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WD-40 Co. (WDFC)

Q1 2022 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 First Quarter Fiscal Year 2022 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 the host for today's call, Ms. Wendy Kelley, Vice President of Stakeholder and Investor Engagement. Please proceed.

Wendy Kelley

Vice President-Stakeholder and Investor Engagement, 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 November 30, 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 on today's call, we will talk about certain forward-looking statements about our expectations for the company's future performance. 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.

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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, January 6, 2022. The company disclaims any duty or obligation to update any forward information, whether as a result of new information, 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. Today, we reported net sales of $134.7 million for the first quarter of fiscal year 2022, which was an increase of 8% compared to last year. We are pleased with these top line results. However, this is a different game that we're playing now. We are facing a volatile and challenging environment, and that first quarter gross margin came in at 51% reflecting significant cost inflation. As a result, net income for the first quarter was $18.6 million compared to $23.6 million in the first quarter of last fiscal year, a decrease of 21%.

Jay will talk in greater detail in a few moments about what has impacted our gross margin and what we're doing to restore it to historic levels. But, first, let's start with a discussion about our strategic initiatives. Our strategic initiatives are the continuing plan we have in place to achieve the company's long-term aspirations. As most of you will recall, we recently decided to refresh our strategic initiatives so they more accurately and holistically reflect the top priorities of our organization. Our strategic initiatives support our long-term revenue growth aspirations, which is to drive net sales to between $650 million and $700 million by the end of fiscal year 2025. We strive to do so while following our 55/30/25 business model.

Strategic initiative number one is to build a business for the future. Our goal under this initiative is to build an enduring business that we'll be proud to pass on to the next generation. The desired outcome for this strategic initiative is to further embed infinite-minded decisions into our business and to fully integrate our ESG initiatives into the heart of our strategic planning process.

We recently completed an internal diversity, equity, inclusion and belonging survey in support of both our ESG efforts, as well as strategic initiative number two, which is to attract, develop and engage outstanding tribe members. We believe that by building and nurturing an inclusive and diverse, purpose-driven learning and teaching organization, our tribe members will succeed together while excelling as individuals.

One of our tribal attributes is belonging. We believe that belonging is the psychological feeling of acceptance, connectedness, security, support, inclusion and identity. I'm happy to share with you that 92% of our tribe members experience a sense of belonging and 88% agree that WD-40 is an inclusive place to work. Although these results are positive, our work is not done. We are exploring new ways to create an even more diverse, equitable and inclusive workplace where all tribe members experience a sense of belonging.

Strategic initiative number three is to strive for operational excellence. Our goal under this initiative is to foster a culture of continuous improvement in which operational excellence is the responsibility of every tribe member. The world is full of volatility, uncertainty, complexity and ambiguity, more so now than we've ever seen in our lifetime. Almost everything we buy has travelled along some of the millions of miles of networks that make up the world's supply chains.

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Like many other companies, we've been unable to fully meet increased consumer demand for our products in some markets due to the current state of the global supply chain. In the spirit of making it better than it is today, we are proactively increasing the capacity and the resilience of our supply network in our markets.

In the United States, we will double the number of third-party manufacturers we partner with [ph] for (06:58) this fiscal year. While adding the extra capacity is very important, it's equally important that we maintain our high-quality standards throughout this process. Our tribe members are working diligently to maintain consistently high product quality as we move through this project to onboard new manufacturers.

Strategic initiative number four is to grow WD-40 Multi-Use Product. Our goal under this initiative is to make the blue and yellow can with the little red top available in more places to more people who find more uses more often. We will grow the WD-40 Multi-Use Product line through continued geographic and digital expansion, increased market penetration, educating end users about new uses, and through the development of new and unique delivery [ph] systems (07:48) that make the product easy to use.

In the first quarter, sales of WD-40 Multi-Use Product increased 14% globally to $107.1 million. The desired outcome for this strategic initiative is to grow sales of WD-40 Multi-Use Product to approximately $525 million by 2025.

Strategic initiative number five is to grow the WD-40 Specialist line. Our goal under this initiative is to leverage the WD-40 brand by developing new products and categories which build and reinforce the core brand positioning and create growth through continued geographic and digital expansion. In the first quarter, sales of WD-40 Specialist decreased 5% globally to $12.5 million. Steve will speak in a few moments about the causes of these declines. He will also share some very positive news of how WD-40 Specialist is setting some new and exciting benchmarks. The desired outcome for WD-40 Specialist in this initiative is to grow sales to approximately $125 million by 2025.

Strategic initiative number six is to expand and support portfolio opportunities that help us grow. Our goal in this initiative is to expand and support brands that provide us protection and help us grow. Brands under this initiative include 3-IN-ONE and GT85, as well as our home care and cleaning products brands. In the first quarter, sales of products included under this initiative decreased 12% globally to $15.1 million. Our home care and cleaning products were up against a very strong comparable period, as they benefited from increased demand as a result of the pandemic last year. In addition, we've been unable to fully meet consumer demand for our products due to the challenging supply chain environment.

The desired outcome for this strategic initiative will be sales in this category of approximately $50 million by 2025. To reach that number, we expect sales growth of brands like 3-IN-ONE, GT85, 1001 and no vac. Many of our other home care and cleaning product brands will most likely decline in sales but will continue to contribute healthy returns. Supporting our strategic initiatives are our must-win battles. These are focused action plans that supports the strategic initiatives.

I would now like to pass the call to Steve, who will share an overview of our sales results and update on our must-win battles.

Steven A. Brass

President & Chief Operating Officer, WD-40 Co.

Thanks, Garry, and good afternoon. When we last spoke, I shared with you that end user demand for our products continued to be exceptionally strong, and that September was the second largest sales month in the

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company's history. Today, I'm happy to report total global sales growth of 8% for the quarter. Compared to the double-digit growth we experienced for most of fiscal year 2021, our sales results have softened a bit, but remember, we did not guide to the level of sales growth that we saw last year. What is important for investors to appreciate is that the watermark is higher now. Despite our comparable period being very strong, we continue to experience strong demand for our products, and believe that many of the new end users who have interacted with them during the pandemic have become permanent users of our brands.

Let's take a closer look at what's happening in our trade logs, starting with the Americas. Net sales in the Americas, which includes the United States, Latin America and Canada, were up 4% in the first quarter to $56.3 million. Sales of maintenance products increased 7% in the Americas due to increased sales in Latin America of 42%. This increase was due to higher sales in many markets in the region, including our newest direct market in Mexico. We continue to see momentum in Mexico from the shift we made in fiscal year 2020 from a distributor model to a direct market. In addition, in our American distributor markets, we saw strong sales due to successful promotional programs and increased product availability, as well as the timing of customer orders.

The increase in maintenance product sales in Latin America was mostly offset by decreases in sales in both the United States and Canada. Net sales of maintenance products in the United States decreased 1% compared to last year. We experienced strong end user demand in the United States, resulting in a 5% increase in sales of WD-40 Multi-Use Product. Unfortunate, this was completely offset by declines in sales of WD-40 Specialist and 3-IN-ONE, which declined 28% and 30%, respectively. While we continue to experience very strong end user demand for our maintenance products, we were unable to fully meet those demands due to capacity constraints in our US supply chain.

In Canada, net sales of maintenance products decreased 2%, primarily because we were up against a very strong year-over-year comparable period. As a reminder, our maintenance products exclude our home care and cleaning brands. Sales of our home care and cleaning products in the Americas decreased 24% compared [audio gap] (12:59) year, largely due to lower sales of Spot Shot, 2000 Flushes and X-14. In total, our Americas segment made up 42% of our global business in the first quarter. Over the long term, we anticipate sales within this segment will grow between 5% to 8% annually.

Now, on to EMEA, net sales in EMEA, which includes Europe and Middle East, Africa and India, were up 5% in the first quarter to $57.5 million. 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 1% compared to last year.

Sales of maintenance products increased by 6% in EMEA due to increased sales in both our EMEA direct and our EMEA distributor markets, which increased 4% (sic) [3%] and 9%, respectively. In our EMEA direct markets, we experienced a 4% increase in sales of both WD-40 Multi-Use Product and WD-40 Specialist. We saw particularly strong sales in Italy, France and Spain, where sales were up 17%, 9% and 18%, respectively. These sales increases were primarily due to new distribution and successful promotional programs. In the first quarter, net sales in our EMEA direct markets accounted for 63% of the region's sales.

In our EMEA distributor markets, we experienced a 10% increase in sales of WD-40 Multi-Use Product. We saw particularly strong sales in Poland, Russia and India, where sales were up 68%, 15% and 30%, respectively. These sales increases were primarily due to new distribution, successful promotional programs, and favorable changes in foreign currency exchange rates. We continue to experience very strong end user demand for our products in these regions. But we weren't able to meet some of this demand due to shipping container and transportation shortages related to the current state of the global supply chain. In the first quarter, net sales in our

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EMEA distributor markets accounted for 37% of the region's sales. In total, our EMEA segment made up 43% of our global business in the first quarter. Over the long term, we anticipate sales of [ph] this (15:18) 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, were up 34% in the first quarter to $20.9 million. Changes in foreign currency exchange rates had a favorable impact on sales for the Asia-Pacific segment from period-to-period. On a constant currency basis, sales would have increased by 31% compared to last year.

In China, net sales were $6 million in the first quarter, up 69% compared to last year, driven primarily by successful promotional programs, as well as the timing of customer orders. We remain optimistic about the long-term opportunities in China. We expect volatility along the way due to economic and health-related impacts of COVID-19, the timing of promotional programs, the building of distribution, shift in economic patterns and varying industrial activities.

In our Asia distributor markets, net sales were $9.3 million in the first quarter, up 36% compared to last year. These sales increases were primarily driven by improved economic conditions as a result of reduced lockdown measures during the first quarter, which resulted in increased demand and higher sales, particularly in Indonesia, Malaysia, Taiwan and Hong Kong.

In Australia, net sales were $5.5 million in the first quarter, up 7% compared to last year, due primarily to increased sales of WD-40 Specialist, which were up 45% compared to last year. In total, our Asia-Pacific segment made up 15% of our global business in the first quarter. Over the long term, we anticipate sales within this segment will grow between 10% to [ph] 30% (17:05).

Now a brief update on our must-win battles. Our must-win battles are the primary areas of action that will enable us to deliver against our revenue growth aspirations to drive net sales to between $650 million and $700 million by the end of fiscal 2025. These hyper-focused actions support [audio gap] (17:26) strategy and other key drivers of revenue growth. Our largest growth opportunity and our first must-win battle is the geographic expansion of the blue and yellow can with the little red top.

We continue to experience impressive growth for our flagship brand with global sales of the WD-40 Multi-Use Product up 14% compared to last year. We've recently made some significant investments in brand building and awareness or what we refer to internally is making the end user aware and these investments are paying off.

We've seen significant growth in priority markets like China, Mexico, India and Russia where, in the first quarter, sales of the blue and yellow can with the little red top increased by 79%, 58%, 30% and 14%, respectively. In fiscal year 2022, we will continue to invest in building our flagship brand with end users around the world.

Our second must-win battle is the premiumization of WD-40 Multi-Use Product. Premiumization creates opportunities for revenue growth, gross margin expansion and, most importantly, a delight for our end users.

In the first quarter, sales of WD-40 Smart Straw and EZ-Reach when combined were $48.3 million, up 10% compared to last year. Our Smart Straw Next Generation delivery system is currently being rolled out in Canada and the United States, and we expect it will be made available in Europe later this fiscal year. Smart Straw Next Generation supports our objective to grow premium delivery system penetration to greater than 60% of our WD-40 Multi-Use Product sales by 2025.

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Our third must-win battle is to grow WD-40 Specialist. As Garry mentioned earlier, global sales of WD-40 Specialist were down 5% compared to last year. We saw solid sales of WD-40 Specialist in EMEA and Asia Pacific where sales were up 4% and 21% [ph] respectively (19:18). However, these increases were entirely offset by lower sales in the United States.

We continue to experience very strong end user demand for WD-40 Specialist in the United States. We were unable to fully meet those demands due to capacity constraints in our US supply chain. We are beginning to see improvements, but we do not expect to be able to fully meet demand on WD-40 Specialist in the Americas until the second half of fiscal year 2022.

We believe that, for the full fiscal year, WD-40 Specialist will grow as we work towards restoring our supply chain and reap the benefits of our new packaging and brand architecture. We have seen very positive results in the regions where we have rolled out the new packaging such as in Australia where it is setting a new benchmark with sales of WD-40 Specialist reaching 36% of WD-40 Multi-Use Product sales in the country.

Our final must-win battle is digital commerce. Our vision for digital commerce is to engage with end users at scale, making it easy to access, learn about and purchase our brands. We are and always have been channel-agnostic. A critical factor in our success has always been that we distribute our products in over 62 unique trade channels around the world, which makes them easy to buy. Whether end users choose to purchase our brands online or in physical stores, we aim to provide a seamless online and offline experience. We see driving digital engagement of our brands as a key accelerator of our growth going forward.

That being said, in the first quarter, we've seen a rebalancing of sales towards brick-and-mortar locations. Global e-commerce sales were down 22% compared to last year. For the full fiscal year, we continue to expect strong digital commerce growth.

That's it for me. I will now 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.

Thank you, Steve. We delivered solid results in our first quarter, fueled by strong end user demand in the face of a volatile and challenging supply chain environment. Let's start first with [audio gap] (21:21) 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 towards 30% of net sales. And finally, the 25 represents our long-term target for EBITDA.

First, the 55, our gross margin; in the first quarter, our gross margin was 50.8% compared to 56.4% last year. This represents a decline of 560 basis points. Over the last four quarters, we've seen a consistent decline in gross margin due to inflationary headwinds and the challenges [audio gap] (22:22) supply chain. Like others, we're experiencing significant increases in input and transportation costs as well as increased costs from our third-party manufacturers.

Our opportunity this fiscal year is to reverse this sequential trend and drive gross margin back up to historic levels by the end of fiscal [audio gap] (22:46). In the first quarter, changes in Specialty Chemicals were the primary driver of this decline and negatively impacted our gross margin by 390 basis points.

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Higher warehousing, distribution, and freight costs primarily from supply chain constraints in the Americas and EMEA negatively impacted our gross margin by 140 basis points. Gross margin was also negatively impacted by 80 basis points due to foreign currency exchange rates and 70 basis points from higher billing fees paid to our third-party contract manufacturers primarily in the Americas.

These factors were partially offset by a benefit of 120 basis points from sales price increases we've implemented over the last 12 months. The impact to gross margin linked to foreign currency exchange rates is due to fluctuations in the exchange rates for the euro and the US dollar against the pound sterling in our EMEA segment. This is because in EMEA, the majority of our finished goods are sourced in pound sterling while approximately 70% of revenues are generated in currencies other than pound sterling to offset these declines in gross margin pricing markets and geographies.

However, tactical price increases like those we've recently implemented take time to embed their way into our reported results. And we have yet to see the full benefit of the price increases we implemented this quarter. This operating environment is different than anything we've seen in a long time. Historically, we've implemented price increases when necessary to offset rising input costs. This has usually resulted in price increases being made on a very infrequent basis.

But this is a different game, and we are using a different playbook. We expect the operating environments to remain challenging and volatile, and we expect to continue to face incremental cost headwinds. Due to the current inflationary environment, we will be implementing multiple price increases this fiscal year. We are confident that our plans to rebuild margin, coupled with the advancement of our margin-accretive must-win battles will enable us to deliver on our long-term gross margin and sales goals. While it may take a few quarters, we will take the necessary actions to restore our gross margins to 55% or higher and to continue to drive sales growth to the mid to high-single digits.

Now, I'll address the 30 or our cost of doing business. In the first quarter, our cost of doing business was approximately 32% of net sales, flat compared to last year. Although, SG&A expense increased by $2.5 million compared to last year, our cost of doing business as a percentage remained flat due to the increase in revenue this quarter. The increase in SG&A expense in the quarter was primarily due to changes in foreign currency exchange rates, higher travel and meeting expenses along with higher freight costs.

So the first quarter, 79% of our cost of doing business came from three areas, people 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 4.2% in the first quarter. And finally, the freight costs to get our products to our customers. Our long-term goal is to drive our cost of doing business towards 30% of net sales.

And this brings us to EBITDA the last of our 55/30/25 measures. EBITDA was 19% of sales for the first quarter, which is down significantly compared to last year primarily due to lower gross margins we reported. We expect to return to historic EBITDA levels as we rebuild our gross margin.

Well, that completes the discussion on our business model. Now, let's discuss some of the items that fall below the EBITDA line. The provision for income taxes was 19.8% this year compared to 15.7% last year. The increase in the effective income tax rate was primarily due to an increase in non-deductible performance-based compensation expenses. We expect that our effective tax rate will be approximately 21% to 22% for the full fiscal year 2022. Net income for this quarter was $18.6 million compared to $23.6 million last year. And diluted earnings per common share for the quarter was $1.34 compared to $1.72 for the same period.

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Now, a word about our balance sheet and our capital allocation strategy. The company's financial condition and liquidity remain strong. Our capital allocation strategy includes a comprehensive approach to balance investing and long-term growth while providing strong returns to our shareholders. We continue to return capital to shareholders through regular dividends and share repurchases.

On December 13, our board of directors approved a quarterly cash dividend of $0.78 per share, reflecting an increase of more than 8% over the previous quarter's dividend. And last quarter, I shared with you that our board of directors had approved a new $75 million share repurchase plan, which became effective November 1. And during the first quarter, we repurchased 32,000 shares of our stock at a total cost of approximately $7.4 million under this plan.

In fiscal year 2022, we expect to invest approximately $14 million in capital projects, the majority of which will be used to complete the procurement of the machinery and equipment we're using to manufacture our Next Generation Smart Straw delivery system.

One item that I would like to call your attention is the recent increases in our inventory levels. As we improved the resilience of our US supply chain, we have increased the number of components and finished goods that we have in inventory to improve our ability to meet the market demand.

Now, let's turn to fiscal 2022 guidance. While our net income range remains the same, we have updated our guidance to reflect higher sales, as well as higher costs associated with the inflationary pressures that continue to impact our gross margin. With that, we expect net sales growth projected to be between 7% and 12% with net sales between $522 million and $547 million.

Gross margin for the full fiscal year is expected to be between 52% and 54%. Advertising and promotion investment is projected to be between 5.5% to 6% of net sales. And the provision for income tax is expected to be between 21% and 22%. Net income is projected to be between $71.7 million and $73.6 million. Diluted earnings per share is expected to be between $5.24 and $5.38 based on an estimated 13.7 million weighted average shares outstanding.

We want to remind everyone that there are dynamics outside of our control that may impact our fiscal year 2022 results, including the impact of fluctuating foreign currency exchange rates, unanticipated inflationary headwinds and other unforeseen events. This guidance does not include any future acquisitions or divestitures.

And 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 today? You heard that we are operating in an environment that is volatile, uncertain, complex and ambiguous and that this is a different game we're playing now. You heard the total net sales were up 8% in the first quarter. You heard that sales of WD-40 Multi-Use Product were up 14% in the first quarter. You heard that sales in Asia Pacific were up 34% in the first quarter. You heard that we continue to return capital to investors through regular dividends and we raised our dividend by more than 8% last month. You heard that though we have been experiencing pressure on gross margin, we have a restoration plan in place that will take some time to execute. You heard that we've adjusted our guidance for fiscal year 2022, and we believe that net sales will grow between 7% and 12%.

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In closing today, I'd like to share a quote with you from Seth Godin. If the game is designed for you to lose, don't play that game, play a different one. Thank you for joining us today and we would be pleased to take your questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] The first question comes from the line of Daniel Rizzo of Jefferies. Please proceed with your question.

Daniel Rizzo
Analyst, Jefferies LLC

Q

Hi, everyone. Thank you for taking my questions. You indicated that some sales were – there were some sales lost, I guess, in the quarter due to supply chain constraints. I was wondering if they're losses deferred, if it's just delaying the sales or is it something that's really tough to get back.

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

A

Thanks, Daniel. This is Garry. That's not an easy question to answer. My history has been, if you lose a sale, you lose a sale. Now, having said that, the thing that's really important is that, in the quarter, 80% of our revenue came from our core product, which is WD-40 MUP, and it was up 14% in the quarter. And as you note, Daniel, much of our long-term growth is based on the expansion of our WD-40 Multi-Use Product. So there's a lot of noise going on around the business in certain areas. Some areas are up significantly, some are a little slower, supply chain or whatever. But I think it's important to really reflect on the fact that 80% of our business, which is our core business, was up 14%.

Daniel Rizzo
Analyst, Jefferies LLC

Q

No. Yeah. Okay. That's helpful. And then with the real – the strength in China, which I think was up 60-plus percent, I was wondering if that was something – that there's some pull forward there. I know it can be pretty lumpy from time to time, and in some portion [indiscernible] (35:07) down 40% because of delays. I was wondering if there was any pull forward here in anticipation of the Chinese New Year or something like that.

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

A

Not materially. Chinese New Year is coming up, and we would expect, hopefully, that Chinese New Year will go through in its normal way and we won't see any massive disruption. But we're looking for a solid year in China. Of all markets in the world that are COVID-affected, it seems to be the most stable right now because of – it's China. So, we would think that this year will be a reasonably good year in our China market.

Daniel Rizzo
Analyst, Jefferies LLC

Q

Okay. And just a couple more. You mentioned that, by 2025, I think you want 60% of MUP sales to be – 60% of MUP sales would be Smart Straw. I was wondering what the percentage is now like what is the growth projection there?

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

A

Steve, would you like to address that?

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

A

Sure. Hi, Daniel. Yeah. So our first quarter sales were just in the mid-40s. Last year, we closed at 50% for the full year. So we expect for the year to be approaching that 50%-plus rate between Smart Straw and EZ-Reach sales combined.

Daniel Rizzo
Analyst, Jefferies LLC

Q

Okay. Okay. And then finally, you mentioned raising awareness in China, like one of the strategy is raising awareness in China, Russia, India and Mexico. I was wondering how you do that. I mean, is it like an ad campaign, billboards? I mean, I know you're going to – I think to like commercial first. I was wondering what specific steps you take if you can provide any color on that.

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

A

Steve, would you like to speak on that?

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

A

Sure. So it's the old formula of expanding distribution, so making the product available in more places, whilst also making the end user aware. And a big part of making the end user aware of WD-40 Company globally is sampling programs. So, China, a lot of that growth that we're seeing in China now has come from big investments and more substantial investments we made at the end of last year in sampling industrial end user across all of China. So, sampling programs across all of our major growth potential markets are very effective way of us bringing in new users.

Daniel Rizzo
Analyst, Jefferies LLC

Q

Thank you.

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

A

Daniel, you may remember – you may remember, Daniel, in Q4 last year, as Steve referenced, we made a substantially larger marketing investment and we referenced the fact that we were doing it in these markets. So, as Steve said, we're starting to see some of those sampling programs pay off.

Daniel Rizzo
Analyst, Jefferies LLC

Q

Okay. Thank you.

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Operator: Thank you. And our next question comes from the line of Linda Bolton Weiser of D.A. Davidson. Please proceed with your question.

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

Q

Yes. Thank you. Hi. Happy New Year. How you doing?

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

A

Hi, Linda. We're great.

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

Q

Good. So your top line results certainly were strong in the quarter, and you've talked about the fact that the core product was so strong, so up double-digit against pretty much a hard comparison last year. So can you just give a little more color on like what is going on? I mean, do you think that this isolation-renovation consumer behavior is continuing, just as a normal behavior, doing more stuff around the home or whatever? And do you think there's – and can you comment too if there's anything in your business in particular related to Omicron that you think is affecting demand?

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

A

Omicron, who knows? I think what we're seeing – and I'll talk a little bit and then I'm going to pass to Steve to talk about some of the new end users that we feel that we've pulled in. But again, I think what we're really witnessing in our business, and you can see it by the different growth rates in different countries around the world and specifically now I'm talking about COVID, we're seeing the positive resilience of having a very diversified business around the world because I just returned from Australia two days ago. And while I was there, Omicron blew up in a massive way. And we're seeing pockets of this everywhere.

But because we're so diversified globally, we still saw in Europe in the past quarter very strong growth in Italy, as we talked about Spain, areas where things opened up and closed down. So I think we've kind of got used to maneuvering these really unusual business conditions. But thank goodness, we have the infrastructure and the global awareness and distribution that we have because we're not getting hit all at once in one place. So that's my view on the continued learning of the effect of COVID and Omicron and who knows what the next one is, I don't know.

Steve, do you want to talk about the overall demand and how we're seeing end users et cetera?

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

A

Sure. Thanks, Garry. And hi, Linda. Yes. So those new users, the kind of DIY boom, the isolation-renovation phenomenon Garry referred to many times, those new users, we believe, will be permanent users of our brands and that will carry forward. There has been a definite reduction across many areas of the world, not all, but many areas of the world on the DIY side. So our DIY channel sales have flattened somewhat, but that's been replaced by a switch to – certainly towards professional use. Our industrial sales across the globe are doing really, really well. So, I believe our industrial sales are up mid-30s percent across the world, and that includes China and those investments we've made which are mainly in industrial sampling to industrial end users in China. So there's been

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some switch there, some rebalancing. You heard of the e-commerce rebalance towards physical stores as well. So there's been some channel shifts, but thankfully, it's still resulting in strong overall revenue growth.

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

Q

Okay. Great. That's helpful. And then, can you – just, I mean, looking at your gross margin, it was a little bit lower than we had thought in the quarter. And I guess the way we had modeled it, we thought it might have bottomed out last quarter and then maybe gone up sequentially this quarter, and then – and yet, it went down sequentially again. So, do you think that this quarter is the bottom? I know it's hard to project, but do you think this is kind of the trough and then you have a sequential little bit of increase maybe in the second quarter? Do you have any view on that?

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

A

Jay, do you want to talk on that?

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

A

Yeah. Thank you, Garry. Yeah. Linda, this surprised us as well from a standpoint of where we ended up in the quarter. We had – and it really has been a result of just continued cost increases that have come at us. And like we said in the call, we are attempting and will be having additional price increases to help recover that gross margin.

So the timing of which, as we are modeling it today, suggests that we'll be able to see a flattening out and with some slight uptick in margin in the second quarter. But I hate to make that commitment given the fact that we've continued to see waves of cost increases. But we would expect that where we'd really like to see the recovery of margin will be closer to the fourth quarter at the level that we were – at historical levels, rather than kind of in the third quarter where we had initially thought. So we've been pushed out a quarter, probably a little bit longer maybe.

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

Q

Okay. Thank you. That's very helpful. And then, I think you did explain this, I think I asked this like a couple quarters ago, about the Specialist supply chain issues and why it's different from regular WD-40. Is it different factories or different – like why is there's a problem with that but not so much with the regular product?

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

A

Because we chose to prioritize. The Specialist supply chain issue was mainly in the United States, and that's where we had the most pressure on aerosol manufacturing supply in the world. So, we made a choice. We said we will forever protect our core and we will forgo some WD-40 Specialist business to ensure that that 80% of our business is in the most robust supply it can be.

Now, as you may have heard, we are doubling the amount of manufacturers we have in the US, and progressively now, those new manufacturers are coming online and primarily to support our Specialist product line. So, it was a sad day for us because Specialist has proven and is proving to be a really huge opportunity, particularly since we made the change in the trade risk.

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You may have heard Steve reference that in Australia now, where we've had no disruption in the Specialist supply, it's now 37% of our MUP sales. And when we first came out with Specialist, our estimate was we could get it to 25% of our MUP sales. So in a number of markets around the world, we've proven that the benchmark is higher, which means the long-term opportunity is higher. But we will recover in the US and we're slowly getting there as we bring on new suppliers, we have to go through stability, quality checking. There's − it's not easy to turn on a supplier and maintain our high quality standards as we must do. So that's the reason, Linda. It was a choice we made. And we are working through it and we'll get over it and we'll be back on track in the near term.

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

Q

Okay. Thank you. That's very good explanation. And finally, let me just slip in one more about your A&P ratio in the quarter was a little lower than we had expected at 4.2% and that's a little lower than what you're kind of planning for the year. Is there any way to be able to give us some guidance on how that will go in the corners? I mean, do you expect more spending in the second half of the year or is it hard to predict?

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

A

We would expect to come in for the full year in the range that we're predicting now. Some of this is timing about – ability to be able to execute programs. As you know, a lot of our marketing is around sampling, and if we get shut down in markets, sometimes, it's hard to do so. It shifts. Also, our revenue was a little higher than, I guess, you predicted also. So, the percentage is a little lower. But we would think that the range we have for the year will work out that way and we don't run our business on a quarter-to-quarter basis.

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

Q

Great. Okay. Well, thank you so much and good luck with everything.

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

A

Thank you. Thanks, Linda, for the questions. Appreciate it.

Operator: Thank you. And ladies and gentlemen, 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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