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Tyson Foods, Inc. (TSN)

Q1 2015 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Welcome to the Tyson Quarterly Investor Earnings Call. This call is being recorded. If you have any objections, you may disconnect. All lines have been placed on listen-only mode until the question-and-answer portion of today's conference. [Operator Instructions]

And now, I'd now like to turn the conference over to Mr. Jon Kathol, Vice President of Investor Relations. Sir, you may begin.

Jon Kathol

VP-Investor Relations & Assistant Secretary

Good morning, and thank you for joining us today for Tyson Foods' conference call for the first quarter of the 2015 fiscal year. On today's call are Donnie Smith, President and Chief Executive Officer and Dennis Leatherby, Executive Vice President and Chief Financial Officer.

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.

Following our prepared remarks, we'll go to Q&A. 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.

Because our annual meeting of shareholders takes place this morning, we will need to stay on schedule by ending Q&A at the top of the hour. We hope to get to all of your questions but we'll have to put a hard stop on the call to get to the shareholders meeting on time.

I'll now turn the call over to Donnie Smith.

Donald J. Smith

President & Chief Executive Officer

Thanks, Jon, and thanks to all of you for joining us today. Q1 was another great quarter with adjusted earnings of \$0.77 a share. Sales were a record \$10.8 billion, up 23% from last year. Adjusted operating income was a record \$564 million, which is a 37% improvement year-over-year. Our overall adjusted operating margin was 5.2%, and we reduced debt by \$650 million in the quarter.

We realized \$60 million of synergies in Q1 and we're on pace to exceed \$225 million in synergies for the fiscal year in operational improvements, procurement, manufacturing and logistics, and organizational change. We're off to a fast start and we're confident in our ability to achieve at least the \$500 million target set for the end of fiscal 2017.

Let's take a look at the operating segments. In Q1, the Chicken segment reported a record 12.6% return on sales with volume up 3.1% and average pricing of 1.5%. Industry dollar growth for retail fresh chicken, was up 8% and our growth was in step with the overall strong industry growth. We maintained the number one branded share in fresh, individually frozen, and Cornish chicken and demand is very strong especially for fresh tray pack. In fact,

we're still short of supply in tray pack. Now, the foodservice industry saw much needed growth in our fiscal Q1 and I'm pleased to say that Tyson's Chicken sales growth at foodservice was more than double that of the restaurant industry on a sales dollar basis.

The production issues in two of our value-added chicken plants last year are resolved, and all of our lines are operational. We're now working to build the pipeline and fulfill the pent-up demand. By the end of Q1 we had regained a little over 2 share points and we'll continue to expand our distribution and regain the lost share in Tyson's frozen, cooked chicken.

USDA indicates an increase in production of 3% this fiscal year. Although other more recent data might indicate a greater increase in supply, we believe demand will more than keep pace. With this strong demand, a shift to a more profitable mix, strong pricing and increased further-processing capacity, we now think our return on sales will be above 11% for the remainder of the year. There looks to be more chicken supply coming in 2016 as well and we're working on plans to capitalize on it. We created our buy versus grow strategy for this scenario and we see it as an opportunity to value up.

The Beef segment was just under breakeven for the quarter. Volume was down 2.7% with average pricing up nearly 21%. Continued record-high beef prices at retail have caused a shift in consumption away from beef towards other proteins leading to margin compression in our Beef business.

Despite marginal losses, we improved our position relative to industry indexes. We have adjusted our slaughter to recover margins and have already seen improvement in Q2. However, the segment will continue to be challenged in the quarter. I'll hurry on to say that the pressure in our Beef segment has been more than offset by benefits we see from the balance of our portfolio.

Our Pork segment had a 7.9% return on sales in the first quarter. Volume was up 1% while average pricing increased 7% indicating strong demand. We expect further recovery from the PED virus and expect industry hog supplies to increase around 2% to 3% in fiscal 2015. It should be another good year for the Pork segment and we expect results similar to last year's.

The International segment had an operating loss of \$14 million, which was half of the loss compared to Q1 of 2014. The sale of our business in Brazil was finalized in Q1 and we expect the sale of our Mexico assets to be completed by the end of March. It's still a tough demand environment in China. Pork pricing has been pressured, which also affects Chicken. Wholesale poultry prices are down 10% since September and are now only about 2% above the trough we saw back in January of 2014. We'll continue on a holding pattern with our operations in China as we await for demand to improve.

Regarding our International exports, lower pricing has essentially offset the appreciation in the U.S. dollar allowing us to maintain our volume so far this year. Our primary concern about exports is coming from ongoing interruptions at West Coast ports, which is pressuring logistics that could eventually affect livestock producers if the situation isn't resolved soon.

Now, moving on to Prepared Foods, the segment had an adjusted 5.2% return on sales for the first quarter. With the Hillshire Brands integration, volume was up nearly 90% and average pricing was up 24%. On a pro forma basis, we had an unfavorable input cost impact of \$83 million, largely offset by synergy capture and price. We streamlined our operation in Prepared Foods by closing plants, improving capacity utilization as we continue to tightly manage cost, invest in our brands and drive our growth agenda. The integration is going very well, and it didn't take us long to realize that we're much stronger together.

Let's use category captaincies as an example. Strategic retail customers see the benefit of leveraging our products, capabilities and expertise to grow their business, and since combining Tyson and Hillshire, we've added 11 category captaincies for a total of 76, indicating our customers trust our insights and partnership in leading category growth decisions.

So, in terms of macro trends affecting the industry, I'd like to address our perspective on the consumer marketplace and how we're capitalizing on shifting demand to grow our business and our customers' businesses. In the past quarter, consumer confidence, lower gas prices and unemployment data were tailwinds that we expect will continue to favor food spending in the New Year. But pressures like long-term unemployment and limited wage growth still weigh on a lot of people. We've talked about this situation before as the bifurcated consumer or the barbell economy, and it factors into consumer spending habits which, in part, drive our innovation agenda. We continue to see consumers moving from red meat to poultry, and 68% say the cost of red meat is the reason they're making the shift. However, beef prices have remained at record levels because demand has been so strong among people who can afford it. Chicken is the only protein to grow annual consumption during the past four years.

Lower fuel prices appear to have benefited food purchases, both at grocery and foodservice, mainly at QSR and casual dining, which saw traffic growth in our Q1 for the first time since the recession. There are also positive growth in on-site foodservice such as lodging, deli and healthcare where we have a strong presence. If lower gas prices continue into the summer, foodservice could see even more recovery.

Our innovation pipeline is grounded in the strong understanding of these market dynamics coupled with deep consumer insights. As you heard at Investor Day, we're gearing up for two new product platform launches for the back half of the year: Hillshire Snacking and Ball Park jerky. This is in addition to our ongoing new product news that happens throughout the year. We grew dollar sales in eight of nine track categories in Q1 behind pricing but also supported the strong distribution and new products. We'll continue to build on this momentum with our advantaged portfolio through brand building and innovation.

We have a lot to be excited about in Tyson Foods. Q1 was a great quarter. While I don't expect our second quarter to be as good as Q1 because it's typically our most difficult, I do expect it to be better than Q2 of last year. We're reiterating our guidance of adjusted earnings in the range of \$3.30 to \$3.40 a share with results weighted towards the back half of the year. We have a balanced, diversified business model and a focused growth agenda that give me confidence that not only can we handle whatever challenges are ahead, we're going to thrive.

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

Dennis Leatherby

Chief Financial Officer & Executive Vice President

Thanks, Donnie, and good morning, everyone. This morning, I will be referring to our first quarter adjusted operating income and EPS. Please refer to our press release issued earlier this morning for a full reconciliation of our GAAP to adjusted results.

Fiscal 2015 is off to a great start. With record sales, operating income and operating cash flows, we were able to reduce debt by \$650 million. First quarter revenues were \$10.8 billion, representing over 23% growth compared to a year ago, as we continued to execute our growth strategy as evidenced by increased sales in Chicken, Beef, Pork, and Prepared Foods. Total company adjusted return on sales for the quarter was 5.2% and adjusted operating income was \$564 million representing a 37% increase over Q1 of 2014.

Our adjusted earnings of \$0.77 per share represents a 7% increase over a strong comparative period a year ago. We have record operating cash flow for the first quarter at \$812 million and we spent \$231 million on capital expenditures. This outpaced our depreciation by \$83 million as we continued to invest at projects with a focus on delivering high ROIC.

Our effective tax rate for the first quarter was 28.8%. On an adjusted basis, this rate was 34.8%. Net debt to EBITDA for the past 12 months was 3.5 times. And on a gross debt-to-EBITDA basis, this measure was 3.7 times. On a pro forma basis, including Hillshire's results for the past 12 months, net debt to EBITDA was 2.7 times on an adjusted basis.

Including cash of \$381 million, net debt was \$7.1 billion. Total liquidity was just over \$1.6 billion remaining above our goal of \$1.2 billion. Net interest expense was \$75 million during the first quarter. For the quarter, our diluted shares outstanding were 416 million. As Donnie pointed out, we closed on the sale of our Brazil chicken operations during the first quarter. As a result of the sale, we received proceeds of \$130 million with additional proceeds expected in the second quarter relating to the working capital adjustment. The sale of our Mexico chicken operation is expected to close in the second quarter.

Now, looking forward, here are some additional thoughts on 2015. Please note our accounting cycle results in a 53-week year in fiscal 2015 as compared to a 52-week year in fiscal 2014. Accordingly, this outlook is based on a 52-week year to make a better year-over-year comparison.

We expect revenues of approximately \$42 billion for fiscal 2015, which is 12% growth over fiscal 2014. This is driven primarily by a full year of Hillshire Brands results offset by a reduction from the sale of our Brazil and Mexico chicken operations. We expect to capture more than \$225 million in fiscal 2015 from our Prepared Foods profit improvement initiatives and Hillshire Brands synergies.

Net interest expense should approximate \$280 million for fiscal 2015. We currently estimate our adjusted effective tax rate to be around 35.5%. CapEx is expected to be \$900 million which represents approximately \$300 million or 50% more than our depreciation expense as we continue to focus on projects that will create long-term shareholder value.

Based on our average share price in Q1, we expect our diluted shares in Q2 to remain around 416 million prior to considering any further changes in our stock price, which would impact the dilution from our tangible equity units.

Our priorities for the significant cash flows that our operations will continue to generate are for rapid deleveraging and strengthening our balance sheet, a continued focus on disciplined capital allocation to drive long-term shareholder value and debt capacity to fund acquisitions to fill our growth strategies and to return cash to shareholders through share repurchases and dividends, all while ensuring we maintain plenty of liquidity.

We have a lot of momentum going into fiscal 2015 with the addition of the Hillshire business and team. We are pleased with our first quarter results delivering 7% EPS growth over Q1 of fiscal 2014. Our Q2 should beat last year but likely will be less than Q1 due to our typical seasonality. And the third and fourth quarters are expected to be really strong.

As we continue to capture synergies from combining two great businesses, we're confident we will deliver adjusted EPS within our range of \$3.30 to \$3.40 for fiscal 2015 which represents an increase of over 12% compared to fiscal 2014.

This concludes our prepared remarks. Jane, we're ready to begin Q&A.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question comes from David Palmer with RBC Capital Markets. Sir, your line is open.

David S. Palmer
RBC Capital Markets LLC

Q

Good morning, guys.

Donald J. Smith
President & Chief Executive Officer

A

Good morning.

Dennis Leatherby
Chief Financial Officer & Executive Vice President

A

Good morning.

David S. Palmer
RBC Capital Markets LLC

Q

You noted that Chicken margins are expected to be above 11% for the remainder of the year and we've seen what's going on with supply growth, seems to be inching up a little bit. What gives you confidence in that Chicken segment guidance?

Donald J. Smith
President & Chief Executive Officer

A

David, so we've modeled our 2015 Chicken performance using several models. And I'm very confident in our ability to deliver 2015. So, if you take – if you look at not only our brand leadership in fully cooked and in the fresh IF and Cornish categories at retail, plus our leadership in foodservice, we've got a great broad balanced portfolio. On top of that, we've made a lot of improvements in our sales mix. I've mentioned in my prepared remarks that we've got great growth in tray pack. We're going to have peak capacity in place to be able to take advantage of further-processing business that we might – we think will come our way in foodservice.

We've got [ph] a great (16:32) innovation pipeline. We've made a lot of operational improvements and we'll continue to see benefit from our capital and investments. So, if you look at that balanced portfolio, our pricing structure and these other factors, we'll deliver 2015.

David S. Palmer
RBC Capital Markets LLC

Q

One question on the foodservice side. We're seeing a lot of demand not just for protein, but increasingly, there are players out there that want to upgrade the protein in some ways, assure consumers that it's all natural. Maybe down the road, antibiotic-free chicken will be a bigger thing, but is there an opportunity for Tyson with that – how big of a deal could that evolution or perhaps even a margin constraint could that be having to shift to perhaps a more natural product as demand shifts? Thanks.

Donald J. Smith

President & Chief Executive Officer

A

That's a great question. It appeals, frankly, both at foodservice and retail to a different consumer segment than what is broadly addressed by most of our portfolio today, which is great news for us. We've got a tremendous innovation engine and I think with our capabilities in our Discovery Center and our ability to drive innovation, I think we're advantaged in the ability to capture that.

I would also add that our live production team is about as good as there is in the industry. When you look at benchmarking data – actually, when you look at benchmarking, they are the best in the industry, which, I think gives us an advantage in what might be considered a little bit more challenging live production environment. So, I feel good about our opportunity to continue to capture on that in the future.

Our NAE line, which we launched, what, half a year ago or a little further, we've doubled it since the launch and our growth continues. We're adding more. We're adding about 100,000 birds a week to that business next month. So, we continue to see growth and we continue to use our supply chain to fill those needs.

David S. Palmer

RBC Capital Markets LLC

Q

Thank you.

Donald J. Smith

President & Chief Executive Officer

A

Sure.

Operator: I'm sorry. Are you ready for the next question?

Donald J. Smith

President & Chief Executive Officer

A

Yes, we are.

Operator: I apologize. We have a question from Akshay Jagdale with KeyBanc. Sir, your line is open.

Akshay S. Jagdale

KeyBanc Capital Markets, Inc.

Q

Good morning.

Donald J. Smith

President & Chief Executive Officer

A

Good morning.

Akshay S. Jagdale

KeyBanc Capital Markets, Inc.

Q

Congratulations on the Chicken margin, I think as far as I can tell, it's the best I can remember in the history. Is that accurate?

Donald J. Smith
President & Chief Executive Officer

A

Yes.

Dennis Leatherby
Chief Financial Officer & Executive Vice President

A

Correct.

Akshay S. Jagdale
KeyBanc Capital Markets, Inc.

Q

So, my question, I'm going to start with – I have two. I'll start with, it's Hillshire related, say acquisition-related, but it's more of a sort of outlook on Pork, right? So, supply expected to increase on pork. All the hog prices have come down. The retail values have come down. Presumably that should help a value-added Pork business. So, one, am I thinking of that generally correctly? And, two what are the implications of that on your segment margins for Prepared Foods, which you maintained your guidance as far as I can tell? So that's my first question. I have a follow-up.

Donald J. Smith
President & Chief Executive Officer

A

Okay. So, two things you should expect. Number one, with increased supply, that will likely also improve – besides the Prepared Foods piece, which would come later, maybe Q4, Q1, Q2, that type – Q1, Q2 of 2016, that type thing, you should also expect improvement in the back half in our Pork segment. So I think there we will have a double advantage, if you will, inside of our portfolio. But, Akshay, you're absolutely thinking about it right, about an improvement in the raw material structure underneath our Prepared Foods business. And at the retail brands, we're using our marketing support to position ourselves very well to take advantage of that.

Akshay S. Jagdale
KeyBanc Capital Markets, Inc.

Q

But what does it mean for your – I mean, so how should we think of your guidance in relation to that?

Donald J. Smith
President & Chief Executive Officer

A

Okay, got it. So, as we mentioned on the call, Q2 is always a bit challenging and we kind of made the right comments about that. We will see the improvements back-half-loaded. You'll see the run rate in Prepared Foods accelerating through the year and taking that momentum into 2016. And so it's still early in the year. So we're maintaining our current guidance at \$3.30 to \$3.40, but there's some things at play that could certainly advantage that.

Akshay S. Jagdale
KeyBanc Capital Markets, Inc.

Q

Okay. And then on Chicken, this quarter obviously very good, especially given that the spot margin sequentially declined, yours expanded, so you're sort of advantaged relative to spot expanded as well. So, in light of that, you've obviously commented on your Analyst Day that if and when the cycle turns, you'll be 500 basis points above on margins. So, can you just conceptually help us understand why your business today is in a position to deliver those type of margins even if the industry is not making money?

Donald J. Smith

President & Chief Executive Officer

A

Sure. So, as we talked about in New York, we have a very balanced portfolio between the bird classes, the tray pack size, small bird, big bird, and the other sizes. So, that helps, coupled with the pricing structures that we've worked with our customers on in the last couple of years. So, now, we have this balanced portfolio. We've got a very good balance of pricing structures and mechanism, some that are tied to the market, some that aren't. And remember, we index – we correlate a lot closer to the whole bird market values than we do to the breast meat values.

Now, one other thing that might help is, we do have, I'm going to say X percent of our portfolio that is subject to, I'll call it, market pricing. But we also have X percent of our portfolio that's very balanced to that that we buy on the outside market. So when the price goes down on the portion of our portfolio that we sell based on market prices, we get a commensurate benefit in a different part of the portfolio from the lower cost to buying that raw material. And, hey, add on top of that, we have a great brand presence, number one at retail in fully-cook, which we're rebuilding that category and we're number one in fresh tray pack, we're number one in IF, we're number one in Cornish. We have a leading brand in foodservice. So, you add all that together and our buy versus grow strategy positions us well to take advantage of this.

Akshay S. Jagdale

KeyBanc Capital Markets, Inc.

Q

Great. I'll pass it on.

Operator: Our next question comes from Robert Moskow with Credit Suisse. Your line is open.

Robert B. Moskow

Credit Suisse Securities (USA) LLC (Broker)

Q

Hi. Thanks, Donnie. I think you've covered what happens when supply expands, but is it fair to say that the egg set that came out in the industry data were above your expectations, because I seem to remember at the Analyst Day you're saying that you didn't think the 3% growth would continue. Is that fair to say?

Donald J. Smith

President & Chief Executive Officer

A

That is fair to say. Yes. What I was expecting was we had that gap because people took cuts last season that they didn't take this season, and I expected that to level off after January, and that has not happened. So, that 3% type number has continued.

Robert B. Moskow

Credit Suisse Securities (USA) LLC (Broker)

Q

Okay. And whole bird prices, to your point, have done nothing but go up. You've seen some fluctuation in commodity fresh meat parts. What would stop that forward momentum in whole bird prices? I always get concerned about the supply growing. You seem to think that demand is going to be strong enough to offset all of it. But is 3% egg sets just not enough to offset that forward momentum in whole bird?

Donald J. Smith

President & Chief Executive Officer

A

Frankly, we've modeled past that and still with our pricing structures and the balance of how we go to market, we're still in good shape as supply increases above what a 3% egg set might indicate. Our buy versus grow strategy

is – we care a lot more about how much chicken we sell than how much chicken we grow. And if you look at the last three weeks, slaughter, we're over 1 billion slaughter pounds. So since the beginning of the year, slaughter has increased something on the order of 7%. And if you look at particularly front half pricing, wings, tenders and breast meat, that's up 15%. So there's every indication that demand is more than going to offset the supply increases.

Robert B. Moskow

Credit Suisse Securities (USA) LLC (Broker)

Q

Okay. And where I'll end it is on corn prices, obviously very benign and your cost structure is getting better because of it. Let's say, corn – I'm sure you've been asked this question before, but let's say we get another increase in corn and it goes up to \$6 instead of \$4, how much of that is contracted with your customers as a pass-through? I seem to remember it being a pretty large number now.

Donald J. Smith

President & Chief Executive Officer

A

Yes. We call those fixed-margin contracts, and we have – I won't necessarily mention the bird types, but we have – in particularly two of our classes of business, we have extended those type of contracts fairly dramatically so that that raw material cost doesn't impact our margins.

Now, hey, in super high commodity price margins, like, maybe we saw last summer, we give up a little bit. We know that. But we want to have stable, consistent earnings growth, which we're displaying now, and using our buy versus grow strategy, our pricing models, and certainly our innovative capability to continue to perform well for our customers, that's how we're going to continue the stable earnings growth.

Robert B. Moskow

Credit Suisse Securities (USA) LLC (Broker)

Q

So that commodity benefit that you're talking about this year, that's gross, isn't it? That's not net of what you've passed back to customers, or is it net?

Donald J. Smith

President & Chief Executive Officer

A

Yes. That's correct. That's correct. It's the change in, like, \$400 million I think. We originally – when we went into the year, I thought we'd have about \$450 million plus maybe benefit, and so far it's only about \$400 million, but that is in our cost of goods.

Robert B. Moskow

Credit Suisse Securities (USA) LLC (Broker)

Q

Okay. So that's gross?

Donald J. Smith

President & Chief Executive Officer

A

And frankly, some of that does leak in pricing.

Robert B. Moskow

Credit Suisse Securities (USA) LLC (Broker)

Q

Can you say how much?

Donald J. Smith
President & Chief Executive Officer

A

No.

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

Q

Okay. All right. Well, I'll make my own judgment. All right. Thank you.

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

Adam Samuelson
Goldman Sachs & Co.

Q

Yes. Good morning, everyone.

Donald J. Smith
President & Chief Executive Officer

A

Hey, Adam.

Dennis Leatherby
Chief Financial Officer & Executive Vice President

A

Good morning.

Adam Samuelson
Goldman Sachs & Co.

Q

So, a question in Prepared Foods, and I'm just trying to think about how – now that we have a full quarter of Hillshire under our belt, how we can evaluate the kind of combined pro forma performance. Last year, your Prepared Foods segment did \$16 million of profit, Hillshire on a GAAP basis did \$116 million. And you talk about \$60 million of synergy capture. Is that synergy capture number a run rate or realized in the quarter? And so, I'm just trying to think about that \$132 million pro forma versus the \$111 million realized and synergies less the fire and other material inflation. Help us bridge some of the performance of the pro forma [indiscernible] (30:01)?

Donald J. Smith
President & Chief Executive Officer

A

Okay. Good question. So, in the Prepared Foods segment, the raw material impact was \$83 million. The synergy capture was captured in Q1, it's not a run rate, it's captured in Q1, and I think \$55 million of the \$60 million was in the Prepared Foods segment.

So, think about it this way. In the front half – I think we mentioned this at Investor Day that we typically, in Hillshire, locked in supply, raw material supply for about six months. So, we've got the, call it – in our Q1, we've got that pretty high cost raw material in the summertime and the cost of goods. It's going to be about \$140 million or so impact in the front half of our fiscal year. But then we get relief in the back half of the fiscal year.

So, another part of the improvement that we saw some in Q1, it will get more prevalent in subsequent quarters as we close these plants and we've taken that production and put it into other plants to increase our capacity utilization. Demand is up. Demand has been strong. All of our brands – I mentioned we grew sales in eight of nine

categories and sharing five of nine categories, so we look at. So, I feel very good about our building momentum out forward. Does that help?

Adam Samuelson

Goldman Sachs & Co.

Q

Okay. It does. And maybe as a follow-on on the synergies. I mean, as you kind of think about where you are today, \$60 million realized in the December quarter, what annualized run rate are you at today? Where in the – in excess of \$225 million, what areas are driving the upside in the 2015 plan relative to what you thought a few months ago? And any thoughts moving forward? I know you've talked about things that are still not in the \$500 million plus number internal raw material procurement and – or higher faster organic growth. Any thoughts on putting a finer point on those buckets at this point?

Donald J. Smith

President & Chief Executive Officer

A

So I'll start at the back and work my way to the front. It's a bit too early, although we have teams now that are beginning to action projects that will affect us in 2016 and 2017. So, we're coming into a bit more clarity, but we've still got open project – we're still building projects that will affect us in 2016 and 2017. So it's just a little bit too early for us to comment on that.

On 2015, the operational improvements in the legacy Prepared Foods business were a bit more than we were expecting. They came a little earlier. And frankly, we got some purchasing synergies in Q1 that we weren't expected to see a little bit – to see until probably maybe Q2 or Q3. So, I feel comfortable we'll be better than the \$225 million. It's a little too early to call because the over delivery in Q1 was really pulling forward some benefit that we had originally expected to get in Q2. So, I hope that helps.

Adam Samuelson

Goldman Sachs & Co.

Q

Very helpful. I'll pass along. Thanks very much.

Dennis Leatherby

Chief Financial Officer & Executive Vice President

A

Thank you.

Donald J. Smith

President & Chief Executive Officer

A

Thanks, Adam.

Operator: Our next question comes from Ken Goldman with JPMorgan. Your line is open.

Ken B. Goldman

JPMorgan Securities LLC

Q

Hey. Thanks for the question. I just wanted to follow up on what Adam was asking because, let's say you kind of want to normalize year-on-year. Last year, you had, just for Hillshire, \$1 billion in revenue or \$1.1 billion and \$139 million in EBIT. This year, if you take out the synergies and you take out the \$83 million in costs, you're exactly the same EBIT, \$139 million, and yet, you've added a significant number of revenues, right, whether you want to look at it as Tyson adding on to Hillshire or Hillshire adding on to Tyson.

I know there's D&A. I know there's some moving pieces. But I just don't see how you can add that many revenues, \$1.2 billion and not have EBIT go up a little more, even if you exclude all those cost synergies. You understand what I'm saying? And if not, I can clear it up after the call. I'm just having a hard time seeing why this margin wasn't higher.

Dennis Leatherby

Chief Financial Officer & Executive Vice President

A

All right. Ken, let me give you one point to bear in mind. Incremental depreciation and amortization year-over-year for Hillshire, because of the step-up around purchase price accounting, is more than \$40 million. So, part of it is in that story.

Ken B. Goldman

JPMorgan Securities LLC

Q

Yes.

Donald J. Smith

President & Chief Executive Officer

A

Yeah. Ken, I think you're right. It's probably going to take a long time. Why don't we just take this one off line? But...

Ken B. Goldman

JPMorgan Securities LLC

Q

All right. We'll do it off line then. I appreciate D&A is part of it.

Donald J. Smith

President & Chief Executive Officer

A

[indiscernible] (35:22) Prepared Foods is frontloaded raw material cost that we'll recover in the back half, and we'll take – the margin improvement will improve sequentially quarter-over-quarter through our year and take that momentum then into 2016. So, we're very optimistic about the start. We've got – how we started and have some possible tailwinds to make the end maybe even a little better than we're calling it today.

Ken B. Goldman

JPMorgan Securities LLC

Q

Okay. So, 1Q didn't really come in that different than your expectations, is that fair?

Donald J. Smith

President & Chief Executive Officer

A

No. Actually, our Q1 was slightly over plan, not by much, but it was slightly over plan.

Ken B. Goldman

JPMorgan Securities LLC

Q

Okay.

Donald J. Smith
President & Chief Executive Officer

A

Yeah.

Ken B. Goldman
JPMorgan Securities LLC

Q

And then, let me shift subjects then. Donnie, how are you thinking about export dynamics today given where the dollar is trading? I might have expected some additional pressure on the back half of the bird by now. Are you surprised, linked-quarters are hanging in there? Are you modeling in some weakness going forward? I'm just curious what you guys are looking for down the road?

Donald J. Smith
President & Chief Executive Officer

A

Sure. So, two things I'm concerned about. Now, hey, not – don't be thinking when I use the word concern that it changes our guidance in any way. But this West Coast port slowdown is now starting to back up a little bit of meat. We're starting to see some cuts like plates and that type thing go into grinding meats. We're not there yet, but we're starting to see ground beef prices drop a little bit. Now, we're getting some fairly encouraging news or at least we did in the front end of the week about a possible resolution, but that is going to be a little bit of a logistics upheaval probably for the next month, six weeks, two months, something like that.

Now, I don't see that, frankly, impacting our margins because as the cutout drops, that will get – those are spread businesses, Beef and Pork are spread businesses and that will, frankly, move into livestock cost. So, now, if you look at Chicken – so that's kind of the picture on Beef and Pork.

If you look at Chicken, we are starting to see softness in jumbo leg quarters. We've got the ban from – China has banned now because of the AI problems on the West Coast. We've had AI in Europe. Russia is not taking any U.S. leg quarters. And so, there's been a repositioning of leg quarter movement. The small and medium prices really haven't changed very much. They're still hanging around the \$0.40-ish-type number.

But recent trades in jumbo leg quarters for Feb-plus time period are probably slightly below \$0.30 a pound. So, now, we have all that factored into what we're talking about, and we've dramatically reduced our exposure to leg quarters. And there's some internal offsets in – like the fuel prices that we experienced in our live production area and feed haul and that kind of thing.

Plus, we dramatically increased our production in boneless dark meat, and that's a category that's growing both at foodservice and retail. So, we continue to shift our leg quarter mix into the boneless category. I hope that's pretty good color.

Ken B. Goldman
JPMorgan Securities LLC

Q

It is. Thank you very much, gentlemen.

Donald J. Smith
President & Chief Executive Officer

A

You bet.

Operator: Our next question comes from Tim Ramey with Pivotal Research. Your line is open.

Timothy S. Ramey

Pivotal Research Group

Q

Good morning, and thanks for the opportunity. Donnie, thinking back at the – over the last several years, I remember lots of commentary on high gas prices and weak consumer picture on QSR demand. And you touched on that but I expected a little more enthusiasm maybe for the outlook on QSRs. I know I sure think that there is a lot of incremental spending that's going to shift out of gas tanks and into breakfast, various QSR revenues. What are your thoughts on that?

Donald J. Smith

President & Chief Executive Officer

A

So, seeing casual actually grow traffic for the first time since the recession is a very good sign. You're right. QSR is leading the growth. Frankly, if you take out one large QSR, QSR grew by 3.6%. So there is a lot in that. It's interesting to note in foodservice that you're seeing the younger brands outperform the more mature brands. So that's an interesting dynamic that we'll be able to take advantage of. So one other thing, I mentioned offsite. We have a very strong presence in deli and retail, and that business is very, very strong. We're seeing like 3.5% growth in deli. You're seeing lodging and these other offsite categories grow by 3.5%, so – where we have, by the way, a very strong presence.

So we are very optimistic about – now, we don't have that QSR promotional order today, but we're in a lot of conversations and we still think that ground beef prices are going to be relatively high and foodservice is going to want to promote chicken this year. So we feel really good. By the way, that also plays a bit to our advantage in our buy versus growth strategy and we've got – we'll have four incremental FP lines in production by late spring. So we're ready. Last year, we gave up some promotions because we just didn't have the capacity to do them. This year, we can do them.

Timothy S. Ramey

Pivotal Research Group

Q

Okay. And then, just a quick follow-up on Beef, it sounds like you had adjusted slaughter rates down a little bit. Did Beef catch you off guard in the first quarter? Were you a little out of position operating a too high of an operating rate or – in other words, again, I would normally expect 2Q to be worse than Q1 and I was surprised that you actually lost money in the Q1.

Donald J. Smith

President & Chief Executive Officer

A

Yeah. I wouldn't say we were out of position. I would say that cattle availability while it was in our area – the cattle continues to move to the Midwest to be fed just because of the freight rates that it takes to get the corn outside of the corn belt. So, cattle continue to move towards – I think probably we pushed some cattle forward. When I look at – and the reason I say that, when I look at how quickly cattle prices responded to market signals in Q1, it told me they were in pretty strong hands.

And now, when you look at this last cattle on feed report, it indicates to me that some cattle did get pushed forward which is probably going to help us in the latter part of Q2 and certainly going into spring. And the front half is always weaker than the back half, and we tend to look at our cattle business not quarter to quarter, but throughout the season. So, it may have moved a month or two versus what we would have thought, but we're well

– we were well positioned to take advantage of it. I mentioned our index has improved versus – we keep an index of our performance versus the USDA numbers, and we did improve. So, that's what I'm looking for.

Timothy S. Ramey
Pivotal Research Group

Q

Thanks so much.

Donald J. Smith
President & Chief Executive Officer

A

You bet.

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

Farha Aslam
Stephens, Inc.

Q

Hi. Good morning.

Donald J. Smith
President & Chief Executive Officer

A

Good morning.

Dennis Leatherby
Chief Financial Officer & Executive Vice President

A

Good morning.

Farha Aslam
Stephens, Inc.

Q

Two questions. The first, Donnie, you had highlighted that tight supplies of Pork and Beef are supporting demand for Chicken. Kind of going forward as Pork becomes more available, how much pressure do you think that will put on Chicken and is there any particular sector it'll have more of an impact versus a less?

Donald J. Smith
President & Chief Executive Officer

A

Farha, it stands to reason it'll put some. But typically, if you look at the per capita consumption data, per capita consumption of pork is relatively flat, and we export about 25% of the pork that we produced. A little bit of concern on the West Coast now, but in general, global demand for protein, for pork particularly, continues to grow. And so we will export more, and like I said, the prices have dropped to offset the increase in the value of the dollar.

So, it's not so much a Pork versus Chicken story as it is a Beef versus Chicken story, and beef prices are going to remain relatively high. Plus, don't forget, as pork prices drop in our portfolio, we get a offsetting benefit or an additional benefit in Prepared Foods that might offset any softness in chicken prices for example. That type of thing.

Farha Aslam

Stephens, Inc.

Q

That's helpful. And going on to Prepared Foods, you said that this year you expect \$225 million or so in synergies, and over three years, \$500 million. Could you just help bridge the \$225 million to \$500 million, kind of key buckets that you're looking for in terms of where those cost savings are going to come from?

Dennis Leatherby

Chief Financial Officer & Executive Vice President

A

There's four buckets – operational improvements in Prepared Foods that largely comes in fiscal 2015. Procurement, frankly, we would get some benefit in 2015, but more benefit as we get out into 2016 and 2017. And then, we'll also begin to pick up additional synergies in manufacturing and logistics as we get the network built out and that type of thing. For this year, and I think we said this in New York that we're looking for about \$140 million in the operational improvement bucket in 2015, \$40 million in procurement, \$25 million the plants and in logistics, and then \$20 million from kind of G&A savings, if you will.

If you move forward, you get more and more savings in procurement, you get more savings in manufacturing and logistics and network optimization. And then, into 2016 and 2017, those buckets begin taking the majority of the synergy versus the initial legacy Prepared Foods changes in 2015. Does that help?

Farha Aslam

Stephens, Inc.

Q

That's very helpful. Thank you.

Dennis Leatherby

Chief Financial Officer & Executive Vice President

A

You bet.

Operator: Our next question comes from Brett Hundley with BB&T. Your line is open.

Brett M. Hundley

BB&T Capital Markets

Q

Hey. Good morning, gentlemen.

Donald J. Smith

President & Chief Executive Officer

A

Good morning.

Brett M. Hundley

BB&T Capital Markets

Q

I had a question Donnie on Prepared Foods. I just wanted to understand more of the competitive dynamic within packaged meat right now, what you're seeing and hearing. And really, what I'm getting at here is as some of these raws come off, I want to try and understand Tyson's ability to drive margin alongside its innovation schedule, if that makes sense. So, just wanted to see what you're hearing and seeing on the competitive dynamics front within packaged meat.

Donald J. Smith

President & Chief Executive Officer

A

Sure. So, you're right. We will be able to continue to drive our profitability, and the real reason behind that is we're continuing to support the innovation that we have in the marketplace today. We're building for more innovation in the back half of our year and kind of extending into some categories. So that's going to continue to help.

And I believe what we have seen in – as we have entered the year, we're exactly on plan with where we thought we would be. And by the way, we're going to adjust the marketing support a little bit for our any time launch. Velocity is not exactly where we want it to be, their distribution is great, but we need to tune up velocity there which will happen in the back half of the year and we're in – I think great shape in our categories and the categories are very strong.

So if you add our positioning, how we will adjust MAP spending throughout the year to keep a good balance between volume and profit and then we're positioning ourselves because we have a pretty good feel for what the raw material will do, we're positioning ourselves to maintain that margin growth and accelerate through this quarter and then accelerate it in the back half of the year.

Brett M. Hundley

BB&T Capital Markets

Q

Good point about categories being in such good shape that they are. I...

Donald J. Smith

President & Chief Executive Officer

A

We have advantaged brands in advantaged categories, and that is very good for the long-term potential of both our Prepared Foods and our Chicken business.

Brett M. Hundley

BB&T Capital Markets

Q

Okay. And you just offered me a segue over to – back to Chicken rather. It's nice to hear you guys acknowledge some of the bigger numbers that we're seeing here recently and your confidence in being able to not only perform but take your expectations higher.

And you talk about the strong demand. I'm seeing you quoted in an article where you had said that higher beef prices were may be driving a 3% improvement in chicken demand. We understand there's a very large QSR out there buying chicken for an H1 promo, and I suppose that this demand step-up can help eat its way through this extra supply that we're seeing, but you're going to continue to see that supply growth with where we see smooth pullet data. You know that portends a 3% or higher head count. You have weights that have been running higher. And so, as we get past summer when maybe some of this demand comes off a little bit, we worry a little bit about that supply/demand pricing dynamic.

And so, I'd love for you to just address, as we move 2015 into 2016 here, what protects you, again, better than the rest. I know you said some things regarding that. But also more so, I don't want to put you on the spot with 2016, but your confidence alongside Chicken with the rest of your business in this company being able to drive earnings growth in years ahead not just 2015 but beyond. I appreciate it.

Donald J. Smith

President & Chief Executive Officer

A

Sure. So, let's talk about four components, and I don't disagree that recent data – or I agree with you, recent data would indicate that supply will be higher in the year. And remember, we don't really care how much we grow. We care how much we sell. And so, we will manage our production based on our forecasted demand. We balance to the nearest whole bird increment in whatever size that is and then our buy versus grow strategy puts us in a position to buy raw materials that are out of balance which doesn't leave us stranded with parts who may be having maybe an excess, that type of thing. So that's kind of the general framework.

But on top of that, think about this, explosive growth in tray pack and we're a tremendous tray pack supplier. We're adding capacity and we are going to be unencumbered in our growth in tray pack and tray pack is – fresh tray pack retail is really benefiting from higher retail beef prices, okay? So that plus we're increasing our further-processing capability to be able to take advantage of growth both in retail, frozen, fully cooked as we take this great innovation engine and grow that category with new news, plus at foodservices, the foodservice operators want to grow there.

We have a very balanced and broad portfolio. We have a good balance between the bird sizes and tray packs and smaller bird and all those things. Plus you take our pricing structures which we have a blend and some are based on the market, some are based on raw materials, but what we have done is establish a way to protect our margins and grow our customers business using our great service and our great innovative capability, which is very valuable to them and they frankly don't get anything like it from anyone else.

Add on top of that, we have continued to spend pretty strong against our Chicken business and we continue to be more and more efficient. One quick case in point, when we saw our production issue in our fully cooked business, we actually added an incremental million pounds a week of capacity to one of those locations and created an even more efficient operation. So that will pay off in the future.

So, if you take a blend of the consumer benefits that we can take advantage of with our portfolio and then the customer who depends on us for innovation, quality, service and those components, and the balance of our portfolio, on top of our buy versus grow strategy, it's a winning combination and it stabilizes our earnings and that's why we took 2015 up and we feel very strong about 2016 because the same dynamics will be applied.

Brett M. Hundley
BB&T Capital Markets

Q

All right. Thanks, Donnie.

Operator: Our next question is from Tim Tiberio with Miller Tabak. Your line is open.

Tim J. Tiberio
Miller Tabak + Co. LLC

Q

Good morning and thanks for taking my question. My first question is around your buy versus grow strategy. Now that supply growth seems to be a little bit ahead of your initial expectations, can you give us an update of what percentage you're buying in in the second quarter and how much you see that growing year-over-year in fiscal 2015?

Donald J. Smith
President & Chief Executive Officer

A

I'll give you a general answer. I don't want to be very specific. The amount we buy will be balanced against the amount of our other pricing that has market exposure. So, we're very balanced there, kind of gives us an internal

hedge, plus there are some parts of our business where, like tray pack or small bird, we have to grow the bird, in other parts of the business, we don't. And so, the way we're set up we think we have a very good demand picture and we see demand very strong out in front and we have built our supply chain to be able to buy raw material to fill that demand. We'll buy it, put it in our further-processing plants and fill the demand.

Tim J. Tiberio

Miller Tabak + Co. LLC

Q

Great. And my second question, I may have missed this earlier, have you set a target for full-year debt reduction in 2015? It seems like that's a key component of potentially driving accretive earnings power from 2015 into 2016?

Donald J. Smith

President & Chief Executive Officer

A

Sure, Tim. We're expecting at least \$1.2 billion, maybe a little bit more.

Tim J. Tiberio

Miller Tabak + Co. LLC

Q

Perfect. Thanks for your time.

Operator: Our next question comes from Diane Geissler with CLSA. Your line is open.

Diane R. Geissler

CLSA Americas LLC

Q

Good morning.

Donald J. Smith

President & Chief Executive Officer

A

Good morning.

Dennis Leatherby

Chief Financial Officer & Executive Vice President

A

Good morning.

Diane R. Geissler

CLSA Americas LLC

Q

Congratulations on your quarter.

Dennis Leatherby

Chief Financial Officer & Executive Vice President

A

Thanks.

Diane R. Geissler

CLSA Americas LLC

Q

I just wanted to ask about, I think it's pretty widely observed that 2015 is going to be a good year. But I'm still getting the sense from clients that I talk to that sort of it all falls apart in 2016.

And so, I just want to get to this point about the QSR and this idea that chicken purchases are a durable good. I mean, to me, I look at it and say, well, if gas prices are down and still low, I mean, maybe they move a little bit higher but I don't think anybody is predicting that they go back to where they were 12 months ago. And wage rates we know are up this year and most of the states that raised their minimum wages are raising them again next year. We know we don't have any supply on the Beef side coming for at least two to three years. So, I guess, I look at 2016 and just say, is there anything you're hearing from QSR, any of your major channels that would suggest to you that demand is just going to – it's kind of pent-up demand for chicken over the summer and then it just evaporates because I really can't believe that?

And then my follow-up which I'll ask just now is based on that answer, I mean, I look at your changes to your outlook in your major segments, and all of them are positive like lower interest expense, better margin in Chicken, et cetera, et cetera, and so I look at the guidance range of \$3.30 to \$3.40 and there's been no movement there yet. You have guided to mostly positive changes in the outlook on a segment basis. Is there any reason why you're not taking your earnings range up today? I mean, the two questions are sort of linked. Thanks.

Donald J. Smith

President & Chief Executive Officer

A

Sure. So, I agree with you. I'm not hearing anything that would indicate to me that there is a cliff in demand, frankly quite the opposite. And here's how I think about, let's say, 2016 and it's early – to your point on guidance, it's early in our year. And so, you're right. The outlook is positive when you balance all the factors but it's just early for us.

So, here's how I think about it. Number one, we've got advantaged brands in advantaged categories. We've got leading brands with leading share in categories that are very meaningful to consumers, and we will continue to see growth not just based on the category but also and more importantly based on our brand-building capabilities and our innovation pipeline. But in 2016, obviously, we'll have an incremental year in capturing the synergies. As I mentioned earlier, we're setting our supply up to be able to take advantage of whatever industry supply we see to meet that demand. I believe because of the shortness in the cattle supply, we'll continue to see red meat pricing high and that will provide an umbrella for the alternative proteins because the relative value of chicken to beef, I think, remains largely unchanged over the next couple, three years.

We're going to have new tray pack capacity. We'll have new fully cooked capacity, and that will be in our results. I think cattle, frankly, and hogs are moving closer to us, so that advantages us there. As you mentioned, we're going to be generating a lot of cash, and we'll continue to improve the balance sheet and create optionality for us. We've got a strong CapEx agenda to continue to grow the business and add to our profitability. If you just look at the lower interest cost in the future and as the stock price goes up, the change in tangible equity units will help EPS. Again, so there's just a lot of reasons to be optimistic about our 2015 guidance. It's just early.

Diane R. Geissler

CLSA Americas LLC

Q

Okay. Great. Thank you.

Donald J. Smith

President & Chief Executive Officer

A

You bet.

Operator: Our next question comes from Michael Piken with Cleveland Research. Your line is open.

Michael L. Piken

Cleveland Research Co. LLC

Q

Yeah. Thanks for the question. Just wanted to circle back and take a multi-year view and maybe you could talk a little bit specifically first on Beef when you think we might be able to get back to normalized margins or if cattle supplies are going to remain tight through 2016, and maybe even to the beginning of 2017 when we might expect a return to normalized margins?

And then the second follow-up question would be on Prepared Foods. It definitely sounds like there's a headwind from the raw material cost that'll continue into 2Q. But what is the pathway to 10% to 12% margins and should we expect straight-line growth from this point forward? Thanks.

Donald J. Smith

President & Chief Executive Officer

A

So, in terms of Beef, the supply will probably be flat to down 1% again in next year, and I think it may take, gosh, four or five years to rebuild the herd back to the 2013 level. But I think over time the margins in our Beef business will improve.

In Prepared Foods, you're right. We've got some front-end headwinds on raw materials. We've talked about that. It will dramatically improve in the back half and we'll continue to grow our margin potential, one, as we gain the synergies in the out-years, plus we continue to grow the brands.

Operator: Our final question comes from Ken Zaslow with Bank of Montreal. Your line is open.

Kenneth B. Zaslow

BMO Capital Markets (United States)

Q

Hey. Good morning, everyone.

Donald J. Smith

President & Chief Executive Officer

A

Good morning, Ken.

Kenneth B. Zaslow

BMO Capital Markets (United States)

Q

Glad you were able to slip me in. Let me just go back to this business hog issue. It seems like, again, the supply of hog is far greater than anybody expected. It seems like we might actually be swimming in hogs in the next year or two. When you were thinking about your forecast on a 10% to 12% longer term as well as the nearer term, how much of this recent movement in hog supply as well as the lower pork cost will really incorporate in your expectations, hold on the pork packer side as well as the input cost to the Hillshire?

Donald J. Smith

President & Chief Executive Officer

A

Frankly, none, Ken. I mean, as you look out front, what we did is we took, let's say, five-year average pork prices and then layered in the synergy capture and then what we felt like we could do by organic growth in new categories and that's how we came to the 10% to 12% number. So any benefit that, frankly, our Pork segment and our Prepared Foods segment would see from an increased hog supply, it has not been factored in.

Kenneth B. Zaslou

BMO Capital Markets (United States)

Q

Okay. So let me just make sure I understand this. So you took up your Chicken margins to 11%. You hit more synergies than the \$225 million to get you on a run rate of \$240 million. You're seeing more hog supplies. You start buying back stock and you lowered your interest expense and yet you think your expectations are still \$3.30 to \$3.40.

Donald J. Smith

President & Chief Executive Officer

A

I think it's early. Well, I like your story.

Kenneth B. Zaslou

BMO Capital Markets (United States)

Q

I didn't make any story.

Donald J. Smith

President & Chief Executive Officer

A

You got. You absolutely have it. Yes.

Kenneth B. Zaslou

BMO Capital Markets (United States)

Q

Okay. My last question is cash flow. Just to make sure I understand this. You actually started buying stock, although it's only to offset compensation earlier than I think you expected. So I think your cash flow is better than you expected. What is that attributable to?

Dennis Leatherby

Chief Financial Officer & Executive Vice President

A

Seasonally, in the first quarter, we typically have our cattle and hog producers. They don't want to be paid in December for cash tax reasons. Typically, that deferral that carries over at the end of December is in the neighborhood of \$200 million to \$250 million. This year was more than \$400 million. So there was a little bit of extra cash that we were able to redeploy in the quarter.

Kenneth B. Zaslou

BMO Capital Markets (United States)

Q

Maybe you guys will stop buying back stock today. Anyway, thanks a lot.

Donald J. Smith

President & Chief Executive Officer

A

Thanks, Ken.

Donald J. Smith

President & Chief Executive Officer

Thanks, everyone. So, we're off to a great start towards another record-setting year for our company, and we'll continue to accelerate our growth as an insights-driven, consumer-centric branded food company. And as always, we appreciate your interest in our company and hope you have a great weekend.

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

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