Operator

Good Afternoon and welcome to the Innovative Food Holdings Third Quarter 2024 Earnings Conference Call. My name is Ronit Wallerstein and I'll be moderating today's call. With me on today's call for Innovative Food Holdings is Bill Bennett, our CEO; and Brady Smallwood, our COO. Throughout the conference, we will be presenting both GAAP and non-GAAP financial measures including, among others, historical and estimated EPS, adjusted EBITDA, which is net income before costs associated with amortization, depreciation, interest and taxes, and excluding certain one-time expenses; and adjusted fully diluted earnings per share, using the weighted average shares outstanding for the quarter ended 9.30.24.

These measures are not calculated in accordance with GAAP. Quantitative reconciliation of certain of our non-GAAP financial measures to their most directly comparable GAAP financial measures appear in today's press release.

I would also like to remind everyone that today's call will contain forward-looking statements from our management made within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities and Exchange Act of 1934, as amended, concerning future events.

Words such as "aim", "may", "could", "should", "projects," "expects", "intends", "plans", "believes", "anticipates", "hopes", "estimates", "goal" and variations of such words and similar expressions are intended to identify forward-looking statements. These statements involve significant known and unknown risks and are based upon a number of assumptions and estimates, which are inherently subject to significant risks, uncertainties and contingencies, and many of which are beyond the Company's control.

Actual results, including without limitation, the results of our Company's growth strategies, operational plans, as well as future potential results of operations or operating metrics (and other matters to be addressed by our management in this conference call), may differ materially and adversely from those expressed or implied by such forward-looking statements.

Factors that could cause actual results to differ materially include, but are not limited to, the risk factors described and other disclosures contained in our filings with the Securities and Exchange Commission including the risk factors and other disclosures in our Form 10-K and our other filings with the SEC, all of which are accessible on www.sec.gov. Except to the extent required by law, we assume no obligation to update statements as circumstances change.

With that, I would like to turn the call over to Mr. Bill Bennett. Please go ahead.

Bill Bennett

Hello everyone and good morning or good afternoon. I'm happy to welcome you to our Q3 2024 earnings call. We'd like to excuse Gary Schubert from the call, as he's dealing with a death in the family. Our thoughts and prayers are with him and his family.

Hopefully you saw the press release this morning with some highlights from the quarter. We will also file our full 10-Q shortly, for your reference.

As I've mentioned several times before, we are working through our three-phase plan to first Stabilize the company, then Lay the Foundation for Growth, then Build and Scale for the future. With this quarter's report, I think we can confidently declare that we've exited our Stabilization phase. Let me recap a bit of the last 18 months: We've finished divesting our unprofitable, declining, or off-strategy businesses. Revenues have now bottomed, and are back to growth in our remaining core foodservice business. We have a large new business we're ramping up with a national retailer that will be worth tens of millions in revenue for us. Gross margins are up several hundred basis points since we started this journey. Our SG&A is down several hundred basis points as a rate of sales since I joined. We're consistently profitable on an adjusted EBITDA basis. We've announced our first acquisition, which will contribute to earnings on day 1. We've implemented a new company culture focused on serving businesses and professional chefs. And we've dramatically ramped up our transparency and communication with our investor base, delivering on every single forward-looking comment we've made in the 20 months since I joined. I'd now consider that a stabilized company.

As we enter our second phase, we are calling this phase "Laying the Foundation for Growth". Our objective during phase two is to define, establish, and prove our long-term business model which we aspire will someday achieve a $1B in revenue. As some of our initial actions during this phase, we will begin integrating our first acquisition, Golden Organics, scaling our new retail business, finding and scaling additional large customers, and growing profit in the process. These actions will start to demonstrate our long term business model and growth potential. We've said before that our first milestone on this journey will be 100/10, meaning our first $100M in revenue, and our first $10M in adjusted EBITDA. This quarter was an exciting step down the path of our second phase.

For the third quarter of 2024, our core specialty foodservice business officially returned to meaningful growth, increasing 5.5% vs. Q3 of 2023. This is a really exciting milestone, since we've been messaging for nearly a year that we'd be back to growth by the back half of 2024, and now here we are. This growth was driven by four new businesses that were nearly non-existent a year ago:

1. First, in our new retail business, this was our first full quarter of having 10 test stores with our new retail partner. This of course will scale dramatically in Q4 as we expand to a full rollout. In fact, as we stated in our recent press release, our Q4 revenue to date for the total company is growing over 25% vs. the prior year period. This is going to be game changing for our company, and expect this business to drive tens of millions of dollars in revenue. We are incurring startup costs in Q4 as we get up to scale, but anticipate the business will begin delivering profit early next year.

2. Second, our new broadline distributor business continues to scale as we add more perishable items, as their only partner who's capable of doing so, and we expect these trends to continue to accelerate as our sourcing efforts add to our assortment. This is giving us great exposure and building a deeper relationship with this distributor.
3. Third, we've significantly ramped up our efforts to grow our offering on Amazon, adding hundreds of items, enabled by our shifting of resources that used to be focused on our consumer business, over to managing a foodservice business on Amazon. This is a low-cost, no-capital way to grow our platform, since we already carry these items.
4. Fourth, we are now ramping quickly with another airline caterer which is driving significant incremental business for us. We see this business following a similar trajectory as Gate Gourmet over the next couple years, becoming a large, meaningful part of our growth.

These four new businesses drove approximately four points of growth in our foodservice business, and we expect them to continue to accelerate.

In addition to these new businesses, we also saw strong growth in our business with Gate Gourmet where we continue to win new items on their menus, and further integrate ourselves into their planning cycle, as well as growth in our Artisan Specialty Foods business in Chicago, as our investment in sales staff has begun to payoff. This growth was partially offset by continued negative sales trends in our legacy drop ship business, but this business only declined in the single digits, which is an improvement over prior quarters. We continue to work to get this business back to growth.

As we move down the P&L, gross margins declined by 158 bps vs. prior year, as the high-gross-margin e-commerce business mixed smaller in our portfolio. Also, we ran our 10-store retail test at negative margins, in anticipation of improved cost of goods during the rollout, which we are now achieving in Q4.

In Q3, we continued on our journey of cost savings, driving down SG&A by $482 thousand, after excluding non-cash and non-recurring legal and transactional expenses. These savings resulted in a savings of 222 bps as a percentage of sales, relative to the same period last year. These savings are critical as we continue run leaner and achieve more per dollar of SG&A we spend, while we also lean in to growth spending to support our new growth opportunities.

GAAP net income from continuing operations was $1.3M, or $0.026 per fully diluted share, compared to $0.1M, or $0.003 per fully diluted share in the third quarter last year. Adjusted net income grew $209K, and adjusted EBITDA grew $76K. The largest adjustments this quarter pertained to the gain on the sale of the iGourmet assets, and the legal and transactional costs related to that divestiture, as well as those related to the acquisition of Golden Organics.

Now that I've finished discussing Q3, I did just want to express my excitement about our recently announced acquisition of Golden Organics. It gives us access to new customers, expertise in new categories, and opportunities for large synergies as we plug the business into our national sales channels, and ultimately will become a playbook for future acquisitions.

I'll turn some time over to Brady to talk in more detail about the Golden Organics transaction, as well as discuss some details of the iGourmet divestiture and the retail business ramp up. Brady?

Brady Smallwood

Thanks Bill and hello everyone. I'll be hitting my 18-month mark with IVFH this week, and I'm excited now more than ever to be talking to you under the context that Bill shared a minute ago. Despite a relatively short tenure still, we have worked diligently to stabilize the company and have been transparent along the way with you, our shareholders, and I am pleased at the progress we have made towards our 3 phase agenda.

When I started, a key focus of mine was to determine the path forward on ecommerce that would eliminate the financial drag it had been on the company for multiple years. I am happy to say that in early September, we officially closed the sale of our iGourmet business, and at the end of September we wound down any remaining fulfillment for iGourmet after completing a 30-day transition period for the buyer. This also removed an approximately $350K liability from our balance sheet associated with future gift card commitments.

In October, we also completed the sale of a small amount of remaining Mouth.com assets--mainly the legacy IP such as the trademark, domain, and website. We ceased operations of Mouth.com in Q1, but we were left with another approximately $175K in future gift card liabilities, many with 4-5 years remaining until expiration. The sale of the remaining assets was in exchange for an assumption of that liability, which you will see reflected in a further balance sheet improvement in Q4.

As I stated a minute ago, the goal of the stabilization phase was to eliminate the financial drag of ecommerce, which I consider to have been accomplished with these transactions. I am very proud of the resilience of the team in our Pennsylvania warehouse throughout this first phase, because despite a turbulent year as we exited these businesses, we had a number of long-time employees who stuck with us as we actively planned for these growth phases. The collective effort of the team pulled forward the transition to growth by at least 1-2 quarters as we quickly moved the warehouse to be dedicated to our foodservice, airline, and nascent retail business.

Pivoting to focus on retail required a revamped business model: 10 SKUs (instead of 2K), large quantities (instead of a low-turn, broad assortment), and consolidated shipping to distribution centers (instead of small parcel shipping to consumers). In short order, we converted what once was an ecommerce fulfillment warehouse into a production line focused on quality and precision at scale.

The work has paid off and in October we had a press release announcing the successful fulfillment of our largest-ever purchase order of $676K as we began to scale nationwide. That purchase order was just Wave 1 of our rollout, where we reached approximately half of our store expansion list. Two weeks later we also executed Wave 2, which was a similar number of stores as Wave 1 and means that we are now scaled to the several hundred stores we disclosed in a press release in late August. Though weekly replenishment volumes will be lower than the initial set, we expect the volume to be in the tens of thousands of pounds of cheese each week.

We are in the early stages of our retail foray, but given the retail experience of our leadership team, we understand the opportunity and what it takes to be successful. Part of the need was to prudently invest ahead in the warehouse, staff, equipment, and working capital (mainly inventory) to enable these October launches. You can expect that the first full quarter of results, Q4, will include those startup costs, but now that we are scaled and reaching new efficiency milestones each week, we continue to be confident that this business is set up to be profitable and generate positive cash flows in 2025. Higher sales volume with less inventory and operating expenses is a big win for our operation in Pennsylvania, and a big win for IVFH overall and its shareholders.

I also wanted to provide you an update on the acquisition of the assets of Golden Organics, LLC based in Denver. On October 18th we announced the signing of the definitive agreement, and we are pleased with the progress towards closing since then. We have had our new president of Golden Organics, Taeshaud Jackson, working onsite since the signing of the agreement, we secured new safety and organic certifications, negotiated the assumption of the remaining lease, and completed most of the "housekeeping" items on our closing checklist. The last major milestone before closing is to true-up working capital, and we anticipate finalizing that within the next week. The largest part of that is to conduct a physical inventory, and that is scheduled to kick off this weekend.

I wanted to provide a little more context on the rationale and why it will be a value generator for us. First of all, the prudent structure of the deal reduces our financial risk as the upfront cash of $1.4M is essentially buying an equivalent value of inventory, while the seller note payments will be self-funded by future earnings of the purchased assets. Along with this, we also receive $100K in equipment, valuable supplier relationships, and an existing customer base. We also receive very few liabilities as the receivables will approximately offset the payables, there is one truck lease, and the warehouse lease has less than 3 years remaining.

We could tell very quickly that this business had good bones and that our experience and capabilities would complement it well to drive a refresh in strategy, technology, and warehouse management to achieve greater levels of scale. And with consistent profitability and a revenue CAGR of 22% over the past 6 years, our projected IRR is attractive without needing to assume any kind of accelerated growth that those synergies will bring, which means that as we achieve synergies, our returns will only further accelerate.

We look forward to updating you soon as we cross the finish line of this transaction.

With that, I will turn it back to Bill before we open up to Q&A.

Bill Bennett

Thanks, Brady. Hopefully you can get a sense that we're in a great position to move into our phase two this year, cement a much stronger business model, and prepare to begin investing for the future.

With that said, we're happy to take some Q&A, so I'll turn it back to Ronit to moderate the Q&A for us.

Operator

We'll now move to the Q&A section of the call. If you'd like to ask a question, please use the Zoom function to "raise your hand" or dial *9 if you are calling in from a phone. Please limit your comments to one question and one follow up if needed, and keep your comments professional and respectful. We've allocated approximately 20 minutes to this portion of the call.

Bill Bennett

Okay, we got one question through the chat from Brian Harper: "Can you discuss gross margin effects from the new retail cheese effort as well as how much ecom is impacting." Yeah, thanks for that question, Brian, I appreciate it. So as we mentioned in both the press release and the comments, of course, our gross margins did take a dip this quarter. The funny thing about the ecommerce business is that we would typically run 50 to 70% gross margins on that business because of the extreme expense levels to actually get an order out the door. So once you incur all the labor, all the packaging and all the FedEx costs then you of course lose money which is why we've exited this business. But it does come in at a very high gross margin and so as we're ramping down that business it's of course bringing down our overall corporate gross margin rate.

On the retail cheese business – I also mentioned this in the earnings comments – but the key here was that during our 10-store test, we didn't have the scale yet to purchase the cheese at the cost of goods that we knew we'd be able to once we got to scale, but we didn't want to pass that cost along to our retail partner or we wouldn't have won the business in the first place, so we chose to take a loss during the weeks of the 10 store test, and it's funny because 10 stores sounds so small relative to where we're going here, but 10 stores of volume is still material for a company our size, so that did have a material impact to gross margins as well during Q3; but like I mentioned in Q4 now that we're up to our scale of purchasing, we were able to knock several points off of the cost of goods we were paying for that cheese, and now we're at the kind of gross margin that we need to be for that cheese business going forward, so we expect gross margins to get back to a healthy place into the future. Thanks for the question, feel free to give me a follow up if I missed anything.

I got another question by chat from JD Abouchar: "Can you go over the financial model of the Amazon business?" Yeah, sure. So on Amazon, we run a third party seller store that's similar to all the other sellers that exist on Amazon. So we typically run about a 15% commission is the way that Amazon gets paid. So we set pricing, based on our own internal models, then once a sale consummates, we owe Amazon 15% of the retail price of those products that sold. Like I mentioned, these are all foodservice products, so the ring on those items is much higher than we would have seen historically on the consumer business, and because of that, we're able to adequately bake in the margin to ship the product, pay the commission to amazon, etc., so at the end of the day, the cost model isn't that different from our business model with US Foods or any of the other distributors where we either pay a commission, or they in some cases make a margin themselves. So it really isn't too different of a business model. So as long as we can make money, this is a great low cost, no-capital way to leverage our existing assortment and vendor relationships. Great – what else?

Another question from Brian Harper: "Within specialty, are there any competitive or other factors that have impacted what gross margins were say in 2017 vs. what it would look like going forward? I'm speaking of what existed before." So yeah, you're referencing the years when we didn't have an e-commerce business, and it was purely a drop ship business. We don't think anything has impacted our gross margins since those days. As the P&L continues to clean itself up as we begin to lap the rampdown of the ecommerce business I think you'll start to see those margins shine through again. Drop ship is our highest margin business, any food distribution where we actually touch the inventory is definitely going to be lower margin, and as I've mentioned before, retail tends to be the lowest of all of those. So the business will continue to mix more into the food distribution business with our Golden Organics acquisition, and the growth of Artisan Specialty Foods, and of course will mix more towards the retail business as that continues to scale, so I think we'll continue to see corporate margins move all over the place, but the drop ship business will be strong and continue to shine through as the ecommerce impact goes away. Perfect. Good.

Okay, what else? Quiet group today.

Okay, we'll give it about 30 more seconds. Then we'll call it. You can feel free to type your question, or raise your hand.

Okay, we got a typed in question from Carlos Graf: "Because of your business model, shouldn't your inventories be trending lower in dollars?" So definitely on the drop ship business, we don't own inventory, so as that business grows and scales over time, we would expect to be able to do so without an increase in inventories. What's happening right now though is we're of course ramping up this cheese business in the retail segment and we do own the inventory there. We've actually purchased a few million dollars of cheese to be able to start that business up. And that's what you're seeing right now in an increase in inventory. Most of that hasn't even hit yet in Q3 numbers. We'll expect the increase in inventories to hit more in the Q4 report. So it really just depends on the mix of businesses we're scaling. Right now, so much of the scale is coming from the growth in the retail business, so we do expect inventories to grow. Hope that answers your question, Carlos.

All right, speak now or forever hold your peace.

All right. Thanks, Ronit, for moderating. Thanks, everyone, for your questions today and for your attendance and engagement on the call. It's really inspiring to see the level of interest in Innovative Food Holdings. As always, I'm happy to make myself and my leadership team available to connect with investors who have further questions about publicly available data. Please feel free to reach out to Gary Schubert, whose contact info is included in our press release, if you'd like to schedule a touch base. Take care, and we look forward to continuing to update you on the progress of our strategy at our Q4 update this Spring. Thanks all, and have a great day.