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TSN - Q4 2015 Tyson Foods Earnings Conference Call

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OVERVIEW:

Co. reported FY15 adjusted revenues of \$40.6b and adjusted EPS of \$3.15. Expects FY16 revenues to be around \$41b and adjusted EPS to be \$3.50-3.65.



CORPORATE PARTICIPANTS

Jon Kathol *Tyson Foods, Inc. - VP of IR*

Donnie Smith *Tyson Foods, Inc. - President and CEO*

Dennis Leatherby *Tyson Foods, Inc. - EVP and CFO*

CONFERENCE CALL PARTICIPANTS

Adam Samuelson *Goldman Sachs - Analyst*

Diane Geissler *CLSA Limited - Analyst*

Brett Hundley *BB&T Capital Markets - Analyst*

Farha Aslam *Stephens Inc. - Analyst*

Ken Zaslow *BMO Capital Markets - Analyst*

Mike Henry *Cleveland Research Company - Analyst*

Robert Moskow *Credit Suisse - Analyst*

Ken Goldman *JPMorgan - Analyst*

Tim Ramey *Pivotal Research Group - Analyst*

David Palmer *RBC Capital Markets - Analyst*

PRESENTATION

Operator

Welcome to the Tyson Foods quarterly investor earnings call.

(Operator Instructions)

This call is being recorded. If you have any objections you may disconnect at this point. Now I'll turn the meeting over to your host, Jon Kathol, VP of Investor Relations. Sir, you may begin.

Jon Kathol - *Tyson Foods, Inc. - VP of IR*

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

Our remarks today include forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. These statements are subject to risks and uncertainties that could cause actual results to differ materially from our expectations and projections. I encourage you to read the news release issued earlier this morning in our filings with the Securities and Exchange Commission for a discussion of the risks that can affect our business.

We use non-GAAP results to provide investors with a better understanding of the Company's operating performance by excluding the impact of certain non-recurring items affecting comparability. This morning we will be referring to our fourth-quarter and fiscal-year adjusted results. As a reminder FY15 included 53 weeks, with the additional week falling in the fourth quarter. Because our guidance for FY15 was on a 52-week basis the adjusted results that we will be referring to exclude the impact of the additional week. Please refer to today's news release for a full reconciliation of GAAP to adjusted results.



To insure we get to as many of you as possible during the Q&A session, please limit yourself to one question and one follow-up and then get back in the queue for any additional questions. I'll now turn the call over to Donnie Smith.

Donnie Smith - *Tyson Foods, Inc. - President and CEO*

Thanks, Jon. Good morning, everyone, and thanks for joining us today. I'd like to begin with a recap of another record year.

With record adjusted earnings of \$3.15 a share, it was our fourth consecutive year of EPS growth. Adjusted sales were \$40.6 billion, a record for the sixth consecutive year. Adjusted operating income was a record \$2.3 billion, an increase of 37% over last year and the third consecutive year of growth.

Cash flows from operations were a record \$2.6 billion, nearly doubling our previous record set in 2010. And the three-year compound annual growth rate for adjusted EPS is 17%. We're certainly pleased with those accomplishments, especially in light of knowing we achieved them despite unusual challenges throughout the year.

The West Coast port slowdown was a significant disruption for beef and pork exports, resulting in a \$90 million negative effect. There's an avian influenza outbreak that closed several export markets for our chicken business and affected our turkey operations, for a total impact of \$139 million. And in the last couple of weeks of the fiscal year, there was an unprecedented decline in the live cattle futures market, resulting in \$70 million in losses from mark-to-market positions and an LCM inventory charge.

We did not adjust our earnings for the nearly \$300 million these challenges caused and we still produced record adjusted sales, earnings, operating income, and cash flows. Meanwhile, we paid down debt, bought back \$250 million of our stock and successfully integrated two companies into Tyson 2.0 while capturing \$322 million in total synergies. We have a great team at every level of the organization and I want to thank them for staying focused and delivering despite all of the challenges and distractions.

Now I'd like to give you some color on our operating segments, but keep in mind that adjusted operating income and adjusted return on sales for the fourth quarter and for the year exclude the impact of the additional week in FY15. Please refer to our press release for non-GAAP reconciliations.

The prepared foods segment produced fourth-quarter operating income of \$171 million with a 9.2% return on sales. Volume for the quarter was up 74% reflecting the addition of Hillshire Brands. And average sales price was up 15%.

For the fiscal year, operating income was \$636 million with a return on sales of 8.3%. Volume for the year was up 78%, again reflecting the additional volume from Hillshire, and average sales price was up 20%.

The majority of our synergies were captured within the prepared foods segment as a result of operational improvement, \$81 million for the quarter and \$285 million for the year. Not all of those synergies will fall to the bottom line because we're investing some into MAP spending and pricing to grow our brands and launch new platforms.

In FY16, we'll ramp up our MAP spend even more behind the Hillshire Snacking and Ballpark jerky launches and the new Jimmy Dean's Shine On Marketing campaign. Also in the fiscal year we'll continue to work on optimizing our prepared foods operations, as you saw in the press release last week. And we expect return on sales for the segment to be near the low end of the 10% to 12% range in FY16.

In the chicken segment for the fourth quarter, operating income came in at \$344 million with a 12.3% return on sales. Volume for the quarter was up 3% while average sales price was down 2%. For the year, operating income was \$1.3 billion with a return on sales of 12%. Volume for the year was up 2% while pricing was down 1.6%.

We've proven that by purchasing up to 10% of our chicken needs on the open market and further processing it into value-added convenience foods, we can produce strong stable returns even in times of falling commodity chicken pricing. Our chicken business model is primarily value-added

as a large branded component and is anchored in consumer insights and demand, and has only a small amount of commodity exposure. To help you understand the value-added nature of our chicken business I'll break it down into the categories on a sales dollar basis.

About 52% is consumer retail. This includes products such as fresh tray pack, deli rotisserie, frozen strips and nuggets, any'tizers, Tyson Grilled & Ready and IQF portions. Demand for these products is driven by three factors -- brand, convenience and freshness.

About 16% of our chicken sales are in food service national accounts, and include products like eight-piece cut up and batter-breaded, par-fried and fully-cooked tenders, wings and breast strips. Demand is driven by quality, ease of prep and flavor. And national account consumers are often on the leading edge of our innovation.

About 17% of our sales are in foodservice value-added and, like national accounts, include batter-breaded, par-fried, and fully-cooked tenders, wings, breast strips and patties. These products are typically sold through broad-line distributors to food service operators, and brand is very important to them as it signifies quality and consistency.

Only about 15% of our sales are commodity products such as bulk leg quarters, [DVB] breast meat and renderings. Our commodity leg quarter volume is less than half of what it was a few years ago. And we're working to continue reducing our commodity exposure through growth in consumer demand for dark meat and our buy versus grow strategy. Had we grown all the birds we needed rather than buying parts on the market, we would have had an additional four million pounds of leg quarters a week to sell.

Our chicken business is balanced and diversified and we have the flexibility to move where the consumer is going. We've created a model that's about 90% customer and consumer pull, with only about 10% of our sales being pushed out into the market. Our customers value our innovation, consumer insight, broad product portfolio and category leadership, all of which help them grow their business. This is how we're building long-term growth and stability and why we believe our chicken segment will produce returns exceeding 10% in FY16.

Turning to our beef segment, in the fourth quarter, operating income was a negative \$20 million resulting in an operating margin that was negative by 0.5%. Volume was down by 1.5% and average sales price dropped by 6%.

For the year, operating income was a negative \$53 million with a return on sales of minus 0.3%. Volume was down for the year about 2.2% because we processed fewer cattle. The average sales price was up 7% for the year.

We saw improvement and a return to profitability in beef in the fourth quarter, but then an unprecedented dramatic decline in the live cattle future's market occurred in the last two weeks of the quarter, resulting in the \$70 million loss I mentioned earlier. With cattle supplies flat to perhaps slightly higher in FY16, the beef business should approximate the low end of the newly revised normalized range of 1.5% to 3%.

Our pork operating income was \$88 million with a 7.2% return on sales in the fourth quarter. Excluding the impact of our Heindl business sold in Q1, sales volume was up about 7% while sales prices were down 23% for the quarter. For the fiscal year, pork operating income was \$373 million with a return on sales of 7.2%.

Volume was up about 4% for the year excluding Heindl while average sales price was down 16%. We're expecting FY16 to be another solid year for the pork segment with returns in the 6% to 8% range.

You might have noticed in our press release this morning we're now reporting our chicken operations in China and India in other results. The business in India, while very small, is profitable and has good potential. While we still believe in China's long-term potential, its operations haven't achieved profitability.

Given the ongoing losses generated in this business, record low chicken pricing, the slower economic outlook for China, and our changing strategy, we recorded an impairment charge of \$169 million in the fourth quarter. We've been doing a significant amount of work on our go-forward strategy for China and India and we'll share our plans with you in the coming months.



Let's move on to our view of domestic consumer demand and our innovation efforts. At foodservice, traffic is expected to be flat to up just slightly. Non-commercial and fast-casual are driving traffic growth, while breakfast and snacking continue as the growing daypart categories. We're diversified across all dayparts, all types of foodservice operations, and across the types of products we sell.

We have several new product launches and platform expansions planned for 2016. Because they are customer specific I can't go into details but it's fair to say we're broadening our thought process within prepared foods and value-added chicken to provide some exciting innovation for our customers that will meet consumers' breakfast and snacking needs.

In the retail channel, we're seeing increased featuring of pork, as pricing has come down. For the most recent year-over-year comparison, fresh pork volume was up 6% on 2% lower pricing. Fresh chicken volume was up 1.5% on 3% higher pricing.

The difference becomes more pronounced when looking at the past month, with pork volume up 11% on 13% lower pricing, and fresh chicken volume down 2% with about a 2% increase in pricing. Whole muscle and ground beef saw volume increases in the past month as pricing finally began to ease up.

In our retail business, we have advantaged brands and advantaged categories, and we've regained share in Tyson value-added poultry following operational disruptions last year. We've also worked on closing pricing gaps to competitors in core Jimmy Dean and Hillshire Farm items to regain or to maintain share.

When we look at our retail IRI data, we focus on what we call our core nine business lines, which are Hillshire Farms smoked sausage, Aidells smoked sausage, Hillshire Farm lunch meat, Jimmy Dean frozen protein breakfast, Jimmy Dean breakfast sausage, Wright and Tyson Brand bacon, Ball Park hot dogs, Tyson Brand value-added poultry, and State Fair and Ball Park corn dogs. These are the biggest volume and dollar-driving categories for our retail business and we focus our resources to insure these brands and categories stay strong.

Looking at the core nine, sales dollars for the period ending November 8, whether you're looking at data for the latest month, the latest quarter or the latest year, grew in the 1% to 3% range. Volume, while flat for the year, grew 2% to 4% for the latest month and the latest quarter.

So, we feel good about the health of our core retail branded business and we're adding new platforms to sustaining innovation on top of the core. I mentioned the Hillshire Snacking and Ball Park jerky launches and both are doing very well.

The end market performance of Hillshire Small Plates is far exceeding projections. And the velocity of Hillshire grilled chicken bites is up substantially and performing well against competitors. The Ball Park jerky launch is going very well, too, and we believe we have a superior product that will drive repeat purchases.

We kicked off heavy C store channel selling in mid October and also began a national media and PR last month. Innovation will be a growth driver in 2016 across our retail categories. And we'll talk about specific products at our CAGNY presentation in February.

But one thing I'd like to tell you about now is the upcoming launch of Jimmy Dean bacon in early calendar 2016. Of course, we have Wright brand bacon, which is our premium stack-pack thick-cut bacon. And we also have Tyson bacon, which is a very good quality mainstream product with a loyal following. But we see room to expand loyalty for a premium L-board bacon behind the Jimmy Dean brand bolstered by our deep capabilities in sourcing, making and selling bacon.

Positioning Jimmy Dean in the bacon category is a great revenue synergy that came out of the integration of Tyson and Hillshire. And to be clear, we don't include revenue synergies in our total synergy numbers.

Speaking of total synergies, that is going extremely well and we see more opportunity. We're raising our synergy estimates for FY16 to more than \$500 million and for FY17 to more than \$700 million. The additional synergies will allow for more investment in innovation, new product launches, and strengthening our brands.



2015 was our first full year of having Tyson Foods and Hillshire Brands together as one company. At the time of the acquisition I said one plus one equals three and we're seeing that in our results. The integration has gone extremely well and we're just scratching the surface on what we can accomplish.

I don't think there's a food Company that's better positioned than we are and we will capitalize on the opportunities we've created. 2016 should be another record year with projected adjusted EPS of \$3.50 to \$3.65 a share. Dennis?

Dennis Leatherby - *Tyson Foods, Inc. - EVP and CFO*

Thanks, Donnie. And good morning, everyone. FY15 was another record year as we proved our diversified business model can generate strong steady cash flows. Our operating cash flow of \$2.6 billion allowed us to invest in our businesses, reduce debt, and resume meaningful share repurchases as we bought back \$250 million worth of shares in the fourth quarter and \$200 million so far in Q1 of FY16 for a combined total of \$450 million in more than 10 million shares.

FY15 adjusted revenues were \$40.6 billion, representing 9% growth compared to prior year, driven by a full year of Hillshire Brands results, offset by reductions from divestitures in our international operations. Total Company adjusted return on sales for FY15 was 5.5% and adjusted operating income was approximately \$2.3 billion, representing a 37% increase over FY14.

Our adjusted earnings of \$3.15 per share represents a 7% increase over our previous record of \$2.94 last year. As we described in our press release this morning live cattle futures experienced a large and rapid decline in September. This negatively impacted our us in the fourth quarter by \$70 million from losses on mark-to-market open derivative positions and lower cost or market inventory charges, which cost us approximately \$0.11 per share. To be clear, we have not added this back for adjusted EPS purposes.

We spent \$218 million on capital expenditures for the fourth quarter and \$854 million for the full fiscal year. This outpaced our depreciation by \$245 million in FY15 as we continued to invest in projects with a focus on delivering high return on invested capital.

On a GAAP basis our effective tax rate in FY15 was 36.3%. On an adjusted basis this was 34.3%.

In the fourth quarter we completed the sale of our Mexico operation and received \$374 million in net proceeds which were used to retire the 2015 notes. Net debt to adjusted EBITDA for the past 12 months was 2 times as expected. And on a gross debt to adjusted EBITDA basis this measure was 2.2 times.

Net interest was \$69 million during the fourth quarter and \$284 million for FY15. Including cash of \$688 million net debt was \$6 billion, down \$1.7 billion from Q4 of 2014. Total liquidity was \$1.9 billion, well above our goal of \$1.2 billion. Our average diluted shares for fourth quarter was 411 million.

Now looking forward here are some thoughts on FY16. We believe sales should be around \$41 billion, which represents approximately 1.5% organic growth as we offset the impact of FY15 divestitures. We expect to capture more than \$500 million in synergies, primarily from our prepared foods profit initiatives and Hillshire Brands synergies.

Net interest expense should approximate \$255 million. We currently estimate our adjusted effective tax rate to be around 35%. CapEx is expected to approximate \$900 million as we continue to focus on projects that will create long-term shareholder value. Prior to adjusting for any additional share repurchases, as well as changes in our stock price, which will impact the dilution from our tangible equity units, we expect our diluted shares in Q1 2016 to approximate 403 million based on our share price at the end of Q4.

This morning we reported our Board of Directors increased our quarterly dividend by 50% from \$0.10 to \$0.15 per share on our Class A common stock payable on December 15. This increase brings our dividend to \$0.60 per share annually for class A shares from \$0.40.

Beginning in FY17, 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 demonstrates our confidence in the enduring strength and stability of our cash flow.

As we have 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 through organic growth and operational efficiency capital projects with attractive returns, 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 credit ratings and strong incremental debt capacity.

We are confident that we will deliver continued growth in operating income and EPS in FY16. Chicken margins should be above 10%. Prepared foods margins should be near the low end of our 10% to 12% expected range. Pork margins should be in the normalized range of 6% to 8%. Beef margins should approximate the low end of the new normalized range of 1.5% to 3%.

Net debt to EBITDA should remain around 2 times as we return most of our free cash flow to shareholders through dividends and share repurchases. And we expect adjusted EPS in the range of \$3.50 to \$3.65 which represents 11% to 16% growth compared to FY15.

In closing, this has been an amazing year for Tyson 2.0. I would like to thank our team members for delivering record sales, record operating income, record EPS and record cash flows. I am proud of what we have accomplished together and look forward to our continued growth.

I'll now turn it over to Donnie for some closing remarks.

Donnie Smith - *Tyson Foods, Inc. - President and CEO*

We've wrapped up a record-setting year at Tyson Foods and we're off to a great start for 2016. From where we sit today, it looks like it will be another record year as we continue to deliver on our goal of at least 10% annual EPS growth over time. We're capitalizing on the benefits of our diverse portfolio and our branding power.

Our prepared foods business is performing very well and we'll be capturing even more synergies this year giving us fuel to drive growth. Our chicken business is strong. Pork continues to do well and we think the worst is behind us in beef.

We bought back \$250 million of our stock in Q4 and \$200 million so far in Q1. We're projecting strong cash flow and a positive outlook that will allow us to continue buying back our shares through 2016. And, as Dennis said, we've just increased our regular dividend by 50% and plan to continue increasing it by at least \$0.10 per share annually. We've got a lot of reasons to be confident and we think 2016 is going to be another great year of producing strong shareholder returns.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Our first question coming from the line of Adam Samuelson of Goldman Sachs.



Adam Samuelson - *Goldman Sachs - Analyst*

Great, thanks. Good morning, everyone. My question, Donnie, on guidance, a couple different pieces here -- first, I want to understand the guidance for the prepared food margins near 10% despite the fact that you've got about \$175 million of year-over-year synergies and very sizeable year-over-year raw material tail winds. Can you help us think about the scale of SG&A and reinvestment that you're doing in the business? And then, second, in chicken, help us bridge the 12% margins you did this year to around 10%-plus that you're expecting for next year. Thanks.

Donnie Smith - *Tyson Foods, Inc. - President and CEO*

Sure, Adam. On the prepared foods part, we'll take that first. Typically we spend 5% of sales in MAP. We're going to be spending a little over that this year as we focus on the Hillshire Snacking and Jimmy Dean launch and the new Jimmy Dean marketing campaign.

We're also investing in price gaps versus the competition. We've got some room in Jimmy Dean roll sausage. We've got price gaps in Hillshire Farms smoked sausage. And we need to get our lunch meat business -- we've just moved back the line pricing there as now we've got the turkey raw materials coming back to us from the AI. It's very important for us that we regain our volume growth in these categories. So we're going to be investing in trade and investing in MAP spending to drive our growth in those categories.

Switching over to chicken, you have a pretty cheap environment now with fresh meat trading pretty regularly below \$0.90 a pound delivered. You've got leg quarter markets trading sub \$0.20. And depending on how disjointed your logistics are, you're probably FOB the plant somewhere in the \$0.12 to \$0.13 range. That's a pretty soft environment for pricing. We've got a lot of volume that is in RFP now.

So, we feel very comfortable that we'll be better than 10% but we want to be cautiously optimistic until we get through this RFP season on our chicken business. But let me hasten on to say that our brands give us a good bit of insulation from our competition, plus our quality service and innovation helps set us apart. And we've done a lot in the last four years to optimize our poultry portfolio and to structure the pricing models within each part of that portfolio to deliver stable results. And that's what we think will happen again this year.

Adam Samuelson - *Goldman Sachs - Analyst*

That's very helpful. And then maybe as a follow-up, can you help us think through the export assumptions you're thinking about for early chicken, beef and pork, and how those are influencing your margin outlook?

Donnie Smith - *Tyson Foods, Inc. - President and CEO*

In chicken, we've actually forecasted sub \$0.20 leg quarters for the rest of the fiscal year inside of our projections. If we get a few of these AI closed markets to open up, that could be a little upside for us but we don't have that baked into the plan.

As we look at pork and beef, we're going to continue to see, based on our strong dollar competition from other regions around the world, you might think that we'll have maybe a little bit of growth in the beef export volume for the year, probably not expecting very much in pork, and then maybe you see chicken exports improve.

One thing to note, though, I think we mentioned in the last call or two that we were taking a lot of our beef items, like short plates and those kind of things, and rolling those into the trim stream. Those are now going back out into the export markets. They are going back into the markets at much lower pricing than they were before but it is better than the trim stream.

And one thing that -- I say one thing, there's been about three things, sorry -- one last thing I'd like investors to think about is we have not projected any impact for MCOOL. Depending on whether or not Congress fails to act or acts, and there are retaliatory tariffs, those would provide some cautionary note in our export sales. But we don't have anything forecasted for that And we also don't have any AI impact built into our projections. So, that's the view.

Adam Samuelson - *Goldman Sachs - Analyst*

Okay, that's very helpful. I'll pass it along, thanks.

Operator

Our next question is coming from the line of Diane Geissler of CLSA.

Diane Geissler - *CLSA Limited - Analyst*

First of all, congratulations on your quarter and just really your operations all year long. And thanks also for some of the details on your value-add portfolio and the break down consumer retail versus foodservice.

I just want to come back around on the chicken outlook and say that I think in the press release you said it was 2% from the USDA, but you actually expected it to be up a little bit more than that, and that foodservice could possibly see demand lower than supply. So, when we think about these breakdowns that you've given us, how much of that is already booked in with a guaranteed margin -- you've priced out a contract with a national account, you know what the margin on that will be in 2016? Can you provide us some color on what you know you've already booked versus maybe what's a little bit more open to the market as we get later in FY16?

Donnie Smith - *Tyson Foods, Inc. - President and CEO*

Difficult to answer with a lot of specificity, but let me say this. As far as what we would have booked today that have pricing set and has perhaps the cost in commodity futures underneath it, you're talking sub 20% of the portfolio. But we have a lot of our portfolio that is line priced, we have a lot of portfolio that has very short volume windows. So, if you ask me what is my expectation about how well we will do through pricing season and how well we'll be able to maintain at least 10% margins or better, I feel very good about that.

A couple of reasons. We've got the largest branded presence out there in the US in chicken. Our value-added portfolio, now we've got capacity around this to where we can continue to grow that. And, by the way, our buy versus growth strategy in a year like this is a competitive advantage because we're able to buy very cheap raw materials and then further process that into value-added items for predominantly foodservice but also some at retail.

We've got best-in-class quality. We've got best-in-class service. And I think that drives our customers to us to ask us to help them grow their categories. And we've got the innovation capabilities that they're looking for to continue to grow their business. That sets up very well for us and I'm very positive about our chicken business for 2016.

Diane Geissler - *CLSA Limited - Analyst*

Have you finished most of the fall contracting with the foodservice?

Donnie Smith - *Tyson Foods, Inc. - President and CEO*

No, it will take us about another 60 days or so to get through it. I can tell you that the early read is it's going pretty good.



Diane Geissler - CLSA Limited - Analyst

And just on the export, to follow-up on that question, it's been awhile since we've had a new AI case discovered on the back of the high path that happened earlier this spring. So, just based on your experience, how long does it take for the trade partners to open the doors? At what point will they look at it and say -- okay, there's no new cases, we don't expect anymore cases and now we're going to think about taking product from the US again?

Donnie Smith - Tyson Foods, Inc. - President and CEO

Historically it's been around six to nine months, although I can tell you we haven't very many. We're about nine months past March 5 now and we haven't had very many regions open the doors yet. There's a lot of trade negotiations going on. TPP is up in the air, you've got M-COOL up in the air. There's just a lot going on around trade.

I don't know how much that's impacting whether or not these countries open up. We feel very safe about our supply chain. I don't see any reason there for there to be any reason not to want to take great product from the US. I'd really hesitate to try to guess on when these things will open up. So, what we did, Diane, is we just put the current pricing in our year for the whole year and if anything breaks loose then it will benefit us.

Diane Geissler - CLSA Limited - Analyst

Okay, terrific. Thank you.

Operator

Thank you. Our next question is coming from Brett Hundley of BB&T Capital.

Brett Hundley - BB&T Capital Markets - Analyst

Good morning, gentlemen. Just two questions for me. Donnie, I can certainly appreciate your lowering your normalized range on beef just given challenges in recent years. But maybe to put this move into Wall Street jargon, I wonder if you're downgrading the segment at the bottom here.

One of your competitors in the space fairly recently was more bullish than I would have expected on the beef market going forward. I'm just wondering, if, as you add up the pieces, if you could potentially find yourselves above that new normalized range and back within your old range by 2017 or so?

Donnie Smith - Tyson Foods, Inc. - President and CEO

First, let me explain why we took the action we did. We really do feel it's important for our investor base to have a really solid understanding of what we feel the margin environment is going to be that we face out over the next few years. The relatively low cattle supply, you've got too much -- well, I should not say too much, that's probably not the right way to say it -- but you've got excess industry capacity and that limits our ability to drive margins above the 1.5% to 3%, we think.

I would say this, though, is that are there likely to be quarters out in those future years where we would see margins in the previous? Yes, I think you should expect that. But overall, for annual guidance, as we look forward for the next few years, this is the environment we think we'll be operating in.



Brett Hundley - *BB&T Capital Markets - Analyst*

I appreciate that. And then my last question is just on your prepared foods business. Just to maybe help me with modeling that top line better going forward, I was wondering if maybe you would separate out your legacy and Hillshire areas, or maybe even talk to the different parts of your prepared foods business, more about volume and price expectations going forward. You have a very vast business there.

When I walk the stores here in my area I see a fair amount of competitive behavior amongst all the participants. And you talked about your wanting to push volume growth. You've mentioned the synergy capture that you guys are garnering, which I think gives you a lot of fire power there. But I just want to understand top-line dynamics better on a go-forward basis between different areas of your business there.

Donnie Smith - *Tyson Foods, Inc. - President and CEO*

As you look at the prepared foods business -- and I'm going to be painting with a fairly broad brush -- it's relatively evenly split between retail and foodservice. So, if you think about our foodservice prepared foods business, let's look at that first, you've got predominantly a pizza toppings business and other ingredient meat combined with the portfolio of breaded products -- tortillas, flatbreads, that kind of thing -- and the former, if you will, bakery and sweet goods business from Hillshire Brands.

A lot of the meat in that portfolio is priced on a trailing basis to the market. So, as the markets go down, and we do expect cheaper pork raw materials, typically our pricing in prepared foods would go down, as well, but we would hang on to the margin and it would recover in some period of time. We've tried to shorten that window from 90-plus days to 45 to 60 days or so, and that should help stabilize the margin regardless of which way the market is moving.

The bakery and sweet goods business has a very stable low double-digit margin. So, again, there's opportunities for us to grow a bit in that category, although we do think that the largest potential is to continue to grow the meat business inside of prepared foods on the foodservice side.

Now, let's switch over to retail. We talked about the core nine on the script. And what we're seeing is -- let's take it apart just a little bit -- Jimmy Dean breakfast sausage, Hillshire Brands smoked sausage and our Hillshire Brands lunch meat have been the three categories where we need to drive volume. Let's go from the bottom up.

Hillshire farm lunch meat -- obviously our shortage of raw material in turkey has hurt our volume in that business. Now, frankly, we've been able to replace some SKUs with some additional ham skewers. We've been able to replace some of those SKUs with chicken lunch meat SKUs. But, overall, the absence of turkey has hurt our volume.

We're now in a position to where, after the first of the year, say, late January, something like that, we'll be back to full production in our turkey operation after the AI problems, and we'll have the raw material around us we need to reset our pricing in our turkey lunch meat to line pricing, and then drive promotional volume from there. So, feel great about our ability to get our price gaps right and grow that business.

In breakfast, Jimmy Dean breakfast sausage, the issue there is really around reestablishing price gaps to the competition to drive volume. We have a lot of promotional activity going on during this holiday season and we feel very good about our ability to drive our volume by getting these price gaps right. Frankly, some of our retail partners were a little bit slow in reflecting our pricing gaps at that level, so that has slowed our volume a bit, but we'll get there.

And then on rope, frankly, we're seeing unprecedented rope competitive pricing. We lowered our pricing gaps but probably need to do that again. And, fortunately, we've got lower raw materials and we've got increased synergies that gives us a lot of power to fuel the growth in these categories. I feel very comfortable that Andy and the team have a great focus on how to get the volume back and regain the share that we've given up. And I could not be more optimistic about our prepared foods business.



Brett Hundley - *BB&T Capital Markets - Analyst*

Thanks, Donnie.

Operator

Thank you. Our next question is coming from the line of Farha Aslam of Stephens Inc.

Farha Aslam - *Stephens Inc. - Analyst*

Hi, good morning. Donnie, could you talk about the synergy targets that you've set out. You've increased your long-term synergy target by \$100 million. Could you share with us what gave you the confidence and where you're finding that extra \$100 million of cost savings?

Donnie Smith - *Tyson Foods, Inc. - President and CEO*

Sure, Farha. Operational improvements through FY15 were more than we thought, and we see increased opportunity as we get into 2016 there in the operational improvement. We're just getting started on some of the network stuff. That's probably going to be more of a 2017 answer for us.

The purchasing synergies, as we've worked with a lot of our great supply partners we've worked on several packaging innovations, just rethinking a lot of the categories. And together with our supply partners, we're finding ways to lower our cost in a lot of these purchasing categories. And that has really been the increase that we see the most of in 2016. It is really a good story and it provides a lot of fuel to fuel our growth.

Farha Aslam - *Stephens Inc. - Analyst*

And just to be clear, are you including internally sourcing your meat for Hillshire in this 2017 number now?

Donnie Smith - *Tyson Foods, Inc. - President and CEO*

No not yet, Farha. We're still under contract with other suppliers with our former Hillshire Brands raw materials until those contracts run out. And that could be anywhere from 12 to 24 months we'll still be buying raw materials for that business from other folks.

Farha Aslam - *Stephens Inc. - Analyst*

That's helpful. And just as a follow-up, if we can think about Tyson's longer-term ROIC targets and how beef fits in with those targets with your new reduced beef margins, that would be helpful.

Donnie Smith - *Tyson Foods, Inc. - President and CEO*

I'll take a break and get a cup of coffee. (laughter)

Dennis Leatherby - *Tyson Foods, Inc. - EVP and CFO*

Farha, this is Dennis. Our longer-term goal would be to be at 20% ROIC overall. And just to give you a little bit of perspective around beef, even at a 2% return on sales, we would have about a 15% ROIC. So, 2.5% gets you pretty close to 20%. And we see no reason why we can't work our way toward it.



Farha Aslam - *Stephens Inc. - Analyst*

Okay, thank you very much.

Operator

Our next question is coming from the line of Ken Zaslow of BMO Capital Markets.

Ken Zaslow - *BMO Capital Markets - Analyst*

Good morning, everyone. Just a couple of follow-up questions. You recently closed one of your beef plants. How much operating profit or cost reduction will you get from that? How much does that add to your margin structure? I know that you took down the beef packer margin outlook but I would think that would be at least somewhere between 30 to 40 basis points incremental. How do you think about that?

Donnie Smith - *Tyson Foods, Inc. - President and CEO*

No, Ken, you'd be high there. Obviously it depends on the fundamentals in that region about the cattle that come to market and that kind of thing, but 30 is too high. As I think through this it's hard for me to put a number on it but you're high at 30, I promise.

Ken Zaslow - *BMO Capital Markets - Analyst*

Okay. And then the \$139 million associated with the bird flu and turkey, how much does that get recuperated next year and the year after, and how do you think about that?

Donnie Smith - *Tyson Foods, Inc. - President and CEO*

Quite a bit of that's tied up in the export markets not being able to ship. Obviously, I don't know the break out of the \$139 million and how much is the chicken export number versus how much is the actual turkey problems but the Turkey part of that should rebound as we get the plant full and we have the raw materials and we regain those sales. You should see that start flowing in. We've got it modeled in Q2 so you should see that flowing in then.

Ken Zaslow - *BMO Capital Markets - Analyst*

And just talking about pork a little bit, the pork packer outlook, it seems like we're flush with plenty of hogs out there. The reason I'm assuming that you're keeping it within the guidance range is because the export markets are still influx. Is that a fair way of thinking about it? Because the domestic side of the pork outlook seems exceedingly strong. How do I look into that?

Donnie Smith - *Tyson Foods, Inc. - President and CEO*

You hit the nail on the head, Ken. We feel very good about pork. There's going to be good hog availability. Which, by the way, provides good, cheap raw materials for our prepared foods business.

But this is just a cautionary note on exports and the high dollar and competition from other regions in the world for some primary markets. So, that's the cautionary note there. If some of that changes then obviously there's upside in our pork segment.

Ken Zaslow - *BMO Capital Markets - Analyst*

Great, I appreciate it, thank you.

Operator

Thank you. Our next question is coming from the line of Michael Piken of Cleveland Research.

Mike Henry - *Cleveland Research Company - Analyst*

Hi, this is Mike Henry, actually, in for Michael Piken. Thanks for taking my question. You highlighted some of the near-term contracts that are more under negotiation with chicken. I was wondering if you could comment on what percent of the contracting has already been completed for the year that might be a little bit of a tail wind as you go in over the next several quarters.

Donnie Smith - *Tyson Foods, Inc. - President and CEO*

It's hard to say, Mike. My guess is, of the volume that is RFP'd, maybe 10%, 15% at most, something like that -- now, you've got to remember, there's a lot of different pricing models that we have, some where we have guaranteed volume and we relook at the price every 30, 60 or 90 days. We've got a good bit of our chicken business that's just line priced. But of that volume that will go through RFPs, I'm guessing you're in the low double digits. There's a lot yet to come there.

Mike Henry - *Cleveland Research Company - Analyst*

And then just one follow-up, if I may, going back to the question on the market being oversupplied potentially for chicken. Given where prices are today, do you think that we're seeing this? And then when we're in this oversupply situation how is Tyson adjusting or reacting? Thank you.

Donnie Smith - *Tyson Foods, Inc. - President and CEO*

Our reaction is to ramp up our buy versus grow strategy. We're buying a lot of raw material these days. We're buying breast meat sub \$0.90 delivered to our plants. So, we've got the opportunity to take advantage of this outside raw material in an oversupplied situation to supply our value-added businesses.

As we said in the script, about 90% or so of our volume is really consumer pull and only about 10% is pushed out. We don't sell very much CDP breast meat. We're working hard every day to value up our leg quarters and not have any leg quarters to sell. It's a time like this when our buy versus grow strategy really helps us maintain our stable margins.

Mike Henry - *Cleveland Research Company - Analyst*

Thanks.

Operator

Thank you. Our next question coming from the line of Robert Moskow of Credit Suisse.



Robert Moskow - *Credit Suisse - Analyst*

Hi, thanks. A couple questions. Donnie, when you say only 10% of your volume is pushed out, is that a good proxy for saying only 10% is exposed to commodity pricing on a regular basis? Like, if I just made a blanket statement that commodity prices are going to be down 25% year over year, could I apply that to that 10% to figure out commodity exposure for chicken? And then I had a quick follow-up.

Donnie Smith - *Tyson Foods, Inc. - President and CEO*

I think I'd rather you think about the 15% of our sales that are CDP breast meat, leg quarters and our rendering products, those are the ones that have the most commodity exposure. Now, there's also a minority portion, for example, of our fresh tray pack business that gets priced off the Georgia dock. So, there are some market influences in those businesses. But in terms of just commodity exposure, probably think of the 15% of our portfolio and not the larger percent.

Robert Moskow - *Credit Suisse - Analyst*

Okay. And then the follow-up is two-fold. You said about 20% of the volume you've got good visibility on in terms of locking in margins. I think that's what you said. Is that typical for this time of the year? Are you ahead or is that about average? How does that compare to last year?

And then, also, how do I think about the \$100 million improvement in your grain costs? How much of that are you able to drop to the bottom line?

Donnie Smith - *Tyson Foods, Inc. - President and CEO*

Two great questions. Yes, this year is about like every other. So, we're going through about the same amount of RFP that we went through last year. Again, let me reiterate that it's going pretty good so far. Still got some room to go but going pretty good. The second part of your question, remind me of that again?

Robert Moskow - *Credit Suisse - Analyst*

The grain.

Donnie Smith - *Tyson Foods, Inc. - President and CEO*

Oh, yes, the grain. One thing that we always do is look at opportunities to lock in margins when we do get pricing contracts established. So, we'll look at that. So, it's hard to say this early about how much of the impact of that \$100 million will drop to the bottom line until we get through this big RFP season because if we can get the chance to lock in our margins underneath that, we will. But -- that's probably enough.

Robert Moskow - *Credit Suisse - Analyst*

Okay, thank you.

Operator

Our next question is coming from Ken Goldman of JPMC.



Ken Goldman - JPMorgan - Analyst

Good morning, everybody. Forgive me if this was asked, I didn't hear it. Industry-wide we are seeing some extraordinarily strong beef and pork processing margins the last few weeks, if not more. And I recognize that, just as we saw this past quarter with beef, sometimes it's hard to translate what we're seeing industry-wide to what a specific company's margins will be.

But as we model out the year, is it reasonable for us, at least in these two segments, to give a little bit more juice to the first half of the year, or at least the first quarter, just given some of the timing and what we are actually seeing in the market today? Because some of the margins we're seeing are just extraordinarily high and unusual for this time of the year.

Donnie Smith - Tyson Foods, Inc. - President and CEO

Probably able to do that in pork. I'd be cautious about doing that in beef. We had a pretty good October but here in the middle part of November, beef cut out has dropped quite dramatically. I don't know what Friday's close was but it's probably going to be around 2.05 or something like that and dependent on where cattle are North versus South. Sometimes it takes you a little while to get that change reflected in the cost of the cattle.

Beef, my guess is that you're probably more back-end loaded. Cattle, we saw the cattle and feed numbers Friday, our estimates would be that the increase in fed cattle coming to market this year would be in Q3 or Q4. So, you're probably a little front-end loaded, maybe, in pork, and a little back-end loaded in beef, is the way I'm thinking about it.

Ken Goldman - JPMorgan - Analyst

All right, that's helpful. And then a follow-up, if I can, on beef. It's obviously been an unexpected, at least from our perspective, drag on earnings the last two quarters. I think you guys have hinted -- and this is my interpretation, you have said it -- but if you wanted to divest it, if you decided -- this business is an albatross on our evaluation, let's just punt it -- do you think there would be a robust, even diverse, group of suitors for the business? Or would it be really challenging to find someone interested and maybe even able to take a look at it from an anti-trust perspective? I'm just curious what the market might be for something like that out there, if you can even answer that.

Donnie Smith - Tyson Foods, Inc. - President and CEO

No, I can't answer that. No.

Ken Goldman - JPMorgan - Analyst

All right, well, I gave it a shot. Thanks.

Operator

Thank you. Our next question is coming from Tim Ramey of Pivotal Research Group.

Tim Ramey - Pivotal Research Group - Analyst

Thanks so much. Donnie, you mentioned getting started on some of the network stuff to be a FY17 event. Can you flush out a little bit what that means for us?



Donnie Smith - *Tyson Foods, Inc. - President and CEO*

Sure. That wasn't such a technical term was it, Tim? We're in the process now -- you saw our announcement last Friday -- of optimizing the production footprint. We'll be moving lines of products within that footprint to optimize the logistics around the raw material and optimize the cost of the production. From that point, then, the next move is to really look out into the distribution network and make sure that we have the right nodes of distribution, both from a hub-and-spoke and from a forward positioning basis, to optimize our transportation cost and our service offering.

Once we get the production footprint established -- largely, it won't be perfect -- then we will begin working on the distribution network. There's a couple things that we're starting to focus on now around rationalizing some of the SKUs. We've got some end-to-end opportunities between primarily our pork business but, to some small extent, our beef business and our prepared foods business to continue to work to optimize cost inside that network. All of that, we will begin working on that in 2016 but largely the effect of those changes will happen in 2017.

Let me hasten on to say, too, that we've got work inside our chicken business, as well. We've just completed the conversion in South Georgia to tray pack. We've got a lot of FP capacity around us now, so we're able to go out and bid on business that we weren't able to bid before. Our antibiotic-free business continues to grow. As those grow, that will help us optimize the production and the distribution network, as well. Hope that clears it up a little bit.

Tim Ramey - *Pivotal Research Group - Analyst*

Just a follow-on on beef, with the timing difference relative to the price decline in the futures market, it doesn't sound like you're saying that's recopied in the Q1. Is it more of we should think about that as coming back into the numbers throughout the FY16 year or how should we think about that?

Donnie Smith - *Tyson Foods, Inc. - President and CEO*

Yes, I would spread that cost throughout the FY16 year. We sell boxed beef out front and buy cattle futures against it to lock in the margin. Some of those contracts are fairly well out through the year, so just spread that cost on through the rest of the fiscal year.

Tim Ramey - *Pivotal Research Group - Analyst*

Okay. And we used to talk a lot about pie season back in the day. Anything to say about the sweet goods sales?

Donnie Smith - *Tyson Foods, Inc. - President and CEO*

It's going well. We did have a problem which, Tim, you know my background, it would be hard for me to think about a sweet potato problem, but the flooding that we had in South Carolina actually disrupted our supply chain a little bit on sweet potatoes. We had a great team around that, worked through it very well, and I think did as good as we could to get as much of our volume into the marketplace as we can. We just had some heroic efforts on the part of that business and our supply chain. So, yes, it's going pretty well.

Tim Ramey - *Pivotal Research Group - Analyst*

Okay thanks.

Operator

Thank you. Our next question is coming from David Palmer of RBC Capital Markets.



David Palmer - *RBC Capital Markets - Analyst*

Thanks, good morning. As a follow-up about buy versus grow you mentioned the purchase mix can shift up to 10% or so over time. Any sense of where that stands now? And has that been evolving already as you head into 2016?

Donnie Smith - *Tyson Foods, Inc. - President and CEO*

We're a little bit shy of the 10% now. It's pretty easy for us, frankly, to buy about 100 loads a week. Most of that will be breast meat. Some will be breast meat portions.

And then if wings were to soften up and we had good promotional volume for next spring's wing season we will always be out there buying wings and a few tenders when they're available. Typically the size tenders that we need aren't very readily available. So, mostly think breast meat. But, yes, we do spread that around to the other raw materials when we can use them.

David Palmer - *RBC Capital Markets - Analyst*

Has your team guessed where the chicken industry profit margins would be around as we exit 2015? Is the segment up low single digits in margin or so?

Donnie Smith - *Tyson Foods, Inc. - President and CEO*

David, honestly, we spend all of our time just focusing on our customers and our margins. We don't spend a whole lot of time trying to figure out what the industry is doing.

David Palmer - *RBC Capital Markets - Analyst*

And then just one small question about the dollar, it feels like the strong dollar. And we often talk about the AI trade restrictions. But the strong dollar is perhaps holding back your earnings in indirect ways, like limiting chicken export and encouraging beef imports from Australia. Could you comment on that? And if the dollar does stabilize, is that at least removal of a negative?

Donnie Smith - *Tyson Foods, Inc. - President and CEO*

Very much so, removal of a negative. And I would say that today the dollar impact is probably having more of an impact on pork and beef exports than it would chicken. I feel comfortable that if the export restrictions based on AI were relieved then we could increase our exports in chicken pretty readily. So, the dollar wouldn't necessarily impact the chicken as much, but on pork and beef, yes.

David Palmer - *RBC Capital Markets - Analyst*

Thank you very much.

Operator

Thank you. And that ends our Q&A session. I'll hand it back over to Donnie for closing comments. Thank you.



Donnie Smith - *Tyson Foods, Inc. - President and CEO*

Thanks, everyone, for joining us today and certainly for your interest in Tyson Foods. We wish you all a very happy Thanksgiving. Have a good day.

Operator

Thank you and that concludes today's conference. Thank you all for joining. You may now disconnect.

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