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# Sovos Brands, Inc. (SOVO)

Q2 2022 Earnings Call

## CORPORATE PARTICIPANTS

**Joshua A. Levine**

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**Todd R. Lachman**

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

**Christopher W. Hall**

*Chief Financial Officer, Sovos Brands, Inc.*

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## OTHER PARTICIPANTS

**Ken Goldman**

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**Andrew Lazar**

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## MANAGEMENT DISCUSSION SECTION

**Operator:** Good day, ladies and gentlemen. Thank you for standing by, and welcome to Sovos Brands Second Quarter Fiscal Year 2022 Earnings Conference Call. At this time, all participants are in a listen-only mode. After the speakers' presentation, there will be a question-and-answer session. [Operator Instructions] Please be advised, that today's conference may be recorded.

I would now like to turn the conference over to your speaker host today, Josh Levine. Please go ahead.

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**Joshua A. Levine**

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

Good afternoon, and thank you for joining us on Sovos Brands' second quarter fiscal year 2022 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 June 25, 2022 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.sovosbrands.com](http://ir.sovosbrands.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.

Lastly, please note that all consumption data cited on today's call will refer to dollar consumption as of the 13-week period ended June 26, 2022 and growth versus the prior year comparable period, unless otherwise noted.

With that, I would now like to turn the call over to Todd.

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## Todd R. Lachman

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

Thanks, Josh. I would like to start today's call off by discussing a few highlights on the quarter and then provide an update on the current operating environment before turning it over to Chris Hall for greater detail on our second quarter results, as well as our full-year outlook. Looking to our second quarter results, I am very proud of how well our team persevered in today's uncertain consumer environment while managing through continued supply chain headwinds. We delivered robust 22% top line growth with results led by 13% volume and 9% price. Our core businesses, sauce, yogurt and frozen, which represent 90% of our portfolio, delivered strong dollar growth rates.

Sauce, represented by the Rao's brand, grew dollar consumption over 30%, well ahead of the category. Yogurt, represented by the noosa brand, grew 5%, supported by pricing, which stepped up through the quarter. And finally frozen, which includes Rao's and Michael Angelo's entrées, as well as Birch Benders' waffles grew 6%. Volume growth continues to be a key driver for us, whereas pricing remains essentially the sole driver of growth for the categories in which we play. Notably, and as expected, our pricing accelerated this quarter compared to the first quarter as our recent pricing actions in a number of categories flowed through to the market. Net sales growth remains strong for our largest brand, Rao's, as we rapidly progressed towards building \$1 billion brand. Rao's continues to be one of the fastest growing center store brands of scale in the US and represents more than half our portfolio. We grew total Rao's franchise dollar consumption 34%, led by 28% unit growth that was driven by gains in distribution and velocities across our categories. From a household penetration standpoint, total Rao's increased by 260 basis points versus prior year to 14.6% as a result of year-over-year gains across sauce, frozen, soup and pasta. Specific to sauce, Rao's dollar consumption increased by over 30%. This rate of growth translated into a 170 basis point increase in dollar share versus the prior year, as dollars and units were supported by a balanced mix of double-digit distribution and dollar velocity growth.

Additionally, unit growth of 23% was 20 points ahead of the category leading to unit share gains. Household penetration growth for Rao's sauce was the fastest in the category, increasing by 210 basis points versus the same time last year to 11.9%. In addition to our success with the Rao's brand in sauce, we continue to see very strong volume-led performance in soup, pasta and frozen entrées, a testament to the strength of the brand and its ability to travel to other categories.

For our soup business, the fifth largest brand in the category, dollar consumption was up 30% with units up 26%. Our pasta business grew dollars 62% and units 57%. And finally, Rao's frozen entrées grew dollars 67% and units 52%. While we grew total frozen entrées dollar consumption by 7% in the quarter, behind strong Rao's growth, we experienced significant supply chain headwinds on our frozen business during the quarter. Specifically, as you might recall, last quarter, we shared that our primary pasta supplier to our frozen entrées business was hit by a

tornado. This had a material impact on our ability to supply product to the market, causing us to pull nearly all promotional activity to better service our base business. We have reinstated frozen promotional activity in Q3 as inventories are nearly back to target levels.

On our noosa yogurt brand, we grew core spoonable yogurt dollar consumption mid-single digits, behind nearly 10% dollar velocity growth, with consistent growth across our core 8-ounce multi-pack and 24-ounce sizes. Gelato continues to increase distribution, and our marketing efforts are gaining traction as we see improving trends through the summer.

Lastly, on Birch Benders, the second quarter once again proved challenging as we expected. The declines were driven primarily by lapping the balance of a key customer promotion that similarly impacted us in the first quarter, while we continue to see declining trends in keto. Our teams are working to improve performance. However, in light of these recent trends and the brand's underperformance, we took a non-cash goodwill impairment that Chris will speak more about later.

Shifting to the supply chain, disruptions once again impacted our performance during the second quarter, even as we put [ph] up (08:13) strong 13% volume growth. We experienced intermittent outages in certain key inputs, including glass, foils, pasta, chicken and eggs, while also being forced to weather the impacts of higher diesel cost and ongoing delays at the ports. Specifically Rao's sauce was impacted by shortages of certain jar sizes. And Sovos frozen entrée business was impacted by outages of dry pasta for a number of weeks, which resulted in gaps on shelves during the quarter and elevated downtime in our plant.

In the quarter, we also realized heightened inflationary pressures, including increased raw materials, packaging, logistics, labor and energy cost. At this point, as we look ahead, we don't see the current challenges abating in a meaningful way in the near term. As you know, in response, we have announced pricing against all of our brands with our second list price increase on Rao's sauce going in the market as we speak.

We are also executing against our full suite of productivity and net revenue management projects, supporting our path to margin recovery. As we've stated in the past, we will not hesitate to respond with additional actions if warranted by the market. In summary, we are pleased with our performance in the first half on the top line and remain confident in the strength of our brands. As a result of our 16% organic sales growth during the first half of the year and confidence in our continued growth momentum, we are raising our sales guidance for the year. I want to commend our team for how they have responded to the challenges we continue to face and [ph] know (10:05) that we will remain nimble and tenacious, taking action quickly to ensure we continue our growth momentum.

We remain laser-focused on driving household penetration by expanding distribution and awareness, and we will continue to make strategic investments beyond sales, marketing, innovation, supply chain and other necessary capabilities to drive future share gains for our one-of-a-kind brands, even in the face of a challenging cost environment.

Finally, before I turn it over to Chris, I want to welcome the newest member of our board of directors, Mr. Tamer Abuaita. Tamer brings 25 years of supply chain experience and perspective, including nearly 20 years at established CPG companies, including Nestlé, ConAgra, Heinz and SC Johnson. He is currently the SVP of Operations and Chief Supply Chain Officer at Stanley Black & Decker. In today's volatile and challenging supply chain environment, and from his long experience in our industry, I have no doubt he will be a great addition to our board.

I will now hand it over to Chris for more details on the quarter and our updated perspective on the second half of the fiscal year.

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## Christopher W. Hall

*Chief Financial Officer, Sovos Brands, Inc.*

Thank you, Todd, and good afternoon, everyone. Second quarter, total net sales were \$197.4 million, a \$36 million or 22% increase over the prior-year period. This growth was entirely organic and was driven by 13.3% volume growth and 8.7% price. We are very pleased by how we have executed our price increases across our portfolio with our volume growth remaining robust. From a category perspective, our growth was driven by strength in our core category, sauce, yogurt and frozen. And at the brand level, the growth was primarily driven by Rao's and noosa, offset by declines at Birch Benders. Rao's remain the driving force behind our growth, increasing net sales 43.6% driven by sauce.

On a year-to-date basis, sauce sales for the Rao's brand have grown 30%, roughly in line with consumption. When comparing total Rao's net sales growth relative to 2019, this was the third consecutive quarter where we grew at a 55% CAGR, reflecting remarkable strength and consistency considering the brand size of nearly \$0.5 billion in net sales. Noosa net sales were up 8.8% in the quarter as pricing flowed through to the market coupled with the initial contribution from Gelato.

Adjusted gross profit of \$55.2 million increased \$5.5 million or 11.1% year-over-year benefiting from our strong top line results. Adjusted gross margin were 28% of net sales for the quarter, reflecting a 270 basis point decline versus the prior-year period and a 200 basis point improvement versus Q1 2022. The year-over-year margin decline was due to the impact of low double-digit inflation, with specific pressures observed in our dairy, proteins, packaging, logistics and energy costs. These headwinds were partially offset by the benefits of pricing and productivity in the quarter, each of which sequentially improved versus the last quarter. Adjusted operating expenses of \$32.5 million increased by \$7.5 million or 30.2% over the prior-year period, primarily due to increased spending behind marketing, R&D and G&A as we invested in our brands, talent and capabilities to drive growth for the long term. For perspective, in the second quarter, we increased our growth investments as defined by marketing plus R&D by 26% versus the prior year. The quarter also included public company costs, which were not present in the prior-year period when the company was private. Adjusted EBITDA of \$25.7 million declined \$1.6 million or 6% versus Q2 2021, while adjusted EBITDA margin was 13% versus 16.9% in the prior-year period.

Net income for the quarter was a loss of \$30.3 million or negative \$0.30 per diluted share, compared to a loss of \$1.3 million or negative \$0.02 per diluted share in the prior-year period. The loss was primarily related to an impairment of Birch Benders' goodwill. We test our goodwill for impairment at least annually or when circumstances warrant and report any related impairment loss as an expense. Due to the year-to-date underperformance of Birch Benders, we performed a quantitative assessment, which resulted in a full impairment of Birch Benders' goodwill totaling \$42.1 million. We believe this should resolve future impairment risk to the brand.

Adjusted net income was \$12.7 million and adjusted EPS was \$0.13 per diluted share compared to \$13.3 million or \$0.17 per diluted share in Q2 2021. Due to the timing of our IPO in September 2021, I would point out that our fully diluted share count of 101.3 million shares was 31% higher than the prior-year period and represented a \$0.03 headwind to our Q2 2022 adjusted EPS. At the end of the second quarter, cash and cash equivalents were \$72.6 million and total debt was \$482 million, resulting in a net debt to adjusted EBITDA ratio of 3.9 times.

I would now like to discuss our updated outlook and some of the underlying assumptions that support it. On the top line, we are raising our fiscal 2022 guidance to \$825 million to \$835 million, reflecting 15% to 16% growth. This compares to our prior guidance of \$800 million to \$815 million or 11% to 13% growth. Our updated guidance reflects 16% organic sales growth year-to-date and confidence in our continued growth momentum through the balance of the year, including the benefit from incremental pricing on our Rao's that just went into effect. Remember that this guidance includes the benefit of the 53rd week in Q4, which equates to an additional 2 points to the top line on a full-year basis.

Finally, I want to provide some additional color to our second half sales growth assumptions. First, we expect price in the second half to be generally in line with Q2, as the benefit of the recent Rao's sauce price increase is expected to be offset by the reinstatement of frozen entrée promotions. And second, we continue to expect elasticities to normalize during the second half as we enter what many expect [ph] could (18:03) be a more challenging and uncertain environment for the consumer.

Regarding profitability, we are maintaining our full year adjusted EBITDA range of \$116 million to \$122 million, with guidance at the lower end. We continue to assume we will see benefits from price realization and productivity initiatives, as we move to the back half of the year. We still expect our full year inflation to fall within the low double-digit range. However, our updated expectations reflect slightly higher inflation assumptions through the balance of the year, the primary drivers being higher dairy, glass, logistics in North America, and third-party manufacturing costs. Growth remains our top priority, and I want to reiterate that we will continue to invest in the business to enable the multi-year growth opportunity that we see ahead.

From a balance sheet perspective, given our updated outlook, higher interest costs and investments to support our growth, we expect that our leverage will finish the year below 3.5 times.

Let me now turn the call back over to Todd for some final remarks.

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### **Todd R. Lachman**

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

Thanks, Chris. We are very pleased with the first half of 2022, led by our robust top line growth. We continue to invest in our brands, talent, supply chain, and capabilities to drive growth well into the future, even as we manage against inflationary pressures and supply chain disruptions. As we have said many times in the past, while sales growth will always be our top priority, we will work tirelessly to combat near-term margin pressures and secure long-term profitability.

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

## QUESTION AND ANSWER SECTION

**Operator:** Thank you. [Operator Instructions] And our first question coming from the line of Ken Goldman with JPMorgan.

**Ken Goldman**

*Analyst, JPMorgan Securities LLC*

Q

Hi, thanks so much. Chris, I wanted to follow up on a bit of guidance that was issued last quarter about the gross margin, it was supposed to be on path to, I think, be up modestly year-on-year as you exit the year. I just wanted to get a little bit more color, how do we think about the third quarter gross margin in light of 2Q coming in 200 basis points above 1Q? So, I just wanted to get some color there. And I know there was some promotional pull-backs. And then I just wanted to get a little bit of sense of how you still see the gross margin exiting the year, if you had a little more clarity on that at this point. Thank you.

**Christopher W. Hall**

*Chief Financial Officer, Sovos Brands, Inc.*

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Yeah. [ph] Sure, Ken, you bet. I think (21:10) we're pleased with the sequential improvement we saw in Q2 on the gross margin line. You may recall that's what we did expect coming out of our last call and we see continued gross margin improvement as we go across the back half of the year, moderate expansion, Q3 to Q4. We do see incremental inflation versus where we were last time, we – that we spoke. Areas like dairy and glass and freight remain high and in some cases have elevated since our Q1 call. So, we do see more [ph] price (21:55) in the back half of the year. We're pleased with the level of price that we have in the marketplace here as it flowed through in Q2. And we're pleased with the progress we're making on our productivity initiatives as we mentioned, that would also be more heavily weighted to the back half of the year. So that combination of higher inflation, still low double-digits in total for the year, pricing flowed through, the elasticity that was experienced in Q2, the productivity [indiscernible] (22:23) back half of the year, we do see that moderate gross margin expansion, though in Q4, we do see landing slightly below where we landed last year. So in our previous call, we hoped to get back to that Q4 level. Given this higher level of inflation in Q4, some uncertainty we see in a couple of areas, we are de-risking that Q4 gross margin a little bit.

**Ken Goldman**

*Analyst, JPMorgan Securities LLC*

Q

Got it. Thank you. If I could just ask a quick follow-up and then I'll pass it along. I thought that guidance previously was for maybe the gross margin to be up modestly year-on-year, kind of as you exit the year, so maybe in the last month of the year. I just wanted to make sure that, and I'm probably being too nitpicky here, but just wanted to make sure that as you talk about, that expansion landing slightly below where you were last year, is that for that same period, sort of the end of the quarter? Is it for the whole fourth quarter? Again, I just want to make sure I'm hearing you correctly so we can think about it, right?

**Christopher W. Hall**

*Chief Financial Officer, Sovos Brands, Inc.*

A

Yeah, Ken, that'll be for the entirety of Q4 year-over-year. It'll be improved versus Q3 of this year, but below Q4 of 2021.

**Ken Goldman**

*Analyst, JPMorgan Securities LLC*

Got it. Thank you so much.

Q

**Christopher W. Hall**

*Chief Financial Officer, Sovos Brands, Inc.*

Okay. Thank you.

A

**Todd R. Lachman**

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

Thanks, Ken.

A

**Operator:** Thank you. And our next question coming from the line of Andrew Lazar with Barclays. Your line is open.

**Andrew Lazar**

*Analyst, Barclays Capital, Inc.*

Great. Thanks so much. I guess, first off, I think it was last quarter where you mentioned some of the supply chain challenges you faced, maybe kind of curbed your overall sales growth by, maybe it was low single digit sort of impact to the top line. Do you have an estimate of around, even directionally, what it might have held back sales by this quarter?

Q

**Christopher W. Hall**

*Chief Financial Officer, Sovos Brands, Inc.*

Yeah. As we talked in Q1, we expected and did realize \$3 million to \$5 million of business move out of Q1 into Q2. So we did realize that in Q2. As we operated in Q2, we still did see some sporadic supply chain challenges, notably at couple sizes of our glass jars, array of sauce, not our main 24 ounce, but like a 22 ounce and 40 ounce. And importantly, we had supply chain challenges in our frozen entrées business. You may recall we talked about a tornado that had hit our third-party pasta manufacturer, which we had to go then and find a secondary supplier for that. So, we lost some time at the plant as well then. So, we did have those challenges in Q2 on frozen entrées. Fortunately, as we're closing the quarter, we're closing in a much better position and getting the inventory rebalanced back into the marketplace. We did cancel the vast majority of our promotions in Q2 against our frozen business, and we will be reinstating that as well here in the back half of the year. So, we don't think – we think it was a very marginal impact at all as we exited Q2 on any volume that will be shifting over into Q3.

A

**Todd R. Lachman**

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

Just to build on that one point. Hey, Andrew, it's...

A

**Andrew Lazar**

*Analyst, Barclays Capital, Inc.*

Yeah.

Q

**Todd R. Lachman**

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

A



...it's Todd. The – our service levels now on frozen and sauce are very close to target levels with those inventories back and we're back promoting frozen full on as we enter – as we're into Q3.

**Andrew Lazar**

*Analyst, Barclays Capital, Inc.*

Q

Great. And then, Todd, what are you seeing on elasticity right now, I realize you're planning for it to be more going forward, which is prudent, but \*dynamic is playing out maybe in your key brands between any trading down that you're seeing versus trading in to at-home meeting, even to some premium brands like yours, given it's still a much better value, obviously, than eating out?

**Todd R. Lachman**

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

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Absolutely. So let me hit a couple of those points. So first [ph] is (26:32), right on the elasticity. To-date, look, we've seen lower elasticities to our sauce pricing than we expected. And even at the category level, pricing sensitivities remain below historical levels like through Q2. So, the sauce and our volume and [ph] when we (26:49) see our volume growth, very, very strong on the Rao's sauce brand, up 23%, unit consumption, unit velocity is up 7%. Now, as we implement the second LPI, given elevated gas prices, double-digit inflation across all major areas of spending, we're being cautious as we assume elasticities will revert to normal. [ph] Let me just hit (27:12) the yogurt and then I'll talk about the trade-down point. On yogurt, the brand has grown net sales 8% to 9%, consumption consistently mid-single digit. But we have seen the category continue to evolve with an increasing number of pricing actions, ourselves included. As we look at the LPI that went into market, the list price increase in the market in May, we believe we're seeing elasticities on par with our initial projection. So a little bit different on yogurt, and we've basically been conservative as we've seen them through the balance of the year.

And to get to your question on trade-down, the first area, as you said, and it's in line with, as we read all of our peers, I mean, we are seeing all of the data that what consumers are cutting back on is out of home eating, and therefore, those dollars are going towards in-home, and we've seen historically notably on a brand like Rao's which provides restaurant quality, premium tastes and food that, therefore that's helping continue to grow the brand, as you see in the dollar consumption. And I'm just quoting now some Kantar research in June, 42% of consumers have intentionally decided to eat out less often, 48% of consumers are uncomfortable spending money to eat out, 49% expect to cut back or stop spending on food away from home. I'd also quote recent source of volume data on both Rao's and noosa, we have sourced volume from private label versus private label sourcing from us. So, the private label is growing, private label is sourcing as it traditionally does for mainstream brands. So, private label is usually an analog to a mainstream brand, not a premium brand like a Rao's or a noosa. So, maybe slowing down a little bit, but, Rao's is really consistent growth as we're seeing. So, I kind of ramble there, but try to hit all the points that were embedded in your question.

**Andrew Lazar**

*Analyst, Barclays Capital, Inc.*

Q

Appreciate it. Thank you.

**Todd R. Lachman**

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

A

Yeah.

**Operator:** Thank you. And our next question coming from the line of Chris Grove with Stifel. Your line is open.

**Christopher R. Growe**

*Analyst, Stifel, Nicolaus & Co., Inc.*

Hi. Good afternoon. [ph] I just had a quick (29:33)...

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**Todd R. Lachman**

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

Chris, how you're doing?

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**Christopher R. Growe**

*Analyst, Stifel, Nicolaus & Co., Inc.*

Hi. I'm doing great. Thank you. I just had a quick question for you and a bit of a follow-on. I guess, to be clear with this increase in cost inflation you expect in the second half or a slightly higher level of increase, given your pricing is in place and has been announced already, do you expect pricing, I guess, and productivity savings to offset cost inflation in the second half of the year?

Q

**Christopher W. Hall**

*Chief Financial Officer, Sovos Brands, Inc.*

Hey, Chris, we – as we've seen this inflation continue to rise in these areas as we mentioned, we continue to pursue the other pricing actions that we've put in the marketplace through now, including the Rao's second LPI, which is literally in the marketplace just now as we speak. And as we mentioned, our productivity initiatives would be more back-half weighted, and we're seeing that as well. So, as we move across H2, we will see still a lag on our pricing and productivity versus the inflation that we are seeing. So, we – as I mentioned previously, we don't anticipate getting back to the Q4 prior-year margins as we exit the year. So, we're not covering 100% of that inflation that we're projecting into Q4 as we exit the year.

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**Christopher R. Growe**

*Analyst, Stifel, Nicolaus & Co., Inc.*

Okay. Thank you for that. And just I had a question. You had a pretty aggressive increase in marketing R&D and that flowed through SG&A. That was obviously very encouraging future growth of the brands. I just want to get a sense, is that something you expect to continue, any kind of framework for how to think about it for the year? And maybe then from a high level kind of where that's directed, where that – kind of where you're focusing a lot of those dollars?

Q

**Christopher W. Hall**

*Chief Financial Officer, Sovos Brands, Inc.*

Yeah. No, very good. Well, as we mentioned, really, all of our calls, top line growth is our number one priority. And we've seen the result of that. And we are benefiting from the investments that we have and continue to make throughout Q2. We actually saw marketing and R&D investment [ph] still (31:35) up by 20% year-over-year.

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And as we move across the back half of the year, we expect to continue to make those investments and we will actually spend a bit more investment into the marketplace in the back half of the year than we did in the first half year on that combination of marketing and R&D. While the growth rate may not be as much as it was year-over-year, it will be incremental dollars going into the marketplace for the back half of the year versus the first half of the year. So, we are committed to making those investments. We're committed to [ph] reaping (32:10) the top line momentum that we see ahead of us.

**Christopher R. Growe**

*Analyst, Stifel, Nicolaus & Co., Inc.*

Okay. Thank you.

Q

**Todd R. Lachman**

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

Yeah. Thanks, Chris.

A

**Christopher W. Hall**

*Chief Financial Officer, Sovos Brands, Inc.*

Thanks, Chris.

A

**Operator:** Thank you. And our next question coming from the line of Robert Moskow with Credit Suisse. Your line is open.

**Robert Moskow**

*Analyst, Credit Suisse Securities (USA) LLC*

Hi. Thanks. Maybe just a couple of questions. Chris, can you just remind us like how to quantify the productivity benefit of Alma opening up? And how that will help your back half? Because it is a very steep ramp of EBITDA growth required to still hit your guidance in the back half. So what's the unlock there? And then secondly, on Birch Benders, does writing down this brand impact at all your long-term growth algorithm that you provided during the IPO?

Q

**Todd R. Lachman**

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

I would – hey, Robert, it's Todd. [ph] On Birch Benders, so let's pass it to Chris (33:11) on the other question, so the answer is no. The writing-down of Birch Benders in no way, shape or form affects our long-term algorithm in regards to growth. So I'll just leave it that – leave it at that.

A

**Robert Moskow**

*Analyst, Credit Suisse Securities (USA) LLC*

Okay.

Q

**Christopher W. Hall**

*Chief Financial Officer, Sovos Brands, Inc.*

Okay. Yeah. Thanks. And specific to Alma, so Alma is open and operational and we continue to ramp up production. It is fully commissioned and making sauce that really matches the high quality sauce we're making in Italy as well. And we're building supplies right now, building inventory on both jars and Italian tomatoes in Alma. We've talked before about some of the major benefits of the US operation are – include balance sheet. It does allow us to have a much shorter order to fulfillment timeline, it allows us to take advantage of short-term marketplace opportunities. And we won't need to maintain as much inventory as we have previously as much safety stock when it was all coming out of Italy. Now, on the productivity front versus, we currently source roughly 20% of our Rao's sauce domestically, Alfredo and meat-based sauce predominantly from other domestic suppliers that then will shift into the Alma operation and we will see productivity there that the Alma operation will be less costly than the other domestic suppliers that we have. So, we will see productivity there, but we have a

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whole other slate of productivity initiatives really hitting in the back half of the year. We mentioned previously that we had seen delays in productivity coming out of the first half of the year as we were having delays in getting equipment and even engineers into our plants. We've talked a lot about the automation we're putting into our Austin frozen entrées plant. Well, now that is the two lines that we're automating. One is now up and operational. The second one will come here as we exit Q3. So, that will be in place down in Austin and up in our Bellvue, Colorado plant making noosa, we've in-housed our fruit preparation and our puree preparation and we will see those cost savings bring that in-house in the back half of the year as well. So really that back half, [ph] which is a confidence in (35:53) the sequential improvement of margins and the full flow-through of pricing and that more heavily weighted productivity in the back part of the year, Alma and the other initiatives that we have in place.

**Robert Moskow**

*Analyst, Credit Suisse Securities (USA) LLC*

Q

Thanks. I think you've quantified some of the dollars of those productivity savings in the past. Is there any way to give us a rough range?

**Christopher W. Hall**

*Chief Financial Officer, Sovos Brands, Inc.*

A

In total for the year, we'll see 2% to 2.5% of our total cost of sales productivity, very heavily weighted to the back half of the year, 60% to 70% of that or more will be in the back half of the year.

**Robert Moskow**

*Analyst, Credit Suisse Securities (USA) LLC*

Q

Very helpful. Thank you.

**Christopher W. Hall**

*Chief Financial Officer, Sovos Brands, Inc.*

A

Okay. Thank you.

**Todd R. Lachman**

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

A

Thanks, Rob.

**Operator:** And our next question coming from the line of Peter Galbo with Bank of America. Your line is open.

**Peter T. Galbo**

*Analyst, Bank of America*

Q

Hey, guys. Good afternoon. Thanks for taking the question.

**Todd R. Lachman**

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

A

Hi, Peter.

**Peter T. Galbo**

*Analyst, Bank of America*

Q

Hey, Todd, I just wanted to maybe expand on your comments around the poor congestion issues. There's been some stories, I think, about more rampant congestion in the southeast. And I just want to know, are you having more issues, I guess, getting finished product imported into parts of the country or is it really hey, we can't get raw materials in through, Savannah or Charleston to get it over to Alma for production of Rao's, just any greater detail there would be helpful.

**Todd R. Lachman**

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

A

Yeah. I would say a keyword is intermittent [ph] and effects (37:29). As we talk about it, it's really the finished goods that are coming over from Italy here. I mean, there's also effects of other elements. But I wouldn't say it's affecting any one – the southeast port more than the northeast that we use. There was an example of foils that occurred in Q2 on noosa, et cetera. But it's a little bit hit or miss and it's affected us. But I would say it's more intermittent, Peter, versus something that's longstanding. And very importantly, honestly, our supply chain has done an absolutely phenomenal job managing through that congestion. We have a just a great supply chain team, logistics team, et cetera, [ph] in that (38:22) they've been able to fly through the turbulence and make sure that we're able to get all the [ph] five new flights (38:28) that we need in light of the very unprecedented operating environment that we're in today. I would also – I guess the last thing I'd say too is that, we do have expanded utilization of our West Coast DC, which will diversify our volume between the east and west, which will be a longer term benefit for us as well.

**Peter T. Galbo**

*Analyst, Bank of America*

Q

Okay. No, that's helpful. And Chris, maybe just on the increase in marketing and R&D in the second half, just any way to help us quantify that sequentially, how much of a step-up in dollar terms we might see?

**Christopher W. Hall**

*Chief Financial Officer, Sovos Brands, Inc.*

A

On a year-over-year basis, it will be up double-digits. I can't say exactly how much, but it'll be at double digits, but not as much as the 26% that we put in in Q2. And within the year, we've – typically, we'll see, [ph] yeah, I'd call it (00:39:36) 40%, 60% split, 40% H1, 60% H2, I think will give you a good range to what you actually see in the marketplace.

**Peter T. Galbo**

*Analyst, Bank of America*

Q

Got it. Thanks very much, guys.

**Christopher W. Hall**

*Chief Financial Officer, Sovos Brands, Inc.*

A

Sure. [indiscernible] (39:50)

**Operator:** Thank you. And our next question coming from the line of Cody Ross with UBS. Your line is open.

**Cody Ross**

*Analyst, UBS Securities LLC*

Q

Hey, guys. Thank you for taking our question. You raised your full year sales guidance. However, your 2H guidance is pretty much in line with the Street suggesting a modest slowdown across your portfolio from what you

just posted. Just want to get a sense, is that more conservatism from your end or have you actually begun to see a bit of a slowdown from your recent price increases?

**Christopher W. Hall**

*Chief Financial Officer, Sovos Brands, Inc.*

A

You bet. So, we are very, very pleased with the growth that we see in the first half of the year. 16% net sales through the first half, 12% volume growth. And then, like as you mentioned, our pricing really taking hold in Q2 and into the second half of the year. And we have a – obviously, we had a lot of confidence in the back half of the year, taking that full year guidance up to roughly 15% to 16% from the prior 11% to 13%. We will see that growth in the back half of the year more weighted towards pricing versus what we saw in the first half for volume. And that's especially true in Q3 where there are a couple key individual customer events that we ran back last year that we are not repeating this year. So, our volume growth in Q3 will be a little muted versus [ph] what (41:17) we've seen year-to-date. And then importantly, we've modeled into our projections for the back half of the year, that elasticities normalize. We mentioned the second Rao's [indiscernible] (41:30) marketplace right now. So, we thought it prudent to assume we would see more historical level elasticity here in the back half of the year.

And then with just the uncertainties going on in the world, in the US, especially today, do we see the pressure on the consumer? Will we see a return in general to the elasticities that we have expected to see and have seen historically? So, it's really that return to normalized elasticities that has landed where we have the back half projections.

**Cody Ross**

*Analyst, UBS Securities LLC*

Q

Great, that's helpful. And I just want to clarify some of your comments on pricing, because I think some of it was helpful. But I am a little confused. You did 8.7% roughly price mix this year, or this quarter. Some of it was benefited by not having promotions on your frozen business, and you expect price mix to largely be in line with what we saw from this quarter, so call it, 8%, 9%, but yet you expect price to be a bigger contributor in the back half. I believe your back half guidance is for roughly 15%, 16% growth. So that would be roughly 50/50. So, how do I square these?

**Christopher W. Hall**

*Chief Financial Officer, Sovos Brands, Inc.*

A

Yeah, so, we've – again, we've talked all year about – we knew our growth will be more volume driven in the first half of the year and price driven in the back half of the year. As I mentioned, Q3 specifically, we will see muted volume growth due [ph] to not overlapping a couple of entry brand (43:06) last year, promotional events. So, the back half, [ph] well, it (43:13) feels like that, call it, 9% pricing. We do then therefore see volume more than 5% to 6% range in the back half to get to that 15%. So that's [ph] how (43:24) we see that more heavily weighted pricing in the back half of the year.

**Cody Ross**

*Analyst, UBS Securities LLC*

Q

That's helpful. I'll pass it on. Thank you very much.

**Christopher W. Hall**

*Chief Financial Officer, Sovos Brands, Inc.*

A

Thank you.

**Operator:** Thank you. And our next question coming from the line of Michael Lavery with Piper Sandler. Your line is open.

**Michael S. Lavery**

*Analyst, Piper Sandler & Co.*

Thank you. Good afternoon.

Q

**Todd R. Lachman**

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

Hey, Michael.

A

**Michael S. Lavery**

*Analyst, Piper Sandler & Co.*

You talked about some of the capacity constraints and how that impacted promotional activity. Did that also have any impact on distribution, expansion, momentum or innovation launches or anything that may now give a little bit of a volume lift in the second half once you've got some of the relief there?

Q

**Todd R. Lachman**

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

Hey, Michael, it's Todd. So, the direct answer is, is no, didn't affect any really new distribution at all. We are, I mean, [ph] but look at it (44:22) did affect in Q2, our ability to service notably frozen, secondarily, some key sizes on sauce. And, those results didn't affect new distribution opportunities and they did not affect any new any new launches. That said, as you know, Chris highlighted before, we are now fully promoting frozen in Q3 when we pretty much went dark on promoting frozen in Q2. So that, and as retailer inventories get [ph] restocked, et cetera (44:57), it'll have a beneficial impact in Q3, but nothing on new products or new distribution per se except for retail pipeline [ph] fill (45:06).

A

**Michael S. Lavery**

*Analyst, Piper Sandler & Co.*

Okay. That's helpful. And just wondering if you can give the latest on how you're thinking about any further M&A. You mentioned you expect to finish with 3.5 times net leverage which presumably means excluding M&A, but does it mean that you also are planning not to have any between now and then?

Q

**Todd R. Lachman**

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

No, I mean, I'll let Chris talk to the – I'll let Chris talk to the leverage side. Look, strategically, M&A will play the same role going forward as it has historically. But the first thing I will highlight that I have highlighted on the last several calls is that we are primarily focused right now on growing our core categories. I mean, [ph] we (45:56) expect 22% net sales growth driven by volume. I mean, I'd be remiss [ph] if I didn't (46:00) highlight. Right now, this is our – sorry, Michael, [ph] I'm shamelessly killing your question trying to highlight. It's our (46:04) fourth quarter as a public company. Four quarters in a row, double digit top line growth; four quarters in a row, double-digit growth led by volume; four quarters in a row that volume driven by our core categories of sauce, yogurt and frozen. And as we've talked about, the distribution opportunities across those three, notably sauce, which is the largest percentage of our portfolio, are massive. So, we are focused on driving those volume gains. We're focused on driving distribution. It also [ph] saves, as I've (46:36) highlighted before, we have driven double digit distribution growth on rails every quarter since we have acquired that brand, which is rapidly on track to grow to

A

\$1 billion. That said, [ph] we've least (46:53) used M&A as a lever in the past and we continue to see a steady flow of M&A opportunities. At any given moment, we're evaluating a number of targets, maintain a long list of potential companies that meet the criteria. And so that's the lever that we'll continue to look at as we grow in the future. But right now, we're really focused on continuing to drive our business organically, notably in our core categories. And I'll pass it to Chris just for a second on the leverage question, Michael.

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**Christopher W. Hall**

*Chief Financial Officer, Sovos Brands, Inc.*

A

[ph] Yeah (47:22), sure. So, we – any M&A work that we would do would obviously have to make outstanding economic as well business sense. And we've – we have strict guidelines for what we'll consider as an acquisition we've done for over the five-plus years of our existence. We definitely are modeling the impact of even potential interest rate increases in our M&A work. And ultimately, what's important to us is that we have – we can comfortably service whatever debt we do take on and ensure we can pay down that debt to a comfortable level in a short amount of time. And, we don't really solve for particular leverage, we solve for how quickly we can delever down to a normal state of leverage following acquisition. So, cash flow generation is definitely something we scrutinize. We've had a history of very solid cash flow, robust generation and the ability to pay down debt. Once we do, go to the credit market, we do pay down that debt faster than our underwriting would have suggested. So, we were – we're [indiscernible] (48:35) we like the range that we're in now for leverage. We're right under 4. And we may go above that for an acquisition. But again, the key is to quickly delever and get back into that range we've [ph] spoken of before kind of under 4, 4.5 – really at (48:53) on a pro forma basis.

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**Michael S. Lavery**

*Analyst, Piper Sandler & Co.*

Q

That's great color. Thank you [ph] both (48:57).

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**Christopher W. Hall**

*Chief Financial Officer, Sovos Brands, Inc.*

A

You bet.

---

**Operator:** [Operator Instructions] One moment for our next question. And our next question coming from the line of Jon Andersen with William Blair. Your line is open.

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**Jon Andersen**

*Analyst, William Blair & Co. LLC*

Q

Hey, [ph] get in there (49:21). Thanks for the question. I want to get a sense for how things are progressing with the new noosa launch in gelato. I know it's early, but you're moving that brand into a multibillion dollar ice cream category and would just love to hear your view on how it's going so far, sell-in, sell-through and maybe your kind of expectations for that going forward.

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**Todd R. Lachman**

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

A

Sure. Hey, Jon, Todd Lachman here. As we – what we can really highlight is it's exceeding our expectations in selling. So better than expected sell into the new frozen yogurt gelato, have you been able to taste it Jon?

---

**Jon Andersen**

*Analyst, William Blair & Co. LLC*

Q



It tasted it at Expo West. [ph] Terrific (50:09)

**Todd R. Lachman**

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

A

Okay. Fantastic. Well, anyway, absolutely delicious. We're selling this better than expected. And velocity continues to build as a result of national marketing promotions across the board, big in-store promotional push. So that's really what we can say on gelato. I mean, we really – just we're in the middle of the summer season, we're really bullish on the loss, on the launch of gelato so – but selling better than expected.

**Jon Andersen**

*Analyst, William Blair & Co. LLC*

Q

Okay. I'll stay tuned for more updates in the future.

**Todd R. Lachman**

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

A

Perfect.

Second question is in frozen, you have two brands that play there and I'm wondering if you didn't talk too much about Michael Angelo's in the prepared comments. I'm wondering if you could discuss a little bit about the interaction between Rao's and Michelangelo's in Frozen. Are they both – what role they play, can co-exist? Is that how you kind of – you see those two brands kind of developing in that particular category as you go forward. Thanks.

**Jon Andersen**

*Analyst, William Blair & Co. LLC*

Q

Absolutely. No. They can absolutely coexist. Michael Angelo's is premium price for the category. Rao's is super premium price to the category. Look, Rao's is newer, so it's growing at a much higher rate than Michael Angelo's. So, our total frozen business consumption grew 7% in the quarter. But I will say as we discussed, we had supply issues that impacted our entire frozen business. And so therefore, [ph] where it was consumption, Michael Angelo's was (51:52) down a little bit, net sales for the brand were up. I mean, you'll see that through. In light of the supply chain constraints, we did need to make a priority call. We prioritized Rao's a bit over Michael Angelo's. So that was a little bit of a tweak that affected Michael Angelo's for the quarter. But Michael Angelo's has a very loyal following. It's been a consistent contributor to our portfolio since we acquired it in January of 2017 and what we have seen that those two brands are able to coexist very well where they're both in distribution together. There's also some unique items that Michael Angelo's has, for example, eggplant parmigiana that we don't have on Rao's and that Rao's has such as frozen meatballs that's not offered by Michael Angelo's. So – and those are just a couple of different examples. So, some unique items, some premium ingredients on Rao's that justifies the premium price and, this – we said our total frozen business, we're very bullish on it, and we're driving both of those brands. But the priority of the two is Rao's as we are really driving Rao's to the \$1 billion sales goal that we're well on track for.

**Jon Andersen**

*Analyst, William Blair & Co. LLC*

Q

Thanks so much.

A

**Todd R. Lachman**

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

You got it, John. Thanks.

**Operator:** I'm showing no further two questions at this time. I would now like to turn the call back over to Mr. Todd Lachman for any closing remarks.

**Todd R. Lachman**

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

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

**Operator:** Ladies and gentlemen, [ph] that does conclude our (53:40) conference for today. Thank you for your participation. You may now disconnect.

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