REFINITIV STREETEVENTS

EDITED TRANSCRIPT

FLO.N - Q4 2023 Flowers Foods Inc Earnings Presentation (Q&A)

EVENT DATE/TIME: FEBRUARY 09, 2024 / 1:30PM GMT

OVERVIEW:

Company Summary

CORPORATE PARTICIPANTS

A. Ryals McMullian *Flowers Foods, Inc. - CEO & Chairman of Board*

J. T. Rieck *Flowers Foods, Inc. - Executive VP of Finance & IR*

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

CONFERENCE CALL PARTICIPANTS

Connor J. Rattigan *Consumer Edge Research, LLC - Research Analyst*

James Ronald Salera *Stephens Inc., Research Division - Analyst*

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

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

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

PRESENTATION

Operator

Good morning, and thank you for standing by. Welcome to the Flowers Foods Fourth Quarter and Full Year 2023 Results Conference Call. Please be advised that today's event is being recorded. I would now like to hand the conference over to your opening speaker today, J.T. Rieck, Executive Vice President of Finance and Investor Relations. Please go ahead, sir.

J. T. Rieck - *Flowers Foods, Inc. - Executive VP of Finance & IR*

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

Please note that in this Q&A session, we may make forward-looking statements about the company's performance. Although we believe these statements to be reasonable, they are subject to risks and uncertainties that could cause actual results to differ materially. In addition to what you hear in these remarks, important factors relating to Flowers Foods business are fully detailed in our SEC filings.

We also provide non-GAAP financial measures for which disclosure and reconciliations are provided in the earnings release and at the end of the slide presentation on our website.

Joining me today are Ryals A. McMullian, Chairman and CEO; and Steve Kinsey, our CFO. Ryals, I'll turn it over to you.

A. Ryals McMullian - *Flowers Foods, Inc. - CEO & Chairman of Board*

Okay. Thanks, J.T. Good morning, everybody. Thanks for joining the fourth quarter call.

We're proud of our team's accomplishments in the challenging consumer environment we're facing. Our brands performed very well, gaining unit and dollar share for the first time since the first quarter of 2022. Dave's Killer Bread was a particular standout, reaching $1 billion in retail sales and growing unit volume 10%, while the overall bread category declined 2.6%. We're excited about the multitude of future growth prospects for Dave's and our other brands, and we are investing in marketing and innovation to capitalize on that potential. Our 2024 forecast calls for continued solid results despite these category headwinds. We expect these results to be first half weighted, benefiting from wraparound pricing and branded retail, new pricing and selected food service accounts and moderating commodity costs.

Our second half forecast incorporates more caution due to the uncertain consumer and promotional environment. We remain focused on the significant longer-term opportunities we see ahead of us, filling in white space and geographic and product adjacencies while leveraging innovation to push into new categories. I've never been more confident in our long-term potential, and I look forward to building on our strong base throughout 2024.

So with that, Norma, we can open it up for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Robert Dickerson with Jefferies.

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

Just a couple of quick questions. I guess -- kind of just first piece, maybe this is more for Steve. As we think through the year kind of especially kind of first half -- second half, how are you feeling about gross margin progression, just given some of the pullback in your inputs, but then also maybe some ongoing kind of promotional reinvestment potential?

A. Ryals McMullian - *Flowers Foods, Inc. - CEO & Chairman of Board*

Yes, Rob, let me start, and Steve can certainly fill in. So from a gross margin standpoint, we expect better results. We saw a nice gross margin increase in the fourth quarter, and we expect that to continue. A couple of other factors, though, to think about impacting bottom line performance. One, we are investing in the business. So whether that's ERP or our marketing investments, et cetera, behind Dave's and Nature's Own and the new bar launches and everything, we are spending more marketing dollars investing in the business. So that will somewhat pressure margins from an EBITDA or bottom line standpoint. But obviously, those were intended to fuel future growth and our investments we're happy to make. But we would expect some improvement in gross margin.

But one other thing to note, somewhat offsetting that, we talked in the prepared remarks about stranded overhead from the strategic exits. That does, particularly from a labor standpoint affect those margins somewhat. However, the exciting thing about that for us is the opportunity we have ahead to refill that capacity with higher margin volume, which was the intention all along. Now obviously, that won't come all at once. It will take a little bit of patience. But we've got a really significant opportunity ahead of us to refill that extreme low margin business that we've exited with much more profitable business.

Steve, do you want to add.

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

Yes. I mean, as Ryals commented and as you saw in the script too, we are being a little more cautious on the consumer in the back half. So when you think about overall cadence currently kind of in the guidance range, we do see stronger performance in the first half. A lot of that, as Ryals said, will be driven by some positives and negatives, specifically to some of the I'd say, commodity moderation pressure. If you think about last year, the first half was tougher than the back. So from an overall comp perspective, that will be driving some of the improvement in the first half as we've seen things pull back somewhat. We do expect first half of 2024 to benefit more than the back half with regard to overall commodity inputs.

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

Okay. Perfect. All right. And I guess just secondly, I think inherent in the guide is potential for ongoing volume declines. Clearly, I understand little pressure consumer backdrop, clearly, a decent amount of pricing going through. Dave's is doing well, but I guess that's a little different. So I'm just curious like if we listen to a number of other companies that are all kind of going through some form of volume pressure, there is kind of this expectation, so to speak, that as we get through the back half of '24, the probability should increase that volumes actually start to grow again, partially just driven by lower base and easier comp in the back half of '23. So I mean it sounds like you're being a little bit more cautious and maybe you're a bit more rational than others. So kind of the straight question is just kind of why not you do forecast a little bit more on the positive volume side as you get through the year? Or maybe that could play out. It's just you don't really know if it does, and that's probably realistic.

A. Ryals McMullian - *Flowers Foods, Inc. - CEO & Chairman of Board*

Yes. Look, it's a fair point. And it's clearly obvious the category continues to be under pressure and with private label trade down. But if you look at our market share performance, it's been quite admirable what we've been able to do even in this environment. Now certainly, we understand that market share performance in a declining category doesn't necessarily translate in the bottom line profitability, but it does show the investments that we're making in our brands enable us to continue relative strong performance in a pressured category.

Now as to the volume outlook for the year, I don't disagree with you. I mean there's certainly a possibility as the market adjusts to sort of post pandemic reality that the category finds its equilibrium which is what I think it's trying to do. And we could see more positive volume performance in the second half. But at the same time, part of our reason for caution is the offset of what a higher promotional environment could look like in that circumstance. I mean if the category in order to drive unit volume, decides it needs to become more promotional, then that could be an offset. The other thing that I would note though is our volume performance continued to improve throughout '23.

And we finished the year with branded retail volume only down 30 basis points, which was a substantial improvement and overall volume improved. We were down, I think, 2.4% in the fourth quarter as opposed to 4.1% if you look back to the third quarter. So the sequence has been good, and so that's certainly a reason for optimism, which I think we're capturing at the upper end of guidance. But again, just given the uncertainty and the relative weakness of the category, we thought caution was prudent at least at this point.

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

All right. And then pardon me for asking a third quickly, just the California legal decision, you had said in the prepared remarks, decision shouldn't be made any time sooner than March 1. Could you just maybe just add a little color as to kind of what that decision could imply like if decision goes one way, we likely would incur (inaudible) damage or what have you, I'm not sure, or probably there's not some material impact. I'm just trying to understand kind of what that could mean relative to the current guide.

A. Ryals McMullian - *Flowers Foods, Inc. - CEO & Chairman of Board*

Yes. So we've already announced what the settlement will be in terms of cost to the company. I think probably the more relevant answer to your question is what happens post March 1 if the settlement is approved? And what will happen, if that is the case, is that we will then set about converting all of the distributors in California to an employee-based model. That is at least out the gate, likely to be somewhat dilutive to our results out in California at least in the short term until we can get everybody trained up, et cetera, bring all the employees on. The good news there is, though, it will be a phased-in approach, Rob. So we have 12 months from the date of the settlement to get that done. So we'd expect -- I think we said in the prepared remarks, probably first quarter of '25, that conversion should be complete.

Operator

Our next question comes from the line of Bill Chappell with Truist Securities.

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

Just a little bit more maybe commentary on the foodservice, the cake business, kind of the thoughts there, in particular, kind of what initiatives we're looking at to kind of improve on the tasty cake side or just to cake in general and kind of how you see the trends play out there versus the core?

A. Ryals McMullian - *Flowers Foods, Inc. - CEO & Chairman of Board*

Yes. So I think we've mentioned this a couple of times on prior quarter calls, but good question. I'd like to discuss it some more. So clearly, pricing has been important in both of those areas, all of those areas, private label foodservice and the cake business. And we've also, as you know, done some pretty significant SKU rationalization and strategic business exits, primarily in foodservice and cake, but also a little bit in private label. However, the profitability of all 3 of those businesses has improved markedly. .

So the strategy is working from that standpoint. And obviously, there are offsets in other parts of the business, the soft variety and white bread area, Bill, as you know, is the most susceptible to private label trade down. So obviously, that's a negative. And then offset by the DKB performance in terms of unit volume. But frankly, even DKB's profitability was down last year pretty significantly because we had substantially higher organic wheat cost last year.

Now the margins are still very attractive for Dave's. I know we don't disclose particular numbers there, but still among the highest in the portfolio. But they were down roughly 500 basis points last year just because of the increased organic wheat costs, which this year will moderate somewhat. So we'll recapture some of that. So really good progress on those parts of the business, somewhat offset by category weakness in commodity cost and those effects on other parts of the business.

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

Okay. And then a little bit on the commodity front. I guess, historically, you've just kind of said, hey, we hedged 6 to 9 months out. I know it's most of the same thing, but this time, you're saying, hey, we're 70% locked on your input costs. So is there any change to how you're looking at things? Or we're just using percentages versus months?

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

No, not really, Bill. We continue to look at our strategy to be 6 to roughly 12 months out. So probably more in the lower term of that in some cases. But the reality is, I think last year, coming into the year, we were roughly 60% -- 65% coverage. So we stay pretty steadfast to our overall strategy. We do -- we have added some things kind of to the toolkit, if you will, to try to manage the volatility, the trading there better. But no changes to how we think about coverage and how long we're planning, how long we're willing to go.

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

Got it. And no -- and actually one follow-up on the DKB bars, is there -- and I'm sorry if I -- if you already covered this, but is there something you can -- you're seeing repeat rates or something that gives you, it's just a little pushback [wheat] here is it's a crowded category. And I know DKB has a great brand, but how you differentiate yourself or get incremental shelf space versus the 20 other bars that are there? And what gives you that confidence what you've seen over the past 3, 4 months in terms of as you expand this year?

A. Ryals McMullian - *Flowers Foods, Inc. - CEO & Chairman of Board*

Yes. So as we noted in the prepared remarks, really pleased with the results in '23. We got a lot more stores than we had targeted. First of all, it's a great product. And we think that's what differentiates us. I mean that's what differentiates the loaf items and the breakfast items, it's just the superior quality. It's a baked bar, great flavor and texture, great nutritional panel on it. A lot of the bars in that category are cold-pressed. So we have more of that fresh baked flavor, which you can -- if you've tried them, you can certainly attest to. But you are right about shelf space. I mean we're only 3 SKUs on the shelf. And so positioning is really important.

And what we're seeing where our positioning is strong, kind of middle, eye level on the shelf even with those 3 SKUs, the standout colors we have are really drawing consumers to the brand, whether they're current DKB shoppers or they're new to the brand, which is net incremental to the DKB consumer base. I do think it's going to help us tremendously as we bring in the 3 additional protein SKUs this year, giving us more visibility on the shelf. And as we said before, those protein bars in test market are proving incremental to the first 3 SKUs. So we're kind of reaching a wider consumer base with that higher protein offering. So velocities are in line with the categories, so we're all good there. We can always do better and we will get better. We said many times, we're treating this as a start-up business. We're learning a bit as we go through, Bill. But so far, so good.

And then of course, behind that, we've got a nice innovation pipeline, 4 days coming with the snack bites in the back half and even more beyond that in '25. So we're off to a good start. We've got nice momentum. The team is excited consumers and retailers alike are excited about it. So we're feeling really good about where we are so far. It's early days, but we're in good shape.

Operator

Our next question comes from the line of Jim Salera with Stephens.

James Ronald Salera - *Stephens Inc., Research Division - Analyst*

In your prepared remarks, you mentioned some uncertainty in 2024, obviously, around the consumer and promotions. I think we all get kind of the consumer piece of that. But to double-click on the promotion side, is the concern that some of the larger competitors in the category are going to maybe revert to how they behaved in the past where they really aggressively chase volume. Or is it more that retailers are going to come to you guys expecting price deflation than using promotion as a tool to achieve that?

A. Ryals McMullian - *Flowers Foods, Inc. - CEO & Chairman of Board*

Yes. Jim, definitely the former. We've seen this in our category before. We haven't seen it in a long time. And even though as we noted in our remarks, we even promoted a bit more in the fourth quarter just because, as you know, there is seasonality in our business not being a big dinner roll supplier that the fourth quarter can be a little bit volatile. So we promoted a bit more to drive more unit volume, got good effectiveness out of those promotions, but we also didn't spend nearly as much in trade to get it and maintained one of the highest average price points in the category. But yes, the caution is much more around the other competitors in the space that it is pressure from retailers, which we really have not felt to date.

James Ronald Salera - *Stephens Inc., Research Division - Analyst*

Okay. Great. Because it seems like and we've talked about this in the past, but part of the challenge is you have this channel shift dynamic that's going on and from the branded retailers' perspective or over the branded food company's perspective rather, if you're putting promo dollars in the channel, but the consumer is in the wrong channel, you're essentially just giving price away, at least that's kind of the way we viewed it. And so would we have to wait until the consumer shifts back to traditional grocery before we see those promotional increases be put into place? Or is it something that even with the consumers still in kind of value-oriented channels, competitors might just put promo in the channel anyway just to see what comes up on the other side.

A. Ryals McMullian - *Flowers Foods, Inc. - CEO & Chairman of Board*

Yes. I mean it could be either. I think that's just going to need to be a wait and see and monitor the environment and react accordingly.

James Ronald Salera - *Stephens Inc., Research Division - Analyst*

Okay. Great. And then maybe if I could sneak in one more. In the breakdown for the 2024 sales guide, I know you guys mentioned you have some wraparound pricing benefit in the first half and some business exits that negatively impact the volume side. If we just think about -- there was a pull forward on business exits into 2023, so I would've thought that it give you guys a more favorable lap in the back half of 2024. So if you can maybe just kind of separate of the volume decline, how much of it that you anticipate is still coming from business exits versus just kind of organic volume declines?

A. Ryals McMullian - *Flowers Foods, Inc. - CEO & Chairman of Board*

Yes. Yes. Most of it is still going to be business exits. And I do want to note if folks didn't pick up on it in the prepared remarks, barring something unforeseen, we do expect this to be the last year of strategic exits. I mean we're done with what we wanted to do. And I mentioned earlier that what we're thrilled about is the opportunity we have in front of us and believe me, there is a lot of opportunity to go back and refill that capacity with higher-margin business, which will not only drive profitability, but go a long way to help bring the unit volume back up. But you are correct, it is first half weighted. You'll see most of that effect in the first half. And then as we move into the back half, it would be much less significant. And then, again, that should be it.

Operator

Our next question comes from the line of Mitchell Pinheiro with Sturdivant and Company.

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

So just a couple of questions. When it comes to the gross margin in 2024, excluding sort of your input costs, your commodity costs, are we seeing like a flattish gross margins because of stranded fixed costs as you exit these businesses, or are we seeing -- is there something else happening that needs to be called out? Like I would expect that some of your digital transformation would start to show up in fiscal '24 a little bit, improved operational sort of the overall equipment effectiveness and things like that. When are we -- when should we start to see real gross margin improvement absent your commodity costs and some things like that?

A. Ryals McMullian - *Flowers Foods, Inc. - CEO & Chairman of Board*

Yes. So as we said, we do expect gross margin improvement this year. And you're right, some of it will be the commodity moderation. There's puts and takes there. Flower is better. There are some other cost buckets that are up. But net-net, we expect to see overall gross margin improvement to that. And frankly, also aided by all the things that you just said, (inaudible) the future of delivering better OEE results. And then some of that will -- what we've experienced is that's been somewhat offset by primarily labor. And that is some of that stranded overhead costs showing up.

And again, I want to emphasize that's temporary because we will refill that capacity and eventually, that will go away. But right now, it is a little bit of a strain. And then as you move down the P&L, thinking about marketing and ERP costs, little bit of labor and SG&A to that where some of that stranded overhead shows up is what's pressuring the EBITDA margin line a bit, at least at this time, though again, we expect, as we go through the year and then particularly in the '25 for all of those things to improve as we refill that capacity and cover the stranded cost.

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

I know you have -- so you're a little cautious on the second half. You just talked about it, a question before about promotion, the potential for maybe a little more promotional environment. But you guys have invested in your promotional management tools. What -- can you talk about that and as it might apply to the back half?

A. Ryals McMullian - *Flowers Foods, Inc. - CEO & Chairman of Board*

Yes. I think it's a great question. And it's timely because that really showed up in the fourth quarter. If you look at the syndicated data, you'll see, as I said, that we had among the highest average prices in the category. And yet our units on promotion were up a bit. We did promote more. But we did so much more effectively and with much less trade spend than we might have historically needed to use really good display execution in support of those promotions. And for the first time in a while, you actually saw a nice lift and got a good return off of those promotions. And for the past few years, we've been talking about how promotions have not been very effective. Not seeing a lot of lift from them, but in the fourth quarter, for the first time in a while we did. So that trade promotion management tool that you referenced is enabling us to be a lot more effective when we do promote.

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

Okay. And then anything to call out from a geography performance point of view? Were there any geographies that were stronger than you expected or weaker in the last quarter?

A. Ryals McMullian - *Flowers Foods, Inc. - CEO & Chairman of Board*

Yes, not stronger and weaker than expected, but we continue to really do well in the Northeast. It's a great growth market for us. We've talked in the past, Mitch, about what a share point is worth up there, some $35 million or so at retail, and we still got a lot of room to grow. So when you think about opportunities for future growth, whether it's there, PAC Northwest, still on the West Coast and in particularly the upper Midwest where we're really not present. We're excited about the prospects we have in front of us, retailer excitement about having us move into those areas, et cetera, bringing Nature's Own, Dave's and Canyon to those consumers. There's still quite a bit of headroom left for us.

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

Okay. And then I guess last question on your comments in the prepared remarks regarding M&A. So are you at the point now where you can kind of see past the obviously, the ERP implementation and just the general -- your investments, is it -- are we at the point where a more meaningful acquisition besides just the Papa pita is in the works or contemplated? Or are we still a little bit a ways away before we want to make a bigger commitment?

A. Ryals McMullian - *Flowers Foods, Inc. - CEO & Chairman of Board*

No, we're ready when the right opportunity comes along, and that's the key is what will that opportunity be? And when will it come? But when it does, we're absolutely ready to go. We've got plenty of dry powder to spiral up things we have going on. We certainly have the capacity to do a meaningful acquisition. And as we said in the prepared remarks, we're very proactive. I'm more optimistic about M&A activity, seeing more founders and sellers that we talk to contemplating transactions. Don't know exactly when they'll come, but when they do, we'll be ready.

Operator

Our next question comes from the line of Connor Rattigan with Consumer Edge.

Connor J. Rattigan - *Consumer Edge Research, LLC - Research Analyst*

Yes. So we heard some other reporters to see so far this season that the breakfast occasion has remained remarkably resilient in foodservice channels and away-from-home with maybe some more weakness in the at-home. I guess, have you guys seen any different levels of elasticity by Dave's part or product types across your portfolio or maybe within the category at large?

A. Ryals McMullian - *Flowers Foods, Inc. - CEO & Chairman of Board*

Connor, it was a little tough to hear you, breaking up a little bit, but I think I got the gist of it. But simply put, elasticities have remained below our forecast and below historic levels kind of across all those channels you mentioned.

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

Okay. Got it. Hopefully, you can hear me a little bit better now. Also so on Dave's Killer Bread, so it sounds like things are going great to bars. I guess just my question is, on the 98,000 stores called out in the prepared remarks, could you maybe help us contextualize that number a little bit? I guess just maybe how much more room is there to run on distribution, probably maybe 1/4 of the way there? And are there maybe any channels lagging behind others that you view as an opportunity?

A. Ryals McMullian - *Flowers Foods, Inc. - CEO & Chairman of Board*

Yes. I mean, the ACV is still pretty low, Connor. So we've got a lot of runway. We've got more opportunity in club. I think we mentioned convenience, which we really haven't even tapped into yet. We started in our areas of strength in mass and grocery. So we've still got a lot of runway ahead of us. I don't have the number in front of me, but I want to say that ACV is somewhere still in the 30s. Is that directionally right?

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

(inaudible).

A. Ryals McMullian - *Flowers Foods, Inc. - CEO & Chairman of Board*

I think that's -- we'll double check that, but I think that's pretty close. So we've got a lot of runway and to give you a comparable, DKB is somewhere in the 75-ish ballpark from an ACV standpoint, just to give you something to compare it to.

Operator

And I'm currently showing no further questions at this time. I'd like to hand the conference back over to Mr. Ryals McMullian, Chairman and Chief Executive Officer for closing remarks.

A. Ryals McMullian - *Flowers Foods, Inc. - CEO & Chairman of Board*

Okay. Norma, thank you. I just want to thank everybody for taking time today and joining us for questions. We very much appreciate your interest in our company. And as always, we look forward to speaking with you again next quarter. Everybody, take care.

Operator

This concludes today's conference call. Thank you for your participation. You may now disconnect. Everyone, have a wonderful day.

A. Ryals McMullian - *Flowers Foods, Inc. - CEO & Chairman of Board*

Thanks, Norma.

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

Thank you.
