

NAVIGATING EARNINGS SEASON: THE PRICE OF PROFIT

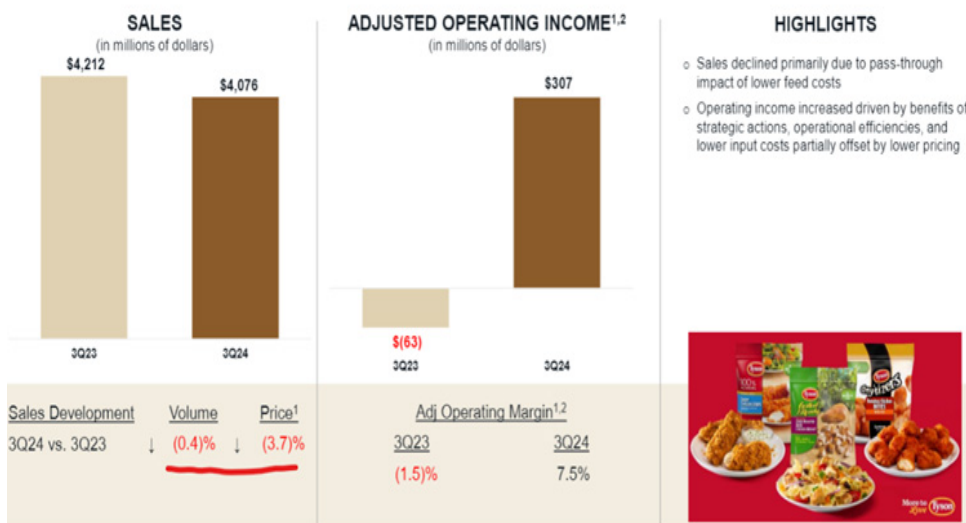
Samuel Rines – Macro Strategist, Model Portfolios
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Welcome to the latest installment of our new blog series, [Navigating Earnings Season](#). In this series, I dive into the world of earnings reports from major companies, spanning giants like JP Morgan and Pepsi, as well as niche players in various sectors. As the earnings season unfolds, these corporate outlooks offer real-world insights that often contrast sharply with the uncertainty emanating from the Federal Open Market Committee (FOMC).

Earnings season has been overshadowed by various bouts of carry trade unwinds and the resulting sharp movements in equity indexes globally. That is understandable. *It is difficult to focus on the fundamentals when they do not seem to matter.* But that would be a mistake. We believe when the dust settles, markets will begin to refocus attention on results. And some of them have been rather surprising.

Tyson Foods

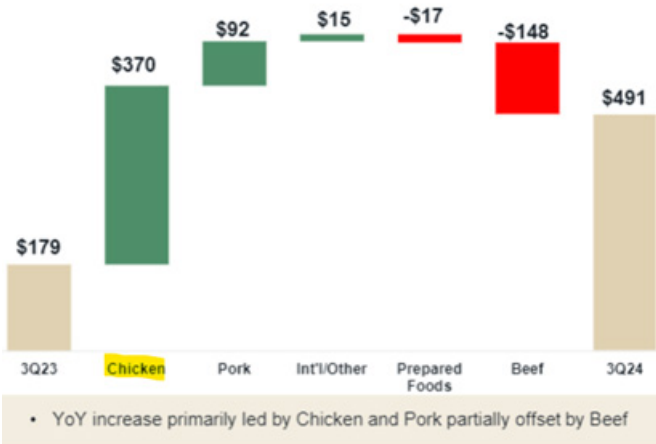
Third Quarter FY24 vs Comparable Prior Year Period



Source: Tyson Foods Q3 Fiscal 2024 Supplemental Information, 8/5/24 (emphasis added).

Tyson Foods is largely a proteins commodity company. But that description masks its position as an often-overlooked part of the market *with useful informational value*. This quarter showed something of an oddity. *Price and volume* were both negative. Selling less chicken at a lower price definitionally leads to a lower revenue line. Normally, this would be problematic. This time, it was not.

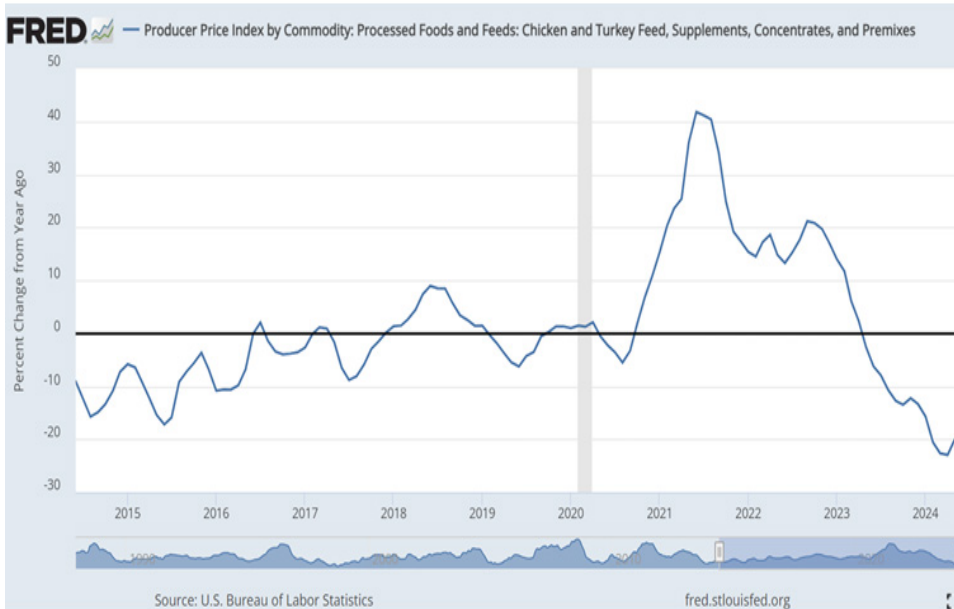
ADJUSTED OPERATING INCOME¹
(in millions of dollars)



Source: Tyson Foods Q3 Fiscal 2024 Supplemental Information, 8/5/24 (emphasis added).

The oddity is that lower revenue came with much higher profitability. Why? Feed costs fell (some of it was passed on through lower prices), input costs were lower and there were “operational efficiencies” (usually fewer workers). While the revenue line is a simple calculation of price multiplied by volume, the profit line is not quite so straightforward. Selling less does not mean lower profits when it costs less to grow and process the chickens.

Producer Price Index by Commodity: Processed Foods and Feeds: Chicken and Turkey Feed, Supplements, Concentrates and Premixes



Source: St. Louis Federal Reserve, Bureau of Labor Statistics, as of 8/6/24.

Yes, there is an index for chicken feed prices. And it has declined precipitously from its dual crisis highs (COVID and Russia’s invasion of Ukraine). That dynamic–lackluster revenues with improving cost structures and better bottom lines–is not a one-off phenomenon either.

Yum! Brands

Reported Results	System Sales Ex F/X	
		Same-Store Sales
KFC Division	+2	(3)
Taco Bell Division	+7	+5
Pizza Hut Division	Even	(3)
Worldwide	+3	(1)

Source: Yum! Brands Second Quarter Results, 8/6/24. System sales growth figures exclude foreign currency translation ("F/X") (emphasis added).

There is perhaps no chicken brand more recognizable than KFC. The Colonel’s sales did not go all that well in the last quarter, however. Their same-store sales metric (which measures sales at stores open at least a year) declined 3%, with the U.S. measure declining 5%. On the surface, it could be worse. But—with a seemingly ever-increasing selection of establishments selling fried chicken—it may also be something else entirely.

KFC DIVISION

	Second-Quarter			
	2024	2023	%/ppts Change	
			Reported	Ex F/X
Restaurants	30,689	28,500	+8	N/A
System Sales (\$MM)	8,226	8,298	(1)	+2
Same-Store Sales Growth (%)	(3)	+13	NM	NM
Franchise and Property Revenues (\$MM)	405	416	(3)	Even
Operating Profit (\$MM)	334	326	+3	+6
Operating Margin (%)	46.6	47.7	(1.1)	(0.4)

Source: Yum! Brands Second Quarter Results, 8/6/24.

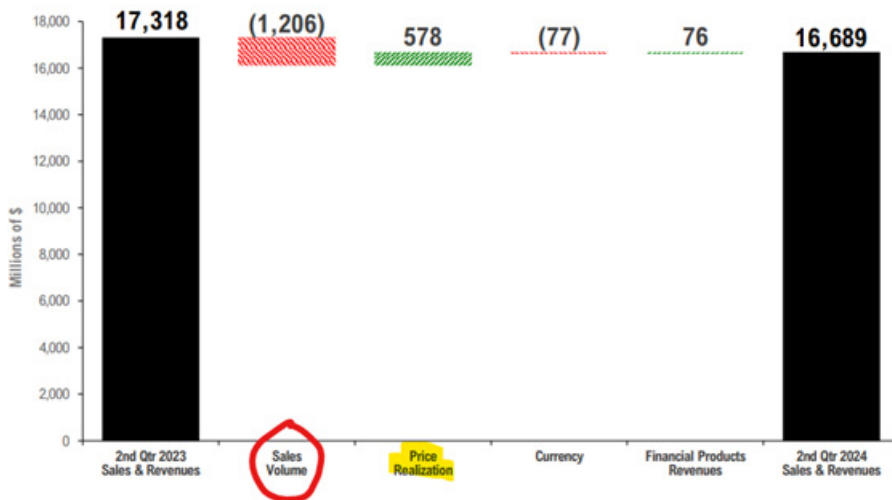
After all, KFC also reported their store count grew 8% year on year to 30,689. Despite the rapid growth in store count, revenues were down due to the drag from the existing ones. And, unlike Tyson, margins did not improve and there was deleveraging in the system. As it turns out, not all chicken is the same.

Granted, Yum! also owns Taco Bell. And it had a great quarter. The consumer is becoming “choosy” with its spending but is certainly not pulling back meaningfully.

Caterpillar

Consolidated Sales & Revenues

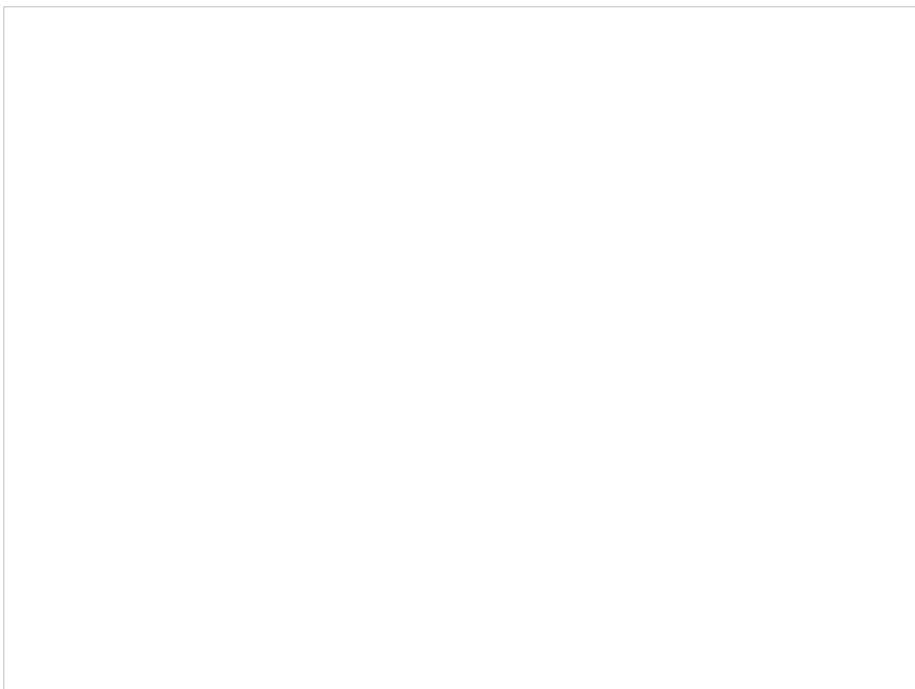
Second Quarter 2024 vs. Second Quarter 2023



Source: Caterpillar 2Q 2024 Earnings Release, 8/6/24 (emphasis added).

Then comes Caterpillar. Which has little to do with the consumer or chicken, but quite a bit to do with *price flowing to profits*. COVID was unkind to Cat, like most manufacturers. There were disruptions and parts delays leading to depleted dealer inventories. There was a catch-up period of “over-production” to get dealers back to normal levels. Prices were increased due to labor and other input costs. Volumes were a secondary consideration.

Fast-forward to the current quarter. Volumes declined meaningfully, and price did not quite make up for it. Revenues declined.



Source: Caterpillar 2Q 2024 Earnings Release, 8/6/24 (emphasis added).

Kindly, Caterpillar made it clear how powerful pricing is for the profit calculus. The entirety of the pricing power flows through to operating profit. *Changing a price tag*

does not cost anything. Not to mention, the sales volume decline did not detract as much as the price increases added. Again, that is important. *Price flows through to the bottom line.* Given the numerous companies who successfully raised prices over the last few years, there may be plenty of price left to flow through.

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