SANDERSON FARMS INC
Form 10-Q
May 24, 2007

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

(MARK ONE)

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

For the quarterly period ended April 30, 2007

OR

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

For the transition period from __________to__________

Commission file number 1-14977

Sanderson Farms, Inc.

(Exact name of registrant as specified in its charter)

Mississippi	64-0615843
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
127 Flynt Road, Laurel, Mississippi	39443
(Address of principal executive offices)	(Zip Code)

(601) 649-4030

(Registrant s telephone number, including area code)

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

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

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 as defined in Rule 12b-2 of the Exchange Act.

Large Accelerated filer o Acclerated filer þ Non-accelerated filer o

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

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

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

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date. Common Stock, $1 Per Share: Par Value shares 20,131,758 outstanding as of April 30, 2007.

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SANDERSON FARMS, INC. AND SUBSIDIARIES

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PART I. FINANCIAL INFORMATION
Item 1. Financial Statements

SANDERSON FARMS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

	April 30, 2007 (Unaudited)	October 31, 2006 (Note 1)
	(In thousands)	
Assets		
Current assets:		
Cash and cash equivalents	$ 14,554	$ 7,396
Accounts receivable, net	61,912	40,930
Refundable income taxes	0	14,402
Inventories	115,497	96,490
Prepaid expenses and other current assets	15,581	13,179
Total current assets	207,544	172,397
Property, plant and equipment	636,627	573,422
Less accumulated depreciation	(275,840)	(263,112)
	360,787	310,310
Other assets	2,320	2,360
Total assets	$ 570,651	$ 485,067
Current liabilities:		
Accounts payable and accrued expenses	$ 65,863	$ 55,081
Current maturities of long-term debt	4,440	4,433
Total current liabilities	70,303	59,514
Long-term debt, less current maturities	131,933	77,078
Claims payable	3,200	3,200
Deferred income taxes	14,830	16,935
Stockholders equity:		
Preferred Stock:		
Series A Junior Participating Preferred Stock, $100 par value: authorized 500,000 shares; none issued, Par value to be determined by the Board of Directors: authorized 4,500,000 shares; none issued		
Common Stock, $1 par value: authorized 100,000,000 shares; issued and outstanding shares 20,131,758 and 20,094,571 at April 30, 2007 and October 31, 2006, respectively	20,132	20,095
Paid-in capital	20,045	17,181
Retained earnings	310,208	291,064
Total stockholders equity	350,385	328,340
Total liabilities and stockholders equity	$ 570,651	$ 485,067

See notes to condensed consolidated financial statements.

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

	Three Months Ended April 30,		Six Months Ended April 30,	
	2007	2006	2007	2006
Net sales	$ 360,471	$ 239,082	$ 653,182	$ 475,285
Cost and expenses:				
Cost of sales	303,764	251,180	587,437	488,034
Selling, general and administrative	12,988	14,367	25,455	27,751
	316,752	265,547	612,892	515,785
OPERATING INCOME (LOSS)	43,719	(26,465)	40,290	(40,500)
Other income (expense):				
Interest income	61	25	107	149
Interest expense	(1,266)	(560)	(2,486)	(636)
Other	7	15	11	54
	(1,198)	(520)	(2,368)	(433)
INCOME (LOSS) BEFORE INCOME TAXES	42,521	(26,985)	37,922	(40,933)
Income tax expense (benefit)	15,590	(10,336)	13,840	(15,678)
NET INCOME (LOSS)	$ 26,931	$ (16,649)	$ 24,082	$ (25,255)
Earnings (loss) per share:				
Basic	$ 1.34	$ (.83)	$ 1.20	$ (1.26)
Diluted	$ 1.33	$ (.83)	$ 1.19	$ (1.26)
Dividends per share	$ .12	$ .12	$ .24	$ .24
Weighted average shares outstanding:				
Basic	20,120	20,067	20,111	20,066
Diluted	20,267	20,067	20,223	20,066

See notes to condensed consolidated financial statements.

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

	Six Months Ended April 30,	
	2007	2006
	(In thousands)	
Operating activities		
Net Income (loss)	$ 24,082	$ (25,255)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	16,658	14,637
Non-cash stock compensation	1,665	1,459
Change in assets and liabilities:		
Accounts receivable, net	(20,982)	521
Receivable from insurance companies	0	9,058
Inventories	(19,007)	(5,961)
Other assets	11,905	(4,431)
Accounts payable, accrued expenses and other liabilities	6,205	(30,361)
Total adjustments	(3,556)	(15,078)
Net cash provided by (used in) operating activities	20,526	(40,333)
Investing activities		
Capital expenditures	(67,400)	(46,807)
Net proceeds from sale of property and equipment	401	674
Net cash used in investing activities	(66,999)	(46,133)
Financing activities		
Principal payments on long-term debt	(138)	(131)
Net borrowings from revolving line of credit	55,000	10,000
Proceeds from long-term borrowings	0	50,000
Net proceeds from issuance of common stock (37,187 shares in 2007 and 30,769 shares in 2006)	905	648
Tax benefit on exercised stock options	331	27
Dividends paid	(2,467)	(2,457)
Net cash provided by financing activities	53,631	58,087
Net change in cash and cash equivalents	7,158	(28,379)
Cash and cash equivalents at beginning of period	7,396	34,616
Cash and cash equivalents at end of period	$ 14,554	$ 6,237

Supplemental disclosure of non-cash financing activity:

Dividends payable	$ (2,471)	$ (2,453)

See notes to condensed consolidated financial statements.

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SANDERSON FARMS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
April 30, 2007

NOTE 1 BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments consisting of normal recurring accruals considered necessary for a fair presentation have been included. Operating results for the three and six months ended April 30, 2007 are not necessarily indicative of the results that may be expected for the year ending October 31, 2007.

The consolidated balance sheet at October 31, 2006 has been derived from the audited consolidated financial statements at that date but does not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. For further information, reference is made to the consolidated financial statements and footnotes thereto included in the Company s annual report on Form 10-K for the year ended October 31, 2006.

The condensed consolidated statements of operations, for the three and six months ended April 30, 2006, include a reclassification of certain expenses to cost of sales from net sales, in order to conform with the classification in the current periods. The reclassification to cost of sales from net sales was $14.0 million and $28.1 million, respectively, during the three and six months ended April 30, 2006.

NOTE 2 INVENTORIES

Inventories consisted of the following:

	April 30, 2007	October 31, 2006
	(In thousands)	
Live poultry-broilers and breeders	$ 67,873	$ 53,011
Feed, eggs and other	15,873	13,840
Processed poultry	18,845	18,102
Processed food	7,821	6,492
Packaging materials	5,085	5,045
	$ 115,497	$ 96,490

NOTE 3 STOCK COMPENSATION PLANS

Refer to Note 9 of our October 31, 2006 audited financial statements for further information on our employee benefit plans and stock compensation plans. Total stock based compensation expense applicable to the Company s restricted stock grants for the six months ended April 30, 2007 and April 30, 2006 was $1,665,000 and $1,459,000 respectively. During the six months ended April 30, 2007, participants in the Company s Management Share Purchase Plan purchased a total of 9,135 shares of restricted stock at an average price of $33.57 and the Company issued 2,253 matching restricted shares.

During the quarter ended April 30, 2007, the Company granted 15,000 shares of restricted stock to certain directors. The restricted stock had a grant date fair value of $33.70 per share and vests three years from the date of grant.

During the quarter ended January 31, 2007, the Company entered into performance share agreements that grant certain officers and key employees the right to receive a target number of 106,000 shares of the Company s common stock, subject to the Company s achievement of certain performance measures. The aggregate target number of shares specified in performance share agreements outstanding as of April 30, 2007 totaled 179,950. No compensation cost was recognized for performance shares during the three and six months ended April 30, 2007 because achievement of the applicable performance measures is not considered probable.

NOTE 4 EARNINGS PER SHARE

Basic net income (loss) per share was calculated by dividing net income (loss) by the weighted-average number of common shares outstanding during the period. Diluted net income (loss) per share was calculated by dividing net income (loss) by the weighted-average number of common shares outstanding during the period plus the dilutive effects of stock options and restricted stock

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outstanding. Restricted stock and employee stock options representing 71,618 and 80,271 common shares for the three and six months ended April 30, 2006 were excluded from the calculation of diluted net loss per share for the periods because the effect was antidilutive. Restricted stock and employee stock options representing 146,668 and 111,969 common shares for the three and six months ended April 30, 2007 are included in the calculation of diluted net income per share, respectively.

NOTE 5 NEW ACCOUNTING PRONOUNCEMENTS

In July 2006, the FASB issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109. Interpretation 48 clarifies the accounting for uncertainty in income taxes recognized in a company s financial statements in accordance with Statement No. 109 and prescribes a recognition threshold and measurement attribute for financial statement disclosure of tax positions taken or expected to be taken on a tax return. Additionally, Interpretation No. 48 provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. Interpretation 48 is effective for fiscal years beginning after December 15, 2006, with early adoption permitted. The Company is currently evaluating the impact the adoption of Interpretation 48 will have on the Company s consolidated financial position, results of operations and cash flows.

NOTE 6 OTHER MATTERS

On June 6, 2006, Annie Collins, a former employee of the processing division subsidiary, on behalf of herself and as representative of a class of individuals who are similarly situated and who have suffered the same or similar damages filed a complaint against the Company s processing and production subsidiaries in the United States District Court for the Eastern District of Louisiana.

Plaintiffs allege that the Company s subsidiaries violated the Fair Labor Standards Act by failing to pay plaintiffs and other hourly employees for the time spent donning and doffing protective and sanitary clothing and performing other alleged compensable activities, and that Sanderson automatically deducted thirty minutes from each worker s workday for a meal break regardless of the actual time spent on break. Plaintiffs also allege that they were not paid overtime wages at the legal rate. Plaintiffs seek unpaid wages, liquidated damages and injunctive relief.

On July 31, 2006, following various procedural motions, the Company filed its Answer to the plaintiffs Complaint.

On July 20, 2006, ten current and former employees of the processing division subsidiary filed an action nearly identical to the one described above. Approximately 3,700 individuals purportedly have given their consent to be a party plaintiff to this and the aforementioned actions. Since the filing of these two complaints, six other substantially similar lawsuits were filed in United States District Courts for the Jackson and Hattiesburg divisions of the Southern District of Mississippi. Unlike the two previous suits referenced above, these Complaints are specific to individual processing locations of the subsidiary Corporation.

On March 26, 2007, the parties filed a Joint Motion for Preliminary Approval of Collection Action Settlement and Appointment of Plaintiff s Counsel as Class Counsel. On April 11, 2007, the Court denied the joint motion on two grounds: (1) The motion was premature because no motion to certify a collective action had been filed in the case, and (2) certain contingencies contained in the settlement agreement gave rise to concerns about whether the settlement agreement was in accordance with the Fair Labor Standards Act. The parties filed a Joint Motion for Reconsideration of this order of the Court, which was granted in part and denied in part by order dated May 3, 2007. In the order, the Court stated it would permit notice to the class to proceed. The Court also stated that if certain contingencies agreed to by the parties in the settlement agreement concerning class participation are met, it will consider the reasonableness of the proposed settlement at a fairness hearing. This hearing will take place after the August 1, 2007 deadline the Court has set for class members to opt in to the lawsuit. The parties have agreed to proceed in this manner, and the Court has authorized the distribution of notice to the class.

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

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

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders
Sanderson Farms, Inc.

We have reviewed the condensed consolidated balance sheet of Sanderson Farms, Inc. and subsidiaries as of April 30, 2007, and the related condensed consolidated statements of operations for the three-month and six-month periods ended April 30, 2007 and 2006, and the condensed consolidated statements of cash flows for the six-month periods ended April 30, 2007 and 2006. These financial statements are the responsibility of the Company s management.

We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures to financial data, and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

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

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of Sanderson Farms, Inc. and subsidiaries as of October 31, 2006, and the related consolidated statements of operations, stockholders equity, and cash flows for the year then ended not presented herein, and in our report dated December 27, 2006, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of October 31, 2006, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ Ernst & Young LLP
New Orleans, Louisiana
May 23, 2007

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

General

The following Discussion and Analysis should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations included in Item 7 of the Company s Annual Report on Form 10-K for its fiscal year ended October 31, 2006.

This Quarterly Report, and other periodic reports filed by the Company under the Securities Exchange Act of 1934, and other written or oral statements made by it or on its behalf, may include forward-looking statements, which are based on a number of assumptions about future events and are subject to various risks, uncertainties and other factors that may cause actual results to differ materially from the views, beliefs and estimates expressed in such statements. These risks, uncertainties and other factors include, but are not limited to the following:

(1) Changes in the market price for the Company s finished products and feed grains, both of which may fluctuate substantially and exhibit cyclical characteristics typically associated with commodity markets.

(2) Changes in economic and business conditions, monetary and fiscal policies or the amount of growth, stagnation or recession in the global or U.S. economies, either of which may affect the value of inventories, the collectability of accounts receivable or the financial integrity of customers.

(3) Changes in the political or economic climate, trade policies, laws and regulations or the domestic poultry industry of countries to which the Company or other companies in the poultry industry ship product, and other changes that might limit the Company s or the industry s access to foreign markets.

(4) Changes in laws, regulations, and other activities in government agencies and similar organizations applicable to the Company and the poultry industry and changes in laws, regulations and other activities in government agencies and similar organizations related to food safety.

(5) Various inventory risks due to changes in market conditions.

(6) Changes in and effects of competition, which is significant in all markets in which the Company competes, and the effectiveness of marketing and advertising programs. The Company competes with regional and national firms, some of which have greater financial and marketing resources than the Company.

(7) Changes in accounting policies and practices adopted voluntarily by the Company or required to be adopted by accounting principles generally accepted in the United States.

(8) Disease outbreaks affecting the production performance and/or marketability of the Company s poultry products.

(9) Changes in the availability and cost of labor and growers.

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

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

The Company s processed and prepared foods product line includes over 100 institutional and consumer packaged food items that it sells nationally and regionally, primarily to distributors, food service establishments and retailers. A majority of the prepared food items are made to the specifications of food service users.

On January 12, 2006, the Company announced that sites in Waco and McLennan County, Texas had been selected for the construction of a new poultry complex, consisting of a processing plant, hatchery and wastewater treatment facility. The plant is expected to begin operations during the Company s fourth fiscal quarter of 2007, and at full production will process approximately 1.2 million head of chickens per week.

On April 27, 2007, the Company amended its revolving credit facility to, among other things, change the covenant requiring a minimum debt to total capitalization ratio to 55% during fiscal 2008 and 2009, increase the available credit to $225.0 million from $200.0 million and extend the expiration date until April 1, 2012. As of April 30, 2007, the Company was in compliance with all covenants and had $145.0 million available to borrow under the revolving credit facility.

EXECUTIVE OVERVIEW OF RESULTS

The Company s financial results for the three and six months ended April 30, 2007 reflect significant improvement in market prices for the Company s poultry products and improved efficiencies at the Company s poultry complexes in South Georgia and Collins, Mississippi. The improvement in the first half of fiscal 2007 over the first half of fiscal 2006 is also the result of the negative impact during the first quarter of fiscal 2006 on the Company s Mississippi and Louisiana poultry operations due to the effects of Hurricane Katrina. The South Georgia complex reported a significant increase in the volume of poultry products sold during the three and six months ended April 30, 2007 as compared to the same periods of fiscal 2006 due to the start-up of operations during fiscal 2006. The Collins, Mississippi processing facility also increased the pounds of poultry products sold as a result of the conversion of the plant in the first quarter of fiscal 2006 to the big bird deboning market from the chill pack market. That facility was down for one week during the first quarter of fiscal 2006 to allow for the installation of certain equipment required for the conversion of the facility to the big bird deboning market. The effect of the improvements in market prices for the Company s poultry products and increased efficiencies were partially offset by an increase in the cost of feed grains during the first half of fiscal 2007 as compared to the first half of fiscal 2006. The market price for corn, which has been higher in part because of increased demand from ethanol producers, is expected to remain high and volatile at least through the end of the Company s 2007 fiscal year and into next year. The Company expects its feed grain costs to be approximately $113 million higher in fiscal 2007 than fiscal 2006.

RESULTS OF OPERATIONS

Net sales for the second quarter of fiscal 2007 were $360.5 million as compared to $239.1 million for the second quarter of fiscal 2006, an increase of $121.4 million or 50.8%. The increase in net sales during the second quarter of fiscal 2007 reflects a 9.7% increase in the pounds of poultry products sold and a 37.6% increase in the pounds of prepared food products sold. The additional pounds of poultry products sold can be attributed to the new complex in South Georgia, which began operations during the fourth quarter of fiscal 2005 and was increasing production during the first and second quarters of fiscal 2006, and increased pounds of products sold at the Collins, Mississippi processing plant. The Collins, Mississippi processing plant was converted to supply the big bird deboning market on the first shift during the first quarter of fiscal 2006 from the chill pack market. This resulted in a larger bird weight and increased pounds of product sold. Market prices for boneless breasts, tenders, wings and leg quarters were 49.2%, 86.3%, 47.8% and 125.3% higher during the second quarter of fiscal 2007 as compared to the second quarter of fiscal 2006, respectively. A simple average of the Georgia dock prices for whole birds also showed significant improvement, increasing by 11.9%. The improvement during the second fiscal quarter in the overall market prices for poultry products compared to last year s second quarter reflects a comparative oversupply of poultry products during the second quarter of fiscal 2006 as compared to the second quarter of fiscal 2007 due to sluggish demand for poultry products in the domestic and export markets during 2006, which resulted in part from the appearance of the H5N1 strain of avian flu in certain countries of Asia and Europe. Net sales of prepared food products increased $12.6 million, or 45.2% during the three months ended April 30, 2007 as compared to the three months ended April 30, 2006 due primarily to an increase in sales of raw marinated poultry products.

Net sales for the first six months of fiscal 2007 were $653.2 million as compared to $475.3 million for the first six months of fiscal 2006, an increase of $177.9 million or 37.4%. The increase in net sales during the first six months of fiscal 2007 reflects a 16.7% increase in the pounds of poultry products sold and a 29.9% increase in the pounds of prepared food products sold. The additional pounds of poultry products sold can be attributed to the new complex in South Georgia, which began operations during the fourth quarter of fiscal 2005 and was increasing production during the first quarter of fiscal 2006, and increased pounds of products sold at the Collins, Mississippi processing plant, which was down for one week during the first quarter of fiscal 2006 to allow for the conversion to serve the big bird market from the chill pack market. The Company also sold fewer pounds during the first quarter of fiscal 2006 due to the destruction of inventories during Hurricane Katrina that would have been available for sale during the first quarter of fiscal 2006. Market prices for boneless breasts, tenders, wings and leg quarters were 31.0%, 51.0%, 36.1% and 64.5% higher during the first half of fiscal 2007 as compared to the first half of fiscal 2006, respectively, while a simple average of the

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Georgia dock prices for whole birds increased 4.6%. As discussed above, the improvement in the overall market prices for poultry products resulted from a comparative oversupply of poultry products during the first six months of fiscal 2006 as compared to the first six months of fiscal 2007 due to sluggish demand for poultry products in the domestic and export markets, which resulted in part from the appearance of the H5N1 strain of avian flu in certain countries of Asia and Europe. Net sales of prepared food products increased $18.8 million, or 32.6% during the first half of fiscal 2007.

Cost of sales for the second quarter of fiscal 2007 were $303.8 million, an increase of $52.6 million, or 20.9% as compared to the same three months ended April 30, 2006. Cost of sales of the Company s poultry products increased $38.6 million, or 17.1%. The increase in the cost of sales of the Company s poultry products resulted from an increase in the pounds of poultry products sold of 9.7% and an increase in the average cost of feed in flocks sold of 31.1%. These increases were partially offset by increased efficiencies at the Company s facilities in South Georgia and Collins, Mississippi during the second quarter of fiscal 2007 as compared to the second quarter of fiscal 2006. A simple average of the Company s cost of corn and soybean meal during the second quarter of fiscal 2007 as compared to the second quarter during fiscal 2006 reflects an increase of 66.4% and 17.5%, respectively. The Company s cost of sales was also higher during the quarter due to an increase in the pounds of prepared food products sold of 37.6%. The Company s prepared food products have a higher average cost of sales per pound than the Company s poultry products. Cost of sales of prepared food products increased $14.0 million or 55.1%.

Cost of sales for the six months ended April 30, 2007 were $587.4 million, an increase of $99.4 million, or 20.4% as compared to the same six months ended April 30, 2006. Cost of sales of the Company s poultry products increased $81.2 million, or 18.6%. The increase in the cost of sales of the Company s poultry products resulted from an increase in the pounds of poultry products sold of 16.7% and an increase in the average cost of feed in flocks sold of 23.3%. These increases were partially offset by increased efficiencies at the Company s facilities in South Georgia and Collins, Mississippi during the first half of 2007 and the negative impact of Hurricane Katrina of $3.0 million on the Company s Mississippi and Louisiana operations during the first quarter of fiscal 2006. In addition, the impact of Hurricane Katrina resulted in fewer pounds sold during the first quarter of fiscal 2006. As previously mentioned, the Company s cost of sales was negatively impacted by an increase in the cost of feed grains during the first six months of fiscal 2007 as compared to the same period during fiscal 2006. A simple average of the Company s cost of corn and soybean meal during the first six months of fiscal 2007 as compared to the first six months during fiscal 2006 reflects an increase of 61.9% and 8.5%, respectively. The Company s cost of sales was also higher during the first half of fiscal 2007 and compared to the same quarter period during fiscal 2006 due to an increase in the pounds of prepared food products sold of 29.9%. Cost of sales of prepared food products increased $18.2 million or 34.7%.

Selling, general and administrative costs for the three and six months ended April 30, 2007 were $13.0 million and $25.5 million, respectively as compared to $14.4 million and $27.8 million for the three and six months ended April 30, 2006. The decrease in selling, general and administrative costs for the three and six months ended April 30, 2007 resulted from lower advertising expenditures. The lower advertising expenditures during the three months and six months ended April 30, 2007 were partially offset by $1.0 and $1.3 million, respectively, in start up costs related to the new complex in Waco, Texas, which will begin operations during the fourth quarter of fiscal 2007. The Company did not incur any start up costs during fiscal 2006. The Company expects start-up costs related to the new complex in Waco, Texas to be approximately $1.8 during the third quarter of fiscal 2007, which will result in a total start-up costs of $3.1 million for the first nine months of fiscal 2007. All costs associated with the new complex in Waco, Texas will be included in cost of sales during the fourth quarter as the new plant will begin operations during the fourth quarter of fiscal 2007.

For the three months ended April 30, 2007, the Company reported an operating income of $43.7 million as compared to an operating loss of $26.5 million for the three months ended April 30, 2006. The improvement of $70.2 million during the second quarter of fiscal 2007 resulted from the improved market prices of poultry products and increased efficiencies at the Company s poultry facilities in South Georgia and Collins, Mississippi. For the first half of fiscal 2007, operating income was $40.3 million as compared to an operating loss of $40.5 for the first half of fiscal 2006. The improvement in operating income resulted from the improvement in market prices for the Company s poultry products, improved efficiencies at the Company s poultry facilities in South Georgia and Collins, Mississippi, and the negative impact during 2006 of approximately $3.0 million from Hurricane Katrina on the Company s Mississippi and Louisiana facilities. The estimated loss of $3.0 million during fiscal 2006 from Hurricane Katrina resulted from unrecognized lost profits and certain expenses that were the direct result of the Company s efforts to minimize the effect of Hurricane Katrina.

Interest expense during the three and six months ended April 30, 2007 was $1.3 and $2.5 million, respectively, as compared to $0.6 million for both the three and six months ended April 30, 2006. The increase in interest expense resulted from higher outstanding debt during first half of fiscal 2007 as compared to the first half of fiscal 2006, partially offset by the capitalization of interest for the construction of the new complex in Waco, Texas. The Company capitalized $1.2 million of interest costs for the new complex in Waco, Texas during the first half of fiscal 2007 and capitalized $0.3 million of interest costs related to the construction of the new general offices in Laurel, Mississippi and the new feed mill in Collins, Mississippi during the first half of fiscal 2006. The Company expects interest expense during the remainder of fiscal 2007 to be higher than interest expense during the same periods of fiscal 2006.

The Company s effective tax rate for the three and six months ended April 30, 2007 was 36.7% and 36.5%, respectively. The Company s effective tax rate for the three and six months ended April 30, 2006 was 38.3%. The 2007 effective tax rates differ from the statutory federal rate due to state income taxes, certain nondeductible expenses for federal income tax purposes and the benefit of certain federal income tax credits available as the result of the impact of Hurricane Katrina on the Company and certain state income tax incentives. The 2006 effective tax rate differs from the statutory federal tax rate due to state income taxes and certain nondeductible expenses for federal income tax purposes. The Company s actual effective rate for the year ended October 31, 2007 may differ from the current estimates based on the results of operations for the remainder of fiscal 2007 and final determination of the income tax credits available to the Company.

The Company s net income for the second quarter of fiscal 2007 was $26.9 million or $1.33 per share as compared to a net loss for the second quarter of fiscal 2006 of $16.6 million, or $.83 per share. The Company s net income for the first half of fiscal 2007 was $24.1 million or $1.19 per share as compared to a net loss of $25.3 million or $1.26 per share for the first half of fiscal 2006.

Liquidity and Capital Resources

On January 12, 2006, Sanderson Farms, Inc. announced that sites in Waco and McLennan County, Texas had been selected for construction of a new poultry processing plant, wastewater treatment facility and hatchery. Sanderson Farms will also expand its feed mill in Robertson County, Texas to satisfy the live production needs associated with the new complex. The Company invested $15.2 million in this facility during fiscal 2006, and expects to invest approximately $79.7 million in the new complex and expansion of the Robertson County feedmill during fiscal 2007.

The Company s working capital at April 30, 2007 was $137.2 million and its current ratio was 2.9 to 1. This compares to working capital of $112.9 million and a current ratio of 2.9 to 1 as of October 31, 2006. During the six months ended April 30, 2007, the Company spent approximately $67.4 million on planned capital projects, of which $53.4 million pertains to the construction of the new complex in Waco, Texas and expansion of the Robertson County, Texas feed mill.

The Company s capital budget for fiscal 2007 was approximately $107.6 million at April 30, 2007, and will be funded by cash on hand, internally generated working capital, cash flows from operations and available credit. The Company had $145.0 million available under its revolving line of credit at April 30, 2007. The fiscal 2007 capital budget includes approximately $3.5 million in operating leases, $79.7 million to complete construction of the new poultry complex in Waco, Texas and expansion of the Robertson County, Texas feed mill and $2.7 million to renovate the corporate technical lab in Laurel, Mississippi. Without operating leases, the new poultry complex in Waco, Texas, expansion of the feed mill in Robertson County, Texas and the new lab in Laurel, Mississippi, the Company s capital budget for fiscal 2007 would be $21.7 million.

On April 27, 2007, the Company amended its revolving credit facility to, among other things, change the covenant requiring a minimum debt to total capitalization ratio to 55% during fiscal 2008 and 2009, increase the available credit to $225.0 million and extend the expiration date until April 1, 2012. As of April 30, 2007, the Company was in compliance with all covenants and had $145.0 million available to borrow under the revolving credit facility.

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

Critical Accounting Policies and Estimates

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

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

Allowance for Doubtful Accounts

In the normal course of business, the Company extends credit to its customers on a short-term basis. Although credit risks associated with our customers are considered minimal, the Company routinely reviews its accounts receivable balances and makes

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

Inventories

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

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

Long-Lived Assets

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

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

Accrued Self Insurance

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

Income Taxes

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

Contingencies

The Company is a party to a number of legal proceedings as discussed in Note 6 of our unaudited quarterly condensed consolidated financial statements filed with this report. We recognize the costs of legal defense in the periods incurred. A

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

New Accounting Pronouncements

In July 2006, the FASB issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109. Interpretation 48 clarifies the accounting for uncertainty in income taxes recognized in a company s financial statements in accordance with Statement No. 109 and prescribes a recognition threshold and measurement attribute for financial statement disclosure of tax positions taken or expected to be taken on a tax return. Additionally, Interpretation No. 48 provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. Interpretation 48 is effective for fiscal years beginning after December 15, 2006, with early adoption permitted. The Company is currently evaluating the impact the adoption of Interpretation 48 will have on the Company s consolidated financial position, results of operations and cash flows.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

The Company is a purchaser of certain commodities, primarily corn and soybean meal, for use in manufacturing feed for its chickens. As a result, the Company s earnings are affected by changes in the price and availability of such feed ingredients. Feed grains are subject to volatile price changes caused by factors described below that include weather, size of harvest, transportation and storage costs and the agricultural policies of the United States and foreign governments. The price fluctuations of feed grains have a direct and material effect on the Company s profitability.

Generally, the Company purchases its corn, soybean meal and other feed ingredients for prompt delivery to its feed mills at market prices at the time of such purchases. The Company sometimes will purchase feed ingredients for deferred delivery that typically ranges from one month to twelve months after the time of purchase. The grain purchases are made directly with our usual grain suppliers, which are companies in the regular business of supplying grain to end users, and do not involve options to purchase. Such purchases occur when senior management concludes that market factors indicate that prices at the time the grain is needed are likely to be higher than current prices, or where, based on current and expected market prices for the Company s poultry products, management believes it can purchase feed ingredients at prices that will allow the Company to earn a reasonable return for its shareholders. Market factors considered by management in determining whether or not and to what extent to buy grain for deferred delivery include:

Current market prices;

Current and predicted weather patterns in the United States, South America, China and other grain producing areas, as such weather patterns might affect the planting, growing, harvesting and yield of feed grains;

The expected size of the harvest of feed grains in the United States and other grain producing areas of the world as reported by governmental and private sources;

Current and expected changes to the agricultural policies of the United States and foreign governments;

The relative strength of United States currency and expected changes therein as it might impact the ability of foreign countries to buy United States feed grain commodities;

The current and expected volumes of export of feed grain commodities as reported by governmental and private sources;

The current and expected use of available feed grains for uses other than as livestock feed grains (such as the use of corn for the production of ethanol, which use is impacted by the price of crude oil); and

Current and expected market prices for the Company s poultry products.

The Company purchases physical grain, not financial instruments such as puts, calls or straddles that derive their value from the value of physical grain. Thus, the Company does not use derivative financial instruments as defined by SFAS 133, Accounting for

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Derivatives for Instruments and Hedging Activities. The Company does not enter into any derivative transactions or purchase any grain-related contracts other than the physical grain contracts described above.

The cost of feed grains is recognized in cost of sales, on a first-in-first-out basis, at the same time that the sales of the chickens that consume the feed grains are recognized.

The Company s interest expense is sensitive to changes in the general level of U.S. interest rates. The Company maintains certain of its debt as fixed rate in nature to mitigate the impact of fluctuations in interest rates. The fair value of the Company s fixed rate debt approximates the carrying amount at January 31, 2007. Management believes the potential effects of near-term changes in interest rates on the Company s debt is not material.

The Company is a party to no other market risk sensitive instruments requiring disclosure.

Item 4. Controls and Procedures

The Company maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in the Company s Securities Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms, and that such information is accumulated and communicated to the Company s management, including its Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

An evaluation was performed under the supervision and with the p