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Hormel Foods Corp. (HRL)

Q3 2020 Earnings Call
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MANAGEMENT DISCUSSION SECTION

Operator: Good morning and welcome to the Hormel Foods Third Quarter Fiscal 2020 Conference Call. All participants will be in listen-only mode. [Operator Instructions] Please note this event is being recorded.

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

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

Good morning. Welcome to the Hormel Foods conference call for the third quarter of fiscal 2020. 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 Investor 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 the company’s current and future operating conditions, commentary regarding each segment’s performance for the quarter, and an update on the company’s response to the COVID-19 pandemic. Jim Sheehan will provide detailed financial results and commentary regarding the company’s current and future financial condition.
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 questions, you are welcome to get back into the queue.

An audio replay of this call will be available beginning at noon today, Central Standard Time. The dial-in number is 888-317-6003, and the access code is 9237894. It will also be posted on our website and archived for one year.

Before we get started, I need to reference the Safe Harbor statement. Some of the comments made today will be forward-looking and actual results may differ materially from those expressed in or implied by the statements we will be making. Please refer to pages 35 through 42 in the company's Form 10-Q for the fiscal quarter ended April 26, 2020. It can be accessed on our website.

Additionally, please note the company uses non-GAAP results to provide investors with a better understanding of the company’s operating performance. Non-GAAP measures include organic volume, organic sales, and operating free cash flow. Discussion on non-GAAP information is detailed on our press release located on our corporate website.

I will now turn the call over to Jim Snee.

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

Thank you, Nathan. Good morning, everyone. Before we get into the business results of the third quarter, I want to take this opportunity to say thank you to all of our dedicated plant professionals for showing up every day in our manufacturing facilities. They are the true heroes of our company in this crisis.

It has been remarkable to see our team work together to provide safe, high-quality food for millions of consumers impacted by the pandemic. I'm very proud of how all our team members rose to the challenge with a sense of responsibility, purpose and pride.

From the very beginning of this pandemic, we committed to putting the safety of our team members first. I believe this safety first commitment is what has set us apart during the pandemic. Since we last updated you in May, our COVID leadership team including operations, quality control, communications, legal, R&D and human resources has continued to enhance and refine our safety practices. These include expanded automated temperature screenings, the addition of more staggered production shifts and increased training on COVID-19 best practices.

Our awareness campaign, KEEP COVID OUT! is also helping prevent the spread of the virus in the communities where we live and work, and keep the virus out of our production facilities by outlining the various preventive measures we can all practice in order to stay safe. We partnered with the CDC to review our efforts related to COVID-19 and how we have implemented guidance from the CDC and OSHA at one of our production facilities. Their review included a multiple day visit to the facility, along with surveying employees regarding their knowledge, attitude and practices on COVID-19.

I'm pleased with their findings mainly that we had implemented virtually all recommended controls to prevent transmission of COVID-19. The survey of our diverse team found that more than 90% of our employees have a comprehensive understanding of prevention techniques and what to do if they get sick with the virus. In addition, over 98% of our team members surveyed reported that they wear a facial covering when out in public. These actions are making a difference to stop the spread of COVID-19 in our communities.
You have heard me say Hormel Foods is an uncommon company, and that has never been more true than it is today. Our Inclusion and Diversity Guiding Coalition is an example of a group that has demonstrated our uncommon culture during this difficult time. As we witnessed the social unrest this summer, we knew we needed to take action as a company. Hormel's Inspired Giving platform is our response to this important cause.

As a company that is inclusive in all that we do, we decided to let our team members choose how we should launch our new Inspired Giving program, and I am incredibly proud of the partnerships they selected. This team selected three organizations to make donations to: Minorities in Agriculture, Natural Resources and Related Sciences, the NAACP Legal Defense and Education Fund and UNCF. These organizations are all helping change the world by tackling equality and education.

Today, we separately announced a milestone effort in our commitment to education. We believe education has the power to change the world and access to educational opportunities can lift up people and communities. Equality and education can be a game changer, and we have decided to take on that challenge. Through a new program called Inspired Pathways, we are going to make the dream of a college education available to the children of our team members. When you think about how a college education can change a life and start a ripple effect that will be felt for generations, that's the change maker Hormel Foods wants to be.

We will be finalizing the details over the next several months, but beginning in the fall of 2021, Hormel Foods will provide for every graduating senior, who is the child of one of our employees, the opportunity to attend community college on us. This program is one of a kind and truly uncommon. I’m excited to see the difference these two new programs, Inspired Giving and Inspired Pathways, will make in our communities.

Turning to our business results this quarter. We delivered record third quarter net sales as three of our four segments delivered sales growth. This achievement is a testament to the strength of our brands, the dedication of our supply chain teams and the balance across our business. For the quarter, volume increased 4% and organic volume increased 3%, sales increased 4% and organic sales increased 2%.

Before I get into the segment results, I would like to provide some channel perspectives, as each of our domestic segments have exposure to the retail and foodservice channels. Total retail sales increased 19% during the quarter with strength from virtually all of our brands. In many categories, we were able to, once again, capture market share by outperforming our competitors.

According to IRI, during the quarter, we grew share in approximately 60% of the categories where we are the number one or number two brand. We also saw tremendous growth in e-commerce, including direct-to-customer and online grocery pickup and delivery.

During the quarter, our tracked purchases through IRI were up over 100%, and our brands continue to outpace category growth and capture market share in many categories. The investments we have made into our e-commerce capabilities are having a very positive impact on our performance in this important channel.

Throughout the pandemic, we have brought millions of new households into our brands using a combination of IRI data, on-shelf availability data, custom research and data science, we are gaining deep insights into the number of new consumers coming into our retail brands, along with their demographics, behaviors and assessment of whether they will stay in our brand franchises over the long term.
While we know it's unreasonable to retain 100% of the new consumers, as brand stewards, it is our responsibility to keep as many consumers in our brands as possible. While we are seeing a rebound in our foodservice business, as restaurants reopen and pipelines refill, total sales in our foodservice channel declined 19% compared to last year.

Though many patrons are returning to their favorite establishments, it is clear the industry will be in recovery mode for quite some time. We are proud to have built strong relationships in this industry and we're among the first to offer our assistance to those operators who needed our help to navigate their new reality.

We hold deep competitive advantages in the foodservice industry, including our relationships with operators and distributors that span decades, a large direct sales force and a balanced product portfolio. We also have the advantage of being able to quickly turn insights from our sales force, who are on the front lines and kitchens each day, into solutions that solve for the challenges and concerns of operators.

Nowhere is this more apparent than in our pre strategy with pre-marinated, pre-cooked, pre-sliced and fully-prepared product offerings. Brands like Bacon 1, Fire Braised, Austin Blues, Café H, Natural Choice, Burke, Jennie-O, Fontanini, and the recently acquired Sadler's brand, have created solutions for operators in the areas of convenience, safety, versatility and flavor.

For years, many operators have slowly shifted their purchases to these types of products, and we believe the COVID-19 pandemic will accelerate the conversion. I'm confident our portfolio is well positioned to adapt and grow as the industry recovers.

It is also important to note that this isn't the first time our foodservice business has had to emerge from an economic downturn. During the recession in 2008 and 2009, our direct sales force expanded their reach to the emerging channels of lodging, health care, and colleges and universities. This intentional pivot provided significant growth for the next decade.

Today, we are leveraging many of those same strategies with an increased focus on the newest emerging segments.

From a financial perspective, we delivered earnings per share of $0.37, which is flat to last year. Jim Sheehan will provide more details, but I do want to mention that our earnings fully reflect $40 million or almost $0.06 per share in increased supply chain costs related to COVID-19.

Looking at the segments, Grocery Products volume increased 6%, and sales increased 7%. Similar to the second quarter, we saw exceptional growth from nearly every brand, especially brands such as SPAM, SKIPPY, Herdez, Hormel Compleats and Dinty Moore. Earnings for Grocery Products increased 36%, driven by strong volumes and improved margins due to favorable product mix.

It is clear that brands still matter, and never have consumers relied on established and trusted brands to feed their families like they have during these times. Many brands within the Grocery Products portfolio have not only seen extraordinary growth, but they have outpaced the competition. Continuing to invest in these core brands is one of our highest priorities and responsibilities.

One brand which has seen a resurgence of demand is SKIPPY. While the entire peanut butter category has seen growth as kids stay at home, the SKIPPY brand has thrived and outpaced the competition. We've also launched numerous new innovative products which are seeing early success.
SKIPPY Squeeze, SKIPPY No Sugar Added, and SKIPPY Peanut Butter blended with plant protein, each deliver a unique consumer proposition and are helping extend and grow this iconic brand. We were pleased that our SKIPPY Squeeze Pouch recently won an award from Food Network Magazine for smartest new packaging for a long-time favorite.

International volume decreased 5%. Sales increased 2%, and segment profit increased 26%. Results from our China business were very positive during the quarter, primarily due to higher retail sales for SPAM and SKIPPY, but also from other refrigerated products in country.

We saw continued improvement in our foodservice business as restaurants reopened. Similar to the past few quarters, the team in China is working through higher pork prices and are taking the necessary pricing actions to offset cost increases. Worldwide demand for SKIPPY Peanut Butter and SPAM luncheon meat was strong, which drove higher exports and growth from our affiliated businesses in the Philippines, South Korea and Europe.

The dynamics we are seeing in the United States are playing out across the globe in similar ways. We did see a sharp decline in our fresh pork exports as variety meat supplies were limited because of in-plant labor shortages stemming from the COVID-19 pandemic.

Jennie-O Turkey Store volumes declined 9%, and sales declined 4%. We saw a very strong retail sales, led by our Jennie-O Lean Ground Turkey. This growth is a continuation of the progress we made in regaining distribution prior to the pandemic, and we plan to advertise against the Jennie-O brand in key markets later this year.

While we saw strong growth in our retail business, it was not able to offset declines in our foodservice, commodity and whole-bird businesses. Segment profit decreased 67%, driven exclusively by the impact from three plant pauses and incremental supply chain costs related to COVID-19 safety measures. This is an important distinction, as it speaks to how the earnings strength in our retail business was able to offset the declines in our foodservice business.

We were making excellent progress in many areas, but the cascading impact of three plant pauses throughout our vertically integrated supply chain had an outsized impact on profitability this quarter. As such, the overall earnings decline this quarter is not reflective of where I believe this business is going. I'm confident we're on the right path.

Refrigerated Foods volume increased 8% and organic volume increased 7%. Sales increased 5% and organic sales increased 2%. Retail and deli demand was led by strong growth from products such as Applegate natural and organic products, Hormel Black Label Bacon and Columbus grab-and-go charcuterie. Fresh pork sales also increased on strong demand for retail pork.

One brand I want to highlight is Applegate. Consumers are discovering the Applegate brand at a rapid rate, as families are looking for options to feed their kids while at home during the pandemic. Our offerings span multiple categories, including chicken nuggets, hotdogs, burgers and breakfast sausage.

The growth we have seen from Applegate in the last few months is staggering, and we are investing in the business in order to maintain momentum. The Applegate team delivered these impressive results, even as they battled disruptions in their third-party logistics system due to COVID-19 and have had to work creatively to find additional capacity in their supply chain.
The Hormel Deli solutions team has also seen impacts from COVID-19, as consumer shift purchases away from behind-the-glass meats and prepared offerings to pre-packaged and pre-sliced options. During the third quarter, sales into the deli increased 4%, as strength in our grab-and-go offerings more than offset declines in our prepared foods and behind-the-glass businesses. We expect this trend to continue, as our Hormel Gatherings party trays and Columbus branded items provide differentiated at-home experiences.

Another brand I'd like to highlight is our Hormel Gatherings party trays. When the pandemic started, we saw a sharp decline in sales due to social distancing mandates. As always, our marketing team went to work to solve this problem. They quickly repositioned the brand from a focus on social gatherings among friends to a more family-oriented brand message.

Our foodservice business, which represents approximately 40% of Refrigerated Foods sales saw double-digit declines during the quarter. However, we are very confident that as the foodservice industry recovers, our product lines featuring pre-cooked, pre-sliced and pre-marinated products will thrive, as operators look to simplify preparation and reduce handling of products.

As I mentioned in my earlier remarks on the foodservice industry, it is important to remember that we have been through this before. The foodservice industry will re-imagine itself, and we are perfectly positioned to support them during this time.

This past quarter, we successfully integrated the Sadler's Smokehouse Organization into Refrigerated Foods. We received a lot of positive feedback from the prior owners who credited our team for providing access to Hormel Foods resources and necessary support during the pandemic.

Early indications are promising, especially seeing the ease at which Sadler's was able to pivot from foodservice to expanded retail distribution. I'm personally excited to see how our broader organization is able to leverage Sadler's unique product offerings to deliver innovative new products.

Earnings declined 11% due to lower foodservice sales, incremental supply chain costs and losses on strategic hog hedge positions. Setting aside the offsetting channel dynamics within Refrigerated Foods, incremental COVID-19 costs and losses on strategic hog hedges were the primary reasons for the earnings decline.

As we look forward, for the total company, we expect the fourth quarter to mirror many of the dynamics we experienced in the third quarter. We expect continued strength from our retail businesses as consumers engage with our brands at elevated rates. There remains a high level of uncertainty as to how quickly segments in the foodservice industry such as casual dining, lodging and schools will reopen. Therefore, we expect our foodservice business will show declines in the fourth quarter.

As I said in my opening comments, the members of our supply chain team are heroes in the pandemic. Their tireless dedication has allowed us to meet the high level of demand we are seeing across our business. In many businesses, we are producing more product than we ever have to meet the increased demand. Examples include plants where we've not had positive COVID-19 cases or plants where we had excess capacity to meet the surge in demand.

In other businesses, factors such as limited labor availability and short-term inefficiencies due to COVID-19 safety measures are limiting our ability to meet the high levels of demand we are seeing.
Further, the third quarter is historically when we built inventories to meet the seasonally high demand in the fourth quarter. However, the record sales in our third quarter has led to abnormally low levels of inventory, which further limits our ability to meet demand in key categories. Jim Sheehan will provide more details regarding our inventory levels.

Without compromising employees’ safety, our supply chain team is working to find solutions to increase production through continuous improvement, further internal production capacity, and by working with our trusted co-manufacturing partners. Consistent with the second quarter, we are incurring incremental supply chain costs related to COVID-19.

During the second quarter, our costs increased by approximately $20 million. And in the third quarter, our incremental costs were approximately $40 million. These were primarily related to team member bonuses, enhanced safety measures and lower production volumes.

In the fourth quarter, we expect to incur another $20 million to $40 million of incremental costs. In total, we expect our COVID-19 related costs to be between $80 million and $100 million this fiscal year.

In closing, I am confident we have the right strategy, sound business fundamentals, best-in-class management, and the financial strength to thrive and grow in this dynamic marketplace. We are well equipped to weather this storm, and we'll be stronger because of it.

At this time, I will turn the call over to Jim Sheehan to discuss our financial information relating to the quarter, give an update on our financial position, and provide commentary regarding key input cost markets.

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

Thank you, Jim. Good morning. You heard Jim give a few examples of how uncommon Hormel Foods is, I’d like to share another example. Early in the pandemic, the Project Orion team made the commitment to push forward with the go-live of the financial system.

In spite of the difficult circumstances, the team was able to fully convert the financial systems to the cloud, train the finance team, and deliver third quarter financials on time. By doing so, the Orion team kept us on track to achieve the benefits of this best-in-class financial system. These benefits include improved analytics, robotic process automation, and real-time financial data. Further implementation of the supply chain remains on track and will take place later in 2020 and 2021.

Net sales for the third quarter increased 4% to $2.4 billion, which was a record. Higher sales were driven by strong value-added retail sales across all segments. Segment profit declined 3% compared to the prior year as the business absorbed incremental COVID-19-related investments of $40 million, and generated lower earnings from the foodservice businesses.

Net earnings were $203 million, up 2%. Earnings per share of $0.37 was flat to last year. SG&A, excluding advertising, modestly increased to 6.6% of sales compared to 6.5% last year. Higher employee-related expenses were mostly offset by reduced travel expenses. Advertising investment for the third quarter were $24 million. Net unallocated expenses declined $5 million for the quarter due to improved return on investments.
Operating margins were 10.5% compared to 11.2% last year. Margins were impacted by additional investments into the safety of our plant professionals, employee bonuses, higher operating costs, and the impact of operating pauses at Jennie-O Turkey Store. The effective tax rate was 21.6% compared to 23.6% last year.

Even in these uncertain times, the company continued to generate strong and stable cash flows. Cash flow from operations and free cash flow for the quarter increased 59% and 72%, respectively. Cash flow benefited from lower levels of inventory.

The third quarter is usually spent building inventory in anticipation of higher seasonal demand in the fourth quarter. As Jim mentioned, due to the significant demand for our products in the third quarter and limiting factors on production of key brands, inventory levels were unseasonably low as we began the fourth quarter.

To provide context, the current finished good inventory level is 24% lower than last year. The segments most impacted by lower levels of inventory are Grocery Products and Refrigerated Foods. In June, we issued $1 billion of 10-year bonds at the favorable interest rate of 1.8%.

This cash will provide ample liquidity and allow the business to take advantage of strategic opportunities such as M&A. We have $250 million of funds maturing in April 2021. Our solid cash flow, liquidity position, and strong balance sheet gives us the flexibility to fund our capital needs while continuing to invest in long-term growth opportunities.

We paid our 368th consecutive quarterly dividend effective August 17th at an annual rate of $0.93 per share, an 11% increase over 2019. This completes our 92nd consecutive year of dividends. The company did not repurchase shares during the quarter. Capital expenditures in the quarter were $88 million compared to $67 million last year.

Large projects for the remainder of the year include the Burke pizza topping plant expansion, a new dry sausage facility, and Project Orion. The company's target for capital expenditures in 2020 is $350 million.

The hog market was at 20-year lows during the quarter. This benefit was reduced by our mix of hog procurement contracts and losses on strategic hog hedges. These hedges were put in over a year ago to proactively manage the risk of higher prices due to African swine fever.

Currently, pork industry production is operating at near capacity levels. According to the USDA, pork production is expected to be 3% higher for the year. We expect continued lower hog prices in the near term. This environment supports plentiful supplies of pork, though plant disruptions would pose a risk to production volume and commodity prices.

The volatility in commodity values at the beginning of the third quarter negatively impacted margins. The USDA composite cutout peaked in early May at levels not seen since the PED virus outbreak in 2014.

The cutout fell nearly 50% by early July. Pork trim, beef trim, and bellies exhibited similar volatility. Overall, pork trim was higher by 21%, and beef trim was higher by 38% for the quarter. These costs have moderated in the fourth quarter.

Belly prices were 9% lower, and have remained below last year. Worldwide demand for pork is strong. USDA is expecting exports to increase 19% for the year, driven by strong demand from China.
We continue to monitor African swine fever in China, Southeast Asia and Europe. Fundamentals in the turkey industry remain mixed. Poult placements continue to trend lower. Markets rebounded some in the third quarter, but breast meat and thigh meat prices are significantly below last year. Prices are favorable to last year, helping to offset declines at other markets. Beef cost for the third quarter was higher.

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

**QUESTION AND ANSWER SECTION**

**Operator**: We will now begin the question-and-answer session. The first question comes from Ben Theurer of Barclays. Please go ahead.

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

Yeah, good morning, Jim and Jim. And first of all, congrats on the results and on all the initiatives you announced, especially one on education. I think this is a very good way of supporting your workers.

Now, wanted to dig a little bit into what you've said about the inventory levels and the declines here and what it means for the fourth quarter. So, thanks for sharing a little bit of detail already in the prepared remarks on the impact where it mainly is within Grocery and Refrigerated Foods. Now, how do you think this is going to impact your ability to supply the demand into the fourth quarter, which usually obviously has an impact and an uptick in sales? So, just to understand a little bit what might be prohibited in terms of sales and what might be the impact if demand remained that strong and particularly retail channels as we've seen? That would be my one question. Thank you very much.

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

Yes. Well, Ben, thanks for the comments. We sincerely appreciate them. In regards to the business question around inventory levels, I mean, really as we've said multiple times in the comments, the supply chain team since the start of this pandemic has done heroic work to meet the increased demand. And really, what we're trying to convey here is as we think about what happened in Q2, Q3, as we had more – we had the initial outbreaks and we had plant pauses and more significant disruptions to the supply chain, we did have inventory as a buffer. And we're able to continue to fill orders as we were working our way through the initial stages.

Over the course of those quarters, though, I mean, we've burned through that inventory. And so, now as we head into the fourth quarter, I mean, it's going to be very important paramount, if you will, that we keep our supply chain operational. And like I said, the team has done a great job. But we can't afford any disruptions, and although we're not seeing the level of outbreaks of COVID cases, I mean, we are still having cases on occasion and those cases can have production impacts.

So, the team is doing a great job, as you heard, keeping COVID out of our facilities, working with team members in the facilities to make sure they understand the importance.
But really, it's a messaging that says, we were able to have inventory as a buffer, where really in some areas don't have that now. And so, making sure that our supply chain and our production efficiencies are where they need to be is going to be critical to meet the increased demand.

And so, I mean, if you look at some of the demand that we have met, I mean, significant increases in pepperoni, in bacon, in SPAM, some of our center store items. So, we've been able to meet that increased demand. But we just have to make sure that we keep that supply chain and our production facilities going.

Okay. Very clear. And then, just a technical one, of the $40 million, direct/indirect cost, supply chain disruption and so on, can you break that out on a segment basis, just to understand where the majority was impacting? Is it, I suppose, Refrigerated Foods, but also in Jennie-O, how much of an impact did you have there because of some of the unplanned pauses that you had?

Yeah. And so, the majority of those costs were in Refrigerated Foods and JOTS, and obviously, in our comments, we were pretty specific to talk about that outsized impact, if you will, in JOTS. So, that's probably the right way to think about it.

Ben, what I would add to that is because JOTS is vertically integrated, the impact on JOTS not only as in the products they sell and the availability of that product and their production lines, it goes all the way to the [indiscernible] (39:06) side.


Thank you.

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

Good morning. Thanks for taking my questions, and also congrats on the nice quarter. So, I guess I want to go back to Jennie-O. So, clearly, profitability was challenged during the quarter. Are we now past the planned pauses? Or is that still an ongoing headwind? And then, just curious, just any thoughts in terms of how you see the profit recovery unfolding for here for JOTS?

Thank you.
Yeah. Rupesh, thanks for your comment. So, I mean, we haven't had any plant pauses since the beginning of the third quarter. And I mean, we continue to bring labor into the plant. I mean, that's a key ingredient in making sure that we can run the harvest facilities.

Those three plant pauses that we had in Jennie-O Turkey Store and the costs associated, I mean, that had a big impact. Jim just mentioned that it goes all the way back in the vertical supply chain. And when we can't harvest birds, where we have higher life production costs through higher feed and then other issues, so on the supply chain side, big, big impact.

But as we think about the dynamics of the business, my comment about why I feel good about it is we saw the benefits of the distribution that we had regained pre-COVID-19. Now, we understand the impact of consumers going and eating at home more. But obviously, we had to be on a shell for them to be able to find us. So, the distribution gains that we had, we benefited from.

We did have a negative impact in our foodservice business, especially early in the third quarter. Like our Hormel Foodservice business, we've seen some recovery. The Jennie-O Turkey Store foodservice business is a little more skewed to schools, and they have the impact of K-12 and we're trying to understand how that plays out this semester. So, I mean, all-in-all, it really is COVID-related costs that negatively impacted the business. We feel good about the retail side. We've got to have recovery in the foodservice side. But everything that we put in place pre-COVID is playing out and that's why we're optimistic about the business heading into the future.

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Rupesh Parikh
Analyst, Oppenheimer & Co., Inc.

Okay. Great. And then, I guess my one follow-up question, just on e-commerce, you guys had very positive commentary in terms of what you're seeing in e-commerce, both direct-to-consumer and the click and collective of your consumers. From a brand perspective, where are you seeing the most strength right now? And is anything surprising you in terms of where you are seeing that trend?

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

Yeah, we were pleased, Rupesh, because we saw it across the board. We saw it in a lot of our Refrigerated Products and also in our Grocery items. So, it wasn't skewed to any one brand or product line, really good balance across the portfolio.

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Rupesh Parikh
Analyst, Oppenheimer & Co., Inc.

Great. Thank you.

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

Yes.

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Operator: The next question comes from Ben Bienvenu of Stephens, Inc. Please go ahead.

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Ben Bienvenu
Analyst, Stephens, Inc.
Hi. Thanks. Good morning. Appreciate you taking the questions. I've got one for Jim Snee and then one for Jim Sheehan. Jim Snee, I'd be curious to hear your thoughts on what impact, if any, there's been from COVID on the product innovation cycle. You noted some of the call-outs around new packaging for SKIPPY, you all have had a pretty successful heritage of new product innovations that have driven incremental market share. Is COVID and the operational heavy lifting that you have pushing that innovation cycle out? Or are you still making headway on that front?

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

Yes. Great. That's a great question, Ben. And I will tell you, we are making great headway on that front. I referenced the SKIPPY products that we're bringing into the marketplace and having some really good early success in multiple items. I just recently had an update in terms of the pipeline that is coming this fall and I mean, it continues to be very strong. It's exciting. It's on trend and our customers are looking for that innovation. So, I've been really, really impressed with the work that our innovation team, which of course encompasses so many other functional areas, has been able to do remotely.

The other thing that I would mention, and we talked about it on our last call, I don't think we mentioned at this time, but we continue to track at our 15% goal in regards to innovation. And so, in the midst of everything else that's going on, we haven't lost sight of the fact that innovation is part of our lifeblood and something that we need to continue to deliver to drive the company forward, and our team has just done an amazing job responding.

Ben Bienvenu  
*Analyst, Stephens, Inc.*

That's great. Okay. Thanks. Jim Sheehan, you'd called out some of the color around your hedging strategy for hogs. Makes perfect sense in light of what 2020 was supposed to look like in light of African swine fever and what that pretended for hog prices. Would you expect – with your current hedge book, would you expect continued headwinds from hog hedges in the fourth quarter in light of hog prices still being down pretty materially?

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

Yeah. I'd say – good morning, Ben. But as I said, the hogs hit a 20-year low during the quarter. And obviously, our hedge positions where we thought were favorable. But anytime you take a hedge position, you're really mitigating your risk and not trying to time it, and that's our strategy. We look at purchasing hogs on a balanced model. That is some on the open market, some on the Western Cornbelt, some on the composite value and utilizing hedges. So, the hedges will be a headwind as we expect hog prices to be – continue to be down. Production has backed up a bit during the time period that there has been some pauses in production. But again, it's a balanced model. And as we've looked at our hog costs, our hog costs were still down 20% compared to the prior year. So, it takes an approach that is [indiscernible] (45:51) both the future and the current circumstances.

Ben Bienvenu  
*Analyst, Stephens, Inc.*


Operator: The next question comes question comes from Michael Lavery of Piper Sandler. Please go ahead.
Michael S. Lavery
Analyst, Piper Sandler & Co.

Thank you. Good morning.

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

Good morning, Michael.

Michael S. Lavery
Analyst, Piper Sandler & Co.

Can you give a little bit more color on the foodservice? The channel splits that you gave is really helpful. Maybe just some of how that progressed over the course of the quarter and what you've seen since in terms of just the momentum or volatility around that?

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

Sure. Early – late second quarter, early third quarter, I mean, a significant decline that we saw in our foodservice business. And early in the third quarter, we started to see recovery. The business was on a very nice trend, upward trend. And then, as we started to see more COVID outbreaks around the country, what happened, and it actually was kind of nice to see, is we saw the business or the recovery kind of plateau. And so, at the outset, what we saw was that initial significant decline in the business and what we saw this time with some of the outbreaks was that the business maintains a level it was at, it just plateau. So, it didn't continue its recovery. And now, we are starting to see a bit more recovery as different states do get it under control, but I mean the fact is that it's still significantly behind a year ago.

For us, it is all about what does foodservice look like in the future. How does the industry reimagine itself? What are the emerging segments that will come from this? We do believe that food away-from-home is just such an ingrained behavior in our society that it's going to continue in some way, shape or form. But it probably will look different for the foreseeable future.

Michael S. Lavery
Analyst, Piper Sandler & Co.

Okay. That's helpful. And then, just on M&A, I want to follow up on your prepared remarks. You obviously mentioned it as something you consider your balance sheet is great for that, and there's nothing new there. Maybe just was a little interested that it stayed in the prepared remarks or is getting mentioned in an environment like this, where it looks like – it feels like it could be more difficult to get deals done. Is that not your sense? Or is there some better amount of activity there you're doing than it might seem with just the disruptions and some of the things remote and everything else?

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

Yeah. I think the key takeaway there is, again, you go back to the early stages. You had so many companies, so many people just really trying to figure out which way was up. And so, the idea of having M&A activity was not at the top of anyone's list. It was about really running the day-to-day business. And I think as that's moderated a little bit and then people have figured out maybe a little bit of what a new normal might look like, there is – there are more conversations. There is more interest. And I would tell you that the communication is picking up a little bit.
So, from our perspective, we believe that we’re – we continue to be in a really good spot with the strength of our balance sheet. Jim talked about our debt offering, when we did it, why we did it, but then also what that could mean for us down the road. So, we continue to value M&A as an important part of our growth strategy going forward.

Michael S. Lavery  
Analyst, Piper Sandler & Co.

Great. Thank you very much.

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

Yes.


Kenneth B. Zaslow  
Analyst, BMO Capital Markets Corp.

Hey, good morning, guys.

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

Hi, Ken.

Kenneth B. Zaslow  
Analyst, BMO Capital Markets Corp.

Grocery sales seems a little lighter than I would have expected. How much of that is reflecting in the demand side versus how much is it operational inability to get the product to the consumer or the retailer? And then, on addition to that is when you're looking at your inventory levels and your harder ability to get to the retailer, what are the longer-term implications on shelf space and your relationships in terms of shorting customers given the demand?

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

Sure. I'll answer both of those, Ken. And I'll – if Jim has any inventory follow-up, I'll let him do that. As you think about Grocery Products, I mean, the core business, right, the SPAM, the SKIPPY, the Chili, the Dinty Moore, all of that business was very, very strong and able to meet the demand.

Probably that gap you're describing, and we had a little bit of this I believe in the second quarter, is this offset by food away from home and contract manufacturing. So, the food away from home exists in our MegaMex business and that like our Hormel Foodservice and our Jennie-O foodservice business was down. And then, we also saw a decline in our contract manufacturing business.

So, I mean, as you think about that delta, those are probably the two pieces that would lead you to that underperformance comment. But I mean, from our perspective, our legacy, our core Grocery Products business
was really, really strong. And even our MegaMex business was up, but we did have a negative impact from their food away from home business.

On the inventory piece, I mean, your comment is well made that if over a long-term, you're not able to supply a customer, there's going to be ramifications. And I mean, we're not in that position. I mean, we're able to meet and maintain our shelf space with our customers. And going back to my earlier comments, the whole comment around inventory is just that it's shifted, right? We don't have that as a buffer. So, we do need to make sure that the operations are running as efficiently as they can.

So, yeah, we're – as you would expect, and I'm sure you're hearing from others, we're in constant dialog with retailers in terms of making sure that we're meeting their needs, they understand what our situation is. And certainly, we're not going to put any of our business or our shelf space at risk.

Ken, the only thing that I would add to that is that as you think about the inventory decrease, the decreases don't all have the same impact. For instance, we know our foodservice business is down. So, we have purposely decreased our foodservice inventory, so that we could reallocate resources into the retail production. So, the supply chain is doing that all of the time, and we're trying to meet every need we can. So, there are some areas that are not going to have much of an impact because they're short such as some of the areas of foodservice.

And my follow-up, just a clarification. On the Turkey business, is everything working now? And we should be seeing more normal margins at this point relative to whatever the industry is? Or is there still operational legacy issues? I just didn't understand the commentary, and I'll leave it there.

Happy to clarify that. I mean, the plants are all up and running. I think from an industry perspective, I mean, our margins, our business are always at the top of the industry. We do continue to have higher COVID related costs. And so, PPE, some of the labor issues that would lead to lower volumes, lower overhead recovery. I mean, those are still there as we progress in the quarter. But I mean, the plants are still running. We haven't had any pauses since the beginning of the quarter. And so again, the retail demand, especially in the lean ground turkey area, really, really strong, the foodservice business recovering, but still trailing last year. Jim, I don't know if you want to add anything.

Yeah. And as you – again, with being vertically integrated, as you've held birds longer, they're heavier birds, they don't perform as well. We're starting to move through that inventory, but that's why the impact on Jennie-O has a longer tail than in areas where we're not vertically integrated.

And did you clarify if the plants were running what the operating margins would have been? And I really will leave it there. I'm sorry.
James P. Snee  
*Chairman, President & Chief Executive Officer, Hormel Foods Corp.*

Yeah. No. Ken, we'll let you have – you can have that offline with Nathan. Just he can give you a little more clarification.

Kenneth B. Zaslow  
*Analyst, BMO Capital Markets Corp.*

Great. Thank you, guys. Stay safe.

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

Thank you.

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

Thomas Palmer  
*Analyst, JPMorgan Securities LLC*

Good morning. Thanks for the question. In the Refrigerated Foods segment, price mix was down pretty meaningfully. Just wanted to better understand to what extent this reflected a flow-through of lower industry commodity prices, whether mix such as the higher fresh pork sales and retail were a factor.

And then, as we think about how the fourth quarter might play out, how pricing could proceed, especially considering that it sounds like supply is a bit of a constraint right now and that’s some pricing or at least pull back and promo could make some sense.

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

Tom, as you look at the sales of Refrigerated Foods, they certainly were impacted by lower commodity prices. They had volatility, but the prices generally were lower. I mean, as you look at the various items, for instance, even bellies, it’s had volatility, but it ended closer to the – below last year. It was below last year. So, that certainly had an impact in the sales prices in Refrigerated Foods, less than a month.

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

Yeah. And as you think about the fourth quarter, I mean, on the markets, I mean, it feels like all of the supply plants are running at very solid levels and the supplies are going to be adequate going forward. So, would expect more of the levels that we’re seeing right now.

Thomas Palmer  
*Analyst, JPMorgan Securities LLC*

Okay. Thank you. And I guess just to follow up on the co-packers. So, how do you see this margin overhang going away over time? Is it driven by, over the next couple of quarters, taking certain products in-house? Or is it more that as demand can -- the increased demand for products, starts to ease, essentially the co-packer issue solves itself? Thanks.
That's correct, Heather.

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

James P. Snee

Yeah. So, Tom, just to clarify, I mean, we have already a very well-developed and trusted network of co-packers, co-manufacturers that, that support different areas of our business. I guess, what we were saying is, as we think about the need to continue to meet increased demand and make sure that we have the right appropriate risk mitigation, we are finding ways to expand the capacity with some of those trusted co-packers. So, it's really less about bringing it back in-house. It's more about finding those opportunities to expand the supply side of the business.

Analyst, Heather Jones Research, LLC

Heather Jones

Okay. Thank you.

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

James P. Snee

Yeah. I guess, what we're saying there, Heather, is, I mean, we know that there's going to be increased demand, and continue to be increased demand. And to meet that demand, we have to have our plants run as efficiently and effectively as possible because we don't have that safety stock to draw off of. So, I think, we're saying the same thing.

Analyst, Heather Jones Research, LLC

Heather Jones

Okay. Perfect. And then, the second thing is you mentioned the impact from hog hedges that you had put in place last year, but then, some lower cash hog prices. So, for the quarter, did I understand you correctly? And I think this was Jim Sheehan's comment. Did I understand you correctly, though, that net-net, even of the hedge impact, that hog costs were more favorable in Q3 than they were in Q3 of 2019?

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

James N. Sheehan

That's correct, Heather.
Heather Jones  
*Analyst, Heather Jones Research, LLC*

Okay. Perfect. Thank you so much.

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

Thank you.

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

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

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

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

Yes.

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

Jim, I guess, just as we're thinking about foodservice, out over the next couple of quarters, you guys have a large direct sales force, right, that probably has more touch points, with some of your restaurant customers, maybe than some of your competitors.

And I guess the question we're kind of grappling with at this point is as the weather starts to turn, maybe people go – are forced to go back inside, outdoor dining isn't really as much of a possibility. Just what are some of the high-level conversations that your salespeople are having with customers at this point that you'd be willing to share with us?

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

Sure. I mean, that's a great question. And that is certainly a risk to the next couple of quarters. But I think the other part that we've seen, Peter, is so many restaurants have become so much more proficient at takeout, right?

I mean, again, as this started, takeout was not a big part of the foodservice, operators, MO. I mean, some did it better than others. And clearly, had drive-throughs, I get all that. But some of the casual dining locations, they had it as an option, but it wasn't a very well-developed option. But I think it's fair to say that operationally, from a packaging perspective, so many foodservice operators have become so much more better, so much more proficient with that.

And then, I go back to this idea of how does foodservice reimagine itself. And so, this idea that over all these years, we've developed this behavior of food away from home. And now, that's just going to – I get that it went away for a period of time, but to think that it's going to go away forever just seems to be bit of a stretch if you ask me.
So, I do think that food prepared away from home is going to continue to be on everyone’s radar. And I think as more and more, especially casual dining segments, get comfortable with to go, takeout, that's going to continue to be an opportunity.

We also are seeing and working with operators on different grab-and-go options. So, not just food that you bring back into your house, but as you think about where individuals would maybe want to go and sit and have a meal, they're not doing that. It is more of a grab and go. And so, everything that we have in our portfolio that we described around all of our pre options sets us up really well to take advantage of that as foodservice continues to reimagine itself.

So – and our direct sales force, as you mentioned, is going to play a critical role in making sure that we understand and that we're on the front end of this reimagination. It's going to be really, really important for us. So, I mean, those are just some of the conversations we're having. But I mean, it's still – this is going to be a work in process, but we feel good about where we're at in the cycle.

Peter T. Galbo
Analyst, BofA Securities, Inc.

Okay. No, that's helpful. Thanks very much. And maybe just Jim Sheehan, a quick one. Just – you're kind of a month into the quarter at this point. You saw the – a pretty wide range on the COVID costs for the fourth quarter. Just – what would drive you to the high end versus the low end of the $20 million to $40 million? Thanks very much, guys.

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

The issue that would create the highest cost would be a plant pause. The fact that – we talked about this, I think, in the last quarter. Every day, we're getting better at running our facilities under the current structures and the current cost matrix that we have.

And we'll be – we were better at the end of the quarter than we were at the beginning of the quarter, and the end of the fourth quarter will be much better. So, we continue to improve and we address these costs, but they're real cost and they are there. So, we're building efficiencies. If there are going – if there's a plant pause, that would have the biggest risk of increasing our costs.

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

Adam Samuelson
Analyst, Goldman Sachs & Co. LLC

Yes. Thanks. Good morning, everyone. And appreciate with me...
...squeezing me in. So, my question is just thinking – wrapping all, there’s a lot of ground covered. The comments on the fiscal fourth quarter kind of mirrored the dynamics of the third quarter. I’m just trying to translate that into kind of operating performance a little bit.

And is that intended to reflect sales and – year-on-year sales and EBIT, or year-on-year margin performance would look similar, absent kind of a substantial change in the COVID kind of outlook? Or just help me think about kind of what that actually means as we think about sales margins in your business.

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

Yes. So, Adam, good morning. I guess, I’ll take it more from a sales perspective. And so, when we say similar dynamics to Q3, I mean, we’re thinking about continued strong retail demand, both from Grocery Products, Refrigerated Foods and JOTS.

Still experiencing recovery in the foodservice businesses and just a reminder that they’re a big part of Refrigerated Foods and JOTS. So, we have continued to work to do. Our international demand is strong across most geographies. We expect that to continue. As I said earlier, from a supply chain perspective, not having outbreaks, but we continue to battle on the production front, as we do have individual cases and that can create production challenges. We’ve talked about the safety stock as a buffer, and the need to have supply chain hitting on all cylinders. And so, that’s when we say the dynamics are similar to Q3. I mean, that’s how we’re thinking about it from a demand and a supply perspective. So, hopefully, that’s helpful to you.

**Adam Samuelson**  
*Analyst, Goldman Sachs & Co. LLC*

It is. And just last quick one. The $80 million to $100 million of COVID-related costs that you’re expecting to incur in fiscal 2020. Do you have any rough idea of what that could look like in fiscal 2021? I imagine there’s a portion of that that's bonuses that you wouldn't necessarily plan on repeating.

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

Yeah. We don’t have an estimate on that for 2021 yet. We – we’re starting that whole process, and we’re trying to get a better read on those that are permanent or longer-term and those that were temporary. So, we don't have that today. And as soon as we get more clarity on that, we'll pass that along.

**Adam Samuelson**  
*Analyst, Goldman Sachs & Co. LLC*

Okay. Thank you.

**Operator:** And the last question today will come from Robert Moskow of Credit Suisse. Please go ahead.

**[05QKJ5-E Rob Moskow]**
What an honor to be the wrap-up question. Okay. Believe it or not, it's still about inventory levels. So, one point of clarification, I guess, is last quarter, I think what we learned is that maybe 20% of the Grocery division is contract manufacturing, also some alternative channels that are not growing within Grocery.

So, is it fair to say that that's the reason why maybe your Grocery division is not demonstrating the same level of growth that most of us could see in Nielsen-measured channels at retail? It's – I am having trouble figuring out whether retailers reduced inventory or not. It sounds like they really didn't in the third quarter. Did that – that really the difference between the Nielsen-measured and what you're reporting here is really just the alternative channels.

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

Yes. I think that's right, Rob. First, I'd say, it's always an honor to back clean up. So, we're honored to have you. But you're right. I mean, we do have that delta in Grocery products that is at the food away from home that's in MegaMex, and then the contract manufacturing that I know we talked about last quarter. And so, that is the delta. From a retailer perspective, I mean, we haven't seen anything significantly different in terms of what they're doing with their inventory levels.

Q  
Okay, got it. So, it's not like we're going to have a big refill in the October quarter related to the fall season or anything like that? You'll ship to consumption in the fall – in the October quarter is your expectation?

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

Yes. Exactly.

Q  
Okay. Okay. And then, last question. On Refrigerated, you said that your commodity costs [indiscernible] (01:09:29) are down. You used to give us fresh pork profits in the past when it was kind of normalizing lower. So, are fresh pork profits higher in this quarter versus a year ago as a result of those [indiscernible] (01:09:45) costs being down?

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

They're actually relatively comparable.

Q  
Comparable?

A  
James P. Snee  
Chairman, President & Chief Executive Officer, Hormel Foods Corp.
Yeah, they're comparable because obviously there's been so much volatility in the markets. I mean, it's just been wild. Bellies were low – as low as $89 and as high as $267. And the timing of when you're buying and when you're selling just could have a – can play havoc on that. So, Rob, this is – fresh pork isn't probably the most – this isn't the best quarter to measure profitability of fresh pork, but it was in the range.

[05QKJ5-E Rob Moskow]

Okay. And when you're talking about fresh pork, you're talking about also including those hedges as well [indiscernible] (01:10:28) unfavorable in the quarter?

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

That's true, Rob.

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

Right. Okay. All right. Got it. Thank you very much.

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

Yes. Thank you, Rob.

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

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

Well, thank you for joining us on our call today. One of our cultural beliefs is results matter. And as you heard today, we delivered results. We delivered results in many areas. We delivered results in our business, we delivered results in keeping our team members safe. And once again, we delivered results as a great corporate citizen. To our team members listening in, thank you for all you do. Stay safe.

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