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Tyson Foods, Inc. (TSN)

Q4 2016 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Jon Kathol

Vice President-Investor Relations, Tyson Foods, Inc.

Good morning and welcome to the Tyson Foods, Incorporated fourth quarter and 2016 fiscal year earnings conference call. On today's call are Donnie Smith, Chief Executive Officer; Tom Hayes, President; and Dennis Leatherby, Executive Vice President and Chief Financial Officer.

Slides accompanying today's prepared remarks are available as a quarterly supplemental report on the Investor Relations section of our website at ir.tyson.com. Tyson Foods issued an earnings news release this morning which has been filed with the SEC on Form 8-K and also is available on our website at ir.tyson.com.

Our remarks today include forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. These statements reflect current views with respect to future events such as Tyson's outlook for future performance on sales, margin, earnings growth and various other aspects of its business. These statements are subject to risk and uncertainties that could cause actual results to differ materially from our expectations and projections. I encourage you to read the release issued earlier this morning and our filings with the SEC for a discussion of the risks that can affect our business.

During the call, there will be a discussion of some items that do not conform to U.S. generally accepted accounting principles, or GAAP, including adjusted EPS. Tyson has reconciled these items to the most comparable GAAP measures in the earnings release and on our website at ir.tyson.com.

I would like to remind everyone that this call is being recorded on Monday, November 21, 2016 at 9:00 AM Eastern time. A replay of today's call will be available on Tyson's website approximately one hour after the conclusion of this call. This broadcast is the property of Tyson Foods, and any redistribution, retransmission or rebroadcast of this call in any form without the express written consent of Tyson Foods is strictly prohibited.

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

Donald J. Smith

Chief Executive Officer & Director, Tyson Foods, Inc.

Thanks, Jon. Good morning, everyone, and thanks for joining us today.

Before we get into our earnings discussion, I'd like to comment on this morning's other announcement. As you may have heard, Tom Hayes will be succeeding me as CEO effective at calendar year end. The board and I agree that now is an excellent time to make this transition. The company is performing exceptionally well and realizing significant growth in shareholder returns through our hybrid strategy of branded prepared foods and fresh meats. Simply put, I believe the company has a bright future and that Tom is the right leader for this next phase of our development.

We've worked hard to create a strong platform that will take Tyson into the future, and we have an impressive pipeline of talented management to help us do that. We're leveraging scale, developing our brands and building value for shareholders.

Since his promotion to President earlier this year, Tom has reminded me, the board, and the rest of the management team on a daily basis exactly why we hold him in such high regard. He's a capable leader, a strategic thinker and a team player, who's ready to build on what we've accomplished to date and drive this company forward. He has the skills to deliver on our strategic goals and complete the transition toward our hybrid model.

I've committed to him I will remain available as a consultant for the next three years. As you can imagine, it's a time of mixed emotions for me. I joined Tyson Foods 36 years ago and have spent my entire professional life here. In return, I've been given opportunities I could never have imagined. At Tyson, I've worked alongside some of the best, most impressive people you could ever hope to meet, and together, we've worked tirelessly to build a great company. I'd like to thank both the board and the Tyson family for their encouragement and support, without which I could have not succeeded.

More than just delivering good financial results, we've been able to make a positive difference in people's lives. I'm thankful for the seven years I had the opportunity to serve Tyson as a CEO, and I'm excited about its future and confident that Tom is the right leader for the next chapter.

And with that, let's now turn to the quarter. Fiscal 2016 was our fourth consecutive year of record results with record operating income, operating margin, adjusted EPS, cash flow, Pork segment margins and Prepared Foods segment margins.

Adjusted EPS grew 39% versus the prior year. Using the midpoint of our fiscal 2017 guidance of \$4.70 to \$4.85, the projected EPS five-year CAGR would be 19%, which is outstanding.

Fourth quarter results were slightly below our internal expectations, impacted largely by \$35 million or \$0.06 a share in mark-to-market and lower cost of market accounting treatments primarily in Beef and Pork, a production issue in Prepared Foods, and one-time factors in Chicken that Tom will go into in more detail shortly.

Synergies for the fourth quarter were \$165 million, with \$67 million incremental over Q4 of last year. Synergies for the year were \$580 million with \$258 million incremental to last year and well exceeding our \$500 million target. We currently expect synergies of approximately \$675 million in fiscal 2017, below our previous estimate of \$700 million. While we still expect to achieve at least \$700 million in total, due to the timing of some projects, we now expect some of the synergies to fall into fiscal 2018. We bought back 8.3 million shares of stock for \$600 million in Q4 excluding repurchases to offset dilution from equity compensation.

For the fiscal year, share repurchases totaled 28.2 million for \$1.7 billion. We were able to repurchase at this level due to our record operating cash flows of more than \$2.7 billion. 2016 was a great year, beyond setting records. We made tremendous progress leveraging the combined strength of the Tyson team, and we're well positioned for even more success in fiscal 2017.

Now, let's go to Tom for report on our operating segments.

Thomas P. Hayes

President, Tyson Foods, Inc.

Thanks a lot, Donnie.

Let's begin with the Prepared Foods segment. Operating income in the fourth quarter was \$133 million with a 7.2% operating margin. Average price was down 3.9%, primarily reflecting the pass-through of overall lower raw material cost. Adjusting for the additional week in 2015, volume compared to Q4 last year was up 2.6%. Margin in the Prepared Foods segment were lower year over year, primarily due to a sharp increase in pork trim raw material costs in Q4 that were not passed through to customers within the quarter and increased marketing spending.

In the food service portion of Prepared Foods in Q4, we had strong results in our bakery business but softer than expected results in prepared meats. As a part of our efforts to improve our production network, we closed the plant and transferred production to newer facilities. Unfortunately, this transition wasn't seamless, causing us to incur overtime in our operations and higher distribution costs in an attempt to satisfy our customers' needs. We've since taken steps to improve production efficiency and are building additional network capacity for a long-term growth. Despite these challenges, Prepared Foods had a record year and delivered planned synergies.

Synergies for the segment were \$119 million for the quarter and \$38 million incremental to Q4 last year. For the full year, Prepared Foods synergies were \$441 million, with \$156 million incremental to fiscal 2015. For the fiscal year, Prepared Foods operating income was \$734 million with a record 10% margin. Pricing was down 3.4% on lower raw materials. Adjusted volume was down 1% for the year, primarily due to the rationalization of some unprofitable ingredient meat SKUs.

We're growing volume where we want to grow by focusing on strategic brands and categories to increase operating income over time. We supported our brand equities across Prepared Foods through marketing, advertising, and promotional spending to grow volume and secure our position on the shelves of retailers and

restaurants. For example, we increased our support behind the Jimmy Dean frozen breakfast franchise and Hillshire Farm lunchmeat. And in our fourth quarter, volume was up 9% and 28% respectively. We also grew our share by 1.5 points in the frozen protein breakfast category and by 2.3 points in lunchmeat.

We expect beef and pork raw material to be deflationary to input costs in addition to pricing in 2017. We'll continue to invest in innovation, new product launches, and MAP to grow our brands. We're expecting margins in 2017 to be similar to those in 2016, with solid volume growth that outperforms the categories where we compete.

In the Chicken segment for the fourth quarter, operating income was \$220 million with a 7.8% operating margin. Adjusted volume was down 3.2% due to a planned temporary decrease in production. And average price was up 3.5%, as we focused on selling higher-margin products.

There were three factors leading to lower than expected results in the fourth quarter in Chicken. First, our production forecasts are based on consumer demand. And through our sales and operations planning process, we received indications of lower demand in July and August. As our business model dictates, we reduced production in response to softening consumer demand. Secondly, we absorbed a sharp spike in soybean meal input costs within the quarter that affected margins in the short term. And third, having completed the restaging of the Tyson brand, we turned MAP back on to grow points of distribution heading into the new fiscal year.

As a result, our Tyson brand frozen value-added chicken volume was up 6% in Q4 of 2016 and is gaining momentum, portending very strong Chicken segment volume in our first quarter of 2017.

Chicken segment results for the year were outstanding with an 11.9% operating margin. We were just shy of last year's record return. Operating income was \$1.3 billion. Adjusted volume was down 0.7% due to the reduced demand in the fourth quarter that I just spoke to. Average pricing was down for the year by 1.5%, as some input cost deflation was passed on to customers.

The USDA is now projecting chicken supply to be in the U.S. increased by 2% in 2017, and our input costs should be flat. We'll continue growing where we want to grow by selling more Tyson branded value-added chicken. We expect the returns for the Chicken segment to be at or above the upper end of our normalized range of 9% to 11% again in fiscal 2017.

Moving on to the Beef segment, operating income was \$139 million in Q4 with a 4% operating margin. Adjusted volume was down slightly by 0.3% while average sales price declined 14.9%, reflecting reduced cattle cost. For the fiscal year, operating income was \$347 million with a 2.4% operating margin. Adjusted volume was up slightly by 0.8% while pricing declined 14.9%, again, on lower cattle costs.

Following a rocky start to the year, the Beef segment finished strong, with favorable pricing environment continuing into our Q1. We're expecting our Beef margin to be at the upper end of its normalized range of 1.5% to 3% in fiscal 2017, reflecting the favorable environment that we expect to continue for some time.

I'll wrap up the segment performance by recapping the Pork segment results. Operating income was \$108 million with an 8.7% operating margin. Adjusted volume was up slightly at 0.4%, while average pricing was up 1% in the quarter. For the year, operating income was \$528 million with a record 10.8% margin. Excluding the additional week in fiscal 2015 and the divestiture of our Heindol business in Q1 of last year, Pork volume was up 1.2% and average price was down 4.4%, reflecting lower hog costs. In fiscal 2017, we expect a favorable operating environment to continue and are estimating operating margin of at least 10% for the year.

Currently, the USDA is projecting supplies of our protein categories to be up 2% to 3% next year with moderate export growth. Domestic demand for protein has been strong, and we expect it will continue in a deflationary environment, and we're very well positioned across all proteins and customer channels to respond to the changing demands of consumers.

We're making significant investments in consumer insights, innovation, our brands, our customer relationships, our facilities, and our people. In addition to \$1 billion in CapEx in 2017, we're investing in improving safety, animal well-being, warehousing and distribution, and attracting and retaining talent throughout the organization. These investments should improve costs and turnover as well as continue to drive long-term sustainable growth.

While protein demand overall is strong and growing, we're seeing a shift in how consumers spend, specifically in retail. When beef prices decline, more consumers buy beef as the relative price premium versus other forms of protein narrows. This interaction is especially pronounced in the dynamic between ground beef and hot dogs. While the hot dog category overall was down in the 13 weeks ended October 2, we grew Ball Park volume by 11% and increased volume share by 2.5 points. This is a great example of the power of a strong leading brand like Ball Park and the consumer loyalty and strong customer support it garners.

Overall, Tyson Foods is performing very well at retail. In the 13-week period roughly corresponding with our fourth quarter, our Core 9 product lines grew dollar share in all nine categories and grew volume share in eight of nine categories. In total, we grew volume 9.6%, eight points ahead of total food and beverage.

If you take a look at the slides we have posted online, you'll see that both the Core 9 and total Tyson at retail are outpacing growth among the top 10 branded food-only companies in both sales and volume dollars. In sales volume, Tyson is only one of the three companies that posted positive volume growth. In sales dollars, we are the only company to show positive growth with a 4.7% in the Core 9 and 2.1% overall, and that's in a deflationary protein pricing environment. I want to extend my congratulations to Andy Callahan and the entire retail package brands team for their outstanding performance.

Turning to the food service channel, traffic remains roughly flat and growth is driven by average check size, which is up about 2%. That was a case in calendar year 2015 and thus far in 2016 and is expected to continue through 2017. And despite a lackluster environment, Tyson Foods is doing well at food service. Our insights team using data provided by NPD has developed analytic tools to give us a better look into the broad line distribution sector within food service.

Broad line distribution has long been an important channel to us, but now, we're getting a better perspective on the role we play, the importance of value-added chicken and the strength of the Tyson brand. Over the 52 weeks ended in July, the most recent data available, our volume grew 3.9%. More than double the category growth rate.

By far, Tyson is the largest brand with a 33% share and growing. The next closest competitor is private label with a 20% share, and it's worth noting we're a substantial producer of private label, value-added chicken for our distributor customers. We look forward to being able to give you more and more insight into our food service business as our insights team continues to build out more analytic tools, which is a great example of the strength of our combined capabilities across the company.

I continue to be encouraged by the pace of new product innovation as we extend our brands into adjacencies. Sales from new products launched in the previous three years has resulted in a vitality index of 14% in retail and 21% in food service. When we think about innovation, it's not only about new products. It really starts to

understand how people shop and how shopper behavior opens up new platforms for innovation. Partnering with our customers to leverage the opportunities of the e-commerce space is a great example of this.

We began selling Tyson Tastemaker meal kits through e-commerce in September. While it's still early, we're very encouraged by the initial consumer acceptance and feedback. This platform combines our innovation capabilities, supply chain at scale and leading brands in a way no other food company can. Expect to hear more in 2017 as we extend this platform into multiple formats and e-commerce and traditional retail.

2016 was a great year, but more importantly, we laid the foundation for 2017 and beyond. We're capitalizing on our momentum and taking a systematic approach to success.

I'm now going to turn it over to Dennis, who will report on the fourth quarter and the year as well as our expectations for fiscal 2017.

Dennis Leatherby

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

Thanks, Tom, and good morning everyone.

Fiscal 2016 was our fourth consecutive year of record earnings as we continue to demonstrate the power of our diversified business model producing strong stable margins. We are investing our cash flows back into our businesses as we focus on long-term sustainable growth. Total company return on sales was a record 7.7% for fiscal 2016. Operating income was also a record at \$2.8 billion, representing a 26% increase over adjusted operating income a year ago. On an adjusted basis, this represents our fourth consecutive year of growth in operating income and return on sales. Our record adjusted EPS of \$4.39 represents a 39% increase over \$3.15 per share last year. Our operating cash flow was a record \$2.7 billion and we have invested \$695 million in capital expenditures. This outpaced our depreciation by \$78 million as we continue to invest in projects with a focus on delivering high ROIC.

We also used our record cash flow in fiscal 2016 to return cash to shareholders and to retire debt. We increased the dividend for fiscal 2016 by 50% from the prior year. We also repurchased 28.2 million shares for \$1.7 billion during the year. Combined, we returned over \$1.9 billion to shareholders in share repurchases and dividends and that's after we retired some high coupon debt during the year which further strengthened our balance sheet.

In fiscal 2016 our effective tax rate was 31.8% and on an adjusted basis was 33.8%. Net debt to EBITDA for the past 12 months was 1.7 times. Including cash of \$349 million, net debt was \$5.9 billion and total liquidity was \$1.3 billion. Net interest expense was \$57 million during the fourth quarter and \$243 million during fiscal 2016.

For the quarter, average diluted shares outstanding were 381 million. ROIC was 18.1% and is approaching the pre-Hillshire acquisition level of 20.5%, which illustrates the strength and stability of our earnings as well as our commitment to creating incremental shareholder value.

Now looking forward, here are some thoughts on fiscal 2017. We expect similar revenues as we grow volume across each segment offset by the impact of lower beef prices; net interest expense should approximate \$225 million. We currently estimate our effective tax rate to be around 35%. CapEx is expected to approximate \$1 billion as we focus on capacity expansion and operational improvements that create long-term shareholder value. Prior to adjusting for any additional share repurchases subsequent to this call and based on our average share price so far in Q1, we expect our average diluted shares to be around 376 million.

This morning we reported our board of directors again increased our regular quarterly dividend by another 50% from \$0.15 to \$0.225 per share on our Class A common stock payable on December 15. This increase brings our dividend to \$0.90 per share annually for Class A shares from \$0.60. As we stated last year, we expect to increase future dividends for Class A shares by at least \$0.10 per share annually. This increase and our commitment to steady future dividend increases demonstrate our confidence in the enduring strength and stability of our cash generation capabilities.

We have a tremendous amount of momentum going into fiscal 2017 as we come off a year of 39% EPS growth. Our fiscal first quarter in 2017 is off to a phenomenal start, which gives us confidence in achieving annual adjusted EPS growth of 7% to 10% to a range of \$4.70 to \$4.85 per share. This new guidance range represents a five-year adjusted compounded annual growth rate of at least 19%.

While we are pleased with the growth we have achieved, we are excited about the significant increase in investments in fiscal 2017 that will drive growth for the future. In addition to \$1 billion in CapEx, we are planning heavy investments, as Tom mentioned previously, while we continue to grow organically. Additionally in fiscal 2017, we expect to return even more cash to shareholders by our announced increased dividend and additional share repurchases. We see compelling value in our shares. And so far, in the first quarter fiscal 2017, we've repurchased another 3.4 million shares for \$240 million. While some of our investments will not immediately fall to the bottom line, we are creating a sustainable blueprint for success that will allow us to grow in a responsible way for the future.

In closing, we take a long-term view toward investing in our people, our brands and our facilities, which will drive value and generate attractive shareholder returns. That concludes our prepared remarks.

Denise, we are ready to begin Q&A.

QUESTION AND ANSWER SECTION

Operator: Thank you, Mr. Leatherby. [Operator Instructions] And your first question will come from Ken Zaslow of BMO Capital Markets. Please go ahead.

Kenneth Bryan Zaslow

Analyst, BMO Capital Markets (United States)

Hey. Good morning everyone.

Q

Donald J. Smith

Chief Executive Officer & Director, Tyson Foods, Inc.

Good morning.

A

Dennis Leatherby

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

Good morning, Ken.

A

Kenneth Bryan Zaslow

Analyst, BMO Capital Markets (United States)

Donnie, congratulations. It's been a pleasure. I wish you well. And, Tom, congratulations on your promotion, I think. With that, Donnie, I have to say your timing of your retirement may not be perceived as optimal; Tyson is in the middle of a class action suit, earnings fell short of expectations on the perception that you've kind of reached peak earnings, and you're in a debate over your Georgia Dock pricing, it seems like. So let me just tackle one issue at a time. Why not hand the reins over once the dust settles a little bit? Second, how much of the earnings shortfall in the quarter will be recaptured in the first quarter? Third, if Georgia Dock prices go away, how much would Tyson's outlook actually change?

Q

And then, Dennis, just to kind of go back on – this is on the share repurchases, given that your stock seems to be probably pricing down at least 10% to 15% today, what is the expectation for share repurchases going into this first quarter?

Donald J. Smith

Chief Executive Officer & Director, Tyson Foods, Inc.

Okay. So I'm going to take the first one of that and then Tom and Dennis will start from there. Ken, I think this is an excellent time for us to be making this transition. Company is off to a phenomenal start for the quarter. We're on a very solid foundation. As we've said before, we dispute the claims. We're looking forward to our opportunity to defending ourselves in court on the litigation. So that has nothing to do with the transition. So, yeah, we're – there's not a better time. We've got a great team. Tom's a very capable leader. So, in terms of all of that, there couldn't be a better time to be making this transition. Now, Tom, I'll let you start on the second, third and fourth.

A

Thomas P. Hayes

President, Tyson Foods, Inc.

A

So thanks, Ken. What I'll say is the timing, I think, from everybody's perspective, actually couldn't be better given the great shape that Donnie has brought the company to, and we are all just thrilled about the opportunities ahead of us.

As it relates to the Q4 to Q1, yes, there is a shortfall in Q1, and I think largely you'll see it show up in a strong Q4 show up in Q1. So the lower than normal results in Prepared Foods and Chicken sort of relate to MAP spending that I spoke to, but I think we're in a great shape, particularly in Beef and Pork, which I think shouldn't surprise you.

As it relates to the Georgia Dock, what we've talked about before several times is that we really don't use it that much. It's about 4%, maybe a little less of total Chicken volume sales that are priced off the Georgia Dock. We have talked several times that we use a lot of different pricing mechanisms, and we are diversified. We don't feel like it has a significant impact to us, but the Georgia Dock has had very little influence on our pricing strategy. Dennis, I don't know if you want to add?

Dennis Leatherby

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

A

As far as the share repurchases go, Ken, on that question, last quarter we bought \$600 million worth of stock. We've bought \$240 million so far and we have a phenomenal quarter going, which means heavy cash flow. So you can expect we'll have another big quarter. I won't get into the exact number, but we'll buy quite a bit of stock back.

Kenneth Bryan Zaslou

Analyst, BMO Capital Markets (United States)

Q

Just to be clear, so how much of the – just making sure I get the answer, how much of your earnings shortfall will come back in the first quarter? And then if Georgia Dock prices go completely away, will that have any impact on Tyson's outlook?

Thomas P. Hayes

President, Tyson Foods, Inc.

A

As far as the earnings going into this quarter, all of it will come back into the quarter from the shortfall standpoint. As far as the Georgia Dock goes, how much it will impact, it will have no impact if Georgia Dock went away.

Kenneth Bryan Zaslou

Analyst, BMO Capital Markets (United States)

Q

Okay, thank you.

Donald J. Smith

Chief Executive Officer & Director, Tyson Foods, Inc.

A

Thank you.

Operator: And the next question will come from Jeremy Scott of CLSA. Please go ahead.

Jeremy Scott

Analyst, CLSA Americas LLC

Q

Hey, I appreciate some of the clarity there. And congratulations, Donnie and Tom, I echo that, but I also echo some of the surprise maybe at the timing. Just to follow up on the Georgia Dock, can you repeat what percentage of your sales are tied to the Georgia Dock? And then secondly, can all of your clients that are pricing on Georgia Dock without restriction or penalty opt to price on an index other than Georgia Dock theoretically right now?

Thomas P. Hayes

President, Tyson Foods, Inc.

A

So to repeat, it's about 4%, maybe 3.5% to 4% of our total Chicken sales off the Georgia Dock. And customers can negotiate to price it off of whatever index they would like. What we have found is that's not a good proxy for costs, and we have some very sophisticated buyers that tend to look more at grain inputs than they do the Georgia Dock. Certainly, it's got a lot of history and it's something that's been around for a while, but we find increasingly our customers are looking to have discussions about where do they think grain is.

And then in addition to that, I'd say there are a lot of discussions, which we've also spoken about this, less about price than it is about everything else we offer as a company. And we're getting more and more into those discussions frankly, and less and less about the absolute price of input costs. So again, I don't know if that answers your question, but that is the way we think about it. It's a very, very, very small part of what we do.

Jeremy Scott

Analyst, CLSAAmericas LLC

Q

Okay. I just wanted to ask about Chicken again. Obviously, a big surprise miss in the quarter, it didn't really add up to any of our models. I appreciate the three factors that you flagged. Can you quantify them in terms of the impact on margins of each factor and how they will roll over into the first quarter?

Donald J. Smith

Chief Executive Officer & Director, Tyson Foods, Inc.

A

So I'll go through the specific impact of each one. What I will say is, when the soybean meal market went up, we are probably less hedged. As we go towards the end of the year, we're looking for the new crop. That is something that certainly – if there are spikes, it's going to play through our numbers.

As we go through our negotiations with customers, we look to capture everything that we can. We have, I think on the last call we talked about severe run-ups, quick – the slope of the curve is high. We have a harder time passing through those costs to our customers, so that was certainly a big impact.

Thomas P. Hayes

President, Tyson Foods, Inc.

A

Just to reiterate, Jeremy, we are saying that for the year that the earnings in Chicken will be at or above the normalized range.

Donald J. Smith

Chief Executive Officer & Director, Tyson Foods, Inc.

A

Right.

Jeremy Scott

Analyst, CLSAAmericas LLC

Q

Okay. And then just lastly on the CapEx, what exactly is driving the incremental investment there? I realize you talked about some of the initiatives that you're taking. But can you break that down into pieces?

Donald J. Smith

Chief Executive Officer & Director, Tyson Foods, Inc.

A

So the biggest one is we are spending quite a bit of money to expand production at our plants. We've got a lot of growth opportunities. I mentioned briefly in the prepared meats sector and food service we have some capital spending there. We have increased our spending against or increased our production capacity on cooked chicken, fully cooked chicken, and we're pretty close to being well through that capacity and we need to build more.

So I think about the largest percentage of that will be focused on growth. And we have, in addition to that, we're spending to make sure all of our process is working well, animal well-being, a lot of sustainability efforts. But to answer your question on CapEx, it's predominantly focused on growth.

Jeremy Scott

Analyst, CLSAAmericas LLC

Q

Okay, I'll jump back in the queue. Thank you.

Operator: And the next question will come from Adam Samuelson of Goldman Sachs. Please go ahead.

Adam Samuelson

Analyst, Goldman Sachs & Co.

Q

Thanks. Good morning, everyone, and I'll echo Ken and Jeremy's comments. Donnie, congratulations, and Tom, congratulations as well. Maybe my first question, in Prepared Foods, and just to be clear, on the margin guidance for fiscal 2017 of 10%, basically flat margins year over year, can you quantify both the fourth quarter? It seems like there were some production issues that you don't seem to be expecting to lap. There's still about \$100 million of year-over-year synergies. You're growing your volumes strongly and your highest margin value-added categories in the Core 9, and you've got some nice commodity deflation at your back. Can you talk about the level of reinvestment spend in Prepared Foods that you wouldn't expect some better margin leverage, and/or kind of earnings improvement? Thanks.

Thomas P. Hayes

President, Tyson Foods, Inc.

A

We think about the – ROS is flat, of course, and OI, but we think what we want to make sure that we continue to do is focus on volume. Hopefully, you see on those charts, if you were able to see those online, the investments are paying off. So we have significant investment going into, not the least of which is MAP in Q4. It was a big impact on the rate. But then as you look at what we're doing for preparing ourselves for this 2017, it's all about making sure that we have the shelf space, we are driving innovation and we continue to invest, and frankly, lift the investment in some of the categories that weren't ready for and some of the brands that weren't ready for the mass spending as much as they are today.

So we think in terms of, the fourth quarter played out pretty much as we thought it would, and as we talked in the last call, we're executing that strategy that we want to be continually at 10% and we did it in 2016. With more protein on the market next year, we want to make sure we're in a good position that I spoke to and we want to continue to drive category growth with our customers. So we're continuing to invest significantly and growing where we want to grow, which is in the Core 9 as we demonstrated.

Adam Samuelson

Analyst, Goldman Sachs & Co.

Q

Okay, that's helpful. Then maybe switching gears to Chicken and understanding that there were some issues in the fourth quarter that it doesn't sound like you think repeated maybe other than the MAP spending. And you've guided margins at or above the high end of the 11% normalized range. Can you talk about kind of the bigger swing factors in Chicken as you look out through 2017?

The feed costs given the harvest that we just had would seem to be fairly benign. It seems like you've got good mixed tailwinds in terms of your value-added business. Export markets are okay. Can you talk about some of the bigger drivers of variance that you'd think about in up or downside risks in chicken for the next 12 months?

Thomas P. Hayes

President, Tyson Foods, Inc.

A

Sure. I mean you called it as it relates to the grain, we feel like that is pretty much flat. We'll be in the same position in 2017 as we are in 2016, as far as we know today. What we continue to do is drive the core of that business up, so retail and food service, value-added products, and we drive the non-core and the commodity linked quarters and byproduct down. So roughly the value-added products are up about 4%, the commodity products down 7%, so the net is, as you look at the total, the chicken platform you see is roughly flat but the mix in between is continuing to improve towards value added.

Adam Samuelson

Analyst, Goldman Sachs & Co.

Q

All right, thank you. I'll pass it along.

Operator: And the next question will come from Robert Moskow of Credit Suisse. Please go ahead.

Robert Moskow

Analyst, Credit Suisse Securities (USA) LLC (Broker)

Q

Hi, thank you. I thought also one of the comments about chicken was that you had expected chicken demand to be down in July, August, so you reduced production and you said it was related to consumer demand and I guess that's related to lower beef prices. Was consumer demand as weak as you thought it was for chicken? I mean it seems to me that demand for chicken had been a huge part of the story overall. Are you seeing any kind of weakening in that regard?

And then I had a follow-up on trim prices, which we track. Other than a little bit of a spike in July, I really didn't see anything else for the quarter. In fact, they came down quite a bit in August and September. So I wanted to maybe get a sense of just how sharp of an increase that was for your Prepared Foods margins.

Thomas P. Hayes

President, Tyson Foods, Inc.

A

Sure. Yeah. So as it relates to poultry first, the volume was softer for sure, Rob, in Q4. So we saw it coming. We have a good S&OP [Sales & Operations Planning] process. I think it probably is as good as we've ever experienced, and having those signals allows us to modify production in advance of seeing that now. As Dennis has said and we talked about, we have seen that come back in the first quarter here. So the volume was off, and it now has come back. And the other thing that we want to make sure that we do is we have lower inventories. We

want to make sure that we don't run into a season with high inventories and that certainly helped us. We were selling through the inventory to a large degree in Q1, so it was a right thing to certainly pull back on production.

As it relates to the trim pricing, so if you look at 72% and 42% trim for the Prepared Foods business and particularly as it relates to hot dogs and grinding materials for sausage and so forth, there was a sharp spike and then it dropped off dramatically. As the trim is dropping off, it's good for us because costs are going down and prices up. But when they shoot up in any given period, the slope of the change is going to cause us particularly on the food service business for formula price to have our raw material costs higher and our formula price is lagging by about 30 days. So that was a short-term impact, we're through that, but that's the situation there.

Robert Moskow

Analyst, Credit Suisse Securities (USA) LLC (Broker)

Q

And why do you think chicken demand is coming back? I mean beef prices continue to fall, so you might see more consumer demand shifting to beef. I mean how do you know it's not just a head fake and it might get weak again?

Thomas P. Hayes

President, Tyson Foods, Inc.

A

We see that the value that we provide for all of our customers is predominantly focused on how they grow their categories overall, and when we look at chicken, we have significant MAP spending that they want. They want us to invest in the business and continue to drive growth. We have seen certainly some share gains and that's something that we're tremendously excited about. As we look at how chicken, the retail value-added poultry or the Tyson brand at retail, it's been doing very well. We've got a lot of innovation behind it.

So those are sort of the key drivers. And some of the food service business that we picked up over the summer is starting to kick in. So there's a lot of things that – I can't give you all the detail on it, Rob, but there's a lot of things that are sort of working together that give us tremendous confidence about chicken volume, not just Q1 but for 2017.

Robert Moskow

Analyst, Credit Suisse Securities (USA) LLC (Broker)

Q

Okay. Congrats again, Donnie, and good luck, Tom.

Thomas P. Hayes

President, Tyson Foods, Inc.

A

Thanks.

Donald J. Smith

Chief Executive Officer & Director, Tyson Foods, Inc.

A

Thanks.

Operator: And next question will be from Ken Goldman of JPMorgan. Please go ahead.

Kenneth B. Goldman

Analyst, JPMorgan Securities LLC

Q

Hi. And thanks for taking my question. I just wanted to make sure I understood when you're talking about all the shortfall in the fourth quarter, chicken business shifting into 1Q, can you just elaborate on what that means? I wasn't quite certain if you were talking profit or volume.

Thomas P. Hayes

President, Tyson Foods, Inc.

It's more profit, Ken.

A

Kenneth B. Goldman

Analyst, JPMorgan Securities LLC

Okay. With that in mind – thank you for that – can you help us – and I know you're getting the same question in 10 different ways, so forgive me. But can you help walk us through the mechanics of that because I'm not quite sure, like the soy issue, that doesn't reverse, right? MAP spending, I assume, it's not coming down in the first quarter. So I guess it's mostly fixed cost deleverage issue that gets reversed. Does that imply that volumes have to be significantly better than they usually are in 1Q? Again, you've talked about it. So I just want to make sure I'm thinking about this in the right way.

Q

Thomas P. Hayes

President, Tyson Foods, Inc.

Yeah, sure. So, Ken, soybean meal, yeah, you've seen the chart. Everybody has seen it. It spiked up and then it almost looked like the shape of an M. It was up and was down and up and now it's flattened back out, right? So yes, it has come back down, and it's staying down, so that is helping our cost base. And I'd say as it relates to the feed costs in Q4, it's always a lag in our COGs. So now that, in speaking to the profit, we are going to be in a much better shape based on doing a couple things. One is reducing the amount that we produce, so our inventories were drawing down and also continuing to do what I said which is focused on driving growth at retail through the Tyson brand and driving growth with the new food service customer prices.

A

Kenneth B. Goldman

Analyst, JPMorgan Securities LLC

Okay. I may have missed this, but I wanted to ask about retail beef and pork prices. They really haven't fallen as much as wholesale, and farm prices have for cattle and hogs. I know the retail prices are always much less volatile. It just seems a little more so this time, they're really kind of being sticky. I'm just curious what your updated thoughts are. And if that changes, when that might change, are you having any conversations with your grocery customers about the proper prices that they should have on the shelf at this point?

Q

Thomas P. Hayes

President, Tyson Foods, Inc.

They kind of run that. We don't influence necessarily the price that they're going to be charging on the shelf, but you've got it nailed. The dynamic is that the livestock prices have not come – they've come down faster than the retail prices have, which has allowed us to make the margins that we have right now in both beef and pork. So how that sticks through the season, I think it remains to be seen, but that is the dynamic that's allowing us to have a very, very strong first quarter.

A

Kenneth B. Goldman

Analyst, JPMorgan Securities LLC

Okay, thanks so much.

Q

Thomas P. Hayes
President, Tyson Foods, Inc.

A

Sure.

Operator: And the next question will come from Farha Aslam with Stephens, Inc. Please go ahead.

Farha Aslam
Analyst, Stephens, Inc.

Q

Hi. Good morning.

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

A

Good morning.

Thomas P. Hayes
President, Tyson Foods, Inc.

A

Good morning.

Farha Aslam
Analyst, Stephens, Inc.

Q

Again, on chicken, could you just share with us your commentary about demand declines and recovery? Is that for Tyson specific or is that the industry? And why would Tyson's demand be different than the industry?

Thomas P. Hayes
President, Tyson Foods, Inc.

A

So Farha, this is Tom. We're talking about Tyson as that's all we can really speak to, right? I mean that's what we've focused on. And it is the Tyson brand retail, significant innovation, advertising. We have been on air with television. We're seeing the definite result of that activity, like I mentioned up 6%, heading into much stronger Q1. And I'll speak to again, I hate to be a broken record here, but we have taken on some significant business throughout whether it's food service or retail predominantly on the Tyson brand. Certainly, there is retail private label that we play in but it's predominantly the Tyson brand that we're seeing the increases in.

Farha Aslam
Analyst, Stephens, Inc.

Q

Okay. And then when you look at your Prepared Foods business and the operational issues that you faced during the quarter, could you roughly quantify how much they were and if they're completely fixed, any carryover to the first quarter?

Thomas P. Hayes
President, Tyson Foods, Inc.

A

So we won't quantify it in specific terms, but we'll say that it was some of the downdraft on Q4. There was – as we close one of our factories that produced pizza toppings, we had challenges moving to the factories that we're actually increasing capacity at. So it was not our finest hour in terms of how we execute and we are in a much better position now because we have – the good news is we have strong customer demand and we are building capacity to meet that customer demand. And it was a one-time issue that's going to be certainly as we ramp up to

serve the volume, we're going to see some continued at capacity numbers. But I would say that it was predominantly due to that plant closure that affected it. And sorry I can't quantify it for you, but that's the story.

Farha Aslam

Analyst, Stephens, Inc.

But you're done with it now?

Q

Thomas P. Hayes

President, Tyson Foods, Inc.

We are still going to be going through the first half of this year getting some stability against it. In terms of impacting our numbers, it's more of an opportunity. In order to drive the results, getting all the volume that we have subscribed out the door in terms of customer orders, that's the biggest challenge. I would say that all the supply chain issues will be solved for the second half of the year. That's when significant stability will come as well as our ability to serve all the orders that we have on the improved demand.

A

Farha Aslam

Analyst, Stephens, Inc.

That's helpful, thank you.

Q

Thomas P. Hayes

President, Tyson Foods, Inc.

You're welcome.

A

Operator: And the next question will come from Akshay Jagdale of Jefferies. Please go ahead.

Akshay Jagdale

Analyst, Jefferies LLC

Thank you. And first, congrats, Donnie. I know with everything going on with the stock today, that's been pushed to the side. But congratulations on your retirement, I guess. But my question is again on chicken. Is it fair to say that if you didn't have these three one-time issues that your numbers for chicken would have been at or above the normalized range? I know you're hesitating for some reason to quantify it, but I just wanted to first understand the magnitude of the impact.

Q

Thomas P. Hayes

President, Tyson Foods, Inc.

The answer to that, Akshay, is yes. They would have been within the normalized range that you have typically become used to. And it is unfortunately a one-time occurrence that we are feeling good about in terms of Q1 and the rest of the year.

A

Akshay Jagdale

Analyst, Jefferies LLC

Okay. And then just related to the guidance, obviously, again on chicken, you're guiding to similar results like this year, which is above the normal range. But I guess the market is not really believing that. So the demand issue – so what's priced into your – what's built into your projection? If retailers do reduce the price of beef and pork, are you able to navigate through that and still deliver the results you're promising for next year? And then can you just

Q

elaborate a little bit more on what the demand issue was in terms of weakness and why it caught you by surprise since you gave last your guidance?

Thomas P. Hayes

President, Tyson Foods, Inc.

A

Sure. So what I can tell you is we're seven weeks into our fiscal year, and we have a lot more to come. We feel great about it. But everything that we know in terms of our beef and pork pricing and our chicken business and Prepared Foods, it's in our projection. And so as we move through the year, we feel like we're going to be in great shape. We're seven weeks in, and everything that we know is in our projection. That's all we can say about that.

In terms of demand signal, that's what drives our SOP. When you cross the end of a year, it's certainly difficult. But at the end of a quarter, I think of it as while we've got to put those couple of months together or couple quarters together to really get a good look at what the demand is. That's not an insignificant thing, certainly, as we're coming at the end of the fiscal year for us here. So getting into Q1, you will see that those two things are offsetting. But certainly, beef pricing has I think not necessarily helped the other proteins, but beef pricing has been down significantly, so you see the volume up rather sharply on beef.

Akshay Jagdale

Analyst, Jefferies LLC

Q

So again, what happened with the demand being weaker? Was it related to beef pricing being lower? I'm just trying to understand what on demand for chicken really changed because we just want to make our own judgments on whether that factor will continue in 2017. Thank you.

Thomas P. Hayes

President, Tyson Foods, Inc.

A

Sure. Beef was probably the largest, the sharpest up of all the proteins. You can't say that it's any one in particular issue. There's a lot of things that go to work to drive the volume, and customers are loading in at different times for the season. They're trailing off inventories. There's not a specific thing that you can pin it to other than we did see certainly beef was probably the largest factor.

Akshay Jagdale

Analyst, Jefferies LLC

Q

Thank you.

Thomas P. Hayes

President, Tyson Foods, Inc.

A

You're welcome.

Operator: The next question will be from Michael Piken of Cleveland Research. Please go ahead.

Michael Leith Piken

Analyst, Cleveland Research Co. LLC

Q

Hi, just a question on the Pork segment. I mean it looks like margins for the packers are at an all-time high. I'm just wondering if we should expect to see – I know you guided to 10%-plus, but it looks like potentially fiscal 2017 could even be better than 2016. Is that a fair assessment of the market?

Thomas P. Hayes

President, Tyson Foods, Inc.

A

So it's definitely going to be a good year for pork. That's what we have guided to. Well above the normalized range of 6% to 8%. We said we think it's going to be 10%-plus. So we continue to see strong demand for pork. It's seasonal for sure, but we have very strong demand for pork. And supplies are roughly I think in unison with demand, so that's a good thing for us. And so that's why for us, we feel like it's going to be a good year on pork.

Michael Leith Piken

Analyst, Cleveland Research Co. LLC

Q

As you look further ahead, two of the vertically-integrated hog producers are adding some packing capacity which is supposed to come online next summer. Are you guys already sort of looking at alternate suppliers, or how do you see your pork utilization rates trending as these other facilities come online, and how are you looking to source your hogs in the future? Thanks.

Thomas P. Hayes

President, Tyson Foods, Inc.

A

So it looks like there's going to be sufficient harvest capacity to stay ahead of the increased hog supply. Our math is showing that the supply growth and demand growth, like I said, are relatively in balance over the next few years. And so that looks good for us. We feel like as it relates to the season, the carcass weights are still not as high as you might think they would be indicating supply as relatively current. So it remains to be seen how that affects us. But we're feeling in a great position. We feel like we're well-balanced between supply and demand

Jeremy Scott

Analyst, CLSA Americas LLC

Q

Okay, thank you.

Operator: And the next question will be from David Palmer of RBC Capital Markets. Please go ahead.

David Palmer

Analyst, RBC Capital Markets LLC

Q

Thanks, good morning and congrats Tom and Donnie. First question, you noted that the Georgia Dock price is not the primary driver of chicken pricing. Perhaps you could just talk about how Tyson is getting its chicken pricing, which, I believe, is up 3.5% this quarter, and what your near-term outlook is for pricing in that segment?

Thomas P. Hayes

President, Tyson Foods, Inc.

A

Thank you, David. Georgia Dock is one of many elements that we use. I would say that – as we've talked about in the past, probably the best for us is if we have something that's tied to any indices, it's really the underlying grain. So if we have a customer that's willing to lock for a period of time, then it's smart for us to lock the grain underneath to make sure we have a margin that's locked up.

Beyond that, I'd say we continue to see our portfolio move more and more to what I'll call list pricing, list pricing with a promotional element on top of it. So regardless of whether it's food service or retail, that's the model that we have within Prepared Foods. A lot of the chicken value-adds acts like Prepared Foods. So I'd say that's the predominant model beyond locking in against a grain underlying input cost.

David Palmer

Analyst, RBC Capital Markets LLC

Q

As a follow up to that, you discussed the soy spike over the summer and the impact on margins. Does this in some way refrain the cyclical nature of margins according to feed costs? In other words, if we were to see a significant reversal in feed costs, corn and soy; will the Chicken segment margins perhaps dip below the long-term range of 9% to 11% at least on a temporary basis if that were to occur?

Thomas P. Hayes

President, Tyson Foods, Inc.

A

I think that's fair. It depends on when it happens in the year and how steep the curve is. So that's what's going to drive whether or not they're going to have a short-term impact and how acute it's going to be. So I think that's fair.

David Palmer

Analyst, RBC Capital Markets LLC

Q

Thank you.

Thomas P. Hayes

President, Tyson Foods, Inc.

A

You're welcome.

Operator: And the next question will be from Jeremy Scott of CLSA. Please go ahead

Jeremy Scott

Analyst, CLSA Americas LLC

Q

Hey. Thanks, guys, for the follow-up. I'm sure this won't surprise you that I have a follow-up on Chicken. Just the way I calculate it, based on your commentary, a loss – the shortfall in the quarter was upwards of \$80 million to \$120 million in Chicken. And first of all, is that number somewhere in the ballpark? But secondly, when you say you will recapture that shortfall in the first quarter, you mean you will recapture the margin not necessarily a piece of that \$80 million to \$120 million? Are there mark-to-market losses that we need to be factoring in that will unlock in the first quarter? Or how should we think about that?

Donald J. Smith

Chief Executive Officer & Director, Tyson Foods, Inc.

A

Yeah. The mark-to-market, I'll ask Dennis to chime in here, but no, the margin structure we're talking about coming back to where we expect it should be. And again, I'll just repeat that we have not small amount of marketing, advertising and promotional investment.

Dennis Leatherby

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

A

As far as the mark-to-market that's not much of a factor.

Jeremy Scott

Analyst, CLSA Americas LLC

Q

Okay. Thank you.

Operator: And ladies and gentlemen, this will conclude our question-and-answer session. I would like to hand the conference back over to Tom Hayes for his closing remarks.

Thomas P. Hayes

President, Tyson Foods, Inc.

Okay, thank you very much. What I would like to say is, A), thank you for your interest and your continued interest during this Thanksgiving holiday season. We're very happy that our investors, sell side/buy side analysts continue to be interested in our stock, and certainly thanks to Donnie Smith, who's been a great partner, bringing me up to speed on everything I need to know about the Tyson Foods family. And as he said in his remarks, he's not going anywhere for three years, he's going to be on speed dial for me, so I'm very happy about that. So I would just say thank you very much for your attention and I appreciate it and we'll be talking to you soon.

Operator: Thank you, sir. Ladies and gentlemen, the conference has now concluded. Thank you for attending today's presentation. You may now disconnect.

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