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Tyson Foods, Inc. (TSN)

Q1 2016 Earnings Call

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Donald J. Smith
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MANAGEMENT DISCUSSION SECTION

Operator: Welcome to the Tyson Foods Quarterly Investor Earnings Call. At this time, all participants will be on a listen-only mode. After the presentation, we will conduct a question-and-answer session. [Operator Instructions] This call is being recorded and if you have any objections, you may disconnect at this time.

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

Jon Kathol
Vice President-Investor Relations

Good morning and thank you for joining us today for Tyson Foods conference call for the first quarter of the 2016 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.

Because of our Annual Meeting of Shareholders takes place this morning, we'll need to end the call at the top of the hour to get to the meeting on time. I ask that you limit yourself to one question and one follow-up during the

Q&A portion of our call, so we can get to as many of your questions as possible. If you have additional questions, please get back in the queue and we'll get to as many of you as we can before we have to go.

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

Donald J. Smith

President, Chief Executive Officer & Director

Thanks, Jon. Good morning, everyone, and thanks for joining us. Fiscal 2016 is off to a great start with record EPS of \$1.15, up 49% over Q1 of 2015's adjusted results. All of our segments performed very well with Prepared Foods and Chicken producing record operating income for the quarter, Pork had its second best quarter ever, while Beef showed significant improvement over Q4 of 2015 and Q1 of 2015.

In total, we produced record operating income of \$776 million, up 38% over Q1 of last year. We had a record operating margin of 8.5% and record operating cash flows of \$1.1 billion. Revenues were down due to the deflationary environment of the raw materials, and the divestiture of a few non-core businesses. Excluding the divestitures, sales volume was down just over 1% in Q1 as we sold more higher-margin value-added products, upgraded our mix to more profitable sales and processed fewer cattle. We're very pleased with the total synergies, capturing \$121 million in Q1, \$61 million was incremental to Q1 last year, and we're on track to achieve more than \$500 million this fiscal year. These synergies are a major source of funds for Prepared Foods growth.

In the Prepared Foods segment, operating income was \$207 million with a 10.9% return on sales, which was a record. Returns benefited primarily from declining raw materials and synergy capture. Volume for the quarter was down 7.7% with pricing lower by 3.6%. The lower volume was a result of optimizing the sales mix by reducing private label products at retail and to a lesser extent, the impact of avian influenza on our turkey lunchmeat business and a slower than planned price reduction reflected on retail shelves.

For the balance of fiscal 2016, we anticipate continued savings on raw materials as well as synergy capture and we'll invest a good portion of these savings into pricing, innovation and brand building. Our margin outlook for Prepared Foods is near the low end of the 10% to 12% range.

The Chicken segment produced record operating income of \$358 million with a record 13.6% return on sales. Volume for the quarter was down 0.5% with 4.7% lower pricing. The slight sales volume decline in Chicken again is a reflection of upgrading our mix. Results in the Chicken segment can be chalked up to solid execution. We're outperforming the industry and widening the gap.

I believe we've demonstrated separation from the commodity players in large part due to the disproportionately high mix of value-added products in our portfolio as well as the production flexibility created with our buy versus grow strategy, which also reduces commodity exposure. Remember on the last call, I broke out the categories of how we sell chicken and only 15% is pure commodity. As we continue to grow our value-added sales, produce less than we sell, execute extremely well and gain some benefit from lower grain costs, we now expect the Chicken segment margin to improve to more than 11% for the year, up from our previous estimate of more than 10%.

In the Beef segment, operating income was \$71 million with a 2% return on sales. Volume for the quarter was down 3.8%, while price was down 14.4%. Volume was down due to the Denison plant closure. Retail pricing has declined significantly, but Beef is still expensive for consumers with the beef-to-pork and the beef-to-chicken price ratios at record levels. I'm pleased with the turnaround from the losses we sustained in Q4. Some of the improvement can be attributed to the mark-to-market and LCM from Q4. We've got about half of it back in Q1,

and the remainder will come over the next year or so. Better cattle supplies in Q1 coupled with the realignment of our Denison and Dakota City plants moderately improved our capacity utilization.

We feel good about our Beef business and the team is executing very well. Cattle supplies appear to be growing and the recent semi-annual cattle on feed report indicated that total inventory is up 3.2% over the previous year. However, there is still regional disparity in the location of the cattle. Q2 can be a little uneven due to the weather and consumption around lent. So, we're going to remain conservative with our guidance of an operating margin at or above the low end of 1.5% to 3% normalized range. I'll add that I'm pleased about the repeal of mCOOL. Our contention was that it added incremental cost with no real consumer benefit and now that it's been repealed, we're able to reduce the complexity of our business by eliminating around 800 SKUs.

In the Pork segment, operating income was \$158 million with a 13% return on sales. Volume was down 2.2% with pricing down 19.5%. Volume was down due to the divestiture of our Heindl Hog Markets business in Q1 of last year. Excluding this, Pork volume was up 5.5%. There were plenty of hogs on the market in Q1, which lowered our hog cost as well as our average selling price. With more hogs, we improved capacity utilization, which helped widen the margin spread and Prepared Foods segment benefits from lower pork raw material prices as well.

We expect hog industry supplies to be up around 2% to 3% for the fiscal year, so we should be able to continue with good capacity utilization. We haven't seen any significant improvement in export markets. However, domestic pork demand is good. With near-record results in Q1, we are increasing our Pork segment outlook for the fiscal year, which should produce returns above 8%.

Now let's move from the segments to our view of consumer demand. Lower gas prices and unemployment at the lowest levels since 2008 are translating into some growth into the perimeter of the grocery store and more consumer spending on eating away from home. With the diversity of our portfolio, we're prepared to respond to these shifting consumer behaviors. In the last three months, foodservice traffic was up 1% while check size was up 2%. While we play across all areas of foodservice, we're especially well aligned with the categories in the national food service chains that are showing the most growth.

On the retail side, overall grocery trips are down, but shoppers are spending more on our Core 9 product lines compared to total food and beverage and overall packaged meats. This is important because our Core 9 product lines are the primary drivers of sales and profitability within our package retail offering and includes brands like Jimmy Dean, Tyson, Hillshire Farm, Ball Park and Aidells.

I'd like to talk a little more about volumes, specifically at retail and what you might be seeing reported by Nielsen and IRI. Although the top-10 branded food companies, including us, lost volume in calendar year 2015, our Core 9 product lines grew 1.2%. We are now seeing the price investments we've made begin to take hold as sales volume was up 2% in the latest 12-week period, but accelerated to a 4% increase in the latest four-week comparison.

I also want to point out that the Core 9 product lines in aggregate grew in Q1 ahead of the categories. In total, our share of these categories was up and where our leading brands grew the most, the categories performed the best. Additionally, our volume growth improved through the quarter and on into January. I feel really good about our retail brand and expect to see the recent trends continue for the remainder of the year as we see the full impact from pricing, recovery from AI and strong brand support.

So all that's to say, a volume decline at the total Tyson level isn't indicative of the health of our business. And I think the overall returns we delivered this quarter and the optimism around our outlook, give us confidence for another record-setting year, which is why we're raising our fiscal 2016 EPS guidance by \$0.35 on the low end to \$3.85 to \$3.95. We have a consumer-relevant portfolio packed with advantage brands in advantage categories. We

have a superior supply chain. We have a high-performing team focused on execution. I like the position Tyson Foods is in, I like where we're headed and I like the momentum that's building towards fiscal 2017.

Dennis?

Dennis Leatherby

Chief Financial Officer & Executive Vice President

Thanks, Donnie, and good morning, everyone. Fiscal 2016 is off to a phenomenal start. We've been repeating over the past several years the value in our diversified portfolio, which has been evident in strong steady returns. With our first quarter results, you can see our earnings potential when all segments perform well and finish within or above their normalized ranges.

With record EPS, record operating income and record operating cash flows, we were able to repurchase 6.4 million shares for \$300 million in Q1. So far through the second quarter of this year, we've repurchased 3.9 million shares for \$200 million. In total, over the past seven months, we have now repurchased 16.2 million shares for \$750 million. I'm also pleased to announce that yesterday our board of directors increased the shares authorized for repurchase under this program by 50 million shares underscoring our commitment to continue returning cash to shareholders.

First quarter revenues were \$9.2 billion, which is a decrease of 15% from Q1 a year ago due to significant declines in beef, pork, and feed prices. Sales volumes declined 7% as reported. However, when excluding the divestitures of the Brazil and Mexico Chicken operations and the Heindl Hog Markets business, our total company sales volume decreased 1%. Despite this small decline in volume, we are continuing to execute our strategy of growing in value-added categories, which is evident in our first quarter results. Total company return on sales was a record 8.5%.

Operating income was a record \$776 million, representing a 38% increase over adjusted operating income from Q1 a year ago. Our record earnings of \$1.15 per share represents a 49% increase over \$0.77 adjusted earnings per share in Q1 last year. I would also like to note that on an adjusted basis, our last 12 months EPS is \$3.53. Our operating cash flow for the first quarter was a record \$1.1 billion and we spent \$188 million on capital expenditures. This outpaced our depreciation by \$37 million as we continued to invest in projects with a focus on delivering high ROIC. Our effective tax rate in the first quarter was 35.2%, net debt-to-EBITDA for the past 12 months was 1.7 times, and on a gross debt-to-EBITDA basis, this measure was 2.1 times.

Including cash of \$1.2 billion, net debt was \$5.5 billion. Total liquidity was over \$2.4 billion significantly above our goal of \$1.2 billion. Total liquidity at the end of the first quarter was enhanced by cash held for payments to livestock producers deferred to calendar 2016 as well as cash held for the retirement of \$638 million in notes coming due in the second quarter. When these notes are retired, we will have paid down \$2.4 billion of gross debt since the acquisition of Hillshire in August 2014. Our rapid leverage reduction in only 19 months reflects our commitment to maintaining investment-grade credit metrics. Net interest expense was \$65 million during Q1. For the quarter, our diluted shares outstanding were 400 million.

Now, here are some additional thoughts on fiscal 2016. We now expect revenues of approximately \$37 billion, which includes the impact of fiscal 2015 divestitures and expected declines in beef, pork and feed prices. We expect to capture more than \$500 million of synergies in fiscal 2016, which includes more than \$200 million of incremental synergies over fiscal 2015 from our Prepared Foods' profit improvement initiatives, and Hillshire Brands synergies. Net interest expense should approximate \$245 million. We currently estimate our effective tax rate to be around 35%. CapEx is expected to be \$900 million as we continue to focus on projects that will create

long-term shareholder value. Prior to adjusting for any additional share repurchases subsequent to this call and based on our average share price in Q1, we expect our diluted shares to be around 394 million.

As we've demonstrated, our capital allocation priorities 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 organically through operational efficiency and capital expansion projects, along with investing in innovation and brand building; acquiring businesses that support our strategic objectives; and returning cash to shareholders through share repurchases and dividends, all while maintaining plenty of liquidity, investment-grade ratings and continuing to expand our debt capacity.

In closing, our Q2 should beat last year but will be less than Q1 due to our typical seasonality. And third quarter and fourth quarters are expected to be strong. As mentioned in this morning's release, we are raising our EPS guidance range to \$3.85 to \$3.95 for fiscal 2016, up from \$3.50 to \$3.65. This represents a four-year EPS compounded annual growth rate of more than 18% annually. With each of our segments demonstrating tremendous overall performance, we view Q1 not as an exception, but as a new foundation, which provides momentum for our continued growth.

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

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] And our first question comes from Mr. Brett Hundley from BB&T Capital Markets. Sir, your line is now open.

Brett Michael Hundley
BB&T Capital Markets

Q

Morning. Congratulations on what you've put together here.

Donald J. Smith
President, Chief Executive Officer & Director

A

Thanks, Brett.

Brett Michael Hundley
BB&T Capital Markets

Q

Donnie, one question for you. A number of packaged food companies, both large and small we've seen, have talked this earnings season about the macro becoming more challenging. Snacking has been one area highlighted in particular, and then conversely it looks like U.S. frozen categories seem to be improving some. Companies are also talking without the need to up brand support spend, in an effort to contain volume deterioration. Your Prepared Foods volumes were down in the quarter, but you talked to the reasons behind that. Your profitability was solid.

Can you give us your view of the packaged foods macro? You touched on it in your prepared remarks. But can you give us your view of the prepared packaged foods macro from your vantage point? And within this question, can you specifically address this Core 9 effort that you're talking about this morning? And how Core 9 insulates you, not only within the broader macro, but also within packaged meats specifically?

Donald J. Smith

President, Chief Executive Officer & Director

A

Sure, Brett. I'm going to try to take that like from snacking through frozen into the Core 9 to kind of give you the full feel. So, not all snacking is created equal, right? What continues to grow in the snacking category is protein snacking. If I've got my numbers right, total snacking is probably growing at around 6% or so year-over-year, and as you know that's a major focus for us in our innovation this year. Looking on into the frozen categories, breakfast and value-added poultry are two categories that are growing faster than total frozen and total food and beverage, and that's our key focus. But also if you look at 84% of the refrigerated categories in which we compete are growing, and then 87% of the fresh categories in which we compete are growing and it really reinforces our statement around having advantaged brands in advantaged categories.

So now, let me loop over into the Core 9. So, if you look at the Core 9 brands, or product lines really, those are so important because that's where we have the greatest value potential over the long term. Within the Core, we have the highest growth potential, we've probably got the strongest position with both consumers and customers and great margins. So, that's why we focus on what we call the Core 9 and we spelled those out in the last call because they are categories in which are growing faster than other refrigerated meats and faster than total food and beverage over the long term. And then we have advantaged positions within those categories.

Brett Michael Hundley

BB&T Capital Markets

Q

Very clear. Thank you. And then Dennis, I just had a follow-up question on liquidity, use of cash. You touched on it there at the end. You're driving really strong cash flow right now, you do traditionally anyway. Your debt is in a very manageable position. You talked about the notes in April. But getting outside of that, you've been choosing to repurchase a lot of shares here. And can you give us any insight into this strategy? Why the heavy share repurchase now and you talked about some of your priorities for cash, but how might your priorities for cash change in months and quarters ahead? Thanks for taking my questions.

Dennis Leatherby

Chief Financial Officer & Executive Vice President

A

Sure. Thank you, Brett. As I said in my remarks, we do have \$638 million notes coming due. We'll pay that off. We have more than \$300 million in cattle and hog deferrals that we've already paid off. But you're right, we're throwing off a lot of cash, and it leaves us a lot of options. As we've been saying for the last year or so, we wanted to put ourselves in kind of an enviable position in that we wanted to maintain investment-grade ratings. We wanted to keep really strong debt capacity for M&A, which we do and we have lots of capacity for M&A. And in the absence of that, if the right target doesn't come along that fits our strategy, then we're going to return cash to shareholders while still growing organically through capacity expansion projects and investing heavily in our brands and innovation. So, we really like where we're at and you can see us continue with that.

Brett Michael Hundley

BB&T Capital Markets

Q

Thanks, guys.

Donald J. Smith

President, Chief Executive Officer & Director

A

Thank you.

Operator: And our next question comes from Farha Aslam from Stevens, Inc. Sir, your line is now open.

Farha Aslam

Stevens, Inc.

Hi. Good morning.

Q

Donald J. Smith

President, Chief Executive Officer & Director

Good morning.

A

Dennis Leatherby

Chief Financial Officer & Executive Vice President

Good morning.

A

Farha Aslam

Stevens, Inc.

Congratulations on a great quarter.

Q

Donald J. Smith

President, Chief Executive Officer & Director

Thank you.

A

Dennis Leatherby

Chief Financial Officer & Executive Vice President

Thank you.

A

Farha Aslam

Stevens, Inc.

I have a question on poultry. Your poultry margins were exceptional this quarter, and you spoke constructively about your outlook. Could you just give us a little bit more color about your thoughts around the second quarter? That is seasonally a bit weaker in poultry, but the macro trends around poultry are getting better. Should we think your margins for the rest of the year, you're being very conservative with your 11% guidance?

Q

Donald J. Smith

President, Chief Executive Officer & Director

So, we feel great about the second quarter. We're off to a good start. If I look at our mix, we continue to improve our value-added mix. We've got a lot of capacity to continue to grow in those areas. That gives me a lot of optimism to continue with a favorable outlook. It feels like to me that the categories, retail frozen is certainly growing. The retail frozen poultry is growing faster than frozen, and certainly that category is growing faster than food and beverage, and it feels like that we've fully overcome problems we had in the past, and that we are back in business and growing.

A

Our volume has been good in January. So, feel good about that. And as I look forward, there's a couple of things that we still want to see. While we have quite a bit of a [ph] grain book (23:16), we don't have it all, so it's hard to paint the full picture for the year, but I do believe that the changes we've made in the portfolio, the changes we've made in the pricing strategy, certainly the advantages that our supply chain gives us are creating a long-term view

of much more consistent stable earnings in our poultry business and in Prepared Foods and other parts of the business.

Farha Aslam

Stephens, Inc.

Q

So kind of conservative you'd say, given the strong start in the second quarter?

Donald J. Smith

President, Chief Executive Officer & Director

A

I like where we are, and we're off to a good start.

Farha Aslam

Stephens, Inc.

Q

That's helpful. And then a follow up perhaps for Dennis, you had – and Brett's question answers your desire to repurchase shares. Could you share with us a little bit more color on M&A? And your outlook of what you're seeing in the market right now?

Dennis Leatherby

Chief Financial Officer & Executive Vice President

A

Farha, I understand why you'd want to ask the question, but you know we can't comment on M&A.

Farha Aslam

Stephens, Inc.

Q

That's fair. Just in terms of longer-term kind of areas of interest where you would look to build Tyson's position in terms of M&A in particular, if there's areas of interest?

Dennis Leatherby

Chief Financial Officer & Executive Vice President

A

Sure, Farha. I mean, value added poultry and Prepared Foods international growth, those are the areas that we intend to focus on continuing to grow our branded presence here and internationally, that's the focus of our strategy going forward.

Farha Aslam

Stephens, Inc.

Q

Great. Thank you very much.

Dennis Leatherby

Chief Financial Officer & Executive Vice President

A

You bet.

Operator: And our next question comes from David Palmer from RBC Capital Markets. Sir, your line is now open.

David Palmer

RBC Capital Markets LLC

Q

Thanks. Good morning and congratulations on the quarter.

Dennis Leatherby

Chief Financial Officer & Executive Vice President

A

Thank you, David.

David Palmer

RBC Capital Markets LLC

Q

Question on – good morning. The Beef segment, that was particularly impressive to us given the fact that you're perhaps entering a cycle there. How are you thinking about perhaps go back and talk about how that margin happened with as much detail as you can? And how are you now thinking about the long-term of that differently? Is the long-term future for that business really one where you're going to be bouncing around the low end of – low single digits? Or perhaps can we think about that being a healthier margin business going forward? Thanks.

Donald J. Smith

President, Chief Executive Officer & Director

A

So let's talk a little bit about the quarter. So if you go back as far as Q3 when the feedlots started extending the turns, if you will, and keeping cattle in the feedlot longer, coupled with the heifer retention and the reduction in cow slaughter that we saw as the beginning parts of the supply chain and the cow-calf operator began the effort to expand the herd, cattle supply dried up and strained margins.

So as we moved out of Q4 into Q1, there was some regional disparity. But overall, the feedlots began to market those cattle and become more current, if you will, with the inventory they have in the feedlots. That provided us the supply we needed to be able to improve our margins. Plus if you'll remember back at the end of Q4, right, so in the last couple weeks or so of the quarter, we had a lower cost of market adjustment and a mark to market adjustment that we made. And so we got about half of that back in Q1.

Now the rest of that will keep coming back to us as we progress on through the year because you had beef sold out front and then you bought live cattle futures against it to hedge it. So put all that together, we're kind of in the – well, we were at 2%, sort of towards the low end or getting towards the middle of that range. As we look forward, Q2 is always tough quarter for us. You've got a lot of weather issues around as we're seeing this week up in the Midwest. Lent is kind of a low demand period for beef particularly.

So I want to see us get through that, but then it feels like that after Easter, should see cattle supply improving, and the back half ought to improve. So, I think longer-term our beef margins should stay within that 1.5% to 3% range. Feel good about that.

David Palmer

RBC Capital Markets LLC

Q

So this is really about the capacity utilization side? And I know you have some easier comparisons in Q3, but I'm just wondering longer-term if these margins can be built upon and maintained? Or is there anything about these recent developments that make you think significantly different about the longer-term for beef?

Donald J. Smith

President, Chief Executive Officer & Director

A

No, David. So I guess my headline would be, look, the worst is over in terms of the cattle supply. We expect – I don't know – 3%, 3.5% cattle supply increase in the back half of the year, and you should see – it's a little bit hard

to tell at the very beginning of a herd rebuild, but you should see something on the order of 1% to 2% more fed cattle available per year I think for the next 2 years, 3 years. And so as the supply of cattle improves then we should see our margins improve as well. So that's the reason for the confidence in our outlook that Q1 is not an aberration. Now remember, Q2 is going to be Q2, but looking at it over the year, I'm comfortable that we should be in the range that the 1.5% to 3%.

David Palmer

RBC Capital Markets LLC

Thank you.

Q

Donald J. Smith

President, Chief Executive Officer & Director

You bet.

A

Operator: And our next question comes from Adam Samuelson from Goldman Sachs. Sir, your line now open.

Adam L. Samuelson

Goldman Sachs & Co.

Thanks. Good morning, everyone.

Q

Donald J. Smith

President, Chief Executive Officer & Director

Morning.

A

Dennis Leatherby

Chief Financial Officer & Executive Vice President

Good morning.

A

Adam L. Samuelson

Goldman Sachs & Co.

I want to pick up on something, Dennis, that was at the end of your prepared remarks. You talked about this quarter being a new foundation for future performance, rather than a peak. And I wanted to maybe follow-up on Farha's question a little bit on the Chicken business in particular, because the margins here are very strong and now running well above your normalized range of 7% to 9%. And I'm trying to think about what would be the drivers of margins going back to that normalized range if you remain confident on the value-added mix and the operating momentum that you have and maybe think about that trajectory a little bit? Thank you.

Q

Dennis Leatherby

Chief Financial Officer & Executive Vice President

Great question. We feel very good about our Chicken business. It's really set up well. It's largely a pull business, from 85%, 90% pull business. We've got our mix set up straight. We are in the position where we can grow even more, especially in the further processing side, take advantage of oversupply situations where we can buy meat really cheap, put a nice spread on it. So in our Tray Pack business with the conversion of our plant in South Georgia is really starting to take off at an even higher level and then we're just going to continue to improve our value-added mix over time.

A

Adam L. Samuelson

Goldman Sachs & Co.

Q

All right. That's very helpful. And then maybe going onto this Core 9 concept. And A, I was hoping can you talk about how much of Prepared Foods and Chicken actually sales are driven by the Core 9 at this point? And then second, maybe a little bit more color by categories and areas of inflection that you've seen off late. Sausage in particular I think, has improved in the last couple scanner periods, but a little more detail by category. Thanks.

Donald J. Smith

President, Chief Executive Officer & Director

A

Yeah. Sure. So when we look at our Core 9, I'm just going to run through that real quick, We're really talking about Hillshire Farm Smoked Sausage, Aidells Smoked Sausage, Hillshire Farm lunchmeat, Jimmy Dean frozen breakfast, Jimmy Dean breakfast sausage, and then our core branded bacon, then Ball Park hot dogs, our retail value-added poultry, and then State Fair and Ball Park corn dogs. So those are what we call the Core 9 where we have the disproportionate ability to grow faster than the categories, and they're very meaningful categories.

So if I look – and what we've really been focused on is the recent trends in our volume versus the category volume. I think I mentioned in my comments, I think I said this, that we were a little bit slow in seeing the price declines reflected at retail. And now, through the last four weeks or so, we've pretty much seen the pricing get reflected on the retail shelf, and volume is responding. If I looked at say smoked sausage, in the last four weeks, our volume growth is up 4% versus – that's the last four weeks versus 2% for the 52 week and 2% for the 12 weeks. And last week it was up double-digits like 10% or so.

If I look at Jimmy Dean breakfast sausage, for example, we're up 2% in the latest 52 weeks, but 11% in the latest four-week comparison, and that's what we've been looking for to see momentum in volume as we see the price reflected on the shelf.

So we feel really good about the core of our business. Also one on hot dogs real quick, we did see a little bit of impact I think from the IARC announcement in hot dogs, but we are seeing a response there. We feel great about the brand support for the summer grilling season and we're really, really anticipating a very, very strong grilling season this year. So feel great about that. Hope that helps.

Adam L. Samuelson

Goldman Sachs & Co.

Q

That's great color. Thanks very much.

Donald J. Smith

President, Chief Executive Officer & Director

A

You bet.

Operator: And the next question comes from Ken Goldman from JPMorgan. Sir, your line is now open.

Ken Goldman

Q

Hey. Good morning, everybody. When I look at retail margins on chicken, beef, and pork, at least as implied by USDA data, they're very strong right now, kind of across the board, and we're seeing some indication, I guess, of minor slippage in those retail prices but not a whole lot. So I'm curious from your perspective, what are your

expectations for meat prices on shelf going forward. Are you seeing any indication they'll really start to fall further from here which could help your volumes going ahead?

Donald J. Smith

President, Chief Executive Officer & Director

A

It's hard, it's really hard during this time of the year to get your best feel for what retail meat prices are going to do through the year because next week we're going to enter into Lent, and it's just a difficult season to predict prices. But if you just look at the macro fundamentals, right, we've got the lowest unemployment we've had since 2008, we got really cheap gas prices, and that is returning disposable income to the consumer, and we are seeing traffic up a little bit at food service, not a lot, and we're not expecting a whole lot. But we are seeing a movement to the perimeter of the store which is where we have great strength.

So I'm optimistic that the consumer will respond well to what should be fairly favorable prices. If you look at the supply of cattle coming to market, supply of hogs coming to market, supply of chickens in the market, you should have reasonable pricing structures, and certainly pricing structures that would allow us to continue to flourish, so.

Ken Goldman

Q

Okay. Thank you. And then my other question is you are guiding to a pretty significantly bigger benefit from feed cost than you did three months ago, I think. But as I look at corn and meal, I'm not seeing much of a change over that time in spot or futures prices. I mean, there's some, but not a huge amount. So maybe you talked about this and I missed it, but I'm just curious what's driving this degree of change in your outlook for feed?

Donald J. Smith

President, Chief Executive Officer & Director

A

Yeah, we had about a – I think, it was round numbers, wasn't it, Dennis, \$100 million change from...

Dennis Leatherby

Chief Financial Officer & Executive Vice President

A

Yeah.

Donald J. Smith

President, Chief Executive Officer & Director

A

– from our previous quarter's guidance to this one. And it just reflect – if you look at just corn futures all Q1 long, and I think meal futures too, the market just continued to decrease. We stayed really short and were able to just basically buy it as we ship it, or price it as we ship it. And that's allowed us to have a cheaper cost structure. And when we talk about, by the way, our outlook, we're talking about what's in cost of goods. So we feel good about how our year is going to shape out. We've got quite a bit, not all but enough to feel very comfortable about our cost structure in chicken already priced throughout the year. So feel good about that.

Ken Goldman

Q

Thank you so much.

Donald J. Smith

President, Chief Executive Officer & Director

A

You bet. Thanks.

Operator: And our next question comes from Mr. Robert Moskow from Credit Suisse. Sir, your line is now open.

Robert Moskow

Credit Suisse Securities (USA) LLC (Broker)

Q

Hi. Thank you. One of the reasons I've been skeptical on Tyson and maybe others too, and obviously very wrong, is that there's the thinking that the chicken cycle would end up turning and hurting the business. But you're seeing two things this year in your guidance, or I am, is your feed costs are better, so that's a reason to take up the number. But you're obviously benefiting from the lower chicken cost commodities as well. Can you give us a little bit of a more color on the extent to which the lower commodity chicken cost helped you in the quarter, and how that is factored into your guidance for the year? Thanks.

Donald J. Smith

President, Chief Executive Officer & Director

A

Yeah, Rob, I'd add – you know, not knowing what chicken prices are going to do for the rest of the year, it'd be hard to quantify it for the year. But I can give you a very good feel. During Q1, we probably bought on the order of 75 loads a week of poultry raw materials, maybe more than that. But say round number is that, and we're buying that meat well below a dollar instead of selling it well below the dollar. Plus with our buy versus grow strategy, we don't have that excess leg quarters, so we are selling fewer leg quarters today, and I've been here a long time. I can't ever remember us selling fewer leg quarters than we are today.

And the buy versus grow certainly plays a part of that, but with great innovative capabilities, we're finding ways to upgrade that raw material into value-added high-margin opportunities, and that's a real key. So when you combine the strength of our value-added portfolio, the strength of our brands both at fresh and frozen, when you look at the diversity of the portfolio between small bird and value-added and fresh, and then you combine that with this great marketing and innovation engine that we've got, it really does help stabilize the earnings of our Chicken business over time. It's not the same Chicken business that it was a few years ago.

Robert Moskow

Credit Suisse Securities (USA) LLC (Broker)

Q

Yep. That's very clear. And then a follow-up on Prepared Foods and the Core 9. I guess your guidance really hasn't changed that much even though as you said the volumes are starting to improve on your Core 9. Are you expecting volume growth in the Prepared Foods segment for the rest of the year? Can we expect to see a very strong volume number in second quarter? Or is it going to be kind of negative for a while and then eventually kind of lap the challenges in turkey in the back half?

Donald J. Smith

President, Chief Executive Officer & Director

A

No, you should expect growth. We are very intent. And obviously with the raw materials where they are, with synergy capture we have, we have the dry powder, we need to get the pricing right, to drive growth, to support these brands to drive growth. We have, matter of fact, we're preaching our investment in innovation to be able to drive long-term growth in these brands.

And the early read – during November and December, frankly, we didn't get the price realization on the shelf that we needed to, to drive volume. During the month of January, the pricing gaps were reflected on the shelf and we saw the volume response that we were looking for. So I feel great about our growth going forward for the year. We

have advantaged brands and advantaged categories, and we fully intend to take advantage of that because that's what the consumer wants us to do. And you're right, we will be lapping the AI problems. We've got to get some points of distribution back, but we've got a great sales team working on that. We continue to improve the mix. One of the volume issues in Q1 was that we didn't repeat some private label volume and frankly it's like – I don't know – spiral sliced hams and private-label bacon, and we just have so much more opportunity in branded consumer pull categories that it was the right thing to do for our business and for the customer to not repeat those very low, if not negative margin private-label sales and improve that into a – but as you can tell...

Robert Moskow

Credit Suisse Securities (USA) LLC (Broker)

Q

Hey, Donnie, I get all that. But your sales down 11% in first quarter, if you can help us model out what you think the sales growth for Prepared Foods this year? Are you still down because of the private-label decisions? Or are you going to go back to positive pretty quickly here?

Donald J. Smith

President, Chief Executive Officer & Director

A

No, I think, no, you're going to see positive sales growth as well, absolutely. We got to get the volume to support the lower pricing to get the total dollars up. But yeah, we're headed that way.

Robert Moskow

Credit Suisse Securities (USA) LLC (Broker)

Q

Great.

Donald J. Smith

President, Chief Executive Officer & Director

A

Sorry. I misunderstood your question.

Robert Moskow

Credit Suisse Securities (USA) LLC (Broker)

Q

All right. Thank you.

Operator: And our next question comes from Akshay Jagdale from Jefferies. Your line is now open.

Akshay Jagdale

Jefferies LLC

Q

Good morning, and congratulations on a really outstanding quarter.

Donald J. Smith

President, Chief Executive Officer & Director

A

Thanks, Akshay.

Akshay Jagdale

Jefferies LLC

Q

So let me ask about the chicken margin sustainability in a different way as well. Obviously you outperformed what the commodity markets did in our estimates by about 1,000 basis points. So I think what I'm seeing is, and just help me if I'm wrong here or if I'm reading it incorrectly, but relative to the market your portfolio is more stable,

higher-margin products and that's starting to play through on the revenue line. And clearly this quarter we saw that. Right? And I think what we're seeing clearly is your big bird segment, if I may, where you're taking a lot of this cheap meat out of the big bird plants and adding value to it, that's been a great strategy.

So my question really is more on the retail tray pack side of your business and potentially on the small bird side. Can you talk about the sustainability of the margins on those two sort of subcategories? Like a lot of people think your Tray Pack business is not as – it can't maintain these margins at these levels if supply increases, right. So if you look at three segments for the chicken market, it seems to me that whatever supply increase has been coming into the market, it's been on the big bird side. So what happens if and when the retail tray pack supply industrywide increases? What does that do to your margin structure? And then similarly on the small bird. I mean, I know, it's not happening right now, right? We know that there's no new capacity coming in on those two segments, but just help me think through that for a second?

Donald J. Smith

President, Chief Executive Officer & Director

A

Yeah, sure. So first of all, as evidenced in South Georgia, we have the flexibility within our supply chain to move our mix to where the consumer is going. If you look at a macro view, although recent volumes – because at fresh, for example, because you've got so much pork, price is way down and pork demand is up, but in general remembering that Chicken is twice the size of the category of Beef or Pork. Chicken demand is really good. And it over indexes to the Millennials, as they enter the workplace and begin in earnest consuming food.

So we feel great about the macro trends and where they're leading us. We have the flexibility within our supply chain to move within small bird, fresh, whatever we might do. Certainly it's not in our business model to oversupply big bird. We'd rather buy that meat and add value to it, as you mentioned. The thing about our business to remember is we've got the number one fresh brand at retail, we've got great penetration across a broad segment of customers nationally, and we have phenomenal quality, service and innovation. So I feel good that we will remain the leading fresh supplier as we move out front, whether it's a small bird into the retail deli or fast food cut-up, or whether it's at retail. Plus we've got a lot of innovation that we can continue to innovate in these fresh categories, and our customers rely on that. So I think that is a big portion of what stabilizes our fresh Chicken business, if you will, for the future.

Akshay Jagdale

Jefferies LLC

Q

Okay. And then just on Prepared Foods, how much of the revenue guidance cut is related to, let's say, the Prepared Foods business not doing as well as you thought previously? And then your margin guidance on Prepared Foods, although pretty solid in light of the \$250 million commodity tailwind and roughly \$200 million incremental synergies seems a bit light. I think what it means is you're spending or planning on spending a lot of money on brand building. But why do that when sort of volumes, if you look historically last 12 weeks or so, haven't been as robust?

Donald J. Smith

President, Chief Executive Officer & Director

A

Okay. I'm going to start kind of at the back in and work my way back up is that the reason the volumes haven't been as robust as we want them to be in our Prepared Foods, there's really two things in that. Number one, it depends on your view of everything that you look at in Nielsen or IRI about our data. Because there's two categories that if you do the – kind of the macro view of everything, Tyson and IRI, you've got two categories in there that would be IF chicken and then the UPC ground beef chubs also show up.

So the one and three-pound rolls of ground beef, which is a huge portion by the way of the volume decline or a huge proportion of the volume decline, that meat is going fresh. And frankly for us, if the consumer would rather have that breast meat in a fresh tray versus having it in an IQF bag, we're going to go where the consumer is because frankly its margins is up a little bit. Same thing on ground beef, if they'd rather have it – that volume not in the UPC, but in a non-UPC tray, we're going to do that. So first of all bear that in mind.

Now backing up to your other question, the big revenue issue overall for the company really comes in three places. Beef and Pork commodity prices are down a lot, and then the other thing is the divestitures of the Mexican business, the Brazilian business and our Heindl Hog Markets business. So that is the overwhelming majority of the revenue decline quarter-over-quarter, and it's driven primarily by Beef prices, and by the way, will be for the year. So, well, we would expect it to be for the year. Does that help?

Akshay Jagdale

Jefferies LLC

Q

Yeah, I know that some vast majority going from \$41 billion to \$37 billion is those three issues...

Donald J. Smith

President, Chief Executive Officer & Director

A

Yeah.

Akshay Jagdale

Jefferies LLC

Q

...but is it fair to say Prepared Foods you're expecting lower sales than you previously were? And how much so roughly?

Donald J. Smith

President, Chief Executive Officer & Director

A

No. I don't think it's fair to say that. Now in our Prepared Foods business, about half of it is food service, and those do use pricing formulas and the deflation in the raw materials does take some of the pricing down, but it doesn't affect the margin. If you look at the Retail business, we are seeing the response that we want to see from the pricing and the brand support that we're giving these brands. And we will continue to do that all year because we've got a great opportunity [ph] for us (50:19).

Akshay Jagdale

Jefferies LLC

Q

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

Donald J. Smith

President, Chief Executive Officer & Director

A

Thanks.

Operator: And our next question comes from Michael Piken from Cleveland Research. Sir, your line is now open.

Michael Leith Piken

Cleveland Research Co. LLC

Q

Thank you, and congrats on a good quarter. If we could just shift over to Pork, there's been a lot of talk about the sustainability of the Chicken margins at these levels, I'm just wondering [ph] to sort of get (50:42) your thoughts as we sort of move through the year on Pork, and in particular could you stay at these elevated margins if the export markets pick up?

Donald J. Smith

President, Chief Executive Officer & Director

A

So, we do have one eye always kind of on the export markets, and we're not seeing a lot of improvement in that yet. Could still happen, if it does, it's certainly upside. If you look at the macro picture here, you're probably going to have somewhere on the order of about 2% to 3% more hogs for the year. We should have very good capacity utilization. I feel good about where we are in terms of where the hogs are, so we should be competitive there. So I feel good about margins and certainly it's a little bit too early to predict what might happen in the back half of the year, but yeah, it feels like we've got a good pork year coming.

Dennis Leatherby

Chief Financial Officer & Executive Vice President

A

Certainly off to a great start.

Michael Leith Piken

Cleveland Research Co. LLC

Q

Okay. Great. Maybe if I ask it a little bit in a different manner. I mean, I guess, obviously the expert outlook is a little bit more uncertain, but just judging by how you did in the first quarter, should we sort of think about the rest of the year as being – if the hog availability is still strong, and the domestic demand kind of remains where it is, everything else, I mean, you said kind of above 6% to 8%, but I mean is it double-digits? Is 10% possible for the year? What are we sort of generally looking at because there's a lot of room between above 6% to 8% what you did in the first quarter? Thanks.

Dennis Leatherby

Chief Financial Officer & Executive Vice President

A

Yes, there is. And I think Q1 and hogs is always strong, and I wouldn't want to predict the whole year based on Q1, but it feels very good to us that this should be a good pork year.

Michael Leith Piken

Cleveland Research Co. LLC

Q

Okay. Thank you very much.

Dennis Leatherby

Chief Financial Officer & Executive Vice President

A

You bet.

Operator: And our next question comes from Patrick Chen from BMO Capital Markets. Sir, your line is open.

Patrick Chen

BMO Capital Markets (United States)

Q

Hi. This is Patrick in for Ken. Just a question about Prepared Foods. Just wondering how long will the reinvestment of all the synergies will go on? It seems like it's been, I guess, holding your margins back, I'm just try

to figure out what the timing is as to when margins will improve from these levels, especially with chicken margins kind of potentially doing better than Prepared Foods this year. Thank you.

Dennis Leatherby

Chief Financial Officer & Executive Vice President

A

Yeah, so with advantaged brands and advantaged categories, we're really built for growth. We've got a great innovation pipeline that we're investing in for the long-term, and so there's always a balance, right, between margin and growth. And our intent is to make sure that with the advantages that we have, that we continue to grow. Frankly, the retailers depend on us to grow these categories, and we're going to continue with strong brand support. We spend a lot of time understanding the consumer and using those insights to build the right kind of innovation pipeline for the future. And so we will always balance growth and margin. Obviously in Q1 we didn't get the growth that we wanted, and the reason we didn't get the volume, growth we wanted, we didn't get the prices reflected on the shelves in the time period that we had predicted, so that our price caps would be right. That is now fixed, or pretty much fixed. And I think you're going to see the volume growth that will support the overall dollar of margin growth over time.

Donald J. Smith

President, Chief Executive Officer & Director

A

Patrick, from my perspective, what I like that I'm seeing is our vitality index numbers are really strong and that's a good sign for volume growth in the years ahead that really excites us to keep that margin solid and growing.

Patrick Chen

BMO Capital Markets (United States)

Q

Great. Thank you.

Operator: And our last question comes from Ms. Diane Geissler from CLSA. Ma'am, your line is now open.

Diane R. Geissler

CLSA Americas LLC

Q

Good morning.

Donald J. Smith

President, Chief Executive Officer & Director

A

Good morning, Diane.

Diane R. Geissler

CLSA Americas LLC

Q

Congratulations on your quarter.

Donald J. Smith

President, Chief Executive Officer & Director

A

Thank you.

Diane R. Geissler

CLSA Americas LLC

Q

I have a question, so the guidance range for this year if we exclude the extra week last year, is sort of 22% to 25%. And I guess when I look at it, I mean, look, breast meat is at \$1, leg quarters are at \$0.25. You're going to have margins in the Chicken segment above the, way above the top end of your normalized range. So as we look into fiscal 2017, appreciate we don't know what's going to go with pricing, et cetera, but it seems to me that with the way the Chicken business is set up now, you should be able to sustain margins above the top end of the normalized range, and therefore earnings next year should be up 10% plus. Am I thinking about that wrong?

Donald J. Smith

President, Chief Executive Officer & Director

A

Diane, we are very optimistic about this year and the foundation that we've built for next. If you look at it, next year we've got more synergies coming. I think we're going to [ph] prove solidly (56:25) in the next few weeks in the quarter or so that we've got great brands that are well positioned. I think protein demand is going to remain pretty strong. I know we have great consumer relevance. It's really hard to predict what input prices will be a year from now or whatever, but if you just look at the macro view, it feels pretty good that they'll be reasonable and certainly within our ability to manage, should have plentiful supply of livestock. We've got a great innovation pipeline, great cash flow as Dennis talked about. If I look at – anyway, so yeah, we're really optimistic.

Diane R. Geissler

CLSA Americas LLC

Q

Okay. So I guess the short answer is we can make money when breast meat is at \$1 and we can also make money when breast meat is at \$2?

Donald J. Smith

President, Chief Executive Officer & Director

A

Yes, we can.

Diane R. Geissler

CLSA Americas LLC

Q

Is that the takeaway?

Donald J. Smith

President, Chief Executive Officer & Director

A

That is the takeaway.

Diane R. Geissler

CLSA Americas LLC

Q

Okay. Great. Thank you.

Donald J. Smith

President, Chief Executive Officer & Director

A

Thank you.

Jon Kathol

Vice President-Investor Relations

So, listen, we appreciate your interest. We certainly appreciate your involvement in our company. We plan to carry this momentum generated in Q1 through the rest of this year and on into 2017. We're off to the shareholders meeting now. Hope you have a great weekend. See you.

Operator: And that concludes today's conference. Thank you so much for your participation. You may disconnect at this time.

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