23-Feb-2017

Hormel Foods Corp. (HRL)

Q1 2017 Earnings Call

CORPORATE PARTICIPANTS

Nathan P. Annis
Director-Investor Relations, Hormel Foods Corp.

James P. Snee
President, Chief Executive Officer & Director, Hormel Foods Corp.

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

OTHER PARTICIPANTS

Farha Aslam
Analyst, Stephens, Inc.

Adam Samuelson
Analyst, Goldman Sachs & Co.

Jeremy Scott
Analyst, CLSA Americas LLC

Heather Jones
Analyst, Vertical Trading Group LLC

Kenneth Bryan Zaslow
Analyst, BMO Capital Markets (United States)

Akshay Jagdale
Analyst, Jefferies LLC

Sean P. Naughton
Analyst, Piper Jaffray & Co.

Robert Moskow
Analyst, Credit Suisse Securities (USA) LLC

Rupesh Parikh
Analyst, Oppenheimer & Co., Inc.

Eric Larson
Analyst, The Buckingham Research Group, Inc.

Mario Contreras
Analyst, Deutsche Bank Securities, Inc.

MANAGEMENT DISCUSSION SECTION

Operator: Good morning, ladies and gentlemen, and thank you for standing by. Welcome to the Hormel Foods first quarter 2017 conference call. At this time, all participants are in a listen-only mode. As a reminder, this conference is being recorded Thursday, February 23, 2017.

I would 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 first 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, President and Chief Executive Officer; and Jim Sheehan, Senior Vice President and Chief Financial Officer. Jim Snee will review each segment's performance for the quarter and also provide an outlook for the remainder of the fiscal 2017. Jim Sheehan will provide detailed financial results for the quarter and further assumptions relating to our fiscal 2017 outlook.

The line will be opened for questions following Jim Sheehan's remarks. As a courtesy to the other analysts, please limit yourself to one question with one follow-up. If you have additional questions, you are welcome to get back in the queue. An audio replay of this call will be available beginning at 11:00 am Central Standard Time today, February 23, 2017. The dial-in number is 888-468-2440 and the access code is 5626388. It will also be posted to our website and archived for one year.

Before we get started with the results of the quarter, I need to reference the Safe Harbor statement. Some of the comments made today will be forward-looking, and are made under the Private Securities Litigation Reform Act of 1995. Actual results may differ materially from those expressed in or implied by the statements we will be making. Among the factors that may affect the operating results of the company are fluctuations in the costs and availability of raw materials and market conditions for finished products. Please refer to pages 31 through 35 in the company's annual stockholders report for the year ended October 30, 2016 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 divestiture of the Diamond Crystal Brands business, the divestiture of the Farmer John business, and the acquisition of Justin's specialty nut butters. 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 adjusted sales and volume.

I will now turn the call over to Jim Snee.

James P. Snee

President, Chief Executive Officer & Director, Hormel Foods Corp.

Thank you, Nathan. Good morning, everyone.

Earlier today, we announced record first quarter results of $0.44 per share, up 2% from last year. Sales for the quarter were down 1% on a 2% decrease in volume. Adjusted sales grew 3% while adjusted volume grew 5%.

For the quarter, three of our five segments reported earnings growth. Refrigerated Foods, International, and Grocery Products grew earnings, while Specialty Products earnings were flat. Jennie-O Turkey Store had a difficult quarter versus last year with earnings down 25%. Sales were up 13% and volume was up 22% compared to last year. Segment profit margins declined from over 24% in the first quarter last year to 16% this year.

As a reminder, last year, we made dramatic shifts to product mix and cut operating expenses as we managed through avian influenza and a substantial decrease in volume through our system. As we communicated during our fourth quarter call, we knew the first half of the year faced difficult earnings comparisons. However, the erosion in market conditions was deeper and faster than we expected. Three main issues affected Jennie-O Turkey Store's profitability this quarter: declining turkey prices, increased expenses and increased competition. We can handle any one of these issues during a given quarter or year, but all three factors in the same quarter created a difficult operating environment that we did not expect.

First, turkey prices such as breast meat have fallen over 60% year-over-year to seven year lows, which were much lower than we expected. Jim Sheehan will discuss our outlook for key commodities, but given the industry, now appears to be in an oversupply situation. We do not see near-term relief on commodity prices which will pressure our pricing in the marketplace.

Second, we incurred higher operating expenses primarily for bio-security measures in our live production system and lower yields in our plant operations. We will continue to make investments throughout our business, including additional investments in bio-security to protect our business from an avian influenza outbreak.

Third, as we have addressed in the past, competing proteins continue to pressure our business in addition to increased competitive pressure. We experienced this across all three sales divisions; foodservice, retail and deli.

The team at Jennie-O Turkey Store is taking the appropriate actions to address near-term operating conditions and challenges. We remain very optimistic about the demand for JENNIE-O branded products. We have improved similar turkey commodity cycles before and we always emerge in a stronger position. We will continue to support the brand, deliver innovative new items and invest in the business.

Refrigerated Foods had another strong quarter. First quarter operating profit increased 4%, with sales and volume down 3%. As previously announced, we completed the divestiture of the Farmer John business on January 3, 2017. Excluding the divesture, adjusted sales were down 1% while adjusted volume was flat. Refrigerated Foods continues to benefit from growth in both retail and foodservice value-added products.

In foodservice, innovative items such as Hormel BACON 1 fully cooked bacon and Hormel Fire Braised meats delivered solid growth. In our retail business, items such as Applegate bacon and breakfast sausage, Hormel Gatherings party trays, and Hormel Natural Choice meats delivered very nice growth. International operating profits increased 5% while sales decreased 2%.

Our fresh pork exports during the quarter were very strong. We did experience a temporary slowdown in our branded export business due to changes in import regulations in certain countries, which have since been resolved. Our SKIPPY business in China performed well while our meat business in China continues to experience high pork raw material prices.

Specialty Foods operating profit was flat while sales declined 19% and volume declined 30%. Excluding the divestiture of Diamond Crystal Brands, adjusted sales were up 10% while adjusted volume was up 12%. CytoSport posted growth this quarter, driven by our success in the food, drug, mass, and convenience channels in addition to growth in CytoSport powders. Innovative new items such as Muscle Milk bars and Muscle Milk yogurt smoothies continued to perform well.

We saw strong sales growth once again in Grocery Products. Sales were up 7% with volume up 4%. Adjusted sales grew 3% while adjusted volume grew 2%. The addition of Justin's specialty nut butters and strong sales from brands such as Wholly Guacamole, Herdez, and SKIPPY all contributed to sales and volume growth. We completed the integration of the Justin's business during the quarter, and the business is on track to meet our valuation expectations. Segment profit for Grocery Products was up 1%.

As we look to the remainder of 2017, the balanced model we have intentionally built in our business will allow us to overcome the challenges at Jennie-O Turkey Store. We expect Refrigerated Foods results to be better than we projected for the remaining three quarters. We see continued growth in many of our brands across both retail and foodservice, such as Hormel Natural Choice, Hormel Gatherings, Hormel Pepperoni, Hormel BACON 1 fully-cooked bacon, and Hormel Fire Braised meats. Grocery Products will continue to build momentum, especially in the back half of the year. We continue to see sales growth aided by product lines such as SKIPPY peanut butter, Justin's specialty nut butters, and our Mexican Foods portfolio.

Specialty Foods is expected to perform slightly better than projected for the full year. The team has done an excellent job offsetting the Diamond Crystal Brands divestiture. And as a reminder, we will lap the Diamond Crystal Brands divestiture in May.

International will perform as planned for the full year. We anticipate strong sales for SPAM luncheon meat, SKIPPY peanut butter, and CytoSport protein products in the International segment for the year. We expect the Jiaxing plant to begin producing products in the third quarter, enabling us to produce SPAM in China for the first time. We also expect relief in China pork prices in the second half of the fiscal year, which will improve the operating environment for our China meat business.

We continue to see positive demand trends for JENNIE-O branded products, but market conditions are expected to cause full-year sales to be flat to last year. Percentage declines in earnings for the second quarter will likely be similar to the first quarter, while decreases in the back half of the fiscal year are expected to be in the mid-single digits.

While it is early in the year, our assessment of the impact of turkey prices at seven-year lows creates challenges for Jennie-O Turkey Store and the total company's full-year outlook, despite expected growth in other segments. As such, we are adjusting our full-year guidance to $1.65 to $1.71 per share. We are confident in the balance we have purposely built into our business and expect strong performance from our other segments to overcome the market headwinds at Jennie-O Turkey Store.

At this time, I will turn the call over to Jim Sheehan to discuss the financial information relating to the quarter and additional key drivers for the remainder of 2017.

James N. Sheehan

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

Thank you, Jim. Good morning, everyone.

Volume for the first quarter was 1.2 billion pounds, a 2% decrease compared to last year. Sales for the first quarter were $2.3 billion, a 1% decrease. Excluding Diamond Crystal Brands, Farmer John, and Justin's, volume increased 5% and sales increased 3%.

Net earnings for the first quarter were $235.1 million, flat compared to last year. SG&A expenses on a dollar and percentage of sales basis were flat to last year. General corporate expenses were lower in the first quarter compared to last year, primarily on lower employee-related and legal expenses. We expect general corporate expenses to be lower than last year for the balance of the year.

Advertising expenses for the quarter were $52 million compared to $48 million last year. Depreciation and amortization for the quarter was $31.3 million compared to $31.8 million last year. We expect depreciation and amortization to be approximately $125 million for 2017. Equity in earnings for the quarter was $13 million, up 16% compared to last year. The increase was due to strong MegaMex results, including Herdez and Wholly Guacamole brands.

Our effective tax rate in the first quarter was 33.7% compared to 33.6% last year. For 2017, we expect our effective tax rate to be between 33% and 33.5%. Cash flow from operations was $178 million, down from $278 million, primarily due to the changes in working capital.

Capital expenditures totaled $38 million compared to $33 million last year. We expect capital expenditures to be approximately $200 million this year. Projects include completion of our plant in China, numerous capacity expansions for our value-added products, and ongoing investments for food and employee safety.

We paid our 354th consecutive quarterly dividend effective February 15 at an annual rate of $0.68 per share. We repurchased nearly 870,000 shares of common stock, spending $31 million in the first quarter. We have 12 million shares remaining from the current authorizations, and we'll continue to repurchase stock to offset dilution from stock option exercises.

Total company operating margins fell 10 basis points to 15.6% compared to last year. The Jennie-O Turkey Store segment was the primary driver for the reduction. Jennie-O Turkey Store incurred higher expenses, including increases in bio-security measures, upgrades in our facilities, and investments into consumer trends such as our raised-without-antibiotic products.

Input costs for the first quarter were mixed. Feed costs were lower compared to last year, but bird yields underperformed. The Jennie-O Turkey Store team continues to make adjustments to improve performance in live production. Barring any unforeseen weather events, we expect favorable grain prices for 2017.

Although we anticipated decreases in turkey markets, the decline, especially in breast meat, was deeper and faster than we expected. Breast meat prices are now down 60% since last year's record levels. Since October, most turkey markets are down 20%. Based on current inventory and production levels, we do not expect a material change to prices for the balance of the year.

Beef prices were lower for the quarter, which provided a benefit to many of our value-added products. However, lower beef prices are putting pressure on the ground meat category, including ground turkey. We expect slightly lower beef prices for the full year. Hog and belly prices experienced significant increases in January. Hog prices increased 17% and belly prices increased 20%, 72% pork trim prices were over 20% higher than last year. Higher trim prices and the rapid increase in belly prices created short-term margin pressures for some of our value-added products.

Belly prices are being impacted by lower cold storage levels and higher demand for bacon. We project belly prices to be significantly higher compared to last year. We expect pork trim markets to be similar to last year for the balance of the year. Based on the futures market, we expect hog prices to be slightly higher than last year.

As we assess the long-term future of the hog industry, we see three areas of focus: export demand, domestic consumption, and total U.S. harvest capacity. The majority of the new harvest capacity is reportedly coming online in late summer to early fall, representing an eventual capacity increase of about 8%. In our opinion, utilization of the additional capacity is dependent on increases in exports and domestic consumption. We will closely monitor the market dynamics as the new capacity comes online. At this time, we believe Hormel is at the right level of capacity given the current market conditions. We are well-positioned to make the necessary adjustments in our business to address changes in the pork industry.

We remain confident in our balanced model. While Jennie-O Turkey Store may struggle this year, our growth in our other segments will be able to offset the declines.

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] Our first question comes from Farha Aslam with Stephens Inc.

Farha Aslam
Analyst, Stephens, Inc. Q

Hi. Good morning.

James P. Snee
President, Chief Executive Officer & Director, Hormel Foods Corp. A

Morning, Farha.

Farha Aslam
Analyst, Stephens, Inc. Q

First question is on Jennie-O. Are you able to adjust your internal production to buy more from the outside to take advantage of some of the low prices in the open market?

James P. Snee
President, Chief Executive Officer & Director, Hormel Foods Corp. A

Farha, Jim Snee here. We do already purchase some meat on the outside, and we do have flexibility at times. But our production cycle is a relatively long production cycle. So the flexibility doesn't really allow you to capitalize on all of that opportunity. But certainly, our team is looking at that and watching those market dynamics and taking advantage of it as they can.

Farha Aslam
Analyst, Stephens, Inc.

Q

That's helpful. And then the second question is regarding M&A. I think you have a debt free balance sheet. Could you share with us what opportunities you're seeing out there? And where Hormel's focus is right now?

James P. Snee
President, Chief Executive Officer & Director, Hormel Foods Corp.

A

Sure, Farha. We're very active on the M&A front. And like most quarters, we feel good about the pipeline we have. For us, the biggest issue continues to be getting it across the finish line. That's always the most difficult part. But as we think about what we are focused on, the need to become more global, businesses or items that afford us the opportunity to become more healthy, holistic, on-the-go, multicultural are all things that are squarely in our wheelhouse. And then we also, of course, are looking for those right opportunities that will add scale or support existing businesses with the idea that we want businesses that are margin accretive, that are one or two in the categories where they compete, and we want to make sure that we're bringing more than just a check that we really can add value to the business. But I think the important thing to understand is that Fred and his team are very active. The pipeline is full, and we'll continue to work hard in that area.

Farha Aslam
Analyst, Stephens, Inc.

Q

Great, thank you.

Operator: Our next question comes from Adam Samuelson with Goldman Sachs.

Adam Samuelson
Analyst, Goldman Sachs & Co.

Q

Yes, thanks. Good morning, everyone. Maybe first continuing in Jennie-O, hoping you could dimensionalize a little bit and you did a little bit this before, but how much of the guidance reduction for the full year was really just the first quarter realized versus a weaker expectation for pricing and maybe some operational stuff in the balance of the year? And then I think you alluded, Jim, in the prepared remarks to Refrigerated, actually the guidance – the implicit guidance coming up a little bit and any way to – it was a $0.03 reduction at the total level kind of the Jennie-O decrease versus the Refrigerated increase, and how we should think about the size of the two of those?

James P. Snee
President, Chief Executive Officer & Director, Hormel Foods Corp.

A

Sure. So, Adam, as we put together our new guidance, on the JOTS side of the business, we do expect in Q2 to see similar decreases that we saw in the first quarter, and of course in half two, we're calling for mid-single digit declines for JOTS. We don't feel like we're being overly optimistic there, we are taking a realistic look at the business. We do expect stronger performance in Refrigerated Foods have very strong value-added sales, we expect that to continue. Specialty Foods group, the business and CytoSport which, of course, includes Muscle Milk, continues to perform well. So we are expecting stronger performance throughout the year. And then, Grocery Products have seen a lot of good sales momentum, we expect that to continue. International, same thing. So, we are expecting that those two business units will meet expectations. And then as we said, when we roll that all up, it's really – what we tout is our balanced business model that will offset some of those challenging market conditions for JOTS.

Adam Samuelson
Analyst, Goldman Sachs & Co.

Q

Okay, that's helpful. And then within Refrigerated, I was hoping that the pork packing environment in November and December were exceptional, frankly, and I'm just wondering. Can you talk about the contribution of that to the Refrigerated and I guess the International business a little bit on the export side versus maybe some of the pressures you felt on the belly inflation that you saw in January and how those dynamics impacted the quarter?

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

A

So, Adam, this is Jim Sheehan. You're right. We did have good market conditions more in the early part of the quarter, for us November, December. What we saw in January was that there was a freezer report that showed that there were some low levels of inventory, especially in the belly areas. And you saw some drastic increases in belly prices, trim prices were up and hogs were up, hogs were up, I think, 17%, bellies were up 20% in that one month alone. So that created some pricing pressure – short term pricing pressure but as those prices increase so quickly, it's hard to keep up with the pricing. There is generally about a 30-day delay before we can reset our prices and with that type of an increase, it put pressure in Refrigerated Foods.

Adam Samuelson
Analyst, Goldman Sachs & Co.

Q

Okay. And if I can just squeeze one final quick one. In Grocery, Justin's, it seems like there was only $13 million of sales in the quarter, I think the guidance for the year was $100 million. Can you just talk about what was going on there?

James P. Snee
President, Chief Executive Officer & Director, Hormel Foods Corp.

A

Yeah. Adam, we did – that your number is right and for us what it is the seasonality in the business. And we learned through the rollout – our innovative SKIPPY PB bites items, that once you get past Halloween, there are some seasonality, downturn in the confectionary business. So, it wasn't totally unexpected. But we are on track for the $100 million and the $0.01 EPS accretion this year. So feel really good. I think at its core, the volume for Justin's year-over-year was up 20%. So the business is doing quite well.

Adam Samuelson
Analyst, Goldman Sachs & Co.

Q

That's helpful. Thank you.

James P. Snee
President, Chief Executive Officer & Director, Hormel Foods Corp.

A

Yes.

Operator: Our next question comes from Jeremy Scott with CLSA.

Jeremy Scott
Analyst, CLSA Americas LLC

Q

Hey, thanks. Good morning. And thank you for the new disclosures in the press release. It's very, very helpful to break that out. I think in the past, you've talked about how ground beef wouldn't be a major challenge to turkey demand as it came back online. Are your views changing on this? Have consumers reacted to the drop in retail beef prices more actively than you previously thought?

James P. Snee
President, Chief Executive Officer & Director, Hormel Foods Corp.

A

Good morning, Jeremy. Jim Snee. I don't know if we've ever said that ground beef wouldn't be a major challenge. They obviously have a very strong position. Our position has been that we've seen growth in ground turkey because it continues to be on trend for consumers. And we expect over time that we are going to see growth in the share. We're going to see growth in the category. Obviously, in any given quarter or any given year you run the risk of the supply cycle, and I think that's what's happened here. Obviously, from a pricing perspective, we've seen some discounts.

The one thing that I would point out is that our tray pack volume was still very strong for the quarter. The tray pack volume was up 15%. And so that tells us that the product is on trend with consumers. But ground beef is certainly going to be a challenge for us as we continue, but we feel like we've got the right product connecting with the right consumers.

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

A

Jeremy, this is Jim Sheehan. One of the things that I'd remind you is with our balanced model, the lower beef prices are providing lower input costs for both Refrigerated Foods and Grocery Products, as beef is a major input for both of those segments. So there's a bit of an offset of the challenge in the turkey business.

Jeremy Scott
Analyst, CLSA Americas LLC

Q

Okay. Just on that point, I think we saw the ramp up in futures, and to a certain extent has continued, for beef that is, throughout the first couple months of 2017. But it almost seems like we're starting to reverse that and turkey is getting more futures support. So are these new numbers just a conservative outlook on 2017? Can we see upside to what you're currently posting at 15% – 16% margins?

James P. Snee
President, Chief Executive Officer & Director, Hormel Foods Corp.

A

As we looked at the rollup, Jeremy, we really feel like we've done a deep assessment of the business, and this is a realistic outlook for the business. We've got some good strong sales growth even in the first quarter in retail, foodservice, deli. But the fact is there is competition out there, and we understand that. We understand the market dynamics. And so we feel like this guidance is a very realistic look, not only at JOTS, but all of the business segments.

Jeremy Scott
Analyst, CLSA Americas LLC

Q

Okay. And if I could just squeeze in one last one, we're hearing that some of the plants coming online are having difficulty finding labor, an issue that seems to be pervasive throughout the industry. Can you address that? Can we expect capacity to maybe be a little bit slower than originally thought in terms of the ramp?

James P. Snee
President, Chief Executive Officer & Director, Hormel Foods Corp.

A

That's a hard one, Jeremy. And we've talked about that a lot in terms of when we've been asked the question about what does it mean to you, one of the things we have responded with is tell us when. And so once we know when this is all going to happen, we'll be able to give you a better answer. And I think labor certainly is one of the variables that comes into the mix. From our perspective, clearly, we've got a great long-term workforce in many of our facilities, so we're well positioned. And so we will be watching the timing of these plants coming online very closely and trying to better understand what that means.

Jeremy Scott
Analyst, CLSA Americas LLC

Q

Okay, thank you very much.

James P. Snee
President, Chief Executive Officer & Director, Hormel Foods Corp.

A

Yes.

Operator: Our next question comes from Heather Jones with Vertical Group.

Heather Jones
Analyst, Vertical Trading Group LLC

Q

Good morning. I was wondering if you could give us some color on Refrigerated Foods, specifically with regards to Q2. You said your outlook for the rest of the year was incrementally more bullish than previously. But for Q2, the comparisons are difficult on the fresh pork margin side, and the belly prices have been high. And so I was wondering if you could give us some color on how quickly you're able to pass through those higher belly prices with your bacon pricing, and if you could just give us some sense of the cadence as far as year-on-year for the rest of the year for Refrigerated.

James P. Snee
President, Chief Executive Officer & Director, Hormel Foods Corp.

A

Sure, Heather. This is Jim Snee. From our perspective, as Jim Sheehan described earlier, we did see a spike in belly prices, and we took appropriate pricing action. It's going to take a little while to work through the system, but we feel really good about our ability to continue to take pricing in that category. We've also seen some competitive pricing action in that category as well, which bodes well, we believe, for our future, especially in bacon.

In Refrigerated Foods also, let's not forget about our strong foodservice business. They had another great quarter in the first quarter, and there's no signs of that business slowing down. So we feel really good about that. And so the second quarter should be a good quarter for Refrigerated Foods, and that's what's leading us to say we do expect it to be a stronger performance for the full year.

Heather Jones
Analyst, Vertical Trading Group LLC

Q

Okay. So we should expect Q2 Refrigerated to be up year on year despite the margins we're seeing on the packer side?

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

A

This is Jim Sheehan, Heather. Again, we're less concerned about the packer margins. We're more concerned about our input costs. So we do expect belly prices to be higher. Trim we think will be similar to last year, so we think it's going to decline a little bit. And hogs, we believe, will still remain a bit high.

Heather Jones
Analyst, Vertical Trading Group LLC

Q

Okay, thank you.

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

A

So we have those input pressures, but we're confident about Refrigerated Foods.

Heather Jones
Analyst, Vertical Trading Group LLC

Q

Okay, thanks. And on the Jennie-O side, could you give us a sense of where you're seeing the most – you mentioned breast meat prices being down roughly 60% year on year, and you mentioned there's pricing pressure in all the channels, but is there any specific channel that's seeing the most price pressure?

James P. Snee
President, Chief Executive Officer & Director, Hormel Foods Corp.

A

Heather, I would say it's pretty consistent across retail, foodservice, and deli.

Heather Jones
Analyst, Vertical Trading Group LLC

Q

Okay, thank you.

Operator: Our next question comes from Ken Zaslow with Bank of Montreal.

Kenneth Bryan Zaslow
Analyst, BMO Capital Markets (United States)

Q

Hey. Good morning, everyone.

James P. Snee
President, Chief Executive Officer & Director, Hormel Foods Corp.

A

Good morning, Ken.

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

A

Good morning.

Kenneth Bryan Zaslow
Analyst, BMO Capital Markets (United States)

Q

So when I think about the $0.03 guidance reduction, how does this change your earnings power in 2018 and 2019?

James P. Snee
President, Chief Executive Officer & Director, Hormel Foods Corp.

A

Ken, it's early. First thing, obviously, is we're looking out the balance of the year driven by JOTS. As we get throughout the year, we'll be able to take a closer look at that, but it is early for us to be looking out into 2018 and 2019.

Kenneth Bryan Zaslow
Analyst, BMO Capital Markets (United States)

Q

Let me rephrase this a little differently. I'm not looking for guidance. I'm saying, does this change your ability to deliver the 5% and 10% and your margin expansion opportunities in 2018, 2019, and 2020 going out? How much does this structurally change how you think about your business going forward?

James P. Snee
President, Chief Executive Officer & Director, Hormel Foods Corp.

A

Okay, thanks for the clarification, Ken. I don't think that it structurally changes our business going forward. We're obviously in a market cycle. That cycle will correct. And when we think about JOTS in particular, from our perspective, we know that there's history here. History has been on our side. We've seen this in 2003 and in the 2008, 2009 timeframe. In each case, we've emerged stronger. We know that it's important for us to stay disciplined. And JOTS, as you know, it's a key part of our balanced model and a key part of our business. So in terms of structural change, we don't see it, we just have to get through this cycle and we will.

Kenneth Bryan Zaslow
Analyst, BMO Capital Markets (United States)

Q

Okay. And my next follow-up question to this is, on Refrigerated Foods, you indicated that it's going to be better than expected this year. Again, pork pack margins coming down, belly is higher. Help us understand how your business actually functions because I think those indicators would suggest otherwise, and yet you're saying it's stronger. So, help us understand how this business can actually operate in a subsiding pork packer margin environment.

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

A

This is Jim Sheehan, Ken. Our Refrigerated Foods segment is the hardest segment to model. And it's difficult to model because of the focus on not only providing raw materials for our own – their own products in Refrigerated Foods, but it provides products to other businesses, especially International and Grocery Products. For instance, this quarter, fresh pork was actually transferred to International because International margins were greater than the margins that could be attained in fresh pork. So that – what you're referring to is the packer margin, you're really seeing some of that benefit in International and not in Refrigerated Foods.

We had a strong quarter for the value-added products within the division. We're focused on what our input costs are, and I think we've given you some ideas to what input costs are going to be. There will be some commodity benefit. But in general, we think that spread will be offset by higher belly and trim prices. So again, focus on what's happening with the hog markets; what's happening with belly and trim prices.

Kenneth Bryan Zaslow
Analyst, BMO Capital Markets (United States)

Q

Great. I appreciate it.

Operator: Our next question comes from Akshay Jagdale with Jefferies.

Akshay Jagdale
Analyst, Jefferies LLC

Q

Good morning. So I wanted to just get a little bit more clarification on the turkey shortfall. It looks like – and your disclosure, again, we really appreciate the extra disclosure. But it looks like profits are going to be off for the year by close to $100 million. But I'm trying to break that down into its components, right? So you said there is competitive pressure, and it looks like competitive pressure can be broken into two things, which is competing needs, and I'm not sure if there are any competing brands that are causing any pressure. But it looks like it's all competing needs. So, can you break down sort of the pressure into buckets, whether it's competing needs and lower turkey prices versus higher costs that are in your control? Like maybe just give us some sense of order of magnitude of those three.

James P. Snee
President, Chief Executive Officer & Director, Hormel Foods Corp.

A

Sure, Akshay. Jim Snee. So the first part around competition and competitive pressure, I mean, we are seeing it in the markets, or in the meats, as you say, and we are also seeing it from competitors. We're not the only company that was coming back out of AI looking to regain distribution and regain business. So there is an element of market pressure and competitive set pressure. So we are seeing that on both sides. And then when we think about the next piece when you talk about expenses, Jim Sheehan referenced some of the bird performance on the live production side and we know that those are cycles and our team, again, coming out of AI is already working on addressing that in the live production side of the business.

So competition does have both parts. The expenses with bird performance. The other thing that we mentioned, which is going to be a very good thing for us over the long-term is our venture into raised without antibiotics. And right now, obviously, we're making investments in that business. We know that it's the right thing to do. And that includes feed, supply chain densities. There's a lot of things too that go into that. And then the last thing, Akshay, and I want to make this part just clear on your opening comment. We are not projecting $100 million decline year-on-year for Jennie-O Turkey Store.

Akshay Jagdale
Analyst, Jefferies LLC

Q

Yes.

James P. Snee
President, Chief Executive Officer & Director, Hormel Foods Corp.

A

We would expect it to be less than that, more – maybe half of that.

Akshay Jagdale
Analyst, Jefferies LLC

Q

Yes. I meant relative to what your expectations were. So, yeah. I mean your guidance basically points to a $50 million decline, but relative to what you maybe were expecting before the delta might be that much. But that was helpful. So just want to delve into those issues a little bit more. So when you look at your projections now going forward, have you taken into account, there was – so I'm at CAGNY, there was a very large competitor in chicken that's getting into the ground poultry business, if I may. Is that included in your guidance? Do you think that's going to have a major impact this year?

James P. Snee
President, Chief Executive Officer & Director, Hormel Foods Corp.

A

Akshay, we saw that release earlier this week as well. Obviously, chicken has been in that space for a long time. And so it's too early to tell. We haven't seen the product, haven't really heard what the consumers think, haven't heard what retailers think. So it's really too early to tell on that specific product line. But clearly we'll be watching it closely.

Akshay Jagdale
Analyst, Jefferies LLC

Q

Okay. Just last one. Prior to this quarter you were guiding to – Refrigerated EBIT growth to be flat for the year. Obviously, now you are saying it's better. Can you give us an order of magnitude how much better? I mean it looks like Refrigerated Food projection being better is the major offset to JOTS being lower. So, it looks like there's a significant positive change in your Refrigerated Food operating margin assumption. But can you just give us some order of magnitude what you expect EBIT growth in Refrigerated Foods for this fiscal year? Thank you.

James P. Snee
President, Chief Executive Officer & Director, Hormel Foods Corp.

A

Thanks, Akshay. Really we've got stronger performance for the balance of the year in both Refrigerated and Specialty Foods. On the Refrigerated side, the big driver there is going to be continued strong value-added sales both on the retail side of the business and continued strong performance from our foodservice team. And then on the Specialty Foods side, like we said, the CytoSport business continues to do well gaining distribution, but also some great, new innovative items that are really starting to take hold in the marketplace. So between those two things, that's really what's going to offset some of the difficult market conditions for JOTS.

Akshay Jagdale
Analyst, Jefferies LLC

Q

Thank you.

Operator: Our next question comes from Sean Naughton with Piper Jaffray.

Sean P. Naughton
Analyst, Piper Jaffray & Co.

Q

Good morning. Thanks for taking the questions. On the Grocery Products side, is it fair to say and I think you broke this out in the release, I'm just trying to clarify that the category was up about it 3.1% on the top-line? And then I guess as a follow-up there, we didn't really see a lot of operating profit growth in that category but we did see a little bit of advertising jump in Q1. Is it fair to say that we expect to harvest some of those advertising investments as we get through the remainder of the year?

James P. Snee
President, Chief Executive Officer & Director, Hormel Foods Corp.

A

Yes, Sean. Jim Snee. That's a fair statement. Really in terms of expenses, obviously, advertising was up on the quarter. There, as you would expect, were expenses associated with the Justin's integration that are one-time expenses. So certainly advertising will play a benefit for the rest of the year. We won't have the ongoing integration charges, but the bigger driver in all of this is really the sales momentum for Grocery Products. And so SKIPPY continues to do really well. Our MegaMex portfolio of products is doing well. And then we do see some favorable market conditions that will help them out and then again the full year benefit of Justin's. So that's really what's driving our outlook for Grocery Products.

Sean P. Naughton
Analyst, Piper Jaffray & Co.

Q

Okay, that's great. And then, I guess, a follow-up would be just on the Refrigerated Foods segment. And there's been a lot of discussion about different commodities that are happening out there. But is there anything that you can talk about just in terms of structural changes that have been made in this segment? And I'm thinking specifically about the mix of sales and value-added versus commodity within that segment which may limit some of the downside pressure that you may have experienced 5 years to 10 years ago. Just any sort of delta in the value-add there.

James P. Snee
President, Chief Executive Officer & Director, Hormel Foods Corp.

A

I think, Sean, we've talked a lot about the continued growth, the migration up the value ladder, if you will, in our Refrigerated Foods segment, and it occurs not just in packaged items. We're doing it across the entire Refrigerated Foods organization, in fresh pork, in meat products. It's happening everywhere. And so we'll continue to work on that, and we've been very successful.

The other part to really consider is the, once again, strong growth of our foodservice business. That's a business that continue to deliver quite well for our organization. We don't expect that to slow down. And then a lot of the innovation work that we are doing in on-the-go with our party trays and some of our other items that we've developed. So is it a structural difference? It certainly is a structural shift, and we will continue to be working on that so that we do eliminate volatility over the long-term.

Sean P. Naughton
Analyst, Piper Jaffray & Co.

Q

Okay, thank you.

Operator: Our next question comes from Robert Moskow with Credit Suisse.

Robert Moskow
Analyst, Credit Suisse Securities (USA) LLC

Q

Hi. I think most of the questions have been asked here. But two things. Just a follow-up to Ken Zaslow's question about your long-term margin aspirations. I think we need to hear it from you, Jim. Are you adhering to that long-term goal of being in your top quartile of your peer group and the range being 15% to 19%? Can you stick with that?

And then the second thing, just more a technical thing. I think you said tray pack sales up 15% in Jennie-O. Is that a true consumer demand number, or does that also reflect just being on shelf more with an easy comparison to the AI from last year?

James P. Snee
President, Chief Executive Officer & Director, Hormel Foods Corp.

A

Sure. Thanks, Rob. So to your first question, the answer is yes. We are committed to that long-term margin guidance, and clearly the impact of Jennie-O on just this one quarter moved us back a little bit. But we do believe that this business is going to rebound and will emerge stronger and it's going to be a key part of that journey in the margin improvement. So the answer is yes. We are committed to that.

And to your second question, certainly there are elements of both, right? I think we are still probably gaining back some distribution, but you're gaining back distribution because there's consumer demand. And so again, the underlying fundamental there is we feel really good about the business, it's connecting with consumers and it's on trend, and we expect to continue to do that.

Robert Moskow
Analyst, Credit Suisse Securities (USA) LLC

Q

Okay, thank you.

James P. Snee
President, Chief Executive Officer & Director, Hormel Foods Corp.

A

Thanks, Rob.

Operator: Our next question comes from Rupesh Parikh with Oppenheimer.

Rupesh Parikh
Analyst, Oppenheimer & Co., Inc.

Q

Good morning and thanks for taking my questions. So I had two questions just related to your recent acquisitions. So first on Justin's, do you still believe you can achieve the $100 million sales target for this fiscal year? And then on Applegate, I was just curious how that's performing versus expectations. And as you look at the environment, clearly seeing deflation in more of the conventional offering, just wondering if that's at all challenging the Applegate offering.

James P. Snee
President, Chief Executive Officer & Director, Hormel Foods Corp.

A

Sure, Rupesh. Good morning, Jim Snee. Yeah, just following up on the earlier question around Justin's, the $13 million in the first quarter does account for some seasonality in the business in the whole confectionary space. But we do want to point out that the volume is up 20% year over year. And so we do believe that we're on track for $100 million for the full year and still remain very positive about that acquisition and that business going forward.

And as you get to the Applegate business, our team there continues to work through the rebound of the supply situation, both on the pork side, and then that was compounded with turkey supply shortages through AI. And as you think of that business in specific parts of the store, the walled deli space is extremely competitive. The team's making progress there, but that's been a battle. Really a lot of continued success in the meat case and the freezer. Hot dogs, dinner sausage, the nuggets, the chicken breakfast sausage, those items are doing well. And we're working now on developing business in the foodservice channel as well. So we think that that business is very healthy and going to continue to do well.

Rupesh Parikh
Analyst, Oppenheimer & Co., Inc.

Q

Thank you.

Operator: Our next question comes from Eric Larson with Buckingham Research Group.

Eric Larson
Analyst, The Buckingham Research Group, Inc.
Q

Good morning, everyone. Thanks for getting me worked into the Q&A. Really a follow-up on the grocery sector, Jim and Jim. When you look at certain commodities, obviously you've had some cost inflation with avocados. You've got trim costs. Is that leading to some higher pricing in your guacamole and maybe even your SPAM division? I think guacamole prices have actually gone up a little bit.

And then can you just talk about – your revenue growth is really strong there and I would think that that would be more of a positive mix, with SKIPPY growing, et cetera. So obviously with one-time expenses in the quarter, it held back your margins and your profits this quarter. But isn't there also a positive mix shift going on here as well for grocery which would be beneficial to margins as you move forward?

James P. Snee
President, Chief Executive Officer & Director, Hormel Foods Corp.
A

Sure. Eric, good morning, Jim Snee. Thanks for those questions. I'll try to break those down here. So the first one around avocados – and you are correct. We have taken pricing increases on Wholly Guacamole. And those prices have been in the marketplace a little while now, but consumer demand remains strong for the products. In terms of the avocado market, there are a couple of things. Prices are historically high, but they are down from some of their October peaks.

The other thing to understand is that there is adequate supply. And so we have a number of – or a lot of the supply that comes out of Mexico, but we have other sources for supply as well. So there's adequate supply in that space. And we again feel really good about the business going forward.

From a Grocery Products perspective, our guidance is consistent with what we laid out in the fourth quarter call. And so the business is very healthy, a lot of sales momentum. And you're right, once you get through some of these one-time expenses, we'll be able to deliver the guidance we laid out. And yeah, there is a mix shift [indiscernible] (53:56), a mix shift as we think about the Justin's and SKIPPY and all of those product lines that really continue to build a nice broad base in the Grocery Products portfolio. So we feel really good about what Grocery Products is doing and where they're headed.

Eric Larson
Analyst, The Buckingham Research Group, Inc.
Q

Okay, thank you, Jim.

James P. Snee
President, Chief Executive Officer & Director, Hormel Foods Corp.
A

Thanks, Eric.

Operator: Our next question comes from Mario Contreras with Deutsche Bank.

Mario Contreras
Analyst, Deutsche Bank Securities, Inc.

Q

Hi, good morning.

James P. Snee
President, Chief Executive Officer & Director, Hormel Foods Corp.

A

Hi, Mario.

Mario Contreras
Analyst, Deutsche Bank Securities, Inc.

Q

I just wanted to follow up on the 5% sales growth target that had been laid out in the previous quarter, 5% excluding M&A. I didn't really hear much mention of that today. So my first question would be, is that intact? And then if it is, what's going to allow you to get to that? It would require some amount of acceleration over the upcoming quarters here. You're not going to have the benefit of the turkey supply normalization. That will have already been lapped at some point this year. So is there any additional detail you can provide on that? Thank you.

James P. Snee
President, Chief Executive Officer & Director, Hormel Foods Corp.

A

I think we're on track for the 5% organic growth number. As you go around all of the different business segments, Refrigerated Foods, the strong value-added sales will continue to deliver there. JOTS will be slightly lower. We are going to see some volume growth, but obviously we understand the market conditions. Specialty Foods will continue to perform well. And then International, Grocery Products are all on track for what we said they were going to do. So we do believe, Mario, that we're going to be able to deliver that 5% organic number.

Mario Contreras
Analyst, Deutsche Bank Securities, Inc.

Q

Okay. And I guess, is there any specific segment that is going to contribute more than what we've seen so far? Or is it going to be fairly evenly balanced?

James P. Snee
President, Chief Executive Officer & Director, Hormel Foods Corp.

A

I mean, I think, we've said our stronger performance will come from Refrigerated and Specialty, but there's some really nice sales momentum in Grocery Products, and we don't expect that to slow down.

Mario Contreras
Analyst, Deutsche Bank Securities, Inc.

Q

Okay, thank you very much. That's all for me.

James P. Snee
President, Chief Executive Officer & Director, Hormel Foods Corp.

A

Thanks, Mario.

Operator: Our next question comes from Jeremy Scott with CLSA.

Jeremy Scott
Analyst, CLSA Americas LLC

Q

Hey. Thanks for the follow-up. Just on that point, your organic growth in Specialty has been very, very strong and it's a little bit different than what we are tracking. So, if you can just point to that, what's your – I know you're just kind of bottling up all the different segments to get to your 5% number but could you give some indication on what Specialty Foods organic volume growth could be this year?

James P. Snee
President, Chief Executive Officer & Director, Hormel Foods Corp.

A

Specialty Foods, you've got to remember that that's still a mix of CytoSport, HHL and our Specialty Products group. And so when we talk about that business, we are talking across all those different categories that are performing well. So I think we expect that business to continue to be strong, and even within that segment there's a bit of a balance that goes on at any given time. We've seen some nice growth with CytoSport in some more traditional channels. Remember, the C-store business, which is a big part of the CytoSport business, isn't measured. And the team's done a great job not only gaining distribution but creating innovative new items to meet the needs of that channel. So it's all of those things that are really setting it up for a strong 2017.

Jeremy Scott
Analyst, CLSA Americas LLC

Q

Okay, thank you.

Operator: Our next question comes from Heather Jones with Vertical Group.

Heather Jones
Analyst, Vertical Trading Group LLC

Q

Thanks for taking the follow-up. I just had a quick question on exports. Historically, Hormel has not been a big exporter on the pork side, but you guys mentioned that this quarter they were strong. I was wondering, the Chinese pork market continues to be strong but it has cooled some. So, should we expect that strong export volume to continue for the rest of the year? Or how should we think about that?

James P. Snee
President, Chief Executive Officer & Director, Hormel Foods Corp.

A

Heather, just a reminder, fresh pork exports are – they are a decent-sized part of the International business. They're not, I would say, a huge part of the overall company. And on any given year, obviously, we've had strength and then we've had some challenges with pricing pressure with products coming out of the European markets the last several years. But it does look like the markets are setting up for a strong full year. Certainly, you've got the China conditions, but I think we've also all read what's happened, or what is happening in South Korea, which is a strong export market for us. So I mean we do feel like it'll continue to be strong throughout the year.

Heather Jones
Analyst, Vertical Trading Group LLC

Q

But am I correct in thinking and maybe I misunderstood this because the industry as a whole, it's roughly a quarter of the volume goes to export. I had thought that Hormel's – their exposure was less than that, but are you all in line with the industry?

James P. Snee
President, Chief Executive Officer & Director, Hormel Foods Corp.

A

No, we're less than that, Heather.

Heather Jones
Analyst, Vertical Trading Group LLC

Q

Okay, thank you.

Operator: And we have one final question from Akshay Jagdale with Jefferies.

Akshay Jagdale
Analyst, Jefferies LLC

Q

Hey. Thanks for the follow-up. Just on turkey, can you just help me understand the dynamics of lower commodity prices on your portfolio, because 80% or so is value-added, so lower commodity needs should be good for a majority of your business? So I'm just a little bit – I'm trying to understand why that is causing such a big impact negatively on your margins. Thank you.

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

A

Akshay, this is Jim Sheehan. And really what's happening with that lower commodity prices are the pricing pressure that it's putting on to the sales price. So that's really where we're feeling the impact.

Akshay Jagdale
Analyst, Jefferies LLC

Q

Right. But on to – because you are value-added, typically you would be able to have a better margin, right? Your inputs, when you are doing value-added, are down so your end price shouldn't be coming down as much, right, typically. So I guess...

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

A

I think to understand what occurred in the first quarter, one of the things that you shouldn't lose sight on is the bird performance, because the birds that we raise, we've talked about that we had some additional costs in those flocks. The flocks that we raised cost more and then they provided less meat than they typically will provide, and especially less breast meat. So the cost of raising the birds was the same price. Yes, there is some advantage in the commodity prices for breast meat that we're buying on the outside, but it's really the pricing pressure.

Akshay Jagdale
Analyst, Jefferies LLC

Q

Got it. That's super helpful. Thank you.

Operator: And there are no additional questions at this time, gentlemen.

James P. Snee
President, Chief Executive Officer & Director, Hormel Foods Corp.

Great. Well, thank you all very much. While unfavorable market conditions in the turkey industry challenged our Jennie-O Turkey Store business, the balance we have intentionally built into all of our businesses allowed us to deliver earnings growth this quarter. Our team has a track record of delivering results, and we clearly understand what needs to be done this year to deliver the guidance range we provided. On behalf of the team here at Hormel Foods, thank you for joining us today.

Operator: This concludes today's conference. Thank you for your participation. You may now disconnect.