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# Sovos Brands, Inc. (SOVO)

## Q1 2023 Earnings Call

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# MANAGEMENT DISCUSSION SECTION

**Operator**: Greetings and welcome to Sovos Brands First Quarter 2023 Earnings Call. At this time, all participants are in a listen-only mode. A brief question-and-answer session will follow the formal presentation. [Operator Instructions] As a reminder, this conference is being recorded. It is now my pleasure to introduce your host, Josh Levine, VP Investor Relations. Please go ahead.

## Joshua A. Levine

*Vice President-Investor Relations, Sovos Brands, Inc.*

Good afternoon and thank you for joining us on Sovos Brands First Quarter 2023 Earnings Conference Call. On the call today are Todd Lachman, President and Chief Executive Officer; and Chris Hall, Chief Financial Officer. By now, everyone should have access to the earnings release for the period ended April 1, 2023 that went out this afternoon at approximately 4:00 PM Eastern Time. The press release, as well as supplemental slides, can be found on the company's website at ir.sovosbrand.com. And shortly after the conclusion of today's call, a webcast will also be archived and available for replay.

Before we begin, let me remind everyone that today's discussion contains forward-looking statements based on the environment as we currently see it, and as such does include risks and uncertainties. If you refer to the company's earnings release, as well as its most recent SEC filings, you will see a discussion of factors that could cause Sovos Brands actual results to differ materially from these forward-looking statements. Please remember the company undertakes no obligation to update or revise these forward-looking statements in the future.

We will make a number of references to non-GAAP financial measures. We believe that these measures provide investors with useful perspective on the underlying growth trends of the business and have included in our earnings release a full reconciliation of non-GAAP financial measures to the most comparable GAAP measures. Please note that all consumption data cited on today's call refers to dollar consumption on a total [ph] mueler (00:02:18) basis as of the 13-week period ended April 2, 2023 and growth versus the prior year comparable period unless otherwise noted.

And lastly, to avoid any confusion for discussions pertaining to first quarter results and full fiscal 2023 guidance and growth expectations, organic net sales growth is calculated as net sales growth adjusted for acquisitions, divestitures in the 53rd week in 2022.

With that, I will now pass it to Todd.

## Todd R. Lachman

*Founder, President, Chief Executive Officer & Director, Sovos Brands, Inc.*

Thanks, Josh. I will begin with a discussion of the exceptional performance we delivered this quarter and that we continue to expect in future quarters before turning it over to Chris to provide greater detail on our results and updated 2023 outlook. When we spoke to you on our last earnings call, we said that Q1 was off to a strong start, building on the robust fourth quarter. Today's results reflect sector-leading, volume-driven net sales and profit growth with meaningful margin expansion as a result of excellent operational execution.

We have generated very strong momentum in Rao's Megabrand which we expect to continue through the second quarter and balance of the year. Given our robust Q1 results and the continued momentum in our business, we are raising our guidance for net sales and adjusted EBITDA. Robust trends for the Rao's brand continued in Q1. Rao's grew net sales 38%, surpassing $600 million on an LTM basis and for the first time ever achieved the number 1 dollar share in the [ph] Food Channel (00:04:09).

The primary driver of this growth was the substantial gain in household penetration, up 120 basis points versus Q4 for the total franchise and up nearly 100 basis points for sauce. These gains represented the largest quarterly increase in household penetration in the last three years, benefiting from robust distribution growth, which was up 22% for sauce in the quarter, as well as higher brand awareness that was driven by a substantial increase in marketing.

Recall that awareness grew [ph] 10 full (00:04:49) percentage points to 58% in 2022. As a result, dollar consumption for the Rao's franchise grew 26% in the quarter. In sauce, we grew dollar consumption 22% with units up 16%, both well ahead of the category. We also delivered sustained growth in frozen entrées, soup and pasta, with combined retail dollars up 46% in the quarter, with each of these Rao's businesses growing distribution, household penetration and dollars well-ahead of their respective categories, resulting in market share gains.

As we show on slide 8, we have made considerable progress over the last few years developing these highly incremental businesses with our non-sauce Rao's branded products now accounting for nearly 20% of trailing 52-week measured retail sales. And our most recent non-sauce launch in the frozen pizza, although still in the early stages, it's delivering in line with our expectations and we are excited about the retailer and consumer interest we have received thus far.

Importantly, we continue to see massive whitespace for the Rao's franchise and Rao's sauce in particular. While we did experience the largest quarterly household penetration gains in three years of Rao's sauce, our household penetration is still less than half the level of several competitors, unit share is below 7%, and awareness of 58% is well below the greater than 90% levels for peers. And the brand remains highly underpenetrated and undershared in each of its non-sauce businesses. With many more at home eating occasions today than prior to COVID and traffic trends at restaurants remaining under pressure from cautious consumers, we see a long runway to provide many more consumers the opportunity to enjoy a restaurant-quality meal at home with their family.

Turning to noosa. The brand grew net sales 8% in the quarter, driven by strong performance in non-measured channels. Our core [ph] 8-ounce (00:07:17) offering grew dollar consumption 9%, outperforming the category on a unit basis and benefiting from distribution and velocity. We continued to invest meaningfully in the brand, highlighting its taste leadership and strengthening our assortment to drive higher trial and consumption. And we're building a pipeline of delicious innovation, most notably in core spoonable yogurt to capitalize on the brand's leadership and indulgence and appeal across all day parts. Michael Angelo's net sales were down 6% in the quarter, with the launch of [ph] Sauce (00:07:54) partially offsetting the proactive decision to exit certain lower margin frozen SKUs. We continue to drive growth in frozen with key grocery retail partners and are gaining distribution in new channels.

Our total frozen entrées business inclusive of Michael Angelo's and Rao's, grew net sales 10% in the quarter with consumption up 11% which was ahead of the category. With healthy inventories, significantly better service and increased brand investments, we are growing distribution and velocity in our Sovos Brands frozen business and remain confident there is a long runway ahead for growth. Broadly speaking, our increased investments in marketing, R&D, selling and supply chain are driving robust sales and profit results for our company.

In marketing and R&D, we increased our growth investments a combined 27% in the quarter following a high-single-digit increase last year. For example, our new advertising campaign for Rao's called the [ph] deliciousness of slow (00:09:07) highlights key points of what makes Rao's sauce so unique, including high-quality, fresh ingredients, and the slow simmer, open-kettle cooking process that results in our thick, delicious, one of a kind sauce.

We're leveraging our roster of celebrity fans and influencers who showcase the many ways they use Rao's products in their kitchens to their millions of followers.

In R&D, we're leveraging our new Innovation Center of Excellence in Austin, Texas, to continue delivering delicious innovation and new products across the portfolio. In sales, we're adding more resources in customer-facing roles. We're strengthening our net revenue management capabilities, and we're investing in data to enable better decisions. And in our supply chain, our investments in talent and capabilities are really paying off. I want to commend the team on their performance in the quarter, helping to deliver over 200 basis points of gross margin expansion and 30% adjusted EBITDA growth.

Our inventories are healthy with service for sauce and yogurt consistently above target and service for frozen is in a significantly better position than this time a year ago. In addition, our team is doing an excellent job proactively managing our input costs and we are successfully delivering on a wide range of productivity initiatives within the four walls of our factories. We see our supply chain capabilities as an important enabler in sustaining our volume-led growth.

In summary, we are very proud of our first quarter performance. We are executing well across the organization and investing in the business to drive continued household penetration gains. In fact, with household penetration for Sovos Brands now in excess of 25%, over one quarter of all households in the US have a Sovos Brands product in their kitchen. And to reiterate, given the strong momentum in our business, we are raising our full year guidance.

We will continue to invest in brand building, talent, and capabilities to support our sector leading volume-led growth. And we'll take the right actions to support profitable growth for our business in the quarters and years ahead.

Chris Hall will now discuss the details of our first quarter and our updated guidance for 2023.

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## Christopher W. Hall

*Chief Financial Officer, Sovos Brands, Inc.*

Thank you, Todd, and good afternoon, everyone. First quarter total net sales $252.8 million, a $42.9 million or 20.4% increase over the prior year period. On an organic basis, growth of 26.7% was driven by 15.6% volume and 11.1% price. For the quarter, Rao's increased total net sales 37.7%, exceeding our expectation with continued robust growth across all categories and channels. We are adding distribution and driving improved velocities across nearly all of our categories. Our sauce business, in particular, that our growth performance in market accelerated across the quarter as a result of the big distribution and household penetration gains Todd spoke about earlier.

noosa had a good quarter of 8.2% year-over-year, with growth driven primarily by non-measured channels. We also successfully implemented a list price increase in February, which will provide a tailwind to the balance of the year. And Michael Angelo's declined 5.6%, primarily as a result of exiting certain channel-specific lower margin SKUs. Total frozen entrées, including Rao's and Michael Angelo's, grew net sales 10.1%.

Adjusted gross profit of $71.1 million increased $16.6 million or 30.4% year-over-year, driven primarily by double-digit growth from volume and pricing. Adjusted gross margins were 28.1%, for the quarter, up 210 basis points versus the prior year period. Margin expansion was a result of pricing and productivity as well as favorable mix driven by higher sauce growth. We also began to see favorability for certain key items in our raw material and packaging costs as prices moderated more quickly than we had previously expected.

As Todd noted earlier, we are very pleased with the progress we've made in operations and supply chain following the successful implementation of automation projects, particularly in our frozen entrée plant, value engineering on our packaging and other process and cost initiatives, including greatly improved operating systems. Along with these projects, we are confident that our pipeline have yet to be implemented that initiative such as optimizing our logistics network, enhancing partnerships with key suppliers and leveraging our increased scale will help us take cost out, improve our margins and free up capacity for further volume-led growth.

Adjusted operating expenses at $38 million, increased $8.4 million or 28.3% over the prior year period. This included a 26.9% increase in growth-oriented investments such as marketing and R&D. As well as increased support for our talent and capabilities. Adjusted EBITDA of $36 million, increased $8.3 million or 30.2% year-over-year. Adjusted EBITDA margins were 14.2%, up 100 basis points versus the prior year period.

Net income for the quarter was $7.8 million or $0.08 per diluted share compared to net income of $4.1 million or $0.04 per diluted share in the prior year period. Adjusted net income was $18.1 million and adjusted EPS was $0.18 per diluted share compared to adjusted net income of $13.8 million or $0.14 per diluted share in Q1 2022. At the end of the first quarter, cash and cash equivalents were $153.6 million and total debt was $482.7 million.

Our net leverage finished the quarter at 2.6 times trailing 12 months adjusted EBITDA compared to nearly 4 times post IPO, which was just 18 months ago. We continue to believe that a strong cash position gives us a lot of flexibility to invest in our business.

Turning to our 2023 outlook, we are increasing our guidance for net sales and adjusted EBITDA. This primarily reflects our expectation for stronger performance from Rao's than we previously assumed given the robust Q1 performance and our increased visibility to the balance of the year. For net sales, we are now guiding to a range of $935 million to $955 million, which implies full year organic net sales growth of 14% to 17%. We expect volume to continue to be the primary driver of growth led by higher household penetration as a result of Rao's distribution gains and continued velocity performance. We also continue to expect that elasticities will normalize, albeit at a slower pace than we previously anticipated.

For adjusted EBITDA, we are now guiding to a range of $136 million to $141 million or 13% to 18% growth. The increase to our guidance largely reflects the flow through from higher expected net sales. We continue to expect moderate gross margin expansion for the full year, with the benefit of pricing and productivity fully offsetting mid-single-digit inflation. We remain committed to investing to support our long-term growth plans and our updated outlook incorporates high teens growth for combined marketing and R&D as we seek to capitalize on the massive whitespace opportunity ahead of us.

From a phasing perspective, we continue to expect volume-led, double-digit organic net sales growth in both halves of the year, with growth in the remaining quarters expected to be consistently in the low double-digit to mid-teens range. We expect Q1 gross margin to be the lowest of the year with an improved level of the balance of 2023 as we move out of the heaviest promotional quarter for this year. For adjusted EBITDA, we continue to assume growth and margin expansion will be stronger in the first half. And finally, given the strong Q1 performance, we now expect the first half to account for a slightly higher percentage of full year adjusted EBITDA than we previously assumed.

For a summary of these and other annual guidance item, please see slide 14 in our earnings slide deck posted on our Investor Relations website.

I will now hand it back to Todd, for some final remarks.

## Todd R. Lachman

*Founder, President, Chief Executive Officer & Director, Sovos Brands, Inc.*

Thanks, Chris. We are excited by how the year has begun. We have a tenacious, highly talented and energetic team that is executing well. The Rao's brand is firing on all cylinders, adding households through distribution and awareness gains, and rapidly progressing on its path to $1 billion of annual net sales and beyond. And with strong operational performance, we are expanding our margins and driving bottom line growth, helping to maximize shareholder value.

With that, Chris and I are now available to take your questions. Operator?

# QUESTION AND ANSWER SECTION

**Operator**: Thank you. We will now be conducting a question-and-answer session. [Operator Instructions] Our first question comes from Ken Goldman with JPMorgan. Please go ahead.

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**Kenneth Goldman**
*Analyst, JPMorgan Securities LLC*

Q

Hi. Thank you. Two for me. My first one is you mentioned that Rao's, the non-sauce business of Rao's I think is now nearly 20% of your measured retail takeaway. Correct me if I'm wrong on that. And you also talked about how pizza's in line with your expectations. Can you maybe add a little bit of color or just an update, really, on how the other businesses are doing, be it soup or pasta or whatever you think is worth discussing? I'm just trying to get a sense for how each of them is progressing versus your expectations.

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**Todd R. Lachman**
*Founder, President, Chief Executive Officer & Director, Sovos Brands, Inc.*

A

Awesome. Hey, Ken. How are you doing? This is Todd.

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**Kenneth Goldman**
*Analyst, JPMorgan Securities LLC*

Q

Hey, Todd.

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**Todd R. Lachman**
*Founder, President, Chief Executive Officer & Director, Sovos Brands, Inc.*

A

Hey. Yes. So on the Non-sauce business is you're right, 20%. We have some detail on that in the slides, but we couldn't be more pleased. So if you take total non-sauce IRI last 52 weeks, $130 million of retail sales up 46% year-on-year CAGR since 2020, 60% for that combined entity. And these businesses, Ken, have been in market for a while. We launched soup four years ago. It's now the number 5 dollar share, number 1 or number 2 fastest growing soup brand over this time period. Meaning, we've either been the fastest or the second fastest growing 13-week period after 13-week period. We're shipping some new items now with more items to come at the end of the year, we're very pleased. [indiscernible] (00:22:50) 13 weeks, dollar sales up 20% year-on-year versus a flat category. This TDP is up 7% and velocity up 12% with a 2% dollar share.

Pasta launched actually about six months before soup. We're, I don't know, our fifth year now. We're the number 6 brand, grew more than 50% in 2022, but we only have a 1.3% share. Last 13 weeks, the number [ph] should (00:23:18) bizarre even to say up 73% year-on-year, 50 basis points – up 50 bps in share continue to build distribution with velocities also improving. We also have some new items, shipping more items to come distribution up 14% versus distribution to category up 1%. Velocity up a very strong 52%.

And then frozen, our Rao's frozen business up 46% in dollars versus 6% for the category. Distribution up 33% and velocity up 10%. So, if you look at those three businesses, 20% that share of total is growing, although sauce is growing robustly as well. And then pizza, the area to highlight with pizza is that it's early, so in the very early stages. That said, initial sell in is going according to plan, commitments continue to build, we're generating very strong interest from across the accounts. And as we've discussed, we expect distribution to build as the year progresses. Remain confident that our entry into this very large $7 billion frozen pizza category can be a very meaningful contributor to the brand in the years ahead, which will lead to further volume growth for the business.

And I know this wasn't one of your questions, Ken, but I'll just sort of conclude in highlighting, yes, our results were up a very strong 27% in the quarter, but 16% volume versus down minus 5.2% for the peer average. And then if you look at the last 12 months, our volume up 13% versus volume down 4% for the peer average. So, yes, our growth is high, but highly differentiated in the fact that it's volume led when many of our peers are declining in volume and offsetting that with price.

**Kenneth Goldman**
*Analyst, JPMorgan Securities LLC*

Q

Got it. Thank you for that. And then quick follow-up. I think your previous guidance was for volume to be up high single-digits and then inflation to be up mid-single-digits. I guess in light of the new top line guidance and your comment about maybe some costs mitigating a little bit faster than you had expected, are those rangers or – ranger, rather, still the proper ones to think about?

**Christopher W. Hall**
*Chief Financial Officer, Sovos Brands, Inc.*

A

Hey, Ken. This is Chris. On volume, that's really what has driven us to take up our guidance. Pricing pretty much the same range we had anticipated for the year mid-single-digit. But we're now in the kind of low double-digit range for volume and that should be fairly consistent across the year. Pricing, of course, falls off across the year versus the pricing we [ph] saw also true (00:26:09) in Q1, but pricing as well as inflation are both mid-single-digits across the year. Again, it's really the volume that's driving the upside to our prior guidance.

**Kenneth Goldman**
*Analyst, JPMorgan Securities LLC*

Q

Thanks. I'll let it go there. Thank you.

**Operator**: Next question comes from Peter Galbo with Bank of America. Please go ahead.

**Peter T. Galbo**
*Analyst, BofA Securities, Inc.*

Q

Hey, Chris, Todd. Thank you guys for taking the question.

**Christopher W. Hall**
*Chief Financial Officer, Sovos Brands, Inc.*

A

You got it.

**Todd R. Lachman**
*Founder, President, Chief Executive Officer & Director, Sovos Brands, Inc.*

A

Hey, Peter.

**Peter T. Galbo**
*Analyst, BofA Securities, Inc.*

Q

Hey. Mine are pretty quick. Just curious around the sales guidance. Obviously, you raised kind of by more than the beat relative to consensus on the quarter. And Todd, I think you talked at length about some of the factors that are that are driving that. And it's probably unique within packaged food. But just curious [ph] filling (00:27:02) a few questions, if any of that raise as well as like a load in factor for pizza just as you roll that out more naturally, if there's any way to dimension that, just would like a clarification there.

**Todd R. Lachman**
*Founder, President, Chief Executive Officer & Director, Sovos Brands, Inc.*

A

Sure. None of that is driven by a loading factor in regards to our guidance, et cetera. I mean, really, really, I mean, as you recall from the last quarter, I mean, I stated there were beginning – really, strong out of the gates as we began Q1 following a very strong 2022 and Q4 momentum; honestly, even stronger than expected. And what are some of those highlights? I mean, first, we knew household penetration would increase. We did not expect it to be the largest household increase in the household penetration in the last three years, 240 bps year ago on total and 110 bps on sauce. And the key driver there is just very healthy, distribution gains, up 22% year-on-year TDPs with more than one quarter of our top 20 accounts growing TDP double-digits for a brand, the size – again, the total Rao's franchise is $618 million LTM. And as highlighted in our slides, again, this is the Rao's brand $618 million LTM of 40% year-on-year.

So, we look at distribution. We talked last call about awareness going from 48% to 58%. We don't get awareness on a quarterly basis. But given our investment levels, we certainly expect that to continue to increase. And it's about getting the brand into more households. And we are only in sauce, less than 13% of households. So volume-led growth, number 1 in the food channel, non-sauce business is up 46%, the increase year-on-year profit growth, inclusive of 27% marketing and R&D spend, et cetera, et cetera. So I highlight these to say that this is nothing to do with any one-time shipments, any pipeline fill. It's due to the momentum of the business, notably the very strong household penetration gains on sauce and on the balance of the Rao's franchise.

**Peter T. Galbo**
*Analyst, BofA Securities, Inc.*

Q

Got it. Thanks for that, Todd. And then, Chris, just maybe a two-parter that should be relatively easy. I think you said the EBITDA percentage in the first half or second half would be higher versus previously – I think previously you had like a 47/53 split. Just wanted to confirm if that was the prior split versus the new one. And then secondly, if we can just revisit the topic of debt paydown, just given where rates are and borrowing on the term loan. Thanks very much, guys.

**Christopher W. Hall**
*Chief Financial Officer, Sovos Brands, Inc.*

A

Yeah. You bet. So, yes, we talked at our last call, we mentioned 47% first half EBITDA based on the strength of Q1, again, primarily top line driven for the reasons that Todd just gave us. But also good on gross margin expansion over a couple hundred points above our expectations where it would come in. Productivity kicked in. We've got our automation up and running now down in our Austin plant really delivering cost savings. Pricing was very strong for the quarter, so very strong gross margin quarter led to a higher EBITDA.

So we're more – it's not a dramatic shift in the phasing of EBITDA, but more like 48% to 48.5% H1 now is what we're seeing. And again, that assumes all of the things that we know today on inflation, which we mentioned of mid-single-digit number higher in the first half, lower in the back half, but still both halves and basically mid-single-digit, pricing stronger in the first half as we overlap the actions from last year plus some actions that we took in Q1 of this year. So that's our EBITDA phasing.

And on cash, we're very pleased with the cash we continue to generate. We're very pleased with the strength of the balance sheet. But we – the cash that we have taken, we're holding on to that for now. We've talked in the past about our uses of cash, which are primarily to reinvest in the business, either to drive top line or to drive productivity. We don't anticipate paying any dividend. We – so, therefore, we really use that cash, gave us optionality moving forward. That optionality could be, again, reinvesting in the business, could be for M&A down the road if there was an opportunity. But that optionality is very important to us.

And I had mentioned last time, I'll just reiterate, we are earning a nice return on the cash that we're hanging on to. So that will continue to be our strategy for now. We will [indiscernible] (00:32:04) on a net debt basis. And we'll see what happens here over the next several months and what happens with interest rates, and then we'll decide where to – how to optimize that cash.

**Peter T. Galbo**
*Analyst, BofA Securities, Inc.* Q

Awesome. Very helpful. Thanks, guys.

**Christopher W. Hall**
*Chief Financial Officer, Sovos Brands, Inc.* A

You bet.

**Todd R. Lachman**
*Founder, President, Chief Executive Officer & Director, Sovos Brands, Inc.* A

Thanks, Peter.

**Operator**: Next question comes from Jon Andersen with William Blair. Please go ahead.

**Jonathan Andersen**
*Analyst, William Blair & Co. LLC* Q

Hey. Good afternoon, guys. Congrats on a great quarter.

**Todd R. Lachman**
*Founder, President, Chief Executive Officer & Director, Sovos Brands, Inc.* A

Hey. Thanks, Jon.

**Jonathan Andersen**
*Analyst, William Blair & Co. LLC* Q

Yeah. I wanted to just come back to the mix of Rao's, the total franchise now nearly 20% non-sauce. How do you see that evolving both near term and longer term? Do you think that non-sauce portion of the business becomes a bigger part of the franchise in the next year, three years? And what are some of the margin implications of that mix overall? Are you seeing through your automation efforts and productivity efforts, the ability to kind of lift the margin structure of the non-sauce business? Because I know the sauce business is particularly strong. Thank you.

**Todd R. Lachman**
*Founder, President, Chief Executive Officer & Director, Sovos Brands, Inc.* A

Hey, Jon. Sure. Let's talk about the – we've sort of have publicly talked about in several of the other calls when we talked about Rao's to $1 billion, we've talked about non-sauce being about 20% today. We – I'd say roughly when we get to $1 billion sooner than later, think of non-sauce roughly 30%, sauce roughly 70%. And we've sort of talked about [ph] that versus (00:33:49) non-sauce will be a larger percentage. But most importantly, sauce, 70% of the business.

And I'll just highlight again why that is. I mean, you've got household penetration of sauce at 13% versus the three – two to three key peers above 30%. You've got unit share of sauce, less than 7%. You've got the other two leading players with dollar share of 16% – unit share of 16% and 18%, respectively. We're in the number 2 dollar share [indiscernible] (00:34:26). We are the number 1 dollar share for Q1 in food, but we're number 7 in unit share. So it shows you the opportunities awareness 58% versus there's five brands in sauce that have awareness above 90%. And then the distribution, we've talked about just average number of items of barely 14 versus several peers above 20. So that just shows you of why sauce is going to continue to be the key driver.

And then I highlighted some of the opportunities and just the penetration. I mean, less than 3% on our non-sauce categories share, 2% or less, et cetera, on his other businesses. So we've got very, very strong upside on both. And that's why I continue to emphasize that our number 1 priority is driving Rao's to $1 billion as quickly as possible.

I'll pass it to Chris in regards to your margin question, Jon.

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**Christopher W. Hall**
*Chief Financial Officer, Sovos Brands, Inc.*

A

Thanks, Todd. So, as we could create new products that we engineer those P&Ls to be at our overall company average on the gross margin line, we may be investing more early on in trade and slotting and things like that. But as the items [ph] feed (00:35:41) in the marketplace, we anticipate those margins getting up to that company average. We are investing money as we've spoken at our plants in Austin to more fully automate that plant for all our frozen [ph] that (00:35:56) Michael Angelo's or Rao's has produced.

And so we're really starting to see now the impact to that and the cost savings, the efficiencies of those lines. And as we scale up the businesses, let's take pizza for example, that continues to grow. We will be advantaged on pricing as it does grow in scale. So we may launch a product at a lower margin. As we enter new TAMs, the incrementality is such that it enables us to do that. We're getting new space, new sections of the store, new shoppers. So we'll take a look at trade off in the early days of incrementality, and then that margin will build up to the company average or better as we progress.

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**Jonathan Andersen**
*Analyst, William Blair & Co. LLC*

Q

Very helpful. One quick follow-up. You mentioned that obviously the volume growth has been terrific, above plan, and kind of a driver of the guidance range for the year. Where are you from a capacity standpoint? I know you've added some capacity, I believe in Omaha. Sounds like automation is helping you. Do you have any pinch points with respect to capacity or do you feel like the operations and the supply chain are set to kind of support the growth that you foresee with kind of normal CapEx levels over the next 12 to 18 months? Thanks.

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**Todd R. Lachman**
*Founder, President, Chief Executive Officer & Director, Sovos Brands, Inc.*

A

Sure. Yeah. Thanks, Jon. I would say, minimal pinch points across -

our largest businesses, let's just talk total sauce. And I'll just compare because in Q1 of last year, we did have pinch points less because of like more supply constraints. If you recall, there was a fire at our dry pasta supplier that we used for frozen and glass shortage due to the war in Ukraine, et cetera. There's a variety of aspects we talked about in our Q1 and Q2 call. So, if we just take our fill rates as a measure of we had basically – I mean, were at/or above target on our sauce business up 14 full percentage points service Q1 versus Q1 year ago, and our total frozen business up 30 full percentage points this Q1 this year versus Q1 last year. It's a business that we had mentioned that we had some, when I say capacity, it's more around supply constraints that caused capacity issues that led to some service degradation.

So we just – we have a best-in-class supply team and we're constantly making sure that we're tenacious and nimble around ensuring that we have the right ingredients and packaging, et cetera. We've got a variety of capacity issues and productivity in the factories that we run for yogurt and frozen. And you're always going to have some pinch points here and there on the business. But to me, that's all part of running a business that's growing as rapidly as ours. But right now, as I said in the prepared remarks, that we are at/or above target on our sauce and yogurt business and significantly better than year ago, and approaching target on the frozen business for service.

**Christopher W. Hall**
*Chief Financial Officer, Sovos Brands, Inc.*

A

And I'll just add to that [indiscernible] (00:39:03) with all the opening up for the sauce business, with other additions that we've made both in the – in our co-packers Italy facility as well as Omaha, we have ample growth available us on the sauce business. Even down in Omaha, we currently have operating with 10 cattles. We have the infrastructure there to double that quickly to 20 cattles. And over time, that facility has room that we can expand even further by just adding additional cattles. So we're in really good shape for the type of growth we've been seeing on the sauce business in 30% plus, and we're well – good amount of capacity on the [indiscernible] (00:39:48) business as well in our plant in Colorado.

**Jonathan Andersen**
*Analyst, William Blair & Co. LLC*

Q

Sounds great. I'll pass...

**Todd R. Lachman**
*Founder, President, Chief Executive Officer & Director, Sovos Brands, Inc.*

A

Thanks, Jon.

**Christopher W. Hall**
*Chief Financial Officer, Sovos Brands, Inc.*

A

Thanks, Jon.

**Operator**: Next question comes from Matt Smith with Stifel. Please go ahead.

**Matthew E. Smith**
*Analyst, Stifel, Nicolaus & Co., Inc.*

Q

Hi. Good afternoon. Thanks for taking the question.

**Todd R. Lachman**
*Founder, President, Chief Executive Officer & Director, Sovos Brands, Inc.*

A

Hey, Matt.

**Christopher W. Hall**
*Chief Financial Officer, Sovos Brands, Inc.*

A

Hey, Matt.

**Matthew E. Smith**
*Analyst, Stifel, Nicolaus & Co., Inc.*

Q

I wanted to ask first about the impact from your latest round of pricing that went into effect in February. Was that just the noosa business or was there or do you expect additional pricing in the Rao's brand? And the pricing actions to date have had very little impact on your [ph] volume (00:40:27) performance and don't seem to be impacting household penetration gains. So are you seeing anything in the market with your latest round of pricing that indicates elasticities are picking up or does the outlook calling for softening of elasticity really just reflect a degree of caution given the environment?

**Christopher W. Hall**
*Chief Financial Officer, Sovos Brands, Inc.*

A

Thank you for that. Our pricing actions that we've taken over 2022 into Q1 of 2023 basically took two rounds of pricing on across every category, every brand. The latest being in February, a roughly 8% to 10% pricing on noosa depending on the SKU and on our frozen portfolio. So it hit the marketplace in February. And at this point, we have adequate pricing in the marketplace or the inflation that we are anticipating. So we're pleased with our [ph] core (00:41:26) pricing is. We're very pleased with the elasticities which have continued to be better than historical and better than what we had modeled especially on the Rao's business.

That's a function of distribution gains, helpful gains, awareness gains. So we're getting a lot of new buyers into that category driving great volume growth. And the pricing has been well-accepted by our retailers as well as our consumers. A little more elasticity on the yogurt front where we did put our second round of pricing in February. Across our first round of pricing, we also took up the depth of our promotions and try to [indiscernible] (00:42:11) price points where our competitors really maintained existing prices when on deal.

So we've seen a little bit unit fall off there, that we're going back, we're fine tuning that. We will returning [indiscernible] (00:42:24) to some of our more effective volume driving noosa promotions and that's in the marketplace now. We're seeing a positive impact from that. So we do not anticipate further pricing at this point. We're always prepared to if the conditions warrant. But we're pleased our promotional strategies have been consistent across the year. Same promotional -- we were roughly 40% on deal for instance in the sauce category and have been consistently over time. And we successfully raised the depth of those promotions again, which is helping us drive through the 11% pricing that we saw in Q1. That will drop as we move across the year with the overlap of the actions we took in 2022.

The key message is there are no further pricing anticipated and no real changes to our promotional strategy or cadence.

**Todd R. Lachman**
*Founder, President, Chief Executive Officer & Director, Sovos Brands, Inc.*

A

And the other area – Matt. Hey, how are you doing? This is Todd. It's just to highlight the idiosyncratic nature of Rao's as it relates to elasticity. [indiscernible] (00:43:36) I use that often, but now use quite frequently. We talk about Rao's and the point being that you have -- when you have the household penetration that we do which is very low, let's just take sauce, 13%. So you've got 87% of households that have not purchased Rao's sauce. So at any given moment and you increase household penetration at the slope and rates that we are, in the sauce aisle, at the same time, you could have a consumer that potentially, oh, you know what, I'm not going to buy Rao's sauce today because of the price.

And at the same time, a new consumer is going to be, well, I haven't purchased Rao's in the past year or maybe I've never purchased Rao's, I'm going to purchase it. And so, it's an element that I believe is unique. I think it will continue to be a tailwind for us as we go forward. I know a variety of -- in the analyst community have talked about it, but I do think it helps sort of insulate us in an inelastic fashion as to the new households that are continually coming into the franchise. And when it's your first time, you're therefore by definition inelastic because you have to purchase the brand before regardless of what Rao's category you're purchasing into.

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**Matthew E. Smith**
*Analyst, Stifel, Nicolaus & Co., Inc.*

Q

Thank you for that. And maybe just as a follow-up then, maybe a better measure to understand the impact of pricing will be your view of the ultimate, achievable household penetration for Rao's. Is that impacted by the degree of pricing you've had to take or perhaps you're seeing a lower buy rate from some of these newer households falling into the brand or lower repeat rate reflecting the higher price point?

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**Todd R. Lachman**
*Founder, President, Chief Executive Officer & Director, Sovos Brands, Inc.*

A

Hey, Matt. I think you know my voice. A couple of things, so let me just hit your first point. I think -- we don't really think of the ceiling on household penetration necessarily as it relates to pricing per se, just because price gaps stayed relatively consistent kind of like pre-post, et cetera. So we kind of -- if you think of the market leaders, the mainstream market leaders of which or 3 times more expensive of and you've got -- I'm talking the other peers that are in the top three, they're above 30%.

So I think realistically, we're probably not going to make it to 30%, but I think it would -- it's totally -- I mean, we have our sights on 20% household penetration for sauce at least. We're at 13% today. I mean, that's a massive increase in share going from 13% to 20% as we think about it. And that 12.9% sauce penetration is right now we're about a $16 dollar share, etcetera. So that's point number one. Point number two, we actually -- Rao's if you look over the past several years, we've had a significant increase in two-plus buying households. So we have the strongest repeat in the category. We have the, very significant growth in households that buy 2 times or more, et cetera. The last thing I'll talk about, I've mentioned this before. We measure every quarter sort of a nine box grid. When we look at three different generational cohorts, Gen Z, millennials at one end, boomers and seniors at the other end. And we look at lower middle and upper class and we're consistently the only brand that is growing.

And households, percent of households buying in all nine [ph] boxes (00:47:25). And lower income households contributed to 23% of Rao's total sauce growth in the last quarter. So we're -- regardless of price, we're showing growth across all income cohorts and growing robustly in the lower and middle income cohorts. And the last point I will highlight, and I think I've talked about this before, I mean, if you go to the store now, while I know that Rao's is 3x mainstream, we know that it's dramatically different sauce, right? It's whole tomatoes, slow simmered, simple high-quality ingredients versus, paste, sugar, water and dehydrated onions and canola oil in jar.

And people see it. They recognize the difference. But if you look at the price of Rao's right now and you walk a store, this is last 13 weeks, average price is up top selling items. One of the top selling hot sauces that is very familiar, not going to say the name, is more 12 ounce bottle more expensive than Rao's. A variety of the leading brands of cereal, more expensive than Rao's 24 ounce. A leading 36 ounce several salad dressings, more expensive than Rao's. So, in the end, I know I've talked before about feeding your family for $15 or less. I think a very relevant comparison is walk the store and look at the cost of variety of items. And, given the inflation in the store, Rao's sauce compares very, very favorable to a host of commonly purchased items in the food store.

**Matthew E. Smith**
*Analyst, Stifel, Nicolaus & Co., Inc.*

Q

That's great context. Thank you for that. I'll pass it on.

**Todd R. Lachman**
*Founder, President, Chief Executive Officer & Director, Sovos Brands, Inc.*

A

Got it.

**Operator**: Next question comes from Cody Ross with UBS. Please go ahead.

**Cody Ross**
*Analyst, UBS Securities LLC*

Q

Good afternoon. Thank you for taking our question. I just wanted to discuss your Rao's performance because it continues to outperform our expectations. Can you just discuss how it performed relative to your expectation? It sounds like it's higher. Where is the brand exceeding your expectation? What's driving that? Is it the distribution gains? It sounds like you knew some of that from last quarter. Is it the buy rate? If you could just shed some light and then I have a follow-up.

**Todd R. Lachman**
*Founder, President, Chief Executive Officer & Director, Sovos Brands, Inc.*

A

Sure. Hey, Cody. It's Todd. Yeah. I mean, honestly, the household penetration gains significantly greater than expected. We didn't expect at this point in time, given the size of the household penetration, even though we're underpenetrated, did not expect the largest quarterly increase in household penetration in the last three years. So household penetration is one. And what's driving that? I mean, one is the distribution gains. We knew the coming into the quarter that we had new distribution, 22% growth in TDPs greater than we had expected at the time when all the pieces kind of came together. So that's robust.

I think we'll see when we look back awareness gains that we grew full 10 percentage points last year. We're continuing to invest very heavily in the business. Total marketing and R&D was up 27% year-on-year, off of a strong base. So we are investing heavily and the majority of that goes to Rao's, secondarily noosa. So I think those are some areas when you look at distribution growth, you look at awareness, velocity.

As we look at, you know, the sauce business, is doing quite well when it's often difficult to keep velocity at a good level when you increase distribution as robustly as we are. And then as I talked about previously, I mean, we've got the soup business growing. It's the fifth year in soup growing 20% category flat. Pasta, fifth year growing 73%, category 11. Frozen up 46% of category six. So we were expecting a strong quarter, but it's stronger than we had expected.

I think secondly, there was some strong growth in unmeasured channels. If you look at the difference of our net sales growth versus IRI, I think 38% versus like 26-ish. So part of that is unmeasured channels. And that's not just one time [indiscernible] (00:51:53). That's a really solid distribution -- permanent distribution gains that we garnered in the second half of the year in unmeasured customers that's paying dividends for us in Q1 and will pay dividends throughout the year. So those are just some highlights.

**Cody Ross**
*Analyst, UBS Securities LLC*

Q

That's super helpful. And then I just want to talk about your capital allocation and M&A. You've done a great job delevering the balance sheet, and it's terrific to see your goal that you're on track to reach 2.5 times leverage by the end of the year. As you think about capital allocation and M&A, would you look for M&A in separate categories, adjacent categories, or could it be a case where you look within your existing categories and perhaps other smaller players within either sauce or yogurt that have come on the scene or are starting to do well? I'll leave it there. Thank you.

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**Todd R. Lachman**
*Founder, President, Chief Executive Officer & Director, Sovos Brands, Inc.*

A

Yeah. I think so -- yeah. Look, I mean, I think it's Chris – I'll really highlight, honestly, right now. And Chris sort of touched on it, Cody, but just to [indiscernible] (00:52:58) I mean our number one focus is driving Rao's to $1 billion and beyond. And as we have learned and seen, as we launched in the dry pasta and soup and how well that they are doing in market, we could acquire a one of a kind soup brand, but we would rather launch Rao's into the soup category.

We could acquire a one of a kind frozen pizza brand. There's some really nice highly differentiated niche brands that are under-penetrated that we could expand, but we would rather launch Rao's into that segment. So I think right now, the focus for our use of cash, et cetera is to reinvest back in the business to drive the Rao's franchise primarily noosa secondarily. That said, we are constantly fertilizing our list of potential opportunities in the food area. And I think I've mentioned before that, clearly, categories that are adjacent to some of ours now whether that's the around the aisles that we're in now, et cetera would potentially be attractive.

But right now, honestly, our number one priority is driving Rao's to $1 billion and beyond. We're focused now on the pizza launch. More new category launches to come that we can talk on future calls. Not at this time. And that's what we're looking to leverage our kind of capital for us, again, to extend this Rao's brand that is connecting very, very well to consumers both from a brand equity standpoint and product standpoint in 2023 and the years to come.

[indiscernible] (00:54:51) read the next question, please.

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**Operator**: [Operator Instructions] Next question comes from Michael Lavery with Piper Sandler. Please go ahead.

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**Michael S. Lavery**
*Analyst, Piper Sandler & Co.*

Q

Thank you. Good afternoon.

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**Todd R. Lachman**
*Founder, President, Chief Executive Officer & Director, Sovos Brands, Inc.*

A

Hey, Michael.

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**Christopher W. Hall**
*Chief Financial Officer, Sovos Brands, Inc.*

A

[indiscernible] (00:55:13)

**Michael S. Lavery**
*Analyst, Piper Sandler & Co.*

Q

Can you just touch on the second quarter a little bit more? And especially with just volumes, sales and volumes in particular so strong in the first quarter, should we be mindful of maybe any pull forward or any unmeasured channel moves that might be a part of that that we should just keep in mind as we think about modeling particularly on the top line?

**Christopher W. Hall**
*Chief Financial Officer, Sovos Brands, Inc.*

A

Yeah. So I sure will. This is Chris. One difference moving forward is pricing. If you recall back to last year, we really had very minimal pricing in the first quarter and overlapped that this year with -- there was 11%, pricing. That will fall off in Q2 and for the back half the year. We had good, robust double-digit pricing in Q2 of last year. So that's one big change. So we're still very excited low – mid double-digit growth across all the quarters for the balance of the year that we're projecting. So still very solid growth. We won't have the pricing in it. It'll be more volume-driven starting in Q2 and for the balance of the year.

And then we all said it's already last year where in Q1 of last year shipments, our net sales was well below consumption. And then in Q2 of last year, that reversed. And then in this year, in Q1, our net sales was higher than consumption and then that will probably reverse back here in Q2. On a two-year basis, they're totally aligned.

**Michael S. Lavery**
*Analyst, Piper Sandler & Co.*

Q

Okay.

**Christopher W. Hall**
*Chief Financial Officer, Sovos Brands, Inc.*

A

Last year -- yeah, last year in Q1, we had some [indiscernible] (00:57:02) service outages. So that really gave Q1 a boost. So again, it's kind of a mid-double-digit growth balance of the year starting in Q2 with less pricing where we see ourselves landing.

**Michael S. Lavery**
*Analyst, Piper Sandler & Co.*

Q

Yeah. That reversal from 1Q to 2Q happening looked likely. So that's good to make sure to be aware of. And then could you just give an update on the Michael Angelo's sauce launch in terms of distribution? I think it went into one retailer at first. Is that heading anywhere a little bit more broadly?

**Todd R. Lachman**
*Founder, President, Chief Executive Officer & Director, Sovos Brands, Inc.*

A

Sure. Hey, Michael. It's Todd. So I'd say, yes, it's really -- it's just one retailer now and both I will highlight all the exclusive retailer that we're now, and ourselves, Sovos Brands, pleased with the results. We're outperforming a variety of other similarly priced items so although early. And the national rollout is still something we're assessing. We're pleased with the performance right now, and we're beginning to expand our launch into other select retailers for shipment in the second half.

But right now, both ourselves and the retailer are very pleased. And honestly, I think as I've talked from previous calls, Michael, we see opportunity, honestly, to take a larger share of the overall category with the two brands at very different price levels. They're both great tasting, kettle-cooked, slow-simmered sauces. But they're very different from each other, cook time, type of tomatoes that we use, some of the ingredients, et cetera. So I figured that there's an opportunity for that Michael Angelo's equity to play at a price point significantly below Rao's but above that of mainstream brands at a price that justifies the quality which is dramatically different than mainstream paste-based sauce.

**Michael S. Lavery**
*Analyst, Piper Sandler & Co.*

Q

Okay. That's great. And just a last quick housekeeping one and I apologize if I just missed this, but I know you said that Rao's sauce is now the number 1 dollar share. Did you say what that share is? Apologies if I just didn't catch it.

**Todd R. Lachman**
*Founder, President, Chief Executive Officer & Director, Sovos Brands, Inc.*

A

Yeah. So that's the number one dollar share in the Food Channel. So that's essentially – it's 17% dollar share in the Food Channel. So we're number two in total [indiscernible] (00:59:30). But in the Food Channel, we are number one dollar share in the Food Channel, Rao's sauce.

**Michael S. Lavery**
*Analyst, Piper Sandler & Co.*

Q

And it's up 17 share you said?

**Todd R. Lachman**
*Founder, President, Chief Executive Officer & Director, Sovos Brands, Inc.*

A

That's a 17% share.

**Michael S. Lavery**
*Analyst, Piper Sandler & Co.*

Q

That's great. Thanks so much.

**Todd R. Lachman**
*Founder, President, Chief Executive Officer & Director, Sovos Brands, Inc.*

A

Thank you, Michael.

**Operator**: There are no further questions at this time. I would like to turn the floor back over to Todd Lachman for closing comments.

## Todd R. Lachman
*Founder, President, Chief Executive Officer & Director, Sovos Brands, Inc.*

Awesome. So thanks again for joining us and showing an interest in our story. We look forward to engaging with many of you in the coming weeks. Please feel to reach out to Josh for follow-up discussions. Until then, have a great evening and take care.

**Operator**: This concludes today's teleconference. You may disconnect your lines at this time. Thank you for your participation and have a great day.