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WD-40 Co. (WDFC)

Q3 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 Third 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. Joining us 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. Also joining us for today's call is our Vice President, Global Finance Strategy and incoming Chief Financial Officer, Sara Hyzer.

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 May 31, 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.

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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. 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, July 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. Before we begin, I'd like to take a moment to welcome Sara Hyzer to our call today. We shared with investors yesterday that Sara will become Vice President, Finance, Treasurer and Chief Financial Officer effective November 1, 2022, once we have completed the filing of our fiscal year 2022 10-K. Sara joined our tribe in 2021 and has worked closely with global finance and accounting teams as a financial strategist for this last year.

We are thrilled that she has accepted this opportunity within our tribe. Sara will be available during the question-and-answer portion of today's call to answer any questions you have for her. As you may know, Jay announced his planned retirement late in 2020. Jay has been our Chief Financial Officer since 2008, and his impact on our company has been immeasurable. Jay will be with us on the next quarter call to report our full fiscal year results and then he will sail off into the sunset and enjoy his well-deserved retirement.

Now let's turn to our results. Today, we reported net sales of $123.7 million for the third quarter of fiscal 2022, which was a decrease of 9% compared to the same quarter last year. As a reminder, in the third quarter of last year, we reported record sales driven by robust demand for our maintenance products, coupled with strong operating performance. Against such a comparable, the bar was high. In addition, you've heard me say for 25 years not to follow us quarter to quarter. If you follow our business closely, you'll notice fluctuations in performance quarter to quarter are not unusual. This has been especially true since the COVID-19 pandemic began. Although the sales results we are reporting today are down, we believe we are positioned to achieve sales growth for the full fiscal year, which will result in record sales results for our tribe. Steve will talk in greater detail in a few moments about the sales results in our trade blocs and what our expectations for the remainder of the year are. Unfortunately, we continue to face a challenging inflationary environment and our third quarter gross margin came in at 48%, reflecting significant increases to our cost of products sold.

Inflationary cost pressures are broad based and continue to increase with little sign of near-term relief. These operational challenges are not unique to WD-40 company. However, we think that the strategies we've chosen will position us to manage through these challenges over time. Jay will talk in greater detail in a few moments about what the impact has been on our margin and what we are doing to restore it. We continue to be a business with a strong moat, diversified across many trade channels in countries around the world. We have a strong balance sheet, generate steady cash flows and continue to return capital to our investors with regular dividends.

In addition, the WD-40 brand is strong and robust brands like ours are great assets in turbulent times. Most critical of all, we have a tribe of passionate and committed employees who are dedicated to our company's purpose. Let's talk for a minute about our strategic initiatives. Our strategic initiatives are the continuing plan we have in place to achieve the company's long-term aspirations. Our strategic initiatives support our long-term revenue

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growth target, which is to drive net sales to between $650 million and $700 million by the end of fiscal 2025. We strive to do so while following our 55/30/25 business model.

Steve and the tribe remain committed to the company's long-term aspirations and strategies we have in place to get there. 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 are making great progress in setting our ESG priorities, and we expect to file our next ESG report early in fiscal 2023. In that report, we will be articulating our position and our progress on key ESG matters. We're in the early stages of determining what we need to do to reduce our greenhouse gas emissions to be in line with the Paris Agreement. We will also provide stakeholders with an update on progress we have made on our diversity, equity, inclusion and belonging efforts. One of the biggest desires we have as human beings is to belong. That's why we've added and created our own acronym for this critical area,

D, E, I and B.

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 they excel as individuals. Recently we've shared that we've added some new tribe members at the board level. Last month, Edward Magee was appointed to our board and will serve as a member of our Audit and Finance Committee. Ed currently serves as Executive Vice President, Operations at Fender Musical Instruments. He has significant senior leadership experience in manufacturing, sustainability, supply chain and logistics.

Additionally, we shared that Cynthia Burks has been nominated to stand for election at our next annual meeting. Cynthia most recently served as Senior Vice President and Chief People and Cultural Officer at Genentech. Cynthia has extensive knowledge of human capital strategy and a fundamental understanding that culture is a competitive advantage, which makes her a perfect fit for the WD-40 company, where it really is all about the people.

Strategic initiative number three, 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. Our commitment to operational excellence continues to be an enormous asset for us as we navigate the global economic challenges likely in front of us. Using our 55/30/25 business model as a framework, we measure ourselves against this operational excellence initiative.

Strategic initiative number four, 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 will find more uses more often. We will grow 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. Although WD-40 Multi-Use Product sales were down by 11% to $92.3 million this quarter, we've seen strong growth in recent years as we inch closer towards our 2025 aspiration. 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 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 positioning and create growth through continued geographic and digital expansion. In the third quarter, sales of

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WD-40 Specialist increased 12% globally to $16.7 million. 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, 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 and GT85, as well as our homecare and cleaning brands. In the third quarter, sales included under this initiative decreased 16% globally to $14.7 million. 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 homecare and cleaning product brands will most likely decline in sales over time, but they will continue to contribute healthy returns.

Supporting our strategic initiatives are our must-win battles. These are focused action plans that support revenue growth.

I will now pass the call 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 & Director, WD-40 Co.

Thanks, Garry, and good afternoon. As Garry mentioned earlier, net sales were $123.7 million in the third quarter, down 9%, or $12.7 million, compared to the prior year. There were a couple of significant events that led to these declines, including severe lockdown measures instituted in Shanghai and the military action taken by Russia. In addition, we experienced decreased demand for our products in certain regions of EMEA, compared to the record sales we reported in the third quarter of last year. Currency also negatively impacted us in the third quarter, particularly in EMEA.

On a constant currency basis, net sales would have been $127.9 million in the third quarter, a 6% decline from the prior year. However, year-to-date net sales were up 4% compared to last year. And we experienced strong sales in the month of June, which we believe will position us to achieve sales growth for the full fiscal year of between 6% and 9%.

Let's take a closer look at what's happening in our trade blocs, so that we can get a better understanding of these impacts. We will start with the Americas. Sales in the Americas, which includes the United States, Latin America, and Canada, were up 2% in the third quarter to $61.5 million compared to last year. Sales of maintenance products increased 3% in the Americas, due to the increased sales in Canada and Latin America, which were up 23% and 10%, respectively.

In Canada, we experienced strong sales of WD-40 Multi-Use Product, which increased 30%, primarily due to increased promotional activities and a higher level of demand for our products in the industrial channel. In Latin America, we also experienced strong sales of WD-40 Multi-Use Product, which increased 16% primarily due to the positive momentum in Mexico from the shift we made in 2020, from a distributor model to a direct market, as well as the price increases that went into effect earlier this fiscal year.

In the United States, sales of maintenance products remain constant, primarily due to increased sales of WD-40 Specialist, which were completely offset by lower sales of WD-40 Multi-Use Product. WD-40 Specialist sales were up 78% in the quarter because of increased production capacity and improved availability as our supply chain continues to strengthen. These sales increases were offset by lower sales of WD-40 Multi-Use Product in the quarter due to the timing of customer orders and shifting promotional programs.

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In total, our Americas segment made up 50% of our global business in the third quarter. Over the long-term, we anticipate sales in this segment will grow between 5 to 8% annually. Now, on to EMEA, sales in EMEA, which includes Europe, the Middle East, Africa and India, were down 16% in the third quarter to $49.5 million compared to last year. Sales of maintenance products also decreased by 16% in EMEA, due to decreased sales in both our EMEA direct and our EMEA distributor markets, which decreased 13% and 21%, respectively. In our EMEA direct markets, we experienced a 13% decrease in sales in the third quarter. However, if we take currency into consideration, sales in our direct markets only declined 5%. This decrease in sales is primarily attributable to reduced demand for our maintenance products compared to the prior period.

In the third quarter of 2021, we experienced record sales linked to renovation and maintenance trends associated with the pandemic. These trends were particularly strong in certain regions of EMEA in the third quarter of last year. This quarter, sales in our EMEA direct markets accounted for 71% of the region's sales.

In our EMEA distributor markets, we experienced a 21% decrease in sales of maintenance products, primarily due to our suspension of sales in Russia, which resulted in decreased sales of $3.6 million compared to last year. 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 had an unfavorable impact on our sales in this region this quarter. In the third quarter, sales in our EMEA distributor markets accounted for 29% of the region's sales.

In total, our EMEA segment made up 40% of our global business in the third quarter. Over the long term, we anticipate sales in this segment will grow between 8% to 11% annually.

Now onto Asia Pacific. Sales in Asia-Pacific, which includes Australia, China and other countries in the Asia region, were down 28% in the third quarter to $12.8 million. In our Asia-Pacific distributor market, sales were $3.2 million in the third quarter, down 56% compared to last year. These sales declines were due to disruptions caused by the pandemic. The product we sell in our Asia-Pacific distributor markets is sourced from a third party manufacturer in Shanghai. Sell-through to our end user customers in the Asia-Pacific distributor markets remained strong throughout the third quarter. However, we were unable to replenish inventories due to the severe lockdown measures instituted in Shanghai, which significantly impacted our ability to ship product to our marketing distributors. The severe lockdown measures also impacted China, where sales were $3.3 million in the third quarter, down 25% compared to last year.

Lockdown measures in Shanghai were lifted on June 1. Subsequent to that date, we resumed shipping product to our customers in Asia and in China. Barring any further supply chain disruptions, we expect to ship most of what we were unable to ship in the third quarter in the fourth quarter.

In Australia, sales were $6.2 million in the third quarter, up 4% compared to last year, due primarily to the increased ongoing growth of our base business, increased promotional activities and price increases that went into effect in February.

We continue to see strong sales of WD-40 Specialist in Australia. In the third quarter, sales of WD-40 Specialist increased by 39%. In total, our Asia-Pacific segment made up 10% of our global business in the third quarter. Over the long term, we anticipate sales within this segment will grow between 10% to 13% annually.

Now a brief update on our must-win battles. Our must-win battles are the primary areas of action that would enable us to deliver against our revenue growth aspirations to drive sales to between $650 million and $700 million by the end of fiscal year 2025. These hyper-focused actions are the key drivers of revenue growth.

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Our largest growth opportunity and first must-win battle is the geographic expansion of the blue and yellow can with the little red top. We continue to experience growth of our flagship brand with global sales of WD-40 Multi-Use Product up 6% year-to-date. We estimate the global market growth opportunity for the WD-40 Multi-Use Product to be approximately $1 billion. We've identified a list of priority markets which show the highest potential for growth, and we're focusing our time, talent and treasure on these high potential geographies.

Even in the volatile environment we are operating in, we've experienced year-to-date growth in priority markets like China, Mexico and India, where sales increased by 26%, 29% and 16%, respectively. We will continue to invest in building our flagship brand with end users in these and other key markets around the world.

Our second must-win battle is the premiumization of WD-40 Multi-Use Product. Year-to-date, sales of WD-40 Smart Straw and EZ-REACH, when combined, represented 47% of global sales of WD-40 Multi-Use Product. Our objective for this must-win battle is to grow sales of premiumized products to greater than 60% by 2025.

For a long time, we have assumed that due to price point concerns, emerging markets couldn't be easily premiumized. We recently conducted some extensive market research with fantastic results and learned that we have huge opportunities in emerging markets around premiumization. We believe that there is a significant opportunity to drive sales of premiumized products in both developed and emerging markets.

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 Specialist across all of our segments, particularly in the Americas, where we have turned the corner on the capacity constraints we have been experiencing in our US supply chain. In addition, we've recently conducted research and now have evidence to support what we already knew. The new packaging and brand architecture improved the sell-through of our WD-40 Specialist brand products.

Our final must-win battle is digital commerce. Our vision for digital commerce is to engage with end users at scale, making it easier to access, learn about and purchase our brands. In the first nine months of fiscal year 2022, global e-commerce sales were down 13%. For us, digital isn't just about how many units we sell in pure play digital channels. It's about embracing digital transformation at the organizational level. There is a significant opportunity ahead of us in the digital space. That means competitive market share that is there for the taking. For the full year, we expect sales in the e-commerce channel will remain relatively constant compared to the prior fiscal year. More importantly, we will continue to leverage this critical channel as an integral part of our growth story going forward.

In closing, I want to share a few thoughts with you about the remainder of the fiscal year. In the third quarter, we were up against very strong sales comparisons and we are managing through several global disruptions that have negatively impacted our top line results. Despite these disruptions, market conditions suggest that for the full fiscal year, net sales are likely to be in a range between $519 million to $532 million, which reflects year-over-year growth of between 6% and 9%.

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

Jay W. Rembolt

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

Thank you, Steve. To begin with, I would also like to welcome Sara to the call. As many of you may recall that in late 2020, I announced my intention to retire. Since that time, we interviewed dozens of internal and external

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candidates to find the right person for the job. It gives me great pleasure to let you know that Sara is that right person. I've known Sara for six years and I am thrilled to be handing the reins to such a capable leader. I believe you will enjoy and appreciate working with Sara as much as I now.

Well, now onto the results. In the third quarter, the challenging inflationary environment and geopolitical uncertainty continued to impact our reported results. Unfortunately, we don't see any near-term relief in sight and expect the operating environment to continue to remain challenging.

However, we remain committed to our 55/30/25 business model and are focused on managing our business so that we can restore gross margin to our target of 55%. With that said, we're not sticking our head in the sand and ignoring the macroeconomic geopolitical supply chain and inflation concerns that exist in the market today. We continue to actively manage our supply chain as we implement various initiatives to increase the capacity and flexibility of our supply chain for the long-term. In tandem with these efforts, we have been implementing strategic price increases across all segments in response to the increased costs we continue to experience.

In times like these, I'm glad that our stakeholders can see the forest through the trees. What I mean by that is even though we're underwhelmed by our third quarter results, I am as confident as I've ever been about the long-term opportunities for our company. As Garry mentioned earlier, we continue to be a business with very strong moat diversified across 62 trade channels and 176 countries around the world. We have a strong balance sheet and generate steady cash flows and continue to return capital to our investors. We have a long track record of both top line and bottom line growth and a high degree of confidence in the future growth as evidenced by our 2025 revenue target. Most importantly, our business and brand have very strong end user affinity, which will enable us to continue taking pricing actions as needed to offset inflation.

Now let's discuss the third quarter results relating to 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 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 EBIDTA.

Let's start with the 55 for gross margin. In the third quarter, our gross margin was 47.7% compared to 53.1% in the same period last year. This represents a decline of 540 basis points due primarily to the challenging inflationary environment we are experiencing. Increased global supply chain challenges, increased cost of raw materials, and continued constraints related to the pandemic have resulted in increased inflation globally. In the third quarter, changes in specialty chemical costs and aerosol cans were the primary drivers of our margin decline. When combined, they negatively impacted our gross margin by 620 basis points.

Specialty chemical costs negatively impacted our gross margin by 400 basis points, while the remaining 220 basis points came from the higher costs associated with aerosol cans. Higher warehousing, distribution, and freight costs, primarily due to supply chain constraints, negatively impacted our gross margin by 150 basis points. The tight freight market, labor shortages, increased demand for distribution services, particularly in the Americas and EMEA, continued to impact our freight and distribution costs. Gross margin was also negatively impacted by 130 basis points from higher filling fees paid to our third-party contract manufacturers, primarily in the Americas. And finally, gross margin was negatively impacted by 90 basis points due to product mix and other higher miscellaneous costs incurred during the quarter.

On a positive note, our gross margin restoration plan is beginning to help. These negative factors were partially offset by a benefit of 490 basis points from sales price increases, which have been implemented this year. To

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offset impacts of inflation, we have been implementing sales price increases on nearly all of our products worldwide this year. However, keep in mind that we have yet to see the financial impact of the price increases that we've implemented in some of our largest markets.

For example, in late Q3 of this year, we implemented a 25% price increase in the United States, but the impact of that price increase will not flow into our financials until the fourth quarter. We are also implementing significant price increases in Europe this summer. As a result, we will continue to see the benefits from price increases in future quarters.

Our tribe members are doing a great job executing pricing actions that continue to offset inflationary impacts. However, we expect the business landscape to remain challenging and volatile over the near term. Make no mistake, we will continue to take measures and implement price increases to offset rising input costs. As I said earlier, we remain focused and committed to managing our business so that we can restore gross margin back to and above our target of 55%.

Now, I'll address the 30, our cost of doing business. In the third quarter, our cost of doing business was approximately 31% of net sales, compared to 32% last year. For the third quarter, approximately 71% 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 percent of net sales, our A&P investment was 4.9%; and finally, the freight costs to get our products to our customers.

SG&A expense decreased by approximately $4.5 million compared to last year, primarily due to lower incentive compensation accruals, as a result of our current estimate, which is projecting that we will – there will be lower level of achievement when compared to the prior year. These lower employee-related costs were partially offset by increases in travel and meeting expense due to the resumption of travel as the pandemic restrictions have been lifted.

Now this brings us to EBITDA, the last of our 55/30/25 measures. EBITDA was 17% of net sales this quarter, which was down from 21% compared to last year. Our cost of business was down. The pressure we are experiencing on gross margin, together with the reported sales decline, put pressure on EBITDA this quarter.

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 of income taxes was 20.9% this quarter compared to 21.9% last year. And 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 $14.5 million compared to $21 million last year. Diluted earnings per common share for the quarter were $1.07 compared to $1.52 in 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 balance investing in long term growth while providing strong returns to our shareholders. We continue to return capital to our shareholders through regular dividends and share repurchases.

On June 21, our board of directors approved the quarterly cash dividend payment of $0.78 per share payable on July 29 to shareholders of record at the close of business on July 15. During the third quarter, we repurchased approximately 23,000 shares of our stock at a total cost of approximately $4.2 million.

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In fiscal 2022, we continue to expect we'll invest approximately $15 million in capital projects, the majority of which will be for the machinery and equipment we are using to manufacture our next generation Smart Straw delivery systems.

One other item of note that I would like to bring to your attention is the recent increases in our inventory levels. As we continue to work to improve the resilience of our supply chain, we have increased the raw materials, components and finished goods that we have in inventory to ensure supply and improve our ability to meet market demand.

Now, let's turn to fiscal 2022 guidance. We've adjusted our guidance slightly to reflect our current view of the business. As Steve mentioned earlier, we expect net sales growth to be between 6% and 9% with net sales between $519 million and $532 million. Gross margin for the full year is expected to be around 50%.

Advertising and promotion investment is projected to be between 5% and 5.5% of net sales. The provision for income tax is expected to be between 20% and 21%, and net income is projected to be between $69 million and $70.1 million.

And diluted earnings per common share is expected to be between $5.02 and $5.10, based on an estimated 13.7 million weighted average shares outstanding. Guidance is based on management's current view of anticipated results and does not include any future acquisitions or divestitures or the impact of fluctuating foreign currency exchange rates. Additional COVID-19 related lockdowns in China and other unforeseen events may further impact the company's financial results. That completes the financial overview.

Now 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 Steve is going to be joined by Sara Hyzer, who will be the next CFO of WD-40 company effective November 1, 2022.

You heard that despite the fact that the third quarter sales results were down, we continue to believe we are positioned to achieve sales growth for the full fiscal year, which will represent a record sales result for our company. You heard that we continue to be a business with a very strong moat, diversified across many trade channels and countries around the world. We have a strong balance sheet, generate steady cash flow and continue to return capital to our investors through regular dividends.

You heard that sales of WD-40 Specialist were up 12% in the third quarter and we continue to experience strong momentum due to the increased production capacity and improved product availability. You heard that although we have been experiencing pressure on gross margin from the challenging inflationary environment, we have a solid gross margin restoration plan in place.

You heard that some of the significant price increases we implemented in the third quarter, particularly in our Americas trading bloc, were implemented at the end of the quarter and the positive impact has yet to flow through our gross margin. You heard that we've adjusted our guidance for fiscal year 2022 and believe that earnings per share will be between $5.02 and $5.07.

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In closing today, I'd like to share with you a quote from Vivian Green. Life isn't about waiting for the storm to pass. It's about learning to dance in the rain. Thank you for joining us today. We would be pleased now to take your question.

QUESTION AND ANSWER SECTION

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

Daniel Rizzo
Analyst, Jefferies LLC

Q

Hello, everyone. Thank you. Thank you for taking my question. You mentioned, I think, a $1 billion market, I think you highlighted for the Multi-Use Product. I was wondering if that that market worldwide includes premiumization or is premiumization is something that you're holding separate which is a separate market that could add to that?

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 & Director, WD-40 Co.

A

Sure. Thanks, Garry. Hey, Daniel. Yeah, the $1 billion would include premiumization in total and that's a $1 billion worth of growth. It's not $1 billion total opportunity, it's $1 billion-plus actually based – that $1.2 billion based upon the top geographies around the world and our benchmark. So, yeah, it would include premiumization, but it's actually about $1.2 billion in total in growth opportunity.

Daniel Rizzo
Analyst, Jefferies LLC

Q

And could you just provide more color on the digital platform? I think you said it was flat year-to-date. I was wondering – it's just, I guess, a little surprising given it's still a somewhat new platform. And I thought it was growing better than that. I'm just – I don't know, maybe I missed something.

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

A

Thank you, Daniel.

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

A

So, I can take that one as well, Garry. Yeah. In terms of, so digital commerce, we have been, we have been catching up. And so, a lot of it has been related to our Americas region and out of stocks, and it's absolutely rolling back in the last few months. So, overall, I believe that digital commerce for the year, so year-to-date, we were down 13%, but that is improving with every month now that goes by. And so, quarter three, for example, the Americas is actually up 42% over prior year. So, we are beginning to catch up and a lot of that was linked to pricing – sorry – to out of stocks on WD-40 Specialist.

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Daniel Rizzo
Analyst, Jefferies LLC

Q

Okay. Thank you. And then finally, obviously, I mean, costs are an issue, but I mean, it just seems – are they plateauing or is it just an unending rise, because obviously, you still have to do a lot of catching up? But I was wondering if there's any signs of light at the end of the tunnel.

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

A

Yeah, Daniel. Thank you. I'll take that. The margin issue is absolutely a timing issue. If you look at this year in total, in Q1, pricing added 120 basis points. In Q2, pricing added 200 basis points. In Q3, pricing added 490 basis points, which was offsetting the increases that were coming through primarily not from necessarily oil, because oil is fluctuating in that range, but from aerosol cans and other components of our cost of goods.

So, what I think the light at the end of the tunnel is each quarter, the pricing action we're taking is starting to offset the embedded costs of our raw materials. As we mentioned in this call, the price increase that we've just taken in the Americas or in the US, in fact, of about 25% will not show up until Q4. So, yes, this is totally a timing issue. We are all convinced that we will get back to 55% or greater over time. It just – it can't happen all at once.

Daniel Rizzo
Analyst, Jefferies LLC

Q

Great. Thank you very much.

Operator: Your 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

Yes, hi. How are you?

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

A

Hi, Linda. I'm great.

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

Q

Good. So, can I just ask you, like maybe I'm sort of losing track of things here, but I thought that when you last reported in early April, that we kind of knew about the China lockdowns at that point. And maybe I'm mistaken, but I thought we kind of knew the situation, and in fact, the analysts and investors were more like looking – like talking to when they might be lifted. So, I guess, I mean, what sort of changed with regard to the situation that you weren't foreseeing kind of back in April, I guess, if you could just explain more about that.

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

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Sure, Linda. The lockdown that we're talking about, which started in May, in fact, and it was a complete lockdown of Shanghai. And Shanghai was locked down for, I think, nearly six weeks. And at that time, all of the shipments

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out of Shanghai were suspended. People couldn't go to work. And you probably observe that in the media or whatever.

I don't know that we understood how long it was going to go on for or the severity of it. But it certainly shut – it did shut down the operation. We shipped all of our Asia distributors and all of our China local business out of our packages in Shanghai. And we could not ship a case of product during that time. Those have subsequently been lifted, as Steve said, in early June, and we've started to ship again. So, it was absolutely a surprise and something that we couldn't have anticipated.

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

Okay. So then, the trend of business sort of in the May quarter would have been much better in March and April and then really got bad in May. Is that kind of how it trended through the quarter?

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

Steve? I don't have that in front of me, but do you have...

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

I think the key point is that the – certainly for the Asia distributor market, it was just a question of not being able to ship, right? So, in market, we had – so our marketing distributors across the Asia region had stock in local markets and were able to service their markets. All that happened was inventories got a little lower. We weren't really out of stock in those markets.

So, we fully believe that the shipments that didn't ship in April and May will fully ship in the fourth quarter. So, we won't have lost any revenues in those markets or very little. It will just move from Q3 sales into Q4 sales. And you heard us talk about a very strong June, and that was partially reflected by as significantly increased shipments to our Asian distributor markets. Now some of the lockdown in China that will have deferred business, so there would have been – because of the lack of economic activity, factory closures, complete lockdowns in some cities, there will be some loss of Chinese business from that period.

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

Yeah, and another, just to add to that, Linda, the – half the city of Shanghai closed down kind of late March. The government at that time said they thought it would last a week. On around about the 15th – or no, about the 8th or 9th of April, the full lockdown happened in Shanghai, and that continued until the 16th of May, when return to normal was announced by the officials.

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

Okay. All right. Thanks. And then just on the commodity side or specialty chemical side of things, I thought that you had said that your guidance for the fiscal year included a planning assumption of oil around $100 to $120 per barrel. And since you last reported, I mean, oil is down. I mean, it hit a high of $120 around there, but now it's more close to $100. So, it just seems to me that the situation maybe has not gotten significantly worse. And we've seen the tin and plastic resin – tinplate and plastic resin have actually come down into spot prices in the market.

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So, I guess I'm just wondering, like it just seems like surprising that the gross margin guidance would be lowered, even though the commodities are within the range maybe of what you were planning.

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

A

So, number one, we have seen no decrease in the price of our aerosol cans. We had a 60% increase which we shared in aerosol cans, that's been embedded and flowing through our costs at different times. So even though spot rates are moving, it has no impact whatsoever on the price of aerosol cans.

And the real issue here is, as we've shared, is the timing of the flow-through of the cost of goods and the offset of price increases. Yes, oil has been fluctuating between $100 and $120, but, Linda, as you know well, it takes a lot, 90 to 120 days, for any impact of oil to flow into our system. So just because it's moved in the last couple of weeks, it has no impact. And in fact, yes, it went to $95 last week and it's back over $105 today.

So, in this scenario, oil is not the thing that's had the biggest impact in the short term over the last few months. It's the impact of the cost of aerosol cans, the cost of plastics, the cost of filling fees, all of which have been flowing into our supply chain at varying times, in varying places, from varying packages all around the world. This is purely a timing issue.

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

Q

Okay. Thanks for that. And then, I mean, I haven't really run my number to the model yet, but I think your gross margin guidance for the year implies that gross margin would be up sequentially in the fiscal fourth quarter, am thinking of that kind of correctly?

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

A

It has to.

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

Q

Yeah. Okay. Okay. Just wanted to make sure about that.

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

A

Yeah. Yeah.

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

Q

Okay. And then I guess, you had mentioned on the call last time that there was a new product that you were planning on launching. It sounded kind of interesting. Maybe it was some kind of clean or green product. I can't quite remember. Is that something that is still on track and is that something that could be something that's important?

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

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Yes, it is. That product is in final stages of stability and quality testing and once it's through that, we would be expecting to announce full details of it in the upcoming quarters. But it's still on track and we're excited about it. It is a product that will be very – I think, seen as being a product that's ESG friendly and yeah, it's on track and it'll be coming.

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

Q

Okay. And then finally you know, we've heard from various retailers about running to work down inventory and you supply a bunch of different channels. But even among like, say, industrial distributors and things like that, are you seeing any kind of work-down in inventory that they're trying to do because of any kind of slowdown in demand?

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

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Steve, do you want to cover up on that?

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

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Yeah. No, no, we're not basically. I mean, that might be ahead of us. Who knows where things are headed. But we haven't seen that yet. I mean, we've got – trade channels continue to grow strongly. So our industrial sales we reported last quarter were globally very strong. We're still up 25% in the industrial market globally. We've talked about our e-commerce, which is kind of going to be flat this year and we're still getting – the pandemic kind of boosts we got from e-commerce and DIY, it's where it's kind of flattened for us and that's just reflecting those channel sales, I think, and the retail sales in those channels. And we're continuing to grow very nicely around the world in automotive, hardware and industries. So, no, we haven't seen those inventory kind of control measures coming in yet.

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

Q

Okay. I'll leave it there then. Thank you very much.

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

A

Thank you, 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 lines.

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