CORPORATE PARTICIPANTS

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

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

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

OTHER PARTICIPANTS

Michael S. Lavery  
Analyst, Piper Jaffray & Co.

Ben Bienvenu  
Analyst, Stephens, Inc.

Rupesh Parikh  
Analyst, Oppenheimer & Co., Inc.

Adam Samuelson  
Analyst, Goldman Sachs & Co. LLC

Jeremy Scott  
Analyst, Mizuho Securities USA LLC

Robert Moskow  
Analyst, Credit Suisse Securities (USA) LLC

Kenneth B. Zaslow  
Analyst, BMO Capital Markets (United States)

Heather Jones  
Analyst, Vertical Group

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

Thomas Hinsdale Palmer  
Analyst, JPMorgan Securities LLC

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

Rebecca Scheuneman  
Analyst, Morningstar, Inc. (Research)
MANAGEMENT DISCUSSION SECTION

Operator: Good morning, ladies and gentlemen, and thank you for standing by. Welcome to the Hormel Foods' Second Quarter 2019 Earnings Release Conference. At this time, all participants are in a listen-only mode. As a reminder, this conference is being recorded Thursday, May 23, 2019.

I'd 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 second quarter of fiscal 2019. 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, 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 question, 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 800-263-0877 and the access code is 5051059. 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 will be making. Please refer to pages 31 through 36 in the company's Form 10-Q for the quarter ended January 27, 2019 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 operating performance by excluding the impact of certain non-recurring items affecting comparability. Discussion on non-GAAP information is detailed in our press release located on our corporate website. Please note that during our call we will refer to these non-GAAP results as adjusted earnings.

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 long-term strategy we call our formula for success. This includes building strong brands, developing innovative new items, making strategic acquisitions and creating intentional balance. We have strengthened our competitive position in the past three years through intentional actions such as evolving to a broader global branded food company, accelerating our food service business, modernizing our supply chain and divesting non-strategic assets.
Today, these actions leave us with a better business: a strong balance sheet, consistent cash flows and the ability to make a transformational acquisition when the opportunity presents itself. Many of our businesses continue to exceed expectations and demonstrate our strategy is working. We recognized progress is not always linear. So we are focused on executing against our plans in the marketplace, while delivering the long-term results our shareholders expect.

This morning we announced second quarter earnings per share of $0.52, adjusted earnings per share we're $0.46, a 5% increase compared to last year. Three segments delivered volume and sales growth resulting in a volume increase of 1% and a sales increase of 1%. There are many bright spots I want to highlight as we look at our top line results.

First, our foodservice business across the company had a very strong quarter delivering mid-single digit sales growth, products such as Hormel Bacon 1 cooked bacon, Hormel Fire Braised meat, Austin Blues authentic barbecue, and Jennie-O foodservice business, all delivered strong growth. Each year food service becomes more and more important to us as we find new and innovative products that deliver value to operators.

Next, our portfolio of Grocery Products had a solid quarter with growth coming from offerings such as the SPAM family of products, Herdez salsas, Skippy peanut butter, Dinty Moore stew, Black Label bacon bits and Hormel Microwave Meals. These brands along with many others in our portfolio continue to demonstrate growth is occurring in the center of the store.

We achieved record value added sales within Refrigerated Foods as we continued to convert lower margin commodity products into higher margin value added products. The net result is a double-digit decline in commodity sales and an increase in value-added sales. Once again, this is consistent with the long-term trajectory of Refrigerated Foods and reflects the clarity of goods and alignment this team exhibits.

Looking at the segment, Grocery Products had a strong quarter as sales increased 2% on a 3% volume increase. Segment profit increased 12% due to higher volume and margin across many of our brands including SPAM and Dinty Moore in addition to lower expenses for CytoSport. We completed the divestiture of CytoSport on April 15.

During the quarter, we took a measured and calculated response to a competitor's price decrease in order to defend our Skippy peanut butter franchise. Our responsibility as a branded food company is to elevate the category through brand building and innovation. We believe competing on the basis of price alone is not how branded food companies should operate. Throughout this process our commitment to use revenue growth management techniques to optimize our promotional strategies has been very well received by our retail partners. We continue to be encouraged by our new Skippy PB&J Minis, our market test was successful and we are currently rolling out the product nationwide. In addition, our current pipeline of out of the jar innovation for nut butters is very robust.

Refrigerated Foods sales increased 1% on flat volumes. While segment profit declined, it was driven by a 65% decline in commodity profits and rapidly increasing input costs such as bellies and trim. Brands such as Hormel Bacon 1, Fire Braised, Austin Blues, and Black Label all had an excellent quarter. We continue to be encouraged by the new Hormel Deli Solutions division, especially the performance of the Columbus brand and our prepared foods portfolio of products. Our Applegate and Natural Choice brands continue to grow as consumers look for better-for-you options that fit their lifestyles.
International volume declined 7%; sales declined 9%; and segment profit declined 31%. The key driver to the decline continues to be lower fresh pork exports volume and pricing caused by global trade uncertainty related to tariffs. We also experienced higher freight costs, primarily relating to flooding near Fremont, Nebraska which affected our ability to ship export products. We saw continued growth in our China business led by key brands such as SPAM and Skippy.

Jennie-O Turkey Store volume increased 2% while sales were flat. We delivered growth in our foodservice business led by our Jennie-O sliced turkey products. Segment profit declined 45% driven by start-up costs at our Melrose whole-bird plant, higher feed costs and lower retail sales. The Melrose plant is now the most automated production facility we own and certain automation components are new to Hormel Foods and in the industry. Within one week, we switched from a highly manual plant to an automated plant and the process took more time than we expected to get up to full speed. The extremely cold weather compounded the problem as we were unable to move birds into the facility during certain days. The additional startup cost this quarter was $0.01 earnings per share.

We are now very close to hitting our efficiency targets and expect lower net production costs in the years to come. The lingering effects of two voluntary recalls for lean ground turkey during the first quarter, led to lost retail distribution. Throughout the recall event, we have maintained a close watch on key brand health metric and are pleased to report all measures showed that Jennie-O brand is strong.

Starting in the third quarter, we will reactivate promotional activity and advertising in order to gain back our lost distribution. We continue to work with the turkey industry on the issue of salmonella. Our efforts across the entire supply chain have helped decrease levels of salmonella in our facilities. We have also maintained our leadership role of educating consumers on how to safely handle and prepare raw turkey.

From an industry perspective, we continue to see lower poult placements but cold storage levels remain at elevated levels. Market prices are starting to show modest increases. As we think about our first half, excluding the one-time gain on the CytoSport divesture, strong results from Grocery Products and favorable SG&A were offset by higher than expected plant startup costs at Jennie-O Turkey Store and margin compression in International and Refrigerated Foods. Overall, the business finished below our expectations for the first half.

As we look forward, the biggest unknown in the protein industry is related to the outbreak of African swine fever in China. I’d like to take the opportunity to walk you through the dynamics of African swine fever, our expectations, the actions we are taking, and the expected impact on our financial results. This will give you a deeper understanding of our business results and context for our guidance.

First, [ph] the best (00:12:39) industry information shows that China has lost between 150 million and 200 million hogs. This is equivalent to more than the entire pork production in the United States. In addition, China is the largest pork producer and consumer of pork in the world. Second, due to the losses of hogs in China, we have seen hog prices in China increased by approximately 20% during our second quarter. Prices will likely continue to move higher as cold storage stocks in China are drawn down.

Finally, the United States will play a vital role in filling the global supply gap in response to the higher demand and increased exports, domestic prices have already increased and will likely increase further. We started to see the markets effects of ASF in our second quarter. We saw rapid increases in key input costs for hogs, the USDA composite cutout, bellies, and trim during the quarter. We expect all these markets to increase in the coming months; and Jim Sheehan will provide our high-level assumptions for the markets during his comments.
In response to these input cost increases and the cost increases we expect to come, we announced pricing action on a majority of our pork-related products portfolio across Refrigerated Foods, Grocery Products, and International. Depending on the category, our announced pricing generally takes 30 to 75 days to become effective on shelf at retail. As such, most pricing actions will be effective in the back half of the third quarter. Within foodservice, we are able to adjust pricing every two weeks, which allows us to stay closer to any market changes.

Our prior experiences such as with PEDv in 2014, suggest our brands can operate and grow in both low and high market conditions. However, the speed at which markets move can cause short-term margin expansion and compression as our prices lag input cost changes. Second quarter demonstrated this dynamic as near-term margins were pressured. We expect similar periods of margin pressure as markets move higher in the back half of 2019. We do expect short-term volume declines but they will vary by category. We have taken proactive actions to maintain volumes, such as adjusting our promotional activity and shifting our advertising to support key brands.

Once again, we will be leveraging our direct sales force to communicate directly with our customers on how ASF will affect our categories. Pricing discussions with customers are never easy but finding the right solutions for our customers truly differentiates our company. Animal Health issues are not new to us. In fact, this will be our third situation in the last five years. Each event comes with its own unique challenges and issues. ASF will be different than PEDv in 2014 and different than High Path Avian Influenza in 2016. But the lessons we learned in those events will be important as we manage through ASF. I'm confident our experienced management team will continue to guide our company forward and our dedicated team of employees will help deliver our Q results.

Turning to our guidance for fiscal 2019, higher forecasted input costs and the lag in pricing are expected to impact Refrigerated Foods, Grocery Products and International earnings in the second half. We have also lowered our expectations for Jennie-O as we reinvest to gain back our retail distribution. Our guidance also includes a positive $0.02 net impact to the year for the divestiture of CytoSport. Taking all factors into account, we are lowering our full year guidance to $1.71 to $1.85 per share and our sales guidance to $9.5 billion to $10 billion.

At this time, I will turn the call over to Jim Sheehan to discuss our financial information relating to the quarter and our earnings guidance in addition to 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. Volume and net sales for the quarter grew 1%. Volume was 1.2 billion pounds as growth from Grocery Products and Jennie-O Turkey Store offset the decline in International. The record sales of $2.3 billion was due to strength in Grocery Products and record value-added sales in Refrigerated Foods. Net earnings for the second quarter were $282 million, up 19% from last year. Diluted earnings per share was $0.52; adjusted earnings per share was $0.46, up 5% increase.

The CytoSport transaction was closed April 15, gain was $0.06 per share, and recognized in net unallocated expense and taxes. The second half impact to earnings for 2019 is a reduction of approximately $0.04 per share. Full-year sales for CytoSport were expected to be approximately $300 million. SG&A excluding advertising was 5.7% of sales compared to 7.2% last year. The decline was driven by the one-time benefit from the CytoSport sales and reductions in selling expenses. Advertising for the quarter was $35 million, a decline from $37 million last year. Advertising investments are expected to be down modestly due to the sale of CytoSport.
Operating margins were 13.3% compared to 12.9% last year. The increase was primarily due to lower SG&A and stronger results from Grocery Products. The effective tax rate was 11.1% down from 20% last year. The gain from the CytoSport sale drove the decline. The full-year effective tax rate is expected to be between 17.5% and 19.5%.

Year-to-date cash flow from operations was $366 million, down 18%. The decrease is due to higher levels of working capital, primarily from building inventory in anticipation of higher raw material costs. For the quarter, capital expenditures were $48 million compared to $87 million last year. We expect to spend approximately $310 million in 2019. Weather issues delayed the expansion of the Burke facility, which will shift capital spend into 2020. We paid the 363rd consecutive quarterly dividend effect of May 15 at an annual rate of $0.84 per share, a 12% increase over the prior year. Share repurchases in the quarter were $23 million, representing 562,000 shares. We will continue to repurchase stock to offset dilution from stock option exercises and based on our internal valuation.

We received $474 million from the CytoSport transaction. We used the proceeds to pay $375 million of short-term debt related to the purchase of Columbus Craft Meats. Net debt is negative.

The company remains in a strong financial position to fund strategic investments. Domestic hog supply and production are balanced. Industry expansion continues as global demand increases. The supply shortage in China caused by African swine fever should drive domestic prices higher. We expect to operate in a high cost and volatile environment for multiple quarters.

Hog markets increased year-over-year, rising more than 50% throughout the second quarter. USDA composite cutout value increased 20%. The company's grain-based contracts and balanced approach to hog procurement provided some protection against the rapid market increases during the quarter. Prices for belly and lean trim increased as much as 40% during the quarter before declining in the last few weeks.

The guidance range for the remainder of the year is based on the following market expectations. The range reflects our view of the impact of ASF in China without an outbreak in the United States. We expect hog prices and the USDA composite cutout to climb 10% to 30% from the current price levels, while maintaining a high level of volatility. The last time markets were at this level was 2014 during the domestic PEDv outbreak. Belly prices have historically been the most volatile of our key inputs. We expect cost to rise to a new price range of 30% to 40% higher than the current range.

Our guidance includes continued volatility within the expected range. [indiscernible] (00:23:14) trim markets have doubled from February to around $80 per hundredweight. We expect 10% to 20% increases compared to the current prices. Although there are various opinions on the impact of ASF on future poult markets, we feel providing our outlook provides better insight into our guidance.

Turkey poult placements were down 4% from the last six months, and down 5% year-to-date. Breast meat in cold storage remains elevated, 7% above last year. Compared to last year, turkey breast prices were up 28% and whole-bird prices rose 6%. Meat cost was higher by 7% during the quarter.

We continue to make excellent progress on Project Orion, a strategic initiative to streamline and transform how we operate as a global branded food company. This project will generate efficiencies across the entire company and represents the next step in the execution of our long-term growth strategy.

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

Michael S. Lavery
Analyst, Piper Jaffray & Co.

Q Good morning. Thank you.

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

A Good morning, Michael.

Michael S. Lavery
Analyst, Piper Jaffray & Co.

Q Can you just give a little more color on your pricing actions relative to cost increases? And you said that it had – cost increases and expected cost increases in mind, can you give a little bit of color on what some of those expectations are? How much are you leaning in on pricing? Would it cover all of that? Would it more than cover all of that? What's the right way to think about where you land from a margin standpoint?

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

A Sure. I'll go ahead and start around pricing, and then I'll maybe let Jim talk a little bit more about some of the market conditions. As we saw the run up in markets in the second quarter, we were quick to react and took some very proactive pricing actions across a number of our key categories that obviously are pork related. What was interesting in the quarter is we saw a quick run up and then we saw a moderation of pricing. And so when we say expected pricing going forward, we do project that pricing will return to the levels that we saw in Q2; in some cases, maybe a little higher. The other thing to remember, Michael, and we've talked about this a lot is that lag in pricing. So, again depending on the channel in foodservice, we're a little closer to the market. When you think about Refrigerated Products, that's a little further out; and then GP, our Grocery Products, our shelf-stable portfolio, is really what takes the longest to be reflected.

So, I mean we feel good about the pricing actions that we've taken. For us, it's really that volatility that creates the compression or in some cases expansion, but it's really getting to the new level. Once we get to a new level that becomes a little more stabilized then that's when we'll get margins back to normalized levels. So, it's really this volatility that creates the disruption. And I'll turn over to Jim maybe for little more market clarity.

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

A Certainly, Michael, we expect to see volatility as these prices continue to grow and to give you an example of the challenges, the belly market for instance in the second quarter had a low of $120 and a high of $215, and it wasn't a consistent line; you'd see increases and then you'd see sudden drops; and that creates a lot of difficulty in getting the timing of the pricing correct. We expect those challenges to continue. We expect that volatility for us to create a challenge in the pricing as we go forward.
Michael S. Lavery  
Analyst, Piper Jaffray & Co.

Even if it's volatile, you have obviously some visibility on costs. What about on the consumer side, do you have a sense of their ability to bear further pricing? And what, if any, limits there are to where you start to see real meaningful elasticities and how may that compare to five years ago with PEDv?

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

I think this is going to be a little bit different in that PEDv was probably a little more short lived. I mean all the prognosticators are saying that this could be a little longer term. So I think there are some key learnings that are very applicable. I think there are some things that are a little bit different. Any time you take pricing, especially in the short term, you do have an impact on volume. We're talking about a number of different categories. So the volume impact, the elasticities are very different across all of those categories. The most recent reference point we have of course would have been the fourth quarter of 2017, where we had a significant run up in key markets. And again, we put our elasticity models to work and the good news is, in many cases, we were able to outperform what was projected. But we've done all the homework and understand that there will be some volume implications as we take pricing.

Michael S. Lavery  
Analyst, Piper Jaffray & Co.

Okay. Thank you very much.

Operator: We'll now take our next question from Ben Bienvenu from Stephens Incorporated. Please go ahead.

Ben Bienvenu  
Analyst, Stephens, Inc.

Hey. Thanks. Good morning, guys.

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

Good morning, Ben.

Ben Bienvenu  
Analyst, Stephens, Inc.

I'm going to ask – and I appreciate, Jim, the color on your outlook for the individual primal as well as your outlook on hogs. You alluded to some comment around duration, but with what you know now, what is the duration of volatility that you're expecting and/or for what period of time are you thinking about elevated prices sustaining?

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

Yeah. I mean that's part of the uncertainty that we're dealing with. There is a point of view that says you could see this being a multi-year event and that's really what we're preparing for. But I think in the short term especially, it's really interesting how the dynamics and the information is changing so rapidly. So, as we're talking to others in the industry, you hear points of view where the market is getting ready to run very soon; and then you talk to others who say maybe freezer stocks in China are a little higher than anticipated, and it's going to take some while to
clear them. So there is really a lot of uncertainty around when how much, how fast, how long, what happens in the competitive landscape, who decides to export, who is focused on value added. So with all that uncertainty, we’re giving you our best estimates.

What we really want to focus on is the certainty and what we know to be true, and that's really our ability to price to new market level, and then as always, we're going to do what's in the best interest of the company, the customers, consumers, foodservice operators. So we really need to focus on the things that we can control and then really just do our best to try to understand the uncertainty that's in the marketplace.

Ben Bienvenu
Analyst, Stephens, Inc.

Understood. On the Jennie-O business, some operational challenges that you mentioned in the quarter and some go-forward investment around regaining retail distribution. What does that timeline look like for getting back to some of those distribution points and then I'd love to hear what you guys think about the turkey outlook with a little bit more detail as well as the magnitude of the cost of reestablishing those retail distribution points.

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

Sure. So I mean it starts with the fact that the impact of the voluntary recall was that we lost distribution. The other thing that we've had to understand is what's happened with the brand and so what we know is that the brand strength is still very strong among consumers and where we have product on shelf which is still quite expensive because we're the number one brand. Our velocities are good; the velocities haven't decreased at all. So obviously, having the number one brand really does matter.

So as we think about the back half of the year, I mean we see this as an entire back half play in terms of regaining distribution. Even though we have the number one brand, it doesn’t happen overnight. And as you mentioned, there will be some impact with the investments that we need to make, but we feel confident that by reactivating promotional activity really engaging with our advertising and going customer by customer. We're still very positive on the JOTS business. As we think back to this business, where it's come from, it's clearly the best performing acquisition we've ever made, the combination of Jennie-O and Turkey Store.

So we're not resting on our laurels or looking back. It's really about how we're going to carry this business forward and we have some work to do. But when we regain the distribution, we know the brand is strong, and we know that the velocities are there in that lean ground space.

Operator: We'll take our next question from Rupesh Parikh from Oppenheimer. Please go ahead.

Rupesh Parikh
Analyst, Oppenheimer & Co., Inc.

Good morning and thanks for taking my questions. So first on your cash balance, so clearly it continues to build on the sale of CytoSport. So just curious how you guys are thinking about deploying that excess cash?

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

I think that our focus is the same and it's investing and growing the business.
James P. Snee  
Chairman, President & Chief Executive Officer, Hormel Foods Corp.

Yeah. And, Rupesh, I would tell you, as we mentioned in our comments, that we're in a really good position should we find obviously the right acquisition; and we referenced a transformational acquisition. So we've talked about the level of the size of the deal that we could do, would be comfortable with; that still holds true. The key is, as always – we've got a number of deals that we're looking at, that we're reviewing, that are in the pipeline – it's getting them to the finish line. And then the other part is in terms of having the one deal that fits that price range can sometimes be difficult. So as Jim mentioned, it is this constant view of how do we re-investing and grow in the business whether that's through value-added capacity expansion or through external strategic acquisitions. I mean our team is as focused as ever on both of those.

Rupesh Parikh  
Analyst, Oppenheimer & Co., Inc.

Okay, great. And then on the Refrigerated Foods segment. So there is another big decline in commodity profits. So I was just curious – if you can just give us a little more color on what's driving that decline, and whether the company is now worse off or better following the Fremont plant sale.

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

Yeah. I mean we're better off than we were three years ago. I mean, as we've said, this is a better business today. The moves that we've made to really strengthen our earnings' power put us in a really strong position. The Refrigerated Foods piece is – now it's the fifth consecutive quarter of steep declines in commodity profits. And even though we had record value-added sales, it still wasn't enough to overcome that. And then of course you throw in all the combination of the margin compression from the run up in markets. But as we think about the portfolio especially in Refrigerated Foods, I mean it is as strong as it's ever been and well-positioned for future growth.

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

Rupesh, one area I pointed to was that the hog markets increased about 50% year-over-year in the second quarter where the composite carcass value, the basis of what we purchased from the WholeStone Group, increased about 20%. So I think that's consistent with the strategy of reducing the level of volatility in this transaction.

Operator: We'll now take our next question from Adam Samuelson from Goldman Sachs. Please go ahead.

Adam Samuelson  
Analyst, Goldman Sachs & Co. LLC

Yes. Thanks. Good morning, everyone.

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

Good morning, Adam.
Adam Samuelson  
Analyst, Goldman Sachs & Co. LLC

So I just want to dissect a little bit – you lowered the fiscal 2019 guidance by $0.06, that includes a net $0.02 benefit from the CytoSport divestiture, so $0.08 kind of pre- that and I presume the corporate – I mean it seems like corporate actually will like this quarter, so maybe the operations is a little bit more than that. But can you allocate that – the change in outlook to the businesses if at all? Obviously, the Jennie-O business has gotten more challenges and you've got the input pressures on pork that spread throughout the portfolio, but how should we think about the change in outlook by operating segments?

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

Well, Adam, I'll start on the discussion around the [ph] net (00:38:21) unallocated being down. It's down because of the CytoSport transaction, some benefit in the interest income, but it's also down because our general administrative expenses and some selling expenses – the amount that we've allocated to the businesses is less than what our actual spend is. It has to do with we allocate those expenses on a fixed amount based on our budgets and really we've done a very nice job of managing those expenses so that's really a reduction and it's consistent with what you're seeing in SG&A where you're seeing a reduction on our SG&A costs.

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

Yeah. And then as we think about the businesses, Adam, I mean the key take away is that our first half was lower than expected but the majority of the gap is in the second half due to the ASF and the business at JOTS. So as you think about each segment, Grocery Products will have a slight decline as you think about higher trim markets. And we haven't talked about the Skippy pricing yet, but that will have an impact in the second half of the year. For Refrigerated Foods, we expect continued strong results from our brands across all the channels, but there will be a lag in pricing. So we would expect to see a slight decline in Refrigerated Foods in the back half. And really the same holds true for International through the ASF and tariff issues. And then as we talked about JOTS because of the reinvestment in lean ground and we're still not seeing the improvement in the market like we'd like to see. So we are seeing some improvements, but they continue to be slow. So it's a little bit across the board but the majority of the gap is in the back half.

Adam Samuelson  
Analyst, Goldman Sachs & Co. LLC

Okay, that's helpful color. And then I guess my second question is more just about a competitive in the U.S. pork market, as we think about the prospect of higher pork exports. Do you feel that puts you at any sort of competitive disadvantage where some of your bigger packer and processed meat competitors are a bit more vertically integrated and more tied to the export market might have more visibility in terms of product flow before you fully see that? So I'm thinking specifically in the event of the U.S. exporting whole carcasses to China and the net impact that would have on belly and trim markets. But just broadly does not having a bigger export business today put you at a competitive disadvantage given the market landscape?

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

What I would say to that, Adam, is you've got short-term issues and then long-term strategies. And so there are different operating models that will certainly be able to capitalize on some of those short-term opportunities better than we can. But from where we sit, we're in the business we want to be in. And we know that there's going to be...
that volatility, less supply, increased costs and as we’ve talked about, it’s that lag that hurts us or that compresses us in the short-term. But we know and we’ve demonstrated our ability to price to the new market levels with the businesses, the brands, the portfolios that we’ve chosen to participate in. And so, advantage, disadvantage, I guess it really depends on the business you want to be in and how you want to run short-term, long-term. But we feel good about where we are. We just really need to get through the ups and downs of the markets and then we’ll be fine.

Operator: We’ll take our next question from Jeremy Scott from Mizuho. Please go ahead.

Jeremy Scott
Analyst, Mizuho Securities USA LLC

Hey. Good morning.

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

Good morning, Jeremy.

Jeremy Scott
Analyst, Mizuho Securities USA LLC

I wonder if you can offer any color on how your customers in each of your channels are addressing the looming supply disruption. I think one thing we’re hearing more from restaurant operators is that there’s an elevated urgency to lock up price or even lock up volumes. So – and then I guess on the other hand, we’re hearing how operators are adjusting menus and features towards other protein. So I appreciate your comments on pricing elasticity and contract duration. But is there a risk of customers in anticipation of a shortage are already making adjustments to their purchase behavior and may be less willing to absorb a pricing action at this point?

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

Yeah. Jeremy, we feel like we’re pretty close, especially to the foodservice market, and I will tell you that we have not seen that with our foodservice operators where others are thinking about substitution or trying to lock up supply. I think your – the first part of your comment is very accurate, that when you get into these situations, there is a propensity to want to try to lock up pricing. And obviously from our perspective, we go the other way and say that’s the last thing we want to do and we want to get closer to the market. And that really is what we’re able to do each and every day.

Is our pricing in foodservice is closer to the market? We’ve steered clear of long-term pricing agreements. We don’t believe that they’re actually in either party’s interests. Our focus continues to be on creating solutions, right, making sure that we can help them with their pain points around creating great menu ideas for their patrons, making sure that we can help them with their labor, their insurance, their safety issues. So I’m not going to go so far as to say it’s business as usual, because it’s not, there certainly a different mindset, but a lot of what we’re doing still plays out in the marketplace.

Jeremy Scott
Analyst, Mizuho Securities USA LLC

Got it. And I appreciate the color that you had on your expectations for raw material inflation. I just get – given all the internal changes in Refrigerated Foods division over the last couple years, I think there’s been some haziness
in terms of your net sensitivity to different pricing. So maybe if I can ask on the cost side of the equation, meaning, assuming [ph] you take now (00:45:02) price. What is the earnings sensitivity to let's say a 10% increase in bellies and trim?

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

The answer that I would give you, Jeremy, is it's more about the volatility in the change as opposed to the magnitude of the change. So as this process matures, I think you're going to see less volatility in the markets. There'll be less rumors because people will understand the facts around ASF. Right now, what's happening again is that you're just seeing wild swings day to day in the markets.

Once we hit a level that there's more stability, there's less rumors or speculation going on, we'll be able to manage this fine. So the increase in the price is not the primary concern; it's how much volatility you're getting. For instance, we've seen I think from the beginning of the quarter to the end of the quarter, I talked about the volatility in bellies. The price only changed 6% between the beginning of the quarter and the end of the quarter. But as I said, the price has ranged between $120 and $215 in that quarter. That's difficult to manage.

So my advice would be pay more attention to volatility. That's what's going to be – sometimes it's a benefit. And what volatility does, it creates noise in a quarter. So for instance, if we priced up and our input costs dropped the last two or three weeks, it may look – may make the quarter look a little bit better than it really should or the other way around. Take a look at it on the long-term run as to how we're performing and somewhat ignore the noise of the quarterly movement because of volatility; and hopefully that's helpful.

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

Robert Moskow  
Analyst, Credit Suisse Securities (USA) LLC

Hey, thanks. I appreciate all the comments about the volatility and the fundamental challenges, but I am a little confused as to your messaging here on your pricing, because how decisive have you been able to be with your customers on these price increases that you've taken? Like, are you telling them that, hey, we're taking these price increases but in a couple of weeks we might have to take more based on our outlook or are you saying, hey, there's a lot of volatility, so this might not stick? It's a little unclear to me like how decisive you can actually be in how you're communicating to your customers?

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

Yeah, that's a great question, Rob. And we have been very decisive with our customers in terms of the pricing that we've taken across multiple categories. Although there's all this uncertainty, again as I said about the when, the how much, how long, there's a consensus that the markets are going to increase. And so we have been decisive with pricing. In terms of what the markets do and when it's reflective, we have gone customer-by-customer and worked on a promotional basis to make sure that pricing is not negatively impacting the category. But it's important to get that pricing out front and center as soon as possible. So the pricing actions have been decisive, working closely with them on a customer-by-customer basis. As the markets move with that volatility, it is something that we watch very closely. So hopefully, that gives you a little more color on how we're thinking about the pricing.
Robert Moskow  
Analyst, Credit Suisse Securities (USA) LLC

Okay. And then in the Grocery division, is it easier in the Grocery division to kind of just take a price increase and have it stick, because the underlying [ph] meat (00:49:07) is a smaller component of the overall cost of the product? Is that a fair statement?

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

I wish it was.

Robert Moskow  
Analyst, Credit Suisse Securities (USA) LLC

Oh. Oh, dear!

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

All right. As we know, the pricing conversations are always hard. And so I wouldn't say that it's any easier. It is a smaller component, you're correct. But you've got to have the market data, or the industry facts to support your case, and I think that's really – I mean I would say that they're fairly equivalent in terms of Grocery Products or Refrigerated Foods.

**Operator:** We'll take our next question from Kenneth Zaslow from Bank of Montreal. Please go ahead.

Kenneth B. Zaslow  
Analyst, BMO Capital Markets (United States)

Hey, good morning, everyone.

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

Good morning, Ken.

Kenneth B. Zaslow  
Analyst, BMO Capital Markets (United States)

So a couple of questions. One is, when I think about 2020, how much of the turkey issues will be resolved that you will be able to enjoy whatever recovery there is by 2020? And why would you not have any benefit from African swine fever in the turkey operation in 2020? And then my second question would be, when I think about your pricing on the Skippy side, how much elasticity have you had and where do you expect that to go?

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

So, great questions, Ken. As we think about 2020, I mean you're right. I mean we should see the benefit of a couple of things. One, we'll be working hard in the back half of this year to regain that distribution knowing we have a strong brand, strong velocities. So the retail business, we should be able to see that or, as you said, enjoy the positive impact. The food service business at Jennie-O Turkey Store had a good quarter and we expect that business to continue to grow and perform well. And then I think your last point on turkey is a very good one also.
And we just – it's hard to project, right. I mean I do think there's a school of thought that says if you have the impact to pork, there are going to be other proteins – chicken, beef, turkey – that will benefit. So I mean we haven't modeled a lot of that into our back half just because we know that we have work to do to regain that distribution, but certainly that's a wildcard as we think about the impact of African swine fever.

And then on the pricing for Skippy, we've taken a price decline and we've worked customer-by-customer because our ultimate goal is really to be great stewards of the category. And so we've worked and been very reliant on revenue growth management to help retailers still try to grow the category. And our focus is continuing on the brand building and innovation. But it's a battle right now. It's a battle in the category. And again, we don't like the idea of competing solely on price. We want to focus on the brand building and innovation. So, we're fighting. We've got a great brand and we've got some great things in the pipeline coming to take peanut butter out of the jar. We talked in our prepared comments about being pleased with the Skippy PB&J Minis and our ability now to roll those out nationwide. Certainly, that will have a positive impact on the brand. So, again, some short-term things that we'll work through, but we know that will come out the other side stronger and better.

Operator: We'll take our next question from Heather Jones from Heather Jones Research [sic] [Vertical Group] (00:53:10). Please go ahead.

Heather Jones

Good morning. Thanks for taking the question. My questions are actually – my two questions are related. So just – you've talked about what your outlook is for hog and belly pricing, etcetera, for the rest of this year. I just wanted to think about 2020; you mentioned the 150 million hogs to 200 million hogs that [ph] conventional wisdom is has (00:53:35) been lost in China and just that magnitude has far surpasses PED. So I was just wondering when you're thinking and your early thinking about 2020, would you expect hog prices to take another big leg up then, and if you've thought about the volume elasticity on your products, because it's become cliché but I mean I think most would agree that this is unprecedented. So like just wondering how that affects volume, etcetera, and your business when you have to pass on that magnitude of cost increases?

James P. Snee

Chairman, President & Chief Executive Officer, Hormel Foods Corp.

Yeah, I mean you've asked the question and I think a lot of ways to answer it, Heather, is that we're in some unprecedented or we expect to be in some unprecedented areas for a longer period of time than we've seen. And so you certainly – if demand stayed static, you could, to your point, see another run up in prices. But I do think at a certain level, because of the elasticity, you're going to have demand destruction or, to Ken's earlier comment, you're going to have this migration to other proteins. So are just – there's so much uncertainty in terms of how you're going to have these interactions with the consumer across other proteins. It's really hard to project what those ultimate impacts are going to be.

Heather Jones

Analyst, Vertical Group

Okay. And I was wondering if you could compare and contrast – you mentioned that you've been through three health events in the last five years and PEDv seems to be the most relevant to this one. Since your business has changed fairly substantially, you've divested Farmer John's, you've divested Fremont, but given your Jennie-O business and then given your less control, I guess for a lack of a better word, of the hogs, do you view the business as better positioned relative to 2014. Because you don't control the hog, so you're more exposed to the
belly cutout, et cetera, but you're less exposed to the run in lean hogs. So just wondering if you could just give us some color on how you're thinking about how the business is positioned relative to the 2014?

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

Yeah. The business in our opinion for where we want to be is much better positioned because our goal is not to be a commodity company or commodity organization. As I've said several times already, this is a better business today through the intentional changes that we've made. Some of the things we're talking about are short-term and commodity in nature.

Going back to the first part of your question in terms of what have we learned, I mean, clearly from PEDv what we learned was how important it is to be proactive with your pricing. And so I mean, I would say that we certainly have led the charge in the industry in terms of being proactive with our pricing. But I think that's important just because it gets the right mindset into the marketplace. And then as things changed, we've got other levers we can pull to help customers and consumers. But when it's all said and done, this company, this portfolio is in a much better place than it was in 2014. And as I said pretty broadly within our [ph] four roll offs (00:57:39) is I've never had as much confidence and as much faith in our business, our strategy, and our people.

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

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

Yeah. Thanks. Thanks for the question. I just have a couple – the first one is as a quick follow up to Rob's question in that I know you're quite a bit closer to the market with your foodservice business. Does that allow you to adjust prices downward as well if the market volatility would suggest that you should do that? I think that's a harder plan to implement at retail, but do you have flexibility to work with your customers on the downside as well?

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

Yes, Eric, that's a correct assessment. That foodservice channel does give us that flexibility, but it's also very typical. So because we're closer to the market, we take the ups and downs and that's clearly understood in the channel and in the marketplace.

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

Okay. Then the final two things are kind of second derivative calls here. You've been very proactive with your pricing in the market. Your competitors are facing the same issues. So are they with you on that? And then equally more important or as important, what are your hogs producers telling you? Are they – is the farming community gearing up to increase production as well? You've got low grain prices, you have this supposed big increase in demand coming, and that's all expectations at this point. But has it changed the way the producers are thinking about what they're going to do for the next couple of years as well?

James P. Snee  
Chairman, President & Chief Executive Officer, Hormel Foods Corp.
So, Eric, I'll take the first part and then Jim Sheehan can answer the second half. As I said and you agreed, I mean we have been proactive with our pricing and we're the first ones out of the gate. We are starting to see some competitive follow up, which obviously supports our position and helps to support the overall pricing model. So it's happening slower than we would have liked but it is starting to happen. Jim, I'll let you answer [indiscernible] (01:00:12).

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

Yeah. I'll speak that our producers appear to be in a very good position to meet any demand for increased hog production. We feel that they're in a very good position and we're confident that we will have the supply of hogs that we need.

Operator: We'll take our next question from Thomas Palmer from J.P. Morgan. Please go ahead.

Thomas Hinsdale Palmer  
Analyst, JPMorgan Securities LLC

Good morning. Thanks for the question.

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

Hi, Tom.

Thomas Hinsdale Palmer  
Analyst, JPMorgan Securities LLC

I just wanted to ask on the Jennie-O side, the lost shelf space. Who are you losing that to; and as you look to win it back, what's the pitch for displacing it? It's a little surprising I guess at how well velocities have hung in to see this level of distribution losses. So what are your retail is telling you? Who are they giving it to and what's the pitch to win it back?

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

Yeah. I mean, there are obviously are other competitors that are filling that space. And so, it again depends on the retailer, who's filling the void. The pitch becomes – what's happened to their category since we've been gone. And in most cases, it's not a good category story for them. And so, to us that speaks volumes that, A, brand still matter and, B, the number one brand really matters. So there was a reason through the voluntary recall. There is a reason that we were off shelves and we understand that. But this idea that the brand is still strong through all of our research is very important. The idea of those places where we didn't lose distribution, that the velocities are still hanging in there is very important. So it really becomes all of those things. That's the story that we're telling to the retailers. But again, it doesn't happen overnight. You don't show up with a magic wand and you're back on shelf. We know that we have to earn the right to be back on their shelves and we'll do that. But once we're there, we know that we'll be able to help them grow their category.

Thomas Hinsdale Palmer  
Analyst, JPMorgan Securities LLC

Okay. Thank you. And I also wanted to follow up on the hog side. You referenced the run up in spot pricing. I think in the past, you've had maybe a little bit less volatility than spot pricing because of your negotiated pricing and
your hedges. Have you decreased that exposure, I mean, is this a situation where as those hedges roll off, we look for more inflation and say the fourth quarter than in the third quarter or should we be thinking about it a little differently than that?

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

 Probably the biggest difference you’ve seen between the first quarter and second quarter we believe will go into the back half is in the first quarter, grain-based contracts were dragged off. They were more expensive than other formula pricing that we had; and it's an advantage to us right now. Those are coming in at a little bit lower cost. We still take future positions. We still work with our producers of course when we made the change in the structure of Fremont. We took a look at rebalancing the type of contracts we have and we think we're in a really good position right now. We have a nice balance.

Thomas Hinsdale Palmer  
Analyst, JPMorgan Securities LLC

Okay. Thank you.

Operator: We'll take our next question from Benjamin Theurer from Barclays. Please go ahead.

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

Hi. Good morning, Jim and Jim. Just a quick one, so obviously with the disruption in China, the roughly 150 million to 200 million hogs which you expect and your exposure on the sales side, what have you seen on Chinese demand for different products? Have you seen people switching? Have you still seen the similar demand dynamics as in the past? Just to understand how the Chinese consumer is reacting and how you feel about demand going forward on the Chinese side, just in order to understand a little bit what the opportunity could be for imported products from [ph] others (01:04:38) and how that's most likely is going to shake out on a global basis. That would be great to get some color.

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

Yeah. Great question, Ben. So, I mean we have seen and you probably heard that there’s been an increase in the chicken consumption in China, but consumers in China are still eating pork and so our in-country business still remains very strong both the retail and foodservice Refrigerated meat business. We’ve also seen, as we’ve mentioned, a strong growth in our SPAM and Skippy business. But I do think that you hit on something that we are watching very closely is that we are trying to understand the consumer demand and what the impact of ASF is having on them. At this point, we haven't seen it flow through in the business, but it is something obviously that's top of mind.

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

Okay. And then just one quick one on your updated tax guidance, is it fair to assume that the second half is basically unchanged to what the initial guidance was and that reduction for full year is solely driven by the lower effective tax rate of the second quarter?
James N. Sheehan  
Executive Vice President & Chief Financial Officer, Hormel Foods Corp.

That's correct, Benjamin.

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

Okay, that was all. Thanks.

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

Thank you.

Operator: And we'll take our last question from Rebecca Scheuneman from Morningstar. Please go ahead.

Rebecca Scheuneman  
Analyst, Morningstar, Inc. (Research)

Good morning and thank you. So I was just wondering if you can talk about what percentage of the International business pork exports are. Is that less significant now with the Fremont sale? And I'm just wondering if that will help offset some of the cost pressures we're seeing in the pork business because some of the other pork producers are seeing increased margins year-over-year in their pork export business?

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

Yeah so a couple of things there, Rebecca. Our transaction with the Fremont facility really has no impact on our ability to supply the International export pork business. I mean it's still an important part of the overall portfolio; and so when it's down to the extreme that it was this quarter, it impacts the overall business. And so obviously we've been very intentional, very focused on our ability to grow our multinational businesses both in China and Brazil. And so we – of course we've got our plant expansion, our new plant in Jiaxing, to support that growth in country, put in our first ever SPAM production line that we own outside the United States. And so, I mean, that's really what we're focused on in terms of our International business. And over time, our goal is for our pork exports to become less and less meaningful and less and less a part of our International business.

Rebecca Scheuneman  
Analyst, Morningstar, Inc. (Research)

Okay. So you don't expect that to materially impact your results for the back half of the year even as those margins improve; that really won't impact anything?

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

I mean, it depends, right. I mean, obviously we've got the impact of ASF but you've also got tariff issues still. I mean, there's still a lot of moving parts, so it could still have an impact on our International group, but again it's really hard to tell at this time.

Operator: Thank you. And that concludes today's question-and-answer session. At this time, I'd like to turn the call back over to today's presenters for any additional or closing remarks.
James P. Snee  
Chairman, President & Chief Executive Officer, Hormel Foods Corp.

Well, I want to thank all of you for your participation today. Obviously, we’ve covered a lot of ground and talked a lot about the uncertainty that exists in the marketplace. But through all of the uncertainty that exists in the marketplace, as I mentioned earlier, I have never had more confidence and faith in our team, our business and our strategies, and their ability to continue to deliver key results for our company. I want to wish you all a safe Memorial Day weekend and thank you for your time today.

Operator: And that does conclude today’s conference. Thank you for your participation. You may now disconnect.