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Valvoline Inc. (VVV) Q4 2024 Earnings Call Transcript

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Play Call



Press Release



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EPS of \$0.46 **beats by \$0.04** | Revenue of \$435.50M (11.67% Y/Y) **beats by \$3.03M**Valvoline Inc. (NYSE:[VVV](#)) Q4 2024 Earnings Conference Call November 19, 2024 9:00 AM ET

Company Participants

Elizabeth Clevinger - IR

Lori Flees - President and CEO

Mary Meixelsperger - CFO

Conference Call Participants

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David Bellinger - Mizuho
Steven Vangeli - Citi
Lauren Ng - Morgan Stanley
Justin Kleber - Baird
Mike Harrison - Seaport Global Securities
Thomas Wendler - Stephens
Peter Keith - Piper Sandler
Bret Jordan - Jefferies
David Lantz - Wells Fargo
Steve Shemesh - RBC Capital Markets

Operator

Hello everyone and welcome to Valvoline's Fourth Quarter Fiscal 2024 Conference Call and Webcast. My name is Lydia, and I'll be your operator today. [Operator Instructions]

I'll now hand you over to Elizabeth Clevinger with Investor Relations to begin. Please go ahead.

Elizabeth Clevinger

Thank you. Good morning, and welcome to Valvoline's fourth quarter fiscal 2024 conference call and webcast.

This morning, Valvoline released results for the fourth quarter and fiscal year ended September 30, 2024. This presentation should be viewed in conjunction with that earnings release, a copy of which is available on our Investor Relations website at investors.valvoline.com. Please note that these results are preliminary until we filed our Form 10-K with the Securities and Exchange Commission. On this morning's call is Lori Flees, our President and CEO; and Mary Meixelsperger, our CFO.

As shown on Slide 2, any of our remarks today that are not statements of historical fact are forward-looking statements. These forward-looking statements are based on current assumptions as of the date of this presentation and are subject to certain risks and uncertainties that may cause actual results to differ materially from such statements. Valvoline assumes no obligation to update any forward-looking statements unless required by law.

In this presentation and in our remarks, we will be discussing our results on an adjusted non-GAAP basis unless otherwise noted. Non-GAAP results are adjusted for key items, which are unusual, non-operational or restructuring in nature. We believe this approach enhances the understanding of our ongoing business. A reconciliation of our GAAP to adjusted non-GAAP results and a discussion of management's use of non-GAAP and key business measures is included in the presentation appendix. The information provided is used by our management and may not be comparable to similar measures used by other companies. As a reminder, the retail services business represents the company's continuing operations and the former Global Products segment is classified as discontinued operations for the purposes of GAAP reporting.

With that, I will turn it over to Lori.

Lori Flees

Thanks, Elizabeth, and good morning, everyone. Thank you for joining us.

On today's call, we'll cover our financial results for the quarter and fiscal year, provide a progress update on our strategic priorities and give guidance for fiscal year 2025. Let me start with a few key messages. First, we delivered compelling growth and results in fiscal 2024 that were largely in line with our expectations. Our performance is driven by a market-leading position and important competitive advantages, including a quality and well recognized brand, well capitalized franchisee partners, operational excellence, proprietary technology and marketing expertise.

Our robust and differentiated business model positions us to deliver strong and durable profit growth fueled by a compounding of same-store sales growth and new-store additions. Our value creation is supported by strong capital discipline focused on growth investments that generate high returns, a commitment to a healthy balance sheet and consistent share repurchases to return excess cash to our shareholders.

Let's look at some key highlights for fiscal year 2024 on Slide 4. System wide store-sales were \$3.1 billion, a 12% increase over the prior year. We also delivered our 18th consecutive year of system-wide same-store sales growth with 6.7% growth for the year. The network continued to grow at a strong pace and we ended the year with 2010 stores.

From a profit perspective, adjusted EBITDA was up 17% to \$443 million and adjusted EBITDA margin improved 100 basis points to 27.3%. This year, we completed over 28 million customer transactions across the network.

In October, we were pleased to be ranked number 18th overall in Best Customer Service by Forbes as we continue to focus on delivering a quick, easy, trusted experience to our guests. I'd like to thank our team of over 11,000 and our strong franchise partners for all the work that went into driving these results.

Slide 5 shows our performance over time on key metrics. Since our IPO in 2016, we have seen strong and stable growth in new stores, system-wide same-store sales and profit. Our growth and financial performance as a pure play retail service provider sets us apart within our category and within retail services overall.

Turning to Slide 6. We'll take a look at our FY '24 results compared to our FY '24 guidance. Net revenues and same-store sales came in just below the midpoint of the guidance range. Adjusted EBITDA, adjusted EPS and store additions all came in at or just above the midpoint of the range. Our capital expenditures were modestly above the range driven by the timing of certain payments related to CapEx versus what we had planned. Overall, we're pleased with our fiscal 2024 results and the continued growth of our business.

Now I'd like to provide an update on the progress we've made on our strategy. We remain committed to our three strategic priorities of driving full potential in the existing business, accelerating network growth and targeting customer and service expansion. Actions across these three areas will enable us to deliver financial growth both in the near and longer-term.

On Slide 9, we'll start with a look at the progress we've made in driving the full potential in our core business. About 20% of the customers we serve are new and the majority come from outside the Quick-Lube channel. Convenience and speed are the main differentiators we offer to these new customers.

The remaining 80% of customers we serve are returning. Our brand, which stands for quality and trust combined with our best-in-class customer experience, network scale and the investments we're making in marketing and technology continue to be key differentiators and reasons why we have high customer loyalty.

Our stores typically take about three to five years to ramp to maturity. We continue to increase vehicles served per day each year that a store is open. And our mature stores continue to grow their top line while improving margins with a top line growth and better cost management. With a significant portion of our stores being immature, we expect a meaningful lift to profit as these stores mature.

Taking into account our refranchising efforts, we would expect to add about \$70 million of an additional EBITDA with the maturing of this immature store base. The strength of our brand, increasing scale and operational excellence continue to drive the full potential of the core business. Now I'd like to talk about accelerating network growth. We closed the year with strong delivery of 49 new stores in Q4, bringing our total to 158 new stores for the year. As we close fiscal 2023, we recognize the need to improve the consistency of delivery of the new store additions.

The company and franchise teams continue to work together through our Franchise Development Council to share experiences and best practice, which is driving process improvements for both. We also improved our pipeline visibility as we increase the number of new stores that are ground-up additions. In fiscal year 2024, over 100 of the new store additions were ground ups. This is a testament to our real estate analytics capability and our marketing and operational learnings on how to successfully open new build locations.

Two years ago, we established a target of reaching 250 new stores per year by 2027 and accelerating our franchisee store growth. We've taken significant actions to accelerate our network on the franchise side.

During the fourth quarter, we completed two refranchising transactions, which converted 28 company stores to franchise in the growing markets of Las Vegas and Denver. As we announced this morning, in October, we signed a definitive agreement to refranchise an additional 38 stores in Central and West Texas.

The franchisees for these three markets have committed to significant development, which will drive market share gains more quickly and deliver long-term benefits to shareholders as we accelerate the network growth in a more capital efficient manner. We've welcomed several new franchise partners into our network this year, including Velocity Auto Care, Fluid Automotive and Yellowstone Investment Group.

In addition, Interstate Auto Care recently joined us with the purchase of stores from a retiring franchisee. All of these partners have committed to meaningful growth in their respective markets. We look forward to working with our new franchise partners and continue to have encouraging discussions with additional parties who have expressed interest in joining our network. With the new stores our franchisees have planned or committed to and the ongoing interest, we remain confident in our ability to deliver 250 new stores per year by fiscal year 2027. We are very pleased with our overall store growth.

The momentum building in our franchise network this year, along with the sustained growth of company stores gives us continued confidence in our path to a 3,500 plus store network. Let's turn to the third priority of targeting customer and service expansion.

Our fleet business continues to grow at an attractive pace with transactions growing at over a 14% compounded annual growth rate over the last three years. Our focus on business-to-business sales across both company and franchise markets is delivering strong growth in new accounts as well as improving activation within those accounts.

With a large addressable market and fleet owners looking for a quick, easy, trusted way to keep their vehicles productive, we see a long runway for growth in our fleet business. On the services side, our franchise and company stores have seen great success in improving non-oil change revenue service penetration this year. System wide, we have seen an impressive 17% compound annual growth rate over the past three years. The investment in our teams, best-in-class training and Super Pro process execution allows us to present these services to our guests in an effective way.

Before I turn it over to Mary to discuss our financial results in more detail, I'd like to comment on our recent announcement of Mary's intention to retire. We've started a comprehensive search to identify a successor that will include both internal and external candidates. We very much appreciate that Mary has agreed to continue to serve as our CFO until a successor is selected and successfully onboards. I want to personally thank Mary for her continuing leadership.

With that, I'll turn it over to Mary.

Mary Meixelsperger

Thanks, Lori.

It's an honor and a privilege to be part of the Valvoline team. I'm grateful for the opportunity to work with amazing teammates and franchisees and am committed to ensuring a smooth and successful transition. Now let's turn to look at our financial performance for Q4 and fiscal year 2024.

On Slide 13, we'll start with the top line performance. For the fourth quarter, net sales grew to \$436 million, an almost 12% increase over the prior year. System-wide same-store sales grew 5.4% and 15.4% on a two-year stack. We saw positive transaction growth despite a 40 basis point impact from CrowdStrike and the hurricanes that occurred during the quarter. For the fiscal year, net sales grew just over 12% to \$1.6 billion. System-wide same-store sales grew 6.7% and 18.6% on a two-year stack. For the year, ticket drove the majority of the comp.

Non-oil change revenue service penetration was the largest contributor along with a balanced contribution from net price and premiumization. I'd also like to call out that we intend to update our approach to determining same-store sales beginning in fiscal 2025 to be more consistent with common retail practices. With the updated approach, stores will enter the comp at the beginning of the month after 12 full months in operation within the system. For fiscal year 2024, the change would increase the system-wide same-store sales 40 basis points to 7.1%.

Slide 14 looks at the other drivers of the financial results for the quarter. For Q4, we saw a 110 basis point increase in year-over-year gross margin rate, driven by lower product cost and store expenses, offset by business mix. Adjusting SG&A as a percentage of sales is flat year-over-year. Excluding depreciation, SG&A had deleverage of 70 basis points. We continue to make investments in advertising and technology. Overall, adjusted EBITDA margin increased 50 basis points over prior year, driven by the improvements at the gross margin line.

Turning to the next slide, we'll take a look at the financial drivers for the full fiscal year. Our adjusted EBITDA margin of 27.3% is a 100 basis point improvement over prior year. We've been pleased with the progress we're making in scaling the business and managing costs, which are driving benefit to our operating margin rates. Gross margin increased 50 basis points to 38.2%, driven by the labor efficiency we saw in the front half of the year and lower product costs, partially offset by modestly increased star expenses due primarily to the growth of the immature base.

On Slide 16, we'll take a look at overall profitability. In fiscal 2024, adjusted net income increased 7% to \$206 million, driven by operating income growth of 16%, partially offset by higher adjusted net interest expense of \$27 million due to utilizing cash for share buyback versus prior year interest income generation. We saw record adjusted EBITDA of \$443 million, an increase of 17%, fueled by top line growth and margin expansion. Adjusted EPS increased 33% to \$1.57 per share from both the growth in the overall business and lower share comp.

Turning to Slide 17, we'll look at the balance sheet and cash position. We ended fiscal '24 with \$1 billion of net debt. During the year, we reduced our net leverage ratio to 3.4 times adjusted EBITDA on a rating agency adjusted basis at the end of the year.

Full-year cash flows from operating activities were \$283 million, which is \$70 million lower than the prior year, which had the one-time benefit from establishing the payment terms for the supply agreement with Valvoline Global Operations.

Share repurchases totaled \$15 million and \$227 million for the quarter and full-year, respectively. As a reminder, we reported a material weakness in the second quarter of fiscal 2024, primarily related to IT General Controls. While we have made significant progress in our remediation efforts, there is still more work to be done.

With that, I will turn it over to Lori to summarize and provide our outlook for fiscal year 2025.

Lori Flees

Thanks, Mary.

Valvoline delivered compelling growth and financial results, demonstrating the attractiveness of our customer value proposition and the robustness of our business model. We're pleased with the progress we're making to accelerate our network growth, adding 158 new stores in fiscal year 2024, the refranchising transactions and welcoming new franchise partners will all increase our growth momentum. We are well positioned to deliver strong and durable growth in fiscal year 2025. So let's take a look at our guidance for the upcoming year.

On Slide 19, we've laid out our outlook and have provided additional information on the impact of the refranchising efforts to demonstrate the underlying growth of the business. We expect same-store sales growth of 5% to 7% and overall network growth of 160 to 185 new stores. Because the stores included in the refranchising transactions contributed approximately \$100 million in revenue and \$24 million in adjusted EBITDA for fiscal year 2024, we've shown the impact as pro forma results on this slide. Adjusting for this impact, we expect the underlying business to deliver top line growth of 10% to 14% and adjusted EBITDA to grow to \$450 million to \$470 million.

This EBITDA growth includes technology modernization and tailwind investments necessary to scale the business to the next level and deliver profitable growth into the future. Similar to prior years, we would anticipate approximately 40% to 45% of adjusted EBITDA dollars to come in the front half of the year based on the typical seasonality of our business, along with the timing of certain expenses such as our annual store meeting expense, which occurred during the first quarter.

Due to the lapping of the pricing and NOCR actions we took in fiscal 2024, combined with some volume push from the hurricanes in September. We do expect a higher comp in the first quarter of fiscal year 2025 compared with other quarters, and it is possible we experienced a quarter below the provided range.

The same-store sales guidance we're providing is for a full-year result. Our fiscal year 2025 guidance reinforces the underlying strength and trajectory of our business. We're excited to continue to deliver best-in-class financial results and performance within our industry.

With that, I'll turn it over to Elizabeth to begin the Q&A.

Elizabeth Clevinger

Thanks, Lori. Before we start the Q&A, I want to remind everyone to limit your question to one and a follow-up so that we can get to everyone on the line. Operator, please open the line.

Question-and-Answer Session

Operator

Thank you, Elizabeth. [Operator Instructions] Our first question comes from David Bellinger with Mizuho. Your line is open.

David Bellinger

Hi, good morning. Thanks for the question. Just focusing on Q4 first. Comps are again a little light this quarter. Maybe they were higher if we back out some of the external factors. But bigger picture, how should we think about the 6% to 9% longer-term comp sales algorithm? You just mentioned you might have a quarter below 5% for next year. So how do we square all that together and just give us more confidence in the 6% to 9% going forward?

Mary Meixelsperger

Yes. So David, I'll start with your comment on fourth quarter comps. We did in fact see some impact in the quarter, first in July from the CrowdStrike event that we mentioned in our last earnings call. And then in - excuse me, in September, towards the end of the month, we saw an impact from the hurricanes, specifically impacting some of our franchisees much more significantly than it did our company stores as the markets in the Southeast were primarily driven by those - impacted by those hurricanes.

So you'll see some of the differences between company store performance and franchise store performance in the quarter that explain a portion of that gap. We do expect that in the first quarter of fiscal '25, we're going to regain some of that business. Typically, when we see weather events, we typically see that push out and we're able to regain the sales from the weather events.

So we are expecting our first quarter in fiscal '25 to demonstrate strong comps overall. And then in terms of the full-year, we're expecting to continue to see a ticket be the driver of the majority of the same-store sales growth with transactions contributing nicely, but still not as balanced as we'd like to see them over the longer-term. Lori, do you want to comment about the longer-term outlook and comps?

Lori Flees

Sure. Happy to. So we continue to evaluate our longer-term sales - same-store sales guide and hope to provide an update in the near future. There are many unknowns related to the change in the political administration that we're trying to factor in and until we start to see in the first half of the year how some of the actions that were talked about during the election come to fruition. I think we'll have more confidence in a guide beyond fiscal year 2025.

Just to give context, there's obviously both tailwinds and headwinds that could come and there's uncertainty around the magnitude of those on the tailwind side, obviously, a lower corporate tax rate would be a benefit for EPS growth. And the more gradual shift to EVs over the longer-term obviously benefits us in terms of the timing of investments we make in developing the services required to maintain a customer's vehicles in an electrified car park, but also miles driven could go up just given some of the potential administration actions.

On the headwind side, obviously, tariffs depending on the magnitude or breadth - magnitude and breadth and timing would have an impact on our COGS and we would have to figure out ways that we would pass those through to customers or mitigate those through our own efficiency actions.

And then there's just whether or not the macro consumer environment, whether inflation subsides or increases and how that affects competitive pressure. So we typically see in other automotive players who are seeing their core business have deferral or trade down. They tend to then and we're seeing it now start to promote oil changes as a way to drive some traffic into their service centers.

And so that environment, if it worsens, obviously will not impact our retention of customers, but could impact our ability to attract customers out of that channel and into the Quick Lube channel. And also then the labor impact of mass deportation and how broad that is and how quickly that is and how it impacts the lower level wage environment for retail. So there are a number of unknowns that we're assessing and watching and making sure that we're prepared to mitigate.

But those things, I think we're - we have those fact - those potential upsides and downsides factored in the guidance for FY '25 given the timing of that and the timing of our fiscal year. But beyond FY '25, I think it's still a little early to provide a forward guide. But we do hope to do that as soon as some of that gets more clear.

David Bellinger

Got it. Appreciate all those details. And then my second question, if we back out the refranchising piece for 2025, that implies adjusted EBITDA is growing at a lesser pace than total revenues. It looks like adjusted EBITDA is up about 10% at the midpoint, revenues up about 12%. So could you just help us unpack that? And then in what areas of the business are you expecting some type of margin compression? I think you mentioned tech modernization and talent. So maybe just give us more details on those could be helpful. Thank you.

Mary Meixelsperger

Yes, David. So consistent with what Lori talked about in terms of the guidance we're providing through '25, we are taking into account a more uncertain environment overall that includes uncertainty around our underlying cost environment.

We did recently receive a notification from one of our used oil collection providers suggesting that their collection reimbursement payments to us will go down substantially and we've yet to fully understand how that will fully play out in terms of the underlying product cost. We're also closely watching the inflationary environment. Labor is our largest component of our cost of goods sold and that inflationary and labor environment could significantly impact us over time.

So we're taking what I think is a reasonable and conservative view of our guidance in light of some of those uncertainties. And then we are making investments in on our G&A expenses specifically around technology and talent, we do require system modernization. The systems, both financial and our HRIS systems have been in place since prior to the IPO.

And we did update and replace the financial ERP system in '23 and we're working on the rollout of the updated HRIS system and that's requiring investments in cloud-based systems that will allow us to really scale the business from where we are today to the 3,500 plus stores that we're focused on in the future.

And then we're very focused on talent and making certain we have the right talent in the right places to drive the business going forward longer-term. So in some ways, '25 is really kind of a reset year with some of those investments that we're making in order for us to scale and drive that continued long-term growth opportunity that we still strongly believe is in the business.

Lori Flees

Yes, I'd just add the infrastructure around ERP and HRIS, the systems that we have in place prior to the implementations we've either done on the financial system side or will do on the HR side are systems that were in place within Ashland when we spun out. And those are not fit for retail. They also are going end of life and we have partial year fees for those that were in last year's financial, but not full-year. And we also have the development cost of implementing those systems, which will start to come through in depreciation.

So those are the most significant increases in G&A investment that we're doing. And then I think a few areas of talent investment, specifically around the things that our franchisees are asking us to invest in as they're committing to more unit growth and we want to make sure that we have the right support and talent in place to ensure that they can do that successfully.

Mary Meixelsperger

And Lori, just a clarification on my comments. I did mention that we had started the ERP in '23, we actually implement - in calendar '23, we actually went live with that system in January of '24 and our second quarter of last fiscal - of fiscal '24. So I just wanted to clarify that.

David Bellinger

Got it. Thank you both.

Lori Flees

Thank you.

Operator

Our next question comes from Steven Vangeli with Citi. Please go ahead. Your line is open.

Steven Zaccone

Hi, great. It's Steve Zaccone from Citi. Thanks for taking my question. I wanted to follow-up on the prior question because I think - can you guys hear me?

Lori Flees

Yes.

Mary Meixelsperger

Yes.

Steven Zaccone

Okay, great. Sorry. I wanted to follow-up on the prior question because the guide for 5% to 7% same-store sales this year and then the uncertainty of when you're going to address the algorithm. Maybe help us think through what you view as the market growth rate for the industry, right, and then like the overall ticket versus transaction because used to have a formula to get to that 6% to 9% growth. Has anything changed there because I think we're all going to kind of come off this call and is 5% to 7% the right run rate for the business? Could it be potentially a little bit lower than that? I guess like that's where I think we're trying to just understand as we go forward.

Mary Meixelsperger

Yes, Steve, look, you know the 5% to 7% guide relative to the 7.1% on a restated basis that we did for fiscal '24, really the biggest difference is more moderate net pricing in the comp. We are assuming with a more challenging overall environment and some continuing challenges in the consumer environment that will likely not be as required to be able to take pricing at the same level that we have in the past, especially given the historical inflation that we've seen in pricing.

We do expect to see, as I mentioned earlier, a transaction growth. We expect to continue to see strong benefits from premiumization. We are lapping in the second quarter of '25 actions we took to drive stronger non-oil change revenue penetration. And so we think that will be a little bit more modest on a year-over-year basis as well. Lori, anything that you'd add to that?

Lori Flees

Sure, Steve. I think what I would step back and reflect on is that we fully expect that with our competitive advantages, we're going to outperform the industry and deliver strong absolute and relative same-store sales for retail. And when you look at our industry overall, it's been trending 3% to 4% in the post-COVID environment and we have outperformed that. When you look at the inflation levels, when you go back to 2022 when we set the algorithm, we had significant double-digit same-store sales comps, which came from pricing pass through of inflationary costs.

And so I think when you look at a different labor and - sorry, a different macro and inflationary environment, we're not as confident in that the inflationary pass throughs are going to be included to the extent they were back in '22 and even '23. I think when you do that combined with the competitiveness we're seeing from outside the Quick Lube segment and that could be short lived, but at least it's what we're seeing now.

It ends up having a factor and the ability to drive the new customer acquisition because as you'll note from the presentation, significant part of our new customer acquisition comes from channels outside the Quick Lube space, 75%. And as those channels are trying to keep the traffic in discount or bundle - provide bundled pricing on preventative maintenance, it makes it harder for us within a reasonable cost to acquire those customers to try our channel.

Once they try our channel, see the quality and the convenience, we have years and years of history that would suggest once they shift, they stay. And so it's just really factoring in those two things. One, inflationary cost pass through and two, just a little bit more intensifying of the competitive environment and that impact on new customer acquisition?

Steven Zaccone

Okay. Okay. That's helpful detail. And then the follow-up I had is just on the decision to rebrand some stores. What's the decision criteria to potentially do more of these as we go over the course of the year and then even on a multi-year basis, just why does this make sense for you? Like how do you think about potential additional ones in the future?

Mary Meixelsperger

Yes. Lori, do you want to go?

Lori Flees

I'll start. I think strategically, we've been very clear that we have an opportunity to expand our market share and drive considerable growth. We also - in looking at the overall markets, there's a lot of markets where we have franchisee territories that have opportunity to grow. And then on the company side, we have - we've put together the capability of the team to grow our business on the company side, but there's more growth within those markets.

And so we've always said that if we have a well-capitalized partner who has the same - has the brand - wants to deliver the brand standards and has a focus on people, which drive this business. And they're willing to commit to significantly higher development of new units in a market than we otherwise would, that we would factor that into an overall transaction. Obviously, they have to recognize the value of the stores that we're currently operating if we're going to sell those to the franchisee, but it's more about the long-term growth in a more capital efficient way.

So while it looks - it appears dilutive in the short-term, in the long-term, it's very accretive given the capital efficient growth at a higher level and it allows us to drive more network sort of completeness, which also has an impact on sales, at least as it relates to fleet customers. So there's a circular loop. It's more capital efficient, it drives more growth and reinforces itself. Mary, is there anything I've missed?

Mary Meixelsperger

The only other thing I would say, Lori, is we've done three of these transactions, the two we completed in fourth quarter and the one that we announced today that will close relatively soon. We have a lot to absorb with those three transactions. So I think that we'll be monitoring and ensuring that the changes that we've put in place here in just the last six months are going well and then we'll continue to evaluate what from a longer-term perspective, what's in the best interest of driving longer-term shareholder value.

Lori Flees

But when you look at the IRR on the return on these transactions over the period of time and commitments that the partners are given, it definitely is accretive over the long-term, delivers very attractive shareholder return. Otherwise, we wouldn't have entertained them.

Steven Zaccone

Okay. Thanks for all the detail. And Mary, all the best on your retirement if this is your last call.

Mary Meixelsperger

Thank you very much.

Lori Flees

It's not our last. save that, please.

Mary Meixelsperger

May or may not be. We'll see.

Operator

Our next question comes from Simeon Gutman with Morgan Stanley. Please go ahead.

Lauren Ng

Hi, this is Lauren Ng on for Simeon. Thank you so much for taking our question. Our first question is, can you just talk a little bit more about the competitiveness in quick oil changes? And separately, as you guys expand, are you finding same opportunities in new markets versus existing markets? Thank you.

Lori Flees

Sure. I think as it relates to the overall market, the Quick Lube space continues to do again 20% to 25% of the total oil changes that are done in the do-it-for-me market. So it's still a very small percentage of the overall TAM. And we continue to see the same competitiveness with our other Quick Lube competitors. So there's not a significant change in the environment. I think in the Q3 earnings, we talked about some advertising competitive advertising activity. I think some of that has already moderated. So we're not seeing the competitiveness within our category increase by - in any material way or across any geographies.

As it relates to the 80% - 75% to 80% that of oil changes that are done outside of our category or outside of our segment, we are seeing pockets of promotional tactics specific to oil changes or preventative maintenance to drive traffic. And this is not new. This is consistent with history when there is pressure on the consumer and they're trading down or deferring on other maintenance like, for example, tires, that those competitors, and again, it's all - it's a very fragmented base. So it's unlikely to be at national scale, but you'll see some discounting that's happened. Same with what we saw previously with dealerships.

We're not seeing that as such. But so I would say the competitive dynamics are relatively consistent in the Quick Lube space. From a real estate perspective and opportunities for acquisition or new builds, we're not seeing any significant differences in the competitive landscape within our space. If anything, it's the market opportunity outside of Quick Lubes that we are seeing pockets of promotional tactics. But it's not new and it's not pervasive or at national scale?

Lauren Ng

Okay, got it. That's helpful. And I guess our follow-up is just on the refranchising piece, we're starting to see it pick up into 2025. Is there a percentage franchise mix maybe you're comfortable sharing with us? Thank you.

Lori Flees

It's a good question and when we get asked a lot. We don't have a target specifically on shifting our business more to franchise. We do want to accelerate our franchise growth. And I think we're very encouraged by both the plans and commitments that we've gotten from our existing franchise partners as well as the updated commitments and the new commitments that we've got with the refranchising transactions that we have announced to date and the additional interest that we still have from parties who would love to join our network. And we are entertaining those and looking at white space opportunities to bring on a handful of additional partners, so.

Mary Meixelsperger

And Lori, we did bring on some new partners in recently in several markets, including one important new partner who acquired a franchise business from a retiring franchisee and with that acquisition came a strong development agreement in that territory as well.

Lauren Ng

Great. Thank you.

Operator

Thank you. Our next question comes from Justin Kleber with Baird. Please go ahead.

Justin Kleber

Hi, good morning, everyone. Thanks for taking the questions. First one, I wanted to ask just about non-oil change revenue and where you finished '24 at in terms of percentage of system-wide sales? And then how much variability is there across the system from a penetration standpoint? What tends to drive that variability?

Lori Flees

It's a great question. Obviously, Mary mentioned that non-oil change revenue was our biggest contributor to ticket in '24 and we ended the year, I think the - we started some of our efforts there, some significant efforts there in the second quarter of '24 and those have largely stayed. It really comes down. And just to be clear, the improvement in non-oil change revenue dollars per transaction, it's coming from all services. It's not just coming from one or two services. It's actually across the board.

And we go back to the fact that we recertified everyone on our Super Pro process and made sure that they understood what the services were with - in the process and how to explain those to guests, but also we're trained in conducting them. We also made some efforts to increase the speed of service because we know if we have the core service - sorry, of an oil change faster, then the customer is more likely to take an additional service because they have the time and it's all around convenience and speed.

So when we look at the year-over-year, it's across the board. Now we still look at quartiling our stores and there is significant differences between stores. And some of that comes down to the tenure of the staff in the store. And if you have a younger staff, they're less confident, less educated both in explaining the service to the guest, but also in completing the service as well as just the speed of their performance.

And so there are significant differences between the top quartile and the bottom quartile. I think what we're pleased by is all quartiles improved year-over-year in 2024. And as we start the year, the work that we began in January and February of the calendar year continue into this new fiscal year. So we're very encouraged. We spend time with our store managers at our annual meeting in October, and this is one of the key topics that we spend time on just educating and making sure that they know what the expectation is and that we address any barriers in serving their guests.

Justin Kleber

Very helpful. Thank you, Lori, for that color. And then unrelated follow-up, Mary, I just wanted to get some more color on the comment regarding the decline in collection reimbursement payments for waste oil. It seems like at least from my perspective that Safety Kleen's decision to make this change is being driven by a decline in base oil, which I'd assume would be beneficial to your lubricant cost, but it sounds like you expect these changes to be a net negative to product costs. I just wanted to clarify that.

Mary Meixelsperger

Not necessarily. It was just really a cautionary point that we still don't have full visibility yet as to how the overall product costs will be impacted. So we're still working on that and we'll have an update for you at the end of the quarter. Historically, collection revenue has always been a modest hedge to overall product costs. So as product costs went up, we saw a benefit from collection revenues and as product costs came down, we saw a related decline in collection revenues and it's not clear to us that this change from, that we've received will follow that same cadence as historical.

Over time - over the longer-term time, I expect it will straighten out. The real question is shorter-term, will there - what will the impact be? But you're right, longer-term, we should see benefit on the product costs. And in fact, in fourth quarter, we did see benefit from lower product costs benefit our margins in the fourth quarter. So as we get more information and have a clear outlook on it, we certainly will provide investors with that information.

Justin Kleber

All right. Great. Thank you, both.

Operator

Thank you. Our next question comes from Mike Harrison with Seaport Global Securities. Please go ahead.

Mike Harrison

Hi, good morning.

Lori Flees

Good morning, Mike.

Mike Harrison

Maybe just a follow-up - maybe just a follow-up on the discussion that you just were going through on lower product costs helping you in Q4. Can you talk a little bit about gross margin expectations into next year and maybe some of the puts and takes as we're thinking about base oil costs, the waste oil collection, reimbursement.

I don't know if anything is changing or evolving in your agreement with Aramco around the supply agreement and obviously, there's a leverage and kind of labor cost issue that could be affecting your gross margins. So do you - I mean, at the end of the day, do you expect gross margin to be up next year or kind of flat year-over-year?

Mary Meixelsperger

Yes, when - in our guide, Mike, we're assuming it to be relatively flat year-over-year and we really, as I said before, are waiting to see shorter-term here the impact of some of the changes in the waste oil collection relative to product costs. I do - as I mentioned, we did see some benefit from lower product costs in the fourth quarter and we'll see how that flows through into the first part of the year as we are entering into our new fiscal year. We do think that there will continue to be some labor cost increases, although we think the labor inflation will moderate from where it has been over the last couple of years.

But we still think that we will see labor inflation that will impact our overall cost of goods. And then we expect to see some leverage from the continuing scale that we have in the business. And then a headwind will be just the number of immature stores that are in the overall base. And so as those stores ramp to maturity, they generally have lower four wall margins during that ramp period. Lori, anything you'd add to that?

Lori Flees

Yes. I mean, I would just say that, Mike, our teams did an excellent job this year managing their labor, particularly managing in and around the storms and the hurricanes to not overspend when customer demand or traffic was down and then be ready with the right staffing when they came back after those times.

And we'll - I think our teams are set up well to continue to manage their labor well. I do think we, like every retailer has to counter the wage increases, the minimum wage increases and just the competitive environment for talent.

Now some areas of our business have more wage pressure than others where the states have enacted some step-ups in minimum wage and all of that is factored in and part of the reason why we're - we don't expect to have significant leverage on the gross margin year this year. We are implementing some technology and tools in order to mitigate - continue to mitigate the increases in labor costs. And so some of that is factored into the investments that we need to make.

Mary Meixelsperger

But we'll see the benefit of those investments in late --

Lori Flees

In later years.

Mary Meixelsperger

In later years. With this being the year of implementation, it will be tough to see a lot of the payback short-term.

Mike Harrison

All right, that makes sense. And then wanted to ask on the refranchising of stores. It looks like about 66 stores now and a value of \$24 million worth of EBITDA. You mentioned that you want to make sure you're getting the value for the stores that you're selling to these franchisees. So what do the proceeds from those transactions look like, what kind of multiple do you expect to get on that \$24 million of EBITDA?

Mary Meixelsperger

So the stores that we sold in the fourth quarter, the proceeds from the sale are disclosed in Table 3 to the press release, Mike. The statement of cash flows in the press release does show the \$71 million from the disposition of businesses that we sold in the quarter. We haven't disclosed the proceeds from the transaction we announced today. We did see a substantial gain on sale related to the businesses that we sold in the quarter. That gain was in excess of \$40 million pre-tax.

And you'll also see that we've treated that as a key item or an adjustment to EBITDA because of its non-recurring nature and that will be consistent once the transaction that we announced today closes as well, where we also see to expect to see a substantial gain.

So I think that we've done well in terms of the positioning of those stores in terms of the sale, but most importantly is the focus on the long-term rate of return that we expect to see with the faster growth in the overall network that the refranchising will provide in order to really ensure that the business is well positioned for the long-term?

Mike Harrison

Okay. And the \$71 million for the stores you sold this quarter, I believe you had said that, that was going to be about a \$2 million EBITDA headwind in the quarter. So \$8 million a year. So you got less than 10 times - closer to 9 times EBITDA?

Mary Meixelsperger

Yes, we aren't going to disclose the multiple that we had on those stores. There was some modest benefit in that cash flow related to the disposition of the Russian business that we kept in the retail business when we sold the VGO business and that had a very modest net proceeds as well. But overall, again, our focus is on the long-term returns that the refranchising will provide in terms of value creation.

Mike Harrison

All right. Thank you very much.

Operator

Our next question comes from Tom Wendler with Stephens. Please go ahead, your line is open.

Thomas Wendler

Hi, good morning, everyone. Most of my questions have been answered, but maybe going back to same-store sales comps. With the new way of looking at maturing stores, can you give us an idea of the impact it had on fiscal year 2025 outlook.

Mary Meixelsperger

Yes, we think the impact on '25 outlook. We did mention that on '24, the impact was about 40 basis points between the old method and the new method. And importantly, that impact starts smaller in the first quarter of the year and grows by quarter over the year from a cadence perspective. So in fiscal '25, we expect that impact to be 50 plus basis points.

Thomas Wendler

Perfect. Thank you. And then maybe just touching on repurchases, \$15 million in the fourth quarter. What kind of repurchase activity are you expecting as you look into fiscal year '25?

Mary Meixelsperger

Yes, we actually guided to repurchase activity. So if you look in terms of our guidance tables, you'll see that we guided to a range. Let me make sure I say it correctly. We guided to total share repurchase activity of \$40 million to \$70 million.

Now, of course, that is subject to market conditions and also subject to whether or not we identify any other significant growth opportunities during the year that we think would provide a better opportunity for that capital. But we do think that it being able to distribute a significant component of our free cash flow to shareholders during the year is a significant part of our long-term value creation for shareholders.

Thomas Wendler

Perfect. Thanks for answering my questions and great quarter.

Lori Flees

Thank you.

Mary Meixelsperger

Thank you.

Operator

Thank you. Our next question comes from Peter Keith with Piper Sandler. Please go ahead.

Peter Keith

Hi, thank you. Good morning. Looking at the EBITDA guidance and trying to adjust out the refranchising and get to roughly about 10% EBITDA growth at the midpoint. And it seems like with the Q&A, you're characterizing FY '25 as an investment year. And so the heart of the question is, could you maybe frame up how much pressure the investments are causing on the EBITDA guide? Like is there a certain percentage taking out of EBITDA growth year-on-year.

Mary Meixelsperger

Yes, I didn't specifically call that out, Peter, but I would tell you that we certainly would expect to see a growth in our G&A costs that would likely cause some modest deleverage, not significant, but certainly modest deleverage that would put some pressure on our overall EBITDA growth for the year.

Peter Keith

Okay. And that's people and technology.

Lori Flees

Yes.

Mary Meixelsperger

Yes. Yup.

Lori Flees

I think the - Peter, the point is we - marketing will continue at roughly the same pace that we had in '24. So we're not increasing marketing faster or it's immaterial. It's really just around the G&A investments and then assuming that gross margin holds relatively flat.

Peter Keith

Okay. And then you did flag some potential concern with tariffs. I wasn't thinking of you guys as tariff exposed. Maybe you could frame up what your exposure is. I guess, is there particular countries where you have exposure? Is it direct import exposure or is it more indirect and your suppliers have pass on pricing? Just help us understand how that could have some negative impact potentially?

Lori Flees

Yes. Happy to. Most of our impact is indirect through our suppliers. If you look at lubricant pricing, most of the base oils are actually imported just given the spec to meet the standards of our brand in terms of the Valvoline Global Products brand. And so it just depends on whether or not there's broad tariffs across more than just China or just China. As it relates to China, we do have some of our ancillary services. Like some of our filters and our wipers do our sourced from China. So when you look at our COGS line, obviously, labor being the highest.

We do have a reasonable amount in COGS for materials that we use in our services. And that's the piece that we could see some pressure. Now we're already looking at ways that we could mitigate some of that in the short-term as it relates to filters and wipers, can we bring more of those in now before any tariff were enacted? But longer-term, there could be an impact.

Peter Keith

And the filters and wipers are - those are direct source or those are still indirect through suppliers? As it relates.

Lori Flees

They're indirect through suppliers that actually do our distribution.

Peter Keith

Very good. Okay. Thanks so much for telling.

Lori Flees

And obviously - yes, obviously, Peter, we're - we've got contracts in place with some of those suppliers, but we're looking at alternative sources to mitigate some of that as well. There's just a lot of work underway. But it's all the things that we're looking at that we need to be agile in order to protect margin.

Peter Keith

Okay. Very good. Thank you.

Operator

Our next question comes from Bret Jordan with Jefferies. Please go ahead.

Bret Jordan

Hi, good morning.

Mary Meixelsperger

Good morning.

Bret Jordan

I guess if we think about the comp set - the mix, could you give us more color on just really what was car count, what was same service price and what was premiumization in the comp in the quarter?

Mary Meixelsperger

Yes. We don't get that specific around the comp, Bret, but I would tell you that the majority of the comp was driven by ticket in the quarter and the largest contributor to that ticket was non-oil change revenue penetration followed by a combination of net pricing and premiumization. So we continue to see strong contributions on all three of those lines with non-oil change revenue service penetration leading the contribution. We did see a transaction growth during the quarter, but it was a more modest component of the comp overall.

Lori Flees

And I think the transaction growth across all quarters was true even with the fourth quarter, which was impacted by CrowdStrike and the hurricane. So that would have impacted transactions.

Bret Jordan

What are you seeing from a consumer trend? I guess, are you seeing deferral or same customer oil change cycles getting extended at all or the ability to sell premiumization, I guess, sequentially pressured as the year has gone on? Or are you seeing people getting more optimistic as we get into the end of the year and the elections behind us?

Lori Flees

Yes. I think our business and the demand for preventative maintenance has historically and continues to be resilient. We do not see our customers trading down or deferring the service. I think in the last quarter, we talked about how lower income had a lower penetration rate of services added to an oil change. We haven't seen that get worse. In fact, the penetration or the non-oil change revenue dollars per transaction went up year-over-year in Q4 at a higher level than it did in Q3.

We still see differences by income level, meaning higher incomes tend to spend more on added services per transaction than lower household income quartiles, but overall, all quartiles grew in penetration. So we're not seeing some of the macro uncertainty affect our active customer base. I think where we're looking is the activity typically help impacts our ability to acquire customers out of other channels if those customers are value seeking and they don't understand the value proposition of Quick Lube and Quick Easy Trusted.

Bret Jordan

Great. Thank you.

Operator

Our next question is from David Lantz with Wells Fargo. Your line is open.

David Lantz

Hi, good morning and thanks for taking my questions. Within the 160 million to 185 million unit guidance for '25, is it safe to assume that still embeds 100 company operated stores and the balance being franchised? And then can you also talk about the opening cadence throughout the year in a bit more detail?

Lori Flees

Sure, happy to. I think we've said two years ago that we were targeting to get to 100 stores on the company side, new units. So you're right, we would expect within that guide company to be in or around 100 and for franchise to be the balance. As it relates to quarterly openings, obviously, we've worked really hard after 2023 to create a little bit more even cadence quarter-to-quarter. There's always going to be a higher quarter typically at the end of summer, which is our fourth quarter. But in general, we see it to be a bit more evenly paced across the quarter, both for us and for our franchise partners.

Now some of that is based on acquisition timing and new builds. And I would say, we've always had good visibility of what's in front of us. I think with the new build number becoming a higher percentage of the total, it actually allows us to have better visibility over the year. And so I do think we're putting in the right support and tools in order to get to a more consistent delivery of new units by quarter?

David Lantz

Got it. That's helpful. And then on the fleet business, transactions have grown at a 14% CAGR over the last three years. Curious if you can provide any additional color around expectations for 2025.

Lori Flees

We have made some investments in our business-to-business sales team that are continuing to pay off for us. In the last year to year and a half, we have started to take on more of that business-to-business selling for regions that are operated by our franchise partners as an additional service that they can opt into.

And part of that is just because they've seen the growth that we've had on the company side and how the frequency of visit and the ticket are attractive relative to an overall consumer. So we don't really share the specific growth rates that were included, but we would expect it - our fleet business to continue to grow faster than our consumer business is growing in FY '25 and beyond.

David Lantz

Great. Thank you.

Operator

Thank you. And our next question comes from Steve Shemesh with RBC Capital Markets. Your line is open.

Steve Shemesh

Great. Thank you. I appreciate you squeezing me in. And Mary, I'll offer my congratulations as well. I just wanted to circle back to top line. I know you mentioned you expect 1Q same-store sales to be a bit higher than the rest of the year. Can you maybe comment on where we're trending quarter-to-date? And I guess just how much of a benefit you think hurricane deferral from 4Q into 1Q might contribute? And then just secondly, you mentioned the possibility of a quarter coming in below the full-year guide. I mean, I guess we're already seeing the tire and maintenance shops being a little bit more promotional at this point. So it feels like that's kind of the norm. I guess, what would need to happen to get you to a sub-5% in the quarter. Thanks.

Mary Meixelsperger

Yes, we're pleased where the business is trending quarter-to-date. We saw a strong October. That was clearly influenced by the weather pickup early in the month and as well as comping against a weaker October last year. I don't know if you recall, but in our first quarter call last year, we talked about some marketing weakness we had early in the quarter last year that we were comping up against that is helping us this year.

It's been a little choppy in more recently, but everything in - as you look at the quarter-to-date is really trending in line with our expectations of it being a strong quarter. So I would tell you that I certainly expect the comps in the quarter to outperform what we saw in the quarter last year. So with that, I might turn it over to Lori to get the second part of your question.

Lori Flees

Yes, I think when you look at the promotional activity that you're talking about, it really - the impact will be to the number of new customers that we can acquire. So if across our fleet, 80% of the customers are customers that we've seen before and 20% are new. We obviously don't grow our same - we don't grow our number of stores by 20% when you look year-over-year.

So some of that is acquiring customers into our existing stores and they come from other channels. And that's where there'll be some potential for pressure if we see the continued promotional activity broaden, beyond just the pockets that we're seeing today. And so that's really the difference around whether or not we could go below the guide is really around that promotional activity that we see and the impact it has to our new customer acquisition rates relative to what we planned. And what we have been experiencing.

Steve Shemesh

Yes. Okay. And just to clarify, I mean, when there are promotions in the environment, you're holding price largely. So we're anticipating that there's going to be somewhat of a traffic slowdown, but you're still going to get at least flat or maybe some positive pricing there?

Lori Flees

Yes. So we hold our pricing, but we allow our stores. If a customer that we've served before gets an offer and they bring it into the store, we don't match it, but we'll do the right thing to keep the customer. And so you could see a little bit in those areas of competition, a little bit of discount increase, but a maintaining the traffic. Now that's a comment with the retention of existing customers.

What I'm talking about is the promotional activities that we do to try to get new customers to try us that perhaps haven't been to a Quick Lube before or definitely haven't been to a Valvoline before. And if they are seeing other promotions, our promotion may not be as attractive and they don't know what the experience difference is. And so it's just more promotional activities competing for customers that are in that decision window or in the service need window.

Steve Shemesh

Got it. Thank you very much.

Lori Flees

So I don't think it's an increase - it's not an increase in discount for new customers, but it's more dollars chasing those in the marketplace. And that's going to be market-by-market dependent.

Steve Shemesh

Thank you.

Lori Flees

Thank you. We have no further questions in the queue. So I'll turn it back over to you, Elizabeth, for any closing comments.

Elizabeth Clevinger

Thank you, Lydia, and thank you all for your time today. This concludes our call.

Operator

This concludes our call. Thank you very much for joining. You may now disconnect your lines.

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