

22-Nov-2016

# Hormel Foods Corp. (HRL)

Q4 2016 Earnings Call

## CORPORATE PARTICIPANTS

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James N. Sheehan

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

James P. Snee

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## OTHER PARTICIPANTS

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## MANAGEMENT DISCUSSION SECTION

**Operator:** Good morning, ladies and gentlemen, and thank you for standing by. Welcome to the Hormel Foods Fourth Quarter Earnings Conference Call. At this time, all participants are in a listen-only mode. As a reminder, this conference is being recorded, Tuesday, November 22, 2016. I would now like to turn the conference over to Nathan Annis, Director of Investor Relations. Please go ahead.

Nathan P. Annis

*Director-Investor Relations, Hormel Foods Corp.*

Good morning. Welcome to the Hormel Foods conference call for the fourth quarter of fiscal 2016. 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](http://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 fourth quarter and also provide outlook and guidance for 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're welcome to get back in the queue.

An audio replay of this call will be available beginning at 11:30 AM Central Standard Time today, November 22, 2016. The dial-in number is 877-627-6590, and the access code is 5999118. 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 cost and availability of raw materials and market conditions for finished products. Please refer to pages 33 through 40 in the company's Form 10-Q for the quarter ended July 24, 2016, for more details. It can be accessed on the website.

Additionally, please note the company used non-GAAP results for fiscal 2015 to provide investors with a better understanding of the company's operating performance by excluding the impact of certain non-recurring items affecting comparability. Discussion on non-GAAP information is detailed in our press release located on our corporate website. During our call today, comparisons to the fourth quarter and full year of fiscal 2015 will be made to these non-GAAP results.

I will now turn the call over to Jim Snee.

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## James P. Snee

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

Well, thank you, Nathan. Good morning, everyone. Earlier today, we announced record fourth quarter results of \$0.45 per share, up 22% from last year. Sales for the quarter were up 9% on a 9% increase in volume. For the full year, earnings per share were \$1.64, up 24% versus fiscal 2015. Sales were \$9.5 billion, up 3% and volume was up 2%.

For the quarter, three of our five segments reported volume sales and earnings growth, demonstrating the strength of our balanced business model. Refrigerated Foods and Jennie-O Turkey Store posted excellent earnings, both up double digits. Grocery Products recorded solid gains, while Specialty and International earnings were down for the quarter.

I am particularly pleased with our top line results, with four of our segments generating sales growth. Refrigerated Foods fourth quarter operating profit increased 51%, with sales up 8% and volume up 9%. Refrigerated Foods benefited from excellent growth in both retail and foodservice channels and from lower input costs, notably hogs and bellies.

In foodservice, items like Hormel BACON 1 fully cooked bacon and Hormel Fire Braised meats delivered solid growth, while our retail business was led by items such as Applegate deli meats, Hormel Natural Choice, and Hormel Gatherings party trays.

Jennie-O Turkey Store fourth quarter segment profit increased 26%, with sales increasing 29%. Volume was up 32%. As a reminder, last year's results were negatively impacted by avian influenza. Higher bird weights and low grain prices were a benefit for the quarter. Our Jennie-O Turkey Store foodservice business performed well, with growth coming from many areas such as our Jennie-O raw boneless breast and sliced breast meat categories.

We also experienced sales growth in our retail and deli businesses. We were back on air with the Jennie-O Make The Switch campaign through October and have seen a positive response once again from our consumers. We

saw a strong sales growth in Grocery Products, up 16% and segment profit was up 5%. Our legacy portfolio performed nicely with organic sales up 10%, including gains from many brands such as SPAM luncheon meat, SKIPPY peanut butter, Hormel Compleats and Herdez salsa.

In addition, Justin's specialty nut butters contributed approximately \$25 million in sales to the quarter and is well on track to meet our valuation pro forma and the \$100 million fiscal 2017 sales we guided to when we announced the acquisition.

International sales increased 2% while operating profit decreased 16%. While we are encouraged by the results from our SKIPPY business in China, our meat business continues to be pressured by high input cost. Exports of fresh pork improved as U.S. exports became more competitive due to lower hog prices.

Specialty Foods, excluding Diamond Crystal Brands, grew sales 6% and volumes 11%. CytoSport posted excellent sales growth as they continue to introduce new innovative items in both ready-to-drink and powder formats. The CytoSport team also launched new Muscle Milk bars featuring 12 different flavors. Acceptance by our retail partners has been favorable. The decline in segment profit is attributed to increased advertising on a year-over-year basis for the Muscle Milk brand.

Innovation has been a foundation of our company's success over the last 125 years, which is why we recently announced a new innovation challenge for the year 2020, to have 15% of our total sales come from new products introduced in the previous five years. We finished 2016 with approximately 12% of sales from new products launched in the fiscal years 2011 to 2015. This is a stretch goal for our organization and we expect to make substantial progress next year aided by recently introduced products as well as those in the pipeline.

Looking to fiscal 2017, we have positive momentum in each segment, employees all working towards the same goals and numerous initiatives in each of our strategic growth pillars of global, multi-cultural, healthy and holistic and on-the-go.

Grocery Products is expected to show growth in excess of their long-term growth goals of 3% top line and 6% bottom line. Growth is expected to come from the positive momentum we have in SKIPPY peanut butter products, Herdez salsas and Wholly Guacamole dips in addition to Justin's. We will continue to invest in our key brands in 2017.

Yesterday, we announced the divestiture of the Farmer John, Saag's and PFFJ farms businesses. While the business has performed well, they no longer met our strategic goals. Additionally, the divestiture allows for the integration of the pork processing facility at Farmer John with the majority of live production operations, which supply the facility and are currently owned by Smithfield. This divestiture is in the best interest of our shareholders, and we continue to seek opportunities to utilize our cash towards investments aligned to our growth goals.

We are expecting decreased sales in Refrigerated Foods, as increased sales of value-added products will be offset by the divestiture of Farmer John, which represents approximately \$500 million. We see continued growth coming from brands, such as Hormel Natural Choice, Hormel Gatherings, Hormel Pepperoni and Applegate in addition to foodservice sales growth from Hormel BACON 1 fully-cooked bacon, Hormel Fire Braised meats and Hormel pizza toppings.

Due to the earnings per share dilution of approximately \$0.03, Refrigerated Foods earnings are expected to be flat. Jim Sheehan will provide more color on the hog and pork environment in fiscal 2017.

We expect strong sales and earnings growth for the full year as the Jennie-O brand continues to resonate with retail, deli and food service customers and consumers. Results will be weighted to the back half of the year as the first half faces more difficult comparisons.

We intend to continue our advertising investments through the Make The Switch campaign to highlight the versatility of turkey in many of our consumers' favorite recipes. We expect our International segment to deliver strong profitable growth.

In addition to improving results in China, we anticipate stronger exports for SPAM luncheon meat, SKIPPY peanut butter and the CytoSport protein products. Our International team is eager to get our Jiaying plant up and running in the first half of the year, so they can leverage new production capabilities to grow our retail and foodservice businesses.

Specialty Foods results will likely show year-over-year declines in the first half due to the divestiture of Diamond Crystal Brands, but we expect organic sales and earnings increases in the back half as we anniversary the divestiture.

The Muscle Milk brand has been performing well in both the protein beverage and powder categories, and we expect those results to continue. I am also very excited about our new Muscle Milk smoothies and many new Muscle Milk items in the innovation pipeline.

As we roll up our earnings outlook, we would have expected our guidance range to be \$1.71 to \$1.77 per share, representing a 4% to 8% increase. We took into consideration the three prior years of double-digit earnings growth and the one less week in 2017 as compared to 2016.

However, factoring in the divestiture of Farmer John business, representing earnings per share of approximately \$0.03, we are setting our guidance range to \$1.68 to \$1.74 per share. From a sales perspective, excluding the impact of both, the Diamond Crystal Brands and Farmer John divestitures, and the positive impact of the Justin's acquisition, we anticipate our business will generate organic sales in line with our long-term target of 5%. We believe our company can continue to grow at 5% top line and 10% bottom line over the long term.

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

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## James N. Sheehan

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

Thank you, Jim. Good morning, everyone. Volume in the fourth quarter was 1.4 billion pounds, a 9% increase compared to last year. Sales for the fourth quarter were \$2.6 billion, a 9% increase also. Excluding the impact of both the sale of Diamond Crystal Brands and the Justin's acquisition, volume was up 14% and sales were up 11%. Net sales for the fourth quarter were \$244 million, up 30% compared to GAAP net earnings last year of \$187 million. Net earnings were up 22% compared to non-GAAP earnings of \$200 million last year.

Fiscal 2016 was a 53-week year, with the extra week falling in Q4. We estimate the impact from this extra week was between 1% to 1.5% for the full year. Advertising expense for the quarter was \$55 million compared to \$30 million last year as we continue to invest in our brands.

Looking into 2017, we anticipate advertising expenses to be similar to 2016. Depreciation and amortization for the quarter was \$35.4 million compared to \$34.4 million last year. Equity and earnings for the quarter was \$11 million, up 41% compared to last year. The increase was a result of our strong results in MegaMex, with brands such as Herdez Salsa and Wholly Guacamole performing well in the marketplace.

Our effective tax rate in the fourth quarter was 33% versus 35.2% in 2015. For 2017, we expect our effective tax rate to be between 33% and 33.5%. Cash flow from operations was \$371 million in the fourth quarter, up 23% over last year.

During the quarter, \$145 million of short-term debt was repaid. Capital expenditures for the quarter totaled \$90 million compared to \$47 million last year. The increase in CapEx is primarily related to our new plant in Jiaxing, China and lean ground turkey expansion at Jennie-O Turkey Store.

For fiscal 2017, we expect capital expenditures to be approximately \$250 million compared to \$256 million in 2016. Major projects for 2017 include the completion of our plant in China and numerous capacity expansions for value added product lines.

We will continue to invest capital to support our value added products and improve food and employee safety. We paid our 353rd consecutive quarterly dividend effective November 15 at an annual rate of \$0.58 per share.

Our board of directors approved an annual dividend rate of \$0.68 per share, representing a 17% increase. Fiscal 2017 will represent the 51st consecutive year of increasing our dividends. Jim Snee and I intend to continue this longstanding policy.

We repurchased 1.2 million shares of common stock, spending \$43 million in the fourth quarter. We have 13 million shares remaining to be purchased from the current authorization. We will continue to repurchase stock to offset dilution from stock option exercises.

As we discussed in our third quarter conference call, we are providing a total company margin goal. Our goal for 2020 is to have our EBIT margin to be on the top quartile of our peer group.

Today, the top quartile range is 15% to 19%. The goal is consistent with our long-term growth goals of 5% top line and 10% bottom line. We experienced favorable input cost for the fourth quarter in many, but not all of our businesses. Key inputs such as hog and belly prices were down compared to the fourth quarter last year.

Trim prices were below – were flat. Beef prices were down. Corn and soybean meal prices were lower for the quarter versus 2015. Turkey breast meat prices were below 2015 during avian influenza. We expect favorable hog and pork markets for 2017. The USDA is [indiscernible] (18:07) 3% to 4% increase in the hog supply in 2017. The majority of the new industry capacity is anticipated to come on line after the summer of 2017.

We expect hog harvest levels at our Austin and Freemont plants to be down 1% due to one less week in the fiscal year. Barring any unforeseen weather events, we expect favorable grain prices for Jennie-O Turkey store in 2017. We anticipate turkey breast meat prices to be below 2016 levels.

Going forward, we expect lower beef and chicken input costs for our value-added products. We also see comparable prices to 2016 for other key raw materials such as peanuts and tomatoes. One area we are watching closely is the avocado market. The avocado market increased substantially in 2016. We are maintaining an adequate supply of avocados by leveraging our global supply chain.

Overall, we are confident the strength of our value-added products, recent acquisitions, and favorable market conditions will provide Hormel another record year.

At this time, I will 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] And we will take our first question from Robert Moskow with Credit Suisse.

**Robert Moskow**

*Analyst, Credit Suisse Securities (USA) LLC (Broker)*

Q

Hi there. Thank you. I thought that Jim and Jim that you were going to give us at some point kind of a three-year to five-year outlook for operating margins, and then where do you think margins can go kind of longer term. Are you working on that or am I mistaken?

**James N. Sheehan**

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

A

We did provide a margin goal that is to be in the top quartile of our peer group by 2020. Currently, that margin range is 15% to 19%. We're currently in the third quartile of that group, so to reach that goal, we not only need to improve our own margins, but we need to outperform our peers.

**Robert Moskow**

*Analyst, Credit Suisse Securities (USA) LLC (Broker)*

Q

Okay, got you. So, top quartile of 15% to 19%, that's three – over three to five years, or is that correct?

**James N. Sheehan**

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

A

15% to 19% is where those margins exist now. We intend to be in the top quartile in 2020.

**Robert Moskow**

*Analyst, Credit Suisse Securities (USA) LLC (Broker)*

Q

2020. Okay. All right, sounds good. And I guess my follow-up here would be I think specifically on your Refrigerated outlook, obviously, Refrigerated to be flat in fiscal 2017 despite losing some profit from the divestiture is quite bullish for the business. Can you give us a sense about the mix of that, do you expect your fresh pork profits to be up or do you expect those to be down, and value added mix, do you expect those profits to be up or down? Can you give us a sense of what the breakout is?

**James P. Snee**

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

A

Sure. Well, good morning, Rob. This is Jim Snee. I think as we think about our Refrigerated Foods portfolio and we've got a lot of positive momentum. Our foodservice organization had a great year in 2016. We expect that to continue in 2017. Our Meat Products group, with a number of their value-added items, Bacon, Party Trays,

Natural Choice, all performed extremely well this year. So, we expect that to continue and clearly those will be – those will all have a positive impact as we head into 2017.

Robert Moskow

*Analyst, Credit Suisse Securities (USA) LLC (Broker)*

Q

Okay. So with profits being flat, is the implication that value-added is up and maybe commodity is down a little bit?

James P. Snee

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

A

Yes, that's correct.

Robert Moskow

*Analyst, Credit Suisse Securities (USA) LLC (Broker)*

Q

Okay. I'll stop there. Thanks.

James P. Snee

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

A

Thanks, Rob.

**Operator:** And we will now hear from Farha Aslam with Stephens.

Farha Aslam

*Analyst, Stephens, Inc.*

Q

Hi. Good morning.

James P. Snee

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

A

Good morning, Farha.

James N. Sheehan

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

A

[indiscernible] (22:34)

Farha Aslam

*Analyst, Stephens, Inc.*

Q

Could you talk about the new pork plants that are coming online? How you anticipate that will affect your business and in particular how that would affect your pork operations?

James N. Sheehan

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

A

Good morning. We are expecting hog prices to be similar to 2016 and 2017. We believe there's a balanced supply and demand of hogs in 2017. The USDA is estimating that the hogs will be up about 3% to 4%. The plants that are coming online are expected to come online after the summer of 2017.



Farha Aslam

*Analyst, Stephens, Inc.*

Q

And so beyond 2017, how do you think Hormel is positioning itself for those new plants coming online?

James N. Sheehan

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

A

We think we're well positioned. We're constantly looking at the supply needs that we have for our value added products. The reason that we harvest hogs is to provide those value added products – or the raw materials for the value added products, so we're really balancing that with the value added products that we need.

Farha Aslam

*Analyst, Stephens, Inc.*

Q

Okay. So you can just purchase more of the meat coming out of those facilities...

James N. Sheehan

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

A

That's exactly right.

Farha Aslam

*Analyst, Stephens, Inc.*

Q

...rather than the hogs? So, you continue to maintain that balance in your portfolio?

James N. Sheehan

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

A

That's correct.

Farha Aslam

*Analyst, Stephens, Inc.*

Q

Okay. And then my last question is on M&A. You have a pristine balance sheet. What are you seeing out there? What are you interested in right now?

James P. Snee

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

A

Good morning, Farha. This is Jim Snee. Our pipeline on the M&A side is full. Just as a reminder, we're looking for opportunities that are accretive to our overall portfolio are number one, number two in the categories in which they compete. And we want to make sure that we can bring value to the business.

So I mean, we start there, but we make sure that they're aligned around our strategic growth areas of becoming more global, more multicultural, items or brands that are more on the go and then of course this area of healthy and holistic.

It's all about timing and getting some of them across the finish line, but I would tell you that the pipeline is robust and full.

Farha Aslam

*Analyst, Stephens, Inc.*

Q

That's helpful. Thank you.

James P. Snee

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

A

Yeah.

**Operator:** And our next participant is Jeremy Scott with CLSA.

Jeremy Scott

*Analyst, CLSA Americas LLC*

Q

Hey. Good morning.

James N. Sheehan

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

A

Good morning, Jeremy.

Jeremy Scott

*Analyst, CLSA Americas LLC*

Q

So, pretty impressive guidance number next year. I just wanted to clarify from your commentary, it seems like – and correct me if I'm wrong, but it seems like Grocery Products is driving the majority of the organic top line and bottom line? And just based on some of the trends we've seen in our in our checks, that seems like a little bit of a stretch, but can you just maybe synthesize and break down exactly where most of the earnings growth will come from next year?

James P. Snee

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

A

Sure. Well, good morning, Jeremy. I mean, we feel good about all five of our business units. Grocery Products is planning to have a strong year next year, organically in line with our 3% top line, 6% bottom line goals, but then the addition of Justin's. So, I mean, we feel really good about the momentum that we have in Grocery Products coming off a very strong fourth quarter. Our Specialty Foods group, with the work that we've done building the Muscle Milk brand, is showing impressive growth.

As I mentioned earlier, we do see strong value-added growth across a number of the Refrigerated Foods portfolios. And then we're well positioned. We're back in supply with Jennie-O Turkey Store and so really believe that all five business units are going to be able to show very positive contributions as we head into 2017.

Jeremy Scott

*Analyst, CLSA Americas LLC*

Q

Okay. And then just maybe on the long term, the top quartile of the 15% and 19%, can you get there on the core business, or does that include some type of mix of acquisitions, divestitures, including obviously the Farmer John, which is margin accretive but sales dilutive?

James P. Snee

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

A

Yes. It's going to be a mix of all those things, Jeremy. I mean, we know that we need improvements in our organic business. We will have M&A along the way, and we're constantly reviewing our portfolio. If we have pieces of it that don't fit, that are no longer strategic, I think we've clearly established that we'll make the right moves there as well.

Jeremy Scott

*Analyst, CLSAAmericas LLC*

Q

Okay. I'll jump back in the queue. Thanks.

James P. Snee

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

A

Thank you.

**Operator:** We will now hear from Akshay Jagdale with Jefferies.

Akshay Jagdale

*Analyst, Jefferies LLC*

Q

Hi. Good morning. Thanks for the question. Just two questions. First, on the long-term target, obviously, very much in line with what you've done historically. But if you look at the last four years, margins are up, I think, 460 bps. A vast majority, 70% of that, has been driven by Refrigerated Foods margins improving.

Part of that, I would say – I mean, I don't know how much of it is related to industry dynamics being favorable. So, I'm just trying to understand like the building blocks of the next four years considering or coming off or will be coming off of a pretty favorable environment in one of your segments that happens to have driven a vast majority of the increase historically. So, that's my first question.

And then secondly, again, related to Refrigerated Foods, when this capacity does come on – which clearly you're saying in 2017 doesn't look like it's going to cause any disruption – when it does come on, there's likely to be some disruption on the processing margins. How do you envision navigating through that environment from an earnings growth perspective? Thank you.

James P. Snee

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

A

Well, great. Thanks, Akshay. So, on your first question, I mean, for us, we need to continue to grow our value-added businesses in all of our portfolios. And so we've been transparent that market conditions have provided some of the improvement in Refrigerated Foods, but certainly not all of it. We've had a number of value-added improvements. We've had some M&A activity in that space that's proved to be accretive. And so those are the things that we'll continue to do across all of our businesses to move into that top quartile.

Your second question in regards to some of the capacity that's coming online, I guess, post 2017. We have navigated through volatility and delivered earnings growth 28 out of 31 years now. And so, as markets change, clearly, we know that we have to react, and I think we've demonstrated that we can react – that our business can react and deliver growth. So I mean, we're watching all of it very closely. Jim's assessment of the timing, we

believe it's the most accurate timing that we have, and we'll take advantage of it while we can. And then when market conditions change, I mean, we'll act accordingly.

Akshay Jagdale

*Analyst, Jefferies LLC*

Q

Thank you. I'll get back in queue.

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

Adam Samuelson

*Analyst, Goldman Sachs & Co.*

Q

Yes. Thanks. Good morning, everyone. I was hoping to dig deeper on the sales growth guidance of 5% organic for the year and think about it by business a little bit, because I see your market outlook, and you talked about on your costs that is, at best, neutral but probably a little bit deflationary, given the key proteins that you touched, and that kind of organic growth maybe save easy comps in Jennie-O in the first half of the year, that for the totality of the portfolio hasn't done 5% organic for some time. And I'm trying to just think about where the acceleration is coming from in the base to get that kind of organic revenue growth, especially given the commodity environment that we're likely to continue to see for some time?

James P. Snee

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

A

Sure. Well, thanks, Adam. This is Jim. As we've talked about all of our growth goals for each of the business units, we've had Grocery Products which is at 3% and 6% organic, and we do feel like we're well positioned with the success that we've had with SPAM and SKIPPY, and our Herdez line of products.

To be able to deliver on their organic goal, as you mentioned, the Jennie-O Turkey Store piece, which we do believe we'll be able to exceed that 5% top line number. The Specialty Group, we're going to have to anniversary the DCB piece, but feel really good about the Muscle Milk business which is the driver of that organization.

We see a return to our accelerated growth rates from our international business which is a 10% top line, 15% bottom line. And so obviously, Refrigerated Foods with the divestiture, you're going to have a lot of moving parts there, but as we go around the horn and think about all of our business units, I think we see a lot of momentum and feel really positive as we head into 2017. We understand that inflationary piece that you're talking about and there are some commodity portions of the portfolio that will react to that, but so much of our portfolio is value added that it's less impacted.

Adam Samuelson

*Analyst, Goldman Sachs & Co.*

Q

Okay. And then maybe just a clarification point on that long-term margin piece. A, 15% to 19% would be where the top quartile is now. Just so we're talking apples-to-apples, the number for fiscal 2016 [ph] just the (33:17) equity and kind of the minority interest, just definitionally, what was the realized 2016 number? And second is that long-term margin goal. Is that going to be a part of long-term management incentive compensation in any form?

James N. Sheehan

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

A

The 5% and 10% will continue to be the goals that we set and we measure against. But as you take the 5% and 10%, we will increase our operational margins. I want to be clear that we're talking about not 2015 and 2019 and 2020, we're just giving you the range that we see the top quartile currently.

Adam Samuelson

*Analyst, Goldman Sachs & Co.*

Q

Right. I'm just asking where you are today.

James N. Sheehan

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

A

[ph] Up 14%. (34:01)

Adam Samuelson

*Analyst, Goldman Sachs & Co.*

Q

14%. Okay. But it won't be part of – formally part of long-term management compensation as such?

James P. Snee

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

A

No, Adam, this is Jim. I mean we'll continue to be focused on 5% top line, 10% bottom line. And we have, as I mentioned a little while ago, some business units that are 3% and 6% in GP and then 10% and 15% in International. But those are the long-term growth goals that we'll continue to be focused on and incenting our top management.

Adam Samuelson

*Analyst, Goldman Sachs & Co.*

Q

Got it. Thank you.

James P. Snee

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

A

Yes.

**Operator:** We will now hear from Rupesh Parikh with Oppenheimer.

Rupesh Parikh

*Analyst, Oppenheimer & Co., Inc. (Broker)*

Q

Thank you for taking my questions. I also wanted to touch on the operating margins. So again, another strong year of operating margin expansion. Is there a way to isolate the impact from the changes in your portfolio from divestitures and the recent acquisitions that you made? What type of benefit that helped in 2016, and how we should think about the mix impact next year?

James N. Sheehan

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

A

The acquisitions have been accretive to our margins, and we see those acquisitions continuing to perform strongly in 2017. So they've been an advantage.

James P. Snee

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

A

And the divestitures would be the same. Those obviously are lower than the margins we've historically had.

James N. Sheehan

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

A

Correct.

Rupesh Parikh

*Analyst, Oppenheimer & Co., Inc. (Broker)*

Q

Okay. Is there any way to quantify what that benefit could be for the upcoming year?

James P. Snee

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

A

No.

Rupesh Parikh

*Analyst, Oppenheimer & Co., Inc. (Broker)*

Q

Okay.

James P. Snee

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

A

We have [inaudible] (35:33) quantify that. Yeah.

Rupesh Parikh

*Analyst, Oppenheimer & Co., Inc. (Broker)*

Q

Okay. Great. And then on the Grocery Products portfolio, very strong performance in your legacy portfolio with that 10% organic growth. Just want to get a sense of what's driving that this quarter? How do you think about the sustainability of the strength there?

James P. Snee

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

A

Yeah. Our team has done a great job. When you think about the portfolio, we've had ongoing success as a result of the SKIPPY acquisition, the investments we've made in that brand, the distribution we've gained, the innovation that we've had. And if you go across that entire line, SPAM had great performance as well. That's a brand that we continue to invest in. We think about our multi-cultural product offerings, Herdez sauces, salsas and dips, again something that's resonating with consumers that's on trend.

And we did have a nice fourth quarter from Compleats as well. And so, obviously, as we head into the future, some of the comps are probably a little easier. But I do think that our team is continuing to figure that brand out, that product line. And so we just feel good about the momentum that we have in Grocery Products.

Rupesh Parikh

*Analyst, Oppenheimer & Co., Inc. (Broker)*

Q

Okay. Great. Last one for me. Clearly, your results have been an outlier compared to other food companies. As you look at the grocery backdrop and even on the foodservice side, have you seen any changes in the overall backdrop out there on the macro front?

James P. Snee

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

A

From a foodservice perspective, our team has consistently outperformed what's happening in the industry, and they're doing that through their ability to connect with foodservice operators by the sales force, the direct sales force that we utilize, their ongoing innovation and really creating great solutions for operators. So we expect that to continue.

From a retail perspective, it's the same thing. I mean we understand what's happening with the consumer, but the consumer is shopping many different parts of the store. And I think the beauty of our portfolio is that no matter where they're going in the store, they're center store or on the perimeter, I mean we've got a full offering of products to meet their needs, and I think that really sets us up for strong future growth.

Rupesh Parikh

*Analyst, Oppenheimer & Co., Inc. (Broker)*

Q

Great. Thank you.

**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

Good morning, Mario.

Mario Contreras

*Analyst, Deutsche Bank Securities, Inc.*

Q

So, about a year ago, we were hearing about relatively high pork operating margins. It moderated somewhat over the next couple of quarters. But fast-forwarding today, it looks like that's once again at pretty historically high levels in terms of where the cutouts are versus live hog prices. So I just wanted to get a sense of how you view that dynamic. What's driving the widening spread, and where do you see that going over the next couple of quarters here?

James N. Sheehan

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

A

Well, we focus primarily, Mario, on hog prices. And we see hog prices being similar to 2017 – as they were in 2016 and 2017, the USDA is looking for an expansion of 3% to 4%. It appears that the supply and demand is in balance. So we look at the hog markets as being favorable as we go into 2017. It's important to understand that we're a net buyer of other commodities. So, we're impacted by some of the decreases in the other inputs such as bellies and trim.

Mario Contreras

*Analyst, Deutsche Bank Securities, Inc.*

Q

Okay. And then just one question on China. I just want to understand where you see that recovery coming from in 2017. I know you have the plant that's going to be opening up at some point during the year. So is that going to be driving most of the improvement or are there some other factors at play there? Thanks.

James P. Snee

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

A

Yeah. Thanks, Mario. This is Jim. This year, the story in China really was the higher input costs. And as we head into 2017 when we get past the Chinese New Year, we're forecasting a decline in that raw material market. And so it wasn't a story of volume in China. The retail business got off to a slow start but it rebounded. Our foodservice meat business was strong throughout the year. It really was more about the input cost and the tightening of the margins. We expect to get some relief after the Chinese New Year. So, we would expect to continue the volume growth and then have margin expansion as well.

Mario Contreras

*Analyst, Deutsche Bank Securities, Inc.*

Q

Okay. Thanks, everyone.

**Operator:** We will now hear 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.

Kenneth Bryan Zaslow

*Analyst, BMO Capital Markets (United States)*

Q

I just want to touch base on this. Your margin outlook, getting into that 15% to 19% CAGR by 2020, what is the progression step to get there?

James N. Sheehan

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

A

I think it's the continued growth of the value-added product. The moving of the value-added product up what we've referred to is the value ladder taking them to higher levels of margins. Clearly, acquisitions are a part of our strategy. We've sold off some businesses that were on the lower end of that range. So, I think that's the focus on improving our operating margins across the board.

Kenneth Bryan Zaslow

*Analyst, BMO Capital Markets (United States)*

Q

What about also favorable operating leverage? As you talk about sales growth this year, you're in a deflationary environment. Your volumes are going to clearly exceed your pricing. My pricing could be down or flattish or



whatever, but it's all volume. And yet you're not talking about leveraging your facilities or any sort of structural reassessment of your plants. Is there any other enhancement from a structural basis that we could think about?

James N. Sheehan

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

A

Certainly. We're constantly looking at leveraging our capacity and finding the correct capacity, utilizing the capacity in the optimal manner. Continuous improvement is the focus of all of our plans. Taking cost out of the system is a focus of our operations every day. So, we're constantly focused on taking cost out whether it's through cost reductions or efficiencies in the operations. We've made movements with a few plants now where we've optimized other capacity and been able to eliminate some excess capacity to improve the efficiencies.

Kenneth Bryan Zaslou

*Analyst, BMO Capital Markets (United States)*

Q

Okay. And just I think it's a great target and I think that over time hopefully, we may be able to get a little bit more insight on is the progression, really the strategic improvement of how to get there because again, I think somebody earlier mentioned it that you guys have defied logic and [ph] not a commodity become (42:52) the top quartile as the growth of your packaged food peers and you're continuing to do that. So, I'm just trying to figure out exactly what's the next steps to be able to get to that 15% to 19% and then get the value added. And I'm just trying to figure out how you're going to go from being top quartile – not top quartile in margins but in your growth rate to continuing that process. So any sort of clarity on that is always helpful. Thank you.

James P. Snee

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

A

Yeah. Well, thanks, Ken. This is Jim. I mean I think you hit on it, right. There's been a very logical strategic progression, and we do expect to continue down that path. Now, it will be supplemented along the way, certainly with the right M&A opportunities. But fundamentally, and I've talked about it many times in the past is, for us, it really is all about this formula for success, right?

So, it's investing in the right brands. It's making sure that we have the right innovation process. I mean we're challenging ourself with this increased innovation goal, and then the strategic acquisitions aligned around our growth pillars. And so, it is a very logical progression. It's also a very disciplined progression.

And I think what Jim Sheehan described to you in terms of our focus on continuous improvement, each and every day going – our people are going to work saying, how do I do things a little more efficiently, a little more effectively to take costs out of the system. Those all add up to that logical progression in getting us to that top quartile. So, I appreciate your comments, but I mean that's how we're going to get there.

Kenneth Bryan Zaslou

*Analyst, BMO Capital Markets (United States)*

Q

Great. Thank you.

James P. Snee

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

A

Yes.

**Operator:** And our next question comes from Eric Larson with Buckingham Research Group.

Eric Larson

*Analyst, The Buckingham Research Group, Inc.*

Q

Yeah. Good morning, everyone. First question, I just want to clarify and make sure that I'm correct in this. With the divestiture of Farmer John that effectively takes you out of all harvesting activities, do you have anything else anywhere else?

James P. Snee

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

A

Yeah. Eric, hi. This is Jim Snee. Yeah. No, we still have our harvest facilities here in Austin, Minnesota and Fremont, Nebraska on the pork side of the business.

Eric Larson

*Analyst, The Buckingham Research Group, Inc.*

Q

Yeah. But you don't effectively own those. I mean via what – from the labor settlement that you had, I believe somebody else actually operates that for you. Is that correct?

James P. Snee

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

A

No. In Fremont, I mean we own and operate. In the Austin facility, we do have a third-party relationship. But I mean that's, in essence, a pass-through. So we do have – I mean, in our opinion, we have two harvest operations, one in Austin and one in Fremont.

Eric Larson

*Analyst, The Buckingham Research Group, Inc.*

Q

Okay. Great. Well, thanks for that clarification. And then it was an impressive dividend increase. I was actually thinking that you were going to have a – you're going to have a greater dividend increase, given the year that you had. And I think it now probably puts you at a payout ratio of about 41%. And I think your peer group is a little bit higher.

Can you kind of clarify kind of how you're targeting your payout ratio? And maybe you're going to maybe return more cash to shareholders through maybe modestly more aggressive buybacks, more than – maybe just covering your dilution from stock options. Can you kind of discuss that dynamic?

James N. Sheehan

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

A

Certainly. Again, this is Jim Sheehan. I'll do the math for you. Of our peer group, we are number 11 out of 18 as we look at the peer group. And we do have a goal to move that up over the years. We've done it in a fairly consistent but aggressive manner. We are focused on the use of cash. Dividends is one of the four uses of cash that we have. We certainly have been focused on acquisitions. We've made acquisitions over the last several years. We'll reinvest \$250 million into CapEx in 2017. Those are primarily to support our value-added businesses, and along with the dividend, we also do some stock buyback.

Eric Larson

*Analyst, The Buckingham Research Group, Inc.*

Q

Okay. Great. Thanks, everyone. Happy Thanksgiving.

James P. Snee

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

A

Yes. You, too. Thank you.

**Operator:** And once again, we would hear from Jeremy Scott with CLSA.

Jeremy Scott

*Analyst, CLSA Americas LLC*

Q

Hey. Thanks for the follow-up. I know you've probably heard this question a number of times but given the significant move in wholesale ground beef costs, does Jennie-O need a higher level of ad and marketing support going forward in order to sustain volume growth?

James N. Sheehan

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

A

This is Jim Sheehan. I'll take that question. [ph] Justin's had – (47:51) continues to increase household penetration of ground turkey. Ground turkey represents about 10% to 12% of the total ground meat markets. We're competing well against the ground beef, and we continue to see growth in that. We've actually expanded capacity for our ground turkey business.

James P. Snee

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

A

Yeah. So Jeremy, this is Jim Snee. Finance Jim's become a sales and marketing guy [ph] and I think (48:19) that's great. No, I mean we need to watch that. I mean clearly, we understand what's happening in that competitive set. But again, our main focus is making sure that we have the right products that consumers are looking for. And we've been through this before with ground beef pricing.

And so to use, I guess, a comment from an earlier question is there's a logical progression here. So, this lean ground turkey is connecting with consumers. Jim Sheehan described how it's growing in terms of its relative share to the ground meat market. And so, we feel like we're well positioned. Will we be opportunistic where we need to be? Absolutely. But the fact is – I mean, we're in the right place. This is an on-trend consumer product that we know is going to continue to grow.

Jeremy Scott

*Analyst, CLSA Americas LLC*

Q

[indiscernible] (49:13) And I was hoping if you could just give a broader assessment of grocery trends relative to foodservice. Obviously, we're seeing a growing gap between the relative inflation rates and perhaps a shift in demand. You noted strong sales in SPAM and SKIPPY. Are you starting to see some pantry restocking, and which categories will continue to benefit in this environment?

James P. Snee

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

A

Yeah. Again, just going back to how we think about our business heading into 2017, we just feel really good about the momentum we have in our Grocery Products division. Again, SKIPPY has had a nice long run of quarter-over-quarter growth. SPAM will show growth again in 2017.

And then you referenced our foodservice business. Again, great year, 2016; poised for another great year in 2017. We've talked a lot about our BACON 1 fully-cooked bacon and the capital investments that we've made there to support that business. So, I mean we feel really good about both Grocery Products and foodservice.

Jeremy Scott

*Analyst, CLSAAmericas LLC*

Okay. Thanks for the follow-up, then.

Q

James P. Snee

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

Yeah. Thanks, Jeremy.

A

**Operator:** [Operator Instructions] And we will now take a follow-up from Robert Moskow with Credit Suisse.

Robert Moskow

*Analyst, Credit Suisse Securities (USA) LLC (Broker)*

Hi. Thanks. I just want to make sure I understand the guidance on Jennie-O correctly. I think you said that it's a difficult – it would be more of a back-half-loaded year. Did you mean that in terms of sales and profit or just sales? And if I recall, I think January is when you think that you're going to get more distribution on shelves for your ground turkey business because that's when retailers are resetting their merchandising? Thanks.

Q

James P. Snee

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

Yeah. So, Rob, this is Jim. I mean I think from a sales growth perspective, I mean we see that being fairly consistent throughout the year. The earnings comp would be skewed to the back half. And certainly, gaining distribution is tied to the plan, the schematics that the retailers have, so we'll continue to take advantage of that. I think again, the underlying premise here is that our team is doing a great job. They are gaining distribution, and it's a product line, the lean ground turkey, that is squarely in the consumer needs set and we feel really good about it.

A

Robert Moskow

*Analyst, Credit Suisse Securities (USA) LLC (Broker)*

Okay. So you're on track in terms of your distribution expectations?

Q

James P. Snee

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

Yes, absolutely.

A

Robert Moskow

*Analyst, Credit Suisse Securities (USA) LLC (Broker)*

Great. Thank you.

Q

James P. Snee

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

Yeah. Thank you.

A

**Operator:** Once again, we will hear from Akshay Jagdale with Jefferies.

**Akshay Jagdale**

*Analyst, Jefferies LLC*

Q

Hey. Thanks for the follow-up. Again, just as we think about the long-term goal, can you – I know [ph] you're trying not (52:14) willing to give out like a number on percentage value-added, et cetera, because I don't think that's how you manage the business. But can you give us some color on sort of segment by segment how you're going to get to this margin target? I mean basically, it equates to your normal algorithm of double-digit EPS growth. So, we know the formula is to increase percentage of value added, right, but probably what's more important mathematically is the margin profile of value added. You're always enhancing that. So, can you – without getting into the numbers, can you just give us some sense of how you're managing – how it's managed at the segment level? That would be helpful. And I just have one more follow-up.

**James P. Snee**

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

A

Sure, Akshay. This is Jim. I mean I think the important thing when you're thinking about this is we have to absolutely remain focused on the long-term growth algorithms that we've set for each of our business units. And so we talk about Grocery Products at 3% and 6%, and that's going to be a mix of organic growth and acquisition. We're going to see the same thing across all of our business units. The other, Refrigerated Foods, Jennie-O Turkey Store, Specialty Foods, 5% and 10%. And then we'll need International to return to their 10% and 15% long-term growth algorithm.

If we're able to deliver that and we know we will, and we'll do it through a balance of organic growth, you referenced the mix of value-added, which is something we do each and every day. And then also having the right strategic acquisitions, I mean that's the logical progression for how we get there.

**Akshay Jagdale**

*Analyst, Jefferies LLC*

Q

Okay. And just one more. So, when you look back the last four years, obviously, you would, I think, agree that there's been a benefit from grain costs and I guess favorable hog prices, if I may. It's hard to quantify that, but generally speaking, I think you'd also agree that potentially that's going to reverse going forward. So, when you think about levers that you can pull to offset that, clearly, I think M&A is an area where you can get more aggressive given your balance sheet and your solid track record. But can you just give us any incremental sort of buckets that may be historically one part of the equation that you might be considering?

**James P. Snee**

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

A

Akshay, I think our story of the market's ebb and flow in our history of delivering 28 out of 31 years of growth in some of the most volatile market conditions, I mean I think there's a bucket to consider in terms of our ability to be able to weather unfavorable market conditions. Clearly, you hit it on the head that there are M&A opportunities for us as we head into the future. We've got, as I mentioned earlier, a robust pipeline of opportunities that we're pursuing.

And then, I think the other thing we have to remember is we delivered the growth 28 out of 31 years, but we also have a management team that has 26 years of experience with Hormel Foods who are responsible for delivering

those results. So as we head into the future, I mean we're confident that we have the right people, the right products, the right processes in place to be able to get into that top quartile.

**Akshay Jagdale**

*Analyst, Jefferies LLC*



Perfect. Thanks a lot.

**Operator:** And with no further questions in the queue, I would like to turn the call back over to your host for any additional or closing remarks.

**James P. Snee**

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

Yes. Well, thank you all very much for your participation today. Before we leave today, I would like to take this time to acknowledge our outgoing CEO, Jeff Ettinger. As we previously announced, Jeff retired as CEO effective on October 30. During Jeff's tenure over the past 10 years, the company significantly increased revenues, net earnings, dividends and shareholder value. Under Jeff's leadership, the company continued to focus on innovation while adding new brands and companies into the Hormel Foods family. Brands like SKIPPY, Wholly Guacamole, Muscle Milk, Applegate and Justin's. I personally look forward to working with Jeff in his role as non-Executive Chairman of the Board.

I also want to let everyone know we will be holding our Investor Day in New York on June 15. I am excited to showcase our senior leadership team and take you deeper into each of our segments while also describing our plans for growing the business. You will see a press release soon.

And finally, I just want to conclude this call by saying, I am extremely proud of the excellent results our team posted this quarter and for the full year. 14 straight quarters of record results is truly an accomplishment. One of our seven cultural beliefs here at Hormel Foods is results matter, and I know our team is up to the challenge of delivering another record year in 2017.

On behalf of the team here at Hormel Foods, I thank you for your participation and I want to wish you all a safe and happy Thanksgiving. Thank you for joining us today.

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

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