24-May-2018

Hormel Foods Corp. (HRL)

Q2 2018 Earnings Call
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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, ladies and gentlemen, and thank you for standing by. Welcome to the Hormel Foods Second Quarter 2018 Earnings Release Conference Call. At this time, all participants are in a listen-only mode. As a reminder, this conference is being recorded on Thursday, May 24, 2018.

I would now 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 second quarter of fiscal 2018. 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 Investor Section.

On our call today is Jim Snee, Chairman of the Board, President and Chief Executive Officer; and Jim Sheehan, Senior Vice President and Chief Financial Officer. Jim Snee will provide a review of each segment's performance for the quarter and our outlook for the remainder of 2018. Jim Sheehan will provide detailed financial results for the quarter and further assumptions relating to our 2018 outlook. The line will be open for questions following Jim Sheehan's remarks.

As a courtesy to the other analysts, please limit yourself to one question with one follow-up. If you have additional questions, you are welcome to get back into the queue. An audio replay of this call will be available beginning at 11 AM today, Central Standard Time. The dialing number is 800-239-9838 and the access code is 9118102. It will also be posted to our website and archived for one year.

Before we get started, I need to reference the safe harbor statement. Some of the comments made today will be forward-looking and actual results may differ materially from those expressed in or implied by the statements we will be making. Please refer to pages 31 through 38 in the company's Form 10-Q for the quarter ended January 28, 2018 for more details. It can be accessed on our website.

Additionally, please note the company uses non-GAAP results to provide investors with a better understanding of the company's second quarter operating performance by excluding the sales and volume impact of the acquisitions of Ceratti, Columbus Craft Meats and Fontanini.

Discussion of non-GAAP information is detailed in our press release located on our corporate website. Please note during our call today we will refer to these non-GAAP results as organic net sales and organic volume. I will now turn the call over to Jim Snee.

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

Thank you, Nathan. Good morning, everyone. I am pleased to report on our second quarter results this morning. Our team successfully navigated through macro and commodity headwinds this quarter to deliver record earnings per share of $0.44, up 13% and in line with our expectations. Our balanced business model allowed us to mitigate
double digit increases in freight, a dynamic pork environment, and continued oversupply in the turkey industry. The benefit from tax reform also contributed to our record results.

Second quarter sales were also a record for our company and we are encouraged by many positive trends across our portfolio. Total company sales for the quarter were up 7% on a 3% volume increase. The increases were driven by the recent strategic acquisitions of Ceratti, Columbus Craft Meats, and Fontanini.

On an organic basis, volume decreased 1% while sales were flat. Many value-added brands in each segment grew but the gains were offset by lower results from Jennie-O Turkey Store, CytoSport, and our contract manufacturing business.

Recent third-party consumption data supports the growth we are seeing across many of our brands, and household penetration figures also suggest solid momentum especially with millennials. In terms of segment performance, Refrigerated Foods grew segment profit 18% despite a difficult freight environment and a 25% decline in commodity profits. The strength of our value-added portfolio in both retail and foodservice coupled with lower input cost allowed us to generate strong growth.

Sales increased 14% on a 6% volume increase, primarily related to the acquisitions of Columbus Craft Meats and Fontanini. Our Hormel Natural Choice franchise showed very strong growth this quarter. The Natural Choice brand has been gaining share in the retail marketplace and with foodservice operators since its introduction in 2006. Over the past few years, the brand has evolved with the change in consumer preferences towards all natural.

We have broadened our offerings in the lunch meat category while expanding into bacon, pepperoni and handheld snacks. This past quarter, we fully converted our [ph] row of (06:06) product line to an all-natural formulation and re-launched the products under the Natural Choice brand. The results to date have been impressive. We have increased our distribution, grown household penetration, and improved in-store velocities. Natural Choice is a great example of how a strong brand combined with our culture of innovation can drive growth and expand overtime.

Foodservice sales of Hormel Bacon 1 fully cooked bacon, Hormel Fire-Braised meats and Café H products all generated excellent growth this quarter as we continue to partner with and deliver innovative solutions to operators who are facing time and labor challenges.

We have successfully integrated Fontanini’s manufacturing and logistics into our global supply chain and are in the process of integrating the sales and marketing functions into our Hormel foodservice division. In addition to the Fontanini integration, the re-organization of our various deli businesses into Refrigerated Foods is well underway and we are in the early stages of integrating the Columbus Craft Meats business. Both the Fontanini and Columbus acquisitions are on track and meeting expectations.

Our International segment delivered sales growth of 22% on a volume increase of 14%, primarily related to the acquisition of Ceratti. Organic sales growth of 8% was driven by improved business in China. Our SPAM sales in China continue to gain momentum, placing us ahead of our distribution expectations. International segment profit growth was 6% as improved profitability in China was partially offset by higher advertising expenses.

Jennie-O Turkey Store earnings declined 34%, while sales declined 4%. Lower whole bird pricing and volume drove the lower results this quarter. Jennie-O lean ground turkey and our Oven Ready brand continued to perform well.
As a reminder, our Grocery Products and Specialty Foods teams merged as of the beginning of this fiscal year, and we now report consolidated results as Grocery Products. For the quarter, our core Grocery Products portfolio continue to remain healthy and vibrant, delivering low single-digit sales growth led by established brands such as SPAM, Dinty Moore, and Hormel chili, as well as the emerging brands such as Wholly Guacamole and Herdez. The gains in our center store portfolio were not able to offset the decline in sales from CytoSport and our contract manufacturing business.

Total Grocery Products segment profit was down due to increased promotional activity and lower volumes at CytoSport and lower earnings from our contract manufacturing business. The CytoSport business is facing numerous headwinds. Our team understands the various dynamics in each of the key channels.

Our challenges lie primarily in our convenience store and specialty channel businesses. We are having success in the food, drug, and mass channel which will continue to be an area of focus for us as we work to grow the Muscle Milk brand. While this business is not where we expect it to be, the move into the Grocery Products segment will provide more branding and marketing resources, and I expect that shift will return CytoSport to growth.

Turning to our second half outlook, we expect a strong finish in many of our businesses. We expect Grocery Products to continue their strong momentum in our core portfolio into the second half and return to growth. For Jennie-O Turkey Store, we still expect earnings to decline in the back half compared to last year.

Beginning next quarter, the commodity pressures we felt in our value-added businesses last year will be annualized, but we will not lap the declines in the whole bird business until the first quarter of 2019. Our successful Make The Switch campaign will return this summer, supporting our lean ground turkey and other value-added businesses. Signs of supply reductions are encouraging, and we see Jennie-O Turkey Store returning to growth in the first half of fiscal 2019.

The outlook remains positive for our International segment as we continue to capture the benefits from our new plant in Jiaxing, China. To-date, we have been successful exporting pork around the world. However, given the uncertain impact of the tariffs on the pork industry, we are expecting modestly lower sales and margin in our export business. Favorable performance from our China meat business should offset the potential impact on export sales.

Our view of Refrigerated Foods has not changed from the first quarter. We expect our value added businesses in retail and foodservice and the acquisition of Fontanini and Columbus to offset declines in commodity profits and freight headwinds. Jim Sheehan will provide insights into our view of the hog and pork industry and where we continue to see volatility.

This quarter, we saw a double-digit increase in per unit freight costs due to both the lack of availability of trucks and an increase in diesel fuel surcharges. We continue to work with our customers to find mutually agreeable solutions to offset these increases. Rising freight costs will continue to have an impact in the second half of 2018 and into 2019.

Taking all these factors into account, we are reaffirming our sales guidance of $9.7 billion to $10.1 billion, and our earnings guidance of $1.81 to $1.95 per share. As we think about the second half, we see a slightly higher cadence in the fourth quarter as we were dealing with a run-up in key input costs last year.
At this time, I will turn the call over to Jim Sheehan to discuss the financial information relating to the quarter and key assumptions for the remainder of fiscal 2018.

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

Thank you, Jim. Good morning, everyone. Volume for the second quarter was 1.2 billion pounds, a 3% increase compared to last year. We had record sales for the second quarter of $2.3 billion, a 7% increase. Organic volume decreased 1% and organic sales were flat.

Net earnings were $237 million, up 13% compared to last year. Refrigerated Foods benefited from our strategy of growing value-added sales through innovation and acquisitions as well as the benefit of declining input costs. As Jim reported, Refrigerated Foods profits were up 18% while commodity profits declined 25%. Commodity profits reflect the fresh pork and provisions sales less the cost to procure and process hogs. Commodity profits in the quarter were below the long-term benchmark of 15% of total Refrigerated Foods profits.

Excluding advertising, selling, general and administrative expenses were 7.1% of sales compared to 6.9% last year. Excluding acquisitions, SG&A was flat on a dollar basis. Advertising expense this quarter was $37 million compared to $30 million last year. We expect to increase advertising by approximately 20% in 2018. We are currently advertising key growth brands including Skippy, SPAM, Jennie-O, and Natural Choice.

General corporate expenses increased primarily due to higher employee related expenses including healthcare. As you think about the remainder of the year, the universal stock option award made to our 20,000 employees will impact corporate expenses in the third quarter. This represents approximately $0.01 per share. Operating margins were 13.1%, a 130-basis point decrease compared to last year. The decline is primarily a result of lower margins at Jennie-O and CytoSport along with higher freight costs.

Our effective tax rate was 20% compared to 33.2% last year. The lower tax rate provided a $45-million benefit compared to the prior year. As we continue to assess tax reform, we have narrowed the range for our full year tax rate to be between 17.5% and 19.5%. Year-to-date, we have generated operating cash flows of $443 million, up 58%. The increase was related to higher earnings and improved working capital.

As we communicated at Investor Day, one of our priorities is to improve our cash conversion cycle. To the last 12 months, we took three days out of our cash cycle as all three components improved. Capital expenditures for the quarter totaled $87 million compared to $39 million last year. We expect capital expenditures to be approximately $425 million in 2018. Projects include the replacement of our Melrose plant, the bacon expansion in Wichita, upgrades to the Austin plant, numerous capacity expansions, and ongoing investments for food and employee safety.

In the quarter, we paid $99 million in dividends at the annual rate of $0.75 per share. This marked our 359th consecutive quarterly dividend. Total debt is $810 million. This is split between short term loans, which we plan to pay off this fiscal year, and long-term debt. We remain in a strong financial position to fund other investments. We repurchased $20 million in stock this quarter at an average price of $32.95 per share. Input costs for the second quarter were mixed. Hog prices were 9% lower than last year.

As we communicated in prior quarters, our expectation is for low single digit increases to hog prices in the back half of our fiscal year. We will continue to focus on three factors; export demand, domestic demand, and total hog supplies compared to industry capacity.
Exports continue to be strong, and the USDA forecasts exports to be up 5% in 2018. We are watching export demand carefully. Domestic consumption remains very strong. Retail pork prices remain steady, and we continue to see pork clearing the market at current prices. We expect hog supplies to increase 3% to 4% this year. We continue to believe total hog supplies are well matched to industry capacity over the long-term.

We remain vigilant in our assessment of the industry, and we'll make the necessary changes to ensure we are sourcing pork for our value-added products at the lowest possible cost. We continue to procure more raw materials externally, offsetting the 3% decrease in our existing hog harvest facilities.

Belly prices were 20% lower than last year. We expect belly prices to remain volatile but in line with 2017 levels for the back half of the fiscal year. 72% pork trim prices were 5% below last year. We expect trim markets to be lower than 2017 levels in the back half. 50% beef trim was 7% lower compared to last year. We expect beef prices to be lower than 2017 levels.

Market costs for feed were higher compared to last year. We expect feed costs to be higher year-over-year in the back half. We are starting to see the early signs of a recovery in the turkey industry. All placements have shown low single-digit declines in recent months. Industry harvest levels have decreased and turkey breast meat in cold storage is now below last year. Inventory of whole birds remains elevated at 14% above last year.

Turkey breast meat prices increased during the quarter. Breast meat is currently trading around $1.84 per pound compared to $1.55 per pound at the beginning of the quarter. We expect moderate increases in turkey prices for the back half of the year. Whole bird prices are 19% lower than 2017 levels, and we do not expect a material change in pricing until the first quarter of fiscal 2019.

Regardless of our market projections, the one constant in the current market is volatility. The second quarter demonstrates our ability to manage through volatility. Rapid changes in markets can affect results in the short term, but we have the capacity to adjust and continue growing earnings for our shareholders.

At this time, I will turn the call over to the operator for the question-and-answer [audio gap] (21:42).
QUESTION AND ANSWER SECTION

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

Lubi Kutua
Analyst, Jefferies LLC

Hi. Good morning. This is actually Lubi on for Akshay. I wanted to ask a question on turkey. So, you mentioned that you’re seeing some encouraging signs in the turkey business. It seems to be making your outlook for Jennie-O in fiscal 2019 somewhat more positive. I’m wondering if you could just elaborate a little bit more on what exactly you’re seeing out there and maybe what’s changed the most since the last quarter run. I think you might have tempered expectations a little bit less last time around.

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

Right. Well, good morning. Our Jennie-O Turkey Store business, they are continuing to navigate difficult industry conditions, but we are seeing signs of supply reductions. We talked about the industry harvest which is down 3% year-to-date. We are seeing poult placements down low single digits, which is a good metric. The cold storage inventories, we’re seeing breast meat down 3%. On the other hand, we are seeing whole birds up 14%.

So as we’re thinking through this, clearly, those are some positive indicators for the business, but because of that run-up in whole bird inventories and the decrease in the whole bird market, that’s still going to have an impact on the back half of this year and into early 2019. But we do think these indicators are going to continue.

And then of course through the work that we’re doing on the value-added business with our lean – Jennie-O lean ground turkey or Oven Ready turkey items, we believe that we’re still well-positioned to return to growth in the first half of 2019.

Lubi Kutua
Analyst, Jefferies LLC

Thanks. That’s helpful. And then if I could ask a question on the freight cost situation, so I know freight costs continue to be a challenge and I think last time around, you had mentioned that you were starting to look at some measures to mitigate some of that impact. I’m wondering if you could just give us sort of a progress update on how that’s been going and to the extent that you are looking to pass some of that on, how are those conversations been going with some of your customers. Thanks.

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

Sure. Well – and again a reminder, freight is – has been a headwind. We expect it to continue in the second half and into 2019. And we’ve been working to solve it a few different ways. We did talk about working with our customers to find mutually agreeable solutions. And we’re thinking about minimizing miles, maximizing weights, how many days or week do you need delivery, and I will tell you that our customers are very open to those discussions.
Of course, we’re working internally to make sure that we are as efficient as we can be. And then there are situations where we are taking pricing as well when we’re not able to find those mutually agreeable solutions. So it is a variable plethora of things that we’re working on. But again the big message here I think is that it’s going to continue to be a headwind back half of this year and into 2019.

Lubi Kutua  
Analyst, Jefferies LLC

Thanks. I’ll get back in queue.

Operator: Thank you. We will now take our next question from Rupesh Parikh of Oppenheimer. Your line is open. Please go ahead.

Rupesh Parikh  
Analyst, Oppenheimer & Co., Inc.

Good morning, and thanks – thanks for taking my question. So maybe to start out, as we look at your guidance range for this year you guys reaffirmed guidance, but you still kept a pretty wide range. So just curious, as you look at that range, what factors could drive you to high end versus the low end of the range?

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

Well, good morning. The reason we have kept the range where it is, is we know that there’s still volatility in the marketplace, and volatility in terms of what’s happening in the pork industry, volatility in terms of what’s happening in the freight industry. And so, we felt that it was very appropriate to keep that range.

From our perspective as we think about the second half of the year, Refrigerated Foods is poised to have a strong second half. Our value-added business will continue to offset what we expect to be commodity declines. Jennie-O Turkey Store is going to continue to be up against industry, over supply pressures, and whole bird pricing.

Our International business, we talked a little bit about what could potentially happen with tariffs in pork but our business in China is doing quite well. And so, I mean, there’s a number of things out there that can set us up for a strong second half and that’s what we’re expecting in our business.

Rupesh Parikh  
Analyst, Oppenheimer & Co., Inc.

Okay. Great. Thanks. And then switching gears to CytoSport. So, you mentioned in your prepared comments some of the challenges in the convenience and specialty channels. So, I was curious, as you look at the challenges there, is that more – is that category challenges or is something changing from a competitive perspective, and what the plans are to improve performance within those two channels?

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

Great. From our perspective, it’s really a competitive issue and we called out the c-store and the specialty channel because that’s where our challenges are. In the c-store business we are still recovering from third-party recall in 2016. We thought we had some signs of life in the first quarter that didn’t play out into the second quarter so we know that we still have work to do to get our distribution back in line.
Our brand teams are working on consumer messaging and making sure that we have the right pricing. The specialty channel is something that is less competitive and probably more structural as sales in that channel continue to migrate online. We're working to move more of our sales online through our digital experience effort that we have going on.

And so, the other thing I would tell you is, at the beginning of the year, we did merged Specialty Foods into Grocery Products, and we believe that that is going to offer the appropriate level of branding and marketing support.

So we do expect results to improve in the back half but we would tell you that that's mostly due to easy comps. Our bigger concern for the business is really getting it back to a healthy and sustainable growth level.

Rupesh Parikh  
Analyst, Oppenheimer & Co., Inc.

Okay, great. Thank you.

Operator: Thank you. We will now take our next question from Ken Zaslow of Bank of Montreal. Your line is open. Please go ahead.

Ken Zaslow  
Analyst, BMO Capital Markets (United States)

Hey. Good morning, everyone.

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

Morning, Ken.

Ken Zaslow  
Analyst, BMO Capital Markets (United States)

Just two questions. One is can you give us an update on the cost savings program, where is that right now? What is your technology to be able to capture the synergies? Where are you on that? That's the first question. Thank you.

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

Sure. So we told you in Q1, Ken, that we're working to get the structure and process in place. We've had Glenn Leitch heading up our supply chain now for all of four months and we are making progress in that area and our focus is on progress. He's been very busy working on a number of different things, operational consistency, labor utilization, looking at our broad co-packer network. We had a question already around freight and so he's been active in that space.

And so we are still in, I would say, the structure process and progress mode and we're pleased with the progress we're making, but we are still not where we need to be in terms of the methodology.
How long will that take before you have parameters? And even if you don't give us the details when will you guys have insight into what you will accomplish by when and if that will impact 2019?

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

Yeah. I mean, I think we have insights into what we're achieving. So, I mean, we know what we're capturing. I think the issue for us is we want to make sure that those numbers, whether they are being reinvested or going to the bottom line, that is still a work in process for us. Cost savings, as we've told you, it's not new to us. It's something that we have had throughout our business for a very long time. We are just trying to take this more global approach to it.

Ken Zaslow  
Analyst, BMO Capital Markets (United States)

Great. Thank you.

Operator: Thank you. We will now take our next question from Adam Samuelson of Goldman Sachs. Your line is open. Please go ahead.

Adam Samuelson  
Analyst, Goldman Sachs & Co. LLC

Yes. Thank you. Good morning, everyone. I guess my first question would be around Refrigerated and maybe just trying to get a little bit more color on the performance and the expectation with – in organic volumes down year-on-year. Is that just a function of lower harvest levels internally? And, I mean, the price mix was up year-on-year despite pork price declines and especially belly price declines. I'm just trying to think about kind of how that mix kind of really evolved between some of your more commodity products on the sales side and the value-added, some of the pieces in there.

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

Sure. So, I mean, we've said for some time on Refrigerated Foods the focus on the long-term trend really is for growing our value-added sales, and we know that there's going to be some short term noise with changes in markets and commodity profits, and I think we're still seeing that play out. Some of the new capacity has come online much slower than announced.

But we're still worried about controlling what we can control and really that's driving our value-added business, and we're doing that with Natural Choice, Bacon 1, the strategic acquisition of Columbus which is doing very well, and that's the Refrigerated Foods story going forward. And so, we're pleased with that business. We are – and we did say that the volume growth was driven by those acquisitions. And so, we're pleased that those strategies are playing out as well.

Adam Samuelson  
Analyst, Goldman Sachs & Co. LLC

All right. And then on the acquisitions, I mean, can you talk about how they were doing themselves organically between Columbus and Fontanini, and as we think about just kind of where those have been performing?
James P. Snee  
Chairman of the Board, President & Chief Executive Officer, Hormel Foods Corp.

Yeah. I would tell you that both of those are meeting our expectations and both of them are showing growth year-over-year. They're in different stages of the integration process. Fontanini, we've got the operations piece integrated and we're ahead on the sales and marketing integration in the foodservice.

From a Columbus perspective, we are starting the systems and operations integration here in the next several weeks, and then the sales and marketing integration is a work in process, but that will be up and running for fiscal 2019.

Adam Samuelson  
Analyst, Goldman Sachs & Co. LLC

Okay. Great. I'll pass it on. Thanks.

Operator: Thank you. We will now take our next question from Farha Aslam of Stephens, Inc. Please go ahead.

Farha Aslam  
Analyst, Stephens, Inc.

Hi. Good morning. My first question is really focused on a broader pricing question. I mean, as you've looked across the various parts of your business, how successful have you been in terms of implementing pricing for freight, packaging and commodity? And could you share with us your ability to price in the current market environment to protect margins?

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

Sure. Good morning, Farha. Thanks for the question. Just as a reminder, there are different ways that we price in both the foodservice and retail channel. In our foodservice business, we probably had a 30-day lag; on the retail side of the business, probably more like 60 days. And we feel like we are still in a very strong position to be able to take pricing when appropriate and we think what happened to our business towards the tail end of last year really supports that position.

If you think about how we were faced with significant input cost increases in six of our seven largest inputs, we took pricing on Wholly Guacamole, Skippy, chili, stew, hash. And yeah, it's not easy, but we're able to get that pricing through. So, it's not easy, but it certainly is achievable. And then I think you can see how that plays out as we wrap up the second quarter. Some of the items that we're talking about that showed growth were Wholly, chili, stew and hash. So, we believe that we have the appropriate pricing power when necessary.

On the freight side of the business, I wouldn't say that we've recaptured all the freight cost, but I think the fact that we're going at it in a myriad of different ways is the right way to do it.

Farha Aslam  
Analyst, Stephens, Inc.

That's helpful. And then a very specific question, could you address the contract manufacturing? Is that decline simply your purposeful exit of lower margin business? Is that something that will continue to be a factor for Hormel, or is this contained in the current quarter?
James P. Snee  
Chairman of the Board, President & Chief Executive Officer, Hormel Foods Corp.

Well, our contract manufacturing business is – it's not a strategic play for us. It is – and I think we have been pretty open about it, it is more of a capacity play for us. And I think we all see what's happening in the contract manufacturing environment. It's a tough competitive environment. We experienced that this quarter and we know that it's going to continue to be a challenge.

Our goal in all of it is we want to fill up our capacity with our value-added sales, and that's our number one goal. So, it did have an impact this quarter, and we do see it ebb and flow from quarter-to-quarter and from year-to-year.

Farha Aslam  
Analyst, Stephens, Inc.

So, not a significant factor longer term?

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

I'm sorry?

Farha Aslam  
Analyst, Stephens, Inc.

So, not a significant factor longer term, it's sort of a quarter-specific issue?

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

More of a quarter-specific issue this time, yeah. We do see it ebb and flow over time.

Farha Aslam  
Analyst, Stephens, Inc.

That's great. Thank you.

Operator: Thank you. We will now take our next question from Heather Jones of the Vertical Group. Your line is open. Please go ahead.

Heather Jones  
Analyst, Vertical Group

Good morning. Thanks for taking the question.

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

Hey, Heather.

Heather Jones  
Analyst, Vertical Group
Hi. I was wondering did I hear you say that you expect belly prices to be flat year-on-year, flattish year-on-year for the second half?

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

That's correct, Heather.

Heather Jones  
Analyst, Vertical Group

And I just – because last year in the second half, you had – not you, but the end of – the belly pricing in general was up dramatically and inventories are much higher this year. Just curious as to why you all are expecting that.

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

It's an average. We've seen a lot of volatility in the belly prices and on average we see them relatively flat to last year. They are lower right now than last year. So, again, these are all markets that have been very volatile. That's our best estimate at this time.

Okay. And on your foodservice side, you mentioned a 30-day lag. And from what I understand – and if I'm misunderstanding please correct me, but from what I understand, those tend to be cost pass through. But on the retail side, pricing is stickier on the way up and the way down.

But I was wondering given the environment out there on the consumer side, what have you been experiencing thus far, and the ability to keep pricing at the retail level given some pull back and some of the input cost you mentioned like trim and bellies and avocados? And have you so far, this quarter and all, are you experiencing success with keeping pricing in place?

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

Yeah, Heather, on the foodservice side of the business. I think you talked about it being a cost pass through and we do see some of that, but I would tell you in our foodservice business we really believe we have some stickiness in the pricing as well.

On the retail side of the business, we have been able to hold on onto the price increases that we saw at the end of last year. And then also we've seen strong volume growth in many of those brands that we took pricing on. So, the Wholly Guacamole, chili, stew, hash items, we have retained pricing and we've seen some nice volume growth.

Heather Jones  
Analyst, Vertical Group

Okay. Thank you so much.

Operator: Thank you. We will now take our next question from Eric Larson of The Buckingham Research Group. Your line is open. Please go ahead.
Eric J. Larson  
Analyst, The Buckingham Research Group, Inc.
Yeah. Thanks for taking my question everybody, and good morning. Just look – a question kind of on the turkey side of the business. Again, I think you've dialed up your – last year you took your advertising off of Jennie-O and some of your major programs and you've – I think you've now reinstated that and that's probably going to again negative impact your second half here, too.

What do we need to see? We saw cold storage come down for turkey in the most recent months, that just came out and what – is it just a cutting back of supply here again yet, Jim, that we still need to see and maybe fewer poult placements? What is it that gets this kind of extended a lot longer than we had thought decline in the turkey business back on track?

James N. Sheehan  
Senior Vice President & Chief Financial Officer, Hormel Foods Corp.
Eric, I'd look for a couple of things. You're seeing the harvest level go down 3% as we've talked about. That's a good indicator. For poult placements, if I were to give you a number it'd probably be 5%. To see a 5% decline in poult placements would tell us that we're getting there.

Breast meats, in general, at a $2 breast meat, the market becomes healthy again. What's the real drag now is this whole bird situation, which whole bird inventory is still up 14%. The market I think is at $0.87, right now $0.84 somewhere in there. And that pricing is going to drag on until the first quarter. So, we certainly see some good indications that things are turning in the right direction.

James P. Snee  
Chairman of the Board, President & Chief Executive Officer, Hormel Foods Corp.
And, Eric, you're also correct, I mean, we are going to be back with our very successful Make The Switch campaign. We know and we've seen the results that that can deliver. And we are focused on the value-added portfolio at Jennie-O with our lean ground turkey, Oven Ready products. So, all of those things in concert is really what lead us to have our view that we'll see growth in the first half of 2019.

Eric J. Larson  
Analyst, The Buckingham Research Group, Inc.
Okay. And then just another follow-up, I know you touched base on already, I guess the issue with CytoSport that you said, it's a competitive issue again and I guess what surprised me was that it was just – it seemed like in your first quarter, you really did have maybe some improvement in that whole dynamic and it just seemed to reverse very quickly and oddly again, is there a particular one player up there that's doing this? I mean, I guess I'm lacking kind of the [indiscernible] (44:13) just going on there?

James P. Snee  
Chairman of the Board, President & Chief Executive Officer, Hormel Foods Corp.
Yeah. I mean, there is one very aggressive competitor in the marketplace. In the category itself, I mean we saw – at the most recent report, we saw some share growth, but we saw sales decline because we had to be very aggressive and take on that competitive activity.

And so, I mean, you're right in the first quarter, we did feel like maybe we had turned the corner but the second quarter did not continue that trend. And we know that we still have to work to get our distribution line. We've got a
great distribution partner with Pepsi but we haven't solved it yet. And so, we are working on a lot of fronts in terms of distribution, messaging, pricing, branding. It is – it's all hands on deck. And we do believe the transition from Specialty and Grocery Products will help over the long-term.

Eric J. Larson  
Analyst, The Buckingham Research Group, Inc.
Okay. Thanks. I know there's other questions, so I'll get back in the queue. Thanks, guys.

James P. Snee  
Chairman of the Board, President & Chief Executive Officer, Hormel Foods Corp.
Thank you.

Operator: Thank you. We will take our next question from Robert Moskow of Credit Suisse. Your line is open. Please go ahead.

Robert Moskow  
Analyst, Credit Suisse Securities (USA) LLC
Hi. A handful of questions here. You mentioned the price increases on stews, Wholly Guacamole and Skippy, but your Grocery Products pricing in the quarter, unless I'm doing the math wrong, was it down organically?

James P. Snee  
Chairman of the Board, President & Chief Executive Officer, Hormel Foods Corp.
Yeah. It was, Rob.

Robert Moskow  
Analyst, Credit Suisse Securities (USA) LLC
Okay. So, what drove it down?

James P. Snee  
Chairman of the Board, President & Chief Executive Officer, Hormel Foods Corp.
But mainly driven by CytoSport. So, remember, we've got the consolidation of Specialty Foods which is now CytoSport and also Grocery Products.

Robert Moskow  
Analyst, Credit Suisse Securities (USA) LLC
Okay. So, ex that, do you think your pricing was up in like your traditional retail kind of [ph] grocery division? I'm sorry.

James P. Snee  
Chairman of the Board, President & Chief Executive Officer, Hormel Foods Corp.
Yeah. Correct, Rob. We'd say our Grocery Products score was up low single-digits in sales.

Robert Moskow  
Analyst, Credit Suisse Securities (USA) LLC
In sales. Okay. But pricing unclear?
James P. Snee  
Chairman of the Board, President & Chief Executive Officer, Hormel Foods Corp.

And pricing, yeah, exactly. Yes.

Robert Moskow  
Analyst, Credit Suisse Securities (USA) LLC

All right. And then you do have some steel can cost exposure. I was trying to do some math in my earnings preview. Can you give us a sense of when that would start to flow through and whether you would need more pricing again?

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

Yeah. For the steel impact on our business, it runs probably 1% to 2% of our cost of goods. We have not seen pricing impact. We don't expect to see pricing impact for the balance of this year. And at this point, it looks like it's going to be on product coming from China. Our supply chain is not dependent on the product coming from China. The soonest that we would see increases just on a regular increase basis would be in calendar 2019.

Robert Moskow  
Analyst, Credit Suisse Securities (USA) LLC

Okay. A different question, feed cost for turkey. I thought that those feed costs would start to raise – rise higher or do you have – that doesn't appear to be in your outlook, though.

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

No, we have higher feed costs in the second half. We've seen some volatile pricing because of the weather in South America, strong demand. There's been delayed planting in the U.S. So, the main driver is higher soybean meal, and we are hedged for half two and some of 2019 between 25% and 75% through derivatives and forward purchases.

Robert Moskow  
Analyst, Credit Suisse Securities (USA) LLC

Okay. And then last question. One of your protein competitors was talking about a slow start to the grilling season this year because of cold weather in April. Has that impacted your business at all and do you think that's just a one-month thing and it comes right back again?

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

Yeah. We haven't seen that kind of impact, Rob. Our value-added business in our Refrigerated Foods segment continues to be healthy. And, I mean, if – whatever impact there might be, I would suspect that it is a short term impact and then it comes back.

Robert Moskow  
Analyst, Credit Suisse Securities (USA) LLC

Okay. Thanks for the questions.
James N. Sheehan  
Senior Vice President & Chief Financial Officer, Hormel Foods Corp.

Yeah. Thank you.

Operator: Thank you. We will now take our next question from Benjamin Theurer of Barclays. Your line is open. Please go ahead.

Benjamin M. Theurer  
Analyst, Barclays Capital Casa de Bolsa SA de CV

Hi. Good morning, Jim and Jim. Just a quick question basically following up on what you've laid out about a year ago with your priorities, and one of that was that you've mentioned that you were considering divesting non-strategic assets. Now, taking a look at the performance of the CytoSport and, I mean, you for sure got that question in the past.

But just considering the ongoing challenges in sales, it's basically dilutive and in a certain degree to the category here. Is that something which is on the table and under discussion to get potentially sold at some stage if you're not going to be able to turn the business around? What's your take on that more from a medium term strategic approach on that business?

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

Yeah. Benjamin, the CytoSport business is – I mean, it's on trend. It's a great addition to our portfolio, and we still like the business. Have we had some headwinds and challenges, some in our control, some outside control? Absolutely.

I think from a more holistic approach, I mean, we are still committed to reviewing our entire portfolio and making sure that it's a good healthy strategic review and for those businesses that no longer makes sense, we will take the appropriate action. So, we haven't backed off that strategic perspective, but I would say, at this point, CytoSport is still a very positive business, very on trend and a great addition to our portfolio.

Benjamin M. Theurer  
Analyst, Barclays Capital Casa de Bolsa SA de CV

Okay. Perfect. And then on the second topic, it actually goes into the same direction more of that medium term strategic outlook on if you have any update on your planning for the supply chain modernization. What's the focus, next steps, and where do you think the challenges might arise over the coming quarters on that integration target?

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

Right. So, as I said, we've had Glenn Leitch in the role now for about four months, and he's been busy with a number of different initiatives getting into operational consistency across all of our facilities as we break down the different silos going from a business unit approach to one global supply chain and...

Benjamin M. Theurer  
Analyst, Barclays Capital Casa de Bolsa SA de CV

Yeah.
James P. Snee  
Chairman of the Board, President & Chief Executive Officer, Hormel Foods Corp.

...looking at labor utilization, efficiencies. We've got a very broad co-packer network and looking for opportunities for improvement there. Freight obviously has been probably a disproportionate amount of the time that they are working on as we again work on minimizing miles, maximizing weight, and working with our customers.

He is also looking at ways to mitigate, moderate volatility throughout the supply chain. Inventory management is a key focus.

Benjamin M. Theurer  
Analyst, Barclays Capital Casa de Bolsa SA de CV

Yeah.

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

So there certainly are a number of things that he's working on. And for us, the big thing is that they are finding and going to continue to find the efficiencies that we wouldn't have found without having this one supply chain across our organization.

Benjamin M. Theurer  
Analyst, Barclays Capital Casa de Bolsa SA de CV

Okay, perfect. And if you then – you've just mentioned that that would be just in regards to that, what were the issues why – you mentioned that inventories went up so that was basically because of the acquisitions and it's just not optimized yet at the acquired assets, or is there some sourcing issues and then you have to work with longer inventories?

So just to get an idea because you've mentioned in cash conversion cycles it's a focus and obviously inventory is an important part here. So, just to understand what drove the increase in inventory aside from the acquisition or the issues of an acquisition asset level. That's basically the question.

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

The main driver was the acquisition of the businesses. We've taken three days out of our cash cycle. We identified that as one of our priorities. So, we've been very pleased with the progress that we're making on the number of days of the inventory we're holding, turning our receivables quicker, and also taking advantage of our ability to manage our accounts payable better. So, we're very pleased with the progress we've made on the improvement in the cash conversion cycle.

Benjamin M. Theurer  
Analyst, Barclays Capital Casa de Bolsa SA de CV

Okay. Perfect. Thank you very much, Jim.

Operator: Thank you. [Operator Instructions] We will now take a follow-up question from Ms. Heather Jones of The Vertical Group. Your line is open. Please go ahead.
Heather Jones  
Analyst, Vertical Group

Well, I just had a quick question on turkey. So, you mentioned whole bird and those inventories are relatively heavy. On the value-added side, the strength you've had in Ovengold and ground turkey. Are you starting to see a return in profitability in that piece of the business close to what we had pre-AI before all the distortion of AI and all – our margins there getting close to what they were historically and it's just the whole bird piece that's weighing things down?

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

Yeah. So, we expect to see margin improvement on the value-added businesses as we continue to move through this cycle. I mean it is what you said. I mean, the whole bird impact right now is what really is weighing the business down.

Heather Jones  
Analyst, Vertical Group

Okay. All right. Thank you so much.

Operator: Thank you. We will take a follow-up question from Ken Zaslow of Bank of Montreal. Please go ahead.

Ken Zaslow  
Analyst, BMO Capital Markets (United States)

Hey, guys. Two questions, one is on the – you've discussed the turkey outlook for 2019 a little bit. Can you frame the other businesses and how you think about it in – I think last quarter you guys implied that you guys would be largely back or approaching your long-term growth rate. Is that still a fair assumption? Is there anything that has changed in your outlook for 2019?

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

So, as we think about 2019, Ken, we always tell you we haven't started the formal process yet, but we're still very optimistic about the earnings power that we feel like we've created through the strategic acquisitions, the CapEx investments that we're making, and the focus on those strategic imperatives.

For Refrigerated Foods, continued strong fundamentals in growing our value-added sales both in retail and foodservice. The impact of the new deli group as a growth vehicle for Refrigerated Foods will play a positive role. In Grocery Products, we expect continued momentum in the core Grocery Products portfolio. And we're going to continue to be working to get CytoSport back on track in that GP model also.

JOTS, it's going to be an ongoing recovery in turkey. And then our lean ground turkey, our Oven Ready products, the whole value-added initiative, so we do see that return to growth in 2019. And then still very optimistic about our International business. The new plant in China is adding the much needed capacity. The business is healthy. Our branded exports are very strong. The addition of Ceratti in Brazil is going well with good volume growth. So, I mean, we're optimistic about the business going forward as we head into 2019.
And then the acquisitions can you run to us how much accretion there would be from each of them? I think you've said one, but not both of them. Can you just talk about the accretion contribution in 2019 for both of them?

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

We've said Columbus was going to be accretive by two sets in 2018. And Ceratti was going to be basically one set in [ph] 2019 (57:32).

Ken Zaslow  
Analyst, BMO Capital Markets (United States)  

Yeah. But what about 2019? I thought there was a $0.05 from each?

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

2019 Columbus will be accretive, $0.06 to $0.08 and – I'm sorry. Ceratti will be – we haven't really set anything yet.

Ken Zaslow  
Analyst, BMO Capital Markets (United States)  

Is there a reason that it wouldn't be accretive by the $0.05 region? Is that a fair parameter to start with?

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

We're still evaluating the business. It will be accretive. We haven't identified what the final accretion will be.

Ken Zaslow  
Analyst, BMO Capital Markets (United States)  

Okay. Thank you very much.

Operator: Thank you. We will now take a follow-up question from Robert Moskow of Credit Suisse. Your line is open. Please go ahead.

Robert Moskow  
Analyst, Credit Suisse Securities (USA) LLC  

Might as well use the whole hour here. So, operating profit, yeah, in Refrigerated, the acquisitions added 13% to the quarter. Can you give us a sense of how much profit it added? Was it close to 13% as well?

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

Oh, I mean, it – obviously, it had a very positive impact on the business, both Columbus and the Fontanini. So, I mean, still a very positive impact for Refrigerated. Refrigerated was up without them, but it did have – it was an addition.

Robert Moskow  
Analyst, Credit Suisse Securities (USA) LLC  

Okay. And then this is the last one. I think you and Jim have been very cautious in your commentary about what kind of savings to expect from this supply chain consolidation, and you've mentioned efficiencies but the word reinvestment keeps kind of popping up. Are you finding that as you dig deeper into the supply chain that there is a lot of need for reinvestment in labor, logistics, things like that?

**James P. Snee**
*Chairman of the Board, President & Chief Executive Officer, Hormel Foods Corp.*

From our perspective, the areas that are going to need investment is – automation clearly is one of them. And as we think about what's happening with the labor force going forward, we're just – it's an issue we're going to have to deal with, and automation will be an area that can help us.

From a distribution perspective, I do think that we're going to have to continue to reevaluate our distribution structure as we have changes into the business with some of these acquisitions and where – maybe where their supply chains are located. But a lot of that is just normal course of business.

We don't see a significant change to our maintenance CapEx level. We see our investments really coming – continuing to come to drive our value-added capacity needs, but the supply chain is doing some great work to make sure that we're properly aligned for the future.

**Robert Moskow**
*Analyst, Credit Suisse Securities (USA) LLC*

Okay. Thank you.

**James P. Snee**
*Chairman of the Board, President & Chief Executive Officer, Hormel Foods Corp.*

Yes.

**Operator:** Thank you. It appears there are no further questions at this time. I would now like to turn the conference back to our speakers for any additional or closing remarks.

**James P. Snee**
*Chairman of the Board, President & Chief Executive Officer, Hormel Foods Corp.*

Great. Well, thank you, all, for joining us today. We are pleased with the record earnings announced and I'm confident in our strategic priorities and our direction, as well as our ability to continue to proactively manage the challenges facing us for the balance of this year. We have an experienced and talented team in place that will allow us to overcome these challenges, deliver our key results, and continue to drive growth for our shareholders. Have a safe Memorial Day weekend.

**Operator:** Thank you. Ladies and gentlemen, that concludes today's call. You may now disconnect.