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Hormel Foods Corp. (HRL)

Q2 2023 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, and welcome to the Hormel Foods Second 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] Please note that 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 Dahlstrom
Director of Investor Relations, Hormel Foods Corp.

Good morning. Welcome to the Hormel Foods conference call for the second quarter of fiscal 2023. We released our results this morning before the market opened, around 6:30 AM Eastern Time. 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 second quarter results and give a perspective on our outlook for the balance of fiscal 2023. Jacinth will provide detailed financial results and further commentary on our outlook, and Deanna will join Jim and Jacinth 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

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queue. At the conclusion of this morning's call, a webcast replay will be posted to our investor 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.

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. We had clear priorities heading into the second quarter, and our results demonstrate our team's ability to execute on those commitments, deliver results in line with our expectations for the quarter, and most importantly, keep us on track to drive growth in the back half of the year.

Before I dive deeper into our quarterly results and reaffirmed outlook for the year, I want to start this morning by providing an update on the progress we have made addressing inventory levels, improving our margin structure, stabilizing the Planters business and continuing the implementation of our GoFWD operating level.

First, I'd like to discuss the progress we made rectifying the inefficiencies caused by elevated inventory levels. This was a top priority in the company during the second quarter and we took immediate actions to sell excess non-productive inventories, to slow manufacturing in areas where supply was exceeding demand, to bring back outside production into our facilities, allowing us to better utilize new and available internal capacity, and we implemented several changes to our demand and supply planning processes.

As anticipated, these actions had a margin impact during the quarter, but were necessary to bring inventory levels into greater balance. For the back half of the year, we have further plans in place to responsibly manage and lower inventory levels and all costs associated with these actions are accounted for in the outlook.

As a result, we expect to begin fiscal 2024 with benefits from better process control, lower freight and warehousing expenses, lower distressed sales and higher investment income resulting from an improvement in our cash cycle.

Second, we continue to make progress improving our margin structure as evidenced by a sequential increase in operating margins during the quarter, even with our actions to reduce elevated inventory levels. In addition to managing costs and driving supply chain savings through continuous improvement programs, our inflation-justified pricing actions are leading to gradual margin improvement. We have announced targeted pricing actions effective at the end of the third quarter on additional retail items and are evaluating further pricing actions accordingly.

Another way we are actively improving our margin structure is by optimizing promotional and advertising spend. We demonstrated that discipline this quarter by responsibly shifting some advertising spend to promotions, working with our retail partners to drive the best returns for our leading brands and growing the categories in which they compete.

We are still expecting a year-over-year increase in advertising spend to support our leading brands. Specific to the second half of the year, our teams are focused on several projects aimed at reducing cost and complexity to

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further improve our margin structure, and we expect to see return from some of these projects by the fourth quarter.

Third, we took action to improve the Planters business. During the second quarter, we regained significant distribution and placements for the Planters brand, which started shipping at the end of the second quarter. We introduced much-needed innovation to the category with flavored cashews and new Corn Nuts varieties. And we shifted promotional resources to drive consumption for the Planters brand.

The brand saw shipments increase 8% for the quarter, aided in part by the strong promotional execution. While early, data for the latest 13-week period on a volume basis indicates that the Planters brand is outpacing the packaged nuts and seeds category and is showing positive takeaway growth for peanuts and cashews. This summer, we are also running a national campaign for our new flavored cashews to maintain momentum for this business.

Our progress during the second quarter represents a positive proof point in the turnaround for Planters. Planters remains at the center of our snacking & entertaining strategy and we are fully committed to the Planters brand, Corn Nuts brand, and the snack nuts category. We know what we need to do to change the trajectory of the business and our teams are focused on accelerating the pace of change.

Finally, we made further progress implementing the GoFWD operating model and standing up our brand fuel center of excellence. With the structure now mostly in place, we can better resource other long-term projects including advancing the supply chain workstream of Project Orion.

We temporarily scaled back some workstreams as we prioritize the integration of the Planters snack nuts business, our transformational actions at Jennie-O Turkey Store and the implementation of GoFWD.

The supply chain workstream represents some of the most important and highest return deliverables on the entire Project Orion roadmap. We have also kicked off a series of multi-year projects such as a modernization of our order-to-cash system, improvements to the end-to-end planning processes, and a pilot project to implement new ways of working across the manufacturing network. We plan to provide more detail on these large scale and strategic projects as well as our continued evolution as a global branded food company at our Investor Day in October.

Results for the second quarter were in line with our expectations. From a top-line perspective, sales declined 4% on a volume reduction of 6%. Volume declines were largely attributed to impacts across the turkey supply chain due to highly pathogenic avian influenza or HPAI in our supply chain last fall.

In addition to the large headwind from turkey, net sales were negatively affected by significant pork deflation during the quarter. This had the most profound effect on the Retail bacon and Foodservice value-added portfolios. Diluted net earnings per share for the quarter was $0.40.

Earnings headwinds were understood heading into the quarter and included strategic investments to stabilize the Planters business, margin impact related to our actions to address inventory levels, challenging operating conditions in China, lower turkey sales, higher feed and pension costs and a higher tax rate.

Turning to the segments. Strong bottom line growth from the Foodservice segment during the quarter and the benefit from cost relief in certain areas was offset by lower results from the Retail and International segments.

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Again, this quarter, we leveraged our longstanding relationships, differentiated product portfolio, and direct sales team to drive growth for our Foodservice business.

Volume and net sales growth in the sliced meats, pizza toppings, and premium breakfast sausage categories was more than offset by the impact of lower turkey volumes and lower net pricing, reflecting raw material commodity deflation. Our Foodservice business remains extremely well positioned.

We have available capacity to regain business lost over the last three years due to constrained supply, especially on key categories such as bacon and pizza toppings. We will also continue to lean into our world-class culinary team, innovative items, and food forward mentality, all which further differentiate our business from the competition.

At retail, we benefited from pricing actions and the strength of our leading brands, helping to partially offset the impact of unfavorable mix and higher operating costs. During the quarter, net sales growth from the global flavors vertical was more than offset by lower net sales across the other retail verticals.

Like the Foodservice segment, the impact of lower turkey volumes and lower bacon pricing were the primary drivers of lower top-line results as elasticities played out better than expected in most categories.

The MegaMex business housed in our global flavors vertical had another strong quarter. Net sales growth was led by the WHOLLY, La Victoria and Herdez brands. The pricing actions we have taken across this business to combat inflationary pressures, coupled with commodity relief on avocado inputs are leading to significant year-over-year gains in equity and earnings.

Elasticities on this portfolio remain favorable and we expect to benefit from continued distribution gains from our innovation pipeline, including Herdez branded guacamole and refrigerated sauces. The bacon vertical also delivered another quarter of outstanding results due to strong demand for Black Label items and lower belly prices.

Black Label raw bacon takeaway for the quarter exceeded 20% in volume sales. We are executing extremely well in the bacon category and anticipate continued growth in market share and household penetration, while benefiting from cost favorability. The convenient meals and protein verticals saw sales growth from many of its branded products, including chili, SKIPPY peanut butter, Square Table, refrigerated entrees, Dinty Moore stew and Mary Kitchen hash.

Overall net sales for the vertical declined due to lower contract manufacturing results as we prioritize higher margin branded businesses. The Convenient Meals & Proteins business has secured additional customer distribution for the back half of the year. And our categories, brands and household penetration growth trends remain favorable.

Net sales declined for the snacking & entertaining vertical, primarily due to strong promotional activity for the Columbus brand last year. Planters branded volume increased 8% for the quarter, while the Hormel pepperoni and Hormel Gatherings brands grew net sales double-digits compared to the previous year.

As noted earlier, we expect to continue to benefit from favorable customer resets for the Planters business and from distribution gains on our pepperoni items in the back half of the year. In the emerging brands vertical, Applegate drove growth for its frozen breaded chicken and breakfast sausage items. And the Applegate business continue to diversify its channel exposure, which is key to its long-term growth.

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Distribution gains in the mass channel and the strength of its e-commerce business are helping offset some weaknesses in the natural and organic channel. The final vertical, value-added meats was most heavily affected by lower turkey availability, leading to volume and net sales declines. We expect a strong finish to the year from this vertical due to higher Jennie-O turkey volumes and positive trends in the deli.

The Retail environment remains extremely competitive and the benefits we've seen from GoFWD to better focus and resource our teams position us well to deliver our plans in the second half of the year.

While the International segment remain challenged, the team drove excellent growth for the SKIPPY and Planters brands as well as another quarter of growth from the team in Brazil. Segment profit declined significantly due to lower sales in China and lower turkey export sales. In China, Foodservice sales improved sequentially throughout the quarter, helping offset the difficult comparison to retail pantry loading and sales to food security programs last year.

Though we have seen an acceleration in our Foodservice business, a recovery in our Retail business following the COVID-related policy changes earlier in the year has been slower than anticipated. The team in China has aggressive plans in place to drive improved results in the back half of the year.

Limited commodity turkey supplies and restrictions on turkey exports continued to affect results as export turkey volumes declined 50% compared to last year. With the rebound in turkey supplies, we expect this headwind to lessen in magnitude in the back half of the year.

The second quarter also marked the first full quarter of minority ownership in Garudafood, one of the largest food and beverage companies in Indonesia. Garudafood delivered returns in line with expectations during the quarter, and we look forward to further leveraging the strengths and capabilities of both companies to expand the business in Indonesia and Southeast Asia.

International business is structurally sound and increasingly balanced. We are confident that the near-term dynamics will gradually abate allowing our teams to resume delivering accelerated growth. We expect sequential improvement in the back half of the year on contributions from our branded exports, multi-national businesses, and partnerships around the world.

Finally, it's important to note that we are experiencing a direct benefit from our multi-year efforts to align resources to value-added platforms and reduce exposure to commodity businesses. Since 2017, we have made many decisions to align our pork supply chain to the long-term trends of the industry, guarantee supply for our value-added businesses and reduce the earnings volatility from commodity exposure.

In this difficult commodity environment, we have benefited as a net buyer of trim and bellies. So we have absorbed significant losses on our harvest operations like others in the industry. We will continue to monitor long-term industry trends and where necessary, make adjustments that are supportive of our value-added growth strategies and our longstanding partnerships throughout the supply chain.

Shifting to our outlook. We expect sales and earnings growth in the back half of the year. Growth from the Foodservice segment and an inflection in the International segment are expected to be the primary drivers of the year-over-year gains. All the businesses are expected to benefit from a rebound in turkey volumes and improved fill rates in key categories such as, bacon, pepperoni, snack nuts, and for our SPAM family of products.

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Coupled with the progress we have made on GoFWD, including standing up Brand Fuel, restructuring our sales teams, and resourcing the marketing teams to better support our leading brands, we remain confident in our growth outlook as we continue to meet the needs of our customers, consumers, and operators.

On a related front, we have made significant commitments and investments to ready the business to serve our customers in California. As of January 2022, we have been Prop 12 compliant on a portion of our pork supply, absorbing the cost of compliance in our operations since that time. As we begin serving the important California market under new regulations later this month, we expect to begin recovering the cost from these investments.

Considering these factors, we are reaffirming our full-year net sales and diluted net earnings per share guidance ranges. We expect net sales growth of 1% to 3% and diluted net earnings per share of $1.70 to $1.82. We are encouraged by the progress we have made and our team's sense of urgency to address the near-term challenges impacting the business.

At this time, I will turn the call over to Jacinth Smiley to discuss detailed financial information related to the second 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 second quarter were $3 billion. In the second half, the negative top-line headwinds from our new pork supply agreement and the beginning of HPAI last year will have fully annualized. We expect a strong volume rebound in our turkey business in the back half of the year.

Second quarter gross profit was $491 million. The benefit from pricing actions was more than offset by unfavorable mix and higher expenses. For the second quarter, SG&A expenses as a percentage of net sales decreased to 7.1% from 7.3%. Through the first half of the year, SG&A as a percentage of net sales is in line with last year, demonstrating our disciplined cost management.

Advertising investments were $35 million during the quarter as we continued to support our leading brands in the marketplace. We expect full year advertising expenses to increase compared to the prior year. Equity and earnings of affiliates from the second quarter increased significantly compared to last year due to improved results from MegaMex.

Operating income for the second quarter was $296 million. Operating margins of 9.9% improved from 9.7% in the first quarter. Net unallocated expenses in the second quarter increased 6% due to higher pension costs, which were partially offset by improved rabbi trust investment results.

The effective tax rate for the quarter moved higher to 22.1% compared to 18.7% last year. As anticipated, we did not repeat last year's favorable rate, which reflected higher stock option exercises. The effective tax rate for fiscal 2023 is still 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 flows and capital allocation. Our financial position remains an area of strength, allowing us to satisfy our required strategic and opportunistic uses of cash. Operating cash flow was $208 million for the second quarter compared to $193 million last year, an 8% increase. We paid our 379th consecutive quarterly dividend effective May 15 at an annual rate of $1.10 per share, a 6% increase over last year.

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We also announced our August dividend payment earlier last week, which will represent 95 years of uninterrupted dividend payments to our shareholders. We are now targeting $280 million in capital projects, which is in line with our historical investment in CapEx. We continue to prioritize investments in capacity for growth, innovation, cost savings, automation, and maintenance. Our current net leverage ratio remains within our stated goal of 1.5 to 2 times.

As a reminder, our next debt payment is due June of 2024. In April, we made an additional $15 million investment in Garudafood, bringing our minority ownership from approximately 29% to 30%. As noted last quarter, we do not expect the investment in Garudafood to have a material financial impact on fiscal 2023 results.

Finished products inventory increased 1% compared to the first quarter as our actions to mitigate the impacts from higher inventory levels were offset by inventory build for SPAM promotions later this summer and as we restore SKIPPY inventories to healthy levels. As we responsibly work through higher inventory levels over the balance of the year, we expect a reduction in non-productive inventory levels for days sales in inventory to return to a normalized range below 60 days.

Lastly, we repurchased 310,000 shares for $12 million during the quarter. We will continue to repurchase shares opportunistically based on our internal valuation with authorization to purchase roughly 3.7 million additional shares. As Jim detailed, we are reaffirming our net sales and diluted net earnings per share outlook for the year.

In addition to successful execution against our plan for the Planters snack nuts business and a recovery in China, growth for the balance of the year is dependent on: continued improvement across the supply chain, including delivering on our internal cost reduction goals; year-over-year favorability in commodity and freight markets; and a strong recovery in turkey volumes.

In the second quarter, our fill rates saw meaningful improvement and are now exceeding 95% across the domestic businesses. With this came higher service levels and a financial benefit from on-time deliveries, a credit to our supply chain team and the strategic investments we have made in our business.

I'm also proud to report that we remain on track for one of the safest years in our company's history. As Jim noted, our team has also committed to several projects aimed at reducing cost and complexity to improve our margin structure. These projects span many areas of the supply chain, including procurement, manufacturing, and logistics to accelerate, identify and capture cost savings opportunities.

Specific to the back half of the year, we are assuming incremental freight and indirect supply savings and a higher than historical run rate from our legacy cost mitigation efforts. Signs of continued market stabilization and cost relief in areas such as raw materials and freight are also supportive of our gradual margin improvement for the business.

As expected, prices on key protein inputs during the second quarter generally declined compared to last year and the first quarter. The USDA composite cutout declined 23% compared to last year and was 7% lower than the first quarter. This decrease was driven primarily by bellies, which declined 50% compared to last year. Trim prices are also trending lower than the prior year and declined counter-seasonally heading into Memorial Day.

The full financial impact of more favorable raw material prices will continue to lag as we work through the elevated inventory and absorb higher grain and beef costs. We have assumed lower freight expenses in the back half of the year due to the actions of the supply chain team, softening industry demand for trucks, and increased carrier capacity.

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Driver participation is above pre-COVID levels and has remained stable. These savings will be partially offset by continued headwinds from warehousing expenses as industry-wide cold storage constraints persist. The overall impact of HPAI on domestic poultry supply chain in the US this spring was minimal. The risk associated with the return of the virus now appear to be low heading into the summer months.

Turkey markets moved lower in the second quarter and have continued to decline due to a rapid recovery in supply. We are again producing full assortment of turkey items and our teams are selling with confidence into the Retail, Foodservice, and International markets.

As we said last quarter, demand for Jennie-O turkey products remains positive and we expect improved 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 fee positions.

Our team is delivering on the commitments we laid out last quarter and is continuing to lead in the area of social responsibility. Recently, we were recognized as one of Barron's 100 Most Sustainable Companies named as one of the top 5 Conscientious CPG companies by Progressive Grocer and honored with the distinction of being named one of America's Most Trustworthy Companies by Newsweek for the second year in a row.

We strive to earn and keep the trust of our customers and stakeholders every day through our actions and commitments to transparency, accountability, and integrity. All of these recognitions are a testament to the dedication and hard work of our team members who are the foundation of our continued success.

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] Your first 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

So you had been pretty clear about the headwinds in the second quarter and the focus, I think, really is more in the second half. You've reiterated your outlook there. Can you just give us a sense for – you've laid out a lot of drivers, for the sales and earnings growth, you pointed to Foodservice as a key contributor there. And obviously, its earnings grew in the second quarter, but turkey and bacon pricing weighted down from – on the top-line. Is it just turkey availability improvement that really moves the needle? And if that's a key factor, can you give a sense of just your visibility on that into the second half? And just how much risk there may or may not be?

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

A

Yeah. Michael, thanks for the question. I mean, there's a combination of things as we think about the back half of the year. Foodservice will continue to be a driver in our business as it has been this year and previous years. But as we think about the availability of turkey, when we think about some of the capacity that we now have with projects that have come online, our most recent SPAM line, our expansion of pepperoni, the continued growth and performance of the Planters business.

And then the other variable to consider is, as we think about the back half of the year, although they're not there today, we've built in some higher markets for the back half of the year. So especially for those items where the pricing is more pass-through, you're going to have a top-line impact, but then all those other things contribute to both top-line and bottom line. So those are the things that we really can control and that's what we're focused on as we head into the back half of the year.

Michael S. Lavery
Analyst, Piper Sandler & Co.

Q

Okay. That's great color. And just to follow-up on the pricing comment that you mentioned the pricing in 3Q, in most of the group, the pricing really seems to have peaked and there's fewer and fewer announcements like that. Have you gotten a lot of pushback? How broad of a price increase is it? Can you just give a little more color on how we should think about that?

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

A

Michael, thanks for the question. This is Deanna. Relative to Retail, we've taken pricing in Q2 in a few categories. We have a few categories we're looking at as we head into Q3. But we're being extremely mindful to protect both our margins, but also to protect our relationship with our customers and our consumers.

I think, when we approach the retailers with the right information that support the price increase, we've been able to come to terms and move forward, we've always – obviously, it's their job to protect their margin. It's their job to protect the consumer. Those aren't new conversations to us in regards to approaching pricing. So it's really about having all the data and the facts to support what you're doing and why.

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

A

And just as a reminder, Michael, our Foodservice business tends to be closer to the market with pricing than Retail.

Michael S. Lavery
Analyst, Piper Sandler & Co.

Q

Yeah. Okay. Thanks so much.

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

A

Yeah.

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

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

Q

Yeah. Good morning and thanks for taking my question. Just following along these lines and wanted to understand a little bit if you could elaborate what you're seeing more recently and what your expectations are as it relates to volume. I mean, with the pricing actions being taken, how do you feel about the volume reaction into the back half? And how much of that maybe volume recovery is then ultimately going to help you to drive some of the profit recovery you're looking for? That would be my first question.

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

A

Good morning, Ben. Similar to the previous question, the turkey volume is volume that's coming back. And so, as Jacinth mentioned, the impact of HPAI this spring has been minimal. We're now producing a full slate of items. We've got our sales teams focused and reengaged on selling turkey. You don't just flip a switch after a year of not having turkey, but they are focused and reengaged. And so, that is, call it, new replacement volume, whatever the right term is, that's that returning volume on the turkey side of the business.

We have been capacity constrained on a couple of the categories I mentioned earlier. So having those freed up, allow the sales team to go out and sell. And then, the really good work that our team has done on Planters really has the opportunity to drive additional top-line and bottom line in the back half of the year. And maybe Deanna can add some color on some of the – maybe some of the categories.

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

A

Sure. As we think about volume in the back half, we're really encouraged to have turkey back with the ability to promote. So we're out actively setting up promotions for the back half of the year with our retailers. Bacon continued to enjoy growth in the first half and we don't see anything stopping that in the back half. The brand performed really well in regards to gaining new households as well as gaining growth in the marketplace.

We'll continue to support those brands with both promotions, with advertising, as well as innovation, which was planned as we added capital in the areas of bacon, pepperoni. And as we think about Columbus and Planters, you'll see really advertising, promotion, and media across all of those as well as innovation. So we feel good about the volume through, again, turkey, bacon, pepperoni, Columbus, Applegate, and Planters, as we saw some improvement in Planters most recently at the end of the quarter and have plans as we head into the back half.

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

Q

Okay. And then, just one quick housekeeping as it relates to CapEx and the reduction here and the new target. Can you explain the reason why you're lowering the CapEx? Is it the delay? Is it not execution? Is it just being more cautious on capital allocation in general? Just a few comments around that would be appreciated.

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

A

Good morning. Thanks for your question, Ben. So just to start off, we are in a very strong financial position and continue to be. As we look at the spend, the spend is absolutely in line with our historical levels. And quite frankly, I mean, we've gone into the year with an expanded CapEx spend and this is just a natural fallout that happened as you go to execute for different reasons.

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There is slippage that actually happens when we try to execute so many projects during the year. That being said, we're in a great position in terms of what we've invested in our capacity for the business and also what we need to do from a maintenance perspective.

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

Q

Okay. Thank you.

Operator: Thank you. The next question comes from Ben Bienvenu of Stephens. Please go ahead.

Ben Bienvenu
Analyst, Stephens, Inc.

Q

Thanks. Good morning.

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

A

[ph] Good morning, Ben (00:41:47).

Ben Bienvenu
Analyst, Stephens, Inc.

Q

[ph] I wanted to ask (00:41:46) about mix across each of the segments. It was a factor that unfavorably influenced the Retail business, favorably influenced the Foodservice business. I'm curious to understand the factors influencing mix. How much of them were externally driven? And what are the things that you all can do from an initiative or internal perspective that either amplifies the benefits that you're getting in Foodservice or combats the challenges you're facing in Retail?

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

A

Sure. Thanks, Ben. On the Retail side, when we think about the mix, again, it's always a mixed bag. We've had our bacon business, which has had a positive impact. Planters has had a dilutive effect on mix, when we think about what's happened in China. And so, there's a lot of moving parts across the entire portfolio even when we think about the commodity side of the business and what's happened.

But I think the Retail team is focused on the right opportunities to drive and improve mix. And when we think about the sales and volume opportunities in the back half of the year, a lot of those are improved mixed items. The Foodservice team does a great job historically of really laddering up and increasing the value-added proposition of their portfolio. And so, we expect that to continue. And then, in the International business, just as China moderates and we see that inflection point and improvement as markets open up for them to be able to move more product, we see that mix improving as well.

Ben Bienvenu
Analyst, Stephens, Inc.

Q

Okay. Great. On International, you talked about availability of turkey getting better. HPAI seems to be mostly in the rearview. I know, it's still – we're still in monitor mode. What is the pace of improvement that you're expecting in that business and then exports in particular?

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

A

Ben, I think, probably the most important piece here is when we think back to the back half of last year and our volume was down of 30%. That was very, very significant. And so, as we're looking at the back half of this year, we do expect Q3 to be relatively flat, maybe a slight increase and then, in Q4, would expect an increase.

Specifically on the International business, there are some nuances with the Jennie-O turkey business as we've restructured the business and moved into our GoFWD model. A lot of that responsibility was in Jennie-O this year. It's in the International business and they've been negatively impacted by market closures tied to AI. And so, we've already started to see some markets reopen, which will allow them to move additional volume and then also, obviously, additional margin with that.

Ben Bienvenu
Analyst, Stephens, Inc.

Q

Okay. Very good. Thanks so much.

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

Thomas Palmer
Analyst, JPMorgan Securities LLC

Q

Good morning and thanks for the questions. I wanted to maybe just touch on the expected cadence of earnings in the second half of the year. If we go back many years, your third quarter earnings have typically been the lowest quarter of the year. I know the first couple of quarters of this year had some unusual headwinds, but it does sound like pricing actions, some operational improvements, and some of the volume recovery, right. Is a bit more weighted to the fourth quarter?

It also sounded like maybe there's a bit more work to do on working down inventory in the third quarter. So I guess with respect to that third quarter, should we expect 3Q to follow this historical cadence, meaning, something below the $0.40 of the past two quarters? Or just given some of the improvements is more of a rebound expected this year?

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

A

Yeah. Thanks for the question, Tom. I think, there's a couple of things to consider. And historically, I get the point of reference, but I would say this is a fundamentally different business that we're operating today. And so, as we think of Q3 in terms of cadence, we do expect to be marginally higher than last year.

To your point about the work that remains, as we said on our first quarter call, we had very clear priorities and team did a great job executing against them, but the work is not done. And so, we do expect to see some of those benefits in Q3, additional benefits in Q4. So [ph] well (00:47:10) the work is not done, team is doing a great job, but the priorities remain the same for us.

Thomas Palmer
Analyst, JPMorgan Securities LLC

Q

Okay. Thanks for that detail. And then, maybe just on the pricing side, you mentioned it is inflation-justified pricing. Maybe just some color on what commodities are the general focus for this pricing? And is this related to

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inflation that's cropped up in recent months or is this more catch-up for something that happened in past quarters?

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

A

Good morning. Thanks for the question. It's really a couple of different things. Some of it will be catch-up, not necessarily based on markets, but it will be a collection of the input costs going into our items. We also have to factor in, we've invested into capacity, and obviously, depreciation comes at us as a result of that. So we're always thinking where we need to grow and obviously, growth has to be paid for.

The other piece would be looking forward in regards to some of our markets that are a bit more annualized as we start looking into next year and where we're expecting some input increases and positioning ourselves for that to maintain our margins as well as to be able to ensure we can invest in our brands through trade and advertising.

Thomas Palmer
Analyst, JPMorgan Securities LLC

Q

Great. Thank you.

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. Thanks for taking the question.

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

A

Good morning, Peter.

Peter T. Galbo
Analyst, BofA Securities, Inc.

Q

Jim, I know we've kind of beat this topic over the head. But just on the sales and revenue cadence for the year, I just want to make sure I have it clearly – the guidance, even to get to the low-end of the range kind of implies you go from like a minus 3% in the first half to actually accelerating the sales to like 5% plus in the second half. And understanding you're lapping Jennie-O and there's a lot of other moving pieces on the volume side from the WholeStone contract from last year. Just can you help us understand what's actually embedded in your volume assumptions by segment, if possible, but even at the full level would be helpful?

And then, the second part to that would be just like how much of this is you need demand to reaccelerate from a volume standpoint versus you know because of pipeline fill and I think you said shelf resets that allows you to kind of get there on the volume side. Just if you could really unpack that for us, it would be very helpful.

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

A

That's a lot to unpack, Peter. I'll do my best here. I think, again, starting at the end, demand is always important. But this idea that we need some unbelievable demand acceleration, that's not necessary for us to be able to deliver growth in the back half of the year. And I know it's going to sound repetitive, but a big part of this is getting

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turkey back, getting that full assortment back, being able to now sell in some categories that were capacity constrained, stabilizing and growing that Planters business.

And those are all the things, in addition to the other parts of the business that are growing already. And as we think about the segments that you asked about, Retail has got a lot of dynamics and a lot of puts and takes. So even if we said Retail volume will be relatively flat, we do expect volume growth in Foodservice and International. And when we roll all of that up, your number or your estimate is appropriate and we've got the ability to get there with all the dynamics I mentioned.

Peter T. Galbo
Analyst, BofA Securities, Inc.

Q

Okay. No, that's very helpful, and appreciate that. And then, maybe just for Deanna and I know we've talked about pricing a lot as well, but like your largest customer has come out and said, hey, we need food companies to bring pricing down and again, with incremental pricing actions going in, understanding it's inflation justified. How do you reconcile kind of those comments?

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

A

Yeah. So as we think about the back half, if you recognized last year, we didn't have trade promotions in place. So the lot of the work we're doing with our retailers is jointly talking about category growth as well as where are the consumers at and really trying to pull strategies that leverage trade. We shifted some dollars from below the line to above the line to continue to support promotions as well as a lot of in-store activation, coupled with advertising.

And so, while we may start with a price request, we can come to the table and talk about, price is only one factor and what else do we need to do together to really think about category growth as well as ensuring that the consumer is remembering what value our brands play in their lives. And price doesn't do that alone. And so, we really tend to come to the conversation with them, really focusing on – that's one thing. Let's talk about that. But let's talk about how we can bring in pricing promotion as well as displays into the store and that's – you'll see from us in the back half.

Peter T. Galbo
Analyst, BofA Securities, Inc.

Q

Great. Thanks very much, guys.

Operator: Thank you. The next question comes from Rupesh Parikh of Oppenheimer. Please go ahead.

Rupesh Parikh
Analyst, Oppenheimer & Co., Inc.

Q

Good morning. Thanks for taking my question. So I just want to get your thoughts on a consumer backdrop. I know there's [ph] snap (00:53:14) reduction in the market that could be impacting Retail. So curious just what you guys are seeing in Retail. And then just in Foodservice, I think late last year, you guys may have seen a slowdown, but just curious what you're just seeing right now in the demand side in Foodservice.

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

A

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Yeah. Good morning, Rupesh. So when we think about just the consumer dynamics in general and I'll let Deanna add some color on the Retail space. But I think – the one thing that we don't want to lose sight of is the fact that we've touted and we've built very intentionally this balanced business model.

And so, in this really dynamic environment, dynamic is probably an understatement, we really benefit from that balanced business model, whether it's premium tier, value tier, think about the alternate channels, protein inputs. I mean, there's a lot of balance across everything that we do. And that really benefits us in this environment. From a Foodservice perspective, the volume and then the business remain strong.

And so, the team recently at the National Restaurant Show and the feeling there is a level of maybe cautious optimism, but optimism nonetheless. And as you think about, people are still traveling. And what we're seeing in all the different segments, which again, is the balance that we've built in that Foodservice business as well, really serves us well. So, that's why we're still optimistic about the Foodservice business. We believe the demand is there. And then, we also – we believe that our focus on the different segments allows us to capitalize on opportunities as that business can shift from segment-to-segment. Deanna?

Rupesh Parikh
Analyst, Oppenheimer & Co., Inc.

Q

Great. And maybe just one follow-up question just [indiscernible] (00:55:07)...

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

A

I'll let Deanna to add some commentary on the Retail side, Rupesh.

Rupesh Parikh
Analyst, Oppenheimer & Co., Inc.

Q

Okay. Perfect.

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

A

Rupesh, what I'd add for the Retail side is, we're seeing consumers [ph] being (00:55:17) extremely intentional about their spending, not only where they're shopping, how they're shopping, and then what types of items they're buying. As a result, we continue to see consumers gravitate towards surprisingly, our premium offerings. And when you think about – so think about a party tray or Columbus charcuterie board, those are items that are bringing value to their lives and are a part of their family and something that they're extremely proud of.

So parts of our portfolio may have some near-term impact, but a lot of our brands are really still very, very important. And as I mentioned earlier, that's why we continue to [indiscernible] (00:55:58) advertising and promotions and then store activation, so that they remember the role that the brands play.

Rupesh Parikh
Analyst, Oppenheimer & Co., Inc.

Q

Thank you. I'll pass it on.

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

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Adam Samuelson
Analyst, Goldman Sachs & Co. LLC

Q

Yes, thank you. Good morning, everyone.

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

A

Good morning, Adam.

Adam Samuelson
Analyst, Goldman Sachs & Co. LLC

Q

I guess, my first question is on turkey. And Jim, you clarified kind of that volumes is kind of normalizing without HPAI, I mean, there was an allusion to commodity turkey pricing, which has fallen pretty meaningfully kind of since the start of the year. Again, how do we think about the profit kind of contribution of turkey at this point?

I think kind of coming into the year, kind of when Jennie-O [indiscernible] (00:56:55) business. I think [indiscernible] (00:56:56) that was going to be roughly flat [indiscernible] (00:57:00) volume growth and offsetting or volume normalization in the back half offsetting kind of feed costs, but kind of the commodity turkey environment has kind of come in pretty meaningfully since where you guys were in November and December. And just trying to think about how that would impact the profitability [ph] of your (00:57:17) total turkey business, which is obviously [indiscernible] (00:57:22) different businesses?

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

A

Got it. Thanks for the question, Adam. And I do think it's the offset in terms of the return of the volumes. And that tonnage increase in the back half. And you're right, we've seen markets come down, but there is that corresponding offset, because we just haven't had that volume to sell. And so, our ability to be able to now have the value added products on a regular basis, whether it's the lean ground turkey in Retail or having a full product offering on the Foodservice side of the business, that's really a differentiator. And the bottom line to all of this is that, it is great to have turkey back, right?

So fundamentally, in our portfolio, turkey is a very, very important part of what we want to get done. And so, we're glad to have this volume back. The ability to regain focus on the value-added portion of the business is what our team is focused on right now. And like I said, you don't just flip a switch, when you haven't had something that's held for a year, but the teams' Retail, Foodservice are very aligned and focused on moving turkey again in the back half of the year.

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

A

Yeah. The other piece I'll also add there, Adam, is that the team has done a really, really good job from a supply chain standpoint. And as you think about the profitability, the yields have been really good and have improved the bird performance. And so, that will definitely help us as you think about margins.

Adam Samuelson
Analyst, Goldman Sachs & Co. LLC

Q

Okay. And then, I had a follow-up on cash flow. And Jacinth, I think, [ph] there was another (00:59:13) question about the CapEx reduction. [ph] But in some discussion also (00:59:19) about kind of inventory dollars improving

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over the balance of the year. Has the cash flow kind of performance through the quarter and year-to-date actually hit your own expectations? And can you dimensionalize kind of by the end of the year, kind of what the anticipated release of working capital dollars should be?

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

A

Yes. So I'll start out by saying, I mean, we continue to generate really strong cash flow, and we expect that to continue and improve through the rest of the year. And so, that continues to give us that healthy balance sheet I talk about and just being able to flex as needed from a cash utilization standpoint for the business. So not feeling any different about our cash flow and our availability and ability to generate cash.

Adam Samuelson
Analyst, Goldman Sachs & Co. LLC

Q

Okay. But did the cash flow performance in the period kind of actually [indiscernible] (01:00:23) you were expecting? And how much kind of – what is the anticipated kind of working capital release as we think about the balance of the year?

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

A

Yes. So definitely met expectations for the quarter and the detail around your second piece of the question, Adam, you can definitely follow-up with David on that piece.

Adam Samuelson
Analyst, Goldman Sachs & Co. LLC

Q

Okay. I appreciate. I pass it on. Thank you.

Operator: Thank you. There are no further questions. I will turn the call back to Jim Snee for closing remarks.

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

Well, thank you. While very dynamic, the second quarter demonstrates our team's ability to do what we say we're going to do with the appropriate sense of urgency. I'm very proud of the work the team did this quarter to set us up to deliver sales and earnings growth in the back half of the year. We are still focused on the same priorities and remain confident in our team's ability to deliver the results that we expect. Thanks to all of you for joining us this morning.

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

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