Q1 2022 Earnings Call

Company Participants

- Marcos Antonio Molina dos Santos, Chairman of the Board
- Miguel Gularte, Chief Executive Officer
- Paulo Pianez, Sustainability and Communications Director
- Tang David, Chief Financial and Investor Relations Officer
- Tim Klein, Chief Executive Officer of North America Operations

Other Participants

- Ben Theurer
- Rob Dickerson

Presentation

Operator

Good morning, everyone and thank you for waiting. Welcome to Marfrig Global Foods S.A First Quarter of 2022 Conference Call. With us here today we have Mr.Marcos Molina, Founder and Chairman; Tim Klein, Chief Executive Officer of North America Operations; Mr.Miguel Gularte, Chief Executive Officer of South America; Mr.Tang David, Chief Financial and Investor Relations Officer; Mr.Paulo Pianez, Sustainability and Communication Director; Mr.Eduardo Puzziello, Investor Relations Director.

This event is being recorded and all participants will be in a listen-only mode during the company's presentation. After Marcos' remarks, there will be a question-and-answer session. At which time further instructions will be given. (Operator Instructions) This event is also being broadcast live via webcast, and maybe accessed to Marfrig website at http://ri.marfrig.com.ir, where the presentation is also available.

Participants may view live replay in the order they wish. The replay will be available shortly after the call concludes. Those following the presentation via the webcast, may post their questions on our website. They will be a answered by the IR team after the conference is finished.

Before proceeding, let me mention that forward-looking statements are based on the beliefs and assumptions of Marfrig Global Foods S.A. Management, and on information currently available to the company. They involve risks and uncertainties because they relate to future events, and therefore, depend on circumstances that may or may not occur. Investors and analysts should understand that conditions related to macroeconomic conditions, industry and other factors could also cause results to differ materially from those expressed in such forward-looking statements.

Now, I will turn the conference over to Mr.Marcos Molina. Mr.Molina, you may proceed.

Marcos Antonio Molina dos Santos {BIO 15363967 <GO>}

Thank you all for participating in Marfrig conference call on the results for the first quarter of 2022. As always, first of all, I want to thank and congratulate our more than 30,000 employees, each one of them contributed with hard work and dedication of the excellent results we will present here. Traditionally, the first months of the year are the most challenging for our industry. Even so, Marfrig has just had the best first quarter in its history. To get there, we had to deal with a very complex scenario. We faced strong cost increases in all regions where we operate, and even so, we kept our units running with a high level of return.

Once again, Marfrig's simplified management structure brought agility and efficiency to our business model. This was reinforced by strategic investments. With this, we improved the efficiency of our operations and ensured greater exposure to value-added products. In this first quarter, we invested around BRL460 million in CapEx. We invested an additional BRL418 million in PlantPlus for the acquisition of Sol Cuisine in Canada. And we purchased back BRL77 million of Marfrig shares and also follow the important capital increase in BRF by investing another BRL1.8 billion.

All of that totaled BRL2.8 billion in the first quarter. All this progress happened while the company improved its leverage ratio, which reached 1.36 times at the end of the first quarter. This demonstrates our commitment to sustainable growth, cash generation, and excellent capital allocation, while maintaining a low level of indebtedness. This was recently recognized by the international rating agency S&P, which upgraded Marfrig's risk rating to BB+. Now, we're just one notch away from investment-grade. We will continue our work to generate value to all of our partners and shareholders.

Now, I'll turn it over to Tim Klein, the CEO of our North American Operations.

Tim Klein {BIO 16522695 <GO>}

Thank you, Marcos. Let's begin on slide 4, where I will comment on the results for the first quarter, starting on the left. Sales volume in the quarter was 2.9% higher than the same quarter of last year. Net revenue, however, was 30.6% higher than the previous year, driven by higher prices for beef and beef by-products. This resulted in a significant improvement in gross profit, which was almost 60% above that of last year.

Finally, we achieved EBITDA BRL453 million, 47.5% higher than last year with an EBITDA margin of 15%, a record for our first quarter. The key driver of our performance was continued strong demand for U.S. beef products, combined with ample availability of fed cattle. All other business units posted improved results versus last year as well.

Please now move to slide 5, where I will talk about U.S. market data, starting on the left. Industry slaughter levels decreased 0.7% from the same quarter of last year. Cattle prices as reported by the USDA averaged BRL138.46 per hundredweight, up 22.5% year-over-year on strong demand from packers. The USDA comprehensive cut-out averaged BRL273.59 per hundredweight, up 21.8%, while the drop credit increased 43.6% to an average of BRL13.81 per hundredweight, led by increases in tallow and hide values.

The cut-out ratio was 1.98 versus 1.99 last year. Note that despite the slightly lower cut-out ratio, unit margin dollars were higher as the components of the ratio, cattle prices and box beef values were meaningfully higher. Drop credit values also contributed to the higher margin. Now, I'll pass to Miguel.

Miguel Gularte {BIO 20767495 <GO>}

Thank you very much, Tim. We will now move on to slide number 6, where I will explain the performance of the South American operation in the first quarter of 2022. As you can see in the chart on the left, total sales volume had a growth of 11% compared to sales in the first quarter of 2021, justified by the combination of a strong resumption of sales to China, which returned to normal at the end of last year, and the recovery of demand in the domestic market.

We now move on to the central graph on the slide, net revenue. We can see that we reached in the first quarter of 2022, the amount of BRL6.5 billion, 41% above the revenue of the same period in 2021. This good performance is explained in addition to the higher sales volume by the pricing, which was 30% higher in Reals than prices charged in the same period of 2021, both in the domestic market and in exports.

Finally, in the graph on the right, EBITDA. We can see that we reached the amount of BRL411 million in Q1 2022, a growth of 95% over the EBITDA of Q1 2021. This better performance can be explained by the effects of higher volumes, and better prices as I talked about earlier, and by the evolution of the captures from the operational efficiency programs.

However, these positive factors were partially mitigated by higher cattle prices in all geographies where we operate, and by the strengthening of the Real against the dollar, which impacted our exports. Thus, we reached an EBITDA margin of 6.4% in Q1 2022, 1.8 percentage points higher than the margin in the same quarter of 2021.

Once again, I'd like to highlight our business model with integrated platforms in the countries where Marfrig operates. This model provides us with a differential in the trading of our products and the results are translated into the performance presented here, which confirms the assertiveness of our strategy.

Moving on to slide 7, I will talk about it impact of exports in the first quarter of 2022 results of the South American operations. As can be seen in the graphs on this slide, referring to the evolution of exports, we can notice a significant variation in the main export destinations. This movement was caused by the restriction in exports from Brazil to China during almost the entire last quarter of 2021.

In this scenario, the company had the ability to change the sales destinations of the Brazilian operations to market such as Europe and North America, which minimized the impact of the restrictions to the Chinese market. After this period of limitation, that was a return to normalization with a strong resumption of exports to China, which needed to rebuild part of the emergency stock used during the period without imports from Brazil. As a consequence, prices and volumes went up significantly in the first quarter of this year.

Financial results for the first quarter of 2022. Starting with slide 9 in the graph on the left, in the first quarter of 2022, we generated a consolidated net revenue of BRL22.4 billion, an increase of 29.6% compared to the first quarter of 2021. I'd like to point out that more than 93% of our revenue is generated in currencies other than the Real with more than 90% generated in dollars.

In the graph on the right, this quarter, we generated BRL2.8 billion in adjusted EBITDA with a margin of 12.3%, a nominal growth of 60.9% and 240 basis points versus the EBITDA of the first quarter of 2021. And of this total EBITDA, 85% was generated in North America. As presented in the previous slides at the beginning of our presentation, the strong performance of North America combined with the gradual improvement of margins in South America are the main drivers of this growth.

We now move on to slide number 10. On this slide, we will comment on the net financial result in the first quarter of 2022, which was an expense of BRL1.2 billion. The mark-to-market of the investment in BRF shares of BRL795 million was the main driver of the expense in the quarter.

In the quarter, interest expenses were BRL526 million, an increase of BRL35 million, compared to Q4 2021, explained by the increase in the basic interest rate in Brazil, given the new debt profile with greater exposure to that in the local market. The exchange variation was positive by BRL166 million caused by the difference between the final tax of the periods in Q1 2022, BRL4.74 versus BRL5.58 in Q4 2021.

On the next slide, number 11, we will show the net result for the first quarter of 2022. In the first quarter, the net result before taxes was BRL1.3 billion, this cut in taxes which were BRL763 million and other BRL384 million of minority interest. The net result was BRL109 million. After the ordinary general assembly, dividends of BRL383 million were paid in April, which represented approximately BRL0.58 per share, still referring to the results earned in 2021. In the second graph below, we show the net result accumulated in the last 12 months. Due to the excellent operational performance we obtained a net profit generation of more than BRL4.2 billion.

On the next slide, number 12, we will present cash generation. We generated in Q1 2022 more than BRL1.2 billion of operational cash flow. Discounting the investment in CapEx and interest paid in the period, the free cash flow was negative BRL175 million, as shown in the graph above. In the graph below, we present the accumulated operational cash generation in the last 12 months totaling BRL10.4 billion, more than BRL2.7 billion were invested in important projects of organic growth and in products with higher added value.

Interest expenses totaled BRL1.8 billion Thus, the free cash flow generation was BRL5.9 billion.

Slide number 13, net debt and leverage. Our net debt at the end of the first quarter of 2022 totaled $4 billion. When measured in Reals, net debt was 3.5% lower, BRL21.2 billion in the first quarter of 2022 versus BRL21.9 billion in the last quarter of 2021. We invested BRL1.8 billion in BRF shares acquired in the following process promoted by the company in January of 2022. In the first quarter of 2022, we paid BRL350 million to national beef minority shareholders.

As a result, our leverage stood at 1.53 times when measured in dollars, and 1.36 times when measured in Reals, lower leverage levels compared to the same period in 2021. At the end of the first quarter of 2022, approximately 70% of our debt was indexed in U.S. dollars, and 30% in local currency. The increase in the exposure to the Real is part of the strategy of better liability management, taking advantage of the good opportunities in the domestic market.

On slide 14, we will present the details of our debt profile. Starting with the chart on the left, the debt schedule. We ended March with cash on the order of $2.4 billion, a 60% growth compared to cash at the end of 2021. This increase is explained by the term loan made for $800 million, whose objective is liability management, and the management of financial expenses since its cost is lower than that of current debts.

Additionally, we have a revolver line available of $900 million at the national beef level. In the graphs on the right, we can see that the gross debt is equalized between commercial bank lines and bonds, in that 78% is allocated to the long-term and close to 72% in dollars.

I now turn it over to call to Paulo Pianez who will comment on the sustainability highlights. Thank you.

Paulo Pianez

Thank you, Tang. Just as Marfrig closed 2021 with robust results in sustainability, this first quarter of 2022 was no different confirming its real commitment to developing innovative low-carbon deforestation free cattle farming. In line with its strategy to establish a low-carbon meat production supply chain, Marfrig had its reduction target for greenhouse gas emissions approved by the science-based targets initiative submitted last year.

The company is the only one in the beef protein sector in the Americas to have its targets approved and to commit to limiting the increase in global temperature to up to 1.5 degrees C. Marfrig targets are, in Scopes 1 and 2, to reduce absolute greenhouse gas emissions by 68% base year 2019 by the year 2035. In Scope 3, which includes Marfrig's entire supply chain to reduce the intensity of emissions by 33% by 2035 base year also 2019. This scope includes methane gas emitted from enteric fermentation of cattle.

And also, increase the use of renewable energy, which is today 27% to 100% by 2030. In order to make the monitoring system even more robust, Marfrig has established a partnership with MAPBIOMAS, one of the most renowned collaborative initiatives in territorial intelligence, and has been working to incorporate maps into the control layers of its geo monitoring system.

This is within the scope of the Marfrig Verde + plan launched in July 2020. And that is based on the produce, conserve and include strategy. This program brings us much closer to the producers and has been showing very positive results in the first quarter of 2022, mainly on the inclusion and traceability fronts.

On the inclusion front, the company supported and re-included more than 2,200 farms in its supply chain, which represents more than 770,000 animals. This is a clear example that the inclusion strategy is the most effective solution to reconcile production and conservation.

On the supply chain traceability front, including indirect suppliers, Marfrig already monitors 100% of its direct suppliers in the Amazon and Cerrado regions. As for indirect suppliers, we closed the first quarter of this year with the identification of 67% in the Amazon region, and 70% in the Cerrado.

And finally, Marfrig is pride of the B3's carbon efficiency index, the ICO2, and also in the preview published recently by B3, the ISE Corporate Sustainability Index. These efforts and results obtained with the Marfrig Verde + plan, as well as international evaluations, prove our commitment to generating positive impacts, contributing to the development of a low-carbon economy, and to the maintenance and recovery of biodiversity in the territories where we operate.

Questions And Answers

Operator

(Question And Answer)

Excuse me. The floor is now open for questions. (Operator Instructions) And our first question comes from Ben Theurer of Barclays.

Q - Ben Theurer

Yeah, good morning, and thank you very much for taking questions and congrats on the very good results for the first quarter. First question is actually for Tim. Can you share an outlook and what you're seeing and what your expectation is for the coming two quarters just given that those tend to be the strong quarters over summer. Obviously, you have a very tough comp to deal with on a year-over-year basis.

We've seen some of the cut-out come down a little bit recently, but sometimes the data we're seeing might not properly reflect what you're seeing. So, any comments you have on what you're seeing in 2Q so far, and what your expectation is over next coming months, that would be much appreciated. Thanks, Tim.

A - Tim Klein {BIO 16522695 <GO>}

Great, Ben. What we see, to your point comping against last year is not possible, given the impacts COVID has actually on last year, and the year before. So, we kind of look back at 2019 as a base year and our expectations are, we'll have very strong quarters, stronger the second and third quarter than we had in 2019.

Demand continues to be very good, of course, we're watching the inflation trends and how that might affect consumer buying. But so far, we haven't seen any major impact from that. We are getting a late start to the normal run-up in the cut-out due to the weather -- colder wet weather we've had here in the U.S., but all in all we're still confident in our outlook.

Q - Ben Theurer

Okay. Perfect, Tim. Thank you very much. And then, my next question is for Miguel. I'll speak slowly so we can get the translation through. Miguel, in the Brazilian operational of the South American operation, we saw a significant improvement on a year-over-year basis, and particularly, a re-acceleration in exports over to Asia, particularly China, Hong Kong. Now, can you give us the latest on what you're seeing on the export side, given the more strict lockdowns in China, and particularly, over the last couple of weeks? And do you expect this to impact somehow second quarter exports given all the backlog at the ports? Thank you.

A - Miguel Gularte {BIO 20767495 <GO>}

Good morning. Thank you for your question. What we see right now is a situation where the logistics has been -- was a reason for concern 10 days ago, but now, it's going back to normal. The bottlenecks we saw at Chinese ports are beginning to disappear, and vessels are being unloaded without any problems.

And that can be explained because Chinese ports are highly automated. So, once operations go back to normal, products flow quite easily. In terms of the market, what we see is, if we compare the market to 2021, it's looking much more promising, because in the first quarter 2021, there was low cattle supply and that's not the case this year. There was an increase in slaughter supply in Brazil of 10%, and at Marfrig, that was 25% in the first quarter.

Now, if we consider the fourth quarter of 2021, so that we compare to 2022, the fourth quarter in 2021, Brazil didn't take part in the exports because it was delisted. We hope that won't happen in 2022. And the price of raw material was much more competitive for exporting packing houses such as ours, if you compare 2022 to 2021.

So, raw material prices are more competitive. So, we have more supply and the export market. The Exchange rate is very favorable towards the BRL. And in China, which is our main destination, and that's very, very positive for Marfrig, because we have the largest number of qualified plans to export to China from South America. The Chinese market has much higher prices now than the previous year. We're talking about $2,000 per ton comparing year-on-year and month-on-month. So, it looks like we're going to have a great export year with lots of raw material at very reasonable prices.

Q - Ben Theurer

Okay. Perfect. And then, last question if I may, that one's actually then for Tang. So, we go all through here. On the financing side and leverage, so net debt as of the first quarter depending on how we want to express it, but it's been somewhat stable in dollars. I mean obviously because of BRL depreciation -- appreciation, it came down in BRL, but if we look forward in the need to consolidate Brazil Foods, any initial thoughts you can share in regards to where you think the leverage is going once you consolidate the higher lever to BRF stake within your financials?

And also given obviously the expectation of EBITDA over summer being less than last year, your leverage is likely to continue to go just slightly up given the tough comp page from last year. So, how should we think of leverage over the coming quarters as we start seeing the consolidation? Thank you.

A - Tang David {BIO 18672578 <GO>}

Okay. Leveraging, considering BRF's share in Marfrig will only be considered as of the second quarter. So, that's the first important point. The second point is, as in my answer about capital allocation, that's liability management, and also reducing the service of the debt. So Marfrig's leveraging should not go up. It won't go up. Okay.

Q - Ben Theurer

Okay. Perfect. Thank you very much.

Operator

Our next question comes from Rob Dickerson, Jefferies.

Q - Rob Dickerson {BIO 19993946 <GO>}

Great. Thanks so much. Tim, just kind of a broad question for you. I think you had said in response to an earlier question that demand seems to be so very good. Right. I mean, obviously, pricing has put a roof to certain times. As we enter the grilling season, we start to think about maybe some competitive activity, there's a lot of conversation around on elasticity and trade-down rests throughout the entire food industry. Do you have kind of any feel or kind of guess personally as to what might happen if you just lay a look back in the prior-period that might not be exactly the same, but somewhat similar in terms of price inflation consumer strength what have you?

And I'd really just two because obviously demand has been strong for over two years and pricing continue to get stronger. So just trying to think about kind of what could happen if we get through the back half of the year, and how you think about those puts and takes? Thanks.

A - Tim Klein {BIO 16522695 <GO>}

Yeah. Great question. We are watching price trends on all food products and other products as consumer spending may change. However, what we do normally see on beef is a trade-off between different cuts. So, in normal recessionary time periods, for example, we see consumers buying more of the less expensive beef cuts, and walking away from the more expensive.

But all in all, when you put it back together, the overall cut-out value remains relatively stable even through that environment. We do not see very much trade away from beef to pork or poultry or less expensive forms of protein. So, we're watching it, but we're not overly concerned that we're going to see a change in consumer demand for beef.

Q - Rob Dickerson {BIO 19993946 <GO>}

Okay, super. And then, maybe excuse my ignorance before I ask this question, but it's always good to hear from you Tim again. It's just live cattle prices are down a little bit over the past few months, but obviously, there's a lot going on I assume on the feed side. So, maybe just kind of the brief explanation as to why you think those prices have moved down and kind of if you have any perspective as to where you think they settle out as we get through the year? That's it. Thanks.

A - Tim Klein {BIO 16522695 <GO>}

Well, live cattle actually, since the first of the year have been relatively stable and have actually moved up a little bit. We would expect a normal seasonal decline from now until the summer months. And then, probably back up again in the fourth quarter. The shorter supplies and the highest prices will be out there in Q4, from what we can see here. But all in all, the industry continues to run at full capacity, and there are still at least through the first quarter enough cattle for everybody to run it at full capacity. That will continue for at least another quarter, and then, we'll see fewer numbers as we allot them to Q3, and particularly Q4.

Q - Rob Dickerson {BIO 19993946 <GO>}

Okay, super. Thank you so much.

Operator

(Operator Instructions) Excuse me, this concludes today's question-and-answer session, and thus concludes Marfrig Global Foods S.A. Conference call for today. Thank you very much for your participation and have a nice day.