Corrected Transcript

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Hormel Foods Corp. (HRL)

Q2 2021 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day, and welcome to the Hormel Foods Second Quarter 2021 Earnings Webcast and Conference Call. All participants will be in a 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. Please go ahead.

Nathan P. Annis

Director of Investor Relations, Hormel Foods Corp.

Good morning. Welcome to the Hormel Foods conference call for the second quarter of fiscal 2021. 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 the company's current and future operating conditions, commentary regarding each segment's performance for the quarter, and a perspective on the balance of fiscal 2021. Jim Sheehan will provide detailed financial results and commentary regarding the company's current and future financial condition.

The line will be opened 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 the call will be available beginning at noon today, Central Standard Time. The dial-in number is, 877-344-7529, and the access code is 10155508. 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 26 through 32 in the company's Form 10-Q, for the fiscal quarter ended January 24, 2021. It can be accessed on our 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. Once again, this quarter, I want to recognize the heroic work of our production team members. This team deserves much of the credit for our record sales results this quarter, as they continued working to produce safe, high quality food for millions of consumers and customers.

Our number one priority has been to keep our team members safe, and our cross functional COVID-19 leadership team is ensuring we are on the leading edge of the country's vaccination efforts.

To-date, we have fully vaccinated over 51% of our domestic workforce, which is well ahead of the country's vaccination rate. We are encouraged by the rapid decline in cases in our communities.

From a top line perspective, our balanced business model has again proven to be a winning formula, as our team delivered record sales for the second quarter, and first half. In total, sales for the quarter, increased 8%, compared to last year, and sales increased over 5% for the first half of the year.

A key driver of our sales performance is the rebound in our food service business. As expected, our food service team experienced a strong recovery and took numerous actions to properly position our organization to capitalize on the industry recovery. For the quarter, food service sales increased 28%, this reflects an increase of 1% over 2019 pre-pandemic levels. This is a significant accomplishment, especially knowing where the industry was just a few short months ago.

Since the beginning of the pandemic, our food service teams have been doing their part to support the industry. Within days of the crisis, we worked closely with our distributor and operator partners to assist their businesses in many different ways, whether it was a rebate program to offset food costs, extending payment leniency, helping adjust to the new takeout delivery and pickup environment, or simply being available to personally check in with the restaurateur to see how they are doing.

Our confidence in the industry recovery never wavered. We know these actions benefited our distributor and operator partners and are playing a part in our outperformance of the broader industry trends. During this difficult labor environment, our experienced and tenured direct sales force is helping operators meet their accelerating demand with products that simplify their food preparation, save time and minimize labor, all while preserving the flexibility to add their own unique touch to a menu item.

Products like Hormel Fire Braised meats, Sadler's authentic smoked barbecue, Fontanini authentic Italian meats, Hormel Bacon 1 fully cooked bacon, Wholly Guacamole and Jennie-O Turkey are uniquely positioned to meet this need. The brightest spot in our food service portfolio has been our pizza toppings business. Prior to the pandemic, we capitalized on the continued growth in this category, especially for premium products, and invested heavily in capacity to meet future demand.

We've also been investing in plant-based offerings and are seeing growth from our plant-based pepperoni and crumbles products. We're excited to leverage our expertise in the pizza toppings category to drive growth in plant-based toppings. With our new capacity expansion at Burke and with additional peperoni capacity set to open at the beginning of fiscal 2022, we are set up nicely to meet the consistent growth we have seen in this space.

With the food service industry recovery well underway, we will continue to strengthen our relationships with our valued partners, invest in our direct sales team, and support the industry's return to growth with innovative, convenient and flavorful product solutions. In addition to food service growth, our retail and deli businesses also remain healthy with demand elevated compared to pre-pandemic levels.

Total retail sales this quarter were flat to last year, as we lapped the months when consumers were stocking their pantries in anticipation of the pandemic. Sales finished up 16% compared to the second quarter of 2019. And we continue to see strength from our leading brands such as SPAM, Applegate, Jennie-O, Black Label, Herdez and Wholly. As a reminder, we experienced an immediate and sustained demand surge for our shelf-stable products in the Grocery Products segment at the onset of the pandemic.

The second wave of demand that impacted our perishable and refrigerated items happened weeks later in the third fiscal quarter. Sales in the deli channel increased 4% this quarter and are up 9% over pre-pandemic levels.

Hormel Gatherings party trays delivered strong growth, as consumers started to spend more time with family and friends, and consequently are purchasing more products to entertain their guests.

The Columbus brand remains a cornerstone for our deli business and is now benefiting from the opening of our new plant in Omaha, which is providing much needed capacity.

Columbus is a leader in charcuterie. And we now have the capacity to continue expanding distribution. Across the retail and deli space, our consumer takeaway metrics continue to be positive according to IRI.

Many of our brands have made large gains in household penetration. Overall, buy rates are improving, and we are seeing an expansion in cross-purchasing across our brands.

E-commerce sales grew double digits in the last 12 weeks according to IRI. And we are gaining share in important categories. We will continue to increase our investment in this important channel.

Throughout the quarter, our supply chain continued to improve, as we were able to increase production levels, through a combination of gaining efficiencies, increasing capacities and leveraging our strategic supply chain partners.

Another area we have made great strides is in our distribution network. Over the last year, we have opened a new grocery product distribution center, and in recent weeks have opened a refrigerated distribution center serving the West Coast.

These strategic investments will reduce overall freight miles and costs, improve our customer service levels, support growth for our value-added businesses and reduce greenhouse emissions.

From a bottom-line perspective, operating Income showed a slight decline. We saw raw material and feed prices, rapidly increase throughout the quarter. We have taken pricing actions in many categories but did not see the full benefit of these actions during the quarter.

As we have previously discussed, in volatile market conditions pricing will lag the markets, which will shift profits to subsequent quarters. Net earnings and diluted earnings per share were flat to last year. A higher tax rate negatively impact earnings by $0.1 per share compared to last year.

Turing to the segments, Refrigerated Foods volume increased 3% and sales increased 17%, with growth coming from almost every division. Value added sales increased 18%, driven by a significant recovery in the food service businesses.

As anticipated, we saw a rapid increase in food service demand, as the quarter progressed. Almost all categories within food service grew sales, led by our pizza toppings portfolio and brands such as Fontanini and Bacon 1. In fact, pepperoni pizza toppings, Bacon 1 and Fontanini authentic Italian meats, all showed growth compared to the second quarter of 2019.

We also experienced a recovery in the premium breakfast portfolio with growth from our Old Smokehouse brand. Additionally, we saw excellent growth from our premium prepared proteins, which include brands such as Austin Blues, Fire Braised, Cafe H, and Sadler's. These items are key to our pre-strategy. Items that are, pre-marinated, pre-cooked, pre-sliced and fully prepared.

As the industry recovery accelerates into the summer and labor remains the predominant challenge for most operators, our line of products offer convenient, safe, versatile and flavorful solutions.

Our retail and deli teams delivered a strong quarter on the top line with growth coming from products such as Black Label bacon, Hormel Gatherings, Applegate, Lloyd's Barbeque, Hormel pepperoni and Columbus prepared foods items.

Refrigerated Foods segment profit increased 32% due to higher foodservice sales, higher retail fresh pork profitability and decreased operational expenses due to abating COVID-19 cost pressures.

International delivered its fifth consecutive quarter of record earnings growth, with sales increasing 17% and segment profit increasing 6%. The performance of the team in China remains impressive. Foodservice volumes have recovered to pre-pandemic levels, driven by growth from SKIPPY pizza toppings and bacon items.

Retail demand for the SPAM and SKIPPY brands has also been outstanding. The company's innovative offerings, including beef jerky, SKIPPY snacking items and two new SPAM varieties are providing additional avenues for growth. And we remain confident in the long-term prospects for our China business.

Branded exports also grew with growth coming from the SKIPPY and SPAM brands, higher foodservice sales, and improved margins on fresh pork items. In addition, our partners in the Philippines, South Korea and Europe continue to experience elevated demand for shelf-stable products.

Grocery Products results were strong given the difficult comparison to last year due to the extremely high levels of demand experienced at the onset of the pandemic. Even though volume declined 14%, sales declined 8% and segment profit declined 23%, we are encouraged by the segment's performance as we have seen sustained consumer demand for many of our brands compared to pre-pandemic levels.

Sales for center store brands such as SPAM, Hormel chili, Compleats and Mary Kitchen hash, were all over 20% higher compared to our second quarter of 2019. We will continue to support our leading brands, including SKIPPY, SPAM, Compleats, Herdez, Wholly, Justin's and Hormel chili, and we're resuming promotional activity as inventory levels normalize.

Our MegaMex joint venture performed well, as equity in earnings increased 26%. Both the Herdez and Wholly brands grew as consumers looked for authentic and convenient Mexican products to enhance their at-home eating occasions. Herdez brand continues to outperform the salsa category. This brand has grown households by 3 million since the start of the pandemic and has introduced industry leading innovation to the marketplace in recent years.

Following the highly successful performance of Herdez Guacamole Salsa, we continue to expand distribution and grow share with two new product lines, Herdez Taqueria Street Sauces and Herdez Salsa Cremosa. Recently, Herdez also entered the hot sauce market with the introduction of Herdez avocado hot sauce, another versatile offering that can enhance any meal.

The Wholly brand had a strong quarter as well, as it continues to target consumers, looking for convenient solutions to enjoy avocado offerings. Our recent innovations, including Wholly Smashed and Wholly Diced Avocado products solve for that consumer needs, and as we saw across many of our refrigerated foodservice businesses, demand for avocado products in the channel started to return during the quarter.

Jennie-O volume decreased 3%, and sales increased 2%, a recovery in the foodservice business, and higher whole bird sales drove the sales increase. Foodservice volumes were up double digits compared to last year. Demand for Jennie-O retail products such as lean ground turkey remained above pre-pandemic levels.

Jennie-O Turkey Store segment profit declined 54% due to the impact from higher feed costs. Grain prices continue to increase significantly during the quarter, while pricing action had yet to be fully reflected in the marketplace. Jim Sheehan will provide further commentary on the actions we have taken to manage higher corn and soybean meal costs.

Looking into the balance of the year, we are increasing our full year sales guidance range to $10.2 billion to $10.8 billion and reaffirming our earnings per share guidance range of $1.70 to $1.82 per share. As a reminder, this guidance range does not include the estimated impact of the pending acquisition of the Planters snacks nut business.

Our diversified and balanced business model gives us confidence. We can perform well in many different economic scenarios and market conditions. We have a very positive outlook on the foodservice business, as we head into the second half of the year. We are well-positioned from an inventory and capacity standpoint to meet the demand from our distributor partners and operators and are confident in our ability to gain share throughout the recovery.

Additionally, we are increasingly confident that K-12 schools and colleges and universities will open and operate in a more traditional manner this fall. This should benefit both Refrigerated Foods and Jennie-O Turkey Store.

We continue to see elevated demand in the retail, deli and international channels. We expect to further benefit from pricing actions, increased capacities on key product lines, and continued improvements in our supply chain. This year we have seen rapid increases in key input costs across our businesses, and we expect to operate in a high cost environment for the remainder of the year.

Our experienced management team has a proven ability to navigate and grow our business in volatile and inflationary market conditions. And once again, we will be leveraging our direct sales force to partner with our customers to mutually grow our businesses.

As a reminder, our operations were heavily impacted by plant shutdowns, supply shortages and lower production throughput, caused by the effects of the pandemic in the back half of fiscal 2020. This ultimately led to lower levels of inventory, which negatively affected the third and fourth quarters.

For the strategic actions we have taken to improve all facets of our operations and based on our record first half performance, we expect to benefit from more normalized operations in the back half of fiscal 2021. I am confident in our ability to continue growing, and I'm looking forward to closing the acquisition of Planters next month.

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. Record sales for the second quarter were $2.6 billion, an increase of 8%. First half sales increased 5% to $5.1 billion, also a record. Pre-tax earnings increased 2% for the quarter compared to last year. Diluted earnings per share for the quarter was $0.42 per share flat to last year.

Second quarter results reflected approximately $0.01 per share in incremental COVID-related costs and $0.01 in higher tax expense. SG&A excluding advertising was 6.5% of sales down slightly to last year. Advertising spend for the quarter was $31 million.

Operating margins for the quarter were 11.1%, compared to 12.1% last year. Higher raw material and feed costs negatively impacted margins as pricing lagged input cost increases. We have taken numerous pricing actions across the portfolio to protect profitability. The actions will take place early in the third quarter with additional pricing actions likely.

COVID-related expenses were $6 billion. The impact of COVID expenses continued to decline. Net unallocated expenses decreased due to higher investment income.

The effective tax rate for the quarter was 22.1%, compared to 20.6% last year. Excluding the impact from the Planters acquisition, we estimate the full year tax rate to be between 20% and 21.5%.

We built inventory during the quarter in preparation for higher demand and to support continued growth for the remainder of the year. Our strategic action to build inventory was the primary driver of lower operating cash flow during the quarter.

We paid our 371st consecutive quarterly dividend, effective May 17, at an annual rate of $0.98, a 5% increase over the prior year. Share repurchases were minimal during the quarter.

Capital expenditures were $45 million in the quarter. The company's target for capital expenditures in 2021 is $260 million. During the second quarter we saw dramatic increases in pork and hog prices.

USDA composite cutout prices since January have increased by more than $30, with all primals contributing to the increase. Key inputs such as bellies and trim, increased 57% and 76% respectively during the quarter.

Pork exports also set an all-time record in March, due to African swine fever outbreaks in China, Southeast Asia, and Europe. We anticipate strength in pork markets due continued export demand and a foodservice recovery domestically.

USDA is now projecting pork production for the year to be slightly lower than 2020. Industry operating efficiencies are expected to improve as COVID pressures abate. However, labor availability, tighter hog supplies and reductions in the sow herd support higher markets.

Our balanced approach to hog import procurement mitigated cost volatility during the quarter. In high cost and volatile environments, the strength of our leading brands and balanced approach to procurement continues to be a competitive advantage.

The guidance range assumes elevated and volatile market conditions for the balance of the year, with some moderation heading into the fall. We expect hog prices in the USDA composite cutout to remain well above year ago levels due to strong domestic and export demand along with tighter hog supplies.

We anticipate prices to peak during the summer and to gradually decline in the fall, consistent with the seasonal increase in harvest. Belly prices are projected to remain higher than last year in historical averages.

We anticipate markets to stabilize near the current levels, but volatility due to low cold storage levels and strong demand in the food service channel could cause inflationary pressure.

Pork trim prices are expected to moderate from the current levels, but labor shortages across the industry remains a key risk to trim prices as limited boning capacity directly impacts trim supply and pricing.

Due to the higher beef harvest levels in [indiscernible] (26:44) months, beef prices are anticipated to be lower in the back half of 2021. In response to global supply and demand imbalances in corn and soybean meal, we have taken strategic hedges to fully cover grain costs for the remainder of the year.

The positions also provide a benefit if markets decline. These hedges coupled with the previously announced pricing actions are expected to protect Jennie-O's profitability.

Turkey poult placements and egg sets have declined. Inventory levels are lower compared to last year. The tightening of supply has led to higher whole turkey and fine meat markets.

We have also recently seen an increase in breast meat prices and recovery in the foodservice industry remains the key driver for higher prices for this important market. We anticipate inflationary pressure on freight in the back half of the year.

The tactical action to optimize our distribution network with two new DCs combined with improvements in load efficiencies will help mitigate a portion of the increase. We have attained the required regulatory approvals for the acquisition of the Planters snack nut business. The scheduled close date is in June.

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. We will now begin the question-and-answer session. [Operator Instructions] The first question today will come from Peter Galbo with Bank of America. Please go ahead.

Peter T. Galbo
Analyst, Bank of America

Q

Hey, guys. Good morning. Thank you for taking the question.

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

A

Good morning, Peter.

Peter T. Galbo
Analyst, Bank of America

Q

And Jim Sheehan, thank you for all of the commentary. Jim, I guess, just thinking about the guide and the move in sales relative to kind of keeping EPS flat, if we were to just take the midpoint of the sales guide, it kind of implies that you'll see a relatively decent acceleration in gross margins in the back half of the year, something in the magnitude of 60 basis points to 70 basis points kind of versus what you did in the front half. A, I just wanted to see if that's kind of how directionally you're thinking about it, and just given all the headwinds you called out, understanding that the pricing actions that are coming through, what would drive kind of that sequential improvement in gross margin.

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

A

Yeah. Good morning, Peter. Thanks for the question. And really what we're talking about here is the timing, the volatility, the magnitude of the inflation that we're seeing. And so, the pricing actions that we've taken didn't happen all right at the beginning of the second quarter, and quite frankly we're not done with all the pricing actions that we need to take.

So, we've got a lot of activity on that front. And so, just the sequential action in our pricing is what will lead to that sequential improvement in margins. And so, as you think about Q3, you'll see improvement, but probably some slightly lower margins as pricing hasn't quite caught up. Q4 really start to see more normalized margins as full pricing takes effect across the board. And I think, it's important to note that we've either taken or will take price across almost all of our business.

Peter T. Galbo
Analyst, Bank of America

Q

Yeah. That's helpful. Maybe just to clarify there Jim, on the third quarter is that lower margins sequentially versus last year versus normal. And then just the second question, as we think about Jennie-O, obviously you've locked in some of the feed cost for the remainder of the year. Jim Sheehan, I think, you tossed out a 9% operating margin bogey as a target maybe for this year. Is that timeline kind of pushed out to 2022 or 2023 at this point? Thanks very much guys.

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

Well, I'll start at Q3, and I think, your – the first question is that's relative to last year, so slightly lower margins to last year, just as pricing hasn't fully caught up.

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

Yeah. I'll touch on the JOTS issue, Peter. First of all, as we talked about there pricing is now in place to cover that first ramp up of grain costs, and as we talked about, we've protected the grain cost for the rest of the year, and with also having downside protection on that. So, we're 100% covered on grain.

The other thing is that – that we talked about is what's happening in the markets. When you think about Jennie-O, the fundamentals which we keep pointing towards over the last few years are better. Hog sets and – or egg sets and poult placements are both down 3% to 4%, and you're starting to see that with the cold storage levels continue to be at 26 – below 26% below the five-year average.

What you're starting to see now is some nice improvements in the commodity markets around turkey. For instance, yesterday, you saw breast meat at $2.11. There are a lot of watch outs on JOTS, but there's also a fair amount of upside. And we're starting to see that upside come through. We've watched these – the fundamentals point towards better markets for probably a year now. They really haven't taken place, but they do seem to be taking place as we go forward. As far as the 9%, yeah, these – the drastic jump up in grain costs obviously delayed that. So, we look at the full year margin of 9% that's really been pushed out a bit.

Peter T. Galbo
Analyst, Bank of America
Q

All right, guys. That's very helpful. Thank you.

Operator: The next question today will come from Adam Samuelson with Goldman Sachs. Please go ahead.

Adam Samuelson
Analyst, Goldman Sachs & Co. LLC
Q

Yes, thanks. Good morning, everyone.

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

Hi Adam.

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

Hi Adam.

Adam Samuelson
Analyst, Goldman Sachs & Co. LLC

Q

Hi. Jim Sheehan, maybe continuing on some of the JOTS questions there, and in your last response, you referenced kind of a whole bunch of some positives, but a bunch of watch outs. Apart from grain cost, I'd love to hear kind of the key things that are still on your mind as reflective of demand growth and kind of your performance in retail, shelf penetration, what are you kind of focused on there besides the grain cost as the key watch out?

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

A

Well, I'll start with a little bit on the watch outs, and I'll turn it over to Jim to talk about performance. I think as you look at the inflation that we've seen recently, and as you look forward, obviously, you have the grain is impacting inflation for that. You've got the demand. We know the demand is very solid. Weather conditions look pretty good, [ph] planning intentions (34:10) seem to be maybe a little bit understated at the USDA. So that looks okay. It looks, looks good at this point.

Obviously in June, we'll have a better read of that. But as I would look at things, I think the other thing that's impacting inflation is labor availability. I mean, getting people back into their jobs will I think alleviate some of the labor pressure. From a COVID standpoint, we're in really good shape, but it's getting new hires, it's getting people back to the job that probably is a watch out for me, not only at JOTS, but across the industry.

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

A

Yeah. And Adam, I would say more from a business perspective, I think our retail business has performed well. Again, it's hard in a year-over-year environment, but if we go back to pre-pandemic, especially on our lean ground turkey, very, very strong performance, pleased with distribution gains, household penetration, the velocities that we're seeing. And from a foodservice perspective, they are a little bit more exposed to the K-12, the school business, which obviously didn't come back in full strength.

We do expect to see that in the fall and then spill over into 2022. So, as we think about it from a retail and foodservice perspective, you know, there is optimism on the business front.

Adam Samuelson
Analyst, Goldman Sachs & Co. LLC

Q

All right. That color is really helpful. And then my second question was really just thinking about trajectory of foodservice. As we go into the back half of the year, you kind of gave some color where the second quarter was up versus 2019 levels. How do you think the industry performed or, I guess, the relevant categories for you on a similar metric and just areas where you think you're maybe gaining some outsized share, like giving you some optimism?

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

A

Yeah. I mean, I think, it's fair to say in a really broad base, we outperformed the industry here in the second quarter, and that – that's not new. Right, I mean, as even pre-pandemic, we talked about our foodservice business typically growing at double the industry rate and so we're confident that we've outgrown or grown faster than the industry.

Now for us where we see future opportunities in a number of our segments, we haven't seen lodging come back. We really haven't seen college and university fully come back, which is a big part of our Hormel foodservice business. I referenced K-12 for the Jennie-O foodservice business. So, there's still a lot of dynamics at play. And so even as these other segments, these other channels really start to reopen those are going to have a favorable impact on our foodservice business as well.

Adam Samuelson
Analyst, Goldman Sachs & Co. LLC
Q

All right. I really – I appreciate that color. I'll pass it on. Thanks.

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

Thank you.

Operator: The next question today will come 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 guess, you know just given what we saw in Q2, foodservice now above where you were in 2019, groceries still very strong. So, as you exit the pandemic, I mean, do you guys think now that you'll have a much higher foodservice and grocery business going forward?

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

Yeah, I think, Rupesh, I mean, we've always felt very confident in all of our business obviously. We've talked a lot about the strength of our business in particular in center of the store and so we think it will continue to be strong post pandemic. You are going to have some moving parts and some volatility in year-over-year, quarter-to-quarter. But I want – I believe once things settle down, we'll see our continued strength in center of the store grocery business, continued strength in our refrigerated retail business. And then we've always talked about our real competitive advantage in the foodservice space. And I think that's playing out right now. It will continue to play out this year and into the future.

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

Great. And then maybe one follow-up question. So, as you look at Grocery Products, I was curious how you guys are thinking about that segment for the balance of the year, and then as sales trend have turned negative for other players as well, how would you characterize the current promotional backdrop?

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

Yeah. The biggest driver for us right now Rupesh is getting some of those Tier 2 and Tier 3 items back on shelf. And that's really what retailers need as we want to provide more promotional activity in the back half of the year and into 2022. You can't just have one variety and have a promotion. So, as our supply chain has recovered and we've been able to focus on those varieties, we're seeing retailers being a lot more willing to engage in promotional discussions which will be very, very helpful for the business and the balance of 2021 into 2022.

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

A

The only thing I'd add to that Rupesh is that remember our fourth quarter in GP was significantly constrained by capacity issues in our operations.

Rupesh Parikh
Analyst, Oppenheimer & Co., Inc.

Q

Great. Thank you for all the color. I will pass it on.

Operator: The next question will come from Tom Palmer with JPMorgan. Please go ahead.

Thomas Palmer
Analyst, JPMorgan Securities LLC

Q

Hi. Thanks for the question.

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

A

Hey, Tom.

Thomas Palmer
Analyst, JPMorgan Securities LLC

Q

You mentioned on the earnings call that more prices are expected to flow through in the second half of the year. Price mix 11% this quarter, highest in years, I know you typically don't provide this, but just given the magnitude of the price mix figure, could you help with some detail on how much mix really contributed to that number in the second quarter?

And then, how much, maybe pricing we should expect to really ramp, as we look at the second half of the year. I mean, you're putting up a limit now. I mean, throwing 5% on top of that or some sizable number?

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

A

Yeah. No, it's a great question, Tom, as you think about our business and that price mix. I mean, really a key driver in the second quarter was our foodservice business, which tends to track markets more closely than the retail business.

We have – we did have some impact of retail pricing in the quarter. But again, it wasn't for the entire quarter. But the big driver in the quarter was food service.

Thomas Palmer
Analyst, JPMorgan Securities LLC

Q

Okay. Thank you. And then, in the prepared remarks, Jim Sheehan, you noted the magnitude of hog and pork price increases.

Last year, saw some weaker hog pricing, you called out hedging losses. I know, there'll be more color in the 10-Q, but just any detail on hedging this quarter, such as, maybe gains that flowed through?

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

Sure. Tom, I appreciate the question. Remember, our accounting method is one that we did not mark-to-market our positions, but we run them through the cost of goods at the time a product is sold.

So, as you look at our realized gains and losses are in the quarter, the unrealized are in other comprehensive income. And those will be in the $45 million range of unrealized gains and losses. And that would be for hogs, grain, and our interest positions.

Thomas Palmer
Analyst, JPMorgan Securities LLC
Q

Okay. Thanks for that detail. Just to confirm, not a factor this quarter it would be recognized in.

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

It didn't give us much help this quarter. It was a pretty immaterial amount.

Thomas Palmer
Analyst, JPMorgan Securities LLC
Q

Okay. Thank you.

Operator: And the next question will come from Robert Moskow with Credit Suisse. Please go ahead.

Robert Moskow
Analyst, Credit Suisse Securities (USA) LLC
Q

Hi. I guess, a couple of clarity questions. Just on that, Jim, the $45 million, I guess, those are hedging gains. So those will flow through on a positive way to your P&L, as you sell the product.

But it's also – there's also higher input costs flowing through also. So, they're kind of fighting against each other, for the next couple of quarters. Is that...

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

Yeah. I mean, they're unrealized gains. They're gains based on the market at the close what would be a factor. Now we also, as I stated before, we also have our interest hedges in there too. So, those are more related to the debt that we will be issuing.

Robert Moskow
Analyst, Credit Suisse Securities (USA) LLC
Q

All right.

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

And have a longer tail that obviously the grain or the hog markets. So, it's a mixture.

Robert Moskow
Analyst, Credit Suisse Securities (USA) LLC

Q

Okay. Okay, I'll follow-up on that. Regarding the 6% pricing in grocery, in the quarter, can you give a little color on what kind of product lines, you raised the pricing on? Is that going to accelerate as well? Or is that kind of like a new normal for a while, because of actions you took in March?

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

A

Yeah. Price, the biggest driver to pricing in the front part of the year Rob was the Skippy price increase that we took earlier in the year. In GP, I mean, we still have additional pricing action to come, whether it's SPAM or Herdez, I mean, a number of different GP items. So, we did have some in the first half, but there's still more to come in the back half of the year.

Robert Moskow
Analyst, Credit Suisse Securities (USA) LLC

Q

Okay. Okay, that's my questions. Thanks.

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

A

Thank you.

Operator: And the next question will come from Michael Lavery with Piper Sandler. Please go ahead.

Michael S. Lavery
Analyst, Piper Sandler & Co.

Q

Thank you. Good morning. Just wanted to go back to the share gains kind of broadly, and maybe try to understand a little bit the landscape at a high level. I guess, just looking at kind of your foodservice growth versus 2019 and the strong retail growth versus 2019, assuming people aren't just eating more, there's clearly some momentum there that is coming from somewhere. And I suppose there's a chance there's maybe a permanent reset of pantry inventory, but even that probably is small. So, can you just give a sense of who you're gaining share from? Are there smaller competitors that have suppliers that have gone out of business or – just how do you – kind of understanding how you're sourcing your share gains?

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

A

Yeah. I mean, it's a mix, again depending on which category you're talking about. I mean, in some cases, we are in line with category so whether you think bacon or spam or peanut butter. I think, we've seen some outpacing in some of our meal offerings, as you mentioned. I think we've seen it in our Mexican portfolio, which really is taking that share from competitors. So I think as you go across the portfolio, Michael, it really is a mixed bag of where those share gains are coming from.

Michael S. Lavery
Analyst, Piper Sandler & Co.

Q

Okay, thanks. And just following up on the foodservice piece, you called out the boost it gave partly from the pass-through pricing there. Can you give us a sense of how much pricing is pass-through in your portfolio versus just what requires a list increase?

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

A

I mean, the majority of the foodservice business is, I'll call it off a traditional priceless, so that gets adjusted on a weekly basis and we tend to see that pricing reflected in, we've always said within 30 days. So, a significant portion of our business is still done that way. We do have some other pricing arrangements obviously with larger national accounts. But just think about it, where more than the majority of the business is on a pass-through basis.

Michael S. Lavery
Analyst, Piper Sandler & Co.

Q

And on the retail side.

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

A

Well, I mean we've always said that's more of a 90-day price action in terms of having a discussion with a customer, getting it accepted and then getting it implemented. Really the only difference there would be retail fresh pork, which, I mean does play a role and still as a significant part of our portfolio, but that is priced on a weekly basis.

Michael S. Lavery
Analyst, Piper Sandler & Co.

Q

Okay, great. Thanks so much.

Operator: The next question will come from Eric Larson with Seaport Global Securities. Please go ahead.

Eric Jon Larson
Analyst, Seaport Global Holdings LLC

Q

Yeah. Good morning, everyone. Thanks for taking my question. So the first question is, and I think Jim Sheehan, kind of referred to some of this. But can you talk a little bit about hog supplies. We're not going to see a huge increase in production this year. These high grain prices probably are disincentive, yet we have hog prices, live prices well over $100 – 100 weight right now, supply constraints on your biggest raw material, is that a possibility going forward here and it looks like grain prices could be high for a while. So, how do you look at maybe the next couple of years, not just this year, but maybe next in terms of hog production in the US and what are farmers doing out there?

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

A

Well, as we've talked about in the past Eric, we do long term contracts with our producers. And as you are aware, these producers are large operators with a high level of capital and tend to keep their barns filled. We also get a large portion of our production from a contracted facility, the Fremont facility which is made up of producers. They tend to like to keep their own plants full. So I'm very confident that we'll have the supply that we need both short term and long term. We go through these cycles all the time. And hog prices have increased rapidly. The prices have gone up a lot. You're right. Grain prices are high right now. We'll see how the growing season – what the results are from the growing season to see what impact it has on prices, but these are long term agreements and we're not having anybody get into negotiations about taking down their volume, so I'm highly confident.

Eric Jon Larson
Analyst, Seaport Global Holdings LLC

Q

Okay. Then my follow-up question is on your supply chain conversion and all your efforts that you've done on that which has been quite remarkable and I think we even alluded to the benefits of your improved supply chain in the press release, but I believe, if we go back, I think, at one point you said that, supply chain was going to – I may have this number incorrect, so correct me if I'm wrong, but about $75 million of supply chain cost benefits, but that was a while back. Can you give us a quick update on how the supply chain is helping you here and it's got to be helping your cost structure and then obviously, it keeps you from having to price too aggressively as well. So, can you share that dynamic with us and give us a little update there?

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

A

Sure, that's a great question, Eric. And we have spent a lot of time and effort over the last three-plus years putting together our One Supply Chain. And it's really been our initiative to take this fragmented approach throughout the supply chain and really capitalize on the efficiencies and take cost out. And so, we've done a lot of great work, in our operations, in our logistics, as we mentioned, some of the warehousing initiatives that we still had going on. And you're right, probably the first two years of supply chain and even going into the pre-pandemic, we talked about our ability to have cost savings of $75 million.

Last year, obviously, was a bit of a disruption, but that didn't stop the good work that was happening behind the scenes. And I think you'll see that play through when we talk about our ability to open up new warehouses to help mitigate some of the cost pressure on GP and now on our refrigerated portfolio.

And the other thing is, for me personally, I can't imagine us having gone through the pandemic with a fragmented supply chain. Having one voice from the top, setting direction, and making sure that the entire team was aligned was very, very powerful and necessary for the organization. So, I mean, the benefits to the organization have far outweighed the financial returns, and we are in a significantly better place today as a result of our efforts on One Supply Chain.

Eric Jon Larson
Analyst, Seaport Global Holdings LLC

Q

Okay. Great. Thanks and have a great Memorial Holiday.

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

A

Yes. Thank you too Eric.

Operator: The next question will come from Ben Bienvenu with Stephens. Please go ahead.

Pooran Sharma
Analyst, Stephens, Inc.

Q

Hi. Good morning. This is Pooran on for Ben. I just had one quick question. What has the ramp in foodservice sales and the corresponding capacity utilization improvement contributed to margin?

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

Oh, yeah. I mean, I think, there's – obviously they go hand-in-hand and we've talked about some of – coming out of it or I should say in the midst of the pandemic, the underutilized capacity, which, of course, led to some of our increased COVID costs. So there has been a benefit, but really the big driver and the way you should think about the foodservice business is the volume that we've been able to drive in the marketplace.

And really it's the reopening, the reengagement with distributors and operators. And then I mentioned earlier, with a number of different segments that really haven't opened yet or hit their stride. So not only we feel good about where we are today, but the opportunities that are yet to come.

Pooran Sharma
Analyst, Stephens, Inc.
Q

Great. And maybe if I could just squeeze one more in.

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

Yeah. Go ahead.

Pooran Sharma
Analyst, Stephens, Inc.
Q

Just regarding your price increases, do you think that you'll be able to hang on to some of these increases after this period of cost inflation abates? And maybe you can just help us think through, what will be easier versus harder to achieve?

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

Yeah. That's a great question and it's something that we talk about a lot because nobody likes to be in the midst of the inflationary period with all the market volatility, but it's not new to us, right, I mean, we've managed through multiple inflationary periods over the course of our business and our management team, our leadership has a well established plan for how we take pricing, how we appropriately promote. And really to your point about how we work hard to maintain that pricing over time. So, yeah, we do believe that we'll be able to do that as we've demonstrated in the past.

Pooran Sharma
Analyst, Stephens, Inc.
Q

Great. Thank you for the questions. That's it for me.

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

Yeah. Thank you.

Operator: The next question will come from Antonio Hernández with Barclays. Please go ahead.

Antonio Hernández Vélez
Analyst, Barclays Capital Casa de Bolsa SA de CV

Q

Hi. Good morning. Thanks for taking my questions. [indiscernible] (54:49) international segment, I mean international segment sales were very good, good margins. [indiscernible] (54:56) will be increasing. Could you give us a little bit more guidance and what you're seeing there. Is there any difference from expenses and cost point of view in the international segment and your domestic segment? Thanks.

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

A

Yeah. I'd say the big issue, the big difference between the international and domestic right now is the whole ocean freight issue including containers. That's creating some additional cost to the system.

Freight, we've been able – freight's up a little bit domestically. We've been able to manage that as we've improved our supply chain. But ocean containers, freight availability goes back to this issue around labor. That's created some not only higher cost, but also some shipping interruption. And I think that's probably going to last for the rest of the year.

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

A

Yeah. But the optimism that we have in our international segments, I mean, it is broad base, but certainly with a high level of focus on the continued growth and the continued success that we're seeing in China, from both our retail and foodservice businesses.

And I mentioned in my remarks, that we're really excited about the performance of SPAM. How we've been able to really gain distribution and the acceptance of that brand, and how we're launching innovative new flavors.

The SKIPPY business continues to be very, very strong, non-traditional innovation with our Hormel beef jerky. And so we continue to expect growth coming out of that business and across all areas, other multinational exports and partnerships.

Antonio Hernández Vélez
Analyst, Barclays Capital Casa de Bolsa SA de CV

Q

Perfect. Thanks a lot and have a great day.

Operator: This will conclude today's question-and-answer session. I would now like to turn the conference back over to management, for any closing remarks.

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

Yes. Well, thank you all for joining us today. Our strong performance this quarter once again demonstrated the resilience of our entire team, and the strength of our balanced portfolio.

We know that we still have work to do for the balance of the year, but we remain very optimistic about the future. And we look forward to bringing the Planters business and the Planters team on board in too.

Thanks again for joining us.

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