

HF Foods Group 4Q23 Earnings Call

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Hello, everyone.

Welcome to HF Foods Group's fourth quarter and full year 2023 earnings conference call. Joining me on today's call are Peter Zhang, HF Foods' Chief Executive Officer, and Felix Lin, the Company's President, Chief Operating Officer and interim Chief Financial Officer. In a moment, we'll hear their prepared remarks.

By now, everyone should have access to the earnings release for the period ended December 31, 2023 that went out Thursday, March 14 at approximately 8:00 AM Eastern time. The press release is accessible on the Company's website at investors.hffoodsgroup.com.

Before we begin, let me remind everyone that today's discussion contains forward-looking statements based on the environment as the company currently sees it, and as such, does include risks and uncertainties. If you refer to HF Foods' earnings release, as well as the Company's most recent SEC filings, you will see a discussion of factors that could cause the Company's actual results to differ materially as a result of these forward-looking statements. Please remember the Company undertakes no obligation to update or revise these forward-looking statements in the future.

In these remarks, the Company will make a number of references to non-GAAP financial measures. We believe that these measures provide investors with useful perspective on the underlying growth trends of the business and have included in the earnings release a full reconciliation of non-GAAP financial measures to the most comparable GAAP measures.

Now, I will turn the call over to Peter.

Peter Zhang, CEO

Hello, everyone. I am excited to be speaking to you today. I will start with a quick introduction. Felix will talk to you about our financial results as well as some of the exciting progress we have made with our transformational plan.

For those of you who are new to our story, HF Foods is a leading Asian foodservice distributor for Asian restaurants in the United States. We partner with domestic and international suppliers to offer a wide range of high-quality Asian ingredients for our customers, and our widespread distribution network covers 95% of the United States.

I would also like to note that Felix Lin has taken on the role of President of HF Foods, in addition to being our Chief Operating Officer and Interim CFO.

Now over to you, Felix.

Felix Lin, President, COO and Interim CFO

Thanks, Peter.

I am excited to be speaking with you after our fourth quarter of 2023 in which our gross profit, gross margin, net income, and Adjusted EBITDA all increased compared to the prior year period. We have already begun to see signs of success from our operational transformation plan that we laid out during our third quarter earnings call in November, and I will speak about our progress on these key financial metrics.

Q4 Results

I'll start with our results for our fourth quarter ended December 31st, 2023, versus the same period in 2022:

Net revenue for the fourth quarter decreased 3.8% to \$280.9 million, from \$291.9 million in the prior year quarter. The decrease in net revenue was primarily attributable to deflationary pressure in key commodities as well as the exit of our chicken processing businesses.

Gross profit increased by 3.1% to \$52.3 million for the quarter, compared to \$50.7 million in the prior year quarter and gross profit margins increased 120 basis points to 18.6%. The increase was attributable to improvement in the Seafood category due to successful execution of a centralized purchasing plan.

Distribution, selling, and administrative expenses decreased approximately 24.3% to \$41.0 million for the fourth quarter of 2023 from \$54.1 million for the fourth quarter of 2022. The reduced expenses were due primarily to lower professional fees and were partially offset by higher payroll and related labor costs. During the fourth quarter of

2023, we received net settlement amounts totaling \$10.0 million which reduced our professional fees. Distribution, selling and administrative expenses as a percentage of net revenue decreased to 14.6% from 18.5% in the prior year period primarily due to lower professional fees and partially offset by increased headcount.

Operating income for the fourth quarter of 2023 was \$11.2 million compared to a loss of \$3.4 million for the fourth quarter of 2022. The increase was driven by the lower distribution, selling, and administrative expenses.

Total interest expense increased to \$3.0 million for the fourth quarter compared to \$2.4 million in the prior year quarter.

Net income increased to \$2.7 million, for the fourth quarter, compared to net loss of \$3.5 million for the prior year quarter. Improved net income was driven by lower distribution, selling and administrative costs, and higher gross profit. The increase in net income was partially offset by the \$3.6 million change in the fair value of interest rate swaps, higher interest expense, and decreased tax benefits.

Adjusted EBITDA increased approximately 376% to \$20.5 million for the fourth quarter, compared to \$4.3 million for the prior year quarter. The increase in adjusted EBITDA was primarily due to the net settlement.

FY Results

I'll now turn to our results for the full year ended December 31st, 2023 versus the same period in 2022.

Net revenue for the full year decreased 1.9% to \$1.15 billion from \$1.17 billion in the prior year period. The decrease in net revenue was primarily attributable to declines in the Meat and Poultry and Packaging and Other categories. The revenue decrease was partially offset by higher volume and the Seafood revenue generated due to the Sealand Acquisition that closed in April 2022.

Gross profit decreased 0.7% to \$204.0 million for the full year, compared to \$205.5 million in the prior year period. The slight decline was primarily driven by decreases in Meat and Poultry, and to a lesser extent, Packaging and Other, partially offset by the increased Asian Specialty revenue and the additional Seafood revenue generated due to

the Sealand Acquisition and the successful execution of the Seafood centralized purchasing program. Gross profit margin increased 20 basis points to 17.8% from 17.6% in the prior year.

Distribution, selling and administrative expenses were flat at approximately \$195.0 million for the year.

Operating income was \$9.1 million for the full year in 2023 compared to \$10.6 million in 2022. The decrease was driven by lower gross profit.

Total interest expense increased to \$11.5 million for the full year compared to \$7.5 million in the prior year.

Net income decreased to a net loss of \$2.7 million compared to net income of \$0.2 million for the prior year period. The decrease in net income was primarily attributable to increased interest expense, as well as a change in fair value of interest rate swap contracts of \$2.4 million, partially offset by a change in lease guarantee expense of \$6.1 million.

Adjusted EBITDA increased 11.1% to \$44.6 million for the full year, compared to \$40.1 million for the prior year. The increase was primarily due to \$10.0 million of total net settlement amounts, realized in the fourth quarter of 2023.

Turning to the balance sheet and an update on our liquidity:

At the end of the fourth quarter and full year, we had available capacity of \$37.6 million in additional funds through our line of credit. We feel very comfortable with our current liquidity.

Transformation Update

As a reminder, we've implemented a comprehensive operational transformation plan to achieve our growth targets. I am excited to share with you some of the recent progress we have made.

Centralized purchasing

We have begun to make meaningful progress with centralized purchasing, specifically in certain Seafood categories. We have also partnered with a new vendor that specializes

in chicken processing for the eastern United States market and consolidated our chicken purchases in the region. This has resulted in better quality and pricing for our products. We are now working on expanding this model to the western U.S., and we expect to expand our centralized purchasing initiatives into both our commodities and produce categories in 2024.

Fleet and Transportation

We are excited to announce that in February, we entered into a partnership with a large and reputable national 3PL provider. This is a long-term strategic agreement that will enhance our operational efficiency and help us establish a unified and improved transportation system. We have also implemented a national fuel savings program to improve efficiency and reduce fuel costs. Furthermore, we have finalized our initial truck purchase order, which will enable us to initiate the replacement program for 50% of our aging fleet with the goal to increase efficiency and lower operating costs. We expect to complete the replacement program over the next several years.

Digital Transformation

As for digital transformation, we discussed previously that we are piloting and implementing a modern ERP solution across all of our sites to complement our recent go-live with financial systems to drive efficiencies and provide for greater data driven decision making. The pilot is going very well and we expect to complete implementation within the next 12 months.

Facility Upgrades

As you may recall, we have been conducting a network and facility study to optimize our distribution network and align it with our strategic goals. The study is now complete and we are in the process of making decisions based on its findings. With the upcoming changes, we will be converting certain distribution centers to full broadline facilities that can supply a wide range of products that are in high demand in their respective regions. This will allow us to capitalize on cross-selling opportunities and improve the usage and efficiency of our facilities and distribution centers. We are also currently working to open a new broadline facility and convert an existing space into broadline functionality

in key markets, which we look forward to sharing further updates on in the coming quarters.

One of the ways that we are improving our distribution network is by utilizing cross docks, which are facilities that allow us to transfer products from one truck to another without storing them. We have cross docks in strategic locations such as Las Vegas, Ohio, Texas, and California, which enable us to reduce transportation costs, inventory levels, and delivery times. We are adding cross docks where it makes sense, as we continue to streamline and make our operations more efficient.

As a reminder, in 2023 we divested our two poultry processing businesses on the east and west coast, as part of our commitment to refocusing on our core business and exiting low-margin businesses.

I am pleased with what we have accomplished so far with our transformation plan, as we now have the corporate infrastructure in place to set the stage for efficiencies and success. In 2024, we are fully committed to executing our plan diligently in order to achieve sustainable long-term growth and deliver value to shareholders.

M&A

To briefly touch on our M&A growth strategy: We believe we have established ourselves as the preferred acquirer for many Asian food distributors, and we regularly have potential targets approach us first to explore opportunities. We are exploring using M&A as an opportunity to expand into new markets and regions. We believe our M&A strategy will enable us to realize significant synergies and expand our presence geographically.

Closing Remarks

To sum it up, we are a trusted partner for thousands of restaurants across the United States, offering them high-quality specialty products that deliver authentic experiences. We provide restaurant owners with a one-stop-shop that combines a friendly cultural connection and national scale, enabling them to serve their customers with quality products at affordable prices. We are well-positioned to capitalize on the growing demand for Asian food, driven by favorable market trends and demographics. We have the infrastructure, industry knowledge, and experience to support our growth.

Thanks to our deep understanding of our customers' needs, their loyalty and satisfaction have helped us to build HF Foods into an enterprise that generates over \$1.1 billion of net revenue annually. Our long-term financial profile is attractive, with a clear strategy to expand margins and grow revenue. We are laser focused on executing our transformation plan to improve operations as we continue to pursue growth. We are proud of our progress so far and believe that our financial metrics will reflect our success in the upcoming quarters.

We look forward to speaking with you again on our first quarter earnings call and updating you on the progress of our operational transformation plan. Thank you everyone and have a great day.