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Sovos Brands, Inc. (SOVO)

Q4 2021 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day, and thank you for standing by. Welcome to the Sovos Brands Fourth Quarter 2021 Earnings Conference Call. At this time, all participants are in a listen-only mode. After the speakers' presentation, there will be a question-and-answer session. [Operator Instructions] Please be advised that today's conference is being recorded. [Operator Instructions]

I would now like to hand the conference over to your speaker today, Chris Mandeville, Managing Director, Investor Relations. Please go ahead.

Christopher Mandeville
Managing Director-Better Living, ICR

Good morning, and thank you for joining us on Sovos Brands fourth quarter and fiscal year 2021 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 fiscal year ended December 25, 2021 that went out this morning at approximately 7:00 AM. Eastern Time. 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 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 December 26, 2021 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, Chris, and good morning, everyone. 2021 proved to be an exceptional year for Sovos Brands, and I want to thank the entire Sovos team and all of our partners for working tirelessly during this landmark year, notably our frontline heroes, who come to work every day to produce our absolutely delicious Sovos products. We achieved many important milestones, such as becoming the number two brand in the pasta and pizza sauce category and successfully completing our IPO last fall. We also delivered record financial performance and exceeded our full year guidance, generating over $719 million in net sales and $115 million in adjusted EBITDA. This represents 25% plus annual growth and marks all-time highs for both metrics.

We also had a very strong finish to the year, highlighted by double-digit growth for the top and bottom line in Q4. These results reflect our team's unwavering commitment to profitable long-term growth, even in the face of today's very dynamic environment. We are very pleased with the continued volume growth across our portfolio as distribution and household penetration continue to expand for our disruptive high growth, one-of-a-kind brands.

For today's call, I'd like to begin with a few fourth quarter highlights to underscore the ongoing strength of our business as well as offer some thoughts on our advantage positioning heading into 2022. I will then turn it over to Chris Hall to discuss our financial results and outlook in greater detail before opening it up to your questions.

Beginning with our largest brand, Rao's was the fastest growing center store brand of scale over the past two years. The strength and momentum of this brand continues behind further distribution and velocity increases. As we exited the fourth quarter, I am tremendously proud to announce that Rao's became the number two pasta and pizza sauce brand in dollar consumption, marking a new all-time high of 15.4% share as of the four-week period ended 12/26. We have gained share in every four-week period since our acquisition in 2017, and these results represent a 220 basis point share improvement over the last 12 months, as dollar growth was up over 28% compared to down nearly 7% for the category.

I'm particularly proud of the fact that not only were our gains broad based across our entire sauce portfolio, all channels and all regions, but they were also driven on the back of double-digit unit, dollar, TDP and velocity gains, which is in stark contrast to the category where units are down mid-single digits and price has been the driving force behind dollar growth. Our household penetration gains are equally impressive as we've increased penetration of our sauce to 10.9%, up over 260 basis points versus the same time last year. This has been achieved despite Rao's sauce having less than half the distribution and awareness of its top competitors, highlighting the considerable multiyear runway we still have to support further share and household penetration gains.

To offer additional context to our future distribution opportunity, I'd like to point you to slide 9 of our earnings deck where we highlight just how underpenetrated we are relative to our rate of productivity. As we can see, we still only have 11 pasta and pizza sauce items on shelf versus 17 to 22 for our top two branded competitors. These 11 items represent only an 8% share of average shelf compared to our dollar share of over 15%. No other sauce brand of scale has as big of a delta.

When you have 18 sauce items consistently in the top two quintiles on velocities like we do, this represents a compelling argument for why retailers should continue to allocate more shelf space to the Rao's brand going forward. As an additional leg to our long-term growth of the Rao's pasta and pizza sauce offering, we are commencing a new Ventures program in 2022 under the leadership of Risa Cretella, our Executive vice President of the Dinners and Sauces segment. Amongst many growth levers that we look forward to unveiling in the coming year, this program will be inclusive of international, where we plan to begin with expansion into neighboring North American markets such as Mexico and Puerto Rico, as well as optimizing our route to market in Canada.

Panning out to the broader Rao's offering, our efforts to extend Rao's strong brand equity of authentic Italian cuisine into new categories and drive household penetration have proven to be successful. Healthy consumption trends didn't stop with our sauce business, as soups and pasta continue to see growth across all metrics, sales dollars (sic) [dollar sales] (00:08:10), dollar share, units, TDPs and velocities, even after roughly three years in market. Our total frozen entrée portfolio, which includes Rao's and Michael Angelo's, also demonstrated considerable outperformance, also growing dollar sales, share, units, TDPs and velocities. Both brands contributed nicely to our 20% plus growth in dollars and units versus 11% and 1%, respectively for the category, yielding further evidence that the two brands are proven to be complementary on shelf and incremental to growth. Collectively, we have grown household penetration for the total Rao's franchise by 300 basis points to over 13% since the prior year period with our frozen entrée offering, which is less than 15 months old, already the second greatest driver to these gains.

Turning to our second largest brand, noosa. Consumption trends in the quarter were once again strong. Our dollar sales grew at over 2.5 times in the spoonable yogurt category, while our unit velocities remained category leading, up over six times faster versus the category. These results are a testament to our continued investment to grow the core, as well as our marketing efforts that are strongly weighted to digital, along with our highly differentiated taste-led yogurt. It's also worth noting that noosa is delivering such outperformance against the yogurt category, but is experiencing low to mid-single-digit growth that is in contrast to years prior.

Importantly, noosa has grown in excess of this for the last 14 four-week periods. These gains are absent of any pricing, which we expect to begin realizing by the end of Q2. Against this backdrop and because of the renewed focus to which we have on our core noosa offering, we have a strong foundation to build from and are excited about our prospects for continued growth in 2022. This will also include our entry into the ice cream category with frozen yogurt gelato, which I'll touch upon shortly. Before I do so, I want to emphasize the strength of our overall Sovos brands portfolio at a time where most of the center store is lacking unit growth.

In our three largest categories of sauce, yogurt and frozen, which represents over 90% of our portfolio, we saw a positive dollar and unit growth that meaningfully outperformed our respective categories in the quarter. Specifically, on dollar consumption, sauce represented by the Rao's brand grew by 30% in the fourth quarter versus 3% for the category. Yogurt represented by the noosa brand grew by 13% compared to 7% for the category. And finally, frozen, which includes Rao's and Michelangelo's entrées as well as Birch Benders waffles, grew by a combined 27% compared to 10% for the combined categories.

To help bring this outperformance to life, the combination of sauce, yogurt and frozen for Sovos brands grew dollar consumption by over 25% versus 8% for the categories in aggregate, yet we have not even come close to fully realizing price across our portfolio when compared to the majority of our packaged food peers. Consumers across all regions of the country and income groups are clearly voting with their wallets, as well as their preference for great tasting, clean label products. As society settles into a new norm, we believe this will benefit at-home consumption in light of a permanent shift to working from home for many within the labor pool. While trying to maintain a high quality of life, consumers are seeking value and this is exactly where our Sovos portfolio of one-of-a-kind brands delivers.

As consumers have reduced away from home eating occasions, they have sought out premium in-home replacements. In this context, we are well-positioned to continue to deliver robust growth given our runway for distribution and potential to increase brand awareness. As part of our growth playbook, we take our one-of-a-kind brands and selectively extend them into new categories in order to grow their TAM. The successes we have seen in soups, pasta and now frozen for Rao's are a clear example of our playbook at work. And because all of our brands share similar key attributes, we are confident in our ability to take the Sovos playbook to the rest of our portfolio.

In Q1 2022 alone, we will expand our addressable market by nearly $7 billion to $33 billion with the entrée into the ice cream category with noosa. With a strong momentum in our core yogurt business, we are very excited by our recent launch of noosa frozen yogurt gelato into the $7 billion ice cream category with a truly unique and absolutely delicious product. While still early, we can share that we're running ahead of our initial selling expectations. Beyond this introduction, we have a very strong pipeline of innovation for not only additional adjacent categories, but also to continually bolster our core that will support profitable growth for years to come.

In addition to our organic growth, we are continuing to evaluate acquisition targets that complement our portfolio and are accretive to our growth and margins. We have a proven track record of growing through M&A and will continue to leverage our scalable platform to further unlock growth opportunities and synergies that create value for our shareholders over the long term. To lead our efforts on this front, we've recently announced that [ph] Tom Lee (00:14:39) will be joining Sovos Brands as Senior Vice President of M&A and Strategy. [ph] Tom (00:14:45) comes to us from JPMorgan where he was a senior investment banker advising companies in the consumer packaged food sector over the last 10 years and has led numerous M&A and capital markets transactions, including our own IPO last fall. So he is already very familiar with us, our ethos and our strategy. And we are excited to work alongside him as he joins us later this month following the completion of his garden leave.

Before I conclude, I'd like to touch upon the current operating environment, as well as provide an update on the start-up of our Alma facility. As has been widely discussed and similar to our peers across the industry, we are facing a confluence of supply chain and inflationary headwinds, several of which have intensified in recent months. Specifically, in the last 90 days, we have the Omicron variant enter the picture producing elevated supply chain disruption and near-term cost and operating pressures related to raw materials, particularly dairy and proteins, logistics and labor. And now the Russian-Ukraine crisis brings with it heightened uncertainty to the operating environment, as well as incremental costs. As a result, in addition to the pricing and productivity initiatives that we discussed on our Q3 call, we'll be taking further pricing on a new set of products effective by the end of Q2.

In the past 90 days, we have also worked tirelessly to identify additional cost savings opportunities. As we sit here today and with what we currently know, we believe these actions will be sufficient to manage inflation this year. However, we are actively monitoring what continues to be a challenging and evolving operating environment, and we will remain nimble to any adverse impacts to our business that may warrant additional actions. As a means to fortifying and domesticating our Rao's sauce supply chain, I'm pleased to announce that we are beginning production of Rao's sauce in our Alma, Georgia facility this month. With expectations of ramping to full production during Q2, Alma will serve as a key source of supply for Rao's sauce, providing ample capacity and flexibility to support our rapid growth and reducing our exposure to the volatile ocean freight markets, while retaining the unique attributes that makes Rao's a one-of-a-kind sauce.

In summary, the strength of our underlying business is evident. We had a record year financially. We made major gains in market share and household penetration for our core offerings, and I am very proud of all that we have accomplished in 2021. While the operating environment remains highly fluid and supply chain pressures will persist into 2022, we will continue to execute on our plan to relentlessly pursue outsized top line growth leveraging our growth-oriented capabilities and organization, while protecting our margins through pricing actions and productivity initiatives. In addition to our expectations for continued strong growth in volume, we are confident that we are taking the actions needed to support another year of strong, profitable growth in 2022.

With that, let me hand it over to Chris for more details on the quarter and our fiscal year 2022 outlook.

Christopher W. Hall

Chief Financial Officer, Sovos Brands, Inc.

Thank you, Todd, and good morning to everyone on today's call. I am very pleased to report strong fourth quarter results, as well as our beat to our full year guidance for both net sales and adjusted EBITDA, capping off a milestone year for Sovos Brands as we moved into the public domain.

Fourth quarter total net sales of $189.2 million increased by $27.5 million or 17% compared to the same period last year, led by strong volume growth across core categories, sauce, yogurt and frozen. At the brand level, Rao's net sales increased by 25% this quarter, on top of 93% growth realized in Q4 2020. This robust growth was driven by strong consumption and continued market share gain across the Rao's portfolio of sauce, soup, pasta and frozen entrées. Adding to Rao's success in frozen entrées, Michael Angelo's increased roughly 10%, modestly trailing 15.5% consumption growth, which we take as a healthy indicator and our tiered premium approach in frozen entrées is working well. noosa net sales grew nearly 2% in the quarter, with consumption up 13%, which was the brand's fastest growing quarter since acquisition. The delta and net sales to consumption is due to a non-repeat of a key customer event performed in Q4 2020. Unit velocity trends continue to be category leading at a rate of 3.5 times faster than the total category as we focus on assortment optimization on-shelf and building brand awareness.

Finally, Birch Benders contributed $10 million to net sales this quarter. Unit consumption of Birch Benders frozen waffles was up 13% and baking mixes was up 7.8%, both of which continue to outpace the respective categories on unit sales in Q4 behind distribution growth and as consumers adopt our brand. Pancake mix unit consumption at negative 6.6% continue to be down, but ahead of the category at negative 7.4%.

As expected and guiding to on our Q3 call, gross margins realized a notable sequential improvement to 31.4% of net sales versus Q3 2021. Versus the prior year period, margins were down 220 basis points due largely to continued industry-wide challenges, including higher logistics costs, inflation and increased promotional support, particularly when compared to abnormally lower spending levels in Q4 2020. These headwinds were partially offset by favorable mix, as well as productivity realized during the quarter.

Adjusted operating expenses of $42.5 million increased by $2.9 million or 7% over the prior year period, primarily due to $1.6 million in variable sales expense, in light of our strong top line growth, as well as public company costs which were $1.3 million in the quarter [ph] and not (00:21:49) recognized in the prior year period as we were private at that time. Adjusted EBITDA for the quarter increased approximately 10% to $26.5 million or 14% of net sales, versus $24.2 million or 14.9% in the prior year period. However, results for the quarter included a $1.3 million in public company costs, which did not exist in the prior year period. If we look at this on a comparative basis and burden Q4 2020 results with a similar level of public company costs, last year's fourth quarter adjusted EBITDA margin would have been 80 basis points lower. That's apples-to-apples comparison would imply only a 10 basis point reduction in adjusted EBITDA margin for Q4 2021.

Q4 income tax expense was a $4.5 million benefit compared to an income tax cost of $2 million in the prior year period. The decrease in our income tax expense is primarily attributable to an increase in deductible expenses for tax purposes. Net loss for the quarter was $3.8 million or $0.04 per diluted share, compared to a loss of $0.5 million or a $0.01 per diluted share in the prior year period. Adjusted net income came in at $13 million and adjusted EPS was $0.13 per diluted share, compared to $10.8 million and $0.14 per diluted share in the prior year period. Please note that our Q4 2021 adjusted EPS is based on a fully diluted share count of 100.3 million shares, while in Q4 2020, we only used 74.1 million shares. This difference reflects the timing of our September 2021 IPO as well as the subsequent exercise of our greenshoe.

Now turning to our balance sheet, at the end of the quarter, we had a cash balance of $66.2 million and total debt was $481.5 million, bringing our net leverage down to 3.6 times adjusted EBITDA as the primary use of our IPO and greenshoe proceeds were used to reduce debt by roughly $300 million in Q4. This flexibility on our balance sheet as well as our robust cash generation put us in a good position to potentially accelerate growth and unlock incremental shareholder value through accretive high growth M&A that makes business and financial sense.

Turning to our fiscal year 2022 guidance, we expect net sales of $800 million to $815 million, which represents approximately 11% to 13% growth and is expected to be fairly balanced between volume and price mix; adjusted EBITDA of $116 million to $122 million or approximately 1% to 6% growth versus the prior year; net interest expense of $23 million to $25 million; an adjusted effective tax rate of approximately 25%; and capital expenditures of approximately 2.5% of net sales, primarily focused on automation and other productivity projects at our manufacturing facilities, as well as growth enabling initiative.

Two items worth noting for comparability sake are, one, 2022 will be a 53-week period versus 52 weeks observed in 2021. Embedded in our guidance, we expect this additional week to contribute roughly $15 million or 2% to the top line while we plan to reinvest any variable profit generated from this extra week to support future growth. And two, as we were a public company for only three months out of fiscal year 2021, public company costs will weigh more heavily on our adjusted EBITDA growth in 2022. If one were to fully burden fiscal 2021 results with an equivalent $6 million of public company costs expected in 2022, our adjusted EBITDA growth would be approximately 5% to 10% versus the 1% to 6% previously mentioned.

Excluding the impact of a 53rd week in Q4, we anticipate total Sovos Brands' quarterly net sales growth to be fairly consistent and in line with our long-term algorithm in high single-digit range. Underpinning this outlook, our core sauce, yogurt and frozen businesses will continue to serve as the primary drivers, representing approximately 80% of our growth in 2022. While volume will serve as the basis of our net sales growth, pricing as we view it warranted in the current environment will play an increasing role in the coming year.

Since our Q3 call in early November, we have seen a continuation of higher costs for certain input costs such as milk, chicken and packaging, while the combination of robust demand for our products and recent disruption from Omicron, as well as the Russia-Ukraine crisis, have further exacerbated near-term distribution and supply chain pressures. To combat what we now anticipate will be high single-digit inflation for the year versus mid-single digit previously, we are taking more aggressive net revenue management actions having already informed you of list price increases nearly two-thirds of our portfolio, new pricing actions recently announced have us touching all brands with list price increases by the end of Q2. We also continue to work diligently to eliminate our least efficient promotions while keeping a maniacal focus on velocities and unit growth.

In addition to our deep pipeline of productivity initiatives that includes automation in our manufacturing facilities, optimization of our co-manufacturing network, packaging value engineering and further competitive procurement actions, we have identified a number of incremental cost saving activities to help mitigate expected inflationary pressures in 2022. Due to our expectation that supply chain pressures will remain for the foreseeable future and given the timing of our net revenue management actions, productivity and incremental cost savings efforts, we expect growth and adjusted EBITDA margins to be down in the first half of 2022 versus the prior year period.

While we expect to grow Q1 net sales by high single digits against the 40%-plus year ago comparison, we are not immune to the inflationary environment, and pressures to our margins will be most impacted in Q1 by the following. Increased input costs such as dairy, chicken and packaging; continued supply chain costs and logistical constraints; and [indiscernible] (00:29:41) of public company costs that were not realized in the comparable prior year period. Our projections assume pricing and the majority of our input cost consistent with current levels throughout the course of the year, while we actually anticipate further increases in certain oil-based materials. As we progress into the second half, the benefits from our various pricing actions and productivity initiatives should ramp, allowing for margin improvement in Q3 and Q4. That said, if circumstances worsen relative to our forecast, we are fully prepared to take additional actions as warranted. Additionally, let me emphasize that we will continue to prioritize securing supply in order to meet our strong demand and maintain momentum 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 are confident that we will continue to delever in the coming year. Barring any M&A, we expect our leverage will approach 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. 2021 was truly an extraordinary year for Sovos Brands, both operationally and financially. I want to thank all of our associates and team members for managing through these challenging times and their contributions to the company's success to-date. As we move into 2022, we are energized and excited by what lies ahead. The operating environment will remain demanding and we don't discount the potential for further actions being needed if conditions justify it. However, we are highly confident in our ability to rise to the occasion. We have the right brands, one of a kind, authentic and absolutely delicious, high growth brands that consumers love, yet they are still relatively underdeveloped with considerable runway for growth and distribution, awareness and household penetration.

We have the right strategy, the proven and repeatable Sovos' playbook capable of accelerating growth and expanding brand white space. We have the right platform, one that is scalable and well-suited for future accretive M&A. And most importantly, we have the right people who are excited, committed and motivated by what we are creating, a different type of food company, one that is growing faster than any other food company of scale in the US.

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

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question is from Brian Holland with Cowen. Your line is open.

Brian Holland
Analyst, Cowen & Co. LLC

Q

Yeah, thanks. Good morning. I was curious if you could help us think about the top line guide for 2022. As I look at sort of my forecast and sort of dimensionalize this, I'm thinking about consumption, I'm thinking about price, I'm thinking about selling. If we think about since you become public, where have you been most positively impacted? I mean, is it just the – I guess I'm thinking about where that Delta is. Is it just the price or is it maybe the selling for something like noosa frozen yogurt that may have exceeded expectations?

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

A

Hey, Brian. How are you doing? It's Todd Lachman. Good morning. So just getting to your question, I mean, the headline answer, it's volume. And I'll highlight now sort of getting into the Q&A as – I mean, honestly, in stark contrast to our peers, we are driving volume growth. And as we look at growth in 2021, as we're looking at 2022, the majority of our growth is coming from our core businesses that would be sauce, then yogurt and then frozen. But as I've been highlighting again, we are driving volume growth. If we just look at Q4, Rao's volume growth up 29%, this is Rao's sauce and the category down 5%, our soup business in Q4 up 28% in volume, down 2% for the category. And if you look at just our pasta, dry pasta business, up 53% in volume, down 5% on the – from a volume standpoint. And then even if you look at our yogurt business, up about 7% in units in Q4, down 1% and that's continuing.

Brian, as we look at just the most recent data that we have, 13 weeks ended 2/27, Rao's sauce 31% in volume, down 4% in the category, soup up 34%. We don't talk a lot about soup, but in 2021, Rao's soup was the only brand to grow volume in the category of all the top 10 brands. And importantly, there is so much more meat on the bone, for lack of a better expression. You look at Rao's and we massively increased household penetration this year up to 10.9%. You can see in the data on sauce, 13% for total Rao's. We've been increasing household penetration by 60 to 70 basis points per quarter. I know there were some talking about, we just need to increase it 70 to 80 basis points per year. We're blowing that away. We've more than doubled our household penetration over the last several years. You saw that in regards to just our average number of items, 11 versus 17 to 22 for the top two competitors; awareness very, very low.

So we are very, very confident in the high end of our sales growth range. We will prioritize growth and feeling very positive. And then there is pricing to come on our business. As we've talked about, you've got Rao's sauce, pricing being reflected now. As we've talked about, we've taken pricing now across all brands and all portfolios. But really the headline here again in stark contrast to our peers is volume growth, and we see that volume growth continuing through this year and well into next year and beyond. And Chris, any additional perspective on the pricing side, price volume?

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

A

Yeah. No, absolutely. So, as we spoke on our Q3 earnings call, that we had announced pricing across a portion of our business, roughly two-thirds of the business, since that time, given the surge in inflation that we've all experienced industry-wide over the last several months, we have announced additional pricing and at this point, have touched or will touch here over the next couple of months, all of our brands and really across basically all of our categories. So we see pricing – as we continue to progress across really late Q1 into Q2, by the end of Q2, we will see pricing across all brands. Our combination of our pricing actions coupled with the productivity actions we talked about last call and incremental initiatives that we now have in flight, we believe will be covering the majority of the inflation, certainly across the year. There will be a lag across H1 as we implement these programs, so we will see higher margins at the back half of the year than we'll in the first half of the year. And we have factored all that into the guidance that we have provided here today.

Brian Holland
Analyst, Cowen & Co. LLC

Q

Yeah. Thanks, Todd and Chris. Appreciate all that color. And then maybe just kind of a bigger picture question as we move forward, I get asked about the premiumized portfolio that you are on and how that might fare in an increasingly inflationary environment. It's sort of interesting that private label remains under pressure. I think that's supply constraints to some extent. But with higher gas prices, I wonder how you think about – and if you've looked at historically, how brands such as those you own perform in those types of environments, and I'm thinking about the trade between sort of eating out and eating at home. And so two questions there. How do you think those brands have performed in those instances and also how you plan to market that value proposition to consumers?

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

A

Sure, Brian. So just one point really quickly. In the categories in which we compete, sauce, yogurt, frozen entrées, private label has a very low dollar share of category versus kind of the average percentage of stores. So that's point number one. Private label is not a large player in those categories. But then getting to your broader question, I know we've talked about this previously, these are brands that fare well in a down economy. In a broader economic slowdown, consumers cut back on travel and leisure spending, including restaurants, and they look to [ph] serve (00:39:35) the restaurant meals with high quality replacements. As we've looked over time over the last – even when we acquired the Rao's brand, if we look back at the previous 10 years, almost a perfect correlation, if the economy is down, Rao's goes up, et cetera. Now Rao's has been going up regardless, I think as you saw the fastest growing brand in the center store, any brand above $100 million in sales over the last two years.

But consumers are looking for restaurant quality products like ours that are perfectly suited to capture that occasion. Just dinner at home with Rao's pasta [indiscernible] (00:40:10) about $12, $14 depending on where you live, where you shop versus going out to an Italian restaurant that can cost a lot, lot more of that. Same with whether it's breakfast with Birch Benders pancakes or noosa, et cetera. So what we're seeing is our products, which are cleaner label, absolutely delicious, they're highly substitutable with restaurant occasions. I mean, if you would take Rao's – Rao's a great example. We were growing robustly before COVID. We grew even faster during the COVID surge. And we're lapping the COVID surge in the 30% to 40% range. So we see cooking at home is here to stay as habits and practices have changed. And in that recessionary environment, we have full confidence that our products are exactly what the consumers would want.

And lastly, as I've talked about before, our products are highly differentiated. They are not [indiscernible] (00:41:07) mainstream brands that are easily substitutable. There is no sauce like Rao's in regards to its taste and quality. [indiscernible] (00:41:16) everybody else is playing the game, how much taste can we take out of yogurt.

We're looking to put taste into the yogurt and that's behind the strong growth of new businesses as well. So anyway, I think that would hit that one.

Brian Holland
Analyst, Cowen & Co. LLC

Q

Great, thanks. Best of luck.

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

A

[ph] You bet, Brian. Thanks. (00:41:37)

Operator: Our next question comes from Jay English (sic) [Jason English] (00:41:41) with Goldman Sachs. Your line is open.

Jason English
Analyst, Goldman Sachs & Co. LLC

Q

Hey. Good morning, folks. Thanks for [indiscernible] (00:41:47).

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

A

Hey, Jason.

Jason English
Analyst, Goldman Sachs & Co. LLC

Q

Let's see. Congrats on the continued demand and sales success. It's impressive. [indiscernible] (00:41:54) great to see. Obviously, your results and outlook highlight that you're not immune [indiscernible] (00:41:58) out there, but I want to dig in a little bit more on that. I think you said fiscal 2022 guidance [ph] predicated on (00:42:04) high single-digit inflation? Is that as a percentage of your input cost or is that a percentage of COGS overall?

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

A

Yeah. Well, this is Chris. That is a percent of our total cost of sales structure, so including our raw material packaging, [indiscernible] (00:42:22) internal manufacturing, which would include our plant overheads as well as our labor costs. [indiscernible] (00:42:29). Our actual inflation on pure commodities would be higher than that high single digit. But as you absorb it across the total base, you're at that high single digit.

Jason English
Analyst, Goldman Sachs & Co. LLC

Q

Thank you. That is a surprisingly large number, given what we kind of viewed as a relatively fixed cost structure on Rao's. What is happening with Rao's? Are you making concessions to your partner there to help them out in this situation? And is that contributing to that inflation rate?

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

A

Yeah. As we've discussed before, we have a fabulous relationship with La Regina. The quality of the product [indiscernible] (00:43:10) Italy or soon in the US is obviously a key driver of the Rao's growth that we've been experiencing. As we continue to work with La Regina. We do support in various ways to ensure we get the product supply we need to meet this 30%-plus growth that we've been experiencing. In doing so, we have and will continue to pay for accelerated lanes, shipping lanes, cross-Atlantic lanes. [indiscernible] (00:43:43) as we did [ph] much though in Q3 of last year or less in (00:43:45) Q4, again, to ensure that product supply that we have. As you well know the operating environment remains volatile, we have incorporated into our projections current levels that we're seeing in the marketplace across our commodities [indiscernible] (00:44:07) included a potential uptick in oil based, oil derivative, things like resin or packaging. So that's in our guidance factored in today. So we're not opening up [indiscernible] (00:44:20) the contract we do have in place with La Regina, we will lean in and support [indiscernible] (00:44:25) as needed and that is factored into our guidance.

Jason English
Analyst, Goldman Sachs & Co. LLC

Q

So you mentioned the freight lanes that you're leaning in and helping with their – in some sort of contemplation of oil derivatives. You didn't mention tomato costs. The California Tomato Growers Association negotiated 20% increase for fall delivery of tomatoes here in the US. I'm guessing if they could renegotiate today in light of where fertilizer and the fuel for the tractors is going to be running that that would probably be closer to 30% or 40%. I imagine the – your partners over there, La Regina, are going to face similar pressure. Is it prudent for us to assume that you're going to have to absorb higher tomato prices into next year, even though I appreciate the fixed cost nature of your contract?

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

A

So we – the majority of our tomatoes [indiscernible] (00:45:15) used for Rao's that are procured over in Italy, very much advantaged with our co-packer [indiscernible] (00:45:24) very large tomato business and the tomatoes that we use are grown right there, locally, very near our plant. So we don't anticipate any increase that are – in our tomatoes that are used for our Rao's production. We do buy tomatoes domestically as well for things like our frozen entrées, Italian frozen entrées. We are 100% covered, our tomato purchases across 2022. So we think we're in good shape that there is additional tomato inflation.

Jason English
Analyst, Goldman Sachs & Co. LLC

Q

Got it. Okay, thanks. I'll pass it on.

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

A

Thank you.

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

A

Thanks, Jason.

Operator: Our next question comes from Andrew Lazar with Barclays. Your line is open.

Andrew Lazar
Analyst, Barclays Capital, Inc.

Q

Hi, good morning.

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

A

Good morning.

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

A

Good morning, Andrew.

Andrew Lazar
Analyst, Barclays Capital, Inc.

Q

I think like most of your peers, obviously, you expect a back half weighted EBITDA year as it'll take some time for pricing and productivity to sort of catch up. In trying to get, I guess, a better sense of how much flexibility you're building into the plan, I guess, how would you see gross margin playing out for the full year? And to the extent, if you can provide some sort of weighting between first half and second half EBITDA, that would be helpful.

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

A

Very good. So as I mentioned, we have factored into our projections for the year, commodity packaging costs, as we're seeing in the marketplace today. So we're not assuming that we're going to see improvement across the back half of the year. Now, our year-over-year comparisons are more favorable as you work across 2022, as we really saw the inflationary pressures really tick up somewhat in Q2 of last year, but really into Q3 and Q4. So as we move into Q1, we will see a rate of decline on our margins fairly similar to what we saw in Q3 and the gross margin line. That will then improve sequentially across the year, as our overlaps do get easier and more importantly, as our pricing actions, many of which hit in Q2, and our productivity initiatives, again many of that hit in Q2 and beyond, we spoke a lot of those actions that were taken primarily at our internal manufacturing plants versus the automation we're putting in down in our Austin plant. Those will hit more aggressively in Q3 and Q4 as well. So as we think about the year, as you mentioned, Andrew, very much back half weighted, and we will see margin decline year-over-year in the first half and then we'll see that improvement over the second half.

Andrew Lazar
Analyst, Barclays Capital, Inc.

Q

And then I guess lastly, obviously, you talked about how strong volumes have been across the portfolio. As more of the pricing flows through, what type of assumptions are you building in for – into the plant for elasticity, I guess? Would you – were your assumptions called for volume growth to just sort of slow a bit sequentially from obviously [indiscernible] (00:48:29) numbers as more pricing flows through or how do you build that in? Thank you.

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

A

You bet. So as we put Rao's sauce pricing in [indiscernible] (00:48:40) late Q4 into Q1, the very, very good news there is we're seeing very minimal impact [indiscernible] (00:48:45). Todd mentioned volume growth. Volume's still hanging, very much in line with what we saw before the pricing. So [ph] we'd (00:48:54) very positive response so far [indiscernible] (00:48:58).

We have modeled elasticity at more traditional rates into – we factored into our guidance. We are seeing the marketplace – not just for Sovos but across the industry, we have seen favorable elasticities. Now, we do know there has been some more softness more recently than there was initially. So we were fairly conservative in our elasticity assumptions. We've factored it in accurately into the projection that we've provided. Again, the great news is we continue to see tremendous volume growth on the Rao's sauce [ph] that we took the pricing on initially (00:49:36).

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

A

Yeah, Andrew, I'll just build on that. So the full impact of the [indiscernible] (00:49:47) price increase on Rao's is not fully reflected, but ARPs are going up. And as Chris said, we've not seen any statistically significant fluctuation in Rao's elasticity through our recent study since implementing the LPI. And while I know there's a lot of other noise in the data that I'll share right now, if you just look at the four weeks ending 2/27 unit growth on Rao's, 25% last four weeks, 31% last 13 weeks, so that's over the time period that the LPI's been reflected. And if you look at the – it's basically equal to or slightly above our unit sales growth on sauce in the 13 weeks ended 12/26. If I look at unit velocity in Q4 versus Q1 this year for the most recent data, as of two weeks ago, it's roughly flat. It's about 13% for both of those periods. So we are tracking this closely, but we haven't seen a drop-off on unit growth or unit velocity to-date.

Andrew Lazar
Analyst, Barclays Capital, Inc.

Q

Thank you so much.

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

A

Yeah.

Operator: Our next question comes from Chris Growe with Stifel. Your line is open.

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

Q

Hi, good morning.

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

Good morning, Chris.

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

Q

Hi. I just had a quick question, bit of a follow-on to Andy's question. In relation to your kind of first half, second half [indiscernible] (00:51:16), we've some really incredible momentum right now in the business on the top line. So it would seem like the first half of the year, you'd have some of your strongest revenue growth as well. I just want to get a sense of, as we think about [indiscernible] (00:51:29) stronger revenue growth period? And then related to that, how much of the EBITDA margin pressure you see like in the first half of the year? Is that all driven by gross margin? Was there anything on the SG&A side that's affecting as well?

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

A

Yeah. So thank you, Chris. Yeah. As we operate across the – also of importance to us is maintaining the investment that we're making to continue the top line growth. So we will invest behind marketing, R&D, even sliding costs to make sure we're getting the distribution gains both on our core as well as the new product launches such as [indiscernible] (00:52:15), which is actually launching right now and off to a very good start. So we will maintain those investments across the year. We see the top line fairly consistent quarter to quarter, with the guidance provided high single digit across the year, where the consumption that you're seeing year-to-date would be very consistent with that outlook for us. On the productivity front, it will be more back half loaded as we continue to implement not just our CapEx-enabled capital projects, primarily [ph] within our own (00:52:54) internal plans, but as we start up Alma here, as Todd had mentioned previously, as we have value engineering ideas in our packaging, [ph] such as reduce the weights (00:53:04) of resins, things like that, so we do see a ramp-up on productivity in the back half of the year.

And then finally, I will mention this year, we are incorporating public company costs that we did not experience back in 2021 until Q4. So there will be higher OpEx expenses across the first three quarters as we incorporate those costs into our P&L.

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

Q

Okay. Thank you for that. And just one other quick question that's on the new products. You obviously launched gelato [indiscernible] (00:53:41). Just a couple of other new products, [indiscernible] (00:53:45) this year, are we still on track or there – can you talk about maybe the ones [indiscernible] (00:53:51) should come later this year?

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

A

Sure. Hey, Chris. This is Todd. So first, I would say starting with noosa, noosa gelato is that – that's off to a very strong start. Sort of mentioned it in the opening remarks, selling stronger than expected. Kind of – have joked that rumor has it, it was the head of Expo West last week in regards to sampling line going around the whole Expo. So the selling is just started. It's very early. But as of what we know today and as I said, we're very excited about that launch. The second one that was out for this year that we've launched it in the limited customers is Birch Benders Cookies into the cookie category. So with some of our launches, we launched them in a limited distribution, which is what we're doing with Birch Benders Cookies, which similarly, we start launches with the smaller core retailer group.

The second area that I would talk about, I think you're referring to, as we've talked about several times, Rao's into the frozen pizza section. We're looking at that 2023, 2024. So we are on track to launch into that next new category. But we're being judicious about when that timing might be. And the last area that I would say, Chris, is just the focus on the core. You will continue to see innovation from us on our sauce business, whether it's limited reserve line online with a Calabrian chili sauce or white truffle sauce or basically a new pizza sauce item, et cetera. You're going to continue to see innovation in the sauce category.

We're now the number two brand. And it's important that we continue to bring innovation across pack sizes across our flavorings, as well as noosa yogurt as well as frozen. So yes, we have TAM expansion. But honestly, just as if not more importantly, we've got massive opportunity within the core categories that we play in. And I want to double-click on that one point because I know we just talked about elasticity and one, again, very unique element to Sovos that does help sort of counter the potential effects of elasticity is the massive penetration upside on all of our businesses. So while, yes, there might be an effect of higher pricing at some point in time, what we have that is very unique is a brand like Rao's growing 30% to 40% with distribution gains, is the fact that we are only in 11% of households and we're getting households in chunks. So that's a – it's a very nice counter and upside to us as we continue throughout and into future years.

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

Q

Thank you. For that.

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

A

Thanks, Chris.

Operator: And our next question comes from Anoori Naughton with JPMorgan. Your line is open.

Anoori K. Naughton
Analyst, JPMorgan Securities LLC

Q

Hi, good morning. Thanks for the question. I was curious if you could help us with some color on how we should be thinking about your annual sales, either by brand or by category, kind of what are your expectations for growth, would be helpful. Thank you.

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

A

Sure. Hey, Anoori. Good to talk to you. I think what we can – we don't provide guidance for brand per se, but I would just say 80% of our growth this year will come from sauce, frozen entrées and core yogurt. So, again, 80% of our growth will come from sauce, then frozen and then yogurt. What I will also say is, it's very clear as you can see in the consumption data, we have Rao's growing robustly just from a – you saw that – well, I think we mentioned Rao's $420 million of net sales in 2021, up 34%. That's total Rao's brand. But if I just look at Rao's sauce through the most recent period, we've got last 13 weeks Rao's sauce dollars going 36%, Rao's soup going 33%, Rao's pasta going 28% and Rao's frozen up 63% all over those period. So, clearly, we are driving the Rao's business hard. And it's not just by distribution. It's by marketing support. It's by innovation across the portfolio, doing the same with noosa yogurt, again, driving distribution, driving marketing gains, et cetera, and on the frozen portfolio. And we've talked noosa gelato, which is not included in that 80%. So, that's – those are the highlights that I would provide there, Anoori.

Anoori K. Naughton
Analyst, JPMorgan Securities LLC

Q

Great. Thank you. And then as a follow-up, I just – I wanted to get some more color on your international expansion plans. Why is now the right time to be expanding outside of the US? And then what's the timeline on this? And how much is it expected to add to top line in 2022?

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

A

Sure. [indiscernible] (00:59:20) the highlight for 2022, not much. I mean, it's very small. We're – what we've highlighted here and I think we discussed previously is we are putting the foundation in this year for international expansion and sort of building the foundation of the house and framing the – overusing the house analogy – framing the house, doing whatever next year in 2023 to really begin to pay dividends, but really, in neighboring North American markets. We should have a larger share in Canada. We've had successes there with select customers. We're putting in the infrastructure there to really drive Rao's more robustly in Canada, in Mexico, in Puerto Rico. We've had success with some select customers distributing in certain markets. There has been [indiscernible] (01:00:13). As we've talked about, Rao's brand is pretty much known now around the world, and there's been a lot of ask for us to supply Rao's, but we're being selective because right now, the number one opportunity for us is in the US market, first and foremost on sauce, then on yogurt, then on frozen, but in the other areas of Rao's as well. Really little to no incremental benefit this year. But we are putting the foundation in this year, so we can really drive some strong growth in 2023 and beyond.

Anoori K. Naughton
Analyst, JPMorgan Securities LLC

Q

Helpful. Thank you.

Operator: Thank you. Our next question comes from Rob Moskow with Credit Suisse. Your line is open.

Robert Moskow
Analyst, Credit Suisse Securities (USA) LLC

Q

I think that's me. Just maybe a couple things here. Can you quantify how much you think the Alma savings are going to be for the back half of the year when that gets started? And then also, I think you said that you budgeted further premiums for shipping lanes from overseas for 2022. Can you give us a sense of – is it going to be higher than it was in 2021? Is that related to the high ocean freight you have to pay or is it related to volume? Like how much of an increase do you expect in that bucket?

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

A

Yeah. Very good. So once Alma is up and running, there's a few different advantages that we're going to from that. I think first and foremost is a positive impact to cash flow as we will have local production. We will not need to hold on to as much safety stock. We think we can take couple weeks out of our system there. And we can react to immediate demand opportunities with that production here, out of Atlanta, Georgia. So that's the first benefit of the cash flow.

Secondly, we do procure some of our sauces, our Rao's sauce, domestically today, things such as meat, meat-based items. We will have cost reduction versus that balance of production that's made in the US today. And Alma can produce 20% to 30% of our requirements as we look across 2022, once up fully running. So we'll see productivity on that front and we'll see the balance sheet improvement again from that inventory management that will improve. That is factored into our numbers as we shared with you today.

And then on the freight line, that's – we're taking that on a week by week, month by month basis. We are seeing the pressure right now. So we are leaning in and we – as I mentioned, we'll continue to do. So, whether it's more or less than we did last year, it's yet to be determined, given the volatility that we're seeing with first Omicron earlier in the year and now from the global tensions that we're experiencing. But we will just manage that as we progress across the year and we'll react accordingly just to ensure that we have the supply that we need. And then an advantage again of having the Alma plant up and running is we can be much more selective on the rates we pay, whether to expedite shipments or not. We won't need to as much as we may – had to in the past because we'll have that local production. So that's going to be another benefit that we'll realize through our P&L.

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

A

And just one of the comment there. Hey, Rob. Good morning. Good to...

Robert Moskow
Analyst, Credit Suisse Securities (USA) LLC

Q

Hi.

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

A

...hear from you. Look on Alma, we are absolutely thrilled that we are going to have a state-of-the-art, I'd call it a mirror facility to what we have in Italy, the same kettles, the same equipment, I mean under the leadership of our supply chain team from Kirk Jensen and Felice Romano of La Regina. I mean, we are just – we're thrilled about what we've created in Alma. And it'll be running sauce this March, full production, as we head into Q2. And it'll just be a real benefit for us to have, again, a mirror facility of that beautiful facility over in Italy operating here in Alma, Georgia. So very, very exciting.

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

I want to move into closing remarks. Honestly, thanks, again, for your participation, interest in Sovos. Great talking everybody this morning. Incredibly proud of what we've accomplished in 2021 and we're excited to continue the strong execution against our priorities as we drive growth and increase shareholder value in 2022 and beyond. Have a great week and speak to all of you soon.

Operator: This concludes today's conference call. Thank you for participating. You may now disconnect.