FlowersFoods

Fourth Quarter 2020 Prepared Remarks

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CORPORATE PARTICIPANTS

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PRESENTATION

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

Hello everyone and welcome to the pre-recorded discussion of Flowers Foods' fourth quarter and full year 2020 results. This is JT Rieck, SVP of finance and investor relations. As a reminder, we released our fourth quarter results on February 11, 2021. You can find the release and related slide presentation in the investor section of our website along with a transcript of these recorded remarks from our CEO and CFO. We will host a live Q&A session on Friday, February 12 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, and thanks to everybody for your interest in Flowers.

We're going to touch on two main themes today. First, our 2020 performance—areas where we succeeded and also where we have room for further improvement. And second, we'll discuss what we're doing to capitalize on the current environment to position ourselves for long-term success. We'll look at this past year through the lens of our four strategic priorities, again, developing our team, focusing on our brands, prioritizing margins, and pursuing smart M&A.

Starting with developing our team…despite the pandemic-related disruption and uncertainty, we generated sales and adjusted earnings at the highest levels in the company's history.

And that performance wouldn't have been possible without the incredible execution of our team, particularly our frontline workers. I've said it before, but it bears repeating, that I am grateful for their perseverance and I am humbled by their dedication. They have shown great courage and a devotion to ensuring that our consumers have the products they need, and we are committed to doing everything in our power to provide a healthy and safe work environment for them. I am particularly pleased that we were able to award our front-line team with two employee appreciation bonuses during the year in recognition of their dedication.

I think we've got the best team in the industry and the additions we made in 2020 have only strengthened it. We elected four new board members, who bring a wide range of skills and experience that will be invaluable in guiding the company forward. More recently, we added a chief supply chain officer and a chief procurement officer to help drive operational improvements.

We also created new structures to help improve performance, including our strategic organizational realignment to drive brand growth and product innovation, which consolidated our two business units into a single function under the leadership of Mark Courtney, who was named chief brand officer. As part of that realignment, David Roach was named president of cake operations to drive crucial operational improvements in that business.

And we created a transformation office, headed by Heeth Varnedoe, who was named chief transformation officer, to implement key, cross-functional initiatives. And I'll come back to the transformation office in a few minutes.

Our second strategic priority, focusing on brands, is at the heart of our growth strategy and the strength of our leading brands has been essential to our success in 2020. The pandemic has driven extraordinary levels of product trials, and we are doing everything in our power to encourage repeat purchases. We have increased marketing and advertising spend, particularly in digital, with the goal of driving branded growth. The result of that focus is annual sales growth, excluding the 53rd week, of approximately 17% for Nature's Own, 31% for Dave's Killer Bread, 28% for Wonder, and 36% for Canyon Bakehouse.

Our portfolio strategy prioritizes our branded products and promotes our third strategic priority, margins. The increased prevalence of at-home eating caused by the pandemic demonstrates the importance of our portfolio strategy. Despite volume declines in 2020 of 2.9%, our profitability increased markedly with EBITDA margins rising 160 bps to 11.9% as we are now seeing the true power of focusing on our brands.

Further to margin improvement, our portfolio optimization initiative that was launched in 2020 delivered approximately $22 million in cost savings, above our original goal of $10-20 million, and the conversion of our Lynchburg bakery to higher-margin, organic production will further help margins by reducing transport costs and increasing the quality and service levels to the important Mid-Atlantic and Northeast markets.

Our fourth priority is smart M&A. And we remain proactive in the deal space, but we are maintaining our long-established disciplined approach. M&A has always been, and will continue to be, an important part of our growth story. Our criteria for M&A candidates are those that can enhance our branded portfolio, extend our geographic presence, are a strong cultural fit, and bring enhanced capabilities to our company. We believe our strong balance sheet gives us the flexibility to pursue a wide range of deals and when the right one comes along, we will be ready.

More important than our accomplishments in 2020 is what we are doing to capitalize on the current environment and to position ourselves for long-term success.

The three primary areas of focus are driving growth, improving operations, and containing costs. I'll start by discussing our digital initiative, which contains elements of all three. And as I mentioned on our third quarter call, our digital strategy initiative is designed to transform how we operate our business.

Our 3 primary goals with the digital initiative are to (1) enable more agility in our business model, empowering the organization by fundamentally redesigning core business processes and our ways of working; (2) to embed digital capabilities where it matters and transform the way we engage with our consumers, our customers, and our employees; and (3) to modernize and simplify our application and configuration landscape (our ERP system) to remove existing roadblocks and support new ways of working.

Think of our digital strategy as a key enabler of our overall strategic priorities. Successful implementation of digital will support our brand efforts, bringing us ever closer to the consumer, increase our efficiencies in operations, and deliver higher-quality, real-time insights to the team, which will in turn support faster, higher-quality business decisions.

In addition to the upgrade of our ERP system, we have identified 11 domains where we see material expected benefit from digital. To start, however, we are focused on three primary domains, and they are: ecommerce, autonomous planning, and what we call "bakery of the future."

As we all know, ecommerce in grocery has seen a significant lift this year during the pandemic, and I firmly believe that this trend has staying power. It is imperative that Flowers win the digital shelf as well as the physical one. Our vision for ecommerce is to become a category leader, meeting consumers where they are, assuring Flowers' brands are top online brands of choice, and supporting retail partners in omnichannel to deliver an excellent consumer experience.

Autonomous planning covers everything from predictive ordering for our sales operations, to network modelling, to integrated business planning, to supply and demand forecasting. Our vision for autonomous planning is to predict consumer demand with higher accuracy and integrate that insight from point-of-sale through the supply chain to ensure the right raw materials are on site at the right time, the right products are produced at the right bakery every day, and deliveries are optimized to achieve high on shelf availability and customer service.

Finally, bakery of the future. Our vision here is to deliver best in class bakery performance and employee engagement through the application of industry leading digital manufacturing tools, such as real time performance management, automation of repetitive processes and performance visualization, standardization of processes and procedures across employees, shifts, lines, and bakeries, and sensor-based quality checks to improve consistency and reduce time to react to changes.

We are in the early stages of implementing this digital strategy and we plan to begin making investments behind these primary domains this year. As we move ahead in the process over the coming quarters, we plan to update you relative to the timing and amount of the expected benefits of these initiatives, which we expect to materialize over the next few years.

Simultaneously, we will continue to focus on improving operations, particularly at our underperforming bakeries, including the Navy Yard. Enhancing performance at these bakeries represents an achievable and material profit improvement to the company as a whole.

Regarding cost containment, our talent additions, particularly our new chief supply chain officer and chief procurement officer, are expected to drive efficiencies and reduce costs. Those initiatives are especially important given some of the cost inflation we are seeing in freight and commodities.

And, as I mentioned earlier, our portfolio optimization efforts are anticipated to deliver additional benefits in 2021. We currently expect savings, primarily in the first half of the year, to be between $30 and $40 million.

That all of these changes are coming during a period of strength highlights the fact that we are not resting on our laurels. Our culture emphasizes continuous improvement and we are determined to position ourselves to succeed in any market environment.

Flowers is in the midst of a transformation and we have a number of initiatives underway to drive growth and enhance profitability. Because these initiatives are so critical to the company’s success, we have established a transformation office to oversee these efforts led by Heeth Varnedoe, our chief transformation officer. Heeth is a seasoned Flowers executive with years of operational experience who carries enormous credibility in the organization. It is important to note that Heeth was the leader of our portfolio optimization efforts last year that overdelivered on results.

The primary goals of the transformation office are fourfold: (1) overall program management; ensuring that our initiatives stay on-track and on budget and holding the team accountable for results; (2) risk management; proactively identifying key risks to successful outcomes and quickly implementing mitigating measures; (3) value management; ensuring that our implementation plans are firmly connected to strategy and deliver against expected benefits and providing a single, objective ‘source of truth’ to inform executive decision-making; and (4) perhaps most importantly, change management; determining the impacts of the transformation and engaging change ambassadors throughout the company, developing top-down and bottom-up communication plans, tracking metrics and employee feedback to understand progress, and developing upskilling and training materials to ensure a successful transition. We have learned from both the successes and the shortcomings of our initial Project Centennial efforts, and I believe the leaders that we have selected for these efforts, combined with the establishment of the transformation office, will go a long way toward maximizing the benefits of these strategic initiatives.

Now, I'll turn it over to Steve to review the details of the quarter and the year, and to talk about our guidance for 2021, and then I'll come back later to discuss 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 during this challenging time have been nothing short of outstanding. Now, turning to the quarterly results…

As a reminder 2020 was a 53-week year for Flowers Foods, with the additional week falling in the fourth quarter.

Our results continued to be strongly influenced by COVID-19. Total sales rose 11.5%, with the additional week contributing 8.2%, an increase compared to our third quarter growth rate of 2.4%. Price/mix drove 7.7% of the sales increase, with the main factor being the shift in mix to branded retail items due primarily to consumers eating more meals at home. Volumes reduced overall sales by 4.4%, with particular weakness in store branded and foodservice and other non-retail channels.

Looking at sales by channel, directionally results followed the same pattern as in the third quarter. Branded retail sales increased $124.5 million or 22.6% to $675.6 million. Our leading brands continue to drive company performance, with particular strength from Nature's Own, Dave's Killer Bread, Wonder and Canyon Bakehouse. New products, such as extensions of our Nature's Own Perfectly Crafted line and DKB buns, remained significant contributors.

Store branded retail sales decreased $3.7 million or 2.6% to $137.0 million, with weakness across the board as consumers continued their shift to branded products. Our performance is consistent with industrywide trends, as store brands' share continued its long-term decline, falling from 23.1% in 2019 to 20.4% in 2020, and down from 25.8% share in 2015.

Foodservice and other non-retail sales decreased $15.5 million or 6.8% to $210.5 million. Lower volumes due to the impact of the COVID-19 pandemic drove most of the decline. We saw these declines across all categories of non-retail business, except for fast foods.

Excluding the impact of the extra week, branded retail sales increased 13.4%, store branded retail sales decreased 9.8%, and non-retail and other sales decreased 13.5%.

In the quarter, gross margin as a percentage of sales, excluding depreciation and amortization, increased 200 bps as the mix shifted to higher-margin branded retail products. That benefit was partly offset by $4.1 million in appreciation bonuses paid to front-line workers.

Selling distribution and administrative expenses decreased 320 bps as a percentage of sales in the fourth quarter. Excluding the items affecting comparability detailed in the press release, adjusted SD&A expenses increased 10 basis points due to higher distributor discounts, workforce-related costs, and higher marketing expenses, offset partially by a $3.9 million yeast recovery settlement and a $2.3 million positive adjustment to non-retail accounts receivable reserve. Higher distributor discounts were driven by a shift in product mix. Workforce-related costs increased primarily due to higher employee incentive costs due to our improved financial performance and a $2 million appreciation bonus paid to frontline workers not allocated to cost of goods sold.

GAAP diluted EPS for the quarter was 26 cents per share. Excluding the items affecting comparability detailed in the release, adjusted diluted EPS in the quarter was 28 cents per share, up 10 cents compared to the prior year quarter.

Turning now to our balance sheet, liquidity, and cash flow. For fiscal 2020, cash flow from operating activities increased $87.5 million to $454.5 million compared to the year ago period, capital expenditures were $97.9 million, and dividends paid were $167.3 million.

Our financial position remains strong. At quarter-end, net debt to trailing twelve month adjusted EBITDA stood at approximately 1.3-times, down from 2-times at 2019 year-end. At year-end, we held approximately $307 million in cash and cash equivalents and had approximately $501 million of remaining availability on our credit facilities.

Now, turning to our outlook for 2021. We are forecasting sales to decline between 2% to 4%. On the bottom line, we expect adjusted EPS to be in the range of $1.07 to $1.17. As a reminder, 2021 shifts back to 52 weeks, one less week than 2020. The additional week in 2020 contributed 1.8% to full-year sales and approximately 2 cents to EPS.

As we've moved into quarter one, the operating environment has remained relatively consistent with what we experienced in the fourth quarter. Some of the factors we considered when setting sales guidance included the impact of the pandemic and how long consumer behavior would continue to reflect remote working and learning. In addition, our earnings guidance took into consideration inflationary commodity costs and expenses related to our growth initiatives, including our strategic digital initiative.

In a moment, Ryals will share more color on the factors we are watching in 2021. We expect continued strong free cash flow generation, and our capital allocation priorities and philosophy remain consistent with our focus on maximizing return on invested capital and growing shareholder value. For 2021, we are targeting capital expenditures in the range of $140 to $150 million. This level is somewhat elevated compared to recent years primarily due to targeted investments to support supply chain optimization and our digital transformation.

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

Ryals McMullian, *President and CEO*

Thank you, Steve.

We enter 2021 in a position of strength. The positive mix shift driven by the pandemic is persisting into the new year and our leading brands continue to perform quite well.

Steve detailed our guidance for 2021 and it's important to emphasize that this is a transition year. Our assumption is that the impact of the pandemic will wane throughout the year and that we will return to a somewhat more normalized demand environment. If that assumption proves correct, it is reasonable to believe that results will be lower than in 2020.

When we issued our long-term financial targets last August, we were clear that while we expected results over time to be in-line with those targets, results in any one year may differ. In 2020, our performance significantly exceeded those targets and therefore it is reasonable to expect at least some reversion, especially since 2021 will have one fewer week than 2020.

In addition, given the strength of our cash flow and earnings in 2020, we have chosen this year to make important investments for the future, particularly in digital, which will impact 2021 results by approximately five cents. We expect the benefits from those investments to begin accruing in 2022 and beyond.

It's important to highlight that the midpoint of our 2021 guidance is in-line with our long-term targets using 2019 as the base year. Some of the factors that could affect results within that range include the timing of the pandemic-related demand reversion, cost inflation, the pace of our long-term focused growth investments, including digital, and our success in achieving operational improvements at our lower-performing bakeries.

Probably the three biggest levers to keep an eye on during the year are (1) Mix reversion: while we expect some reversion in mix during the year as things normalize, an accelerated or deeper reversion than we expect could adversely impact margins. (2) Commodity inflation and our ability to offset that inflation with cost savings, efficiency improvements, and pricing where necessary. (3) We'll also need to keep a close eye on the promotional environment, which through the fourth quarter of last year and even into the first month of this year has remained stable. However, a significant increase in promotional activity could negatively impact our results as we move through the year.

We'll also be carefully watching the effectiveness of our marketing investments to ensure that they are delivering the desired return and supporting our brand growth efforts.

Taking all of these factors into account, though, I believe it's going to be a great year for Flowers. We have connected with millions of new households that have tried our top brands. We have focused our investments in marketing and brand support across both digital and physical domains. We expect our portfolio optimization savings to continue to deliver in 2021. Our network optimization efforts are ongoing, which will help us further increase efficiencies. And most importantly, our team's morale is high. We are all really excited to get into the year and push ourselves to build on our 2020 accomplishments.

Every year presents its own unique challenges and this year is no different. But the Flowers team has never been better-positioned to meet these challenges head on and deliver performance in line with or above our long-term targets.

Thank you very much for your time. This concludes our prepared remarks. I like to invite you to listen to our live question and answer webcast, which will begin at 8:30 am Eastern on Friday, February 12, and will also be available for replay on the investor section of flowersfoods.com. Thank you very much.

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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 this Annual Report on Form 10-K (the "Form 10-K") 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 Securities and Exchange Commission ("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 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. 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 EPS, adjusted income tax expense and adjusted SD&A, respectively, excluding the impact of asset impairment charges, Project Centennial consulting costs, ERP road mapping consulting 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.