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Lancaster Colony Corp. (LANC)

Q3 2016 Earnings Call

CORPORATE PARTICIPANTS

Dale N. Ganobsik
Director-Investor Relations

John B. Gerlach
Chairman, Chief Executive Officer, President and Director

Douglas A. Fell
Chief Financial Officer, Treasurer & VP

David Alan Ciesinski
President & Chief Operating Officer

OTHER PARTICIPANTS

Frank Camma
Sidoti & Co. LLC

Philip Terpolilli
Wedbush Securities, Inc.

Eric Mitchell Gottlieb
D. A. Davidson & Co.

Jeffrey S. Thomison
J.J.B. Hilliard, W.L. Lyons LLC

Elliott Schlang
Great Lakes Review

Brett Michael Hundley
BB&T Capital Markets

MANAGEMENT DISCUSSION SECTION

Operator: Good morning. My name is Susanne, and I will be your conference facilitator today. At this time, I would like to welcome everyone to the Lancaster Colony Corporation's fiscal year 2016 third quarter conference call. Conducting today's call will be Jay Gerlach, Lancaster Colony's Chairman and CEO; Dave Ciesinski, President and COO; and Doug Fell, Vice President, Treasurer, and CFO. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer period. [Operator Instructions]

Thank you. And now to begin the conference call, here is Mr. Dale Ganobsik, Director of Investor Relations for Lancaster Colony Corporation. Please go ahead.

Dale N. Ganobsik
Director-Investor Relations

Thank you, Susanne. Good morning, everyone, and thank you for joining us today for Lancaster Colony's fiscal 2016 third quarter conference call.

Let me begin by reminding everyone that 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 that 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 at our company's website, lancastercolony.com, later this afternoon.

With that said, I'll now turn the call over to Lancaster Colony's Chairman and CEO, Jay Gerlach. Jay?

John B. Gerlach

Chairman, Chief Executive Officer, President and Director

Thanks, Dale, and good morning. Thank you for being with us today. We're pleased to have with us this morning our new President and Chief Operating Officer, Dave Ciesinski, who is also President of our food business. Dave is an excellent addition to our leadership team, who can help drive our growth into the future. You'll get to hear from Dave, as we wrap up our prepared remarks.

Turning to our third quarter results, we're quite pleased to report both sales growth and operating margin improvement. Sales increased 9.3% in the quarter and still a respectable 6.1% without the benefit of the Flatout acquisition, which we anniversaried on March 13.

Without the benefit of Flatout, retail and foodservice channel sales growth rates were both just a fraction over 6%. Including Flatout, our mix moved heavier to retail by about 100 basis points to 51.2%. Overall, sales growth was driven by the addition of Flatout, increased volumes and pricing. The pricing benefit was largely due to the impact of higher egg costs.

Retail volume was helped by continued growth in refrigerated dressings with Olive Garden – and Olive Garden shelf-stable dressings. We saw gains in frozen garlic bread, but a modest decline in frozen dinner rolls. We feel the timing of these two had a minimal, but favorable impact.

Our foodservice channel saw continued volume growth from our major and national chain customers, including some new limited time offer business. Our rationalization efforts had a small negative impact on sales in the channel.

Segment operating margin improved about 320 basis points, due to the benefit of higher selling prices, lower commodity costs and lower freight costs, partially offset by increased consumer and trade spending. The quarter was helped by the reversal of what we experienced in our first quarter and second quarter when our price recovery lagged the impact of much higher egg costs. With our foodservice pricing now being adjusted downward to reflect currently lower egg costs, we expect the net pricing benefit to greatly diminish in our fourth quarter.

Looking at retail sell-through for our six primary retail categories as measured by IRI for the 12 weeks ended March 20, we maintained our number one leadership position in all categories and saw share growth in all, but two, frozen dinner rolls and refrigerated dressings. New retail product sales were led by our New York Bakery soft pull apart rolls and Simply Dressed avocado ranch dressing.

Let me now ask Doug to make a few comments.

Douglas A. Fell

Chief Financial Officer, Treasurer & VP

Thank you, Jay. Overall, our balance sheet remains strong. I will comment on some of the larger line items within our balance sheet that have changed since June 30.

Turning first to our cash balances. As conveyed in our previous earnings call, the significant decline of \$88 million since June 30, primarily reflects the payment of our \$5 per share special dividend on December 31. As previously reported, this totaled \$137 million. The offset to this event was our fiscal year -to-date cash generated by

operations of approximately \$100 million, reduced by regular cash dividends of \$40 million and property additions of \$12 million.

Our accounts receivable balance increased nearly \$8 million from the June level. In general, the increase primarily reflects higher sales volumes. Consistent with past quarters, we continue to see our overall agings remain solid.

Our inventories remain in line with those at June 30 and our expectations including certain seasonal inventories, as we exit the Easter holiday. We continue to place emphasis on this important element of our working capital.

With respect to our balance sheet capitalization, we continue to have no debt and nearly \$500 million in total shareholders' equity. The reduction in shareholders' equity from last June, in general, reflects the impact of the \$5 special dividend paid on December 31. We ended the quarter with over \$94 million in cash and equivalents, as we continue to benefit from strong operating cash flows.

On April 8, we entered into a new unsecured credit facility that expires in April 2021. Given current market conditions, we slightly increased our borrowing capacity from \$120 million to \$150 million. Subject to the consent of the participating banks in our facility, we have the ability to borrow an additional \$75 million under the new facility. In general, all the major terms and financial covenants of the new facility remain unchanged.

Given our balance sheet posture and overall liquidity, we continue to possess considerable flexibility to address our foreseeable cash requirements, including those supportive of our future organic growth initiatives, acquisition opportunities, continue dividends and opportunistic share repurchases.

Finally, our overall effective tax rate of 34.2% is consistent with our expectations and previous guidance. We would expect a similar effective rate in our fourth quarter.

Thanks, again, for your participation with us this morning. And I will now turn the call back over to Jay for concluding comments. Jay?

John B. Gerlach

Chairman, Chief Executive Officer, President and Director

Thank you, Doug. Looking to the fourth quarter, we feel positive about continued growth in both channels. However, sales gains will be mitigated by the anniversary of the Flatout acquisition, deflationary pricing we expect to see in our foodservice channel and higher placement cost for new retail products that will reduce reported net sales.

Our rationalization initiative will also have a greater impact on foodservice sales volumes this quarter, while growth from our core national chain account customers should continue. We expect higher sales in our retail channel from the same general areas, as we've seen recently.

New retail products will include the further rollout of Marzetti Vineyard dressings beyond the select markets, they've been in the last few months. Brand new items being introduced this spring are: New York Bakery Bake & Break garlic loaves; Marzetti spicy avocado dip; and Olive Garden red wine balsamic dressing.

Several new flavors are also being added to our Marzetti's simply dressed and Girard's dressing lines. We don't anticipate a beneficial impact from these introductions in the quarter, as product placement and other promotional costs offset initial sales in the near term.

From a cost perspective, we expect commodity and freight costs to remain favorable. While we remain focused on manufacturing costs and related cost savings initiatives, we do anticipate some continuing challenges in certain areas of our operations.

Turning to capital investment. We now estimate the year to finish at about \$16 million with dressing, packaging and processing equipment being our biggest investment for the year. We continue to be interested in acquisition opportunities and while we are actively in the market, we have nothing to report today.

With eight full days on the job, let me now introduce and ask Dave Ciesinski to make a few comments.

David Alan Ciesinski

President & Chief Operating Officer

Thanks, Jay, and good morning, everyone. I'm thrilled to have joined the Lancaster Colony Corporation, which has a portfolio of strong brands, relevant categories and a strong track record of execution. I look forward to building on the recent history in the next chapter of our company.

John B. Gerlach

Chairman, Chief Executive Officer, President and Director

Thanks, Dave. Let me close by thanking Bruce Rosa for his countless contributions over 41 years career with us. He played an integral role in the growth of our food business from its early years of less than \$15 million in sales to over \$1.1 billion today.

Susanne, we are ready to take questions.

QUESTION AND ANSWER SECTION

Operator: Excellent. [Operator Instructions] Your first question comes from the line of Frank Camma of Sidoti.

Frank Camma
Sidoti & Co. LLC

Q

Good morning guys, and congratulations on the quarter.

Douglas A. Fell
Chief Financial Officer, Treasurer & VP

A

Hi. Thanks.

John B. Gerlach
Chairman, Chief Executive Officer, President and Director

A

Hi Frank. Thank you. Good morning.

Frank Camma
Sidoti & Co. LLC

Q

I know you commented a little bit about this, but can you break down sort of the benefit you had in the quarter with the -- so you had 6% organic growth about, was that roughly half volume, half price? I'm just trying to drill down on that a little bit more.

John B. Gerlach
Chairman, Chief Executive Officer, President and Director

A

If you put volume and mix together, Frank, that probably is a little over -a-half and pricing is maybe about a-third or so.

Frank Camma
Sidoti & Co. LLC

Q

Okay. Great. Great. The other question, could you comment a little bit on Flatout. I know, in last quarter it disappointed you a little bit, just maybe disappoints from -- but there was some seasonality impact, sales had pulled back a little bit. But obviously it looks like it's going back up this quarter. So I was wondering, if you could talk about that?

John B. Gerlach
Chairman, Chief Executive Officer, President and Director

A

Yeah. I think we've seen a little bit of improvement in Flatout. Still have some of the same headwinds we've talked about in the past, particularly relative to some display in one of our key customers, and the change has impacted us there. But generally, I think the business has been improving and we hope that will continue as we move into the fourth quarter and beyond.

Frank Camma
Sidoti & Co. LLC

Q

Okay, great. And the last thing is just on, because you mentioned commodity cost obviously still favorable. Recently, soybeans I guess have gone up a little bit relative to where they were in the summer time. I was wondering if you could comment on that how, if it stays elevated.

John B. Gerlach

Chairman, Chief Executive Officer, President and Director

A

Well, certainly, if it stays elevated for any period of time, it will have an impact. As you know, we do make forward buys on...

Frank Camma

Sidoti & Co. LLC

Q

Right.

John B. Gerlach

Chairman, Chief Executive Officer, President and Director

A

indiscernible] (11:46) going out a year or a-year plus...

Frank Camma

Sidoti & Co. LLC

Q

Right.

John B. Gerlach

Chairman, Chief Executive Officer, President and Director

A

... in the near-term it's not having a material impact, but we do consistently buy oil, month in and month out. So those higher costs will work their way. And there are average costs, as we start to look several quarters down the road. But in the near-term, not any real material negative impact from that.

Frank Camma

Sidoti & Co. LLC

Q

Right. Okay. So the lag would be a couple of quarters at least basically is what you're saying, it sounds like?

John B. Gerlach

Chairman, Chief Executive Officer, President and Director

A

Yeah, I think that's fair. Yeah.

Frank Camma

Sidoti & Co. LLC

Q

[ph] Fair assumption (12:24). Okay. Thanks guys.

John B. Gerlach

Chairman, Chief Executive Officer, President and Director

A

You're welcome.

Douglas A. Fell

Chief Financial Officer, Treasurer & VP

A

Thank you.

Operator: And your next question comes from the line of Philip Terpolilli of Wedbush.

Philip Terpolilli

Wedbush Securities, Inc.

Q

Yes. Good morning.

John B. Gerlach

Chairman, Chief Executive Officer, President and Director

A

Hi Phil.

Douglas A. Fell

Chief Financial Officer, Treasurer & VP

A

Good morning Phil.

Philip Terpolilli

Wedbush Securities, Inc.

Q

Thanks for taking the questions. Couple on the top line. I guess the first thing and I think you just mentioned a little bit about one of your largest customers. But can you sort of give us an update there, what's going on, not only with Flatout, but also with the frozen business, if you're sort of back to more normalized buying patterns with them?

John B. Gerlach

Chairman, Chief Executive Officer, President and Director

A

Yes. Phil, I think they are relatively normal, certainly for this time of year. As you know, we've got a seasonal component to that, but as we move through the fall holidays is behind us, so little bit of an Easter impact, but not real significant there as far as any kind of changes or anything. So, yes, I think things are operating pretty much as normal.

Philip Terpolilli

Wedbush Securities, Inc.

Q

And that was actually my next question on Easter. You mentioned a slight benefit. Is there any way to sort of quantify your best guess, what do you guys think that was?

John B. Gerlach

Chairman, Chief Executive Officer, President and Director

A

Yeah. It was pretty minimal given the timing was close to last year, Phil. So my estimate, will probably be just \$1 million or less. It's relatively insignificant.

Philip Terpolilli

Wedbush Securities, Inc.

Q

Okay that's helpful. And then just two more, I guess staying on the top line. I guess you were mentioning or you called out in the press release a step-up in the marketing promotional expenses. I would assume a lot of that's around new products. Has that already been happening on some of the new items that you've been launching, the

Vineyard dressings, et cetera, or now that you are it sounds like maybe pressing down, getting more distribution that you're stepping that up a little bit more, how do we think about that?

John B. Gerlach

Chairman, Chief Executive Officer, President and Director

A

Well, I mean a little bit of that does happen as we work through new product introduction. So, yeah, we would have done a little bit on the Vineyard Dressings, Veggie Drizzle, as we brought those to market on a pretty limited rollout basis in the fall. And so we'll be stepping that up a little bit, as we go through the spring as well as a couple of the new items I mentioned.

But we also I think in the quarter and as we've talked about in the past continue to see a little bit of an uptick in our consumer spend, just trying to, again, support the brands and build the brand strength a little bit day in and day out.

Philip Terpolilli

Wedbush Securities, Inc.

Q

And those new products, now that they've been out there a few more months, what's sort of the response in the marketplace or how are they going maybe versus your expectations?

John B. Gerlach

Chairman, Chief Executive Officer, President and Director

A

Again, the rollout was pretty limited on the Vineyard Dressings and the Veggie Drizzles initially, so still a little hard to tell, so I think we'd probably got to go another few months as we more broadly roll them out to get a good sense of that.

Philip Terpolilli

Wedbush Securities, Inc.

Q

All right. Okay. And then, I guess, just lastly on the top line from sort of a maybe bigger picture perspective. I know, we've talked a lot about this, but in terms of competition, you've been in some different categories, particularly, refrigerated dressings, you have sort of driven innovation there. Have seen maybe a few incremental competitors come in, no real impact to you. Have you seen any sort of change in that over the last few months or maybe conversations with retailers as there has been more competing product that wants to get shelf space or are the conversations you're having very much the same that you've always had?

John B. Gerlach

Chairman, Chief Executive Officer, President and Director

A

Well, I think it is a category that certainly got a lot of interest both at the retailer level as well as with the consumers. So there are new entrants into it, so with the limited amount of shelf space, as there always is throughout the store, maybe a little bit more, even where it's in a refrigerated space, you've got to be sure you're delivering value and delivering growth opportunity, hence some of the innovation we're trying to bring into that product line in that space.

Philip Terpolilli

Wedbush Securities, Inc.

Q

Okay. Great. I'll pass it along.

John B. Gerlach
Chairman, Chief Executive Officer, President and Director

A

Thank you.

Philip Terpolilli
Wedbush Securities, Inc.

Q

Thanks everyone.

Operator: Our next question comes from the line of Eric Gottlieb of D.A. Davidson.

Eric Mitchell Gottlieb
D. A. Davidson & Co.

Q

Good morning every one. Thank you for taking my question.

John B. Gerlach
Chairman, Chief Executive Officer, President and Director

A

Good morning [ph] Eric (17:10).

Eric Mitchell Gottlieb
D. A. Davidson & Co.

Q

First, on the top line, is it fair to say that 1% or so of the volumes was due to leap year?

John B. Gerlach
Chairman, Chief Executive Officer, President and Director

A

We didn't calculate a specific number there that you might be in the ballpark with that. Sure.

Eric Mitchell Gottlieb
D. A. Davidson & Co.

Q

Okay. And then can we dive into COGS a little bit more. How much it was lower ingredients versus packaging, if you could break that out?

John B. Gerlach
Chairman, Chief Executive Officer, President and Director

A

I don't know if we can do that quickly off the top of our heads, so I'll look to Doug and see if he could.

Douglas A. Fell
Chief Financial Officer, Treasurer & VP

A

I would just generally convey, Eric, that predominantly it was driven by ingredients. Packaging, while favorable, was far less of a component.

Eric Mitchell Gottlieb
D. A. Davidson & Co.

Q

Got it. That's good enough for me. So within ingredients, how much was egg cost and what were some of the other that maybe you want to highlight?

John B. Gerlach

Chairman, Chief Executive Officer, President and Director

A

Well, still the big savings are coming out of -- year-over-year coming out of soybean oil and flour, but generally across the ingredient that we had some savings. Egg costs, I think, in the quarter were relatively flat with last year.

Eric Mitchell Gottlieb

D. A. Davidson & Co.

Q

Okay. And then, I know, we talked about this a little bit, but your line of sight for these costs going forward, I know, have you been able to take advantage of the lower eggs in the recent weeks, and we already talked about oil and everything.

John B. Gerlach

Chairman, Chief Executive Officer, President and Director

A

Yeah, we'd anticipate soybean oil and flour to continue to be favorable certainly through the fourth quarter at this point, and again, a number of other smaller ingredients being modestly favorable. Eggs do turn favorable as we get into the fourth quarter.

Eric Mitchell Gottlieb

D. A. Davidson & Co.

Q

Okay. And then, moving on to the foodservice LTO programs, when will these run out or some of them have already?

John B. Gerlach

Chairman, Chief Executive Officer, President and Director

A

Well, yeah, have already. They vary in length, by program and by customer. But, we're running through those routinely quarter in and quarter out, so sometimes that can be a little bit of a favorable comparison just from the timing standpoint to prior periods and sometimes it might go the other way, it just depends on the cycles our customers are in, as well as the ones that we're able to participate in versus again prior periods.

Eric Mitchell Gottlieb

D. A. Davidson & Co.

Q

Got it. And have some of these customers announced plans to do other ones or should we see a fall off in the coming quarters? I know they're always continuous, but just from what we know like line of sight?

John B. Gerlach

Chairman, Chief Executive Officer, President and Director

A

Yeah, I think, general line of sight would be probably similar, maybe a little bit better, but again, they're relatively short lived, and coming and going, so timing could be spread over quarters as well. So it's just little hard to predict specific quarter-to-quarter.

Eric Mitchell Gottlieb

D. A. Davidson & Co.

Q

And then two more questions, and then I'll leave it there. How much have you taken pricing down due to the lower COGS? How much have you given back to your customers and when do those go into effect?

John B. Gerlach

Chairman, Chief Executive Officer, President and Director

A

It's a little tough to quantify the exact impact of that, but the primary item that's come down, Eric, is that of the egg cost and those have been passed through back to our chain account customers. And that became effective at the beginning of the quarter.

Eric Mitchell Gottlieb

D. A. Davidson & Co.

Q

Okay. Last question. The rationale for the new debt, I know you said you're actively in the market for acquisitions. Is there a specific area you're targeting by sales size or business line? And then what other uses of this debt would you have?

John B. Gerlach

Chairman, Chief Executive Officer, President and Director

A

Eric, we've been focused on looking for branded retail businesses, product lines that in some broad sense are on trend, and which probably means it's some kind of better-for-you product and it could be a wide spectrum of things that might fall under that. Continue to actively look; we're pretty open-minded to size. But maybe ideally for us it's something in the \$50 million to \$100 million in revenue range. But we could certainly go smaller than that, maybe a fair bit smaller. And we'd certainly be open to larger opportunities if we thought that the opportunity and the fit were appropriate.

So the credit line certainly can be used to fund, not only acquisition growth, but other capital needs, particularly, capital project kind of investment. So it does give us that flexibility. So those are the primary things we'd be thinking about to potentially use that line for.

Eric Mitchell Gottlieb

D. A. Davidson & Co.

Q

Great, I appreciate the color. Congratulations on the solid quarter.

John B. Gerlach

Chairman, Chief Executive Officer, President and Director

A

Thank you.

Douglas A. Fell

Chief Financial Officer, Treasurer & VP

A

Thank you, Eric.

Operator: And your next question comes from the line of Jeffrey Thomison of Hilliard Lyons.

Jeffrey S. Thomison

J. J. B. Hilliard, W. L. Lyons LLC

Q

Thanks, good morning. Very impressive quarter, guys.

Douglas A. Fell

Chief Financial Officer, Treasurer & VP

A

Thanks, Jeff.

John B. Gerlach

Chairman, Chief Executive Officer, President and Director

A

Thank you, Jeff.

Jeffrey S. Thomison

J.J.B. Hilliard, W.L. Lyons LLC

Q

Several questions here. First of all, if we could just go back to the frozen dinner roll topic for a bit, there seemed to be a challenge in recent quarters with you and some other category participants mentioning the competitive environment and perhaps the dynamics of the business to the benefit of the deli bakery area and maybe to the detriment of the frozen aisle. So has this changed or is it more of a reversion to the mean, so to speak, for this category?

John B. Gerlach

Chairman, Chief Executive Officer, President and Director

A

I think this category has been feeling just that for, in our case, for probably the last year, a little bit more, and so that just continues. I don't think we're seeing any big change in that. But those macro challenges are definitely there for the category.

Jeffrey S. Thomison

J.J.B. Hilliard, W.L. Lyons LLC

Q

So it would be relatively unchanged from just a quarter or two quarters ago, or has it changed?

John B. Gerlach

Chairman, Chief Executive Officer, President and Director

A

No, I don't think it's changed. Probably the only difference, again, is the seasonality impact. So the December quarter is just a bigger quarter for frozen dinner rolls, because of both Thanksgiving and Christmas falling in the quarter.

Jeffrey S. Thomison

J.J.B. Hilliard, W.L. Lyons LLC

Q

Got you. Okay. And then a theoretical question on plant capacity and utilization. As you consider using your balance sheet and available capital to pursue good-fit acquisitions, do you currently have excess plant capacity at your existing facilities to integrate a potential acquisition or would an acquisition have to include its own manufacturing facility?

John B. Gerlach

Chairman, Chief Executive Officer, President and Director

A

Most likely the latter; while we do have some capacity, it varies across our product lines, so [audio gap] (24:34-24:39) for example, we were just talking about frozen dinner rolls. We definitely have capacity to make more of that kind of product. But in other areas, salad dressing, in particular, we're still relatively tight on capacity. So it would be a little more challenging to try to integrate something that didn't come with its own capacity there.

Jeffrey S. Thomison

J.J.B. Hilliard, W.L. Lyons LLC

Q

Okay. And then I know it's relatively minor here, but Doug, could you just go over the quarter swing in the [ph] interest/other expense (25:09) line item as they went from an expense in the year-ago period to a positive number in the recent period, because after six months, that items went from an expense figure to a larger expense figure.

Douglas A. Fell

Chief Financial Officer, Treasurer & VP

A

Sure, Jeff. I think, in summary, the primary item, and to your point, is relatively small. It's a small favorable uptick in some of the impact we have on foreign exchange.

Jeffrey S. Thomison

J.J.B. Hilliard, W.L. Lyons LLC

Q

Okay. And then, let's see, I had one more question, as it related to your answer to a previous question, Doug, I think you mentioned that you, in terms of cost savings you had passed through recently at the beginning of the quarter. Were you talking about the beginning of the March quarter that just concluded or the beginning of the current June quarter?

Douglas A. Fell

Chief Financial Officer, Treasurer & VP

A

Sorry for not being clear on that, Jeff; the beginning in the fourth quarter.

Jeffrey S. Thomison

J.J.B. Hilliard, W.L. Lyons LLC

Q

Okay. June quarter, okay. And then welcome to Dave. It's been a good eight days so far for him in terms of our stock price.

David Alan Ciesinski

President & Chief Operating Officer

Q

Thank you.

Jeffrey S. Thomison

J.J.B. Hilliard, W.L. Lyons LLC

Q

Thank you, guys.

John B. Gerlach

Chairman, Chief Executive Officer, President and Director

A

Thanks, Jeff.

Douglas A. Fell

Chief Financial Officer, Treasurer & VP

A

Thank you, Jeff.

David Alan Ciesinski

President & Chief Operating Officer

A

Thank you, Jeff.

Operator: And your next question comes from the line of Elliott Schlang of Great Lakes Review. Your line is open.

Elliott Schlang

Great Lakes Review

Q

Jay, firstly, and most importantly, congratulations on a great quarter.

John B. Gerlach

Chairman, Chief Executive Officer, President and Director

A

Thank you.

Elliott Schlang

Great Lakes Review

Q

Dave, welcome to the company. And I'd be interested in what compelling opportunities you saw at Lancaster Colony in making your decision to go with them? Where might we expect some change, if it's not early to ask, or what do you see as the company's greatest strengths?

David Alan Ciesinski

President & Chief Operating Officer

A

Well, I would focus, Elliott, on the fact that it's been eight days, I think I'm here at the beginning of day nine. But as I outlined in my comments, it was really a portfolio of very strong brands, relevant growing categories that we've talked about here on the call, and also just a tremendously strong track record over a long period of good execution in the marketplace. All that together with a really nice culture made it feel like a nice place to go and build on my career.

Elliott Schlang

Great Lakes Review

Q

Go ahead. Well, congratulations and good luck with it, for all our sakes.

David Alan Ciesinski

President & Chief Operating Officer

A

Thank you.

Elliott Schlang

Great Lakes Review

Q

Jay, there were no purchases of stock during the quarter, if I read the release properly. Any reason for that?

John B. Gerlach

Chairman, Chief Executive Officer, President and Director

A

Yes, that is correct, Elliott. Well, as you know, we did do that just on an opportunistic basis. And while we've still maintained the authorization that's been in place since we haven't been buying many shares, it hadn't changed a whole lot, I think it's right around 1,400,000 shares authorized. We're open to that as conditions present themselves and consider it from time to time, but just haven't done that lately, but it's always something we're evaluating.

Elliott Schlang

Great Lakes Review

Q

And any new comments on any new accounts that have come in, especially with your interest in expanding the distribution toward the West and some of the areas that you're not as strong in?

John B. Gerlach

Chairman, Chief Executive Officer, President and Director

A

Elliott, I don't think I could name a specific new customer in the last quarter or so that I'd call out, but continued opportunity to develop both in the retail channel, but also in the foodservice channel as well.

Elliott Schlang

Great Lakes Review

Q

And it was the McLane-Walmart relationship, I assume there has been no significant changes of note.

John B. Gerlach

Chairman, Chief Executive Officer, President and Director

A

That's correct.

Elliott Schlang

Great Lakes Review

Q

And on the acquisition front, you outlined some of your criteria. Have there been any changes that you're pondering as you look at the acquisition front, and have been modestly successful in getting some good ones, but perhaps not as many as you or we would like to see? Has there been any changes as you get deeper into looking at acquisitions as to what you should be looking at and what you are looking at?

John B. Gerlach

Chairman, Chief Executive Officer, President and Director

A

Elliott, no, I wouldn't say we're thinking about any material changes. I think that the breadth of opportunities we can look at when we're focused on retail, but looking, again, at on-trend, better-for-you is, potentially it will encompass a lot of different things. So it's a pretty wide net. We do look at a lot of different ideas. But we do try to avoid things, such as private label, for example, it's just not something that we spend any real-time on. But no, not a material change.

Elliott Schlang

Great Lakes Review

Q

And with the dramatic changes in trends in nutrition, are you considering reformulating any of your products that would create a new major expenditure or broadening your acquisition search to some areas that may not be fitting as effectively five years ago as they might in the world of future nutrition?

John B. Gerlach

Chairman, Chief Executive Officer, President and Director

A

Well, yes, from that standpoint, again, when you think about that broad, better-for-you definition, it would encompass things like the broad natural and organic space, even GMO-free product that all of those that we would be open-minded to and looking at as potential opportunities. As you know, the trends with the consumer are definitely going in those directions. And if you look back five years ago, one, there are probably less things to look

at, but it wouldn't been as quite a higher priority for us as it would be today. So I think we definitely consider those.

As you know, many of those kind of product lines businesses are somewhat smaller. So when I mentioned \$50 million to \$100 million, some of these natural organic kind of brands, product lines, you might find down in the \$10 million, \$15 million, \$20 million area. So we're certainly open to those size of things as we go forward. And as it relates to reformulating, we have a constant initiative, Elliott, to look at ways to improve our nutrition, our ingredient desk on our entire product offering and make some changes in those from time-to-time.

Elliott Schlang

Great Lakes Review

Q

And last, as you look to expanding geographically, Canada has been relatively minor to you, and I don't think Mexico comes in at all. I maybe wrong on that. But, are you thinking in terms of making a more conservative effort into those two geographies?

John B. Gerlach

Chairman, Chief Executive Officer, President and Director

A

Well, probably, particularly Canada where we do have definitely a bigger presence versus Mexico. And I think we've developed some nice position up there on some of our products, maybe particularly our veggie dip product line. So, yes, we're looking for opportunities to do more in the Canadian market, probably not that level of current priority for Mexico, but we're certainly doing little bit of business there and open to expanding that.

Elliott Schlang

Great Lakes Review

Q

Thank you.

John B. Gerlach

Chairman, Chief Executive Officer, President and Director

A

You are welcome.

Operator: And your next question comes from the line of Brett Hundley of BB&T Capital Markets. Your line is open.

Brett Michael Hundley

BB&T Capital Markets

Q

Hey, good morning, gentlemen.

John B. Gerlach

Chairman, Chief Executive Officer, President and Director

A

Good morning, Brett.

Douglas A. Fell

Chief Financial Officer, Treasurer & VP

A

Good morning, Brett.

Brett Michael Hundley

BB&T Capital Markets

Q

I apologize I joined the call late, so if I cover anything you guys have already spoken on, I apologize. Jay, I think I heard you say that pricing was about one-third of the sales increase for the quarter, is that correct?

John B. Gerlach

Chairman, Chief Executive Officer, President and Director

A

That's right, yes.

Brett Michael Hundley

BB&T Capital Markets

Q

Okay. And I assume you're talking about organic sales growth of 6%, so if I pull out Flatout, maybe of that 6% growth, a third of it was pricing?

John B. Gerlach

Chairman, Chief Executive Officer, President and Director

A

That's right. Yes, it was without Flatout, yes.

Brett Michael Hundley

BB&T Capital Markets

Q

Okay, great. I appreciate that. And then, I also think I've heard you say that Walmart was getting back to normal buying patterns. And if so, I wanted to also ask you about does that include clean store initiatives that have been happening across the retail space, and with that customer, in particular, do you see that clean store initiatives are starting to improve a little bit?

John B. Gerlach

Chairman, Chief Executive Officer, President and Director

A

Well, first of all, I guess I didn't name a customer, so you'll make that assumption. But the clean store initiatives that are out there, I think they're still in place. So, I don't think anything has really changed on that front.

Brett Michael Hundley

BB&T Capital Markets

Q

Okay. But maybe retail or inventory management from the end of last year has become more normalized you're saying?

John B. Gerlach

Chairman, Chief Executive Officer, President and Director

A

Yeah. I'd say that's probably true. And the impact that we saw in the last quarter, again, been as much due to the seasonal component, particularly of our frozen dinner roll business.

Brett Michael Hundley

BB&T Capital Markets

Q

Okay, that's clear. And as your Flatout product has probably been the most impacted by clean store initiatives across the retail landscape, do you guys believe that you've been able to improve upon trade level management at

all? Have you been positively surprised by maybe how well Flatout has been able to do in different areas of the store? Any update you can give there?

John B. Gerlach

Chairman, Chief Executive Officer, President and Director

A

Yeah. I don't know I can give you much of an update, and I don't know that I'd say we've been surprised, but I think where we've seen the product move to other areas of the store outside the deli area, we have found that there is still some good following for the brand and a lot of certainly active users still make their way to wherever it is in the store. Probably just a little bit more challenging to get first trials when you get outside that deli department.

Brett Michael Hundley

BB&T Capital Markets

Q

I might be mis-remembering, but as far as in-store, was Flatout distribution in recent years roughly half in the deli area and half on shelf in the bread space, does that sound about right?

John B. Gerlach

Chairman, Chief Executive Officer, President and Director

A

No. I'd say it was much more heavily in the deli area.

Brett Michael Hundley

BB&T Capital Markets

Q

Okay. And I wanted to ask you also just about this Vermont labeling law and whether or not we should build in any expectations on added cost or complexity in your model going forward from there?

John B. Gerlach

Chairman, Chief Executive Officer, President and Director

A

Well, there's definitely going to be a little bit of complexity and a little bit of added cost. I don't know that we feel it's going to be huge, but there will be a little bit there, and including just some transition costs from current packaging and labeling to the new labeling.

Brett Michael Hundley

BB&T Capital Markets

Q

Okay. And I think I heard you discussing commodity costs. You mentioned egg costs were flat year-on-year. Doug, I don't know if you can remind us what H1 inflation looked like for eggs or what the impact was in the front half for the year?

Douglas A. Fell

Chief Financial Officer, Treasurer & VP

A

Yeah, I don't think we have quantified that prior, Brett, but it was significant and I would qualify it as that.

Brett Michael Hundley

BB&T Capital Markets

Q

Okay.

Douglas A. Fell*Chief Financial Officer, Treasurer & VP*

A

And as sharply as it went up, it really has come back down to current pricing compared to that of the prior year during the third quarter. The industry has really recovered quite nicely.

Brett Michael Hundley*BB&T Capital Markets*

Q

Okay. And I think I heard you say, Jay, that with some of your other commodities that you saw a good savings in the quarter. There has been a fair amount of volatility in the oilseeds complex. Has any of this made you want to go further out on coverage or do you just continue to buy forward commodities as you historically have?

John B. Gerlach*Chairman, Chief Executive Officer, President and Director*

A

We've generally done it as we historically have done it, Brett. So no, we have not jumped up and taken our coverage levels up different than the practices we've had in the past couple of years.

Brett Michael Hundley*BB&T Capital Markets*

Q

And then, just two more from me, if I may. Foodservice, your sales there have been I think solid for a while and some of this I attribute to your customer-specific relations. Another portion of it I think might be macro. I mean we hear stories about how restaurant trends seem to be improving. I think one of your larger customers on the foodservice side reported results that were maybe a little bit more challenging, yet it seems like your results specifically continue to improve nicely. So can you take us through your foodservice segment and maybe describe how much sales strength for Lancaster is due to account-specific growth versus just the macro broadly?

John B. Gerlach*Chairman, Chief Executive Officer, President and Director*

A

Well, the macro side, I think, is improving a little bit. It would probably be the smaller share of the growth. So I think just the mix of top customers we have in our list of chain accounts has certainly been favorable for us. Whether it's everyday business again or they're promotional limited time offer business we were talking about a few minutes ago, I think we've been fortunate on both of those to see good performance from a number of our customers.

Brett Michael Hundley*BB&T Capital Markets*

Q

And then just lastly, I wanted to go back to a question that I heard on this previously. But we watch your refrigerated dressings category pretty closely and in some of the store checks that we do, competitor pricing seems to be all over the place. It seems like it's improved recently just in what we have been able to monitor, but the space has pulled in some other competitors. There has been some competitive activity as people jockey for space. But I'm curious about the expansion of the category as a whole and just how much bigger it can get.

I mean, you guys have a very established brand. You bring a lot of innovation to the category. You're a clear leader there. And I'm just curious, again, going back to the discussions that you have with your customers on category data, category management that you can bring to this space, and what the risk is of the space getting potentially bigger and more competitive over time?

John B. Gerlach

Chairman, Chief Executive Officer, President and Director

A

Well, Brett, one, it's certainly hard to predict growth rates going forward. However, the produce department, refrigerated dressing is definitely a more on trend products than some others. And as you compare it to shelf stable dressings, I'd say definitely more on trend there. It is a category that is seeing more entrants, so more competitive activity, although the entrants generally are coming in with some unique positioning, usually at the higher end of the market from a price standpoint. So it's not like the category is being inundated with competitive pricing activity, but there are some alternative types of products, brands of products that are working their way into the shelf.

In the end, I think there is a limitation with retailers as to how big they'll let that display space get in the produce department. So I don't think you'll see it expand up to sizes like you'd see over in the shelf stable area by any means. It's got a long way to go to get anywhere near that in volume as well. But again, I think it's an attractive department today for both the retailer and the consumers looking more and more in the produce department for those kinds of offerings.

Brett Michael Hundley

BB&T Capital Markets

Q

Thanks, Jay, I appreciate it.

John B. Gerlach

Chairman, Chief Executive Officer, President and Director

A

You're welcome.

Operator: [Operator Instructions] Your next question comes from the line of Philip Terpolilli of Wedbush.

Philip Terpolilli

Wedbush Securities, Inc.

Q

Thanks. Just one quick follow-up. Doug, you were mentioning before on pricing that there was timing in place, I think at the start of the quarter, of [ph] give-back (44:38) there. Was that just in foodservice or were you talking about retail as well?

Douglas A. Fell

Chief Financial Officer, Treasurer & VP

A

Just foodservice, and more specifically, just to the national chain customers.

Philip Terpolilli

Wedbush Securities, Inc.

Q

Got it. Okay, I just wanted to clarify that. Thanks.

Douglas A. Fell

Chief Financial Officer, Treasurer & VP

A

No, sure thing, Phil.

Operator: And there are no further questions at this time. I turn the call back over to Mr. Gerlach for any closing and concluding remarks.

John B. Gerlach

Chairman, Chief Executive Officer, President and Director

Well, thank you again for joining us today. We look forward to talking to you mid-August or so with our fourth quarter and full-year results. Have a great day.

Operator: And this concludes today's conference call. You may now disconnect.

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