Final Transcript

Customer: J & J Snack Foods
Call Title: First Quarter Earnings
Confirmation Number: 48142303
Host: Dennis Moore
Date: January 29, 2019
Time/Time Zone: 9:00 am Central Time

SPEAKERS

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Jerry Law – SVP
Dennis Moore – SVP of Finance and Administration
Robert Radano – Chief Operating Officer
Robert Pape – SVP of Sales
Marjorie Shreiber Roshkoff – Legal
Daniel Fachner – President of ICEE Company

ANALYSTS

Michael Gallo – C.L. King & Associates
Brian Holland – Alliance Bernstein
Jon Andersen – William Blair & Company
Akshay Jagdale - Jefferies
Brian Rafn - Morgan Dempsey Capital Management

PRESENTATION

Operator: Welcome to the J & J Snack Foods First [ph] Quarter Earnings Conference Call. My name is James, I will be your operator for today's call. At this time all participants are in a listen-only mode. Later, we will conduct a question and answer session. [Operator Instructions]. Also note the conference is being recorded.

I'd now turn the call over to Mr. Gerry Shreiber. Gerry, you may begin.

Gerry Shreiber: Thank you. And welcome everybody. I know you're from all over the country, but it's really cold here, but this is not a contest and what's the coldest or what's the warmest. So let me begin with an obligatory statement.

The forward-looking statements contained herein are subject to certain risks and uncertainties that could cause actual results to differ materially from those projected in the forward-looking statements. You are cautioned not to place undue reliance on these forward-looking statements which reflect management's analysis, only as of the date hereof. We undertake no obligation to publicly revise or update these forward-looking statements to reflect events or circumstances that arise after the date hereof.

I'm Gerry Shreiber. I will lead this conference call from my end, but with me today is Jerry Law, our Senior Vice President and my assistant; Dennis Moore, Senior Vice President in charge of Finance and Administration; Bob Radano, our COO; Bob Pape, our Senior Vice President in charge of Sales; and Marjorie Shreiber Roshkoff, who is in charge of legal.

So let me begin. Results of operations, net sales increased 2% for the quarter. Our EBITDA, earnings before interest, taxes, depreciation and amortization, for the past 12 months was $164.3 million. Food Service, sales to Food Service customers increased 3% for the quarter. Our sales increase was due to increased sales of frozen juice bars and ices up 5%, Churros up 4%, Funnel Cake up 3% and bakery sales up 8%. Sales of soft pretzels were essentially flat and handheld sales were down.

Retail supermarkets, which is grocery, sales of product to retail supermarkets were up 1% for the quarter. Soft pretzel sales were down 3% for the quarter, and sales of frozen juice bars and Italian ices were up 13%. Handheld sales were down 15% for the quarter.

Icy and frozen beverages, which includes ICEE and Arctic Blast and Slush Puppie. Frozen beverage and related product sales were up 1% in the quarter. Beverage related sales were down 5% in the quarter compared to being up 21% in the year ago quarter. Service revenue for others was up 4% as this category for us continues to grow quarter after quarter.

Machine sales, that's the beverage machines, were $7.7 million, up from $6.3 million last year. No significant reason for that, but that is a harbinger of what will happen in the future having the machines sales as a tendency to increase beverage sales.

Consolidated gross profit as a percentage of sales was 28.3% in the three month period this year, up from 27.6% last year. Gross profit increased because of improved operations in several of our manufacturing facilities especially at our Labriola production facilities. And because last year we had the burden of shutting down an older plant in Chambersburg, PA, and moving its production to other facilities where it is more efficient.

Operating income in our foodservice segment increased to $18,461,000 from $17,054,000 [ph] in the quarter. And for these reasons and higher bakery sales even though distribution expenses continued to be a burden, there were about $2 million as a percentage of sales. And we continue to be impacted by a recall in our biscuit business a year ago in January.

Total operating expense as a percentage of sales was 20.2% in the quarter up from last year's 19.6%. The increase was due primarily to higher distribution costs.

Capital spending and cash flow. Our cash and investment securities balance of $288 million is up $12 million from our September year end. We continue to look for acquisitions as a use of our cash. A $143 million of our investments are in corporate bonds with a purchase price yield to maturity of 2.6%. Our capital spending was $12 million in the quarter as we continue to invest in plant efficiencies and growing our business. We estimate our spending for the year to be about $55 million to $60 million as several onetime manufacturing projects are in progress and turning towards home for completion.

A cash dividend of $0.50 a share was declared by our Board of Directors and paid on January the 4th. This was an 11.1% increase to the dividend. We did not buyback any shares of our stock during the quarter.

Commentary. Our overall sales increase of 2% in this quarter was largely from the 8% sales increase in our food service bakery business. We are expecting to improve upon this as the year moves along. Although operating income in our retail supermarkets and frozen beverage segments were down from a year ago, against very strong comparison numbers from a year ago, we are pleased our overall operating income has increased this year especially considering sharply higher distribution expense. And as I mentioned, significant manufacturing improvements and higher pricing benefited this quarter and will likely affect the rest of the year too in a positive way.

Our investment income this year was $449,000 less than last year because in accordance with new accounting regulations we recognize over $1 million unrealized investment losses this quarter, about half of these losses have reversed already in January. Because of the various adjustments due to income tax changes we have income tax expenses of $5.6 million this year compared to a $13 million benefit last year. We anticipate an effective tax rate of 28% going forward.

I want to thank you for your continued interest and now I'll turn it back to your end for questions and comments.

Operator: [Operator instructions]. And our first question is from Michael Gallo.

Gerry Shreiber: Good morning Michael.

Michael Gallo: Hi, good morning. Couple of questions, Gerry, would seem this is the first quarter you really started to see some meaningful price realization. Looks like it was up 1.7% and Food Service little better than that in the retail. As I recall, pricing kind of went in as the quarter progressed. So I guess as we think about pricing one, how much do you expect that to be stronger Q2, 3 and 4, versus Q1? And would seem so far it's generally being fairly well received?

Gerry Schreiber: Well, let's just say that we're getting it through. We have good relationships with our customers both in the Food Service and grocery business, but, and I might have mentioned this before, it's always a process to take pricing. But we seem to be, with very, very few exceptions, we seem to be doing okay with that.

Michael Gallo: Great. Gerry, logistics cost still pretty big headwind? I think couple of million dollar headwind year-over-year. There is been some anecdotal signs that perhaps they should start to level off going forward. I was wondering as we think about the rest of fiscal '19, it will start to lap obviously the big increase. And do you see a continuing increase do you see it continue to increase but at a lower rate, or do you see signs that as we kind of go through this year that we could finally see start to see some leveling off? And then from your own logistics cost standpoint as you move things around, you think you could start to see a better impact from mitigation strategies?

Gerry Schreiber: We believe that the worst is over. And with very, very few exceptions there may be some future adjustments, but the worst is over.

Michael Gallo: Great. Thank you. I'll pass the floor.

Gerry Shreiber: Sure.

Operator: Next question is from Brian Holland.

Brian Holland: Thanks, good morning. First question on maybe the topline. Just curious if you could kind of give us an overview of what the pipeline looks like, not just only for new product rollouts in 2019, but also on the M&A, which as you've lapped other acquisitions, you don't have a catalyst in place right now. So just curious about the pipeline on M&A, the new products especially on the retail side, I know you're lapping a few things with Auntie Anne's. And then on the Sour Patch Kids novelty. So just curious how we follow up what was really nice contribution in 2018?

Gerry Shreiber: Well that's true how you just outlined it. We are also doing very well in the fast food and casual dining segment of our business. And as I mentioned before, that was a blank slate for us about six years ago and it quickly went to $40 million $50 million and then we backed off a little bit as it dropped. But we have reason to be excited as we have a couple of new products gone into new and existing chains in there. And we've gotten we've been through the R&D and approval process and we'll have these two major chains will be realizing these sales from this second quarter onwards.

Brian Holland: And then just on the M&A front, what are you seeing out there as far as a pipeline for assets? So there are a lot of assets out there, how do multiples look relative to sort of where your historical discipline has been?

Gerry Shreiber: Well we're always looking. And when we do execute we integrate real quick and make sure that we have everything in place. And we're still looking. And we have a slight war chest in there. But for some reason or other everything that we looked at we have decided against or it's on a hold. And

I don't want to make—and even though we have a war chest for acquisitions and we're always looking, I don't want to bring in things if that are going to not have benefit.

Brian Holland: Of course, understood. Last question for me just on the margin side, obviously nice margin reflection in the quarter. Mike asked about some of the logistics possibilities that could add to the tailwind as we go over the balance of the year. Obviously the acquired facility last year seems to be sort of running as you liked it to, or at least closer to that. The other projects you had going on or is that I understand you had in place as far as planned automation, SKU rationalization across the broader footprint. Any update or color you can give us with respect to how you expect those to come along and potentially further benefit gross margin over the balance of '19?

Gerry Shreiber: Sure. Jerry Law sitting right next to me here and Jerry is my guy for all these operations and for our guy, but we still expect to get margin improvements in some of these projects and Jerry why don't you comment on the Churro line that just got done in there?

Jerry Law: Yes. We're through the big lines starting up and we continue to have a pipeline of projects to offset labor pressure that we're having an increase or yields and throughout the year we'll continue to see those come on line.

Brian Holland: Thanks. Appreciate it. Best of luck.

Operator: Next question will be from Jon Andersen.

Jon Andersen: Good morning everybody. You guys are not horsing around, you have a lot to crow about here.

Gerry Shreiber: You're right, we're not horsing around. But I appreciate the way you let me into that comment, Jon.

Jon Andersen: Very good. My first question is on, well it's on cost pressure that you've experienced over the past three or four quarters. I think the majority of that cost pressure as you've mentioned has been two things. One is distribution or transportation costs. And then I think you also bore some cost pressure or margin pressure due to the—I think it was a biscuit recall, and I'm wondering if you can quantify that a little bit for us. How much those two things have pressured your operating income and whether we are at a point now where that pressure kind of reverses or goes away as you move through 2019?

Gerry Shreiber: Well, we had an experience—a biscuit recall, and even though it's a minor part of our business we still had to execute on the recall, take the product back and make nice-nice with the customers and whatnot. It affected a smaller business of ours on the biscuit and it's essentially done, now we have to work to get back the sales and a momentum that was lost. That is—what effect did that have on—

Dennis Moore: It's actually we would say roughly about a $500,000 hit to operating income each quarter for the past four quarters, although we did have a recovery to offset that in the fourth quarter last year. But that's just about over now, so we should not be seeing any pressure on that in this quarter and going forward.

Jon Andersen: And on the transportation cost?

Dennis Moore: Transportation, if you look at our transportation costs as a percent of sales, if you do your calculation in that way, that's roughly $2 million a quarter was higher last year than this year than last year. And we think that should be leveling off and perhaps it's too early to really tell. But we may have no increase in that regard, starting with this quarter that we're in.

Jon Andersen: Okay, thanks. On the product pipeline, it sounds like there are a couple of new things that are happening to help drive the restaurant business. Are you able to talk with a little more specificity about what those are and are they kind of LTL limited time offer situations, or do you think they're more permanent placement or yet to be determined, I guess?

Gerry Shreiber: Well as I mentioned before you know we always have a bunch of products in the funnel. Every once in a while they get cogged up in there and they take a little longer but every once in a while one or two come out together and we're sitting in the catbird position right now managing this which will add several thousand point of sale locations as well as some existing product, then [ph] a new product. And we think that we're going to have a very good year with respect to that. Jerry you want to comment further?

Jerry Law: These are LTOs, Jon. So we don't know whether they will roll-on if they perform well, they could continue, but right now they are fixed duration.

Jon Andersen: Okay.

Gerry Shreiber: And one of them already begun.

Jerry Law: Yes.

Gerry Shreiber: Correct?

Jerry Law: Yes, January.

Dennis Moore: That would be Burger King with funnel fries.

Jon Andersen: Okay.

Gerry Shreiber: And what it is Jon, even or not, if you recall, we were doing funnel fries with Burger King about four, five years ago—10 years ago, gosh. And then they were acquired and they sliced and diced the menu, but now they're back with this very same product packaged in a different way. And the early, early promise or the early, early results are really promising. So before I bring out the flags and wave the band in there [ph], let's make sure that we have another quarter or two under our belt.

Jon Andersen: Okay. And last question, on the frozen beverage business. I thought it was interesting what you said about I think that the machine sales grew at a strong double digit rate in the quarter. I understand that that is hard to predict. But is there anything specific that you can point to in terms of upgrade activity that's going on that's driving that? And then should we really view that as a leading indicator of maybe future gallon or beverage demand?

Gerry Shreiber: Well, we have Dan Fachner on the phone in a remote location, Dan is the very active president of our ICEE Group. Dan what caused the big increase in machine sales this year, this quarter? And what does that reflect for the future in gallon sales?

Dan Fachner: Yes, Jon, we had a really nice quarter with machine sales. As you know those can be cyclical, but we had a great quarter that included some big sales to our quick serve restaurants, to the theaters, and to the convenience stores. So a nice spread across the different categories. And any machine sales has absolutely the tendency to grow gallons in the future. So hopefully that's a good trend, as you know they've been down for over past few quarters and we'd love to see that up this year.

Jon Andersen: Excellent, that's really helpful. Everybody, thank you very much and good luck going forward.

Gerry Shreiber: Thank you.

Operator: Next question is from Akshay Jagdale.

Gerry Shreiber: Hi Akshay, how are you?

Akshay Jagdale: Good, how are you doing?

Gerry Shreiber: Good.

Akshay Jagdale: So I wanted to ask about bakery. The bakery business drove a significant—almost all of the growth this quarter. So can you talk about what drove that and how sustainable that is? Looks like some [ph] co-packing business might have played a role, but can you give us a little more color on that on the growth that we saw?

Gerry Shreiber: It came from a lot of directions. As you know Food Service is our largest segment, but everybody in Food Service does something in bakery whether it's a cookie or whether it's a special roll or whatnot, and we've gotten our sales came in high gear. The R&D effort that we have within the company has grown significantly the last three or four years. And we've just been the recipient of a lot of these things coming up.

Akshay Jagdale: So how sustainable is it growth rate that we saw?

Dennis Moore: This is Dennis. The increase in the quarter probably half of that is a one-time bump that's not going to continue. So there is a large club rotation with that co-pack customer. And one of our customers as well.

Akshay Jagdale: Right there is two factors in there, one club looks like promotion and one co-packer related, co-packing business related bump up that you don't think will repeat. Am I understanding that correctly?

Dennis Moore: Yes.

Akshay Jagdale: Okay. And that's roughly half of the growth?

Dennis Moore: Yes, maybe even more than that.

Akshay Jagdale: Got it. And the other thing that was—so first, congratulations on getting the margins to inflect. So I had two questions related to that. Number one, I believe you have these sales meeting every whatever three, four years, I don't know how often. And then we see a bump up in—

Gerry Shreiber: More frequent than that, we had that big gala that you're referring to, five years ago.

Jerry Law: We have one every year.

Akshay Jagdale: Yes. But apparently there was a similar margin related meeting. I don't know how big a gala that was but recently—

Gerry Shreiber: Well they weren't. Margin meetings was not a gala. Jerry Law initiated these meetings and he had all of our production and management teams from all of our plants at two different locations and we were driving home the projects and the tasks that need to be done to not only control our costs, but to seek some margin improvements across the board. And guess what, Akshay, they seem to be working.

Akshay Jagdale: Can we call it a boot camp maybe?

Gerry Shreiber: Yes. Because there's several boots kicking a** if they didn't achieve it.

Akshay Jagdale: All right. So my question related to that is, the margin performance this quarter was better than we've seen in several quarters. So that's good news. So, in the context of the initiatives that have just begun in this boot camp, how far are we down the road on that and how much of that is what we're seeing in the numbers? And then I have a follow-up.

Gerry Shreiber: You're seeing very little in the numbers right now with respect to efficiency. But even though there was 60 basis points improvement in manufacturing we certainly expect that to continue and there'll be some other improvements.

Dennis Moore: And you're seeing the benefits from Labriola being turned around, we've had some improvements with our funnel cake and our Churro cost of goods as a result of new lines. You are seeing some benefit, but I can't quantify right now.

Gerry Shreiber: But Akshay, Labriola which we'd looked at about five years ago, six years ago, but it was too pricey for us. By that I mean we bid on the business, we didn't get it, it went to somebody else. They struggled with it. Finally I think at the risk of bankruptcy we acquired. They put it up for sale and we wound up acquiring all of the assets for a fraction of the price that we were willing to pay five or six years—I think was about $6 million, is that right, Dennis?

Dennis Moore: Yes.

Gerry Shreiber: And it's going to be a winner. We made some improvements there, we've transferred some production into there and we've transferred some production out, but that seems to be working out and it will continue to reflect in our performance for the balance of this year.

Akshay Jagdale: Got it. And then just one last one again on margins. What was unique in the quarter and some of what I'm asking about, I guess you just answered, but I'd like more color. Usually you know the mix of your products if it's skewed more towards bakery like it was this quarter, you don't see a margin benefit. Usually when I think about which products are the more profitable ones, obviously I think about pretzels, I think about Churros. So this quarter obviously bakery was leading the charge yet your margins went up. So how do I connect the dots, and going back to the boot camp, where does mix play a role in your overall margin progression plan? Thanks.

Jerry Law: I mean that's the benefit I wouldn't think about the mix. I would think about the change in efficiencies and what we've done at the plants to improve our performance. That is where the bang for the buck is coming from.

Akshay Jagdale: But have you talked about mix as a driver going forward? Because not all products are equal margin, right. So is that something we should expect?

Gerry Shreiber: To comment on Jerry Law's comment. He had his engineering and manufacturing people at these meetings in here and we were primarily talking about what are we running and how we make that better. So, I think that what we've achieved during this year-end and this quarter you could put a multiple on that for the balance of the year.

Akshay Jagdale: Got it, perfect. I'll pass it on. Thank you.

Operator: And a question from Brian Rafn.

Gerry Shreiber: Hi, Brian.

Brian Rafn: Hey, Gerry, good morning. I hope you're sitting near your fireplace.

Gerry Shreiber: I'm sorry?

Brian Rafn: I said, I hope you sitting near a fireplace. Just a question for you, and maybe one for Dennis. What are you guys seeing on commodity feedstock pressures; eggs, butter, shortening, whole wheat, flour, sugar?

Gerald Shreiber: Pretty much flat right now.

Brian Rafn: Okay.

Dennis Moore: Flat to moderately up. So not significant.

Brian Rafn: Okay. And you guys talked in the press release about sales from new products last 12 months. How is relative to budgets on new product launches, how is your versus budget, how is kind of your reflection on how successful those new products have been?

Gerald Shreiber: Better than our projections. And now to the point that we're taking a look at that and how can we make that even better to our projection?

Brian Rafn: Okay. When you look at the new product pipeline Gerry, is it spread across frozen beverages and Churros and funnel cakes and bakery, or is it bulk or is it consolidated in any one specific product, Gerry?

Gerry Shreiber: Most of them are coming into Food Service, which is our biggest group where we have the most experience, with one exception we saw, I think we saw—Dan are you still on the line?

Dan Fachner: Yes I am Gerry.

Gerry Shreiber: Wasn't Taco Bell a big buyer of beverage machines?

Dan Fachner: They were, they're one of the largest in this past quarter. And that will probably continue throughout this year.

Gerry Shreiber: Okay good. And some of these efforts began three and four years ago, and it's satisfying the say that they're coming through now.

Brian Rafn: Okay. When you guys talked you guys had a very, very nice quarter in machine sale installations in that. Are a lot of those machine sales within new product areas or cinemas or convenience stores, or are you actually upgrading the technology of the machine and it's more of a technology retrofit?

Gerry Shreiber: Primarily more of the former. But with our ICEE group and our service group, we're getting specialty projects; some of which include something as mundane as flavor changes, and also some are design and engineering changes.

Brian Rafn: Got you. Over on the grocery side, Gerry, when you see these consolidations whether it be Albertson's or Safeway or Kroger and you're making M&A. How tough is it in shelf space in that? Do you lose shelf space when you see consolidations in the grocery industry or does it transition fairly smoothly when you see that those transactions on the grocery side?

Gerry Shreiber: Well you outlined some of the challenges in the retail grocery business for us. Bob Pape is here, and although we didn't have a great quarter in our retail supermarkets, we seem to think that most of it has passed us right now. Bob is that right, you want to comment?

Bob Pape: Yes that's correct. Some of the softness on the pretzel category we see some trending up in this quarter here. And back to your question, it's really based on the product performance. And what you're adding to the consumer as far as value added. So, our products are well received by consumers and we think that we can hold our shelf space and continue to expand certain product lines that are consumer friendly.

Brian Rafn: Got you. Anything again on new product iterations, flavors and anything on the pretzel side, Gerry?

Gerry Shreiber: Well yes, some of the new products in food service are taking what was a regular soft pretzel in three loops and putting it in—including some other flavors in there. Some of them [ph] have a fried element to it and different taste. And we have a lot of these fast food and casual dining restaurants that are looking for a signature item that they can have, whether it be a pretzel or different serving for a Churro. And we're working with them very closely and they want a signature item. We'll get it down into a product form for them.

Brian Rafn: Got you. And then just on the M&A side. Gerry, you've always been very disciplined with the war chest and that, X multiples of EBITDA or cost of the transaction. Are you seeing any differences in the scale and size of revenues or niche products and do you have any aversion between making a small niche acquisition that you can organically grow, versus something that maybe on day one a much larger sales contribution?

Gerry Shreiber: I'd be happy to look at something in the early stages that would have a larger positive impact on our business. I am relatively risk aversive, I want to make sure that the product fits within our plethora of niche products. And so we're not going to do anything that's stupid and we're not going to do anything that's too far out of our range. But we're constantly looking and hopefully we will be continuing to add to our niche products.

Brian Rafn: Does that pipeline, Gerry, is that as robust as it's been in the past or is it ebb and flow? You know where we are the economy. Just give me a sense as to where that is today, versus maybe in the past.

Gerry Shreiber: Well, every once in a while, I mention Labriola, we looked at it five years ago, we bought it two years ago after [ph] it had been through. But a lot of the things that we've looked at—are when I say the repeats, they're dressed a little bit differently but they have the same negative possibilities that we looked at years ago. They seem to come often times in rushes and I'm content to continue to look and we have our own people that look at that. But again, I don't want to do anything that may be reckless or careless.

Brian Rafn: Yes, with that comment Gerry, do you see conversations that you might have had several years ago come back, where maybe there's a death of the owner or the family, or a transaction pressure or where you are in the cycle, where they end up coming back and you see kind of a recycling of the conversation?

Gerry Shreiber: There is some and we do look at the obituaries every day. Our people, no I don't mean that, and there are people—we have some scouts out there too. But we don't waste a lot of time. And I've mentioned this before, we're not going to go too far from our nucleus the things that we do well.

Brian Rafn: All right, stay warm guys, will see you.

Gerry Shreiber: You too, stay warm and stay healthy.

Operator: [Operator instructions]. Gerry, it looks like you have no more questions.

Gerry Shreiber: All right. I want to thank everybody for their time today and participating. Look forward to talking to you again after the results of our second quarter. Stay warm, be well, be healthy. Thank you very much.

Operator: Thank you ladies and gentlemen, this concludes today's conference. Thank you for participating. You may now disconnect.