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Hormel Foods Corp. (HRL)

Q4 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 Fourth 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 Tuesday, November 20, 2018.

I would now like to turn the conference over to Nathan Annis, Director of Investor Relations. Please go ahead, Mr. Annis.

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

Good morning. Welcome to the Hormel Foods conference call for the fourth 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 hormelfoods.com under the Investors 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 2019. Jim Sheehan will provide detailed financial results and further assumptions relating to our outlook.
The line will be opened for questions following Jim Sheehan's remarks. As a courtesy to the other analysts, please limit yourself to one question with one follow-up. If you have additional questions, you are welcome to get back into the queue. An audio replay of this call will be available beginning at 11:00 AM today, Central Standard Time. The dial-in number is 888-254-3590, and the access code is 9962477. 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 35 through 41 in the company's Form 10-Q for the quarter ended July 29, 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 fourth quarter and full year operating performance. These non-GAAP financial measures should not be considered a replacement for and should be read together with our GAAP results. Discussion on non-GAAP information, in addition to reconciliations to GAAP results are detailed in our press release located on our website. We will refer to these non-GAAP results as organic net sales, organic volume, adjusted segment profit and adjusted earnings per share.

I will now turn the call over to Jim Snee.

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

Thank you, Nathan. Good morning, everyone. Throughout the year, we made significant progress towards our long-term vision as a global branded food company. With an emphasis on brand building, innovation, acquisitions, and intentional balance, our long-term approach allowed us to manage through difficult situations such as commodity market volatility, increased freight and global trade uncertainty.

This year was marked by many milestones. We made the largest acquisition in our company's history with the purchase of Columbus Craft Meats, and we also successfully integrated both Columbus and Fontanini into our supply chain. We reinvested a record amount of capital back into our company to increase capacity and improve efficiency. Major capital projects in 2018 included the Dold Foods pre-cooked bacon expansion and a highly automated whole bird facility. We also delivered many innovative new items to the marketplace. Items such as Herdez guacamole salsa, Natural Choice snacks, Applegate Naturals products in the retail space and Fire Braised Flank Steak for foodservice customers.

From a financial perspective, we delivered record sales, earnings, and cash flows. 2018 also represented the 90th consecutive year of paying a quarterly dividend. Our strong financial results and confidence in the business allowed us to announce our 10th consecutive double-digit increase in the dividend for 2019, which will mark our 53rd consecutive year of dividend increases.

By many measures, 2018 was a success. Refrigerated Foods made impressive contributions to our performance with significant growth coming from value-added brands in retail, deli, and foodservice. However, there are areas of the business that did not meet our expectations. Jennie-O Turkey Store had another difficult year, as they managed through continued oversupply in the turkey industry. And CytoSport had a disappointing year with declines in powder and single serve ready-to-drink product lines. We are taking appropriate actions in both businesses and expect they return to growth in 2019.
Looking at the fourth quarter, we delivered record adjusted earnings per share of $0.51, a 24% increase. Many brands and product lines across all four segments drove growth. This effort was led by the success in Refrigerated Foods, who overcame significant commodity headwinds to deliver impressive results in all parts of their business. Our International team also delivered strong growth in the quarter, led by exports of branded products.

For the total company, sales increased 1% on a 1% decline in volume. The sales increase was driven by our MegaMex joint venture and growth of branded products in Refrigerated Foods. The Fontanini, Columbus Craft Meats and Ceratti acquisitions met our expectations for the year, and contributed to the increase for the quarter. On an organic basis, volume and sales declined 3% due to weakness in contract manufacturing and lower commodity markets.

Refrigerated Foods grew volume 2% and sales 6%. Products such as Applegate natural and organic meats, Hormel Natural Choice products, Hormel Fire Braised meats and Hormel pepperoni, all delivered excellent growth this quarter. Sales also increased due to the Fontanini and Columbus acquisitions. A reduction in hog harvest volume of 3% drove an organic volume decline of 2% and an organic sales decline of 3%. Pricing declined due to lower pork markets.

Refrigerated Foods was able to deliver a 25% increase in profits, even as commodity profits declined 31%. The team was able to offset higher freight costs and higher advertising investments. I am particularly proud of how the Refrigerated Foods team continues to shift the portfolio towards branded value-added products.

International sales increased 7% on volume growth of 5%. We saw strong sales increases on branded exports of products such as SPAM luncheon meat and SKIPPY peanut butter. The addition of the Ceratti business in Brazil also drove the sales increase. International segment profit increased 7% in spite of lower fresh pork exports and increased freight costs. Lower SG&A expenses also contributed to improved earnings.

Jennie-O Turkey Store volume and sales declined 4%, primarily due to whole bird sales decline. As we mentioned on our last call, a portion of our whole bird sales were shifted to the third quarter to minimize cold storage expenses. Sales of Jennie-O lean ground turkey and premium deli items showed sales growth this quarter. Segment profit declined 31% due to lower whole bird prices, increased freight and higher feed costs.

Grocery Products sales decreased 4% as strong volume and sales growth of Herdez salsa and Wholly Guacamole dips did not offset declines in our contract manufacturing business. Adjusted segment profit decreased 6% on lower sales and higher freight expenses. This year, we made excellent progress on our path forward that I laid out at our 2017 Investor Day. This included, becoming a broader food company, expanding and accelerating foodservice, becoming a more global company, reducing volatility, divesting non-strategic assets and modernizing our supply chain. We will continue to execute against these initiatives in 2019.

I anticipate a combination of external factors will impact our business this year. On one hand, we expect to benefit from lower pork input costs and a return to more normalized fundamentals in the turkey industry. On the other hand, we expect continued inflationary pressure in addition to commodity market volatility. Our team’s ability to focus on the controllable elements of the business will help us manage through these challenges.

The quality and speed at which we are bringing innovation to the marketplace will be even better than it was in 2018. Our pipeline of innovative products will help us achieve our 15% by 2020 challenge. We made progress towards this innovation goal in 2018, as more than 14% of our sales came from products innovated in the last five years.
In 2019, we expect continued growth from innovative products such as Bacon 1 fully cooked bacon, Fire Braised meats, Natural Choice snacks, stacks and wraps and Herdez guacamole salsa. The start of fiscal 2019 is also the official beginning of our new Hormel Deli Solutions division, which combines all aspects of our deli brands and businesses into one group within Refrigerated Foods. As we outlined at CAGNY in February, this new division delivers an unmatched array of high quality deli and prepared foods offerings, marketed and sold through a direct sales organization. We are excited to help retailers create the deli of the future.

Looking at the segments for 2019, we expect all four business units to show sales and profit growth. The fundamentals in the turkey industry are showing slow improvement with declines in poult placements and cold storage stocks. For the first time in over two years, we're seeing signs of consolidation within the industry.

While we are encouraged by these factors, we continue to take proactive steps to restore the growth of this business. Our expectations this year is for a modest recovery in the turkey industry and earnings growth from Jennie-O Turkey Store. Commitments to control costs, optimize the supply chain and investments in the Jennie-O brand will be important in 2019.

Similar to 2018, we expect an increase in branded value-added sales and profits in Refrigerated Foods. Growth will be led by our teams in foodservice, deli and Applegate. Gains in our value-added businesses are expected to once again offset a reduction in commodity profits.

International is expected to have a strong year. Exports of branded products and gains in China and Brazil will offset continued declines in fresh pork exports. We see sales and earnings growth in Grocery Products coming from established brands such as SPAM and Skippy, in addition to emerging brands such as Justin's, Wholly Guacamole and Herdez. We also expect a meaningful contribution from the Muscle Milk brand.

Our supply chain is complex and for many years, we were able to capture incremental savings through grassroots projects, known internally as Best of the Best. Since reorganizing our supply chain teams into one structure at the beginning of 2018, our teams have been thinking differently about ways to optimize procurement, manufacturing and logistics.

In 2018, the team was able to capture over $70 million in savings through a focus on insourcing production, better asset utilization and more automation in our manufacturing facilities, all while managing the sale of our Fremont plant and dealing with higher freight costs. These results speak to our culture of corporate and personal accountability.

For 2019, our cost savings target is $75 million. Areas of opportunity cover the entire spectrum of our supply chain. We plan to use the savings to help offset inflation, reinvest into key brands and contribute to earnings growth. One macro factor we are continuing to watch closely is freight. We saw a double-digit increase in 2018 and we expect another large increase in 2019. We remain focused on finding mutually agreeable solutions with our customers and if necessary, increasing prices.

Taking all these factors into account, we are setting our full year earnings guidance at $1.77 to $1.91 per share and our sales guidance at $9.7 billion to $10.2 billion. This guidance reflects pre-tax and segment profit growth across all of our business units, driven by strong retail, foodservice, deli and International performance. As a reminder, we had a significant tax benefit in 2018 due to tax reform.
At this time, I will turn the call over to Jim Sheehan to discuss our financial information relating to the quarter and key assumptions for fiscal 2019.

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

Thank you, Jim. Good morning, everyone. Fiscal 2018 was a record year for sales, earnings per share, operating cash flow and dividends. Our financial strategy is aligned with our vision for the company. The balance sheet is strong and capital allocation decisions support the long-term growth strategy.

Volume for the fourth quarter was 1.3 billion pounds, a 1% decrease compared to 2017. For the full year, volume grew 1%. In the fourth quarter, sales were $2.5 billion, a 1% increase. Sales for 2018 were $9.5 billion, a 4% increase. Net earnings for the fourth quarter were $261 million, up 20% compared to last year. Full year earnings were $1 billion, also a 20% increase. Adjusted earnings per share for the full year were $1.89, a 20% increase. In the quarter, we recognized a non-cash impairment of $17 million, or a $0.03 per share associated with the CytoSport business. The impairment was recorded in the Grocery Products segment.

For the full year, SG&A excluding advertising was 7.2% of sales, compared to 6.8% last year. The impact of acquisitions drove the increase. In 2019, we expect SG&A as a percentage of sales to decline as the company continues to focus on finding efficiencies throughout the organization. For the year, advertising was $152 million compared to $136 million last year. We continue to shift investments between advertising and trade to attain the highest return.

In 2019, we plan to use advertising to support such brands as SPAM, Hormel pepperoni, Hormel Natural Choice, Columbus and Jennie-O. General corporate expenses increased in 2018, primarily due to higher employee related expenses including the universal stock option grant for all employees. For the full year, operating margins for 12.6%, 140 basis points lower than 2017. Higher freight in all segments and whole bird declines at Jennie-O contributed to the decrease. We expect operating margins to improve in 2019.

The full year effective tax rate was 14.3%, compared to 33.7% in 2017. The decline was due to the Tax Cuts and Jobs Act passed December 2017. The effective tax rate for 2019 is expected to be between 20.5% and 23%. In 2018, we generated cash flow from operations of $1.2 billion, compared to $1 billion last year. The primary use of cash was CapEx, the acquisition of Columbus and dividends.

Capital expenditures for the year were $390 million, including the expansion of value-added capacity at Dold and a highly automated whole bird facility. We anticipate capital expenditures to be $350 million in 2019. Major projects include the expansion of value-added capacity, investments to improve efficiencies and expanded automation in our plants.

We paid our 361st consecutive quarterly dividend effective November 15, at an annual rate of $0.75 per share. We also announced a double-digit dividend increase. This is the 53rd consecutive year we have increased the dividend and the 10th consecutive year we have increased the dividend at a double-digit rate. We repaid the remaining short-term debt associated with the Columbus acquisition in the fourth quarter, ending the year with $625 million in total debt. We remain in a strong financial position to fund other capital needs, given our low level of debt and consistent cash flow.

Share repurchases for the full year totaled $47 million, representing 1.4 million shares. We will continue to repurchase stock to offset dilution from stock option exercises and based on our internal valuation. We continue
to monitor supply and demand in the hog industry. We expect hog supplies to increase next year. Near-term volatility is heavily dependent on the progress of the new plants ramping up to full production.

Domestic pork prices have declined due to an abundant supply of protein on the market. We expect this to continue into 2019. Lower protein prices benefit our value-added businesses. We expect exports to be up 3% to 4% in 2019. However, the African swine fever outbreak in China could impact U.S. pork exports.

Input costs for the fourth quarter were generally lower. Hog prices were 16% lower than last year and well below the 5-year average. We expect slight increases to hog prices next year. USDA composite values declined 9%. We expect the USDA composite value to be lower in 2019. In 2019, our hog purchases will decline approximately 30%, reducing the exposure from the volatility of hog prices. When the Fremont sale is final, we will be purchasing all hogs from the facility, based on the USDA composite value.

Included in our guidance is a decline in commodity profits due to the reduced harvest level and lower industry margins. Belly markets declined 11%, finishing below the 5-year average. Overall, we expect modestly lower belly prices and continued volatility in 2019. 72% pork trim prices were 14% below last year. We expect trim markets to be lower in 2019, especially in the first half. 50% beef trim was 9% higher. We expect beef trim prices to be flat next year, compared to 2018. Feed costs were higher driven by soymeal. We expect feed cost to be higher in 2019.

Industry data shows turkey poult placements down 3% over the last six months. Cold Storage of breast meat is 12% below 2017, but higher than the 5-year average. Despite improvements in both key drivers, recovery remains slow. Turkey commodity prices, including whole birds, pressured Jennie-O results in 2018 despite higher breast meat prices. Whole bird prices were 15% lower than last year. The multi-year lows will persist through this calendar year. Whole bird prices next year will be impacted by Thanksgiving volume. Breast meat prices were 33% higher. We expect higher breast meat prices in 2019.

As Jim discussed, we created a new Deli division within Refrigerated Foods. As a result, beginning in 2019, we will report Jennie-O Deli results within the Refrigerated Foods segment. Actual deli sales and profits, including an allocation of supply chain profits will be transferred from Jennie-O to Refrigerated Foods. The size of the Deli business moving from Jennie-O to Refrigerated Foods is approximately $300 million in sales with margins in line with the Jennie-O segment. The company will restate the segment results beginning in the first quarter of 2019.

The sale of the Fremont plant to WholeStone Farms is scheduled to close in December. We will incur approximately $12 million of expenses in the first quarter to build value-added equipment out of the facility and various pension related expenses. In 2018, the team demonstrated an ability to manage through various market factors and volatility. We are confident in the plan for 2019 and our strategy for delivering long-term value to shareholders.

At this time, I'll turn the call over to the operator for the question-and-answer portion of the call.
QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] And we'll take our first question from Michael Lavery with Piper Jaffray. Please go ahead.

Michael S. Lavery
Analyst, Piper Jaffray & Co.

Good morning. And thank you.

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

Yeah. Good morning, Michael.

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

Good morning.

Michael S. Lavery
Analyst, Piper Jaffray & Co.

Can you help clarify a little bit how we should think about the supply chain savings? You've talked about the $75 million, but it doesn't seem like it includes any bigger more restructuring type savings? Is that something that should be likely down the road? Or what's the right way to think about that?

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

Sure. I think the best way to think about it, Michael, is, we started off the year saying, the thing that we had to get right was the structure and the process, right, and making sure that we could identify, capture, validate and strategically reinvest the savings. So, I mean, the team is thinking differently. As we look to optimize procurement, manufacturing and logistics, and certainly 2018, keen focus on labor, overhead, supplies, of course, let's not forget the fact that we put them in the middle of the freight increases and the Fremont divestiture. So, we've had a lot going on.

2019 will have some of the same, but I will tell you that they're also starting to pivot towards the bigger and more structural things. So, an example of that would be, as the baseline for freight has probably shifted over the long-term, is making sure that we have the most optimized network possible. And so what does that look like for distribution centers? How do we travel fewer miles over the long-term? So, yeah, we are getting to those bigger and more structural issues, but right now, it is a combination of some of the short-term and long-term things.

Michael S. Lavery
Analyst, Piper Jaffray & Co.

And your number for 2019, could that have upside as you get into some of these projects later in the year, or do you have a pretty good set amount of visibility and those would be further down the road?
James P. Snee  
Chairman, President & Chief Executive Officer, Hormel Foods Corp.

Those would be a little further down the road. I mean, for us, it's – what is realistic, so that we know it's disciplined and thoughtful and we'll know more as we get closer.

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

The other item I'd add, Michael, is that the $75 million we're talking about, excludes any previously announced synergies that we have in our acquisitions.

Michael S. Lavery  
Analyst, Piper Jaffray & Co.

Okay, great. That's helpful. Thanks a lot.

Operator: And we'll take our next question from Robert Moskow with Credit Suisse. Please go ahead.

Robert Moskow  
Analyst, Credit Suisse Securities (USA) LLC

Hi. Thank you.

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

Hi, Rob.

Robert Moskow  
Analyst, Credit Suisse Securities (USA) LLC

Hey. Couple of things on the guidance I was curious about. What is – is that the sales guide is pretty lofty, especially in light of the fourth quarter numbers being below expectations particularly on price. Can you give us a little more color on how you got there? And are you expecting some price recovery in the commodity markets in order to get there. And then secondly on the guide, you said that you thought hog prices would be up, but that the composite would be lower for 2019 and I wanted to know how you got that assumption as well?

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

Sure. So, I'll go ahead and start, Rob. As we've looked across the different segments, I mean we look at the sales guide as realistic. When we think about Grocery Products coming off a weaker Q4, and really the driver there was the fact that we did have some incremental sales in Q4 of 2018 – we didn't have in 2018 that we did have in 2017, but we think we're set up really well because the baselines for our GP business are very healthy.

So, heading into 2019, we expect that business to show mid-single digits growth. Refrigerated Foods, it's a lot more of the same in terms of the value-added growth that we expect to see. We're not expecting anything crazy in JOTS. I mean, we've got a low single-digit increase there, which we believe is very achievable. And then our International growth on the top line is really in line with our historic expectations of high-single digit.
So, do believe that the guide on the sales is very realistic and achievable. I mean, I'll have — let Jim give you a little more color in the other question.

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

Good morning, Rob. We expect the hog industry to be similar to the structural makeup of 2018, including the supply growth and the volatility based on the capacity coming online. Our prices right now are low, but we expect them to be up in the low single digits. Regarding the spread, we expect the higher supplies of meat that will be available, because of the additional capacity coming online, will lower the commodity prices, including we expect bellies and trim to both be down in 2019.

Robert Moskow
Analyst, Credit Suisse Securities (USA) LLC

Okay. And have you put in any kind of assumptions for China's hog herd disease issues and what that might mean for American exports? Is that a positive or a negative or too soon to tell?

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

It's really too soon to tell and I would tell you, Rob, we have limited African swine fever risk assumed in this plan, because of exactly what you said, right. It's a risk to the China business, but potentially an opportunity for our pork export business. We do believe that if it is a risk to China, that we'll be able to take some pricing in line with the rest of the market, but it is really too early to tell, but we're watching and it's certainly in our radar, like I'm sure it is everyone else's.

Robert Moskow
Analyst, Credit Suisse Securities (USA) LLC

Okay. I'll get back in queue. Thanks.

Operator: And we'll take our next question from Thomas Palmer with JPMorgan. Please go ahead.

Thomas Hinsdale Palmer
Analyst, JPMorgan Securities LLC

Good morning. Thanks for the questions.

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

Hi, Thomas.

Thomas Hinsdale Palmer
Analyst, JPMorgan Securities LLC

I just wanted to ask about the first quarter setup. In the past, you provided some commentary and in the Qs around the call on kind of how you're seeing margins or EBIT overall trend across the different segments. I was hoping you could provide that here again on that first quarter setup?
James P. Snee  
Chairman, President & Chief Executive Officer, Hormel Foods Corp.

Yeah. So, we haven't really done that so much by quarter. I mean, last year, we talked a little bit about JOTS just because of the unique situation we were in and that recovery was heavily skewed to Q2. I would tell you, or I would guide you to a couple of things that we have called out for Q1 that will impact the business, as we did have the benefit last year of a MegaMex tax credit. And then, you heard in Jim Sheehan's comments the fact that we will have some Fremont closing expenses in Q1. So, obviously, you're going to have that as a headwind early in the year.

Thomas Hinsdale Palmer  
Analyst, JPMorgan Securities LLC

Okay. Thanks. And then, just to follow-up on that, on the Muscle Milk side you mentioned meaningful contribution for the year. Is that both top and bottom, and could you maybe talk about what you're already seeing in that business in terms of its inflection?

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

Yeah. So, that would imply top and bottom line growth from the Muscle Milk business. And again, we've talked about several different components. The part of the business that has grown throughout the year and continues to show growth is really the take home or the multi-pack tetra business. You're seeing that in more traditional food, drug and mass, as they expand out their sports nutrition category. Now, that business has been healthy and will continue to be in 2019.

We've seen recovery in their ready-to-drink space. So, we saw growth in the back half of the year like we had said we would, and we expect that to continue in 2019. The area of the business that continues to be under pressure now is the powder business and really the driver there is just that shift from the traditional brick and mortar specialty channel into more online business. And we've spent time and effort and resources building up that Muscle for that digital competency to support the e-commerce business.

Thomas Hinsdale Palmer  
Analyst, JPMorgan Securities LLC

Okay. Thank you.

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

Yeah.

Operator: And we'll take our next question from Akshay Jagdale with Jefferies. Please go ahead.

Akshay Jagdale  
Analyst, Jefferies LLC

Good morning. Thanks for the question. I wanted to ask about the Grocery — sorry, about the turkey business. Obviously, there's been some headwinds in the industry and the commodity pricing being low. But can you — as you've gone through the cycle, which has been quite long, can you talk about what — like maybe help us dimensionlize the company specific issues, cost-wise, that you think you can address going into next year, right? Like, I mean, when you go through a down cycle, I'm sure you tighten the belt a little bit more, but there were also
some specific cost issues in your Gro op division, right. So, can you help us put into context sort of where we are in Jennie-O Turkey margins and how much of the sort of underperformance is industry versus company specific, high level?

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

Yeah. I think the key driver in JOTS is that, we need better fundamentals in the industry. I mean, that really is what is going to get us where we need the business to be in. So, we've seen some of that happening, but we're still disappointed in the pace. And so, as we're looking into 2019, we are just projecting modest growth. But in that modest growth, we know that will continue to outperform the industry.

And so, in some of the areas that you mentioned, Akshay, I mean, we continue to have a keen focus on biosecurity for our facilities to make sure we can avoid another avian influenza outbreak. We had talked about the work that we're doing in the raised-without-antibiotics initiative and our team continues to make progress in there making it more efficient and cost effective.

Clearly, they're impacted as much as anyone on the freight side of the business. And so, that's not unique to them and that's really a company-wide initiative on how can we find those mutually agreeable solutions with consumers, while still working in the long-term to optimize our network.

The other part is, we see it as a business that continues to be on trend. We've reinvested in the brand this year. We'll be reinvesting in the brand again in 2019, as we know turkey is on trend. And so, we have to continue to outperform the industry. And we think the things that we've done put us in a position to be poised to accelerate our outperformance versus the industry.

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

Akshay, one item that I would add is that we're very excited about the new Melrose plant coming online in the spring. That's a state-of-the-art plant that will really take our efficiencies to a new level. So, that will, as Jim said, the business has outperformed the industry for a long time. This is going to allow us to increase that outperformance.

Akshay Jagdale  
Analyst, Jefferies LLC

Perfect. And just one follow-up on what Rob was asking about, but maybe in a different way. Looking through your segments, your business is so unique with the exposure to commodity meat prices that it's hard to really tell what's happening with soup price, right. So, can you high level give us a sense of what you're seeing pricing-wise as it relates to like freight cost being up and overall sort of food industry inflation has picked up, right. And so, we feel like all the companies are talking about taking pricing. But what's your take on where we are in that cycle, are you seeing – are you finding more success now than six months ago, or how would you characterize the environment?

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

Right. I mean, I think you – we're no different than anybody else in that. We're looking at all of these macro factors, so whether it's African swine fever, freight, tariffs, exports. It's clearly a dynamic situation. And we continue to look at it really on a category-by-category basis. And so, Refrigerated Foods and JOTS are more
market-based, closer to the market. And so you do have pricing that'll move a bit more frequently. GP pricing really is less market driven and impacted by the macro issues that we're talking about.

And so, we took pricing obviously late 2017, early 2018 and we are looking at it on a category-by-category basis. And we don't just look at pricing. We're taking that holistic view of each of our brands and each of our categories to understand the levers in regards to trade, other revenue growth management initiatives, and obviously, making sure we understand the corresponding projected elasticities. And I guess, I would leave you with the fact that pricing is never easy, never has been, don't think it ever will be. But the fact that we have number one and number two brands also puts us in a very solid position to make sure that we are taking those leadership roles.

Perfect. And just one last housekeeping one. The guidance for next year, order of magnitude in terms of the profits that will be gone as the result of the Fremont deal, is it roughly still – I forget, but did you say $10 million. I mean, I know the costs are [ph] $12 million (42:02), but what's profit contribution roughly that you're assuming will not be in the P&L next year?

We discussed in the script that commodity profits will be down 40% from this year and the major portion of that is the Fremont plant – the sale of the Fremont plant, but we also expect that those – the margins on those, or the spread on those hogs are going to decrease during the year. So, I think it's a combination of both.

Thank you. I'll pass it on.

Thanks, Akshay.

Operator: And we'll take our next question from Eric Larson with Buckingham Research Group. Please go ahead.

Yeah. Good morning, everyone. Thanks for taking my question. I think I know the answer to this. I just want to make sure it's – a little follow-up on the guidance question. But the expenses that you outlined, which will probably come in Q1, if the sale of Fremont happens in December, I'm assuming that those expenses are included in your guidance, they're not excluded. So, is that a GAAP – I'm assuming it's a GAAP number, is that a fair assumption?

That's a fair assumption, Eric.
Okay. And then the second question, which I want to sort of follow-up on here is, we saw the impairment charge for CytoSport in the quarter. I think Jim talked a little bit about the issue of sales moving more toward the e-commerce side of the business. But is this a business that you're still putting a fair amount of advertising support behind it? Is that the only fix that you need? Or what else in the powder side -- and I think it's also still widely competitive, but what else sort of needs to happen for CytoSport to kind of get back on track?

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

Yeah. One of the things, Eric, that I called out was, as those sales have shifted -- I mean, we were behind the curve in terms of having the digital infrastructure that we needed, and so that has been a big initiative for us. And we feel like we're in a position now where we have the appropriate content and sales infrastructure that we need. From an advertising perspective, the team that we have in place has reallocated some of those advertising dollars into a slightly different messaging, which we're finding to be to be highly effective. And so, I think those were really two of the bigger things that we had to get done. And we're well-positioned for 2019.

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

Okay. Thanks. Happy Thanksgiving to all.

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

Yeah. Same to you.

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

Adam Samuelson  
Analyst, Goldman Sachs & Co. LLC

Yes. Thank you.

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

Hi, Adam.

Adam Samuelson  
Analyst, Goldman Sachs & Co. LLC

I guess the first question in Jennie-O, I think you talked about modest profit improvement for fiscal 2019. Can you talk about the path to recovery here? I mean, I would look like some of the market indicators are moving in the right direction in terms of breast meat pricing being above $2 in terms of poult placements being down, competitor potentially shutting down early in the New Year, and yet still they're calling for kind of modest profit improvement. Can you help us think about the path to getting back to those kind of mid-teens margins that this business did pre-avian flu?
James P. Snee  
Chairman, President & Chief Executive Officer, Hormel Foods Corp.

Sure. And I think you touched on it. It's really the fundamentals are moving in the right direction. I think that the biggest issue there is just really the disappointment in the pace. And so, even though the trend in the last quarter was down for poult placements, if you look at October, it was actually up a little bit. So, I think we've got to stay on track with those fundamentals and see them accelerate.

I mean, you're correct in regards to breast meat pricing, we see that as a positive. We see inventory levels coming down, certainly it's a positive, but again, still at historically high levels. So, I mean, we need to see that accelerate. We'll continue – as we said several times, we'll continue to outperform the industry and the things that we're doing behind the scenes really help us be poised to accelerate the outperformance. But to get back to truly more normalized levels, we need to see the fundamentals accelerate.

Adam Samuelson  
Analyst, Goldman Sachs & Co. LLC

Okay. And then my second question is over in Refrigerated Foods, the organic volumes in the quarter were down 2%, you attributed that to lower hog harvest levels. At what point does the organic volume trajectory in Refrigerated kind of disconnect from hog harvest? And just trying to think about kind of layering in Columbus and Fontanini, as they glare into organic through or after the first quarter, I mean, at some point you need to be growing this on the volume side. Does the new capacity that you've put in, I mean, that happens sooner, or just help us think about the path actually starting to grow the volumes here organically?

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

Yes. That's a great question, Adam. And I think 2019 is the year that you'll see that, where it will be the investments that we've made in those businesses that are driving volume, sales and earnings growth. So, we see that across the board. We've been very intentional in terms of the investments to support that value-added business. And 2019 is the year that you'll see that really connect.

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

Hey. Good morning, Jim and Jim. So, first of all, congratulations to the good close of the year. Now, a question on the deli business, and you've mentioned you're going to move what you basically had within the Jennie-O Turkey up into the Refrigerated Foods segment, and you've nicely associated the sales volume as well as the profitability.
Now the question is, for the whole restructuring and bringing that together, are there any additional costs we should be aware of that you’re going to incur just by consolidating that business. And if you could share what is the size of the business, if it’s at some stage you would consider to actually spin it off from the Refrigerated Foods segment and report it on a standalone basis, so just to get a little more the magnitude of this business? That would be my first question.

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

Sure. Well, first of all, thank you for the recognition on the strong performance. We appreciate that. In regards to the deli business, we don't have any other expenses that we're expecting in 2019 and beyond, as we've consolidated this business. For us, the bigger issue — most of the work was done in 2018, really bringing all of these businesses together and integrating them behind the scenes, there was a lot of work that took place. And so, as we've set off into fiscal 2019, really being able to standup this organization and have them ready to go is exciting.

In regards to the last part of your question, we've said it, it's about a billion dollar business and haven't really given any thought into splitting it off or anything like that, because it is so closely linked and tied to Refrigerated Foods. It makes perfect sense to have it there. And really, the focus now is achieving and doing what we said we were going to do and making sure that it's, A, our next growth engine, and really helping retailers create the deli of the future to capitalize on that opportunity.

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

Okay. Perfect. So, it's going to be — so, basically $1 billion, that's with the $300 million that comes in from Jennie-O, correct?

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

Yeah.

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

Okay. And then, last on the International part. I mean, clearly their sales was strong driven. Could you give a little bit update on how the Brazil acquisition is doing, the Ceratti brand? How you've been doing? How the competitive environment has been doing, because what I've seen is that at least in some of the prepared food side business, we've seen major competitors being relatively aggressive on increasing pricing. So, I wanted to get your exposure there and how you were able to benefit from that environment? Thanks.

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

Yeah. Absolutely. So, the Ceratti acquisition has met all of our expectations. And as we've said, it's really given us a great entry point into the Brazilian market. In 2018, we did take some pricing down there, as they had some macro issues around inflation, but we've been able to successfully pass along pricing. A reminder that the brand is a premium value-added brand, very well recognized by Brazilian consumers. And so, it mirrors a lot of what we have here in the United States in terms of it being a premium, authentic, high quality artisanal brand that resonates with consumers. So, business is meeting all expectations. We're in the midst of continuing to make sure we're innovating, adding capacity to capitalize on the growth opportunities that are down there.
Benjamin M. Theurer  
Analyst, Barclays Capital Casa de Bolsa SA de CV

Okay. Perfect. Thank you very much. I'll leave it here.

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

Thank you.

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Operator: And we'll take our next question from Jeremy Scott with Mizuho. Please go ahead.

Jeremy Scott  
Analyst, Mizuho Securities USA LLC

Hey. Good morning.

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

Hi, Jeremy.

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Jeremy Scott  
Analyst, Mizuho Securities USA LLC

So, just wanted to clarify on the Refrigerated Foods guidance being up next year. So, just want to clarify, this includes the $15 million to $20 million in closing costs, which I think is what you estimated last quarter. It includes the estimated $10 million decline in commodity profits, but it doesn't include the reconciliation of, let's say, $35 million, $40 million in JOTS business being reclassified into Refrigerated Foods. So, is your guidance implying that there's something in the range of $65 million to $75 million in organic operational improvements in fiscal 2019?

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

I think it's fair to say, everything that you've talked about is included in the growth that we're looking for in 2019. I think the $12 million is going to be in general corporate, but it's reflected in our overall number. So, I think the other – I mean, the other elements that you're talking about really are reflected in Refrigerated Foods, and it'll be another strong year for them. And I would – Jeremy, I guess, if there's any more specific detail that you need, certainly Nathan can be available to give you those answers.

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Jeremy Scott  
Analyst, Mizuho Securities USA LLC

Okay. Got it. But I just wanted to make sure that the Jennie-O reclassification is or isn't included in your guidance of Refrigerated Foods being up next year?

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

Yeah. So, that is now the Jennie-O business has shifted into our deli organization, which is now included in Refrigerated Foods. So, we are essentially rebasing Refrigerated Foods to reflect that.
Jeremy Scott  
**Analyst, Mizuho Securities USA LLC**

Got it.

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

I think that makes sense.

Jeremy Scott  
**Analyst, Mizuho Securities USA LLC**

Got it. Okay. Yeah, that does. And I was hoping, can you expand on the pre-Fremont, post-Fremont dynamic in Refrigerated. I think you said, your commodity profits will be done, hog harvest will be down, but given your contract, there would be no impact on volumes, right? So, can you clarify what percentage of the tonnage that you will be buying from WholeStone under contract that will effectively be passed through? Or in other words, the product that you don't turn into value-add, the green hams and their equivalents? Yeah. Just could you quantify that if possible?

And within that, are there products that you're going to be entirely passing through? And will there be products that you don't necessarily add value on, but you'll earn a spread, because you're locked into a contract with a customer, and you're getting [indiscernible] there?

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

So, we will take all of the meat coming off of the Fremont line. Some of that meat will go into our value-added products, some would be sold as fresh pork. We retain our margins on fresh pork sales. So, we're purchasing the meat at the USDA composite carcass value. So, the spread between the carcass value and the sale into either the retailer or the provisions market belongs to Hormel. So, we're taking down our harvest by 30%, and as we see it, this is – with the additional capacity coming online, this is exactly why we made the move to sell Fremont. It de-risked the Refrigerated Foods business and that is the structure.

Jeremy Scott  
**Analyst, Mizuho Securities USA LLC**

Okay. I guess, I'll follow-up with Nathan on that. And then just maybe lastly on the 12% dividend hike into your implied guidance. So, a solid acceleration in the payout ratio, though not entirely off trend, given what you've done over the past decade. But just curious what was the rationale for leaning into the payout in 2019? And should we interpreting that as a retail operation, however, slight – how you're thinking about M&A opportunities that maybe at your doorstep?

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

Well, I mean, I think the biggest driver obviously is the strong cash flows of our business, right. Strong cash flows. And clearly, the balance sheet remains as a strength for the organization. This is consistent with what we've done over the last decade. So, not only the strong cash flows, but the optimism that we have in our business going forward. So, as we head off into 2019 and beyond, clearly the dividend is one of the levers, when we think about capital allocation. But we are in a very, very strong position to make any acquisition that we think is appropriate and strategic for us.
Jeremy Scott  
Analyst, Mizuho Securities USA LLC

Great. Thank you.

Operator: And we’ll take our next question from Heather Jones with Vertical Group. Please go ahead.

Heather Jones  
Analyst, The Vertical Trading Group LLC

Good morning. Thanks for taking the question. Real quick on your comments on freight. So, some of the other companies in the industry are talking about not lower freight in 2019, but honestly, less more benign commentary on the outlook than what you articulated. So, I was wondering if you could – are you envisioning inflation similar to what you saw in 2018 on the freight side?

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

Hey, Heather. I think it’s going to be a little lower than we saw in fiscal year 2018. I mean, we believe that there’s still pressure, but there is a bit more balance in the marketplace. Now that the freight lines have had time to work on it, certainly, we’ve spent time working on it. So yeah, I guess, I don’t want to overstate it, but certainly, it’s a headwind in 2019. And again, it really goes back to this longer-term solution that our supply chain team is working on is, what is the right network optimization for us.

Heather Jones  
Analyst, The Vertical Trading Group LLC

Okay. And then on advertising, so you guys talked about a 20% increase for 2018. It came in below that and I think you made some comment about shifting it into other types of promotion that you found more effective. Could you help us – give us a sense of what you’re thinking in about advertising dollars in 2019, as far as year-on-year increase?

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

Yeah, absolutely. So, at the end of the first quarter, what I said was that we would increase our advertising and promotional spending in the neighborhood of 20%. And as you know, I mean we’re always working to find the highest ROI between all methods of brand support. And while advertising was significantly ahead of last year, good strong double-digit increase, it was below that 20%, but we did see our trade dollars come in above plan by an equal amount. So, we hit the number that we thought we would, and it does ebb and flow in terms of how we spend those dollars across brands and dollars.

The real message here is that we’re dynamically managing this brand support for the highest ROI. And we do a lot of time spend a lot of time around revenue growth management, pricing, trade, advertising, all those things. So, we feel good with what we’ve said and what we ended up spending.

And then, we are going to have a slight increase in 2019 and in Jim Sheehan's comments, he talked about some of the brands where we'll be spending those dollars. We'll continue to support the SPAM brand, who just – they're coming off their fourth consecutive record year and it's a brand that we know responds well to advertising. We've spent a lot of time and effort in dollars under our umbrella brand Natural Choice. And of course, the re-investment...
in the Jennie-O Turkey Store business. So, feel like our investments are giving us the returns that we need, whether they’re advertising or trade.

Heather Jones
Analyst, The Vertical Trading Group LLC

Okay. Thank you. Have a Happy Thanksgiving.

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

Yes. You too, Heather.

Operator: And we’ll take our final question from Robert Moskow with Credit Suisse. Please go ahead.

Robert Moskow
Analyst, Credit Suisse Securities (USA) LLC

Hi. Just a couple things just to clear up. Freight, can you give us a sense of what the dollar inflation was in fiscal 2018 just to get a sense of the headwinds just all-in-all? Second, bellies, like belly prices, I think started pretty low in the quarter and then were rising. Were you hedged on bellies? Did you get a really strong bacon margin in the quarter? And do you expect that to kind of ease off in the first quarter, just because of the slope of the curve going higher? Maybe give us a little more clarity on what those bacon margins look like? Thanks.

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

The freight was $0.06 to $0.08 in 2018. Belly markets, as I said, we think that we will see volatility and we have seen volatility this year in bellies. We do not have a hedge on bellies right now. We still believe that they’re going to be lower over the year and, I’ll let Jim talk a little bit about the margins on the bacon.

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

Yeah. So, Rob, I mean, our bacon business was very strong. And it kind of ties into my previous answer in terms of really, where is the biggest ROI in terms of pricing or trade, and so we navigate through that. But, I would tell you that I mean, we’re very pleased with bacon performance for the year, for the quarter, both top line and bottom line.

Robert Moskow
Analyst, Credit Suisse Securities (USA) LLC

Okay. Last question corporate expense, it was like $60 million this year. I think it’s twice as high as the year before. Should we expect it to be similar in fiscal 2019? I didn’t catch that.

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

Well, we’ll have the $12 million in the closing of the Fremont sale in corporate expenses. So, it will be – that will put pressure on increasing the corporate expenses.
Robert Moskow  
Analyst, Credit Suisse Securities (USA) LLC  
So, something in the mid-70s then, Jim?

James N. Sheehan  
Senior Vice President & Chief Financial Officer, Hormel Foods Corp.  
No. No, we don't see them that high.

Robert Moskow  
Analyst, Credit Suisse Securities (USA) LLC  
Okay. Well, we don't have to play bigger than a breadbox, so I'll get off the queue. Thanks.

Operator: And there are no further phone questions at this time. I would now like to turn the call back over to Jim Snee for any additional or closing remarks.

James P. Snee  
Chairman, President & Chief Executive Officer, Hormel Foods Corp.  
Great. Thank you. On behalf of the team here at Hormel Foods, thank you to all of you for joining us today. To our team members listening in, thank you for all your tireless work that allows our company to be so successful in the marketplace. Your focus on delivering our key results and maintaining our culture of accountability will continue to make this company uncommon in the marketplace. Have a safe and happy Thanksgiving.

Operator: And this concludes today’s call. Thank you for your participation. You may now disconnect.

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