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Sovos Brands, Inc. (SOVO)

Q1 2022 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Thank you for standing by, and welcome to the Sovos Brands First 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]

I will now like to turn the conference over to Josh Levine. Please go ahead.

Joshua A. Levine

Vice President-Investor Relations, Sovos Brands, Inc.

Good afternoon, and thank you for joining us on Sovos Brands first quarter 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 year ended March 26, 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, and shortly after the conclusion of today's call, a webcast will 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 that 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 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 our consumption data cited on today's call will refer to dollar consumption as of the 13-week period ended March 27, 2022 and growth versus the prior year, unless otherwise noted.

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

Todd R. Lachman

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

Thanks, Josh. For those of you who may have missed it a little over a week ago, we announced that Josh has joined us as our new Vice President of Investor Relations. Many of you already know him well from his time on both the buy and sell side and given his familiarity, not to mention his deep knowledge of the packaged food sector, having covered it for nearly 10 years, we are excited to welcome him to the team. I'd like to start today's call off by discussing a few highlights on the quarter. Following updated comments to the current operating environment, I will turn things over to Chris Hall for greater detail on our first quarter results as well as our full year outlook.

Looking to our first quarter results, I am extremely proud of how well our team executed. Faced with unprecedented inflationary and supply chain headwinds, as well as lapping 41% brand net sales growth in Q1 2021, we were once again able to deliver double-digit top line growth with results continuing to be led by volume growth in our core categories of sauce, yogurt and frozen. In regards to these core businesses, which represent over 90% of our portfolio, our brands continue to deliver dollar growth rates that are in line or better than their respective categories.

For sauce, represented by the Rao's brand, we grew dollar consumption by 34% versus 10% for the category. Yogurt represented by the noosa brand grew in line with the category at 5%. And finally frozen, which includes Rao's and Michael Angelo's entrées, as well as Birch Benders' waffles grew by a combined 13%, compared to 7% for the combined categories. The combination of sauce, yogurt and frozen for Sovos Brands grew dollar consumption by nearly 22% versus 7% for the categories in aggregate. With a key point of differentiation being that we delivered such outsized growth almost entirely through increased volume while the categories were the opposite with price as the sole driver to growth while volumes were negative.

Looking to our largest brand, Rao's, which continues to be the fastest growing center store brand of scale in the United States and represents approximately half of our portfolio, net sales growth remained strong, increasing nearly 20% in the quarter versus 84% in the prior year period. Total Rao's dollar and unit consumption grew by nearly 35% and 30%, respectively, supported by continued gains in TDPs and velocities for the entire franchise.

From a household penetration standpoint, total Rao's increased by more than 290 basis points versus prior year to 14%, primarily due to sauce and frozen entrées as they continue to realize substantial distribution, dollar and unit velocity growth. Specific to sauce, Rao's dollar consumption increased by over 30% or over 3 times faster than the category. This rate of growth translated into a 270 basis point increase in dollar share versus the prior year period to 15.1% as dollars, units, TDPs and velocities continued to grow by double-digits, which remains in stark contrast to the category where units are down low single-digits and the entirety of growth is being driven by price.

As a result, household penetration growth for Rao's sauce was the fastest in the category, increasing by 250 basis points versus the same time last year to 11.5%, despite the size of the brand at over $0.5 billion in retail sales and as discussed previously, significant upside opportunity remains to grow sauce distribution given our share of shelf remains low versus dollar share of the category. For perspective, Rao's has a 20% share or greater in retailers representing 27% of the past 52-week pasta and pizza sauce category sales. Notably, these retailers are geographically dispersed throughout the US.

Our total frozen entrée portfolio, which includes Rao's and Michael Angelo's, also outperformed as dollar consumption of 15% was over 2 times faster than the category, while units grew in contrast to a decline for the category. Rao's served as the primary driver to growth, with dollars up over 50% on the back of considerable distribution gains. In addition, Michael Angelo's also contributed solid middle single-digit growth on strong dollar and unit velocity growth rates that notably outperformed this frozen entrée category.

Our soup business, the fifth largest brand in the category, also showed great strength in the quarter with dollar consumption up nearly 30% or 3 times the category, making it the fastest growing soup brand during the first quarter.

Our noosa yogurt brand dollar consumption trends were generally in line with the spoonable yogurt category, while noosa unit consumption trended 290 basis points ahead of the category. Our 5% growth was primarily driven by strategic efforts to drive trade up to and distribution for larger formats with our multi-pack and 24 ounce offerings up strong double-digits on dollars, units and TDPs. Our previously announced list price increase on noosa is starting to take effect here in Q2.

As noted on our Q4 call, we recently launched a first of its kind noosa frozen yoghurt gelato into the $7 billion ice cream category. While still early, selling continues to exceed expectations. In an effort to foster additional distribution gains and drive velocities, we plan to ramp up our sales and marketing efforts for the offering as we enter Q2 and the all-important summer selling season.

On Birch Benders, the first quarter proved challenging with performance not living up to our expectations. Specifically, some diet-focused segments of our pancake and waffle mix business have been trending down as consumer interest in keto has softened following material growth during the pandemic, while competitive offerings have increased substantially. As a result, we will be introducing new pancake and waffle mixes that are crafted for specific dietary lifestyles in order to drive improved performance in this important segment of our portfolio. Meanwhile, we will continue to execute on other key initiatives in the brand.

First, we are focusing sales resources on whitespace opportunities, including our organic pancake and waffle mixes, which have consistently posted double-digit growth along with frozen waffles and baking mixes, which are continuing to grow given the brand's ability to travel across categories. And second, the transition of our waffle production to the US from Belgium in the second half of the year will provide meaningful, long-term savings, as well as greater control over the supply and quality of our product. We remain committed to leveraging Birch Benders differentiated and better few offerings to deliver improved performance.

Continuity of supply remains critical to meeting the outsized demand for our products. However, supply disruptions became increasingly frequent during the first quarter. Due to a confluence of factors at play across the industry, we have observed intermittent outages on certain packaging materials such as trays, foil and lids, as well as continued congestion at the ports. This resulted in service rates below target levels and the suppression of incremental consumption on all brands during the first quarter.

While several of these shortages will persist to varying degrees for the foreseeable future, I am proud of how swiftly our team has reacted to this rapidly evolving environment, as service rates have improved in recent weeks, nonetheless, as is the case, anytime demand outstrip supply, the cost to acquire ingredients and materials rises. As a result, we will continue to execute against our full suite of productivity, net revenue management and pricing initiatives.

With that said, we recently announced we will be taking another round of pricing on our sauce effective late July. Taking all together and based on how we see the world today, we believe these actions should partially offset this latest wave of incremental inflation. As we've stated in the past, we will not hesitate to respond with additional actions if warranted by the market.

In summary, we're off to a strong start in 2022 on the top line with line of sight to hitting the high end of our full year net sales guidance. We will remain laser focused on driving household penetration by expanding distribution and awareness, and we will continue to make strategic investments behind sales, marketing and innovation to drive future share gains for our one-of-a-kind brands. At the same time, we will work tirelessly to ensure supply and protect our profitability in this ever evolving highly inflationary environment.

With that, let me hand it over to Chris for more details on the quarter and our updated perspective on the remainder of the fiscal year.

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

Thank you, Todd. First quarter total net sales were $209.9 million, a $20.5 million or 10.9% increase over the prior year period. This growth was entirely organic and could be attributed to 11.6% volume growth, partially offset by price mix. Volume growth was driven by continued strength across our core categories sauce, yogurt and frozen, while positive price was fully offset by negative mix, resulting primarily from a year-on-year decline in pancake and waffle mix at Birch Benders.

At the brand level, Rao's remained the driving force behind our growth, increasing net sales by 19.4% in the quarter despite a very robust 84% year-ago comparison, as well as intermittent supply challenges that we track it from our ability to fully meet the robust demand for our entire Rao's portfolio. noosa sales were up 7.7% in the quarter as a continued focus on our core offering translated into favorable mix to larger formats as well as solid dollar and unit velocity growth outperformance versus the spoonable yogurt category.

Michael Angelo's grew 6.5%, modestly outpacing consumption, which benefited from strong dollar and unit velocity growth, particularly in single serve. And finally, Birch Benders was down meaningfully in the quarter, the lapping of a notable promotional event of the key account that we elected not to repeat this year accounted for over half of the decline. As Todd discussed earlier, results continue to reflect challenges in diet focused pancake and waffle mix that we are aggressively addressing. This was partially offset by strong performance in frozen waffles and baking.

Gross margins came in at 25.7% of net sales for the quarter, reflecting a 690 basis point decline versus the prior year period. The rate of decline was due to a significant increase in raw material, packaging, energy, logistics and labor costs. For perspective, milk and proteins were up 57% and 83%, respectively, versus prior year. In addition, better than expected selling of our new noosa frozen yoghurt gelato translated into higher slotting. And lastly, as a reminder, the majority of our pricing and productivity actions take place in Q2 and into the back half of the year. Recall, we only had Rao's sauce pricing in the market during Q1 and we'll exit Q2 having executed pricing on the vast majority of our portfolio.

Adjusted operating expenses of $36.4 million increased by less than $1 million or 2.5% over the prior year period, primarily due to an increase in public company costs, which were not recognized in the prior year period, as we were private at that time. Adjusted EBITDA was $27.6 million, a decline of $7.9 million or 22.3% versus Q1 2021. While adjusted EBITDA margin was 13.2% versus 18.8% in the prior year period. In addition to the aforementioned inflationary pressures and slotting to support the launch of noosa frozen yoghurt gelato, adjusted EBITDA dollars and margin were also negatively impacted by public company costs, which were not present in the prior year period when the company was private.

Net income for the quarter was $4.1 million or $0.04 per diluted share, compared to $11.7 million or $0.15 per diluted share in the prior year period. Adjusted net income was $13.8 million and adjusted earnings per share was $0.14 per diluted share compared to $20.8 million and $0.27 per diluted share in Q1 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 nearly 32% higher than the prior year period and represented a $0.04 headwind to our Q1 2022 adjusted EPS. At the end of the first quarter, cash and cash equivalents were $70.1 million and total debt was $481.7 million, resulting in a net debt to adjusted EBITDA ratio of 3.8 times.

On the subject of our outlook, we are maintaining our previously provided guidance for fiscal 2022. However, we would like to offer some perspective on how we expect the coming quarters to unfold. Excluding the benefit of a 53rd week in Q4, which equates to an additional 2 points to the top line on a full year basis, we continue to expect strong net sales growth over the balance of the year. Given our strong Q1 results, we have line of sight to hitting the upper end of our full year outlook, which calls for $800 million to $815 million in net sales and represents 11% to 13% growth year-over-year.

Regarding profitability, we still expect to fall within our full year adjusted EBITDA range of $116 million to $122 million, but we anticipate margins to remain under pressure in the near term, which could result in us landing in the middle to low end of the range. While Q1 should represent the lowest margin quarter and largest year-over-year decline for the year, we expect sequential margin improvement, primarily reflecting an increase in our inflation expectation to low double-digits from high single-digits.

As we enter the second half of the year, greater price realization, elimination of inefficient promotions, and continued execution against our robust pipeline of productivity initiatives should translate into modest year-over-year margin expansion as we exit the full year. As we have said in the past, if circumstances worsened, we are fully prepared to take additional actions as needed. With growth our top priority, I want to reiterate that we will continue to prioritize securing supply in order to meet our strong demand and maintain our focus on driving household penetration and awareness. From a balance sheet perspective, given our cash on hand, strong fundamentals and expectations for solid operating cash flow, we expect that our leverage will approach approximately 3 times by year end.

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

Todd R. Lachman

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

Thanks, Chris. Much like we ended in 2021, we started off strong for 2022 with robust top line growth, growing inflationary pressures, and a host of supply chain headwinds have also continued into the New Year. To that end, while our top line momentum will always take precedence, 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] Your first question comes from Trevor Sahr with William Blair. Please go ahead.

Trevor Sahr
Analyst, William Blair & Co. LLC

Q

Okay, guys. This is Trevor Sahr filling in for John Anderson today. Thanks for all the color so far. I just wanted to ask quickly on pricing so far. I know you mentioned that you've only got pricing covering Rao's sauce through the first quarter so far. Just wondering if you've seen any elasticities on that and consumer reaction so far and if you're expecting to see any second quarters implement more pricing?

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

A

Sure. Hey. It's Todd Lachman. Good to talk to you today. So, on the elasticity, a couple of points like what we've seen is our volumes remain very strong, notably on sauce. We continue to not see any statistically significant fluctuation in Rao's elasticity since implementing our LPI, though we do know there's a lag effect which will continue if the LPI implementation was – we'll continue to see that implementation ramp up in the Q2. That said, our top line guidance reflects conservative level of elasticity for the balance of the year, not just on Rao's but on other brands as well. So, although we have seen little to no evidence, it's time will tell and we've built that in and that's built into our guidance.

I will emphasize a few a few things here, and it's part and parcel with the very good news that we delivered in regards to top line growth. Net sales up 10.9%, lapping 40% growth last year. Household penetration continues to increase robustly for the Rao's brand, as we pointed out. But, if you look at Rao's sauce trends, I know you asked about that in the pricing dollar sales in the first quarter, up 34% category and unit sales up 30% in the category, down 2%. And our unit consumption for the 52 weeks was up 31%. And unit velocity for the first quarter was up 11% versus the category sort of down 3%. And we have new data as of just yesterday and unit sales for Rao's is up 24% versus category, up 3%. So, we'll be monitoring it very, very closely right now. Growth continues to grow strong. But we've been very prudent in how we forecasted our elasticity for the balance of the year.

Trevor Sahr
Analyst, William Blair & Co. LLC

Q

That's helpful. Thanks for that.

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

A

Great. Thanks for the question.

Operator: Your next question comes from Andrew Lazar with Barclays. Please go ahead.

Andrew Lazar
Analyst, Barclays Capital, Inc.

Q

Good afternoon, everybody.

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

A

Hey, Andrew.

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

A

Hi, Andrew.

Joshua A. Levine
Vice President-Investor Relations, Sovos Brands, Inc.

A

Hi there.

Andrew Lazar
Analyst, Barclays Capital, Inc.

Q

I guess to start off. Obviously, the top line momentum, as you've talked about, is very strong. But of course, as you mentioned, competitors have moved on pricing and you still have a lot of that to go as you move into the second quarter, yet you're still comfortable at the high end of the sales range for the year. I guess the thinking about your comfort level as you start to take greater pricing, if you feel like that has any impact on volume just because others have already taken it, if you will? And then I've just got a follow up.

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

A

Yeah. Thanks, Andrew. This is Chris. So, our pricing has ramped up across Q1 and into Q2. You might recall the only pricing we had in place was on Rao's initial 6% list price increase that we put in place at the end of the year. And as the quarter progressed, we did see that flowing through more and more as we close the quarter and that really into the last four weeks and now we're into Q2. So, we've got that in place now and our other pricing on the balance of our portfolio, majority of that is hitting right now in Q2. So, soup, pasta, frozen entrées and noosa will all be seeing pricing in those categories as well. So, that catches up.

We expect to see mid single-digit pricing across Q2 that will continue to build across the balance of the year and as we close the year, we feel our top line growth. As you mentioned, we're seeing that the high end of the range. We'll wait more and more towards pricing as we cross the year while we continue to maintain that unit growth that Todd mentioned. Currently, we anticipate ongoing volume growth as well across the year.

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

A

And Andrew, the area that we – you and I've talked before, it was on the last call during this session was around household penetration. And I do think we're in somewhat uncharted territory with the brand like Rao's that's actually in measured move MULO plus natural specialty, measured its $510 million of retail sales, up 42% CAGR fastest growing brand in the store. But we're increasing our household penetration about 300 basis points kind of year-on-year.

So, while there's certainly going to be an elasticity effect, we're also bringing in tons of new households, where they are buying Rao's for the first time, each time they enter the equation. But we've been very prudent on how we forecasted elasticity going forward. But as you have pointed out, we also were bringing in a lot of new users, not just in the Rao's sauce business, but across the franchise.

Andrew Lazar
Analyst, Barclays Capital, Inc.

Q

Yeah. Yeah. Thanks for that. And then you mentioned mid single-digit pricing as you cruise in through Q2. What would be your estimate of the sort of cumulative amount of pricing that's now been announced as we think about what price might look like in the P&L in the back half of the year? And that's all I've got. Thank you.

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

A

Yeah. No. Thank you. Yeah. So, now that we have announced pricing across our full portfolio as well as the second list price on Rao's sauce, as Todd mentioned. That happens at the end of July, so as we migrate into Q4, we would anticipate high single-digit pricing across the board, including all of our promotional activity. We talked about going after Birch Benders efficiencies as well. So, as it builds mid single-digit going into the summer and then more likely high single-digit as we close the year out.

Andrew Lazar
Analyst, Barclays Capital, Inc.

Q

Great. Thanks so much.

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

A

Thank you.

Operator: Thanks. Your next question comes from Ken Goldman with JPMorgan. Please go ahead.

Ken Goldman
Analyst, JPMorgan Securities LLC

Q

Hi. Thanks. Josh, congratulations and I hope you caught the end of the hockey game last night.

Joshua A. Levine
Vice President-Investor Relations, Sovos Brands, Inc.

A

I know you would.

Ken Goldman
Analyst, JPMorgan Securities LLC

Q

Yeah. Well, you know. Just curious, is there a way to sort of quantify or think about even roughly the impact of supply chain challenges, on the volumes as far as you can tell in the first quarter and do you expect some or really any of that shortfall to maybe be filled in as the year progresses and your operations improve a little bit?

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

A

Sure. Hey, Ken. It's Todd. And I actually caught the end of the game, also. And I think a lot of you for the analyst call knew I guess – I think you all know now we're in the Berkeley office, because you can hear the train in the background. So, I apologize for that. But to answer your question directly, Ken, look, we did have a variety of, call it, service interruptions in Q1. I mean, it's there's just intermittent supply issues that keep coming in for us in Q1. It was foils for noosa, lids for noosa, pouches, proteins, trays. We estimate the lost sales through these outages was roughly $3 million to $5 million or low single-digits.

While we are seeing improvements in our materials ingredients supply across the noosa, we continue to experience some issues as you know as everyone is, a tornado damaged our primary dry pasta supplier facility in Austin, shutdowns in China have impacted ocean freight that have caused some ripples. So, it's a – it's a constant challenge, but we're tenaciously addressing it every single day. But we do estimate in Q1 there was about $3 million to $5 million of lost sales due to those service issues.

Ken Goldman
Analyst, JPMorgan Securities LLC

Q

Okay. And as a follow up, do those supply disruptions in any way affect your ability to maybe meet your goals in terms of the cost reduction initiatives you laid out last quarter? Or is that still on track? No pun intended.

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

A

As we laid it out in our prior conversations, we had a strong set of initiatives that we were taking on the cost savings side from a lot of it, automation we're putting in to our self-manufacturing plant in Austin, value engineering across packaging, the Alma plant, scale as we grow that top line faster than our back office costs. So, while those are all still in flight, there have been some delays on the productivity side that we had hoped to get in Q1 or are now being delayed beyond Q1 to Q2 in the back half of the year.

On top of that, we have, as you would expect, to continue to explore additional ideas, so we have more things on the plate that we'll be seeing here the back half of the year. So, our back half will be higher than we originally anticipated. But there is a shortfall in Q1 in the first half of the year, some caused by the issues as we described, Ken, and as you've asked, some being hard to get technicians into our plants, sometimes hard to get equipment into the plants, on some of the automation that we're putting in. So, I'll call it delays, but we'll still anticipate hitting the full year number, they'll more back half loaded.

Ken Goldman
Analyst, JPMorgan Securities LLC

Q

Thanks so much.

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

A

Thank you, Kevin.

Operator: Thank you. Your next question comes from Chris Growe with Stifel. Please go ahead.

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

Q

Hi. Good evening.

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

A

Hey, Chris.

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

A

Hey, Chris.

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

Q

Hey. Welcome, Josh. And there's a [indiscernible] (00:31:51) tonight at 09:30 Eastern and Blues are playing, so you can talk about. Sorry to do that, but yeah.

Joshua A. Levine
Vice President-Investor Relations, Sovos Brands, Inc.

A

Okay. Yeah.

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

Q

The St. Louis guy here. So, I just had a quick question for you on – and I know we've talked about the pricing and how it's inflecting, at retail you can see it in the data. Just I wasn't sure to what degree you're not seeing elasticity today, but what have you built in going forward? Have you outlined kind of general expectations for a degree of elasticity deeply is appropriate for your brands as you raise pricing?

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

A

Yeah. No, thank you, Chris. So, we believe we've modeled at more historical elasticity rate. The majority of our products that would be close to one elasticity be a little bit lower, a couple but kind of average around one that we built into our projections, whether it was the first round or what we anticipated for the balance of the year. Now we are seeing that elasticity is that we modeled here through the first quarter. So, we're very enthused by that. But we do believe that was the prudent thing to do to model in more historical levels than we've seen in the past.

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

Q

Okay. Thank you. Just a quick follow on or question on, you talked about some volume declines across your categories on a year-over-year basis. This is obviously going to get some very tough comp from the prior year, whether for you or for your categories. Is that the reason you think it's driving it or is pricing becoming through more so in your categories? You're starting to see some of the elasticity that's driving some of that decline in volume in those categories?

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

A

Broadly speaking, Chris – how are you doing? Good talking to you and...

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

Q

Thank you.

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

A

So, broadly speaking, if I look at it just 13 weeks, if I look at the dollar side on our core categories, let's just talk sauce, yogurt and frozen, last 13 weeks or even 52 weeks dollars are up for all of those categories, okay. But on a 13-week basis in all of those categories, units were down on a 13-week basis in the first quarter, and that trend has continued. And that's driven by as prices are basically being reflected on shelf, that's driving dollar sales increases, unit decline. So, again, that's in the broad categories. That's in the categories of frozen entrées in yogurt and in sauce. And that's what we're seeing.

But obviously, we've talked in previously right now about our pricing trends that we have. So, in regards to the pace that we have announced and are taking pricing and right now, we are growing well ahead of that in regards to units notably on sauce, as well as, as yogurt and on our Rao's franchise. And the other I mean on our frozen Michael Angelo's and Rao's as were driving double-digit distribution gains and velocity gains.

I say the other area, Chris, that's I think is unique is, in our categories, private label is very call it underdeveloped. I mean, private label share and total MULO across food and beverage is about 21% in the combined core categories and I just referenced private label has a share of 6.7%. So, it's about less than a third of the total food and beverage MULO, double-click deeper, it's frozen entrées is about a four share, seven private label in yogurt and ten in sauce. So, there's not really much of an effect there.

And Sovos Brands do kind of have a lack of a direct substitute, whether it's a whole tomato kettle sauce or whether it's a whole milk yogurt like noosa. And also our products, while there's a lot of private label substitutes for what we call kind of the, me too, mainstream brands. We're not saying we're fully insulated, I'm just saying, when you look at our categories, if you look at our brands, it's not affecting us as much as it might be some of the other players and other categories.

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

Q

That's great. Thanks for all the information. I appreciate it.

Operator: Thank you. Your next question comes from Brian Holland with Cowen & Company. Please go ahead.

Brian Holland
Analyst, Cowen & Co. LLC

Q

Yeah. Thanks. Good afternoon, everyone.

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

A

Hey, Brian.

Brian Holland
Analyst, Cowen & Co. LLC

Q

I wanted to ask about Rao's and kind of the opportunity that you outlined today. Your quick math suggests a 20% share of sauces would be maybe $150 million opportunity retail, that's before accounting for demand growth, pricing, et cetera. You picked up about maybe 1,000 basis points in the past four years or so. I trust the next 500 basis points will be harder to get than the last 500 basis point. But can you help frame for us sort of a timeline when you think you could get to that 20% threshold?

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

A

So, hey, Brian. It's Todd. Good to be talking. In regards to a timeline if you think I mean we purchased the brand and I get your point whether ease or hard earlier or later in the journey, but we purchased Rao's in July of 2017, called it for a share and we're at 15-ish share now and that's in five years. I'm not going to do the exact math and commit to a number of when we're going to get to a 25% share. I would just say that while I'm here, I mean, I'm really looking at right now the share gain for every region of the country and I'm just using this as a few markers for your really good question, Brian, right. But we are growing anywhere from 1.9% to 4.3% in any of the measured IRI regions. And those range from being in 8% share in the plains to a 21% share in the Northeast.

And so, we are growing in chunks in every single region of the country and we are actually growing dollar share in 14 out of 15 customers' dollars and 11 out of 15 in units in regards to share. And interestingly too, I think, the data is in – we talked about it in the script and we redo this now every quarter. Not only is Sovos the fastest growing food company of scale in the US, but Rao's although it's over $500 million in spins MULO and natural, we continue to be the fastest growing brand of scale of any greater than $100 million, growing 42% over the past two years.

So, as we look at it, the whitespace still and items per shelf and we added a slide in the earnings deck that shows in 27% of the category, Rao's has a greater than a 20 share. So, there are a lot of accounts where we have low-20s, mid-20s, low-30 share. And that's just not in the Northeast, that's across the United States. And we see where we get 16, 17, 18 items in the store, we're going to add up to that share level. So, we're there today. So, that's a little bit of a hesitation in giving a timeline is that we are at that share level today and there's a variety of big banners there.

So, we've got a lot of whitespace and we continue to grow share on an annual basis, anywhere from 200 basis points to 300 basis points, given the measured timeline. And we'll continue to be driving distribution, driving awareness, leading to velocity and growing this brand organically, and sauce, as I've highlighted, Brian, we've talked continues to be the number one priority for us is to grow that sauce business primarily and then secondarily, frozen, across the category and our yogurt business. So...

Brian Holland
Analyst, Cowen & Co. LLC

Q

Yeah. I appreciate the color, Todd. And then on the frozen yogurt side, I just wanted to ask about that. The value proposition as you've communicated it and certainly as I think about it, is competing on taste in core yogurt. The ice cream category certainly doesn't suffer for taste, right. So, when I think about you guys moving over there, I'm just curious if you can help us or preview, kind of the messaging and how you're going to generate trial and build some traction around this brand, because I would guess what works in yogurt may not work quite the same in ice cream?

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

A

Okay. So, Brian, what did you think of the taste of that yogurt?

Brian Holland
Analyst, Cowen & Co. LLC

Q

Well, I thought it was phenomenal. But I guess my question is, if you've ever read my reviews is, well, but the question is, like, when you move into ice cream, if you're trying to convert someone that's eating another ice cream, yeah, what they have is probably they think it's delicious, right. So, just understanding how...

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

A

Sure.

Brian Holland
Analyst, Cowen & Co. LLC

Q

...that's going to work?

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

A

No, no, no. I apologize. I didn't mean to be flip it all there, but. So, we saw a couple of things. Number one, as we talked about it, noosa in the yogurt category is unapologetically about taste. And it is a taste-led yogurt, it is highly differentiated and we are absolutely thrilled that the majority of the category continues to look to take taste and out of yogurt, because it just differentiates noosa more every single day. And so, now how can we bring that great taste of noosa along with the health halo of yogurt into the ice cream category? And I would say and data shown that consumers really aren't that thrilled today with frozen yogurt in the ice cream category. There's nothing that really delivers day in and day out in absolutely delicious taste, much like noosa does in the yogurt category and we believe we've developed that product, it's tested very well, it's in the market now.

And roughly speaking, roughly, depending on the flavor, a pint of noosa frozen yoghurt gelato is about half of the calories of a pint of an ice cream sort of player, which significantly sort of less. And I said roughly because it depends on the flavor, depends of the ice cream you can kind of compare, but it is less. And then you have the yogurt halo there. So, we're basically saying, look, you can have absolutely great taste, but feel better about it because, it's your frozen yoghurt gelato versus just frozen gelato itself.

So, the selling has exceeded expectations. As you saw, there was an element of that that played through in regards to slotting in the first quarter. But it's a good thing that the selling is going well and we're just ramping up our marketing and promotional investment as we enter the summer selling season.

Brian Holland
Analyst, Cowen & Co. LLC

Q

Appreciate the color. I'll leave it there. Thanks.

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

A

Thank you Brian.

Operator: Thank you. Your next question comes from Jason English with Goldman Sachs. Please go ahead.

Jason English
Analyst, Goldman Sachs & Co. LLC Q

Hey. Good evening, folks. Thanks for slotting me in.

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

Hey, Jason.

Jason English
Analyst, Goldman Sachs & Co. LLC Q

Yeah. A couple of questions, I suppose. Your 11% organic sales growth pretty meaningfully like what we saw in Nielsen. It's one of the larger gaps. Is your business growing much slower in our measured channels, specifically Costco, which I know was a big customer for you?

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

I can't comment on Costco, but you hit the key driver of why consumption is greater than sales is basically because IRI measure is about 75% of the total universe and we grew slower in the unmeasured portion of the 25% that IRI doesn't measure, so that basically yes to your question, but we can't comment on the specific customer, because there's a lot of customers in that 25% in the balance of the universe.

Jason English
Analyst, Goldman Sachs & Co. LLC Q

Yeah. The math obviously suggests that it's very low if any growth in the unmeasured channels, if that's what we assume. Your distribution, I know you built out those unmeasured channels a lot quicker and you've had much more of a distribution ramp in the measured channels. Is this an early indicator of what we should expect is like once you reach this distribution saturation points going to a low to no growth in the measured channels as well?

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

No. I mean, I think honestly, there's a couple of things, Jason. Number one, remember we grew 84% on Rao's a year ago. So, that is playing into the – in the spirit of putting everything in the blender of what's coming out. 84% growth on Rao's last year was very, very large. And there absolutely is really no correlation on reaching full saturation of distribution in a variety of the customers in the unmeasured universe. There's an element of some out of stocks that occurred in regards to supply disruptions, et cetera. But we see healthy distribution runway and a majority of the universe and a lot of those that you're kind of would be referencing are kind of in the measured side of the equation, not necessarily, unmeasured. There's just a lot of factors playing into it.

Jason English
Analyst, Goldman Sachs & Co. LLC Q

Got it. That's helpful. And somebody probed earlier on private label value, it all kind of blends together. I appreciate the private label shares low in your agri category basket, but that's in part because you got cheap brands like Banquet and Frozen or Prego and Ragu and some regional brands and sauces that probably suck the oxygen out for private label. Are you seeing any evidence of consumers turning down to those brands or retailers choosing to lean into them a little bit more to get some sharper price points with a heightened sensitivity that maybe values on the brand could begin to matter more for consumers?

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

A

Jason, this is what you said you're talking about leaning in more on, call it, branded...

Jason English
Analyst, Goldman Sachs & Co. LLC

Q

Value brands, yeah, away from your brands. Exactly, because as you point out, you still have a lot of private label in your new categories, but you do have some value brands that are quite big?

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

A

Yeah. We have not seen that. We've actually seen the premium. If you look at it, you have to dissect, we got IRI, I think you guys can also be dissect by price tier, premium still is outgrowing the other tiers. We get data on a quarterly basis by income strata. We grew triple digits past two years with low income, less than $30,000, household income and middle income, $30,000 to $70,000 demographic. So, Rao's is growing robustly across all income demographics, notably lower income demographics as well, because I do think it comes down to the fact that we're not talking about a Tesla, we're talking about a jar of sauce that you can buy on promotion at a pretty affordable price.

And the differentiation of our product, the whole tomato sauce made in an open kettle that tastes just like homemade is highly differentiated versus the balance of the category similar to our yogurt, et cetera. So, we have not seen that trend. As a matter of fact, we've seen our brands that just use Rao's as a proxy, growing not just robustly, but across all income, all demographic groups.

Jason English
Analyst, Goldman Sachs & Co. LLC

Q

Yeah. Got it. Thanks a lot. I'll pass it on.

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

A

You got it, Jason. Thank you.

Operator: And your next question comes from Michael Lavery with Piper Sandler. Please go ahead.

Michael S. Lavery
Analyst, Piper Sandler & Co.

Q

Thank you. Good afternoon.

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

A

Hey, Michael.

Michael S. Lavery
Analyst, Piper Sandler & Co.

Q

Just was trying to get a little bit more color around the top line guidance. And I guess, partly just recognizing your first quarter, you've already got more than a quarter of the year under your belt. You've got the 53rd week coming in the fourth quarter. You've got strong momentum and some new launches. I guess, just also being a new public company, we don't have a huge amount of history. You look at 2020 and of course, it's distorted in the cadence of quarters of pantry loading and stockpiling in 2Q. So, a little bit trying to understand maybe just how much seasonality we need to make sure we keep in mind? And also how much maybe conservatism or any headwinds ahead we should be mindful of?

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

A

Yeah. Thank you. Hey, this is Chris. And we're very pleased with the top line results coming out of Q1, 11% volume, gains in household penetration, gains in distribution, gains in velocity. And again we're just in the early innings of pricing, so again, we've built out our models in being we think prudent on what we anticipate happens about to the year's price. It takes more of a hold as well as there are intermittent supply disruptions. We've managed to those very nicely in the first quarter, but they're still out there as well. So, given those circumstances, we model that to high end of our range, feel very comfortable with those projections, and we anticipate as I mentioned earlier, as we go across the year, we'll continue to see volume growth as pricing takes on more of percent of that growth and that leads up to the top end of that range.

Michael S. Lavery
Analyst, Piper Sandler & Co.

Q

Okay. That's helpful and just a follow up on looking at slide 9, where it shows how your share is, so much stronger in stores where you have greater distribution. No surprise there. But given the high price point and the better margins, the retailer would have for your products, it seems like this is a pretty easy sell story for any of the ones in the less than 20 share to add more items, I guess, how quickly can some of that come? Does it depend on capacity? Is it just waiting for a reset timing, what are some of the things that might be gatekeepers for how much you might be able to add to some of the distribution in the stores where you've got less share now?

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

A

Sure. So, Michael, it's Todd. Good to be talking to you today. So, a couple of things, as you noted and we've talked about 80% of Rao's items like roughly 18 spin in the top two quintile. So, you're right I mean we've got the fastest growing items there. If you look at the other three of the top four competitors, between 30% and 40% of their items spin in quintiles four and five. So, your point is, I get, which is, hey, if there was like no covered or on reset timing or anything else, it feels like there should be an exact flip towards these items.

But you mentioned probably one of the key ones, I mean there is reset timing, some of those have gotten like delayed in the world of COVID in regards to how frequently they occur, et cetera. We don't really see – well, we have had intermittent outages in sauce as we talked about, whether that's packaging related, whether it's port delays, containers. In the end of the day we've been servicing the business at a good rate. It's a little bit below target, but we're getting back and doing a heck of a job. That has not been a barrier to getting any distribution, gains per se, but I'd also say, even though yeah, that, it's a premium sauce, it's a higher unit sale that we bring it to higher basket size we spend well. It's still like not like you walk in and get it. Hey, we have eight items. Now, we're going to get 10 more tomorrow.

It's basically it's the job of our sales organization and our customer service and supply to really kind of make the selling go in. And we have been putting points on the board. I mean, every single 13-week period since we acquired the brand, we have grown distribution double digits and we've grown velocity double digits over that same time period. So, it's remarkable we've been adding them. But it's not like that. It all happens in one 13-week period and one year period. For some of the reasons you mentioned, Michael, but we're going to projecting continued distribution gains. We've got growing household penetration in chunks. And that's going to continue to be a key growth engine for us, notably on sauce, but also on the frozen business, which is growing robustly. And we don't talk much about soup, but little Rao's soup, now the fifth largest soup brand there has been the fastest growing soup brand of the top brands over the past 13 and 52 weeks and we've been in the market now for over three years.

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

That's great color. Thanks for the time.

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

Yeah.

Operator: Thank you. And your next question comes from Peter Galbo with Bank of America. Please go ahead.

Peter T. Galbo
Analyst, Bank of America Q

Hey, guys. Good afternoon. Thank you for taking the question.

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

Hey, Peter.

Peter T. Galbo
Analyst, Bank of America Q

Maybe just a start, I wanted to dig in a little bit on the gross margin in the quarter. Chris, obviously, it came in a little bit lower than I think even we had expected, having spoken to you guys kind of mid-March, seems like some of that was just the end of the month when inflation got worse. But also maybe just that these slotting fees came in higher. Can you quantify for us maybe just how you came in relative to your own expectations, maybe what slotting was as a hit to gross margins, deconstruct it for us on the quarter? Thanks.

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

Yeah. No. Thank you for the question. Yeah. So, as we closed the quarter, we did close the quarter very strong, very strong volume, not just on the gelato, but really across the board. And as we did continue to experience both port issues, congestion, as well as just ongoing high transatlantic trade costs as we absolutely had the bias to grow to where after that volume, we did incur incremental costs above and beyond what we would normally experience against that volume. So for instance, we expedite dredge to get after the boat, demurrage and dredge were higher than we would normally see.

Some of the intermittent supply challenges we've seen as well caused us to have to do things like airfreight and some packaging materials. So, things like that are happening. And as we have this double-digit volume growth, that does add incrementally to those costs. That accounted for roughly half of the margin, the larger margin fall off than we'd anticipated. And really the other half was the slotting fees on noosa, as we've gotten up in over our original ACV targets coming out of Q1. And then as we accrue for those fees at the time of shipment and then the volume comes out, comes in afterward, that goes at the end of period three as well. So, we're very happy with that. But between those items split pretty evenly against the margin.

Peter T. Galbo
Analyst, Bank of America

Q

Got it. That's very helpful. Thanks, Chris. And Todd, maybe just an update on the Alma, Georgia facility, I know you'd had some issues kind of getting it open earlier in the year. Are you are you kind of fully staffed and running it at levels that you're happy with at this point? Just anything to help us there. Thanks.

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

A

Yeah. Fantastic. Peter, good to talk to you today. So, yeah, Alma is up and operational, fully commissioned, making sauce that matches the high quality sauce we make every day in Italy. We're going to continue to ramp up production through Q2, building up inventory on key supplies like jars and Italian tomatoes now and really excited about the improvements in service working capital benefits that the Alma facility will provide to the Rao's brand. So, we're up operational and making sauce in Alma.

Peter T. Galbo
Analyst, Bank of America

Q

Thanks very much, guys.

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

A

Yeah. Thank you.

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

A

Thank you.

Operator: Your next question comes from Cody Ross with UBS. Please go ahead.

Cody Ross
Analyst, UBS Securities LLC

Q

Hey. Good afternoon, guys. Thanks for slotting me in.

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

A

Hey, Cody.

Cody Ross
Analyst, UBS Securities LLC

Q

As the last – hey, there. Gross margins pointed out down more than you expected. It looks like you're taking price later than your competitors are. Why is that?

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

A

Yeah. So, the pricing that we're taking, that is on the pace that we anticipated, the pricing actions. We were measured at the start as we worked through end of last year and measured and we wanted to make sure we remained balanced on household penetration is still very important to us. I know Todd has pointed out that's our huge growth drivers, household penetration distribution in-store and awareness from our equity building campaigns.

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

A

What I would just add to, Cody is, look, I can't speak to competition. I do know that as we've talked about and we have we just announced we've got a second price coming in on Rao's. We've got all the other pricing initiatives that we have. We have productivity. We understand the impacts of inflation, but we have brands with low household penetration and we will make the calls that we need to really get new households in and drive units and you look at a brand like Rao's sauce right now and we are growing units close to 30% on sauce, we're growing units close to 30%.

I mean, if you look at just our – so putting price aside right now, last 13 weeks just maybe yesterday units up 26% on Rao's sauce, 22% on soup, 30% on dry pasta, 36% on frozen and pricing initiatives are taking effect now as well as productivity. And Chris can talk more about the margin profile, but I think the blend of our pricing initiatives, the blend of productivity, all the other things that we're doing to attack that as well as driving unit growth on our brands, we like that combination.

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

A

Yeah. So, Todd said it exactly right. We are very much seeing all that pricing coming through take that last week IRI data and it's getting to the levels that we would have anticipated. Our pricing, of course, there is a lag for us on the surge in inflation that we've been seeing here recently, when our pricing will actually hit the markets lag there and taking the productivity. We talked about some delays due to that just the macro environment and some constraints that are going on really across the globe.

So that lag is pushing the margin improvement that we had anticipated really in the back half of the year. We've always talked about a back half weighted EBITDA year and even more pronounced. So, now with the global tensions there I think that we see going on. But we believe that the level of pricing that we're putting into the marketplace here over the balance of the year, as well as the productivity initiatives that we're going to have a place put us in a good position to manage that inflation as we move across and really exit the year.

Cody Ross
Analyst, UBS Securities LLC

Q

Got it. Thank you. That's helpful color. And then a common question we get from investors is about trade down risk, which has already been discussed on this call. But evidence that those investors speak to is your reluctance to take price or slower moving and take price. So, in combination with your answer that you just provided, how would you respond to the folks that would say, hey, this is evidence that they are at higher risk for a trade down given their premium portfolio?

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

A

Yeah. To date, we'll continue to monitor it closely. But if you look at our brands and the performance, I think number one, trade down risk assumes there's something to trade down too. And as we said, that Rao's is almost competes in a category in and of itself and there's other players there, but it's a whole tomato slow simmer sauce cooked in open kettles with real olive oil, fresh garlic, onions, et cetera, versus canola oil, dehydrated onions and paste and water and added sugar. And so therefore, and consumers are seeing that they can see that as opposed to going out to a restaurant for $60 or so for a family of four, they can feed their family of four Jar Breyer's dry pasta side salad for like $15.

And so, I think what we're seeing, we continue to see growing across every customer, every region of the country, I mean, every demographic. We don't see that trade down issue though we have planned prudently from an elasticity standpoint on going forward that there will be some lost volume from the pricing. So, I think time will tell. But so far we're just continuing to drive distribution and drive mental availability of our brands to increased awareness and really highlighting our highly differentiated products and brands vis-à-vis the competition.

Cody Ross
Analyst, UBS Securities LLC

Q

Great. Thank you. I'll pass it on.

Operator: Thank you. And ladies and gentlemen, this concludes our Q&A session for today. I will turn the call back to Todd Lachman for his final remarks.

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

So, look, thanks again everyone for joining us and showing an interest in the Sovos story. I look forward to engaging with many of you in the coming weeks as we attend several conferences and until then, have a great evening, and take care. Thanks a lot.

Operator: Thank you, everybody, for participating in today's conference. And you may now disconnect.