Q3 2013 Earnings Call

Company Participants

- Ricardo Florence, IR Officer, Chief Financial and Administrative Officer
- Sergio Rial, CEO, Seara Foods

Other Participants

- Aaron Holsberg, Analyst
- Alan Alanis, Analyst
- Alex Robarts, Analyst
- Rolando Springall, Analyst
- Thais Pinho, Analyst

Presentation

Operator

Good morning, ladies and gentlemen. At this time we would like to welcome everyone to Marfrig Alimentos SA conference call to present and discuss its results for the Third Quarter of 2013. The audio for this conference is being broadcast simultaneously through the Internet in the website www.marfrig.com.br/ir. In that address you can also find the slide show 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 Q&A period. (Operator Instructions)

Before proceeding, let me mention that forward-looking statements are being made under the Safe Harbor of the Securities Litigation Reform Act of 1996. Forward-looking statements are based on the beliefs and assumptions of Marfrig's management and on information currently available to the Company.

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

Now I will turn the conference over to Mr. Sergio Rial. Please, Mr. Sergio, you may now begin the conference.

Sergio Rial {BIO 1925337 <GO>}

Well a very good morning. I know it's early for you in the US; or, potentially, late for those in Asia or in Europe. So thanks for joining our call. I have here with me Ricardo Florence, the Group's CFO. We will be announcing and walking you through our Third Quarter 2013; then I will kindly ask you to go to Page 2. And before we dive into Page two straight, I would like to provide the context of the thought process behind this presentation.

A couple of things. One, which have utilized first, and second, and Third Quarter of 2013 as a base for the market to start capturing trends out of the Marfrig Group. We believe it is more important to start establishing some more recent trends, since we are not providing the last three years pro forma results of the Group without Seara. So I think we think at least the last three quarters should be at least a good base to start understanding some of the trends.

Second point -- we are disclosing Seara Brasil's numbers in the release, not in the presentation. I certainly have been asked by a number of shareholders that we should disclose the numbers of Seara Brasil. For those who have followed the Company, you know that Seara Brasil's numbers were embedded together in the division Seara Foods. So for those who are interested to look at the numbers, you will be able to find the Seara Brasil numbers attached to the release that you have received. But we will not today discuss Seara numbers on this presentation.

Everything you see on the presentation, you are going to see on the presentation, is about Marfrig. And it does not in any way have mention to the Seara divestment. So it's all about Marfrig as such.

With that, I go to Page 2. And I think as you are going to see the Third Quarter, there are a number of quite interesting and positive signs on the Third Quarter of the Group. First, you are going to see that the operational performance of the Group has improved. So the fundamentals of what we are doing and what we are in a position to control have improved across all businesses.

Second, you will see that in that capacity, cash flow has certainly become positive on what we call operational cash flow, which is the first line before CapEx and interest expense. And hopefully, we are going to be able to articulate very clearly the reversal in the trend that we believe has started in generating more consistently cash flow.

Third, you will see that the debt profile, or in other words, liquidity and balance sheet strength of the Company have improved really considerably. And now you are going to see it with any noise related to the divestment that I think we have concluded at the end of September.

So on the first of this slide, Slide 2, we basically also said that the profitability of the big business would return to a higher level, and that has happened in the Third Quarter -- part of the operational performance improvement, as I have mentioned. We continue to invest a lot of time in transparency.

And hopefully the Marfrig Day, both in New York and Sao Paulo, did help -- not only to see in a more detailed way what we are planning to execute, but also seeing it through the eyes and the voices of the different management teams. We have set guidance for ourselves, both for 2013 and 2014. We believe it is not necessarily very common in Brazil for companies to give guidance; but we believe in light of the fundamental change of the divestment, where we were, we believed it was important to establish what management expects to see accomplished in 2014. And we are certainly happy to refer to that at any time during the Q&A session.

We have reduced the leverage of the Company. Looking at the last 12 months, including the capital gain of Seara, we have been able to bring the leverage, from a pure covenant calculation point of view, under 3. We will talk more about leverage when we address liquidity and the balance sheet as such later on.

On Slide three we start giving you some of the highlights. The first one is positive operating cash flow of BRL236 million, reversing the picture of BRL427 million in the Second Quarter. Two very important reasons for that -- one is better working capital management. Hopefully, we are going to be able to show you that.

And the second one is with the divestiture that we have concluded, we were able to eliminate a number of structural payables that we had -- unquestionable payables that we had in our balance sheet that will no longer be there. And we will devote more time so that we truly understand the nature of that payable, or the combination of those payables, so that you do not see it as just -- as one item, or one-off item of the Third Quarter, because it isn't.

Growth of the net revenues across all businesses -- if you look Second Quarter, 11% on a consolidated basis. If you look last year, 15%. Keystone, Moy Park and Marfrig -- these all posting very solid numbers.

And Marfrig Beef, as a matter of fact, quite surprising and positive, moving 10% from second to Third Quarter, primarily driven out of a much, much bigger volume of exports. We have increased our exports by more than 50% relative to the Second Quarter, just capturing the opportunity of higher prices in dollars and, certainly, markets being open. We will talk more about Fourth Quarter and what we expect around exports.

EBITDA was BRL375 million -- solid, higher than many of the analysts had predicted for the Group for the Third Quarter. So we are happy to see analysts recognizing the improvement in the operational performance of the Group already in the Third Quarter. And I have to say that the Third Quarter -- particularly for beef, with higher cattle prices, with increased costs in Brazil, from labor to energy to a number of other inputs -- I'm pleased to report that the business has improved its performance overall. And a net loss of BRL92 million, and we will explain what the BRL92 million is and how we get there.

Slide four -- solid revenue growth, as mentioned. We are giving you the three quarters. And Keystone benefiting also from their continued growth in what we call the key accounts, but also Asia. In this respect, the AI, the chicken flu in China, subduing a bit to the Third Quarter. We are not seeing demand to the same levels as we had in the First Quarter, but certainly better than what we saw in the Second Quarter, where we saw it dip. And Marfrig Beef, as mentioned recently.

On Slide 5, it's an attempt to give you four dimensions about what we are in terms of business. So 50% of our business -- as a matter of fact, more than 50% of our business sits outside of Brazil and growing; and 45% in South America -- not only Brazil, but South America; currency, the same. Very, very correlated to dollar and euro.

Then we tried to address the protein side. Some people felt that with the divestiture of Seara, we are a lot more of a beef company then diversified protein company. And I think here is just an attempt to show you that, primarily and fundamentally overseas, we are a chicken business; while in South America, we are definitely a beef business. So I think relatively good geographic diversification as well as protein diversification in different spaces.

On Slide six we now start diving into the financial performance. Worth mentioning the return of the gross profit to a number very close to BRL600 million, an important number for us. Margin -- gross margin back to 12%. And as you see it, very clear signals an improvement in the performance of the Group overall.

Marfrig Beef here playing a very important role, with more than 50% increase in their fresh beef export volumes -- and, again, capturing opportunities and capturing higher prices externally. But I think it's an interesting signal of being able to adapt fast and having that executed in such a short period.

Gross profit in Keystone is very, very solid. Definitely helped by exchange parity when you bring it back to reais, but not only. We have certainly had increases both in volume, but also in average price. Volume has increased 4% in the case of Keystone; and very much noted in Asia, as mentioned before; and by the growth of key accounts in the United States and Asia.

Gross profit from Moy Park, 14%. Moy Park is enjoying a phenomenal period. 2013 will be one of their best years, hopefully more to come. We are seeing United Kingdom, and particularly in what is called Europe, probably the last -- the least affected by the crisis, and the first one to start showing very significant signs of recovery, and particularly in consumer confidence. So we are really well positioned geographically to continue to capture this growth. We will talk more about Moy Park later on.

On Slide 7, another dimension of operational performance which is not immaterial -- which is cost, something that we control. And we are pleased to report that we were able in the Third Quarter to bring our SG&A, when compared to net revenue, under 7%. Very few companies have numbers under 7%. We are going to be striving to bring these numbers down, because I think we can.

In the case it will change from business to business, but Marfrig Beef in particular had its G&A expenses reduced by 70 basis points in terms of percentage towards 2012. It's been remarkable, what they have done -- and particularly having to take into account a year in 2013 of higher cattle prices, higher labor costs, higher energy input, higher inputs overall; and nevertheless, the infrastructure has been optimized.

The same for Keystone. Keystone initiated a process of consolidating what is called its head office, pushing it down to the plant and reducing the overhead in a very significant manner. They have actually hired experts to help them to identify cost opportunities over the last 12 months, and the results are start coming through, which is all part of our agenda to expand our margin. So let's see it as part of Focus to Win, our five-year plan -- margin expansion, trying to get Keystone to an 8% margin level.

Moy Park has had a very, very strong increase in sales. And its expenses relative to net revenues are still acceptable, but we are not able at this point in time to show a decline. And understandably so.

Slide eight -- we go to the EBITDA, important element and metric for performance. Here all the margins have improved across all businesses -- beef moving to 9% from 7.2% in the Second Quarter, recovering, as we mentioned before. Uruguay has also performed better than what we had experienced in the Second Quarter, and we are very hopeful for the Fourth Quarter.

Moy Park and Keystone all moving up to 6.5%, or in the mid-range of 6%, but focusing on their long-term strategy in terms of targets for 2018, as explained in the Marfrig Day. Moy Park expects to work. Their North Star in terms of EBITDA margin for 2018 is a range between 7.5% and 8.5%, while Keystone is higher than that. So I think we are on a good path to fulfill and to increase Moy Park -- particularly Moy Park's level -- by 1% in the years to come.

On Slide nine we start coming to the financial final number. And let me try to walk you through what the number is. So you are seeing the net loss of the last three quarters.

In the number BRL194 million, I'd like to -- if you go to the table -- so here you have the first column. You have income or loss; second, you have it after the tax impact, credit or not. Then the last column you have the net income.

Now, in the case of the Third Quarter, we have a number BRL62 million exchange variation and BRL40 million financial expense. The BRL102 million here is exclusively related to a piece of debt -- part of the Seara transaction that has already been transferred. But the cost -- the financial expense associated with that debt, and the exchange variation Second Quarter to Third Quarter related to that debt -- remain in our P&L. So we feel this is a nonrecurring item for the quarters to come. We felt appropriate to call it out for you to see.

The other piece also is the impact out of that BRL92 million, the other impact that brought us to a net loss, still was the exchange variation on the debt piece -- on the remaining debt piece that is absolutely owned by us, which also had a sort of an impact of BRL90 million, approximately. So if the dollar wouldn't have changed from second to Third Quarter, we would have not had a loss. It would have been a breakeven.

But that doesn't matter; we don't control what foreign exchange markets do, anyway. But it's just to give you materiality that we are on-path to break even in a net basis going forward.

On Slide 10 -- it's an attempt to give you comparisons to 2012. So for those who want to compare it to 2012, you certainly have it. And I think there is more analysis in the release, if you wish to follow.

I would like to invite you to move to Slide 11. And here I think we need to spend some time on the liquidity and debt profile of the Company -- again, consolidated. The first one, as you can see, gross debt has been reduced since the First Quarter of 2013 and coming to a net debt of BRL6.6 million in the Third Quarter.

Some analysts, some market analysts, were counting on BRL6.4 million. So we were a little bit slightly higher. And I can explain what the BRL6.6 million is and why.

But let's first go through the indicators. So the first one is the 2.8 net debt/LTM EBITDA. In the case of the transaction, the divestiture of Seara, we have had capital gain in this quarter. And when you look at the LTM, that 2.8 is taking into account the capital gain in Seara of BRL339 million. I repeat, BRL339 million. Remember, we don't pay taxes on that capital gain. So between Zenda and Seara, the Group has added a very significant piece of capital gains.

Now, if we want -- and we should -- if we should not consider the capital gains, because it is not a recurring item in the quarters to come, by just simply projecting Third Quarter and annualizing it, the EBITDA -- net debt, I'm sorry, to EBITDA annualized would be more 4.4.

But what I want you to keep in mind is actually our guidance. We have told the market that we are going to be looking at an EBITDA -- EBITDA for next year between BRL1.6 billion and BRL1.9 billion. Again, BRL1.6 billion and BRL1.9 billion. As long as the generation of cash flow continues to be the case, as you are going to see in a couple of moments, we should be able to have a more stable debt profile. And with a higher EBITDA, we are structurally a company in the mid-3 range for a leverage standpoint of view. So that is what we are going to be pursuing going forward.

Important element of current liquidity of 2, as you can clearly see. Now, in a couple of minutes we are going to talk about the debt profile, and you can see that the cash position of the Company -- free cash position of the Company relative to the obligations we have in short term -- very, very comfortable. We did the bond recently, in September. Some people have criticized us for buying duration in September and paying 11% at that point in time. And I fully recognize, sometimes, the criticism. But very few companies in the single-B category can claim that they have 51 months of duration at this point in time with an average cost of 7.8%.

Now, why has our average cost reduced, despite the recent bond at 11%? For two reasons. In the very recent past, particularly with the short-term trade finance lines, we have been able to borrow at between 1% to 1.5% lower levels annually -- lower levels than I think we were paying before, point number one.

Point number two -- with the divestiture of Seara, that brought us two important things. We certainly transferred the more immediate debt that we had in our books, and we certainly transferred the most expensive debt that we had in our books. So the combination of term plus costs, coupled with our liability management or our active management of our debt profile, have helped the Group already in the Third Quarter to present an average cost of 7.8%. This is not what we want to see as a Group. This is not where we want to see the Company going, but at least that's an important one.

The other piece is 16.4% of our total debt resides in the short term. That's a very, very important component for a company that has come from a relatively convoluted period of being a lot more levered than I think we are at this point in time. So it's good and really comforting to see that 84% of our total debt -- it's long-term. And it's actually long-term, as you are going to see.

So I ask you, invite you to go to Slide 12. And hopefully we make this point even clearer now, looking at the maturity schedule of the Group. So here we have, in the Fourth Quarter 2013, BRL1.052 billion maturing.

I ask you to look now at the bottom of that page. So let's now -- we are giving you a pro forma Fourth Quarter of that maturity schedule. So out of the BRL1.052 billion, approximately the majority of that, BRL630 million -- it's interest payment on bonds. And it's actually the payment on BNDES convertible bonds. We are paying here 16 months as opposed to 12. So in November, we are paying it today, as we speak.

So the bonds have been paid, and the BNDEA asset's being paid today, as we speak, repeating. That BRL630 million is deducted from our cash position as of today -- talking, as you are seeing it, pro forma.

And the BRL422 million, which is fundamentally trade-related finance -- it's 100% refinancing. Here you have a combination. You have a combination of just, again, refinanced through the Second Quarter 2014; but we also have an important piece we just closed, an export finance line for three years, refinancing most of this BRL422 million through three years at LIBOR plus 4.5%. So this gives us, as you can see, as we basically address our Fourth Quarter 2013, we have no important repayments scheduled until 2017.

So the solidity of the schedule of the Company has improved substantially. And hopefully that is indicated by the cash and equivalents and short-term debt, 2.1 times, on the right side of that page.

Moving to Slide 13, an important slide, which I will also ask the Group CFO to join me in this discussion. We are trying to give you total, absolutely total openness of the operational cash flow of the Group -- first, second, and Third Quarters.

Third quarter, as you can see, two things have happened. One, we are paying attention to the working capital management of the Group. We have been saying that, and hopefully you start -- it's difficult to show it all, what we can do in one quarter. But we already can tell you that we have used BRL126 million in terms of working capital, which is different than what we had used in the prior quarter of almost BRL300 million.

And that is a combination of better receivable terms, but also better inventory management. You are going to see that in a subsequent slide, where we show you a more detailed cash flow analysis.

The second and not less important point of this BRL236 million is a number of payables -- they were sitting on our balance sheet, and they were there structurally for the long haul -- were pretty much eliminated. And the risk of this -- and one is an important piece with the debt, with Brazil Foods -- the risk of this analysis is that one can see it's simply a nonrecurring item going forward. And it is not necessarily the case.

So I would like Ricardo to articulate to the best of his ability why this number -- it's actually a number that, when looking forward, we should not in any way lose it out of sight.

Ricardo Florence {BIO 20008948 <GO>}

The actual operational cash flow of the Company, as Sergio said, in the quarter was BRL236 million. What we had in the quarter -- it was the transfer of what we had to pay to BRF as a consequence of the transaction that we did in the Seara deal. We decreased the other payables of the Company by BRL201 million, and this is what -- it is non-recurrent. The recurrent part -- just to be very clear, it is the BRL236 million.

Sergio Rial {BIO 1925337 <GO>}

Yes. So I think this is an important -- we think an enormous amount of time on this. This is where we and management overall is devoting time. That's where it starts, what we call the stability of the debt piece of the Company. We cannot delever, continue to delever the Group if it's not starting on that line.

Let's move to Slide 14, where we try to give you an even broader and more detailed analysis of the cash flow. And so here we have the -- so starting with BRL194 million, taking into account that the BRL62 million and BRL40 million, it's really cost associated -- that it's with us, but associated a debt that has already been transferred. So that is not going to repeat again.

We get to BRL92 million. You see the impact on trade account receivables of BRL117 million. That's a function of increased sales. We have increased sales and turnover in the Third Quarter. So some of that negative impact is shown there.

Inventories -- a small signal of what we are doing in terms of inventories in one given quarter. A positive impact of BRL25 million. And there are a number of others, especially on the BRL54 million. But then there is a very important one, which is taxes, which is --

structurally, historically, Marfrig has always accumulated more tax credits than it has been able to actually monetize.

And what you are seeing for the first time, essentially, in one given quarter, we have pretty much -- pretty much -- not created any additional weight to the existing tax position of the Company. And maybe Ricardo could, just right now, explain why this time we have been better in optimizing the tax credits that we normally generate.

Ricardo Florence {BIO 20008948 <GO>}

Let me go through the breakdown of what we have in taxes. We basically have an increase in the recoverable taxes of BRL34 million -- much less than what we had in the previous quarters -- used in the deferred tax assets, amounting BRL4 million; and also, decrease in tax payables of BRL1.5 million going to the BRL28 million that you have in total.

Going into a deeper breakdown in the recoverable taxes, which, as you know, is comprised mainly by the state VAT tax, the ICMS in Brazil. We had an increase of BRL6.6 million PIS and COFINS, which are the federal VAT taxes; they increased, respectively, by BRL17 million and BRL39 million, amounting to BRL62 million in total.

We had an increase in provision for the non-realization of the taxes of BRL33 million, and other of BRL4 million, giving us the total of BRL34 million that I mentioned to you in the first part of the breakdown. Much more solid than we had in the previous quarters, giving us a very good confidence in what is to come.

Sergio Rial {BIO 1925337 <GO>}

Yes. And I think the other aspect is that the quality of the EBITDA is significantly better; related to the items inside, they are actually of cash nature. So it's an EBITDA that -- it's a lot closer to true cash generation of the Company than necessarily all non-cash. So I think it also an important signal to be recognized.

Now making a transition, or transitioning, from consolidated numbers to the business unit numbers, Moy Park on Slide 15 -- solid. We have a phenomenal business. Very proud of what we are doing in Europe. The retail -- particularly the retail space in UK is doing extraordinarily well. We have seen very strong sales revenues on the back of the retailers' favoring really sourcing local meat. And we are, of course, extraordinarily well positioned to capture that opportunity.

I don't think this is a transitory trend. I think we are going to see that, certainly, going forward in 2014. If you look at 2013, if you look at their sales, irrespective of foreign exchange variation, they are actually moving solid numbers; and the margin is also reflecting that trend. So we have seen a better sales mix.

We have seen, also, higher levels of productivity, as most of the plants are being at full capacity. Absolutely at full capacity. And we have seen Moy Park doing a very good job in positioning the Moy Park brand in Ireland. In Ireland, we are certainly one of the most recognized chicken brands in the country. So I think we are proud, and I think there's a lot more to come in capitalizing on the Moy Park brand in the United Kingdom.

On Slide 16, it's Keystone, helped by part of the demand that we had seen disappearing during the Second Quarter in China on the back of the chicken flu, AI. It's coming back, avian flu. It is coming back.

So we are seeing better sales in China; we are seeing higher volume also happening in key accounts. So those who haven't followed Keystone for a long time, Keystone used to be the company 100% selling to McDonald's. Today Keystone -- and we are very proud of the heritage; and McDonald's is an absolutely core customer of what we do -- but we have 35%, and moving eventually to 40%, of the Company's profile in businesses with other customers, also in the food service. And some of them growing also as fast, if sometimes even faster, than the McDonald's system.

And in some cases, although they are -- or their very nature of being essentially more transactional, we are able also to capture higher margin. So it's a very good mix, with predictability, long-term predictability with a core customer, coupled with the group of customers that can also be long-term players. But some can also be more transactional, where we can absolutely capture better margins.

I think both for Keystone and Moy Park -- but Moy Park in particular -- one should not ignore that they have been able to deliver this performance despite cost increases in some of the key commodities they operate, both soybean meal and wheat. Moy Park is totally exposed to wheat, not necessarily corn.

Keystone has had historically a very prudent hedging strategy, so they have been able to also manage their grain position very, very well. And of course, we all know, corn -- under $5, as we are experiencing in the US -- probably signifies to some degree higher margins and wider margins to come.

So I think we are really, really positive in capacity of the business to continue to widen their margins with the present scenario. So relatively lower grain prices when compared to 2012 or even to First Quarter of 2013.

Marfrig Beef, on slide 17, in the same token -- they have really gone through in 2013 higher cattle prices. Cattle prices have increased over 20% when compared to 2012 -- over 20% as compared to 2012. They have seen labor increases over 10% in many cases. They have seen increases across different dimensions. Nevertheless, they will present and they are presenting a very solid margin and solid growth, both in sales but also in profitability.

Last but not least, on Page 18 we try to give the market the guidance of 2013. BRL11.5 billion(sic; see presentation slides "BRL18.5 billion") for revenue; EBITDA margin of 7.5%, which is, again, purely, purely based on what we do operationally, nothing to do with non-reoccurring items.

And when we look at the -- if you look in the middle of that table, when you look at the column Fourth Quarter -- or better, maybe, when you look at the column Third Quarter, the column Fourth Quarter tries to give you what is necessary to be able to fulfill the 100% target for guidance in 2013. So we are annualized. We are in a pretty good shape to get where we should get, which is pretty close, if not higher, than 100% with the guidance given.

So in terms of closing remarks -- a lot to do, as always. This is not a story of a quarter. But I would like to remind some of the people, and particularly some of the analysts, and those that I have had discussions with in Brazil, one of the things that I think we are going to start seeing change is when people really look at Marfrig, they are really using sometimes 100% WAC for a Brazilian concern, for a Brazilian-related company.

And now Marfrig, after the divestment of one-third of what it had -- it's 50% internationally. So we don't think the cost of equity of Keystone and Moy Park should be reflected in the same sort of mode of beef being South America and being of a much higher-commodity nature, if you will, than both Keystone and Moy Park. So I hope analysts will start segmenting a little bit the WAC and the cost of equity as one item in that equation for both pieces, both the international piece and Brazil, and get a better blend, what the true value of Marfrig is.

Very few companies in Brazil can actually sell a business for $3 billion, as we have done, in one go. And if you look at the EBITDA numbers of both Keystone and Moy Park, and if you look at what they are projecting as guidance for 2014, we are talking a business on a combined basis in the north of $3 billion enterprise value. Both businesses are unlevered.

So you have right there in the international front a $3-billion plus valuation for very solid businesses. And for the case of Marfrig Beef, there are comparables in the market for people to basically come to their numbers. So I think in the case of Keystone and Moy Park, sometimes comparables are not that easy; less so for Keystone than Moy Park, as a matter of fact.

So the truth of the matter is as the market, as the analyst community starts becoming more precise in how to discount Marfrig, I think the market will be able to start seeing the real and more value. For us as management, we have got to pay attention to solid performance on all different fronts -- in particular, free cash flow.

We have said if the trend -- if the Third Quarter trend is to stay, we are very comfortable going forward in 2014. I think our guidance was a relatively minor loss in terms of free cash flow to breakeven. If that trend continues, I think probably management feels more assertive next year to look at it again. We want to make sure that we give the market the assurance of stability on the debt piece and the stability and growth of the EBITDA with quality.

So this quarter gives you higher margins and revenue growth at all levels. I think we -- hopefully, we have been able to explain the debt profile and how much we have changed, doing what we have done in terms of liability management; but, also, the positive side effect of having divested $2.8 billion of debt, bank debt. And we remain committed to the numbers we presented to the market for 2014.

On Slide 20, just final closing remarks. It's non-financial, but it's in my view as important, which is about the culture. And it's about alignment of management going forward. The compensation structure of the key executives of the Company will be aligned to the strategy Focus to Win, will be aligned to the margins and the expectations I think we have articulated to the marketplace.

But we have also started using these new symbols and logos for the group -- not because they are nicer, but because they should denote a much better alignment across all different businesses towards the goals that I think we have set for ourselves. We will integrate it where it makes sense. We will be pursuing synergies where it makes sense, as articulated during the Marfrig Day. But we also want to see a Group that is culturally a lot more aligned than I think we have been in the past.

We are adding the word Global Foods, for any other reason that we are in 17 countries with plants, with people, producing stuff. So it's not 17 flags, but 17 operating plants across the globe. And I think for a Brazilian company and group, we are very proud of being able to build, and to buy, and to continue to grow businesses that have been acquired and are now more solidly aligned with the rest.

So the name -- on Slide 21 -- the name Marfrig Group, as I mentioned, Global Foods is the clear signal towards our strategic goal of consolidating the Group as a food company, not necessarily as a pure protein. Today we are a pure protein; we are going to be evolving over time, slowly; and delivering, but slowly. The new designs reflect, definitely, on a desire to have a much higher level of cultural alignment and also the way we position in the market as the three names.

And the Moy Park name will lead our global positioning or global brand in many international markets, when we will be selling either chicken or, eventually, even beef. Okay? So with that, I'll stop here, and I will open for questions. Thank you.

Questions And Answers

Operator

(Operator Instructions) Alex Robarts with Citi.

Q - Alex Robarts {BIO 1499637 <GO>}

I would like to focus on the Marfrig Beef business. When we look in the quarter among your three segments, Marfrig Beef clearly shows the most significant operating leverage on a sequential basis. And when we think about the gross profit growing in the quarter sequentially 19%, but adjusted EBITDA 39%, it really seems to come a lot down to the SG&A.

Could you focus, or help us understand a little bit, what was going on with that sequential operating leverage vis-a-vis that SG&A? Thinking about this gradual recovery in Uruguay, versus the domestic business in Brazil, versus the exports.

And I guess the second part of this question relates to how do you see the current environment in the domestic beef business? How has it been going in terms of pricing, particularly wholesale pricing?

And the last question, sorry, is on exports. When we think about the Brazilian export business, which for us came in a little bit stronger than we had expected -- but when we look at the pricing in dollars, right, October, according to SECEX, shows a little bit of a sequential improvement over the export dollar selling price in the Third Quarter. In the first bit of November, even higher.

And this is different from other proteins, where the dollar price seems to be flat or down. If you could comment a little bit on the evolution and the strength of that seemingly strengthening beef export dollar price, that would be very helpful. Thanks very much.

A - Sergio Rial {BIO 1925337 <GO>}

Well lots of questions. But I'll try. Let me just -- so you basically started by saying, help me understand, Sergio, the leverage that I think we have seen in terms of grading leverage in terms of beef.

Of course, in the Second Quarter we had, as we mentioned, Uruguay posting still significant losses on the back of where they were in terms of how the industry was behaving, cattle numbers, and export prices. And we certainly closed down Argentina -- 2 plants.

So as we move to the Third Quarter, Uruguay is in a much better position than I think it was in the Second Quarter. And Uruguay is actually moving to a very positive cycle. Herd numbers have been replenished quite considerably over the last, call it, 18 months. Industry is behaving very, very rationally. And export prices are better than they were in the first half of the year.

So I can say with good confidence that Uruguay, which accounts for 18% of Marfrig's beef business -- again, for Marfrig Beef's business -- should be a very important contributor in terms of not only enhancing but supporting high margins for this business going forward.

Second point -- in the case of Third Quarter, we were very fast and agile in repositioning the business to exports on that quarter. Partially was related to sort of flat prices in Brazil. So as you have seen, cattle prices have increased in the last, call it, six months, while prices domestically haven't really moved that much -- certainly not in tandem with cattle prices.

So the adjusting, adapting our business to the export side was really good. And I am pleased to inform the market that one of our critical plants, Tangara in Mato Grosso, has just been reopened to Russia. So we have another plant open to Russia. We just got the authorization this morning. So pleased to share with you. It will certainly have another positive impact in the Fourth Quarter numbers of our Marfrig Beef business in Brazil.

Now, all of that also led us to say, you know what, if you are running a commodity business, although there is a process through -- there are some elements of value-added. But if fundamentally the core of the business is commodity, you better have a very good grip on SG&A. That should not change. We will see growth in sales here and there. And of course, we are not going to be able to keep always a declining trend, but we have to keep a very tight grip on the SG&A.

So I think there's more to be done in terms of operational leverage in that respect. And the big operational leverage, Alex, is really working capital. So the benefit you are seeing on our operating cash flow basis -- in the inventory level, it's coming out of beef. It's not really coming out of Keystone and Moy Park, fundamentally. It's really coming out of beef, where it's the largest working capital user. So that is the biggest operational lever -- operating lever that I think we have at this point in time.

Still, as part of your question, domestic prices -- wholesale prices have not been good. So what we have been doing is building our presence with small retailers and midsized retailers. So we are doing a very good job, I think, in segmenting the domestic market much better.

The head of our logistics is the man who basically turned around the logistics of Seara. So we are paying attention on the cost to serve, because you've got to pay attention, and trying to shy away from the large wholesale retailers as much as we can. You can't avoid them, because they are large-volume price catchers. But then if we have the export market, and if we do a better segmentation on the front end with small to midsized retailers, we can absolutely reduce the negative impact normally people would have with the large wholesales.

Q - Alex Robarts {BIO 1499637 <GO>}

Okay. And any comment on the export selling prices, Sergio? That would be really helpful. It seems to be really strengthening here as we (multiple speakers).

A - Sergio Rial {BIO 1925337 <GO>}

It is strengthening. So I can't give you numerical targets, but I think the facts -- Russia is very, very strong. And I think we are seeing that also with Asia.

And the other thing that we will be able to articulate better in 2014 is ensuring that, particularly in Uruguay, is actually selling more and more to Keystone in Asia. Many customers are at Keystone and serving today in Asia are becoming a lot more pro-beef.

I'm going to give you a very concrete example. KFC has just announced in China that hamburgers are going to be part of their standard menu. So it's very -- it's almost unique to believe that KFC, known for what it is known, that it's adding hamburgers as part of its standard menu. With that comes a very specific demand for beef, which hopefully we should be able to do a better job in connecting our South American supply chain through Keystone from sales office.

But maybe Ricardo has also more specific numbers for the export side. Ricardo, would you like to --?

A - Ricardo Florence {BIO 20008948 <GO>}

Exactly. This is sort of like your point. It has been very stable. The increase in the average price of the exports in the international beef operations -- if we see the average price in the Third Quarter in our beef exports in Argentina and in Uruguay has increased to BRL11.5 per dollar compared to BRL9.95, which was in the previous quarter, which means an increase of 15.6%. Even if you deduct the exit rate variation that we have had in this period, you have almost a double-digit figure in percentage terms, comparing the two prices.

Now, we mentioned this in the previous quarter -- that this was a trend that we had seen in Uruguay and Argentina, which is confirmed now. And it's based with its sense of improvement that we have said in international beef operations.

Operator

Alan Alanis with J.P. Morgan.

Q - Alan Alanis {BIO 15998010 <GO>}

I just want to double check some numbers here that I'm doing. I'm doing some back-of-the-envelope in terms of trying to estimate your Fourth Quarter results based on the guidance for 2013. And it seems that I'm getting some sort of year-over-year contraction in EBITDA margins of around 150 basis points. Is this right, or am I doing something wrong -- in terms of the Fourth Quarter on a year-over-year basis, in terms of EBITDA margins? That's the first question.

And the second question that I have is, do you have any further debt that should be transferred or can be transferred in relationship to the Brasil Foods asset swap that you highlight there as part of your operating -- of your cash flow for this year, for this quarter?

A - Sergio Rial {BIO 1925337 <GO>}

So the second question -- no, we don't have anything. Everything is done as far as the asset swap.

In the case of -- I think what you have seen is, particularly in 2012 and 2011, I think beef margins were between 10% and 13%. Right? And probably that's where you are having some of the discrepancy.

That doesn't mean that it can't go back, and especially if Uruguay comes back in strides. We have even seen margins in Uruguay in the peak of the cycle above 14%. And I'm absolutely comfortable to say that Uruguay's cycle, going to a more positive sort of environment in 2013 is a given. So that's what I would explain, perhaps, the difference when you look at it.

Q - Alan Alanis {BIO 15998010 <GO>}

Okay. And Uruguay represents a little bit slightly less than 10% of your revenues, correct? Consolidated?

A - Sergio Rial {BIO 1925337 <GO>}

Oh, yes; consolidated, for sure. And as far as the Marfrig Beef, 18%.

A - Ricardo Florence {BIO 20008948 <GO>}

Yes. There is an additional point that I would like to make, Alan, which is the following. Usually the Third Quarter is seasonal in Uruguay, with lower sales which grow going to the Fourth Quarter and in the First Quarter of the following year, which means this participation could increase in the following quarters.

Q - Alan Alanis {BIO 15998010 <GO>}

Got it. And if I may, because the last question were also financial question regarding your -- if we take a look at the financial expense and divide them by the total number, the total amount of debt, and then we annualize that, we get a big number. So what else isn't there in terms of the net financial expenses?

A - Ricardo Florence {BIO 20008948 <GO>}

First of all, Alan, you should exclude all the debt expenses that was still in what we paid in the quarter. But at the end of the quarter it was already transferred to JBS. I mean, you do not see it in the balance sheet.

Other important points that we have reduced, as well -- it has been the average interest that it have in our debt, which, as we mentioned to you, it's 7.8% at this point. We had -- and this was also transferred to JBS -- some exit swaps in part of our debt which no longer have. This has also been transferred together with the rest of the debt.

If you see -- let's go specifically to the financial expenses that you see there in the interest provision. You have there BRL322 billion in the quarter. If you exclude all this that I mentioned to you, you have something around BRL230 million in the quarter, which should be considered the basis of the interest that we are provisioning every quarter in our debt. That's on Page 13 of the release, just to be sure.

Operator

Aaron Holsberg with Santander.

Q - Aaron Holsberg {BIO 16876068 <GO>}

My question has to do with the debt ratios. I've done some calculations, and I just want to make sure I'm looking at this correctly. Your net debt is BRL6.658 billion, and your EBITDA guidance for 2014 is a range of BRL1.6 billion to BRL1.9 billion. So that means that the ratio -- the range of net debt ratio for 2014 is 3.5 to 4.16?

A - Sergio Rial {BIO 1925337 <GO>}

That is what I think. No, you're absolutely correct, Aaron. We don't want to construe it as a guidance; we are not giving guidance on the leverage side. But that's what we have said repeatedly. We are a company under 4. And we are looking at ourselves to be in the mid-range of 3. And that is, of course -- yes. So that's exactly -- you are right. So you are doing the math right.

Q - Aaron Holsberg {BIO 16876068 <GO>}

Okay. To get towards 3, are you expecting to actually be able to repay down debt, lower net debt? Or do you plan to accomplish it entirely by increasing EBITDA?

A - Sergio Rial {BIO 1925337 <GO>}

At this point in time I think we are focusing, as you have seen in the Third Quarter, with operating performance at this point in time. Right? I think over time we have to see which ways we could actually accelerate, perhaps, ways to delever the Company.

We feel -- we still have the high 3s type of leverage. But in the short term, which I think is the other dimension that you need to pay attention on the release, as I'm sure you are, on the slide that I had showed for on Page 15 of the release, is that the Company has eliminated any important repayments between now and 2017.

So that gives us time. So whether the markets are going to be open in 2014 or not, because of whatever happens with the Fed, we are today in a position to say, okay, we have options. Right? Meaning we don't have to do anything to repay anything in 2014.

It is not an immaterial thing from where we were in the past. And that's why we thought it was very important to show the pro forma Fourth Quarter to the market, so that people could see how much money is being paid to the bonds; how much money is being paid to BNDES, convertible -- as a matter of fact, 16 months as opposed to 12. And the remaining piece that got rolled over to a medium-term profile as opposed to just to the next quarter.

Q - Aaron Holsberg {BIO 16876068 <GO>}

Okay. One final question -- JBS assumed -- agreed to assume BRL5.8 billion in debt and, I guess, some payables. But Marfrig's net debt has not decreased BRL5.8 billion, but somewhat less. Is that because -- what is that? Is that the just FX variation, or has there been some negative cash flow?

A - Sergio Rial {BIO 1925337 <GO>}

Very good question. So I would just correct, the BRL5.85 billion includes everything. So it includes bank debt and other payables. So it's not more payables, so it's everything.

And the difference that you are alleging -- you are absolutely right. So partially it is explained by not all transferred, but most of it; more than 90% of it is bank debt. So there were other payables, and the Brasil Foods obligation is certainly one.

That doesn't help you -- doesn't help us, necessarily, on the bank debt stock, per se, but has other positive impacts, like you mentioned, around the payables. So you are right. The other piece that explains the difference is exchange variations from Second Quarter to the Third Quarter, which is actually around -- from round numbers, BRL90 million to BRL100 million.

Operator

Rolando Springall, Maxim Group.

Q - Rolando Springall

My question is pertaining to the real. Basically, that real opened the year around 2, and it's currently at 2.3. I believe, since you are an exporter, it clearly benefits you. Going forward with the Fed tapering, should we expect more volatility in the real, given the fact that the SELIC rate has gone up so much, and maybe the Brazilian authorities have managed to contain the devaluation going forward?

A - Sergio Rial {BIO 1925337 <GO>}

I think you are absolutely right. I think the market has somehow not fully -- fully, capital -- fully understood how sensitive we were going to be from an operating performance if the dollar continues to strengthen, or if the real continues to devalue. It is my belief, but I don't -- we can't plan, and we can't execute a strategy on the back of macro.

But we have to work based on some macro assumptions. And the macro assumptions for us is that we are going to be going through, in 2014, a much -- an environment of a stronger dollar and a weaker real. That will definitely benefit us, not only because we export, but because we are operating also in 17 countries where we are generating dollars.

And so I think the Company has this benefit of having 50% of its footprint actually outside Brazil, between US, Europe, and Asia. And that's not an immaterial benefit. Ricardo, during the Marfrig Day, had mentioned that a 10% deval of the real can actually represent 20 to 40 basis points of margin expansion on the EBITDA level for Marfrig.

Of course, we certainly have the impact on the debt, as well. But we believe that the operating lever with a stronger dollar -- it's much greater than the potential impact on the debt.

Operator

Thais Pinho with UBS.

Q - Thais Pinho {BIO 16733853 <GO>}

Just a quick question. Ricardo, you mentioned in the Portuguese call about the BNDES transaction of the debenture, the convertible debenture -- that the total payment for the 16 months was approximately BRL230 million to BRL250 million. I understand that the BRL50 million got into this quarter, that refers to the three months, and that part of it was already incorporated in the previous quarters.

How much of that is still left, so that we can -- I just wanted to understand the dynamics of the 16, the 12 months. How can we look at this going forward? I'm not sure if that was clear.

A - Ricardo Florence {BIO 20008948 <GO>}

No, Thais, I believe that it is a misunderstanding here. What I said in the Portuguese call was between BRL230 million and BRL250 million. The precise figure, it is BRL240 million that we are paying as of today.

Q - Thais Pinho {BIO 16733853 <GO>}

Okay. So how does that reconcile -- you mentioned BRL50 million that was relative to this quarter, so the three months. And how much of that was already incorporated before?

A - Ricardo Florence {BIO 20008948 <GO>}

One of the analysts posed a question, which was, how much of this figure was included in the P&L of the Third Quarter? And what we recognize every quarter is around BRL50 million, BRL55 million, depending on the level of the CDI in Brazil. That's basically the difference, is the recognition in the quarter and what we are actually paying for the accumulated 16 months.

Q - Thais Pinho {BIO 16733853 <GO>}

Okay. And you did it for the 16 months this time?

A - Ricardo Florence {BIO 20008948 <GO>}

Absolutely right, absolutely right.

Q - Thais Pinho {BIO 16733853 <GO>}

Can you just repeat why 16, and not 12 again? I just wanted to clarify that.

A - Sergio Rial {BIO 1925337 <GO>}

We were -- the payment was going to be happening in July, right, as normally it happens. It's an annual payment of interest that was really coinciding with the transaction with Seara.

We personally felt, as we didn't know how the transaction would be approved or not, in terms of timing, we felt it would be appropriate to wait and see the evolution; to preserve the liquidity of the Company; to really be on a stronger position, in case we would have to support Seara for a longer period.

Seara has consumed cash for the Group for a number of quarters. And again, for those who have basically sometimes been critical with me that we never disclosed the Seara numbers, the Seara Brasil numbers, you now have the Seara Brasil numbers in the release. So you can see it for yourselves why it made sense to be prudent and not necessarily pay at that point in time.

So the NDES was very comfortable in doing that. And we are -- so the 16-month period is being paid today. So we want to make sure that that was completely out of the horizon.

Operator

Excuse me. 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 Rial {BIO 1925337 <GO>}

Okay. Thank you very much. I would like to ask -- and first, to really thank those who have been supporting the Group. And I would like to mention, in particular, the recent share performance of the Company. I fully understand that there is a particular US fund that basically decided to sell its position in the last couple of weeks, which has put quite a bit of pressure on the share price, for which I am not -- management is not necessarily pleased. But we also understand that that particular fund -- there's a lot more fund in the consumer brand story then necessarily in what we have today as Marfrig Group.

We are committed to grow. We will grow. We are committed to performance. And looking at any possible measure, the potential of the Group -- it's certainly there. And I understand, we haven't been necessarily an easy story from an equity standpoint of view over the last couple of years. We absolutely acknowledge that.

And that is guiding everything we are doing each and every day inside of this Company. So I just want to make sure that at least one of the things we have to do, so I want to make sure that I articulate the priorities.

One is certainly the strategies you have seen. The second one is to continue to use perhaps -- I'm going to be paraphrasing the quote -- the operational leverage that we have in the beef to really bring a much higher performance and better-quality performance, even, of our beef business in South America.

Second, we have to work on our shareholder base. We certainly have to build and create the level of confidence with long-term shareholders that truly, truly understand, and bet, if you will, on an international platform that has quite a bit of possibility to grow and to be profitable, particularly our Asian business, in particular.

And certainly, I think that's the most important piece. This quarter ends the divestiture of Seara. So it ends with the disclosure of the numbers. It ends with what it meant.

And we are going to be looking forward and guided by the guidance and the numbers we have put as targets for ourselves for 2014. So for those who are on sidelines, we understand. For those who are tempted, we will do everything we can not to disappoint you. The stock price today -- it is what it is. That's not what is guiding us. But what is guiding us, that we see an enormous amount of value that can still be created inside of Marfrig.

I will assume the position as CEO as from January 1. That's confirmed. It was confirmed in the Portuguese version by Marcos himself as part of the plan. And also, very importantly, I think, is that management compensation will be completely aligned to the Focus to Win strategy. And hopefully in the quarters in 2014, we can even be a bit more -- and we will be more specific around what that comp entails.

So thank you very much for your support, and for listening, and for the questions. Okay. Thank you very much.

Operator

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