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Q2 2019 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day, and welcome to the Tyson Foods, Incorporated Second Quarter 2019 Earnings Conference Call and Webcast. All participants will be in listen-only mode. [Operator Instructions] After today's presentation, there will be an opportunity to ask questions. [Operator Instructions] Please note, this event is being recorded.

I would now like to turn the conference call over to Mr. Jon Kathol, Vice President of Investor Relations. Mr. Kathol, the floor is yours, sir.

Jon Kathol

Vice President-Investor Relations, Tyson Foods, Inc.

Good morning, and welcome to the Tyson Foods, Incorporated earnings conference call for the second quarter of fiscal 2019. On today's call are Noel White, President and Chief Executive Officer; and Stewart Glendinning, Chief Financial Officer. Slides accompanying today's prepared remarks are available as a supplemental report in the Resource Center of the Tyson Investor website at ir.tyson.com.

Tyson Foods issued an earnings release this morning, which has been furnished to the SEC on Form 8-K and 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 risks 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.

I would like to remind everyone that this call is being recorded on Monday, May 6 at 9:00 a.m. Eastern Time. A replay of today's call will be available on our 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 expressed written consent of Tyson Foods is strictly prohibited.

Please note that our references to earnings per share, operating income, and operating margin in today's remarks are on an adjusted basis, unless otherwise noted. For reconciliations to our GAAP results, please refer to this morning's press release.

I'll now turn the call over to Noel White.

Noel W. White

President, Chief Executive Officer & Director, Tyson Foods, Inc.

Thank you, Jon, and good morning, everyone. Our earnings of $1.20 per share and a 6.3% operating margin demonstrate the strength of our diversified business model. The Prepared Foods segments results were a Q2 record, and the Beef and Pork segments executed well despite several significant weather events. Although parts of our Chicken segment have challenges, we are past what is typically our toughest quarter and we're driving changes to improve our results.

As we move ahead with the integration of Keystone Foods, I continue to be encouraged by the opportunities we see both domestically and internationally. The integration process has gone well, and we're leveraging the international operation and the team's expertise as they strengthen our capabilities. We're confident in our ability to achieve our announced synergies as we improve efficiencies and optimize supply chain and production resources.

Pending regulatory approvals, our acquisition of BRF's Thai and European poultry operations is expected to close in our fiscal third quarter, and we're looking forward to this addition to our growing international business.

Moving to our segments, in the second quarter, Prepared Foods continued to perform very well with a $249 million in operating income and a 12.3% return on sales, which is yet another record. Prepared Foods was up 16% in operating income and relatively flat on volume and average price when excluding the divestitures of several non-core businesses last year.

Our year-over-year increase in MAP spending and innovation investments have resulted in volume growth and net share gains. Our Core 9 categories are up an impressive 5.3% in volume over the last 13 weeks, and all categories are showing year-over-year increases. An example of this growth is Jimmy Dean frozen breakfast foods which continues to grow at impressive rates, with volume and dollars up over 6%.

We expect our Prepared Foods input costs to increase in the third and fourth quarters as beef and pork prices rise on concerns of the African Swine Fever outbreak in China. Our plan is to recover these additional costs through pricing, but it will take some time. As a result, we're adjusting our annual outlook for this segment to be between 10% and 12% return on sales.

A key advantage of our end-to-end supply chain is that we can supply raw materials for value-added divisions and our customers when supplies are tight. As we previously announced, we're launching our full-scale initiative to enter the alternative protein space. We'll be introducing products this summer and early in the next fiscal, and we're well positioned to capture growth in this space. We have a deep understanding of how to develop new products, brands, and categories, and our distribution reach will allow us to move quickly into the marketplace.

I'll move on to the Beef segment, which is performing well, having an operating income of $156 million and a 4% margin in what is typically our most volatile quarter. Average price was up 2.3% and volume increased 3.2% compared to the second quarter last year on improved cattle availability and strong demand. The herd rebuilding continues, and we see ample cattle supplies into 2021. The quality of cattle has improved with record Choice and Certified Angus grading, indicating improved genetics which aligns with our growing premium beef programs.

We recently announced that we would be using DNA technology to trace beef back to the individual animal of origin for our Open Prairie Natural brand of Angus beef. The process will assure customers that their Open Prairie beef was sourced from ranches where cattle were raised to specific requirements such as no antibiotics ever and no added hormones.

Global demand for high-quality beef continues to be strong, and we expect our international beef sales to grow in the second half of the fiscal year, contributing to the Beef segment's margins of approximately 7% for the year.

Turning to the Pork segment, operating income was $100 million with an 8.5% margin. Average price was down 8.3%, while volume was up 1% due to the improved availability of live hogs.

News of African Swine Fever in China, along with the increased slaughter capacity in the United States, had a near-term impact of driving up hog costs that initially outpaced the value of pork. We're achieving reasonable returns despite the headwinds while improving our spread to the USDA industry benchmarks versus a year ago. Our ability to execute well is due in large part to record high retention of our frontline team members which has improved both safety and performance.

We currently project the Pork segment's operating margin for the fiscal year to exceed 6%. It is difficult to predict when ASF might positively impact our Pork business. However, we believe any financial benefit will likely occur in late 2019 or later. We are well positioned to be agile and meet customer and consumer needs internationally and domestically.

In the Chicken segment, operating income was $150 million with a 4.4% margin. Volume was up 26.2% and average price was down 11%, primarily attributable to the acquisition of the American Proteins rendering business last year that added considerable volume at relatively low prices.

In the second quarter, pricing began to improve as ASF news drove incremental demand for chicken. We are in a solid position to improve pricing as we talk to customers about contracts in 2019 and into 2020. The big and small bird businesses performed well, offsetting some of the trade pack underperformance and earlier market weaknesses.

In addition to the benefit of moderating grain prices, we have identified opportunities and several initiatives are underway to significantly strengthen the Chicken segment's results. Led by the iconic Tyson brand, our Chicken business has a great foundation, great products, and a robust pipeline of innovation. The Chicken segment is improving, and we're expecting an operating margin of around 6% for the year and continued improvement into 2020.

That concludes my commentary on the business segments. Now, Stewart will take us through the financials.

Stewart F. Glendinning

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

Thanks, Noel, and good morning, everyone. Second quarter EPS of $1.20 was down 6% compared to Q2 2018. Revenues were up $670 million to $10.44 billion. Volume was up 11.6%, and average price was down 4.8% as acquisitions and divestitures affected sales volume and changes in product mix affected pricing in what is typically our most challenging quarter.

Operating income was $654 million, down 5.4% compared to the second quarter last year. Total company return on sales was 6.3% for the quarter driven by continued headwinds in parts of our Chicken segment, partially offset by growth in Beef, Pork, Prepared Foods and Other.

The Keystone acquisition has performed as expected in the short time we've owned it. It is right at breakeven on a cash accretion and income basis. As a reminder, we successfully secured our permanent funding for the acquisition during the second quarter through issuance of senior notes with an average maturity of approximately 16 years.

Our operating cash flows for the quarter were $71 million, which were about what we expected due to deferred capital in hog payments and two tax payments that are typical to our second quarter.

During the second quarter, we repurchased approximately 1 million shares for $63 million. We also directed $338 million toward capital expenditures as we continue investing in growth and efficiency projects with expected returns greater than the cost of capital. Our effective tax rate for the second quarter was 18.5%.

Net debt-to-adjusted EBITDA was 2.9 times. Including cash of $360 million, net debt was $12 billion, and total liquidity was $1.9 billion at the end of Q2. Net interest expense was $114 million. Weighted average shares outstanding in Q2 were approximately 366 million.

For the remainder of the fiscal year, our primary capital allocation priority will be our debt. We have $300 million coming due at the end of this month and $1 billion in August. We expect to address those with our cash flows as well as existing or new short-term liquidity as needed to align with the timing of the maturities. In addition, we will continue to deploy capital for organic growth through CapEx in the range of $1.3 billion to $1.4 billion for the year. We plan to scale back our spending to the $1.1 billion to $1.3 billion range in fiscal 2020, while spending at a rate higher than depreciation.

And finally, I'll update our outlook for 2019 which includes Keystone but doesn't yet include the BRF operations as that transaction has not yet closed. We expect sales to grow to approximately $43 billion with the addition of Keystone. Keystone is expected to be accretive on a cash basis for the year and breakeven on a pre-tax basis when excluding transaction and integration costs. The additional amortization for Keystone will be about $26 million for the 10 months of fiscal 2019 and approximately $35 million per year in fiscal 2020.

Net interest expense should approximate $450 million. Liquidity is expected to remain above our $1 billion minimum target. Our effective tax rate is expected to be around 22.5% for the year, and we're maintaining our earnings guidance of $5.75 to $6.10 per share.

The potential financial impacts of ASF have not been included due to the uncertainty of the timing. Much is uncertain where ASF is concerned, but we are proactive in our preparedness as a global business and in a strong financial position that affords us the agility and opportunities that few other companies have. Broadly speaking, we expect the impact of ASF to be positive for Tyson.

Now, we'll return to Noel for additional commentary. Noel?

Noel W. White

President, Chief Executive Officer & Director, Tyson Foods, Inc.

Thank you, Stewart. This is an unusual, perhaps unprecedented, time for the protein industry. In my 39 years in the business, I've never seen an event that has the potential to change global protein production and consumption patterns as African Swine Fever does. The situation is fluid and fast moving, but we're working with others in the industry, government agencies, and producers to prepare in the event ASF spreads to North America.

A worldwide decrease in pork supply could put pressure on our Prepared Foods business by increasing raw material costs while offering significant upside to our Pork, Chicken, and Beef businesses. The power of our diversified business model and broad product portfolio across multiple geographies will be even more important under these circumstances.

Thinking back to similar instance like PEDV in 2013 and BSE in 2003, we've been able to manage through difficult situation and maximize opportunities when continuity of supply becomes even more important. I believe there is no company better positioned than Tyson Foods to handle what lies ahead.

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

QUESTION AND ANSWER SECTION

Operator: Hey. Thank you, sir. We will now begin the question-and-answer session. [Operator Instructions] The first question we have will come from Ben Bienvenu of Stephens Inc. Please go ahead, sir.

Ben Bienvenu
Analyst, Stephens, Inc.

Q

Thanks. Good morning.

Noel W. White
President, Chief Executive Officer & Director, Tyson Foods, Inc.

A

Hi, good morning.

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

A

Good morning.

Ben Bienvenu
Analyst, Stephens, Inc.

Q

Noel, I wanted to follow up on your concluding comments that you made on African Swine Fever. So you've decided not to update your guidance this morning with respect to ASF, which is understandable given the timing of the impact is tough to gauge. But the comments you did provide were pretty constructive, so I'd love to hear any comments that you can make about what you guys are doing operationally and strategically to position yourselves for the event.

And then if you could provide any more detailed thoughts on each of the major segments with respect to ASF, that would be helpful for us.

Noel W. White
President, Chief Executive Officer & Director, Tyson Foods, Inc.

A

Okay. Ben, it is a matter of timing and how that impacts both 2019 as well as 2020, and I do think that Tyson Foods is uniquely positioned in all of our proteins, in our Beef business, our Pork business, our Chicken business, because you don't have an incident like this where there's some place in the vicinity of 150 million to 200 million hogs that have died in China that there's not a significant impact.

That correlates to about 10 million metric tons of product that has come out of the marketplace from a total protein global supply that's something in the area of 5%. But it's an event that I've never seen happen before that we are well positioned to deal with that in all three proteins.

There's a couple of things that we're doing, Ben, in reaction to that. First and foremost, we want to make sure that this disease doesn't reach the United States. So there has been activity with the industry and the U.S. government to ensure that we're doing everything possible to keep the disease out of the United States and then react to that if in fact it does hit the United States. So, it is an opportunity, I would tell you, for not just our Pork business, but all three species.

Ben Bienvenu
Analyst, Stephens, Inc.

Q

Great. That's helpful commentary. And my second question is related to the Prepared Foods business. Obviously, a strong first half with respect to operating margins, but you've maintained your full year guidance range of 10% to 12%. In light of the strong results that we've seen in the first half of the year, I think to get to the bottom end of that range we would have to see in the ballpark of 8% margins. So, I'm curious, particularly, given that the full year guidance doesn't yet reflect ASF, which you noted pressure profitability, just any commentary you can provide on the Prepared Foods business as we move through the rest of the year would be helpful.

Noel W. White
President, Chief Executive Officer & Director, Tyson Foods, Inc.

A

Yeah, Ben, I'll go back to my original comment on timing. Really, we have seen pork prices start to move in reaction to ASF, but hog prices have risen faster than what product prices has. When product is in fact produced on a large scale for China, that product will come out of the U.S. market and prices are expected to escalate fairly rapidly. So, it's a matter of predicting when that might take place, whether that's Q3, Q4 of our fiscal year, or into calendar 2020. So, the 10% to 12% range that we've given, that is down slightly from where we're at, and it is in anticipation that pork prices will begin rising through Q3 and Q4.

Ben Bienvenu
Analyst, Stephens, Inc.

Q

Understood. Thanks. Best of luck.

Operator: Next, we have Alexia Howard of Bernstein.

Alexia Jane Howard
Analyst, Sanford C. Bernstein & Co. LLC

Q

Good morning. So, my first question is about the Walmart announcement of plans to backward integrate on the Angus beef supply, and I'm just wondering this tendency for the retailers to make those kinds of backward integration moves – we've had Costco doing something in chicken as well. How do you think about that and how do you make sure that strategically Tyson can continue to win even as the retailers start to think about those kinds of moves?

Noel W. White
President, Chief Executive Officer & Director, Tyson Foods, Inc.

A

I think we win by continuing to service them to the greatest extent possible with great product and service, and I hate to comment on any specific customer, but Walmart has been a very strong customer of ours for many, many years. It is a segment that is extremely complex. We will work with them to the extent that we can in assisting in any way. But our business is strong with Walmart and they've been a great partner for many years.

Alexia Jane Howard
Analyst, Sanford C. Bernstein & Co. LLC

Q

And then just as a follow-up, the plant-based – you talked about an upcoming launch of, I guess, a second-generation of plant-based, I'm assuming, burgers or something similar. Do you already have an idea of how quickly you'll be able to scale distribution on those products? And what's the kind of feedback that you're getting from the retailers on that front?

Noel W. White
President, Chief Executive Officer & Director, Tyson Foods, Inc.
A

The product will enter the market yet this summer, Alexia, on a fairly limited basis and on a much larger scale later this fall. So, we will be introducing the product this summer in a fairly limited basis and then on a much larger basis once we get into October and November.

Alexia Jane Howard
Analyst, Sanford C. Bernstein & Co. LLC
Q

Great. Thank you very much. I'll pass it on.

Noel W. White
President, Chief Executive Officer & Director, Tyson Foods, Inc.
A

Thank you.

Operator: The next question we have will come from Heather Jones of the Vertical Group.

Heather Jones
Analyst, The Vertical Trading Group LLC
Q

Good morning.

Noel W. White
President, Chief Executive Officer & Director, Tyson Foods, Inc.
A

Good morning, Heather.

Heather Jones
Analyst, The Vertical Trading Group LLC
Q

So I have a quick question on your Pork business. I was honestly a little surprised to see you raise your guidance there, and you mentioned something about improving your spread to USDA benchmarks, because Q3 to date margins have been contracting. So I was just wondering have you reworked some of your hog contracts or can you help us understand how you've been able to improve your relative performance and have that confidence? Because you made a comment in your release about hog prices running faster than the cutout, but then you raised your guidance for the year, so just could you help us understand the thought process behind that?

Noel W. White
President, Chief Executive Officer & Director, Tyson Foods, Inc.
A

Yeah, the Pork business continues to operate extremely well, Heather. As I've mentioned, our turnover numbers are down. Our safety numbers are greatly improved, productivity is much better, so operationally we're performing exceedingly strong. However, the markets, they have risen substantially, both the hog markets as well as product markets. We saw the effect of that in Q2. We're seeing that in the beginning of Q3 that according to public information, margins are less than what we would like right now. However, we do believe that as we move through Q3 into Q4 and particularly in Q1 of next year, margins will become much, much stronger.

Stewart F. Glendinning
Executive Vice President & Chief Financial Officer, Tyson Foods, Inc.
A

Yeah, Heather, it's Stewart here. One other quick comment that's worth noticing is that you'll – obviously as we project the back half of the year, we have the benefit of knowing what came in the first half of the year. We had a strong Q2. We came in at better than 8% in Q2, so that factors into our confidence for the full year despite the pressure that we're seeing in Q3.

Heather Jones
Analyst, The Vertical Trading Group LLC Q

Okay. Thank you. And then my follow-up is on the Chicken business. So, this is I think the second time that guidance has been tweaked, and it's also the second time that Tyson's second quarter that Tyson's margins have sort of moved in the opposite direction of the industry. So I was wondering if you could help us understand what is going on there and what is being done to address it? Did the demand catch you off guard and you had to buy more product from the outside market, or just help us understand what's going on and how that's going reverse course into late 2019 and 2020.

Noel W. White
President, Chief Executive Officer & Director, Tyson Foods, Inc. A

Yes, Heather. No, there wasn't anything specific that affected the Chicken business. I would tell you that as we came through Q2 that was seemingly the low in the market as it often is. Prices have strengthened as we've moved through Q3 – or Q2 into Q3, and I alluded to the fact that there are a couple of issues in one specific segment in our business that is in the process of being addressed, but it's purely driven by market factors primarily, as well as to a lesser degree some performance issues.

Stewart F. Glendinning
Executive Vice President & Chief Financial Officer, Tyson Foods, Inc. A

Yeah, one other thing I'd just throw in there, Heather. You saw in Q3 and we don't normally get into all of our mark-to-market, but in this quarter versus last year, last year we had a gain in our mark-to-market hedging on grains. We had a loss this year, and the delta between those two had the impact of a couple of percent on our numbers. So that's worth noting as you consider what went on in the quarter.

Heather Jones
Analyst, The Vertical Trading Group LLC Q

A couple of percent, like on the percentage basis, is it like 200 basis points of margins or a couple percent on the absolute dollar amount?

Noel W. White
President, Chief Executive Officer & Director, Tyson Foods, Inc. A

On the margins.

Heather Jones
Analyst, The Vertical Trading Group LLC Q

Okay. Thank you so much.

Stewart F. Glendinning
Executive Vice President & Chief Financial Officer, Tyson Foods, Inc. A

But it's meaningful.

Heather Jones
Analyst, The Vertical Trading Group LLC

Q

Okay. Thanks.

Operator: Next, we have Ben Theurer of Barclays.

Benjamin M. Theurer
Analyst, Barclays Capital Casa de Bolsa SA de CV

Q

Hi, good morning, Noel and Stewart. Thank you very much for the call. So, just quickly following up on Heather's question in regards to the Chicken segment, so clearly, you've done the acquisition with Keystone, pending Brazil Foods. I'd say timing was very good on those acquisitions.

Now, looking on how things evolve and obviously now you getting this more international footprint, could you elaborate a little bit on your expectations for that Chicken segment once you start integrating several of the businesses, and the opportunities you're seeing in terms of be it margin stability or just growth opportunities in the Chicken segment also in the light of most likely people or some customers switching from Pork into Chicken. So just a little bit an update on what you're seeing with Keystone and then later at a stage with Brazil Foods, that would be my first question.

Noel W. White
President, Chief Executive Officer & Director, Tyson Foods, Inc.

A

Yeah, Ben, the integration work has gone extremely well through both the domestic as well as the international parts of our business. There have been nothing disruptive I would say that – it is exactly on plan. Domestically, it's a very stable business for us. The margin structure is relatively stable. It complements some of the other businesses that we currently have.

On the international basis, it solidifies the position that we have in China. It gives us a strong foothold in Thailand as well as other parts of Southeast Asia. So, it's been no surprises so far and has delivered according to plan.

Benjamin M. Theurer
Analyst, Barclays Capital Casa de Bolsa SA de CV

Q

Okay. Perfect. Thanks for that. And then a follow-up would be on Beef. I mean, clearly, there's been a little bit of short-term volatility in cattle pricing because of the weather disruption we had at the beginning of the year. It was just too cold and all those kind of things, so it was surprisingly strong still the margin throughout the quarter. So what have you done in terms of securing some of the live supply and how do you feel in terms of the third and particularly then also the fourth quarter in terms of input cost? And if you look further out, how do you think the whole Beef business is going to turn out, because that's been one of the very strong segments lately, so I would assume that it's going to continue to be the case. But is there anything you've been doing in terms of contract hedging and so on just in order to secure some of the supply here, and what have you done particularly in the quarter to maintain margins at that relatively strong 4% level.

Noel W. White
President, Chief Executive Officer & Director, Tyson Foods, Inc.

A

Okay. From a supply standpoint, Ben, there's nothing unique that we have done most recently. Many of our source of supply are long-term in nature, so either we have formal contracts or informal, so the Beef business has evolved to a large extent over the course of the last 10 years or so where there is a greater knowledge of where the cattle are going to come from as well as from the producer side the fact that they know that we're looking for unique characteristics in some of the cattle.

So, the evolution has been that we have a number of customer agreements and we have to source the cattle that aligns with the type of product that they're looking for. So to do that, we have long-term supply agreements. So with that, I don't see any substantial change as we look at our Beef business. Q3 and Q4 are typically strong quarters for us, and I would expect the same thing this year.

So, as we came through Q2, as you said, it's often the most volatile quarter. There was weather disruption, but as we look into Q3, Q4, it looks like there's both good supply of cattle in the regions in which we operate as well as strong demand going into Q3 and Q4. And I would say the same outlook for 2020, that there's nothing on the horizon at this point that would change that. If anything, it could be stronger than what 2019 has been.

Benjamin M. Theurer
Analyst, Barclays Capital Casa de Bolsa SA de CV

Q

Okay. Perfect. Well, thank you very much.

Noel W. White
President, Chief Executive Officer & Director, Tyson Foods, Inc.

A

Thank you.

Operator: And the next question we have will come from Robert Moskow of Credit Suisse.

Jacob Nivasch
Analyst, Credit Suisse Securities (USA) LLC

Q

Hi. Thank you. This is Jake Nivasch on for Rob. Just a couple of quick questions. So, several years ago, I think you guys reduced your exposure to the chicken export market to reduce commodity volatility, and I guess going forward, do you guys need to operate differently in order to capitalize on the rising export demand related to ASF? And then I have a follow-up.

Noel W. White
President, Chief Executive Officer & Director, Tyson Foods, Inc.

A

I think when we talk about chicken exports, historically that's largely been chicken leg quarters, and you are correct that we have decreased the amount of whole product that we are exporting, specifically leg quarters that we are deboning; many of those today and adding more value to those products. So, it has been done intentionally. And no, there is no plan to switch back to producing more leg quarters and exporting them in the market.

There's greater value in satisfying domestic demand and producing leg quarters for export.

Jacob Nivasch
Analyst, Credit Suisse Securities (USA) LLC

Q

Got it. Thank you. That's helpful. And then just one other quick one. So how quickly can the Prepared Foods division raise prices? I guess specifically, are there any product lines or channels that can raise price faster than others? Thank you.

Noel W. White
President, Chief Executive Officer & Director, Tyson Foods, Inc.
A

I think it's going to be somewhat across the board. Whether it's beef prices, pork prices, really all input prices are expected to increase, so don't think in terms of one specific type of product in Prepared.

With the increase in export demand, it will affect all proteins not only in the United States, but on a global basis. So, as you look at export information of what countries are shipping to what destinations, as an example, you'll see Australia has increased beef exports to China, and with that, the United States has historically been an importer of particularly lean beef trim from Australia, prices have gone up significantly, so it's affecting not only our markets and not only the pork markets, but global markets in all species.

Jacob Nivasch
Analyst, Credit Suisse Securities (USA) LLC
Q

Got it. Thank you.

Noel W. White
President, Chief Executive Officer & Director, Tyson Foods, Inc.
A

Yeah.

Operator: The next question we have will come from Adam Samuelson of Goldman Sachs. Please go ahead.

Adam Samuelson
Analyst, Goldman Sachs & Co. LLC
Q

Yes, thank you. Good morning, everyone. Maybe first I wanted to continue just in the Chicken business a little bit and just understand the performance in the quarter and the reduction or the tempering of the margin outlook there. I'm presuming, Noel and Stewart, that you're alluding to market pressures in the trade pack segment, and just maybe can you give a little bit more color on the market pressures you're facing there and then as well just a little more color on the operational challenges that you faced?

Noel W. White
President, Chief Executive Officer & Director, Tyson Foods, Inc.
A

Well, the markets are trending up, Adam. So as we came into Q2, that was probably the low in the market. So as we came through January, February, that was the low. They've improved since then, so that's a bit of a tailwind. So I think the worst is behind us, Adam. We're seeing demand improve. A year ago, we saw a lot of beef features planned for growing season. This year, there seems to be more poultry planned than what there was a year ago. So, from a demand perspective, seems to be in a very different position than we were a year ago.

On the operational side, I would tell you that there's nothing that is profound that with the number of facilities that we operate, there are always some unique challenges and it just happens to be a couple of challenges in one segment of the Poultry business right now.

Adam Samuelson
Analyst, Goldman Sachs & Co. LLC
Q

Okay. So just to be clear then, the tempering on the margin expectations for fiscal 2019, is that more a reflection of the actual first half performance, or did your expectations on margins in the second half of the year come down at all?

Noel W. White
President, Chief Executive Officer & Director, Tyson Foods, Inc.

A

No, it's really the first half.

Adam Samuelson
Analyst, Goldman Sachs & Co. LLC

Q

Okay. That's helpful. And then just thinking about ASF and the potential impact in Chicken where this is the segment you're vertically integrated in and so one would naturally think there's the most operating leverage to an inflationary environment, but you also operate in a lot of different segments, so maybe just help us think about size, kind of how we should think about inflation and benefiting the Chicken business given the offsets in the Prepared Poultry business, some of the grain or the cost-plus contracts that you have in different market segments as well and just frame kind of what that opportunity would be.

Noel W. White
President, Chief Executive Officer & Director, Tyson Foods, Inc.

A

Yeah, Adam, it's going to benefit all three species, Beef, Pork, and Poultry, and it will be to the detriment of Prepared on a short-term basis. Now, in time, those increase in costs will be passed along, but there is a timing issue. So that is the reason that we tempered the Prepared Foods earnings outlook and the reason that we are in fact a little more bullish than what we were on Beef, Pork and Chicken not only through the balance of 2019 but into 2020.

Adam Samuelson
Analyst, Goldman Sachs & Co. LLC

Q

Okay. I appreciate the color. I'll pass it on.

Operator: Next, we have Michael Piken of Cleveland Research.

Michael Piken
Analyst, Cleveland Research Co. LLC

Q

Yeah, hi. I had a couple of questions. The first one is if you could provide us an update on the status of your new chicken plant. And then the second question is if you could provide us an update on the status of the Financial Fitness cost savings. Just, I know you're not specifically tracking it, but just if things are still on track and if it's still right to put in $200 million a year in savings. Thanks.

Noel W. White
President, Chief Executive Officer & Director, Tyson Foods, Inc.

A

Yeah, Michael, both are on track. The plant that we announced in Tennessee, construction is proceeding as planned. There's timing delays. It's on budget, so no change there.

And then the Financial Fitness, that's just part of our business today, Michael, that we are not breaking that out specifically. However, I would tell you that is part of our fabric. We do track that internally. We don't talk about it externally. But yeah, I think it's fair for you to build that into your model.

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

A

The only thing I'd add, Michael, is just on the cost front, I think Noel mentioned it earlier, but all of the acquisitions as we integrate those, the synergies are coming in as planned as well. So, costs coming out on a number of fronts.

Michael Piken
Analyst, Cleveland Research Co. LLC

Q

Great. Thank you.

Operator: The next question we have will come from Ken Goldman of JPMorgan.

Ken Goldman
Analyst, JPMorgan Securities LLC

Q

Hi. Thanks. Two questions for me. First, regarding ASF, I'm curious what do we know as an industry and what is still up in the air. Obviously, we know that hundreds of millions of hogs are gone, but I'm curious what your research is telling you about, A, I guess whether China has been able to slow down the spread of the disease at all, and B, to what extent China is maybe building out some chicken production to offset the gap in hogs.

Noel W. White
President, Chief Executive Officer & Director, Tyson Foods, Inc.

A

Ken, that would be speculation on my part because there's nobody that knows the exact situation in China. I think the reports that we all read, you have to accept those at face value. There's quite a range, as you know, that's been quoted anywhere from 20% of the herd to 30%, to 30-plus-percent. So, on an equivalent basis, that's more than the entire hog production in the United States on an annualized basis. But there's nobody that knows exactly how many hogs are affected.

And are they increasing poultry production? I would say probably to the extent possible. However, as you know, there's been some limitations within China on the breeding flocks, so it's not as easy as just saying that we're going to start raising more chickens, and you have the factor that the predominant form of chicken that's consumed in China is a yellow bird. It's not the white bird that we produce here. So, it's a different type of product than what we're accustomed to. So, it's not as though you can turn off pork and turn on poultry. It will be multiple years before the supply balance comes back into equilibrium.

Ken Goldman
Analyst, JPMorgan Securities LLC

Q

No, that's helpful. And I do appreciate the candor. I don't think anyone does, but I figured if anyone might, it might be Tyson. But it's hard to know, I'm sure.

And then my second question is I just wanted a clarification. When you are talking about pricing catching up a little bit later as a result of higher hog costs, are you talking about pricing in your Pork segment as well as your Prepared Foods segment? Because I understand the delay, the inevitable pricing on the Prepared Foods side, but in Pork, at least historically, there just hasn't been much of a lag ever in the timing on pork and hog prices. So, wanted to get a little bit of a sense of what you were forecasting there.

Noel W. White
President, Chief Executive Officer & Director, Tyson Foods, Inc.

A

Yeah, it would be sum of each. It would be both in our Pork business as well as our Prepared business. And if I move just specifically to the Pork business, as news of ASF became a little more widespread then the futures market made significant gains, so futures were higher and as a result, hog prices went up as well even though product prices didn't.

So, there can be periods of time that the live markets can lead product markets or vice versa. In this particular case, the live market did get ahead of the product market, so there is a lag that is taking place right now. And then on the product market, I think you clearly understand that as prices rapidly rise on the input side, there's the price recovery that is lagging in capturing it.

So by the end of Q3, Q4, it should be pretty well priced into the market. On the Prepared side, it might take slightly longer.

Ken Goldman Q
Analyst, JPMorgan Securities LLC

Thanks a lot.

Stewart F. Glendinning A
Executive Vice President & Chief Financial Officer, Tyson Foods, Inc.

Yeah. It's worth noting maybe on the Prepared side, the team has already started to go out to the market with some price increases. So that team is well prepared and already taking action.

Ken Goldman Q
Analyst, JPMorgan Securities LLC

Okay. Thank you, Stewart.

Operator: And next is Jeremy Scott of Mizuho.

Jeremy Scott Q
Analyst, Mizuho Securities USA LLC

Hey, good morning.

Noel W. White A
President, Chief Executive Officer & Director, Tyson Foods, Inc.

Good morning.

Jeremy Scott Q
Analyst, Mizuho Securities USA LLC

Just back on the Chicken margin, I think the key thing I've been wrestling with since the Keystone acquisition and probably even before that is the weighted average duration of your chicken contracts or how your customer-centric model limits your ability to pass through pricing. So, I guess, in other words, if commodity chicken prices were to rise by 10% tomorrow, say by government decree, how long would that take to roll through your model, and to what extent would your business mix inhibit your realization of that price?

Noel W. White A
President, Chief Executive Officer & Director, Tyson Foods, Inc.

Jeremy, there's not an exact way to answer that question because we have many, many different types of pricing models. So, it's not as though we have fixed price models that have price list models, that we have a model that allows immediate pass through. We do sell some on a spot basis, but we have many different models.

So, it's not as though we sell one way and the lag is going to be 2 months or 12 months. So there's – I can't give you a specific answer to that. It will take time to pass on through, but that's been done intentionally, Jeremy, that we have set up various pricing models with many different types of customers to provide stability in our earnings and we don't have the volatility that more of the commodity-oriented players have. So, we will not reach the highs in the market when commodity prices go high nor will we reach the lows. We're looking for more stable earnings stream and that's the way that our pricing models been set.

Jeremy Scott Q
Analyst, Mizuho Securities USA LLC

Okay. And just on – yeah, sorry.

Stewart F. Glendinning A
Executive Vice President & Chief Financial Officer, Tyson Foods, Inc.

This is one of the reasons why I think it's best we have the benefit obviously of pretty detailed models internally to be able to see where things are going and it's why we – it's one of the reasons why we prepare a detailed financial forecast for you in terms of giving you that heads up.

I would also say it's worth noting that in the quarter, while we saw some weakness in Chicken, just reflect on where the return on sales were for all of the other businesses and they looked really good.

Jeremy Scott Q
Analyst, Mizuho Securities USA LLC

All right. Just on the Pork side, I think there's maybe some [indiscernible] (45:44) I don't know how much of your plants would be able to export pork to China, if it were to come to that. Would you be willing to work with your hog suppliers to remove ractopamine from your supply, and can you describe how that would impact your product from a yield and quality perspective?

Noel W. White A
President, Chief Executive Officer & Director, Tyson Foods, Inc.

The answer is yes, yes, definitely, Jeremy, that we would be working and have worked with our supply. We do produce ractopamine-free product today and it's an offering that we make into the market both for domestic as well as international use. And we do work with groups of producers for us to do that. We can expand that program. So the answer would be yes, we have the capability on a large-scale basis to meet those international demand. However, I would tell you we will balance that with the domestic customer base that we've serviced for many years and plan to continue to service.

So, some companies might view this as opportunistic. We don't. We view this as a more of a long-term event, and we will structure our business to service not only the international markets as though we have in the past but continue to service our domestic customers as well.

Jeremy Scott Q
Analyst, Mizuho Securities USA LLC

Got it. Okay. I guess can I just ask to the extent that you can, can you give any updates on the class action case? It seems in your disclosure in the Q, it looks like the DOJ issued a grand jury subpoena on discovery documents, so this has been a civil matter here for three years. Was there anything that precipitated the government's involvement recently?

Noel W. White
President, Chief Executive Officer & Director, Tyson Foods, Inc.
A

No, all I can say, Jeremy, is that we're disappointed that it went this far, but I'm not going to make any comments on any pending lawsuits.

Jeremy Scott
Analyst, Mizuho Securities USA LLC
Q

Got it. Thank you.

Operator: Next, we have Michael Lavery of Piper Jaffray.

Michael S. Lavery
Analyst, Piper Jaffray & Co.
Q

Good morning.

Noel W. White
President, Chief Executive Officer & Director, Tyson Foods, Inc.
A

Good morning.

Michael S. Lavery
Analyst, Piper Jaffray & Co.
Q

Could you just give a little more color when you – you said that you're not factoring ASF into your outlook but then I think you're also trying to account for some of that in a little more cautious view on costs in Prepared Foods. Would it be right to characterize your guidance as trying to capture at least the cost increases you have the visibility on without the pricing benefits? Is that the right way to think about the context you're working in?

Noel W. White
President, Chief Executive Officer & Director, Tyson Foods, Inc.
A

I think that would be accurate, Michael, because it is a matter of timing, right, because we have seen raw material prices that have moved higher. It has had an impact on Prepared Foods. But we've not seen the corresponding reaction in livestock prices, so we do think that there will be an expansion of price in beef, pork, and poultry. It's a matter if it's in fiscal 2019 or if that moves into 2020.

Michael S. Lavery
Analyst, Piper Jaffray & Co.
Q

Okay. That's helpful. And just back to your comments about the U.S. and obviously if it came here, I think it's been very clear that would be a major problem, but there hasn't seemed to be a lot of talk about that. Do you have any reason to believe that – that has seemed to me very unlikely. Is that a fair characterization, or how would you quantify the risk around that?

Noel W. White
President, Chief Executive Officer & Director, Tyson Foods, Inc.
A

I think there's a real risk that that can take place. African Swine Fever has been – we've been aware of circumstances globally for a number of years, 10 years, 15 years. But it has spread rapidly in the course of the last 12 months, not only in China, but throughout other parts of Asia as well as Europe. So, I think that the threat is real, and I do think there is a distinct possibility it could come to the United States and we need to be prepared for that. We need to be prepared from a regulatory standpoint.

When we had high path AI in this country a few years ago, the industry and the government quickly mobilized. We need to take that as a lesson and use that in the case that it does come here, as well as from a trade standpoint in talking with our trade partners about regionalization and the fact that it doesn't matter if it's in the United States or within Europe or any other country, it should be on a regionalized basis. And we do have meetings that have and continue to take place with industry associations, with the government, as well as those of us in the pork business.

So there is a coordinated effort that has been underway for the last 60 days or so.

Michael S. Lavery
Analyst, Piper Jaffray & Co.
Q

Thank you. That's helpful.

Operator: And next, we have Eric Larson of Buckingham Research Group.

Eric J. Larson
Analyst, The Buckingham Research Group, Inc.
Q

Yeah, thanks for the question. I just want to follow up on the grain impact on your margins in the chicken sector for the second quarter, 200 basis points down, but when you now look forward, it would not be a positive yet for your third quarter, but we're going to start anniversarying some of these high grain costs, it started coming down in June last year pretty sharply.

I would think that grain, particularly meal, could start becoming a tailwind maybe fourth quarter. I mean, that assumes the prices stay where they are on the spot market and whatever your hedging practices or purchase forward practices have been, but maybe this is more of a 2020 positive event. I mean, how should we look at the forward structure of your grain input costs as opposed to what happened in Q2?

Stewart F. Glendinning
Executive Vice President & Chief Financial Officer, Tyson Foods, Inc.
A

Yeah, look, so a couple of comments on Q2 and then we'll talk about the future. So looking back at Q2, just pure grain prices in Q2 were slightly higher than same quarter last year, and then of course, you had the impact of this timing of the gain in the first quarter last year and last – this quarter – this year.

How those play out into the future of course will depend a little bit on the grain prices themselves. I think actually the key answer to your question lies in your point at the end which is the assumption around price. And when we give you the expected return on sales for the business, we're making assumptions both around our hedging, the price of grains that we expect to pay and then the commensurate prices that we're getting in the marketplace. So, there's no, sort of, easy answer to just say well price of corn will be down and therefore we'll be making a lot more money. We've sort of woven all of that price and cost of corn into the floor cost that we've given you.

Eric J. Larson
Analyst, The Buckingham Research Group, Inc.

Q

Okay. So if you just take the price of corn and soybeans today which kind of translates into the meal, et cetera, we're at really historical lows. We've still got a lot of supply coming in globally, but I would suspect at some point there's maybe more upside risk maybe not near-term than it is more downside. So would this be an environment where you get more aggressive? It seems like the market is pretty short on both the commercial side as well – we know the non-commercial is very short, so wouldn't it seem that there might be more upside risk to that pricing outlook? And then I'll pass it on.

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

A

Yeah, look, potentially, I mean, I think the real thing about grains is it's an input that we have to take. We take that into account in our pricing and our hedging is not in any way speculative. It is designed to take the volatility out of the grains that we use in our business. And so over time, you will see our hedging in a rising market will slow that impact and in a falling market will delay the benefits. But I don't think that you will see any sort of dramatic change in action. Otherwise, we're just entering sort of a trading game which is not our business.

Eric J. Larson
Analyst, The Buckingham Research Group, Inc.

Q

Yeah, I understand. Okay. Thank you.

Operator: And next, we have Ken Zaslow of Bank of Montreal.

Kenneth B. Zaslow
Analyst, BMO Capital Markets (United States)

Q

Hey, good morning, guys.

Noel W. White
President, Chief Executive Officer & Director, Tyson Foods, Inc.

A

Good morning, Ken.

Kenneth B. Zaslow
Analyst, BMO Capital Markets (United States)

Q

Just a couple of questions, I'm sorry.

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

A

Good morning.

Kenneth B. Zaslow
Analyst, BMO Capital Markets (United States)

Q

First, are there any structural issues with your Chicken business that you would not be able to get that back to 2016 levels if the market committed?

Noel W. White
President, Chief Executive Officer & Director, Tyson Foods, Inc.

A

: No, there is not, Ken. No structural issues. We do have a few specific plants that are not performing as well as that we would want, but nothing on a structural basis. The team knows where the opportunities are and they are after those opportunities.

Kenneth B. Zaslow
Analyst, BMO Capital Markets (United States)

Q

Okay. And then I think you said last quarter that you would expect profit to grow in 2020, and obviously we did not have African Swine Flu back then, and then you didn't say exactly the number but you said that you'd expect it to grow given all of the things you're doing. Is that still a fair comment, excluding African Swine Fever?

Noel W. White
President, Chief Executive Officer & Director, Tyson Foods, Inc.

A

Yes, it would. Even excluding African Swine Fever, Ken, I think the outlook as we look into 2020 would be positive for several reasons. One, the cattle herd is at least stable, if not still slightly growing, but the growth has leveled off. However, global demand continues to be extraordinarily strong. So exports have been good, domestic demand has been very strong as well.

Moving over to Pork, as we came through 2019, there was several new plants that came online, so capacity increased at a greater rate than what hog production did. We are seeing growth in hog production, so I think that that delta that we saw change in 2019 will come back in closer balance. So I think that's a positive on the Pork side.

And on Poultry, as I mentioned, we started the year. Q2 was not particularly strong quarter for us, but for the year, we're going to end up in about 6% and it looks like as we move into 2020, it has the possibility of being something stronger than that.

So, all three businesses, in addition to our Prepared which has had several record quarters, continues to perform exceedingly well. So, no, all parts of our business look good at this point.

The last component being our international business, our legacy international business continues to strengthen. We are at breakeven or better at this point, and historically, that was a segment that did not make money. It cost us money, so that is a change in our business as well.

Kenneth B. Zaslow
Analyst, BMO Capital Markets (United States)

Q

Just on international, I know it's a very small part, everybody asked a lot of questions, but international, you will be at a run rate a profit by the fourth quarter, is that a fair assessment?

Noel W. White
President, Chief Executive Officer & Director, Tyson Foods, Inc.

A

Yeah. Yeah

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

Or – yeah, is that fair?

Noel W. White
President, Chief Executive Officer & Director, Tyson Foods, Inc.
A

That's fair, Ken. And that is excluding Keystone. That would be our legacy business that we would be on a run rate to make money.

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

Okay. And my very last question is promotional spending. You have seen that a change in the industry towards chicken. Is that one of the reasons that you think that the Chicken margins have improved from current levels absent any sort of African Swine Fever? In fact, is that a fair assessment? And can you give some anecdotes? And I'll leave it there.

Noel W. White
President, Chief Executive Officer & Director, Tyson Foods, Inc.
A

Ken, I think that it's because of the alternative proteins other than chicken. So, as an example, beef prices are significantly higher than what they were a year ago. So as an alternative, I think that they've chosen to promote more chicken this year than what they did a year ago simply because the price of beef. I mean, the beef cut-out is something let's say $2.30, so it's extraordinarily strong. So as they look at what they want to feature, chicken is a great value right now. So I think that's the primary reason more so than the MAP spend that's going against it.

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

Great. I really appreciate it. Thank you, guys.

Noel W. White
President, Chief Executive Officer & Director, Tyson Foods, Inc.
A

Yeah, thank you.

Operator: Well at this time, we'll go ahead and conclude our question-and-answer session. I would now like to turn the conference call back over to Mr. Noel White, President and Chief Executive Officer, for any closing remarks. Sir?

Noel W. White
President, Chief Executive Officer & Director, Tyson Foods, Inc.

Thank you for joining us today, and thank you for your interest in Tyson Foods. You'll be hearing from us again at the BMO Conference next week and at our Investor Day June 20. Thanks, everyone.

Operator: And we thank you, sir, and the rest of the management team for your time also today. Again, the conference call has now concluded. At this time, you may disconnect your lines. Thank you, again, everyone. Take care and have a wonderful day.