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Lancaster Colony Corp. (LANC)

Q4 2020 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning. My name is Megan, 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 Fourth Quarter Conference Call.

Conducting today's call will be Dave Ciesinski, President and CEO; and Tom Pigott, CFO. All lines have been placed on mute to prevent any background noise. After the speakers have completed their prepared remarks, there will be a question-and-answer period. [Operator Instructions] Thank you.

And now, to begin the conference call, here is Dale Ganobsik, Vice President of Investor Relations and Treasurer for Lancaster Colony Corporation.

Dale N. Ganobsik

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

Thank you, Megan. Good morning, everyone, and thank you for joining us today for Lancaster Colony's fiscal year 2020 fourth 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 fiscal 2021. At the conclusion of our prepared remarks, we'll be happy to respond to any questions you may have.

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 fourth quarter results for fiscal year 2020. I'd like to begin by extending a sincere thank you to the entire Lancaster Colony team for their tremendous effort during the past five months as we confronted the impact of the COVID-19 pandemic from the frontline workers at our plants and distribution centers to all the associates and leaders throughout our business.

I am extremely proud of how we pulled together and worked in common cause to meet the shifting demands of our business. From the onset of the coronavirus pandemic, we've remain steadfast that our mission is fixed, first, to provide for the health, safety, and welfare of our teammates; and second, to ensure that we continue to play our role in our country's vital food supply chain.

Despite all the uncertainty and obstacles that COVID-19 has imposed on our business, we completed fiscal year 2020 with record net sales of over $1.3 billion and record gross profit of $358 million. In our fiscal fourth quarter, excluding Omni Baking sales, consolidated net sales grew 70 basis points. Net sales in our Retail segment grew 24.5%, while our Foodservice segment's reported net sales declined 24.1%.

Retail net sales benefited from higher demand as the impacts of COVID-19 drove increased at-home food consumption. We were pleased to see that our recent new product introductions contributed about 4.5 percentage points to our Retail segment's Q4 sales growth. Notable contributors to growth included our single bottle offering of Buffalo Wild Wings sauces, and separately, Chick-fil-A sauces that we are selling in a regional pilot test in Florida. Both the Buffalo Wild Wings and Chick-fil-A sauces are being sold under exclusive license agreements. Following a strong third quarter, Retail sales trends remained robust in the fourth quarter for our New York Bakery frozen garlic bread, Sister Schubert's frozen dinner rolls and Olive Garden dressings.

In our Foodservice segment, excluding all Omni Baking sales, fourth quarter sales decline 22.2%. The Foodservice segment was adversely impacted by COVID-19, particularly, in the month of April but recovered notably in May and June, led by the quick-service restaurant customers within our national account base.

Despite the unfavorable influences of COVID-19, we grew our fourth quarter consolidated gross profit by $10.9 million or 13.9% to a fourth quarter record $89.1 million. The gross profit improvement was driven by the favorable sales mix, our cost-savings programs and improved net price realization in Retail. Notable offsets to gross profit attributed to COVID-19 included much deserved wage rate increases for our frontline employees and, in keeping with our top priority, investments to promote safe operations at all of our facilities.

I'll now turn the call over to Tom Pigott, our CFO, for his commentary on our Q4 financial results.

Thomas K. Pigott

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

Thanks, Dave. Overall, the quarter's results exceeded our expectations. After a challenging April, the business recovered strongly. The performance was reflective of the many actions taken by our employees to address the impacts of the COVID-19 outbreak and the focus they maintained on our key objectives.

Fourth quarter consolidated net sales decreased 90 basis points to $320.9 million. Excluding Omni Baking sales of $2.8 million in the current-year quarter and $7.7 million in the prior-year quarter, consolidated net sales increased by 70 basis points. As you recall, Omni Baking sales are attributed to a temporary supply agreement. These sales will continue to decline as the supply agreement comes to an end during our fiscal second quarter.

Consolidated gross profit increased $10.9 million, or 13.9% to $89.1 million, and gross margins grew by 360 basis points. The increase was driven by the strong revenue growth in the Retail segment, our cost-savings programs, improved net price realization in Retail, and lower commodity costs. These favorable impacts were partially offset by the COVID-19 related items including nearly $3 million in incremental frontline worker pay as well as other costing to ensure the safe operation of our facilities.

Selling, general and administrative expenses increased $8.9 million, or 22%. There were two major drivers behind the increase. First was the investment we're making in our ERP program entitled Project Ascent which accounted for $3.8 million of the increase. The second main driver was a $3.2 million write-off of previously capitalized engineering costs related to our decision to cancel the Horse Cave expansion project.

As we discussed in our Q3 call, we elected to cancel this project and reassess our longer-term capacity needs given the rapid change in demand we are seeing. Note that the expansion project with a different design remains a strong possibility for the future and we'll have more to share on these plans in an upcoming call.

Consolidated operating income declined $3.1 million versus the prior year to $40.2 million. It's important to note that the prior results included a $7.4 million favorable adjustment to contingent consideration, and the current year results include the incremental $3.8 million in the ERP expenses and the COVID-19 items mentioned above. Key drivers of the strong operating income growth, excluding these items, include the top line performance, favorable mix and cost-savings programs.

Our effective tax rate was 24.6% this quarter versus a tax rate of 25.4% in the fourth quarter of fiscal 2019. We estimate our tax rate for fiscal 2021 to be 24%. Fourth quarter diluted earnings per share decreased $0.10 to $1.10. Increased expenditures for Project Ascent accounted for $0.10 of the decline. The prior year fourth quarter benefited from a change in contingent consideration which totaled $0.21 per share.

With regards to capital expenditures, our fiscal 2021 payments for property additions totaled $82.6 million. Our investment in fiscal 2020 included expenditures for our frozen dinner roll capacity expansion project and the purchase of the Omni Baking facility that was previously leased. Looking forward to fiscal year 2021, we are forecasting total capital expenditures between $65 million and $85 million based on plans currently in place. We're in the process of evaluating additional and potentially significant investments to meet the rapid growth in demand for our products. These projects will be additive to this forecast. We'll provide you with future updates on our plants once they are more fully developed.

In addition to investing in the business, we also returned funds to shareholders. Our quarterly cash dividend paid on June 30 was $0.70 per share, an 8% increase from the prior year amount. Our longstanding streak of annual dividend increases reached 57 years this past December. Despite the higher level investments and increased dividend payments, our financial position remains very strong as we finished the quarter debt free with $198 million cash on the balance sheet.

So, to wrap up my commentary, this quarter featured strong underlying performance highlighted by increased consumer demand for our Retail products and improving sales trends in our Foodservice segment. The business continues to monitor and adjust to the impacts of the COVID-19 outbreak on investing for longer term growth.

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 to fiscal year 2021, sales for both our Retail and Foodservice segments will remain subject to the shifts in demand resulting from COVID-19. The extent and duration of the pandemic-related impacts are unpredictable and contingent upon the future spread of the virus and the resulting effects on consumer behavior.

That said, we anticipate continued top-line growth in the Retail segment from shelf-stable dressings and sauces sold under license agreements, most notably Chick-fil-A sauces, Buffalo Wild Wings sauces and Olive Garden dressing. In Foodservice, the heavier mix of our business towards quick-service restaurants which represents over 60% of our Foodservice segment's total sales will remain a positive in the current environment.

On the commodity front, we're projecting a moderate rise in the coming year following a favorable year in fiscal 2020. We expect that our cost-savings programs and favorable net price realization will help offset commodity cost inflation. With respect to our ERP initiative Project Ascent, we recently completed the design and build phase as planned and are now into the test phase.

We expect to finish the test phase near the end of fiscal 2021 followed by the deployment phase. Strategically, as we look ahead to fiscal 2021, we 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.

Number one, to accelerate our base business growth; number two, to simplify our supply chain to reduce our cost and grow our margins; and number three, to identify and execute complementary M&A to grow our core.

Before opening up the call to questions, I'd like to take a few moments now to share with you some information regarding discrete actions that we, in keeping with our vision to be the better food company, have underway here at Lancaster Colony to do our part to eradicate racism and commit to diversity, inclusion and belonging, both in the workplace and in the communities where we operate.

First, we established a new position within the organization, Vice President of Corporate Affairs and Government Relations to provide leadership in developing and executing plans to drive our companies' engagement in state and local government, corporate citizenship, social responsibility and sustainability initiatives. I'm pleased to announce the hiring of Clarence Mingo to this position effective August 17. Clarence's role will also include oversight of our diversity and inclusion programs.

Second, I'm happy to share that Lancaster Colony has formally adopted a diversity hiring statement otherwise known as the Rooney Rule which reinforces our commitment to including highly qualified women and minority candidates as well as highly qualified candidates with other diverse backgrounds, skills and experiences in the pool of candidates we consider for new leadership positions.

Third, I'm excited to announce that we've entered into a partnership with Cristo Rey High School here in Columbus, Ohio. Cristo Rey provides a work-study model of education for students from low-income families whereby corporate partners provide tuition support and work-study mentorship for their students. Cristo Rey High School was established in 2013, and has been nourishing the growth of students and sponsors alike since its inception.

Finally, in support of our team members here at Lancaster Colony, we will be establishing an employee relief fund. The purpose of this program will be to assist our employees that encounter tragic life events that result in financial hardship. While the company plans to make an annual contribution to this fund, our employees will also have the opportunity to support the fund through their personal donations.

In closing, I would again like to thank the entire team here at Lancaster Colony for all they have done to help make fiscal 2020 a success despite all of the unprecedented challenges. I would also like to thank our shareholders and other stakeholders, including our customers and suppliers for their ongoing support. We look forward to partnering with them to pursue the opportunities that lie ahead in fiscal 2021 and beyond.

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

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Our first question is from Brian Holland with D.A. Davidson & Co. Your line is open.

Brian Holland
Analyst, D.A. Davidson Companies

Q

Thanks. Good morning and congratulations.

Thomas K. Pigott
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

Hey, Brian. Good morning.

Brian Holland
Analyst, D.A. Davidson Companies

Q

So quickly on Foodservice to start, down 24% in 4Q. Can you provide some context around how those trends progressed through the quarter and maybe where that segment is sort of trending today?

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

A

Yeah. That's a great question. So Brian, if you look at April across all the away from home dining, April was a very, very tough month. If you look across all segments QSR mid-scale casual dining, it was probably down 40%. As May and June progressed, it improved notably. Probably coming out of June, we were looking at transaction

volumes from NPD crest that were down somewhere in the order of, let's say, 12%. As we've continued to march through the remainder of June and into July and early August, what we're seeing now is transaction volume again from NPD crest is running probably down around 10%.

Now, if you layer onto that, that transactions, it doesn't include the size of the check. What we're looking at is sales are slightly better than that. And there are some customers, notably Pizza QSR, Chick-fil-A and a handful of others that are actually posting positive comps and, in some cases, record sales. So that was sort of the continuum. Started very, very low in April and then rebounded nicely thereafter. But we're still pacing on the transaction level down, let's say, somewhere in the single digits – the high-single digits.

Brian Holland
Analyst, D.A. Davidson Companies

Q

Okay. So down high single-digits dollars, maybe slightly better than that, and then if I'm thinking about your business, one of the key things that I think has been clear and evidenced today is you've got more favorable exposure than if you look at the broader Foodservice landscape given the QSR mix...

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

A

Yeah.

Brian Holland
Analyst, D.A. Davidson Companies

Q

...and more notably the national chain. So fair to assume that you're trending maybe even a little bit better than what you're just referring to from an industry level?

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

A

Maybe ever, slightly better than that. I think the stats that I gave you also provide for the fact that QSR is just over development within Foodservice at large, and that [indiscernible] (00:17:07) lot of that benefit.

Brian Holland
Analyst, D.A. Davidson Companies

Q

Okay. Perfect. Appreciate the color. On the Retail side, I think you mentioned 4.5% contribution from new products.

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

A

Yeah.

Brian Holland
Analyst, D.A. Davidson Companies

Q

I just want to be clear because you have myriad of new products coming to market and channel expansion initiatives, et cetera. So does that comment refer specifically to the licensed products, most notably Buffalo Wild Wings and Chick-fil-A or are there other contributors to that mix that you're referencing?

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

A

It's the ones you've mentioned, Buffalo Wild Wings, it's Chick-fil-A sauce, and then smaller contributions from this great item we launched called BIBIBOP and some of our own items like Tastefully Dressed. Maybe what I'll do is even then kind of step back and provide just a little broader context on the Retail segment. So over the same period of time, as we saw the Foodservice segment really back off in April, obviously, we saw Retail really recognize a spike. We enjoyed that spike as well.

Now, as you sort of proceed forward, what we're seeing now from the multi-outlet data for all food categories in IRI. And so again all food, this would include Retail plus mass merchants, et cetera, et cetera. What we're seeing is food these days is running plus about 10%, maybe 11%. And given the categories that we're playing in, we're performing better than that and you saw that in our scanner data. I don't have to necessarily take you through that.

As we look forward, one of the great questions that we're trying to sort of predict and so our peers in the industry is when and how does the industry begin to revert to something that's a little bit more in keeping with traditional norms, i.e., Retail backs off a little bit; Foodservice picks up a little bit. What we expect is the strength of our new items, particularly, behind Chick-fil-A sauces, BWW, and honestly just continued organic growth of Olive Garden is going to continue to give us a nice tailwind as we look out across the next year.

Brian Holland
Analyst, D.A. Davidson Companies

Q

Okay. Yeah. I appreciate that. The last one for me and then I'll hop back in the queue, just kind of big picture here because there's been a lot of conversation in the market around Chick-fil-A and Buffalo Wild Wings, in particular. I know there are other items there. The context that's always out there is Olive Garden is $100-million brand which I think progressed over a period of about eight years. And folks are wondering the pace at which you can maybe replicate that as you talked that in both of these brands have potential to be as big or bigger than Olive Garden given the category characteristics, the brand awareness, et cetera. So can you just kind of walk through the puts and takes behind, specifically, the pace at which you think these can go or continue to build using maybe that $100 million marker, reasons that it would happen faster or materially faster or at about the same pace as Olive Garden?

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

A

Sure. It's a great question. And you're exactly right, maybe just building on Olive Garden, it was $100 million business. It's actually bit larger than now with the benefits of COVID. We're finding that we're continuing to capture new users and that business is growing very nicely, strong double-digits.

Now, to the second and more important question that you had on the table around Chick-fil-A sauce and Buffalo Wild Wings, absolutely, everything that we've seen in our fiscal fourth quarter and today the first quarter, continue to affirm our belief that both of those items have the potential to be at least as big and quite possibly bigger than Olive Garden. And the timing will likely be faster.

I don't know if I would necessarily project. I would tell you that we've been in the Olive Garden space about seven years. It started first in club then it moved into Retail, expanded through Retail, and now we're taking it into some of the dollar channels and drug channels and places like that. I think what you can expect is now that we understand the opportunity more completely, we're going to look to capitalize on that growth more quickly.

I think the other thing that's played out is that it's really twofold. One, Foodservice operators are seeing the power of their brands in Retail to generate another source of revenue. But the other is our Retail partners are seeing the strength and the relevance that these brands have and the way that they move off the shelf. Brian, I know you're big into data and one of the points that I would point to is if you look at the velocity on those items, they're considerably – all of them are considerably higher than the other items in the category which gives us a lot of optimism about the potential if we can execute on it.

Brian Holland
Analyst, D.A. Davidson Companies

Q

Thanks. Appreciate it. Best of luck.

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

A

Thanks, Brian.

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

A

Thank you, Brian.

Operator: Your next question is from Ryan Bell with Consumer Edge Research. Your line is open.

Ryan Blaze Bell
Analyst, Consumer Edge Research LLC

Q

Morning, everyone.

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

A

Hi, Ryan.

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

A

Good morning, Ryan.

Ryan Blaze Bell
Analyst, Consumer Edge Research LLC

Q

I appreciate that there are a lot of moving parts right now but could you speak a bit more about your fiscal 2021 outlook? What your expectations would be for the Retail business, the cadence of the Foodservice recovery? And then could you highlight in a little bit more detail some of the negative commodity pressures that you're expecting?

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

A

So why don't I take the first part and I'll then give it to Tom for the second part on the commodity outlook. So, Ryan, in keeping with our tradition, we don't provide guidance but maybe what I'll share with you is just anecdotally some of what we're seeing right now. I know you're tracking the same scanner data or a lot of the

same scanner data that we are. And you'll note that multi-outlet for all food is running around plus 10%. It's been running there for quite some time. Well, it's a little bit higher, it sort of moderated into about 10%. We've been running stronger than that. And our view is as long as we continue to see the COVID outlook the way it is, with people continuing to eat more at home, we continue to see those trends that we've seen today to continue.

The big thing that we just quite simply can't predict is when do we start to see something like a therapeutic or a vaccine that allows people to return to the workplace more aggressively, return to eating out more aggressively and do we begin to see the Retail trends start to moderate. Our belief is, though, as they do start to moderate, just given the strength of the new items and the size of the opportunity of those new items, it's going to continue to provide us a very nice tailwind for top line growth in Retail.

Now maybe I'll turn it over to Tom and...

[Multiple Speaker](00:23:56)

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

A

Sure. Yeah. Yeah. So a little bit about that margin outlook. So Q4 that certainly benefited from the mix shift to Retail, which was a key driver of that margin growth we experienced. And certainly, the outlook, a lot depends on how long that growth continues in the Retail segment. Certainly, we feel really good about the new product pipeline we've got and some of the spending we're doing to try to convert some of the new users to repeat users.

In terms of the headwinds, we do expect commodities to be more inflationary. We see it in oil, a little bit in sweeteners based on kind of some of the hedging positions we took previously where we did not feel a lot of the unfavorability that other companies felt in last fiscal year. As that coverage wears off, we do expect higher costs there.

That said, we do have some cost-savings programs and revenue management initiatives to help offset the impact of those commodities. And then going forward, the other piece I'll mention is we do expect to have some higher COVID-19-related expenses continuing into this fiscal year.

Ryan Blaze Bell
Analyst, Consumer Edge Research LLC

Q

Thanks for the color. And maybe drilling a little bit more into the Foodservice business. We've seen better recovery of QSRs. You seem to be exposed pretty heavily to the QSRs business. Can you talk about the percentage of your sales in the Foodservice business that come from QSRs and maybe what the margin differences might be between the QSR portion of your business and the other parts that might be recovering a little bit slower?

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

A

Sure. Well, why don't we just talk about the Foodservice business in general and the trend. So if you look at our Foodservice segment, which coming into this period was roughly half of the business, 60% of that is in QSR and that would include traditional QSR as well as pizza QSR and most of those concepts are performing quite well, some of which are posting record numbers. The pizza QSR chains, a lot of them are, as well as folks like Chick-fil-A. That really is a significant sort of benefit for our Foodservice business.

As we look at the other pieces, there's about 20% of our – let me back up there. So about another 15% of our business that's in other national accounts, which would include mid-scale and casual dining. Casual dining actually is rebounding pretty nicely as well. As you look at folks like Buffalo Wild Wings and a range of others, they're also performing quite well under the circumstances. And really, it's an amazing testament to the leaders in those organization and the managers that run their local sites that they're figuring out how to operate and deliver food or to provide pick-up and to do it in a way where they can keep their businesses not just floating but in many cases now growing.

Now, there's a smaller portion of our business that's probably somewhere in the 20% range that we would sort of categorize as branded. That tends to be schools, universities, noncommercial stuff like that, that's a part of the business that honestly just has not really began to recover. And then the last piece is industrial where we're selling products to likely other food manufacturers in the industry and that's remained quite robust.

So there's 80% of our business in probably simply said, maybe even little higher, 85%, that's doing very, very well. There's 15% that's not, but you put that together, it continues to again leave us relatively bullish about even Foodservice. We're going to continue to see headwinds, but not nearly at the rate that we did back in in April or even early May.

Ryan Blaze Bell
Analyst, Consumer Edge Research LLC

Q

Thanks. That's very helpful. And on that sort of branded portion, the smaller part, is there any way you could give a little bit of detail about the magnitude of the declines we're still seeing? I think that's the part that we would have a little bit less visibility from other data that's out in the market.

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

A

Yeah. They're still up double digits, I would say probably somewhere in the 20% range. And the big X factor is when and if do schools begin to open, how do those mom-and-pop operators begin to be affected. But, Brian, I'll share with you what we're also seeing anecdotally which is interesting. As those mom-and-pop operators are affected and in some cases struggling to open, what we're finding is that their demand is actually flowing back out to national chains.

One of the hypotheses that we have as we're digging into the data is that just as we're seeing in Retail as consumers go back to trusted brands, we're finding that a lot of away-from-home diners, if in the event their neighborhood place is struggling to stay open, are going back to bigger chains. And as a consequence, we're seeing that as a tailwind into places like Olive Garden, Buffalo Wild Wings, Applebee's and a range of others. So as you look at that, I would maybe caution you against looking at that segment as static. And what you're likely to see is that the demand is somewhat fungible and it's moving back into chains.

Ryan Blaze Bell
Analyst, Consumer Edge Research LLC

Q

Thanks. I appreciate the color on the Foodservice business. That's it for me.

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

A

Okay. Thank you.

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

A

Thank you, Brian.

Operator: Your next question is from Todd Brooks with C.L. King & Associates. Your line is open.

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

Q

Hey. Good morning, guys. Congratulations on the quarter.

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

A

Thank you, Todd.

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

A

Thank you, Todd.

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

Q

A few questions for you. First of all, if you can talk about gross margin performance in the quarter which was well above our expectations, and I know there's a mix element to that with Retail versus Foodservice. But, at the same time, I guess I would have expected friction in the quarter as you were balancing production between the rising Retail business and maybe the temporarily impaired Foodservice business and just trying to service that spike in Retail.

If we can talk about what's the right way to think about Lancaster's gross margin potential in fiscal 2021 as we're not dealing with that sort of friction as mix, and we have to make an assumption for how it normalizes between Retail and Foodservice. But then, you also just structurally keep delivering cost savings. And I just want to understand really where you think have we taken a step up in the gross margin potential for this business?

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

A

Yeah. Hi. So this is Tom. Excellent question. So you mentioned the – we talked about unabsorbed overheads in our Q3 call. And certainly, at that point, we were seeing outsized demand reductions in Foodservice. And in the month of April, we felt that. It was an item in April. But then as the Foodservice business began to recover and then Foodservice and Retail, revenue growth remains strong. That friction kind of went away towards the end of the quarter. And we don't really see the unabsorbed overheads being an item going into our next fiscal year.

So then, the key items to look at really as you project this out into fiscal 2021, it's really how the Retail growth because of the margin differential between Retail and Foodservice is a key driver. And then in terms of cost-savings initiatives, yeah, the teams have done an outstanding job, in that, we expect that to continue at consistent levels into the next fiscal year.

Commodities, as I mentioned, do become more inflationary. But we are certainly focused on offsetting that with revenue management. So, overall, we feel very good about our margin prospects going forward, really driven by the Retail revenue growth and the new items Dave mentioned.

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

Q

That's great. That's great. Secondly, I mean, on the Retail category more broadly, you talked about restaurant partners wanting to develop alternate revenue streams and that that desire is maybe magnified out of the pandemic. You did add the insight during the call today that retailers want these products as well. The philosophy is better. The brands to some extent promote themselves with customer awareness.

Can you talk about your pipeline from a development standpoint? Are you seeing either existing kind of Foodservice partners coming to you to build a Retail type of offering, or potentially are you seeing outside customers that you're not doing business with now kind of recognizing the expertise that Lancaster has developed in bringing these products to market and expectations for this growth engine going forward?

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

A

I guess the short answer is yes and yes. We are seeing both new concepts that have reached out to us over the course of the last quarter to express interest and looking at opportunities. But then as we look closer in, just at the brands that we have these partnerships with, you can think of them as being able to grow, sort of, laterally and vertically. Laterally, the opportunity exists for us to move in to other channels of trade, and then beyond that, vertically, to introduce new flavors.

And one of the things that's exciting, particularly, about Buffalo Wild Wings and Chick-fil-A sauce is just the range of different flavors that they can play in. And as you think about it, it allows us to move into different occasions.

So yeah, it's an exciting time. And to your point, I think, a fair amount of credit for this goes to the team at Darden Restaurants that saw this opportunity early on and was willing to lean forward and take a chance that it wasn't going to cannibalize their business. And they were open-minded and we partnered together. We agreed on the data that we wanted to look at to make sure that it was beneficial to all of their business, both their restaurant business and their – and then this opportunity in Retail, and it played out. And I think as its continued to play out and the restaurants have benefited and the company at large has, it's given other operators out there more confidence to play in the space.

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

Q

Okay, great. And then two more quick ones for me, one, you talked about moving into the testing phase for Project Ascent. Is there any color you can give us on what the costs during this kind of year-long fares for fiscal 2021 should like for ERP?

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

A

Sure. So, maybe I'll start and just give you a couple of overview comments, and I'll turn it over to Tom and he can give you maybe a little bit more info about the financial outlook. First, what I would tell you, it's – great credit is due to this team and to our integration partner, Capgemini because as you might expect, they've had to go back to the drawing board and figure out how do you do an ERP design and build in the throes of a pandemic, right.

Ordinarily, these people would be clustered very closely together partnering within functional verticals in our business, designing the functionality and traveling regularly to our site to make sure that they were ready to take on this technology.

They had to step back and figure out how to do this work safely without being able to travel extensively or work very, very closely and they've done exactly that. So during the course of this past year in the throes of everything else, we did complete the design, we did complete the build, and now we've moved into the testing.

And you can expect to see us take a couple of small pieces of the business that aren't related to the core that won't jeopardize the operations of the core life during the fiscal year itself. They're going to provide us a bit of a test blueprint to see how the company at large handles it, and then our plan is to go live on the system whole and order to cash very closely after the beginning of the next fiscal year. But I really wanted to just say that the team deserves a great amount of credit for figuring out how to do this remotely. And they're doing that same thing on testing now.

Now, Tom, as far as the pacing of the spend, maybe I'll let you speak to that.

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

A

So as you look at Q4, the gross spend was a little over $9 million. A portion of that was capitalized and $5.5 million hit the P&L. As you go into the next fiscal year, what we capitalized is the design of the system. And with the design work being done, we won't be capitalizing as much. The spend will go up slightly. So you'll see a bigger – a slightly higher P&L charge going into the next fiscal year on ERP as we've completed the design phase, and we're moving towards implementation.

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

Q

Okay. Great. That's helpful. Thank you. And then the final question and this is maybe just so we can maybe expectations that as we look out the fiscal 2021, the obvious success of the pilot of the Chick-fil-A sauce is in the Florida market. Can we talk about how that program goes from here as far as regional rollouts, national timing? But then also you've talked about broadly touching more categories. You talked about launching in more points of distribution than the initial launch of Olive Garden. So as we're starting to think about how meaningful this business can be kind of fiscal 2021, fiscal 2022, any way that you can kind of maybe help rightsize us on our expectation for this launch would be great. Thank you.

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

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So, first, I'll just talk about sort of the pacing of how we're going to go to market and maybe help you think about dimensionalizing it. So, next month, we're going to begin a national rollout of a catering bottle that they're going to have in their restaurants. And a lot of the restaurants today they have tubs, in some locations, they have bottles. In partnership with them, we're converting their takeaway business, their catering or offsite business to bottles. That's an initiative that they're very excited about.

And towards the end of October, we're going to begin the first rollout in regions in the southeast. And then on the heels of that, about eight weeks later, what you can expect to see is that we're going to take a bigger swath of the southeast and roll it out there with our Retail partners. And then after the beginning of the calendar year, we're

going to take it out across another swath of the United States, so that by the end of the fiscal year, we'll have it in full national distribution across all of Retail.

So it's going to be a relatively fast ramp-up given what we are doing to make the comparison with Olive Garden. We were in club for probably the first two to three years with Olive Garden before we went into Retail, at least two years before we went into Retail. So we're going to be going after the bigger opportunity here which is Retail considerably faster and then looking at club and other points of distribution thereafter.

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

Q

Okay. Great. Thanks for the color, and Congratulations again.

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

A

Thank you.

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

A

Thank you.

Operator: There are no further questions, we will now turn the call back to Mr. Ciesinski for closing comment.

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

Thank you, Megan and thank you everyone for participating this morning. We look forward to sharing our first quarter results with you in early November.

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