Q3 2018 Earnings Call

Company Participants

- Andre Nogueira de Souza, President & Chief Executive Officer
- Gilberto Tomazoni, Chairman, Pilgrim's Pride Corporation & Chief Executive Officer, JBS Foods
- Jeremiah Alphonsus O'Callaghan, Investor Relations Officer
- Wesley Mendonça Batista, Director & President-JBS Brazil
- [09PT62-E Jerry O'Callaghan]

Other Participants

- Alan Alanis, Analyst
- Benjamin M. Theurer, Analyst
- Bryan C. Hunt, Analyst
- Carla Casella, Analyst
- Luca Cipiccia, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning, everyone, and thank you – and welcome to JBS' Conference Call. During this call, we will present and analyze the results for the third quarter of 2018. As requested by JBS, this event is being recorded. The recording will be available this afternoon and can be accessed by following the instructions posted on the company's website at www.jbs.com.br/ir.

Taking part on this call, we have Mr. Gilberto Tomazoni, COO of JBS Global; Mr. Andre Nogueira, President of JBS USA; Mr. Wesley Batista Filho, President of JBS Brazil; and Mr. Jerry O'Callaghan, Investor Relations Officer of JBS SA.

Now, I'll turn the conference over to Mr. Jerry O'Callaghan. Please go ahead, sir.

[09PT62-E Jerry O'Callaghan]

Thank you and good morning. Welcome to our conference call. Thank you all for being with us. Just to mention before I hand you over to Mr. Tomazoni here, we posted a presentation on our website about half an hour ago which we will use as a base during this presentation, during our prepared comments. So, please bear that in mind and page 2 of that presentation is a disclaimer. So, we recommend that you read that disclaimer as well in order to get the content of it.

And so before we get into the actual presentation itself, I want to hand you over to Mr. Tomazoni who will make some initial comments here. Mr. Tomazoni?

Gilberto Tomazoni {BIO 2090061 <GO>}

Well, thank you, Jerry. Good morning. Welcome to our third quarter earnings conference call. We are very pleased to report another quarter of solid performance. In the last four quarters (00:01:55), we have consistently delivered everything we promised. Nothing happened by chance. We are harvesting the benefits of our focus on executing our simple strategy, which is to produce high-quality products positively (00:02:15) manage the mix of those products and brands, and to do so with great discipline with regards to cost and cash generation.

Most importantly, our team, we have an extraordinary team with deep knowledge of the industry and each of the business. Our senior management lead with ownership (00:02:41) to perform with sense of urgency and absolute determination to let things happen. It has also been evident that our performance in recent quarters showed the power of our business model diversified by region and by type of closing (00:03:04).

Before I get to – in the details of the quarter results, I want to emphasize our priorities. In previous quarters, I have done this at the end of the call, but I thought it's appropriate to bring it to the beginning because our priorities underpin what we are going to present today. Our priorities are, first, continuous focus on operational excellence. We strive to be the best operator in the market and many of our business has consistently outperformed their direct competitors. Second, organic growth, which means optimize our assets to the maximum. Third, continuous investment in quality and innovation. In this regard, I would like to point out that, in October at SIAL fair in Paris, Seara won the innovation award of the 100% Natural Chicken category. Number four, deleverage. Here, I want to make an important point. Since the second quarter of 2017, we have repaid $4.3 billion on debt which translate into annualized reduction in financial cost of around $300 million. In summary, we delivered what we have promised. And finally, our robust Global Compliance Program which has received compliments and acknowledgements in Brazil and abroad.

Well, let's turn to the numbers. Net revenue in the quarter was approximately BRL 50 billion, a 20% increase over the second quarter. EBITDA was a record BRL 4.4 billion. Operating cash generation was BRL 4.3 billion, and free cash generated in the quarter was BRL 2.3 billion. Our short-term debt decreased from 27% in the third quarter in 2017 to 5% in the quarter, a significant change in profile.

To reinforce what I have said since – or what I've said since 2017, second quarter 2017 or in the last 12 months, we have repaid $3.3 billion. In additional, in October, we paid another $1 billion. Speaking to (00:06:24) my initial remarks, I want to emphasize two points. First, value added products are growing in importance in our portfolio. One of the drivers of growth has been acquisitions, Seara in in Brazil, Moy Park in Europe, Primo in Australia, and Plumrose and (00:06:49) in U.S. However, innovation is also incredibly important to us. The product, our team has successfully created and brought to the market is truly impressive.

The second point has to do with growth. The growth of protein consumption in Asia is quite remarkable. As a result of our diversified platform, we are extremely well-positioned to meet the demands. In addition, our focus on superior product quality and our obsession with excellent customer service enable us to sign several memorandum of intent with local companies during the SIAL, this – the China Import Expo Fair (00:07:41). The total value of this memoranda is $3.4 billion.

Now, I will hand it over to Jerry who will take you through the financial details of the quarter. Jerry, please.

[09PT62-E Jerry O'Callaghan]

Thank you, Tomazoni. Thank you very much. Again, just remembering, I will make reference to page numbers in the presentation that we have on our website as I go through our numbers and I will start on page 3. Some of these numbers are repeated but I will try to be as short as I can.

Net revenue, as Tomazoni mentioned, approached BRL 50 billion, BRL 49.4 billion, that was up over 20% in relation to the same quarter in 2017. Consolidated EBITDA increased by 2.6% to BRL 4.4 billion, that is the highest EBITDA that JBS has had in a quarter in the history of the company.

Adjusted net income was BRL 2.1 billion and we reported a net loss with the adjustment of BRL 133.5 million. Importantly, cash flow from operation – operational activities was at BRL 4.3 billion and free cash flow, as Tomazoni mentioned, was at BRL 2.3 billion.

Leverage in U.S. dollars reduced to under 3 times in the quarter, compared to 3.45 times in the corresponding quarter in 2017. We had $710 million of reduction in net debt in the third quarter in 2018. Short-term debt as a percentage of total net debt reduced to 5%. That was 27% a year ago.

So, on page 4, we see again net revenue increased in relation to the previous year. Gross profits were up also 11.3%, although gross profit margin was down from 16.7% down to 15.4% in the corresponding quarter.

EBITDA on page 5 in our presentation was at BRL 4.43 billion, up from BRL 4.32 billion in the corresponding quarter last year. EBITDA margin was down from 10.5% to 9%. And again, adjusted net income came in at BRL 2.13 billion (sic) [BRL 2.14 billion] (00:10:18) in the quarter and when considering the non-recurring events of the quarter, we reported a net loss of BRL 133.5 million.

Operating cash flow increased in relation to the corresponding quarter of 2017 from BRL 3.5 billion to BRL 4.3 billion and our free cash flow in the quarter was down from the BRL 3.2 billion in the third quarter last year to BRL 2.3 billion in the third quarter of this year.

In terms of leverage we have on page 7 of our presentation, a picture that goes back to the second quarter of 2017 to demonstrate how leverage has evolved since then, and particularly leverage in dollar. And I do recommend that we look at leverage in dollar because of the amount of debt or that 95% of the total debt of the company is in U.S. dollars. And also, a major portion of operating income and net EBITDA is also in U.S. dollars.

We had net debt in U.S. dollars from the second quarter of 2017 reduced from $15.2 billion to $12.4 billion at the end of the third quarter in 2018. And we see leverage declining from above 4 times in dollars down to 2.99 times at the end of the quarter. Also in reais, we've seen a relevant decline in leverage. But the evolution of FX of the real against the U.S. dollar in the last quarter doesn't reflect the reality of the leverage reduction in reais.

Tomazoni mentioned gross debt reduction over the last five quarters as well, and we see this on page 8 in our presentation. Gross debt declined from $18.7 billion down to $15.4 billion, a $3.3 billion reduction in gross debt up to the end of September in 2018. And we see that cash and availability increased over that period from $4.2 billion at the end of the second quarter of 2017 up to $5 billion availability including those committed lines that we have in the U.S.

After the end of the third quarter, we already announced to the market, and I will quickly summarize the liability activities that we had in the fourth quarter. We made a tender offer for the redemption of $1 billion of JBS SA bonds which mature in October 2020. And we also made a tender offer for the redemption of approximately $500 million of the Senior Notes of JBS USA which mature in 2021.

Parallel, we issued a new bond at JBS SA for $500 million and, together with the proceeds of that new bond which matures in January 2026, with cash on hand, we were able to repurchase the totality of the 2020 bonds and also pay the tender offer with – in relation to the 2021 JBS SA (sic) [JBS USA] (00:13:55) bonds.

So, gross debt effectively after the quarter reduced by a further $1 billion. So, when we add that on to the $3.3 billion of gross debt reduction over the last five quarters, that's a total of $4.3 billion that we've reduced gross debt which, as Tomazoni mentioned in his initial remarks, represents a reduction in financial expenses in the region of $300 million per annum.

Also, after the end of the quarter, JBS USA renewed its revolving credit facility in the U.S., a total of $900 million, which is guaranteed for the next five years in conditions and in price similar to the previous agreement. And additionally to the revolving credit facility in the U.S., JBS Australia took on a new revolving credit line in the amount of AUD 200 million, which is guaranteed for the next couple of years as well.

On to page 9 in our presentation, and a little bit more about our debt situation. Firstly, our liquidity or our availability of available cash, there's $12.1 billion. And when we add the BRL 8 billion of committed facilities in the U.S., that gives us a total liquidity of BRL 20 billion at the end of the quarter. As I mentioned, 95% percent of our net debt is in the long term, 5% percent in the short term. The breakdown today is 77% in capital markets and 23% with commercial banks. By entity, 62% practically of our debt is at JBS USA,32% at JBS SA, and 6% at Seara. And by currency, also I mentioned earlier, 96% practically of our debt is in U.S. dollars and 4% in reais with the cost under 6% with our U.S. dollar denominated debt and under 9% with the real denominated debt.

Now on page 10 and over the next few pages, some more color with regard to each one of our business units. There are five business units starting with Seara which is our pork, poultry, and prepared foods in Brazil. Net revenue increased by 8.8% in relation to the corresponding quarter last year from BRL 4.6 billion to practically BRL 5 billion in the period. EBITDA went from BRL 508 million (sic) [BRL 508 million] (00:16:40) to BRL 512 million with EBITDA margin decreasing from 11.1% to 10.3%.

As I mentioned, net revenue was up 8.8% in the quarter, mainly as a result of higher sales prices. In the domestic market, net revenue grew by 9.8% compared to the third quarter in 2017, fresh poultry and prepared foods being the highlights, where average sales prices increased by 11.9% and 8.4% respectively.

Net revenue from exports increased by 7.6% compared with the quarter of last year, with average export prices up 25.1% in fresh poultry and 21.6% in prepared foods. This quarter's results were significantly impacted by higher corn and soybean costs in Brazil, up 44% when compared with the same period last year.

Seara continues to focus on profitability prioritizing higher value added products and premium brands to the detriment of lower priced brands. And Seara is also developing a brand strategy in the Middle East. Recently, Seara has been awarded some relevant accolades F1 Innovation Awards (sic) [FI Innovation Awards] (00:18:08) which is a Latin America innovation platform awarded Seara a first prize and a third prize in relation in two of its categories, the Seara Rotisserie product and as Most Innovative Food Product in 2018, and the DaGranja natural products in third place in the same category. Also last month, in Paris at the SIAL food fair in Paris, Seara was awarded there SIAL Innovation Award for the same Seara Natural – 100% Natural product line in the poultry category in Brazil.

Moving on to page 12 in our presentation, what we call JBS Brazil which includes our beef business in Brazil, our leather and hides business in Brazil, and also related businesses. Net revenue was up quite substantially from BRL 5.1 billion last year to over BRL 7 billion this year, up 37.2%. EBITDA also was up almost 10 times from BRL 72 million last year to BRL 712 million this year with an EBITDA margin increasing from 1.4% to 10.1%.

In the domestic market, net revenue grew by 23.2% thanks to an increase of 18% in volume and 4.4% in sales prices. Net revenue for the export market grew by 54.1%, as a result of a 30% (sic) [30.5%] (00:19:45) higher volumes and an 18.1% higher sales prices. The devaluation of the Brazilian real also positively impacted revenue growth in the export market. EBITDA margin 10.1% reflects adequate capacity utilization as well as the focus on sales through more profitable channels and brands, coupled with more favorable market conditions.

JBS USA Beef, page 13 in our presentation, our largest business unit, and here we are reporting in U.S. dollars and not in reais anymore. Revenue came in at $5.4 billion in the period, down marginally from $5.5 billion in the same period last year. EBITDA was up from $405 million to $447 million with EBITDA margin increasing from 7.3% last year to 8.2% this year.

The strong economic fundamentals in the domestic markets boosted beef consumption in North America, in the U.S. and in Canada. A more diversified product mix and strategic partnerships with local and foreign key customers enhanced beef results in the United States and in Canada. Export market share has continued to grow with increased profitability as a result of an improved mix of exports in – of products in the export market.

JBS Australia posted stronger results in comparison to the corresponding quarter last year. Geographical proximity to Asia represents a key competitive advantage in supplying increasing demand from the Asian region. With an innovative, high quality product offering, good customer service level, and focus on operational efficiencies, Primo Smallgoods in Australia was able to increase sales and deliver relevant profitability.

JBS USA Pork, page 14 in our presentation. Revenue declined by 17.5% from $1.69 billion, down to $1.39 billion, primarily as a result of a decrease in average sale prices. EBITDA was down from $256 million to $138 million, a decline of almost 46%. EBITDA margin was down from 15.1%, down to 9.9%. There was an increase in pork supply in the domestic market in the US. Raw material costs also declined during the quarter, minimizing the impact of the decrease in prices on margins.

In the third quarter 2018, JBS USA Pork increased production capacity and sales of higher value added products, strengthening its mix while meeting demand from important customers. Plumrose, which is part of the JBS USA Pork business unit, continued to successfully implement its strategy of increasing production and launching innovative products. For the period, the company again delivered – Plumrose again delivered solid operating results in line with previous quarters.

Special attention has been given to the outbreaks of African Swine Fever, which are being recently reported, particularly in China and also in Europe due to the potential impact of these outbreaks in the global supply and demand of pork products.

Pilgrim's Pride even (00:23:24) has already reported its earnings to the market a couple of weeks ago. Revenue was down 3.4% from $2.8 billion, down to $2.7 billion basically. EBITDA was down from $463.6 million in the third quarter of last year, down to $156 million in the third quarter of this year. EBITDA margin declining from 16.6% to 5.8%. There were lower domestic sales which were partially offset by higher volumes.

In Mexico, revenue was down 10% as a result of a reduction in sales prices and a negative impact from FX variation of the Mexican peso into U.S. dollars. In Europe, net revenue grew by 2.4% thanks to a 4.6% higher sales prices partially offset by lower volumes. Integration of Moy Park into PPC is tracking better than expectations and is ahead head of the $50 million dollar synergy target which was set for the next two years.

A little bit about the rating agencies having spoken about the business units, page 16 in our presentation. We've had relevant evolution in our ratings at JBS SA in 2017. So, we demonstrate it on page 16. We've had our rating – Moody's increased from B3 rating at the end of the year to a Ba3 rating recently. And going into the fourth quarter in 2018, similar trends from Standard & Poor's where our rating at the beginning of the year was a B flat rating. Today, the company is rated by Standard & Poor's as a BB- with a positive outlook at Standard & Poor's.

Moving on, just – Tomazoni mentioned this also in his prepared remarks, about China. There was a China International Import Exposition earlier this month, early in November in China. And JBS had a relevant presence at the event. And we signed a number of memorandums of understanding with a variety of customers to supply a bigger portion of meat products not only from Brazil but also from other regions (00:25:52) where JBS has production platforms. The most relevant MoU was with Alibaba to supply them $1.5 billion worth of products over the next three years. Also, we signed agreements with Unifood, with Grand Farm, with CP, and with others. In a total amount of $3.4 billion of exports to China in the coming years.

And just before I – we open up for Q&A, and to do a little bit with the global demand that we see outside of the platforms where we have production. On page 18 in our presentation, we wanted to highlight our unique global platform where we have activities in North America, in South America, in Europe, and in Asia. And where we basically export to all of the global markets out of these production platforms with a relevant presence in Asia, in Africa, and in the Middle East, some relevant sales to Europe, around South America as well. So, just to demonstrate our unique global production and export platform on page 18.

With that, that then concludes our presentation. We would like now to open up the line for questions and answers. Operator, can you please do that. Thank you.

Q&A

Operator

Thank you. Ladies and gentlemen, we will now begin the question-and-answer session. Our first question comes from Bryan Hunt, Wells Fargo.

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

Hi, Bryan.

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

Good morning, Jerry. I was wondering if you could talk about the new Supply Agreement with Alibaba, whether you'll need to invest any capital to meet those demands? And how does that agreement influence exports out of your other entities in the U.S. and Australia perhaps? Thank you.

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

Okay, Bryan. Well, the agreement – it's a memorandum of understanding, let's be clear on that. Obviously, we need to work on making it operational. Basically, it's an agreement to supply Alibaba their – what they call their Win-Chain (00:28:24), which is their refrigerated distribution chain in China, out of Brazil. So, it's basically out of Brazil. It's beef, poultry and potentially pork in the future as well. It does not involve any initial investments or any incremental investments. The plan is that we dedicate a portion of our production capacity in Brazil to supply this channel, which is a channel obviously which has a lot of potential for growth because it's a channel to the end user. So, basically, no incremental investment and potential to supply that out of our existing facilities in Brazil.

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

Okay. And sending that incremental volume to China over and above what you're sending today, does that influence how the company balances exports out of Australia and/or the United States to other markets?

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

Yeah. Well, Australia is a relevant exporter and also signed an agreement during that exposition that we mentioned to supply products also to its customer base in China. So, basically, Australia is also enhancing its exports into that market. The U.S. right now doesn't have a lot of access directly into the Chinese markets. So, there isn't a lot of influence on U.S. exports which are basically directed to other markets. Many of them in Asia and growing export volumes out of the U.S. as well but not directly into China.

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

What's the relevant size of the Australian agreement into China?

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

That was published by the import company. If I am not mistaken, Bryan, it was about $150 million – $145 million, $150 million.

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

And that's annually?

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

(00:30:19) by the import company.

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

Okay. Shifting gears, how is the drought in New South Wales and Victoria? That's been ongoing for over 12 months. Is that impacting your Australia Southern Division's availability of livestock, and if so, when do you see it curing itself and normalizing?

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

Andre?

A - Andre Nogueira de Souza {BIO 17758053 <GO>}

Hi, Bryan. Just to complete a little bit the previous questions, I think that the relevance of China region overall, Bryan, is the growth in demand and the growth in imports. If you combine China, Hong Kong 10 years ago, they would each (00:31:02) import 160,000 metric tons of beef. Now, they import 1.6 million metric tons of beef. So, it's 10 times and became the largest importer globally. That's something that we cannot lose the perspective, how big has been the growth (00:31:22) of demand and there's a consequence (00:31:25) protein overall in Asia (00:31:28). And there is no company that has the footprint, the access, the distribution that we already have (00:31:35) to supply the demand. So, I think that we have our extremely strong position from Brazil, from Australia, from U.S., from Canada to support the growth of demand in between that area (00:31:48).

Talk about New South Wales now. They're a little bit of improving the drought. The impact in the drought in that area, Bryan, is in grain price (00:31:58) in Australia. That's an important area to produce grain. Grain price more than doubled this year compared to last year. They are not really a (00:32:10) producer of cattle, so cattle in Queensland is delivered in Queensland (00:32:14) (00:32:16-00:32:21) so I think that I can say that Queensland overall, it's bearable, normal. So, New South Wales is not causing the disruption of beef. A little bit more relevant in land (00:32:33) but again, start of (00:32:36-00:32:42) it started there within (00:32:42) South Australia, in Victoria with very good conditions, so on the other hand, from their growing demand production there, the land are in (00:32:53) very good condition (00:32:54) so, the big impact is in grain. Grain price in Australia right now is double the cost of grain price of Australia last year.

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

Great. And then, my final question, and I'll hand off. I mean, the JBS SA stock has reacted favorably given the improvement in the balance sheet and improvement in the fundamentals over the last 12 months. Does this change the company's strategy of potentially going public in the U.S. and if not, what are the hurdles that remain to listing on the U.S. Exchange? That's it for me. Thank you.

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

Thank you, Bryan. Now, the company's plans to be listed in the U.S. have not changed. We continue to pursue that listing actively as a priority. Basically, the company continues to operate normally and to look or analyze the market so that this can be done as early as possible. The obstacles that exist are obstacles that the company is working on. So, depending on market conditions to do that listing as early as possible.

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

Thank you for your time and best of luck on the fourth quarter.

Operator

The next question comes from Benjamin Theurer, Barclays.

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

Hi, Ben.

Q - Benjamin M. Theurer {BIO 17248534 <GO>}

Hi. Hey, good morning, Jerry, Tomazoni, Filho (00:34:29). First of all, congratulations on the results. I have a question on the U.S. market, Beef and Pork. So, first on Beef. I mean, clearly, that was another quarter of very strong profitability. We're seeing an environment that's really fairly strong on that side. Could you share a couple of what you've been seeing into Q4 and what your expectation is into next year? I mean, what you're seeing in terms of availability and obviously what you think margins are most likely going to look like in coming quarters, is that going to continue to be as high or should we expect some sort of normalization?

And then, at the same time Pork, I mean, clearly, it was somewhat under pressure during the quarter. I mean we know there have been issues on exports with Mexico and then there's China whatsoever, and then there's oversupply. But could you shed a little bit of light on that capacity that was supposed to come in and seems to be a little delayed, and how actually exports have been doing to Mexico which is an important part and on pork considering that they're about to sign that USMCA (00:35:39) deal? Those would be my initial questions and then I have one follow-up.

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

Andre. Andre? Did we lose Andre?

A - Andre Nogueira de Souza {BIO 17758053 <GO>}

No, no. I'm here, Jerry. So, good morning, Ben. So, about the U.S. (00:36:03), you're right. The cattle supply is in very good shape. I think that what you should expect that we are going to have the normal seasonality quarter, so exactly in the third quarter (00:36:15) always (00:36:17) very strong quarter. Export demand continued to be very strong. So, you can compare in the same quarter of last year producing more beef (00:36:26) and sell it at higher price.

In the supply side, we know that we are going to have more (00:36:35) next year than we have this year, probably around (00:36:37) 2% more. We have the visibility because of the cattle herd and the number of cows that the supplier being a very healthy situation in 2019 to (00:36:47) and up to 2021(00:36:48) but we can have the visibility for the next three (00:36:51) years and we know that we'll be in very good shape. So, I don't think...

Q - Benjamin M. Theurer {BIO 17248534 <GO>}

Okay.

A - Andre Nogueira de Souza {BIO 17758053 <GO>}

...anything could relevantly change (00:36:57) in terms of margins on the foreseeable future, consider that this export (00:37:04) are going to be what they're talking about Asia

(00:37:07) I don't see that changing. (00:37:10) I don't see the normal seasonality (00:37:11) quarter-over-quarter (00:37:14) the level of margin that we have right now.

What you can see (00:37:22) not yet in the level that was in the past. It's still better than last year but should be a drag in our results when you combine with U.S. (00:37:35) So, that we can see the (00:37:36) improvement of the Australia side.

But you're right, Ben, despite of all the challenges we go through (00:37:42), we have more supply, we have more capacity in U.S., we have some (00:37:47) and some volatility during the quarter. Despite of all these, we deliver 9.9% on its (00:37:56) 10% margin EBITDA. That show how strong the operation Pork side (00:38:02), how efficient we are and that this execution for our portfolio and the results that we have been doing in the value added (00:38:10) side.

So, we're happy and it's in line with what we anticipate in the previous quarter that we are going to run along with them (00:38:18) In the future, there is no exports. (00:38:20) U.S. are going produce more pork, and with additional production need to go (00:38:27) to the export market.

We have been very successful finding new market and growing new markets (00:38:32). I'll point out that the growth this year compared to last year for Colombia it's 50% growth; to Republic – Dominican Republic is almost 30% growth; Honduras, 20% growth; South Korea, 40% growth. So, U.S. is very competitive and continuing to find new markets for export.

Next, it's very important and that's with implement of tariff in U.S. this year. What was the impact on that was the price. The volume is still the same volume of last year, did not increase but did not reduce. But the price of the product that were – was exported to Mexico (00:39:14) had a impact. The tariff will go – change in next year (00:39:19) the new agreement. We expect an improvement the next year. And let me call your attention today (00:39:25) (00:39:26) very relevant. All of (00:39:28) very close attention to what's going on with the African Swine Flu that's going on in China. China, they are responsible for 50% of the global (00:39:38) (00:39:40) also 50% of the global demand. So, if you (00:39:45) relevant disruption to production in China, that can completely change the supply and demand picture (00:39:51) for the global (00:39:53).

Q - Benjamin M. Theurer {BIO 17248534 <GO>}

Okay. That would have actually been my follow-up. So, on the African Swine Fever, do you have somewhat a sense – I mean, you mentioned 50% consumption, 50% of production, but do you have like – I mean, what we've been seeing, it's been spreading out all over the place and obviously could have implications on, call it, the diet from the Chinese switching maybe from pork to chicken or from pork into beef depending on the regions and the case (00:40:21) and what's available. How do you think that is going? What's your take how this is going to end out? And could you remind us what are the restrictions you have from, for example, the U.S. in terms of shipments into China and what would you have to ship potentially out of Brazil and if you would have the capacity to actually serve that market if there would be a need?

A - Andre Nogueira de Souza {BIO 17758053 <GO>}

I'm think it's too early for us to speculate about the impact. What we know is, every other country that have the Swine Fever, there was a relevant impact in the production. But I think that's another one to two quarters to (00:41:07) for us to start having better visibility (00:41:08) about what's the impact in the production and if that impact in production and the communications, are there an impact (00:41:12) (00:41:15) which it's too early.

Q - Benjamin M. Theurer {BIO 17248534 <GO>}

Okay.

A - Andre Nogueira de Souza {BIO 17758053 <GO>}

The way – if we are assuming that will have an impact, if we are assuming that we're going to have an impact in production in China, and China will import more -remember that China, in the last 10 years (00:41:30). They had been growing production but less than the growth in consumption. So, now the import 3 million (00:41:38) metric tons of pork every year. That's a huge volume. So, if there is a disruption in production, that China will grow import in a structured pace (00:41:49), I think that will delivery come first through (00:41:52) Brazil, Canada and Europe. And as U.S. compete with Canada and Europe, in several different markets (00:42:01), that would be the impact for U.S. It will open (00:42:04) a strong demand in Korea, in Japan, in Mexico, if Canada and Europe put more production in China. But I think that's too early to speculate about the real impact (00:42:22) will bring, but can be very relevant.

Q - Benjamin M. Theurer {BIO 17248534 <GO>}

Okay. Got you. Perfect. Very good. That's all on my side. Thank you very much and congratulations again.

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

Thank you, Ben.

Operator

The next question comes from Alan Alanis, UBS.

Q - Alan Alanis {BIO 15998010 <GO>}

Thank you so much for taking my question...

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

Hi, Alan.

Q - Alan Alanis {BIO 15998010 <GO>}

Hey, Jerry. Congrats for the quarter. Thanks for taking the question. Just a couple of brief questions. First, regarding Brazil and Seara, I mean, clearly you faced significant cost pressures on the price of corn going up more than 40% and you were able to pass this pretty successfully and at the same time expand margins. We've got an EBITDA margin higher than your main competitor. The first question is how do you see the competitive environment with BRF on the back of this very, very positive competitive outlook, competitive result on the third quarter? That would be my first question, then I just have a follow-up on a different topic.

A - Gilberto Tomazoni {BIO 2090061 <GO>}

It's Gilberto Tomazoni speaking. About the environment of the – environment in the market, I believe that now we are more rational behavior in the market and...

Q - Alan Alanis {BIO 15998010 <GO>}

Okay.

A - Gilberto Tomazoni {BIO 2090061 <GO>}

... this moment that (00:43:43) Brazil (00:43:46) a lot of the increase of the price, the grain – the price of the grain. I believe that all of the market is focused on the positive costs to the price.

Q - Alan Alanis {BIO 15998010 <GO>}

Okay. And you think that that rationality will continue through 2019? Correct, Tomazoni?

A - Gilberto Tomazoni {BIO 2090061 <GO>}

It's difficult to say that.

Q - Alan Alanis {BIO 15998010 <GO>}

Okay.

A - Gilberto Tomazoni {BIO 2090061 <GO>}

What we see now is more rational. But I cannot predict what is the behavior of the competitor, I can't tell you (00:44:18) – we are focused on improve our margin by managing mix because it's so important not just for the price (00:44:29) the mix of price is to managing mix and we are focused to reduce the level – the volume that we have at the less valued product, brand, regional brand. We try to reduce the volume we are selling that we give (00:44:51) give value trend. We are focused on premium brands. This isn't our main focus. You can see that we are able – Seara was able to increase the price because of the 4% premium. The premium is a part of the price of the recent price of course, but to managing mix and this is all be our target. We are invested in brand. We are invested in innovation, we mentioned during the presentation, Seara won two prize in – one in Brazil, the best innovation in Brazil, in Rotisserie, in fact (00:45:24) this is a focus. Focus on improving, enhance mix, and try to reduce the volume in the regional brands, not the pricing brand (00:45:36). We are against pricing brand (00:45:36). We are focused on premium brand.

Q - Alan Alanis {BIO 15998010 <GO>}

Well, congrats. Clearly, a lot of progress since success with this Seara brand position at that level. My last question regarding the tax regularization program. I mean, you've been one of the few companies that we track that has been bringing off balance sheet's taxes into the balance sheet and getting into these negotiations. How do you see any change in taxation outlook on the back of the new government taking over in Brazil, if any? And do you see or do you anticipate any of these kinds of agreements like the one you had with Funrural in the near future? Thank you.

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

Yeah. Alan, Jerry here. It's difficult to predict what sort of tax policies future government will have. So, we wouldn't like to speculate on that. Basically, what we consider to have been any relevant tax liabilities have been dealt with by the company over the last 12 months. So, we don't see any further necessity for any further agreements or any further negotiations with regard to tax liabilities going into the future.

Q - Alan Alanis {BIO 15998010 <GO>}

Got it. Okay. Thank you so much.

Operator

The next question comes from Carla Casella, JPMorgan.

Q - Carla Casella {BIO 2215113 <GO>}

Hi. I just want...

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

Hi, Carla.

Q - Carla Casella {BIO 2215113 <GO>}

Hi. I just want to clarify. So, the discussions you made around China and that new business, that's all – is that all related to Alibaba and is that all coming from the Brazilian supply?

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

No, Carla. If you look at slide number – let me check the number here – number 17 in our presentation which is on our website, we break it down by import company. So you've got the names of the import companies that – with whom we've signed various memorandums of understanding. It's not one memorandum. It's a memorandum in each one of those customers. And this, by the way, Carla, is independently of the business that we conduct normally with our customers in China, which is a market where we have a regional sales office and we have a regular customer base. This is incremental memorandums that we have agreed upon in this recent exposition. The majority of the product is due to come from Brazil, but not all of it. Australia also signed a memorandum of agreement to supply some of its high-quality products into customers in China as well.

A - Gilberto Tomazoni {BIO 2090061 <GO>}

But to be clear, the agreement is a global agreement with JBS. Of course, Brazil will supply more because there is a agreement between the countries that influence the supply.

Q - Carla Casella {BIO 2215113 <GO>}

Right. And this – was this a new event that was hosted in China or was it something that was new for you to participate in?

No.

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

This isn't the first China International Import Exposition. This is the first of what is earmarked to be continuous events where China seemingly plans to have a relevant event in order to be able to source products, and particularly food products for the Chinese consumer.

Q - Carla Casella {BIO 2215113 <GO>}

Okay, great. And do you see any other Asian markets that may follow suit? And do similar type events or similar – opening up more to additional imports?

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

Maybe, Andre would like to mention this as well but the other Asian markets are traditional markets for all (00:49:38) products from various platforms. So, we have ongoing volumes going into many other Asian markets. There's been a lot of incremental volume into China. Andre earlier mentioned the statistic which I thought was very interesting with regard to the volume of imports and how they've increased over the last 10 years into the Chinese market. Maybe, Andre, you could just highlight that again.

A - Andre Nogueira de Souza {BIO 17758053 <GO>}

Well, (00:50:05) China, of course, is, because of its size and because the amount of the growth in the last 10 years, call a lot of attention, but let's keep in mind that China is (00:50:15) the most important market for U.S. in Beef; South Korea is the second most important market for U.S. in Beef. And both are very important markets for Canada and Australia.

But of course, the operation's growth, that's not only in (00:50:28) in China, (00:50:31) Philippines now is the seventh largest market for U.S. Beef. The growth for the last year (00:50:37). Indonesia became a very important market for the Australian Beef. And Canada, it's growing their exports to China in the very fast pace.

So, with the whole Asia, that's – we wanted to report (00:50:52) China because of their size, call a lot of attention. But let's keep in mind that now, we don't have production there (00:51:00) in the protein side, JBS exports 50% (00:51:06) percent of the total global sales to Asia. We're selling in Asia today $7.5 billion every year and the way that that has been growing, the position that the company has, I would assume that this will be much, much bigger than that in five years from now.

Q - Carla Casella {BIO 2215113 <GO>}

That's great. Very helpful. Thank you.

Operator

Our next question comes from Luca Cipiccia, Goldman Sachs.

Q - Luca Cipiccia {BIO 6914452 <GO>}

Hi. Good morning, everyone.

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

Hi, Luca.

Q - Luca Cipiccia {BIO 6914452 <GO>}

Thanks for taking the question. Just a couple of follow-ups on some points that were discussed earlier. The first on this – on the China agreement, maybe if you could clarify a little bit more the timeline, the next steps and impact maybe on an annualized basis that we realistically will be able to see in 2019 and in the forward (00:52:07)? That will be my first question and then I have a quick follow-up on Seara as well.

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

Yeah, Luca. That the agreements that were signed in China just to remind you, there are memorandums of understanding. So, obviously, there's a period where – on how to transform a memorandum of Understanding into actual business. But the timeline between one and the other, it's not a prolonged timeline. Our expectations are that this business will take shape and will be a relevant volume by early 2019.

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

So, Luca, this is Wesley. If I can add, I think the main meaning of these memorandums of understanding and what's the main relevance of these MoUs for our business is that the consumption of protein in China is growing. And more and more customers there that partners with us are looking for relevant suppliers, and suppliers that are prepared to meet the demand. So, this memorandum of understanding, I guess, is more of a product of us being in that market, growing in the market, having better ties in their market, having better relationships in that market, and have invested in our plans to be ready to supply to that market with the quality and service that they need.

So, I guess, more than anything, more than the actual – it's the partnership that we're building together to meet the challenge of selling more protein in that market. I think that's the main message of those MoUs.

Q - Luca Cipiccia {BIO 6914452 <GO>}

Yeah. Understood. And maybe on – I think you commented on earlier but I think it's fair to assume that all we're talking about here is incremental? It's not shifting channel, it's all incremental volumes potentially. Is that correct?

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

Yeah, that's correct.

A - Gilberto Tomazoni {BIO 2090061 <GO>}

Exactly.

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

That's correct. 00:54:24

Q - Luca Cipiccia {BIO 6914452 <GO>}

All right. Cool. And then, second – the second question I had was on Seara. I found it's quite interesting that you are talking about premium and improvement in mix and price increases at a time when it seems that the Brazilian consumer has been quite slow at returning to trading up, if we can call it that way. So, I was wondering if you'd comment a little bit more maybe on the type of responsiveness that you've seen in the consumer for this initiative or if you are embarking in the sort of new push. Arguably, you played quite well the down part of the cycle when, I think, Seara gained share, maybe when consumer was looking even a little bit more value or more value for money, if we can call it that way. I think it's interesting that you seem to be shifting now more on the – on a mix improvement.

But, again, looking at some of the messages from other companies across different product categories, many commented that this type of trade up or mix benefit are quite slow in coming. So, maybe any more color on that on how the consumer is reacting and why you see that it's already the right time to shift gears maybe on that front?

A - Gilberto Tomazoni {BIO 2090061 <GO>}

It's Gilberto Tomazoni speaking. First, I think it's important to understand, as the dynamic of our market, we produce the raw materials. We have chicken, we have pork, and we process it and we disassemble, and then we assemble. Then, the cost of the raw material is the same. It's independent of the cuts (00:56:19). Your cost is the same. Then, to say that you are using your one cut (00:56:26) to put on a product, the value is lower than the order (00:56:31) is just an internal decision because the cost is the same. Then, when we sell a product with low value, we are losing the opportunity to sell products with high value because the raw material is not different at cost. And then, because of that, we are investing in the brand. Improve the preference of the brand.

From the beginning, when JBS bought Seara, we focused on improving the value of the brand and we are keeping newer (00:57:07) – I think that Seara is doing a great job in -to improve the value of the brand. And of course, we need to adapt our portfolio. When there is more value in the brand, we have an opportunity to sell value added products. Because of that, last year, we launched (00:57:28) Seara Gourmet. Why Seara Gourmet? Because Seara Gourmet, it's a high-value product. We make the best product in the market. There is good, there is very good, and then Seara Gourmet. It's really the best part in the market (00:57:46). Why? It's just because we need to achieve this capital level (00:57:51) – the best value in the – possible in the market.

Of course, there is a breakdown of the – there is low and – medium and low. But the consumers like to buy good products, not cheap products, good products. If the good product is cheap, it's another thing. It's perfect, but it's (00:58:13) good, good product. And this – because of that, when we start, we start a lot of regional brands. Now, we reduce the regional brand. Not makes sense because of the same (00:58:25) and this is a trend we are focused on to really strengthen because you, all the time, you'll find someone in the market can sell a cheap product. A lot of small company in the market, they have focused on that. We don't want to compete with this in this market.

Q - Luca Cipiccia {BIO 6914452 <GO>}

And that is very clear, but you're seeing a consumer that is somewhat, a bit more a bit healthier in terms of accepting or having the possibility to trade up to better products. That seems to be the case?

A - Gilberto Tomazoni {BIO 2090061 <GO>}

Yes.

Q - Luca Cipiccia {BIO 6914452 <GO>}

Okay. Thank you. Thank you, everyone

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

Thank you.

Operator

The next question comes from (00:59:09), Santander.

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

Hi, (00:59:14).

Q - Operator

Hi, Jerry. How are you?

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

Good.

Q - Operator

I have a couple of questions. So, it's been about two years now since the initial headline and price fall (00:59:28) started. And since then, the company, I think, has done a pretty good job of managing through it. We are still waiting for some pieces of information like the DoJ resolution, which I imagine you guys will require before you update your S1 (00:59:44). But generally speaking, the volatility risks have subsided. So, what is next with respect to the balance sheet? At below 3 times net leverage in dollars, what's the right amount from a return equity perspective, given that your equity is still 25-plus-percent below the levels it was before the last two-year period began?

You're still a couple of notches below the ratings from this timeframe. So, is that important to the company at this point or should we expect cash upstreams to J&F to increase in 2019, given the expected cash flow generation? That's pretty much it.

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

Okay. Thank you, (01:00:30). So, with regard to what are the next steps for the company, we've already – and Tomazoni is going to highlight a couple of points in his concluding remarks as to what are the continuing targets of the company, and one of them is to continue deleveraging. We are in the 3 times range right now. We've already indicated that we want to continue to reduce that. So, that is part of the strategy, deleveraging.

With regard to the rating agencies, obviously, the rating agencies is a consequence of the actions of the company. We believe that we are performing the correct strategy, the correct actions at the company, and this will eventually be reflected in the ratings. So, we do not set as a target, a rating, but we do feel that the rating will be a consequence of the activities, I think Tomazoni wants to talk (01:01:34).

A - Gilberto Tomazoni {BIO 2090061 <GO>}

So, I would like to add about the deleverage, the company. I think this – first, it's important that we deliver what we have promised about the retouch of the debt (01:01:48) because it is so important. And we are focused on deleverage. Then, the level of deleverage will depend the performance of the business, but we are focused on cash generation and cash generation will perform (01:02:04).

Q - Operator

Understood. And my point was, just to be a bit more specific, is given that you've done a lot of that, as referenced in your presentation and you talked about it over the past 18 months and you're back to a sub 3 times net debt to EBITDA level in dollars, what do you think, at this point looking into 2019, is the optimal level versus using your cash generation to upstream and pay equity holders because your equity has lagged?

From a balance sheet perspective, you've done a lot of work at getting back to where you were, still can be reflective a bit more maybe in ratings if that's a priority. But certainly, you're going to have cash flow most likely in 2019. What's the optimum use of that? Is it 2.5x is it 2x? Are you better off to increase the dividends from a return on equity, return on capital perspective?

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

So, setting a target right now, like Tomazoni said, we continue to generate cash. We continue to prioritize deleveraging. One of the comments which I thought was very relevant which Tomazoni made in his initial comments is that, we've actually reduced our annual cost of servicing debt by $300 million by reducing our gross debt. So, we believe we can continue to do that.

We are not prioritizing dividends. We don't have any plans beyond what is legally required with regard to dividend. So, we will continue to pursue the deleveraging process and the improvement of our balance sheet and this will be reflected. When you see the reduction in the cost of servicing our debt, this, in our view, will be reflected in the equity of the company over time.

Q - Operator

Thanks very much.

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

Thank you, (01:04:00)

Operator

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

A - Gilberto Tomazoni {BIO 2090061 <GO>}

I think we want to emphasize that – just because in the last question – I think we need to re-emphasize it's important, our top priority at the company, continuous focus on operational efficiency, organic growth, investment in innovation and quality, focus on deleverage, and world-class global compliant products.

This is the focus from the beginning. It's one year the focus, we'll keep the focus. And then, the results of this we are (01:04:57) deliver now. And what will be the future, we are (01:05:00) keep focus. This is important.

The second point I want to emphasize is that our food – our business model. We have a global footprint and we are discussing now about China or about Asia to grow with protein (01:05:17). I believe, I strongly believe, we are well-positioned to take advantage, to take the opportunity for this growth because we are a global company in our global footprint.

And to finalize, to mark the conclusion, I want to thank each one of you for joining this conference call. I would like to thank our leadership team who have done and continue to do a terrific job. And I would like to thank our more than 200,000 employees who, with their hard work every day, have helped make this company the success it is.

Finally, I would like to thank everyone who supported our growth and contribute so significant to our success. Thank you.

Operator

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