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Hormel Foods Corp. (HRL)

Q2 2022 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning and welcome to the Hormel Foods Second 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 David Dahlstrom, Director of Investor Relations. Please go ahead.

David W. Dahlstrom

Director-Investor Relations, Hormel Foods Corp.

Good morning. Welcome to the Hormel Foods' conference call for the second 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 will provide a review of the company's second quarter results, an update on business initiatives, and a perspective on the remainder of fiscal 2022. Jacinth will provide detailed financial results and further commentary on the second 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're welcome to get back into the queue. An audio replay of this call will be available beginning at noon today Central Time. The dial-in number is 877-344-7529 and the access code is 8061295. 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 our most recent annual report on Form 10-K and quarterly reports on Form 10-Q which can be accessed at hormelfoods.com under the Investors section. 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 net sales. Discussion on non-GAAP information is detailed in our press release and located on our corporate website. We have also posted supplemental information on the second quarter and our outlook. This can be found on our investor website, investor.hormelfoods.com.

I will now turn the call over to Jim Snee.

James P. Snee

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

Thank you, David. Good morning, everyone. Our team continues to successfully navigate some of the most difficult operating conditions in the company's 130-year history as we again delivered strong top and bottom line growth this quarter. I want to express my gratitude to the entire team for their commitment and ability to drive results. There are many examples across our company of our results matter focus, and I would like to specifically acknowledge two teams who showed incredible dedication and determination during the last quarter.

First, I want to recognize our Jennie-O Turkey Store team. In March, highly pathogenic avian influenza or HPAI was confirmed in our supply chain, and our team quickly and effectively mobilized into crisis mode. This involved

working long hours over the course of many weeks to protect the safety of the turkey flux, provide transparent communication to customers and operators, and plan for future business interruptions all while operating the day-to-day business. This was compounded by severe weather in early May which also impacted several facilities within the supply chain. Our Jennie-O team went through a lot this quarter, showing unwavering commitment and resolve in the face of some exceedingly demanding situations. I thank them for the work they've accomplished and for the work yet to come.

Second, I would like to applaud our team in China for their incredible execution during truly unprecedented times. Strict lockdowns forced the partial closure of two of our manufacturing facilities. Some of our team members volunteered to sleep and live inside the facilities for 10 days to ensure the plants remained operational until normal production could resume. Simultaneously, our sales and marketing teams drove outstanding retail sales gains in anticipation of widespread lockdowns. The ingenuity, resourcefulness, and grit displayed by our entire team in China was truly commendable and another example of what makes our company uncommon.

In the second quarter, our team delivered its sixth consecutive quarter of record sales and third consecutive quarter of earnings growth. Operating margin also improved compared to the first quarter, an indication that our balanced business model and efforts to mitigate inflationary pressures are working. Customer and operator demand for our leading brands remained robust as we continue to realize the benefits of investments in our direct sales force, diversified product portfolios, increased advertising, brand building, and innovation. Across all channels, our brands have responded well to pricing actions and we are actively managing pricing and promotional levers to ensure the long-term health of our brands and the categories in which they compete. We also made meaningful progress across our supply chain during the quarter where our investments in capacity and recovery in staffing levels contributed to improved fill rates, inventories, and production volumes.

One of our most important strategies has been to create a balanced, flexible, and diversified business model able to withstand market volatility, business fluctuations, and other unforeseen events. As our second quarter and first half results clearly demonstrate, our strategy to bring balance into our business continues to differentiate Hormel Foods from others in the industry. One of the ways we do this is through our channel diversification. In the initial stages of the pandemic, we leaned heavily on our retail businesses, both domestically and internationally, to drive growth. In the current environment, we are growing with the foodservice industry through its recovery and continuing to meet elevated demand at retail.

From a top line perspective, we drove 15% growth from our retail businesses in the second quarter and continued to see elevated demand for our leading brands, including WHOLLY, SKIPPY, Hormel Square Table refrigerated entrees, SPAM, Hormel Gatherings, Jennie-O, Columbus, and Applegate. We are also seeing our investments in the e-commerce channel pay dividends with solid above-category sales growth and share gains. As measured by IRI, sales increased 5% for the quarter, ending with a strong April. E-commerce constitutes around 12% of our tracked retail sales and is an important part of our future growth.

We demonstrated our leadership position in the foodservice channel again during the second quarter, driving sales growth of 32% compared to last year. Growth was extremely balanced with strength in both Refrigerated Foods and Jennie-O Turkey Store. We have made substantial gains in the fast-growing convenience store channel in large part due to the scale the Planters brand brings to our company. Growth from the Planters and Corn Nuts businesses in this channel is enabling expanded placements of other products. Recent wins in the retail and snacking space include SPAM, Chili, SKIPPY Peanut Butter, COMPLEATS, Black Label Bacon and Egg Bites, Columbus Snack Trays, Justin's Items, and Hormel Gatherings Party Trays. Additionally, we placed premium foodservice items such as Austin Blues Barbecue, Fire Braised Meats, and Bacon 1 Pre-Cooked Bacon

to be used in prepared items in this channel. Like e-commerce, in the retail channel, convenience stores provide an important part of our future growth in foodservice.

Internationally, we are continuing to make progress to bring even more balance to the company. Our business in China is a great example of this. This quarter, we again experienced demand softness in foodservice due to the country's COVID-related restrictions. Our team quickly pivoted its resources from foodservice to the retail channel. Sales of SPAM and SKIPPY surged, and our team was also able to effectively redirect foodservice items to food security programs to help supply those experiencing lockdowns. Our strategy to meet consumers where they want to eat with a broad portfolio of products, from mainstream to premium, both domestically and internationally is a strategy that has served us well and will continue to serve us well into the future.

From an earnings perspective, our Jennie-O Turkey Store segment had an outstanding quarter as its ability to adjust to current market conditions and meet strong foodservice demand drove higher results. Likewise, our foodservice businesses and Refrigerated Foods were able to price for inflation and deliver excellent volume growth. These businesses more than offset higher freight expenses for all segments and the earnings decline in Grocery Products, which absorbed significantly higher costs for certain inputs such as avocados, protein, and packaging. We have announced another round of pricing actions across our Grocery portfolio to help mitigate these inflationary pressures but will, in the meantime, lean into our balanced model as we did this past quarter. The balanced business model has been a key driver behind our recent success and our long-term growth. We remain confident in our ability to withstand volatile economic conditions and market cycles through our continued focus on balance.

We successfully completed the integration of all aspects of the Planters snack nuts business during the second quarter and the business continues to perform at the high end of our expectations. During the cutover period in February, we experienced lower fill rates as we fully transitioned inventory into our logistics network and assumed control of the entire supply chain. While this did have a short-term impact on sales and consumption, we have seen improvements in customer service levels and expect consumption data to show continued improvement in the coming months. As we celebrate one year of owning the Planters business, I am proud of the excellent progress we have made on our commitments from last June. We have invested heavily behind the Planters and Corn Nuts brands. We are on track to capture the synergies identified during diligence, and we have leveraged this business to amplify our scale in snacking and entertaining.

After an excellent first quarter and significant profit growth in the second quarter, our Jennie-O Turkey Store team is facing an uncertain period ahead due to the impacts and risks to its supply chain from HPAI. Similar to what we experienced in 2015, HPAI is expected to have a meaningful impact on industry poultry supplies over the coming months, including large supply gaps in the Jennie-O Turkey Store vertically integrated supply chain beginning in the third quarter. On a positive note, it appears that the biosecurity measures the company has implemented since 2015 have provided additional protection against the virus as the number of company-managed turkeys impacted to-date is 25% lower than during the previous event. Breast meat prices have already risen to levels higher than any point in 2015, currently trading above \$6 compared to the previous all-time high of \$5.85. We have seen increases in other turkey markets as well.

From a cost perspective, feed prices are significantly higher with corn and soybean meal up more than 125% and 40% respectively as of early May. Additionally, there is further upside risk to feed prices with later plantings due to cold and wet weather across the Midwest this spring. The cost of production labor at company manufacturing facilities has also increased more than 50% on average compared to 2015. Our team is taking the appropriate actions to protect the health of the turkeys across our supply chain, managing through operational challenges caused by the outbreaks and adapting to changing business conditions.

While simultaneously managing through the impacts of HPAI, our team made progress on the Jennie-O Turkey Store business transformation. During the second quarter, we closed the Benson Avenue facility and successfully transferred approximately 200 employees to the newer and larger manufacturing facility in Willmar. We remain on track to integrate business functions, consolidate the Jennie-O Turkey Store supply chain into the broader Hormel Foods One Supply Chain, and drive SG&A cost synergies of approximately \$20 million to \$30 million annually by fiscal 2023. Above all, the team is focused on creating a business model that is better aligned to the changing needs of our customers, consumers, and operators to drive long-term sustainable growth.

I also want to provide an update on the great work our team is doing to fulfill our ESG commitments and achieve our 20 By 30 goals. During the second quarter, we announced we are on track to match 100% of domestic energy use with renewable sourcing by the end of 2022. We announced that our Justin's brand is transitioning to jars that use 30% less plastic. We were ranked 57 on the US Environmental Protection Agency's Fortune 500 list of the largest green power users. We were named one of America's Most Trustworthy Companies by Newsweek. And in May, for the 13th time, we were named one of the 100 Best Corporate Citizens by 3BL Media. This ranking recognizes outstanding environmental, social, and governance transparency and performance. We are proud and honored to continue to be named a top corporate citizen.

Lastly, I want to share a recent success story from our Inspired Pathways free community college program. This week, we hired the first individuals from the program to participate in paid summer internships. This marks yet another example of why we believe this program can be generational for our employees, their dependents, and for the future of the company.

We are re-affirming our sales guidance range of net sales between \$11.7 billion and \$12.5 billion and narrowing the earnings range of \$1.87 to \$1.97 per share. We are confident in our ability to deliver our sales guidance given robust demand for our brands across the retail, foodservice, and international channels; improvements in our supply chain, investments in capacity; and from strategic pricing actions. From an earnings perspective, we expect a strong finish to the year from our Refrigerated Foods business. We anticipate a fourth quarter improvement from pricing actions taken across our Grocery Products portfolio. We are navigating the impact of HPAI on the Jennie-O Turkey Store supply chain and external factors affecting the International & Other segment, including current export logistics challenges and COVID-related lockdowns in China. Our teams have actions in place to manage through these challenges and drive results for the company.

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

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

Thank you, Jim. Good morning, everyone. We delivered another quarter of record sales of \$3.1 billion, a 19% increase compared to last year. Organic sales increased 10%. Gross profit increased \$77 million compared to last year, a 16% increase. This improvement was driven by strength in Jennie-O Turkey Store, growth from Refrigerated Foods, the addition of the Planters snack nuts business, and strategic pricing actions to offset inflationary pressures. Gross profit margin was 17.9% compared to 18.3% last year and 17.7% in the first quarter.

SG&A expenses increased 12% compared to last year due to the addition of the Planters snack nuts business and higher advertising investments in our brands. SG&A as a percent of sales decreased to 7.3% from 7.7% last year. This speaks to our continued strong sales growth and disciplined cost management. We increased

advertising investments in the second quarter to support the Planters, Columbus, and SPAM brands. For the quarter, advertising expense increased by 27% or approximately \$0.01 per share.

Operating income increased 16% to \$335 million. Operating margins were 10.8% compared to 11.1% last year. Operating margin increased sequentially from 10.5% in the first quarter. As anticipated, we delivered quarter-over-quarter improvement in operating margins and made continued progress in mitigating the significant inflation we experienced. Interest and investment income declined \$9 million primarily due to lower results from our rabbi trust which generally tracks with equity markets. Interest expense increased \$7 million compared to last year.

Our effective tax rate was 18.7% for the quarter, down from 22.1% for the same period last year. The lower rate this quarter was primarily due to tax benefits from increased stock option exercises. Our effective tax range guidance of 20.5% to 22.5% is unchanged from the prior outlook. The net result of all these factors was diluted earnings per share of \$0.48, a 14% increase over \$0.42 last year.

Turning to cash flow. Operating cash flow for the second quarter increased 24% to \$193 million. Operating cash flow for the first half of 2022 increased 60% to \$577 million. Strong earnings growth has been a key catalyst to these increases. Capital expenditures in the second quarter were \$78 million compared to \$45 million last year. During the quarter, we benefited from new capacity, including our pepperoni expansion at Papillion Foods plant in Nebraska and raw bacon investment in our plant in Austin. Our fiscal 2022 target for capital expenditures is unchanged at \$310 million.

We paid our 375th consecutive quarterly dividend, effective May 15, at an annual rate of \$1.04 per share. We did not repurchase any shares during the first half. We will repurchase shares opportunistically based on our internal valuation. We expect to make our first payment and begin our deleveraging related to Planters acquisition in the back half of the year. We remain committed to maintaining an investment grade rating and deleveraging to 1.5 times to 2 times EBITDA by 2023.

Turning to our segment results. Segment profit increased by 15% as growth in Jennie-O Turkey Store and Refrigerated Foods more than offset declines in Grocery Products and International & Other. The company benefited from Planters sales of \$239 million in the quarter and the related profit contribution. Refrigerated Foods volume declined 13% and organic volume decreased 14%. The decline in volume was primarily due to our strategic decision to restructure a pork supply agreement, reducing our exposure to low-margin commodity pork business and better-aligning resources to value-added growth. Sales increased 13% and organic sales increased 11%.

Refrigerated Foods segment profit increased 3%. Refrigerated Foods saw meaningful improvement in many areas across the supply chain due to improved labor availability and additional production capacity helping to offset production constraints. Grocery Products volume increased 19% and sales increased 39% due to the addition of the Planters business. Organic volume increased 2% and organic sales increased 7%. Segment profit declined 9% as organic sales growth and the addition of Planters snack nuts business was unable to offset considerable inflationary pressures and lower results from MegaMex.

Jennie-O Turkey Store had another excellent quarter with sales up 16% and segment profit up nearly 400%. Higher commodity prices and improved foodservice sales drove the substantial improvement in segment profit. HPAI had an immaterial impact on the segment's results for the second quarter. For the International & Other segment, volume was down 14% and organic volume declined 15% due in large part to lower commodity sales associated with the company's new pork supply agreement. Segment profit declined 3% as profit growth in China did not overcome lower results from the export business.

We continue to battle extreme input cost volatility and inflation. We have seen increases across all our inputs, including raw materials, packaging and supplies, freight and logistics, and labor. We expect stabilization as demand and supply come more into balance and anticipate certain costs such as labor to be more structural in nature. Protein markets have generally remained elevated and above year-ago and historical levels. For context, pork prices as measured by the USDA composite cutout were 6% higher in the second quarter compared to last year and more than 30% higher than the five-year average. We have seen similar dynamics across beef and chicken markets and witnessed an acceleration in the turkey market during the quarter due to the emergence of HPAI.

Feed also continues to be highly inflationary. Our hedging program at Jennie-O Turkey Store has effectively helped us manage risk near-term. Looking to the back half of the year, we expect protein and feed costs to remain volatile and elevated compared to historical levels. Costs for packaging and supplies are up double-digits on average over last year and accelerated during the most recent quarter. Trucking freight is also up significantly on both an absolute and per volume basis. This is being driven by volatility in the spot market and soaring diesel fuel prices. While we're noticing some relief in spot markets in the third quarter, increased fuel surcharges are partially offsetting this benefit. Ocean freight rates and export logistics continue to challenge our international team.

Labor shortages have been underpinning the inflation we have seen across many of our inputs and in our own facilities. We continue to see positive trends in staffing levels which has allowed us to increase production in important product lines such as SPAM, raw bacon, and pizza toppings. Inefficiencies related to new team members and turnover continue to impact operations, but we expect improvement in the back half of the year. As labor recovers across the industry-wide supply chain, we expect fewer upstream and downstream challenges. Our experienced management team has done an excellent job managing profitability in the face of these challenges through strategic shifts in product mix, disciplined management of SG&A, and driving efficiencies through our One Supply Chain.

As Jim mentioned, we are re-affirming our full year fiscal 2022 sales guidance and narrowing our earnings guidance range. For Refrigerated Foods, we expect a strong finish to the year led by continued strength in the foodservice businesses and strong demand for retail products. Our Grocery Products business will continue to be challenged by inflationary pressures until the recently announced pricing actions for this segment becomes effective in the fourth quarter. Given the uncertainty regarding HPAI, and based on our current expectations, Jennie-O Turkey Store sales volumes are expected to decline approximately 30% in the back half of the year due to supply gaps in its vertically integrated supply chain. With the third quarter representing the seasonal earnings low for this business, we expect third quarter earnings to be in line with last year.

The International & Other segment continues to see strong demand both in its export business and in China. However, due to the impact of two partial plant shutdowns in China as a result of COVID-related restrictions and persistent export logistics challenges, there remains a risk to earnings growth in the back half of the year. Across our retail businesses, we expect continued strong demand and anticipate improvements in fill rates, assortment, and its strategic promotional activity to potential downside of elasticities. We continue to see strong momentum in the foodservice channel with demand from many items outpacing our ability to supply. This strong demand coupled with supply chain improvements give us confidence in our ability to deliver sales and earnings growth in the second half of the year.

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: We will now begin the question-and-answer session. [Operator Instructions] The first question is from Ben Biennu of Stephens. Please go ahead.

Jack Hardin

Analyst, Stephens, Inc.

Yes. Hello. This is Jack Hardin subbing in for Ben Biennu.

Q

James P. Snee

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

Good morning, Jack.

A

Jack Hardin

Analyst, Stephens, Inc.

Hello. You touched on the volume impact. But on HPAI, would [ph] your (00:34:35) margin benefit on the back side of HPAI next year just like we saw in 2015?

Q

James P. Snee

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

Yeah. Jack, thanks for the question. We've spent a lot of time over the last several years working on our JOTS business. We know we've got a fantastic brand. We've been doing a lot of work to continue to build a stronger business model that leverages our entire enterprise. And we had a strong finish to 2021, a great first half; we've got uncertainty in the back half of 2022. And we are going to begin to repopulate those barns, and we're going to return the supply in a very safe and timely manner. And so, we know that the demand is there for the product. And as supply comes back in line, we expect strong demand across retail and foodservice.

A

What we tried to highlight were a couple of the differences in terms of what's changed since 2015 when we think about feed costs, when we think about labor costs. But I think the most important thing for us is that as we get supply ramped back up, we know that the demand is going to be there both in the retail channel and the foodservice channel because of the work that we've done. And as markets stay strong, and if markets are better, that opportunity certainly exists.

Jack Hardin

Analyst, Stephens, Inc.

Awesome. Thank you. That's it for me. Congrats on a strong quarter.

Q

James P. Snee

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

Great. Thanks, Jack.

A

Operator: The next question is from Antonio Hernández of Barclays. Please go ahead.

Antonio Hernández Vélez

Analyst, Barclays Capital Casa de Bolsa SA de CV

Q

Hi. Good morning and thanks for taking my question. Congrats on the results. The question is regarding what's the situation in China as it started to recover [indiscernible] (00:36:36), if it's slowly opening and if it's still too early to tell. Thanks.

James P. Snee

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

A

Yeah. So, Antonio, thanks for the question. Again, the work that we've done to develop our business in China has been really, really successful as we've been able to build out a very balanced and strong business model both on the retail and foodservice side of the business. If we go back to 2020, at the outset of the pandemic when, really, China led the way in terms of shutting down and some of the current – some of the similar dynamics that they're facing today, the business behaved much like it is today. We saw a slowdown in foodservice, a ramp-up in retail. But then, as things got back to somewhat normal, we saw a return in our foodservice business.

And so, having that near-term experience, that we would expect to see our business return to a very strong growth trajectory. That being said, knowing that we're dealing with these two partial shutdowns that really will have more of an impact in our Q3, there may be some short-term impact on the China business. But really, there's absolutely no change in our long-term outlook. Very confident in the business and very strong demand in all aspects of it.

Antonio Hernández Vélez

Analyst, Barclays Capital Casa de Bolsa SA de CV

Q

Okay. Perfect. Thanks a lot [indiscernible] (00:38:20).

Operator: The next question is from Ken Zaslow of Bank of Montreal. Please go ahead.

Kenneth B. Zaslow

Analyst, BMO Capital Markets Corp.

Q

Hey. Good morning, guys.

James P. Snee

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

A

Hi, Ken.

Kenneth B. Zaslow

Analyst, BMO Capital Markets Corp.

Q

So, on the price, the inflation on Grocery, can you talk about if you're taking – the pricing that you're taking, does that cover all your expenses and your inflation? And have you seen any pushback from any of your retailers? And then, lastly on this is what is your demand elasticity across your portfolio and which products have the least and which ones have the most?

James P. Snee

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

A

Yeah. Ken, so this round of pricing in GP will cover down our costs, our expenses. And as you know, I mean, we are very, very thoughtful about the managing of our pricing and promotions to ensure the long-term health of our business. And we always take a long-term view because as we said in our comments in our press release, we know that we have a responsibility to our customers, to our consumers, and to the category.

In regards to pushback, what I would say is that really, the pricing dynamics haven't changed. We've always had to build a business case and have strong justification for why a price increase is necessary. I would say that what has changed is probably that we're all, retailers and manufacturers, we're all experiencing the same broad-based inflation. And even though that's the case, I mean, it still doesn't make conversations any easier because we're all going for the same thing, and that's that responsibility to protect the equity of the brand and the business.

And then, I would say in terms of pricing, the brands or the categories that we've seen the most impact on, and this is the price increase impact, would be SPAM because of our protein inputs and some of our packaging costs and then WHOLLY GUACAMOLE because of avocados, and then really least impacted would be SKIPPY. SPAM and WHOLLY have both, as you look at the data, they both held up incredibly well in the face of some pretty strong pricing actions. So hopefully, that gives you some clarity.

Kenneth B. Zaslou

Analyst, BMO Capital Markets Corp.

Yeah. Great. Thank you so much.

Jacynth C. Smiley

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

And just to add to – yeah, I just wanted to add to Jim's comment. I mean, this portfolio does very well during these slowdowns, and we're currently leaning into advertising in our key brands like SPAM and Planters and really expect to continue to see strong growth as we're seeing in the face of all this inflation negatively impacting the bottom line. But there is still very strong top line growth in consumption data; continues to be very positive with double-digit growth in many of our key categories.

Kenneth B. Zaslou

Analyst, BMO Capital Markets Corp.

Great. I appreciate it. Thank you.

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

Michael S. Lavery

Analyst, Piper Sandler & Co.

Good morning. Thank you.

James P. Snee

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

Good morning, Michael.

Michael S. Lavery

Analyst, Piper Sandler & Co.

Just want to follow-up on that train of thought a little bit with consumer trading, maybe not elasticity exactly but just curious what you've seen historically with down-trading just since I think you just mentioned you see some benefit. But how do you balance or what tends to be the net result of maybe down-trading to some products from, say, beef to perhaps pork or SPAM or something like that versus some of the color we heard from Walmart the other day where they were calling out down-trading to private label in some categories like bacon and deli and lunch meat that are of course very big ones for you? Is it typically a net positive even with all those moving parts? Can you just maybe call out what some of the biggest moving pieces are there?

James P. Snee

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

A

Yeah. It's a great question and I know a conversation we'll be having as we continue to head into the – or face some of these economic challenges. But I think the key takeaway for us is this balance that we've continued to build across all of our business. And as we think about our portfolio, we've got such an incredibly wide range of offerings when we think about the value consumer. And that's where Jacinth talks about our GP portfolio that historically has done well during slowdowns. And this quarter, we've been able to demonstrate great top line growth, great volume growth; now, we just have to get caught up on some of the inflationary factors.

But as you think about that balance across consumer type, across channel, across products, across brands, we're able to navigate these environments really, really well. And while we're talking about the value consumer, I mean, the thing to remember is that we still have premium consumers and premium offerings that are doing incredibly well; the strength of our Columbus business when we think about entertaining and snacking, when we see the continued strength of our Applegate business which is more of a food-forward type brand and product line. [ph] At the end, (00:44:16) it all goes back to really the balance that we've built across the portfolio that sets us up incredibly well for so many different economic conditions.

Michael S. Lavery

Analyst, Piper Sandler & Co.

Q

Thank you. That's really helpful. And can I just do a follow-up on your guidance? Jim, you called out the responsibility to protect the equity of your brands as the lead off to that text, and its language I don't think I've seen before and just was curious if there's some significance to that we should make sure that we understand. It looks like the advertising spending in the quarter was up but probably maybe a lift from Planters. Is it a big factor in how you think about the outlook? What's the weight of that remark?

James P. Snee

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

A

Yeah. I would say there's not really a dramatic change; it really is just a call out in terms of what we do. We talk a lot about the strength of our brands and the investments that we make in our brands every year, and that is our responsibility. It's something that we believe is a differentiated capability for us as we think about brand stewardship. And it's also about the recognition that we have a responsibility to our brands. We understand that there are others in the channel that we have an obligation to as well to make sure that we're taking care of our customers, that we're taking care of our consumers. And even in our foodservice business, we've got to take care of our operators to make sure that we're servicing their needs and providing great value. But again, all of it goes back to this long-term view that we always take, is to make sure that yes, we have to run the business for today but we want to make sure that we have long-term healthy businesses, long-term healthy categories.

Jacinth C. Smiley

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

A

And I'll just add it's just having that, again, that long-term view but maintaining that stickiness that we have with our ultimate consumers and not really doing anything in our mind that would really destroy that brand equity that we have built up over time with our consumer base.

Michael S. Lavery

Analyst, Piper Sandler & Co.

Okay. That's great. Thanks so much.

James P. Snee

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

Yes.

Operator: The next question is from Bryan Spillane of Bank of America. Please go ahead.

Bryan D. Spillane

Analyst, Bank of America

Hi. Thanks, operator. Good morning, everybody. This is Bryan sitting for the honeymooning Pete Galbo.

James P. Snee

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

Good morning, Bryan.

Bryan D. Spillane

Analyst, Bank of America

And hopefully, I don't screw this up. I think he may be listening. So, a couple questions. First, just you mentioned a little bit in terms of the earnings phasing. Can we just get a little bit more color? I think typically, the margins in the third quarter are lower sequentially than the second quarter. So, is that still kind of the pacing? Would we have that normal sort of seasonality in margin as we move through the back half of the year? And I guess, as we're thinking about earnings effectively being flat year-over-year, how much of that is seasonality? How much of that is, I guess, the mismatch or beginning to match-up your pricing versus covering your inflation? So, just trying to understand some of the moving parts in terms of the phasing as we look through the third quarter and fourth quarter?

James P. Snee

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

Yeah. It's a great question, Bryan. You didn't mess that up; nice job. So for us, as we've talked about this year in the first quarter, we were expecting some sequential margin improvement throughout the year. So, the impact this year is really what's going to happen with Jennie-O in the third quarter, so that is a big factor. The other thing is our mix, right? Our mix does change in our third quarter. And then like I said, the jobs impact will be a significant impact. And then, as we get into the fourth quarter, we'll continue to have strong business in Refrigerated Foods. We've got still some uncertainty in jobs, but we expect that to perform better. And then, the big driver is the Grocery Products pricing that we talked about which will take hold in the fourth quarter.

Bryan D. Spillane

Analyst, Bank of America

Okay. So sequentially, margins will be down 3Q to 2Q like they normally would be and then there's these other pressures, and then we would see it sort of begin to catch-up more in the fourth quarter? That's roughly the way to think about it both at the gross and, I guess, EBITDA margin line?

Jacinth C. Smiley

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

A

Yes.

James P. Snee

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

A

That's correct.

Bryan D. Spillane

Analyst, Bank of America

Q

Okay. And then, just a follow-up is I know we've talked a little bit about elasticity on this call and trade-up/trade-down. Can you give us a sense of just how you're looking at maybe the – planning maybe cross-elasticity between channels? And I guess what I'm after is with inflation being as pronounced as it is for the consumer, we're beginning to see some choices that they're making about discretionary versus non-discretionary spending, so spending on food but not buying discretionary items or general merchandise let's say in Walmart. So, I guess as you're planning your business forward for what we would expect to be a more inflationary period in general, would your expectation be that there's going to be a little bit of a shift away from foodservice and into grocery or within foodservice within channels? Just generally, how you're kind of thinking about that in the context of inflation going to be with us for a while and consumers will have to start making some discretionary choices.

James P. Snee

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

A

Yeah. Bryan, it is one of the things obviously that we watch very closely. We talk a lot about the strength and the competency of our foodservice business, our foodservice direct selling organization, the incredible portfolio that we've built over the last several decades. And so, we know that we're well-positioned to support the foodservice industry with all of their needs that they have. Top of mind of course is labor.

But specifically to your question, as we're watching these dynamics – and intuitively, you would say with all of this soaring inflation and soaring gas prices – that what you described would take place. But as we think about what we're hearing with flight bookings, what we're hearing about lodging bookings, what we are seeing and hearing from restaurant reservations is that certainly in the short-term, and I think even beyond that, we're going to continue to see...

[Technical Difficulty] (00:51:33-00:54:58)

Yeah. So, Bryan, I believe I got cut off in the middle of my response to your second question.

Bryan D. Spillane

Analyst, Bank of America

Q

I promised Pete I wouldn't screw this up and I apparently broke the line.

James P. Snee

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

A

Well, that's what we said in private but we weren't going to say that publicly; you did. But really, I think the key takeaway here is we're well-positioned as the foodservice business may shift from segment-to-segment within the channel. And then just on a broader basis, we don't see any short-term slowdown in the foodservice business. We do think there's still incredible pent-up demand and we're able to take advantage of it. The one thing I did talk about was as individuals may change the way they travel, if they're not flying because of airline prices and they begin to drive even though fuel prices are higher, the C-store channel is an area where we've made tremendous progress in a short period of time, and the acquisition of Planters has really helped us both in the retail aspect but the foodservice or the takeaway food aspect of the convenience store channel. So, that's the shorter version of my long answer.

Bryan D. Spillane

Analyst, Bank of America

Q

All right. Thanks, guys. Thanks for the insights.

James P. Snee

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

A

Yeah. Have a good day.

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

Thomas Palmer

Analyst, JPMorgan Securities LLC

Q

Good morning and thank you 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 to start off, if I could clarify the comment about third quarter earnings being in line with last year. There was the unusual costs, so you had kind of two earnings numbers a year ago, the \$0.32 and the \$0.39. When you're talking about in line with last year, to which last year are you referring?

Jacinth C. Smiley

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

A

We're referring to the GAAP number which is \$0.39, right, which is the adjusted 30-day [indiscernible] (00:57:13).

Thomas Palmer

Analyst, JPMorgan Securities LLC

Q

Okay. Thank you for that. And then, maybe to follow-up on Ken's question on Grocery Products segment, just the pricing. So, can I just clarify? Is the pricing – were you able to fully offset the inflation that you are currently seeing with that pricing? And then, you mentioned the fourth quarter kind of being the impact in terms of that pricing

flowing through. Should we think about it as the pricing flows through during the fourth quarter and therefore, you have even added impacts when we think about the first quarter of fiscal 2023? Or is this – it flows through in part during the third quarter; the fourth quarter reflects kind of the full benefits?

James P. Snee

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

A

No. We would expect the effect or the benefit will take – will have an impact. It'll be right at the end of the third quarter, beginning of the fourth quarter. And so naturally, of course, that'll flow into the first quarter of 2023, but the full fourth quarter will be impacted in a positive way.

Thomas Palmer

Analyst, JPMorgan Securities LLC

Q

Okay. And that is – you were able to secure pricing that essentially addresses the inflation that you were seeing at the time of those negotiations?

James P. Snee

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

A

That's correct.

Thomas Palmer

Analyst, JPMorgan Securities LLC

Q

Okay. Thank you.

James P. Snee

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

A

Yeah.

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

Eric Larson

Analyst, Seaport Global Securities LLC

A

Yeah. Thanks for sneaking me in, guys. So, Jim, I'm kind of curious. I'm going back to 2015, the last AI breakout. You've said that your impact, your bird impact was 25% less than that impact in 2015. But I think one of the things in 2015 that hurt you pretty badly was that you were a net buyer of supply so that you could meet your demand, and those high spot prices really hurt your numbers. And then, it took quite a while to kind of repopulate those grow houses, those birds take longer to grow out, so maybe I'm missing it. So, it sounds like maybe that's not going to be as big a deal this time, or when should we expect to see the volumes actually start recovering as you kind of repopulate the grow houses?

James P. Snee

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

A

Yeah. So, Eric, thanks for the question. And the comparisons to 2015 are never perfect, so when we say we're down 25%, right, we are talking about our company-owned facilities. Your other question about us buying meat and that we are not currently buying meat this year. And then again, let's just think about the timing which is usually 26 weeks, and so we've started some repopulation when you think about when the event started. So, the volume will get better in Q4 but still down compared to normal. And then, assuming that we don't have any more

outbreaks from this event or that we don't see a re-occurrence in the fall, we would expect again to have more traditional volumes available in Q1.

Eric Larson

Analyst, Seaport Global Securities LLC

Q

Okay. So then, the second follow-up to this whole thing is so did you decide in 2015, one of your actions given what happened with AI, to actually increase your internal production so you don't have to buy outside supplies? Or did you – are you converting more of the commodity stuff to – So, what is the change between being a net buyer of supply outside of your company to being right now you're not buying product? So, I'm just trying to figure out what the dynamic is there.

James P. Snee

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

A

Sure, sure, sure. So, the two biggest drivers really as we think about the supply side of the business, one is feed cost which is significantly higher today, and then we have had significant SKU rationalization. So, as we think about the work that we're doing in this transformation of jobs to make sure that we've got a stronger business model, we have rationalized a number of different SKUs that have made us far less dependent on outside meat purchases.

Eric Larson

Analyst, Seaport Global Securities LLC

Q

Got it. Thank you. That helps explain the difference. Thank you.

James P. Snee

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

A

Yeah, absolutely.

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

Robert Moskow

Analyst, Credit Suisse Securities (USA) LLC

Q

Hi. I came a little late to this call so I apologize if you've kind of addressed this already. But maybe you could tell me, like, the timing of the Grocery price increases, you're saying it's starting in July really. Were those negotiated, like, a couple of months ago or very recently? Like, how long did it take for that kind of negotiation to get implemented in the marketplace? And then, given what we've heard from Walmart, is there – I'm sure you've answered this already, but do you expect any pushback on future price increases in processed meats categories given that they kind of called them out by name?

James P. Snee

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

A

Yeah. Rob, we talked a little bit but happy to revisit that. Yeah, the pricing that we're talking about has been negotiated recently. And as you know, we do have in our GP portfolio – there's really a 60 to 90-day lag to have our pricing take effect. And so, we're in that window and that's why we're talking about the end of July or the end of Q3.

What we talked about earlier in terms of the pricing and the environment that we're in is that really, the pricing dynamics haven't changed in regards to the justification that we had to provide. What we think has changed and what we know has changed is that everybody is experiencing that same broad-based inflation. So, the data is being felt by everyone and it doesn't make the conversations any easier. So, we've had a lot of the same conversations; it's just that everyone is feeling or seeing the same information. And then, the other thing that we did talk about was understanding that we've always taken a very thoughtful approach to the management of our pricing and promotions because while we have this inflationary environment that we're in, we need to ensure the long-term health of our brands.

And so, that's how this has played out in terms of the pricing for GP, and then that's how we're thinking about the actual pricing environment that we're in.

Robert Moskow

Analyst, Credit Suisse Securities (USA) LLC

Okay. I'll follow-up later. Thank you.

Jacinth C. Smiley

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

And I just want to – this is Jacinth. I just want to clarify my answer to Tom. Our adjusted GAAP EPS number in Q3 of last year was \$0.39 less Planters, one-timer. That is what we're comparing to, and we expect to be in line – to be better than that in Q3.

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

Arthur Almeida

Analyst, Goldman Sachs & Co. LLC

Hi. This is Arthur filling in for Adam this morning.

James P. Snee

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

Hi, Arthur.

Arthur Almeida

Analyst, Goldman Sachs & Co. LLC

I was just wondering if you could help us think about how you're thinking about maintaining branded retail placements throughout this, let's call it, a difficult period. And if you could just help us how has demand elasticity evolved from the time we last spoke. Thank you.

James P. Snee

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

Yeah, sure. So, Arthur, I mean, the placement of our products remains very, very strong and continues to get better as our supply chain improves. We're able to improve the assortment of our products, the mix. And as our supply chain and our capacity continues to get better, we are able to engage in select promotional activity as well. So, from a distribution perspective, continues to be strong and getting better as our supply chain continues to recover.

As we think about elasticity, there is still a lot of noise in terms of fill rates, assortment, promo, really getting some of the second and third-tier items back on the shelf from the impact of the pandemic. And so, I mean, we're watching that very closely, but we still see lots of noise in the system for the balance of the year. And our brands have responded well to that pricing, so we're going to continue to support them with advertising and promotion and we've got any potential impact factored into the guidance that we've provided for the back half of the year.

Arthur Almeida

Analyst, Goldman Sachs & Co. LLC

Okay. That makes sense. Thank you.

Q

Operator: The next question is from Carson Barnes of Consumer Edge. Please go ahead.

Carson Barnes

Analyst, Consumer Edge Research LLC

Good morning. Thanks for the question. Can you touch on the labor issues a bit and discuss what you're doing to mitigate those impacts from a product mix perspective? And then, how are you thinking about correcting those issues longer-term? Thanks.

Q

James P. Snee

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

Yeah. Carson, thank you. I mean, as we go back several years and the work that we've done to create our One Supply Chain and really leverage the strength of the enterprise, it's one of the key factors that's allowed us to navigate this incredibly difficult operating environment. Since we last talked, we have seen meaningful improvement in our supply chain since the end of January. And those improving labor trends have really helped in terms of our improved production, the building of some inventory, improvement of fill rates, and that has had a very positive impact on our business.

A

So that being said, while we're continuing to get better with labor within our own facilities, we continue to see upstream and downstream challenges and those challenges are significant on a weekly basis. Whether it could be a packaging or ingredient headwind or when it comes to freight, ability to get product into and out of ports that impacts our international business, that is still a very real constraint for us that hasn't cleared yet. So, we feel good about the work that we've done to improve our supply chain. There's still some upstream and downstream things that need to clear. But as that labor gets better, we expect that to mitigate over time.

Carson Barnes

Analyst, Consumer Edge Research LLC

Thanks. Appreciate it.

Q

Operator: The next question is from Rebecca Scheuneman of Morningstar. Please go ahead.

Rebecca Scheuneman

Analyst, Morningstar, Inc. (Research)

Good morning. So first of all, you had said that demand has remained strong in the face of inflation, but volumes were quite a bit weaker than we expected. Could you maybe help quantify what the impact was from the labor constraints?

Q

James P. Snee

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

Yeah. Rebecca, the biggest issue in terms of total volume was the reduction in pork supply as we renegotiated our pork supply agreement at the end of last year. Labor was a factor, but wouldn't say it really was a significant driver. It was really less, far less than pork in terms of the total impact on the volume.

A

Rebecca Scheuneman

Analyst, Morningstar, Inc. (Research)

Okay. Could I be [ph] subtle (01:11:14) just to ask you to quantify the impact of the pork?

Q

James P. Snee

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

Yeah. That is something that we've broken out before. And actually, what I probably would do is, just so we get you the exact information is we'll have David follow-up with you so you got the exact number of pounds that we've talked about in the past.

A

Rebecca Scheuneman

Analyst, Morningstar, Inc. (Research)

Okay. Sounds good. Thank you. And secondly, is it fair to assume that HPAI could maybe delay some of the planned cost savings in jobs?

Q

James P. Snee

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

No. The work that we've done on the transformation of the business has not slowed down.

A

Jacynth C. Smiley

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

Yes. And if anything, Rebecca, we would say it has actually accelerated some of the work that was already underway to be able to reposition the business and reposition the plants the way we were planning to restructure this business to continue to be very consumer-focused and really leaning towards and embracing the trends that we're seeing in the consumer space. And so, if anything, it really has been a positive and we continue to be on track to realize the timeline and the savings that we have communicated externally.

A

Rebecca Scheuneman

Analyst, Morningstar, Inc. (Research)

Okay. Great. Thank you.

Q

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 and thank you all for joining us today. I'm incredibly proud of the results our team delivered in the face of an incredibly difficult operating environment. We've spent a lot of time and effort over the years developing

a strategic and balanced portfolio for times just like these, and it's our people, our brands, and our culture are what gives me confidence in our ability to continue to deliver results. Thanks again, 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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