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Hormel Foods Corp. (HRL)
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MANAGEMENT DISCUSSION SECTION

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So, our next presenter is Hormel Foods. Hormel has been one of the most consistent operators in the packaged food space over time, reflecting its disciplined management approach, ongoing improvements in margin mix and value-enhancing M&A. We’re honored to be joined by the company’s 10th President in its long history, Jim Snee, who was announced yesterday will become CEO effective October 31; as well as CFO-elect, Jim Sheehan, both of whom will discuss the company’s recent progress and forward opportunities.

Plus, congratulations, James and Jim, on your new roles and we look forward to your presentation. I’d also like to take this opportunity to congratulate Jeff Ettinger, who is also here today on an exceptional tenure as CEO and well-deserved retirement. But we’re pleased we still have the opportunity to interact with you in your continued role as Chairman of the Board.

With that, I'll pass it on to James.

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

Thank you, Andrew. Before we begin, I need to remind you that certain statements will be forward-looking and are based on our current conditions. You can find a listing of the risk factors at our most recent 10-Q. Please note that all earnings per share information have been adjusted for our most recent stock split effective February 9.

We recently reported our 13th consecutive record quarter. In the quarter, sales were up 5% and earnings were up 33%. Three of our five segments delivered sales, volume and earnings growth. Refrigerated foods and Jennie-O Turkey Store had excellent quarters. Refrigerated foods benefited from the inclusion of Applegate, strong food service results and favorable market conditions.
Jennie-O Turkey Store grew sales and earnings, as the business returned to more normalized production levels. International had a good quarter. Sales and earnings were up 5%. They saw growth in fresh pork, SKIPPY and SPAM.

Grocery products sales were up, while earnings were flat primarily due to the [ph] adjusted deal (02:12) cost and increased advertising expenses. Specialty foods sales and earnings fell based on the sale of the Diamond Crystal Brands, which occurred in May of this year.

We have a long track record of generating strong free cash flow. Since 2010, we have reinvested $900 million into capital projects, primarily focused on value-added products. In 2016, the projects include capacity expansion for BACON 1, Lean Ground Turkey and our new plant in Jiaxing, China.

In this period of time, we have also invested $2.4 million in strategic acquisitions, including SKIPPY, CytoSport, Applegate and our most recent acquisition, Justin's. Since 2010, we have paid over $1.2 billion in dividends and repurchased almost $500 million in stock. We expect to maintain these priorities going forward.

The sound investment decisions we've made in the business continues to pay off with high returns on invested capital. Hormel has been in the top quartile of our peers on both 10-year and 15-year averages. This demonstrates our ability to insulate ourselves from commodity market fluctuations and economic cycles. We are confident our long-term strategy of investing in innovation, disciplined acquisitions and the focus on cost management will assure Hormel continues to be in the top quartile of our peers.

Process innovation is an important strategy at Hormel. Hormel has teams of engineers, cost accountants and Six Sigma experts dedicated to driving costs out of our manufacturing processes without compromising employee safety, food safety or product quality.

The focus on innovation in operations enhances results through yield improvements, capacity optimization and raw material utilization. Similar attention is paid to the processes within the sales, marketing and administrative functions. Process innovation and SG&A continues to improve efficiencies and service levels, while minimizing cost.

The result is a sustainable expansion of gross margins and continued leverage of SG&A. Our balanced model is one of the keys to our success. The leadership position in the protein sector established by refrigerated foods and Jennie-O is balanced by our packaged food business in grocery products, specialty and international.

The deep investments we've made in our pork and turkey supply chains allow us to control the quality and consistency of our products and remove cost from our system. We balance our supply chain by purchasing other key inputs, such as nuts, avocados and tomatoes, reducing our exposure to growing cycles and minimizing our capital investment. Our direct sales force in retail and food service allows us to grow in various economic conditions.

Finally, our company is financially conservative. This conservative approach is complemented by our pursuit of innovation, allowing us to stay relevant with a changing consumer.

I now would like to turn it over to Jim Snee, who has just been named our new CEO and President.

James P. Snee
President & Chief Operating Officer, Hormel Foods Corp.
Great. Well, thank you, Jim. Andrew, thank you for hosting us today, and thanks to all of you for sticking with us at 4:30 this afternoon. I know it's been a long day for all of you, so thank you.

After we announced our third quarter results, we raised our full year earnings guidance to $1.60 to $1.64 per share, and we are reaffirming that guidance here today. And as we look to the future for the balance of this year and into 2017 and we feel like we have some really good momentum in our business. We see favorable input costs in the form of lower pork and beef for both grocery and refrigerated foods.

And in our refrigerated foods segment, we do expect to continue to see strong value-added product sales in both our retail and food service channels, and that would include items like our Natural Choice deli meat as well as our food service, Hormel BACON 1 fully-cooked bacon. And we expect our grocery products segment to deliver sales growth with increased sales of SKIPPY and the recently acquired Justin's brand as well as the great work that's being done around Wholly Guacamole.

In the Jennie-O Turkey Store, we do expect to see favorable input costs on the grain side of the business. We also expect to continue to regain distribution that was curtailed during the avian influenza outbreak last year. And based on some of the recent Scan Data, we're doing a great job regaining that distribution. And as we announced on our third quarter earnings call, we're very excited to be back on the air with a very successful Make the Switch advertising campaign for both the third quarter and fourth quarter of 2016.

Our Muscle Milk protein beverages and powders continue to perform quite well, and we really like where that brand is going especially with some of the recent and forthcoming innovations. As Jim mentioned, and I want to remind you again, please remember that the specialty foods segment will not show year-over-year growth as a result of the recent divestiture of the Diamond Crystal Brands.

And our international business is coming off a strong third quarter and we expect that group to continue to work their way back to double-digit growth with sales of iconic brands like SPAM and SKIPPY. And we are very proud of the fact that we have been able to grow our earnings 27 years out of the last 30 years. And as we wrap up 2016, it will make a 28 years out of 31 years. And you won't find another company in the food space that comes even close to that type of track record. And when you think about that great growth achievement, even more impressive is our team's ability to grow earnings amidst some significant volatility.

So, since 2006, our team has navigated such events as a significant recession, high grain markets, PEDv and the last year's avian influenza outbreak. And during each of those events, our management team found a way to deliver results. And the balance across our businesses allowed us to offset the impact of those volatile market conditions. And we're confident that we're very well positioned to navigate any future volatility.

We also announced on our third quarter earnings call that we will submit a plan showing growth in both sales and earnings for fiscal 2017, and we'll give you more precise EPS guidance on our fourth quarter earnings call at the end of November.

So, how do we keep doing this? And as we think about how we can continue to position our portfolio for future growth, we are focused on increasing our presence in the strategic growth areas of becoming more global, becoming more multi-cultural, identifying companies and brands that are more healthy and holistic and expanding our presence in the on-the-go space.

Now, we acknowledge that our portfolio is primarily a domestic portfolio today, but we believe that our international segment will continue to grow organically through our continued expansion in China, as well as the
growth in our iconic brands like SPAM and SKIPPY. And we will continue to seek opportunities to expand our
global footprint through acquisitions. And we view multi-cultural items with new and adventurous flavors such as
those found in our MegaMex portfolio as an excellent growth vehicle, as our population becomes even more
diverse over time.

And our most recent acquisition of Justin's specialty nut butter along with Applegate, Muscle Milk, Wholly
Guacamole and our internally developed line of Natural Choice products are all great examples of our strategic
intent and interest in products that are not only healthy, but have a significant holistic attribute to them as well.

And I think it's fair to say that none of us are getting any more time in our day. So, on-the-go continues to be a
significant trend across all dayparts. And guess what? We're aligned with that trend. Many of our brands, such as
Muscle Milk, SKIPPY, REV, Wholly Guacamole and Justin's, have an on-the-go presence that aligns us well with
this consumer trend. So, we believe that these strategic growth areas provide focus, clarity and alignment to
where we need to go. And we have many businesses and brands that can get us there.

Let's start with Muscle Milk. Our acquisition of the Muscle Milk brand in 2014 gave us the firepower of a strong
leading brand to complement our existing manufacturing capabilities in the protein beverage and powder space.
And when we acquired this business, we said that we are going to reignite innovation, increase distribution in
more traditional retail channels and improve the margin profile with our manufacturing expertise. And we've done
all of those things.

And I'm very proud to report that we now hold the number two share in protein powder, which nicely complements
our number one share in ready-to-drink protein beverages. And from an innovation perspective, one of our goals
is to develop products that draw more female consumers to the category. And that led us to launch Muscle Milk
protein smoothies made with Greek-style yogurt. We're also excited to be launching a reformulated Muscle Milk
bar this fall. It will allow us to participate in the fastest growing segment of the active nutrition category, which is
protein bars.

And as I said, none of us are getting any more time or getting less busy, so snacking and on-the-go eating is not
going away. In fact, the number of snacks consumed daily has doubled since 2010. And Hormel's innovation
machine is capitalized on this trend with the launch of REV Wraps in 2013. This year, we're excited to be
launching REV Bites, which is a follow-on innovation, consisting of smaller bites and flavors such as turkey, ham
and pepperoni.

Another [ph] closed-end (15:35) innovation for us comes from one of our iconic items, Hormel Pepperoni. And
we've seen pepperoni go from a pizza-only item to both a snack and ingredient. And our team has capitalized and
responded with items like Hormel Pepperoni Snack Bites and Hormel Pepperoni Minis. Meat as a snack, it's more
than just products you can consume on the go. Snacking also takes place in households and during impromptu
parties.

Hormel Gatherings Party Trays meets the need for any get-together. And this meat, cheese and cracker tray has
been doing incredibly well in the marketplace. We're excited about the innovation that we believe can continue to
come in this space. And so, as we think about our performance, combined, our Pepperoni, Party Trays and REV
product lines have been growing at a rate of 6% since 2013.

Prior to 2013, Hormel did not have a presence in the nut butter category, and that changed with the 2012
acquisition of SKIPPYP and this year's acquisition of Boulder, Colorado-based Justin's. These two brands provide
an excellent avenue for organic growth and allow us to be an innovation leader for both retailers and consumers.
And we really like how these two brands fit together. They each attract a different consumer. SKIPPY is more of a mainstream brand associated with nutrition and fun, while Justin's is a premium lifestyle brand associated with health and wellness. Now, each brand is rolling out new items, new products targeting on-the-go consumers, items like SKIPPY P.B. Bites and Justin's Snack Packs, and both of these brands are perfect platforms for innovation and we’re excited about the pipeline of products that are coming.

Now, the other exciting aspect of these brands is the distribution gains that they've been able to make. Since 2013, SKIPPY and Justin's have combined to capture 3.7 percentage points of market share, a pretty impressive accomplishment.

In our Mexican foods portfolio, represented in the marketplace by MegaMex Foods, contains many great brands, but most notably we're known for Wholly Guacamole and HERDEZ. Both brands have been performing very well, and the metrics are bearing that out. Household penetration for these brands have been growing at very healthy compound growth rates of 5% and 7%, respectively, since 2013. And each have a long runway ahead of them when you consider the size of the categories in which they compete.

And this year, we've combined our love for Wholly Guacamole and HERDEZ salsa to create a new innovative product called HERDEZ Guacamole Salsa. Now, this product was introduced into the Mexican market by our Mexican partner, Herdez Del Fuerte. The product in Mexico has been a resounding success. So, we decided to bring that success from Mexico to the United States, and we are very optimistic about the future of this item as both a dip and a cooking sauce.

Now, our Jennie-O Turkey Store business continues to be a growth vehicle for our organization. We have a great brand, an industry-leading supply chain and high-performing products. You put that together with strong consumer demand towards leaner, better-for-you proteins and we have an amazing growth story to tell.

One metric we track closely is how much turkey makes up of the total ground meat category. Now, turkey share has been growing steadily since 2010 and just surpassed 12% in 2016. Jennie-O lean ground turkey makes up a large portion of that turkey category as we hold a dominant 40% share of lean ground turkey. And as I mentioned earlier, we are very excited to be back on the air with our Make the Switch campaign, and we know that that will help us put more turkey on more plates.

And we continue to increase our advertising support for our strong brands. We've had strong double-digit increases in both 2014 and 2015. And for three quarters of this year, we have already surpassed last year's advertising spend and we're projecting another very strong double-digit increase for this year. The important thing is that we're confident that this investment is well placed and will continue to translate into top line growth for years to come.

And so, now, I'd like to share with you some of the recent creative work that our teams have done.

[Video Presentation] (21:33-25:09)

And innovation also continues to be a critical part of our success. Now, in 2012, we announced our $3 billion by 2016 innovation challenge. The goal was to sell $3 billion of new products created since the year 2000 in our fiscal year 2016. Now, we'll be wrapping up this successful challenge over the next several months, but we are already announcing another new challenge for our team.
Our new goal for 2020 is to have 15% of our total sales come from new items that were introduced in the previous five years. So, as you can see, we are tightening the window on innovation, and we have clearly raised the bar on innovation results as we finished the year in 2015 with 11% of our net sales coming from new products launched between 2010 and 2014. I have no doubt that our team is up to this challenge, and we'll be able to deliver this result by the time we get to 2020.

And so, everything that Jim and I have talked about here today really can be boiled down into what we call our formula for success, and this is not a formula that's built on commodity markets, but it's built on having a team that consistently builds and nourishes strong brands, a team that is constantly seeking innovative solutions and a team that can make and integrate strategic acquisitions that enhance our portfolio in a meaningful way.

And in addition to those areas of growth, another important component is having this balanced portfolio or this balanced approach to business that Jim Sheehan described earlier. This balanced model, this balanced approach allows us to weather the ups and downs of various commodity and economic cycles, and we believe it's our formula for success that's enabled us to deliver such strong results, including 5% top line growth, which is in line with our long-term target; 12% bottom line growth, which exceeds our long-term target of 10%; and 50 consecutive years of dividend increases, one of the longest in the S&P 500. And all of this has currently translated into shareholder returns that have exceeded those of the S&P 500 and our packaged good peers.

And while we're pleased with our stock performance over time, our management team and dedicated employees understand that we must remain focused on those things that are in our control. And so, this year, we were fortunate to celebrate our 125th anniversary, and our celebration included the new SPAM Museum grand opening. It was an incredible event. And we also had a community-wide event in our hometown of Austin, Minnesota, culminating with a community concert featuring The Band Perry.

And while this was a great time for teambuilding and community building, more importantly, it gave us a unique chance to reflect not only on how far we've come, but a unique chance to really start to focus on the next 125 years. And so, with the team, we talked about, as we set out on this journey of the next 25 years, we need to develop and share our purpose. It's a vision of sorts that will guide us as we set out on our journey for the next 125 years, and I'd like to share that with you today.

[Video presentation] (29:42-31:29)

And so, we are an inspired group in Austin, Minnesota and no one has inspired our organization more than Jeff Ettinger. And yesterday was a big day as we announced the retirement of Jeff Ettinger as CEO. And Jeff has been Chairman of the Board, CEO for the last 11 years. And under his tenure, the company has almost doubled in size and earnings per share have more than tripled.

Now, Jeff doesn't need much of an introduction as this is his 12th time speaking at the back-to-school conference. So, please, join me in welcoming Jeff Ettinger, our retiring CEO but remaining Chairman of the Board.

Jeffrey M. Ettinger  
Chairman & Chief Executive Officer, Hormel Foods Corp.

Well, we are indeed at Hormel Foods inspired by the exciting blend of both the traditional products that we’ve had in place for many years and these new business franchises that form our balanced business model, and we’re also inspired by the talent within our organization.
So, as Andrew and Jim mentioned, yesterday was the announcement of my upcoming retirement after 11 years as CEO of Hormel Foods. And this tenure was – is actually consistent with the 10-year to 12-year tenures of my predecessors, I.J. Holton, Dick Knowlton and Joel Johnson, enjoyed with the company as well. We kind of recognize that this length of tenure is somewhat of an oddity in corporate America, but it is also representative of the strength of Hormel Foods. And this strength is not just limited to the CEO position.

Our senior leadership team heading into 2017 will have an average of 26 years of experience with Hormel. I am particularly excited about Jim and you should be, too. Jim Snee and I started at Hormel Foods in the same year, 1989, although he was right out of college versus me being an LA lawyer with a little bit of business experience.

One of the hallmarks of our promotion-within culture is providing opportunities to grow from within. So, just as I had the chance to receive a broad background consisting of law, marketing, finance and then a general management opportunity with a subsidiary, in my case, Jennie-O Turkey Store, Jim Snee has a broad background in sales, marketing, logistics and purchasing and two general management opportunities running affiliated foods as part of refrigerated and the international segment for four years.

We are concluding a strong fiscal 2016, and Jim Snee has been responsible for all of our business segments in his role as President during this past year. He also took on the senior leadership role in bringing the Justin's business onboard. Jim Sheehan's background with the company is more focused in the accounting and finance area but is every bit as impressive. In more than 35 years with Hormel Foods, his leadership roles have included President of Hormel Financial Services, Treasurer of Hormel Foods, Vice President and Controller and most recently as Chief Accounting Officer.

In finance, Jim has extensive experience of financial policies, controls and reporting as well as the general cost and business unit accounting areas, and he will hit the ground running as our new CFO. Our company's experience level remains strong as you move further into the company's ranks as well. Our core managers have an average tenure with the company of 23 years. Their experience is crucial to the company's ability to make sound decisions that keep our products relevant for changing consumer needs and maintain our roles as valued partner to our customers. This experience also keeps our pipeline full of talent for future senior leaders.

Jim Snee mentioned our celebration of the company's 125th anniversary, and this indeed provided us a unique opportunity to bring many of our company's employees together to celebrate the occasion. After visiting with team members from all over the country and indeed from all over the world, I have never been personally more optimistic about our company's future.

I've always enjoyed this excellent conference. I had the chance when it was brought by Joel Johnson in 2004 when John McMillan was hosting this, the Prudential Conference. And Andrew has been our gracious host for the last several years as well. I hope you take away from today's presentation that our company, Hormel Foods, remains focused on growth. We are confident that we have the branded franchises and the team to meet our growth goals of 5% top line and 10% bottom line in the years to come.

We want to thank you for your attention this afternoon. And now, we'll be prepared and take your questions.
QUESTION AND ANSWER SECTION

Andrew Lazar
Analyst, Barclays Capital, Inc.

Q

Thank you. I guess, first, I would love to touch a little bit on that last slide there, the long-term growth algorithm. The 5% top line, 10% EPS growth, long-term algorithm certainly compares very favorably to many of your packaged food peers. And I think, recognizing the company has been able to deliver on these goals pretty consistently over time, we'd love if you could help identify, I guess, internally the view as to the biggest risk factors of the achievement of these goals going forward. And conversely, are there any parts of the business maybe that you would call out as likely to be bigger contributors going forward than has been the case historically?

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

A

Yeah. I think, Andrew, the last several years have been indicative of some of the risk factors when we think about the impact of some of the animal disease around PEDv and avian influenza. So, something like that in the future certainly could mitigate our ability to hit the top side of the business. But again, we need to focus on the things that we can control, which is that balanced model which provide us nice offsets to those businesses.

And so, we are extremely optimistic about the portfolio that we have in place. And so, as we think about our refrigerated foods business, the acquisition of Applegate and when we bought that business, we talked about some of the supply issues that we knew we were going to have. We've rectified that situation and feel like we've positioned the businesses in a position to grow going forward.

From our specialty foods segment, I talked about Muscle Milk and the great work that's been done in ready-to-drink in powders and now our reentrance, if you will, into the bar space, in grocery products. Our work with SKIPPY is not done. Since the acquisition, we've done great work. And now, we're going to layer on top of that Justin's. Jennie-O Turkey Store returning to healthy supply puts us in the position that we want to be in. And so, there is – as we go across our segments, there's a lot of really great things that are happening that give us that confidence to be able to deliver those growth goals.

Andrew Lazar
Analyst, Barclays Capital, Inc.

Q

In recent years, Hormel has been notably aggressive in targeting companies that have significant growth tailwinds and in some cases [ph] better foyer (38:49) orientation, such as CytoSport, Applegate, Justin's.

I guess, can you provide a reminder on how these businesses have trended relative to sort of the initial underwriting expectations, including maybe a few areas that have been better than expected? And is it fair for investors to view similar growth assets as the most likely M&A targets going forward?

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

A

Yeah. I mean, I think what we like to talk about is just the process even before we acquire the business. When we're thinking about the M&A process, it's a very disciplined approach with our business unit leaders, making sure
that they're taking ownership and that they're developing the valuation from the ground up. What can they do on the growth side, where does innovation play, what synergies can they deliver?

And so, then, once we bring those businesses in, it's up to them to help spearhead the integration and the ongoing success. And so, from a recent acquisition perspective, I mean, we've got a great recent track record of success. So, at SKIPPY, Applegate, Muscle Milk or CytoSport, all are right on the valuation expectations that we have for that business. And so, we attribute a lot of that to the disciplined approach going in, so that we know exactly what our game plan is going to be and our ability to execute on that has set us up for success.

Andrew Lazar  
Analyst, Barclays Capital, Inc.

All right. [indiscernible] (40:12) right here.

Q

So, the three risks you talked about, PEDv, AI, grain costs that were in your chart, they're all supply kind of constraints. We're kind of in the opposite scenario now, where there are a lot of pigs or so many pigs that are swimming off the island. But can you talk about specifically how you adjust pricing in a deflationary environment, when the input costs are coming down and then, more specifically, with Applegate how pricing for the Applegate chicken tenders, for example, would comp to something like a Tyson as they bring their commodity basket for the more generic ones down? Do you price [ph] on a grade with that or (40:51) you maintain margin as the input costs come down?

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

Well, I mean, it's imperative that we get pricing right from the get-go. And so, understanding what a consumer is willing to pay for a package of Applegate by selling meats or chicken tenders or any of our items is very important. Clearly, there is the connection with the consumer, there's the competitive environment. And so, we've done a lot of work around pricing. And we want to make sure that, if we're going to ask for a premium price, that we can clearly communicate and identify what those attributes are to the consumer. And so, we've been able to do that with our Applegate chicken nuggets example that you used. I mean, that's one of our fastest growing items in the Applegate franchise, and we've been able to do that with a premium price approach.

So, certainly, cognizant of – we always want to make sure that we're getting a premium if we're delivering the right attributes. We're aware of what's happening in the competitive set. And clearly, and when you're in deflationary price times, you got to be sensitive to that as well. So, all of those things, there's not one silver bullet, just making sure that we're aware and cognizant of what's happening around us. And I think our team has done a great job keeping us at a premium price, but also keeping us competitive.

Andrew Lazar  
Analyst, Barclays Capital, Inc.

Why don't we cut it off there and head to the break-out session? Please join me in thanking Hormel for being here.