

Tyson Foods

Second Quarter 2023 Earnings Call

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CORPORATE PARTICIPANTS

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Brady Stewart - *Group President, Fresh Meats*

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PRESENTATION

Operator

Good morning, and welcome to the Tyson Foods Second Quarter 2023 Earnings Conference Call. All participants will be in a listen-only mode. Should you need assistance, please signal a conference specialist by pressing the * key, followed by 0. After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press * and then 1 on your touchtone telephone. To withdraw your question, you may press * and then 2. Please also note, today's event is being recorded.

At this time, I'd like to turn the conference call over to Sean Cornett, Vice President, Investor Relations. Sir, please go ahead.

Sean Cornett

Good morning. And welcome to Tyson Foods' Fiscal Second Quarter 2023 earnings conference call and webcast. Prepared remarks today will be provided by Donnie King, President and Chief Executive Officer; and John R. Tyson, Executive Vice President and Chief Financial Officer. Additionally, Brady Stewart, Group President, Fresh Meats; Stewart Glendinning, Group President, Prepared Foods; Wes Morris, Group President, Poultry; and Amy Tu, President, International and Chief Administrative Officer, will join the live Q&A session.

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 on our webcast. During today's call, we will make forward-looking statements regarding our expectations for the future. These forward-looking statements made during this call are provided pursuant to the Safe Harbor Provisions of the Private Securities Litigation Reform Act of 1995. Forward-looking statements include all comments reflecting our expectations, assumptions or belief about future events or performance that do not relate solely to historical periods.

These forward-looking statements are subject to certain risks, uncertainties and assumptions, which may cause actual results to differ materially from our current projections. Please refer to our forward-looking statements disclaimer 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 projections. We assume no obligation to update any forward-looking statements.

Please note that references to 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. Now I'll turn the call over to Donnie.

Donnie King

Thanks, Sean, and thank you to everyone for joining us this morning. Last quarter, we said that we expected Q2 to be tougher than Q1, and this quarter was definitely a tough one. As you will have seen in our release earlier this morning, results were weaker than expected and top line performance was mixed, particularly when compared to our strong performance last year. At the same time, we outperformed our large, branded-food peers in volume and dollar sales and continue to gain pound and dollar share in our retail core business lines.

As I also said last quarter, I can't remember a time when our business faced the highly unusual situation that we're currently seeing, where all three of our core protein categories, beef, pork and chicken, are experiencing market challenges at the same time. This unusual confluence of issues

continued in Q2 and directly impacted our results. I know that you watch the protein markets closely, and like us, know that there are many factors at play here that are macro in nature.

For example, beef is cycling out of historically strong margins that were seen throughout most of fiscal 2021 and '22. Cutout values across protein complex are much lower than a year ago. Inflation has also remained elevated and persistent, which has dramatically impacted our cost. The current macro backdrop is clearly tough. We have a strong growth strategy and are bullish on our long-term outlook. We continue to implement our strategy, focus on the things that we can control, and build upon the strong foundation we have in place.

Late last month, we announced important initiatives to simplify our structure and right-size our team. These are a logical next step in our ongoing efforts to drive operational and functional excellence, as we strive to be best-in-class in our industry. Last quarter, we talked about executional issues that we needed to improve and operational performance did get better. We set a high bar to execute with excellence and are making progress.

Despite our overall results, there were strong positive highlights in the quarter that serve as proof points that our strategy is working. As you know, our branded foods business is a key growth pillar for the future, and in Q2, the business performed well. These results were driven by the strength of our share position, especially for our core brands, including Jimmy Dean, Tyson, and Hillshire Farm, which helped deliver strong margins compared to the same, 13-week period last year.

We continue to grow both pound and dollar share and to outperform our large food peers in volume, based on Nielsen data. It's clear we are winning with consumers. We also continue to win with our customers. We're proud to have been moved up into the top ten, for the first time ever, in the most recent Kantar power rankings. In fact, Tyson finished in the top ten, in six of the nine categories they measure, as we continue to focus on meeting customer needs and planning the future together with them.

While strong performance continued in our branded foods business, I know that our results in chicken are top of mind for many of you. So I want to spend a few minutes walking through our chicken business in detail. I want to point you to three important things on the macro environment. First, market conditions remain very challenging. Commodity prices for most fresh chicken cuts are much lower than last year, with boneless breast meat, tenders, and wings down more than 50%.

While we're not fully exposed to commodity markets, we are not immune to their dynamics. Some might expect these dynamics to impact our results immediately. But in fact, they work through on a lag. As chicken commodity prices declined in Q1, the impact continued into our Q2, while price increases we saw during the quarter are expected to affect Q3. Second, input costs were higher compared to last year as our feed ingredient cost increased \$145 million. We also realized an unfavorable, year-over-year derivative impact of approximately \$135 million, due to volatility in commodity grain prices.

Third, while high-path avian influenza has not had a significant impact on our live operations, key export markets remain closed. While we can't control markets, we are focused on the things we can control. We made a series of strategic decisions to better position us for the future. For example, we converted two of our plants from bone-in to boneless, specifically to add new business and to continue growing with an important customer. We further rationalized assets, SKUs, and inventory.

In fact, we reduced our finished inventory pounds by nearly 20% during the quarter. We also made the difficult choice earlier this quarter to close two of our less productive chicken plants. These strategic actions are expected to generate significant efficiencies, going forward, although some of them generate incremental cost in our current results. Despite challenging market conditions, we continue to execute our strategy and have significant opportunities in front of us.

We increased our internal production, gaining 130 basis points of harvest share compared to last year. This led to pound share gains of 250 basis points in value-added retail and 60 basis points in food service. As you can see, we are well positioned to keep growing. We continue to invest in automation and digital capabilities, with opportunities to improve our yield. We now have 50 debone lines that are fully automated. We have room to optimize our cost structure and a portion of the actions we took last month are focused on this.

Importantly, we are working more closely than ever with our customers to create value jointly. We're building long-term supply partnerships that have clear benefits for both sides. We improved order fill rates by more than 20%. This was no accident, and I'm proud of our team for accomplishing this. We're winning in the marketplace by winning with our customers.

Now I've given you specific details on the business, I want to step back and remind you of our overall strategy. Our approach to building and growing chicken is based on three, key elements - first, we strive to be the best-in-class operator by executing with excellence. This includes filling our plants to continue increasing our capacity utilization.

Second, we plan to grow our value-added business focusing on fully cooked in retail and food service channels and by innovating and differentiating our offerings. And third, we expect to win with consumers behind the #1 brand in chicken, and win with our customers by being their go-to supplier. I want to underscore that we are focused on improving our results in chicken. We can do that by implementing our strategy leading to continued growth and improved margins. And I'm confident that we have the right leadership team in place to get us there.

Now turning to the continued strong performance of our retail branded business. With our iconic retail brands, Tyson, Jimmy Dean, Hillshire Farm, and Ball Park, Tyson core business lines continue to outpace total food and beverage and our peers in both sales dollars and volume growth, up 13% and 7%, respectively, compared to a year ago, per Nielsen. Our brands continue to perform well, as Tyson core business lines grew pound share by 2.4 points, relative to prior year quarter.

We continue to show market share leadership in most of the retail categories in which we compete, delivering both dollar and pound share growth in the aggregate by more than two points and also across all dayparts. As proven by our growth compared to last year, we know that consumers will spend on categories and brands they know and trust. The trajectory of our Tyson core business lines volume share growth shows the momentum we have gained with consumers.

We remain focused on maintaining our improved fill rates and on-shelf availability, while investing in merchandising and advertising to support our brands, which, along with our strong business fundamentals, resulted in pound share growth increasing sequentially over the past four quarters. Tyson, Jimmy Dean, Hillshire Farm and Ball Park, all hold favorite brand status with consumers by a large margin over our nearest competitor. It is evident that we're delivering the brands and products that consumers desire.

As I mentioned earlier, our move into the Kantar top 10 demonstrates that we continue to gain the confidence of our customers. Winning with customers and consumers is a key priority, and it's clear we're having success with both. Now let me tell you why I'm so optimistic about our future. Tyson is an iconic company, with a broad portfolio of products and powerful brands that has been a recognized leader in protein for nearly 90 years.

We've been through market cycles before. I've been through them before myself, and we've always come out stronger on the other side. We have the right strategy, seasoned leadership, and team members in place to do it once again. Our vision is to deliver sustainable, top line growth and margin improvement.

Our strategy to drive growth is built on the foundation of three key pillars -- first, we will drive growth in our core protein platform, where we harvest and process fresh meat across a diverse portfolio. We expect global demand for protein to continue to grow in the years ahead, driven by population growth and per capita income expansion. Tyson is well positioned with the capacity in place to meet demand.

Second, we will drive growth through our branded food portfolio. We have over 30 prepared food and snacking brands, including some of the strongest brands in all of food, namely Tyson, Jimmy Dean and Hillshire Farm. Branded food is our best opportunity to drive faster growth, higher margins and stronger results. Third, we will expand internationally, where it makes sense. Most of the growth in protein consumption is expected to take place outside the U.S.

We can capture this significant opportunity by scaling our existing business, expanding our customer base, and exploring new markets. These pillars are enabled by our relentless focus on customers and consumers, operational excellence, and digital capabilities to drive margin improvement. We win with customers and consumers by building growth partnerships, delivering top-tier customer service and fill rates, and product innovation. We expect to realize our operational excellence goals as we modernize our operations, driving efficiencies, saving on costs, and increasing throughput.

And we continue to build our digital capabilities, operating at scale with digitally enabled standard operating procedures and utilizing data, automation, and AI tech for decision-making. With the combination of our growth strategies and focus on margin improvement, we can deliver the food that consumers love, and create long-term value for our customers, for our team members, and for our shareholders.

We've put a strong proven leadership team in place here at Tyson. I've never been more confident in the talent that we have, and I know that we have the right people to capture the opportunities in front of us. Now I'll turn things over to John to discuss our financial results for the quarter in more detail.

John Tyson

Thank you, Donnie. First, for a quick touch on our total company financial performance and then a review of the individual segments. Total company revenue was up slightly compared to last year's previous record Q2 performance, as the benefit from significant volume growth in chicken were offset by the reduction in price per pound in beef and in pork. For the total company, and individually in chicken and prepared foods, we continue to deliver record high sales performance, now for a fifth consecutive quarter. We remain focused on driving growth in these businesses to enhance our margin profile over time.

Now turning to profitability -- more than 90% of the decline in adjusted operating income was driven by lower earnings in beef and chicken. Higher input costs per pound in all segments, except pork, increased our cost of goods sold. The majority was driven by inflationary impacts on raw material and labor costs. The remainder of the increase was due to a few things -- inventory value adjustments, unfavorable derivative impacts, and a shift producing more value-added mix. And this was partially offset by savings from our productivity program, reduced outside meat purchases in chicken, and decreased supply chain costs.

Our pricing decreased, led by lower cutout values in beef and pork. This was partially offset by volume growth in chicken. Now let me go to the individual segment results, starting with beef. Sales in our beef segment decreased 8.3%, compared to a record high sales in the second quarter of last year. Price was down 5.4%, due to reduced domestic demand and softer export markets, and volume was down 2.9%, due to fewer head processed.

Live cattle costs increased approximately \$305 million on a like-for-like volume in the quarter, as the reduction in the beef cattle herd continues to tighten supply and increase competition for cattle. The margin compression resulting from reduced sales and increased cattle costs led to a segment operating income of \$8 million and an operating margin of 0.2%, down from the historically high second quarter margin of 12.7% last year.

Looking next at the pork segment -- the volume gain of 1.1%, driven by improved hog availability, was more than offset by the 10.3% decline in average sales price, due to the soft global demand environment, leading to a decrease in overall sales of 9.2% versus the second quarter last year. The pork segment posted an operating loss of \$31 million for the quarter, which was driven by the industry headwinds compressing pork packing margins and inflationary pressures on operating costs.

Moving on to the chicken segment results -- the sales increase in chicken of 8.4% over the prior year quarter was driven by a 6.4% uptick in volume, due to increased internal production. Benefits of prior period pricing actions drove 2% growth in sales, despite a challenging commodity market. At a loss of \$166 million, second quarter operating income was impacted adversely by market conditions and near-term impacts of strategic decisions we made that Donnie discussed earlier.

Other headwinds experienced in the quarter included continuing export impacts from HPAI, as well as higher feed ingredient cost of \$145 million, and an unfavorable year-over-year derivative impact of approximately \$135 million, including a \$35 million loss in this current quarter and \$100 million gain in Q2 of last year. The industry operational headwinds do not change our approach, though. We expect to perform as the industry best-in-class operator while growing our internal production with our customer demand, enabling us to improve our fixed cost leverage, grow volume, and gain market share.

In addition to the continuous improvement of our operations, growing the market share of our portfolio of value-added products is imperative to maximizing our profitability and our long-term strategy. Now lastly, to prepared foods, where our retail brands like Jimmy Dean, Hillshire Farm and State Fair continue to deliver industry-leading performance, outpacing all peers in both revenue and volume growth in the quarter.

Total sales revenue grew 1.2%, primarily driven by pricing gains. The slight volume decline of 0.4% was driven by softness in food service volumes, as the trajectory of this channel's recovery remains uneven. This was almost all offset, though, by the strong performance of our retail brands, driven by their category-leading position, improved supply, and our MAP investments.

Compared to the prior year period, segment operating income decreased modestly due to increased raw material costs and brand building investments. This was partially offset by productivity gains and price increases. While down slightly against the historically strong comp, we are pleased with the operating margin performance of 10.4% in this challenging macro environment. We continue to be excited for the future in prepared foods, as the segment is critical to valuing up beef, pork and chicken commodity meat products and delivering strong earnings at a time when the commodity protein segment's profitability is under pressure.

We will continue to unlock value by increasing plant utilization, implementing productivity initiatives, and we will grow through innovation of new offerings, expansion of our existing product portfolio, and the recovery of our food service business. Now to our financial position and capital priorities, we're building financial strength, investing in our business and returning cash to shareholders remain the priorities of our capital allocation strategy.

First, let me spend a minute talking about our financial policy and long-term capital allocation, and provide a bit more color around our approach to CapEx deployment. Our financial policy remains unchanged. We are committed to building financial strength, maintaining our investment-grade credit rating, and targeting net leverage of at or below two times net debt to EBITDA for the long term. Our capital allocation prioritizes investing in our business through CapEx, as well as strategic and disciplined M&A, while also returning cash to shareholders through dividends and share repurchases.

As owner operators, our approach to CapEx is simple and effective. We support our maintenance CapEx needs and then we focus on growth and profit optimization, investing in opportunities that generate the greatest returns while maintaining a strong balance sheet. We don't expect our total CapEx this year to exceed \$2.3 billion, which is down from our prior guidance of at or around \$2.5 billion.

Now moving on from CapEx, during Q2, we returned \$167 million to shareholders through dividends and \$19 million in share repurchases. We have increased our dividend for 11 consecutive years and remain committed to supporting our dividend. We ended the quarter with \$2.2 billion of liquidity and net leverage of 2.4 times. Last week, we entered into a new term loan agreement for \$1.75 billion, to further enhance our liquidity.

These funds will be used to pay off our existing commercial paper that's outstanding, and some upcoming bond maturities and also to fund our investments in the business, including the pending acquisition of Williams Sausage, which will support our strategic focus on branded, retail growth. We remain committed to maintaining a disciplined yet opportunistic capital allocation strategy, ensuring that we deploy resources to maximize long-term shareholder value.

Now let's review our updated outlook for fiscal 2023. Based on performance, year-to-date, and a moderating outlook for revenue growth, we are lowering our total company sales guidance to \$53 (billion) to \$54 billion, or flat to 1% growth for the year. In our beef segment, based on the deterioration in current market dynamics, we now expect margins to be between a loss of 1% and a gain of 1% for the fiscal year. Also, due to challenging market dynamics, this time in our pork segment, we are lowering margin guidance for the year to be between a loss of 2% and breakeven.

In chicken, we now expect full year margins to be between a loss of 1% and a gain of 1%. Based on our results so far in April, we anticipate Q3 margins to be roughly breakeven, as we gain

momentum and exit the fourth quarter at or above the high end of the full year range. In the second quarter, prepared foods continued its strong performance, resulting in a first half margin above the guided range for the fiscal year. So we are maintaining that at 8% to 10%, driven by historical seasonality and continued brand support.

And in our international business, we remain committed to expanding globally in the fastest-growing protein consumption markets in the world. Driven by continued year-over-year volume and revenue growth from new facilities ramping up, we are confident of our improved profitability in fiscal 2023, with stronger quarterly performance in the back half of the year, compared to Q2. As I mentioned earlier, we're reducing our expectations for CapEx to approximately \$2.3 billion. And our net interest expense and tax rate are now expected to be around \$340 million and 22%, respectively.

In summary, the first half was challenging and many of the headwinds experienced are likely to persist for the remainder of the fiscal year. Although the current operating environment has proven to be difficult, we view this as an opportunity to grow and improve our business operations, and we are optimistic on our long-term, value driver prospects. We have great leadership and operational teams, growing demand for our products, robust portfolio diversity, and the differentiated asset footprint needed to win in the marketplace, as we continue to grow our business and provide desirable returns for our shareholders.

So now, let me turn the call back over to Sean for Q&A instructions. Thanks, Sean.

QUESTION-AND-ANSWER SESSION

Sean Cornett

Thanks, John. Now we will move on to your questions. Please recall 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 instruction.

Operator

Ladies and gentlemen, we will now begin the question-and-answer session. To ask a question, you may press * and then 1 on your touch tone telephones. If you are using a speaker phone, we do ask that you please pick up your handsets before pressing the keys. To withdraw your questions, you may press * and then 2. We do ask that you please limit yourselves to one question and one follow-up. If you do have further questions, you may re-enter the question queue.

And this time, we will pause momentarily to assemble the roster.

And our first question today comes from Ben Bienvenu from Stephens Inc. Please go ahead with your question.

Ben Bienvenue

Hey, thanks. Good morning.

Donnie King

Good morning.

Ben Bienvenue

So my first question is a two-part question on the chicken segment. So first part of the question, in the quarter, results, obviously, were weak and considerably weaker than we saw, I think, in the

broader market. Could you talk to a few of the things that might have contributed to company-specific weakness in the segment?

And then as you look, going forward, you talked about -- John Randall -- margins being flat in 3Q, or breakeven and then ramping into 4Q. What all is incorporated into that assumption? Is it what we've seen already in terms of improvement in quality fundamentals? Do you need to take further actions around closing underperforming facilities or reducing inventory? And maybe just help us understand what's embedded in that expectation, going forward.

Donnie King

Okay, Ben, this is Donnie. I'll start off. And then, for the chicken portion of this, I'll flip it over to Wes and let him add some detail to this. But, I would say this quarter was not a surprise to us. We knew Q2 was going to be challenging, and it was. I've talked about the fact that I've never seen this highly unusual situation, where beef, pork, and chicken were all experiencing challenges at the same time.

Many of these are macro in nature. But in chicken specifically, we have seen operational improvements and market recovery. While slower than expected, it will recover and, of all of our businesses that are challenged right now, chicken will recover first. In the quarter, of our \$166 million loss, \$90 million of that came from three, main areas. There was about 1/3 of it in market-to-market, inventory adjustment, SKU rationalization accounted for about 1/3 of it, and start-up costs associated with the mix change and improvement, from bone-in to boneless, plus a few asset impairments.

So I would then go on to say, chicken remains a top priority for me. We have the #1 brand in chicken. Our model doesn't give us the highs and lows of the commodity markets. That doesn't mean that we're not impacted by that. And variable pricing model that we have in place, there are lags that go with that. About two years ago, I laid out for you the plan that we had with our chicken business, and we're following it. We're growing our volume and improving our mix.

We sold what we harvested and we reduced inventory by 20%. And I would tell you that we are relentless on operational execution. We continue to invest in automation and digital capabilities, and we will and do compete with the very best in the industry. We're winning in every area in which we play. We have market leadership in every category. Customers and consumers are key priorities for us, and it's clear we're having success with them.

We've just recently announced that we moved up into the top 10 for Kantar, for the first time ever, for the most recent power rankings. We expect to win with consumers behind the #1 brand in chicken, and win with our customers by being their go-to supplier. And I have confidence in the team that we have in our chicken business. We have the right strategy and are doing the right things for growth.

We continue to implement this strategy and focus on the things that we can control, and we'll build on this strong foundation that we have in place. Now with that, let me stop, Ben, and let me flip this to Wes Morris, who leads that chicken business and that team, and let him add some additional color.

Wes Morris

Good morning, Ben, thanks for the question. No question, Q2 was tough for us, and for the industry as a whole. The combination of grains and markets, some of the key parts being down as much as 50%, and then the ongoing export opportunities. Simply said, versus a year ago, grain

up 11%, price up two, and then \$135 million change in derivatives. We did something nobody else, though, in the industry has done, growing net sales, 8.4%, volume, 6.4% and improving our capacity 4%.

Based on published data, we competed, actually better than the average company in the industry, and we kept investing at the same time. Donnie referenced the \$90 million. I'd ask you to think of 2/3 of that as investments in our business going forward. The SKU rationalization and inventory adjustments, along with the packaging and ingredients makes us both more efficient and more consumer-centric at the same time.

So let me talk about four, key areas that my team is focused on, and give you some insight into what we got done in the quarter -- the four, key areas of people, service, growth, and performance. Our plants were staffed for the entire quarter. Our teams delivered the volume we needed to win with customers and consumers. And we sold everything we processed, plus another 100 million pounds. So demand for our products were good in Q2.

Our service levels increased 20 points, year-over-year. We're back to historical levels of service. We executed very well at the holidays of Super Bowl and March Madness, gaining share in both food service and retail. We continue to invest in Danville, fully-cooked location, which will come on this fall. We're now filling over 99% of what we call our core eight retail products. And so winning with consumers and customers at the same time.

Donnie referenced the two plants we converted in the quarter, from bone-in to boneless. And then we announced the closure of two facilities, which will improve our efficiency, while increasing our volume. And we've seen operational improvements every week in the last quarter, and in April. So we're well positioned to win with customers, consumers, and drive out cost at the same time, going forward.

John Tyson

And, Ben, I want to just pick up on a couple of specific parts of your question there. I think, first off, you were asking, are there further actions that we're contemplating, and just to address that directly. We're always looking at the footprint, but everything that we're doing is focused on growing our business today. And I would note that with the two announcements we made earlier in the quarter, we're still growing the business.

You mentioned inventory, too. Part of working through, some of the changing market conditions does mean continuing to pull down inventory. And so that will influence the outlook. But you noted correctly from the earlier remarks on moving to breakeven and improving through the back half of the year is what we expect to see in poultry.

Ben Bienvenu

Okay. Thanks to all. That's helpful color. Maybe shifting gears a little bit, to the prepared food segment -- that's been a bright spot, certainly, for the first half of the fiscal year. The guidance for the balance of the year implies some margin moderation. I know you guys are focused on picking up some food service business that you lost, and I think carries some lower margins.

Is that key to what's embedded in the operating margin guidance for the balance of the year? And what are the potential sources, upside or downside, to that expectation?

Stewart Glendinning

Got it. Let me pick up on that. We're pleased with the overall performance in the first half of the year. And I can see that we're making progress with both of our brands and our operations to improve margins. You're seeing that in the results. You're also, by the way, you're seeing it in absolute dollars, because I think if you looked at the first half this year versus last year, we're up about 10%. So all of that is good news.

When you're looking forward, the shape of our year, on a quarterly basis, will look similar to last year in the sense that we expect a stronger first half than the second half. And this is because of 2 things -- first, because of normal seasonality in the business; and second, because we expect to have some higher brand investments behind our retail brands in the back half.

That's important. Those brands are doing well. They have strong engagement with customers. And I want to make sure that we have continued investment to reinforce that. There is more work to do in food service. And in that space, the customer decision and contract cycles are longer. So it takes a little bit to win back that business. But we have a strong platform. We have good products, and I'm confident we're going to start to see the benefits of that improvement in the future.

Ben Bienvenu

Okay. Thanks so much. Best of luck.

Donnie King

Thank you, Ben.

Operator

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

Adam Samuelson

Yes, thank you. Good morning, everyone.

Donnie King

Good morning.

Adam Samuelson

Good morning. Maybe my first question, just in beef, and taking the revised outlook, and it would seem to imply the business is operating breakeven or a loss for the next couple of quarters; and I just want to make sure I'm thinking about that properly, in the context of industry packer margins, which, while certainly off their highs, are not negative.

And just how do we then think about the implications of that into fiscal '24 and '25, candidly, and is cattle availability is just going to get worse, progressively, over the next couple of years, given what we know about the cattle herd right now.

Donnie King

Okay, Adam. I'll start off. And then I will pass it to Brady for some greater detail around that. But as expected in beef, there was tightness in cattle supply. We saw increased live cost and a softer export market. Probably the thing that is most interesting there, and unfortunately, I'm not going to be able to give you the answer to this, but it's around cow and heifer retention. We do have better pasture growing conditions.

If you look at central Texas up to Nebraska, there still needs to be some more moisture. We saw cow harvest towards the end of the quarter began to decline -- some indication of the closure of the liquidation cycle. If you look at heifer feed numbers, we're not in a rebuild phase, just yet. More retention is needed on the heifers before we're ready to signal that the rebuild has begun.

So with that, Brady, you add some additional color, if you would?

Brady Stewart

Thanks, Donnie, and thanks, Adam, for the question. I think there's a few specific call outs, relative to standard industry gross margin calculations that we need to take into account during this specific time frame, here in '23. And number one is, while we still see export demand being relatively strong, from a quarter-over-quarter perspective and versus prior periods, the opportunity for us to arbitrage our exports opportunities versus domestic, with some cutout runs that have occurred in specific products, has actually diminished our opportunity to capture some of those results, from a Tyson perspective.

Number two is, we've seen some pullback on drought credit values and again, versus the previous cattle cycle, we saw drought values are strong. However, from a quarter-over-quarter perspective, again, we saw some pullback, as well, that certainly impacts some of the calculations relative to gross margin. And number three, from a brand versus choice perspective, we've seen a pullback in USDA data indicates that the spread between branded and choice actually decreased \$4.03 hundredweight, quarter-over-quarter, from a sequential standpoint. So those are certainly some of the factors that are, in our mind, as we continue to look at the remainder of '23.

As we move into 2024 and beyond, in addition to the comments that Donnie made, relative to the cycle that we're in, there's reasons for both challenges, from an industry perspective, relative to gross margin. There's also reason for us to be optimistic. And number one, we'll absolutely be relentless, in terms of operational excellence. And really, it's about Tyson and our team controlling what we can control. The markets will do their job, over time, but we have a world-class beef business, and the expectation is we'll continue to perform at a very high level as we move through the cycle.

Number two is we have the opportunity to get closer to our customers and our consumers. We have capacity within our case-ready and value-added business. We've been working diligently to fill that capacity and feel very good and comfortable, in terms of the future of that business to get closer to the consumer, as well. So while there are challenges ahead, relative to the markets, I feel we're in a very good position to weather those challenges as we move forward.

Adam Samuelson

Okay. I appreciate that color. And maybe a follow-up for John Randal -- you guys don't give a specific EPS or EBITDA guidance, but if I kind of roll through the revised sales outlook and middle of the range on the different operating units, it would seem to imply that, by the end of the fiscal year, net debt to EBITDA could be at or above 4 times. Just want to get your perspective on, given your own earnings outlook, if that's actually correct and your comfort level of operating at that place for a period of time, particularly if beef isn't quickly reversing.

John Tyson

Yep. Thank you for that question. And let me talk about the outlook, and give a little more clarity on that. And then, let me talk about leverage. I'm glad you asked this question. So if you look at the return on sales guidance that we've given, on a segment-by-segment basis, it could take a few different shapes. So a point I want to make sure that our listeners take away today is that,

when we look at a total operating income number for the second half of the year, we expect that to be, in aggregate, similar to or maybe slightly down compared to the first half of the year.

So depending on the different movements within the various core proteins, that's the net of it. We want to make sure it lands, from an outlook perspective. And as you suggested, that does have implications for what our total leverage ratio, as we move into the back half of the year. And what I can say is, we're focused in the long run, on that two times number. And I think just pointing to what we've done in the last couple of years, we were diligent in paying off \$3 billion worth of debt. We've invested in the business, from a growth standpoint, we've got new operations coming online in the retail branded chicken, bacon, and a lot of growth outside the U.S., aligned with our strategy.

So I think, while the timing on some of the capital expenditures, for example, puts a pressure on the operating cash flows, I think we're comfortable with where we are and feel good about the outlook. I think that we know there's volatility in our business. Ratings agencies keep up with that. I can't speak for them this morning, but we're in constant communication, providing them outlooks about the business. So overall, we feel good, but yes, the leverage ratio will pick up for a little while.

Adam Samuelson

I appreciate that color. I'll pass it on.

Donnie King

Thanks, Adam.

Operator

Our next question comes from Andrew Strelzik from BMO. Please go ahead with your question.

Andrew Strelzik

Hey, good morning. Thanks for taking the questions. I wanted to start on the chicken side. And I'm curious, philosophically, how you're thinking about growth and, which is clearly the focus, on growing the volumes versus balancing that with the medium-term margin outlook. Have you changed at all, your expectations, on the back half chicken volumes that you would expect to realize, and just philosophically how you think about that? Thanks.

Wes Morris

Andrew, this is Wes. Thanks for the question. First and foremost, we got to stay focused on our business and our customer expectations. And so we will, in fact, improve our capacity utilization over time. I think it's important to understand that our supply plan is actually our demand plan -- that we start with the demand plan and work backwards. And as we see more demand for our products, we improve our capacity utilization. So thank you. Hopefully, that answers your question.

John Tyson

Yeah. If I can add to that, though, I think you asked specifically about how do we balance the profitability versus the growth. And what I want to point out is that, we've pulled down the total sales outlook for the business, but we're still projecting to grow, from a volume standpoint. So I think the chicken call, compared to a quarter ago is still up, but slightly less than what we had initially projected, just because of the demand that Wes referenced.

Andrew Strelzik

Got it. Okay. That's helpful. And if I could ask one also on productivity? Obviously, having achieved the targets well ahead of your original expectations, how are you thinking about the productivity opportunity from here? I know there's a continuous improvement mindset -- but any way to frame how you think about magnitudes of opportunity around productivity. Thanks.

Donnie King

Well, thanks for that question. It's still, as we've said, I mean, we are continually focused on being the absolute best, from an operations perspective. We want to be the best company, the best brand, the best protein, wherever we choose to play. And what we're doing, very simply, is executing those things through productivity, through efficiency to deliver that. Some of that requires adding volume, for example, in chicken.

Some of that requires improved yield and labor utilization. It includes, looking at the assets that you have and trying to make sure that we modernize those and invest in those and get the right footprint, not only today but going forward. We'll do all those things and -- or continue doing all those things. But the whole efficiency-productivity piece is top of mind for everyone in this organization today.

Andrew Strelzik

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

Donnie King

Thank you.

Operator

Our next question comes from Alexia Howard from Bernstein. Please go ahead with your question.

Alexia Howard

Good morning, everyone.

Donnie King

Good morning.

Alexia Howard

Sticking with chicken, can I ask about the price -- the market pricing dynamics? I know obviously, last quarter, there was a challenge, because there was an excess of fresh chicken flooding the market over the holiday period. I get the point that that sort of bled into this quarter, as well. Is there any visibility into how that might -- whether that might firm up in the second half of the fiscal year? Or where are we in that cycle? And then I have a follow-up.

Wes Morris

Yes. Sure. This is Wes. I'll answer that. We didn't see a lot of movement in January and February, and we started seeing a little more strength in March, which for us, will flow through the next quarter. We have seen some pullet numbers that would indicate a little stronger markets in the back half of the year.

Alexia Howard

Great. Thank you. And then on to the prepared foods, with the Kantar Power Ranking study, I'm just wondering what it was that's changed in your retailer relationships, because that is a big move. To get into the top ten, there's a lot of larger, more established, CPG-type companies that

are not in the top ten. I'm just wondering what you think has changed over the last couple of years to have got you there? Thank you, and I'll pass it on.

Donnie King

Thank you, Alexia. Well, first, I would tell you it was on purpose. We talked about, very simply -- and the mantra around here is winning with our team members, creating a differentiated place to work. Getting happy team members, having fully staffed operations was important. And then, winning with customers and consumers. We've invested a lot and continue to support customers and consumers with our brands, with innovation, with all those things.

We want to be the best, or be their go-to supplier in every part of our business. And then finally, and this is where the rubber meets the road, but winning with executional excellence throughout this organization. And what you're seeing in this survey is a result of the work that this team has done.

Alexia Howard

Thank you, and I'll pass it on.

Donnie King

Thank you.

Operator

Our next question comes from Ken Goldman from J.P. Morgan. Please go ahead with your question.

Ken Goldman

Hey, thank you. I do appreciate, Donnie, your comments about the macro. Certainly, there's a lot of challenges that everyone is facing. I wanted to ask, it looks to me like, at least for this one quarter, the performance gap, as measured by margin, did widen a little bit between the industry and Tyson in both beef packing and in chicken. I'm just looking at some of your bigger competitors in chicken, and I'm just looking at HedgersEdge and our own model for beef margins. So I know those aren't perfect comparisons.

But I'm just trying to get a sense of, A, is that how you guys see it, as well, or are my assumptions there wrong? And B, how quickly, if they are right, can we reverse that and you can get back to growing in line or having the margin in line with those major segments?

Donnie King

So Ken, I'll start off and then I will flip that, to give a little more color, from Wes around Chicken, and Brady on beef. But I did talk about the macro a lot. And I got to tell you, it pains me to talk about that, because that -- we've never been able to control macro or economic issues or market conditions. But what I can tell you is, we are controlling what we can. And we have a full-court press on being the best that we can be in operational excellence and winning with customers and consumers.

But the other thing I would tell you, Ken, is that here at Tyson, and as you know, I've been through a number of these cycles before, this company has been, in its 90-year history, has been through a number of them before. But what we have done in the past, and we're doing this time, is we're accelerating in the bottom of this cycle, and we always come out better and stronger. And I see no reason to believe that we won't do that this time, as well. And let me flip it to Wes to add some chicken color.

Wes Morris

Yeah, good morning, Ken. I think take into consideration the timing of how our pricing flows through is different than others. We have a further lag. Number two, the \$135 million, year-over-year derivative change, and then the \$60 million of the \$90 million Donnie talked about in efficiency investment, I believe we competed better than the average in the industry.

Ken Goldman

All right. Thank you for that. If I could ask another quick question. The Williams Sausage acquisition -- I think we got a price today in the 10-Q of \$200 (million) to \$250 million. Could you give us a little bit of detail on what the expected revenues are, or the last 12-month revenues? And why now is the right time to do a deal, given some of the challenges you have in the balance sheet?

John Tyson

Yes. This is John. Let me say a couple of things on that. First off, let me just make a shout out and thanks to the Williams family, who we've got this transaction with, and we're grateful to them for entrusting 60-plus years of a family business to be part of the Tyson family.

As it relates to the contours of the transaction, let me answer the question why now. We're always being diligent and thoughtful about the M&A opportunities that we're pursuing. And I think this was a transaction that we got across the finish line, based on the characteristics of the branded portfolio and the return profile. So when we close that in the coming months, we're excited to bring that into the Tyson Prepared Foods business.

Stewart Glendinning

Yeah. Ken, let me just add a little bit here. This is Stewart. Look, this is a company with some great brands and some really great facilities. And two things are going to come out of this. First, there are capabilities we're going to have, because right now, most of our sow harvest goes through a single facility. This is going to provide some redundancy that makes sense for our business, particularly because Jimmy Dean is so important to the portfolio.

And then second, when you look at the brands that are going to be complementary to our brands, along with a DSD network that, frankly, we haven't had in our portfolio before, I think we're setting up for a very interesting deal here that is going to be a good addition to Tyson.

Operator

And our next question comes from Peter Galbo from Bank of America. Please go ahead with your question.

Peter Galbo

Hey, good morning, everyone. Thanks for taking the questions.

Donnie King

Good morning.

Peter Galbo

Maybe we can just start going back off of Ken's question, particularly around beef. First, I think there's probably been some noise out there in the market that just shifts are being cut across the entire beef network and some of that maybe is due to the lower harvest levels. But if you can kind of comment there.

And then secondly, Brady, I'd just be curious for your perspective, with cattle prices basically at all-time highs, in speaking to cow-calf operators, like what are the unit economics looking for them like, in real time? How does that change their decision-making process around retention or not? Because again, looking at the spreadsheet math, you'd think the price would be enough of an incentive, but obviously, a lot of their cost structure has probably changed, as well. So I would appreciate any color there.

Brady Stewart

Well, thanks for the question, Peter. First of all, let me address both the question that Ken posed and you posed, as well, around beef. And I think there's a few important aspects of Q2 that we need to focus on. So first is relative to timing. Tyson has quarterly pricing that we use for several of our large customers. And so in very specific primal areas where we've seen some inflation, from a cutout perspective, in those primals, quarter-over-quarter, we have a timing lag, relative to those specific customers and agreements.

Second is, we did see some hedging losses in the quarter that impacted performance. Third, would be our volume. And so as you mentioned, we did see a decrease, relative to volume. And so when we lost some volume leverage, relative to our cost structure and our assets. We're working diligently, from an efficiency perspective, and seen some good improvements in that area, as well, to help offset that as we move forward.

As I mentioned earlier, export demand has been softened. The strength of the U.S. dollar and FX has had an impact on some export demand, and specifically the substitution products that we see from a domestic portfolio, we're not seeing those large gains as we did in previous quarters. That relative to drop value all go into play, in terms of what our actual results are versus some of the index modeling that occurs as well.

And relative to the cow-calf operator and how they look at the business, obviously, a lot has changed since the last cycle. Interest rates are up right now. There is some incentive for the cow-calf operator to go ahead and market the heifer into feed yards, as opposed to retain, just relative to the strength we're seeing from feeder market, as well. So we're still seeing some drought conditions from central Texas up through Central Nebraska, that's creating some challenges. But the good news is, for the cow-calf operators that are working outside of that space, we've seen some remedy, relative to drought conditions and moisture here within the last several months that provides some optimism as well.

Peter Galbo

Great. That's very helpful. And Donnie, I just wanted to go back to one of your comments. I think you did mention, I think, around chicken, that you took some asset impairments in the quarter. I'm not sure that I saw those in the Q. But just maybe thinking on a longer-term basis. Look, chicken has been a business where you've been quite acquisitive. I think the margin profile, self admittedly, has probably been a little bit weaker than you would have thought.

Just as we sit here today and go through the balance of the year, like how do we think about further impairment risk in that business, particularly as the margin improvement, even coming out of this year isn't expected to be at your long-term average?

Donnie King

Thanks for that question. I'll touch on this at a high level. But in terms of your question, for the past few years, we've taken bold and aggressive steps to advance productivity and efficiency.

We're constantly evaluating how we can be more efficient, push down decision-making, and remove duplication of work. Those are all top of mind today.

But we also have done a number of things looking at our footprint, looking for what it would take to make our less efficient assets -- and this would be across the portfolio -- how do we either make them efficient, how do we automate them, how do we redesign them or, in some cases, you could look at how would you sell it or how would you close it? And we look at all those different options.

But I want to remind you that our strategy is all about growth -- growth in our base or core protein businesses, growth in our branded portfolio, and growth internationally, where it makes sense. So making sure that you understand, clearly, that we are in a growth mode and at the same time, trying to right-size our footprint in our production machines to deliver those products that customers and consumers love.

Operator

And our next question comes from Ben Theurer from Barclays. Please go ahead with your question.

Ben Theurer

Yeah, good morning, everyone. And thanks for taking my question. Just wanted to come back to chicken, and actually some of the, like, historic context and ask about your performance, particularly as it relates to hatch rates and hatchability. Because it was interesting -- in the past, it seems like the performance itself was impacted by the very specific issues you were facing.

We saw the industry relatively soft, I would say, in the last couple of weeks, but it feels like that your performance, at least from a volume perspective, has done better. So any comment you can share, as to your own initiatives and improving that supply, and then ultimately less need to buy outside. How do you feel about this? How was it in the last quarter? And how do you feel about it, going forward? That would be my first question. I have a quick follow-up, as well.

Donnie King

Okay. I will start off, and then I'll flip it for Wes for even greater level of detail. But I would remind you that, a couple of years ago, I outlined a road map for us to, what I would call, restore our chicken business to its rightful position. Those were almost my exact words. And we're still on that road map. We've had bumps along the way, in live production, in the life cycle of the animals that -- we had some issues with some of the breeding stock, particularly the males, and that's been well chronicled, everywhere.

We had issues with hatch, and we're very competitive, as it relates to that today. We've made lots of improvement. We were buying, if you recall, a significant amount of product on the outside and paying a premium in the height of the market. And we began to reduce our dependence on outside meat, and wanted to utilize the assets that we have in place and get the fixed cost leverage by producing those live animals, and then converting those into those products that our customers and consumers love. And we've done all those things, and we're still on this journey.

And I would tell you that we got the right people in place to complete that mission, not that you ever implied, but to continue down the road, a great leadership, a great team in place now to do that. And I'm excited. I'm optimistic about the future of our chicken business and where it's going, and even in this quarter, losing \$166 million, I'm still excited about the future of the #1 brand in chicken and the opportunity that we still have before us. Wes?

Wes Morris

Yes. Thanks for the question, Ben. The whole industry is not seeing the kind of hatch rates we saw four or five years ago. Ours, in particular, is down a few points from Q1, but not near the volatility that we're seeing in the industry, as a whole. And so we have a more stable, predictable supply chain, to include our hatch rate, that makes it easier to manage, going forward. As for outside buy, we'll continue to buy and grow, as we have fluctuations in our demand, but much more imbalanced than in years past.

Ben Theurer

Perfect. Thank you, very much. And then, just a second question, just around capital allocation. Obviously, you've reduced the CapEx a little bit, but in the same time, because of the loan, you got a little higher interest. You did some share repurchases throughout the quarter. How should we think about for the balance of the year, also in light of what Adam pointed out as leverage, could go somewhere north of four times.

How should we think about share purchases, dividends, further CapEx and ultimately, M&A, which is also something that popped up during the quarter? So just to understand the priorities here. Thank you.

John Tyson

Yes. Sure thing, and thanks for the question. Let me just talk about the priorities, and then talk about where we are in the year and what the outlook is. So first and foremost, we're always looking to invest in our business. And I think it's important to recognize that the CapEx deployment wave that we're in right now is higher than our historical average. Over the long run, something more like \$1.5 billion is what we would target on an annual, CapEx number. So I think that as we go into the coming years, we'll trend in that direction.

And then we look at strategic M&A, where we can. We've been pretty, I think, thoughtful in that approach. We're really pleased about the Williams deal, and see that as a valuable part of investing in our business. And then, on the returning cash to shareholders, we remain committed to the dividend and share repurchases. I think we'll continue to be conservative and look at something that's in line with historical norms. Obviously, there are a lot of different variables that go into that, on a quarterly or annual basis as we make those choices.

But, yes, I think just where we are with the profitability outlook in the business, the CapEx cycle and the borrowing, we're conscious of and aware that our leverage ratio will tick up. But again, we're making choices and decisions around investments, for the long term of this business. So we're comfortable, although, we don't like the tick up, we're comfortable with these cycles where leverage ratios may be a little bit elevated compared to our longer-term target.

Ben Theurer

Thank you. Thanks for that, John.

Operator

And our next question comes from Michael Lavery from Piper Sandler. Please go ahead with your question.

Michael Lavery

Thank you. Good morning.

Donnie King

Good morning.

Michael Lavery

I just wanted to come back to the idea of growth versus profitability and just how to think about balancing that, not just for one segment, but broadly. And just with so many of the headwinds you're pointing to, broad -- in the macro environment and without really much change ahead, in terms of it sounding like it's going to get better very soon, does that impact how you think about maybe different priorities to improve profitability?

Or just to make sure the margins come through better, as much as you have some things you can control? Or what's the right way to think about some of that, in terms of any investment trade-offs or ways to maybe improve the execution a little bit?

Donnie King

Yes. Thanks for that question. And first thing I would tell you is that, just to acknowledge the macro environment and what it's been and the fact that the magnitude and the duration of the challenges, they do continue. However, if you think about this company in particular, we've had a 90-year history of successfully managing macroeconomic cycles, and we've always come out stronger.

We have never been able to control those cycles. And what we can do is control what we can control. And there's a lot of opportunity there for us to be better. And we are, obviously, focused on that and across all businesses and functions. In terms of growth at any cost, that's not what we're talking about here. The growth that we have is in service to our customers and those consumers.

And I think, as Wes had mentioned this earlier, that we always start with the demand plan, and we work back to a supply plan, and so we wouldn't be growing chicken, beef or pork or beef -- prepared foods, for that matter, if we didn't have a demand plan that says that we have a consumer wanting this. And then the second part of that is we, obviously, had no intention of just growing for growth's sake, and we always balance growth with profitability, and I wouldn't expect this time to be any different than that.

But we see this as -- this cycle as something we've seen before, and we've always accelerated out of these type cycles in a growth pattern, accelerating out of the curve, if you will. And that's what we're doing this time, as well.

John Tyson

And I think if I can add on to what Donnie is saying, just to emphasize growth and the focus on high-quality growth. We've just completed a fifth, consecutive quarter of record sales growth. The same is true for the chicken segment and the prepared foods segment. And we're growing in the parts of those businesses that we see as attractive, from a margin standpoint.

And of course, in poultry, as we've talked about, part of that has to do a little bit with just you getting the capacity utilization footprint back right. And then it's also worth pointing out that we've got a business outside of the U.S. that is trending towards tripling in about five years. And so I think as we think about the long term, that becomes a profit engine for us, and we're excited about the investments we've made there as well.

Michael Lavery

Okay. Thanks so much.

Donnie King

Thank you.

Operator

And ladies and gentlemen, with that, we'll be ending today's question-and-answer session. I'd like to turn the floor back over to Donnie King for any closing remarks.

CONCLUSION**Donnie King**

Thank you. And as you've heard today, this is a challenging moment, but my optimism about the future has not changed. Our customers and consumers are behind us. We're winning with both. This is not an accident, but is a result of the hard work our team members do every day. And I thank them for it.

As we continue to build a world-class organization positioned to take advantage of the opportunities in front of us, we remain confident that our strategy will deliver long-term growth and shareholder value. Thanks for your interest in Tyson Foods, and we look forward to speaking soon.

Operator

Ladies and gentlemen, the conference has now concluded. We thank you for attending today's presentation. You may now disconnect your lines.