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# Lancaster Colony Corp. (LANC)

Q1 2022 Earnings Call

## CORPORATE PARTICIPANTS

**Dale N. Ganobsik**

*Vice President-Investor Relations & Treasurer, Lancaster Colony Corp.*

**David A. Ciesinski**

*President, Chief Executive Officer and Director, Lancaster Colony Corp.*

**Thomas K. Pigott**

*Vice President, Chief Financial Officer & Assistant Secretary, Lancaster Colony Corp.*

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## OTHER PARTICIPANTS

**Ryan Blaze Bell**

*Analyst, Consumer Edge Research LLC*

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## MANAGEMENT DISCUSSION SECTION

**Operator:** Good morning. My name is Cheryl and I will be your conference call facilitator today. At this time, I would like to welcome everyone to the Lancaster Colony Corporation Fiscal Year 2022 First Quarter Conference Call. Conducting today's call will be Dave Ciesinski, President and CEO; and Dave Pigott (sic) [Tom Pigott] (00:22), CFO.

All lines have been placed on mute to prevent any background noise. After the speakers have completed their prepared remarks, there will be a question-and-answer period. [Operator Instructions] Thank you.

And now, to begin the conference call, here is Dave Ganobsik, Vice President of Corporate Finance and Investor Relations for Lancaster Colony Corporation.

Ladies and gentlemen, this is the operator for today's call. We apologize for the inconvenience. However, Lancaster Corporation's conference call has been delayed. This call is expected to resume momentarily. Until that time, your lines will again be placed on hold. Thank you for your patience.

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**Dale N. Ganobsik**

*Vice President-Investor Relations & Treasurer, Lancaster Colony Corp.*

Good morning and sorry for the delay. Thank you, everyone, for joining us today for Lancaster Colony's Fiscal Year 2022 First quarter Conference Call.

Our discussion this morning may include forward-looking statements, which are subject to the Safe Harbor provisions of the Private Securities Litigation Reform Act of 1995. These statements are subject to a number of risks and uncertainties and could cause actual results to differ materially, and the company undertakes no obligation to update these statements based upon subsequent events. A detailed discussion of these risks and uncertainties is contained in the company's filings with the SEC.

Also note that the audio replay of this call will be archived and available on our company's website, [lancastercolony.com](http://lancastercolony.com), later this afternoon.

For today's call, Dave Ciesinski, our President and CEO, will begin with a business update and highlights for the quarter. Tom Pigott, our CFO, will then provide an overview of the financial results. Dave will then share some comments regarding our current strategy and outlook. At the conclusion of the prepared remarks, we'll be happy to respond to any of your questions. Once again, we appreciate your participation this morning.

I'll now turn the call over to Lancaster Colony's President and CEO, Dave Ciesinski. Dave?

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**David A. Ciesinski**

*President, Chief Executive Officer and Director, Lancaster Colony Corp.*

Thanks, Dale, and good morning, everyone. It's a pleasure to be here with you today as we review our first quarter results for fiscal year 2022. I'd like to begin by expressing my sincere and heartfelt thanks to everyone here at Lancaster Colony for their tremendous efforts and ongoing commitment to servicing our customers and growing our business.

In our first fiscal quarter ended September 30, consolidated net sales grew 12.3% to a record \$392 million. Net sales in our Retail segment grew 15.6%, while net sales in our Foodservice segment advanced 8.1%. As expected, we experienced significant cost inflation during the quarter that reduced our profit before our pricing initiatives took full effect. The 15.6% growth in Retail net sales comps to a strong first quarter last year, when Retail net sales grew 16.6% as the impacts of COVID-19 drove increased at-home food consumption.

Retail sales growth in this year's first fiscal quarter was driven by our licensing program, led by Chick-fil-A sauces and Buffalo Wild Wings sauces. The sales for those two product lines combined to account for nearly 13 percentage points of growth for the Retail segment in the quarter. IRI scanner data for the 13-week period ending September 26 showed total US food sales of Chick-fil-A sauces at \$35.1 million, and sales of Buffalo Wild Wings sauces at \$13 million.

Olive Garden dressings remains another bright spot in our licensing program, as it continues to gain market share in the \$2.1 billion shelf-stable dressing category. Per IRI, Olive Garden dressings grew their category share to 6.3% during the quarter.

With respect to our own brands, per IRI data for the 13-week period ending September 26, highlights included a 450-basis-point pickup in market share for our own New York Bakery in the frozen garlic bread category.

In our Foodservice segment, excluding the Omni Baking sales attributed to a temporary supply agreement that ended October 31 last year, net sales increased 10.1%. The increase in net sales was driven by inflationary pricing and volume growth for our branded Foodservice products.

Excluding inflationary pricing, sales volumes to our national chain restaurant customers were similar to last year. Foodservice operators industry-wide are facing the challenges of a tight labor market, product supply issues, and rising costs. NPD CREST data for US Foodservice industry shows that weekly transactions for the quarter ending September 30 were pacing ahead of last year through mid-August, and then fell slightly below prior-year levels for the remainder of the quarter.

I'll now turn the call over to Tom Pigott, our CFO, for his commentary on our first quarter financial results. Tom?

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**Thomas K. Pigott***Vice President, Chief Financial Officer & Assistant Secretary, Lancaster Colony Corp.*

Thanks, Dave. Overall, the results for the quarter reflected strong top line performance as well as significant inflationary cost impacts.

First quarter consolidated net sales increased by 12.3% to \$392.1 million. This growth was driven by consolidated volume growth of approximately 5%, pricing primarily in our Foodservice segment, and favorable revenue mix.

Consolidated gross profit decreased by \$300,000 to \$92.4 million. Gross profit benefited from the volume and pricing actions. These benefits were offset by a significant amount of commodity inflation. Our raw material costs were up in the mid-teens on a percentage basis. This commodity inflation, in excess of our pricing, was the primary driver of the 290 basis point gross margin decline we reported in the quarter.

As we've shared, our planned retail pricing will be fully reflected in the second quarter. In addition, our Foodservice pricing lagged the commodity increase during the quarter. Beyond the significant commodity inflation, we incurred higher co-manufacturing costs as we outsourced additional production to meet our growing demand, as well as higher freight and warehousing costs and labor inflation. These increases were partially offset by reduced costs related to COVID-19 and our productivity initiatives.

Selling, general, and administrative expenses increased \$3.7 million or 7.6%. The largest driver of the increase was Project Ascent, which was up \$1.1 million. Other increases included investments in personnel and business initiatives to support growth.

Consolidated operating income declined \$8.4 million or 17.2% versus the prior-year quarter to \$40.5 million. The main driver of the reported operating income decline was the prior year's net \$4.5 million benefit for the special items related to the Bantam Bagels business. These items included a \$5.7 million favorable reduction in contingent consideration and a \$1.2 million intangible asset impairment charge, as specified on our income statement. Excluding these items, our operating income was lower due to the modest gross profit decline and the increase in SG&A expenses.

Our effective tax rate was 24.4% this quarter versus a tax rate of 24.3% in the first quarter of fiscal 2021. We estimate the tax rate for fiscal 2022 to be 24%. First quarter diluted earnings per share decreased \$0.24 to \$1.11. The decrease was primarily driven by the prior-year favorable impact of the Bantam special items I mentioned previously. These items benefited prior-year EPS by \$0.13 a share. In addition, costs related to Project Ascent reduced this quarter's EPS growth by \$0.03 per share. The remainder of the decline related to the underlying performance of the business.

With regard to capital expenditures, first quarter payments for property additions totaled \$30.2 million. For our fiscal year 2022, we are forecasting total capital expenditures between \$170 million and \$190 million. This forecast includes approximately \$105 million for the Horse Cave expansion project that will help us meet the increasing demand for our dressings and sauce products. In addition to investing in our business, we also returned funds to shareholders.

Our quarterly cash dividend of \$0.75 per share paid on September 30 represented a 7% increase from the prior-year amount. Our enduring streak of annual dividend increases currently stands at 58 years. Even with the investments we are making and the increased dividend payments, our financial position remains very strong, as we finish the quarter debt-free with \$130 million in cash on the balance sheet.

To wrap up my commentary, this quarter featured strong top line growth and significant inflationary impacts in advance of our full pricing actions. We continue to monitor and adjust for the inflationary cost increases we are forecasting this year while investing in the long-term potential of the business.

I'll now turn it back over to Dave for his closing remarks. Thank you.

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**David A. Ciesinski**

*President, Chief Executive Officer and Director, Lancaster Colony Corp.*

Thanks, Tom. As we look ahead, Lancaster Colony will continue to leverage the combined strength of our team, our operating strategy, and our balance sheet in support of the three simple pillars of our growth plan. Number one, to accelerate our core business growth; number two, to simplify our supply chain, to reduce our cost, and grow our margins; and number three, to identify and execute complementary M&A to grow our core.

In our fiscal second quarter, we expect our licensing program to remain an important source of growth in the Retail segment. Our Foodservice segment should continue to benefit from higher demand for our Foodservice products and growth from select QSR and pizza chain customers. We anticipate the inflationary environment will continue as we face higher commodity costs, particularly for soybean oil, along with increased costs for packaging, freight and labor. Inflationary pricing, including Retail segment pricing actions that took effect near the end of our first fiscal quarter, combined with additional pricing in the Foodservice segment, will help to partially offset the input cost inflation.

Our ongoing cost savings programs and other net price realization efforts will also serve to reduce the unfavorable impact of inflation in the quarter. Note that our projected financial results and expectations remain subject to the impacts of COVID-19, including shifts in consumer demand between the retail and Foodservice channels, industry-wide supply chain challenges and inefficiencies, and higher costs to produce our products and service to our customers.

Moving on to our supply chain strategy, our significant investment in production capacity and our dressing and sauce facility in Horse Cave, Kentucky is progressing as planned with the target completion timeframe in the first quarter of fiscal year 2023.

Given the strong growth we are experiencing across our portfolio of products, we are continuing to evaluate other alternatives to add production capacity and grow our manufacturing footprint. Finally, consistent with the update that we shared with you in our fourth quarter earnings results back in August, the implementation phase of our ERP project, Project Ascent, is scheduled to begin in the first quarter of fiscal year 2023.

This concludes our prepared remarks for today, and we'd be happy to answer any questions you may have. Cheryl?

## QUESTION AND ANSWER SECTION

**Operator:** [Operator Instructions] The first question is from Ryan Bell of Consumer Edge Research. Please go ahead.

**Ryan Blaze Bell**

*Analyst, Consumer Edge Research LLC*

Good morning, everyone.

Q

**Thomas K. Pigott**

*Vice President, Chief Financial Officer & Assistant Secretary, Lancaster Colony Corp.*

Hi, Ryan.

A

**David A. Ciesinski**

*President, Chief Executive Officer and Director, Lancaster Colony Corp.*

Hi, Ryan. Good morning.

A

**Ryan Blaze Bell**

*Analyst, Consumer Edge Research LLC*

With respect to the top-line growth in the Retail business, continuing to see strength, driven by Chick-fil-A partnership. It appears there's room for that to continue growing throughout fiscal [ph] 2022 3Q (15:15)? How are you thinking about the growth prospects as you lapped the national launch last year, and specifically the months where it had been nationally distributed already?

Q

**David A. Ciesinski**

*President, Chief Executive Officer and Director, Lancaster Colony Corp.*

Yes, absolutely. Ryan, if you go back and you look at the scanner data sales, Q4 of the last fiscal year I think was about \$38 million. Q1 of this quarter scanner data was about \$35 million. And I think what you're likely to see is sequential growth as we continue through at least the next several quarters.

A

When we get into Q4, we're probably going to be close to a push because, as you're well aware right now, we're constrained, and this is just on Chick-fil-A sauce I'm talking about here – we're constrained on capacity. As you look at more broadly, across the algorithm in Retail, we expect to see continued growth, sequential growth throughout the year.

Now, let's kind of take a step back and talk about Chick-fil-A. As we think about it, as we finish this fiscal year and we continue this growth, there are several things that are going to start to open up as we get into the next fiscal year. The first of which is we're bringing online incremental modeling capacity that's going to allow us to take the product off-allocation with our customers and allow them to begin to merchandise the item in ways that you would other items in a grocery store.

And the other thing that that's going to allow us to do is to bring to the market new flavors and new sizes, and these are discussions that are actively underway with our partner at Chick-fil-A, and we're going to be excited to share more news about that with you in the forthcoming quarters. So, we're excited to see how this product is

performing, and we continue to see strong results in terms of trial and repeat. And we just think that there is a ton of upside on this brand proposition.

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

Q

Thanks. That's helpful. And then, it seems largely the biggest thing, at least from the Chick-fil-A partnership, that's holding you back is just the capacity. And then, as we're thinking about potentially other opportunities within our Foodservice partnerships, at Retail, how do you think about that playing out?

**David A. Ciesinski***President, Chief Executive Officer and Director, Lancaster Colony Corp.*

A

It's another great question. So, as we look at it, the way we're looking at this in general is, almost Brian like the way you would look at other inorganic growth. In our company, like others, we're constantly looking at acquisition opportunities, and we think of them in terms of a pipeline. We take that exact same approach, though, when we apply to the way we think about licensing, right, with the first and closest in opportunities being expanding with existing partners, and then looking at new partners.

And there again, when we bring that capacity online, it's going to give us the opportunity to bring online new partners and potentially some new categories. I'm not in a position to share that with you right now, but we have a number of great things that are underway and look forward to sharing more of that with you in due course.

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

Q

Thanks. In terms of the Project Ascent costs, could you provide any details regarding the expected magnitude of those costs over the coming quarters and then, just a little bit more detail again on your decision to shift the implementation out until 2023.

**David A. Ciesinski***President, Chief Executive Officer and Director, Lancaster Colony Corp.*

A

Yes. So, what I would tell you is, next quarter's going to be on or about cost proximate to where we were in this quarter. You can expect to see probably a very marginal uptick in Q3 and Q4 as we get ready for the final push and then go live in Q4, and then you can expect to see those costs start to wind down into fiscal year 2023 sort of the way that they are cadenced out.

And the reason why they're essentially going to be flat for the first quarter and this quarter is because at this point, we're into testing. As we cross over into the next calendar year, our Q3 and Q4, really we're going to be going through very intensive training and getting employees ready to go – to take this product live. And these aren't expenses that you can capitalize. You're running through the P&L, and it's the final push.

As you think about what we're doing, that first wave that we're bringing live is the back office of the business. It's order to cash, it's procure to pay, it involves trade spending, and we're also bringing online our frozen DCs and just a couple of factories.

In the subsequent waves, what will happen is that the scope of the implementation will start to wind down, and we're going to be essentially stamping out factories several at a time until we're completed with this project, which will wind its way down through the end of 2023 for the timing.



Now, there's a second question, which is why did we elect to defer the project to make it lined up with the fiscal year? And there are a couple of reasons for that, Ryan. Look, the first is we stepped back and we said, what are truly the priorities of our business? And first and foremost, it's servicing our key strategic customers, namely our Foodservice customers, be it Darden Restaurants and Olive Garden, and other elements, Chick-fil-A, Buffalo Wild Wings and others.

In many cases, we're sole supplier to those guys and their menu for their items. And for us to put them in a situation where we're not able to deliver not only impacts our business, but it could severely impact their business.

And getting all the external complexities that we were seeing when we went through our planning process, we elected that it would be safer to push it out a little bit farther to ensure that we are in a position to build up inventory and to execute it safely.

So, parenthetically, if you go through – when you get a chance and [ph] if you look at the queue (21:26) – you're going to see some movement in our inventory. Part of that is driven by a rebound because of inflation, but part of that is driven by the fact that we are carrying more inventory as a buffer to make sure that we can service our business now and in preparation for servicing our business when we prepare to go live. So, really, that decision more than anything else was just driven by the fact that we want to make sure that we nail the implementation for our company and our shareholders, but we also nail it for those strategic partners.

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**Ryan Blaze Bell**

*Analyst, Consumer Edge Research LLC*

Q

Thanks. And where in your business are you seeing the largest inflationary pressures? I was thinking about gross margins throughout the balance of the year, I know you don't provide guidance, but any color on the moving pieces would be helpful. And then maybe some of the impacts that you're seeing Foodservice coming back, Retail still growing strongly, but at some point, that's going to fade out. Just some the implications that you'd see in terms of gross margins coming from those – the balance of those moving pieces.

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**Thomas K. Pigott**

*Vice President, Chief Financial Officer & Assistant Secretary, Lancaster Colony Corp.*

A

Thanks, Ryan. Yes. This is Tom. So, overall, we did see commodity inflation in the quarter in the mid-teens. The most pronounced impact for us was in soybean oil, where the costs are close to double. That impacts both of our segments. But in this particular quarter, we saw more of an impact in the Foodservice PNOC as our pricing lagged the commodities, and you can see that in the Foodservice results we've reported.

Now, going forward, as we shared on the retail side, we do have – we'll get the full impact of the first round of pricing that will be reflected in Q2 fully, as well as the catch-up on Foodservice pricing, which will improve our margins there as well versus the declines we reported this quarter.

Now, in the future, certainly, we're modeling our PNOC and forecasting the commodities. We look at it very closely. We have a number of scenarios on the board. And over time, our goal and our belief is that we'll be able to offset these commodity impacts, be it through pricing, trade reductions, other revenue realization approaches.

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**Ryan Blaze Bell**

*Analyst, Consumer Edge Research LLC*

Q

Thanks. That's helpful. And then as we're looking at some of the Foodservice trends, the continuous improvement, how much of it hasn't really covered due to COVID yet? And then I know you touched on some of



the NPD trends in your prepared remarks, but would you also go into a little bit more detail about some of the industry level trends we're seeing in Foodservice and then maybe how you think about that in terms of the potential for sequential improvement continuing for the Foodservice business?

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**David A. Ciesinski**

*President, Chief Executive Officer and Director, Lancaster Colony Corp.*

**A**

Yes. Ryan, I'll go ahead and take that one. It's an interesting quarter. If you look at where the quarter began in July, what we saw was, and I'm going to talk about transaction data, right, is transactions were actually strong. They were running in the low- to mid-single-digit, mid-single-digit range for all the various outlets, QSR on a consolidated basis.

As we got towards middle of August, all of a sudden, we started to see transaction data start to pull back. And it actually started to go slightly negative, let's call it 1%, and it sort of ran that way through the remainder of the quarter. Now, as you pull that apart, what you saw were there were some segments like mid-scale that continued to perform pretty darn well through the whole quarter. But bear in mind that those segments were lapping a horrible comp last year, where they would have been down 60% or 70%, right?

But if you kind of go to where is the center of gravity on Foodservice, which is around QSR and casual dining, but QSR principally, I think the story to watch is that, as we started the quarter again, we were in the, let's call it, the mid-single digits positive, and then it flipped slightly negative. So, by the time you look at a 13-week data period in NPD, you're looking at transactions that are basically flat.

What we believe is going on in this case is that operators are wrestling with labors. And as a consequence, they're curtailing their hours of operations and, in some cases, their days of operations, and that's translating into fewer transactions. If you look at the sales data, given the fact that they're passing on inflation, it's masking that. But in terms of what we see in terms of the volume that runs through their boxes, we are seeing a modest pullback there.

So, as we look across the remainder of our fiscal year, what I would continue maybe to focus on is, fortunately, we are going to be lapping some softer comps. But to some degree, we're going to be beholden by how well they're able to staff and run their operations.

I wouldn't expect to see a material pullback in hours in operations from where they are today, but every one of these guys out there are making triage decisions. In some cases, they're limiting menu items to reduce complexity in the restaurant. In other cases, they're limiting hours in order to manage complexity. And in the final case, some of them, in the case of QSR, are closing their dining rooms and focusing on their drive-through or takeout business.

So, we do see line of sight to continued growth given the soft comps. It's a business that we believe in. But their challenges are manifest, and they're real.

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**Ryan Blaze Bell**

*Analyst, Consumer Edge Research LLC*

**Q**

Thanks. That's helpful. And then, in terms of capital allocation priorities for fiscal 2022, would you be able to provide any details about that, potentially thoughts on M&A or any additional capital expenditures that supports the demand that you're seeing within the Retail business?

**Thomas K. Pigott**

*Vice President, Chief Financial Officer & Assistant Secretary, Lancaster Colony Corp.*

Yes, Ryan. That's an excellent question. So, as we've shared this year, we'll be spending between \$170 million and \$190 million, heavy spend behind that Horse Cave expansion project.

Today, we are looking at a number of growth scenarios on the business. And as it relates to capital allocation, I think decision one is supporting that growth. So, we're looking at potential Greenfield/Brownfield expansions, as well as potential acquisitions of existing dressings and sauce businesses to support the robust growth.

And then, beyond that, we do think about M&A. But, I think our focus in the short term is to take care of our existing demand, support the continued growth of the licensing platform with our capital allocation, and then implement the ERP system, and then potentially think about other alternatives to continue to support our growth.

**Ryan Blaze Bell**

*Analyst, Consumer Edge Research LLC*

Thanks. That's it for me.

**David A. Ciesinski**

*President, Chief Executive Officer and Director, Lancaster Colony Corp.*

All right.

**Thomas K. Pigott**

*Vice President, Chief Financial Officer & Assistant Secretary, Lancaster Colony Corp.*

Thanks, Ryan.

**David A. Ciesinski**

*President, Chief Executive Officer and Director, Lancaster Colony Corp.*

Thank you, Ryan.

**David A. Ciesinski**

*President, Chief Executive Officer and Director, Lancaster Colony Corp.*

Well, if there aren't any other questions, I want to thank each of you for joining this morning, and we look forward to getting together on the call when we share with you our second quarter updates. And, in the meantime, I hope you guys have a happy, safe, and productive fall.

**Operator:** This concludes today's conference call. You may now disconnect.

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