**Freshpet, Inc.**
**Third Quarter 2024 Earnings Call Prepared Remarks**
**Monday, November 4, 2024 at 8:00am ET**

**CORPORATE PARTICIPANTS**
**Jeff Sonnek –** Managing Director, Investor Relations (ICR)
**Billy Cyr –** Chief Executive Officer
**Todd Cunfer –** Chief Financial Officer

**PRESENTATION**

**Jeff Sonnek**
Thank you. Good morning, and welcome to Freshpet's third quarter 2024 earnings call and webcast. On today's call are Billy Cyr, Chief Executive Officer, and Todd Cunfer, Chief Financial Officer. Scott Morris, President & Co-founder, will also be available for Q&A.

Before we begin, please remember that during the course of this call, management may make forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These include statements related to our long-term strategy, 2027 goals and pace in achieving these goals, prospects for growth, timing of capacity expansion, new products and new technology, and 2024 Guidance. Words such as anticipate, believe, could, estimate, expect, guidance, intend, may, project, will, or similar conditional expressions are intended to identify forward-looking statements. These statements are based on management's current expectations and beliefs and involve risks and uncertainties that could cause actual results to differ materially from those described in these forward-looking statements including those associated with such statements. Please refer to the Company's annual report on Form 10K filed with the Securities and Exchange Commission and the Company's press release issued today for a detailed discussion of risks that could cause actual results to differ materially from those expressed or implied in any forward-looking statements made today.

Please note that on today's call, management will refer to certain non-GAAP financial measures, such as EBITDA and Adjusted EBITDA among others. While the Company believes these non-GAAP financial measures provide useful information for investors, the presentation of this information is not intended to be considered in isolation or as a substitute for the financial information presented in accordance with GAAP. Please refer to today's press release for how management defines such non-GAAP measures, why management believes such non-GAAP measures are useful, a reconciliation of the non-GAAP financial measures to the most comparable measures prepared in accordance with GAAP, and limitations associated with such non-GAAP measures. Finally, the Company has produced a presentation that contains many of the key metrics that will be discussed on this call. That presentation can be found on the Company's investor website. Management's commentary will not specifically walk through the presentation on the call – rather it is a summary of the results and guidance they will discuss today. With that, I would like to turn the call over to Billy Cyr, Chief Executive Officer.

**Billy Cyr**
Thank you, Jeff, and good morning, everyone. First, for those of you who are wondering, Jeff was gracious enough to fill in for our VP of Investor Relations, Rachel, while she is on maternity leave.

Now, to the business: The message I would like you to take away is that we are beginning to establish the kind of consistency and reliability in our manufacturing operations that we have been delivering on the top line for some time. That has enabled us to rapidly increase our margins while simultaneously generating the kind of growth you have come to expect from us.

As you know, our objective this year was to continue our strong top line growth but do it at a rate that would enable us to live within our capacity limits while strengthening our operating performance and cash generation. The result would be category-leading growth, outsized improvement in profitability, and more effective cash management. We described that as disciplined growth. If we do that well, consumers will win, customers will win, and our shareholders will win.

And that is what we are delivering. In Q3, we delivered our 25th consecutive quarter of 25% year-on-year growth, a significant expansion in our adjusted gross margin and adj. EBITDA margin, and sizable operating cash flow. In fact, this is the third quarter in a row where our adj. gross margin exceeded our 2027 target and our 6th consecutive quarter where our logistics cost was better than our long-term target. And, we have generated more than $100 million in operating cash flow so far this year.

I suspect that many of you are now wondering if – or when – we are going to adjust our long-term targets to reflect the early achievement of so many of our long-term financial goals. While we are very encouraged by our progress, we don't want to get ahead of ourselves. We want to see sustained improvement across the full year before we conclude that we can deliver more than what we have already committed. We are also very mindful that we are operating in a dynamic environment and would like a bit more time to see where the current trends – particularly on inflation – settle out. So, this is something we are giving a great deal of thought to – in consultation with our Board – but we aren't yet ready to update our long-term targets.

I would now like to call out a few key highlights from the quarter and then Todd will provide a bit more detail on the financial results and will update you on our thinking on guidance. First, I am very encouraged by the net sales growth we saw in the quarter. We grew 26% and virtually all of it was due to volume growth. This volume growth was driven by strong HH penetration growth – particularly amongst our HIPPOH's. Overall HH penetration growth was up 17% -- despite lapping a sizable gain in HH's in the year ago period – and the HIPPOH growth rate was 24%. Recall, our media investment is more backloaded this year than it was last year so you should expect that HH penetration – which is a 52-week measure – will lag our long-term growth rate in the back half of this year due to the change in the media timing. However, it should re-accelerate in the first half of next year when we are getting the benefit of this year's second half media investment in the 52-week measure. We continue to believe that we are well on track to deliver our 2027 target of 20 million HH's and are increasingly focusing our attention on the 5 million HIPPOH's, who now represent ~90% of our revenues.

Second, our team did an outstanding job managing the balance between capacity and demand – allowing us to simultaneously drive strong growth rates and strong operating performance. Recall that we chose to limit our first half media investment to a rate that was below our rate of sales growth so that we could reliably meet demand until our new roll line in Ennis was up and operating at the end of Q3. That plan worked. We were able to grow 26% in the quarter but did it with a customer order fill rate of 99% for the quarter. As I have said before, a strong fill rate is a very good indicator of overall operating performance for us and that was definitely true in Q3. We were able to deliver this strong performance because the reliability of our media model provided a very accurate forecast of demand, and our operations team generated strong throughput on our existing production lines and started-up the new roll line one week early. In essence, we were able to "thread the needle" – i.e., generate strong growth without exceeding our capacity limits and while maintaining exceptional customer service. We expect to apply that same type of robust planning as we bring on new lines over the next few years – carefully managing our media investment and capacity to ensure good customer service, strong net sales growth and healthy margins.

Third, the production, quality and logistics teams in the Freshpet Kitchens continued to drive improved performance – including yield, throughput and quality costs – while also delivering exceptional customer service at our lowest logistics costs as a percent of net sales ever. On a year-over-year basis, the sum total of our input costs, logistics and quality improved by 790 bps and that contributed to a 630-bps improvement in our adj. gross margin. We believe this is the result of the investment we have made in our hourly production workforce and their training – i.e., the Freshpet Academy, -- the Freshpet Performance Excellence program we began about two years ago, and a more stable external environment.

Finally, our customers continue to believe that Freshpet is the future of pet food and continue committing additional retail space to Freshpet. At the end of the quarter, we had 22% more Total Distribution Points (TDP's) due to the addition of more than one thousand new stores year-to-date, more than 750 additional stores with second and third fridges year-to-date, and a sizable increase in shelf space in retailer owned fridges. We continue to also see a strong connection between the increased retail visibility and the efficiency of our media investment – as our retail presence amplifies the media investment. This is visible in our Customer Acquisition Cost (CAC), which continues to be in line with our long-term targets and is helping us drive a strong return on our advertising investment. Now I'll provide an update on KPI's we track for our "Main & More" plans --Mainstream, Main Meal, More Profitable plans.

Focusing on the idea of Mainstream… Freshpet is becoming increasingly mainstream but still has a long runway for growth. According to Nielsen Omnichannel data, which includes ecommerce and direct to consumer, as of September 28, 2024, total U.S. pet food is a $54 billion category. We only have a 3.2% market share within the $37 billion dog food segment, which is the majority of our business today. Within the fresh/frozen subcategory in measured channels, Freshpet has 96% market share. Fresh continues to outperform the broader pet food category and many retailers believe it is the future of pet food. As a result, Freshpet now commands 66% ACV in Nielsen XAOC, and we continue to add distribution breadth and depth with second and third fridges.

Our household penetration gains also demonstrate that we are well on our way to making Freshpet more mainstream. As I mentioned earlier, Household penetration is on track to meet our target of 20 million households by 2027, but, more importantly, the complexion of the households underpinning our growth continues to improve. Our HIPPOH's are growing 24% vs. the prior year period, surpassing our broader household growth of 17%. We think the combination of retail support and our ability to drive household penetration is a clear indication that Freshpet is leading the way towards making fresh pet food a mainstream idea.

Our HIPPOH penetration also extends to the Main Meal part of the strategy. Currently, 39% of Freshpet users are HIPPOH's and they represented 90% of our sales in the third quarter. Of those users, about 325,000 – or less than 3% of our total users – buy more than $1,000 of Freshpet per year and this group grew 23% over the past year. They now represent ~27% of our business. We are increasingly focusing our attention on this audience and trying to create a much larger cohort of users who look like they do.

Part of our strategy for making Freshpet into more of a main meal item is to offer a range of items that meet the broadest range of consumer needs. This year, we have launched several new items that do that, and they are doing very well. In particular, our Large Dog product – while still in limited distribution – has grown quite nicely and is becoming a very successful item for us as it broadens the appeal of Freshpet into larger dogs. Similarly, our multi-packs have done very well. Early next year, we will be launching a product for seniors – further broadening Freshpet's appeal. Adding second and third fridges enables greater distribution of our wider assortment. Based on Total US Pet Retail Plus data from Nielsen, we currently have an average of 20.5 SKUs per point of distribution – up from 18.0 SKU's one year ago.

Now to the "more" part of Main & More—More Profitable… We had another strong quarter of margin improvement. Adjusted gross margin improved 60 basis points versus the strong results we posted in Q2 to 46.5% and we ended the third quarter with an Adjusted EBITDA margin of 17.2%.

As I mentioned earlier, the margin improvement came in our key focus areas of quality, input costs and logistics. It is becoming increasingly apparent that the improved organizational capability, improved analytics systems and intense focus on those drivers of profit improvement are not only working but generating better results than we had expected and sooner than we had anticipated. We are very pleased with this progress but also believe that there is significant upside that we can deliver over time.
I would also like to give you an update on our efforts to expand our capacity.
As a reminder, we continue to focus our capacity expansion plans on three key drivers of improved capital efficiency. They are:

1. Maximizing the throughput of our existing lines
2. Maximizing the capacity of our three existing sites, and
3. Developing and implementing new technologies that generate more throughput per line.

We are making good progress against all three parts of that strategy. In Q3, we achieved another milestone with the start-up of the fourth line in Ennis – a roll line – giving us two bag lines and two roll lines at that site. That fourth line started up one week early, under budget and ramped up faster than we had projected. We have also largely completed the installation of the fifth line – which will be our third roll line in Ennis because it was more efficient to install two roll lines at the same time in the new space. That fifth line will be commissioned in Q4, and, between those two new roll lines, we will have enough rolls capacity to last well into 2026 once we have fully staffed those lines. We are in the final stages of installing our next bag line in Kitchens South and expect that to start up in late Q1 of next year. We have also added staffing at Kitchens South on the existing lines so that we will have adequate bag capacity for the balance of 2024 and into 2025.

In Bethlehem, the team is focused on increasing capacity utilization or OEE on our existing lines. Our Freshpet Performance Excellence program has driven sizable gains in throughput, yield and quality since it was launched almost two years ago, and we believe that investment has unlocked a sizable amount of "free capacity." We believe there is significant upside remaining and are increasing the resources we devote to that effort and re-applying the program to Ennis.

The Bethlehem team is also in the process of remodeling some dry storage space in Kitchens 2 to accommodate a production line that uses a new technology for our bag products. That line is on track for start-up in the second half of 2025.

In summary, I think we are making good progress at proving that we can reliably deliver improved operating performance and strong growth simultaneously. This disciplined growth is the result of our strengthened organizational capability, improved analytics systems, and intense focus. That has enabled us to generate outsized gains in productivity and profitability. We are increasingly confident that we can sustain this type of performance and deliver the levels of shareholder returns that we believe the proprietary Freshpet business model is capable of generating.

Now, let me turn it over to Todd to walk through the details of the Q3 results and our updated guidance. Todd…

**Todd Cunfer**
Thank you, Billy, and good morning, everyone. As Billy mentioned, we are very pleased with the third quarter results, particularly our ability to deliver on profit improvement. Now I'll give you some more color on our financials and updated guidance for the year.

- Third quarter net sales were $253.4 million, up 26% year-over-year. Nielsen measured dollar growth was 23% vs. the prior year period, with broad-based consumption growth across channels. We saw 24% growth in XAOC, 22% in US Food, 11% growth in pet specialty, and over 70% growth in the unmeasured channel.
- Third quarter adjusted gross margin was 46.5%, up 630 basis points year-over-year. This was driven by improvements in input costs, yield, throughput, and quality costs. Specifically, input costs as a percent of net sales improved 450 basis points vs YA due to better yields and lower commodity costs, and quality costs improved by 220 basis points vs YA. We did have a timing benefit in our quality costs that will reverse in Q4, but it was a strong quarter, nonetheless.
- Third quarter adjusted SG&A was 29.3% of net sales, compared to 28.6% in the prior year period.
    - We spent 10.8% of net sales on media in the quarter, up from 9.5% of net sales in the prior year period. Total media investment was up 43% year-over-year. Recall, our media plan was less front-loaded this year than in years past so that we could manage our growth to live within our capacity limits. As a result, our media investment in the back half of 2024 will grow significantly faster than our sales will grow and that will position us for a faster start in 2025.
    - Logistics costs continued to improve and were 5.6% of net sales in the second quarter, a decrease of 120 basis points compared to the prior year period. The majority of the improvement was due to strategic actions we have taken to increase fill rates, reduce miles driven by increasing the number of states served by our second distribution center, and negotiations with various carriers, with the remainder being more macro-driven with more favorable lane rates and lower diesel costs.
    - Other SG&A, which was 13.0% of net sales, increased 60 basis points driven by higher incentive compensation.
- Third quarter adjusted EBITDA was $43.5 million, or 17.2% of net sales, compared to $23.2 million, or 11.6% of net sales in the prior year period. This improvement was primarily driven by higher gross margin, as well as improved logistics costs and partially offset by higher media investment and incentive comp.
- Capital spending in the third quarter was $34.0 million. This was lower than expected due to the timing of projects and payments. We expect a much higher rate of spending in the fourth quarter. However, we are lowering our estimate of capital spending this year due to the timing of projects. We now expect capex this year to be approximately $180 million vs the previous guidance of $200 million.
- Operating cash flow in the third quarter was $56.1 million, and we had cash on hand of $274.6 million at the end of the quarter. We continue to believe that we have adequate cash to fully fund our growth through 2025 and will be free cash flow

positive in 2026. Our strong improvement in Adj. EBITDA this year also makes it unlikely we will need any additional capital.
- Net Income: We generated $11.9 million in net income in third quarter, bringing our year-to-date net income to $28.8 million.

Now turning to guidance for 2024…

- We are updating our outlook to reflect our outperformance in the third quarter, as well as our conviction in our ability to execute in the final quarter of the year.
- We are raising our net sales guidance from at least $965 million to approximately $975 million, or growth of ~27%. We are able to do this because of the significant improvements in our operating efficiency and the strong start-up of the new roll line in Ennis. Collectively, those efforts will allow us to sell a bit more this year than we had originally projected and still maintain strong customer service. We are also keeping in mind the capacity needed to support next year's growth and do not want to get too far ahead of our original plans.
- As far as cadence, we continue to expect net sales to have sequentially lower percentage growth in the fourth quarter of 2024 as the lower first half media spending will result in slower growth in the second half – something that we deliberately did to manage our growth to live within our capacity limits. In our business, the first half media investment really dictates the demand we will have in the second half of the year and the second half media investment will drive the demand we experience in the first half of the next year. For this reason, our second half media investment will be significantly larger than the investment we made in the previous year. We are expecting second half 2024 media investment to be more than 50% larger than in the comparable prior year period.
- For Adjusted EBITDA, we are raising guidance from at least $140 million to at least $155 million to reflect the over-delivery in Q3.
- We now expect adjusted gross margin to expand by approximately 600 bps for the full year, compared to 500 bps previously.
- Capital expenditures are now projected to be approximately $180 million, compared to approximately $200 million previously, to support the installation of capacity to meet demand in 2025. The reduction is due to the timing of certain expansion projects. Some of that reduction will push spending into 2025.

In summary, the third quarter results have continued to build our confidence in our ability to deliver our long-term financial goals. We are operating more effectively and more efficiently, and you can see that up and down the P&L and in the way we show up to our customers and consumers. We believe that is the result of our investments in capacity and organizational capabilities as they are now delivering the scale benefits we believe are possible in the Freshpet business model.

That concludes our overview. We will now be glad to answer your questions.