J&J Snack Foods (Q3 2024)
August 8, 2024

Corporate Speakers

- Norberto Aja; J&J Snack Foods; Investor Relations
- Daniel Fachner; J&J Snack Foods; Chief Executive Officer
- Ken Plunk; J&J Snack Foods; Chief Financial Officer

Participants

- Todd Brooks; The Benchmark Company; Analyst
- Connor Rattigan; Consumer Edge; Analyst
- Jon Andersen; William Blair; Analyst
- Andrew Wolf; CL King; Analyst
- Robert Dickerson; Jefferies; Analyst

PRESENTATION

Operator^ Good day and thank you for standing by. Welcome to the J&J Snack Foods Third Quarter 2024 Conference Call.

(Operator Instructions) Please be advised that today's conference is being recorded.

I would now like to hand the conference over to your first speaker today, Norberto Aja, Investor Relations.

Please go ahead.

Norberto Aja^ Thank you, Operator. And good morning, everyone. Thank you for joining the J&J Snack Foods fiscal 2024 third quarter conference call.

Before getting started, let me take a minute to read the safe harbor language.

This call contains forward-looking statements within the meaning of the Private Securities Litigations Reform Act of 1995.

All statements made on this call that do not relate to matters of historical facts should be considered forward-looking statements including statements regarding management's plans, strategies, goals, expectations, and objectives, and/or anticipated financial performance.

These statements are neither promises or guarantees and involve known and unknown risks, uncertainties, and other important factors that may cause results, performance, or achievements to be materially different from any future results, performance, or achievements expressed or implied by the forward-looking statements.

Risk factors and other items discussed in our Annual Report on Form 10-K for the year ended September 30, 2023, and our other filings with the Securities and Exchange Commission could cause actual results to differ materially from those indicated by the forward-looking statements made today.

Any such forward-looking statements represent management's estimates as of date of this call Tuesday, August 6, 2024. While we may elect to update forward-looking statements at some point in the future, we disclaim any obligation to do so. Even subsequent events cause expectations to change.

In addition, we may also reference certain non-GAAP measures on the call today including adjusted EBITDA, adjusted operating income, or adjusted earnings per share -- all of which are reconciled to the nearest GAAP measure in the company's earnings press release, which you can find in our Investor Relations section of the website.

Joining me on the call today is Dan Fachner, our Chief Executive Officer, along with Ken Plunk, our Chief Financial Officer.

Following management's prepared remarks, we will open the call for a question and answer session.

With that, I would now like to turn the call over to Mr. Dan Fachner.

Please go ahead, Dan.

Daniel Fachner^ Thank you, Noberto. Good morning, everyone. And thank you for joining us today. J&J Snack Foods delivered an excellent third quarter, building on our strong momentum from the first half of the year.

I'm so proud of the J&J team and employees who continue to execute our strategy while delivering consistent results. These results continue to validate that the investments we have made and the strategies that we have implemented are having a positive impact on the sales and earnings power of our business, and it's positioning J&J to win in what remains a dynamic consumer and operating environment.

To further illustrate our success, I will share a few highlights from the quarter, followed by a review of our sales performance and operations.

Our record third quarter net sales of $440 million marked the second highest quarterly net sales performance in our company's 53-year history. This impressive result was led by strong sales in our Food Service and Retail segments, offset by temporary challenges in the Frozen Beverages, which were impacted by softer sales in the theater channel.

Our ability to grow the top line 3.3%, while maintaining a healthy 33.6% gross margin, underscores the strength of our strategy, led by improved operating efficiencies and a balanced and diverse portfolio of products, brands, and customer channels.

We continued our trends of growing profits faster than sales, with the third quarter operating income and net earnings growth of 3.8%.

This resulted in a record high quarterly earnings per diluted share in the quarter. Ken will provide more insights into our financial performance in just a few minutes.

Our strategies to leverage innovation and cross-selling opportunities to expand placements of our core products and brands continue to deliver positive results. Taking a closer look at our sales performance, third quarter net sales growth was driven by higher volumes across most of our core products and brands, as well as strong business performance in our Food Service and Retail segments.

As we had anticipated, production delays related to the 2023 actors' strike had a negative effect on this quarter's film slate as compared to last year, especially in April and May.

The theater industry reported declines in attendance during the quarter of approximately 30%, which impacted fiscal third quarter sales of frozen beverages, soft pretzels, and churros.

We estimate that these temporary challenges impacted sales by approximately $7 million compared to the same period last year.

While the sales in theater channel declined in the third quarter, I do want to highlight the impact of great movie releases in the market and why we remain so confident in growing sales in this channel. The opening of Inside Out two in mid-June created momentum as we closed the quarter, resulting in a record month of frozen beverage sales with gallons up 4% and overall sales increase of 6% compared to last year.

Inside Out two was the first of several strong releases planned for Q4 and the remainder of the year.

This momentum should also benefit our Dippin' Dots business as they complete the rollout to AMC, Cinemark, and Marcus Theatres over the next few months.

Looking ahead, our movie theater customers as well as industry observers expect box office and attendance trends to begin to recover in the second half of calendar 2024. These positive trends are expected to continue into calendar 2025 with a greater number of titles including a diverse offering of proven franchise films and highly anticipated new titles.

As a result, we expect sales of our products and brands to significantly improve in this channel as attendance trends recover. Moving on to our segments.

In Food Service, frozen novelty sales increased 9.1%, led by the continued growth of Dippin' Dots, which increased 5.3%. Bakery sales increased 6.8%, driven by unit volume growth in cookies, new products, encouraging Thinsters results, and expanded customer placements.

In addition, we saw a meaningful improvement in the handheld sales, up 25.3%.

Overall, Food Service segment sales grew 3.7%, with the increase in these product categories, partially offset by softness in soft pretzels and churros due to the previously mentioned challenges in the theater.

We continue to see strong growth in churros, with the third largest QSR, and remain confident in this opportunity going forward.

Moving to Retail.

We experienced broad-based growth across nearly all of our product categories, resulting in a 12.4% increase in sales for the quarter. Handhelds grew approximately 70%, driven by expanded placements with a major mass merchant.

Frozen novelty sales increased 11%, led by growth of LUIGI's, ICEE Tubes, and DOGSTERS, which was driven by unit volume growth and incremental placements in the club channel.

Soft pretzel sales increased 8.2%, led by our continued expansion of SUPERPRETZEL products, largely reflecting strong demand for SUPERPRETZEL Bavarian sticks.

Biscuit sales were down slightly in the quarter. The Frozen Beverage segment declined 2.6% for the quarter, driven by the previously discussed softness in the theater channel.

Frozen beverages decreased 1.1%, due to a 6% drop in gallons.

However, gallons increased 3% in Q3, excluding the impact of theaters. Let me just say that one more time.

Gallons increased 3% in Q3, excluding the impact of theaters, driven by strong performance in mass merchandisers, amusement, and QSR.

We continue to diversify our customer portfolio, finding growth opportunities in channels like QSR.

In fact, we are very encouraged with the current test at KFC that was recently highlighted on Good Afternoon Kentucky, as they market this new program and new flavors like Sweet Lightning and Blackberry Lemonade in the local Lexington market. Repair and maintenance revenues decreased 1.6%, reflecting lower preventative maintenance call volumes. Machine sales, while exceeding our internal budget for the quarter, were down 15.4%, as we lapped a large QSR rollout from last year.

Let me quickly highlight a couple of other important focus areas, as we continue to cross-sell our brands and products across channels.

Starting with SUPERPRETZEL. This iconic brand is outperforming the snack category and continues to provide opportunities for growth, new product extensions, or new points of sale.

We are expanding across retail, led by the launch of Bavarian Sticks, which remains the #2 seller in the SUPERPRETZEL portfolio, reaching an ACV now of 28% and growing.

I'm so pleased with the incremental distribution we are achieving with leading retailers.

In late fiscal Q4, we expect to double our store count with a major grocery retailer under the SUPERPRETZEL and Auntie Anne's brands. Let's talk about Dippin' Dots.

Summer promotions are underway with Regal and Chuck E. Cheese, resulting in higher volumes and increased brand awareness.

We also continue to roll out Dippin' Dots at AMC, Cinemark, and Marcus Theatres, with expectations to be in approximately 930 locations by the end of the calendar year.

Currently, we have installed Dippin' Dots at 176 AMC locations, 134 Cinemark locations, and 51 Marcus locations.

Also we are actively testing new opportunities with convenience store customers and will be installing freezers in approximately 230 locations with a major Food Service customer.

We remain confident in our plans to expand Dippin' Dots across customers and channels.

I'd like to spend some time highlighting the significant impact of our operational investments over the last couple of years. The investments we have made in manufacturing and distribution capabilities are resulting in improvements across key efficiency metrics.

Starting with our supply chain strategy. All three RDCs are exceeding expectations and will enable us to continue driving productivity improvements.

At this time, 85% of our sales orders are shipped from the new distribution network versus only 26% a year ago, with the average length of haul decreasing by 38%, and on-time performance improving to over 82% versus 73% a year ago. Line haul cost per pound decreased 17% compared to the same quarter last year in our snack food business.

We have reduced the number of cold storage locations to 10, driving efficiencies in how we ship products and reducing transfers across our network by 9%.

Shifting to operations. The addition of six new production lines has significantly expanded our capacity. This has enabled added efficiency and given us the ability to meet growth opportunities across our core products such as pretzels, churros, and frozen novelties. The expanded capacity has created production efficiencies and higher output metrics through better automation, which improves product margins, decrease in overtime, and provides the flexibility to respond to new sales opportunities.

Fill rates have reached 98.5%, a high point for [J&J] business, and high relative to the overall industry trend.

Finally, as many of you likely saw in our 8-K filing, our CFO, Ken Plunk^ , will be retiring at the end of this calendar year. The company will be conducting a thorough search process to identify a successor and to ensure a smooth transition. Ken's been a great partner and leader to both me and the organization.

I want to thank Ken for his help and support as we transformed the business over these past four years. The entire J&J team, the Board of Directors, and I wish him and his family the very best in his new chapter of his life.

Thank you, Ken.

In summary, I am pleased with our ability to post record third quarter sales and profits while managing through continued challenges in the consumer environment.

I'm so proud of how the J&J team continues to execute on our growth agenda.

While we expect our 2024 fiscal fourth quarter results to be impacted by one less sales week versus the comparable prior year period, it is clear that our strategies to maximize sales across our customer channels and improve operating efficiencies are working.

We have a strong portfolio of beloved products and brands with tremendous growth opportunities ahead of us, and we remain confident in our ability to deliver long-term value to our employees, our partners, and our shareholders.

With that, I would now like to pass the call over to Ken to review our financial performance in more detail. Ken?

Ken Plunk^ Thank you, Dan. And good morning, everyone.

I will start by saying that it has been a tremendous honor to serve as CFO for J&J Snack Foods, and I am truly blessed to have worked alongside Dan and his amazing team to improve and grow this business.

I'm proud of the finance and IT organization that we have developed over the last four years and confident that the foundation is set to continue delivering strong financial discipline, business performance, and system capabilities. Turning to our results.

I am pleased with our ability to deliver strong performance for the quarter including record fiscal third quarter net sales.

This, combined with gross margins of 33.6%, contributed to significant profit growth and profits growing faster than sales. Net sales for the quarter totaled $440 million, an increase of 3.3% versus the prior year.

As Dan mentioned, top line performance was led by higher volumes and new business performance in our Food Service and Retail segments, more than offsetting softer sales in our Frozen Beverages segment.

Food Service, our largest segment, saw sales increase 3.7% to $264 million. Handheld sales increased 25.3% to over $21 million.

Bakery and frozen novelties increased 6.8% and 9.1%, respectively, driven by unit volume growth in cookies and a 5.3% increase in Dippin' Dots sales. Growth across the segment was offset by a decrease in soft pretzels and churros sales of 6.3% and 0.7%, respectively, driven primarily by the challenges in our theater channel that Dan referenced earlier.

In addition, sales of new products and added placement with new customers totaled approximately $6.4 million, driven primarily by the addition of churros to the menu of a major QSR customer. This led to third quarter operating income of $20.2 million, a decrease of 2.6% versus the prior year period, reflecting a less favorable sales mix. Moving to our Retail segment.

Q3 '24 retail sales totaled $68.7 million, or an increase of 12.4%, driven by handheld sales growth of 69.9% as we expanded product placement with a major mass merchant.

In addition, frozen novelty sales increased 10.9%, led by the growth of LUIGI's, ICEE Novelties, DOGSTERS, and an overall higher shipment as customers added inventory for the peak spring and summer seasons.

Soft pretzel sales increased 8.2%, led by a continued expansion of SUPERPRETZEL products in retail, while biscuit sales decreased 5.8% in the quarter.

We also benefited from new product innovation and customer placement in this segment of approximately $3.1 million in the quarter. This was largely the result of the SUPERPRETZEL Bavarian sticks launched earlier in the year into the Retail segment.

We expect continued growth of this product as a major retailer expands placement in the fourth quarter. This led to an operating income of $7.8 million, or an increase of $3.6 million versus the prior year period, reflecting the improved sales, product mix, and higher gross margin.

As it relates to our third segment, Frozen Beverages, sales were $106.8 million, a 2.6% decrease compared to a record Q3 2023. Beverage sales were down 1.1%, or approximately $800,000 below prior years, reflecting weakness in the theater customer channel.

Overall gallons sold declined 6% in the quarter, but did increase 3%, excluding the impact of the theater channel.

And this was led by growth in amusement, convenience, and mass merchandisers.

As Dan mentioned, we expect volumes to experience a significant improvement in the back half of the calendar year, given the stronger schedule of film releases. Apparent maintenance revenues also decreased by 1.6% as we saw lower preventive maintenance call volumes. Machine sales were down 15.4% as we lapped a significant customer rollout from last year. This led to operating income of $22.1 million compared to Q3 '23 operating income of $23.3 million, with the decrease driven by weaker top line sales.

Our investments and initiatives over the last two years to enhance profit margins and drive efficiency across our business are proving to be successful.

For the quarter, gross profit totaled $147.8 million, a 3.4% increase compared to Q3 2023. This led to a gross margin of 33.6%, flat versus prior year, despite a less favorable sales mix.

We remain confident in our ability to deliver strong and consistent profit margins and expect to achieve gross margin of 30% or better for the full year.

As it relates to inflation across our portfolio of raw materials, we saw net low-mid-single-digit inflation increases, with the net increase primarily driven by increases in the cost of cocoa/chocolate and, to a lesser extent, increases in the cost of sugar and sweeteners.

Those increases were somewhat offset by deflationary trends seen in flour, cheese, dairy mixes, and eggs. Pricing adjustments and contractual cost true-ups helped minimize the majority of the impact on our gross margins in the quarter.

Our procurement team continues to effectively manage [supply and costs].

We are well-positioned to respond to any impacts.

Looking at expenses, total operating expenses increased $3.1 million, or 3.2%, representing 22.2% of sales for the quarter, flat with the prior year.

Distribution costs were 10.2% of sales in the quarter compared to 10.4% in the prior year period, as the investments we have made to increase efficiency across our distribution network and supply chain continue to drive expense savings. Marketing and selling expenses were 7.4% of sales, flat versus the prior period, as we continue to invest in our product innovation, brand promotions, and new selling opportunities. Administrative expenses were 4.5% of sales in Q3 '24 compared to 4.4% in Q3 '23. This led to operating income of $50.1 million, or a 3.8% increase, compared to $48.3 million in Q3 '23. Adjusted operating income was $53.1 million, or a 3.9% increase compared to Q3 '23.

After the impact of income taxes of $14.1 million, compared to $12.6 million in the comparable prior year, net earnings increased 3.8% to $36.3 million, resulting in record quarterly earnings per diluted share of $1.87 compared to $1.81 in the prior year period. Adjusted earnings per diluted share were $1.98 for the quarter compared to $1.92 in the prior year period. Adjusted EBITDA increased 6.3% to $70.9 million from $66.6 million in the prior year period, and our effective tax rate was 27.9% in the third quarter.

Looking at our liquidity position, we continue to have a healthy balance sheet and overall strong liquidity, with $64 million in cash and approximately $12 million in debt.

Our ability to improve cash flow through working capital initiatives and stronger profitability is generating more cash to pay down debt, pay dividends, and continue investing in our business.

Our focus will continue to be on maintaining a healthy balance sheet and prudent leverage position, which enables us to continue investing in the growth of our business and returning value to our shareholders.

In addition, we have ample availability under our revolver of approximately $203 million and additional borrowing capacity. To sum it all up, while we recognize there's still much work to be done to capture the vast opportunities in front of us, we are encouraged by our results to [improve] every aspect of how we do business.

We are confident that the power of our brand portfolio and the unwavering dedication of our employees will continue to deliver strong results and added value for our shareholders.

I would now like to turn the call over to the operator for Q&A.

Operator?

QUESTIONS AND ANSWERS

Operator^ (Operator Instructions) Our first question comes from the line of Todd Brooks with The Benchmark Company.

Todd Brooks^ Nice results in the quarter here, absorbing some of that pressure in the theater channel.

First question is on that theater channel, and I think this might be helpful for all of us.

Can you size, if you think about Food Service and Frozen Beverage, what percentage of each of those segments is made up by the theater channel?

Daniel Fachner^ We don't have that exact number on the Food Service side.

We know on the Beverage side, it's about 25% of the ICEE beverage sales. The Food Service side is much less than that but growing.

It's a nice piece of business for us that continues to grow, and we've even added some people from a company standpoint into that group to try to energize it.

Todd Brooks^ Secondly, the churro's success with Subway has obviously been a great story.

I look at that sidekick line, and I see three products that J&J would be well-suited to make, not just the churros.

Have you had any luck making inroads with either the cookie offering there or the soft pretzel offering?

Daniel Fachner^ We've built a really nice relationship with that company through this program that they have. Both that and their buying arm, we've built a great relationship.

We're continuing to have conversations and absolutely believe that in the future, we'll have the opportunity to be making some of those products or some others. There's some nice opportunities for us coming.

Todd Brooks^ And then a final one, and you touched on the KFC test a little bit, Dan, but was just wondering if you look forward a couple of calendar quarters here, what we're seeing either on the new product launch side, the distribution side, or maybe some tests that are out there that can help you continue -- you drove, I think, almost a little over $9 million in revenues from new placements and new products, which is great to see.

I'm just wondering what you can share with us in the go-forward look for what may continue to drive that.

Daniel Fachner^ I'm not sure I can share some names, but I will tell you we have a tremendous pipeline.

In Retail, we've got a couple of things that are really strong for us, and a lot of customers expanding the distribution.

On the Food Service side, we've talked about this in the past, whenever a particular customer like Subway comes out with a churro product, there's lots of others who are watching that. And so we have some tests in play that some will even kick in before the year's end with some other large organizations out there that we'll see continue to grow. And so really happy there.

The bakery side, as you watch those numbers, we've got some good things in some private label areas that we're continuing to grow that we're happy about. And then just the ICEE with the KFC, as you mentioned, that's a really big opportunity for us. And so far, that test has gone extremely well with a lot of press around it, a lot of people, a lot of attention to it.

So I love our pipeline right now.

I think we've got a really good chance of having a really strong 2025.

Operator^ Our next question comes from the line of Connor Rattigan with Consumer Edge.

Connor Rattigan^ Yes. So you guys called out the weakness in Frozen Beverages, driven by the theater channel.

So I'm curious, could you guys maybe share how trends looked across the other channels to maybe give us a better sense of relative performance across those channels? Like, was performance relatively even outside the theaters, or was there may be quite a bit of volatility by channel?

Daniel Fachner^ Well, we were up in volume in most of all of our big brands and products.

It was a pretty good quarter overall for us. And I mentioned this in my opening, even inside the beverage side of our business, inside ICEE, if you took the theater channel out, we would have been up by 3%. And so overall, a pretty good quarter with all of our products, and we're seeing some nice growth.

Ken Plunk^ Yes, Connor, we were purposeful in making that comment about what the gallon increase was without theaters.

So that tells you amusement was up, QSR was up, mass merchandise was up as it relates to Frozen Beverages.

So again, this was really a tale of particularly in April and May where the theater industry was as related to releases, and you can read pretty much any publication from any of the theater companies, and you'll see that.

Outside of that, really, really good quarter for us on that side of the business.

Connor Rattigan^ Awesome. So also in the press release, you guys noticed some strength in amusement parks, specifically with Dippin' Dots.

So I'm curious, what did you guys really see as the driver there? Was it just strong summer seasonal traffic? Maybe was there some pricing, distribution gains?

Any color on that would be great.

Daniel Fachner^ Our teams do a great job, Connor, of getting into the amusement park industry and making sure we're well positioned when the season comes. And the Dippin' Dots team really excels in that area.

In fact, I toured one of our amusement parks last week with a group of leaders, and the Dippin' Dots presentation across that Six Flags Park was tremendous. They just do a really good job making sure we're positioned right, making sure that it's marketed appropriately.

It certainly helps when you have a nice warm summer, and we're having that.

But that industry seems to be doing really well in all facets of our business right now.

Connor Rattigan^ Awesome. And then just one last quick follow-up.

So you guys had previously mentioned that about 80% of your product was flowing through the new RDC system.

I'm not sure if I missed it, but did that pick up a little bit during the quarter?

Ken Plunk^ I think it picked up, I want to say, Connor, maybe 200 basis points.

I think, again, doing this on memory, I want to think Q2 was around 78%.

So yes, it ticked up somewhat from Q2.

Operator^ Our next question comes from the line of Jon Andersen with William Blair.

Jon Andersen^ And Ken, thanks for your help the past few years, and best to you in your retirement down the road.

Ken Plunk^ Thank you, Jon.

Jon Andersen^ Yes. You bet.

I guess I wanted to first ask just a big picture question around the consumer, what you're seeing in terms of any macro impacts on your business relative to the consumer. Are they exhibiting more value-seeking behavior, or any channel shift you're seeing across the various channels that you serve that suggest either the consumer remains healthy or you're seeing some pockets of weakness?

Daniel Fachner^ Jon, we talked a lot about this, and I used this term last quarter, and I'd probably use it the same again today.

I still think the consumer is a little fickle. I think they react to what has been said in the media.

I think even over the last 24 hours, we saw stocks plummet and then come back up. And I think when you don't -- you expected some interest rate drop last week and that didn't happen, the consumer reacts to that.

I think what we see still is somewhat of a tale of two cities, right? I think the low-end consumer still is under pressure in a lot of ways, and they're cautious, and they're careful about how they spend. And then I think we see the opposite end of that spectrum where they're looking for premium or [experiential] environment to be able to spend on things. And I think it's still a fickle customer, and I think it probably will remain that at least during this period of time as we're going through an election.

So we're going to have to watch that really close, right?

I think they're discerning on where they spend their money.

Jon Andersen^ Makes sense. So if you stripped out the theater channel this quarter, it looks like your sales would have been up about 5%.

I think historically that has been an area that I think the company has grown organically.

Is that a reasonable a mid-single-digit organic growth rate expectation, a reasonable way to think about the business as you look to not just the fourth quarter, but fiscal 2025, like you've got a lot of great tests in the works, you've got some good new products that are expanding distribution, just a lot of cross-selling stuff that's working.

So trying to get a better sense for how that all rolls up and do a top line view here.

Daniel Fachner^ Jon, I think that's a really good way to look at it.

We are working really hard to be right in that mid-single-digit growth year over year. And I think we're well-positioned for that in the future. And you mentioned the theaters, and I just want to highlight the impact of what good movie releases can do for us.

So theater industry really struggled in April, struggled in May, and struggled most of June.

But we get into the back half of June, and we get a couple really good movie releases out there. And we just catapult our sales, so much that ICEE ends up having a record month of June, right? And so what we're encouraged by is that we can continue what we've talked about with the new product releases and the new distributions and seeing the growth in our core products. And then you get the theater business to come back, which all indications look like it will in back half of '24.

I think what I heard is they have 10 big movies.

Only four of them have been released so far.

So we got six of them in the back half of the year. And then 2025, a great lineup. All of that combined, we feel pretty well-positioned to be in that mid-single-digit growth for the future.

Jon Andersen^ That's helpful. And I guess following on that, is it fair to say that because your products that you're selling in theaters are some of the core brands, that's a margin-accretive part of your business as well?

Daniel Fachner^ Yes, absolutely. And we're growing with the Dippin' Dots side of that with AMC, Cinemark, and Marcus Theatres, and a couple other regional chains. And as you know the margins through Dippin' Dots are really healthy.

Ken Plunk^ I was just going to add, and we stated this in Dan's script, but a really big deal. When we add over 900 theaters between now and the end of the year for Dippin' Dots, that's going to be a really nice business. And then, obviously be accretive to margins as we go into those winter months.

So that's another reason we feel optimistic as we head into the end of the year and into next year.

Jon Andersen^ That's helpful.

Also ties into my last question. You reaffirmed the outlook for gross margin this year to be above 30%, which I think was an interim target for you at one point.

Assuming you deliver on that this fiscal year and the work that you've done from an operational perspective, a productivity perspective, and again, centering your investments around some of the core higher margin parts of your business, have you given any thought to what gross margin might look like longer term?

Ken Plunk^ Yes. I think, Dan and I both talked last quarter, we have a desire, and this won't be next year, it may even be two, three years down the road, to get us up close to that mid-30s range.

But as we focus on building plans where profits go faster themselves, and obviously, gross profit's going to play a big role in that, we expect to keep inching that number up. And some of that will be based on focusing on really driving the core growth of those products that you mentioned earlier, and then improving the margins of our lower-margin business, which we've really made nice progress in a couple of those areas this year.

But that's where we're headed.

I feel good about where we're going to land for this fiscal year, given the first three quarters, and I think that will build from there.

Operator^ Our next question comes to the line of Andrew Wolf with CL King.

Andrew Wolf^ I also wanted to ask about the gross margin. Just back of the envelope, looks like if the $7 million of movie theater business had come, the gross margin would have expanded, I don't know 10 to 20 basis points, something in that range.

Is that reasonable --

Ken Plunk^ Yes. That's a good estimate, Andrew.

Andrew Wolf^ Okay. The other thing I wanted to ask about gross margin was just pricing power.

Some of the big retailers, their customers are hurting, at least a lot of them, and they're mass marketers, so they have everybody. And inflation for you, I guess, is running, you said, low- to mid-single digits on the ingredient side.

Obviously, there's an offset with your productivity improvements.

But what do you feel about pricing power? There's contractual things, I think, certainly in Food Service, but maybe in Retail, and just in general, just the ability to pass through, not to try to get margin out of price, but just to make yourself [wholes] on the production side.

Daniel Fachner^ Well, it's a great question.

I think you have to be really careful with pricing during this environment that we're in.

As you talked about, we do have some contractual things that we're able to pass on, and we're able to do that with rise in cocoa or chocolate. And then you have to earn pricing outside of that, right. We have to be really careful about where we price and how we price and making sure that we have earned that price increase.

Our new three RDCs and the efficiencies that we're gaining there, and the new capacity that we have, and making sure that we're delivering to customers on time and efficiently, allow us to be able to earn some of that.

But we're going to have to be really careful how we price that on.

I think, like I said, we were able to do that with chocolate, and we'll watch any other of those key items in the future to make sure that we're being diligent and disciplined about how we do it.

Andrew Wolf^ Okay. And the last thing, since you mentioned Thinsters, is there an opportunity for a quite small brand like that to actually get some meaningful distribution, given your relationships --

Daniel Fachner^ We love the product. Yes. We love the product.

Andrew Wolf^ (inaudible) M&A strategy, or do you need bigger brands like a Dippin' Dots when it comes to M&A?

Daniel Fachner^ Well I'd love to find bigger brands.

We've talked about that all along, but Thinsters was such an easy acquisition to make because it's such a great product and very well-recepted, and we believe that we do have an opportunity to grow that.

I don't know how big that can be, but our teams are really excited about out there and represent it and growing it, and we see some opportunities in the short-term with it.

We'll continue to look for larger ones like Dippin' Dots, but it doesn't mean we won't look for something like this that's easy to strap on and grow.

Operator^ Our last question comes from the line of Robert Dickerson with Jefferies.

Robert Dickerson^ Just a couple quick clarification questions, a little perspective.

I guess just in the Retail segment, op margin was around that 11% level.

We have seen some decent volatility in the past few years in that segment.

I'm assuming that was more cost/price related.

If we think about the 11%-ish in Q3, are we back on track to get to a more normalized standard run rate going forward, or are there puts and takes, et cetera?

Ken Plunk^ Yes. No, Rob, that's a great question.

I do think we're back on track.

I'm not going to commit to 11% every quarter, but I think much more in that range.

I think we've finally gotten things dialed in as it relates to how we manage margin in those retail products.

We're moving and growing more in those higher cores, frozen novelties, soft pretzels.

As long as we do that, that's going to mix out much better than it was a few quarters ago or a couple of years ago.

So I do think this is more realistic to what we ought to be able to do there versus, say, a year or so ago.

Robert Dickerson^ Fair enough. It seems more realistic.

Okay. And then I guess just a broader question on the margin mix vis-a-vis new distribution.

I heard you say, got more distribution to mass retailer.

I think there's more distribution coming, more stores from a bigger grocer.

We talk about Subway; you got the KFC launch potentially coming at some point.

As you enter those new stores, let's just take KFC as an example, let's say, okay. We're in two stores now and then we go to 100, and maybe we go to 500, whatever it is. And this would be, I guess, a similar dynamic on Dippin' Dots.

Once you're in, let's say, a movie theater or KFC with those products, is that just you get your normal margin rate on that product and that dollar per product from the start?

Or is there scalability in this business? It seems like there usually is, but I'm asking because I'm not really sure if there is. Maybe it's just day 1, that's what we get. And yes, the more we sell the more profit we make.

Or the more you sell in movie theaters or KFC or Subway or what have you, you actually are getting incremental volume leverage and scalability benefits in the overall business.

Daniel Fachner^ Boy, it's a really good question. Anytime you have volume, you do get some scalability. You're talking about a couple of areas that are a little bit different when you're talking about ICEE or Dippin' Dots.

It's not quite the same thing, but if you're growing Dippin' Dots, and you're able to produce more products, you're getting some scalability inside that plant where we produce it.

So you do get some advantages there.

On the ICEE side, we're always very, very conscious what the cost is there typically is the piece of equipment. And so, you get some scalability around buying large numbers of pieces of equipment, and hopefully, you're able to be careful about how many people you have to hire to take care of that business. And so, there's some scalability that happens there, but it's not quite the same as in a manufacturing plant.

I hope that answers your question.

It's a little bit different of a question, but the answer is, yes, there is some scalability, but maybe not as sizable as you might think.

Robert Dickerson^ Okay. Yes. And Dan, I'm also asking because look, clearly you don't provide long-term guidance, right? But you've spent a lot of money on the efficiency side that gives you a lot of benefits. And then I'm also hearing, we're also getting a lot of distribution across pretty much all channels, at least, all major channels.

Daniel Fachner^ Really are, yes.

Robert Dickerson^ And then there's like a volume-led story, right? So usually what follows is a margin expansion story, we just don't have a slide that's showing us that.

So it seems like that's clearly the idea here. Is that fair?

Daniel Fachner^ It is. And it falls right into what I talked about with the RDCs and the efficiencies that we're gaining from that. And if you think about the Dippin' Dots side, we caught those RDCs early enough to be able to build a box inside a box. And maybe we're even a little bit ahead of ourselves.

We knew that was something that needed to happen to be able to grow that piece of business.

And now we're growing into that box in a box, which will help us gain some efficiencies in the go-forward.

Ken Plunk^ Yes. Rob, these are all pieces in our ability and confidence to continue to move that gross margin number up.

As we grow volume in these areas, leverage automation, that's going to create bits of efficiency that grab basis points in margin that should help us evolve to a higher gross margin rate over the next two, three years.

Operator^ Thank you.

I'm showing no further questions at this time and would now like to turn it back to Dan Fachner for closing remarks. Go ahead.

Daniel Fachner^ Thank you, Operator.

In closing, we remain extremely confident in our path forward and in our ability to continue to execute at a high level.

We are building a culture that emphasizes improving every aspect of our business in order to leverage the opportunities in front of us, as well as to create some new opportunities of our own.

We look forward to updating you on our progress later this fall.

In the interim, should you have any questions or wish to speak to us, please contact our Investor Relations firm, JCIR, at 212-835-8500.

Thank you.

And have a great morning.

Operator^ Thank you for your participation in today's conference. This does conclude the program.

And you may now disconnect.