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FLO.N - Q2 2024 Flowers Foods Inc Earnings Call

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OVERVIEW:

Company Summary

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

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Robert Frederick Dickerson *Jefferies LLC - Analyst*

Davis Holcombe *Truist Securities - Analyst*

Jim Salera *Stephens - Analyst*

Mitchell Brad Pinheiro *Sturdivant & Co - Analyst*

Stephen Robert R. Powers *Deutsche Bank - Analyst*

PRESENTATION

Operator

Welcome to the Flowers Foods second quarter 2024 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.

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

Thank you, Sharon, and good morning. I hope everyone had the opportunity to review our earnings release posted to our prepared remarks and view the slide presentation that were all posted earlier 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 and could cause actual results to differ materially.

In addition to what you hear in these remarks are important factors relating to Flowers Foods' business are fully detailed in our SEC filings, but also provide non-GAAP the 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 McMullian our 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 I'm very pleased with our solid top and bottom line results for the quarter. Our leading brands are outperforming the category--growing volumes and gaining market share. And our portfolio strategy is enhancing profitability in our private label and away-from-home businesses. At the same time, our savings initiatives have improved our cost structure, significantly boosting our margins compared to the first quarter and enabling us to better leverage our top line performance as we go forward.

The inflationary environment is encouraging some consumers to seek value, but many are increasingly looking for differentiated products. And that desire is manifesting itself in the strong performance of our leading brands.

Consumers are clearly recognizing our brands differentiation, resulting in the largest dollar and unit share gain of any company in the category. We're investing to increase that differentiation, further aligning our brand portfolio with the consumer.

Our quarterly performance bolsters our confidence that we'll deliver results in line with our annual guidance. We're working to drive further improvements, and I look forward to continuing our progress throughout 2024. So with that, Shannon, we're ready to open it up for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Robert Dickerson with Jefferies.

Robert Frederick Dickerson - Jefferies LLC - Analyst

Great. Thanks so much. Happy Friday. Good morning, everyone. Okay. Ryals I guess just a question around the promotional environment. The prepared remarks you did you said you have promoted a little bit more, doesn't sound like a lot, but a little bit more, and it looks like you're taking both unit and dollar share in bread. So I'm just curious, as you know, I feel like you to since the beginning of the year in the guidance has allowed for some promotional risk, right, may be some increase in their promotional activity. As you get through the back half of the year, you promote a little bit more.

You're also taking share. So I'm just curious, like you know, as we sit here today, do you feel like there's maybe a little bit more risk because usually if you're taking share than maybe others notice and they could start to promote more. Thank you.

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

Yes, sure, Rob. Thanks for the question. Yes. Look, I suppose that's possible. And we indicated in our prepared remarks and even embedded in the guidance that we are accounting for that risk as we go through the year. We called it out at the beginning of the year, and I think it's still prudent to call it out now.

As we noted, consumers are responding a bit more to promotions, whereas not too long ago, they were not. And we all know that the consumer is-- alongside of differentiation, the consumer is seeking value. I think we saw that in a large retailer report this week. We're seeing the channel shift, and we've been calling that out for several quarters now from grocery to mass, club, dollar. And that's kind of across income spectrums, too.

So to sum up, I think it's only prudent that we continue to watch that and be a little bit cautious as it relates to our outlook. Having said all that, while promotions are up, things still remain pretty rational and are still well below pre-pandemic. So you'd have ways to go before you got to kind of 2019 promotional levels.

Robert Frederick Dickerson - Jefferies LLC - Analyst

Okay. Fair enough. And then it sounds like as you got through kind of the end of the quarter, you started to see some improvement in these trends, and you called out an increasing shift maybe back to at home to seek value middle of August. I mean, what we've seen in the data kind of through July was that was ongoing actually even improved a little bit. I don't know if there's any way to provide any color kind of as what you've seen, let's say, through kind of the summer months and kind of how you're thinking about that momentum into back-to-school?

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

Yes. So we have -- as you know, we have a large food service business, and a significant component of that is quick serve, fast food chains. And it's been in the news. Folks have seen results at some of these QSR-oriented restaurants be a little bit challenged. And I think a lot of that is inflation, obviously, but it also affects our foodservice volumes since that's a pretty significant part of the portfolio.

But on the flip side, that tends to benefit the retail business. And so I do think that, that's somewhat of a tailwind for our branded retail business as we move through the next -- at least the next couple of quarters. We'll kind of see how the economy does.

Operator

Bill Chappell with Truist Securities.

Davis Holcombe - *Truist Securities - Analyst*

This is Davis Holcombe on for Bill Chappell. Just wondering if you could help us kind of unpack the impact of the business exits on volume? If there's any way that we can kind of get a quantification. Were volumes kind of flattish, up? What does it look like directionally, I guess, from there?

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

Yes. Sure. We don't break that out to that granular of a level. But when you look at volumes in the quarter, they were very positive overall on the branded retail side and particularly, on the branded bread side. Now that was some way down -- somewhat weighed down rather by weakness in the cake business. You've seen that across the sweet baked goods category.

And then as for the rest of the business, as we said, foodservice volumes have been a bit weak due to that QSR weakness, in addition to the strategic exits that we've talked about for several quarters now. However, it's important to remember that those strategic exits roll off in Q4. So they have virtually no impact on us in Q4. We're almost through them, as we mentioned last quarter. And so going forward, you'll see much less impact from that.

Davis Holcombe - *Truist Securities - Analyst*

Excellent. And I was just also wondering if you could kind of help us get a feel for how the distribution, I guess, is going for the DKB like the protein bar rollout and everything like that. Just a little bit more color there.

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

Yes, sure. Overall, we're really pleased with how well we're doing. Look, it's -- as I've said several times before, this is a start-up business for us. It's brand new. It's a different form of merchandising. It's not distributed DSD on the bread trucks. It goes to the warehouse.

Right now, we have a limited number of SKUs, so we're working to expand our shelf presence. We've got the 3 snack bars. We've got the 3 protein bars that are coming out. So our shelf presence is getting better. At our top accounts, large retailers, where we're doing well, we're doing really well. And we've got velocities well within the top 10 in the category.

However, there's been a couple of places where we stubbed our toe from an execution standpoint, and that's part of the learning curve, and we're correcting that. But looking at it overall, we think we've got a great product under a great brand umbrella, and we're very confident about where this is going, not to mention the additional pipeline of innovation with the snack bites coming later this year and then full distribution next year. So overall, we're pleased.

Davis Holcombe - *Truist Securities - Analyst*

Awesome. Thanks for the color. We're going to pass it on.

Operator

Jim Salera with Stephens.

Jim Salera - *Stephens - Analyst*

Hey, good morning, guys. Thanks for taking our question. Ryals, I wanted to maybe see if you could run through puts and takes on -- if we look at the exits from the business impacts, mentioned the pressure on the QSR business, but then if we think about netting those against the strong results at DKB and Canyon plus, what seems like a benefit from food at home shift and take all that --

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

Sorry to interrupt you. Can you start your question over because we had some really bad audio at the beginning of your question?

Jim Salera - *Stephens - Analyst*

Yes, no problem. Is that better? Okay. Perfect spot.

I was just asking if we could maybe net the exit from the business impacts with some of the pressure you mentioned in QSR and then thinking about that against the strong results of DKB, Canyon, benefit from a shifted food at home. If we think about all that together, could we see positive volumes in 3Q and then obviously rolling into 4Q?

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

Yes. I think definitely for 4Q, that's a reasonable assumption, particularly with all the new business, Jim, that we have coming on. We talked about that last quarter. So that will have more of an impact in Q4. And then with the roll-off of the strategic exits, if we can continue to enjoy good momentum from all the brands you mentioned, then yes, I think that's a distinct possibility. I mean, frankly, we were almost there in Q1. Branded retail was actually pretty positive in Q1. So yes, I think that's a reasonable possibility.

Jim Salera - *Stephens - Analyst*

Okay. Great. And then maybe if you could just give us some detail on -- you mentioned in your prepared remarks, restructuring the retail team. Can you just talk about how that changes some of the capabilities relative to the previous structure? And maybe when/how we might see that show up on shelf?

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

Yes. I mean I think you got to give us a little bit of time, Meredith just started not just a few weeks ago, but we brought Terry on -- Terry Thomas on as the Chief Growth Officer. He had some significant experience and insights from his time at Unilever and other places.

And one of the things we lacked here was a channel-specific approach to strategy and execution at the retail level. And I think that's one of the areas where it's going to -- these restructurings are going to benefit us the most. Whereas before, to shorthand it, it's a little bit of a peanut butter spread approach to all channels. Now you're looking specifically at mass, you're looking specifically at club, dollar, whatever it might be. And even as we roll out our snack items, convenience is a tremendous opportunity for us because we're so deeply underpenetrated in that channel.

Jim Salera - *Stephens - Analyst*

Great. Appreciate the color, guys. I'll hop back into queue.

Operator

Mitchell Pinheiro with Sturdivant & Company.

Mitchell Brad Pinheiro - *Sturdivant & Co - Analyst*

So curious, you talked about making headway in some of your underpenetrated geographic regions. And I'm curious like what's driving that? And is it a sustainable growth that you can see there? Because it's a big part of your growth story is while you have extraordinary strength in the South and Southwest, it's -- there's a lot of sort of white space. And just curious if it's sustainable.

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

Well, we certainly think so. As you rightly pointed out, our largest share concentration is in the South. That's a pretty saturated market for us. There's still certain growth pockets, and we're seeing that with the Nature's Own Keto loaf. Dave's continues to grow. And then even in the South, if you break up the geographies and look at it, market share gains has been a little bit tougher in the South, frankly. A little bit more promotional activity. Basically, 2 primary competitors, our most mature market. But what we've been able to do is find areas within the category to grow. So that's Keto, that's breakfast, that sandwich buns and rolls even in the South.

Now more directly to your question on underpenetrated markets, I absolutely think that's sustainable. When you look at a 17, 18 overall dollar share nationwide and only a 10 in the Northeast, and we haven't even really been there that long, Dave's been there, DKB has been there for even less time.

But as you know, a lot of our -- we don't have a national marketing campaign, at least not yet. So that's one of our focus markets for our advertising campaign. We still got room to grow out West, Pac Northwest and probably most importantly, in the Upper Midwest, which we've already started to enter and we'll continue to roll that out as we go forward.

So not only do we have M&A to look to, innovation to look to, but we've also got these underpenetrated regions where we've got a lot of runway to grow to get our fair share of the category.

Mitchell Brad Pinheiro - *Sturdivant & Co - Analyst*

Okay. Then on margins, Steve, in the prepared remarks, you talked about moderating ingredient and packaging cost. Is that something -- you obviously have a lot of visibility there with the amount. You're pretty much set for the remainder of this year with visibility there. Is that something we're going to see not just moderating increases, but are we going to see declines?

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

Yes. I mean, obviously, when you look at kind of the margin performance year-to-date, we've done really well, and we're pleased with where we are. We continue to hedge. I mean our strategy hasn't changed. We say 6 to 9 months ahead of the market, so we understand the cost structure. We did see the first half is actually the largest benefit with regard to the moderating costs. So while we do expect benefit in the half -- in the back half, that benefit will begin to decline somewhat. But overall, we're still forecasting a decent margin improvement for the year.

Mitchell Brad Pinheiro - *Sturdivant & Co - Analyst*

Okay. And then I guess just one last question just on M&A. You've been a little quiet. Is that -- is this -- do you anticipate -- I'm curious what the pipeline might look like, and whether or not -- are you sort of waiting for a lot of the ERP and California and things like that to sort of get behind you before we see M&A? Or are they just unrelated and mutually exclusive?

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

No, we're ready to go. I mean when the right opportunity comes along, it's time for some M&A for us. And I'll reiterate again, we're very proactive in the market. We're out there building relationships. We know what could be coming. We know what we're interested in.

In some cases, we've even done some advanced commercial diligence work so that we're able to execute quickly when the right opportunity comes along. And again, those opportunities can come both in the core and in adjacent categories. I do think -- I mean, there's been some big deals announced over the last week, over the last 6 months or so, but I think there's more ahead. The M&A market seems to be getting healthier as we noted last quarter. So we're bullish on that Mitch.

Mitchell Brad Pinheiro - *Sturdivant & Co - Analyst*

. Okay. I think you appreciate the questions. Thanks.

Operator

Steve Powers with Deutsche Bank.

Stephen Robert R. Powers - *Deutsche Bank - Analyst*

So first question, just a little bit more color on how you're thinking about the price versus -- the kind of reported price mix versus the volume outlook across branded retail as we go through the back half. Obviously, you kind of cycled a year ago pricing actions. Like most recently in the data that we all kind of track week-to-week, it looks like pricing in the category, pricing for your own portfolio, has dipped negative.

So as we go through the back half, as you make those targeted promotional investments and you probably have some channel package mix that's negative despite the premiumization trend, is the base case that pricing -- reported pricing runs negative in the back half with volume making up the difference? Or do you think you can hold price mix to kind of neutral as you flow through '24?

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

Yes. So let's take it -- let's break it up a little bit. I mean on the branded side, all of our pricing is in. Now when you -- the data that we look at, Steve, our average price was up \$0.07 in the quarter, not down. But that's also driven by mix because as we've talked about, DKB had a great quarter. Canyon had a great quarter. Nature's Own did well given the environment. So that mix is driving that a bit. And if we can continue that trend, and

Steve, you should comment on this, too, if we can continue that trend, I would expect mix to be a positive benefit for us as we move through the rest of the year.

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

You're right. I mean obviously, as Ryals said, all of our branded pricing is in. You've seen the kind of the cost environment as well and also some slight promotions. So mix is a big part of the back half. And as Ryals said, if brands continue to perform well and things play out as we think, with some of the new business, by the fourth quarter, we might see some positive volume as well.

Stephen Robert R. Powers - *Deutsche Bank - Analyst*

Okay. Okay. Great. And just on ERP as it relates to the bakery rollout, obviously, that's on hold pending the California distribution transition. I guess as we look out through that transition, how quickly -- what's the base case plan for when the bakery rollout resumes? Is that sort of middle of '25 or sooner or later? How do we think about that?

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

Today, we're obviously trying to work through California, but the plan is to pick back up bakery rollouts late this year or first quarter of next year. And they come with a pretty strong plan to try to stay on our original targets. Obviously, if things shift, we'll let you know. But I think the good thing is right now from an overall cost perspective, we're not anticipating anything to change. So that's critical from that standpoint as well.

Stephen Robert R. Powers - *Deutsche Bank - Analyst*

Okay. So the resumption could happen before the distribution right purchases are fully complete? That's what I'm gleaning from what your answer was.

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

Yes. The goal is to pick back up no later than Q1 next year.

Operator

And I'm currently showing no further questions at this time. I would now like to turn the call back over to Ryals McMullian for closing remarks.

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

Okay. Thanks, Shannon. Thanks, everybody, for taking time today and joining us for questions. We appreciate your interest in our company. And as always, we look forward to speaking with you again next quarter. Take care.

Operator

This concludes today's conference call. Thank you for your participation. You may now disconnect.

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