Corrected Transcript

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Hormel Foods Corp. (HRL)

Q4 2019 Earnings Call

CORPORATE PARTICIPANTS

Nathan P. Annis
Director-Investor Relations, Hormel Foods Corp.

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

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

OTHER PARTICIPANTS

Eric J. Larson
Analyst, The Buckingham Research Group, Inc.

Kenneth B. Zaslow
Analyst, BMO Capital Markets (United States)

Thomas Palmer
Analyst, JPMorgan Securities LLC

Ben Bienvenu
Analyst, Stephens, Inc.

Michael S. Lavery
Analyst, Piper Jaffray & Co.

Heather Jones
Analyst, Heather Jones Research, LLC

Robert Moskow
Analyst, Credit Suisse Securities (USA) LLC

Rupesh Parikh
Analyst, Oppenheimer & Co., Inc.

Adam Samuelson
Analyst, Goldman Sachs & Co. LLC

Rebecca Scheuneman
Analyst, Morningstar, Inc. (Research)

Peter T. Galbo
Analyst, Bank of America Merrill Lynch

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

MANAGEMENT DISCUSSION SECTION

Operator: Good morning, ladies and gentlemen, and thank you for standing by. Welcome to Hormel Foods' Fourth Quarter 2019 Earnings Release Call. At this time, all participants are in a listen-only mode. As a reminder, this conference is being recorded Tuesday, November 26, 2019.

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

Nathan P. Annis

Director-Investor Relations, Hormel Foods Corp.

Good morning. Welcome to the Hormel Foods conference call for the fourth quarter fiscal 2019. We released our results this morning before the market opened around 6:30 AM Eastern. If you did not receive a copy of the release, you can find it on our website at hormelfoods.com under the Investors section.

On our call today is Jim Snee, Chairman of the Board, President and Chief Executive Officer; and Jim Sheehan, Executive Vice President and Chief Financial Officer. Jim Snee will provide a review of each segment performance for the quarter and our outlook for 2020. Jim Sheehan will provide detailed financial results and further assumptions relating to our outlook. The line will be open for questions following Jim Sheehan's remarks.

As a courtesy to the other analysts, please limit yourself to one question with one follow-up. If you have additional question, you are welcome to get back into the queue. An audio replay of this call will be available beginning at 11:00 AM today Central Standard Time. The dial-in number is 888-220-8451 and the access code is 1340983. It will also be posted to our website and archived for one year.

Before we get started, I need to reference the Safe Harbor statement. Some of the comments made today will be forward-looking and actual results may differ materially from those expressed in or implied by the statement we will be making. Please refer to pages 35, 41 in our company's Form 10-Q for the quarter ended July 28, 2019 for more details. It can be accessed on our website. Additionally, please note the company uses non-GAAP results to provide investors with a better understanding on the company's operating performance by excluding the volume and sales impact of the CytoSport divestiture. Discussion on non-GAAP information is detailed in our press release located on our corporate website. Please note that during our call, we will refer to these non-GAAP results as organic volume and organic sales.

I will now turn the call over to Jim Snee.

James P. Snee

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

Thank you, Nathan. Good morning, everyone. We have the opportunity to outline our company's growth strategy at our Investor Day in October. Our 2020 Path Forward, a set of six strategic priorities sets us up for growth in 2020 and well into the future. The six priorities we presented were: one, growing our deli and foodservice businesses; two, accelerating growth in ethnic cuisines; three, pursuing both new innovations; four, expanding our global presence; five, protecting our core brands; and six, continuing to transform our company through one supply chain and Project Orion initiatives.

These priorities represent another step forward for Hormel Foods as a global branded food company. We made great progress in 2019. Notably, we launched the Hormel Deli Solutions division and Refrigerated Foods; delivered $700 million in sales from our MegaMex joint venture, which also celebrated its 10th anniversary; completed our state-of-the-art whole bird facility at Jennie-O Turkey Store; exited two non-strategic businesses, CytoSport and the hog harvest in Fremont, Nebraska; and made tremendous progress on our [ph] one supply chain (00:04:25) and Project Orion initiatives.

From a financial perspective, we grew organic sales by 1%; improved our cost structure and operating margins; invested over $290 million back into our business with capital projects such as the Burke Pizza toppings facility and an additional Fontanini production line; raised our dividend for the 54th consecutive year, the 11th consecutive year of double-digit increases; repurchased $174 million in common stock, the highest annual repurchase in our history; reduced our long-term debt and grew our cash balance.

From a segment perspective, Refrigerated Foods grew earnings in spite of a 50% decline in commodity profit as our value-added businesses delivered strong growth. The Black Label, Bacon 1, Fire Braised, Natural Choice and Applegate brands were all meaningful contributors to value-added growth. Grocery Products had a year of mixed results. We grew organic volume and sales for the year, driven by brands such as Herdez, Wholly and Dinty Moore. I'm also really proud to say, SPAM had its fifth consecutive year of record sales, which is a tremendous accomplishment.

However, sales and profits declined for SKIPPY as we face deflationary pricing pressure due to competitive dynamics in the peanut butter category. Our team rallied, and did an excellent job using revenue growth management with a number of customers to identify the right pricing and promotional tactics to drive category growth for our customers. MegaMex continues to generate excellent top line growth. From a bottom line perspective, earnings declined as they lap a tax benefit and were impacted by higher avocado markets during the year. Jennie-O Turkey Store managed through both industry oversupply and the effects of two lean ground turkey recalls. The fourth quarter proved that the Jennie-O brand remains strong and the additional investment we are making in the business is the right long-term decision. This team clearly has momentum going into 2020.

The full year results for the International segment were disappointing as the team encountered numerous challenges, stemming from African swine fever in China, the impact from tariffs and global trade uncertainty. These headwinds greatly masked excellent growth in our China business. Looking at the fourth quarter, we delivered earnings per share of $0.47. This put our full year earnings at the top end of the guidance range we provided at our Investor Day in October.

Sales decreased 1% on a 2% decrease in volume. Organic sales increased 2% on a 1% increase in volume. Three of our four segments, Refrigerated Foods, Grocery Products and Jennie-O, delivered organic volume and sales growth. Total company sales growth was led by brands such as Columbus, Fire Braised, Bacon 1, Natural Choice, Gatherings, SPAM, Herdez, Wholly, and Hormel Chili. Refrigerated Foods grew volume 1% and sales 4%.

While many products across retail, deli and foodservice contributed to the sales growth, I would be remiss if I didn't call out the growth we are seeing from Bacon 1. The Hormel foodservice team is doing an excellent job growing Bacon 1 account-by-account. We also recently introduced the product into the club channel under the brand Hormel Thick Cut Reserve. The recent expansion at our facility in Wichita, Kansas is providing the necessary runway to continue growing this important business. Strong earnings growth from our value-added businesses was not able to overcome a 46% decline in commodity profit, leading to a Refrigerated Foods segment profit decline of 3%.

Grocery Products volume declined 9% and sales declined 10% due to the divestiture of CytoSport. Organic volume increased 2% and organic sales increased 1%. Center-store brands such as SPAM and Herdez drove sales and earnings growth. Lower pricing on SKIPPY peanut butter remained a headwind this quarter. Jennie-O Turkey Store volume increased 5% and sales increased 3%, primarily due to whole bird and commodity sales increases. Segment profit increased 6% due to operational improvements across their supply chain.

As expected, we are regaining distribution on our most important item, lean ground turkey. We recently gained distribution back at a large customer, but still have work to do in order to get back to our pre-recall distribution levels. Advertising and promotional activities in select key markets also helped drive growth during the quarter. It's important to note, this quarter represents the first time since the fourth quarter of 2016 that we grew volume, sales and segment profit at Jennie-O Turkey Store.

International volume sales and segment profit declined dramatically during the quarter. We saw weakness in our export sales and in our Brazil business due to higher protein prices. We are taking the necessary pricing actions to offset these cost increases. From a total company perspective, we expect to deliver sales growth in excess of our 2% to 3% organic sales growth goal in fiscal 2020. Two key drivers to sales growth across the company are innovation and e-commerce. First, we continue to see innovation successes across our business and remain confident as we close in on the final year of our 15% by 2020 challenge. The percentage of sales from products innovated in the last five years has grown to just under 15%. Products such as Natural Choice snacks, stacks and wraps, Herdez Guacamole Salsa, the Applegate Blend Burger and SKIPPY P.B. & Jelly Minis are all important initiatives help us achieve our 15% goal.

Second, our e-commerce capabilities continue to improve, especially for the online grocery pickup segment. Through our efforts in analytics, package optimization and customer expansion, we see another year of strong double-digit growth for e-commerce. We expect to deliver another year of operating income growth in 2020. The biggest risk factor continues to be the impact African swine fever could have on our business. While we have seen volatility in the market, we have not seen a major and sustained increase in pork costs as we and much of the industry expected. A combination of higher domestic pork production, higher levels of cold storage in China and presumably lower Chinese consumer demand are factors keeping prices in check. Jim Sheehan will provide more details related to our market outlook.

We are still very confident in our ability to manage through ASF. First, we are very optimistic about the demand for our products whether from an up and coming regional pizza chain using our Hormel pizza toppings, a deli consumer looking for more premium charcuterie items like Columbus Craft Meats or a family looking for affordable and versatile protein like our SPAM family of products.

Second, we hold leadership positions in many of the categories in which we compete. This affords us the ability to be pricing leaders when market conditions warrant. We demonstrated our ability to pass higher pricing during PEDv in 2014 and again during the market run-up in 2017. As a global branded food company and a leader in the industry, we believe it is our responsibility to lead in these situations.

Finally, we expect input cost volatility to persist into fiscal 2020. As a net buyer of protein, major market swings can shift profits from quarter-to-quarter when our pricing lags the market.

Looking at the segments for 2020, we expect three of our four business unit to show sales and profit growth, with the exception being Grocery Products as they lap the CytoSport divestiture for the first half of the year. We do, however, expect sales and segment profit growth for the rest of the Grocery Products segment, led by center store brands such as SPAM, Dinty Moore and SKIPPY. We also expect growth from MegaMex and remain extremely confident in our ability to continue growing the Herdez and Wholly brand. I am excited by the authentic and innovative products they are bringing to the marketplace such as Herdez, Refrigerated Guacamole, Herdez Taqueria Street Sauces and Wholly Smashed Avocados.

We expect 2020 will represent a return to growth for Jennie-O Turkey Store. A clear focus on regaining lost lean ground turkey distribution, the efforts to realign our cost structure and slowly improving industry fundamentals gives us confidence we will get this business back in growth mode.

International is expected to show sales and segment profit growth in 2020. However, we do expect volatility as we manage higher input costs in China and Brazil in addition to short-term noise related to an uncertain global trade picture. Again this year, we expect Refrigerated Foods will grow sales and profits led by many brands across foodservice, retail and deli. I have a high level of confidence in this team's ability to execute in the marketplace and continue to grow branded value-added profit.

At Investor Day, we highlighted the great work happening within our supply chain group and I am pleased to report we achieved our $75 million cost savings goal this year. We also highlighted our long-standing key result of holding controllable cost increases to less than 1% over the prior year. While large investments can impact a single year, we have specific targeted actions to improve our cost structure over time. Achieving our 1% key result implies savings in 2020 of approximately $75 million, similar to 2019.

Taking all these factors into account, we are setting our full year earnings guidance at $1.69 to $1.83 per share and our sales guidance at $9.5 billion to $10.3 billion. Our expected fiscal 2020 organic pre-tax earnings growth rate is in line with our near-term goal of 5% to 7% organic pre-tax earnings growth we outlined at our Investor Day. As a reminder, CytoSport earnings in 2019 contributed $0.10 to earnings per share. We also expect a higher effective tax rate in fiscal 2020.

At this time, I will turn the call over to Jim Sheehan to discuss our financial information relating to the quarter and key assumptions for fiscal 2020.

James N. Sheehan

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

Thank you, Jim. Good morning, everyone. Net sales in the fourth quarter were $2.5 billion, down 1%. Organic net sales were up 2% with three to four segments showing growth. Sales for 2019 were $9.5 billion, down 1%. Organic sales were up 1%. Pre-tax earnings were $324 million, up 1% compared to the fourth quarter of last year. For 2019, the company grew pre-tax earnings to $1.2 billion, a 2% increase. The full year effective tax rate was 19.1% compared to 14.3% last year. The 2018 tax rate was impacted by deferred tax remeasurements. The effective tax rate for 2020 is expected to be between 20.5% and 22.5%. Earnings per share for the quarter was $0.47 a share compared to $0.48 last year. Earnings per share for 2019 was $1.80, a 3% decline. The higher effective tax rate contributed to the lower earnings for the quarter and the year.

For 2019, SG&A, excluding advertising, was 6.3% of sales compared to 7.2% last year. The decline was due to the impact of the CytoSport sale and lower selling and employee-related expenses. In 2020, we expect SG&A as a percentage of sales to increase. Excluding CytoSport, expenses will increase because of the costs related to Project Orion. Net unallocated expense was down significantly in 2019, resulting from the gain on the sale of CytoSport, lower selling expenses and a legal settlement in the first quarter.

Advertising was $131 million, down from $152 million in 2018. The decline was due to the CytoSport sale. In 2020, we plan to increase advertising expense to support our leading brands, including Natural Choice, Black Label, Wholly, Herdez, SPAM, SKIPPY and Jennie-O.

For the full year, operating margins were 12.6% compared to 12.4% in 2018. Lower SG&A was a benefit to margins in 2019. In 2020, we anticipate operating margins to be flat, but we may experience periods of volatility due to input costs. We generated cash from operations of $923 million during the year, down 26%. The decline resulted from higher working capital as we strategically built inventory in anticipation of higher input costs due to African swine fever. The primary uses of cash in 2019 were dividends, debt reduction, CapEx and share repurchases.

We paid our 365th consecutive quarterly dividend, effective November 15 at an annual rate of $0.84 per share. We also announced an 11% dividend increase for 2020, making the new annual rate $0.93 per share. This marks the 54th consecutive year we have increased the dividend and the 11th consecutive year of double-digit increases. In 2019, we repaid the remaining $375 million in debt associated with the Columbus acquisition. Capital expenditures for 2019 were $294 million, including the expansion of the Burke facility, Project Orion and additional capacity for Fontanini products.

We targeted capital expenditures of $360 million in 2020, with a focus on value-added capacity projects and automation. Share repurchases for 2019 totaled a record $174 million, almost double any single prior year. 4.3 million shares were repurchased. We will continue to take a disciplined approach to capital allocations utilizing our strong balance sheet to grow through acquisitions and capital investments. We will remain focused on long-term investments to drive exceptional shareholder return. The generally higher input costs for the fourth quarter were in line with expectations. The 2020 guidance range assumes higher protein prices for key inputs.

African swine fever continues to impact the global hog supply as the disease spreads in China, Southeast Asia and parts of Europe. The USDA is projecting exports to grow 7% to 8% in 2020. To meet the growing need for exports, total domestic production is expected to increase 2% to 3% according to the USDA. Hog prices are expected to increase in excess of 15% in 2020. We anticipate the USDA composite value increases to be consistent with increases in hog prices.

Selling prices in 2020 are projected to be marginally higher with periods of volatility. We expect pork and beef trim markets to be higher in 2020. The Turkey industry is beginning to show signs of recovery. Industry data shows turkey placements down 3% since the beginning of 2019. Additionally, cold storage of whole birds continued to decline leading to improved pricing.

Pricing for the fourth quarter was up modestly over 2018. We should see the majority of the pricing benefit realized for the 2020 holiday season. Cold storage of breast meat is 5% below last year. Breast meat pricing has traded near $2 over the past 12 months. We expect the market to improve in the second half of 2020. Other turkey commodity items such as [ph] value meat (00:26:19) should benefit from better pricing in 2020 due to supply shortages on other competing protein. [indiscernible] (00:26:29) which were up modestly compared to 2018 are projected to be marginally higher next year. Project Orion continues to progress on schedule.

In the first quarter of 2020, we will begin the implementation across HR, finance and supply chain organization. We are excited to begin the transformation of our company to increase efficiency and our analytical capabilities to manage our business.

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

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] We will now take our first question from Eric Larson with Buckingham Research Group. Please go ahead.

Eric J. Larson
Analyst, The Buckingham Research Group, Inc.
Q

Yeah. Good morning, everyone. Happy Thanksgiving to all.

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

Thanks, Eric. Good morning.

Eric J. Larson
Analyst, The Buckingham Research Group, Inc.
Q

Well, a quick question. As Jim outlined, we saw a fairly significant inventory build at the end of the year. So, how much cost visibility does that give you folks? Does it cover the first half or a good portion of 2020? Or how should we look at your ability to control your costs for the near-term with that inventory?

James N. Sheehan
Executive Vice President & Chief Financial Officer, Hormel Foods Corp.
A

Happy Thanksgiving, Eric. This is Jim Sheehan.

Eric J. Larson
Analyst, The Buckingham Research Group, Inc.
Q

Thanks, Jim.

James N. Sheehan
Executive Vice President & Chief Financial Officer, Hormel Foods Corp.
A

We did build inventory at the end of the year and that'll give us visibility on some important primals into the first quarter. So, I would say well into the first quarter.

Eric J. Larson
Analyst, The Buckingham Research Group, Inc.
Q

Okay. Thanks. And then just real quickly as a follow-up question on your marketing spend here. It was down sharply for the year, was mainly divestiture of CytoSport. But you also bumped up your spending in Jennie-O with your burger campaign which has been very successful. So, if you were to look at your marketing spend for the year kind of on an apples-to-apples basis excluding CytoSport, would it have been flat, up, down slightly? I mean, how should we look at that marketing spend number?

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

Eric, I would say that for the year it was relatively flat. One of the things that we've done really well over time as we've been able to consolidate some of our advertising dollars against key brands where – we used to have dollars spread a little more widely. But when you think about the work that we've done with SPAM, with SKIPPY, with Natural Choice, with Hormel pepperoni and now really getting back in the game with our Jennie-O Turkey Store advertising efforts in select key markets, our focus has changed a little bit, but we've been pleased with the results and the dollars we'd say relatively flat for the full year.

Operator: We will now take our next question from Ken Zaslow with Bank of Montreal. Please go ahead.

Kenneth B. Zaslow
Analyst, BMO Capital Markets (United States)

Q

Good morning, guys. [ph] What's up (00:29:56)

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

A

Hi, Ken.

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

A

Good morning.

Kenneth B. Zaslow
Analyst, BMO Capital Markets (United States)

Q

Just two questions, one is you talked about two projects that you are underway, one the plans for the state-of-the-art sausage production, as well as pizza toppings. How much capital are you putting to that? What's the return on that?

And my second question would be on the Turkey side, it seems like you've gotten more positive on the underlying fundamentals, is that because of the trade opening? Or can you discuss more on that? And I'll leave it there.

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

A

Okay. I'll start with the second one first, Ken, in terms of the Turkey business. We are very positive as we head into 2020 and it's really – the story is being able to do what we set out to do when we talked to you last quarter. We talked about the need to regain distribution and we've been able to gain some of that distribution back in the fourth quarter. We have more work to do for the full year, but we do expect to see a sequential improvement as we progress throughout the year. And, of course, not only just gaining back that distribution, but being able to support that business with appropriate advertising dollars that really we had backed off for the last several years as we were facing some of those headwinds.

In regards to the two expansion projects that we talked about, we're going to – between the two of them, we'll be roughly $300 million combined. As a reminder, we have already spent some of the money in the Burke project when we announced that and we are quite a ways along. Again, the key message to remember here with both of these projects is that they're supporting our value-added growth.

The new plant in Nebraska is designed to support our Columbus business which has performed incredibly well and the same thing with our Burke business. Not only does it support the Burke organization, but it supports the pizza topping business and our core foodservice organization. So, we're excited to not only announce those projects, but have them come online to really support the business.

Kenneth B. Zaslow
Analyst, BMO Capital Markets (United States)

Q

Okay. Thank you.

Operator: [Operator Instructions] We will now take our next question from Thomas Palmer with JPMorgan. Please go ahead.

Thomas Palmer
Analyst, JPMorgan Securities LLC

Q

Good morning. Thanks for the question.

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

A

Good morning.

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

A

Good morning.

Thomas Palmer
Analyst, JPMorgan Securities LLC

Q

First, I just wanted to clarify guidance. Your EPS guidance range is $0.14. Your pre-tax income range, I think it can explain about $0.04 of the variance. Your tax rate guidance can explain around $0.05. So, I'm getting kind of a $0.05 gap, could you maybe help reconcile that $0.05 gap? And then also just give us some clarity on what exactly the base number is for 2019 that we should be applying that growth from?

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

A

Yeah. Thomas, I think the best way to think about it. In 2019, our results included about $0.10 EPS for CytoSport which is in our Grocery Products segment profit. And then when you consider that along with a higher tax rate of about $0.03, I mean that's really where you'll find how our growth is in line with that 5% to 7% organic growth target. So, thinking about 2019 actual $1.80, Cyto at $0.10, [ph] tax at $0.03 (00:33:54), gets you to [ph] $1.67 (00:33:55) number really as probably a base. And I would say, if there's additional information you need, feel free to follow up with Nathan.

Thomas Palmer
Analyst, JPMorgan Securities LLC

Q

Okay. Thanks for that. I probably will follow up a little bit. And then I just – on the International segment, it sounded like there were two main issues, the export side and then rising input costs. On the export front, did you shift some of your pork sales, because exports were weak, into the Refrigerated segment?

And then on the input cost front, you made reference to price increases that you were instituting, sounds like now-ish. What are you assuming in terms of kind of the bounce-back in that segment? Are you assuming that exports continue to lag, but you get the pricing flow through? And then is there an offset as we think about Refrigerated just given the reallocation? Just trying to understand how that plays out?

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

A

Sure. Let me try to help you. When we talk about our export business and International, there's really two components. We've got a strong branded export business. And you would think more around SPAM and SKIPPY, and then our pork export business. So, there are two parts. And as we think about 2020, our branded export business is expected to be strong. And although, we talked about it being a little bit soft in the fourth quarter, that really was more of a timing issue.

When you think about the fresh pork piece, that's really driven by everything that's happened in the marketplace as you think about some of the global reorganization of how pork has slowed, especially throughout the Asia region. And that's going to continue to be a headwind until all of the tariffs and global trade uncertainty gets resolved. So, that's the first piece, the export piece.

The second piece in terms of cost increases in Brazil, we saw kind of a constant run-up throughout the year, the biggest impact really in the fourth quarter. And so, we did get a little more aggressive with our pricing in the fourth quarter and then we expect some of those cost increases to moderate next year. But that's really what's driving those comments around exports and input costs in Brazil.

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

A

Thomas, back to your first question, when you think about that $0.10 in CytoSport, you should think about it $0.04 came out of Grocery Products, $0.03 was a reduction on net unallocated through the gain. And then there was a $0.03 tax gain. So, that's how you can think about the $0.10.

Operator: We'll now take our next question from Ben Bienvenu with Stephens. Please go ahead.

Ben Bienvenu
Analyst, Stephens, Inc.

Q

Hi, thanks. Good morning.

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

A

Good morning.

Ben Bienvenu
Analyst, Stephens, Inc.

Q

I wanted to ask about [ph] Jennie-O (00:37:08), really impressive sequential improvement and the results there. In particular, noteworthy, I thought that you mentioned you'd won back distribution with a large customer. I'm curious to hear what is the factor or factors that are driving that conversion to get distribution back with your larger customers. Do you have to allocate additional trade spend or professional dollars or is it just demonstration of more consistent results and improved execution?

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

A

Yes. So, I mean we are very pleased with what the team was able to get done in the fourth quarter and it's consistent with the commentary that we've provided that when we did lose distribution, the category tended not to perform for the retailer and that where we did have distribution, the category was performing as expected. And so, being able to take that story and remind the retailers of what we're able to do with the leading brand has been very powerful. And then of course, we are supporting it. We've talked about some of the advertising in select key markets. We are supporting it with trade dollars, especially at the outset. But the big win here is the distribution gain as we head off into 2020.

Also, would remind you that we have more work to do. So, we have regained distribution but we have more work to do early in the year and really throughout the year. And then just as a reminder for the JOTS business, we are going to still lap some pre-recall sales in Q1. So, when you take the total year, we are very, very optimistic about the JOTS business, starting with what we've been able to get done in the fourth quarter.

Ben Bienvenu
Analyst, Stephens, Inc.

Q

Okay, great. And then a follow-up question on guidance, just thinking about the top end versus the bottom end of the range, kind of the swing factors that dictate that whether it's the timing or magnitude of African swine fever, given that you've considered some implication associated with price inflation and cost inflation there, maybe some of the other key factors that we should be considering as we monitor sort of the progress of results through the year.

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

A

Sure. I mean, you hit on obviously the key risk factor and we talked about that in the comments in regards to if ASF is less of an event from an international perspective. If tariffs are lifted and we see a more – what we would consider a more normalized flow of product. And then the other thing that we just talked about is if we're able to gain back distribution at JOTS faster than anticipated. I mean, those are things that really drive us towards the top side.

On the bottom side, if the impact of ASF is sustained and steady increases in costs that continue to compress margins as we're catching up with pricing that could be a headwind but as we talked about, that's on the way up. And once costs moderate, we'll be in a much better position. But that's really how we're thinking about bottom side and top side of the range.

Operator: We'll now take our next question from Michael Lavery with Piper Jaffray. Please go ahead.

Michael S. Lavery
Analyst, Piper Jaffray & Co.

Q

Good morning. Thank you.

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

A

Hi, Michael.

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

A

Good morning.

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

[indiscernible] (00:40:54) cut off for a minute so, hopefully, somebody didn't just ask this, but when you mentioned the protein increases that you expect – that you factor in the guidance, how does that compare to now and what sort of magnitude do you have already as your expectation in kind of base case scenario?

James N. Sheehan
Executive Vice President & Chief Financial Officer, Hormel Foods Corp.
A

Certainly. So, let's start with hogs. Hogs went up about 11% in the fourth quarter of 2019 and we anticipate that they'll go up 15% over 2020. With higher prices in the back half compared to the first half. The cutout value was up 4% in the fourth quarter. We think it will go up probably just under that 15% and with a similar run rate with higher prices in the second half compared to the first half.

Bellies were up 15% in the first quarter and we think that they're going to go up low-single digits and we see bellies fairly consistent across the timeframe. Now bellies are up $132 now, so they're a little bit lower right now but we've seen a lot of volatility in the belly markets. So, we've seen some significant moves even day-to-day in the belly market. And then 72% trim, which of course is an important input, was up 9% in the fourth quarter. We think they'll be up high-single digits in 2020 with higher prices probably in the back half. They're at $76 as we look at it today, so they've already seen a little bit of a run-up from where they were in the fourth quarter. So, you're seeing that volatility in the trim and the bellies and, as we always say, volatility will create some noise for us between quarters. In the end we'll be able to recover those costs but volatility will be important to us. We'll watch that.

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

Okay, that's very helpful. And then just a follow-up on some of the language in that [ph] first guidance paragraph (00:43:00), you mentioned some of the brands that are key drivers of growth. But then you mentioned a few that you're going to put a lot of energy behind. It reads initially like maybe that's not as bullish but your prepared remarks for Bacon 1 certainly sound quite optimistic. How do we think about Bacon 1 and the outlook there? Do you still expect it to grow? And then also the same question for Fire Braised which wasn't [ph] on either list (00:43:25).

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

Yeah. Michael, I mean we are very bullish. I mean, all the brands that we had in the press release, I mean those are the ones that have grown and really are on trend with today's consumer. And not only are we growing the core business, but we're innovating against those. And when you talk about our foodservice brands, especially Bacon 1 and Fire Braised, the growth opportunity is for both of those brands in our foodservice space are still very, very strong. We talked about the Bacon 1 growth and how it happens account by account and that's really a hallmark of how our foodservice business operates. It's the ability to penetrate, saturate and dominate the operator community with these key brands. We also have obviously plenty of capacity for Bacon 1 as we completed the expansion of our Wichita, Kansas facility last year to meet the needs for that business.

The other thing that we talked about in the prepared remarks is the fact that we're now moving Bacon 1 into the club channel under our Thick Cut reserve brand where it's met with a lot of consumer acceptance. So, we feel good about both Bacon 1 and Fire Braised, not only in core foodservice. But then we didn't even talk about the opportunities that they represent in the deli business for the prepared foods section. So, very bullish on both of those, along with all the brands that we have listed in our press release.

Operator: [Operator Instructions] We will now take our next question from Heather Jones with Heather Jones Research.

Heather Jones
Analyst, Heather Jones Research, LLC

Q

Good morning.

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

A

Morning.

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

A

Morning.

Heather Jones
Analyst, Heather Jones Research, LLC

Q

Look, I have a quick details question on corporate expense. So, even taking out the gain on sale and all, it was down considerably from 2018 and 2017. I was just wondering how we should be thinking about that run rate for 2020?

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

A

For 2020, I would target it in the $40 million to $60 million range, Heather. It's a small number, so small changes have a big percentage impact. We had the CytoSport gain in 2019. But we've also lowered our selling expenses. We had lower employee-related expenses. Some of the cost-saving programs that we put in place are showing their impact in SG&A. But I would see it in the $40 million to $60 million range.

Heather Jones
Analyst, Heather Jones Research, LLC

Q

Okay. Thank you for that. And then my second question is on Jennie-O, a two-part question. So, from what I remember, you guys are a net buyer of breast meat. So, is this business – should I be thinking about this in the sense of if exports for that business pick up at all, that would be – I guess, more simplistically, would you rather the dark meat part of the bird to go higher over, et cetera? Or would you rather breast meat go higher?

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

A

Yeah. I mean really, Heather, that changes every year and, of course, our supply chain people are able to navigate and take advantage of the opportunities. Obviously, there was an announcement in regards to China here recently. We just learned that we have seven of our plants that are approved. We're still working through the details but at a very high level we expect that announcement and the opening of the market to be positive for us.

Operator: We'll now take our next question from Robert Moskow with Crédit Suisse. Please go ahead.

Robert Moskow
Analyst, Credit Suisse Securities (USA) LLC

Q

Hey, thanks, and Happy Thanksgiving.

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

A

Happy Thanksgiving.

Robert Moskow
Analyst, Credit Suisse Securities (USA) LLC

Q

Yeah. Jim and Jim, your forecast for a 15% increase in the cutout value that's for the full year but then you said that the second half you expected to be, I guess, the inflation to be higher than the first half. So, I mean, does that kind of indicate like a pretty sharp run-up in the second half? And are you thinking first half is like single-digit and then it spikes quite a bit higher because of – I don't know frozen inventories running out in China. And if that's how you think about it, how have you prepared your customers for that type of an increase? And then I have a follow-up.

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

A

Now that is not how we think about it. We're thinking about it just being a few percentage difference between the first and the second half. So, we don't see a significant run-up in the market.

Robert Moskow
Analyst, Credit Suisse Securities (USA) LLC

Q

Okay.

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

A

And from a pricing perspective, Rob, I mean, if there's a dramatic run-up in pricing, what we've talked about it in regards to what's happened or what happened with PEDv and really there you had the run-up – belly prices for example went up, I think it was at [ph] $1.30 to $2.50 (00:48:58) in three months. And we were able to take pricing, the market warranted it and customers understood that. And if you go back to what happened on-shelf, bacon, that was usually $3.99 to $4.99, went to $9.99. And so, there's a precedent here and I think depending on how the markets warrant that pricing, we've had the conversations with the customers, really we've been talking about ASF for over a year now and it's not going to be a surprise to anyone.

Robert Moskow
Analyst, Credit Suisse Securities (USA) LLC

Q

Okay. Can you give us a little more detail into fourth quarter itself? One of your competitors said that there was a lot of inflation in bellies and then it kind of all reversed very quickly and that movement made it hard to change pricing quickly enough to react. Did you see something similar for yourselves? Or were you able to adjust accordingly? Or maybe the timing was different?

James N. Sheehan
Executive Vice President & Chief Financial Officer, Hormel Foods Corp.
A

Bellies averaged about $157 in the fourth quarter and right now bellies are at $132. So, you've seen some movement but you've seen volatility in bellies for the last two years. So, I wouldn't say that amount of volatility we've seen in bellies in the fourth quarter and early into our first quarter is anything unusual.

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

Yes. And from a pricing perspective and I think really to speak of on the retail front, some adjustments on foodservice but we always talk about how we're able to stay a little bit closer to the markets with our foodservice business but nothing that was overly impactful.

Operator: We will now take our next question from Rupesh Parikh with Oppenheimer. Please go ahead.

Rupesh Parikh
Analyst, Oppenheimer & Co., Inc.
Q

Good morning and thanks for taking my question. So, I wanted to follow up on Happy Little Plants launch that you guys discussed at the Analyst Day. I was curious what type of retailer and foodservice interest you're seeing so far? And how you guys are thinking about the contribution from this launch this year?

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

Yes, the contribution, Rupesh, is going to be minimal in 2020. Really for us, it's the learning about that space. Another is the reception at the retailer and consumer level has been positive. We're probably seeing a little more acceptance in the foodservice space. And so, the foodservice team has done a nice job with that same retail pack introducing it into foodservice operators. In addition, just some of the blend burger items that we talked about on Investor Day.

So, it's really the combination of I'll say the pure play and then also the blended play that we're very intrigued by our agile team is already working on 2.0 to build out that line, thinking about different forms that we should be taking to the marketplace. And based on the early read, it's positive. We're still heading down that path to build out the line, but wouldn't look for any meaningful contribution in 2020.

Rupesh Parikh
Analyst, Oppenheimer & Co., Inc.
Q

Okay, great. And then a quick follow-up question, so for the full year guidance, does that at all contemplate share buybacks within the EPS targets?

James N. Sheehan
Executive Vice President & Chief Financial Officer, Hormel Foods Corp.
A

It does take into account some share repurchase and we face share repurchase on our intrinsic value of the stock and the amount of stock options that are being exercised to offset the dilution. So, we do have a number in there, so, yes.

Operator: We will now take our next question from Adam Samuelson with Goldman Sachs. Please go ahead.

Adam Samuelson
Analyst, Goldman Sachs & Co. LLC

Q

Yes, thank you. Good morning, everyone. So, a follow-up, Jim Sheehan, on the guidance on pork costs. And if I heard your comments correctly before, you talked about a 15% increase in hog prices, a 15% or so increase in the cutout values, but then lower increases in bellies and trim as components of that cutout. So, should we take that to imply that you think that there's more inflation likely in other cuts of hams, shoulders and butts that would actually present opportunities on the commodity profit side and the contribution that that would present? I'm just trying to understand the piece of that. Because the cuts that you typically would be long seem to be the ones do you think there's more inflation in.

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

A

Yeah, Adam. I think a good example is hams right now. Hams averaged $69 in the fourth quarter and they're up to $94 early in or late last week. So, you're seeing some inflation in hams that I would say normally you wouldn't see. So, I would say there's opportunities in some of the other commodities.

Adam Samuelson
Analyst, Goldman Sachs & Co. LLC

Q

Okay. And then taking a step back at a high level with the guidance, I think you talked about increases year-on-year in advertising and SG&A, I believe as a percent of sales. Do you have what the clean gross profit would be in – gross profit margins would have been in 2019 if we'd strip – fully strip CytoSport out? I'm just trying to get a sense of what kind of gross profit expansion is embedded in the guidance at least, can you talk about operating margins up. So, I'm just trying to make sure I understand that in the context of higher SG&A.

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

A

Well, when we're talking about advertising costs, we're talking about the increase that we're seeing in advertising costs for instance we're expecting in the high-single digits and that's off the base without CytoSport. You're going to see higher SG&A because we're going to have some Orion implementation cost in SG&A. So, I'd say that those would be unusual from a run rate. So, we're talking about some unusually high expenses in SG&A because of the implementation of Project Orion that will start actually in the next couple of weeks. We'll start some implementation with that.

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

A

And, Adam, I would say, I mean for some of the more detailed items, certainly your follow up with Nathan is appropriate and that we, for us, the message here is really the pre-tax operating profit growth that's in line with that 5% to 7% organic target that we laid out at Investor Day.

Operator: We will now take our next question from Rebecca Scheuneman with Morningstar. Please go ahead.

Rebecca Scheuneman
Analyst, Morningstar, Inc. (Research)

Q

Yeah. Thank you. Good morning. We've talked a lot about ASF and the impact you expect that to have on your pork export business, I mean your JOTS business. But I'm kind of wondering how you expect that to impact your SPAM business, given the increasing popularity that we're seeing of SPAM in China and I assume that there's probably some positive demand opportunities, probably some cost risk. But I'd just like to hear the way you're thinking about ASF's impact on that brand and kind of what you're expecting for 2020.

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

A

Yeah. It's a really, really good question. And at a high level with ASF, we fully understand the scenario that results in higher prices. And I think we've talked a lot about our ability to price in the event that we see a larger scale or bigger impact ASF event whether that's domestically or in our business in China.

The SPAM brand is a brand that has probably some of our strongest pricing power. To be honest with you, it's in a category by itself, so to speak. And if you remember, we did take SPAM pricing this year based on some of the runoff that we saw, not only in the market, but some of the buildup that we'd have in expenses over the last couple of years.

And we do have a scenario modeled where if we have to take pricing again, we're positioned to do that. But we are closely watching the fundamentals of supply and demand. And if we need to take pricing with SPAM, we'll do that. To your point, what's happening in China with SPAM is incredibly positive. It's exceeded all of our expectations and we've been able to really build out that distribution even faster than we expected.

Rebecca Scheuneman
Analyst, Morningstar, Inc. (Research)

Q

Okay. And then as a follow-up, like, so are you – I know you're experiencing very strong growth in the brand in China but have you seen an acceleration to-date? Or maybe that's delayed due to the high cold storage?

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

A

Are you talking about SPAM?

Rebecca Scheuneman
Analyst, Morningstar, Inc. (Research)

Q

Yeah, yeah.

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

A

Yeah. I mean the growth has been steady, but it has exceeded the expectations when we modeled putting in the SPAM line in our plant in [ph] Jiaxing (00:58:32), China. We've been able to exceed the distribution growth expectations that we had even in spite of some of the higher costs.

Rebecca Scheuneman
Analyst, Morningstar, Inc. (Research)

Q

Okay. Great. Thank you so much.

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

A

Yeah.

Operator: We will now take our next question from Peter Galbo with Bank of America. Please go ahead.

Peter T. Galbo
Analyst, Bank of America Merrill Lynch

Q

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

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

A

Yeah. Good morning.

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

A

Good morning.

Peter T. Galbo
Analyst, Bank of America Merrill Lynch

Q

Jim, just wanted to ask on the sales guidance. I would assume that kind of the high end of the range is assuming some pricing goes through to offset some of the inflation that you're expecting. I guess what will be helpful though is what kind of demand elasticity are you assuming in relation to any price increases on things like bacon or pepperoni?

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

A

Yes, Peter you're right. I mean, we do have – the high end of the pricing would be driven by the scenario that results in higher cost coming from ASF and the elasticity really vary across business unit and vary across brand. What we saw, and again I'll go back and reference what we saw during the PEDv event where you saw belly prices go from $1.30 to $2.50, retails go from $3.99, $4.99 to $9.99 and we still saw very strong volumes in that bacon category.

And so, it does vary from category to category, business to business, but we obviously are very incredibly sensitive to that working closely with the retailers and having the brand strength, the brand power that we referenced in our comments and then also having that direct-selling organization in our foodservice business is the opportunity to get in front of the customers and tell the story of the products as a solution versus just a cost.

Peter T. Galbo
Analyst, Bank of America Merrill Lynch

Q

Got it. Okay, that's helpful. And then maybe just one quick clean up one, on Jennie-O, I mean with Thanksgiving being as late as possible as it could be this year, is there an extra kind of week of shipments that you've got maybe that's spilled over into 1Q that we should be thinking about on the volume side?

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

A

No. I mean we haven't really thought about it that way. Just again, as a reminder, we're still lapping some of the pre-recall sales from Q1 of last year as we head into 2020. And really the key takeaway for JOTS is this distribution wins for lean ground turkey. We're obviously working on the next few wins and we've got to bring those across the finish line. Still early but we're really seeing the right signs for this business and that's why we feel like they have so much momentum going into 2020.

Operator: We will now take our last question from Benjamin Theurer with Barclays. Please go ahead.

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

Q

Hey. Good morning, Jim and Jim. Just a quick follow-up on the CapEx, so I kind of realized last quarter you were guiding for like $250 million for full year. As you said there were a couple of delays in some of the things, and then actually you ended up spending $294 million. Could you elaborate a little bit on that significant increase of what was spent already in the third quarter? Is it all related to the new plant for Columbus? And then if you could lay down a little bit in between what is the Burke pizza toppings, the facility in Nebraska and Project Orion. Can you just split what the CapEx is going to look like, what each segment is going to get from the $360 million in 2020?

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

A

Thanks, Benjamin. You are correct. The increase [indiscernible] (01:02:32) what we expected in 2019 had to do with the early stages of the acquisition of the property for the Columbus expansion. Originally, we thought that was going to fall into 2020 but we got to close it a little bit faster than what we've thought. And you are correct in the three big projects that we're looking at in our $360 million. It's finishing up the Burke project, the Columbus expansion and Project Orion and I'll refer to you to Nathan to get a little bit more detail on the actual breakout of those numbers.

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

Q

Okay, perfect. And then on the inventory, you've clarified already the increase on purchases to be prepared for ASF. But can you give us a little bit of an idea of how much actually the decrease was because of the divestiture of CytoSport? So, how would have been inventory a year ago, if we would have to exclude CytoSport just to get a clean like-for-like comparison to understand the actual magnitude of the increase?

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

A

Certainly. CytoSport's inventory ran $25 million, in that range.

Operator: This concludes the Q&A session. I'd now like to turn it back to the speakers for any additional or closing remarks.

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

So, on behalf of the team here at Hormel Foods, thank you to all of you for joining us today. To our team members listening in, thank you for all your tireless work that allows our company to be so successful in the marketplace. Your focus on delivering our key results and maintaining our culture of accountability is truly uncommon. Happy Thanksgiving.

Operator: This concludes today's call. Thank you for your participation. You may now disconnect.