Y 2018 Earnings Call

Company Participants

- Eduardo Miron, 'CEO'
- Marco Spada, 'CFO'
- Marcos Molina, 'Chairman'
- Tim Klein, 'Head North America'

Other Participants

- Analyst

Presentation

Operator

Good morning, ladies and gentlemen. At this time, I would like to welcome everyone to Marfrig Global Foods SA conference call to present and discuss its results for the fourth quarter 2018. The audio for this conference is being broadcast simultaneously through the Internet in the website, www.marfrig.com.br/ir.

In that address, you can also find the slideshow presentation available for download. We inform that all participants will only be able to listen to the conference call during the company's presentation. (Operator Instructions) Before proceeding, let me mention that forward-looking statements are being made under the Safe Harbor of the Securities Litigation Reform Act of 1996. Forward-looking statements are based on the beliefs and assumptions of Marfrig's management and on information currently available to the company.

Forward-looking statements are not guarantees of performance. They involve risks, uncertainties and assumptions because they relate to future events and therefore depend on circumstances that may or may not occur in the future. Investors should understand that general economic conditions, industry conditions and other operating factors could also affect the future results of Marfrig and could cause results to differ materially from those expressed in such forward-looking statements. And now, a message from Mr.Marcos Molina, Founder and Marfrig Global Foods Chairman.

Please, Mr.Molina, you may now begin the conference.

Marcos Molina {BIO 15363967 <GO>}

(Foreign Language) Good afternoon, everyone. Before I hand the call over to Miron, I would like to thank the whole Marfrig team for the exceptional year of 2018. (Foreign

Language) Also the team from the North American operations, which became part of our team in 2018.

(Foreign Language) And the South American team that we have restructured with a new management and focused operational excellence. (Foreign Language) And also, the finance team, who have successfully executed major M&A transactions in 2018. (Foreign Language) We have today an industrial and operational based focus in beef protein. (Foreign Language) With the SAC and then widen products.

That paves the way for a long-term sustainable growth. (Foreign Language) And we are optimistic for 2019 and the following years. (Foreign Language) I would like to now to pass the floor to Mr.Miron.

Eduardo Miron

Good afternoon.

I want to start by thanking everyone for participating in another earnings conference call of Marfrig Global Foods. Today, we'll be commenting on the results for the fourth quarter and fiscal year 2018. With me today is Marco Spada, our CFO and Investor Relations Officer. And given the company's important moment, our transition, also with me are Tim Klein, Head of North America operation; and Miguel Gularte, Head of the South American operation.

And before I get to the results, on Slide 3 and 4, I will go over the strategic decisions and transactions of 2018 that captures for Marfrig to be company it is today. Let's turn to Slide number 3 please. The year 2018 was marked by Marfrig's strategic shift towards a focused beef protein and higher value-added products. And to make that happen, we worked on two relevant strategic projects.

The first was the decision and subsequent announcement of the acquisition of a controlling interest in National Beef, the fourth-largest beef processor in the United States. And with this transaction, we redirected Marfrig's focus onto its core business of beef, becoming the world's second largest beef producer. With this strategic redirection, we thought that we should accelerate our deleveraging process, and to do that, we decided to an announced jointly with the acquisition noted, the decision to buy back Keystone Foods, which was completed last November. At the end of these processes, we registered a significant improvement in our capital structure.

We reduced our indebtedness by over 50% and ended 2018 with a leverage ratio of 2.39 times, below our target of 2.5 times. This transaction has enabled us to achieve an adequate financial and production structure, allowing us to advance in our strategy of optimizing our product mix for more higher value-added products. Moving to Slide number 4. And to strengthen enchanter [ph] our position in North America and complement the portfolio of the recently acquired National Beef, we decided to maintain North Baltimore business of Keystone Foods.

The North Baltimore plant, which has capacity to produce 91,000 tons annually of frozen and fresh beef patties, is one of the largest plants in the United States and a key supplier to the foodservice channel. The carve-out of this asset was carried out in November with the conclusion of the sale of Keystone and its result became part of the North American operation. Before the carve-out, the North American operations had an annual beef patty production capacity of only 50,000 tons, which now has increased to 106,000 tons. By the same logic, to expand and strengthen our South American operation, we announced in December the acquisition of a controlling interest in Quickfood, an Argentine company, that is the country's leading producer of beef-based products and the owner of leading brands such as Paty and Vienissima to the retail channel.

On December occasion, we announced the acquisition of Varzea Grande plant located in Mato Grosso state, which, among other products, produces beef patties, meatballs, and among other products. And we closed a strategic partnership with BR Foods by entering in a long-term contract to supply beef products to them. These transactions, which focus on higher value-added products, has made Marfrig the world's largest beef patty supplier, with annual processing capacity of over 203,000 tons to serve the best foodservice brands and chains. In summary, today, Marfrig is the world's second-largest beef producer and the largest beef patty producer, with a capital structure adequate to the sector.

Let's move to Slide number 6 where we begin our comments on Marfrig's results. On this slide, I will comment on the financial highlights of the fourth quarter of the year, in line with our expectation we concluded by the end of 2018, the divestment of Keystone, which generated proceeds of R$2.2 billion. The reduction in net debt allowed us to end the year with a leverage ratio of 2.39 times, which is below our long-term target of reaching 2.5 times by the end of 2018. The achievement reflects the successful execution of our strategy.

And lastly, we had generated two extremely important results. Net income in the quarter was BRL2.2 billion, reversing the net loss in the first 9 months and to close the year with net income of BRL1.4 billion. And for the second straight quarter, we delivered positive free cash flow of BRL380 million in the quarter. I will now pass the call over to Marco Spada, who will comment on our results in the fourth quarter and fiscal year.

Marco Spada {BIO 19715083 <GO>}

Thank you, Miron. Good afternoon, everyone. Please turn Slide number 7, where I will resume the presentation. On this slide, you can see the variations in Marfrig's consolidated net revenue in the fourth quarter of 2018 compared to the same period of 2017.

As you can see in the chart, we have adopted three bases to show the main factors that led to the variation, which are sales volume, sales price and exchange rate. Marfrig's net revenue in the quarter was around BRL11 billion, representing a growth of 21% year-over-year. The lower sales volume, which was influenced by the contraction is loitering [ph] at the South American operation, had a negative contribution of BRL201 million, which was partially offset by the higher average price, which made a positive contribution of BRL22 million. The depreciation in the Brazilian real against the US dollar on the exports from

Brazil and on the translation of revenue from the international operations had a positive impact of BRL1.4 [ph] billion, which reinforces the international profile of Marfrig today.

Net revenue from the North American operation, which accounted for 70% of Marfrig's fourth quarter net revenue, was BRL7.5 billion, growing 17% over the prior year. In addition to the effects on local currency depreciation in the comparison period, the stability in primary processing levels and the higher-average sales price, which were supported by the ample supply and solid demand, have offset the lower price of certain products. When measured in US dollars, net revenue was practically in line with the same period last year. Meanwhile, South American operation net revenue in the fourth quarter was BRL3.2 billion, 2% higher year-over-year, this is the effect from the weaker real on its ports, offsetting the lower average price and lower sales volume.

The better domestic price in Brazil was offset by lower export price in US dollar, following the industry trend and also was affected by the export mix, leading to higher share of volumes benefit for countries under the so-called general list compared to more profitable destinations, which acquire specific authorizations that the company is still in the process of (inaudible) Meanwhile, the lower sales volume is mainly explained by the reduction in primary processing due mainly to the incident at the Mineiros unit in the Brazilian state of Goias. As we announced to the market in mid-October, we had a fire of medium proportions without victims. In the Mineiros unit resumed its operations in January, but the (inaudible) level attributes some 70,000 head in slaughtering in the last quarter of the year. This same area was further impacted by the lower primary processing in Uruguay, which was explained by the retention of cattle by some farmers to take advantage of the better weather conditions in the field.

In this context, market strategy remains centred on serving higher-value chains. Now compared to the fourth quarter of 2017, the highlight was the growth in volumes to the foodservice and retail channels, of 6% and 7.4% respectively. We also observed some improvement in the share of special brands such as Bassi steakhouse and an alliance with Fogo de Chao, whose sales volume in comparison to the fourth quarter of 2017, grew 37% and 50% respectively. Let's move now to Slide 8 please.

On this slide, I will comment on the evolution in Marfrig's key operational indicators in the fourth quarter compared to the same quarter last year. Total primary processing stood at 1.6 million head, down 8% year-over-year. As I mentioned earlier, this declined was due to the lower primary processing in the South American operation. In the quarter, Marfrig posted consolidated gross profit of BRL1.2 billion.

Adjusted EBITDA was BRL881 million, 18% higher than the prior year period, main factors were the solid result of the North American operation, which posted record-high adjusted EBITDA in the fourth quarter, and strong beef demand enabled cattle supply, the effect from Brazilian real's depreciation against the dollar and also the recovery in the industry's profitability in Argentina, driven mainly by the external market. Let's move to the next Slide, please. On Slide number 9, I will comment on Marfrig's consolidated cash flow in the fourth quarter of 2018. Here, the main important factor is that we were able, for the second quarter in a row, to deliver positive cash generation.

Marfrig's operating cash flow was BRL900 million, reflecting the good performance of its operations and improvement in working capital due to the seasonal lengthening of supplier payment terms and the actions to improve inventory management, which are part of our operating efficiency activities. CapEx was BRL221 million, with the North American operations accounting for around 60% of this amount, reflecting the continuous investments in small expansions such as warehousing space and expanding our capacity in operational [ph] products, as well as the ongoing expenditures related to maintenance and operational improvements. Interest expenses were BRL299 million, down 11% on the prior quarter. Note that this amount includes a temporary effect of BRL47 million related to the interest expenses paid to the bridge loan in order to acquire the control of National Beef and which was settled in December, which the procedure receiving [ph] from the sale of Keystone.

As a result, free cash flow in the quarter was positive BRL380 million, marking yet another quarter of positive cash generation. This positive free cash flow corroborates marketing strategy of maintaining a diversified production platform in the Americas, focused on beef protein and higher value-added products. Moving to the next Slide, please. This slide shows our debt profile and key financial indicators after the conclusion of the strategic divestment of Keystone.

We have ended the year with net debt of BRL8 billion or $2 billion, which is more than 50% lower than the previous quarter. This important reduction is explained by the conclusion of the Keystone sale. In terms of financial leverage, as you can see on the chart on the right hand of the slide, the ratio of net debt to adjusted EBITDA in the last 12 months fell to 2.39 times. This result reflects the success of the strategic transactions during 2018 and exceeded the company's leverage ratio target, which was 2.5 times by the end of 2018.

To date, Marfrig has one of the lowest leverage ratios in the industry. Moving to the next Slide. Here, I will comment on the financial highlights of the year. As I already highlighted, we surpassed our leverage ratio target of 2.5 times to end the year with a ratio of 2.39 times.

We have posted record-high consolidated net revenue of BRL41 billion, an increase of nearly 20% compared to 2017, which I will go in more details in the next Slide. 2018 also set a record for cash generation capacity with adjusted EBITDA of BRL3.4 billion, a margin of 8.2%. The improvement in our operating performance, combined with the Keystone divestment, led Marfrig to end the year with net income of BRL1.4 billion. Moving to the next Slide.

Here, we presented the selected [ph] indicators for the year. In 2018, primary processing volume was around 7 million head, up 18% over the previous year, positively affected by the higher supply of cattle at both operations. We posted a record net revenue of BRL41 billion, in addition to the effects on local currency depreciation in Brazil, which generated, again, a gain of BRL4.5 billion. Net revenue growth was also driven by the higher sales volume, which made a positive contribution of BRL3.2 billion, with these factors offsetting the lower average price, which had a negative impact of BRL878 million.

Adjusted EBITDA also set a new record of BRL3.4 billion, growing 35% from 2017. The main factors were the record high results in the North American operation, reflecting the set of positive scenario in United States, the higher profitability of operations in the Southern Cone, driven mainly by the industry recovery in Argentina and the market share gains in Uruguay and also the weaker Brazilian real. I will now hand the call back to Miron for his closing remarks.

Eduardo Miron

Thank you, Marco.

And let's move now to Slide 14 for my closing remarks. As we have (inaudible) highlighted, 2018 marks not only a strategic redirection in Marfrig's strategy, but also the successful execution of our strategic transaction for the year. We have become the world's second largest beef producer and the world's leading beef patty producer. With a simpler and more focused business model, we have consolidated our operations in a diversified beef production platform in the Americas to serve the world's largest and most important consumer market.

For 2019, the outlook for the industry remains positive. In the United States, the expectations for the cattle supply to remain aligned with the industry's available processing capacity, which should lead margins to be above the industry's historical average in the country. In South America, the perspective is that the region consolidate its position as a key beef production platform to serve the world's growing demand for beef protein. The potential for new optimizations of Brazilian plants by China, opening in the US [ph] market through Argentina and the Japanese market through Uruguay are some of the factors that should contribute to the performance of this sector in the region.

In this context, Marfrig's strategy remains centered on the pursuit of operational excellence and on creating sustainable value. And once again, I will emphasize that what does not change in this entire process, which is our non-negotiable commitment to the financial discipline. That concludes today's presentation. But before we go to the Q&A session, I would ask Tim Klein, CEO of National Beef, to share his thoughts on the market regarding 2018 and 2019.

Tim, could you please take the word?

Tim Klein {BIO 16522695 <GO>}

Thank you, Eduardo. 2018 was very good year for the US beef processing industry, with record margins being recorded by everyone. This was due primarily to three factors. Number one is a very strong US economy that has driven a lot of business for the foodservice sector and restaurant trade.

Pointed [ph] number 2, is plentiful [ph] supplies of cattle that have resulted in very much lower prices for beef relative to competing proteins; and has allowed our plants to run at higher utilization. The higher utilization rate for the industry is running above 90%, which has allowed our plants and others to run very efficiently. So those factors really have driven the margin structure for the US industry. We continue to be focused on increasing our value-added product lines as we have been and also expanding our customer base in our various business segments.

Since the acquisition by Marfrig, we have worked closely with our South American team to identify and implement synergies and best practices between North and South American operations. These efforts have yielded incremental margins for both company and much more to come. As we look forward to 2019, industry dynamics will continue to be in our favor. According to USDA data, cattle supplies in the US are expected to rise 2% from 2018 and are not expected to peak until 2021.

As you know, Uruguay has been approved to export beef products to Japan. We, at National Beef, we are the largest exporter of chilled beef to Japan from the US One of our key initiatives in 2019 will be to use our position there to rapidly expand Marfrig Uruguay's position in that lucrative market. The other project we are working on is the integration of Marfrig's North American ground beef patty operation into NBP, in the National Beef, and to identify and realize the synergies of having the integrated model for our customers here in the US. So all in all, a very good year.

2019, the expectation is we'll continue to have good margins.

Eduardo Miron

Thank you very much, Tim, for your thoughts. And now let's go to the Q&A session.
(Question And Answer)

Operator

Thank you, ladies and gentlemen we will now begin the Question-and-Answer session (Operator Instructions)

Marco Spada {BIO 19715083 <GO>}

This is Marco Spada here speaking.

I have received a question here on the web, asking if we will issue a bond from National Beef. So basically, it's not in our intention to create leverage at National Beef. We are studying any possibilities of maybe issuing out of the holding that holds the shares of National Beef in the United States, trying to reach some other pockets. But it's something that we should decide and study.

There's nothing really planned at home to produce that.

Operator

Our next question comes from Joe Ha [ph] from Morgan Stanley. Please John, you may proceed.

Analyst

Hey, good morning and thanks for the call.

I was going to ask, again, about the National Beef. I didn't get to hear that. You kind of broke up on the phone. But there was a story earlier that said you guys may pursue even a share sell.

Maybe could you expand on that? And what could you use the net proceeds for, and any sort of timing that you might give? And then separately, maybe could you talk about the cash structure and any thoughts about what you're thinking this year in terms of your debt amortizations? You do have a call in June and you have the bonds that are due in September. And I believe those are financed already. I mean, maybe if you can just go into that a little bit.

Eduardo Miron

John, unfortunately, the quality of the sound is not great.

Could you repeat your question, which I believe is twofold? So could you go through the first, please?

Analyst

Yes. Sure. The first question is regarding -- I saw -- regarding what you talked about, already about National Beef and potentially looking at ways of raising capital there. I didn't get to hear your question, the question you answered from the Internet [ph] before, and I was looking to hear maybe a repeat of that.

And maybe you can clarify the news story that said you might look at an IPO of the beef sector and maybe what you could use those proceeds for and if there is timing. And I'll follow up with a second.

Eduardo Miron

Okay. Yes.

So certainly, there is -- it's Miron speaking. So there is absolutely no plans for any IPO at this point. I think what you may have heard or seen in the media is this, an answer that I provided to one journalist regarding if we were close to the idea of doing an IPO in US And my answer was that we are not close to any good solution or idea. As you may remember, we worked extremely hard to do the IPO of Keystone.

That was one of the affirmers. So we don't have any problems regarding the US market and the IPO, but that's not something that is in our radar at this point. At same time, it's not simply that we are saying that we will not consider at all.

Analyst

Okay.

And do you have any comments on your bonds outstanding? Do you have any comments on -- about any sort of plans to refinance? Or any sort -- you do have a call on the 2023 notes in June, and you do have your bonds due in June as well. Maybe we do know you have some proceeds from the 2025 notes issued last year. Maybe you can give some color as to what you're thinking about your capital structure and if there is any sort of financing needs?

Marco Spada {BIO 19715083 <GO>}

Sure, John. This is Spada here speaking.

Well, we are very glad that we have done our homework in the past regarding our liability management. It's better that it was done prior to the improvement in the treasury in the US So we are very confident that we have a very comfortable situation now. It's the only maturity coming really in 2023. Taken in to consideration for 2019, we already have debt and the cash on hand for the liability management, all for the payment of the 2019 bond.

Regarding the market, any possibility, we are, of course, looking at some good opportunities. There is a very good opportunity in local market, with some operations in the local market that we are studying and we might reach local markets very soon. And about the management and also the exposure and on opportunity in the future with the bonds, we definitely will be paying attention to the market and (inaudible)

Operator

This concludes today's question-and-answer session. I would like to invite Mr.Eduardo Miron to proceed with his closing statements.

Please go ahead, sir.

Eduardo Miron

Again, thank you for attending this call. 2018 was an exceptional year for the company. And we appreciate your interest in our company as we continue to work absolutely hard to deliver the results we promised.

Thanks and have a great day.

Operator

Thank you. That does conclude our Marfrig conference call today. Thank you very much for your participation and have a nice day.