Janney Montgomery Scott LLC

BASIC REPORT
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Hormel Foods
NEUTRAL
HRL (NYSE)

Stability Is Not Immobility

Hormel produces a variety of meat, grocery, and foodservice products. Although pork remains a major raw material exposure, Hormel is several years into a plan to emphasize branded, value-added packaged items rather than commodity meat. In recent years, the company's emphasis has led to the introduction and growth of ethnic lines, such as Chi-Chi's (Mexican), House of Tsang (Asian), Carapelli (Italian), and Patak's (Indian).

INVESTMENT CONCLUSION:

- **Initiating With A NEUTRAL Rating And $34 Fair Value.** Management's been clear it's not interested in moving down the value-add ladder by acquiring commodity protein companies, however the opportunity to buy assets cheaply is too big to ignore. It has its pick of meat assets or could add $0.25 to EPS with a share buyback.
- **Nearly Debt-Free Balance Sheet.** Boasting one of the cleanest balance sheets & a solid cash flow profile at a time when the protein industry as a whole is starving for capital, puts Hormel in an enviable position – it can either punish its competitors while they're on the ropes – or it can buy them inexpensively.
- **What Recession?** While investors have thrown the baby out with the bath water on stock prices, we note that unlike protein competitors who have built much of their business around shipping commodity meat abroad, Hormel is positioned well for the slowdown domestically with belly-filling products like Spam and Dinty Moore.

VALUATION: Hormel has its fair share of commodity exposure, requiring livestock feed for its turkeys, as well as having significant exposure to pork and turkey prices (a combined 70% of sales). Given commodity volatility, some near-term challenges exist, but with a great long-term outlook and a very reasonable valuation (CY09E EV/EBITDA of 6.7x), we believe Hormel's risk/reward is just above average.

Company Statistics

Price:	$30.78
Sector:	Food & Beverage
Market Capitalization (M):	$4,191
Dividend Yield:	2.4%
Average Daily Volume (1-month):	707,658
52-wk Range:	24.81-42.77
Shares Outstanding (M) fd:	136,172
EV/EBITDA:	6.7x
Last 12 Month's Price Change:	-20.8%
Long Term Debt/Total cap:	14.8%

Financials

FYE Oct		2008E	2009E	2010E
EPS:	Q1	$0.64	$0.51	$0.57
	Q2	$0.56	$0.54	$0.57
	Q3	$0.38	$0.42	$0.45
	Q4	$0.50	$0.74	$0.78
Total		$2.08	$2.21	$2.36
Revenue (M):	Q1	$1,621.2	$1,691.9	$1,740.2
	Q2	$1,594.1	$1,671.6	$1,719.7
	Q3	$1,678.1	$1,744.1	$1,793.9
	Q4	$1,861.5	$1,947.4	$2,004.0
Total		$6,754.9	$7,055.0	$7,257.8

Research Analyst Certification and Important Disclosures are located on page 11.

KEY POINTS:

- A pristine balance sheet (0.5x Debt/EBITDA), balanced portfolio, and track record of rich returns, in an industry reeling from commodity volatility, makes Hormel the strongest participant in the protein space, and a very decent risk/reward.

- With the world of protein in disarray from cycling high feed costs and now facing low meat prices (Pilgram's Pride (PPC) bankruptcy, Smithfield (SFD) and Tyson (TSN) capital-deprived), Hormel's value-added portfolio is revealing itself as a beacon of stability, and its conservative management team has positioned it enviably.

- The consolidation opportunity is too big to ignore. While management has made it clear it's not interested in moving back down the value-add ladder by acquiring commodity-oriented protein companies, the opportunity to buy meat assets inexpensively is too great to ignore.

Heads Hormel Wins – Tails Hormel Wins.

If the market's assertion that shut-down risk for additional competitors (beyond PPC) is correct, no one stands to benefit more -- however, if protein prices rebound before the failure of other meat companies, Hormel should more easily resume its 10%ish EPS growth trajectory. While Hormel won't see the roller-coaster recovery in protein profitability of its more commodity-driven peers, it also doesn't have nearly the same risk profile. Management's prudence extended beyond its disciplined use of capital into its decision to judiciously build out an export platform, which also substantially reduces its downside risk.

Nearly Debt-Free Balance Sheet.

Boasting one of the cleanest balance sheets in food and a solid cash flow profile at a time when the protein industry as a whole is starving for capital puts Hormel in an enviable position – it can either punish its competitors while they're on the ropes -- or it can buy them inexpensively.

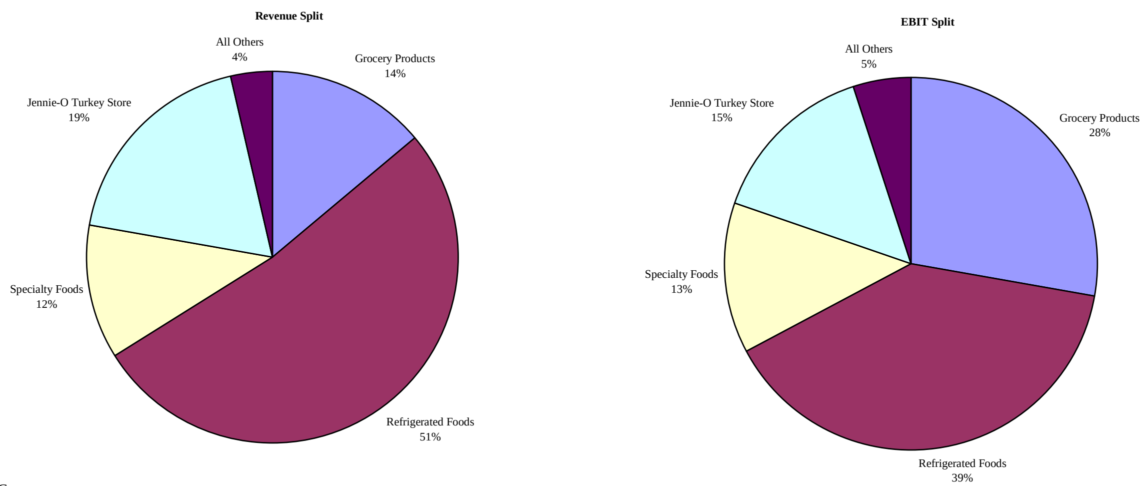
What Recession?

While investors have thrown the baby out with the bath water, we note that unlike protein competitors who have built much of their business around shipping commodity meat abroad, Hormel is uniquely positioned to benefit from the global slowdown domestically, as its belly-filling products like Spam and Dinty Moore prove to be recession favorites.

Balanced, Value-Added Portfolio Deserves Some Premium To Protein.

This advantaged protein portfolio has reported EBIT margin between 7-8% every year since 2001--so it's difficult to envision macro headwinds this portfolio shouldn't weather. Long term, we expect earnings to resume a 10%-ish trajectory, and when Turkey profits finally recover there should be a lot of upside for the company to reinvest in less commodity-driven initiatives, like growing out the Compleats franchise and its other innovative franchises ($1.3B in sales are from post-2000 innovations, with a goal of $2B by 2012)

Figure 1: Hormel Foods Revenue Mix

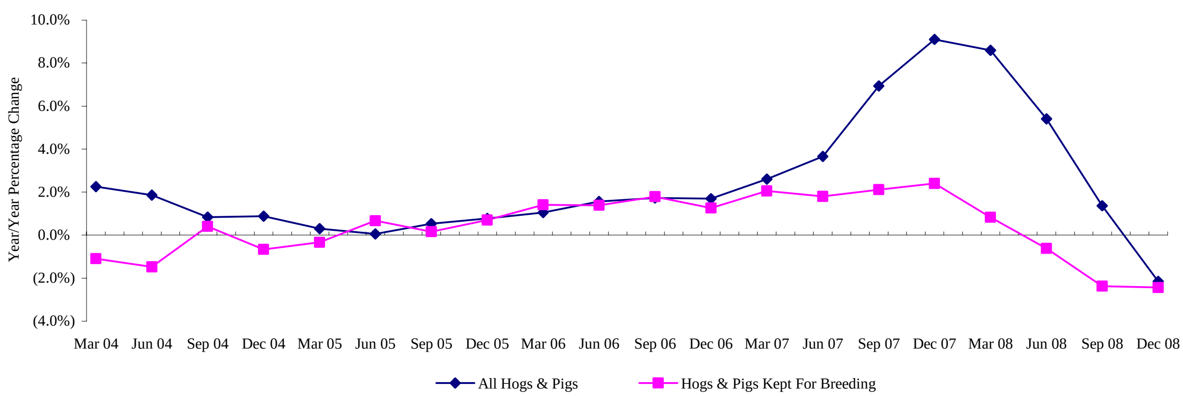


Source: Company reports

Management Recognizes Tighter Hog Supply In F09.

In response to an abysmal year for hog growers, management indicated supplies are finally on the mend, and higher hog costs may be ahead for processors -- while we've long believed a hog recovery was inevitable, we now take a much more neutral stance, as apparently slowing global demand for U.S. pork and a general commodity slide continue to weigh on hog costs.

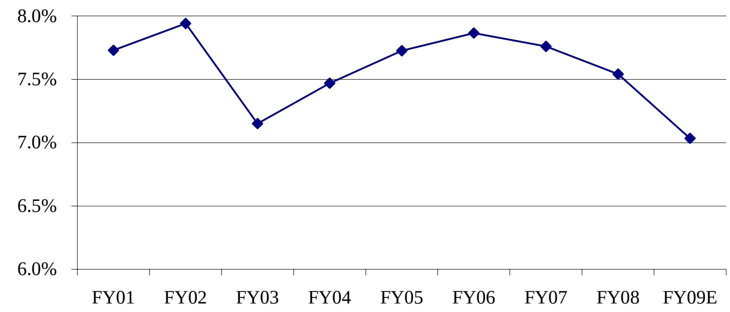
Figure 2: Breeding Hog & Market Hog Inventory In The U.S.



Source: USDA

Management has historically shared reliable hog visibility and to be sure, hog prices have a way to go to reverse the trailing year of enormous losses for hog growers. All this said, we highlight Hormel's track record of keeping margin in a fairly tight band, which should only improve as innovation and mix further mitigate commodity volatility.

Figure 3: Hormel Foods EBIT Margin History



Source: Company reports, JMS estimates

Industry Highlights

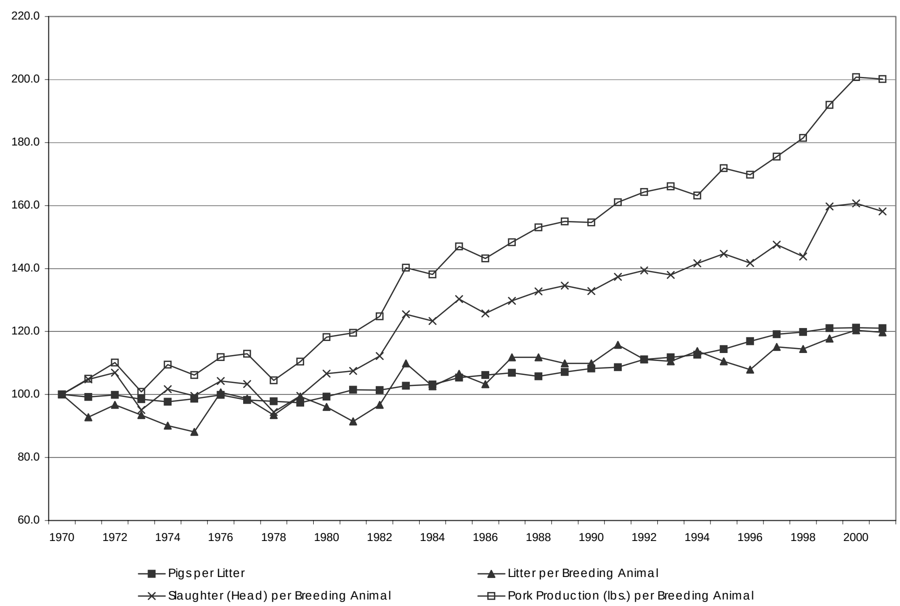
Production

There are three primary segments in hog and pork production:

- Sow/farrowing barns,
- Finishing farms, and
- Packer/processor.

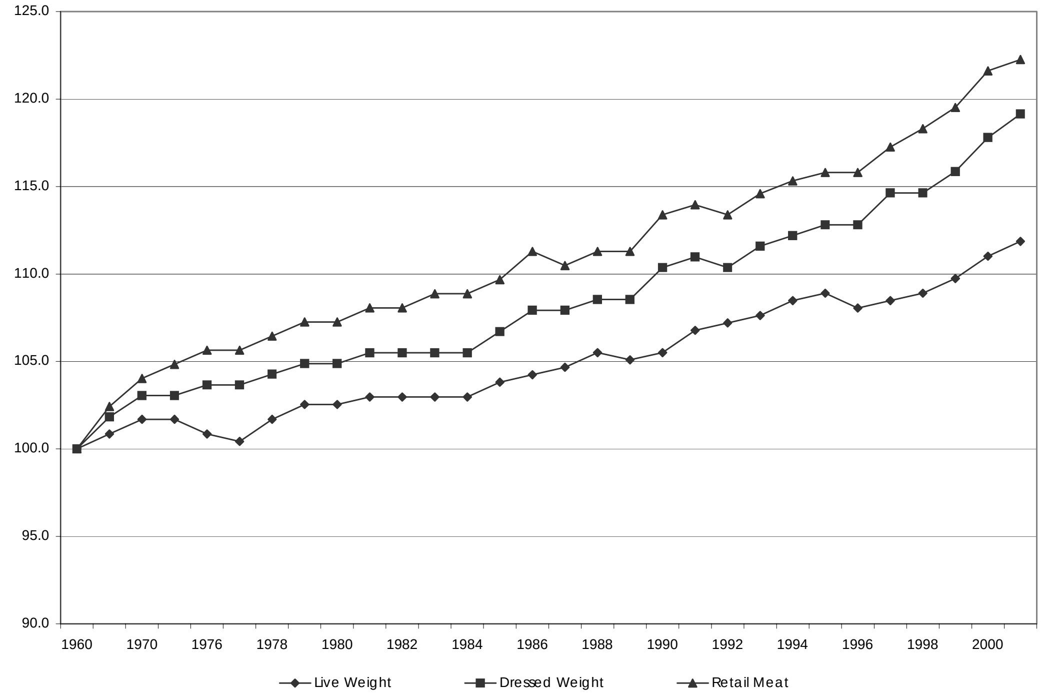
The only part of the hog production cycle that has not changed with the times is gestation -- roughly 114 days. Births or farrowings average nine to 10 pigs per litter, while on average one of these piglets is lost before weaning. Better practices have increased the number of pigs weaned per sow over the years from 6 in the mid-1970s to the current level around 9. The pigs are generally weaned and moved to a finishing farm, or in some cases a nursery, at three to four weeks. A large finishing farm such as those operated by Smithfield Foods in North Carolina can feed up to hundreds of thousands of hogs in one place. These finishing farms receive pigs of anywhere from 20-50 lbs. and put 200-230 lbs. on them as soon as is practical – typically 18-20 weeks. Across the industry, it takes from 3.6-3.8 lbs. of feed for the pig to add a pound of meat. The production process ends when the pig gets on the truck – at which time a price is negotiated by the producer typically based on live weight or anticipated carcass yields.

Figure 4: Productivity Measures of U.S. Pig Herd



Note: 1970 indexed to 100
Source: University of Missouri

Figure 5: <u>Weights per Hog</u>
(in pounds)



Note: 1960 indexed to 100
Source: USDA

The short-term profitability of a producer hinges largely on factors beyond his or her control – the price of feed (up to 75% of costs) and the price of live hogs per hundredweight. Over the long term, there are two main value drivers:

(1) Efficient Operation – including environment control, capital investment and labor costs.
(2) Superior Genetics – delivering better quality meat, higher reproductive yield, lower feed conversion ratios and lower mortality. Pork producers use purebred seed stock of nine major swine breeds (Yorkshire, Duroc, Hampshire, Landrace, Berkshire, Spotted, Chester White, Poland China and Pietrain) or synthetic lines derived from these breeds by breeding companies.

Producing is an entirely separate business from processing – even vertically integrated producer/processors such as Smithfield Foods book the incoming pigs to its processing facilities at fair value. This separates the production profits, which are influenced only by market price and conversion cost, from processing profits, which are driven much by the company's ability to market and add value to fresh meat.

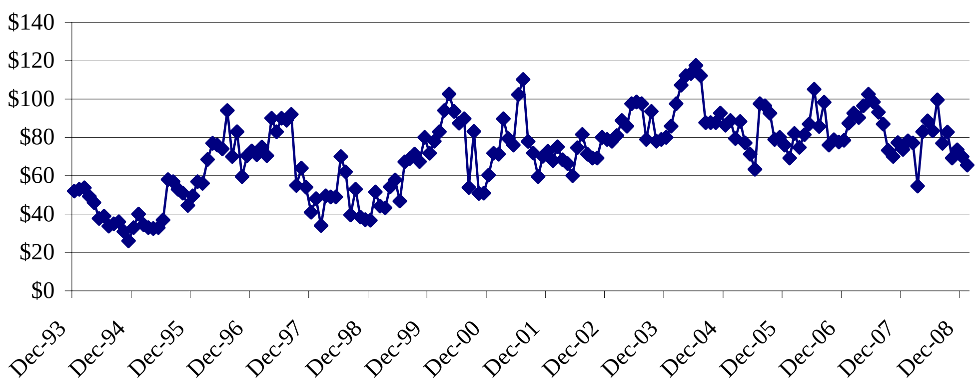
<u>Processing</u>
Until the past decade, processing merely consisted of the two-day process of bringing pigs in the back door and selling wholesale cuts of fresh pork out the front. This process yields 0%-5% operating margins depending on cost of logistics, capital and labor, but probably always delivered very tight returns on capital -- frequently below the typical cost of U.S. public equity capital (8%). More recently, industry leaders led by Hormel, Tyson and Smithfield Foods have recognized that further processed and case-ready meats can turn those $1.15 wholesale pounds of pork into $3.00 wholesale pounds of pork with comparable time and investment. Equally important, the returns to creating consumer brands and differentiated products are steadier, like those of large packaged food companies.

Two Regular Factors Drive Pig Prices

Seasonal variation is caused by changes in production efficiency due to weather and by different demand levels. Retail demand for pork is high in the spring and summer months and declines modestly in the winter. Reproductive efficiency is higher in the winter, but mortality due to exposure is higher as well -- much less of a factor in more sophisticated farms. Seasonal variation can be readily anticipated and is typically not severe.

Cyclical variation results from old-fashioned greed. When pig prices are as high as they were in the late 1990s (see figure 6), more sows are bred and more pigs are produced (assuming "normalized" feedcosts). But many producers typically have the same idea at the same time, and pigs will not reach the market for about a year after they are conceived. Furthermore, periods of high pig prices allow less efficient hog farms to enter and remain in business -- as the gains from favorable commodity spreads far outweigh the losses from inferior management and genetics. Eventually, supplies increase to the point that retail demand for pork is overmatched, prices fall, sows are culled and inefficient operators typically bust. Occasionally, unusual effects on retail pork demand can ripple through the system and trigger or exacerbate a pig bust, such as the consumer protein glut caused by an unexpected Russian poultry ban in the spring of 2002. Since consumers regularly substitute between pork, chicken, turkey, and to a lesser extent beef and seafood, falling prices in one product can affect demand for all -- and their supply chains as well.

Figure 6: Pork Belly Prices
($ Per CWT.)



Source: Baseline

Company Highlights

Poised to Lead a Changing Meat Case

While most industry observers agree that the meat case is changing radically to more branded, case-ready and further-processed products, there is sharp disagreement as to who will be the winner among meat companies. In our opinion, the hard part of the process is building brands and distribution to get products to market, work that Hormel has already done successfully for the past few years and seems on a course to continue.

Ethnic Foods Is a Profitable, Growthy Niche

We estimate that Hormel derives roughly 5% of its sales from ethnic foods under the Marrakesh, Chi-Chi's and several other national labels. In many cases, Hormel is the only national competitor to local companies with pockets of ethnic consumers, such as Southern California, Chicago, and throughout the East Coast. While these opportunities are undoubtedly recognized by larger food companies, we believe only Hormel is small enough that these pockets can move the revenue and earnings dial over the next few years. The future for the ethnic foods category remains bright, in our opinion, with Hispanic and Asian populations set to rise at 2.0x-3.0x the rate of white and African-American populations nationally. In the regional pockets of strength for Hormel's ethnic foods, these growth disparities are substantially larger, suggesting ample returns for Hormel's existing strategy of targeting ethnic foods as a growth driver.

Turkey Is a Long-Term Positive

While chicken has seen a dramatic increase in per capita consumption over the past decade as a healthy meat, we believe turkey has many of the same healthy characteristics and economic value. Much of the success of chicken can be attributed to the efforts of leading processors such as Tyson and Perdue, bringing chicken to the mainstream as a substitute center of the plate item and adding value through brands. Despite having similar healthy characteristics, turkey had much less success in retail over the past decade. Through the company's Jennie-O production operations and Turkey Store deli and value-added turkey products, we believe Hormel can help turkey turn the corner to some extent through branded and case-ready ground turkey, burgers, and fried turkey.

Investment Risks

Food Safety

While Hormel's long-term track record of consumer safety speaks for itself, we believe its strategy of building national meat brands implies substantial risk from a food safety perspective. While food companies have insurance for food safety tragedies, the damage to the reputation of a brand would be difficult and painful to rebuild. We believe Hormel is giving adequate attention and capital to food safety, but it remains the single largest exogenous investment risk for any meat company.

Labor Relations

While recent history has been solid, Hormel has weathered a number of difficult negotiations with employees as well as a major strike in the 1980s. Given the labor intensity and inherent dangers of working with knives and heavy machinery, Hormel may have difficulty retaining skilled workers for its meat plants and driving productivity. Hormel's voluntary profit sharing initiatives speaks to an improved labor-management relationship, but an interruption is always possible given the nature of the work and high level of unionization.

Increased Competition from Packaged Food Companies

We believe that Hormel will be able to define its strengths by focusing on profitable niches and small categories. It clearly suffers inferior scale in distribution and marketing relative to large and consolidating packaged food leaders such as Kraft, General Mills and Sara Lee. As Hormel articulates a strategy of relying more on branded foods, the risk of aggressive competition from one or more of these giants increases.

Business Segment Overview

Grocery Products Segment (14% of sales)

The Grocery Products Segment consists primarily of processing, marketing, and sale of shelf-stable food products sold predominately in the retail market. Strong selling brands in this segment include Hormel (bacon bits, chunk meats and chili), Carapelli (olive oil), Dinty Moore (Classic Bakes dinner kit casseroles and stew), and SPAM (canned meat products).

Refrigerated Foods Segment (52% of sales)

The Refrigerated Foods Segment includes meat products and foodservice. The segment primarily consists of processing, marketing and sale of pork products for the retail, foodservice and fresh customer markets. Branded products in this segment include Always Tender pork products, Hormel Fully Cooked Entrees, Cure 81 dinner hams, Old Smokehouse bacon, and Austin Blues pre-smoked ribs.

Specialty Foods Segment (12% of sales)

The Specialty Foods Segment includes the Diamond Crystal Brands (acquired in December 2002), Hormel HealthLabs, and other specialty items. This segment consists of the packaging and sale of various sugar, sugar substitute, salt and pepper products, dessert mixes, gelatin products and private label canned meats to retail and foodservice customers. It also includes processing, marketing and sale of nutritionally enhanced food products sold to hospitals, nursing homes, and other health facilities.

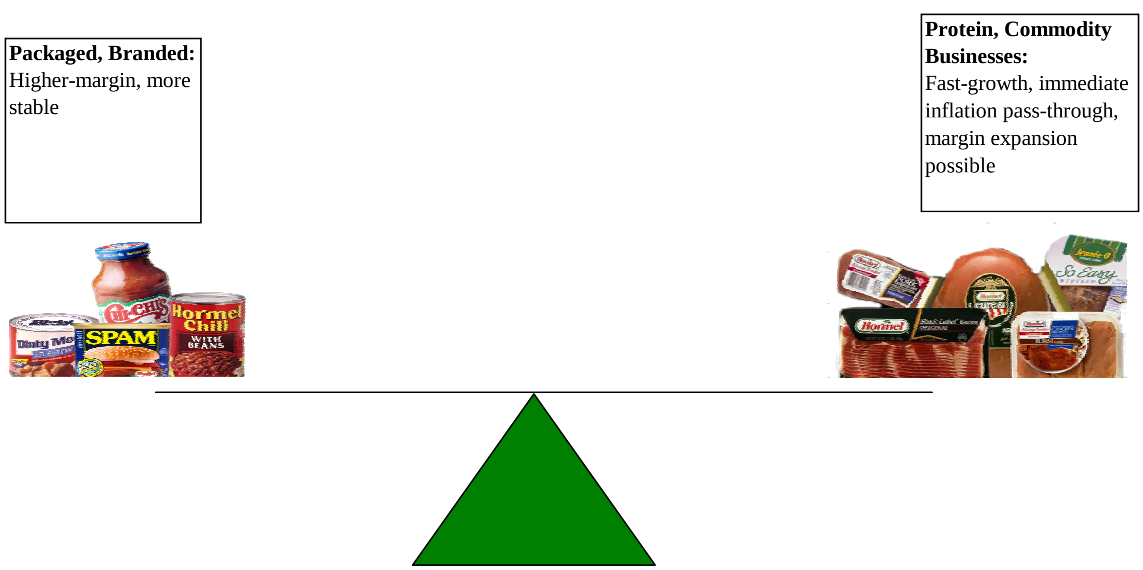
Jennie-O Turkey Store Segment (19% of sales)
The Jennie-O Turkey Store Segment consists primarily of processing, marketing and sale of turkey products for the retail, foodservice and fresh customer markets. Newer value-added products include Jennie-O Turkey Store marinated tenders and So Easy fully cooked entrees.

All Others Segment (4% of sales)
The All Others Segment includes the Dan's Prize, Inc., Vista International Packaging, Inc. and Hormel Foods International Corporation operating segments. These businesses produce, market, and sell beef products, food packaging (i.e. casings for dry sausage) and manufacture, market and sell Hormel products internationally. This segment also includes various miscellaneous corporate sales.

Natural Business Hedges Mute Volatility

The source of the pressure on margins in the grocery products business (beef, pork, chicken) are items that on margin help Hormel as a whole when inflationary. Increases in meat input costs are typically good for protein businesses as the supply chain quickly passes input costs through to consumers -- reflective of a stronger market for Hormel's commodity and near-commodity protein products. Furthermore, the minimum of direct production ownership (only in turkey) lessens exposure to rising corn costs. In all, Hormel has a balanced model that has proven remarkably stable in prior protein market dislocations (note the 1 and 3% reductions to EPS in the protein swoons of 2004 and 2008, respectively).

Figure 7: <u>Balance Of Portfolio Illustrated</u>



Source: Company reports, JMS research

The Balance Sheet Is The Silver Bullet.

Virtually debt free with just under $700 million of EBITDA, there is no company in the food group more poised to capitalize on depressed M&A multiples than Hormel Foods. On the other hand, Hormel could easily keep up its pace of share repurchase, given a robust free cash flow outlook, protected by management's commitment to postpone capital projects which are not time sensitive.

Valuation Appropriately Balances Great Long-Term Outlook With Meaningful Near-Term Risks

We see a stock that is 25% off its highs and 15% off its average NTM P/E, despite remarkably low leverage, and already depressed profits in its most vulnerable business (Jennie-O Turkey Store profits 38% off their highs)). We believe this is based on a combination of poor market sentiment (which could be with us for a while) and a general misunderstanding of the risks to Hormel's profits (which we believe could pass). We see value at roughly 7.5x next year's EBITDA or $34 per share.

Figure 8: Hormel Foods Income Statement

Income Statement (dollars in millions, except per share data)	FY08	Jan-09 Q1E	Apr-09 Q2E	Jul-09 Q3E	Oct-09 Q4E	FY09E	Jan-10 Q1E	Apr-10 Q2E	Jul-10 Q3E	Oct-10 Q4E	FY10E
Net Sales	$6,754.9	$1,691.9	$1,671.6	$1,744.1	$1,947.4	$7,055.0	$1,740.2	$1,719.7	$1,793.9	$2,004.0	$7,257.8
Costs of Goods of Sold	5,233.2	1,297.8	1,285.0	1,393.5	1,531.6	5,507.9	1,331.3	1,318.5	1,429.8	1,572.2	5,651.8
Gross Profit	1,521.7	394.2	386.6	350.6	415.7	1,547.1	408.9	401.2	364.2	431.8	1,606.1
Selling & Delivery	834.3	234.2	228.3	212.5	214.8	889.7	243.0	236.5	220.1	222.5	922.0
Administrative & General	178.0	39.0	38.0	42.6	38.3	157.9	38.4	37.4	42.1	37.4	155.2
Total Expenses	6,245.5	1,571.0	1,551.3	1,648.6	1,784.7	6,555.5	1,612.6	1,592.4	1,691.9	1,832.0	6,729.0
EBIT	509.4	121.0	120.3	95.4	162.7	499.4	127.6	127.3	102.0	171.9	528.8
Depreciation and Amortization	126.2	34.2	37.5	40.8	44.2	156.7	47.5	50.8	54.2	57.5	210.0
EBITDA	635.6	155.2	157.8	136.3	206.8	656.1	175.1	178.1	156.2	229.4	738.8
Equity in Earnings of Affiliates	4.2	1.0	1.0	1.0	1.5	4.5	1.5	1.0	1.0	1.5	5.0
Interest and Investment Income	(28.1)	(5.0)	1.0	1.0	1.0	(2.0)	1.0	1.0	1.0	1.0	4.0
Interest Expense	(28.0)	(7.4)	(7.4)	(7.4)	(7.4)	(29.6)	(7.4)	(7.4)	(7.4)	(7.4)	(29.6)
EBT	457.5	109.6	114.9	90.0	157.8	472.3	122.7	121.9	96.6	167.0	508.2
Income Tax	(172.0)	(40.0)	(41.9)	(32.9)	(57.6)	(172.4)	(45.5)	(45.2)	(35.8)	(61.9)	(188.3)
Net Income Before Items	285.5	69.6	73.0	57.2	100.2	299.9	77.2	76.7	60.8	105.2	319.9
Unusual Items											
Tax Benefit (Payment)											
Unusual Items, Net of Tax											
Net Income After Items	285.5	69.6	73.0	57.2	100.2	299.9	77.2	76.7	60.8	105.2	319.9
Basic Shares Outstanding	135.4	134.6	134.5	134.4	134.3	134.4	134.2	134.1	134.0	133.9	134.0
Diluted Shares Outstanding	137.1	136.1	136.0	135.9	135.8	135.9	135.7	135.6	135.5	135.4	135.5
Diluted Operating EPS	**$2.08**	**$0.51**	**$0.54**	**$0.42**	**$0.74**	**$2.21**	**$0.57**	**$0.57**	**$0.45**	**$0.78**	**$2.36**
Diluted Reported EPS	**$2.08**	**$0.51**	**$0.54**	**$0.42**	**$0.74**	**$2.21**	**$0.57**	**$0.57**	**$0.45**	**$0.78**	**$2.36**

Key Growth & Margin Analysis	FY08	Q1E	Q2E	Q3E	Q4E	FY09E	Q1E	Q2E	Q3E	Q4E	FY10E
Sales Growth	9.1%	4.4%	4.9%	3.9%	4.6%	4.4%	2.9%	2.9%	2.9%	2.9%	2.9%
Gross Profit Margin	22.5%	23.3%	23.1%	20.1%	21.3%	21.9%	23.5%	23.3%	20.3%	21.5%	22.1%
Change	(0.3%)	(1.5%)	(0.5%)	(0.5%)	0.0%	(0.6%)	0.2%	0.2%	0.2%	0.2%	0.2%
Selling & Delivery / Sales	12.4%	13.8%	13.7%	12.2%	11.0%	12.6%	14.0%	13.8%	12.3%	11.1%	12.7%
Change	(0.1%)	1.0%	0.5%	0.0%	(0.4%)	0.3%	0.1%	0.1%	0.1%	0.1%	0.1%
Administrative & General / Sales	2.6%	2.3%	2.3%	2.4%	2.0%	2.2%	2.2%	2.2%	2.3%	1.9%	2.1%
Change	0.0%	(0.5%)	(0.4%)	(0.4%)	(0.3%)	(0.4%)	(0.1%)	(0.1%)	(0.1%)	(0.1%)	(0.1%)
EBIT Margin	7.5%	7.2%	7.2%	5.5%	8.4%	7.1%	7.3%	7.4%	5.7%	8.6%	7.3%
Change	(0.2%)	(2.0%)	(0.6%)	(0.1%)	0.7%	(0.5%)	0.2%	0.2%	0.2%	0.2%	0.2%
EBITDA Margin	9.4%	9.2%	9.4%	7.8%	10.6%	9.3%	10.1%	10.4%	8.7%	11.4%	10.2%
Change	(0.4%)	(2.0%)	(0.3%)	0.4%	1.3%	(0.1%)	0.9%	0.9%	0.9%	0.8%	0.9%
EBT Margin	6.8%	6.5%	6.9%	5.2%	8.1%	6.7%	7.1%	7.1%	5.4%	8.3%	7.0%
Change	(0.7%)	(2.1%)	(0.7%)	0.4%	1.8%	(0.1%)	0.6%	0.2%	0.2%	0.2%	0.3%
Tax Rate	37.6%	36.5%	36.5%	36.5%	36.5%	36.5%	37.1%	37.1%	37.1%	37.1%	37.1%
Change	2.2%	(0.2%)	0.4%	1.3%	(5.4%)	(1.1%)	0.5%	0.5%	0.5%	0.5%	0.5%
Net Margin	4.2%	4.1%	4.4%	3.3%	5.1%	4.3%	4.4%	4.5%	3.4%	5.2%	4.4%
Change	(0.6%)	(1.3%)	(0.5%)	0.2%	1.5%	0.0%	0.3%	0.1%	0.1%	0.1%	0.2%
EPS Growth	(3.2%)	(20.2%)	(4.8%)	11.0%	48.2%	6.0%	11.3%	5.4%	6.7%	5.3%	7.0%

Source: Company reports and JMS estimates

IMPORTANT DISCLOSURES

Research Analyst Certification
I, Jonathan Feeney, the Primarily Responsible Analyst for this research report, hereby certify that all of the views expressed in this research report accurately reflect my personal views about any and all of the subject securities or issuers. No part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views I expressed in this research report.

Janney Montgomery Scott LLC Equity Research Disclosure Legend January 15, 2009

Company	Disclosure(s)
Hormel Foods (HRL)	7,8

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Definition of Ratings

BUY Janney expects that the subject company will appreciate in value. Additionally, we expect that the subject company will outperform comparable companies within its sector.

NEUTRAL Janney believes that the subject company is fairly valued and will perform in line with comparable companies within its sector. Investors may add to current positions on short-term weakness and sell on strength as the valuations or fundamentals become more or less attractive.

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Price Charts

Contact JMS for the charts containing rating and price target information of covered companies.

Janney Montgomery Scott Ratings Distribution as of December 31, 2008*

BUY	NEUTRAL	SELL
48%	49%	3%

*As a percent of total coverage. See ratings definition above.

Janney Montgomery Scott Ratings of Investment Banking Relationships as of December 31, 2008**

BUY	NEUTRAL	SELL
11%	2%	0%

**Percentages of each rating category where JMS has performed Investment Banking services over the past 12 months.

Other Disclosures

Investment opinions are based on each stock's 6-12 month return potential. Our ratings are not based on formal price targets, however our analysts will discuss fair value and/or target price ranges in research reports. Decisions to buy or sell a stock should be based on the investor's investment objectives and risk tolerance and should not rely solely on the rating. Investors should read carefully the entire research report, which provides a more complete discussion of the analyst's views.

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