

Q2 2019 Earnings Call

Company Participants

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

Other Participants

- Analyst
- Luca Cipiccia

Presentation

Operator

Good afternoon, ladies and gentlemen, and thank you for waiting. At this time, we would like to welcome everybody to Minerva Second Quarter of 2019 Results Conference Call. Today, with us, we have Mr. Fernando Queiroz, Chief Executive Officer; and Edison Ticle, CFO and 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 conference presentation.

(Operator Instructions) The audio and slideshow of this presentation are available through the live webcast at www.minervafoods.com/ir and in MVIQ platform. The slideshow can also be downloaded from the webcast platform in the Investor Relations section in this website. Before proceeding, we wish to mention that all forward-looking statements may be made during this presentation relating to Minerva's business prospects, operation and financial estimates and goals. They are based on the beliefs and assumptions of the company management and on the information currently available.

They involve risks, uncertainties and assumptions because they relate to future events and therefore depend on the circumstances that may or may not occur in the future. Investors should understand that the general economic conditions, industry conditions and other operating factors could also affect the future results of Minerva and could cause the results to differ materially from those expressed in such forward-looking statements. I wish now turn over the floor of the conference call for Mr. Fernando Queiroz, CEO, who will begin the presentation. Mr. Queiroz, you may proceed with your presentation.

Fernando Galletti de Queiroz {BIO 15387377 <GO>}

Thank you. Good morning, everyone, and thank you for participating in Minerva conference call on the results for the second quarter of 2019. I'd like to begin this conference with a brief discussion about our topic that has been widely discussed in the

last few months, the African swine fever and the opportunities related to the outbreak. Let's move on to Slide 2.

African swine fever is a disease that since the second half of 2018 has been disseminating in pig herds in Asia, particularly in China with a great impact on the animal protein market. In the graphic on the right, we see that pork accounts for a large share of the global meat diet, especially in China, where it represents almost 50% of the animal protein consumption. Almost all of which is supplied by their domestic production, this means that -- as a direct effect of the ASF outbreak in general, we expect to see a substantial reduction in this production therefore, prices rising and consumption of pork are suffering with it. According to the FAO the ASF outbreak has reached to 234 regions with confirmed cases, most of which in China and neighboring countries such as Vietnam, Cambodia and also in Eastern Europe.

Containing the outbreak represents an enormous sanitary challenge, since the disease is spread easily it is highly lethal to the herds and does not have any control mechanisms, such as preventive vaccines. As a result, some experts believe China Pig herd will shrink by 30%, which would be a great impact on the entire animal protein chain. It's worth noting that China has approximately 50% of the global peak herd. In the graph on the bottom left corner, we can see some interesting figures, such as the significant decline in pork production in China in 2019, and the prediction for 2020.

A clear consequence of the recent and the still present ASF outbreak in the country. There are some markets, indicators supporting that this supply shock will be offset --avoided partially by consumption of other proteins, such beef, thus creating a great opportunity to our industry. As we can see in the information on the bottom right corner, due to the availability of a healthy herd and low production costs in South America players currently account, we currently account for the 70% of the Chinese beef imports which have been increasing substantially in recent years. Thanks to the higher income levels urbanization and the homogenization of the consumption patterns in China.

These increase share of South American exporters also benefit from difficulties faced by other players, such as Australia, which has been increasingly facing tough climate conditions over the past few years, and United States, which has export restrictions due to the utilization of hormones in the herd, that is forbidden in China. And also the uncertainty related to the trade war. I would like to highlight Athena food exposure to the Chinese market mainly through our operations in Argentina. In the first half of 2019, our Rosario plant was on a global basis, the plant with the largest volume of beef exported to China among 100 and other unities worldwide.

In view of this good moment and in order to maximize the opportunity in the Chinese market in June, we resumed our operation in Venado Tuerto unit also in Argentina, currently this unit is in the ramp-up stage and it will be at full operation by late August. To conclude, we believe that African swine fever will further drive growth of beef consumption in china, indirectly benefiting beef producers in South America, the region is best prepared to meet growing demand in Southeast Asia. In this context, we believe that our footprint in south America. Our expertise and the Chinese market in the first effect of

the African swine fever outbreaks on animal protein consumption and its production chain will create great business opportunity in the upcoming quarters.

It's also worth to say, that this is -- this impact is not only a temporary issue, it's also has interesting long-term perspectives. As ASF outcome implies in protein consumption changes, not only because of prices, but also due to changes in population consumption habits. Let's move to Slide 3 to discuss the main highlights for the second quarter of 2019. We will begin with operating cash flow which totaled BRL322 million in the Q2 of 2019, and BRL1.3 billion in the last 12 months.

Another cash indicator, the free cash flow was positive for the sixth consecutive quarter, totaling a BRL143 million in the 2Q, 19, and BRL642 million in the last 12 months. Thanks to this strong operational performance, consolidated gross revenues totaled BRL4.3 billion in the 2Q, 19, and in all time highs BRL17.8 billion in the last 12 months ended in June. Our revenues breakdown shows that 43% of gross revenues or BRL1.9 billion came from Athena foods, our operation in South America, ex Brazil, the Brazilian industry division accounted for 42% of the total or BRL1.8 billion of consolidated revenues. Our Trading Division was responsible for the remaining 15%, with approximately BRL630 million.

In the second quarter minerva exports, once again stood out accounting for 67% of the gross revenue in the 2Q, 19, 14% higher than in the 2Q, 18. Consolidated net revenues reached BRL4 billion in the 2Q, 19, 8% more than in the 2Q, 18, reaching BRL16.7 billion in the last 12 months ended June. EBITDA totaled BRL364 million in the 2Q, 19, up 3% over the 2Q, 18, with an EBITDA margin of 9%, 20 basis points higher than in the previous quarter. Adjusted EBITDA came to BRL1.6 billion in the last 12 months, with an adjusted EBITDA margin of 9.6%.

The net result adjusted for the non-cash and non-recurring effect totaled approximately BRL27 million in the quarter. We closed the second quarter with leverage measured by net debt to LTM EBITDA ratio of 3.8x, in line with the 1Q, 19. Our debt duration remained at a very comfortable level at around five years, it's worth noting that in early April, we concluded the redemption of our perpetual bonds, our most expensive debt reinforcing the company's commitment to pursuing a more efficient capital structure. Let's have a look on Slide 4, where we'll talk briefly about Minerva's operating performance beginning with our exports.

In the 2Q, 19, Minerva continued to be the main exporter in the countries where it operates. In Paraguay, we accounted for 47% of the beef exports, consolidating our position as the country's main exporter, In Uruguay, we had 20% market share of beef exports. In Argentina, our market share reached 70%, six percentage points more than in the previous quarter. It's important to point out that we maintain our position, as the leading South America beef exporter, with 21% market share.

and recalling that South America, represents 35% of the global exports, Minerva's total exports represent approximately 7% of the worldwide exports of beef. On the right side of this Slide, we have a breakdown of exports by region. In the Brazilian industry, division the two main destinations, were Asia and Middle East, which together accounted for more

than half of the division. In Athena Foods exports, Asia was once again, the main destination accounting for 42% of exports, 11 percentage points more than in the same period last year.

I believe that it will be useful to talk about increasing Athena exports growth to China, in particular as revenues from exports to this country as they grew 61% between 2Q, '18, and 2Q, '19. This means, that in addition to the market share growth, we also had a significant increase in our volume of exports to Asia in the last 12 months. I'd now pass the floor to Edison that will discuss Minerva main financial and operating highlights.

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

Thank you, Fernando.

Let's move to Slide 5. Minerva's gross revenue reached BRL 4.3 billion in the 2Q, '19, 80% more than in the 2Q, '18, in the last 12 months ended in June, gross revenue reached BRL17.8 billion, an all-time high and a 14% higher than in the LTM second quarter '18. The Brazilian Industry divisions capacity utilization rate declined to approximately 76.7%, following 3.4 percentage points from the previous quarter. The decline was mostly due to the rainy season, which lasted a little longer than normal at the beginning of the quarter, and the one week and also the one week suspension of exports to China.

At Athena Food, the capacity utilization rate stood at 75.4% in the quarter, 3.9 percentage points higher than in the first quarter of '19. We were able to increase the capacity utilization rate, thanks to higher demand in China; and this increase was more noticeable in Argentina; and partial normalization of paraguay's laughter volumes that were a little bit lower in the first quarter due to the rainfall. Overall, the company's consolidated installed capacity utilization rate was at 76% in the second quarter, in line with the first quarter, and we're seeing the 75% to 80% range that we considered to be ideal. On the upper right corner, we have a breakdown of the company's gross revenue by division.

For the first time, Athena Foods Division accounted for 43%, and became bigger than the other Divisions in Minerva. Brazilian Industry Division contributed 42% and the Trading Division generated 15% of gross revenues in the second quarter '19. Finally, on the bottom right corner, we also again emphasized that the great exposure of Minerva consolidated exports to regions with strong potential demand, such as Asia, especially China that accounted for 37% of total exports in the quarter. Let's move to Slide 6 to continue discussing operating results.

The Company's consolidated net revenue reached BRL4 billion in the second quarter, 8% higher than in the same period last year, while in the last 12 months ending June, net revenues stood at BRL16.7 billion. A growth of 12% year-on-year, also regarding our top line exports accounted for around 67% of gross revenue in the Brazilian Industry Division, and 77% in Athena Foods. EBITDA reached BRL364 million in the quarter, 3% higher year on year, and also a record for our second quarter with an EBITDA margin of 9%. In the last 12 months adjusted EBITDA reached BRL 1.6 billion, with a margin of 9.6%.

FINAL

Bloomberg Transcript

FINAL

Finally, the net debt to EBITDA ratio stood at 3.8x in the quarter, practically in line with fourth quarter and first quarter '19. We will now move on to Slide 7 to discuss net results and cash flow. Considering the net results before income and social contribution taxes and excluding the non-cash effect that impacted the results, such as FX variation, monetary correction in Argentina, FX hedge and exceptionally in this quarter, the payment of the consent solicitation to our bond holders, the company would have record a net income before taxes of approximately BRL27 million. Bear in mind that the consent was a waiver signed in April, to exclude Athena Food from the guarantees structure of the bonds issued by Minerva.

In terms of cash operating cash flow, we have BRL322 million in the second quarter, net income adjustment was BRL336 million, while the working capital variation was a positive BRL99 million. Our working capital line was supported by the suppliers line, that contributed with BRL46 million in cash in the quarter and the other payables line which includes the advances from clients, that generated cash of around BRL132 million. This line is a little bit volatile, because it's correlated to our credit policy and to the destinations of our export. The credit policy requires prepayments depending on the countries, depending on the client credit score, so there's a great correlation between this account and the breakdown of our sales.

In the second quarter '19, recurring free cash flow was BRL143 million, we begin to build up with an EBITDA of BRL264 million, CapEx of BRL68 million, and negative financial result of BRL295 million and finally a positive variation of working capital of BRL99 million, which resulted in a positive free cash flow of approximately BRL100 million. However, with the adjustment for the non-recurring effect of BRL43 million related to the consent solicitation, the recurring free cash flow in this quarter was BRL143 million. It's important to highlight that this is the sixth consecutive quarters of positive free cash flow, which is a very important indicator for the industry, since we are in a commodity sector, so cash flow generation is pretty much volatile. This results reflect the company's commitment to pursuing a more efficient and operational financial management for the long-term.

Finally, recurring free cash flow reached a substantial BRL642 million in the last 12 months. We started, with an EBITDA of BRL1.6 billion in the period, CapEx of BRL186 million, negative financial result of approximately BRL1 billion and a positive variation in working capital of BRL196 million resulting in a positive free cash flow of approximately BRL580 million. Finally, adjusting for the recurring -- adjusting for the nonrecurring items in the period that were around BRL63 million, we have recurring free cash flow of BRL642 million for the last 12 months. Let's move to the last Slide of the presentation to discuss capital structure.

Our leverage as we already mentioned measured by the net debt to EBITDA ratio remained flat at 3.8x at the end of June, the company had a cash position of BRL3.1 billion at the end of the quarter and around 75% of our debt was exposed to the dollar variation. Duration of our debt is approximately five years, and it's also worth noting, the reduction of approximately BRL750 million in our gross debt. Showing our commitment to pursue a more balanced capital structure in order to reduce the carrying costs of our cash and also reduce the financial expenses going further. Still on the topic of liability management in the second quarter, we issued a local debenture in -- we issued BRL400 million of a local

debenture at the rate of CDI plus 180 basis points, it's a three-year debenture and 100% of the proceeds were used it to refinance short-term debt.

This concludes our presentation and let's now begin the Q&A section. Thank you very much. (Question And Answer)

Operator

Thank you. We will now we have a question from Luca from Goldman Sachs.

You may proceed.

Luca Cipiccia {BIO 6914452 <GO>}

Hi, good morning. Thanks for the for the question. I listened to the earlier call.

So I only have a more of a -- maybe more of a general sort of follow-up on capital structure. I mean the results today I mean think everything we keep hearing and seeing clearly shows the environment, the outlook for the sector has improved the changed, is looked better. And especially compared to when you sort of initially started to examine or look into the Athena Food transaction since then. So with that in mind, can you maybe walk us through how -- is that still, the only and preferred option or how fluid is that discussion in terms of other alternatives for deleveraging capital structure, especially considering what might be the optimal corporate structure sort of in the medium term, now that the urgency still there from a balance sheer financial standpoint, but maybe it's a little less pressing given how the sector and the outlook has evolved? Thanks.

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

Hi, Luca. Just one thing I think that deal of Athena Food has two important objectives for us. The first one obviously is to speed up the deleveraging process of our balance sheet. But I think there's another one which is unlock value -- unlock or hidden value from our international operations.

So when we pursued the growth of Athena Food, we have these two main objectives in mind. We have been very careful in terms of evaluation to do this IPO We have the chance or the option to the IPO until April next year. But obviously, we are open to the opportunities, to other alternatives. But so far, we keep having the IPO of Athena Food as our plan A.

Luca Cipiccia {BIO 6914452 <GO>}

Right. And sorry just when you say hidden value, why would it be hidden? At the end of the day, you're in the same sector, you are listed in Brazil which is arguably the most developed of the markets in LATAM and one where there's probably a greater awareness and understanding about the protein industry in general. So when you -- I think you mentioned the hidden value before, but like why would it be hidden?

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

Yeah. It's a good question Luca.

Firstly, the multiples of the companies in the sector in Brazil, they suffered a bit because of the high leverage of the sector. As you probably know Athena Food has practically no debt. So this would imply a premium to Athena food compared to any other listed player in Brazil. The second is that the growth of Minerva, 100% of the growth will be done in Athena Food.

So when you see the growth in Minerva, it's diluted in our operation, when you focus on in Athena, Athena Foods, it tends to be an important growth company. And third, Athena Foods has more access to markets that are growing more fast in the world, like Asia, like China, it's much more exposed to those markets than Minerva as a whole. So I think that there are couple of reasons that would imply Athena Food to have a better valuation than Minerva. I think I mentioned 3 the 3 most important of them, but if you want, we can discuss further other reasons why we see Athena Food at the higher valuation than Minerva.

Fernando Galletti de Queiroz {BIO 15387377 <GO>}

I would add to what Edison said Luca, that our position as leading in northeast countries in South America that we are in, this also brings a different value for being the number one or number two exporters in Northeast countries that we have.

Luca Cipiccia {BIO 6914452 <GO>}

Thank you. That was clear. Thank you.

Thanks for the clarification for the answers. Very interesting. Thank you.

Operator

(Operator Instructions).

Our next question is from Thiago Melo from [ph]. Thiago, you may proceed.

Analyst

Yeah. Hi, Fernando, thanks for the question.

So I'd like to ask you on food service. So in our view, the segment has become something of a trending topic, and we see it gaining some investor attention. So I would like to know if you have any updates on this segment in both in both terms of growth and profitability. Especially now due to the ASF? And also we have talked to some other protein

companies such as for example BRF, and they have mentioned interest in teaming up for possible food service partnership.

So I would like to know if that would be on the table for Minerva. Thank you.

Fernando Galletti de Queiroz {BIO 15387377 <GO>}

Worldwide, we are present in three main segments. It's the retailers, the industries, and the food service.

There is a big growth and a lot of demand from the food service segment. That's why Minerva is specialized in working in Niche. So we have -- we are one of the biggest exporter of organic, we are one of the biggest exporter on the special breeds such as Hereford or Angus So things like that, it's part of our strategic plan. The growth especially in Southeast of Asia, is very focus into the food service where our presence is very strong and keeps growing.

We are world suppliers of food service chains. So we are very close and we're partnering with them on the development or their development on their products. It's a part of our strategy to be and it's part of what's happening to the world that will be more and more segmented.

Luca Cipiccia {BIO 6914452 <GO>}

Okay.

Thank you. So just a quick follow-up. So in terms of partnerships, would you see something possible due to either protein portfolio diversification?

Fernando Galletti de Queiroz {BIO 15387377 <GO>}

No. We will not go down to the chain.

Our focus is to produce in the organs and to have partnerships in delivering the product to our clients. We are not operators of food service chain, is not our focus.

Luca Cipiccia {BIO 6914452 <GO>}

Yeah, okay. Thank you very much.

Operator

(Operator Instructions). As there are no further questions. This concludes the question-and-answer session. At this time, I would like to turn the floor over to Mr.Fernando Queiroz for any closing remarks.

Fernando Galletti de Queiroz {BIO 15387377 <GO>}

I would like to end this conference call by emphasizing that we remain confident in our business model, in our team's hard work, and in the combination of meritocracy, appropriate strategy, operational efficiency, capital discipline, and commitment to the ethical and sustainable as is the best way to create long-term value. Once again, would like to thank all the Minerva team for their effort and dedication to reach the results that we discussed today. I would like to thank you all for the interest in Minerva, and please feel free to contact us, should you have any questions. Thank you very much.

Operator

Thank you. This concludes today's presentation. You may disconnect your lines at this time. Have a nice day.

This transcript may not be 100 percent accurate and may contain misspellings and other inaccuracies. This transcript is provided "as is", without express or implied warranties of any kind. Bloomberg retains all rights to this transcript and provides it solely for your personal, non-commercial use. Bloomberg, its suppliers and third-party agents shall have no liability for errors in this transcript or for lost profits, losses, or direct, indirect, incidental, consequential, special or punitive damages in connection with the furnishing, performance or use of such transcript. Neither the information nor any opinion expressed in this transcript constitutes a solicitation of the purchase or sale of securities or commodities. Any opinion expressed in the transcript does not necessarily reflect the views of Bloomberg LP. © COPYRIGHT 2022, BLOOMBERG LP. All rights reserved. Any reproduction, redistribution or retransmission is expressly prohibited.