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Hormel Foods Corp. (HRL)

Q1 2023 Earnings Call

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CORPORATE PARTICIPANTS

David W. Dahlstrom
Director-Investor Relations, Hormel Foods Corporation

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

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

Deanna T. Brady
Executive Vice President-Retail, Hormel Foods Corp.

OTHER PARTICIPANTS

Rupesh Parikh
Analyst, Oppenheimer & Co., Inc.

Robert Moskow
Analyst, Credit Suisse Securities (USA) LLC

Eric Larson
Analyst, Seaport Global Securities LLC

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

Thomas Palmer
Analyst, JPMorgan Securities LLC

Peter T. Galbo
Analyst, BofA Securities, Inc.

Michael S. Lavery
Analyst, Piper Sandler & Co.

Adam Samuelson
Analyst, Goldman Sachs & Co. LLC

MANAGEMENT DISCUSSION SECTION

Operator: Good morning, and welcome to the Hormel Foods First Quarter 2023 Earnings Conference Call. All participants will be in a listen-only mode. After today's presentation, there will be an opportunity to ask questions. [Operator Instructions] Thank you. 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, sir.

David W. Dahlstrom

Director-Investor Relations, Hormel Foods Corporation

Good morning. Welcome to the Hormel Foods conference call for the first quarter of fiscal 2023. 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; Jacinth Smiley, Executive Vice President and Chief Financial Officer; and Deanna Brady, Executive Vice President of the Retail segment. Jim will review the company's first quarter results and give a perspective on the rest of fiscal 2023. Jacinth will provide detailed financial results and further commentary on our outlook. And Deanna will join for the Q&A portion of the call.

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. At the conclusion of this morning's call, a webcast replay will be posted to our investor website and archived for one year. Additionally, earlier this week, we filed a Form 8-K with the US Securities and Exchange

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Commission that included supplemental segment financial information for fiscal years 2021 and 2022 related to the GoFWD initiative. We have posted a copy of the Form 8-K to our investor website, investor.hormelfoods.com.

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.

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. With the release of our recast financial information earlier this week, our transition from a structural and reporting perspective is now complete for the GoFWD initiative. I want to take time to acknowledge the immense amount of work the entire team has put in to transition the business to our new strategic operating model. We have spent time discussing the strategic rationale and how our actions over the past decade have positioned us for GoFWD, but there has been a lot of blocking and tackling that had to take place first to get us to where we are today.

Over the past six months, we stood up three new business segments and consolidated the Jennie-O Turkey Store segment. This included organizing the Retail segment into six distinct verticals and combining the Foodservice businesses across the enterprise. We invested in new centers of excellence, including Brand Fuel and a dedicated FP&A team. And we made changes to the administrative side of the business to recast the financial statements, align and structure our entities and duties, maintain controls across the business and, of course, operate our business without interruption. We have learned a lot about our people, processes and technology going through this transition.

While we have work to do in all of these areas, I am encouraged by the conversations that are taking place across the organization. The operating environment remains challenging. And while many areas of the business performed ahead of last year during the first quarter, our results were disappointing and below our expectations. From a top line perspective, demand from consumers and operators generally remained elevated in key categories. And we delivered balanced growth between volume and price across many parts of our portfolio. We continued to see elevated demand for many of our center-store, refrigerated, Mexican and premium items at retail, including Black Label bacon, Columbus charcuterie, Hormel chili, Hormel pepperoni, Applegate breaded chicken, Herdez products, Square Table entrees and Mary Kitchen hash.

Likewise, solutions-based items in our Foodservice segment had another strong quarter, with volume growth in sliced meats and from brands such as Cafe H, Fire Braised, Bacon 1 and Austin Blues. For the quarter, sales declined 2%. As a reminder, there continues to be volatility in our overall volume and net sales results, given the planned volume declines in commodity pork and the volume impacts across the turkey supply chain due to highly pathogenic avian influenza or HPAI. Diluted net earnings per share for the quarter was $0.40, a $0.04 decline compared to last year. Our results reflect the persistent impact from inflationary pressures, supply chain inefficiencies and lower sales volumes across each of the business segments.

Now, turning to our segments, results in the Retail segment declined compared to last year. Net sales growth from the bacon, global flavors, convenient meals and proteins and emerging brands verticals was offset by lower sales in the value-added meat and snacking and entertainment verticals. Segment profit declined as the benefit from pricing actions across the portfolio, higher equity in earnings from MegaMex and improved results for the

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bacon business were more than offset by the impact from lower net sales, unfavorable mix, and higher operating costs.

The bacon vertical delivered outstanding results in the quarter due to elevated demand for our Black Label items. There was also a benefit from commodity relief in pork bellies throughout the quarter as we work through higher-cost inventory. This is a category where we have made significant investments and one we expect to show growth for the year. Similarly, the global flavors vertical made up of our MegaMex business had an excellent start to the year. The pricing actions that we've taken across this business to combat inflationary pressures coupled with commodity relief on avocado inputs led to revenue and equity and earnings gains for the quarter.

The emerging brands vertical delivered volume and sales growth for the Applegate brand, led by frozen breaded chicken and wall deli items. The convenient meals and proteins vertical achieved another quarter of net sales growth led by Hormel chili, Square Table refrigerated entrees, and Mary Kitchen hash in addition to a benefit from pricing actions we implemented last year. We will have new capacity for SPAM items beginning in the second quarter. In addition to supporting our highest selling products in the category, this new capacity allows us to restore assortments, introduce new flavors such as maple, and relaunch our 7-ounce SPAM item after a three-year hiatus. This provides excellent value for consumers seeking a more affordable option in the category.

SKIPPY peanut butter sales for the quarter were significantly behind last year. Last May, when we made the decision to relentlessly support our customers and the peanut butter category, we knew it would pressure inventory levels and have lingering impacts into fiscal 2023. This was the right decision for all stakeholders and our team deserves credit for growing the peanut butter category and making the product readily available for our customers and consumers when they needed it. Demand remains robust for the SKIPPY brand and the category and we are working diligently to maximize capacity and return inventories and fill rates to normalized levels.

Net sales declined for the snacking and entertaining vertical as growth for the Columbus and Hormel pepperoni brands was more than offset by a year-over-year decline in the snack nuts business. The final vertical, value-added meats, was most heavily impacted by lower commodity pork and turkey availability, leading to net sales declines. In the Foodservice segment, products in the sliced meats, pepperoni, premium prepared proteins, and premium bacon and breakfast sausage categories grew volume and net sales for the quarter. Like Retail, the overall decline in volume was driven primarily by limited turkey and fresh pork availability. Segment profit increased for the quarter due to improved mix across the portfolio. Results for this segment were below our expectations, reflecting industry softness from mid-December into January. However, we have seen a sharp rebound in orders to begin the second quarter and are confident in our ability to grow the business this year.

Finally, the International segment was heavily impacted by external factors during the first quarter. From a top line perspective, our branded export business had a strong quarter led by the SPAM and SKIPPY brands. We also saw another quarter of improved results in Brazil as the team continues to focus on its premium products and foodservice strategy. Commodity turkey volumes declined almost 80% compared to last year due to restrictions on turkey exports and limited supply as we strategically diverted raw material to support the domestic business.

Our team in China faced incredibly difficult operating conditions throughout the quarter as the impact of COVID-related policy changes had dramatic short-term effects on the business as well as our employees, customers, and operators. Taken together, the impact from lower turkey exports and disruptions in China represented a more than $0.01 earnings per share impact on the quarter compared to last year. We are seeing improvement in China to begin the second quarter, especially in our Foodservice business. As conditions normalize, we expect our China business to resume delivering accelerated growth.

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During the quarter, we purchased a minority stake in Garudafood, one of the largest food and beverage companies in Indonesia. This investment supports our international growth ambitions and the global execution of our snacking and entertaining strategy. Garudafood is a market leader with strong and reputable brands, local expertise, and a best-in-class distribution network. We have been partnering with the Garudafood team for several years and this strategic investment enhances that partnership. Jacinth will provide the financial details of the transaction later in the call.

As we disclosed earlier this morning, we are reaffirming our top line expectations and reducing our diluted net earnings per share outlook for fiscal 2023. Our top line remains healthy and despite softness in the first quarter, we are on track to deliver growth for the year. Demand for our leading center-store and refrigerated retail brands remains favorable, the Foodservice segment expects strong growth for remainder of the year, and we anticipate the near-term challenges impacting the International segment to abate over the coming months. Compared to our expectations heading into the year, earnings are being pressured by inefficiencies across the supply chain, persistent inflationary pressures, and softness in the snack nuts category. I want to detail how we plan to address each of these challenges for the balance of the year.

First, I would like to discuss the state of our supply chain. It is important to note that we have made progress over the last year staffing our facilities, expanding production capacity and improving fill rates for each of our businesses. This has allowed us to catch up to demand in most categories and further supports the confidence we have in our revenue outlook for this year and longer term. Since the fall, we have been operating with elevated inventories due to our efforts to increase production, optimize plant performance and return fill rates to historical levels. We expected this inventory to clear during the normal course of business. This has not happened. And in fact, we have seen inventories continue to grow in a number of areas. This has resulted in inefficiencies across the supply chain and higher operating costs.

We are taking immediate action to combat these inefficiencies by focusing on selling excess inventories and reducing the reliance on third-party warehouses and co-packers. These actions are expected to cause short-term margin compression, but they are necessary as we look to restore profitability to normalized levels and reduce complexity. Simply said, after almost three years of chasing unprecedented demand, our ability to supply our customers, consumers and operators caught up to and in some cases began to exceed demand and we needed to react sooner. Rectifying the inefficiencies caused by elevated inventory levels is the top priority in the company.

Second, we continue to operate in a volatile, complex and high-cost environment and cost pressures remain high. Our Retail businesses, especially in the center-store, continue to be disproportionately impacted by high inflationary pressures. And the pricing actions we have taken over the last 18 months still lag inflation. To help mitigate some of this pressure, we have announced additional inflationary justified pricing actions in certain retail categories, effective late in the second quarter. We are evaluating further pricing actions but as we've said, our teams remain highly focused on the long-term needs of the business and protecting the equity of our brands. For the remainder of the year, we believe we can stabilize these margin pressures through a combination of pricing actions, operational cost management and supply chain cost savings initiatives.

Third, after meeting expectations last year, our Planters business is off to a slower-than-expected start in 2023. There are numerous factors at play, including general category softness, a consumer shift away from certain higher-priced items, production challenges and timing issues. We are taking immediate action to address the current challenges, stabilize the top line and grow the consumer base. Beginning in the second quarter, we are shifting resources to drive consumption. This includes increasing promotional support and prioritizing peanut items and pack sizes aimed at value-seeking consumers. We are bringing much needed innovation to the category with flavored cashews and several new Corn Nuts flavors.

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We're expanding assortments as we continue to gain distribution for the brand. And we are investing in capital for higher growth items that are relevant for today's consumer. Long term, we remain fully committed to the Planters brand and the snack nuts category. This business is at the center of our snacking and entertaining strategy, our ambitions to grow in the convenience store channel and as we look to become even more balanced as a company. We know what we need to do to change the trajectory of this business and our teams are focused on accelerating the pace of that change.

Considering these factors, we expect full year net sales growth of 1% to 3% and diluted net earnings per share of $1.70 to $1.82 per share. While we have work to do the rest of this fiscal year, we cannot lose sight of the progress we have made over the last two years. We are a significantly larger company today, 30% bigger, in fact. We are a more balanced company through the products we sell and in the ways we reach our customers, consumers and operators. We have transformed our company, not only through the GoFWD initiative, but with the investments we have continued to make in technology, capacity and capabilities. And we have made all of this progress, while simultaneously navigating a dynamic and volatile environment and managing through the impacts of HPAI. Our brands remain vibrant and relevant. Our strategies remain effective. And our business is positioned for long-term growth.

At this time, I will turn the call over to Jacinth Smiley to discuss detailed financial information related to the first quarter and additional 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. Net sales for the first quarter were $3 billion, a 2% decline to last year. Planned lower commodity pork and turkey volumes were the primary drivers of the decrease in net sales. We have now lapped our new pork supply agreement as of January and turkey supplies have improved since the fall. We anticipate more normalized volume comparisons for the remainder of the year, barring a return of HPAI in the spring. First quarter gross profit was $496 million, compared to $539 million last year. Gross profit margin declined 100 basis points as the impact from pricing actions was more than offset by unfavorable mix and persistent inflationary pressures.

For the first quarter, SG&A expenses, as a percent of net sales, increased marginally to 7.5%. The company continued to support its leading brands through advertising investments. Advertising expenses were $47 million during the quarter comparable to last year. Of note, we promoted Black Label bacon over the holiday season and the Planters brand was once again front and center at this year's Big Game with The Roast of Mr. Peanut. Equity in earnings of affiliates for the first quarter increased significantly compared to last year due to improved results for MegaMex and our joint venture in the Philippines.

Operating income for the first quarter was $289 million, compared to $320 million last year. Operating margins compressed to 9.7% compared to 10.5% last year. Net unallocated expenses in the first quarter increased $7 million. This increase was driven by higher employee-related expenses and outside consulting fees. The effective tax rate for the quarter moved modestly higher to 22.6% compared to 22.4% last year. Last year's rate reflected higher stock option exercise benefits. The effective tax rate for fiscal 2023 is expected to be 21% to 23%. The net result of all these factors was diluted net earnings per share of $0.40.

Turning to cash flow, operating cash flow was $204 million for the first quarter compared to $384 million last year. This decline was driven by lower net earnings and an increase in working capital. As Jim mentioned, we purchased a 29% common stock interest in Garudafood, a leading food and beverage company in Indonesia. We

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obtained a minority interest from various shareholders for a purchase price of $411 million, including associated transaction costs. The transaction was funded using cash on hand. We do not expect the transaction to have a material impact on our fiscal 2023 results.

We are targeting $350 million in capital expenditures for 2023. In addition to the newly commissioned SPAM product line, we recently approved a [ph] $40 million (00:24:45) expansion for our Columbus line of premium charcuterie products and additional capacity for higher-demand Planters items at the Fort Smith, Arkansas facility. We also continue to invest heavily in automation projects as evidenced by our recently completed project supporting turkey processing at the Faribault, Minnesota facility. The project automates more than 30 difficult, highly repetitive jobs at the plant, further aiding our efforts to improve employee retention and satisfaction.

We paid our 378th consecutive quarterly dividend effective February 15 at an annual rate of $1.10 per share, a 6% increase over last year. We ended the first quarter with $3.3 billion in debt, unchanged from the prior year. We remain committed to maintaining an investment-grade rating. As Jim detailed, we have lowered our diluted net earnings per share outlook for the year and have action plans in place for the balance of fiscal 2023. In terms of cadence for the year, we expect diluted net earnings per share in the second quarter to be significantly lower than last year.

We expect unfavorable mix in the Retail segment, short-term margin compression due to our immediate actions across the supply chain and for continued COVID-related disruption in China to negatively affect the second quarter. We are also not expecting a repeat of last year's lower effective tax rate. As we look to the second half of the year, we expect earnings growth compared to last year, led by the Foodservice and International segments, gradual improvement in the cost environment and higher turkey volumes. We are beginning to see signs of market stabilization and even cost relief in certain areas such as raw materials and freight.

As anticipated, prices on key protein inputs generally declined during the quarter compared to last year and the fourth quarter. The USDA composite cutout declined 19% compared to the fourth quarter and was 2% lower than last year. This decrease was driven primarily by bellies, which declined 26% compared to last year. Higher cost inventory was generally a headwind in the first quarter and will continue to affect results as we work to reduce inventories. We have assumed a benefit from lower raw materials costs in the back half of the year.

Similarly, we saw a more balanced freight environment during the first quarter as demand for trucks moderated. We expect freight rates for the remainder of the year to be lower compared to last year. In addition to the actions we are taking to address inventory levels and inflation, our teams remain focused on identifying and capturing cost savings opportunities as supply chain conditions normalize. HPAI remains a significant risk facing the business. While the last reported case in our supply chain was early December, the virus continues to impact domestic poultry supplies. There is increased risk to our supply chain into the spring as migration begins along the Mississippi Flyway.

Assuming current conditions hold, reduced production volume in our turkey facilities is expected through the end of the second quarter before steadily improving in the back half of the year. This should be supportive of our turkey business as demand for genuine turkey products remains strong. Turkey markets have become less favorable as breast meat prices have steadily declined over the last month. Additionally, historically high feed costs remain a headwind for our business. Considering these factors, we expect to improve meat availability in the back half of the year to drive higher sales volumes for our turkey business, offsetting the impact of market declines and higher feed costs.

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Additionally, we made significant progress towards fully integrating Jennie-O Turkey Store into the company's One Supply Chain and new operating segments during the first quarter. We remain on track to achieve $20 million to $30 million of savings on a run rate basis by the end of the fiscal 2023. As noted, last quarter there were incremental investments planned against One Supply Chain and GoFWD. Our new business model demands this and our strong financial position allows us to continue investing for the long term. In closing, I want to acknowledge the demanding work of all the teams across the organization to make the GoFWD initiative possible. I remain confident that once fully implemented, our new strategic operating model will better align the businesses to the needs of our customers, consumers, operators, and shareholders to deliver sustainable long-term growth.

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

QUESTION AND ANSWER SECTION

Operator: Thank you. Ladies and gentlemen, we will now begin the question-and-answer session. [Operator Instructions] The first question comes from Rupesh Parikh of Oppenheimer. Please go ahead.

Rupesh Parikh

Analyst, Oppenheimer & Co., Inc.

Q

Good morning and thanks for taking my question. So, to start out for us, the report today is not really consistent with what we typically see from Hormel. So, what happened and what are the key efforts from here to improve performance?

James P. Snee

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

A

Good morning, Rupesh. We agree with you. The word that we used is we're disappointed and these are not results that we expected. But I do think it's important that even with that disappointment to remember just how far we've come with our supply chain and everything they've been through over the last three years. We go back to obviously the COVID impact when plants were shut down and we didn't have labor and then when we did have labor it was turning over. And so, we are in a more stable operating environment for sure, and so fill rates continue to improve, labor is better, and production capacity across key categories for us is good.

But as we think about quarter one, that in the context of this dynamic and volatile environment is a bit more explainable. We talked about China; that's easy to understand. Foodservice had a period of softness, but their business continues to be strong and will stay strong for the balance of the year. We mentioned Planters which we met our expectations last year but are seeing a slower start this year, and we know what we need to get done there. And then, avian influenza, still battling that. So, we've said since the fall we've been operating with elevated inventories; we wanted to get fill rates up; we needed more inventory to support our expanded network.

The big thing here is probably a misalignment of our inventory and our demand because we expected the inventory to clear. It didn't and it hasn't and it's resulted in inefficiencies across the supply chain and higher operating costs when we think about product and warehouses and probably moving it more than we had expected, and so those are real dollars that impacted us in the quarter. And then, the other thing is we want to be careful when we talk about inventory because as we progress throughout the year, it's not going to be as simple as just looking at a dollar amount to gauge how we're doing. Mix is huge in our portfolio. When we think about pounds versus dollars, impacts of markets, a potential rebound in turkey, times when we may be building inventory to support customer promotional activity, all those things are part of our inventory mix.

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And really, for us, we'll be talking to all of you just like we're doing today in a very transparent manner to say is our demand or is our inventory aligned with our demand, and that's really going to be the key indicator going forward. So, we're disappointed where we are but we know what we need to do. And probably said the most simple way possible is that after almost three years of chasing this unprecedented demand, supply caught demand and we needed to react sooner and we didn't.

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

A

Yeah. And another important point to just mention here, Rupesh, is that as we have this elevated inventory, what it does is also just delay us from recognizing and benefiting from some of the costs coming down. When we think about freight rates, markets coming down, we haven't really been able to realize those and that's been delayed. We talked about it in the fourth quarter that we should see that relief here and those benefits showing up in our margins this quarter, and that's been delayed as well and affecting where we're sitting right now from a guidance perspective.

Rupesh Parikh
Analyst, Oppenheimer & Co., Inc.

Q

Great. Thank you for the color and I'm going to slip in another question. So, I think in your prepared comments, you mentioned something about learning about people, I think you said technology and processes. What are the key learnings there? And then, how quickly can they be implemented?

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

A

Yeah. I'll go ahead and start on that, Rupesh. I mean, I think there's a couple of things there that we need to talk about just to level-set those comments. I mean, the first thing is we're a much larger company today than we were two years ago, and it's not just the Planters acquisition. That's part of it, but we've seen significant growth in our business. We haven't stopped acting on our strategic priorities. Everything that we've talked about in terms of becoming more balanced, transforming our company, we've continued to move that forward all while navigating this crazy current environment and managing through avian influenza. And so, when we say that we've learned a lot about our people, we have the right people.

As we've gone through our GoFWD initiative, we just need to make sure that we have them doing the right work, and GoFWD we'll help with that. When we talk about processes, as we've integrated businesses, there are processes that will need a refresh. When we think about inventory, pricing decisions, brand resourcing, and GoFWD will help with that as well. And then on the technology side, I'll maybe let Jacinth add some color there.

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

A

Yeah. So, from a short-term perspective, we are – probably just to level-set, I mean, this team knows how to manage inventory. And so, what we're doing in the immediate term here is just returning to that pre-pandemic discipline when we think about S&OE and the process that is aligned with ensuring that we're listening to demand signal, connecting our commercial team with our supply chain team and getting all our supply planning aligned, and so that's what we're doing in the immediate term. And then from a long-term perspective, we have made significant investment from a systems and technology standpoint with Project Orion. And we pause that intentionally as we work integrating Planters, integrating JOTS and that was purposeful to get those done

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correctly. And now, we're now continuing that work to enhance our S&OP and our end-to-end planning and be able to leverage our technology and our people to get us to the next level.

Rupesh Parikh
Analyst, Oppenheimer & Co., Inc.

Q

Great. Thank you for all the color and best of luck.

Operator: Thank you. The next question comes from Robert Moskow of Credit Suisse. Please go ahead.

Robert Moskow
Analyst, Credit Suisse Securities (USA) LLC

Q

Hi. Thank you. I guess I'm a little confused as to where the inventory is building up in terms of your portfolio and what categories did you underestimate the volume weakness. Is it bellies? Is it protein? Is it in the freezers? Because you mentioned in your prepared remarks, a lot of products that did really, really well and you talked about strong demand. So, what kind of demand were you expecting? And where did it fall short?

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

A

Yeah, good morning, Rob. We did also say that we had across all segments, some volume softness. So, we certainly had a lot of brands and categories that did really well. We talked about Planters being off to a slower start. So, that's a part of it. And we did also talk about that period of time with our Foodservice business, where we had softness. And so, that, too, is part of it. The Foodservice piece will experience growth for the balance of the year, less concerned about that. But it's really – I mean it's a little bit across the board on the sales and volumes side. But then the other part to consider is what we're talking about with our supply chain is there's a level of overproduction as well. And so, as we've gotten better in our supply chain and wanted to run it more productively, more efficiently, they've been running hard, and we've built that inventory. In some cases, that inventory is not aligned with the demand. And so, that's really our issue is it's a little bit across the board on the product side or I'll say, the sales side, and then across on the supply chain side, this overproduction, which built the inventory.

Robert Moskow
Analyst, Credit Suisse Securities (USA) LLC

Q

Okay. Because if I can dig in a little, Jim, like I think six to nine months ago, the issue was labor shortages, turnover couldn't run the plants effectively enough to meet demand. And now they're overproducing?

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

A

Exactly. Yeah, Rob, I mean...

Robert Moskow
Analyst, Credit Suisse Securities (USA) LLC

Q

Okay.

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

A

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...that's exactly – and I said that a little while ago, if we go back over the last three years, everything that we've been through and that – those different scenarios of, you're right, not having people. And then when we were getting people, they were turning over. And now, that we're getting people, we're keeping people. The plants are running more productively and more efficiently. And our goal is to make sure that we're getting up to fill rates, and that we do have some production capacity. So, our plants have gotten better. And like I said, in some cases, they've outproduced demand, and that is definitely part of the problem.

Robert Moskow
Analyst, Credit Suisse Securities (USA) LLC

Q

Okay. Last question on Planters. When I look at the Nielsen tracking data, the unit sales are certainly down. The volumes are down over the last 12 weeks, like 6% or 7%, but that's been consistent for the past 52 weeks. Unit sales have been down by that amount. Were you expecting a big pick-up in unit sales and total sales in the quarter on stronger marketing and Super Bowl marketing and it just didn't play out?

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

A

Yeah, I think a couple of things there, Rob, and then I'll turn it over to Deanna. As we think about Planters in the short term, it is about execution, driving demand and also the mix. We've said this multiple times, and it just bears restating is that we did deliver on our year one commitments. We've maintained some stable distribution. And we've seen some channel shifting with the businesses as well. But the demand is certainly lower versus our expectations in Q1. And so, as we're thinking about this business now, it's really what are we going to do in the short-term from an execution perspective. And Deanna, I'll let you add some color there.

Deanna T. Brady
Executive Vice President-Retail, Hormel Foods Corp.

A

Yeah, sure. Thanks, Rob. Just as we think about it, we knew this business was – where it was when we acquired. And then again, we were interested in this business from the snacking perspective and really is a long-term ambition for us. So, when we think about plant-based protein, entertaining, snacking and our ambitions for C-store, those still remain front and center. In the short term, we do have execution challenges, in particular, our base business, which is a top priority for the team. When I also look to Q1, that was when we cut over the inventory from the prior owner, so there is some noise there and some things that happened in the quarter, as well as we inherited some distribution losses right out of the gate that the team has been working against. And as we head into Q2, we'll recover some of those important distribution points that will really help stabilize the base business. We're really energized by the innovation. I was with our Planters R&D and marketing team earlier this week, and the pipeline of innovation that this team has in front of us for both the rest of 2023, 2024 and beyond is exceptional and really energizing in regards to where they see this business going.

When we talk about innovation, you'll also see innovation launch in this quarter, both in the core business as well as in our C-store business. You mentioned Super Bowl. We did have a really fun Super Bowl ad that was really centered on peanuts, because we do know that the consumers are thinking about the mix of nuts and snacking right now, and peanuts are really valuable item for them, so reminding them of how much fun Planters peanuts can be as well as the protein they deliver and a great snacking option. We'll see that. It wasn't just a 30-second commercial. You'll see activation both before the event, after the event and really leads us into the quarter as we activate some of the other seasonal launches later in the year.

The other thing to think about is not only that this business was starved and we've been investing both from an advertising perspective, from an innovation standpoint, as I mentioned, and then also from a capacity standpoint.

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So, for us to grow this business, we need to add capacity, which we've invested in, in regards to tube nuts for the C-store channel as well as the club channel, and we'll see that come online here later this year and into next. We also have work to do with the portfolio. Frankly, the assortment and price pack architecture, it's a big portfolio. And we know there's optimization that will allow us to unlock growth. And really, again, just thinking about where we're at with this business, we acquired the business, last year, we integrated the business. And right now, we're executing the business, and we know we've got work to do, but really confident in what I saw this week with the teams and where we're headed into Q2 and the rest of the year.

Operator: Thank you. The next question comes from Eric Larson, Seaport Research Partners. Please go ahead.

Eric Larson
Analyst, Seaport Global Securities LLC

Q

Thank you everyone. So, just a couple of questions. Can you provide a little bit more detail again or just remind us kind of the cadence of turkey volumes. I think turkey volumes on a year-over-year basis still have a difficult comp in Q2. And then I believe you were expecting those to start rebounding in the second half. And then also do the same thing for us with your commodity pork volumes. You should be starting to anniversary, I think, when you offloaded with the new contracts, some of that commodity volume. When do we sort of anniversary sort of the adverse comp that you would have on your commodity pork?

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

A

Yeah. Good morning, Eric. So, on the turkey side, the numbers that we've been talking about have come through that turkey has been down high 20s, 30% in terms of volume. And we expect that through the first half or now the second quarter of this year and expect volumes to rebound in the back half of the year. And that's all with the assumption that we don't have another significant AI outbreak like we did last year and then, of course, some events into the winter months. On the pork side, we are now just lapping that supply agreement. And so, as we go throughout the balance of the year, the comps will be more normalized.

Eric Larson
Analyst, Seaport Global Securities LLC

Q

Okay. Thanks. And then just a quick follow-up and this is maybe for Deanna. Can you give us a little – you mentioned elasticities and where you were seeing some of the – maybe more elasticity in some of your retail products. Can you give us a little bit more color on where those are and whether you may have to have some promotional adjustments on that? That was mentioned, I believe, in some of the prepared comments.

Deanna T. Brady
Executive Vice President-Retail, Hormel Foods Corp.

A

Yeah. So, it's very interesting, because it's a bit bipolar in that, you've got some categories where the elasticities are playing out exactly as expected. We've got other categories where the consumer has acknowledged the change in price on shelf and continues to purchase in their regular cycles. I would say where we're seeing more elasticity would be in areas that could be higher rings. So, thinking of like a fully cooked rack of ribs, we've seen some demand declines there. Obviously, having other areas for the consumer to shift to, so take a tub of barbecue or a dinner entree that has a lower price ring, but still allows – or meets the same consumer need of putting dinner on the table.

So, making sure that, as you mentioned, that we're promoting our products and pulsing in some of those areas and that we're advertising and making sure our consumers understand the value of our products and how they

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can utilize them speaks to the breadth of our portfolio. We've always talked about why it's valuable to have products at different price points and that meet different consumer need states, and it's exceedingly important right now.

Operator: Thank you. The next question comes from Ben Theurer of Barclays. Please go ahead.

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

Q

Yes. That was interesting on the last name. Thanks for taking my question. Just one I had on the different demand drivers, Retail versus Foodservice, in particular, because if we look into it, they're both somewhat equally down in sales, but then at the same time, in Foodservice, you were actually able to expand margins, on retail, we saw the margin contraction. So, if we come back to the whole inventory and the misalignment and demand kind of exceeding – well supply kind of exceeding demand, is that particularly in retail where you've got these issues and this misalignment, which caused the margins to be under pressure? Or is that also something you saw in Foodservice just not at the same magnitude, maybe because of mix that falls into Foodservice? Thank you.

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

A

Yeah, Ben, I think the way you described it there at the end of your question is correct. I mean there are inventory issues in both, but Retail is currently more. As you talked about the Foodservice pricing and sales, the element of that is, and we've talked about this frequently is we have seen some commodity relief and on the Foodservice side of the business, they're able to price closer to the market. The pricing is a lot more fluid.

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

Q

Okay. And then my follow-up, just quickly on China. I mean, we all know fourth quarter, particularly December, was a very tough one with the whole reopening and cases, et cetera. But as of today, early March, have you seen like particularly in February and like signs of consumers being in a more normal environment of consumption? Is it fair to assume that that could be an easier fix go-forward than maybe some of the issues you have on the inventory side over in North America?

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

A

Yeah. Again, Ben, that's a very fair assessment and we said that we have seen early in the second quarter the China Foodservice business has seen a nice uptick or nice rebound as consumer or Chinese population seems to be making their way through COVID and are now heading back out, so we've seen Foodservice up. On the Retail side of the business, we're really excited about the continued innovation that we've been able to deliver. The other thing, when we built that plant several years ago, we put in a SPAM line. And our SPAM business has done really well, especially our SPAM Singles business, and so we've seen that continue to grow on the retail side to the point where we'll be making some additional investments to support that growth. But your take on China is exactly what we're seeing and how we're thinking about it.

Operator: Thank you. The next question comes from Tom Palmer of JPMorgan. Please go ahead.

Thomas Palmer
Analyst, JPMorgan Securities LLC

Q

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Good morning and thank you for the question. I'm sorry to belabor the inventory discussion. I just want to clarify something a bit. So, it sounded like in the prepared remarks there were some constraints in terms of sourcing pork and turkey right now and that you're unable to produce enough peanut butter. So, maybe I heard this wrong but I don't think Planters can account for a lot of the inventory issue, so I just hope to better understand what types of products you've built up too much inventory of. And is it certain pork products that fall into that equation?

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

A

Yeah. So, Tom, I'll start with that first question. So, we didn't have any difficulty sourcing pork products for production. What we've said is it's just the decline is what we would've normally had coming at us that we don't today, so we used to have to sell it, today we don't; that's what we're talking about for the pork decline. The turkey is absolutely not enough turkey coming through to support the business. But as we think about the inventory across the entire portfolio, you're right. I mean, it's not all Planters; I mean, that's part of it. When we think about – as I described earlier, some of it is inventory that has been built for promotion, so think SPAM as we get into bigger promotions throughout the year.

We do have elevated inventories of ribs, we have some elevated inventories of complete bacon bits, so it is a mixed bag – other perishable refrigerated items. So, it's a mixed bag across the inventory that we have and the portfolio and so, yeah, we're not trying to pin this on any one item or one category. I mean, it is broad-based.

Thomas Palmer
Analyst, JPMorgan Securities LLC

Q

Okay. Thank you and thanks for all the details. And maybe just follow-up on the price increases you mentioned in Retail. Just any detail on how much of the portfolio is being addressed with pricing? Any help on the magnitude, the timing? And then, just are there certain commodity types that need to be addressed in particular?

Deanna T. Brady
Executive Vice President-Retail, Hormel Foods Corp.

A

Yeah, Tom, thanks. This is Deanna. I'll jump in there. So, we still have wraparound pricing that's flowing through. We took several price increases last year and some of those are still flowing through. We have a chunk of the portfolio that is in – currently in price increases, roughly about 5%. We've taken a very mindful approach to our pricing and thinking about elasticities, volumes, where we've added capacity. Obviously, we want to make sure that we're able to leverage that capacity, and so we've tried to be very mindful. So, we've taken multiple price increases, probably in smaller increments than some of our competitors have announced.

And really, the increases we're taking are justified for inflation, and so – and we'll continue to monitor that. We've got the ones as I mentioned that are already in the quarter happening and we've got a few other categories that we're evaluating as we sit today.

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

Peter T. Galbo
Analyst, BofA Securities, Inc.

Q

Hey, guys. Good morning. Thank you for taking the question. Maybe just the first question, more of a technical question around the re-segmentation and just to level-set everybody on the call. Have you disclosed at all just what percentage of the new Retail business will be captured in scanner data, so in Nielsen and IRI? And I think

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you had a helpful breakout for Retail, particularly just on the different verticals. Is there anything you can do to help us on the Foodservice side? I don't think there was anything in the slide deck from Tuesday.

Jacinth C. Smiley
Executive Vice President & Chief Financial Officer, Hormel Foods Corp.
A

So, in terms of the Retail component, it'll be somewhere around 80%. And then on the Foodservice side, I mean, there wouldn't be anything that you would actually see.

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

Yeah. We...

Peter T. Galbo
Analyst, BofA Securities, Inc.
Q

Right. No – sorry, go ahead.

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

No, that's okay. Peter, we're not going to have the same kind of vertical structure within Foodservice just because it doesn't – I mean, the industry doesn't even really think about it that way. What we will try to do over time is provide you more color. So, for example, in this quarter, as we integrated the JOTS business and we've talked about how that is going to be a benefit to both the JOTS business and the Hormel business, a channel like K-12, our school business had a really good quarter. So, we'll continue to try to provide that type of color, but from a, I'll say a typical reporting, it will all roll up just into Foodservice.

Peter T. Galbo
Analyst, BofA Securities, Inc.
Q

Okay. Thanks for that, Jim. And then...

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

Yeah.

Peter T. Galbo
Analyst, BofA Securities, Inc.
Q

...again, just to go back to the inventory side and maybe just to think about it in a little bit of a different manner, if you are going to be selling through more of your inventory or trying to get it more rightsized, I guess why wasn't there an adjustment to the sales line as well, just thinking about if you're going to sell into, I don't know, more discount channels or whatever you're going to have to do? And then, the second part of that question is just in your conversations with retailers, how should we think about what they're asking you to do? Is it to carry more of the burden of working capital, carry more inventory for them because they want to have less in terms of their working capital needs? And just the implications as how you're thinking about it on cash flow? So, I know that's a lot kind of as a two-part question, but appreciate the thoughts.

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

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Yeah. No, it's a really good question and so no, we have not moved off of our top line guidance. We know that there's a turkey uncertainty and expect that to come back in the back half of the year. The other part of this is our Foodservice business, and so even though we had some softness for a period of time in the first quarter, we expect growth for the balance of the year. So, those really are two drivers. And then as we expect our international business to come back with some of those challenges abating, we do believe that we'll be able to deliver that top line.

And then the second part of that question, we're not getting that pressure from retailers in terms of keep more inventory. As Jacinth said earlier, we know how to run this business. And historically, we've had very, very strong fill rates. It's obviously some of the supply chain challenges that we've had over the last two, three years that have prevented us from getting to those fill rates. But slowly but surely, we are getting those fill rates back to where they were. And so, [ph] we weren't (01:00:55) able to operate the way that we did pre-pandemic, that's really the expectation.

Operator: Thank you. The next question comes 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

Good morning.

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

I just want to come back to Planters specifically, when you detailed some of these challenges, it's one of the three things you call out as a focus area in terms of optimizing promotional support and everything else. But then you also called out the capacity expansion even though those volumes have been down kind of mid or more single digits for some time. Can you just maybe elaborate on what pain point the capacity expansion solves given the current situation?

Deanna T. Brady
Executive Vice President-Retail, Hormel Foods Corp.
A

Sure. Thanks, Michael. The capacity expansion specifically address the continued evolution of snacking as well as C-store and club channel. So, the capacity we're adding a specific packaging that really is on trend with how consumers want to snack today. Then you think about the tube nut in particular, both in a singular purchase as well as in a club variety. The additional capacity is really designed to help us continue to meet the demand, which is exceptional there. And then the other area of growth that we haven't talked about that is really a hidden gem in the portfolio is the Corn Nuts business and some really great flavors that are coming to market. And as we think of the convenience store business, really the 100 days of summer is where that business really comes to life. So, adding capacity both for C-store and club store is where we're leaning into right now.

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

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And I think it's important to know, Michael, these are things that we knew when we bought the business, right? We knew that there was going to have to be some packaging innovation, which we did last year with the new bottle and then also some capacity investments. So, it was existing packaging, but we saw that as an opportunity. It was just a matter of what the timing was that we were going to need it. And then as Deanna mentioned, we've seen really, really strong growth since day one for the Corn Nuts business, and we don't expect that to slow down.

Michael S. Lavery
Analyst, Piper Sandler & Co.

Q

Okay. That's helpful. And just coming back to Garuda, did you have an option for a bigger stake there or could you at some point? How do we think about whether or not that ever becomes part of above the line in operations?

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

A

Yeah. I think for now, it was – we took out the previous private equity owner. That was the big stake that was for sale. So, for us, it was the right size at the right time. And again, I mean, we've been a partner with them, but it's early days, and we still need to learn about the business, about the market. We know it supports our two strategic initiatives: first, adding scale in snacking and entertaining and developing that global presence. And so, as we go along, we certainly think there will be opportunities for us to – if the business delivers for us to take a bigger position.

Operator: Thank you. Our last question comes from Adam Samuelson of Goldman Sachs. Please go ahead.

Adam Samuelson
Analyst, Goldman Sachs & Co. LLC

Q

Yes. Thanks for squeezing me in. So, I guess, first question just on Jennie-O or turkey, I should say, you're talking about volumes improving and starting to normalize in the back half, assuming no further HPAI, but I think – and you already started to see this commodity breast meat pricing coming down and that would continue if there is no further supply disruptions in the turkey market. Commodity breast meat pricing was actually a big margin uplift to that business last year. I know it's now getting – it's now split between Retail and Foodservice and International, so it's not as visible. But did your full year outlook for your turkey business profitability actually come down with this update? I just – it's not clear, because it would seem like turkey breast meat pricing is a pretty big – could be a pretty big headwind over the balance of the year?

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

A

Yeah, Adam. Good morning. We have not changed the outlook for the turkey business at all. You're right that we've seen lower breast meat markets. But the turkey business is still in a very favorable position. Turkey demand is strong. The value-added portion of the business continues to do well. And as we get more meat, we'll be able to fill more of that. We know that whole birds cleared really well this holiday season. And that bodes well as we head into the next holiday season. And then I do think, for us, this is all about what happens with AI. And we'll know a lot more here in the next couple of months as to what, if any, impact it will have in the business. But yeah, we've not changed our outlook and feel like there's still plenty of opportunities to drive a strong performance even as the breast meat market has gone lower.

Adam Samuelson
Analyst, Goldman Sachs & Co. LLC

Q

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Okay. And then, if I could just ask one last follow-up and this inventory question has come up in a lot of different ways. But I guess, I'm struck with the new reporting structure and the new segment structure kind of there's a little bit less kind of connectivity between some of the plants and the end sales channels than there might have been before. There's always some disparity, but you now have like bacon going through two different channels versus one previously or two reporting units. And how are you thinking about kind of the ownership on working capital and kind of tying performance of business leaders to not just segment profit or sales, but also whether it's a cash flow, return on net asset kind of metric that I don't think has been a big part of the incentive compensation structure previously?

James P. Snee

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

A

Yeah. So, Adam, I mean, the flow of the product through the sales side really hasn't changed. And we've had it – the bacon example you mentioned, we've had it going into Retail, and we've had it going into Foodservice the same way that we always have. If anything, this structure actually centralizes and creates less confusion in terms of who has responsibility with – Deanna, now overseeing Retail. And it's really, really helpful. We do have elements of our incentive that are – that do take into account return on invested capital. We use that more as a modifier to make sure that the team continues to keep an eye on that because we know how important it is. But we're not – we don't have any plans to change the rate of that as an element of compensation. We feel like we've got the proper oversight to drive improvement over time.

Jacinth C. Smiley

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

A

Yeah. And just to clarify or just to emphasize, the GoFWD structure hasn't in any way mudded up the waters in terms of how we look at the business and how incentives are aligned to drive the results. It actually does the complete opposite. And now there is very clear delineation and transparency in terms of objectives in driving the results and the outcome for the business.

Operator: Thank you. Ladies and gentlemen, this does conclude your conference call for today. We thank you for your participation and ask that you please disconnect your lines.

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