here in the U.S., and if your pea protein product can capitalize on the same trends in the consumers that are driving beyond and impossible and similar vegan products?

Stéfan Descheemaeker:

Well, Jon, it's an excellent question. It was not left unnoticed obviously. Eighty-eight million euro dollars of revenue with a $3.8 billion, which is close to our market cap, by the way, so that's interesting. Aside from that, I think with what we see as the fundamentals of plant protein, and plant protein is definitely there to stay, to grow, and we want to be part of this. We're starting with two very interesting launches, one is PEASE in the Nordics, and we're doing very well—great feedback from the consumers and from the retailers; and we're just launching right now Green Cuisine in the U.K., so we're very well accepted by the trade. Obviously, more to come in terms of obviously advertising this summer, and, more fundamentally, more to come also in terms of SKUs. We're starting, obviously, with a limited assortment and then as time goes by we will obviously expand the range. It's absolutely a very important category for us and not limited to the Nordics and to the U.K. It's going to go way beyond that.

Time will tell how it's going to impact our market cap, but at least business wise it makes a lot of sense.

Jonathan Tanwanteng:

Great. Thanks for the color, guys.

Operator:

We'll take our next question from Robert Moskow with Credit Suisse.

Robert Moskow:

Hi. A few questions. Can you give a little more detail on why the €5 million dollars in media shifted into second quarter? I thought on the last call you were pretty specific about the timing of it and just wanted to know the circumstances. Second, we use Nielsen to track your market share data; it's probably not perfect. Last year you had some pretty significant gains versus private label across several categories. Those market share gains seem to slow in first quarter. I think in your commentary you said that you're growing, the category is growing, but can you talk a little bit about your market share in first quarter?

Samy Zekhout:

Yes. I'll start, Robert, tackle the first question on media. It's primarily driven by the fact that we've been seeing some shift in campaigns which is primarily driven by the fact that Goodfella's moved from the year-to-year March to early April, and that has been contributing to mostly to the shift from Q1 into Q2.

Robert Moskow:

And the market share?

Stéfan Descheemaeker:

The market share at this stage is flat, so I think within a good industry, at this stage it's flat. As we know, obviously, we've been through a major price increase which is fundamental. Then, as we said, we're going to see—at this stage we're moving according to plan, so that was expected, and in the coming weeks and months we will see whether it's moving as we said in terms of price elasticity. So far so good, but we also know that it takes some time to be fully reflective in the industry and understood by the consumers. But at this stage, with that kind of price increase, we think a flat performance is a good performance.

Robert Moskow:

Is the intention to now start increasing on vegetables as well as fish, or not, and how would that affect your pricing kind of ramp up for the year?

Samy Zekhout:

Well, let's put it this way, Robert. Fish wise, we've been through a very, very significant cost increase that we have been able to—that we really understood, let's say, starting, H2 last year. So, we've organized ourselves, I think, very well. I think the countries have taken the challenge very well, and, ultimately, it's been—obviously it's always difficult, but it's been reasonably well-received by the trade.

In veggies it's a bit different. We don't see the same thing. It's more category by category. I would put it that way. Peas, for example, what we've seen is we see that our peas are declining for the first quarter for a very simple reason: we had a very poor harvest and so why would we promote, for example; it doesn't make any sense when you're supply-constraint. We made the right thing. We did the right thing with peas.

In terms of price increase for the future, again, fish was, I would not say, unprecedented, but it was big, and we don't see the same thing happening in veggies at this stage.

Robert Moskow:

Last question. On Goodfella's you said you shifted the media by a month. I thought I had picked up that there was some reconfiguration of Goodfella's product line. I don't know if it's packaging or product or what. Is there anything to that, or is Goodfella's just kind of on track?

Stéfan Descheemaeker:

Goodfella's is absolutely on track. I don't think you should read too much into one month, which was March. It was a combination of many different things. But we're not changing our flywheel. In other words, what we said from the start with Goodfella's, we're going to first improve the quality; we're going to improve the packaging; we're coming with a new campaign, that's exactly what I mentioned with the "Godmother" and obviously "Made with Respect"; and it's really starting now. Sometimes it's switched by a few weeks, which is—anyway, if we're not ready, we're not ready. I think we're very pleased with what we're seeing right now and pizza for us is doing well.

Robert Moskow:

Okay. Great. Thank you.

Stéfan Descheemaeker:

You're welcome.

Samy Zekhout:

Thank you.

Operator:

As a reminder, it is star, one to ask a question. We'll take our next question from Bill Chappell with SunTrust.

William Chappell:

Thanks. Good morning.

Stéfan Descheemaeker:

Good morning.

William Chappell:

I may have missed it. Did you quantify what the Easter shift was, and is that expected to be fully picked back up in this next quarter?

Samy Zekhout:

Yes. We did mention the fact that it was going to be around 1.5%.

William Chappell:

That's what you expected kind of all along?

Samy Zekhout:

Yes, the shift between Q1 and Q2 in sales growth.

William Chappell:

Okay. Then in terms of just the overall category, I mean, you say it's healthy, it's growing. Is there any way to kind of quantify it's accelerating over the past two or three quarters and are there others driving that growth, is it consumers driving that growth, or is it just really you and kind of being back and innovating and advertising behind it that's driving that growth?

Stéfan Descheemaeker:

Well, at this stage I wouldn't say that there was an acceleration. I think it's been very consistent in terms of low-single digit growth. By the way, that's our algorithm, and as we said, obviously it's our job to invest further in the category and then that's our ambition obviously in the long-term, to see this algorithm improve in terms of quality and quantity. But that's going to take a bit of time.

And back to market share, by the way, I forgot to mention that on an MAT basis we are increasing our shares. So, that's a combination. It's no surprise in terms of category. Second, a flat short-term, but also on an MAT basis increased market share, despite price increases.

William Chappell:

Got it. But you're seeing volumes continue to improve, I guess, not just on pricing?

Stéfan Descheemaeker:

Well, as we said, the first quarter, which was expected, we've seen obviously some volume reduction which is a combination of PPA and obviously initial reaction from the consumer in terms of price. But we see that obviously going down over time and very fast. And obviously, I forgot to mention, which is also a big thing, which is the famous 1.5% coming from Easter.

William Chappell:

Then last one for me, we actually heard from bigger companies from Coke and Pepsi and others that there was some inventory management around the Brexit noise. I know it's not a huge—there's a lot of local market manufacturing, but was there any kind of impact to your business intra-quarter from that?

Samy Zekhout:

No. We had mentioned the fact that we are going to be prepared for the March 29 deadline originally, so we just had about a $15 million impact from an inventory standpoint and that we are going to deplete over the months to come.

Stéfan Descheemaeker:

Obviously, we see what October tells us, at some stage we may have to come out with a ramp up again. Life is full of surprises.

William Chappell:
Yes. It keeps it interesting. Thanks so much.

Stéfan Descheemaeker:

Yes. You're welcome.

Samy Zekhout:

Thanks.

Operator:

At this time there are no further questions. I'd like to turn the conference back over to CEO Stéfan for any additional or closing remarks.

Stéfan Descheemaeker:

Okay. Thank you, Operator, and thank you for joining us on the call today to review our first quarter results. The year is off to a good, strong start with Q1 representing our ninth consecutive quarter of organic revenue growth despite the Easter shift. We're very much on pace to deliver another year of growth against our algorithm and have a well-capitalized balance sheet ready to be deployed.

With that, thank you for your participation, and I look forward to updating you on our progress where we next report second quarter results in August.

Operator:

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