J&J Snack Foods (First Quarter Conference Call)

February 06, 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:

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

PRESENTATION

Operator^ Thank you for standing by. And welcome to J&J Snack Foods Fiscal 2024 First Quarter Conference Call. (Operator Instructions) I would now like to hand the call over to Norberto Aja, Investor Relations. Please go ahead.

Norberto Aja^ Thank you, Operator. And good morning, everyone. Thank you for joining J&J Snack Foods' fiscal 2024 first quarter conference call. We will start in just a minute with the management's comments and your questions.

But before doing so, let me take a minute to read the safe harbor language. This call contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995.

As such, 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 our anticipated financial performance.

These statements are neither promises nor guarantees that 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.

Factors discussed in our annual report on Form 10-K for the year ended September 30, 2023 -- and there are other filings with the Securities and Exchange Commission -- could cause actual results to differ materially from those indicated by the forward-looking statements made on this call today.

Any such forward-looking statements represents management's estimates as of the date of this call, February 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 if subsequent events cause expectations to change.

In addition, we may also reference certain non-GAAP measures on the call today, including adjusted EBITDA, operating income or earnings per share, all of which are reconciled to the nearest GAAP measure in the company's earnings press release, which can be found in our Investor Relations section of our 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 go ahead and open the call for a question-and-answer session. With that, I would now like to turn the call over to Mr. Dan Fachner, J&J Snack Foods' Chief Executive Officer. Please go ahead, Dan.

Daniel Fachner^ Thank you, Norberto. And good morning, everyone. We appreciate you joining us this morning to discuss J&J Snack Foods fiscal 2024 first quarter results. I am pleased with our ability to successfully manage through a challenging consumer environment with many of our customers experiencing year-over-year declines in consumer traffic and consumption.

Our customers adapted to consumer trends by reducing inventories ahead of the holiday season, especially in product categories like pies, cookies and frozen novelties. I am proud of how the J&J team leveraged our iconic brands and incremental customer opportunities to maximize every sales opportunity in the first quarter. This resulted in a sales decline of just under 1%, largely in line with the trends in the overall industry.

While we experienced a 4.1% decline in sales across our Food Service segment, driven by softness in our bakery, we saw resilience in Retail and continued strong growth in Frozen Beverages as sales grew 1.6% and 8.5%, respectively. Our ongoing focus on gross margin expansion resulted in a 130 basis points improvement to 27.2%, driven by our strategy to grow higher-margin core products as well as continued gains in overall productivity.

Importantly, the success of our strategic initiatives is becoming increasingly visible. Despite softer sales, we delivered a meaningful year-over-year improvement in the overall profitability of the business, including a 20.6% increase in adjusted operating income and a 19.2% increase in adjusted EBITDA.

I'd like to take a few minutes talking about our sales performance in the quarter. We have never been more confident in our ability to grow even as our industry faces a more challenging consumer environment.

For J&J, it's about continuing to leverage innovation and cross-selling opportunities to expand placements of our core products and brands. Our business is gaining incremental opportunities and is well positioned as consumption trends improve. Here are a few insights into the performance of our core brands and products during the first quarter.

In our Retail segment, sales of our soft pretzel products increased 27.4% compared to the prior year. Bavarian sticks, a new product launched late in fiscal 2023 is now the number two best seller in the super pretzel retail product portfolio. We also gained incremental items within our Super Pretzel portfolio across major retailers, including Publix, Stop & Shop and Woodman's to name a few. Moving to soft pretzels in our Food Service segment. Sales declined 4%, primarily driven by soft traffic trends in key channels.

However, the team did gain new business, including the launch of a super pretzel filled Jalapeno knot nationwide with a major theater customer and incremental sales gains in Pretzel bites and buns. Also several national fast casual chains are making pretzels a permanent part of their menu. We continued to gain market share this quarter compared to last year. Let's talk about churros. We continue to see strong momentum across the Food Service segment and remain excited about the growth opportunities.

The team successfully secured an opportunity with Subway to manufacture a Footlong Churro for all U.S. locations. This rollout began in the first quarter and is already exceeding expectations. We also began to roll out up churros with a major food distributor in September of 2023, and they have recently doubled their original order given the strong momentum. Finally, we are leveraging innovation with flavor extensions such as the recent launch of our Chocolate Filled Churro that is driving new sales opportunities.

Our iHola! Churros brand is also performing at or above expectations in the Retail segment. We expanded distribution at Wakefern, Schnucks, Giant-Landover and Grocers Supply and are awaiting feedback from additional retailers. Sales for Dippin' Dots, which is part of the Food Service segment, were slightly positive for the quarter, led by an approximate 3.5% increase in sales of our top 30 customers. This was, however, offset by some softness in the franchisee part of the business.

We continue to see growth opportunities for Dippin' Dots and are moving quickly to activate new business. Just this past quarter, we completed the rollout of Peter Piper Pizza extended our agreement with Chuck E. Cheese through 2027 and received a commitment from a convenience store customer for another 200 placements. In addition, we continue to expand across the theater channel with ongoing rollouts at Cinemark, commitments to install vending at 56 locations for Marcus Theatres and incremental tests at a third major theater chain. Moving to frozen beverages.

This segment posted an 8.5% increase in sales, led by the continued strength of ICEE. Overall, theater volume increased for the quarter compared to the prior year, but was below expectations due to lower performing movie releases and softer traffic.

Sales in Mexico, the amusement channel, mass merchandise retailers and restaurants increased for the quarter. The rollout of a new self-serve program for a major club customer is delivering strong results with over 100 locations converted to date with plans to continue rolling out locations in the second quarter. We also had a positive impact from our Trolls marketing campaign at major retail outlets such as Target as well as continued overall C-store channel strength.

Looking ahead, we are excited about a major QSR opportunity entering a test phase in Q2. Also we received a commitment from our partners at Dave & Buster's to roll out across to 150 locations by late April. As previously mentioned, Frozen novelties declined in the quarter as key customers reduced orders and inventory levels in this category.

This impacted our year-over-year sales growth for most of our key brands, but we continue to grow faster than the market in many areas. In fact, our Luigi's Italian Ice brand gained market share compared to top competitors during the quarter, and our team secured incremental retail shelf placements at additional grocery retailers.

Products like our ICEE branded novelty and Dogsters continue to perform well. I'm really excited about our Dogsters as it delivered strong results, outpacing the growth of our largest competitors. Dogsters also recently gained incremental shelf placements something we expect will continue as retailers reset later in 2024. We continue to see strong growth opportunities across our Frozen novelty portfolio as we approach peak season for spring and summer seasons. Finally, I'd like to talk about our bakery business.

For the quarter, bakery sales decreased 6.4%, driven entirely by the impact of reduced customer orders for pies and cookies during the holiday season. Many of our largest customers experienced lower traffic and moved the tighter management of inventory to manage through softer consumption trends.

Looking ahead, we are focused on product innovation that drives more profitable sales while we continue rationalizing lower-performing SKUs. This strategy is helping us improve bakery gross margins while identifying new selling opportunities. On the growth front, we recently secured new cookie opportunities with several customers, introduced cakeables and seasonal cookies across a handful of partners, and we are working on opportunities to launch Pretzel Croissants and SUPERPRETZEL Bavarian buns in the retail outlets across grocery, in-store bakery and convenience.

From an operational perspective, as we have mentioned on prior calls, we continue to execute initiatives to enhance overall operations and to better support our growth opportunities. Starting with our supply chain strategy. We have now opened two of the three distribution centers, Terrell, Texas and Woolwich, New Jersey. These two new DCs are exceeding expectations and will enable us to continue driving productivity improvements in our supply chain. We are scheduled to open the third DC in Glendale, Arizona, in the second quarter.

In fact, I think we're opening it this week. Shifting to operations. The addition of six new production lines gives us the capacity and flexibility to grow core products such as pretzels, churros and frozen novelties across new customers and channel opportunities.

These lines also create production efficiencies and higher output and metrics through better automation, which improves product margins and profitability. Our team is aligned and focused as we execute the five core strategies: grow and protect our brands, dominate core categories, cross-sell the portfolio, invest in our future and embrace our culture.

In closing, I want to thank our J&J employees for their unwavering commitment to establishing a winning culture and to their commitment to our partners and customers. The diverse nature of our business along with the power of our brands and the channel diversity of our products is something that we are confident will continue to serve us well in fiscal 2024 and beyond.

Our company has never been more aligned in its vision and strategy, and we are excited about the opportunities ahead of us to deliver long-term value to our employees, partners and 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. As Dan just discussed, we are pleased with our team's ability to navigate a softer consumer environment in fiscal Q1. For the quarter, we did experience a slight sales decline compared to the prior year, but were in line with overall industry trends. As Dan stated, we were executing our strategy, improving operational efficiency and profit margins and expanding growth opportunities across channels and customers. This helped balance declines in consumer traffic and consumption that impacted many of our customers.

Net sales for the quarter totaled $348.3 million, down 0.9% versus the prior year. Food Service, our largest segment saw sales decrease 4.1% to $228.6 million, primarily reflecting reduced inventories of pies and cookies among certain customers during the holiday season as well as a decline in handheld sales due to a contractual cost true-up agreement.

Bakery sales decreased 6.4% and handheld sales declined 6.5% in the quarter. Although volume sales for our core food service and handhelds did increase for the quarter. These declines were partially offset by our Churros category, which grew 8.9% as we continue to drive growth in this high-margin business.

Sales of soft pretzels and frozen novelties declined 4% and 3.3% in the quarter respectively, driven by the previously discussed consumer pressures. This led to Q1 '24 Food Service segment operating income of $6 million or a decrease of 5.8% versus the prior period. This reflects softer sales and onetime costs associated with the opening of our New Jersey distribution center, which impacted distribution expenses. Moving to our Retail segment. Q1 '24 retail sales increased 1.6% to $43.8 million compared to Q1 of '23.

Handheld sales grew by 90.5% while soft pretzel sales increased 27.4% led by our continued expansion of SUPERPRETZEL products into retail. Frozen novelties and biscuit sales declined 28.4% and 11.1%, respectively, versus the prior year period. This resulted in Q1 '24 Retail segment operating income of $0.5 million or a decrease of 59.3% versus the prior year period, driven by product mix, lower gross margin and the onetime costs associated with the opening of the New Jersey distribution center.

As it relates to our third segment, Frozen Beverages, sales were $75.9 million and beat Q1 of '23 sales by 8.5%. Beverage sales grew 8.5% or $3.3 million higher than Q1 '23, led by solid performance across key channels, including convenience, amusement parks, mass merchants and restaurants.

Machine service revenues increased 3.1% versus the prior year period while equipment sales increased 26.8%, driven by strong growth from the convenience in QSR channels. Q1 '24 operating income in the Frozen Beverage segment also improved $3.2 million, a 75.7% increase compared to Q1 of '23. Our focus on gross margin expansion through an improved mix of core products, more line pricing and cost of goods efficiencies is clearly benefiting our results. For the quarter, gross profit totaled $94.6 million, a 4.1% increase compared to Q1 of '23. This led to a gross margin of 27.2%, favorably compared to 25.9% in Q1 of '23.

Despite the softer consumer environment in fiscal Q1 '24, we remain confident in our plans to improve profit margins and expect to achieve gross margin of 30% or better for the full year. Overall, we experienced slight inflation for the quarter. The cost of ingredients, including flour, oil, dairy and eggs have declined. However, this was offset by double-digit inflation in sugars, sweeteners, mixes, chocolate and meats, which continue to impact products such as frozen novelties and baked goods. Looking at expenses.

Total operating expenses increased $3.4 million or 4.1%, representing 24.4% of sales for the quarter compared to 23.2% in Q1 of '23. It is important to note that during the quarter, we incurred $2.2 million in onetime expenses, reflecting transition costs related to the October opening of our second distribution center in New Jersey.

This was a planned cost of our distribution network strategy and is expected to drive meaningful cost savings once we complete this initiative. Our third distribution center will open in Glendale, Arizona in the second quarter and will incur similar onetime transition costs. Distribution costs were 11.6% of sales in the quarter compared to 12% in the prior year period, even with the previously mentioned onetime transition costs.

The year-over-year improvement in distribution expense was already driven by more favorable inflationary environment and the benefits of our initiatives to improve logistics management and increase efficiency across our distribution network and supply chain. Marketing and selling expenses were 7.9% of sales versus 6.7% in the prior period, driven primarily by incremental promotional marketing support on core brands and new products.

Administrative expenses were 5.2% of sales in Q1 '24 compared to 4.7% in Q1 '23, attributable to investments in incremental resources as well as hosting our national sales meeting for the first time since the pandemic. This led to an operating income of $9.7 million or a 3.8% increase compared to $9.3 million in Q1 of 2023. Adjusted operating income was $13.5 million or a 20.6% increase compared to Q1 '23.

After the impact of income taxes of $2.6 million compared to $2.3 million in Q1 of fiscal '23, net earnings increased 9.8% to $7.3 million, resulting in reported earnings per share of $0.37 compared to $0.34 in the prior period -- prior year period. Adjusted diluted earnings per share was $0.52 per share for the quarter compared to $0.42 in the prior year period. Adjusted EBITDA increased 19.4% to $30.2 million from $25.3 million in the prior year period, and our effective tax rate was 26.6% in the first quarter.

Looking at our liquidity position, we continue to have a healthy balance sheet and overall strong liquidity position with $50 million in cash and approximately $7 million in debt. Our ability to improve cash flow through working capital initiatives and stronger profitability is generating more cash to pay down debt, raise 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 $208 million in additional borrowing capacity. In summary, we are executing our strategy and remain confident in our plans to continue driving profitable growth and value to our shareholders. I would now like to turn the call over to the operator for questions and answers. Thank you.

QUESTIONS AND ANSWERS

Operator^ (Operator Instructions) Our first question comes from the line of Andrew Wolf of CL King.

Andrew Wolf^ I wanted to ask about this contractual cost true-up with the handheld product. I guess it was the second quarter in a row. So first, is that kind of -- is that a normal thing that happens quarterly and because there's been such big swings in your cost -- input costs, it's worth calling out? Or is -- just what's the nature of that? Like how can we, on the outside, try to get a handle on how to model that and think about how that might occur going forward?

Daniel Fachner^ I'm doing great. It's a good question. It is a quarterly true-up. And we saw that as prices were -- our costs were going up, and we're seeing that as costs are coming down, we do it quarterly. Ken, do you want to add anything to that?

Ken Plunk^ Yes. It's a larger amount. The reason we call it out, Andrew, is because of the phenomenon of the last few years. So the cost in many areas two years, 18 months ago, up 20%, that obviously drove the opposite. And then as those commodities have had deflation, we've been trued up quarterly, and it's had the opposite effect, which is us passing and reducing that cost to that customer.

And therefore, that has an impact on sales and on profits for that area. But we should lap the significance of that probably in the next quarter, we should be lapping that, Andrew, but that's why that number has been as big as it's been.

Andrew Wolf^ Okay. And could you give us like the dollar amount, so we can at least think about what earnings would be on a kind of a commodity neutral basis? I realize it's real money, but...

Ken Plunk^ Yes. It's over $1 million -- closer to $1.5 million, Andrew.

Andrew Wolf^ Got it. And then I wanted to ask as a follow-up on the situation with Costco and the Churros, which at least according to the Internet. Costco is discontinuing materials and replacing them with cookie -- chocolate chip cookie. So wanted to confirm, is that accurate? And is that kind of going to be a firm impact you guys across Costco?

And what the timing of that would look like? And when you look at your relationship with Subway, is it where do you end up net-net in a year's time when those two events have matured, rolled out?

Daniel Fachner^ Yes, Andrew, this is Dan. That is a great question. Yes. The account has rotated and they've done that in the past. They will offer different things periodically throughout time. They have a limited SKU within their locations, and so they do a rotation that churro has rotated off the menu at this point.

That happened towards the end of December. And we saw some of the impact there. In regards to our Subway contract, we're really excited about that. It's a really good size opportunity for us, and it outweighs what we would potentially be losing at Costco, the Subway outweighs that just by the sheer numbers of locations, there's 20,000 to 21,000 Subways out there today and the product is being accepted really, really well. So we're excited about the growth in the churro business.

Operator^ Our next question comes from the line of Todd Brooks of the Benchmark Company.

Todd Brooks^ A couple of questions as well. Just want to ensure -- if we look at the fourth quarter sales results, was there any operational friction in there that cost us anything on the revenue line either around the new RDC coming up during the quarter or maybe some of the new lines ramping to full productivity? Or did the shortfall on the revenue side really just reflect softer end market demand?

Daniel Fachner^ Yes. No, Todd, it really did just reflect the softer market. And really, what we saw more than anything is inventories being tightened up across the board, not just with our customers, but with distributors as well. In fact, we have some data that would show really strong sales even during the month. When you look at IRI or Circana, but inventories certainly were narrowed down.

And so you could somewhere make that assumption that somewhere down the line, those inventories will come back into play. It won't happen in a January period or a February period, but it might happen as we get closer to spring. But the operational side did not affect sales going out in any way.

Todd Brooks^ That's good to hear. And Dan, you brought up January, February. Obviously, the data points to really kind of tough consumer traffic through the month of January here. And obviously, what's going on in California is not helping right now. How do we think about what you're hearing through the channel for just a slowdown in consumer traffic, whether they're digesting holiday spend, whether it's the Omicron lap from the prior year.

There's a bunch of different crosscurrents here. But what are you seeing in your end customer channels in Food Service?

Daniel Fachner^ Well, I think you're reading probably the same data we're reading as well. It's hard to come off a quarter like we just come off and not be concerned or cautious about what the future looks like. We're still very confident in our long-term strategy in what we're doing, and we're seeing that play out really well. And I think by the time that we close up the year, we'll have another strong year. But we're certainly cautious, and I think the consumer is cautious out there today.

A couple of things that I've read that are interesting that I think makes a lot of sense to me. One, I do think we pulled back on inventory, and so I believe that inventory will come back around. The second is just the price increases that we had at such a rapid rate caused what they call kind of like a food reference price that people are shopping out there and they see a higher price and they're waiting for that price to come back down. And until water kind of seeks its own level, and you get used to that pricing, we may see a little bit of a softness there. Overall, I think it's short-lived.

I don't know that for sure, but I think it's short-lived. I don't think that we can look at a January, February period of time and say, "Boy, that's what we're going to predict for the year." I feel really confident in the new business that we're generating and the play that the team is executing, and I feel very confident about our long-term play still.

Todd Brooks^ I think that's great. Sorry, go ahead.

Ken Plunk^ Sorry, if I could just give a bit more context on sales. Because I went back and kind of look back at it and we thought we were going to have the stronger quarter than we did, not really expecting some of the consumer softness. But when you look at the last two years, we're laying growth on top of a little over 10% growth a year ago Q1 and 32% growth two years ago, Q1.

So the foundation of what we're building growth on is on top of some really significant numbers. And a lot of that played out in post-COVID and supply chain, and you kind of know the story there, but to be able to have two segments to have positive sales growth on top of that in the environment that we saw in the quarter, we're actually pretty happy about it even as we continue to look at opportunities to continue to grow sales year-over-year.

Todd Brooks^ Great. And one more, and I'll jump back in queue. Dan, as you're looking forward into '24, you made the comment in the release you see building sales momentum for the balance of the fiscal year here. If we just put aside the consumer, the consumer is going to do what the consumer does, if you look at kind of new customer wins, cross-sell success, new product launches, what sort of growth rate did those three, if you're looking at the forward kind of pipeline deliver and then we can all adjust for what we think the macro is on the back end as you're thinking about fiscal '24?

Daniel Fachner^ Yes. I don't know if we have a number to give you on that growth rate, Todd. But I just kind of remind you of some of the exciting things that the team is generating. Love the Subway opportunity and the way that it's kicked off and how that's going and it might even lend to some additional opportunities for us there that we're working on as we speak today. Like the way that the iHola! Churro and Retail has kicked off.

The Bavarian sticks moving up into the number two position of what we sell, and we see that a little bit unlimited at this point. Like some of the things that the bakery is doing. We've continued to narrow the bakery and rationalize some of the SKUs, but I like some of the things that they have going on right now with our cakeables, which is a gourmet cookie and our seasonal cookies and working on sticks and buns in that area. We've talked about ICEE and now rolling out the Dave & Buster's. We've got a QSR that we're going to test this quarter that I'm really, really excited about.

The club store conversion to self-serve is working out great. We're going to escalate the way that we install that. Dippin' Dots growth in the theaters and convenience and just see a lot of the right things happening that can really impact our margins. And again, we talked about even on the operational side, the three DCs opening, the one in Glendale is actually opened yesterday. And so we're starting to see that take effect the new lines doing well as we fill those up, just really encouraged by what the future looks like.

Operator^ Our next question comes from the line of David Shakno of William Blair.

David Shakno^ This is David Shakno stepping in for Jon Andersen. Can you talk about price and volume a little bit. If I recall from the last call, you mentioned you were looking at some areas to take pricing in calendar '24? And then I just wanted to understand also how you're looking at volumes for the balance of the year?

Ken Plunk^ Yes. Well, what I can tell you, volume for the quarter, again, it can vary somewhat a little bit depending on the business and channel, but Overall, volume was down 1% to 2%, depending on what area of business you're in.

Again, I think kind of speaks to some of the things that we talked about, David, with the consumer. So if you just kind of look at that number against where we landed at negative 0.9%, you can kind of get some idea of the price benefit overall for the company. As you look forward, we did take a price increase in January in our ICEE business.

We took a price increase in Dippin' Dots in January or December as well. And then on the snack food side, you got a lot of -- you've got some commodities with deflation, you got some with inflation. So we're kind of taking a surgical approach to that, David and really looking case by case, where we think we've got a place to increase price, but the market has an opinion on that as well in terms of price points. So that's kind of what's been done and what's planned. As we look forward on volume, I would just kind of echo what Dan said, we're coming out of a core that makes us a bit cautious.

We have data that we're looking at each and every week to get a sense of kind of where the consumer is at when you get into spring, we're hoping that, that kind of launches people getting out and will benefit our business. But if I was looking forward, there might be some slight improvement in volume, but I think we're still cautious about what's out there in front of us.

David Shakno^ For that price increase on ICEE in January, should we think of that similar to, I think, the price increases the past couple of years each January, so that has been mid-single digits or so. Correct me if I'm wrong. Should we be thinking about it roughly the same again?

Ken Plunk^ Probably not quite as high as the last two years where we were with inflation, but some are in that mid-single digit, maybe a hair under that, probably David, is the way to think about that.

David Shakno^ Great. And then one other thing, if I can. Historically, second half gross margins, those tend to be, I think, 200 to 300 bps higher than the first half just with one quarter down here for the fiscal year. Are you still kind of expecting that cadence for the second half of fiscal '24? And then regardless, can you just kind of outline some of the puts and takes there?

I know you mentioned a little bit on the pricing question about commodities. But if you could just kind of outline that in general, that would be great.

Ken Plunk^ Yes. Yes. We still feel really good about what we're doing as it relates to driving profit margins. We actually -- we're very happy with gross profit for this quarter even with some of the challenges on the sell side that we exceeded our internal budgets on that. We saw our bakery gross margins improve over 100 basis points, strong margin performance in ICEE and in Food Service. So we like what we're doing.

I think the initiatives we mentioned are working. What we're focused on is mixing out better. And then to your point, as we get into Q2 and particularly in three and four, those will makes much heavier ICEE, much heavier Dippin' Dots, which are some of our highest margin businesses, and we expect that to generate those 30-plus percent gross margin that we did a year ago. And so we see no reason to back off of kind of what we've talked about, which is getting above 30% for the year. And we think what we've done in the first quarter is a good sign that we're moving in the right direction on that.

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

Connor Rattigan^ Yes. So I just wanted to touch on the top line a little bit, specifically on the Food Service pressure. So I guess first thing first, I guess, was this more isolated to maybe a select channel or a customer? Or was it may be a more broad-based pullback? And also, was there any deflationary pricing involved in there?

Daniel Fachner^ There really was no deflationary pricing involved in it at all. We talked about Food Service being affected and really being affected through our pies and cookies. And so if you looked at it surgically, that had a pretty sizable impact on where we were off and saw that in inventory reductions as early as early December, late November, started to see that. And that's real. Again, I mentioned this earlier, we looked at some IRI and Circana data and our volume looks good through that.

And so you know that these inventories were pulled back and so we don't over complicate it. We think the consumer is cautious as we've said already, but we really do feel like a good portion of this is inventory related.

Ken Plunk^ And just to magnify, you're trying to get into kind of particular product areas. The pie decline was the majority of the decline in bakery year-over-year. And then we mentioned cookies on top of that. But that's a product that once it gets on display and retailers as a shorter shelf life and so as they start to see retailers and grocery stores, concerns about traffic coming into the holidays, they back down their orders. And so that was a big number in terms of year-over-year comparison.

Connor Rattigan^ Got it. So I guess it sounds like more the inventory and deload that you saw there on the pies and whatnot, should be more of a onetime headwind and nothing to persist throughout the balance of the year. Is that fair?

Daniel Fachner^ We believe that to be true. Certainly, we're going to come off a quarter and be cautious about that, right, and watch it really, really closely and why we're looking at all the different data points that we can find, but yes, we do believe that. And remember, pies business is really a onetime a year business, too, that doesn't stretch out for four quarters.

Connor Rattigan^ Got it. Got it. And then just one more for me that I'll squeeze in. So a pretty significant step-up in marketing in the quarter. I mean, can you maybe touch on some of your initiatives there?

And I guess, maybe what we should expect for the balance of the year? And do you maybe see a need to spend some more or maybe do some more advertising sort of in light of the slowing traffic and consumption?

Ken Plunk^ Yes. We -- I think we talked about this before, Connor. We love what we're doing in terms of marketing Lynwood Mallard and his marketing team have really done a great job of both with our new products and with brands that we had are really investing and getting a lot out of those investments to ground growth. And we believe that is a key to us continuing to build these brands and grow. And so we continue to invest accordingly.

Just remember a lot of those -- the spend of that has impacts and benefits to the rest of the year and even beyond that. So it's not always just a contained in a quarter-by-quarter kind of thing. It's also against our -- one of our lowest sales bases. When you look at Q1, Q2 will be much the same. You've got that kind of spend on a lower sales base. So that should level its way out as we get through the year and ultimately in the year, probably in that low to 7.1% to [7.12%] of sales range.

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

Robert Dickerson^ Great. I guess just to kind of circle back to the -- like the pies and the cookies situation relative to kind of what I'm hearing around maybe new distribution potential at Subway and kind of new distribution kind of potential overall. Maybe just provide some color as to kind of how you see the portfolio performing or recently performing maybe like a branded versus nonbranded basis, right? Because I'm asking because I hear SUPERPRETZEL is doing great, right? ICEE still doing pretty well.

So it almost sounds like there's maybe a little bit more momentum on the branded side versus the non-branded side. And usually, that also provides some positive mix -- margin mix uplift over time. So just any updated thoughts there would be great.

Daniel Fachner^ Rob, that's a really good question. You know this. We've talked about it several times. I love branded products, right? I love the fact that we have an opportunity to get out there and advertise and market our branded products.

And I think our team is doing that really, really well. Within our brands like SUPERPRETZEL, we've been able to release some really good new products that are being really well accepted out in the industry. And so I think we're seeing some nice lifts from that like the Bavarian sticks. Almost feels like a natural that we should have done it maybe prior to this, but everything is about timing. And so I do like where our branded products are going and think we have some real opportunities.

I think iHola! Churros and Retail still have some great opportunities. We're seeing our Dogsters really grow at a nice pace. And so our branded products are growing well, and we'll continue to push our brands as that's one of our core strategies in our organization. However, we do have some opportunities as well on the nonbranded like the opportunity we have with Churros right now.

That's our churro and it's doing extremely well. And if we continue to be a good supplier, we think there's more opportunities other than just the churro side of that business that we're going to continue to look at. So I think we have some nice growth going that way too. It's a balancing act, always, right?

And so we're going to push the brands because we love them, and there's an opportunity to get behind them and advertise them and do some of the right things, but we're also going to seek out those opportunities that makes really good sense for us as an organization around nonbranded.

Robert Dickerson^ All right. Great. Another quick one. I guess just very specifically, in your Retail Supermarket business, just when I look at the op margin, I just kind of feels a little low. And clearly, there could be some one-off true-up dynamic maybe in that segment.

I'm just trying to gauge like if you're kind of doing well in that business and a decent amount of that business clearly is branded like maybe like why is the operating margin kind of so low now? And then if we think forward longer term, to 2, three years, what have you, is that like a business that we do think can kind of get to that, I don't know, high single digit or low double-digit op margin? Just trying to gauge kind of where we are today and then kind of what could come later.

Ken Plunk^ Yes. Rob, thanks. Great question. Let me just provide a little bit more clarity on Retail operating income. So included in that number is roughly $1.3 million of that onetime distribution expense.

So if you're thinking about kind of adjusting that out as a one-timer, that starts to change that picture a little bit. Operating income would have grown, I think, roughly 8.5%. If you factor that in, it was a bit of a mix impact on gross margin because of higher sales in Handheld and lower in Frozen novelties.

Again, we've got data that says in many of those frozen novelty areas like Luigi's, the consumer bought more on sell, but our customer ordered less. And we think that is somewhat tied into this inventory leveling that many are doing kind of after the supply chain challenges, and we mentioned that in a couple of areas.

So we think that will work its way out. Yes. We think we can get that retail business. I think if we ended Q3, Q4, it was moving up closer to that mid-single-digit range. Certainly expected to improve and get up into that range once we cycle some of these things.

Robert Dickerson^ All right, super. And then maybe one last question. More theoretical. Clearly, you're saying today, just being a little bit more cautious, right? Consumer seems to be a little bit more cautious, it's clearly not the only company saying that, right?

We consistently hear the term value seeking thrown around a lot over the past couple of quarters. You guys are kind of about to enter, probably 2, three months left, but you are start -- about to enter kind of that seasonal uplift on the business. So when we think about kind of the cautious thought process as we get through the year. And then we also just think about price points, right? Like some could argue that having an ICEE drink is mandatory, right?

It's a need state, some others might argue it's more of a launch state, maybe it's a little bit more discretionary. So I'm just curious where you sit today, if you're thinking about like May, really June, right, opening of all amusement parks, like it's time we're all out and about time to go. Are there areas where in these varied channels where you can promote a little bit more, I don't know, like maybe put a little bit more signage or just try to kind of push the consumer basically into consumption?

Daniel Fachner^ Yes, Rob. Absolutely. There are ways for us to do that. ICEE does that really well. In fact, the team led by Steve Avery, even as soon as last week, have been revisiting all those ways that we can energize sales as we get to the core months, right?

And signage is a big part of that. Our flavor rotations becomes a big part of that. Getting out in front of the customer and talking about promotional items or BOGOs or something along that lines.

And so the teams are already engaged in doing that. And we're proactive to make sure that as we get into that peak selling season that we're going to be able to get everything that we can. And I love your thought about ICEE being in need rather than an impulse item. I hope we can spread that across the country.

Operator^ I would now like to turn the conference back to President and CEO Dan Fachner, for closing remarks. Sir?

Daniel Fachner^ Great. Thank you. As we turn to 2024, we remain confident in our strategy to continue growing sales and profits. The J&J team is executing across all facets of the business, and we continue to secure incremental growth opportunities across the customers and channels that we serve. This positions us well for continued growth as the overall consumer environment improves.

We look forward to updating you on our progress throughout fiscal 2024. 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 very much. Have a good afternoon.

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