Q3 2014 Earnings Call

Company Participants

- Frank M. Ravndal Jr., CEO of Keystone Foods
- Janet McCollum, Chief Executive Officer
- Ricardo Florence dos Santos, Chief Financial & Administrative Officer, IRO
- Sergio Agapito Lires Rial, Chief Executive Officer & Director

Other Participants

- Alessandro Arlant, Analyst
- Daniel Sensel, Analyst
- Jose J. Yordan, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning, ladies and gentlemen. At this time, we would like to welcome everyone to Marfrig Global Foods SA conference call to present and discuss its results for third quarter of 2014. The audio for this conference is being broadcast simultaneously through the Internet in the website, 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. After the company's remarks are over, there will be a Q&A period. At that time, further instructions will be given.

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.

Now, I will turn the conference over to Mr. Sergio Rial, Marfrig Global Foods' CEO. Please, Mr. Sergio, you may now begin the conference.

Sergio Agapito Lires Rial {BIO 1925337 <GO>}

Very good morning. Thanks for attending our conference call this morning. I have the pleasure to have together with me here besides the Group CFO, Ricardo Florence; I have the CEO of Moy Park, Janet McCollum; and I also have the CEO of Keystone, Frank Ravndal, who will together with me and Ricardo be talking particularly around the businesses they are leading. So I'm really pleased to have both of them this time with us.

So let's start getting to the results of third quarter. And I will start with slide two, but what I'd like to show the market a couple of things, so another quarter of consistent performance, with exception of Keystone clearly having a more challenging quarter, and we will explain more in detail. But the quarter, what I think the company has one more time reinforced its commitment to free cash flow.

So we were able to generate R$84 million despite a very significant push towards exports in Marfrig Beef Brazil, which as you very well know, does put an additional burden from a working capital point of view. And also, some one-offs related to a local travel tax program that we have decided to adhere, which we call local new REFIS (03:19), which led us to have a disbursement in the second half of this year of about R$93 million for which already expensed in the third quarter. So also from a cash flow point of view, a negative impact there.

So despite a clearly more prolonged export flow, and also the one-off tax-related program that we have accepted to, and we will talk more about it later on, we were able to generate the R$84 million that I mentioned, bringing the overall number to R$71 million. And I think that's very important. I can understand that it sounds, it's certainly not a very significant number, but it is a significant number from where we are coming from. So I think the delta, the variance of where we were in 2013 or 2012 to where we are today is absolutely a milestone that I think the team is extremely proud of.

The other piece that I think will start showing some clear intangible results is what we call our Productivity Agenda for Marfrig Beef in Brazil. In a segment where we are also, on one side, completely convinced of the opportunities in the animal protein space, they are real, they exist, and we're going to talk more about it. But at the same time, cattle crisis have also increased double-digits almost quarter-after-quarter in reais.

So we started a real clear structured process in the early part of 2014 to address our infrastructure in Brazil. There is more than just cutting costs. It's about redesigning, rethinking from process design but also from the way we're actually managing and industrializing the cattle numbers that we're bringing every quarter. The third quarter has been a record quarter in terms of slaughtering. We slaughtered over 650,000 animals. That's certainly a record for the history of Marfrig, and on top of that we certainly reached 45% of what we did in Brazil was destined to international markets of which, again, we are very, very proud.

Slide three, guidance, targets, our commitment to all of you. We are on track, and I think again this is important. And the challenge from an operating performance point of view, this is another again clear good operating quarter. And the negative side which we're going to talk more about it is certainly the short-term impact, the 11% exchange devaluation on the real has had on our net debt, which we're going to talk about it, and how important that is as I sit here and look towards the future.

So we have reached all targets. If I look at net revenue, I am still very comfortable that we will hit between R$21 billion and R$23 billion. Remember that we're talking about a quarter where the operating performance of the company was really measured and valued at an average real of R$2.28, while the balance sheet, particularly the debt side, has been basically revalued where it should be, which is the last exchange rate of the quarter which was R$2.45.

So there's a bit of a mismatch when you look at the balance sheet and when you look at the flows. It is what it is. But my only point here on the net revenues is more that the average foreign exchange level for the fourth quarter was only a bit different than $2.28. The real has almost hit $2.60 today. So it's certainly going to be in the range of $2.40 plus going forward, which hopefully we're going to be able to show the market how correlated we are with a weaker real.

So a weaker real for us, it's absolutely positive. In the first moment, we only see the negative impact on the debt, but the market hasn't yet seen the possible positive impact on the operating flows including the EBITDA. So happy to hear that we are on track, and we will deliver guidance for a company where many people didn't have a lot of faith that we'd be able to hit the targets as we have articulated them back in 2013.

Slide four, net revenues grow 6%, R$5.2 billion. It is the highest revenue line for the year. But I would be expecting certainly a higher number for the fourth quarter. So I would expect that this is not yet the top of what Marfrig can do in terms of revenue. And I think here what you see is both Brazil Beef and Moy Park adding to the thrust of the revenue growth.

On slide five, pleased to see that our EBITDA has been above market consensus. So we have reached R$435 million. Again, very much helped for this quarter by beef in South America, in Moy Park. And very important, really very important to mention is the fact that all businesses are today above 7% EBITDA margin.

Slide six, another couple of points that I think we'd like to share with market. First, two upgrades, both from Standard & Poor's and Fitch, basically reaffirming and sending clear signals that we are on the right track in terms of what we are doing with the balance sheet, with the capital structure of the company. As mentioned before, this is the quarter also where we certainly have the impact of a non-cash foreign exchange impact on the debt. So the net debt in reais does move from R$6.7 billion to R$7.5 billion. In dollars, it remained unchanged. So it depends very much how you want to see it in reais (09:04) without a doubt. I mean, we have seen 11% increase. And again, I'd like to remind that we haven't seen the real (09:11) impacted, positive impact on EBITDA numbers as of yet.

Short-term debt remains under 12%. And I think what is important here, and I'm going to just spend two minutes because this is something that is very familiar to the Brazilian audience but not necessarily to the foreign audience. I mean, the Brazilian Government has basically reached out to the public in general, to the corporate world in Brazil, to basically say, well all your disputes at the federal tax level, so taxes that are only related to the federal tax, all those disputes, if you want to stop disputing them in court, which many companies in Brazil do and are, we are prepared to offer a long-term program to settle all that in 180-plus months. So it's a long period.

And we basically said, although most of those issues would be remote in our assessment, I believe and so does the rest of the management team, it's better to basically bring it to zero. It basically means eliminate altogether any disputes that would still be on the company's balance sheet at the federal tax level. So we have basically accepted what we call the REFIS program. With that, we basically will be able to do, which is over the period in which those payments are going to be happening, we're going to be using around R$600 million of tax credits that are today (10:48) sitting our balance sheet, and they will, over time, be reduced as those payment flow continues.

So I find that to be two things; one, we eliminate all risks related to the federal tax from Marfrig's balance sheet; two, we're going to be over time be able to reduce those tax credit which are only a federal nature by R$600 million over time. The counter aspect of what I just said is, of course, we have to make an extra payment of R$93 million for the second half; part of it already expands in the third quarter as mentioned before, not helping free cash flow for the year. But despite all that again, delivering free cash flow. So this is the right decision from a balance sheet point of view and certainly from a tax management point of view. We're really happy that the board and the rest of the team endorsed that decision.

Slide seven, we like the fact that I think the market is absolutely monitoring us much closer. Not only that, but that we also, the communication between Marfrig and the rest of the market is certainly better. I mean you do not see significant deviations from performance to what the market is actually saying with the exception – but it's always a good exception to see that we are above the consensus on adjusted EBITDA and also above consensus on margins.

Now, on the financial performance on slide eight, I'd mentioned R$5.2 million on revenue. This is not the highest number we're going to see for the year, but in the right trajectory and the right pattern, helped as clearly spelled out on the slide by Moy Park, part of it is pretty on the back of currency translation, but also by some real growth in the retail channel, in particular, and also through consolidation of beef sales of Marfrig in Europe into their numbers. Remember, that Moy Park, we always said Moy Park would become our commercial platform in Europe, and you're seeing that now happening more from an accounting point of view as well.

Keystone certainly had a challenging quarter, I will wait a little bit more for Frank to comment, but some of it will be very well explained, and I think you're going to be able to understand Keystone in that respect. At Marfrig Beef, we did cover two very important aspects, a higher export orientation on the back also of a much more significant cost containment.

Gross margin on slide nine. Nothing to report differently. So we are between 12% and 13%. Hopefully, we're going to be working on that going forward. But pleased to see not much of a variation there. So I think that in itself is good. And I think if I look forward with a different currency environment in Brazil, I would expect the company from a margin point of view to continue expand the margin as we have laid out on our Focus to Win plan.

Slide 10 is one that we are proud because not only we're doing what we're supposed to do, but we're also a little bit different than some of the other companies in the sector in Brazil, in the beef space in Brazil. I think we are the only company that has shown an SG&A containment for the third quarter. All the other companies in this sector has shown expanded SG&A relative to their revenue line.

So I think we have done here two things; we certainly have expanded the revenue line; but more importantly we have contracted smartly our SG&A in roughly 50 basis points. So we were able to monetize R$13 million already in the third quarter. Out of a annual target that we have laid out for the market of R$13 million, I believe we're going to be able to do more than that. It's too early to start establishing a new number, so let's deliver the R$13 million annually and then re-underwrite eventually a different number.

But we are ambitious. We'd like to see more. And Andrew Murchie, who is the CEO of the beef business in Brazil, with his team, very, very committed because they understand there are very few things we can control. When cattle prices are increasing double-digit every quarter, and we're not in control of our prices at the earnings (15:11) level, so we've got to control and look at our industrial footprint and everything that is in it to see how we can at least create a cushion for continued higher cattle prices.

What we have been doing on slide 11, we start this process back in the early part of 2014, so this is not something that it's a short-term reaction, so we're not just reacting to cattle prices being significantly higher. We actually anticipated that cattle prices would continue to be on the rise. It's just; one just needs to see supply and demand equation of beef in the world. So it didn't take a lot of intelligence to understand that prices would only go one direction, which will be higher. So we started basically saying what can we do? What can we do to anticipate what's coming our way? So we started with the diagnosis, analysis. Then we actually start putting execution, really as from July. And we're seeing some of that execution already coming our way in the third quarter of 2014.

We're giving you a couple of examples here of what we're actually doing. It all sounds pretty simple, but it's pretty complex when you're dealing with 19,000 people and a number of plants throughout the country. So it's pretty complex because you really have to go to a level of granularity that is not only typical, but more importantly, is to execute and monitor. This is not a one-off. This is not an approach of dieting. This is an approach of making the business stronger. And from a cost management point of view, far more than I think, some of our competitors in the space. This is something that we truly believe, that would create differentiation for us. And I think you can see that in a way, on the same slide, on slide 10. It gives you a clear direction where we're going with that.

Now, moving to the liquidity and debt side, I will do this slide and then I'll pass the word to Ricardo on the financial piece. But very clearly here, it's self-explanatory. Net debt does increase on the back of 11% deval of the real. Does that concern me? Well, I don't like to see this, what I would call, pretty, pretty important movement, 11% in a quarter. It's a pretty sizeable movement from a foreign exchange point of view. It doesn't concern me in a way because we are very positively correlated to a weaker real. But hopefully, we're going to be able to show that in the quarters to come.

So the risk here is to really have a sort of major reaction, and only see the balance sheet correction at R$2.45 and not really taking the time to understand that the flows of Marfrig of the third quarter were really valued at R$2.28. So there is a clear mismatch between how we are valuing the balance sheet, which is driven out of accounting, that's the way it should be, and the way the flows out of the three businesses have been valued in the third quarter. We're going to get benefit of straight translation out of Moy Park and Keystone for fourth quarter without even doing anything. So that's just a tangible benefit that comes in the back of currency translation.

And then we're going to get some of the benefit of a much more export-oriented Marfrig Beef Brazil with a different exchange rate than R$2.28, which we have experienced in the third quarter.

With that, I pass to Ricardo. Ricardo, slide 14.

Ricardo Florence dos Santos {BIO 20008948 <GO>}

Okay. Thanks, Sergio. Well, it's important that in the slide you'll see that we have had a stable net debt in U.S. dollars during all the year. This level $3.1 billion that we currently have was the same one that we had in the second quarter.

If we go to the next page, page number 15, they're the same test that we have done in all the previous quarters, I mean, dividing the net debt by the annualized adjusted EBITDA. We have the level 4.3 times even considering that this EBITDA of the third quarter was - it was a level of R$2.28 and not at the same level of the net debt that at the quarter-end, it was at R$2.45. We have kept a very good liquidity of 2.2 times. Less than 15% of our debt it is in the short-term showing the importance that we have given to the structure of the capital of the company.

In other (20:03) it's important also to notice that the contracts that we have with banks and all the marketing with regard to the leverage of the company, they consider the effects of the exchange variation, excluding them from the calculation of the leverage. If you do the calculation (20:32) for this purpose, the leverage is 3.6 times. Going to the next page - on page number 16, this is how it looks like the maturity schedule of the company. No peak ahead of us until 2018. The exercise of liability management that we have done in this year, they have been able to basically increase the duration of our financing. At the same time in that we have had a decrease in the average coupon that we have in the senior notes.

Going to the cash flow operation. On the cash flow bridge that you can see on page number 17, one of the largest work that we have had, it has been on the working capital management. In this particular quarter, we've been able to improve it by R$400 million, in which the main (21:59) were improvements in trade accounts receivables which is a combination of the receivables – both terms falling from 28 days to 27 days in the third quarter, I mean comparing the second with the third quarter.

It's true that we had increased inventories both in China and also in Brazil as a consequence of increase in cattle costs, but we've been able to offset them based on these reasons that I just explained to you. This other (22:48) here, they are most related to market transactions such as swap and commodity contracts. We were very disciplined on the execution of the CapEx. Accumulated figures. (23:07) executed in the year, R$127 million in the quarter and cash disbursement of R$252 million in the financial expense, given the free cash flow of R$84 million for the quarter.

Going to page number 18. That's the difference between what we were and what we have presented now, almost one year now of a stable company and continue – it's true that at this point, we are just starting to generate free cash flow. But it's a good pleasure for us to continue to deliver the guidance that we have provided to the market, R$84 million. As regarding to the bottom line, we had a net loss of R$303 million, which was caused by the currency variation which is non-cash, and because of the expenses related to the REFIS program that Sergio explained to you. If it was not because of this, we would be very close to breakeven already in this quarter.

Now, I pass to Sergio.

Sergio Agapito Lires Rial {BIO 1925337 <GO>}

Thank you, Ricardo. So I think, the summary up to now is very steady performance of all businesses. We're going to get now into more detail of the businesses. Definitely, on the free cash flow position, pleased to report – but, I guess, I'll go back to Ricardo's point which is, let's pay attention to where we were and let's also see where we are, which is what I call rebating Marfrig. So, the year 2014 is the year where we actually rebate the company. We're in control of the working capital dimension that would allow us to then really move to a more structured deleveraging program, which we'll talk more about it going forward.

The leverage, after the 11% impact of the real, it is what it is. It does not concern us at this point in time, because, again, it is management's belief that the operating performance of the company is highly correlated on a positive note with a weaker real; and hopefully, we're going to be able to show that in the quarters to come.

Having said that, we're certainly not denying that a 4.3 leverage, if you look at EBITDA third quarter annualized forward against $3.1 billion of net debt, it's not levered. Yes, we'll lever it, and we certainly will continue paying attention to our capital structure, as we have given the market signals of that. So we'll talk more about it.

Now, let's spend some time on the business, because at the end, it's making sure that the market understands what's going on in the three businesses. I'll certainly spend time more on the beef side this time, but we'll start with Moy Park.

And again, as I mentioned, here, we have the pleasure of having Janet together with myself, and Janet will walk you through a little bit about what happened in the third quarter. But also equally important, what's going on in Moy Park in 2014. It's been a great year for Moy Park, and there is still fourth quarter ahead of us.

So, Janet, with you.

Janet McCollum {BIO 17090604 <GO>}

Thank you, Sergio and good morning everyone. Moy Park, really pleased to share with the market our continued focus of underlying sales growth, and also sustained EBITDA margins, which are above 7%. And you will see that the nine month 2014 is averaging 7.1%.

And a couple of things, first of all, that are important to highlight in respect of our revenues, which are reaching in the quarter a high of R$1,345 million in the quarter. And this is demonstrating an underlying 3% positive sales growth.

Firstly, as Sergio has touched upon, as part of our focus to win strategy, we did plan that Moy Park would become Marfrig's distribution platform in Europe. And we're happy to show that in quarter three, we have now integrated the Marfrig canned beef business into Moy Park. This does give us a once-off revenue uplift in the quarter. And we will hopefully be able to build further on this opportunity in the future.

Our second key growth is, we've achieved strong growth in our UK and Ireland performance, with revenues growing across our retail fresh poultry and convenience ready-to-eat and coated category. And this positive growth is reflective of the polarized market growth trends in the UK retail market, coupled also with some gains in market share.

Our commercial teams are continuing to engage very closely with our customers, and helping them to win with consumers, through providing good commercial capability and innovation, food development, our consumer insight in our category market, and helping grow in new channels such as online and convenience stores.

This strong growth in UK and Ireland and the new beef business has been partially offset then by price reduction, which is reflective of the favorable grain environment that we see today and also the strengthening of the GB sterling currency relative to the euro, which is reducing the sterling reported values of our European revenues.

If I move on then to our EBITDA performance, adjusted EBITDA in the quarter, you will see, reflects R$96 million, which is a margin of 7.1%, and increasing 23% up from our quarter three 2013 EBITDA, up 70 basis points. And most importantly, for the third consecutive quarter this year, we're pleased to share that the business has continued to sustain margins above 7%. This actually gives us an improvement of a 110 basis points in our cumulative year-to-date margin of 7.1%, when we compare to the prior-year cumulative margin.

And just to share with you some of the main factors which are contributing to this margin enhancement. They very much reflect the greater efforts of our Moy Park team in improving operational performance. And that's in such areas such as raw material, yield, management improvement, where we've targeted investment in new equipment, have a clear focus on cost control, and also in continuous improvement programs focused on waste and downtime (30:46). And that includes also the benefits of our Grantham project.

In addition, through great teamwork and enhanced focus, we've been improving the planning of our birds into our production facilities, and also increased our production efficiencies through the volume growth through our operations. And you'll also see some margin benefit attributed to lower grain cost in the period.

So, we remain very focused on finishing our 2014 with the strong operating results, and I feel comfortable with the rest of the team that the fourth quarter should continue to reflect strong performance in our EBITDA margin performance, as we continue to focus on the customers in terms of innovation, service and quality, and turkey sales should also add to our bottom line in the fourth quarter, along with encouraging favorable grain environment. Thank you.

Sergio Agapito Lires Rial {BIO 1925337 <GO>}

Thank you, Janet. That's very helpful. So, we're now moving to slide 21. It is where we have Keystone. They certainly had a challenging quarter, Frank. So, I'll have now Frank, Keystone's CEO, to address us.

Frank M. Ravndal Jr. {BIO 2412717 <GO>}

Thanks, Sergio and good morning everyone. It was a challenging quarter overall for Keystone. Revenue was flat from prior quarters and down close to 5% versus the year-earlier period, and that reduction is largely in the U.S. and it's really the result of pricing agreements that we have in place with several large customers, with the cost of raw material or the feed costs are passed through to the final price. So, as grain prices are down from a year-ago levels, revenue on those sales has reduced as well.

Revenue in APMEA was also down slightly, as the sales mix was impacted by the incident in late July involving a competing protein supplier. Let me take a minute to talk about that situation and its impact on Keystone.

It was a very difficult situation for the industry overall, and had immediate impact on consumer confidence and sales with several customers. Following the closure of several plants of another supplier, we worked very closely with customers to work out new production schedules, to incorporate new SKUs and new volumes, and quickly work to ramp up capacity. And we mobilized a regional and global team from Keystone to help China in that effort.

Really, it was really a remarkable team (33:27) had the opportunity to go out to China on three separate occasions in August and September. And on one of those, we visited a facility where we were starting a new - getting new beef capacity online. And just in that room, there were several people from Australia, Korea, Thailand, U.S. in addition to a team from China from a different facility that was there to help that start-up.

I'm very proud of how our team in APMEA has responded to serve our customers' needs in a difficult situation. And we've picked up volume, and that impact will be seen more fully in the fourth quarter, as consumer confidence continues to return.

For Keystone overall, sales volume in the quarter grew slightly with a 6% increase in APMEA, largely offset by a small volume decline in the U.S. due to less promotional activity across our QSR customer base. And EBITDA margin in the quarter was 6.1%, which was down from 6.4% a year ago. The main drivers for that change were the higher prices for outside meat purchases that we need to make - remember, we are not 100% vertically integrated in our U.S. operations, as well as the R$2.3 million mark-to-market loss in the quarter as a result of grain hedges.

The high meat prices we have seen over the past five or six months have eased seasonally in the fourth quarter. The fourth quarter, overall, looks very solid. We are seeing lower prices on the outside meat. We have lower grain cost working our way to our vertical operations in the fourth quarter. And new volumes in APMEA will start to make an impact in the fourth quarter as consumer confidence continues to build.

Though the third quarter's EBITDA was disappointing, we've achieved a nine-month year-to-date margin of 7.1%. And I'm confident that the fourth quarter will be over 7% as well. Sergio?

Sergio Agapito Lires Rial {BIO 1925337 <GO>}

Thank you. Looks very good; I would like to thank both (35:34) and certainly recognize the efforts of our international businesses year-to-date. All businesses above 7%, but certainly two business that a year ago were more in the 6% range than they were in the 7%. So, thanks, I think it's a signal of being aligned and really working on the focus to win the strategy.

Slide 22, Marfrig Beef, very much helpful. Some of the things we already covered, a world that is short of beef. Demand is clearly there, and yet, in the third quarter, we haven't really fully capitalized as mentioned before on a weaker real. So, the business is still (36:16) exchange rate, and hopefully, we're going to see a better performance, even than we've seen in the third quarter and the fourth quarter.

It's interesting, not so much the shift to export, but where that meat has gone? I think China, and particularly, China/Hong Kong is already representing a very important destination for our businesses. Both in Brazil and Uruguay, I don't see that trend changing. I really see both the Chinese complex, if you will, become a very significant destination. And I think we, as Marfrig, have the obligation to do it better than our competitors in Brazil. One, because of what we have in China. We do have an operation and a good one, which is Keystone. So, we have to figure out how we can really connect smartly the critical destination market that it is for beef – for the beef industry overall and hopefully do better than most of our competitors trying to address the same market.

I don't think we're there yet, but we have to figure out. We certainly have established a small commercial team in Shanghai, but that's something not going to be enough in light of the huge opportunity, the Chinese market will represent for both Uruguay and Brazil.

I'm also really proud of what we're doing on the back of the things we can control, which is the so-called productivity agenda, as you can clearly see on that slide. So a 10.2% margin; solid margin there, and equally important helping the business, helping Marfrig, overall, to generate cash.

Slide 23, we're trying to give you – here, there are two very important messages. If you look to the right side of the table, Brazil (38:00) accessing a number of very important key markets. So North America together would be bigger than China in 2015. Of course, over time, China will take both the North American market and will be the biggest importer of meat, red meat, in the world, as they have been for most commodities in the world. But it's still today, the combination of U.S., Canada and Mexico would be the biggest destination market and we're seeing signals that things can change so much so that we have just got signals that Japan may actually open to Uruguay, which for us, would be terrific, because – not only because we're the largest company in Uruguay, but because the second and more important, Japan has the world's highest margins for beef business and a market that has been traditionally in the hands of American meatpackers.

So hopefully, we're going to see – unfortunately, we don't have as much volume as we would like to see out of Uruguay to address Japan. But it is just the beginning of a trend that we believe is going to be highly positive for Marfrig, and we're certainly well-positioned.

I would like to offer now, we go to slide 26. There are two other slides showing the recognition of the equity markets, what we are doing and also the bonds, but I think they're self-explanatory. And we always look at them with a lot of humility, because it's a lot of work ahead of us.

So, final remarks, on track, which I think in itself, it's an important achievement, despite sometimes anti-negative sentiments on the macro Brazil. But I think, again, we are well-positioned; 50% of our business in South America, beef and lamb; 50% outside of Brazil, primarily poultry.

So, we believe we're, from a portfolio point of view, really good, delivering positive free cash flow. It wasn't that clear one year ago, lots of people really raising their eyebrows. Can you actually do that for the year 2014? So, so far, we've been able to do it. And more importantly, the variance from where we were to where we are, a totally different redesigned debt maturity; you've seen that. But more importantly for me, it's operating performance; steady operating performance. All businesses above 7%, and I think uniquely positioned portfolio to capture those high-priced animal protein space that we're going through.

Marfrig Beef, for the same reasons that I just mentioned, I believe the export orientation should not change. But again, when we look at that, we don't have a particular goal that it's got to be x% to export markets. I think we do like to be closer to 50%, but we will always try. What is important here is to be flexible and nimble, to really capture where the opportunity is.

And sometimes the opportunities are in the food service channel and the small retail channel in Brazil. So, this is not about just going all the way to export. This is about balancing the portfolio and creating an infrastructure that's nimble and flexible, to really respond to where margins are. This is a classic commodity business that you've got to be very up-to-speed in the way you respond to significant changes of S&D, supply and demand.

We still believe there are plenty of opportunities to get this business to better – better levels of performance. I absolutely do. And whether it's China, we have a very significant import pool for all the market, being the second largest beef company in Brazil and the third in the world, we have the obligation to lead on a number of fronts, and we will.

The R$30 million target annually of cost savings is the beginning. It is modest. If we see the R$30 million already achieved in the third quarter, it can lead people to say, well why wouldn't you revise that? Because just the R$13 million on an annualized basis will be more than R$30 million. Well, we probably will. So let's first deliver what we said we would, and then we'll certainly – we're not going to be afraid of revising the targets. But let's first have the money in the counters before we really start revising it.

But what you can count is from my team, including myself and Marcos Molina for that matter, that the productivity agenda in Brazil is something that is very, very much on top of our mind, because if there's one thing we know, is one, there is demand for beef. Two, with that, cattle prices are not necessarily going to get cheaper. So, we got to have cushions around that can really help us to get levels of profitability and free cash flow than we deserve, and certainly shareholders deserve to see.

Uruguay, we believe fourth quarter will be even stronger. So, I have evidence of October. It's not the whole quarter, but I feel pretty comfortable that Uruguay will post its best performance in the fourth quarter. And for those who were not, Uruguay accounts for roughly 28% of total Marfrig beef – I think – sorry 20%, approximately 20% of whole Marfrig beef in Brazil. Cattle prices will not change in the short-term. So, we'll continue monitoring and we're going to try to do the best we can.

Keystone Foods, I would just stick to the last bullet point, which Frank was kind enough to share his conviction about fourth quarter. But more importantly than the fourth quarter, it is his conviction, I think, that this is a business that is structurally now on more of a 7% range, and we'll do whatever we can to continue improving that, more to come as we think about the year 2015 and 2016.

Moy Park, a business that we acquired back in 2008, selling £800 million and a business that by the end of this year will be selling – will be having revenues above £1.4 billion. If that's not a growth story, I don't know what that would be, without necessarily large acquisitions. So, this has been a phenomenal organic growth story; has certainly taken its share of CapEx, but it has also delivered.

And I think Janet, like Frank, are very much committed to margin expansion, and in doing the right thing from a growth perspective. Remember focus doing (44:02) profitable growth, not just growth.

I would like to share where (44:11) the market – the four graphs that you see here at the bottom of the page, page 30. There have been questions around Moy Park's IPO in 2014. I mean, we've said we were exploring, raising equity through the stocks, particularly Moy Park was (44:29) better prepared to do that from an IPO point of view than Keystone. And what we have seen in the UK market in 2014, first of all, very active. A very large number of IPOs did happen in UK, probably more than a combined number of years, the last three or four years.

And you see the price dynamic of what happened throughout the year. In the first quarter of 2014, most IPOs were actually priced – more than 50% of those IPOs were actually priced off or above the range. And as you move on to the second quarter, things will start changing in the third quarter, where we could potentially be in a position to really access the market, it would have not been the right timing to do it.

So, the whole thing about IPO of Moy Park is, first – (45:14) Moy Park in this particular case is being enabled. And today, I would say, we're a lot more prepared today than we were in the beginning of 2014.

If you go to slide 31, we do say and I would like to reaffirm (45:27) market that we will continue looking at smart equities through the subs. So if the conditions, as we have seen in the first half of 2014 would repeat in 2015, most likely, we would consider very seriously to IPO Moy Park, and we would do it for two very distinctive reasons.

I mean one, we do see the growth that Moy Park has had as still the beginning of what can happen in Europe – I mean Europe does post a phenomenal story of consolidation, still it would allow Moy Park to grow a lot faster and hopefully also with Marfrig. It would also help us to pay down debt.

There has been a report from a sales side basically saying, well Marfrig now because of the 11% (46:15) on the real is probably more under pressure to do the IPO of Moy Park, because its leverage is 4.8. If we just look – so, absolutely not. I mean I'm not particularly concerned about the third quarter 11% impact on the net debt in reais of Marfrig, because I know the operating performance will respond to a completely different exchange ratio.

We will do the IPO preserving value to Marfrig shareholders. Point number one, rebalancing, repricing 30% of the group, which is more or less what Moy Park represents hopefully at different multiples, and more importantly, being completely clear about our growth plan for Moy Park. Going to the market without a very clear growth plan of what we plan to do with the equity, it is not the right way to do it. And I feel having reached the end of 2014, and I think we have a pretty good idea about, Janet and I, what we could do with the rest of the team of Moy Park in terms of additional growth in Europe.

We remain very focused on the year 2014. We haven't finished. So we still have to deliver what we said we would do. And in terms of final remarks for the years to come, we are very close to 2015. We are certainly thinking about construing a two-year plan for 2015 and 2016, to give the market a couple of things.

First, what do we plan to do in terms of operating performance for the three businesses, for 2015 and 2016, on a very realistic (47:48) and date, but also how would the capital structure of Marfrig evolve in the next two years until a very important time, which is January 2017, when R$2.1 billion of converts, mandatory converts become equity. And from that moment on, we no longer have $100 million of interest expense to carry on.

So there, we hopefully we're going to be able to show the market couple of things. What we're going to do additional in terms of operating performance going forward? How it's going to be our cash flow position in 2015 and 2016? Can we actually see some more cash being generated to a point that not only we have, because in 2014, we have stabilized the group. But I think the market is probably expecting in those businesses, generate more cash, Moy Park, Keystone and Marfrig Beef, to a point that it can actually signal that Marfrig can at least give some signals of deleveraging. What kind of additional equity can we bring through the subs? And that's an important piece. But I think we will have to show, not just stock, and we will do it in a value-accretive way when the right opportunity comes.

So, with that, I'll stop, so that we allow time for Q&A. Thank you very much.

Q&A

Operator

Thank you. Ladies and gentlemen, we will now begin the question-and-answer session. Our first question comes from Daniela Savoia, JPMorgan.

Q - Daniel Sensel {BIO 16854713 <GO>}

Yes. Hi. Good morning. This is Daniel Sensel. So, you mentioned at the end that leverage is not that high, especially when you take into consideration that the balance sheet is suffering more of the weak FX, right? But if we analyze the last quarter, where you had a weaker FX, so your Brazil business had took the advantage of exporting more. (50:01) your net leverage is still four times, so it's slightly higher to what I think it should be.

So, on the other hand, we have - there's some pressure on cattle prices, not only Brazil, but also in other regions. So, the question is do you have - have you planned to take any other measures to reduce leverage, just in case there's no - margins don't improve as much as you expected? And also, when you're talking about IPO in Moy Park, what percentage of the company you might be willing to sell to the public? Thank you.

A - Sergio Agapito Lires Rial {BIO 1925337 <GO>}

Thank you , Daniel, (50:50) for your questions. So, we are a four times leveraged company, whether it's 4.2, 4.3, we don't need - I certainly don't need to be surgical. So, I recognize, a four times leverage for animal protein business, it is not where I would like to see the group to be on. Does that concern me right now? Absolutely not.

Do I want to see that reducing on a multi-year, which is not going to be five years? But in the next two, three years, absolutely. So, I think I put this point, we're a multiyear deleveraging company. Don't expect big swings in one particular quarter, because it's just not going to happen. What is going to happen is focus on performance, focus on cash flow, focus on reduction of interest expense, and focus on finding equity, if we can at the right time and at the right level.

So, we will not do the IPO of Moy Park because of four times leverage. We will do the IPO of Moy Park, because we will and we still do believe in Moy Park's growth, which over time is good for shareholders and for Marfrig.

Two, we will use the Moy Park - eventually IPO if it happens - to really position part of 30% of the portfolio, hopefully, at a different multiple than six times, which is where today, we are trading.

Third, use more of that proceeds to basically pay down debt. But even if we do that, I mean, it's not going to be significant to a point of changing the needle from four times to two times. I mean, there wouldn't be that sort of amount that would enable us to do that. So, it's all about small and multiple actions all in the right direction, that will, over time, bring us to where it should be.

Now, again, I want to make sure that I'm not seeking perfection. We're not going to be trading perfection for what's possible and optimal. But I think the fundamental piece - I don't know if you're on the fixed income side, but it feels like you're in the fixed income side - I think the fundamental piece has to be, are the three businesses of Marfrig performing as they should relative to their peers and relative to what they said they would.

So, if you look at our EBITDA for this year, I'm just putting that as a - not as a target, but let's say, it can get to R$1.7 billion just to put a number. Our interest expense, it's running on an annual basis of R$900 million. We're talking about a CapEx that is R$600 million, yet we are not deleveraging, but the company is, what I call, base zero; stable, nothing to worry at this point in time, have been able - so far the R$1.7 billion EBITDA, if we get there by the end of the year, it reflects an average foreign exchange in reais of R$2.29 not R$2.45 (53:44).

So I think the potential uplift of Marfrig's EBITDA for 2015, provided the performance doesn't get surprised with too many missiles - external missiles that can always happen, we should we going in the direction of R$2 billion going forward against our target. But it's just a reflection of the different foreign exchange role.

Q - Daniel Sensel {BIO 16854713 <GO>}

Okay. Yeah, well, that helps. My other concern is that I think in terms of interest expense, you've done a lot of liability management this year. So, besides maybe calling up on (54:21) here and there the next couple of years, I don't see much more that you can do there besides the converts. But okay. Thank you.

A - Sergio Agapito Lires Rial {BIO 1925337 <GO>}

No, thank you. I appreciate it.

Operator

Our next question comes from Jose Yordan, Deutschebank.

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

Hi. Good morning, Sergio and everyone. Well, thanks for the thorough presentation. Most of my questions have been answered except for one. I mean this cost plus pricing Keystone and the U.S., in theory, if you have a fixed margin and your costs go down, your percentage gross margin should be going up, and yet, that's not happening. So can you help me understand what's happening here in terms of how these things work? I realize that this is not all sort of cast in stone, et cetera. But in theory, much lower grain costs should have led to a slightly higher gross margin and any color you can give us on that would be great.

A - Sergio Agapito Lires Rial {BIO 1925337 <GO>}

Can you just make sure that you repeat your question? I want to make sure that - I mean, Frank and I, we're here, I want to make sure that I hear you. So you're saying - I'm going to repeat to make sure I understood. You're saying, okay, the cost (55:40) completely perfect. But as we move to a lower grain environment, why wouldn't I be seeing higher expanded gross margins? Is that what's the question?

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

Right. Because if you're making a $0.05 and your costs are $1, you're making 5%. If that same nickel on cost of $0.80 should give you a - should be a higher gross margin in general, in theory.

A - Sergio Agapito Lires Rial {BIO 1925337 <GO>}

Okay. Frank, would you like to respond?

A - Frank M. Ravndal Jr. {BIO 2412717 <GO>}

Yeah. I think we have that model in place for, I would say, the majority of our U.S. business, but not all of it. So we also have a very vibrant key account business, and many of those pricing mechanisms are not based on more of that commodity cost or pass-through, plus a specific profit margin type of formula. Even on the part that does have that, it can be a mix issue too just in terms of whether it's more value-oriented items or more premium items at a particular time. But I think we have about half of our sales in the U.S. really that are – at least half of our sales in the U.S. that are not on that basis.

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

And I guess what happened there was a mixed deterioration or something...

A - Frank M. Ravndal Jr. {BIO 2412717 <GO>}

So what you see on the number of our Key Accounts businesses when I talked about the impact of the higher meat prices on the outside purchases, that has a margin impact. It was negative for us this quarter.

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

All right. Understood. Thank you.

A - Sergio Agapito Lires Rial {BIO 1925337 <GO>}

Thank you.

Operator

Our next question comes from Alessandro Arlant, Merrill Lynch.

Q - Alessandro Arlant {BIO 15732215 <GO>}

Good afternoon to everyone. I have a question. If you could just talk about the material effect that was released in October, you're talking about taking ownership of five plants that you leased or that you have been leasing since 2009. Sergio, if you could give us some color on what are the expectations there and what could possibly be the cost of acquiring these plants, that'll be a good start. Thank you.

A - Sergio Agapito Lires Rial {BIO 1925337 <GO>}

Very good. Thanks for asking. A couple of things. We've done a number of – we have had a number of initiatives in the beef space in Brazil in terms of footprint. We actually have closed couple of plants. We haven't done a lot of noise because there's no point in creating a lot of noise. There's one that we have been very vocal about it which has been Alegrete, in the down south of Brazil which we have engaged the government and the unions to see where we can make that plant viable.

We're constantly looking at our footprint. We want to do as much as we do today with fewer plants. So that would be my dream design. I wish I could only have one and do the same amount. That's certainly technically not possible. But we certainly don't need 20 plus. So we will be looking and we continue to look. That's part of the productivity agenda, which is really look very close to footprint (59:10). Now, in the south and some of the other plants, (59:14), so we have those plants leased. We've been paying rental for those plants for a number of years. And now has come an opportunity for us to look whether we want to bring that situation from a rental to an ownership.

It's too early to give you more details about what the implications could be. I see this more something of a 2015. Whatever happens has to be in line with a very long tail because we're not just going to be adding that short term for the company. We're just not generating cash for that. So what I want to give the market reassurance is that however we construe, first, we have to be convinced that owning is a better decision long term for the company.

Second, how we do it equally important because we don't have a lot of space in the balance sheet to fool around. Third, I think, count on seeing more plants also being re-leased. I mean we have a number of plants that are on rental, and I think we will continue looking at that, Andrew Murchie is looking at that. So I would not be surprised if we're probably going to be freeing up two or three plants between now and end of 2015. So there's going to be a combination, whether the total doesn't change, but the mix and the design of our plants may change.

Q - Alessandro Arlant {BIO 15732215 <GO>}

Okay. Could you just give us some color on the capacity for these five plants, overall just so we can do some estimates (01:00:42) in terms of what you're talking about in terms of valuation?

A - Sergio Agapito Lires Rial {BIO 1925337 <GO>}

I mean, you're going to have to tell me if I can access cattle because part of the problem of those plants is not so much their capacity, it's part of the challenges. There isn't cattle remaining at the places where they are. It may change, not all of them, not all of them. But I wouldn't be able to give you right now what the capacity would be because I know exactly where you want to go, but rest assured that as early as next year, we're going to be able to explain to the market, if we come to the decision of really moving to ownership, that it will make sense for Marfrig.

Q - Alessandro Arlant {BIO 15732215 <GO>}

Okay. Fair enough. Thank you so much, Sergio.

Operator

This concludes today's question-and-answer session. I would like to invite Mr. Sergio Rial to proceed with his closing statements. Please go ahead, sir.

A - Sergio Agapito Lires Rial {BIO 1925337 <GO>}

So thank you very much. Thank you, all for being on the call. There are a number of people from different parts of the world, so I really appreciate. It's been a busy day in terms of release from a number of companies. So I appreciate you took the time to listen to our story. I want to thank both Janet and Frank for being here, together with Ricardo and myself. And now, we are working to focus on the fourth quarter. So hopefully we will end the year delighting the market. And actually whatever we can, being even ahead of our own target. So we'll do everything we can to really end 2014 with a very strong, strong result. So thank you very much.

Operator

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