31-Jan-2019

Lancaster Colony Corp. (LANC)

Q2 2019 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.

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

OTHER PARTICIPANTS

Michael W. Gallo
Analyst, C.L. King & Associates, Inc.

Jason A. Rodgers
Analyst, Great Lakes Review

Brian P. Holland
Analyst, Consumer Edge Research LLC

MANAGEMENT DISCUSSION SECTION

Operator: Good morning. My name is Denise, and I will be you conference call facilitator today. At this time, I'd like to welcome everyone to the Lancaster Colony Corporation Fiscal Year 2019 Second Quarter Conference Call. Conducting today's call will be Dave Ciesinski, President and CEO; and Doug Fell, Vice President and 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, Denise. Good morning everyone and thank you for joining us today for Lancaster Colony's fiscal year 2019 second 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 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 with you today as we review our second quarter results for fiscal year 2019. Doug and I will provide comments on the quarter and our outlook. Following that, we'll be happy to respond to any of your questions.

For the quarter, we are pleased to report that consolidated net sales increased 9.4% to a second quarter record $349.6 million versus $319.7 million last year. Excluding acquisitions, consolidated net sales grew 7.3%. Retail net sales increased 3.9% to $186.3 million. Excluding net sales contribution of $800,000 from the Bantam Bagels acquisition, organic net sales increased 3.5% led by volume gains on shelf-stable dressings and sauces sold under license agreements, caramel dips, and frozen garlic bread. Retail net sales also benefited from higher net pricing. Bantam Bagels net sales were impacted by relatively significant product placement cost and trade spending in support of new and expanding distribution with retailers.

Foodservice net sales increased 16.3% to $163.3 million with organic net sales up a notable 12.2% driven by higher demand from our national chain restaurant accounts, incremental sales resulting from continuation of service issues with some of our foodservice competitors, and pricing actions we implemented in early January 2018 in response to higher freight and commodity cost. Foodservice net sales attributed to Bantam Bagels totaled $1.9 million. Incremental net sales resulting from the interim supply agreement related to the Omni Baking acquisition totaled $3.8 million for the quarter.

Consolidated gross profit improved $7.5 million to $91.4 million. The 8.9% increase in gross profit was driven by organic sales growth, including the benefit from higher pricing and cost savings generated from our ongoing Lean Six Sigma program, partially offset by higher warehousing cost and one-time charges resulting from our decision to discontinue the Marzetti Simple Harvest line of refrigerated dips.

SG&A expenses increased $3.5 million to $39.8 million primarily due to transaction expenses incurred for the Bantam Bagels and Omni Baking Company acquisitions and, separately, higher severance cost associated with leadership changes implemented in our Retail segment in late October.

You'll note in the financial tables for our earnings release today that we have included a line item for the change in contingent consideration that is now separate from other SG&A expenses. We added this line item to provide more transparency and clarity for our acquisition-related earnout arrangements. Specific to our current quarter, this line item includes the favorable impact of a $9.7 million non-cash reduction to the fair value of the contingent consideration for the future earnout payment for Angelic Bakehouse. Excluding this $9.7 million adjustment, consolidated operating income increased 9.2% to $51.5 million from a prior year total of $47.1 million while consolidated operating margin was unchanged.

In the Retail segment, and excluding the adjustment, operating margin declined from 20.8% to 18.8%. The Retail segment margin was impacted by cost resulting from the discontinuation of our Marzetti Simple Harvest dips, the severance charges and increased product placement cost and trade spending to support the expanding distribution for Bantam Bagels. The Foodservice segment operating margin improved from 9.6% to 11.9% driven by higher organic sales volume, a more favorable organic sales mix, and higher pricing.

Net income was $47.9 million or $1.73 per diluted share compared to $45.9 million or $1.67 per diluted share last year. In the current quarter, the fair value adjustment increased net income by $7.4 million or $0.27 per diluted share. The prior year taxes of only $1.8 million include a one-time benefit of $8.9 million or $0.32 per diluted share resulting from the remeasurement of the company's net deferred tax liability under the Tax Cuts and Jobs Act of 2017. The regular quarterly cash dividend paid on December 28, 2018 was $0.65 per share, an 8% increase over last year's $0.60 per share.

Turning our attention to retail sell through data from IRI for the 13 weeks ending December 30, 2018, we maintained our leadership position in five of our six key categories and came up just short of the top spot in the flatbread category due to the exit of unprofitable promotions. We increased our share position in three of the remaining key categories.

For the six months ended December 31, 2018, net sales increased 7.7% to $666.2 million compared to $618.6 million a year ago. Net income for the six-year (sic) [six-month] (00:08:00) period totaled $86.9 million or $3.15 per diluted share versus the prior year amount of $75.3 million or $2.74 per diluted share. Consistent with the impacts of the fair value adjustment increased net income (sic) [net income increased] (00:08:19) by $7.4 million or $0.27 per diluted share. The prior year net income value includes the one-time benefit of $8.9 million or $0.32 per diluted share resulting from the remeasurement of the company's net deferred tax liability under the Tax Act.

With regard to that fair value adjustment, I'd like to take a couple of minutes to share the Lancaster Colony's use of earnouts as an important part of our acquisition strategy as we pursue smaller founder-owned food businesses. We acknowledge that this strategy comes with the potential for future adjustments, up or down, to the estimated earnout payments. We believe it's inevitable, particularly in small businesses where forecasted results can change notably with the addition of one or two customers, that changes to the contingent consideration for future earnout payments may be needed. To be clear, we remain committed to earnouts as a part of our go-forward acquisition strategy for smaller founder-owned food businesses that fit our criteria for fit and value and where we wish to keep the founders actively involved in growing the business.

Now, specific to Angelic Bakehouse, over the course of the past year we've launched a new strategy with greater focus on premium sprouted grain wraps and less emphasis on certain other products, particularly private label loaf bread. This strategic shift has created some short-term underperformance which contributed to the reduction in contingent considerations for the earnout payment, but we remain very positive about the future of Angelic Bakehouse and the opportunities that lie ahead for that business. I'd like to note that the actual earnout payment for Angelic Bakehouse will not be made for over two years and will be based upon fiscal year 2021 results.

With that, I would like to turn it over to Doug to make some comments on the balance sheet and related items.

Douglas A. Fell

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

Thank you, Dave, and good morning everyone. Consistent with our past commentary, our balance sheet remains strong. I will make a few brief comments on the more meaningful changes in our balance sheet since June 30. From a high-level perspective, the decline in our cash balances reflects cash paid for our two acquisitions during our second quarter. More specifically, nearly all of the decrease in our cash balances of $11 million since June 30 can be summarized as follows: cash provided by operating activities of $113 million offset by cash paid for acquisitions for $58 million, regular dividends of $34 million, and property additions of $28 million.

In general, our accounts receivable balances remain in line with sales volumes and our expectations. Consistent with past quarters, our agings remain solid. Trade receivables related to our two acquisitions totaled nearly $4 million at December 31. In addition, inventories related to our two acquisitions totaled nearly $2 million at December 31. Adjusting for this, our inventory balances were essentially flat from that of June and are consistent with our expectations and inventory plans.

Regarding our recent acquisition of Bantam Bagels and Omni Baking, we expect their impact on our total net working capital requirements to be relatively minimal throughout this fiscal year. As I mentioned, first half cash expenditures for property additions totaled $28 million. We continue to anticipate capital expenditures to be in the range of $60 million to $80 million for fiscal 2019. And consistent with our past commentary, we'll focus on projects to increase capacity and productivity. We have broken ground on our Sister Schubert's capacity expansion project and it is planned to be in production roughly a year from now. Our innovation center continues to proceed as planned and we anticipate it to be completed in Q4. We have various packaging and end-of-line automation projects also underway. As we conveyed in our last earnings call, given the timing of our projects we anticipate our cash outflows for CapEx to increase as we move through the second half of fiscal 2019.

Depreciation and amortization expense totaled $7.5 million for Q2, including the impacts of our two acquisitions. Adjusting for these two events and other capital projects, we anticipate our depreciation and amortization to be nearly $8 million per quarter for the second half of fiscal 2019. As expected, the increase in our other assets reflects the addition of intangible assets and goodwill related to our two acquisitions. These amounts, along with the entire preliminary purchase price allocation, will be further defined within our Form 10-Q that we will file in early February.

Consistent with our past commentary, the increase in our accounts payable since June largely reflects continued emphasis by our procurement team to extend payment terms with our vendors. Additionally, the total accounts payable related to Bantam and Omni transactions totaled $5.7 million at December 31 and, consequently, also contributed to the increase since June.

With respect to our balance sheet capitalization, we continue to have no debt, nearly $705 million in total shareholders' equity, and nearly $195 million in cash and equivalents. Borrowing capacity under our credit facility remains at nearly $150 million.

Finally, and broadly speaking, as expected our income tax provision for our second quarter was favorably impacted by the Tax Cuts and Jobs Act. Our blended effective tax rate for our second quarter was estimated to be 24% yet our actual tax rate was 23%. Consistent with our first quarter, the favorable difference of 100 basis points largely reflects the accounting treatment of employee stock option exercises within our tax provision. Looking forward, at this time we estimate our effective tax rate for the second half of fiscal 2019 to be approximately 23.5%. However, the timing and magnitude of employee stock option exercises may, again, favorably influence our ultimate effective rate.

As always, we appreciate you joining us this morning. I will now turn the call back over to Dave for his concluding comments. Dave?

David A. Ciesinski

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

Thanks, Doug. We were pleased to finish our fiscal second quarter with record sales and organic growth of 12.2% in our Foodservice segment and 3.5% in the Retail segment. While we incurred acquisition-related expenses during the quarter and some one-time charges in other areas of the business, we continue to make great progress in positioning our business for future growth. We're excited to have successfully completed two acquisitions in the past quarter with Bantam Bagels providing us an entry into the large and fast-growing frozen breakfast category and Omni Baking offering us much improved control over the supply and production of our frozen garlic bread products. Looking ahead, it's worth noting that we've identified opportunities for meaningful improvements at Omni Baking and we will begin implementing these improvements over the second half of our fiscal year. As a result, we expect some modest near-term headwind to our financial results as their supply chain team works to fully integrate that facility.

Overall, our core strategic plan remains the same, to grow our base business; to simplify our supply chain and achieve cost savings; and to selectively identify good, fitting acquisitions that will drive us forward. Beyond our successful Lean Six Sigma program, we have other initiatives underway to reduce our input cost such as a new transportation management system that went live earlier this month. These initiatives should help us offset the modest inflation that we expect to see persist through the remainder of the year.

That concludes our prepared remarks for today and we'd be happy to answer any of your questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Your first question comes from Michael Gallo with C.L. King. Your line is open.

Michael W. Gallo
Analyst, C.L. King & Associates, Inc.
Q

Hi. Good morning everybody.

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

Good morning, Mike.

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

Good morning, Mike.

Michael W. Gallo
Analyst, C.L. King & Associates, Inc.
Q

Just wanted to take a few minutes to unpack the Retail margins. I think when I look at the quarter it was down about 200 basis points, and last year if I recall with the fire at New York Bakery it was down about 270 basis points. I was wondering you can parse out some of the one-time versus ongoing items between severance, the discontinuation of the Simple Harvest line, and then also trade promotions, new shelf space around Banta which I assume there'll be likely some continuation of that. So I guess first question would be what of that's ongoing and what were each of those buckets? And then, as we sort of think about Retail margins going forward, obviously you're going to lap the price increases that were taken, and generally given the holiday quarter historically this is a pretty good quarter for Retail margins. Thanks.

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

Yeah. So why don't we, well, just dive into the question, Mike? As you noted in the commentary in the release, we were off about 200 basis points in Retail and, really, three items drove that. The first was the discontinuation of Simple Harvest dips, the second of that was the severance cost that tied into the announcement that we made back in October, and the last was the heavy trade spending that we had with the Bantam acquisition. You take those three items out and essentially the margins were flat versus prior period. It's probably the easiest way to think about that. Two of those items clearly were transitory, the severance and Simple Harvest dips. And I would submit even that the heavy outspending that we had on Bantam was unusual just in this particular period.

Michael W. Gallo
Analyst, C.L. King & Associates, Inc.

Q

And could you speak to the discontinuation of Simple Harvest dips? I mean, you really didn't have it launched for very long. So, one, sort of what drove that? Two, will you kind of be able to put other products in its place as you discontinue it or does that sort of shelf space that you lose doesn't come back? And then, three, how much did you have in sales in subsequent quarters or in this quarter from the selling of that product?

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

A

Sure. So kind of screwing right into the basis of the question, what drove the decision to pull the product from the marketplace, it was essentially just the velocity of the item on the shelf and we watched it closely. If you remember, it was launched at the very end of the last fiscal year, our Q4, and really didn't account for much if anything in Q4 and was a modest contributor in our fiscal first and second quarter. And we can try to get you more specific numbers on that, but I think it's going to be a low 7 figure number in the aggregate.

As far as why the decision to pull it from the marketplace and relatively quick, Mike, I would tell you that my lessons on these things is that discretion is the better part of valor. When the product isn't performing well in the marketplace, you're better off to be decisive and pull it. We don't expect it to cost us net any space on the shelf. We have a hardy pipeline of other products that we're looking at behind it. But I'll tell you sort of the mechanics of what leads me to usually encourage the team when we have a dog that won't hunt and just to pull it off the field is that in this case what we had was cost tied up in raw materials and packaging. And as painful as it is to pull that off the marketplace or to pull that, once you convert that to finished goods you take something that could be a potential write-off of x and you could take it, you could turn it into a write-off of 3x. And I've seen it before in my career and honestly, I swear to myself, I didn't want to do it again and good for our team, their credit. I think we all just squared up honestly inside. This thing isn't performing the way we want so let's not compound this by doubling down and investing against it. So, honestly, we just made the decision to pull it and move on.

Michael W. Gallo
Analyst, C.L. King & Associates, Inc.

Q

Okay, great, and then final question just on Omni. Yeah, you noted some changes you're going to be making to upgrade the operations. I was wondering if you can give us some more color on that, speak to – I think you mentioned there'd be some modest headwind as a result of that. So I guess more specificity on what we should presume to be modest? And then, when do you expect those kind of lines to cross and you start to see some incremental benefits?

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

A

Yeah. No, great question. I would say this is going to be very low 7 figures that you can expect in terms of a headwind. It's going to be encountered in the first six months. And, really, the nature of the expenses that we're putting into the place are a heavying up in maintenance-related costs. So as you might imagine, you buy an old house and you're going to fix it up, it takes a little bit of energy particularly in the upfront period. And as we go in and we do this, we made a master list of the things that we wanted to address that we believe will ultimately help drive better throughput and cost. Some of these expenses can be capitalized over a longer period of time, but some of them honestly you just have to expense in the period. All of them are tied ultimately to strengthening the facility and giving us the flexibility we need. But from an accounting perspective as we look at it, some of it – they're just going to have to be expensed in the period because of the nature of what we're doing.

Michael W. Gallo
Analyst, C.L. King & Associates, Inc.
Q

Thanks very much.

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

If I may before we leave the point, we continue to believe that that acquisition is going to really pay us dividends downstream. One, it's going to help us control our output. But I think of equal importance, we feel like over the intermediate term it's going to give us the ability to bend the cost curve on that important garlic bread business.

Operator: Okay. Your next question comes from the line of Jason Rodgers with Great Lakes Review. Your line is open.

Jason A. Rodgers
Analyst, Great Lakes Review
Q

Yes. Good morning.

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

Good morning, Jason.

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

Good morning, Jason.

Jason A. Rodgers
Analyst, Great Lakes Review
Q

Good morning. Could you quantify the acquisition-related costs and the one-time charges from the discontinued product in the quarter?

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

The transaction cost in broad figures, Jason, would be in the mid-6 figure/ upper 6 figure range. And then, the second part of your question...

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

The discontinuation of the item, of Harvest dips.

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

And that would be a low 7 figure digit number.

Jason A. Rodgers
Analyst, Great Lakes Review

Q

All right. And how much did price contribute to results by segment?

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

A

That's a great question. Why don't we maybe take them by segment? On the Foodservice side, I would say it was quite modest. We're at the point now where we're lapping that, so the organic increase of let's call it 12%, it was probably 2 points. On the Retail side of the equation, if you look at the total growth, probably was a little bit bigger component overall. But I would ascribe that to the fact that we're making a tradeoff between going after net price by trade reduction which is going to cost us volume, so that naturally is going to put downward pressure on the volume of the business.

Jason A. Rodgers
Analyst, Great Lakes Review

Q

And then you did this last quarter, but as far as the Foodservice organic growth, if you could just parse out how much was higher consumer or customer demand versus ongoing issues at competitors which I'm assuming are pretty close to coming to an end?

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

A

Yeah. So I would say organic volume and mix was the overwhelming majority of the changes that happened there. I would probably put that at, let's say, 7% of that total 12%. I mentioned that 2% of that or 2.5% was priced and then the remainder is our competitors.

Jason A. Rodgers
Analyst, Great Lakes Review

Q

And then just looking at the Foodservice segment, obviously some very strong growth here. And given the difficult comparisons you'll face in that segment starting in the fourth quarter, do you think you can still grow Foodservice on an organic basis?

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

A

Well, I'll tell you that the business is galloping at a pretty rapid rate. What we would expect to see is the business normalize probably more into the mid-single-digit range with maybe some upside to do a little bit better depending on how things fall into place with some new business. But I think where we sit today, I see a line of sight, the team sees line of sight, Doug sees line of sight to a mid-single-digit growth rate which is still quite exceptional considering the peer group in the segment, but certainly not the sort of numbers that we're tearing off now.

Jason A. Rodgers
Analyst, Great Lakes Review

Q

No. I think if you can grow that rate on top of what you've done, I mean, that's pretty impressive. And then just finally, if you could provide just more information on the new transportation management system and the automation projects, maybe how much you're looking as far as potential savings and the timeframe there?

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

A

Yeah, absolutely. Well, I'll start with the TMS project. I guess starting probably seven months ago, we launched this initiative to look at our transportation capabilities end-to-end. Parenthetically, it started just around the same time that we started to see transportation cost run out of control. Essentially, what we've done is implemented a package by the name of Manhattan which is a top-tier TMS package, and it's automating all of the routing and planning that we're doing. We expect it to certainly help us bring down those costs in the long-term. We have five principal sites, three of which are already up and running; the next two sites are going to be up and running by the end of February. So by the end of February, we'll have 85% of our business on the system, and I think that's when we'll really start to see the benefit from the initiative.

Maybe worth just stepping back for a second and a half, here at Lancaster Colony this is probably the most significant IT endeavor that the team, both IT and supply chain, have taken on in recent history, at least a decade, and the team has done, really, a tremendous job of bringing this to life and, I'm going knock on wood here on the desk, without any disruption to our customers. And so we're super excited about that.

The other projects that we referenced, I would think of them in terms of several tranches. There's the normal sort of smaller Lean Six Sigma projects. Those things continue to run at sort of the ordinary rate. As a matter of fact, in the conference room behind us we have another class of green belts that are undergoing their training and sharing their projects. Then, what we're looking at are also some bigger, more capital-intensive projects, one of which is beginning to come online where we're automating broad swaths of our manufacturing facilities, particularly at the end of the line, by putting in place robotic palletizers, and that will continue to run – that particular project I'm thinking about – through the remainder of this year and into early next year.

Jason A. Rodgers
Analyst, Great Lakes Review

Q

Thanks very much.

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

A

You're welcome

Operator: [Operator Instructions] Your next question comes from Brian Holland with Consumer Edge Research. Your line is open.

Brian P. Holland
Analyst, Consumer Edge Research LLC

Q

Thanks. Good morning, gentlemen.

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

A

Good morning, Brian.

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

A

Good morning, Brian.

Brian P. Holland
Analyst, Consumer Edge Research LLC

Q

So forgive me if I misheard this. When you talked, Dave, at the beginning in Michael's question about kind of the bucket of things that were impacting negatively gross margin in the second quarter, did you say that absent Simple Harvest warehousing, and I forgot what the other one might've been, that gross margins would be flat for the quarter year-on-year?

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

A

First, good morning, Brian. What we said is if you pull out Simple Harvest dips and the severance expenses and the expenses associated with Bantam that the Retail margins would be flat. We would go from essentially – it'd be a 200-basis point swing and bring us flat with prior period.

Brian P. Holland
Analyst, Consumer Edge Research LLC

Q

Okay, got it.

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

A

And just to clarify, I think what Mike was trying to understand is what in those costs were, when we sort of characterize, as transitory and we sort of – clearly, the severance and pulling the item off the shelf were transitory, and I would view the level of spending that we had on that particular product in that particular period is transitory as well.

Brian P. Holland
Analyst, Consumer Edge Research LLC

Q

Okay, yeah. That's perfect. I misheard where that impact was falling.

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

A

Absolutely.

Brian P. Holland
Analyst, Consumer Edge Research LLC

Q

That makes a lot more sense. Go ahead. I'm sorry.

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

A

I'm sorry, Brian. But I was just going to note, too, for those – I know all of you guys sort of have models you break it down by segment. And the other thing that we're saying is as our Foodservice grows at the rate at which it is, that also creates sort of downward pressure on our consolidated margins. And as you work your way through the model, you'll see that that's probably 40 or 50 bps on a consolidated basis as well.

Brian P. Holland
Analyst, Consumer Edge Research LLC

Q

Okay, perfect. I appreciate that. Most of my questions have been answered, but I do want to ask about kind of the margin trajectory going forward. So you called out, you highlighted Omni Baking so appreciate that. As we start to think about what else is there, so obviously you started to lap pricing in this quarter; freight, I think beginning right around now you start to get past or you start to get into lapping the toughest compare, so then a moderating headwind if you will, maybe a tailwind – I don't know if you can let us know how you think about that; and then [ph] eggs (00:31:54) I think helped maybe this past quarter. So just curious as we think about the input cost backdrop and we think about the balance of the year and the puts and takes how we should think about your gross margin.

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

Sure. No, I would say in the aggregate I continue to see room for us to expand our margins. On the input cost front, we're seeing the inflation moderate. I would say on a gross basis I'd call it 1, 1.5 points just depending on how things work out. What comprises that inflation is shifting. What we're seeing are things like corrugate and resin cost going up; transportation cost also, if you include fuel in that, continue to be a bit of a headwind. But we are seeing tailwinds in some of the commodity classes. But if you put all of that together and you aggregate it, it still nets out to low single-digit, let's call it, 1% to 2% gross inflation. Having said all of that, because of the Six Sigma initiatives that we have and even notwithstanding list price changes, I think there's opportunities for us to continue to grow our margins and offset that headwind. And Doug, I don't know. I'll look to you to see if you had any other color you'd offer to that.

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

No. I think you covered everything there, Dave. Thank you.

Brian P. Holland
Analyst, Consumer Edge Research LLC
Q

Okay, thanks, and then just quickly going back to the Foodservice catalysts. Again, just tremendous organic growth on that business. I was a little bit surprised to see that the competitor supply disruptions were still a catalyst. I recall last quarter you said that was about a third of your volume growth. So I guess the first question there would be where does that stand as a catalyst relative to last quarter and how do we see that sort of tapering off over the balance of the year? And then how much of that organic growth – and forgive me if you've mentioned this and I missed it – but how much of that growth, and I appreciate if you don't want to get into too many specifics, but the pace at which you're picking up new accounts, I think you've highlighted that in the past few quarters. I'm wondering if there's any sequential uptick in maybe those success stories that are worth highlighting.

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

I think the way I would probably characterize it, Brian, first and foremost, is the foodservice space is all benefiting in the current economic environment and I would say we're disproportionately benefiting because we're winning with winners. Some of the new business that we have picked up, and we usually don't mention them by name, are the national chain accounts out there that are also benefiting from organic growth, so that's a big part of what's going on and that's a big part honestly why we can look into the future and feel relatively comfortable for the intermediate period of time around that growth rate. It's constantly a battle back and forth because there's other guys sitting in another conference that are trying to figure out how to take it from us, but if you look at where we are today that is sort of what we see.

In terms of the supply disruption that we're seeing, it did in fact moderate versus the prior period. We think it's essentially run its course at this point. But I think I probably said it the last time characterize it as a competitor stubbing their toe. We can't necessarily predict when they're going to stub their toe, but we're not necessarily unhappy when they do or just not banking on it on a go-forward basis and that's why we come back probably to the mid-single-digit range.

Brian P. Holland
Analyst, Consumer Edge Research LLC

Q

That's helpful. And curious with some of those new account wins. Again, acknowledging that you can't be too specific, how much of that is kind of around your dressings and dips versus maybe – I mean, are you seeing any wins on the Foodservice side at this point related to any of your sprouted grain or wraps products, etcetera?

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

A

A lot of the growth has been in dips and dressings. We've also seen tremendous organic growth in Sister Schubert's. I mean, that business is growing exceptionally fast, faster than the average honestly, so that's a part of it that has. Our industrial business in Foodservice was up quite high as well. So we are seeing it and it's sort of broad-ranged and across the board, but just in the law of large numbers what is moving the thing the most continues to be the dressings and dips.

Brian P. Holland
Analyst, Consumer Edge Research LLC

Q

Okay, thanks. And then last question for me, maybe a little bit high level, and it doesn't appear as though it's impacting you at all, but we had a few companies in the [ph] baked roll (00:36:46) space highlight inventory or destocking issues. There seems to be a little bit of noise around that on the Retail side. It's still kind of early in earnings season so we'll see how broad-based that might be. But just curious from your seat, from your perspective, what you're seeing there. Do you anticipate more pressures? And kind of to the extent that you can comment on it, what do you think is driving that? Is it channel fragmentation or what other factors might be out there that might be worth highlighting?

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

A

It's a great question. Based on we saw some of the peer news that came out not too long ago when we saw the comment, and ironically we had our sales team together last week and we posed the question to them. So each of the people that oversee our large accounts do include Walmart, and we posed the question directly to them and they didn't see that necessarily as it pertains to our business. Now, what we do seem to see is that we're seeing, where we can, customers are preferring smaller orders and more frequent orders. They are certainly managing their working capital expenses and things like that. They're clearly focused on driving operational efficiencies in their supply chain.

But what we couldn't necessarily point to anywhere was sort of an across the board destocking that was impacting our business. And it could be that if you look at our business given that it's a refrigerated set of products and it's a frozen set of products, they just don't have the space to hold a lot of that stuff. There isn't the holding power in the back of the store, on either the refrigerator or the freezer, and it could be that maybe it's the dry categories. Obviously, I'm not as close to all of my peers as you guys maybe that are following them, but I don't know if dry categories are more susceptible to this than refrigerated or frozen. But I can tell you just in the direct question that we had with our own team to understand whether or not this was impacting us, we didn't walk away with the impression that it was making a material impact.

Brian P. Holland
Analyst, Consumer Edge Research LLC
Q

Got it. Thank you. Appreciate the color as always. Thanks a lot.

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

Yeah. Thanks, Brian.

Operator: Okay. If there are no further questions, we will now turn the call back over to Mr. Ciesinski for his concluding comments.

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

Well, thank you for joining us today and we'll look forward to talking with you later this spring as we share our third quarter results. I hope you guys have a safe and warm rest of the day.

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