HF Foods Group 3Q24 Earnings Call

Anna Kate Heller, ICR

Hello, everyone.

Welcome to HF Foods Group's third quarter 2024 earnings conference call. Joining me on today's call are Felix Lin, Interim Chief Executive Officer, President and Chief Operating Officer, and Cindy Yao, Chief Financial Officer.

By now, everyone should have access to the earnings release for the period ended September 30, 2024 that went out Tuesday, November 12 at approximately 4:05 PM 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 because 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 a 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 Felix.

Felix Lin, Interim CEO, President and COO

Hello, everyone. Welcome to HF Foods third quarter earnings call. I will provide an operational update and our CFO Cindy will speak to our third quarter financial results.

Before we start, I want to say that I am grateful for this opportunity to enter the interim CEO position, and I am incredibly excited about the future of HF Foods. Our team is fully aligned in the mission ahead of us, which is to transform our business so that we can deliver sustainable long-term growth for years to come. I am pleased to be speaking with you after we have made progress on the execution of our operational transformation plan as we are undergoing major transformations in all areas of our business.

While we continue to set ourselves up for long-term success, the broader industry has been facing some softer trends as the consumer remains cautious with their spending habits. Restaurants experienced some headwinds in the quarter, with decreased foot traffic and reduced spending. For us, this led to some weaker ordering patterns and increased competition. The environment remains choppy, yet we were still able to deliver net revenue growth this quarter.

Transformation Update

We are making great strides with our operational transformation plan. The initiatives we have put in place are already showing promise, and we expect them to drive substantial growth and cost savings for HF Foods in the long term. Let me walk you through some key developments:

Centralized purchasing

I am pleased to report that our centralized purchasing program is making solid progress. After a successful pilot last year, we have now rolled out the program across our entire seafood category among all seafood distribution centers. We will further roll out the program at the remaining DCs across all categories in 2025. This expansion marks a significant milestone in our efforts to streamline our procurement processes and leverage our scale. Seafood gross profit increased $1.3m from Q3 2023 to Q3 2024 while gross profit margin was approximately flat. Seafood margin has been relatively consistent compared to the volatility in other categories such as chicken. The increased competition in distribution and the slowdown of the restaurant industry in general has been a headwind to margins. We stocked up certain seafood items like shrimp and snow crab at a lower price earlier this year, which mostly offset the margin pressure.

We are also in the process of expanding our centralized purchasing program to cooking oil within our commodity category. We've signed a lease on cooking oil equipment and signed a service agreement with a cooking oil processor in Kansas City. We are currently ramping up operations and expect it to be fully operational by the start of 2025. Distribution will initially focus on the West Coast, with plans to expand nationwide throughout 2025. The facility when fully deployed has full year revenue capacity of $60 million. By bringing our cooking oil packaging business in-house, we're not just improving our supply chain resilience; we're positioning ourselves to capture additional value and improve our overall gross margin profile over the long term. This vertical integration of cooking oil aligns seamlessly with our ongoing implementation of a new ERP system across all distribution centers. Together, we expect these strategic moves to enhance operational efficiencies, strengthen our competitive position, and propel growth and margin expansion in the years to come.

Our strength in purchasing power in seafood and protein has enabled us to gain access to broader wholesale channels. While we expect the wholesale business to remain a relatively smaller part of our business, the added volume will further strengthen our overall purchasing capabilities and partially offset gross profit dollar decline in selective markets due to lower restaurant foot traffic.

Fleet and Transportation

Turning to our fleet and transportation initiatives, where we continue to drive improvements in efficiency and cost reduction. Our strategy now and throughout 2025 includes the ongoing modernization of our vehicle fleet and the rollout of an enhanced route optimization initiative.

These improvements will be further amplified as our facility upgrades are completed, including the renovation of our Charlotte, North Carolina facility that is expected to be complete by early 2025. Once fully operational, the upgraded facility is expected to optimize our distribution network substantially. By reducing travel distances and times for our drivers, we anticipate cutting distribution costs in the Southeast region.

Digital Transformation

We have begun the implementation of our modern ERP solution and expect to complete the rollout across all distribution centers in the first quarter of 2025. This strategic investment will significantly boost our ability to enhance and broaden our centralized purchasing program.

Alongside our ERP rollout, we are launching the first phase of our e-commerce business in the first quarter of 2025. While currently a small portion of our business that primarily serves restaurant owners in remote areas for a limited number of SKUs, we see exciting potential in this higher-margin channel. Following the launch, we will work towards bringing our entire product catalog online, offering an alternative to our traditional call center ordering system.

This e-commerce expansion caters to the evolving needs of younger generation business owners and opens new channels for non-Chinese speaking customers, including the Hispanic segment. Leveraging our existing distribution network gives us a competitive advantage in this space.

We believe this digital initiative will be a tailwind to our margins and enhance our overall operational efficiency, positioning us for sustainable growth in an increasingly digital marketplace.

Facility Upgrades

As previously mentioned, the renovation of our Charlotte, North Carolina facility is on track for completion by early 2025. This upgrade will significantly improve our distribution capabilities on the East Coast.

I'm pleased to announce that we've finalized the lease for our new Atlanta facility, which will double our capacity in that region. We're adopting a multi-phase approach, with the first phase of facility readiness expected by the end of 2026 and full operational status anticipated in mid 2026. This expansion will drive growth through increased cross-selling opportunities in the Southeast.

In the Western U.S., we're transitioning our Las Vegas operations from a cross-dock facility to a full distribution center. We expect to sign the lease for the distribution center in late 2024, followed by capital investment and facility improvements throughout 2025. The goal is to achieve operational status by the end 2025 or early

2026, which will significantly enhance our West Coast operations by reducing route lengths and improving overall productivity.

In Salt Lake City, we are in the process of consolidating warehouse space to drive further operation efficiency.

These strategic facility upgrades across the country will strengthen our distribution network, improve operational efficiency, and support our long-term growth objectives. We'll continue to provide updates on these projects in the coming quarters.

M&A

Regarding our M&A growth strategy: we continue to explore M&A opportunities for geographic expansion of our business, particularly targets that will allow us to realize meaningful synergies.

Hurricane Relief Efforts

Before turning it over to Cindy, I want to highlight our recent community support initiatives in North Carolina. In the aftermath of Hurricane Helene, HF Foods actively participated in relief efforts across Asheville and Black Mountain region. Our team coordinated multiple deliveries of essential supplies to first responders, local churches, and World Central Kitchen, including water, food supplies, and protein products. This initiative aligns with our commitment to being a responsible corporate citizen in the communities we serve, particularly in times of crisis. These efforts were coordinated through our local distribution network, demonstrating the agility of our operations to respond to community needs while maintaining our core business functions.

Now, over to you Cindy.

Cindy Yao

Thanks Felix. I will now review our results for the third quarter ended September 30th, 2024, versus the same period in 2023:

Net revenue for the third quarter increased 6.0% to $298.4 million, from $281.5 million in the prior year quarter. The increase was primarily driven by inflation and higher pricing, particularly in the seafood and meat & poultry categories. The increase was partially offset by decrease in sales volume for meat & poultry, vegetable, Asian specialty, and packaging.

Gross profit decreased by 1.5% to $50.2 million for the quarter, compared to $50.9 million in the prior year quarter, and gross profit margins decreased to 16.8% from 18.1%. The decrease was primarily attributable to a decrease in margins on meat and poultry. It's important to note that gross margins on wholesale sales are generally lower than those on retail sales due to the larger quantities purchased by wholesalers. While we expect wholesale sales to continue to make up less than 5% of our revenue, we do see a slight uptick in wholesale mix in Q3 vs the prior year period. We see this trend continuing and that this will benefit the retail business in the long term as retail volume increases. We've seen the margin expansion initiatives yielding positive results in seafood , which partially offsets margin losses in selective markets due to lower restaurant foot traffic. As a result, we expect the net margin expansion to remain muted in the short term.

Distribution, selling, and administrative (DSA) expenses increased slightly to $49.7 million for the third quarter, driven primarily by higher rental expenses and insurance costs. However, DSA expenses as a percentage of net sales decreased to 16.6% from 17.4%, largely due to increased net revenues and reduced professional fees. With the SEC settlement now behind us, as mentioned last quarter, we expect professional fees to continue declining. Looking ahead, we have identified strategic cost optimization opportunities across key spending categories. We are finalizing a comprehensive plan to reduce our cash DSA expenses by 3-5% by the end of 2025, while preserving our core growth initiatives. We look forward to sharing more in the coming quarters.

Operating income for the third quarter of 2024 was $0.5 million, compared to $2.1 million in the prior year quarter. The decrease was driven by the lower gross profits and increased distribution, selling, and administrative expenses.

Total interest expense was $2.6 million for the third quarter, in line with the prior year quarter.

Net loss of $3.9 million decreased compared to net income of $2.0 million for the prior year quarter. The decrease was driven primarily by the change related to the fair value of interest rate swap contracts of $5.3 million non-cash expense, and the increases in rental expenses and insurance costs, partially offset by an income tax benefit of $1.3 million.

Adjusted EBITDA decreased to $8.3 million for the third quarter, compared to $10.1 million in the prior year quarter. The decrease was primarily due to the decrease in operating income.

At the end of the third quarter, we had available capacity of $27.3 million in additional funds through our line of credit.

Thank you, and back over to you Felix.

Felix – Closing Remarks

As we navigate the rest of the year and look ahead to 2025, our focus remains steadfast on executing our transformation plan. This includes critical investments in facility upgrades and supply chain enhancements, which are pivotal in addressing capacity constraints and laying the groundwork for growth in 2026 and beyond.

Our team is working tirelessly to establish the infrastructure and systems necessary to set the stage for long-term success. 2025 will be a year of strategic investment and focus on fortifying our operational foundation, advancing our digital capabilities, and optimizing our facilities to support robust growth. We remain committed to driving margin improvement and are actively exploring additional cost reduction and efficiency measures that we'll talk more about in the coming quarters.

We are confident that these strategic investments and operational improvements will yield substantial returns in the years to come. As always, we appreciate your continued support as we navigate this transformative period and position HF Foods for a future of sustained growth and increased shareholder value. There are favorable market trends and demographics driving growing demand for Asian food, and we are extremely well positioned to capitalize on this.

We look forward to speaking to you again on our next call. Thank you.