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Hormel Foods Corp. (HRL)

Q1 2022 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, and welcome to the Hormel Foods First Quarter 2022 Earnings Conference Call. All participants will be in listen-only mode. [Operator Instructions] After today's presentation, there will be an opportunity to ask questions. [Operator Instructions] Please note, this event is being recorded.

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

Nathan P. Annis

Director of Investor Relations, Hormel Foods Corp.

Good morning. Welcome to the Hormel Foods conference call for the first quarter of fiscal 2022. 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 Jacinth Smiley, Executive Vice President and Chief Financial Officer. Jim Snee will provide a review of the company's first quarter results, strategic initiatives and a perspective on the rest of 2022. Jacinth Smiley will provide detailed financial results and further commentary on the first quarter and our outlook.

The line will be open for questions following Jacinth'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 Standard Time. The dial-in number is 877-344-7529 and the access code is 3905859. 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 5 through 10 in the company's Form 10-K for the fiscal year ended October 31, 2021. It can be accessed on our website.

Additionally, please note the company uses non-GAAP results to provide investors with a better understanding of the company's operating performance. These non-GAAP measures include organic volume and organic sales. Discussion on non-GAAP information is detailed in our press release located on our corporate website. We have also posted supplemental information on the first quarter and outlook. This can be found on our Investors 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. I want to start off by thanking our dedicated team members around the world for, once again, achieving strong results in a complex and dynamic environment. The combination of our execution and balanced business model allowed us to deliver strong first quarter results, keeping us on track to achieve our sales and earnings guidance for the year. These results further demonstrate the importance of our strategy, the positive impact of our actions, and our team's ability to perform in challenging operating conditions. Our entire team can be proud of our accomplishments this quarter.

In the first quarter, our team delivered its fifth consecutive quarter of record sales and achieved high-quality earnings growth. Net sales surpassed \$3 billion for the second consecutive quarter, a 24% increase. Operating income also increased significantly, up 19%. Most importantly, demand for our products remained elevated across all our business segments and go-to-market channels. We increased advertising investments during the quarter to sustain our momentum.

Our One Supply Chain team once again demonstrated their resiliency and allowed us to deliver organic growth in our domestic value-added businesses for the quarter. From late December through January, our team experienced some of the heaviest operational impacts that we have seen since the start of the pandemic. These impacts stemmed from significant labor shortages due to the Omicron variant, severe upstream and downstream disruptions, and industry-wide operational challenges.

I want to again thank our One Supply Chain team for their tireless work and their unwavering commitment to employee safety in these challenging times.

Fiscal 2022 is an important year as we return to top and bottom-line growth. Our Path Forward, which we detailed at our Virtual Investor Day in October, represents the six strategic imperatives that will guide our actions over the next few years. These include expanding our leadership in foodservice, protecting and growing our core brands, aggressively developing our global presence, amplifying our scale in snacking and entertaining, enhancing growth of our ethnic and Food Forward portfolios, and continuing to transform our company.

To provide added color on the quarter as well as our long-term views on the business, I'd like to give an update on the progress we have made since October. In the first quarter, we again demonstrated our leadership position in

the foodservice channel. Sales were 51% ahead of last year. We continue to benefit from our direct sales force and differentiated portfolio, which is perfectly positioned to meet the needs of today's foodservice operators with labor and time-saving products. We saw improvement in almost every category across our portfolio of foodservice businesses.

Consumer demand for food away from home has been very strong. And according to recently published government and Technomic data, conditions are improving across the foodservice industry to help meet this demand.

Foodservice sales have risen at an average rate of approximately 25% over the trailing 12-month period, accelerating through the close of calendar year 2021. Operator sentiment also continues to improve from pandemic lows, and foodservice industry employment has made steady gains. These factors, coupled with the demand we are seeing for our products across all geographies in the US, support our positive views on the near-term and long-term health of the industry.

As we look forward, we plan to further expand our leadership position in areas like restaurants, hotels, colleges and universities and use the scale of the Planters brand to grow our company's presence in emerging growth spaces, such as convenience stores.

We also expect to protect and grow our core brands in fiscal 2022 and into the future. Our retail businesses grew sales 17% during the first quarter. We have leading positions in over 40 categories, with brands such as Hormel Black Label, SPAM, SKIPPY, WHOLLY and Jennie-O. Elevated demand for many of these core brands over the last two years has surpassed our ability to fully supply.

And in these highly inflationary times, having leading brands that connect to consumers in meaningful ways is vital to success. We understand the importance of brand stewardship. And in the first quarter, we increased advertising investments in each business segment to ensure our brands remain well supported, collectively increasing advertising investments by 38%.

The strong brand equity we have built over a decade has allowed us to simultaneously increase our household penetration, grow the size and our share in many of the categories in which we compete, and implement strategic pricing actions to help offset inflationary pressures. We have made excellent strides connecting with consumers in the e-commerce channel as well.

During the quarter, we exceeded overall category growth, with more than 12% of our IRI-tracked retail sales now coming from this particularly important and fast-growing channel.

Transitioning to our third priority, we need to aggressively develop and expand our global presence. Our International business is healthy and positioned for long-term growth despite issues affecting the first quarter. Similar to the broader industry in China, we experienced some demand softness, predominantly in foodservice, due to the country's COVID-related restrictions.

Additionally, limited railcar availability and US port congestion negatively affected our export business. As we look ahead, our export business is expected to benefit from demand for our global brands such as SPAM and SKIPPY. Our China business is expected to see growth from its scalable foodservice business as well as from retail, with momentum behind the SPAM brand and innovative snacking items such as beef turkey and SKIPPY Funky Nuts.

And we have made considerable progress growing our global presence through our partnerships in the Philippines, South Korea, Europe and Indonesia. We have great partners in these geographies who share our growth mindset.

To further support growth, we plan to continue to make many investments into our International business this year. During the first quarter, we increased brand investments in advertising. Later this year, we will open a new Asia Pacific research and development facility, which will support our operations in China and throughout Southeast Asia. And we have plans to further build out our infrastructure in the important Chinese market.

We expect to bring meaningful scale to other select global markets as well and we are making the necessary investments to succeed long-term.

Our fourth priority focuses on our next growth platform, snacking and entertaining. Snacking and entertaining cuts across all segments and channels, and we are ideally positioned to leverage our powerful and complementary portfolio of brands across salsa, guacamole, nut butters, nuts and premium deli meats.

Planters is a cornerstone to our snacking platform, and that business continues to perform at the high end of our expectations. We completed the supply chain integration of the Planters and Corn Nuts businesses in February. As a result, we expect continued synergies and improved customer service levels going forward.

As we discussed, when we announced the acquisition of the Planters business, we are on track to launch many new innovative items, including Planters Sweet & Spicy Dry Roasted peanuts and introduce a refresh to the branding and packaging. We're also investing in the brand, including our newest campaign, All or One. Seeing the great work of our teams has made me even more confident about where we can take this brand in the future and further strengthens our belief in the potential for Planters.

Our fifth initiative is to enhance the growth of our ethnic and Food Forward portfolios. Our MegaMex and Applegate businesses have been growing, and we are evolving our portfolio at a rapid pace to meet the changing needs of today's consumers. Our MegaMex business grew volume and sales during the first quarter, led by strong demand for WHOLLY products at retail. Applegate delivered another outstanding quarter, with growth across the portfolio from products such as breaded chicken, breakfast sausage and sliced meats.

Applegate has given us a clear competitive advantage in the natural and organic meat space and has provided a platform for some of our most important environmental work, such as regenerative agriculture. Finally, we need to continue to transform our company to enable future growth by modernizing our organization. Initiatives like Project Orion, One Supply Chain and our automation efforts are all focus areas, as is the work we are doing to transform the Jennie-O Turkey Store business.

As promised from our fourth quarter call, we want to give you an update on our Jennie-O Turkey Store transformation. Our priority has been to build a more demand-oriented and optimized turkey portfolio that is better aligned to the changing needs of our customers, consumers, and operators that will result in long-term growth, improved profitability and lower earnings volatility. To that end, we have taken numerous actions and will take many more actions to optimize our business model.

During the first quarter, we started to see the benefits of our actions of shifting from commodity to branded value-added products. For an example, as an industry leader in turkey, we are investing behind the Jennie-O brand to drive greater growth in our most profitable, high-growth product lines in retail and foodservice. In conjunction with driving improvement in our value-added products, we are also taking aggressive actions to optimize our portfolio.

Combined with increased pricing, our brand investments and SKU rationalization are leading to a healthier business.

From a supply chain perspective, we remain on track to close the Benson Avenue facility in Willmar, Minnesota, in the second quarter. Our Benson Avenue team members are currently transitioning to our newer and larger facility in Willmar, which will supplement our staffing levels.

To-date, the Jennie-O supply chain has largely been run separately from the rest of our supply chain due to it being vertically integrated. By the start of fiscal 2023, we will leverage our One Supply Chain capabilities to integrate all facilities into the broader Hormel Foods network.

As we integrate these plants into the Hormel Foods network and rationalize commodity SKUs, we will free up plant space for additional production capacity of many product lines that will service any brand in the Hormel Foods portfolio. This is a monumental step and one that will make our entire company more efficient.

Similar to the integration of the supply chain, we will integrate key business functions more deeply into the Hormel Foods organization. In addition to integrating IT services, finance and accounting, and HR, we integrated the R&D organization into Hormel Foods' R&D during the first quarter.

Looking to the remainder of the fiscal year, we will start the process to integrate other business functions, such as our selling organization and marketing teams into the broader organization. This integration will leverage the strengths of the parent company and the knowledge of Turkey to create a better business model.

Over time, we expect the Jennie-O Turkey Store business to achieve higher, more stable growth and improved profitability. We also expect other financial gains, including increased asset efficiency, higher manufacturing throughput, better labor utilization, and CapEx avoidance. We expect these changes will drive selling, general and administrative costs synergies of approximately \$20 million to \$30 million annually by fiscal 2023.

In addition to the progress we have made on our 2022 Path Forward, we continue to invest in our people, our partners, and our communities to deliver on our ESG commitments. During the first quarter, we distributed our annual profit sharing for the 83rd consecutive year. We continued our environmental stewardship work, with investments in additional wind energy projects, which strengthens our position in renewable energy.

We supplied donations to many causes, responded to crises where we could help and supported many local communities. Additionally, our Inspired Pathways Community College program continued to receive accolades and was awarded an Anthem Award for the most impactful corporate initiative in Education, Arts, and Culture. And because of our good work, we continue to be recognized.

We were recently named one of America's Most Responsible Companies by Newsweek, one of the World's Top Female-Friendly Companies by Forbes, and as a Best for Vets Employer for the ninth consecutive year by the Military Times.

With our strong start to the year in the face of challenging operating conditions, we are reaffirming our sales and earnings guidance for fiscal 2022. We expect net sales to be between \$11.7 billion and \$12.5 billion and for diluted earnings per share to be between \$1.87 and \$2.03 per share.

Our outlook for the remainder of the year assumes, among other things, elevated levels of demand across our go-to-market channels, margin improvement from our efforts to combat inflation, including pricing actions and a

positive shift in mix, strength from our high-growth brands and businesses including Columbus, Applegate and foodservice, continued Planters performance at the high end of our expectations, improved supply chain performance as labor pressures ease, and the benefit of new capacity for dry sausage, pizza toppings, bacon and other value-added products.

I believe our team has always had a keen competency to evolve and adapt as conditions change. We have certainly improved upon this competency over the last two years and we were able to leverage it again to drive growth in the first quarter. I expect our team will continue to navigate and overcome the challenging operating environment to deliver our growth goals this year. Our results-focused mentality is just another factor that makes our company and our Inspire team members uncommon.

At this time, I will turn the call over to Jacinth Smiley to discuss financial information relating to the quarter and provide more color on key drivers to our outlook.

Jacinth C. Smiley

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

Thank you, Jim. Good morning, everyone. I want to echo Jim's comments on how proud I am of our entire team and how we collectively rose above the challenges we encountered in the first quarter. During the first quarter, we delivered record sales of \$3 billion, a 24% increase. Organic sales increased 13% for the quarter. Gross profit increased \$89 million compared to last year, a 20% increase. This improvement was driven by strength in Refrigerated Foods, Jennie-O Turkey Store, and the addition of the Planters snack nuts business.

Gross profit margin was 17.7% compared to 18.3% last year. Pricing actions across all businesses did not fully offset double-digit increases in freight expenses and continued supply chain disruptions. We are encouraged by the quarter-over-quarter improvement in gross margin as our pricing initiatives catch up with the dramatic inflation we have seen over the past year. We increased advertising investments in all four segments to support the Planters, SPAM, Jennie-O, and SKIPPY brands as well as the Hormel pepperoni and Hormel chili product line.

For the quarter, advertising expense increased by 38% or approximately \$0.02 per share. SG&A expenses increased 15% compared to last year due to the addition of the Planters snack nuts business and higher advertising investments for our brands. SG&A as a percent of sales decreased to 7.4% from 8% last year. This speaks to our strong sales growth and disciplined cost management.

Operating income increased 19% to \$320 million. Operating margins were 10.5% compared to 10.9% last year. Operating margin increased sequentially from 10.4% in the fourth quarter. Interest expense increased \$6 million compared to last year, driven by the debt we took out in June to fund the acquisition of the Planters snack nut business. We expect a similar amount of interest expense for each quarter during fiscal 2022.

Our effective tax rate increased to 22.4% from 19.7% last year, a 270 basis points increase. Last year's tax rate benefited from a state tax settlement. Our effective tax rate guidance of 20.5% to 22.5% is unchanged from our prior outlook. The net result of all these factors was diluted earnings per share of \$0.44, a 7% increase over \$0.41 last year.

Turning to our segment results. Three of our four segments delivered sales and profit growth, which is a testament to our balanced business model. In total, segment profit increased by 13% as growth in Refrigerated Foods, Grocery Products and Jennie-O Turkey Store more than offset the decline in International. Refrigerated Foods volume decreased 4% and organic volume decreased at 5%. The decline in volume was due to our

strategic decision to restructure a pork supply agreement to reduce our exposure to low-margin commodity pork business.

Sales increased 19%, and organic sales increased 17%. Refrigerated Foods segment profit increased 15%, led by the strength in our foodservice business and decisive pricing actions we took across many of our branded businesses. The team was able to overcome double-digit increases in freight rates and significant supply chain challenges to deliver this impressive result. Like prior quarters, Refrigerated Foods continues to be negatively affected by production constraints due to labor challenges.

Market conditions for key inputs such as hogs, bellies, pork trim and beef trim remained elevated and above the year-ago levels. Further, most markets increased throughout the quarter, which can cause margins to narrow as our pricing catches up with input costs.

Looking at the first month of the second quarter, we continue to see increases in hogs, cutout and belly prices. Elevated levels of domestic and international demand, low levels of cold storage and industry-wide labor shortages continue to be material factors affecting protein production. Grocery Products volume increased 22% and sales increased 48% due to the addition of the Planters snack nuts business. Organic volume increased 1% and organic sales increased 7%.

Segment profit increased 8% due primarily to the addition of the Planters snack nuts business. This more than offset a decline at our MegaMex joint venture due to steep increases in avocado prices and significant increases in freight, steel, aluminum and other supply chain costs across the business. Production constraints also limited our growth in volume, sales and segment profit.

Jennie-O Turkey Store had an excellent quarter, with sales up 15% and segment profit up 62%. Improvements in foodservice, increased whole bird shipments and pricing actions across all categories contributed to the performance. Like our other businesses, Jennie-O Turkey Store also absorbed higher logistics and supply chain costs. Feed costs increased by over 35% compared to last year. We took decisive action last year to hedge most of our grain costs, which protects us from major shifts in market prices during the fiscal year.

The International segment had a challenging first quarter caused by COVID-19 related restrictions in China and US export logistics challenges, volume decreased 17% and organic volume decreased 19%. Sales decreased 3% and organic sales decreased 6%. Segment profit declined 19% due to lower sales and logistics challenges. We see the current challenges as more transient in nature and remain optimistic about our international growth opportunities.

Turning to cash flow. Operating cash flow from the first quarter increased 87% to \$384 million. Capital expenditures were \$50 million compared to \$40 million last year. Our target for capital expenditures in 2022 is unchanged at \$310 million. We paid our 374th consecutive quarterly dividend effective February 15 at an annual rate of \$1.04 per share, a 6% increase over last year. Dividend growth remains a high priority. We did not repurchase any shares during the quarter. We will repurchase shares opportunistically based on our internal valuation.

We ended the first quarter with \$3.3 billion in debt or approximately 2.3 times EBITDA. Although no mandatory debt repayments are required until 2024, based on our strong and consistent cash flow, we expect to make incremental payments as soon as the second half of 2022. We remain committed to maintaining an investment-grade rating and deleveraging to 1.5 times to 2 times EBITDA by 2023.

As Jim mentioned, we are reaffirming our sales and earnings guidance for fiscal 2022. A key factor in our outlook is the ongoing complexity of the current operating environment. We are managing several key factors, including input cost inflation and the performance of our upstream and downstream supply chain. We see elevated demand, both domestically and abroad, but disruptions from both suppliers and logistics partners are impacting our ability to fully meet the demand.

Our One Supply Chain team continues to improve the hiring and retention of team members and has developed many innovative strategies to mitigate the effect of labor shortages. With the strong demand that we continue to see across all our businesses, we are maximizing our production flexibility to produce the items that are most in demand, increasing internal capacity, leveraging our co-manufacturing partnerships to increase throughput and making improvements to transportation load factors.

We have been combating extreme input cost volatility and inflation over the past two years. Our experienced management team has done an excellent job managing profitability through multiple rounds of pricing actions, effective management of promotional expenses, strategic shifts in product mix, and disciplined management of SG&A.

Financially, the actions our team is taking should result in quarter-over-quarter improvement in operating margins throughout fiscal 2022. During my first quarter as Chief Financial Officer, I have been incredibly impressed with the accountability, commitment to results and pride I see across our entire company. This gives me even more confidence in our ability to deliver growth in fiscal 2022 and beyond.

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

QUESTION AND ANSWER SECTION

Operator: We will now begin the question-and-answer session. [Operator Instructions] The first question is from Ken Zaslow of the Bank of Montreal. Please go ahead.

Kenneth B. Zaslow

Analyst, BMO Capital Markets Corp.

Good morning, guys.

Q

James P. Snee

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

Hi, Ken.

A

Kenneth B. Zaslow

Analyst, BMO Capital Markets Corp.

Can you talk about elasticity, of where you're seeing it, where you're not seeing it? And how you're thinking about it for the next 6 to 12 months?

Q

James P. Snee

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

A

Yes. I mean really, Ken, we haven't seen any elasticity across any of the portfolio. As we've said, really strong demand across all channels in all categories. And for us right now, I mean, there is just so much noise in distribution, in fill rates, demand being strong. But we just haven't seen that elasticity yet.

As you would expect, we're continuing to monitor all the various dynamics, but just haven't seen it yet, and it's really, really hard, with all that noise, to draw a line in the sand to say when we're going to start to see it. You know it's going to come, but it's just really hard to project when that's going to happen given all the other issues I described.

Kenneth B. Zaslou

Analyst, BMO Capital Markets Corp.

Q

And then my follow-up question is, when you think about your capability to supply products and your production, supply chain, can you talk about from a time period, so last year, now, and now going a year forward, where have you seen the most supply constraints in your production? Where are you now relative to that? And where will you be in a year from that? And how does that change or help your sales and operating profit? And I'll leave it there, and I appreciate it.

James P. Snee

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

A

Sure. Thanks, Ken. Actually, I'm going to start with the last part. And obviously, a year from now, we expect to be in a much better position. And when we think about not only the continued improvement with labor that we're seeing across the entire supply chain, the added capacity that we've recently completed, projects that we have in the queue that we've talked about, and then lots of other small project as well as continuing to build out our co-manufacturing network, a year from now, we will be in a much better position.

As we progress throughout the balance of this year, we expect to be incrementally better as we go along. And so, the biggest driver right now is our ability to continue to add labor to our facilities. I'd say, right now, we've got about one-third of our plants that are fully staffed and have made progress across all of our plants. If you remember, in our last conversation, I talked about how we had made progress in some select plants. Now, we've made progress in all of our facilities. And all of that's going to lead us to be in an incrementally better position throughout the year.

Operator: The next question is from Tom Palmer of JPMorgan. Please go ahead.

Thomas Palmer

Analyst, JPMorgan Securities LLC

Q

Hi. Thank you for the question. Maybe to kick off, I just want to clarify the EBIT margin outlook. I think you said expect it to improve sequentially throughout the year. If I look, though, on EBIT margin, it looks like the second quarter on just kind of a seasonal basis is typically one of the stronger ones of the year and then you see the second half a bit weaker. So is it even, looking past seasonality, you expect to kind of have a linear progression of increases as the year progresses?

James P. Snee

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

A

Yeah. So, Tom, it's a great question. And as we've talked about, we're starting to see margins improve quarter-over-quarter. And really, the driver is our pricing, right? And so, our pricing is catching up with inflation. But of course, inflation continues to move further and further away from us. And as you think about pricing, there's really,

in my mind, three ways to think about it. There is the pricing that's fully implemented. There is pricing that we currently have in process. And then there is pricing that's really yet to come. And so, that's what's going to drive the margin improvement. And we do, for the rest of the year because of that pricing, strong demand, expect continued quarter-over-quarter improvement.

Thomas Palmer

Analyst, JPMorgan Securities LLC

Q

Okay. Thank you for that. And I guess, the follow-up would be on kind of the gross margin side. I think a quarter ago, the talk was gross margin expansion for the year. I assume that's still in place, just given the guidance. But maybe for the second quarter, should we look for gross margin to expand year-over-year? Or is that more a second-half event? Thank you.

Jacynth C. Smiley

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

A

Yeah. So the expectation, Tom, is exactly that, that we'll continue to see that expansion for the second quarter, but also continuing through the rest of the year as well.

Operator: The next question is from Peter Galbo of Bank of America. Please go ahead.

Peter T. Galbo

Analyst, BofA Securities, Inc.

Q

Hey, guys. Good morning. Thanks for taking the question.

James P. Snee

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

A

Yeah.

Peter T. Galbo

Analyst, BofA Securities, Inc.

Q

Jim, in your prepared remarks and in the press release this morning, you spoke pretty positively about Planters. It seems like in some of the Nielsen data, though, there has maybe been a bit of a disconnect, and I don't know if that's around service level issues or untracked channels. So, I was just hoping, as service levels improve, do you expect to see the scanner data start to get better? Can you just give us a more full picture on exactly what you're seeing at Planters that might be disconnected from the data? Thanks.

James P. Snee

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

A

Yeah. I'd say, it's a great question, Peter, and you've hit it right on the head. I mean, we are optimistic about the Planters business, and there's a couple of things to consider. The IRI data only covers a portion of the business, albeit a large portion. There is still a significant portion in our foodservice or convenience channel that's really off to a good start as well.

But your comment is exactly right is that we have had service level issues in Q1. It's fair to say that we've had a disproportionately amount of lower fill rates across the board. We talked about how we now have this business under our full control as of Q2. And in the first period of Q2, I mean we've already seen improvements in fill rates.

And so, the team has done a really nice job with Planters and doing what we said we were going to do in terms of how we invest in the advertising.

Of course, we only had our Super Bowl ad that we ran, the work that we're doing in innovation, introducing a new sweet and spicy flavor with packaging innovation yet to come. Our sales team, now that they've got their arms around the business are doing a nice job expanding distribution. And then I mentioned the foodservice channel with convenience stores really have an impact there as well. So that's why we're so optimistic. But your read through in terms of service levels and fill rates in Q1 is exactly the issue in the short term.

Jacinth C. Smiley

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

A

Yeah. And just to add to that, with all that Jim has just mentioned, we expect Planters to continue to perform at the top end of the guidance that we have given.

Peter T. Galbo

Analyst, BofA Securities, Inc.

Q

Okay. No. That's helpful. Thank you for that. And maybe just on Jennie-O, helpful detail around the SG&A savings for 2023. I was just curious though, I think last quarter you had mentioned maybe we'd get a more detailed breakout this quarter on upfront costs related to shutting down the plant and some of the other transitional costs. And then as well on Jennie-O, the comment on feed costs, up 35%, is that inclusive of your hedging? Or is that just what cost would be up if you weren't hedged, I guess? Thanks very much.

James P. Snee

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

A

Yeah. So we'll probably tag-team this one, Peter. As we think about what's happened in the Jennie-O operating environment, obviously, it's become an incredibly dynamic this quarter, when you see what's happened with some of the fundamentals, all of which are favorable. And so it's really hard to go through line by line in such a volatile environment. The key takeaway remains so that there's a long-term strategy here that will alter this business to become more demand-oriented. And that's really the most important takeaway in all of this.

And so the team has done a lot of great work in terms of how we are going to optimize this business over the long term, how we're going to leverage the strengths of both Jennie-O Turkey Store and the parent company. Obviously, we talked more about the integration of some of the sales and marketing efforts going forward. And I mean, those are the things that are going to get us to the long-term strategy of that demand for key value-added products over the long term. And so that's really the key takeaway. I'll let Jacinth maybe talk a bit more about the grain prices.

Jacinth C. Smiley

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

A

Yeah. As it relates to the grain prices, certainly, the costs that you're seeing and the prices that we're seeing is included in them in what we have hedged. And so we are more hedged than normal. So we feel good about being able to just cover down in some of that headwind from a grain price perspective.

Operator: The next question is from Rupesh Parikh of Oppenheimer. Please go ahead.

Rupesh Parikh

Analyst, Oppenheimer & Co., Inc.

Q

Good morning. Thanks for taking my question. So just given your exposure to both foodservice and retail, I was just curious how you guys think about maybe normalization of food-at-home demand in the coming quarters, especially with COVID cases going down now?

James P. Snee

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

A

Yeah. I mean it's really hard, again, Rupesh, to say when that's going to happen, what behaviors have changed. What we do know is from a foodservice perspective, there is pent-up demand. This has been a bit of a roller coaster ride over the last two years in terms of starting and stopping, consumers being able to get out and travel, go on vacation, then actually have to retreat back to the home.

And so again, it's hard to project exactly when and how those shifts are going to take place. The important part here is how we've built this portfolio. The balance that we have across the organization, both foodservice and retail. So as that shift occurs, we're going to be well prepared to take advantage of it. But I do think, again, the foodservice business has obviously demonstrated incredible growth and we really don't see any signs of slowing down because of that pent-up demand that I described.

In addition to that, it's the great work that our direct sales team is doing to connect with operators who, even though they're seeing improvements in labor, they still have challenges. And so all of that, again, leads us to be very optimistic about the entire portfolio and the intentional balance that we've built across the portfolio over the years.

Rupesh Parikh

Analyst, Oppenheimer & Co., Inc.

Q

Okay. Great. And then maybe just one follow-up question. So on MegaMex, I know there's a smaller contribution this quarter due to some of the cost pressures. Do you expect that contribution to improve in the future quarters?

James P. Snee

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

A

Yeah. I mean I do think the avocado situation was a bit out of the ordinary for this time of the year, and so we do expect that business to get better throughout the year.

Operator: The next question is from Ben Theurer of Barclays. Please go ahead.

Benjamin M. Theurer

Analyst, Barclays Capital Casa de Bolsa SA de CV

Q

Good morning, everyone, and thanks for that. I actually wanted to follow up on MegaMex, if I can, one moment. Can you elaborate how the situation has now turned out in terms of the supply of some of the avocados that's coming in? I mean they received some big disruption. Are you having some inventory issues here? And when do you think that is going to be resolved? That would be my first question. Thank you.

James P. Snee

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

A

Yeah. No, Ben, we don't have any supply issues. Product is – a lot of the product is actually produced in Mexico. What we are – I mean what we have is obviously the runoff in the cost of the avocados that's impacted the performance of the business in the short-term.

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

Q

Okay. Perfect. And then if we look into Jennie-O, I mean, obviously, it was a significantly better quarter, and thank you very much for elaborating on that. Now, as we look forward and all the strategic initiatives you've talked about, how should we think about the level of profitability for Jennie-O going forward? Is it about to get it back to a more, call it, branded food level, in the low to mid-teens? Or is there still going to be somewhat of volatility just because of the commodity piece you won't be able to get rid of completely?

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

A

Yeah. Ben, it's a great question. From our point of view, the work that we're doing is being done to eliminate the volatility in the earnings. And so by doing this, we know that we're going to be able to improve the quality of earnings over time and reduce the volatility. And so really, that's how you should think about it. As we're sitting here today, you've got obviously, breast meat prices at significantly higher prices. You've got corn and soy at very high prices. So there's just a lot of moving parts and a lot of volatility. But the big driver, again, the most important thing to take away is that this is going to be a demand-oriented businesses – demand-oriented business that will have less volatile earnings over time.

Operator: The next question is from Michael Lavery of Piper Sandler. Please go ahead.

Michael S. Lavery*Analyst, Piper Sandler & Co.*

Q

Thank you. Good morning.

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

A

Hi, Michael.

Michael S. Lavery*Analyst, Piper Sandler & Co.*

Q

You mentioned the elasticities and how they're holding up. I just want to come back to that and see if you can elaborate on what your assumptions are going forward in your guidance. Do you expect that to continue? Or do you, at least for modeling purposes and guidance, assume it reverts back to more normal levels or something in between?

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

A

Yeah. I mean right now, Michael. I mean, we expect it to continue because it really is all about supply. And just it goes back to the point about all the noise that's out there in distribution, fill rates, strong demand. And really, until some of those issues work themselves out, it's going to be hard to prognosticate about elasticities. Do we expect there to never be elasticities? Again, no. But what we do know is that we've got to solve – continue to solve the supply side of the business, and then we'll have a better view on elasticities over time.

Michael S. Lavery

Analyst, Piper Sandler & Co.

Q

Okay. That's helpful. And just also following up on Planters, I certainly appreciate there's some supply disruptions or service levels, you called that out pretty broadly. But I want to make sure I understand it, that would seem to impact your shipments and make those worse than the sales growth we see in the scanner data, but our numbers are showing this kind of high single-digit declines or even slightly more in January.

Do you see selectively where some regions or retailers are performing better than that on a sell-through basis that you would point to the supply disruptions as how the business is doing better than you think? Or what are your expectations for this level on the high side and it's coming through where you would have expected?

James P. Snee

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

A

Yeah. It's like – it's a combination of all those things. I mean, we are seeing some retailers who are continuing to perform better. I referenced the other part of the business in foodservice. And then until we had total control of the business, we were expecting some of these disproportionately lower fill rates and then that came to fruition. So it is, it's a little bit of a rethink.

What we do know and what we're so optimistic about is having this business under our control, full control operationally, total supply chain, obviously, the sales part. It just allows us to be able to run the business the way that we want to run the business.

And then I talked about T-stores and foodservice, but you've also got the club channel that's not included in the scanner data either. So there are parts that aren't in there. And you add that to the supply chain issues, we feel like we've got it under our control. We're ready to continue to drive this business forward.

Operator: The next question is from Robert Moskow of Credit Suisse. Please go ahead.

Robert Moskow

Analyst, Credit Suisse Securities (USA) LLC

Q

Hi, there. Jim and Jacinth.

James P. Snee

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

A

Hi, Rob.

Robert Moskow

Analyst, Credit Suisse Securities (USA) LLC

Q

A couple of questions. This is more backward looking. But the decision to have a Super Bowl ad probably wasn't yours, it was probably by prior management. But typically, you do those ads when you know that retailers can merchandise aggressively around it, you do it for the retailers. But you did at this time at a time of supply chain challenges. Can you talk about whether this ad created the goodwill with retailers you hoped it would? Or did it cause any issues?

And then secondly, regarding the assumption on margins getting progressively better, does that assume that your costs kind of level out as the year goes on? Or have you included an assumption of continued inflation throughout the year?

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

A

Yeah. Thanks, Rob. You're right on the Super Bowl ad, obviously, we had a – there was a commitment to that work. But I would say that it didn't build any ill will with retailers. Supply disruptions are so broad-based in today's environment. That wasn't an issue. It did accomplish exactly what we wanted it to do in terms of brand building, making sure that we were getting the impressions in the marketplace that we wanted to get. To your point, we were able to get still a lot of display activity. But we would consider the Super Bowl ad a success.

And then in regards to margins, we have built in continued inflation throughout the year. We've also built in some continued pricing. As I said, we've got pricing that's both in process and pricing that's yet to come. That's going to contribute to that margin improvement.

Robert Moskow*Analyst, Credit Suisse Securities (USA) LLC*

Q

Okay. And just a follow-up. Does it also assume that your labor issues get sequentially better during the course of the year, too?

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

A

Yeah. For sure, Rob. Absolutely. We've seen some improvement, but we expect that to continue throughout the year.

Operator: The next question is from Ben Bienvenu of Stephens. Please go ahead.

Ben Bienvenu*Analyst, Stephens, Inc.*

Q

Hi. Thanks. Good morning. So, I want to ask about the International business, and specific to the M&A strategy that you expect to deploy there. That business has, I know, become a prominent piece of your long-term strategy. Do you expect the opportunity for growth to be driven disproportionately by M&A versus organic growth? And given kind of the debt profile of the business right now and the leverage profile, which is very manageable, given the cash flow of the business, how aggressive are you in terms of pursuing M&A in that business at the moment?

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

A

Sure, Ben. A couple of questions in there. So, we are very optimistic about the International business over the long term. We expect these logistics challenges to be temporary, same with the COVID restrictions that we experienced in China.

What we're so optimistic about is the platform that we have built and continue to build across the entire International business. The strongest part of that foundation is in China, where we've been the longest, we've learned a lot about the business, we've added infrastructure and feel like we can continue to leverage what we

already have and continue to scale up that business. And not just in China, but also throughout Asia Pacific, because of what we've done in China.

And so, we have not backed off at all of our M&A strategy, whether internationally or domestically, to be honest with you. We're continuing to look for those opportunities that fit into the strategic initiatives that I laid out in my prepared remarks. So, we know that we have the financial wherewithal. We have the structure in parts of the world where we can do additional M&A. It's all about finding the right opportunity at the right time. And we continue to prospect for those opportunities internationally and domestically.

Ben Bienvenu

Analyst, Stephens, Inc.

Q

Okay. Great. Revisiting the repositioning of the JOTS business, you characterized the savings, the \$20 million to \$30 million of savings, I think as G&A. But it sounds like the breadth of some of the actions you're taking there might extend beyond just G&A savings. Should we think of that \$20 million to \$30 million as a baseline and incremental rationalization and supply chain savings stacked on top of that? Or would those broader actions be contained within that \$20 million to \$30 million that you referenced?

James P. Snee

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

A

Yeah. You're thinking about it the right way that that would be the baseline and there will be additional opportunities.

Operator: The next question is from Adam Samuelson of Goldman Sachs. Please go ahead.

Adam Samuelson

Analyst, Goldman Sachs & Co. LLC

Q

Yes. Thank you. Good morning, everyone. I was hoping to go back to Grocery. And obviously, you talked about some of the discrete pressures that MegaMex and you can kind of see that with some part of the equity earnings line being down year-on-year at the corporate level. But you still have the Planters acquisition contribution in there.

So I'm just trying to get a sense on maybe ex-MegaMex, ex-Planters, there would seem to be a pretty significant year-on-year profit decline implied by the fiscal first quarter results. You talked to especially packaging inflation. But maybe just talk a little about the rest of the portfolio, between the canned meats and nut butters and what kind of you're seeing there from a margin perspective, and how we should think about that going forward?

James P. Snee

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

A

Yeah. There is a couple of things there, Adam. I mean, the first thing is that the demand across the portfolio remains exceptionally strong. And as we've said several times, we cannot fully supply all of that demand. GP had a significant impact in terms of inflation in freight, steel, aluminum, trim, avocado. So, it really was across the board and broad based. The thing that we have done, obviously, is we've taken pricing to offset that. And we've got, again, pricing that's in process and some pricing that we're evaluating that can be yet to come. And so, they have had that significant inflationary impact, but the demand across the business remains extremely, extremely strong.

Adam Samuelson

Analyst, Goldman Sachs & Co. LLC

Q

Okay. All right. That's helpful. And then, just over in Refrigerated, I mean organic volumes were down on a year-on-year basis. And I imagine there's at least some elements of the new pork supply agreement, having less kind of fresh pork running through that business. But can you help us think about the organic volume trajectory moving forward with some of the new capacity that you have? I'm just trying to think about once we hit a peak on pricing, I mean the way you grow the business, it's got to be volume over time. And I'm just trying to think about how we get there.

James P. Snee

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

A

Yes. So, you're exactly right, Adam. The decline was due to the effect of the new pork agreement. But the biggest driver for us right now is this added capacity. And so, we've got our pepperoni capacity that's up and running in Omaha. We've started additional bacon capacity in a number of different locations. We've talked about other projects and building out our co-manufacturing network. And all of those are having a very, very positive impact on Refrigerated Foods because, again, both the retail and foodservice demand remain incredibly, incredibly strong.

Operator: The next question is from Eric Larson of Seaport Research Partners. Please go ahead.

Eric Larson

Analyst, Seaport Global Securities LLC

Q

Yeah. Thank you and thanks for taking my questions. Good afternoon – good morning, everyone. So, the question – let me just step back and maybe ask the question on pricing a little differently, Jim. So without, you were not highlighting specific products that you may or may not have priced. What percentage of maybe Grocery revenue still requires further pricing that you may not have taken already? Maybe that's a better way to kind of clarify it.

James P. Snee

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

A

Yeah. I mean – so look, I just want to make sure I understand the question, Eric. I mean, we've taken pricing on everything. So there's, again, some pricing that's fully implemented. We've got some pricing that's in process. We've got pricing that's yet to come. And then we're still evaluating the need for future pricing. So we're pretty aggressive on the pricing front in GP and Refrigerated Foods.

Eric Larson

Analyst, Seaport Global Securities LLC

Q

Okay. Thanks. So my follow-up question is, can you give us – it's a pretty dynamic environment in the meat protein sector with pork. We – it looks like the USDA is looking for lower hog production this year, maybe 1% to 2%. It looks like maybe you've got really high soy meal costs. So it's farmers – incentive for farmers to maybe increase production is not as great, at least right now. And maybe some of the Chinese demand might be backing off after a couple of years of really strong demand. So can you kind of give us a feel for how your pork and your hog costs might look for the remainder of the year?

James P. Snee

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

A

Yeah. I mean the biggest thing there, Eric, is they're going to be elevated. For all the reasons that you described, we do expect them to continue to be elevated and we expect them to continue to be volatile. I mean, the other element of this to consider is labor. And we do expect to see continued improvement in labor. But we've talked in the past about raw materials that are impacted by labor and pork trim. And so as we continue to get more labor, we'll be able to do more boning and get more pork trim, but we also know that all the variables you described will have an impact leading us to those higher costs.

Operator: This concludes our question-and-answer session. I would like to turn the conference back over to Jim Snee for closing remarks.

James P. Snee

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

Well, thank you, everyone, for joining us this morning. I do want to take a moment to recognize Nathan Annis, who is completing his final earnings call as Director of Investor Relations as he transitions into his new role of Vice President of Corporate Development. Nathan has done a great job helping us to evolve our Investor Relations messaging over the last five-plus years. I know he'll be equally successful in his new role.

And replacing Nathan is Dave Dahlstrom, who has been alongside Nathan over the last several years and is well prepared to assume this very important role. I want to personally congratulate both of them as they begin their new assignments.

In closing, we remain very optimistic about our business and we are well prepared to navigate the balance of our fiscal 2022. Again, thank you for joining us, and have a great day.

Operator: The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.

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