

SMITHFIELD FOODS INC
Form 10-Q
September 05, 2008
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended July 27, 2008
COMMISSION FILE NUMBER 1-15321

SMITHFIELD FOODS, INC.

200 Commerce Street

Smithfield, Virginia 23430

(757) 365-3000

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Virginia
(State of Incorporation)

52-0845861
(I.R.S. Employer Identification Number)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer	<input checked="" type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/>	Smaller reporting company	<input type="checkbox"/>

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

At August 29, 2008, 141,410,175 shares of the registrant's Common Stock (\$.50 par value per share) were outstanding.

Table of Contents

SMITHFIELD FOODS, INC.

TABLE OF CONTENTS

	PAGE
<u>PART I FINANCIAL INFORMATION</u>	
Item 1. <u>Financial Statements</u>	3
<u>Consolidated Condensed Statements of Income 13 Weeks Ended July 27, 2008 and July 29, 2007</u>	3
<u>Consolidated Condensed Balance Sheets July 27, 2008 and April 27, 2008</u>	4
<u>Consolidated Condensed Statements of Cash Flows 13 Weeks Ended July 27, 2008 and July 29, 2007</u>	5
<u>Notes to Consolidated Condensed Financial Statements</u>	6
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	18
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	30
Item 4. <u>Controls and Procedures</u>	30
<u>PART II OTHER INFORMATION</u>	
Item 1. <u>Legal Proceedings</u>	31
Item 1A. <u>Risk Factors</u>	31
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	31
Item 3. <u>Defaults Upon Senior Securities</u>	32
Item 4. <u>Submission of Matters to a Vote of Security Holders</u>	32
Item 5. <u>Other Information</u>	32
Item 6. <u>Exhibits</u>	32
<u>SIGNATURES</u>	35

Table of Contents**PART I FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****SMITHFIELD FOODS, INC.****CONSOLIDATED CONDENSED STATEMENTS OF INCOME**

(in millions, except per share data)

	13 Weeks Ended	
	July 27, 2008	July 29, 2007
	(unaudited)	
Sales	\$ 3,141.8	\$ 2,616.7
Cost of sales	2,944.9	2,335.9
Gross profit	196.9	280.8
Selling, general and administrative expenses	190.6	165.0
Equity in (income) loss of affiliates	2.1	(13.8)
Minority interests	1.7	1.6
Operating profit	2.5	128.0
Interest expense	44.5	41.4
Income (loss) from continuing operations before income taxes	(42.0)	86.6
Income tax expense (benefit)	(13.5)	30.0
Income (loss) from continuing operations	(28.5)	56.6
Income (loss) from discontinued operations, net of tax of \$9.1 and \$(1.0)	15.9	(2.0)
Net income (loss)	\$ (12.6)	\$ 54.6
Income (loss) per share:		
Basic:		
Continuing operations	\$ (.21)	\$.43
Discontinuing operations	.12	(.02)
Net income (loss) per common share	\$ (.09)	\$.41
Diluted:		
Continuing operations	\$ (.21)	\$.43
Discontinued operations	.12	(.02)
Net income (loss) per diluted common share	\$ (.09)	\$.41
Weighted average shares:		
Weighted average basic shares	135.5	132.7
Effect of dilutive stock options		0.3
Weighted average diluted shares	135.5	133.0

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See Notes to Consolidated Condensed Financial Statements

Table of Contents**SMITHFIELD FOODS, INC.****CONSOLIDATED CONDENSED BALANCE SHEETS**

(in millions, except share data)

	July 27, 2008 (Unaudited)	April 27, 2008
ASSETS		
<i>Current assets:</i>		
Cash and cash equivalents	\$ 59.8	\$ 57.3
Accounts receivable, net	782.7	738.1
Inventories	2,261.7	2,278.4
Prepaid expenses and other current assets	238.9	119.7
Assets of discontinued operations held for sale	654.8	656.5
Total current assets	3,997.9	3,850.0
Property, plant and equipment	4,425.0	4,332.8
Accumulated depreciation	(1,549.6)	(1,482.8)
Property, plant and equipment, net	2,875.4	2,850.0
Goodwill	873.2	864.6
Investments	717.6	694.6
Intangible assets, net	396.2	396.5
Other assets	220.4	212.2
Total assets	\$ 9,080.7	\$ 8,867.9
LIABILITIES AND SHAREHOLDERS EQUITY		
<i>Current liabilities:</i>		
Notes payable	\$ 178.7	\$ 169.3
Current portion of long-term debt and capital lease obligations	241.8	239.7
Accounts payable	554.4	589.8
Accrued expenses and other current liabilities	650.9	538.8
Liabilities of discontinued operations held for sale	143.1	138.4
Total current liabilities	1,768.9	1,676.0
Long-term debt and capital lease obligations	3,591.6	3,474.4
Other liabilities	576.7	652.4
Minority interests	17.6	16.9
<i>Commitments and contingencies</i>		
<i>Shareholders' equity:</i>		
Preferred stock, \$1.00 par value, 1,000,000 authorized shares		
Common stock, \$.50 par value, 200,000,000 authorized shares; 141,410,175 and 134,398,175 issued and outstanding	70.7	67.2
Additional paid-in capital	1,231.5	1,130.2
Stock held in trust	(53.2)	(53.1)
Retained earnings	1,825.9	1,838.5
Accumulated other comprehensive income	51.0	65.4

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Total shareholders' equity	3,125.9	3,048.2
Total liabilities and shareholders' equity	\$ 9,080.7	\$ 8,867.9

See Notes to Consolidated Condensed Financial Statements

Table of Contents**SMITHFIELD FOODS, INC.****CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS****(in millions)**

	13 Weeks Ended	
	July 27, 2008	July 29, 2007
	(Unaudited)	
<i>Cash flows from operating activities:</i>		
Net income (loss)	\$ (12.6)	\$ 54.6
Adjustments to reconcile net cash flows from operating activities:		
(Income) loss from discontinued operations, net of tax	(15.9)	2.0
Equity in (income) loss of affiliates	2.1	(13.8)
Depreciation and amortization	68.9	64.7
Changes in operating assets and liabilities and other, net	(121.7)	(135.6)
Net cash flows from operating activities	(79.2)	(28.1)
<i>Cash flows from investing activities:</i>		
Capital expenditures	(83.4)	(107.1)
Business acquisition, net of cash acquired		(40.0)
Investments and other	0.3	1.3
Net cash flows from investing activities	(83.1)	(145.8)
<i>Cash flows from financing activities:</i>		
Proceeds from the issuance of long-term debt	400.0	523.6
Principal payments on long-term debt and capital lease obligations	(14.5)	(188.7)
Net repayments on revolving credit facilities and notes payable	(282.8)	(152.3)
Proceeds from the issuance of common stock and stock option exercises	122.3	0.3
Purchase of call options	(88.2)	
Proceeds from the sale of warrants	36.7	
Other	(11.0)	(5.8)
Net cash flows from financing activities	162.5	177.1
<i>Cash flows from discontinued operations:</i>		
Net cash flows from operating activities	3.8	1.8
Net cash flows from investing activities	(3.5)	(3.3)
Net cash flows from financing activities		
Net cash flows from discontinued operations activities	0.3	(1.5)
Effect of foreign exchange rate changes on cash	2.0	0.7
Net change in cash and cash equivalents	2.5	2.4
Cash and cash equivalents at beginning of period	57.3	57.8
Cash and cash equivalents at end of period	\$ 59.8	\$ 60.2
<i>Non-cash investing and financing activities:</i>		
Investment in Butterball	\$ 24.5	\$

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Common stock issued for acquisition	\$	\$ 620.2
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See Notes to Consolidated Condensed Financial Statements

Table of Contents

SMITHFIELD FOODS, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

NOTE 1: GENERAL

Smithfield Foods, Inc., together with its subsidiaries (the Company, we, us or our), is the largest hog producer and pork processor in the world. Currently, we are also the fifth largest beef processor in the U.S., subject to the sale of those operations discussed in Note 3 Discontinued Operations. We conduct our continuing operations through five reporting segments: Pork, International, Hog Production (HP), Other and Corporate.

You should read these statements in conjunction with the audited consolidated financial statements and the related notes which are included in our Annual Report on Form 10-K for the fiscal year ended April 27, 2008. The enclosed interim consolidated condensed financial information is unaudited. The information reflects all normal recurring adjustments which we believe are necessary to present fairly the financial position and results of operations for all periods.

Unless otherwise stated, the amounts presented in these notes to our consolidated financial statements are based on continuing operations for all fiscal periods included. Certain prior year amounts have changed as a result of including our beef operations in discontinued operations.

NOTE 2: RECENT ACCOUNTING PRONOUNCEMENTS

In May 2008, the Financial Accounting Standards Board (FASB) issued FASB Staff Position (FSP) No. APB 14-1, Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement) (FSP APB 14-1). FSP APB 14-1 specifies that issuers of convertible debt instruments that may be settled in cash upon conversion (including partial cash settlement) should separately account for the liability and equity components in a manner that will reflect the entity's nonconvertible debt borrowing rate when interest cost is recognized in subsequent periods. The amount allocated to the equity component represents a discount to the debt, which is amortized into interest expense using the effective interest method over the life of the debt. FSP APB 14-1 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. Early adoption is not permitted. Therefore, we expect to adopt the provisions of FSP APB 14-1 beginning in the first quarter of fiscal 2010 (beginning May 4, 2009). The provisions of FSP APB 14-1 are required to be applied retrospectively to all periods presented. We have not yet finalized our evaluation of the impact of FSP APB 14-1 on our financial statements. However, when we are required to retrospectively apply the provisions of FSP APB 14-1 in fiscal 2010, we anticipate that interest expense for fiscal 2009 will be increased by \$9.0 million to \$14.0 million.

In March 2008, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 161, Disclosures about Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133 (SFAS 161). SFAS 161 requires (1) qualitative disclosures about objectives for using derivatives by primary underlying risk exposure, (2) information about the volume of derivative activity, (3) tabular disclosures about the balance sheet location and gross fair value of derivative instruments, and income statement and other comprehensive income location and amounts of gains and losses on derivative instruments by contract type and (4) disclosures about credit-risk-related contingent features in derivative agreements. SFAS 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. Therefore, we expect to adopt SFAS 161 beginning in the fourth quarter of fiscal 2009.

In December 2007, the FASB issued SFAS No. 141R, Business Combinations (SFAS 141R). SFAS 141R establishes principles and disclosure requirements on how to recognize, measure and present the assets acquired,

Table of Contents

the liabilities assumed, any noncontrolling interests in the acquiree and any goodwill recognized in a business combination. The objective of SFAS 141R is to improve the information included in financial reports about the nature and financial effects of business combinations. This statement is effective for business combinations with an acquisition date on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. Therefore, we expect to adopt SFAS 141R for any business combinations entered into beginning in the first quarter of fiscal 2010 (beginning May 4, 2009).

Also in December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements* an amendment of ARB No. 51 (SFAS 160). SFAS 160 establishes accounting and reporting standards for a noncontrolling (minority) interest in a subsidiary and for the deconsolidation of a subsidiary. This statement clarifies that a noncontrolling interest in a subsidiary is an ownership interest in the consolidated entity and should be reported as equity in the consolidated financial statements, rather than as a liability or in the mezzanine section between liabilities and equity. SFAS 160 also requires consolidated net income be reported at amounts that include the amounts attributable to both the parent and the noncontrolling interest. SFAS 160 is effective for fiscal years beginning on or after December 15, 2008. Therefore, we expect to implement the standard beginning May 4, 2009 (fiscal 2010). We are currently in the process of evaluating the impact of SFAS 160 on our financial statements.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value in accounting principles generally accepted in the United States, and expands disclosures about fair value measurements. It does not require any new fair value measurements. SFAS 157 is effective for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years for financial assets and liabilities, and for fiscal years beginning after November 15, 2008 for all nonrecurring fair value measurements of nonfinancial assets and liabilities. We adopted the provisions of SFAS 157 for financial assets and liabilities in the first quarter of fiscal 2009. The adoption of SFAS 157 did not have a material impact on our consolidated financial statements. We do not believe the adoption of SFAS 157 for our nonrecurring fair value measurements of nonfinancial assets and liabilities, effective May 4, 2009 (fiscal 2010), will have a material impact on our consolidated financial statements. See Note 13 *Fair Value Measurements* for additional disclosures on fair value measurements.

NOTE 3: DISCONTINUED OPERATIONS

Smithfield Beef

In March 2008 (fiscal 2008), we entered into an agreement with JBS S.A., a company organized and existing under the laws of Brazil (JBS), to sell Smithfield Beef, our beef processing and cattle feeding operation that encompassed our entire Beef segment, to JBS for \$565.0 million in cash.

The sale to JBS will include 100% of Five Rivers. We also entered into an agreement with Continental Grain Company (CGC) in March 2008 (fiscal 2008) to acquire from CGC the 50% of Five Rivers that we do not presently own in exchange for 2.167 million shares of our common stock. This transaction with CGC will occur immediately before the JBS transaction, is conditioned upon the JBS transaction taking place, and, assuming no changes in the beneficial ownership of CGC or in the number of our outstanding shares from the date of this report through the closing, will make CGC a beneficial owner of approximately 9% of our common stock. Paul J. Fribourg, a member of our board of directors, is Chairman, President and Chief Executive Officer of CGC. Michael J. Zimmerman, an advisory director of the Company, is Executive Vice President and Chief Financial Officer of CGC.

The JBS transaction excludes substantially all live cattle inventories held by Smithfield Beef and Five Rivers as of the closing date, together with the associated debt of Five Rivers. Live cattle currently owned by Five Rivers will be transferred to a new 50/50 joint venture between us and CGC, while live cattle currently owned by Smithfield Beef will be transferred to another subsidiary of ours. The excluded live cattle will be raised by JBS

Table of Contents

after closing for a negotiated fee and then sold at maturity at market-based prices. Proceeds from the sale of the excluded live cattle will be paid in cash to the Smithfield Foods/CGC joint venture or to us, as appropriate. We believe that most of the live cattle inventories will be sold within six months after closing, with substantially all sold within 12 months after closing. As of July 27, 2008, the proceeds from the sale of Smithfield Beef's live cattle inventories and our interest in Five Rivers' cattle inventory, net of the associated debt, are expected to be in excess of \$150.0 million.

The respective transactions are subject to customary adjustments, including working capital adjustments. The transactions are also subject to regulatory review. On July 11, 2008, we completed our filing in response to the second request from the Antitrust Division of the Department of Justice. Barring regulatory delays, we anticipate the transactions will close during the second quarter of fiscal 2009. Accordingly, the results of Smithfield Beef are now being reported as discontinued operations. We expect that the net proceeds of the transactions will be used principally for debt reduction.

Smithfield Beef had sales and after-tax income of \$814.1 million and \$17.7 million, respectively, for the 13 weeks ended July 27, 2008. Smithfield Beef had sales and after-tax income of \$747.5 million and \$5.5 million, respectively, for the 13 weeks ended July 29, 2007. After-tax income included interest expense of \$9.8 million and \$10.4 million for the 13 weeks ended July 27, 2008 and July 29, 2007, respectively. Interest expense is allocated to discontinued operations based on specific borrowings by the discontinued operations.

The carrying amounts of the assets and liabilities held for sale at Smithfield Beef (including its investment in Five Rivers) are as follows:

	July 27, 2008 (in millions)
Accounts receivable, net	\$ 116.9
Non-cattle inventories	96.3
Prepays and other current assets	10.1
Property, plant and equipment, net	147.3
Goodwill	115.9
Investments	156.7
Intangible assets, net	8.0
Other assets	3.6
Assets of discontinued operations held for sale	\$ 654.8
Accounts payable	\$ 63.2