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SPEAKERS

Gerry Shreiber - President, CEO
Dennis Moore - CFO
Jerry Law - Assistant and SVP
Bob Pape - SVP, Sales

ANALYSTS

Jon Andersen - William Blair & Co
Francesco Pellegrino - Sidoti & Company
Jonathan Feeney - Janney Montgomery Scott

PRESENTATION

Operator: Welcome to the J&J Snack Foods Fourth Quarter Earnings Conference Call. My name is Christine, and I will be the 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. Please note that this conference is being recorded.

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

Gerry Shreiber: Good morning, and thank you, Christine. I'm Gerry Shreiber, President and CEO and J&J Snack Foods, and with me today is Dennis Moore, our CFO; Jerry Law, Senior Vice President and assistant to me; Teddy Shepherd, CED; and Bob Radano, our COO. Also joining us by telephone in Canada is Bob Pape, our Senior Vice President of Sales, and just entering in the room is Steve Taylor, National Accounts Manager for Sales of Products to Restaurant and Casual Dining.

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. We undertake no obligation to publicly revise or update these forward-looking statements to reflect events or circumstances that arise after the date hereof.

Results of operations, net sales increased 2% for the quarter and 6% for the year. Without the sales timing benefit from the acquisition of PhillySwirl, which was acquired in May 2014, sales were up 5% for the year. For the quarter, our net earnings decreased by 4% to $19.8 million or $1.05 a share from $22.2 million or $1.18 a share a year ago. For the year, our net earnings decreased by 2% to $70.2 million or $3.73 a share from $71.8 million or $3.82 a share last year.

And after-tax investment loss of $2.3 million or $0.12 a share in the quarter compared to an after-tax investment income $768,000, $0.04 a share, in last year's quarter, and an after-tax investment loss of $516,000, $0.03 a share, in the year compared to an after-tax investment income of $2.8 million or $0.15 per share last year. What I've really said there, that we didn't do well with our investments, and as they continued to decline, we sold them off so that we would reduce our exposure.

Our EBITDA, that's earnings before interest, taxes, depreciation, and amortization, for the past 12 months was $150.3 million, again, a new record. Sales to food service customers increased 2% for the quarter and 4% for the year. Soft pretzel sales, however, were down 2% for the quarter but up 3% for the year. Italian ice and frozen juice bar and dessert sales increased 2% for the quarter and 1% for the year.

Churro sales were up 9% in the quarter and 1% for the year. Excluding sales to one restaurant chain which discontinued selling our churros in August 2014, churro sales increased 15% for the quarter and the year. Bakery sales were up 3% in the quarter and 7% for the year.

Retail supermarkets, sales of products to retail supermarkets were down 9% for the quarter and up 10% for the year. Excluding the sales timing benefit of the PhillySwirl acquisition, sales were up 1% for the year. Soft pretzel sales were down 3% for the quarter but up 3% for the year. Sales of frozen juice bars and Italian ices were down 5% in the quarter.

For the year, without the sales timing benefit of the PhillySwirl acquisition, sales of frozen juice bars and Italian ices were up 6%. Handheld product sales were down 27% in the quarter and down 11% for the year.

ICEE and frozen beverages: ICEE and frozen beverage and related products sales were up 10% in the quarter and 10% for the year. Beverage-related sales alone were up 10% in the quarter and up 7% for the year, with gallons, that is drinks, up 8% in our base ICEE business in the quarter and 7% for the year. Managed service revenue for others was up 6% in the quarter and 10% for the year.

Consolidated gross profit as a percentage of sales in the quarter decreased to 31.7% from 32.4% last year and for the year decreased to 30.8% from 31.3%. The gross profit percentage in this year's quarter compared to last year was impacted by higher trade spending in retail supermarkets and inventory reserve adjustments in our ICEE frozen beverages, and they were helped by improved product sale mix in our food service, along with a beginning of improvements in manufacturing efficiencies which had been a slight drag over the past several quarters.

Total operating expense as a percentage of sales decreased to 18.8% of 19.5% in last year's quarter, with the increase mainly attributable to efficiencies and lower distribution cost.

Capital spending and cash flow: Our cash and investment securities balance increased $10.1 million in the quarter to $240 million as we continually generate cash in excess to our needs. We continue to look for acquisitions as a use of our cash.

Our capital spending was $13.9 million in the quarter as we continue to invest in plant efficiencies and growing our business. We are presently estimating capital spending for 2016 to be $40 million or so, a drop of about $10 million from this past year.

Our investments generated before-tax income of $1.2 million this year, down from $4.5 million last year, as sales of our mutual fund investments generated a realized loss of $4.1 million this year. Although we recognized losses as we decreased our investments in mutual funds, our overall return on the funds has been positive since we first made the investments in October 2012. And although we are not happy we incurred these losses this year, we are nevertheless satisfied with our overall return.

We have invested the proceeds from the sales of these funds into preferred stock and corporate bonds which we plan to hold to call dates or maturity. A cash dividend of $0.36 a share was declared by our board of directors and paid on October 6, 2015. During the quarter, we purchased and retired 52,154 shares of our common stock at a cost of $5.9 million or $113 a share.

Commentary: Sales of soft pretzels and food service weakened as the year progressed. Sales to convenience stores continued to be strong during the quarter, but sales to schools and restaurant chains were down significantly from a year ago.

Frozen juice and ices and food service were up slightly, due entirely to sales of WHOLE FRUIT frozen organic juice tubes to one customer. Handheld sales and food service continue to decline down 3% in the quarter and 10% for the year. Churro sales continue to be very strong, aided by sales of OREO churros which were introduced about a year ago.

Sales of soft pretzels in our retail supermarket segment were relatively flat on a volume basis for the year but down 2% for the quarter, although, our core SuperPretzel product sales were relatively strong in the quarter, offset by declines in two newer items, our SuperPretzel Bavarian Pretzel Bread and SuperPretzel dog products.

Frozen juice and ICEEs were flat on a volume basis, with strong sales of Luigi's Italian Ice and weakness in some of our other brands. Handheld sales in the retail supermarket were down 27% in the quarter as sales drop to one customer accounted for more than half of the decrease and lower sales of Patio Burritos. In ICEE and frozen beverages, all facets of the business continue to perform well.

Our estimated income tax rate was 38.4% for the quarter this year and 34.8% last year and for the year increased to 37.3% from 35.4%. The higher rate this quarter is because the losses in sales of our mutual fund investments are not tax deductible.

We're estimating a rate of about 36% to 36.5% in fiscal year 2016. I thank you for your continued interest and support in J&J, and I will turn it back to listening audience for any questions or comments.

Operator: Thank you. We will now begin the question-and-answer session. (Operator instructions.) Our first question comes from Jon Andersen. Please go ahead.

Jon Andersen: I guess I wanted to ask a little bit about your thoughts at this point on fiscal 2016 sales. Obviously there's been slowing in a couple of areas of the business that have been important topline drivers, I'm thinking the soft pretzel business to restaurants and schools more recently. There is some commentary in the press release around sales, I think, up slightly quarter-to-date. So, can you help us, just think about the balance of the next year and what you kind of have on tap, whether it's new products or initiatives in certain business and how does that kind of all come together to a topline outlook for the next 12 months?

Gerry Shreiber: John, we got a lot of irons in the fire, and some of these irons in the fire are beginning to get smoking hot. So, we are cautiously optimistic not only about 2016 and beyond. Although, it's true that some of the segments slowed for one reason or another, it’s not like we'd lost any kind of significant market share, and it's not like there is anything happening transformational. We had a slow quarter, and that's about all I can say about it at this time. We're looking forward to getting back to those mid-single-digit growths that we're used to.

Jon Andersen: Okay, but given that you're not kind of, it sounds like at least in the present, you're now kind of at the mid-single-digit run rate that we're all used to. What would allow that to change, whether it be new customers in the restaurant segment, improvement in the handheld business? I guess, what are some of the initiatives? Can you comment on those, Gerry, and how long they might take to get some traction?

Gerry Shreiber: A year ago we introduced these OREO churros, which is starting to get some traction, but more recently we were approved to enter it into retail supermarkets with them being prefilled. We are very excited about that, and we're getting acceptances across the table. We're not going to be hitting those things till January. Bob Pape, you're on the phone, Bob?

Bob Pape: I am, Gerry.

Gerry Shreiber: Maybe you could tell us why you're so bullish on the OREO churros and on the new Pillsbury licenses that we have.

Bob Pape: Yes, through new licensing we gained an advantage of branded products that are known throughout the country, throughout the world. OREO is an icon brand for the industry, and with the churro products and a lot of what the trends are as far as product mash-ups go, we think that those items will perform very well. And Pillsbury certainly is a brand that's trusted by consumer, and a large portion of American consumers have Pillsbury products in their homes.

So, through some dessert products that we're doing with Pillsbury, we expect that to perform very well as well, and we've gotten very good initial responses.

Jon Andersen: Okay.

Gerry Shreiber: Bob, is a conservative guy. He's really a conservative guy. He's Campbell-trained, he's been with us 15 years, and he runs a good, tight ship. But we're expecting improved sales in supermarkets as well as continued improvements with our convenience store business. How do we get the fast food restaurants and some of the other service sales of soft product back on to that higher track? We're working on a lot of things. And it's not like we've lost any business, but like I said, we have a lot of irons in the fire, and we're about ready bring them out and stoke them.

Jon Andersen: Okay, thanks. Just from a gross margin standpoint, the margin in the quarter and for the year were bit lower than 2014, and I kind of get that you've been working through some your manufacturing efficiency issues, and I guess maybe volumes in some of the higher-margin businesses have also effected gross, but how should we think about margin structure in 2016, given that you did say we're at the front end here of better efficiencies in some of your manufacturing plans? I mean, is 2016 setting up as year where we could see margin improvement? How are you seeing that right now?

Gerry Shreiber: We believe so, Jon. We believe so. The new lines that we've been installing for close to a year in one of our nearby facilities are essentially done. They're being turned on, they're being tested. But put it this way, we're not going to see any lower margins.

Jon Andersen: Okay, last one for me. Where are you now in terms of the sale of some of the investments that have generated some of the losses to date? Are you done with that now? Do you have some additional work to do?

Gerry Shreiber: I'll kick it over to Dennis.

Dennis Moore: Yes, we have sold off almost all of the mutual fund investments we have. We still have an unrealized loss of over $800,000, but we don't anticipate that we would be recognizing that anytime soon, and maybe if we do, then over time. We have reinvested our funds in instruments where we would expect to eventually redeem them at par, primarily corporate bonds and some other things.

One of the problems that we had with the investments that we're getting out of is that returns on them were front ended, and unfortunately we—according to the way you have to treat them for accounting purposes, we weren't able to recognize losses as we went along. So, over the period of the three years that we were in these mutual funds, we generated income of roughly $10 million before tax, and now we have to take the losses these past two quarters.

But going forward, hopefully we're not going to have same kind of issue in terms of reporting losses.

Jon Andersen: Thanks, guys. Good luck.

Operator: Thank you. Our next question comes from Francesco Pellegrino. Please go ahead, sir.

Francesco Pellegrino: Just wanted to hit on the operational inefficiencies you talked about a bit, and the one thing that I noticed was your food service operating margins were up about, it looks like 210 basis points. I'm just wondering, when I start thinking about the story, are these operational inefficiencies, can we link them more towards products than certain segments? How should I really go about approaching just a thought process and modeling out the story into, I guess, fiscal 2016?

Gerry Shreiber: Dennis?

Dennis Moore: The operating inefficiencies that we've discussed and the improvements will all basically be in the food service segment.

Francesco Pellegrino: If they were in the food service segment, then why were your operating margins up in food service then?

Dennis Moore: In this last quarter?

Francesco Pellegrino: Yes.

Dennis Moore: Well, first of all, the inefficiencies that we had were waning, and we actually started to see improvement in those areas. But our distribution cost, especially when you looked at it by segment, were down in the food service segment, which was the major driver of the improvement—well, one of the major drivers of the improvements in the food service segment margins in this quarter.

Francesco Pellegrino: And then when we look at frozen beverage and retail supermarkets, was this also distribution cost as well that contributed to the lower operating margins mostly?

Dennis Moore: No, it was primarily that the improvement was in the food service segment.

Francesco Pellegrino: Okay, but then I noticed in the fourth quarter operating margins in frozen beverage were down 340 basis points, and then in retail supermarket operating margins were down 460 basis points, year-over-year.

Dennis Moore: Well, in our retail super market business, the issue that we had primarily was we had lower sales in handhelds, which accounted for a drop of half of the sales in the quarter, and also our trade spending that we recorded was higher than what we would have hoped, so that was the other driver of the downward numbers in that segment.

In terms of the other, in terms of frozen beverages, a good portion of it was we needed to reserve for some parts inventory during the quarter.

Francesco Pellegrino: Okay, so increases in trade spending for retail and then increase in parts inventory for the frozen beverage?

Dennis Moore: And both of those issues are not issues that we expect that will move forward into the New Year.

Francesco Pellegrino: Okay, that was helpful. You also mentioned in food service you faced a bit about headwinds with some sales into schools. Were these due to menu changes? Could you give us a little bit of color on those difficulties?

Gerry Shreiber: It was combination of unrelated factors. There were changes in menu. Last year we had a big, big sell-in, big, big buy-in, and we still are facing certain restrictions on our core products, soft pretzels in there, that they are being not allowed to be sold or restricted. The other product that we're selling there, the whole wheat and the 51% whole grain in there, they are being accepted as far as an item, but the kids are not buying as many of them. There has been a concerted effort by our food service group to look to sell our products to the other avenues in the school system, including the fundraising and the bands and the stadiums.

Francesco Pellegrino: So, if kids are sort of pushing back against your whole grain pretzel, what type of alternative would they have for purchases at schools, as I guess the only alternative I could see would may be bringing lunch, which I don't think is a great alternative for a majority.

Gerry Shreiber: Leafy spinach to carrots, right? Then the school food service and the educational channel has been somewhat struggling with establishing criteria, some of them really rigid rules in there. I think it's to our credit that we've been able to comply with most of this, and we have a lot of products in place that do meet the standards. And we've done everything nearly possible to improve the taste so that the children will not only be eating a product that meets the new USDA guidelines, but they'll be smiling and enjoying it too.

Francesco Pellegrino: Okay, that was helpful. One thing I know that you talked a bit about on the last conference call was just where egg prices are. I know that you were able to push through price increases during the quarter. Are you currently on the market for liquid egg products or have you locked yourself into some longer-term price contract for eggs going forward?

Gerry Shreiber: We're pretty much buying spot. Let me turn that to Jerry Law because he's been struggling with the egg prices.

Jerry Law: We continue to buy spot until we see a market that's returned back to normal.

Gerry Shreiber: Or close to normal.

Francesco Pellegrino: Okay. Keeping with the egg category, any feedback on how Mary B's is performing at retail, the new product, the breakfast sandwich?

Gerry Shreiber: It's still too early. It's a good product. We think it's going to be if not a major boost in the arm for handheld, I think it's going to be helping them. Product tastes great, looks good. We got Walmart and others in there that are going from test to beyond, so I think we'll have more to say on that in the next few quarters to come.

Francesco Pellegrino: All right, and last question for me is first, here in the Northeast, we've had some pretty good weather. When I think about last year, I think it actually snowed on Halloween, so we have warmer weather now. I think this would sort of allow you to have greater frozen beverage sales trickling into maybe your first quarter. What other products should we see perform well in the warmer weather in this first quarter as compared to be maybe a year earlier? And if you want to talk about maybe how it will be on certain segments, certain products.

Gerry Shreiber: Francesco, we don't sell candy.

Francesco Pellegrino: Right.

Gerry Shreiber: But obviously our ICEE business, which includes ICEE, Arctic Blast, Slush Puppie, and Parrot Ice, they benefit from warm weather, but they really benefit when schools are out. So, when school are out, they have children out in there, we get the benefit of not only weather but the kids being out there. What helped us last year and throughout the year was the movie theatre business. There were a lot of, let's say, exciting movies for children and adults in there, and we've done a good job, our ICEE group has done a good job over the years not only getting ICEE into the concession stands in the theatre, which is no small task, but featuring it in there.

So, there are times even when the weather is chilling, snowy, and rainy, and we could see the benefit of ICEE sales in movie theatres.

Francesco Pellegrino: Any other products that might have a better correlation to weather? Outside of just maybe other events like stronger movie theatre performance, is there anything to really latch onto, or am I just sort of grabbing at nothing?

Gerry Shreiber: I think nothing that I could comment.

Francesco Pellegrino: Okay, that's it for me. Thanks again, guys.

Operator: Thank you. Our last question comes from Jonathan Feeney. Please go ahead.

Jonathan Feeney: Forgive me for asking a very granular question, but it's been critical to your business. When you look at the communication you've given us about food service soft pretzels in chains, I'm trying to understand the timing. Obviously it was a very tough fourth quarter. I know they're very menu-dependent items, and you had a tremendous amount of success growing those, but the flipside to that is it's lumpy, and if one or two chains decide they're not putting your pretzels on the menu, that has draconian implications for that.

So, my first question would be where do you stand with that sort of menu placement, and do you feel good about that chain store and just generally restaurant food service soft pretzel business next year?

Gerry Shreiber: Well, we feel good about the segment, and again, I got to go back and look at that segment. Five years ago, it was blank. Our people have done a great job in getting our product out there, getting it tested, making specialized product for the venue in there. They do occasionally, and this happens all the time, they will suffer from menu fatigue, and as a result, sales will slip or they'll be discontinued and then they'll come back. But overall, we feel cautiously optimistic about the segment, and we don't expect to have further declines.

Jonathan Feeney: That's helpful, thanks. And on the handheld business, I mean this was an interesting business you bought out of ConAgra. It's an interesting—had some pretty decent initial success with it. It seems incredibly on trend from, you look at the proliferation of anything that's protein heavy in the convenience to takeaway channel, it seems like very on trend. Why do you think has that struggled, and what's the kind of future for that handheld business? Because this is a pretty significant percentage decline, this quarter in the face of what seems some pretty good trends for that type of product in those channels.

Gerry Shreiber: Well, you raise a good point. When we bought it, it was already spiraling down in sales, and it's only been recently that we have made major R&D and product improvement efforts on there, and we're seeing some of the first benefits of this in the past six months or so. This product that's going out under the label Pillsbury and Biscuit Melts, we're hopeful of those products.

We've been private labeling for some of—companies like Nutrisystem and others in there, and these products will be hitting in January. But you're right, we thought the product and that whole protein wrapped category was on trend, and it allowed us to take our pretzel products and fit it into this category.

We're looking at others who are doing it well. We've also been shadowed to some degree by Nestle, who has struggled with it. But we expect to make improvements in the handheld category over the next year.

Jonathan Feeney: Last question, Gerry. You mentioned if you look at acquisition world, and specifically—I think in that, related to that protein insight, I mean, everything that's on fire in the convenience store where it seems like you've had a lot of your success in the past, seems to be protein-driven, and a lot of companies out there selling fried chicken or whatever it is. I mean, how are you feeling about the acquisition environment right now, and is something in that sort of utilizing that ConAgra handheld insight, trying to address that trend, where would that be on your priority list?

Gerry Shreiber: Jerry Law, I'm going to give this one to you.

Jerry Law: We continue to adjust trends in handheld with empanada products, the melt products, the pies, and innovate them and connect them with our new license brand as well. So, we continue to like the space [audio disruption] improve the plans and operations here. We think we'll see a chance in 2016.

Jonathan Feeney: Great. Okay. Well, thank you very much, guys.

Operator: Thank you. (Operator instructions.) We have no further questions at this time.

Gerry Shreiber: Well, I want to thank everybody for joining our quarter conference call. Although we had in essence an okay quarter, we're not happy with the results, and we're looking forward to improving next quarter and beyond. Thank you.

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