

Tyson Foods Inc.

Second Quarter 2021 Earnings

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CORPORATE PARTICIPANTS

Megan Britt -- *Vice President of Investor Relations*

Dean Banks -- *President & Chief Executive Officer*

Donnie King -- *Group President Poultry & Chief Operating Officer*

Stewart F. Glendinning -- *Executive Vice President & Chief Financial Officer*

PRESENTATION

Operator

Good morning, and welcome to the Tyson Foods Second Quarter 2021 Earnings Conference Call. All participants will be in listen-only mode. Should you need assistance please signal a conference specialist by pressing the star key followed by zero. After today's presentation there will be an opportunity to ask questions. To ask a question, you may press star then one on your touchtone phone. To withdraw your question please press star then two. Please note this event is being recorded.

I would now like to turn the conference over to Megan Britt of Investor Relations. Please go ahead.

Megan Britt

Hello and welcome to the second quarter fiscal 2021 earnings conference call for Tyson Foods. On the call today are Dean Banks, President and Chief Executive Officer; Donnie King, Group President Poultry and Chief Operating Officer; and Stewart Glendinning, EVP and Chief Financial Officer. We have prepared presentation slides to supplement our comments, which are available on the Investor Relations section of the Tyson website and through the link to our webcast.

During this call we will make forward-looking statements regarding our expectations for the future. These statements are subject to risks, uncertainties and assumptions, which may cause actual results to differ materially from our current projection. Please refer to our forward-looking statement disclaimers on Slide 2 as well as our SEC filings for additional information concerning risk factors that could cause our actual results to differ materially from our projection. Please note that references on earnings per share, operating income and operating margin in our remarks are on an adjusted basis unless otherwise noted. For reconciliations of these non-GAAP measures to their corresponding GAAP measures, please refer to our earnings press release.

I'll now turn the call over to Dean.

Dean Banks

Thank you, Megan. Before we get started, I'd like to welcome Donnie King to the earnings call and congratulate him on his recent promotion to Chief Operating Officer. I would also like to thank our 140,000 team members for their continued efforts and resilience. They are what makes this company an incredible place to work, and I'm proud of their focus on raising the world's expectations for how much good food can do.

Earlier today, we released our second quarter results for fiscal 2021. We delivered a solid operating earnings performance, recording \$739 million in adjusted operating income for the quarter, which represents a 43% increase relative to the same period last year. We delivered \$1.34 in adjusted earnings per share; that's 68% increase from the same period last year. These results were reinforced by our solid performance in retail, our continuing efforts to ensure the safety of our team members, our partnership with customers to enable recovery and our focused execution to overcome inflationary headwinds. Our results in the quarter reflect our continued focus on team member health and safety. This is our top priority, and I'm proud of the progress that we have made on our comprehensive safety, health and wellness agenda along with our recent vaccine deployment efforts.

We also saw improvement in the foodservice channel during the quarter. We've been working closely

with our customers to support foodservice recovery. As consumer demand patterns continue to create operational complexities, we've taken action to make our organization more responsive to demand signals and customer needs to accelerate our speed to market. Agility is increasingly important as we look to extend the gains that we have achieved in the retail channel. We continue to drive retail volume growth across our core business lines, delivering growth, and the recent quarter is particularly notable as we are now comparing to a prior quarter that included some benefit from initial COVID-19 pantry loading.

As we navigate market volatility and rising inflationary pressures, we're focused on operational excellence and disciplined cost management. Our balance sheet is strong and we continue to invest in our business. We have prioritized capacity expansion and automation technology investments and have significantly increased our capital allocated to both of these areas. As an example, our Humboldt production facility in Tennessee has recently commenced operations, and our team shipped the first salable product in late April.

To support growth in case-ready beef and pork, we are also excited for the reopening of our Columbia, South Carolina plant as well as the grand opening of our Eagle Mountain Utah plant, both occurring later this year. We are expanding capacity in our international operations and have six sites where new capacity is currently under construction, positioning our international business for continued growth and profitability in the future.

As we look at the balance of the year, we realized that we have a challenging second half ahead as inflationary pressure has continued to build. We also have several bright spots, notably, our performance in the retail channel and the continued strength in our beef segment. Looking past the inflationary headwinds that are impacting our input costs, I'm confident that our team is executing on the right priorities to meet our commitments and drive shareholder value creation.

Turning to Slide 4. Team member health and safety is and will continue to be our top priority. Through our partnership with Matrix Medical in our local communities, over 42,000 of our team members have been vaccinated since February. As of today, we've offered on-site vaccination clinics at over 100 locations in more than 30 states. We've also launched a pilot project to enhance health and wellness of our team members. This involves the opening of seven clinics that will enable team members and their families to receive easier access to high quality healthcare services. Our first facility opened recently in Newbern, Tennessee.

Turning now to Slide 5. Our total Tyson and core business lines have posted 11 consecutive quarters of volume and share growth. Notably, our team delivered volume growth in Q2 despite the unusually strong demand associated with pantry loading that occurred during the comparable quarter last year. Sales volume for Tyson core business lines are up 12.7% and total Tyson is up 8.5% in the latest 52 weeks. Our share growth has been the strongest in breakfast sausage, hot dogs, frozen value-added poultry and frozen protein breakfast.

Our growth during these periods was driven in large part by our ability to bring incremental households into our branded product lines. Total Tyson household penetration reached 81% for the latest 52 weeks. Also, consumers continue to rely on low to no contact buying methods. As a result, we experienced e-commerce sales growth of 105% in the latest 13 weeks compared with last year. This equated to approximately \$425 million of sales through our e-commerce channel partners.

Turning to Slide 6. Innovation is important to our success in both retail and foodservice channels, and we continue to invest in the launch and scaling of new product innovations. On this slide, we have three examples of how our product innovation is tied to meaningful consumer insights. In a recent survey,

nearly half of Americans expressed dissatisfaction with available plant-based options for the grill. This insight spurred our recent nationwide Raised & Rooted launch, which includes three new products to meet increasing demand for plant-based protein options.

We're also excited for our recent launch of alternative protein offerings in the Europe and Asia Pacific markets, which will support growing global demand for protein. For Jimmy Dean breakfast nuggets, are another example of our ability to pair brand and category leadership in frozen breakfast with our unique production capabilities to deliver protein-dense offerings that complement Tyson's current product portfolio. Finally, annual servings per capita for breaded chicken sandwiches at restaurants are up 14%, and our products in this space have enabled us to capitalize on the growing popularity.

Moving to Slide 7. As we continue to navigate complex consumer dynamics overall, we're closely monitoring several factors to effectively engage with our customers and consumers in support of the overall recovery. Protein has remained relevant throughout the pandemic with 54% of consumers indicating a deliberate intend to increase protein intake within their daily diet and 20% indicating that they are consuming animal protein more often than they were a year ago. In addition to overall protein consumption, we are closely monitoring reopening and recovery patterns. Approximately 76% of the US states are now at 75% or more capacity for in-restaurant dining.

With vaccine rollouts and consumer mobility improving, away from home traffic is gradually increasing on a sequential basis. Currently, QSR and C stores are leading the recovery as consumers are very comfortable with ordering takeout. While we are seeing some challenges in our international markets, progress against COVID domestically should continue to improve consumer confidence and mobility in the second half.

The US economy is improving rapidly in part due to government stimulus. While we expect some degree of elevated retail consumption to remain post-COVID, our success in growing retail share and driving relevant innovation will allow us to meet the strong demand for protein and serve our customers across all channels.

I'll now turn the call over to Donnie to walk us through the segment operating results in detail.

Donnie King

Thanks, Dean. I will start with the chicken segment performance captured on Slide 8. Sales were \$3.6 billion for the second quarter, up 5%. Overall volumes were down in the quarter, primarily due to COVID-related production inefficiencies. Severe winter weather also impacted volumes, operating costs and production efficiencies in the quarter. Average sales price was up substantially during the period due to the favorable mix and the benefit of higher retail volume. Our reported price improvement also reflects actions that we've taken to cover the inflationary pressure we have experienced from higher grain, labor and freight costs. Despite our efforts in the quarter, we did not fully offset the inflationary impacts as a substantial portion of our business is contracted on a fixed annual price basis with terms negotiated and locked ahead of the recent surge in grain costs.

Adjusted operating income was \$6 million during the second quarter and \$110 million for the fiscal year-to-date, down versus both comparable periods. Fiscal year-to-date operating income was negatively impacted by \$145 million of higher feed ingredient cost as well as \$95 million of increased grow-out expenses and outside meat purchases.

For the second quarter, feed ingredients were \$130,000 million higher, while grow-out expenses and outside meat purchases were \$60 million higher. Segment performance also reflects net derivative gains during the second quarter of \$40 million and \$110 million for the fiscal year-to-date, both versus the

respective comparable periods. These gains are associated with realized gains as well as open positions.

Last quarter we shared our imperatives for improving chicken operating results, which are captured on Slide 9. Our goal has not changed. We remain committed to restoring top-tier performance. The first imperative is related to being the employer of choice. Despite implementing pay rate increases, we continue to deal with elevated absenteeism and turnover. We are implementing a range of initiatives to improve the team member experience and achieve the status of the employer of choice, including flexible work schedules and a competitive wage rate. At this time, we estimate our average base pay plus benefits for domestic production workers is valued at over \$22 per hour.

The second imperative relates to our strategy to improve overall operational performance. Although we have made some progress improving our plant performance, we're not where we planned to be at this stage. Our strategy to improve our operational performance includes restoring our production volume to full capacity. However, we've struggled to raise the harvest to full capacity due to upstream supply issues, including issues caused by lower hatchability rates. Consequently, we have offset raw material shortages with outside meat purchases at a higher level than we had historically.

With the recent move in market prices, our cost disadvantage from outside purchases has widened. To compensate for cost headwind, we are working to recover our historical advantage on live costs, reduce the number of pounds we are sourcing in the open market and to increase our plant efficiency as we gradually restore volume over the balance of the year. The final imperative relates to serving our customers. Our focus is to deliver the highest levels of service to our customers, especially with respect to order fill rates.

When our customers are successful, we are successful. We are sustaining share gains in retail value-added as we start to lap the COVID-19 surge and are also leading foodservice recovery and growth. At the same time, our sales team is working to recover raw material and supply chain cost inflation via pricing. To sum all these imperatives is a restoration of our chicken business to top-tier competitiveness and the coveted position of being our customers' go-to supplier. Acknowledging the uncertainty associated with the continued COVID-19 recovery, we are increasingly confident in our ability to bring our adjusted operating income margin back to at least 5% to 7% range over time.

Moving to Prepared Foods. Sales were \$2.2 billion for the quarter, up 4% relative to the same period last year. Total volume was down 4% in the quarter as growth in the retail channel was offset by a reduction in foodservice volumes. Sales growth outpaced volume growth driven by the partial pass through of raw material costs, lower commercial spending and better sales mix.

Segment operating income was \$217 million for the quarter, up 14% versus prior year. For the first half, operating income was \$483 million, up 30%. Operating margins for the segment were 10% for the second quarter, an improvement of 80 basis points versus the comparable period. Improvement in operating income was driven by the mixed benefit a strong retail performance, lower commercial spending and pricing pass-throughs which more than offset higher operating and raw material costs.

In the second half, demand is expected to remain elevated at retail with volumes continuing to exceed pre-COVID levels and foodservice showing sequential improvement. Overall, we're seeing an accelerating inflationary environment that is creating a meaningful headwind for Prepared Foods in the back half of the year. We're seeing raw material costs up over 15% as well as increases in logistics, packaging and labor. To offset inflationary pressure, we're focused on pricing, revenue management, commercial spend optimization while ensuring the continued development of brand equity through marketing and trades [ph] pork.

Moving to the Beef segment. Segment sales were approximately \$4 billion for the quarter, up 2% versus the same period last year. Key sales drivers include the strong domestic and export demand for beef products with average sales price up 7.5% for the quarter. Sales volume for the quarter was down due to severe winter weather and production inefficiencies related to the challenging labor environment.

Segment operating income was \$445 million for the quarter. Operating income improvement was driven by strong global demand for beef products and a higher cut-out, which were partially offset by higher operating costs. Operating margin for the segment improved 790 basis points to 11% for the second quarter. Our Beef segment performance has been driven by a favorable supply and demand dynamics, which look to persist deeper into the year.

On beef supply, slightly higher domestic production for the calendar year is being more than offset by lower imports and higher exports, resulting in lower projected domestic availability for the full year. Adequate supply coupled with continued strong domestic and export demand will sustain cut-out values in our strong segment results.

Now let's move on to Pork segment on Slide 12. Second quarter results reflect the benefit of strong retail demand and higher exports, which were more than offset by higher hog cost and operating expenses. Segment sales were \$1.5 billion for the quarter, up 17% versus the same period last year. Key sales drivers for the segment included higher average sales price due to stronger demand, partially offset by lower volumes due to production inefficiencies. Average sales price increased by over 17% while volumes were down slightly, relative to the same period last year.

Segment adjusted operating income was \$67 million for the quarter, down 28% versus the comparable period. Overall operating margins for the segment declined by 280 basis points to 4.5% for the quarter. The operating income decline was driven by lower volumes, higher hog costs and increased labor and freight costs. To improve our operating income results for the segment, we have implemented several actions to alleviate production constraints and to improve our volume throughput.

As we look ahead, we are closely monitoring hog supply estimates. Recent USDA projections show a historically sharp drop in hog supplies. The sharp decline in supply and strong demand for certain pork items have pushed the cut-out 59% from the end of December. As it stands now, pork cut-out is at the highest level for this time of year since 2014. Looking at the overall calendar year, lower projected 2021 pork production and continued robust consumer demand are expected to support hog prices at well above 2020 levels.

Finally, Slide 13 captures some highlights related to our international business. We continue to invest behind our international platform, which provides an opportunity to grow our sales and our margin by leveraging global production capabilities to feed consumers abroad. We're using our One Tyson framework to identify opportunities to maximize the value of our products and capabilities from farm to table at a global level. Our existing depth of experience in protein production, brand management and global customer relationships creates the right recipe for growth and positions us with the right to win internationally.

I'll now turn the call over to Stewart to provide additional detail on our financial performance.

Stewart F. Glendinning

Thanks, Donnie. Turning now to a summary of our total company financial results. We're pleased with our year-over-year growth in sales, adjusted operating income and earnings per share. We performed well despite a challenging operating environment that spans tough labor availability, significant inflationary pressures in raw material cost, global supply chain challenges and an evolving demand

backdrop.

Adjusted operating income was up 43% during the second quarter due to strong performance in our Beef business along with growth in Prepared Foods earnings, partially offset by softness in Chicken and Pork. For the first half of fiscal 2021, we delivered adjusted operating income growth of 32%. Adjusted EPS grew nearly 70% during the second quarter driven by higher operating income. Fiscal year-to-date adjusted EPS was up 41% on a year-to-date basis.

Slide 15 bridges our total company sales for the first half. Ongoing retail strength drove much of our sales results. We delivered growth across all our reporting segments in the retail channel. Overall, retail accounted for \$700 million in sales improvement during the first half and over \$260 million in the second quarter versus comparable periods.

Moving to foodservice. Sales declined over \$400 million in the first half compared to the same period last year, but improved \$69 million in the second quarter. Foodservice recovery was most evident during the second quarter in higher Chicken and Prepared Foods sales versus the same period last year. Our foodservice mix in Chicken indexes to QSRs, which saw volumes above pre-COVID levels during the period.

In Prepared Foods, we're seeing recovery in foodservice foot traffic and strong sales into the distribution channel. Exports were up over 5% versus the comparable period, led by Beef where sales improved nearly \$100 million for the first half. China is a key driver of Beef exports strength. Lastly, we've seen some strength in industrial, particularly in Pork as renewable fuels continue to drive growth in fat and oils demand. In addition, the pace and shape of foodservice recovery will affect the composition of our channel and segment sales in the second half of the fiscal year.

Slide 16 shows the bridge for adjusted operating income for the first half. Lower volumes, primarily from production inefficiencies in foodservice, were \$100 million headwind on gross margin in the first half. Price mix benefited during the first half from price recovery of raw material cost inflation, improved mix, strong Beef segment performance and continued retail strength across segments.

Adjusted operating income was burdened by \$664 million in cost of goods sold pressure for the period. This amount reflects significant raw material and supply chain cost inflation. Of the total feed ingredient, grow-out costs and outside meat purchases associated with the Chicken segment, contributed \$240 million of pressure. Other large contributors included freight and labor costs. Year-to-date, SG&A benefited from the \$54 million loss in fiscal 2020 compared to a \$55 million gain in fiscal 2021 associated with the cattle supplier fraud and certain reductions in freight spend and travel costs.

Slide 17 captures our financial outlook for fiscal 2021. Given continued strength in the Beef segment and our expectations for ongoing foodservice recovery, we are raising our sales guidance for the full year. We now expect to deliver annual revenues in the range of \$44 billion to \$46 billion. This guidance reflects our expectation of partial price recovery relative to continued feed ingredient and supply chain cost inflation.

At the segment level, we expect our directional annual guidance of lower operating margins in Chicken and Pork versus the prior year to hold. Because of stronger than expected performance in Beef and current market conditions, we are raising our guidance on the Beef segment. We now expect segment earnings to be up versus prior year.

Finally, we are lowering our guidance in Prepared Foods due to back half inflationary pressures and now expect the segment's earnings to be flat versus the prior year. De-risk to this guidance include freight

rates, labor cost, grain costs in the Chicken segment, raw material costs for our Prepared Foods business and continued export market strength along with price volatility in commodity meats.

Our capital expenditures outlook of \$1.3 billion to \$1.5 billion remains unchanged, though we now expect to be at the lower end of the range. Net interest expense is expected to be lower than our previous outlook at approximately \$420 million. This update reflects an incremental term loan repayment of \$750 million relative to our prior guidance that resulted in the early payout of our \$1.5 billion term loan, offset by \$500 million of new indebtedness associated with a new bilateral term loan facility.

Our outlook on effective tax rate is unchanged. We will continue to monitor the potential implications of any new legislation, but do not currently expect to see impacts to our adjusted rate this fiscal year. Our expectations related to liquidity are also unchanged. As we noted last quarter, liquidity decreased from \$4.2 billion at the end of the first quarter, ending the second quarter at \$2.6 billion. Finally, our COVID-related costs which totaled \$95 million in the quarter are now expected to be approximately \$365 million for the year.

Turning to Slide 18. With our strong operational performance through the first half of 2021, we've seen an increase in operating cash flow. We have prioritized deleveraging through the first half consistent with our priority to maintain a strong balance sheet with financial flexibility. Investing organically in our business has been an important priority, which will increase our production capacity and our market capabilities as well as modernize our operations while providing strong returns.

We will continue to explore parts to optimize our portfolio through M&A. We have a disciplined approach, which focuses on returns and generation of shareholder value. Finally, we're committed return cash to shareholders through dividends and buybacks. In short, we view the cash generation capabilities of this business as both strong and diverse, and we expect our deployment to deliver strong shareholder returns.

Now I'd like to turn the call back to Dean.

Dean Banks

Thanks, Stewart. To close our prepared remarks, I just want to make a few comments about our priorities for the second half. Looking at the work ahead of us, we are focused on improving operating margins, growing above the market and driving sustainable return for shareholders. To improve our operating margins, we are driving enterprise-wide operational excellence, working aggressively to restore our competitive position in our Chicken segment and structuring our teams to operate at the speed of the market.

To grow above the market, our team is focused on working closely with our customers to enable foodservice recovery and support ongoing retail demand. We've also increased investment in value-added capacity expansions and automation technology, which will support increased sales, high efficiency processing and more agile customer service. Lastly, the strength of our balance sheet will allow us to continue to invest in our business and return capital to shareholders consistent with our stated priorities.

And with that, I'll now turn the call back to Megan.

Megan Britt

Thanks, Dean. We will now move on to your questions. Please recall that our cautions on forward-looking statements and non-GAAP measures apply to both our prepared remarks and the following Q&A. Operator, please provide the Q&A instructions.

Questions and Answers:

Operator

We will now begin the question and answer session. To ask a question you may press star and then one on your touchtone phone. If you are using a speaker phone you must pick up the handset before pressing the key. To withdraw your question please star then two. We ask that you please limit your call to one question and one follow-up. If you have further questions you may reenter the question queue. At this time we will pause momentarily to assemble our roster. And our first question will come from Ben Theurer of Barclays. Please go ahead.

Benjamin Theurer

Hey, good morning, and thank you very much for taking my question. So maybe Donnie, that's one for you. Just wanted to follow-up on the initiatives within Chicken. And I mean, clearly, you've laid out very much detailed -- the plan on how to work on improving and get back to that mid to—mid-single-digit, high-single-digit operating income margin. Now more short-term, if we take a look at the cost headwinds; corn, soy, I mean, obviously, that's significantly impacting, how do you feel about your ability to negotiate on pricing with what you usually have on your negotiated and contract pricing with customers? Just considering that the overall environment seems to be very inflationary, so do you have—do you see any flexibility around the pricing mechanisms in the short-term? Thank you.

Donnie King

Thanks for the question. Short answer is, yes. We have obviously locked in some pricing early before we saw the run-up in grain that we've been having non-stop conversations with all of our customers around the inflationary need for pricing, and they have been very responsive. We've had a lot of really good results in, let's call it, mid-contract, going and having conversations with those customers. Remember, our relationships with our customers; it is a relationship, it is not a transactional event for us, and we've vested as they have through the years. And so they've been very supportive. They certainly understand the inflationary need. And I think we will be quite successful in this endeavor.

Benjamin Theurer

Okay, perfect. And just to kind of look ahead, I mean, where do you think are low-hanging fruits in terms of operating efficiencies to bring margins back up from the headwinds? Like really what's feeding [ph] your hand? What have you identified since you took over a more serious review of the business a couple of months ago? And where do you think are the low-hanging fruits and where are the bigger challenges to bring that back to that 5% to 7% margin range you've talked about?

Donnie King

Sure. Well, let me start with this as we started the fiscal year. We had one objective and that was to simply be the best chicken company as we move forward. And we obviously recognized that's not where we were and—or where we are. And so we began to work on that. And as we get into—as we got into this, we started seeing good results, particularly in Q1. However, in January, we still—the recovery slowed down driven by volume constraints due primarily to chicken availability from an unexpected decline in hatch.

The winter storm Uri affected our operations broadly, a significant event. We essentially lost a week across our entire poultry enterprise and more broadly across the rest of the businesses as well. As a result of these supply shortages, we compensated with outside meat purchases, which has driven our cost up as market price rallied sharply, particularly after the first quarter. At the same time, cost inflation accelerated with the grain and the highest in the last six years. Wage increases and freight cost also

impacted us. And as I mentioned earlier, we contracted a large share of our portfolio in the fall and early winter before the prices began to increase materially.

We're continuing to deal with turnover and absenteeism, and—but what I would tell you, despite these headwinds, the fundamentals of our business looking forward are actually quite good. Customer and consumer demand is strong. Sustained demand in retail and foodservice recovery with ongoing chicken sandwich promotions. So the outlook alongside the operational improvements that we're making and the pricing opportunities that we have are quite good.

So—but very specifically, I think about this business and the seven levers of this business or this business model, and the levers are price. We simply need to be—to get paid fair market value. We certainly can't eat all the inflation that we're experiencing now. We've got to get volume back under us. Our business is growing and we got to get the harvest numbers back up for our business, and we have to continue to get more FP capacity online. We've had a great improvement in mix. We're still struggling with absenteeism. And then we need to make sure our spend is in balance with the volume at which we are processing.

And finally, we need to return our live production spreads—our historical spread to the industry. We need to regain those spreads. So what I can tell you is we know where we are really and we're not happy with where we are, and we fully understand that we can't talk our way through our poor performance. We do have a great plan in place to be the best chicken company, and we've made great progress and we'll accelerate that in the back half of the year. I'll tell you we have a great team in place. Everybody knows what they're doing. And we're not afraid. We're not discouraged. We're a little bit delayed from the some of the winter and some of the activities inflation in Q2, but we're very optimistic about this business as we move forward.

Dean Banks

And I just want to add, just a compliment to Donnie and the team. We had committed in previous calls to have visible operating metric improvement at the end of the second quarter. And everything we've seen early in the quarter and coming out of the previous year, we have seen those operating improvements materializing. It's unfortunate that we're experiencing all the headwinds, but I'm proud with how Donnie and the team is managing those headwinds and the operating improvements they made, which will become visible as we navigate the headwinds coming.

Benjamin Theurer

Okay, perfect. Thank you very much, Donnie, Dean, for the comments. Congrats.

Donnie King

Thank you.

Operator

The next question comes from Ken Goldman of J.P. Morgan. Please go ahead.

Ken Goldman

Hi. Thank you. Good morning.

Dean Banks

Good morning.

Ken Goldman

I wanted to make sure I understood guidance. When you say that the results in a particular segment are likely to be higher or lower than the prior year, I think you're talking about operating margin because that's what it says in the slide, and that's what you've historically done. But in your prepared remarks, I thought you said profit or earnings. I just wanted to clarify whether it's margin or earnings or both when you're talking about those terms?

Stewart F. Glendinning

Yes. Ken, Stewart here. Absolutely it's percentage from a rate—return on sales. And as you point out, that's what you see in the slide.

Ken Goldman

Great. Thank you for that. And then as a quick follow-up, can you talk a little bit about some of those hatch issues that you mentioned? How structural are those? How much of those related—are related to some of the weather that we saw? I'm just trying to get a sense of your outlook for those.

Donnie King

Sure. Great question. We think some of them are structural. In our program, we changed one of the males that we were using in our business and great broiler performance, but we're not seeing those maternal characteristics such as egg production and hatch, namely hatch. And so we've got some of those issues going on. But in terms of the weather, it's a little hard in February with the Uri, with the impact of that, with all the power outages and so forth. We had eggs sitting on a farm without power. So we saw a loss of embryos as a result of that. So from February into March, think about this, those animals that were—those chicks that were impacted also went through the grow-out cycle and they had issues as they went through there.

So the initial impact was very expensive, but you think about the knock-on effects of that. It's—those persisted all the way through April, and we're just now clearing ourselves of that. But the other side of this or the view of this is they are—in terms of hatch, it is improving. It will improve marginally as we move forward. As we elevate—if you think about our business and our breeder performance, we have a spread from the best to the worst. So just elevating and tightening that spread will give us improvement.

Seasonally, we will get a little bit of improvement, and the knock-on effects from the winter storm will give us a little improvement. So we're not going to be all the way bright. It will take us time to work, the males that we're changing out. We'll have a new male in place everywhere or let's call it fall, but it will take a full year to see this come back to bright. But we're confident in that. And so that's where we are.

Ken Goldman

Thank you very much.

Operator

The next question comes from Alexia Howard of Bernstein. Please go ahead.

Alexia Howard

Good morning, everyone.

Dean Banks

Good morning.

Donnie King

Good morning.

Alexia Howard

Okay. So two questions from me. The first one. You talked about pork operational inefficiencies, I was just wondering if you could clarify what those problems were and how quickly you expect them to be resolved? And then I have a follow-up.

Donnie King

Thanks. Great question. In terms of the issue, it's—think of it in terms of a staffing issue impacting capacity. If I think about our Pork business, it's been taking us about six days to do five days worth of work because turnover absenteeism. The other part of that is, in terms of the performance, is related to not having skilled people in place. And so we've not been able to give mix optimization in terms of maximizing the cut-out. All those variety meats, all those components that are highly attractive from a margin perspective. We are short staffed right now in our pork plant. We are working on things that you might would expect in terms of work schedules. We're looking at wages in all of those cases. And we are also investing in terms of automation and technology to try to alleviate these more difficult and higher turnover jobs.

Alexia Howard

Great. And then as a follow-up, could you give us a quick sort of update on the current status of the African swine fever situation in China? Is that—we didn't hear anything about that this time around. I know that you think that it's probably going to continue to have an impact on the global meat supply and demand balance for some time. But are we getting through to the other side of that or it is having less of an impact on your export business for example?

Dean Banks

Yeah. So first off, the case is not just in China, but what we've seen in Germany has really disrupted global protein flows, similar protein with [indiscernible] for Asia. China—early reports where they were having some success of repopulating, but our latest research shows that that's really not happening anywhere near the pace that they hoped. So we still see really strong exports going into China to cover that gap.

Alexia Howard

Great. Thank you. Best of luck.

Donnie King

Okay. I would add to that just that China is still at a pork deficit. There are new herd losses from ASF, which is slowing their recovery. So based on the numbers I saw quoted from Rabobank recently, they will be flat to about 2020.

Alexia Howard

Great. Thank you very much. I'll pass it on.

Operator

Our next question comes from Adam Samuelson of Goldman Sachs. Please go ahead.

Adam Samuelson

Hi, thanks. Good morning, everyone.

Dean Banks

Good morning, Adam.

Donnie King

Good morning.

Adam Samuelson

Good morning. I wanted to maybe tie together some of the comments that you've given on the Chicken business through the call already. As we think about the balance of this fiscal year and the kind of pathway to that—to 5% to 7% margins, maybe can you help us think about where we would be kind of at the end of September at the end of fiscal '21 in terms of some of the live productivity issues? Where you'd hope to be from a labor and attrition perspective? Kind of where you think you will be on kind of price versus feed kind of balance by the end of the fiscal year? And the 5% to 7%, just help us think about—you talked about as the medium term target, what do you think the timeline realistically is to get back there?

Donnie King

Sure. So as I think about the—and let's start with the hatch issue. I covered off a number of those things in terms of—it will be improving sequentially. But we're changing out a male that quite frankly we made a bad decision on. And we will not be all the way bright till, let's call it, mid-year of '22, but we will sequentially get better between now and then in hatch.

So it will help us in supply and supply that we quite frankly need today. We are too dependent on the outside purchase of meat right now. And we've—the market has run up there. So it's—the ability to pass on that cost in the marketplace is next to impossible. And so we need to get our own animals in place. And by the way, that outside purchase is predominantly breast meat, but we have good sales for the back half of the chicken. All the rendered products that came with that, of course, you see the wing markets that are well over—that are over \$3 right now. But in terms of getting to the 5% to 7%—and when I say 5% to 7%, I'm talking about 5% to 7% in a business that's growing, growing top-line, growing bottom line.

And so we got to staff the plants. I mean, that's an imperative here. And we have to compete with the very best. And competing in this example is we just need to have a cost structure that is best in class, and quite frankly, we haven't had that. But we're well on the road. We have—much like we did in 2008, we have a path forward. We're looking at those big rocks. Most of them would be in the labor yield spend. Volume is certainly a big component of that as well. And we've got to service customers better.

Quite honestly, we have not serviced our customers well in almost two and a half years. I talked about the SAP cut over and then COVID of last year. And so we got to do that better for our customers, and that certainly helps us. And then that puts us in a position to continue to grow our business. We're being very successful right now with the growth in the business. And when we service the customer in full, all the time, across all channels, then we get the opportunity to grow our business at even a higher rate.

So all those things are—all those things that would get you to the 5% to 7% and growing, but it's the fundamentals. It's the fundamentals of the business that we have to get in order. And we're very much aware of those. We're very much aware of where our gaps are to each one of those cost components. And so—and we've got a good team working on. So more to come.

Dean Banks

One other point I wanted to make related to the hatch issue is that it's a bit of a double-edged sword. And it's not only are we buying protein in the market to service or further process customers, but in the primary processing, our plant is not running full, has some deleveraging. And so will you'll see us in the coming quarters as we get hatch fixed, we increase capacity in our facilities, we'll absorb some of that deleveraging and get back to operating metrics and operating performance that come along starting that.

Adam Samuelson

That color is really helpful. And then maybe a follow-up question I think for Stewart just thinking on the capital allocation front. You're at your kind of long-term kind of leverage target of two times at the end of the second quarter, maybe just help us think about kind of deploying incremental cash flow from here? And I think in your prepared remarks, I think any reference to M&A I was interested kind of is talk about optimize the portfolio didn't seem kind of—to have aspirations for a lot of offensive of M&A, but maybe just help us think about cash deployment from here?

Stewart F. Glendinning

Yeah, sure. Well, look, I mean I'll tell you, we feel really good about our options here. If you think about our capital allocation in three big planks [ph]; first, we've been focused on building financial strength, and that's certainly true as you pointed out. Our debt-to-EBITDA ratio is looking good. We do have more debt coming due later this year. And of course, we have a term loan that's outstanding. So it's about \$1 billion between those two.

Then think about investing in the business. M&A is opportunistic, but of course, we have and we'll continue to be pretty disciplined there from a return standpoint. Where you have seen increased capital deployment has been around capex. We did earlier this year guide that we would see as high as \$1.5 billion. We haven't been able to get some of the projects away as quickly as we have wanted, but you might take away from that early guidance that we have an appetite to invest behind our company in organic kinds of investments. And we have a lots of strong opportunities in automation and then other profit improvement areas in our business. And notably, lots of opportunity for us to invest in new capacity in our business.

We've got a number of new plants coming online. In the prepared remarks, we talked about six different sites in our international business where we're investing in new capacity. Donnie spoke about a couple of new plants coming online in the US; Humboldt has come online. So more capital is going against capacity and that is needed for a growing business. And then lastly, of course, 10 years of dividend growth, we have not been shy to share that cash with shareholders, and we expect to continue to do that in the future. So I think step back, we've got a well thought out and well balanced approach to capital allocation.

Adam Samuelson

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

Operator

The next question comes from Ben Bienvenu of Stephens. Please go ahead.

Ben Bienvenu

Hey, good morning, everybody.

Dean Banks

Good morning, Ben.

Ben Bienvenu

I want to ask about the Prepared Foods segment. Your commentary makes perfect sense just given the raw material cost inflation that we've seen. I'd love to hear some commentary on the cadence of pricing that you expect to realize. What you're looking at from a competitive standpoint and demand elasticity standpoint in that business? And how we should be thinking about kind of the realization of margin recovery in that business relative to raw material cost and pricing increases?

Dean Banks

Sure. I'll take first shot at this and then pass it over. We still see tremendous continued retail strength in Prepared Foods. And with 11 straight quarters of growth in our core business lines, we're able to commend a strong presence there. And as it relates to pricing, we are obviously experiencing high input costs from the Pork business and that will ultimately get passed along. Most of our pricing in retail specifically, we're in position where we interact with our partner customers quite frequently and they see what we're experiencing there and we're able to pass some of that on. We are—we do expect in the next half to be increasing that spend. It's going to be a requirement obviously to remain competitive in the marketplace. Those investments have paid off in the past. Taking you to—as you read and heard, 81% household penetration, that's something where we can leverage long-term.

In Prepared Foods -- the other thing to really keep in mind is that foodservice is coming back. So we've mentioned that 75% of the areas which recover are recovered at about 75%. While we've seen about a 10% drop out in restaurants, those are getting backfilled with those kitchens and variety of other creative models and ultimately addition to restaurants to fill that void. We think that business is going to recover strong. It's a lower margin business. So we'll see that balancing out not only due to throughput in the restaurants, but also channel filling as we get prepared for the full recovery.

And I think I mentioned about foodservice is that, please keep in mind, it's obviously regional and it's very different across channels. So clearly we've not seen a recovery in K-12 that we'd expected. And some areas of the world that impact our business, specifically in Europe, they're still buckling under the pressures of COVID. So foodservice hasn't recovered quite as much as we'd want.

So with that, I'll hand it over to Stewart to talk about margin outlook.

Stewart F. Glendinning

Yeah. Look, the only thing I would add to what Dean has said is that our expectations for price recovery in the second half are already included in the guidance. Of course, philosophically, we believe as a company that raw material costs ultimately will be passed along. And therefore, you should think about seeing more to come next year. But the current expectations around pricing are built in our guidance.

Ben Bienvenu

Understood. Okay, great. My second question is just around the buy versus grow strategy in chicken. And in particular, you talked about the hatchability issues and that how that should resolve some of your issues over time related to the need to buy breast meat on the outside market. What role does Humboldt play, if any, in that equation? And as it relates to Humboldt, is that on time, on budget? What are the latest qualitative or quantitative commentary points that you could offer us?

Donnie King

Sure. Great question. Humboldt—let me start with it. Humboldt is a fresh chicken plant. As we look at that business, it's a growing category for—predominantly, for our retail customers. So we started in the late April with some FP-type products flowing through Humboldt. It'll be July, late July before we actually are harvesting any animals in the Humboldt. It'll be incremental. It will help us from a flexibility of our footprint. There is Humboldt—or actually across our fresh portfolio help us de-clog and streamline some of our operations.

Now the question around buy versus grow, we still support buy versus grow. It's still a good program and we will continue to use that. What I've tried to portray is that we moved to far on the buy instead of growing our own. And we were late, quite honestly, to be able to get the animals down and growth, but we started this year. If you look at the Q1 numbers, we were seeing pretty nice performance in Q1 and

then we get into January and hatch really hit us and then the storm in February. And so we're still processing all of that to understand what it means. But long-term, we'll be fine. But buy versus grow is still a good strategy. We're just over dependent upon it right now.

If you think about the marketplace, historically, the market would be around \$1.10, \$1.20 maybe even inching up from there. For jumbo boneless skinless breast meat, as of Friday, it was \$2.11. So pretty significant increase in the market. And so trying to get pricing around that going to be—that's a little tricky, but certainly all our models would indicate that growing would be the right course in this market environment.

Stewart F. Glendinning

One other thing just to add to Donnie's answer. Just thinking about Humboldt specifically, as a reminder, there is a start-up cost for Humboldt, which is about \$60 million in the year with most of that in the second half. So just keep that in mind for your models.

Ben Bienvenu

Okay. Thanks very much.

Operator

The next question comes from Ken Zaslow of Bank of Montreal. Please go ahead.

Kenneth B. Zaslow

Hey, good morning, guys.

Dean Banks

Good morning.

Donnie King

Good morning.

Kenneth B. Zaslow

Just two questions. One is on the beef side, how long do you think that the cattle supply relative to the packing will be in this situation, because I understand that there has been —the cattle from last year hasn't been fully killed? So this positive environment, how long does it last? And then obviously into 2022, you're still in a good environment. Just want a comment on that and then I have a follow-up.

Dean Banks

Sure. We're projecting and observing ample cattle supply through the end of the year. And as we're continuing to setup our plants and increase production, we're going to continue to work through that. But everything looks strong through the end of the year and into '22. Donnie, do you want to add any color?

Donnie King

Sure. I will add a little bit too. There is obviously a higher grain costs on the beef side and then of course the drought conversations which could impact heifer retention which could portend some longer term negative implications. But based on everything we see, throughout '20 into '22, at least halfway of what we can see today, there will be ample cattle supply.

Kenneth B. Zaslow

Great. And my second question. Donnie, if I look back in 2008, how do you compare and contrast this fix on the chicken operation versus then? And again, if you kind of do that compare and contrast, it seems like there is a real linear path to those type of margins that you once got back in the 2009 - '10

period? And I'll leave it there, and I appreciate it.

Donnie King

Thanks. Well, there are a lot of similarities. The good news/bad news is that we've been down this road before. If I look at some of the differences—if I go back to 2015, for example, our volume—our harvest volume in pounds sold is flat to 2015. So that's the problem one. If you think about in this timeframe, we purchased Keystone, which I think it was like 4.5 million chickens a week from that. So we've essentially rationalized that volume through all of our locations.

Our capacity utilization is in the low-80s from harvest perspective. So if you—I mean, if you look at the numbers today, if you look at a 20% opportunity on top of that with all the latent capacity, there is a lot of upside from a cost perspective as you look at that. At the same time, our volumes remained flat and our operational costs have risen, let's call it, a 5% CAGR. We—on flat volume, and quite honestly, our customers aren't willing to pay for our inefficiencies and we don't expect them to.

We've seen pretty significant price increase if you think from 2015 to 2021. It looks like probably half of -- \$500 million worth of price decreases because of the market dynamics. And we've had a couple of special events. The SAP cut over in 2019 and then COVID-19 in 2020. So a long story short there is we have a higher cost and we get lower volume. And you can put together very simplistically what we have to do to get this business right, to get it to 5% to 7%. And then—and I say 5% to 7%, that's where we're going. But I want to point out that it's 5% to 7% and growing our business, meaning FP business. It could be meat, it would mean harvesting animals to support that business. And so we think we've got a lot of upside, and the future looks a lot brighter than it does today.

Kenneth B. Zaslou

Thank you very much. Be well, guys

Dean Banks

Thanks a lot, Ken.

Operator

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

Peter Galbo

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

Dean Banks

Good morning, Peter.

Peter Galbo

Good morning. Stewart, the operating income range—first of all, very helpful. Thank you for including that. Just a question there. It looks like kind of in the front half of the year your sales price mix was more than double the COGS inflation, and obviously, you're expecting that to reverse pretty materially in the second half of the year. Just is there any view to help us understand the magnitude of how much price will cover on the COGS side in the back half as you think about it on an enterprise-wide level?

Stewart F. Glendinning

Maybe just a couple of things to point out. First of all, you really point out that the mix of the big impact, nice to go, perhaps a little bit more detail is an acute [ph] in the segment detail in Note 14, because you're going to be able to take away from that chart that a heavy influence on this number is beef. And that is why you're going to see the movement looking like you're getting a coverage, which you are in total. But

when you break it down at the business level, you're going to see a very different dynamic obviously in Prepared Foods, Dean covered that for the back half of the year.

Only other thing I'd point out just as a modeling tip is the cost of grains has gone up substantially. And even since the beginning of this quarter, you will see the grain has shot up. Think back to the data that we gave you during the prepared remarks for grain costs in the first quarter were sort of \$10 million or so higher than last year. In the second quarter, we were \$135 million higher than the same quarter last year. That's reflecting that higher cost of grain coming through. Yes, we're hedging, but you need — those hedges sort of roll. So the further you get out, at some point you start actually taking that higher cost of grain, and that's what you're seeing as you look through those numbers.

So the second half of the year is going to be bearing grain costs that are a lot higher and our ability to offset that will be dependent on Donnie's set price recovery. But we've given you our best estimates in the guidance that we've laid out. There are some areas of fairly significant inflation in the back half.

Peter Galbo

Got it. No, that's helpful. And Donnie, maybe just to kind of dot the eye on chicken, I just want to understand if the labor problems that we're now reading about pretty consistently across all industries are really incremental to what you had been experiencing over the past six months to a year and how you kind of see that labor picture, particularly in chicken, and how you see that labor picture, I guess, shaping up? When we would expect it to maybe start to alleviate a little bit, at least from your perspective?

Donnie King

Well, if I look at the time horizon over the last year, it's — I wouldn't — I would say it would be improved somewhat to, let's call it, the height of COVID. We are able to staff plant. We are pretty close to staffing. Just absenteeism that we are seeing is really unusual for us. And — but if I look at prior to COVID, we're probably something in order of five, let's call it, maybe 50% more absenteeism what we experienced prior to that.

And so there is not a magic bullet here. We're looking at all kinds of things, trying to generate worker-driven solutions. We talked about wage and we quoted our wage rates that we have today. And — but we're also looking at different shift model so that our workforce today wants us to be able to tell them exactly when they start to work and exactly when they get off, and very few are interested in a six day week or a surprise based on customer consumer demand. Of course we're investing heavily in terms of automation and technology to try to eliminate the more difficult higher turnover jobs. But I would say across Chicken, Beef, Pork, Prepared, in terms of — it takes about six days right now to get five days worth of work done. And so it's impacting capacity and costs.

Dean Banks

Peter, one other thing I'd mention is, it's just not — we wouldn't want to avoid mentioning the impact of stimulus. And that's ultimately going to wind down and should have a positive impact on our ability to recruit. And also further something Donnie said, we have invested heavily into automation. And some of the tougher to staff is portions of the facilities, we can take that talent and redeploy to other parts of the facilities. You'll see that coming in the second half of the year.

Peter Galbo

Thanks very much, guys.

CONCLUSION

Operator

This concludes our question-and-answer session. I would like to turn the conference back over to Mr. Dean Banks for any closing remarks.

Dean Banks

Thanks again everyone for your interest in Tyson Foods. We hope you and your families stay healthy and safe, and we look forward to speaking to you again soon.

Operator

The conference is now concluded. Thank you for attending today's presentation and you may now disconnect.