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Hormel Foods Corp. (HRL)

Q1 2019 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' First Quarter 2019 Earnings Release Conference Call. At this time, all participants are in a listen-only mode. As a reminder, this conference is being recorded Thursday, February 21, 2019.

I'd 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 first quarter of fiscal 2019. We've 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, Executive 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 2019. Jim Sheehan will provide detailed financial results and further assumptions relating to our 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 in 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 1445918. 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 statement we’ll be making. Please refer to pages 7 through 9 and 28 through 30 in the company’s Form 10-K for the year ended October 28, 2018 for more details. It can be accessed on our website.

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. As a global branded food company, we remain focused on our formula for success which includes building strong brands, developing innovative new items, making strategic acquisitions and creating intentional balance. This time-tested strategy continued to serve us well this quarter, as improvements in our branded value-added businesses once again offset significant declines in our commodity businesses. We will continue to be intentional about shifting our portfolio away from commodity products and the associated earnings volatility.

Our efforts in brand building continue to pay off, as retail brands like SPAM, Dinty Moore, Mary Kitchen hash, Hormel bacon toppings, Wholly Guacamole, Herdez, Hormel pepperoni, Natural Choice, Columbus, and Applegate, all showed solid growth this quarter. Our brands have a number one or number two share in over 40 categories. That is up from 35% a year ago. As you think about the footprint of a retail outlet, there aren’t too many places where you won’t find a brand or product owned by Hormel Foods.

Our foodservice business remains robust both domestically and in China. Growth this quarter was led by brands such as Old Smokehouse, Hormel Fire Braised, Jennie-O, and Skippy. Our products continue to solve for the challenges faced by operators around the globe. With exciting innovation pipelines, retail brands such as Natural Choice, Skippy, Justin’s and Applegate, will continue to deliver innovation to the marketplace at a faster cadence than ever before.

We continue to be very optimistic on key innovation in foodservice as well, with brands like Fire Braised and Hormel Bacon 1. This was the first quarter we had sufficient production capacity for Hormel Bacon 1 fully-cooked bacon at our newly expanded Wichita, Kansas plant. Our strategic acquisition of Columbus Craft Meats and the subsequent creation of our new Hormel Deli Solutions division within Refrigerated Foods is delivering on our commitment to help retailers create the deli of the future.

In addition to the very strong financial performance, I am also incredibly proud of the work the deli group and all supporting integration functions have done in the past year to put Hormel Deli Solutions in a position to outperform our expectations this quarter. Finally, our focus on intentional balance was evident, as earnings growth in Refrigerated Foods, International and Jennie-O more than offset a decline in grocery products.

Looking at the first quarter, we delivered earnings per share of $0.44, a 21% decline compared to last year. Recall that last year’s results included a large one-time benefit from The Tax Cuts and Jobs Act. We grew pre-tax earnings by 1%, as three of our four segments delivered earnings growth. Three segments also delivered sales
growth, resulting in increased sales of 1% on volume growth of 1%. Refrigerated Foods grew sales 2%. As I previously mentioned, our new Hormel Deli Solutions division delivered excellent result, led by Columbus branded items and Jennie-O premium deli meats.

Our growth in the deli channel was balanced as all three focus areas; grab-and-go, prepared foods and behind-the-glass, showed improvements for the quarter. Refrigerated Foods grew earnings 3% even as commodity profits declined 70%. This represents the fourth consecutive quarter in which branded value-added product growth has more than offset a dramatic decline in commodity profits. And there are two brands that are playing an important role in the performance of Refrigerated Foods. The first brand is Hormel pepperoni.

Over the past few years, we have increased the media spend on this brand and our consumers are responding. According to IRI, our baseline volumes are up 10% in the past quarter. Hormel pepperoni has also generated a compound annual growth rate over the last three years of 2%, as we continue to gain new points of distribution. Like our iconic SPAM brand, Hormel pepperoni is another example of how we can continue to grow a 100-year-old brand.

Next, the Applegate brand. We have known for quite some time that there was an opportunity in both foodservice and value-added fresh pork to leverage this market-leading brand. The combined team of Applegate, Hormel Foodservice and the Hormel Fresh Pork Group have been able to make excellent progress in expanding the Applegate brand beyond their current product lines. In foodservice, we are making inroads with colleges and universities, healthcare facilities, and other key customers and lodging. We are also starting to sell value-added fresh pork items, allowing us to improve the efficiency of our natural and organic raw materials supply chain.

Grocery product sales increased 1% on a 3% volume increase. Brands such as SPAM, Dinty Moore, Mary Kitchen hash, Hormel bacon toppings, Herdez and Wholly Guacamole generated excellent sales growth. Gains in these brands offset declines in contract manufacturing. The segment profit declined due to the effect of a non-operating tax benefit in our MegaMex joint venture last year. We also had a legal settlement this quarter which compensated us for lost profits and offset part of the tax benefit last year. International sales increased 2% on volume growth of 1%.

The SPAM and Skippy brands showed solid growth this quarter for both our export business and in China. Our business in China grew many product lines including refrigerated retail and foodservice products, SPAM luncheon meat and Skippy peanut butter. Our launch of the SPAM brand in China is exceeding expectations and our in-country team continues to make excellent progress, growing households and points of distribution.

International segment profit increased 1%. The progress we made in branded exports and in China exceeded the steep declines in fresh pork exports. Global trade uncertainty continued to impact our fresh pork exports.

Jennie-O Turkey Store volume, sales and profits were flat for the quarter. We saw solid sales growth from our foodservice and commodity divisions, but those gains were offset by lower retail sales. We are starting to see incremental improvements in the turkey industry, driven by lower poult placements and lower cold storage levels. We have yet to see meaningful improvements in commodity prices.

During the quarter, we issued two voluntary recalls for lean ground turkey due to the presence of salmonella [indiscernible] (11:18). This resulted in a 10% decline in scanned retail sales volume of lean ground turkey during the quarter. The issue of salmonella isn't new and it is an industry issue. We plan to continue our leadership role in the effort to reduce salmonella and to educate consumers on how to safely handle and prepare raw turkey.
Even though we experienced a rebound in sales after the recalls and have confidence in the long-term growth of lean ground turkey, we are being very conservative on our sales outlook. Additionally, the extreme cold weather this winter will adversely impact raw material costs in the next two quarters. We will continue to focus on improving our turkey supply chain and investing in the Jennie-O brand. But because of these recent events, we expect Jennie-O Turkey Store to fall below the plan we had for them this year.

We are encouraged by the outlook for Refrigerated Foods, Grocery Products and International. We expect deli, foodservice and our China business to outperform our expectations.

As we announced on Tuesday, we signed a definitive agreement to sell the CytoSport business to Pepsi. The CytoSport team should be pleased with the gains they made in the innovation space, with the creation of the Evolve product line, Muscle Milk bars and multiple new flavors and formats for the Muscle Milk product line. The team also generated nice growth in the food, drug and mass channel.

However, it became apparent that Pepsi was the right long-term owner of this business given their expertise and scale in the beverage space. Pepsi has been a longstanding distribution partner for CytoSport and the Muscle Milk brand, which puts them in a strong position to grow this dynamic business. Jim Sheehan will provide more information regarding the financial details of the pending transaction.

We are reaffirming 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 does not include any impact from the pending CytoSport transaction.

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 the remainder of fiscal 2019.

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

Thank you, Jim. Good morning, everyone. Volume, net sales and pre-tax profit for the first quarter were up 1% compared to 2018. Volume was 1.2 billion pounds with growth primarily coming from Grocery Products. Net sales of $2.4 billion and pre-tax profits of $307 million resulted from a strong performance of value-added products in Refrigerated Foods and International.

Net earnings for the first quarter were $241 million, down 20% compared to last year. Earnings per share were $0.44, down from $0.56. First quarter earnings in 2018 included a benefit of $0.12 per share related to tax reform. Results were negatively impacted by $0.02 per share related to the sale of the Fremont facility. Expenses included the cost to move value-added equipment out of the facility and various pension-related items. These expenses were recognized in net unallocated expense.

SG&A excluding advertising was 6.6% of sales compared to 7.7% last year. The decline was due to a benefit of $0.02 per share from a legal settlement. This settlement was primarily recognized in net unallocated expense and the Grocery Products segment. Advertising for the quarter was $39 million compared to $40 million last year. Advertising investments are expected to remain consistent with our prior guidance as we support brands such as SPAM, Hormel pepperoni and Wholly Guacamole.

Equity and earnings declined, reflecting the impact of a MegaMex non-operating tax benefit last year and lower earnings from international joint ventures. Operating margins were 13%, unchanged from last year. The effective tax rate for the first quarter was 21.3% compared to 0.6% last year. The increase was primarily due to deferred
tax remeasurements in 2018 as a result of The Tax Cuts and Jobs Act. The effective tax rate for 2019 is expected to be between 20.5% and 23%.

For the quarter, capital expenditures were $39 million compared to $54 million last year. We anticipate full year capital expenditures to be $350 million. We paid our 362nd consecutive quarterly dividend effective February 15, at an annual rate of $0.84 per share, a 12% increase over the prior year. Share repurchases for the quarter were $45 million, representing 1.1 million shares. We will continue to repurchase stock to offset dilution from stock option exercises and based on the internal valuation.

As expected, hog supplies have increased and domestic pork prices have declined due to the abundant supply of protein on the market. Based on the supply structure after the sale of Fremont, less than half of pork raw materials will be sourced from the Austin harvest operation. This structure reduces the impact of hog costs on the business. Commodity profits in Refrigerated Foods declined 70% due to higher contracted hog costs. The sale of the Fremont plant did not materially impact commodity profits this quarter.

Quoted hog markets were down 19%, while the USDA composite value declined 12%. Both markets were down significantly relative to the five-year average. Hormel’s hog cost exceeded the market due to a higher mix of grain-based contracts used during the quarter. Belly prices and beef trim were flat compared to last year, while 72% pork trim prices declined 27%. Industry data shows improvement for turkey. Poult placements continue to be lower and fresh meat cold storage has declined. Fresh meat prices were 36% ahead of last year, but remained below the five-year average.

Beef costs were up slightly in the first quarter. Our outlook for input costs remain unchanged with continued volatility due to global trade uncertainty related to African Swine Fever and tariffs. Regarding the CytoSport transaction, the purchase price is $465 million, subject to adjustments at closing. The transaction is expected to close in the second quarter.

Sales in 2018 were approximately $300 million, with operating margin slightly below the total company. We expect the sale to impact ongoing earnings by approximately $0.03 to $0.05 per share for fiscal 2019. We expect a gain on the sale of $0.06 to $0.12 per share in the second quarter. Combined, the full year estimate is expected to be a net $0.02 to $0.09 gain. Current guidance of $1.77 to $1.91 assumes no impact from the sale of CytoSport. We will update the impact of the sale in guidance after the sale is final. This quarter we started Project Orion, a strategic initiative that will streamline and transform how we operate as a global branded food company.

Hormel Foods currently runs multiple and independent on-premise support systems. The goal is to create a unified Oracle cloud-based platform that brings the conveniences and technology of our everyday lives to the business environment. Our supply chain and HR teams will benefit from integrated systems with new capabilities. The finance organization will benefit from the transition of the on-premise Oracle financial system to the Oracle cloud-based platform, including the use of robotic process automation.

Systems will be simplified and modernized, giving our teams the actionable and timely data needed to drive deeper analytics and gain insight into our business. This project will generate efficiencies across our entire company and represents the next step in the execution of our long-term growth strategy. Our phased approach will allow us to see benefits this fiscal year and in future years.

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: Thank you. The question-and-answer session will be conducted electronically. [Operator Instructions] And we'll take our first question from Michael Lavery with Piper Jaffray.

Michael S. Lavery
Analyst, Piper Jaffray & Co.

Good morning. Thank you.

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

Good morning.

Michael S. Lavery
Analyst, Piper Jaffray & Co.

You've talked about the value-added portion of the portfolio being a driver for growth, and yet you've also said that you're holding your advertising spend constant. How should we think about your brand building? And as that becomes not only a bigger part of the portfolio, but a bigger part of the growth, why wouldn't you think about increasing your marketing levels?

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

Yeah. Michael, though – I mean the way we think about it is, there is a lot more to brand building than just advertising. Certainly, that's a key part of it. But as we think about how we align price promotions, advertising, what's the right assortment, and then also just improving efficiencies as we're dealing with customers, retailers, I mean those are all very, very important. And we feel very comfortable with our spend levels across our brands and are very confident that the spending levels that we have are enough to support our strategy of increasing the value-added portfolio. So, it is more than just advertising.

Michael S. Lavery
Analyst, Piper Jaffray & Co.

And then, would it be right to say that you might have, with the deli group, a little bit higher selling costs, but that's also another lever that isn't obviously advertising.

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

Well, I mean we have a direct selling organization in the deli space, which you would assume is a higher cost. But certainly from our perspective, more efficient and more important selling organization, it's an approach that we use across our foodservice business, our consumer product sales division, and now with the creation of our deli solutions. So, it's an important part also of all those things that we talked about; the price promotion, advertising, assortment. The sales force is critical to our success in deli as well.

Michael S. Lavery
Analyst, Piper Jaffray & Co.
Okay. Thank you very much.

Operator: And next we'll go to Eric Larson with Buckingham Research Group.

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

Yeah. Good morning, everyone.

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

Good morning.

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

And thanks for the question. Just a quick, maybe I missed this and this is probably for Jim Sheehan. Jim, did you quantify the amount of the insurance gain in the quarter? I mean, it looked like your unallocated corporate wasn't hugely different year-over-year. And where would that number have gone into? Would it be in Grocery or how would that show up?

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

Thank you, Eric. The legal settlement we quantified to be about $0.02. Now, I would point out that that's a gross number. We did incur expenses during the quarter regarding this issue and there was some lost profit in the quarter. The impact on Grocery Products was less than $0.01, which is where we split it between Grocery Products and net unallocated.

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

Got it. Okay. So, it's kind of a split in between all of that. Okay. And then, I know this might be sort of a – more of a specialized question. But in your prepared comments you mentioned that you were seeing some higher costs due to cold weather here, lot of snow in the Midwest I think in Jennie-O.

And back five years ago when we had that issue, you basically run your [ph] grow-all (25:49) houses with LP as I recalled, and you were at that time going to start making an effort to try to get as much natural gas into some of those facilities, et cetera. Where do you sit on that? And is LP still of a higher cost item? Is that an issue yet for running your [ph] grow-all (26:09) houses in your turkey division?

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

Yeah. Eric, it's not an issue. And we've made good progress around natural gas, but obviously there is still some LP in the system. Really the bigger issue was getting birds into the facilities. And so, we've been in the middle of this polar vortex that everyone's talking about. And so, it has been problematic just really from getting the birds into the facility. That's what we're talking about.
Okay. I wasn’t sure exactly...

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

[indiscernible] (26:43)

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

Go ahead.

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

Eric, I want to follow up on your question. You also asked where we would have been with SG&A without these adjustments. Remember, last year we also had a transaction in the SG&A. If you look at our SG&A, it’d be down slightly from last year when you take out the adjustment.

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


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

Thanks.

Operator: All right. And next we’ll go to Heather Jones with Vertical Group.

Heather Jones
Analyst, The Vertical Trading Group LLC

Good morning. Thanks for taking the question.

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

Good morning.

Heather Jones
Analyst, The Vertical Trading Group LLC

Good morning. So first, just a quick question on CytoSport. So when you update your guidance, I want to make sure I understood, so it would be estimated $0.03 to $0.05 dilutive to ongoing earnings, but then there would be a gain on sales. So, when you all update your guidance once the transaction closes, are you going to include that gain on sales? So should we expect your guidance to go higher?

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

Yes. We will give you guidance based on GAAP numbers, but we will make it clear enough so that you will understand how much the gain on the sale is.
Okay. And then, going back to Jennie-O and I think you – I was on another call and I think I missed some of this commentary, so I apologize for making you repeat. But the reduction in your guidance as well as the weaker showing in the quarter, how much of that was due to weakness and the more commodity – the [ph] hen (28:22) part of the business and how much of it was related to lower demand because of the recall?

Yeah. Heather, the quarter was actually shaping up to be a good quarter for us. Then we did have the recalls and then as the – we talked a little bit about the polar vortex, but foodservice had a good quarter, our commodity sales were positive. As a reminder, we did move Jennie-O deli turkey to Refrigerated Foods and we had a good quarter there. It really was the retail lean ground business. And that was impacted, as we said, down 10%. We did see some spill over into other products. So, I mean, the recall really did – is what set us back for the quarter.

Okay. Thank you so much. I appreciate it.

Yeah.

Operator: And next we'll go to Rupesh Parikh with Oppenheimer.

Good morning, and thanks for taking my questions. So first I wanted to ask about some of the pricing changes that you guys have made over the past few quarters. I was curious how they played out versus your expectations and whether you've seen the expected volume impact associated with those pricing changes.

Sure. Probably the closest in more CPG-like pricing we've taken was on Hormel pepperoni and the volume has actually exceeded our expectations. We talked a little bit in our prepared comments about the success that we've had with that 100-year-old brand, that 100-year-old business. So having the number one, number two brands certainly gives us a lot of brand power and pricing strength. And so that has played out. If you go back a little further, we'd taken some increases across our Grocery Products portfolio. And again, those all exceeded our expectations. So, we feel good about where we are in our pricing environment right now, Rupesh.

Okay. Great. And then second question. On the commodity profit decline that we saw in Refrigerated Foods, I was just curious if you can just give us any thoughts in terms of how you're thinking about this headwind for the balance of the year.
James N. Sheehan  
*Executive Vice President & Chief Financial Officer, Hormel Foods Corp.*

The biggest impact on the profitability was the hog costs. We buy hogs on a variety of formulas, including the Western Corn Belt cutout and grain-based formulas. The grain-based formulas were significantly a higher cost formula than the Western Corn Belt or other programs right now. So we will see some increase in the hog costs as we go forward. We think we'll see some recovery in the market, so that the difference between the programs won't be as great as they were in the first quarter. You're starting to see them even out a little bit as we've gone into the second quarter, if that helps.

Rupesh Parikh  
*Analyst, Oppenheimer & Co., Inc.*

Okay. Great. Thank you.

Operator: All right. And next we'll go to Adam Samuelson with Goldman Sachs.

Adam Samuelson  
*Analyst, Goldman Sachs & Co. LLC*

Yes. Thank you. Good morning, everyone.

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

Hey, Adam.

Adam Samuelson  
*Analyst, Goldman Sachs & Co. LLC*

I guess, first, I want to just make sure I'm understanding on the outlook and the different pieces what has changed, and any order of magnitude for how much the Jennie-O outlook has been trimmed? And if you could dissect that between costs, weather impact and lower retail sales, that'd be helpful. And then, just the other businesses to offset to keep the full year outlook unchanged. I'm just trying to make sure I understand the magnitude of the different pieces.

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

Yeah. Adam, so I think what we would tell you is the outlook for Jennie-O Turkey Store, we're now moving that to more flat to slightly down. And the other businesses that we talked about that are really going to show growth or overperform, we talked about the deli business which is off to a great start in the first quarter. Foodservice continues to deliver and then the success that we're seeing in China.

So, we have the right offsets there to maintain the guidance for the full year. As you get into some of those more maybe specific questions, you might want to take that offline with Nathan and he can probably add some additional color for you.
Okay. And then as a follow up, just trying to get an updated sense on how you’re planning for the impact of ASF across both your Chinese business and your U.S. business over the balance of the year. Number of cases continues to grow, could start having a more meaningful impact on hog and pork prices in China as you move through the year. Would guess it was a benefit this quarter and just how that progression plays out would be helpful.

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

Sure. So we expect it to have a positive impact in future quarters as well. There is available meat in China as a result of ASF, and it is at competitive prices. So, we are being very strategic and intentional on the supply side of the business, that will carry us through just about the balance of the year. So we feel really good about the input cost side of the China business. But I will tell you, the other side of the story is the sale side. So, really seeing the growth in the refrigerated retail, refrigerated foodservice, the Skippy business, the continued implementation of our SPAM presence there. All of those are going really well. When you think about the rest of the globe, clearly, like everybody else, we’re monitoring the situation closely. It’s really too hard to say. So for us really it’s that focus in China and controlling the thing that right now we can control and we feel like we’re in a really good place.

Adam Samuelson  
Analyst, Goldman Sachs & Co. LLC

But is it fair to say, if you move later in the year and you started to see an impact on pork prices in the U.S., that would be potentially an offset?

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

I mean, it’s hard to say. I mean, if we think about – if you go back to what happened during PEDv, you’re going to have a lot of moving parts. And so, we don’t want to get out too far ahead of ourselves. Clearly, we could have some benefit. We talked about the steep decline in our International exports. We’re going to have some benefit there. So I hear what you’re saying, but it’s still too early to give a good read on that situation.

Adam Samuelson  
Analyst, Goldman Sachs & Co. LLC

Okay. I appreciate it. I’ll pass it on.

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

All right. Thank you.

Operator: All right. And next we’ll go to Thomas Palmer with JPMorgan.

Thomas Hinsdale Palmer  
Analyst, JPMorgan Securities LLC

Good morning. Thanks for the question.

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

Yeah.
Wanted to first kind of ask on the balance sheet. Following the sale of CytoSport, you're approaching net cash balance. I know you can't get too specific but any color on the M&A pipeline and also where you have the internal bandwidth to take on new businesses? I would assume, for instance, the deli operations have a good bid on their plate already?

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

Yeah. That's a fair assessment, Thomas. We're continuing to be very, very active looking for impactful M&A. The areas that – we've talked a lot about our desire to continue to add on to our very strong foodservice presence. We have capacity in our International business to do more. And then, I think even in our domestic Grocery Products segment, we believe that with some of the M&A activity that's taken place, there'll probably be some carve-outs.

And we also want to be very intentional about our ability to expand our MegaMex business. That's a business that's done really well for us, it's on trend and we'd love to get bigger faster there. So, we've got a number of different places where M&A can fit and we are being very, very active.

Okay. Thanks for that. And I had a quick follow up on the ASF situation. So my understanding, you mentioned that kind of near-term supply was being aided, I guess, in part because farmers kind of pushing forward slaughter for some of their hogs. But I guess, I was a little surprised that you thought that would endure for much of this year. How long can that kind of excess supply linger in China, and maybe at what point do you think it kind of reverses.

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

Yeah. So, I don't know how long it's – I don't know how long the market will last, I guess, what I was saying in terms of our position on what we have in our supply chain to secure our business for the balance of the year. I have not received an update or an outlook on what that looks like in China. But I would tell you that we feel good about our own supply chain to support our business through the balance of the year.
Hi. I have a couple of questions.

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

Hi, Rob.

Robert Moskow  
Analyst, Credit Suisse Securities (USA) LLC

One is on Skippy. I noticed you didn't mention it in your press release as a brand that grew. Nielsen data indicates that you were up. And your biggest competitor has had some real big market share declines and now they've announced some price cuts. Can you give us an update on what's happening with Skippy? And how you might have to react to your competitor lowering price?

And then I had a question on cash flow. Cash flow was strangely down a lot in the first quarter. It looks like there is something going on on the working capital side. Can you give us a little more color on that?

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

Sure. I'm going to let Jim Sheehan handle the cash flow question first, Rob, and then I'll follow up on Skippy.

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

Good morning, Rob. The big impact...

Robert Moskow  
Analyst, Credit Suisse Securities (USA) LLC

Hi.

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

...on the operating cash flow was the fact that this year our hog producers did not defer as much of their payments into the next year. Last year there was an extremely large amount of deferral even into the second and third quarter of their payments from the hogs that they had delivered the prior year. That was down drastically this year, and that's the impact that you're seeing in the operating cash flow.

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

So more of a timing issue than anything.

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

Yeah.

Robert Moskow  
Analyst, Credit Suisse Securities (USA) LLC
Okay. And then, let's talk about Skippy. Your first question or comment around we didn't talk about it. Obviously, we had a laundry list of brands in our prepared comments that we did talk about. So, Skippy certainly would have had a place in that list of brands because we have continued to see growth. As we mentioned, over the last 12 of 52 weeks, we've maintained our share, we're actually seeing some growth, while the number one or share leader is down slightly. Clearly, there's growth in that private label space.

From our perspective, we're a bit disappointed with the competitive dynamics, where we knew this was coming and we are in the process of responding accordingly. We've been here before. We had a similar situation several years ago. Believe that we emerged out the other side as a stronger brand and stronger business. And I would just say, when it's all said and done, I mean we do believe that the brand matters. The brand is important. And that really trying to compete with private label on price is not a winning strategy over the long term. But make no mistake about it, our teams understand what happened. We're in the process of reacting; we'll respond accordingly, and that response will be our continued focus on innovation.

We've talked a lot about taking peanut butter out of the jar since we acquired the business and we've done that with Skippy P.B. Bites, Skippy Fruit Bites; different formats. And now, of course, we're in the midst of introducing our Skippy PB&J Minis, which are just starting to roll out. But again, early reads are very positive. So, feel really good about the business, feel really good about the brands and we'll manage through this situation as appropriate.

Well, your tone on Skippy sounds more negative than on CytoSport, maybe I'm misreading the tone. But what's happening with private label, [ph] is it weak (41:55)?

Well, let me clarify that. That was not intended. The tone should be very positive.

Okay. Okay.

Yeah.

But looking forward, are the retailers expanding shelf space for private label? Is that the problem that's hurting the category?
James P. Snee  
Chairman, President & Chief Executive Officer, Hormel Foods Corp.

Well, I mean I think as you look at points of distribution and what's happened with private label, what's happened to the number one leader, I think there is a direct correlation. What I would tell you is, we've held our own in terms of points of distribution, which has really allowed us to maintain that share and deliver growth.

So, I mean that's why — again, I just want to reiterate. The tone is not negative, Rob. The tone is very positive about Skippy and the things that we have going on; the innovation — the pipeline of innovation, we feel really good about the business.

Robert Moskow  
Analyst, Credit Suisse Securities (USA) LLC

Okay. Got you. Thank you.

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

Yeah.

Operator: And next we'll go to Jeremy Scott with Mizuho.

Jeremy Scott  
Analyst, Mizuho Securities USA LLC

Hey. Good morning. Just want to ask about the — another question on the advertising levels. I know CytoSport is excluded from earnings guidance for the moment. But does your advertising guidance reflect the fact that business will be gone? I know you'd plans to support sales in 2019, but presumably you no longer have any planned marketing investments in the second half baked into your guidance. So is it all kind of rolled up into that 3% to 5% ongoing number?

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

Yeah. So Jeremy, right now the guidance that we've given just assume business as usual. So, everything...

Jeremy Scott  
Analyst, Mizuho Securities USA LLC

Got it.

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

...is still in that number. When the deal closes, we will provide updated guidance and clarity around the business.

Jeremy Scott  
Analyst, Mizuho Securities USA LLC

Got it. Okay. And then on the Refrigerated Foods, volume down 1%. First, is that an organic number? In other words, did that include the sales transfer from Jennie-O in the quarter? And if it is, can you unpack that number between the ongoing strategic harvest reductions and just the general demand environment?
James N. Sheehan  
Executive Vice President & Chief Financial Officer, Hormel Foods Corp.  
The...  

James P. Snee  
Chairman, President & Chief Executive Officer, Hormel Foods Corp.  
Yeah. Go ahead, Jim.  

James N. Sheehan  
Executive Vice President & Chief Financial Officer, Hormel Foods Corp.  
Sure. Jeremy, the biggest cause of the reduction in sales had to do with the harvest reduction. And you are looking at like numbers. So both the prior year and current year have the adjustment of deli going into Refrigerated Foods [indiscernible] (44:31) deli going into Refrigerated Foods.  

Jeremy Scott  
Analyst, Mizuho Securities USA LLC  
Got it. Maybe just the last question. Where are you with this $75 million in targeted savings? And does the disposition of CytoSport changed that – guided all, changed what you can achieve this year?  

James P. Snee  
Chairman, President & Chief Executive Officer, Hormel Foods Corp.  
Yeah. Not all that much. I mean, we’re still on target and working diligently to attain it. I mean, we’re committed to that target. A lot of what we said in Q4 still holds true in terms of, there is some near-term and long-term solutions the team is working on. I think the one thing that will really help our team, and Jim Sheehan mentioned it in our prepared remarks, is this; this Project Orion, and really putting in technology to modernize and optimize not only supply chain, HR, but a number of our different operations. So, that is really going to help the team as well. So, we feel good where we are from a supply chain perspective.  

Jeremy Scott  
Analyst, Mizuho Securities USA LLC  
Thank you.  

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

Operator: And next we’ll go to Ken Zaslow with Bank of Montreal.  

Ken Zaslow  
Analyst, BMO Capital Markets (United States)  
Good morning, everyone.  

James P. Snee  
Chairman, President & Chief Executive Officer, Hormel Foods Corp.  
Good morning, Ken.
Ken Zaslow
Analyst, BMO Capital Markets (United States)

Just a follow-up on Rob's question. So in terms of the Skippy side of it, you are going to hold steady and not react and focus more on brand building and innovation. Is that the expectation?

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

No, not at all. I mean, from our perspective, Ken, we have to; A, digest what we heard, we've got to understand how it's going to impact retailer by retailer and we will respond accordingly. And so, could it be aligning price promotion to increased advertising? I mean, there is a lot of things there. So, the idea that we're just going to stand pat and hope for the best is not at all correct. So we will respond accordingly, but we will do what's in the best interest of our business.

Ken Zaslow
Analyst, BMO Capital Markets (United States)

And you don't think the reaction is enough to change one way or the other way the outlook for your businesses? Is that a fair assessment? So, basically you think it's somewhat contained or that you can offset it with other parts of your business that would outperform. Is that fair?

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

Yeah. I mean, I think so. I think the other thing is that this is still really early, and we need to understand exactly how this is all going to flow through on the customer side of the business. It's one thing to say you're going to have a price reduction. It's another thing to see how that actually plays out. Is it reflected on shelf? Are margins just are captured? So, there is a lot of variables here that we have to be on the lookout for.

Ken Zaslow
Analyst, BMO Capital Markets (United States)

Okay. And then my [indiscernible] (47:32) question is, can you talk a little bit about innovation pipeline for this year? Which are the key areas within the business that you will see an acceleration? And where do you think you're kind of just doing more modest stuff? That would be helpful. Thank you.

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

Yeah. Absolutely. Yeah. I mean, so we've spent a lot of time and will continue to spend a lot of time on the Skippy business. That's very important to us. We talked a little bit about the increased success that we're having at Applegate and we're going to continue to spend our innovation focus there. A lot of work in our foodservice business, so we've had incredible success with a number of different items. And then, we are spending time with our Justin's brand as well.

So, it's across a lot of our businesses. Some of the recent successes that we've had we've talked about in our MegaMex portfolio with our guacamole salsa, with Natural Choice snacks, stacks and wraps. I talked about Skippy with the launch of the PB&J Minis. So these are items that are coming to – that are in market, but we've got robust pipelines backing up all of those brands, Ken.
Okay.

Operator: And next we'll go to Benjamin Theurer with Barclays.

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

Hey. Good morning, Jim and Jim.

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

Good morning. Ben.

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

Good morning.

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

So, just to follow up what — two questions. So first, in the Refrigerated Foods segment, clearly you show that the segment profit was up nicely. Can you somehow quantify how much that had to do with the fact of being less integrated on the pork business and basically taking more advantage of the availability of fresh meat to put it into your prepared stuff, into the bacon things and the Applegate products and so on? So, that will be my first question. So, how much of an impact that you've seen from having one plant less operated by yourself.

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

The Fremont impact in the first quarter was fairly neutral.

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

Okay.

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

So when you looked at the sourcing cost on the carcass value compared to the prices that we were paid and the cost to operate, the impact was neutral. But I would say that one of the areas that we will see a longer-term gain is the ability to focus on the value-added products and not having the resources tied up with that commodity operation.
Benjamin M. Theurer  
Analyst, Barclays Capital Casa de Bolsa SA de CV

Okay. Got you. And then one question I wanted to follow up on the supply chain integration, the project you've been running. Can you update us on how you're doing there, where you see maybe issues, if you're on track or not, because I haven't found anything in your prepared remarks about the supply chain? You mentioned the project and to technology and so on which has to do with it, but an update of the status quo, that would be much appreciated.

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

Sure. And as I said a little while ago, I mean, we're on track and committed to the target we provided on the fourth quarter call. We do think that Project Orion will be a technology catalyst to help our efforts as well, and it is. There is a number of short-term things that we're working on. We continue to work on freight-related issues, thinking about network optimization, maybe structural changes. So, I mean, the team continues to be hard at work and really the bigger message is we're committed to the $75 million.

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

Okay. Perfect. Thank you very much, Jim and Jim.

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

Yeah.

Operator: And next we'll go to Heather Jones with Vertical Group for a follow up.

Heather Jones  
Analyst, The Vertical Trading Group LLC

Thanks for taking the follow up. I just had two quick questions. Wondering, Jim Sheehan, you had mentioned earlier that on the pork side [ph] part of the attraction (51:47) was having some grain-related hog contracts. I was wondering, did you say there was a greater proportion of those this year versus last year or was it just how the impact fell out?

I guess I'm trying to think, as we go further in the year and the thought is as supplies will tighten up as the year progresses, do you still have significant exposure to the Western Corn Belt or are you much more heavily weighted to grain-based now?

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

Well, our exposure to the Western Corn Belt in all of these contracts have decreased with the sale of Fremont. As we change the source of hogs, as we close Fremont, there's going to be some short-term imbalance where we need some time to rebalance our contracts as contracts come due and we renegotiate those contracts. So right now we have a heavier percentage of grain-based contracts than we did last year at this time.
Heather Jones  
*Analyst, The Vertical Trading Group LLC*

Okay.

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

And with the volatility that you've seen in the hog prices, the grains obviously have not decreased in cost at the same rate as the hog prices have. So, that's creating the imbalance right now. But we are actively managing our contracts right now, that will adjust our supply base to a more balanced approach across all of those multiple formulas.

Heather Jones  
*Analyst, The Vertical Trading Group LLC*

A more balanced approach similar to what you had last year pre-Fremont sale?

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

I would say, pre-Fremont sales, I would – the item that I'd take you to, Heather, is that in effect, all of the Fremont – the meat that we get out of Fremont is a carcass value. So we have to take that into account as we negotiate new contracts for Fremont or for us, and I'm sorry.

Heather Jones  
*Analyst, The Vertical Trading Group LLC*

Okay. Okay. And then my second follow up was on the bacon business. It seems like, I mean bellies have clearly been very weak and understandably we're starting to see more promotional pricing in that category at retail. But from what I understand, you guys tend to be more capacity-constrained there. So, do you have any – what are your thoughts about how the categories getting more promotional like how do you intend to respond?

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

I mean, Heather, we talked a little bit about categories and revenue growth management. So, it is all of those things with pricing and promotion and advertising. But I'd tell you, our bacon business is still very healthy both on the retail and foodservice side. We've referenced our foodservice business, Bacon 1, in our prepared comments. But the expansion of that Wichita, Kansas facility also opened up some capacity on the retail side of the business for us. So from a capacity perspective, we're in a good place. And we clearly understand all of the category dynamics and are managing it very effectively to be able to deliver continued growth in that space.

Heather Jones  
*Analyst, The Vertical Trading Group LLC*

Okay. Thank you so much.

**Operator:** And next we'll go to Eric Larson with Buckingham Research Group for follow-up.

Eric J. Larson  
*Analyst, The Buckingham Research Group, Inc.*
Yeah. Thanks, guys. One other quick question. Thanks for the follow-up. It's really related to CytoSport, and I know that Pepsi obviously distributed – controlled all the distribution into the convenience channel. But I do believe that you had hope that that acquisition would also give you more exposure and a way to leverage that C-store channel. And I do believe that you feel you're under indexed in that sales channel.

So how do you think about that channel going forward? Does that – maybe you didn't really received much benefit from that. But to get exposure there, will you need to acquire to get in there? Or I mean how does the C-channel now resonate with CytoSport exiting your portfolio?

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

Yeah. Eric, I think the convenience store channel and the service that Pepsi provided on the beverage side, it was really going to be hard for them to take us anywhere else in the C-store space. As we think about that channel – I mean, we do quite a bit of business there on a number of different fronts. We have some of our MegaMex portfolio is there in the grab-and-go space. Our C-store has become more of a – almost a traditional foodservice operator, if you will. A number of our items with a number of customers are going into their commissaries to support that growth. And we can do that through our foodservice organization.

So between our foodservice organization, our efforts with our MegaMex team, I mean we have an effort against the C-store channel. You’re just not going to see Hormel products in a beverage cooler obviously. But if you think back, we did everything that we thought we were going to do when we acquired that business in terms of expanding distribution. Did a really nice job with food, drug and mass with innovation; what we did with our Evolve brand with the bar business; and then capturing synergies in them.

So, we did all those things. I think the bigger issue, the key takeaway for us was that we didn't have control of that biggest part of that supply chain, so DSD distribution and on the ready-to-drink manufacturing side. So it really became more difficult to control your own destiny. And so, we obviously evaluated our options. And it's clear, Pepsi is the best long-term owner of that business. So, I mean we have nothing to apologize for, we feel really good about the business, how we ran it when we had it. And I think it will be fun to see Pepsi really lean into that business now.

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

Okay. Yeah. It makes sense. Thanks for the clarification.

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

Yeah.

Operator: And that does conclude today's question-and-answer session. I'll now turn the call back over to Nathan Annis, for any additional or closing remarks.

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

Yeah. Good morning. And on behalf of the team here at Hormel Foods, we want to thank all of you for joining us today. And as always, a big thank you to all of our team members around the globe for all of their hard work. I
would add that on February 1, we were saddened by the news of the passing of Dick Knowlton, former Chairman of the Board, President and CEO of Hormel Foods. We offer our deepest condolences to all of Dick's family, and want them to know that he will be remembered as a great leader, ambassador and gentleman.

Thank you for your time today.

Operator: That does conclude today's conference. We thank you for your participation. You may now disconnect.