49838639- J & J Snack Foods - J & J Snack Foods Third Quarter Earnings - 07-28-2020

Operator: Welcome to the J&J Snack Foods third quarter earnings conference call. My name is Cheryl 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, if you have a question you could press star, then one on your touch tone phone. Please note that this conference is being recorded. I will now turn the call over to Gerald Shreiber, so you may begin.

Gerald Shreiber: Good morning, everybody and welcome to our third quarter conference call. With me today are Rob Radano, our senior vice president and chief operating officer, Rob Pape, senior vice president of sales, Marjorie Roshkoff, vice president, secretary and in-house counsel. And remote is Dennis Moore, our senior vice president of finance and Dan Fachner, president of our J&J group, but Dan is calling in from Tennessee. I think I got everybody. Let me begin. I'll begin with the obligatory statements. 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 data here off. We undertake no obligation to publicly revise or update these forward-looking statements to reflect events or circumstances that arise after this date.

Results of operations, net sales decreased 34% for the quarter. Without sales from the acquisition of two ICEE groups in October 2019 and February 2020, sales decreased 35% for the quarter. We had an operating loss of $19.4 million compared to operating income of $39 million a year ago. Food service. Sales to food service customers decreased 40% for the quarter and 14% for the nine months. Our sales decrease for the quarter was due to decreased sales of soft pretzels, frozen juices, and ices sales, churros and as well as funnel cake and handhelds and bakery products. We had an operating loss of $18.2 million in the quarter in our food service segment compared to operating income of $21 million a year ago, primarily because of lower production and sales volumes due to COVID-19, which had a devastating effect and impact on our customers and on ourselves. This year's quarter also included approximately $5 million of cost for employee safety and increased COVID-19 compensation. Additionally, we decided to close a manufacturing facility in the Midwest during the quarter and recorded an impairment charge of $5.1 million.

We expect to reduce manufacturing overhead and distribution costs by about seven to $8 million annually as a result of this plant closure. Retail supermarkets and groceries, the unitary bright spots. Sales of products to retail supermarkets were up 38% for the quarter. Soft pretzel sales were up 74% for the quarter. Sales of frozen juices and Italian ices were up 26%. Hand-held sales were up 6% and biscuit sales were up 56%. Sales were significantly higher for all product lines because of increased sales to supermarkets generally since mid-March of 2020, due to the COVID-19. Operating income in our retail supermarket segment increased in the quarter to $7.9 million from $3.8 million a year ago, all due to higher sales.

ICEE and frozen beverages, which includes Arctic Blast and Slush Puppie. Those and beverage and related products sales were down 56% in the quarter. And beverage related sales alone were down 71%. Without the sale of ICEE Distributors and Bama ICEE, overall sales were down 60%. And beverage related sales were down 78%. Service revenue for others was down 23% as this part of the business held up relatively well. Machine revenue was $6.4 million down from $11.8 million last year. Last year had two large installation projects for customers. We had an operating loss in our frozen beverage segment of $9.1 million compared to 14 million - $14.2 million operating income in last year's quarter, and again, primarily because of COVID-19. Consolidated, gross profit as a percentage of sales fell to 17% in a three-month period this year, down from 31% last year. Gross profit percentage decreased primarily because of lower volume in our food service and frozen beverage segments, higher cost related to production disruptions due to volume exchanges and expenses related to employee safety and increased COVID-19 compensation and reserves of approximately $1.5 million for inventory write down.

Even though total operating expense decreased $5.7 million this quarter to a $10.8 million decrease, not including the plant shutdown impairment charge, operating expenses as a percentage of sales increased at 26% a quarter up from last year's 19.7%. The percentage increase was because of the drop in sales and our inability impossibility in the short term to reduce expenses in line with the decrease in sales because of fixed costs that do not fluctuate with sales. Our EBITDA, that's earnings before interest, taxes, depreciation and amortization for the past 12 months was $103 million. Capital spending and cash flow. Our cash and investment securities balance of 270 million was up $3 million from our March balance as our balance sheet remains strong and we have no liquidity issues during this COVID-19 time. 86 million of our investments are in corporate bonds with a purchase price yield to maturity of 2.8% of which 75 million mature within the next two years.

Our bank preferred stock and mutual funds, 13 million have stabilized in value since the drop in value at the end of the March. We continue to look for acquisitions as a use of our cash. Our capital spending was $11 million in the quarter. Although down from last year in the quarter, we continue to invest in plant efficiencies and growing our business and have committed and are looking at further manufacturing capital projects to improve efficiencies on an ongoing basis. A cash dividend of 57 and a half cents a share was declared by our board of directors and paid on July 7th. We did not buy back any of our stock during the quarter. Our investment income decreased from $2.8 million last year to $1.3 million this year, primarily as a function of lower interest rates. Regarding where we are now. Net sales from the first four weeks of our current fourth quarter were down approximately 25% from a year ago. Although we cannot estimate whether net sales will continue to be down at the same rate for the balance of the quarter, we expect that our operating results for the fourth quarter will be improved from our third quarter, although operating income in the quarter will be materially lower than last year.

As we have said, approximately two third of our sales are down to venues and locations that have shut down or sharply curtailed their food service operations. So, we anticipate COVID-19 will continue to have a negative impact on our business. As we have $270 million of cash and marketable securities on our balance sheet, we do not expect to have any liquidity issues. We have operated our business during the crisis, both with short term consideration and for long-term as well. We have placed a high priority of continuing to keep our employees safe while looking for ways to improve our business going forward, including reviews of manufacturing and distribution network. We have plans to close a manufacturing facility in the Midwest, and we have worked with our customers developing significant new products to sell as they open up. We continue to be optimistic about our future during these unusual tough times. I want to thank you for your continued interest and look forward to talking to you again at the end of our fourth quarter. I will now turn it back to the listening audience for any preguntas and comments.

Operator: Thank you. We will now begin the question and answer session. If you have a question or a comment, you can press star, then one on your touch tone phone. If you are using a speakerphone, please pick up your handset first before pressing any numbers. Our first question comes from John Anderson. Your line is now open.

Gerald Shreiber: Hi John.

John Anderson: Hi Gerry. Good morning everybody, hope everyone is well.

Gerald Shreiber: We are well, we just hope that the sports and leisure and movie industry and schools get well.

John Anderson: Yeah, don't we all? I miss all of that. So, you mentioned that your sales during the quarter, at least the rate of decline got better, improved. I think you had previously said that in April sales were trending down 45% and it sounds like June, you're much better trending down but 25% nearly cut that in half. And I guess my question for you is, do you anticipate at this point, given what you're seeing in your food service customer base and your frozen beverage customer base, do you anticipate that that rate of decline continues to improve in the second half of the calendar year, which would correspond with the fourth quarter and the first quarter of your fiscal year? Is there reason to believe that the sequential trend should continue to improve from here?

Gerald Shreiber: We're cautiously optimistic. We are hopeful. Once the sports and leisure venues get back to a full time, that's going to make a big difference. The movie theaters are open, and schools are coming back, and that represents a significant part of our business.

John Anderson: The improvement that you have seen from April to June, which segments, or venues or locations have driven that improvement?

Gerald Shreiber: That's really any of the ones that were closed. This is new business that we were able to secure.

John Anderson: New business.

Gerald Shreiber: We would have had a hell of a year if we had not lost all of our sports and leisure and movie theaters.

John Anderson: Okay. Okay.

Dennis Moore: This is Dennis, yes, I mean, it's certainly new business, but its new business related to what was lost. I mean, the biggest improvement was because of venues opening up, there was a lot more venues that are open now than there were in April, plus it was also the, I guess the shock of the initial shut down. So, a lot of distributors held back their orders and whatnot, but over time as more and more opened up, it's the primary reason why we have improved sales, not new business per se.

John Anderson: Right, right, right. Okay. Okay. But kind of there is cautious optimism, I think is the word you used that we could see sequential improvement from here that the trough is in the June quarter in terms of the sales department.

Dennis Moore: Yeah. At this point we certainly hope that's the case. And things are - continue to be, venues are continuing to open up and we hope that that continues. But we don't know where we're going to start at, whether we will continue to increase towards being down zero or somewhere between 25% and zero. It depends basically on what continues to open up.

John Anderson: Fair point. And then on the profitability side, I think on the prior conference call, you mentioned, you thought you could be profit neutral to maybe a modest profit loss. Where you kicked in with operating loss of, I think 19 million in the quarter, was that in line with your expectations? And in our group basis, I understand you're balancing the need to kind of maintain your capacity and your capabilities for the other side of this. But at the same time, also trying to manage costs to some extent as we move through it. Was the property in line with your expectations and are there additional steps you're taking to reduce costs as we move forward?

Dennis Moore: I would say that initially from back in April, the loss is higher than what we anticipated at the time. And we went into the quarter, we had two primary, I guess things that we wanted to accomplish, main things we wanted to accomplish. One was to keep our employees safe. And that entails a lot of additional expense, not only $5 million of direct expenses in terms of setting up barriers, spacing people apart, having safety gear or supposed to be also taking temperature, right, screening all the employees every single day for temperature and to make sure that they're okay. So, there were all those direct costs, but also efficiency because plants were not able to run as often as we would have liked one, because of volume, also because of actually cleaning shut down and all that. So, all that added more costs than we had anticipated.

The other thing that - the other primary goal that we wanted to make sure we attained in the quarter was to meet our customer requirements and fill all the orders. And to some extent, we had to do things that entailed additional costs. We had some bottlenecks because of increased volumes in certain segments of the business which meant, for example, we might have had - not might have, we did have to make product on the West coast that normally we would make on the East coast both at a higher cost and with higher distribution costs, we had to individually wrap products and better shipping box. So, there were a bunch of costs that were added that were extra costs. But having said all that, we did reduce our operating expenses, backing out the impairment charge for the plant. So, at the end, we reduced them by about $10 million, which was a 17% drop.

But again, it's hard when your sales are down 30% it's hard to take out as much of the cost as you want. And in the manufacturing end of the business, our costs did not come down and they did not come down for two reasons. One, our goal, as we've said before was not to cut and slash because one, we didn't have to, we have enough cash and liquidity on our balance sheet that we could weather the storm, so to speak. And we didn't want to do things that would come back to bite us six months from now or a year from now. So, we took a somewhat cautious approach to making those kinds of cuts. The other thing is when you look at, I guess maybe some of the mix, like for example, ICEE, this is ICEE's strong period of the year. And ICEE gallons without the new business that we acquired last year, ICEE gallons were down 78%. I mean, that is a huge, huge drop and so many things you just can't overcome. And we didn't, obviously we didn't. So, I would say to answer your question is yes, the numbers were not - were probably were worse than we had anticipated. I would say not tremendously worse. We obviously, when your sales are down 34%, there's not a lot you can do. And that's an awful tough nut to crack.

John Anderson: That's helpful.

Dan Fachner: John, this as Dan Fachner and I also just want to add to that two things. One you asked about sales, and sure, we're not exactly sure of what the future holds, but as you said may was better in April, June was better than May and July has held up to that number so far as well. So, we're encouraged by that fact. And then the second question around expenses, we are going to continue to monitor and look at under every rock that we can. We want to be careful not to cut into the bone because as Dennis said, we really don't have to. But we're going to be diligent about looking at every spot that we can so that we're prepared for the future, the best that we can.

John Anderson: That's helpful. Thank you. And then you mentioned a manufacturing facility that you closed in the Midwest. Has that been completed at this point and do the seven to 8 million in savings, annualized savings associated with that, does that begin in the fiscal fourth quarter or there's some additional work there before you start to realize the benefits there?

Dan Fachner: We waited at the end of this month. Dennis, you want to answer the question about the savings, but the plan will be completed the end of the month.

Dennis Moore: And as Dan said, it is shutting down right now, or this week actually. So, the savings will start to kick in, they won't be in August. But they won't be at the run rate of seven to $8 million right off the bat, but beginning of next fiscal year, they should be.

John Anderson: Okay. Great. Last one for me. Gerry, you mentioned M&A still really looking for deals. I suppose in this environment no one would wish this environment on anyone, but it probably creates, put some pressure on companies that aren't as well capitalized as you are. And I don't know, maybe that presents some opportunities. Any thoughts or comments on the M&A outlook, and whether you're seeing some opportunities to pick things up in a challenging environment?

Gerald Shreiber: We're looking, and we take a very careful approach on the acquisition front, but we've made them in the past and I expect we will make some in the future.

John Anderson: Great. Thank you. Thank you everybody. Appreciate it. And good luck going forward.

Gerald Shreiber: Thank you.

Operator: Thank you. Our next question comes from Todd Brooks. Your line is now open.

Todd Brooks: Hey, good morning, everybody.

Gerald Shreiber: Good morning, Todd.

Todd Brooks: Jerry, I hope you and the team are all well and kind of hanging in there as we model our way through this.

Gerald Shreiber: We are, we're healthy and strong. We're not used to this, so we're going to come out, looking to - we're going to come out swinging.

Todd Brooks: Well, I'm looking forward to that, and it kind of leads into my first question. If I look at the June quarter, it's really in my mind kind of a tale of two quarters. There was the initial digestion of kind of shifts in food service demand, spikes in retail grocery demand, which I can picture bringing some distribution inefficiencies with it. But when we look at that five week period at the end of the quarter that was talked about and the release being down in the mid-20s or at the start to this quarter, as we've moved further into whatever the new normal is, we've digested some of shifting lines, maybe between end markets and we've gotten volumes back to this down mid 20s level. Is the company set up for profitability in the mid-20s now, or does it still require more recovery in sales before we can get back to a profitable result?

Gerald Shreiber: Well, let me see if I understand the question. Yeah, the company is and has been adjusting our profitability glean[?] as sales have dropped. And we're confident that we will get back to our profitability levels in the early part of this next fiscal year.

Todd Brooks: But as far as the down mid 20s sales results get us back to a better than breakeven level from a profit.

Dennis Moore: Yes, this is Dennis. I would say in that range, we hopefully would be there.

Todd Brooks: Okay, great. And the second question I had, and I know that we've used, you guys have used the balance sheet in the past offensively. I mean, you talked about it in the March quarter, kind of not cutting into the bone, keeping especially human capital resources in place while a lot of others were furloughing or laying off employees. When I look at marketing expense in the quarter, I would have expected that expense to be one that could have been more variable. And I was wondering if we could talk about that expense line as far as, is the company still playing offense on the marketing side because the balance sheet allows it to do so?

Gerald Shreiber: Well, I'm trying to understand the question, keep in mind that the lead sports arenas and leisure and seam and whatnot, those kind of programs were preset as far back as the beginning of our fiscal year. And it's awfully hard to cut them and to rewrite them once the seasons have started. But we're spending, I think we're spending less on marketing than planned and as the business comes back, we'll put our foot on the gauge a little bit there.

Dennis Moore: Todd, this Dennis. And also, the other part of that is that the marketing name is kind of a misnomer in that we also - that includes selling expenses as well. So, a good part of that is selling and not what we do, we consider marketing or plus advertising.

Todd Brooks: Okay. So, if we look at the 22 million spent in the quarter, what percentage of that would you say was fixed versus variable?

Gerald Shreiber: Dennis?

Dennis Moore: Yeah. And I'm thinking now. I would say yeah, probably a half or so, a little less than half of that is fixed cost.

Todd Brooks: Okay, great. And then two more quick ones. I know in this quarter there were a decent amount of initial COVID related expenditures for employee safety, incremental employee wages to kind of thank them for their service during the real tough times with the pandemic. If you think about the 5 million in COVID spend in the quarter, what's the continuing go forward versus kind of a onetime startup nature to the COVID expenses?

Dennis Moore: We would say probably a third of that at this point, at least would be ongoing.

Gerald Shreiber: We're still doing screening, we're providing masks. We have checkpoint systems. And so, there is some cost added to that.

Todd Brooks: Okay, great. And then finally, Gerry, you touched on kind of new products and new business that you were able to secure. Anything you could share with us on the new product pipeline coming up by now? Some of the efforts switched to packaging solutions post COVID, but just any commentary on that new product pipeline would be great. And then I'll hop after that.

Gerald Shreiber: We have an array of new products, some that are a single customer base, others that are for food service, and we're very optimistic that these things will come out either in the fourth quarter or next year's first quarter, and they will add to our sales and growth.

Todd Brooks: Okay, great. Thank you all very much.

Operator: Thank you. Our next question comes from Brian. Brian, your line is now open.

Gerald Shreiber: Hi Brian.

Operator: Brian, your line is open.

Brian: Hello.

Dennis Moore: Yes, Brian we can hear you.

Brian: Great. Is there anything we should be thinking about with respect to the percentage of your business that's exposed to venues that facilitate larger gatherings? I mean, we know a meaningful portion of the sales goes through malls and shopping centers, stadiums, arenas, theme parks, movie theaters and schools. So as things get back a bit more to normal, like what are we thinking? What type of percentages of sales would be allocated towards venues that are larger gatherings and people may be a little bit slower to come back to?

Gerald Shreiber: Well, I touched on them all in the beginning, the sports venues, the leisure and theme, the Disney's of the world, the movie theaters. So, all of those venues are going to have an impact on us. But as they come back a bit slowly, we are hopeful that we will be able to increase our locations and thus our sales.

Brian: And so, do you see a lot of that being predominantly driven by government policies or by consumer behavior?

Dan Fachner: This is Dan. I think there's a little mixture of both of those, but we're hopeful to see a good percentage of that start to come back over the next quarter and maybe even two quarters. But as Gerry has mentioned, the ballparks and the theaters and some of the food service areas that we have suffered from over last quarter are now starting to open up or predicting to open up over the next month or so.

Brian: Great. Thank you. That's pretty helpful. And then next year as you're thinking about all of these parts of your businesses that were negatively impacted, how do you see the lapping of that and the pent-up demand and increase potential interest in things like sports and movie theaters and theme parks?

Gerald Shreiber: Well, hopefully if we get this quarter off, we'll be able to project with a little bit more clarity as we move on here. But right now, it's still a - it's mixed bag. I was all set to watch the Yankee Phillies game on TV the other night. And even though there were no fans, but they canceled it because of COVID-19 spreading in the locker room.

Brian: Right. And you shut down one plant. Is there any risk that another plant may need to be shut down over the next quarter or so if demand doesn't come back or that essentially either you need-?

Gerald Shreiber: I don't think so. The plant we down was acquired a few years back and as it was, it was excess to our needs. And we finally made the decision to close it up and take care of the severance and whatnot in there and go forward. We still have 17 plants that are operating throughout major geographical locations throughout the country. So, we're in a good position for production and even better position for distribution. We need our sales back.

Brian: Thanks. That's pretty helpful. And if for whatever reason, a good number of schools end up opening up virtually rather than in person, what type of impact would that have on your business?

Gerald Shreiber: Virtually does not help us. All right. We like schools were open when they have students in their grades from K through 12 and they get lunch and they get breaks and whatnot in there because we are feeding them during lunch and breaks.

Brian: And is there any way to understand what the impact might be overall on your business were that to happen?

Dennis Moore: Well Brian, school sales are roughly five to 6% of our overall sales. And so, I guess, but to some extent it's not all lost by them because a lot of school districts insist and throughout the country continue to feed the children even though they may not actually be having class.

Dan Fachner: And also, as you know Brian, if you're watching, all across the country, there are schools that are still open and some not open. And so, it's hard to put a finger on it. But as Dennis said, in total, it's five to 6% of our business.

Brian: Perfect. That's very helpful. Well, I think that's it for me. Thank you very much.

Operator: Thank you. Our next question comes from Ashish. Your line is now open.

Ashish: Hi, good morning. This is Ashish for Rob. I just had a couple of quick questions.

Gerald Shreiber: Okay Ashish.

Ashish: Yeah. So, in terms of the uptake improvement that you-

Gerald Shreiber: Ashish, who are you with, who are you with?

Ashish: Rob Dickerson from Jefferies.

Dennis Moore: Very good.

Ashish: Okay. Sure. So, one of the questions I had was, in terms of the improvement, I was wondering if you could give a little more color on specific channels like C-stores, QSRs, where you're seeing the improvement? Also, how have the trends shaped up in the first month, in the month of July compared to the last five weeks of the third quarter?

Gerald Shreiber: Well, our C-store business is something that we began focusing on a few years back has been growing nicely. And we expect that - and we have multiple products in C-stores now, ICEE, pretzels and occasionally one of our other products. But the second part of your question, I'm really not sure how C-stores were June to July, but we're happy with our C-store growth with the exception of having to wrap everything for them, which slows down our process and adds some cost, we're happy with our C-store growth.

Ashish: Got it. And in terms of the sales trends for the overall company because you mentioned like the trends for the last five weeks of June were trending 24% down year over year. I was wondering, how are those trends shaping up in the month of July?

Gerald Shreiber: Too early to tell yet, we're still looking at that.

Ashish: Got it. Thank you. And then the last one for me, like in terms of changes or initiatives that you're looking into from cost control perspective, I was wondering if you could give a little more color on that?

Gerald Shreiber: I'm sorry. I don't understand the question.

Ashish: In terms of cost controls that you're looking into, so what were some of the initiatives that you're looking into from the cost control perspective?

Gerald Shreiber: We've had an ongoing focus on labor since labor appears to be an issue almost all over the country. So, we've been working on projects that will control labor and or reduce labor. That's going to be a continued focus.

Dan Fachner: Ashish, in addition to that, we've had some plant improvements as well. And then we mentioned the closure of one of the plants and that's part of the cost improvement that we've been working on.

Ashish: Got it. Thank you. That's it for me.

Operator: Thank you. Once again, if you have a question or comment, please press star, then one on your touch tone phone. And speakers, at this time I show no further questions. Thank you.

Gerald Shreiber: Well, thank you. I want to thank everybody for being on this conference call and we look forward to talking to all of you again at the end of our fourth quarter.

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

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