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WD-40 Co. (WDFC)

Q2 2021 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, thank you for standing by. Good day and welcome to the WD-40 Company's Second Quarter Fiscal Year 2021 Earnings Conference Call. Today's call is being recorded. At this time, all participants are in a listen-only mode. At the end of the prepared remarks, we will conduct a question-and-answer session. [Operator Instructions]

I would now like to turn the presentation over to your host for today, Ms. Wendy Kelley, Director of Investor Relations and Corporate Communications. Please proceed.

Wendy Kelley

Director-Investor Relations & Corporate Communications, WD-40 Co.

Thank you. Good afternoon and thanks to everyone for joining us today. On our call today are WD-40 Company's Chairman and Chief Executive Officer, Garry Ridge; Vice President and Chief Financial Officer, Jay Rembolt; and President and Chief Operating Officer, Steve Brass.

In addition to the financial information presented on today's call, we encourage investors to review our earnings presentation, earnings press release, and Form 10-Q for the period ending February 28, 2021. These documents are available on our Investor Relations website at investor.wd40company.com. A replay and transcript of today's call will also be made available at that location shortly after this call.

On today's call, we will discuss certain non-GAAP measures. The descriptions and reconciliations of these non-GAAP measures are available in our SEC filings, as well as our earnings presentation. As a reminder, today's call includes forward-looking statements about our expectations for the company's future performance.

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Of course, actual results could differ materially. The company's expectations, beliefs and projections are expressed in good faith, but there can be no assurance that they will be achieved or accomplished. Please refer to the risk factors detailed in our SEC filings for further discussion.

Finally, for anyone listening to a webcast replay or reviewing a written transcript of this call, please note that all information presented is current only as of today's date, April 8, 2021. The company disclaims any duty or obligation to update any forward-looking information whether as a result of new information and future events or otherwise.

With that, I'd now like to turn the call over to Garry.

Garry Owen Ridge

Chairman & Chief Executive Officer, WD-40 Co.

Thank you, Wendy. Good day and thanks for joining us for today's conference call. Jay, Steve, Wendy and I, are once again dialing in from our respective homes. We hope that you and your families are staying safe and healthy. Our tribe continues to work together through the challenges and opportunities associated with the COVID-19 pandemic. We continue to experience very high demand for our maintenance products due to the renovation trends associated with the pandemic or what we call isolation renovation.

As a result, today, we reported net sales of $111.9 million for the second quarter of fiscal year 2021, up 12% compared to the second quarter of last year. Translation of our foreign subsidiaries results from their functional currencies to the US dollar had a favorable impact on sales in the second quarter. On a constant currency basis, sales would have been $109.2 million, up 9% compared to the second quarter of last year.

Net income for the second quarter was $17.2 million compared to $14.3 million last year. Diluted earnings per share for the second quarter was $1.24 compared to $1.04 for the same period last year. I do want to caution investors that due to the uncertainty, the health crisis continues to present, it is very difficult for us to estimate how our business will be impacted by the pandemic over the short to medium term. We offer a variety of maintenance products that have been in very high demand due to renovation trends associated with the pandemic. However, the pandemic has also caused some disruptions and constraints to our supply chain primarily in the United States.

Steve will share these puts and takes with you in greater detail in a moment. But first, I'm going to share a quick update with you on our strategic initiatives. As you know, our growth aspirations are to drive consolidated net sales to approximately $700 million and to do so while following our 55/30/25 business model. Strategic initiative number one is to grow WD-40 Multi-Use product. Our goal under this initiative is to make the blue and yellow can with a little red top available to more people in more places that will find more users more often.

In the second quarter, sales of WD-40 Multi-Use product were $86.4 million, up 14% compared to last year. This increase was driven primarily by increased sales in EMEA and Asia-Pacific, which increased 22% and 34% respectively. The increase in WD-40 Multi-Use product sales in EMEA was driven primarily by increase in user demand lead to isolation renovation trends throughout the trading block.

In Asia-Pacific, we experienced significantly improved market conditions in China compared to the second quarter of last year. You will recall, our China market was materially impacted during the second quarter of fiscal 2020 due to the COVID-19 outbreak in the country. Our long-term growth aspirations for this strategic initiative is to grow WD-40 Multi-Use product to approximately $530 million over the long-term.

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Strategic initiative number two is to grow the WD-40 Specialist product line. In the second quarter, sales of WD-40 Specialist increased 4% globally to $9.2 million compared to the second quarter of last year. This growth was driven by stronger e-commerce sales, as well as increased demand linked to renovation trends associated with the pandemic.

These trends led to increased sales in EMEA and Asia-Pacific of 30% and 102%, respectively, but were partially offset by a 36% sales decline in the Americas linked entirely to the pandemic-related supply chain disruptions in the United States. End user demand for WD-40 Specialist product remains exceptionally high in all three trading blocks. Therefore, we are optimistic about the long-term opportunities for WD-40 Specialist and believe we can grow the product line to approximately $100 million in revenue over the long term.

Strategic initiative number three is to broaden product and revenue base. Strategic initiative number three includes 3-IN-ONE, WD-40 BIKE, GT85, 1001, Spot Shot, Solvol, Lava, and no vac. Global sales of the products included under this initiative was $13.7 million in the second quarter, up 7% compared to last year.

Global sales of WD-40 BIKE remained particularly strong in the second quarter, up nearly 34% compared to last year, as people are buying, fixing and riding bicycles more often due to the pandemic. We believe we are on track to reach a combined revenue for these products of approximately $70 million over the longer term.

Strategic initiative number 4 is attract, develop and retain outstanding tribe members. Our goal under this initiative is to attract, develop and retain talented tribe members and to grow our tribe member engagement to greater than 95%. We had last measured tribe member engagement levels immediately before the pandemic began. At that time, our overall global employee engagement score was 93%.

I am not sure we would have thrived during the pandemic had we had not entered it with a highly engaged workforce. As we approached the one-year anniversary of the pandemic, we decided to conduct a brief tribal check into measure the engagement level of our tribe one year into being in an almost entirely virtual work environment. I'm happy to share with you that the results from that survey were very positive and we have been able to maintain our employee engagement levels.

In addition, we've learned from the survey that 98% of our tribe is excited about WD-40 Company's future direction. This metric improved 4 percentage points since our last survey, which I believe has to do with trust. Our tribe is more confident about our future because together we successfully navigated a very turbulent year and we are emerging from it stronger and a more intact tribe than ever before.

I want to take a moment to thank the tribe for their hard work and for their dedication during these challenging times. You have reinforced something to me that I already knew. Purpose-driven passionate people guided by values create amazing outcomes.

Strategic initiative number five is operational excellence. Our goal under this initiative as best summarized by one of our core values here at WD-40 Company make it better than it is today. Our commitment to operational excellence continues to be the [ph] enormous (10:25) asset, as we continue to navigate the challenges associated with the pandemic. Using our 55/30/25 business model as a framework, we measure ourselves against this operational excellence initiative.

That's it for my update. I will now pass the call to Steve, who will share an overview of our sales results with you and discuss some other developments.

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Steven A. Brass

President & Chief Operating Officer, WD-40 Co.

Thanks, Garry and good afternoon. When we last spoke, I shared with you that despite the many disruptions close to our business by the pandemic, we were experiencing increasing demand for our products due to a change in end user behavior caused by the isolation renovation phenomenon. Today, I'm happy to share with you that those trends continued throughout the duration of the second quarter. And today we're reporting total global sales growth of 12% for the quarter.

However, we also encountered some challenges in the Americas related to keeping up with end user demand in a COVID environment. Like many consumer goods companies, we are experiencing significant disruptions and constraints within our supply chain in certain geographies. In the United States, some of our third-party manufacturers have been experiencing increased absenteeism and labor shortages which have resulted in slower line speeds, capacity constraints and increased competition for line capacity within the aerosol industry.

In addition, we've been managing raw material shortages and transportation bottlenecks, which have impacted our ability to deliver products and meet some of our normal levels of service with our customers in some markets. These challenges have mostly impacted our Americas trade block and have resulted in lower sales for the United States, as well as increased cost of goods for the quarter. Jay will talk in more detail about the gross margin impact in a moment.

Let's take a closer look at what's happening in our trade blocks starting with the Americas. Net sales in the Americas, which include the United States, Latin America and Canada, were down 1% in the second quarter to $46.2 million. Sales of maintenance products decreased 3% in the Americas due to decreased sales of WD-40 Specialist and WD-40 Multi-Use Product in the US, which declined 42% and 5%, respectively. These sales declines were related to the supply chain constraints and disruptions I mentioned a moment ago.

In addition, sales in the US were also negatively impacted by the severe winter storms that took place during the second quarter. There is a supply chain recovery plan underway, which includes adding more shifts of third-party manufacturers, bringing onboard new third-party manufacturers, and expanding our launch of Next Generation Smart Straw into the US, which is scheduled to be on store shelves during the fourth quarter of this fiscal year. We believe these issues will begin to resolve in the second half of our fiscal year 2021, but we expect continued volatility along the way due to these supply chain impacts of COVID-19.

Now, the good news. Partially offsetting these declines was a 16% increase in maintenance product sales in Canada and a 28% increase in Latin America. In Canada, the sales increase was driven by the isolation renovation phenomenon and increased sales through the e-commerce channel during the pandemic. Canada is also benefiting from the successful introduction of Next Generation Smart Straw, which is doing phenomenally well.

In Latin America, we saw increased sales during the second quarter, primarily due to strong sales in our newest direct market of Mexico, while we anticipate a continued successful build of our direct customer base in Mexico, we expect there may be a bit of volatility along the way as we continue to develop this exciting new direct market.

In addition, in our other Latin American markets, we saw increasing end user demand due to decreased COVID-19 restrictions in the region. Sales of our homecare and cleaning products in the Americas increased 10% in the second quarter compared to the prior year, largely due to higher sales of 2000 Flushes which increased 27%.

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We have experienced a significant increase in sales of many of our homecare and cleaning products in the United States and Canada due to increased demand because of the pandemic. However, we continue to consider our homecare and cleaning products except for those strategic brands as harvest brands continue to generate meaningful contributions in cash flows, but are generally expected to become a smaller part of the business over time. In total, our Americas segment made up 41% of our global business in the second quarter. Over the long-term, we anticipate sales within this segment will grow between 2% to 5% annually.

Now onto EMEA. Net sales in EMEA, which includes Europe, the Middle East, Africa, and India, were up 19% in the second quarter to $49.8 million. This represents an important milestone for EMEA segment. For the second quarter in a row, EMEA was our largest trading block in terms of net sales. Changes in foreign currency exchange rates had a favorable impact on sales for the EMEA segment from period to period. On a constant currency basis, sales would have increased by 15% compared to last year.

Sales of maintenance products increased by 22% in EMEA due to increased sales in both our EMEA direct and our EMEA distributor markets which increased 17% and 35% respectively. In our EMEA direct markets, we experienced a 14% increase in sales of WD-40 Multi-Use product and a 31% increase in sales of WD-40 Specialist due to the isolation renovation phenomenon and increased sales through the e-commerce channel during the pandemic. In the second quarter, net sales in our EMEA direct markets accounted for 67% of the region's sales.

In our EMEA distributor markets, we experienced 36% increase in sales of WD-40 Multi-Use products and a 19% increase in WD-40 Specialist sales, primarily due to improved economic conditions because of reductions in COVID-19 related movement restrictions. We saw particularly strong sales of WD-40 Multi-Use product in India, the Middle East and Northern Europe areas where we are experiencing strong recoveries.

In the second quarter, net sales in our EMEA distributor markets accounted for 33% of the region's sales. In total, our EMEA segment made up 45% of our global business in the second quarter. Over the long-term, we anticipate sales within this segment will grow between 8% to 11% annually.

Now on to Asia-Pacific. Net sales in Asia-Pacific which includes Australia, China and other countries in the Asia region grew 39% in the second quarter to $15.9 million. Changes in foreign currency exchange rates had a favorable impact on net sales for the Asia-Pacific segment from period-to-period. On a constant currency basis, sales would have increased by 32% compared to last year.

Sales of maintenance products increased by 40% in Asia-Pacific due to increased sales in China and Australia which increased 227% and 45% respectively, although partially upset by a 4% decline in sales in our Asia distributor markets. In China, net sales were $4.7 million in the second quarter, up 227% compared to last year, primarily due to improved market conditions.

In the second quarter of last fiscal year, the COVID-19 outbreak was in its earliest stages and sales declined 70% during the quarter as compared to the prior year due to the health crisis with no comparable event occurring this year, our China market is doing well. We are seeing accelerating growth and a steady return to normal. However, it's important to remind investors that though we remain optimistic about long-term opportunities in China, we expect some lumpiness in the coming quarters.

In the third quarter of fiscal 2020, COVID-19 lockdown measures were reduced considerably in China, and as a result, sales were very strong as they began to resume normal operations, and we're able to shift some sizable orders that have been delayed due to COVID-19. Since there will be no comparable event occur in this fiscal

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year, our third quarter sales for China this year may be lower than last year. Overall, we expect strong sales growth for China for the full fiscal year.

In Australia, net sales were $5.3 million in the second quarter, up 39% compared to last year driven by increased demand for both our maintenance and homecare and cleaning products. Furthermore, sales of WD-40 Multi-Use Product and WD-40 Specialist were also up 37% and 92% respectively, due to the isolation renovation phenomenon.

Sales of our homecare and cleaning products were up 32% due to both the increased demand we've seen for these products due to COVID-19 pandemic and a good market traction we've continued to gain for our homecare and cleaning products in Australia.

In our Asia distributor market, net sales were $6 million in the second quarter, down 4% compared to last year, attributable to the shift and the timing of customer orders as well as delayed shipments of certain customer orders in the second quarter of this year linked to the worldwide shipping container shortages. These container shortages are most heavily impacted the Asian market which has been unable to retrieve empty containers from North America and Europe.

In addition, our Asia distributor markets have been a bit slower to recover from the pandemic with some countries recovering faster than others. Our marketing distributors are continuing to normalize their inventory levels which has also impacted sales results in the second quarter. In total, our Asia-Pacific segment made up 14% of our global business in the second quarter. Over the long-term we anticipate sales within this segment will grow between 10% to 13% annually.

As we set our sights on emerging from the pandemic and seek to execute and deliver against our anticipated revenue targets, we are increasing our focus on our key drivers of revenue growth which we call our must-win battles.

Our largest growth opportunity and first must-win battle is a geographic expansion of the blue and yellow can with a little red top. Significant growth opportunities exist within this must-win battle. Nearly, all our top markets under this must-win battle are delivering growth in FY 2021. Year-to-date sales of WD-40 Multi-Use Product were $180.6 million, up 19% compared to last year. We continue to look at ways to further accelerate the growth and identify markets.

Our second must-win battle is to grow the WD-40 Multi-Use Product through premiumization. Premiumization creates opportunities for revenue growth as well as gross margin expansion. Year-to-date sales of WD-40 Smart Straw and EZ-Reach when combined were $82.8 million representing nearly 46% of total global sales of WD-40 Multi-Use Product.

Despite the supply chain constraints we've been experiencing in some geographies, we've been able to bring on new third-party manufacturers in order to accelerate our launch of Next Generation Smart Straw. This acceleration is expected to create incremental capacity around the globe which will enable us to continue to convert end users from classic cans and to Smart Straw. As we continue to roll out next generation Smart Straw, our objective is to grow Smart Straw global penetration to greater than 60%

Our third must-win battle is to grow WD-40 Specialist. The product line has been a tremendous success for us since its launch 10 years ago. It has enabled us to deliver solutions that span end user needs and to remove

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competitors from store shelves around the world. It has also become increasingly clear to us that e-commerce and digital are critical channels for the success of WD-40 Specialist.

We believe the refresh packaging we launched last year will accelerate awareness and improve findability in-store and online and is expected to accelerate sales of WD-40 Specialist. Year-to-date, sales of WD-40 Specialist were $20.7 million, up 20% compared to last year.

Our final must-win battle is focused on driving digital commerce. Our ambition for this battle is to engage with end users scale and create positive lasting memories online making it easy for end users to educate themselves and find and purchase our brands. We see a world where e-commerce will be one of the largest sales channels for our company and a world where most purchases are influenced at some point on the path to purchase by a digital touch point.

In the first half of fiscal year 2021, global e-commerce sales grew by over 61% with strong sales growth across all three trading blocks. This is the testament to just how much our tribe's digital IQ has grown. We believe we are well-positioned to benefit from the significant shift to online behaviors in the years ahead.

Now, a word on what the short- and long-term future looks like. We believe there is a tailwind coming out of COVID. Over the long term, we are optimistic that many of the new end users who have interacted with our products during the pandemic will become permanent uses of our maintenance and homecare solutions. People have developed new habits and hobbies and we believe at least a portion of them will stick.

Moreover, we're seeing a new generation of DIYs, who have tried home improvement for the very first time during the pandemic. We've also helped to educate both new and existing end users on how to improve their homes, maintain their bikes or even how to take care of their new RV.

In addition, in some cultures where there was a long-standing do-it-for-me preference, we are seeing a new mindset emerge. COVID has created an environment in which people have not wanted to invite professionals into their homes. Therefore, to fix something in the home, one must do it themselves. We believe this trend has created a DIY tipping point in many markets and cultures around the world. It remains to be seen if this trend will continue in a post-COVID world, but we are optimistic that many of these new end users will become brand loyalists.

Over the short term keeping up with demand in a COVID environment continues to be a challenge. We are managing through the market constraints impacting our supply chain. And there is a recovery plan underway. We believe these issues will be mostly resolved in the second half of our fiscal year 2021, but expect continued volatility along the way due to the impacts of COVID-19.

Despite these uncertainties and risks, we remain cautiously optimistic about fiscal year 2021. We've increased our revenue expectations and believe current market conditions suggest that for the full fiscal year, total net sales are likely to be in a range of between $445 million to $475 million. This upward revision is driven primarily by favorable changes in foreign currency exchange rates.

Now, I'll turn the call over to Jay, who will provide you a financial update on the business.

Jay W. Rembolt

Vice President-Finance, Treasurer & Chief Financial Officer, WD-40 Co.

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Thanks, Steve. Let's start with a discussion about our 55/30/25 business model, the long-term targets we use to guide our business. As you may recall, the 55 represents gross margin, which we target to be at 55% of net sales. The 30 represents our cost of doing business, which is our total operating expenses excluding depreciation and amortization. Our goal is to drive our cost of doing business over time toward 30% of net sales. And finally, the 25 represents our long-term target for EBITDA.

First the 55 or our gross margin; in the second quarter, our gross margin was 55.4% compared to 53.6% last year. This represents an improvement of 180 basis points year-over-year. Changes in major input costs, which include petroleum-based specialty chemicals and aerosol cans, positively impacted our gross margin by 210 basis points. Petroleum-based specialty chemicals positively impacted our gross margin by 160 basis points, and the remaining 50 basis points came from lower costs associated with aerosol cans.

Although the price of crude oil has recently increased compared to the prices seen in early calendar 2020, the average cost of crude, which flowed through our cost of goods sold, was lower during the second quarter of fiscal 2021 compared to the prior fiscal year's quarter. In addition, we achieved favorability in the cost of aerosol cans due to higher than anticipated purchase volumes, especially in our EMEA segment, also positively impacting our gross margin or sales price increases, which impacted our gross margin by 20 basis points in the second quarter.

And finally, additional miscellaneous costs, favorable sales mix changes and changes in foreign currency exchange rates when combined positively impacted our gross margin by [ph] 20 (27:27) basis points. These positive impacts to gross margin were partially offset by the negative effects of higher warehousing and inbound freight costs in the Americas and in EMEA, which negatively impacted our gross margin by 60 basis points. The unfavorable impacts were primarily due to increased freight and warehousing expense due to the high demand and labor shortages and distribution networks, primarily related to the pandemic. Finally, higher discount charges negatively impacted our gross margin by 30 basis points.

Now, let's talk about gross margin expectations a bit. We'll start with the major input costs, which include petroleum-based specialty chemicals. Crude oil is one of the primary feedstocks of our petroleum-based specialty chemicals. As I mentioned a moment ago, the price of crude oil is higher this year than it was a year ago. And as we've shared with you in the past, it takes considerable time, approximately 90 to 120 days for the changing commodity prices to impact our cost of goods.

Though the lower crude oil prices have been a net positive to gross margin in recent quarters, if the cost of crude remains at its current levels, we will most likely see pressure on gross margin in the future. We believe there will be increased pressure on gross margin in the second half of 2021, driven by the recent increase in the cost of oil as well as additional costs associated with the disruptions within our supply chain that Steve discussed earlier.

The supply chains disruptions related to the pandemic have led to higher filling fees with our third-party manufacturers and increased component and petroleum-based raw material costs and because demand is high for consumer goods, the cost of transportation has also increased. But that being said, I'd like to remind investors that our long-term gross margin is not contingent upon any of these factors. And though we may see some volatility in the short to mid-term, we'll continue to be focused and deliberate in managing our business so that we can maintain gross margin at or above the 55% over the long-term.

Now, I'll address the 30 or cost of doing business. In the second quarter, our cost of doing business was approximately 36% of net sales compared to 34% last year. SG&A expense increased by $5.6 million compared to the second quarter of last year, primarily due to higher employee related costs associated with incentive compensation accruals. For the second quarter, 80% of our cost of doing business came from three areas, people

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costs or the investments we make in our tribe, the investments we make in marketing, advertising and promotion. As a percentage of sales, our A&P investment was 4.9% in the second quarter. And finally the freight costs to get our products to our customers.

That brings us to the EBITDA, the last of our 55/30/25 measures. EBITDA was 20% of net sales for the second quarter, unchanged from the comparable period last year and that completes our discussion of our business model metrics.

Now let's discuss some of the items that fall below the EBITDA line. The provision for income taxes was 15% in the second quarter compared to 17.6% last year. The decrease in our effective income tax rate was primarily due to an increase in excess tax benefits from the settlements of stock-based equity awards along with the lease of liabilities related to uncertain tax positions. We expect that our effective tax rate would be approximately 17% to 18% for the full fiscal 2021 compared to an effective tax rate of 19.6% in fiscal year 2020.

Now, worried about our balance sheet and our capital allocation strategy. The company's financial condition and liquidity remains strong. We remain vigilant in managing our cash and liquidity during these unprecedented times. Our capital allocation strategy includes a comprehensive approach to balance investing in long-term growth, while providing strong returns to our shareholders. We continue to return capital to our shareholders through regular dividends.

On March 16th, our board of directors approved the quarterly cash dividend of $0.72 per share reflecting an increase of greater than 7% over the previous quarter's dividend. The quarterly dividend is payable April 30, 2021 to stockholders of record at the close of business on April 16, 2021. In fiscal 2021, we will invest approximately $20 million in capital projects, majority of which will be used to complete the procurement of our proprietary machinery and equipment which we are using to manufacture our Next Generation Smart Straw delivery system.

So with that let's turn to fiscal year 2021 guidance. As a result of the continued uncertainty, regarding the pandemics near-term impact on our business, we will not be issuing comprehensive financial guidance for fiscal 2021 at this time. As Steve shared with you earlier, we've increased our revenue expectations for the full fiscal year and believe that total net sales will likely be in the range of $445 million to $475 million. This upward revision to net sales is primarily driven by favorable changes in foreign currency exchange rates. That completes the financial overview.

Now, I'll turn it back to Garry.

Garry Owen Ridge

Chairman & Chief Executive Officer, WD-40 Co.

Thanks, Jay. In summary what did you hear from us on this call? You heard that sales of WD-40 Multi-Use Product were up 14% in the second quarter. You heard that sales of WD-40 Specialist were up 4% in the second quarter. You heard that sales of WD-40 BIKE were up 34% in the second quarter due to strong demand around the world. You heard that sales of our homecare and cleaning products were up 3% in the second quarter. You heard that global e-commerce sales grew by over 61% in the first half of fiscal 2021 with strong performance across all three trading blocks. You heard that our board of directors increased dividend by more than 7% last month.

You heard that we are experiencing disruptions and constraints within our supply chain in the Americas and these headwinds are impacting our ability to entirely meet the increased end user demand in the US market. You heard that disruptions within our supply chain and increased commodity costs will most likely result in some pressure to

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our gross margin in the second half of fiscal 2021. You heard that despite of these uncertainties, we remain cautiously optimistic about fiscal 2021 and believe our current market conditions suggest for the full fiscal year.

Total net sales are likely to range between $445 million and $475 million, and this upward revision is driven primarily by favorable changes to foreign currency exchange rates. And you heard that while we are not issuing comprehensive guidance, we'll remain confident that our long-term revenue growth aspirations remain a realistic future opportunity.

In closing today, I'd like to share with you a quote from Winston Churchill, Kites rise highest against the wind, not with it. Thank you for joining us. And we'd like to now open for questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] And our first question comes from the line of Linda Bolton Weiser with D.A. Davidson. Please go ahead with your question.

Linda Bolton Weiser
Analyst, D. A. Davidson & Co.

Q

Hi, how are you?

Garry Owen Ridge
Chairman & Chief Executive Officer, WD-40 Co.

A

Good morning, Linda.

Linda Bolton Weiser
Analyst, D. A. Davidson & Co.

Q

So, can you perhaps quantify in anyway the impact of the supply chain disruptions. And did you say that affected both the Americas and Asia. Is there any way you can quantify any to those regions?

Garry Owen Ridge
Chairman & Chief Executive Officer, WD-40 Co.

A

Sure. Thanks. I will. The major impact was in the United States. In the US, we would estimate that we shipped roughly 50% of the volume of Specialist and 85% of the volume of our MUP product against that demand signals. Now those estimates are probably wrong and roughly right. But more important is that the end-user demand based on point-of-sale remains high. So the major impact is on the US market.

In Asia-Pacific, the impact was only in the marketing distributor markets and it was primarily due to our inability to ship because of shortage of containers. We don't have a supply chain issue in Asia-Pacific or in the [ph] MD (37:40) markets, it's a container shortage issue and we haven't actually quantified that completely. But it was enough to ensure that we didn't grow as we wanted to in the quarter.

Linda Bolton Weiser
Analyst, D. A. Davidson & Co.

Q

Okay. And then just, maybe you said this, but I didn't catch it. But did you say that these issues would be all cleared up kind of in the third quarter or more in the fourth quarter?

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Garry Owen Ridge
Chairman & Chief Executive Officer, WD-40 Co.

A

We're working through them and currently we are working to with a recovery plan. And we should be through this completely by the end of the fourth quarter, but it will be a ramp up completion. But things are improving and we hope to see better results around supply against demand signals as we move further through the year. Again it is totally or primarily isolated to the United States. And the biggest impact is in the United States on our specialist product line and into a lesser extent onto our MUP line.

Linda Bolton Weiser
Analyst, D. A. Davidson & Co.

Q

Okay. And then, I guess sort of maybe you can marry that idea with the comment from Jay that the gross margin would kind of still be impacted by the issues. Is that kind of like a gradual improvement there? Or is there some kind of disconnect between the revenue impact and the gross margin impact?

Garry Owen Ridge
Chairman & Chief Executive Officer, WD-40 Co.

A

I'll let Jay talk about that.

Jay W. Rembolt
Vice President-Finance, Treasurer & Chief Financial Officer, WD-40 Co.

A

Thanks, Garry.

Garry Owen Ridge
Chairman & Chief Executive Officer, WD-40 Co.

A

Guys, off to you.

Jay W. Rembolt
Vice President-Finance, Treasurer & Chief Financial Officer, WD-40 Co.

A

Yeah. Thank you, Garry. We see that we could have some deterioration somewhere between 200 basis points to 300 basis points from where we are today as we go through the third and fourth quarter. It would be a kind of a – and it really depends on how the timing of the plan that we have in place, should we see delays in the plan that might slow some of the recovery down, but we would expect to feel the impact potentially through – or through the end of the year.

Linda Bolton Weiser
Analyst, D. A. Davidson & Co.

Q

Okay. And then did I catch you saying that the new Smart Straw was launched in the Americas in the fourth fiscal quarter, is that what you said? And is that what the original plan was or is that delayed a little bit?

Steven A. Brass
President & Chief Operating Officer, WD-40 Co.

A

Sure, Linda. What we've been able to do in the recovery plan because part of the volume increase in Specialist has really put a strain on our production of the Specialist delivery system, the 1.0. A good thing happened is we were able to commission some of the new machinery for the 1.5 and that's going into production during May.

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So you'll see that come into the market after May, probably the June period, which means we have enough of the 1.0 delivery system to continue to fuel the growth in other markets around the world. So it's coming in earlier. One of the machinery is coming in earlier and that's going to allow us to meet the overall demand for Smart Straw.

Linda Bolton Weiser
Analyst, D. A. Davidson & Co.
Q

Okay. And then finally just a question about your marketing plans, your marketing spending plans. If you're experiencing these sort of shortages a little bit here, has that caused you to – like should you pull back on marketing? While you're having shortages in certain areas, are you still kind of going to spend as per your plan?

Garry Owen Ridge
Chairman & Chief Executive Officer, WD-40 Co.
A

We're going to invest as per plan, because a major part of our investment is really around growing the must-win battle number one in a lot of markets around the world. So we don't have one of those turn the tap off/turn the tap on kind of marketing programs. So, no, we would expect that we would continue to drive it forward.

Linda Bolton Weiser
Analyst, D. A. Davidson & Co.
Q

Okay. Thanks. That's it for me. Thank you.

Garry Owen Ridge
Chairman & Chief Executive Officer, WD-40 Co.
A

Thank you, Linda.

Operator: And our next question comes from Daniel Rizzo with Jefferies. Please proceed with your question.

Daniel Rizzo
Analyst, Jefferies LLC
Q

Hi, everyone. Thank you for taking my question.

Garry Owen Ridge
Chairman & Chief Executive Officer, WD-40 Co.
A

Hi Daniel.

Daniel Rizzo
Analyst, Jefferies LLC
Q

Just relating to the supply constraint issues that we kind of talked about, I was just wondering why it's becoming an issue or was an issue in this quarter and not in the past. [ph] Have we got until a (42:50) point where it's just kind of a – I don't know it's just overwhelmed finally some of your suppliers and that wasn't the issue in the past. I don't know, I mean as we kind of come out of the pandemic, I thought this could have been an issue one to two quarters ago. And two, could it become an issue in Europe which seems to be unscathed at this point?

Garry Owen Ridge
Chairman & Chief Executive Officer, WD-40 Co.
A

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The first part of the question is these supply chain pressures have been on us ever since the start of the pandemic. And what has happened is, is that as demand started to increase and the pressures became greater, the gap became wider. And at the same time, we've had increased demand around aerosol fill line demand around the US. So this thing has been bubbling.

We've talked about it a little bit in the past and we're taking the steps to get back to where we need to be. The good news is when we come out of this completely, the steps that we're taking now will give us enough upside production to carry us through. In Europe, we don't see the issue there, because it's a more diversified supply chain. And so we don't see them. We have had some, but they're not as obvious as they are here in the United States.

Daniel Rizzo
Analyst, Jefferies LLC

Q

Okay. Thank you. Thank you for the color. And then you mentioned about introducing additional third-party manufacturers to kind of alleviate the issue. I was wondering if that's kind of a long process or how that works. And again a two-part question, some of the lost sales you've had here in this quarter, are they lost or are they just delayed?

Garry Owen Ridge
Chairman & Chief Executive Officer, WD-40 Co.

A

The first part of your question, it depends. In one case, we were able to in one of our manufacturing partner plants bring on a second shift. That took about two months to actually bring that into play, by the time we were able to bring the second shift into play, because labor shortages have been evident across the markets. Lines have slowed down because of distancing. There's been a whole lot of things that happened.

So – and then if we are bringing on a completely new supplier, we still need to go through our mandatory safety, quality and R&D testing at a plant before we commission it and spin it to be able to manufacture our product, that takes anything from 30 days to 60 days. So that has been some of the delay. But the new plants that we – or one of the new plants that we've brought on is up and running now and we're now bringing new product in behind it. So there is a delay mainly caused by quality, research and development clearance, regulatory clearance, et cetera.

Daniel Rizzo
Analyst, Jefferies LLC

Q

Okay. Last question. I was looking at the cash flow statement, it seems like working capital has improved recently. I don't know if this is just kind of the lumpiness or if something's changed where it should be, I don't know the numbers should be improved just as we kind of model going for the next couple of years or so.

Garry Owen Ridge
Chairman & Chief Executive Officer, WD-40 Co.

A

I'll ask Jay to answer that.

Jay W. Rembolt
Vice President-Finance, Treasurer & Chief Financial Officer, WD-40 Co.

A

Yeah, I think that, the one thing that we have noticed is that we've had a lot lower levels of inventory than we would have certainly had in the past. And it really is reflective of some of the supply chain problems that are being

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discussed. So we would much rather have more inventory and have that investment in our working capital than the situation we've found ourselves in. So yes, so some of that should come back and normalize.

Daniel Rizzo
Analyst, Jefferies LLC

Q

All right, thank you very much, guys.

Garry Owen Ridge
Chairman & Chief Executive Officer, WD-40 Co.

A

Thanks, Daniel.

Operator: And our next question comes from Rosemarie Morbelli with G.research. Please proceed with your question.

Rosemarie J. Morbelli
Analyst, G.research LLC

Q

Thank you. Good afternoon, everyone.

Garry Owen Ridge
Chairman & Chief Executive Officer, WD-40 Co.

A

Hello, Rosemarie.

Rosemarie J. Morbelli
Analyst, G.research LLC

Q

You mentioned the supply issue and I was wondering if that is solely because of the deep freeze in Texas and the strong demand? Or if there is some impact from the ship jammed in the middle of Suez Canal and whether we will see that impact in the next few quarters in terms of container shortages in Asia?

Garry Owen Ridge
Chairman & Chief Executive Officer, WD-40 Co.

A

We don't see any evidence at this time that we're having any material impact from the delay that happened in the Suez Canal. The container issue has been one that has been around this ever since COVID started. So yes, I think there will be some shortage of containers continuing. It's a periodic thing and it goes away. The supply chain, yes, there was some impact from Texas. There was some – but really the majority of the impact has been the increased demand on aerosol fill line time and the slowing of those lines due to labor restrictions caused by COVID that's been the main – those are the main impacts.

Rosemarie J. Morbelli
Analyst, G.research LLC

Q

All right. Thanks. And looking at the gross margin, I understand that the supply maybe an impact, but isn't the largest impact coming from the inflation on your raw materials side?

Garry Owen Ridge
Chairman & Chief Executive Officer, WD-40 Co.

A

Jay?

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Jay W. Rembolt
Vice President-Finance, Treasurer & Chief Financial Officer, WD-40 Co.
A

There – yeah, there will be the cost of oil will be also impacting that and have a fairly significant impact. We've got other costs. We're seeing other component cost increases as well. So, yeah, it's a combination of both the impacts from these supply chain disruptions as well as from input costs.

Rosemarie J. Morbelli
Analyst, G.research LLC
Q

Okay. And then lastly if I may. When you get a new third party manufacturing – manufacturer online, are they doing it at a similar cost basis or is it at a higher cost than your existing relationships?

Garry Owen Ridge
Chairman & Chief Executive Officer, WD-40 Co.
A

It depends on what they're feeling. If we're bringing on most of the supply chain impact has been on Specialist in the United States and Specialist – the runs of Specialist product are shorter runs. So already the fill fees are higher. So, yes, there are depending on what the SKU is there could be a slight increase in our fill fees. On the other side, where we have high speed lines around MUP if we have to move some of our MUP production from some of the higher speed production facilities to a lower speed, yes there could be a slight increase in the fill fee for that as well, but it depends on where we move what and when.

Rosemarie J. Morbelli
Analyst, G.research LLC
Q

And the potential impact on the SG&A, SG&A as a ratio to revenues was higher. So should we anticipate that this is going to continue in shape?

Garry Owen Ridge
Chairman & Chief Executive Officer, WD-40 Co.
A

You mean the cost of doing business?

Rosemarie J. Morbelli
Analyst, G.research LLC
Q

Yes, but on the SG&A side.

Garry Owen Ridge
Chairman & Chief Executive Officer, WD-40 Co.
A

So, our cost of doing business year-to-date is 34%, which is 2 percentage points lower than year-to-date last year. The increase in cost of doing business or the SG&A in this quarter particularly as Jay mentioned was due to adjustments to our accruals for in safety compensation anticipated by the results we expect through the end of the year.

So we would expect that our cost of doing business will be again somewhere in that 34% range as we end up through the rest of the year.

Rosemarie J. Morbelli
Analyst, G.research LLC
Q

Okay. Thank you very much.

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Garry Owen Ridge
Chairman & Chief Executive Officer, WD-40 Co.

A

Thank you, Rosemarie.

Operator: And ladies and gentlemen, thank you. And that does conclude our allotted time for questions. We thank you for your participation on today's conference call, and ask that you please disconnect your line.

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