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Tyson Foods, Inc. (TSN)

Q3 2014 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Welcome to the Tyson Quarterly Investor Earnings Call. I would like to remind the parties that their lines have been placed on a listen-only mode until today's question-and-answer session. Today's conference is being recorded. If you have any objections, please disconnect at this time.

And I will be turning the call over now to Jon Kathol, Vice President of Investor Relations. Sir, 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 third 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.

Today, we announced the launch of public offerings of Class-A common stock and tangible equity units. We will not be commenting on these offerings and will not answer any questions regarding those offerings on this call. 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 we appreciate you joining us a little early today. As you saw in our press release, we had a record third quarter with an adjusted \$0.75 a share. We did have some one-time issues that I'll talk about when we get to the segments, but otherwise, our results were in line with our expectations. We're pleased with the quarter, we're wrapping up what will be our best year so far, and we're looking forward to starting 2015 which looks to be an outstanding year even before we add Hillshire Brands' great products, brands, and people to Tyson Foods.

Before we get to the third quarter commentary, I'd like to say a few words about the Hillshire acquisition. Several others had the opportunity to spend some time in Hillshire in Chicago, and we're beyond impressed with their team. We're excited about taking their expertise and combining it with ours to create a Prepared Foods business with strong, stable margins and steady growth.

As we execute our Prepared Foods strategy, we're estimating the impact of the synergies with Hillshire, along with the cost savings and production efficiencies associated with the plant closures that I'll say more about shortly, will be more about \$225 million in fiscal 2015 and should exceed \$500 million by the end of year three. We expect the acquisition to be accretive in fiscal 2015 and substantially accretive thereafter as we generate synergies. We plan to continue delivering on our 10% EPS growth target in 2015, and we want to use our strong cash flows to delever the balance sheet quickly.

While I'm excited about the prospects of Tyson and Hillshire coming together, we must stay focused on the fundamentals that got us into position to make this acquisition. So let's take a look at our segments because we had some issues and there's room for improvement.

The Chicken segment has a 6.9% return on sales in Q3. Pricing was down 1% due to the untimely and unfortunate events that resulted in the loss of volume in our high-margin value-added products.

In February of this year, we experienced a fire at one of our fully-cooked processing plants. Fortunately, no one was injured. But the damage to the infrastructure was more serious than we had originally thought, and our ability to supply products suffered. The mechanical repairs are now complete and the plant is back to producing normal volumes.

Additionally, in Q3, a segment sizable fully-cooked processing plant experienced a series of operational issues, and the volume it supplies has been significantly impacted. New equipment has been ordered and is being installed, and we expect to be back at full production volume in the early weeks of our fiscal Q1 of 2015.

On our Q2 call, you remember that I mentioned that we're completely out of fully-cooked capacity in our Chicken business which is why we weren't able to move production to other facilities following either event. So, we've endured prolonged, sizeable production shortfalls in one of our highest-revenue, most profitable business, during a time when high-priced beef and pork accelerated the demand for chicken.

These temporary disruptions and the resulting actions we took with customers have and will cost us between 1.5% and 2% return on sales in Q3 and Q4 in our Chicken segment.

In FY 2015, we'll be back to our full productive capability and we'll have additional fully-cooked capacity coming online in the spring, so our Chicken segment is expected to fully recover and deliver a 10% return on sales in 2015.

Moving on to the Beef segment which had a 2.4% return on sales, the quarter got off to a slow start but finished strong as the summer grilling season brought robust demand despite record high pricing. And even with those high prices, we were successful in promoting our premium-branded beef programs, our commitment to operational excellence, and revenue-enhancing programs continues to work well.

People often forget that a business with a 2% return on sales can still generate a pre-tax ROIC of 15% if you maximize the efficiency of your assets to turn your capital quickly, which is what we do.

Looking on to 2015, we expect next year to look a lot like this year from a cattle supply and an operating margin perspective. Heavier weight cattle are expected to continue to come in the market and we're starting to see signs of heavy retention, but we're seeing adequate supply of cattle in our regions.

The beef industry is becoming a combination of several small geographic marketplaces. Cattle continue to be moving to the feedlots in the grain belt, so it makes sense to have plants close to the feedlots as we do.

Turning to the Pork segment, we had a record third quarter with a 7.2% return on sales. We've managed the supply challenges created by the PED virus very well. We were able to move supply among our facilities, adjust orders, and maximize revenue. In fact, our volume was up 5% versus the same quarter of year-ago, and demand remained strong as indicated by pricing that was up 26%.

Looking ahead into fiscal 2015, four factors indicate that we should have an adequate supply of hogs for tending another solid performance from that segment. Futures prices indicate the industry is expecting more hogs later this fall. Hog weights are already very heavy, and we would expect that to continue. PED seems to have slowed through the warmer months, but of course, may reappear as we head into winter. And finally, lower-priced corn may incentivize some level of expansion into 2016.

In the Prepared Foods segment, first, let's address the negative return on sales of 5.5%. We incurred a \$49-million impairment charge related to the three plant closures we announced Friday. Although it's always a difficult decision to close a plant, let alone three, it was necessary to improve our capacity utilization and streamline our cost structure. We aren't eliminating any sales volume from the closings – we're simply shifting the mix to more efficient facilities because it's imperative that we are cost-competitive in these predominantly private label and food service categories.

Also in the Prepared Foods Q3 results were higher raw material cost of \$95 million. Although this is typically recovered in future quarters, we're working on reducing the lag in our formula pricing to help our earnings correlate more closely with moves in the input costs.

Parts of the legacy Prepared Foods segment are performing extremely well, and the outlook for 2015 shows considerable improvement. Additionally, we expect to realize substantial synergies from the combination of our Prepared Foods business with Hillshire. Synergies are expected to come from operational improvements, purchasing, and distribution, and when combined with the plant closure cost savings and efficiencies, will be more than \$225 million in fiscal 2015, and should exceed \$500 million by the end of year three. We'll be looking at revising the normalized range for the Prepared Foods segment after the transaction closes.

Finally, in the International segment had a negative 4.1% return on sales. Sales volume has improved and operating losses were cut in half from Q2 to Q3. Demand in China is in the early stages of recovery, but it's slow and, as indicated by the recent news of another food scandal, still vulnerable to food safety concerns. While a negative short-term demand, these events continue to reinforce the validity of our business model in China which emphasizes biosecurity, supply chain integrity, and food safety.

We're currently better supply balance resulting from a drop in grandparent stock imports, which will be supportive of pricing in 2015. As for our business, we're now processing 100% company-controlled birds and have eliminated market birds entirely from our supply chain.

Also regarding our International segment, we announced this morning that we're selling our operations in Mexico and Brazil to JBS for \$575 million. Although these were good businesses with great team members, we haven't had the necessary scale to be a market share leader in either country, which is our preferred position. The sale represents an attractive price, and the proceeds will be used to pay down debt associated with the Hillshire acquisition.

Now, to wrap up my thoughts on Q3 of fiscal 2014. Despite the challenges in our Chicken segment and Prepared Foods segments, we believe we'll still generate an adjusted EPS of at least \$2.78 a share in FY 2014, which is more than a 20% growth over last year. Just to clarify, that excludes any earnings or costs associated with Hillshire.

FY 2015 is setting up to be another record year for sales, operating income, and EPS. We'll have a better idea of how it will look on our November call, but initially we expect Chicken margins to be at or above 10% as we get past the issues and the two value-added plans I told you about, and we see the benefits from around \$400 million in lower feed ingredient cost. We think Beef and Pork margins would look similar to FY 2014.

Prepared Foods margins should be much stronger as we run a sound legacy business and integrate Hillshire into the Prepared Foods segment. We're excited about the synergy prospects as we execute our Prepared Foods strategy and anticipate more than \$225 million in synergies in 2015 and \$500 million by the end of the third year.

The International segment's operating income should improve by about \$50 million. We're expecting to continue our trend of at least 10% EPS growth and we anticipate Hillshire being accretive to earnings next year and substantially accretive thereafter.

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. We had a record-setting third quarter. Our top line revenue growth was 11% over Q3 a year ago and quarterly sales again surpassed the \$9-billion mark. We continued to execute our growth strategy as evidenced by increased sales volumes in Chicken, Pork, and Prepared Foods. Total company adjusted return on sales was 4.2% and adjusted operating income was \$407 million or \$351 million prior to the adjustments described in our press release.

Our adjusted earnings of \$0.75 per share is a record for a third quarter and represents a 9% increase over adjusted EPS of \$0.69 in Q3 of 2013. Our GAAP earnings this quarter were \$0.73 and we also provided a reconciliation in our press release. Year-to-date adjusted EPS is \$2.07, or a 33% increase compared to last year's \$1.56 adjusted EPS coming from continuing operations. We achieved an adjusted 12-month pre-tax return on invested capital of

just over 20% compared to 17% for the prior -year period. Operating cash flow through three quarters was \$543 million after funding \$479 million in additional working capital as we grew our business.

We spent \$144 million on capital expenditures for the third quarter and \$437 million for the first nine months of fiscal 2014. This outpaced our depreciation and the amortization by \$55 million, as we continue to invest in projects that 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 third quarter, we did not repurchase any shares under our share repurchase program. This was a conscious decision to maximize liquidity for the upcoming Hillshire Brands acquisition. As a reminder, since May 2011, we've repurchased just over 50 million shares at an average price of about \$24 per share. In order to facilitate deleveraging, we currently do not plan to repurchase shares other than to fund obligations under our equity compensation programs.

Our effective tax rate in Q3 was 16.8%. On an adjusted basis, this rate was 31.2%. Net debt-to-EBITDA for the past 12 months was 0.6 times, and on a gross debt-to-EBITDA basis, this measure was 0.9 times. Including cash of \$587 million, net debt was \$1.2 billion. Total liquidity was just over \$1.5 billion, remaining above our goal of \$1.2 billion, and gross debt remained at just over \$1.8 billion. Year-to-date, net interest expense was \$72 million, down 30% from a year ago. Average diluted shares for the quarter were 356 million. This reflects the dilutive effect of options and warrants of 3 million settled earlier in the quarter.

Consistent with our Prepared Foods strategy, we will close three plants to improve capacity utilization and streamline our cost structure. We expect the closure of these facilities will result in significant cost savings and production efficiencies, but will be revenue-neutral as the sales volumes of these closed plants will be absorbed by capacity at existing facilities.

Additionally, our Prepared Foods segment will benefit from the addition of a great business in Hillshire Brands. We will achieve significant synergies from operational improvements, purchasing, and distribution. For fiscal 2015, we expect the impact of the Hillshire Brands synergies, along with the cost savings and production efficiencies associated with the plant closures will positively impact our Prepared Foods segment by more than \$225 million and should exceed \$500 million by the third year following the close of the acquisition.

Additionally, as announced today, we have entered into an agreement to sell our chicken operations in Mexico and Brazil for \$575 million. This transaction is expected to close in the next few months, and we plan to use the sales proceeds to delever, following the Hillshire brands acquisition.

Now, here are some thoughts on the full-year for fiscal 2014 and some thoughts on fiscal 2015. Please note the outlook for fiscal 2015 does assume that the Hillshire acquisition will close in fiscal 2014. Additionally, the fiscal 2015 outlook also factors in the sale of our Mexico and Brazil operations, along with the synergies expected from the Hillshire acquisition and the closing of the three Prepared Foods plants. We expect revenues of approximately \$38 billion for fiscal 2014 which is 10% growth over fiscal 2013. Revenues for fiscal 2015 are expected to grow 11% to \$42 billion.

Net interest expense should approximate \$130 million for fiscal 2014, including the financing for the Hillshire Brands acquisition. For fiscal 2015, we expect net interest expense of \$290 million, reflecting the full impact of the financing.

The adjusted effective tax rate should be around 34.5% for fiscal 2014 and is expected to be around 36% for fiscal 2015. CapEx is expected to be \$600 million to \$650 million for fiscal 2014. And for fiscal 2015, CapEx is expected

to approximate \$900 million, as we not only look for projects that improve productive capabilities, labor efficiencies, yields and sales mix, but to also implement projects that drive efficiencies between Tyson and Hillshire Brands for future growth.

We expect diluted shares in Q4 of approximately \$356 million prior to the equity offerings we launched this morning. You can refer to our pro forma information filed earlier today for the potential additional shares. We still believe we'll generate at least \$2.78 adjusted EPS which is more than 20% growth over fiscal 2013. This excludes any earnings or costs associated with the Hillshire acquisition.

Fiscal 2015 is setting up to be another record year for sales, operating income, and EPS. Chicken margins should be at or above 10%. Prepared Foods margin should be stronger as we integrate Hillshire and realize the benefits of the significant synergies and other operational improvements within our legacy Prepared Foods business as we execute our Prepared Foods strategies.

The International segment should improve by \$50 million, and as a result, we expect at least 10% EPS growth in the Hillshire acquisition to be accretive in 2015 and substantially accretive in future years. Our priorities for excess cash are: significant de-leveraging from the strong combined cash flows of Tyson and Hillshire; capital spending to improve and grow our existing businesses; 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.

To wrap up with the operational disruptions and other significant challenges we faced throughout the quarter, we still maintain focused and delivered another record quarter with adjusted earnings per share of 33% for the year. We believe that fourth quarter should be almost as strong, and we are confident we can deliver on our targets.

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

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question comes from Diane Geissler. Your line is open. And she is with CLSA.

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 wanted to ask about the U.S. Chicken operations and the operational issues that you had during the quarter. When you look at that, I mean, in particular, the second plant where you said you had to order machinery – it's not going to be back up online until I guess the first quarter of fiscal 2015, did that cause you to go back and look at all of your other facilities? Because I know you went through a period when grain prices were very high that you had cut CapEx, et cetera. Just a little bit nervous about being so close to like complete capacity utilization that if you have one outage, it causes such a problem.

And then the second question I have is just relating to the new segment reporting where you're stripping out International. Can you give us an idea about what you think the domestic business should carry on a normalized basis in terms of the margin there? Thank you.

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

A

Thanks, Diane. So, yes, we have been through all of our facilities. And a couple of things that we'll do differently, we'll move some of the retail fully-cooked capacity among other plants, which will add a little bit of buffer in preventing this type of thing from happening again.

Also, we have pinpointed all of the locations where we can and should, over the next few incremental quarters, put in fully-cooked capacity. We'll have two more lines that'll come on in our – about the – right after the first year. So, call that about Q2 of FY 2015. And frankly, we need that capacity early in that fiscal year.

Also, on your second question, we carve out International in the Chicken segment. I think for 2015, we feel very good about being at or above 10% and we're at the point where we're rethinking our normalized range for Chicken. It's a little bit early with all that we've got going on in our – in that segment in this quarter until we get all our productive capability back up and all of that to do that. But we're rethinking that and we'll be talking about that in subsequent quarters.

Diane R. Geissler
Analyst, CLSAAmericas LLC

Q

Okay. So, maybe just as a follow-up to that, is your – I think your previous range of 5% to 7% – I guess what I'm trying to ask here is your guidance for fiscal 2015 at 10%-plus would be above what the U.S. – above a normalized range for the U.S. operation [inaudible] (21:55). Correct?

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

A

Yes, yes. Certainly. Certainly.

Diane R. Geissler
Analyst, CLSAAmericas LLC

Q

But that's not – okay. Great. Thank you.

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

A

Thanks, Diane.

Operator: Thank you. Our next question comes from Brett Hundley from BB&T Capital Markets. Your line is open.

Brett M. Hundley
Analyst, BB&T Capital Markets

Q

Hi. Good morning, gentlemen.

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

A

Hi, Brett.

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

A

Brett.

Brett M. Hundley
Analyst, BB&T Capital Markets

Q

My first question is just on the Prepared Foods segment, the language that you guys gave for 2015. Can you discuss at all the synergy portion from Hillshire? Does that take up a majority of that \$225 million? Is it half? Can you just speak to that and also speak to whether you're taking into account rebound in Hillshire business, if in fact PED comes off and some of those costs abate?

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

A

Okay. So, your second question first is no. And on your first question, think about the legacy Tyson Prepared Foods synergies being a little over half of that \$225 million. So you'd see, it's fairly balanced. There's a lot of

opportunity there. And those synergies are around operational efficiency, purchasing, supply chain efficiency, those types of things. So, we feel really good about our ability to capture those.

Brett M. Hundley

Analyst, BB&T Capital Markets

Q

Perfect. And then just my second question is back to your legacy Chicken business. Donnie, with the drop in feed, can you just talk a little bit about your approach going forward? Would – do you think that you guys will become a little bit longer as it relates to your procurement of feed? And just, again, going back to the confidence that you have, Chicken margins can be up – even up again year-on-year for 2015? I appreciate it.

Donald J. Smith

President & Chief Executive Officer, Tyson Foods, Inc.

A

Yeah. So, two things. Number one, on our commodity procurement strategy, we really won't change that very much. I mean, we always look for opportunities when they present themselves to use options to help us with some of the commodity volatility. But we're pretty conservative when it comes to grain. We want to make our money grow in processing, marketing, and selling chicken.

So, on the other part, how to – I'm going to – so, how to think about Chicken going forward. So, we're leaving a good bit of money on the table in Q3 and Q4. So, that then will be captured. And then, as we continue to grow value-added, our case-ready Chicken business is doing very, very well, as fresh chicken at retail becomes much more popular with consumers, particularly in light of the really high beef and pork prices. And so, we've got to expand that part of our business and we'll be working on that as well.

So, we feel very comfortable with our 2015 outlook in terms of what we're doing with our mix and how we view our underlying cost structure. The one question that some investors want to know about is, okay, what about chicken supply? And as we look at that, we don't see that there will be a meaningful increase in chicken supply until around July 4 or so next year. So, if you look at all of that combined, that sets up for a very good 2015 for us.

Brett M. Hundley

Analyst, BB&T Capital Markets

Q

Very helpful. Thank you.

Donald J. Smith

President & Chief Executive Officer, Tyson Foods, Inc.

A

You bet.

Operator: Thank you. Our next question comes from Farha Aslam from Stephens. Your line is open.

Farha Aslam

Analyst, Stephens, Inc.

Q

Hi. Good morning.

Dennis Leatherby

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

A

Hi, Farha.

Farha Aslam

Analyst, Stephens, Inc.

Q

Quick question about your 10% earnings guidance growth for next year, is that kind of off of that \$2.78 base that you're discussing? Because, Donnie, your comments were that you're very confident about 10% growth, and Dennis, your comments about the fourth quarter implied about a \$2.78, \$2.80 core year, but consensus is at \$2.90. I just want to clarify the outlook that you're providing.

Donald J. Smith

President & Chief Executive Officer, Tyson Foods, Inc.

A

Yeah. Been thinking about the 10% growth over, we keep saying we expect to do at least \$2.78, so be expecting the 10% growth over that.

Farha Aslam

Analyst, Stephens, Inc.

Q

Okay. That helps. Great. And then in terms of the Hillshire synergies, I mean that step-up versus your initial \$300 million comment's pretty material, and I was just wondering what in particular, as you got under the covers basically on Hillshire and got a deeper read, what makes you confident about that significant bump-up in synergies?

Donald J. Smith

President & Chief Executive Officer, Tyson Foods, Inc.

A

Yeah. So, when we look at combining our legacy Prepared Foods business and Hillshire together, the businesses are very complementary and the more time that we now have gotten to spend with some of the Hillshire folks as we began planning the integration, it's pretty easy to say that there's going to be significant synergies in the supply chain arena, in logistics, and operational efficiencies, and those kind of things, plus we had an early conversation about latent capacity and the footprint.

And so, as we worked through that, what it made sense to do was to unfortunately close those three locations and then move that production into more efficient facilities that frankly had better supply chain cost as well. So when you combine all that together, that's how we get to the, at least, the \$225 million number. Feel really good, then, about adding to not just the legacy deal continuing to improve after that, but certainly, with the Hillshire synergies combined, being able to build that on up to at least the \$500-million range, so...

Farha Aslam

Analyst, Stephens, Inc.

Q

And will some of those \$500 million be captured in your Pork division as you source that product internally more and more, that supply?

Donald J. Smith

President & Chief Executive Officer, Tyson Foods, Inc.

A

No. We do believe there's great value in the end in Pork and Prepared Foods, but we're just talking about the synergies that will be reported in the Prepared Foods segment.

Farha Aslam

Analyst, Stephens, Inc.

Q

Oh wow, so there's greater upside. That's very helpful. Thank you.

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

A

Yes.

Operator: Thank you. Our next question comes from Adam Samuelson from Goldman Sachs. Your line is open.

Adam Samuelson
Analyst, Goldman Sachs & Co.

Q

Yes. Thanks. Good morning, everyone. A little bit more detail on the forward chicken supply outlook. And, Donnie, I was hoping you could comment on your own order book at Cobb and how you see that order book playing out over the next year, year and a half, in relation to kind of future growth in pullets and chickens in the U.S. Thanks.

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

A

Hey, as I said on one of the previous questions, what it looks like to us in terms of the pullet supply coming to the market, as far as building the breeder flock, it looks like to me, the increase in broiler meat on the market would appear at about somewhere mid-summer, so call it July 4-ish. And I think that before that, it's just physiologically impossible to get a whole lot more supply on this market.

Adam Samuelson
Analyst, Goldman Sachs & Co.

Q

Okay, that's helpful. And then on the Chicken – confidence on the Chicken margins next year, I mean, excluding some of the operational issues that you had this year, it looks like fiscal 2014 would have been somewhere in the 8% to 9% range for the whole year. I mean is the improvement then just solely on feed with stable pricing or is there something else there beyond the feed cost that give you the confidence for the margin expansion?

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

A

Well – hey, if you look at the environment, you got to believe that these prices, because of supply situation, you're going to have a similar environment next year as this year. As you get into Pork a little bit, it looks like to us that more hogs are going to be coming to the market in the fall. With grain prices coming down, you're likely to see a little bit of finished hog expansion, perhaps, in the latter part of our fiscal 2015. So, that's just a great environment there in the pricing structure.

The parts of our business where the demand is growing are in profitable parts of our business, our fresh chicken business, and unfortunately, because of the operational issues, our value-added business has seen great demand. You saw during the school season in the winter, lot of demand for fully-cooked retail products. So, as we get our capacity back on line, that looks like it will be another great year for us in that deal. So, you're really talking about three things. Yes, you're going to have a favorable grain environment. You're also going to have a favorable market environment structurally, in terms of chicken and its relative pricing to beef and pork. And the parts of our business where we're seeing the greater demand are the parts of our business where we have good margins.

Adam Samuelson
Analyst, Goldman Sachs & Co.

Q

All right. Great. Thanks very much.

Operator: Thank you. Our next question comes from Akshay Jagdale from KeyBanc. Your line is open.

Akshay S. Jagdale

Analyst, KeyBanc Capital Markets, Inc.

Q

Good morning. Can you hear me?

Donald J. Smith

President & Chief Executive Officer, Tyson Foods, Inc.

A

Oh yeah. Good morning.

Akshay S. Jagdale

Analyst, KeyBanc Capital Markets, Inc.

Q

Hi. So, first question is on the 2015 guidance. I'm trying to reconcile two things: one is at least 10% EPS growth implies around, I think, \$3.06 or \$3.05 in EPS if you take \$2.78 as a base. And then, if I look at your operating income guidance for Chicken and the other segments, I'm getting to much higher consolidated EBIT growth, obviously the interest expense is going up, but when I factor all of that in, including the estimate that you've given and the share issuance this morning, it looks like 10% EPS growth is very conservative, I'm getting to closer to 20%. I mean, can you give us some help? I know you're – there's some things you can't comment on, but the EBIT guidance seems to be well in excess of, what you're calling sort of 10% growth. Can you just help me out a little bit there? Thanks.

Donald J. Smith

President & Chief Executive Officer, Tyson Foods, Inc.

A

Okay. So, it's early for us, coming out of Q3, right? I would agree that our earnings guidance is conservative, but that's because we're early. So here's how we think about that. So – and let's just talk in ballpark terms, okay? If you look at how you view where this year's going to end up, if you look to the last 12 months, it's like a 1.6 in...

Dennis Leatherby

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

A

Operating income.

Donald J. Smith

President & Chief Executive Officer, Tyson Foods, Inc.

A

...operating income-wise, and then – you go back in using at least the \$2.78. And then, if you take 10% return on sales on our Chicken business, that's going to be worth an incremental \$200 million or so. If you look at Hillshire's earnings, you've got to be thinking about an incremental \$400 million or so. The Prepared Foods synergies will be \$225 million. International will improve by about \$50 million or so. You're right on the interest expense, and it's probably a little early to talk about that in too specific of detail.

Dennis Leatherby

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

A

Other than we're estimating in pro forma, it's about \$290 million.

Donald J. Smith

President & Chief Executive Officer, Tyson Foods, Inc.

A

Right. So – then you use a 36% tax rate and adjust for the new shares, and I think you got the math.

Akshay S. Jagdale

Analyst, KeyBanc Capital Markets, Inc.

Q

Okay. Good, good. So I'm on the right track. All right. And second question is just a follow-up to, I guess, what Farha was saying. The \$500-million synergy number is impressive in itself in terms of just increasing it from \$300 million so fast. But can you just help us understand eventually what impact might this acquisition have on your Pork business? And also, does it have the potential to positively impact the Prepared Foods portion of the Chicken business? And ultimately, are those two factors that will really, in your mind, make this a really successful acquisition versus an okay one?

Dennis Leatherby

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

A

Well, we certainly believe this is going to be an extremely successful acquisition. If you look at the Pork segment end-to-end, and we look at end-to-end value creation, we see a lot of opportunity there. I would hasten on to say it's a little bit too early. We saw Hillshire a little bit today but not very much. So, that – we'll need to get through the deal itself and then be able to drill down on that a little bit more. But that certainly seems like that there should be two benefits: one, a stabilization of earnings between the two segments; and then, there should be some opportunity end-to-end to capture even more savings. So, that's how we're looking at that.

Akshay S. Jagdale

Analyst, KeyBanc Capital Markets, Inc.

Q

And just one last one, and this is a housekeeping, perhaps you may not be able to answer this, but any – can you give us some guidance on D&A for 2015, and I'm assuming a share count of between \$405 million and \$410 million. Is that roughly correct?

Donald J. Smith

President & Chief Executive Officer, Tyson Foods, Inc.

A

Akshay, I can't comment on the share count. That's related to the equity offering. As Jon said out front, we can't comment on that. But we do have information out there to help you with the calculation. As far as D&A goes, we think about \$700 million or so.

Akshay S. Jagdale

Analyst, KeyBanc Capital Markets, Inc.

Q

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

Operator: Thank you. And our next question comes from Michael Piken from Cleveland Research. Your line is open.

Michael L. Piken

Analyst, Cleveland Research Co. LLC

Q

Yeah. Good morning. First question, again on Chicken, just want to get your thoughts on what your expectations are for the industry in terms of taking your normal seasonal fall cuts. Do you expect people to sort of take the

normal levels or do you think that the margins, being as strong as they are, that we might see people hold on to their bullets a little bit longer?

Donald J. Smith

President & Chief Executive Officer, Tyson Foods, Inc.

A

I can only comment on what we're doing. Typically, we'll pull out a couple of days in the fall for placement cuts for the holidays. This year, because, frankly, we dug a pretty deep hole in our value-added business, we are going to need to back off what we typically do just a hair to make sure that we've got the raw material supply to be able to run what then will be all of our fully-cooked lines running full because we've got to build back the pipe and we've got to build some incremental inventory for promotional activity next year because of the situation that we've caused with our customers this year.

So, I can only talk about what we'll do. That's not – and that's not a significant increase in production, what I just said. It's just we're going to need some incremental – particularly breast meat, to keep running our FP lines full.

Michael L. Piken

Analyst, Cleveland Research Co. LLC

Q

Okay. And then you mentioned in your prepared remarks that you're no longer buying breast meat on the open market. Is that sort of a long-term strategy or would you expect to kind of switch back once you get everything ramped up back to the old strategy of buying on the open market?

Donald J. Smith

President & Chief Executive Officer, Tyson Foods, Inc.

A

I don't remember that being said. And if it was said, it was said by mistake because we're still buying not only breast meat, but we're buying some tenders. And frankly, Michael, one of the customer-related issues is, if you're short among our FP, you sure don't need to have poor service and poor order fill in their fresh offering, particularly as important as that is today in light of high beef and pork prices.

And so frankly, we've been buying some whole birds, and we've been buying some other parts to take in to our [ph] tray pack (39:49) plants and frankly run that on overtime. Now, that's not a favorable economic position, but we're going to fix our fully-cooked issue and when we do, we don't want to make customer any angrier than they already are about not getting their orders. So, we've made the decision to take very good care of them in all other lines of business so that we can quickly recoup from the FP side. So, yes, we're very much out in the marketplace buying raw material.

Michael L. Piken

Analyst, Cleveland Research Co. LLC

Q

Okay. Sorry, I misunderstood. And then lastly, just shifting over to the Pork side of the business, obviously, you did very well in the case of PEDV, I guess if you could just talk about sort of some of the factors – has this been sort of all demand-driven or was this, some operational things you did right and sort of what are your expectations for kind of going forward? I know you said DDV, it's too early to call but it sounds like you're expecting supplies to alleviate. Any other color you can provide on how you're able to do so well in Pork would be helpful?

Donald J. Smith

President & Chief Executive Officer, Tyson Foods, Inc.

A

Sure. For us – let me talk about the industry of pork. We think that what we'll see is about, for the year, will be about 5% less hogs. Now, we're at the point where we are seeing, I guess the biggest supply dip, but I also want to

say that on a national numbers, if you take out North Carolina and Oklahoma, then the supply dip for the industry is really only about 3%. And so, most of our hog operations are in Eastern Nebraska and Iowa.

And so, we have a very good grasp of the supply situation around us. What our team did to manage that – number one, we worked very closely with our customers on those items that are sold off, say, by the each instead of by the pound, knowing that with a little bit cheaper grain bases in the Midwest, hog producers were going to be able to put a little bit more weight on the hogs which – actually, they put considerably more weight on the hogs – which has offset some of the volume in things like ham and that type of thing. But now, with bellies or ribs, we work with our customers very closely to manage those promotions.

Secondly, our buyers – we have very good relationships with our hog producers, most of whom we've been doing business with for years. We stay very close to them. And we're able to dial in the supply fairly specifically, at least to the point that we can move hogs between facilities in order to spread out the production runs and give ourselves the best opportunity to service our orders.

So, when you combine those two things, our team really, really did a great job. In terms of fresh pork supply and demand, the demand for pork is up significantly. We know the pounds are going to be down just because we're not producing them. But in the last four weeks ended in May, pork pricing, just in that last four weeks that retail, was up 23%.

So, the demand for pork is very strong. Frankly, the demand for beef and chicken is very strong. It's just chicken has been the only one to really be able to supply some portion of the demand. So, if you look at ground beef pricing for the four weeks ended, you're up 12.5%. Fresh beef was up 10.5%. Chicken was up another 4.5%. And, like I said, fresh pork was up 23%. So, the demand for protein is really strong.

Michael L. Piken

Analyst, Cleveland Research Co. LLC

Q

Okay. Thank you.

Operator: Thank you. [Operator Instructions] Our next question comes from Ken Zaslow from 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

Hi, Ken.

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, just starting off. Just so I understand the guidance for a second. Your maintaining guidance, you have about \$100 million less Chicken profitability and you have a higher interest expense and less share repurchases. Is that kind of what I'm hearing?

Donald J. Smith

President & Chief Executive Officer, Tyson Foods, Inc.

Yes. And also, as you have noticed, we did not -

Dennis Leatherby

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

Ken, I might interject on the higher interest expense. When we said \$130 million for 2014, that was enclosed of the initial Hillshire financing. And when we talk about the \$2.78 though, it's still at the old run rate that we described before of about \$95 million or \$100 million.

Kenneth B. Zaslow

Analyst, BMO Capital Markets (United States)

Okay. But still, you're keeping your guidance, so you did stop your share repurchases which is probably another \$0.02 to \$0.03 and you have about \$100 million that you're going to lose in your Chicken profitability because of operational issues and you're still [ph] keeping the (45:04) number?

Donald J. Smith

President & Chief Executive Officer, Tyson Foods, Inc.

Yeah. And the other thing to, perhaps, not miss there is, in Q3, we absorbed \$95 million in incremental Prepared Foods raw material cost that we did not recapture all of that in our pricing structure because of the way our pricing works. By the way, that's up \$160 million for the year. And so, there was the \$50-million write-off in Prepared Foods, but there's also the inability, because the markets were still going up, to capture any raw material costs. So if the markets will stabilize, then that capture will happen in future quarters. Now, we're doing what we can to shorten the lag, but it takes a while to work through that. So, I think that's another important thing to keep in mind.

Kenneth B. Zaslow

Analyst, BMO Capital Markets (United States)

So you think the number's actually higher than what you're saying, and you would expect it to grow 10% off that, is that a fair way of also thinking about it a little bit?

Dennis Leatherby

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

Could you repeat that one more time?

Kenneth B. Zaslow

Analyst, BMO Capital Markets (United States)

Your base number is actually higher than what your advice is. And then your goal is obviously to grow 10%. So...

Donald J. Smith

President & Chief Executive Officer, Tyson Foods, Inc.

Yeah. I think the easiest way to look at that is what we've said was our EPS guidance would be off where we land this year, but I think we can see that there's upside potential to that. And we tried to have – because we're just talking about this now in our Q3, which normally we don't talk about that too much until November. So I think what we're trying to say is we've got a pretty conservative baseline of growth with upside to that.

Kenneth B. Zaslou

Analyst, BMO Capital Markets (United States)

Q

Okay. Then my two follow-up questions – one is, you obviously have a bit of clarity to the cost savings. What did you find out that gave you any confidence or changed your view on that? Like, obviously, you probably had one meeting or two meetings with the Hillshire folks. Can you talk about that and exactly why you came up with a different synergy number?

Donald J. Smith

President & Chief Executive Officer, Tyson Foods, Inc.

A

Yeah. So – you're exactly right, Ken. As we got to talk, we would have this assumption about a particular category, and let's say some category in purchasing. And so we have a quick conversation and you find, oh, you know what, that's probably not right, but – and then here's another category where we didn't think there might be very much savings that there ends up being more.

When we look at capacity utilization, when we look at transportation and logistics savings around, we have a different basic tenet around our distribution model. And so being able to combine that and get fuller trucks in both refrigerated and frozen, being able to shorten the distance of – that raw material travels to the manufacturing plant that we can figure out how to do a network optimization model to streamline that all the way to the customer, those are some of the things as we started these conversations that kept popping up that makes us feel really good about what we'll see going forward.

And two, all we're using in our synergy number is really the – let's call them, hard synergies, the cost savings and supply chain savings and purchasing savings and that kind of thing. When you start thinking about the innovative capability, new product development, sales growth, efficient MAP spending and brand spending, there's a lot of incremental value that will be created through this acquisition, and – but we want – on the front end, especially before the deal's even closed, we want to only talk about those hard synergies that we can report back on every quarter.

Kenneth B. Zaslou

Analyst, BMO Capital Markets (United States)

Q

Okay. And then my last question is, you didn't talk about hog supply and the impacts, again, I get the PED virus, but I'm actually thinking about the hog production – I know you're not in the business of hog production – it seems to be pretty great if not at near-record levels.

Dennis Leatherby

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

A

Yeah.

Kenneth B. Zaslou

Analyst, BMO Capital Markets (United States)

Q

I would assume that there would be at least some expectation of expansion over the next two months to three months or of the start of it, at least. What's your take on that? And then, how is that factored into your expectations? Because I'm assuming you don't expect sow prices to be at \$ 90.

Donald J. Smith

President & Chief Executive Officer, Tyson Foods, Inc.

A

So, here's the way we're thinking about that, Ken. The farm – most, well, first, a hog producer that does not have PED is having an outstanding year. Unfortunately, many have had PED, and obviously that's a devastating loss to those farms. If you go back into the early spring, there was a potential to lock up really decent margins hedging. And so, a lot of guys put on hedges and their margin calls have been significant.

And so, frankly, the farm banks have been, I think, a little hesitant maybe so far, until these producers are able to clear that hedge in Chicago – the margin issue in Chicago by selling out the hogs – they've been a little bit hesitant as we understand it to talk much about expansion, but in my opinion, as you get on into the fall, assuming, of course, that we don't have an early frost and all that, we have a decent corn crop, it's – there's going to be a compelling financial case for lot of these hog producers who have [ph] healed then (51:03) a lot of their balance sheet, to be able to add some finishing capacity and move forward.

And you know, I think the finishing capacity is probably the – of the capacity to spend on, it's probably the cheaper to spend. And so, that gives us confidence that with the bio security precautions that producers have taken, they're seeing incremental benefits in other diseases that they typically work with during a year or two years. So, that gives us confidence that we're going to see the hog supply up about 2% or so next year.

Kenneth B. Zaslow

Analyst, BMO Capital Markets (United States)

Q

Great, I appreciate it.

Donald J. Smith

President & Chief Executive Officer, Tyson Foods, Inc.

A

Thanks, Ken.

Operator: Thank you. And our next question comes from Akshay Jagdale from KeyBanc. Your line is open.

Akshay S. Jagdale

Analyst, KeyBanc Capital Markets, Inc.

Q

Thanks for taking the follow-up. First one is on Chicken. So, there's two questions, a 10% margin would be, obviously, the highest not only annual margin but I think even on a quarterly basis, we haven't seen 10% from your Chicken business, at least in a while. So, help me understand why that's not only possible but, perhaps, conservative and something you're confident in.

And secondly, what happens when chicken supply does pick up? What is the bottom of – in terms of the range, where are we now in terms of bottom-of-the-margin range for Tyson? Because we could argue and debate what the top end is because you sort of haven't really pushed that up as much as we would've thought. But certainly, I think you've proven that the bottom end is higher. So, when chicken supply does pick up maybe in 2016, what's the worst we could see from the Chicken business?

Donald J. Smith

President & Chief Executive Officer, Tyson Foods, Inc.

A

Okay. So, let's think about 2015 first. Obviously, we're leaving money on the table with our production issues. Then, if you just pull that \$100 million or so in and then we're going to have grain down, say, \$400 million – and remember, the parts of our business where we're seeing the greatest demand is the parts of our business where we have the best margin structure, rightfully so. And so, when you put all three of those things together, I think it's pretty easy to see that you're certainly – I mean if you do 10% on an \$11 billion business, that's pretty easy math.

Now, let's think about going forward into the latter part of 2015 and on into 2016. So, because we are working hard to maintain our investment grade rating, if you keep a great capital structure, we're going to have the available cash flows to be able to keep spending on our business and we intend to do that, and we've got several projects in Chicken where we can continue to spend money and generate cost efficiencies. And I think we've done pretty well over the last three years or four years proving that we can do that. I think over a four-year average, we're probably like a what, 25%-ish MRRR on our CapEx all-in. So, we know how to spend efficiently to gain cost improvements.

Second thing, we will continue to grow our value-added business. Frankly, the only thing keeping us from selling a whole lot more value-added is our productive capability. So, we're getting all that big, more case-ready. Case-ready chicken is growing at retail because of high beef and pork prices, I think, that will continue for several years and we'll continue to add capacity into that offering.

By the way, we'll grow our No Antibiotics Ever line of predominantly fresh chicken, so we've got opportunity there. What we strive for, Akshay, is a more stable business model. We have birds in all of the major bird size classes. And we strive for variable pricing models to be able to deliver consistent growing earnings over time. And we spent a lot of time getting this business under us. Unfortunately, we've had that production issue in the last half of this year. But once we get that behind us, I think we've got a great future going forward.

Then if you look at the rest of the business, our case-ready beef and pork offering will continue to grow. Of course, we're adding Hillshire, great capabilities there, plus all of the synergies there. We should see adequate pork supply. We'll start seeing some improvement in our International business. We'll see benefit from our legacy Prepared Foods benefits (sic) [business] (56:08) as we get the production footprint right and stabilize the raw materials.

So when you combine all that, that's a great story going forward that'll carry you beyond 2015, on into the 2016-plus. And besides that, by keeping that investment-grade rating and then rapidly delevering this debt, we have multiple growth options open to us in the very not-too-distant future. And that's important to continue the Tyson story out front.

Akshay S. Jagdale

Analyst, KeyBanc Capital Markets, Inc.

Q

Donnie, that's useful. Just follow up on that. I mean, what -

Operator: Thank you. Now I'd like to turn the conference call back over to Donnie for any closing remarks.

Donald J. Smith

President & Chief Executive Officer, Tyson Foods, Inc.

Thanks, Kelly. Hey, before we go, let me just re-iterate a few key points. Number one, we expect to continue our trend of at least 10% EPS growth next year. We anticipate Hillshire being accretive to earnings in 2015 and substantially accretive thereafter. We think our Prepared Foods segment synergies will be over \$225 million as we execute our Prepared Foods strategy in 2015 and \$500 million by the end of the three years.

So, thanks for joining us today and we hope you have a great day.

Operator: Thank you. That does conclude today's conference call. You may all disconnect at this time.

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