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Bob Radano – Chief Operating Officer
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Dennis Moore – Senior Vice President of Finance and CFO
Daniel Fachner - President, ICEE Company

ANALYSTS

Michael Gallo - CL King & Associates
Jonathan Feeney - Consumer Edge Research
Brian Rafn - Morgan Dempsey Capital Management
Robert Costello - Costello Asset Management
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PRESENTATION

Operator: Welcome to the J&J Snack Foods First Quarter Earnings Conference Call. My name is Maddie, 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. During the question and answer session—

Gerald Shreiber: This is Gerry Shreiber. Can you tell me how many participants we have on the call?

Operator: Sure. On the line with us right now we have just over 70 participants.

Gerald Shreiber: Right. Okay. There's five or six of us here, and we always have a pool going on how many participants.

Operator: Okay. So, we are live with the audience right now.

Gerald Shreiber: Good morning. This is Gerry Shreiber, and welcome to our First Quarter conference call. With me today is Bob Radano, our COO; Dennis Moore, our Senior Vice President of Finance and CFO; Jerry Law, our Senior Vice President and my Special Assistant; and Marjorie Shreiber Roshkoff, our what are you, Marjorie? Marjorie is our—

Marjorie Shreiber Roshkoff: In-house counsel.

Gerald Shreiber: In-house counsel. Let me begin with the 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, that's today. We undertake no obligation to publicly revise or update these statements to reflect events or circumstances that arise after the date hereof.

Results of operations. We had another good quarter. Net sales increased 18% for the quarter. Excluding sales from Hill & Valley, acquired in January 2017, an ICEE distributor located in the Southeast acquired in the summer of 2017 and Labriola Bakery, which was acquired in August of 2017, sales increased approximately 7% for the quarter. Nevertheless, a healthy increase, notwithstanding the acquisitions which were later. Our EBITDA for the past 12 months once again set a record, $169.5 million.

Food Service. Without Hill & Valley and Labriola, sales were up 6% for the quarter. Sales to Food Service customers increased 21% for the quarter. Our sales of 6% without Hill & Valley and Labriola was due to increased sales of soft pretzels, which were up 14%, increased sales of handhelds, which were up 37%, and increased sales of Churros and funnel cakes. Sales of frozen juices and ices were down 4% for the quarter, and bakery sales, without Hill & Valley, were essentially flat.

Retail, grocery supermarkets. Sales of product to the grocery supermarkets were up 7% for the quarter. Soft pretzel sales alone were up 18% for the quarter, and sales of frozen juice and Italian ices were down 1%. Handheld sales were down 12% for the quarter.

ICEE and frozen beverages, which of course includes Arctic Blast and Slush Puppie, frozen beverage and related product sales were up 12% in the quarter, 10% without the sales of the acquired ICEE distributor. Beverage-related sales alone were up 21% in the quarter, 19% without the acquired ICEE distributor, with gallon sales up a healthy 15% in our base ICEE business. Service revenue for others, which has grown consistently and constantly, was up 5%.

Consolidating. Gross profit as a percentage of sales was 27.63% in the three-month period this year and 29.21% last year. About 20% of the gross profit percentage decrease in the quarter resulted from lower gross profit percentage of the Hill & Valley business.

The balance of the decrease was caused by higher costs for our payroll, insurances, inefficiencies in our recently acquired Labriola production facility, compounded somewhat by the integration of products previously manufactured at other facilities, product mix changes and significantly lower volume concentrated in specific facilities. And also shutdown costs of our Chambersburg, Pennsylvania production facility, which has now been consolidated and integrated into Labriola, and somewhat higher ingredients costs. We had no benefit of pricing to offset these higher costs in the quarter.

Operating income in our Food Service segment decreased from $17 million to $15,900,000 in the quarter, all for the reasons just outlined. Total operating expenses as a percentage of sales was 19.6% in the quarter, down a full point from last year's 20.6%. The decrease was primarily related to lower media spending in our supermarket business and lower marketing expenses of the acquired Hill & Valley and Labriola business.

Capital spending and cash flow. Our cash and investment securities balance of $243 million was up $2 million from our September year-end. We continue to look for acquisitions as a use of our cash, $125 million of our investments are in corporate bonds with a yield to maturity of 2.2%. Our capital spending was $15 million in the quarter, as we continue to invest in plant efficiencies and growing our business. One of the investments in growing our business I just did a tour of about a half an hour ago, and it is online, in time and is going to be increase in the capacity of our Churro production by almost 300% when done.

We estimate our spending for the year to be about $50 million, as several one-time manufacturing projects have been, or will, shortly be completed. A cash dividend of $0.45 a share was declared by our Board of Directors and paid on January 4, 2018. This represents a 7.1% increase in the dividend. We did not buy back any shares of our stock during the quarter.

Commentary. Sales of our Food Service products improved this quarter, with significant increased sales of soft pretzels in restaurants and movie theaters, funnel cakes in schools and handhelds to a handful of customers. Bakery sales, without Hill & Valley were essentially flat this quarter as sales to private label businesses leveled off and sales to schools were down in the quarter. Sales of our new Brauhaus pretzel have been very encouraging.

Handheld sales were up a healthy 37% for the quarter, as we have had strong increases to a handful of customers, both existing and new. Hill & Valley sales, which was acquired about a year ago, were $55 million in its first full year with us, with $2 million of operating income. Soft pretzel sales in our Grocery and Supermarket segment were up a strong 18% for the quarter, primarily because of continued increase of sales and the recently licensed Auntie Anne's pretzels.

Operating income was up very strong, $1.5 million, because of the increased soft pretzel sales and because we reduced media spending and couponing, primarily related to Oreo Churros and Pillsbury dessert products. These products have not performed as well as we had projected. Sales in our Frozen Beverage segment were up a very strong 10% for the quarter, backing off the benefit of sales of the acquired ICEE distributor. Service revenue was up 5% for the quarter as this business continues its sales growth.

Machine sales were down 10% in the quarter, although it may follow no significant guides. Operating income was up a very strong $1.5 million due to increased beverage sales growth. Overall, consolidated operating income in the quarter increased $1.9 million from a year ago. We have reported an overall income tax benefit this quarter due to the re-measurement of deferred tax liabilities based on a lower federal tax rate of 21%.

On a going forward basis, we expect an effective tax rate of 28% to 29% for the last three quarters of the fiscal year 2018, and 26% to 27% for our fiscal year 2019. We continue to invest in the long term for the business with both efficiencies in the plants and new products and R&D.

I want to thank you for your continued interest, and now turn this back to our audience at large.

Operator: Were you ready to take questions, sir?

Gerald Shreiber: Yes, we're ready.

Operator: [Operator Instructions]. We do have a question on the line from Michael Gallo. Michael, your line is open.

Gerald Shreiber: Good morning, Michael.

Michael Gallo: Good morning, and congratulations on the strong sales performance in the quarter.

Gerald Shreiber: Thank you.

Michael Gallo: I was wondering, Gerry, or perhaps, Dennis, if you can dimensionalize some of the various issues you highlighted in terms of the gross margin. I know you mentioned some of them were addressed, but between Labriola, Chambersburg ingredient costs, what's worked out or not worked out, and what are your plans for pricing in 2018? Thanks.

Gerald Shreiber: Well, the plant in Chambersburg was part of an acquisition that dates back perhaps seven years ago and that has worked well for us. We decided to close the plant because we needed more efficiency and capacity. So we closed it very recently, took care of the required closing costs, both with employees and utilities and whatnot, and we moved its products, both to Pennsauken and to our Chicago facility, which are much more efficient. We took a little short-term hit for some long-term gains, and we project that these will work out well.

Michael Gallo: How much was the cost that kind of ran through for Chambersburg?

Gerard Law: It's about $700,000 between Chambersburg and Labriola for one-time costs, integrating them, getting them up and running, and we're, for the most part, over the hump.

Michael Gallo: Okay, that's helpful. And then just the plan for pricing. I know you've had obviously a number of increases, freight and the like, obviously, industry-wide issues, but what are your plans for pricing going forward?

Gerald Shreiber: So far we've absorbed most, if not all, of the cost increases. But the plan is to, almost beginning with the effective date coming in February and March, that we will pass these on appropriately.

Michael Gallo: Thank you.

Operator: And our next question comes from Francesco Pellegrino.

Gerald Shreiber: Good morning, Francesco. Are you on?

Operator: Francesco, your line is open. We can just go on to our next question. Next we have Jonathan Feeney.

Gerald Shreiber: Good morning, Jonathan.

Jonathan Feeney: Good morning, Gerry and team. How are you?

Gerald Shreiber: We're good. Thank you.

Jonathan Feeney: Two questions this morning. First, did I just hear you right in your remarks that you're expanding Churro production 300—capacity, sorry, not production, capacity 300%? And if so, is that related to some known business wins you have? And I have one other after that.

Gerald Shreiber: It's related to the known growth we've experienced over the past five years. And as we continue to introduce products and look at our costs, we look at new technology, both in existing equipment and some equipment that we've developed, and this was a planned project that goes back somewhat a year ago?

Gerard Law: About a year and it's primarily—we increased the capacity through new technology, but the lines that we were on were essentially out of capacity. So when we built new, we increased our capacity for the future.

Jonathan Feeney: I got you. That's helpful. Actually two more, if I might. On the handheld business, maybe this is more of a philosophical question, but you have exponentially expanded the sales of this business, and according to your disclosures, it doesn't even appear you're close to the capacity you got in those two facilities in 2011. I'm wondering, is it private label that's driving that business? And how is it that you went about selling and distributing products that are essentially the same and doing in a quarter almost what the former owners were doing in a year? How is it you're so good at finding that demand, Gerry?

Gerald Shreiber: I don't know if we're so good, but we've been driving our sales team, and Bob Pape is on this call, he's in Minnesota remotely. But we make a good product and our R&D efforts over the last five years have improved exponentially too. And part of it is a rallying call, hey, look at what we can do, we can make--oh, can you do this? Yes, we can do this. So we’ve got to send out the message and we hit on a few things.

Now it's a product that is not quite a core product, but all the things that we do to make a core product, including some technology, like twisters in there, we're trying to see if we can complement these handhelds. That's a business, if you remember, we acquired along with a couple of efficient plants from ConAgra about six years ago, and we've been kind of like, I might say, goosing ourselves, why can't we do better. And it's starting to bear fruit in Food Service, and we'll let Bob Pape comment later on, on some of the issues we’ve had in grocery. But we're pleased with some parts of that business and we're dedicated to continuing to increase.

Jonathan Feeney: Any comment on what role private label growth played in that?

Gerald Shreiber: Significantly, because we had a couple of big hits in the past two years.

Gerard Law: Co-manufactured more so than private label and—

Gerald Shreiber: And it gets down to it that -- and I've said this before, we're in niches, we are real good producers, and part of that reputation has spread.

Jonathan Feeney: That's really helpful. And finally, maybe a field question for you, Gerry. You sold a lot more—your same-store sales of soft pretzels were very significant to date. I'm wondering if you could parse that between how much of that is distribution gains, you got new customers, and how much of that is just like-for-like sales in places like theaters that are economically sensitive.

I'm wondering when you look at your business today, pretzels specifically, and the business more broadly, how much of this is just the economy doing really, really well and these kind of Food Service volumes being very, very strong as opposed to distribution wins or something specific to J&J Snack Foods?

Gerald Shreiber: Well, it's part and parcel to everything you just said. Our theater business was strong this quarter, just like it was weak a year ago. Good movies help, but also improved distribution and marketing aids help. Our new product that we, I guess, developed about nine months ago, Brauhaus, that's done well in the field and now we're trying to complement that with our other soft pretzel extensions, and we think it's very helpful.

All the while, we've got to contend with things like the economy, suddenly, one of our larger customers decided to shut 10% of its stores, which will affect our beverage business, and to some degree, our soft pretzel business. But our people are equal to the test and they're constantly being driven and challenged, and so far I'm both pleased and proud that it's working out.

Jonathan Feeney: Thank you very much for your time. I'll pass it on.

Operator: Our next question comes from Brian Rafn.

Brian Rafn: Good morning, guys. Good morning, Gerry, Dennis.

Gerald Shreiber: How are you?

Brian Rafn: A question for Dennis. What are you guys seeing on the commodity inflation side, eggs, whole wheat, sugar, shortening, what are you seeing maybe the next year out?

Gerald Shreiber: Well, we're not seeing any kind of lower pricing like we did two years ago. But let me give it to Dennis, who studies this on a more direct basis.

Dennis Moore: Well, essentially what Gerry says is correct and we are seeing some mild inflation in the areas that you mentioned. So we would expect to have some impact—well, we had some impact this quarter and we would expect to have continuing impact going forward.

Brian Rafn: Yes, if you're seeing kind of a trough or valley here, does that force you guys to do any forward buying or stockpiling, or is it just the delta changes in that the magnitude isn't enough to do that?

Dennis Moore: We generally would buy out in advance six months to a year on many of our ingredients and sometimes a little bit longer depending. But, yes, we tend to try to take advantage of dips in the market as they happen.

Brian Rafn: Yes. Got you. Dennis, and everyone is going to be diving all over this tax with the Tax Act. For you guys going forward, I think Gerry said that you're looking at kind of a 26% to 27% next year run rate versus the statutory roughly 21%. What's the spread for you guys?

Dennis Moore: I'm not sure what the question is, but we pay two taxes. We pay federal taxes and we pay state taxes. Our state taxes—

Brian Rafn: Okay. All right. So it's just the state. All right. Yes, okay. I just wanted color on that. And then, the capex, you said $50 million, where is that being spread around?

Dennis Moore: It would be roughly half and half between our Frozen Beverages business and our Food Service business.

Brian Rafn: Is that square footage or just machinery?

Gerald Shreiber: It's really machinery. We're not building any new plants, and we've taken a look at all of our plant capacity, and we closed one plant, which was in the plans in the offing and we don't plan to close any others.

Brian Rafn: Okay. Gerry, you made a comment, Hill & Valley, I think at $55 million. I think you bought it, the run rate was about $45 million in sales, a nice $10 million incremental. Was that all organic to Hill & Valley, or were you loading other products or recipes in there?

Gerald Shreiber: It was all organic.

Brian Rafn: All organic. Okay.

Gerald Shreiber: The management at Hill & Valley, they have stayed on. And we're pleased with that.

Brian Rafn: Okay. Okay. When you look at your purchase of Labriola, you've added a new—I think it says in your notes, prebaked breads and rolls and soft pretzels. Are these distinguishly different recipes than what you guys have, and do you bring other products into that and look at Labriola as just a geographic manufacturing staging area, or is it really new recipes, new flavors, new product lines?

Gerald Shreiber: Labriola was a good producer of specialty soft pretzels and breads. We looked at it perhaps some five or six years ago and we were part of the auction. We didn't get it. It went to others, including some private equity people, perhaps for 30% more than we thought it was worth.

It turned out five years later they put it up for sale and we looked at it again, and we wound up acquiring it for less than what we had offered five or six years ago. Then our challenge is, how do we make it better? It was put under Jerry Law's group, and ultimately, after a 60 or 90 day study we decided to shift production from a plant in Pennsylvania that we closed, and also from Oregon. So we will benefit probably in quarter three and four of this year with all the moves that we made.

Brian Rafn: Okay. So would you also bring product or recipes or the type of things that Labriola maybe had unique to their business, would you also move that to your other factories, or do you keep that underneath their footprint?

Gerald Shreiber: Still looking at the possibilities. In fact, I mentioned before, we haven't built any new plants in several years and we're looking to maximize the efficiencies at our larger facilities, including Pennsauken, and now Labriola's included in that.

Brian Rafn: Got it. I'll just ask one more and get in line. Any developments in the C stores, the convenience stores, the dollar stores, any product launches or anything?

Gerald Shreiber: All of our products are now being introduced and generally reviewed in the C store industry, and that's been part of our growth.

Brian Rafn: Thanks, guys.

Gerald Shreiber: Thank you.

Operator: And our next question comes from Robert Costello.

Robert Costello: How are you doing? Gerry, Kroger, sale of the stores that they talked about, is that a benefit, or does it hurt you?

Gerald Shreiber: I'm sorry. I didn't hear the question.

Robert Costello: The sale that Kroger is putting up, their C Stores up for sale, they have like 800 stores.

Marjorie Shreiber Roshkoff: You said the customer is closing 10% of their stores.

Gerald Shreiber: I'm sorry. Bob, I understand what you asked, alright, and I'm trying—I said a customer is closing 10% of its stores. I didn't—

Robert Costello: No. I'm not talking about that. I'm saying, the sale of Kroger stores, would that be a benefit to you in the future that you could get new business, or is that someone that you already sell to right now?

Gerald Shreiber: We're selling—

Robert Costello: With ICEE and whatnot.

Gerald Shreiber: We're selling to Kroger C Stores now, and after it all shakes out, I don't know who's going to buy it or when it's going to close, but we will be as close to being on top of that.

Robert Costello: Okay. The profitability you mentioned in your speech on the baking business, Labriola, you said quarter three or quarter four you should see the benefits of the restructuring.

Gerald Shreiber: That would be our quarter three or quarter four, which would run from April through September. Keep in mind, we just acquired Labriola in August, so it was September until October we started to make year-end plans in there. And I've got a little bit of cushion in that, but suffice to say, the benefits of distribution and integration and of production efficiencies will come in the second half of the year.

Robert Costello: Great. So when you're done with the changes, do you expect it to be the average of the group or better? What's your goals for what you're doing?

Gerald Shreiber: We expect it to be more in line with the benefits that we're getting out of the bigger production facilities, including Pennsauken and Vernon, which would be a strong improvement for them.

Robert Costello: Last question. You mentioned the gallon increase at ICEE, could you be a little more specific, ex the acquisition, what's driving it?

Gerald Shreiber: We've got a good team with good management and they're driven to grow that business every year. And you know what, when you look at ICEE, not just its recent history but its long-term history, it gets better and better and better.

Robert Costello: Thanks very much.

Gerald Shreiber: Thank you.

Operator: And we do have Francesco on the line again.

Francesco Pellegrino: Hi, Gerry. Can you hear me now?

Gerald Shreiber: I can hear you now. What happened before, Francesco?

Francesco Pellegrino: I don't know. But I wanted to ask, how do I get on that caller pool you guys have going? I would have taken—

Gerald Shreiber: It's too late now.

Francesco Pellegrino: Yes, I know.

Gerald Shreiber: Guess who won the caller pool?

Francesco Pellegrino: Dennis, because he's good with numbers.

Gerald Shreiber: He's real good with numbers, but yours truly won it.

Francesco Pellegrino: Ah, okay.

Gerald Shreiber: It has its rewards. It's just a thing that we do.

Francesco Pellegrino: Got it. Jumping right in, I wanted to ask you a question about the Frozen Beverage segment, because if you get this nice performance in the first quarter I'm not really sure what the read-through is for the rest of the year because it's a rather lumpy business, depending upon when beverage machine sales happen, when gallon sales occur. There's no real way to extrapolate that data going forward. And I guess, just looking at the segment from a longer time frame, is this a segment that can return to operating margins in the low double digits like it was five years ago?

Gerald Shreiber: Well, I'm going to defer the answer to Dan Fachner, who runs that group for us, and Dan is on the other line remotely in ICEE's home base in Ontario. Dan, do you want to tackle that?

Daniel Fachner: Yes. Hi, Francesco. How are you?

Francesco Pellegrino: Good.

Gerald Shreiber: I think you guys have met before, when we were racing through New York.

Daniel Fachner: I think we did too.

Francesco Pellegrino: Yes.

Daniel Fachner: I am actually remote at an airport, and so hopefully the connection is good. But our future I think, this year looks really bright. The first quarter was strong, driven by the theater industry, and the theater industry had a good first quarter. I think last year was an off year for them and this year will be a strong year, and I expect our year to follow that trend.

Francesco Pellegrino: Dan, are you talking about a rebound in maybe the customer base? I would have thought that as you acquire more ICEE franchisees, that the platform to sort of leverage the existing business model would create greater operational synergies or greater operating leverage to sort of drive improved operating margins?

Daniel Fachner: It does improve our margin somewhat. But our business, we have branches all across the country, and so as you buy one of those operating branches you're able to consolidate some of that, but you still need all the service and delivery personnel to be able to make the program work. So there's not probably as much infrastructure consolidation as you might think. It's good for us. As we buy the other ICEE distributors it helps our licensing piece of our business to be able to grow and grow in those areas, but there's not as much profit consolidation as you might think.

Francesco Pellegrino: Got it.

Gerald Shreiber: It's not a question of moving other cows out of the pasture and consolidating them, but there are efficiencies. And sometimes we want to be careful we don't get raw bone deep in the efficiencies that it affects our service or other distribution.

Francesco Pellegrino: Got it. Okay. Gerry, could you go over that churro manufacturing efficiencies increasing utilization by 300%. Were you visiting Bellmawr, Colton or Vernon, when you were seeing this, first off?

Gerald Shreiber: Well, we put a new line in here in Pennsauken, but the combination of effects of our production increase came from our experience with Colton, Bellmawr and Vernon.

Francesco Pellegrino: My question for you then is, why would you be adding another churro line in Pennsauken if you have your Colton and Vernon manufacturing facilities currently operating each below 50%?

Gerald Shreiber: Well, I don't know if they're below 50% in churros, but we added because we looked at our long-term sales projections. We've been making churros here for 15 or 20 years, but this is improved technology, improved production equipment. And we’ve kind of projected out, and don't quote me on this, but if we project out that our overall churro business is going to grow, in essence, perhaps double over the next five or six years, but there will be lower cost.

Gerard Law: Francesco, the new lines that we're putting in, we've improved our efficiencies, we'll have a lower cost and the products are coming out of our Bellmawr plant into Pennsauken.

Gerald Shreiber: And it's going to be less distribution cost in the future.

Gerard Law: And the capacity comment you had, that's across the whole plant, not necessarily lines inside of a plant—the churro line.

Francesco Pellegrino: Okay. But isn't Colton just churros?

Gerald Shreiber: Yes.

Francesco Pellegrino: Okay. And that operates under a 50% utilization?

Gerald Shreiber: No.

Gerard Law: Not this.

Francesco Pellegrino: Okay. I thought that's what the 10-K said, but I won't split hairs on that. So then based upon what you're doing with the new churro line, is this a bullish read-through for what's going to be happening with churros over the next four to eight quarters?

Gerald Shreiber: Well, give us a couple of—

Francesco Pellegrino: If you've only got 1% churro growth in the current quarter.

Gerald Shreiber: Only in this quarter. And part of that was due to capacities and it's trying to avoid excess logistics.

Gerard Law: Yes, and our East Coast line was at capacity. We put a line in to reduce our cost and improve our efficiencies, and that resulted in something that had much more capacity than we currently need. But we're always building for the future.

Francesco Pellegrino: Okay. I guess, just sticking with Jerry Law for a minute, just bigger picture, right now one-third of your existing manufacturing facilities operate with a utilization rate below 50%, 80% of your manufacturing facilities operate with utilization rates below 70%. Gerry Schreiber just said on the call that you guys aren't really looking to consolidate any more existing facilities, but besides just getting greater volume into these underutilized facilities it just seems as if you guys have a great opportunity potentially to consolidate facilities to drive greater manufacturing leverage. And it just seems as if that's not a route you guys are going to generally take.

So outside of that, how do we get greater leverage outside of volume growth from these facilities, given all the capex spending that has occurred over the past few years to improve—

Gerard Law: The capex spending [audio disruption] the capacity growth that we have. When we build lines, we don't build it for today's production. We build it for what we're going to need five or seven years down the road as well, so we don't have to continue to invest. This past quarter we closed Chambersburg, as we look at our capacities, and we're comfortable with the capacity we have. Anything beyond about 80% is tough to manage from a scheduling perspective.

Gerald Shreiber: We still have to run the lines and manage the lines, you still have to get them a day off and a weekend for worship or for family. And so it becomes a balance.

Francesco Pellegrino: It totally makes sense, because as I understand the acquisitive nature of your business, how you drive revenue growth, earnings growth through acquisitions, make these types of tasks or reviews of these facilities even harder as when you acquire a business, you acquire their manufacturing facility, so it sort of just magnifies the underutilization for certain facilities. So it just seems as if it's an ongoing or perpetual task that you need to do. I don't think it's easy by any means, but—

Gerald Shreiber: You're right on all points in there, but sometimes we acquire companies or plants or facilities because of great product extensions, but once in a while they're dogs. And when I say they're dogs, they're dogs compared to our modern state of technology. And we want to either improve them, like we've done with some, or close them, like we did in a plant in California some seven or eight years ago, and like we recently did in Chambersburg.

All of these plants, and the people thereof, contributed to us, and we take great pains when we see some of the talent that we have at these facilities, to extend them at another plant instead of just shutting it down. Chambersburg is a great example of that. That's an old industrial area. The plant had been turned over three or four times before we acquired it about eight or nine years ago. It served a useful and healthy purpose for us, and we moved the products into existing facilities where we won't lose any efficiencies, and we are placing the people so that they have continuous job growth with us.

Francesco Pellegrino: Awesome. Thank you. That was very helpful, Gerry. Thanks again.

Operator: Okay. We have another question on the line from Charlie Carter.

Gerald Shreiber: Good morning, Charlie.

Charles Carter: Good morning. Just a couple quick ones. I saw a press release yesterday that Sonic Drive-in is going to do a limited time offer of pretzels. Can you speak to whether that's your product?

Gerald Shreiber: Well, if you asked me that question last week I would probably have to say "no comment." But since you're asking me today I can tell you that that is a product that we developed with them. We ran some trials two months ago, we attacked some issues, and I'm both pleased and proud to say that it was Jerry Law and his group. That is our product, and I think they're doing commercialization of that and into the stores like today, tomorrow.

Gerard Law: Yesterday.

Gerald Shreiber: Yesterday. And according to projections, theirs, not ours, it will play a significant part in our next quarter's business, and we got there production-wise and efficiency wise and quality-wise, at a record-breaking pace.

Charles Carter: That's great. And then the store closures you mentioned, that's a prominent club store operator?

Gerald Shreiber: You're exactly right. And I don't want to tell you who it is, but their name begins with an "S."

Charles Carter: Okay. Alright. Thanks very much.

Operator: And we do have Brian Rafn on the line again.

Brian Rafn: Yes, Gerry, you talked a little about Labriola and Hill & Valley. Give us just maybe a snapshot of some of the acquisitions that you had in the past, New York Pretzel, Kim & Scott's, Daddy Ray's, Philly Swirl, how are these doing?

Gerald Shreiber: They're all doing well. They're all contributing to our sales and our future. New York Pretzel was an institution, they were around for 70 years. They were big when we were just getting started. We went through many a war with them, and when I say many a war—and ultimately we acquired them about five years ago and retained the elder statesman there, Ronnie Orfinger who—that's his life. He gets in there at five in the morning. He doesn't leave until the afternoon. He runs that plant like it was his own. And he's a valuable part of the integration and we continue to benefit from that. That gave us a stronger position in that New York corridor.

You mentioned a couple of other plants in there?

Brian Rafn: Yes, Daddy Ray's, Philly Swirl, Kim & Scott's, anything on them?

Gerald Shreiber: Daddy Ray's, Jerry Law and I visited them about seven years ago because they were involved in making fig and fruit bars, maybe it was eight years ago, but we were making fig bars for Paul Newman, may he rest in peace. It was a very small business.

And we heard about this little company that was outside of St. Louis in a small town named Moscow Mills. We visited with them, and after being stopped at the door for about 45 minutes to an hour they invited us in. That was about a $15 million company. We made a quick deal with a handshake and we acquired it, which included some valuable real estate right next door, industrial use, and its sales have grown from about $15 million, $16 million, Dennis?

Dennis Moore: Yes.

Gerald Shreiber: To where it's now pushing $70 million this year. It's a different part of the business. It doesn't quite have the overall margins that we have perhaps with some of our other products, but it's contributed nicely. Dennis has—

Dennis Moore: Yes. Pardon me. Just to the operator, Akshay, one of our analysts is trying to get in and he's unable to get through, for some reason.

Operator: Okay. I do show him in the queue, so would you want us to take his question now.

Gerald Shreiber: They'll just have to be patient.

Brian Rafn: All right. Am I still open?

Gerald Shreiber: Yes. You're still up—

Brian Rafn: Yes. Okay. Let me ask you, Gerry, you guys talked about R&D and you're always developing new flavors and recipes and that. Is that domiciled at each plant and at the culture of each one of your acquisitions, or is that more of a centralized R&D effort coming out of Pennsauken?

Gerald Shreiber: I'm going to give that to Jerry Law because what we had originally in Pennsauken has now grown where it feeds—we're like the centralized location but we have feeder plants all over. Jerry?

Gerard Law: The plants all have R&D locally that allows us to be fast-to-market and products are readily commercial. And so that is where it's going to stay is out in the field, where we can be quick and agile.

Brian Rafn: Yes. When you look at something that might be a local flavor or a local seasoning, can you migrate that across the country, or is it really kind of a regional or local?

Gerard Law: We do both. Sometimes we can get it across the country, but the rest of the country's got to like the stuff too.

Brian Rafn: Yes. Yes. Okay. Let me ask with Amazon taking on Whole Foods and some of these chaotic things going on in the grocery store, as you see consolidations, how has that affected shelf space and imports, the ability to bring in new products? How disruptive is that, what's going on in the grocery industry?

Gerard Law: We haven't seen much of that in our business thus far.

Gerald Shreiber: But we're in the process of looking at how we can improve our e-commerce thoughts, so that we're able to provide the answers, both to ourselves and to our customer base.

Brian Rafn: Okay. I'll just ask, in the past you guys have done some kind of co-branding, co-licensing, like Barq's Root Beer and you had the Minute Maid Lemonade. What's going on in that whole side? Is that an area of your business that is diminished, or is that something you're focusing on? How have those co-branded deals gone, you had the Oreo, Pillsbury, the churro thing, just maybe comment.

Gerard Law: We **c**ontinue to look at licensing as a way to extend our operations and leverage our capabilities. We just signed on for Sour Patch, and the acceptance has been pretty good so far, the preliminary acceptance. And this is a frozen novelty that we're going to be manufacturing.

Brian Rafn: Gerry, I'll ask you one more and I'll get off. What are you guys from the standpoint—you bought the business for $70,000 out of bankruptcy eons ago, what is your total pretzel, do you guys have a measurement in volume or pounds? What does J&J do on an annual basis in total pretzels?

Gerald Shreiber: About 22% of our total sales, which is $1,100,000,000 comes from pretzels. And I want to correct you, the price I paid for that business in September of 1971 was $72,100.

Brian Rafn: Got you. Alright, Gerry. Thanks much.

Gerald Shreiber: You're welcome. Do you want to put through the [indiscernible].

Operator: Yes. We have his line open.

Gerald Shreiber: Okay.

Akshay Jagdale: Is that a cue for me? This is Akshay.

Gerald Shreiber: Yes.

Akshay Jagdale: Thank you for taking the question. Gerry, I wanted to talk a little bit about the sales growth, obviously, outstanding performance. I think it was 7% organic growth, if I did my math correctly. So the sales meetings that you have every now and then to rally the troops seem to be working. Is that fair?

Can you give us a little more color on the soft pretzel growth? It looks like the Brauhaus, am I saying that right, that might be the new product that's sort of driving that, if I'm reading it correctly? But just a little more color on the top line trend and then I have a couple of follow-ups.

Gerald Shreiber: Well, pretzel growth greatly improved in the past year, and Brauhaus was part of that. But just like years ago, we made pretzels only under the SUPERPRETZEL brand, and then we added a Bavarian brand, and then we added Bakers Best through acquisition, but overall pretzel growth has been pretty good. And we're going to continue to, not push the limits, but build the mountains for that product so that we can continue to be the captain of that industry.

Churro growth has also come the same way, and let us not forget ICEE. ICEE was approximately a, Dennis, what $12 million, $13 million business when we acquired it in 1987, and it's now running at $250 million-plus.

Akshay Jagdale: Right. So I guess, what I'm trying to get at is how sustainable is this growth? So 20% obviously, it wouldn't be prudent to model 20% growth for the rest of the year even, but can you give us a sense—it tends to be a little choppy with the channels and the customers that you have, but how sustainable is this strong double-digit growth, in your opinion, on soft pretzels?

Gerald Shreiber: Well, we were really projecting organic growth of mid-single digits, and every once in a while, there will be an acquisition possibility; some years there have been as many as two or three, some years none. This past year we did a couple of small ones that fit in nicely. So I could tell you that every effort from every senior manager complemented by the marketing and sales growth are continually quarter-by-quarter, month-by-month, working directly to that. And when we have these meetings and we set these goals and review them, we're not horsing around. We're generally working towards whatever we can do to continue to grow this company.

Akshay Jagdale: Okay. And then just on profitability, so quite a different story than top line. So maybe you need to have an annual or semiannual or every two-year operational meeting going forward, but what's going on—

Gerald Shreiber: I don't want to be in the position, Akshay, that we're having meeting after meeting. They get the message. Even though our profitability has grown significantly over the years, there are still some gaps that we can improve that, and we're going to continue to work on that.

Akshay Jagdale: Yes, what I'm specifically referring to is in each of the last four quarters the profitability has not been great, especially relative to what's been going on, on the top line where things are accelerating. And ever since I've followed your company that has never been an issue until recently, right, profitability.

So can you take a step back and maybe give us a sense as to how you're thinking about it? Is this something structural that needs to change more broadly with some deeper measures on cost, or is it just some transitory issues? I know you've discussed moving product from one plant to another, but you've got some issues with volume in bakery. There's some mix issues overall in your product portfolio that are hampering margins related to acquisitions.

So can you just take a step back and long-term view, why is it that the last four quarters have shown an unusual trend on profitability that we've never seen before, and what does that mean going forward?

Gerald Shreiber: Well, part of that has been product mix. And you're right, part of it was a shifting of logistics in here. But it's something that we have targeted for multiple efforts and projects for the next year.

Gerard Law: And Akshay, you'll see that's part of the reason we stepped up our capex last year was to focus on improving our margins and efficiencies. Getting these projects online takes some effort when they come up and we expect them shortly to start giving us some growth here. But it's been a focus on the gross margin to be able to try to improve it through operational efficiencies and synergies between the plants.

Gerald Shreiber: And it goes all the way through sales and allowances as we maintain our commitment to our customers without the benefit of high price increases.

Gerard Law: Last year we had no price, there was no price in the mix. This year we're working harder to take price and be effective on the street, and we announced our price increase and we're moving forward.

Akshay Jagdale: Okay. Just one last one. More broadly on capital allocation, maybe one for Dennis here. With the change in, obviously, the tax legislation here and the tax rate going down, how are you thinking more broadly about returns on capital and how that informs your capital allocation decisions? I'm assuming the returns on everything related to cash have gone up because of this, but can you give us a sense of how you're thinking, outside of acquisitions?

Gerald Shreiber: Well, the primary use of our cash—we believe the best use of our cash would be acquisitions. Keep in mind, and even though it doesn't take away, we're looking to keep our employees and we're looking to expand their benefit for themselves and their families. We don't have to come out with an annual dollar or a $1,000 bonus to the employees because of the tax benefit. I've read and I’ve bemused that a lot of the bigger companies are rewarding their employees with either a raise or a one-time payment. We do that all the time. Our employees are getting fairly paid and they have incentive goals, which would also increase their annual compensation.

We've done all these things consistently without having to have a major reorg and whatnot. And along the way we started a dividend that we've now increased over a 10-year period some 42 times, or we've paid it some 42 times. But there is no disregard to continuous profitability as we grow sales.

Akshay Jagdale: And I know I said the last one, but just one last one, I promise. M&A, so why has it taken this long? It's been a while since you did like a sizable deal, I guess, that's how I'd put it, but I know you're always looking hard and obviously you passed on probably a lot of things, but we're starting to see activity pick up a little bit, are you starting to see that? Are expectations on multiples coming in, and is that really what's kept you on the sidelines? Because I'm sure you see a fair amount of opportunities and you just didn't find the right price, right? Am I explaining that correctly?

Gerald Shreiber: It's not always a matter of the right price, sometimes it's a matter of the right fit. And like I said, if you look at our history, really look at it, we've made as many as two, three acquisitions in a year and then we've gone several years without anything. Labriola is something that we have to fix, but it's in the right product category for us, soft pretzels that does specially baked goods. And over the years, we've found a lot of these kind of companies and we fit them.

Now I'm not going to do and we're not going to do anything that's going to be transformational, and particularly, that we don't have a lot of good, sharp, solid experience. In my opinion, that would be reckless. And even though Dennis Moore, Jerry Law and Dan Fachner are all part of our acquisition team, we want to make sure that we stay within the guidelines of what we've stood for, for the past multiple decades, quality product, niche products that we can lead, if not dominate the category and become an efficient producer. That sets well for not only acquiring the company, but for continuing its growth.

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

Operator: And our next question comes from Charlie Carter.

Charles Carter: Yes. Just a quick one that dovetails off that last one. So I'd seen an article about Paul Newman Foundation being potentially forced to sell itself because of a tax bill they just couldn't afford to absorb. And you mentioned earlier just having done some contract manufacturing for them, and I think, in a meeting with you, you'd mentioned also doing their cookies at one point. So I didn't know if that, A, represented an acquisition opportunity for you or B, if it's something that might be a little too big or pricey if you might lose a material amount of business if it went to someone else.

Gerald Shreiber: Let me plead ignorance here. Where are you calling from, New York or Connecticut?

Charles Carter: I'm actually in Florida.

Gerald Shreiber: Okay. I'm not aware of that. And when you say them having to sell—I'm not aware of that. But we produce for under a license, so we're contributing to that foundation.

Charles Carter: Okay. Thanks.

Operator: And the last question that I'm showing is Brian Rafn again.

Brian Rafn: Yes, Gerry, just a couple more. When you guys talk about efficiency in manufacturing, are you talking about line speed? Are you talking about the capacity to move more volume of product in a specific time frame? Give me your definition of efficiency, what is that you're looking for? Is it just cost?

Gerald Shreiber: Well, it's cost and quality, and it's expandable. Whereas, some of our plants are modern from top to bottom, some of them were older plants that we have improved over time.

Brian Rafn: Okay. And then, relative to the M&A side, certainly you guys have been very judicious, Gerry. You're probably the best guy in M&A in the whole packaged food area. Are you guys looking at in your funnel or your radar, are you looking at dozens of deals a year or hundreds of deals, how big is that universe?

Gerald Shreiber: Well, it's not hundreds, but it's probably somewhere between double digits and multiple teens. We look at some 25, 20 deals. Some of them are small, but that's just to look at. Some of them we wind up spending a little more time on and then we want to see the product, then we want to see the facility, then we want to see what kind of talent that they have, that they can complement us or we can complement them.

Brian Rafn: Yes. Do you have a specific preference between a turnaround restructure or something like a Daddy Ray's where you take a concept very small, very local and expand it regional, nationally, where you can really grow as you did ICEE?

Gerard Law: We would do both. We look for something that's small, that we can grow and we look for growth, but we look for things that we can inject our culture and wrap our arms around readily and improve.

Brian Rafn: Alright**,** guys. Good for me. Thanks a lot. Great job.

Gerald Shreiber: Thank you. Anybody else?

Operator: And I'm not showing any further questions.

Gerald Shreiber: Well, I want to thank everybody that was on the call for participating. And I look forward to talking to you all again next quarter. I'm going to sign-off.

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