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FLO.N - Q1 2021 Flowers Foods Inc Earnings Call

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OVERVIEW:

Co. reported 1Q21 GAAP diluted EPS of $0.34. Expects 2021 adjusted sales to decline between 2.0-3.5% vs. 2020 and adjusted EPS to be $1.10-1.17.

CORPORATE PARTICIPANTS

A. Ryals McMullian *Flowers Foods, Inc. - President, CEO & Director*

J. T. Rieck *Flowers Foods, Inc. - SVP of Finance & Investor Relations*

R. Steve Kinsey *Flowers Foods, Inc. - CFO & CAO*

CONFERENCE CALL PARTICIPANTS

Faiza Alwy *Deutsche Bank AG, Research Division - Research Analyst*

Mitchell Brad Pinheiro *Sturdivant & Co., Inc., Research Division - Research Analyst*

Robert Frederick Dickerson *Jefferies LLC, Research Division - MD & Senior Research Analyst*

Ryan Blaze Bell *Consumer Edge Research, LLC - Research Analyst*

William Bates Chappell *Truist Securities, Inc., Research Division - MD*

PRESENTATION

Operator

Good day, and thank you for standing by, and welcome to the Flowers Foods First Quarter 2021 Results Conference Call. (Operator Instructions) Please be advised that today's conference is being recorded. (Operator Instructions) I would now like to hand the conference over to your speaker today, J.T. Rieck, Senior Vice President of Finance and Investor Relations. Please go ahead.

J. T. Rieck - *Flowers Foods, Inc. - SVP of Finance & Investor Relations*

Thank you, Victor, and good morning. I hope everyone has the opportunity to review our earnings release, listen to our prepared remarks and view the slide presentation. These were posted yesterday evening on our Investor Relations website. After today's Q&A session, we will also post an audio replay of this call.

Please note that in this Q&A session, we may make 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.

We also provide non-GAAP financial measures for which disclosure and reconciliations are provided in the earnings release and at the end of the slide presentation on our website. Joining me today are Ryals McMullian, President and CEO; and Steve Kinsey, our CFO. Victor, we're ready to start the Q&A, please.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question will come from Rob Dickerson from [Jefferies] (added by company after the call). You may begin.

Robert Frederick Dickerson - *Jefferies LLC, Research Division - MD & Senior Research Analyst*

Great, from Jefferies. So look, quarter was a good quarter. It sounds like you have decent conviction in the revenue guidance. It also sounds like or it seems like those consumers that have been consuming at home or continue to consume at home with retail brands still elevated, which is great.

I would just ask because I think this is kind of the main question for a lot of investors right now, there's a line in the prepared remarks and said, "it seems as if maybe commodity inflation is somewhat manageable for this year. But for next year, right, if prices kind of remain where they are, there could be a bit more pressure." So I would just appreciate any more color on that, color potentially around some of those offsets, including pricing potential in the back half of this year. And then I'll just leave it at that.

R. Steve Kinsey - *Flowers Foods, Inc. - CFO & CAO*

Sure, Rob. Hey, this is Steve. Obviously, there's a lot of volatility in the commodity markets. Our guidance takes into consideration what we believe will play out for 2021. And as you know, we do hedge and we take coverage usually on the 7- to 9-month time horizon and typically stay on the long end of that. So we do believe we have good visibility for the rest of 2021. There are a few things that we can't cover. They're a little more near term, some in the packaging area, and you are seeing a lot of volatility and volatility and inflation in packaging, particularly around the corrugated area and arena.

But like I say, we do feel like we have decent visibility. Ryals said in his comments, there are several levers we can pull, pricing being one of those, but we are looking at efficiencies across our bakeries as well as other cost initiatives. So I do feel pretty good about the guidance range we have out there. And obviously, due to the volatility and the way things move so quickly, as the year progresses, we'll be able to change any guidance as necessary. But I think given the point we're at, we feel pretty comfortable with that.

Looking into 2022, obviously, we're not prepared to give guidance for 2022. But the reality is when you look at what's driving kind of the commodity inflation, a lot of that is not necessarily weak. I mean the wheat crop is in pretty decent shape but it's other grains like corn and beans. And it's more of a global market. We are seeing China back into that market in a big way. And just as grains turn to feed grains and there's tightness on availability of supply, then that starts to impact things like wheat and other grain crops.

So the reality is that today's prices, if we had to go out and cover, there would be significant commodity inflation, but we still have a lot of runway with regard to the corn crop, the bean crop, and we'll cycle a wheat crop. But we just thought it was important to get that out there from a transparency perspective.

A. Ryals McMullian - *Flowers Foods, Inc. - President, CEO & Director*

Rob, just to add a couple -- Rob, add a couple of points to that. Steve's spot on across the board. But we've -- as you know, we've been through periods like this many times in the past. Yes, we've been able to adequately cover most of most of the inflation that we've experienced over the years. I would say that I think we're better positioned today perhaps than we've ever been just with the -- if you think about the strength of our branded portfolio now and the focus on it, consumers' obvious desire for branded products with a point of difference. I think that positions us even better as you think about some of the levers we can pull from an inflationary environment standpoint.

Robert Frederick Dickerson - *Jefferies LLC, Research Division - MD & Senior Research Analyst*

Okay. That makes sense. And just a quick follow-up. Like you said, consumers continue to focus on brands. Your branded business is doing very well, right? You call out in the prepared remarks just the growth overall with DKB and Canyon, which has been phenomenal. And even relative to 2019, right, revenues still remain elevated.

So I guess like the larger question then is as consumers, they start to revert back. Are you seeing kind of 1 of the 3 things you're keeping your eye on, right, is reversed and basically channel reversion? Is there anything that you would say now relative to 12, 18 months ago, that has changed your way of thinking of maybe how to service some of the channels? Like are there benefit to maybe not reverting as much, like just say, okay, we're going to leverage some excess capacity over here a little bit in private label, a little bit in the foodservice. We know what, we've learned through the pandemic this -- or no? Is it just kind of get back to business as usual? And that's all.

A. Ryals McMullian - *Flowers Foods, Inc. - President, CEO & Director*

Yes. Thanks, Rob. No, I don't think it goes back necessarily business as usual. As we've said before, I do think there are -- some of these patterns are probably permanent. But we've also consistently said we do expect to see some movement back to prepandemic levels. So I don't think it will go all the way back. I do think that when school starts in August, that should give us a better kind of long-term indication of where these trends are ultimately going to land. Having said all that, no matter what that environment looks like, we believe that we're very well positioned with our branded portfolio, as I mentioned. But also, as you think about foodservice. Coming back, which it already did somewhat in the quarter, we started to see some moves up in foodservice. And the good story there is via our customer strategy work, it is coming back at better margins. So as that mix reverts and foodservice starts to come back, it won't have as significant of an impact as it would have prior to the execution of that strategic work.

Operator

Our next question will come from the line of Bill Chappell from Truist.

William Bates Chappell - *Truist Securities, Inc., Research Division - MD*

First, a follow-up on pricing. Have you seen any pricing from -- on the competitive landscape? I think we heard on the other day that like Little Debbie and the cake side had already led some pricing. Imagine not all of your competitors are kind of headed the same way you are. So they might be feeling the pinch sooner than later. So I didn't know if you've seen anything there or look to follow it from that standpoint.

A. Ryals McMullian - *Flowers Foods, Inc. - President, CEO & Director*

Yes, nothing really significant, Bill. The one comment I'd make relative to pricing just in the competitive environment is the promotional cadence. And still consistent with past quarters, we haven't seen really any move relative to promotions, still remain well down, base sales really driving everything, though, obviously down year-over-year just given the pantry loading months but nothing significant. I mean we know that some of the regional players perhaps don't hedge like we do or at least, not as far out. So they're a little bit more exposed to the spot market and that kind of thing, but thus far, nothing notable at this point. Bill, it also could be more of a -- just like for us, it could be more of a back half dynamic than a full half dynamic.

William Bates Chappell - *Truist Securities, Inc., Research Division - MD*

Yes. Sure. And then on private label, I mean, it's pretty astounding that it's gone from 26% of the category down to 20%, which has got to be one of the lowest in years. And I think I've asked this question before, but since you supply so much of the private label, I mean, at what point can you go in and push more of your branded products on the shelf and show that, "Hey, this is not really a great use of the space." I mean since you do service it with DSD, I would think that, that's something that's pretty apparent to the retailers as well as the industry.

A. Ryals McMullian - *Flowers Foods, Inc. - President, CEO & Director*

Indeed, it is. Yes, you're right. We've talked about this a little bit on prior calls, but I mean, I think the retailers are seeing the benefit in our category and others, frankly, of consumers' preference for brands. So we have been able to expand our shelf space, particularly with Dave's and Perfectly Crafted's and Canyon, some of those leading items that we have, again, just kind of highlighting the importance of the portfolio strategy overall. But I agree with you, it is pretty amazing to see see how far down it is, but I think that's a reflection of consumer behavior more than anything else. And I'm certain that the retailers are pretty in tune with that.

William Bates Chappell - *Truist Securities, Inc., Research Division - MD*

Sure. And then last one for me. Just going back a year ago, you had your 40-ish bakeries being able to, in short period of time, hit a massive surge in sales. And now that we've come -- or we're coming back down or we're normalizing, I mean do you look back and say, "Boy, the supply chain, the number of facilities we have could be streamlined even further? We're really much more efficient than we could or be more efficient and could be even more efficient by cutting out a few plants here or there?" Or is that not the case? Is it, "Hey, let's just continue to operate and grow with it?"

A. Ryals McMullian - *Flowers Foods, Inc. - President, CEO & Director*

No. To the contrary, look, I mean network optimization has been one of our key areas of focus, as you know. We did convert that Lynchburg bakery. We have some other projects going on this year. And you've seen with the elevated CapEx numbers this year, so still very much a focus point for us. As we often say, it's -- there are a lot of levers you can pull in an inflationary environment, but it's always incumbent upon us to make sure we're being as efficient as possible. So we're constantly evaluating our network from that standpoint.

William Bates Chappell - *Truist Securities, Inc., Research Division - MD*

Got it. But more just kind of normal process, I mean would you -- I guess -- sorry, would you expect CapEx to be elevated going into 2022? Or is this really the big year of change?

R. Steve Kinsey - *Flowers Foods, Inc. - CFO & CAO*

Well, Bill, this year, the focus is on kind of the digital initiatives. We have said that the digital is a 2- to 3-year initiative. So while we're not prepared to give guidance on 2022, I would expect you could see some elevated CapEx for the next 2 to 3 years, whether it's digital or whether it's working on our portfolio and optimization, some of those projects.

Operator

Our next question will come from the line of Faiza Alwy from Deutsche Bank.

Faiza Alwy - *Deutsche Bank AG, Research Division - Research Analyst*

I just wanted to follow up on the inflation point, and I don't know if you're willing to say anything on this. But I'm curious, are you still hedging out into 2022? Because it sounds like are you expecting sort of these prices on wheat, et cetera, to come down into '22? So you'd rather have open positions? Or are you sort of continuing your programmatic hedging program at these current prices?

R. Steve Kinsey - *Flowers Foods, Inc. - CFO & CAO*

Yes. I mean we wouldn't comment specifically on 2022 at this point. But we tend to stick to our overall hedge strategy, which is the 7 to 9 months. So we do have some visibility into the first quarter of 2022, but the reality is it's still pretty volatile. And beyond that, I probably wouldn't comment much on our particular coverage with regard to the long end of our coverage range. But we do -- we are beginning to think about what we do for 2022.

Faiza Alwy - *Deutsche Bank AG, Research Division - Research Analyst*

Okay. That's helpful. And then just secondly, you talked about improving the profitability of the nonretail segment. And I know you talked about this previously. But I wonder if there's more color. Are there numbers that you can put around that? Just more details around how much of an impact this could have going forward or has had so far.

A. Ryals McMullian - *Flowers Foods, Inc. - President, CEO & Director*

Yes. Well, Faiza, I mean, obviously, foodservice on a relative basis remains pretty depressed, if you -- particularly if you compare it back to 2019. So it's just starting to recover. The quick-serve business has been the fastest to recover. I think that's actually up a bit over '19 with the balance of the foodservice business still being a little bit off. We haven't quantified it before, but it's something that we measure internally. We have set new margin thresholds for our foodservice business. And the way we're approaching it is if we cannot get a piece of foodservice business to that acceptable margin threshold via price or our own efficiencies or whatever levers may be out there for us to pull, that we have a decision to make about whether or not that's some business that we want to continue. And so far, we've been pretty successful in getting a nice piece of that business up to those margin thresholds.

Having said that, we're not done yet. I mean we've still got a long way to go. We've only been executing on this for 9 months or so but early returns have been really good. And as I said, as that business has come back, it has come back at an overall higher margin level. So as we go forward, I expect it to be a meaningful contributor to the overall. We've said in the past that foodservice is never going to be at the margin level of branded retail, but there's certainly a lot of room for improvement. And I think in years past, our foodservice team, and we have, I believe, the best one in the industry, there was a bit of a different strategic vision for foodservice that was based more on volume and sales gains than margin.

But that team has now been given permission, if you will, to go get that margin even if it means walking away from some business from time to time. Not all of it's going to fit but there is a lot of opportunity out there in foodservice that we think can be nicely additive to the overall. Hopefully, that helps give you a little bit more color.

Faiza Alwy - *Deutsche Bank AG, Research Division - Research Analyst*

Yes, definitely. And then just last one for me. Just on the digital initiatives, have you made any of these investments so far? Cause just my reading of your comments was that you're sort of -- you're not there yet, but you're still committed to the $0.05 of spending that you've talked about. Are those more -- should we expect those to come through more in the back half? Or have you already sort of started making these investments?

A. Ryals McMullian - *Flowers Foods, Inc. - President, CEO & Director*

Yes. No, we have already started. I mean a lot of it on the front end is working with our outside partners in the -- for the planning and design phases. But the $0.05 is still good for the year, though that will be a little more heavily weighted in the back half as we start executing on the plan, at which time also, later this year, we'll be giving you guys some more detail on where we're headed from a digital strategy standpoint.

Operator

Our next question will come from the line of Mitch Pinheiro from Sturdivant.

Mitchell Brad Pinheiro - *Sturdivant & Co., Inc., Research Division - Research Analyst*

Yes. So a couple of questions here. First, back to private label for a second. Is -- it is a remarkable drop when you look at the trend from just even several years ago. And you talked about it being sort of consumer behavior-led. Is any of this retailer-led?

A. Ryals McMullian - *Flowers Foods, Inc. - President, CEO & Director*

I don't think so. I think it's -- it is consumer-led. If you think about the category overall, Mitch and just back up, let's just call it 5 years ago, just to use a round number. There wasn't nearly as much innovation, if you will, in our category. You didn't have DKB nationwide. Certainly, that was basically a West Coast phenomenon until we bought it kind of the same thing we can. That was all in Costco or in the freezer case, et cetera. And since then, I mean, we'll even talk about our competitors, I mean, certainly coming out with ---, it's coming out with Perfectly Crafted and then obviously, layering on DKB and Canyon. I think a lot of the innovation on the bread wall is driving this, too. And as you know, in our category, there's not much differentiation among private label items in our category. It's basically white and wheat bread.

Similarly, within the category, we've seen a shift from kind of your traditional flows, still lots sold. But your 100% whole wheats or honey wheat to these specialty items. Buns, breakfast in particular, there's kind of been a mix shift in the category that we've been watching for some time. And obviously, with our new items in both of those subsegments, we benefited. I think that's the primary driver, Mitch.

Mitchell Brad Pinheiro - *Sturdivant & Co., Inc., Research Division - Research Analyst*

Okay. Okay. And then looking at your 2-year stack growth, you did 3% in this quarter versus '19 first quarter. That's -- looking at that over 2 years, obviously, it's a little above your long-term growth rate. Is that -- do you -- and then looking at your sort of revenue guidance for the remainder of the year, it looks like you expect to see this type of stack growth for the remainder of the year. Is that accurate?

A. Ryals McMullian - *Flowers Foods, Inc. - President, CEO & Director*

Yes. We actually feel pretty good about that, Mitch. I mean our branded retail business is actually up 13.7%, I believe it was, J.T., over '19. So we're really pleased with the overall trajectory. Frankly, it -- to me, it's even more exceptional considering the fact that private label is off as much as it is, plus we've done quite a bit of SKU over that period of time, too. So taking all that complexity out of the portfolio, really focusing on the winners. I think we're showing that, that's paying some nice dividends and we see that through the rest of the year. We're quite optimistic there.

Mitchell Brad Pinheiro - *Sturdivant & Co., Inc., Research Division - Research Analyst*

Have you ever defined your SKU rationalization drag?

A. Ryals McMullian - *Flowers Foods, Inc. - President, CEO & Director*

I'm sorry, Mitch. Say that one more time.

Mitchell Brad Pinheiro - *Sturdivant & Co., Inc., Research Division - Research Analyst*

Have you redefined or given us any color on what the SKU rationalization drag was in percentage terms on your growth rate?

A. Ryals McMullian - *Flowers Foods, Inc. - President, CEO & Director*

No, I don't think so.

Mitchell Brad Pinheiro - *Sturdivant & Co., Inc., Research Division - Research Analyst*

Okay. I mean how meaningful is it? Is it in the low single digits? Or is it less than 1%? I mean is it -- how meaningful is SKU at to these numbers?

A. Ryals McMullian - *Flowers Foods, Inc. - President, CEO & Director*

Yes. Well, I'll have to go back and look at that, Mitch. I don't have that in front of me.

Mitchell Brad Pinheiro - *Sturdivant & Co., Inc., Research Division - Research Analyst*

Okay. And then as it relates on the same thing on looking at your growth in adjusted EBITDA from '19's quarter to the current quarter, how -- is it all mix? Or is there anything else in there? Any cost of goods savings in there? Or anything else in the side shift, the positive mix shift?

A. Ryals McMullian - *Flowers Foods, Inc. - President, CEO & Director*

Yes. No, there absolutely is. We had our $10 million to $20 million in portfolio optimization savings last year. We actually beat the top end of that. So you've got that piece of it. And that's a mix of procurement savings, overhead savings, SG&A savings so it's kind of a broad cost basket. We have a target of $30 million to $40 million out there for this year in many of those same categories, and we're on track to deliver on that as well.

For then, Mitch, if you think about the bakery efficiencies and some of the underperforming bakeries, making some really nice progress at Navy Yard, which I know you'll be happy to hear, things like that, our efficiency was up in the first quarter. Those add meaningfully to the bottom line as well.

Mitchell Brad Pinheiro - *Sturdivant & Co., Inc., Research Division - Research Analyst*

Okay. Terrific. And then last question. So your market share has been creeping up in bread over the last year or 2. And is there -- have you seen anything to call out among regional differences there? I mean, are you -- I don't see the regional scanner data. But is that -- any noteworthy changes in any regional market share gains or losses over the last year or so?

A. Ryals McMullian - *Flowers Foods, Inc. - President, CEO & Director*

Mitch, not really. I mean it's -- overall, the share trends have been good, obviously, a little bit down over the quarter last year, just given the massive gains but sequentially up from Q4, which is great to see. There's been a lot of talk about geographic shifts and people moving out of the Northeast to Florida or out of California to Texas, whatever it might be. We've looked at that but there's nothing specific to call out. except for one region, which is the Northeast, and that's the one that we've been focused on. We've been talking about that for the last few quarters where we're kind of underpenetrated there and making some nice share gains as we focus on that important market. So that's just one that I would call out to you.

Operator

(Operator Instructions) Our next question come from the line of Ryan Bell from Consumer Edge Research.

Ryan Blaze Bell - *Consumer Edge Research, LLC - Research Analyst*

If we're trying to get a benchmark of your nonbranded business from what we can see in track channel trends, and how should we think about that going forward? In general, I mean, we've been seeing private label across your categories declining. But given your intentional emphasis on your branded products, you've been seeing softer growth from your private label business relative to what we see in tracked channels. Is that something that we should expect to see for the foreseeable future?

A. Ryals McMullian - *Flowers Foods, Inc. - President, CEO & Director*

Well, I mean it's yet to be seen, right? I mean, obviously, we're focusing on our brands. And as I've said, I think the consumer is driving a lot of this. So again, the shift to brand, the differentiation and brand that you don't find in private label, I think, is driving a lot of that. Now we are making some decisions about select pieces of our private label business, kind of the same way that we're looking at foodservice to the extent it's underperforming or underdelivering relative to what it should. I mean private label is what it is. We have made some decisions to exit certain pieces of business, but I wouldn't describe that in terms of magnitude as being the primary driver. The primary driver is consumer-driven.

Ryan Blaze Bell - *Consumer Edge Research, LLC - Research Analyst*

That's helpful. And then you talked about M&A being your fourth strategic priority. Would you be able to provide any updated thoughts about the current M&A landscape just in terms of availability of the assets and valuations overall?

A. Ryals McMullian - *Flowers Foods, Inc. - President, CEO & Director*

Absolutely. Yes, things are -- in short, things are really heating up. I mean since the first of the year, you have people sort of took a break largely last year. And it's -- there's a lot of books flying around out there right now. I'm sure you guys have read about some of the more public ones, but there's quite a bit of opportunity. Ryan, the challenge, as it has been for the past few years, is valuation. We're committed to maintaining our disciplined approach. We certainly have the balance sheet to lean in where we've got high conviction but we're only going to do so in a reasonable way. And there's always so far we'll go and maintain our disciplined approach.

So I'm pleased to see the opportunities start to come back. Certainly, we're active. We remain active. And I think it will be a -- I think, overall, it will be a very active year in the food space. There's just a lot of money sloshing around out there trying find a place to land.

Ryan Blaze Bell - *Consumer Edge Research, LLC - Research Analyst*

Okay. And I think this is the last one for me. In terms of the organic growth side, you talked about some innovations in line with flatbread. Could you maybe talk about the opportunity or how fast you see some of those expansion?

A. Ryals McMullian - *Flowers Foods, Inc. - President, CEO & Director*

Absolutely, yes. We're really pleased with the flatbreads that we introduced in the Northeast. Obviously, continuing to innovate with Dave's. The ryes out there, it's doing great, right on target, great reception from consumers. If you haven't tried it, I suggest you do. It's a great loaf for rye bread. And then further out, I mean, we're standing up our agile innovation team its early days. We're just getting ramped up. But the early prototypes they've shown me of some of the things that we're looking at are just outstanding. So there's a lot of great things to come. And we all know how important innovation is going to be for us to continue to grow our top line in line with the long-term targets.

Operator

(Operator Instructions) And I'm not showing any current questions in the queue.

A. Ryals McMullian - *Flowers Foods, Inc. - President, CEO & Director*

Okay. Well, thank you very much, everyone, for your interest in Flowers, and we look forward to speaking to you next quarter. Take care.

Operator

This concludes today's conference call. Thank you for participating. You may now disconnect.