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Performance Food Group Co. (PFGC)

Q3 2018 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day and welcome to the PFG Fiscal Year 2018 Q3 Earnings Conference Call. Today's call is scheduled to last about one hour including remarks by PFG's management and the question-and-answer session.

I would now like to turn the call over to Mr. Michael Neese, Vice President, Investor Relations for PFG. Please go ahead, sir.

Michael D. Neese

Vice President, Investor Relations, Performance Food Group Co.

Thank you, Melissa, and good morning, everyone. We're here this morning with George Holm, Performance Food Group's CEO, and Jim Hope, PFG's CFO. We issued a press release regarding our fiscal third quarter results this morning. The results discussed in this call will include GAAP results and non-GAAP results adjusted for certain items. The reconciliation of these non-GAAP measures to the corresponding GAAP measures can be found at the back of the earnings release.

You can find our earnings release at the Investor Relations section of our website at pfgc.com. Our remarks in the earnings release contain forward-looking and cautionary statements and projections of future results. Please review the forward-looking statements section in today's earnings release and our SEC filings for various factors that could cause our actual results to differ materially from forward-looking statements and projections.

Now, I'd like to turn the call over to George.

George L. Holm

President, Chief Executive Officer & Director, Performance Food Group Co.

Thanks, Michael. Good morning everyone and thanks for joining our call today. We are pleased with our third quarter net sales, profitability, and strong free cash flow particularly given the multiple snow storms that occurred during the quarter. Total case volume of nearly 1% included a 4.8% increase in independent cases and independent sales growth of 7.6% as we benefited from a 2.1% inflation and a 0.7% increase due to the mix business.

Net sales for the quarter grew 2.7% and excluding the Customized Georgia facility closure, net sales would have been 4.2% for the quarter and 7.2% on a year-to-date basis. Adjusted EBITDA increased 6.7% and adjusted EPS increased 25.9%. We have strong cash flow, free cash flow during the quarter and our return on invested capital improved which Jim will be highlighting later in the call.

Based on our results for the first nine months, we remain on track to deliver our goals and objectives that we set out to accomplish earlier this year. Weather dominated the headlines in this quarter where we over-indexed in our broadline distribution footprint as the bulk of our large distribution centers are on the East Coast.

However, we improved sequentially throughout the quarter and had to experience signs of a solid recovery specifically in April where independent case growth was back over 6%. We did have a record sales week last week for both [ph] Performance independent (3:15) and Performance Foodservice as well as total PFG. That was for the week ending May 5; we expect to top that with the week ending May 12 and Mother's Day.

Performance Foodservice top line growth for the quarter was nearly 5% while EBITDA growth was 4.5%. The increase in net sales was driven by an increase in selling price per case, as a result of inflation and customer and product mix changes. Net sales were also driven by an increase in cases sold including independent case growth and a solid independent customer demand for Performance Brands.

Performance Brands grew from 44.7% of our total sales to 46.3% and our independent sales grew from 43.3% of Performance Foodservice sales to 44.1%. We believe weather impacted our independent case growth by approximately 150 basis points. And we also achieved in excess of a 6% case growth in the companies that we have in the West that were not affected by the weather.

Turning to Vistar, the segment had a robust third quarter; net sales were up 9% driven by strong broad based base case sales growth in all channels and some M&A activity. The Black Panther movie dominated the box office in calendar Q1, our fiscal Q3, performed above expectations and drove top-line growth for Vistar during what would have been a relatively soft box office quarter.

Third quarter EBITDA for Vistar was up 14%, gross profit dollars increased a healthy 17% and that was fueled by an increase in the number of cases sold and a favorable change in mix towards higher margin channels.

We continue to work through some expense headwinds associated with the CCSI acquisition. However, we're encouraged by what the team has accomplished over the past several months. All the strategic planning and hard work from the Vistar team progressed and we expect continued strong momentum in fiscal 2019. We will be closing the CCSI corporate headquarters at the end of June and all but two of the distribution centers will be closed by the end of fiscal second quarter of 2019. So we'll experience some nice synergies from that acquisition.

Turning to Customized, net sales for PFG Customized decreased 7.3% for the quarter. This decrease was primarily a result of the Georgia facility that was closed in the fourth quarter of fiscal 2017 and the challenging casual dining environment. For the first nine months excluding the impact of Georgia, net revenues would have essentially been flat to the previous year. The Customized EBITDA decreased by 1%. The decrease in EBITDA was driven by higher operating expenses, including higher warehouse, personnel costs and fuel expense partially offset by an increase in gross profit.

As a result of our performance during the first nine months of our fiscal year, we are tightening our fiscal 2018 adjusted EBITDA outlook and now expect growth in the range of 9% to 11%. We remain confident in our full year outlook and our strategies for future growth. We continue to be bullish on our prospects in the years to come.

Before I turn the call over to Jim to discuss our financial details, I'd like to highlight one of our fantastic associates. [ph] Donna Freemanus (7:04) has served as a driver for our Customized New Jersey location for 16 years making her the most tenured female driver working for our company. It's quite an accomplishment. [ph] Donna (7:15) and her team of drivers are often unsung heroes playing a key role in serving our customers and being the face of our company. I want to thank [ph] Donna (7:24) and all the PFG drivers who contribute to our daily success.

Now, I will turn the call over to Jim Hope, our CFO.

James D. Hope

Chief Financial Officer & Executive Vice President, Performance Food Group Co.

Thank you, George and good morning everyone. Let me take you through our third quarter financial results including some detail on cash flow and return on invested capital. Net sales increased 2.7% over the prior year period to \$4.3 billion due to an increase in selling price per case as a result of inflation and mix and we also experienced strong net sales in Vistar.

Food cost inflation was approximately 2.1% for the quarter driven by eggs, produce, and meats. Gross profit dollars grew over 7%. Gross profit per case increased \$0.26 while gross margin as a percentage of net sales was up 50 basis points over the prior year period to 12.8%. The gross profit increase was fueled by an improved sales mix of customer channels and products primarily sold in the independent channel.

Operating expenses grew 5% in the third quarter to \$498.6 million. The increase was primarily due to acquired case volume and the resulting impact on variable expenses as well as higher fuel prices, acquisition, integration costs within Vistar and an accelerating increase in sales personnel within Performance Foodservice. Of the nearly \$24 million increase in OpEx, acquisitions represented approximately half of the increase. So excluding acquisition costs, OpEx would have increased approximately 2.5%.

Operating profit was up 28.7% to \$60.1 million, driven by strong gross profit increase of 7.2%. Our adjusted EBITDA increased 6.7% to nearly \$96 million which reflects the benefit of solid growth in Vistar, as well as continued strong control of corporate expenses. Net income for the third quarter of fiscal 2018 grew 62% to \$33.7 million. The growth was primarily a result of an increase in operating profit and a decrease in income tax expense partially offset by interest and other expenses. The decrease in income tax expense was primarily a result of the impact of the Tax Cuts and Jobs Act.

The effective tax rate for the third quarter of fiscal 2018 was 24.8% compared to 36.8% in the third quarter of last year. Third quarter adjusted diluted EPS increased 25.9% to \$0.34 per share compared to the prior year period.

Let's turn to cash flow. In the first nine months of fiscal 2018, PFG generated nearly \$230 million in cash flow from operating activities, an increase of nearly \$130 million versus the prior year period. The improvement in cash flow from operating activities was largely driven by higher operating income and strong working capital management. We're also pleased with our free cash flow of \$156.4 million through the first nine months.

For the first nine months of fiscal 2018, the company invested just over \$73 million in capital expenditures and we now expect capital expenditures for fiscal 2018 to be between \$115 million and \$140 million. The fiscal 2018 capital expenditure estimate is lower than previously communicated due to the timing of projects and our disciplined use of cash.

Our return on invested capital significantly improved during the quarter. The increase was driven by strong operating profit, a lower tax rate and robust cash flow which was used to reduce debt. There's more work to do here but we're pleased with the progress so far this year. Also our net debt to adjusted EBITDA is now less than 3 times. So to wrap it up, we had a solid quarter and delivered strong earnings in cash flow. Our first nine months' results are on plan and we feel confident in our fiscal 2018 financial goals.

Now I'd like to turn it back to George for a final word on Vistar's promising growth prospects.

George L. Holm

President, Chief Executive Officer & Director, Performance Food Group Co.

Thanks, Jim. Before we get into Q&A I'd like to return to Vistar for just a couple of minutes. As most shareholders know, Vistar is a leading distributor of candy snacks and specialty beverages and other single serve impulse and immediate consumption items. Vistar has a national distribution network with an unparalleled inventory variety, it also has the infrastructure to leverage specialized inventory to penetrate new customer channels. To support the growth in Vistar we have been opening new channels over the past few years both organically and through M&A. Vistar continues to look at new opportunities for growth where consumers are buying candy, snacks, and specialty beverages.

Today, Vistar has strong market shares in the vending, movie and office coffee channels. Most recently it has acquired a new channel in the corrections space, specifically corrections commissary. We believe Vistar serves a unique opportunity in the marketplace and has so much growth ahead both organically and through strategic M&A. So while today about two thirds of our overall profitability comes from traditional broadline distribution, we believe Vistar is a very unique part of our business and that it will increasingly contribute to our success over time.

In closing, we're pleased with our year-to-date results remain on track to achieve our strategic and financial objectives for 2018. We're continuing to make strategic investments in our sales associates and our customer and associate facing technologies. Our associates are determined to provide the best customer centric experience, we believe we have the right strategies to deliver best-in-class and top-line growth. We're investing in technology and more important, investing in our customers, so they can thrive.

We believe the M&A pipeline remains robust and we continue to look for potential acquisition opportunities in specialty Vistar and Performance Foodservice.

With that, we're here to take your questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] And your first question is from John Heinbockel with Guggenheim Securities.

John Heinbockel

Analyst, Guggenheim Securities LLC

Q

So George, you brought up Vistar, where do you think the greatest opportunities are still today, right, when you think about where your share is the lowest? And on the retail side, are you hindered, and there are certain accounts that you probably don't have because – because you don't distribute tobacco, how big of a hindrance is that?

George L. Holm

President, Chief Executive Officer & Director, Performance Food Group Co.

A

Well, certainly it would allow us to kind of cast a wider net for customers and there are places not having tobacco. It just makes it harder for us to sell them, candy snacks and specialty beverage, if that's a fairly significant part of their business. And as far as, where the opportunities are, it's real simple, if a good percentage of what an account relies on for revenues come from candy, snack and beverage, we think we're just in a good spot to be the person to deliver that. We have a large SKU base, so we're extremely deep from a SKU perspective in fairly, fairly small product categories. So it's just – it just makes us probably a fairly difficult competitor in that area.

John Heinbockel

Analyst, Guggenheim Securities LLC

Q

Okay. And then to switch gears, the ramp up in salesperson hiring. When do you expect that to start showing up in local case growth? To what degree I mean will that be something that's quite noticeable. I don't know if it can get you back to where you were a couple years ago, right in the real high single-digits but and then the people you've hired, are they more productive in terms of what they can do per person than those you might have hired in the past or the profile of who you've hired is pretty much the same.

George L. Holm

President, Chief Executive Officer & Director, Performance Food Group Co.

A

The profile is very similar, probably a little less so in direct Foodservice distribution experience. Once again kind of casted a little wider net. We have hired at a faster rate than we have in the past, as I mentioned on the last call, we did get behind. And as to when we'll start seeing some benefit from that, we might have saw some in April. It's kind of hard to tell. We were back over 6%, and been a long time since we had not done that. Although when we look at the fiscal third quarter, and we look at a two-year stack, we were at 6.7%. But if April is a reflection, the first couple weeks of May can be difficult to tell because you know the holiday has such a huge impact. But I feel we're starting to see some benefit from the hiring that we've done.

John Heinbockel

Analyst, Guggenheim Securities LLC

Q

Okay. Thank you.

Operator: Your next question is from Edward Kelly from Wells Fargo.

Edward J. Kelly

Analyst, Wells Fargo Securities LLC

Q

Yeah, good morning guys. Hey George, just a quick question. I know maybe it's hard but from a total case growth perspective is it possible to size up the weather impact? I know you did it for independents.

And then as we think about April performance and sort of like where you are now, it sounds like the independent business has really bounced back. Is that similar for organic case growth overall as well?

George L. Holm

President, Chief Executive Officer & Director, Performance Food Group Co.

A

Yes, it is for overall. It was an interesting quarter because actually we get better sequentially each month. I mean January was a very difficult month. March was actually a good month in spite of the nor'easters that hit four weeks in a row. We had tried to quantify the impact that it's had on the businesses outside of our independent – I think independent probably a little bit easier for us to do. It certainly affected us in Customized, although I would say that the Northeast is not as big for us as the Southeast. And when you go west, the chains that we supply aren't as big west. So the impact in the Customized area was kind of more mid-winter impact than March. March was actually fairly good.

Within Vistar, we certainly had an impact in dollar stores and I think that's similar to restaurants; people just couldn't get out and get into them. The vending business actually tends to do quite well when the weather is bad. People don't leave the office as much. So it's kind of hard to tell, I think when it comes to a restaurant occasion if people didn't go out, it's not like they're going to turn around and go out more often coming up. But when it comes to something like a movie, if they were planning to go to a movie and they didn't go because of a snowstorm, they're still going to go see that movie; it's a movie they want to see. So, we have so many variables that we deal with. I think probably the biggest impact was the independents. So if you take that one and a half, it probably goes down from there.

Edward J. Kelly

Analyst, Wells Fargo Securities LLC

Q

Okay. And just thinking about organic case growth overall, it looks like excluding weather sort of thinking year-to-date, you're kind in like this 2% range which is less than what we've seen historically. Low margin Customized obviously is a headwind to it. Just how should we be thinking about organic growth and your goals, particularly as we look out beyond the fourth quarter?

George L. Holm

President, Chief Executive Officer & Director, Performance Food Group Co.

A

Yeah. Well we've pretty much stayed 3% to 5% and that's probably what we'll continue to do and we've continued to do that if you exclude what we've experienced with Customized. And those are good customers but the quality of that sale is different for us from the margin component and the profitability component. So if we're 3% to 5% outside of that channel, we're real comfortable that we can leverage that and put out the kind of earnings growth that's expected.

Edward J. Kelly

Analyst, Wells Fargo Securities LLC

Q

Okay. Just last question for you is on freight. You didn't mention freight really this quarter and you didn't last either but your peers did. I'm just wondering the impact that it's having on your business. And if so, sort of like how are you managing the headwind better than some others?

George L. Holm

President, Chief Executive Officer & Director, Performance Food Group Co.

A

Ed, I've had Jim spend a lot of time on that. So I'm going to go ahead and have him take that question.

James D. Hope

Chief Financial Officer & Executive Vice President, Performance Food Group Co.

A

Yeah. Thanks, George. So freight remains a headwind for us but it's certainly a manageable headwind. Sequentially we're seeing it start to loosen up a bit. From a year-over-year perspective, it's still an increase. I can you tell that internally our supply chain team's working to manage as many inbound loads as we can which helps us. And while there's a multitude of logistic challenges, we're working our way through it. We think all these will settle and we will continue to successfully manage through it like we have been. But it's a headwind.

George L. Holm

President, Chief Executive Officer & Director, Performance Food Group Co.

A

Yeah. No. I'll add some color to that because you mentioned it may be different for our competitors. If you start first of all with our Vistar business, I mentioned our big inventory we have a very wide SKU base, but we have heavy, heavy volumes with key suppliers that we buy only in truckload into each distribution center. And we have a truckload price from them and we don't have an FOB price from them. So, there is no opportunity for us to manage the freight and they manage it, it's their kind of cost that. So we don't have a negative impact there.

Then when you get to our Customized business and our whole strategy there has been for many years that we use as few distribution centers as possible for that customer and we land in truckloads as much of their product as we possibly can. So it's somewhat the same situation where the continuity of our business is straight truckloads into these centers where we're ordering it from the manufacturer and they're delivering it to us either on their equipment or they're arranging the freight. Long answer but probably worth doing and we're just, we're in a different situation, so it doesn't have as big an impact on us.

Edward J. Kelly

Analyst, Wells Fargo Securities LLC

Q

Great. Thanks. That's helpful.

Operator: Your next question is from with Karen Short with Barclays. Karen, your line is open.

Karen Short

Analyst, Barclays Capital, Inc.

Q

Hi. Sorry about that. Thank you. Just a quick question – a couple quick questions. I guess at this late stage in the fourth quarter your guidance for the full year still is a fairly wide range and obviously implies a relatively wide range for the fourth quarter, so wondering if you could just talk to that.

George L. Holm

President, Chief Executive Officer & Director, Performance Food Group Co.

A

Well, I think that we've only seen really one month of this fourth quarter and I think when you come off of some of the headwinds that we worked our way through, I would say that we're confident in the higher end of our range, but we certainly don't want to give guidance that that is something that we want to change. So I guess it's that simple.

Karen Short

Analyst, Barclays Capital, Inc.

Q

Okay. And then on Vistar, you obviously had great growth, profit dollar growth but OpEx was also, growth was significantly higher than what we're looking for and I think you pointed to closing headquarters for CCSI at the end of June, so that should abate, but is there anything else to look for in terms of mitigating that OpEx?

George L. Holm

President, Chief Executive Officer & Director, Performance Food Group Co.

A

Well, they have nine distribution centers and there's only two that will continue to be open and long-term there won't be any that will be open, so that will be a help. And then I think that couple things. And these aren't major, but a couple things. One is we certainly don't have the driver issues in Vistar that we would have in Performance Foodservice. It's not as difficult a job. It's not as physical a job. But there's still a driver shortage, so we deal with some transportation headwinds and we're handling those well.

The other thing is that our growth continues to be in higher margin channels that also have higher cost to serve. So that tends to put us in a position where as we move along in Vistar we should see higher gross margins and somewhat higher expense ratios and that's just the norm in how we do business today. That could change as we continue to look at other channels. But for today we feel like we're going to continue to see margin improvement and it could just be a little choppy as to where the expense ratios go.

Karen Short

Analyst, Barclays Capital, Inc.

Q

Okay. That's helpful. And then just last question on the M&A front, one of your competitors indicated that things would be a little slower this year just in general, I'm wondering if you could just comment on how you see the M&A environment and how we should think about M&A this year?

George L. Holm

President, Chief Executive Officer & Director, Performance Food Group Co.

A

Yeah. We're – we're actually we feel like we're in a good spot right now from an M&A standpoint, for it actually to be a better year than last year, maybe not in number of deals but potentially in the revenue and EBITDA impact from those deals. It could be a little similar to CCSI where a lot of the benefit comes more so in a year two than year one; tends to be the way we like to look at it. We don't touch a business very much in the first year, but our – we have activity that's going on today in the Vistar world, in the specialty, and that would probably be more where you'll see it.

Karen Short

Analyst, Barclays Capital, Inc.

Q

Great. Thanks.

Operator: Your next question is from Andrew Wolf with Loop Capital Markets.

Andrew Wolf

Analyst, Loop Capital Markets LLC

Q

Thanks. Good morning. So I assume that you jump in independent case growth into April was all organic, if you haven't announced any recent acquisitions. And also, if you confirm that, could you give us a sense of what the independent case growth was organically in the quarter or in April, if you take out – I think you have a small acquisition or two helping out that division.

George L. Holm

President, Chief Executive Officer & Director, Performance Food Group Co.

A

Yeah. We haven't done any broadline acquisitions for quite a while, I mean well over a year. So basically we have – all the growth that we have is organic growth. I mean, a little bit but not material in any way.

Andrew Wolf

Analyst, Loop Capital Markets LLC

Q

Oh, okay, great. So you're not rolling specialty into Performance Food when you calculate these numbers I guess?

George L. Holm

President, Chief Executive Officer & Director, Performance Food Group Co.

A

We didn't until we lapped, okay, so.

Andrew Wolf

Analyst, Loop Capital Markets LLC

Q

Yeah. [indiscernible] (28:48)

George L. Holm

President, Chief Executive Officer & Director, Performance Food Group Co.

A

We didn't put it into the growth until we went through that 52-week period of time and our independent was what's – where we had the sales histories in place. And the reason that we did that is we moved some business around and we had some product that before that say that meat or the seafood company they were cutting it and delivering it themselves and we started doing it on our own trucks and some of it vice versa. So we just felt let's get through the 52 weeks where we're not given out regular number and organic number because it would have been confusing. So the numbers that we put out right now, the numbers that you get are organic but they do have those three specialty companies in there once we've lapped the histories on them.

Andrew Wolf

Analyst, Loop Capital Markets LLC

Q

Okay.

George L. Holm

President, Chief Executive Officer & Director, Performance Food Group Co.

A

[indiscernible] (29:41) confused.

Andrew Wolf

Analyst, Loop Capital Markets LLC

Q

No, no. That's actually clarifying. It's good to hear that. [indiscernible] (29:45). Okay, and just to follow up on Vistar, where is the Memphis facility at in terms of smooth operation sort of from picking to packing to delivery and so forth, capacity utilization? How are those processes ramping? I know you had some...

George L. Holm

President, Chief Executive Officer & Director, Performance Food Group Co.

A

Yeah. Right. It's gone very well. We have excess capacity there which is always a nice thing to have. It's continuing to grow. We're being fairly conservative with it. We are in the process now of looking at number two and we're doing a lot of work around what the difference will be between the current one and the second one where we get it to a level of profitability and the right productivity quicker and we'll be talking more about that particularly as we get into our next call, but as far as the current facility, no issues; nothing to talk about there.

Andrew Wolf

Analyst, Loop Capital Markets LLC

Q

Great. So, I won't ask my follow-up because it sounds like you're going to approach it more, give us greater depth on the next call so that's it for me. Thank you.

George L. Holm

President, Chief Executive Officer & Director, Performance Food Group Co.

A

Great. Thanks, Andy.

Operator: Your next question is from Vincent Sinisi with Morgan Stanley.

Vincent J. Sinisi

Analyst, Morgan Stanley & Co. LLC

Q

Hi, great. Good morning, guys. Thanks a lot for taking my question here. I wanted to – you've been in the last few months certainly talking more about Vistar, which is great obviously, the franchise part of your business so wanted to just put the first question back on that. When you look at, obviously, like the word vending encompasses a lot of different customers that you have, lot of different parts of the business, kind of where do you think right now you know you're kind of – you have the best share but where do you think you're most underpenetrated and should we think of it as you know essentially like endless opportunities for you and especially since there's no other large player in that space?

George L. Holm

President, Chief Executive Officer & Director, Performance Food Group Co.

A

Yeah. Well, vending has not been what I would call a real growth channel for many, many years. Actually it was negative for several years and we were always able to grow just by taking share. It's kind of hard to even to determine growth there. I think the channel is growing but it's growing because of micro markets and micro kitchens. We're seeing very nice growth in vending; we're seeing nice growth in every single channel that Vistar is in. But I think, and this is just only I think, that a very high if not just about all of our growth is coming from micro markets and micro kitchens within vending. And remember, we are selling the vend operator. So we only have a certain amount of insight into whether that product ends up in a machine or it ends up in a micro market environment or it ends up in a micro kitchen environment. And our share...

Vincent J. Sinisi

Analyst, Morgan Stanley & Co. LLC

Q

Okay. All right. That's helpful.

George L. Holm

President, Chief Executive Officer & Director, Performance Food Group Co.

Yeah. Our shares are comparable...

Vincent J. Sinisi

Analyst, Morgan Stanley & Co. LLC

Okay.

George L. Holm

President, Chief Executive Officer & Director, Performance Food Group Co.

... across the channels that we're in with the exception of the corrections commissary business where we have actually a quite low share. So we have a lot of potential there.

Vincent J. Sinisi

Analyst, Morgan Stanley & Co. LLC

Okay. So that's most underpenetrated then and do you – I mean I know no kind of forecast out there but do you – to your comment earlier, George, about kind of becoming more and more of a contribution to this business. If you look out 10 years, should we expect it to be a meaningfully higher part of the business when you're looking at both the core sales and profitability?

George L. Holm

President, Chief Executive Officer & Director, Performance Food Group Co.

I think you could see that in the next – potentially in the next year or two. But I believe Performance Foodservice is what's going to provide us the best growth in probably both sales and EBITDA.

Vincent J. Sinisi

Analyst, Morgan Stanley & Co. LLC

Okay. All right. Helpful. And then maybe just for the follow-up just more of a housekeeping. Just on the full-year tax rate, I believe you said last quarter that you were expecting 33% for the full year. Is that still the case? Thanks a lot guys.

James D. Hope

Chief Financial Officer & Executive Vice President, Performance Food Group Co.

Yeah. That's right. That's still the case, Vinnie.

Vincent J. Sinisi

Analyst, Morgan Stanley & Co. LLC

All right. Perfect. Best of luck going forward.

George L. Holm

President, Chief Executive Officer & Director, Performance Food Group Co.

Thanks, Vincent.

Operator: Your next question is from Kelly Bania with BMO Capital.

Kelly Ann Bania

Analyst, BMO Capital Markets (United States)

Q

Hi, good morning. Thanks for taking my question. Just wanted to maybe talk a little bit more about gross margin. That continues to come in at least ahead of our expectations, so you called out the growth of \$0.26 per case and obviously the margin expanded 50 basis points. And there's clearly some improved mix with the business, but maybe you can just help us understand, is there any impact there from the Customized and the closure of the facility there, and maybe should we start to see that settle back down over the next couple quarters or just how you feel about that, the drivers of that gross margins. Thank you.

George L. Holm

President, Chief Executive Officer & Director, Performance Food Group Co.

A

Yeah. I'll go through that. I think it's a little bit complicated; I don't want to overcomplicate it. I think if you take and you look at the Georgia closure that was low gross margin business and if you look at the decline in sales in Customized, that's our lowest gross margin. So, that contributed to a 50-basis point increase in margin.

Also when you get into the Vistar business, it is the higher margin but I also mentioned higher cost to serve, but it's the higher margin business that is growing at the fastest rate. And in Performance Foodservice today, we've continued to grow our independent at a faster rate than we've grown our chain business. What I expect to see as we get into next fiscal year would be the margins probably continuing to improve, but they're not going to improve at the rate that they're improving today.

But we also, with better growth, expect to be able to leverage it better. So I think that as we get into next year, what I am looking at is better gross margins than we have today but not the kind of improvement that we've been running and a little better effort around cost control, particularly with some of this overhead going away from CCSI. Hopefully that helps...

Kelly Ann Bania

Analyst, BMO Capital Markets (United States)

Q

Yeah. That makes sense. Thank you. Just wanted to follow up too on the status of MarketWatch and how that's rolled out to the sales organization and how you feel about the implementation of that tool.

George L. Holm

President, Chief Executive Officer & Director, Performance Food Group Co.

A

Okay. It is fully implemented as of the end of March. And I think it's always difficult to tell, but it has helped our margins and I really wouldn't be comfortable to say how much. I mean our independent margins have improved not dramatically but they've improved and I would think that we could attribute it to our people having more knowledge than they've had in the past. And that's probably about all I could really say with it. It's still new and we're just now fully implemented.

James D. Hope

Chief Financial Officer & Executive Vice President, Performance Food Group Co.

A

The one comment I would add is our margins are doing well in a period of inflation, and that's important to know. So I think MarketWatch has given the salespeople the information they need to understand what the right price is.

Kelly Ann Bania

Analyst, BMO Capital Markets (United States)

Great. Thank you.

Q

Operator: [Operator Instructions] And your next question is from Ajay Jain with Pivotal Research Group.

Ajay Jain

Analyst, Pivotal Research Group LLC

Yeah. Hi. I wanted to ask if you can quantify the improvement in Customized and in the PFS segment in the current quarter, George. George, I think you mentioned some sequential improvement for April but are you back at what you would consider to be a more normalized level in terms of case growth and I'm asking for both independents and in your multi-unit business. And by normalize what I'm really asking is if you think you're back to the level that you were contemplating a few months ago? I think back in February you were expecting to be at the higher end of the EBITDA range for the year so, I was just wondering if there's been you know you're back to a more normalized level?

Q

George L. Holm

President, Chief Executive Officer & Director, Performance Food Group Co.

Well, for the month of April and the first two weeks of May, I can say we're pretty normalized when it comes to independent growth. But you know it's – it's six weeks, so that's not a long period of time to establish that, but we feel real good with it. Customized, you know we roll off the histories after this quarter of the Georgia closure and we had one other account where we had a bankruptcy that we've got sales histories for. So that should that – well, it should normalize within what the norm is in that business and that's a fairly slow casual dining environment.

A

Now I will say that it is better than it has been in the past. We're real encouraged by what we see, particularly out of a couple of the customers, I mean some real true improvement in some same-store sales growth. So if that continues that would be great. I don't know that how that area does, it's going to have a real material impact on what our EBITDA growth is as a company but today we feel real good around Performance Foodservice. We've invested heavily in sales people. We said we would do that with questions around what we would do with the tax savings. We did a great job there. And our Vistar business we just have a lot of confidence around next year in both sales growth and then kind of a little better expense level than we had had in this year.

Ajay Jain

Analyst, Pivotal Research Group LLC

And with respect to Vistar...

Q

George L. Holm

President, Chief Executive Officer & Director, Performance Food Group Co.

And we'll be giving guidance by the way on our August call, so we'll do a whole lot of work around that and give the best guidance that we can give.

A

Ajay Jain

Analyst, Pivotal Research Group LLC

Okay.

Q

George L. Holm

President, Chief Executive Officer & Director, Performance Food Group Co.

Go ahead, you had another question?

A

Ajay Jain

Analyst, Pivotal Research Group LLC

Just one final question with respect to Vistar, is there any way to give a breakdown of like the segment performance without the benefit of acquisitions? So I'm just wondering about the organic growth trends both top-line and EBITDA for Q3?

Q

George L. Holm

President, Chief Executive Officer & Director, Performance Food Group Co.

It's very hard to do because when we make acquisitions, we merge business in pretty quick. Nobody has the footprint that we have with the national footprint. So we'll make an acquisition, we did a small one in January and we had customers that went into five different distribution centers and many of the customers we already sold something to. So it's very hard even in the case of CCSI when we got to October we saw the projections on Star Wars for December and made the decision that we weren't going to be able to do the job as good as we should do from a service standpoint if we kept that business in, so we moved a lot of that.

It's real hard but if you just look at what the top-line was of these acquisitions that we made and what our top-line is now, so more directionally we're still running at worst mid-single digit organic growth and from a case standpoint.

A

Ajay Jain

Analyst, Pivotal Research Group LLC

Great. That's helpful. Thank you very much.

Q

Operator: And your final question is from Judah Frommer with Credit Suisse.

Judah C. Frommer

Analyst, Credit Suisse Securities (USA) LLC

Hi, guys. Thanks for taking the question. First maybe just higher level on independents, if you kind of exclude the weather maybe look at the last six weeks or so, what are you seeing just from a health of the underlying customer and maybe some color on penetration of existing customers versus new business and how the churn is in that business, do you have plenty of new openings offset in closings there?

Q

George L. Holm

President, Chief Executive Officer & Director, Performance Food Group Co.

Yeah. I don't think a lot's changed since the last call. I think the independent channel is still doing well. And then when you start to dig into how it looks from our numbers I think we always got to remember that we have like a 5% to 6% share in a lot of the country we don't cover from a full broadline aspect. But what we're seeing is that we're still pretty dependent on new accounts. We grow our new business at a good bit faster rate than we lose business. And then if you get into the penetration that we have, we're doing well but we're growing our lines faster than our cases, which tells me probably they're buying less cases of what they bought the previous year or I mean I guess you could say maybe we already had the high case movement items in our penetrations coming further

A

down the tail of movement. So not sure there, but all-in-all excluding weather, I think that the independent channel was good in the quarter and I think it continues to be a tailwind for us.

Judah C. Frommer

Analyst, Credit Suisse Securities (USA) LLC

Q

Okay. Thanks. And then just one follow-up maybe on inflationary, you called out a few categories. But I mean PPI data, just maybe it's not the best way to track it but it doesn't look all that great. As far as you can see, inflation kind of continues in that 2%-ish range that you're thinking about. Is there anything besides the categories you called out that may be helping there?

George L. Holm

President, Chief Executive Officer & Director, Performance Food Group Co.

A

Do you want to comment on that, Jim?

James D. Hope

Chief Financial Officer & Executive Vice President, Performance Food Group Co.

A

Yeah. We don't have a crystal ball, of course but that being said, we don't see anything that should drive a big change or make things different than they are to do today so given the marketplace, I would think we're looking at 2% to 2.5% inflation going forward.

Judah C. Frommer

Analyst, Credit Suisse Securities (USA) LLC

Q

Okay. Thanks, guys.

Operator: I will now turn the call back to management for closing remarks.

Michael D. Neese

Vice President, Investor Relations, Performance Food Group Co.

Thank you for your time this morning. We are hosting a CAGNY luncheon tomorrow in New York City at Maloney & Porcelli at 12 o'clock. To register for the lunch, please visit consumeranalystgroupny.com and select Monthly Lunchables tab. You will be directed to the membership portal where you can sign up sign up as either a member or a nonmember non-member. And we hope you can make it. Thank you for your time today.

Operator: This concludes today's conference call. You may now disconnect.

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