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The Blue Tower Global Value strategy returned 15.93% gross of fees in Q3 2016 (15.61% net) and for 2016 year-to-date, it has returned 28.44% gross of fees (27.42% net). This has been the best quarter, performance-wise, for the strategy and comes on the heels of what was the previous best quarter.

One of our investments which has been successful for us has been Tyson Foods (TSN). We initiated this position back in May and June of 2014, buying shares at an average price of \$37.33 over those two months. With the price appreciation (trading at \$69.54 as of October 21st) and the dividends received, this position has done quite well.

Tyson Foods (TSN)

Based in Arkansas, Tyson Foods is one of the largest meat producers in the United States. They segment their operations into four divisions; poultry, beef, pork, and packaged foods. Tyson produced 23.3% of US broiler chicken production in 2015¹ giving it the largest market share of any company and is also the largest beef producer. As these are cyclical commodity businesses, there will be volatility in profitability in each business segment. Tyson's large size gives it benefits in economies of scale, and it has invested significantly in husbandry of its animal stock, improving selection of desirable traits.

Segment Data For Tyson - 2015

2015	Revenue % of total	Income % of total
Chicken	27.5%	63.0%
Beef	41.7%	-3.0%
Pork	12.7%	17.5%
Prepared Foods	18.9%	27.1%
Other	2.1%	-4.6%
Intersegment Transactions	-2.9%	-

Source: Tyson Foods 2015 10-k filing

¹ WATT Global Media

One thing that sticks out from this chart is that the largest segment by revenue, beef, was unprofitable for 2015. This was due to the high cost of cattle, export difficulties, and the cheap cost of competing meats. Tyson also lost money from derivatives positions when futures markets moved against them in September 2015. The beef segment has been profitable the previous four full calendar years.

While the company's history has been as a commodity meat producer, they are quickly moving up the value chain of production into packaged goods. One thing we can quickly see looking at the segment data is the increasing portion that prepared foods are making as a percentage of revenue and operating income. In 2013, prepared foods only made up 7.3% of revenues and 9.7% of operating income. The recent acquisition of Hillshire Brands in August 2014 was a leap forward in this regard. Tyson now has many consumer food brands which include Tyson, Jimmy Dean, Hillshire Farms, Sara Lee, Ball Park, Wright, Aidells, and State Fair.

Tyson will not only have more pricing power than other meat producers, but will have a vertically integrated cost advantage relative to other prepared foods companies. The pricing power comes from the economic moat of retail customer loyalty which inherently increases the quality of the business. The best time to invest in companies is not when they have had their economic moats around their business firmly established but rather when they are still building them up.

The trend in meat production markets in the US has been towards a greater concentration of companies. This will likely act as a boost to the profitability of the industry as a whole due to economies of scale and oligopolistic pricing taking hold.

Chicken pricing controversy

On September 2, food distributor Maplevale Farms sued 14 poultry producers including Tyson Foods on allegations that there has been a price-fixing conspiracy since 2008 to reduce the supply of broiler chickens and increase their price. A recent piece from an equity research outfit, Pivotal Research, repeats the allegations and claims that Tyson (along with other major poultry producers) will have their chicken business materially impacted. The companies included in this allegation report production data through a service called Agri Stats which then sells the data back to industry participants. Pivotal Research alleges that the companies used the data from this service to control production levels and that the management of the poultry producers colluded through private communication. The act of providing information to an industry data aggregator does not in and of itself prove collusion. In our opinion, neither the research outfit nor Maplevale Farms has yet presented compelling evidence of collusion. Another fact to keep in mind is that chicken prices have not increased greatly since 2008. We do not believe that there is much merit to these allegations, but we will continue to monitor the situation.

Valuation and Thesis

Our investment thesis in Tyson is predicated on three key traits of the company.

As one of the largest meat producers in the world, Tyson enjoys great economies of scale. This efficiency allows the company the enviable position of a low cost producer.

As the company expands its footprint in prepared foods, they will move up the value chain of food production from commodity producer to consumer goods company which will improve the quality of the company's earnings.

As food is inherently a consumer staple, this is a noncyclical business.

We estimate based on the historical 7-year average of the free cash flow generated per dollar of earnings by Tyson and the analyst consensus estimates of earnings for the next twelve months that the company will generate \$4.32 of free cash flow per share over the next twelve months. At its current price (\$69.54), this works out to a forward free cash flow yield of 6.2%. At this time, based on our estimates of the long-term growth prospects for the food industry and Tyson's business quality and risk, we would be willing to hold this stock at a forward free cash flow yield between 4%-5% which works out to between \$86.40 and \$107.99 per share.

Sincerely,

Andrew Oskoui, CFA
Portfolio Manager

Disclaimer: This commentary does not represent a recommendation to trade any particular security, but is intended to illustrate Blue Tower's investment approach. These opinions are current as of the date of this commentary but are subject to change. The information contained herein has been obtained from sources believed to be reliable but the accuracy of the information cannot be guaranteed. Past performance is no guarantee of future results.