THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

FLO - Q1 2020 Flowers Foods Inc Earnings Call

EVENT DATE/TIME: MAY 14, 2020 / 12:30PM GMT

OVERVIEW:

Co. reported 1Q20 GAAP diluted loss per share of $0.03 and adjusted diluted EPS of $0.41. Expects 2020 adjusted EPS to be $1.00-1.08.

THOMSON REUTERS

CORPORATE PARTICIPANTS

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

J. T. Rieck *Flowers Foods, Inc. - Treasurer and VP of IR & Financial Analysts*

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

CONFERENCE CALL PARTICIPANTS

Brian Patrick Holland *D.A. Davidson & Co., Research Division - Senior VP & Senior Research Analyst*

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 *SunTrust Robinson Humphrey, Inc., Research Division - MD*

PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Flowers Foods' First Quarter 2020 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. Thank you. Please go ahead, sir.

J. T. Rieck - *Flowers Foods, Inc. - Treasurer and VP of IR & Financial Analysts*

Thank you, and good morning, everyone. Yesterday evening, we released our first quarter results. Our earnings release and quarterly slide presentation are posted on the Investors section of the Flowers Foods website. Our 10-Q is available on the SEC website. Before we begin our discussion, please be aware that it may include forward-looking statements about the company's performance and other matters, such as the impact of the COVID-19 pandemic. 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 the matters we'll discuss during the call, important factors relating to Flowers Spirit's business are fully detailed in our SEC filings. Participating on the call this morning are Ryals McMullan, Flowers Foods' Chief Executive Officer; and Steve Kinsey, Chief Financial Officer. Ryals, I'll turn the call over to you.

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

Okay. Thanks, J.T. Good morning, everybody. I know we're one of your last calls amidst what's been a really hectic earnings season, I'm sure for all of you. So thanks for joining us today. On behalf of Flowers, I do want to express my hope that you and your family and the ones you care about are staying safe and managing through this as best you can. These are certainly challenging times for everybody. And we've all had to pretty much adjust every aspect of our lives, both at home and at work. Our collective thoughts and prayers are certainly with all those who have been affected by the virus including members of our own Flowers family. As we've worked to manage through the crisis, we've remained committed to 3 key priorities. First and foremost, obviously, it's imperative that we maintain a safe workplace and support our employees in every way possible. Second, it's crucial that we fulfill our obligation as a key part of the nation's food supply. And third, as always, we're committed to supporting the communities that we serve. As far as our team goes, it's really difficult to adequately describe how incredibly proud I am to serve them. Across our company from plant operations to sales, distribution, head office and support staff, their performance has been flat out amazing. I firmly believe that our success during the quarter reflects the collective loyalty, commitment and passion of our team. Our core values of service, integrity and character have always been and always will be our guiding light, and those values served us well as we navigated previously unchartered waters. I'm especially grateful for the hard work, dedication and personal sacrifices of our front-line workers. Last month, we distributed incremental bonuses to our heroes to recognize their extraordinary efforts.

Now our top priority is ensuring the health and safety of the team, and in the early days of the crisis, we established a pandemic steering committee and a task force, led by senior Flowers executives. We've carefully followed guidance from health authorities, and we've instituted a number of safeguards for the protection of our employees, including enhanced sanitation, wellness and temperature screenings, travel restrictions, company provided masks, remote work, and of course, social distancing. We've also enhanced our benefit programs that are enabling our employees affected by the virus to care for themselves and their families. Despite these efforts, we have had some confirmed cases. And while certainly one affected employee is one too many, we have been fortunate in that we've experienced relatively few cases overall. And I think that robust bakery training, guidance, vigilance, constant communications from our pandemic task force are largely responsible for this result.

So heartfelt thank you to all the members of the steering committee and the task force as well as our regional vice presidents, plant general managers and the broader team for helping us maintain the safe conditions of our facilities. We take very seriously our responsibility to help feed America, and we have an enormous responsibility to ensure our products are readily available to our consumers. Now because our bakeries are strategically located around the country and close to the markets they serve, we were able to supply the market despite the unprecedented increase in retail demand. During the height of the panic buying in March, we streamlined our product assortment just like we do in advance of a hurricane, but in this case, we did it virtually nationwide. That allowed us to maximize production by focusing on longer runs of our best-selling items. Furthermore, we were able to reallocate some of our foodservice production to support the growth in the retail channel. Our production teams did an amazing job keeping up with the changing marketplace and ensuring our customers and consumers had the products they needed. For a number of weeks there, they were literally running around the clock, and our independent distributor partners played a key role and continue to faithfully serve their markets despite the personal risk. And finally, we have a deep connection to the many communities we serve, and as always, we're supporting them during this challenging time. That includes donations of food and supplies from our bakeries throughout the country, to their local food banks, hospitals and first responders. Like many companies, this year, we're conducting our annual shareholder meeting virtually. And so we made the decision to donate a portion of the funds budgeted for that meeting to Second Harvest of South Georgia in conjunction with Feeding America. Flowers is a Feeding America mission partner, donating more than $10 million worth of baked goods last year. And this most recent gift enables the provision of approximately 450,000 meals for the hungry right here in South Georgia. Some of our bakeries with underutilized food service lines have worked with Feeding America's regional warehouses to provide millions of buns to food kitchens in need. So these 3 priorities, maintaining a safe workplace, helping to feed America and supporting our communities have been our North Star and have helped to guide us through.

So later in the call, I'll discuss the current business environment and the steps we're taking to deal with this extraordinary situation. But first, I want to turn it over to Steve to review the details of the quarter and share our current outlook for 2020. Steve?

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

Thank you, Ryals, and good morning, everyone. I'd like to also echo Ryals' comments and express my sincere thanks to our team whose efforts during this time have been nothing but outstanding. Our quarterly results are important, but in this unprecedented environment, we think it's even more important to go beyond just reporting the numbers and also provide as much clarity as we can about what drove our performance in the quarter, what we are seeing presently and what could occur over the remainder of the year. Our look into the future is no better than anyone else. But we are committed to offering as much transparency as possible given the uncertain times in which we find ourselves.

Now turning to the quarterly results. Given our first quarter is 16 weeks and includes the first 2 weeks of April, our results were strongly influenced by COVID-19. Looking at the cadence of our top line during the quarter, like most food companies, we experienced a soft January. Sales improved through February and early March prior to the widespread shelter-in-place orders. Once those orders took hold in mid- to late March, we saw our retail sales accelerate as consumers began eating more meals at home. As a result, we generated record earnings and sales and delivered a second consecutive quarter of adjusted EBITDA margin improvement. Consolidated sales increased $85.5 million or 6.8% quarter-over-quarter. We estimate that sales increased by approximately 6.5% to 7.5% due to the impact of the COVID-19 pandemic in the quarter.

Price/mix drove 6.2% 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 contributed 0.6% to the overall sales increase, with retail channel volume growth offsetting declines in the foodservice and other nonretail channels.

Looking at sales by channel. Branded retail sales increased $133.8 million or 17.7%. Our brands continue to thrive with particular strength from Nature's Own, Canyon Bakehouse, Dave's Killer Bread and Wonder. Store branded retail sales decreased approximately $1 million or 50 basis points. Increases in sales of breads, buns and rolls was offset by lost store branded breakfast business and lower volumes in store branded cake. Foodservice and other nonretail sales decreased by $47.3 million or 15%. Lower volumes due to business disruptions for most of our non-retail customers caused by the pandemic drove most of the decline. We saw these declines across all categories of our foodservice business, including QSR, broad line distribution and schools and other institutions.

In the quarter, gross margin excluding depreciation and amortization, increased 190 basis points as the mix shifted to higher-priced branded retail products. Partially offsetting that benefit were $4.1 million related to appreciation bonuses paid to frontline workers and $1.7 million of start-up costs incurred with the ongoing conversion of our Lynchburg, Virginia facility to an organic bakery.

Excluding the items affecting comparability detailed in the release, adjusted SD&A expenses increased 70 basis points as a percentage of sales. The shift in product mix from nonretail to branded retail resulted in higher distributor distribution fees. Workforce-related costs increased primarily due to $2.1 million of appreciation bonuses paid to frontline workers, also due to performance, we recorded higher employee incentive costs. Considering the economic uncertainty, during the quarter, we recorded additional bad debt allowances of $2.7 million for certain retail -- for certain food service customers.

GAAP diluted EPS for the quarter was a loss of $0.03 per share. This loss was driven by a $0.41 noncash charge related to the termination of a defined benefit pension plan. During the quarter, we transferred the remaining benefit obligations and administrative responsibilities of our largest defined benefit plan to a highly rated insurance company. This was done as part of our pension-risk mitigation strategy, which has helped to significantly reduce our exposure to changes in pension liabilities due to falling interest rates. We are pleased that this transaction was completed in line with our forecasted financial impacts, both cash and noncash. Excluding this charge and the other items affecting comparability detailed in the release, adjusted diluted EPS in the quarter was $0.41 per share. Up $0.09 compared to the prior year quarter. Based on our best judgment and analysis, we estimate the changes in the marketplace as a result of the pandemic caused GAAP and adjusted EPS to increase by approximately $0.09 to $0.10 per share.

Turning now to our balance sheet, liquidity and cash flow. In the first quarter of fiscal 2020, cash flow from operating activities increased $10 million to $106.2 million. Capital expenditures were $21.7 million, and dividends paid were $40.3 million. Our financial position remains strong. At the end of the quarter, net debt to trailing 12-month adjusted EBITDA stood at approximately 1.8x, down from 2x at 2019 year-end.

Given the significant impact that COVID-19 has had on global financial markets, out of an abundance of caution and to ensure liquidity in these uncertain environments, during the quarter, the company drew an incremental $200 million on our credit facility. At quarter end, we held approximately $253 million in cash and cash equivalents and had $266.6 million of remaining availability on the credit line. All told, we have been pleased with how the business has performed in this uncertain environment, and we expect to reduce these excess borrowings over time.

Now turning to our outlook for the rest of 2020. As we think about the year going forward, like most companies, we are navigating an uncertain business environment. In putting together our outlook, we balanced our outsized first quarter results against potential scenarios that could play out over the rest of the year. Based on this analysis and the most likely scenarios, we are forecasting sales growth in the range of 2% to 4%. This includes the 53rd week, which is expected to contribute approximately 1.5%. We are forecasting adjusted EPS to be in the range of $1.00 to $1.08 per share, which includes the impact of the COVID-19 pandemic. As I said, there are a wide range of outcomes, some of which could result in sales and adjusted EPS outside of the ranges we are providing today. In a moment, Ryals will share more color on the factors we considered when setting guidance. For 2020, we are targeting capital expenditures in the range of $95 million to $105 million, which includes approximately $19 million related to the conversion of our Lynchburg bakery to an organic production facility. We expect continued strong cash flow generation and our capital allocation priorities and philosophy remain consistent with our focus on maintaining and maximizing return on invested capital and growing shareholder value.

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

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

Okay. Thank you, Steve. Well, suffice it to say, the current situation is certainly unlike anything we've ever seen. To provide you with some perspective, I'd like to walk you through the environment we saw in the first quarter, how we responded to that and then what we're seeing now so far in the second quarter. As Steve said, the quarter began with sales roughly flat for the first 10 weeks. Like a lot of the food industry, January was particularly weak for us. We were up against a difficult comparison, relative to the prior year, primarily due to early SNAP payments and some winter storms that occurred in '19. We saw things begin to recover in February and early March. And then at the outset of the crisis, we saw a jump in net sales with our week 11 up approximately 12% as consumers began to stock up on groceries in anticipation of stay-at-home orders and that performance continued until the last week in the quarter, which was comping against a really strong Easter a year ago. Sales momentum then resumed in the second quarter, with the first 3 weeks coming in at approximately 7% to 8% over last year. The primary driver of the sales growth has been our branded retail business, which is experiencing growth far more than we would normally expect under normal circumstances, having increased 17.7% in the first quarter.

During the peak of demand in March, our weekly branded retail sales growth exceeded 70% versus the prior year. In the final weeks of the quarter, the rate of growth did moderate, but remained elevated at about 20% above prior year. Looking at the overall category, while it showed some nice growth, I am happy to report that we outperformed the category by a large margin. IRI data shows dollar sales of fresh packaged bread in the quarter were up 13%, while Flowers branded bread sales grew 21.2% in the tracked channels. Our top brands performed especially well, Tastykake was up 3%, Nature's Own was up 18%, Wonder was up 30%, Dave's Killer Bread was up 32% and Canyon Bakehouse was up 77%.

As I mentioned earlier, our financial performance in the quarter was primarily due to our ability to quickly respond to marketplace demands. From the very beginning of the crisis, we streamlined production and sped up service to the market, and our customer's shelves were, in large measure, well stocked. Also contributing to market share gains were new products from our leading brands, which continued to attract consumers, and our DSD distribution model. And in times of rapidly increasing demand like what we saw in the quarter that advantage becomes even more apparent as our IDPs worked tirelessly to keep product on the shelves. Not only did that distribution advantage result in higher sales in the quarter, but we also benefited from much greater numbers of consumer trials. For example, one major retailer reported that more than 2 million households tried our brands for the first time during the quarter. That's just one retailer. And we attribute that largely to our quality and the availability of our products. So we certainly hope to retain a number of these new consumers and realize a longer-term benefit as a result. As consumers spend more time at home, their shopping behavior has also changed, with fewer in-store visits and greater use of online shopping, and we think this will continue going forward. So to attract and retain these new digital consumers, we shifted advertising dollars away from traditional media and increased our e-commerce budget. The result of the shift in consumer activity and our greater emphasis on the e-commerce category was a significant increase in bread sales through that channel in the quarter, much of which occurred in the last 6 weeks. E-commerce sales and tracked channels of Nature's Own fresh bread and rolls increased 80%. DKB was up 86% and Wonder was up 274%. We believe the advantages of powerful brands are even more pronounced in the growing online channel, and we hope to attract many of these new buyers by working to build strong, meaningful connections with them.

Now in contrast to the strong retail sales, foodservice results have been pressured, as many restaurants closed or had to sharply curtail service. The timing of the decline directly corresponds to the much higher retail demand that we saw as the crisis unfolded. As states began to implement stay-at-home orders and other business restrictions, our foodservice results were negatively impacted beginning in mid-March and then worsening into April. So to give you a sense of the magnitude of that decline, in the final 4 weeks of our first quarter, non-retail sales were down more than 40% compared to the prior year period.

Despite the decline in non-retail sales, though, our adjusted EBITDA margins did increase 120 basis points. Again, a primary driver of that margin expansion is the flexibility of our bakeries, many of which can produce a variety of products that serve both retail and non-retail customers. So as the demand for food service products declined, we were able to shift production to our retail products, which obviously were experiencing much greater demand. So although total volume in the quarter was relatively flat, it was that mix shift combined with lower stale product return that primarily drove the margin expansion in the quarter.

Opportunities often come disguised as problems. And our recent results are particularly instructive relative to one of our strategic priorities, portfolio optimization, which we continue to work on, even as we manage through the crisis. Our performance in the quarter illustrates the significant potential of our optimization work, combining the right portfolio mix, with an optimal bakery network structure, can drive significant margin improvement. And these results have strengthened our team's resolve to accelerate our work in this area and position ourselves to deliver improved margin performance over time.

So that's really what we saw in the quarter and how we responded. And I certainly hope that you can see from our results. The strength and commitment of our team and the steps we've taken to ensure our success going forward. Now to give you a sense for what we're seeing so far in the second quarter, branded retail sales certainly remained below the peak levels we saw in March, but are holding strong with 20% plus year-over-year growth rates. Foodservice results have improved slightly from the first quarter, but they do still remain depressed. So as I said, overall, so far in the second quarter, we're seeing total year-over-year weekly sales growth around 7% to 8%.

Looking forward, it's really anybody's guess where the market will find equilibrium. As I'm sure many of you have, as I've reviewed white papers and other resources, it seems to me that you can find research to support just about any position you want to take. To paraphrase Churchill, "Life would be intolerable if we could foresee to any large extent the unfolding course of events". So at the end of the day, we don't know better than anybody else exactly how or when the market will change. But it does seem reasonable to assume that retail sales will eventually return to more normalized growth as people return to work and school and spend less time eating at home. And when that occurs, we would expect our nonretail business to benefit as restaurants open for more normal service and schools and workplaces drive cafeteria and vending sales. The real question is the trajectory and the speed of that recovery. On the one hand, you can imagine a large amount of pent-up demand with consumers kind of itching to get back out in the world as things begin to reopen. But on the other hand, you can also imagine many consumers remaining cautious for some time to come until they're convinced that the risk of eating out is acceptable. I think, in particular, about the travel and lodging industries and how long it might take them to fully recover. Less business travel, in my mind, means a lot less eating out in restaurants. In any event, life is unlikely to return completely to normal right away.

Furthermore, summer holiday spending may remain muted to accommodate household-only celebrations. In fact, 1/3 of consumers already report their Memorial Day plans will be different this year due to the virus. How these changes of plans might affect the summer bun season is just one of the many, many factors we've taken into account as we think about our outlook for the balance of the year.

Given the business shutdowns and the resulting high unemployment, it's also likely that we're already experiencing a recession. We have a diversified portfolio of products that target various price points. But our margins could be impacted if consumers decided to trade down from premium brands. The good news for us is that because the vast majority of our business is fresh DSD, we're able to quickly react to changing market dynamics and adjust our mix to meet whatever the market demands.

So looking ahead, as Steve mentioned, while we did have a very strong start to the year. The reality is that lack of visibility does make predictions very difficult. We've tried to give you at least a sense for what variables, both positive and negative, could impact our business. Barring extraordinary circumstances, we feel comfortable that our current guidance range is appropriate. While there are certainly scenarios in which our earnings could come in above the range for now and given the facts available to us and keeping in mind the summer bun season is still ahead, we expect our results to fall within existing guidance.

In summary, we'll do our best to position ourselves to succeed no matter what the environment. Now as I've consistently reminded our team, while it was vitally important that we managed well through the crisis, it's equally important that we manage well as we come out of the crisis. And that's why we've got to keep one eye focused on the future and not lose sight of our 4 strategic pillars: focusing on our brands, prioritizing improved margins, pursuing smart M&A and developing the team. Our brands are strong and they're driving growth. Our margins have improved for 2 consecutive quarters, and we expect our supply chain and portfolio optimization program to propel further improvement going forward. And in fact, we remain committed to the $10 million to $20 million in savings for 2020 that we quoted to you in February despite the disruption from the virus. And while we can't comment on specific M&A targets, our recent acquisitions continue to generate strong results. And we're actively pursuing similar acquisitions to help drive growth in the future.

And finally, our talented and dedicated team is performing exceptionally well under very difficult circumstances and they've adjusted nicely to remote working, utilizing a variety of technologies to stay connected with each other and the business. In fact, personally, I've been very pleasantly surprised at how well this has worked for us. And like many companies, we will likely consider increased use of these technology platforms and permanent changes to remote work policies going forward.

In this period of heightened uncertainty, our business is well positioned to thrive. With weekly data on sales trends, the ability to shift our production mix quickly, an advantaged distribution network and a strong liquid capital position, we can capitalize on opportunities as they present themselves. And rest assured, we're doing everything in our power to do just that.

Now Julie, we'll -- if you're ready, we'll open up the line for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And your first question comes from Bill Chappell with SunTrust.

William Bates Chappell - *SunTrust Robinson Humphrey, Inc., Research Division - MD*

I wanted to just talk a little bit more on to foodservice. Maybe just remind us of the kind of the breakdown of both quick serve versus fast-casual and then kind of your exposure? I mean, I know you have fairly national exposure for retail, but just in terms of foodservice, how it relates to some of the states that are moving faster to open versus slower? I mean, be it California versus Georgia?

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

Sure. Bill, we normally don't break out the foodservice segment into those discrete items. But just speaking overall, it's about 20% of our business, overall foodservice. And we generally serve all the channels within foodservice, whether that be bread line or vending or QSR, restaurants, that sort of thing. So it's fairly broad across all those categories. Obviously, as the lockdowns began and restaurants closed, the effect was pretty immediate on the foodservice business.

More recently, we've seen the QSR-oriented folks, the ones that are able to maintain drive-through service, a little bit on the take out side has started to come back a bit. And even within that, in the QSR segment, there are kind of those that are doing better than others. Some have maintained pretty good pretty good base of sales, all things considered, whereas others have experienced a pretty precipitous drop-off in business. Obviously, the sit-down restaurants, the fast-casual type things they can't host any patrons. They've been significantly affected, which in turn significantly affected our foodservice business.

Now as states start to reopen, it's a little too early, I think, to really tell. We've -- as I mentioned in the prepared remarks, we have seen volumes start to come back, but it's been rather slight so far. Just kind of, I would say, over the last maybe 2 to 3 weeks, we've seen a little bit of improvement there, but not enough to call it a trend just yet.

William Bates Chappell - *SunTrust Robinson Humphrey, Inc., Research Division - MD*

Got it. And then switching just to kind of cost, especially promotional and advertising. I mean, how does that schedule -- your promotional schedule or your advertising, especially with advertising rates coming down on TV side, and I imagine other areas as well over the next few months, I mean, how do you change that? And is there any offset with -- I don't know if you have plans for other incremental pay, bonus pays or stuff like that, that's baked into your guidance?

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

Sure. Well, on the promotional side, I mean we work retailer by retailer to basically incorporate the plans that they would like to put in place. I mean, overall, I would say, promotional activity has been a little bit lower during this period. Advertising, dollar-wise, as I've mentioned, we did have a pretty robust advertising budget set for the year, but we have shifted some of those dollars away from traditional media. And in addition to that, actually implemented some increases mostly targeted at digital and the e-commerce channel.

Operator

And your next question comes from Rob Dickerson with Jefferies.

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

It sounds like everyone at Flowers is doing a great job providing bread to the United States. So thank you for that. So look, I guess I just -- I have a bunch of questions. I'm going to try to keep it short, though. In terms of the guidance, kind of like you said upfront, you said you're basically the last of of those reporting on a calendar basis. We've had companies lift guidance, keep guidance, increase guidance. You're holding guidance for the year and speaking more specifically to the top line, but obviously, the first quarter came in very strong given the COVID lift. And then you have comments around the first few weeks of the quarter around 7% to 8%. So I guess the first question I have is -- I'm not sure if you can potentially dimensionalize like your base case. And if we think about branded retail versus private label versus food service. And I just ask that, obviously, because once you x out the 53rd week, we're kind of talking, let's say, 1% or 2% organic. But the first half of the year, obviously, seems fairly strong. So trying to understand better what could decelerate maybe in that back half. And I know you mentioned buns in the summer, but still just given what that first half could be, it seemed like a little bun pressure might not be that big of a deal? And then I have a follow-up.

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

Sure. Well, Rob, let me start, and Steve may want to provide some additional color. But I mean, look, we considered a variety of things as we thought about guidance. Obviously, where we landed was maintaining what we had as we looked at various outcomes and scenarios that could take place for the balance of the year, trying to take into account, as you said, the really outsized results of the first quarter, but also tempering that against a very uncertain outlook for the remaining 3 quarters for us. We felt it was most prudent and most reasonable. And given what we know today at least, the most likely outcome would be that we would fall somewhere within the current guidance range. I think the the real uncertainty is centered around where everything settles out. And what I mean by that is, how long does the elevated retail environment remain elevated? And then on the other side, what is -- as I said, what is the trajectory and speed of that foodservice recovery and the balance between the 2. And also factoring into that foodservice recovery is how it recovers because kind of to Bill's previous question in the mix of our foodservice business, if it it turns out to be the case that what recovers the quickest and the most is the QSR business that just so happens to be the lowest margin foodservice business we have. And so from a mix standpoint within foodservice, obviously, that's not the optimal outcome for us. So there are a variety of scenarios. We talked about the summer bun season, how much is that going to be affected. I know in my home state of Florida, you still can't rent -- you still can't do rentals, beach rentals in Florida, for example. And if that does open up before Memorial Day, it's going to be limited to in-state residents, nobody from out-of-state can rent. And then there's got to be like a 3-day waiting period in between rentals. So it's just those kind of restrictions that you can see that being somewhat disruptive to that really important summer bun season for us. And it's just -- at the end of the day, it's just too early to make that call. And so again, we just thought the most prudent conservative way to handle this was not to pull guidance because we also thought that was extreme that was not necessary. We feel confident with the range that we have out there. But by the same token, too early to make any other adjustment. Steve, anything else you want to add to that?

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

Yes. Just one other comment, Ryals. I mean, obviously, the unemployment rate and unemployment continues to be a national concern, and the impact that -- how that will impact the consumer. I think Ryals mentioned in his comments, a trade down from premium to non-premium even on the retail side. As you said, to service the market, we did like we typically do with hurricanes, we shifted to long runs of products. So there's not a lot of changeovers. As markets kind of normalize and you start bringing back some of that SKU assortment to the market, there's also the risk of a shift, even with eating meals at home. So just concerned about that factor as well. So you couple that with kind of the trajectory of the recovery around foodservice and how the country opens back up. We thought it was just, as Ryals said, prudent to remain where we are today until we have more clarity.

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

Okay. That all makes complete logical sense. And just for the follow-up, this is more of a, I guess, kind of a theoretical question around DSD. You mentioned there was a larger shift to online. So I guess one is just, obviously, in the near term, there will be no change to your DSD system. But kind of more conceptually, do you need to think about if there are longer-term effects and how Flowers would address those? And then really quickly, just any commentary maybe from you, Steve, just on kind of the go forward, mainly in Q2 around any incremental SG&A costs driven by COVID?

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

Yes. Good question, Rob. And it is fascinating to watch these changing market dynamics. The rise in e-commerce. It's still -- overall, it's still pretty small. I mean, we quoted you some pretty high percentage growth numbers, but bear in mind, that's off of a relatively small base. But we believe that some of these changing behaviors might be permanent. And as consumers were almost forced in a way to adopt a different way to grocery shop they've gotten more comfortable with it along the way, too. I mean, you guys have seen the number of employees that Instacart, for example, has hired and that alone demonstrates just the wild growth of this and so as the marketplace changes, we'll have to change with it. Certainly not prepared to comment on any changes to our distribution system. We don't have any plans to do that currently. But certainly, as the market changes, it's incumbent upon us to evolve with it.

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

Yes, Rob, just one follow-up on Ryals's comment is most of the surge buying actually happened in brick-and-mortar. It was through click and pick. So that drove Instacart that drove other major retailers where primarily the consumer with ordering online, but either picking up or having home delivery. It wasn't like they were necessarily reaching out to order online and you have it delivered through other channels. With regard to SD&A costs, again, primarily, it will depend on the mix of products going forward as you look at distribution discounts. We also expect some probably heightened workforce-related costs as this continues, if the growth and the kind of the buying continues at the 20% range or so, the 7% to 8% that Ryals talked about. So nothing really out of the ordinary. It's just some of the same factors we've seen historically, maybe driven by different conditions than they were historically but elevated workforce. Right now, we talked about heightened AR write-offs, but the reality is our business is so near-term on a weekly basis. We believe we have a good handle on that and barring anything catastrophic across the board. I don't anticipate that to really get out of hand. So we feel comfortable with that.

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

Rob, I just -- this is Ryals. I just want to circle real quick back to the guidance question and say one more thing about it. I do want to make sure that it comes across as we are optimistic about the business. We were optimistic before the crisis, and we're still optimistic now. But we do need to be responsible and temper that optimism against the lack of visibility that's ahead. But having said that, we certainly believe in our brands, we believe in the strategies behind the brands, the resources we're deploying behind them, our portfolio and supply chain optimization work. All of these are net positives. And as I mentioned in the prepared remarks, that work has, in large measure continued on even as we manage through this process. So in very large measure, all that remains on schedule. So we do still feel very, very good about the business. It's just -- it's an unprecedented, uncertain environment, simple as that.

Operator

And your next question comes from Mitch Pinheiro with Sturdivant and Company.

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

A couple of questions. I was actually curious how you calculate the COVID sales benefit to your business. Was it just looking at what your plans were versus last year? How do you come up with a number like that?

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

So Mitch, what we did is we went back and looked kind of at the performance coming out of January and through February. And then -- and we did several different scenarios and built off of the trends that we were seeing through those first 2 months. And then we made some adjustments based on what we thought would -- could potentially happen in the back half of the first quarter with the holiday period as well. So we feel like we did -- we made our best attempt to that, and we did it in 2 different functions. We did it within our insights group, and we also did it within our FP&A and accounting teams. And so we took different views on sales trajectory as well.

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

Okay. Then I'm curious like from your customer point of view, at the height of the lockdowns and you go to the supermarket, obviously, shelves were bare. And I imagine customers -- your customers just would take any product that they could get in terms of fresh bread. And I'm curious like -- so at that point, I mean, do your customers maintain their order pattern, your brands and private label? Do they just accept anything? Do you guys from an internal -- to make the long runs and things like that, do you guys just say, we're not doing private label right now. How does that whole situation pan out? And how is it evolving today?

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

So Mitch, I mean, at the end of the day, the retailers want the shelf stocked. Now even with the exemplary service that we provided, I'm not going to sit here and tell you that we didn't have some out of stocks. I mean, the panic buying was so large, particularly around our week 12, which I think was the peak of it for us. It was super hard to keep it fully stocked 24 hours a day. But we -- like I said, we shifted production over from foodservice to help support. And as far as the private label branded mix, in order for us to get that much production out faster, we have to eliminate changeovers. And so what you want to do is get the longest runs you can of the best-selling items, and that's how you get to the market the fastest.

The change over times, changing different private label bags and things like that eats up so much time during the day that it does impact your ability to get enough product out. So that's why, just like in a hurricane, in Florida, that's why you go to that limited SKU assortment, so you can get as much out as possible. Just this time, we did it in, virtually, every bakery.

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

Okay. And then, Ryals, you spoke about how you and your team are looking at -- you've been focused on the right assortment within the bakery and the right configuration of your bakeries. And a lot of that drove your one of the highest EBITDA margins, I've seen in a long time. How how do you keep that going? How do you maintain -- is that -- has this opened your eyes to different -- any other different -- not objectives, but the way you're going to look at mix in the future? I mean, can you talk about that a little bit?

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

Sure. I wouldn't say that it's changed any of our viewpoints, but it certainly solidified the viewpoint that we already had. I mean, certainly, we understand the value of having the right mix and a skew, if you will, more towards branded products, particularly as we've begun to acquire some of these really fast-growing, more premium-priced brands. But I think what it did -- this is an extreme example to be sure. But I think what it did for me and the team is really solidify the fact that our -- the way we're approaching it, the way we're thinking about this is the correct way. Again, extreme example, but over time, as we focus more on branded products as we optimize our foodservice business, et cetera, you would hope to see over time that shift in mix to become a more permanent fixture and us be more skewed towards higher-margin branded items.

Operator

Your next question comes from Brian Holland with D.A. David.

Brian Patrick Holland - *D.A. Davidson & Co., Research Division - Senior VP & Senior Research Analyst*

I was surprised by the magnitude of share gains, given, I believe most of your competitors utilize that DSD route to market. So I was curious if you could just highlight where that share capture was most acute in the quarter. I mean, was it more pronounced within any brand price point category channel?

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

It was pretty broad-based. The reason for, at least in my estimation is what I largely covered in the prepared remark, which is very early on, we were able to quickly shift production, get to those longer runs that I was just talking about, get product out and then our unbelievable network of independent distributor partners that were there and ready to go in serving the market. I mean, it was really -- we're used to doing this, we've always done it for winter storms, for hurricanes or whatever. I like to joke, "They don't have hurricanes in California, but the guy that runs that region used to be based in Florida". So he knows how to do this. So even out there in California, we have our personnel out there that understand the business and understand how to get product out quickly. So to me that, in probably the largest measure, was the reason for our share performance in the quarter.

Brian Patrick Holland - *D.A. Davidson & Co., Research Division - Senior VP & Senior Research Analyst*

Okay. And then Steve, I wonder if you could provide -- or Ryals, any context into how significant kind of the grilling season is as it pertains to your business? And I guess, as you look at insights, and I've read some of the same surveys, Ryals, that you referenced, I mean, is there a thought that when we balance out maybe fewer gatherings into the summer holidays versus just the underlying demand surge that continues to persist at above-average levels. I mean, is there a scenario in which that category is flat or down around these holidays? If you could just provide a little more context around that.

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

Certainly. I mean, anything is possible. It just depends on how severe it is. I mean, on the one hand, you could see it because people aren't allowed to gather or whatever reason it might be, you could see less holiday celebrations. I mentioned the restrictions here in Florida. But on the other hand, if every household has a celebration, you could still have a pretty good bun season. Now I will say, we have taken steps to as best we can, make sure that our level of production is in line with what we -- our best estimate of what demand might be. And so we're not -- a lot of times, we -- in order to completely serve the full bun season we have to go outside the company, the co-packers to help us manufacture. We're doing less of that this year and not taking on quite as much. So again, it's one of the reasons for us being conservative on the guidance is it's just -- we'll have to just wait and see how it plays out. I hope as we move through the summer, that hopefully July 4 is better. Labor Day is not nearly as big of a holiday as it used to be for us, schools start back, but then they start back so much earlier than they used to. But thinking about other factors on

THOMSON REUTERS

the retail side. Obviously, kids are out of school still in the summertime, but there -- a lot of these summer camps are canceled, too. So you're still going to have a lot of families still at home together through the summer, which could help maintain that elevated level of in-home eating.

Brian Patrick Holland - *D.A. Davidson & Co., Research Division - Senior VP & Senior Research Analyst*

That's helpful color. Last question for me. The M&A landscape, I mean some reference to it. I'm just curious, we've heard some commentary from folks, maybe more on the foodservice side about maybe the backdrop sort of opening up here as we come out of this, maybe your focus would be a little bit more on the branded side. So just curious what you're hearing or seeing? Is there an increased appetite for folks to sell in this environment? Are valuations getting any more palatable? Just curious what you're seeing there.

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

Not really any change from the commentary I made last quarter, which is that they're starting in kind of the back half of last year I saw a pretty substantial decline in the level of M&A activity. A decline in a level of companies that were interested in maybe pursuing a transaction. And really, that's kind of continuing right now. They're sort of trickling in, whereas up until call it, June of last year, they were coming in, it seemed like, once a week. So I don't know whether this has necessarily changed people's appetite to engage in a transaction. I certainly haven't seen a whole lot of change in at least valuation expectations, if not actual valuations from completed transactions. But nonetheless, whatever the environment, we remain active, we remain engaged with those that we're interested in.

Operator

And your next question comes from Faiza Alwy with Deutsche Bank.

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

A couple of questions from me. First, I see that you still have $10 million to $20 million of sourcing, savings or benefits that you have in the back half. And I know last time when we talked, there were sort of other savings that you were thinking about that we were supposed to talk about this year. I imagine that, that's more on the back burner. But I just wanted to get a sense of do you -- is there a risk that you don't get these sourcing savings, if things don't sort of normalize by the end of the year? And how should we think about incremental cost savings that we were talking about last time?

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

Sure. So on the $10 million to $20 million, obviously, we remain committed to that. Everything remains on schedule. Amazingly, even with everything else that's going on. So we feel very good about that $10 million to $20 million. I do think that there is likely some additional benefit behind that, but we're still in the midst of doing our work around that and not ready to comment any further just yet.

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

Okay. And then I know you've historically talked about improving the margin mix as it relates to the foodservice business. And I'm wondering if sort of this crisis -- does this make it more difficult for you? Or is this -- does this provide an opportunity for you to maybe have some of those conversations with your customers and sort of improve the margin mix as we look ahead?

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

Well, it doesn't make it any easier or any harder. I think what the crisis has done is kind of strengthen our resolve to go ahead and speed up some of the work, which is what we're doing. We were already talking to various customers about the margin profile of their business and how it fits strategically with us and with them, frankly, going forward. And I think we can expect to accelerate some of that work and continue to focus on the higher-margin foodservice business. The food service side of things, while it is overall lower margin than the branded side, it is a very important part of our business in the sense that it does cover a lot of overhead for us. We're a very high fixed cost business. So it serves a very, very important role there. And then in addition to that, as we mentioned, when you have extraordinary situations like this, you're able to flex production to retail as well. But at the end of the day, to answer your question, it doesn't make it any easier or any harder. It's necessary work either way.

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

Okay. Understood. Just last question. I wanted to get your take on private label as we look ahead to the rest of the year. I think you mentioned that you think we're already in a recessionary scenario. And historically, we have seen private labels take share in a recession. But this time might be different as you're not seeing that much -- you're not seeing consumers sort of go out to eat. So there's more demand at home, and there's been a lot of talk about consumers going back to trusted brands. So I'm just curious how -- what your take is on how this will play out through the course of this year? Are consumers going to want stick with trusted brands? Or do you see a greater risk towards private label?

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

Sure. Well, historically, in our category, and I'm just speaking to our category not others. In our category, in prior recessions, we've held up pretty well. You might see a little bit of trade down, but generally speaking, the branded side of the business has held up quite well. Remember that private label is pretty overdeveloped in our category relative to others. So it's already a pretty high share of the total market as it stands today. The one difference that I would point out is that because of some of our more recent acquisitions, particularly Dave's and Canyon, that do carry an even higher premium price than Nature's Own does, one can at least imagine a scenario where if we remain in a deep recession and we don't bounce out of it pretty quickly that you could see some trade down from those, call it, super premium items, if you will, more down to Nature's Own. But I wouldn't expect to see too much from Nature's Own to private label, for example.

Operator

And your last question comes from Ryan Bell with Consumer Edge Research.

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

When we look at a meaningful portion of your 1Q, we see less than normal trend. As we get out of the peak stock-up activity, how do you think about the cost impact that would be seen if we assume that, say, the latest 3 or 4 weeks that you talked about, the trends that we're seeing there are more similar over the next few months?

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

Yes. I think when you look at the category and you look at our business, we're not a typical pantry loading category. I mean, due to the shelf life of our product, the turns are pretty robust and things happen pretty quickly, so to say we don't have normal trends. Much of our cost elements go in tandem with our volume. And because of the volume increases on the retail side of the business, you did see some elevated costs within the gross margin overall. And then you also did see the elevated distribution costs because of the higher priced items and the fact they were primarily flowing through DSD. So I think relative to the sales line, most of the costs should trend relatively the same as it progresses, even if the top line pulls off -- your backs off somewhat. The one area where we did see significant benefit this quarter, and we actually have talked about this for several years now was the stale line. Obviously, as the market reacted and shelves were empty. We did see a fairly significant decline in our overall stale percentage that is the one cost element or the one item that could trend slightly differently. As the top line pulls back somewhat over the next quarter or 2, and we'll just continue to watch that. But realistically, I don't expect any significant cost pressure to come out of less sales that we haven't already seen.

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

That's very helpful. And what types of efforts do you plan to take around encouraging increase -- retention of the increased house hold consumption that we've been seeing as we get into a more normalized environment?

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

Sure. Well, I mean, we -- as I mentioned earlier, we have increased our e-commerce budget. We already had a very robust plan, marketing plan for this year to continue to support our brands. And if you'll remember, that's a big difference from 2 or 3 years ago. We've raised that overall budget significantly. And frankly, we've seen some very, very nice results from it. I think that's part of the reason that our top line has performed so well. In addition, we very, very briefly mentioned new product introductions, but we did have several that went out right at the end of the quarter, and so continue to innovate and bring new exciting products to consumers is another way that we hope to continue to retain their loyalty.

Operator

And Mr. McMullian, there are no more questions at this time.

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

Okay. Well, thank you all very much for your time today and for your interest in Flowers, and we certainly hope that each and every one of you continues to stay safe. Take care.

Operator

Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.
