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TSN - Q4 2013 Tyson Foods Earnings Conference Call

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OVERVIEW:

TSN reported FY13 sales of \$34.4b. FY13 EPS from continuing operations was \$2.31 and adjusted EPS was \$2.26. 4Q13 EPS was \$0.70. 2014 revenue guidance is \$36b.



CORPORATE PARTICIPANTS

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Dennis Leatherby *Tyson Foods - EVP and CFO*

Jim Lochner *Tyson Foods - COO*

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PRESENTATION

Operator

Thank you for standing by, and welcome to the Tyson quarterly investor earnings conference call.

(Operator Instructions)

Today's conference is being recorded. If you have any objections, you may disconnect at this time. And now I will turn today's meeting over to Jon Kathol, Vice President of Investor Relations. Thank you, sir. You may begin.

Jon Kathol - *Tyson Foods - VP, IR*

Good morning, and thank you for joining us today for Tyson Foods' conference call for the fourth quarter and 2013 fiscal year. On today's call are Donnie Smith, President and Chief Executive Officer; Dennis Leatherby, Chief Financial Officer; and Jim Lochner, Chief Operating Officer.

I need to remind you, our remarks today include forward-looking statements as defined by the Private Securities Litigation Reform Act of 1995. These statements are subject to risks and uncertainties that could cause actual results to differ materially from our expectations and projections. I encourage you to read today's press release and our filings with the Securities and Exchange Commission for a discussion of the risks that can affect our business.

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



Donnie Smith - *Tyson Foods - President and CEO*

Thanks, Jon. Good morning, everybody, and thanks for joining us.

As we close the books on fiscal 2013, I want to celebrate what Tyson Foods achieved this past year. We produced record earnings of \$2.26 a share or 15% growth over the previous year, surpassing our goal of at least 10% EPS growth. We grew sales by 4%, achieving our goal and reaching a new record of \$34.4 billion.

Operating income grew 7% or \$89 million over the prior year, despite \$470 million of incremental feed costs. We grew sales of value-added products by nearly 6% against a very aggressive goal of 6% to 8%. We made significant progress in building our international chicken production, growing sales by 20% against a goal of 12% to 16%.

We returned \$650 million to shareholders by paying out \$100 million in dividends and buying back 21.1 million shares of stock for \$550 million. Our stock was up 78% for the fiscal year. And we reached a new all-time high stock price. ROIC continues to be over 18%. At the end of the fiscal year, net debt was \$1.3 billion, and net debt to cap was at 17%.

We made two prepared foods acquisitions, Don Julio and Circle Foods. And we had a greater focus on growth drivers, while maintaining a steadfast commitment to operational excellence, which is carrying us into another year of growth in 2014. That's what we did. Now, let's look at the macro environment we were operating in.

We continued to see a shift away from food service into retail, reflecting the overall economy. Now, that is not to say our food service business wasn't successful. In fact, it did very well in a challenging year for the food service industry in general. We were nimble to respond as consumers moved among proteins and channels, depending on their confidence in the economy and the effect gas prices had on disposable income.

We are also seeing more bifurcation among consumers between those choosing higher-priced, value-added products and those moving down value-stream to save money. According to Nielsen data for the year coinciding with our fiscal year, total fresh meat pounds sold at retail were up 1.4%, while pricing was up 2.3%. Ground beef and fresh beef pounds declined 0.3% and 1.4%, respectively, as price rose over 3%. Four pounds increased 5%, as price declined 4%.

Fresh chicken was the winner, with pounds up 2%, even with a 7% increase in pricing, indicating that chicken was still viewed as a value relative to the other proteins. Tyson captured share as the number one brand of fresh chicken in the United States.

Now, let's take a moment to talk about where we are going and how we will get there. Earlier today, we issued a press release announcing several new leadership positions. This structure is focused on the key elements of our strategy, allowing us to accelerate our growth, reinforce our operational excellence, and create opportunities for our team by deepening our best-in-class talent. By separating our poultry and prepared foods division, we are sharpening our focus on these two crucial growth areas.

Noel White, a proven leader in our fresh meats business, will now be leading our Poultry division. Steve Stouffer, a 30-year veteran of our fresh meats business, will lead our Fresh Meats team. Donnie King will be leading our Prepared Foods division, and will create an integrated sales and marketing organization to strengthen our customer relationships. Hal Carper will lead in the areas of Strategy and New Ventures.

I am excited about these changes, because they will allow us to capitalize on these leaders' considerable experience and talent as we carry out our long-term growth plans. As we make these transitions, we will minimize distractions and concentrate on customer service, product quality and innovation.

This morning we also announced Jim Lochner's decision to retire at the end of our 2014 fiscal year. During the upcoming year, Jim will be working with the Fresh Meats Group to ensure a smooth transition. And he will help us make the move to a new organizational structure. I personally want to thank Jim for being an integral part of developing our performance-based, metrics-driven approach to business.



Operational excellence is a hallmark of our culture. And as Jim makes his transition, he will help us sustain this mindset for long-term success and growth beyond 2014. He will continue in an advisory role for several more years. I am happy that Jim will get to enjoy the rewards of his four decades of hard work and dedication.

I just said a lot about growth and strategy in the future. But I'd like to give you some specific examples that illustrate how we are executing on these broad concepts. We study consumers' needs and behaviors, and we have identified opportunities to grow retail value-added sales beyond center-of-the-plate chicken. Breakfast emerged as a high potential category.

Wright Brand Breakfast Sausage is a natural follower to Wright Bacon, and a category that makes perfect sense for us as the leading pork processor. We recently rolled out Wright Sausage, starting in the Southeast, where Wright Bacon has the strongest following. And we are supporting this premium product line with highly targeted media.

Another breakfast category, frozen handheld, is also a good fit for us. At nearly \$1 billion in annual sales, it is a large category that grew more than 20% over the last year. Consumers told us they think a good breakfast should include protein. And Tyson is the brand they trust to deliver high-quality protein. 48% of consumers who buy frozen breakfast items also buy Tyson frozen value-added chicken. So we have a base of familiarity and positive perceptions as we enter this new era.

We are launching seven products under the Tyson Day Starts brand that will include biscuit sandwiches, flat breads, and wrapped omelets. After consumer taste-testing, 93% of consumers who already buy in this category said they would buy Tyson Day Starts. And 89% said our products were better than anything currently on the market. Sell-in is underway now, and we have received a great response from our customers. We will begin shipping in January, and we will support our entry into this category with significant MAP spending.

Day Starts is a great example of our push for innovation, as we set a goal to have 20% of our domestic poultry and prepared food sales coming from new product innovation. We define that as something that we have developed within the past three years. And in 2013, we exceeded our goal, with 21.5% of our sales resulting from innovation.

Turning to another growth area, international. This time last year, projections for improvement in our international performance would be around \$80 million. But due to avian influenza in China and a weak fourth quarter in Mexico, we improved by only \$45 million. I will quickly add that I'm still confident in our business plans in China, Brazil, Mexico and India. And believe that we are headed in the right direction for long-term success.

Before we go to Dennis, I would like to give you an indication of what to expect from Tyson in 2014. First on the list is paying off the \$458 million in convertible notes, which we did in early October, in cash. It should be another very good year of growth. And we are off to a strong start, especially in the chicken segment.

On our last call, we said, overall, 2014 would look a lot like the back-half of 2013 times two. We still see it that way, meaning we should over-deliver on our EPS growth goal of at least 10% a year. And like 2013, we think earnings will be more weighted to the third and fourth quarters.

As a reminder, our other annual goals are 3% to 4% top line sales growth, 6% to 8% value-added sales growth, and 12% to 16% international sales growth. We expect an ROIC that continues to grow and drive shareholder value. With AI in China hopefully behind us, our plan is to reach breakeven profitability, and processing almost 100% Company-controlled birds by the end of the fiscal year.

As I just explained, we will roll out several major product launches, including Tyson Day Starts and Wright Brand Breakfast Sausage. We will stay focused on our strategy, investing in growth, and setting ourselves up for a great 2015 and beyond.

Now, let's go to Dennis for the financial update, followed by Jim with the segment results.

Dennis Leatherby - *Tyson Foods - EVP and CFO*

Thank you, Donnie, and good morning, everyone. I also want to personally thank Jim publicly for his great leadership role in our turnaround and ongoing success. Jim, I thoroughly enjoy working with you, and I'm glad you are still going to be around to help us achieve our long-term strategic plans.

In this morning's earnings release, we reported fourth-quarter earnings of \$0.70 per share, up 23% compared to \$0.57 per share a year ago. As a result of another strong quarter, I am pleased to report a record year of earnings from continuing operations of \$2.31, or \$2.26 after excluding the currency translation adjustment in the second quarter.

This \$2.26 adjusted EPS compares to \$1.97 adjusted EPS in 2012. Up 15% year over year and beats our previous best of \$2.22 in 2010, despite \$1.4 billion in increased feed costs and many other significant challenges since 2010.

Pre-tax return on invested capital for the past 12 months was 18.5%. Over the past three years, pre-tax ROIC has averaged just over 18%, again in the face of considerable challenges. Our operating cash flow for 2013 was \$1.3 billion, and is consistent with our four-year average. We have shown the ability to sustain high levels of cash generation, and this should increase as we continue to grow our earnings.

Capital expenditures were \$133 million for the quarter, bringing the 2013 total to \$558 million. During the fourth quarter, we acquired 9.9 million shares for \$300 million under our share repurchase program. Since May 2011, we have repurchased 43.3 million shares for \$950 million.

Our effective tax rate from continuing operations was 32.5%. For the full year, the effective tax rate from continuing operations was 32.6%, or 33.1% excluding the currency translation adjustment in the second quarter. Net debt to EBITDA for the last 12 months was 0.7 times. On a gross debt to EBITDA basis, this measure was 1.3 times. Including cash of more than \$1.1 billion, net debt was just under \$1.3 billion.

Total liquidity was \$2.1 billion, well above our targeted range of \$1.2 billion to \$1.5 billion. Gross debt was just over \$2.4 billion. I am pleased to report that our \$458 million convertible notes matured two weeks after our year end, and we paid the balance with cash on hand.

Our diluted average shares for the fourth quarter was 370 million. This included dilution of 12 million for our convertible notes, 6 million for their warrants, and 5 million for stock options. As we previously reported, we had call options for the convertible notes, which will cancel out its dilution starting in Q1 of 2014.

As a result, our diluted shares will decrease in Q1 by the 12 million shares from these convertible notes. Additionally, in Q1 we should realize a reduction of another 4 million diluted shares versus Q4 of 2013, as we benefit from the full impact of the Q4 share repurchases.

Now looking forward, here are some additional thoughts on 2014. We expect revenues of \$36 billion, up almost 5% over 2013. Net interest expense should be about \$100 million, down \$38 million from 2013, primarily due to the payoff of our convertible notes. The effective tax rate should be around 35%. Our preliminary CapEx plan is around \$700 million, up \$140 million from 2013, and \$180 million greater than our depreciation and amortization expense.

Based on our average share price in Q4, we expect our diluted shares in Q1 to be around 354 million, prior to considering changes in our stock price, which would impact the dilution from the warrants and stock options. This also does not reflect the impact of any additional share buybacks.

And finally, this morning we reported our Board of Directors increased our quarterly dividend from \$0.05 to \$0.075 per share on our Class A common stock, a 50% increase, payable on December 13. Over the past four years, we have made a lot of improvements that have provided us with a balance sheet that we believe is a competitive advantage and is a solid foundation for our strategic growth plan.

During this time, we have generated \$5 billion in operating cash flows, and that is after funding \$700 million in working capital increases. We invested \$2.5 billion back into our business, including acquisitions, which is \$0.5 billion greater than depreciation and amortization, and is a further reflection of our growth plans. We also paid down over \$1 billion in debt, and returned \$1.3 billion back to our shareholders via share buybacks and dividends.



Our priorities for excess cash remain the same, which include additional capital spending to improve and grow our existing businesses, acquisitions to fulfill our growth strategies around value-added products and our international footprint, and returning cash to shareholders through share repurchases and dividends. All while ensuring we maintain plenty of liquidity at our disposal.

As Donnie mentioned earlier, we are off to a strong start in 2014. And we still expect it to look like the back half of 2013 times two, with the strongest quarters in Q3 and Q4. This would be well ahead of our annual goal to deliver at least 10% EPS growth.

With that, I will turn it over to Jim for a closer look into our operating segments.

Jim Lochner - *Tyson Foods - COO*

Donnie, Dennis, I appreciate your kind words earlier. I've always had a goal to retire at 62. And we have worked on the development of the team and the organizational structure, which allows me to accomplish this. I feel very fortunate to have worked with some really great people over the last several decades. I am excited to begin the next chapter of my life. And I'm also very excited about the future of Tyson Foods.

I really like the new organizational structure and the senior leadership changes. And I look forward to supporting this great team over the next year and beyond. I am confident Tyson is poised to move to the next level. The new structure, processes, people and strategy are aligning in such a way that the earnings power of this Company can move to a higher plane. And I am looking forward to watching it happen.

Now let's talk about the segments, starting with the chicken segment. In the fourth quarter we reported \$175 million in operating income and a 5.5% return on sales. Volume and pricing increased 2.4% and 4.3%, respectively, over Q4 last year. Through operational mix and price improvements, we offset a \$30 million increase in feed costs for the quarter.

For the fiscal year, the chicken segment produced \$646 million in operating income and a 5.3% return on sales. Volume for the year was up nearly 2%, while price per pound was up over 6%, which partially offset the \$470 million incremental feed cost for the year. Our buy-versus-grow strategy continues to work for us. By keeping our production short of demand, we can make opportunistic purchases on the open market for breast meat used in value-added products, while keeping our late-quarter inventories in check.

We will maintain this strategy into fiscal 2014, as it allows us to be responsive to customer needs and market shifts. Seven weeks into the new fiscal year, the chicken segment is off to a strong start. We expect chicken supplies to be up 3% to 4% for the year. But we also expect demand to be up as well, due to the relative strength in beef and pork pricing, and chicken features at both food service and retail.

We will continue to diversify to a more value-added product mix in total, particularly focusing on dark meat products for domestic customers. We currently project our feed costs will decrease approximately \$500 million in fiscal 2014. However, the cost of grain is only one factor in our pricing conversations with customers.

Chicken supply and consumer demand, along with the value we provide through quality, service and innovation, are all part of the pricing dynamic. They are important factors in the growth of our domestic chicken business as well, as we continue on a path to develop more value-added chicken products, in addition to increasing chicken production in our international locations.

Turning to the beef segment. In the fourth quarter, we generated \$162 million in operating income and a 4.3% return on sales. Volume was up 4%, while price was up nearly 5%. For the fiscal year, operating income was \$296 million, with a 2.1% return on sales. Volume for the year was down nearly 2%, while pricing increased 6.6%.

Our beef exports increased, while overall industry exports declined. 2014 will have challenges similar to those we experienced in 2013. And like last year, we will concentrate on being a best-in-class producer, growing exports, increasing revenues through premium programs and brands, such as Star Ranch Angus, Open Prairie Natural beef, Reuben Brand Corned Beef, and our case-ready program. And we will continue providing our customers with options by adding value to wholesale cuts, such as our closely trimmed subprimals.



Moving on to the pork segment. Operating income for the fourth quarter was \$68 million, with a 4.9% return on sales. Pricing was up 12.6% on a 5.6% decrease in volume. For the fiscal year, operating income was \$332 million, and return on sales was 6.1%. Price was up approximately 2% on 3.6% fewer pounds.

A ban on Ractopamine limited total US exports to Russia and China. We are working with our customers in both countries, especially China, to meet their specific needs. We adjusted by keeping our supply in balance with demand, which accounts for some of our volume decrease. Additionally, we adjusted our mix to increase price realization. The effects of the PED virus started showing up this month. Although we are not expecting shortages in our plants, the overall reduced volume should be favorable for wholesale pricing.

As with beef, we continue to increase revenue in the pork segment through product mix and premium programs, such as case-ready pork and the high-quality Chairman's Reserve and Supreme Tender brands. We think 2014 will be another solid year for the pork segment. And we will work to maintain and build on our reputation as a best-in-class producer.

In the prepared foods segment, we generated \$16 million in operating income for the fourth quarter, with a 1.8% return on sales. Price was up nearly 4%, and volume increased 5.2%. For the fiscal year, prepared foods' operating income was \$101 million, and return on sales was 3%. Price was up less than 1%, and volume was up almost 2%.

Our prepared foods segment is a mix of strong, profitable businesses, growth platforms, and businesses in the early stages of turnaround and start-up. While not in the normalized range, there were numerous factors that led to these results, including conscious decisions we made. Because we view prepared foods as a growth vehicle, we have been investing heavily in new product categories, and expanding existing categories.

In addition to the frozen breakfasts and raw sausage Donnie mentioned, we are entering the smoked dinner meats category as well. As we have discussed before, we are investing to make a push to expand our highly value-added offerings in all channels.

We expect our Houston lunch meat plant to come back on line in December. We have invested in that location to allow us more packaging and mix flexibility, because we see it as a longer-term higher-margin play. As we work to become a low-cost, high-quality lunch meat provider, we expect steady improvement in this business over the year.

Although investing in turnaround and start-up businesses, along with MAP spending, have diluted prepared food segment profitability in 2013, we are building a foundation for future growth. If we added these investments back in, profitability would have been in the historical range. Looking two to three years out, our models suggests strong returns for the products and categories we are working on now.

In closing, I'd like to thank the Tyson management team for their attention to details. Starting with taking care of the customer, taking care of our team members, and driving a spirit of continuous improvement, their enthusiasm to take on new challenges has been very gratifying.

That's the end of our prepared remarks. Candy, we are ready to begin Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Ken Zaslow, Bank of Montreal.



Ken Zaslow - *BMO Capital Markets - Analyst*

Jim, I just want to congratulate you on your retirement. It is well-deserved, and we will definitely miss you. Thank very much for all your help throughout the years. So we will miss you.

Jim Lochner - *Tyson Foods - COO*

Think you very much.

Ken Zaslow - *BMO Capital Markets - Analyst*

Let me just go to some questions as well. Tyson's free cash flow has accelerated over the last couple quarters to new levels. So my question is, at these current run rates, is this the current run rate of cash that you expect, these current levels, or can it even accelerate to new levels? And your share repurchases clearly have accelerated in the last quarter. Is that the new run rate of how you're thinking about deployment of cash through the next year or two?

Dennis Leatherby - *Tyson Foods - EVP and CFO*

Thanks, Ken. Multi-part answer. First, I want to say that, yes we are on a new run rate. As we continued to grow earnings, like we said, back half times two, that would certainly mean more cash flow and so more options for us to deal with that cash flow.

We want to just reiterate that it's first on growth, CapEx over and above depreciation for our existing businesses, acquisition activity, and then returning it back to shareholders. But you are right. Cash flow is growing.

Ken Zaslow - *BMO Capital Markets - Analyst*

But what about share repurchases? I think you did \$300 million, going from \$250 million to \$300 million -- it was \$550 million for the year.

You were at \$300 million last quarter. I don't know if the \$550 million, \$600 million is the new run rate on an annual basis that we can start thinking about. As that the way to think about it?

Dennis Leatherby - *Tyson Foods - EVP and CFO*

It certainly would be more Ken, but it depends on what might come in front of it, in terms of growth opportunities.

Ken Zaslow - *BMO Capital Markets - Analyst*

Okay. And my second question is, when I look at your numbers, I get that you have committed to doubling the back half of 2013 throughout the year. But if I actually take your numbers and use your quantitative guidance, I get a much higher number than what you're saying.

I'm not saying that you don't want to be conservative here, but is something wrong with my math of how I'm doing -- the numbers that you're saying, with the share count where it is, plus the chicken margin being at the higher end or above, beef being the same, I'm getting to numbers -- at least \$0.10 to \$0.15 ahead of what you are implying on the double. Can you talk to that?

Donnie Smith - *Tyson Foods - President and CEO*

Sure, Ken. Like we said, we are off to a good start, particularly in chicken, in this fiscal year, which feels really good.

I think the things you can have in mind: we feel good about our top line sales growth. We feel good about our value-added sales growth bringing that 6% to 8% range.

In chicken, we are heading into a lower cost environment. A little bit higher supply, but we also think that will be offset with some, call it, pricing Halo effect from really high priced beef and pork this year. So we like the way that the chicken supply and demand fundamentals are setting up.

We will continue to get some tailwinds from grain, moving on through our Q1 and then into Q2. And as Jim said in his comments, we have done a great job with our quality, service and innovation, and we think that will pay off in our pricing conversations with our customers, because they view our product offering as one that has additional value, because of those attributes.

If you are looking beef and pork, it looks like to me that the supply dynamics set up next year or 2014, about like 2013. Jim talked about prepared foods, certainly with Houston coming on, our new technology coming on in December, we expect that business, our lunch meat business, to get better through the year, so that has some potential to be additive.

In our international business, Mexico has been a little difficult for us in the pricing so far this quarter, but the market seems to be firming up a little bit. The supply seems to be giving us an opportunity to get our pricing up on top of us a little bit.

China is still -- we are still getting better in China. As we get more of our housing in -- our Company-controlled housing -- our costs will get better. So as we ramp through the year, we anticipate that part of our business being profitable by the tail end of the year.

So it feels like, to us, we've got some early tailwinds, and some possibilities to gain momentum through the year. So that's how we feel about it.

Ken Zaslow - *BMO Capital Markets - Analyst*

Great. Thank you very much.

Operator

Brett Hundley, BB&T Capital Markets.

Brett Hundley - *BB&T Capital Markets - Analyst*

Jim, let me offer my congratulations, as well, if I can even offer congratulations on your retirement, I don't know if you can call it that, it sounds like they are going to hold onto you pretty well. But congratulations.

Jim Lochner - *Tyson Foods - COO*

We'll be close to it, don't worry. But thank you.

Brett Hundley - *BB&T Capital Markets - Analyst*

I wanted to start with pork. Jim, I thought your comment was very interesting on not expecting shortages at Company plants related to PED. And I wanted to work through some of my calculations with you, and see maybe if this is how you are thinking about it, or just to get further clarity.

But when we heard about PED expanding, like it has been in North Carolina, we were thinking maybe anywhere from a 3% to 5% potential reduction in headcount, call it February through April, May, June, kind of a thing. However, we are also noticing increased weights, increased litter rates, increased gilt retention, we think that could be stronger demands in periods going forward, potentially related to demand from Asia for US products.



And so, I had thought that we could see some offsets there. But I just wanted to get, A, to see if you agree with that, but B, what you are really talking about when you say that you don't expect big reductions at your plants.

Jim Lochner - *Tyson Foods - COO*

Let me start with some of the swine veterinarians that we have talked to around the country, that would suggest about 10% of the sows in the US, somewhere around the 550,000 zone, might be impacted. And generally it's thought it might impact 10% productivity on the effect of herds. So that quickly equates to a potential on an annualized basis of 1%.

So the key will be at what points and what locations. But it seems that Oklahoma and North Carolina zones were early impacted, haven't heard yet, although I am sure that we expect to see some impact in the upper Midwest and the corn belt. But again, based on that, we expect to see that 1% impact could be greater, but where also, it would maybe just negate the productivity increases we have been seeing.

And I agree with you. I think particularly on the wholesale pricing side, I think the export demand in total will probably start the increase for 2014. And so a combination of containment of potential increases and pounds produced, with exports, should be fairly favorable for wholesale pricing increases.

Brett Hundley - *BB&T Capital Markets - Analyst*

Okay. I appreciate that. And my follow-up is related to pork, but it has implications for other proteins.

And certainly, Donnie, you talked about the picture and the outlook for chicken. And I certainly agree with you on the demand side. My only worry would be on supplies, potentially building greater than expected.

But back to the demand side, we have noticed some recent featuring of pork items at QSR, and a lot of times, this featuring tends to be temporary. Do you worry at all that this recent activity shows some consumer fatigue surrounding all the chicken featuring that's been done, or how do you view the demand dynamic going forward through fiscal 2014? I appreciate it.

Donnie Smith - *Tyson Foods - President and CEO*

Sure. It's great to have a diversified portfolio, because we can take advantage of whatever they are featuring. But here's how we view it. Beef 50s and beef 90s look like they're going to have another really, really strong year.

So if you are a QSR in the last couple of years, you've been running chicken promotions. It's going to be really hard to comp a chicken promotion with a beef promotion. And more likely than not, that would dominate the feature activity.

So the great thing about chicken is it carries a lot of the flavors, shapes, and forms. And I don't see any fatigue at all at QSR for chicken. So here's kind of the way we think about it.

Beef and pork prices ought to be pretty high. Beef prices, particularly, which sets up a pretty good halo, and chicken, relatively speaking, is a very good value when compared to those high beef prices, so we continue to think you will see a demand shift.

In some of the numbers we talked about, you have chicken pounds up 2% on 7% increase in pricing year-over-year. And what we saw was the beef pounds struggle a little bit as they reach some pricing inelasticity. The key thing about us in the beef and pork deal has been around where the animals are, and we are very well-positioned from a supply base around a lot of the feedlots that are high-volume, high-capacity feedlots.

So we like the way our beef business is set up this year. We view it a lot like we did last year. Does that help?

Brett Hundley - *BB&T Capital Markets - Analyst*

Very much so. Thank you.

Operator

Farha Aslam, Stephens.

Farha Aslam - *Stephens Inc. - Analyst*

Jim, congratulations on a very, very successful career.

Jim Lochner - *Tyson Foods - COO*

Thank you.

Farha Aslam - *Stephens Inc. - Analyst*

My first question is on chicken. Donnie, you had mentioned that you are really managing Tyson's US business for earnings consistency, as well as growth. Could you just highlight how Tyson approaches chicken, that might help the Company manage through the ups and downs of the commodity volatility, better than possibly the rest of the industry?

Donnie Smith - *Tyson Foods - President and CEO*

Sure, Farha. Thanks. A couple of principles that are really important to us is maintaining a manageable minimum of inventory, and then the second thing is, we never want to get long chicken, we don't want excess supply. Our buy versus grow strategy plays into part there.

As we look back a couple of years ago, it seemed apparent to us that we needed to use our pricing structure, as well, as a way to manage the commodity volatility. So when you think about our business, we are probably not going to hit the highs during the summer high peaks in the commodity markets.

We're certainly not going to hit the lows during the wintertime dips in the commodity markets. And we're going to have a more consistent profile, because our pricing profiles are a bit different.

In the last couple of years, we have moved about half of our pricing contracts, to adjust to either the grain costs or the parts markets, and what that will allow us to do is protect our dollar margins, and give us a more stable return in up or down grain markets. That's really our focus, is to present to our shareholders a stable return -- I'm going to say almost regardless of what the commodity markets are doing.

Farha Aslam - *Stephens Inc. - Analyst*

That's helpful. And then on beef, there's considerable concern right now about the tight supply of cattle. Notably, commodity beef margins just registering negative.

Does that mean Tyson's beef division is running red right now? Or is there it programs that you have that can help you outperform the commodity average?



Jim Lochner - *Tyson Foods - COO*

Let me answer that by saying we are not red right now. They've compressed, as I said in my remarks and before, we have put a tremendous amount of focus on beating the revenue components through mix, through pricing, through yield, through a variety of other product management.

And we know one thing. The market won't let us buy cattle any cheaper than the market. So we have put all our focus on driving revenue and staying in position.

We really watch very carefully what the forward demand for cattle -- excuse me, what the forward supply for cattle availability are, and we keep our product sales in reasonably good alignment with that, so we can manage margins by plant, as best we can. Again, all our focus has always been on the execution components within our control.

So that's really the play. If you look forward, I think 2014 will be very similar to 2013, but with a gradual decline in some periods where the supply is very adequate, and some periods where the supply is a little bit more challenging. And that's the essence of margin management, to really see what's out in front of you, and make your adjustments accordingly.

Farha Aslam - *Stephens Inc. - Analyst*

Great. Thank you very much.

Operator

Akshay Jagdale, KeyBanc Capital Markets.

Akshay Jagdale - *KeyBanc Capital Markets - Analyst*

Congratulations, Jim. Hopefully you are still going to be teaching some classes that maybe someday we can join, but congratulations on a great career.

Jim Lochner - *Tyson Foods - COO*

I've been teaching a long time. I plan on continuing to do so.

Akshay Jagdale - *KeyBanc Capital Markets - Analyst*

Well, I wanted to talk a little bit about chicken, if I may. So the fourth quarter, at one point, I don't know if it was last quarter or the quarter before, we expected margins to be at the high-end. Could you just talk a little bit about what happened this quarter?

I'm having a hard time understanding why margins were down sequentially. Perhaps it was Mexico and China. So maybe you can tell us how the US business did.

Can you just help me understand that? Why were margins down as much as they were sequentially?

Donnie Smith - *Tyson Foods - President and CEO*

That's what it was, Akshay. It was China and Mexico. The commodity markets.



I think what happened is maybe the supply rebounded in central and southern Mexico, perhaps a little quicker than what others expected. And certainly did, more than what we expected. And so we faced some pretty cheap commodity markets down in the Mexico City area, and that hurt our Mexican numbers, too.

And we continue to struggle through the rebound in the markets in China. What happened, in the spring, there is evidently a lot of chicken that went into the freezer in China, and that's been coming out. And it's kept the commodity markets softer than what we thought they would be.

Our volume rebound, we are probably around maybe back to 80% of our pre-AI volume, but the markets haven't responded like we thought we would, and we think that has to do with some excess inventory. So domestic business is running great.

You have to remember, too, that there's a significant -- I say significant, there's there is about an eight-week or so lag in the commodity costs. And so, we still have really, really high grain prices into mid August. In the last half of August and then September, we started taking a little truck grain in, which we hedged it up and it was typically cheaper.

But it was really like the second week of September before we really got into heavy truck grain. Well, by then, you are really looking at mid-Q1 of FY14 for a cost drop. So it was really the way the commodity market -- the futures looked cheap. The basis levels looked high. But that drop really gets shoved into Q1 and Q2 of 2014 in your chicken cost structure. That make sense?

Akshay Jagdale - KeyBanc Capital Markets - Analyst

It makes sense. But can you give us -- I think it said for fiscal 2013, you get 80% of the \$100 million in losses back, so it's going to be an \$80 million improvement, if I may, in international. So I guess we didn't end up with that number? The only reason I'm asking is --

Donnie Smith - Tyson Foods - President and CEO

You're right, Akshay. We only got \$45 million. And that's part of the -- that and coupled with what happened in Mexico is the money you are looking for in Q4.

Jim Lochner - Tyson Foods - COO

Both China and Mexico.

Akshay Jagdale - KeyBanc Capital Markets - Analyst

So what's the expectation embedded into 2014 for international, on the same operating income number?

Donnie Smith - Tyson Foods - President and CEO

We should get consistently better quarter after quarter. But China probably won't reach profitability until our Q4.

Dennis Leatherby - Tyson Foods - EVP and CFO

But overall, it will be profitable for the year.



Donnie Smith - *Tyson Foods - President and CEO*

Yes.

Akshay Jagdale - *KeyBanc Capital Markets - Analyst*

Okay. And then you said chicken is off to a good start. Can you help me on this end, what but a good start means for you in terms of operating margin? That would be helpful, and then I just have a follow-up on supply.

Donnie Smith - *Tyson Foods - President and CEO*

No, other than saying we are off to a good start, I really can't give you any more help than that, Akshay. We're off to a good start.

Akshay Jagdale - *KeyBanc Capital Markets - Analyst*

Okay. And then just on supply, you increased your supply estimate for 2014 3% to 4%. Why did you do that? Have you seen something in the pullet placement numbers or what's the reason for the higher supply, and why doesn't that impact your margin guidance negatively?

Donnie Smith - *Tyson Foods - President and CEO*

Okay. So head up a little bit. You're right. The pullet supply for 2014 is what it is.

But we think weights were particularly heavy this quarter, and we think weights are going to continue to increase next year, driven, of course, by cheaper grain costs. The reason it's not impacting our results negatively, is that we have planned for it and our buy versus grow strategy will have us buying cheaper raw materials and then upgrading those into value-added sales. And that's our model.

Jim Lochner - *Tyson Foods - COO*

The other thing you really have to look at, Akshay, is Oct-Nov-Dec period here year-over-year is up, and we are talking about fiscal. So you're starting with this period with a fairly high increase in pounds. So you've got to get yourself adjusted to the fiscal versus the calendar as well.

Operator

Ken Goldman of JPMorgan.

Ken Goldman - *JPMorgan - Analyst*

Jim, congrats as well. I hope this doesn't mean you've gone vegan on us.

Jim Lochner - *Tyson Foods - COO*

Let me put the probability of that happening at 0% to negative 100%.

Ken Goldman - *JPMorgan - Analyst*

Good. I appreciate your comments on packaged meats and some of the opportunities you have to turn that business around. Are you there?



Donnie Smith - *Tyson Foods - President and CEO*

Ken, we got you.

Ken Goldman - *JPMorgan - Analyst*

I hear something else. Based on your comments from a year ago, maybe a turnaround is taking slightly longer than you initially (technical issue) difference in the categories to compete in.

I'm just curious. If the turnaround eventually doesn't work the way you hope, what would it take for you to potentially turn to some acquisitions, to get some brands that are maybe more established in some categories, call it lunch meat or whatnot, to solidify and accelerate your growth?

Ken Zaslow made a good point, I thought. You have a lot of cash, and you are generating even more cash every year. So I'm just curious about that make or buy proposition in packaged meats.

Donnie Smith - *Tyson Foods - President and CEO*

This is Donnie. We absolutely have our eye on multiple ways to grow our prepared foods business.

With our cash flow, it's obvious that acquisitions are within our view. We did a couple of small acquisitions last year to try to fill in some gaps, and we obviously have capacity and options now, with our great balance sheet, to be more aggressive if we need to, if there is a right fit.

Dennis and I have talked a lot over the last couple of years about how we view acquisitions. We approach them fairly clinically. We want to make sure that an acquisition can be accretive to our ROIC within a fairly short and reasonable period of time.

We try to target something that can -- if our total ROIC is going to be 20% or better, we want to target an acquisition that can get there within a two- or three-year time period, that type of thing. So that's the math we use, whenever we are looking at an acquisition target.

But we're also committed with our current facilities to continue to improve. I'm extremely confident that the moves we are making, particularly in our lunch meat business, will have us very well-positioned by say this time next year, in our lunch meat business.

Again, our prepared foods business is a broad range of categories. Some of those businesses are doing very, very well with great margins, and we will continue to drive those. They are very important to the customer targets that they focus on.

So we feel really good about our prepared foods business, and if you noticed in our organizational changes, we are doubling down. We have got great talent against our prepared foods segment, and we're going to put a lot of focus on prepared foods going forward. Jim, do you want to add anything to that?

Jim Lochner - *Tyson Foods - COO*

The only thing I would add is, as I said in my remarks, we made a lot of conscious decisions, and I think some people sometimes underestimate the start-up costs and investment in G&A, putting the right organizational structures, the MAP spend, they don't accrete earnings right away.

You've got to bet on it going forward. So that's part of what we saw in the dilution this year, and particular this quarter, as we look at multiple categories. We've got our eye on a lot of things, and this area has a lot of potential. We've put a lot of manpower and good talent around it.

Dennis Leatherby - *Tyson Foods - EVP and CFO*

Ken, this is Dennis. I would just add that prepared foods, were it not for all these turnaround expenses and start ups, it would have generated about a 4.5% return on sales, which is, as you know, within our range. We think that next year we're going to continue to improve the business. The real fruits of this labor will come in 2015 and beyond, as these businesses build out and fill out, I think they will be nicely profitable.

Ken Goldman - *JPMorgan - Analyst*

Thank you very much for the color.

Operator

Tim Ramey, D.A. Davidson.

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

Let me add my great wishes to Jim. I just threw open my 1988 initiation on IBP, and he was there, as Jim P Fidgety, had this demeanor of a commodities trader, super bright, and nothing has changed really. So congratulations, Jim. It's been fun to be hanging around you for 25 years. That could have been due to working for Bob Peterson at the time, I'm not sure.

Jim Lochner - *Tyson Foods - COO*

I did have hair in 1988, I think.

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

That's true. So you made a comment, Donnie, on profitability in the fourth quarter, in China, fourth quarter of 2014. But you featured China right up there in your first paragraph. And so I'd love to have you dream a little bit more publicly about what that might look like in 2015 and 2016, just to re-satiate our appetites on the outlook on that one.

Donnie Smith - *Tyson Foods - President and CEO*

The tough thing about FY13 was the financial impact on our business. We were about half of our production is in Company-owned or Company-controlled birds, now, and our cost structure in those houses is really effective. So we can't get our land-use rights, and can't get these farms built fast enough for our taste. And we're doing pretty good.

Our initial plan as you go back to, 2, 2.5 years ago, was to be completely built out by FY14, by the end of FY14. We're probably going to miss that by a few weeks, but still, the vast preponderance of our chickens will be in Company-controlled housing. So it gives us a cost advantage and it gives us a marketing advantage. The thing we have seen is the importance of the supply chain that we are developing.

And what we have seen in 2013, although it's not been great for us financially, it has validated our business model. So we think having a supply chain that is -- from pullet to plate, is very consistent with a lot of cost controls, and a lot of bio-security controls, is going to be very good for us in 2015 and beyond.

So what we see is going into 2015, we would have an advantaged cost structure. We would have a very unique and very differentiated selling story.



I tell you, I think we've got a great opportunity. Yes, we deal with the food service QSR, and that kind of thing, but we have a great retail offering in China as well. And we have got the ability to take the Tyson brand across more areas of China, and to expand that geographically, and have a really strong branded presence.

Because as you well know, Tyson Foods has meant trusted food and great quality for years and years in America. And we want to bring that as well to China. So we are very optimistic about what happens in 2016 and beyond, and really looking forward to getting there.

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

And just to kind of restate the focus on food safety and bringing it all in-house, leads you to believe that pricing will be such that you can charge premium prices, as well as get your costs under control. I think you originally said they could have twice the margins of the domestic business. Is that still roughly your thought process?

Donnie Smith - *Tyson Foods - President and CEO*

Absolutely. In a mature complex. We intend to grow China pretty aggressively.

And so we may have two mature complexes that are at those levels of margins, and then we may have an immature complex or a partnership or that kind of thing that's still coming on stream, that would be in the mix as well. But when these complexes get full, just like a US complex today, we are still confident that they will carry a very aggressive margin structure, about twice of what we see here.

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

Terrific. Thanks.

Operator

Michael Piken, Cleveland Research.

Michael Piken - *Cleveland Research Company - Analyst*

Congratulations, Jim, on your retirement. I just wanted to make sure that, on the beef side, a couple quick questions. You had talked about a 2% to 3% decline in fed cattle supplies. If you look at USDA's numbers, which are more on a pounds basis, they are suggesting beef production for calendar 2014 will be down more like 6%.

Was that 2% to 3% more for the cattle supplies in your area, or is that an industry-wide outlook? And secondarily, if production is really down about 6%, do you think that the industry as a whole might need to take down another packing plant? Thanks.

Jim Lochner - *Tyson Foods - COO*

I saw the USDA pounds estimate. You have to factor in the probability of beef cow slaughter being down appreciably.

We are thinking more in the fed steer and heifer, was what we referenced, because we don't participate in the other category on the process side, so we don't process cows. And I'm just really basing that off looking at the prior calf crops in 2011, 2012, and 2013. And being in that 2%, last year in our fiscal year, 2013 versus 2012, we were down 1.5%.

So we're thinking that trajectory is down, which it hasn't shown signs of yet, that number changes. If heifer retention doesn't happen, that number could actually lessen. So we're just really basing everything off the calf crop going forward.

And to answer your question, as supplies based on the beef cow and the dairy cow herd, and the calf crop going forward, we still have overcapacity. There is probably some peripheral plants outside the feeding zones that will struggle.

Again, our plant is set right where the bulk of cattle feeding occurs, and so we're fairly comfortable. And we pay very close attention always to the forward supplies, and try to keep ourselves in very good balance.

Michael Piken - *Cleveland Research Company - Analyst*

Okay, great. And just as a follow-up on that, I know you had mentioned earlier on Farha's question, that you are profitable right now. And this is typically, this quarter and into your second fiscal quarter, the weaker time for beef.

If you guys are profitable now when the industry margins are lower, I guess could you explain why you think your margins could potentially be below your normalized range? Thanks.

Jim Lochner - *Tyson Foods - COO*

Well currently, we expect -- Q2 would normally be the tougher quarter. We are fairly pleased, as we look back at 2013, and we sat here a year ago during the Oct-Nov-Dec period, and then went into the Jan-Feb-March period, and we felt like we were struggling, but we came back strong in our last two quarters, and I expect pretty much a repeat of that.

If we continue our emphasis on controllables, which I'm very pleased that the team there is extremely focused on those. It could be better than that. But we are factoring in some periods that we think that the cattle will be a little tighter and the industry margins as a whole could compress. But we certainly think there are times when they could expand. So that's why really, we said we think 2014 will be similar with similar challenges that we had in 2013.

Michael Piken - *Cleveland Research Company - Analyst*

Thanks a lot.

Operator

Tim Tiberio, Miller Tabak.

Tim Tiberio - *Miller Tabak - Analyst*

Jim, I want to add my best wishes to you.

Jim Lochner - *Tyson Foods - COO*

I appreciate that. Thank you.

Tim Tiberio - *Miller Tabak - Analyst*

And then, just two very quick questions on your outlook for 2014. Do you feel that the country of origin labeling, that the supply chain has fairly well-adjusted to that event? And are the potential for higher costs reflected in your outlook for the prepared foods segment in 2014?

Jim Lochner - *Tyson Foods - COO*

Let me address country of origin labeling. We factored that in, and maybe that will change.

There is still an opportunity for the farm bill or adjustments to take care of that. If it doesn't, we fully adjust, and we are in compliance today. We've made the adjustments we need to, and looking forward on the long-range supply activity to accommodate that.

And then I'm not following your second question. Is that jumping into the prepared foods segment or related to cattle or beef?

Tim Tiberio - *Miller Tabak - Analyst*

I guess cattle and beef, and whether you think that you've got a good handle on the cost structure. Obviously, you are bringing in more feeder cattle from Canada to the US.

So, just wanted to get a sense if you feel like the supply chain is prepared for that impact. And it sounds like that is the case.

Jim Lochner - *Tyson Foods - COO*

Yes. Definitely. We did announce that we would curtail at least for a while, any direct importation of Canadian cattle.

And we can always reevaluate that, and adjust our SKU count accordingly. But in the interim, we are going to try to simplify the product mix out there. But as a whole, I'd say that the adjustment has happened, and we'll just have to see and let those take some supply potentially out of the US beef.

Tim Tiberio - *Miller Tabak - Analyst*

Okay. And just secondly, on the international outlook, does your outlook include the potential for increased supply in Brazil? As soy milk prices come down, there is obviously the potential for production in that country to grow.

They're obviously a large competitor in the export markets. I just wanted to get your thoughts with regards to Brazil. Thanks.

Jim Lochner - *Tyson Foods - COO*

As Brazil exports more beef to more countries and has an increase of supply, that puts a little more pressure on the manufacturing. It might indirectly work for we see more 90 or imported lean beef coming into the US. That could potentially offset some of the cow slaughter reduction that's there. So those are always balances that you are watching very carefully, simply because they do impact raw material cost, they impact the pounds, and they impact the utilization of particularly manufacturing in beef.

And that's why it is a global market. US beef and Brazilian beef don't necessarily compete in like markets, for like causes and uses, but they are all in that balance. So, thank you.

Donnie Smith - *Tyson Foods - President and CEO*

By the way, on the chicken side, very much intend to grow our business in Brazil, not just in terms of a number of heads process, but also in our value-added offerings. So very much a growth vehicle there.

Tim Tiberio - *Miller Tabak - Analyst*

Great. Thanks for your time.

Operator

Rachael Nabatian, Credit Suisse.

Rachel Nabatian - *Credit Suisse - Analyst*

I just wanted to say congratulations to Jim. Now, your beef results came in a little better than we were expecting. So I was just wondering if you got a short-term benefit on cattle bidding from the USDA shutdown?

And this is particularly when the outlook and the conditions were weak. And I also wanted to know, is the LFTB issues, have those turned back into a positive, and are you now monetizing LFTB again?

Jim Lochner - *Tyson Foods - COO*

Let me start with, no we did not have any benefit. We just used alternative pricing mechanisms. We gave both buyers and sellers alternatives.

If they didn't want to use the alternative formulas, non-USDA reported markets, let's go to negotiate it on beef and pork as well. It did create some disruption for a period of time, but both buyers and sellers all did adapt, and we -- traditional or old market reports were negotiated. So had really no impact from that.

Lean finely textured beef, no, the volume is still not utilized anywhere close to the same percentage. And quite clearly, going forward, we and others will clearly label its presence in ground beef, so that issue can not be attacked again. So that's kind of a play on that.

Really again, in the margin scheme, it's also probably neutralized itself. Not probably, it has neutralized itself. We're not seeing any impact one way or the other from it at this stage.

Rachel Nabatian - *Credit Suisse - Analyst*

Understood. Okay. Thank you.

Donnie Smith - *Tyson Foods - President and CEO*

Before we go, I want to thank our team members for all you've done to make 2013 such a great year. And I'd also like to thank our investors for your continued support of Tyson Foods. Hope you have a happy Thanksgiving, and eat some chicken, beef, and pork instead of turkey this year. Would you? Thank you, everybody.



Operator

Thank you for your participation. That does conclude today's conference. You may disconnect at this time.

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