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The J. M. Smucker Company (SJM) CEO Mark Smucker on Q1 2020 Results - Earnings Call Transcript

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FQ1: 08-27-19 Earnings Summary

Press Release *10-Q* *Slides*

EPS of $1.58 misses by $-0.17 | Revenue of $1.78B (-6.50% Y/Y) misses by $-96.95M

Earning Call Audio

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The J. M. Smucker Company (NYSE:SJM) Q1 2020 Earnings Conference Call August 27, 2019 8:30 AM ET

Company Participants

Aaron Broholm - Vice President, Investor Relations

Mark Smucker - President and Chief Executive Officer

Mark Belgya - Vice Chair and Chief Financial Officer

Conference Call Participants

Andrew Lazar - Barclays Capital

Bryan Spillane - Bank of America Merrill Lynch

Robert Moskow - Credit Suisse

Pamela Kaufman - Morgan Stanley

Jason English - Goldman Sachs

John Baumgartner - Wells Fargo Securities, LLC

Christopher Growe - Stifel Nicolaus

Alexia Howard - AB Bernstein

Scott Mushkin - Wolfe Research, LLC

Rebecca Scheuneman – Morningstar

Operator

Good morning, and welcome to The J. M. Smucker Company's Fiscal 2020 First Quarter Earnings Conference Call. This conference is being recorded and all participants are in a listen-only mode. At the request of the company, we will open the conference up for questions-and-answers after the prepared remarks. Please limit yourself to two questions during the Q&A session and requeue if you have additional questions.

I will now turn the conference call over to Aaron Broholm, Vice President, Investor Relations. Please go ahead, sir.

Aaron Broholm

Good morning, and thank you for joining us for our fiscal 2020 first quarter earnings conference call. After this brief introduction, Mark Smucker, President and CEO, will give an overview of the quarter's results and an update on our strategic priority. Mark Belgya, Vice Chair and CFO, will then provide detailed analysis of the financial results and our fiscal 2020 outlook. A Q&A session will follow the prepared remarks.

During today's call, we will make forward-looking statements that reflect the company's current expectations about future plans and performance. These statements rely on assumptions and estimates, and actual results may differ materially due to risks and uncertainties. I encourage you to read the full disclosure concerning forward-looking statements in this morning's press release, which is located on our corporate website at jmsmucker.com.

Additionally, please note the company uses non-GAAP results to evaluate performance internally as detailed in the press release.

We have posted a supplementary slide deck summarizing the quarterly results and fiscal 2020 full-year outlook. The slides can be accessed on our website and will be archived there along with a replay of this call. If you have additional questions after today's call, please contact me.

I will now turn the call over to Mark Smucker.

Mark Smucker

Thank you, Aaron. Good morning, everyone, and thank you for joining us. Let me begin by providing comments on our first quarter results, which were below our expectations. Given the momentum we generated in the past two quarters, the miss relative to our expectations in this first quarter is unacceptable, particularly as it relates to our top line sales.

Our team is already executing on plans to address recent performance, which include improving the consumer value proposition at shelf, the continued launch of new advertising across multiple brands and driving awareness and trial in premium dog food. Underpinning all of these actions is a focus on accelerating the execution of our strategic growth imperatives, which is the key to unlocking the growth potential of all our brands.

We are also taking decisive near-term actions to ensure we maintain financial discipline, deliver on our commitments and increase shareholder value, including: one, reprioritize – reprioritization of company-wide initiatives; two, a reduction or elimination of certain discretionary expenses; and thirdly, the evaluation of planned marketing programs with an increased focus on maximizing return on investments.

Let me provide additional details on first quarter results. Organic sales – organic net sales decreased 4% compared to the prior year, which was below our expectations, primarily as a result of three factors. First, the timing of shipments, primarily in coffee and peanut butter; second, the deflation in the coffee and peanut butter categories; and thirdly, increased competitive activity in the premium dog food category.

Our adjusting EPS declined 11% compared to the prior year. The reduction was driven by lower net sales and resulting SD&A deleverage, which was only partially offset by gross margin expansion with improved mix in Pet Food, resulting from the decline of private label sales.

With respect to the shortfall in U.S. Retail Coffee, we are confident that this was a temporary dynamic. While we expected a sales deceleration from the fourth quarter, the decline was greater than anticipated. This was partially due to timing of distribution gains across all formats that have shifted to the second quarter.

As part of this change, we gained incremental shelf space going forward across all formats. We are already seeing momentum build in the second quarter and continue to expect top and bottom line growth for the Coffee segment this fiscal year.

Our category leadership position remained strong. Along with the number one Folgers brand, Dunkin' became the number three brand in retail sales during the quarter and continue to outpace category growth. In addition, we own four of the top five brands growing household penetration in the coffee category, and our K-Cup portfolio is outpacing category growth by approximately two times in the latest four, 12 and 52-week periods.

We also recently launched innovation with Dunkin' Signature Series, 1850 Single Origins and Folgers Noir products that will contribute to top line growth as the year progresses, since retailer acceptance is consistent with our projections.

In Consumer Foods, a net sales decline in peanut butter was primarily attributable to a list price decline taken in the fourth quarter. Certain retailers also reduced inventory following a 15% increase in the company's peanut butter shipments in the prior quarter, and a key promotion was shifted to the second quarter.

While we did see a volume benefit since taking a price decline, it was lower than anticipated. We maintain a nearly 50% volume and dollar market share for the category and consumer takeaway for our peanut butter offerings performed better than other branded competitors and the overall category during the quarter as our velocity have increased following our pricing actions.

In Pet Food, while we anticipated comparable sales to be down slightly, sales were below expectations, down 4%. Momentum for the majority of our pet brands continues to be masked by the decline in our private label business and the Natural Balance brand in the Pet Specialty channel.

The shortfall expectations resulted from underperformance of Nutrish dog food as a result of greater than anticipated impact from premium competitors aggressive pricing actions. We are taking targeted actions to reaccelerate Nutrish dog food growth, which include improving the consumer value proposition at shelf to increase – to drive increased trial and loyalty and launching new advertising to increase awareness.

While we anticipate continued softness for the Nutrish brand in the second quarter, we remain confident in the strength of the brand as a key growth driver for the balance of the fiscal year, including the launch of new innovation platforms.

For the remainder of the fiscal year, we expect Nutrish to grow mid to high single digits. We are actively defending our position and remain confident in the long-term growth potential of our Pet business. There were areas where we made solid progress this quarter, with key brands delivering growth in both shipments and consumption. Cat food continued to deliver strong sales growth, driven by an 8% increase for Meow Mix, as well as growth for 9Lives and Nutrish.

Our dog snacks platform also grew, led by sales increases for the Pup-Peroni, Nutrish and Milk-Bone brand. Pet innovation delivered over $20 million in net sales during the quarter, and we also continue to project $100 million in annualized sales for new products launched by the end of the year.

Turning to the progress made against our long-term growth imperatives, we continued to execute and build momentum with our three consumer-centric growth imperatives to lead in the best categories, build brands consumers love and be everywhere. I'll share a couple of examples from the quarter of how we are leading in the best categories.

Snacking remains a key focus area with our total snacking portfolio generating net sales growth of 7% during the quarter, mostly driven by Uncrustable sandwiches, which grew 11%. We are now shipping Uncrustables products produced at the recently completed

Longmont facility. The volume shipping from this plant is currently small as we execute the startup process.

As planned, we will expand capacity throughout the year to support a significant increase in sales during the second-half of the year. We remain on track to grow this business to over $500 million in net sales within the next few years, compared to approximately $300 million in fiscal 2019.

In addition, the Jif Power Ups platform has helped increase household penetration for the Jif brand by over 2 million households over the past year as a result of our new on-trend snack offerings. While growth slowed this quarter with lapping of initial sell-in last year, we remain confident in the growth opportunities for the Jif snacking platform. We recently launched new line extensions and expect to expand distribution as the year progresses.

Turning to our strategic imperative of building brands consumers love. Last fiscal year, we began implementing our new Power of One marketing model, which includes a new structure within our marketing teams, in addition to consolidating work with a new agency. Although we're at the very beginning of this new brand support hitting the market, we're excited about the brand refresh underway and recently launched new advertising for the Jif and Smucker's brands.

We will continue to launch new campaigns across nine of our key brands in the upcoming month. These new breakthrough campaigns are bold, strengthen our brands' relevance in today's culture and set a new bar for CPG creative effectiveness, which we fully expect to support top line growth.

We remain committed to our investments in marketing and innovation and we continue to project marketing spend to be in the range of 6.5% to 7% of net sales for the year. This commitment to support our brands and new products is critical to accomplishing our financial goals and increasing shareholder value.

Our third growth imperative is to be everywhere. We understand the consumer shop and interact with brands on demand and multichannel. Therefore, we need to be wherever consumers shop and available anytime.

Within the e-commerce channel, we compete in categories that are well suited to a subscription model, particularly Pet Food and Coffee. In the first quarter, our sales to pure play e-commerce retailers were up over 30%, while enforcing price discipline to protect pricing architecture and the equity of our brands. The e-commerce channel now accounts for nearly 5% of total U.S. retail sales, which is pacing in line with our goal to reach 5% by the end of the fiscal year.

The focus of our Away From Home business has always been on offering branded products that consumers desire while outside of the home. During the first quarter, we increased our market share in three of our four strategic categories: liquid coffee, fruit spreads portion control offerings and peanut butter portion control offerings. Our shared market in each of these categories is well over 50% and more than twice the number two competitor.

In the roast and ground coffee category, we will further strengthen our position by launching 1850 coffee, which complements the retail 1850 business, which was the number one launch in the coffee category last year. In the frozen handheld category, we are excited about being able to expand our Uncrustables business within additional Away From Home outlet.

Before turning it over to Mark, here are a few thoughts we hope you take away from my comments. We are quickly adapting to competitive and market dynamics to deliver results that represent the strength of our organization. We operate in strong categories that are aligned with current consumer trends. We are making good progress on our consumer-focused framework and three growth imperatives designed to deliver on our long-term financial growth priorities and increase shareholder value.

We remain confident in our strategy, our strong portfolio of brands and the new brand support that will together drive results. And we firmly believe, we’re moving forward with the right approach and are taking decisive actions to provide improved results for the remainder of the fiscal year.

Finally, as always, I want to acknowledge our dedicated employees. We thank them for what they have done and what they will do to drive the business moving forward.

I will now turn the call over to Mark Belgya.

Mark Belgya

Thank you, Mark, and good morning, everyone. First quarter net sales decreased 6%, which included an incremental $25 million contribution from the Ainsworth acquisition and $73 million of lost sales related to the divestiture of U.S. baking business included in the prior year results.

Excluding the noncomparable results, sales declined 4% in the first quarter. Unfavorable volume/mix, primarily for private label pet food and coffee had a 3 percentage point impact on net sales and lower net price realization, primarily for coffee and peanut butter reduced sales by 1%.

Adjusted gross profit decreased $30 million from the prior year, or 4%. Excluding the noncomparable Ainsworth and U.S. baking business, gross profit was down 3%, primarily reflecting the declined volume/mix. Favorable costs were mostly offset by lower net pricing, as lower commodity costs for coffee and peanut butter were passed through to consumers.

Adjusted operating income declined $26 million compared to the prior year, reflecting the decline in gross profit. Marketing expenses decreased $7 million and was 7.5% of net sales. $5 million of incremental expenses were incurred relating to the startup of the new Uncrustables facility, partially offsetting the decrease in marketing.

Below operating income, interest expense decreased $4 million, driven by a lower debt balance, resulting from repayments made over the prior 12 months. The adjusted effective income tax rate was slightly higher than guidance at 25.2% in the quarter. Factoring all of this in, first quarter adjusted earnings per share was $1.58, compared to $1.78 in 2018, a decrease of 11%.

Let me now turn to segment results beginning with Pet Food. Net sales were comparable to the prior year. Excluding the two-week stub period for Ainsworth, sales decreased by 4%. Sales of private label products were up 4% headwind to the quarter, which included the planned discontinuation of certain business.

The Natural Balance brand declined 12% and was the other significant factor driving the decrease. Meow Mix and 9Lives drove solid cat food growth, while Pup-Peroni led within Pet Snacks, along with growth for both Nutrish and Milk-Bone treats.

Pet Food segment profit increased 20% compared to the prior year. Excluding the noncomparable period related to Ainsworth acquisition, segment profit increased 16%, which included lapping the $11 million unfavorable fair value accounting adjustment in the prior year. The realization of acquisition synergies and favorable net price realization, partially offset by higher input costs and lower volume/mix, also impacted profitability.

Turning to the Coffee segment. Net sales decreased 5% compared to the prior year. The decrease was primarily due to lower net price realization, driven by increased trade spend, as lower commodity prices are being passed through to our consumers. Lower volume/mix for the Folgers brand also contributed to the sales decline.

Dunkin' coffee net sales were comparable to the prior year, with the gap between our sales and 4% growth in Dunkin' coffee consumption trends during the quarter being driven by timing and shipments in our fourth quarter were up mid-teens over the prior year. Coffee segment profit decreased 13%, primarily reflecting decline in volume/mix and the net impact of lower pricing in green coffee cost.

In Consumer Foods, net sales decreased 17%, reflecting the divested U.S. baking business. Comparable net sales decreased 3%, driven by lower net sales for Jif, primarily due to the list price decline effective this past March. The decline in Jif was partially offset by the Smucker's brand, which grew in both Uncrustables and Fruit Spreads categories.

Excluding the prior year profits from the divested U.S. baking business, segment profit declined 8% due to expenses associated with the construction of the new Uncrustables facility and the net impact of price and cost.

And lastly, in the International Away From Home segment, net sales declined 7% compared to the prior year. Volume/mix accounted for a 3 percentage point decline, most notably for Folgers. Lower net price realization reduced sales by 2 percentage points and unfavorable foreign currency exchange was $2 million. Segment profit decreased 26% due to the impact of lower volume/mix and unfavorable price cost relationships, expenses related to the long run startup and incremental tariffs.

First quarter free cash flow was $149 million, which represented a $7 million increase over the prior year, reflecting a $28 million reduction in capital expenditures, partially offset by decreased cash from operating activity. CapEx for the quarter was $73 million, representing 4.1% of net sales.

The company continued its intention of deleveraging by paying down $130 million of net debt in the quarter, bringing net debt repayments to more than $900 million in the past 12 months. We finished the quarter with a total debt balance of just under $5.8 billion. Based on trailing 12 months EBITDA of approximately $1.6 billion, our leverage ratio was reduced to 3.6 times.

Let me now provide additional color on our revised outlook for fiscal 2020. Reported net sales are now anticipated to be flat to down 1%, compared to the prior year, which includes $106 million of baking sales in the prior year, $33 million of which were in the second quarter, and the incremental $25 million Ainsworth sales recognized in the first quarter of this year.

On an organic basis, net sales are expected to be flat to up 1%. Private label pet food is expected to be up $40 million to $50 million headwind for the full-year, with a majority of the remaining impact occurring in Q2 and to a lesser extent in Q3. Changes from our previous guidance reflect: one, the first quarter sales mix versus our expectations; second, increased competitive activity in premium pet food; and third, a continued deflationary environment in coffee and peanut butter.

Furthermore, we expect sales to improve sequentially each quarter, with the third and fourth quarters delivering growth over the comparable prior period. The capacity provided by the Longmont production facility is expected to accelerate growth for Uncrustables sandwiches in the third and fourth quarters.

Second quarter net sales are expected to be down versus the prior year, primarily impacted by the divested baking business and declines in private label pet food. We expect gross profit margin for the year to be approximately 38.5%. Overall commodity cost projections remain lower, driven by green coffee and peanuts, which have already been reflected in lower pricing.

In addition, continued synergy and cost savings benefiting both COGS and SD&A will be offset by increased manufacturing expenses, including startup costs associated with the new Uncrustables facility. In addition, as Mark stated, We are aggressively pursuing cost management over the remainder of the year to deliver earnings growth, despite the decrease in our sales guidance.

As a result, SD&A expenses are now projected to decrease slightly compared to the prior year versus our prior estimate of an increase. Below operating income, we're planning $200 million to $210 million in interest expense in fiscal 2020 and a tax rate of approximately 24.5% to 25%. Taking all these factors into consideration, we expect adjusted EPS in the range of $8.35 to $8.55.

Similar to the cadence in net sales, the earnings per share growth is also expected to be realized in the back-half of the year, as the same headwinds impacting sales in the first-half are also impacting profit. As a reminder, the company realized the $27 million gain on divestiture in the second quarter last year that was mostly offset by a higher effective tax rate.

We continue to project full-year free cash flow to range from $875 million to $925 million, with CapEx between $300 million and $320 million. We'll continue to prioritize cash for debt reduction and expect to repay an additional $400 million by year-end, taking our leverage down to just above 3 times at the end of the fiscal year.

In closing, let me reiterate Mark's opening comments that while first quarter results were below expectations, the team is focused on critical actions to achieve our near-term and long-term financial targets. We remain steadfast that the actions we are taking to transform our company, while maintaining financial discipline, will deliver long-term value to our shareholders.

We thank you for your time this morning and we'll now open the call up for your questions. Operator, if you would please queue up the first question?

Question-and-Answer Session

Operator

Thank you. The question-and-answer session will begin at this time. [Operator Instructions] Our first question will come from the line of Andrew Lazar with Barclays. Please state your question.

Andrew Lazar

Good morning, everybody.

Mark Smucker

Good morning.

Mark Belgya

Good morning.

Andrew Lazar

Hi there. Okay. So just two questions for me. One would be, Mark, I was hoping you could just maybe get into a little more detail around, I think, your comment was reprioritizing company-wide initiatives. And I was hoping to get a little more clarity on what you meant by that?

And then specifically in Pet, it would be – with respect to some of the competitiveness in the premium space, do you view this more as maybe somewhat transitory around just competitive launches in premium that you sort of need to weather albeit with some additional spend versus is there some maybe structural change in what has typically been a very rational environment impact, particularly in premium pet? Like, do you feel like that's in, I guess, a concern around that changing more structurally or, again, more temporal something that you've got to weather albeit with some additional spend? So hopefully, that's clear and thank you?

Mark Smucker

Andrew, thanks. This is Mark Smucker. So, yes, on reprioritizing company initiatives, I would just say that, that is really about taking a very detailed look at a lot of the actions and things that we're doing as a company and really prioritizing those initiatives, which truly are going to drive the business. And where there are – now, I won't get into specifics of where there are actions or projects that are not specifically driving the business, we may stop or postpone some or many of those activities.

As it relates to Pet, your first conclusion is correct. I guess, let me just walk through a little bit more detail, because this is obviously the most important question that we could get today, and it is one that we clearly have to address and are addressing.

I guess, I would start by saying that, we did not fully anticipate how broad and aggressive some of the pricing actions would be on trial sizes in premium dog food. This is specific to premium dog food and relatively specific to trial sizes. We had not seen this level of aggressive pricing in previous other interactions and other channels. And we viewed this trial size dynamic as temporary and somewhat unsustainable.

So that would go to your question about, we don't view this as a structural change. It clearly created a temporary misalignment kind of in terms of the value proposition and led to some of our consumers trialing ultra-premium product. But we do continue to believe that our consumers remain largely distinct, and would just like to assure you and our investors that we are taking aggressive steps to ensure we're positioned properly in the market – marketplace across several levers, price is one, obviously, customer and merchandising support would be another, and then I mentioned brand support in the prepared remarks.

But we would expect progress to be steady for Nutrish, particularly, obviously, we're still talking about dog food in the back-half. And we would again expect mid to high single-digit growth for the remainder of the year. All of that said, were we disappointed in the results this quarter? Yes.

But two things I would just like to hammer home. One is, more broadly, our pricing action that we had taken has stuck. And so we have been pleased with where we obviously took a broader pricing action across the portfolio that stuck. And then there are many other parts of the pet portfolio, which are doing very well. So that gives us confidence in the portfolio as a whole, but clearly, we have to address this more immediate issue.

Mark Belgya

Hey, Andrew, this is Mark Belgya. Just to tag onto the first question. Obviously, the refocus, if you will, on prioritization is to address and drive the matters that are most affecting the business. But it just also underscores the comfort, it was in my scripted comments, where we will see a reduction in our SD&A. So not only is it resulting an emphasis on the key areas that we need to go after, but it is going to have a cost reduction. And that's again, allowing us to stay – hit our guidance with – recognizing that our planned sales are down a bit.

Andrew Lazar

And as you said that wouldn't incorporate a reduction in marketing spend. I think you did mention that, so just wanted to clarify.

Mark Belgya

It's real. But I – yes, thank you for raising it, because I think it's an important note. I will give a lot of credit to our teams. We look at this – at the most detailed level and the intent was not to just cut dollars, it really was to identify opportunities that can maximize return. And in those events that just were not going to achieve, we just took a hard line and either postponed or cancelled.

So while there will be a reduction in marketing, we still very comfortable with all our new creative that we've been talking about for months will be coming on air over the next several weeks in support of our innovation. So we're comfortable with it, but it will be lower.

Andrew Lazar

Thanks, and see you next week.

Mark Belgya

Thank you.

Operator

Thank you. Our next question will come from the line of Bryan Spillane with Bank of America Merrill Lynch. Please state your question.

Bryan Spillane

Hey. Good morning, everyone.

Mark Smucker

Good morning.

Bryan Spillane

I – so just two for me. One, I guess as we're thinking about the implied improvement in revenues that's embedded in the guidance for the back-half of the year. Can you just break down in – maybe in broad stroke, how much of it do you expect to come from the incremental – the innovation, the new products and how much of it comes from or is dependent upon an improvement in the base?

Mark Belgya

Yes. Bryan, it will come from both. I won't get into specifics – between those two specific buckets, but it will come. And so if you just think about what we have talked about in the last couple of quarters as well as our Investor Day and at CAGNY, we really have focused on portfolio. We've also talked about our growth brands, our base brands. So we see growth coming in both our growth brands, in our core brands.

So in our base brands, we see it coming from Nutrish as it – as we address some of the issues that Mark discovered. We also see Uncrustables as being a contributor, particularly in the back-half of the year. With our plant in Longmont, Colorado, coming on Board, we'll see volume gains there that will allow us to increase sales.

We also see our coffee brands, particularly Dunkin' and Bustelo will drive growth that it will see that the core – or the – I'm sorry the growth brand. And then in the core, we're going to see our coffee business turnaround in the back-half, as well. So we did the combination across those both areas.

Bryan Spillane

Okay, that's helpful. And then maybe just a follow-up to Andrew's question about the resources. I think if we go back to the Investor Day, maybe I guess it was last year, talked about one of the things that had happened at Smucker's in the past was maybe not sticking with things long enough. And so I guess, as you're kind of thinking about resource allocation and which projects you are going to stay with, and not, are you looking at it maybe differently than you had in the past, just to guard against making sure that you're not sort of cutting something prematurely?

Mark Smucker

Bryan, this is Mark Smucker, thanks for the question. You are correct. We use the phrase stick to your guns. So that is precisely what we need to do as it relates to supporting the brand, I talked about the advertising campaigns that are just beginning.

So we're just now beginning to see the fruits of our labor on the marketing. And there across nine or 10 brands, I think, I said nine in the prepared remarks are coming over the next couple of quarters. And so we've got to maintain, that's why obviously the level of commitment to the marketing spend and then also making sure that we continue to support the innovation in the marketplace.

So that is true across not just the 1850 and Jif Power Ups, but innovation in Pet. Although it started a little late, we've been pleased with the results we've seen customer pickup in line with our expectations. So it is a matter and large degree of continuing to be consistent and continuing to support those innovations for an extended periods to make sure that they gain traction in a foothold.

Mark Belgya

Yes, Bryan, I would – this is Mark Belgya. I would just add that a little bit as an add on to my last comment, Andrew, is that, on the marketing side, we went through and we identified what we felt was a reasonable reduction in areas. But the intent was to make sure that we maintained the dollar support from marketing that was necessary to support that innovation pipeline.

So if you look at what we have done historically over the last couple of years and what we're going to do even more this year around the cost reductions is, while we're clearly trying to identify opportunity to help deliver the guidance in light of the lower sales volume, we also – the organization recognizes the importance of folks sticking to our guns and providing the financial support to do that. So it's sort of an all in to get that cost structure such that we can continue to protect that that innovation.

Bryan Spillane

Okay, and that's great. That's helpful. Thank you.

Operator

Thank you. Our next question will come from the line of Robert Moskow with Credit Suisse. Please state your question.

Robert Moskow

Hi, thanks. I guess my question is about coffee margins. Last year, I think you had a nice pickup in your margins, because coffee commodity costs were down and you lowered price, but your Folgers profits grew in the process. This year, I guess, I'm a little unclear like what the expectation is coffee commodity costs are still falling a lot. You're off to a slow start in the first quarter, but that you're saying the rest of the year, you will have growth. So should we expect your margins to be flat in this dynamic, or are you going to have to give up a little bit more than you normally would? Thanks.

Mark Smucker

Rob, it's Mark Smucker. I'll start. We would expect them to be relatively consistent with last year. As you know, coffee costs are at 30-year lows, and they've been at 30-year lows for sometime. They continue to be at very low prices. So we have continued to use the lever of trade to make sure that we're – our competitive position is strong, but we do not see any significant change in both the performance of coffee. We do expect it to come back and we are actually already seeing some momentum in the category across all the segments, and then margins will be more or less consistent with last year.

Mark Belgya

Hey, Rob, this is Mark Belgya. Yes, I – absolutely, what Mark is saying, obviously, the 20%, call it, 28% we have for the quarter is below where we typically look. And where we will see the pickup over the back three quarters will come just from continued lower cost as a key driver, and then just getting the volume back quite candidly will help. And then that brings to it obviously things like favorable rate absorption. So there are some drivers that will help turnaround what you saw in first quarter to get back to sort of last year's numbers.

Robert Moskow

And you said that one of the drivers was just that there were some new product launches that were delayed, specifically into second quarter. Can you help us quantify, like what the gap was between first and second in that?

Mark Belgya

Yes, Rob, this is Mark Belgya, again. It wasn't necessarily new items. It was just we anticipate increased distributions that it will be more of a second quarter and a go-forward as opposed to the first quarter. So it's not necessarily just innovation, it is also some base business across the brands.

Robert Moskow

And why are retailers increasing your distribution in coffee?

Mark Smucker

Well, frankly, because several of our lines and items are performing very well. In the prepared remarks, I mentioned how well our K-Cup offerings are doing. So we are seeing some expanded distribution in K-Cup, as well as in our premium coffee set as well. And in some cases that may be at the expense of competitors. But generally speaking, because our customers have seen good performance. They are, in several cases, taking on some expanded points of distribution.

Robert Moskow

Okay. All right. Thank you.

Mark Smucker

Thank you.

Operator

Thank you. Our next question will come from the line of Pamela Kaufman with Morgan Stanley. Please state your question.

Pamela Kaufman

Hi, good morning. I just wanted to follow-up on your top line outlook. So volumes came in softer during the quarter. And I wanted to understand how much of the reduction to your top line outlook is driven by changes to your expectation for volume versus plans to invest more in price? And previously, you expected organic growth across customer pet and coffee. Do you still expect growth across all three segments this year?

Mark Belgya

So, Pam, this is Mark Belgya. Let me just start. So if you look at – let me just take a step back and sort of say where the top line, what droves Q1 and sort of what we expect from volume/mix over the remainder of the year. So for the reasons that Mark and I outlined, particularly the timing of shipments, notably, coffee and peanut butter that we're really strong in Q4. So that drove our volume/mix some in Q1.

So the thing is, you have to remember, too. You Probably know this, when we have that volume impact with particularly those two categories, those are highly profitable and high dollar value item, so we get sort of a double whammy and thus the vol/mix.

As we look forward, we still expect to see volume increase – volume/mix grow because of the fact of the matter is, there's going to be innovation coming across the various categories – across various brands as well. So that will drive. I don't know if we'll really get into the specifics on each segment. But again, we said organic growth should be positive for the year, and it is going to be a combination, as I said earlier, it will be our growth brands.

So again, Nutrish, Dunkin', Uncrustables and that's some innovation, that's obviously capacity come on Board Longmont. And then for some of the things that Mark just spoke to, for example, on the K-Cups and other coffee areas, we're going to see growth there.

So it is sort of the same story. I'd say that the biggest change for maybe what we said back in June is that, the impact of the strong fourth quarter probably drove – had a bigger impact on shipments than we would have assumed in Q1.

Pamela Kaufman

Okay, thanks. And just to follow-up on Nutrish. Can you elaborate on your plan for accelerating growth in the brand? And last quarter, you talked about some of your white space launches shifting into the first quarter? Did this occur as you had expected?

Mark Smucker

Pam, I didn't hear the last part of the – second part of your question.

Pamela Kaufman

So the…

Mark Smucker

You asked me to elaborate on Nutrish, and what else?

Pamela Kaufman

And then last quarter, you talked about some of your white space launches shifting into the first quarter. So this happened as you expected?

Mark Smucker

Yes, in treats – in cat treats, we did see some shifting of timing. But again, as I mentioned earlier on the innovation piece, we have seen good customer acceptance. It is – some of the customers reset their shelves later than initially expected. So that drove some of the timing. But so far, what we've seen is in line with our projections that we've been pleased with the innovation pickup in general.

And then as it relates to Nutrish, I won't get into specifics other than to say and just reiterate that, again, the dynamic in the premium pet dog, dog food category was actually a couple of competitors. It was not only one competitor that there was some aggressive pricing. Obviously, we will respond to that, as I mentioned, we will make sure that our pricing, particularly on those trial sizes and other items is where it needs to be to compete. And then we will continue to support the brands, both at a customer level and as well as from a consumer support in terms of brand support and advertising.

Pamela Kaufman

Okay. Thank you.

Operator

Thank you. Our next question will come from the line of Jason English with Goldman Sachs. Please state your question.

Jason English

Hey, good morning, folks.

Mark Smucker

Hey, Jason.

Jason English

Thank you for responding me in. I have a couple of questions. I guess, to start with, do you have an approximation of how much of a drag on organic sales was the inventory destock at retail related to Folgers and Jif this quarter?

Mark Belgya

Hey, Jason, it's Mark Belgya. I guess, I would just without getting specific, I would just say that it was a primary driver of the overall mix for the company. We said the 4%, 3%, that was volume/mix and a fair portion of it was related to that.

Jason English

Okay. So as I think about the remainder of the year, you gave us some commentary in the second quarter. It sounds like the growth recovery is really back-half weighted. And to get to your guide, I kind of need like 2% to 4% organic sales growth. And I'm obviously going to have to comp the over-shipment in the fourth quarter.

So on an underlying basis that that 2% to 4% is probably closer to 3% to 5%. It seems like a really big number for volume/mix, particularly in consideration of the environment overall. If you could touch maybe a little bit more on what gives you confidence there? And also give us some context of the amount of flexibility you have within your earnings algorithm to still deliver on earnings if that type of growth doesn't actually transpire?

Mark Belgya

So let me start with your second first question first. So as I said earlier, the team spent an incredible amount of time over the last several weeks identifying these opportunities. And we recognize that our investors and our followers question the ability to hit the earnings in the event that we cannot drive the sales performance that we're estimating.

So I would suffice it to say that we have – we've looked beyond just covering some of the costs that are necessary and anticipate that the top line, if it delivers even fall a little short that we feel that the guidance range is achievable.

In terms of the sales, you're right, it is definitely a back-half loaded forecast. And I guess, as I think, I mentioned earlier, it really is coming through a number of areas. But if you just look across the portfolio, we are going to see significant improvement in our growth brands in Q – particularly Q3 an 4, but over the back nine months, and that is going to be driven by Nutrish. And we feel with the actions that the teams have taken and are taking, we will reverse first quarter performance.

We also feel that the Dunkin' and Bustelo, again, some of these distribution gains as well as some innovation are going to benefit. And one of the things that actually will help by going away is this private label, which had a big impact on Q1, which is $26 million. We've got another $20-plus-million coming primarily in Q2, that pretty much goes away in Q3 and completely goes away in Q4. So that's a big drag that we don't have as well.

So that's the primary areas that we see, I think, the programs we have in place. And again, I know that you guys, we haven't gone on air with – except for Jif and Smucker's our new advertising. But we really believe that will be a driver of volume growth in the back-half as well.

Jason English

Okay. And on – I'm sorry, go ahead, Mark.

Mark Smucker

Jason, if I may just add a couple of comments from a historical perspective. Just on the private label – just before I do that, on the private label piece, some of that was planned exit in Pet. We will expect to replace some of that more than likely in the fourth quarter. So there is this lag. So Mark comments were right in terms of the specifics of that being one of the factors.

I guess, what I would just like to frame in is, clearly, as a CEO of this company, delivering on our commitments to our shareholders is a foundational priority. And so, we clearly – we won't do our initial guidance in – on a top line, but we will do whatever is within our power to ensure that, that we deliver earnings growth.

And as we've said before that we're in the business for the long-term. The progress is not linear and it can be lumpy. This quarter is an example of lumpiness. And it is – we have been in previous years many times with a back-half loaded plan. And so that is not new. And for those of you that have covered us for a while, you've experienced that in many different years.

I guess, I would point to and clearly we don't measure our success on a single quarter. But I would point, if you look back historically, in fiscal 2017, our business was declining at 3%. In 2018, it was declining around 1%. And last year, we were flat. And this year, we intend to deliver some positive growth. So if you look at that annual trend, clearly, we're moving in the right direction. And that's – that, obviously, is the goal, and our entire company is focused on making sure that we can deliver the guidance that we set for.

Jason English

Thank you very much.

Operator

Thank you. And our next question will come from the line of John Baumgartner with Wells Fargo. Please state your question.

John Baumgartner

Good morning. Thanks for the question.

Mark Smucker

Hey, John.

John Baumgartner

Just wanted to stick with the Pet business, because there's a lot of discussion around competition in premium around Rachael Ray and some of the newer entrants, maybe there's some substitution risk, maybe there's not. But if we focus more on the mainstream portfolio, I think, the consensus there is the growth in – is coming from trade up. And we've seen the impact the Gravy Train, Kibbles pricing is down 20% over the past three years. So when you model the business going forward, how are you comfortable with the relevance of the Kibbles franchise and defending the mass part of the portfolio from here?

Mark Smucker

So I've talked on previous calls – this is Mark Smucker. I've talked on previous calls about the breadth of the category and how – there is a very broad pricing set from ultra premium all the way down to value. And fundamentally, there is a similarly broad set of consumers that are looking for all different need states.

So our portfolio is very broad as well. We believe it clearly meets many of those need states, but really supporting those brands and continuing to drive our marketing investment against those is clearly going to have a strong impact. I would point to the fact that, Kibbles – you referenced Kibbles is a relatively small piece of the portfolio. Meow Mix is another example of a brand that is a mainstream brand, but it grew at 8% this year – for this quarter.

So about 65-ish percent of dog purchases is roughly in the premium and in our portfolio is in the premium space. So our portfolio does queue little premium. And so again, regardless of which segment we're talking about premium or value, it's all about communicating with the consumer, getting the price right at shelf, supporting the brands at shelf and making sure that our advertising is speaking to the consumer it's intended to.

John Baumgartner

Okay. Thank you, Mark.

Operator

Thank you. And our next question will come from the line of Chris Growe with Stifel. Please state your question.

Christopher Growe

Hi, good morning.

Mark Smucker

Hey, Chris.

Christopher Growe

Hi. I just had two questions for you, if I could. I wanted to ask first, in terms of your sense of the inventory adjustments that occurred this quarter, do you expect those to start from here or even reverse in this level? I just want to understand how that fits into your volume growth outlook for the year? And any inventory changes?

Mark Smucker

I – this is Mark Smucker. I would just say there will probably be some reversal in coffee, we are seeing that and probably some in peanut butter. I don't think we've quantified that. As we've said before, occasionally, customers do make inventory adjustments, you can't predict that. And this was one of those instances, but we continue to be encouraged by the trends, particularly on coffee.

We have seen some nice pickup, as I mentioned on peanut butter, and particularly versus other brands. And then again, one thing we didn't know in coffee is that the Dunkin' canister. We've had a lot of questions about that in the past. And that product is doing extremely well and it's highly incremental, much more incremental than we expected.

So we are not cannibalizing ourselves as much as we have originally expected and it's actually supporting category growth as well. So all of the things continue to give us confidence. And again, the inventory thing is sort of, we deal with it when it happens and this is one of those instances.

Christopher Growe

Okay. And then just another follow-up question we have on the Pet division. We talked about some delay until the new product launches into fiscal 2020. Are those occurring now as you expect to kind of spread across the year? You talked about some Nutrish products coming in the second-half of the year. So to get a sense of that how that's progressing, if you will, throughout fiscal 2020?

Mark Smucker

Yes, you are correct. There was some, as I mentioned before, some delayed shelf reset, which caused customers to take them later than we expected. Again, the Milk-Bone long-lasting chew items are doing very well. And so again, I know we are seeing the right level of pickup, meeting our projections a little later than expected, but it's going well. And there are other new product launches that are coming throughout the remainder of the year. So it's not all in yet, if you will.

Christopher Growe

Okay, thank you.

Operator

Thank you. And our next question will come from the line of Alexia Howard with Bernstein. Your line is now open.

Alexia Howard

Good morning, everyone.

Mark Smucker

Good morning.

Alexia Howard

Hi, guys. So just one question for me. The EPS guidance change for the year. It's fairly unusual guiding down modestly so early in the year, I think, it's about a 1% cut to the share guidance for fiscal 2020. I'm just curious about your thinking behind that, why do a small amounts now? And particularly given the uncertainty around the competitive dynamics, the retailer environments and so long, why not expand the guidance at all which is still very narrow? Thank you, and I'll pass it on.

Mark Smucker

Alexia, it's Mark Smucker. As a CEO, I remain very committed to being transparent with our investors. And given what we know this quarter, we, despite being disappointed in the guide down, we felt that it was the right thing to do and making – just making sure that we're having transparent and focused conversation about our results and what we truly believe we can deliver. So it is my obviously imperative to continue to ensure that we're providing that level of transparency going forward. So it's just – it's where we feel comfortable.

Alexia Howard

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

Mark Smucker

Thank you.

Operator

Thank you. And our next question will come from the line of Scott Mushkin with Wolfe Research. Please state your question.

Scott Mushkin

Hey, guys, thanks for taking my questions. So I guess, in listening to what you guys have been saying and the optimism in the back-half of the year, I've spent a lot last week in a lot of different stores, obviously, the Kroger for a couple of hours. And it just seems like the competition in some of your categories, I guess, I wouldn't be as encouraged. You look at Skippy, they're advertising and they've been doing a lot of efforts at stores.

You look at the pet category and we didn't notice like Nutrish and all the competition coming in there. And then on coffee, clearly Nestlé is doing an incredible job with Starbucks and creating some challenges in that category. So I guess, the question is that, why – I know you have plans in place, but why do you think competition, specifically against you is going to maybe ebb? Is there any signs of that?

Mark Smucker

Well, I don't think it's going to ebb. I mean, we're – we've been competing for 122 years, it's not. So that's a fair comment. What I would say is, again, we're in three amazing categories that are all, essentially snack, pet and coffee growing faster than center store in aggregate. So we're in good categories.

Most importantly, we have leading brands, and in many cases, number one brands that are really flagship brands within each category, or within segments of categories. And so that clearly gives us a competitive strength and gives us the permission to compete and obviously, to lead in many cases with price.

As we've done, I would point to as well, even in Pet, as you had new entrants come in, and despite being somewhat disappointed with our results in premium dog, we actually retained more points of distribution than other competitors did in – when those new entrants came in. So again, pointing to the fact that that being a leader, having strong brands, will allow us to continue to compete effectively.

But it is – there is a lot of competition, and we just have to continue to be disciplined, do the right things for our brands, support them through marketing and make sure that our pricing architecture is fair and supports the equity of those brands.

Scott Mushkin

Great. And then my follow-up question actually goes to the marketing side. As we seem to say, we see marketing maybe picking up, you guys say, you're going to cut back a little bit on it. So I was just wondering if you could give us a specific example of like marketing that you're going to like pull away that you think is ineffective? And would you actually be better off reallocating that to other things that you are – that you believe are more effective?

Mark Smucker

So I would – okay. So first of all, we are committed to doing marketing on all of the nine brands that we discussed. You should have seen both new advertising on Jif and Smucker in the market, or in the marketplace. And we feel very good about those and the ability of those to drive. top line. Where you would see that we will be pulling back is less so on media, it's really on challenging ourselves on non-working marketing dollars to make sure that those spends are truly necessary.

And so where we can drive efficiencies out, it's in those areas that are what we would call non-working marketing dollars. But supporting the brands and stuff that you would see going to consumers, that's what we're committed to making sure it's out in the public domain and we're reaching our consumers. So those areas we need to protect.

Scott Mushkin

All right, guys. I appreciate it. Thanks for your thoughtful answers.

Mark Smucker

Thank you, Scott.

Operator

Thank you. Our next question will come from the line of Rebecca Scheuneman with Morningstar. Please state your question.

Rebecca Scheuneman

Good morning. I was actually about to ask a very similar question that was just asked, now that we're about a year into the step-up and marketing spend. And kind of along the same lines, I was wondering, you did mention that you're – since you are pulling back on some marketing. I just was wondering if you have kind of looked at this and say, especially for some of your brands that are facing some secular headwinds. Are we may be better off instead of managing these brands for growth? Just trying to maximize cash flows, and if there's any changes there?

Mark Smucker

We're trying to stay focused, obviously, on the brands that we have. Recall that we recently made significant realignment to our portfolio by divesting the baking business. So we're very comfortable with the brands that we have and they all need support. Some need more support than others. And so they're not all created equal. But because of where we are, we are focused on these three categories and need to continue to support these brands.

The type of marketing can differ. So you may see, for example, or you may probably have seen a brand like Cafe Bustelo, we do a lot of experiential marketing. We do pop-up cafes. We had a coffee shop in Houston for about, I think, it was about three months. And so those types of marketing are different. So it's not always on air, television advertising, but there will be a lot more of that.

Earlier in your question, you mentioned that we're – I don't know about a year in, well, yes, we're a year into restructuring our marketing functions. But we're at the very beginning of launching new creative work on all of these brands. So the way in which we're communicating with consumer, making these brands relevant in today's culture, that's what's changing. And you've only begun to see the beginnings of that. So look for a lot more of that over the next, call it, six months or so.

Rebecca Scheuneman

Okay, great. Thank you. That's very helpful. My second question is actually on R&D investment. And so if I can look at the percentage of the sales you've got in the last few years from new brands, I think, it was about 7% in 2018 and then it fell to 5% in 2019. I know you're expecting a big step up on that this year. But kind of, if I look at what Smucker spends on R&D at about 70 to 80 basis points of sales. It is lower than your peer set. And I'm wondering if that is something that you thought about maybe stepping up the R&D – level of R&D investment, as well as you have done with the marketing? Thank you.

Mark Belgya

So, Rebecca, this is Mark Belgya. We – obviously, as we go through our long range planning and our budget on an annual basis, we always give consideration to making sure that we're appropriately supporting R&D and we'll continue to see opportunities. But right now we feel the spend and the talent that we have with that is excellent. And I think just based upon some of the innovation we brought to market is probably the best evidence of that.

In terms of the reference to, I think, what you were saying was basically sales that have come from new products, which we would define as over the last three years. That number peaks and valleys a little bit, if you think about a few years ago, when we launched Dunkin' Donuts K-Cups the years that followed that had a bigger hit than a normalized year.

So you've got to watch that a little bit. We think it is our innovation, a particular platform innovation we spoke to over the last year continues to flow into the market. You'll see that percent of total sales represented by new products will increase maybe to more of the levels that you're accustomed. But I just put a little cautionary tale out there, depending if you just take an absolute change.

Mark Smucker

Yes, I guess, Rebecca, this is Mark Smucker. I would just add that some of the development of new products, if you will, falls under our innovation team. So there are some costs that are in that space. In fact, we actually – my leadership team has a meeting later today to actually review innovation that is further out two to three years out. And so that is something that we do as a team. We involve marketing and R&D and everybody is in the room.

So we feel good about our process. We know we have significant R&D facilities here on site in Orville, pilot plants for pet and coffee and some of our Consumer Foods businesses. So we're pretty, I think, we're – we feel that we're in a good place and the process that we have in place is very disciplined and it's working.

Rebecca Scheuneman

Okay, great. Thank you.

Operator

Thank you. This concludes our question-and-answer session for today. So now I'd like to hand the conference over to Mark Smucker to conclude the call.

Mark Smucker

So again, thank you all for listening in today. We appreciate you taking the time, given the fact that this quarter, clearly, we had a hiccup. We just want to reinforce our commitment to doing what's right, remind the group that we really do manage our business year-over-year.

And if you look at our annual performance, it has steadily improved over the last few years. And despite being disappointed with this quarter, we still feel very strongly that our strategy is right, as we've seen evidence that it's working in multiple areas of our business, and just remaining committed to being transparent with you all and appreciate the support and the time that you've spent with us today. Thank you.

Operator

Ladies and gentlemen, this concludes our conference call today. Thank you for participating and have a nice day. All parties may now disconnect.