Q3 2016 Earnings Call

Company Participants

- André Nogueira de Souza, President & Chief Executive Officer
- Jeremiah Alphonsus O'Callaghan, Director of Investor Relations
- Wesley Mendonça Batista, Chief Executive Officer of the Global Business

Other Participants

- Alexander Robarts, Analyst
- Bryan C. Hunt, Analyst
- Farha Aslam, Analyst
- Jose J. Yordan, Analyst
- Lauren Torres, Analyst
- Luca Cipiccia, Analyst
- Pedro Leduc, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning, everyone, and welcome to JBS Conference Call. During this call, we will present and analyze the results for the third quarter of 2016. As requested by JBS, this event is being recorded. The recording will be available this afternoon and can be accessed by following the instructions posted on company's website at www.jbs.com.pr/ir.

Taking part on this call, we have Mr. Wesley Batista, Global CEO of JBS; Mr. André Nogueira, President of JBS U.S.A.; Mr. Gilberto Tomazoni, President of Global Operations; Mr. Russ Colaco, CFO of JBS Foods International; and Mr. Jerry O'Callaghan, Investor Relations Officer.

Now, I'll turn the conference over to Mr. Wesley Batista. Please go ahead, sir.

Wesley Mendonça Batista {BIO 15243148 <GO>}

Thank you. Good morning to all. Thank you for joining us in our third quarter earnings call this morning. So, I will give you a overview about the performance of each part of our business in the third quarter and as well the outlook in each business unit going forward.

Starting with Pilgrim's Pride that already reported their third quarter results. So, when we look Pilgrim's Pride, this is the third year that we are operating Pilgrim's Pride in a double-digit type of margin.

We have been doing a lot of things inside of Pilgrim's. We completely changed our portfolio. Today, we have a very, very good and very well set portfolio that is giving us a differentiation for our operation. We are satisfied where we are, but we still have a lot of work to capture more benefit from our internal operation. Bill and the whole team is really focused on getting more results inside of each part of our business. When we look the dynamic of the chicken industry, we are very positive going forward. When we see demand that is still growing around the globe, we see grain price favor – favored.

So, overall, we are satisfied where we are, but we think we even can deliver stronger results going forward. I'm very positive when I look ahead for the fourth quarter and even beyond to the fourth quarter, in 2017, I definitely think we're going to be collecting good results from Pilgrim's Pride.

So, moving to Pork, we have a very strong third quarter in our Pork business, saw 14% margin. I think it's important to re-emphasize after our last acquisition, our Pork business today is a $5.5 billion business that can deliver over $500 million EBITDA and is going to deliver around this number. Again, we are also very positive on the outlook for our Pork business. When we see today, U.S. is the most competitive market to produce hogs and to produce pork meat is very competitive. Europe is declining their production. China is importing more and more. U.S. pork price today is in a very, very competitive place. Even we delivered this result, with 14% margin, we strongly believe that our Pork business is going to keep delivering very strong margins going forward.

This business has been a stable business over the last years. The integration of our last acquisition has been very good. We have been able to integrate this business very, very well. Actually, capturing more synergies than actually we anticipate in the beginning. Our team is doing an outstanding job in this division. And with all the dynamics that's going on in the market around the world, this business, we are very confident that, in 2017, is going to be a double-digit margin business, and it's going to be very positive for JBS.

So, moving to our North America Beef business, actually, includes Australia in the results of our North America Beef business. We have been discussing for a while in terms of the cycle of this business, and definitely, we believe, we got in a positive cycle now. We had a good quarter, 5% margin. A lot of things is going on around this business, so we are seeing more cattle available in the U.S. Import, U.S. import is declining, so actually has declined this year, year-to-date 14% import. And in the other hand, export is growing. The U.S. market grew 8.5% this year, export, that business is also very positive.

Inside of JBS, our export growth is over 30% this year compared to last year. So, the combination of market available, less import and more export is definitely giving a very positive dynamic for the U.S. Beef business now. We are very satisfied and very well organized internally. We did some change in our Beef business in North America in the past 12 months, and we are very satisfied where we are today. We believe we have a very strong structure and very strong team to be able to capture all the benefits that we can capture in our Beef business in the U.S.

Looking forward, we are very positive about the industry and we are positive about our capability to deliver strong results in these coming years. I'm very positive. We are already in the mid of the fourth quarter, and the fourth quarter is performing even stronger than the third quarter that is very positive. And I see 2017 that we are going to be able to deliver margin in the top of the range. When we say top of the range, we mean 5% in our analysis, in our projections. We are going to shoot for higher than this top of the range, and we think we have a very strong business and a very strong chance that we can even deliver above to the top of the range in terms of margin.

So, moving to Australia, the Australian beef industry reduced a lot the amount of meat available due to the fact that we are seeing less cattle available to be processed. This is positive mid-term and long-term that we are seeing a rebuild in the herd in Australia. But also this is benefiting U.S. because Australia meat is more expensive, so U.S. is importing less meat from Australia. So, when we see for JBS (9:15) very positive.

And on top of that, we are very satisfied with our Primo acquisition in Australia. Adding the Primo business inside of Australian business changed dramatically our portfolio there, and this is very beneficial and we are seeing better margins in the third quarter already, comparing to the first quarter and the second quarter, the performance was quite weak in Australia. And we believe the worst got behind in our Australian business, and we are going to see better performance going forward overall there.

So, Moy Park, we acquired Moy Park just a year ago. We have been able to improve the margins in Moy Park. Still more work to be done. We are looking to run this business in a double-digits margin and we believe we can do that. It's going to take some time for us to get there, but definitely we believe this business we should be able to run in a double-digits margin. We are well positioned in the UK market and very satisfied with our team there. And we believe Moy Park is going to keep improving the margins and the results going forward.

Now, moving to South America and just talking more about Brazil, we are facing some challenged moments in the Brazilian market. Seara specifically is suffering three main things. The appreciation of the real that was around BRL 4 in the end of last year, and now, it's around BRL 3.23, BRL 3.30. Our Seara business is about 45% export. So, this has been putting pressure in the export margin due to the fact that the real appreciates a lot.

And also, corn price in Brazil this year almost doubled the price comparing to last year. And on top of that, the chicken international sales price was low due to the fact that the real went to BRL 4 last year and the industry increased volume in the international market last year and put pressure in prices. So, all these three things is putting challenge on the performance of Seara. We believe that the worst just got behind us in the end of this third quarter, basically, because we're already seeing a lower corn price and a recovery in international sales price and we believe this is going to be progressively improving grain price and international sales price.

So, we are positive for 2017. We believe that Seara is going to be back in a normal margin level. We call normal margin level 15% margin and we believe during 2015, we are going to be able to...

Jeremiah Alphonsus O'Callaghan {BIO 19817115 <GO>}

2017.

Wesley Mendonça Batista {BIO 15243148 <GO>}

...2017, sorry – we are going to be able to put margin back where margin was before in Seara.

Moving to our beef business and to finalize our business units also is getting pressure in terms of margin. We are seeing contraction in our margin in the beef business and basically, the main – pretty much the same as I said in Seara. Exchange rate is hurting our export beef business and as well international sales price that was lower and is recovering prices in the international market.

So, we – again, we have a very competitive beef business in Brazil. And we believe this business also is going to be back to a normal margin level in 2017. We are very confident that, overall, in South America and in Brazil, in the Brazilian market, things – overall, the economy, all the difficulty in the Brazilian economy also is getting behind. And overall, the mood is much better in the Brazilian market and this, of course, is going to benefit our business overall in South America.

So, our biggest focus now on and during 2017 is going to be cash generation. We believe we are going to be able to generate a strong amount of cash and we are going to be able to deleverage our balance sheet. Only to remind everybody, so we did a lot of acquisition in the last 18 months. We acquired Moy Park in the UK, we acquired...

Jeremiah Alphonsus O'Callaghan {BIO 19817115 <GO>}

Primo.

Wesley Mendonça Batista {BIO 15243148 <GO>}

...Primo in Australia, the Cargill pork business in the U.S. and the chicken business in Mexico and in Brazil. So, we did a lot of acquisition, over $5 billion in acquisition in the last 18 months.

And now, we are very focused on generating cash and deleveraging our balance sheet. We are very optimist. When we look JBS overall, we definitely – we think we built a unique platform globally in terms of our diversification in segments and as well our geographic diversification. So, we are very optimist when we look each part of our business. And we are confident that we are going to have a very, very strong 2017.

So, with that, I'm going to stop here and pass to Jerry to go through the numbers and the each business unit performance as well. Thank you.

Jeremiah Alphonsus O'Callaghan {BIO 19817115 <GO>}

Thank you, Wesley. Thank you, and good morning to everybody. As I go through these numbers, I am going to make reference to our presentation, which is on our website and available, and I will mention page numbers to facilitate people accompanying of my conversation here.

So, starting with page three in our presentation, the consolidated highlights for the third quarter, starting with net sales. Net sales declined by just over 4% to BRL 41.16 billion from just over BRL 43 billion in the same time last year, always bearing in mind the FX associated with these numbers. Gross profit declined from BRL 6.24 billion in 2015 to BRL 5.34 billion this year, a decline of just over 14% with gross profit margin declining from 14.5% to 13% in the period.

Moving on to the next page and speaking of EBITDA and of net income. EBITDA declined to BRL 3.14 billion, a decline of 18% from BRL 3.83 billion in 2015. EBITDA margin declined from 8.9% to 7.6%. Net income in this quarter – in this third quarter 2016 was BRL 887 million or BRL 0.32 per share, a decline of 74% when compared with the same quarter in 2015 where net income was BRL 3.44 billion or BRL 1.19 per share.

Moving on to cash flow. Operating cash flow in this third quarter 2016 was BRL 1.83 billion as compared with just over BRL 3 billion in the same period last year. Free cash flow in this quarter was positive; BRL 782 million against a negative BRL 8.5 billion in the same period in 2015.

Speaking of net debt and leverage a little bit and moving on to page six in our presentation. Leverage, as Wesley mentioned, has moved up. It's 4.32 times net-debt-to-EBITDA at the end of the third quarter. Net debt actually declined from BRL 49.2 billion to BRL 48.8 billion when compared with the previous quarter – with the second quarter in 2016. But leverage moved up because of the lesser EBITDA in the third quarter of 2016 when compared with 2015. Our debt maturity is also on page six. More than one-third of our debt maturing after 2021.

Having a little bit of a closer look at our debt profile on page seven of our presentation, the breakdown by currency firstly. Almost 92% is in U.S. dollars and just over 8% in reais. The cost per currency just over 5% in dollars and 14.45% in reais.

By source, almost 60% coming from commercial banks and 40% coming from the debt capital market. And then, the breakdown by company, it's almost 47% at JBS SA, that's parent, 44% at JBS USA and the difference at Seara here in Brazil.

Short-term debt is at 31% of the total debt, which is similar to where it has been in previous quarters and we always highlight the fact that the major portion of short-term debt is trade finance and that's because of the volume of exports that we have out of

Brazil, by far the cheapest source of financing in Brazil and for that reason we have that portion of our short-term debt in trade finance.

Now speaking of the business units and moving on to page nine in our presentation, Seara net revenue was down 8.6% to BRL 4.57 billion against just over BRL 5 billion in the same quarter last year. EBITDA, as Wesley mentioned, declined quite a bit in this business unit. EBITDA was down to BRL 334 million against just over BRL 1 billion in the same period last year. EBITDA margin declined from 20.7% to 7.3%.

In fact, we had growth in our domestic sales due to an increase in sales prices and in volumes domestically and what really jeopardized this business was the FX variation as again we mentioned earlier and the cost of grains, which impacted the quarter quite a bit, although we do see an improvement in the input cost of feed.

We also saw an improvement in service levels and a growth in our customer base in Brazil reaching 143,000 active customers in the domestic market in Brazil. We also introduced the Seara Gourmet line and we also innovated with an organic line in Brazil under the Seara DaGranja brand.

Moving on to our Mercosul business, page 10 in our presentation. Again, revenues declined here. Again, FX is a factor in the reduced revenues from BRL 7.14 billion in 2015 to BRL 6.78 billion, a decline of 5% in revenue. EBITDA down from BRL 640 million to BRL 340 million. EBITDA margin from a 9% margin at this time last year to a 5% margin this year. We saw a reduction in the revenue primarily due to a decrease in export volumes in reais and this was partially offset by an increase in prices and volume sold in the domestic market again. We had higher raw material costs and, again, the FX variation.

And in this business unit, we inaugurated right at the end of the third quarter a new beef processing facility in Paraguay, which will increase our capacity in that country by 75%. And I'd like to highlight the fact that the fastest growing herd in South America is actually in Paraguay.

Now, moving on to our North American business, JBS USA Beef, which includes Canada and Australia. And in dollars here, we have revenues of $5.36 billion in the quarter against $5.75 billion in the same quarter last year. EBITDA increased from $197 million to $270 million, with EBITDA margin going from 3.4% to 5%. We had a good increase in cattle availability in the U.S. We had a decrease in revenue due to a decline in beef prices in the U.S. market as a result of the decline in cattle prices. And we had a growth of – and Wesley mentioned, there's a growth of over 30% in our U.S. exports due to strong demand coming particularly out of the Asian market.

Our Pork business in the U.S., JBS USA Pork, we had a big increase in revenue due to the integration of the acquired assets at the end of last year. Revenues growing from $785 million in the third quarter of 2015 to $1.35 billion in 2016. EBITDA went from $48 million to $190 million, with an EBITDA margin going from 6.2% to 14%. Primarily, we had higher export prices, again, boosted by a strong demand coming particularly out of Asia and an improvement in efficiencies with an increase in productivity and the capturing of the synergies from the integration of the assets we acquired at the end of last year.

JBS USA Chicken, Pilgrim's Pride, which already reported its numbers. So, briefly, just over $2 billion in sales, down from $2.1 billion in the same quarter last year. EBITDA was $211 million in the period against $274 million in the same quarter last year, with an EBITDA margin declining from 13% to 10.4%. We had lower sales due to a reduction in volume sold of processed products. We had a decline in sales when we convert into dollars in Mexico due to the depreciation of the Mexican peso, which was partially compensated by higher prices and volumes sold domestically in Mexico. EBITDA was impacted by a lower capacity utilization at one of our largest prepared foods plant as the company modernizes that facility.

JBS Europe, Moy Park basically, and now in pounds sterling. Revenues increased marginally to £352 million from £350 million in the same quarter last year. EBITDA went from £26.8 million to £31.4 million, with EBITDA margin increasing from 7.6% to 8.9%. We had a decrease in volumes of prepared products sold in the domestic market, which was offset by an increase in prices in the international market. And we also had a growth in our exports from our Moy Park business. We also saw an improvement in margin results, resulting from synergies to increase operational efficiencies implemented by the management after the acquisition in September of 2015.

That concludes our remarks about our business units. So, thank you very much. And we now open for Q&A. Thank you.

Q&A

Operator

Our first question comes from Farha Aslam, Stephens.

Q - Farha Aslam {BIO 6151888 <GO>}

Hi. Good morning.

A - Wesley Mendonça Batista {BIO 15243148 <GO>}

Hi, Farha.

A - Jeremiah Alphonsus O'Callaghan {BIO 19817115 <GO>}

Hi, Farha.

Q - Farha Aslam {BIO 6151888 <GO>}

Two questions, both longer term in nature. The first one is on your Pork business. Your Pork business performed very well in the quarter, but in the U.S. you are having four to five new processing facilities that are coming in line over the next three to four years. How are you thinking about your Pork profitability over that period of time? And how are you preparing your business in light of the increased capacity in the industry?

A - Wesley Mendonça Batista {BIO 15243148 <GO>}

André, can you answer Farha's question?

A - André Nogueira de Souza {BIO 20244486 <GO>}

Yes. Good morning, Farha. So far there is two important and sizable new pork plants under construction right now. Another one is pretty small. I think that the growth in the hog availability will be enough to supply this plant. And I think that the most important thing is the global demand, how would be the global export and I think that you see what's going on right now is U.S. is recovering market share in the important markets for U.S.

I think that you have the reduction in the (27:57) numbers in China. You have the reduction in production in Europe. In U.S., pork price is very competitive on a global basis. So, as long as we continue to grow in export, and that's what is happening now, and I think that we have a long way to go to recover all the export market that we lost during the PEDV, the virus in U.S.

I think that we expect that the profitability in the business will continue at a very healthy level. What we're doing is the same that we have been doing the last several years. I think that's invest in our operation, make sure that our operation, our plants work in a very efficient way. We have been outperforming the industry for a very long time now. It's a very health gap between ourselves and the industry, create successful relationships, differentiate our products to make sure that each day you are (29:00) that our products deserve a premium and have the preference from the customer. That's what we're doing and are being very successful doing that.

If you see the level that we sell our products, the quality of our products both in the domestic and in the international market, we are clear different from most of our competitors. And that's the way that we prepare ourselves from that, and I think that the global demand and I think that we're producing more right now and demand continue to be in a very good level on a global basis.

A - Wesley Mendonça Batista {BIO 15243148 <GO>}

Farha, just to add one more comment on André's comments. So, on top of everything that André already said, in our view, the ramp-up of these new projects, these new plants in U.S. is going to take much more time and it's not going to be fast like was before due to labor constraints. We believe that this is going to take longer than before and even than the market is anticipating how this ramp-up is going to happen. And on top of the competitiveness in terms of how U.S. can produce hogs today, we believe the market is going to demand – demand is going to be there to absorb more production from U.S.

Q - Farha Aslam {BIO 6151888 <GO>}

That's helpful. And perhaps just one follow-up. Recently, we've had a big political change in the U.S. with Trump being elected. And one of the campaign promises is increased tariffs of products from Mexico, in particular, and China. Are you concerned about a trade war brewing and that impacting U.S. protein exports?

A - Wesley Mendonça Batista {BIO 15243148 <GO>}

Well, Farha, we are not concerned about any change in government. At the end of the day, we are going to compete in the market with everyone else and we are very focused to be very good in what we are doing, in what we do and we are not concerned at all about any change in government.

Q - Farha Aslam {BIO 6151888 <GO>}

Okay. Thank you.

A - Wesley Mendonça Batista {BIO 15243148 <GO>}

Thank you.

Operator

The next question comes from Luca Cipiccia, Goldman Sachs.

Q - Luca Cipiccia {BIO 6914452 <GO>}

Hi. Good morning. Thanks for taking my questions. I wanted to ask two things. One is if you can comment on the current and expected competitive environment for Seara in Brazil. Maybe as you go into the fourth quarter, what type of strategy, commercial initiatives you're putting in place, value relative to mix? We're seeing a lot of trading down. We're seeing a lot of dynamics. Maybe what type of competitive environment do you think we will see in the fourth quarter, how disciplined or not as well as looking out in 2017?

And then secondly, on the beef recovery, U.S. Beef division. Can you quantify given the swings in currency and relative performance what is the contribution of Australia now and the net profitability of that unit combining Beef and Primo, was it higher or lower than the consolidated margin that you reported? That would be my questions. Thank you.

A - Wesley Mendonça Batista {BIO 15243148 <GO>}

Look, I'm going to take the first part of your question about Seara. Look, we have been working since grain price went almost through the roof in Brazil this year and also when the exchange rate dropped so much to recover price in both markets in the international market and we have been able to get some price increase. And also in the domestic market, we are working to reposition each (33:23) price given the fact that the cost is different this year comparing to last year. We are going to keep working on that. We have planned to pass more price in the international market as well in the domestic market.

So, the fourth quarter is usually a better quarter overall. You have Christmas that we sell a lot of products and we sell a good amount of products through the Christmas period. And we are going to have a better fourth quarter and we are more positive for 2017 due to the fact that we are seeing corn price declining and as well export and domestic price picking up. And we saw the market quite challenged in the third quarter, but we have seen a better outlook already for 2017. So, we are going to be focused.

In terms of market trending down, actually, we are working in the opposite way. We just launched a product line by the name Seara Gourmet and we are actually pushing to trend up our portfolio and we have been able in some extent, even with all the challenge in the Brazilian economy, we have been able to hold our mix without seeing a big trending down due to these initiatives that we are doing, launching like the Seara Gourmet and the organic chicken. And we believe this is going to keep happening.

So, I'm going to pass it to André to comment about your question on beef. André, please?

A - André Nogueira de Souza {BIO 20244486 <GO>}

So, Luca, when you look our segments inside of the beef U.S. that we have Australia, we have Canada, we have the regional business more of a cow business. And we have the fat – the best performer in the quarter was the fat business. The others performed in a similar level, but a little bit less into the Australia.

And of course, inside of Australia, Primo was the highest performance and the lambing business in the South was the lowest performance. It is kind of the seasonal low for the lamb anyway. We are going to see a better performance in Australia in the fourth quarter compared to the third quarter because it's the time that that business will improve, but Primo has performed in a much better level than the average of Australia, of course. But the best performance in the quarter was the fat business in U.S. The gap between the businesses are much smaller than it was in the first quarter and the second quarter.

Q - Luca Cipiccia {BIO 6914452 <GO>}

Okay. Very clear. Thank you.

Operator

The next question comes from Bryan Hunt, Wells Fargo.

Q - Bryan C. Hunt {BIO 1530288 <GO>}

Thank you for your time this morning.

A - Wesley Mendonça Batista {BIO 15243148 <GO>}

Thank you, Bryan.

Q - Bryan C. Hunt {BIO 1530288 <GO>}

Yeah. You gave us a lot of good color with regards to each of the divisions in terms of margin prospects or whether you felt like Seara and the Australia business was bottoming out. Do you feel like this is peak leverage for the company at the current time, and what type of leverage target would you have for 2017 given the earnings outlook?

A - Wesley Mendonça Batista {BIO 15243148 <GO>}

Yeah. We see leverage in the peak now in the end of the third quarter. If you look our LTM results by each quarter, fourth quarter – first quarter 2016. So, the quarters that we are going to replace is weaker, then we definitely believe we are going to deliver it. So, only due to the fact that we are going to replace strong quarters against your lower quarters is going to improve our leverage.

And on top of that, we are very confident the amount of cash that we are going to be able to generate going forward. And on top of that, we have been spending pretty strong amount of money inside of our business. In the last many years, we have been acquiring these businesses. Some of these businesses have been not performing well and was a pretty big need in terms of capital in a lot of business that we acquired.

And when we look forward, the need in terms of investment is going to be smaller because all the plants and all the assets is in a very, very good shape now due to the amount of money that we put over the past many years. So, the combination of strong amount of free cash flow and strong results, yeah, we think that this is the peak of our leverage, and it is going to decline quarter-by-quarter, and we believe we are going to see this leverage much lower than it is now by the end of 2017. I'm not going to go specifically about where the leverage is going to be. We are closing to finalize all of our projections for 2017, but it's going to decline substantially.

Q - Bryan C. Hunt {BIO 1530288 <GO>}

My next question is when you look at your last couple of acquisitions like Moy Park and the Cargill pork acquisition, just isolating those two, can you talk about the synergies that you've garnered so far and how much maybe left for both of those businesses?

A - Wesley Mendonça Batista {BIO 15243148 <GO>}

Yeah, sure. André, can you go on the Cargill acquisition?

A - André Nogueira de Souza {BIO 20244486 <GO>}

Yeah. Bryan, you probably remember when we announced the acquisitions that the synergy was around $100 million. Then after we assumed the plants, we update the number for $150 million. And that's what we believe that is the possibility of the total synergies. We are now – we just complete one year that we did this acquisition. We already captured over $100 million, so we have $50 million more to go, and this is more in the EU (40:02) side and a little bit to the sales side.

The cost side of the equation is pretty much done, but we have a little bit more opportunity in the sales side. But, again, we are very proud of the work that the team has done here in less than a year. (40:18) four or five months that this was run absolutely inside of our systems, IT, form of operation, form of leadership with integrated team. We did that in four or five months. And now it's a year we captured most of the synergies, still some to go that we did investment as well as we said in the two plants to capture (40:43) and we believe that we'll capture that in the next six months.

A - Wesley Mendonça Batista {BIO 15243148 <GO>}

So, on Moy Park, so if you look the historical Moy Park results comparing to our latest quarters, we have been really able to improve 1.5% margin in Moy Park and we believe still 2% more to go and we are well on track to capture this.

Q - Bryan C. Hunt {BIO 1530288 <GO>}

All right. And my last question, I know you all made a significant investment in Scott Technology and I believe you've been testing some robotics in Greeley. You've touched on – maybe some of your competitors would have a tough time getting access to labor with their new plant constructions. Can you talk about the initial test of Scott Technology and what kind of cost savings you may be seeing from using robotics in either hog processing and/or on the beef side? And that's it for me. I appreciate your time.

A - Wesley Mendonça Batista {BIO 15243148 <GO>}

André?

A - André Nogueira de Souza {BIO 20244486 <GO>}

So, first, the investments (41:55) are relatively small investments, around $40 million to buy 51% of the company and control the company. But it's too early, Bryan, to see any big impact. Of course, we have in our lamb plants in Australia full robot system of cut the carcass and deboning. We are implementing this in a second lamb plant. We're working with Scott in several different areas. One is in the safety.

They have a – they're great in developing the last few years a very good season that improved the safety in the saws that we have in the plant dramatically. And we're implementing this in a lot of our plants. That's a big savings in the cost of many safety issue that we have in the plant. But to expand, to elaborate about possible savings in the pork and in the beef business, it's too early for that. We're working on that, but too early to anticipate any number.

Q - Bryan C. Hunt {BIO 1530288 <GO>}

Thank you so much. I appreciate your time.

A - Wesley Mendonça Batista {BIO 15243148 <GO>}

Thank you.

Operator

The next question comes from Alex Robarts, Citigroup.

Q - Alexander Robarts {BIO 1499637 <GO>}

Yeah. Hi, everybody. Thanks for taking the question.

A - Wesley Mendonça Batista {BIO 15243148 <GO>}

Hi, Alex.

Q - Alexander Robarts {BIO 1499637 <GO>}

Hi. Listen, I was keen to actually go back and see if we could drill down into some of the factors that you've described about Beef USA that – we are seeing finally this recovery both in the cycle, but also operationally with you, guys, as you've given us interesting guidance also for fourth quarter and next year. So, around Beef USA, it was just kind of three related questions. You mentioned first in your prepared remarks that in the last 12 months you've – I guess, you've (44:08) executed some changes in that business.

And I was wondering if there was one or two that you could highlight that you think was particularly relevant in getting us up into this – a little higher than what we had expected margin in the third quarter in Beef USA in kind of this very high conviction guidance that you've got over the next few quarters?

And secondly, it seems Australia had kind of been a drag in the first half of the year on Beef USA. You've outlined the case that Primo had been helping Australia, and I'm wondering around Primo, is it safe to think that this can be a sustainable double-digit margin business and can it be scalable and exportable the brand to – and products to other of your – other markets that you've got in the JBS platform?

And the 5% – this is the third bit, the 5% kind of higher end of the range – margin guidance for Beef USA next year, what kind of just industry or I should say the cattle price range are you thinking about for next year as you set out that target? So, kind of three related questions on the Beef USA margin recovery outlook. Thanks very much.

A - Wesley Mendonça Batista {BIO 15243148 <GO>}

Thank you. André, can you answer the question, please?

A - André Nogueira de Souza {BIO 20244486 <GO>}

Yes. So, Alex, the first, you asked about the change. The most important change that we did more than 12 months ago, we used to run the beef business in the U.S. as one business. We've separated the beef business here in two businesses, that's the fat business, the regional (46:02) business. And we're started to collecting the benefits of that with more focus both in the operation and in the sales side that they are different businesses, they have different dynamics. And it was the right move, we had some pain initially when we did the move, separate the teams, create the folks (46:26), create the ownership, set up the team, but we're started to collect.

Again, we had a relative in terms of operation, fourth quarter last year was weak, the first quarter of this year was weak, below our expectation. It's started to improve in the second quarter and improve a lot in the third quarter. We're not there yet. We have space to continue to improve and we'll work on that. But for sure, if you know that we are in the right direction. But the most important change was the set up of the business and divide the business in two teams and have the right people in place.

About Australia, so just about Primo, no question, we bought the business to be a double-digit business and the direction for us is in the high double-digits, not in the low point of that. So (47:21) very confident. Again, the team is in place there. Since we bought the business, we have a new head of the business, a new leader for sales, a new leader of preparation (47:32), and we're starting to collect the benefits of the team in place and the structure. So, absolutely no question, we'll be very unhappy if this business is run in the next one year, two years below – anything below 15%. And we believe that's between 15%, 20% margin business, the Primo business there.

Well, the cattle price, I think that we're back to the normal level, and we're going back to the normal level of cattle price in U.S., historical price. So if you look at how well the historical price before the drought and before the big reduction in herd that we had, so if you go back in 2009, 2010 and 2011, more in the normal cycle, that started to change dramatically in 2012, 2013, 2014 and 2015. If we go back then 2015, $85 and $100 (48:35) and that's probably what we're going to see in the next few years, between $85 and $100 (48:40).

Q - Alexander Robarts {BIO 1499637 <GO>}

Okay. Fair enough. Very clear. And just, I mean, is Primo something, André, that you feel will just be built in Oceania, or is it something that you could perhaps start exporting or they're going to pretty much remain a domestic business there in Oceania?

A - André Nogueira de Souza {BIO 20244486 <GO>}

Yeah. Again, the business in Australia and New Zealand, we already have some level of export. We believe that's possible. It used to go a lot, but we need to do a lot of work on that. We are not there yet. But yes, we believe that this is a business that can have an important presence in Asia.

Q - Alexander Robarts {BIO 1499637 <GO>}

Okay. Fair enough. Thank you.

Operator

The next question comes from Lauren Torres, UBS.

Q - Lauren Torres {BIO 7323680 <GO>}

Yes. Hi. Good morning, everyone.

A - Wesley Mendonça Batista {BIO 15243148 <GO>}

Hi, Lauren.

A - Jeremiah Alphonsus O'Callaghan {BIO 19817115 <GO>}

Hi, Lauren.

Q - Lauren Torres {BIO 7323680 <GO>}

Hi. I just have a follow up on Seara. I appreciate the level of detail that you're giving with respect to the pressures that you're seeing and it does appear, going into next year, a lot of these pressures will abate, so we'll see recovery in margins. I guess, I just have a bigger picture question on the margin contraction that we've seen this year. It seems that being the branded business that you have, there should have been less variability in margins. Meaning this 21% margin a year ago going down to 7% seemed quite of a wide drop and once again having some pricing power in good brands under this platform, maybe that drop was more than you thought.

So, I guess, just thinking, even though with the environment improving next year, if you feel there's kind of been lessons learned about maintaining a better more sustainable margin even in light of market or industry pressure.

A - Wesley Mendonça Batista {BIO 15243148 <GO>}

Yeah. We agree, Lauren. Actually, the margin declined more than we anticipated in the beginning of this year. The biggest pressure came from corn more than anything else, even though the real appreciate a lot, but we were following what's going on and was – in some extent, was in the account that the real was going to appreciate, but with corn going from BRL 25 per bag to BRL 45, or even to BRL 50 per bag was something that I think no one anticipated that this was going to happen. And the reality, the industry was not able to pass price in the same velocity and in the same magnitude that we saw in pork and (51:38) pressure in terms of cost.

So, definitely, it's a lot of lessons for us that we learned from this big change in the market, and I think the industry is going to be much well prepared for next year to be able to recover margin. We are working very focused on improving our portfolio, and we have been able to do that. We are well satisfied. The work that we are doing around the Seara brand, the expansion that we are seeing in our customer base, in all these fronts, we are very satisfied.

But in reality, the industry was not able, and we are part of the industry to pass the pressure in cost in the same magnitude in the same velocity, and again, I think we are just going to start 2017 in a much positive scenario when we look forward.

A - Jeremiah Alphonsus O'Callaghan {BIO 19817115 <GO>}

Just to add to that, we had the appreciation of the real from about BRL 4 to about BRL 3.20 in the middle of the year, so that was quite a rapid appreciation adding that on to the corn issue. And just projecting for 2017, we just sort of look at the most recent projections for corn production in Brazil. I think it's kind of interesting to have this on your radar as well, Lauren. And the early harvest, which is in January and February now in 2017, we have a projected increase of about 7.5% in this harvest when compared with the harvest of early 2016.

But more importantly, in the second harvest, which we call in Portuguese, the safrinha, which comes out in the middle of the year, projections are indicating that we will have an increase in production of corn of close to 40% in the middle of the year. So, we should have a bumper harvest. Climate has been favorable up until now and that would give us a completely different dynamic in terms of feed and feed costs for 2017.

Q - Lauren Torres {BIO 7323680 <GO>}

Okay. And that's very helpful. If I could just ask as a follow-up to that on Seara, you mentioned that there are or there is room for further pricing going into next year. And I'm curious to get your perspective on the consumer in Brazil. We're hearing about maybe a gradual recovery or at least a more stable environment, but are you seeing this and do you feel there is room for further pricing in light of how the consumer's behaving right now? Is it something that can be well absorbed, or we should be cautious going into next year?

A - Wesley Mendonça Batista {BIO 15243148 <GO>}

Look, we believe that the worst on consumer's confidence and as well in consumer's ability to spend on food is definitely is behind. We believe that we are just starting in the last three months a more positive sentiment from consumers, and we are slowly seeing this in our business overall that demand is starting to, not in a big way, but is starting to be better and we believe that this is going to keep improving in Brazil. And we are very focused on improving our portfolio and our mix.

We just launched the Seara Gourmet and it's going very, very well. And all these initiatives, is – to have a better portfolio for us to be able to capture better margins. And we believe that consumers is going to be there to buy very, very good products with a good value proposition, even we are trying and working to push up the trend.

Q - Lauren Torres {BIO 7323680 <GO>}

Very good. Thank you.

A - Wesley Mendonça Batista {BIO 15243148 <GO>}

Thank you.

Operator

The next question comes from Jose Yordan, Deutsche Bank.

Q - Jose J. Yordan {BIO 1496398 <GO>}

Hi. Good morning, everybody. My question is about PPC. I'm just wondering to what extent this modernization of the prepared food plant is – what role it's playing in your sales declines? Because, obviously, in the U.S., it's been now, I think, six quarters of sales declines. So, I'm wondering if you can tell us when this stuff's becoming a factor and whatever other factors are causing it, which are namely perhaps substitution from lower beef prices and just all that. So, it'd be great to get a little color on when you see sales growing again, and what a normalized sort of production and sales growth number we should be looking at?

A - Wesley Mendonça Batista {BIO 15243148 <GO>}

André.

A - André Nogueira de Souza {BIO 20244486 <GO>}

Well, first, sales overall, you have the impact of the sales price for the whole industry. That's has been affect not only for a few but for the whole industry. Specifically for Pilgrim's, yes, volume in the prepared foods was affected in the last – especially in the last two quarters. And on top of that, we did and we are doing some transformation some plants. We have transformed one of our plants in organic plant (57:38). We have transformed another plant from (57:42) to a better mix for a specific customer that impacted the last quarter and will impact the fourth quarter a little bit. So it's a combination of sales price for the overall industry and volume in doing the transformation that we are doing inside of the company.

(58:02) expect that the plant to be in full run, (58:06) will be in the full run at the end of the first quarter and the transformation that we did in the other three plants will be done and will be run in the first quarter. So, in terms of volume, we will have a better position in volume in the first quarter.

In terms of trade down or trade up, demand in retail continues to be very strong for chicken. Despite of being very good in beef and pork too, but chicken demand in retail is still in a very, very good position, so we don't see any impact of any trade down. In fact, if you look the break up the consumption in U.S. have been growing in the last several years and we expect that to continue to grow.

Q - Jose J. Yordan {BIO 1496398 <GO>}

Okay. That makes sense. Thank you.

A - Wesley Mendonça Batista {BIO 15243148 <GO>}

Thank you, Jose.

Operator

The next question comes from Pedro Leduc, JPMorgan.

Q - Pedro Leduc {BIO 16665775 <GO>}

Good morning. Thank you for the question and the call.

A - Wesley Mendonça Batista {BIO 15243148 <GO>}

Sure.

Q - Pedro Leduc {BIO 16665775 <GO>}

In respect to the U.S. operations and then across the board, you've been mentioning very strong exports helping your profitability. In this respect, we've seen, let's say, in the last few weeks, we saw dollar strengthening or other currencies moving a lot in respect to the dollar. So, we're wondering if you see room perhaps to retain your dollar pricing or how you're seeing clients behave in that respect? And then the second, movement, we know that Mexico is a relevant source of U.S. protein exports, right? 20% of pork and poultry and slightly less than that in beef. You operate on both sides of the border, obviously, and so, we're wondering if you can help us understand how you're perhaps preparing for a trade shift, if at all? And if it were to happen, how do you believe it can affect your operations outside of the U.S. as you re-route these former Mexican volumes, again, if it were to happen? Thank you.

A - Wesley Mendonça Batista {BIO 15243148 <GO>}

So, Pedro, I'm going to ask (01:00:12) a portion of your question and ask André to add on my answer. So, we have not seen any change yet in exports volume or customers interest in terms of buying U.S. protein, because depreciation of the dollar that has been happening in the last two weeks. And I think it's too early for a call, that the U.S. dollar is going to be much stronger or not.

So, we are going to – like I mentioned before, we are not doing anything, we're not preparing to any change because any change in government gives us – we don't have any control on that and what's going to happen. In the end of the day, U.S. produce protein in a very competitive way. Pork is very, very competitive. Chicken is very competitive. And even beef now is back to be very competitive.

So, we are very focused on our business internally and we want to make sure that we operate our business regardless anything that is going to happen in government very, very well. And we think Mexican consumers is going to still be there and they still are going to be looking to buy protein to meet their needs. And not only Mexico, in Japan, in South Korea, in China. And if you look the two main places around the globe that is very, very competitive and produce a meaningful amount of protein is North America and South America, and we are glad that we are in both of these region well positioned to what's going to happen.

I don't know, André, you want to add anything more?

A - André Nogueira de Souza {BIO 20244486 <GO>}

I just want to add that Australia is very important too in beef and lamb. Don't forget them. But in terms of price and dollar impact, if you look especially in beef that Japan and South Korea, the two most important markets for the U.S. beef. And U.S. is growing a lot in these two markets this year. It's much more relate with how competitive U.S. it is with the mass production. And the mass production in these two countries is so much higher the cost compared to the import beef that allows the currency to move a lot. 30%, 40%. U.S. continue to be extremely competitive with the mass production there.

And same with the (01:03:07), we have seen a big increase of the U.S. export, at the same time that Australia is keeping the same volume for (01:03:15) South Korea saw a little bit of growth. So, U.S. is growing. Australia is growing. So, we are replacing the mass production there.

A - Wesley Mendonça Batista {BIO 15243148 <GO>}

One more comment, Pedro, that I'm going to repeat what I said in the beginning. So, we believe we built a unique platform, and I wanted to remind a strong dollar is actually pretty good for us overall. So, overall, seeing the dollar getting a little stronger is not a bad thing for JBS overall. So, if you'll see the amount of forex that we generate in dollars, and as well the amount of product that we export from Brazil, actually, it's pretty positive.

So, overall, actually, we like to see the U.S. dollar getting a little stronger.

Q - Pedro Leduc {BIO 16665775 <GO>}

Okay. Thank you.

A - Wesley Mendonça Batista {BIO 15243148 <GO>}

Thank you.

A - André Nogueira de Souza {BIO 20244486 <GO>}

Thanks, Pedro

Operator

This concludes today's question-and-answer session. I'd like to invite Mr. Wesley Batista to proceed with his closing statement. Please go ahead, sir.

A - Wesley Mendonça Batista {BIO 15243148 <GO>}

I want to thank you all for being in the call, the third quarter earnings call, and look forward to speak with you again in our coming quarters. Thank you. Thank you very much. Bye-bye.

Operator

This concludes JBS audio conference for today. Thank you very much for your participation, and have a good day.