Flowers Foods

First Quarter 2021 Prepared Remarks

May 20, 2021

CORPORATE PARTICIPANTS

J.T. Rieck, *SVP of Finance and Investor Relations*

Ryals McMullian, *President and CEO*

Steve Kinsey, *CFO and CAO*

PRESENTATION

J.T. Rieck, *SVP of Finance and Investor Relations*

Hello everyone and welcome to the pre-recorded discussion of Flowers Foods' first quarter 2021 results. This is JT Rieck, SVP of finance and investor relations. As a reminder, we released our first quarter results on May 20, 2021. Along with a transcript of these recorded remarks from our CEO and CFO, you can find the earnings release and related slide presentation in the investor section of our website. We will host a live Q&A session on Friday, May 21 at 8:30 a.m. Eastern. The details are posted in the investor section of flowersfoods.com.

Before we get started, keep in mind that the information presented here may include forward-looking statements about the company's performance. Although we believe these statements to be reasonable, they are subject to risks and uncertainties that could cause actual results to differ materially. In addition to what you hear in these remarks, important factors relating to Flowers Foods' business are fully detailed in our SEC filings.

Providing remarks today are Ryals McMullian, president and CEO, and Steve Kinsey, our CFO. Ryals, I'll turn it over to you…

Ryals McMullian, *President and CEO*

Thanks JT.

It's a pleasure to welcome everyone to our first quarter call.

I'm happy to share our first quarter results with you today. It was an exceptional quarter for us, particularly considering that we run a 16-week first quarter and had to cycle the pantry loading weeks that occurred with the onset of COVID last year. Our company is as strong as it's ever been, and we look forward to building upon what we've achieved over the last couple of years. The current business environment does present some challenges, but also great opportunities. We'll talk about how we expect to capitalize on those opportunities and mitigate the challenges all through the lens of our four strategic priorities: developing our team, focusing on our brands, prioritizing margins, and pursuing smart M&A.

Starting with developing our team…. I'd like to begin by once again expressing my appreciation to the entire Flowers team for their continued devotion to producing quality products for our consumers and faithfully serving our markets. Our strong performance continues to be the direct result of their hard work, passion, and dedication.

On past calls, we've discussed the steps we've taken to strengthen our team. We continue to focus on building an exceptional team of leaders who bring new capabilities that will add tangible value and help drive our strategic priorities forward.

Our second strategic priority is focusing on brands. Our company has never been in a better position to succeed given the strength of our leading brands and the investments we are making in them.

We've been able to capitalize on our #1 loaf, organic, and gluten-free market share by successfully extending our product lines into adjacent categories, such as breakfast and buns and rolls. For some time now we have been seeing a shift within the category from traditional loaf to specialty items like breakfast and buns. We feel very well positioned to capitalize on this shift by continuing to innovate with new items with a distinct point of difference like our Perfectly Crafted Brioche buns, and our DKB breakfast and bun offerings.

As we work to fully stand up our agile innovation function, we are aggressively developing new and innovative products to capture greater wallet share of those consumers who already enjoy many of our existing products. Recent introductions include both Dave's Killer Bread and Nature's Own Perfectly Crafted Rye breads, Nature's Own Perfectly Crafted flatbreads, and Wonder English muffins that aim to grow our share in product segments where we are underrepresented. Our entry into rye and flatbreads target $300 million and $228 million markets respectively where we have been absent until now.

Alongside these product introductions, we have ramped up our marketing spend. A particular area of focus for us continues to be in e-commerce, where we currently have a 17.9% market share (slightly above our overall market share of 17.7%). E-commerce now represents 9.6% of our retail sales, up from 4% in the prior year period. We have a unique opportunity to capitalize on the renewed interest in bakery products triggered by the pandemic and we are making every effort to attract and retain these additional consumers.

And those efforts are paying off. Even with the difficult prior year comparisons of peak pandemic demand, tracked channel sales of Canyon Bakehouse and Dave's Killer Bread rose, growing approximately 14% and 7% respectively versus the prior year period, while Nature's Own declined only 3.5%. Comparing our first quarter results to the pre-pandemic levels of 2019, Canyon, Dave's Killer Bread, and Nature's Own rose approximately 101%, 42%, and 16% respectively. This performance is squarely aligned with our portfolio strategy, which aims to shift our mix to a higher percentage of branded sales. That percentage rose to 66.1% in the first quarter, compared to 66.0% in the prior year period, and 59.9% in the first quarter of 2019.

For perspective, in the first couple months of 2021, we saw strong branded retail levels, similar to what we experienced through the back half of last year. In the final months of the quarter, while branded retail moderated somewhat, it remained elevated well above 2019 levels. And, in fact, through the first several weeks of the second quarter, we continue to see elevated levels of branded retail demand despite some marked improvement in foodservice, which gives us confidence that our portfolio strategy is working. Consumers' increasing preference for brands is consistent with industrywide trends, as store brands' share continued its long-term decline, falling 40 basis points to 20.0% in the trailing twelve months, and down from 26% in 2015.

When I think about our performance in the quarter, it's exceptional to me that our total sales were up 3% over the first quarter of 2019, considering the drop in foodservice sales, the amount of SKU rationalization we have done over that two-year period, and the decline in private label. It is further testament to our portfolio strategy and the performance of our team.

Our third strategic priority is margins and that focus was certainly on display in the first quarter. With sales down 3.5% versus the prior year pandemic-inflated quarter, we succeeded in increasing EBITDA margins 30 basis points to 12.4% primarily driven by improved pricing and mix.

We've highlighted our expectation for $30-40 million of portfolio optimization savings in 2021 on top of the $22 million we achieved in 2020, and we remain on track to deliver on that goal. We've seen progress at some of our lower-performing bakeries, such as the Navy Yard, and expect continued improvements as we move through the year.

I know a particular area of focus for many food companies is commodity inflation. It's no secret that prices for transportation, labor, and commodities have increased significantly. In the shorter-term, our buying strategies help mitigate inflationary pressures. If these higher prices persist, over the longer-term we will address them using the levers at our disposal.

Price is obviously the most powerful of those levers and we have been successful in using price to minimize the impact of higher costs. Another lever is trade spend efficiency, which has improved over the last several years as we've leveraged new trade promotion management tools. And of course, it's always incumbent upon us, inflation or no inflation, to continue to improve our own efficiencies.

Our fourth priority is smart M&A. We have a long and successful track record in this regard and our solid balance sheet provides the flexibility to be aggressive where we have strong financial, commercial and operational conviction. As the economy reopens, the pace of deal flow is increasing. And, as always, we are proactively seeking out potential deals, while maintaining our disciplined approach.

Now, I'll turn it over to Steve to review the details of the quarter, and to talk about our guidance for 2021, and then I'll come back later to discuss our outlook for the current business environment. Steve?

Steve Kinsey, *CFO and CAO*

Thank you, Ryals – and hello everyone. I'd like to echo your comments and express my sincere thanks to our incredible team whose efforts have been nothing short of outstanding. Now, turning to the quarterly results…

As Ryals indicated, the pandemic continues to influence our results, though we do see some indications of mix reversion. Our first quarter is 16 weeks, and, therefore, our first quarter 2020 comparisons may be more impacted by the pandemic-related demand increase that occurred in March through mid-April than our peers were. That said, we are pleased with our overall sales and mix in Q1 2021. Because of the uniqueness of that year over year comparison, in some circumstances we will also provide comparisons to the pre-pandemic results in the first quarter of 2019.

Total sales declined 3.5% from the prior year period, but increased 3% compared to the first fiscal quarter of 2019. Lower volumes drove the decline, down 6.9%, due to difficult prior year comparisons in most channels aside from foodservice. Partially offsetting the volume declines was a 3.4% increase in price/mix, across almost all parts of the business, which was split fairly evenly between price and mix. Results were strong compared to pre-pandemic levels throughout the quarter with the exception of Easter timing, which provided a temporary headwind in April that reversed in the second quarter.

Looking at sales by channel, branded retail sales decreased $29.1 million or 3.3% to $861.4 million. As Ryals noted earlier, despite those strong prior year results, both Dave's Killer Bread and Canyon Bakehouse grew meaningfully, partially offsetting volume declines in other branded retail categories.

However, compared to the first quarter of 2019, branded retail sales increased 13.7% as our leading brands continue to benefit from pandemic-related demand increases and our initiatives to drive further growth. New products, such as extensions of our Nature's Own Perfectly Crafted line and DKB buns, were particularly strong contributors.

Store branded retail sales decreased $27.9 million year over year or 14.6% to $162.9 million, as consumers continued to express a preference for more-differentiated, branded products. Compared to the 2019 first quarter, store branded sales were down 14.7%.

Non-retail and other sales increased $9.8 million or 3.6% to $277.9 million as we lapped significant pandemic-induced declines in the prior year period. Non-retail sales benefitted from improved price/mix, partly due to internal initiatives to improve the profitability of this business. Foodservice recovery was particularly noteworthy, while institutional and vending sales were weaker.

Non-retail and other sales overall remain below pre-pandemic levels, with sales down 11.8% compared to the 2019 first quarter, though fast food is the exception and is higher versus 2019. As non-retail sales continue their recovery, we expect that the work we've done to improve the profitability of this business will result in that recovered business coming back at higher margins than before.

In the quarter, gross margin as a percentage of sales, excluding depreciation and amortization, increased 30 basis points. Higher ingredient and packaging costs as a percentage of revenue were offset by lower short-term incentive compensation and better overall plant efficiencies. In Q1 2020, we also recorded $1.7 million of start-up costs related to the conversion of our Lynchburg, Virginia facility to an organic bakery. Outside purchases of product were also lower as we streamlined our SKU count.

Selling distribution and administrative expenses decreased 20 basis points as a percentage of sales in the first quarter. Excluding the items affecting comparability detailed in the press release, adjusted SD&A expenses were unchanged from the prior year period as lower bad debt expense and distributor distribution fees were partly offset by higher e-commerce marketing expenses and lower sales.

GAAP diluted EPS for the quarter was 34 cents per share. Excluding the items affecting comparability detailed in the release, adjusted diluted EPS in the quarter was 41 cents per share, unchanged from the prior year period.

Turning now to our balance sheet, liquidity, and cash flow. For the first quarter of 2021, cash flow from operating activities decreased $8.2 million to $98.0 million compared to the prior year period, capital expenditures increased $5.6 million to $27.3 million, and dividends paid increased $2.2 million to $42.5 million.

Our financial position remains strong. At quarter-end, net debt to trailing twelve month adjusted EBITDA stood at approximately 1.2-times, down from 1.3-times at 2020 year-end. At quarter-end, we held approximately $251 million in cash and cash equivalents and had approximately $671 million of remaining availability on our credit facilities. Importantly, we issued $500 million in 2031 notes, the proceeds of which were partly used to redeem our $400 million notes that would have matured in 2022. We were pleased with the pricing of the notes, particularly given their long-term maturity. We believe the strong investor interest in the offering demonstrates the confidence of the capital markets in our company and our strategic plans.

Now, turning to our adjusted outlook for 2021. We are forecasting sales to decline between 2% to 3.5% versus 2020, compared to prior guidance of down 2% to down 4%. Relative to 2019 results, our guidance implies top line growth of 2.7% to 4.3%. For earnings, we are raising the bottom end of our guidance range to adjusted EPS of $1.10 to $1.17, compared to our prior guidance of $1.07 to $1.17 and 2019 adjusted EPS of $0.96.

Our updated guidance range is now fully within or above our long-term financial target ranges of 1-2% sales growth and 7-9% EPS growth off the 2019 base, even with the five-cent headwind from our digital/ERP initiatives. As a reminder, 2021 shifts back to 52 weeks, one fewer week than 2020. The additional week in 2020 contributed 1.8% to full-year sales and approximately 2 cents to EPS.

As we've completed the first quarter and moved into quarter two, the operating environment has been better than we initially forecasted. In fact, branded retail constituted 66.1% of our total sales in Q1 compared to 66.0% in the fourth quarter of 2020, and also the prior year first quarter, which included the peak of pandemic-driven sales. Branded retail has maintained its large percentage of our total sales despite the recovery in our non-retail and other business.

Some of the factors we considered when setting guidance included the impact of the pandemic on the pace of reopening, as well as inflationary commodity costs. Although our 2021 plan did contemplate some inflation, markets have been much more volatile than anticipated. Where possible, we've fixed input costs for the remainder of 2021, but cost inputs that do not offer forward buying could cause some inflationary pressures in the second half.

While we still have a good bit of 2021 remaining, should commodity prices stay at current levels, we would expect meaningful inflation in 2022. In a moment, Ryals will share more color on the factors we are watching in 2021.

Free cash flow generation is expected to be strong, and our capital allocation priorities and philosophy remain consistent with our focus on maximizing return on invested capital and growing shareholder value. Although our Q1 capex spend of $27 million was somewhat below our full year run rate, we do anticipate the pace of investment to pick up over the remainder of 2021 as we support our supply chain optimization and digital transformation initiatives. We continue to expect capital expenditures in the range of $140 to $150 million for the year.

Thank you. And now I'll turn it back to Ryals.

Ryals McMullian, *President and CEO*

Thank you, Steve. I'm pleased with our start to the year and optimistic about the steps we are taking to continue our success well into the future.

Steve detailed our guidance for 2021 and I'd like to provide some more color around how we are thinking about the remainder of the year. Last quarter, we highlighted some of the factors that could affect results within our guidance range. Those factors included the timing of the pandemic-related demand reversion, cost inflation, the pace of our long-term growth investments, including digital, and our success in achieving operational improvements at a few of our lower-performing bakeries.

With regard to digital, we are off to a solid start. Our digital initiatives are on track and, as our plans solidify, we expect to provide further details later in the year. With regard to guidance, we specifically pointed out three levers to keep an eye on, mix reversion, commodity inflation, and the promotional environment, and I'd like to update you on how these are trending.

(1) Mix reversion: so far, as I mentioned earlier, branded retail has remained strong, solidly ahead of 2019 levels, while foodservice is recovering, though still below 2019, and store branded retail continued the weak trends that began well before the pandemic. We are keeping a close eye on the changing dynamics we foresee in the back half of the year as kids return to school.

(2) Commodity inflation is certainly picking up and we are doing the things we've always done to offset that inflation with cost savings, efficiency improvements, our portfolio strategy, and pricing and trade spend optimization where necessary. As I said earlier, we've been successful in using price to minimize the impact of higher costs so far and we expect that we will be able to continue to do so when necessary given the combination of our strong brands and the recognition throughout the industry that everyone will need to offset these higher costs, and…

(3) The promotional environment has remained stable so far. Obviously, we'll keep a close eye on this and I'm confident that with our enhanced capabilities we will be able to maximize the effectiveness of our promotional strategies.

Finally, I'd just like to note that our company has been in business for almost 102 years. I certainly recognize that the indicators of inflation we're all seeing are foremost on everyone's mind. However, it's important to remember that we have been through similar periods many times before. We have experienced inflationary environments, deflationary environments, recessions, and even depressions. We've weathered them all.

Our core products are staples of the American diet. They are weekly purchases, and that consistency has helped drive our strong cash flow over many years. While we recognize and appreciate the potential short-term impact of inflation on our results, we believe we have accounted for that in our 2021 guidance. Consumers have demonstrated a clear preference for differentiated brands and we believe our strong brands position us better than ever before to navigate today's environment.

So, no matter the environment, we are committed to maximizing our performance by driving top line growth and expanding margins. Our leading brands and high-performing team give me great confidence that we are on the right path and well-positioned to deliver results in-line with our long-term financial targets.

Thank you very much for your time. This concludes our prepared remarks. I'd like to invite you to listen to our live question and answer webcast, which will begin at 8:30 am Eastern on Friday, May 21, and will be available for replay on the investor section of flowersfoods.com. Thank you and take care.

Forward-Looking Statements

Statements contained in this transcript and certain other written or oral statements made from time to time by Flowers Foods, Inc. (the "company", "Flowers Foods", "Flowers", "us", "we", or "our") and its representatives that are not historical facts are forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. Forward-looking statements relate to current expectations regarding our future financial condition and results of operations and the ultimate impact of the novel strain of coronavirus ("COVID-19") on our business, results of operations and financial condition and are often identified by the use of words and phrases such as "anticipate," "believe," "continue," "could," "estimate," "expect," "intend," "may," "plan," "predict," "project," "should," "will," "would," "is likely to," "is expected to" or "will continue," or the negative of these terms or other comparable terminology. These forward-looking statements are based upon assumptions we believe are reasonable. Forward-looking statements are based on current information and are subject to risks and uncertainties that could cause our actual results to differ materially from those projected. Certain factors that may cause actual results, performance, liquidity, and achievements to differ materially from those projected are discussed in our Annual Report on Form 10-K (the "Form 10-K") and Quarterly Reports on Form 10-Q filed with the Securities and Exchange Commission ("SEC") and may include, but are not limited to, (a) unexpected changes in any of the following: (1) general economic and business conditions; (2) the competitive setting in which we operate, including advertising or promotional strategies by us or our competitors, as well as changes in consumer demand; (3) interest rates and other terms available to us on our borrowings; (4) energy and raw materials costs and availability and hedging counter-party risks; (5) relationships with or increased costs related to our employees and third-party service providers; (6) laws and regulations (including environmental and health-related issues); and (7) accounting standards or tax rates in the markets in which we operate, (b) the ultimate impact of the COVID-19 outbreak and measures taken in response thereto on our business, results of operations and financial condition, which are highly uncertain and are difficult to predict, (c) the loss or financial instability of any significant customer(s), including as a result of product recalls or safety concerns related to our products, (d) changes in consumer behavior, trends and preferences, including health and whole grain trends, and the movement toward more inexpensive store branded products, (e) the level of success we achieve in developing and introducing new products and entering new markets, (f) our ability to implement new technology and customer requirements as required, (g) our ability to operate existing, and any new, manufacturing lines according to schedule, (h) our ability to execute our business strategies which may involve, among other things, (1) the integration of acquisitions or the acquisition or disposition of assets at presently targeted values, (2) the deployment of new systems and technology, and (3) an enhanced organizational structure, (i) consolidation within the baking industry and related industries, (j) changes in pricing, customer and consumer reaction to pricing actions, and the pricing environment among competitors within the industry, (k) disruptions in our direct-store-delivery distribution model, including litigation or an adverse ruling by a court or regulatory or governmental body that could affect the independent contractor classifications of the independent distributors, (l) increasing legal complexity and legal proceedings that we are or may become subject to, (m) increases in employee and employee-related costs, (n) the credit, business, and legal risks associated with independent distributors and customers, which operate in the highly competitive retail food and foodservice industries, (o) any business disruptions due to political instability, armed hostilities, incidents of terrorism, natural disasters, labor strikes or work stoppages, technological breakdowns, product contamination, product recalls or safety concerns related to our products, or the responses to or repercussions from any of these or similar events or conditions and our ability to insure against such events, (p) the failure of our information technology ("IT") systems to perform adequately, including any interruptions, intrusions or security breaches of such systems or risks associated with the planned implementation of a new enterprise resource planning ("ERP") system; and (q) regulation and legislation related to climate change that could affect our ability to procure our commodity needs or that necessitate additional unplanned capital expenditures. The foregoing list of important factors does not include all such factors, nor necessarily present them in order of importance. In addition, you should consult other disclosures made by the company (such as in our other filings with the SEC or in company press releases) for other factors that may cause actual results to differ materially from those projected by the company. Refer to Part I, Item 1A., Risk Factors, of our Form 10-K and Part II, Item 1A., Risk Factors, of our Quarterly Reports on Form 10-Q for additional information regarding factors that could affect the company's results of operations, financial condition and liquidity. We caution you not to place undue reliance on forward-looking statements, as they speak only as of the date made and are inherently uncertain. The company undertakes no obligation to publicly revise or update such statements, except as required by law. You are advised, however, to consult any further public disclosures by the company (such as in our filings with the SEC or in company press releases) on related subjects.

Information Regarding Non-GAAP Financial Measures

The company prepares its consolidated financial statements in accordance with U.S. Generally Accepted Accounting Principles (GAAP). However, from time to time, the company may present in its public statements, press releases and SEC filings, non-GAAP financial measures such as, EBITDA, adjusted EBITDA, EBITDA margin, adjusted EBITDA margin, adjusted net income, adjusted EPS, adjusted income tax expense, adjusted selling, distribution and administrative expenses (SD&A), gross margin excluding depreciation and amortization, free cash flow, and the ratio of net debt to adjusted EBITDA. The reconciliations attached provide reconciliations of the non-GAAP measures used in this presentation or release to the most comparable GAAP financial measure. The company's definitions of these non-GAAP measures may differ from similarly titled measures used by others. These non-GAAP measures should be considered supplemental to, and not a substitute for, financial information prepared in accordance with GAAP.

The company defines EBITDA as earnings before interest, taxes, depreciation and amortization. Earnings are net income. The company defines free cash flow as operating cash flow minus capital expenditures. The company believes that free cash flow provides investors a better understanding of the company's liquidity position. The company believes that EBITDA is a useful tool for managing the operations of its business and is an indicator of the company's ability to incur and service indebtedness and generate free cash flow. EBITDA is used as the primary performance measure in the company's 2014 Omnibus Equity and Incentive Compensation Plan. Furthermore, pursuant to the terms of our credit facility, EBITDA is used to determine the company's compliance with certain financial covenants. The company also believes that EBITDA measures are commonly reported and widely used by investors and other interested parties as measures of a company's operating performance and debt servicing ability because EBITDA measures assist in comparing performance on a consistent basis without regard to depreciation or amortization, which can vary significantly depending upon accounting methods and non-operating factors (such as historical cost). EBITDA is also a widely-accepted financial indicator of a company's ability to incur and service indebtedness.

EBITDA should not be considered an alternative to (a) income from operations or net income (loss) as a measure of operating performance; (b) cash flows provided by operating, investing and financing activities (as determined in accordance with GAAP) as a measure of the company's ability to meet its cash needs; or (c) any other indicator of performance or liquidity that has been determined in accordance with GAAP.

The company defines adjusted EBITDA, EBITDA margin, adjusted EBITDA margin, adjusted net income, adjusted diluted EPS, adjusted income tax expense and adjusted SD&A, respectively, excluding the impact of asset impairment charges, Project Centennial consulting costs, business process improvement costs, lease terminations and legal settlements, acquisition-related costs, and pension plan settlements. Adjusted income tax expense also excludes the impact of tax reform. The company believes that these measures, when considered together with its GAAP financial results, provides management and investors with a more complete understanding of its business operating results, including underlying trends, by excluding the effects of certain charges.

The company defines net debt as total debt less cash and cash equivalents. Net debt to EBITDA is used as a measure of financial leverage employed by the company. Gross margin excluding depreciation and amortization is used as a performance measure to provide additional transparent information regarding our results of operations on a consolidated and segment basis. Changes in depreciation and amortization are separately discussed and include depreciation and amortization for materials, supplies, labor and other production costs and operating activities.

Presentation of gross margin includes depreciation and amortization in the materials, supplies, labor and other production costs according to GAAP. Our method of presenting gross margin excludes the depreciation and amortization components, as discussed above.

Reconciliations of the non-GAAP measures used in this script to the most comparable GAAP financial measure are published in the earnings release issued in advance of this earnings call and posted on our website at flowersfoods.com/investors.