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Sovos Brands, Inc. (SOVO)

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Andrew Lazar
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MANAGEMENT DISCUSSION SECTION

Andrew Lazar
Analyst, Barclays Capital, Inc.

So, welcome back, everybody, to our fireside chat with Sovos. With me today are Chairman and CEO, Todd Lachman, Founder, Todd Lachman as well; and CFO, Chris Hall. Welcome, gentlemen. And it's truly great to be with you in person in Boston.

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

It's great.

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

Great to be here, Andrew.

QUESTION AND ANSWER SECTION

Andrew Lazar
Analyst, Barclays Capital, Inc.

Q

So, maybe, I think a good place to start, Todd, is really the founding thesis of Sovos for people that aren't as familiar. It's really sticking together kind of a one-of-a-kind or unique brands that grow faster than average, tend to be priced at premiums on the shelf as well. Large CPG companies, as we've talked about, tend to stumble a bit with smaller brands in their portfolios.

I guess, what characteristics determine a one-of-a-kind brand. And I know you've talked about things such as taste superiority and Net Promoter Score and sort of disruption in the category. But oftentimes these are in slower growth categories as well. So, can you talk about this and how you leverage this playbook.

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

A

Sure. So, again, great to be here. Great to see everybody. Let me take a step back, and you mentioned it around kind of larger company stumble. But when I set out to start my own company after a relatively long career in a large CPG, there's data that was well trumpeted, like 2015-ish, how the 100 largest brands in the food store were either declining and/or losing share. And what was growing at their expense, it was, if you look at the analysis, it was the smallest brands in the store, the bottom quartile in size.

If you actually slice them by price, it was the most expensive brands. So, smaller, premium priced brands, on trend in some way, shape, or form were stealing share and/or growing at the expense of larger brands. And also, based on my experience, large CPG does a great job building billion-dollar brands, but tends to stumble with that with smaller brands. And it's because the center of gravity always, more often than not, reverse back to the billion-dollar brand, the brand that pays the likes.

And we did research as I was putting together the thesis before I hitched wagons with Advent and Bill Johnson, our Chairman, and saw that a commonality amongst those growth brands were, as you mentioned: one, taste superiority or close to it in the category; highest Net Promoter Score or close to it in the category; ability for the brand to travel to other categories, not necessarily a hallmark, but something that we have found is distinctive and can leverage a brand equity, and we've had some good discussions about that; and what we call category disruption potential, and we do leverage whether it's our scanner data and/or data that we kind of glean from our A&U studies, et cetera; and also, just sort of common sense and knowledge about the category.

So, for example, Rao's, it's truly disrupting the category. Not because it's growing so fast, but because the sauce is so different than mainstream sauce. Whole tomatoes, slow simmered for roughly an hour in open kettles. Basically, whole tomatoes, olive oil, basil, fresh onions, et cetera, versus mainstream sauce, which is 80% of the category still today, which is paste, added sugar, canola oil, dehydrated onions, et cetera. So, that type of sauce, that's Rao's, and a few other smaller brands, is truly disrupting the category in a way that is quite different from other categories.

And we do look, honestly, because the question comes up a lot, as you know, hey, how come you're not in – or maybe it was relevant at the time, less now. How come you're not in plant-based protein? How come you're not in pet even though, Todd, half of your career was in pet? Well I can go through the reasons of why we're not, but our thesis is really looking at stable, lower growth categories that do not really have a premium on trend offering for the brand.

And I think the other point I would make is that we have launched into other categories in a way that we also could have acquired. Meaning, we could have acquired a super-premium soup in a glass jar, if there was one, but we decided to launch Rao's in the soup, because we saw, like, why in this $4 billion category is the consumer land-locked into a can?

And let me tell you, I'm sure everybody out there, you're not going to bet an eye saying, what else can I buy in a can? And so, we said, let's have a soup that's the equivalent of a great tasting meal in a glass jar that the consumer can see. So, I use that as a proxy our launch in the soup for the type of brand that we would look to also acquire.

Andrew Lazar
Analyst, Barclays Capital, Inc.

Q

Got it. Yeah. Helpful. Sovos has a $1 billion annual sales goal for the Rao's brand. At 50% of total sales, this really is the key linchpin, right, to achieving this target. You've already had quite a bit of success even in just the past few years. I mean, you've [indiscernible] (00:05:07) distribution on the brand from 40% to 80%, quite average number of items on the shelf from like 3.5 to 12; brand awareness, 50% from like 14%.

So the question that keeps coming up, obviously, is how much is left there, specifically on sauce? And what gives you the confidence that the brand can still be the key to driving high single-digit company-wide organic sales growth, all in the context of, as you've talked about, what's typically been a more mature, broader sauce category?

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

A

Sure. So, the Rao's brand is awesome.

[indiscernible] (00:05:42)

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

A

[indiscernible] (00:05:44) know those numbers. You're helping me out like a cheat sheet by mentioning it there. But for those who are unaware, the Rao's brand is at about 65% of Sovos' total sales, sauce is about 50%. And, yes, we have been quite – and let me take a step back. Sovos grew 16% net sales in the first half of the year, total Sovos; Rao's, well above that, roughly 30% year-to-date net sales growth. And we meaningfully took up our guidance for the year. And so the total Sovos project – to the extent we had to top it, it's like continuing to grow the business like 16%. Rao's brand, very accretive in that growth level.

We also, as per your question, have been quite definitive that we have a target to get Rao's to $1 billion. But we've also been – I know that in the past, even myself in a previous life, have used the $1 billion level. It's sort of a vision that you could have, that maybe as a BHAG-type goal. But for Rao's, for us, it is absolutely achievable, and I'll take you through a few proof points on that. One of which is when we acquired the brand, it was high 60s in net sales, and the LTM were about $0.5 billion in net sales today, just the Rao's brand.

And we actually, if you take the end of 2020 versus where we'll be in a few years, I mean, that is well over $200 million of net sales. You can see the brand is growing in leaps and bounds. It's growing about over 30% now. But one of the building blocks to going from what is now $0.5 billion to $1 billion, number one, as you said, is continuing to drive sauce. We are only in 11% of households. We've been increasing household penetration. We had some really good discussions about household penetration. We've been growing at anywhere from 1 to 2 percentage points per year.

And if you think about it, Rao's now the number two brand, the fastest growing. 90% of households or 88% that purchase sauce do not purchase Rao's. So, we continue to add households to the franchise. In addition, we're only a 14% share today, but we're at 25% share in accounts where we have, call it, 17, 18 items, which is about 20% of the IRI measured universe. So, we are growing share in every region of the country. So, if you just take sauce of where we are, only 11 average items, as you pointed out, getting towards a target level, we see sauce being the biggest building block to $1 billion.

And secondly, if you take the three adjacencies that we've entered – soup, frozen, and dry pasta, all of which are the fastest growing, if not close to the fastest-growing brands within the top five or six in their respective categories – that amount of sales over the last 12 months has been about $100 million of GSV growing 30%. That's bigger than the Rao's brand I acquired before. So, we've got a beachhead in those three categories.

For those that are unaware we're testing frozen pizza in four accounts today. That's a nice little $8 billion category in need of a super-premium offering. And we've talked about some other categories that we're interested in as well, and doesn't even include international. So, we have very specific targets by year and much sooner than the five years that we've grown to $0.5 billion do we believe we can get Rao's to $1 billion. And that is our primary focus more than anything else in the category, more than future M&A, is getting Rao's to $1 billion in net sales.

Andrew Lazar
Analyst, Barclays Capital, Inc.
Q

And correct me if I'm wrong. I think you've said previously that retailers make essentially per jar of Rao's in profit what most other mainstream pasta sauces sell for?

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

Yes. I'm smiling because we kind of laugh internally that it is the right stat. It's almost like we made it up to make it sound good.

Andrew Lazar
Analyst, Barclays Capital, Inc.
Q

Right.

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

But it's just the way the arithmetic works, is that the gross profit per jar that the retailer makes on a jar of 24-ounce Rao's sauce is equal to what they sell the market leader for.

Andrew Lazar
Analyst, Barclays Capital, Inc.
Q

Yeah. Yeah. Incredible. Another opportunity that you've mentioned is for the companies to extend brands into adjacent categories. Can you talk a bit about the performance of your recent brand extension for Rao's, notably in soup, frozen, and dry pasta. And I guess just broadly speaking, extending brands into new categories has not always been a successful endeavor for a lot of packaged food companies. And I guess how do you think about the brand's right to win when entering into new categories, and sort of what are the checks and balances that you look for to get a sense of whether, hey, this is hitting the milestones that you want, or potentially risk diluting what is really a great brand?

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

Sure. So, a few things to unpack there. Number one, in the thesis that I put together, I'm just talking here as Todd, but I know from my executive team, the board, we're aligned. I've always had the mind-set that brands are more elastic in the consumer's mind than many packaged food companies give them credit for, if you put the muscle into it and you have the right proposition. Meaning, the consumer, when they walk up to the frozen case, they're not shocked that Rao's frozen is in the freezer case or that Rao's brand is in a soup.

Secondly, we test at diligence. So, call it in – we acquired the Rao's brand July of 2017. In April of 2017 we were fielding 10 concepts, broad-based consumer on all the different areas that the Rao's brand could play. So, we had a playbook to the extent that we're going to acquire the brand, which we did, on where we could enter and when. So, from a consumer basis, we understand that.

And then we are also judicious around when we're going to launch. Now, most importantly, when we acquired Rao's, the first thing we did was, the brand was growing 20% over the LTM period when we acquired it. Just the sauce brand alone averaged 40% up until the COVID demand surge. And why was sauce growing? Well, they're our main focus. Before we focused on any of the categories that you just mentioned was, a, to get Rao's sauce from 40% to 80% ACV; b, to get it from 3 average items to probably at the end of that period, it's about 8 or 9 average items. It's 11 today.

We quickly launched Rao's. There was no Alfredo sauce. There was no pesto sauce. There was no meat sauce. There was no large sizes. I mean, all of those are some of our fastest-growing variants today. So, we drove more ubiquitous distribution. When we acquired the brand, they were spending $400,000 in marketing. We're spending over $20 million on the brand today. So, I just want to say that was job number one was to focus on sauce.

The easiest adjacency out of the gate – look, I haven't been in the pasta sauce category before. I didn't realize it. I was kind of like, hey, how come Barilla is the only one that has a sauce and a pasta? It just kind of feels like it's kind of a match made in heaven. Like, why doesn't anybody else have a dry pasta? I'm like, I don't know. I think we should. So, we launched Rao's in the dry pasta, and it's not one of our largest businesses, but it's growing. It's been the fastest growing, if not one of the fastest growing brands in dry pasta now since we launched it four years ago. It's doing very well.

Then we launched into soup. Again, a logical adjacency in a similar aisle or close to it than sauce. We knew there was overlap with the shoppers, and it was easy to formulate with our R&D talent that we had at the time, et cetera. And that Rao's soup at the top seven brands, continues to be the fastest growing. We're the number five soup brand, and we launched that – this has been our fourth year.

And then Rao's frozen was a nice revenue synergies because we had owned the Michael Angelo's brand, which absolutely delicious, homemade, authentic Italian food that's flash frozen, and then we use those capabilities to launch Rao's in the frozen, and we have a nice frozen business that's approaching a [ph] two (00:14:11) share of the total frozen category. So, all those three are doing very well under the Rao's brand.

Andrew Lazar
Analyst, Barclays Capital, Inc.

Q

And there's probably a limited amount you can talk about this, but where can Rao's go next? You mentioned testing premium frozen pizza. Where else can we potentially see some extensions going forward?

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

A

Sure. [indiscernible] (00:14:28) exact categories, except to say that there are a variety of categories that are adjacent to or in the same, like, part of the store that Rao's is in today that we're pretty excited about. I would say, though, that – I mean, frozen pizza, that's a big category. That's a big launch. And so, for a new entry for the next couple of years, that's really going to be a primary focus.

If we do something else with the Rao's brand, it might be test related, a single customer exclusive, just a – we do have a philosophy make a little, sell a little, learn a lot. We're doing that now online. If you want to buy a delicious Calabrian chili sauce or white truffle marinara, you can purchase it online. So, by doing things direct-to-consumer online, we're sort of constantly getting consumer – gauging consumer interest, etcetera.

Andrew Lazar
Analyst, Barclays Capital, Inc.

Q

And maybe what are examples or an example where a brand extension maybe didn't work the way you thought it would, and what were the learnings around that?

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

A

Sure. I think that's one of the reasons – I mean, majority of our new launches, we will look to – this isn't always the case, but we'll look to co-manufacture. So, if we need to cut bait, it's not that painful versus adding assets to a factory right away in the beginning. And I think a good one that did not work out well was we extended the noosa brand into the Greek category.

Now, if you do the typical profit pool analysis and you look at the size of the total spoonable yogurt category and the size of Greek within that, and, yes, noosa stands for taste and they – and I know you talked about it. I mean, thank God most of the competitor taking all the taste in sugar-added yogurt so that it almost makes your mouth pucker up and that's why noosa can fit – and I said, like, doesn't the consumer deserve something that just tastes great in this $8 billion yogurt category.

But we got a little over focused on that giant profit pool. We launched noosa Greek and the consumer, I wouldn't say they rebelled, they're just like, hey, we have enough choices. When we think of noosa, we think of that thick, velvety, whole milk taste; we don't think of Greek. And we tried it for 18 months and we pulled it out, and I think it was really good learning and that helped us really double down and realize that what noosa is to the consumer is just a super great tasting [indiscernible] (00:17:05) in the yogurt category. The consumer deserves to be indulged with some offerings.

And so actually as we look forward on the noosa brand, just we launched into the ice cream category of frozen yogurt, gelato, that's a great example. That's sort of the opposite. We're launching into the ice cream category.

We've got other things in our pipeline which go the opposite direction of what – if Greek is here and noosa is here, we're looking at offerings over here, leveraging that taste halo. So, you can always claim some good learnings even out of a failure.

Andrew Lazar
Analyst, Barclays Capital, Inc.

Q

Yeah. Yeah. Sovos was created by essentially three deals, right, all in different temperature states; shelf stable, refrigerated, and frozen. I guess, what are the similarities among them that made this the right approach, as we typically don't see this kind of construct in the food space?

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

A

I just smiled because I got some good grief about that. [indiscernible] (00:17:58), like, what the heck are you doing purchasing a frozen brand and then a shelf stable sauce brand, and then a refrigerated yoga brand. But I think what it did, it really highlighted, and clearly my team was aligned as well as the board that Sovos is about acquiring one-of-a-kind brands, and that we're a growth thesis and we look for brands that are taste superior, high Net Promoter Score, disruption potential in categories where the consumer either doesn't have or deserves an offering something different than the mainstream brands today. And we are agnostic to temperature state.

What would be more typical would be what a variety of our competitors do and I get – because I've been, as you look out the back of your windshield and you say, what assets do I have? Wow, I've got a lot of canning assets. I guess, I got to figure out more stuff to launch in a can, or I've got – and we did. We leveraged our frozen facility with Rao's or just got a frozen portfolio or a snack portfolio, which I totally get, but that was not Sovos.

Now, there's still a lot of synergies to be had with the three different types of temperature states, right. it's scaled over one leaderships team. We have one selling organization that sells those brands. We have one finance accounting, IT organization. There are actually more logistics synergies than there might be you would think at first glance across of those different businesses. So it's been highly synergistic, but we're less focused on kind of back-end supply chain synergies as we are more about acquiring brands that we know we can deliver our long-term growth algorithm, ideally double-digit growth, in the years to come.

Andrew Lazar
Analyst, Barclays Capital, Inc.

Q

Your one-of-a-kind brands tend to sell at some pretty significant premiums in their respective categories. Maybe talk a bit about how this plays in times when consumers obviously are under increasing economic pressure.

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

A

Sure. So, when we acquired the Rao's brand, I know there's a big – you can imagine we had Michel Angelo's and then majority shareholder, Advent, which been a great partner of ours and backer, it's a big question. Hey, you're buying a brand that albeit small is super premium priced. Todd, I get the whole tomato, taste delicious. And then we mapped out because I knew based on my experience, even notably on the pet food side, running the Mars Global Pet business and previous to that, that interestingly super premium pet brands, a lot of pet brands do well in times because you overindulge your pet, not just snacks, but with food.

And you look at Rao's. Rao's spiked in 2008. Now, that was – and so what happens is in times recessionary environment what's the first thing a consumer cuts back on is travel and leisure spending, and notably restaurant meals. And that they can buy a jar of Rao's sauce and a bag of pasta and a side salad for $15, and have a restaurant quality meal versus going out to a chain Italian restaurant and feeding your family for $70.

Now, that seems to imply though that the Rao's brand will only do well when consumers cut back on travel and leisure spending. And that's just – I think that's one tailwind that the brand certainly has, but the biggest tailwind is the fact that it just offers the consumer something totally different that they just weren't getting.

And at that point in time, Rao's was the same size as Victoria. There are a couple other small brands. But that premium whole tomato offering driven primarily by Rao's shows the consumer that they can have a restaurant quality meal at any time, whether the economy is good or the economy is not so good.

But a point that I made – might have been – in response to a question that you asked in the last call. If you look at, we had the data for the first half of – for this year, 2022. And it showed, if you just take a nine box grid. So, if you take all the cohorts in regards to three generation cohorts in regards to low-, middle-, high-income, the only two brands – and you have Rao's, private label, and the other four leading brands – the only brands that have nine green boxes, mean they're growing across every income in every cohort, were private label and Rao's.

So, that we are...

Andrew Lazar
Analyst, Barclays Capital, Inc.

Q

So barbell.

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

A

The barbell effect of, and I think I've mentioned this on the calls is that we have sourced from private label over the last 52 weeks and last 26 weeks, but the two fastest growing brands in sauce are Rao's and private label. Because private label is sourcing for mainstream. There's a ton of great private label sauces out there, but their analog's for mainstream sauce, not for a whole tomato sauce. You see, you have a super-premium Rao's exploding, you have private label exploding; and, yes, kind of that barbell effect.

Andrew Lazar
Analyst, Barclays Capital, Inc.

Q

Yeah. Great. Maybe talk about elasticity a little bit. I know you're being prudent about this going forward, as your second price increase has been implemented. But maybe you can talk a bit about what you're kind of currently seeing. And do you see any brands as particularly vulnerable to elasticity, perhaps where you are crossing maybe certain key pricing thresholds?

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

A

Do you want to talk elasticity?

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

A

Well, sure. The majority of our pricing hit in Q2 of this year. We did do Rao's sauce [indiscernible] (00:23:35) pricing at the very end of last year, but really it started hitting in the marketplace beginning of Q2. And we had modeled and we had assumed that we would revert to kind of historical levels of elasticity, call it, one; elasticity of one. What we have seen, though, since Q2 up until now, really, is much better performance in elasticities, and you hear that from a lot of suppliers I know. And especially on Rao's and especially within the soft category, basically, no elasticity effect at all.

Todd mentioned we were growing Rao's sauce 30% the last two years combined. We're still in that range, even as we've taken a second list price on Rao's and listed some of our promotional [indiscernible] (00:24:21) in late Q3. So, we're tracking very nicely in elasticities on the sauce brand; really, all three of the Rao's categories we've taken a list price. We've taken a pricing on all of our categories.

Where we have seen more historical levels of elasticity really in the new supply in the yogurt category or we're kind of moving in, in line with where the category is. So, we're very pleased with what we're seeing from our volume growth. One of the things that really differentiates us, not only this year and in the past, is our volume growth. Has still remained dynamic, 12.5% for the first half of the year, and a total of 16% net sales growth for the entirety of the first half. So, that combination of the velocity growth, a lot is driven from household penetration gains, gaining [indiscernible] (00:25:16) distribution. We're Maintaining and actually growing our investments behind marketing and R&D, slotting for new products.

So, we're very pleased with what we're seeing. Now, we've assumed at our projection it's more normalized the levels of elasticity, a little bit of prudence, I think, financially as we think about the balance of the year. So that's what our projections are based on, but we're very pleased with what we're seeing.

Andrew Lazar
Analyst, Barclays Capital, Inc.

Q

Good. And that brings us into talking a little bit more about noosa. How have you been able to get this brand back to growth the way you have and in a very crowded yogurt category. And with summer nearly over, what can you tell us about, I guess, [indiscernible] (00:25:50) for noosa gelato but also maybe some of the sell-through relative to your expectations.

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

A

Sure. So, you people haven't tried that product, by the way.

Andrew Lazar
Analyst, Barclays Capital, Inc.

Q

It is delicious.

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

A

Yeah. Thanks for the plug.

Andrew Lazar
Analyst, Barclays Capital, Inc.

Q

Surely.

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

A

So, yeah, for everyone's education, noosa brand was like really the growth darling of the industry let's just call 2013 to 2017-ish, it was like one of the fastest growing [indiscernible] (00:26:23). And then 2017 to 2018, it hit a real rough spot. And when we closed – when we were diligencing and then closed the deal in November of 2018, the brand was declining double-digits in units and double-digits in dollars. So, that's what Andrew was referring to, sort of the noosa turnaround.

Now the question would be, wow, like, why would you lean into a turnaround? And, to me, like a real turnaround is something that we would never be interested in is the turnaround where we need to like close factories and take a brand that has historically always been low growth and try to get it to grow. But we knew – it was very clear why it wasn't growing. I mean, the team at that time had slashed promotional spend. They were spending on very inefficient marketing programs.

There was a hesitancy to launch into the single-serve arena, which is like to us that was made all the sense in the world. We've got to get the greatest tasting yogurt to more consumers' mouths. And there was just some failed innovation at the time. So, we closed on the acquisition. We launched in the single-serve. We rightsized the promotional budget. We got some better innovation into the marketplace, except for Greek. And 44 straight months of unit growth that we saw in that business in the first half of the year. Net sales grew nicely with dollar consumption ahead of the category.

Now, on the gelato side, selling better than expected. And we've got – I mean, what we can say is we've got sell through ticking up every single kind of period. Really can't say more than that. I mean people that have access to the data can show it. It's a highly competitive category. And we are very committed to making sure that noosa is successful in that gelato category.

Andrew Lazar
Analyst, Barclays Capital, Inc.

Q

Maybe it brings me to M&A a little bit. I know [indiscernible] (00:28:09) as a platform of sorts. I guess, how do you prioritize the importance of M&A versus the core? And what learnings maybe from one of your smaller brands, Birch Benders, do you have that would inform sort of future M&A decision?

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

A

Sure. So I think the most important area to kind of highlight on M&A is that, right now, while we are fertilizing our list of potential targets, we have those types of right conversations, I mean there's just so much growth on the Rao's brand as I highlighted before. That clear glide path to $1 billion, that is our focus. Our focus is getting to Rao's to $1 billion of sales profitably as soon as possible, and leveraging and driving a robust business in the spoonable yogurt area and extending that noosa brand appropriately. So, that is really our focus.

That said, M&A does play a role. We've been a roll-up four acquisitions. I'm not being cliché but, I mean, the learnings first that we would apply to the next acquisition are the learnings that we've had from Rao's and noosa and Michael Angelo's. Because all of those have been successful in their own right for Sovos, so we want to make sure we leverage those learnings.

That said, we have not been as successful on Birch Benders, and there are certainly some learnings that we can glean from that as we go forward as well.

And what are a few? So those who are unaware that we acquired the Birch Benders business, It was growing 60% two-year CAGR prior to acquisition, had some of the fastest growing spending items in the category in pancake and waffle mix, keto and paleo, and highest Net Promoter Score amongst organic consumers in the category. So, it checked a lot of boxes for us. We completely underestimated on how steeply the pancake and waffle mix category would plummet.

I mean, I guess we should have known that moms and dads throughout the United States were sick of making flapjacks for their kids or themselves. And so, the category sort of fell off a cliff in addition to the keto subsegment being smaller with more people crowding in there. So, when you have a brand of where 60-percent-plus of the Birch Benders brand had keto on the label of some variant, both of those hit.

And lastly – so I think we underestimated the fall off from COVID of the category. We diligence well sort of the keto area. But I think we have good learnings from that. And we're very mindful about customer concentration. There is one customer, we've been public about this, that represented 25% of the brand and we lost distribution in that one customer. And that's why if you look at the brand's decline first half versus year ago, it's 35%; and IRI measured [indiscernible] (00:31:13) world is just 11%, and that gap is that one kind of unmeasured customer.

Now, it's less than 5% of our net sales. We're still growing robustly in light of the Birch Benders situation, but we've got the right resources against it. And we've also said, we'll be showing growth in that brand in Q4 versus prior year based on a variety of initiatives that we're undertaking.

Andrew Lazar
Analyst, Barclays Capital, Inc.

Q

Okay. Last couple of minutes, so maybe Chris. Sovos is expecting, I think, the benefit from price in the second half to be roughly in line with the result you delivered in the second quarter. With more pricing actions flowing through, I guess, the question is, why would we not see the benefit from price accelerating sequentially from here?

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

A

Sure. As I just mentioned, the majority of our pricing actions did hit in Q2. We took list prices across all – basically all of our portfolio, across all the brands. And just below 10% pricing that flowed through in the quarter. Now, to Q2, that also included – we had some supply chain challenges on our frozen Italian entrée business which could be branded either as Rao's or Michael Angelo's.

Some supply chain, a, Omicron hit in Q1 so we had some staffing issues. We actually had a tornado hit the pasta plant, which is near our frozen plant. Took out – or for a few weeks, we didn't have the pasta we needed [indiscernible] (00:32:46). So as a result of that, we basically canceled all of our promotions on the frozen entrée business in Q2. So that kind of impacted [indiscernible] (00:32:57) just over 10%.

As we move into Q3, we're in much better shape from a supply perspective. So, we turned back on those promotions on the frozen businesses. We're actually seeing very nice consumption trends now [indiscernible] (00:33:08). We did take a second list price on Rao's sauce mid- to late-Q3. The combination of those get you right about to that 10-ish percent. So, that's what we anticipate hitting in Q3 and in Q4. And that also sets us up nicely as a tailwind into 2023.

We saw, as I mentioned earlier, just terrific volume growth in the first half of the year. That will slip a little bit here in Q3. The back half of the year is going to be weighted more towards pricing. But we do continue, as you've seen from our guidance, very high single-digit or low double-digit net sales growth just weighted more towards pricing in the back half than the front half, but still quite robust.

Andrew Lazar
Analyst, Barclays Capital, Inc.

Q

And then, lastly, I guess would you expect pricing along with productivity to be able to offset costs in the second half of this year? As you enter 2023, at least, based on what you can see today in the cost environment, being in a better position to start to get some additional margin recovery?

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

A

Yeah. The answer to that is yes, and for the reasons you stated. So, I might have mentioned, I'm not sure, that our productivity – so our first driver of gross margin improvement will be productivity. It is more weighted in the second half of this year than we had originally planned. As we did see delays coming out of first half with Omicron hit in Q1 and we weren't sending engineers into plants. And then, it became delays on getting equipment set in. We're doing a lot of automation projects down in one of our two plants down in Austin, Texas that makes us frozen dinners.

They're also doing some initiatives up at our Bellevue, Colorado plant, which is where we make noosa, to drive that productivity. And we originally planned for 2% to 2.5% of our cost of sales base productivity this year weighted fairly evenly across the year. And as I've said, it turned out, it'll be much more weighted to the second half. Almost 70% of that productivity will come in the back half of the year. Again, providing a nice tailwind into next year.

The inflation flow, we've talked about low double-digit inflation across a lot of the same categories that everyone's talking about. In our world, milk is a big driver, and that's still continuing at a pretty high rate. We're not really feel that's all off yet. We do ship a lot of – our Rao's comes across the Atlantic. The transatlantic shipping rates have been up. So, we still do have some things that are starting to crest on the inflationary front.

But the combination of pricing, productivity, the inflation that we see does lead to margin improvement across the back half of the year; not as much as we saw in Q2 versus Q1, which is actually a 200-basis-point improvement to 28%. But we see sequential improvement setting us up as we end the year approaching a 30% gross margin [indiscernible] (00:36:14) for a run rate as we enter 2023.

Andrew Lazar
Analyst, Barclays Capital, Inc.

Great. Perfect. Okay. We've come up against time. So, why don't we continue this discussion in the breakout room. Plenty more to talk about. And thank you, Todd and Chris, for being here today. Appreciated it.

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

Thank you very much, Andrew. Great.

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

Yeah. Thanks.