Flowers Foods

SECOND QUARTER 2022 PREPARED REMARKS

August 11, 2022

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' second-quarter 2022 results. This is JT Rieck, SVP of finance and investor relations. As a reminder, we released earnings on August 11, 2022. Along with a transcript of these recorded remarks, 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, August 12 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 second-quarter call.

We continued to execute well in the first half of 2022, driving second-quarter sales to record levels. Effective implementation of our June price increase boosted sales and helped offset inflationary pressures. And the faster-than-expected mitigation of the supply chain issues we discussed last quarter led us to raise the bottom-end of our EPS outlook.

Our leading brands performed quite well despite the fact that consumers are increasingly feeling the strain of inflationary pressures. Nature's Own grew sales dollars during the quarter more than any other brand in the category. And both Nature's Own and Canyon Bakehouse grew market share. Dave's Killer Bread gained share in the organic category despite headwinds related to regional capacity constraints and packaging shortages. We have resolved both of those issues and remain supremely confident in DKB's growth potential. The additional West Coast capacity that we discussed in our first quarter call will allow the brand to compete more aggressively in that market.

Meanwhile, DKB continues to gain share in the strategically important Northeast market. And our breakfast products, which are a key area of focus for us, performed especially well in the quarter. The DKB brand resonates profoundly with consumers, and the purpose behind every loaf and unparalleled quality and taste engenders fierce loyalty. That loyalty gave us the confidence that it could move across categories and inspired the development of our DKB snack bars.

As we mentioned last quarter, we are thrilled with the initial results of the bars in test markets, which continue to exceed expectations, and we are actively working to expand distribution. The prospect of a snack item that adheres to the unique brand equities of Dave's Killer Bread excites retailers and consumers alike and expands our growth potential. Our core business is solid and growing, but we also intend to diversify and leverage the power of our number one brands to move into adjacent categories.

In the second quarter, our overall market share declined slightly, by 10 basis points, due to several factors. The packaging shortages that impacted DKB, and which we spoke about last quarter, also impacted sales across our business, though we mitigated most of the effect midway through the quarter. SKU rationalization related to the execution of our portfolio strategy reduced sales largely in cake, foodservice, and private label. And our price increases, which we took a bit earlier than usual in June, to mitigate inflation led to a temporarily less-favorable competitive position, which also hampered revenues.

Lastly, we were comping Hurricane Elsa in the prior-year period. As you know, we typically outperform our competition during major weather events, so this timing also contributed to the share change on a year-over-year basis. Although top line results were impressive given the environment, performance could have been even stronger were it not for these discrete items that we believe are temporary.

The supply chain issues we discussed on the last earnings call impacted results early in the second quarter, but strong execution by our procurement team minimized the impact of those headwinds later in the quarter. The June price increase also helped drive an EBITDA improvement in the latter part of the quarter.

Our product mix regressed slightly as the long-term trend of share losses in the private label category paused, and the price increases in that business exceeded other categories, as we work to improve its profitability. Those efforts are paying off and as a result we expect such share shifts, should they continue, to be less dilutive to margins than in the past.

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.

First, as always, I'd like to thank our Flowers team for their hard work and dedication, which has made our strong performance possible. I just mentioned the effort our procurement group made to minimize the impact of supply chain disruptions, and that is just one example of many demonstrating the extraordinary efforts of Flowers team members. In an environment of unprecedented challenges, their execution continues to drive exceptional results.

The labor market remains challenging, particularly in our bakeries. To mitigate these pressures and help build a stronger Flowers team, we have implemented a mentor program that supports our newest team members as they begin their career journey at Flowers. New hires are matched with a compatible mentor, who meets with them regularly and checks in on their progress. Mentors act as a resource, provide encouragement and support, and intervene when a mentee faces a challenge that might lead them to leave their job. The program is relatively new, but early indications are that it is improving the onboarding process and reducing turnover, and we believe it will help improve efficiencies.

Our second strategic priority is focusing on our brands. Last quarter we detailed our portfolio strategy, which aims to shift our sales mix to higher-margin branded retail products, and our results this quarter demonstrate the effectiveness of that approach. Our Accelerate Growth and Learn and Prove portfolio roles are driving continued growth. Tracked channel sales of our leading brands in the quarter were strong, with Nature's Own up 12.4%, Dave's Killer Bread up 9.8%, and Canyon up 22.2%.

We've maintained many of the new consumers we gained during the height of the pandemic, and we are working to build upon that growth through continued elevated marketing and brand investments. Our 17.5% dollar share exceeded pre-pandemic levels in the second quarter of 2019 by 80 basis points. Investments in innovation are delivering promising results from recent launches, including DKB Epic Everything breakfast bread, Nature's Own Hawaiian loaf, Canyon Bakehouse Brioche rolls, and Nature's Own Perfectly Crafted Sourdough. And we remain focused on improving profitability in our Balance Growth and Maximize Profitability portfolio roles, which I will detail shortly.

Our third strategic priority is margins, which remain a particular focus given the inflationary environment. In addition to the margin expansion we expect from our portfolio strategy-driven mix shift, we are implementing cost savings programs and improved processes to run our business as efficiently as possible. The $25 to $35 million of savings from operational efficiencies and procurement that we are targeting for this year are on track. And those are on top of the $60 million in additional cost savings we achieved in the two prior years.

Last quarter we discussed the Dave's Killer Bread capacity we added in the West and the benefits that would have in meeting growing demand and improving efficiencies at nearby bakeries. In conjunction with that move, we recently announced the pending closure of our bakery in Phoenix, which is planned to occur in the fourth quarter. In keeping with our portfolio strategy, we expect this closure of an older, less-efficient bakery to reduce lower-margin private label and foodservice production in the region, while nearby bakeries will service the remaining branded retail needs. We will maintain ample capacity to service future growth in this important market.

Our portfolio strategy calls for us to improve the profitability of our Balance Growth and Maximize Profitability portfolio roles. Consistent with that objective, as private label demand is showing initial signs of stabilizing, we are focused on enhancing the profitability of that business. We implemented price increases to mitigate inflation and continue to work with our retail partners to drive efficiencies.

Our digital transformation initiative remains on track, and we are confident in our ability to implement it as planned. We believe the investments we are making in digital technology will help drive meaningful efficiency improvements in our bakeries, and, as we have emphasized, will be a key driver of improved margins over time.

Our fourth priority is smart M&A. We hope you noted our recent investment in Base Culture, a fast-growing, female-founded and led baked foods company offering better-for-you, gluten-free and grain-free sliced breads and baked goods. The products are both Paleo and Keto certified and are on trend with consumers seeking those attributes. We expect our investment will allow Base Culture to grow distribution, scale marketing, and bolster its existing manufacturing capabilities to offer its products to more consumers than ever before. We have been considering venture type investments for some time as we seek to enhance our internal agile innovation efforts, and we believe this is a great first move into that space. This small investment may serve as a model for future investments in other leading-edge companies.

In addition, 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, and we remain committed to our disciplined approach.

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 second quarter performance.

Total sales increased 11.0% from the prior-year period. Improved price/mix drove the adjusted year-over-year increase, up 14.4%, primarily due to price increases to mitigate inflationary pressures. That increase was partly offset by a shift in sales mix from branded retail to store branded retail. Volume decreased 3.4%, mostly due to SKU rationalizations in cake, foodservice, and private label. Other volume headwinds included the supply chain issues related to packaging and the temporary impact of price increases on our competitive position. Overall, elasticities were in line with our expectations.

In the second quarter, gross margin as a percentage of sales, excluding depreciation and amortization, decreased 240 basis points to 48.1%. Comparisons were impacted by higher ingredient and packaging costs, partly offset by higher sales that leveraged labor expenses, and timing differences in the sell-through of product inventories.

Selling distribution and administrative expenses decreased 130 basis points as a percentage of sales to 38.8% in the second quarter, benefitting from price increases and lower labor and marketing expenses and distributor distribution fees, partially offset by higher logistics expenses. Excluding the items affecting comparability detailed in the press release, adjusted SD&A expenses decreased 90 basis points to 37.5%.

GAAP diluted EPS for the quarter was 25 cents per share compared to 26 cents in the prior-year period. Excluding the items affecting comparability detailed in the release, adjusted diluted EPS in the quarter was 31 cents per share, down 1 cent from the prior-year period, due to the factors mentioned above, as well as lower interest income and a higher tax rate.

Turning now to our balance sheet, liquidity, and cash flow.

For the first half of fiscal 2022, cash flow from operating activities decreased by $39.6 million to $183.8 million. Capital expenditures increased $39.6 million to $97.9 million, largely due to the ongoing ERP upgrade, digital investments, and production capacity additions. Dividends paid increased $6.4 million to $93.4 million.

In the first quarter, our board increased the company's share repurchase authorization by 20 million shares. Year-to-date, we repurchased shares for $16.5 million and invested $9 million in Base Culture. We intend to continue to use our strong balance sheet to capitalize on similar opportunities as they present themselves.

Our financial position remains strong. At the end of the second quarter of fiscal 2022, net debt to trailing twelve month adjusted EBITDA stood at approximately 1.5-times. At quarter end, we held approximately $163 million in cash and cash equivalents and had approximately $690 million of remaining availability on our credit facilities.

Now, turning to our outlook for 2022. We are raising the bottom end of our adjusted EPS outlook by 5 cents to $1.25. Our new guidance of $1.25 to $1.30, implies a 9.9% compound annual growth rate off the 2019 base, and reflects faster-than-expected mitigation of the supply chain issues we detailed last quarter. 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.

Regarding earnings cadence, our second quarter results exceeded our expectations due to the faster-than-expected mitigation of the bread bag shortage. As Ryals mentioned, inflation remains a headwind and we expect its impact to peak in the third quarter. We believe the pricing actions we have taken to date are sufficient to mitigate those costs for the remainder of 2022. Benefits from our growth and efficiency initiatives are expected to contribute primarily to the second half of the year.

At the end of the second quarter, 97% of our key commodities were covered. As always, we will execute our hedging strategy to minimize volatility and provide adequate forewarning to allow for price adjustments.
We remain optimistic that, combined with other internal actions, we should continue to be able to obtain the higher prices necessary to mitigate inflationary costs.

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

Ryals McMullian, *President and CEO*

Thank you, Steve.

You've just heard detail on how our strong execution translated into better-than-expected financial results. Now I'd like to address some of the key factors impacting the current environment, including the economy, inflationary pressures, and the state of the U.S. consumer.

Consumer sentiment has fallen to its lowest level in recent history. Following the 2020 recession brought on by the pandemic, sentiment initially recovered, but unprecedented inflationary pressures have continued to strain consumer confidence. Government stimulus money blunted the downturn and kept consumers flush. But now, with savings eroding, the consumer price index indicates food-at-home costs rose more than 10% in the last 12 months ended June, gas grew 60%, and home energy increased almost 20%.

So clearly the average American consumer is feeling the effects of inflation. While job growth has been surprisingly strong, as indicated by last week's Labor Department report, the participation rate remains below pre-pandemic levels and hiring rates are falling. This conflicting data makes it somewhat difficult to predict the consumer outlook.

Recent commentary from retailers suggests that consumers are cutting back spending in other, more discretionary areas, such as general merchandise. In addition to altering what they buy, consumers also have been shifting where they shop, making more of their food purchases at value-oriented merchants such as mass, dollar, and club stores.

As you might expect, purchasing decisions vary significantly based on household income. Lower income consumers have tended to trade down to less expensive products more than those with higher income. This behavior has been particularly stark in the premium category, where higher income consumers have actually increased purchases of some products, including DKB. On the other hand, we have seen lower income households reduce their number of purchases. We are closely monitoring these developments and maintaining our marketing investments to keep our brands top of mind and entice these consumers back when that economic pressure is relieved. In short, we believe the premiumization of the category remains a long-term trend despite some shorter-term challenges.

Flowers is well positioned to support consumers in this unique environment. Our broad product lineup offers options at all price points, for a variety of occasions. In retail we distribute everywhere from discount stores to high-end grocery, with a similarly wide range of distribution in foodservice.

Like other companies, we came into the second quarter pressured by inflation and supply chain issues. Our June price increases to mitigate inflation led to a temporarily less favorable competitive position. That dynamic, combined with supply issues that limited capacity of some products, including Dave's Killer Bread, temporarily hampered share gains. More recently, due to widespread inflationary pressures affecting virtually all companies, our prices are more competitive, and we expect our share performance to continue to improve.

One area of note this quarter is a pause in the longstanding decline in private label market share. On the surface, this change seems to indicate that inflationary pressures are encouraging consumers to trade down. However, those aggregate results have been driven by concentrated activity in the mass merchandise channel where private label retail prices have not adjusted to reflect recent inflationary pressures. The resulting wide price gaps to branded products seem to be driving much of the stabilization in private label share. Areas of retail that reflect price gaps more in line with historical levels, such as in the grocery channel, show continued private label share losses.

Considering the margin pressure retailers are facing in some categories outside of food, investors have speculated that future food price increases will be harder to come by. It's important to note that all three of our recent price increases were the direct result of significant, measurable inflationary pressures that impacted virtually all companies in the food industry and beyond. Although retailers are always reluctant to accept price increases, there was a general acceptance that such increases were necessary given the environment.

So should we encounter further inflationary pressures, we believe we will have similar success in implementing additional price increases to mitigate those pressures. We are keeping a close eye on changes in inflation and the consumer response. So far, the impact of our price increases on demand has been in line with our expectations, with elasticities remaining below historical levels.

It's important to note that in our more than 100 years in operation, Flowers has experienced numerous periods of inflation and a variety of economic environments. Every period is different, but we are confident that by focusing on our four strategic priorities—team, brands, margins, and M&A—we will be able to weather any environment and emerge stronger.

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.

Flowers Foods reserves the right to make changes to documents, content, or other information on its website without obligation to notify any person of such changes.

The information contained in this transcript is a textual representative of Flowers Foods' conference call and although efforts are made to provide an accurate transcription, there may be material errors, omissions, or inaccuracies in the reporting of the substance of the conference call. In no way does Flowers Foods assume any responsibility for any investment or other decisions made based upon the information provided on this website or in any transcript. Users are advised to review the conference call itself and our SEC filings before making any investment decision.

Forward-Looking Statements

Statements contained in this filing 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) 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 implement and achieve our environmental, social, and governance ("ESG") goals in accordance with suppliers, regulations, and customers; (i) 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, (j) consolidation within the baking industry and related industries, (k) changes in pricing, customer and consumer reaction to pricing actions (including decreased volumes), and the pricing environment among competitors within the industry, (l) our ability to adjust pricing to offset, or partially offset, inflationary pressure on the cost of our products; (m) 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, (o) labor shortages and turnover or increases in employee and employee-related costs, (p) the credit, business, and legal risks associated with independent distributor partners and customers, which operate in the highly competitive retail food and foodservice industries, (q) 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, (r) 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 (s) 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 July 16, 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.