04-Nov-2019

Lancaster Colony Corp. (LANC)

Q1 2020 Earnings Call

CORPORATE PARTICIPANTS

Dale N. Ganobsik
Vice President-Investor Relations & Treasurer, Lancaster Colony Corp.

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

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

OTHER PARTICIPANTS

Jason A. Rodgers
Analyst, Great Lakes Review

Frank Camma
Analyst, Sidoti & Co. LLC

MANAGEMENT DISCUSSION SECTION

Operator: Good morning. My name is Sharon, 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 2020 First Quarter Conference Call. Conducting today's call will be Dave Ciesinski, President and CEO; and Tom Pigott, 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 Dale Ganobsik, Vice President of Investor Relations and Treasurer for Lancaster Colony Corporation.

Dale N. Ganobsik
Vice President-Investor Relations & Treasurer, Lancaster Colony Corp.

Thank you, Sharon. Good morning, everyone, and thank you for joining us today for Lancaster Colony's fiscal year 2020 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 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.

For today's call, Dave Ciesinski, our President and CEO, will begin with an update on our strategic initiatives and the 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 outlook for the remainder of our fiscal year. At the conclusion of our 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?

David A. Ciesinski

President, Chief Executive Officer & 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 2020. Roughly three years ago, we launched our Better Food Company growth plan, which consists of three simple pillars: Number one, accelerate our base business growth; number two, simplify our supply chain to reduce our cost and grow our margins; and, number three, identify and execute complementary M&A to grow our core.

During the last several years, we have focused on strengthening our team, implementing our growth plan and harvesting the results. During this past quarter, we continued to leverage our strategy and grew our base business organic net sales by 2.6%. Our Retail segment grew organic net sales by 1.5%, while our Foodservice segment grew organic net sales by 3.9%.

The increase in Retail organic net sales was fueled by growth of our Marzetti branded produce dressings, veggie dips and caramel dips, our return to growth for New York Bakery frozen garlic bread and continued growth of shelf-stable dressings and sauces sold under license agreements.

We were particularly pleased with the performance of our Retail team in Q1, which included relevant new innovation items such as the launch of New York Bakery 3-Cheese Cheese Sticks and Sister Schubert's Pumpkin Spice sweet treats. The team is also successfully executing brand renovation initiatives, such as our Marzetti branded dips with a more simplified ingredient panel and improved taste.

Shifting our attention to our Foodservice segment, the 3.9% increase in organic net sales was led by volume gains with key national chain restaurant account customers, higher sales of branded products sold through distributors, and increased sales for our industrial business, which is predominantly frozen pasta. It is worth noting that this is the seventh consecutive quarter of organic net sales growth for the Foodservice segment with an average gain of 7.7% per quarter over that period.

Our supply chain team posted another quarter of strong results in reducing cost and improving productivity. These results were driven by our Lean Six Sigma program, which is now in its third year. Our new transportation management system, which started to go live last January, was a noted source of cost savings in the quarter. Combined with the benefit from the growth in sales and some favorability in commodity cost, the supply chain team's effort led to a 13.4% increase in gross profit and a 170 basis point increase in gross margin for our fiscal first quarter. Since we launched our strategy to simplify our supply chain to reduce our cost and grow our margins, the supply chain team has achieved gross savings in excess of $20 million per year.

Updating you on our recent acquisitions, Bantam Bagels continues to perform in line with our expectations, as we invested to further expand Retail distribution. We are also pleased to report that per IRI data, Retail sales for Bantam Bagels nearly doubled for the 52-week period ending September 29. On the Foodservice side, Bantam achieved a sequential improvement in sales of about 15% in FY 2020 Q1 compared with FY 2020 (sic) [2019] (5:50) Q4, as Bantam is gaining placement in the counter display case at Starbucks cafes nationwide.

Consistent with the comments we shared during Q4 FY 2019 earnings call, our supply chain team remains fully focused on implementing operational improvements at our Omni Baking facility which we acquired in November 2018. We expect most of these changes to be completed by the end of this calendar year. Overall, we were pleased with the progress made during our fiscal first quarter in growing our base business, reducing our cost through supply initiative, and integrating our most recent acquisitions.

I'll now turn the call over to Tom Pigott, our CFO, for his commentary on our Q1 financial results.

Thomas K. Pigott

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

Thanks, Dave. Overall, the results of the quarter exceeded our expectations. Consolidated net sales increased 6.4% to a first quarter record of $337.1 million. This growth was driven by increases in both the Retail and Foodservice segments. Excluding net sales attributed to the acquisitions of Bantam and Omni, organic net sales increased 2.6% for the quarter.

Consolidated gross profit increased $10.9 million, or 13.4%, to $92.1 million. The increase was driven by higher net sales, cost savings from our Lean Six Sigma project, as well as favorable commodity costs.

Selling, general, and administrative expenses increased as we invested behind the strategies Dave highlighted. Reported SG&A increased $7.4 million or 23%. The largest driver of that increase was our ERP program in which we incurred $2.7 million in costs related to the design phase of the project. Other investments included higher consumer promotional spending in our Retail segment to drive top line growth, incremental costs from the Bantam acquisition as we begin to scale that business, and increased personnel costs.

Consolidated operating income increased 5.3% to a first quarter record of $51.7 million. The increase reflects the higher gross profit, investments in SG&A, as well as the $900,000 restructuring charge related to the plant closure that we announced in Q4. It's important to note that the ERP investment combined with the restructuring charge reduced our operating income growth by 730 basis points for the quarter.

Our effective tax rate increased this quarter to 23.3% from 22.6% in the first quarter of fiscal 2019. The increase reflected a lower tax benefit on stock compensation as well as an increase in state taxes. Our tax rate for the remainder of fiscal year 2020 is forecasted to be 24%.

First quarter earnings per share increased $0.06, or 4.2%, to $1.48. The investment in the ERP reduced earnings per share by $0.08, and the restructuring charge had a negative $0.02 impact. Together, these two items reduced our reported earnings per share growth by $0.10 or 710-basis-point.

With regard to capital expenditures, we continue to project our fiscal year 2020 expenditures to be in the range of $80 million to $100 million. Our Q1 expenditures of $43.2 million included ongoing investments for the capacity expansion in our frozen dinner roll facility in Horse Cave, Kentucky that we expect to be complete near the end of the second quarter, and the purchase of the Omni Baking facility property that was previously leased.

So to wrap up my commentary, overall, the quarter featured nice top line growth, pricing discipline, commodity favorability, and cost savings programs that help fund our investments for future growth.

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

David A. Ciesinski

President, Chief Executive Officer & Director, Lancaster Colony Corp.

Thanks, Tom. Looking ahead to the remaining three quarters of our fiscal year, our expectations for consolidated top line growth remain in the low- to mid-single-digits. Overall commodity costs are projected to be generally flat in our fiscal second quarter, and then turn modestly inflationary in the back half of our fiscal year. Our supply chain team's Lean Six Sigma program, including initiatives in strategic procurement, combined with our net price realization programs will help offset the impact of commodity cost increases.

We also anticipate continued progress with our Bantam Bagel (sic) [Bantam Bagels] (10:18) and Omni Baking acquisitions. Our planned investment in production automation for Bantam, which we expect to be completed near the end of our fiscal third quarter, will add capacity for continued growth and provide a notable benefit to the overall profitability of that business. Our supply chain team will also continue with upgrading and automating our Omni Baking facility to reduce cost and increase productivity.

Finally, I'd like to provide you with an update on our ERP initiative, Project Ascent. As you may recall, Project Ascent will enable us to replace our 20-year-old ERP system and provide us with a long-term scalable system infrastructure well into the future to facilitate organic growth and scale acquisitions while also helping us drive cost savings. We have recently completed the groundwork of building our internal team and selecting our system integrator and software vendor. We're now beginning the design phase of the project with deployment scheduled to start in the first half of fiscal 2021. We expect to have more details to share with you regarding the cost and the timeline for Project Ascent during our fiscal second quarter earnings call. We will continue to disclose the ERP project costs separately in our quarterly earnings releases and SEC filings to provide the investment community and all of our stakeholders with a clear understanding of the associated expenditures for this important project.

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

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Your first question comes from Jason Rodgers with Great Lakes Review.

Jason A. Rodgers

Analyst, Great Lakes Review

Q

Yes. Just had a question on the gross margins, obviously, very strong at the 27% level. Just wondering on the sustainability of that going forward, just expectations around material cost and everything else baked in there as far as just modeling that margin out.

David A. Ciesinski

President, Chief Executive Officer & Director, Lancaster Colony Corp.

A

Sure. Jason, as we pointed out in the back part of my commentary, we expect in the second quarter for commodities to be essentially flat and then to turn modestly inflationary in the back half of the year. We do think we're going to be able to offset that commodity inflation through a combination of our Lean Six Sigma program and our disciplined PNOC program that we have in place. So I think generally, that gives you a view for things of how we see them today. I don't know, Tom, if you'd want to add anything...

Thomas K. Pigott

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

A

Yeah. I mean, overall, we're – it was a very strong quarter. And as Dave highlighted, we did benefit from some commodity favorability in it that we do expect to moderate as the year progresses.

Jason A. Rodgers
Analyst, Great Lakes Review

Q

And could you quantify what that benefit was as far as the lower raw material cost?

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

A

So it was approximately $2 million in commodity favorability. We also had some convert, some procurement savings that increased that number. But it was roughly around $2 million.

Jason A. Rodgers
Analyst, Great Lakes Review

Q

All right. And then, just as far as the costs that you're incurring to automate processes at Omni and Bantam and expanding distribution at Bantam, I wonder if you could kind of give us an idea of what those were in the quarter and how we should be thinking about those going forward.

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

A

Sure. I'll describe them for you a little bit on the front end. First of all, with Bantam, essentially where we're spending, there's two areas, one of which is in slotting to help continue to expand the distribution of the product in Retail. The second area in Bantam where we're investing is, in essence, we're building a end-to-end automated line for this product. Today, where it's manufactured, we literally have envisioned dozens of people – or more than a dozen people that are working on a line that are manually filling the bagel balls with cream cheese or eggs or whatever the filling is.

The new line will be completely automated and it's going to take that manual labor off, and it's also going to run at a considerably faster pace to allow the product to continue to scale. We've been negotiating with the equipment manufacturers. The project has begun. And as we mentioned in my prepared comments, we expect that to be complete at the end of our third quarter; so, think roughly March timing, somewhere around there.

As it pertains to Bantam, what we're doing there is it was November of 2018 when we bought it. Excuse me. They were and are a – they were a co-packer for us at our New York Texas Toast business. They did about half of our volume. We bought the business and, over the course of the last year, what we've been doing is investing and upgrading ovens, freezers, and automating some of their processes as well. And the nature of the costs that we're taking on there, in some cases, our CapEx and others, it's expense. I'll give you a case in point. When we need to replace or repair a floor, if we replace an entire floor in a building, we can capitalize that. If it's a portion of a floor, it gets expensed.

The other area that we end up taking on headwind with that project, in particular, is whenever we do these heavy maintenance or heavy investment projects, we end up shutting the factory down for several days at a time, two, three, four, five days at a time, which results in a lot of absorption in the period. You put those together, they're both running, I would venture to guess, somewhere in the low- to mid-single-digits in the period. And we're going to expect those to continue on, and then taper as we work into the back half.

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

A

Yeah, the impact, combined, of the two was a low-seven-digit impact on the quarter's results.

Jason A. Rodgers
Analyst, Great Lakes Review

Q

Okay. That's helpful. And just finally, obviously, Bantam is doing well with the expanded distribution, Starbucks. How much of a contribution can that make to the top line in fiscal 2020?

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

A

I think it could be material. I don't know. Have we – I'm looking around here in the room. Have we disclosed...

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

A

Yeah. At this point...

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

A

...how big the...

[indiscernible] (16:42)

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

A

Yeah. I think at this point, we're very optimistic about the growth potential of the business. But given that we're in kind of a rollout mode, we don't want to put a specific number out there for you, right now. But as we get better visibility as we progress, we'll certainly be happy to share that information.

Jason A. Rodgers
Analyst, Great Lakes Review

Q

Okay. Thank you.

Operator: [Operator Instructions] And we have a question from Frank Camma with Sidoti.

Frank Camma
Analyst, Sidoti & Co. LLC

Q

Hey. Good morning guys. How are you doing?

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

A

Good morning, Frank.

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

A

Good morning, Frank.

Frank Camma
Analyst, Sidoti & Co. LLC
Q

Hey. I was wondering if you could talk about the benefit in the quarter. I don't know if you quantify this at all, either from a margin or – not just the benefit, but maybe the head – how it impacted the quarter from revenue from eliminating some SKUs that last year wasn't very profitable. So obviously, you had a bit of a headwind to your revenue going into the quarter, but you probably benefited, I guess, on the margin side, if you could talk about that about.

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

Right. And I think I would probably point to two cases in point where we have – several cases in point where we focused here. One is Sister Schubert, where if you remember, we announced a restructuring project. We closed our Saraland facility. We discontinued some items there. If you're looking at the IRI data, you could see some headwind on that business. If you look at the profit, we don't disclose by segment, it was a pretty significant pickup on the bottom line; and, that same thing would be true on Angelic and on our flatbread wraps. And it was roughly to the tune of about what we'd call – well, go ahead, Tom.

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

Yeah. I would say the tune, together, about 100 basis points of growth impact.

Frank Camma
Analyst, Sidoti & Co. LLC
Q

Okay. And that must have, well, positively affected the growth, so I'm assuming.

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

Yes.

Frank Camma
Analyst, Sidoti & Co. LLC
Q

Since it was lower than your – okay.

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

Yes.

Dale N. Ganobsik
Vice President-Investor Relations & Treasurer, Lancaster Colony Corp.
A

Yes.

[indiscernible] (18:47)

Dale N. Ganobsik
Vice President-Investor Relations & Treasurer, Lancaster Colony Corp.
A

Frank, the Angelic will lap that in October and the flatbread will lap that in November.

Frank Camma
Analyst, Sidoti & Co. LLC

Q

Okay. That's helpful. And then, my other question is just on the Foodservice side, the strength that you're seeing there, particularly you mentioned the national accounts. Can you just give us a little more color on that as far as are you seeing it from – obviously, the underlying accounts must be doing good. But is it because they're opening more doors, is it because they're just doing well overall? Can you just talk about – or are you gaining more customers? I assume it's not the last what I said, but if you can kind of talk about that.

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

A

Sure. Well, the single largest component of the growth is an increase in same-store sales growth from some of our key customers. Another contributor to that would be some store openings. But the lion's share of it has been from our biggest customers, an increase in same-store sales growth. And then, in other cases, we are selling more to some existing customers as well, but if you're trying to think your way through how to think about this, I would say half of it at least is being powered by same-store sales growth of our largest customers.

The next piece would be coming from store openings of some of those customers. And then, the last would either be new sales to existing customers or just new customers altogether. So it's overall, a pretty healthy mix on our national accounts. And on the branded side, we're just – we've talked about it for a while now, we're building share and we're driving penetration.

Frank Camma
Analyst, Sidoti & Co. LLC

Q

Got it. Thank you. That's all I have.

Dale N. Ganobsik
Vice President-Investor Relations & Treasurer, Lancaster Colony Corp.

A

Thanks, Frank.

Operator: [Operator Instructions] And if we do not have any telephone questions at this time, we will now turn the call back to Mr. Ciesinski.

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

Thanks everyone for your participation this morning. We look forward to sharing our second quarter results with you in early February.

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