
Flowers
FOODS
FIRST QUARTER 2022
PREPARED REMARKS
May 19, 2022
Nature's Own
PERFECTLY
Crafted
THICK SLICED
SOFT RYE
NON GMO Project
VERIFIED

CORPORATE PARTICIPANTS

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

Ryals McMullian, *President and CEO*

Steve Kinsey, *CFO*

PRESENTATION

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

Hello everyone and welcome to the pre-recorded discussion of Flowers Foods' first-quarter 2022 results. This is JT Rieck, SVP of finance and investor relations. As a reminder, we released our first-quarter results on May 19, 2022. Along with a transcript of these recorded remarks from our CEO and CFO, you can find the earnings release and related slide presentation in the investor section of flowersfoods.com. We will host a live Q&A session on Friday, May 20 at 8:30 a.m. Eastern. Further details are posted in the investor section of our website.

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

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

Ryals McMullian, *President and CEO*

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

We are off to a record start in 2022 as our leading brands continue to gain share and drive strong top line growth. Sales were up more than 10% year over year in the first quarter to all-time highs. Pricing to help mitigate higher commodity prices drove the bulk of this sales increase, and combined with efficiency actions, produced record adjusted EBITDA and adjusted EPS.

These results could have been even stronger were it not for higher-than-expected inflation, supply chain disruptions, and the deliberate rationalization of our product line during the quarter in accordance with our portfolio strategy. We implemented a price increase in January, which was intended to address the inflation we saw coming into the year. Since then, commodity prices have risen meaningfully higher than our original expectations due to a variety of factors, not the least of which is the conflict in Ukraine. Although virtually none of our raw materials originate in Ukraine, the current events there do impact the world market for wheat and other commodities. To help mitigate this additional inflation, we have implemented another pricing action that will become effective in early June.

On top of inflation, supply chain disruptions hampered our ability to procure adequate quantities of certain raw materials and packaging items. The impact was more heavily weighted to packaging, specifically bread bags, and the shortages resulted in production cuts in the quarter. Our procurement team is working diligently to mitigate these shortages, and we expect the impact to be resolved in the third quarter.

In prior calls I've talked about our portfolio strategy, which aims to shift our sales mix to higher-margin branded retail products. As part of that strategy, we continued to rationalize our product line, cutting less-differentiated, lower-margin products. This process, which impacted sales in the quarter, has the benefit of reducing complexity in our bakeries and opening up capacity to produce more of our higher-margin branded products, which should increase sales and margins over the long-term.

Despite these headwinds and difficult prior-year comparisons, we grew market share, which helped drive our sales to a new quarterly record. Flowers' fresh packaged bread sales gained 30 basis points of market share in tracked channels, with Nature's Own, Dave's Killer Bread, and Canyon Bakehouse adding 20, 20, and 10 basis points respectively. This performance bolsters our confidence in our 2022 sales outlook, which we are increasing today.

Now I'll address our four strategic priorities, which we expect to drive our results in 2022 and beyond: developing our team, focusing on our brands, prioritizing margins, and pursuing smart M&A.

Starting with the team…. I'd like to thank our Flowers family for their hard work and dedication, which has made our performance in recent years possible. In a dynamic environment with unprecedented challenges, our team's execution has driven exceptional results.

Ensuring we have the right team in place is crucial for our future success. Nothing will make us more successful if we do it properly, or less successful if we don't. And that's why we've established our agile innovation, transformation office, digital, and change management teams to address the specific initiatives we have in place to drive our future growth.

Complementing the experience and knowledge of our many long-term team members, we have added talented new hires across many functions who bring a diverse set of experiences, backgrounds, and capabilities that we didn't have in house. That combination is proving invaluable as we seek to enhance the performance of our company.

Our second strategic priority is focusing on our brands. I spoke about our portfolio strategy of shifting sales to higher-margin branded products, and how the pandemic accelerated that shift. Initially we assumed demand would eventually revert somewhat back to pre-pandemic levels. However, branded retail has remained strong, and as a percentage of sales it was actually higher this quarter than in the first quarter of 2020.

The pandemic induced significant trial of our products, and we've been able to convert that trial into new and loyal customers. In fact, we've added 5.2 million new households since 2019. Further, the increased prevalence of hybrid-work arrangements, which encourage greater at-home eating, seems to be enduring.

In addition, we believe a lot of the continued momentum is due to the work we are doing to strengthen our brands through our portfolio strategy--driving more-profitable branded retail sales and increasing the profitability of our non-retail and store branded products.

We have built leading shares in the loaf, organic, and gluten free categories and, with our portfolio strategy as a guide, we intend to continue that growth. Innovation has been an important driver of this market success and we are continuing to invest in new products. Exciting, recently launched products include Nature's Own Hawaiian loaf, Nature's Own Perfectly Crafted Sourdough, Dave's Killer Bread Everything Breakfast Bread, and Canyon Bakehouse Brioche rolls.

Our agile innovation group goes one step further by developing products that capitalize on our strong brands, which allow them to play outside our core category. So far, we have commercialized three varieties of Dave's Killer Bread Bars. Results in the test markets have exceeded our expectations so we are working to expand distribution for these products. We also have an exciting pipeline of additional snack items under the DKB brand that we expect will bolster our entry into the healthy snacking category.

Innovation, particularly outside of our core categories, is a crucial part of our portfolio strategy and our future growth story. The early results are very encouraging, and we are focused on growing in these new categories. We've also invested in greater marketing and advertising spend to increase awareness and penetration. Our portfolio strategy allocates the majority of our spending to the highest potential brands, and the returns on those investments have been positive.

As I mentioned, our leading brands once again gained market share this quarter. Those share gains helped drive sales for Nature's Own, Dave's Killer Bread, and Canyon Bakehouse, which were up 11%, 15%, and 21% respectively in tracked channels. An even more encouraging note is that despite higher prices and supply chain headwinds, volumes for those brands increased as well, up 1.7%, 5.3%, and 13.1% respectively.

To meet that higher demand for our products, we've added new capacity with the addition of a Dave's Killer Bread line at our Henderson, Nevada bakery. This new line, which began production near the end of the first quarter, allows us to better serve the rapidly growing west coast market, and for other nearby bakeries to operate at a more optimal capacity.

Because it's such a crucial driver of our long-term growth targets, I'd like to give a bit more insight into our portfolio strategy. As part of this process, we placed each business cell into one of our four portfolio roles based on our right to win and growth potential. Slide eight in our earnings presentation illustrates these four portfolio roles, which are Accelerate Growth, Learn and Prove, Balance Growth, and Maximize Profitability.

Business cells within the Accelerate Growth and Learn and Prove portfolio roles are priorities for investment and growth, whereas the brands in the other two categories are intended to generate cash to support that growth. We expect our Accelerate Growth and Learn and Prove business cells to grow meaningfully ahead of their categories. Balance Growth business cells are profitable with a demonstrated ability to win but have lost some consumer appeal and are expected to maintain market share. Our final portfolio role includes business cells where our primary aim is to Maximize Profitability or thoughtfully exit.

Simply put, our strategy over time is to evolve our business as much as possible to the right-hand side of the chart, where we believe our top brands can grow at attractive rates and generate improved margins for the company overall.

Our third strategic priority is margins, which remain a particular focus given the rapid inflation we've experienced. Our playbook here is unchanged: in addition to the margin expansion from our portfolio strategy-driven mix shift, we are implementing cost savings programs and installing improved processes to run our business as efficiently as possible. We are also investing in digital robotics and automation, and placing those capabilities on top of the improved processes.

Last quarter we highlighted that we expected to generate $25 to $35 million of savings this year related to operational efficiencies and procurement. Those initiatives are coming along well, and we believe we are on track to achieve our savings target.

Finally, we expect our digital transformation initiative to result in meaningful efficiencies over time. We devoted significant resources, including standing up our transformation office and change management team, to ensure that implementation does not negatively impact our operations. The process is coming along as expected and we are confident in our ability to implement it as planned.

Our fourth priority is smart M&A. We continue to monitor the deal market, actively seeking potential acquisitions that add capabilities, brands, or products to our strong existing lineup. We believe our balance sheet positions us well to act when we have financial, commercial, and operational conviction. Portfolio fit is crucial, but just as important is the expected return on any potential deal. We are not averse to paying a premium for high-quality assets, but we also require an attractive return. We will not stray from our disciplined approach if a potential deal does not meet all of our required criteria.

Now, I’ll turn it over to Steve to review the details of the quarter, and then I'll come back a little bit later to discuss our outlook for the current business environment. Steve?

Steve Kinsey, *CFO and CAO*

Thank you, Ryals – and hello everyone. I’d like to echo your comments on our incredible team and express my sincere thanks for their outstanding efforts. As Ryals mentioned, we are very pleased with our first quarter performance.

Total sales increased 10.3% from the prior-year period. Improved price/mix drove the adjusted year-over-year increase, up 13.5%, more heavily weighted to price than mix. The primary factors were price increases to mitigate inflationary pressures and growth in our more-profitable branded retail products. Partially offsetting the sales increase was a 3.2% volume decrease mostly driven by declines in our cake, fast food, and store branded business, partly due to the supply chain disruptions Ryals mentioned in his opening commentary.

In the first quarter, gross margin as a percentage of sales, excluding depreciation and amortization, decreased 110 basis points to 49.5%. Comparisons were impacted by higher ingredient and packaging costs, partly offset by higher sales and reduced outside purchases.

Selling, distribution and administrative expenses increased 10 basis points as a percentage of sales to 38.6% in the first quarter, impacted by incremental consulting costs and transportation cost inflation, largely offset by favorable price/mix, lower workforce-related costs, and increased scrap dough income. Excluding the items affecting comparability detailed in the press release, adjusted SD&A expenses decreased 20 basis points to 38.0%, from lower workforce-related costs and increased scrap dough income, partially offset by higher logistics costs.
GAAP diluted EPS for the quarter was 40 cents per share compared to 34 cents in the prior-year period.

Excluding the items affecting comparability detailed in the release, adjusted diluted EPS in the quarter was 44 cents per share, up 3 cents from the prior-year period. A lower tax rate caused by a windfall on stock compensation vesting benefited adjusted diluted EPS by one cent.

Turning now to our balance sheet, liquidity, and cash flow. For the first quarter of fiscal 2022, cash flow from operating activities increased by $26.2 million to $124.2 million. Capital expenditures increased $23.2 million to $50.5 million, largely due to the ongoing ERP upgrade, digital investments, and production capacity additions. Dividends paid increased $4.2 million to $46.7 million.

Our financial position remains strong. At the end of the first quarter of fiscal 2022, net debt to trailing twelve month adjusted EBITDA stood at approximately 1.4-times, comparable to the leverage at the end of the fourth quarter of 2021. At quarter end, we held approximately $205 million in cash and cash equivalents and had approximately $692 million of remaining availability on our credit facilities.

Now, turning to our outlook for 2022. We are raising our sales guidance to account for the additional price increase that will become effective in early June, as well as better-than-expected volume and elasticities. Sales are now expected to increase 10% to 12% versus 2021, which, at the midpoint, implies a 5.2% compound annual growth rate off the 2019 base. The new sales growth guidance compares to our prior estimate of 7.6% to 8.4%. We are reducing our adjusted EPS guidance to $1.20 to $1.30, which, at the midpoint, implies a 9.2% compound annual growth rate off the 2019 base. The midpoint of this guidance exceeds our long-term financial targets of 1% to 2% sales growth and 7% to 9% EPS growth off the 2019 base.

As Ryals mentioned, we experienced significant headwinds due to inflation and supply chain disruptions. These discrete headwinds are expected to impact second and third quarter results by a total of 5 cents per share with the greatest impact in the second quarter.

Regarding earnings cadence, our first quarter results were in line with our internal plan. While our January pricing initiatives will impact the full year, our June pricing will largely benefit the second half of 2022. This timing will result in a headwind due to the lag between the onset of the inflationary pressures and the implementation of the price increase. We expect to mitigate the supply chain disruption impact, specifically related to bag availability that Ryals referenced earlier, in the third quarter.

Based on this timing, we expect the entirety of any additional financial impact from these headwinds to be limited to the second and third quarters. The benefits from our growth and efficiency initiatives are expected to contribute primarily to the second half of the year.

When we issued our initial 2022 guidance, we noted that our expectation was for high-single-digit cost increases and that 70% of our key raw materials were covered. Our commodity coverage is now approximately 95%, and we expect cost increases of high-single-digits to low-double-digits. So far, we've been successful in obtaining the higher prices necessary to offset inflation. We remain optimistic that, combined with our internal actions, we should continue to be able to mitigate inflationary costs, though with some lag effect.

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

Ryals McMullian, *President and CEO*

Thank you, Steve.

You've just heard Steve detail how our ability to execute on our initiatives has driven strong financial results despite market volatility. I'd like to address some of the key factors impacting the current environment.

Inflation is top of mind for everyone right now with commodity prices surging near historical highs in many categories, and Steve talked about how those costs have increased beyond our initial expectations for the year. As I mentioned, we have implemented another pricing action that will become effective in early June, and we stand ready to take more actions to protect our margin dollars should inflationary pressures increase further.

The current environment also underscores the importance of our leading brands. We believe consumers continue to see value in the differentiated attributes of our products, and recent results seem to confirm exactly that. Even with price increases of 9.8% in tracked channels compared to the year-ago period, our volumes were down just 0.1%. And recall that this slight volume decline includes the impact of supply chain disruptions and SKU rationalization. We outperformed the category overall, which posted a 10.1% price increase with a volume decline of 1.8%. Importantly, we've seen less elasticity in the most-premium products in our portfolio.

In addition to inflation, acute supply chain disruptions are increasing distribution costs and, in some instances, resulting in a shortage of materials. Those shortages may persist into the second half of the year, but we are actively working to mitigate them and expect the issues to be resolved in the third quarter.

We are also keeping a close eye on possible demand reversion related to the waning pandemic and a potential economic recession. Earlier I discussed the enduring strength of branded retail despite a decline in Covid cases, but I do want to provide more color on a potential recessionary impact.

The last period of significant inflation coincided with the financial crisis and aftereffects that occurred roughly from 2007 to 2012. The common perception is that recessions encourage consumers to trade down to lower priced products, particularly private label. However, what we found during this period was that despite the severe economic hardships, including high unemployment and low consumer confidence, private label did not gain meaningful share, though we did see a shift from foodservice to branded retail as consumers cut back on more-expensive restaurant visits. Further, differentiated products held up better than more commodity-like products.

I would also note the significant changes we've seen in the competitive environment since that period. The industry was much less consolidated, and some larger players were under financial distress, which led to pricing pressure. Our product portfolio was also less differentiated as we had not yet acquired Dave's Killer Bread or Canyon Bakehouse. Nor had we yet developed the Nature's Own Perfectly Crafted line.

Today, we operate in a much more consolidated industry, with a much stronger portfolio of brands that is even more differentiated compared to private label. Given the evolution of the industry and Flowers, that earlier period suggests that our products should hold up well in a potential recessionary environment.

Moving forward, our four strategic priorities—team, brands, margins, and M&A—guide our focus. We continue to strengthen our industry-leading team to ensure that we have the right capabilities to meet today's challenges. We are investing in our leading brands and driving initiatives to increase efficiencies and margins. And our strong balance sheet and cash flow position us well to bolster our brands and capabilities through M&A.

In closing, although we are lowering our adjusted EPS guidance, I want to emphasize that the reduction is due to discrete issues that we expect to be resolved in the third quarter. Barring these items, we would be on track to meeting our original guidance.

I am truly excited about our prospects. The fundamentals of our business remain strong, as our portfolio strategy drives increased sales of our leading brands and expanding margins. I've never been more optimistic about the initiatives we have in place to ensure our future success.

The entire Flowers team is working hard to enhance shareholder value and we expect to continue to deliver results in line with, or better than, our long-term financial targets. Thank you very much for your time. This concludes our prepared remarks.

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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 our Annual Report on Form 10-K (the "Form 10-K") and Quarterly Reports on Form 10-Q filed with the Securities and Exchange Commission ("SEC') and may include, but are not limited to, (a) unexpected changes in any of the following: (1) general economic and business conditions; (2) the competitive setting in which we operate, including advertising or promotional strategies by us or our competitors, as well as changes in consumer demand; (3) interest rates and other terms available to us on our borrowings; (4) supply chain conditions and any related impact on 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 pandemic and future responses and/or measures taken in response thereto, including, but not limited to, new and emerging variants of the virus and the efficacy and distribution of vaccines, which are highly uncertain and are difficult to predict, (c) our ability to manage the demand, supply and operational challenges with the actual or perceived effects of the COVID-19 pandemic; (d) the loss or financial instability of any significant customer(s), including as a result of product recalls or safety concerns related to our products, (e) changes in consumer behavior, trends and preferences, including health and whole grain trends, and the movement toward more inexpensive store branded products, (f) the level of success we achieve in developing and introducing new products and entering new markets, (g) our ability to implement new technology and customer requirements as required, (h) our ability to operate existing, and any new, manufacturing lines according to schedule, (i) our ability to implement and achieve our environmental, social, and governance ("ESG") goals in accordance with suppliers, regulations, and customers; (j) our ability to execute our business strategies which may involve, among other things, (1) the ability to realize the intended benefits of planned or contemplated acquisitions, dispositions or joint ventures, (2) the deployment of new systems (e.g., our enterprise resource planning ("ERP") system), distribution channels and technology, and (3) an enhanced organizational structure, (k) consolidation within the baking industry and related industries, (l) changes in pricing, customer and consumer reaction to pricing actions (including decreased volumes), and the pricing environment among competitors within the industry, (m) our ability to adjust pricing to offset, or partially offset, inflationary pressure on the cost of our products; (n) disruptions in our direct-store-delivery distribution model, including litigation or an adverse ruling by a court or regulatory or governmental body, or other regulatory developments, that could affect the independent contractor classifications of the independent distributor partners, (n) increasing legal complexity and legal proceedings that we are or may become subject to, (p) labor shortages and turnover or increases in employee and employee-related costs, (q) the credit, business, and legal risks associated with independent distributor partners and customers, which operate in the highly competitive retail food and foodservice industries, (r) any business disruptions due to political instability, pandemics, armed hostilities (including the ongoing conflict between Russia and Ukraine), 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, (s) the failure of our information technology ("IT") systems to perform adequately, including any interruptions, intrusions, cyber-attacks or security breaches of such systems or risks associated with the planned implementation of the upgrade of our ERP system; and (t) the potential impact of climate change on the company, including physical and transition risks, higher regulatory and compliance costs, reputational risks, and availability of capital on attractive terms. The foregoing list of important factors does not include all such factors, nor necessarily present them in order of importance. In addition, you should consult other disclosures made by the company (such as in our other filings with the SEC or in company press releases) for other factors that may cause actual results to differ materially from those projected by the company. Refer to Part I, Item 1A., Risk Factors, of the Form 10-K, Part II, Item 1A., Risk Factors of the Form 10-Q for the quarter ended April 23, 2022 and subsequent filing with the SEC for additional information regarding factors that could affect the company's results of operations, financial condition and liquidity. We caution you not to place undue reliance on forward-looking statements, as they speak only as of the date made and are inherently uncertain. The company undertakes no obligation to publicly revise or update such statements, except as required by law. You are advised, however, to consult any further public disclosures by the company (such as in our filings with the SEC or in company press releases) on related subjects.

Information Regarding Non-GAAP Financial Measures

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

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

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

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

The company defines 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 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.