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# Sovos Brands, Inc. (SOVO)

## Q3 2021 Earnings Call

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# MANAGEMENT DISCUSSION SECTION

**Operator**: Good morning and thank you for joining us on Sovos Brands Third Quarter 2021 Earnings Conference Call. On the call today are Todd Lachman, President and Chief Executive Officer, and Chris Hall, Chief Financial Officer.

Please note that during the call, management may make forward looking statements based on current expectations and beliefs. Any forward-looking statements are made pursuant to the Safe Harbor Provisions of Private Securities Litigation Reform Act of 1995. These forward-looking statements involve a number of risks and uncertainties that could cause actual results to differ materially from expectations. Please refer to today's press release and the company's SEC filings for a detailed discussion of risks that could cause actual results to differ materially from those expressed or implied in any forward-looking statements we made today. The company undertakes no obligation to revise or update any forward-looking statements except as required by law.

Management's remarks today will focus on non-GAAP or adjusted financial measures. Non-GAAP measures should not be considered as a substitute for financial information presented in accordance with GAAP and can differ from similarly titled non-GAAP measures used by other companies. Please refer to today's earnings release posted on an Investor Relations website ir.sovosbrands.com for a reconciliation of our non-GAAP financial measures to the most directly comparable GAAP measures. We have also posted supplemental slides in our Investor Relations website. This call is being webcast and a replay will be available on our website for the next 30 days. All consumption data cited on this call refer to dollar consumption as of the 13 week period ended October 3, 2021 and growth versus the prior year, unless otherwise noted.

Now, I'd like to turn the call over to Todd.

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

Thanks, Christina, and hello, everyone. I am pleased to share our strong third quarter results following our IPO in September and to introduce many of you to the Sovos Brands story. For today's call, I will spend some time sharing why Sovos Brands is one of the most exciting, disruptive, growth oriented companies in the packaged food sector. I will touch upon a few quarterly highlights that underscore the financial and operational strength of our business. Following my remarks, Chris will discuss our Q3 financial results in greater detail as well as provide our outlook for 2021. After that, we will open the call for questions.

Let me begin by introducing our company. Sovos Brands is the fastest growing food company of scale in the United States. We are a high growth purposely built food platform and growth accelerator, pioneering a new approach to packaged food with a portfolio of one of a kind brands. Our vision is to build a portfolio of brands that creates joy for consumers by providing absolutely delicious food, resulting in growth that outpaces the food industry average. All our brands, Rao's, Michael Angelo's, noosa and Birch Benders are built with authenticity at their core, using simple, high quality ingredients providing unforgettable food experiences.

Our business model is grounded in acquiring one of our kind brands and leveraging a common infrastructure and shared playbook to drive growth. And the significant white space for each of these brands supports our algorithm for sustainable long term, profitable growth. We have achieved a combination of double digit growth and profitability. In the last 12 months, we generated $695 million of brand net sales, up 25% versus year ago with an adjusted EBITDA margin in the mid-teens. Our leading net promoter scores underline our strong brand affinities. And with household penetration of 10% or less today, our brands have a significant runway to gain share in $26 billion of addressable market with an exciting pipeline of potential new products to double our TAM to at least $50 billion over the next several years.

Now let's talk about each of our brands. Rao's is the largest and fastest growing brand in our portfolio, offering a selection of pasta and pizza sauces, dry pastas, frozen entrées and soups. At the core of Rao's is our sauce business, representing approximately 48% of sales and the third largest brand in the pasta and pizza sauce category today with market share reaching an all-time high of 13.2% this quarter. Consumption of Rao's sauce is growing 29% compared to category growth of 1%, with dollar velocities more than two times the category and distribution growing over 30%. Rao's homemade sauces are made with naturally ripened whole Italian tomatoes, pure olive oil and fresh onions. Our sources are slow simmered in open kettles and made in small batches just like homemade. We are in the early innings of growth with significant distribution opportunities ahead of us.

Recent household penetration data for the pasta and pizza sauce category in the last 52 week period ending October 3 marks an important milestone for Rao's, with penetration increasing to 10.3%, up 3 full percentage points versus just one year ago. Importantly, Rao's still has substantial runway for growth in the sauce category, with household penetration less than one-third of the two market leaders. Rao's top quintile velocity performance and leading net promoter score enables us to further expand national distribution while extending Rao's strong brand equity of authentic Italian cuisine into new categories such as dry pasta, frozen entrées, and soup. Rao's frozen entrées are growing consumption at a triple digit rate, making Rao's the fastest growing brand in the frozen entrée aisle and a strong complement to our well-established Michael Angelo's brand, known for its homemade authentic Italian heritage and unwavering commitment to quality and fresh ingredients.

Combined, net sales of our frozen entrée business are growing mid-teens, and as Rao's leverages the scale of our Austin manufacturing facility, we expect to generate meaningful operational efficiencies. Noosa is one of the best tasting brands in the yogurt aisle, with products made with high quality ingredients such as whole milk, real fruit and 100% pure North American honey. Noosa has outperformed the category in unit sales for 34 straight months, and dollar sales are currently growing at twice the category rate. With the strong momentum in our core yogurt business, we are very excited for our plans to expand Noosa into the ice cream category in early 2022 with the launch of the first ever frozen yogurt gelato. Feedback from consumers and our retail customers has been very, very strong.

Birch Benders our newest acquisition differentiates itself through its Better-For-You, diet friendly and guilt free offerings across traditionally high-guilt categories. Birch Benders clean ingredient breakfast foods and snacks cater to a variety of lifestyles, including organic keto, paleo protein and plant-based diets with the number one net promoter score among organic pancake and waffle mix consumers. Birch Benders enjoys consumer brand advocacy and loyalty. Although we are experiencing a challenging lap versus last year's COVID surge in the pancake and waffle mix category, we are pleased with the brand's early success in frozen waffle, baking mix and frosting categories and plan to launch Birch Benders into ready to eat cookies, a $9 billion market in the first half of 2022.

Consumption of our brands in our three largest categories sauce, yogurt and frozen, which represent approximately 90% of our brand net sales increased double digits in the third quarter, significantly outpacing their respective categories. Sauce represented by the Rao's brand accounts for approximately 48% of sales and grew consumption by 29% in the third quarter versus 1% for the category. Yogurt represented by the noosa brand accounts for approximately 25% of sales and grew consumption 11% compared to 5.5% for the category.

Finally, frozen which includes Rao's and Michel Angelo's entrées and Birch Benders waffles, is our third largest business at approximately 17% of sales and grew consumption by a combined 28%. At first glance, it is easy to find more differences than similarities across our brands, but that is far from the truth. Our brands share the same attributes, appeal to a similar consumer demographic, are sold in the same channels, and retailers leverage the same growth playbook and utilize the same Sovos Brands infrastructure and capabilities. We are strategic and valuable partner to retailers as our brands generally drive incremental sales, reinvigorate the categories in which they compete, and attract a highly coveted consumer base with high repeat rates and large basket sizes. Additionally, our premium price points generate higher gross profit per unit for retailers, offering a compelling value proposition.

We are very proud to have received Vendor of the Year at Target and Supplier of the Year at Whole Foods in 2020 due to our strong brand performance and best-in-class customer service levels. Our strategy is focused on increasing household penetration by increasing distribution, expanding brand awareness and innovating into new categories.

Our platform is designed to provide a foundation for future growth and to capture material synergies as we scale and add new brands. Our successful brand stewardship makes us an attractive partner for many founders who want to take their brands to the next level. Over time, we expect to continue to acquire one of the kind brands with Sovos Brands attributes and significant growth potential that we can unlock with our playbook.

Before I hand it over to Chris, let me touch on our Q3 performance. We delivered a 31% increase in net sales, or a 17% increase in brand net sales, which includes Birch Benders in bulk comparable periods. Similar to our top line, adjusted EBITDA also grew 31%, resulting in a consistent year-over-year adjusted EBITDA margin of 14.4%. We will continue to invest in our brands to fuel market share gains and increase household penetration, and we expect a strong finish to 2021 with projected full year growth of mid-to-high teens for brand net sales and mid-20s growth in adjusted EBITDA.

I am confident the disciplined execution of our Sovos Brands playbook will fuel long term high single digit net sales growth with expanded margins, making our company one of the most exciting players in the packaged food sector today.

With that, let me hand it over to Chris for more details on the quarter and our fiscal year 2021 outlook.

## Christopher W. Hall

*Chief Financial Officer, Sovos Brands, Inc.*

Thank you, Todd. Good morning, everyone, and welcome to our first earnings call. We were pleased to demonstrate our continued momentum in Q3 with healthy double digit sales and adjusted EBITDA growth in line with our top line. Excluding amortization and acquisition-related costs, initial public offering readiness, non-cash equity-based compensation and other items detailed in this morning's press release, adjusted diluted EPS were $0.10 per share this quarter. Third quarter net sales of $178.7 million increased by nearly $42 million or 31% compared to the same period last year. The Birch Benders brand which was acquired in October 2020 and was therefore not included in the results this quarter for the prior year, contributed $13.8 million of the increase. The remainder of the net sales increase was primarily attributed to increased shipments, with our two largest brands, Rao's and noosa, driving the most significant increases. Including Birch Benders Q3 2020 net sales prior to the acquisition, brand net sales increased by 17% in Q3 2021.

Net sales of Rao's increased by 35% this quarter, driven by strong consumption and market share gains across sauce, soup and pasta. Consumption for the total Rao's brand increased 36%, driven by strong distribution gains for our core portfolio, while unit velocity has continued to grow. Double digit growth in the consumption of Rao's sauce continue to outpace the category by 28 percentage points, consistent with the pre-COVID trend and velocity growth with more than double the category average.

Rao's dollar market share in the sauce category reached 13.2%. In addition, sales from new categories such as soup continue to grow, driven by both distribution gains and favorable velocities.

Rao's soup is also outpacing the category in terms of dollar growth by 4x and is now the fifth largest brand in the ready-to-serve soup category.

Lastly, Rao's frozen has gained market share with dollar growth outpacing GDP growth. Combined with Michel Angelo's, consumption of our total frozen entrée business is up double digits.

Net sales of noosa this quarter increased by 9%, benefiting from higher velocity, strong merchandising events, and new distribution gains. Consumption continued to accelerate in the third quarter, with gains in every top 10 account. We remain focused on driving healthy growth for the brand, and going forward we expect to achieve mid-single digit growth annually.

Finally, Birch Benders contributed $14 million to net sales this quarter. While consumption of pancake and waffle mixes has moderated with challenging COVID-related year-over-year comparisons. On a two year basis, Birch Benders brand net sales were up 84% on a year-to-date basis. The brand is finding good success with its new frozen waffles and baking mixes with strong consumption gains in the third quarter, demonstrating the brand's ability to travel to new categories.

Gross margin was 27.9% of net sales, compared to 33% in the same period last year. The margin decline, which was largely anticipated, was a function of higher logistics cost inflation and increased promotional support, particularly when compared to abnormally lower spending levels last year. We incurred higher transportation costs to secure and expedite supply critical for meeting the strong demand for our products and navigate unprecedented port logjams in volatile shipping costs. With our growth oriented mindset and the momentum in our business, we will continue to make the right decisions and investments to drive the industry leading growth of the Sovos Brands portfolio. And I will discuss our inflation expectations and the actions we are taking in a few moments.

Gross margin was also impacted by the acquisition of Birch Benders, which will see margin improvement as we implement our full value creation plan as part of its integration. Adjusted operating expenses of $33.9 million declined by 1% over the previous year. Depreciation and amortization expense increased to $7.2 million from last year. Excluding adjustments of $4.6 million this year and $5.1 million the prior year period, adjusted operating expenses declined 1% due to lower marketing and general and administrative expenses, partially offset by the inclusion of Birch Benders. Despite the incremental cost increases we've incurred to meet consumer demand, I am pleased to report that we delivered adjusted EBITDA growth of 31% to $25.8 million, resulting in an adjusted EBITDA margin of 14.4% consistent with the same period last year.

Operating income of $11.4 million grew 81% versus the same period in the prior year. Interest expense of $12.5 million represented an increase of $8.3 million. The increase in interest expense resulted from a higher balance of borrowings outstanding related to our June 2021 shareholder distribution as well as borrowings associated with the Birch Benders acquisition. Income tax of [ph] $3 million (00:18:08) for the 13 weeks ended September 25, 2021, represented an increase of $3.7 million compared to the income tax benefit of $0.2 million in the prior year period. The increase in our income tax expense is primarily attributable to an increase in non-deductible expenses for tax purposes.

Third quarter net income was a loss of $4.6 million or a loss of $0.06 per diluted share compared to a gain of $2.2 million or $0.03 per diluted share in the prior year period. Adjusted net income was $7.1 million compared to $9.6 million last year. Adjusted diluted earnings for the quarter were $0.10 per share based on 74.1 million shares on a diluted basis. With the timing of our IPO and the subsequent exercise of the greenshoe shares outstanding were approximately 101 million shares as of October 5, 2021.

Now, let me touch on a few highlights from our balance sheet and cash flow. At the end of the quarter, we had a cash balance of $43.1 million and total debt was $774.8 million. Our primary use of net IPO and greenshoe proceeds of $302.7 million will reduce debt by $299 million in Q4 as proceeds were received post Q3 close, which will also reduce our future interest payments. Operating cash flow for the 39 week period was $18.3 million, compared to $52.8 million for the prior year period, primarily due to higher working capital, driven by lower accrued expenses, higher accounts receivable related to net sales growth and inventory replenishment following the high COVID-19 demand in the previous year.

Now, let me discuss our outlook for full year 2021. With our continued momentum, we expect net sales of $710 million to $715 million and adjusted EBITDA of $113 million to $115 million. We expect a full year adjusted EBITDA margin of approximately 16%. We continue to expect higher inflation, including higher distribution costs given the tight global supply chain and we anticipate mid-single digit inflation to persist near-term.

Like the other companies, we are seeing cost increases in several raw materials like milk, fruit, resins, and cardboard. Transportation challenges continue due to logistical issues at major ports, as well as intermodal and trucking delays, which have resulted in long lead times and higher logistics costs.

We have and will continue to develop multiple levers to mitigate inflationary pressures on top of the many initiatives that are currently in place. Some of our current levers include automation in our manufacturing facilities, optimization of our co-manufacturing network, packaging value engineering and further competitive procurement actions.

In addition, we are partnering with our largest supplier [indiscernible] (00:21:37) domestic manufacturing facility, which will provide sourcing flexibility and [ph] low inflated (00:21:42) cost capabilities. We expect this facility to become operational in early 2022. Collectively, these initiatives will reduce our supply chain costs while improving manufacturing efficiency and customer service. Our extensive list of cost reduction initiatives will begin implementation in late Q4 with substantial completion by late Q1 to early Q2 2022. These actions are expected to mitigate additional inflation and we expect gross margin trends to improve sequentially from Q3 levels. However, we will remain nimble as we manage our pricing and cost structure and will react accordingly as conditions warrant. While volume gains across our portfolio remain our greatest growth enabler, we will continue to take price as necessary and maximize trade efficiencies with a holistic approach towards net revenue management.

We previously announced a list price increase for our largest product line Rao's sauce, which takes effect late Q4. To combat additional inflation, we have seen and expect in the coming year, we have announced new list price increases for additional products effective in late Q1 2022. We are also removing our least efficient promotions to drive net price increases and assist in mitigating inflation. We expect our new pricing actions to take hold in the marketplace and become more beneficial beginning next year. Our performance this year has enabled us to [ph] lab (00:23:21) comparisons from the 2020 COVID surge and grow brand net sales by 72% on a year-to-date basis over the comparable period in 2019.

Long term, we believe our focus against increasing household penetration of our current brands as well as selective TAM expansion via new product innovation will sustain high single digit sales growth organically. We expect adjusted EBITDA growth in the low double digits with expanding growth and EBITDA margin as we increase productivity and leverage capabilities across our shared organization. And finally, with our robust cash generation, future M&A opportunities will provide additional optionality for growth. To conclude, investing in growth remains our highest priority for capital allocation. With our operational discipline, we are well-positioned among the high growth profitable names in the CPG sector with a promising stable of brands that will delight consumers for years to come.

With that, let me turn the call back over to Todd for some final remarks.

## Todd R. Lachman

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

Thanks, Chris. Before we open the floor for questions, let me reinforce how pleased we are with our third quarter results. The Sovos team will remain steadfast in our focus on the growth opportunities and synergies across our portfolio. We expect our business to outpace the market as we pursue organic and acquisitive avenues for growth. This momentum and our robust pipeline of productivity initiatives underpin our confidence in our ability to weather external conditions improve profitability and generate attractive shareholder returns over the long-term. I am proud of our ability to keep up with the market demand for our products and I want to thank our supply chain and commercial teams for their continued focus on our customers. Sovos Brands is in the early innings of a remarkable growth trajectory and we are excited to embark on this next stage of growth as a public company. We're now available to take your questions. Operator?

# QUESTION AND ANSWER SECTION

**Operator**: Thank you. [Operator Instructions] Our first question comes from Michael Lavery at Piper Sandler. Your line is open.

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

Q

Good morning, thank you.

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

A

Hey, Michael.

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

Q

[ph] Just curious (00:26:04) from a competitive perspective. You know, there's certainly a lot of companies talking about service levels and struggles to fill orders, but, certainly at least the magnitude of your growth suggests that's probably less of a problem. Can you give any sense of if you've been able to drive distribution gains from having a better ability to serve your customers, and if that's just helping accelerate some of your growth and for distribution?

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

A

Sure. Hey, Michael. It's Todd Lachman. Good to be talking to you this morning. First thing I just want to highlight is, again, how pleased we are with our third quarter results, first reported quarter as a public company. And while I can't comment on competition, our ability to service our customers has absolutely been a key driver of our ability to increase distribution on our brands. I'd reflect back on and we've talked about Vendor of the Year at Target and Supplier of the Year at Whole Foods. Those two awards were driven primarily by our ability to keep our products in service during 2020. Just for example, Rao's growth in Q4 versus prior year was up 86% in 2020 versus 2019, but we were able to keep our distribution in our products and in stores. If you look at Rao's now growing well at sauce well above 30%. We've got our frozen business growing triple digits. We've got soup -- fastest growing soup business in the entire category and we are increasing distribution, I mean, our frozen business distribution up 88%. Our soup business distribution up 18%.

Baking mix on Birch Benders, basically distribution up significantly, as well as Rao's sauce as large as it is, we've got our sauce business continually growing double digits, as you've seen in the data. So, absolutely our ability to keep products in supply is driving that distribution. I think you saw also we're going to make the choices that we need with a growth oriented mindset to invest in the right levels of cost and investment to ensure that we keep our products and supply and maintain our growth momentum.

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

Q

No. That's great. And sorry, I got so excited about the distribution. I skipped right over, congrats on the first quarter and [indiscernible] (00:28:29).

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

A

Yeah. No problem. We get excited about it also, Michael.

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

Q

And a follow-up on the Georgia facility, obviously that will help capacity. But then can you just give a sense of what if anything that means for costs because you still obviously have ingredients coming from Italy, is there any shipping savings? What's the right way to think about the margin impact? And will it have the same fixed terms that, that you currently have in terms of just the predictability of your input costs there too?

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

A

Yeah. Hey. Thank you. This is Chris Hall. And so the Alma facility that's still [ph] in flight (00:29:11) and we anticipate it opening up here early next year. We will provide a number of advantages for us. One, that type of [ph] offshoring (00:29:20) provide a second level of redundant capacity that we'll have available for us to meet the near-term marketplace opportunities. We'll be able to lessen our safety stock, shorter lead times, things like that. And in addition, [ph] first is (00:29:36) it is the same cost that are landed case for cost base is coming out of Italy, but will provide us for arbitrage possibilities against other domestic suppliers that we have in the network today. So that will drive down our overall costs especially on sauce, and we may produce other items at that facility as well. And as I mentioned that will be up and running early next year.

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

Q

Okay, great. Thanks so much and – yeah, congrats again.

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

A

Thank you.

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

A

Yeah, thanks a lot, Michael.

**Operator**: Thank you. Our next question comes from Peter Galbo with Bank of America. Your line is open.

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

Q

Hey, guys, good morning. Thanks for taking the questions and congrats on the quarter.

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

A

Thanks, Peter.

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

A

Thank you.

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

Q

Todd, maybe if I could just follow up actually on the Alma question. I think that have been delayed a little bit from kind of when we'd spoken previously about opening in Q4. Just curious like what the biggest bottleneck is to getting that opened sooner, is it construction materials? Is it ability to hire in a place like Georgia where maybe labor is tight? Just any additional color there would be helpful on why I guess it's not opening sooner.

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

A

Absolutely, Peter, thanks, great question. And we had originally communicated in October and now will be Q1 2022. It is absolutely not driven by labor shortages in the area. So that is not the reason. It's really just COVID pandemic delayed completion of some key equipment arriving to Georgia from overseas, government restrictions for travel, delayed technicians arrival on site in Georgia because of travel restrictions from technicians coming from Italy to install and started up. But honestly nearly all of these issues are substantially behind us, so we're confident in starting up the facility in Q1.

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

Q

No. That's helpful. Thanks very much, Todd.

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

A

You bet.

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

Q

And maybe just secondly, one of the things, I guess, we're hearing a lot of now, particularly on price increases is the consumer is maybe starting to push back ever so slightly from elasticity standpoint. And so, just with the sauce increase that's gone in, I don't know if [ph] Rich is (00:31:52) on the call or not, but just what are you hearing from customers in terms of elasticity at this point? Are things still relatively strong? How are you balancing that thinking about next year?

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

A

Sure. So, Peter, Todd, again. So, a couple of things to take a step back. So as discussed, our array of sauce price increase will be effective in the marketplace in late Q4. Our retailers have accepted the price increase. And also, as Chris mentioned, we've announced additional pricing actions with effective dates in late Q1 2022. And we're implementing list price increases across about 65% of our portfolio I will highlight here and I know it'll come up again that we believe the current announced pricing will cover 100% of the expected year-on-year 2022 inflation. And regards of elasticity, honestly of what we're seeing is kind of less elasticity than expected.

So, while we have modeled in in normal times elasticity of a one-to-one effect, these are not normal times with rising prices across the store. And I think as I've seen a lot of you kind of reporting and hearing from other companies, the impact on units has been minimal or less than expected. For example, data from widely cited that across the store prices have been going up by mid-single digits, with unit declines of only low single digits. We expect our pricing actions to be in line with categories that we compete and we see no headwind in Rao's ability. Post pricing to continue to significantly increase household penetration awareness, dollar share and distribution and I want to highlight again all-time record share for Rao's now about 13% and record household penetration above 10%. So, we don't see the elasticity being as significant as originally expected.

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

Got it. Thanks. Thanks so much, guys. I'm looking forward to using my Rao's tonight for dinner. So thanks and good quarter.

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

[indiscernible] (00:33:53). Thanks Peter.

**Operator**: Thank you. Our next question comes from Ken Goldman of JPMorgan. Your line is open.

**Ken Goldman**
*Analyst, JPMorgan Securities LLC*
Q

Hi. Thanks so much. Todd, I know it's not your biggest brand, but Birch Benders, I think -- I know that it has a difficult comparison, but, I think maybe it's fair to say some of us might have hoped it would have been growing a little bit more by now just given some of the distribution gains and some of the new products that are there. So, as you analyze what some of the core issues are with Birch Benders, first of all, are there core issues as we see it or is that not something you'd agree with? And second, what do you think some of those are and how easy are they just to fix in your mind? Again, I don't mean to be overly negative on a smaller part of the business, but it is -- it's something I'm curious about?

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

Sure. How are you doing, Ken? Good to talk to you this morning. And so, a couple of things on Birch Benders. Number one, we're absolutely thrilled that we've added Birch Benders to the Sovos portfolio, [indiscernible] (00:34:57) checks every box of what it takes to be a Sovos Brands. It's absolutely delicious, highest net promoter score among organic consumers, cleaner, better few ingredients. I'll emphasize we've only owned Birch Benders now for one year. The full impact of the playbook will be recognized in 2022. We've got a lot of confidence in the business in 2022. As you know some highlights here, we're renovating existing products by launching a new and improved keto pancake waffle mix offering, continuing the growth of frozen waffles with Birch Benders as the fastest growing brand in the category. And we've successfully launched Birch Benders into the baking mix category. And in 2022, extending the brand in the 9 billion ready to eat cookie category, but the headwind I know behind your question is the performance of Birch Benders in the pancake and waffle mix category. This is a category [indiscernible] (00:35:44) like a lot of people making pancakes every morning during the COVID time, and there's a lot of people not making pancakes now in a post-COVID environment and the category is down.

We are performing a little bit worse than the category. We get it, but we have the full intention to drive awareness and household penetration of not just that category, but as I said, fastest growing frozen waffle business along with baking mix along with the entry into ready to eat cookies. And last thing I'd mention Ken is, we talked about noosa before, when we purchased noosa, it was declining double digits in dollars and units. And we knew it was going to take us a year to really get that brand rocking and now we've got noosa growing 34 straight months of unit sales greater than the category. We've got dollars growing double the category through implementation of our playbook. So, [indiscernible] (00:36:37) year and we fully expect with full implementation of the playbook, in 2022 we're going to have that business growing and rocking again.

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**Ken Goldman**
*Analyst, JPMorgan Securities LLC*

Q

All right. Thanks for that. And then, Todd, obviously M&A is a big part of your strategy, you mentioned it this morning. I'm just curious in the current environment, where so many companies and potentially companies you're trying to acquire are challenged in terms of their supply chains, their ability to service customers? Does that make it – does that make them more likely to sell in your view or because they just may throw up their hands and say, that's it, let's give it to someone else or does it make them less likely because maybe the EBITDA base is a little bit lower than what they want. I'm just trying to get a sense for the -- how you see the [ph] whiteness (00:37:22) of the M&A environment right now, so to speak?

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

A

Sure. [indiscernible] (00:37:28) I can't really opine on whether it would make them more or less likely to sell Ken. What I can say is that I think in an environment like this, a company like Sovos is the perfect partner for those type of companies that you just described. And we continue to be an acquirer of choice for founder-led companies. We know how to execute M&A. It is a core competency of ours. I know we've talked about this previously. This is not something that we kind of come out of the ground every five years or seven years and decide to do a deal. I mean we've averaged about one a year. We've got a playbook. We know how to do the diligence. We know how to do the integration. We've been successful in the businesses we've acquired to-date. And we've got a long list of potential targets that meet the criteria of what it takes to be a Sovos Brands. We will be disciplined. Since our founding, we've looked at over 250 brands. We've executed on four. We're going to stick to our knitting as we've talked before. But to your question, difficult to say, I think you could argue either sides of the essence of your question. But what I would emphasize is that a company like Sovos with our capabilities, our agile supply chain, our selling capabilities, marketing R&D, we're just a perfect match for companies that might be looking for that next chapter of growth with Sovos being the perfect partner to take them to that next level.

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**Ken Goldman**
*Analyst, JPMorgan Securities LLC*

Q

Great. Thank you.

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

A

You got it, think you, Ken.

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**Operator**: Our next question comes from Chris Growe of Stifel, your line is open.

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**Christopher R. Growe**
*Analyst, Stifel, Nicolaus & Co., Inc.*

Q

Hi, good morning.

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

A

Hey, Chris, good morning.

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**Christopher R. Growe**
*Analyst, Stifel, Nicolaus & Co., Inc.*

Q

Hi. Then I'll let my congratulations as well. I want to ask – first, I had just two questions. And – as we think about the inflation environment that's kind of developed here and obviously risen since we last talked is, should we think about the second quarter of next year as a point we will start to see some of that gross margin stability based on the timing of your price increases. Is that kind of [indiscernible] (00:39:29)? Maybe some [indiscernible] (00:39:31) dollar profit starts to benefit from the pricing in relation to the inflation?

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

A

Hey, Chris. This is Chris speaking. Thank you for the question. Great talking to you. And yeah, I think that's a fair assessment. As we put the full suite of our very comprehensive pricing and productivity actions in place, that will definitely ramp up and take hold in Q2. We've talked before, as Todd mentioned, we'll have a list price on 65% of our portfolio and the other 35% we will [ph] tack (00:40:02) across eliminating or at least reducing or at least efficient promotion. Todd mentioned, we will cover 100% of our year-over-year inflation. By the time we have fully implemented that list price increasing, which will hit in mid-to-late Q1. So, by Q2, we will be fully embedded in the marketplace.

And on our productivity actions as well, the automation that we're putting into our facilities, further optimization of our co-manufacturing network, packaging, value engineering opportunities that we're exploring right now, the further [ph] sanitization (00:40:36) of Birch Benders and even the scale we get and the leverage we get from our operation as we continue to grow that high single digit top line, we should see that and we'll see that stabilization as you mentioned earlier in the year and especially across Q2.

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**Christopher R. Growe**
*Analyst, Stifel, Nicolaus & Co., Inc.*

Q

And then do you kind of build that normal kind of one to one sort of elasticity? I'm sure it's definitely by brand, but is that the way you kind of build it in? And obviously, we've seen it to be lower of late. And then just hope it's better, is that the way to think about the way you're building in next year?

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

A

Yeah, that's how we built our projections out. And as you mentioned, like the [ph] rest (00:41:11) industry, we are -- yeah, we would not be a total surprise if we beat that expectation, but that is what we have in our model.

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**Christopher R. Growe**
*Analyst, Stifel, Nicolaus & Co., Inc.*

Q

Okay. I think just one final question, which is just in relation to some of the rebuilding of marketing spending. Have you adjusted any those plans due to like supply chain challenges, your ability to get product into the store? And that's been a real high point for you, but is any of that change the way you're approaching some of your marketing plans? And that's my final question. Thank you.

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

A

Yeah. Sure, Chris. So honestly, in 2021, well, I mean, I'll reinforce again, I think I mentioned before that we have, I think the only time it really was back in Q2 of 2020 at the height of the COVID demand surge. But, honestly, since then, our supply chain organization, sales organization has just done a phenomenal job keeping our customers and service. One of our guiding principles is obsessed with the front line. We'll make the necessary investments that we need. So we have not dialed down marketing or other investments in driving the top line. As I'd say again, with our growth-oriented mindset, the momentum of our business, we will continue to make the right decisions and investments to drive the industry-leading growth of the Sovos Brands portfolio. So we have not – we have not taken the foot off the accelerator on the investments of our brands. And that's I think what's driving the fact that, I mean, I think you saw 90% of our portfolio sauce, yogurt and frozen, all of those businesses growing double digits versus prior year regards to consumption.

**Christopher R. Growe**
*Analyst, Stifel, Nicolaus & Co., Inc.*

Q

Thank you.

**Operator**: Thank you. Our next question comes from Robert Moskow Credit Suisse, Your line is open.

**Robert Moskow**
*Analyst, Credit Suisse Securities (USA) LLC*

Q

Hi, and congratulations again. Just a modeling question for gross margin in fourth quarter, would you expect to be down again another 500 basis points just because the pricing hasn't fully made its way through or do you expect it to be a little better?

And then on SG&A, I think the -- the run rate now should be $34 million, but I think you said that you are going to have full absorption of your public company cost in fourth quarter. So does that mean SG&A would be higher in fourth because you have a full quarter of it or is it about the same? Thanks.

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

A

Yeah. No, thank you for the question. This is Chris. As we operated across Q3 and as we've mentioned and just to reinforce, yes, our very strong growth that we continue to see as we operated across Q3 and our very growth oriented mindset, we absolutely prioritize growth and profits, the momentum in our business. We continue to make the right decisions in investments as Todd mentioned, to drive that industry leading growth as the portfolio.

As we operate across Q3, we saw week after week in our consumption reports 30-ish percent growth in the Rao's brand sauce plus all the the products that we we've [ph] extended into. And with that extended (00:44:29) demand, we lead in and ramped up production expedited freight at a time where a transatlantic ocean freight rates were elevated. And in addition, if you recall back to that Q2, Q3 timeline, we saw New Jersey experienced unprecedented long logjam, significant congestion, which also led to excessive demurrage and even drayage expenses. So we made those investments in Q3. Fortunately, we are able to offset that down to EBITDA line and [ph] hope (00:45:03) consistent margins year-over-year for Q3. As we move into Q4, our inventory is at a very good position. We have a very good flow of supply coming out of Italy and domestically across the portfolio.

So we do not anticipate anywhere near that level of cost that we experienced in Q3. So it's very fair to say we do anticipate higher margins in Q4 than you saw in Q3. And as we mentioned previously as we lead into 2022, we'll continue to see expanded margins across the year and as we mentioned earlier, really full stabilization in Q2 and beyond. On the SG&A side, absolutely, we will incur and absorb in Q4 that that full suite of a public company cost, the hirings and we have all that head count in place that we -- that we will be putting in and that will carry on through 2022. That as well as that incorporate into our [ph] planning has taken for our (00:46:02) 2022, but you will see higher SG&A costs as you mentioned within that that line as well as we rebuild marketing I just discussed to that 5.5% to 6% of net sales range.

**Robert Moskow**
*Analyst, Credit Suisse Securities (USA) LLC*

Q

I'm sorry, can you maybe refresh our memory as to what those ongoing public costs are, like how much did you have in third quarter and how much more would you have in fourth?

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

A

Yeah we -- the hirings that we have put in place, the roles that we have now for instance, investor relations, internal audit, things like that as well as things like listing fees on Nasdaq, public market, insurance, [indiscernible] (00:46:49), we've got $1.5 million to $2 million a quarter depending on the quarter that we will start in Q4 and across 2022.

**Robert Moskow**
*Analyst, Credit Suisse Securities (USA) LLC*

Q

Got it. Thank you.  Oh, yeah, was any of that in Q3 or not really?

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

A

Yeah, there was a smaller amount in Q3. We didn't take on any of those public market expenses until Q4, but we did have some of those hirings in place in Q3.

**Robert Moskow**
*Analyst, Credit Suisse Securities (USA) LLC*

Q

Okay. I heard the whispering, so I figured I'd ask it since it was discussed. All right, thank you.

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

A

Thank you.

**Operator**: Thank you. Thank you, our next question comes from Brian Holland of Cowen and Company. Your line is open.

**Brian Holland**
*Analyst, Cowen & Co. LLC*

Q

Yeah, thanks. Good morning. The question on the innovation pipeline, I guess two-fold. One, we've obviously seen through COVID a relatively narrow assortments on shelves, et cetera. You have a long innovation pipeline.

Have you had any issues getting new products or do you anticipate any issues getting new products into stores? And maybe this is less of an issue for you given service levels, et cetera. But just kind of curious your view there?

And then secondly, what do you expect? Do you have a framework for what innovation could contribute on an annualized basis going forward either as a percentage of growth or overall revenue, et cetera?

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

A

Sure. Brian, how're you doing? Good morning. It's Todd Lachman. So on the – a couple of things on the innovation side, I think to the first part of your question, we have had no difficulty getting our innovation to shelf, obviously, it's a core competency of ours through rapid distribution that we got even going with back to soup [ph] we got 50% (00:48:41) ACV in 90 days of our soup business. Now the number five soup brand, basically in the category, only launching in 2019 fastest growing, obviously soup brand, even at the number five level ahead of all competitors growing distribution dollar velocities. But -- so number one, we've not had a problem getting innovation to shelf. The type of brands that we – the type of products and brands that we'll bring to market are those types that are disruptive for the category. They're not made to mainstream offerings, I'll give example, frozen noosa gelato that we're launching in Q1, couldn't be more excited about that launch of extending the noosa brand known for its absolutely delicious indulgent yogurt and now expanding that into the $7 plus billion ice cream category with frozen yogurt gelato, so we are permissible offering in the ice cream category that honestly taste as good, if not better than any ice cream out there.

So that -- that's an example and that's one that's gotten acceptance across the board so far. We're very excited about the potential of that, but those are the type of innovations that we'll bring to the category, frozen -- Rao's frozen that – and the Michael Angelo's offerings that are super premium in nature and very differentiated versus what's out there. If you look at our frozen business last 13 weeks ended 10/3 growing 227%, distribution up 88%, velocity 77%, again providing consumers and retailers with a super-premium restaurant quality meal. You've got Birch Benders baking mix, again, offering consumers that down the baking aisle with the keto offering growing 65% last 13 weeks, gaining distribution, 114% versus year ago of TDPs. And what I say in regards to modeling as a percentage, we do not have innovation as a percentage of sales kind of going forward.

We -- I mean honestly, we really look [ph] at it as we said (00:50:44), our number one lever is driving our core sauce business and our yogurt business, driving household penetration of those brands. And so that's number one as we've talked about. And if you look at the source frozen and yogurt businesses 90%, all of those businesses grew above double digits in consumption last year. And so, as we go forward, we'll continue to drive TAM expansion. We've added $7 billion of TAM, but we don't really have a formula or an algorithm that says X percent needs to be from core and X percent needs to be through innovation. We're just looking to drive distribution and awareness and ultimately household penetration of our brands. And driving that -- the type of growth that we showed in Q3 and Q4 and for this year in the next year.

**Brian Holland**
*Analyst, Cowen & Co. LLC*

Q

Appreciate the -- appreciate the color. Second question, I wanted to probe the idea of Sovos as sort of an advantage to acquire with founder-led businesses. I think typically when we hear about – we hear acquirer of choice, it's generally category specific. And, you're talking about founder-led businesses. So I'm curious how that manifested itself, right? I mean, does that, does that mean that founder-led businesses are calling you and maybe they're less competitive bids or are you able to get assets cheaper because you're going to stick to the brand ethos in a way that maybe other competitors are promising or can you bid more aggressively because you're confident in the ability to generate the synergies. So, however, [ph] that involves (00:52:19) just really curious to hear how Sovos does advantage with founder-led brands?

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

A

Sure. So, yeah, I'm not going to touch on – Brian, I get the essence of your question, not going to touch on whether the bidding or et cetera. What I will get into [indiscernible] (00:52:37) having discussions – having had discussions with the founders of the business that we've acquired and those that they have. And if you remember, we take a step back the core grounding thesis of why we created Sovos was that you have these one of a kind brands. If you looked at the 100 largest center store brands at this period of time going back five years. But I think it's still relevant. You've got these large center store brands declining and what's going at their expense with these smaller one-of-a-kind brands. Some of the brands that whether they're better for you or they taste delicious but they are offering something differentiated to the consumer, those were growing the most rapid and I felt that there was an opportunity to create a company that had the capabilities in the infrastructure to focus on acquiring, integrating and growing those one of a kind brands because large CPG does a great job building billion dollar brands, but when it comes to these brands, let's just say roughly $50 to $100 million in net sales trying to acquire those that might sound good on day one, but then they just got to get lost in the morass of the large CPG entity.

And we built Sovos to basically be the company that could acquire these brands that share similar attributes regardless of temperature state, the highly delicious premium, authentic heritage leading brand affinity as measured by net promoter score, disrupting categories like the first -- basically a homemade whole tomato sauce or the keto offerings of Birch Benders sharing the same consumer base, the same playbook. And when we talk to founders, they're like, wow, my brand is going to have a great home in your company. You're going to -- you're going to give it the tender loving care that it deserves. And I'm confident that you're going to take it to the next chapter of growth. And that's why all the founders of the four businesses that we acquired have been or continue to be very involved in our business. And I think that's the differentiating aspect. And they can see versus maybe a large CPG player, their brand or company might get lost in the tentacles of that company versus it's really going to get the focus of our senior management team and our capabilities here at Sovos. And our capabilities are very specific to those types of brands. There's brands we're not going to buy, but that Sovos Brands, the type when we talked about are the ones that we will acquire.

**Brian Holland**
*Analyst, Cowen & Co. LLC*

Q

Thanks, again. Best of luck.

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

A

You got it. Thank you.

**Operator**: Thank you. And for our last question, it's from Andrew Lazar, Barclays. Your line is open.

**Andrew Lazar**
*Analyst, Barclays Capital, Inc.*

Q

Great. Thanks very much. I guess I know you're not giving sort of detail guidance yet for next year. But based on some of your comments around pricing, that'll be in place your comments around gross margin being up in 2022, it sort of sounds like at this stage you would anticipate to sort of be on algorithm next year in terms of sales and

EBITDA growth, even with some of the, let's say, incremental investments that you're having to make to supply your customers the way you want to. Is that a fair assessment or are we missing something?

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

A

Yeah, no. Thank you. This is Chris and great question. And, today, we're not providing formal 2022 guidance, we will as soon as we -- as we progress into our Q4 conference call in March. But, we can say that we expect 2022 net sales and EBITDA growth in line with our long time – long-term guidance of high single digit top line growth and low double digit EBITDA growth.

As we discussed, we see just massive growth potential across our brand continue to outperform our categories. As Todd mentioned, increasing awareness and distribution of the brands and that growth, the momentum which we're going to close this year, there are significant white space opportunity really for all of our brands as we enter 2022. 90% of our businesses as Todd mentioned growing double digit consumption here as we progressed across Q3.

And on the margins side, yeah, it'll be -- It's going to be uneven across the year, as we discussed earlier. We'll see that the pricing take further hold Q1 to Q2, those productivity initiatives in the Q2 and beyond, and we'll really realize those benefits across the back part of the year. So it would be a little bit uneven across the year and remembering that we did grow 41% this year in Q1. Part of that as a result of -- it was really the last quarter of stay-at-home mandates, we had explosive growth here in Q1 of this year that will be overlapping and that commodity inflation and some of the shipping higher costs we've seen really started taking hold Q2, Q3 and beyond. So as we overlapped that as well across H1 and H2 next year, it will be slightly uneven, but for the full year, we should be able to [indiscernible] (00:57:23) for our longer term guidance.

**Andrew Lazar**
*Analyst, Barclays Capital, Inc.*

Q

[indiscernible] (00:57:27). And then just one quick clarification, I think you'd mentioned originally that the Rao's price increase was effective. I think it was October 25. I think today you mentioned the price that would kick in in sort of late Q4, and maybe I'm just splitting hairs, but I want to make sure there was no sort of change in sort of the timing on how that pricing came through and if there was kind of why would that be? Thanks a lot.

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

A

Hey Andrew, it's Todd. No change. You played it back perfectly.

**Andrew Lazar**
*Analyst, Barclays Capital, Inc.*

Q

Okay. Thanks very much.

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

A

You got it. Thank you.

**Operator**: Thank you. Ladies and gentlemen, I'd like to turn the call back over to Todd Lachman for any closing remarks.

## Todd R. Lachman

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

Fantastic. Thank you very much. Well, thanks, everybody for your participation. I want to thank our employees, our board, our investors and the people who supported us throughout the process of becoming a public company. Very exciting times. It's been enormously gratifying to lead Sovos through this journey. We're absolutely thrilled about what we've created so far, but the best is yet to come. I look forward to speaking with all of you again in March when we report our fourth quarter earnings. Have a great day.

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**Operator**: Thank you. Ladies and gentlemen, this does conclude today's conference. Thank you all for participating. You may now disconnect. Have a great day.