

SMITHFIELD FOODS INC
Form 10-Q
October 26, 2016

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

FORM 10-Q

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

For the quarterly period ended October 2, 2016

COMMISSION FILE NUMBER 1-15321

SMITHFIELD FOODS, INC.

200 Commerce Street
Smithfield, Virginia 23430
(757) 365-3000

Virginia 52-0845861
(State of Incorporation) (I.R.S. Employer Identification Number)

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

Indicate by check mark whether the registrant 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.

Large accelerated filer	☐ Accelerated filer	☐
Non-accelerated filer	☒ 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 ☒

At October 26, 2016, 1,000 shares of the registrant's Common Stock (no par value per share) were outstanding.

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PART I—FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

SMITHFIELD FOODS, INC.

CONSOLIDATED CONDENSED STATEMENTS OF INCOME

(in millions and unaudited)

	Three Months Ended		Nine Months Ended	
	October 2, September 27,		October 2, September 27,	
	2016	2015	2016	2015
Sales	\$3,538.6	\$ 3,406.1	\$ 10,337.5	\$ 10,509.2
Cost of sales	3,066.1	3,021.1	8,995.6	9,299.6
Gross profit	472.5	385.0	1,341.9	1,209.6
Selling, general and administrative expenses	233.8	238.4	669.7	692.9
Income from equity method investments	(7.6)	(7.1)	(21.3)	(11.3)
Operating profit	246.3	153.7	693.5	528.0
Interest expense	32.0	32.3	96.8	98.5
Non-operating loss	—	—	—	12.1
Income before income taxes	214.3	121.4	596.7	417.4
Income tax expense	70.5	38.1	194.1	132.9
Net income	\$143.8	\$ 83.3	\$402.6	\$ 284.5

See Notes to Consolidated Condensed Financial Statements

SMITHFIELD FOODS, INC.

CONSOLIDATED CONDENSED STATEMENTS OF COMPREHENSIVE INCOME

(in millions and unaudited)

	Three Months Ended		Nine Months Ended	
	October 2016	September 2015	October 2016	September 2015
Net income	\$ 143.8	\$ 83.3	\$ 402.6	\$ 284.5
Other comprehensive income (loss), net of tax:				
Foreign currency translation	19.8	(14.4)	11.6	(55.2)
Pension accounting	1.3	—	3.7	47.7
Hedge accounting	61.4	(27.5)	86.6	(36.3)
Total other comprehensive income (loss)	82.5	(41.9)	101.9	(43.8)
Comprehensive income	\$ 226.3	\$ 41.4	\$ 504.5	\$ 240.7

See Notes to Consolidated Condensed Financial Statements

SMITHFIELD FOODS, INC.
CONSOLIDATED CONDENSED BALANCE SHEETS
(in millions, except share data)
(unaudited)

	October 2, 2016	January 3, 2016
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 277.6	\$ 704.9
Accounts receivable, net	851.7	760.0
Inventories	2,314.9	2,099.7
Prepaid expenses and other current assets	121.0	176.4
Total current assets	3,565.2	3,741.0
Property, plant and equipment, net	2,952.4	2,867.3
Goodwill	1,621.7	1,619.5
Intangible assets, net	1,363.6	1,365.7
Investments	142.2	142.5
Other assets	171.4	158.0
Total assets	\$ 9,816.5	\$ 9,894.0
LIABILITIES AND EQUITY		
Current liabilities:		
Current portion of long-term debt and capital lease obligations	768.9	30.3
Accounts payable	519.6	686.1
Accrued expenses and other current liabilities	840.5	828.3
Total current liabilities	2,129.0	1,544.7
Long-term debt and capital lease obligations	1,557.7	2,257.9
Other liabilities	1,117.2	1,216.5
Redeemable noncontrolling interests	58.9	53.9
Commitments and contingencies		
Equity:		
Shareholder's equity:		
Common stock, no par value, 1,000 shares authorized; 1,000 issued and outstanding	—	—
Additional paid-in capital	4,189.2	4,185.1
Retained earnings	1,039.8	1,013.1
Accumulated other comprehensive loss	(275.8)	(377.7)
Total shareholder's equity	4,953.2	4,820.5
Noncontrolling interests	0.5	0.5
Total equity	4,953.7	4,821.0
Total liabilities and equity	\$ 9,816.5	\$ 9,894.0

See Notes to Consolidated Condensed Financial Statements

SMITHFIELD FOODS, INC.

CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS

(in millions and unaudited)

	Nine Months Ended	
	October 2016	September 27, 2015
Cash flows from operating activities:		
Net income	\$402.6	\$ 284.5
Adjustments to reconcile net cash flows from operating activities:		
Depreciation and amortization	180.5	174.9
Stock-based compensation expense	6.7	14.7
Income from equity method investments	(21.3)	(11.3)
Changes in operating assets and liabilities and other, net	(361.2)	(375.1)
Net cash flows from operating activities	207.3	87.7
Cash flows from investing activities:		
Proceeds from sale of equity interest in Campofrio Food Group	—	354.0
Capital expenditures	(273.9)	(240.3)
Net expenditures from breeding stock transactions	(36.3)	(41.6)
Other	3.2	(32.3)
Net cash flows from investing activities	(307.0)	39.8
Cash flows from financing activities:		
Proceeds from the issuance of long-term debt	30.0	—
Principal payments on long-term debt and capital lease obligations	(1.7)	(409.0)
Proceeds from Securitization Facility	50.0	290.0
Payments on Securitization Facility	(50.0)	(290.0)
Net proceeds (payments) on revolving credit facilities	18.3	(3.7)
Payment of dividends	(375.9)	(30.0)
Net cash flows from financing activities	(329.3)	(442.7)
Effect of foreign exchange rate changes on cash	1.7	(3.1)
Net change in cash and cash equivalents	(427.3)	(318.3)
Cash and cash equivalents at beginning of period	704.9	433.5
Cash and cash equivalents at end of period	\$277.6	\$ 115.2

See Notes to Consolidated Condensed Financial Statements

SMITHFIELD FOODS, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

Organization

Smithfield Foods, Inc., together with its subsidiaries ("Smithfield," "the Company," "we," "us" or "our"), is the largest hog producer and pork processor in the world. We produce and market a wide variety of fresh meat and packaged meats products both domestically and internationally. We conduct our operations through five reportable segments: Fresh Pork, Packaged Meats, Hog Production, International and Corporate.

Basis of Presentation

The accompanying unaudited consolidated condensed financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. You should read these statements and notes in conjunction with the audited consolidated financial statements and the related notes included in our report on Form 10-K for the twelve months ended January 3, 2016. The information reflects all normal recurring adjustments which we believe are necessary to present fairly the financial position and results of operations for all periods included. The three and nine months ended October 2, 2016 correspond to the third quarter of 2016, and the three and nine months ended September 27, 2015 correspond to the third quarter of 2015.

Recently Issued Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, Revenue from Contracts with Customers (Topic 606) (ASU 2014-09). The standard outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance. The core principle of the revenue model is that an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The ASU applies to all contracts with customers, except those that are within the scope of other topics in the FASB Accounting Standards Codification. Compared with current GAAP, the ASU also requires significantly expanded disclosures about revenue recognition. In August 2015, the FASB issued Accounting Standards Update 2015-14, Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date (ASU 2015-14) which defers the effective date by one year to fiscal year and interim periods within those years beginning after December 15, 2017. Early adoption is permitted as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within those annual periods. The guidance is not currently effective for us and has not been applied in this Form 10-Q. We are currently in the process of evaluating the potential impact of future adoption but at this time do not anticipate it will have a material impact on our consolidated financial statements.

In February 2016, the FASB issued Accounting Standards Update 2016-02, Leases (Topic 842) (ASU 2016-02). ASU 2016-02 requires that a lessee should recognize a liability to make lease payments (the lease liability) and a right-of-use asset representing its right to use the underlying asset for the lease term on the balance sheet and to disclose qualitative and quantitative information about lease transactions, such as information about variable lease payments and options to renew and terminate leases. The new guidance is effective for fiscal years and interim periods within those years beginning after December 15, 2018 with early adoption permitted. The guidance is not currently effective for us and has not been applied in this Form 10-Q. We are currently in the process of evaluating the impact of adoption on our consolidated financial statements, however, the primary effect will be to record assets and obligations for current operating leases.

In March 2016, the FASB issued Accounting Standards update 2016-09, Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting (ASU 2016-09). ASU 2016-09 addresses several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities and classification on the statement of cash flows. The new guidance is effective for fiscal years and interim periods within those years beginning after December 15, 2016 with early adoption permitted. The guidance is not currently

effective for us and has not been applied in this Form 10-Q. We are currently in the process of evaluating the impact of adoption on our consolidated financial statements.

In June 2016, the FASB issued Accounting Standards update 2016-13, Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments (ASU 2016-13). ASU 2016-13 will impact how entities measure credit losses for most financial assets and certain other instruments that are not measured at fair value through net income. The ASU replaces the current incurred loss impairment methodology with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. The new guidance is effective for fiscal years and interim periods within those years beginning after December 15, 2019 with early adoption permitted beginning in the first quarter of 2019. We are currently in the process of evaluating the potential impact of adoption but at this time do not anticipate it will have a material impact on our consolidated financial statements.

In August 2016, the FASB issued Accounting Standards update 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments (ASU 2016-15). ASU 2016-15 is intended to reduce diversity in practice in how certain transactions are classified in the statement of cash flows. The ASU provides additional clarification guidance on the classification of certain cash receipts and payments in the statement of cash flows. The new guidance is effective for fiscal years and interim periods within those years beginning after December 15, 2017 with early adoption permitted. We are currently in the process of evaluating the potential impact of future adoption but at this time do not anticipate it will have a material effect on the presentation of our consolidated statements of cash flow.

NOTE 2: INVENTORIES

Inventories consist of the following:

	October 3, 2016	January 3, 2016
	(in millions)	
Fresh and packaged meats	\$ 1,052.5	\$ 885.2
Livestock	934.5	882.3
Grains	193.7	204.5
Manufacturing supplies	85.6	80.3
Other	48.6	47.4
Total inventories	\$ 2,314.9	\$ 2,099.7

NOTE 3: DERIVATIVE FINANCIAL INSTRUMENTS

Our meat processing and hog production operations use various raw materials, primarily live hogs, corn and soybean meal, which are actively traded on commodity exchanges. We hedge these commodities when we determine conditions are appropriate to mitigate price risk. While this hedging may limit our ability to participate in gains from favorable commodity fluctuations, it also tends to reduce the risk of loss from adverse changes in raw material prices. We attempt to closely match the commodity contract terms with the hedged item. We also periodically enter into interest rate swaps to hedge exposure to changes in interest rates on certain financial instruments and foreign exchange forward contracts to hedge certain exposures to fluctuating foreign currency rates.

We record all derivatives as either assets or liabilities at fair value in the balance sheet, with the exception of normal purchase and normal sale contracts that are expected to result in physical delivery. Accounting for changes in the fair value of a derivative depends on whether it qualifies and has been designated as part of a hedging relationship. For derivatives that qualify and have been designated as hedges for accounting purposes, changes in fair value have no net impact on earnings, to the extent the derivative is considered perfectly effective in achieving offsetting changes in fair

value or cash flows attributable to the risk being hedged, until the hedged item is recognized in earnings (commonly referred to as the "hedge accounting" method). For derivatives that do not qualify or are not designated as hedging instruments for accounting purposes, changes in fair value are recorded in current period earnings (commonly referred to as the "mark-to-market" method). We may elect either method of accounting for our derivative portfolio, assuming all the necessary requirements are met. We have in the past availed ourselves of either acceptable method and expect to do so in the future. We believe all of our derivative instruments represent economic hedges against changes in prices and rates, regardless of their designation for accounting purposes.

Changes in commodity prices could have a significant impact on cash deposit requirements under our broker and counter-party agreements. Additionally, certain of our derivative contracts contain credit risk-related contingent features, which would require us to post additional cash collateral to cover net losses on open derivative instruments if our credit rating was downgraded. As of October 2, 2016, the net liability position of our open derivative instruments that are subject to credit risk-related contingent features was not material.

We are exposed to losses in the event of nonperformance or nonpayment by counter parties under financial instruments. Although our counter parties primarily consist of financial institutions that are investment grade, there is still a possibility that one or more of these companies could default. However, a majority of our financial instruments are exchange traded futures contracts held with brokers and counter parties with whom we maintain margin accounts that are settled on a daily basis, thereby limiting our credit exposure to non-exchange traded derivatives.

Determination of the credit quality of our counter parties is based upon a number of factors, including credit ratings and our evaluation of their financial condition. As of October 2, 2016, we had gross credit exposure of \$27.6 million on non exchange-traded derivative contracts. After taking into account the effect of netting arrangements, we had credit exposure of \$6.8 million on non-exchange traded derivative contracts.

The size and mix of our derivative portfolio varies from time to time based upon our analysis of current and future market conditions. All derivative contracts are recorded in prepaid expenses and other current assets or accrued expenses and other current liabilities within the consolidated condensed balance sheets, as appropriate.

The following table presents the fair values of our open derivative financial instruments on a gross basis.

	Assets		Liabilities	
	October 2, 2016	January 3, 2016	October 2, 2016	January 3, 2016
	(in millions)	(in millions)	(in millions)	(in millions)
Derivatives using the "hedge accounting" method:				
Grain contracts	\$6.1	\$ 1.1	\$36.1	\$ 32.3
Livestock contracts	119.9	11.3	0.2	—
Interest rate swaps	—	—	0.2	0.2
Foreign exchange contracts	0.7	—	0.1	1.2
Total	126.7	12.4	36.6	33.7
Derivatives using the "mark-to-market" method:				
Grain contracts	1.7	4.2	7.7	1.0
Livestock contracts	17.3	8.3	21.2	0.8
Energy contracts	3.4	—	2.6	15.7
Foreign exchange contracts	0.7	0.4	—	0.3
Total	23.1	12.9	31.5	17.8
Total fair value of derivative instruments	\$149.8	\$ 25.3	\$68.1	\$ 51.5

The majority of our derivatives are exchange traded futures contracts held with brokers, subject to netting arrangements that are enforceable during the ordinary course of business. Additionally, we have a smaller portfolio of over-the-counter derivatives that are held by counterparties under netting arrangements found in typical master netting agreements. These agreements legally allow for net settlement in the event of bankruptcy. We offset the fair values of derivative assets and liabilities, along with the related cash collateral, that are executed with the same counterparty under these arrangements in the consolidated balance sheets. The following tables reconcile the gross amounts of derivative assets and liabilities to the net amounts presented in our consolidated condensed balance sheets and the related effects of cash collateral under netting arrangements that provide a legal right of offset of assets and liabilities.

October 2, 2016

	Gross Amount	Netting of of Derivative Assets/ Liabilities	Net Derivative Assets/Liabilities	Cash Collateral	Net Amount Presented in the Condensed Consolidated Balance Sheet
(in millions)					
Assets:					
Commodities	\$148.4	\$ (59.5)	\$ 88.9	\$ (33.5)	\$ 55.4
Foreign exchange contracts	1.4	(0.1)	1.3	—	1.3
Total	\$149.8	\$ (59.6)	\$ 90.2	\$ (33.5)	\$ 56.7
Liabilities:					
Commodities	67.8	(59.5)	8.3	(0.5)	7.8
Interest rate swaps	0.2	—	0.2	—	0.2
Foreign exchange contracts	0.1	(0.1)	—	—	—
Total	\$68.1	\$ (59.6)	\$ 8.5	\$ (0.5)	\$ 8.0

January 3, 2016

	Gross Amount	Netting of of Derivative Assets/ Liabilities	Net Derivative Assets/Liabilities	Cash Collateral	Net Amount Presented in the Condensed Consolidated Balance Sheet
(in millions)					
Assets:					
Commodities	\$24.9	\$ (14.1)	\$ 10.8	\$ 16.1	\$ 26.9
Foreign exchange contracts	0.4	(0.4)	—	—	—
Total	\$25.3	\$ (14.5)	\$ 10.8	\$ 16.1	\$ 26.9
Liabilities:					
Commodities	49.8	(14.1)	35.7	(26.9)	8.8
Interest rate swaps	0.2	—	0.2	—	0.2
Foreign exchange contracts	1.5	(0.4)	1.1	—	1.1
Total	\$51.5	\$ (14.5)	\$ 37.0	\$ (26.9)	\$ 10.1

See Note 7—Fair Value Measurements for additional information about the fair value of our derivatives.

Hedge Accounting Method

Cash Flow Hedges

We enter into derivative instruments, such as futures, swaps and options contracts, to manage our exposure to the variability in expected future cash flows attributable to commodity price risk associated with the forecasted sale of live hogs and fresh pork, and the forecasted purchase of corn, wheat and soybean meal. In addition, we enter into interest rate swaps to manage our exposure to changes in interest rates associated with our variable interest rate debt, and we enter into foreign exchange contracts to manage our exposure to the variability in expected future cash flows

attributable to changes in foreign exchange rates associated with the forecasted purchase or sale of assets denominated in foreign currencies. As of October 2, 2016, we had no commodity-related cash flow hedges for forecasted transactions beyond December 2018.

When cash flow hedge accounting is applied, derivative gains or losses are recognized as a component of other comprehensive income (loss) and reclassified into earnings in the same period or periods during which the hedged transactions affect earnings. The ineffective portion of derivative gains and losses is recognized as part of current period earnings. Derivative gains and losses, when reclassified into earnings, are recorded in cost of sales for grain contracts, sales for lean hog contracts, interest expense for interest rate contracts, and sales and selling, general and administrative expenses (SG&A) for foreign exchange

contracts. Gains and losses on derivatives designed to hedge price risk associated with fresh pork sales are recorded in the Hog Production segment.

During the nine months ended October 2, 2016, the range of notional volumes associated with open derivative instruments designated in cash flow hedging relationships was as follows:

	Minimum	Maximum	Metric
Commodities:			
Corn	34,660,000	93,335,000	Bushels
Soybean meal	315,600	1,270,200	Tons
Lean hogs	150,040,000	1,515,800,000	Pounds
Interest rate	17,238,832	18,385,250	U.S. Dollars
Foreign currency ⁽¹⁾	16,516,467	50,654,702	U.S. Dollars

⁽¹⁾ Amounts represent the U.S. dollar equivalent of various foreign currency contracts.

The following table presents the effects on our consolidated condensed financial statements of pre-tax gains and losses on derivative instruments designated in cash flow hedging relationships for the periods indicated:

	Gains (Losses) Recognized in Other Comprehensive Income (Loss) on Derivative (Effective Portion)		Gains (Losses) Reclassified from Accumulated Other Comprehensive Loss into Earnings (Effective Portion)		Gains (Losses) Recognized in Earnings on Derivative (Ineffective Portion)	
	Three Months Ended October 2, 2016 (in millions)		Three Months Ended September 27, 2015 (in millions)		Three Months Ended October 2, 2016 (in millions)	
Commodity contracts:						
Grain contracts	\$ (46.8)	\$ (6.4)	\$ 3.2	\$ (15.7)	\$ (2.6)	\$ (0.3)
Lean hog contracts	200.0	0.2	50.0	55.3	17.7	0.1
Interest rate swaps	(0.1)	(0.2)	(0.1)	—	—	—
Foreign exchange contracts	0.8	(0.5)	0.5	(0.8)	—	—
Total	\$ 153.9	\$ (6.9)	\$ 53.6	\$ 38.8	\$ 15.1	\$ (0.2)
	Nine Months Ended October 2, 2016 (in millions)		Nine Months Ended September 27, 2015 (in millions)		Nine Months Ended October 2, 2016 (in millions)	
Commodity contracts:						
Grain contracts	\$ (2.2)	\$ (40.2)	\$ (15.6)	\$ (60.3)	\$ 0.1	\$ (4.1)
Lean hog contracts	186.7	145.8	61.2	225.3	17.6	2.1
Interest rate swaps	—	0.1	(0.1)	—	—	—
Foreign exchange contracts	2.4	(2.8)	0.6	(2.4)	—	—
Total	\$ 186.9	\$ 102.9	\$ 46.1	\$ 162.6	\$ 17.7	\$ (2.0)

For the periods presented, foreign exchange contracts were determined to be highly effective. We have excluded from the assessment of effectiveness differences between spot and forward rates, which we have determined to be immaterial.

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As of October 2, 2016, there were deferred gains of \$66.2 million, net of tax of \$41.8 million, in accumulated other comprehensive income. We expect to reclassify \$17.1 million (\$10.4 million net of tax) of deferred gains on closed commodity contracts into earnings within the next twelve months. We are unable to estimate the amount of unrealized gains or losses to be reclassified into earnings within the next twelve months related to open contracts as their values are subject to change.

Fair Value Hedges

We enter into derivative instruments (primarily futures contracts) that are designed to hedge changes in the fair value of live hog inventories and firm commitments to buy grains. When fair value hedge accounting is applied, derivative gains and losses are recognized in earnings currently along with the change in fair value of the hedged item attributable to the risk being hedged. The gains or losses on the derivative instruments and the offsetting losses or gains on the related hedged items are recorded in cost of sales for commodity contracts.

During the nine months ended October 2, 2016, the range of notional volumes associated with open derivative instruments designated in fair value hedging relationships was as follows:

	Minimum	Maximum	Metric
Commodities:			
Corn	1,025,000	11,705,000	Bushels

The following table presents the effects on our consolidated condensed statements of income of gains and losses on derivative instruments designated in fair value hedging relationships and the related hedged items for the periods indicated:

	Gains Recognized in		Losses Recognized in	
	Earnings on		Earnings on Related	
	Derivative		Hedged Item	
	Three Months Ended		Three Months Ended	
	October 2, 2016		September 27, 2015	
	(in millions)		(in millions)	
Commodity contracts	\$ 2.5	\$ 2.8	\$(2.5)	\$ (2.7)
	Nine Months Ended		Nine Months Ended	
	October 2, 2016		September 27, 2015	
	(in millions)		(in millions)	
Commodity contracts	\$ 6.9	\$ 5.0	\$(6.8)	\$ (4.8)

We recognized gains of \$1.0 million for the three months ended October 2, 2016 and gains of \$3.4 million and \$1.4 million for the nine months ended October 2, 2016 and September 27, 2015, respectively, on closed commodity derivative contracts as the underlying cash transactions affected earnings.

Mark-to-Market Method

Derivative instruments that are not designated as a hedge, have been de-designated from a hedging relationship, or do not meet the criteria for hedge accounting are marked-to-market with the unrealized gains and losses together with actual realized gains and losses from closed contracts being recognized in current period earnings. Under the mark-to-market method, gains and losses are recorded in cost of sales for commodity contracts and SG&A for foreign exchange contracts.

During the nine months ended October 2, 2016, the range of notional volumes associated with open derivative instruments using the "mark-to-market" method was as follows:

	Minimum	Maximum	Metric
Commodities:			
Lean hogs	200,000	223,240,000	Pounds
Corn	45,000	24,140,000	Bushels
Soybean meal	900	50,600	Tons
Soybeans	55,000	4,810,000	Bushels
Wheat	—	5,190,000	Bushels
Natural gas	7,790,000	10,720,000	Million BTU
Heating oil	630,000	2,100,000	Gallons
Live cattle	2,320,000	13,440,000	Pounds
Diesel	3,619,000	17,444,000	Gallons
Crude oil	9,000	36,000	Barrels
Foreign currency ⁽¹⁾	13,206,842	58,507,350	U.S. Dollars

⁽¹⁾ Amounts represent the U.S. dollar equivalent of various foreign currency contracts.

The following table presents the amount of gains (losses) recognized in the consolidated condensed statements of income on derivative instruments using the "mark-to-market" method by type of derivative contract for the periods indicated:

	Three Months Ended October 2, 2016		Nine Months Ended October 2, 2016	
	2016	2015	2016	2015
	(in millions)		(in millions)	
Commodity contracts	\$ (4.8)	\$ 10.4	\$ 7.1	\$ (0.7)
Foreign exchange contracts	0.8	—	1.1	(0.6)
Total	\$ (4.0)	\$ 10.4	\$ 8.2	\$ (1.3)

The table above reflects gains and losses from both open and closed contracts including, among other things, gains and losses related to contracts designed to hedge price movements that occur entirely within a quarter. The table includes amounts for both realized and unrealized gains and losses. The table is not, therefore, a simple representation of unrealized gains and losses recognized in the income statement during any period presented.

NOTE 4: DEBT

Working Capital Facilities

As of October 2, 2016, we had aggregate credit facilities totaling approximately \$1.5 billion, including an inventory-based revolving credit facility totaling \$1.025 billion (the Inventory Revolver), an accounts receivable securitization facility totaling \$275.0 million (the Securitization Facility) and international credit facilities totaling \$169.5 million. As of October 2, 2016, our unused capacity under these credit facilities was \$1.3 billion.

As part of the Securitization Facility agreement, all accounts receivable of our major Fresh Pork and Packaged Meats subsidiaries are sold to a wholly owned "bankruptcy remote" special purpose vehicle (SPV). The SPV pledges the receivables as security for loans and letters of credit. The SPV is included in our consolidated financial statements and therefore, the accounts receivable owned by it are included in our consolidated balance sheets. However, the accounts receivable owned by the SPV are separate and distinct from our other assets and are not available to our other creditors should we become insolvent. As of October 2, 2016, the SPV held \$503.9 million of accounts receivable.

NOTE 5: PENSION PLANS

The components of net periodic pension cost consist of:

	Three Months Ended October 2, 2016		September 27, 2015			Nine Months Ended October 2, 2016		September 27, 2015	
	2016	2015	2016	2015		2016	2015	2016	2015
	(in millions)		(in millions)			(in millions)		(in millions)	
Service cost	\$12.8	\$ 13.8	\$12.8	\$ 13.8		\$38.4	\$ 44.0	\$38.4	\$ 44.0
Interest cost	20.3	20.0	20.3	20.0		61.0	58.0	61.0	58.0
Expected return on plan assets	(24.7)	(25.5)	(24.7)	(25.5)		(74.0)	(69.7)	(74.0)	(69.7)
Net amortization	2.3	0.2	2.3	0.2		6.9	2.6	6.9	2.6
Net periodic pension cost	\$10.7	\$ 8.5	\$10.7	\$ 8.5		\$32.3	\$ 34.9	\$32.3	\$ 34.9

In 2016, we have made \$225.0 million in voluntary contributions to fund our qualified pension plans.

NOTE 6: EQUITY

Other Comprehensive Income (Loss)

The following tables present changes in the accumulated balances for each component of other comprehensive income (loss) and the related effects on net income of amounts reclassified out of other comprehensive income (loss).

	Three Months Ended October 2, 2016			September 27, 2015		
	Before Tax	Tax	After Tax	Before Tax	Tax	After Tax
	(in millions)			(in millions)		
Foreign currency translation:						
Translation adjustment arising during the period	\$19.9	\$(0.1)	\$19.8	\$(14.4)	\$—	\$(14.4)
Pension accounting:						
Actuarial gain	—	—	—	—	—	—
Amortization of actuarial losses and prior service credits reclassified to cost of sales	1.3	(0.5)	0.8	—	—	—
Amortization of actuarial losses and prior service credits reclassified to SG&A	1.0	(0.5)	0.5	—	—	—
Hedge accounting:						
Gains (losses) arising during the period	153.9	(59.7)	94.2	(6.9)	2.7	(4.2)
Gains reclassified to sales	(50.5)	19.6	(30.9)	(55.3)	21.6	(33.7)
Losses (gains) reclassified to cost of sales	(3.2)	1.2	(2.0)	15.7	(6.1)	9.6
Losses reclassified to SG&A	—	—	—	0.8	—	0.8
Losses reclassified to interest expense	0.1	—	0.1	—	—	—
Total other comprehensive income (loss)	\$122.5	\$(40.0)	\$82.5	\$(60.1)	\$18.2	\$(41.9)

	Nine Months Ended October 2, 2016			September 27, 2015		
	Before Tax	Tax	After Tax	Before Tax	Tax	After Tax
	(in millions)					
Foreign currency translation:						
Translation adjustment arising during the period	\$12.1	\$(0.5)	\$11.6	\$(101.7)	\$11.0	\$(90.7)
Translation losses reclassified to non-operating loss	—	—	—	54.6	(19.1)	35.5
Pension accounting:						
Actuarial gain	—	—	—	76.1	(29.8)	46.3
Amortization of actuarial losses and prior service credits reclassified to cost of sales	3.7	(1.7)	2.0	1.7	(0.7)	1.0
Amortization of actuarial losses and prior service credits reclassified to SG&A	3.1	(1.4)	1.7	0.7	(0.3)	0.4
Hedge accounting:						
Gains arising during the period	186.9	(72.1)	114.8	102.9	(40.5)	62.4
Gains reclassified to sales	(61.8)	24.0	(37.8)	(225.3)	87.7	(137.6)
Losses reclassified to cost of sales	15.6	(6.1)	9.5	60.3	(23.4)	36.9
Losses reclassified to SG&A	—	—	—	2.4	(0.4)	2.0
Losses reclassified to interest expense	0.1	—	0.1	—	—	—
Total other comprehensive income (loss)	\$159.7	\$(57.8)	\$101.9	\$(28.3)	\$(15.5)	\$(43.8)
Dividend						

We paid dividends totaling \$375.9 million for the nine months ended October 2, 2016 to our parent company, recorded as a reduction to retained earnings.

NOTE 7: FAIR VALUE MEASUREMENTS

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. We are required to consider and reflect the assumptions of market participants in fair value calculations. These factors include nonperformance risk (the risk that an obligation will not be fulfilled) and credit risk, both of the reporting entity (for liabilities) and of the counterparty (for assets).

We use, as appropriate, a market approach (generally, data from market transactions), an income approach (generally, present value techniques), and/or a cost approach (generally, replacement cost) to measure the fair value of an asset or liability. These valuation approaches incorporate inputs, such as observable, independent market data, that we believe are predicated on the assumptions market participants would use to price an asset or liability. These inputs may incorporate, as applicable, certain risks such as nonperformance risk, which includes credit risk.

The FASB has established a three-level fair value hierarchy that prioritizes the inputs used to measure fair value. The fair value hierarchy gives the highest priority to quoted market prices (Level 1) and the lowest priority to unobservable inputs (Level 3). The three levels of inputs used to measure fair value are as follows:

Level 1—quoted prices in active markets for identical assets or liabilities accessible by the reporting entity.

Level 2—observable inputs other than quoted prices included in Level 1, such as quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar assets and liabilities in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3—unobservable for an asset or liability. Unobservable inputs should only be used to the extent observable inputs are not available.

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We have classified assets and liabilities measured at fair value based on the lowest level of input that is significant to the fair value measurement. For the periods presented, we had no transfers of assets or liabilities between levels within the fair value hierarchy. The timing of any such transfers would be determined at the end of each reporting period.

Assets and Liabilities Measured at Fair Value on a Recurring Basis

The following tables set forth, by level within the fair value hierarchy, our financial assets and liabilities, including assets held in a rabbi trust used to fund our non-qualified defined benefit plan, that were measured at fair value on a recurring basis as of October 2, 2016 and January 3, 2016:

	October 2, 2016				January 3, 2016			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
	(in millions)				(in millions)			
Assets								
Derivatives:								
Commodity contracts	\$80.5	\$ 8.4	\$ —	—\$88.9	\$10.8	\$ —	\$ —	—\$10.8
Foreign exchange contracts	—	1.3	—	1.3	—	70.0	—	70.0
Insurance contracts	—	74.7	—	74.7	—	70.0	—	70.0
Total	\$80.5	\$ 84.4	\$ —	—\$164.9	\$10.8	\$ 70.0	\$ —	—\$80.8
Liabilities								
Derivatives:								
Commodity contracts	—	8.3	—	8.3	18.6	17.1	—	35.7
Interest rate swaps	—	0.2	—	0.2	—	0.2	—	0.2
Foreign exchange contracts	—	—	—	—	—	1.1	—	1.1
Total	\$—	\$ 8.5	\$ —	—\$8.5	\$18.6	\$ 18.4	\$ —	—\$37.0

The following are descriptions of the valuation methodologies and key inputs used to measure financial assets and liabilities recorded at fair value on a recurring basis:

Derivatives—Derivatives classified within Level 1 are valued using quoted market prices. In some cases where quoted market prices are not available, we value the derivatives using market based pricing models that utilize the net present value of estimated future cash flows to calculate fair value, in which case the measurements are classified within Level 2. These valuation models make use of market-based observable inputs, including exchange traded prices and rates, yield curves, credit curves, and measures of volatility.

Insurance contracts—Insurance contracts are valued at their cash surrender value using the daily asset unit value which is based on the quoted market price of the underlying securities and classified within Level 2.

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

Certain assets and liabilities are measured at fair value on a nonrecurring basis after initial recognition; that is, the assets and liabilities are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances, for example, when there is evidence of impairment. During the nine months ended October 2, 2016, we had no significant assets or liabilities that were measured and recorded at fair value on a nonrecurring basis.

Other Financial Instruments

We determine the fair value of public debt using Level 2 inputs based on quoted market prices. The carrying amount of all other debt approximates fair value as those instruments are based on variable interest rates. The following table presents the fair value and carrying value of long-term debt, including the current portion of long-term debt as of October 2, 2016 and January 3, 2016.

	October 2, 2016		January 3, 2016	
	Fair Value	Carrying Value	Fair Value	Carrying Value
	(in millions)			
Long-term debt, including current portion	\$2,383.0	\$2,302.0	\$2,336.8	\$2,263.7

The carrying amounts of cash and cash equivalents, accounts receivable, notes payable and accounts payable approximate their fair values because of the relatively short-term maturity of these instruments.

NOTE 8: CONTINGENCIES

Like other participants in our industry, we are subject to various laws and regulations administered by federal, state and other government entities, including the United States Environmental Protection Agency (EPA) and corresponding state agencies, as well as the United States Department of Agriculture, the Grain Inspection, Packers and Stockyard Administration, the United States Food and Drug Administration, the United States Occupational Safety and Health Administration, the Commodities and Futures Trading Commission and similar agencies in foreign countries.

We from time to time receive notices and inquiries from regulatory authorities and others asserting that we are not in compliance with such laws and regulations. In some instances, litigation ensues. In addition, individuals may initiate litigation against us.

North Carolina Nuisance Litigation

As previously disclosed in our Report on Form 10-K for the twelve months ended January 3, 2016, in July, August and September 2013, 25 complaints were filed in the Superior Court of Wake County, North Carolina by 479 individual plaintiffs against Smithfield and our wholly owned subsidiary, Murphy-Brown alleging causes of action for nuisance and related claims. All 25 complaints were dismissed without prejudice in September and October 2014. In August, September and October 2014, 25 complaints were filed in the Eastern District of North Carolina by 515 individual plaintiffs against our wholly owned subsidiary, Murphy-Brown, alleging causes of action for nuisance and related claims. The complaints stemmed from the nuisance cases previously filed in the Superior Court of Wake County. On February 23, 2015, all 25 complaints were amended, one complaint was severed into two separate actions, and several additional plaintiffs were joined, bringing the total number of plaintiffs to 541. On June 29, 2015, the Court granted Murphy-Brown's motion to strike certain allegations in the complaints, and plaintiffs subsequently amended all 26 complaints pursuant to the Court's order. Ten plaintiffs dismissed their claims without prejudice. Murphy-Brown filed its answers and affirmative defenses to all 26 complaints on August 31, 2015, and the parties are engaging in discovery. During discovery, several additional plaintiffs dismissed their claims. The 26 currently pending complaints include claims on behalf of 511 plaintiffs and relate to approximately 14 company-owned and 75 contract farms. All 26 complaints include causes of action for temporary nuisance and negligence and seek recovery of an unspecified amount of compensatory, special and punitive damages. The Company believes that the claims are unfounded and intends to defend the suits vigorously.

Our policy for establishing accruals and disclosures for contingent liabilities is contained in Note 1—Summary of Significant Accounting Policies in our report on Form 10-K for the twelve months ended January 3, 2016. We established a reserve for our estimated expenses to defend against these and similar potential claims in 2013. Consequently, future expenses associated with these claims will not affect our profits or losses unless our reserve proves to be insufficient or excessive. However, legal expenses incurred in our and our subsidiaries' defense of these claims and any payments made to plaintiffs through unfavorable verdicts or otherwise will negatively impact our cash flows and our liquidity position. Given that these matters are in the preliminary stages and given the inherent

uncertainty of the outcome for these and similar potential claims, we cannot estimate the reasonably possible loss or range of loss for these loss contingencies outside the expenses we will incur to defend against these claims. We will continue to review whether an additional accrual is necessary and whether we have the ability to estimate the reasonably possible loss or range of loss for these matters.

NOTE 9: REPORTABLE SEGMENTS

Our operating segments are determined on the basis of how we internally report and evaluate financial information used to make operating decisions and assess performance. For external reporting purposes, we aggregate operating segments which have similar economic characteristics, products, production processes, types or classes of customers and distribution methods into reportable segments based on a combination of factors, including products produced and geographic areas of operations. Our reportable segments are Fresh Pork, Packaged Meats, Hog Production, International and Corporate.

The Fresh Pork segment consists of our U.S. fresh pork operations. The Packaged Meats segment consists of our U.S. packaged meats operations. The Hog Production segment consists of our U.S. hog production operations. The International segment is comprised mainly of our meat processing and distribution operations in Poland, Romania and the United Kingdom, our interests in meat processing operations in Mexico, our hog production operations located in Poland and Romania, our interests in hog production operations in Mexico, and our former investment in Campofrío Food Group. The Corporate segment provides management and administrative services to support our other segments.

The following table presents sales and operating profit (loss) by segment for the periods indicated:

	Three Months Ended		Nine Months Ended	
	October 2, September 27,		October 2, September 27,	
	2016	2015	2016	2015
	(in millions)		(in millions)	
Sales:				
Segment sales—				
Fresh Pork	\$1,286.2	\$ 1,210.8	\$3,756.6	\$ 3,909.4
Packaged Meats	1,682.9	1,630.6	5,084.9	4,885.8
Hog Production	711.4	759.8	2,008.1	2,350.8
International	387.0	365.0	1,075.2	1,047.7
Total segment sales	4,067.5	3,966.2	11,924.8	12,193.7
Intersegment sales—				
Fresh Pork	(17.5)	(15.2)	(51.6)	(44.0)
Packaged Meats	—	—	(0.1)	(0.1)
Hog Production	(500.4)	(534.0)	(1,503.2)	(1,606.5)
International	(11.0)	(10.9)	(32.4)	(33.9)
Total intersegment sales	(528.9)	(560.1)	(1,587.3)	(1,684.5)
Consolidated sales	\$3,538.6	\$ 3,406.1	\$10,337.5	\$ 10,509.2
Operating profit (loss):				
Fresh Pork	76.7	14.1	234.5	32.2
Packaged Meats	136.8	112.3	516.8	461.1
Hog Production	34.5	47.1	(33.8)	79.8
International	28.1	15.3	61.5	46.0
Corporate	(29.8)	(35.1)	(85.5)	(91.1)
Consolidated operating profit	\$246.3	\$ 153.7	\$693.5	\$ 528.0

NOTE 10: SUBSEQUENT EVENT

2018 Bonds

On September 21, 2016, we issued a notice to our bondholders to call \$250.0 million principal of our bonds maturing August 1, 2018, at 101%. The redemption of the bonds on October 21, 2016, together with the premium and accrued, but unpaid interest, was funded entirely with cash. Accordingly, this debt has been reclassified as a current liability as of October 2, 2016. We expect to recognize a loss on debt extinguishment of \$4.6 million in the fourth quarter of 2016 as a result of the redemption.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

You should read the following information in conjunction with the unaudited consolidated condensed financial statements and the related notes in this Quarterly Report and the audited financial statements and the related notes as well as Management's Discussion and Analysis of Financial Condition and Results of Operations contained in our report on Form 10-K for the twelve months ended January 3, 2016.

EXECUTIVE OVERVIEW

We are the largest hog producer and pork processor in the world. In the United States, we are also the leader in numerous packaged meats categories with popular brands including Smithfield®, Eckrich®, Farmland®, Armour® and John Morrell®. We are committed to providing good food in a responsible way and maintaining robust animal care, community involvement, employee safety, environmental, and food safety and quality programs.

We produce and market a wide variety of fresh meat and packaged meats products both domestically and internationally. We operate in a cyclical industry and our results are significantly affected by fluctuations in commodity prices for livestock (primarily hogs) and grains. Some of the factors that we believe are critical to the success of our business are our ability to:

- maintain and expand market share, particularly in packaged meats,
- develop and maintain strong customer relationships,
- continually innovate and differentiate our products,
- manage risk in volatile commodities markets, and
- maintain our position as a low cost producer of live hogs, fresh pork and packaged meats.

We conduct our operations through five reportable segments: Fresh Pork, Packaged Meats, Hog Production, International and Corporate. The Fresh Pork segment consists of our U.S. fresh pork operations. The Packaged Meats segment consists of our U.S. packaged meats operations. The Hog Production segment consists of our U.S. hog production operations. The International segment is comprised mainly of our meat processing and distribution operations in Poland, Romania and the United Kingdom, our interests in meat processing operations in Mexico, our hog production operations located in Poland and Romania, our interests in hog production operations in Mexico, and our former investment in Campofrío Food Group (CFG). The Corporate segment provides management and administrative services to support our other segments.

In February 2015, we announced an organizational realignment and key senior management appointments that unify all of our independent operating companies, brands, marketing and employees under one corporate umbrella (One Smithfield). We believe moving to a more centralized structure allows for a more efficient and effective approach to customers, best utilizes management talent, maximizes the manufacturing platform and plant efficiency and optimizes marketing, innovation and brand management. We believe the impact of One Smithfield has resulted in pre-tax profit margin improvements of approximately 100 basis points and is expected to further improve pre-tax profit margins by another 100 basis points over the next eighteen to twenty-four months.

Third Quarter Summary of Results

Net income for the third quarter of 2016 was \$143.8 million compared to net income of \$83.3 million for the third quarter of 2015. The following summarizes the operating results of each of our reportable segments and other significant changes impacting net income for the third quarter of 2016 compared to the third quarter of 2015:

Fresh Pork operating profit increased by \$62.6 million primarily due to lower live hog market prices resulting from higher hog supplies in the U.S.

Packaged Meats operating profit increased by \$24.5 million primarily as a result of higher selling prices and volumes. Hog Production operating results decreased by \$12.6 million primarily as a result of lower live hog market prices, partially offset by lower feed costs.

International operating profit increased by \$12.8 million primarily due to higher sales volume and prices, and lower feed costs in our European operations.

The following table provides a reconciliation of net income to EBITDA and adjusted EBITDA for all periods presented. EBITDA and adjusted EBITDA are non-GAAP measures. We believe EBITDA is a useful measure to our stakeholders because it excludes the effects of financing and investing activities by eliminating interest and depreciation costs. We also believe adjusted EBITDA is a useful measure as it excludes the effect of non-operating activities. EBITDA and adjusted EBITDA are not intended to be substitutes for our comparable GAAP measures and should not be used by investors or other users of our financial statements as the sole basis for formulating decisions as they exclude a number of important cash and non-cash charges.

	Three Months Ended		Nine Months Ended	
	October 2016		September 27, 2015	
	2016	2015	2016	2015
	(in millions)		(in millions)	
Net income	\$ 143.8	\$ 83.3	\$ 402.6	\$ 284.5
Interest expense	32.0	32.3	96.8	98.5
Income tax expense	70.5	38.1	194.1	132.9
Depreciation and amortization	61.6	58.5	180.5	174.9
EBITDA	307.9	212.2	874.0	690.8
Non-operating loss	—	—	—	12.1
Adjusted EBITDA	\$ 307.9	\$ 212.2	\$ 874.0	\$ 702.9

Tender Offer

In January 2015, we commenced a cash tender offer for our 7.75% senior unsecured notes due July 2017, 5.25% senior unsecured notes due August 2018, 5.875% senior unsecured notes due August 2021 and 6.625% senior unsecured notes due August 2022, subject to a maximum aggregate purchase price up to \$275 million (Tender Offer). The Tender Offer expired in February 2015. As a result of the Tender Offer, we paid \$275.0 million to repurchase \$258.1 million of principal and recognized losses on debt extinguishment of \$12.8 million, including the write-off of related unamortized premiums and debt issuance costs.

Renewable Fuel Standard

The federal Renewable Fuel Standard (RFS) program requires that bio-fuels be blended into transportation fuels at ever-increasing volumes up to 36 billion gallons in 2030. In October 2010, the Environmental Protection Agency (EPA) granted a “partial waiver” to a statutory bar under the Clean Air Act prohibiting fuel manufacturers from introducing fuel additives that are not “substantially similar” to those already approved and in use for vehicles of model year (MY) 1975 or later. Prior to the EPA's decision, the ethanol content of gasoline in the United States was limited to 10 percent (E10), which created a barrier, commonly referred to as the “blendwall,” to the expansion of blended bio-fuels as prescribed by the RFS. The EPA's decision allows fuel manufacturers to increase the ethanol content of gasoline to 15 percent (E15) for use in MY 2007 and newer light-duty motor vehicles, including passenger cars, light-duty trucks and medium-duty passenger vehicles. In January 2011, the EPA granted another partial waiver authorizing E15 use in MY 2001-2006 light-duty motor vehicles. Judicial challenges to these rulemakings by a coalition of industry groups were dismissed.

On May 29, 2015, the EPA proposed renewable volumetric obligations (RVOs) to establish the annual percentage standards for cellulosic biofuel, biomass-based diesel, advanced biofuel and total renewable fuels that apply to all gasoline and diesel produced or imported in years 2014, 2015 and 2016 as well as the volume of biomass-based diesel for 2017. The proposed volumes are below statutory levels, but above historical output of renewable fuels. On November 30, 2015, the EPA finalized RVO standards for 2014, 2015 and 2016 at higher levels than the proposed volumes, but below statutory targets. The 2016 standard is set at 18.1 billion gallons of renewable fuels, or 10.1% of the motor fuel pool. On May 18, 2016, the EPA proposed 2017 RVOs, which again were below statutory levels but above the previous year's output. The proposed volumes for 2017 are 18.8 billion gallons of renewable fuels. The EPA is expected to issue their final rule in November 2016.

Representative Bob Goodlatte (R-VA) has re-introduced legislation in the 114th Congress that would eliminate the conventional (corn starch) ethanol mandate, cap the blendwall at E10, and require the EPA to set cellulosic standards at production levels. Additionally, Sens. Dianne Feinstein (D-CA) and Pat Toomey (R-PA) have introduced similar legislation which would eliminate the conventional ethanol mandate. Although the long-term impact of the RFS is currently unknown, studies have shown that expanded corn-based ethanol production has driven up the price of livestock feed and led to commodity-price volatility. We cannot presently assess the full economic impact of the RFS program on the meat processing industry or on our operations.

GMO Labeling

On July 14, 2016, Congress passed legislation creating a national standard of disclosure for food products containing genetically modified organisms (GMO) or bioengineered ingredients. The legislation, which was signed into law, will preempt any state laws on GMO labeling and disclosure, such as those that went into effect in Vermont on July 1, 2016. The bill requires mandatory disclosure of GMO ingredients in food, giving food manufacturers the option of disclosing that information online or via on-package labels. Foods where meat, poultry, and egg products are the main ingredient are exempt from labeling requirements. Furthermore, food derived from livestock is not considered to be bioengineered based solely on whether the animal consumes feed derived from a GMO product. The U.S. Department of Agriculture has two years to develop regulations and implement the legislation. At this time, we do not know the full economic implications of this legislation on the industry or the company.

Outlook

The commodity markets affecting our business fluctuate on a daily basis. In this operating environment, it is difficult to forecast industry trends and conditions. The outlook statements that follow must be viewed in this context. Our most exciting growth prospect is the ongoing development of our packaged meats business. Although we have experienced meaningful and consistent improvement in packaged meats margins, we believe significant growth potential remains. We will continue to strengthen our consumer-focused marketing programs and promote innovation to improve our product mix toward branded, value-added products. We expect these actions to result in continued broad-based gains in packaged meats sales, volume, market share, distribution and margins.

With our organizational realignment, we are taking steps to build on our strong results in 2015 and thus far in 2016 as we continue to solidify Smithfield's position as a global leader in branded packaged meats. There is a plethora of benefits to moving to a centralized structure and unifying all our resources and brands together as "One Smithfield," which should position us to take advantage of growth opportunities in the following ways:

- Leveraging Smithfield's size and scope in pork industry;
- Maximizing our manufacturing platform and distribution system;
- Approaching the market more efficiently and effectively;
- Best utilizing management talent across company;
- Aligning our operations to provide better customer service;
- Optimizing operations in areas like brand management, manufacturing, sales, and marketing; and
- Strengthening marketing, brand building and innovation across all brands.

We will continue to sharpen our strategic focus and drive operational improvements across our entire platform, including our Fresh Pork, Hog Production and International divisions. We are focused on growth and believe that Smithfield is in an ideal position to continue to achieve strong results for the remainder of 2016.

RESULTS OF OPERATIONS

Consolidated Results of Operations

The table presented below compares our results of operations for the third quarters of 2016 and 2015.

	Three Months Ended		
	October 2, September 27, %		
	2016	2015	Change
	(in millions)		
Sales	\$3,538.6	\$ 3,406.1	4 %
Cost of sales	3,066.1	3,021.1	1 %
Gross profit	472.5	385.0	23 %
Selling, general and administrative expenses	233.8	238.4	(2)%
Income from equity method investments	(7.6)	(7.1)	7 %
Operating profit	246.3	153.7	60 %
Interest expense	32.0	32.3	(1)%
	214.3	121.4	77 %
Income tax expense	70.5	38.1	85 %
Net income	\$143.8	\$ 83.3	73 %

The following items explain the significant changes in our consolidated results of operations for the three months ended October 2, 2016 as compared to the three months ended September 27, 2015:

Sales increased 4% primarily due to higher domestic and international meat volumes and selling prices.

Gross profit increased 23% primarily as a result of higher sales, lower domestic pork processing raw material costs and lower hog feed costs in the U.S. and Europe.

	Nine Months Ended		
	October 2, September 27, %		
	2016	2015	Change
	(in millions)		
Sales	\$10,337.5	\$ 10,509.2	(2)%
Cost of sales	8,995.6	9,299.6	(3)%
Gross profit	1,341.9	1,209.6	11 %
Selling, general and administrative expenses	669.7	692.9	(3)%
Income from equity method investments	(21.3)	(11.3)	88 %
Operating profit	693.5	528.0	31 %
Interest expense	96.8	98.5	(2)%
Non-operating loss	—	12.1	(100)%
	596.7	417.4	43 %
Income tax expense	194.1	132.9	46 %
Net income	\$402.6	\$ 284.5	42 %

The following items explain the significant changes in our consolidated results of operations for the nine months ended October 2, 2016 as compared to the nine months ended September 27, 2015:

Sales decreased 2% primarily as a result of more favorable hedging results in the prior year, lower average selling prices of domestic fresh pork and the impact of foreign currency translation. These declines were partially offset by higher average selling prices of domestic packaged meats products and higher sales volume in Europe.

Gross profit increased 11% primarily as a result of lower domestic pork processing raw material costs and lower hog feed costs in the U.S. and Europe.

Selling, general and administrative expenses decreased 3% primarily due to an increase in the cash surrender value of company-owned life insurance policies, the reimbursement of expenses associated with a legal settlement and a reduction in advertising expenses.

Equity income in the prior year was negatively impacted by our former investment in CFG. Equity income also increased due to improved results in our Mexican joint ventures.

The non-operating loss in the prior year is primarily related to a loss on debt extinguishment of \$12.8 million as a result of the Tender Offer.

Segment Results

The following information reflects the results from each respective segment for the third quarters of 2016 and 2015.

	Three Months Ended		
	October 2, September 27, %		
	2016	2015	Change
	(in millions)		
Sales:			
Fresh Pork	\$1,286.2	\$ 1,210.8	6 %
Packaged Meats	1,682.9	1,630.6	3 %
Hog Production	711.4	759.8	(6)%
International	387.0	365.0	6 %
Total segment sales	4,067.5	3,966.2	3 %
Intersegment sales	(528.9)	(560.1)	(6)%
Consolidated sales	\$3,538.6	\$ 3,406.1	4 %
Operating profit (loss):			
Fresh Pork	76.7	14.1	444 %
Packaged Meats	136.8	112.3	22 %
Hog Production	34.5	47.1	(27)%
International	28.1	15.3	84 %
Corporate	(29.8)	(35.1)	15 %
Consolidated operating profit	\$246.3	\$ 153.7	60 %

Fresh Pork

Sales increased 6% due to a 5% increase in volume and a 1% increase in average selling prices.

Operating profit increased primarily due to lower live hog market prices relative to fresh pork market prices.

The number of hogs processed increased 9%.

Packaged Meats

Sales increased 3% due to a 2% increase in average selling prices and a 1% increase in volume.

Operating profit increased primarily due to higher sales while raw material costs were relatively unchanged.

Hog Production

Sales decreased 6% due to lower live hog market prices, partially offset by a higher volume. The number of market hogs sold increased 4% while average hog weights were down 2%.

Operating profit decreased due to lower live hog market prices, partially offset by lower feed costs. Operating results benefited from favorable hedging activities in both years.

International

Sales increased 6% primarily due to a 5% increase in volume and a 5% increase in average selling prices in our European operations, partially offset by the impact of foreign currency translation.

Operating profit increased due to higher sales and lower feed costs in our European operations.

Nine Months Ended
October 2, September 27, %
2016 2015 Change
(in millions)

Sales:

Fresh Pork	\$3,756.6	\$ 3,909.4	(4)%
Packaged Meats	5,084.9	4,885.8	4 %
Hog Production	2,008.1	2,350.8	(15)%
International	1,075.2	1,047.7	3 %
Total segment sales	11,924.8	12,193.7	(2)%
Intersegment sales	(1,587.3)	(1,684.5)	(6)%
Consolidated sales	\$10,337.5	\$ 10,509.2	(2)%

Operating profit (loss):

Fresh Pork	234.5	32.2	628 %
Packaged Meats	516.8	461.1	12 %
Hog Production	(33.8)	79.8	(142)%
International	61.5	46.0	34 %
Corporate	(85.5)	(91.1)	6 %
Consolidated operating profit	\$693.5	\$ 528.0	31 %

Fresh Pork

Sales decreased 4% primarily due to lower average selling prices.

Operating profit increased primarily due to lower live hog market prices and slightly higher fresh pork market prices. The number of hogs processed increased 3%.

Packaged Meats

Sales increased 4% primarily due to an increase in average selling prices.

Operating profit improved as a result of higher sales prices, which more than offset higher raw material costs.

Hog Production

Sales decreased 15% primarily due to significantly lower live hog market prices and more favorable hedging activities in the prior year.

Operating results decreased primarily due to lower sales, partially offset by lower feed costs.

International

Sales increased 3% due to an 8% increase in volume in our European operations, partially offset by the impact of foreign currency translation.

Operating profit increased primarily due to higher sales and lower feed costs in our European operations and improved results from our Mexican joint ventures. Equity income in the prior year was negatively impacted by \$4.9 million in losses from our former investment in CFG.

LIQUIDITY AND CAPITAL RESOURCES

Summary

Our cash requirements consist primarily of the purchase of raw materials used in our hog production and pork processing operations, long-term debt obligations and related interest, lease payments for real estate, machinery, vehicles and other equipment, and expenditures for capital assets, other investments and other general business purposes. Our primary sources of liquidity are cash we receive as payment for the products we produce and sell, as well as our credit facilities.

We believe that our current liquidity position is strong and that our cash flows from operations and availability under our credit facilities will be sufficient to meet our working capital needs and financial obligations for at least the next twelve months. As of October 2, 2016, our liquidity position was approximately \$1.6 billion, comprised of approximately \$1.3 billion in availability under our credit facilities and \$277.6 million in cash and cash equivalents.

Sources of Liquidity

We have available a variety of sources of liquidity and capital resources, both internal and external. These resources provide funds required for current operations, acquisitions, integration costs, debt retirement and other capital requirements.

Accounts Receivable and Inventories

The meat processing industry is characterized by high sales volume and rapid turnover of inventories and accounts receivable. Because of the rapid turnover rate, we consider our meat inventories and accounts receivable highly liquid and readily convertible into cash. The Hog Production segment also has rapid turnover of accounts receivable.

Although inventory turnover in the Hog Production segment is slower, mature hogs are readily convertible into cash. Borrowings under our credit facilities are used, in part, to finance increases in the levels of inventories and accounts receivable resulting from seasonal and other market-related fluctuations in raw material costs.

Credit Facilities

Facility	October 2, 2016				
	Capacity	Borrowing Base Adjustment	Outstanding Letters of Credit	Outstanding Borrowings	Amount Available
	(in millions)				
Inventory Revolver	\$1,025.0	\$ —	\$ —	\$ —	\$ 1,025.0
Securitization Facility	275.0	—	(82.6	) —	192.4
International facilities	169.5	(0.5	) (0.2	) (57.4	) 111.4
Total credit facilities	\$1,469.5	\$ (0.5	) \$ (82.8	) \$ (57.4	) \$ 1,328.8

Cash Flows

Operating Activities

	Nine Months Ended	
	October 2, 2016	September 27, 2015
	(in millions)	
Net cash flows from operating activities	\$207.3	\$ 87.7

The following items explain the significant changes in cash flows from operating activities:

Cash paid to outside hog suppliers decreased due to a 5% decline in live hog market prices.

The current year included net tax receipts of \$16.5 million for domestic income taxes compared to \$91.3 million paid in the prior year.

In the current year, we received \$187.1 million for the settlement of derivative contracts and for margin requirements compared to \$132.3 million in the prior year.

Cash paid for grain and other ingredients purchased by the Hog Production segment increased approximately \$37.0 million from the prior year.

In the current year, we contributed \$225.0 million to our qualified pension plans compared to \$200.0 million in the prior year.

In the prior year we received a cash dividend of \$14.3 million from one of our Mexican joint ventures.

Investing Activities

	Nine Months Ended	
	October 2, 2016	September 27, 2015
	(in millions)	
Proceeds from sale of equity interest in CFG	\$—	\$ 354.0
Capital expenditures	(273.9)	\$ (240.3)
Net expenditures from breeding stock transactions	(36.3)	(41.6)
Other	3.2	(32.3)
Net cash flows from investing activities	\$(307.0)	\$ 39.8

The following items explain the significant investing activities:

Capital expenditures during both years primarily related to plant and hog farm improvement and expansion projects, including the replacement of gestation stalls with group pens, which is more fully explained under "Additional Matters Affecting Liquidity" below. Current year expenditures include costs related to a new domestic enterprise resource planning system.

In June 2015, we sold our entire equity interest in CFG for \$354.0 million in cash.

In the prior year, we incurred costs for the construction of a distribution center that was a pending sale-leaseback, as shown in other investing activities above.

Financing Activities

	Nine Months Ended	
	October 2, 2016	September 27, 2015
	(in millions)	
Proceeds from the issuance of long-term debt	\$30.0	\$ —
Principal payments on long-term debt and capital lease obligations	(1.7)	(409.0)
Proceeds from Securitization Facility	50.0	290.0
Payments on Securitization Facility	(50.0)	(290.0)
Net proceeds (payments) on revolving credit facilities	18.3	(3.7)
Payment of dividends	(375.9)	(30.0)
Net cash flows from financing activities	\$(329.3)	\$ (442.7)

The following items explain the significant financing activities:

In the current year, we received proceeds of \$30.0 million from a long-term, local currency financing in Romania.

In the prior year, we paid \$258.1 million of principal payments as a result of the Tender Offer as well as \$150.0 million on our Rabobank term loan.

Financial Position

Our balance sheet as of October 2, 2016, as compared to January 3, 2016, was impacted by the following significant changes:

Accounts payable decreased by \$166.5 million mainly due to the timing of payments.

Inventory increased by \$215.2 million attributable to an increase in seasonal ham inventory as we prepare for the holiday season.

The Company has \$426.2 million of senior unsecured public notes maturing on July 1, 2017. Accordingly, this debt was classified as a current liability as of October 2, 2016. While we may choose to use other sources of capital to fund this upcoming maturity, adequate liquidity resources are available to address this maturity in its entirety.

In September 2016, the Company issued a notice to bondholders to call \$250.0 million principal of our bonds maturing August 1, 2018, at 101%. Accordingly, this debt was classified as a current liability as of October 2, 2016. The bonds were redeemed on October 21, 2016. We expect to recognize a loss on debt extinguishment of \$4.6 million in the fourth quarter of 2016 as a result of the redemption.

Additional Matters Affecting Liquidity

Capital Projects

We anticipate capital expenditures of approximately \$350.0 million for 2016 to upgrade facilities with new machinery and equipment in order to improve our competitive cost structure and achieve least cost/best in class operations. These expenditures are expected to be funded with cash flows from operations and/or borrowings under credit facilities.

Group Pens

In January 2007, we announced a voluntary, ten-year program to phase out individual gestation stalls at our company-owned sow farms and replace the gestation stalls with group pens. We anticipate the full cost of our transition to group pens will total approximately \$360.0 million, including associated maintenance and repairs. This program represents a significant financial commitment and reflects our desire to be more animal friendly, as well as to address the concerns and needs of our customers. As of the end of 2015, we had completed conversions to group housing for 82% of our sows on company-owned farms. We remain on track to finish conversion to group housing for all sows on company-owned farms by the end of 2017. Worldwide, we have pledged to convert all company sow farms by 2022. Our hog production operations in Poland and Romania completed their conversions to group housing facilities a number of years ago, and our joint ventures in Mexico are currently working toward the 2022 goal.

In January 2014, we announced the recommendation that all of our contract sow growers join us in converting their facilities to group housing systems for pregnant sows. We asked contract sow growers to convert by 2022 and offered a sliding scale of incentives to accelerate that timetable through the receipt of contract extensions upon completion of the conversion.

Risk Management Activities

We are exposed to market risks primarily from changes in commodity prices, and to a lesser degree, interest rates and foreign exchange rates. To mitigate these risks, we utilize derivative instruments to hedge our exposure to changing prices and rates, as more fully described under "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations—Derivative Financial Instruments" in our Report on Form 10-K for the twelve months ended January 3, 2016. Our liquidity position may be positively or negatively affected by changes in the underlying value of our derivative portfolio. When the value of our open derivative contracts decreases, we may be required to post margin deposits with our brokers to cover a portion of the decrease. Conversely, when the value of our open derivative contracts increases, our brokers may be required to deliver margin deposits to us for a portion of the increase. During the nine months ended October 2, 2016, margin deposits posted by us ranged from \$(49.4) million (negative amounts representing margin deposits we have received from our brokers) to \$87.1 million. The average daily amount on deposit with our brokers during the nine months ended October 2, 2016 was \$26.9 million. As of October 2, 2016, the net amount on deposit from our brokers was \$(33.0) million.

The effects, positive or negative, on liquidity resulting from our risk management activities tend to be mitigated by offsetting changes in cash prices in our core business. For example, in a period of rising grain prices, gains resulting from long grain derivative positions would generally be offset by higher cash prices paid to farmers and other suppliers in spot markets. These offsetting changes do not always occur, however, in the same amounts or in the same period, with lag times of as much as twelve months.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The preparation of consolidated condensed financial statements requires us to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. These estimates and assumptions are based on our experience and our understanding of the current facts and circumstances. Actual results could differ from those estimates. There have been no significant updates to our critical accounting policies and estimates described in "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" in our report on Form 10-K for the twelve months ended January 3, 2016.

FORWARD-LOOKING STATEMENTS

This report contains "forward-looking" statements within the meaning of the federal securities laws. The forward-looking statements include statements concerning our outlook for the future, as well as other statements of beliefs, future plans and strategies or anticipated events, and similar expressions concerning matters that are not historical facts. Our forward-looking information and statements are subject to risks and uncertainties that could cause actual results to differ materially from those expressed in, or implied by, the forward-looking statements. These risks and uncertainties include, but are not limited to, the availability and prices of live hogs, feed ingredients (including corn), raw materials, fuel and supplies, food safety, livestock disease, live hog production costs, product pricing, the competitive environment and related market conditions, risks associated with our indebtedness, including cost increases due to rising interest rates or changes in debt ratings or outlook, hedging risk, adverse weather conditions, operating efficiencies, changes in foreign currency exchange rates, access to capital, the cost of compliance with and changes to regulations and laws, including changes in accounting standards, tax laws, environmental laws, agricultural laws and occupational, health and safety laws, adverse results from litigation, actions of domestic and foreign governments, labor relations issues, credit exposure to large customers, the ability to realize the anticipated strategic benefits of the acquisition of Smithfield Foods, Inc. by WH Group Limited, the ability to make effective acquisitions and successfully integrate newly acquired businesses into existing operations and other risks and uncertainties described under Part I, Item 1A. "Risk Factors" in our report on Form 10-K for the twelve months ended January 3, 2016. Readers are cautioned not to place undue reliance on forward-looking statements because actual results may differ materially from those expressed in, or implied by, the statements. Any forward-looking statement that we make speaks only as of the date of such statement, and we undertake no obligation to update any forward-looking statements, whether as a result of new information, future events or otherwise. Comparisons of results for current and any prior periods are not intended to express any future trends or indications of future performance, unless expressed as such, and should only be viewed as historical data.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

For complete quantitative and qualitative disclosures about market risk affecting the Company, see "Item 7A. Qualitative and Quantitative Disclosures About Market Risk" in our report on Form 10-K for the twelve months ended January 3, 2016. The following table presents the sensitivity of the fair value of our open commodity contracts and foreign currency contracts to a hypothetical 10% change in market prices or in interest rates and foreign exchange rates, as of October 2, 2016 and January 3, 2016.

	October 2, 2016	January 3, 2016
	(in millions)	
Grains	\$42.6	\$ 18.9
Livestock	11.6	1.4
Energy	8.6	3.3
Foreign currency	5.8	7.4

ITEM 4. CONTROLS AND PROCEDURES

An evaluation was performed under the supervision and with the participation of management, including the Chief Executive Officer (CEO) and the Chief Financial Officer (CFO), regarding the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended) as of October 2, 2016. Based on that evaluation, management, including the CEO and CFO, has concluded that our disclosure controls and procedures were effective as of October 2, 2016.

There were no changes in our internal control over financial reporting during the three months ended October 2, 2016 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II—OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

There have been no material changes with respect to the legal proceedings disclosed under Part I, Item 3. "Legal Proceedings" in our report on Form 10-K for the twelve months ended January 3, 2016, nor have any significant new matters arisen during the three months ended October 2, 2016.

ITEM 1A. RISK FACTORS

There have been no material changes with respect to the risk factors disclosed under Part I, Item 1A. "Risk Factors" in our report on Form 10-K for the twelve months ended January 3, 2016.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Not applicable.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

Not applicable.

ITEM 6. EXHIBITS

- Exhibit 3.1 Amended and Restated Articles of Incorporation of Smithfield Foods, Inc. (incorporated by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K filed with the SEC on September 26, 2013).
- Exhibit 3.2 Amended and Restated Bylaws of Smithfield Foods, Inc. (incorporated by reference to Exhibit 3.2 to the Company's Current Report on Form 8-K filed with the SEC on September 26, 2013).
- Exhibit 31.1 Certification of Kenneth M. Sullivan, President and Chief Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).
- Exhibit 31.2 Certification of Glenn T. Nunziata, Executive Vice President and Chief Financial Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).
- Exhibit 101 The following financial statements from Smithfield Foods, Inc.'s Quarterly Report on Form 10-Q for the quarter ended October 2, 2016, formatted in XBRL: (i) Consolidated Condensed Statements of Income, (ii) Consolidated Condensed Statements of Comprehensive Income, (iii) Consolidated Condensed Balance Sheets, (iv) Consolidated Condensed Statements of Cash Flows, and (v) the Notes to Consolidated Condensed Financial Statements (filed herewith).

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Smithfield Foods, Inc.

/s/ GLENN T. NUNZIATA

Glenn T. Nunziata

On behalf of the registrant and as

Executive Vice President and Chief Financial Officer

Date: October 26, 2016