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SPEAKERS

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Robert Pape - Senior Vice President of Sales
Gerard Law - Senior Vice President

ANALYSTS

Michael Gallo - CL King & Associates
Akshay Jagdale - Jefferies
Jon Andersen - William Blair & Company
Brian Rafn - Morgan Dempsey Capital Management

PRESENTATION

Operator: Welcome to the J & J Snack Foods Third Quarter Earnings conference call. My name is Paulette and 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] Please note that this conference is being recorded.

I will now turn the call over to Jerry Shreiber. You may begin.

Gerald Shreiber: Thank you, Paulette and welcome everybody. I want to begin with the forward-looking statements that pre-empt the conference call. 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 these 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 this date.

With me today is Bob Radano, our Senior Vice President and COO; Gerry Law, who is our Senior Vice President and my personal assistant; Bob Pape, who is Senior Vice President in charge of sales; Dennis Moore, who is our CFO and Bo Powell, who is our Vice President of Sales Food Service. Also on the phone in a remote location is Dan Fachner, F-A-C-H-N-E-R, President of our ICEE group.

Alright, I will begin. Results of operations. Net sales increased 4% for the quarter and 9% for the nine months. Excluding first 12-month sales from Hill & Valley which was acquired in January of 2017, and an ICEE distributor located in the Southeast acquired in June of 2017 and Labriola Bakery which was acquired last August 2017, sales increased approximately 2% for the quarter and 5% for the nine months.

For the quarter, our net earnings increased by 3% to $26.1 million, that's $1.39 a share, from $25.3 million or $1.34 a share a year ago. For the nine months, our net earnings were $80.2 million or $4.27 a share, an increase of 46% from $54.8 million or $2.91 a share from a year ago. Our EBITDA for the past 12 months, that's earnings before interest, taxes, depreciation and amortization, was $168.1 million.

Food service. Without Hill & Valley and Labriola, sales were up 3% for the quarter and 5% for the nine months. Sales to food service customers increased 5% for the quarter. Our sales increase of 3% without Hill & Valley and Labriola was due primarily to increased sales of soft pretzels up 11%, and handhelds up 16%. Sales of churros were down 5% and funnel cake was down 10%. Frozen juices bars and ices were down 21% for the quarter and bakery sales were up 3%.

Sales to food service customers increased 11% for the nine months. Our overall sales increase of 5% without Hill & Valley and Labriola was due to increased sales of soft pretzels, up 10%, and handhelds up 27% and funnel cake up 11%. Sales of frozen juice bars and ices were down 12% for the nine months and bakery sales were up 4%. Churros sales were flat for the nine months.

Retail and grocery super markets. Sales of products to retail supermarkets were up only 1% for the quarter and 5% for the nine months. Soft pretzel sales were down 2% for the quarter and up 9% for the nine months, and sales of frozen juice bars and Italian ices were up 5% for the quarter and 7% for the nine months. Handheld sales were down 17% for the quarter and 16% for the nine months.

Frozen beverages which include ICEE, Arctic Blast and Slush Puppie. Frozen beverage and related product sales were up 2% in the quarter and 5% in the nine months; 2% and 4% without the benefit of sales of the acquired ICEE distributor. Beverage sales alone were up 3% in the quarter and 2% without the acquired ICEE distributor and 9% and 8% for the nine months. Gallon sales were up 7% for the quarter and 7% for the nine months in our base ICEE business. Service revenue for others continued its strong gain, so it was up 6% in the quarter and 7% for the nine months.

Consolidated. Gross profit as a percentage of sales was 30.85% in the three months period this year and 32.08% last year. A gain on an insurance recovery of $1.8 million recorded in last year's third quarter related to product issues in our 2016 fiscal year, increased last year's gross profit percentage by 60 basis points. Let me just repeat that, we were successful in an insurance recovery gain of $1.8 million last year, which we resulted in a 60 basis points benefit compared to this year.

That accounts for half the difference in gross profit percentage between this year and last year. The balance of the decrease resulted primarily from higher costs for payroll and insurance, product mix changes particularly involving our bakery products, and significantly lower volume concentrated in specific facilities and higher ingredients cost.

Operating income in our food service segment decreased from $22 million to $19,663,000 in the quarter for the above reasons. And a sharp increase in distribution expenses and a decrease in operating income in connection with our biscuit business because of a recall in January of 2018. Operating income in our retail grocery supermarket segments decreased from $4,890,000 last year to $3,203,000 in this quarter, primarily due to lower sales of soft pretzels and LUIGI's Real Italian ices and increases in trade spending, coupon redemptions, and distribution costs.

Total operating expenses as a percentage of sales was 19.5% in the quarter, up from last year's 19.3%. The increase is primarily due to higher distribution expense, meaning freight and warehousing as previously mentioned.

Capital spending and cash flow. Our cash and investment securities balance of $248 million was an increase of $16 million from our March balance. We continue to look for acquisitions as a use of our cash. $127 million of our investments are in corporate bonds with a safe yield to maturity of 2.3%. Our capital spending was $17 million in the quarter as we continue to invest in plant efficiencies and growing our business for now and the future.

We estimate our spending for the year to be about $55 million as several one-time manufacturing projects have been or shortly be completed. A cash dividend of $0.45 a share was declared by our Board of Directors and paid on July 5, 2018. We bought back 20,604 shares of our stock during the quarter at a cost of $2.8 million or $135.60 a share.

Other commentary. Sales of our food service products were not as strong this quarter, although we continued to have strong sales growth of soft pretzels in restaurants and movie theaters and through our customer base. Sales of our new Brauhaus Pretzel have been very encouraging. Bakery sales were up modestly this quarter. Handheld sales were up a strong 16% for the quarter as we have had strong increases to a few customers', existing and new.

Churros sales were down 5% because sales of churros to a particular warehouse club store in last year's quarter were discontinued. Frozen juice bar and ices sales were down 21% because of a loss of a promotion and distribution, both in warehouse club stores. Although funnel cake sales were down this quarter due to lower sales to restaurant chains, sales to schools continue to grow, they were up 40% this year.

Overall sales to restaurant chains have been strong this year, while sales to schools have been down modestly. Soft pretzel sales in our retail supermarket were down 2% for the quarter, primarily because of increased trade spending. Frozen novelty sales were strong as we rolled out a line of a licensed product Sour Patch Kids Ice Pops. We're focused on reducing trade spending going forward.

Sales in our ICEE frozen beverage segment were up a modest 2% for the quarter. Service revenue was up 6% in the quarter as this business continues its solid sales growth. But machine sales were down $852,000 or 13% in the quarter. Operating income was up a solid $1.1 million. For reasons already mentioned, overall consolidated operating income in the quarter was down 8% or $2.9 million from a year ago.

We have reported an overall income tax benefit of $0.18 a share this quarter due to lower tax rates. On a going forward basis, we expect an effective tax rate of 28% to 29% for the fourth quarter of this year and 26% to 27% for fiscal year 2019.

I want to thank you for your continued interest. And now I'll be happy to field your questions and comments.

Operator: Thank you. We will now begin the question and answer session. [Operator Instructions] Our first question is from Michael Gallo. Please go ahead.

Gerald Shreiber: Good morning, Michael.

Michael Gallo: Hi, good morning. Jerry you spoke to being determined to improve your margins going forward. I think you mentioned some reduced trade spending in your prepared remarks. I know you've put through some pricing although not in the retail channel. So I was wondering if you can elaborate more specifically on some of the things you're doing to improve your margins and when you think we should start to see that inflection where you'll start lapping some of the higher distribution and other costs and you have the combination of pricing or other initiatives that you think will help margin. Thanks.

Gerald Shreiber: Well we've already met with my senior management team particularly in sales and retail and we are going to be acting forthwith quickly and efficiently on pricing. In addition to a kick in a** so to speak in there, we have been a little bit slow for all the obvious reasons and passing on price increases. In the past year, two years, we've had major increases and all the benefits as well as some commodities, but we are focused on increasing and getting our margin back to where we believe they should be, all the while maintaining good customer relationships.

Michael Gallo: And the other sort of cost and other initiatives. I know you have been consolidating facilities, moving some things around logistically, but if you could update us also on some of the other initiatives in terms of just improving operations.

Gerald Shreiber: Well we had several projects in our major plants to improve cost. They appear to be right on schedule and we're looking forward to getting the benefit of these costs beginning probably in first quarter of next year, which would be October, November, December and continuing on

Michael Gallo: Thanks very much.

Gerald Shreiber: Thank you.

Operator: Our next question comes from Akshay. Please go ahead.

Akshay Jagdale: Good morning.

Gerald Shreiber: Good morning Akshay, how are you?

Akshay Jagdale: Good, how you doing?

Gerald Shreiber: Yeah, I read your comments and you're right on and we're taking them very seriously.

Akshay Jagdale: Thank you. So yes, let's start with the question that probably a lot of people have. So what are you doing differently on the margin side such that we have better results there? The sales growth, although it slowed a little bit sequentially, still pretty solid relative to what most of the food companies are doing. So can you just help us understand what are the initiatives that are underway internally to help the margin progress that are different from before, and why is it taking a bit of time to see those flow through in your P&L.

Gerald Shreiber: Well I have both of my key confidants here, Gerry Law who is my assistant and responsible for manufacturing, and Bob Pape and we have been meeting on this over the last couple of days. Bob, care to comment on what we're going to be doing with respect to pricing?

Robert Pape: We have as Gerry mentioned earlier we have to move forward with price initiatives across the retail business and make sure that those are implemented as quickly as possible.

Gerald Shreiber: And when are we doing it?

Robert Pape: Our timing would before the first quarter.

Gerald Shreiber: Well I think now effective the first quarter. Gerry, as far as manufacturing the one project is done and—

Gerald Law: Yes, and actually we've completed a bunch of projects in the quarter in New Jersey. We have another one coming up, it appears it will be online in the first quarter where we're moving some manufacturing to the point of distribution for Texas up in New Jersey that will have a good effect. Our CI pipeline is strong and we continue to have some pickups there, which is different for us and we've never had such a group robust pipeline of projects going to reduce costs; but we have to get price and we have to be aggressive with the price.

Gerald Shreiber: This is Jerry again. Not that we got comfortable, but we're going to have increase our bases of getting these things completed on time and efficiently so that we recapture at least some of the margin loss that we have over the past year or so.

Akshay Jagdale: And are you able to give us some order or magnitude on these cost continuous improvement savings, or I don't want to ask you to do something you're uncomfortable with, but maybe down the road should we expect some sort of quantification of what those savings might be; because it seems like it's a new initiative which is good. A lot of other food companies have been doing that for a while, but is there an annual number that you're targeting and what's the basis for the magnitude of the savings that you're targeting?

Gerald Shreiber: There was an annual number that we were targeting, but as sometimes happens we were a little bit soft on the annual number, and there was certainly room to improve that annual number, and we're hopeful that you will see this beginning at the conclusion of our first quarter next year, which would be in the October and December period.

So we understand the business that we're in and every once in a while we don't fall, but we'll slip a wrong and we get back up there real quickly.

Akshay Jagdale: Okay and then just, somewhat related is the question on mix. So are you thinking any differently on product mix because obviously product mix has been a negative margin driver, for a while now including some of the M&A that you've done. So are we thinking about that any differently now and if so, how and how might that impact the margin trajectory?

Gerald Shreiber: We are committed to improving our margins and we're going to do it on an increased emphasis both on sales pricing and certainly on costs, which are closer to being accomplished than not.

Akshay Jagdale: Okay and one last one on M&A, so any updates there. I mean obviously evaluations, public market come in, but I know you're very disciplined, but maybe the market might be okay with you spending a little bit more and buying something that's not a turnaround. Have you considered buying things that are not turnarounds at this stage of the company's lifecycle?

Gerald Shreiber: Certainly we have, but we're still committed and disciplined not to do anything that is fundamentally different than what we've accomplished and what we've done in the past. We look at things, sometimes we consider them from first base all around the third, but we don't want to be thrown out at home, if you know what I mean.

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

Operator: Our next question comes from Jon Anderson. Please go ahead.

Gerald Shreiber: Good morning, Jon.

Jon Anderson: Good morning everybody. How are you Jerry?

Gerald Shreiber: Good, I'm good thank you.

Jon Anderson: Good to here. My first question is on pricing and whether you're willing to talk a little bit more about parts of the business where you think pricing is more necessary, and if there's any way to think about quantifying the magnitude of pricing you're going after, and when we should start seeing that show up in the P&L.

Gerald Shreiber: Sure Jon. Some of our pricing particularly in the grocery retail supermarket, we've had no increases in the past two years. And we're looking at changing that in a disciplined way well within that we maintain our market share, but we recognize we need to get margin back and that process is in the making now and I got two nods of the heads here from the Bo and Gerry Law who are both involved in this. Am I right Ger [ph]?

Gerald Law: Yes.

Jon Anderson: And is there also pricing on the food service side of the business and are these things that we expect to benefit fiscal '19, as opposed to the balance of the current year.

Gerald Shreiber: Well, you want see in the balance of the current year, which is fiscal '18, but you should expect it for fiscal '19, which begins this coming October.

Jon Anderson: Okay, great. And then your sales have been really good the last three, four quarters even with, as Akshay put it, some sequential deceleration this quarter, I think to about 2% you said organic. As you look forward, I mean what are the biggest white space opportunities for you on the topline to continue to grow your business better rate, that frankly is in excess of most food companies. Is it specific product categories where you have opportunities, is it channels where there's a lot of white space, if you could talk about maybe some examples where you see the most opportunity over the next year or so, and if we should still be thinking about your business as a mid-single-digit topline grower.

Gerald Shreiber: Well, we're certainly thinking about it as a mid-single-digit topline and then plus whatever accretive value we would get from acquisitions. But Bob, why don't you comment, Bob Pape, on the white space that—

Robert Pape: Yes, we still have a lot of room to grow as far as our product innovation and some of the retail channels that we have growth potential in. On the food service side our chain restaurant business and our national account certainly are areas where we still feel there's a huge amount of potential. And then along the lines of our healthcare accounts, our convenient store channels, those are all areas where we feel that we have ample opportunity moving forward.

Gerald Shreiber: Just to add to Bob's comments on growth, the restaurant and casual dining group which we got into about five or six years ago, we've had a good year with it, but not only that, we've identified key markets and customers that we could continue with that growth 2019 and beyond. So we're looking for a lot of opportunities there across a broad spectrum of our products, soft pretzels of all kinds, filled, churros, [indiscernible] all of it.

Jon Anderson: Excellent and the last one for me is, if you could comment on what you're seeing from the distribution cost per freight perspective, distribution cost. I know it was called out in the press release and I know everyone's been dealing with it in the industry, whether it be the supply demand shortages, the electric logging device initiative. But are you seeing any loosening in that market, any improvement or is this just something we think we're going to be grappling with for several quarters?

Gerald Shreiber: We're going to be grappling with it for several quarters. I read an interesting article yesterday that there is a shortage of 50,000 truckers, that's truck drivers currently. I don't know how they get up to these numbers, but we are focusing on our logistics; that would be trucking and warehousing as a major task and challenge for us and I think it slowed a little bit or at least the increases aren't coming as fast as they were a year ago, but it took us a solid nine months to realize it that these increases are indeed being permanently secured with metal bolts to our costs. So the fact that we're going to be focusing on it and we can do certain things by shifting our sales by products to the [indiscernible] being produced, it will help us in that, but we expect the cost challenges and logistics to be there for a while.

Jon Anderson: Okay, thank you. Thanks a lot guys and good luck going forward.

Operator: Our next question comes from Brian Rafn. Please go ahead.

Brian Rafn: Good morning, Jerry. Good morning, Dennis.

Gerald Shreiber: How are you Brian?

Brian Rafn: Good, I want to ask you Jerry a little different question on the margins you guys are getting queried about. What do you see across your product lines relative to kind of the defense or resistance of price elasticity amongst consumers across different product lines? Where is it tougher to raise prices and where might it be easier by product?

Gerald Shreiber: Well, we want to consider the consumer and the customer along all of these lines. We think we have room in our core products, that would be pretzels and churros and perhaps even ICEE. Partly it's due to brands, ICEE is fairly resilient because they're being compared to a higher beverage god, meaning the Coke's, the Pepsi's, the Dr. Pepper's. But we always have to take into consideration the pricing and whether that's going to lose volume. Fortunately for us, we're in a pretty good position with all of our major brands and our products, so we want to take that into consideration, but at the same time we expect to advance pricing more than we have in the past

Brian Rafn: Okay, on that, when you're talking about advanced pricing Jerry, are you talking about a quantitative price hike or are you talking more about maybe reducing couponing or volume discounts?

Gerald Shreiber: We're talking about pricing.

Brian Rafn: Okay, let me also ask you guys. You guys have been very, very resistant and adamant. What you're seeing amongst a lot of the package food companies, you see it even in the personal hygiene area. They play around with unit volumes, they play around with portion sizes, portions per container. You guys have always had that you're not making a smaller product volume-wise at a price, what are you looking for going forward, are you going to stick to that?

Gerald Shreiber: We're going to stick to that. If anything, we've developed products that have a value to the customer or some kind of specialty pricing, be it a bigger pretzel, be it involved in a wheel, so we're not going to cut back the size by weight or ounce or count of our traditional six pack, 50 count, 100 count. We're going to an increase their steps to market and market cascade.

Brian Rafn: Alright that's obviously very solid Ger. How about weather across the United States this summer, you do have leverage with heat and hot weather. How would you see the 2018 summers played out across the US for you guys, kind of benefit, headwind or neutral?

Gerald Shreiber: Well, it started a little bit cool and then we’ve had some real good weather in the past two weeks or so. But we'd like to have the attitude that we're going weather the storm no matter what the weather, and that's the approach I'm sending to our people.

Brian Rafn: Okay, when you look at some of your newer acquisitions, more recently I’m thinking in New York Pretzel or Philly Swirl and how has the performance been on the more recent acquisitions, versus something maybe back a little further like a Daddy Ray's?

Gerald Shreiber: Well, Daddy Ray's a real solid performer now. Daddy Ray's was a small company, doing $15 million, $16 million when we bought it seven years ago, will now do $70 million out of that plant and that facility in there. When I talk long-term we focus on major things for long. New York Pretzel was a natural for us because it fit in that corridor into New York and New England, and we're having—it's been a few years since we acquired Philly Swirl—but it's having its best year ever.

Brian Rafn: Okay, awesome. What are you seeing in the grocery area, Jerry, in the battle between national brands and private label and are you seeing grocers come to you for a more private label business?

Gerald Shreiber: Bob Pape, why don't you reply to that.

Robert Pape: Yes, for customers that we feel have a strategic partner with, we are trying to develop a balance of branded as well as private label offerings.

Gerald Shreiber: But the emphasis on branded.

Robert Pape: And still understanding that we have a heritage as a branded company.

Brian Rafn: Okay, on the grocery side you're seeing a lot more front end display racks and that for single service, quick to go lunches, and it might be pre-made sandwiches or that. Are you guys getting any concentration in those speed racks?

Gerald Shreiber: We're really not per say, although we've looked at a couple opportunities. Keep in mind most of our items gone into grocery are frozen, and so if they go into the daily yeah, they're going to need some hand prep.

Brian Rafn: Got you, anything on the convenience store side, benefits, sales, more products, anything developing there?

Gerald Shreiber: Well, our convenient store business is growing nicely and we've identified a team that is concentrating on that and we think there's plenty of room to move that needle for the future.

Brian Rafn: And then one final one Jerry on M&A, as you've gotten bigger, has your kind of strategic view point on the size, the dollar sales—you hear a lot of companies say, it's the same due diligence, the same prep for us whether we buy a $10 million sales company versus 50 or 60—are you still looking at all opportunities regardless of sales side?

Gerald Shreiber: Well, we're looking at the opportunities that we think that fit with us strategically and that's something that they can add value to or incoming value, so we're looking at a broad range of potential acquisitions, but again, they have to meet our criteria for not just immediate but for the long-term.

Brian Rafn: Jerry, do you get a lot of deals pitched to you guys or you guys out kind of on your own radar, looking at different potential acquisitions?

Gerald Shreiber: Well, we get a few deals pitched to us and just consider when they're coming and they're calling on you couple of times a week, you got to look behind the numbers, you're going to look behind their claim of urgencies. So we reject way more than what we follow through on.

Brian Rafn: Got you, thanks guys. Good job, we'll see you.

Operator: Our next question comes from Michael Gallo. Please go ahead.

Gerald Shreiber: Good morning, Michael.

Michael Gallo: Hi, good morning. Just a quick follow up. I see a very strong quarter. I know you've mentioned in the past that you're looking at some opportunities perhaps to expand that within quick service restaurants, I was wondering if you can give us an update on that. Thanks.

Gerald Shreiber: We'll be happy to give you an update in the next quarter because we have several things happening now that may come into fruition come next calendar year.

Michael Gallo: Okay, thanks very much.

Operator: And we're showing no further questions. I will now turn the call back to Gerry Shreiber for closing remarks.

Gerald Shreiber: Alright, I'll give you a moment. If there are any questions, I'd be happy to address them, but I want to thank everybody for participating in our third quarter conference call. We look forward to doing this again three months from now and we are certainly hopeful and confident that the total operations will be improved and we believe in our long-term success for the benefit of our customers, our shareholders, and our employees. That will never change.

Operator: And we do have a question online, a follow-up question from Brian Rafn. Please go ahead.

Brian Rafn: Yeah, Jerry just one more I've got. You have a great problem with the major massive size of your cash reserve, liquidity on your balance sheet. Are you going to stick kind of with the short-term corpus and I'm going back just from the experience you guys had with some of those—they were preferred stock or whatever—you were looking for a higher yield. Are you going to stay with the short-term money market type stuff and the corporate securities?

Gerald Shreiber: We're comfortable with our yields with our yields with our cash investments. We're not comfortable or excited about the results of operations. That's where our focus is going to be on, but we're yielding I think a composite of 2.3, 2.2, we'll keep building cash or use the cash, but we're comfortable with that yield.

Brian Rafn: Alright, Ger, thanks again.

Gerald Shreiber: Alright, if there's no more questions I can exit now.

Operator: We're showing no further questions.

Gerald Shreiber: Thank you. And I appreciate everybody's continued interest in us. I'm going to disengage.

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