

SANDERSON FARMS INC  
Form 10-Q  
August 23, 2018

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

FORM 10-Q

(MARK ONE)

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

For the quarterly period ended July 31, 2018

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_  
Commission file number 1-14977

Sanderson Farms, Inc.  
(Exact name of registrant as specified in its charter)

Mississippi 64-0615843  
(State or other jurisdiction of (I.R.S. Employer  
incorporation or organization) Identification No.)

127 Flynt Road, Laurel, Mississippi 39443  
(Address of principal executive offices) (Zip Code)  
(601) 649-4030  
(Registrant's telephone number, including area code)  
(Former name, former address and former fiscal year, if changed since last report.)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer

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

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

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

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

**APPLICABLE ONLY TO CORPORATE ISSUERS:**

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. Common Stock, \$1 Par Value Per Share: 22,837,956 shares outstanding as of August 20, 2018.

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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  
(In thousands, except number of shares)

|   | July 31,<br>2018<br>(Unaudited) | October 31,<br>2017<br>(Note 1) |
|---|---------------------------------|---------------------------------|
| Assets  |                                 |                                 |
| Current assets:   |                                 |                                 |
| Cash and cash equivalents   | \$288,284                       | \$419,285                       |
| Accounts receivable, net  | 130,921                         | 138,868                         |
| Inventories   | 282,056                         | 252,765                         |
| Refundable income taxes   | 26,266                          | —                               |
| Prepaid expenses and other current assets   | 44,235                          | 38,620                          |
| Total current assets  | 771,762                         | 849,538                         |
| Property, plant and equipment   | 1,869,845                       | 1,657,084                       |
| Less accumulated depreciation   | (856,039 )                      | (780,276 )                      |
|   | 1,013,806                       | 876,808                         |
| Other assets  | 6,036                           | 6,897                           |
| Total assets  | \$1,791,604                     | \$1,733,243                     |
| Liabilities and stockholders' equity  |                                 |                                 |
| Current liabilities:  |                                 |                                 |
| Accounts payable  | \$110,220                       | \$90,904                        |
| Dividends payable   | 7,308                           | —                               |
| Accrued expenses  | 71,361                          | 101,168                         |
| Accrued income taxes  | —                               | 6,649                           |
| Total current liabilities   | 188,889                         | 198,721                         |
| Claims payable and other liabilities  | 9,667                           | 9,762                           |
| Deferred income taxes   | 68,036                          | 91,898                          |
| Commitments and contingencies   |                                 |                                 |
| 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—22,837,956 and 22,802,690 at July 31, 2018 and October 31, 2017, respectively | 22,838                          | 22,803                          |
| Paid-in capital   | 144,407                         | 134,999                         |
| Retained earnings   | 1,357,767                       | 1,275,060                       |
| Total stockholders' equity  | 1,525,012                       | 1,432,862                       |
| Total liabilities and stockholders' equity  | \$1,791,604                     | \$1,733,243                     |
| See notes to condensed consolidated financial statements.   |                                 |                                 |

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SANDERSON FARMS, INC. AND SUBSIDIARIES  
 CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)  
 (In thousands, except per share amounts)

|                                     | Three Months Ended |           | Nine Months Ended |             |
|-------------------------------------|--------------------|-----------|-------------------|-------------|
|                                     | July 31,           |           | July 31,          |             |
|                                     | 2018               | 2017      | 2018              | 2017        |
| Net sales                           | \$852,434          | \$931,901 | \$2,437,856       | \$2,422,285 |
| Cost and expenses:                  |                    |           |                   |             |
| Cost of sales                       | 781,568            | 692,585   | 2,187,079         | 1,954,259   |
| Selling, general and administrative | 55,778             | 62,036    | 163,390           | 151,747     |
|                                     | 837,346            | 754,621   | 2,350,469         | 2,106,006   |
| Operating Income                    | 15,088             | 177,280   | 87,387            | 316,279     |
| Other income (expense):             |                    |           |                   |             |
| Interest income                     | 745                | 327       | 2,069             | 823         |
| Interest expense                    | (519)              | (515)     | (1,548)           | (1,375)     |
| Other                               | 3                  | 3         | 9                 | 8           |
|                                     | 229                | (185)     | 530               | (544)       |
| Income before income taxes          | 15,317             | 177,095   | 87,917            | 315,735     |
| Income tax expense (benefit)        | 3,842              | 61,261    | (16,712)          | 108,861     |
| Net income                          | \$11,475           | \$115,834 | \$104,629         | \$206,874   |
| Earnings per share:                 |                    |           |                   |             |
| Basic                               | \$0.50             | \$5.09    | \$4.58            | \$9.10      |
| Diluted                             | \$0.50             | \$5.09    | \$4.58            | \$9.10      |
| Dividends per share                 | \$0.32             | \$0.24    | \$0.96            | \$0.72      |

See notes to condensed consolidated financial statements.

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SANDERSON FARMS, INC. AND SUBSIDIARIES  
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)  
 (In thousands)

|   | Nine Months Ended |            |
|---|-------------------|------------|
|   | July 31,<br>2018  | 2017       |
| Operating activities  |                   |            |
| Net income  | \$ 104,629        | \$ 206,874 |
| Adjustments to reconcile net income to net cash provided by operating activities: |                   |            |
| Depreciation and amortization   | 81,549            | 73,055     |
| Non-cash stock compensation   | 13,697            | 13,412     |
| Provision for losses on accounts receivable                                       | —                 | 80         |
| Deferred income taxes   | (23,862)          | 19,585     |
| Change in assets and liabilities:   |                   |            |
| Accounts receivable, net  | 7,947             | (26,736)   |
| Income taxes  | (32,915)          | 32,616     |
| Inventories   | (29,291)          | (35,829)   |
| Prepaid expenses and other assets   | (5,539)           | (7,181)    |
| Accounts payable  | 17,249            | 7,655      |
| Accrued expenses and other liabilities  | (29,559)          | 26,600     |
| Total adjustments   | (724)             | 103,257    |
| Net cash provided by operating activities   | 103,905           | 310,131    |
| Investing activities  |                   |            |
| Capital expenditures  | (216,587)         | (130,617)  |
| Net proceeds from sale of property and equipment                                  | 892               | 409        |
| Net cash used in investing activities   | (215,695)         | (130,208)  |
| Financing activities  |                   |            |
| Payments for debt issuance costs  | —                 | (2,416)    |
| Proceeds from issuance of restricted stock under stock compensation plans         | 1,119             | 732        |
| Payments from issuance of common  | (5,717)           | (3,164)    |

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|   |            |   |            |   |
|---|------------|---|------------|---|
| stock under stock<br>compensation plans                       |            |   |            |   |
| Dividends paid  | (14,613    | ) | (10,916    | ) |
| Net cash used in<br>financing activities                      | (19,211    | ) | (15,764    | ) |
| Net change in cash and<br>cash equivalents                    | (131,001   | ) | 164,159    |   |
| Cash and cash<br>equivalents at<br>beginning of period        | 419,285    |   | 234,111    |   |
| Cash and cash<br>equivalents at end of<br>period              | \$ 288,284 |   | \$ 398,270 |   |
| Supplemental<br>disclosure of non-cash<br>financing activity: |            |   |            |   |
| Dividends payable   | \$ (7,308  | ) | \$ (5,459  | ) |
| See notes to condensed consolidated financial statements.     |            |   |            |   |

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SANDERSON FARMS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

July 31, 2018

NOTE 1—ACCOUNTING POLICIES

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles ("U.S. GAAP") 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. GAAP for complete financial statements. In the opinion of management, all adjustments consisting of normal recurring accruals considered necessary for a fair presentation have been included. Operating results for the three and nine months ended July 31, 2018 are not necessarily indicative of the results that may be expected for the fiscal year ending October 31, 2018.

The condensed consolidated balance sheet at October 31, 2017 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. GAAP 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 its fiscal year ended October 31, 2017.

New Accounting Pronouncements

In July 2015, the Financial Accounting Standards Board ("FASB") issued guidance that requires an entity to measure inventory at the lower of cost or net realizable value. The guidance is effective for annual reporting periods and interim periods within those annual reporting periods beginning after December 15, 2016, our fiscal 2018. The Company adopted this guidance during the first quarter of fiscal 2018, and it did not have a material effect on the Company's consolidated financial statements.

In June 2018, the FASB issued Accounting Standards Update ("ASU") 2018-07, Improvements to Nonemployee Share-Based Payment Accounting, which expands the scope of Topic 718, Compensation - Stock Compensation, to include all share-based payment transactions in which a grantor acquires goods or services to be used or consumed in a grantor's own operations by issuing share-based payment awards. The guidance is effective for interim and annual periods beginning after December 15, 2018, our fiscal 2020. Early adoption is permitted. The Company is currently evaluating the impact this guidance will have on our consolidated financial statements.

In May 2017, the FASB issued ASU 2017-09, Scope of Modification Accounting, which amends the requirements related to accounting for changes to stock compensation awards. The guidance is effective for interim and annual periods beginning after December 15, 2017, our fiscal 2019. Early adoption is permitted. The impact this guidance will have on our consolidated financial statements will depend on the nature and extent of future changes, if any, to the terms and conditions of the Company's Stock Incentive Plan.

In March 2017, the FASB issued ASU 2017-07, Improving the Presentation of Net Periodic Pension Cost and Net Periodic Post-retirement Benefit Cost. The guidance requires the service cost component of defined benefit pension plans and other post-retirement benefit plans to be reported in the same line item or items as other compensation costs arising from the services rendered by the pertinent employees during the period. The other components of net benefit cost are required to be reported outside of operating income. The guidance is effective for interim and annual periods beginning after December 15, 2017, our fiscal 2019. Early adoption is permitted. We do not expect adoption to have a material effect on our consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, Leases. The guidance is intended to increase transparency and comparability among companies by requiring an entity that is a lessee to recognize on the balance sheet the right-of-use assets and lease liabilities arising from all leases with terms, as defined by the guidance, of greater than twelve months. The guidance also requires disclosure of key information about leasing arrangements. The guidance is effective for annual reporting periods and interim periods within those annual reporting periods beginning after December 15, 2018, our fiscal 2020. Early adoption is permitted. The Company is currently evaluating the impact this guidance will have on our consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers, which changes the criteria for recognizing revenue. ASU 2014-09 was amended by ASU 2015-14 to defer the effective date by one year. The



guidance also modifies the related disclosure requirements, clarifies guidance for multiple-element arrangements and provides guidance for transactions that were not addressed fully in previous guidance. The guidance, as amended, is effective for annual reporting

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periods and interim periods within those annual reporting periods beginning after December 15, 2017, our fiscal 2019. Early adoption is permitted for annual reporting periods and interim periods within those annual reporting periods beginning after December 15, 2016. Companies have the option to adopt retrospectively or modified retrospectively with a cumulative effect adjustment. The Company will adopt this standard as of November 1, 2018, the beginning of our fiscal 2019, using the modified retrospective approach. The Company is currently evaluating the impact this guidance will have on our consolidated financial statements by evaluating our various types of contracts with customers, various costs related to those contracts, and various other costs related to the selling process. Although we are still evaluating the overall impact, we do not currently expect adoption to have a material effect on our consolidated financial statements, other than additional disclosure requirements, which will require the disaggregation of our revenue into categories that depict how the nature, amount, timing and uncertainty of revenue and cash flows are affected by economic factors.

**NOTE 2—INVENTORIES**

Inventories consisted of the following:

|                                    | July 31,<br>2018 | October<br>31, 2017 |
|------------------------------------|------------------|---------------------|
|                                    | (In thousands)   |                     |
| Live poultry-broilers and breeders | \$186,624        | \$161,575           |
| Feed, eggs and other               | 42,019           | 35,361              |
| Processed poultry                  | 33,976           | 37,769              |
| Prepared chicken                   | 12,856           | 12,207              |
| Packaging materials                | 6,581            | 5,853               |
|                                    | \$282,056        | \$252,765           |

**NOTE 3—STOCK COMPENSATION PLANS**

Refer to Note 8 and Note 9 of the Company's October 31, 2017 audited financial statements in the Company's 2017 Annual Report on Form 10-K for further information on our employee benefit plans and stock based compensation plans, respectively. Total stock based compensation expense during the three and nine months ended July 31, 2018 was \$3.1 million and \$13.7 million, respectively, as compared to total stock based compensation expense of \$4.0 million and \$13.4 million for the three and nine months ended July 31, 2017, respectively.

During the nine months ended July 31, 2018, participants in the Company's Management Share Purchase Plan ("MSPP") elected to receive a total of 8,749 shares of restricted stock at an average price of \$127.93 per share instead of a specified percentage of their cash compensation, and the Company issued 2,101 matching restricted shares.

During the three and nine months ended July 31, 2018, the Company recorded compensation expense for the MSPP shares, included in the total stock based compensation expense above, of \$46,000 and \$211,000, respectively, as compared to \$99,000 and \$297,000 during the three and nine months ended July 31, 2017, respectively.

During fiscal 2018, 2017 and 2016, the Company entered into performance share agreements that grant certain officers and key employees the right to receive shares of the Company's common stock, subject to the Company's achievement of certain performance measures. The performance share agreements specify a target number of shares that a participant can receive based upon the Company's average return on equity and average return on sales, as defined, during a two-year performance period beginning November 1 of each performance period. Although the performance share agreements have a two-year performance period, they are subject to an additional one-year period during which the participant must remain employed by the Company before they are paid out. If the Company's average return on equity and average return on sales exceed certain threshold amounts for the performance period, participants will receive 50 percent to 200 percent of the target number of shares, depending upon the Company's level of performance. Accruals for performance shares begin during the period management determines that achievement of the applicable performance based criteria is probable at some level. In estimating the probability of the number of shares that will be awarded, the Company considers, among other factors, current and projected grain costs and chicken volumes and pricing, as well as the amount of the Company's commitments to procure grain at a fixed price throughout the performance period. Due to the high level of volatility of these commodity prices and the impact that the change in pricing can have on the Company's results, the Company's assessment of probability can change from

period to period and can result in a significant revision to the amounts accrued related to the arrangements, as the accruals are adjusted using the cumulative catch-up method of accounting.

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The target number of shares specified in the performance share agreements executed on November 1, 2017 totaled 53,850. As of July 31, 2018, the Company could not determine that achievement of the applicable performance based criteria is probable due to the uncertainties discussed above, and therefore recorded no compensation expense related to those agreements.

The Company also has performance share agreements in place with certain officers and key employees that were entered into on November 1, 2016. During the quarter ended January 31, 2018, the Company determined that achievement of the applicable performance based criteria for the November 1, 2016 agreements is probable at a level between the target and maximum levels. Accordingly, because the accrual is made using the cumulative catch-up method, the three and nine months ended July 31, 2018 include compensation expense of \$0.4 million and \$5.2 million, respectively, as compared to no compensation expense recorded during the three and nine months ended July 31, 2017 related to the agreements entered into on November 1, 2016. As of July 31, 2018, the aggregate number of shares estimated to be awarded related to the performance share agreements entered into on November 1, 2016 totaled 97,763 shares. The actual number of shares that can be awarded for those agreements could change materially from that estimate due to the Company's actual performance during the remaining three months of the performance period ending October 31, 2018, and due to potential forfeitures. The Company will recognize the remaining unearned compensation related to these shares over the remaining service period.

The Compensation Committee of the Company's Board of Directors has determined that the performance share agreements entered into on November 1, 2015 have been earned at a level between the target and maximum levels, subject to the satisfaction of the additional one-year service period ending on October 31, 2018. Accordingly, the three and nine months ended July 31, 2018 include compensation expense of \$0.8 million and \$2.5 million, respectively, related to those agreements, as compared to compensation expense of \$1.2 million and \$5.7 million, respectively, during the three and nine months ended July 31, 2017. Because management's initial determination of probability was made during the three months ended January 31, 2017, and because the accrual is made using the cumulative catch-up method, the compensation expense recorded during the first three quarters of fiscal 2017 related to the agreements entered into on November 1, 2015 was greater than that recorded during the first three quarters of fiscal 2018. As of July 31, 2018, the aggregate number of shares estimated to be awarded related to the performance share agreements entered into on November 1, 2015 totaled 145,469 shares. Since the performance period for those agreements has ended, the actual number of shares that will be awarded can change only due to potential forfeitures during the remaining three months of the service period ending October 31, 2018. The Company will recognize the remaining unearned compensation related to these shares over the remaining service period.

Had the Company determined that it was probable that the maximum amount of those outstanding awards from the agreements entered into on November 1, 2016 and November 1, 2017 would be earned, an additional \$1.8 million and \$4.0 million, respectively, would have been accrued as of July 31, 2018.

The Company's compensation cost related to performance share agreements is summarized as follows (in thousands, except number of shares):

| Date of Performance Share Agreement | Number of shares issued (actual (a) or estimated (e)) | Three months ended |               | Nine months ended |               |
|-------------------------------------|---|--------------------|---------------|-------------------|---------------|
|                                     |   | July 31, 2018      | July 31, 2017 | July 31, 2018     | July 31, 2017 |
| November 1, 2014                    | 102,193 (a)   | \$—                | \$722         | \$—               | \$2,065       |
| November 1, 2015                    | 145,469 (e)   | 843                | 1,249         | 2,517             | 5,733         |
| November 1, 2016                    | 97,763 (e)  | 379                | —             | 5,224             | —             |
| November 1, 2017 (1)                | —   | —                  | —             | —                 | —             |
| Total compensation cost             |   | \$1,222            | \$1,971       | \$7,741           | \$7,798       |

Note (1) - As of July 31, 2018, the Company could not determine that achievement of the applicable performance-based criteria is probable for the agreements entered into on November 1, 2017 due to the uncertainties discussed above, and therefore recorded no compensation expense related to those agreements.

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On November 1, 2017, the Company granted 53,850 shares of restricted stock to certain officers and key management employees. The restricted stock had a grant date fair value of \$148.23 per share and will vest on November 1, 2021. On February 15, 2018, the Company granted an aggregate of 11,400 shares of restricted stock to all of its non-employee directors. The restricted stock had a grant date fair value of \$131.61 per share and vests one, two or three years from the date of grant. The Company also has unvested restricted stock grants outstanding that were granted during prior fiscal years to its officers, key employees and outside directors. The aggregate number of shares outstanding at July 31, 2018 related to all unvested restricted stock grants totaled 282,156. During the three and nine months ended July 31, 2018, the Company recorded compensation expense, included in the total stock based compensation expense above, of \$1.8 million and \$5.7 million,

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respectively, related to restricted stock grants, as compared to \$2.0 million and \$5.3 million during the three and nine months ended July 31, 2017, respectively. The Company had \$12.8 million in unrecognized share-based compensation costs as of July 31, 2018, which will be recognized over a weighted average remaining vesting period of approximately 1 year, 9 months.

**NOTE 4—EARNINGS PER SHARE**

Certain share-based payment awards described in Note 3 - Stock Compensation Plans above entitling holders to receive non-forfeitable dividends before vesting are considered participating securities and thus are included in the calculation of basic earnings per share, to the extent they are dilutive. These awards are included in the calculation of basic earnings per share under the two-class method. The two-class method allocates earnings for the period between common shareholders and other security holders. The participating awards receiving dividends are allocated the same amount of income as if they were vested shares.

The following tables present earnings per share.

|   | Three months ended                      |               |
|---|---|---------------|
|   | July 31, 2018                           | July 31, 2017 |
|   | (in thousands except per share amounts) |               |
| Net income  | \$ 11,475                               | \$ 115,834    |
| Distributed and undistributed (earnings) to unvested restricted stock | (163 )                                  | (1,755 )      |
| Distributed and undistributed earnings to common shareholders—Basic   | \$ 11,312                               | \$ 114,079    |
| Weighted average shares outstanding—Basic                             | 22,513                                  | 22,399        |
| Weighted average shares outstanding—Diluted                           | 22,513                                  | 22,399        |
| Earnings per common share—Basic                                       | \$ 0.50                                 | \$ 5.09       |
| Earnings per common share—Diluted                                     | \$ 0.50                                 | \$ 5.09       |

|   | Nine months ended                       |               |
|---|---|---------------|
|   | July 31, 2018                           | July 31, 2017 |
|   | (in thousands except per share amounts) |               |
| Net income  | \$ 104,629                              | \$ 206,874    |
| Distributed and undistributed (earnings) to unvested restricted stock | (1,493 )                                | (3,186 )      |
| Distributed and undistributed earnings to common shareholders—Basic   | \$ 103,136                              | \$ 203,688    |
| Weighted average shares outstanding—Basic                             | 22,508                                  | 22,391        |
| Weighted average shares outstanding—Diluted                           | 22,508                                  | 22,391        |
| Earnings per common share—Basic                                       | \$ 4.58                                 | \$ 9.10       |
| Earnings per common share—Diluted                                     | \$ 4.58                                 | \$ 9.10       |

**NOTE 5—FAIR VALUE OF FINANCIAL INSTRUMENTS**

The Company holds certain items that are required to be disclosed at fair value, primarily cash equivalents. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. A three-level hierarchy is followed for disclosure to show the extent and level of judgment used to estimate fair value measurements:

Level 1 – Inputs used to measure fair value are unadjusted quoted prices that are available in active markets for the identical assets or liabilities as of the reporting date.

Level 2 – Inputs used to measure fair value, other than quoted prices included in Level 1, are either directly or indirectly observable as of the reporting date through correlation with market data, including quoted prices for similar assets and liabilities in active markets and quoted prices in markets that are not active. Level 2 also includes assets and liabilities that are valued using models or other pricing methodologies that do not require significant judgment since the input assumptions used



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in the models, such as interest rates and volatility factors, are corroborated by readily observable data from actively quoted markets for substantially the full term of the financial instrument.

Level 3 – Inputs used to measure fair value are unobservable inputs that are supported by little or no market activity and reflect the use of significant management judgment. These values are generally determined using pricing models for which the assumptions utilize management’s estimates of market participant assumptions.

At July 31, 2018, and October 31, 2017, the fair value of the Company's cash and cash equivalents approximated their carrying value due to the short maturity of these financial instruments and were categorized as a Level 2 measurement. Inputs used to measure fair value were primarily recent trading prices and prevailing market interest rates.

### NOTE 6—COMMITMENTS AND CONTINGENCIES

#### Property, Plant and Equipment

In March 2017, the Company announced the selection of sites in Lindale, Mineola and Smith County, Texas, for the construction of a new poultry processing complex. The completed complex will consist of a hatchery, feed mill, processing plant and waste water treatment facility. Construction commenced on this project during the fourth quarter of fiscal 2017, and initial operations of the completed complex are expected to begin during the first calendar quarter of 2019. The Company estimates the total investment in the complex will be approximately \$225.0 million. As of July 31, 2018, the Company has entered into commitments totaling approximately \$220.0 million related to the new complex, of which approximately \$107.6 million has been spent to date.

As of July 31, 2018, the Company has outstanding commitments totaling \$7.6 million related to purchase agreements for future delivery of aircraft. These commitments are expected to be paid as follows: \$3.5 million during the remainder of fiscal 2018 and \$4.1 million during fiscal 2019.

#### Litigation

Between September 2, 2016 and October 13, 2016, Sanderson Farms, Inc. and our subsidiaries were named as defendants, along with 13 other poultry producers and certain of their affiliated companies, in multiple putative class action lawsuits filed by direct and indirect purchasers of broiler chickens in the United States District Court for the Northern District of Illinois. The complaints allege that the defendants conspired to unlawfully fix, raise, maintain, and stabilize the price of broiler chickens, thereby violating federal and certain states’ antitrust laws, and also allege certain related state-law claims. The complaints also allege that the defendants fraudulently concealed the alleged anticompetitive conduct in furtherance of the conspiracy. The complaints seek damages, including treble damages for the antitrust claims, injunctive relief, costs, and attorneys’ fees. As detailed below, the Court has consolidated all of the direct purchaser complaints into one case, and the indirect purchaser complaints into two cases, one on behalf of commercial and institutional indirect purchaser plaintiffs and one on behalf of end-user consumer plaintiffs.

On October 28, 2016, the direct and indirect purchaser plaintiffs filed consolidated, amended complaints, and on November 23, 2016, the direct and indirect purchaser plaintiffs filed second amended complaints. On December 16, 2016, the indirect purchaser plaintiffs separated into two cases. On that date, the commercial and institutional indirect purchaser plaintiffs filed a third amended complaint, and the end-user consumer plaintiffs filed an amended complaint. On January 27, 2017, the defendants filed motions to dismiss the amended complaints in all of the cases, and on November 20, 2017, the motions to dismiss were denied. On February 7, 2018, the direct purchaser plaintiffs filed their third amended complaint, adding three additional poultry producers as defendants. On February 12, 2018, the end-user consumer plaintiffs filed their second amended complaint, in which they also added three additional poultry producers as defendants, along with Agri Stats. On February 20, 2018, the commercial indirect purchaser plaintiffs filed their fourth amended complaint. The parties are currently engaged in discovery. We intend to continue to defend the lawsuits vigorously; however, the Company cannot predict the outcome of these actions. If the plaintiffs were to prevail, the Company could be liable for damages, which could have a material, adverse effect on our financial position and results of operations.

Between December 8, 2017 and August 16, 2018, additional purported direct-purchaser entities individually brought twelve separate suits against 17 poultry producers, including Sanderson Farms and Agri Stats, in the United States District Court for the Northern District of Illinois and the United States District Court for the District of Kansas. These suits allege substantially similar claims to the direct purchaser class complaint described above. Those filed in the Northern District of Illinois are now pending in front of the same judge as the putative class action lawsuits. The



parties are currently engaged in discovery. On June

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26, 2018, the defendants filed a motion to transfer the case filed in the District of Kansas to the Northern District of Illinois. That motion is still pending. It is possible additional individual actions may be filed.

Sanderson Farms, Inc.; Joe F. Sanderson, Jr., the Chairman of the Registrant's Board of Directors and its Chief Executive Officer; and D. Michael Cockrell, director and Chief Financial Officer, were named as defendants in a putative class action lawsuit filed on October 28, 2016, in the United States District Court for the Southern District of New York. On March 30, 2017, the lead plaintiff filed an amended complaint adding Lampkin Butts, director, Chief Operating Officer, and President, as a defendant, and on June 15, 2017, the lead plaintiff filed a second amended complaint. The complaint alleges that the defendants made statements in the Company's SEC filings and press releases, and other public statements, that were materially false and misleading in light of the Company's alleged, undisclosed violation of the federal antitrust laws described above. The complaint also alleges that the material misstatements were made in order to, among other things, "artificially inflate and maintain the market price of Sanderson Farms securities." The complaint alleges the defendants thereby violated the Securities Exchange Act of 1934, as amended (the "Exchange Act"), including Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder, and, for the individual defendants, Section 20(a) of the Exchange Act, and seeks damages, interest, costs and attorneys' fees. On January 19, 2018, the Court granted the defendants' motion to dismiss and entered judgment for the defendants. On January 31, 2018, the plaintiff filed a notice of appeal to the United States Court of Appeals for the Second Circuit, and the case is scheduled for argument on August 31, 2018. The Company cannot predict the outcome of this action or the appeal. If the plaintiffs were to prevail in the action, the Company could be liable for damages, which could have a material, adverse effect on our financial position and results of operations.

On January 30, 2017, the Company received a letter from a putative shareholder demanding that the Company take action against current and/or former officers and directors of the Company for alleged breach of their fiduciary duties. The shareholder asserted that the officers and directors (i) failed to take any action to stop the alleged antitrust conspiracy described above, despite their alleged knowledge of the conspiracy, and (ii) made and/or caused the Company to make materially false and misleading statements by failing to disclose the alleged conspiracy. The shareholder also asserted that certain directors engaged in "insider sales" from which they improperly benefited. The shareholder also demanded that the Company adopt unspecified corporate governance improvements. On February 9, 2017, pursuant to statutory procedures available in connection with demands of this type, the Company's board of directors appointed a special committee of qualified directors to determine, after conducting a reasonable inquiry, whether it is in the Company's best interests to pursue any of the actions asserted in the shareholder's letter. On April 26, 2017, the special committee reported to the Company's board of directors its determination that it is not in the Company's best interests to take any of the demanded actions at this time, and that no governance improvements related to the subject matter of the demand are needed at this time. On May 5, 2017, the special committee's counsel informed the shareholder's counsel of the committee's determination. As of the date of filing of this report, and to the Company's knowledge, no legal proceedings related to the shareholder's demand have been filed.

On January 27, 2017, Sanderson Farms, Inc. and our subsidiaries were named as defendants, along with four other poultry producers and certain of their affiliated companies, in a putative class action lawsuit filed in the United States District Court for the Eastern District of Oklahoma. On March 27, 2017, Sanderson Farms, Inc. and our subsidiaries were named as defendants, along with four other poultry producers and certain of their affiliated companies, in a second putative class action lawsuit filed in the United States District Court for the Eastern District of Oklahoma. The Court ordered the suits consolidated into one proceeding, and on July 10, 2017, the plaintiffs filed a consolidated amended complaint. The consolidated amended complaint alleges that the defendants unlawfully conspired by sharing data on compensation paid to broiler farmers, with the purpose and effect of suppressing the farmers' compensation below competitive levels. The consolidated amended complaint also alleges that the defendants unlawfully conspired to not solicit or hire the broiler farmers who were providing services to other defendants. The consolidated amended complaint seeks treble damages, costs and attorneys' fees. On September 8, 2017, the defendants filed a motion to dismiss the amended complaint, on October 23, 2017, the plaintiffs filed their response, and on November 22, 2017, the defendants filed a reply. On January 19, 2018, the Court granted the Sanderson Farms defendants' motion to dismiss for lack of personal jurisdiction. The motion to dismiss the complaint filed in the Eastern District of Oklahoma on its merits is pending as to the remaining defendants. On February 21, 2018, the plaintiffs filed a

substantially similar lawsuit in United States District Court for the Eastern District of North Carolina against Sanderson Farms and our subsidiaries and another poultry producer. Defendants subsequently moved to consolidate this action with the Eastern District of Oklahoma action in the Eastern District of Oklahoma for pre-trial proceedings, which was denied. On July 13, 2018, the defendants moved to dismiss the lawsuit in the Eastern District of North Carolina. That motion is pending. We intend to defend this case vigorously; however, the Company cannot predict the outcome of this action. If the plaintiffs were to prevail, the Company could be liable for damages, which could have a material, adverse effect on our financial position and results of operations.

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On February 21, 2017, Sanderson Farms, Inc. received an antitrust civil investigative demand from the Office of the Attorney General, Department of Legal Affairs, of the State of Florida. Among other things, the demand seeks information related to the Georgia Dock Index and other information on poultry and poultry products published by the Georgia Department of Agriculture and its Poultry Market News division. The Company is cooperating fully with the investigative demand, and we have responded to all requests received to date; however, we are unable to predict its outcome at this time.

On June 22, 2017, the Company was named as a defendant in a lawsuit filed in the United States District Court for the Northern District of California. The complaint, which was brought by three non-profit organizations (the Organic Consumers Association, Friends of the Earth, and Center for Food Safety) alleged that the Company is violating the California Unfair Competition Law and the California False Advertising Law by representing that its poultry products are “100% Natural” products raised with “100% Natural” farming procedures. Among other things, the plaintiffs alleged that the Company’s products contain residues of human and animal antibiotics, other pharmaceuticals, hormones, steroids, and pesticides. Plaintiffs seek an order enjoining the Company from continuing its allegedly unlawful marketing program and requiring the Company to conduct a corrective advertising campaign; an accounting of the Company’s profits derived from the allegedly unlawful marketing practices; and attorneys’ fees, costs and interest. On August 2, 2017, the Company moved to dismiss the lawsuit on various grounds. On August 23, 2017, the plaintiffs filed an amended complaint, which includes substantially similar allegations as the original complaint, and the Company filed a motion to dismiss the amended complaint on September 13, 2017. On February 9, 2018, the Court denied the Company’s motion to dismiss. On February 13, 2018, the Company filed a motion for sanctions under Federal Rule of Civil Procedure 11 on the basis that Plaintiffs and their counsel knowingly included false or inaccurate statements and unsupported allegations in their complaints and other filings. The Court denied that motion on April 2, 2018. An initial scheduling conference was held on March 1, 2018, and discovery is underway. On June 25, 2018, the plaintiffs amended their complaint for a second time, including to remove allegations that the Company’s products had been found to contain residues of antibiotics or other substances. On July 9, 2018, the Company filed a motion to dismiss the second amended complaint, and such motion is currently pending. On July 18, 2018, the parties stipulated to the voluntary dismissal of one of the plaintiff organizations (the Organic Consumers Association). The other two plaintiffs continue to prosecute their claims. The Company continues to vigorously defend itself; however, the Company cannot predict the outcome of this action. If the plaintiffs were to prevail, the Company’s reputation and marketing program could be materially, adversely affected, which could have a material, adverse effect on our financial position and results of operations.

The Company is involved in various other claims and litigation incidental to its business. Although the outcome of these matters cannot be determined with certainty, management, upon the advice of counsel, is of the opinion that the final outcome of currently pending matters, other than those discussed above, should not have a material effect on the Company’s consolidated results of operations 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. After a considerable analysis of each case, the Company has determined that no accrual is required for any of the foregoing matters as of July 31, 2018. Future reserves may be required if losses are deemed reasonably estimable and 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 reserves or by accruals of losses to reflect any adverse determinations in these legal proceedings.

**NOTE 7—CREDIT AGREEMENT**

The Company is a party to a revolving credit facility dated April 28, 2017, as amended on November 22, 2017, and June 14, 2018, with a maximum available borrowing capacity of \$900.0 million. The facility has annual capital expenditure limitations of \$105.0 million, \$110.0 million, \$115.0 million, \$120.0 million and \$125.0 million for fiscal years 2018 through 2022, respectively, and permits up to \$20.0 million of the unused capital expenditure limitation for any fiscal year starting with fiscal 2017 to be carried over to the next fiscal year. The normal capital expenditure limitation for fiscal 2018 is \$125.0 million, including \$20.0 million carried over from fiscal 2017.

The credit facility also permits capital expenditures up to \$250.0 million, as amended on June 14, 2018, on the construction of a new poultry processing complex in Lindale, Mineola and Smith County, Texas, up to \$210.0 million

on the construction of a potential additional new poultry complex, up to \$15.0 million on expansion of the Company's existing prepared chicken facility in Flowood, Mississippi, up to \$60.0 million on a potential new prepared chicken facility, and up to \$70.0 million on the purchase of three new aircraft. As amended on November 22, 2017, the facility also excludes from the normal capital expenditure limits certain capital projects in an aggregate amount of up to \$135.0 million. These additional projects, which include the construction of a new feed mill, and other expansions, equipment and changes to the Laurel, Collins, McComb and Hazlehurst, Mississippi complexes; the Waco, Palestine and Brazos, Texas complexes; the Moultrie, Georgia complex; and the Kinston, North Carolina complex, are each subject to their own expenditure limitations.

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Under the credit facility, the Company may not exceed a maximum debt to total capitalization ratio of 50%. The Company has a one-time right, at any time during the term of the agreement, to increase the maximum debt to total capitalization ratio then in effect by five percentage points in connection with the construction of any of the three aforementioned new complexes for the four fiscal quarters beginning on the first day of the fiscal quarter during which the Company gives written notice of its intent to exercise this right. The Company has not exercised this right. The facility also sets a minimum net worth requirement that at July 31, 2018, was \$1,030.9 million. The credit is unsecured and, unless extended, will expire on April 28, 2022. As of July 31, 2018, and August 22, 2018, the Company had no outstanding draws under the facility, and had approximately \$21.4 million outstanding in letters of credit, leaving \$878.6 million of borrowing capacity available under the facility.

**NOTE 8—INCOME TAXES**

On December 22, 2017, President Trump signed the "Tax Cuts and Jobs Act" (the "Tax Act") into law. The provisions of the Tax Act that will materially affect our fiscal years 2018 and thereafter include, but are not limited to, a reduction in the corporate federal income tax rate from 35% to 21% and a change in the bonus depreciation rules to allow full expensing of qualified property in the year placed in service. Provisions of the Tax Act that will not affect our fiscal year 2018, but could materially affect our fiscal years 2019 and thereafter include, but are not limited to, a lower tax rate on foreign-derived intangible income, the repeal of the domestic production activities deduction and changes to the rules regarding the deductibility of excessive employee remuneration for certain employees.

Our financial statements for the first nine months of fiscal 2018 were materially affected by the changes enacted by the Tax Act to the Internal Revenue Code of 1986, as amended. U.S. GAAP requires that the effects from changes in tax laws be recognized in the period in which the new law is enacted, which for the Tax Act was our first quarter of fiscal 2018. For fiscal 2018, our statutory federal income tax rate will decrease from the previously enacted 35% to approximately 23.3%. The fiscal 2018 statutory rate will not decrease entirely to 21% because it is a blended rate of two months at 35% (before the Tax Act became effective) and ten months at 21% (after the Tax Act became effective). In addition to benefiting from the lower corporate federal income tax rate on current earnings, the Company recorded a tax benefit in accordance with U.S. GAAP related to the revaluation of its deferred tax assets and liabilities using the enacted tax rate expected to apply when the temporary differences from which the deferred taxes arose are expected to be settled.

Following the enactment of the Tax Act, the United States Securities and Exchange Commission issued guidance in Staff Accounting Bulletin 118 which provides the Company up to a one-year measurement period, beginning on the Tax Act's enactment date, in which to complete the required analysis and accounting for the effects of the Tax Act. The guidance allows the Company to record provisional adjustments related to the impacts of the Tax Act when the accounting for the effects of the Tax Act is incomplete, but when reasonable estimates can be made regarding the effects of the Tax Act. Our accounting for the Tax Act is not complete, because it required the Company to estimate the timing of settlement of the temporary differences from which our deferred taxes arose; however, we were able to make reasonable estimates, and we recorded those estimates as provisional adjustments. The Company will continue to monitor these estimates as we move through the measurement period. If any adjustments to the provisional amounts are required, those adjustments will be recorded in the period such new information becomes available.

The Company's estimated annual effective tax rates for the three and nine months ended July 31, 2018 were 25.1% and (19.0)%, respectively, as compared to 34.6% and 34.5%, respectively, for the three and nine months ended July 31, 2017. The revaluation of our deferred taxes using the newly enacted tax rate resulted in a \$37.5 million discrete income tax benefit recognized during the first quarter of fiscal 2018. There were no other material discrete items affecting the comparative periods. Excluding the effects of discrete items, the Company's estimated annual effective tax rate for the nine months ended July 31, 2018 would have been approximately 24.6%, as compared to approximately 35.0% for the nine months ended July 31, 2017, which is primarily due to the aforementioned decrease to the statutory federal income tax rate as a result of the enactment of the Tax Act.

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Review Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders

Sanderson Farms, Inc.

We have reviewed the condensed consolidated balance sheet of Sanderson Farms, Inc. and subsidiaries as of July 31, 2018, and the related condensed consolidated statements of operations for the three-month and nine-month periods ended July 31, 2018 and 2017 and the condensed consolidated statements of cash flows for the nine-month periods ended July 31, 2018 and 2017. These financial statements are the responsibility of the Company's management.

We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), 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, 2017, and the related consolidated statements of operations, stockholders' equity, and cash flows for the year then ended (not presented herein) and we expressed an unqualified audit opinion on those consolidated financial statements in our report dated December 14, 2017. In our opinion, the accompanying condensed consolidated balance sheet of Sanderson Farms, Inc. and subsidiaries as of October 31, 2017, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ Ernst & Young LLP

New Orleans, Louisiana

August 23, 2018

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

General

The following 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, 2017.

This Quarterly Report, and other periodic reports filed by the Company under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and other written or oral statements made by it or on its behalf, may include forward-looking statements within the meaning of the "Safe Harbor" provisions of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Exchange Act. These forward-looking statements 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 risks described in the "Risk Factors" section of our latest 10-K and 10-Q reports, and 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, any of which may affect the value of inventories, the collectability of accounts receivable or the financial integrity of customers, and the ability of the end user or consumer to afford protein.
- (3) Changes in the political or economic climate, trade policies, laws and regulations or the domestic poultry industry of countries to which the Company or other companies in the poultry industry ship product, and other changes that might limit the Company's or the industry's access to foreign markets.
- (4) Changes in laws, regulations, and other activities in government agencies and similar organizations applicable to the Company and the poultry industry and changes in laws, regulations and other activities in government agencies and similar organizations related to food safety.
- (5) Various inventory risks due to changes in market conditions, including, but not limited to, the risk that net realizable values of live and processed poultry inventories might be lower than the cost of such inventories, requiring a downward adjustment to record the value of such inventories at the lower of cost or net realizable value as required by generally accepted accounting principles.
- (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, or the contamination of its products.
- (9) Changes in the availability and cost of labor and growers.
- (10) The loss of any of the Company's major customers.
- (11) Inclement weather that could hurt Company flocks or otherwise adversely affect the Company's operations, or changes in global weather patterns that could affect the supply and price of feed grains.
- (12) Failure to respond to changing consumer preferences and negative or competitive media campaigns.
- (13) Failure to successfully and efficiently start up and run a new plant or integrate any business the Company might acquire.
- (14) Unfavorable results from currently pending litigation and proceedings, or litigation and proceedings that could arise in the future.



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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 report, the words “believes,” “estimates,” “plans,” “expects,” “should,” “outlook,” and “anticipates” and similar expressions as they relate to the Company or its management are intended to identify forward-looking statements. Examples of forward-looking statements include statements about management’s beliefs about future growth plans, future earnings, production levels, capital expenditures, grain prices, global economic conditions, supply and demand factors and other industry conditions.

GENERAL

The Company’s poultry operations are integrated through its control of all functions relative to the production of its chicken products, including hatching egg production, hatching, feed manufacturing, raising chickens to marketable age (“grow out”), processing, marketing and distribution. The Company’s prepared chicken product line includes approximately 120 institutional and consumer packaged chicken items that it sells nationally, primarily to distributors and food service establishments. A majority of the prepared chicken items are made to the specifications of food service users.

Consistent with the poultry industry, the Company’s profitability is substantially affected 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.

In March 2015, the Company announced the selection of St. Pauls and Robeson County, North Carolina, for the construction of a new poultry processing complex. The completed complex consists of a hatchery, processing plant, and waste water treatment facility with the capacity to process 1.3 million chickens per week, and an expansion of the Company's existing feed mill in Kinston, North Carolina. Construction began in July 2015, initial operations of the new complex began during the first quarter of fiscal 2017, and the facility reached full capacity during April 2018. During the three and nine months ended July 31, 2018, the St. Pauls processing plant processed approximately 139.4 million pounds and 387.8 million pounds of dressed poultry meat, respectively, as compared to 76.4 million pounds and 126.6 million pounds, respectively, during the three and nine months ended July 31, 2017.

In March 2017, the Company announced the selection of sites in Lindale, Mineola and Smith County, Texas, for the construction of a new poultry processing complex. The completed complex will consist of a hatchery, feed mill, processing plant and waste water treatment facility with the capacity to process 1.3 million chickens per week. Construction is underway, and initial operations of the new complex are expected to begin during the first calendar quarter of 2019. Before the complex can become operational and reach full capacity, we will need to enter into contracts with a sufficient number of independent contract poultry producers to house the live inventory and hire and train our workforce. See "The construction and potential benefits of our new facilities are subject to risks and uncertainties" in the Risk Factors section of our Annual Report on Form 10-K for the fiscal year ended October 31, 2017.

The Company is a party to a revolving credit facility dated April 28, 2017, as amended on November 22, 2017, and June 14, 2018, with a maximum available borrowing capacity of \$900.0 million. The facility has annual capital expenditure limitations of \$105.0 million, \$110.0 million, \$115.0 million, \$120.0 million and \$125.0 million for fiscal years 2018 through 2022, respectively, and permits up to \$20.0 million of the unused capital expenditure limitation for any fiscal year starting with fiscal 2017 to be carried over to the next fiscal year. The normal capital expenditure limitation for fiscal 2018 is \$125.0 million, including \$20.0 million carried over from fiscal 2017.

The credit facility also permits capital expenditures up to \$250.0 million, as amended on June 14, 2018, on the construction of a new poultry processing complex in Lindale, Mineola and Smith County, Texas, up to \$210.0 million on the construction of a potential additional new poultry complex, up to \$15.0 million on expansion of the Company's existing prepared chicken facility in Flowood, Mississippi, up to \$60.0 million on a potential new prepared chicken facility, and up to \$70.0 million on the purchase of three new aircraft. As amended on November 22, 2017, the facility also excludes from the normal capital expenditure limits certain capital projects in an aggregate amount of up to

\$135.0 million. These additional projects, which include the construction of a new feed mill, and other expansions, equipment and changes to the Laurel, Collins, McComb and Hazlehurst, Mississippi complexes; the Waco, Palestine and Brazos, Texas complexes; the Moultrie, Georgia complex; and the Kinston, North Carolina complex, are each subject to their own expenditure limitations.

Under the credit facility, the Company may not exceed a maximum debt to total capitalization ratio of 50%. The Company has a one-time right, at any time during the term of the agreement, to increase the maximum debt to total capitalization ratio then in effect by five percentage points in connection with the construction of any of the three aforementioned new complexes for the

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four fiscal quarters beginning on the first day of the fiscal quarter during which the Company gives written notice of its intent to exercise this right. The Company has not exercised this right. The facility also sets a minimum net worth requirement that at July 31, 2018, was \$1,030.9 million. The credit is unsecured and, unless extended, will expire on April 28, 2022. As of July 31, 2018, and August 22, 2018, the Company had no outstanding draws under the facility, and had approximately \$21.4 million outstanding in letters of credit, leaving \$878.6 million of borrowing capacity available under the facility. For more information about the facility, see Item 1.01 of our Current Report on Form 8-K filed May 4, 2017 and Item 1.01 of our Current Report on Form 8-K filed November 29, 2017, which are incorporated herein by reference, and Exhibit 10.1 filed with this Quarterly Report on Form 10-Q.

**EXECUTIVE OVERVIEW OF RESULTS**

The Company's margins decreased significantly during the third quarter of fiscal 2018, when compared to the same period a year ago, reflecting both counter-seasonal weakness in selling prices and higher average costs of goods sold. The lower average selling prices were primarily attributable to significantly lower market prices for products produced at our plants that process larger birds and sold primarily to food service customers. Lower average selling prices were also, to a lesser extent, due to lower market prices for products produced at our plants that process medium sized birds and primarily sold to retail grocery store customers, and for products sold to export customers. We believe our lower average selling prices domestically reflect to some extent pressures from lower wholesale prices for, and abundant supplies of, competing proteins. We believe uncertainty regarding trade negotiations abroad has negatively impacted export demand. Our higher average costs of goods sold reflect higher feed costs per pound of chicken processed and an increase in other costs of goods sold, details of which are described in the "Results of Operations" section below. Prices paid for corn and soybean meal were slightly higher during the third quarter of fiscal 2018 as compared to the same period a year ago. Those higher prices, partially offset by improved broiler performance, resulted in an increase in our average feed costs in broiler flocks processed of 5.8% as compared to the third quarter of fiscal 2017. We have priced substantially all of our corn and soybean meal needs through the remainder of fiscal 2018. Based on these prices, we expect our costs of feed grains to be approximately \$36.7 million higher during fiscal 2018 as compared to fiscal 2017.

**RESULTS OF OPERATIONS**

Net sales for the third quarter ended July 31, 2018 were \$852.4 million as compared to \$931.9 million for the third quarter ended July 31, 2017, a decrease of \$79.5 million, or 8.5%. Net sales of poultry products for the third quarter ended July 31, 2018 and 2017, were \$790.4 million and \$888.1 million, respectively, a decrease of \$97.8 million, or 11.0%. The decrease in net sales of poultry products resulted from a 15.4% decrease in the average sales price of poultry products sold, partially offset by a 5.2% increase in the pounds of poultry products sold. During the third quarter of fiscal 2018, the Company sold 1,124.2 million pounds of poultry products, up from 1,068.8 million pounds during the third quarter of fiscal 2017. The increased pounds of poultry products sold resulted from a 6.7% increase in the number of head processed, partially offset by a 1.1% decrease in the average live weight of poultry processed. The new St. Pauls processing facility, which began initial operations in January 2017, processed approximately 16.5 million head during the third quarter of fiscal 2018, or approximately 10.5% of the Company's total head processed during the period, and sold approximately 139.6 million pounds of poultry products during the third quarter of fiscal 2018, or approximately 12.4% of the Company's total poultry pounds sold during the period. By comparison, the St. Pauls facility processed approximately 9.2 million head during the third quarter of fiscal 2017, or approximately 6.2% of the Company's total head processed during the period, and sold approximately 76.1 million pounds of poultry products during the third quarter of fiscal 2017, or approximately 7.1% of the Company's total poultry pounds sold during the period. Overall, market prices for poultry products decreased during the third quarter of fiscal 2018 as compared to the same quarter of fiscal 2017. When compared to the third quarter of fiscal 2017, Urner Barry average market prices for boneless breast meat, tenders, leg quarters and jumbo wings decreased by 26.6%, 15.1%, 12.0% and 35.4%, respectively. Average market prices for chicken products sold to retail grocery store customers remained relatively stable during the third quarter of fiscal 2018, and continue to reflect good demand. Net sales of prepared chicken products for the quarters ended July 31, 2018 and 2017 were \$62.0 million and \$43.8 million, respectively, or an increase of 41.8%. This increase resulted from a 47.1% increase in the pounds of prepared chicken products sold, partially offset by a 3.6% decrease in the average sales price of prepared chicken products sold. During the third

quarter of fiscal 2018, the Company sold 31.3 million pounds of prepared chicken products, up from 21.3 million pounds during the third quarter of fiscal 2017.

Net sales for the first nine months of fiscal 2018 were \$2,437.9 million as compared to \$2,422.3 million for the first nine months of fiscal 2017, an increase of \$15.6 million, or 0.6%. Net sales of poultry products for the first nine months of fiscal 2018 and 2017 were \$2,290.4 million and \$2,293.9 million, respectively, a decrease of \$3.5 million or 0.2%. The decrease in net sales of poultry products resulted from a 7.0% decrease in the average sales price of poultry products, partially offset by a 7.4% increase in the pounds of poultry products sold. During the first nine months of fiscal 2018, the Company sold 3,298.0 million pounds of poultry products, up from 3,071.6 million pounds during the first nine months of fiscal 2017. The increased

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pounds of poultry products resulted from an 8.7% increase in the number of head processed, partially offset by a 1.5% decrease in the average live weight of poultry processed. The new St. Pauls processing facility, which began initial operations in January 2017, processed approximately 46.1 million head during the first three quarters of fiscal 2018, or approximately 10.3% of the Company's total head processed during the period, and sold approximately 389.6 million pounds of poultry products during the first three quarters of fiscal 2018, or approximately 11.8% of the Company's total poultry pounds sold during the period. By comparison, the St. Pauls facility processed approximately 15.2 million head during the first nine months of fiscal 2017, or approximately 3.7% of the Company's total head processed during the period, and sold approximately 132.5 million pounds of poultry products during the first nine months of fiscal 2017, or approximately 4.3% of the Company's total poultry pounds sold during the period. Overall, market prices for poultry products decreased during the first nine months of fiscal 2018 as compared to the same period during fiscal 2017. When compared to the first nine months of fiscal 2017, Urner Barry average market prices for boneless breast meat, tenders and jumbo wings decreased by 13.5%, 8.0% and 23.2%, respectively, while average market prices for bulk leg quarters increased by 1.9%. Average market prices for chicken products sold to retail grocery store customers remained relatively stable during the first nine months of fiscal 2018, and continue to reflect good demand. Net sales of prepared chicken products for the nine months ended July 31, 2018 and 2017 were \$147.5 million and \$128.4 million, respectively, or an increase of 14.9%. This increase resulted from a 16.2% increase in the pounds of prepared chicken products sold and a flat average selling price per pound. During the first nine months of fiscal 2018, the Company sold 74.6 million pounds of prepared chicken products, up from 64.2 million pounds during the first nine months of fiscal 2017.

Cost of sales for the third quarter of fiscal 2018 was \$781.6 million as compared to \$692.6 million during the third quarter of fiscal 2017, an increase of \$89.0 million, or 12.8%. Cost of sales of poultry products during the third quarter of fiscal 2018, as compared to the third quarter of fiscal 2017, was \$722.5 million and \$651.3 million, respectively, which represents a 5.5% increase in the cost of sales per pound of poultry products. As illustrated in the table below, which for comparative purposes includes poultry products sold to the Company's prepared chicken plant, and excludes poultry products processed and sold under our agreement with House of Raeford Farms as described in "Note (2)," the increase in the cost of sales per pound of poultry products resulted from a \$0.0140 per pound increase in other costs of sales of poultry products and an increase in the cost of feed per pound of broilers processed of \$0.0145, or 5.8%.

## Poultry Cost of Sales

(In thousands, except per pound data)

| Description                 | Third Quarter 2018       |          | Third Quarter 2017           |          | Incr/(Decr) |            |
|-----------------------------|--------------------------|----------|------------------------------|----------|-------------|------------|
|                             | Dollars                  | Per lb.  | Dollars                      | Per lb.  | Dollars     | Per lb.    |
| Beginning Inventory         | \$30,428                 | \$0.3745 | \$18,758                     | \$0.3822 | \$11,670    | \$(0.0077) |
| Feed in broilers processed  | 305,987                  | 0.2655   | 270,134                      | 0.2510   | 35,853      | 0.0145     |
| All other cost of sales     | 436,809                  | 0.3790   | 392,862                      | 0.3650   | 43,947      | 0.0140     |
| Less: Ending Inventory      | 33,976                   | 0.3752   | 30,269                       | 0.4317   | 3,707       | (0.0565 )  |
| Total poultry cost of sales | \$739,248 <sup>(1)</sup> | \$0.6491 | \$651,485 <sup>(1) (2)</sup> | \$0.6176 | \$87,763    | \$0.0315   |

## Pounds:

|                     |                          |                              |
|---------------------|--------------------------|------------------------------|
| Beginning Inventory | 81,259                   | 49,080                       |
| Poultry processed   | 1,152,463                | 1,076,265 <sup>(2)</sup>     |
| Poultry sold        | 1,138,944 <sup>(1)</sup> | 1,054,894 <sup>(1) (2)</sup> |
| Ending Inventory    | 90,560                   | 70,121                       |

Note (1) - For comparative purposes, includes the costs and pounds of product sold to the Company's prepared chicken plant.

Note (2) - On April 17, 2017, the Company announced that it had agreed to process chickens grown by House of Raeford Farms at the Company's processing facility located in St. Pauls, North Carolina. House of Raeford Farms, a private company headquartered in Rose Hill, North Carolina, operates poultry grow-out operations and processing facilities in four southeastern states. The House of Raeford Farms Teachey, North Carolina, facility was severely damaged by a fire in late February 2017. Under the terms of the agreement, the Company purchased, processed and sold chickens grown by House of Raeford Farms through mid-December 2017. During the third quarter of fiscal 2017,

the Company processed and sold approximately 19.2 million pounds of chicken as a result of this agreement. For comparative purposes, those pounds and the associated direct and indirect costs have been excluded from the data set forth in this table.

Other cost of sales of poultry products consists primarily of labor, packaging, freight, maintenance and repairs, utilities, antimicrobial interventions, contract grower pay, chick costs and certain fixed costs. These non-feed related costs of poultry products sold increased by \$0.0140 per pound processed, or 3.8%, during this year's third fiscal quarter compared to the same quarter a year ago. During the third quarter of fiscal 2017, other costs of sales of poultry products include approximately \$8.2

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million of expenses related to the Company's bonus award program, as compared to no such expenses during the third quarter of fiscal 2018. Excluding those bonus-related expenses, other cost of sales of poultry products increased by \$0.0217 per pound processed, or 6.1%, during the third quarter of fiscal 2018 compared to the same period a year ago. This increase is primarily attributable to higher labor, contract grower pay, antimicrobial interventions, maintenance and repairs, and freight costs. These higher costs were partially offset by efficiencies realized at the Company's new St. Pauls, North Carolina facilities, which were in the early stages of operations during the third quarter of fiscal 2017 and reached full capacity during April 2018. Excluding the St. Pauls facilities and bonus-related expenses, other costs of sales would have increased by approximately \$0.0364 per pound processed, or 10.3%.

Costs of sales of the Company's prepared chicken products during the third quarter of fiscal 2018 were \$59.1 million as compared to \$41.2 million during the same quarter a year ago, an increase of \$17.8 million, or 43.2%, primarily attributable to a 47.1% increase in the pounds of prepared chicken sold.

Cost of sales for the first nine months of fiscal 2018 was \$2,187.1 million as compared to \$1,954.3 million during the first nine months of fiscal 2017, an increase of \$232.8 million, or 11.9%. Cost of sales of poultry products during the first nine months of fiscal 2018, as compared to the first nine months of fiscal 2017, was \$2,049.7 million and \$1,838.7 million, respectively, which represents a 3.8% increase in the cost of sales per pound of poultry products. As illustrated in the table below, which for comparative purposes includes poultry products sold to the Company's prepared chicken plant, and excludes poultry products processed and sold under our agreement with House of Raeford Farms as described in "Note (2)," the increase resulted primarily from a \$0.0183 per pound increase in other costs of sales of poultry products and an increase in the cost of feed per pound of broilers processed of \$0.0008, or 0.3%.

## Poultry Cost of Sales

(In thousands, except per pound data)

| Description                 | Nine Months Ended<br>July 31, 2018 |          | Nine Months Ended<br>July 31, 2017 |          | Incr/(Decr) |           |
|-----------------------------|------------------------------------|----------|------------------------------------|----------|-------------|-----------|
|                             | Dollars                            | Per lb.  | Dollars                            | Per lb.  | Dollars     | Per lb.   |
| Beginning Inventory         | \$37,769                           | \$0.4437 | \$15,378                           | \$0.3397 | \$22,391    | \$0.1040  |
| Feed in broilers processed  | 840,948                            | 0.2525   | 775,188                            | 0.2517   | 65,760      | 0.0008    |
| All other cost of sales     | 1,236,301                          | 0.3712   | 1,086,761                          | 0.3529   | 149,540     | 0.0183    |
| Less: Ending Inventory      | 33,976                             | 0.3752   | 30,269                             | 0.4317   | 3,707       | (0.0565 ) |
| Total poultry cost of sales | \$2,081,042 <sup>(1)</sup>         | \$0.6273 | \$1,847,058 <sup>(1)(2)</sup>      | \$0.6050 | \$233,984   | \$0.0223  |
| Pounds:                     |                                    |          |                                    |          |             |           |
| Beginning Inventory         | 85,120                             |          | 45,272                             |          |             |           |
| Poultry processed           | 3,330,473                          |          | 3,079,320 <sup>(2)</sup>           |          |             |           |
| Poultry sold                | 3,317,637 <sup>(1)</sup>           |          | 3,053,014 <sup>(1)(2)</sup>        |          |             |           |
| Ending Inventory            | 90,560                             |          | 70,121                             |          |             |           |

Note (1) - For comparative purposes, includes the costs and pounds of product sold to the Company's prepared chicken plant.

Note (2) - On April 17, 2017, the Company announced that it had agreed to process chickens grown by House of Raeford Farms at the Company's processing facility located in St. Pauls, North Carolina. House of Raeford Farms, a private company headquartered in Rose Hill, North Carolina, operates poultry grow-out operations and processing facilities in four southeastern states. The House of Raeford Farms Teachey, North Carolina, facility was severely damaged by a fire in late February 2017. Under the terms of the agreement, the Company purchased, processed and sold chickens grown by House of Raeford Farms through mid-December 2017. During the nine months ended July 31, 2018, the Company processed and sold approximately 14.2 million pounds as a result of this agreement, as compared to approximately 36.3 million pounds during the nine months ended July 31, 2017. For comparative purposes, those pounds and the associated direct and indirect costs have been excluded from the data set forth in this table.

Other cost of sales of poultry products consists primarily of labor, packaging, freight, maintenance and repairs, utilities, antimicrobial interventions, contract grower pay, chick costs and certain fixed costs. These non-feed related costs of poultry products sold increased by \$0.0183 per pound processed, or 5.2%, during the first nine months of fiscal 2018 as compared to the same period a year ago. During the first nine months of fiscal 2017, other costs of sales

of poultry products include approximately \$8.2 million of expenses related to the Company's bonus award program, as compared to no such expenses during the first nine months of fiscal 2018. Excluding those bonus-related expenses, other cost of sales of poultry products increased by \$0.0210 per pound processed, or 6.0%, during the first nine months of fiscal 2018 compared to the same period a

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year ago. This increase is primarily attributable to higher labor, contract grower pay, antimicrobial interventions, maintenance and repairs, and freight costs, along with higher fixed costs across our operations. These higher costs were partially offset by efficiencies realized at the Company's new St. Pauls, North Carolina facilities, which were in the early stages of operations during the first nine months of fiscal 2017 and reached full capacity during April 2018. Excluding the St. Pauls facilities and bonus-related expenses, other costs of sales would have increased by approximately \$0.0335 per pound processed, or 9.7%.

Costs of sales of the Company's prepared chicken products during the first nine months of fiscal 2018 were \$137.4 million as compared to \$115.6 million during the same period a year ago, an increase of \$21.9 million, or 18.9%, primarily attributable to a 16.2% increase in the pounds of prepared chicken sold.

The Company recorded the value of live broiler inventories on hand at July 31, 2018 at cost. When market conditions are favorable, the Company values the broiler inventories on hand at cost, and accumulates costs as the birds are grown to a marketable age subsequent to the balance sheet date. In periods where the Company estimates that the cost to grow live birds in inventory to a marketable age, process, and distribute those birds will be higher in the aggregate than the anticipated sales price, the Company will make an adjustment to lower the value of live birds in inventory to the net realizable value. No such charge was required at July 31, 2018 or July 31, 2017.

Selling, general and administrative ("SG&A") costs during the third quarter of fiscal 2018 were \$55.8 million, a decrease of \$6.3 million compared to the \$62.0 million during the third quarter of fiscal 2017. SG&A costs during the nine months ended July 31, 2018 were \$163.4 million, an increase of \$11.6 million compared to the \$151.7 million during the nine months ended July 31, 2017. The following tables include the components of SG&A costs for the three and nine months ended July 31, 2018 and 2017.

## Selling, General and Administrative Costs

(in thousands)

| Description                | Three    | Three    | Increase/(Decrease) |   |
|----------------------------|----------|----------|---------------------|---|
|                            | Months   | Months   |                     |   |
|                            | Ended    | Ended    |                     |   |
|                            | July 31, | July 31, |                     |   |
|                            | 2018     | 2017     |                     |   |
| ESOP expense               | \$2,400  | \$12,500 | \$ (10,100          | ) |
| Bonus expense              | —        | 5,880    | (5,880              | ) |
| Stock compensation expense | 2,897    | 3,918    | (1,021              | ) |
| Marketing expense          | 7,887    | 8,763    | (876                | ) |
| Trainee expense            | 5,373    | 4,001    | 1,372               |   |
| Administrative salaries    | 10,654   | 9,044    | 1,610               |   |
| Legal expense              | 4,284    | 1,652    | 2,632               |   |
| Start-up expense (Tyler)   | 4,082    | 91       | 3,991               |   |
| All other SG&A             | 18,201   | 16,187   | 2,014               |   |
| Total SG&A                 | \$55,778 | \$62,036 | \$ (6,258           | ) |

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(in thousands)

| Description                  | Nine      | Nine      | Increase/(Decrease) |
|------------------------------|-----------|-----------|---------------------|
|                              | Months    | Months    |                     |
|                              | Ended     | Ended     |                     |
|                              | July 31,  | July 31,  |                     |
|                              | 2018      | 2017      |                     |
| Start-up expense (Tyler)     | \$7,340   | \$91      | \$ 7,249            |
| Legal expenses               | 12,402    | 5,453     | 6,949               |
| Administrative salaries      | 31,418    | 26,323    | 5,095               |
| Trainee expense              | 16,204    | 11,223    | 4,981               |
| Stock compensation expense   | 13,176    | 13,105    | 71                  |
| Marketing expense            | 25,460    | 26,272    | (812 )              |
| Start-up expense (St. Pauls) | —         | 4,022     | (4,022 )            |
| Bonus expense                | —         | 5,880     | (5,880 )            |
| ESOP expense                 | 2,400     | 12,500    | (10,100 )           |
| All other SG&A               | 54,990    | 46,878    | 8,112               |
| Total SG&A                   | \$163,390 | \$151,747 | \$ 11,643           |

Regarding both tables above, the decrease in bonus expense, payouts of which are based on profitability, is the result of management determining that it is probable that fiscal 2018 earnings will not reach levels that will allow payouts of the incentive. During the third quarter of fiscal 2017, management determined that fiscal 2017 earnings would be at levels that would allow a payout, and accrued that expense accordingly. The decrease in ESOP expense, payouts of which are based on profitability, is attributable to the difference in the level of profitability that management deems probable for fiscal 2018 and the level of profitability that management deemed probable for fiscal 2017 as of the third quarter. The increase in legal expense is primarily attributable to our ongoing defense of the litigation described in "Part II. Other Information, Item 1. Legal Proceedings" of this Form 10-Q. The change in start-up expense in any particular period relates to the stage of the start-up process in which a facility under construction is in during the period. Non-construction related expenses, such as labor, training and office-related expenses for a facility under construction are recorded as start-up expense until the facility begins operations. As a facility moves closer to start-up, the expenses incurred for labor, training, etc. increase. As a result, amounts classified as start-up expenses will increase period over period until the facility begins production. Once production begins, the expenses from that point forward are recorded as costs of goods sold. The increases in trainee expense and administrative salaries are primarily attributable to increases in personnel that coincide with the Company's current and future growth plans, as well as wage increases. The increase in all other SG&A expenses is the result of a net increase in various other categories of SG&A costs.

The Company's operating income for the three and nine months ended July 31, 2018 was \$15.1 million and \$87.4 million, respectively, as compared to operating income for the three and nine months ended July 31, 2017 of \$177.3 million and \$316.3 million, respectively. The decrease in operating income for the three months ended July 31, 2018, as compared to the same period a year ago, resulted primarily from lower average selling prices and higher average costs of goods sold, partially offset by a 6.0% increase in pounds sold during the same comparative period. The decrease in operating income for the nine months ended July 31, 2018, as compared to the same period a year ago, resulted primarily from lower average selling prices and higher average costs of goods sold, partially offset by an 7.6% increase in pounds sold during the same comparative period.

Interest income during the third quarter and first nine months of fiscal 2018 was \$0.7 million and \$2.1 million, respectively, as compared to \$0.3 million and \$0.8 million, respectively, during the third quarter and first nine months of fiscal 2017. Interest expense during the third quarter and first nine months of fiscal 2018 was \$0.5 million and \$1.5 million, respectively, as compared to \$0.5 million and \$1.4 million, respectively, during the third quarter and first nine months of fiscal 2017.

The Company's estimated annual effective tax rates for the three and nine months ended July 31, 2018 were 25.1% and (19.0)%, respectively, as compared to 34.6% and 34.5%, respectively, for the three and nine months ended July 31, 2017. As described in our financial statement footnote "Note 8 - Income Taxes," the revaluation of our deferred taxes using the tax rate enacted during our first quarter of fiscal 2018 resulted in a \$37.5 million discrete income tax benefit recognized during the first quarter of fiscal 2018. There were no other material discrete items affecting the comparative periods. Excluding the effects of discrete items, the Company's estimated annual effective tax rates for the first nine months of fiscal 2018 and 2017 would have been approximately 24.6% and 35.0%, respectively. The Company estimates its effective tax rate for the full fiscal year 2018, exclusive of discrete items, will be approximately 24.6%.

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As of July 31, 2018, the Company's long-term deferred income tax liability was \$68.0 million as compared to \$91.9 million at October 31, 2017, a decrease of \$23.9 million. This decrease is attributable to the revaluation of deferred tax assets and liabilities, as U.S. GAAP requires that deferred tax assets and liabilities be measured using the enacted tax rate expected to apply when the temporary differences from which the deferred taxes arose are expected to be settled. Prior to the enactment of the Tax Cuts and Jobs Act, our deferred taxes were measured using the enacted 35% federal income tax statutory rate. Following enactment, we remeasured our deferred taxes using a 23.3% blended federal income tax statutory rate for temporary differences expected to reverse in fiscal 2018 and a 21% federal income tax statutory rate for temporary differences expected to reverse after fiscal 2018.

During the three and nine months ended July 31, 2018, the Company's net income was \$11.5 million, or \$0.50 per share, and \$104.6 million, or \$4.58 per share, respectively. For the three and nine months ended July 31, 2017, the Company's net income was \$115.8 million, or \$5.09 per share, and \$206.9 million, or \$9.10 per share, respectively. These decreases are attributable to lower average selling prices and higher average costs of goods sold, as described above.

Liquidity and Capital Resources

The Company's working capital, calculated by subtracting current liabilities from current assets, at July 31, 2018 was \$582.9 million, and its current ratio, calculated by dividing current assets by current liabilities, was 4.1 to 1. The Company's working capital and current ratio at October 31, 2017 were \$650.8 million and 4.3 to 1. These measures reflect the Company's ability to meet its short term obligations and are included here as a measure of the Company's short term market liquidity. The Company's principal sources of liquidity during fiscal 2018 include cash on hand at October 31, 2017, cash flows from operations, and funds available under the Company's revolving credit facility. As described below, the Company is a party to a revolving credit facility dated April 28, 2017, as amended on November 22, 2017, and June 14, 2018, with a maximum available borrowing capacity of \$900.0 million. As of July 31, and August 22, 2018, the Company had no outstanding draws under the facility and had approximately \$21.4 million outstanding in letters of credit, leaving \$878.6 million of borrowing capacity available under the facility.

The Company's cash position at July 31, 2018 and October 31, 2017 consisted of \$288.3 million and \$419.3 million, respectively, in cash and short-term cash investments. The Company's ability to invest cash is limited by covenants in its revolving credit agreement to short-term investments. All of the Company's cash at July 31, 2018 and October 31, 2017 was held in bank accounts and highly-liquid investment accounts. There were no restrictions on the Company's access to its cash, and such cash was available to the Company on demand to fund its operations.

Cash flows provided by operating activities during the nine months ended July 31, 2018 and 2017, were \$103.9 million and \$310.1 million, respectively. Cash flows from operating activities decreased by \$206.2 million, resulting primarily from a decrease in market prices for poultry products during the first nine months of fiscal 2018, as compared to the same period in fiscal 2017, in addition to an increase in cash bonuses paid by the Company, which totaled approximately \$36.0 million during the first nine months of fiscal 2018, as compared to \$0.4 million during the first nine months of fiscal 2017. The bonuses paid during the first nine months of fiscal 2018 related to fiscal 2017 performance, and the bonuses paid during the first nine months of fiscal 2017 related to fiscal 2016 performance.

Cash flows used in investing activities during the first nine months of fiscal 2018 and 2017 were \$215.7 million and \$130.2 million, respectively. The Company's capital expenditures during the first nine months of fiscal 2018 were approximately \$216.6 million, and included approximately \$94.3 million related to construction at the Tyler, Texas complex, and approximately \$29.3 million related to progress or final payments made under purchase agreements for delivery or future delivery of new aircraft as described below. Capital expenditures for the first nine months of fiscal 2017 were \$130.6 million, including approximately \$25.4 million related to construction at the St. Pauls, North Carolina complex and approximately \$24.0 million related to progress payments made under the aircraft purchase agreements.

Cash flows used in financing activities during the nine months ended July 31, 2018 and 2017 were \$19.2 million and \$15.8 million, respectively. During the first nine months of fiscal 2018, the Company paid approximately \$14.6 million in dividends to its shareholders, as compared to approximately \$10.9 million during the first nine months of fiscal 2017. Additionally, during the first nine months of fiscal 2018, the Company paid approximately \$5.7 million to repurchase shares pursuant to the Company's Stock Incentive Plan, under which shares may be withheld upon vesting

to satisfy tax withholding obligations, as compared to approximately \$3.2 million during the first nine months of fiscal 2017. Lastly, the Company paid approximately \$2.4 million in costs to renegotiate its revolving credit facility during the first nine months of fiscal 2017, as compared to no such expenditures during the first nine months of fiscal 2018.

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As of August 19, 2018, the Company's capital budget for fiscal 2018, excluding operating leases, is approximately \$373.9 million. The Company expects the 2018 capital budget to be funded by internally generated working capital, cash flows from operations and, as needed, funds available under the Company's revolving credit facility. The fiscal 2018 capital budget includes approximately \$178.0 million for construction of the Company's new Tyler, Texas complex, approximately \$32.2 million for progress payments due under purchase agreements for future delivery of new aircraft as described below, approximately \$38.0 million combined for multiple large-scale equipment upgrades and corresponding building upgrades at multiple complexes further described below and approximately \$4.2 million to complete the expansion of the Company's existing prepared chicken facility in Flowood, Mississippi. Excluding the budgets for the projects detailed above, the fiscal 2018 capital budget is approximately \$121.5 million. These amounts are estimates and are subject to change as we move through fiscal 2018.

The Company is a party to two separate purchase agreements for two new aircraft to be delivered at different dates during fiscal 2019. The new aircraft will replace aircraft currently owned by the Company that are scheduled to be retired and removed from service in the ordinary course of business. The agreements require that the Company make periodic progress payments, with final payment due upon delivery of each aircraft. Under a separate purchase agreement akin to the two that remain open, the Company took delivery of a new aircraft during the second quarter of fiscal 2018 and accordingly made final payment on that aircraft. To date, the Company has made payments totaling \$58.3 million under the three agreements, and expects to make payments of approximately \$3.5 million during the remainder of fiscal 2018 and approximately \$4.1 million during fiscal 2019.

In March 2017, the Company announced the selection of sites in Lindale, Mineola and Smith County, Texas, for the construction of a new poultry processing complex. The completed complex will consist of a hatchery, feed mill, processing plant and waste water treatment facility with the capacity to process 1.3 million chickens per week. Construction is underway, and initial operations of the new complex are expected to begin during the first calendar quarter of 2019. Before the complex can become operational and reach full capacity, we will need to enter into contracts with a sufficient number of independent contract poultry producers to house the live inventory and hire and train our workforce. See "The construction and potential benefits of our new facilities are subject to risks and uncertainties" in the Risk Factors section of our Annual Report on Form 10-K for the fiscal year ended October 31, 2017.

On October 2, 2017, the Company filed a shelf registration statement on Form S-3 to register for possible future sale shares of the Company's common and/or preferred stock. An indeterminate amount of common stock and preferred stock may be offered by the Company in amounts, at prices and on terms to be determined by the board of directors if and when shares are issued. The registration statement became automatically effective upon filing with the SEC on October 2, 2017.

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.

**Revolving Credit Facility**

The Company is a party to a revolving credit facility dated April 28, 2017, as amended on November 22, 2017 and June 14, 2018, with a maximum available borrowing capacity of \$900.0 million. The facility has annual capital expenditure limitations of \$105.0 million, \$110.0 million, \$115.0 million, \$120.0 million and \$125.0 million for fiscal years 2018 through 2022, respectively, and permits up to \$20.0 million of the unused capital expenditure limitation for any fiscal year starting with fiscal 2017 to be carried over to the next fiscal year. The normal capital expenditure limitation for fiscal 2018 is \$125.0 million, including \$20.0 million carried over from fiscal 2017.

The credit facility also permits capital expenditures up to \$250.0 million, as amended on June 14, 2018, on the construction of a new poultry processing complex in Lindale, Mineola and Smith County, Texas, up to \$210.0 million on the construction of a potential additional new poultry complex, up to \$15.0 million on expansion of the Company's existing prepared chicken facility in Flowood, Mississippi, up to \$60.0 million on a potential new prepared chicken facility, and up to \$70.0 million on the purchase of three new aircraft. As amended on November 22, 2017, the facility

also excludes from the normal capital expenditure limits certain capital projects in an aggregate amount of up to \$135.0 million. These additional projects, which include the construction of a new feed mill, and other expansions, equipment and changes to the Laurel, Collins, McComb and Hazlehurst, Mississippi complexes; the Waco, Palestine and Brazos, Texas complexes; the Moultrie, Georgia complex; and the Kinston, North Carolina complex, are each subject to their own expenditure limitations.

Under the credit facility, the Company may not exceed a maximum debt to total capitalization ratio of 50%. The Company has a one-time right, at any time during the term of the agreement, to increase the maximum debt to total capitalization ratio then in

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effect by five percentage points in connection with the construction of any of the three aforementioned new complexes for the four fiscal quarters beginning on the first day of the fiscal quarter during which the Company gives written notice of its intent to exercise this right. The Company has not exercised this right. The facility also sets a minimum net worth requirement that at July 31, 2018, was \$1,030.9 million. The credit is unsecured and, unless extended, will expire on April 28, 2022. As of July 31, 2018, and August 22, 2018, the Company had no outstanding draws under the facility, and had approximately \$21.4 million outstanding in letters of credit, leaving \$878.6 million of borrowing capacity available under the facility. For more information about the facility, see Item 1.01 of our Current Report on Form 8-K filed May 4, 2017 and Item 1.01 of our Current Report on Form 8-K filed November 29, 2017, which are incorporated herein by reference, and Exhibit 10.1 filed with this Quarterly Report on Form 10-Q.

### Critical Accounting Estimates

We consider accounting policies related to allowance for doubtful accounts, inventories, long-lived assets, accrued self-insurance, performance share plans, income taxes and contingencies to be critical accounting estimates. These policies are summarized in Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the year ended October 31, 2017.

### New Accounting Pronouncements

In July 2015, the Financial Accounting Standards Board ("FASB") issued guidance that requires an entity to measure inventory at the lower of cost or net realizable value. The guidance is effective for annual reporting periods and interim periods within those annual reporting periods beginning after December 15, 2016, our fiscal 2018. The Company adopted this guidance during the first quarter of fiscal 2018, and it did not have a material effect on the Company's consolidated financial statements.

In June 2018, the FASB issued Accounting Standards Update ("ASU") 2018-07, Improvements to Nonemployee Share-Based Payment Accounting, which expands the scope of Topic 718, Compensation - Stock Compensation, to include all share-based payment transactions in which a grantor acquires goods or services to be used or consumed in a grantor's own operations by issuing share-based payment awards. The guidance is effective for interim and annual periods beginning after December 15, 2018, our fiscal 2020. Early adoption is permitted. The Company is currently evaluating the impact this guidance will have on our consolidated financial statements.

In May 2017, the FASB issued ASU 2017-09, Scope of Modification Accounting, which amends the requirements related to accounting for changes to stock compensation awards. The guidance is effective for interim and annual periods beginning after December 15, 2017, our fiscal 2019. Early adoption is permitted. The impact this guidance will have on our consolidated financial statements will depend on the nature and extent of future changes, if any, to the terms and conditions of the Company's Stock Incentive Plan.

In March 2017, the FASB issued ASU 2017-07, Improving the Presentation of Net Periodic Pension Cost and Net Periodic Post-retirement Benefit Cost. The guidance requires the service cost component of defined benefit pension plans and other post-retirement benefit plans to be reported in the same line item or items as other compensation costs arising from the services rendered by the pertinent employees during the period. The other components of net benefit cost are required to be reported outside of operating income. The guidance is effective for interim and annual periods beginning after December 15, 2017, our fiscal 2019. Early adoption is permitted. We do not expect adoption to have a material effect on our consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, Leases. The guidance is intended to increase transparency and comparability among companies by requiring an entity that is a lessee to recognize on the balance sheet the right-of-use assets and lease liabilities arising from all leases with terms, as defined by the guidance, of greater than twelve months. The guidance also requires disclosure of key information about leasing arrangements. The guidance is effective for annual reporting periods and interim periods within those annual reporting periods beginning after December 15, 2018, our fiscal 2020. Early adoption is permitted. The Company is currently evaluating the impact this guidance will have on our consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers, which changes the criteria for recognizing revenue. ASU 2014-09 was amended by ASU 2015-14 to defer the effective date by one year. The



guidance also modifies the related disclosure requirements, clarifies guidance for multiple-element arrangements and provides guidance for transactions that were not addressed fully in previous guidance. The guidance, as amended, is effective for annual reporting periods and interim periods within those annual reporting periods beginning after December 15, 2017, our fiscal 2019. Early adoption is permitted for annual reporting periods and interim periods within those annual reporting periods beginning after December 15, 2016. Companies have the option to adopt retrospectively or modified retrospectively with a cumulative effect

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adjustment. The Company will adopt this standard as of November 1, 2018, the beginning of our fiscal 2019, using the modified retrospective approach. The Company is currently evaluating the impact this guidance will have on our consolidated financial statements by evaluating our various types of contracts with customers, various costs related to those contracts, and various other costs related to the selling process. Although we are still evaluating the overall impact, we do not currently expect adoption to have a material effect on our consolidated financial statements, other than additional disclosure requirements, which will require the disaggregation of our revenue into categories that depict how the nature, amount, timing and uncertainty of revenue and cash flows are affected by economic factors.

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## 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 commits to purchase feed ingredients for deferred delivery from one month to nine months after the time of the commitment. The grain purchases are made directly with our usual grain suppliers, which are companies in the business of regularly supplying grain to end users, and do not involve options to purchase. Such purchases occur when our chief operating decision maker 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, our chief operating decision maker believes the Company can purchase feed ingredients at prices that will allow the Company to earn a reasonable return for its shareholders. The Company sometimes purchases its feed ingredients for prompt delivery to its feed mills at market prices at the time of such purchases. Market factors considered by our chief operating decision maker in determining whether or not and to what extent to commit 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 affect 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 affected 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 in ASC 815, "Accounting for Derivatives for Instruments and Hedging Activities," or any market risk sensitive instruments of the type contemplated by Item 305 of Regulation S-K. The Company does not enter into any derivative transactions or purchase any grain-related contracts other than the physical grain contracts described above.

Although the Company does not use derivative financial instruments as defined in ASC 815 or purchase market risk sensitive instruments of the type contemplated by Item 305 of Regulation S-K, the commodities that the Company does purchase for physical delivery, primarily corn and soybean meal, are subject to price fluctuations that have a direct and material effect on the Company's profitability as mentioned above. During the third quarter of fiscal 2018, the Company purchased approximately 30.5 million bushels of corn and approximately 283,611 tons of soybean meal for use in manufacturing feed for its live chickens. A \$1.00 change in the average market price paid per bushel for corn would have affected the Company's cash outlays for corn by approximately \$30.5 million in the third quarter of fiscal 2018. Likewise, a \$10.00 change in the price paid per ton for soybean meal would affect the Company's cash outlays by approximately \$2.8 million.

Although changes in the market price paid for feed grains affect cash outlays at the time the Company purchases the grain, such changes do not immediately affect cost of sales. 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. Thus, there is a lag between the time cash is paid for feed ingredients and the time the cost of such feed ingredients is reported in cost of goods sold. For example, corn delivered to a feedmill and paid for one week might be used to manufacture feed the following week. However, the chickens that eat that feed might not be processed and sold for

another 48-62 days, and only at that time will the costs of the feed consumed by the chicken become included in cost of goods sold.

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During the third quarter of fiscal 2018, the Company's average feed cost per pound of broilers processed totaled \$0.2655 per pound. Feed costs per pound of broilers processed consist primarily of feed grains, but also include other feed ingredients such as vitamins, fat and mineral feed supplements. The average feed cost per pound is influenced not only by the price of feed ingredients, but also by the efficiency with which live chickens convert feed into body weight. Factors such as weather, poultry husbandry, quality of feed ingredients and the quality, size and health of the bird, among others, affect the quantity of feed necessary to mature chickens to the target live weight and the efficiency of that process. Generally, however, a \$1.00 change in the average price paid per bushel of corn fed to a chicken during its life would have affected average feed cost per pound of broilers processed by \$0.0265, based on the quantity of grain used during the third quarter of fiscal 2018. Similarly, a \$10.00 change in the average price paid per ton of soybean meal would have influenced the average feed cost per pound of broilers processed by \$0.0024 during the third quarter of fiscal 2018.

The following table shows the impact of hypothetical changes in the price of corn and soybean meal on both the Company's cash flow and cost of goods sold, based on quantities actually purchased in the third quarter of fiscal 2018:

| Feed Ingredient | Quantity Purchased during the Third Fiscal Quarter of 2018 | Hypothetical Price Change | Impact on Cash Outlay | Ultimate Impact on Feed Cost per Pound of broilers Processed |
|-----------------|--|---------------------------|-----------------------|--|
| Corn            | 30.5 million bushels                                       | \$1.00 per bushel         | \$30.5 million        | \$0.0265/lb processed  |
| Soybean meal    | 283,611 tons   | \$10.00 per ton           | \$2.8 million         | \$0.0024/lb processed  |

The Company's interest expense is sensitive to changes in the general level of interest rates in the United States, and when the Company is indebted, it typically maintains certain of its debt as fixed rate in nature to mitigate the impact of fluctuations in interest rates. At July 31, 2018 the Company had no outstanding debt on its balance sheet.

#### 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 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.

As of July 31, 2018, an evaluation was performed under the supervision and with the participation of the Company's management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures. Based on that evaluation, the Company's management, including the Chief Executive Officer and Chief Financial Officer, concluded that the Company's disclosure controls and procedures were effective as of July 31, 2018.

There have been no changes in the Company's internal control over financial reporting during the fiscal quarter ended July 31, 2018 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

## PART II. OTHER INFORMATION

### Item 1. Legal Proceedings

Between September 2, 2016 and October 13, 2016, Sanderson Farms, Inc. and our subsidiaries were named as defendants, along with 13 other poultry producers and certain of their affiliated companies, in multiple putative class action lawsuits filed by direct and indirect purchasers of broiler chickens in the United States District Court for the Northern District of Illinois. The complaints allege that the defendants conspired to unlawfully fix, raise, maintain, and stabilize the price of broiler chickens, thereby violating federal and certain states' antitrust laws, and also allege certain related state-law claims. The complaints also allege that the defendants fraudulently concealed the alleged anticompetitive conduct in furtherance of the conspiracy. The complaints seek damages, including treble damages for the antitrust claims, injunctive relief, costs, and attorneys' fees. As detailed below, the Court has consolidated all of the direct purchaser complaints into one case, and the indirect purchaser complaints into two cases, one on behalf of commercial and institutional indirect purchaser plaintiffs and one on behalf of end-user consumer plaintiffs.



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On October 28, 2016, the direct and indirect purchaser plaintiffs filed consolidated, amended complaints, and on November 23, 2016, the direct and indirect purchaser plaintiffs filed second amended complaints. On December 16, 2016, the indirect purchaser plaintiffs separated into two cases. On that date, the commercial and institutional indirect purchaser plaintiffs filed a third amended complaint, and the end-user consumer plaintiffs filed an amended complaint. On January 27, 2017, the defendants filed motions to dismiss the amended complaints in all of the cases, and on November 20, 2017, the motions to dismiss were denied. On February 7, 2018, the direct purchaser plaintiffs filed their third amended complaint, adding three additional poultry producers as defendants. On February 12, 2018, the end-user consumer plaintiffs filed their second amended complaint, in which they also added three additional poultry producers as defendants, along with Agri Stats. On February 20, 2018, the commercial indirect purchaser plaintiffs filed their fourth amended complaint. The parties are currently engaged in discovery. We intend to continue to defend the lawsuits vigorously; however, the Company cannot predict the outcome of these actions. If the plaintiffs were to prevail, the Company could be liable for damages, which could have a material, adverse effect on our financial position and results of operations.

Between December 8, 2017 and August 16, 2018, additional purported direct-purchaser entities individually brought twelve separate suits against 17 poultry producers, including Sanderson Farms and Agri Stats, in the United States District Court for the Northern District of Illinois and the United States District Court for the District of Kansas. These suits allege substantially similar claims to the direct purchaser class complaint described above. Those filed in the Northern District of Illinois are now pending in front of the same judge as the putative class action lawsuits. The parties are currently engaged in discovery. On June 26, 2018, the defendants filed a motion to transfer the case filed in the District of Kansas to the Northern District of Illinois. That motion is still pending. It is possible additional individual actions may be filed.

Sanderson Farms, Inc.; Joe F. Sanderson, Jr., the Chairman of the Registrant's Board of Directors and its Chief Executive Officer; and D. Michael Cockrell, director and Chief Financial Officer, were named as defendants in a putative class action lawsuit filed on October 28, 2016, in the United States District Court for the Southern District of New York. On March 30, 2017, the lead plaintiff filed an amended complaint adding Lampkin Butts, director, Chief Operating Officer, and President, as a defendant, and on June 15, 2017, the lead plaintiff filed a second amended complaint. The complaint alleges that the defendants made statements in the Company's SEC filings and press releases, and other public statements, that were materially false and misleading in light of the Company's alleged, undisclosed violation of the federal antitrust laws described above. The complaint also alleges that the material misstatements were made in order to, among other things, "artificially inflate and maintain the market price of Sanderson Farms securities." The complaint alleges the defendants thereby violated the Securities Exchange Act of 1934, as amended (the "Exchange Act"), including Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder, and, for the individual defendants, Section 20(a) of the Exchange Act, and seeks damages, interest, costs and attorneys' fees. On January 19, 2018, the Court granted the defendants' motion to dismiss and entered judgment for the defendants. On January 31, 2018, the plaintiff filed a notice of appeal to the United States Court of Appeals for the Second Circuit, and the case is scheduled for argument on August 31, 2018. The Company cannot predict the outcome of this action or the appeal. If the plaintiffs were to prevail in the action, the Company could be liable for damages, which could have a material, adverse effect on our financial position and results of operations.

On January 30, 2017, the Company received a letter from a putative shareholder demanding that the Company take action against current and/or former officers and directors of the Company for alleged breach of their fiduciary duties. The shareholder asserted that the officers and directors (i) failed to take any action to stop the alleged antitrust conspiracy described above, despite their alleged knowledge of the conspiracy, and (ii) made and/or caused the Company to make materially false and misleading statements by failing to disclose the alleged conspiracy. The shareholder also asserted that certain directors engaged in "insider sales" from which they improperly benefited. The shareholder also demanded that the Company adopt unspecified corporate governance improvements. On February 9, 2017, pursuant to statutory procedures available in connection with demands of this type, the Company's board of directors appointed a special committee of qualified directors to determine, after conducting a reasonable inquiry, whether it is in the Company's best interests to pursue any of the actions asserted in the shareholder's letter. On April 26, 2017, the special committee reported to the Company's board of directors its determination that it is not in the

Company's best interests to take any of the demanded actions at this time, and that no governance improvements related to the subject matter of the demand are needed at this time. On May 5, 2017, the special committee's counsel informed the shareholder's counsel of the committee's determination. As of the date of filing of this report, and to the Company's knowledge, no legal proceedings related to the shareholder's demand have been filed. However, we are voluntarily disclosing the existence of the shareholder demand in light of its relationship to the putative antitrust and securities class action lawsuits described above.



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On January 27, 2017, Sanderson Farms, Inc. and our subsidiaries were named as defendants, along with four other poultry producers and certain of their affiliated companies, in a putative class action lawsuit filed in the United States District Court for the Eastern District of Oklahoma. On March 27, 2017, Sanderson Farms, Inc. and our subsidiaries were named as defendants, along with four other poultry producers and certain of their affiliated companies, in a second putative class action lawsuit filed in the United States District Court for the Eastern District of Oklahoma. The Court ordered the suits consolidated into one proceeding, and on July 10, 2017, the plaintiffs filed a consolidated amended complaint. The consolidated amended complaint alleges that the defendants unlawfully conspired by sharing data on compensation paid to broiler farmers, with the purpose and effect of suppressing the farmers' compensation below competitive levels. The consolidated amended complaint also alleges that the defendants unlawfully conspired to not solicit or hire the broiler farmers who were providing services to other defendants. The consolidated amended complaint seeks treble damages, costs and attorneys' fees. On September 8, 2017, the defendants filed a motion to dismiss the amended complaint, on October 23, 2017, the plaintiffs filed their response, and on November 22, 2017, the defendants filed a reply. On January 19, 2018, the Court granted the Sanderson Farms defendants' motion to dismiss for lack of personal jurisdiction. The motion to dismiss the complaint filed in the Eastern District of Oklahoma on its merits is pending as to the remaining defendants. On February 21, 2018, the plaintiffs filed a substantially similar lawsuit in United States District Court for the Eastern District of North Carolina against Sanderson Farms and our subsidiaries and another poultry producer. Defendants subsequently moved to consolidate this action with the Eastern District of Oklahoma action in the Eastern District of Oklahoma for pre-trial proceedings, which was denied. On July 13, 2018, the defendants moved to dismiss the lawsuit in the Eastern District of North Carolina. That motion is pending. We intend to defend this case vigorously; however, the Company cannot predict the outcome of this action. If the plaintiffs were to prevail, the Company could be liable for damages, which could have a material, adverse effect on our financial position and results of operations.

On February 21, 2017, Sanderson Farms, Inc. received an antitrust civil investigative demand from the Office of the Attorney General, Department of Legal Affairs, of the State of Florida. Among other things, the demand seeks information related to the Georgia Dock Index and other information on poultry and poultry products published by the Georgia Department of Agriculture and its Poultry Market News division. The Company is cooperating fully with the investigative demand, and we have responded to all requests received to date; however, we are unable to predict its outcome at this time.

On June 22, 2017, the Company was named as a defendant in a lawsuit filed in the United States District Court for the Northern District of California. The complaint, which was brought by three non-profit organizations (the Organic Consumers Association, Friends of the Earth, and Center for Food Safety) alleged that the Company is violating the California Unfair Competition Law and the California False Advertising Law by representing that its poultry products are "100% Natural" products raised with "100% Natural" farming procedures. Among other things, the plaintiffs alleged that the Company's products contain residues of human and animal antibiotics, other pharmaceuticals, hormones, steroids, and pesticides. Plaintiffs seek an order enjoining the Company from continuing its allegedly unlawful marketing program and requiring the Company to conduct a corrective advertising campaign; an accounting of the Company's profits derived from the allegedly unlawful marketing practices; and attorneys' fees, costs and interest. On August 2, 2017, the Company moved to dismiss the lawsuit on various grounds. On August 23, 2017, the plaintiffs filed an amended complaint, which includes substantially similar allegations as the original complaint, and the Company filed a motion to dismiss the amended complaint on September 13, 2017. On February 9, 2018, the Court denied the Company's motion to dismiss. On February 13, 2018, the Company filed a motion for sanctions under Federal Rule of Civil Procedure 11 on the basis that Plaintiffs and their counsel knowingly included false or inaccurate statements and unsupported allegations in their complaints and other filings. The Court denied that motion on April 2, 2018. An initial scheduling conference was held on March 1, 2018, and discovery is underway. On June 25, 2018, the plaintiffs amended their complaint for a second time, including to remove allegations that the Company's products had been found to contain residues of antibiotics or other substances. On July 9, 2018, the Company filed a motion to dismiss the second amended complaint, and such motion is currently pending. On July 18, 2018, the parties stipulated to the voluntary dismissal of one of the plaintiff organizations (the Organic Consumers Association). The other two plaintiffs continue to prosecute their claims. The Company continues to vigorously defend itself; however,

the Company cannot predict the outcome of this action. If the plaintiffs were to prevail, the Company's reputation and marketing program could be materially, adversely affected, which could have a material, adverse effect on our financial position and results of operations.

The Company is involved in various other claims and litigation incidental to its business. Although the outcome of these matters cannot be determined with certainty, management, upon the advice of counsel, is of the opinion that the final outcome of currently pending matters, other than those discussed above, should not have a material effect on the Company's consolidated results of operations 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. After a considerable analysis of each case, the Company has determined that no accrual is required for any of the foregoing matters as of July 31, 2018. Future reserves may be required if losses are deemed reasonably estimable and probable due to changes in

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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 reserves or by accruals of losses to reflect any adverse determinations in these legal proceedings.

## Item 1A. Risk Factors

In addition to the other information set forth in this quarterly report, you should carefully consider the risks discussed in our Annual Report on Form 10-K for the fiscal year ended October 31, 2017, including under the heading "Item 1A. Risk Factors", which, along with risks described in this report, are risks we believe could materially affect the Company's business, financial condition and future results. These are not the only risks facing the Company. Other risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect the Company's business, financial condition and future results. Risks we have identified but currently deem to be immaterial could still materially adversely affect the Company's business, financial condition and future results if our assumptions with respect to such risks prove incorrect or if circumstances change.

There have been no material changes from the risk factors previously disclosed in the Company's Form 10-K for the fiscal year ended October 31, 2017.

## Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

During the third quarter of fiscal 2018, the company repurchased shares of its common stock as follows:

| Period                 | (a) Total Number of Shares Purchased <sup>(1)</sup> | (b) Average Price Paid per Share | (c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs <sup>(2)</sup> | (d) Maximum Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Plans or Programs <sup>(2)</sup><br><sup>(3)</sup> |
|------------------------|---|----------------------------------|---|---|
| May 1 - May 31, 2018   | —   | \$ —                             | —   | 2,000,000   |
| Jun. 1 - Jun. 30, 2018 | 1,092   | 105.15                           | 1,092   | 2,000,000   |
| Jul. 1 - Jul. 31, 2018 | —   | —                                | —   | 2,000,000   |
| Total                  | 1,092   | \$ 105.15                        | 1,092   | 2,000,000   |

<sup>1</sup> All purchases were made pursuant to the Company's Stock Incentive Plan, as amended and restated on February 11, 2016, under which shares were withheld to satisfy tax withholding obligations.

On May 31, 2018, the Company's Board of Directors expanded and extended the share repurchase program originally approved on October 22, 2009, under which the Company was originally authorized to purchase up to one million shares of its common stock and is now authorized to purchase up to two million shares of its common stock in open market transactions or negotiated purchases, subject to market conditions, share price and other considerations. The authorization will expire on May 31, 2021. The Company's repurchases of vested restricted stock to satisfy tax withholding obligations of its Stock Incentive Plan participants are not made under the 2018 general repurchase plan.

<sup>3</sup> Does not include vested restricted shares that may yet be repurchased under the Stock Incentive Plan as described in Note 1.

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Item 6. Exhibits

The following exhibits are filed with this report.

Exhibit 3.1 Restated Articles of Incorporation of the Registrant. (Incorporated by reference to Exhibit 3.1 filed with the Registrant's Quarterly Report on Form 10-Q for the Quarter ended on July 31, 2015.)

Exhibit 3.2 Bylaws of the Registrant, amended and restated as of October 24, 2017. (Incorporated by reference to Exhibit 3 filed with the Registrant's Current Report on Form 8-K on October 24, 2017.)

Exhibit 10.1\* Second Amendment to the Credit Agreement by and among Sanderson Farms, Inc., BMO Harris Bank N.A., as Agent, and the Banks party thereto, dated as of June 14, 2018.

Exhibit 15\* Accountants' Letter re: Unaudited Financial Information.

Exhibit 31.1\* Certification of Chief Executive Officer.

Exhibit 31.2\* Certification of Chief Financial Officer.

Exhibit 32.1\*\* Section 1350 Certification.

Exhibit 32.2\*\* Section 1350 Certification.

Exhibit 101.INS XBRL Instance Document

Exhibit 101.SCH XBRL Taxonomy Extension Schema

Exhibit 101.CAL XBRL Taxonomy Extension Calculation Linkbase

Exhibit 101.DEF XBRL Taxonomy Extension Definition Linkbase

Exhibit 101.LAB XBRL Taxonomy Extension Label Linkbase

Exhibit 101.PRE XBRL Taxonomy Extension Presentation Linkbase

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\* Filed herewith.

\*\* Furnished herewith.

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INDEX TO EXHIBITS

| Exhibit Number | Description of Exhibit  |
|----------------|---|
| 3.1            | <u>Restated Articles of Incorporation of the Registrant. (Incorporated by reference to Exhibit 3.1 filed with the Registrant's Quarterly Report on Form 10-Q for the Quarter ended on July 31, 2015.)</u> |
| 3.2            | <u>Bylaws of the Registrant, amended and restated as of October 24, 2017. (Incorporated by reference to Exhibit 3 filed with the Registrant's Current Report on Form 8-K on October 24, 2017.)</u>        |
| 10.1*          | <u>Exhibit 10.1* Second Amendment to the Credit Agreement by and among Sanderson Farms, Inc., BMO Harris Bank N.A., as Agent, and the Banks party thereto, dated as of June 14, 2018.</u>                 |
| 15*            | <u>Accountants' Letter re: Unaudited Financial Information.</u>   |
| 31.1*          | <u>Certification of Chief Executive Officer</u>   |
| 31.2*          | <u>Certification of Chief Financial Officer</u>   |
| 32.1**         | <u>Section 1350 Certification.</u>  |
| 32.2**         | <u>Section 1350 Certification.</u>  |
| 101.INS        | XBRL Instance Document  |
| 101.SCH        | XBRL Taxonomy Extension Schema  |
| 101.CAL        | XBRL Taxonomy Extension Calculation Linkbase  |
| 101.DEF        | XBRL Taxonomy Definition Linkbase   |
| 101.LAB        | XBRL Taxonomy Extension Label Linkbase  |
| 101.PRE        | XBRL Taxonomy Extension Presentation Linkbase   |

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\* Filed herewith.

\*\* Furnished herewith.

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SIGNATURES

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

SANDERSON FARMS, INC.

(Registrant)

Date: August 23, 2018 By: /s/ D. Michael Cockrell  
Treasurer and Chief Financial Officer

Date: August 23, 2018 By: /s/ Tim Rigney  
Secretary, Corporate Controller and  
Chief Accounting Officer