SMITHFIELD FOODS INC
Form 10-K
June 28, 2007
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES

EXCHANGE ACT OF 1934

For the fiscal year ended April 29, 2007

Commission file number: 1-15321

SMITHFIELD FOODS, INC.

(Exact name of registrant as specified in its charter)

Virginia **(State or other jurisdiction of** **incorporation or organization)**	**52-0845861** **(I.R.S. Employer** **Identification No.)**
200 Commerce Street **Smithfield, Virginia** **(Address of principal executive offices)**	**23430** **(Zip Code)**

(757) 365-3000

(Registrant s telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, $.50 par value per share	**New York Stock Exchange**

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes x No ¨

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No x

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 x No ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨

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

Large Accelerated Filer x Accelerated Filer ¨ Non-Accelerated Filer ¨

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

The aggregate market value of the shares of registrant s Common Stock held by non-affiliates as of October 27, 2006 was approximately $2.3 billion. This figure was calculated by multiplying (i) the $26.41 last sales price of registrant s Common Stock as reported on the New York Stock Exchange on the last business day of the registrant s most recently completed second fiscal quarter by (ii) the number of shares of registrant s Common Stock not held by any officer or director of the registrant or any person known to the registrant to own more than five percent of the outstanding Common Stock of the registrant. Such calculation does not constitute an admission or determination that any such officer, director or holder of more than five percent of the outstanding shares of Common Stock of the registrant is in fact an affiliate of the registrant.

At June 11, 2007, 134,221,139 shares of the registrant s Common Stock were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Part III incorporates certain information by reference from the registrant s definitive proxy statement to be filed with respect to its Annual Meeting of Shareholders to be held on August 30, 2007.

Table of Contents

TABLE OF CONTENTS

Table of Contents

PART I

Item 1. *Business*

Smithfield Foods, Inc., the registrant, together with its subsidiaries, is referred to in this document as the Company .

General

The Company is the largest hog producer and pork processor in the world and the fifth largest beef processor in the United States (U.S.). The Company conducts its business through six reporting segments, Pork, Beef, International, Hog Production (HP), Other and Corporate, each of which is comprised of a number of subsidiaries. See Notes 1 and 13 in Item 8. Financial Statements and Supplementary Data Notes to Consolidated Financial Statements for additional segment and geographic information.

Pork Segment

The Pork segment produces a wide variety of fresh pork and packaged meats products in the U.S. and markets them nationwide and to numerous foreign markets, including Japan, Mexico, Canada and Australia. The Pork segment currently operates over 40 processing plants.

During the preceding five fiscal years, the Company s main acquisitions and the initial investment dates in the Pork segment were:

Initial Investment Date	Acquisition	Description
Fiscal 2007	Armour-Eckrich	Producer of mostly branded packaged meats products with large market share in hot dogs, dinner sausages and luncheon meats, based in Naperville, Illinois.
Fiscal 2006	Cook s Hams, Inc. (Cook s)	Producer of traditional and spiral sliced smoked bone-in hams, corned beef and other smoked meat items, based in Lincoln, Nebraska.
Fiscal 2004	Farmland Foods, Inc.	Sixth largest pork processor in the U.S. producing 1 billion pounds of fresh pork and 500 million pounds of packaged meats under the Farmland, Carando, Ohse and Roegelein brands. Farmland Foods is headquartered in Kansas City, Missouri.
Fiscal 2004	Cumberland Gap Provision Co.	Processor of premium, branded hams, sausages and other specialty products, based in Middlesboro, Kentucky.
Fiscal 2003	Stefano Foods, Inc.	Producer and marketer of Italian convenience foods, including stuffed pizza rings and calzones, based in Charlotte, North Carolina.

The following table shows, for the fiscal periods indicated, the percentages of the Pork segment revenues derived from fresh pork, packaged meats and other products.

	Fiscal Year Ended		
	April 29, 2007	April 30, 2006	May 1, 2005
Packaged meats	52%	50%	49%
Fresh pork	46%	48%	50%
Other products	2%	2%	1%
	100%	100%	100%

Table of Contents

Fresh pork products. The Company s Pork segment sold approximately 3.1 billion pounds of fresh pork in fiscal 2007, a 12% decrease from the prior year, which reflects the Company s strategy of converting fresh meat raw materials into value-added further processed meats. The Company s Pork segment processes hogs at seven plants (five in the Midwest and two in the Southeast), with a current aggregate slaughter capacity of 101,000 hogs per day. A substantial portion of the Pork segment s fresh pork is sold to retail customers as unprocessed, trimmed cuts such as butts, loins (including roasts and chops), picnics and ribs.

Packaged meats products. The Company s Pork segment sold approximately 2.9 billion pounds of packaged meats products in fiscal 2007. The Company produces a wide variety of packaged meats, including smoked and boiled hams, bacon, sausage, hot dogs (pork, beef and chicken), deli and luncheon meats, specialty products such as pepperoni, dry meat products, and ready-to-eat, prepared foods such as pre-cooked entrees and pre-cooked bacon and sausage. The Company markets its domestic packaged meats products under labels that include Smithfield, Farmland, John Morrell, Gwaltney, Great, Cumberland Gap, Armour, Eckrich, Margherita, LunchMakers, Dinner Bell, Carando, Kretschmar, Lean Generation, Lykes, Cook s, Esskay, Valleydale, Ember Farms, Rath, Roegelein, Ohse, Stefano s, Williamsburg, Tom & Ted s and Jamestown. The Pork segment also sells a substantial quantity of packaged meats as private-label products. The Company continues to emphasize a strategy of converting more of fresh meat raw materials into value-added, further processed meats. With the acquisition of Armour-Eckrich in fiscal 2007 and Cook s in fiscal 2006, and the addition of new bacon lines, the Company added the capacity to be a net buyer of both hams and bellies. In addition, the Company s new 210,000 square foot state-of-the-art manufacturing facility in North Carolina was completed and opened in July 2006 (fiscal 2007).

The Company s product lines include leaner fresh pork products as well as lower-fat and lower-salt packaged meats. The Company also markets a line of lower-fat value-priced luncheon meats, smoked sausage and hot dogs, as well as fat-free deli hams and 40% lower-fat bacon. Management believes that leaner pork products and meal options that deliver convenience, variety and ease of preparation, combined with the industry s efforts to heighten public awareness of pork as an attractive protein source, have led to increased consumer demand.

Raw materials. The primary raw materials of the Pork segment are live hogs. Historically, hog prices have been subject to substantial fluctuations. Hog supplies, and consequently prices, are affected by factors such as corn and soybean meal prices, weather and farmers access to capital. Hog prices tend to rise seasonally as hog supplies decrease during the hot summer months and tend to decline as supplies increase during the fall. This tendency is due to lower farrowing performance during the winter months and slower animal growth rates during the hot summer months.

The Pork segment purchased approximately 40% of its U.S. live hog requirements from the HP segment in fiscal 2007. In addition, the Company has established multi-year agreements with Maxwell Foods, Inc. and Prestage Farms, Inc., which provide the Pork segment with a stable supply of high-quality hogs at market-indexed prices. These producers supplied approximately 12% of the hogs that the Pork segment processed in fiscal 2007.

The Pork segment also purchases hogs on a daily basis at its Southeastern and Midwestern processing plants, at company-owned buying stations in three Southeastern and five Midwestern states and from Canadian sources. The Pork segment also purchases fresh pork from other meat processors to supplement its processing requirements. Additional purchases include raw beef, poultry and other meat products that are added to the Pork segment s sausages, hot dogs and luncheon meats. Those meat products and other materials and supplies, including seasonings, smoking and curing agents, sausage casings and packaging materials, are readily available from numerous sources at competitive prices.

Discontinued Operations. In fiscal 2007, the Company completed the sale of substantially all of the assets and business of Quik-to-Fix, Inc. (Quik-to-Fix) for net proceeds of $28.2 million. As a result, Quik-to-Fix is being reported as a discontinued operation.

Table of Contents

Facility closures. During fiscal 2006, as part of its east coast restructuring plan, the Company ceased fresh pork processing in one of The Smithfield Packing Company, Incorporated s (Smithfield Packing) Smithfield, Virginia facilities, and during fiscal 2007 and 2006 closed its plants located in Salem, Virginia, Bedford, Virginia and Madison, Florida. During fiscal 2006, the Company recorded, in cost of sales, accelerated depreciation totaling $7.9 million and an impairment charge totaling $18.4 million related to this restructuring plan.

Beef Segment

The Beef segment is composed mainly of two U.S. beef processing subsidiaries, the Company s cattle feeding operations and the Company s interests in cattle feeding operations.

The Beef segment produces mainly boxed beef and ground beef (both chub and case-ready) and markets these products in large portions of the U.S. Prior to December 2003 (fiscal 2004), the Company s Beef segment sold to over 16 foreign markets, including Canada, China, Japan, Mexico and South Korea.

In December 2003, a case of Bovine Spongiform Encephalopathy (BSE) was discovered in the State of Washington. In response to this discovery, many foreign countries, including Japan, South Korea and other key Asian markets imposed bans on beef imports from the U.S. Since 2003, several more isolated cases of BSE have been discovered in the U.S. Japan lifted the ban on U.S. beef imports in December 2005 but reinstated it six weeks later when a single shipment of veal from the U.S. was determined to violate certain agreed-upon protocols. In June 2006 (fiscal 2007), the U.S. and Japan announced a new agreement to move towards restarting partial trade in U.S. beef from animals 20 months and younger. In May 2007 (fiscal 2008), South Korea reopened partial trade in U.S. beef from animals 30 months and younger. However, the vast majority of U.S. beef remains ineligible for export to Japan, South Korea and other key Asian markets due to the age limitation on cattle. It is not known at this time when remaining restrictions on U.S. beef exports will be lifted.

During the preceding five fiscal years, the Company s main investments in the Beef segment were:

Initial Investment Date	Investment	Description
Fiscal 2006	Five Rivers Ranch Cattle Feeding LLC (Five Rivers)	Cattle feeding joint venture headquartered in Colorado with a one time feeding capacity of 811,000 head.
Fiscal 2005	MF Cattle Feeding, Inc. (MFI)	Cattle feeding operations in Colorado and Idaho with a one time feeding capacity of over 357,000 head. Subsequently, the non-cattle assets, including the feeding capacity, of MFI were contributed to the Company s cattle feeding joint venture, Five Rivers.

The following table shows, for the fiscal periods indicated, the percentages of Beef segment revenues derived from fresh beef, cattle feeding and other products (including hides and rendering).

	Fiscal Year Ended		
	April 29, 2007	April 30, 2006	May 1, 2005
Fresh beef	78%	81%	80%
Cattle feeding	1%	11%	11%
Other products	21%	8%	9%
	100%	100%	100%

Table of Contents

Beef products. The Company is the fifth largest beef processor in the U.S., producing approximately 1.5 billion pounds of fresh beef in fiscal 2007. It processes cattle at four plants (two in the Midwest, one in the Northeast and one in the Southwest), with a current aggregate processing capacity of 7,600 cattle per day. Its beef is sold to retail and foodservice customers as boxed beef and ground beef.

Cattle feeding. As of April 29, 2007, the Company had approximately 320,450 head of cattle on feed valued at roughly $260.3 million located at both company-owned and custom feedlots throughout the Northwest, Southwest, Midwest, and East regions of the U.S. In fiscal 2007, the Company increased its utilization of the Beef segment s company-owned cattle program to meet the increasing demands of the Beef segment s customers for consistent, quality boxed beef products resulting in fewer head sold to outside parties. The Company also had a decrease in the number of head on feed.

In May 2005 (fiscal 2006), the Company and ContiGroup Companies, Inc. (ContiGroup) formed Five Rivers, a 50/50 joint venture between their respective cattle feeding businesses, MFI and ContiBeef LLC (ContiBeef). Five Rivers is a stand-alone operating company, independent from both the Company and ContiGroup, currently headquartered in Loveland, Colorado, with a total of ten feedlots located in Colorado, Idaho, Kansas, Oklahoma and Texas. Five Rivers has one-time feeding capacity of 811,000 head making it the largest commercial cattle feeding operation in the U.S. Five Rivers sells cattle to multiple U.S. beef packing firms using a variety of marketing methods that were already in place at MFI and ContiBeef.

Raw materials. The primary raw materials of the Beef segment are live cattle. Historically, cattle prices have been subject to substantial fluctuations. Cattle supplies and prices are affected by factors such as corn and soybean meal prices, weather and farmers access to capital. In addition, there is currently a ban on the import of Canadian cattle over 30 months of age that has reduced the supply of cattle in the U.S.

The Beef segment s four processing plants purchase lean Holstein steers and cows and other cattle primarily from feed yards, auction barns, direct contract relationships with suppliers in close proximity to processing plants and from the Beef segment s existing cattle feeding operations. The close proximity of these plants to most of their suppliers reduces transportation costs, shrinkage and bruising of livestock in transit. The Beef segment generally maintains a bought ahead position of a one- to two-week supply of live cattle. The Beef segment procures approximately 15% of its live cattle from its existing cattle feeding operations and 25% of its live cattle on a forward contract basis, filling the remainder of its live cattle requirements in the spot market.

Facility closures. During fiscal 2006, the Company closed its Gering, Nebraska facility due to the economics caused by the ban on importing cattle from Canada into the U.S. and the reduced availability of western range cows and bulls.

During fiscal 2005, the Company ceased operations at the Showcase Foods, Inc. (Showcase Foods) facility in the Beef segment. In connection with the closing, the Company recorded a pre-tax charge of $4.0 million related to ceasing the use of certain leased equipment. In addition, Showcase Foods incurred operating losses of $5.2 million during fiscal 2005. Since the date of the initial closing, the Company has explored various ways to use the available Showcase Foods facilities and the remaining equipment. During fiscal 2007, despite the Company s best efforts to create a viable business in the facility, it was determined that it was not economically feasible to reopen the facility. The Company recorded a pre-tax impairment charge of $8.2 million to write down the remaining assets to their realizable value.

International Segment

The International segment includes the Company s international meat processing operations that produce a wide variety of fresh and packaged meats products. The Company has controlling interests in international meat processing operations located mainly in Poland, Romania and the United Kingdom. In addition, the Company has interests in international meat processing operations, mainly in Western Europe, Mexico, Romania and China. Also included in the Company s international meat processing operations are the Company s strategic investments in Spain.

Table of Contents

During the preceding five fiscal years, the Company s main acquisitions and the initial investment dates in the International segment were:

Initial Investment Date	Acquisition/Investment	Description
Fiscal 2007	Groupe Smithfield	50/50 joint venture with European brand names such as Aoste, Justin Bridou and Nobre, based in Paris, France.
Fiscal 2005	Morliny S.A.	A producer and marketer of pork and beef in Poland, which markets its products both domestically and through export channels.
Fiscal 2005	Comtim Group S.R.L.	A hog and pork producer and pork marketer based in Romania, which markets its products mainly domestically.
Fiscal 2005	Jean Caby S.A. (Jean Caby)	Producer and marketer of branded and private-label hams and other specialty products primarily in the French market.
Fiscal 2004	Agrotorvis S.R.L.	Pork processing business in Romania.

Groupe Smithfield. In August 2006 (fiscal 2007), the Company formed a 50/50 joint venture, named Groupe Smithfield, with Oaktree Capital Management, LLC, which purchased the European meats business of Sara Lee Corporation. The Company contributed Jean Caby and cash of 50.0 million (approximately $63.1 million). As of the date of the formation of the joint venture, the Company no longer consolidates Jean Caby. The Company accounts for its investment in Groupe Smithfield as an equity investment and records 50% of the earnings of Groupe Smithfield as Equity in income of affiliates in its consolidated statements of income.

The Company also has a strategic investment of 23% of the common stock of Campofrió Alimentación S.A., a packaged meats manufacturer and marketer headquartered in Madrid, Spain.

The following table shows, for the fiscal periods indicated, the percentages of International segment revenues derived from packaged meats, fresh pork and other meat products. Fiscal 2007 reflects the contribution of Jean Caby to the Groupe Smithfield joint venture.

	Fiscal Year Ended		
	April 29, 2007	April 30, 2006	May 1, 2005
Packaged meats	34%	56%	58%
Fresh pork	23%	19%	20%
Other meat products	43%	25%	22%
	100%	100%	100%

Polish facility temporary shutdown. During the first quarter of fiscal 2006, the Company s Polish operations temporarily shut down a red meat plant in connection with media reports regarding food safety and related issues. The Company voluntarily shut down the plant for ten days and recalled some previously shipped product. The shutdown and returns resulted in approximately $5.0 million of operating losses during fiscal 2006. After the shutdown, the Polish operations experienced a sharp reduction in packaged meat volumes that significantly improved in fiscal 2007. The Polish operations incurred increased marketing and promotional expenditures in the areas affected by the recall in an attempt to recapture lost business. Those expenditures have since returned to normal levels.

Table of Contents

The Pork, Beef and International Segments in General

Customers and marketing. The Pork, Beef and International segments have significant market presence throughout their respective geographic areas where they sell their fresh pork, packaged meats, beef and other meat products to national and regional supermarket chains, wholesale distributors, the foodservice industry (fast food, restaurant and hotel chains, hospitals and other institutional customers), export markets and other further processors. The Company uses both in-house salespersons as well as independent commission brokers to sell its products. In fiscal 2007, the Company sold its products to more than 3,500 customers, none of whom accounted for as much as 10% of the Pork, Beef or International segments revenues. The Company has no significant or seasonally variable backlog because most customers prefer to order products shortly before shipment and, therefore, do not enter into formal long-term contracts.

The Company s fundamental marketing strategy is to provide quality and value to the ultimate consumers of its fresh pork, packaged meats and beef products. The Company incurred advertising expenses of $97.5 million and $109.4 million in fiscal years 2007 and 2006, respectively, on consumer advertising and trade promotion programs designed to build awareness and increase sales distribution and penetration. The Company also provides sales incentives for its customers through rebates based on achievement of specified volume and/or growth in volume levels.

In fiscal 2007, export sales comprised approximately 9% of the Pork segment s volumes and 6% of the Beef segment s volumes. The Company provides Japanese markets with a line of branded fresh pork, as well as other chilled and frozen unbranded fresh pork products. In addition to Japan, the Company has export sales to Mexico and to more than three dozen other foreign countries. Export sales are subject to factors beyond the Company s control, such as tariffs, trade barriers and other governmental restrictions. The Company s Pork and Beef segments conduct the majority of their export sales in U.S. dollars and therefore bear very little currency exchange risk. The Company s International segment has sales denominated in foreign currencies and, as a result, is subject to certain currency exchange risk. See Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations Derivative Financial Instruments for a discussion of the Company s foreign currency hedging activities.

Seasonality. The meat processing business is somewhat seasonal in that, traditionally, the periods of higher sales for hams are the holiday seasons such as Christmas, Easter and Thanksgiving, and the periods of higher sales for smoked sausages, hot dogs and luncheon meats are the summer months. The Pork segment typically builds substantial inventories of hams in anticipation of its seasonal holiday business. The Beef segment also enjoys a stronger spring and summer period during the traditional grilling season .

Risk management and hedging. The Company s Pork, Beef and International segments use price risk management and hedging techniques to enhance sales and to reduce the effect of adverse price changes on its profitability. The Company s price risk management and hedging activities currently are utilized in the areas of forward sales, hog production margin management, procurement of raw materials for seasonal demand peaks, inventory hedging, hog and cattle contracting and truck fleet fuel purchases. For further information see Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations Derivative Financial Instruments for a discussion of the Company s commodity hedging activities.

Trademarks. The Company owns and uses numerous marks. These marks are the Company s registered trademarks or are otherwise subject to protection under applicable intellectual property laws. The Company considers these marks and the accompanying goodwill and customer recognition valuable and material to its business. Management believes that registered trademarks have been important to the success of the Company s branded fresh pork and packaged meats products. In a number of markets, the Company s brands are among the leaders in selected product categories.

Distribution. The Pork, Beef and International segments use a combination of private fleets of leased tractors and trailers and independent common carriers and owner operators to distribute fresh pork and beef and packaged meats to their customers, as well as to move raw materials between plants for further processing. The Company coordinates deliveries and uses backhauling to reduce overall transportation costs. In the U.S., the Company s Pork and Beef segments distribute their products directly from some of their plants and from leased distribution centers in Missouri, Pennsylvania, North Carolina, Kansas, Wisconsin, Indiana, Illinois, Connecticut, California, Michigan, Arizona and Texas. The Company also operates distribution centers adjacent to its plants in Bladen County, North Carolina, Sioux Falls, South Dakota, Green Bay, Wisconsin, Souderton, Pennsylvania and Crete, Nebraska. Internationally, the Company distributes its products through a combination of leased and owned warehouse facilities.

Competition. The protein industry generally, and the pork and beef processing industries in particular, are highly competitive. The Pork, Beef and International segments products compete with a large number of other protein sources, including chicken and seafood, but the Pork, Beef and International segments principal competition comes from other pork and beef processors.

Management believes that the principal competitive factors in the pork and beef processing industries are price, product quality and innovation, product distribution and brand loyalty. Some of the Company s competitors are more diversified than the Company. To the extent that their other operations generate profits, these more diversified competitors may be able to subsidize their meat processing operations during periods of low or negative profitability.

Hog Production Segment

As a complement to the Company s Pork and International segments, the Company has vertically integrated into hog production. The HP segment operates numerous hog production facilities with approximately 888,000 sows producing about 13.9 million market hogs annually. In addition, through its joint ventures, the Company has approximately 114,000 sows producing about 1.5 million market hogs annually. Domestically, the HP segment produces approximately 52% of the Pork segment s live hog requirements. Internationally, the HP segment produces approximately 50% of the International segment s live hog requirements. The profitability of hog production is directly related to the market price of live hogs and the cost of corn and soybean meal. The HP segment generates higher profits when hog prices are high and corn and soybean meal prices are low, and lower profits (or losses) when hog prices are low and corn and soybean meal prices are high. Management believes that the HP segment furthers the Company s strategic initiative of vertical integration and reduces its exposure to fluctuations in profitability historically experienced by the pork processing industry. In addition, as food safety becomes increasingly important to the consumer, the Company s vertically integrated system provides traceability from conception of livestock to consumption of the pork product.

The Company owns certain genetic lines of specialized breeding stock which are marketed using the name Smithfield Premium Genetics (SPG). The HP segment makes extensive use of these genetic lines, with approximately 749,000 SPG breeding sows. In addition, the Company has sublicensed some of these rights to some of its strategic hog production partners. In addition, through its joint ventures, the Company has approximately 66,000 SPG breeding sows. All hogs produced under these sublicenses are supplied to the Company. The Company believes that the hogs produced by these genetic lines are the leanest hogs commercially available and enable it to market highly differentiated pork products. Management believes that the leanness and increased meat yields of these hogs enhance the Company s profitability with respect to both fresh pork and packaged meats. In fiscal 2007, the Company processed 12.4 million SPG hogs domestically and 815,000 SPG hogs internationally.

Hog production operations. The HP segment is the world s largest hog producer. This segment uses advanced management techniques to produce premium quality hogs on a large scale at a low cost. The Company develops breeding stock, optimizes diets for its hogs at each stage of the growth process, processes feed for its hogs and designs and builds hog containment facilities. The Company believes its economies of scale and production methods, together with its use of the advanced SPG genetics, make it a low cost producer of premium

Table of Contents

quality hogs. The HP segment also utilizes independent farmers and their facilities to raise hogs produced from its breeding stock. Under multi-year contracts, a farmer provides the initial facility investment, labor and front line management in exchange for a service fee. Currently, approximately 71% of the HP segment s market hogs are finished on contract farms.

Nutrient management and other environmental issues. The HP segment s hog production facilities have been designed to meet or exceed all applicable zoning and other government regulations. These regulations require, among other things, maintenance of separation distances between farms and nearby residences, schools, churches, public use areas, businesses, rivers, streams and wells and adherence to required construction standards.

Hog production facilities generate significant quantities of manure, which must be managed properly to protect public health and the environment. The Company believes that it uses the best technologies currently available and economically feasible for the management of swine manure, which require permits under state, and in some instances, federal law. The permits impose standards and conditions on the design and operation of the systems to ensure that they protect public health and the environment, and can also impose nutrient management planning requirements depending on the type of system utilized. The most common system of swine waste management employed by the HP segment s hog production facilities is the lagoon and spray field system, in which earthen lagoons are utilized to treat the manure before it is applied to agricultural fields by spray application. The nitrogen and phosphorus in the treated manure serve as a crop fertilizer.

The HP segment follows a number of other policies and protocols to minimize the impact of its operations on the environment, including: the employment of environmental management systems; ongoing employee training regarding environmental controls; walk-around inspections at all sites by trained personnel; formal emergency response plans that are regularly updated; and collaboration with manufacturers regarding testing and developing new equipment. For further information see Environmental Stewardship and Regulation below.

Other Segment

The Other segment is comprised of the Company s turkey production and hatchery operations and its 49% interest in Butterball, LLC. In October 2006 (fiscal 2007), concurrent with the Company s acquisition of Armour-Eckrich, Carolina Turkeys, LLC, an existing partnership of which the Company owns 49%, financed and purchased the Butterball and Longmont turkey processing and production businesses from ConAgra for $325.0 million and changed its name to Butterball.

Discontinued operations. In April 2007 (fiscal 2007), the Company decided to exit the alternative fuels business and dispose of substantially all the assets of Smithfield Bioenergy, LLC (SBE). As a result, SBE is being reported as a discontinued operation.

Subsequent Event

In May 2007 (fiscal 2008), the Company acquired Premium Standard Farms, Inc. (PSF), one of the largest vertically integrated providers of pork products in the U.S., producing pork products for the retail, wholesale, foodservice, further processor and export markets. PSF has become a recognized leader in the pork industry through its vertically integrated business model that combines modern, efficient production and processing facilities, sophisticated genetics, and strict control over the variables of health, diet and environment. PSF is one of the largest pork processors in the U.S. with processing facilities in Missouri and North Carolina. PSF is also one of the largest owners of sows in the U.S. with operations located in Missouri, North Carolina and Texas.

Employees

As of April 29, 2007, the Company had approximately 53,100 employees, approximately 22,000 of whom were covered by collective bargaining agreements. The Pork segment had approximately 32,300 employees, approximately 17,400 of whom were covered by collective bargaining agreements; the Beef segment had

Table of Contents

approximately 5,600 employees, approximately 2,500 of whom were covered by collective bargaining agreements; the International segment had approximately 9,100 employees, approximately 2,100 of whom were covered by collective bargaining agreements; the HP segment had approximately 5,700 employees, none of whom were covered by collective bargaining agreements; the Other segment had approximately 100 employees, none of whom were covered under collective bargaining agreements; and the Corporate segment had approximately 300 employees, none of whom were covered by collective bargaining agreements. The Company believes that its relationship with its employees is satisfactory.

Labor organizing activities occasionally occur at one or more of the Company s facilities. For example, the Company was involved in proceedings regarding union representation of employees at the Company s processing facilities at Wilson and Tar Heel, North Carolina. In a proceeding involving the Company s Wilson plant, an administrative law judge directed that a bargaining order be entered against the Company. The Company s appeal of that order was successful and the judge s recommendation was rejected by the National Labor Relations Board (NLRB). While other matters related to the Wilson plant remain pending in the United States Circuit Court for the District of Columbia on appeal from the NLRB s order, including the scope of remedial relief that could affect the conduct of any future NLRB conducted elections, a new election will be required to determine whether the Wilson employees want union representation.

In a proceeding involving the Company s Tar Heel plant, the NLRB found that the Company has engaged in certain unfair labor practices in connection with a prior representation election and ordered, among other things, that the Company allow a new election to be held. The Company appealed the NLRB s findings with respect to unfair labor practices to the Circuit Court of Appeals for the District of Columbia, which denied that appeal in May 2006. Accordingly, the Company has now complied with the NLRB s order. If and when the NLRB schedules another representation election at the Tar Heel plant, the Company will participate in the election process. The outcome of that election, if and when it takes place, will determine whether approximately 5,500 employees at the Tar Heel plant will be union represented.

Environmental Stewardship

In calendar year 2000, in furtherance of the Company s continued commitment to responsible environmental stewardship, Smithfield Foods, Inc. and its North Carolina-based hog production subsidiaries voluntarily entered into an agreement with the Attorney General of North Carolina (the Agreement) designed to enhance water quality in the State of North Carolina through a series of initiatives to be undertaken by the Company and its subsidiaries while protecting their access to swine operations in North Carolina. These initiatives focused on operations of the Company s hog production subsidiaries in the State of North Carolina, particularly areas devastated by hurricanes in the fall of 1999.

Under the Agreement, the Company assumed a leadership role in the development of environmentally superior and economically feasible waste management system technologies. Pursuant to the Agreement, the Company and its subsidiaries committed to implement environmentally superior and economically feasible technologies for the management of swine waste at the subsidiaries farms in North Carolina following a determination made by an expert from North Carolina State University, with advice from peer review panels appointed by him, that such technologies are both environmentally superior and economically feasible to construct and operate at such farms. The Company and its subsidiaries have agreed to provide $15.0 million to fund the technology research and development activities under the Agreement and to provide certain financial and technical assistance to those farms under contract to the subsidiaries as necessary to facilitate their implementation of such technologies determined to be environmentally superior and economically feasible. These technology research activities have now been completed and the technology development, environmental enhancement and conversion agreement portions of the Agreement remain in place. Although none of the technologies evaluated under the Agreement were found to be economically feasible for existing farms, a specific solids separation/nitrification/denitrification/soluble phosphorous removal system in combination with any one of four specified solids treatment systems was found to meet the environmental performance standards established under the Agreement. These combinations of technologies were found to be both economically feasible and environmentally superior for new farms. The Company and its subsidiaries are committed to building on the technology research and development work completed under the Agreement, and are in the process of evaluating options for continued technology development work in North Carolina.

The Agreement also reflects the Company s commitment to preserving and enhancing the environment of Eastern North Carolina by providing a total of $50.0 million to assist in the preservation of wetlands and other natural areas in eastern North Carolina and to promote similar environmental enhancement activities. This commitment is being fulfilled with annual contributions of $2.0 million over a 25 year period beginning in 2000.

In 2000, PSF, which was acquired by the Company in May 2007, entered into a similar agreement with the Attorney General of North Carolina where it agreed to pay $2.5 million to a fund for technology development, for environmental assessment activities, and for the defrayal of costs incurred by the state related thereto.

The Company has assumed a leadership role in the development of environmental management systems, and except for certain acquisitions (including those in Romania), some international operations, and new facilities, all of the Company s hog production operations and meat processing operations have developed and implemented environmental management systems meeting the requirements of the International Organization for Standardization 14001 (ISO 14001). ISO 14001 is a standard which establishes a coordinated framework of controls to manage environmental performance within an organization. To obtain ISO 14001 certification, an organization must meet a rigorous and comprehensive set of requirements and criteria developed by experts from all over the world and submit to independent audits of its environmental management systems by third parties.

In addition, throughout the Pork, Beef and International segments, the Company promotes a variety of pollution reduction projects related to energy and water conservation, recycling and pollution prevention.

Animal Welfare Program

The Company has a formalized animal welfare program which it believes to be one of the most comprehensive animal welfare programs in its industry.

The Company s animal welfare program includes processes and procedures relating to the safety, comfort and health of its animals. The Company retained the services of two internationally recognized experts on animal behavior and animal handling, who verified that the Company s animal welfare program is credible, science-based and auditable. Going forward, the audit component of the Company s animal welfare program will be rolled into the National Pork Board PQA Plus program.

The Company s animal welfare program includes procedures designed to monitor animal well-being at all stages of the animal s life through a series of checklists, inspections and audits. Through this program, the Company s production personnel receive specific training in the proper methods and practices for the promotion of animal well-being.

In January 2007 (fiscal 2007), the Company announced that it is in the beginning stages of phasing out individual gestation stalls at its sow farms and replacing the gestation stalls with group pens over the next ten years. The Company believes this decision represents a significant financial commitment and was made as a result of the desire to be more animal friendly, as well as to address certain concerns and needs of our customers. The Company does not expect that the switch to penning systems at sow farms will have a material adverse effect on its operations.

Regulation

Regulation generally. Like other participants in the industry, the Company is subject to various laws and regulations administered by federal, state and other government entities, including the United States

Table of Contents

Environmental Protection Agency (EPA) and corresponding state agencies, as well as the United States Department of Agriculture, the United States Food and Drug Administration, the United States Occupational Safety and Health Administration and similar agencies in foreign countries. Management believes that the Company currently is in compliance with all these laws and regulations in all material respects and that continued compliance with these laws and regulations will not have a material adverse effect on the Company s financial position or results of operations.

Water. In February 2003 (fiscal 2003), the EPA promulgated regulations under the Clean Water Act governing confined animal feeding operations (CAFOs). Among other things, these regulations impose obligations on CAFOs to manage animal waste in ways intended to reduce the impact on water quality. These new regulations were challenged in federal court by both industry and environmental groups. Although a 2005 decision by the court invalidated several provisions of the regulations, they remain largely intact. Similarly, the State of North Carolina Department of Environment and Natural Resources (NCDENR) announced in July 2002 the issuance of general permits intended to protect state waters from impacts of large animal feeding operations. Environmental groups have initiated proceedings challenging the NCDENR s action, and the Company s North Carolina subsidiaries have intervened. These proceedings are pending. Although compliance with the federal regulations or state permits will require some changes to the Company s hog production operations resulting in additional costs, the Company does not believe that such compliance will have a material adverse effect on the Company s hog production operations. However, there can be no assurance that pending challenges to the regulations or permits will not result in changes to those regulations or permits that may have a material adverse effect on the Company s financial position or results of operations.

Air. The EPA is also focusing on the possible need to regulate air emissions from animal feeding operations. During calendar year 2002, the National Academy of Sciences (the Academy) undertook a study at the EPA s request to assist the EPA in making that determination. The Academy s study identified a need for more research and better information, but also recommended implementing without delay technically and economically feasible management practices to decrease emissions. Further, the Company s hog production subsidiaries have accepted the EPA s offer to enter into an administrative consent agreement and order with owners and operators of hog farms and other animal production operations. Under the terms of the consent agreement and order, participating owners and operators agreed to pay a penalty, contribute towards the cost of an air emissions monitoring study and make their farms available for monitoring. In return, participating farms have been given immunity from federal civil enforcement actions alleging violations of air emissions requirements under certain federal statutes, including the Clean Air Act. Pursuant to the Company s consent decree and order, the Company has paid a $100,000 penalty to the EPA. Prior to the acquisition of PSF in May 2007, PSF s Texas farms and company owned farms in North Carolina also agreed to participate in this program. The National Pork Board, of which the Company is a member and contributes funds, will be paying the costs of the air emissions monitoring study on behalf of all hog producers, including the Company, out of funds collected from its members in previous years. The cost of the study for all hog producers is approximately $6.0 million. The agreement has been challenged in federal court by several environmental organizations. New regulations governing air emissions from animal agriculture operations are likely to emerge from any monitoring program undertaken pursuant to the consent agreement and order. There can be no assurance that any new regulations that may be proposed to address air emissions from animal feeding operations will not have a material adverse effect on the Company s financial position or results of operations.

The State of Missouri promulgated a rule that came into effect on January 1, 2002 to regulate odor emissions from large animal feeding operations such as the PSF operations in Missouri. This rule required PSF to develop plans to reduce odor emissions and to submit such plans to state authorities, which they have done. This rule also required PSF to make certain changes to reduce odors at the property line to certain established levels. PSF does not anticipate material costs to comply with the rule as promulgated.

Regulatory and other proceedings. The Company from time to time receives notices from regulatory authorities and others asserting that it is not in compliance with such laws and regulations. In some instances,

Table of Contents

litigation ensues. The Water Keeper Alliance, an environmental activist group from the State of New York, has filed or caused to be filed a series of lawsuits against the Company and its subsidiaries and properties. These suits are described below.

In February 2001 (fiscal 2001), the Water Keeper Alliance, Thomas E. Jones d/b/a Neuse Riverkeeper and Neuse River Foundation filed two lawsuits in the United States District Court for the Eastern District of North Carolina against the Company, one of the Company s subsidiaries, and two of that subsidiary s hog production facilities in North Carolina, referred to as the Citizens Suits. The Citizens Suits alleged, among other things, violations of various environmental laws at each facility and the failure to obtain certain federal permits at each facility. The lawsuits have been settled and resolved with the entry of a consent decree, which was approved and entered by the court in March 2006 (fiscal 2006).

The consent decree provides, among other things, that the Company s subsidiary, Murphy-Brown LLC, will undertake a series of measures designed to enhance the performance of the swine waste management systems on approximately 260 company-owned farms in North Carolina and thereby reduce the potential for surface water or ground water contamination from these farms. The effect of the consent decree on the Company will not have a material adverse effect on the Company s financial position or results of operations. The consent decree resolves all claims in the actions and also contains a broad release and covenant not to sue for any other claims or actions that the plaintiffs might be able to bring against the Company and its subsidiaries related to swine waste management at the farms covered by the consent decree. There are certain exceptions to the release and covenant not to sue related to future violations and the swine waste management technology development initiative pursuant to the Agreement described above under Environmental Stewardship. The Company and its subsidiaries may move to terminate the consent decree on or after March 2013 provided all of the consent decree obligations have been satisfied.

In May 2007, the Company acquired PSF, which, prior to the acquisition, had entered into environmental consent decrees with the State of Missouri and with the federal government and a citizens group. The decrees generally required that PSF pay penalties to settle past alleged regulatory violations, and the decrees and the voluntary agreement require that PSF research, develop, and implement new technologies for environmental controls at the Missouri operations.

In 1999, PSF entered into a consent decree to settle a suit filed by the State of Missouri. The settlement required PSF to invest $25.0 million in capital expenditures on what was characterized in the decree as Next Generation Technology for researching, installing and operating improved technology. The proposed technologies were to be approved by a panel of independent university experts and were to be completed by 2004. In 2002, the State of Missouri filed a suit against PSF for alleged new violations of environmental regulations, the settlement of which modified the 1999 consent decree by (i) removing the $25.0 million spending requirement, instead specifying that Next Generation Technology be installed on the 11 largest farms and (ii) extending the schedule to implement Next Generation Technology from 2004 until 2010, in each case to ensure that the technology PSF installs will be effective in reducing potential impacts to the environment. In 2004, PSF estimated that it would invest approximately $33.0 million in additional capital for Next Generation Technology by the 2010 deadline, of which $15.4 million has been spent as of March 31, 2007. Included in this commitment is a fertilizer plant in northern Missouri that will convert waste into commercial grade fertilizer. The fertilizer plant construction has been substantially completed and the plant continues to operate in the start-up phase. Through March 31, 2007, PSF has spent $10.2 million on the construction of the plant.

In 2001, PSF entered into a consent decree with a citizens group and the United States to resolve alleged violations of the Clean Air Act, Clean Water Act and the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA). This consent decree was built upon the 1999 consent decree with the State of Missouri referenced above and requires that the Next Generation Technology employed meets certain performance standards, such as a 50 percent reduction in nitrogen concentration of the effluent applied to area fields over a prescribed time period. PSF paid a civil penalty in the amount of $350,000 in connection with this settlement.

Table of Contents

Available Information

The Company s website address is *www.smithfieldfoods.com*. The Company makes available free of charge through its website its annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and any amendments to those reports as soon as reasonably practicable after filing or furnishing the material to the SEC. You may read and copy documents the Company files at the SEC s public reference room at 100 F Street, N.E., Washington D.C. 20549. Please call the SEC at 1-800-SEC-0330 for information on the public reference room. The SEC maintains a website that contains annual, quarterly and current reports, proxy statements and other information that issuers (including the Company) file electronically with the SEC. The SEC s website is *www.sec.gov*.

Item 1A. ***Risk Factors***

The following risk factors should be read carefully in connection with evaluating our business and the forward-looking information contained in this Annual Report on Form 10-K. Any of the following risks could materially adversely affect our business, operations, industry or financial position or our future financial performance. While we believe we have identified and discussed below the key risk factors affecting our business, there may be additional risks and uncertainties that are not presently known or that are not currently believed to be significant that may adversely affect our business, operations, industry, financial position and financial performance in the future.

Our results of operations are cyclical and could be adversely affected by fluctuations in the commodity prices for hogs, cattle and grains.

We are largely dependent on the cost and supply of hogs, cattle and feed ingredients and the selling price of our products and competing protein products, all of which are determined by constantly changing market forces of supply and demand as well as other factors over which we have little or no control. These other factors include:

- competing demand for corn for use in the manufacture of alternative fuels,
- environmental and conservation regulations,
- import and export restrictions,
- economic conditions,
- weather, including weather impacts on our water supply,
- energy prices, including the effect of changes in energy prices on our transportation costs, and
- crop and livestock diseases.

We cannot assure you that all or part of any increased costs experienced by us from time to time can be passed along to consumers of our products directly or in a timely manner.

Additionally, commodity pork prices demonstrate a cyclical nature over periods of years, reflecting changes in the supply of fresh pork and competing proteins on the market, especially beef and chicken. For example, our fiscal 2006 fourth quarter and fiscal 2007 first half financial results were impacted negatively by an over-supply of protein that decreased selling prices of our fresh and packaged meats. Also, recent expansion of pork processing capacity by industry participants has negatively affected fresh pork margins.

We attempt to manage certain of these risks through the use of our risk management and hedging programs. However, these programs may also limit our ability to participate in gains from favorable commodity fluctuations. For example, in the first half of fiscal 2005, we were unable to benefit fully from strong hog prices due to our hedging activities. Additionally, the majority of our commodity derivative contracts are marked-to-market such that the unrealized gains and losses are reported in earnings on a quarterly basis. This accounting treatment may cause volatility in our quarterly earnings.