Q1 2014 Earnings Call

Company Participants

- Edison Ticle de Andrade Melo e Souza Filho, Chief Financial Officer
- Fernando Galletti de Queiroz, Chief Executive Officer

Other Participants

- Jose Yordan, Analyst
- Lauren Torres, Analyst
- Unidentified Participant
- Violeta Ramos, Analyst

Presentation

Operator

Good morning, ladies and gentlemen, and thank you for waiting. At this time, we would like to welcome everybody to Minerva's First Quarter of 2014 Results Conference Call. Today with us we have Fernando Galletti de Queiroz, Chief Executive Officer; Edison Ticle, Chief Financial Officer and Eduardo Puzziello, Investor Relations Officer.

We wish to inform you that this event is being recorded and all participants will be in listen-only mode during the company's presentation. (Operator Instructions) The audio and slide show of this presentation are available through a live webcast at www.minervafoods.com/ir. The slide show can also be downloaded from the webcast platform in the Investor Relations section of this website.

Before proceeding, we wish to mention that forward-looking statements may be made during this presentation, relating to Minerva's business prospects, operating and financial estimates and goals. They are based on the beliefs and assumptions of company management and on information currently available. 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 Minerva and could cause results to differ materially from those expressed in such forward-looking statements.

I would now like to turn the conference over to Mr. Fernando Galletti, CEO, who will begin the presentation. Mr. Galletti, you may start your presentation.

Fernando Galletti de Queiroz {BIO 15387377 <GO>}

Good morning, everyone. First, I'd like to thank you for participating in Minerva's conference call on the results of the first quarter of 2014. On slide number two, we will comment the highlights in the quarter. Let's have a look on the slide two, Minerva delivered a solid result in period with a focus on profitability, despite the seasonal factors typical of the first quarter and the more challenging scenario in terms of cattle supply as we will discuss later.

The company focus on purchasing cattle at a competitive conditions joined on its efficient risk management instruments, geographical diversification of industry units and basis average rate. Considering the seasonal factor typical of the first quarter and then more diverse scenario in terms of cattle supply, which led us to purchase cattle in the spot market I would like to point out that the company prioritized profitability despite the increase in working capital use. Note that this strategy was about thanks to the high liquidity of the company, which allows the strategic flexibility at the opportune times. As a result, return on invested capital stood at 19.8% in the quarter, 1.6 points more than in the first quarter of 2013.

Net income came to R$69 million, with a net margin of 5%. EBITDA totaled a R$136 million, 36% higher than in the first quarter 2013, with a margin of 9.7%, a 130 bps up on the same period of 2013. This was the highest margin for our first quarter reported by the company. We maintained our commercial strategy of prioritizing sales to more profitable markets, both in the domestic and export markets. As a result, net revenues, once again, climbed by significant 17% over the first Q of 2013, totaling R$1.4 billion.

The company maintained a solid cash position, our leverage measured by the net debt EBITDA ratio stood at 3.58 times. In line with our expansion strategy and the investment plan already announced to the market, we took two important steps in the first Q of 2014. As we mentioned in our last call, we concluded the acquisition of Janauba plant located in Minas Gerais state.

We will begin investments and remodeling the plant and start off this plant for the second half of 2014. In late March, we announced the acquisition of Frigorifico Carrasco in Uruguay. As we will discuss later, the scenario is very positive for the (inaudible) with high cattle supply and access to major markets, with higher margins.

We believe this process has been concluded as we started to operate this plant on May 1. As we added these two acquisitions with BRF plants, we have increased capacity by 40%. Just remember that we are waiting for CADE's -- the anti-trust approval on the acquisitions of BRF plants.

Lastly, we would like to comment on the company perpetual bond issued in the amount of 300 million carried out in the end of the quarter. In addition to boosting liquidity, the operation will further increase flexibility of our capital structure and diversify our client base. We remained four times higher than the size of the issue shows the market confidence on the company long-term fundamentals.

Let's now move now to slide three where we're going to discuss the industry overview and cattle supply in the quarter. Slide three, in the first quarter, we observed off-season characteristics in a period with typically high cattle supply, reflecting the drop period that lasted from late January through mid-March, which affected cattle supply in February and March, encouraging farmers to retain the cattle for a longer time. It increased the cattle price and reduced its slaughtering rates.

Due to rainfall returning to normal levels in the second half of March, cattle supply increased in mid-April and this should continue in May and June. We also expect growth in (inaudible) operation in 2014, especially in the first round of the year, which should mitigate volatility in cattle price in the off-season.

Let's move to slide four, where we will analyze the performance of Brazilian exports in the first Q of 2014. In the first Q '14, Brazilian beef exports maintained the upward trend observed in 2013, climbing 22% over the first Q of 2013. The lower production, by key global players, coupled with the appreciation of the dollar against the real has allowed continuous growth in Brazilian exports.

Russia remained the main destination of exports; however, it's worth noting that Hong Kong, China remained the second largest market, confirming that the increasing exports to this region represents an actual change in the animal protein consumption patterns.

Let's move to slide five, which presents the performance in the domestic market. Slide five, the domestic market had an interesting dynamics in the first Q of 2014. This demand, typically lingering in the beginning of the year increased led by the weather conditions, especially in the coastal regions in Brazil and in the country side of the of the country. Domestic beef supply was limited, impacted by strong exports, mainly in January and February. This slaughtering volume declined in March due to the increase in cattle price. In this scenario, domestic beef supply was lower, contributing the increase beef prices and sustaining the industry margin as presented in the chart.

Let's move to slide six, where we will discuss the industry in Paraguay. The first quarter was marked by the regaining of our margin recovery trend in Paraguay, after a period of strong increase in cattle price in the 4Q of 2013. Price is beginning to show a down trend, while slaughter moved up slightly. Revenues from exports climbed 21% in the first Q of 2014, over the same period in 2013.

The main change in the sale mix was the reduction in Russian share from 60 to 36 of the total exports of the country, reflecting the reopening of the Chilean and other markets to the Paraguayan beef in the second quarter of 2013. As was the case with Brazil, Paraguayan beef exports to China, Hong Kong increased significantly, accounting for 10% of the total exports in the quarter. 300 bps up on the first Q of 2013.

Now let's have a look in Uruguay on slide seven. As I mentioned in the beginning of this presentation, the industry in Uruguay has presented a strong margin rebuilding trend, which began in the end of 2013 and gaining strength in the first quarter of 2014. This performance was led by two factors. First, the higher price of Uruguayan beef in international market, which has benefit producers and exporters. Second, the lower capital price reflecting the higher supply and streamline production in the industry, especially as from the second half of 2013. Added to this factor is the beginning of a positive cycle in Uruguay with higher cattle supply expected for the coming years.

In this scenario, profitability of operations should remain high, especially considering its outstanding position in the international market with access to the United States, Canada, South Korea and niche markets in Europe at a time of low global beef supply. In this context, I would like to emphasize that the acquisition of Carrasco fully aligned with the company's geographic expansion plan in South America took place at extremely favorable movement in the industry.

Let's move to slide eight where we will detail Minerva operating results. Slide eight, in the first quarter of 2014, the company's slaughtering volume was impacted by the drop period in February and March. Nevertheless, our capacity utilization in the last 12 months stood at 75% on industry benchmark. We continue to allocate a significant share of our production to the export market in order to profit from extremely favorable scenario for Brazilian beef exports. As a result, exports represented 68% of the total gross revenue in the first Q of 2014, a 160 bps more than in the first Q of 2013.

Let's move on to slide nine, which presents the company exports strategy in more details. Slide nine, in the first 2014, the company remains the second largest beef exporter in Brazil, with a 17% [ph] market share. In Uruguay we represented 8% of the exports, including Carrasco, which we began to operate in May. In other market share we totaled 40% in Uruguay. In Paraguay, we consolidated our market share at 17%. This slide also shows Minerva export trend by region, it's worth highlighting the following regions.

Americas, the retail share in the mix grew by 160 bps in the 12 months period ended March 2014, reflecting the increase in export to Chile; thanks to the reopening of these markets in Paraguay in beef in the second quarter of 2013, and the increase in sales to Venezuela. Note that our exports are carried out through letters of credit approved by LADE, the Latin America Integration Association, it represents the credit risk of Brazilian Central Bank. In other words, we are not exposed to credit risks from exports to Venezuela.

Asia has been constantly increasing its share of exports, which moved up by 400 bps in the comparison period, which is 12% risen by China, Hong Kong and Malaysia. The CIS in particular Russia has been historically the main destination of our exports. In the last 12 months, this region accounted for 21% of Minerva exports, lower than in the 12 months period ended March 2013. Note the company reallocated part of exports previously sold to Russia to markets with higher margins, especially in the Middle East.

As a result, exports in the Middle East increased from 17% to 20% in the last 12 months. The main destination being Iran, Lebanon (inaudible) for Paraguay in exports. This increase is also due to our focus on niche markets, which present higher profitability.

The slide 10 presents revenue growth in Minerva main business units. In slide 10, gross revenue grew by 17% [ph] over the first Q of 2013. The beef division sales moved up by 50% led by the 20% upturn in exports, and a 5% growth in domestic sales. The others division expanded by 25%, chiefly due to the MFF's results in the life cattle, leather and resale segments.

I'll now turn to Edison, who'll comment on the financial highlights.

Edison Ticle de Andrade Melo e Souza Filho {BIO 15435343 <GO>}

Thank you, Fernando and good morning, everyone. Slide 11 presents our financial highlights. Let's begin by presenting our net revenue, which came to R$1.4 billion in the first quarter of 2014, 17% higher than in first quarter of 2013, as Fernando has already mentioned.

EBITDA was R$136 million, 36% up on first Q '13 with a margin of 9.7%, a 130 basis points higher than the same quarter of last year. It was the highest EBITDA margin reported by the company in our first quarter results since the company went public in 2007.

As mentioned in the beginning of the presentation, considering the seasonal factors, fiscal first quarter and the limited capital supplies (inaudible) return on operations despite the higher investment in working capital. As a result, return on invested capital stood at 19.8% in the first quarter of '14, 160 basis points more than in the first quarter of '13. Our leverage measured by the net debt to EBITDA ratio stood at 3.58 times higher than in the first quarter of '13 due to the 12% depreciation of the real against dollar as around 67% of our debt is exposed to the dollar currency.

On the next slide, we will present our net income in the quarter. As you can see on the table on this slide, the company posted net income of R$69 million in the first quarter '14, up from R$5 million in the first quarter of '13. Our net margin was around 5%, 450 basis points higher than in the same quarter of the year.

Let's move now to slide 13 to present our capital structure. Our cash position reached R$1.3 billion at the close of the quarter enough to amortize our debt through 2018 as presented in the sharp [ph]. I would also like to point out that part of the cash is invested in bonds issued by Minerva, bought back during the second half of last year at prices below par value.

Short-term debt represented 19% of total debt and around 67% of our debt was dollar-denominated. We maintain our policy of maintaining our natural hedge in relation to the breakdown of our exports revenues, which were around 68% in the first quarter of '14. Note that the capital structure does not include the effect from the perpetual bond issue concluded in the end of the first quarter concluded in March, which was settled in the beginning of the second quarter as we're going to discuss further.

Moving to slide 14, we will present the sensitivity analysis of Minerva's leverage, considering the acquisitions announced recently. The table on this slide shows four different EBITDA margin scenarios for the assets acquired recently. Note that we began operating Frigorifico Carrasco in early May. We are investing in the renewing and remodeling of Janauba plant, which we will start up operating in the second half of this year.

The acquisition of BRF plant is still under analysis by CADE, the Brazilian antitrust authority. Considering the EBITDA margin scenarios, which range from 5% to 12.5% and the last 12 months EBITDA of R$587 million reported by the company, Minerva's leverage would range from 3.2 times net debt to EBITDA ratio, when you consider a margin of 5% to 2.6 times when you consider a margin of 12.5%.

If we consider the 10% margin, which is the past 12 months average margin of the company that average would be at 2.8 times leverage measured by net debt to EBITDA ratio. Note that these figures are based on assumptions announced -- already announced to the market in the notice and material effects related to each acquisition. This analysis shows the company's commitment to continue advancing in our expansion plan, to continue executing our strategic plan, while keeping our financial discipline.

On slide 15 we will briefly discuss the recent transaction involving the perpetual bond issue. In the end of the first quarter of '14, the company issued a perp bond worth $200 [ph] million with that coupon up 8.75% per year. This operation was started on April 3rd, and therefore, it will only impact the company's results in the second quarter.

We will now discuss the rationale supporting this transaction. Firstly, the operation contributes to the diversification of Minerva's investors base as a profile of buyers of perp bond is different from the buyer from the profile of buyers of dated bonds. We also believe that the transaction will bring more flexibility to the company's capital structure as we have the option to pay back the bonds -- or to buy back the bond every five years paying 100% of its face value, which means paying no premium as opposed to bond with the final maturity.

Lastly, perp bonds improve the credit metrics used by rating agencies, especially, when we use the proceeds to repay debt or to refinance part of our debt because we are exchanging that (inaudible) that has no maturity defined.

As the proceeds of the issue, $150 million will be used to replace the current cash invested in our bonds. As I mentioned, we bought back around $150 million of bonds, especially the 2023 bonds and part of the proceeds of this transaction will be used to replace the cash that is invested in those bonds. $100 million will be used to refinance short-term debt. That debt is maturing on [ph] 2015 and $50 million will be used for general corporate purpose related to the CapEx and to the working capital needs for the recent acquisitions.

I will now turn to Fernando, who will comment on the company's expansion plan. Thank you.

The slide 16, the slide 16 presents the focus on consistent growth of Minerva. You can see on the left side the Minerva footprint in South America, including the company acquisitions in recent months, which are fully aligned with our investment plans announced to the market. After the conclusion of the acquisition of BRF plants, the company will own 11 plants in Brazil, representing 75% of its installed capacity.

In Uruguay, our capacity increased by 64% through the acquisition of the Carrasco. As a result, the country now accounts for 40% of our total capacity, including Janauba, Minerva's capacity has expanded by around 40%. We should become operational in the second half, except for Carrasco, which Minerva begins operating in May.

In the bottom right side, we revise our investment plan that was put into the market two years ago. We opened two of the distribution centers in 2013 out of six that we're planning to be opened until 2050 [ph]. The geographic expansion in South America, this is what we just mentioned that you can see the consistency that we have. And also the expansion in our processed product lines of MFF. The investments are ongoing and we shall reach capacity of 3,300 tons a month by the end of 2015.

All this shows Minerva's disciplined focus and consistency, the pillars of our growth and the pillars of the company. The company is fully committed to integrate these operations especially the new acquisitions in accordance with the strategy and management practices adopted by the Group. We will seek to capture the synergies expected from the acquisitions, reducing costs and promoting benchmarks among the unities will be final goal of creating value to our shareholders. I thank you all for attending the call. And now I'll turn over to the operator to begin the Q&A session.

Questions And Answers

Operator

Thank you. We will now start the question and the answer session for investors and analysts. (Operator Instructions) And our first question comes from Jose Yordan at Deutsche Bank. Please go ahead. One moment, please.

Q - Jose Yordan {BIO 1496398 <GO>}

Hi, good morning, everyone. Just wanted to get some clarification, in the Portuguese call, you talked about the pattern of working capital basically repeating itself next year, but obviously, the increase in working capital this year was much greater than it was in the first quarter last year. So any color on how many days of customers and you expect to get to by year-end would be helpful.

And also, any update on what's happening with all the recoverable taxes if there is any change in the -- in that situation coming from the government or from any other strategies you might pursue?

A - Edison Ticle de Andrade Melo e Souza Filho {BIO 15435343 <GO>}

Jose, well, you have to have in mind that the company is roughly 20% bigger than it was in the first quarter of last year. Nevertheless, we expect the cash conversion cycle to return back -- to come back to the levels that we saw in the fourth quarter of last year, which will be around 12 to 13 days by the end of this year. So it's a process that will take the whole year. The tax [ph] will be very similar to what we saw let the year in our opinion. But the main goal is to bring in the cash from conversion cycle back to something around 12, 30 days by the end of the year.

A - Fernando Galletti de Queiroz {BIO 15387377 <GO>}

Just adding to the comments that Edison did, also there is a change on the profile of our export destinations. And as we reduce the countries that present small risk, and therefore, we reduce the prepayment amount that we received. This also has an impact on the cash flow that's different from last year. In terms of taxes, the federal taxes, they keep on the same trend as before. So we are using part of it, compensating the ongoing operations, especially on the value-added products. And the tax of -- the state taxes, they keep in the normal flow of being used to pay investments and suppliers. So there is no major deterioration, but also there is no major improvement on the tax recover.

Q - Unidentified Participant

Okay, very clear. Thank you and congrats on the record margins.

Operator

(Operator Instructions) And our next question comes from Lauren Torres from HSBC. Please go ahead.

Q - Lauren Torres {BIO 7323680 <GO>}

Good morning, everyone. It's encouraging to see you increase production capacity. And I was just curious to get your -- maybe first short-term and then longer-term thoughts on where you're supplying -- supply-demand dynamics in Brazil, it seems with the weaker currency the export makes sense, but I was just curious if you could talk about the demand aspect that you're seeing right now in Brazil.

And then, longer term, how you think about your company being more of an international company, the markets that are priority to you and how do you go about doing that as far as where you want to be and kind of the expansion plans outside of Brazil?

A - Fernando Galletti de Queiroz {BIO 15387377 <GO>}

Let's start from the second part of the question, first, Lauren. Definitely, we are done in terms of acquisitions in Brazil and we keep looking at other opportunities in South America. Our focus is this in South America. So, Uruguay, Paraguay presents good countries to originate cattle and beef and Minerva keeps growing in these countries. In terms of the domestic consumption, they -- we see it is flat. And regarding our growth strategy and our geographic diversification, it's not only about installed capacity, but also there is a lot of value on it by using it to arbitrage different regions.

As you can see in the map, the last move that we never did they are in areas that we were not present before. So this increased our capacity of arbitrage in the market on the top of increasing its capacity. We see the increasing of capacity has a very positive trend because more and more we see South America as the main origin to supply our growing demand all over the world, both in the emerging markets that we are growing the demand because of the better distribution of income and because of the increase of the GDP of these countries, but also in the developed countries, where there is a drastic reduction on their local supply. So the amount of the debt [ph] of imports is widening and South America is covering it.

Q - Lauren Torres {BIO 7323680 <GO>}

And if I could also just ask about leverage, seeing your net debt to EBITDA go up a bit, I mean, what's the goal, how do you think about paying down debt and what's the comfortable level for you, keeping in mind that maybe there is more deal activity here or other things that you'd look to invest in?

A - Edison Ticle de Andrade Melo e Souza Filho {BIO 15435343 <GO>}

Lauren, as we presented in the sensitivity analysis, after all the acquisitions are fully integrated, we expect using the numbers of the end of the first quarter, leverage would be around 2.8 times, if you consider 10% margin, which is the margin to the company as presented in the past 12 months.

Going forward, we expect to be very close to two times within two years' time. So by the end of '15 or the beginning of '16, our goal is to have net leverage around two times. What would allow us to increase or to speed up the payout of dividend and any step that we took in terms of growing the company in terms of making more acquisitions would not take out the company from the route for the path to reach a two times net leverage in a two years' time. This is our goal, this is our plan.

Q - Lauren Torres {BIO 7323680 <GO>}

Okay. Very clear. Thank you.

Operator

And our next question comes from Carl Reitman from Torre Investments [ph]. Please go ahead.

Q - Unidentified Participant

Yes, hello, thank you. This is Carl Reitman, calling from Torre Investment Stockholm, Sweden. I would like to know just if you can discuss a little bit how certain you are about carrying out the transaction with BRF and when do you expect that transaction to be completed? Thank you.

A - Fernando Galletti de Queiroz {BIO 15387377 <GO>}

We expect that to have the transaction closed and the CADE antitrust approval not later than one-and-a-half months. So we've been talking consistently with them. We will be providing all the information required and we are very close to how the process finished. So being with the side, we believe by one-and-a-half months or so, we shall have well concluded. This doesn't represent any track to the deal. We don't see any track to the deal. It's only more comfort that the antitrust wants to get from both companies in terms of proceeds for this year. So this is where we stand and this is the time frame that we have that we are working on.

Q - Unidentified Participant

Thanks.

Operator

Our next question comes from Katerina Petroff [ph] from BES Securities. Please go ahead.

Q - Unidentified Participant

Hi, good morning. I have two questions, actually. The first one is, how you're seeing your margins, especially in the short term, because we have been seeing cattle prices quite flat, they haven't been going down as expected. And on the other hand, beef prices may have been receiving, especially in Brazil. Mostly, I guess, because of the FX that's not valued as (Technical Difficulty).

And my quick question is, do you have any calculation of what would be the ideal distribution between the three countries that you produce beef in, I mean, is it mostly -- will you continue mostly in Brazil, or will you start increasing more and more the other two countries to balance out the different cycles of the cattle?

A - Fernando Galletti de Queiroz {BIO 15387377 <GO>}

We definitely are done, starting from the second question, we are definitely done in Brazil. So if there is an increase, it will be in the other countries of South America. If we look at the future, we feel comfortable and we are now 60% in Brazil, 40% in the other countries outside Brazil.

So -- and we feel pretty comfortable with this breakdown. In terms of margins and your analysis on prices, you are right that the market is really flat and it's not going down, but also is not going up and we referred to the drop that we faced it, there is more even distribution, there is more homogeneous distribution of cattle availability during all months of the year.

So, we don't expect any picks or values on the market from the supply side. In the other side, in terms of demand, we also see that the price is flat, is lightly up in some countries. So we see the trend as a positive trend, also inside Brazil, where today, if you have to talk about margins, we don't see much different from what we saw in 2013.

Q - Unidentified Participant

Okay, thank you.

Operator

(Operator Instructions) And at this point we have no further questions. This concludes the question-and-answer session. And I'm sorry, we do have one more question. Violeta Ramos from Neuberger Berman. Please go ahead.

Q - Violeta Ramos {BIO 17504911 <GO>}

Hi. How are you? Thanks for your call. I was just wondering if you can give us your outlook on Russia and what percentage of your revenues come from that country? And if you expect any slowdown from there?

A - Fernando Galletti de Queiroz {BIO 15387377 <GO>}

Violeta, I was in Russia four weeks ago and what we are seeing is that there is no decrease in Russia, its' the opposite. With United States and Europe tracking the Russians who have some restrictions, the Russians are building stronger bridge with South America. So we expect the -- and we are already seeing the flow of goods out of South America, especially proteins out of South America to Russia, including. So the situation in Russia, we see it as positive for our trade, particular for our trade. So we don't expect any negative surprises from them and the opposite to expect when we are seeing signs of positive trends.

Q - Violeta Ramos {BIO 17504911 <GO>}

Perfect. Thank you.

Operator

The next question comes from Daniel Finsol [ph] from JP Morgan. Please go ahead.

Q - Unidentified Participant

Yes, hi. Good morning. Quick question, can you repeat again, what are you guys going to do with the bonds that you acquired in the last few months? Thanks.

A - Fernando Galletti de Queiroz {BIO 15387377 <GO>}

Now, we haven't done nothing. The bonds, I mean, our cash balance, we are studying with the lawyers and with the auditors if it's good for the company to cancel the bond. But so far, the bond in our cash balance what we're doing, we're just releasing to the market the size of the buyback that we did in the second half of '13. And we are highlighting that part of our cash balance is now invested in our own bonds.

Q - Unidentified Participant

Okay, thank you.

Operator

This concludes the question-and-answer session. At this time, I would like to turn the floor back to Mr. Fernando Galletti for any closing remarks. Please go ahead.

A - Fernando Galletti de Queiroz {BIO 15387377 <GO>}

Thank you. To conclude, I would like to say that we remain very optimistic about the industry outlook, given the strong protein demand in the domestic and export market in particular. The weakening of certain producing markets, our competitors and the positive cattle supply scenario that we see in Brazil, Paraguay and Uruguay. We remain at your disposal for any necessary clarifications. Thank you and have a great day.

Operator

This concludes the conference call. Please disconnect.