03-Aug-2015

Tyson Foods, Inc. (TSN)

Q3 2015 Earnings Call

Copyright © 2001-2015 FactSet CallStreet, LLC

CORPORATE PARTICIPANTS

Jon Kathol
Vice President-Investor Relations

Donald J. Smith
President, Chief Executive Officer & Director

Dennis Leatherby
Chief Financial Officer & Executive Vice President

OTHER PARTICIPANTS

Kenneth B. Goldman
JPMorgan Securities LLC

Adam Samuelson
Goldman Sachs & Co.

Farha Aslam
Stephens, Inc.

David S. Palmer
RBC Capital Markets LLC

Michael Leith Piken
Cleveland Research Co. LLC

Diane R. Geissler
CLSA Americas LLC

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

Kenneth B. Zaslow
BMO Capital Markets (United States)

Timothy S. Ramey
Pivotal Research Group LLC

Akshay S. Jagdale
KeyBanc Capital Markets, Inc.

Brett Michael Hundley
BB&T Capital Markets

Copyright © 2001-2015 FactSet CallStreet, LLC

MANAGEMENT DISCUSSION SECTION

Operator: Welcome to the Tyson Foods' Quarterly Investor Earnings Call. Participants will be in a listen-only mode until the question-and-answer session of today's conference. [Operator Instructions] This call is being recorded. If you object, you may disconnect now.

I will now turn the call over to Jon Kathol, Vice President of Investor Relations. Sir, you may begin.

Jon Kathol

Vice President-Investor Relations

Good morning, and thank you for joining us for Tyson Foods' conference call for the third 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 the news release issued earlier this morning and our filings with the Securities and Exchange Commission for a discussion of the risks that can affect our business.

This morning, we will be referring to our third quarter adjusted operating income and EPS. The company uses non-GAAP results such as adjusted EPS, adjusted operating margin and adjusted operating income to provide investors with a better understanding of the company's operating performance by excluding the impact of certain nonrecurring items affecting comparability.

Please refer to today's news release for a full reconciliation of our GAAP to adjusted results. As always, we'll have a Q&A session following our prepared remarks. 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 & Director

Good morning, everyone. Thanks for joining us today. Well, by now you've seen the results in our press release, so I'll start by saying that there were four areas where we over delivered and one that was a negative. The four positives are that synergies are ahead of expectations, Prepared Foods exceeded forecast, the Chicken segment exceeded forecast, and cash flow was $864 million allowing us to reduce net debt by $688 million. The one negative was that Beef under-delivered our expectations by $84 million. We could not offset the quick and substantial impact of Beef in the quarter despite the significant progress across the rest of the portfolio, and I'll talk more about that in my commentary on the operating segment.

Synergy capture from the integration of Hillshire Brands is going extremely well. We have raised our estimates last quarter to more than $250 million this fiscal year, and now we're on track for about $300 million, largely driven by operational improvements in the Tyson legacy Prepared Foods operations. The majority of the synergies, $79 million for the quarter, fell within the Prepared Foods segment, where we continue to rewrite the cost structure of the business.

Copyright © 2001-2015 FactSet CallStreet, LLC

In the third quarter, Prepared Foods produced record adjusted operating income of $197 million, with an adjusted 10.9% return on sales. Volume was up 77% reflecting the addition of Hillshire Brands, and average sales price was up 13%.

The fundamentals in this segment remains strong and we continue to focus on a long-term growth and brand building. We anticipate our retail margins will moderate a bit in the fourth quarter as we spend against the national launches of Hillshire Snacking and Ball Park jerky, as well as increased MAP spending behind innovation and the base business. We'll also see an impact from price reductions in some product lines to respond to commodity declines, particularly in pork raw materials.

Our strategy is to protect margins over the long-term while maintaining competitive price premiums versus the competition in the market. Our actions will set us up for a strong 2016 when we should reach the low end of our new range of 10% to 12% a full year earlier than originally planned.

Moving on to the Chicken segment, operating income was $313 million with an 11.4% return on sales. Operating income for the last 12 months exceeded $1.2 billion. Volume was up 3%, while average sales price was down 5% versus Q3 of 2014. The Chicken segment should finish strong with an operating margin of around 12% for the year. And despite disruptions caused by export bans and predicted supply increases, we expect our Chicken segment to perform at or above the top end of its normalized range of 7% to 9% again next year.

We're pulling innovation projects forward and adding new ideas to the pipeline that include dark meat utilization. Most of these products will fall into our Prepared Foods segment for branded items like Aidells Sausage, Ball Park Flame Grilled Chicken Patties, and a host of foodservice applications. So, we're excited about the opportunities there, not just for the short term, but for the longer term as well.

Turning to the Pork segment, operating income was $64 million with a return on sales of 5.3%. Volume was down 5% due to the sale of our Heinold business in Q1 and average sales price was down 28%. Excluding the divestiture, volumes were up 3% versus Q3 of 2014.

Exports continue to be a challenge. A strong dollar, lower prices from the EU and Canada, and the West Coast port slowdown have been contributing factors. Despite all of this, we still came close to being in our normalized range for the quarter.

Expansion of the hog herd has been taking place as expected, and it should continue into 2016. With productivity improvement, we expect 3% to 4% more hogs and more pork on the domestic market, which should be a positive for our Prepared Foods segment. Demand for pork is strong, especially when consumers compare it to the price of beef. So, we expect our Pork segment to continue to do well and be in its normalized range for fiscal 2015 and fiscal 2016.

Our Beef segment continue to struggle this quarter, resulting in an operating loss of $7 million. Sales volume was down 4%, while average sales price was up 7% versus Q3 of last year.

There were two issues in the Beef segment that caused the loss. First was the West Coast port situation. There was a significant amount of meat in the pipeline and we sold it at lower values in alternative markets rather than building inventory and tighten up our working capital. This cost us about $84 million in the third quarter.

The second issue began in late May, early June when feedlot margin erosion accelerated. Feedlot slowed the pace of their cattle marketings from the normal 150 days to about 180 days. As a result, we haven't seen the anticipated

Copyright © 2001-2015 FactSet CallStreet, LLC

summer push of cattle. However, the most recent cattle on feed report indicates that there are more cattle on feed than a year ago. Because we run for margin and not for market share, we're not willing to overpay for cattle and we've had to cut back on our hours at our plants resulting in inefficiencies and added costs. In the short term, we are negatively impacted, but markets will equilibrate and conditions are expected to improve for the long term.

Pasture conditions have recovered dramatically and are supporting the rebuilding of the cattle herd. The USDA cattle inventory report released July 24 indicated that beef heifer retention is at 106.5% of a year ago, the largest percent since 1986. Only 32.5% of the cattle on feed were heifers, a record low. The beef cattle herd should have the largest percentage increase since 1980 at 3% or 750,000 head year-over-year. When those cattle come to market, we'll be ready with the plants positioned close to high-density feeding areas, the most efficient operations in the industry and the most knowledgeable experienced team in the business to run them. So while the current headwinds in our Beef segment don't have a quick fix and challenges will continue into 2016, we still believe in the long-term viability of our Beef business.

And for the final segment report, International was positive in Q3 with $1 million in operating income. Average sales price was down 10.5%. Volume was down 25% due to the sale of our Brazilian operation and weak demand in China, partially offset by stronger demand in Mexico. We're still in a holding pattern in China and the sale of our Mexico business closed on June 29, following the end of the third quarter.

Now, let's move from the segments to consumer demand. At foodservice, dollar sales were up 3% for all commercial restaurants, for both the latest year and the latest quarter. The largest growth was in QSR Mexican with QSR chicken showing the second highest growth rate. We expect consumption to continue growing at foodservice.

In the retail channel, fresh chicken and pork remained highly advantage categories. For the most recent year-over-year comparison, fresh chicken volume was up 2% behind 4% higher pricing and fresh pork volume was up 1% with pricing up nearly 6%. But it's important to note that in the near term, the pork situation has changed dramatically.

In the last 13 weeks, pork volume was up 18% with pricing down 12%. The lower fresh pork pricing could translate into slower growth in fresh chicken as the gap in price per pound has narrowed nearly 50% with chicken having a $0.55 a pound advantage to the consumer today versus $1 a year ago. Both ground and whole-muscle beef volume were down behind higher pricing.

Tyson Foods has retail expertise in fresh meats, as well as numerous Prepared Foods and frozen value-added categories. Retailers have recognized our capabilities by trusting us with an additional 30-category captaincies versus a year ago for a total of 95. And they continue to rely on us to provide the insight and leadership to grow their categories. Eight of our non-core business lines are showing positive dollar sales growth in the latest 52 weeks. Five of the nine have realized dollar share growth over that same period.

Jimmy Dean Frozen Breakfast is a notable performer and grew at more than two times the category growth rate, up 15% in the most recent 13-week period. Additionally, our retail value-added poultry business continues to improve and at a [ph] $0.55 (10:00) share, is back to category growth levels that's set up well for long term growth. I feel good about the strength of our brands moving into Q4 and 2016, and expect a continued share growth across the majority of our brands, supported by our brands, spend, and closed management of fundamentals.

I'm also excited about our innovation and product pipeline. We judge our success on a vitality index of the percentage of sales from products launched in the last three years. And we're in the best-in-class range in both

Copyright © 2001-2015 FactSet CallStreet, LLC

retail and foodservice. We've got a great line-up of innovation coming in the next several months, and in the next few years, and I expect this to stay best-in-class.

One of the largest platform launches in Q4 is the national expansion of Hillshire Snacking. This platform is highly incremental to the portfolio, leverages one of our strongest brand equity, and will drive category growth by bringing new consumers into the snacking section. Consumer response has been very strong and will accelerate our support for this launch through Q4 as we drive consumer trail with targeted advertising.

Our second major platform launch in Q4 will take the Ball Park brand, America's number one hotdog brand into the jerky category with a point of difference. Our flame-grilled process delivers a uniquely tender jerky that both consumers and customers are enthusiastic about. We have many more new products, new platforms and innovations in the pipeline. And I look forward to sharing those with you in the coming quarters.

As a wrap-up on my comment, I'll say that in the near term, we continue managing the acute issues of beef supply in exports while accelerating momentum in Chicken and Prepared Foods. I think it's important to expand the lens and bring into view some things that are going our way in the year ahead. We have leading brands in growing categories, and we're supporting our brands to maintain our leadership position. Prepared Foods should benefit from favorable raw material prices. We have the number brands of fresh and frozen value-added chicken, and we now have additional tray pack and fully-cooked capacity to help grow these businesses and build on recent market share trends.

Synergy capture is going very well. We're on track for about $300 million this year and expect more than $400 million in 2016 and more than $600 million in FY2017. We generated strong cash flow that we've used to pay down debt, and we expect to reach our leverage ratios ahead of schedule. We think our stock is a great value, so we plan to start buying back shares in the fourth quarter, again, ahead of schedule.

Although we never expected perfect operating environment, most things are going very well and we're positioned for long-term growth. We're excited about what's ahead and we're confident in our ability to achieve at least 10% EPS growth next year and average at least 10% over time.

Dennis?

Dennis Leatherby

Chief Financial Officer & Executive Vice President

Thanks, Donnie, and good morning, everyone. With record third quarter earnings at $0.80 per share on an adjusted basis, this was our ninth consecutive quarter of year-over-year EPS growth. Adjusted operated income of $568 million was a 40% improvement over Q3 last year. Our results were in line with our projections, but how we got there was different than we expected.

Revenues grew 4% to $10.1 billion compared to the same quarter a year ago with adjusted return on sales of 5.6%. Year-to-date adjusted EPS is $2.32 or a 12% increase compared to the prior year of $2.07. Operating cash flow through three quarters was approximately $1.7 billion and we spent $636 million on capital expenditures which was $189 million greater than depreciation as we continue to invest in projects with a focus on delivering high ROIC. Our effective tax rate in the third quarter was 33.6%.

Subsequent to quarter-end, we completed the sale of our Mexico operation and received $400 million in proceeds, subject to a working capital true-up in Q4. We used the proceeds to retire the 2015 notes last week.

Copyright © 2001-2015 FactSet CallStreet, LLC

Net debt to EBITDA for the past 12 months was 2.6 times. Net debt to EBITDA was 2.2 times on a pro forma basis when including Hillshire's results for the past 12 months and adjusting net debt for the $400 million in proceeds related to the sale of our Mexico operation. Net interest expense was $70 million during the third quarter. Including cash of $471 million, net debt was $6.8 billion, down $688 million from Q2. Total liquidity was $1.7 billion, remaining above our goal of $1.2 billion. For the quarter, our average diluted shares outstanding were $414 million.

Now, here are some thoughts on the full year of fiscal 2015 and some early thoughts on fiscal 2016. Please note that although our accounting cycle results in a 53-week year in fiscal 2015, our outlook is based on a 52-week year.

We expect revenues of approximately $41 billion for fiscal 2015, which is over 9% growth compared to fiscal 2014. This is driven primarily by a full year of Hillshire Brands results offset by reductions in our International operations. We believe 2016 revenues should be similar to fiscal 2015 as we grow our current businesses to offset the impact of fiscal 2015 divestitures. We expect to capture approximately $300 million from our Prepared Foods profit improvement initiatives and Hillshire Brands synergies in fiscal 2015 and more than $400 million in fiscal 2016.

Net interest expense should approximate $280 million for fiscal 2015 and $260 million in fiscal 2016. We currently estimate our adjusted effective tax rate to be around 34.5% for fiscal 2015 and to be around 36% for fiscal 2016. CapEx is expected to be $900 million for fiscal 2015, and between $900 million to $950 million in fiscal 2016 as we continue to focus on projects that will create long-term shareholder value.

We expect net debt-to-adjusted EBITDA of approximately two times by the end of fiscal 2015. Prior to adjusting for any future share repurchases as well as changes in our stock price, which will impact the dilution from our tangible equity units, we expect our fiscal 2015 and 2016 diluted shares to approximate $413 million based on our share price at the end of Q3.

As we have demonstrated over the past several years, our capital allocation decisions are governed by our disciplined focus on driving long-term shareholder value. Our priorities for deploying the significant cash flows that our operations generate are for growing our businesses through organic growth and operation, efficiency capital projects with attractive returns, acquiring businesses that support our strategic growth objectives and returning cash to shareholders through share repurchases and dividends all while maintaining plenty of liquidity and investment-grade ratings.

Following the Hillshire acquisition, we shifted our priority for deploying discretionary cash toward debt reduction. Strong cash flows have allowed us to make great progress toward fulfilling our deleveraging commitment, and including the notes we paid off last week, we have paid down more than $1.6 billion in debt since the acquisition. Now that the balance sheet has been appropriately strengthened, we're in a position to begin buying back our stock in Q4, which is a full quarter earlier than we had originally anticipated.

As Donnie mentioned, we see compelling value in our shares. Buying back our stock now is a great way to return cash to shareholders while enhancing long-term shareholder returns.

Our Chicken and Prepared Foods segments have driven great results so far in fiscal 2015. However, as a result of the unanticipated export disruptions experienced in our Beef segment in Q3 and its continued margin pressure, we have modified our guidance to $3.10 to $3.20 adjusted EPS for fiscal 2015. While not what we previously anticipated, it still represents growth of 5% to 9% over fiscal 2014 despite the headwinds we faced.

Copyright © 2001-2015 FactSet CallStreet, LLC

Fiscal 2016 is poised for continued growth in operating income and EPS, and we expect Chicken margins should be at or above the top end of its normalized range of 7% to 9%. Prepared Foods should reach the low end of our new range of 10% to 12% which is a four year earlier than originally planned. Pork margins should be in its normalized range of 6% to 8%. Beef margins should be profitable but below its normalized range of 2.5% to 4.5%. And we expect adjusted EPS growth of 10% plus compared to fiscal 2015.

In closing, we are very focused on finishing the year strong. Our team has been remarkable in coming together and successfully integrating the largest acquisition in our history to deliver another record year for Tyson 2.0. Overall, I am personally proud of the results our team has accomplished to propel us into 2016 and beyond.

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

QUESTION AND ANSWER SECTION

Operator: Thank you, speakers. We will now begin the question-and-answer session. [Operator Instructions] Our first question is coming from the line of Ken Goldman of JPMorgan. Sir, your line is now open.

Kenneth B. Goldman
JPMorgan Securities LLC

Q

Hi. I have one quick one and then a longer follow-up if I can. So, first one, are you still looking for, just to confirm, 10% plus earnings growth next year? I was a little confused by the phrasing in the printed document.

Donald J. Smith
President, Chief Executive Officer & Director

A

Yeah, Ken, we are. So, here's the way I'm looking at it. So, even if we're a tick or two off this year, when you look at our 2016, nothing has really fundamentally changed and, hey, while it's early, I really expect that anything that we've given up this year would come back to us again next year as we deal with this acute issue in Beef. So that's where we're thinking about it.

Kenneth B. Goldman
JPMorgan Securities LLC

Q

And then, thinking of Beef, if the main issues were marketing delays by feedlots, which we can see in the data, right, and nonrecurring, I guess, port issues if we can, doesn't that suggest the problems are more temporary in nature? Not the Beef doesn't have longer-term issues, but you're getting cattle back next year. The port issues will be cleaned up, so I'm just curious, is that the right way to look at it? Is it really a temporary issue? At this point next year you should be back to slightly below normal, I guess.

Donald J. Smith
President, Chief Executive Officer & Director

A

Yeah. Certainly, we're looking at it. I mean, if you look at the most recent cattle on feed data, we're going to have more cattle next year, the calf crop's up. Looks like it's going to be up about 1.2% this year, which portends a fed slaughter of about 1.2% to 1.5% next year. So more cattle are going to show up. The way we're looking at it is, once we get past and get through the – now what we're lingering – what's lingering are the supply issue now that we've dealt with the export issues. While it's still a little bit too early to tell, it feels like that if we go back and look at FY 2012 through FY 2014, our margins in Beef were about 1.5%, 2%, something like that, and it feels like, to me, that

Copyright © 2001-2015 FactSet CallStreet, LLC

2016 is setting up to be about like that range. And so, again, too early to say for sure, but it feels like to us today that these issues are temporary and that next year will be about like what we saw in 2012 through 2014, something like that.

Kenneth B. Goldman
JPMorgan Securities LLC

Q

I'm just confused about one thing. It's very helpful. But we knew that the feedlot issue, we kind of thought that marketing delays would be happening, you can see that build up. You still have price mix in Beef up 7% in the quarter. So when these issues, especially the port one that cropped up, was that at the very end of the period? Or was that more evenly spaced throughout the three months?

Donald J. Smith
President, Chief Executive Officer & Director

A

Yeah. So let me give you more detail on exactly what happened. So late in May, several of our export customers began telling us that they could not take delivery on their orders. So if you'll remember about that time the cutout was at about $2.60-ish or so, and it felt really toppy to us. And so feeling weakness in the cutout, we made the decision frankly to just resell that product and not take a chance. So we sold it into other markets. And when we look at the price differential between what we had expected to receive and what we ultimately resold it for, it costs us about $84 million.

Now I hasten on to say, I'm really glad we did it because looking back, pricing continued to deteriorate all through the month of June and has continued to deteriorate. You saw a little bump at 4th of July, but we didn't have very good sell-through at all at the 4th of July holiday, so the cutout has continued to erode. So I'm glad we don't have an inventory problem to deal with. Our inventory is in great shape. And as soon as these markets can respond, we'll be ready to do that. Maybe even a finer point, so you've got some items – I'll give you like a beef short rib or rib short rib or something like that, they command quite a premium in some of the export markets. And so these items today, though, we're having to roll those into our grinds. And so you can't really see it in the cutout, but that's a significant value decline on items like that. So that's what we're dealing with now. Again, we think this issue is acute and hopefully we'll get on through it throughout this quarter.

Kenneth B. Goldman
JPMorgan Securities LLC

Q

Thanks, Donnie.

Donald J. Smith
President, Chief Executive Officer & Director

A

Sure.

Operator: Thank you. Our next question is coming from the line of Adam Samuelson of Goldman Sachs. Sir, your line is now open.

Adam Samuelson
Goldman Sachs & Co.

Q

Thanks. Good morning, everyone. So, Donnie, maybe just continuing on the last point – upon questioning on Beef, it sounds like the forward view for next year and beyond has not really changed. Is that actually...

Copyright © 2001-2015 FactSet CallStreet, LLC

Donald J. Smith
President, Chief Executive Officer & Director
A

That is correct.

Adam Samuelson
Goldman Sachs & Co.
Q

Okay. So I wanted to just clear that up. In Prepared Foods, I mean, the margin performance in the quarter was very strong, well above our expectations and I believe the company's, can you help us think about the outlook where you're guiding? It seems like pretty healthy sequential margin decline in the fiscal fourth quarter and next year only at the low end of the range – of the 10% to 12% range despite about $100 million incremental year-over-year synergies. It looks like some healthy year-over-year cost tailwinds. Just help us think through what the spending environment in Prepared Foods that's only getting to low end of that margin range.

Donald J. Smith
President, Chief Executive Officer & Director
A

Okay. So let's start with Q4. So we're launching two new platforms, the Hillshire Snacking and the Ball Park jerky, and we're fully supporting those launches. We're also going to have somewhere between $25 million and $30 million worth of AI impact lingering into Q4, so we'll deal with that. We are increasing net spending for back-to-school in two, three of our categories there. And then we're going to be lower in the price in a couple of categories to make sure that we've managed our price gaps versus our competition to make sure that we stabilize or sustain our growth rates going into 2016. So that's – Dennis?

Dennis Leatherby
Chief Financial Officer & Executive Vice President
A

Adam, I'd just add one fine point at Donnie's comment about AI. That's related to the turkey part of our business.

Donald J. Smith
President, Chief Executive Officer & Director
A

Yeah. That's correct. Yeah. Yeah. No leg quarter in Chicken impact there at all, just in Prepared Foods. So that's our Q4. As we go into the fall, we expect to see very good growth in our categories. The categories are very solid. We want to regain some share in a couple, three of our major categories and feel very good about – if you look at this year's average, we'll probably average around 8% on sales in Prepared Foods for the year and then seeing a 200-basis-points-maybe-plus increase next year while growing that business. That feels really good to us.

Adam Samuelson
Goldman Sachs & Co.
Q

Okay. And then maybe just a quick one for Dennis, if I could. Dennis, can you walk us through how to think about the pace of share repurchases and planning just go into the market, no ASRs or anything like that?

Dennis Leatherby
Chief Financial Officer & Executive Vice President
A

Sure. So the way we're thinking about it is we expect to break through our leverage target of 2 times. So we see that as kind of a sweet spot for us to be in the 1.5 times to 2 times net debt-to-EBITDA. So that being said, that allows us to start buying back stocks, so we're going to start this quarter as opposed to next. And we're going to kind of watch that ratio. So that's really kind of govern how much we do each quarter as we go forward, but should be a fairly significant amount.

Copyright © 2001-2015 FactSet CallStreet, LLC

Adam Samuelson
Goldman Sachs & Co.
Q

All right. Thank you very much.

Operator: Thank you. Our next question is coming from the line of Farha Aslam of Stephens, Inc. Your line is open.

Farha Aslam
Stephens, Inc.
Q

Hi. Good morning.

Donald J. Smith
President, Chief Executive Officer & Director
A

Good morning.

Dennis Leatherby
Chief Financial Officer & Executive Vice President
A

Morning.

Farha Aslam
Stephens, Inc.
Q

Could we just switch to Chicken for a moment? You've had a very strong quarter guided up for this year. And going into next year, there's a fair degree of confidence in your guidance despite the weak pricing in dark meat. But your guidance is – previously was at least 9.5%. Is your guidance today a change or pretty consistent with what you were saying before?

Donald J. Smith
President, Chief Executive Officer & Director
A

No, we've tried to stay really consistent at being at or above the top end of the range.

Farha Aslam
Stephens, Inc.
Q

Okay. So your guidance hasn't really changed?

Donald J. Smith
President, Chief Executive Officer & Director
A

That's correct.

Farha Aslam
Stephens, Inc.
Q

So we could expect next year to be another strong year in Chicken?

Donald J. Smith
President, Chief Executive Officer & Director
A

Copyright © 2001-2015 FactSet CallStreet, LLC

We think so. Farha, if you think back over the last two years, three years in our Chicken business, we like the way that we balanced our portfolio across the various bird classes. We spend a lot of time adjusting our pricing strategies to be able to reduce volatility and stabilize our margins. We've been able to grow our value-added mix. Our tray pack business is just doing great. We've spent a lot of work and a lot of time and improved our cost structure.

I think I said on the last call, we reduced our export exposure on leg quarters by 50% over the last five years and we'll continue to do that in the upcoming year. I mentioned in my prepared remarks that we've got an opportunity inside some of our Prepared Foods category to move some dark meat there. So the CapEx that we spend against our business is really paying off and making our plants very efficient. So when you combine all that up, it gives us a lot of confidence in our ability to stay at or above the top end of that range next year.

Farha Aslam
Stephens, Inc.

Q

That's really helpful. And then in Prepared Foods, this is a bigger, larger business for Tyson. So could you help us understand kind of your amount of marketing spend, you MAP spend, kind of how you're thinking about this for this year and next year, because clearly this is just not a commodity-related margin that we need to just look at. We need to understand how you market these products.

Donald J. Smith
President, Chief Executive Officer & Director

A

Sure.

Farha Aslam
Stephens, Inc.

Q

Could you share with us how much your marketing expenditures are for this year and going into next year?

Donald J. Smith
President, Chief Executive Officer & Director

A

Yeah. Farha, we target a spend about 5% on sales on MAP in our retail brands. That can fluctuate a little bit depending on the timing of innovation, if we're making some price changes and that type of thing. Well, a notable example of that would be this Q4. We're launching two new product lines. We're supporting those with MAP. We're increasing our MAP spend a bit this quarter for back-to-school. So, it'll fluctuate a little bit, but over the year, our target is 5%. And I think it's really important for investors to know that we're going to maintain our investment in brand building.

And when a brand is ready for MAP spend we're not going to pull back from the brand-building commitment. And that's why going into 2016, we feel very good about moving from 8% return on sales in Prepared Foods this year up to about 10% plus or so next year, while maintaining a very good growth posture from that point forward. We've got a great innovation pipeline behind these brands that we'll continue to deliver to the marketplace over time. So that's kind of our whole view.

Farha Aslam
Stephens, Inc.

Q

That's helpful. Thank you.

Copyright © 2001-2015 FactSet CallStreet, LLC

Donald J. Smith
President, Chief Executive Officer & Director
A

You bet.

Operator: Thank you. Our next question is coming from the line of David Palmer from RBC Capital Markets. Your line is open.

David S. Palmer
RBC Capital Markets LLC
Q

Thanks. A question on Pork. Obviously you – the Street had your percentage margin in fiscal 3Q higher than where you came out. That shortfall might have been higher for the Street than what you're internally budgeting. But why was that margin down sequentially and from a year ago and you're saying 6% to 8% for 2016, how quickly can you get back within that range? Thanks.

Donald J. Smith
President, Chief Executive Officer & Director
A

Yeah. I think the real change for us we saw more imported pork into the U.S., and frankly into other markets where we ship products. A bit more than we expected, and that caused our Pork margins to be a tad lower than what we thought. As we look at domestic disappearance though, when we look at the availability, you got quite a bit of availability on the domestic market. We think you got a lot of hogs coming to us as we move on into the fall, so we expect that margin to expand a bit. But I'd say the biggest impact on Q3 was probably AU or Canadian or other countries that export into pork markets had a little bit more pork on the market than what we expected.

David S. Palmer
RBC Capital Markets LLC
Q

And how much was Pork, just the input benefit to the Prepared Foods segment itself? Obviously, that's a big segment for the synergies, but if you sort of tease out the implied Pork downstream benefit, how much was that do you think?

Donald J. Smith
President, Chief Executive Officer & Director
A

David, repeat that question again? I want to make sure I got it right.

David S. Palmer
RBC Capital Markets LLC
Q

There's a lot – there's presumably one of the benefits of a pressured pork market might be on the margins you get on Prepared Foods, was that a benefit there?

Donald J. Smith
President, Chief Executive Officer & Director
A

Yes. We did see improvements in Prepared Foods due to lower raw material costs. However, just a quick reminder, so far our Prepared Foods business still has long-term commitments with other pork producers for our pork raw material. So, we did see a market – pork raw materials are down. It's a benefit through our Prepared Foods business. There's really not been any synergy capture yet from an end-to-end basis, because we'll maintain our commitment to the previous suppliers until those contracts run out and then we'll be able to have an additional synergy coming up. I hope that helps.

Copyright © 2001-2015 FactSet CallStreet, LLC

Dennis Leatherby
Chief Financial Officer & Executive Vice President
A

But as we say in the earnings release in the Q, it's $170 million for Q3, $200 million year-to-date.

Donald J. Smith
President, Chief Executive Officer & Director
A

Yeah.

David S. Palmer
RBC Capital Markets LLC
Q

Thank you.

Operator: Our next question is coming from the line of Michael Piken from Cleveland Research. Your line is open.

Michael Leith Piken
Cleveland Research Co. LLC
Q

Yeah. Thank you. Just wanted to talk a little bit about within your Chicken business, maybe the profitability of some of the various businesses and kind of – with the pressure on leg quarters and maybe even kind of the big-bird deboning, if you could just sort of talk about the profitability of your various businesses and how you sort of see retail versus foodservice? That would be helpful.

Donald J. Smith
President, Chief Executive Officer & Director
A

Sure. So, the foodservice demand – if you look at traffic, traffic is flat to up slightly. But we do feel right now that with gas prices moderating, that will continue through the rest of the year. So, feel better about improved demand at foodservice. In retail, fresh chicken is still a clear winner against very, very high beef prices. Certainly, the increase of pork on the market recently has tamed a little bit of Chicken's growth, but it still feels really good at around 2% or so. At one point, we saw about 3% or so demand growth in Chicken. But the retail growth still feels good. It's relatively priced. It's a very cheap protein for consumers.

When we look at our business, we don't – we tried over time to build some internal hedges within our business to where – if we have pricing exposure to parts markets like breast meat or whatever, we try to build into our production plans the ability to offset a good portion of that through purchases on the outside market. That way we don't succumb to the movement of those markets.

If you look at our pricing versus the parts market, we don't correlate very well to the breast meat and that type thing. Probably the whole bird market is a better pricing indication of how our business will perform. So, if you look at our small bird business, business is doing great. We've moved to a lot more, what we would call whole body form sales, whether it's eight-piece cut up, at foodservice or at retail rotisserie. Those types of things continue to move the business forward there, it feels good.

Tray pack, of course, is doing great. Our big bird business is fine. A lot of what we do is supply raw material through our big bird business into the value-added further processed items at both foodservice and at retail. As I mentioned in my script, in the last four weeks, our retail frozen business is now back up to a 55 share which is

Copyright © 2001-2015 FactSet CallStreet, LLC

where we were before we had our production problems. So, we feel great being able to grow that business. Hopefully, that's a pretty good recap of how we view our segments inside Chicken.

Michael Leith Piken
Cleveland Research Co. LLC

Q

Okay. And just as a quick follow-up, I mean, have you done any buy versus grow up with the weakness in leg quarters or is it still a cheaper feed cost more profitable for you to run your plants full out?

Donald J. Smith
President, Chief Executive Officer & Director

A

Absolutely. A big part of our – I'm going to say that this past quarter, we probably bought something on the order of 90 loads of breast meat a week. And what that does is, it allows us, of course, to fulfill the demand in our value-added further processing lines without having a leg quarter to sell. So, it's key to stabilizing our margins. When we build our production plans, we look at forward demand and then balance to the nearest whole bird increment and back that back in to our production plan. Might hasten on to say too that this year our production will be flat. And next year, we do not have a production increase in the plan. And so, we will continue to be able to buy raw material on the market and add value to it without the exposure to the leg quarter. Next question?

Operator: Our next question is coming from the line of Diane Geissler from CLSA. Your line is open.

Diane R. Geissler
CLSA Americas LLC

Q

Good morning.

Donald J. Smith
President, Chief Executive Officer & Director

A

Good morning.

Diane R. Geissler
CLSA Americas LLC

Q

I wanted to ask on the Beef division, if you could give us an idea about where you were in terms of capacity utilization. And then, I think you've quantified the resale of the product that was expected to go to a certain export customers that had to be redirected due to the divergence, export, the pork issue, but could you just – is there a way to quantify the lower run rate within your plant in terms of what that might have done to the margin overall?

Donald J. Smith
President, Chief Executive Officer & Director

A

Yeah. If I look at the industry capacity utilization, we're probably on the low 70s and I think that's about where we are. We tend to have our plants in areas where there's a little bit higher concentration in the cattle, so we may be a point or two above that. In terms of quantifying the impact, I can't say – we know when we're running 34s and 36s a week in our plants that does cost us in – it raises the cost in our plant, makes us a lot less efficient. So it does have a cost to us. I don't know that I can quantify that right off the bat, but it does impact margin.

Diane R. Geissler
CLSA Americas LLC

Q

Copyright © 2001-2015 FactSet CallStreet, LLC

Okay. So you would say it's fair to say it's not only the diversion of this product into a less lucrative market, but the lower run rate within your plants that caused the headwind?

Donald J. Smith
President, Chief Executive Officer & Director
A

Diane, [indiscernible] (40:50)

Diane R. Geissler
CLSA Americas LLC
Q

Both of those came into play in the quarter?

Donald J. Smith
President, Chief Executive Officer & Director
A

You're right. That does have an impact.

Diane R. Geissler
CLSA Americas LLC
Q

Okay. And then, just as a quick follow-up. I mean, looking at the inventory report that came out, I guess, two weeks ago, it looks like 2016 is going to be more back-end loaded so as we look to model 2016, you've given some data in terms of like what you think you will be for the full year, but I would guess that the numbers are going to come on stronger in the second half and then really ramp into fiscal 2017, the numbers would indicate sort of mid-single digit increase in fiscal 2017 in terms of cattle supplies. Is that how – are you reading it the same way we are?

Donald J. Smith
President, Chief Executive Officer & Director
A

Yes, very much so. When we look at the cattle on feed now, the feedlots have slowed turns down, but the cattle are still there. So, they're going to be coming into the market later on this fall, but when you look at calf crop that's building, that's really a latter part of 2016 and then on into 2017 issue.

So I think we're modeling it exactly the same way. I would think that if you look out over time and so I'm going to go 2016 over 2015, you're probably looking at 1.5% or so increase in supply. Based on heifer retention we're seeing today kind of feels like something like a 1.5%, 2%, I feel a little bit better than that 2017 over 2016, but it's a little bit early to make that call. But, I certainly think you're right. You've got – it's going to be in the back half of 2016 and then incrementally better in 2017 in terms of beef supply.

Diane R. Geissler
CLSA Americas LLC
Q

Okay. Terrific. Thank you.

Operator: Our next question is coming from the line of Robert Moskow from Credit Suisse. Your line is open.

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

Hi. Thanks. Hey, Donnie, there's a lot of commentary today on the call and in the press release about bigger supplies, you're talking about it in Beef, particularly more cattle in 2017. And then, in the press release in Chicken, I sensed a little more conservatism or caution regarding supplies maybe exceeding demand.

Copyright © 2001-2015 FactSet CallStreet, LLC

And then, in Pork you're talking about greater hog supplies too, and all this in a context of a much stronger dollar, which I think has kind of a more of a permanent impact on exports. So, I understand all of the benefits of the capacity utilization for Beef and Pork, but is there a concern that a year from now, you might be looking at an environment with a lot of backup of domestic supply because of weaker export and maybe just a much weaker domestic pricing as a result. Is that a concern?

Donald J. Smith
President, Chief Executive Officer & Director

A

So, what we see in 2016, we look at protein availability or the per capita consumption, if you will, of protein up about 2.3%. We think that supplies are backing up here near term. But as we look forward, you've got increased demand for protein on a global basis. As we look at Pork, for example, in 2016, you're probably going to see less pressure from outside markets next year than you saw this year, which should improve Pork demand.

If you look at what's happened in China, China has significantly reduced their sow herd. If you look at what day old pigs and pig replacement prices are doing and what Pork is doing, for example, at retail, pork prices and hog prices are increasing in China, which tells us that there's likely to be more demand for pork in China next year than this year. Again, this Beef deal, you've got very record high-price spreads at retail. And I think with the slow growth in the beef herd that we're projecting and call that 1.5%, 2% or so, we think Beef is going to maintain an umbrella, if you will, at premium price, if you will, to the other proteins.

By the way, more pork on the domestic market is good news for our Prepared Foods business certainly. And so, the real key is Chicken. And when you look at Chicken, we plan to use our buy versus grow strategy to make sure that the 2% or so in domestic availability that we expect next year that we can buy a lot of that raw material and be able to add value to it and protect our margins and stabilize our margins like we talked about a little earlier in Q&A. So that's really the way we look at the landscape in front of it. And that's what gives us a lot of cause to think. Fundamentally nothing in our 2016 view has changed.

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

Q

Right. Okay. One follow-up, the pipeline that you said backed up in Beef and then kind of flow through at a lower price, is that all done or is there still a pipeline, so to speak a product that needs to clear for export?

Donald J. Smith
President, Chief Executive Officer & Director

A

So, the clearing part is over and we basically resold that product into other markets where we could move it. Now the one issue that still lingers which and by the way you wouldn't be able to necessarily see this in the cutout is some of these items like beef plates and rib short ribs, and short ribs, and flap tails, and those kinds of things that normally we have a good sale for into export markets that while demand is down, particularly in Asia, these markets are getting rolled into grind – these items are getting rolled in the grinds. So, that still has an impact on our price realization.

The supply situation has continued to linger as feedlots. We looked at the cattle on feed numbers in June to understand they were stretching out their turns. The cattle on feed report in July indicated they continue to stretch out turns. So, there's a near-term squeeze there, if you will, on the supply. But a lot of the demand issues that were very acute are behind us and we think we'll be able to see our price realization increase a little bit over time as some of these export markets begin to equilibrate a bit. Now, the flow off the coast is much improved. Port

Copyright © 2001-2015 FactSet CallStreet, LLC

of LA is great. We're still seeing a little bit of difficulties down in Oakland, but the flow is beginning to get much more normal, if you will, to what we're seeing before these port disruptions.

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

And drop credits? How are those trending right now?

Donald J. Smith
President, Chief Executive Officer & Director
A

Drop credit is down and that does affect our margins and a lot of that has to do with – if you want to call the economic impact of the economy slowing down, if you will, a bit in Asia. That will correct over time. We think that – if you look at – and I don't want to get into a whole bunch of detail on drop credit items, but you've got two big categories, your variety meats and then your hides in both of those prices are weak. So we should see that come back over time. I suspect that would be a fairly slow climb out of the hole.

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

Got it. Thank you, Donnie.

Donald J. Smith
President, Chief Executive Officer & Director
A

You bet.

Operator: Our next question is coming from the line of Ken Zaslow of Bank of Montreal. Your line is open.

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

Good morning. Can you hear me?

Donald J. Smith
President, Chief Executive Officer & Director
A

Yeah.

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

So, a couple of questions. One, just semantics, if you're seeing that nothing changed in 2016 and your language was previous to this – that you'd say at least 10% on 2015 numbers. Why not change your language to indicate that 2016 nothing has changed, because you're keeping the same thing of at least 10% growth on top of your long-term growth. Is there something to read into this? I just want to be perfectly clear here.

Donald J. Smith
President, Chief Executive Officer & Director
A

No. It's just early, Ken. I mean, frankly, the situation in Beef has not changed through July. I want to spend a little bit more time looking at that. Hey, I'd like to get this crop in the bin. And so, we typically wait until this next quarter in Q4, before we get more clarity on that. It's just early.

Copyright © 2001-2015 FactSet CallStreet, LLC

Kenneth B. Zaslow
BMO Capital Markets (United States)

Q

And what are the signs that you can point to over the next 36 months that would either give you more confidence or less confidence in the 2016 outlook?

Donald J. Smith
President, Chief Executive Officer & Director

A

So, I feel great about Prepared Foods. And we are lowering prices in a couple of categories and I'm sure looking for the volume response to that. That would continue to give us – that would be the confidence we need there. So, I feel great about that. I feel good about Chicken. We obviously would love to see some of these export bans removed which – third quarter has particularly hurt us a bit in Arkansas. So, I'd love to see that improve. But there, again, that doesn't necessarily change the outlook for 2016. So, it really is this unexpected acute issue in Beef and getting a little bit more clarity on how that's going to turn out. That's the one.

Synergy is still great. If you look at the things coming up, we've got, again, great brands and great categories. We're going to have a full year of our new tray pack operation in South Georgia. We've got plenty of fully-cook capacity now to be able to grow both foodservice and retail and fully-cooked. We're going to have plenty of hogs around us. That feels good. Certainly, it will help the raw materials in Prepared Foods. I think beef prices are going to continue to provide an umbrella. I mentioned synergies, we're generating a lot of cash, which gives us a lot of opportunity to pay, buyback stock or invest in the business. So, we've got a lot of things going for us. We just really want to see this beef thing play itself out for another month or two.

Kenneth B. Zaslow
BMO Capital Markets (United States)

Q

And philosophically, as you shift away from commodities and take more of a valuated approach, what would it take for you to just put Beef and Pork on the market, and just say I'd rather just focus on Prepare Foods and Chicken, and that's what we're really trying to shift that portfolio towards.

Donald J. Smith
President, Chief Executive Officer & Director

A

Well, if you look at over the very, very long term, we still feel good certainly about Pork in our portfolio. We feel good about having Beef as a long-term business. So, we really look at this thing with a very, very long-term view, and so it still feels good to us for them to be in the portfolio.

Kenneth B. Zaslow
BMO Capital Markets (United States)

Q

So no indication that you'd even think about that?

Donald J. Smith
President, Chief Executive Officer & Director

A

No.

Kenneth B. Zaslow
BMO Capital Markets (United States)

Q

And my last, very last question. Again as you said, we would buy a fairly significant amount of stock. How do I quantify that?

Copyright © 2001-2015 FactSet CallStreet, LLC

Dennis Leatherby
Chief Financial Officer & Executive Vice President

A

Again, Ken, the way we're looking at it is we're trying to keep net debt to EBITDA around that 2 times level. So, we de-levered to the point where we're pretty comfortable looking at first and foremost growth through CapEx, organic type of growth expenditures. But then, think about free cash flow. It's $1 billion. It's going to grow over time. So, that's going to – so to the extent we don't do much more deleveraging then it gives us more options in terms of buying back stock and working on dividends too.

Kenneth B. Zaslow
BMO Capital Markets (United States)

Q

Okay. Thank you.

Operator: Our next question is coming from the line of Tim Ramey of Pivotal Research Group. Your line is open.

Timothy S. Ramey
Pivotal Research Group LLC

Q

Hi. Good morning. Thanks. We've talked a lot about the export demand, and I assume that some of these specialty items were big into Korea. Are you just seeing weak economic activity in Korea and so that's backing up through the system for these otherwise high-price, high-value-added items that are now going into grind?

Donald J. Smith
President, Chief Executive Officer & Director

A

By and large, that's right. I wouldn't necessarily limit the softness in demand we're seeing just to Korea. There is softness across broader Asia. And as you know, those are great markets for a lot of those items. So, a little bit broader than just Korea.

Timothy S. Ramey
Pivotal Research Group LLC

Q

And, Donnie, was any of this attributable to kind of the restart of Dakota City or did that really occurred just as expected?

Donald J. Smith
President, Chief Executive Officer & Director

A

Yeah. It has occurred as expected. I think we mentioned in our last call that we had some start-up issues that we were working through. That did not – the start-up issues that we worked through in Q3 did not impact earnings beyond what we would have expected them to. All that came as planned. It really was this acute issue of making the decision to get that moving off the West Coast so we wouldn't have to deal with it in even softer markets.

Timothy S. Ramey
Pivotal Research Group LLC

Q

And just finally on – always good to hear you managed for margin not market share. We love that. But does that mean that at least in maybe the 12 months' outlook there might be an opportunity to kind of trim back capacity utilization or improved capacity utilization by shutting a line here or there?

Copyright © 2001-2015 FactSet CallStreet, LLC

Donald J. Smith
President, Chief Executive Officer & Director
A

Tim, we look at a lot of those things constantly in our efforts to manage margins. Too early to say about any potential moves we might have inside the system but certainly we're working through the math on a lot of those issues. And as you know, we get that down to about the fourth decimal point to make that call. So, we're looking at all that, don't see the opportunity yet.

Timothy S. Ramey
Pivotal Research Group LLC
Q

Okay. Thanks a lot.

Donald J. Smith
President, Chief Executive Officer & Director
A

Thank you.

Operator: The next one is coming from the line of Akshay Jagdale of KeyBanc. Your line is open.

Akshay S. Jagdale
KeyBanc Capital Markets, Inc.
Q

Good morning.

Donald J. Smith
President, Chief Executive Officer & Director
A

Morning.

Dennis Leatherby
Chief Financial Officer & Executive Vice President
A

Morning.

Akshay S. Jagdale
KeyBanc Capital Markets, Inc.
Q

So, first on Beef, I just want to be clear. So, we all calculate industry margin and based on, obviously, publicly available data, your Beef results underperformed that significantly, I think the first time in like seven or eight years. So, I understand the issue that you explained clearly but what I'm – I just want to understand if it's a company-specific issue like it looks like from the outside. And maybe if you can give us a little more color on what's company-specific, right? So, everything you were saying, the way you were saying it so far, seemed like the rest of the industry should be dealing with those issues too but the numbers that I'm looking at for the industry point to your performance being way worse. So, can you just help me clarify that? What could we be missing? I mean, maybe it's just that the cut out doesn't reflect some of these issues yet, perhaps?

Donald J. Smith
President, Chief Executive Officer & Director
A

I think large – what you just said, Akshay, is largely correct. It's that you wouldn't be able to look at cut out and see the price differences between the revenue that we get from some of these export items and what we then get for it when we roll it into [ph] $50s (57:04). So that's part of the issue. I don't know – I don't want to comment on

Copyright © 2001-2015 FactSet CallStreet, LLC

what the industry says or what they may show. But we felt like the right thing to do was to make sure that we didn't have an inventory problem because it felt like to us that going into Memorial Day to feel the cutout getting toppy like we did in Memorial Day, it felt like the right thing for us to do was to resell all that product.

Now, that may have hurt us worse than what the cutout or what the industry indices would have indicated but it was the right thing to do for our business. We don't have excess inventory. If you look at Beef inventories, I don't what they're up 20%, 30% or so, ours is not and that feels really good because we'll be able to immediately respond when the market conditions give us an opportunity.

Akshay S. Jagdale
KeyBanc Capital Markets, Inc.

Q

So, overall, you'd characterize the beef issue as something impacting the industry equally, right? You've taken some strategic actions which you believe are putting you in a better position but overall this is an issue that everybody in the industry is dealing with. You're not dealing with it more so than anybody else, correct?

Donald J. Smith
President, Chief Executive Officer & Director

A

Akshay, I don't know what other people are doing in the industry or how they're dealing with it. I think I can safely say that our market share in Asia is historically pretty large. And so, maybe we were impacted greater because of this issue based on that. But I don't have any comment about how it may be impacting us versus the rest of the industry or whatever. I'm just telling you what happened to our business.

Akshay S. Jagdale
KeyBanc Capital Markets, Inc.

Q

Okay. And then moving to Prepared Foods, is there any way you can give us a sense of how the businesses are doing on an organic basis. Obviously, you're still going through the first year of the deal. The numbers look good this quarter, but just help me, the way I'm thinking about it is you have $300 million in synergies, right, this year that is going to help in that business. You have now what you've quantified, which is very helpful, $320 million in lower raw material cost. That's a positive $600 million tailwind. And on my numbers your EBIT is increasing couple of hundred million. Now, you're investing a lot. So, can you give me a sense of, one, what's the base business doing like from a growth perspective, market share overall just broadly? And two, can you quantify some of these MAP investments? Give us some sense. Is it $50 million, $100 million, a couple hundred million, and what do you expect from a growth perspective next year to get a return on these investments you're making? Thanks.

Donald J. Smith
President, Chief Executive Officer & Director

A

Yeah. So, hopefully, this perspective will help, Akshay. So, if you look at our categories at retail – by the way, our foodservice business is great. If you look at QSR Mexican and some of the other growth in foodservice, that plays very well into our portfolio. So, we feel great about foodservice demand and our ability to continue to grow that part of our Prepared Foods business.

At retail, if you look back over this last quarter, we grew sales in eight of our nine categories and grew share in five of nine. So, if you just look at the category growth, that gives you a good indication of where we are.

Now, I can't tell you that in Q3 we lost share in a couple of categories that are meaningful to us. And so in Q4, we're going to reduce the price gap between us and the competition to regain that volume. There's always a

Copyright © 2001-2015 FactSet CallStreet, LLC

balance between managing new gross margin and managing new market share. And so, we're going to reduce those price gaps to maintain our market share because we – or to get some market share back, because we want to go into the fall with a position in the – well positioned in the categories for growth into 2016.

So, again, on the Prepared Foods synergies, about 90% of those, so I think you're seeing that right about 90% of those or so are in – of the total synergies are in Prepared Foods. And really what we're doing is just re-rating our cost structure for that business down, and then we'll take advantage of the raw material improvements over next year to have plenty of firepower on our map and to make sure we keep our pricing gap right, so we'll continue to grow the business, all the while, expanding our margins by a couple of hundred basis points over what we did this year. So we feel really good about that.

Operator: And our last question is coming from the line of Brett Hundley from BB&T Capital Markets. Your line is open.

Brett Michael Hundley
BB&T Capital Markets

Q

Hey, guys. Good morning. And thanks for fitting me in.

Donald J. Smith
President, Chief Executive Officer & Director

A

Yeah. Sure.

Brett Michael Hundley
BB&T Capital Markets

Q

I wanted to ask you a question on Chicken, and get a more – maybe a more definitive sense, Donnie, of where things can fall out for you guys in that business next year, and maybe just how good Chicken can be? You've given a lot of talking points, but I want to understand, is there – in your mind really is a definitive floor at 7% if you can do another 12% next year, I want to understand that range of outcomes just given everything that you talked about, about maybe being a little bit more supply on the market relative to demand, Pork continuing to be an incremental competitor to Chicken at retail, but then your guys instituting buy versus grow, reducing your exposure to leg quarters. I thought it was really interesting. Your comment on dark meat utilization and Prepared Foods and maybe you can give us a sense of whether that can be sizeable or not for you? But anyway, just wanted to understand those different talking points.

Donald J. Smith
President, Chief Executive Officer & Director

A

Okay. Brett, I think you've absolutely got the right list. I'll tell you and I'm probably going to frustrate you a little bit with my answer, I'm sorry, but it's just a little bit too early for us. Really, I'd like to get the crop in the bin before we can get more definitive. But I'm very comfortable saying that in FY 2016, we're going to be at or above the top end of our new 7% to 9% range.

For all the reasons you mentioned, reducing our exposure to leg quarters, we've done a great job in balancing and changing our pricing structures to be able to balance our margins and stabilize our margins, while growing the business. We feel great that we've got the portfolio inside of Chicken appropriately sized across all the bird classes. That feels good.

Copyright © 2001-2015 FactSet CallStreet, LLC

And a key component to making 2016 a great year is we're going to have a full year of our new tray pack plant in South Georgia and we got plenty of capacity to be able to grow our retail value-added fully-cooked business and our fully-cooked foodservice business. And we see opportunities for demand to increase there.

So, we've got a lot of components that are in our favor. And it's really the combination of the work over the last three or four years to put all of the pieces together to be able to stabilize our margins and then grow the business with that new stabilized margin structure. So, I think you're all there. I feel great about 2016. More details to come on our next call.

Brett Michael Hundley
BB&T Capital Markets

Q

Okay. And then, just lastly, either Donnie or Dennis. Does your M&A desires act as a governor at all on your share repurchase plans? And can you go back over kind of what your landscape looks like across M&A? You've talked about branded before you talked about value-added chicken. I want to be sure, does your M&A plan, do they extend in the packaged foods or is it – are you just looking at protein? So, M&A as the governor on share repo and then just looking at what your landscape is specifically for M&A.

Dennis Leatherby
Chief Financial Officer & Executive Vice President

A

I'll start with the M&A as the governor. What we're trying to do is design our capital structure and cash flow and capital allocation in a way that allows us to have kind of the best of both worlds. So, think about generating a billion or more in free cash flow, while investing heavy in organic growth in our existing businesses, but also maintaining a solid investment grade rating and good liquidity and then just as importantly, having quite a bit of incremental debt capacity to make acquisitions. So, with that, I'll turn it over to Donnie to talk about strategy a little bit.

Donald J. Smith
President, Chief Executive Officer & Director

A

Yeah. So, the M&A strategy is very consistent; value-added poultry, Prepared Foods and at some point, International. And that's our focus. And obviously, we want to continue to grow the branded value-added part of our portfolio to continue to de-risk and de-commoditize our portfolio and make sure that our businesses is very, very consumer centric. So, that's the plan forward. I think Dennis did a great job on the – whether or not that's a governor or not. We don't think of either/or, we think of and.

Brett Michael Hundley
BB&T Capital Markets

Q

Thanks, guys.

Donald J. Smith
President, Chief Executive Officer & Director

A

You bet.

Donald J. Smith
President, Chief Executive Officer & Director

So, thanks – okay. I think that's all the time we have for today. Hey, listen, we're going to stay focused on our long-term growth of delivering at least 10% annual EPS growth over time by growing our value-added in Prepared

Copyright © 2001-2015 FactSet CallStreet, LLC

Foods businesses and supporting our brands to maintain a leadership position. Thanks for joining us today and have a great week.

Operator: Thank you, speakers. And that concludes today's conference. Thank you all for joining. You may now disconnect.

Disclaimer
The information herein is based on sources we believe to be reliable but is not guaranteed by us and does not purport to be a complete or error-free statement or summary of the available data. As such, we do not warrant, endorse or guarantee the completeness, accuracy, integrity, or timeliness of the information. You must evaluate, and bear all risks associated with, the use of any information provided hereunder, including any reliance on the accuracy, completeness, safety or usefulness of such information. This information is not intended to be used as the primary basis of investment decisions. It should not be construed as advice designed to meet the particular investment needs of any investor. This report is published solely for information purposes, and is not to be construed as financial or other advice or as an offer to sell or the solicitation of an offer to buy any security in any state where such an offer or solicitation would be illegal. Any information expressed herein on this date is subject to change without notice. Any opinions or assertions contained in this information do not represent the opinions or beliefs of FactSet CallStreet, LLC. FactSet CallStreet, LLC, or one or more of its employees, including the writer of this report, may have a position in any of the securities discussed herein.

THE INFORMATION PROVIDED TO YOU HEREUNDER IS PROVIDED "AS IS," AND TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, FactSet CallStreet, LLC AND ITS LICENSORS, BUSINESS ASSOCIATES AND SUPPLIERS DISCLAIM ALL WARRANTIES WITH RESPECT TO THE SAME, EXPRESS, IMPLIED AND STATUTORY, INCLUDING WITHOUT LIMITATION ANY IMPLIED WARRANTIES OF MERCHANTABILITY, FITNESS FOR A PARTICULAR PURPOSE, ACCURACY, COMPLETENESS, AND NON-INFRINGEMENT. TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, NEITHER FACTSET CALLSTREET, LLC NOR ITS OFFICERS, MEMBERS, DIRECTORS, PARTNERS, AFFILIATES, BUSINESS ASSOCIATES, LICENSORS OR SUPPLIERS WILL BE LIABLE FOR ANY INDIRECT, INCIDENTAL, SPECIAL, CONSEQUENTIAL OR PUNITIVE DAMAGES, INCLUDING WITHOUT LIMITATION DAMAGES FOR LOST PROFITS OR REVENUES, GOODWILL, WORK STOPPAGE, SECURITY BREACHES, VIRUSES, COMPUTER FAILURE OR MALFUNCTION, USE, DATA OR OTHER INTANGIBLE LOSSES OR COMMERCIAL DAMAGES, EVEN IF ANY OF SUCH PARTIES IS ADVISED OF THE POSSIBILITY OF SUCH LOSSES, ARISING UNDER OR IN CONNECTION WITH THE INFORMATION PROVIDED HEREIN OR ANY OTHER SUBJECT MATTER HEREOF.

The contents and appearance of this report are Copyrighted FactSet CallStreet, LLC 2015 CallStreet and FactSet CallStreet, LLC are trademarks and service marks of FactSet CallStreet, LLC. All other trademarks mentioned are trademarks of their respective companies. All rights reserved.