Operator

Good morning and welcome to the Innovative Food Holdings Third Quarter 2023 Earnings Conference Call. My name is Ronit Wallerstein and I'll be moderating today's call. With me on today's call for Innovative Food Holdings is Bill Bennett, our CEO; Brady Smallwood, our COO; and Richard Tang, our CFO. Throughout the conference, we will be presenting both GAAP and non-GAAP financial measures including, among others, historical and estimated EPS, adjusted EBITDA, which is net income before costs associated with amortization, depreciation, interest and taxes, and excluding certain one-time expenses; and adjusted fully diluted EBITDA per share, using the weighted average shares outstanding for the quarter ended 9.30.23.

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

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

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

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

Factors that could cause actual results to differ materially include, but are not limited to, the risk factors described and other disclosures contained in our filings with the Securities and Exchange Commission including the risk factors and other disclosures in our Form 10-K for the year ended December 31, 2022 and our other filings with the SEC, all of which are accessible on www.sec.gov. Except to the extent required by law, we assume no obligation to update statements as circumstances change.

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

Bill Bennett

Hello everyone and good morning. I'm happy to welcome you to our second consecutive earnings call. I'm also glad to welcome our new COO, Brady Smallwood, to our call today. You'll be hearing from him a bit later on the call.

We'll be discussing the results from our third quarter of 2023, which was my second full quarter in the role as CEO of IVFH. Hopefully you saw the press release this morning with some highlights from the quarter. We'll also be filing our full 10-Q later today for your reference.

As I outlined in our call last quarter, I want to start my comments today by reminding investors of some strategic context to the moment we're in as a company. Our goal at IVFH is to grow shareholder value by building a company that delivers long term profitable growth to our investors. With my arrival at the company a few months ago, I outlined to our board a three-phase approach we're taking to build towards that goal. As a reminder, those phases are as follows:

Our first phase is focused on the "stabilization" of our business. We need to build credibility that we can consistently deliver a profitable business model and positive cash flow. This is why we've been focused so heavily on right sizing our margins, expenses, and uses of cash. We anticipate that this phase will last for my first year.

We're calling phase 2: "Laying the Foundation for Growth," which will entail making several strategic moves to build a next generation business model. We're calling phase 3: "Build and Scale," when we'll be prepared to make the investments to scale the successful business models we've fully tested.

As we traverse this path, I think it's helpful to remember that we are still squarely in our "Stabilization" phase, but our commitment to investors is transparency and candor along that journey.

With that introduction, let's jump into results for Q3 2023. Our focus on improving profitability continued to make strong progress. Gross margins continued to show significant YoY growth of 568 bps, as we optimize our pricing strategy. SG&A increased by 3.8%, primarily due to one-time charges, which Rich will delve a bit deeper into. Lastly, our adjusted EBITDA improved to $887,673, an improvement of $397,184 vs. LY. During the third quarter, our revenue declined by approximately 14%, compared to the same period in 2022, as we work through the "Stabilization" phase of our plan. Our Professional Chef business was the main driver of the decline. As I said earlier, we want to continue to demonstrate that even in the face of the expected lower revenue this year, we are building a sustainable, profitable business model, and I think this quarter was a great example of the progress we're making.

Now I'll turn some time over to Brady to talk through some of the specific improvements we've made to the operation of our business this quarter. Brady?

Brady Smallwood

Thanks, Bill. Let's start with the Specialty Foodservice side of the business, which we call "Professional Chef" to help our teams focus on our end customer. Here, revenue declined 16% as we faced our first full quarter of lapping post COVID reopening strength. We also saw foodservice market trends soften, with Q3 experiencing the lowest comps in two years and industry pundits pointing to consumer headwinds, slowing inflation, and a return to more normal seasonality as reasons for the slowdown (Barclays, U.S. Restaurants Industry Update, Sep 2023). These headwinds, combined with our recent price increases and a change in the technology platform used by a key customer, have led to a smaller, though significantly more profitable business for us. I'd also like to remind the group that our Professional Chef revenue is still up 29% compared to pre-Covid levels, so we've held on to the majority of our post-COVID sales growth, but we are now operating with an improved business model. Now, I mentioned some headwinds, but we also saw encouraging growth in some other areas. This quarter, we expanded our geographic presence with a leading broadliner, signed a brokerage agreement that will support us pursuing opportunities in retail channels, and started a relationship with a top airline catering brokerage firm. Opportunities like this abound in the roughly $1 trillion foodservice market, and our differentiated value proposition give us confidence in Professional Chef's future growth with both new and existing customers.

Now moving to the eCommerce business. We continued to restrict marketing spend relative to historical levels, and now that we are lapping the start of this restricted marketing strategy in Q3 of last year, our ecommerce sales declines moderated to -0.7% (vs. -31% YoY in Q2). Our largest online brand, igourmet.com, where we have focused the most resources, was flat on sales while materially increasing gross margins and decreasing SG&A. Over the last two quarters, we conducted an end-to-end assessment of order-level economics, customer lifetime value, and other key ecommerce business factors. As a result, we have implemented tactics to boost margin, reduce shipping and packaging costs, optimize marketing channels, and streamline our warehouse operations. Ecommerce does continue to generate losses, but it's good to see the progress the team has made to materially reduce those losses and enable the total company to return to consistent profitability.

A little more on gross margins. Our gross margins improved 568 basis points compared to Q3 of 2022. The majority of this improvement came from now having a full quarter of the pricing actions in place from Q2, which counter the margin declines experienced in the prior year. We have also rationalized our shipping carriers, consolidating to a more favorable contract with FedEx, and gained efficiencies in our warehouse operations, which both positively impacted our gross margin.

Overall, we are encouraged by the margin improvement and the stable foundation it provides for future growth.

With that, I'll turn the mic over to Rich.

Rich Tang

Thank you, Brady. Hello everyone. – My name is Richard Tang and I've been the CFO at IVFH for the past 2.5 years.

I'll touch on expenses and profit in my comments.

In Q3, due to one-time actions, we saw SG&A increase by $162K over Q3 last year, driven primarily by a quarterly re-valuation of our COO's stock appreciation rights plan, but partially offset by savings in office expenses. On a year-to-date basis, SG&A increased by $768 thousand, primarily from 1 time severance expense of $1.9M in Q1 2023. This was offset, to a large extent, by a decrease in marketing expense related to our ecommerce business. As a reminder from our last call, we've been highly focused on removing SG&A from the P&L where unnecessary, but many of the changes we are making now have yet to fully flow through to the P&L. This will lead to nice tailwinds in the future. For instance, we have exited the lease for our Brooklyn office space. We cut travel expenses, renegotiated our contracts for insurance, legal services, investor relations, and facilities services. We have re-structured several teams, and significantly reduced labor at our e-commerce warehouse. We even cut our printing service expense by 90%. We are getting extremely deep into the weeds to understand every dollar the company is spending and why. I am personally reviewing every single check that goes out the door before we process it. We still have a lot of opportunity on the SG&A front, and we're committed to resetting the company's cost structure to give us a profitable base to grow from.

Now to Profit… our Q3 GAAP net income came in at $134 thousand, a $124k improvement compared to Q3 2022. After five consecutive quarters of profit growth, this is the first quarter we're lapping our progress, so we're extremely proud to see significant continued progress on profit. Adjusted EBITDA swung from a profit of approximately $490 thousand last year, to an Adjusted EBITDA profit of about $888 thousand this year, almost doubling last year's performance. This adjusted EBITDA amounts to 5.1% of revenue, compared to 2.4% in Q3 of last year. On a per share basis, our adjusted EBITDA was $0.018 (one point 8 cents) compared to $0.010 (one cent) last year. This demonstrates how our focus up and down the P&L is helping us to create a sustainable business model.

Regarding cash flow, you'll notice that we did post a use of cash from operations in Q3. This was due to a one-time shift of $500 thousand in cash payments from 2 key customers that settled 2 days after quarter end, other changes in net working capital, and ongoing payments to a prior executive that were previously expensed.

On the balance sheet, we paid down the $2 million balance on our revolving line of credit, opening up access to our full line of $3 million. Our Net Working Capital remained unchanged from last quarter at $4.6M, a positive swing of $7.8 million from year end 2022.

We continue to be aggressive in driving down accounts receivable, and streamlining our inventory procurement process, and remain diligent in scrutinizing each payment that leaves each of our subsidiaries, looking for opportunities to renegotiate contracts and/or cut costs out altogether.

Lastly, I want to mention that we've revamped our investor relations site to be more intuitive and easier to navigate. Please check us out at IVFH.com.

Thank you. Back to Bill.

Bill Bennett

Thanks, Rich. Hopefully you can get a sense of how excited we are about this quarter, and that as we work through Phase 1 of our plan, despite the lower revenue, we're in a great position to stabilize the company this year, cement a much stronger business model, and prepare to begin investing for the future.

As we've alluded to in the past, we've been working hard on a full review of the business, which I'd like to start to give you a peek into. As we've analyzed, debated, and discussed what this business could be someday, we've aligned on the fact that we don't want to be a small company forever. We want to be a $1B revenue company someday. I tell you that now because I want you to know that every decision we make is focused on that goal. Now, we aren't going to jump to $1B overnight, so our first milestone on that journey is what we call our "100/10 plan". This entails getting to our first $100M in revenue, and driving $10M in adjusted EBITDA. We want to achieve this first milestone with zero incremental debt, and no other capital raises, over the next 2-3 years. This entails our Phase 1 and Phase 2 plans.

We've talked a lot about our Phase 1 plans, and you're seeing the play out in our financials, so let me now pull back the curtain a bit on our Phase 2 plans. We're calling this Phase "Laying the Foundation for Growth", because our goal is to better allocate capital in our profitable businesses, evolve our business model, and demonstrate a differentiated value proposition that can later be further scaled. We're going to make deliberate decisions, focused on logical investments that will generate cash to help fund our future phases. I'll separate these comments into two sections: capital allocation and core business growth.

First, capital allocation. As CEO, I consider one of my most important jobs to be the allocation of resources and capital. As I dove into the business over the last 7 months, I've seen large opportunities to drive growth and profitability purely through capital allocation. Let me share a few metrics to highlight what I've seen. As I dug into our historical financials, I found that our e-commerce business has been the primary driver of losses for the company. Over the past five years since we purchased our e-commerce businesses, we have lost in excess of $12M on those businesses, more than our entire debt outstanding. During this time, the Professional Chef side of our business remained nicely profitable, but the overall company lost money for most of those five years. E-commerce is a $10M business, so about 12% of our company revenue has been losing enough money to more than offset the profit of the remaining 88% of the company. Now, while e-commerce was driving that $12M loss over the last five years, IVFH was also investing differentially in that business. For example, we own approximately $21M of appraised real estate value today. About 85% of that is tied up in our e-commerce fulfillment center in Mountain Top, Pennsylvania. So the 12% of revenue that's losing money is tying up 85% of our real estate capital. Another example: we have about 125 people employed by IVFH, about a third of whom are primarily dedicated to e-commerce. So again, the 12% of our revenue that's losing money requires a third of company headcount. I could say similar things about the skew of resources around cash management, marketing spend, inventory, expenses, legal fees, maintenance capital, management's time, etc. We have spent significant effort deep diving into a profitability plan for the e-commerce business, and have come to the conclusion that without a larger ecommerce business to bolt this onto, we would need to triple its size to get to an accretive model. This would take 5+ years, and require large additional investment, entailing significant risk, and we don't believe this is a good use of the company's resources and time.

So, we're going to dramatically shift our capital allocation to better align to our business and profit objectives. This will require several chess piece moves. First, we are exploring strategic alternatives for the e-commerce business with a variety of different potential paths forward, but all of which eliminate the profit drag on the total business. You will see us continue to cut marketing spend, which will result in continued revenue declines in e-commerce. Second, we are exploring making some big moves in our real estate portfolio, looking at unlocking the value in our Florida office building, and our Pennsylvania warehouse. Lastly, we are simplifying other non-material parts of the business so we can help the company focus on the core. We have exited several partnerships, and we are selling our small consulting business, called Grow Brand Management. With these strategic moves, we expect to unlock somewhere between $7-$13M in capital based on their appraised values, and net of the associated loans. This will eliminate ongoing losses associated with those businesses.

So what will we do with this capital we've unlocked? Our hope is to reinvest into our Professional Chef business. A decade ago, we bought a specialty food distributor in Chicago called Artisan Specialty Food. It has essentially doubled in size since our purchase, and does a nice, profitable business for us in specialty food distribution in Chicagoland, but is limited by the size of its small 17K square foot warehouse. Accordingly, we're looking at investments to expand, including the opportunity to grow our warehouse space, add additional cold storage, or even M&A. We're exploring immediately accretive bolt-on acquisitions that could further accelerate the Artisan business, in adjacent categories like Meat, Seafood, or Produce. This could allow us to expand our customer base, and cross sell a broader portfolio, with larger sales per order delivered – a key metric in food distribution. Our goal with this capital reallocation is to shift investment from our long-term loss-making businesses, into our consistently profitable and growing businesses, while reducing or even eliminating our debt, and while causing zero incremental dilution to our shareholders. These moves will make a significant impact to our P&L as we reduce losses in e-commerce, allocate capital to profitable business growth, and reduce interest expense for the company. Okay, that's capital allocation.

Now onto core business growth. With our capital better-allocated, we will be well positioned to push growth in our core, profitable businesses, and drive significant profit impact. We break our growth strategies down into three buckets: 1) growth of existing customers and sales channels, 2) growth in new customers and sales channels, and 3) leveraging existing infrastructure to launch new business models. To support these initiatives, we've built out significant primary and syndicated data research, talked to dozens of chefs and restaurant owners, and built a better articulated strategy around serving a carefully considered target market. One of the key conclusions we came to is that too often, we think of "specialty food" as something that only appeals to high end restaurants. Instead, our research uncovered that all foodservice establishments utilize specialty products to some degree or another. So rather than focus on a specific restaurant segment, we've chosen to focus our efforts on a specific breed of chef, which we're calling the "Choosy Chef". This is someone who has deep culinary experience, a long track record in foodservice, and is passionate about delighting their customers with new and unique dishes. And it's a customer that's underserved today. As we talked to Choosy Chefs, we found four consistent unmet needs: 1) high quality specialty products are hard to find, and the search process is complicated, 2) Chefs' time is dominated by product ordering and office tasks, 3) pricing is often inconsistent and uncompetitive, requiring chefs to research and price compare frequently, and 4) relationships with sales people need to be tighter partnerships. To solve these needs, we are uniquely positioned to 1) tell compelling stories behind the unique products we carry, 2) offer ingredients when and how chefs need them, 3) offer fair, transparent, and consistent pricing, and 4) build a chef-driven organization of culinary experts. These insights and strategy dramatically expand our addressable market, and will help us hone our message and marketing channels to the chefs who will find the most appeal in our products.

Armed with this insight, we've begun to structure the growth plan in a new way. We recently transitioned our Professional Chef customer service team into a sales team, and are implementing sales targets, commission models, and management tools to help us more proactively build our business. We are investing in technology, like a new Customer Relationship Management platform, and a new app we recently launched for our Artisan business in Chicago. We also plan to revamp our entire drop ship vendor base, cutting out middlemen, reducing prices, increasing freshness, and sourcing closer to the farm, ranch, boat, or manufacturer. We will continue to share more details of our core business growth plan over time. Okay, that's Core Business Growth.

Now that we've talked about capital reallocation and driving core business growth, hopefully you're understanding a bit more about where Phase 2 will take us. These actions will have a significant positive impact on revenue, SG&A, and adjusted EBITDA. Remember, our Phase 2 near term goal is to get to 100/10, or $100M in revenue and $10M in adj. EBITDA. And as a reminder, this is just the first milestone on our way to becoming a $1B revenue company.

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

Operator

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

Brian Harper

Hey, good morning. Great to see the renewed strategic direction and improvement in gross margins and a lot of decisions being made. I missed the first minute and a half or two minutes of the call. This is the first I've heard of the change with the key customer, and I was wondering if you could elaborate on those changes, in terms of whether they are taking more stuff in house, more kind of broadline stuff, or what's going on there. Thanks.

Bill Bennett

Sure. Thanks Brian. Appreciate your question. We've actually used very similar language to what we used last quarter and you're welcome to take a look at what we said back then as well, but I'm happy to reiterate some of that. The change in technology platform, really what happened with this customer, is we lost, I shouldn't say lost, they had a change in the item numbers for a portion of the assortment that we have for them. What that does is we lost the entire sales history for all of the customers buying those items. If you know anything about food service, you know that most chefs order from an order guide every week, which is really just a list of items they've ordered historically. And so, essentially years and years of order history we had with these restaurants was lost overnight when these item product numbers changed. So anyway, we have a great partnership with this customer. They're moving forward – it's not a change that they're going to unwind, which is why we keep messaging that unfortunately these headwinds are going to be with us for the year, and we're going to need to rebuild that portion of the business, and we don't think that happens overnight. I want to be clear that the relationship we have with this customer remains incredibly strong, and in fact, we continue to pursue new growth opportunities together, but unfortunately this part of the business has been impacted, and we'll begin lapping that in Q1.

Pretty quiet. Brian, did you have a second question? I see that you have your hand up again.

Brian Harper

Yes, thanks for the response. It sounds like it was almost more of a technical issue? Are you guys going to make any changes to where we are going to track customer history differently in the future, in case something like this were to happen in the future, or are some of these customers lost, or I guess with this side we don't have as much of a direct connection with the customer? If you could address that, thanks.

Bill Bennett

Yeah, you hit the nail on the head that the struggle with this part of the business is that while the restaurant is the ultimate customer, the customer we connect with is the broadliner. We have the contact information of the restaurants, but it's not how we've historically done business with those restaurants, so we can really do an end-around, I guess you could say. We need to work through the broadliner to build back that business and that's what's caused the headwind there. And you're absolutely right, it is a pure technological challenge. It's unfortunate that it had such a big impact on us, but I'll just reiterate that the team we work with over there has been great in helping us look for new growth opportunities. It's just that in the B2B space, everything takes time. Everything is contractual, and relationships take time to build, restaurants don't make decisions overnight to change the products they're sourcing, so that's absolutely the focus of the team, and why we expect to get back to sales growth again next year. Does that answer your question, Brian?

Brian Harper

Yeah, that's great color, thank you. Now somebody else ask a question.

Bill Bennett

No worries. All right, nice and quiet. I don't even have any anonymous questions today to fill the air with, so we'll give it one more second here.

Operator

Thank you for your questions. I'll now turn it back over to Bill to wrap up.

Bill Bennett

Actually, just saw one come through the chat.

"Do you have any timing on the potential sale of the real estate?"

So, great question. The two properties I mentioned, Florida and Pennsylvania, are just getting listed as we speak. So, of course, it will depend highly on the amount of traffic those properties get, and how that process proceeds. We are bullish, I would say, on the timing. Both of those real estate markets are strong for the types of properties that we'll be marketing and so we expect the process to move quickly, but we'll definitely keep the group updated through press releases as we get to the binding offer stage.

Great. Thank you to all of you for joining today. Thank you Ronit for moderating. Appreciate everyone's attendance and engagement on the call today. It really is inspiring to see the level of interest in IVFH. As always, I'm happy to make myself and my leadership team available to connect with investors who have further questions about publicly available data. Please reach out to Richard Tang, whose contact info is included in our press release, if you'd like to schedule a touch base. Take care, and we look forward to continuing to update you on the progress of our strategy at our Q4 update this Spring!

Thanks, all. Have a great day.