Q3 2021 Earnings Call

Company Participants

- Marcos Molina, Founder and Chairman
- Miguel Gularte, Chief Executive Officer, South America Operations
- Paulo Pianez, Sustainability and Communications Director
- Tang David, Chief Financial Officer
- Tim Klein, Chief Executive Officer, North America Operations

Other Participants

- Analyst
- Benjamin Theurer
- Nick Ivanov

Presentation

Operator

Good morning, everyone, and thank you for waiting. Welcome to Marfrig Global Foods S.A. Third Quarter Conference Call. With us here today we have Mr.Marcos Molina, Founder and Chairman; Tim Klein, Chief Executive Officer of our North America Operation; Mr.Miguel Gularte, Chief Executive Officer of South America; and Tang David, Chief Financial, Investor Relations Officer; Mr.Paulo Pianez, Sustainability and Communications Director; and Mr.Eduardo De Oliveira, Investor Relations Director. This event is being recorded and all participants will be in a listen-only mode during the company's presentation. After Marfrig remarks, there will be a question-and-answer session. (Operator Instructions)

This event is also being broadcast live via webcast and may be accessed through Marfrig website at ri.marfrig.com.br where the presentation is also available. Participants may view the slides in any order they wish. The replay will be available shortly after the event is concluded. Those following the presentation via webcast may post their questions on our webcast. They will be answered by IR team after the conference finished.

Before proceeding, let me mention that forward-statements are based on 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 depends on circumstances made that may or may not occur. Investors and analysts should understand that conditions relate to market economic conditions, industry and other factors could also cause results to differ materially from those expressed in such forward-looking statements.

Now I'll turn the conference over to Marcos Molina. Mr.Molina, you may begin your presentation.

Marcos Molina {BIO 15363967 <GO>}

Thank you all for participating in our conference call for the third quarter of 2021 results. I would like to start by thanking and congratulating our entire team for another set of record results. Our net revenue this quarter was R$23.7 billion and we had an EBITDA of more than R$4.7 billion, the highest results in our history. Our operation in North America had another record performance, reaching more than $850 million in EBITDA. In South America, we overcame the problems in shipments that hindered exports. We maintained profitability and continued to experience strong sales growth. Thanks to our geographic diversification strategy.

Based on disciplined financial management and strong cash generation, we lower our leveraging to the lowest historical level. We ended the third quarter with a leverage of 1.10 times net debt over EBITDA measured in reals. The strong cash generation combined with lower financial cost has allowed the company to focus more on investing in organic growth. Proof of this was that in the third quarter we invested more than R$530 million, and most of it was in the growth of processed and higher added value products with constant improvement in our production processes. With the reduction of administrative and financial costs, we continue in a virtuous cycle of results and value generation for our shareholders, fulfilling our role with society, being an innovative company that is truly committed to sustainability and with the best corporate governance practices.

I now give the floor to the CEO of the North American operation, Tim Klein.

Tim Klein {BIO 16522695 <GO>}

Thank you, Marcos. Let's begin on Slide 4 where I will comment on the results for the third quarter. Starting on the left, sales volume in the quarter was 0.6% higher than the same quarter of last year. Net revenue, however, was 43.2% higher than the previous year coming in at $3.2 billion, a new record for the company. This achievement was driven by continued high prices for beef and beef byproducts, and the improvement in sales volume.

On the chart on the right, we also achieved a record EBITDA of $857 million for the quarter, a 166.7% higher than last year with an EBITDA margin of 26.8% which was also another record. The key drivers of our performance continue to be strong demand for US beef products combined with ample availability of fed cattle, allowing us to operate our plants at full capacity. Although fed cattle prices increased from a year ago, beef and beef byproduct values more than offset that increase.

Please move now to Slide 5 where I will talk about US market data. Starting on the left, industry slaughter volume were down 2.4% from last year. Cattle prices as reported by the USDA averaged $121.54 per hundredweight, up 20.9% year-over-year on strong demand from packers. The USDA comprehensive cutout averaged $298.69 per hundredweight, up 42.6% over last year. At the same time, drop credit values increased 93.7% to an average of $14.42 per hundredweight, led mainly by increases in hide and tallow values. The cutout ratio was 2.46, up from 2.10 last year. Higher cutout values and drop credit values resulted in a 113% increase in per head gross margins versus last year. As we look forward to Q4 and the rest of 2021, industry fundamentals continue to be in our favor. Fed cattle supplies remain adequate while beef demand is robust, both domestically and internationally. Margins for the industry should continue to be favorable.

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 operations in the third quarter of 2021. As we can see in the first graph on the left, the comparison between sales volumes, there was a 5.4% growth compared to the same period last year from 370,000 to 390,000 tons in the third quarter. This increase in volume is explained by the 15% growth in exports in the period and by the strong sales volume of industrialized products in the domestic market, which grew 13% compared to last year.

In the center graph, net revenues, we can see that we reached R$6.9 billion this quarter, 44% higher than the revenue of the same period in 2020. It is worth talking a little more about the challenges that we faced over the past quarters. Despite the logistical difficulties in South America with the unavailability of ships and containers, we were able to reverse this issue throughout the third quarter, especially in July and August. This had a positive impact not only on the sustainability of volumes, but also on the working capital of the operations.

Furthermore, thanks to Marfrig's geographic diversity. In the beginning of September, after Brazil suspended exports to China, we were able to move up blanket vacations of certified plants in Brazil and quickly change the destination to our operations in Uruguay and Argentina where we have six plants qualified to export to China. This strategic advantage minimized the impacts of Brazil's decision to suspend exports to China on the consolidated results of the South American division.

In the domestic market, I'd like to highlight again that despite the small growth in sales volume of 4% compared to the same period of 2020, this quarter we managed to increase net revenue by 41%. That is, there was an increase of about 36% in the average sales price resulting from the combination of a strategy to optimize commercial channels with a focus on sales growth of industrialized and branded products.

In the graph on the right, EBITDA, we can see that this quarter we reached R$301 million with a margin of 4.4%. This behavior of the margin is explained by the impact of the increase in the cost of cattle in Brazil and by the impacts of the suspension of Brazilian exports to China. These effects were partially offset by the operations in Uruguay, Argentina and Chile, as well as by the growing share of industrialized products in our results, which accounted for 15% of revenues this quarter compared to 11% in the same period of 2020.

Turning now on to Slide 7, I will talk about exports and the operational efficiency program in Q3 2021. Exports accounted for 62% of this quarter's revenue, the same percentage as in the same period of 2020. However, out of this total, 64% were exports to China against 51% in the third quarter of 2020. It is worth mentioning that even with the restrictions on exports to China as of September 4, the inventory built up at the port at the end of the second quarter was sold throughout the third quarter and offset the reduction in exports to China in the last month of the quarter. As I have been saying over the past few results, Marfrig has been striving to implement operational programs through efficiency programs in its operations in Brazil, Uruguay, Argentina and Chile.

Looking at the table on the right of the slide, we can see that through the implementation of these measures this quarter we were able to capture operational improvements that positively impacted our results by about R$15 million when compared to the previous quarter.

I will now turn to Tang who will comment on the consolidated results and the financial highlights of the operation.

Tang David {BIO 18672578 <GO>}

Thank you, Miguel. In the next slides we will present Marfrig's Q3 2021 consolidated financial results. The robust performance of our North American operation coupled with the maintenance of results in our South American operation, which performed resiliently in the face of an adverse quarter, resulted in strong profit and cash generation in the quarter, allowing us to reduce that and further reduce our leveraging.

Starting with Slide 9 in the left chart, we've generated in Q3 2021 a consolidated net revenue of R$23.6 billion, an increase of 40.4% compared to Q3 2020. In the right chart, we generated this quarter more than R$4.7 billion in adjusted EBITDA with a margin of 20%, a nominal growth of 115.6% and 700 basis points versus the Q3 2020 EBITDA. And out of this total EBITDA, 95% was generated in North America. As commented by our CEOs Miguel and Tim, the growth in net revenue and EBITDA is a result of the record profitability of our North American operation and the sequential improvement in the South American operation with higher sales volumes and better prices.

We now move on to Slide 10. The net financial result in Q3 2021 was an expense of R$578 million. The increase in the interest rates in Brazil and the mark-to-market of the passive investments in BRF shares were the main drivers of this expense in the quarter. In the quarter, the exchange variation was negative R$696 million, caused by the difference between the final PHX of the periods; Q3 2021, R$5.44 versus R$5 in Q2 2021.

Now on to Slide 11, net results. The strong operational performance added to the captures of the operational efficiency program and fixed cost control resulted in a net income generation of R$1.7 billion in Q3 2021. In the second graph below, we present the accumulated net profit of R$3.7 billion in the nine months of 2021, an increase of 73.3% in relation to the same period of 2020. We remind you that in the third quarter we advanced payments of R$958.4 million of interim dividends to Marfrig shareholders. This amount is equivalent to a dividend yield of approximately 7%.

On Slide 12, we present cash generation. In Q3 2021 we generated more than R$4.7 billion in operational cash flow. Discounting the investments and CapEx and interest paid in the period, the free cash flow totaled R$3.8 billion as shown in the graph above. In the graph below, we present the operating cash flow generation for the last 12 months totaling R$9.9 billion and the free cash flow generation for the last 12 months totaling R$6.5 billion.

On Slide 13, net debt and leverage. Our net debt at the end of the third quarter totaled $2.5 billion, a reduction of 12.2% in relation to Q2 2021, a direct consequence of the strong cash generation in the period. As a result, our leverage reached its lowest historical level, both in reals 1.1 times and in dollars 1.07 times. In Q3 2021, R$958.4 million were paid in dividends to Marfrig shareholders and R$784 million to national beefs minority shareholders. Some details of our debt in the graph on the right. 79% of our debt is indexed in US dollars. The increased exposure to the real is part of the strategy to better manage our liability, taking advantage of the good opportunities in the domestic market. 75% of our debt is long term with an average maturity of 4.9 to 7 years and an average cost of 5.46% per year.

On Slide 14, we present the details of our debt profile. Starting with the graph on the left, the debt schedule. We ended Q3 2021 with a cash volume of about $2.9 billion, enough to cover maturities until practically 2026. In the graph on the right, we see the evolution of net debt in dollars over the last three years. The net debt shown in Q3 2021 is 23.5% lower than the net debt at the end of 2019 and 12.8% lower than at the end of 2020.

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

Paulo Pianez

Thank you, Tang. Marfrig has historically been at the forefront of an innovative low-carbon and deforestation free cattle farming industry. Always trying to engage the entire supply chain, especially producers, the company has been working under the premise of inclusion, believing that this is the key to transform the industry. It believes that it is inclusion that will make it possible to reconcile production with the conservation of our biodiversity, building a production system that is profitable, innovative and that effectively contributes to the social and economic development in the regions in which it operates.

The means by which Marfrig addresses the relevant challenges in this supply chain is through a robust ESG management model and a sustainability platform based on six pillars. Origin control of raw materials, technology and innovation to reduce greenhouse gas emissions; practices that ensure animal welfare; rational use and optimization of natural resources, especially water and energy; always seeking renewable sources of generation; reduce generation of waste and affluence, and their proper disposal; and finally and very importantly, respect and social support to communities and native peoples in the regions where it sources and produces.

Furthermore, given the complexity of establishing this new standard in livestock farming and the production of differentiated products, we believe that we must go further. In this sense we launched the Marfig Verde+ plan in 2020, a program that is already generating robust results. It is important to point out that the plan was conceived in partnership with the Dutch public-private institution IDH, initiative for sustainable trade, aiming to ensure that 100% of the company's production chain is sustainable, low-carbon and deforestation free in all biomes by 2030. There is an intermediate target that by 2025 these targets will be met for the Amazon biome.

This quarter, under this program, Marfrig included more than 1,100 producers in its supply chain, helping them to bring their production systems back into full compliance with the company's social and environmental purchasing criteria. This was equivalent to about 200,000 head of cattle produced in a profitable and sustainable manner. Marfrig also started an ambitious program to diagnose the need for environmental adequacy in its supply chain, the PAA Environmental Adequacy Program. The first stage of this program has already been concluded. The program conducted a diagnose of the situation of the areas on site and the need for remediation measures.

With this producers will have the necessary technical tools to identify the best instrument of reparation, ranging from natural regeneration to the total replanting of forests. Other relevant results were the first slaughters under the Sustainable Calf Production Program, a project in partnership with IDH, initiative for sustainable commerce. Carrefour Foundation, Sal Marcello farms and now also Marfrig, which is already contributing with $2 million for the expansion of the program that will go from 150 small livestock producers to more than 300.

The premise of this program is an integrated model of livestock production from origin, that is from the moment the animal is born until the moment it goes to retail and becomes available to our consumers. And all of this with total traceability. In this quarter, Marfrig also published the audit report Public Commitment to Cattle Farming in the Amazon, with 100% compliance of its supply chain. It is worth noting that Marfrig is the only company in the sector that publishes this report with such an achievement, that is 100% compliance.

On July 15, Cattle Breeders Day, Marfrig launched the portal (inaudible), the breeders portal, a relationship channel with its supply chain to discuss topics relevant to daily production activities, especially highlighting the vast production practices such as animal welfare, sustainable management, production intensification, crop livestock, forest integration, genetic improvement, among others. Since this launch, Marfrig has promoted monthly webinars addressing these topics with producers. These efforts and results harbored under the Marfrig Verde+ program prove our commitment to generate positive impacts, contribute to the development of a low-carbon economy and to the maintenance and recovery of biodiversity in the territories where we operate in.

Questions And Answers

Operator

(Question And Answer)

Thank you. The floor is now open for questions. (Operator Instructions) Our first question comes from Ben Theurer with Barclays. Please, you may proceed.

Q - Benjamin Theurer

Yeah, good morning everyone and thanks for taking my questions. I have one for Tim, maybe to start off that might be an easier one. So, Tim, obviously it was a very good quarter and the industry is doing very well. If you look into the fourth quarter and you think about your specific capacity and still with the cutout being fairly attractive, are there any ways for you to potentially increase a little bit the slaughter. I mean, we've seen in the quarter the volume was essentially flat. Do you have any flexibility to potentially add given that it looks like a very strong fourth quarter so far?

A - Tim Klein {BIO 16522695 <GO>}

Well, currently we're running at 100% capacity utilization. So, there is no opportunity to increase production from what we've been operating.

Q - Benjamin Theurer

For that do you need to run from time to time Saturday shift or are you running just the five days and that's it because you don't want to stress your labor?

A - Tim Klein {BIO 16522695 <GO>}

We are running six-day operations right now although we -- in each of our plants we provide once a month a Saturday off in order to keep our workforce happy.

Q - Benjamin Theurer

Okay. Perfect. And then one for Miguel and I'll wait for the translation to go through and I'll say it slowly. If we take a look at the current cattle price environment in Brazil as cattle prices have come down over the last couple of weeks because of the decision to stop or not being able to export to China, are you seeing opportunities that the lower cattle price can translate into lower beef price to be supportive to volume in the domestic market?

A - Miguel Gularte {BIO 20767495 <GO>}

Good morning. Thank you so much for your question. Buying price and sale price are always adjusted according to the market reality. And right now the arroba price has been dropping and the price of beef, both wholesale and retail has also been decreasing. What had been happening the weeks prior to this one was that the price of the arroba had been decreasing less than the price of beef or decreasing more slowly. And as time goes by, that adjust. So in answer to your question, yes, we should expect the price of the arroba and the price of beef to be balanced over the next few days at a lower level. What we don't know for sure is if once the Chinese market is open again, what the upwards adjustment will be, but definitely when China comes back, there will be a balance again and it will be possible to expect a partial or full recovery of the price of the arroba.

Q - Benjamin Theurer

Okay. Perfect. Thank you very much and congrats on the strong results.

Operator

(Operator Instructions) Our next question comes from Antonio Gomez with (inaudible) Please go ahead, sir.

Q - Analyst

Thank you for your time. My question is with regards to the cycle and states. As you can see the results have been very strong, margins has been exceptionally high. It seems like you've got the perfect track factor of ample supply, limited processing capacity and very high demand in the state. Just wanted to hear your views on how that's going to develop going into '22. You mentioned that Q4 is going to be quite strong and whether you see supply getting more mitigated or demand falling or even capacity -- more capacity coming online. And as a follow-up to that, what's your view on Biden's comments with regards to investigating the beef market for price fixing?

A - Tang David {BIO 18672578 <GO>}

Regarding 2022, it appears based on USDA data that there continues to be plenty of cattle available. As we forecast in 2022, our expectation is total cattle numbers would be declined marginally, maybe around a 1% decline from 2021. Don't forget, 2021, we were dealing with the backlog of cattle that didn't get killed in Q2 of '20, so still plenty of cattle. The industry continues to operate at full capacity. There are more cattle available each week than we can process as an industry and that will continue going into 2022.

Although we'll have fewer cattle and the margins won't be quite as robust as they are this year, but certainly we expect that they will remain well above the historical averages. In terms of new capacity coming on, there's no new capacity that will affect our industry at least for the next two to three years. If somebody decided to build a plant today, it would be three years before they're processed in any cattle. So, no new capacity there.

The investigation is going on in Washington, various segments of our industry. We will continue, we're cooperating fully with any request for information. We don't expect anything to come of that or any process that would change the structure of the industry.

Q - Analyst

And on the demand side?

A - Tang David {BIO 18672578 <GO>}

Demand remains very strong. One thing we're seeing is as consumers started going back to restaurants, when they do eat at home, they're eating a higher quality cut of beef rather than ground beef. They are buying more expensive items that really drive our margins up. So that continues to be the case as we're seeing all segments, retail, food service or export markets, the demand is very, very good and we don't see anything changing on that front in the near future.

Q - Analyst

Okay. Thank you.

Operator

Our next question comes from Nick Ivanov with PGIM. Please go ahead sir.

Q - Nick Ivanov {BIO 2459687 <GO>}

Hi, thank you. Actually, my question has been answered. My question was about cattle supply in 2022 in the US because I've seen, as you mentioned, the USDA data for September where cattle placement have been down. They are at 97% versus expected 101.4%. And you stated that your expectation for cattle supply in the US will be probably only 1% down. I'm also looking at the price of cattle year-on-year change is 21% up, 2021 versus 2020. So I see a mirror image in the US, obviously to Brazil. In Brazil, they are always coming down, prices for arroba. But beef is dropping more, the prices, the final price. In the US, the opposite. And I wonder whether 2022 will be the year when the two will kind of catch with each other and margins will, as you mentioned, be weaker but much weaker than you expect. What's the reason for that? Thank you.

A - Tang David {BIO 18672578 <GO>}

Yes, the increase or the decrease in cattle supply will drive prices higher somewhat. We expect prices in 2022 to be somewhere around 8% higher than they are in 2021 on average. The cutout values will remain very high, and because of that, we're going to maintain very strong margins, but not as high as we experienced here in 2021.

Q - Nick Ivanov {BIO 2459687 <GO>}

Okay. Thank you.

Operator

This concludes today's question-and-answer session. And this concludes Marfrig Global Foods SA conference call for today. Thank you very much for your participation and have a nice day.