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Lancaster Colony Corp. (LANC)

Q3 2020 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning. My name is Ursula, 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 Third 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, President of Investor Relations and Treasurer for Lancaster Colony Corporation. Please go ahead, sir.

Dale N. Ganobsik

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

Thank you, Ursula. Good morning, everyone, and thank you for joining us today for Lancaster Colony's fiscal year 2020 third 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 a business update and highlights for the quarter. Tom Pigott, our CFO will then provide an overview of the financial results. Dave will then share some

comments regarding our outlook for our fiscal fourth quarter. 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 third quarter results for fiscal year 2020. I'd like to begin by sharing some comments regarding the coronavirus pandemic and its impact on our business. But before I do, on behalf of all of us at Lancaster Colony, I'd like to thank all the healthcare workers and first responders for their tireless efforts to keep us safe.

From the onset of the coronavirus pandemic, we've been steadfast and our mission is fixed. First, provide for the health, safety and welfare of our teammates; and second, ensure that we continue to play our role in our country's vital food supply chain. Thanks to the diligence and care of our teammates, I believe we've remained true to both elements of our mission. All the while, we have fortified and sustained our business.

I'd like to extend a very sincere thank you to our front-line teammates including those that work in manufacturing, distribution, transportation and retail merchandising for the incredible work they do every day to keep our business operating. Through it all, our business continues to source ingredients, manufacture products and ship them to our customers. We've done this all the while having implemented safety protocols as outlined by the by the CDC, OSHA, FDA, and local government authorities to ensure that we continue to operate safely.

I would also like to extend the special thank you to our office-based teammates for embracing this change and sustaining our business during this unprecedented time. Collectively, they've conducted countless Microsoft Team meetings with customers, suppliers, partners, and each other. Our sales teams have conducted virtual category reviews with our customers. Our marketers have launched marketing campaigns, procurement team has brought on board new suppliers. Our transportation team has conducted carrier bids. And our finance team has closed the book and helped us prepare our third quarter filings.

Moving on to fiscal third quarter financial results, our reported consolidated net sales grew by 1.1%, excluding all Omni Baking sales, consolidated net sales grew 1.9%. Net sales in our Retail segment increased 10.7%, while net sales in our Foodservice segment declined 7.8%.

Retail net sales benefited from higher demand, as the COVID-19 outbreak led to increased consumer demand that built upon solid base business performance. Third quarter sales also benefited from new product offerings, including Buffalo Wild Wings sauces in single bottles and a promising start for a regional pilot of Chick fil-A sauces that we are supplying to grocery stores. Both Buffalo Wild Wings and Chick fil-A sauce are sold under exclusive license agreements.

Separately, sales trends for our New York Bakery frozen garlic bread products remain favorable, as the brand continues to gain share. Olive Garden dressings posted share gains for the quarter and our Sister Schubert's brand of frozen dinner rolls achieved significant sales growth in the quarter as well. It's notable that prior to the impact of COVID-19, our quarter-to-date retail sales were up about 4% due to the contributions from our new product introductions and growth from our core retail business.

In our Foodservice segment, excluding all Omni Baking sales, net sales declined 6.6%. Foodservice channel demand was adversely impacted by COVID-19 beginning in mid-March, as the restaurant dine-in purchases were eliminated, and consumer purchase options were limited to carry out delivery and drive-through. These service restrictions in the food service industry, combined with the stay-at-home orders, led to reduce consumer demand and lower sales for our Foodservice segment.

Despite the unfavorable influences of the COVID-19 pandemic, we grew our fiscal third quarter consolidated gross profit, $1.6 million or 2.1% as we benefited from the favorable sales mix shift to the retail channel along with our ongoing cost savings program.

Gross profit was reduced by a $4.5 million inventory write-down, resulting from an abrupt slowdown in Foodservice orders in mid-March due to the COVID-19 impacts. It was further reduced when we paid out $1 million in bonuses to front-line employees in our factories and distribution network in gratitude for their work in helping meet the shifting demand within our business.

I'll now turn the call over to Tom Pigott, our CFO for his commentary on our Q3 financial results.

Thomas K. Pigott

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

Thanks, Dave. Overall, we are pleased with the underlying business performance in the many actions taken by our employees to address the COVID-19 outbreak during the quarter.

Consolidated net sales increased 1.1% to a third quarter record of $321.4 million. Excluding Omni Baking sales at $5.3 million in the current-year quarter and $7.9 million in the prior-year quarter, consolidated net sales increased by 1.9%. As you recall Omni Baking sales are attributed to a temporary supply agreement. These sales will decline from the current level in coming quarters with the expectation that the supply agreement will end by December of 2020.

Consolidated gross profit increased $1.6 million or 2.1% to $77 million and gross margins grew by 20 basis points. The increase was driven by a favorable product mix as revenues shifted from Foodservice to Retail, our cost savings programs, lower commodity costs, improve net price realization. These improvements were offset by the $4.5 million inventory write-down and the $1 million spent on the front-line bonuses. These two items reduced our gross margin growth by 170 basis points.

Selling, general and administrative expenses increased $8.9 million or 24%. The largest driver of the increase was our ERP program, which accounted for $4.9 million in SG&A costs for the quarter. Other drivers to the increase included higher spending on information technology and increased consumer promotional spending, as well as $0.5 million increase in our allowance for doubtful accounts related to the impact of COVID-19.

Consolidated operating income declined $7.3 million or 20%, due in part to the COVID-19 items I mentioned, which totaled $6 million and the ERP investment of $4.9 million. These two items reduced our operating income growth by 29 percentage points. Key drivers of the operating income growth excluding these items include the top line performance, favorable mix and cost savings programs. Our effective tax rate increased to 27% this quarter from 21% in the third quarter of fiscal 2019.

This increase reflects an adjustment to our estimated foreign-derived intangible income tax credit, higher state taxes and a lower tax benefit from stock-based compensation activities. We estimate the tax rate for the fiscal fourth quarter to be 24%. Third quarter diluted earnings per share decreased $0.30 to $0.81. The decline was due

to the COVID-19 items, the investment in ERP and the higher tax rate, partially offset by the underlying business performance.

With regard to capital expenditures, we project our fiscal year 2020 expenditures will be approximately $90 million. Our year-to-date payments for property additions of $72 million include investments for the capacity expansion project at our frozen dinner roll facility in Horse Cave, Kentucky that we recently completed and the purchase of the Omni Baking facility that was previously leased. Separately, specific to our ERP initiative, we also capitalized $4 million in expenditures in our fiscal third quarter for application development stage activities.

In addition to investing in our business, we also returned funds to shareholders. Our quarterly cash dividend paid on March 31 was $0.70 per share, an 8% increase from the prior-year amount. Our long-standing streak of annual dividend increase has reached 57 years this past December. Despite the higher level of investments and increased dividend payments, our financial position remains very strong as we finished the quarter debt free, with $178 million of cash on the balance sheet.

The company also replaced its revolving line of credit during the quarter, which remains at the same size of $150 million. This facility was [ph] replaced (00:10:25) in the ordinary course of business and not prompted by the impacts of COVID-19. The term of the previous facility was set to expire in April of 2021. We have no borrowings against the facility.

So, to wrap up my commentary, the quarter featured strong underlying performance as well as some significant impacts from COVID-19, the business continues to monitor and adjust to the COVID-19 outbreak while investing for longer-term 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. As we progress through our fiscal fourth quarter, we're going to continue to focus on delivering against our mission. First, provide for the health, safety, and welfare of our teammates; second, ensure that we continue to play our role in the country's vital food supply chain. And we will add one additional priority that levers the combined strength of our team our operating strategy in our balance sheet, to seek opportunities to better position ourselves for future growth.

During the month of April, our business overall continued to be impacted by the same factors in Retail and Foodservice that shaped our fiscal third quarter results. In Retail, the supposition is supported by IRI data, and in Foodservice, this is supported by NPD transaction data.

Looking forward to the remainder of Q4, we anticipate net sales in our Retail segment will continue to benefit from increased demand due to the stay-at-home orders and other changes to consumer behavior attributed to COVID-19. We also expect our recent new product introduction and channel expansion into dollar and drug channels remain important contributors to our retail segment sales growth.

Separately, we expect the Foodservice industry overall will continue to be negatively impacted by COVID-19. We expect the negative impact to be most pronounced on the casual dining and mid-scale segments and the impact to be more muted on the QSR segment. For reference prior to the impact of COVID-19, our Foodservice segment customer mix was approximately two-thirds QSR, which has and will continue to help soften the impact on our business.

I'll now provide an update on a couple of notable projects for our business.

During our fiscal second quarter earnings call back in February, I referenced our plans for a major capacity expansion project of one of our dressing facilities. Based on the impact of COVID-19 and related near-term uncertainties, we have decided to cancel this project. We will continue to invest in capacity as required to support the growth of our business. However, we felt it was prudent to halt this project until we had a better feel for the near and intermediate term outlook.

With respect to our ERP initiative, Project Ascent, due to the current work environment, including stay-at-home orders and travel restrictions, we are delaying the implementation timeframe for the project until the back half of fiscal year 2021 or early 2022.

In closing, while the impacts of COVID-19 have unfavorably influenced our short-term results, we remain very confident in future of our business. Excluding the COVID-19 impacts, we delivered another quarter of solid financial results. We entered the COVID-19 pandemic from a position of financial and competitive strength, and we expect to emerge the same way with opportunities to grow both, organically and through acquisitions.

In the interim, our Foodservice segment, as our national chain customers face deep challenges, we are focusing our efforts to support them through this period of uncertainty and offer our assistance as they develop plans to return to full service. In the Retail segment, we will continue in our pursuit of growth in new product introductions and channel expansion.

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

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Your first question comes from Brian Holland with D.A. Davidson.

Brian Holland
Analyst, D. A. Davidson & Co.

Q

Hello. Thanks. Good morning, gentlemen.

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

A

Good morning, Brian.

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

A

Good morning, Brian.

Brian Holland
Analyst, D. A. Davidson & Co.

Q

So, I guess, first question on the Foodservice side. Can you give us a sense of how much of your Foodservice business is down, say, 50% or more, due either to stay-at-home orders or maybe doors closing? And I know you have high exposure to national chains, but just have you had customers go out of business, and if so, can you maybe quantify any contribution from those?

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

A

Sure. So maybe starting with the breakdown, we said during the prepared remarks, Brian, that two thirds of our business is QSR. So, among that – and that's all our Foodservice sales trade at two thirds across all of our various product types is QSR. And that's the segment that seems to be least impacted by this. And if I had to sort of ballpark that for you, I would say they're probably down in terms of traffic 30% with some doing better than that.

But notable, all of these customers are experiencing larger ring for each transaction. So, chances are their sales through, let's say, April were probably down somewhere closer to 20%, with the pizza chains actually closer to flat and maybe up.

I would then clarify, as you look at April, it looked like mid-April was the low watermark. If March 8, let's say, was a line of demarcation where sales, all of a sudden, dropped off. What we found was basically the second week of April, the end of the second week of April with the low watermark. And what we've seen is sequentially those trends getting better with that each passing week in April into the first week here now of May.

But [ph] matter in (00:16:25) back up to your question, two thirds of our business is QSR, I would say, those businesses are probably off, let's just say on average to-date somewhere like 20%, maybe a little bit less than that. The part that's down hardest is casual dining. And then it's going to vary a little bit by segment. Some of those chains are probably operating closer to 50%, as there are a couple of them that are off a little bit harder than that.

I would submit the segments that are the absolute hardest hit are the non-commercial segments that are tied into schools and venues because, as you might imagine, they're just altogether shut down. Other venues that have been hit hard are mom-and-pop shops up and down the street because they don't have drive-through and they may not have had, let's say, the balance sheet to withstand them.

But we have not had any big customer that's gone bankrupt on us to-date, just hasn't happened. And to the best of my knowledge, there's one national chain that has announced something but they're not one of our customers.

Brian Holland
Analyst, D. A. Davidson & Co.

Q

Okay. Got it. That's very helpful. So I guess the sort of spinning forward your sort of breakdown on the Foodservice channel, I would imagine even though you're getting better or you're seeing better trends coming off of the mid-April trough, they're still probably down. Just trying to think forward here, I guess, near term first. I mean, should we expect Foodservice sales to be materially worse in Q4 than they are – than they were in Q3 just kind of in a year-over-year basis? And if not, what would you sort of be point to as...

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

A

Yeah. I would say...

[indiscernible] (00:18:13)

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

A

...worse, Brian. I don't know if I would dimensionalize [indiscernible] (00:18:17)

Brian Holland
Analyst, D. A. Davidson & Co.

Q

Yeah.

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

A

...for the following reason that if you think about it, for all intents and purposes, Q3 was really just the last couple of weeks, right? I mean...

Brian Holland
Analyst, D. A. Davidson & Co.

Q

Yes.

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

A

...the COVID-19 was on the horizon. I think we talked about it together towards the end of – was it the end of February? No. It was very beginning of March actually. We spoke with you during your – the conference, and we were talking about it coming upon the horizon and the impacts of Italy. But in the US, if you look at what happened in terms of store closings, it was really in the back half of March. So we're going to see more of a

financial impact through the entirety of the fourth quarter, this quarter. And then – but I think what you're going to see is it's going to hit the low watermark in April.

And then with openings in various states taking place now, you're going to just continue to see sequential improvements.

Brian Holland
Analyst, D. A. Davidson & Co.

Q

Okay. And then just operating expenses, should we – I guess for how long should we anticipate or do you anticipate those sort of maybe remaining elevated specific to COVID-19? Is that another quarter? Do you see drag on beyond Q4?

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

A

Well, here's what I would do. I'll let Tom comment on the charts that we took for inventory. I view that a bit more – strictly transitory, maybe, of an event. What we've done is we initially granted a $300 bonus for the month of April. And then, what we've done for our front-line employees is we've actually put in place a $2-an-hour increase, and we've tied them to the stay-at-home orders., with the idea of being that once a local government authority lifts its stay-at-home orders, we intend to pull back on that $2-an-hour increase. So, it's going to vary a little bit state-by-state, jurisdiction-by-jurisdiction.

And in some cases where it's counties that are making those calls, you could have the state that maybe leaning one way and a county leaning another way. But that's in essence to the agreement that we've put forth with our employees that, I mean, I just can't say enough good things about the way they're operating. My guess is we'd probably have at least another quarter, two in the fourth quarter of that, and we'll see what it looks like into the first quarter of next fiscal year.

Brian Holland
Analyst, D. A. Davidson & Co.

Q

Okay. And then, I'll just – just one last one from me. On the Retail side, you referenced in your prepared remarks, obviously the 4% growth prior to the COVID-19 demand surge. Obviously, you had big channel expansion plans and initiatives underway. Just curious given the commentary that we've heard, it sounds like those flowed through, although I'm sure there's some demand surge in there as well. Any impact to the timing or your ability to get all of those sort of plans that have been set in place, I guess, specifically club and dollar channels ahead of all of this and whether there's any impact going forward?

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

A

So far, no. I mean, we were fortunate that we began shipping those products in January, and in some cases February. So, those pipes were already starting to build. I think the more likely impact could be on future products that are in the works because – as I'm sure your canvassing other manufacturers in your conversations, what you're hearing is retailers are really focusing pretty narrowly on execution.

But within the realm of what you're talking about there, those products have been out there. And I would say the same is true for things like Buffalo Wild Wings and Chick-fil-A sauce. I mean, unfortunately, those products are relevant enough because customers are excited about them enough that they're saying, hey, just bring them even in spite of everything that's going on.

Brian Holland
Analyst, D. A. Davidson & Co.

Q

I appreciate the color as always. I'll get back in the queue.

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

A

Of course. Hey, Brian, one thing that I would...

Brian Holland
Analyst, D. A. Davidson & Co.

Q

Yeah.

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

A

...note that wasn't in my prepared comments. But it may help you understand the algorithm a little bit, as far as our operating costs. So, we've done two things. And one is, obviously, we put in place bonuses and incentives for front-line workers that I have talked about. But the other thing that we've done is we did enact a voluntary furlough program at select locations where we're allowing employees that may have an underlying health concern, or maybe of such an age that they're concerned about working. And we're allowing those employees to opt out.

And then what we're doing is we're taking the savings from that voluntary furlough program and we're actually using that to fund the incremental $2 an hour that we're paying for those other employees. So if you're modeling this out on a labor basis, it's essentially a push. The voluntary furlough program is funding what we're doing on the incremental bonus.

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

A

Yeah, Brian. I'll just add – this is Tom, I'll add a little more color to our margin outlook. From the way we look at it today, you have a favorable tailwind to the mix that Dave talked about. But you also have a reduction in Foodservice volume, which will impact our factory overhead absorption in that we have less volume going through the facilities and a fixed factory overhead piece to absorb. You've got the front-line incremental pay that Dave mentioned, but then trying to offset that with the furlough program.

And then, there are some other items that we're doing to make sure we operate safely, the ship separations, sector sanitation, and other procedures just to manage the risks. So there are a number of tailwinds as well headwinds as we look at Q4 and going forward.

Brian Holland
Analyst, D. A. Davidson & Co.

Q

Thanks, Dave and Tom. Appreciate that context.

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

A

Of course.

Operator: Your next question comes from Ryan Bell of Consumer Edge Research.

Ryan Blaze Bell
Analyst, Consumer Edge Research LLC

Q

Hi, everyone. Do you see your current environment helping to create more opportunities to bring Foodservice products to retail in the short term, and then maybe in the medium term?

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

A

Certainly over the intermediate term. I think, as much as I'd like to say, it'll help us right now. I mean, for deals that we have negotiated license agreements, I think retailers are excited about it and I believe our Foodservice customers are excited about that. As it pertains to new deals, I would surmise that Foodservice operators are really focusing on their core business.

Over a longer period of time, Ryan, I think this is really going to help us because it helps to create a diversified stream of revenue and profit for the operators, to help them sustain any sort of things that their business might encounter, hopefully, not another COVID-19 or a COVID-20, let's say. But just creates another source of revenue and just another source of strength for their business.

Ryan Blaze Bell
Analyst, Consumer Edge Research LLC

Q

Great, thanks. And during the recessionary environment, could you speak about your thoughts on the puts and takes between food-at-home and food-away-from-home consumption especially as you have two business units that operate in each?

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

A

Yeah. Well ordinarily, they're a natural hedge. And if you go back to the Great Recession and other periods, what you would ordinarily see is in times of economic uncertainty, consumers would pull back from spending away from home. When they did spend away from home, they tended to spend on QSR, so you would see QSR strengthened during that period of time. And then obviously they would spend more at home. And that shift was a natural hedge for our benefit. And given the shift in mix between Foodservice and Retail, there was a bit of a tailwind for us as well.

During periods of economic expansion when people spent more away from home, you could see it flow the other way. We have looked at that just to see if past is prologue here. But what's so very unique in this set of circumstances is that it's not a slowdown, at least not we're in right now. What we're looking at is just a full-up stop in some cases. As we come out of the shelter-in-place orders and this thing starts to take on a look of maybe a ordinary recession, I would expect those sorts of rules to come back into focus again.

Ryan Blaze Bell
Analyst, Consumer Edge Research LLC

Q

Thanks for the clarity. Do you see any opportunities that your strong balance sheet would afford as you get out of the primary uncertainty that would be related to COVID-19?

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

We're certainly monitoring that. We – I mentioned in the comments that we canceled a large capacity expansion project. And part of that was born out of just the uncertainty of the near-term and intermediate-term environment. We felt like we had enough time to let this play out a little bit before we commit it. But there's always the scenario that an asset comes on the market that we can buy that's both faster and cheaper way to solve our capacity issues. So, yeah, most certainly.

And I think this is why we – from the onset when this broke, we went into a mode where we focused on the two elements of our mission, make sure that our people were safe, let's get a complete understanding of all the safety protocols, let's implement those, right, and then let's make sure that our factories continue to run, albeit safely, to supply food.

Now we're kind of moving the focus beyond just that. We're continuing to do that every day in our factories, and suffice it to say, that's a big challenge. But we are looking at the external world now, we're looking at our balance sheet and trying to figure out is there a way that we can really just not only come out of this but come out of this stronger and position for faster growth in the future.

Ryan Blaze Bell
Analyst, Consumer Edge Research LLC
Q

Great. Thank you. That's it from me.

Operator: Your next question comes from Todd Brooks with C.L. King & Associates.

Todd M. Brooks
Analyst, C.L. King & Associates, Inc.
Q

Hey. Good morning, everybody. I hope you're all well.

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

Good morning, Todd.

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

Good morning, Todd.

Todd M. Brooks
Analyst, C.L. King & Associates, Inc.
Q

A few quick questions for you. One, you talked about how retail was tracking prior to kind of the onset of the COVID-19 outbreak. Do you have any data either through February or through, when you think, you want to call the outbreak start date? How was Foodservice tracking going into the COVID-19-related [indiscernible] (00:28:35)

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

It will be closer to flat.

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

A

It was flattish.

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

A

[indiscernible] (00:28:39) And that was more or less what we had foreshadowed in our Q2 earnings.

Todd M. Brooks
Analyst, C.L. King & Associates, Inc.

Q

Okay. Great. And if you – I know you reviewed some of the new products successes at Retail. Not much discussion yet about the extension of Olive Garden into the drug and discount channel. Any – did that happen as planned and any early reads on success of extending that brand in the new channels of distribution?

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

A

It's a great question. It has and it is. And the way I would characterize it is it's almost like you get an athlete on a team and you sort of track him on the depth chart. And we watch the velocity of the new item. And obviously when we first got out there, it was barely registering, as it was building on the shelf. But we can already see that it's becoming one of the fastest-growing Italian dressings in the segments. And we have every confidence that it's going to continue just to grow and pass the leaders like it has in retail. So very, very excited about that.

And honestly, Chick-fil-A has been a tremendous success so far at retail. The test is just going on in Florida. Consumer demand has been fantastic. We're having, honestly, a very hard time just keeping it on the shelf. It hits the shelf and it disappears. So we're excited about it, and our partners at Chick-fil-A are very excited about it. So we're just going to continue to nurture that and plan and prepare for a national [indiscernible] (00:30:08)

Todd M. Brooks
Analyst, C.L. King & Associates, Inc.

Q

And I think, it was there one point where you talked about maybe seizing that opportunity as equivalent to the Olive Garden dressing opportunity or how are you thinking about it based on early results out of the pilot the size of the Chick-fil-A opportunity?

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

A

I would say it is larger. Just – the way we bask into this was if you look at the overall salad dressing category, it's north of $2 billion but Olive Garden predominantly plays in the Italian sub-segment which is smaller right? Ranch is the big space which is about $700 million. I think Italian is about half of that size. If you look at something like Chick-fil-A sauce, it plays in dipping sauce occasions. I would say the occasion, as the opportunity for occasions there would include the same occasion that ranch might play in, that ketchup might play, that honey mustard might play in, a whole range of dipping sauces.

So, I think that the opportunity here, the playing field, could easily be north of $2 billion. So I would – and not just me, I think the team, our retail team has done a very nice job sizing this opportunity. Our sales team has done a great job. Our retailers believe the same thing. We all tend to believe that the addressable opportunity here is, let's just begin with larger than Olive Garden and we'll see how much larger.

Todd M. Brooks
Analyst, C.L. King & Associates, Inc.

Q

Great. And then my final one and this is just some of my ignorance around manufacturing and efficiencies. But can we talk about either pick an example number of foodservice sales being down x percent, how that kind of volume drop in the production facilities flows through to the [ph] margin (00:31:52) standpoint? Just to get some color around how we should be thinking about the margin impact of that volume drop.

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

A

Yes. So, it's a great question. Overall, Foodservice is two-thirds of our volume. And you look at our factory costs and there's a portion that's fixed, don't I want to get into the specifics on that regard. So as that volume goes down, there is a negative absorption impact to our margins, in that, we're not able to absorb as much cost out of the factories through cost of goods sold. It's very difficult to say what that input [ph] impact (00:32:29) will be right now because it's highly dependent on foodservice volumes. And as David mentioned, we saw the beginnings of the month being down considerably and some recovery towards the end of the month.

So, I hesitate to give you kind of any specific numbers in terms of that impact but it's something that we're monitoring. Some of the things we're doing to manage the incremental costs is to reducing temporary labor and overtime, the voluntary furlough program or reducing hiring. We're also implementing other auterity measures to try to offset this potential impact.

Todd M. Brooks
Analyst, C.L. King & Associates, Inc.

Q

So, not to give out any detail but is there any kind of rule of thumb equation you can give us with a – percent drop in – or maybe a 5% drop in Foodservice equates to some type of drop at the operating margin line? That way we won't know the components but we can [ph] sort the size (00:33:24)

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

A

Well, what I would say is because the situation is so dynamic right now, and we're taking a number of actions to try to minimize that impact, I don't want to put a specific number out right now. Certainly, as we get through this quarter, we'll have much better visibility and be able to share those impacts with you.

Todd M. Brooks
Analyst, C.L. King & Associates, Inc.

Q

Okay, great. Thanks for the time.

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

A

Of course. Thank you, Todd.

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

David A. Ciesinski

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

Thank you, Ursula. And thank you everyone for participating this morning. We look forward to sharing our fourth quarter results with you in August. And in the meantime, we wish that each of you stay safe. Thank you.

Operator: Thank you. Thank you for participating in today's conference. You may now disconnect.