

SANDERSON FARMS INC

Form 10-Q

August 25, 2009

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D. C. 20549  
FORM 10-Q**

(MARK ONE)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES AND EXCHANGE ACT OF 1934**

**For the quarterly period ended July 31, 2009**

**OR**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission file number 1-14977  
Sanderson Farms, Inc.**

(Exact name of registrant as specified in its charter)

Mississippi

64-0615843

(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification No.)

127 Flynt Road, Laurel, Mississippi

39443

(Address of principal executive offices)

(Zip Code)

(601) 649-4030

(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report.)

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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). 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. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company   
(Do not check if a smaller reporting company)

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

APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY PROCEEDINGS  
DURING THE PRECEDING FIVE YEARS:

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes  No

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. Common

Stock, \$1 Par Value Per Share: 20,329,303 shares outstanding as of July 31, 2009.

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## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements

SANDERSON FARMS, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED BALANCE SHEETS

	July 31, 2009 (Unaudited)	October 31, 2008 (Note 1)
	(In thousands)	
Assets		
Current assets:		
Cash and cash equivalents	\$ 33,373	\$ 4,261
Accounts receivable, net	67,213	63,516
Inventories	150,138	137,015
Refundable income taxes	0	31,033
Deferred income taxes	2,200	15,885
Prepaid expenses and other current assets	21,832	15,853
Total current assets	274,756	267,563
Property, plant and equipment	735,676	722,815
Less accumulated depreciation	(341,120)	(311,485)
	394,556	411,330
Other assets	2,860	2,265
Total assets	\$ 672,172	\$ 681,158
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable and accrued expenses	\$ 101,788	\$ 77,565
Current maturities of long-term debt	968	1,219
Total current liabilities	102,756	78,784
Long-term debt, less current maturities	132,918	225,322
Claims payable	2,200	3,000
Deferred income taxes	22,915	20,085
Stockholders' equity:		
Preferred Stock:		
Series A Junior Participating Preferred Stock, \$100 par value: authorized 500,000 shares, none issued		
Par value to be determined by the Board of Directors: authorized 4,500,000 shares; none issued		
Common Stock, \$1 par value: authorized 100,000,000 shares; issued and outstanding shares 20,329,303 and 20,288,643 at July 31, 2009 and October 31, 2008, respectively	20,329	20,289
Paid-in capital	32,492	28,859
Retained earnings	358,562	304,819

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Total stockholders' equity	411,383	353,967
Total liabilities and stockholders' equity	\$ 672,172	\$ 681,158

See notes to condensed consolidated financial statements.

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SANDERSON FARMS, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS  
(UNAUDITED)

	Three Months Ended July 31,		Nine Months Ended July 31,	
	2009	2008	2009	2008
	(In thousands, except per share amounts)			
Net sales	\$ 504,846	\$ 466,915	\$ 1,320,489	\$ 1,263,357
Cost and expenses:				
Cost of sales	413,821	454,678	1,168,507	1,201,067
Selling, general and administrative	21,514	12,979	46,312	40,930
Donning and Doffing Settlement	0	2,693	0	2,693
	435,335	470,350	1,214,819	1,244,690
<b>OPERATING INCOME (LOSS)</b>	<b>69,511</b>	<b>(3,435)</b>	<b>105,670</b>	<b>18,667</b>
Other income (expense):				
Interest income	8	48	19	143
Interest expense	(2,038)	(2,259)	(7,738)	(6,113)
Other	5	(34)	2	7
	(2,025)	(2,245)	(7,717)	(5,963)
<b>INCOME (LOSS) BEFORE INCOME TAXES</b>	<b>67,486</b>	<b>(5,680)</b>	<b>97,953</b>	<b>12,704</b>
Income tax expense (benefit)	24,438	(2,035)	35,438	3,910
<b>NET INCOME (LOSS)</b>	<b>\$ 43,048</b>	<b>\$ (3,645)</b>	<b>\$ 62,515</b>	<b>\$ 8,794</b>
Earnings (loss) per share:				
Basic	\$ 2.12	\$ (.18)	\$ 3.08	\$ .43
Diluted	\$ 2.09	\$ (.18)	\$ 3.04	\$ .43
Dividends per share	\$ .14	\$ .14	\$ .42	\$ .42
Weighted average shares outstanding:				
Basic	20,326	20,283	20,313	20,264
Diluted	20,639	20,283	20,598	20,469

See notes to condensed consolidated financial statements.

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SANDERSON FARMS, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
(UNAUDITED)

	Nine Months Ended July 31,	
	2009	2008
	(In thousands)	
Operating activities		
Net income	\$ 62,515	\$ 8,794
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	32,661	31,143
Non-cash stock compensation	3,307	1,985
Provision for losses on accounts receivable	374	220
Deferred income taxes	16,515	0
Change in assets and liabilities:		
Accounts receivable, net	(4,071)	10,933
Refundable income taxes	31,033	0
Inventories	(13,124)	(67,718)
Prepaid expenses and other assets	(6,729)	(11,066)
Accounts payable, accrued expenses and other liabilities	20,497	23,986
Total adjustments	80,463	(10,517)
Net cash provided by (used in) operating activities	142,978	(1,723)
Investing activities		
Capital expenditures	(15,887)	(42,281)
Net proceeds from sale of property and equipment	156	573
Net cash used in investing activities	(15,731)	(41,708)
Financing activities		
Principal payments on long-term debt	(604)	(289)
Net borrowings from (repayments on) revolving line of credit	(92,051)	66,307
Net proceeds from exercise of stock options and management share purchase plan	367	606
Tax benefit on exercised stock options	0	153
Dividends paid	(5,847)	(5,815)
Net cash provided by (used in) financing activities	(98,135)	60,962
Net change in cash and cash equivalents	29,112	17,531
Cash and cash equivalents at beginning of period	4,261	2,623
Cash and cash equivalents at end of period	\$ 33,373	\$ 20,154



Supplemental disclosure of non-cash financing activity:

Dividends payable	\$ (2,926)	\$ (2,912)
Asset acquired through capital lease	\$ 0	\$ 14,014

See notes to condensed consolidated financial statements.

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SANDERSON FARMS, INC. AND SUBSIDIARIES  
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)  
 July 31, 2009

**NOTE 1 BASIS OF PRESENTATION**

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments consisting of normal recurring accruals considered necessary for a fair presentation have been included. Operating results for the three and nine months ended July 31, 2009 are not necessarily indicative of the results that may be expected for the year ending October 31, 2009.

The consolidated balance sheet at October 31, 2008 has been derived from the audited consolidated financial statements at that date but does not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. For further information, reference is made to the consolidated financial statements and footnotes thereto included in the Company's annual report on Form 10-K for the year ended October 31, 2008.

Subsequent events have been evaluated through the time of filing on August 25, 2009 which represents the date the Condensed Consolidated Financial Statements were issued.

**NOTE 2 INVENTORIES**

Inventories consisted of the following:

	July 31, 2009	October 31, 2008
	(In thousands)	
Live poultry-broilers and breeders	\$ 97,877	\$ 69,715
Feed, eggs and other	18,999	24,460
Processed poultry	20,779	30,477
Processed food	6,547	6,956
Packaging materials	5,936	5,407
	\$ 150,138	\$ 137,015

Inventories of live poultry increased as a result of the \$35.0 million live inventory adjustment at October 31, 2008 to record the Company's live broiler inventory at estimated market value, which was lower than the cost plus the estimated cost to complete that inventory at that date. The Company recorded its live broiler inventory on hand at July 31, 2009 at cost because the estimated market value of the products that will be produced from the live inventory was higher than the inventory's cost plus the estimated cost to complete that inventory.

The decrease in feed, eggs and other at July 31, 2009 when compared to October 31, 2008 reflects lower feed grain prices.

The decrease in processed poultry inventories resulted primarily from fewer units of export product in inventory at July 31, 2009 as compared to October 31, 2008, which resulted from the timing of export sales, and lower feed grain prices.

**NOTE 3 STOCK COMPENSATION PLANS**

Refer to Note 8 of our October 31, 2008 audited financial statements for further information on our employee benefit plans and stock based compensation plans. Total stock based compensation expense applicable to the Company's restricted stock grants for the nine months ended July 31, 2009 and July 31, 2008 was \$3,307,000 and \$1,985,000, respectively.

During the nine months ended July 31, 2009, participants in the Company's Management Share Purchase Plan purchased a total of 16,656 shares of restricted stock at an average price of \$38.65 per share and the Company issued

4,111 matching restricted shares.

On January 29, 2009, the Company entered into performance share agreements that grant certain officers and key employees the right to receive a target number of 60,500 shares of the Company's common stock, subject to the Company's achievement of certain performance measures. The Company also has performance share agreements in place with certain officers and key employees that were entered into in fiscal 2007 and 2006. The aggregate target number of shares specified in performance share agreements outstanding as of July 31, 2009 totaled 229,412. The Company recorded compensation cost of \$434,000 during the three and nine months ended July 31, 2009 related to the performance shares entered into on January 29, 2009. No compensation costs have been recorded for the performance share agreements entered into in fiscal 2007 and 2006.

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Also on January 29, 2009 the Company granted 60,500 shares of restricted stock to key management employees. The restricted stock had a grant date fair value of \$38.24 per share and vests four years from the date of the grant.

On February 19, 2009, the Company granted 18,326 shares of restricted stock to its non-employee directors. The restricted stock had a grant date fair value of \$29.14 per share and vests one to three years from date of grant.

**NOTE 4 EARNINGS PER SHARE**

Basic net income per share was calculated by dividing net income by the weighted-average number of common shares outstanding during the period. Diluted net income per share was calculated by dividing net income by the weighted-average number of common shares outstanding during the period plus the dilutive effects of stock options and restricted stock outstanding. Restricted stock and employee stock options representing 312,697 and 284,765 common shares respectively, were included in the calculation of diluted net income per share for the three and nine months ended July 31, 2009. Restricted stock and employee stock options representing 239,545 common shares were not included in the calculations of diluted net loss per share for the three months ended July 31, 2008, because the effect was antidilutive. Restricted stock and employee stock options representing 205,659 common shares were included in the calculation of diluted net income per share for the nine months ended July 31, 2008.

**NOTE 5 NEW ACCOUNTING PRONOUNCEMENTS**

In September 2006, the FASB issued SFAS No. 157 Fair Value Measurements ( SFAS 157 ). This standard defines fair value, establishes a framework for measuring fair value in accounting principles generally accepted in the United States of America and expands disclosure about fair value measurements. This pronouncement applies whenever other accounting standards require or permit assets or liabilities to be measured at fair value. Accordingly, this statement does not require any new fair value measurements. The Company adopted SFAS No. 157 effective November 1, 2008 for its financial assets and liabilities. The adoption had no material effect on the Company's consolidated financial position, results of operations or cash flows. The Company will adopt SFAS 157 for its non-financial assets and liabilities that are recognized at fair value on a non-recurring basis on November 1, 2009 and is currently evaluating the impact of its adoption.

In February 2007, the FASB issued SFAS No. 159 The Fair Value Option for Financial Assets and Liabilities including an Amendment of FASB Statement No. 115 ( SFAS 159 ). This standard provides companies with an option to measure, at specified election dates, many financial instruments and certain other items at fair value. This Statement also establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. This statement is effective for fiscal years beginning after November 15, 2007. Accordingly, the Company adopted SFAS No. 159 during the first quarter of fiscal 2009. We did not elect the fair value option under SFAS 159 and accordingly the adoption had no material effect on the Company's consolidated financial position, results of operations or cash flows.

In April, the FASB issued FSP No. FAS107-1 and APB 28-1, Interim Disclosures about Fair Value of Financial Instruments. This FSP essentially expands the disclosure about fair value of financial instruments that were previously required only annually to also be required for interim period reporting. In addition, the FSP requires certain additional disclosures regarding the methods and significant assumptions used to estimate the fair value of financial instruments. For the Company, these additional disclosures are required beginning in the third quarter of fiscal 2009. The Company adopted the additional required disclosures during the third quarter of fiscal 2009.

In May 2009, the FASB issued SFAS No. 165 Subsequent Events, which establishes the standards of accounting for and disclosure of events that occur after the balance sheet date but before the financial statements are issued. This statement also requires the disclosure of the date through which subsequent events have been evaluated. The Company adopted SFAS No. 165 during the third quarter of fiscal 2009.

**NOTE 6 FAIR VALUE OF FINANCIAL INSTRUMENT**

The carrying amounts for cash and temporary cash investments approximate their fair values. Fair values for debt are based on quoted market prices or published forward interest rate curves. The fair value and carrying value of the Company's borrowings under its credit facilities, long-term debt and capital lease obligations were as follows (in millions):

July 31, 2009

October 31, 2008

	Fair Value	Carrying Value	Fair Value	Carrying Value
Total Debt	\$138	\$134	\$227	\$227

**NOTE 7 OTHER MATTERS**

The Company is involved in various claims and litigation incidental to its business. Although the outcome of these matters cannot be determined with certainty, management, upon the advice of counsel, is of the opinion that the final outcome should not have a material effect on the Company's consolidated results of operations or financial position.

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The Company recognizes the costs of legal defense for the legal proceedings to which it is a party in the periods incurred. A determination of the amount of reserves required, if any, for these matters is made after considerable analysis of each individual case. Because the outcome of these proceedings cannot be determined with any certainty, no estimate of the possible loss or range of loss resulting from the cases can be made. At this time, the Company has not accrued any reserve for any of these matters. Future reserves may be required if losses are deemed probable due to changes in the Company's assumptions, the effectiveness of legal strategies, or other factors beyond the Company's control. Future results of operations may be materially affected by the creation of or changes to reserves or by accruals of losses to reflect any adverse determinations of these legal proceedings.

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Board of Directors and Stockholders

Sanderson Farms, Inc.

We have reviewed the condensed consolidated balance sheet of Sanderson Farms, Inc. and subsidiaries as of July 31, 2009, and the related condensed consolidated statements of operations for the three-month and nine-month periods ended July 31, 2009 and 2008 and the condensed consolidated statements of cash flows for the nine-month periods ended July 31, 2009 and 2008. These financial statements are the responsibility of the Company's management. We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the condensed consolidated financial statements referred to above for them to be in conformity with U.S. generally accepted accounting principles.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of Sanderson Farms, Inc. and subsidiaries as of October 31, 2008, and the related consolidated statements of operations, stockholders' equity, and cash flows for the year then ended not presented herein, and in our report dated December 18, 2008, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of October 31, 2008, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ Ernst & Young LLP  
New Orleans, Louisiana  
August 24, 2009

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

General

The following Discussion and Analysis should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations included in Item 7 of the Company's Annual Report on Form 10-K for its fiscal year ended October 31, 2008.

This Quarterly Report, and other periodic reports filed by the Company under the Securities Exchange Act of 1934, and other written or oral statements made by it or on its behalf, may include forward-looking statements, which are based on a number of assumptions about future events and are subject to various risks, uncertainties and other factors that may cause actual results to differ materially from the views, beliefs and estimates expressed in such statements.

These risks, uncertainties and other factors include, but are not limited to the following:

- (1) Changes in the market price for the Company's finished products and feed grains, both of which may fluctuate substantially and exhibit cyclical characteristics typically associated with commodity markets.
- (2) Changes in economic and business conditions, monetary and fiscal policies or the amount of growth, stagnation or recession in the global or U.S. economies, either of which may affect the value of inventories, the collectability of accounts receivable or the financial integrity of customers, and the ability of the end user or consumer to afford protein.
- (3) Changes in the political or economic climate, trade policies, laws and regulations or the domestic poultry industry of countries to which the Company or other companies in the poultry industry ship product, and other changes that might limit the Company's or the industry's access to foreign markets.
- (4) Changes in laws, regulations, and other activities in government agencies and similar organizations applicable to the Company and the poultry industry and changes in laws, regulations and other activities in government agencies and similar organizations related to food safety.
- (5) Various inventory risks due to changes in market conditions.
- (6) Changes in and effects of competition, which is significant in all markets in which the Company competes, and the effectiveness of marketing and advertising programs. The Company competes with regional and national firms, some of which have greater financial and marketing resources than the Company.
- (7) Changes in accounting policies and practices adopted voluntarily by the Company or required to be adopted by accounting principles generally accepted in the United States.
- (8) Disease outbreaks affecting the production performance and/or marketability of the Company's poultry products.
- (9) Changes in the availability and cost of labor and growers.

Readers are cautioned not to place undue reliance on forward-looking statements made by or on behalf of Sanderson Farms. Each such statement speaks only as of the day it was made. The Company undertakes no obligation to update or to revise any forward-looking statements. The factors described above cannot be controlled by the Company. When used in this quarterly report, the words believes, estimates, plans, expects, should, outlook, and anticipates expressions as they relate to the Company or its management are intended to identify forward-looking statements.

The Company's poultry operations are integrated through its control of all functions relative to the production of its chicken products, including hatching egg production, hatching, feed manufacturing, raising chickens to marketable age (grow out), processing, and marketing. Consistent with the poultry industry, the Company's profitability is substantially impacted by the market prices for its finished products and feed grains, both of which may fluctuate substantially and exhibit cyclical characteristics typically associated with commodity markets. Other costs, excluding feed grains, related to the profitability of the Company's poultry operations, including hatching egg production, hatching, growing, and processing cost, are responsive to efficient cost containment programs and management practices.

The Company's prepared chicken product line includes over 75 institutional and consumer packaged chicken items that it sells nationally, primarily to distributors and food service establishments. A majority of the prepared chicken items are made to the specifications of food service users.



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On January 12, 2006, the Company announced that sites in Waco and McLennan County, Texas had been selected for the construction of a new poultry complex, consisting of a processing plant, hatchery and wastewater treatment facility. The processing plant began processing chickens on August 6, 2007, and was originally planned to reach full production of approximately 1.25 million head of chickens per week during the fourth quarter of fiscal 2008. However, because of poor market fundamentals in the second half of calendar 2008, moving the plant to full capacity was delayed until the third quarter of fiscal 2009. The plant is now processing at 100% capacity or 1.25 million head of chicken per week.

On July 23, 2009, the Company announced plans to proceed with the construction and start-up of the Company's Kinston, North Carolina, poultry complex with an expected budget of approximately \$121.4 million. Sanderson Farms previously announced plans on April 24, 2008, to invest approximately \$126.5 million for construction of a new feed mill, poultry processing plant and hatchery on separate sites in Kinston and Lenoir County, North Carolina. On June 26, 2008, the Company announced its decision to postpone the project due to market conditions and escalating grain prices. The Kinston facilities will comprise a state-of-the-art poultry complex with the capacity to process 1.25 million birds per week for the retail chill pack market. At full capacity, the complex will employ approximately 1,500 people, will require 130 contract growers, and will be equipped to process and sell 6.7 million pounds per week of dressed poultry meat. Construction began during August 2009 and the Company expects initial operation of the new complex to begin during the first quarter of fiscal 2011.

**EXECUTIVE OVERVIEW OF RESULTS**

Improvements in the overall market prices for poultry products and lower cost of corn resulted in improved margins during the third quarter of fiscal 2009 as compared to the third quarter of fiscal 2008. Demand for fresh chicken in retail grocery stores remained relatively strong during the third fiscal quarter, and is reflected in the Georgia Dock whole bird price. Market prices for boneless breast meat improved during the third quarter of fiscal 2009 as compared to the third quarter of fiscal 2008, but demand from some food service customers remains weak and the Company expects this trend to continue until traffic in restaurants improves. The Company expects its average cost of feed grains to be lower during the fourth quarter of fiscal 2009 as compared to the fourth quarter of fiscal 2008.

**RESULTS OF OPERATIONS**

Net sales for the three months ended July 31, 2009 were \$504.8 million as compared to \$466.9 million during the same quarter of fiscal 2008, an increase of \$37.9 million or 8.1%. Net sales of poultry products for the three months ended July 31, 2009 and July 31, 2008 were \$467.9 million and \$434.1 million, respectively, an increase of \$33.8 million or 7.8%. The increase in net sales of poultry products resulted from an increase in the average sales price of poultry products of 9.4%, partially offset by a decrease in the pounds of poultry products sold of 1.4%. The reduction in the pounds of poultry products sold during the three months ended July 31, 2009 as compared to the three months ended July 31, 2008 resulted from the Company's planned reduction in production, in response to weak demand from some food service customers. The impact of this reduction was partially offset by additional pounds of chicken processed at the Company's new Waco, Texas facility, which began operating at full capacity during the third quarter of fiscal 2009. The increase in the average sales price of poultry products reflects relatively strong demand from retail grocery store customers, offset by continued weakness in demand for chicken from some food service customers. A simple average of the Georgia Dock price for whole chickens was 2.3% higher during the three months ended July 31, 2009 as compared to the three months ended July 31, 2008. In addition, jumbo wing prices averaged 62.6% higher during the three months ended July 31, 2009 as compared to the same quarter a year ago. However, average bulk leg quarter prices decreased 4.9% during the third quarter of fiscal 2009 as compared to the third quarter of fiscal 2008. The average Urner Barry market price for boneless breast meat during the three months ended July 31, 2009 increased 3.4% as compared to the same period a year ago. Net sales of prepared chicken products for the three months ended July 31, 2009 and 2008 were \$36.9 million and \$32.8 million, respectively, or an increase of 12.6%. This increase resulted from an increase in the pounds of prepared chicken products sold of 8.8% and a corresponding increase in the average sales price of prepared chicken products of 3.5%.

Net sales for the nine months ended July 31, 2009 were \$1,320.5 million as compared to \$1,263.4 million for the nine months ended July 31, 2008, an increase of \$57.1 million or 4.5%. Net sales of poultry products increased \$62.8 million or 5.4% and resulted from an increase in the pounds of poultry products sold of approximately 3.7% and

an increase in the Company's average sales price of poultry products of 1.7%. During fiscal 2009, the company implemented a planned reduction in pounds of poultry products processed in response to weak demand from food service customers. The effect of this reduction in the pounds of chicken produced was offset by the additional pounds of poultry products produced at the Company's new poultry complex in Waco, Texas and a reduction in processed inventories. The new Waco complex began initial operations in the fourth quarter of fiscal 2007 and reached full capacity during the third quarter of fiscal 2009. For the first nine months of fiscal 2009 as compared to the same period during 2008 poultry prices were mixed. A simple average of the Georgia dock prices for whole birds increased by 6.8%. In addition, prices for jumbo wings and tenders increased 35.2% and 15.0%, respectively. However, market prices for boneless breast and bulk leg quarters decreased 3.3% and 15.1%, respectively, during the first nine months of fiscal 2009 as compared to the first nine months of fiscal 2008. Net sales of prepared chicken products decreased \$5.7 million or 5.4% during the first nine months of fiscal 2009 as compared

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to the first nine months of fiscal 2008. Pounds sold of prepared chicken products decreased 9.6% during the nine months ended July 31, 2009 as compared to the same period during fiscal 2008, and the average sales price of prepared chicken products increased 4.6%. The Company made changes at the prepared chicken plant to increase that facility's capacity to produce individually frozen poultry products and cooked poultry products in fiscal 2008. Cost of sales during the third quarter of fiscal 2009 decreased \$40.9 million or 9.0% as compared to the same quarter during fiscal 2008. Cost of sales of poultry products decreased \$42.9 million or 10.1% during the third quarter of fiscal 2009 as compared to the third quarter of fiscal 2008, which decrease was the result of a decrease in pounds of poultry products sold and lower feed grain costs. A simple average of the Company's cost of corn and soybean meal purchased by the Company during the third quarter of fiscal 2009 as compared to the third quarter of fiscal 2008 reflected decreases of 26.7% and 1.2%, respectively. The Company believes that grain prices will be lower during the fourth quarter of fiscal 2009 as compared to the prices the Company and industry incurred during the final quarter of fiscal 2008. Cost of sales of the Company's prepared chicken products increased \$2.0 million or 6.6% due to the increase in the pounds of prepared chicken products sold of 8.8% during the three months ended July 31, 2009 as compared to the three months ended July 31, 2008.

Cost of sales for the nine months ended July 31, 2009 decreased \$32.6 million or 2.7% as compared to the nine months ended July 31, 2008. Cost of sales of poultry products decreased \$24.4 million or 2.2% during the first nine months of fiscal 2009 as compared to the first nine months of fiscal 2008 and resulted from the additional pounds of poultry products sold of 3.7%, offset by lower feed grain prices. A simple average of the Company's cost of corn and soybean meal purchased by the Company during the nine months ended July 31, 2009 as compared to the nine months ended July 31, 2008 reflected decreases of 17.2% and 2.7%, respectively. The Company believes that grain prices will be lower for the fourth quarter of fiscal 2009 as compared to the same period a year ago. Cost of sales of the Company's prepared chicken products decreased \$8.2 million or 8.5% due to a decrease in the pounds of prepared food products sold of 9.6% during the first nine months of fiscal 2009 as compared to the first nine months of fiscal 2008. Selling, general and administrative costs for the three and nine months ended July 31, 2009 were \$21.5 million and \$46.3 million, as compared to \$13.0 million and \$40.9 million, respectively, for the three and nine months ended July 31, 2008. The increase in selling, general and administrative costs of \$8.5 million during the third quarter of fiscal 2009 resulted from an accrual for contributions to the Employee Stock Ownership Plan and the Company's Bonus Awards Program. The increase of \$5.4 million for the nine months ended July 31, 2009 and 2008 resulted from the accruals during the third quarter to the Employee Stock Ownership Plan and Bonus Awards Program and was partially offset by a planned decrease in advertising expenditures.

On October 31, 2008, the Company recorded a charge of \$35.0 million to lower the value of live broiler inventories on hand from cost to estimated market value because the estimated market price for the products to be produced from those live chickens when sold was below the estimated cost to grow, process and distribute those chickens. As of January 31, April 30, and July 31, 2009 market fundamentals had improved such that the estimated market prices of the products to be produced from the Company's live broiler inventories were higher than the estimated cost to grow, process and distribute those chickens and, accordingly, the Company recorded its live broiler inventories on January 31, April 30, and July 31, 2009 at cost. The \$35 million adjustment to inventory on October 31, 2008 effectively absorbed into the fourth fiscal quarter of 2008 a portion of the costs to grow, process and distribute chicken that were incurred and would have otherwise been recognized in the first quarter of fiscal 2009.

The third quarter of fiscal 2009 resulted in an operating income of \$69.5 million as compared to an operating loss for the third quarter of fiscal 2008 of \$3.4 million. For the nine months ended July 31, 2009 and 2008 the Company's operating income was \$105.7 million and \$18.7 million, respectively. The increases in operating income for the three and nine months ended July 31, 2009 were the result of lower feed costs and an overall improvement in the market prices for poultry products, as described above.

Interest expense during the three and nine months ended July 31, 2009 was \$2.0 million and \$7.7 million, respectively, as compared to \$2.3 million and \$6.1 million for the same periods during fiscal 2008. The Company significantly reduced borrowings under its revolving line of credit during the third quarter of fiscal 2009 and expects interest expense to be lower during the fourth quarter of fiscal 2009 as compared to the same quarter during fiscal 2008.

The Company's effective tax rate during the three and nine months ended July 31, 2009 was 36.2% as compared to an effective tax rate for the three and nine months ended July 31, 2008 of 35.8% and 30.8%, respectively. The Company's effective tax rate differs from the statutory federal rate due to state income taxes, certain nondeductible expenses for federal income tax purposes and tax credits available as a result of Hurricane Katrina and state credits unrelated to the hurricane. The Company expects its effective tax rate to be approximately 36.2% for the fourth quarter of fiscal 2009. Net income for the three months ended July 31, 2009 was \$43.0 million or \$2.09 per share as compared to a net loss of \$3.6 million or \$.18 per share for the three months ended July 31, 2008. Net income for the nine months ended July 31, 2009 and July 31, 2008 was \$62.5 million or \$3.04 per share and \$8.8 million or \$.43 per share, respectively.

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### **Liquidity and Capital Resources**

The Company's working capital at July 31, 2009 was \$172.0 million and its current ratio was 2.7 to 1. This compares to working capital of \$188.8 million and a current ratio of 3.4 to 1 as of October 31, 2008. During the nine months ended July 31, 2009, the Company spent approximately \$15.9 million on planned capital projects.

As of July 31, 2009, the Company's capital budget for fiscal 2009 is approximately \$23.8 million and will be funded by cash on hand, internally generated working capital, cash flows from operations and, if needed, borrowings under the Company's revolving line of credit. The Company had \$222.5 million available under the revolving line of credit as of July 31, 2009.

On January 12, 2006, the Company announced that sites in Waco and McLennan County, Texas had been selected for the construction of a new poultry complex, consisting of a processing plant, hatchery and wastewater treatment facility. The processing plant began processing chickens on August 6, 2007, and was originally planned to reach full production of approximately 1.25 million head of chickens per week during the fourth quarter of fiscal 2008.

However, because of recent poor market fundamentals, moving the plant to full capacity was delayed until the third quarter of fiscal 2009. The plant is now processing at 100% capacity or 1.25 million head of chicken per week.

On July 23, 2009, the Company announced plans to proceed with the construction and start-up of the Company's Kinston, North Carolina, poultry complex with an expected budget of approximately \$121.4 million. Sanderson Farms previously announced plans on April 24, 2008, to invest approximately \$126.5 million for construction of a new feed mill, poultry processing plant and hatchery on separate sites in Kinston and Lenoir County, North Carolina. On June 26, 2008, the Company announced its decision to postpone the project due to market conditions and escalating grain prices. The Kinston facilities will comprise a state-of-the-art poultry complex with the capacity to process 1.25 million birds per week for the retail chill pack market. At full capacity, the complex will employ approximately 1,500 people, will require 130 contract growers, and will be equipped to process and sell 6.7 million pounds per week of dressed poultry meat. Construction began during August 2009 and the Company expects initial operations at the new complex to begin during the first quarter of fiscal 2011.

On May 1, 2008, the Company entered into a new revolving credit facility to, among other things, increase the available credit to \$300.0 million, increase the capital expenditure limits to allow construction of the Kinston, North Carolina facility, and to change the covenant requiring a minimum debt to total capitalization ratio to 50% during fiscal 2008, 55% during fiscal 2009 and not to exceed 50% for fiscal 2010 and thereafter. The credit remains unsecured and, unless extended, will expire May 1, 2013.

The Company regularly evaluates both internal and external growth opportunities, including acquisition opportunities and the possible construction of new production assets, and conducts due diligence activities in connection with such opportunities. The cost and terms of any financing to be raised in conjunction with any growth opportunity, including the Company's ability to raise debt or equity capital on terms and at costs satisfactory to the Company, and the effect of such opportunities on the Company's balance sheet, are critical considerations in any such evaluation.

### **Critical Accounting Policies and Estimates**

The preparation of financial statements in accordance with accounting standards generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates and assumptions, and the differences could be material.

The Company's Summary of Significant Accounting Policies, as described in Note 1 of the Notes to the Consolidated Financial Statements that are filed with the Company's latest report on Form 10-K, should be read in conjunction with this Management's Discussion and Analysis of Financial Condition and Results of Operations. Management believes that the critical accounting policies and estimates that are material to the Company's Consolidated Financial Statements are those described below.

### **Allowance for Doubtful Accounts**

In the normal course of business, the Company extends credit to its customers on a short-term basis. Although credit risks associated with our customers are considered minimal, the Company routinely reviews its accounts receivable balances and makes provisions for probable doubtful accounts. In circumstances where management is aware of a

specific customer's inability to meet its financial obligations to the Company, a specific reserve is recorded to reduce the receivable to the amount expected to be collected. If circumstances change (i.e., higher than expected defaults or an unexpected material adverse change in a major customer's ability to meet its financial obligations to us), our estimates of the recoverability of amounts due us could be reduced by a material amount, and the allowance for doubtful accounts and related bad debt expense would increase by the same amount.

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**Inventories**

Processed food and poultry inventories and inventories of feed, eggs, medication and packaging supplies are stated at the lower of cost (first-in, first-out method) or market. If market prices for poultry or feed grains move substantially lower, the Company would record adjustments to write down the carrying values of processed poultry and feed inventories to fair market value, which would increase the Company's costs of sales.

Live poultry inventories of broilers are stated at the lower of cost or market and breeders at cost less accumulated amortization. The cost associated with broiler inventories, consisting principally of chicks, feed, medicine and payments to the growers who raise the chicks for us, are accumulated during the growing period. The cost associated with breeder inventories, consisting principally of breeder chicks, feed, medicine and grower payments are accumulated during the growing period. Capitalized breeder costs are then amortized over nine months using the straight-line method. Mortality of broilers and breeders is charged to cost of sales as incurred. If market prices for chicken, feed or medicine or if grower payments increase (or decrease) during the period, the Company could have an increase (or decrease) in the market value of its inventory as well as an increase (or decrease) in costs of sales. Should the Company decide that the nine month amortization period used to amortize the breeder costs is no longer appropriate as a result of operational changes, a shorter (or longer) amortization period could increase (or decrease) the costs of sales recorded in future periods. High mortality from disease or extreme temperatures would result in abnormal charges to cost of sales to write-down live poultry inventories.

**Long-Lived Assets**

Depreciable long-lived assets are primarily comprised of buildings and machinery and equipment. Depreciation is provided by the straight-line method over the estimated useful lives, which are 15 to 39 years for buildings and 3 to 12 years for machinery and equipment. An increase or decrease in the estimated useful lives would result in changes to depreciation expense.

The Company continually evaluates the carrying value of its long-lived assets for events or changes in circumstances that indicate that the carrying value may not be recoverable. As part of this evaluation, the Company estimates the future cash flows expected to result from the use of the asset and its eventual disposal. If the sum of the expected future cash flows (undiscounted and without interest charges) is less than the carrying amount of the asset, an impairment loss is recognized to reduce the carrying value of the long-lived asset to the estimated fair value of the asset. If the Company's assumptions with respect to the future expected cash flows associated with the use of long-lived assets currently recorded change, then the Company's determination that no impairment charges are necessary may change and result in the Company recording an impairment charge in a future period. The Company did not identify any indicators of impairment during the current fiscal period.

**Accrued Self Insurance**

Insurance expense for workers' compensation benefits and employee-related health care benefits are estimated using historical experience and actuarial estimates. Stop-loss coverage is maintained with third party insurers to limit the Company's total exposure. Management regularly reviews the assumptions used to recognize periodic expenses. Any resulting adjustments to accrued claims are reflected in current operating results. If historical experience proves not to be a good indicator of future expenses, if management were to use different actuarial assumptions, or if there is a negative trend in the Company's claims history, there could be a significant increase or decrease in cost of sales depending on whether these expenses increased or decreased, respectively.

**Income Taxes**

The Company determines its effective tax rate by estimating its permanent differences resulting from differing treatment of items for financial and income tax purposes. The Company is periodically audited by taxing authorities and considers any adjustments made as a result of the audits in considering the tax expense. Any audit adjustments affecting permanent differences could have an impact on the Company's effective tax rate.

**Contingencies**

The Company is a party to a number of legal proceedings as discussed in Item 3 of Part 1 of its Annual Report on Form 10-K for its fiscal year ended October 31, 2008 and in this quarterly report. We recognize the costs of legal defense in the periods incurred. A determination of the amount of reserves required, if any, for these matters is made after considerable analysis of each individual case. Because the outcome of these cases cannot be determined with any

certainty, no estimate of the possible loss or range of loss resulting from the cases can be made. At this time, the Company has not accrued any reserve for any of these matters. Future reserves may be required if losses are deemed probable due to changes in the Company's assumptions, the effectiveness of legal strategies, or other factors beyond the Company's control. Future results of operations may be materially affected by the creation of or changes to reserves or by accruals of losses to reflect any adverse determination of these legal proceedings.



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New Accounting Pronouncements

In September 2006, the FASB issued SFAS No. 157 Fair Value Measurements ( SFAS 157 ). This standard defines fair value, establishes a framework for measuring fair value in accounting principles generally accepted in the United States of America and expands disclosure about fair value measurements. This pronouncement applies whenever other accounting standards require or permit assets or liabilities to be measured at fair value. Accordingly, this statement does not require any new fair value measurements. The Company adopted SF