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Hormel Foods Corp. (HRL)

Q2 2020 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, ladies and gentlemen, and thank you for standing by. Welcome to the Hormel Foods Second Quarter 2020 Earnings Release Conference Call. At this time, all participants are in a listen-only mode. As a reminder, this conference is being recorded, Thursday, May 21, 2020.

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

Nathan P. Annis

Director of Investor Relations, Hormel Foods Corp.

Good morning. Welcome to the Hormel Foods conference call for the second quarter of fiscal 2020. We released our results this morning before the market opened around 6:30 A.M. Eastern. If you did not receive a copy of the release, you can find it on our website at hormelfoods.com under the Investor section.

On our call today is Jim Snee, Chairman of the Board, President and Chief Executive Officer; and Jim Sheehan, Executive Vice President and Chief Financial Officer. Jim Snee will provide an overview of the company's response to the COVID-19 pandemic, a review of the company's current and future operating conditions and commentary regarding each segment's performance for the quarter. Jim Sheehan will provide detailed financial results and commentary regarding the company's current and future financial conditions.

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're welcome to get back into the queue. An audio replay of this call will be available beginning at 11 A.M. today, Central Standard Time. The dial-in number is 888-254-3590, and the access code is 7355932. It will also be posted to our website and archived for one year.

Before we get started, I need to reference the Safe Harbor statement. Some of the comments made today will be forward-looking, and actual results may differ materially from those expressed in or implied by the statements we will be making. Please refer to Pages 30 through 35 in the company's Form 10-Q for the fiscal quarter ended January 26, 2020, in addition to a supplemental risk factor related to the COVID-19 pandemic included in our Form 8-K filed this morning. Both 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. These non-GAAP measures include organic volume, organic sales, adjusted pre-tax earnings, adjusted diluted earnings per share and operating free cash flow. Discussion on non-GAAP information is detailed in our press release located on our corporate 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. First off, I want to take this opportunity to express my sincere appreciation to the essential workers showing up every day in food manufacturing facilities across the industry. They should be recognized for the heroic and purposeful work they are doing, and they have my most sincere appreciation and gratitude.

I also want to acknowledge the food industry employees who are showing their commitment every day with the work they do, whether it be in grocery stores, food pantries, restaurants serving patrons for takeout, delivery or curbside pickup. And of course, a big thank you to the healthcare workers and first responders who are keeping all of us safe.

Throughout this pandemic, our number one priority has been to keep our team members safe, especially those who are not in a position to work remotely.

Our COVID leadership team, including operations, quality control, communications, label, R&D, and human resources, have worked tirelessly to ensure we have the appropriate enhanced safety measures in place, including personal protective equipment for all plant team members, temperature and wellness screenings, frequent disinfecting of high-touch areas, reconfiguration of common areas and workstations, revised shift scheduling, reducing production line speeds. We have guidelines on carpooling, more extensive social distancing measures throughout each facility, and where possible, providing remote work opportunities and improved access to COVID-19 testing. I am continually amazed in our management team's ability to find innovative ways to enhance employee safety in our facilities.

Throughout this crisis, we have also been transparent with our team and the public about all we are doing to put safety first. As part of our industry-leading safety measures, we have also developed an awareness campaign we call KEEP COVID OUT!, a program that reinforces various preventative measures at our production facilities and in the communities where we live and work.

As a global-branded food company, we play a critical role in providing safe, high-quality food during this unprecedented time. As we all know, it has not been business as usual over the past several weeks, and we will likely be in this new normal for some time. I am very proud of how all our team members have stepped up and reacted to the rapidly changing dynamics in our industry.

Before I get into the quarterly results, I want to take a moment to tell you a few things about our approach over the last several weeks that really stand out for me. I've told our team that we were made for this. And the following are examples of what really makes this company so uncommon.

As we progressed into the initial stages of the pandemic, our senior leadership team agreed that we would do everything we could to protect the jobs of our thousands of team members. Each day, I heard examples of our supply chain team going above and beyond to shift production between plants or relocate where certain jobs could be done. In many cases, these changes had never been done before. Balancing workloads across plants in the manner we did was not the most cost-effective decision, but it was the right decision.

Another example of what makes this company uncommon is our commitment to making the best long-term decisions for our team members, suppliers, customers and shareholders. Because of our stable cash flows and strong balance sheet, we will not neglect any strategic investments during this uncertain time. We have completed a comprehensive review of our capital projects and, in some cases, have slightly delayed project completion because the additional capacity isn't needed right now.

However, we continue to move forward with many investments that will enhance our long-term performance. One such investment is Project Orion. Our team's ability to effectively and efficiently work remotely has allowed us to keep Project Orion on track, and we have made the decision to go live on our financial system update in June. I know everyone on our finance team is committed to making the important cutover a success. We are confident we will see the benefits from our financial system go-live, just as we are seeing from our HR system upgrade completed in January.

I also want to take a few minutes to highlight key areas that are helping us weather this storm. First, our creation of [ph] One Supply Chain (8:34) three years ago has been instrumental in helping us manage this crisis from one pivot point at an executive level. The quick decisions we made early on could not have been made in the same way if we were operating four or five different supply chains.

Second, the significant investments we made several years ago in our e-commerce team, infrastructure and capabilities, positioned us to quickly grow in this emerging channel. During the quarter, our tracked purchases through IRI were up over 100% and our brands are significantly outpacing category growth and capturing market share in many categories across both center store and perimeter.

Finally, our decision late last year to transition the entire enterprise to one IT platform made virtual coordination much easier than it otherwise would have been. While our decision to transition right before the pandemic was serendipitous, our IT services group deserves a lot of credit for seamlessly transitioning thousands of team members to working remotely in less than a week.

And looking at our sales results for the quarter, the balance we have purposely built into our business is a competitive advantage that has allowed us to perform well in many different economic situations, including the current crisis. For the quarter, volume increased 4% and organic volume increased 7%. We delivered record sales for the quarter with an increase of 3%. Organic sales increased 6%, and three of our four segments delivered increases in sales.

From a channel perspective, total retail sales increased 16% during the quarter. We saw multiple different waves of demand in our retail businesses as the pandemic has unfolded. In the first wave, we saw tremendous demand for nearly all of our center store brands. Our initial assessment was consumers were stocking up, but as the weeks progressed, we continue to see sustained double-digit increases.

The second wave of demand took place as shelter-in-place restrictions were enacted across the country, and consumers shifted from dining in restaurants to purchasing more perishable products across the perimeter of the store. We continue to see perimeter sales increase at double-digit rates over last year.

Throughout the escalation in demand, we've seen a large increase in the number of new buyers and households purchasing our branded products. What I'm particularly proud about is the number of new buyers that are making repeat purchases of our brands. This is an important leading indicator as consumers are using our products, enjoying the experience and repurchasing our brands. I'm also encouraged by our team's ability to capture share in channels that were open and available, mainly the retail channel.

From a total company perspective, we significantly outperform the category, private label, other large brands and small brands. Our ability to capture market share is a testament to our brands and direct sales force, and also to our operations and supply chain teams' ability to ensure our products are on the shelf.

One dynamic from the pandemic that is affecting all of us is what is happening across the foodservice industry. It's heartbreaking to see distributors, restaurants, hotels and many other foodservice venues struggle to survive. I've seen estimates that thousands of restaurants across the United States could close as a result of this crisis. Every entrepreneur behind each restaurant has a unique story of why and how they chose to open their restaurant. Many of these restaurateurs are community members trying to make their neighborhood a better place to live and work, and these closings are tragic.

Our foodservice divisions have been doing their part to help the foodservice industry. Within days of the crisis, our Hormel Foodservice Group offered a rebate program to help offset operators' food costs. This program was successful and exceeded our expectations. We're also working very closely with our distributor partners to support their needs and have recently received accolades for our efforts.

And finally, we've talked a great deal about how our direct sales force is a distinct competitive advantage. And no time is that more true than right now. Our sales team has been on the virtual front lines helping operators quickly adjust to takeout, delivery and curbside pickup with best-in-class guides and tips and sometimes being the only supplier to personally check in with a restaurateur during this difficult time.

Like others in the industry, we saw a sharp decline in our foodservice business starting in late March. For the quarter, our enterprise foodservice sales were down 21%. As you think about our domestic foodservice business, it is primarily sold through the Refrigerated Foods and Jennie-O Turkey Store segments. Prior to the outbreak, our foodservice business represented approximately 40% of sales in both segments and the majority of our operator customers are in key segments, such as mid-scale and casual dining, lodging, K-12 schools, colleges and universities and health care.

Each foodservice segment is experiencing different dynamics during the shelter-in-place restrictions and each will have a different recovery timeline coming out of the pandemic. Even though it is early in the third quarter, we are starting to see orders picked up across our foodservice businesses. From a financial perspective, we delivered earnings per share of \$0.42. Jim Sheehan will provide more details of the moving pieces, but I do want to mention

that our earnings fully reflect \$0.05 per share in investment losses and increased supply chain costs related to COVID-19.

The high-level dynamic during the quarter was similar in each segment, namely demand shifts from foodservice to retail and higher operational costs. However, each segment did experience some unique circumstances, and I'll highlight those areas. Grocery Products volume increased 7%, and sales increased 8%. Organic volume increased 19%, and organic sales increased 20%. We saw exceptional growth from nearly every brand, with some products delivering very strong double-digit growth, including the SPAM family of products, SKIPPY peanut butter and Hormel chili.

Two keys to Grocery Products' success during the quarter was the sales and marketing team's focus on limiting production to our priority high-volume items and frequent conversations with our customers regarding assortment and product availability. We know our center store brands are perfectly suited for value consumers who need affordable, high-quality products for their families. With millions of Americans now unemployed, our shelf-stable products are as important to consumers as they've ever been. Earnings for Grocery Products increased 22% despite the divestiture of CytoSport last year. Strong volumes and improved mix were the key drivers to the double-digit increase.

Jennie-O Turkey Store delivered a strong quarter with volumes up 19%, sales up 12% and a segment profit of 54%. Strong retail, whole-bird and commodity sales more than offset declines in foodservice. The Jennie-O sales and marketing group made excellent progress, regaining distribution prior to the pandemic, which put them in a strong position to succeed. During the quarter, Jennie-O lean ground turkey sales increased by double digits. Higher sales and operational improvements across the supply chain were the key drivers to earnings growth.

International volume decreased 2%, and sales increased 2%. Branded exports, primarily SPAM, offset declines in our China foodservice business. Segment profit increased 62% due to higher branded export margins and increased income from affiliates. I'm pleased to report our China plant operations are now fully up and running to support our retail and foodservice businesses as the country continues on its path for reopening. Our foodservice business in China is improving off the lows we saw during the pandemic, and we are seeing very strong demand from SPAM, SKIPPY and our Refrigerated Products at retail. The team in China is working through higher pork prices, but are taking the necessary pricing actions to offset cost increases.

Refrigerated Foods volume was flat, and organic volume was down 1%. Sales decreased 1% and organic sales declined 3%. Retail demand was led by products such as Hormel Black Label bacon, Applegate natural and organic products, Columbus grab-and-go charcuterie and Hormel pepperoni. We also finalized the acquisition of Sadler's Smokehouse during the quarter. The majority of Sadler's sales are into the foodservice channel but I've been impressed by the way in which this team has quickly pivoted their production to meet the growing needs in retail.

One unique trend we are seeing in the marketplace is consumers searching for products that can replace a restaurant experience. Brands like Sadler's Smokehouse and Lloyd's barbeque fit that need perfectly. In fact, our retail lines at Sadler's and Lloyd's have been operating at capacity to meet the demand for their products.

Our foodservice business saw double-digit declines during the quarter. However, we are very confident that as the foodservice industry starts to open up, our product lines, featuring precooked, pre-sliced and pre-marinated products will thrive, as operators look to simplify preparation and reduce handling of products.

Our deli business experienced consumer dynamics that were a blend between retail and food service. Products like Columbus grab-and-go charcuterie performed well as consumers searched for unique and flavorful products. We did see declines in the behind-the-glass and prepared food businesses as many retailers closed these areas to redeploy labor to other sections of the store.

Earnings were down 17% due to lower foodservice sales and higher operational cost as we paused production at two plants during the quarter. Jim Sheehan will provide more details regarding input cost volatility the Refrigerated Foods team experienced during the quarter.

As we look forward, we are withdrawing our full-year sales and earnings guidance. The decision to withdraw guidance reflects uncertainty created by COVID-19 in several key areas, including consumer behavior at retail and foodservice, volatility in our input costs and supply chain disruptions. Our team is focused on these indicators to guide our decisions and investments in the coming weeks and months.

First, we are paying close attention to consumer behavior across our entire portfolio. We're watching consumer buying patterns in the retail channel with metrics such as household penetration and repeat rates. We're also watching how consumers emerge from shelter-in-place restrictions across the country and reengage the foodservice industry. In addition to monitoring restaurant traffic, we're observing how other segments in the foodservice industry, such as lodging, colleges and universities and K-12 education reopen.

We're also actively managing through the volatility we're seeing in raw material markets. As I mentioned, James Sheehan will provide a detailed assessment of the hog and pork industry as the recent periods of operational pause and start up in processing facilities across the industry are creating dramatic swings in input costs. I have the highest confidence in our ability to pass along the necessary pricing but we may experience short-term margin compression or expansion as raw material markets adjust to the rapid changes in supply and demand.

Finally, while we have implemented industry-leading safety measures, we have experienced operational challenges at some of our facilities due to COVID-19 and we are strategically managing through operational disruptions on a daily basis. These operational disruptions have led to incremental supply chain costs. During the second quarter, our cost increased by approximately \$20 million, primarily related to team member bonuses, enhanced safety measures and lower production volumes. In the second half, we expect to incur another \$60 million to \$80 million of incremental costs that are temporary, and these costs will be weighted to the third quarter.

In closing, I want to emphasize three points. First, our company was built for this. We have the right strategy, sound business fundamentals, best-in-class management and the financial strength to thrive in this dynamic marketplace. Second, we will not do anything to jeopardize our strong financial position. We are well equipped to weather this storm and will be stronger because of it. Third, we have said from the very beginning of this pandemic that our goal was to do our best to do everything right, from people safety, to supporting our partners and customers, to ensuring America has food on its shelves, to donating millions of dollars and millions of meals to hunger-related causes. Everything we are doing is in perfect alignment with our purpose of inspired people, inspired food.

At this time, I will turn the call over to Jim Sheehan to discuss our financial information relating to the quarter, provide commentary regarding key input cost markets and an update on our financial position.

James N. Sheehan

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

Thank you, Jim. Good morning. Net sales increased 3% to \$2.4 billion, a record for the second quarter. Organic sales were up 6%. Segment profit increased 5% to \$310 million as double-digit growth from Grocery Products, Jennie-O Turkey Store and International more than offset a decline in Refrigerated Foods.

Pre-tax earnings were \$286 million, down 10%. Excluding the CytoSport gain last year, adjusted pre-tax earnings declined 5%. This decrease included significant pauses on investments. The effective tax rate was 20.6% compared to 11.1% last year. Last year's rate benefited from a tax gain on the CytoSport sale. Earnings per share for the quarter was \$0.42, down 19%. Adjusted earnings per share was down 9%.

Selling, general and administrative expenses increased year-over-year. Lower expenses last year were due primarily to the gain from the CytoSport sale. Advertising for the quarter was \$35 million, flat to last year. Net unallocated expenses for the quarter increased \$46 million. The increase was due primarily to \$16 million related to the CytoSport pre-tax gain and \$19 million in lower investment results from last year.

Operating margins were 12.1% compared to 13.3% last year. Additional costs included the important investments in COVID-19-related employee safety measures and production professional bonuses. Both reflect our commitment to our production professionals and ensuring their safety.

The company continued to generate strong and stable cash flows, despite the impact of COVID-19. Cash flow from operations and free cash flow more than doubled in the quarter compared to the prior year. We recently renewed our shelf-stable registration (sic) [shelf registration] statement and are considering near-term opportunities to access the debt market at favorable interest rates to provide ample liquidity to take advantage of strategic opportunities.

The company's strong cash flow and balance sheet along with the investment grade credit rating allows us to manage risk as well as make strategic and long-term investments to drive shareholder return even in times of uncertainty. We are confident we will remain in a strong position to fund our capital needs including the dividend, capital expenditures and pension contributions as we grow the business.

We paid our 367th consecutive quarterly dividend effective May 15 at an annual rate of \$0.93 per share, an 11% increase over 2019. Capital expenditures in the quarter were \$80 million compared to \$48 million last year. Large projects for the remainder of the year include the Burke pizza topping plant expansion, a new dry sausage facility and Project Orion. The company's target for capital expenditures in 2020 is \$340 million.

We completed the purchase of Sadler's Smokehouse for \$269 million during the quarter using cash on hand. Share repurchases in the quarter were \$12 million, representing 300,000 shares. We repurchased stock to offset dilution from stock option exercises and based on our internal valuation.

The quarter was impacted by contrasting dynamic forces. Within an 8-week period, the industry experienced a decline in foodservice demand, creating an oversupply of protein. This was quickly followed by plant disruptions, which resulted in significant protein shortages. At the peak, in early May, the industry was operating at 40% below capacity. The changing dynamics of supply and demand caused harsh swings in hog and commodity values, which have continued into the third quarter.

To illustrate the volatility, the USDA composite pork cutout declined 40% from March 23 to April 9. Since April 9, prices have increased by as much as 140% to levels not seen since PEDV in 2014. Likewise, bellies have traded between \$40 and \$270 per hundredweight since the beginning of April. Beef trim traded at both 10-year lows and 10-year highs over the same period.

The most recent USDA supply and demand report estimates a 1% decline in hog production for the year, after estimating a 5% increase in the prior month's report. We feel the hog and commodity values in the near term will be determined by industry processing capacity. Additional plant disruptions will depress hog values and increase commodity values. Alternatively, if the industry is capable of operating at near capacity levels, hog prices and commodity values should moderate. Worldwide demand for pork remains strong. We continue to monitor African swine fever in China, Southeastern Asia and Europe. According to the USDA, exports are expected to increase greater than 10%.

In the near term, we are closely analyzing two key factors, hog processing levels and consumer confidence as restaurants reopen. We are currently using multiple predictive analytic models to monitor and forecast both factors. We are actively managing industry capacity issues by leveraging the three ways we source raw materials, internal processing, contracted sourcing and purchasing primals on the open market. The supply chain strategy is designed to mitigate volatility, though margins could expand and contract as pricing lags changes in cost. This can shift profitability between quarters.

Fundamentals in the turkey industry were mixed in the second quarter, but recent data indicates improving conditions. Consistent with the pork industry, in the near term, we are focused on the ability to maintain turkey operations in the industry and at our facilities. Poult placements in the last six weeks have experienced meaningful declines. This should continue to reduce cold storage levels, which had already significantly declined. We expect whole-bird pricing to remain elevated compared to last year for the remainder of the year.

Turkey breast pricing was significantly lower in the second quarter, but pricing has improved in the third quarter. We successfully implemented the Oracle Human Capital Management system of Project Orion in January. As Jim Snee said, our team is credited with advancing Project Orion as we worked remotely with minimal project delays.

We are proceeding with the finance go-live in June. Our team is already benefiting from enhanced analytics and improved demand planning. In June, we will introduce additional capacities, such as robotic process automation and real-time data integration. Further implementation for the supply chain will take place later in 2020 and 2021.

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

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Our first question from Tom Palmer with JPMorgan.

Thomas Palmer

Analyst, JPMorgan Securities LLC

Q

Good morning, and thank you for the question. You gave some helpful detail on what you're seeing in the hog and pork market. I just wanted to ask about how that translates to your results as you kick off the quarter, right? It would sound – I guess, on the weaned hog side, price is down quite a bit, but you guys historically have not always seen your costs track as closely, just given your negotiated purchases. And then on the more pork input cost side, you're seeing some pretty substantial increases. So, are you kind of messaging that the quarter is going to start off a little bit slower from a profit standpoint? And then you would look to adjust pricing and kind of recapture those input costs or did I miss here?

James N. Sheehan

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

A

Good morning, Tom. First of all, the most important thing on pricing is going to be the ability to keep the plants running and the processing capacity. And right now, that seems to be happening, but there's a great deal of uncertainty as to what plants are going to be hit and the volume impact those interruptions will have. So, that's the most important thing. As you look at our quarter, that can create the volatility that you've talked about.

The other thing that's happening in the industry is that primals or items, raw materials that require additional processing are much more expensive than the less processed items. My example would be hams right now are running at about \$35, but 72% trim today is \$125. Normally, you would take those hams and you'd bone them because of that price discrepancy in the two items, and you'd bone the hams for trim.

But right now, it's hard to find the labor with the absenteeism that's in the plants to do that boning. So, there's quite a bit of diversity in the pricing of the primals right now. As far as hog prices, today, hog prices are at about \$39, says the Western Cornbelt. And last quarter, our pricing for hogs were not far off of the average Western Cornbelt, I think was about mid-50s, \$54, \$55, in that range.

The only thing that was a bit above average for us were grain-based contracts. And so, hog pricing for us is not out of line of what you're seeing in the Western Cornbelt. We're watching the input cost greatly and you're seeing the volatility. I mean, take a look at 72% trim, it was as low as \$34 in the second quarter, went as high as \$145 in the second quarter. That compares against a \$68 price today, [ph] and it's at \$125 (37:46). You've got bellies that range from \$41 at the low to \$267 at the high, averaged about \$113 and it's dropped to \$94 just the last week.

So, it's really hard to read the – or estimate the primal values, the raw material costs, but watch what's happening in the plant performance. Again, as I said before, if we're able to keep plants, both the industry and our plants running at about capacity, we think there'll be a moderation in both hog prices and overall primal values. Hope that helps.

Thomas Palmer

Analyst, JPMorgan Securities LLC

Q

That does. Thank you. And then just wanted to ask on the Jennie-O side, the volume growth, I think traditionally about three quarters of your product has been internally supplied. I'd be surprised if you were able to boost slaughter volumes by as much as that segment's volumes were up. So, could you just talk about your purchases this quarter, any changes to inventory levels and then how you're thinking about kind of the mix versus slaughter and purchases going forward?

James P. Snee

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

A

Yeah. Tom, I mean, obviously, we're really pleased with the quarter that JOTS had. Really good work. Coming off of – coming out of our first quarter call, we talked about what they have done in distribution and really what they've continued to do, especially on lean ground turkey. They've been able to really move through some of that inventory, because we've had the business been driven across the entire portfolio. So, whether it was retail, whole-birds, commodities, it's been a really, really good mix of products that have put them in a great position in the quarter.

In regards to some of the actual harvest volumes and some of those questions, we'll have Nathan follow-up with you on that level of detail, but just overall, really strong demand across many areas. Good quarter for JOTS.

Thomas Palmer

Analyst, JPMorgan Securities LLC

Q

Okay. Thanks, guys.

Operator: And we'll go to our next question from Heather Jones.

Heather Jones

Analyst, Heather Jones Research, LLC

Q

Morning. Thanks for taking the question. Just wondering when you talk about foodservice and the Refrigerated Foods business, I guess a two-part question. Just wondering if you could give us a sense of what proportion of that is like the QSRs or the pizza takeout chains versus like the hotels, institutions business? And then, the second part of the question is just when you talk about you started to see this demand come back, if you could just give us some sense of the magnitude of the recovery you're seeing.

James P. Snee

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

A

Sure. Thanks, Heather, for the question. Our foodservice business really was off to a great start this year. And in the quarter, we saw really strong growth through mid-March and then a sharp decline through the end of the quarter. We talked about business being down 21%. As we think about the channels where we compete, we have a very balanced foodservice business. And so, if you think about lodging, college and universities, K-12, mid-scale casual chains really, really nice balance.

When you talk about QSR, if you're talking about traditional burger chains, probably don't have a lot of business there. But if you think about locations that still have drive-through business available to them, we have quite a bit of business in that channel, if you want to call it that, and so a very balanced model across foodservice.

And as we're starting out the third quarter, we talked about it's early. We're seeing some demand pick up. The part that is really hard to read at this point, we'll be watching closely, is that pipeline filled or is it true consumer demand. So we are certainly not spiking the ball, we know we're going to have to watch it closely over the weeks

and months ahead. But from where we sit, we feel like we're well-positioned here. We talked about our direct sales force that's able to pivot and get out in front of operators as their world has changed dramatically, the products that we've spent years and years creating, Austin Blues, Fire Braised, Bacon 1, Café H, all so well positioned for this new environment.

And so, obviously we're going to watch what happens with capacity, patron comfort level, the speed and magnitude of rebound. So lots of uncertainty there, but when it's all said and done, we've got an amazing, amazing food service group that I know put us in a great position to win.

Heather Jones

Analyst, Heather Jones Research, LLC

Thank you. And then my second question is on – Jim Sheehan, you mentioned utilization of the plants for the industry and for Hormel. I was wondering if you could give us a sense of – with the CDC guidelines, et cetera, what do you think over the next 6 to 12 months is the feasible max utilization for these plants? And are you guys having issues with getting labor to debone hams? Or should – or would you be able to take advantage of those cheap [ph] ham costs for the trim (43:28)?

James P. Snee

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

Yeah. Heather, I'll go ahead and take that one. I mean, I think the thing to remember in our facilities, we're – we don't own any of the harvest facility. So as you think about our processing plants, it is a different business. And so, yeah, we do have some lines, some areas where it is hard to socially distance. Our team has done an amazing job putting in those enhanced safety measures and really meeting or exceeding CDC and OSHA guidelines.

In those plants, I mean, we've seen some lines have to slow down but I wouldn't say that it's anything that's going to have a dramatic impact on the business long-term. The shorter term issue is as you do have more and more positive cases and you get some absenteeism, that's the short-term issue that really is impacting the capacity in some of these plants.

And so we're in a much better place in terms of understanding how to manage through the process. All of our plants are up and running today. And really, one of the keys as we've progressed through this pandemic is the fact that additional testing has really allowed us to maintain the understanding of what's happening and who's positive, who's negative, who has to sit out and who can come back to work. So having more testing widely available has really been a great thing. And I think you'll continue to see that be a benefit as we look to maintain our operations.

Heather Jones

Analyst, Heather Jones Research, LLC

Thank you so much.

Operator: We'll take our next question from Rupesh Parikh with Oppenheimer.

Erica Eiler

Analyst, Oppenheimer & Co., Inc.

Good morning. This is actually Erica Eiler on for Rupesh. Thank you for taking our questions.

James P. Snee

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

Hi, Erica.

A

Erica Eiler

Analyst, Oppenheimer & Co., Inc.

So, in talking about – a little bit about what you're seeing in the foodservice channel here. So far, early in Q3, is there any color you can provide on what you're seeing within the retail channel lately?

Q

James P. Snee

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

Sure. We continue to see very strong dynamic, strong business in the retail channel both in center of the store and in the perimeter of the store. We've been really pleased with what's happened in Grocery Products as we've been able to add households, bring new consumers into the mix.

A

I would say, early on in the crisis, there was this view that it was all just stocking up or pantry loading. But over time, we've seen the velocity. We've seen the sustained demand. So we know that there's a lot of new buyers and stronger new buyer repeat percentage. So that has held up on the retail side of the business, both center of the store and our perimeter.

Erica Eiler

Analyst, Oppenheimer & Co., Inc.

Okay. Great. And just given the challenges in foodservice due to this unprecedented environment, can you just talk about your ability to convert some of your foodservice supply into the grocery retail channel and some of the things you've been doing on this front?

Q

James P. Snee

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

Sure. Yeah. Early on we had our retail team collaborating with our foodservice team where there were opportunities to repack products, we certainly took advantage of that. The government eased some of the labeling requirements, which was a positive as we were able to move more products into the channel. But then the demand was so great. We had a number of retailers who were less concerned about maybe the retail packaging and just wanting product available for shelves. So we started to sell foodservice-packed items into retail channels as well. So it's really been a little bit of everything in terms of converting some foodservice lines into retail, moving foodservice product into retail, all with this idea of how are we helping retailers meeting the increased demand.

A

Erica Eiler

Analyst, Oppenheimer & Co., Inc.

Okay. Great. Thank you so much.

Q

Operator: Our next question from Ken Zaslow with Bank of Montreal.

Kenneth B. Zaslow

Analyst, BMO Capital Markets Corp.

Hi. Good morning, everyone.

Q

James P. Snee

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

Hi, Ken.

A

James N. Sheehan

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

Good morning, Ken.

A

Kenneth B. Zaslou

Analyst, BMO Capital Markets Corp.

When you emerge from the new COVID-19 environment or the new normal, however you want to put it, will Hormel's earnings strength be stronger or weaker or the same? And what financial measures will you think about when you emerge and how do you frame it?

Q

James P. Snee

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

Yeah. Hi, Ken. It's a great question, Ken. You know, I think, when you say when you emerge, clearly, you have to take out the next few quarters just based on the uncertainty that we talked about and really the industry is talking about. I mean, from our perspective, we're thinking two-plus years out, and what we are really confident in is this balanced model that we've intentionally and purposely built and talked about tirelessly over the last number of years.

A

And it's so important because it really allows us to meet the consumer wherever they choose to go. And so in the midst of this crisis, obviously, you had foodservice operations shutting down, so the consumer behavior was forced. But they had to choose perimeter, center of the store, and we were there front and center, right, center store, perimeter, deli, e-commerce. And so we feel really good about the balanced business model we've created.

The other thing that we feel really good about is the way that we've been able to provide value, variety and versatility across this entire portfolio. And so again, as the consumer evolves out of this crisis, where are they going to go? With the number of unemployed Americans now, value is of more importance, certainly in the shorter term than it's ever been. And we're there.

And then if there is a consumer trend that emerges in a big way that maybe we're not competing in today, this balance sheet that we talked about, that Jim Sheehan referenced, I mean, it really allows us to quickly pivot and become competitive either by building or buying. And so, I mean, we remain very bullish on our earnings power over the long-term, as you would imagine, but I think there's some really good data and support behind why we feel so bullish. And so lots of great opportunities in the short term, but we think we're well-positioned over the long-term as well. Hopefully, that's helpful, Ken.

Kenneth B. Zaslou

Analyst, BMO Capital Markets Corp.

I guess what I would say is to what extent do you think the cost structure will increase and be permanent? And if foodservice loses, say, 200 to 500 basis points, are you in a better position or a worse position, I guess, is kind of what I'm – and you did also mention there are – you're thinking of taking on more debt for strategic opportunities, what does that mean? So, again, I guess a three- or four-part question and I'll leave it there.

Q

James P. Snee

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

A

Yeah. No, I mean, it's a great question. But again, it's – so if foodservice does have a permanent decline, where does that business go, right? And so does it go to our Grocery Products organization? Is it going into more fresh meat? I mean that part is still really too early to tell in terms of what is the more permanent consumer behavior. We need to see that play out over time. I think what we are really trying to say is no matter where it goes, we'll be there to be able to capitalize on it.

I mean our goal, obviously, is to maintain and return to the business that we had because, obviously, we know that our foodservice business is very competitively advantaged. In terms of what we talked about, some of the short-term financial opportunities, I mean, clearly, we don't know what's going to happen as this crisis keeps dragging on. And so we just want to make sure, a, that we're well positioned, not only for our existing business, but if opportunities arise to be able to quickly take advantage of it.

James N. Sheehan

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

A

Good morning, Ken, regarding the debt, we do have some debt, \$250 million that matures in April next year so it's within one year. Obviously, interest rates are very favorable right now. We think that there will be an interest in Hormel in the market. So we think that those favorable interest rates will be passed on to us if we decide to go out there. And as Jim said, we want to be well-positioned for any opportunities that exist during this time period and as we come out of this time period to pivot and take advantage of those markets that may provide opportunities, either new markets or existing markets where we can expand, whether by building within that structure or acquiring.

Kenneth B. Zaslou

Analyst, BMO Capital Markets Corp.

Q

Okay. Thank you.

Operator: Our next question from Peter Galbo with Bank of America.

Nathan P. Annis

Director of Investor Relations, Hormel Foods Corp.

A

I'm not sure if Peter's there. Operator, you can move to the next person in the queue.

Operator: One moment, please.

Nathan P. Annis

Director of Investor Relations, Hormel Foods Corp.

A

Operator, are you able to move to the next person in the queue?

[Technical Difficulty] (54:28-56:29)

Operator: Okay. Peter Galbo, go ahead with your question.

Peter T. Galbo

Analyst, BofA Securities, Inc.

Hey, guys. Can you hear me?

Q

James P. Snee

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

Yes. We can.

A

Peter T. Galbo

Analyst, BofA Securities, Inc.

Okay. Great. Thanks very much.

Q

James P. Snee

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

Welcome back.

A

Peter T. Galbo

Analyst, BofA Securities, Inc.

Thank you taking the question. Jim, thanks again for the help. Just kind of in thinking about the three different ways that you source. I guess I just want to focus in on kind of the sourcing of primals. I think a few years ago, you had given a number that – it's around \$700 million to \$900 million annually that you kind of purchased externally in a given basis. I just want to make sure that that's still a good number.

Q

And maybe forgetting about kind of the inflation in pricing you've seen for a moment, has the ability to physically secure supply of product at least improved at all from, say, kind of the end of April through the first couple of weeks in May? And then I have a follow-up as well.

James N. Sheehan

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

Certainly. And I think that's what you're seeing. As I said, you saw bellies at \$267 during the depth of the decline in operations, and now they're back at \$94. And you're seeing the movement as plants come online and start to understand how to operate at this level, you're seeing those prices decrease. Obviously, those are market prices.

A

Right now, we're not doing a lot of buying on the open market. The product that we're getting through our internal sources and our contracted sources are providing enough volume for us, as you've seen the decline in the foodservice industry, the demand from foodservice industry.

Again, it depends on what items you're looking for as to how easy they are, a very – a bone in ham you can find any place, but again, you have to find an operation that has the ability to just source if you're looking for trim. So it takes some work, but we've been doing this for a long time. We have highly-skilled staff that have long relationships and I think suppliers who appreciate operating with Hormel. So those relationships have helped us through this process.

You've seen this in the beef industry, where you have beef 50s that have been as high as \$326, but as operations have come back online, they're at \$198. So it's something that you have to be skilled at, but it's something that we're able to handle.

Peter T. Galbo

Analyst, BofA Securities, Inc.

Q

Got it. Okay. And then just the second question, the retail sales number that you quoted, above 16% kind of seems to imply that maybe you under-shipped consumption relative to what we saw in the scanner data. Was there any inventory drawdown on the part of the retailer or some of your distribution partners that we would have seen? Or is it really that we should expect to kind of see a pipeline refill, so to speak, going into the third quarter?

James P. Snee

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

A

I mean, again, it's early in the third quarter, but so far, retail business both center of the store and the perimeter is holding up and it's strong. I think from an inventory perspective, any inventory retailers had and any inventory that we had on some of the high volume items, those are pretty well cleared and dealing with all current production levels.

I mean our IRI data is still really, really, really strong. We grew share in a number of categories, again, both perimeter and center of the store. So really pleased about where the business is. The part that we've touched on in our comments that we're also really pleased with is our e-commerce business. We made significant investments a couple of years ago and we've seen those investments pay off, very strong growth, capturing share, not only brick-and-mortar, but virtually. And we think we'll continue to see that as a growth engine as consumers continue to get comfortable shopping online, whether it's delivery or click-and- collect, so would say retail business across the board in-store, e-commerce, all really strong, Peter.

Operator: We'll take our next question from Adam Samuelson with Goldman Sachs.

Adam Samuelson

Analyst, Goldman Sachs & Co. LLC

Q

Yes. Thanks. Good morning, everyone.

James P. Snee

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

A

Hi, Adam.

Adam Samuelson

Analyst, Goldman Sachs & Co. LLC

Q

Hi. So I guess, first question, just more a clarification. The \$20 million of supply chain costs you incurred in the quarter and the \$60 million to \$80 million you expect to incur over the balance of the fiscal year, just can you help us think about where those actually fell from a segment perspective? Just so we can understand kind of how the comps lay out next year if most of those don't repeat.

James N. Sheehan

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

A

So in the second quarter, most of that cost came within JOTS and Refrigerated Foods, probably JOTS – or Refrigerated Foods had a little bit higher percentage. And that had to do with some early interruptions in processing that we saw in Refrigerated Foods and then it was followed later by some additional safety measures that we took. And to be very honest, we set a priority of employee safety and we didn't do a lot of negotiation

when it came time to going out and getting the protective gear or taking other actions. We acted quickly so that we could provide that assurance to our employees.

As we go forward, I think that you're going to look at it as to the volume of operations in Refrigerated Foods and Grocery Products will both see a portion of that expense. Probably the highest will fall within Refrigerated Foods, then Jennie-O and then Grocery Products if you think about it roughly, but it's a changing dynamic. That's what we expect right now. But with the uncertainty that's going on in the operations right now, it could shift.

James P. Snee

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

A

And, Adam, I mean, just remember the plant pauses started at the end of Q2, but really the majority that we've seen are in Q3. Jim referenced the lower volumes, lower tonnages, don't forget that we paid significant team member bonuses as well. So the good news is, right now, all of our plants are up and running.

Adam Samuelson

Analyst, Goldman Sachs & Co. LLC

Q

All that makes sense. Thank you for that. And then my second question is in the grocery business, where you've had this big surge in sales for the legacy canned meat business, for peanut butter. How are you thinking about kind of how much inventory is in consumer pantries at this point and kind of any hangover as you get into the latter parts of the year and that gets drawn down? Or do you think that the surge in retail sales is actually being consumed reasonably in real time that there might not be a hangover?

James P. Snee

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

A

Yeah. I think I talked about it a little bit earlier is the early read probably by a lot of companies was that it was a stock-up or pantry-loading. But what we have seen is, again, not only the new households, but the strong repeat rates, the velocities are good. And even the new buyers, there's a good new buyer repeat. And so, are there some brands or some categories? Perhaps. But I think our big brands, when you think about SKIPPY, when you think about SPAM, when you think about Hormel chili, those items seem to be really clearing, not only the retailer, but obviously the households as well.

I mean, so what does that mean for later in the year? I don't know that it's as much about the brands and how much they have in the pantry as much as what happens with that consumer behavior as foodservice perhaps starts to open up a little bit more. And is there pent-up demand as consumers maybe don't want to be eating at home and they want to migrate to foodservice operations? That's the uncertainty that we're thinking about and talking about. But as far as the Grocery Products business and the lift in sales and the repeats, we've been really, really pleased.

Adam Samuelson

Analyst, Goldman Sachs & Co. LLC

Q

Okay. That's helpful color. I'll pass it on. Thanks.

James P. Snee

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

A

Thanks.

Operator: We'll go to our next question from Michael Lavery with Piper Sandler.

Michael S. Lavery

Analyst, Piper Sandler & Co.

Good morning. Thank you.

Q

James P. Snee

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

Good morning.

A

Michael S. Lavery

Analyst, Piper Sandler & Co.

Just starting with a follow-up to Ken's question, I understand your thinking on just capital strategy and the debt, but can you give us a sense of how actively you might be pursuing things like M&A?

Q

James P. Snee

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

Yeah. I mean, from our activity level and how active we are, I mean, nothing's changed. I think the big change is what's happening in the marketplace is just a lot of organizations have really had to hit the pause button. So, I think we continue to look at a number of different processes, evaluate opportunities. But clearly, the market itself is not as active as it was. So when – it's really hard to read when that will pick up, but I mean, we're continuing the very active process that we always have.

A

Michael S. Lavery

Analyst, Piper Sandler & Co.

Okay. That's helpful. And just on the export outlook, can you give us a sense of what your expectations are there? And what, if any, political risk do you think there is of pork going to China, especially if there were to be any instances of shortages here in the US?

Q

James N. Sheehan

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

Well, the USDA is expecting exports to be greater than 10% is what their outlook is. As we've had an interruption in operations, I think it's added some concern about whether we'll be able to meet that level or not. But I think there's still a demand for pork from the United States to be exported out. Political activity, I guess, I'll pass on.

A

James P. Snee

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

Yeah. That's really hard to tell. I mean, obviously, we've seen a lot in the technology space. But people need to eat. And so that's really kind of hard – that's kind of hard to predict.

A

Michael S. Lavery

Analyst, Piper Sandler & Co.

Okay. Thanks very much.

Q

Operator: We'll take our next question from Robert Moskow with Credit Suisse.

Robert Moskow

Analyst, Credit Suisse Securities (USA) LLC

Hi. Thank you.

Q

James P. Snee

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

Hi, Rob.

A

Robert Moskow

Analyst, Credit Suisse Securities (USA) LLC

Hey, look, I'm trying to do a better job of forecasting your grocery division. And looking at our retail tracking data, you've indicated sales up [ph] 48% (01:08:04) just for that division alone. And Jim Snee, I know you said that the retail tracking is doing really well. But is there any reason you do not want to give us exactly what the IRI data is telling you it is?

Q

It would be very helpful to us as we try to correlate your shipments to your – to the retail tracking so that we don't overestimate it. You're kind of touching around on it, but was there any reason you don't want to give us like the total number for that grocery division growth? It should be the easiest thing for us thing for us to forecast from the sell side.

James P. Snee

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

Yeah. I mean, Rob, I guess, we don't have anything that we don't want to tell you about any of our businesses. I mean, I guess our position is all of our Grocery Products data, meat products data or retail data in general is really, really strong. So maybe we can help you do a better job of predicting. It might be worthwhile in your follow-up call with Nathan to maybe get into a little more detail just so we understand and make sure we're talking the same way. But I guess from a broader sense, our retail business has been really strong across the board.

A

Robert Moskow

Analyst, Credit Suisse Securities (USA) LLC

But maybe I'll follow-up this way, you said that your retail shipments are up 20%, is that consistent with your IRI tracking data? Is that up 20%? Because our data would indicate it's up more than that.

Q

James P. Snee

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

Yeah. I mean, we've got, obviously, some unmeasured channels in there. And I think, again, it would be better, probably better if you guys, you and Nathan kind of walk through maybe channel by channel just so you get to a better number.

A

Robert Moskow

Analyst, Credit Suisse Securities (USA) LLC

Okay. My follow-up actually is on the Austin facility. I thought actually that your facility would get some of the excess live hogs from other facilities nearby that had closed entirely and would actually have pretty strong first quarter margins as a result. Is that just kind of making too many assumptions? Or is it not possible to get extra volume from other plants nearby that have closed?

Q

James N. Sheehan

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

A

Well, the facility really had few interruptions during the quarter. We harvested all of our contracted hogs so our first obligation are to the producers that we have long-term contracts with and long-term relationships with. So we have harvested on Saturday. We take these decisions about when we operate the plant as to when it's best financially to operate the plants. There were periods of time when, for instance, the demand in foodservice was so far down there was no reason at all that you would extend your processing capacity. So we've managed the plant in a very reasonable, thoughtful way. But we are not going to shortcut our long term relationships that we have with our producers to harvest another company's hogs.

Robert Moskow

Analyst, Credit Suisse Securities (USA) LLC

Q

Okay. Thank you for that.

Operator: We'll take our next question from Ben Bienvenu with Stephens Inc.

Q

Hi. Good morning, everybody. This is actually [indiscernible] (01:11:49) on for Ben. I just wanted to follow up on M&A front. I know you guys have said your strategy kind of remain constant. But on the foodservice in the deli front, I mean, these have clearly been strong drivers of growth for the company. Are you seeing any changes in valuations or greater willingness to sell in the marketplace, given the sharp drop in demand that we've seen?

James P. Snee

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

A

Are you talking about M&A opportunities?

Q

Correct. Yeah.

James P. Snee

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

A

Yeah. I said a little while ago, I mean, I think the – there's almost been a pause in that activity and so it's really hard to make a statement around valuations just because we haven't really seen the activity. The evaluation process that we're going through is active and consistent but really wouldn't be in a position to make a comment on valuations as of yet.

Q

Okay. Okay. Yeah. That's fair. I just wanted to get your take on the performance of the International business, which was up, it's quite strong. Could you just dive into that a little bit more and just help us think about that business in the next couple of quarters and maybe just the important moving pieces?

James P. Snee

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

A

Yeah. So I think as we look out, I mean, we expect the demand for SPAM on a global basis to remain very strong. We also expect export demand for SKIPPY to be strong. We expect China to continue to improve, especially in the foodservice space. In China, the retail business really remained strong with SPAM and SKIPPY and our Refrigerated Products, both in-store and e-commerce. So as we look forward, probably the biggest difference is the continual build of the China foodservice business, which we expect to continue to improve as they emerge from their lockdown.

Q

Okay. Great. No, thanks for the questions guys. I'll pass it on.

James P. Snee

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

A

Thank you.

Operator: We'll take our next question from Ben Theurer with Barclays.

Benjamin M. Theurer

Analyst, Barclays Capital Casa de Bolsa SA de CV

Q

Hey, good morning, Jim and Jim. And thanks for taking my question. Actually, I wanted to follow up a little bit on retail and what we've been talking in the past. You have the more medium, long-term target, new products, innovation and to actually get basically a contribution from sales, about 15% from innovative products.

So wanted to understand within the more recent dynamic, within the retail channels, could you share a little more detail on repeat rates, purchases amongst like call it the very well-established, long-lasting brands such as SPAM, SKIPPY, Hormel chili versus then the more newer brands or the innovated ones and the innovation, just to understand how velocity in the different subcategories is running? That would be great.

James P. Snee

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

A

Yes. Ben, why don't we start with the, really, the first part around innovation? And what's been really impressive across our organization, even though that we've moved to working virtually, is our innovation hasn't slowed down at all. Our team has done an amazing job being able to work virtually on the innovation process. In fact, I know it's a number that we usually report at the end of the year, but of course, we track it throughout the year, and we met our 15% innovation goal.

And so the results that we're seeing are really, really positive, and there's just lots of great innovation work being done, not only in terms of the R&D process but being able to get them out in the marketplace, having virtual product showcases, virtual cuttings and the innovations across the entire pipeline, so whether it's SKIPPY, Pepperoni, Natural Choice, Happy Little Plants. I mean, you name it, the innovation work continues.

In terms of repeat rates, again, SPAM has one of the highest new buyer repeats. And so a brand that's over 80 years old, as we've said, it's probably more relevant today than it's ever been. The repeat rates for items like Herdez, Black Label bacon, I mean, all really, really strong. So again, kind of piggybacking on my earlier

comments, just very pleased with the retail performance, new buyers, strong new buyer repeats, in store, e-commerce, just a lot to feel really good about in the retail business.

Benjamin M. Theurer

Analyst, Barclays Capital Casa de Bolsa SA de CV

Q

Okay. Perfect. And then my follow-up question, I mean, very clear on the \$20 million now and the \$60 million to \$80 million for the remainder of the year. And you said that most of it is actually nonrecurring. But I could imagine that part of it must be, to a certain degree, recurring in terms of some of the PPE and some of maybe the social distancing that you have to bear in mind. So if you could share a little bit more medium-term outlook, would you think a potential cost burden could be once things are back to a more normal level, but maybe not a perfectly normal level?

James P. Snee

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

A

Right. Well, I mean, I think the things that will – that won't be reoccurring over the long term, right, so we have team member bonuses that are built into those numbers. I mean over the long term, we don't expect those to be reoccurring. We're suffering from some lower tonnages in plants right now. Over the long term, we expect that business – those businesses to rebound and so we won't have that part.

But we are going to have PPE costs, so whether it's masks, face shields, putting up dividers in the plants to make sure that there's that distance, that separation. I mean those things are going to be there on a permanent basis. And so we're right now evaluating which of those costs are temporary and which are more permanent that will need to be passed along. And so this is – again, our number one priority has been to keep team members safe, at all costs. As Jim said, we weren't negotiating prices, we were negotiating supply.

And then, the second was to keep the product on the shelf, which we've done in amazing way. And really our third objective as we go forward is, really, understand what costs are permanent, what costs are temporary. So this is all a work in process.

James N. Sheehan

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

A

Ben, the one thing that I would point out is that many of these costs are industry costs and will be – every participant in the market are going to have these types of costs. The other thing is we have that time to build efficiency around some of these things. We've been reacting to putting the fires out, let's say, and as we have more time to look at line speed and social distancing and the costs around those, we'll be able to build efficiencies into the model.

So what we're trying to do is to analyze these expenses that were just short-term expenses, and to some degree have to be absorbed, and then building a more efficient process with the way that we will have to operate in the future. And we will certainly be able to do that. But right now, we're just reacting to the changes. We'll get better as we go through.

Benjamin M. Theurer

Analyst, Barclays Capital Casa de Bolsa SA de CV

Q

Okay. Thank you. That's totally fair and understandable. Thank you very much.

Operator: We'll take our last question from Jonathan Feeney with Consumer Edge Research.

Jonathan Feeney

Analyst, Consumer Edge Research LLC

Q

Good morning. Thanks very much. I was wondering if it's possible to quantify the effect of profit mix, both within Grocery Products and within Refrigerated Foods. Because it strikes me, and I say if it's possible because I know what you're making on a given product is all over the place when cuts are all over the place.

But if you could imagine a 2019 or more normal sourcing environment, I'm trying to understand how structurally the products that declined compared to the products that grew in terms of the structural kind of profit you'd expect to make in a normal sourcing environment. For the purposes of just looking at where the business comes out, maybe a little bit – getting a little bit more detail on that. I think, Ken Zaslow asked you a similar question about that structural profitability earlier. Thanks very much.

James P. Snee

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

A

Yeah. I think, Jonathan, there's some things to consider. I mean, obviously, Grocery Products have a really nice margin structure. The growth that we saw in SPAM drives a lot of that. The other part that makes it really difficult, as Jim talked about, is this volatility that you see within the quarter. And so, we're still feeling through that, and to get to a normalized number is difficult. The foodservice piece, again, different parts of foodservice, we've got some higher-margin precooked, pre-sliced, pre-marinated. You also have elements of that are going to be commodity in terms of ribs that are going to barbecue businesses.

So the thing to remember is, I mean, we'll – as Jim said, we'll build the efficiencies and processes, but we'll also make sure that pricing is adjusted over the long term. And there's really two components to consider. And we talked about the markets and we've already taken pricing on certain products, such as bacon that's moved in a very volatile way. Some products are more CPG-like, and we're monitoring those markets.

And then there's the conversation we just had around supply chain costs, right? We have to understand which are temporary, which are permanent, which are going to have to be passed along over the long term. So it is a difficult question, and there's a lot of moving parts that we'll continue to be working on over the months ahead.

James N. Sheehan

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

A

I think one way to look at it is, as we improve, especially around foodservice, into a more user-convenient products, that's going to add value both to Hormel and to our operators. And that clearly seems to be a shift that's going to happen in the foodservice industry where there'll be less desire to touch those products. And when you think about our Bacon 1 and some of the other products we offer, those have nice margins on our side, and often the opportunity for the operator to expand their margins, too. So, we think that's a win-win opportunity.

Jonathan Feeney

Analyst, Consumer Edge Research LLC

Q

Interesting. Thank you very much.

Operator: At this time [audio gap] (01:24:04) for any closing or additional remarks.

James P. Snee

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

Well, thank you. On behalf of the team here at Hormel Foods, I want to thank you for listening in today and being patient with our technical difficulties. Now, this is an uncommon company with an incredible 129-year history. We have weathered many storms during those 129 years, and we will weather this storm because we were made for this. I wish all of you an enjoyable Memorial Day weekend, and please stay safe and healthy.

Operator: [Technical Difficulty] (01:24:42:) today's call. Thank you for your participation. You may now disconnect.

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