

# FINAL TRANSCRIPT

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## **TSN - Q2 2011 Tyson Foods Earnings Conference Call**

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## CORPORATE PARTICIPANTS

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**Donnie Smith**

*Tyson Foods, Inc. - President and CEO*

**Jim Lochner**

*Tyson Foods, Inc. - COO*

**Dennis Leatherby**

*Tyson Foods, Inc. - EVP and CFO*

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## PRESENTATION

### Operator

Good morning and thank you for standing by. At this time, all lines have been placed on a listen-only mode until we open for questions and answers. Also, today's conference is being recorded. (Operator Instructions). If anyone has any objections, please disconnect at this time.

I would now like to turn the call over to Ruth Ann Wisener. Ma'am, you may begin.

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### **Ruth Ann Wisener** - *Tyson Foods, Inc. - VP of IR, Assistant Secretary*

Good morning and thank you for joining us today for Tyson Foods conference call for the second quarter of our 2011 fiscal year.

I need to remind you that some of the things we will talk about today will include forward-looking statements. Those statements are placed based on our view of the world as we know it now, which could change. I encourage you to look at today's press release for a discussion of the risks that can affect our business.

On today's call is Donnie Smith, President and Chief Executive Officer; Jim Lochner, Chief Operating Officer; and Dennis Leatherby, Chief Financial Officer.

To ensure we get to as many of your questions as possible, please limit yourself to only one question and then get back in the queue for additional questions. I will now turn the call over to Donnie Smith.

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### **Donnie Smith** - *Tyson Foods, Inc. - President and CEO*

Thanks, Ruth Ann. Good morning, everyone, and thanks for joining us for our second-quarter call. In our press release this morning, you saw that we reported \$0.42 a share, which is the same as we reported in the second quarter last year. Sales were \$8 billion, which is a record, and over \$1 billion more than the second quarter of 2010. Our overall offering margin was 3.8%.

As expected, all segments, with the exception of chicken, were in or above their normalized ranges. Chicken was profitable, and we believe it will continue to be profitable in both the third and fourth quarters. Grain hedges were a factor in chicken's profitability, but not the only factor. We continue to work on operational efficiencies with played a big role. Jim will go into more detail about that and our efforts to increase revenue in chicken in a moment during his comments on our segment performance.

In terms of domestic demand, you usually see some falloff at the beginning of lent, but we didn't see that this year. And on the other hand, we typically get an uptick after Easter, but demand has been sluggish, probably due to the bad weather experienced in much of the country. The slow economic recovery is still a factor as well.

After fairly steady increases, consumer confidence dropped in March. Rising gas and food prices continue to reduce disposable income. According to Nielsen, consumers are likely to remain conservative and hold on to many of the behaviors they adopted in the early stages of the recession, including eating out less, value-conscious shopping, and increased use of coupons.

One difference we are seeing is that consumers are now making more frequent, smaller retail trips to help manage cash flow.

Retail beef and pork prices are very strong, and eventually, this should support chicken prices. Our chicken prices must increase to cover these unprecedented grain cost increases. We are seeing more feature activity in chicken this summer in both retail and food service, and chicken is still a more affordable option for people trying to feed their families in tough economic times.



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In our November call, we predicted food service sales would be flat to up 1% and volume might be up around 1%. Based on the industry data we study, we predict food service sales to increase slightly from our earlier projection in dollar sales, driven by menu price inflation, but volume growth to be flat.

The menu mix is shifting towards value, and some operators are compensating for higher prices with special deals. So in general, I was cautiously optimistic about our brighter outlook for the food service sector based on earlier unemployment figures, but as gas prices continue to rise, my optimism is waning, and I believe we can expect to see an impact on traffic in both QSR and casual dining.

Our international startups are making steady progress. In China and India, we continue to improve our live and processing operations. We're also getting the management teams in place that can drive long-term volume and earnings growth in both those countries. In Brazil, we're upgrading our product mix while focusing on yields and labor cost management. This mix upgrade will allow for more profitable exports as well as growth with major domestic retailers. Our long-standing Mexico business is driving value-added growth through new product innovation and a commitment to quality.

Switching gears a bit, I would like to say a few words about the devastating storms experienced in Alabama less than two weeks ago. Our hearts go out to the victims and they have been in my prayers. Tyson Foods was very fortunate considering the destruction in the area. Two of our plants in northern Alabama were not damaged, although both lost electricity for a while. Now while some of our growers lost a few houses and others experienced varying levels of damage, in total, we lost less than 200,000 birds, which is a small fraction of our company's average placements of around 40 million birds a week.

Now, looking forward to the rest of the fiscal year, there is concern about crop plantings and what that might do to grain prices. We are also concerned that if \$4 or even \$5 gas prices linger, it could have an impact on consumer spending. We're feeling increased pressure from these market dynamics. It will be challenging, but our business is in good shape, and we still think the 2011 EPS will be at or above \$2 or close to our GAAP number last year.

That concludes my opening remarks. I will now turn it over to Jim for a review of our segment results followed by Dennis with the financial report.

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**Jim Lochner** - *Tyson Foods, Inc. - COO*

Thanks, Donnie. Pork continued to perform extremely well with a 10.5% return on sales and operating income of \$146 million. Although down from the record set last quarter, it is a substantial improvement over a strong second quarter last year. Volume was up nearly 7% with average sales prices up 18% quarter over quarter. We do not anticipate a major change in the hog supply, and there should be adequate supplies in the regions our plants are located. Pork segment returns should be above the normalized range in the second half of the year, although we don't expect results at the level of the first half.

The beef segment produced 2.8% return on sales and an operating income of \$94 million. Although down from the previous quarter and Q2 last year, these are still very solid results and within the higher normalized range we set a year ago. Sales volume was down slightly while average price was up about 20% quarter over quarter.

We expect a slight decline in fed cattle compared to last year. However, we should have adequate supplies in the regions we operate our plants. Barring any major market disruptions, beef exports should remain strong the remainder of the fiscal year, contributing to lower domestic supplies and strong pricing. We have been anticipating some domestic demand destruction across the beef complex. However, this is potentially supportive of chicken pricing as more customers and consumers look for alternatives to higher-priced beef products.

As expected, the chicken segment struggled to overcome \$82 million in higher grain costs for the quarter, but managed to maintain profitability with a 1.4% return on sales and \$37 million in operating income. In the second quarter, we were successful

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in getting our inventories to near historic lows. Our increased sales reflect higher pricing and sales from inventory but do not indicate an increase in production pounds. Over the past two years, our poultry business units have done an excellent job of improving our operations and taking costs out of the system to be an efficient provider to our customers. However, the opportunities for cost savings are not enough to fully offset escalating feed costs. Current projections for increased corn and soy costs are approaching \$0.5 billion year over year. We have no choice but to pass along these costs to maintain profitability in the chicken segment.

Our prepared foods segment posted \$31 million in operating income and 4% return on sales, which is at the low end of the normalized range. As a reminder, prepared foods includes numerous businesses such as bacon, lunchmeat, tortillas, pizza crust, pizza toppings, soups and side items. Some of these businesses continued to perform extremely well while others have room for improvement, and we're working on those. All, however, are dealing with higher raw material costs which increased \$59 million for the quarter. Many of our sales contracts in prepared foods have shorter terms or are formula based and we were able to offset rising costs through pricing.

Tyson is facing challenging markets and rising inputs, but as I've said before, it's important to put this in context of global protein supply and demand fundamentals. US per capita protein supplies are forecasted by many to decline slightly in calendar 2011 versus 2010. This would be the fourth year in a row it has declined, which is unprecedented.

Export volumes continued to increase for a variety of reasons and imports continued to decline. There is demand for our products, a global economy willing to pay for them and supply is limited. This means our customers and consumers will continue to see increasing prices in general for protein products.

In closing, I would like to congratulate our business unit managers and their teams. They have taken on these challenging conditions and continued to rise to the occasion, focusing on the details, being our customers' go-to supplier and managing costs. We appreciate their effort and success.

And now we will go to Dennis for the financial report.

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**Dennis Leatherby** - *Tyson Foods, Inc. - EVP and CFO*

Thank you, Jim, and good morning, everyone. As Donnie said earlier, we reported Q2 earnings of \$0.42 per share, which is even with the same period one year ago. Return on invested capital for the last 12 months was a solid 24%, a measure we are proud of achieving and are striving to maintain consistently over time. Capital expenditures were \$161 million for the quarter. This amount reflects numerous capital projects that will continue to enhance production and labor efficiencies, improve yields and sales mix.

Our effective tax rate for Q2 was 34.9%.

As a result of rising input costs from grains, live cattle and hogs, our operating cash flow for Q2 was negative \$117 million. It's important to note, however, that we were able to reduce our inventory volumes to help mitigate these rising costs. In addition, we improved our days receivables to further offset rising working capital needs. Receivables and inventory were up nearly \$750 million compared to a year ago, and were up over \$500 million since fiscal year end. Including cash, net debt was \$1.7 billion, down \$466 million from a year ago, a remarkable accomplishment considering the cash flow used for working capital purposes just mentioned.

Total liquidity was \$1.6 billion, including availability under our credit facility and cash. Bond buybacks were just \$30 million because bond premiums were generally above our repurchase targets.



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From a debt ratings standpoint, we were pleased to receive upgrades from all three rating agencies - S&P, Moody's and Fitch. We also achieved our goal of returning to investment grade with S&P and Fitch and are now just one notch below investment grade with Moody's.

In addition, we amended and extended our credit facility during the quarter. Our new facility is not only lower cost, but also provides us with more operating flexibility. It also includes a collateral release provision that will take effect in August. For this, we are grateful for our banking partners' support in recognition of our improved financial performance over the past few years.

So here is an updated outlook for fiscal 2011. Revenues are expected to exceed \$32 billion, driven largely by rising raw material prices, an increase of more than \$3 billion from 2010. We expect fiscal 2011 net interest expense to be approximately \$230 million, down about \$100 million from fiscal 2010. This is also down \$15 million from our previous guidance. The refinancing of our revolving credit facility, along with recent ratings upgrades, has resulted in further savings.

Effective tax rate should be about 35%.

Our diluted shares for the second quarter were \$383 million. This reflects the dilutive effect of options and convertible bonds which fluctuate depending on our stock price performance.

We will continue to reinvest in our business, and we still expect CapEx to be around \$700 million. Our spending is focused on improving the efficiency and competitiveness of our domestic and foreign operations.

Depreciation and amortization will be approximately \$525 million.

We will use excess cash to repurchase notes when available at attractive rates. From the standpoint of debt maturities, we do not have any significant debt coming due until fiscal 2014. The balance on our 8.25% notes due October 2011 was \$314 million as of April 2. We plan to retire these notes on the last day of the fiscal year with cash on hand, which was nearly \$800 million at the end of Q2 or with future operating cash flows.

In closing, I would like to thank our team for continuing to demonstrate financial and operating discipline while dealing with volatile commodity markets, which have a big impact on our costs and working capital. Team, despite these headwinds, you were able to do what you said you would. That, in itself, is a great accomplishment.

Overall, we have a great financial position with solid debt ratios along with a strong balance sheet and capital structure. This will enable us to continue delivering results in a challenging environment. We believe our current earnings multiple does not reflect what we have accomplished and the obstacles we have overcome. As we continue to improve operations, consistently deliver strong returns on capital, and generate solid earnings in difficult times, we believe the market should more accurately reflect a valuation worthy of our performance.

That concludes our prepared remarks. Operator, we are ready to begin Q&A.

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions). Christina McGlone.

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**Christina McGlone** - Deutsche Bank - Analyst

Thank you. Good morning. Donnie, you had said on the last call that by the end of March, your inventory would be on plan and then you would start your normal production -- you would go back to your original production plan which calls for production increases. And I'm curious if that's still the case, or if that's been tempered at all by the fact that the seasonal uptick in demand has been less robust than normal.

**Donnie Smith** - Tyson Foods, Inc. - President and CEO

Christina, first of all, our inventory is at or actually slightly below what our target was at the time, so we feel very good about that position. And yes, our production plans are in place.

Let me -- hasten on to add, it's important for us that we keep the supply and demand balance in check, and so far so good with our plans, and we continue forward.

**Christina McGlone** - Deutsche Bank - Analyst

Thank you.

**Operator**

Heather Jones. Please state your company name.

**Heather Jones** - BB&T Capital Markets - Analyst

Good morning. BB&T Capital Markets.

A quick question, Jim, on the pork business, the cutout price is down about 10% over the last six weeks, and consequently, packer margins have compressed significantly. And I was just wondering if you could give us a sense of what you are seeing as a primary factor driving that quick of a decline, and what your outlook is with regards to the next couple of months for that.

**Jim Lochner** - Tyson Foods, Inc. - COO

Well, good morning. Yes, the cutout did drop over the last four weeks about 112%, predominantly driven by a correction in the belly price. And even though seasonally hogs do tighten during this timeframe, which they did, and hog costs did come up, our margins held in there very well. We were very pleased with that. And I did really expect to see kind of a correction in the prices as we have seen throughout coming through this timeframe, but in that pork cutout, it was predominantly the bellies, so.

**Heather Jones** - BB&T Capital Markets - Analyst

But was there a correction just in the market because they have gotten too hot or have you seen a decline in demand?

**Jim Lochner** - Tyson Foods, Inc. - COO

Both. The market had really overshot itself early into that 150 zone and then did correct back. So that was that.



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**Heather Jones** - *BB&T Capital Markets - Analyst*

Okay, thank you.

**Operator**

Ken Goldman, Please state your company name.

**Ken Goldman** - *JPMorgan - Analyst*

JPMorgan. Good morning.

I just had a question. You guys made a point there or an argument for an expanded multiple, which I understand, and I have heard some investors who are bullish on Tyson say, look, these guys have earned on a pro forma basis, \$220 million last year; they're going to earn call it \$205 million or so this year; maybe something similar next year. That consistency is something that's not often seen in the protein business. Is that the argument there that you would have or is there a different argument perhaps for the higher multiple as far as you are seeing it?

**Dennis Leatherby** - *Tyson Foods, Inc. - EVP and CFO*

Yes, definitely, Ken. This is Dennis. We believe that we're a different company now. We have basically stabilized our margins. We're on top of what we're doing. Best in class in all three of our major segments, and we are just continuing to improve and drive efficiencies. Our return on capital is high. It's up there in the 20's. We plan to keep it that way. We are trading at a discount to our peers, not only in protein, but in ag, a fairly significant discount. So all that being said, we scratch our heads and wonder why the multiple hasn't expanded. It's certainly something that the Street seems to be struggling with, and we keep saying that we're going to deliver and keep these earnings going.

**Ken Goldman** - *JPMorgan - Analyst*

So just a follow-up then, are you arguing for a peer multiple or a better than peer multiple in your mind?

**Jim Lochner** - *Tyson Foods, Inc. - COO*

Look at our results. Probably better.

**Donnie Smith** - *Tyson Foods, Inc. - President and CEO*

Let me add just a little bit here, Ken. First of all, we have a multi-protein model. We're in all three proteins plus our Prepared Foods model. We also go to market in multiple channels -- multinational, although our international businesses by and large are startups, that paints a picture I think for us in the future.

We've got a very diverse business model within each of the proteins, and those multiple business models all have a commodity and/or a value-added component. We -- no competitor has our product diversification. We've got unparalleled resources. Our team and our discovery center and those type things to create value for our customers through product innovation. We've had great cash flows in the last 24 months, and that's allowed us to dramatically strengthen our balance sheet. Dennis talked about our debt reduction, our liquidity, our capital structure, our return on invested capital. And it gives us the ability to invest in our future productive capability.



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We've done a great job of keeping our inventories in check. We've got a little out of hand in Q1 but we corrected that in Q2 like we said we would. And you know, we've got our team focused on the drivers of our business. We've done a great job in terms of our operational efficiencies and cost competitiveness. So, you know, you add all that up, I think that paints a picture of a completely different company than what we were two or three years ago.

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**Ken Goldman** - *JPMorgan - Analyst*

Thank you.

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**Operator**

Farha Aslam. Please state your company name.

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**Farha Aslam** - *Stephens Inc. - Analyst*

Good morning. Stephens, Inc. First of all, Dennis, just a clarification on mark to market. What caused it in the pork and beef segment in this quarter?

And then my real question is perhaps to Donnie and Jim. Coming out of Easter, you did see demand for proteins a little bit softer because of the high gas prices. And I was wondering how the beef and pork segments have reacted in terms of slaughter levels. Have there been any modifications to better match supply and demand?

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**Jim Lochner** - *Tyson Foods, Inc. - COO*

Let me try to answer your first question, but you said a decline in mark to market. Are you talking derivatives or what were you --

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**Farha Aslam** - *Stephens Inc. - Analyst*

Yes, the derivatives marked to market. I was just wondering what caused it and how does that reverse itself out?

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**Jim Lochner** - *Tyson Foods, Inc. - COO*

Well, first of all, at the end of the quarter, we still have very high prices. And with any short positions we add on to cover forward buys or any livestock positions that we have, we would have had a negative marked to market on those. And they, as the market has corrected lately, they would have been already in that process of correcting. So, on the derivatives, that's the primary purpose on those is forward-bought livestock to protect exactly what we saw as a correction. Okay? Hopefully that answers it. They were fairly clearly spelled out in the magnitude. It didn't surprise me looking at that. Back to your second question.

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**Dennis Leatherby** - *Tyson Foods, Inc. - EVP and CFO*

Farha, could you repeat that again?

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**Donnie Smith** - *Tyson Foods, Inc. - President and CEO*

The question -- let me make sure I get this right. The question was softness out of Easter and did livestock slaughter correct or --?

**Farha Aslam** - *Stephens Inc. - Analyst*

Exactly. Did you see a softness in demand coming out of Easter, and therefore, did pork and beef processors moderate slaughter levels to accommodate that?

**Donnie Smith** - *Tyson Foods, Inc. - President and CEO*

It was a bit soft coming out of Easter, but let me hasten on to add, if you go back into last quarter and what we've said this quarter, we've not ever painted a very rosy picture of demand for the year, especially as it relates to our performance. So with high gas prices, and frankly, I got a little bit encouraged by the drop in unemployment; of course it popped back up to 9%. And if you look at that environment, I don't think you should paint a very rosy picture about demand going forward. So I had a couple of soft weeks; probably weather had a lot to do with that -- rains going through, cool, wet spring. We've dealt with that in the last 30 days particularly. I'm going to let Jim cover the slaughter response to that on beef and pork.

**Jim Lochner** - *Tyson Foods, Inc. - COO*

Yes, we did see a reduction in wholesale prices and they came through lent very, very strong. If anything, I felt that they were extremely strong and probably overdone, and I've already covered the major correction in pork, which bellies are our primary driver on that.

But beef, what we saw is the cutout -- the blended cutout dropped very substantially in that four- or five-week period; in fact, dropped almost 11.44% on the blended cutout for a hundredweight carcass. And then live cattle followed it right down at about the same level. So about the same thing at pork, although the pork live didn't correct. It actually, again, seasonally comes up.

But we did see the demand shift, wholesale prices correct. Part of that was, I think they were a fairly high price coming into the spring. And then we did see with the weather, a combination of events, some weaker pulls across the board in that last week of April. And hopefully this last weekend, we will probably see a reversal of that. But demand is always a precarious scenario on being oversupplied and undersupplied, which will drive prices up or down depending upon the situation.

**Farha Aslam** - *Stephens Inc. - Analyst*

And the response of the industry? Have you seen slaughter levels pull back?

**Jim Lochner** - *Tyson Foods, Inc. - COO*

Well we saw a correction two weeks ago in cattle and we are seeing, seasonally, hogs. So we always try to make sure we're looking forward on that demand picture, and making sure that we have our meat sold and we don't oversupply it. So we really pay very close attention to what we think the forward pulls are going to be and keep ours in balance.

**Farha Aslam** - *Stephens Inc. - Analyst*

Okay. Thank you.

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**Operator**

Diane Geissler. Please state your company name.

**Diane Geissler** - *Credit Agricole Securities - Analyst*

It's CLSA. Could you just tell me, you didn't really give a number in answer to Christina's question about your production plans for the back half of the year. And I guess in light of the fact that you are not painting a rosy picture on demand, why would production be up at all?

**Donnie Smith** - *Tyson Foods, Inc. - President and CEO*

I take it you're talking about chicken?

**Diane Geissler** - *Credit Agricole Securities - Analyst*

Yes.

**Donnie Smith** - *Tyson Foods, Inc. - President and CEO*

We've said that our number for the year would probably be up in the low single digits. We still think that's probably where we will end up. We got a little over revved in Q1. We've corrected that back into Q2. Our focus now is on driving revenue to be able to cover these very expensive input costs. And I tell you, if we are successful in our plan as it stands now, we've -- we will be in good shape holding into that low single digit number. If, as we drive revenue, it calls for a different production number, we will adjust that.

Our goal has been to always balance supply and demand. And if an increase in revenue causes a demands shift, we will adjust our supply accordingly. But currently, we've got several levers to pull to increase our revenue, and I don't see the necessity.

**Diane Geissler** - *Credit Agricole Securities - Analyst*

Okay. So what I'm reading in your press release where you say -- this is my read of your press release; I realize it's not how you quoted it -- but is that basically you are covered on grains through the end of the fiscal year at a profitable position, and then who knows what happens to the grain because right now I've got corn curve in backwardation. So obviously it's not something that you just switch off overnight. So, are you telling me you have some clarity about where your feed costs will be as you move into fiscal '12, and therefore, you can think about what your production levels are today? Or are you completely uncovered in '12 at this point?

**Donnie Smith** - *Tyson Foods, Inc. - President and CEO*

Yes, we do, and I think you've got a pretty good read on how to interpret our press release.

**Diane Geissler** - *Credit Agricole Securities - Analyst*

Okay. All right, great. Thank you.



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**Operator**

Ken Zaslow. Please state your company name.

**Ken Zaslow** - *BMO Capital Markets - Analyst*

Bank of Montreal. Good morning, everyone. Two questions. One is on the demand side, how much pushback are you seeing at retail? And are you seeing any switching in promotional activity among the three proteins?

And then the second question is, Dennis, is there any restrictions for you guys not -- to buy back stock, on your side, and not pay down debt instead, and take some of that money and actually use it to repurchase stock?

**Dennis Leatherby** - *Tyson Foods, Inc. - EVP and CFO*

This is Dennis. I'll take the stock buyback and then kick it over to Donnie and Jim. There's nothing really to stop us from buying back stock other than what's in front of us that's quite uncertain.

What if corn goes to \$10? Those kinds of things; we really maintain a lot of liquidity. It's \$1.6 billion right now. We need to maintain a lot of liquidity. We have great investments to put into our business with high returns. So our priority right now is continuing to make sure that we have plenty of liquidity, make sure that we invest heavily in our business like we are. That's definitely an option. There are no restrictions.

In fact, the new revolver, the restated revolver, gives us quite a bit more flexibility. So we can do that. It's an option, but not now. Sometime later, probably so, but not in the immediate future.

**Donnie Smith** - *Tyson Foods, Inc. - President and CEO*

And on the demand question, I think going into Memorial Day, I believe we will see some pretty good featuring of chicken, although boneless loins in pork and the middle meats in beef are probably going to fill some feature activity as well.

I do think, though, as we move out on into the summer, feature activity in chicken, both at retail and food service, should improve. It's going to be a great value for the consumer. The back half of the bird today is driving revenue growth at the retail level. And obviously breast meat prices are quite a bargain, so we think you will see fairly strong retail and food service featuring into the summer.

**Ken Zaslow** - *BMO Capital Markets - Analyst*

Great. Thank you.

**Operator**

Jeff Farmer. Please state your company name.

**Jeff Farmer** - *Jefferies & Company - Analyst*

Jefferies, and good morning, everyone. You touched on this or you guided to I think about \$200 million in price and mix improvements for the chicken segment. Just curious if that number is still in play for 2011. And I guess more importantly, even

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if the industry sort of sees their chicken pricing sort of stay where it is, if it doesn't move materially, do you think you can still see \$200 million in pricing mix improvements in 2011?

**Donnie Smith** - *Tyson Foods, Inc. - President and CEO*

What we've said before is that we thought we could get a couple hundred million dollars in operational efficiencies, and yes, we are on target to get that. And in the beginning of the fiscal year, we also said that we would be driving towards about that same amount a month -- about that same amount in revenue increases. With the market prices, that's been a bit more of a struggle, but we are being able to see some improvement today. And so I think you can count on our ability to deliver positive quarters in chicken both in three and four. There are raw material prices that are up against those operational efficiencies, but fortunately our team is focused on getting those, which is helping us to combat these higher raw materials.

**Operator**

Lindsay Drucker Mann. Please state your company name.

**Lindsay Drucker Mann** - *Goldman Sachs - Analyst*

Goldman Sachs. Just a quick one on chicken feed costs -- first of all, I just wanted to see if you guys were exploring or what your take was on substituting corn feed for other types of grains, be it wheat or any other opportunities there are in your feed rations to cut out some costs. And then second, just to clarify, you talked about in the first half you -- I think it was \$66 million of feed inflation and you expect the full-year feed inflation to be \$500 million. So am I reading it right that you think there's going to be \$434 million of feed cost increase in the second half of the year?

**Donnie Smith** - *Tyson Foods, Inc. - President and CEO*

Yes, it is certainly back-half loaded Lindsay. And on your first question, we have a great commodity team. They're always looking for alternative ingredients.

Now, in most livestock guides, corn and frankly corn substitutes, whether it be what, DDGs, whatever that might be, are primarily the energy source for the diet. And our guys are always looking at the corn/wheat ratios, at grain sorghum, for example, lots of things that we can do to help mitigate our costs. We're very experienced in doing that, been doing that for years. And I'm confident that if there's an alternative out there, our team is on it, they're researching it, and they know how it will affect our performance.

**Lindsay Drucker Mann** - *Goldman Sachs - Analyst*

Maybe just to follow up on that a bit deeper, is your expectation with the last WASDE update, and we'll get another one this week, there was some controversy on expectations that you would get a fair amount of substitution away from corn to help offset some of the tightness in the old crop balance sheet. In your experience, not just with your chicken operations but just looking at feed lots and other producers across the country, do you see some sort of shift of that magnitude away from corn and into substitutions that you think can alleviate some of the tightness in the balance?

**Donnie Smith** - *Tyson Foods, Inc. - President and CEO*

Not dramatically, no.

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**Jim Lochner** - *Tyson Foods, Inc. - COO*

I would say that the bulk of that -- substitution has already occurred, DDG utilization is -- dried distiller grains utilization is probably optimized throughout. And then, as Donnie said, all livestock species are always looking for alternative feeds; build them into the feed ration in looking at positive impact feed cost versus any potential negative impact on performance.

And our livestock producers and chicken producers throughout the US are very, very adept at utilizing a variety of different feed sources to keep the efficiency and cost of gains in line.

**Lindsay Drucker Mann** - *Goldman Sachs - Analyst*

Thanks.

**Operator**

Tim Ramey. Please state your company name.

**Tim Ramey** - *D.A. Davidson & Co. - Analyst*

D.A. Davidson. Donnie, we've seen a strong export picture and some supply disruption as a result of the tornadoes. Can you talk a little bit more about how you think those two factors might be influencing overall availability in supply and pricing?

**Donnie Smith** - *Tyson Foods, Inc. - President and CEO*

Sure. Tim, obviously, we think the -- one of the predominant factors in determining pricing is domestic protein availability. With very strong exports in beef and pork and strong exports in chicken as well, we see that domestic availability for the 2011 year should be about flat, down slightly maybe.

Then on the other side, the impact in Alabama, I'm not completely sure. As I mentioned in the earlier part, we didn't sustain very much damage at all, thank God, in our businesses in Alabama. But, it looks like to us, industry-wide, there will be some production decline because of that. I don't sense that the impact is going to be tremendous. So, I would say a stronger impact on pricing will come from continued strong exports than from the production disruption from the Alabama storms, and well, the storms that swept through that area, north Georgia, Tennessee and Alabama.

**Tim Ramey** - *D.A. Davidson & Co. - Analyst*

And would you say you are participating in the strong exports? Pilgrims, I think, had a very big number out a week or so ago.

**Donnie Smith** - *Tyson Foods, Inc. - President and CEO*

In terms of participating, yes. But I will be honest with you, in beef and pork. But if you look at our chicken business, honestly, we're looking at shifting more of our production away from the export markets into domestic consumption. It's a -- as you well know, the predominant cuts out of the US in chicken going into export are the back half of the bird. And we see an opportunity in a pretty tough economic climate to revenue up by moving more dark meat domestically, and that's our focus.

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**Tim Ramey** - *D.A. Davidson & Co. - Analyst*

Thanks.

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**Operator**

Robert Moskow. Please state your company name.

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**Robert Moskow** - *Credit Suisse - Analyst*

Credit Suisse. Hey, Donnie, I'm just wondering about your perspective of the chicken industry overall, and in your mind, do you think that the industry is behaving rationally? And, the reason I say that is everyone seems to be hedged for six months or so, but you do have the specter of much higher corn costs when those hedges roll over, and you could see margins staying well below normalized levels through fiscal '12.

So, you argued that the valuation multiples in the group are probably too low and Tyson is trading at a discount, but I think in order to get those multiples higher, investors need to have some sense of comfort that the industry is behaving more rationally this time around, call it tighter lending practices. But maybe you can even marry that up with your plan, which is to keep volume in positive territory. If the industry stayed in volume territory, do you think that margins can still recover? Thanks.

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**Donnie Smith** - *Tyson Foods, Inc. - President and CEO*

Okay, Robert, I'm not going to speak to the industry and that type of thing. I will talk about our business, and so let me talk a little bit about what happens to Tyson when let's say our hedges roll off. Our price risk management activities are important, and we have a great team that manages that. But, hedging is not the ultimate solution. What we are focused on is passing along higher prices because we've really got no choice. Revenue is the solution to our business. So if you look forward into our 2012, we don't see any basics -- basic changes in the fundamentals of the beef and pork segments from what we see today, and as we look forward into the chicken segment, when we get the revenue increases that we need to cover these costs, that should carry on over into 2012.

So, that's our view as we move forward. We will continue to monitor our inventories, and we will continue to balance supply and demand. And as I said earlier, in our focus on revenue, if that changes the demand picture out front, our suppliers will adjust accordingly, but we don't see the need to do that today.

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**Robert Moskow** - *Credit Suisse - Analyst*

Okay. I'll follow up later. Thanks.

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**Operator**

Vincent Andrews. Please state your company name.

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**Vincent Andrews** - *Morgan Stanley - Analyst*

It's Morgan Stanley. Thank you.

You know, the one question I had was -- it goes back to the questions about the pork and beef prices. Has something changed in terms of the pricing at retail?

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For the consumer, my understanding is that in the past, despite the material inflation in raw material costs, the retailer had been acting as a little bit of a shock absorber relative to the consumer. So I'm just wondering if some of the demand weakness is also related to the consumer actually seeing higher sticker prices in the last few weeks? Can you help us with that?

**Jim Lochner** - *Tyson Foods, Inc. - COO*

Yes, I would say the retail prices for beef and pork have been climbing -- inclining, rather. They were up about 11%, 12%. And yes, I'm guessing that the consumer did see a shift. Again, I think that's favorable over the long run to chicken prices, but the market will always do its job, is always the saying. And when the consumer does see it as a pass -- as our customers pass along higher wholesale prices, the consumer does see it and there potentially are shifts.

Interestingly, chicken moves the least -- up the least at 3% during that last 13-week period and had the least influence negatively on pounds which are all virtually flat or down slightly compared to the pound declines that we saw at retail in beef and pork. So the market is doing its job in passing on higher prices and the consumer adjusting accordingly, and you're seeing that in a variety of other food-based products as well, where you are seeing wheat-based and dairy-based products going up.

So, even with all these changes, again, as the wholesale prices did correct, we have been able to maintain a spread throughout this correction, in particularly those spread businesses in beef and pork.

**Vincent Andrews** - *Morgan Stanley - Analyst*

Okay. It just seems to me that (multiple speakers)

**Jim Lochner** - *Tyson Foods, Inc. - COO*

(multiple speakers) you are seeing it right, but that dynamic didn't surprise us, and the market again, makes those adjustments. And I've always got to emphasize, in beef and pork, and I already stated that, that the livestock costs did correct as the wholesale cuts did correct down.

**Vincent Andrews** - *Morgan Stanley - Analyst*

Sure, no, fair enough. And then maybe just a follow-up on the chicken questions. One of your competitors I guess last week or the week before sort of was -- or my take on their comments was that they were willing to produce as long as they were EBITDA breakeven in chicken. And it seems like that's sort of where the industry is today. How do you feel about that metric?

**Jim Lochner** - *Tyson Foods, Inc. - COO*

We look at trying to make money, and EBITDA is not the metric we use. But we are extremely focused, as Donnie has already said, on driving revenue through a combination of mix and price, and hitting all our yield parameters that we set targets for. So we fully recognize or get paid for the inflated input costs, but price is a mechanism as well, and one of the mechanisms on driving revenue. So, we are targeted. As we've said, we think we will be fine and make money in chicken on an EBIT basis, operating income basis, in Q3 and Q4.

**Vincent Andrews** - *Morgan Stanley - Analyst*

Okay. Thanks very much.

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**Operator**

Christine McCracken. Please state your company name.

**Christine McCracken** - *Cleveland Research Company - Analyst*

Christine McCracken. Cleveland Research. Good morning. Just on pork volumes in the quarter, they seem to run pretty significantly ahead of the industry. I'm wondering if that was more of an industry -- or an inventory kind of push, or if there was something in the year-ago period that I might have missed.

**Jim Lochner** - *Tyson Foods, Inc. - COO*

I didn't understand, in the what period? Year-ago period? No, we -- again, we usually set up our whole planning process looking at what we think we have available coming in supply with the producers and suppliers, and staying sold, and really there wasn't any intention, so they were up; it wasn't clearing inventory, is the answer.

**Christine McCracken** - *Cleveland Research Company - Analyst*

Okay; anything specific driving your second-half outlook on pork then? You've mentioned the impact -- the potential impact of higher gasoline prices, but I think it seems like there has been some trade down into pork here over the summer, as you mentioned. Wondering why you are relatively it seems negative on the outlook here through the summer and into the fall?

**Jim Lochner** - *Tyson Foods, Inc. - COO*

I didn't really mean to come across negative at all. I just said they wouldn't be as robust as they have been because they have been up in a very -- well above the normalized range. I think we will be fine and actually above the normalized range, but not at that super high level that we just came through Q2 with. We will see some correction as we come into the Q3 period, which we normally do in May, June. You would normally see a seasonal decrease in supply. And I was concerned because our bellies were so high-priced on a wholesale basis, and anxiously watching to see what clearance, and we did see bellies correct, \$0.25 a pound from \$1.50 to \$1.25 at a very fast rate, and I kind of expected to see that.

I was hoping actually that they didn't go up quite as fast because a fast up is always usually followed by a fast down, and that did drive some margin compression. But I'm certainly not negative at all on the second half. It's just not as strong as we have seen in the first half.

**Christine McCracken** - *Cleveland Research Company - Analyst*

Great. Thanks a lot.

**Operator**

Ryan Oksenhendler. Please state your company name.



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**Ryan Oksenhendler** - BofA Merrill Lynch - Analyst

Bank of America Merrill Lynch. I just wanted to ask about pricing on chicken. One of your competitors talked about being able to change their fixed contracts during the quarter for the rest of the year, and maybe they'll take some pricing here. And your thoughts on being able to take pricing in the fall when a lot of your national accounts come up for bid -- if we don't see production cuts until then, how comfortable are you about getting pricing for fiscal '12?

**Donnie Smith** - Tyson Foods, Inc. - President and CEO

Thanks, Ryan. First of all, we don't have a very large percentage of our business that is in fixed price annual agreements. We have some, but not much, and we talked about this in previous quarters. We tried to mitigate some risk to our business by decreasing the amount of that. So our business will respond favorably to the seasonal increases in market prices that normally happen about this time of the year.

As we move into the fall, the protein domestic availability, even with a increase in production and chicken of say -- USDA's guided at about 1.25%, 1.5% or something like that, even with that, the domestic availability of protein in the US is going to be at or slightly below where it was a year ago. And we think going into the fall, that will be a fairly good environment for us.

But now, a lot of our pricing is based on the value that we deliver to our customers. And so, we've got great quality. We've got great service. We've got great innovative capability, and we've got the ability to get paid for that. So, that's our focus, is on driving value to our business -- to our business partners, to our customers, and getting paid for the value that we supply.

**Ryan Oksenhendler** - BofA Merrill Lynch - Analyst

All right. Thanks, guys.

**Operator**

Stephen Share. Please state your company name.

**Stephen Share** - Morgan Joseph & Co., Inc. - Analyst

Morgan Joseph. Good morning.

Say, I wanted to focus in on beef a little bit. It seems like I realize price was up a lot -- live cattle price was up a lot, but if I look at choice and select cutout, those prices were up, it appears to me, even more in the quarter. So I guess I was surprised that your gross margin wasn't a little bit stronger there.

**Jim Lochner** - Tyson Foods, Inc. - COO

Well, let me quickly say that you're right. The cutout on an aggregated basis quarter over quarter same year was up 24 -- excuse me, 18%. Drop credit was up substantially, but live cattle costs were up 24%. And we had some margin compression compared to the prior Q2 fiscal '10. So we did see that rapid run-up but we saw live cattle followed up very much at the same point in time. So, we were still very much in the normalized range; saw some of that compression compared to that -- a year-ago quarter, and then we're seeing the markets adjust right now. As I stated earlier, even though the cutout came down in this last four weeks, 11%, live cattle costs fell -- or percent dollars per hundredweight, live cattle costs are, on a carcass weight basis, dropped actually at the same rate or slightly above that.

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**Stephen Share** - *Morgan Joseph & Co., Inc. - Analyst*

So will your hedging activity -- should we expect that number, when we look at the operating margin, kind of the 2.8%, would you say that's a pretty good number for the third quarter as well, in the rest of the year? Do you think you will have an opportunity to do better than that?

**Jim Lochner** - *Tyson Foods, Inc. - COO*

I would expect that we probably can work on improving that quite a bit as the fundamental starts up because I'm still very bullish on exports. We did see this correction and then we are coming into bigger seasonal supplies, which generally, historically, this May, June, July period is when packer margins generally expand. So, we're in the situation where I am very comfortable yet indeed. Thank you.

**Stephen Share** - *Morgan Joseph & Co., Inc. - Analyst*

Okay, so there's a decent chance that that 2.8% operating margin might mark the low margin of the fiscal year?

**Jim Lochner** - *Tyson Foods, Inc. - COO*

Yes, I think there's a reasonable chance of that, yes.

**Stephen Share** - *Morgan Joseph & Co., Inc. - Analyst*

Okay. Thank you.

**Operator**

Akshay Jagdale. Please state your company name.

**Akshay Jagdale** - *KeyBanc Capital Markets Inc. - Analyst*

KeyBanc Capital Markets. Jim, the first question is for you, Jim, on beef, just wanted to follow up on the margins. What we see in the spot market is somewhat different from what you are I guess implying for the rest of the year, which is that we've seen in the spot market the beef cutout spreads come down quite a bit in the last month or so. So, is that just, again, going back to your argument about a higher valuation, do you feel like you are outperforming the market you have in the past and you are continuing to do that? Can you help me understand what I may be missing here? Because just looking at the USDA cutout value relative to what's happening in the live cattle market will tell you that the spread has compressed, not -- it's not going up. So what am I missing there?

**Jim Lochner** - *Tyson Foods, Inc. - COO*

Well, what you are missing is always the difficulty of taking aggregate data across a variety of regions and a variety of different cuts and trying to draw a quick conclusion. But as I said, even though the cutout dropped \$11.44 in that last four weeks per hundredweight, cattle costs corrected \$12 per hundredweight flat on the carcass. We maintained margins throughout this whole timeframe.

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Again, our goal is always to beat the revenue on every individual cut. I know one thing the market won't let us buy cattle appreciably cheaper than anybody else, so our margins hold in there on basically beating the revenue side, having a good mix portfolio, export portfolio, a combination of a real strong customer base. So it's a little difficult for you to just take the average USDA cutout numbers and look at that. They are what they are in a negotiated standpoint, but as I've said, that relationship actually corrected in unison, and it went up actually when I go back and cover the numbers I did earlier, Q2 '11 to Q2 '10 actually, you saw live cattle increase at a faster rate than the revenue.

So, we hold it in there and it is a spread game. Our goal, as I've said many, many times on this call is to always beat the indexes on the revenue side and hold onto it, and then really just work constantly at being the low cost high revenue player in the region that we operate. So it's a business fundamental that we go after. I know that's fairly complicated, but that's the basic data that's out there.

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**Donnie Smith** - *Tyson Foods, Inc. - President and CEO*

Let me -- I'm going to add just a touch. And here's the thing that I think we might be missing. We have been beating, we are beating, and we believe we will continue to beat the market spreads, as you would see them today. We've yet to have a negative week in beef and the fiscal quarter. We are operating above what -- if you just looked at the cutout, we're operating above that and we believe we're going to be able to continue to do so.

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**Akshay Jagdale** - *KeyBanc Capital Markets Inc. - Analyst*

That's very helpful. Can you by -- if not now, maybe as a follow-up -- tell us how much you generally beat the cutout by?

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**Donnie Smith** - *Tyson Foods, Inc. - President and CEO*

Now you're pushing it.

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**Akshay Jagdale** - *KeyBanc Capital Markets Inc. - Analyst*

Well, it would help in terms of thinking of a valuation premium, but anyway, I can follow up on that.

The other question is on chicken, Donnie. So, there's a view out there on the chicken side that the cycle is correcting -- it's turning and it's -- there's also some people believe that it's going to correct pretty dramatically and quickly.

So my question to you is, hypothetically, if the rest of the industry cuts supply by 2% to 3% over the rest of the year, do you think Tyson could get to normalized earnings in chicken in 2012?

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**Donnie Smith** - *Tyson Foods, Inc. - President and CEO*

It's going to be very tough for us to have a 5% or better operating income for this fiscal year. We've got a wall of costs coming at us. We talked about grain prices, you know, \$500 million. Plus, you have got a lot of other raw inputs that we deal with -- freight, all those things that -- increased costs, fuel costs, utilities costs etc., health care costs, etc., etc. So, it's going to be tough this year.

But, now looking forward, our goal this year is to be able to get revenue in place that will carry next year into a position to where we could get back up into our normalized range. So, our goal this year -- obviously we're going to continue to improve on operating efficiencies, and we see -- we are on track and we see more runway. So our cost structure, non -- call it grain or input-related will be lower in '12 than it is.

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Now remember, we are also spending fairly heavily on our chicken business to continue to improve our cost structure, and our productive capability as we move forward. So in the back half of the year, our focus is on increasing revenue so that we can get paid for this high cost structure, this market input related cost structure that's affecting our business. So when you combine better operating efficiencies and a lower overall cost structure with the ability to get paid for the input, then we view going forward our ability to get chicken back into its normalized range.

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**Akshay Jagdale** - *KeyBanc Capital Markets Inc. - Analyst*

But that seems all to be company-specific issues. So are you saying that you feel good about getting to a normal range even without any production cuts for the industry this year?

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**Donnie Smith** - *Tyson Foods, Inc. - President and CEO*

I'm talking about our business, and I don't believe, number one, I'm not going to speak for -- or the industry; I'm talking about what we have to do to drive our business performance. I don't want to leave the impression that we are victims to raw material or inputs. Our job is to get paid for what we do. And we provide a great deal of value. And I went through a laundry list of things earlier -- of things that separate us from our competitors in the industry, and our job is to get paid for that. And that's what we're focused on.

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**Akshay Jagdale** - *KeyBanc Capital Markets Inc. - Analyst*

Great. I'll pass it along. Thanks a lot.

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**Operator**

Ann Gurkin. Please state your company name.

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**Ann Gurkin** - *Davenport & Company - Analyst*

Davenport. Good morning. Just wanted to follow up; after listening to the call and your comments, it seems the tone is a little more cautious. And I'm just curious, with the softer consumer demand after Easter, how -- I guess what gives you the confidence to maintain the outlook for '11 versus '10? What am I missing?

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**Donnie Smith** - *Tyson Foods, Inc. - President and CEO*

First of all, I'm not -- Easter was historically very late, okay? And I'm not going to overreact to a couple of soft weeks. This is a long year. The fundamentals of our business are in place. So, we have not had, in any of the expectations about 2011, we've not had a very rosy picture of what economic climate we were going to be flying into, so the climate that we are operating in is the climate we expected to be operating in.

Despite that, we still feel like we are going to be, as I've said, at or around the \$2 mark. Now before, we said GAAP and maybe the adjusted number, now I feel comfortable at \$2 maybe GAAP. So slight adjustment down, but I don't think anything dramatically; and hey, this is going to be a very good year for Tyson Foods.

And the climate that we are operating in, I think it's important to note, the climate that we are operating in is the climate we expected to be operating in and that we built our plans to be operating in. So, we're on plan, and we believe we're going to deliver.



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**Ann Gurkin** - *Davenport & Company - Analyst*

That's very helpful. Thank you.

**Operator**

Lindsay Drucker Mann. Please state your company name.

**Lindsay Drucker Mann** - *Goldman Sachs - Analyst*

Thanks for the follow-up. Just quickly wanted to know if you guys had an update on whether you are seeing anything in the form of inventory restocking out of Japan.

**Jim Lochner** - *Tyson Foods, Inc. - COO*

The export demand out of Japan has remained very strong. So, we've certainly seen no pullback, and if anything we continue to see strong interest up front.

**Lindsay Drucker Mann** - *Goldman Sachs - Analyst*

Any indication that you are seeing accelerated interest and you had a great start to the year. Post earthquake, are you seeing demand above what you had seen starting the year?

**Jim Lochner** - *Tyson Foods, Inc. - COO*

I think -- the information I got from our team is that it's continued strong post the earthquake, and there will continue to be a replenishment and continue to be consumption. And again, I always bring this back that the global supplies -- protein, beef and pork are down and we continue to see this very strong export demand, which has been very supportive of all pricing. And when you really look at the Jan/Feb numbers in all three species, year over year, they are all extremely strong, and I'm quite certain March will print that one, their final in April and out front. So the things we've been talking about on the domestic availability supported by strong -- declining, supported by strong exports is certainly materializing themselves. And again we will be very supportive of pricing. That's one reason we are not as -- that negative going forward. We're very positive for that real strong fundamental that exists.

**Lindsay Drucker Mann** - *Goldman Sachs - Analyst*

Thanks.

**Operator**

Diane Geissler. Please state your company name.

**Diane Geissler** - *Credit Agricole Securities - Analyst*

It's CLSA still. Thanks for the follow-up. So, is -- am I reading you right that the goal in fiscal '12 and the chicken unit is to be within the normalized range on your margins?

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**Donnie Smith** - *Tyson Foods, Inc. - President and CEO*

Yes, ma'am.

**Diane Geissler** - *Credit Agricole Securities - Analyst*

Okay. Thank you.

**Donnie Smith** - *Tyson Foods, Inc. - President and CEO*

Well, I hope you can tell from our answers to your questions, we feel good about where we are as a company. During challenging times in the past, I think we would have looked at this as weathering the storm, but we don't think that way anymore. We're in a strong position. We've improved as a company. We see plenty of opportunities to become even better. I think we can compete favorably with our -- or compare favorably with our competition.

Tyson is in all three proteins plus prepared foods. We have diverse business models within each of those proteins. We have commodity and value-added. No competitor has our product diversification and the resources that we have to create value for our customers through innovation. Our chicken inventories are down to historical lows, and we've got one of the strongest balance sheets in the industry.

Even with the increased grain costs, we continue to invest in our business to improve our efficiency, our profitability, and our production capability. And most importantly, we did what we said we were going to do. The fundamentals are there. As long as we stay focused, there will be more good results in the future.

I want to thank you for your interest in Tyson and I hope everyone has a great day.

**Operator**

Thank you. That concludes today's conference. You may disconnect at this time.

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