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Tyson Foods, Inc. (TSN)

Q2 2014 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Welcome to the Tyson Quarterly Investor Earnings Conference. For today's call, all parties will be on listen only. [Operator Instructions] Today's call is being recorded. If you have any objections please disconnect at this time.

I will now turn today's call over to Mr. Jon Kathol, Vice President of Investor Relations. Thank you. You may begin.

Jon Kathol
VP-Investor Relations & Assistant Secretary, Tyson Foods, Inc.

Good morning, and thank you for joining us today for Tyson Foods conference call for the second quarter of the 2014 fiscal year.

On today's call are Donnie Smith, President and Chief Executive Officer and Dennis Leatherby, Executive Vice President and Chief Financial Officer.

I need to remind you, our remarks today include forward-looking statements, as defined in 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'll now turn the call over to Donnie Smith.

Donald J. Smith

President & Chief Executive Officer, Tyson Foods, Inc.

Thanks, Jon. Good morning, everyone. And thanks for joining us today. With $0.60 a share, Q2 was a record setting second quarter and we achieved it despite some significant hurdles. Q2 is typically our most challenging quarter and we expected that to be the case again this year. Now that it's in the books, I'm feeling like we're in a really good position for the back half of the year.

But before we comment on the balance of the year, let's look at what went on in Q2. Winter weather affected us in several ways, some positive, some negative. Although we saw a dip in our sales to school cafeterias from weather-related closings, we saw an increase in our retail sales because mom went to the grocery stores and stocked up on chicken strips when she heard another round of bad weather was coming.

Our multi-channel business model allows us to serve the consumers' needs wherever they are, which is one of our strengths as a company. Because of road conditions, we had more issues than normal getting orders to our customers, and team members to our plants. Cold temperatures affected livestock productivity, and there were propane shortages that resulted in price hikes of that important fuel source for our growers. We expect this sort of thing every second quarter, at least in some locations, but this season, winter storm started earlier, were more widespread and were more frequent.

Now, switching to the consumer demand picture. Increasing protein prices have indicated continued strong demand for protein, often at the expense of carbohydrates. We're seeing a noticeable shift among the proteins as well. Looking at Nielsen 52 week data, pounds of fresh meat sold at retail were up a little over 1% on nearly 3% higher prices. However, if you look at the most recent four week data for the period ending March 29, total pounds sold were about flat, while dollar sales rose a little over 4%, driven by a 4.6% increase in pricing.

Fresh beef volume is down nearly 7% on a 7% price increase, pork volume is down nearly 1% while prices have gone up 5.5%, and as expected chicken pounds were up 3.5% even though chicken pricing was up 3%, indicating a definite shift towards the relative value of chicken.

On the foodservice side, restaurant spending is up, but the gains are from higher average check prices, not additional traffic. NPD has forecasted traffic growth to be only 1%, which so far in the calendar year, we're seeing predominantly in small chains. Technomic restated its forecast for the year to reflect the winter storms and is now projecting 2.5% to 3% dollar sales growth down from 4% earlier.

At both retail and foodservice, we continue to see the bifurcation of consumers. Food spending is leaning towards either a value priced product or a premium option and the middle is getting squeezed, but again Tyson Foods is serving all of these consumers in whatever channel, price point or type product they're looking for and that's one of the reasons we continue to be successful. I'm really pleased with the 7% growth in sales of our value added products in all of our channels and this is a key part of our strategy.

So, the takeaway for Q2 is that despite bad weather, high prices that affected demand and sluggish food service traffic, our volume was up nearly 3% over Q2 last year and we had a 4% return on sales.

Now, let's see how that looks at the segment level and what we expect going forward. The Chicken segment had an 8.2% return on sales in Q2, volume was up while pricing was off slightly as a result of lower feed ingredient cost. And we expect to be down about $500 million for the year. We expect overall domestic chicken production to be up only 2% to 3% in fiscal 2014 given continued tighter breeder supplies. We think that strong consumer demand for chicken can easily absorb the small supply increase and it should be a strong for the Chicken segment.

The Beef segment had just under a 1% return on sales. We had to deal with a considerable amount of volatility throughout the quarter with temporary supply imbalances due to an extreme run-up in cattle prices. It was difficult to maintain the spread, but we stayed positive for the quarter, one of the ways we managed our spread was to run fewer head, which is why our volume was down, but we effectively maximized revenues and controlled costs through continued attention to detail and execution on the fundamentals. Although we may see more of these temporary imbalances in some regions going forward, our plants are strategically located near the cattle supplies and we expect to have adequate cattle to run our plants. As always we'll manage for margin and we expect beef segment results for 2014 to look similar to last year.

In the Pork segment, we had a 7.2% return on sales in the second quarter. Volume was up on strong demand. Of course the big concern in pork is the PED virus and its impact on hog supplies. We did began to see a supply reduction in our Q2, although heavier weights partially offset fewer head and we were able to make up some by improving yields as part of our continuous improvement effort.

The impact of PED is expected to further affect our hog supplies beginning around the 1st of June, peaking in August and then beginning to ease in October. Hog weights are expected to be higher and offset some of the head reduction. So we anticipate industry pork production to be down as much as 4% for the year. We'll need to adjust our operating hours accordingly, but we think the Pork segment will still perform well this year despite these challenges.

The Prepared Foods segment had a 2.4% return on sales for the quarter. We had strong sales volume, but the rapid run up in raw materials and our formula pricing mechanism created a pricing lag; although, we expect to recoup the difference later in the year. And I don't want to leave with the impression; however, that we're satisfied with these results, because we're not. We are working on product innovation, maximizing the opportunities from our recent acquisitions, investing in our operations and putting MAP spending towards product launches to improve the long term profitability of the Prepared Foods segment.

I'd like to update you on one of these launches that we previously told you about which is Tyson Day Starts. The initial rollout went better than planned and we're exceeding all of our pre-launch objectives. These products had an ACV of 60% by mid-March, which is the fastest growing ACV of any product launch in our history.

Bacon is another bright spot, despite value markets that pushed retail higher, we didn't see any demand erosion in Q2. When you combine our three-tier branding strategy of Wright, Tyson and Corn King, Tyson Foods holds the number two market share in sales dollars and when you add private label to our three branded bacon offerings, we're the biggest seller of bacon at retail. And we'll continue to be aggressive with ACV goals especially with the Wright brand, our premium offering.

Bacon's a strong performer and I think there are several other businesses at varying stages of development within the Prepared Foods segment that can perform as well as our bacon business in the future. Admittedly, we have room for improvement, but I think our Prepared Foods segment is better than the 2.4% return on sales we showed you this quarter and we're determined to prove it.

And our final segment to discuss is our new International segment. I'll give you the highlights and then Dennis will give you the particulars of why we created this new segment and what it comprises. International had a negative 9.1% return on sales. China is still the biggest portion of the loss due to demand destruction. As I said on our Q1 call, we slowed the pace in China as we wait for demand to return. We think the worst is over and that it should get sequentially better from here, but we'll need to see demand recovery before we can predict when we'll reach profitability in China.

Our operations in Brazil also struggled in Q2, but we've restructured our team there to improve the operational focus. And speaking of focus, back in November we announced several leadership changes for the company and a new organizational structure focused on the key elements of our strategy to accelerate growth, reinforce our operational excellence and create opportunities for our team members.

We recently completed the reorganization and now have the teams in place under Hal Carper in Strategy and M&A, Donnie King, in Prepared Foods and Customer and Consumer Solutions, Steve Stouffer in Fresh Meats and Noel White in Poultry. Now that we have this important step behind us, we can turn people lose to do their best work in the areas that have the most impact.

And now, let's go to Dennis for the financial update.

Dennis Leatherby

Chief Financial Officer & Executive Vice President, Tyson Foods, Inc.

Thanks, Donnie, and good morning. As Donnie said earlier, we had a record setting second quarter. Our top line revenue growth was 7.7% over the prior year and quarterly sales surpassed $9 billion for the first time in our history. We continue to execute our growth strategy as evidenced by increased sales volumes in Chicken, Prepared Foods and International. Total company return on sales was 4% and operating income was $361 million, up 53% from Q2 2013.

Our earnings of $0.60 per share is a record for our second quarter and represents a 58% increase over adjusted EPS of $0.38 in Q2 2013. Year-to-date EPS was $1.32 or a 52% increase compared to last year's $0.87 adjusted EPS coming from continuing operations. Our rolling four quarter EPS is $2.71 from continuing operations on an adjusted basis. This compares to $1.95 for the same period a year ago.

We achieved a 12 month pre-tax return on invested capital of just over 20% compared to 16% for the prior year period. This 20% ROIC goal is an important metric for us and one we're proud of attaining. Operating cash flow through two quarters was $265 million after funding $367 million in additional working capital as we grew our business. This compares to operating cash flows of $230 million for the first two quarters of fiscal 2013.

We spent $153 million on capital expenditures for the second quarter and $293 million for the first six months of fiscal 2014. This outpaced our depreciation and the amortization by $39 million, as we continue to invest in projects for both our domestic and international operations. These projects will not only result in improved productive capabilities, labor efficiencies, yields and sales mix, but will also increase our ability to innovate, and introduce new products to our customers.

During the second quarter, we repurchased 2.5 million shares for $100 million under our share repurchase program. Since, May of 2011, we repurchased 50.4 million shares for $1.2 billion. Our effective tax rate in Q2 was 38.3%.

Net debt to EBITDA for the past 12 months was 0.7 times, and on a gross debt to EBITDA basis, this measure was 0.9 times.

Including cash of $438 million, net debt was $1.5 billion. Total liquidity was just under $1.4 billion, remaining above our goal of $1.2 billion, and gross debt remained at just over $1.9 billion. Year-to-date, net interest expense was $48 million, down 30% from a year ago. Average diluted shares outstanding for the quarter were $356 million. This reflects the dilutive effect of options and warrants of $13 million. The impact of the $2.5 million shares repurchased during the quarter will not be fully realized until subsequent quarters.

Now, here are some thoughts on the full year for fiscal 2014. We now expect revenues of approximately $37 billion, up $1 billion from our previous estimates, and almost 8% over fiscal 2013. Net interest expense should approximate $95 million, down $5 million from our previous estimate and down more than $40 million from a year ago. The effective tax rate should be around 35.5%.

CapEx is expected to be in the $650 million to $700 million. We expect diluted shares in Q3 to remain around 356 million and because our convertible notes and warrants are behind us, there should be less volatility in our diluted shares. We still think we'll generate at least $2.78 EPS for the year and at least 10% EPS growth in 2015 and beyond.

Our priorities for excess cash remain the same which are, capital spending to improve and grow our existing businesses, acquisitions either small bolt-ons or larger strategic acquisitions to fulfill our growth strategies around value-added products in international, and returning cash to shareholders through share repurchases and dividends, all while ensuring we maintain plenty of liquidity at our disposal.

As Donnie noted earlier, beginning with the second quarter, we are now reporting our International operations as a separate segment. The International separate segment, which had been included in our Chicken segment, includes our chicken processing operations in Brazil, China, India and Mexico. International became a separate reportable segment as a result of changes to our internal financial reporting to align with executive leadership changes and reorganization Donnie previously mentioned.

We believe this will provide better transparency into our business to enhance understanding of our financial performance. I would also note that our Beef, Pork, Prepared Foods and other results were not impacted by this change. To wrap up, we delivered solid results in a seasonally soft quarter and adjusted earnings per share are up 52% for the first half of the year. We continue to think the back half of the year should be strong and we are confident we can deliver on our targets.

That concludes our prepared remarks. Denise, we're ready to begin Q&A.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] And I do have today's first question from Ken Zaslow with Bank of Montreal. Your line is open.

Kenneth B. Zaslow
Analyst, BMO Capital Markets (United States)

Q

Hey. Good morning, everyone.

Donald J. Smith
President & Chief Executive Officer, Tyson Foods, Inc.

A

Good morning.

Dennis Leatherby
Chief Financial Officer & Executive Vice President, Tyson Foods, Inc.

A

Good morning.

Kenneth B. Zaslow
Analyst, BMO Capital Markets (United States)

Q

Hey, Donnie, your expectation for chicken production levels up 2% to 3%. It's higher than most of the industry that we're hearing from including [indiscernible] (16:17). With lower production in the first half of the year, does that imply a fairly rapid expansion in the back half of year and what are you thinking about 2015 on that? Can you just help us out with that?

Donald J. Smith
President & Chief Executive Officer, Tyson Foods, Inc.

A

The 2% to 3% is driven mainly on weight continuing to increase of what we think placements will be about flat to maybe up 1% or so in the back half of the year. I don't see a meaningful change in poultry production until probably the back half of our 2015. So I don't think there's anything that's going to get away from us, but I also think, Ken, there is going to be a very strong demand pull for chicken. And the industry is going to try to respond as much as it can. The relative value of chicken at both retail and foodservice is going to make for a very, very strong chicken back half. So that's kind of what we're seeing. I don't think the 2% to 3% is anything that would change our margin outlook for the back half of the year.

Kenneth B. Zaslow
Analyst, BMO Capital Markets (United States)

Q

Great. And my follow-up question is this is more of a technicality. Making sure I understand, you're now obviously excluding International from your business. And you said that your chicken outlook is to be above your normalized range. If I net those together, did the net of those two change to the upside, downside, or hasn't changed relative to your initial expectations?

Donald J. Smith
President & Chief Executive Officer, Tyson Foods, Inc.

A

To the upside, if you look at our domestic Chicken business for the first half, we're just under 9% on sales and there is no reason going into the back half of this year for us to not expect our earnings in chicken to be at least that good or better. So, yeah I think in general it adds the total range if you put the two back together to the upside.

Kenneth B. Zaslow
Analyst, BMO Capital Markets (United States)
Q

Great. I appreciate, thank you.

Donald J. Smith
President & Chief Executive Officer, Tyson Foods, Inc.
A

You bet, Ken. Thanks.

Operator: The next question comes from Farha Aslam [Stephens, Inc.]. Your line is open.

Farha Aslam
Analyst, Stephens, Inc.
Q

Good morning.

Donald J. Smith
President & Chief Executive Officer, Tyson Foods, Inc.
A

Good morning Farha.

Farha Aslam
Analyst, Stephens, Inc.
Q

Just continuing on the chicken discussion, could you just give us a read, your pricing was down in the March quarter? And we've seen spot pricing for chicken improve. Kind of your outlook for pricing and profitability and a little bit more detail on the U.S. chicken business for the second half would be helpful.

Donald J. Smith
President & Chief Executive Officer, Tyson Foods, Inc.
A

Yeah. Certainly over the last 30 days, 40 days or so the chicken market has responded. If you look at you know [indiscernible] (19:00), I think beef cutout, topped out around $2.40 or so and pork ran up to $1.30 or so and that provided a huge halo for chicken prices to continue an increase because chicken pricing looks relatively cheap compared to those beef and pork numbers. So we expect to see another strong year of chicken pricing for the summer and think that the outlook for the back half of our year should be better than – the earnings outlook for the back half of the year should be better than the front half.

Farha Aslam
Analyst, Stephens, Inc.
Q

Okay. That's helpful. And then when you look at capital allocation, clearly you have significant liquidity available to you, yet you've said that your share count should be relatively flat for the rest of the year. Can you share with us your thoughts on M&A and the environment you're currently seeing?

Dennis Leatherby
Chief Financial Officer & Executive Vice President, Tyson Foods, Inc.
A

Sure, Farha. Let me take this one by one. First, as far as the share count, that's where we are as of now. So, we're not projecting where we're going to go from here. In terms of the M&A environment, it's a very attractive environment. Over the past 12 months our EBITDA was about $2.1 billion, and so we can put some pretty good leverage on that. And have the ability to both go after small bolt-on acquisitions or larger more strategic acquisitions.

Farha Aslam
Analyst, Stephens, Inc.
Q

And just the transactions, any color on what you're seeing out there right now?

Dennis Leatherby
Chief Financial Officer & Executive Vice President, Tyson Foods, Inc.
A

We're seeing a variety of opportunities in value-added, in International. We're just looking for the right strategic fit, right now.

Farha Aslam
Analyst, Stephens, Inc.
Q

Great. Thank you so much.

Operator: The next question comes from Brett Hundley [BB&T Capital Markets]. Your line is open. Hello, Mr. Hundley, your line is open. Would you like me to move on?

Donald J. Smith
President & Chief Executive Officer, Tyson Foods, Inc.
A

Yes. Please.

Operator: Thank you. Up next is Michael Piken [Cleveland Research Co. LLC]. Your line is open.

Michael L. Piken
Analyst, Cleveland Research Co. LLC
Q

Yes. Good morning. Just wanted to shift over to the red meat side of the business, and if we can start on the Pork side, I see you've taken your production down 4% to 5%; you mentioned in the prepared remarks that you think the supplies are going to be tightest from June to October. But where is the industry in terms of finding a vaccine or something to stop the spread of PEDV at this point as best you can tell?

Donald J. Smith
President & Chief Executive Officer, Tyson Foods, Inc.
A

I'm not aware of any vaccine that has been developed. I do know and working with our pork suppliers, we have a very close, very good relationship with the farmers from which we purchase hogs. And there's been a noticeable increase in biosecurity throughout the areas where we draw our hogs from, but as far as we know, there's no readily available vaccine.

Michael L. Piken
Analyst, Cleveland Research Co. LLC
Q

Okay. So, I mean, do you think at this point, I mean, it seems like at least the spread of the disease has been a little bit contained. How much of that is weather versus just the improved biosecurity, and how confident are you now that sort of we may – the down 4% or so is probably what we're going to see now and that it might not get worse?

Donald J. Smith
President & Chief Executive Officer, Tyson Foods, Inc.
A

Let me approach the back half of that question first. Although, it's difficult to be completely confident, and I'll explain that in a second. We work very closely with our farmers, and we know in the regions where we operate, when which farms were affected, and we work closely with them to understand how much they're affected. We also work closely with them, to know how much longer they're trying to hold their hogs, to put a little bit more weight on them and that kind of thing.

So, we stay pretty dialed in, say within a three week or four week period of what the hog supply is going to look like coming into our plants. Now, the things we can't tell is, for example, with the increased biosecurity around PED, how much improvement is that having on PRRS, for example on these farms. So, there is a little bit of movement in that number, but in general, as we just look at the case accessions, and how they're affected the farmers that we draw hogs from. We're pretty confident that between June, and then probably dipping the deepest in that August set period and then trying to start to recovering or so, in October is the right way to plan our business and we work not only with, of course our plans in making sure we got a good plan dialed in, to be as efficient as we can be and move hogs around where we need to, but we've also been working with our customer base to make sure that those products that are sold by the each, for example ribs or bellies or whatever, are that we understand what the dip is going to look like and how we can help them merchandise through that. So, we think we've got a good plan. We think we're as dialed-in as we can be.

Michael L. Piken
Analyst, Cleveland Research Co. LLC
Q

Okay. Great. And then just shifting over to bacon, it looks like the cattle on feed numbers are supportive of relatively good supply availability over the next two quarters. But as you think about fiscal 2015, could you talk a little bit about your outlook for beef margins? Do you think we can get back to normalized levels? It looks like the cattle supplies might get a little more tight as you head into the early half of fiscal 2015. So any thoughts there in terms of how we think about your Beef business next year?

Donald J. Smith
President & Chief Executive Officer, Tyson Foods, Inc.
A

Little more comfortable in the back half of 2014 certainly and we agree with your assessment there that there should be adequate cattle certainly around us. The drought in the Southwest continues and that tends to push a few more cattle up in the Midwest where the predominance of our processing base is. So, we feel good about having adequate cattle around us.

As you get on out into 2015, I think you can – looking at the calf crop, you can already say that the 2015 numbers will be down another 2% to 3% or so and it looks like that the cattle are going to continue to concentrate in the Midwest creating some of these regional disparities with cattle supply out there. But we feel very comfortable that we're going to have good cattle around us. And at this point there's no reason for us not to think of our Beef business at least as good as last year or better this year, and not a lot of reason to think about it very differently going into 2015 from where we stand today.

Michael L. Piken
Analyst, Cleveland Research Co. LLC

Q

Okay. Thank you very much.

Donald J. Smith
President & Chief Executive Officer, Tyson Foods, Inc.

A

Bet.

Operator: The next question comes from Diane Geissler [CLSA Americas LLC]. Your line is open.

Diane R. Geissler
Analyst, CLSA Americas LLC

Q

Good morning.

Dennis Leatherby
Chief Financial Officer & Executive Vice President, Tyson Foods, Inc.

A

Good morning.

Donald J. Smith
President & Chief Executive Officer, Tyson Foods, Inc.

A

Good morning, Diane.

Diane R. Geissler
Analyst, CLSA Americas LLC

Q

Hey, I just wanted to put together a couple of these comments that you've made about production into 2015 to get more of a holistic view on total protein production in 2015. It sounds like to me you're saying that given the constraints of the hen flock, you might see a little bit more production in chicken later in 2014, but it won't really ramp until later in 2015. I don't know if anybody really has a clear call on hog numbers, because until we get on top of the virus itself, I'm not sure where it's going to go. So I would look at maybe on the hog side flat to up slightly next year and then it sounds like the cattle supply should be down again because of either drought and/or retentions? So to kind of put that all together, are you looking for sort of flat to up slightly in terms of total protein supply next year or do you have a view on that at this point?

Donald J. Smith
President & Chief Executive Officer, Tyson Foods, Inc.

A

The big if for us is what's going to happen with pork. I'd like to think we're going to see a herd expansion, I'd like to think we're – with our security we'll get on top of PED but it's just too early to tell. I think the rest of it, Diane, you're dialed in very well on what to expect from a supply standpoint. So, I don't think I'd change your outlook very much and if anything flat to up maybe a little bit would be a pretty decent call in May. Now, we'll know a little bit more as we get on into the fall. But I think you're dialed in pretty good.

Diane R. Geissler
Analyst, CLSA Americas LLC

Q

Okay. And then maybe just to move to the demand side of the equation, you commented that you've seen a shift – I think we've all seen the shift in terms of out of carbs and into protein. I think that stems all the way back to the initial phase of the Atkins diet back in 2014 (sic) [2004] (28:00), which basically taught consumers to think about their diets in terms of percentages. So, I guess the question is really given what you've seen with the Day Starts, the new line you have in breakfast and what you're seeing from your foodservice and retail partners, do you think that there is sustainability in this shift or are you concerned that we're – it's just another kind of quote unquote diet fad and people will shift back to carbs again at some point down the road? Do you have a – I'm sure you must have a dialog with your customers on this. If you could provide some detail from your conversations, that would be very helpful.

Donald J. Smith
President & Chief Executive Officer, Tyson Foods, Inc.

A

Okay, great. Feel very solid about the trend to more protein and also a trend to, let's say at retail, the perimeter of the store and that bodes very well for us. So, as we look forward into the future and as we listen to the consumers and take those insights and develop those into products, the thing we were hearing from basically from mom about breakfast is, is breakfast is a very important part of meal today, but unfortunately I end up with about 18 minutes to prepare a meal and I need something that's nutritious and that has a good supply of protein to fuel my child for the day. And so – but also need something that we can do on the run. And so, you put all that together, Tyson is a trusted name in protein, you need a handheld type item that's got a protein base in it and thus the Day Starts.

As we look forward, if you just looked at the rate of meat inflation versus the inflation rate, the demand for protein is very strong, and frankly I don't see that changing very much as we look out, as far as we feel comfortable looking maybe into 2015 or 2016 or that type of thing. So, it's going to be important for us to listen to the consumers and develop the type of products that meet their needs as they change and stay out in front of them a little bit. But we feel very good about the prospects for protein to stay, and particularly meat protein by the way with the vitamin balance and all that it carries, to stay very much in favor among consumers. We just got to figure out how to produce and innovate the type of products that they want to reach for.

Diane R. Geissler
Analyst, CLSA Americas LLC

Q

Okay. Thank you.

Operator: And the next question comes from Robert Moskow [Credit Suisse]. Your line is open.

Robert B. Moskow
Analyst, Credit Suisse Securities (USA) LLC (Broker)

Q

Hi, I have two questions, one's kind of short and one's longer. The first one is I want to know if you could quantify the cost overruns in the quarter for the cold weather. And then the second question is, Donnie, Michael Foods, it was clear pretty clear that you were a bidder for that business, I thought it made strategic sense to go after it. And I wanted to know what do you think as you think back on it, what do you think was the limiting factor in not getting the business? Were you using stock to try to finance the deal and was private equity just not interested in that? And your balance sheet is so clean you could have levered up to buy the business. So I just wanted to know how you thought about it.

Donald J. Smith
President & Chief Executive Officer, Tyson Foods, Inc.

A

So the first one's easy. I can put my hands on about $15 million really easy on cold weather related type stuff. And it may have been more, but there is an easy number to get my hands around. As far as the second part, we just never comment on acquisitions and as Dennis said before, we continue to look for targets that make sense and have a good strategic fit for us. And as he said, we – and you mentioned – we've got a clean balance sheet and lots of opportunities. So, that's really about all we'll say about that.

Robert B. Moskow
Analyst, Credit Suisse Securities (USA) LLC (Broker)

Q

Can I just ask about deals going forward, I mean what is your willingness to use your balance sheet to finance say a $1 billion, $2 billion kind of deal?

Donald J. Smith
President & Chief Executive Officer, Tyson Foods, Inc.

A

Dennis.

Dennis Leatherby
Chief Financial Officer & Executive Vice President, Tyson Foods, Inc.

A

Robert, here's the way I think about it. Again, we have about $2.1 billion in EBITDA over the last 12 months. Investment grade rating is important to us and I think we can do upwards of three times leverage and maybe even a little bit more depending on the quality of the assets and the cash flows they throw off. So, we have considerable, you can do the math, but it speaks to the fact that we have considerable ability to put on leverage and still be comfortable.

Robert B. Moskow
Analyst, Credit Suisse Securities (USA) LLC (Broker)

Q

Okay, 3 times. Thank you very much.

Operator: And the next question comes from Adam Samuelson [Goldman Sachs & Co.]. Your line is open.

Adam Samuelson
Analyst, Goldman Sachs & Co.

Q

Hi. Yeah thanks, good morning everyone. Maybe first in the Chicken business and I want to talk about Cobb and your breeding operations, and maybe can you reflect on how if at all you've changed or altered how that business is managed. You're obviously an important supplier to not only yourself but to the industry. And I guess given where production margins are today, I think we're all surprised at how constrained the breeding supply is. Maybe I'll start there.

Donald J. Smith
President & Chief Executive Officer, Tyson Foods, Inc.

A

We've not changed how we operate Cobb at all; it's been very consistent over the years.

Adam Samuelson
Analyst, Goldman Sachs & Co.

Q

Okay. And then shifting gears into Prepared Foods, volume was up nearly 6% in the quarter. That's one of the best performances for the business in sometime, and admittedly a relatively easy comp. But maybe you can help decompose some of that, some of the drivers between the Day Starts and the Wright sausage, some of the recent M&A that you've done or some of the – perhaps some better growth in the legacy portfolio?

Donald J. Smith
President & Chief Executive Officer, Tyson Foods, Inc.

A

Yeah. We have – our Prepared Foods business is really a broad mix of different types of businesses and some are at different stages of maturity. We had several of our segments that responded very well this past quarter, and frankly continue to see good, good opportunity out in front of us. We continue to invest in that business, we've made some significant operational improvements in the lunch meat side of our business and we look for that to bring continual improvement as we move forward.

We're investing pretty heavily in our MAP spending not only in the Day Starts, but also in our breakfast sausage line, and we look for those businesses to respond well to that. And so, really, we do have some strong businesses in that portfolio that are doing very well, and we've got some others that are a bit more immature that we're investing heavily in to get that whole segment up to its normalized range. And I really think looking forward, what you should expect would be for that Prepared Foods segment to be in its range next year, as we see these investments come to fruition in these next two quarters.

Adam Samuelson
Analyst, Goldman Sachs & Co.

Q

Okay. That's helpful. And then maybe just a final quick one from me: in the prepared remarks you alluded to some poor operational execution in poultry in Brazil and you said you had restructured that business. Maybe elaborate a little bit on what's going on down there?

Donald J. Smith
President & Chief Executive Officer, Tyson Foods, Inc.

A

Yeah, we had some folks make some poor decisions around how we handled a part of our processing that – what we had was we had a freezer that needed some repair. Our folks down there frankly did not do a very good job in that. It also backed up into the field and infected our live production. And so, basically, we've changed out our country manager in Brazil, we've changed out the plant manager in that location and the live production manager, and we have a firm grip on the situation from this point forward. So that's behind us, and we're looking forward now to two much better quarters coming ahead.

Adam Samuelson
Analyst, Goldman Sachs & Co.

Q

All right, great. Thanks very much.

Operator: And the next question comes from Akshay Jagdale [KeyBanc Capital Markets]. Your line is open.

Akshay S. Jagdale
Analyst, KeyBanc Capital Markets, Inc.

Q

Good morning.

Donald J. Smith
President & Chief Executive Officer, Tyson Foods, Inc.

A

Hey, Akshay.

Akshay S. Jagdale
Analyst, KeyBanc Capital Markets, Inc.

Q

Hi. So, my question is on chicken. First, on fiscal 2015, obviously, chicken being your largest business. You reiterated 10% EPS growth, but at the same time you did talk a little bit about production in a sense that you think that the industry is going to respond to the margins that we're seeing right now. So, can you just help us understand in a scenario where the industry is increasing production – which I understand may not happen next year-but in a scenario where that's happening, and you're coming off a year where you have above normal margins, how can Tyson still grow earnings at 10%. So first, can it, and what's the strategy to execute on that?

Donald J. Smith
President & Chief Executive Officer, Tyson Foods, Inc.

A

Okay. So let me just take kind of the part B side of your question first on can we grow EPS 10%. Absolutely. You should see significant improvement in Prepared Foods. Next year, International ought to get better. This thing in China is not going to last forever. I can't tell you today – I've been wrong two quarters before in when we thought that thing would turn. So I can't tell you today. But I can tell you that the current situation is not sustainable, and that it will improve. And we're doubling down on our cost efforts particularly in China. So you should see improvement in our international results.

We think beef ought to be every bit as good next year as it is this year. Same story on pork: if we get any kind of production expansion, maybe be a little bit better. And so then kind of back in and then the front part of your question, it really boils back to our buy versus growth strategy, Akshay. We don't have to necessarily grow the chicken to expand our business. We've got two areas of our current Chicken business where we're just about out of capacity, and that's our case-ready fresh chicken, which we're the number one brand at retail. And that's a very, very important segment to our customer and to the consumer. And so we've got to expand our capacity there. Now, don't be thinking necessarily production, just think capacity. So it may mean a capacity move from one process type into another to capture a more value-added segment.

And then speaking of value-added, we're tapped out on our further processing fully cooked capacity as well. So we have two lines under construction now, and we're thinking about another two or three lines, because the consumer is responding to our value-added poultry and we've grown about 7%, I think, so far this year in value-added and see no reason not to believe that we won't sustain that 6% to 8% growth in fiscal 2015 as we move forward.

Dennis Leatherby
Chief Financial Officer & Executive Vice President, Tyson Foods, Inc.

A

And, Akshay, this is Dennis. I would add to that: we have a considerable pipeline of projects in the queue around capital spending. We talked about $650 million to $700 million this year, we fully expect next year to be quite a bit more and as we've talked about in the past, the aggregate MIRR of our projects over the last four years have been just shy of 25%. We fully expect that to continue to be the case in fiscal 2014 and 2015. So there's every reason to believe we can add to the margin structure even through CapEx.

Akshay S. Jagdale
Analyst, KeyBanc Capital Markets, Inc.

Q

That's very helpful, good segue into the next half of my question which is, so do you expect – or what do you expect in terms of supply for the industry next year? So this is live – you know obviously the live part of the industry. What are you expecting for supply next year and, I mean, do you expect industry margins to sort of sustain themselves on the spot level?

Donald J. Smith
President & Chief Executive Officer, Tyson Foods, Inc.
A

I would expect on the supply a good 3% or so driven primarily in the back half as we said earlier. And then, yeah, I mean, with cattle numbers coming down, Cobb poor flat to up a little bit, there's no reason not to expect chicken to not have another good year in terms of its demand, if for no other reason than the relative price versus the other proteins. So, yeah, I think demand for chicken will continue to be strong next year, sure.

Akshay S. Jagdale
Analyst, KeyBanc Capital Markets, Inc.
Q

Okay. And then just the short term, and again sorry to ask so many questions on chicken but, you've clearly proven that in the bottom of the cycle, you can outperform the industry. The question I've always had is when things are good how good can it get for Tyson. So things are pretty good, they have been for the industry now for over a year. You put up a 9.5% margin last quarter, but you'd expect that the next two quarters would be the best environment from a margin perspective for Tyson. Is that – for the U.S. Tyson business in chicken – is that a fair assessment, and can you give us some insight into how the quarter is shaping up one month into it?

Donald J. Smith
President & Chief Executive Officer, Tyson Foods, Inc.
A

No reason to expect the back half of our year to not be at least as good or better than what the front half was from an earnings perspective. But remember, Akshay, we don't respond like pure play commodity guys. Our business model is much more smoothed out through the year. So we won't necessarily hit the peaks in the summer time like the commodity players will. But we also won't see the dips in the lower part of the market too. Our consistent earnings over time is what our business model is shooting for and that's what you should expect.

Akshay S. Jagdale
Analyst, KeyBanc Capital Markets, Inc.
Q

Okay. And just one last one following up on some of the questions on M&A: what I've been sort of impressed by is your discipline on M&A as it relates to the price with your ROIC metric – the 20% return that you talk about. So can you just remind us again about the filter and sort of the priorities off that filter? So, I mean there is – obviously the M&A environment is very good right now, but the type of prices being paid I would argue are also pretty rich especially let's say for Michael Foods to get a 20% ROIC pre-tax would imply, I think, doubling the EBITDA on that business in five years. So can you just help us with your filter and the discipline and put that into context with the environment you're seeing?

Dennis Leatherby
Chief Financial Officer & Executive Vice President, Tyson Foods, Inc.
A

Sure. Akshay this is Dennis. As far as the filter goes, first and foremost, they need to be strategic and fit within our goals to grow in the value-added categories around chicken and Prepared Foods and for that matter possibly even beef or pork to the extent they're available. International's obviously a priority as well. From a discipline standpoint, you're right. Our goal is to achieve a 20% ROIC with an acquisition. To the extent that the M&A environment requires higher price to be paid for companies, that means we have to work that much harder to get there. And we do that through looking at synergies, how we can expand the business within our existing distribution framework and just be very disciplined and get there. That might mean we have to push it out to three years to five years to get that return, but we think ultimately those kind of acquisitions still would be very accretive from an EPS and an ROIC standpoint over time. So really nothing's changed.

Akshay S. Jagdale
Analyst, KeyBanc Capital Markets, Inc.

Q

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

Operator: And the next question comes from Ken Goldman. Your line is open.

Kenneth B. Goldman
Analyst, JPMorgan Securities LLC

Q

Hey. Can you talk a little bit about what's going on in Mexico with avian influenza at the moment? There's some reports it's worse than what the Mexican government and some companies that operate there have stated publicly. I'm just curious to what degree you might expect Tyson to actually benefit from the virus, you might see some more industry exports of meat or [indiscernible] (45:17) to Mexico?

Donald J. Smith
President & Chief Executive Officer, Tyson Foods, Inc.

A

From time-to-time, there is an issue in Mexico. We don't have any flocks that are affected by it right now. You should know we're taking all the necessary steps and all the biosecurity measures to ensure the viability of our supply. Pricing has improved in Mexico and we're reaping the benefit of that certainly. As far as eggs moving down there, we don't have any plans to move any eggs to Mexico.

Kenneth B. Goldman
Analyst, JPMorgan Securities LLC

Q

Okay. And you talked about – separate question, the strength in Day Starts beyond your expectations. Can you talk a little bit about to what extent your success in generating your own brand makes you less likely to buy something in Prepared Foods? I guess to put another it another way, Day Starts has had success, so why buy something if you are finding that you can make it yourself? It's an old make versus buy conundrum I guess.

Donald J. Smith
President & Chief Executive Officer, Tyson Foods, Inc.

A

It is. As Dennis said on the previous question, what we're really looking for is strategic fit and the ability to make an acquisition that will be accretive to our earnings. And so, we're always looking for opportunities to be able to use the insights we have about what the consumer needs to find a way to fill that need and grow our business. We feel great about our organic opportunities, we feel great about our opportunity to invest in our current business, but we're also going to be out there looking for strategic opportunities to fill in the gaps where we need to or to create a little bit more aggressive headspace in a category where we may be able to buy as long as the purchase makes sense and then accelerate growth in that particular category, whichever category that maybe.

Kenneth B. Goldman
Analyst, JPMorgan Securities LLC

Q

Okay. Thanks very much.

Donald J. Smith
President & Chief Executive Officer, Tyson Foods, Inc.

A

You bet.

Operator: And the next question comes from Farha Aslam. Your line is open.

Farha Aslam
Analyst, Stephens, Inc.

Q

Just continuing on that M&A question front, do you feel like you need more chicken capacity? Would you build that with CapEx or via acquisitions? And in terms of M&A, is there a geographic preference or is there a protein preference that you're looking for?

Donald J. Smith
President & Chief Executive Officer, Tyson Foods, Inc.

A

The answer to your first question is, yes. And the answer to our second question is, as long as it's a strategic fit, whether it's an international acquisition, poultry, value-added or Prepared Foods, those are the areas of our business where we believe our growth potential lies and where we can add the most value to the consumer and the most value to the shareholder. And so, our acquisition targets will be focused in those three areas.

Farha Aslam
Analyst, Stephens, Inc.

Q

Okay. And then just one on the base business: when you look at the Texas' facility that you – the lunch meat plant you took down and are ramping back up, could you just give us some color on sort of what that can do for earnings in the second half of the year now that it's starting back up?

Donald J. Smith
President & Chief Executive Officer, Tyson Foods, Inc.

A

In the second half of the year, marginal improvement, but sequentially in 2015, it ought to make a more meaningful difference. It takes a while to get that back up. Frankly, we've got two – we've got the cost side of the equation in good shape now. We've got to get some more business around us and get the revenue side moving. That's going to take us at least a couple more quarters, but we think certainly as we move into 2015, we'll see sequential and meaningful improvement in that part of our business.

Farha Aslam
Analyst, Stephens, Inc.

Q

Great. Thank you.

Donald J. Smith
President & Chief Executive Officer, Tyson Foods, Inc.

Okay. That concludes the call. Thank you for your interest in our business and hope you have a great day. Thanks.

Operator: And thank you for joining in for today's conference call. We appreciate your participation. And you may disconnect at this time.