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Hormel Foods Corp. (HRL)

Q3 2016 Earnings Call

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Chairman & Chief Executive Officer

James P. Snee
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MANAGEMENT DISCUSSION SECTION

Operator: Good day and welcome to the Hormel Foods' Third Quarter 2016 Earnings Conference Call. All participants are in a listen-only mode. Today's conference is being recorded. And at this time, I would like to turn the conference over to Mr. Nathan Annis, Director of Investor Relations. Please go ahead, sir.

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

Good morning. Welcome to the Hormel Foods conference call for the third 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, under the Investors section.

On our call today is Jeff Ettinger, Chairman of the Board and Chief Executive Officer; Jim Snee, President and Chief Operating Officer; and Jody Feragen, Executive Vice President and Chief Financial Officer. Jeff will provide an overview of the quarter, and then Jim will comment on the segment results, outlook, and guidance for fiscal 2016. Jody will provide detailed financial results for the quarter. The line will be open for questions following Jody's remarks. As a courtesy to the other analyst, please limit yourself to one question with one follow-up. If you have additional questions, you are welcome to get back in the queue.

An audio replay of this call will be available beginning at 10 AM Central Time today, August 18, 2016. The dial-in number is 800-533-7619, and the access code, 6233484. It will also be posted to our website and archived for one year.

Before we get started with the results for 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'll 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 32 through 39 in the company's Form 10-Q for the quarter ended April 24, 2016, for more details. It can be accessed on our website.

Now, I will turn the call over to Jeff.

Jeffrey M. Ettinger
Chairman & Chief Executive Officer

Good morning, everyone. Before we get into this quarter's results, I want to express my appreciation for all the contributions Jody Feragen has made to Hormel Foods. As previously announced, Jody will be retiring as CFO at the end of the fiscal year, so this will be her last earning call.

Jody has been a dynamite CFO. During her tenure, our team has delivered exceptional returns to our shareholders, she was instrumental in helping to complete over $2.7 billion in strategic acquisitions that have transformed our portfolio, and she oversaw close to $1.6 billion in dividends delivered to our shareholders. Jody also led numerous initiatives across the Accounting, Treasury, Information Technology, Corporate Development, and Investor Relations areas that have made our company better. Jody will be missed around the office and we wish her well in her well-earned retirement with her husband, Wayne.

Hormel Foods is fortunate to have a very strong bench of talents throughout our organization and the accounting and finance area is no exception. Jim Sheehan will assume the CFO position upon Jody's retirement with a deep knowledge of all areas of finance and accounting, emanating from his experience at Hormel Foods as Controller, Treasurer, and in numerous other roles. We have the utmost confidence in Jim's leadership and capabilities in this new role.

Now, on to the results. Earlier today, we announced record third quarter results of $0.36 per share, up 33% from last year. Sales for the quarter were $2.3 billion, up 5%, while volume was up 1%. Three of our five segments reported sales, volume, and earnings growth. Refrigerated Foods, Jennie-O Turkey Store, and International all posted excellent results.

Grocery Products enjoyed modest top line growth, though earnings were flat for the quarter. The Specialty Foods segment saw declines in sales and earnings due to the previously announced divestiture of Diamond Crystal Brands in May.

I would like to take this opportunity to reconfirm that our long term goals of 5% sales growth and 10% bottom line growth continue to be appropriate for our company. While we recognize any given year may deviate from these goals, we believe they are achievable over the long run due to our proven ability to build strong brands that resonate with consumers, innovate in categories where we compete, make strategic acquisitions, and achieve balanced growth in various market conditions.

For the past two years, we have also provided segment margin ranges. These ranges were intended to offer enhanced clarity to our business. Unfortunately, we believe they have added elements of confusion as they have not always been aligned with our primary performance goals of 5% top line and 10% bottom line growth, and they were not intended to be quarterly ranges.

In light of this, we have decided to curtail the practice of providing segment level ranges going forward. However, we will provide an updated total company margin target during the fourth quarter call that we feel is achievable over the next three years to five years. This long-term total company margin target will be consistent with and supported by our company growth goals.

I will now turn the call over to Jim Snee who will take you through each segment.

James P. Snee

President, Chief Operating Officer & Director

Thank you, Jeff. Good morning, everyone. Refrigerated Foods' third quarter operating profit increased 24%, with sales up 9% and volume up 3%. Refrigerated Foods benefited from the addition of the Applegate business, favorable market conditions, and great results from our foodservice business. And in addition, prior-year results did include $8.6 million in Applegate transaction costs.

Our foodservice value-added products showed robust growth led by brands such as HORMEL BACON 1 fully-cooked bacon, OLD SMOKEHOUSE bacon and Hormel Fire Braised meats. We also saw sales growth from many of our retail products including Hormel Natural Choice lunch meat and Hormel Gatherings party trays.

Jennie-O Turkey Store third quarter segment profit increased 59% on a 20% increase in sales. Production volumes returned to normalized levels during the quarter which enabled the foodservice and deli teams to deliver strong volume sales and margin gains. We also saw nice retail sales growth in Jennie-O Turkey bacon.

Our retail division at Jennie-O Turkey Store continues to gain back distribution that was curtailed during the outbreak last year, even as competitive activity has heightened in the broader ground meats category. International sales and operating profits both increased 5%. Strong exports of fresh pork, SKIPPY peanut butter, and SPAM luncheon meats all contributed to the increase in sales and earnings. Our China business posted strong earnings growth as SKIPPY peanut butter products more than offset declines in processed meats. Higher pork costs continue to pressure the domestic retail China business.

Grocery Products segment profit was flat for the quarter as earnings from value-added products did not offset increased advertising expenses and acquisition transaction costs related to the Justin's deal. Sales were up 3% aided by the inclusion of Justin's specialty nut butters and strong sales from SKIPPY peanut butter, SPAM luncheon meat, and Wholly Guacamole. Our Grocery Products team continues to deliver exciting and innovative new products such SKIPPY P.B. Bites and Herdez guacamole salsa. Both recently introduced products are exceeding our expectations in the marketplace.

Specialty Foods segment profit decreased 13% and sales decreased 25% primarily due to the divestiture of Diamond Crystal Brands and reductions in contract manufacturing sales. Our CytoSport team posted strong growth from Muscle Milk protein beverages and powders once again this quarter. We continue to be pleased with the new Muscle Milk protein smoothies which have been well-received by consumers.

Now, as we look forward into the fourth quarter, we expect Refrigerated Foods to continue growing sales and earnings through increases and value-added products in both the retail and foodservice channels. Our early view on fiscal 2017 shows a roughly 2% to 3% increase in hog supply. With the majority of new industry capacity coming online starting in the summer of 2017, we expect to see favorable market conditions through most of fiscal 2017.

Jennie-O Turkey Store is positioned to show strong sales and earnings growth in the fourth quarter and continues to be focused on regaining distribution. Lower grain input cost should continue to be a tailwind in the fourth quarter.

As we announced in the second quarter call, we are excited to be back on air in the second half of the year with our very successful Make The Switch campaign. We expect this advertising campaign to help improve distribution and growth of our Jennie-O ground turkey product.

We expect continued growth in our SPAM luncheon meat and SKIPPY peanut butter products to drive fourth quarter results for the International segment. Grocery Products is expected to show strong sales growth driven by the inclusion of Justin's and positive momentum in SKIPPY peanut butter and Wholly Guacamole dips.

The Muscle Milk brand has been performing well in both the protein beverage and powder categories, and we expect that to continue. We're also very excited about the innovation the CytoSport team will be delivering in the fourth quarter. The Specialty Foods segment will not show year-over-year sales and earnings growth due to the sale of the Diamond Crystal Brands business.

And finally, we continue to focus our marketing and advertising efforts on brands such as Hormel pepperoni, Applegate, Hormel Black Label bacon, Hormel Natural Choice, SPAM, and Jennie-O. These marketing and advertising efforts are supplemented by the great work being done by our direct sales forces in both retail and foodservice channels.

And we are extremely proud to report that just this week, Hormel Foods was ranked number one in the 50 Best Companies to Sell For ranking by Selling Power magazine. This is a huge honor for the company and is further confirmation of the strength of our brands and sales teams.

So, as a result of a strong third quarter performance, onetime gains from various discrete tax events, and continued confidence in our business, we are raising our full-year guidance from $1.56 to $1.60 per share, to $1.60 to $1.64 per share; and our early look into fiscal 2017 shows us once again growing sales and earnings. We will have more precise guidance for you on our fourth quarter call.

At this time, I will turn the call over to Jody Feragen to discuss the financial information relating to the third quarter.

Jody H. Feragen

Chief Financial Officer, Executive Vice President & Director

Thank you, Jim. Good morning, everyone. Net earnings for the third quarter of fiscal 2016 totaled $195.7 million, up 33% compared to $146.9 million last year. Diluted earnings per share were $0.36, also a 33% increase. Sales for the third quarter totaled $2.30 billion compared to $2.19 billion for the same period last year, a 5% increase. Four of our five segments delivered revenue increases; Specialty Foods sale declined due primarily to the sale of Diamond Crystal Brands. Volume for the third quarter was 1.22 billion pounds, up 1% from the same quarter last year. Tonnage was negatively impacted by the Diamond Crystal Brands divestiture.

The Jennie-O Turkey Store results for the third quarter included a $9.6 million mark-to-market loss on hedges due to temporary ineffectiveness. Advertising expense for the quarter was $52.6 million compared to $33.9 million last year as we continue to invest in our brands across all five segments. Our effective tax rate in the third quarter was 28.6% versus 35.6% in fiscal 2015. The rate was favorably impacted by $14 million of onetime discrete tax items associated primarily with an International entity restructuring. For the full year, we expect our effective tax rate to be between 32% and 32.5%, including the onetime discrete items from the third quarter.

Basic weighted average number of shares outstanding for the third quarter was 529.7 million compared to 528.5 million shares last year. The diluted weighted average number of shares outstanding for the third quarter was 542.2 million shares compared to 541.2 million last year. We repurchased 1.1 million shares of common stock, spending $38.6 million in the third quarter. We have 14.3 million shares remaining to be purchased from the current authorization in place.

Long-term debt at the end of the quarter was $250 million, the same as last year. Capital expenditures for the quarter totaled $66 million, compared to $41.8 million last year. For fiscal 2016, we expect capital expenditures to be approximately $250 million. Depreciation and amortization for the quarter was [ph] $32.6 million, (15:35) compared to $33.3 million last year. We paid our 352nd consecutive quarterly dividend effective August 15, 2016, at the annual rate of $0.58. per share. As a reminder, fiscal 2016 includes an extra week in the fourth quarter.

At this time, I will turn the call over to the operator for the question-and-answer portion of the call. Savannah?

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] And we will take our first question from Akshay Jagdale from Jefferies. Please go ahead. Your line is open.

Akshay Jagdale
Jefferies LLC

Q

Good morning. Thanks for taking the question. Jody, congratulations; you'll be definitely missed.

Jody H. Feragen
Chief Financial Officer, Executive Vice President & Director

A

Thank you, Akshay.

Akshay Jagdale
Jefferies LLC

Q

Yeah. So, I wanted to ask about Refrigerated Foods and just the pork operating environment in general. For next year, I know it's hard to pin down what other people's plans are, but regarding your plan for total company growth and EPS next year, what does that assume for capacity utilization rates for the industry? Because that's an important factor in next year, right. So, that's my first question.

Jody H. Feragen
Chief Financial Officer, Executive Vice President & Director

A

So, the pork operating margins for this year were a bit higher than we had initially expected on our Q2 call, really supported by great supply of hogs, which provided favorable pricing on that environment, and then continued strong demand supporting the cutout. As far as fiscal 2017, we just started our process. We would expect them to be somewhat similar to fiscal 2016 at this point in time.

Akshay Jagdale
Jefferies LLC

Q

Okay. And this – Jeff, on the commentary on the long-term guidance and the change, I mean, I know you've been extremely responsible and have managed the company exceptionally well, so I trust this is the right thing to do. But I'm just trying to make sure that apart from telling us things differently, the management – you're not changing any incentives, et cetera, business as usual there, right? I mean, I think what you are trying to indicate is by providing more and more clarity before, you were trying to help people, but it's starting to maybe hurt the volatility maybe in the shares.

But I just want to make sure nothing is changing from a management compensation and sort of how you day-to-day manage the business now, right? Like, you've grown earnings consistently over time by improving the margin next and making good acquisitions. Everything is essentially the same in that regard, you're just changing the way you're going to be communicating with the Street, correct?

Jeffrey M. Ettinger
Chairman & Chief Executive Officer

A

Appreciate the question, Akshay. Yeah. I mean, really, our company's focus is on meeting the 5% and 10% goals. We found that providing the individual segment operating margin ranges seem to sometimes distract from these goals. And honestly, we've not proven to be overly accurate in estimating the margins for each segment. Things come up, the Jennie-O AI issue, the DCB divestiture, et cetera, and you're dealing with variables to sales and earnings for each business unit when you get into a margin like that.

I'd point to our performance at Jennie-O Turkey Store this quarter is a good example of why we believe the segment margin percentage is maybe a less meaningful measure. On an operating percentage basis, you could look at Q3 and say, oh, that was a bad quarter for Jennie-O Turkey Store because its operating margins fell. But this would obscure the fact that Jennie-O Turkey Store delivered a $20 million improvement in segment profit for the quarter. Honestly, we're seeking to deliver sales and earnings dollars and not specific percentages.

James P. Snee
President, Chief Operating Officer & Director

A

Yeah. And Akshay, this is Jim. If I could piggyback on Jeff's comments. I think we want to be clear that we are still providing segment-specific guidance when it comes to their expected contribution to those overall 5% and 10% goals. I think what we've learned is that some of the discussion around segment margins can be very short-term-focused versus our goal of focusing on some of the long-term measures such as these corporate growth goals.

And so, it will be business as usual, beholding the business units accountable the same way we have in the past. There are no incentive changes, so we will be managing the business in the same way we have.

Akshay Jagdale
Jefferies LLC

Q

Okay. And just one last one on sort of timing of – this goal is meant to – the long-term goals are truly meant to be long-term and we understand that. But help me understand, so you've been outperforming those pretty consistently almost every year, but more so in recent years because of some favorable conditions, if I may. So, when might you be expected to potentially underperform those and I'm specifically referring to, are you worried about this capacity coming on in the pork – in pork processing that we hear about? Thank you. I'll pass it on.

James P. Snee
President, Chief Operating Officer & Director
A

That's a great question, Akshay, and I think it's – in any given year, top or bottom line numbers can significantly over-perform, and we've seen that over the last decade, right? We've had years where we've over-performed on one of those variables and underperformed on the other, but we are focused on the long-term aspect of that.

In terms of what's happening in the industry, we've talked frequently about our balance model. And so, we do believe that for every action, there's a reaction. And so, as this additional capacity comes online, there's excess supply and things that will happen on the input cost side of the business.

And so, we believe that our balance model will allow us to weather any storm, if you will, and I think that's supported by the fact that we've had 27 out of 30 years of earnings growth and this year, obviously, will be 28 out of 31, so that's our position.

Akshay Jagdale
Jefferies LLC
Q

Thank you.

James P. Snee
President, Chief Operating Officer & Director
A

Yeah.

Operator: Thank you. And we'll take our next question from Farha Aslam of Stephens, Inc. Please go ahead.

Farha Aslam
Stephens, Inc.
Q

Hi. Good morning.

Jeffrey M. Ettinger
Chairman & Chief Executive Officer
A

Farha.

Farha Aslam
Stephens, Inc.
Q

Congratulations, Jody.

Jody H. Feragen
Chief Financial Officer, Executive Vice President & Director
A

Thanks, Farha.

Farha Aslam
Stephens, Inc.
Q

My question is focused more on the quarter. There was a lot of M&A acquisitions and divestitures in this current quarter, would you be able to give us kind of volume or sales regarding the acquisition of Applegate and Justin's and the impact of the divestitures of Diamond Crystal Brand, as well as kind of what the impact of the Justin's transaction costs were on the quarter?

Jeffrey M. Ettinger
Chairman & Chief Executive Officer

A

DCB, we have provided on an annualized basis, that was in the $250 million range and the quarters were relatively consistent. Jody can provide you a little color on the Justin's transaction costs.

Jody H. Feragen
Chief Financial Officer, Executive Vice President & Director

A

So, we didn't consider them material to be a callout specifically for the quarter, but they amounted to – between transaction costs and step-up in inventory accounting, they amounted to about $3 million. Grocery Products, really, a lot of their segment margin change was a significant increase in advertising for that segment.

Farha Aslam
Stephens, Inc.

Q

And then, just on the Applegate and Justin's sales contributions or volume contributions in the quarter?

Jody H. Feragen
Chief Financial Officer, Executive Vice President & Director

A

I don't have those off hand, but we guided that Justin's in fiscal 2017 was going to be about $100 million. I'd say we only had them for a part of the – Applegate is – basically, we're lapping that now coming in the fourth quarter. So, I don't have those specifics with me.

Farha Aslam
Stephens, Inc.

Q

Okay. And then, my follow-up is on the $9.6 million mark-to-market in Turkey. Would you be able to elaborate on what caused that? Do we get that back in subsequent quarters? Just more color on that mark-to-market impact.

Jody H. Feragen
Chief Financial Officer, Executive Vice President & Director

A

So, we're probably one of the few companies that actually uses the special accounting treatment for hedge accounting, which allows you to put the mark-to-market gains or losses in any quarter on your balance sheet and then it's recognized as it flows through cost of goods when turkeys come to the plant basically or as the feed is consumed.

What happens when you technically become ineffective, which is a regression analysis comparing futures prices to cash markets, and because of some anomalies in the cash markets this quarter, you can have them go ineffective and you recognize all the gains and losses in your P&L. So, it's we believe a onetime impact. It's recognizing some losses that would have been recognized through the future, but they're just hitting all in one period which kind of skews Jennie-O's results. So, Nathan's really well acquainted with hedge accounting, so if you want to follow-up [indiscernible] (26:34) on that, he'd be a great one to talk to.

Farha Aslam
Stephens, Inc.

Q

And just bottom line, we essentially get that back because you won't have that loss in future quarters?

Jody H. Feragen
Chief Financial Officer, Executive Vice President & Director
A

Absolutely, it's a timing.

Farha Aslam
Stephens, Inc.
Q

So, it's just timing. Thank you very much. That's very helpful.

Operator: Thank you. And we'll take our next question from Adam Samuelson of Goldman Sachs. Please go ahead.

Adam Samuelson
Goldman Sachs & Co.
Q

Great. Thanks. Good morning, everyone. And let me add to everyone's congratulations, Jody, on the retirement. Maybe my first question is on the top line and less so about the quarter specifically and then – but more about getting back on track with that 5% revenue growth target. We're – it has been or likely to continue to be in a fairly deflationary protein price environment for at least the next 18 months which to me would suggest that to get anywhere close to that 5%, maybe it's more like 3% to 4% organic, volumes are going to have to carry a bigger portion of that total mix.

Can you talk about the volume trends that you're seeing in the business today, because if you look at in Grocery and Refrigerated specifically, and there doesn't seem to be a tremendous amount of organic volume growth. And maybe I'm interested in kind of your thoughts if you maybe leaned a little bit too hard into the value-added premiumization of some of these categories that has come at the expense of volumes. Thanks.

Jeffrey M. Ettinger
Chairman & Chief Executive Officer
A

I mean, Our ultimate goal is to sell a higher mix of branded value-added items which kind of absent the switches of market conditions should, over time, make our net sales be a stronger growth vehicle than volume inherently. There clearly are franchises within the company that are more responsive to markets, so our bacon pricing or our pork pricing, our ham pricing would be more along those lines. But most of the Grocery portfolio is less that way. Jennie-O Turkey Store has been able to hold their pricing on a stronger basis.

We have a lot of franchises that we're really excited about that we think are at least 5% growing franchises, many of which did quite well this quarter. And so, we kind of talked in past calls that we were a little disappointed with our top line, but had felt it was trending in the right direction. And, indeed, Q3 showed an acceleration of that trend, and we look at that favorably now heading into next year.

Adam Samuelson
Goldman Sachs & Co.
Q

Okay. That's helpful. And then, maybe just following up on the margin outlook commentary you gave earlier, appreciate withdrawing the segment – specific segment margin guidance, but if you're going to get corporate margin expansion, either your higher margin businesses are growing faster than the core or you're getting aggregate margin expansion across the entire unit portfolio. Can you talk about which pieces of that kind of split you're most excited about, maybe by business or within the portfolio specifically?

James P. Snee
President, Chief Operating Officer & Director

A

Sure. Adam. This is Jim. I think on the sales side of the business, we see positive momentum in brands such as Muscle Milk. Certainly, Jennie-O and the work that they've done with the ground turkey business there and getting back on air with Make the Switch. The addition of the Justin's business, the SKIPPY brand, Wholly Guacamole, Herdez coming out of our MegaMex joint venture.

From a food service perspective, we're really positive about the work that team has been doing. Our Bacon 1 fully cooked Bacon, Natural Choice out of Refrigerated Foods. And so, there's a lot of excitement and momentum that we believe will continue in 2017.

Adam Samuelson
Goldman Sachs & Co.

Q

All right. Great. That's very helpful. I'll pass along. Thanks.

Operator: Thank you. And we'll take our next question from Mario Contreras of Deutsche Bank. Please go ahead.

Mario Contreras
Deutsche Bank Securities, Inc.

Q

Hi. Good morning.

Jeffrey M. Ettinger
Chairman & Chief Executive Officer

A

Good morning.

James P. Snee
President, Chief Operating Officer & Director

A

Hi, Mario.

Mario Contreras
Deutsche Bank Securities, Inc.

Q

So, I wanted to follow-up on the comments around fiscal 2017 guidance. Can you just clarify, I know maybe it's early, but the assumption of growth, is that off of a reported basis or would that be off of a 52nd week comp? And then, on top of that, can you give any color on which specific segments would be more likely to contribute to growth? Thanks.

James P. Snee
President, Chief Operating Officer & Director

A

Yeah. So, Mario, this is Jim. And it would be on a reported basis as we look into 2017. And we recognized we've had many consecutive quarters of great results. And obviously, there are key concerns as whether we really can grow in 2017. So, I talked in the last question about the sales side of the business and the positive momentum that we're seeing.

Another thing that obviously we believe in and it served us well is our balanced business model. And so, we've got a favorable outlook on key inputs such as pork, beef, grains that really is going to combine with the sales momentum that will allow us to submit a plan to our board of directors that will show growth in earnings in 2017. And clearly, we'll give you a more precise look and range in November on the call.

Mario Contreras
Deutsche Bank Securities, Inc.

Q

Thanks. That's helpful. And then just an additional question on Jennie-O. Can you elaborate a little bit more on the competitive environment there? And then focusing on your market share, are you feeling like you're getting placement on the shelves at an appropriate pace relative to your peers? Thanks.

James P. Snee
President, Chief Operating Officer & Director

A

As I commented, obviously, the supply ramped up throughout the quarter and that's really the best position for the Jennie-O Turkey Store business to be in. And as we look across the business, there was strong foodservice performance, strong business in the deli area of the business. The retail distribution has continued to be a battle, but the team is having success. The trays continue to do very well and we recognize that there is competition in the meat case but this is not unusual. I mean, there's been other times in the Jennie-O Turkey Store history where they face this type of competition. And we do believe that we're seeing the growth that we deserve, and we believe that the brand and the product lines continue to be on trend with consumers and, over time, we'll continue to get expanded distribution and share.

Mario Contreras
Deutsche Bank Securities, Inc.

Q

Okay. Thank you very much.

James P. Snee
President, Chief Operating Officer & Director

A

Yeah.

Operator: Thank you. [Operator Instructions] We'll take our next question from Rob Moskow of Credit Suisse. Please go ahead.

Robert Moskow
Credit Suisse Securities (USA) LLC (Broker)

Q

Hi. Thanks and congratulations again, Jody. Just some clarity on the fiscal 2016 guidance. The EPS bump of $0.04, my math is that $0.03 comes from the tax rate and maybe $0.01 comes from operating profit being better than you expected for the year. Is that a fair assessment as to how you're looking at it or is all of the bump from the tax rate and the tax outlook? And then I have a quick follow-up.

Jody H. Feragen
Chief Financial Officer, Executive Vice President & Director

A

No. I would look at the bump from Q3 tax impact as about $0.02. And then, we have the negative hedging impact in Jennie-O that partially offsets it by another – by my math, another $0.01. Our effective tax rate for the fourth quarter will be similar to what our ongoing rate has been. So, getting to a full-year effective tax rate with the lower one in the third quarter, overall, it's not going to be driven by taxes.

Robert Moskow
Credit Suisse Securities (USA) LLC (Broker)
Q

Right. Okay. So, your view is – well, it still helps the year, though, so...

Jody H. Feragen
Chief Financial Officer, Executive Vice President & Director
A

Yeah. It does.

Robert Moskow
Credit Suisse Securities (USA) LLC (Broker)
Q

Yeah. So, operating profit – it's a guide up on operating profit as well.

Jody H. Feragen
Chief Financial Officer, Executive Vice President & Director
A

Absolutely.

Robert Moskow
Credit Suisse Securities (USA) LLC (Broker)
Q

Okay. Good. And then the follow-up I have is on, I guess, Jim's comments about it being a battle in the meat case. I think you said that you're trying to expand your East Coast distribution and capacity in Turkey. Is that what you're really referring to, Jim? And maybe a few more specifics as to how much you've expanded your abilities in the East Coast and what the outlook is?

James P. Snee
President, Chief Operating Officer & Director
A

Sure. I think our challenge has been, clearly, we're just ramping up supply and so, we have talked about the geographic expansion that we did have to put on hold last year and early this year. And so, that's part of the solution, Rob. I think what we're talking about here is regaining even some of the existing distribution that perhaps we were unable to supply last year. So, it's really a combination of both those things and there's no doubt that there is competition in the meat case, but I guess I would just reiterate that it's not unusual, we've been there before and for us, the bigger issue, the bigger message is that this product line, Jennie-O ground turkey is on trend with consumers over the long-term.

Robert Moskow
Credit Suisse Securities (USA) LLC (Broker)
Q

Is there any way to quantify, like, what your distribution percentage is today compared to history and help us – it will help us model out why the growth will continue.

James P. Snee
President, Chief Operating Officer & Director
A

Nathan, if you want to – yeah.

Jeffrey M. Ettinger
Chairman & Chief Executive Officer
A

[ph] We may be able to do on another call (37:00) And it also may depend, Rob, this is Jeff on, I mean, what products you're talking about.

Robert Moskow
Credit Suisse Securities (USA) LLC (Broker)

Q

Right.

Jeffrey M. Ettinger
Chairman & Chief Executive Officer

A

I mean, clearly, we've talked about tray pack quite a bit. It has a certain share position. It has the unique element that it competes not only against other ground turkey brands but significantly against ground beef. But there's a lot of other pieces at both the retail and deli components of Jennie-O, so they would each have their own set of numbers in that regard.

Robert Moskow
Credit Suisse Securities (USA) LLC (Broker)

Q

Yeah. That's what makes it hard for us to figure out where it's going. So, if there's something that we can focus on to help make the case on distribution growth being a driver, tray pack maybe. Is tray pack 30% of the story, 40% of the story? Can you help us in that regard?

Jody H. Feragen
Chief Financial Officer, Executive Vice President & Director

A

You know what? Why don't you take a follow-up with Nathan because I don't have that at our fingertips right here.

Robert Moskow
Credit Suisse Securities (USA) LLC (Broker)

Q

Got it. Okay. Thank you.

Operator: And we'll take our next question from Ken Zaslow of Bank of Montreal. Please go ahead.

Kenneth Bryan Zaslow
BMO Capital Markets (United States)

Q

Morning, everyone; and, Jody, congratulations and well-deserved.

Jody H. Feragen
Chief Financial Officer, Executive Vice President & Director

A

Thank you.

Kenneth Bryan Zaslow
BMO Capital Markets (United States)

Q

My first question is just housekeeping. When you talk about growth in 2017, you said sales and EPS. I just want to make sure you're all talking about operating profit growth and it's not just a tax or corporate expense benefit in 2017. Is that a fair assessment?

Jeffrey M. Ettinger
Chairman & Chief Executive Officer

A

Yes. Yeah.

Kenneth Bryan Zaslow
BMO Capital Markets (United States)

Q

Okay. Then, my second question, really, is when I look at the Grocery Products business, can you talk about how that – for the current quarter, how that actually matched or maybe – it underperformed our expectation. I'm just trying to figure out how you guys thought about that business in terms of operating profit and what you see as the outlook for that business given the lower input cost and somewhat surprising kind of compression on the margin side.

James P. Snee
President, Chief Operating Officer & Director

A

Sure. Ken, this is Jim. Again, from a sales perspective or brand perspective, I mean, clearly, very pleased with the work the team did on continuing to grow of SPAM franchise, the SKIPPY business, the introduction of SKIPPY P.B. Bites continues to go well. Our Mexican foods portfolio also continues to perform well.

As we mentioned, we did have some increased advertising cost, but that's, from our perspective, a positive to support the ongoing and future brand growth. And there's no doubt, I mean, we have a couple of areas in the unit that are work in process. The chunk meats category, which is not a huge part of the portfolio but that's become competitive and our team is working on really taking a different approach with the product offerings that we have there.

Again, we talked about Compleats being down, and we're working very strategically to expand the availability of some of the value tier offerings and really increasing the sales or unit rates. And so, for them, it was a mixed bag, but I think we still feel very positive on the outlook for Grocery Products going forward.

I think one other thing to consider for this quarter would be more of a product mix issue. Some of the canned items are not typically high sellers at this time of the year. But overall, feel very positive about the transformation of the portfolio and where GP is headed.

Jody H. Feragen
Chief Financial Officer, Executive Vice President & Director

A

And I would just add to Jim's comment that we saw quite a run-up in trim, which is an input on a lot of the Grocery Products items. So, while they experienced favorable cost of goods in a lot of areas, that was one area that did negatively impact them.

Kenneth Bryan Zaslow
BMO Capital Markets (United States)

Q

Yeah. I appreciate it.

Operator: Thank you. And we'll take our next question from Jeremy Scott of CLSA. Please go ahead.

Jeremy Scott
CLSA Americas LLC

Q

Hi. Good morning and congrats, Jody, on the retirement.

Jody H. Feragen
Chief Financial Officer, Executive Vice President & Director

A

Thanks.

Jeremy Scott
CLSA Americas LLC

Q

A couple questions on Applegate. Can you talk about the volume performance for this brand since you've taken over. It have some great penetration in some of the upper scale retail channels that are still growing. Just wondering what the outlook for Applegate here on the volume side than what's been in the past year.

James P. Snee
President, Chief Operating Officer & Director

A

Yeah. Jeremy, good morning. This is Jim. I think, just as a reminder, when we took over the Applegate business, I mean, clearly, we knew that there were some raw material or supply issues in terms of supporting that business and then those were compounded with the outbreak of avian influenza.

So, in the short term, the team has worked really hard to get raw material supply back in place, and we feel good about where we are today. So, that certainly made the volume growth a battle for the team. And so, we had to regain some loss distribution, but the growth – we've seen some growth. We've seen some increased distribution.

From our perspective, we still – we love the brand. We love what the future holds for the brand. And, again, on a short-term basis, it's clearly on target to deliver what we said it would deliver at the time of acquisition.

Jeremy Scott
CLSA Americas LLC

Q

Okay. And just on that point, to follow-up to a previous question, how do you view – when you start to lap Applegate in the fourth quarter, where do you see volumes trending as we look now at a more organic basis for Refrigerated Foods?

Jeffrey M. Ettinger
Chairman & Chief Executive Officer

A

Refrigerated Foods.

James P. Snee
President, Chief Operating Officer & Director

A

Oh, for Refrigerated Foods. I'm sorry.

Jeffrey M. Ettinger
Chairman & Chief Executive Officer

A

He's saying for all of our Refrigerated Foods.

Jeremy Scott
CLSA Americas LLC

Q

For all of Refrigerated Foods.

James P. Snee
President, Chief Operating Officer & Director

A

Oh. Well, I mean, I think, again, as we think about the different parts of the Refrigerated Foods portfolios, our meat products team continues to be focused on the value-added items and they're doing a nice job. Our foodservice business continues to outperform the industry and there – we expect that to continue. The Applegate business will continue to show growth now that we've got returns of supply. So, I mean, overall, we feel good about that portfolio as well.

Jody H. Feragen
Chief Financial Officer, Executive Vice President & Director

A

And I would just add that as we transition particularly when you look at Applegate that is more of a sales-driven business than a volume-driven, and as we continue to value add the portfolio, volumes become a little less meaningful as you compare to prior quarters or years that may have had more of a commodity element.

Jeremy Scott
CLSA Americas LLC

Q

Got it. And can you touch on some of the competitive activity you're seeing at retail and do you plan to ramp up promotional activity as a response in the coming quarters?

Jeffrey M. Ettinger
Chairman & Chief Executive Officer

A

Are you talking about any particular part of the grocery store or our business or?

Jeremy Scott
CLSA Americas LLC

Q

I would say in some of the higher traffic channels like sausage and frozen breakfast.

Jeffrey M. Ettinger
Chairman & Chief Executive Officer

A

Yeah. I think, Jeremy, our position on that is clearly we're focused on the effectiveness and our ability to not only deliver a return for us but for the retail partner. And so, we continue to look at categories individually and where there's opportunity to be effective with additional spending, we certainly will take advantage of that. But can't tell you today that there's a significant specific plan in any one given category.

Jeremy Scott
CLSA Americas LLC

Q

Got it. And the last question. In the past, you've been able to repurchase shares as the M&A pipeline thinned out a bit. What is your opportunity to scale up buybacks over the coming years and can you can walk us through your thought process there and some of the hurdles?

Jody H. Feragen
Chief Financial Officer, Executive Vice President & Director

A

So, really, we kind of look at our share repurchase as being an opportunity to offset stock option exercises. We still believe that using that as a compensation element is appropriate to drive our business. So, we're constrained because of the ownership of The Hormel Foundation at about 48% to 49% these days. So, we've agreed that they should be under 50%. So, that would be biggest constraint. Obviously took advantage of some pressure on our stock this past quarter to be in the market and acquire some of those shares.

Jeremy Scott
CLSA Americas LLC

Q

Okay. Thank you very much.

Operator: Thank you. And at this time, we have no further questions. I'll turn in back over to Mr. Annis for any additional or closing remarks.

Jeffrey M. Ettinger
Chairman & Chief Executive Officer

Thanks, Savannah. This is Jeff Ettinger. I'll go ahead and conclude the call for us. So, now, as some of you may have heard, we actually celebrated our company's 125th anniversary recently here in July. This provided us a unique opportunity to bring many of our company's employees together to celebrate the occasion.

After visiting with these employees from across the company, I've never been more optimistic about our company's future and our ability to deliver growth. I'm very proud of our team's performance this quarter, and I look forward to continue the excellent results going forward. I want to thank you all for joining us today.

Operator: This does conclude today's program. Thank you for your participation. You may disconnect at any time and have a great day.