Tyson Foods
Third Quarter 2021 Earnings
August 9, 2021 at 9:00 a.m. Eastern

CORPORATE PARTICIPANTS
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Donnie King – President and Chief Executive Officer
Stewart Glendinning – Executive Vice President and Chief Financial Officer
PRESENTATION

Operator
Good morning, everyone, and welcome to the Tyson Foods Third Quarter 2021 Earnings conference call. All participants will be in a listen-only mode. Should you need assistance, please signal a conference specialist by pressing the star key followed by zero. After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press star and then one using a touchtone telephone. To withdraw your questions, you may press star and two. Please also note that today's event is being recorded.

At this time, I'd like to turn the conference call over to Megan Britt, Vice President of Investor Relations. Ma'am, please go ahead.

Megan Britt
Hello, and welcome to the Third Quarter Fiscal 2021 Earnings conference call for Tyson Foods. On the call today are Donnie King, President and Chief Executive Officer; and Stewart Glendinning, EVP and Chief Financial Officer. We have prepared presentation slides to supplement our comments, and these are available on the Investor Relations section of the Tyson website and through the link to our webcast.

During this call, we will make forward-looking statements regarding our expectations for the future. These statements are subject to risks, uncertainties, and assumptions which may cause actual results to differ materially from our current projection. Please refer to our forward-looking statement disclaimers on Slide 2, as well as our SEC filings, for additional information concerning risk factors that could cause our actual results to differ materially from our projection.

Please note that references to earnings per share, operating income, and operating margin in our remarks are on an adjusted basis, unless otherwise noted. For reconciliation of these non-GAAP measures to their corresponding GAAP measures, please refer to our earnings press release.

I'll now turn the call over to Donnie.

Donnie King
Thank you, Megan. As many of you know, I've been a Tyson team member for close to four decades, and in that time, I've led every business segment. We've always believed in our mission and the vision of John W. Tyson, who founded this company nearly a century ago, because he wanted to find a better way to feed a growing country. Today, on my first earnings call as CEO, I am incredibly proud to stand alongside our team members to continue that legacy. It's an interesting time to be in this industry, and we have a leadership team that together can capitalize on the strengths of this company, and the opportunities ahead.

Let's begin with a view of our overall performance this quarter. First, our retail performance. Twelve consecutive quarters of retail share gains in our core business lines is driven by strength of our brands, along with solid execution from our team. We are in a market that has demonstrated strong demand for protein, and people are reaching most for brands they trust. Our billion-dollar brands, Tyson, Jimmy Dean, and Hillshire Farms, have driven strong share growth with consumers buying more than ever before.

Second, we saw, in the third quarter, growing volume in foodservice channel, as reopening and recovery continue. We saw uptick from outlets nationwide reflected in our sales, which we were up $1.3 billion for the quarter. Our broad production and distribution network is well-positioned to meet this growing demand.
Third, the diversity of our portfolio demonstrated its value during the quarter. Led by beef, we delivered an exceptional result as strong US and export demand, coupled with ample cattle supply, supported elevated margins in that business.

Fourth, we continue to build financial strength. This quarter, we used higher operating cash flow to reduce debt. The steps we've taken position us with a very strong balance sheet and high levels of liquidity.

And finally, we are investing in future growth across our portfolio. We're in the process of bringing 12 new plants online globally to address capacity constraints and growing demand. In all, Tyson delivered a strong quarter. As we look to the future, we want to build on these strengths.

Let's look at how we plan to do that. First, we have built a solid footing to drive consistent results. Our strengths included a diverse portfolio, well-known trusted brands, scale in meaningful markets, and an exceptionally strong balance sheet.

Second, labor is our number one challenge, so we have continued our focus on improving our team member experience, without compromising their health and safety. We are accelerating efforts to make Tyson the most sought-after place to work, because we know how important team members are to our business. One of the ways that we're doing this is to accelerate our investments in automation and technology. This not only helps us to eliminate more difficult, hard to fill tasks, but also reskill our labor profile to enable their contribution to more value-added activities.

Third, we are actively working to recover volume from pandemic lows, and in doing so, improve the reliability we offer our customers. Dynamic and evolving channel demand continues to create operational complexities. We took steps earlier this year to make our organization more responsive to demand signals, and to accelerate our speed to market by getting our sales teams closer to their customers. There is more to do, however, and so our work here continues.

Fourth, our focus on operational excellence and disciplined cost management is especially important during periods of continued market volatility and increasing inflationary pressures. As you will hear today, we continue to be laser-focused in making progress in restoring the competitiveness of our chicken segment. We are also accelerating actions across our enterprise to become more operationally excellent.

Finally, we will continue to optimize our balance sheet, which will give us optionality as we prioritize the delivery of shareholder value.

Turning to Slide 5. We improved our sales and earnings performance this quarter. The results demonstrate the benefit of our multi-protein, multi-channel portfolio. Sales improved 25% in third quarter and 8% year-to-date, reflecting improved volumes, which are up 10% for the quarter and flat year-to-date. It also reflects effective pricing strategies in all of our segments during this inflationary environment.

We delivered strong operating earnings performance, resulting in approximately $1.4 billion in operating income for the quarter. This represents an 81% increase compared to prior year, and translates to $2.70 in earnings per share. Our earnings reflect our three key priorities: one, to be the go-to supplier for customers and consumers; two, to be the most sought after place to work; and three, to be operationally excellent.

We want to be the most sought-after place to work. This starts with an unrelenting focus on safety, every minute, every shift, every day. Health and safety have been, and will continue to be our top priority. We have a history of using all the tools at our disposal to protect our team members, and the vaccine is no
As many of you will have seen, last week we announced that Tyson will require COVID-19 vaccinations for our entire US workforce by November 1. We do this now because the delta variant is more contagious, and getting vaccinated is the single most effective thing people can do to protect themselves, their families, and their communities.

We have raised wages in many markets to ensure we’re competitive, and are exploring other ways to make Tyson the most sought after place to work in the communities where we operate. For example, we are piloting child care facilities at some of our plants, and we have opened medical clinics to make healthcare more accessible to team members and their families. Finally, we are accelerating investments in automation and advanced technologies to make team members’ jobs easier.

We look forward to providing more detail on our automation and technology roadmap at our upcoming Investor Day.

We’re taking aggressive actions to add new capacity to meet demand, adjust our product mix by plant, and match our portfolio more closely with customer and consumer needs. We’re listening to our customers, and are committed to improving reliability of supply.

In the third quarter, we improved volume levels across all segments. In prepared foods, we continued to optimize our product portfolio, remove processing and supply chain complexity, and prioritize products with the highest demand, resulting in lower cost and better service to our customers.

In beef, ample cattle supply, heavier animal weights, and strong demand have driven volumes higher year-to-date. In pork, our volumes are up year-to-date versus pandemic lows. We are pleased to have additional capacity coming online at Eagle Mountain, Utah, and Columbia, South Carolina. Both facilities are expected to grow our prepackaged beef and pork products.

In chicken, volume declined year-to-date despite improved foodservice demand led by QSRs. We also saw sustained retail demand, including the frozen value-added poultry category. Limited capacity and persistent labor challenges have impacted customer fill rates in this segment. However, our new plant in Humboldt, Tennessee continues to ramp-up production, including harvest capacity. This ramp-up is helping us improve customer fill rates. Chicken remains a top priority for me and for our company. We continue to execute against our roadmap to bring operating income margin to at least the 5% to 7% range by mid-fiscal 2022.

Our goal has not changed and we remain committed to restoring top-tier performance. We are making progress. The first imperative is to be the most sought after place to work. I’ve outlined the investments we’re making to enhance our team member experience in my earlier comments.

The second imperative is to improve operational performance. Last quarter, we highlighted the impact of lower hatch rates on our chicken operations. We have begun to deploy new male parent stock. Where this stock has been deployed, hatch rates are improving. We expect a full rollout of this breeder stock to be complete this fall, with harvest capacity improvements occurring by mid-fiscal 2022. Our rate of outside meat purchases has declined 25% versus last quarter, and will continue to decline as hatch rates and utilization improve. We have identified opportunities to reduce mix complexity across our chicken footprint, which will help us operate more efficiently.

The final imperative is to service our customers on time and in full. We’re pleased by the continued share performance of our value-added products like Tyson Chicken Nuggets, Crispy Strips, and Air Fried. We gained share during the third quarter and the last 52 weeks. Looking ahead, we expect further growth, and as a result, we’re investing in line upgrades and increased capacity to drive branded product growth.
We have increased prices to help offset significant raw material and supply chain cost inflation. Pricing has improved nearly 16% in the quarter versus the comparable period last year. We will staff our plants, service our customers, grow our business, and be the best chicken company, period.

Part of being customer-centric means being as efficient as possible and taking cost out where you can, without compromising our ability to execute against our strategic and operational priorities. We have ongoing efforts across the business to reduce costs, but we must also find new innovative ways to be better and stronger. This means investing in advances like automation and artificial intelligence, to deliver productivity gains and competitive advantage. We have already delivered strong productivity gains in fiscal year 2021.

Across our business, we are looking to build upon the strength of those actions in the months and years to come, which we will detail at the Investor Day later this year. These improvements come at a time when we are investing heavily in capacity expansions across segments, to better partner with our customers and meet long-term demand.

I'll now turn the call over to Stewart to walk us through our financial results in detail.

**Stewart Glendinning**

Thank you, Donnie. Let me turn first to a summary of our total company financial results. Sales were up approximately 25% in the third quarter. Volumes were up 9.7%, primarily due to strength in retail and the ongoing foodservice recovery. Average sales price was also up about 17%, largely due to strong results in our beef segment, the mix benefit from retail volume, and the partial recovery of raw material inflation in net sales price.

Operating income was up 81% in the third quarter, due to continued strong performance in our beef business. Chicken and prepared foods also improved their respective segment earnings, while pork earnings were down versus the comparable period a year ago. Year-to-date operating income for the total company improved by 49%.

Earnings per share grew 93% in the third quarter, due largely to strength in operating income, specifically within our beef segment. EPS was up 61% on a year-to-date basis. We performed well, despite a challenging operating environment that span tough labor availability, significant inflationary pressures on raw material costs, global supply chain challenges, and an evolving demand backdrop.

Slide 11 bridges our total company sales on a year-to-date basis. We delivered growth in the retail channel along all reporting segments, which, in aggregate, accounted for more than $1 billion in sales improvement over the year-to-date period, and more than $300 million in the third quarter versus the respective comparable periods.

Moving to foodservice, sales improved by approximately $1.3 billion in the third quarter, leading to a year-to-date improvement for the channel of nearly $1 billion compared to the same period last year. Exports were up over 18% versus the comparable period, led by beef, where sales improved by more than $350 million on a year-to-date basis. Asia has been a key driver of beef export strength. We've also seen some strength in industrial, particularly in beef and pork.

And finally, year-to-date sales grew $79 million, or approximately 6% in our international business. This business is a growth priority for Tyson, and we will continue to invest to develop further capacities and capabilities in new markets to meet growing global consumer demand for protein products. Current capacity expansions across seven international locations are expected to dramatically increase our fully-
cooked production capabilities. These investments are fully aligned to our strategic growth priorities, and when complete, will enhance our international processing capacity by close to 30% versus fiscal 2020.

Overall, we’re pleased with the company’s topline growth year-to-date. We are carefully managing the current inflationary pressures through pricing actions, as well as commercial and operational excellence, with emphasis on productivity and cost. We know that our price recovery efforts relative to inflation must be matched by equal aggressiveness on productivity.

Slide 12 bridges year-to-date operating income. Production inefficiencies and low labor availability resulted in total company volumes roughly flat to the comparable period a year ago. However, we are encouraged by the volume improvement we are seeing across our segments in the third quarter. Price mix benefited substantially in the year-to-date period from price recovery of raw material cost inflation, improved mix, strong beef segment performance, and continued retail strength across segments.

Operating income was partially offset by $2.2 billion of increased cost of goods sold for the period, reflecting meaningful inflation in raw material and supply chain costs. Feed ingredients, labor, packaging and freight, are all key components of this COGS increase, which we’re working to mitigate.

On a comparative basis, SG&A benefited from the $56 million loss in the year-to-date fiscal 2020 period, as compared to a $55 million gain in the first quarter of fiscal 2021, associated with the cattle supplier incident. This was in addition to certain reductions in trade spend and travel costs.

Moving into the chicken segment’s results. Sales were $3.5 billion for the third quarter, up 12%. Volumes were also up in the quarter due to continued strength in retail, improving demand through foodservice and segment-wide operational improvements. These were partially offset by COVID-related production inefficiencies.

Average sales price was up 15% in the quarter, due to favorable mix, sustained retail volume, and strong supply and demand fundamentals.

Our reported price improvement also reflects actions we took to cover the inflationary pressure seen from higher grain, labor, and freight costs. Our conversations with customers on widespread inflationary pressures have been productive, and we’ll continue to partner with customers to ensure we receive a fair return on our products, while working to deliver service levels and fill rates that meet or exceed their expectations.

Operating income was $27 million in the third quarter, and $137 million on a fiscal year-to-date basis, both stronger than comparable periods a year ago. This represents an operating margin of 1.3% year-to-date.

Fiscal year-to-date operating income was negatively impacted by $410 million of higher feed ingredient costs, as well as $210 million of increased grow-out expenses and outside meat purchases. For the third quarter, feed ingredients were $270 million higher, while grow-out expenses and outside meat purchases were $110 million higher. Segment performance also reflects net derivative gains during the third quarter of $125 million and $235 million on a year-to-date basis, both versus the respective comparable periods. These results are associated with realized gains, as well as open positions.

Moving now to prepared foods. Sales were $2.3 billion for the quarter, up 14% relative to the same period last year. Total volume was up 4.5% in the quarter, with strength in the retail channel and continued recovery in foodservice. Sales growth outpaced volume growth, driven by the pass-through of raw material costs, lower commercial spending, and better sales mix.

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Segment operating income was $150 million for the quarter, up over 3% versus the prior year. Year-to-date operating income was $633 million, up 23% versus the prior year period. Operating margins for the segment was 6.5% for the third quarter, a decline of 60 basis points versus the comparable year-ago period. The slowdown in segment operating margins, versus the same quarter last year, were driven by significant increases in raw material input costs. However, on a year-to-date basis, our operating margin of 9.6% was up 170 basis points versus last year, driven by favorable pricing and lower commercial spend.

Demand for the balance of the year is expected to remain elevated at retail, with volumes continuing to exceed pre-COVID levels, and foodservice continuing to recover. During the third quarter, core business lines experienced volume share growth of 90 basis points, while dollar share grew 70 basis points. We continue to believe that the ongoing inflationary environment will create a meaningful headwind for prepared foods in the upcoming quarter.

Raw material costs, logistics, ingredients, packaging and labor are all challenging our cost of production. To offset inflationary pressure, we're focused on pricing, revenue management, and commercial spend optimization, while ensuring the continued build of brand equity through marketing and trade support.

Moving to the beef segment. Segment sales were over $4.9 billion for the quarter, up 36% versus the same period last year. Key sales drivers included strong domestic and export demand for beef products, with average sales price up 12% for the quarter. We had ample livestock available in the quarter, driven by strong front-end supplies. Mounting drought conditions in the Western United States cattle-growing region, as well as elevated cost for grain, also drove some cattle supply liquidation. We have good visibility into cattle availability through fiscal 2022, and currently believe it will also be sufficient to support our customer needs. Sales volume for the quarter was up year-over-year due to continued strong demand, in contrast to a soft comparable period a year ago, driven by lower production volumes.

We delivered segment operating income of $1.1 billion for the quarter. This improvement was driven by strong global demand for beef products and a higher cutout, which were partially offset by higher operating costs. Operating margins for the segment improved 520 basis points to 22.6% for the third quarter.

While our beef segment experienced tremendous results on a year-to-date basis, we're still not at optimal levels of capacity throughput within our beef plants due to labor challenges. Meanwhile, drought conditions and elevated grain prices are creating incremental costs and risks for cattle producers. Until these conditions stabilize, and within the constraints I had mentioned, we will work to maximize our beef processing capacity to provide a reliable outlet for our livestock farmers, and adequate product supply for customers and consumers.

Now, let's move on to the pork segment on Slide 16. Third quarter results reflect higher hog costs and operating expenses that weren't fully offset through pork cutout. Segment sales were $1.7 billion for the quarter, up 54% versus the same period last year. Key sales drivers for the segment included higher average sales price due to strong demand, partially offset by a challenging labor environment. Average sales price increased more than 39%, while volumes were also up relative to the same period last year.

Segment operating income was $67 million for the quarter, down 37% versus the comparable period. Overall, operating margins for the segment declined by 570 basis points to 3.9% for the quarter. The operating income decline was driven by higher hog costs, and increased labor and freight costs. Through the end of this calendar year, lower projected 2021 pork production and strong consumer demand are expected to support hog prices well above 2020 levels.
Slide 17 captures our financial outlook for fiscal 2021. Given the continued strength in our beef segment, and ongoing inflationary pressures that are partially being recovered through price, we are raising our sales guidance for the full year. We now expect to deliver annual revenues in the range of $46 billion to $47 billion. At the segment level, we expect our directional annual guidance to hold. Key risks to this guidance include freight rates, labor cost and availability, grain costs in the chicken segment, raw material costs for each of our businesses, and continued export market strength, along with price volatility in commodity meats.

We’re slightly revising our outlook on effective tax rate to approximately 22.5%. We’ll continue to monitor the potential implications of new legislation, but we do not currently expect to see impacts to our adjusted rate this fiscal year. While our expectations related to liquidity are also unchanged, liquidity during the third quarter improved substantially to $3.4 billion, and has since benefited from $1.2 billion of pre-tax proceeds from the divestiture of our pet treats business in early July.

Finally, we expect our COVID-related costs, which totaled $55 million in the quarter, to be approximately $325 million for the year. As a reminder, some of the costs that were previously described as COVID-related, have evolved to become structural.

Turning to Slide 18. In pursuit of our priority to build financial strength and flexibility, we have substantially delevered our business over the past 12 months, reducing leverage to 1.7 times net debt to adjusted EBITDA. Investing organically in our business will continue to be an important priority, and will help Tyson increase production capacity and market capabilities. Each of these levers, individually and in aggregate, will support strong return generation for our shareholders.

We will also continue to explore costs to optimize our portfolio through M&A, through the lens of value creation and shareholder return.

Finally, we are committed to return cash to shareholders through both dividends and share buybacks. In short, we view the cash generation capabilities of this business as both strong and diverse, and we expect our capital allocation framework to deliver solid returns for our shareholders in the future.

And with that, I’ll turn the call back to Donnie.

Donnie King
Thanks, Stewart. To close, our priorities are clear, being the most sought-after place to work, being our customers’ go-to supplier, and doing so while driving operational and functional excellence across all areas of our business. There is a lot to be excited about. We look forward to discussing where we’re headed during our upcoming Investor Day, and hope you can join us.

Thank you for your interest today in Tyson Foods. Megan?

Megan Britt
Thanks, Donnie. We will now move to your questions. Please recall that our cautions on forward-looking statements and non-GAAP measures apply to both our prepared remarks and the following Q&A.

Operator, please provide the Q&A instructions.

QUESTIONS AND ANSWERS

Operator
Ladies and gentlemen, at this time we'll begin the question and answer session. To ask a question, you may press star and then one using a touchtone telephone. To withdraw your questions, you may press star and two. Please, we do ask that you please limit yourself to one question and one follow-up. If you do have additional questions, you may reenter the question queue. Once again, that is star then one to ask a question.

Our first question today comes from Peter Galbo from Bank of America. Please go ahead with your question.

Peter Galbo
Hi, guys. Good morning. Thank you for taking the questions.

Steward Glendinning
Good morning, Peter.

Donnie King
Good morning.

Peter Galbo
Donnie, maybe we could just start reiterating the back-half 2022 chicken outlook of 5% to 7%, and I guess just based on your prepared comments, a lot of things are starting to move slowly, but in the right direction. So, I guess the question is just, what prevents that from getting pulled forward a bit? Is it just that these hatch-related issues just take much more time, the automation doesn't kick in until later into 2022, or has something else changed incrementally, and maybe really around the labor picture? Has it gotten worse kind of since the last time we spoke?

Donnie King
Thanks for that question, Peter. Let me start with this. As we look forward, the fundamentals of our business look good going forward, and we have strong retail and foodservice demand. We haven't changed our approach. Chicken is our top priority for me and for our company. We continue to execute our plan. That hasn't changed, and that starts with staffing our plants and servicing our customers. And we have to be the most competitive chicken business, but we also want to grow the business.

We are committed to top-tier performance. We're committed to the 5% to 7% AOI by mid-FY22 that we talked about earlier, and we're committed to becoming the most sought after place to work, and we talked a lot about that in the prepared remarks. We've increased wages, and this includes benefits up to $22 an hour. We've instituted flexible work schedules and shifts. We're piloting child care and onsite health clinics for our team members and their families. We're solving transportation problems for our team members. We're investing heavily in automation and technology, and trying to automate those most difficult and higher turnover jobs.

I talked last time, just so you understand the basis of this. The seven levers of our business in chicken are price, volume, mix, labor, yield, spend and live. And so, let me touch on each of those for a moment.

In our live operations, the plan to improve hatch is well underway. The new males will be in place by this fall, as we talked about in 2Q. We will see harvest capacity increase by mid-fiscal 2022. So, here's kind of the formula. That's better hatch equals more birds, which equals more volume, which equals better service, which equals a better cost structure, which equals better performance, and ultimately, better results for us.

But until then, to your point and your question, we are improving hatch and harvest volume now. Even
with these headwinds, we are better than an average company by a sizable margin in our live production area, and we'll get sequentially better between now and mid-2022.

If I look at spend, we talked a lot last time about outside purchases, and Stewart mentioned earlier that we've decreased that by 25%, although at a higher price. The thing that is challenging now is we're paying a lot over time because of inefficiency associated with labor, which is absenteeism and turnover. We've had inflation on all inputs. We believe grain and our cost of goods will crest in early Q4. In fact, it has, based on the forward-looking curves. This is in our cost of goods. We've seen great improvements in our cost management and our execution by our team. Much of that has been masked by inflation.

And then go to labor. Labor is our single biggest issue we face, not only in chicken, but also in our other businesses. We've increased wages and created flexible shifts, child care onsite clinics. The delta variant has been a disruptor. We were on a good trajectory and then the delta variant showed up, and we've taken a step back as a result of that. We have plans to mitigate that, but the health and safety of our team members are our highest priority.

We are more inefficient than we have historically been. Certainly, a big part of what we have to solve, but essentially it takes us six days to get five days' worth of work. I will tell you that execution has improved sequentially through the year.

Our volume's up in the quarter. That's head, that's weight, that's our finished good sales. Volume is negatively impacted by harvesting below plan, which we talked about as a result of hatch. We started this year with a plan to grow the business, and grow our head and grow our sales, but our byproducts and export sales are our biggest misses from a volume perspective. We will see volume increase between now and mid-2022. That's in hatch, that's in head harvested, and that's in volume through our plants.

From a mix standpoint, we've added volume. Value-added volume is very strong. That's ready-to-eat product. That's Wright product. That's our frozen value-added branded products. That's the heart and soul of our business in chicken. We are at capacity with strong retail and foodservice demand. As Stewart referenced earlier, we're adding lines and plants to address very strong demand.

Our pricing is up 16% in the quarter. Most of this increase came in June, and even more in July. We work with our customers, and they've been very responsive. Our relationships are very strong with our customers. We've been successful in getting pricing. Grain, also, at the same time, has continued to escalate, and pricing will certainly lag the cost in this scenario. We're just simply asking for fair market value for these products.

But long story short, we are executing better. We are performing better. We have a great deal of inflation led by grain, but we've gotten pricing around us. And so, as we move into every month and quarter from here, I would expect us to be sequentially better. And that 5% to 7% that we talked about by mid-2022, we're committed to that and we stand with that number.

**Peter Galbo**

Great. Thanks, Donnie. That's very helpful, just all of the detail there. And then just for the follow-up question, Stewart, I guess what's changed in your prepared comments around prepared foods, last quarter I think you had talked about the inflation coming through, maybe it's accelerated a bit, but that you'd be kind of turning on MAP spending in the back half of the year, and maybe that wasn't the case in 3Q, and more so in 4Q. So, is there just a change there, and maybe when can we expect that to start to flow through more? Thanks.
Stewart Glendinning
Yes, thanks. Look, we did turn MAP on in Q3. It was one of the sort of downward levers, as we've had to dial back in the retail space. So, it's already running through the numbers. It was earlier in the year where you saw the benefit. In the back half of the year you're going to see the increases. And that's part of what's in our guidance.

Operator
And our next question comes from Ken Zaslow from Bank of Montreal. Please go ahead with your question.

Kenneth Zaslow
Hi, good morning, guys.

Donnie King
Good morning.

Kenneth Zaslow
Just a quick follow-up. The parent stock is being rolled out fairly quickly, which is actually positive. Can you talk about how confident you are that it will take, and that there will not be any issues; that the hatch rates and the productivity will be in line with your expectations, and just if there are any risks and how you see it? That's my first question.

Donnie King
Sure. Thanks, Ken. As you know, we talked about the fact that this would be phased-in and completing by, let's call it fall. That work is underway. We have converted some of the male stock, and we've seen some results associated with that. Everything we have seen thus far would be in line with what we expected, and we see no reason to expect any disruption from that. So, from that standpoint, everything looks good. It looks like it's on track to deliver the timing that we talked about thus far.

Kenneth Zaslow
Great. Just flipping to the other side, beef business. For the last year or so, between COVID and, unfortunately, your fire, it seems like there's been a lot of cattle that just hasn't been dead as quickly as people may have expected. So, although we may be going through an underlying contraction, there seems to be a lot more cattle out there through, probably at least through the winter, and if not, through 2022. Would you agree with that? Would you kind of put parameters around that? How do you see that?

And then, as a follow-up to that would be the export side with China and Japan, the trade policies, and the shortage of Australian beef, that seems like there is a duration to the export picture as well. And then I'll leave it there, and I appreciate your time, as always.

Donnie King
You bet, Ken. Let me say this, and I think your view of beef, where we had ample cattle supplies and where we had really strong demand, we were constricted in the middle based on labor availability, and I talked about this in chicken earlier, but in our beef business, it essentially takes us six days to get five days' worth of work. So, the inefficiency associated with that allowed cattle to back up on the ranch and in feedlots.

So, here's what we know as we look into 2022. Fed [ph] supplies are expected to be down about 0.5%. June cattle on feed is projected to be up 1.9%. There has been some herd liquidation in the west and Northern Plains, which, according to CattleFax, about 33% of the US cow-calf production is in this drought
area. But 2022 is looking good. Is it going to be at the same level with where we are at 2021? Probably not. I don't think it will be that good. I think it will be better than historical returns. And I'm talking that 1% to 3%, which we talked about forever. It'll be north of that we think. But we think, all in all, beef will have a very nice year in 2022.

In terms of export, to the other part of your question, Asian growth is still solid. US grain-fed beef is preferred around the world. And as you mentioned, key global beef suppliers are rebuilding herds in Australia and Brazil and Canada. So, all of that is true. And so, strong export demand for us, as well as domestic.

Kenneth Zaslow
Okay. I appreciate it, as always.

Donnie King
Thank you.

Operator
Our next question comes from Ben Theurer from Barclays. Please go ahead with your question.

Ben Theurer
Thank you very much. Good morning, Donnie, Stewart. First question is on what your plans are within the prepared foods business just more structurally. So, clearly, we're seeing how pricing is coming through and impacting your beef, pork results, but that obviously puts a lot of pressure on prepared foods, and you've talked about the input cost pressure by the end of the year. So, so far, we're running at about a 9.5% range, but you've always talked about like this 10% to 12% range. So, what keeps you away from being more aggressive from pricing within the prepared foods business to really pass on more of that internal inflationary pressure you're seeing on the ingredients side just to bring it back to the low-teens levels? Because I think guidance, as well, for the year is just below that 10% level. Just to understand what needs to be seen in the market so you're going to be able to put pricing through.

Donnie King
Yes, that's a great question, Ben. We're still very proud of our prepared foods business, and if I look at the detail behind this, demand is expected to remain elevated. Retail orders, for example, are up 30% versus pre-COVID levels. Foodservice is showing sequential improvement as well. We have seen accelerating and unprecedented inflation.

So, what do you do about that? Well, we have significant foodservice pricing already in the market. Retail pricing will be in the market by September 5th. Inflation is up about 14% during our 3Q and 9% year-to-date, we've had, just like other businesses, we've had labor and absenteeism and turnover in the business. We have a number of open positions. So, that certainly has made us inefficient.

And so, we have aggressive pricing going on. Aggressive revenue management and commercial spend management will help mitigate a portion of these inflationary impacts. We'll have to get more pricing, but we're comfortable that, over time, that our prepared foods is a double-digit business for us, and it's just costs are hitting us faster than we can get pricing at this point.

Ben Theurer
Perfect. And then my follow-up question's around the capital allocation, and you've mentioned M&A would be one of the opportunities. So, could you, without obviously going into specifics, but could you explore a little bit of where you think you would have to invest? Is it on the international business? Is it investing into new facilities or just acquiring new facilities, or broaden the footprint in a certain segment?
Just to understand a little bit where your focus would be from an M&A perspective.

Stewart Glendinning
Yes, Stewart, I'll pick that up. I think in terms of the specifics from M&A, I don't think we would talk to what specific places we're going to put the money, but let's just talk about, overall, our view of capital allocation.

First of all, we really feel great about the current position of our balance sheet, and our liquidity was $3.4 billion coming out of the quarter. That was before we took the receipt of the $1.2 billion from pet, and we did repay about $500 million worth of debt subsequent to the end of the quarter. So, the balance sheet is very healthy.

From an investment standpoint, one of the things that we talked about, both in the prepared remarks and in last quarter, is that we expect to invest behind our business. We have significant opportunity to invest in expanding our capacity. And I spoke this morning about international. That will be a growth area for us. The capex that's going into the international space and new facilities will expand their capacity by 30% when compared to last year. That's a big deal.

And I think when you look at the rest of our business, Donnie spoke this morning about automation, and you're seeing that both across prepared foods, as well as in our chicken business, which will certainly help our labor. It will help our efficiency.

And then you look at where we're putting money just behind in terms of new facilities, and Humboldt's gone live. We have a new case-ready facility in Utah that'll be coming online shortly, as well as one in South Carolina. So, we have a pretty active internal agenda.

If something on the outside presents itself that we think it makes sense for our investors, then we'll obviously take a look at that. But hopefully, that gives you a flavor for where we're investing our money.

Ben Theurer
Okay, perfect. Thanks, Stewart.

Operator
And our next question comes from Robert Moskow from Credit Suisse. Please go ahead with your question.

Robert Moskow
Hi, thank you. I have a couple of questions. Just one on the retail side, Donnie. You said that pricing is having trouble keeping up with the inflation, but you do have an increase coming in September. To what extent does that fully offset all the inflation you've seen? Of course, you need another price increase right after that because it's an upward sloping curve.

Donnie King
Thanks, Robert. I mean, you quoted everything I said earlier, but with retail, with the branded portfolio, it can take a little bit longer to get pricing in. We typically don't disclose that kind of information about when we would do it. But here's generally the way we think about this, is that when raw materials, when inputs go up, pricing has to go up, particularly in an environment where we have such rapid and accelerating inflation. We certainly have to be competitive, but we certainly have to get pricing to cover the increase in inputs, and we're doing that and we're doing that very methodically. We're looking at all the metrics around that as we do that, but we're doing it in a very responsible way. And Noelle O'Mara and her team are managing that around the clock.
Robert Moskow
Okay. Well, I'm not sure what that means, Donnie. Like if the inflation that you experienced in the middle of this year is being offset by pricing on September 5th, like you say, but it sounds like inflation continues to rise. Is that it? Can I say that that's a fair statement?

Stewart Glendinning
So, maybe just a couple of things. I'm going to just jump in and give you a couple of facts here. Actually, if you looked at inflation, the biggest driver for prepared foods has been the input cost of commodities, and, of course, for prepared foods that mostly is pork. You have that, of course, along with the increase in MAP spend, which I referred to there.

So, in terms of thinking about price, I think what Donnie's saying is, when we think that commodities are going up, or any inputs are going up, we're going to match that with pricing. That pricing may not follow exactly the track of input inflation, but you also need to think about how that input inflation can move along. While we have labor cost increases, which are going into our workforce, you should think about those as more permanent, of course.

But you have seen the cycles around commodities, and you'll have to take a view of what you think the cost of pork will do over the course of next year. If pork comes off, then that'll be a help to us. If pork doesn't come off, then I think Donnie's point is that we will continue to take price to match the nature of the cost that's coming to us.

Robert Moskow
Okay, great. I appreciate it. On foodservice, obviously, continued sequential improvement, and then big improvement versus a year ago. How are your customers viewing the next three to six months? Do they view reopening pace continuing to accelerate, or are there concerns about delta variant kind of slowing things down? And to what extent are you back to 2019 levels in terms of foodservice?

Donnie King
Well, foodservice, from everyone I've talked to, based on what we see from a demand perspective, is very strong. We're at or near, across all businesses, in some or even above from foodservice from, let's call it pre-COVID levels in 2019. So, I don't know that anyone fully understands what's going to happen with the delta variant, and there are certainly some concern about that. But everyone I talk to in foodservice is optimistic about the future and for their businesses, in particular.

Robert Moskow
Great. Okay, thank you.

Operator
Our next question comes from Ben Bienvenu from Stephens. Please go ahead with your question.

Ben Bienvenu
Hi, thanks so much. Good morning, everybody.

Stewart Glendinning
Good morning, Ben.

Ben Bienvenu
I want to ask about the decision to mandate the COVID vaccines in your facilities, and really from the standpoint of knowing that labor is exceptionally tight. Does that create a dynamic where it potentially
makes labor more tight, or is the net impact of that, it gives you enough certainty around your ability to have continuity and running your facilities that in some ways it kind of ring fences the labor dynamic when you think about trying to get the chicken margins back up, and managing your plants that target the utilization rates?

**Donnie King**
Sure. Thank you, Ben. As we’ve talked a lot, even in our prepared remarks today, but they didn’t just start today, the health and safety of our team is our highest priority. If you go back and look, even in the beginnings of the pandemic, Tyson did a number of things to protect our team members. In fact, I would tell you, we did everything we knew to do to protect our team members. That was our highest priority. From mask mandates, to barriers within plants, to social distancing, to staggering shifts, to temperature sensors, and health screenings prior to going to work every day. We did everything that we knew to do.

With the new vaccine, it’s a new tool. We believe that vaccine is the most effective thing, the most effective tool available today. We’ve studied the data. We’ve researched it to the nth degree, and we’re confident in doing that. And so, we mandated that because we thought it would be irresponsible not to do that, and irresponsible not to protect our team members in every way that we could.

Now, there could be some short-term impacts, but I think they certainly will be offset by a long-term benefit in doing this. And so, that’s the position that we have taken, and it’s out of just an abundance of caution and care for our team members.

**Ben Bienvenu**
Okay. Thanks for that. My second question is on the chicken business. You talked about the critical path to achieving the margin targets you have for middle of next fiscal year. Could I ask about it from a capacity utilization standpoint? I know you have Humboldt coming online and ramping up the capacity.

In years past, I think your utilization rate has been 89%, 90%, or so. When you think about the full year for 2022, is that too high of a watermark to hit on capacity utilization, or should we think about maybe you getting back to that level by the end of fiscal 2022? How should we think about the ramp of getting back to those utilization rates?

**Donnie King**
Yes, great question, Ben. A couple of things with respect to that. When we started fiscal 2021, we had plans in place to increase our harvest head based on capacity utilization, based on demand that we already had. And with the hatch issues, certainly that created a shortfall in terms of head for our business, and then we go outside and start buying.

As we’ve changed this male out and we are starting to see results of that, that’ll ultimately end up in more head for us to harvest, and which is exactly our plan to—we already have that product sold. But I would expect, as we move into 2022 and beyond, that you’ll see our capacity utilization increase at Tyson from a harvest perspective, and all of that will be in service to supporting our value-added branded portfolio.

**Ben Bienvenu**
Okay. Thanks, and best of luck.

**Donnie King**
Thank you.

**Operator**
Our next question comes from Adam Samuelson’s line from Goldman Sachs. Please go ahead with your
question.

Adam Samuelson
Hi, thanks. Good morning, everyone.

Stewart Glendinning
Good morning.

Donnie King
Good morning.

Adam Samuelson
So, I guess, my first question is really maybe on that last point, Donnie, around capacity utilization in poultry, and I'm just trying to think about how quickly and how far you could push it. I mean, if I'm looking, the last 10-K, based on a five-day week, the poultry business was at an 84% kind of operating rate in fiscal 2020. I'd imagine it probably was leaking lower than that in fiscal 2021, given some of the hatch issues. And I'm trying to just dimensionalize, I mean, where do we think that's actually going? You guys are about 20% of the industry. So, if there's a meaningful change in your own internal production and hatch, I mean, it starts to have some meaningful impact at the industry level, in terms of available live supply. Any way you can help frame that?

Donnie King
Sure. Adam, I think you described it very well, and in a lot of way you even answered this. You talked about, based on what you saw, that it was 84%. Well, obviously, 84% capacity utilization in a protein business is not a good number. We acknowledge that. So, we need a number of head. You can do the math on how much outside meat we're purchasing based on volumes, and you could probably convert that to head. I mean, the quick math would tell you that being able to run those products through our plants, and being able to debone those chickens and go into our further process assets, and at the same time, get credit for all the byproducts through our Ingredient Solutions group, and then have the ability with our One Tyson approach to be able to sell export leg quarters, and paws and so forth, along with just the further processing volume increases that we would get, all of that adds up to a much better cost scenario, and a much better performance in our chicken business.

Adam Samuelson
Okay, that's really helpful. And then a follow-up on kind of an unrelated topic. California has their Prop 12 mandate supposedly coming into effect on January 1st, and has implications in terms of the pork that's supplied into the California market. And wondering kind of how, if at all, we should be thinking about the impact of that both to your pork and prepared foods businesses into next year.

Donnie King
Yes, great question, Adam. As we look at Prop 12, it's about 4% of total production. That's not significant for us today. Tyson is currently aligning incentivizing suppliers where appropriate. We can do multiple programs simultaneously, including Prop 12. So, it's not something we were excited about, but we can align suppliers, and we can certainly provide the raw material to service our customers in that way.

Adam Samuelson
Okay. I appreciate the color. I'll pass it on. Thanks.
Operator
Our next question comes from Alexia Howard from Bernstein. Please go ahead with your question.

Alexia Howard
Good morning, everyone.

Donnie King
Good morning.

Stewart Glendinning
Good morning, Alexia.

Alexia Howard
Okay. Can I ask, first of all, about labor costs? They're obviously escalating. I think you talked about $22 an hour. I'm just wondering how much of an increase you're expecting on a permanent basis. I know that right now with over time and incremental payments, it's probably higher than the long-term level, but I'm just trying to get a sense for how much it's going up relative to pre-COVID levels.

Donnie King
Well, there is a pretty significant increase and a pretty significant cost increase associated with that. But in a lot of respect, the market's doing its job. Based on the availability of labor, and it being in shorter supply, it's going up. And I don't see any reduction in that. We believe we're at a good place. We believe we are at the top of the market, if you will, in terms of jobs similar to this. We certainly are very competitive in all the communities where we have assets producing protein. So, we're comfortable where we are, but it's certainly an increase.

But in order to get people into your production location, it's more than just wage, and I want to make that clear. We have to do other things, and I outlined a number of those things that we're doing around child care, transportation, onsite clinic, providing a safe place to work, and flexible shifts, and number of shifts in a week. It's a combination of all those things, and doing all those things well.

And so, when you hear us talk about being the most sought after place to work, those are the type things that we have to do in order to be able to service our customers and to grow our business.

Alexia Howard
Great. And as a follow-up, just a quick one, of the $325 million in incremental COVID costs expected this year, you talked about a certain proportion of that becoming permanent. Can you quantify that?

Stewart Glendinning
Yes, Alexia, it's Stewart. Look, first of all, we feel good about COVID sequentially going down $55 million or so in the quarter. So, that's about half. The progression has sort of been 50%, but we think, over the course of the year, the structural costs are going to be counted in around $200 million or more. But understand that's in our run rate, right? So, anything that could become structural, you're already seeing, it's flowing through the numbers, I wouldn't think about that in terms of, oh, all of a sudden that's going be added to next year. A lot of that are the other labor increases that Donnie was talking to.

Alexia Howard
Very helpful. Thank you very much. I'll pass it on.

CONCLUSION
Operator
And, ladies and gentlemen, with that, we'll be concluding today's question and answer session. I'd like to turn the floor back over to Mr. Donnie King for any closing remarks.

Donnie King
Thanks again for your interest in Tyson Foods. We hope you and your family stay healthy and safe, and we look forward to speaking again soon. Have a great day.

Operator
Ladies and gentlemen, with that, we'll conclude today's conference call. We do thank you for attending today's presentation. You may now disconnect your lines.