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Hormel Foods Corp. (HRL)

Q4 2017 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, ladies and gentlemen. Thank you for standing by. Welcome to the Hormel Foods Fourth Quarter 2017 Earnings Release Conference Call. At this time, all participants are in a listen-only mode. As a reminder, this conference is being recorded, Tuesday, November 21, 2017.

I would now like to turn the conference over to Nathan Annis, Director of Investor Relations. Please go ahead Mr. Annis.

Nathan P. Annis

Director-Investor Relations, Hormel Foods Corp.

Good morning. Welcome to the Hormel Foods conference call for the fourth quarter of fiscal 2017. We released our results this morning before the market opened, around 6:30 AM Eastern. If you did not receive a copy of the release you can find it on our website at www.hormelfoods.com under the Investors section.

On our call today is Jim Snee, Chairman of the Board, President and Chief Executive Officer; and Jim Sheehan, Senior Vice President and Chief Financial Officer. Jim Snee will provide a review of each segment's performance for the quarter and our outlook for fiscal 2018. Jim Sheehan will provide detailed financial results for the quarter and further assumptions relating to our 2018 outlook. The line will be open for questions following Jim Sheehan's remarks. As a courtesy to the other analyst, please limit yourself to one question with one follow-up. If you have additional questions, you're welcome to get back in the queue. An audio replay of this call will be available beginning at 11 AM today, Central Standard Time. The dial-in number is, 888-394-8218 and the access code is 5906948. It will be posted to our website and archived for one year.

Before we get started, I need to reference the Safe Harbor statement. Some of the comments made today will be forward-looking and actual results may differ materially from those expressed in or implied by the statements we will be making. Please refer to pages 32 through 39 in the company's Form 10-Q for the quarter ended July 30, 2017 for more details. It can be accessed on our website.

Additionally, please note the company uses non-GAAP results to provide investors with a better understanding of the company's operating performance by excluding the sales and volume impact of the divestitures of Farmer John and Diamond Crystal Brands, the acquisition of Justin's, Ceratti and Fontanini and the impact of a 53rd week in 2016. Discussion on non-GAAP information is detailed in our press release located on our corporate website. Please note that during our call today, we will refer to these non-GAAP results as organic net sales and organic volume.

I will now turn the call over to Jim Snee.

James P. Snee

Chairman of the Board, President & Chief Executive Officer, Hormel Foods Corp.

Thank you, Nathan. Good morning, everyone. We are pleased to announce our full year and fourth quarter results.

For the year, three of our five segments: Grocery Products, Refrigerated Foods and International, delivered record earnings in spite of one less week than 2016. These three segments also delivered exceptionally strong

organic sales growth. The growth in these segments offset declines at Jennie-O Turkey Store and Specialty Foods, allowing the total company to achieve organic volume and sales growth in 2017.

In spite of a volatile commodity market environment, we delivered a quarter of strong organic volume and sales growth. Fourth quarter earnings per share was \$0.41, in line with our most recent guidance. The fourth quarter was marked by many bright spots. Grocery Products delivered excellent earnings growth. Our Grocery Products team continues to do an outstanding job growing iconic brands in the center store, such as SPAM and Dinty Moore, while simultaneously capitalizing on pockets of growth in dynamic on-trend categories with brands like Wholly Guacamole and HERDEZ.

SPAM was a strong contributor to International sales growth in addition to the inclusion of the Ceratti business for our International team. Our China business experienced strong sales and earnings from SKIPPY peanut butter and our branded meat products. The new Jiaxing plant is producing and shipping products while the Shanghai facility has stopped production. Our current manufacturing operations in China now include Beijing, Jiaxing and our SKIPPY plant in Weifang.

Refrigerated Foods delivered results in line with our expectations. Organic sales growth was driven by foodservice sales of HORMEL Bacon 1 fully cooked bacon and HORMEL pepperoni, in addition to retail sales of Black Label bacon Natural Choice products and Cure 81 hams. Earnings in Refrigerated Foods were down due to the divestiture of Farmer John and favorable markets last year.

The story at Jennie-O Turkey Store is very similar to what we communicated to you on the third quarter call. The turkey market continues to be in an oversupply situation. Lower whole bird and commodity pricing was the key driver to lower sales and earnings this quarter. In spite of these difficult market conditions, Jennie-O lean ground turkey continues to show growth and take share from ground beef.

The results from Specialty products are disappointing, and driven by lower sales of Muscle Milk ready-to-drink protein beverages in this convenience store channel. The new leadership team at CytoSport is making the necessary adjustments to gain back ground from the setback they had this year.

One key theme from this year is the impact record input prices had on our business. For some markets such as bellies and beef trim, prices increased rapidly but also decreased rapidly. Other markets such as turkey breast dropped further and faster than anticipated and remain at depressed levels. Our sales and marketing teams continue to be diligent in their assessment and response to the cost volatility while finding ways to mitigate it.

Overall, this year has been challenging and did not meet the expectations we set for ourselves at the beginning of the year. However, I cannot emphasize enough the importance of the intentional balance that we create in all areas of our business. Even with the disappointing year we had in Specialty Foods and Jennie-O Turkey Store, we still delivered record operating margin, record operating cash flow, returned a record amount of cash back to shareholders and increased our cash balance.

Looking to 2018, we will continue to follow our path forward that I laid out at our Investor Day in June. First, we'll continue to evolve to a broader food company. The Columbus acquisition broadens our portfolio as we expand into a total deli provider and enhance our position in this advantaged growth space.

Second, expand and accelerate foodservice. With the acquisition of Fontanini, we will continue to aggressively grow our competitively advantaged foodservice business.

Third, become a more global food company. We are excited for the Ceratti acquisition in Brazil and our new plant in China. Both strategic investments will allow International to deliver above average growth this year.

Fourth, reduce volatility and increase balance. We continue to increase the sales of value-added products as a percentage of our total sales, and we've complemented that growth with the acquisitions of purely value-added businesses such as Fontanini, Ceratti and Columbus.

Fifth, divest non-strategic assets. We will continue to take a hard look at all underperforming assets, and, if necessary, make the difficult decisions required to ensure we are delivering shareholder value.

And finally, modernizing our supply chain. Today, we announced a reorganization of our supply chain. Glenn Leitch, who led Jennie-O Turkey Store to outstanding growth for the past seven years, will now become Executive Vice President of Supply Chain. Glenn will be responsible for the entire supply chain from procurement to shipment. I would refer you to the separate press release for all the other details related to the reorganization.

Overall, headwinds to our outlook in 2018 include: volatile commodity markets; a slower than expected recovery in the turkey industry; and uncertainty in the hog and pork markets. The tailwinds in our business are clear. In addition to the solid fundamentals that will provide strong organic growth, we have three new strategic acquisitions, numerous strategic investments and value-added capacity, and an innovation pipeline full of exciting new products.

Our focus on innovation has never been stronger as evidenced by the substantial progress we made towards our 15% innovation by 2020 goal. As of the end of 2017, 14% of our total company sales came from products innovated in the last five years. Key products contributing to this growth include: Bacon 1, SKIPPY P.B. Bites and HERDEZ Guacamole Salsa.

Our current pipeline of new products is deep, and our innovation teams are thinking of new and interesting ways to get products to the market faster with more scale and in a more cost efficient manner.

The headline for 2018 will read: strong value-added growth and strategic acquisitions more than offset commodity headwinds.

Looking at the segments for 2018, we expect Jennie-O Turkey Store to continue to navigate difficult industry conditions while the remaining segments will provide earnings growth. We expect modest earnings declines for the full year at Jennie-O Turkey Store. Earnings decreases in the first half will not be fully offset by increases in the back half as turkey market moves towards a slow recovery. We expect continued value-added sales and volume growth led by lean ground turkey, Oven Ready products and turkey burgers. We plan to be back on air with the Make the Switch media campaign in 2018.

Despite the disparity of views in the hog industry, the fundamentals of Refrigerated Foods have never been better. While we anticipate a reduction in the commodity profits in Refrigerated Foods, we expect continued growth in our value-added businesses to more than offset the declines. Again this year, we expect the Hormel Foodservice team to deliver industry-leading results and the addition of Fontanini has put them in a great position to continue that trend. We also expect a solid year of growth from meat products. Once finalized, the acquisition of Columbus will help Refrigerated Foods deliver earnings growth in 2018.

This morning, we also announced the union of the Grocery Products and Specialty Foods segments. Both organizations sell shelf-stable products, have a focus on the food, drug, mass and club channels and are charged

with managing CPG brands. Luis Marconi, who currently leads Grocery Products, will continue to lead this segment.

Combined, this segment will be a model for how to manage iconic brands such as SPAM and SKIPPY while nurturing the growth of fast-growing franchises like Wholly Guacamole, Justin's and CytoSport. Over time, consolidating these two segments will deliver revenue and cost synergies in all aspects of the business while continuing to deliver industry-leading growth.

For 2018 specifically, we expect sales and earnings growth to be driven by our MegaMex line of products, SKIPPY and Justin's nut butters as well as improvement in our CytoSport business. International will have a strong year benefiting from the acquisition of Ceratti, in addition to strong results from our China business.

After taking into account all these factors, we are setting our fiscal 2018 sales guidance at \$9.4 billion to \$9.8 billion and our earnings per share guidance at \$1.60 to \$1.70 per share. This guidance excludes the Columbus acquisition. Consistent with the acquisition announcement, we expect Columbus to be \$0.02 to \$0.03 accretive to earnings in 2018. I'm excited to close the Columbus acquisition and start the consolidation of our deli businesses. We expect to close the deal in December.

Our first quarter comparison will be a difficult one as we annualize the divestiture of the Farmer John business and continue to manage through the oversupply in the turkey industry. Our plan show sales and earnings growth weighted towards the second half of the year aided by acquisitions, innovation, cost reductions and improvements in the turkey market.

At this time, I will turn the call over to Jim Sheehan to discuss the financial information relating to the quarter and key assumptions for 2018.

James N. Sheehan

Senior Vice President & Chief Financial Officer, Hormel Foods Corp.

Thank you, Jim. Good morning, everyone. Volume for the fourth quarter was 1.3 billion pounds, a 10% decrease compared to last year. Organic volume increased 2%. Sales for the fourth quarter were \$2.5 billion, a 5% decrease. Organic net sales increased 5%. Net earnings for the fourth quarter were \$218 million, down to 11% compared to last year. General corporate expenses were lower due to the focus on strategic cost management and lower employee-related expenses. Advertising expense was \$30 million compared to \$55 million in 2016. We plan to increase advertising by 20% in 2018.

Excluding advertising, selling, general and administrative expenses were 6.6% of sales compared to 7.2% of sales last year. Deal costs, associated with the Ceratti and Fontanini acquisitions, were approximately \$0.01 per share in the fourth quarter. Operating margins were 13.2%, a 70-basis-point decrease compared to last year. For the full year, operating margins were 14%, 10 basis points higher than 2016.

We are maintaining our goal to be in the top quartile of our peer group in operating margins by 2020. Today, the top quartile range is 16% to 20%. We plan to attain this goal through a focus on strategic cost management, acquisitions, innovation and by investing capital into high margin products such as Bacon 1 and SPAM production in China.

Our effective tax rate was 33.8% compared to 33.1% last year. In 2018, we are expecting our full-year tax rate to be between 32.3% and 33.3%. Starting in the first quarter, we will adopt the new accounting standards related to stock compensation. This is expected to benefit our effective tax rate in 2018 by approximately 100 basis points

and increase earnings per share by approximately \$0.02. The adoption of the standard will increase quarterly tax rate volatility.

We generated record cash flow from operations of \$499 million, up 34% from \$371 million last year. The increase was primarily related to decreases in working capital. Capital expenditures for the quarter totaled \$103 million compared to \$90 million last year. We expect capital expenditures to be approximately \$425 million in 2018. The higher level of capital is driven by the investments into additional capacity for high margin products and projects to improve manufacturing efficiencies. They include the expansion of baking capacity, modernization of the Austin plant and replacement of the Melrose plant.

We paid our 357th consecutive quarterly dividend, effective August 15, at an annual rate of \$0.68 per share. This morning, we also announced a 10% increase to our dividend. The effective annual rate will be \$0.75 per share. This is our 52nd consecutive year we have increased the dividend, and the 9th consecutive year we have increased the dividend by a double-digit rate.

We repaid the debt associated with the Fontanini and Ceratti acquisition, ending the year with \$250 million in long-term debt, unchanged from 2016. After the Columbus transaction closes, we expect our total debt to be approximately \$1 billion. We remain in a strong financial position to fund any other capital needs.

We did not repurchase stock in this quarter. We will continue to repurchase stock to offset dilution from ops and exercises, based on our internal valuation of the stock. Input costs for the quarter were generally higher with the exception of the turkey markets.

Hog prices in the fourth quarter were 11% higher than last year. Prices last year reached multi-year lows. As Jim mentioned, there are conflicting viewpoints on the hog and pork industry. Hog price forecasts for calendar 2018 vary from high single-digit decreases to mid single-digit increases. Our expectation is for a low single-digit increase in calendar year 2018. We expect earnings pressure in Refrigerated Foods during the first quarter due to the high cost compared to the unusually low cost last year.

We continue to focus on three factors: domestic demand, export demand and industry capacity utilization. With the consumer trend moving towards increased protein consumption, domestic demand remains very strong. The USDA cutout was 5% higher than last year for the fourth quarter.

Export demand continues to be strong. The USDA forecast for exports to be up 7% in 2017 and up another 6% in 2018. Hog supplies are expected to increase 3% to 4% next year. We continue to believe hog supplies are well matched to industry capacity over the long-term. However, we do expect short-term volatility dependent on the progress of the new plants ramping up to full production.

We continue to assess the industry conditions and will make the necessary changes to ensure we are sourcing pork for our value-added products at the lowest possible cost. In 2017, our commodity profits were slightly above average. Based on our market assumptions, we expect commodity profits to be moderately below average in 2018. In 2018, we intend to reduce our hog harvest by approximately 4%. If market conditions change, we have the flexibility to adjust harvest levels.

Belly prices remain volatile. Markets declined in the fourth quarter, but were 25% higher than last year. We expect belly prices to remain volatile and in line with 2017. 72% pork trim prices were 15% above last year, we expect trim markets to be flat to 2017. 50% trim was 25% higher for the quarter. We expect beef prices to be flat to 2017,

but higher in the first quarter. Feed costs were lower compared to last year. We expect feed costs to be flat to last year.

Turkey commodity prices remain at seven-year lows. Breast meat prices were 28% below last year. We have not seen the reduction to poult placements required to alleviate the oversupply condition. Cold storage remains at elevated levels.

Turkey breast inventories are 17% above last year, while whole birds are 23% above last year. Based on the lack of meaningful production declines at high levels of inventory, we do not expect material changes in markets until the back half of the year. Our expectation is Jennie-O first half profits will be below 2017.

We have made good initial progress on the financial strategy I laid out at Investor Day. These include: reducing our general corporate expenses; improving our cash cycle; and leveraging our balance sheet for growth.

At this time, I'll turn the call over to the operator for the question-and-answer portion of the call.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] We'll go first to Farha Aslam with Stephens, Inc.

Farha Aslam

Analyst, Stephens, Inc.

Q

Hi, good morning.

James P. Snee

Chairman of the Board, President & Chief Executive Officer, Hormel Foods Corp.

A

Good morning, Farha.

Farha Aslam

Analyst, Stephens, Inc.

Q

Can you talk about Glenn Leitch's new role at the company, and how you look at your production facilities right now and in particular how you expect the Chinese plant to benefit earnings for next year?

James P. Snee

Chairman of the Board, President & Chief Executive Officer, Hormel Foods Corp.

A

Sure. So let's start with the new supply chain organization. What this is going to do for us is, it's really going to give us better alignment across our entire organization. Today, we have our operations that exist in our business units. And I would say that they're probably a bit fragmented. They're very successful but a bit fragmented, which really – it inherently allows for duplications and inefficiencies. And so, we believe that having this alignment across the organization and getting the structure and process right will allow us to become more cost effective, enhance our speed-to-market and really make us more agile over time as we're facing ever-changing very dynamic market conditions. So, I mean, we believe this is a great move for our organization. It's consistent and very thoughtful with how we've been talking about our business and the needs to do this.

In regards to China, the new facility is going to help us in a couple of ways. I mean, we were at capacity on a number of different lines because of the successful business we have in the foodservice segment. The other part that is going to do when it's more of a slower build is for the first time ever we have in-country production of SPAM. And so, and now that line is up and running, we've already seen some nice early success and are rapidly regaining distribution because we have been in market with that product before. But really feel like not only operationally, but structurally we're set up for long-term success in China.

Farha Aslam

Analyst, Stephens, Inc.

Q

That's helpful. And just as a follow-up, you highlighted variable commodity markets in 2018. Could you talk about Hormel's ability and experience to price for those fluctuations, and how retailers and consumers are accepting those prices?

James P. Snee

Chairman of the Board, President & Chief Executive Officer, Hormel Foods Corp.

A

Sure. I think we've demonstrated a track record of success when it comes to dealing with price increases. And a lot of that has to do with the brand positioning, delivering on the brand promise, but then also being a brand leader. And so, given the strong brand presence that we have across our organization with so many number one and number two brands, we are able to successfully get those through. I would not say that it's easy. I mean, we take all price increases very seriously. And we work with all of our retail customers to make sure that we've got the best outcome for both of us.

The other thing I would say, Farha, is, clearly we understand the data and the insights around price elasticity and build that into our modeling as well. So, feel like we're pretty sophisticated and successful in that area.

Farha Aslam

Analyst, Stephens, Inc.

Q

That's helpful. Thank you.

Operator: We'll go next to Adam Samuelson with Goldman Sachs.

Adam Samuelson

Analyst, Goldman Sachs & Co. LLC

Q

Yes. Thanks. Good morning, everyone.

James P. Snee

Chairman of the Board, President & Chief Executive Officer, Hormel Foods Corp.

A

Hi, Adam.

Adam Samuelson

Analyst, Goldman Sachs & Co. LLC

Q

So, I guess, maybe some clarifying questions on the guidance where you laid out \$1.60-\$1.70 range. From the Fontanini and Ceratti deals, there's \$0.04 to \$0.05 of accretion. You think in the prepared remarks, you alluded to a \$0.02 tailwind on tax from the accounting change. And in the International segment, you should have the new plant up and running. And in fiscal 2017, you were absorbing costs as that started up and had some construction delays.

And, I mean, I guess, maybe there's a bit higher accrual for incentive comp in the 2018 outlook, but I guess, if I put those kind of discrete factors to the side, I'm at the middle to upper-end of your range on an organic basis for profit. And so, is that the right characterization that the sum of Grocery, Refrigerated, Jennie-O and Specialty profits are kind of in the middle to upper part of your range flat on net? Am I doing that math right?

James N. Sheehan

Senior Vice President & Chief Financial Officer, Hormel Foods Corp.

A

Yeah. Adam, you are. I mean, I think if we go back to the headline I described in my comments is that the growth in our value-added business is going to offset some of the commodity volatility that we expect. And so, if you go around really the business units, and I mean, we have merged Grocery Products and Specialty together, but just to help you with some clarity in that area. I mean, Grocery Products is going to be in-line with the growth expectations that we have for that business. And quite frankly, Specialty will have the same growth algorithm that we've talked about as CytoSport, we expect a return to growth in CytoSport.

Refrigerated Foods is going to have low single-digit growth in both sales and earnings. International, you've assessed properly with strong double-digit growth, and then JOTS will have low single-digit sales growth, but really down mid-single digit from an earnings perspective because of the market conditions. So, I think your rollup is fairly accurate getting to that range.

Adam Samuelson

Analyst, Goldman Sachs & Co. LLC

Q

Okay. And then so maybe putting a finer point in Refrigerated and Jennie-O, is there any way to maybe dimensionalize kind of the range of outcomes as you think of like the key variables as you sit here today, is it for packer margins, for Refrigerated, is it belly price volatility and then in Jennie-O kind of the some of the supply factors that you would be looking at to make for a better or stronger, I presume, second half is probably the bigger I note at this point?

James N. Sheehan

Senior Vice President & Chief Financial Officer, Hormel Foods Corp.

A

Certainly. Good morning, Adam. This is Jim Sheehan. I'll talk a little bit about some of the variables. The first thing is that there are very differing views about what's going to happen in the pork industry. The forecast for hog prices are everything from down high-single digits to up mid-single digits. We think we've taken a realistic view and we've identified our model on low-single digits for the outlook. Now, what is involved in that is that we expect to see some volatility. Volatility as these plants ramp up.

Now in the first quarter, the cost of hogs are at \$57 so far. I think it's important to understand that the five-year average in the first quarter is \$75. And if you exclude the impact of PEDV, those costs are at \$70. So, they're still below historical levels. But we had unseasonably low hog cost in the first quarter of 2016. And so, we expect that we will be up against that as we go into 2018. So, we have an unfavorable comparison for the first quarter of 2018.

On the turkey side, I think we've tried to be clear on what we're watching. We're watching the poult placements and we're watching the inventory reports. So far, we just have not seen anything that would tell us that it's bottomed out yet. We believe that we're going to see market improvements in the back half of the year with some flattening of the conditions mid-year, but really not much improvement until the end of the year. So, depending on

how those commodities work, we're trying to be very, very clear as to how we've built our outlook and that should give you some insight as to what could change.

James P. Snee

Chairman of the Board, President & Chief Executive Officer, Hormel Foods Corp.

A

And, Adam, I would add on. Clearly, I mean, a lot of the industry, the turkey industry is operating near breakeven. I mean, clearly, we are well above that range. We feel like we've done what we need to do, and that we've cut production and believe that the rest of the industry needs to do that as well. Quite frankly, we're a bit disappointed that we haven't seen that as of yet. So, I mean, that's the commodity side of the business, but we still feel very confident as I talked about a number of different items that we expect to grow the value-added items that'll grow. Our lean ground turkey business is healthy, showing good growth and then still taking share versus the beef market.

Adam Samuelson

Analyst, Goldman Sachs & Co. LLC

Q

All right. That's all. Very helpful color. I'll pass it on. Thanks.

James P. Snee

Chairman of the Board, President & Chief Executive Officer, Hormel Foods Corp.

A

Yeah.

Operator: And we'll go next to Rupesh Parikh with Oppenheimer.

Rupesh Parikh

Analyst, Oppenheimer & Co., Inc.

Q

Good morning, and thanks for taking my question. So, I wanted to touch on the competitive environment. I was curious what you guys are seeing right now from a private label perspective, and also what you're seeing from some of the other branded players?

James P. Snee

Chairman of the Board, President & Chief Executive Officer, Hormel Foods Corp.

A

From a private label perspective, our belief is that it's pretty standard operating procedure. I mean, private label's been a competitor, been in a lot of the categories for extended period of time. And so, where we continue to focus on what we do best, and that is building our number one and number two leading brands. If we do that and have leading brand positions, I mean, we'll be able to overcome any category challenge. So, we don't see that it's escalated any more than it has in the past. And like I said, we treat it like any other competitor and understand what it is that we have to do to be successful.

Rupesh Parikh

Analyst, Oppenheimer & Co., Inc.

Q

Okay, great. And then switching topics to e-commerce. Can you remind us the size of the business currently and then some of the key efforts that you expect going forward in this area?

James P. Snee

Chairman of the Board, President & Chief Executive Officer, Hormel Foods Corp.

A

Sure, Rupesh. For us, it's still a very small piece of our business. I mean, we've made some strategic investments this year creating our digital investment group. And so, we've got the right structure in place and we're focusing our efforts around not only digital marketing, but e-commerce. And so, we're not quite where we need to be, but believe that we're on the right track. We have the right structure and we'll get there with the team we have in place.

Rupesh Parikh

Analyst, Oppenheimer & Co., Inc.

Okay, great. Thank you.

Q

Operator: We'll go next to David Carlson with KeyBanc.

David Carlson

Analyst, KeyBanc Capital Markets, Inc.

Hi. Thanks for taking the questions. With the union of the Specialty Foods and Grocery Products segments, it becomes a little bit more difficult to gauge the progress of the sales turnaround efforts at Muscle Milk by looking at the Specialty Foods segment on a standalone basis. So, that said, what gives you guys confidence that the issues with CytoSport will start to improve in the latter half of the year? And what else might be required in the form of ongoing investment in the sales turnaround efforts? And I've got a follow-up.

Q

James P. Snee

Chairman of the Board, President & Chief Executive Officer, Hormel Foods Corp.

Sure. Thanks, David. The one thing we want to be clear about is, I mean, we will continue to update you on our progress at CytoSport. It's a very important part of our portfolio and we want to make sure that you understand the progress that we're making in that business. We're still rebounding from the impact of the recall we described to you last quarter, where we saw, obviously, we were off-shelf, saw some increased competitive activity. And we are working, continue to work to get pricing in our assortment correct.

A

I mean, our new leadership team in addition to working on pricing assortment is focused on the consumer and making sure that we're focused on the key attributes of our product offering. And for us as we head into 2018, a key differentiator is, we have very strong alignment with our strategic distribution partner, Pepsi. And working closely with them, we've made this – they have made this a top priority for 2018. We'll continue to make the necessary advertising investments in the business, but having it at the top of their priority list is really an important part of the formula as well. And so that's why we're optimistic heading into 2018 for CytoSport.

David Carlson

Analyst, KeyBanc Capital Markets, Inc.

No. That's a great answer. With respect to the pricing actions you guys took during the fiscal fourth, can you give us just a little bit more clarity on exactly when those prices began to have a positive impact on your P&L? And with so many inputs seeming to be pretty volatile over the last couple quarters, are there any other pricing actions that are in the process of being implemented?

Q

James P. Snee

Chairman of the Board, President & Chief Executive Officer, Hormel Foods Corp.

Yeah. So, the fourth quarter played out just like we told you on the third quarter. I mean, the timing varied by category, but a broad statement they took hold in the 11th period and that's really when we started to expect or

A

experience the benefit. And what I would tell you is, I talked earlier about some of the price elasticity studies that we're doing to make sure we understand the impact that we've exceeded a lot of the pricing study expectations that we had when we took the price increases. Obviously, a very good sign. We do have some price increases in place for Q1 in our Grocery Products line with our Mary Kitchen Corned Beef Hash and Dinty Moore Beef Stew.

David Carlson

Analyst, KeyBanc Capital Markets, Inc.

Thank you for the time.

Q

James P. Snee

Chairman of the Board, President & Chief Executive Officer, Hormel Foods Corp.

Yeah.

A

Operator: We'll go next to Eric Larson with Buckingham Research Group.

Eric J. Larson

Analyst, The Buckingham Research Group, Inc.

Yeah. Good morning all, and happy Thanksgiving.

Q

James P. Snee

Chairman of the Board, President & Chief Executive Officer, Hormel Foods Corp.

Same to you, Eric.

A

Eric J. Larson

Analyst, The Buckingham Research Group, Inc.

Just two – one question on pricing in the book Grocery Products division. I know that you took some pricing. I believe mid-year last year in fiscal 2017 to offset some of the higher belly and both the pork and beef trim cost. Could you reiterate what the kind of the timing of that was and fiscal 2018 should benefit, I would assume at least for the first half from that? Would that be correct?

Q

James P. Snee

Chairman of the Board, President & Chief Executive Officer, Hormel Foods Corp.

Yeah. So, Eric, let's maybe we'll just kind of recap of what we did in pricing in 2017. So, in Refrigerated Foods, mid-year we had some pepperoni price increases as a result of the run-up in the beef trim market. We also saw an early run-up in the belly market, which caused us to increase some bacon pricing. So, that would have been Refrigerated Foods in the mid part of the year that you referenced.

A

And then as we got to the fourth quarter, we had another run-up on belly prices. So, bacon was addressed again. And then we did have some other Grocery Products increases, chili and guacamole and peanut butter in the fourth quarter.

Eric J. Larson

Analyst, The Buckingham Research Group, Inc.

Okay, good. Thank you. That helps. I know there was a lot of activity there, so I just wanted to make sure I understood that. And then just one other follow-up question here, Jim. It's kind of surprising that the turkey market is still as depressed as it is. I think we're about nine months sort of into kind of a lower profitability market, and it's

Q

normally about a 9 to 12-month cycle. So, it seems to be going on longer than normal. Is there something specific that's going on per se that is there a change in why we haven't seen the start of a rebound in that turkey business yet?

James P. Snee

Chairman of the Board, President & Chief Executive Officer, Hormel Foods Corp.

A

We've talked about the rebound being more of a 12 to 18-month cycle, Eric. And so, I mean, we would expect that we would have seen some lower poult placements by this point. But I think one of the things that we need to consider is coming out of AI that we've got a lot of producers who are perhaps awaiting the next outbreak. And so that supply side continues to go – nobody is willing to give up on their supply quite yet.

The other thing I would point you to, is that even though in the midst of AI, there were supply issues. I mean, there were some record profitability. And so, you have some probably better than average capitalized operators that could, I mean, be-holding their breath so to speak a little longer. And I mean, so, we'll see. We're not quite where we think we need to be yet. But like I said earlier, I mean, we've cut our production. We're disappointed that we haven't seen the rest of the industry follow suit.

Operator: And we'll go next to Ken Zaslow with Bank of Montreal.

Kenneth Zaslow

Analyst, BMO Capital Markets (United States)

Q

Hey. Good morning, everyone.

James P. Snee

Chairman of the Board, President & Chief Executive Officer, Hormel Foods Corp.

A

Hi, Ken.

Kenneth Zaslow

Analyst, BMO Capital Markets (United States)

Q

Good. We just go through – trying to quantify the buckets of cost savings because now at this point you have acquisitions, you have the combination of Grocery and Specialty, you have the supply chain savings, you have China and I believe that you have still corporate expenses. Can we bucket them in terms of kind of giving us both the actual numbers or trying to figure out how much it is, and how long it'll go for, so we can kind of contextualize this – bring it from an abstract level to actually something to kind of bring it down to my level?

James P. Snee

Chairman of the Board, President & Chief Executive Officer, Hormel Foods Corp.

A

Sure. That's a great question, Ken. And I mean, I would tell you that we've had a number of different initiatives across the organization. And we've seen some of the benefits, but part of this whole supply chain alignment is to make sure that we have our focus on getting the right structure and process in place. And so, today, we're not in a position to offer you those buckets. I think from our perspective, we're starting with this supply chain organization today it was just announced. We've got to get the structure in place so that we have better alignment across the organization.

I think on one hand, we've always done a good job focusing on things from the bottom up continuous improvement, but on the other hand, I mean, it's just time for us to take a more proactive top-down approach and

we need to aggregate what those projects are, what the buckets are, what the savings are. So, it's early in the process, but we certainly have had some benefit, but our focus today is getting the structure and process in place.

Kenneth Zaslow

Analyst, BMO Capital Markets (United States)

Q

Will there be a – I mean, how long will this go on any sort of – and this will be my follow-up question, so I won't ask anymore. But to me it seems like, will this go on for three years? Is there some sort of a plan that this isn't going to reduce cost structure? And again, there's five or six different plans out there. And you guys are definitely keeping busy. I'm just trying to figure out what is the timeline and the magnitude of this. Are we talking about 100 basis points to margins, are we talking about 400 basis points margins, are we talking about over a three-year period, are we talking about over a five-year period? Just some sort of something to grasp on, would be helpful.

James P. Snee

Chairman of the Board, President & Chief Executive Officer, Hormel Foods Corp.

A

Sure. I...

Kenneth Zaslow

Analyst, BMO Capital Markets (United States)

Q

Seems like you're doing a lot.

James P. Snee

Chairman of the Board, President & Chief Executive Officer, Hormel Foods Corp.

A

Yeah. We are doing a lot. We're doing a lot of good things. I mean, this is not going to be a one hit wonder. I mean, this is going to be an ongoing multiyear approach. But the fact is, the big driver around our supply chain is it's just announced today. And so, we do have to get the structure of the process in place, because I mean we know that with a fragmented supply chain, it inherently allows for the duplications and inefficiencies I talked about earlier. So, this is going to be ongoing, it's not a one-year wonder. But again, we've got to get that organization in place up and running so that the focus can be on the process.

Kenneth Zaslow

Analyst, BMO Capital Markets (United States)

Q

And then similar for the combination of the Specialty business as well, is that also a cost savings initiative?

James N. Sheehan

Senior Vice President & Chief Financial Officer, Hormel Foods Corp.

A

Yeah. And this is Jim Sheehan. And I would say that the one thing I disagree is that there's multiple plans. So, there's really one strategy around managing our costs. We're really taking this top-down approach that Jim has talked about. So, we're setting the standards, we're setting the goals, we're setting the expectations at a very high level. So, yes, the combination of Grocery Products and Specialty is a part of the strategy that Jim laid out all the way back to Investor Day about improving our supply chain.

So, it is engaging every level of the staff, but it's being driven from the top. The other thing that I'd tell you, Ken, is that, it is in the early stages and I think you've seen some of the results already. You can look at the financial statements and see where we've taken reductions in costs out of the staff, out of the expenses. But would we get into the broader levels supply chain, how we go to market, that's when you'll start to see the bigger savings. As

Jim said, I look at this and this is not well defined, but I look at this as probably a four-year project and then it's restructuring the way that we look at things. So, there will be a savings that will go on well beyond this year.

James P. Snee

Chairman of the Board, President & Chief Executive Officer, Hormel Foods Corp.

A

And Ken, going back to your question around Grocery Products and Specialty Foods, I mean, just focus on the fact there is a lot of shared resources in those businesses, both from an operational and support perspective. They operate in similar channels. The brand or the business management is very similar. And so, again, it goes back to the alignment and utilization of resources from a cost side. And then, as I mentioned in my comments, over time, we think that there'll be some revenue synergies as well. So, it probably doesn't get you where you want to be, but I think understand it's early and this is a high priority for the organization.

Kenneth Zaslow

Analyst, BMO Capital Markets (United States)

Q

I appreciate it. Thank you, guys.

Operator: We'll go next to Robert Moskow with Credit Suisse.

Robert Moskow

Analyst, Credit Suisse

Q

Hi. I think, Ken, did his best on the savings question. But I got to say that I'm not used to seeing big announcements like this without some sort of restructuring charge and restructuring savings kind of quantification. And maybe that's just because maybe four-year timeframe, Jim and Jim, I'm just not used to that. And I'm wondering why did you consider or why did you choose to announce it this way, is it just because it's too soon and we're going to get something in a few months or is it just the nature of this is, we're going to get the process right and then we're going to get the savings as we go along?

James P. Snee

Chairman of the Board, President & Chief Executive Officer, Hormel Foods Corp.

A

Rob, I think your latter comment is spot on. I mean, for us, this goes back to our need to optimize the supply chain. I mean, if we think about what we've become over time in terms of the number of production facilities that we have, the number of items, the number of supply ingredients, the number of co-packers that we now utilize, those have all been very thoughtful additions to support our business over time. But I mean, we just need to get the organization aligned because it is somewhat fragmented today.

And so, it's exactly what you said is the focus is getting the structure and the process in place because it doesn't exist in an aligned manner today. So, in terms of major, I'll say, restructuring charges, we don't have that on the horizon. From our perspective, we believe that this is going to be about alignment and the top-down approach which is going to be a different way of thinking about this supply chain.

Robert Moskow

Analyst, Credit Suisse

Q

Okay. And I think, Jim Sheehan, you said that we should be able to see the administrative costs that came out in the quarter. Can you help us quantify exactly how much it is though because there's a lot of moving parts here including advertising down?

James N. Sheehan

Senior Vice President & Chief Financial Officer, Hormel Foods Corp.

A

Yeah. Advertising is down \$25 million. So that would be out of the \$50 million that's down in SG&A, \$25 million of that is advertising. There are other changes, but it has created a reduction in expenses already in 2017. And as Jim said, we've been really focused on getting the structure right, and it will continue to progress as we go into 2018.

James P. Snee

Chairman of the Board, President & Chief Executive Officer, Hormel Foods Corp.

A

Hey, Rob. The other thing I would remind you of is, some of those general corporate expenses. We have made investments back in our business. One of the earlier callers had a question around our digital efforts. So, I mean, we have been able to fund some strategic investments with the savings we achieved also.

Robert Moskow

Analyst, Credit Suisse

Q

But you're comparing this to 14-week period a year ago. Is SG&A kind of unrelated to the extra week or is there a relationship between those? Would SG&A be higher on a 14-week period a year ago?

James N. Sheehan

Senior Vice President & Chief Financial Officer, Hormel Foods Corp.

A

It has a minor impact.

Robert Moskow

Analyst, Credit Suisse

Q

Minor impact? Okay.

James N. Sheehan

Senior Vice President & Chief Financial Officer, Hormel Foods Corp.

A

Minor impact.

Robert Moskow

Analyst, Credit Suisse

Q

Can I ask a question about bacon specifically? You raised prices twice. It seems like the whole category raised prices, but then belly prices started falling like literally the day after you talked about it on the last earnings call. So, do you have any insight as to what the category is going to do next in response to the falling belly prices?

James P. Snee

Chairman of the Board, President & Chief Executive Officer, Hormel Foods Corp.

A

Well, I mean, it did just what you described. I mean, after we talked about it, it decreased. But as of late, we've seen some increase as we're seeing the market going back up. And so, we in Jim Sheehan's comments, we tried to give you the outlook as to what we think the belly market is going to do. But, I mean, it's been a very volatile market. There's no doubt about it. We're watching it closely. I mean, we're pulling all available levers and of course, working closely with the retailers to make sure that we've got a mutually beneficial outcome.

Robert Moskow

Analyst, Credit Suisse

Got it. All right. Thank you.

Q

James P. Snee

Chairman of the Board, President & Chief Executive Officer, Hormel Foods Corp.

Welcome.

A

Operator: And we'll go next to Jeremy Scott with Mizuho.

Jeremy Scott

Analyst, Mizuho Securities USA, Inc.

Hi. Good morning.

Q

James P. Snee

Chairman of the Board, President & Chief Executive Officer, Hormel Foods Corp.

Hi, Jeremy.

A

James N. Sheehan

Senior Vice President & Chief Financial Officer, Hormel Foods Corp.

Hi, Jeremy.

A

Jeremy Scott

Analyst, Mizuho Securities USA, Inc.

Hi. So, just to square up the last 10 minutes or so, you still have that 16% to 20% margin target by 2020. And so that would bring you to about a three-year period. And I assume that – can I kind of bucket this into the cost-led realignment of the supply chain? Number two, the organic recovery of turkey and the value-add portion of Refrigerated Foods and then third M&A, and how would you apportion each of those as you move from 14% to the bottom end of that range?

Q

James P. Snee

Chairman of the Board, President & Chief Executive Officer, Hormel Foods Corp.

Yeah. Jeremy, we think about it in perhaps a slightly different way. As we look at our business, I mean, obviously we know that we're competing in a number of advantaged areas that will allow us to continue to grow the top line. And so, we talk about our Mexican portfolio. Our foodservice business, what's happening with SKIPPY and peanut butter or SKIPPY and Justin's in the nut butters categories, our International business and, of course, what will be coming with the acquisition of Columbus, that is going to support obviously the growth, the top line, a very strong focus on innovation. I referenced in my comments, the great progress that we've made against our 15% by 2020 goal since we're now at 14%. And of course, a lot of that's driven by the great work we do with consumer and operator insights.

A

We know that we're going to continue to be good stewards of our capital, invest for growth, whether it's internal or value-added expansions for Dold and dry sausage, the accretive acquisitions that we're making. And then, as you described, I mean, some of the efficiencies that we need to continue to gain. And the supply chain structure, the supply chain reorganization is going to be a part of that journey to get us to that margin goal.

Jeremy Scott

Analyst, Mizuho Securities USA, Inc.

Q

Got it. And just a follow up on turkey and the basis of the recovery shape that you're expecting in 2018. Do beef supplies need to thin out for JOTS to truly recover?

James P. Snee

Chairman of the Board, President & Chief Executive Officer, Hormel Foods Corp.

A

We're looking this. We're looking at this right now as purely a turkey issue. This is our own industry issue, and we need to make sure that the others are following suit to get us where we need to be. But I would tell you, if we think about some of the value-added items, our lean ground turkey continues to take share from the beef category. So, I mean, we're making progress in the value-added side. It really is a supply chain commodity-driven issue.

Jeremy Scott

Analyst, Mizuho Securities USA, Inc.

Q

Got it. And just quickly, what are you expecting for full-year interest expense?

James N. Sheehan

Senior Vice President & Chief Financial Officer, Hormel Foods Corp.

A

About \$16 million.

Jeremy Scott

Analyst, Mizuho Securities USA, Inc.

Q

Got it. Thank you.

James N. Sheehan

Senior Vice President & Chief Financial Officer, Hormel Foods Corp.

A

That obviously takes into account the Columbus acquisition.

Jeremy Scott

Analyst, Mizuho Securities USA, Inc.

Q

Right. Thanks.

James P. Snee

Chairman of the Board, President & Chief Executive Officer, Hormel Foods Corp.

A

Yes.

Operator: We'll go next to Akshay Jagdale with Jefferies.

Akshay Jagdale

Analyst, Jefferies LLC

Q

Hey. Good morning. Thank you for taking the question. I wanted to ask about the CapEx. I only have my model going back to fiscal 2000 so, bear with me. But I mean, this is by far the highest CapEx rate percentage of sales, however you want to look at it. So, can you give us a little more color on what's maintenance and what the other buckets are? I mean, it's good to see companies getting more and more aggressive at the balance sheet and

allocating cash. So, maybe you can just give us some buckets and maybe talk about the broader sort of balance sheet strategy, right. That would be helpful.

James N. Sheehan

Senior Vice President & Chief Financial Officer, Hormel Foods Corp.

A

Certainly. Good morning, Akshay. This is Jim Sheehan. We've talked about the past that we're probably looking at the range of \$80 million to \$100 million of maintenance in this year, which is an unusual level. The CapEx that we're discussing includes the bacon expansion at Dold, that's a \$139 million project. It's on the early stages. So, we probably have another \$100 million left as we look at it. The Melrose plant, there's another \$100 million that we have budgeted in 2018, to finish that project; \$40 million in Austin, value-added capacities. Those projects that are focused on various other high-margin products expanding the capacity makeup about another \$85 million of it. So, is that helpful?

Akshay Jagdale

Analyst, Jefferies LLC

Q

Yeah. Super helpful. And just put it into sort of the broader context, obviously over the last several years, we've seen the company get more aggressive on M&A, which has been great, but you have kind of a good problem where you keep generating a ton of cash. And I see this as a – first time we've seen a pretty significant step up in CapEx. So, maybe you can just help us understand, should we expect this type of increase for the next couple of years?

And related to the questions about the supply chain realignment, maybe over the next couple years you're not investing in bacon and some of these plants, but maybe you need to invest some cash to generate those savings. So, just overall like what is the right rate of CapEx over the next couple of years and why now sort of a big pickup?

James N. Sheehan

Senior Vice President & Chief Financial Officer, Hormel Foods Corp.

A

I'll do my best here. The first thing that I would like to focus on is the discipline we have when we make an investment. And I think some have heard me say before that I look at investment of capital, the allocation of capital between CapEx and M&A really being determined by the best use of the capital. You're right, we've had a lot of acquisitions recently, \$1.3 billion, but we continue to have a very strong cash flow and the acquisitions are enhancing that cash flow. So, from the standpoint of concern about the cash flow, we're very confident about our cash flow.

Part of the working capital that's coming up this year to the CapEx requirement is just a matter of timing. If we would have started these projects a little bit earlier in the year, it would have been split on a more balanced basis between 2017 and 2018, but capital projects that are this large quite often have their own schedule. We do not see the \$425 million as the new run rate, but as the business increases to go back and to look at that historical spend, would probably understated to some degree as we've done additional acquisitions. That's going to increase the amount of maintenance, the amount of CapEx that's required.

Akshay Jagdale

Analyst, Jefferies LLC

Q

That's helpful. And just one on Refrigerated Foods if I may. So, I don't know if you broke this out, maybe you can remind me again what the EBIT expectation for that segment is? I know you mentioned it, but I may have missed it. The reason I'm asking is, I really would like you to maybe dissect that between what are the acquisitions

adding, in my estimate around \$70 million from the one that you've already completed including synergies and then maybe another \$25 million from the one you're about to close? But just trying to understand sort of how much of it is acquisition related just so that we get a sense for the base business excluding acquisitions, what do you need to do to get the guidance right? That's essentially what I'm trying to get at. Thank you.

James N. Sheehan

Senior Vice President & Chief Financial Officer, Hormel Foods Corp.

A

Akshay, as you think about earnings for Refrigerated Foods, we've said we're going to be low-single digits in 2018. From an acquisition perspective with the guidance that we've given in 2018, Fontanini will be \$0.03 to \$0.04. The full-year impact of Farmer John will probably be \$0.01. I mean, the headline here again for – those are important factors, but the headline still really comes down to value-added being able to offset the decrease in some of the commodity profits.

And so, where we're at with the Refrigerated Foods business is, we believe that it's never been fundamentally stronger. And what we're doing on the acquisition side only strengthens it. So that's how we're thinking about and how we've modeled and got to the low-single digit earnings for 2018.

Akshay Jagdale

Analyst, Jefferies LLC

Q

And just one last one on that. And I really appreciate you giving the incremental color on this. The commodity profits, there is a view there're some concerns that your commodity profits represented a greater percentage of the total segment earnings over the last couple of years. I know you mentioned 2017 was modestly above the long-term average that you presented at Analyst Day. But, just can you be a little bit more granular there, because there's this view that if the pork processing commodity margins go from \$30 ahead on average over the last couple years to \$10 or \$0 that there could be significant declines in your base business, right. That's what we're trying to get at. I mean, you have obviously come out and said that that's not going to – I mean, that volatility doesn't translate into your earnings, and but I'm just trying to get a better sense of that. So, if you could help on the commodity piece and what percentage of earnings that's been that would be super helpful. Thank you.

James N. Sheehan

Senior Vice President & Chief Financial Officer, Hormel Foods Corp.

A

This is Jim Sheehan again. I guess, the first thing I'd want you to focus on is our acquisitions. None of which have a commodity component to them. So, our acquisition strategy is reducing our dependents on those commodity that commodity profitability. In 2017, we talked about in Investor Day that it was about 15% of Refrigerated Foods. But the additional acquisitions will reduce that percentage, because Fontanini, which is in our plan right now and eventually Columbus will both push that percentage down. We've said that it's going to be lower, moderately lower than last year.

James P. Snee

Chairman of the Board, President & Chief Executive Officer, Hormel Foods Corp.

A

And Akshay, I would point you to Nathan. I think, you guys can have a conversation to follow-up if that's okay.

Akshay Jagdale

Analyst, Jefferies LLC

Q

Perfect. I'll follow up. Thank you.

A

James P. Snee

Chairman of the Board, President & Chief Executive Officer, Hormel Foods Corp.

Thank you.

Operator: Now we'll conclude our question-and-answer session. I would like to turn the conference back over to Jim Snee for any additional or closing remarks.

James P. Snee

Chairman of the Board, President & Chief Executive Officer, Hormel Foods Corp.

Well, I want to thank all of you for joining us today. I want to offer my sincere appreciation to all of our inspired people who make inspired food each and every day. And I know that they will continue to challenge themselves in 2018 to hit the key results that we've set for ourselves going forward. I want to wish all of you a very happy Thanksgiving.

Operator: That does conclude today's conference. We thank you for your participation. You may now disconnect.

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