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Hormel Foods Corp. (HRL)

Q4 2015 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day, and welcome to the Hormel Foods Fourth Quarter 2015 Earnings Conference Call. All participants are in a listen-only mode. Today's conference is being recorded.

At this time, I would like to turn the conference over to Jana Haynes, Director of Investor Relations. Please go ahead, ma'am.

Jana L. Haynes
Director-Investor Relations

Good morning. Welcome to the Hormel Foods conference call for the fourth quarter of fiscal 2015. We released our results this morning before the market opened around 6:30 AM Eastern Time. If you did not receive a copy of the release, you can find it on our website at, 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 a review of the operating results for the quarter and the year, and then Jim will comment on our outlook and guidance for fiscal 2016. Jody will provide detailed financial results for the quarter and the year. The line will be open for questions following Jody's remarks.

As a courtesy to the other analysts, please limit yourself to one question with one follow-up. If you have additional queries, you are welcome to get back into the queue. An audio replay of this call will be available beginning at

11:30 AM Central Time today, November 24, 2015. The dial-in number is 888-329-8893, and the access code is 6355504. It will also be posted to our website in archives for one year.

Before we get started with the results of the quarter, I need to reference the Safe Harbor statements. 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 34 through 40 of the company's 10-Q filed on September 4, 2015. It can be accessed on our website.

Additionally, please note the company uses non-GAAP results to provide investors with a better understanding of the company's operating performance by excluding the impact of certain non-recurring items affecting comparability. Discussion on non-GAAP information is detailed in our press release located on our corporate website. Please note that during our call, we will refer to these non-GAAP results as adjusted earnings.

Now, I'll turn the call over to Jeff.

Jeffrey M. Ettinger

Chairman & Chief Executive Officer

Thanks very much, Jana, and good morning, everyone. We are pleased to report a strong finish to fiscal 2015. Adjusted earnings in the fourth quarter were a record $0.74 per share, up 17% from last year. Sales for the quarter were $2.4 billion, down 6%. For the full year, the company earned an adjusted $2.64 per share, representing an 18% increase over fiscal 2014. On an adjusted basis, all five segments registered earnings growth this year.

Sales for the full year were $9.3 billion, a decrease of 1%. Lower sales for the quarter and the year were primarily due to turkey supply shortages in our Jennie-O Turkey Store and price deflation in the pork markets, impacting sales within our Refrigerated Food and International segments.

I will now take you through each segment. Grocery Products operating profit was up 57% in the quarter. Normalized input cost and improved productivity drove the gains. Sales grew 4% this quarter led by SKIPPY peanut butter, DINTY MOORE stew, HORMEL chili, and WHOLLY GUACAMOLE dips. For the year, adjusted segment profit was up 23% and sales were up 4%.

We're especially pleased with the sales growth of our SKIPPY peanut butter products given a price decrease in the peanut butter category earlier this year. We continue to build momentum in our snacking portfolio with excellent results from our WHOLLY GUACAMOLE MINIS! along with positive early reads on our most recent innovation SKIPPY P.B. Bites!

Refrigerated Foods' fourth quarter segment profit increased 27% with sales down 5% and volume up 2%. For the full year, operating profit in this segment was up 26% and sales decreased 6% on a volume increase of 1%. Results in the fourth quarter were driven by nice increases by our affiliated foods businesses, higher pork operating margins, the addition of the APPLEGATE business and an improved product mix.

Our Refrigerated Foods' team had an heightened focus on margin expansion this year and has made nice strides. Lower dollar sales reflect price reductions on some items compared to last year's record high pork markets, and the dissolution of Precept Foods, the latter of which we will have lapped after this quarter.

Our foodservice group continues to deliver innovative solutions for foodservice operators with notable growth on items such as our HORMEL FIRE BRAISED meats and HORMEL pizza toppings. On the retail side of the business, HORMEL Pepperoni, HORMEL refrigerated entrees and HORMEL GATHERINGS party trays, delivered sales gains this quarter.

We have owned the APPLEGATE business for a few months now, and we are pleased with its performance, constrained partially by the availability of pork and turkey raw material during the quarter. The APPLEGATE team remains on track to deliver results consistent with our initial guidance for this business.

Jennie-O Turkey Store fourth quarter segment profit declined 23% on an 18% sales decrease. For the full year, operating profit was up 1% and sales decreased 2%. Results were impacted by high pathogen avian influenza as flocks lost earlier this year created large volume shortfalls in operations and sales. We have now completed the repopulation of all of our turkey barns. We have not experienced any new outbreaks thus far into the fall migration of wild birds.

While we have been able to purchase some turkey meat to partially offset flock losses, turkey breast prices remain at a record high due to overall industry shortages. Our team continues to work closely with government agencies and other organizations as they study this virus and work to control future outbreaks, and with our customers, as we manage through the turkey breast meat shortages. We have made many adjustments and are prepared to minimize any future impact to our operations in the event that the virus returns to our area as the migration season progresses.

Our Specialty Foods segment reported an adjusted operating profit increase of 155%. MUSCLE MILK sport nutrition product sales increased nicely, though the gain was not enough to offset some reduction in contract packaging sales, leading to a net 3% decrease in overall segment sales this quarter. Full year results for Specialty Foods showed adjusted operating profit up 48%, with sales up 22%

The positive fourth quarter segment profit results reflect synergies captured within the CytoSport and Century Foods supply chain, and a beneficial comparison to last year's CytoSport acquisition-related cost of $9.3 million. The CytoSport acquisition is meeting our valuation expectations.

We have decided to explore the sale of a portion of our Diamond Crystal Brands business. While the business is still performing acceptably, we feel it no longer fits within our strategic priorities. We will pursue a sale over the course of the next few months allowing us to redeploy capital and investments that better support our growth goals.

International's fourth quarter operating profit increased 3% on flat dollar sales and a 5% higher volume. Results were driven by strong SPAM luncheon meat exports, and continued growth of our China business, muted by soft demand for fresh pork exports in certain markets. For the full year, adjusted operating profit in the International segment was up 4% on flat sales.

In October, the leader of our International segment for the past few years, Jim Snee, was elected to the position of President and Chief Operating Officer, and was appointed to our Board of Directors. Jim is only the 10th President in our company's 124-year history. In his new capacity, Jim will be responsible for all five reporting segments, while the finance functions, including M&A, R&D, legal, supply chain and human resources will continue to report to me. Jim's vast experience in both our Refrigerated Foods segment and our emerging growth markets internationally position him exceptionally well to take on these additional responsibilities.

I will now turn the call over to Jim to discuss our long-term segment margin guidance and 2016 outlook.

James P. Snee
President, Chief Operating Officer & Director

Thank you, Jeff. Good morning to all of you. Looking ahead to fiscal 2016, we expect renewed revenue growth as the year proceeds. Grocery Products should benefit from improved pork and beef input costs this year especially as compared to the first half of 2015. Along with positive sales trends for our key product lines including WHOLLY GUACAMOLE dips, SKIPPY peanut butter and our SPAM family of products, we have made significant improvements in manufacturing efficiencies over this past year, giving us the confidence to raise our long-term Grocery Products segment operating margin guidance from 12% to 14%, up to the 13% to 15% range going forward.

Our value-added businesses in Refrigerated Foods should benefit from favorable raw material costs, and the segment is positioned to start the year with strong earnings momentum. We expect modestly lower pork operating margins and hog prices in 2016, and plan to increase pork production by 1% to 2% over fiscal 2015.

While Refrigerated Foods clearly benefited from favorable market conditions in 2015, our team has also made significant progress in their efforts to improve product mix and drive sustainable margin improvement. Given these advancements, we are increasing our long-term segment profit margin range from 5% to 8%, up to 7% to 10% going forward.

We look for Jennie-O Turkey Store to return to growth in the back half of the year, if there are no significant recurrences of highly pathogenic avian influenza. Volumes will remain constrained in the early part of the year as we continue to rebuild our system after significant bird losses last spring.

In addition to lower volumes, Jennie-O Turkey Store is also facing difficult comparisons to fiscal 2015's strong first half performance. We expect turkey breast meat prices to remain elevated until the industry can see the impact of the spring bird migration. Lower grain input costs will be a tailwind in 2016. In terms of long-term segment profit margin guidance, we are modestly tightening our guidance range for Jennie-O Turkey Store; previously at 13% to 17%, narrowed to 14% to 17%.

We expect the Specialty Foods segment to deliver increases through the growth of our MUSCLE MILK protein nutrition products. Protein nutrition products remain on trend and promising new products in our innovation pipeline for this category should continue to drive success. Our long-term segment margin guidance for Specialty Foods remains at 8% to 11%. Though we are encouraged to see their upward migration within this range, the range does include contributions from the Diamond Crystal Brands business. If a sale occurs, we will provide an updated guidance range for this segment.

We look for the International segment to achieve year-over-year improved results through increased sales of our SPAM luncheon meat and SKIPPY peanut butter products, along with expansion of our China business. We are maintaining our long-term International segment margin guidance at 14% to 17%.

From a total company perspective, in light of the improved ranges mentioned, we are increasing our operating profit margins range from 9% to 12% to a new range of 10% to 13% reflecting our current business structure, product mix and typical market volatility.

Supporting our brands remains a top focus for us. In 2016, we are planning a double-digit increase in advertising support over the prior year. We will focus advertising dollars on REV snack wraps, HORMEL GATHERINGS party trays, HORMEL pepperoni, our SPAM family of products, SKIPPY peanut butter, MUSCLE MILK protein-rich products. And in the back half of the year, we expect to reignite our Jennie-O Make The Switch campaign. The

MegaMex joint venture will also continue to provide significant marketing support to the WHOLLY and HERDEZ brands of Mexican food products.

We also plan to reinvest in our business through higher capital investments in fiscal 2016. We expect to complete the construction of our new plant in Jiaxing, China and start production there by the end of 2016. Here in the U.S., we intend to increase capacity for our Hormel Bacon products and Jennie-O fresh turkey tray pack items. Additionally, we plan to expand our research and development capabilities thorough the construction of a new facility to support our team's constant focus on food safety, quality and innovation. After taking these significant factors into account, we have established our fiscal 2016 earnings guidance range at $2.85 per share to $2.95 per share.

At this time, I will turn the call over to Jody Feragen to discuss the financial information relating to the fourth quarter and fiscal 2015.

Jody H. Feragen

Chief Financial Officer, Executive Vice President & Director

Thank you, Jim. Good morning, everyone. On a GAAP basis, net earnings for the fourth quarter of fiscal 2015 totaled $187.2 million, up 9% over last year. GAAP diluted earnings per share were $0.69, a 10% increase. Excluding non-recurring charges, adjusted net earnings for the fourth quarter of fiscal 2015 totaled $199.9 million, up 17% from net earnings of $171.3 million last year. Adjusted diluted earnings per share for the quarter were $0.74, up 17% compared to $0.63 per share a year ago.

As Jeff mentioned, we have made the decision to sell a portion of the Diamond Crystal Brands business. This business has now been classified as held-for-sale, and asset impairment tests were performed as part of the evaluation process. The fourth quarter included pre-tax non-recurring charges of $21.5 million relating to a goodwill impairment charge for this business, and it is reflected in our Specialty Foods segment.

We also had a positive $8.9 million adjustment due to a reduction of a contingent consideration liability related to the CytoSport acquisition. This adjustment was due to an updated evaluation of the earn-out targets associated with the acquisition. The CytoSport earn-out agreement requires aggressive financial targets to be met, and sales got off to a slower start than anticipated in the earn-out. To be clear, CytoSport continues to meet the base business case used in our valuation.

For the full year, adjusted earnings per share were $2.64, representing an 18% increase over last year with all five segments contributing to the earnings growth. Sales for the fourth quarter totaled $2.4 billion compared to $2.5 billion for the same period last year, a 6% decrease. Sales were down 10% excluding the incremental impact of APPLEGATE, and MegaMex products not included in last year's results. Lower pork prices, turkey supply shortages due to high-path avian influenza, and the dissolution of the Precept Foods joint venture were the primary drivers of sales declines compared to last year. For the full year, dollar sales were $9.3 billion, down less than 1% compared to last year.

Volume for the fourth quarter was 1.3 billion pounds, down 2% from fiscal 2014. The decrease was primarily the result of lower sales for the Jennie-O Turkey Store segment. For the full year, volume was 5.1 billion pounds, up 2% over the prior year.

Selling, general and administrative expenses in the fourth quarter were 7.9% of sales compared to 6.5% last year. For the full year, selling, general and administrative expenses were 8% of sales compared to 7% last year. We expect selling, general and administrative expenses to be approximately 8% of sales for fiscal 2016.

Advertising expense for the fourth quarter was $29.6 million compared to $22.4 million last year. Full year 2015 advertising expense was $145 million compared to $114 million last year. Equity and earnings of affiliates was $8 million in the fourth quarter versus $5.7 million last year. The increase is largely the result of improved earnings at our MegaMex joint venture.

Interest expense for the quarter was $3.8 million, compared to $3.4 million last year. Year-to-date interest expense was $13.1 million, up from $12.7 million last year. We expect interest expense to be approximately $14 million for fiscal 2016.

Our effective tax rate in the fourth quarter was 35.2% versus 34.1% in fiscal 2014. The year-to-date effective tax rate was 35% compared to 34.3% last year. For fiscal 2016, we expect the effective tax rate to be approximately 34%. The basic weighted average number of shares outstanding for the fourth quarter and full year were 264.3 million and 264.1 million, respectively. The diluted weighted average number of shares outstanding for the fourth quarter and full year were 270.9 million and 270.5 million shares, respectively. We repurchased 400,000 shares of common stock spending $24.9 million in the fourth quarter. We have 7.8 million shares remaining to be purchased from the current authorization in place.

Long-term debt at the end of the quarter was $250 million, unchanged from last year. During the fourth quarter, we paid down $165 million of the $350 million short-term debt associated with the APPLEGATE acquisition. The remaining $185 million is expected to be repaid in fiscal 2016.

Capital expenditures for the quarter totaled $47.3 million, unchanged from last year. For the full year capital expenditures totaled $144.1 million compared to $159.1 million last year. The primary driver for the lower capital expenditures was our decision to delay the addition of capacity for Jennie-O fresh tray pack products in the face of lower turkey supply in 2015. We plan to move forward with this project in 2016, assuming there are no significant recurrences of avian influenza. For 2016, we expect capital expenditures to be approximately $250 million as several projects in process during 2015 are completed in 2016, including the construction of our new plant in China and the other projects Jim mentioned earlier.

Depreciation and amortization for the quarter was $34.4 million, compared to $32.9 million last year. For the full year, depreciation and amortization was $133 million compared to $130 million last year. We expect depreciation and amortization to be approximately $130 million in fiscal 2016.

As Jim mentioned earlier, we have established our fiscal earnings guidance range at $2.85 per share to $2.95 per share for 2016. This guidance includes a full year of contribution from our Diamond Crystal business. When a sale of the business occurs, we will provide updated earnings guidance.

Fiscal 2016 also includes an extra week in the fourth quarter. We have assumed the 53 week will contribute approximately 1% of the earnings increase over last year in our guidance range. We announced the $0.16 per share increase to the annual dividend, making the new dividend $1.16 per share. This represents a 16% increase on top of a 25% increase last year and marks the 50 consecutive year in which we have increased our dividend rates.

At this time, I will turn the call over to the operator for questions-and-answers. Operator?

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] And our first question we'll hear from Adam Samuelson with Goldman Sachs.

Adam L. Samuelson
Goldman Sachs & Co.

Q

Yes. Thanks. Good morning, everyone.

Jeffrey M. Ettinger
Chairman & Chief Executive Officer

A

Good morning.

Adam L. Samuelson
Goldman Sachs & Co.

Q

So I guess more detail on the margins, both in the quarter and in the outlook on the normalized ranges that you provided. Maybe in the quarter, can you provide a little more clarity, especially in Grocery and Jennie-O, the very sharp year-over-year kind of margin improvement that you saw, maybe give a little bit more color on the drivers there; was it simply timing of raw materials, manufacturing efficiencies, mix, a little bit more granularity there?

And then on the long-term targets, appreciate updating the long-term ranges, but I'm just trying to think about where you are today, especially Grocery, Refrigerated, and Jennie-O still running kind of near or at the high end of the ranges that you've laid out. And thinking about the contributors to earnings growth going forward, if you still think your margins are near the high end of the normalized range? Thanks.

Jeffrey M. Ettinger
Chairman & Chief Executive Officer

A

Thanks, Adam. This is Jeff. So in terms of the current quarter, on the Grocery Products side, what we feel we're seeing is kind of a return to normalized margins in terms of some of the raw material inputs, coupled with some systemic changes in our overall operations environment where we feel we've added efficiencies that will stick, and we attribute that to the strong quarter they just generated. And also that was why we have now increased that earnings guidance range by 1% on either end for the Grocery Products group.

In the case of Jennie-O Turkey Store, you'll recall we provided kind of our best-shot at what a second half adjusted guidance range would be in light of avian influenza, and had pulled the range down to the 10% to 12% range. We certainly did see better returns than that in the fourth quarter. On the aggregate for the half, that turned out to be closer to 14%. They were able to do better on some of the dark meat-based items than we had originally anticipated, and they did a nice job of attaining as much efficiency as possible in their operation. In the case of Jennie-O Turkey Store, you'll see we really are not changing the upper end of the guidance range, but we did tighten up the bottom end in light partially to their success in being able to achieve what they did this quarter.

The only other thing I guess I would add in terms of the long-term target ranges is clearly the Refrigerated Foods group with their performance this year broke out of the previous range. We were at 5% to 8% range, and they exceeded 9% this year. We have confidence in that business unit's ability to maintain margins and grow them over time from that level. And hence, we've raised that guidance range to the 7% to 10% range.

Specialty Foods have seen improvement within the range, as Jim indicated in his comments, but the overall results for the year are still within the guidance range we had previously provided. So we're leaving that unchanged, especially with the DCB issue still lurking out there. Overall, what we felt it added up to was kind of a 100 basis point change in the total company margins. And so we're looking at now 10% to 13% as being what we think we can look at going forward versus the 9% to 12% we had previously provided.

Adam L. Samuelson
Goldman Sachs & Co.

Q

That's very helpful, Jeff. And maybe just on the Refrigerated piece, as you think about the 200 basis point increase in the range there, would you attribute that to any particular part of the business? Bacon comes to mind as an area that's been – seems to be particularly strong this year, or really just manufacturing efficiencies and value-added mix, any more color there?

Jeffrey M. Ettinger
Chairman & Chief Executive Officer

A

It's been a strong performance all the way around, and we think it's sustainable progress with these brands. I mean, bacon is clearly a shining spot for that group, both on the meat product and foodservice side. But both of those value-added units had excellent results beyond just the bacon franchises. We mentioned some of the brands that did well in the release, pepperoni and party trays, and entrees for the Refrigerated Foods retail group, and then on the foodservice side, pizza toppings and FIRE BRAISED meats and other items. The affiliated part of Refrigerated Foods which is our Farmer John, Burke and Dan's Prize operations all had excellent years and contributed nicely to the results. And they too, as I mentioned with Grocery, we've tried to attain some long-term efficiencies. Refrigerated Foods certainly has not been quiet in that respect also. And so, it all really adds up to that new level that they're now able to attain.

Operator: And we'll next move on to Farha Aslam with Stephens, Inc.

Farha Aslam
Stephens, Inc.

Q

Hi. Good morning.

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

A

Good morning.

Farha Aslam
Stephens, Inc.

Q

Could you share with us your basic pork margin estimates for this year, and also that's factored into your guidance? And then the longer term outlook, what's kind of in your longer term guidance?

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

A

Sure. I guess everybody's pointing at me, Farha. I have to take the pork operating margin question. So certainly, they were stronger than we expected in the fourth quarter, and moving into the first quarter of 2016, they're pretty robust. I would expect as the year goes on, that those will trend downward and we'll see modestly lower pork operating margins. Supply seems to be robust. Demand at this point in time is robust as well. So that's basically what we factored into our business model going forward. Really this was the first quarter where we saw pork operating margins for the Refrigerated business unit being a contributor to their year-over-year results, and it's really been an improvement on their mix and the value-added products.

Farha Aslam
Stephens, Inc.
Q

And just as a follow-up, could you talk about the recovery in the turkey business and the timing of that recovery?

Jeffrey M. Ettinger
Chairman & Chief Executive Officer
A

So I mean what we're seeing in terms of the supply challenge is fortunately it's been a benign fall thus far. And there's obviously close watch even in terms of wild bird testing to make sure that we're not encountering the renewed presence of high pathogen avian influenza and kind of knock on wood, thus far, we've not seen that. We were able to completely refill our barns. But as we've talked about before, the primary turkey for most of our value-added items is our Tom turkeys. It's a 22-week market cycle. And so, we will not be kind of fully back to normalized volumes till, at the earliest, the second quarter of fiscal 2016.

Now that being said, the team has done the best job they can with making sure that we have the product allocated fairly among our customers in terms of what is available. And then, ultimately, as Jim indicated, if everything continues to go well, and we don't have any further outbreaks, we should be in a position by second half of next year to renew our successful Make The Switch advertising campaign and re-stimulate growth for the Jennie-O Turkey Store brand.

Operator: And next we'll move on to Kenneth Zaslow with BMO Capital.

Patrick Chen
BMO Capital Markets (United States)
Q

Hi. Good morning. This is Patrick Chen in for Ken.

Jeffrey M. Ettinger
Chairman & Chief Executive Officer
A

Hi, Patrick.

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

Good morning.

Patrick Chen
BMO Capital Markets (United States)
Q

One quick question about pork exports. We understand that China has opened its borders again to a couple of processing plants, including yours. Just wondering what the broad implications are for your pork exports, your pork margins, and input costs for other parts of your business? Thank you.

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

Sure. Good morning, Patrick. This is Jim. Last year, 2015, was a struggle with the pork exports, especially in our International business. One of the bigger contributing factors was when Russia banned the imports from the European Union. That supply had to go somewhere, and it did find its way into the Asian market in general at some more favorable currency rates. And so, more supply, favorable rates really were almost a perfect storm against us last year. Certainly, the opening up of the China market and the approval of our plants, while we don't export pork directly into the China markets because of their ractopamine or lack of ractopamine requirement. What we do think it'll do though, is really maybe redistribute the supply of the available product. And so as we're looking into 2016 for our pork exports in the International business specifically, we think sometime in the second quarter or the back half of the year, we'll be able to return to more normalized levels of our export business, which is still a very important part to our overall International business.

Patrick Chen
BMO Capital Markets (United States)
Q

Great. Thank you. I'll pass it along.

Operator: And next we'll move to Heather Jones with BB&T Capital Markets.

Heather Lynn Jones
BB&T Capital Markets
Q

Good morning.

Jeffrey M. Ettinger
Chairman & Chief Executive Officer
A

Hi, Heather.

Heather Lynn Jones
BB&T Capital Markets
Q

Hi. I had a question first on your pork business. Talking about it, you sounded like you have a pretty bullish outlook on the fresh pork side. One thing that we've been hearing from a number of companies in the industry is that when we're looking at the USDA cut-out, just how that's trending? There seems to be a widening gap between what the USDA is reporting on that cut-out and what companies are seeing on a blended basis? And I understand you guys have a lot of value-add, but just wondering if you're seeing a similar trend, so that maybe the USDA cut-out is not as good a proxy as it used to be for just trends for pork prices?

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

I am not familiar with where your data is coming from, but one of the contributing factors could be the fact that the drop credit that are not included in the cut-out have significantly declined from normalized-type level. So that be causing some of it. Those are credits for items that aren't traditionally sold in the U.S. or byproducts of the harvesting process, so...

Heather Lynn Jones
BB&T Capital Markets
Q

Right. Yeah, I was talking about on the cut-out specifically; but it sounds like you all are not seeing the same thing. On your Jennie-O business, from what I understand, Hormel is backwards-integrated back to the breeders, whereas quite a bit of your competitors are not. So it sounds as if Hormel's – Jennie-O's volumes may return to normal barring another outbreak quicker than the overall industry will return to normal, from a volume perspective, is what we understand based upon our conversations. And I guess my question is, I understand the difficult comparisons for the first half, but as we're thinking about late Q2 and Q3, I know a lot of your business is value-added and more fixed-price contract type of thing, but the part that is on the market, should we see some benefit from you guys having your volume return to normal quicker than the overall industry and still being able to benefit from some elevated pricing?

Jeffrey M. Ettinger
Chairman & Chief Executive Officer
A

Well Heather, let me, I guess, make sure we're on the same page in terms of the verticality of the Jennie-O operation. We don't actually engage in the breeder stock. We do have our own hatcheries, so we do have a direct egg source. Our egg experience, from what we're seeing in the industry, may be a little bit better than the overall industry number. But that's as close as I can get to being able to compare ours to others.

In terms of the second half outlook, I mean we frankly been the leader when it comes to branded value-added products for some time. I mean, we're the one that's advertising. We're the company that creates innovative new products. We have a dedicated team that focuses on the sale of those items and to multiple channels. And so, yeah, definitely, if we have the supply in place, that team is primed and ready to renew our momentum of growing the value-added businesses.

Indeed, I mean, before this thing hit in the first half of this year, all three of our groups, the retail, deli, and foodservice, the Jennie-O Turkey Store, their value-added sales were all up double digits. So they were really on a roll here, and we would expect during the second half of this year, if we have the meat supplies available, and can turn the advertising back on to renew that kind of growth.

Operator: And next we'll move to Diane Geissler with CLSA.

Diane R. Geissler
CLSA Americas LLC
Q

Good morning.

Jeffrey M. Ettinger
Chairman & Chief Executive Officer
A

Good morning.

Diane R. Geissler
CLSA Americas LLC
Q

I just wanted to ask on Diamond Crystal. So you obviously took a charge there. I'm assuming that's in anticipation of potential sale. Can you help us, just how big is that business and what is its profit contribution been, so as we model out this year we can kind of get an idea for what the potential dilution to your EPS would be?

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

So I don't think we've specifically called out any profitability numbers on that business, and we will provide you the appropriate guidance when we do have a transaction to talk about. From a sales perspective, it's about $250 million to $260 million. But at a margin structure, that's generally lower than the guided range that we have for the Specialty Foods segment. So we'll try to help you when we have something to talk about.

Diane R. Geissler
CLSA Americas LLC

Q

Okay. Appreciate just giving me the quantification on the size of the business. And then, can I just ask about China? So you talked about the plant and additional CapEx this fiscal year to finish the construction there. What is the timing – how do you think about the timing in terms of – obviously it's for SPAM, et cetera; that's been a product that you've introduced and then you had to pull. Could you just kind of talk about what your plans are with regard to when the plant is up and running, how long you think it will take to get product kind of out the door and onto shelves, and just kind of maybe a longer term 12-month to 24-month outlook on your business in China? Thank you.

James P. Snee
President, Chief Operating Officer & Director

A

Yeah. Thanks, Diane. This is Jim. Our business in China really has been performing exceptionally well here the last couple of years. That team has really hit their stride. In terms of the needed capacity, the sooner we complete this plant, the better off we're going to be. We are expecting the plant to be completed in the fall of 2016, so if we think about the September timeframe.

And as a reminder, that plant will be a combination of refrigerated meats, and also our in-country SPAM production, as you mentioned. And so that plant and the capacity that's going to be made available to our business in China is really going to keep us on the path of sustained growth that we've been able to deliver here the last couple of years. The business is very well developed, both in the retail and foodservice channels, not only on the meat side, but with our SKIPPY business.

And so as we think about it going forward, we're exceptionally well-positioned to continue to grow that business in meat, in SKIPPY, and we're very excited about the synergies that we'll get with the in-country production of SPAM and being able to leverage them against what we've learned through the SKIPPY acquisition integration. So lots of great things coming out of China.

Operator: [Operator Instructions] And next, we'll move on to Mario Contreras with Deutsche Bank.

Mario Contreras
Deutsche Bank Securities, Inc.

Q

Hi. Good morning.

Jeffrey M. Ettinger
Chairman & Chief Executive Officer

A

Good morning, Mario.

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

A

Good morning.

Mario Contreras
Deutsche Bank Securities, Inc.

Q

So I wanted to clarify on the guidance for fiscal 2016, on the 53rd-week. Mathematically, would expect that to add 2%, so given that it's only going to add 1%, I'm just curious if that's related to timing, or is some of that extra week profit going to be reinvested back into the business?

Jeffrey M. Ettinger
Chairman & Chief Executive Officer

A

Okay. Mario, this is Jeff. Our business is a hybrid business between the middle of the store grocery channel and then the protein-based channels. And I guess the way we assess it is, yes, on the protein side, when you have kind of meat coming at you in the system, you should anticipate, frankly, a full extra week, you'll have full cost, and frankly, should deliver full margins. When it comes to the grocery side of the business, which impacts not only our Grocery Products segment, but also our International piece is significantly grocery-based. Our experience in the past has been that when you're on buying programs for those types of items, you really don't get a whole extra week. I mean, a lot of them are on monthly programs and so forth. And so, we're just kind of trying to provide the guidance based on what our best experience has been.

I would say, though, there is a certain element of reinvestment going on. I mean, we've been stepping up our ad spend on an annualized basis, and this current plan is no exception to that. We have a number of brands that we're excited about that we think we can continue to build momentum in the marketplace. And so, there is a little bit of element in general of us making sure we're reinvesting in our brands.

Mario Contreras
Deutsche Bank Securities, Inc.

Q

Okay. Thanks for that. And then just one additional clarification. The corporate expense was a bit higher than its historical trend. Was there anything unusual there this quarter? And what type of run rate do you think would be appropriate going forward for that line item?

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

A

Oh, I would expect that – well, in the fourth quarter, we really had some higher employee-related expenses as we took a look at all of our incentive programs and made adjustments there. We also had some higher legal expenses for some activities that was going on there. On a normalized level, I think you could look at possibly a 5% increase over where we finished this full year. That ends up being a spot where lots of miscellaneous adjustments get. So it's a little harder to forecast.

Operator: And next, we'll move on to Robert Moskow with Credit Suisse.

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

Q

Hi there.

Jeffrey M. Ettinger
Chairman & Chief Executive Officer

A

Good morning, Robert.

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

Q

How is it going?

Jeffrey M. Ettinger
Chairman & Chief Executive Officer

A

Good.

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

Q

A great year, great two years in a row. So, here's a question about turkey. I literally just bought our turkey at Stop & Shop, $75, $3.12 a pound. I mean it seems like a shockingly high price.

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

A

Rob was it a Jennie-O?

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

Q

Would it have been cheaper if – yes, first question, would it have been cheaper or Jennie-O? But second question, I look at your pricing, back half of the year, there is no pricing, despite the fact that the industry is volume constrained. And I'm trying to think about next year for Jennie-O. Well, why is the pricing flattish, and for next year will it continue to be flattish? And then I'm still not quite sure I understand the cautious guidance for the first half for 2016 for Jennie-O, if fourth quarter came in wildly above what I had forecasted, and I understand the volume constraints, but can you give us an order of magnitude on the first half profit guidance for Jennie-O?

Jeffrey M. Ettinger
Chairman & Chief Executive Officer

A

Okay. I mean, first of all, Robert, when it comes to the whole bird pricing, I mean it's a relatively small percentage of the overall results of the business, and you're also dealing with something that's very retailer specific and retailer dependent. I mean, it ranges from apparently you had an experience where the retailer was certainly seeking to attain some margins out of their whole turkey sales, all the way to kind of the more historical treatment, frankly, there's a lot of retailers use it as a loss leader. And so you'll see a price out there, and you might think that's breathtakingly low sometimes, yet that's not necessarily what our value was into them. It's up to the retailer to decide how to price the product. In the aggregate, we came up with as many whole birds as we could for this year, given the shortages we were confronted with and allocated them out on a national basis.

In terms of your question about pricing in general and the guidance, fourth quarter is traditionally our strongest quarter. You can hear most favorable feed conversions and so forth in your birds. You do have the added bump, if you will, of kind of the Thanksgiving sales rolling through. We know we're going to be short product again in Q1. We're certainly going to try to perform as strong as we can where we're going to be comparing against a very robust performance by Jennie-O Turkey Store in Q1 and Q2 in fiscal 2015. So we're comfortable that Jennie-O will be a solid contributor to the guidance range that we've provided you on an aggregate basis with most of it coming in the second half of the year.

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

Q

Okay. But pricing, like, there is no pricing in Jennie-O right now, and I imagine no pricing next year either. In a capacity-constrained environment, I would have expected pricing to be higher; is it because there's contracts in place with the retailers, or is there something else?

Jeffrey M. Ettinger
Chairman & Chief Executive Officer

A

It kind of runs the gamut, Robert. I mean, in some cases, yeah, you're dealing with product shortages. And if you're in a significant enough shortage position, you may end up having to raise the price of what you have left. There's other aspects of the portfolio that you are on more of a contract basis or on a committed basis. And so, it just kind of ends up blending out to the position you're seeing.

Clearly, there has been a steep increase in the commodity turkey pricing, but I think as we've talked about in the past, even in years when we're not short of turkeys, we're not really a net seller of breast meat at commodity meat markets. And so, these very lofty $4 and $5 rates that you're seeing on the commodity breast side, that's not something we're able to enjoy in our sales.

Operator: And there are no further questions. At this time, I would like to turn the call back over to Jeff Ettinger for any additional or closing remarks.

Jeffrey M. Ettinger
Chairman & Chief Executive Officer

Well, thank you very much. I just want to conclude by saying that I am proud of the excellent quarter and full year performance by our team, as we achieved record earnings for 10-straight quarter. It's this extraordinary experience of our employees throughout the company that such a key factor to our ability to consistently deliver strong results for the company. On behalf of this team, I want to wish all of you a happy Thanksgiving. And thank you for joining us today.

Operator: And that will conclude today's call. We thank you for your participation.