

HF Foods Group 2Q24 Earnings Call

Madeleine Kettle, ICR

Hello, everyone.

Welcome to HF Foods Group's second quarter 2024 earnings conference call. Joining me on today's call are Peter Zhang, Chief Executive Officer, Felix Lin, 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 June 30, 2024 that went out Tuesday, August 6 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 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. Welcome to HF foods second quarter earnings call, our President and COO Felix will provide an operational update and our CFO Cindy will speak to our second quarter financial results. Before I turn it over to them, I'd like to share how pleased we are with the final settlement in the second quarter regarding our legacy SEC matters,

Along with our Board, the management team is laser focused in both our short-term and long-term plan to drive value for our shareholders.

Now over to you, Felix.

Felix Lin, President and COO

Thank you. Echoing Peter’s comments, 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 meaningful progress on our key financial metrics, including year over year improvements in net revenue, gross profit, and Adjusted EBITDA.

It is notable that we achieved these results while undergoing major transformations in all areas of our business. The results also included the impact from our discontinued chicken processing businesses in 2023, which was a \$3.1 million offset to revenue during the second quarter. Cindy will provide further details about these key financial metrics that underscore our progress.

Transformation Update

Our comprehensive operational transformation plan is well underway, with each of our initiatives having significant growth or cost reduction impact to HF Foods for years to come as we set the stage for success. I will offer some updates on our progress:

Centralized purchasing

We continued to make progress on our centralized purchasing program. As noted previously, we piloted the program with a handful of seafood products in 2023 and have now expanded the program to a majority of our seafood category buys. In Q2 2024, we have seen our seafood margin grow significantly versus same period last year. The ongoing improvement in seafood margin helps offset margin impacts in other categories such as chicken, which experienced significant cost volatility in the first half of 2024 compared to prior periods.

In the first half of 2024, we expanded the purchasing program to include a portion of our chicken buys. Specifically, we shifted a significant volume of our chicken breast and

leg meat purchases from spot buys to contract commitments with larger processing plants, bypassing brokers. Despite experiencing volatility and inflation in chicken prices, we have successfully expanded our margin on a per pound basis compared to the same period last year. This achievement is particularly challenging given our customers' price sensitivity to high volume items like chicken. Our focus remains on driving gross profit dollar growth, which will help us effectively neutralize major volatilities in key categories.

In the coming months and quarters, we are actively working on expanding the program to include other key product categories such as grain and cooking oil. With our ongoing plan to implement a new ERP system across all of our distribution centers, we anticipate demonstrating more significant progress beyond 2024.

Fleet and Transportation

We are also making progress on improvements to our fleet and transportation. We have implemented a unified fleet telematics system across all our trucks, enabling us to effectively track and monitor fleet performance on a common platform. This shift allows us to focus on driving operational efficiencies. For example, we are actively working to reduce fleet idle times, which will significantly impact our fuel costs. Over time, this will directly lower our distribution costs to customers.

Another key focus area is centralizing our inbound freight program to improve margins from a total cost perspective. Alongside the centralized chicken purchasing program initiated in 2024, we have also consolidated our shipping lanes for those products. This initiative has yielded positive results, and we plan to expand it further.

Digital Transformation

I am excited to announce that we are making very good progress with our digital transformation, as we recently completed implementation of our modern ERP solution at one of our California distribution centers. The implementation will help to streamline our operations, improve data accuracy, and enhance overall efficiency. This successful ERP rollout marks a milestone in our journey towards greater operational excellence and customer satisfaction. We look forward to applying the insights gained from this process to other distribution centers to ensure a smooth transition and minimize any

disruption to operations. We expect to complete implementation at all of our distribution centers by the end of 2024. As I noted earlier, this initiative will yield significant dividends in our effort to expand the centralized purchasing program beyond 2024.

Facility Upgrades

Our facility upgrade plans are progressing well. We have recently begun renovating our Charlotte, North Carolina facility, which spans over 100 thousand square feet and includes nearly 30 thousand square feet of cold storage space. Once operational, this facility is expected to significantly enhance our distribution operations on the East Coast by reducing route lengths for nearly half our customers in the Southeast market. We anticipate completing the renovation by early 2025.

Additionally, we are close to finalizing the lease for a new facility in Atlanta, which will effectively double our capacity in that market. This added capacity will enable us to drive growth through cross-selling in the Southeast. Once the lease is finalized, we expect the new facility to be fully operational by early 2026. However, we will adopt a multi-phase approach to begin utilizing the new facility earlier. We will continue to provide updates in the coming quarters.

I am extremely pleased at the way our team has been diligently executing our transformation plan, setting the stage for sustainable long term growth and delivering value to shareholders.

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.

Now, over to you Cindy.

Cindy Yao

Thanks, Felix. For the second quarter ended June 30th, 2024, versus the same period in 2023:

Net revenue for the second quarter increased 3.4% to \$302.3 million, from \$292.3 million in the prior year quarter. This increase was primarily driven by product cost inflation in the chicken category and improved pricing in seafood, partially offset by the \$3.1 million loss in revenue resulting from the exit of our chicken processing businesses.

Gross profit increased by 3.6% to \$52.5 million for the quarter, compared to \$50.7 million in the prior year quarter, and gross profit margins increased slightly to 17.4% from 17.3%. 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 expect to see an uptick in wholesale mix in the short term as we scale our business. This will ultimately benefit the retail business in the long term as retail volume increases. As a result, we expect margin expansion to remain muted in the short term, despite improvements in retail gross margins.

Distribution, selling, and administrative expenses decreased approximately 4.6% to \$49.8 million for the second quarter of 2024 from \$52.2 million for the second quarter of 2023. The reduced expenses were due primarily to lower professional fees and were partially offset by higher payroll and related labor costs. Distribution, selling and administrative expenses as a percentage of net revenue decreased to 16.5% from 17.9% in the prior year period primarily due to increased net revenue and lower professional fees and was partially offset by increased headcount. I am pleased that since the matter related to the SEC settlement is fully behind us, our professional fees will now be significantly lower on a go-forward basis starting in the third quarter.

Operating income for the second quarter of 2024 was \$2.6 million compared to a loss of \$1.6 million for the second quarter of 2023. The improvement was driven by lower distribution, selling, and administrative expenses.

Total interest expense slightly increased to \$3.1 million for the second quarter compared to \$2.8 million in the prior year quarter.

Net income improved to \$0.2 million for the second quarter, compared to net loss of \$1.6 million for the prior year quarter. The improvement was driven by a \$4.2 million increase in operating income and the \$5.3 million reversal of our lease guarantee

liability, partially offset by the \$3.9 million SEC settlement and the \$2.5 million change in the fair value of interest rate swaps.

Adjusted EBITDA increased approximately 26.4% to \$10.6 million for the second quarter, compared to \$8.4 million for the prior year quarter. The increase in adjusted EBITDA was primarily due to the increase in operating income.

At the end of the second quarter, we had available capacity of \$29.9 million in additional funds through our line of credit.

Back over to you, Felix.

Felix – Closing Remarks

We are diligently executing our ongoing initiatives, many of which are working well. We are focused on inventory and working capital management, reducing costs in transportation and logistics, and enhancing operational efficiencies in our distribution centers. Every decision we make is guided by our commitment to the long-term growth and success of HF Foods. With favorable market trends and demographics driving the growing demand for Asian food, we are well-positioned to capitalize on this opportunity. Our robust infrastructure, industry expertise, and extensive experience equip us to support and sustain our growth.

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