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Hormel Foods Corp. (HRL)

Q3 2021 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day, and welcome to the Hormel Foods Third Quarter 2021 Earnings Conference Call. All participants will be in listen-only mode. [Operator Instructions] Please note today's event is being recorded.

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

Nathan P. Annis

Director-Investor Relations, Hormel Foods Corp.

Good morning. Welcome to the Hormel Foods conference call for the third quarter of fiscal 2021. 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 the company's current and future operating conditions, commentary on each segment's performance for the quarter, and a perspective on the balance of fiscal 2021. Jim Sheehan will provide detailed financial results and commentary on the company's current and future financial condition.

The line will be opened for questions following Jim Sheehan's remarks. As a courtesy to the other analysts, please limit yourself to one question with one follow-up. If you have additional questions, you are welcome to get back into the queue.

An audio replay of this call will be available beginning at noon today, Central Daylight Saving Time. The dial-in number is 877-344-7529, and the access code is 10159436. It will also be posted on 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 28 through 35 in the company's Form 10-Q for the fiscal quarter ended April 25, 2021. It can be accessed on our website.

I will now turn the call over to Jim Snee.

James P. Snee

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

Thank you, Nathan. Good morning, everyone. In the third quarter, our team delivered the highest quarterly sales in the company's 130-year history, while operating in an environment which included inflationary pressures and industry-wide supply chain challenges. Our ability to deliver this performance demonstrates the strength of our balanced business model and strong consumer demand, as we grew sales in all four segments and all four sales channels on an organic basis.

Also in the third quarter, we completed the acquisition of the Planters snack nuts business. This brand fits perfectly into our vision for Hormel Foods, and is another step in our strategic evolution. The integration has been smooth, which has allowed us to effectively operate the business with no disruptions.

These accomplishments were achieved by our team members who never lost sight of our long-term growth strategy in the face of unprecedented industry-wide challenges. To all our team members around the world, including our new Planters' team members, thank you for your accomplishments, and thank you for staying safe.

Now more than ever, our investments across all areas of our business are paying off and have allowed us to reach even more consumers when and where they are eating. Whether it is cooking a meal at home, snacking at work, eating at a local restaurant, hosting a gathering with family and friends or ordering food online, a Hormel Foods' branded product will likely be an option. The proof is in our performance this quarter.

Sales increased 20% on a volume increase of 1%. Compared to the third quarter of 2019, sales increased 25%. This all-time record performance was led by an acceleration in our foodservice business, sustained demand for our retail and deli products, continued growth from our international business, and pricing actions taken across the portfolio.

Excluding a partial quarter of the Planters business, organic sales increased 14% and volume declined 2%. For the quarter, we saw an acceleration in our foodservice business as sales grew 45% compared to last year. What is even more impressive is sales increased 17% compared to 2019 pre-pandemic levels.

Our enterprise foodservice portfolio remains perfectly positioned to meet the most pressing need of today's foodservice operators, which is labor. Our products minimize labor, simplify food preparation and save time, all while preserving the flexibility to add their own unique touch to their menus.

Hormel Bacon 1 fully cooked bacon, Wholly Guacamole, Fontanini authentic Italian sausages and Hormel Fire Braised meats are all excellent examples of products that are succeeding in today's environment.

Our retail business also showed 9% growth compared to 2020. Compared to pre-pandemic levels in 2019, this business delivered outstanding growth of 31%. Brands such as SPAM, Hormel Black Label, Applegate, Jennie-O and Herdez continue to resonate with consumers.

Sales in the deli channel increased 12% this quarter and are up 16% compared to pre-pandemic levels. Hormel Gatherings party trays and Columbus charcuterie items showed another quarter of growth as consumers returned to entertaining and spending time with family and friends.

An important component of our growth in retail and deli is our e-commerce performance. We continue to invest in the digital space, and we are seeing strong results compared to pre-pandemic levels.

Our international channel delivered impressive growth of 36% compared to 2020 and is 33% above 2019 levels. Improvement was led by branded exports and strength from the multi-national businesses in China and Brazil.

Again, I cannot stress enough how proud I am of our entire team for delivering these impressive results in the midst of an incredibly difficult operating environment marked by significant inflation, labor challenges and supply chain disruptions. This not only demonstrates the team's ability to execute our long-term growth strategy, but also reinforces the power of our brands.

On a consolidated basis, diluted earnings per share were \$0.32, a 14% decline compared to 2020. The decrease was due to one-time transaction costs and accounting adjustments related to the acquisition of the Planters business. Adjusted earnings per share were \$0.39, a 5% increase.

Our team did an excellent job actively managing through inflationary pressures and supply chain challenges. During the quarter, we continued to see inflation in labor rates, freight, supplies, raw materials and many other inputs, with an acceleration compared to the second quarter.

Of note, we saw a very high level of inflation in pork input costs. To mitigate this inflationary pressure, we have taken pricing on almost every brand and product across our company. This is a testament to our successful pricing strategy, the power of our brands and the hard work of our entire team, especially our direct sales force.

As a reminder, there is a difference in how quickly pricing flows through by channel, and this can shift profits to later quarters. We have a track record of improving profitability through a market cycle. And we expect margins to improve in the coming quarters.

We also saw a drastic step-up in industry-wide operational challenges caused by labor shortages. This has impacted both our facilities and the operations of supplier and logistics partners. This has created a very complex operating environment, which led to an inability to fully meet customer demand.

To address labor availability in our facilities, we are taking swift actions to hire and retain team members, implement automation across manufacturing facilities and simplify the portfolio. Our entire team from operations to our direct sales force has done an excellent job adjusting, prioritizing and managing through this dynamic environment.

Turning to the segments, Refrigerated Foods volume decreased 2%, sales increased 19% and segment profit was flat. Organic volume decreased 3% and organic sales increased 18%. Volume was lower due to lower harvest levels and commodity sales compared to last year. Our foodservice business accelerated compared to the second quarter, with elevated levels of demand for all our branded products.

Nearly every category grew volume and sales compared to last year, with standout performances from products like Hormel Bacon 1 pizza toppings and sliced meats. Bacon 1, Fire Braised, Fontanini, Applegate and pizza toppings were just some of the items that also grew volume and sales compared to 2019.

Similar to prior quarters, we saw excellent growth from premium prepared proteins, which are the cornerstone of our pre-strategy, offering versatile and flavorful items that come pre-marinated, pre-sliced or pre-cooked. These items solved for the most pressing issues facing operators today, labor shortages. Brands like Bacon 1, Austin Blues, Fire Braised and Café H are designed to solve for this challenge and have never been as important or in higher demand than they are today.

We saw momentum continue for our retail and deli brands in Refrigerated Foods as well. Products showing exceptional sales growth include Hormel Gatherings party trays, Hormel Black Label bacon, Hormel fully cooked entrees and Lloyd's Barbeque.

The Columbus brand has shown no signs of slowing down, as consumers look for premium, authentic charcuterie. I'm pleased with the performance of our new charcuterie plant in Omaha, as the team is quickly filling up the new production lines. We are excited about the upcoming holiday season and expect a high level of demand for our innovative and premium Columbus product lines.

International delivered its sixth consecutive quarter of record earnings growth, with volume up 2%, sales up 26% and segment profit up 18%. Organic volume increased 1% and organic sales increased 24%. Total branded and

fresh pork exports grew during the quarter. We continue to see strong growth from SPAM, SKIPPY and many foodservice brands around the world.

Our business in China continues to perform well led by foodservice and from retail brands such as SPAM and SKIPPY. Our new item launches of beef jerky and SKIPPY snacking items have also been very successful.

Grocery Products volume increased 4%, sales increased 20% and segment profit increased 1%. Brands, including SPAM, Hormel Compleats and Wholly, showed excellent growth during the quarter. We continue to see strong growth relative to 2019 pre-pandemic levels for brands such as SPAM, Hormel Compleats, Dinty Moore, Mary Kitchen and Herdez.

Organic volume decreased 6% and organic sales were flat. Organic volumes faced difficult comparisons due to the extremely high levels of demand during the early parts of the pandemic. Additionally, we have rationalized capacity on numerous contract manufacturing items to support growth of our branded business.

Our MegaMex joint venture delivered excellent results, as equity and earnings increased 30%. The growth from the Herdez and Wholly brands are being driven by the tremendous level of innovation from MegaMex, with products such as Herdez Cremosas, Herdez Guacamole Salsa and Wholly Smashed Avocado. We are also extremely encouraged by our entry into the hot sauce space with Herdez Avocado Hot Sauce.

Jennie-O volume increased 9% and sales increased 22%, a combination of a foodservice recovery and higher whole bird and commodity volumes drove the volume increase. Increased sales is due to higher volumes and pricing actions across the portfolio.

Jennie-O Turkey Store segment profit declined 17%, driven by the impact from significantly higher fee and freight costs. While spot grain markets remained elevated during the quarter, the hedging actions we took stabilized the cost increases.

Looking to the balance of the year, we issued our full year net sales and earnings guidance to reflect the Planters acquisition. We expect net sales to be between \$11 billion to \$11.2 billion and for diluted earnings per share to be between \$1.65 to \$1.69. This guidance reflects the addition of the Planters business and includes the associated one-time transaction costs and accounting adjustments, in addition to the impact from inflationary pressures on our business. We expect a strong finish to the year as pricing actions continue to take effect, the foodservice industry continues to recover, and from the addition of Planters.

Looking beyond the fourth quarter, I feel very optimistic about the future. Our balanced portfolio with diversification across raw materials, channels and categories will allow us to perform well in many economic environments.

Further, we never wavered on our commitment to employee safety and on making disciplined and strategic investments to ensure we are positioned to deliver long-term sustainable growth.

Since the onset of the pandemic, we have made the following strategic investments. We opened a new Columbus charcuterie plant in Omaha, and we immediately invested in Phase 2, representing a major expansion of our pepperoni capacity.

We completed the pizza toppings expansion at our Burke plant in Iowa, which significantly increased our capacity for pizza toppings. We have invested in R&D for plant-based products and launched our plant-based pepperoni and sausage crumble items at the Pizza Expo in mid-August.

Additionally, we bolstered our innovation efforts by investing in new R&D centers, both domestically and in China. We expanded our distribution network for both the shelf stable and refrigerated businesses. We made further progress on building out our One Supply Chain by investing in systems, people and processes.

We acquired Sadler's Smokehouse, which added capacity to support growth during the recovery in the foodservice industry. We completed the HR and finance portions of Project Orion and continue to work towards the multi-phase implementation of our supply chain. We continue to make investments in advertising for our leading brands.

And finally, we made the company's largest investment ever, the acquisition of Planters. We are already seeing the benefits that a large, iconic and well-known brand can have on our business. These are just some of the many investments we have made to further enhance our business and set us up for growth into the future.

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

James N. Sheehan

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

Thank you, Jim. Good morning. Third quarter sales were \$2.9 billion, an all-time record for the company. Net sales and organic net sales increased 20% and 14%, respectively, compared to last year. Segment profit increased 2% for the quarter, driven by strong results in the International segment, foodservice growth and the addition of Planters.

Earnings per share were \$0.32. Adjusted earnings per share, excluding one-time costs and accounting adjustments related to the acquisition of Planters, was \$0.39, a 5% increase. COVID-related expenses during the quarter were immaterial.

Adjusted SG&A was 6.9% of sales compared to 7.6% last year. Advertising for the quarter was \$31 million, an increase of 25%. Adjusted operating margins for the quarter were 8.7%, a decrease from 10.5% last year. We expect margins to show sequential improvement in the fourth quarter, as the impact of pricing actions continue to take effect. Net unallocated expenses increased as a result of the one-time acquisition-related costs for Planters and net interest expense.

The effective tax rate for the quarter was 13.3%. The primary driver of the decline was a large volume of stock options exercised during the quarter and a one-time foreign tax benefit. The revised guidance range assumes a full year tax rate between 19% and 20.5%.

Operating cash flow declined compared to last year, impacted by working capital from the Planters acquisition and higher levels of inventory. Inventory levels were unseasonably low last year during the third quarter.

We paid our 372nd consecutive quarterly dividend, effective August 16 at an annual rate of \$0.98 per share, a 5% increase over 2020. This completes the 93rd consecutive year of uninterrupted dividend payments.

Capital expenditures were \$54 million in the quarter. The company's target for the capital expenditures in 2021 is \$260 million.

The Planters acquisition represents a change to the company's capital structure. In June, we issued \$2.3 billion of notes in 3-, 7- and 30-year tranches. This debt was incremental to the \$1 billion of 10-year notes we issued in 2020. Including the treasury locks, the weighted average cost of debt is 1.6%, and the weighted average maturity is 10.4 years. This attractive debt profile is an ideal balance for our business.

We will continue to use a disciplined waterfall approach to capital allocation, which includes three areas: required, strategic and opportunistic uses of cash. I expect no changes to dividend growth or our CapEx strategy. We are committed to an investment-grade rating and plan to deleverage to 1.5 to 2 times debt to EBITDA over the next two to three years.

The business experienced significant inflationary pressures on pork input costs during the quarter. The dramatic increase in pork and hog prices continued in the third quarter. Hog prices were up 250% compared to 20-year lows last year. Additionally, the prices of pork remained elevated caused by the recovery in the foodservice and the strong worldwide demand. The USDA composite cutout was up 50% compared to last year and 20% compared to the second quarter.

Trim prices and belly prices also experienced inflationary pressure with significant volatility. Compared to the prior year, belly prices were 62% higher and trim prices 27% higher. The business benefited from the balanced approach to hog and pork procurement as we purchased hogs in aggregate at prices lower than the market. However, the rate of the drastic rise in the total pork input costs negatively impacted profitability.

The latest estimates from the USDA indicate pork production for the year to decrease 2% compared to 2020. Lower harvest levels, lighter carcass weights and labor shortages across the industry support higher markets near-term.

We're closely monitoring the discovery of African swine fever in the Caribbean and labor availability across the industry. Both factors could impact input costs going forward.

Fundamentals in the turkey industry improved during the third quarter. Higher prices for commodity items, including breast meat, thighs and whole turkeys were a benefit to the quarter. Additionally, egg sets and poult placements declined. Cold storage remains significantly below historical averages.

Higher operating costs offset the market benefits. Inflationary pressure on corn and soybean meal have resulted in substantially higher feed costs. The strategic hedges on corn and soybean meal have stabilized feed costs. We also absorbed higher costs for freight, packaging, supplies and labor. We are actively managing our logistics network and supplier partnerships to minimize cost increases.

Across the portfolio, pricing actions were effective, but from a timing standpoint, trailed inflation during the quarter. We expect to recover lost profitability due to inflation in the coming quarters as conditions normalize and pricing actions expand.

The strong demand for our key products during the price increases is a testament to the strength of our leading brands. The guidance issued for the remainder of the year includes the impact of Planters and the expectations of continued inflationary pressure and volatile market conditions.

Although the third quarter had its challenges, it also included significant financial milestones. We closed the largest acquisition in the company's history. We financed the transaction by leveraging the balance sheet through an attractive debt structure in both interest rates and tenor, all while maintaining our investment-grade rating. We move into the future with a more efficient capital structure, stronger brands and continued financial strength to invest in our business.

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. We will now begin the question-and-answer session. [Operator Instructions] Today's first question comes from Michael Lavery with Piper Sandler. Please go ahead.

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.

Can you just elaborate on your pricing a bit and give a sense – I know you said it's broad and maybe literally every brand and product. But maybe one, just some of the order of magnitude and how you determined kind of what was appropriate and if it might be enough or you think this covers you for well into next year as well as obviously finishing this one?

Q

James P. Snee

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

Yeah. Good morning, Michael. That's a really complex question, and you hit it right on the head when you say – and we've said it that the pricing is very, very broad based across the portfolio. And I think for us, what we've been watching throughout the second quarter and the third quarter is just to be prepared and making sure that as we're watching not only commodity markets, but packaging costs and freight rates is making sure that we're capturing those in that timeframe.

A

And what's been different in this environment is, obviously, those costs have just continued to move away from us and no different than any other food company that you're talking to. What I do think is different, though, is that we have been ready, we have taken broad-based aggressive pricing, but we've continued to have to do that, and we will continue to have to do that, as we've seen these markets and costs continue to move away from us.

So, again, it's really broad based. It could vary by product, by category. Clearly, we're watching all of the category dynamics. We're watching what's happening with elasticities within our brands and categories. And so, it's obviously a very complex dynamic. The key takeaway, though, is that we're really pleased with the pricing actions

that we've taken. We're pleased with the brand performances. And we know that we're ready to react with some additional pricing going forward.

Michael S. Lavery

Analyst, Piper Sandler & Co.

Q

Okay. That's helpful. And maybe just to clarify. What we see from this report in the third quarter, would that pretty fully reflect the pricing? Or was it really just getting underway, so that we should expect it to accelerate?

James P. Snee

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

A

Well, I mean, again, depends on brand and category, but we've got, as you can tell, significant pricing that took place in the quarter. Some of that will carry over into the fourth quarter, but we also have pricing that is being prepared to go into effect that will take effect in the fourth quarter as well. So it's really going to be a combination of spillover from Q3 into Q4 and then some new pricing actions in Q4.

Operator: Thank you. Our next question today comes from Ben Bienvenu with Stephens. Please go ahead.

Ben Bienvenu

Analyst, Stephens, Inc.

Q

Hey, thanks. Good morning.

James P. Snee

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

A

Good morning.

James N. Sheehan

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

A

Good morning.

Ben Bienvenu

Analyst, Stephens, Inc.

Q

So, I want to ask – so in the adjusted results, it looks like the implied impact from Planters is about \$0.07 per share. That's towards the higher end of what you said the impact would be for the full year to Planters when you provided guidance last time on the deal. Can you give us some color on what you think the full year – for the balance of this year net impact of Planters is that's implied in your guidance, so we can get some clarity on kind of the core business?

James N. Sheehan

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

A

Good morning, Ben. The \$0.07 that you're referencing is only related to those one-time events related to the transaction, so the closing costs and those accounting adjustments that were made. There's obviously some transitional expenses as we bring this business online that always occur with any type of business transfer, so those were included. We still believe that the \$0.02 to \$0.07 dilution in 2021 is reasonable.

Ben Bienvenu

Analyst, Stephens, Inc.

Q

Okay, great. And then, if I think about the – I want to focus on the Grocery Products business. If I think about the margin recovery of the business, you talked about taking price, working to take cost out of the system, drive efficiencies. Can you give us some sense of kind of pace of recovery?

Obviously, implied in the fourth quarter, we're seeing meaningful margin improvement sequentially from the third quarter. But to the extent you could delineate between Grocery Products and the relative segment's contribution to that improvement in margin sequentially and kind of the trajectory from here that you see based on the current market outlook that would be really helpful.

James P. Snee

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

A

Sure, Ben. We can do that for you. I mean, I think the first thing to start with is the Grocery Products' portfolio, probably more than any other part of our business, has the longest lag in pricing.

And so you'll see, what we always say, on average, 60 to 90 days in terms of how that pricing passes through. And for us, I mean, we've taken pricing across that entire portfolio and you think about [ph] 72 pork trim (00:34:27), how that has been through the roof.

And so, we've been very aggressive. We've been ready to take additional price actions. And so we've got a mix – just like I said earlier, we've got a mix that have taken effect in Q3 and will have a bigger impact in Q4. We have another round that will be coming in Q4 that will really have the impact in Q1 of 2022.

Operator: Thank you. Our next question today comes from Tom Palmer, JPMorgan. Please go ahead.

Thomas Palmer

Analyst, JPMorgan Securities LLC

Q

Hi. Thanks for the question.

James P. Snee

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

A

Hi, Tom.

Thomas Palmer

Analyst, JPMorgan Securities LLC

Q

Maybe just circling back to Planters, so you noted about \$40 million non-recurring charges in the third quarter. Your guidance is on a GAAP basis, so it includes these charges. And then, as we look at the fourth quarter, what's embedded for either charges or credits related to that Planters business? I mean, are there going to be additional non-recurring considerations? Or is kind of \$40 million the extent and it's pretty clean going forward?

James N. Sheehan

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

A

Well, I think that you've seen the expenses related to the transaction are included in the \$40 million and some accounting adjustments are included in the \$40 million. But until you complete your purchase accounting and

make all of the accounting adjustments, which we think will be probably finished at the end of the fourth quarter, you can't say that all of the adjustments have taken place.

So we believe that this is the majority of the expenses, the vast majority of the expenses, but there still could be some one-time expenses come through as we close the purchase accounting process. Does that help you?

Thomas Palmer

Analyst, JPMorgan Securities LLC

Q

Yes. So just to clarify, is anything embedded in that guidance number or it would be incremental at this point?

James N. Sheehan

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

A

Yes. That is an all-in number. So that is a GAAP number that we are basing on what we believe is the performance of Planters, and we're pleased with the transition into Planters. We've been pleased with the sales rate at this time period, the expenses that are called out and then those transactional – or transitional expenses that occur any time that you bring a business into your organization. So that is an all-in number.

Operator: Thank you. And our next question today comes from Ben Theurer with Barclays. Please go ahead.

Benjamin M. Theurer

Analyst, Barclays Capital Casa de Bolsa SA de CV

Q

Thank you very much. Good morning, Jim and Jim. Just wanted to go back to the price increases and you've talked about – obviously, you've done [ph] something (00:37:17) in Q3. You expect more to do in coming quarters. On the very initial ones, have you seen some sort of a reaction from consumers and customers in terms of sensitivity to the price increases? And how has that been offset by the brand strength of some of your core brands where you've introduced those price increases?

James P. Snee

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

A

Yes, Ben. I mean, really, we've been really pleased with the performance of the businesses in the face of the price increases. The elasticity models that we typically use, we're outperforming those. And so, we'll continue to watch the brands, the categories, the elasticities going forward.

But I think the last point of your question is a really important one and one that we highlighted in our comments is that, the brand strength that we have, that we've invested in and built over time is more important than it's ever been, as we're faced with such an inflationary environment and making sure that consumers have brands that they recognize and that resonate with them on a day-to-day basis is really, in our mind, is one of the key drivers of our success for the sales growth.

Benjamin M. Theurer

Analyst, Barclays Capital Casa de Bolsa SA de CV

Q

Okay. And then on Planters, I think it's been talked enough about how clean the fourth quarter is going to be. But if we look into fiscal 2022, would you feel comfortable reiterating your initial guidance of accretion in that high-teens range for Planters?

James P. Snee

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

A

Yes. At this point, Ben, we would – I mean, it is early. We've got, what, maybe eight or nine weeks that we own the business in the third quarter, but we're very satisfied with the sales performance. Many of the assumptions that we've made in other parts of the business are all holding up. We've said we've already seen some of the benefits that an iconic brand like that can have on our business. We're experiencing that in the convenience channel. So, yes, at this point, although it's early, we still feel very comfortable with that range.

Operator: Thank you. Our next question today comes from Rupesh Parikh with Oppenheimer. Please go ahead.

Rupesh Parikh

Analyst, Oppenheimer & Co., Inc.

Q

Good morning and thanks for taking my question. So I guess, just on your foodservice business, just given that we are seeing COVID cases spiking in a number of markets, just curious if you've started to see any impact within that business?

James P. Snee

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

A

We have not, Rupesh. I mean, honestly, our foodservice business just continues to accelerate. And it really goes back to the challenge that these foodservice operators are facing, and it's labor, right? And so as you think about how they have the competency for that shortage of labor, our portfolio perfectly aligns with what they need to get done.

And so, we're helping those operators overcome those challenges. We're doing it with our direct selling force, which we've said is a competitive advantage. And again, more than ever, it is a distinct competency of this organization.

So, we haven't seen the foodservice business slow at all. We're seeing it accelerating. And we feel incredibly bullish on our portfolio and what we're going to be able to achieve going forward.

Rupesh Parikh

Analyst, Oppenheimer & Co., Inc.

Q

Okay, great. And then maybe just one follow-up question. And I'm not sure how much you're going to share. But as we look at 2022, like, is there any way you can share just some of the buildings blocks, as you see them right now for next fiscal year?

I mean, clearly, Planters, it sounds like that [ph] \$0.17 to \$0.20 (00:41:02) accretion is still something that's in the range of possibilities. But just wondering if there's any other initial puts and takes you'd be willing to share as we look out to the next fiscal year.

James P. Snee

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

A

Yes. I mean, it's a great question. I'm going to quantify it by – or qualify it by saying it's early. But what we just talked about, our foodservice strength, I mean, we expect labor to continue to be an incredible pain point for foodservice operators. But our portfolio is going to help us overcome that. And we're going to continue to help those foodservice operators.

We do think that some of the additional capacity that we have coming online in early 2022 for our pepperoni business, expansion in our bacon business is going to serve us well. You mentioned the impact of our Planters business.

And we've had a great run with our MegaMex business, the authentic Mexican portfolio, not only the base business, but the innovation that we're generating. We would expect some continued international strength as well. And then, as we talked earlier, the impact from pricing actions will also come into play, and that's all the good news, right?

The offset to that will be what happens with inflation, what happens with labor that will impact our business in our manufacturing facilities. So there's a lot of unknowns on that side. But I think we feel really good about how we've built this portfolio and how we've built the business for the long-term. And we're optimistic about 2022.

Operator: Thank you. Our next question today comes from Ken Zaslow with Bank of Montreal. Please go ahead.

Kenneth B. Zaslow

Analyst, BMO Capital Markets Corp.

Hi. Good morning guys.

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. Zaslow

Analyst, BMO Capital Markets Corp.

Can you let us know is supply chain challenges bigger or smaller than the inflationary pressure that you're feeling? And what are you doing to change the supply chain challenges? And when will they be mitigated?

Q

James N. Sheehan

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

Good morning, Ken, good question. The inflation is one. As we look at our gross margin change, we certainly have had inflationary pressure. But when we look at our pricing action, our improved mix and some efficiencies we've brought online, we have really offset that inflation.

A

The pressure on the gross margin really relates to the labor shortages, not only labor shortages at our facilities, but labor shortages throughout the supply chain. At times, we've had lines that have not been running at full capacity that have created some overheads because we've had shortages in our plants. At other times, we've been notified, let's say, relatively late that our suppliers could not provide us, either packaging or input into our products.

So as we look at the third quarter and as we look forward, really, inflation, we think we've managed very well. It's this labor issue that is creating the pressure right now. So I'd say it's more of a labor issue.

James P. Snee

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

A

Yes. Ken, I would – just to add on to that, I mean, really, the key in all of this is, like you said, what are you doing about it? And there is, as you know, a strong linkage between the labor and inflationary issues. So labor is costing us. The labor that we have is costing us a lot more. Then you have to deal with the missing labor.

So we're pricing for the increased labor. For the labor that we don't have, clearly, we're raising starting wages. We're being more aggressive in how we're finding employee pools to hire. We have to be more aggressive and more disciplined in how we're retaining our employees. We're finding ways to automate. That doesn't happen overnight. But I would tell you that we've had successes in automation when we think about package placement, palletizing and how we can pivot and reallocate those team members to more important manufacturing responsibilities.

And then through it all is how do we simplify our operations, right? And so all of those things go hand-in-hand. And the one thing that this team has been able to do is not find themselves in a victim mentality, but really, say, what are we going to do about it because that's really our challenge.

Kenneth B. Zaslou

Analyst, BMO Capital Markets Corp.

Q

Great. I'm not a big fan of my next question, but I have to ask it just because you have to think about it this way. Which division do you think will be able to have margins at least on par with year ago levels first? And then how does that progress for the other divisions? I know that dollars going to the bank is more important, but I'm just trying to figure it out just because, obviously, the sales is distorted by pricing. And I'm just trying to figure out which divisions does the margin catch up? Which are the first divisions? And then how long will it take? Just kind of framing that and I appreciate it.

James P. Snee

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

A

Sure. And I hate to give the answer, but I'm going to is, it really depends, right? And we think our Grocery Products division, as we've seen some moderation in raw materials, has a really good opportunity to return to a more normalized margin structure. Also – and it's a subset, but foodservice, obviously, within Refrigerated Foods, not only through the growth of the business, but also the mix shift is really going to provide margin enhancement for us over time. So, again, not a big fan of the answer, but I've got to give that.

James N. Sheehan

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

A

Ken, the one thing that I would point you to is that, it's early in the quarter, but we've seen relief on the pork side of the input costs. For instance, hogs were averaging \$118 in the third quarter. They were down to \$93. Bellies have even come off a little bit, but you'd expect bellies to come off at this time of the year. And we're seeing some relief in trim.

Now the only area outside of pork that, from a raw material input that we're seeing increases in is the beef category. Beef started to go up in our second quarter and that trend has continued. So we're seeing relief in the

pork industry. Again, I'll give you the same warning that I did last quarter. Labor is a very important factor as to how these costs are going to trend in both the near and long-term.

Operator: Thank you. Our next question today comes from Peter Galbo with Bank of America. Please go ahead.

Peter T. Galbo

Analyst, BofA Securities, Inc.

Great. Jim and Jim, good morning. Thanks for taking the question.

James P. Snee

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

Good morning, Peter.

Peter T. Galbo

Analyst, BofA Securities, Inc.

Jim, I just wanted to dive in a little bit deeper on the labor situation. A few of your peers have kind of talked about vacancy rates or open requisitions that they have somewhere in the range of like 6% to 10%, which is obviously elevated versus normal. I guess, just the two questions there. One, can you kind of give us a sense of where that stands for you in terms of open positions?

And then secondly, just as we look at kind of the volume number in 3Q, I think it was at least on an organic basis, like 1.15 billion pounds. Is that a good kind of run rate number to use in terms of your total volume that you can actually produce until the labor situation kind of corrects? Just trying to understand that part. Thanks.

James P. Snee

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

Yes. Peter, I would start with – I mean, I think that rate is a good range for us as well. I mean, it ebbs and flows depending on the week, to be honest with you. But I think if you operate with that number or with that range in mind, you're in a ballpark.

I think there's always considerations when we talked about our volume number. Clearly, we had lower harvest level this quarter, which does have a dramatic impact on volumes. And so we've got to watch that closely. But taking it to a higher level, yes, the idea of labor in our plants does have an impact on the volume and what we're able to produce. So that's why it is so important that we do take a very aggressive approach in hiring, retain, finding those areas to automate and how do you simplify your operations.

I mean, we absolutely have to get that done, and there's not a higher priority in the organization from a human resource perspective and a supply chain perspective. So, it doesn't give you the specific number you're looking for, but it does, at a high level, say, yes, labor is a driver for the volume that we're able to produce.

Peter T. Galbo

Analyst, BofA Securities, Inc.

Got it. No, that's helpful, Thanks, Jim. And Jim Sheehan, maybe just two cleanup questions. On the gross margin for the fourth quarter, I think you said improve sequentially, but should we still be expecting that to be down year-over-year? And the second part, I just wanted to make sure the sales guide for the full year still includes the 53rd week, correct?

James N. Sheehan

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

A

Yes. Everything includes the 53rd week. And as we said, that guidance is an all-in GAAP guidance. There's still going to be pressure on margins in the fourth quarter. But again, we have additional pricing action that we're confident will improve this process. And again, we have the same labor issues we dealt with in the third quarter, and we still have the same supply issues that we have been dealing with.

So we know what our employment rate is. But some of our suppliers, we have less visibility to, and we've had surprises that have interrupted the operations and actually have increased our cost as we've had to go out and find alternative solutions. So it's an improving situation, but I would still expect they will trail last year. The fourth quarter of last year had its own challenges, but I think that would be the trend.

Operator: Thank you. And our next question today comes from Carson Barnes of Consumer Edge Research. Please go ahead.

Carson Barnes

Analyst, Consumer Edge Research LLC

Q

Good morning. Thanks for the question. Can you talk a little bit about international pork demand, especially with respect to the African swine fever? As China and other countries work through that, are you seeing any changes in demand or risk to the business moving forward?

James P. Snee

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

A

We really haven't, at this point, Carson. For us, we've been really focused on shifting our international pork supply to a ractopamine-free supply, and that's really allowed us to open up some new markets and price accordingly. So, I mean, for our business, that's really been the big driver on the supply side of the business.

The other piece that we'd be remiss if we didn't mention is just the freight availability for pork and other international exports. Although some of our branded exports showed growth, freight availability continues to be a risk in the supply chain going forward.

Carson Barnes

Analyst, Consumer Edge Research LLC

Q

Thanks a lot. That's helpful.

Operator: And our next question today comes from Adam Samuelson at Goldman Sachs. Please go ahead.

Arthur Almeida

Analyst, Goldman Sachs & Co. LLC

Q

Good morning. This is actually Arthur on for Adam. I was hoping we could tackle the inflation question a bit differently. Just looking at the updated guidance and if we take the midpoint of both ranges, it's about a \$0.09 downward revision. How much of that \$0.09 is attributable to increased inflationary pressures? As you can imagine, the \$0.02 to \$0.07 dilutive range leaves it a bit wide for interpretation in terms of how much is actually impacting the business for this year. And if you could also give some color as to what cost buckets those are in outside of feed and maybe by segment, that would be really helpful? Thank you.

James N. Sheehan

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

A

Well, we've talked about the inflationary pressure that exists with the business, if we think that pork inputs will be above last year, they will moderate, we believe, from third quarter, but there will still be significant pressure on inflation. Beef is going up, as I stated. It's still continuing to grow in the fourth quarter.

The freight issue isn't going away, so there's going to be pressure on freight. If anything, we've seen increases in freight cost recently. Jim has talked about the problems that we're incurring with ocean freight and the additional expenses that it's taking to overcome those challenges.

The labor issue is an issue that is probably the hardest to read right now. What is going to happen to labor, how quickly it will recover or will it recover at all and just the challenges in the supply chain are putting pressure throughout the organization. And those are the issues that we've addressed in our guidance, and we think that we've taken a fair approach to those issues. I think as far as how you categorize it, I would look at the pork and the beef inputs and identify that.

On the other hand, we're seeing tremendous recovery in the foodservice business, and we're still seeing strong demand in the retail. So, the demand is there for our products. We've priced appropriately. It's a matter of having the labor that's available to produce the product to meet the demand.

Arthur Almeida

Analyst, Goldman Sachs & Co. LLC

Q

Thank you. And I guess, on that point, with the labor shortages, is there any way you could quantify the magnitude of some demand that you weren't able to meet due to these labor shortages?

James N. Sheehan

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

A

Well, I think it's – as Jim said, it depends what week it is that we're being challenged. And as we talked about earlier, it's not just the labor that we have available, sometimes it's interruptions in the supply chain that it's categories that we didn't think we were going to have a problem that pop up. So, I would say that the constraint is significant, and it's across the – I can't think of a single segment that hasn't been impacted by this labor constraint.

Operator: Thank you. And our next question today comes from Jacob Nivasch with Credit Suisse. Please go ahead.

Jacob Nivasch

Analyst, Credit Suisse Securities (USA) LLC

Q

Hey. Thank you very much for the question. Just one quick one on pricing, but a little bit of a longer-term perspective here. You've talked about record sales here, but a lot of it is driven by pricing. And I'm just trying to think, once inflation presumably does subside, I know you guys have said in the past that pricing for you guys tends to be sticky.

So, I'm just trying to think, once inflation does subside, what does pricing look like when that time comes? Would we expect to see this kind of – this pricing – the full amount of pricing here to stick? Or I guess, what are you guys thinking, I guess, when that scenario comes?

James P. Snee

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

A

Yes. Thanks, Jacob. The key takeaway from our ability to price is through these cycles, we have demonstrated our ability to expand margins over time. So I think if you start with that as the premise, you'll get a good read on what we're expecting to happen.

Now as you go through each of the different businesses and channels, it will be different. You have our Grocery Products segment, which acts and looks more like a consumer products organization, so that pricing will stick.

You've got our Refrigerated Foods' retail business that has more commodity elements tied to the pricing. And so, you will see that move up and down based on the raw material performance, understanding of course, going back to my original statement that we have a history of being able to expand those margins, and that's really what drives our stickiness comment.

It doesn't mean that the pricing is going – that current level is going to stay in effect, especially in Refrigerated Foods. What we are able to do, though, is expand that pricing over time as raw materials moderate. That's how we think about stickiness and pricing for us.

Jacob Nivasch

Analyst, Credit Suisse Securities (USA) LLC

Q

Understood. Yes. Thank you.

James P. Snee

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

A

Yes.

Operator: And our next question comes from Rebecca Scheuneman with Morningstar. Please go ahead.

Rebecca Scheuneman

Analyst, Morningstar, Inc. (Research)

Q

Good morning and thanks for the question. So when I kind of look at how your Q3 shaped up, obviously, gross margins are lower. But also if you look at the SG&A line, once you strip out those one-time charges, that came in more favorably than I had been expecting. So I'm just kind of wondering like, are these dynamics a reflection of the current environment or is there something about the Planters business that has lower gross margins, lower SG&A expense.

James N. Sheehan

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

A

Well, I think that you have both, Rebecca. First of all, you do have the Planters business coming down and as we've said for a long time since the acquisition, [ph] we knew that (00:59:57) we'd be able to manage this business in a very efficient manner. And I think you're starting to see some of the things that we talked about when we did the acquisition that there's an efficiency here that we believe exists. And the first quarter has given us confidence in that belief. As Jim said, we have a higher sales base and we have not added SG&A at the same level. So I think that's the first thing to look at.

The other thing is, is that, there is an efficiency in the business that we've brought forward with. We've talked about Project Orion for a long time. It's adding efficiencies in our SG&A. One quarter in SG&A doesn't make a trend. But we believe that we have a more efficient operation coming out of 2021 that we had coming into it and we believe that, that efficiency is going to provide a long-term benefit to the company.

Rebecca Scheuneman

Analyst, Morningstar, Inc. (Research)

Okay. Great. Thank you very much.



Operator: And ladies and gentlemen, this concludes our question-and-answer session. I'd like to turn the conference back over to Jim Snee for any closing remarks.

James P. Snee

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

Thank you all for joining us today. We look forward to sharing more about our long-term growth strategy at our Investor Update on October 14.

In closing, it's clear that we've built a portfolio and business for long-term success. And our team is operating in an incredibly complex business environment, yet they've been able to deliver record sales results by continuing to execute our long-term growth strategy. While we still have work to do, I am incredibly grateful to and proud of all our team has accomplished in a difficult operating environment. Have a happy and safe Labor Day weekend.

Operator: Thank you. This concludes today's conference call. We thank you all for attending today's presentation. You may now disconnect your lines and have a wonderful day.

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