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Lancaster Colony Corp. (LANC)

Q2 2021 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning. My name is Michelle, and I'll be your conference call facilitator today. At this time, I would like to welcome everyone to the Lancaster Colony Corporation Fiscal Year 2021 Second 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 session. [Operator Instructions] Thank you.

Now I would like to begin the conference call, here is Dale Ganobsik, Vice President of Investor Relations please for Lancaster Colony Corporation. Please go ahead.

Dale N. Ganobsik

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

Thank you, Michelle. Good morning, everyone, and thank you for joining us today for Lancaster Colony's fiscal year 2021 second 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 current outlook and strategy. 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. And I'll 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 second quarter results for fiscal year 2021. I'd like to begin by extending a sincere and heartfelt thank you to the entire Lancaster Colony team for all their contributions and sacrifices during the past quarter. Despite the uncertainty and obstacles that the pandemic imposed upon our business, we're very pleased to report record sales and gross profit.

Throughout the pandemic, we've remained steadfast that our mission is fixed. First, to provide for the health, safety and welfare of our teams. And second to ensure that we continue to play our role in our country's vital food supply chain. In our fiscal second quarter which ended December 31st, consolidated net sales grew 5.6% to a second quarter record \$375 million. Net sales in the retail segment grew 19.5% while net sales in our foodservice segment declined 9.7%.

Excluding Omni Baking sales consolidated, net sales increased 7.3% and Foodservice net sales declined 6.8%. Retail net sales benefited from higher demand as the impact of the pandemic drove higher at-home food consumption. The success of our licensing program also continued to drive retail sales growth with Olive Garden dressings, Chick-fil-A sauces and Buffalo Wild Wings sauces, noted contributors.

Per IRI key highlights for the quarter included the following. Sales of Marzetti refrigerated salad dressings grew 12.3%. New York Bakery frozen garlic bread grew 16.9%. Branded croutons advanced 21.9%. Sister Schubert's frozen dinner rolls increased 11.8%. And Olive Garden dressings grew a very strong 61.3%. Chick-fil-A sauces and single bottle Buffalo Wild Wings sauces which we introduced last Spring continue to perform very well, adding over 4 percentage points to our retail segment's Q2 sales growth.

The regional rollout of Chick-fil-A sauces continued as planned during the quarter as we expanded distribution beyond the State of Florida with the addition of retailers in Georgia, Alabama, Mississippi and Louisiana. IRI data for the four new states indicate that initial velocity is very strong. In Florida where we introduced Chick-fil-A sauces to the retail market with a pilot test last March, recent IRI data shows the trial of repeat purchases are extremely favourable with cumulative household penetration of 11.1% and a repeat rate of 50.6%.

In our Foodservice segment, sales to national account, QSR and pizza chain customers remained a source of strength, and represented over 60% of our total foodservice sales in the quarter. Recent NPD Crest data shows that our revenue trends in QSR are piece in the head of the QSR segment average. The same data indicates that our sales in the full service segment are in line with the industry average.

We continue to pursue growth opportunities with many of our national account customers on a range of new sauces, dressings and spreads. Separately, we're also pursuing opportunities in other market segments including the home [indiscernible] (00:05:43) market where we've enjoyed some recent success.

Despite the higher manufacturing costs related to the impacts of COVID-19, gross profit grew 7% to a second quarter record \$106.8 million. This was driven by the strength of our Retail segment. As with prior quarters, we continue to follow protocols and guidelines provided by government health authorities. We also continue to make the necessary investments to promote safe operations at all of our plants and distribution centers.

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

Thomas K. Pigott

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

Thanks, Dave. Overall the results for the quarter exceeded our expectations. The stronger revenue growth in the Retail segment offset the higher costs we incurred due the impact of COVID-19, allowing the companies to drive improved bottom line performance.

Second quarter consolidated net sales increased 5.6% to \$375 million. Excluding Omni Baking sales of \$900,000 in the current year quarter and \$6.3 million in the prior year quarter, consolidated net sales increased by 7.3%.

As you recall, Omni Baking sales were attributed to a temporary agreement. The supply agreement ended on October 31, 2020 as planned. Consolidated gross profit increased \$7 million or 7% to \$106.8 million, and margins expanded by 40 basis points. The growth was driven by higher sales and reduced trade spending in the Retail segment.

Items partially offsetting this favorability were higher manufacturing costs, including costs related to the impact of COVID-19 as well as increased commodity and distribution cost inflation. The COVID-19 related items included about \$4 million of incremental frontline worker pay, and other hard costs of about \$1 million for shift separations, expenditures for personal protective equipment and sick leave expenses.

We also incurred incremental soft costs totaling an estimated \$3 million. These costs were driven by increased demand and mixed changes related to COVID-19. More specifically these expenses included increased overtime pay, higher internal freight and distribution costs, and utilization of some less-efficient production lines to help meet demand. We continue to make these investments to ensure the safe operation of our facilities while servicing the demand shifts across our business.

Selling, general, and administrative expenses increased \$2.5 million or 5.5%, driven by higher spending for Project Ascent and partially offset by reduced spending on consumer promotions for the quarter. Consolidated operating income increased \$4.5 million or 8.4% to \$58.6 million.

The key driver of the operating income growth for the quarter was a strong top line performance in the Retail segment and the resulting gross profit improvement. Our effective tax rate was 23.8% this quarter versus a tax rate of 21% in the second quarter fiscal 2020. We estimate the tax rate for the remainder of the fiscal year to be 24%.

Second quarter diluted earnings per share increased \$0.04 to a \$1.62. The increase was driven by the underlying performance of the business offset by the investments we are making in Project Ascent, the increase in our effective tax rate and lower interest income on our cash holdings.

The Project Ascent investment reduced EPS growth by \$0.09 per share. With regard to capital expenditures, second quarter payments for property additions totaled \$15.1 million. For fiscal year 2021, we're forecasting total capital expenditures between \$105 million and \$125 million. This investment includes the spend related to the recently approved expansion project at our Horse Cave, Kentucky facility.

This expansion will allow us to meet the fast growing demand for our dressing and sauce products. The total cost for the expansion is estimated at approximately \$130 million with expenditures of approximately \$30 million planned for this fiscal year.

In addition to investing in our business, we also returned funds to shareholders. Our quarterly cash dividend paid on December 31 was \$0.75 a share, a 7% increase from the prior year amount. Our longstanding streak of annual dividend increases reached 58 years in December. Even with these investments we are making and the increased dividend payments, our financial position remains very strong as we finished the quarter, debt free with \$216 million of cash on the balance sheet.

So to wrap up my commentary this quarter featured strong growth in our Retail segment and solid execution of our strategies across the business. We continued to monitor and adjust to the impacts of the COVID-19 outbreak, while investing in the longer term potential of the business.

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

In our fiscal third quarter, we expect net sales to benefit from continued growth from our licensing program, and frozen bread products. We remain very bullish regarding the future of Chick-fil-A sauces for our business. Shipments to retailers in Texas will start next week with distribution to 10 more states from Oklahoma to the mid-Atlantic set to begin later this month.

We expect to reach national distribution of Chick-fil-A sauces by the end of the fiscal year. The impact of COVID-19 will remain a headwind for our manufacturing costs in our fiscal third quarter while commodities and freight expenses are projected to become increasingly inflationary.

We expect our on-going cost savings program and that price realization efforts to help offset these higher cost. Our ERP initiative, Project Ascent is progressing as planned. Earlier this month we successfully executed [ph] Wave Zero (00:11:54), a limited launch of SAP which included one factory as well as our corporate-wide master data. Thanks to the creativity and perseverance of the Project Ascent team, we remain on track for the larger [ph] Wave One (00:12:09) launch to commence early in fiscal 2022.

Specific to our supply chain strategy as Tom mentioned, we are making a significant investment in production capacity to address the increasing demand for our dressing and sauce products. Here again, thanks to the creativity and perseverance of the supply chain team, groundbreaking for this important project took place last month with the target completion timeframe in the first quarter of fiscal year 2023.

In closing, I would once again like to thank the entire Lancaster Colony team for all that they have done and continue to do to fulfill our mission despite all of the unprecedented challenges imposed by the pandemic.

This concludes our prepared remarks for today and we'd be happy to answer any questions you may have. Michelle, I'll turn it over to you.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] The first question comes from Ryan Bell from Consumer Edge. Your line is open.

Ryan Blaze Bell

Analyst, Consumer Edge Research LLC

Good morning everyone.

Q

Dale N. Ganobsik

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

Good morning.

A

David A. Ciesinski

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

Good morning.

A

Ryan Blaze Bell

Analyst, Consumer Edge Research LLC

The robust growth that we've seen in retail and providing an offset the trends that you've seen in the Foodservice, would you like to talk a little bit more about your assumptions for what Foodservice will look like when it's returning to growth? And how do you think about the balancing act now between Foodservice returning to growth and some of the wind coming out of retail sales [ph] story (00:13:39) against at-home consumption?

Q

David A. Ciesinski

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

Sure. Well, if I may, maybe I'd start with a little context just in terms of the trends that we're seeing in the broader categories in our business for both Retail and Foodservice. Maybe I'll start with Retail first. If you look at all edible categories for all outlets during the handful of let's say probably the last four months, they're averaging vis-a-vis our business and everybody else's in the universe out there, been at about 12.3%.

A

If you look at our business, this is Lancaster Colony for all of our outlets, we're averaging up about 19%. So this is consumption sort of pulled through the business. What I would share with you is in about five to six weeks, we're going to begin to lap the very first of the effects of the coronavirus from last year.

Now if we pivot and then look at the Foodservice business and in this case, instead of IRI, we look at NPD Crest data, what we're seeing is that the entire restaurant universe, this is 71 or 72 of the largest chains are running in transaction totals down roughly 9% for that same period of time.

QSRs are down in transactions more like 7.5%. Mid-scale is down probably more or like 35%, and casual is down more like 30%. And if you look at our business here again, as I shared in my commentary, we're outperforming the Foodservice averages as well.

Now your bigger question that you asked is so how do we think about this from the forecasting perspective and honestly this is a pretty difficult exercise, just because the uncertainty surrounding the pandemic.

What we do know is we're going to begin to lap the impacts of COVID. And we can see on the calendar when that's going to be like I said, that's probably about six weeks out and it's going to be most severe in those first couple of weeks where we lap the stock up that took place in categories and you'll see it begin to sort of slow back down and normalize.

And the offset is true in food service. No, as far as sort of how we're predicting things, internally, we're trying a lot to the availability of the vaccine. Our inside planning hypothesis is as that vaccine becomes more widespread, as people are able to circulate more broadly, we will see restaurants, particularly in urban areas, open up more and people return to work and see traffic resume.

It's really difficult for those of us inside the company to guess. We're seeing – if I – just being transparent with you, we think that we're going to be living with the effects of the COVID pandemic at least through the end of this calendar year, this fiscal year, excuse me, and into the early part of the next.

Ryan Blaze Bell

Analyst, Consumer Edge Research LLC

Q

That was very detailed and helpful. And when we're thinking about some of the incremental costs that you've been having to bear as a result of COVID, I think you said it was \$3 million in soft costs, \$1 million in hard costs. As you're looking out to a point where a critical percentage of your employees do get vaccinated, what type of that – what percentage of that cost or what – what's the size of that cost that ends up getting removed on a permanent basis, and we've heard some firms providing financial incentives to their employees to get vaccinated? If you guys are doing that, would you build to touch on the magnitude of that one-off cost?

David A. Ciesinski

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

A

Sure. Well, why don't we – maybe there's two parts to the question. There's the what, and then, the how we're going to address it. And for the what, why don't I turn it over to Tom, and let Tom dimensionalize the COVID costs in the period. And then, maybe I'll talk briefly about how we're thinking about it on a go forward basis. So, Tom, I'll turn it over to you.

Thomas K. Pigott

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

A

Yes. Thanks, Dave. So, the components of the quarter, we had \$4 million in hero pay and another \$1 million in shift separation to the PPE. That's what we call the hard costs.

And that's really, you know I'll let Dave talk to the outlook on that. But those are – those are really specific COVID costs. And then we have another \$3 million of what we call our soft costs.

And the way to think about those costs, those are really costs we're incurring because the network wasn't necessarily set up for this mix shift. So we're having to run more, less efficient lines, more overtime to keep up with it, the demand shift that we had. And in there you know we've got increased overtime, unfavorable plant mix, transportation to move products around the network.

So those that's – so the total COVID impact is a, five hard, three soft. So I'll stop there and then let Dave share about, you know how we're thinking about the outlook.

David A. Ciesinski

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

A

Yeah. Thanks, Tom. So you guys are probably aware of this, so bear with me. The vaccine is being driven the strategy really in two tiers. First is the availability, which is a function of what's happening at the federal level and then each unique state is responsible for putting in place their implementation plan.

So as we think about our 16 factories that operate in nine states, it's likely to be somewhat different between you know what we see in California and what we might see in New Jersey and where we have an important co-packer or what we might see in Ohio.

What I can share with you is we had an opportunity to talk to the governor yesterday here in Ohio, Governor DeWine and he walked us through how he's thinking through his implementation plans and essentially, you know what he and his team are focused on are frontline healthcare workers in hospital settings and then moving to nursing homes where we had tragically a number of deaths, just given the concentration of an older population here within resident nursing homes.

So he's made it a priority to work through those. And now what he's starting to expand out to our other frontline workers and teachers and then work down just straight across the range age-related vaccines. So I think the plan was he indicated to expanded to people that are 65 and above, starting next week.

So if you think about our employee population, given that it tends to be younger and healthier, whether it's in the State of Ohio or in other states, our view is we're probably still a ways down the line in terms of when we can expect to see it.

What we have begun to do internally though is we early on in the pandemic engaged a pulmonologist and critical care physician and along with this physician, we've developed a series of education e-mails that we've been sending out to our employees to educate them about what is the vaccine, what are the side effects, why should we feel that it's safe for use et cetera, et cetera.

So we've begun that education process. And the second thing that we're in the process of doing is planning, how we can incentivize people to get the shot. And we're leaning towards creating a financial incentive of sorts for our employees rather than something that's punitive.

We feel much better about just a positive financial incentive for their safety and well-being. And we're working through that. And we'll probably be announcing something I would guess in the next 10 months to 12 months as we start to get line of sight to when we would expect to see the vaccine.

So if you sort of then come back, that brings me back to where I started and maybe in earlier comments that we think for all intents and purposes that we're going to have to be ready to deal with some of the challenging impacts of the pandemic without the vaccine through at least the third quarter and looking into the fourth quarter.

Ryan Blaze Bell

Analyst, Consumer Edge Research LLC

Q

Thanks. That was very helpful. And I think one last one for me, as you've commented on and as we've been seeing in the regional and state IRI data, the Chick-fil-A products are doing very well in retail. Can you speak about how this has helped, maybe facilitate conversations with other potential food service partnerships to bring products to retail?

David A. Ciesinski

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

A

Yeah. No, it's a great question and it's true. I think not only has the Chick-fil-A proposition catalyzed incremental conversations, but I would latter back to the fact that if you look at Olive Garden, which is a five plus year overnight success in the most recent period, it was up actually 61% which is eye popping for a very big business.

But I think you put the success of an Olive Garden proposition together with Buffalo Wild Wings and Chick-fil-A, what we're seeing is that, you know with passing days, more and more of our foodservice partners are reaching out just to have early discussions about the suitability [indiscernible] (00:22:26) of a license program.

And, you know what I'm particularly proud of in these cases is that these are not a zero-some game, that when we restructure these appropriately, it's a big win for our food service partners in terms of building branding and awareness.

It's also an important source of incremental revenue and they're seeing the traffic in their core business impacted. And obviously, it's a chance for us to grow, grow with them. So they're just a great proposition and, you know we're just trying to be deliberate as we get the calls, as we sit down in good faith with the new partners and just try to decide you know is it truly going to be a good long-term fit for everybody or not.

Ryan Blaze Bell

Analyst, Consumer Edge Research LLC

Q

Great. Thanks for the color. That's it for me.

David A. Ciesinski

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

A

Okay.

Thomas K. Pigott

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

A

Thank you.

David A. Ciesinski

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

A

Thank you.

Dale N. Ganobsik

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

A

Thanks, Ryan.

Operator: And your next question will come from Brian Holland from D.A. Davidson and Company. Your line is open.

Brian Holland

Analyst, D. A. Davidson & Co.

Q

Hello folks. Good morning, gentlemen.

David A. Ciesinski

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

Good morning.

A

Dale N. Ganobsik

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

Good morning, Brian. Good morning.

A

Brian Holland

Analyst, D. A. Davidson & Co.

So, just curious you provided some, a few metrics there on Chick-fil-A franchising repeat.

Q

David A. Ciesinski

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

Yeah.

A

Brian Holland

Analyst, D. A. Davidson & Co.

Just curious would you want to go that way or look at it from a velocity standpoint too? Can you give us any context for how Chick-fil-A is performing versus its relevant competitors in some of those markets where you serve maybe whether it's in top quartile or whatever...

Q

David A. Ciesinski

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

Sure.

A

Brian Holland

Analyst, D. A. Davidson & Co.

...versus your peers.

Q

David A. Ciesinski

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

Sure. No, happy to Brian. And well, maybe starting with our penetration and repeat rate this was early, so the most comprehensive source of data that we have is in Florida. But we look at that data, and it's performing at and ahead of our own Olive Garden business which has been sort of a benchmark that we've been tracking all along.

A

So that gives us comfort that it's most certainly in line with our expectations maybe with some room beyond that as well. But given that we're so early in this, we're a little bit hesitant to get out over our skis and really commit to more, right? Velocity is another way to look at it. And the velocity of the item has been really strong. It's been up there in the top of the condiments and sauces category that top quartile.

The only reason why we're a little bit hesitant on looking at just velocity is that there we want to be careful that we're not overestimating the novelty effect of this. If somebody buys it once, they love it [indiscernible] (00:25:07) they don't come back. Right? That's why we're looking at trial. We're looking at repeat and we're looking at velocity. But we can triangulate on all three of those metrics and it's all very favorable across the board.

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

Q

That's helpful thanks. And then if I could move to the Horse Cave facility. That sounds like that you'll make a substantial investment that's you know – that's something that's done for \$25 million of revenue or something like that. I'm wondering, what – I mean can you give us any perspective as to the revenue opportunity that could come out of that facility? And how you're thinking about this? I think you said it comes online in 2023. Is the expectation correct?

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

A

Yeah. So, first things first, essentially it's going to double the number of square footage, number of square feet that we have at that facility. Now, that's not the only facility. We're [ph] testing (00:26:02) the facility we have, but it's our largest, it's our [indiscernible] (00:26:10) and it's essentially going to double that.

What I would point to also, Ryan, is that, this particular build isn't just going to include bottling lines, but it's going to include kitchens and then capacity for both Foodservice and Retail.

If you remember, about a year ago, before the onset of the pandemic, we had announced plans for an expansion at Horse Cave, a little bit smaller project just to keep up with the growth of Chick-fil-A, right? Particularly kitchen capacity, and then, [indiscernible] (00:26:38) capacity. Those are the cups, if you go to the restaurant, you get Chick-fil-A sauce, the Polynesian sauce, one of the other ones. And so, that was in place. We backed away from that. Then we've re-scoped the project to include that plus bottling capacity.

So, it's a substantial investment. It's our biggest in terms of dollars that we've made. But I would prefer not to necessarily try to extrapolate for you, how far do the future is going to take us. We feel like it'll comfortably provide capacity based on our growth for probably the next four to five years.

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

Q

I appreciate the -

[indiscernible] (00:27:13)

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

A

...with the co-packers that we have in place.

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

Q

Understood. You mentioned meal kits Dave, briefly in your prepared remarks, forgive my ignorance but what are you doing there in that space?

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

A

It's a great question. So a number of the different meal kit companies have sauces for different protein builds. And the other thing that they're offering their salads of various sorts. And we've been working on both proprietary sauces for their protein builds, but also just proprietary or our own branded salad dressings for their meal kit.

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

Q

Got it. Last one for me. So, perhaps the widest divergence, I think of opinion between the CPG industry and the investment community is the subject of pricing, right? I believe the market is often skeptical, companies can sufficiently pass on higher cost when they need to pull that lever.

So as we watch the commodities market today and contemplate whether food can manage an inflationary basket against the backdrop really of anything we've ever seen, we'd love for you to give big picture perspective on how food companies like yourself are going to try to manage that maybe level of confidence that you can get it through, what you need.

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

A

Yeah. Well Brian, I would say for the industry, it's an execution imperative. If you look at it right now, I think we're in for a period of sustained inflation. It remains to be seen how strong that inflation is. But we're seeing it across our entire basket of commodities.

We're seeing in soybeans, we're seeing in wheat, we're seeing in the other segments as well. We've seen inflation in the transportation space and in packaging. And as you guys on the call can appreciate, there's been so much money pumped into the economy that we feel like it's just inevitable that we're going to see inflation, which brings me back to the fact that for us at Lancaster Colony and for that matter, for other peer companies, we're going to need to figure out how we can pull together the insights and justifiably and appropriately pass on these cost, because we need to.

I don't believe there's a path for us in the sector to cut costs to prosperity, you know cost discipline needs to be an important part of what we do but I think it becomes problematic if you can't at least just pass on the [ph] raw (00:29:41) inflation that you're seeing.

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

Q

Got it, that's it for me. Thank you.

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

A

Of course.

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

A

Thanks Brian.

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

A

Thanks Brian.

Operator: [Operator Instructions] Your next question comes from Todd Brooks from C.L. King & Associates. Your line is open.

Todd M. Brooks

Analyst, C.L. King & Associates, Inc.

Hey, good morning everybody. Congrats on the quarter.

Q

David A. Ciesinski

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

Thanks Todd.

A

Thomas K. Pigott

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

Good morning.

A

Dale N. Ganobsik

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

Good morning.

A

Todd M. Brooks

Analyst, C.L. King & Associates, Inc.

If we could maybe start on the gross margin side and the strong performance we saw in the quarter. You've highlighted a lot of different puts and takes. So you've talked about the inflationary sides of the business. We've had to mix change in real growth in retail, there's obviously the undertones of continued cost saves and your net price utilization gains. Can we walk through the puts and takes that drove the gross margin performance in the quarter?

Q

David A. Ciesinski

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

Well, of course. Tom, why don't I turn that over to you, and let you take that.

A

Thomas K. Pigott

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

Sure. So as I mentioned, the quarter exceeded our expectations and I think obviously the key driver for us as you compared to Q1's performances, we had stronger growth in the Retail segment and that really enabled us to drive better gross profit performance.

A

We also – I would say second on the list were the trade reductions that we did in the face of higher demand. We did latter back the trade spending and that helped margins, that helped the revenue growth in the retail segment as well as the margins.

Commodities and the cost savings programs weren't as big a driver this quarter. Certainly, we do expect commodity inflation to accelerate and as we get into post COVID environment, you could expect to see a bigger impact of our cost savings programs.

But and certainly the COVID costs I have outlined for you. So those were the key items, the things that we're keenly focused in on as Dave mentioned, we do expect going forward more commodity inflation, going forward. So we're certainly going to have to look at different ways to offset that as you get into the second half. And we've got a good effort in terms of identifying opportunities and then executing against them.

Todd M. Brooks

Analyst, C.L. King & Associates, Inc.

Q

That's great. That's helpful. Thank you. And then secondly with the growth that you're seeing with existing programs, I just wanted to spend a few minutes talking strategically about how you're managing that growth. Are there -- are there opportunities that you're not necessarily delaying but maybe not pursuing as aggressively either with additional Foodservice partners or maybe with some of the newer distribution channels like Drug & Dollar as you're managing the strong growth that you've got with the new product rollouts in retail.

David A. Ciesinski

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

A

Tom, I'll take maybe a first shot at that, it's a good question. As we've seen the strong demand and you know look at Olive Garden as a case in point, right? Mature business, great brand, seen 61% growth in consumption and sales in the period.

You know what that is forcing us to do obviously is continue to work hard just to make sure that we have available capacity. The way that we're managing that is by pulling back on trade promotions in various categories. As Tom mentioned in his comments, we also made the choice to pull back on some of our advertising that internally we felt that it didn't make sense to advertise the fire extinguishers when we're in the middle of a sale.

People are buying the fire extinguishers. We don't need to advertise them. And it's a compounding problem. The more we advertise those things and if we don't need service requirements for our customers, we incur penalties, right?

So, it's sort of a double way, I mean. So, we have churn sales in terms of promotion activities and marketing. Obviously, we mentioned in earlier calls how we're working with co-packers. And since we sort of round our way out of COVID and we see things start to normalize, we would expect to resume levels of marketing spend, put back in place profitable promotion strategies.

But one of the other things we can start to do is get more aggressive with just expansion into other channels, which we've just tapped the brakes on a little bit as well because we just didn't want to get ourselves in a situation where because of our own actions, we're driving service issues, disappointing our customers and incurring penalties and fines for that poor service.

Todd M. Brooks

Analyst, C.L. King & Associates, Inc.

Q

That's great. And then, a final question, if I may. If you think about the triers that a lot of your brands in retail saw during pantry loading, and then, just the elevated demand that we've seen during the pandemic, if you talk about -- okay, we'll point back on some trade promotions and advertising, but what does your data show as far as new to brand customers?

How were you able to activate them? How have they been from a repeat standpoint? And as we're thinking about lapping some of the tougher comparers during pantry load, how important are these new customers that you've been able to retain in being able to successfully lap that? Thank you.

David A. Ciesinski

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

A

Yeah. It's a great question. And what I will tell you is our retail team has narrowed their marketing focus on that problem specifically to take those new triers and to get them to try again and to try again. And so far, we've seen a fair amount of success doing that.

So we've taken and focused a lot on the tools in Retail that will allow us to do specifically that. And we're optimistic that we're going to be able to hang on to some of those – our consumers. What we're going to see and this is industry wide is sort of a maybe what's called a regression to the mean, where people begin to go back to their normal patterns in terms of that when they eat away from home and what they're eating at home.

And we know inevitably we're going to see the number of occasions in the home start to revert back to the mean. Our hope in that process is even though the number of occasions go down, we can hold on to a disproportionate share of those new trials on those occasion.

Todd M. Brooks

Analyst, C.L. King & Associates, Inc.

Q

Okay, great. [indiscernible] (00:36:14)

Thomas K. Pigott

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

A

Yeah. Just to add. Dave mentioned as we get further into the year, we do expect to restore spending in both the trade line and the consumer line to try to continue to maintain those customers in the fall.

Todd M. Brooks

Analyst, C.L. King & Associates, Inc.

Q

Okay. Great. And just final, when I look at the segment operating margins for the retail, north of 27% in the quarter, a tremendous result. Can we talk about how much has kind of mixed with the licensed products working in versus this lower promotional level that we're seeing? Because like you said, they're buying the fire extinguishers anyways.

David A. Ciesinski

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

A

Right. So Tom, I'd like you to take a shot on that.

Thomas K. Pigott

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

A

Sure. Yeah. So that mix was certainly the overall growth in the volume based performance was the key driver of that margin expansion. The trade spending was secondary to that. So those were your key items.

And as we said before, the licensing program which was a good part of the growth, the Retail segment achieved, those products are at or above the overall margins in the segment. So, that's going to be the key driver and as

we've progressed into the back half, as Dave mentioned, as we expand the Chick-fil-A sauce, we expect that to be – continue to be a tailwind for us as we start to hit the more difficult comps towards the end of Q3 and Q4.

Todd M. Brooks

Analyst, C.L. King & Associates, Inc.

Okay, great. Thank you all.

Q

David A. Ciesinski

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

Yes. And then may be just a point where hitting again as we think about sort of our outlook across Q3 and into Q4, as we begin to lap the impacts of COVID, that's going to create a natural headwind in our retail business. But at the same time that that's happening as you heard in my comments, we're shipping into Texas tomorrow, not tomorrow, but this week, excuse me. And then next week we're going to begin shipping into a handful of more states, I think it's 10 more states in the mid-Atlantic, Oklahoma, then sort of sweeping back towards the east.

A

We're going to stay in that posture until we build our distribution. And then around the beginning of the fourth quarter begin to expand through the remainder of the United States up to the northeast and the far west. It's those activities that we think as we lap the effects of COVID in retail, is going to allow us to continue to outperform.

Operator: I have no further questions in queue. I now turn the call over to Mr. Ciesinski for closing remarks.

David A. Ciesinski

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

All right, Michelle, thank you. And thank you everyone for participating this morning. We look forward to sharing our third quarter results with you in early May. Have a great rest of the day.

Operator: Thank you everyone. This will conclude today's conference call. You may now disconnect.

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