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WD-40 Co. (WDFC)

Q2 2022 Earnings Call

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Daniel Rizzo
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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 Second 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 go ahead.

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, Chief Operating Officer and incoming Chief Executive 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, 2022. 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. 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, April 7, 2022. The company disclaims any duty or obligation to update any forward-looking 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. We have a lot to cover today, but I'd like to start with the big news since last quarter's call. We shared last month that effective September 1, 2022, Steve Brass is going to be the next CEO of WD-40 Company. We are all so excited for Steve, and the reception so far from our investors and our tribe has been very positive. Steve is going to be the fifth CEO in our company's 69-year history.

As you know, Steve is someone I've worked very closely with for over three decades, and I feel extremely fortunate to hand the reins over to this capable leader. I know he's going to accomplish great things, and I'm looking forward to watching this happen. I'll remain in the CEO's seat until the end of this fiscal year and I will continue to be with you on an earnings call until our fourth quarter earnings call.

For now, let's talk about the second quarter of fiscal 2022. Today, we reported net sales of $130 million for the second quarter of fiscal year 2022, which was an increase of 16% compared to the same quarter last year. We are pleased with these topline results. However, we continue to face a challenging inflationary environment, and second quarter gross margin came in at 50%, reflecting a significant increase to our cost of goods [indiscernible] (03:56) products sold.

Jay will talk in greater detail in a few moments about what has impacted our margin, and what we're doing to restore it. While we have work to do to restore our margin back to our target of 55%, I'm happy to share with investors today that we reported net income of $19.5 million in the second quarter, compared to $17.2 million in the same quarter last year, reflecting an increase of 13%.

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. Steve and I worked closely with our senior leadership team last summer 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 aspiration, which is to drive net sales to between $650 million and $700 million by the end of fiscal year 2025. We strive to do this 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 will be proud to pass on to the next generation. The desired outcome for this strategic initiative is to fully integrate our ESG initiatives into the heart of our strategic planning process. We believe that taking an integrated approach to ESG enhances the sustainability of our business and protects long-term interest of our stakeholders.

We have started to take an outside in look at our business, diving into what we believe are the key trends that will shape the future. ESG and its demands continue to come to the surface in our discussion. I can share with you that this is an area that Steve is particularly passionate about and committed to moving forward. We are making

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great progress in setting our ESG priorities and expect to file our next ESG report in early fiscal year 2023. This report will contain an in-depth review of what we have accomplished since our last ESG report, as well as both short and long-term targets to drive improvements in this important area.

Strategic initiative number two 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. During the second quarter, we asked our tribe members to participate in our biennial employee engagement survey. I'm happy to report that our global employee engagement index score remain industry-leading and increased 50 basis points from two years ago to 93.5%. 98% of our tribe members answered they love to tell people they work at WD-40 Company, and 94% of our tribe members told us they are excited about the company's future direction. We cultivate high employee engagement by creating a culture based on care, candor, accountability, and responsibility, guided by our values and nurtured by learning. Our employee engagement score reflects that way of life.

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 ever seen in our lifetime. Our commitment to operational excellence continues to be an enormous asset for us as we navigate the challenges associated with the pandemic. Using our 55/30/25 business model as a framework, we measure ourselves against this operational initiative.

Strategic driver 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 systems that make the product easier to use.

In the second quarter, sales of WD-40 Multi-Use Product increased 18% globally to $101.7 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 product 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 second quarter, sales of WD-40 Specialist increased 40% globally to $14.6 million. Steve will speak in a few moments of the improvements we have to our supply chain. This improvement paved the way for 125% year-over-year growth of WD-40 Specialist in the United States in the second quarter. In addition, be on the lookout for an exciting new WD-40 Specialist product that will be debuting later this calendar year. This new product is one of the first sustainable products in its category, reduces single use plastic waste, it's packed in recyclable packaging and helps to reduce our carbon footprint. The desired outcome for this strategic initiative is to grow sales of WD-40 Specialist to approximately $125 million by 2025.

Strategic initiative number six is to expand and support portfolio opportunities that help us grow. Our goal under this initiative is to expand and support brands that provide us protection and help us grow. Brands under this initiative include 3-IN-ONE, GT85, as well as our homecare and cleaning brands. In the second quarter, sales of products included under this initiative decreased 9% globally to $13.7 million.

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Our homecare and cleaning products were up against very strong comparable period as they benefited from increased demand as a result of the pandemic last year. The desired outcome for this strategic initiative will be sales in the 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 homecare and cleaning products brands will likely decline in sales, but they will continue to contribute to healthy returns. Supporting our strategic initiatives are our Must-Win Battles. These are focused action plans that support our strategic initiatives.

I will now pass the call on to our soon to be CEO Steve Brass, who will share an overview of our sales results and an update on our Must-Win Battles.

Steven A. Brass

President & Chief Operating Officer, WD-40 Co.

Thanks, Garry, and good afternoon. To begin, I just want to share with you all that I'm humbled and excited to have been asked to serve as the next CEO of this amazing tribe, and to be able to serve all our stakeholders. I also want to take this opportunity to thank Garry for his mentorship over the last three decades and in planning for this transition. He has set me up for success by ensuring I inherit a solid strategy for the company and an excellent team of senior leaders, many of whom I have worked with for many years.

Now, let's take a closer look at what's happening in our trade blocks, starting with the Americas. Sales in the Americas, which include the United States, Latin America and Canada, were up 18% in the second quarter to $54.5 million compared to last year. Sales of maintenance products increased 22% in the Americas, due to increased sales in the United States and Latin America, which increased 26% and 18%, respectively. In the United States, we experienced strong sales of both WD-40 Multi-Use Product and WD-40 Specialist, which increased 19% and 125%, respectively. We have continued to experience a high demand for our maintenance products in the US since the onset of the COVID-19 pandemic.

In the comparable period of last year, we began experiencing significant supply chain disruptions and constraints in our US supply chain. I'm happy to share with you today that we have made adjustments to our supply chain to increase the production capacity of our highest volume products, and these changes have resulted in our ability to deliver a higher volume of products to our customers in the second quarter.

Higher sales were also attributed to the price increases that went into effect beginning in the first quarter of this fiscal year. In Latin America, we experienced strong sales of WD-40 Multi-Use Product, which increased 22%. Our Latin America distributor markets saw strong sales growth due to successful promotional programs and increased product availability. The increase in sales is also attributable to the favorable impact of price increases and the timing of customer orders. We also continued to see positive momentum in Mexico from the shift we made in fiscal year 2020 from a distributor model to a direct market. In Canada, sales and maintenance products remained constant period-over-period.

As a reminder, our maintenance products exclude our homecare and cleaning brands. Sales of our homecare and cleaning products in the Americas decreased 16% compared to last year, largely due to lower sales of 2000 Flushes, Spot Shot, and Lava. Challenges in our Americas supply chain, primarily in the United States, resulted in decreased products availability and lower sales for most homecare and cleaning brands. Though we have seen improvements to our supply chain recently, we had made strategic decisions to prioritize increased production capacity of our maintenance products. In total, our Americas segment made up 42% of our global business in the second quarter. Over the long term, we anticipate sales within this segment will grow between 5% to 8% annually.

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Now, on to EMEA. Sales in EMEA, which includes Europe, the Middle East, Africa and India, were up 9% in the second quarter to $54.1 million compared to last year. Sales of maintenance products increased by 9% in EMEA due to increased sales in both our EMEA direct and our EMEA distributor markets, which increased 6% and 13%, respectively.

In our EMEA direct markets, we experienced a 7% increase in sales of WD-40 Multi-Use Product, and a 9% increase in sales of WD-40 Specialist. The increase in sales is partially attributable to the favorable impact of price increases and the timing of customer orders. In the second quarter, sales in our EMEA direct markets accounted for 65% of the region's sales.

In our EMEA distributor markets, we experienced a 13% increase in sales of maintenance products, primarily due to increased sales in Eastern and Southern Europe. The increase in sales is partially attributable to the favorable impact of price increases and the timing of customer orders. In the second quarter, sales in our EMEA distributor markets accounted for 35% of the region's sales.

In early March, we made the values guided decision to suspend sales of our products to our marketing distributor customers in Russia and Belarus. And this will have an unfavorable impact on our sales in this region in future periods. In addition, we're currently not able to sell our products in Ukraine due to the distribution in the country. Our sales to the regions that are directly impacted were approximately 3% of global sales in fiscal year 2021. We do not have significant operations in these regions other than the distribution and sale of our products through a third-party distributor.

Russia has been a market that we had identified as a significant opportunity for us in the context of our global Must-Win Battles. However, we stand with those being subjected to violence they don't deserve. In total, our EMEA segment made up 42% of our global presence 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. Sales in Asia Pacific, which includes Australia, China and other countries in the Asia region were up 34% in the second quarter to $21.4 million. In our Asia distributor market, sales were $9.8 million in the second quarter, up 64% compared to last year. These sales increases were primarily driven by the timing of customer orders and successful promotional programs. The increase in sales is also attributable to certain customers buying product in advance of future price increases.

In China, sales of $6.7 million in the second quarter, up 42% compared to last year, driven primarily by successful promotional programs, as well as the timing of customer orders related to price increases that went into effect in the second quarter. We remain optimistic about the long-term opportunities in China. We expect volatility along the way due to the economic and health-related impacts of COVID-19, the timing of promotional programs, the building of distribution, shifting economic patterns and varying industrial activities. In Australia, sales of $5 million in the second quarter, down 5% compared to last year, due primarily to decreased sales of homecare and cleaning products, which were down 10% compared to last year.

In total, our Asia Pacific segments made up 16% 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. Many of you may be wondering what the impact of our recent price increases has been on total global revenue for the first half of our fiscal year. Our best estimate is that the sales increase was attributed roughly two-thirds to volume and one-third the price.

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 sales to between $650 million to $700 million

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by the end of fiscal year 2025. These hyper-focused actions support our overall strategy and other key drivers of revenue growth. Our largest growth opportunity and first must-win battle is a geographic expansion of the blue and yellow can with a little red top. We continue to experience impressive growth of our flagship brand with global sales of WD-40 Multi-Use Product up 16% year-to-date. We've recently completed some research to evaluate our largest market opportunities and we estimated the potential global growth opportunity for WD-40 Multi-Use Product continues to be greater than $1 billion. A significant portion of that opportunity is present in just 20 markets.

Year-to-date, we have experienced significant growth opportunity in priority markets like Mexico, India and China, whose sales increased by 31%, 16% and 54%, respectively. We will continue to invest in building our flagship brand with end users in these key markets 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. Year-to-date, sales of WD-40 Smart Straw and EZ-Reach, when combined, represented 45% of global sales of WD-40 Multi-Use Product. I'm also excited to share with you that Smart Straw Next Generation is now appearing on many store shelves across the Americas, and we expect to see it in many more countries around the world in the coming quarters. 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.

Our third must-win battle is to grow WD-40 Specialist. Year-to-date sales of WD-40 Specialist were up 15% compared to last year. We saw solid sales growth of WD-40 Specialists across all three trade blocks here year to date. And I'm very pleased to have turned the corner on the capacity constraints we've been experiencing in our US supply chain. We expect strong growth in WD-40 Specialist as we optimize our supply chain and reap the benefits of our new packaging and brand architecture.

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, to learn about and purchase our brands. In the first half of fiscal year 2022, global e-commerce sales were down 16%, partially due to the continued rebalancing of sales toward brick-and-mortar locations. For the full fiscal year, we expect growth in the e-commerce channel.

We are and always have been trade channel agnostic. Whether end users choose to purchase our brands online or in physical stores, we aim to provide a seamless online and off-line experience. We believe that over the long-term, 70% to 80% of all transactions will involve a digital touch point somewhere along the path to purchase. That is why it's very important that we continue to focus on leveraging digital engagement to educate end users and create better experiences across digital marketing platforms.

That's it for me. I'll now turn the call over to Jay, who'll provide you our financial update on the business.

Jay W. Rembolt

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

Thanks, Steve. This quarter, we delivered solid financial results, despite the fact that the challenging inflationary environment is having a substantial impact on our business. We 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 at or above 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.

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First, the 55 or gross margin. In the second quarter, our gross margin was 50.4% compared to 55.4% in the same period last year. This represents a decline of 500 basis points due primarily to the challenging inflationary environment we were in. Due to continuing challenges in the global supply chain over the last six quarters, we have seen continued declines in our gross margin. Inflationary headwinds have impacted nearly all aspects of our cost of goods sold. Our opportunity this year is to start to reverse this trend and begin to drive gross margin back toward our targeted levels.

In the second quarter, changes in specialty chemicals and aerosol cans were the primary drivers of this decline. When combined, they negatively impacted our gross margin by 410 basis points. Our petroleum based specialty chemical costs negatively impacted gross margin by 370 basis points, and the remaining 40 basis points came from higher costs associated with aerosol cans.

As you know, crude oil is one of the primary feedstocks of our specialty chemicals. We've seen a steady increase in the price of crude oil in the last 12 months, and it accelerated and been particularly volatile in recent weeks. Higher warehousing, distribution and freight costs, primarily due to the challenging environment and supply chain constraints in the Americas and EMEA negatively impacted our gross margin by 110 basis points.

Gross margin was also negatively impacted by 80 basis points from higher filling fees paid to our third-party contract manufacturers, primarily in the Americas and 60 basis points due to foreign currency exchange rates. The impact to gross margin linked to foreign exchange rates is due to fluctuations in exchange rates for the euro and the dollar against the pound sterling in our EMEA segment period to period. This is because in EMEA, the majority of our finished goods are sourced in pound sterling, while approximately 70% of our revenues are generated in currencies other than pound sterling. Gross margin was also negatively impacted by 60 basis points due to higher miscellaneous costs.

These negative factors were partially offset by a benefit of 200 basis points from sales price increases, which have been implemented over the last 12 months. We expect the operating environment to remain challenging and volatile over the near-term. During this period of inflationary headwinds, we'll continue to implement price increases as necessary to offset rising input costs. As much as I don't like seeing oil prices at the levels we are currently experiencing, we have experienced managing our business with crude oil over a wide range of cost levels.

What we really don't like is the commodity volatility we are seeing present. Regardless, we plan to rebuild our gross margin over the near-term with price increases to offset these higher input costs and then use our margin accretive Must-Win Battles to further enhance gross margin over the longer term. We are focused and committed to managing our business, so that we can restore gross margin back to and above the target of 55%.

Now, I'll address the 30 or our cost of doing business. In the second quarter, our cost of doing business was approximately 30% of net sales compared to 36% last year. For the second quarter, approximately 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 4.3%; and then finally, the freight costs to get our products to our customers.

SG&A expense decreased by approximately $700,000 compared to last year, primarily due to lower incentive compensation accruals as our current estimate is projecting that there will be a lower level of achievement when compared to the prior year. These lower employee-related costs were offset by higher freight costs, primarily associated with the current inflationary environment and the limited capacity in the global distribution network.

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This brings us to EBITDA, the last of our 55/30/25 measures. EBITDA was 21% of that sale this quarter, which is slightly up as a percentage of revenue compared to last year. Some of you may be wondering how we were able to maintain EBITDA while gross margin is down 500 basis points. This was a result of a variety of factor, but the primary driver was the decrease in earned incentive accruals. Our employee incentive program is designed to reward our tribe members in good years and protect EBITDA when we encounter headwinds.

Well, that completes the discussion of our business model. Now, let's discuss some of the other items that fall below the EBITDA line. The provision for income taxes was 24.1% this quarter compared to 15% last year. The increase in the effective income tax rate was primarily due to a nonrecurring benefit received in the prior year from the settlement of stock-based equity awards. We expect that our effective tax rate will be approximately 20% to 21% for the full fiscal year 2022. Net income for this quarter was $19.5 million, compared to $17.2 million last year. Diluted earnings per common share for the quarter were $1.41 compared to $1.24 for the same period last year.

Now, a word about our balance sheet and capital allocation strategy. The company's financial condition and liquidity remain strong. Our capital allocation strategy includes a comprehensive approach to balanced investing in long-term growth, while providing strong returns to our shareholders. We continue to return capital to shareholders through regular dividends and share repurchases. On March 15, our Board of Directors approved a quarterly cash dividend of $0.78 per share, payable April 29 to shareholders of record at the close of business on April 15.

And during the second quarter, we repurchased approximately 47,000 shares of our stock at a total cost of approximately $10.8 million. In fiscal year 2022, we expect to invest approximately $15 million in capital projects. The majority of which will be used to complete the procurement of the machinery and equipment we are using to manufacture our next generation Smart Straw delivery system.

One other item I'd like to call to your attention is the recent increases in our inventory levels. As we work to improve the resilience of our US supply chain, we have increased the number of raw materials, components, and finished goods that we have in inventory to improve our ability to beat market demand.

Now, let's turn to fiscal 2022 guidance. While our revenue guidance remains unchanged, we have lowered our gross margin and net income guidance to reflect the impact of the inflationary environment we're currently experiencing. With that, net sales growth is 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 50% and 51%. Advertising and promotion investment is projected to be between 5% and 6% of net sales. And the provision for income taxes is expected to be between 20% and 21%. Net income is projected to be between $70.7 million and $72.5 million. Diluted earnings per share is expected to fall within the range of $5.14 and $5.27 based on an estimated 13.7 million weighted shares outstanding.

We want to remind everyone that there are dynamics outside of our control that may impact our fiscal 2022 results. This guidance does not include any future acquisitions or divestitures or the impact of fluctuating foreign currency exchange rates. It assumes crude oil costs will be between $100 and $120 a barrel. Unanticipated inflationary headwinds and other unforeseen events may further impact the company's financial results.

Now, that completes the financial overview. I'll turn it now back to Garry.

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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 Steve is going to be the next CEO of WD-40 Company effective September 1, 2022. You've heard that we have seen significant improvements in our supply chain, particularly in the United States. You heard that total net sales were up 16% in the second quarter. You heard that sales of WD-40 Multi-Use Product were up 18% in the second quarter. You heard that sales of WD-40 Specialist were up 40% in the second quarter, and that we'll be launching an ecofriendly new Specialist product later this calendar year. Stay tuned.

You heard that we made the values-guided decision to suspend sales of our products to our marketing distributor customers in Russia and Belarus. You heard that although we have been experiencing pressure on gross margin from the challenging inflationary environment, we have a solid restoration plan in place. And you heard that we have adjusted our guidance for fiscal year by approximately 2%, and believe that earnings per share will be between $5.14 and $5.27.

In closing today, I'd like to share with you a quote from my friend, Simon Sinek: We can't choose the game. We can't choose the rules. We can only choose how we play. Thank you for joining us today, and we would be pleased to take your questions.

QUESTION AND ANSWER SECTION

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

Daniel Rizzo
Analyst, Jefferies LLC

Q

Hi, guys. Thank you for taking my questions. So, you had a pretty strong sales quarter and it looks like you're raising prices, but the sales outlook remained unchanged. I was wondering just kind of bridge that, how – like how we should think about it? Was there a timing in the quarter? Or I guess, what's offsetting it? I would have thought you would have raised it a little bit [indiscernible] (35:28). Any color on that?

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

A

Yeah. Thanks, Daniel, this is Garry. What we didn't talk about was the impact of Russia, which if you look at the sales of Russia, which were about 3%, we had to factor those out of our full guidance, but they were offset by further growth in some of the pricing.

Daniel Rizzo
Analyst, Jefferies LLC

Q

Okay. That actually makes sense. Thanks. And then, so you mentioned expanding into different – more different regions of the world, I think, China, India, and Mexico. I was wondering, if when you go into a new region now, do you lead with Smart Straw 2.0? Or is it where you introduce the traditional product and that comes along later? I was just wondering if the dynamics change or how you think about that now given that you have this higher margin, I mean, better product. I don't know, just any color on how the strategy works?

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

A

Thank you, Daniel. This is Steve. Yes. So I mean, it's an interesting question you post. So typically in new emerging markets, we would lead with the plastic can. However, in certain markets, India being a great example more recently, we've been in trials particularly in digital. We're leveraging this new Smart Straw system, the results are very, very positive. So we're kind of learning as we go. Smart Straw became very quickly, one of our top selling SKUs. So I think our opinion is changing of that. Normally, we would lead with plastic cans in these emerging markets. But we are finding increasing evidence of acceptance in emerging markets of the Smart Straw delivery system.

Daniel Rizzo
Analyst, Jefferies LLC

Q

Okay, thanks. And then final question, you mentioned having higher inventory to meet customer needs or customer demand, which makes sense. And I don't know if I asked this on the last call. But I was wondering if you are changing the way you're thinking about holding inventory going forward, just given everything happened worldwide to everybody for the last year, if you will be holding more inventory going forward or if it goes back to more of a just in times thing?

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

A

Hi, Daniel, this is Jay. Certainly for the near-term and probably to the -through the medium-term, we would expect to have higher levels of inventory for some period of time to ensure the robustness of our supply chain and the availability of our products to our customers. So it's really about serving our customers' needs.

Daniel Rizzo
Analyst, Jefferies LLC

Q

All right. Thank you very much.

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

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

Q

Hi, everyone. How are you?

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. Well, congratulations again on the transition, the CEO transition. Steve, you have big shoes to fill, but you've certainly prepared investors and analysts well ahead of time for the transition. So, thank you for that.

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So, I guess – sorry, I got cut off a little bit, I missed what you said the pricing effect on gross margin was. Can you just repeat that?

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

So, the overall global impact on revenues was about one-third pricing and about two-thirds volume of total growth.

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

Right. But you normally give like a pricing effect on gross margin. Did you not give that, or are you able to quantify that?

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

Yes, we did. That was about 200 basis points.

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

Okay. And then I went back and looked at the years that I have in my model. And the year – the last year with the biggest increases in pricing to offset inflationary pressures was FY 2012. And I think about as high as a 220 basis point effect on gross margin positive. So do you think this cycle around that you're going to have – like can you tell us if that's where it's going to pick out or do you think, like it's going to require more to offset the inflation cost pressures?

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

Yeah. It will definitely require more. As we said that we've had a number of price increases already and anticipate more price increases through the – throughout part of the – or throughout the remainder of the year, and we'll see what happens next year.

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

Okay. And then, just on gross margin. Yeah. It was a little bit lower than expected in the quarter and further down sequentially. I mean, are you able to kind of – I guess I could do the math a little bit. But is this the trough in the second quarter or will it still, according to your guidance, kind of go down a little bit more sequentially in the third quarter?

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

We were expecting this to be the trough. I think it's probably pushed out a little bit to the third quarter. We could flatten out in the third quarter, but I – there's a chance it'll continue a little bit more erosion. But what we do see is some – a beginning of the uptick starting in Q4.

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

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Okay. Thank you. That's very helpful. And sorry again, I missed a little bit on what you said on Asia. How is China? Can you just repeat that in the quarter? And did you experience any impacts of lockdown and things like that in China in the quarter?

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

A

So, China is doing extremely well. China for the quarter was very nice growth for the quarter. Growth overall in China was 42% for the quarter in revenues, and then 53% year-to-date, so very strong. And we have major industrial sampling campaigns going on in China and now working absolutely fantastically for us and we're doing really well. The lockdowns have been more about really March going into April. So yes, we are seeing lockdowns impacting availability of factory production, of shipping. So that is going to impact us in the short term over a couple of week period as is expected at the moment.

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

Q

Thank you. And then, of course, with the stock market action and all those analysts that follow Home Depot and Lowe's, they're talking about people being worried about potential impacts like housing type recession on those home center retailers. I mean, obviously, you're not seeing any weakness yet, but can you just kind of remind us why in the last recession, what kind of decline you did see in revenue? I think it was a modest decline, but can you just kind of remind us of what kind of happened back then?

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

A

Yeah. Linda, I was around then, so I'll speak on that and so was Jay. Apart from currency, we actually went sideways or actually in their Multi-Use Product, we grew. So again, one of the things that we've learned over the past years and more so in COVID is that our diversification across geographies and trade channels is really a true moat and strength for our company. We've never said we were recession-proof, but we're somewhat recession-resistant in what we do, whether that's plays out or not, but the past is a reflection of the future. Again, we're probably stronger, we are now stronger than we've ever been as far as the spread of our business across geographies and trade channels, right, Steve?

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

A

Yeah. I think if you look at what's happening already, there's already been a shift of channels from e-commerce. Our industrial sales globally are doing extremely well. We're up over 30% globally in industry, our hardware channels picking up and doing very, very well on 24% year-to-date. So that's the WD-40 distribution system, when one channel down, we make it up in other channels or geographies.

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

Q

Okay. Thank you. And then, one final one just on modeling, I seem to recall here in my model, last year fiscal fourth quarter, kind of had a big profit decline and it was because you really think to invest pretty heavily in advertising and promo in that quarter. It was a really big ratio. I can't quite remember what that was all about. But are you expecting some kind of a similar big investment this year or is that going to represent kind of an easy comparison in the fourth quarter?

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

A

Yeah. Thank you. We don't expect to repeat that level of incremental investment. That was a significant investment we made in our top 20 growth markets, and it was a one-off in nature.

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

A

And quite frankly, a great investment because it's that investment that created the momentum that you're seeing in our top line revenue now. So we're very, very happy that we made that decision. And it's certainly showing us benefit now as we continue through the year.

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

Q

Okay, sounds good. Thank you very much. I appreciate it.

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

A

Okay. Thanks, Linda.

Operator: 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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