Hormel Foods Corporation

Quick Take 1Q08 - ALERT

Neutral

$38.88

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Food & Food Manufacture

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Bottomline: HRL reported EPS of 64c, which was 6c better than the consensus estimate of 58c and 7c better than our estimate of 57c. However, despite today's beat the company kept its guidance for FY08 unchanged at $2.30-$2.40. Lower yoy hog prices and improving turkey prices helped January quarter results and should continue to support earnings growth in FY08 (we highlighted these two trends in our recent note where we upgraded HRL to N). At the EBIT level the company beat our numbers by 10c (interest expense was 3c higher) mainly on stronger than expected results in the more commodity type businesses (Ref Foods and JOTS). Although we are keeping our Neutral rating, we expect the stock to be up today.

- At the consolidated level, HRL beat our EPS estimate by 7c but the beat at the EBIT level was actually 10c (higher than expected interest expense accounted for -3c). The beat at the EBIT level came mainly from higher than expected sales (8% vs. our estimate of 5%) and gross margin (24.8% vs. 24%), and to a lesser extent from SG&A leverage. Gross margin increased 90bps yoy (and was 80bps above our estimate) to 24.8%, while SG&A/Sales decreased by a 40bps yoy to 15.6%. As a result, EBIT margin was up 130bps yoy to 9.2%. At the divisional level, Refrigerated Foods accounted for 8c of the 10c beat relative to our estimate, while JOTS accounted for another 4c, and Grocery Products 1c (Specialty Foods EBIT was below our expectations and Corp Expense were above our expectations).
- EBIT margins for both Refrigerated Foods and JOTS (combined these accounted for 60% of div EBIT in 1Q) increased yoy and were above our expectations, while EBIT margin in Grocery Product was flat yoy but came in slightly ahead of our expectation. On the other hand, EBIT margins for Specialty Foods and All Other (accounted for only 16% of EBIT in 1Q) fell yoy and were below our expectations. Refrigerated Products EBIT margin increased 210bps yoy to 7.3%, which is the highest quarterly margin reported at least over the last three years. The increase was driven by lower hog costs (company had guided for hog cost of $41/cwt live compared to $46/cwt live in 1Q07) and a better value added mix. Although results in JOTS were encouraging (as margin improved 110bps yoy to 11.9%) we do not expect the rate of increase in margins to continue for the remainder of the year given a steeper corn cost curve. Spot corn prices were up only 3% yoy in the January quarter, while futures point to 40% yoy increases in the April quarter.
- HRL trades at 15.5x our normalized EPS of $2.50 and 8x normalized EBITDA of $670M, in both cases below its historical multiples of 17x and 9x, respectively.

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Hormel Foods Corporation (HRL) Price Chart

Date	Rating	Share Price ($)	Price Target ($)
19-Nov-07	N	35.75	-

Source: Reuters and JPMorgan; price data adjusted for stock splits and dividends.
Initiated coverage Nov 19, 2007. This chart shows JPMorgan's continuing coverage of this stock; the current analyst may or may not have covered it over the entire period.
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