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Q3 2013 Earnings Call

Company Participants

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

Other Participants

- Celina Merrill, Analyst
- Jose Yordan, Analyst
- Unidentified Participant

Presentation

Operator

Good afternoon, ladies and gentlemen, and thank you for waiting. At this time, we would like to welcome everybody to Minerva's Third Quarter 2013 Results Conference Call. Today, with us we have Fernando Galletti de Queiroz, Chief Executive Officer; Edison Ticle, Chief Financial Officer and Eduardo Puzziello, Investor Relations Officer.

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

Before proceeding, we wish to mention that forward-looking statements may be made during this presentation relating to Minerva's business prospects, operating and financial estimates and goals. They are based on the belief and assumptions of the company's management and on information currently available. They involve risks, uncertainties and assumptions because they relate to future events and therefore, depend on circumstances that may or may not occur in the future.

Investors should understand that general economic conditions, industry conditions and other operating factors could also affect the future results of Minerva and could cause results to differ materially from those expressed in such forward-looking statements.

I will now turn the conference call over to Mr. Fernando Galletti, CEO, who will begin the presentation. Mr. Galletti, you may begin the presentation, sir.

Fernando Galletti de Queiroz {BIO 15387377 <GO>}

Good afternoon, everyone. First I would like to thank you for participating in Minerva's conference call on the third quarter results where we will discuss not only the solid results recorded by the company, but also the significant progress in Minerva's investment plan.

Let's move to slide two and we will talk about the quarter highlights. Third Q 2013 highlights; the third quarter was marked by a solid beef export from South America, particularly from Brazil and Paraguay, whose exports reached record levels. It reflects the increased demand for beef from emerging countries combined with the reduced supply by some of competitive countries. In this context, the company adjusted its sales mix prioritizing the exports, which represented approximately 70% of the gross revenue in the quarter.

With the ability to adjust our sales with the combination of efficient logistics and risk management instruments that helps us to make advised decisions on the destination of the product to maximize returns from our operations.

Net revenues was a record of BRL1.5 billion, 30% higher than in the last quarter. EBITDA increased by 20% over the same period last year. With the margin of 10.9%, 70% bps up on (technical difficulty). We recorded operating cash flow of 100 million in free cash flow, it was once again positive totaling BRL20 million. As a result, return on invested capital came from 90%, 100 bps higher than in third Q of 2012. With regard to our financial structure, we closed the quarter with a solid cash position of 1.2 billion in line with the company's policy to maintain liquidity cash.

We announced IFC's investment in Minerva, together we'll have 10 year loan agreement. This partnership established with IFC enhances commitment for transparency, value creation, and continuous improvement of internal process. Mainly in terms of corporate governance and sustainability. Moreover, it brings a unique staff to the sector.

Lastly, we are pleased to mention once again the acquisition of two slaughtering and deboning plants from BRF in Mato Grosso State. Announced on November 1, this transaction is fully aligned with the investment plan disclosed to the market in 2012 and finalized our M&A activities in Brazil, as we will explain in this presentation.

Moving on to slide number three, we will discuss the cattle supply. Industry overview; Brazil - cattle supply. This quarter was characterized by a typical off-season combined with slaughter volume 10% higher than in third Q of 2012. Contributing to metro rates of the cattle price. As you can see in the upper right of the slide, the slaughtering has been increasing in Brazil quarter-over-quarter since the beginning of 2012. This is explained by the strong beef demand in the domestic and export markets, whose volume increased 22% when compared to the volume exported in third Q of 2012. Note, however, that despite the significant increase in slaughter volume, estimated at around 11% in January through September 2013, over the same period a year earlier, the arroba price grew by just 6%. This confirms our perception that the company's cattle cycle implies high cattle supply in Brazil.

Now, let's move to slide number four. Industry's overview; Brazil - exports. As you can see in the upper left chart, Brazilian export reached a record volume with 17% growth in the first five months of 2013 over the same period in 2012. The main driver of this performance is a strong demand from Asia, especially Hong-Kong, which in the third quarter consolidated its position as a second largest beef market for Brazilian exports accounting for 19% of the total, behind only Russia.

Another factor is the weakening of important global beef producers such as United States and Europe, which is contributing to reduce beef supply, favoring exports from regions such as South America and especially Brazil. The dollar appreciation has also benefited Brazilian exports, however, the importance of South America has gained as a major global platform for beef exports is unquestionable.

The domestic market has also contributed significantly to Minerva's solid performance as you can see on slide five. Slide five, industry overview; Brazil - domestic market. Beef demand has increased sharply in 2013, sustaining beef prices above 2012 levels as shown in the upper left chart. In addition, should a increase in real income in Brazil, the competitiveness of beef prices as compared to other proteins is also responsible for this growth.

As you can see on this slide, if we compare beef prices with both the poultry and pork, the spread has remained below the average for the last three years through 2013. This was due to the high prices of company protein experienced by grain prices, which led to the replacement by beef and consequently push it up its consumption. In the case of Minerva, the market sales volume increased 30%.

On slide six, we will discuss the industry performance in Paraguay. Industry's overview; Paraguay. And this quarter was once again favorable for beef producers in Paraguay. The slaughter volume remained strong, thanks to the high cattle supply and was driven by solid exports, which expanded by 23% in the quarter, over the same period of 2012.

Despite decrease in demand, cattle price in Paraguay fell by 5% in the third Q of 2013 over the previous three months. Now that cattle price are currently even lower than before the outbreak of foot-and-mouth disease confirms high cattle supply despite decelerating slaughter rate and increasing demand from exports.

Russia remained the main market for Paraguayan exports. Through Chile, share increased -- share significantly after the country resumed import in second Q of 2013. Asia has gained an important as well of the main global beef main process while Paraguay has been consolidating its position as an important beef supplier through that region.

Now let's move on slide seven to discuss the industry performance in Uruguay. Industry overview; Uruguay in slide seven. As shown in the upper right side of the slide, results [ph] remained stable in third Q 2013 with lower slaughter volume and consequently lower cattle price. In this scenario, combined if a higher dollar beef prices in the international market in the second Q of 2013 benefitted Uruguay beef producers and exporters.

Russia remains the main individual importer, although in regional trends, Europe is the main destination for Uruguayan beef exports. It's worth to remind that Uruguay has access to markets such as United States and China which imposed bans on Brazilian and Paraguayan beef. In this context, Minerva uses its operation in Uruguay to diversify its mix of countries and consequently to access these markets.

On slide eight, we present the company's result in the quarter. Slide eight, Minerva; operating highlights. Minerva slaughter volume remained solid in the third quarter. Capacity utilization stood at 77%, in line with historical average. This performance reflects greater efficiency in the operational activities and in operation of the investments made in recent years.

Driven by the solid performance of the exports in markets, exports represented about 70% of the company's gross revenue in the third Q 2013, with 26% increase in fresh beef export.

Let's move on to slide nine, which represents more details on the company commercial strategy. In slide nine, Minerva results from exports. The company use risk management instrument to define its sales mix. All this is focused on maximizing the return for niche markets. Additionally, the geographical diversification of our operation in Brazil, Paraguay and Uruguay provides us with the ability necessary to adapt our strategy and assets in different markets.

The Western Asia has expanded sharply in recent months. Given this scenario, we regret we can't share of our export to that region in order to benefit from this growth. As you can see in this chart, Asia share of the company's consolidated revenue increased from 5% in third Q 2012 to 40% this quarter. The company having initiated risk management instruments and quickly adjusting in the distribution channels is key in this sector. I would also like to point out, we will be in inaugurating an office in China in the coming months.

I'll also highlight of the sharp increase in beef price in Europe. As a result, South American countries became more competitive there. Once again, we adjusted our sales mix and Europe shares in exports moved up from 9% in the third Q of 2012 to 11% in third Q 2013. South America beef has also gained share in North Africa. In third Q 2013, the main highlight was demand from Egypt. In the last 12 months, (inaudible) shares of the company's sales mix grew by 200 bps.

On the next slide, we present growth revenue trends for the main business units. In slide 10, Minerva gross revenues increased by segment. Consolidated growth revenues increased by 30% over the same period in 2012. Beef sales moved up 37%, led by substantial 41% upturn in export volume. Growth revenue from other divisions grew by 8%, followed by MFF which has considerably been delivering records, capital utilization and revenue figures.

Gross revenues from this division grew over 100% when compared to the third Q of 2012 and operating margins also improved significantly. MFF continue to focus on the foodservice market, although the higher dollar also fuelled export growth of ready-to-eat products to other countries. The leather segment posted another strong performance recording a 62% upturn in gross revenues from exports over third Q 2012 with a focus with niche in both the domestic and foreign markets.

Revenue from the domestic market distribution and the resale of third-party product continue to grow substantially, moving up 26% led by the expansion of the foodservice segment in our client bases.

I will now hand over to Edison, who will comment on our financial highlights. Edison?

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

Thank you, Fernando. So let's move to slide 11 to talk about the financial highlights. Net revenues reached BRL1.5 billion this quarter, 30% higher than in the 3Q '12 and our new company record. EBITDA also posted strong growth, increasing by 21% over 3Q '12 reaching BRL163 million in the quarter with a margin of 10.9% higher than in the previous quarter.

The company also again delivered the return on invested capital growth, this time to 19%, 100 basis point up when compared to the same period last year. As for leveraged, we ended the quarter with our net debt to EBITDA ratio of 3.4 times and 0.7 times lower than in September 2012, showing company's efforts to adjust its capital structure.

Now let's move to slide 12 to talk more about the capital structure of the company. The company ended the third quarter with a cash position of BRL1.2 billion, enough to amortize all the debt that matures in due 2019, as against in the chart, and upholds the minimal amount determined by the company's financial policy. Short-term debt accounted for 16% of the total, Minerva's 67% of the debt was dollar denominated, constituting a natural hedge for our exports, which accounted for 70% of our revenue in 3Q13.

Now moving to slide 13, we'll talk about the net debt of Minerva. The shack of this slide shows the items responsible for the variation in our net debt between June and September. Firstly, there was the effect of the cancellation of treasury shares, of shares held in treasury in this quarter, which was fully responsible for the BRL58 million increase in our debt. There was also the exchange variation, a non-cash item, which reaches BRL33 million in the quarter due to the impact of depreciation of the dollar against the real and in fact in our dollar denominated debt. Financial expense, non-cash financial expenses reached BLR52 million and also contributed to increase the net debt. Finally, these effects were partially offset by our free cash flow generation in the quarter that helped us to reduce the debt by almost BLR20 million.

On slide 14, we will discuss our cash flow generation in the quarter. Free cash flow after investments and payments of cash financial expenses were positive again, reaching BLR20 million in the quarter. If we consider cash from operating activities only, or if we take that cash flow from operations, excluding investment and the payment of interest on the debt, cash flow reached BLR100 million in the quarter.

Now moving on to slide 15, we present the sensitivity analysis of the company's leverage following the acquisition of the two BRF plants announced at the beginning of November. In 2012 BRF Beef generated an EBITDA margin of around 4% to 5%.

transaction is approved by CADE, Brazil's antitrust authority. We believe the integration of this plant with Minerva's current operations. Together with the synergies to be captured, they reserve in four possible leverage scenarios for the company ranging from 2.5 times to 3.1 times in terms of net debt to EBITDA ratio, assuming EBITDA margins from BRF operations ranging from 5% to 12.5%.

It's also important to say that the company took another step in its investment plan to reach more growth to increase capacity result increasing debt. Keeping the financials, these premium debt has been marking all the moves that Minerva has been taking in the past years in term of accretion and also in cash growth.

I will turn over to Fernando, who will talk about the company's accomplished investment targets.

Fernando Galletti de Queiroz {BIO 15387377 <GO>}

Thanks, Edison. Let's have a look on slide 16, with investment targets that were accomplished. I would like to talk to you about the Minerva investment plan. As we announced on the occasion of our capital increase a year ago, our growth strategy is based on three fronts. First, six new distribution centers will be opened in three years. In 2013, we opened two of them, one in Uberlandia and the other one in Rolim de Moura. The opening of another four is maintained. Second, expansion of our processed product line. Minerva Fine Foods, in order to add up to 2,000 tons per month of capacity, we are undertaking the necessary investments to rise MFF capacity.

As you can see in this quarter results, where we invested around BRL6 million in the equipments for MFF. This will take care of the bottlenecks that we have on production and have a rapidly increase of our production. The third front is the geographical diversification of our operation in South America, in Brazil, through the state of Mato Grosso, where we didn't have a product yet.

As you know, the expansion to Paraguay and Uruguay and in the future (technical difficulty). The decision of the two BRF slaughtering and deboning plants in Mato Grosso, a state with the biggest beef cattle herd in Brazil announced by the company at the beginning of November marks the first step in this process, concluding our M&A activities in Brazil and consolidating Minerva's position in this country.

I would also like to emphasis that the transaction was restructured to keep the company's deleveraging process. In fact, as Edison has already explained, the transaction will contribute to reduce our debt by adding the result of these plants towards the synergy gains in the expected growth of the operation. It also represents by a strategic partnership with BRF, which will become an important company, shareholder -- establishing our shareholder (inaudible) growth.

To sum up, I would just like to reaffirm that we have consistently complied with the trend announced at the end of 2012, maximizing return for our shareholders and focusing on financial discipline remain our business priorities.

I will now hand over to the operator to begin the Q&A session. Thank you.

Questions And Answers

Operator

We thank you, sir. We will now start the question-and-answer session for investors and analysts. (Operator Instructions) The first question you have comes from Jose Yordan of Deutsche Bank. Please go ahead.

Q - Jose Yordan {BIO 1496398 <GO>}

Hi. Good afternoon, everyone. My question is about the scenarios that you put on a couple slides ago. You mentioned in the Portuguese call that the 12.5% is perhaps the best case scenario. But of the other three, which you would be able give us any idea of what your initial impressions are about which one of those margin scenario you can reach with those plans?

And then my second question is more technical. You had an item in the cash flow statement for calculation of treasury stock, but there's 100 million plus item tied with the treasury stock and you can just clarify what that is? That would be great. Thank you.

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

Sir, can you repeat the second question, please.

Q - Jose Yordan {BIO 1496398 <GO>}

Just a clarification on what the BRL100 million cash flow item that's a treasury stock, I see right below, there is a use of cash of 58 for canceling treasury stock, but there is a positive amount of 100 million.

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

Okay. Talking about the shares in treasury on the cash flow page. The BRL100 million was due to the purchase of shares in the market. So they used BRL100 million of shares (inaudible) BRL58 million during the quarter, and the remaining 42 million was sold to IFC at the end of the quarter. So, that's the explanation about all the operations that we did during the quarter with the shares in treasury. I'll give it to Fernando to answer the first question.

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

I believe that you asked about the BRF possible EBITDA scenarios that we presented. We made an estimation of the possible -- probable scenario that we will face. As you may know, before the antitrust there would be a final approval, we cannot go before then our due diligence in the company. So we've been working on the plans, we've been working on where we can see synergies. While to be more precise, we definitely need more information and to be inside the operations of BRF. But definitely on the first view, we feel confident that we would be able to make it an improvement on the margins by putting Minerva management rules on this operation.

Q - Jose Yordan {BIO 1496398 <GO>}

Great. If I could follow up with when do you expect the deal to close and the recovery approval to come, what's your best estimate at this point?

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

All depends on how long the antitrust will take to analyze. The maximum period that they have is six months, and of course, that we will be working hard to try to anticipate that as much as possible. But of course, that does not depend on us. We cannot predict when it is going to happen.

Q - Jose Yordan {BIO 1496398 <GO>}

Okay, great. Thank you.

Operator

The next question comes from (inaudible).

Q - Unidentified Participant

Thank you. As you've outlined your investment plan for the next few years, what should we expect with regards to capital expenditures? Should we expect them to remain at roughly the same level or are we going to increase investment in that area?

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

So the question will be on market capital rates?

Q - Unidentified Participant

Yeah. What kind of level of CapEx should we expect going forward?

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

Okay. Maintenance CapEx will be around BRL25 million per quarter and we have like special CapEx for next year to MFF operation that will be around BRL50 million. So for 2014, our guess is to have CapEx around BRL100 million on maintenance plus BRL50 million on MFF expansion.

Q - Unidentified Participant

Great. And with regard to the acquisition. How many opportunities do you think exist out that are comparable? And how is the return on capital compared for making an acquisition for the facilities versus building them yourself?

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

Well, there are many opportunities, especially in Paraguay and Uruguay. We have explained each of the opportunities. What I can tell you is that there is nothing in the pipeline, there is nothing to be announced in the short-term. We are very, very focused on concluding the deal with BRF. So we are working together with BRF to speed up the approval from the antitrust regulator in Brazil, Fernando mentioned. In terms of return and investment capital, we try to target companies that can present right over 15%. As you know, Minerva is running at working 19%, so any target that has a possibility, capability to deliver higher than 15%, (inaudible) target for us.

Q - Unidentified Participant

Great. Thank you very much. Congratulations on the quarter.

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

Thank you.

Operator

(Operator Instructions) The next question we have will come from Celina Merrill of Credit Suisse.

Q - Celina Merrill {BIO 6748233 <GO>}

Hi, good afternoon. Congratulations on the results. I had a question about the arroba cattle, I guess basically, a question on slide three. Can you help me understand a little bit more, why it is that we continue to see cattle prices creep up a little bit when there's still a pretty healthy slaughter volume and availability of cattle and what is your expectation for the next few months on that front?

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

First, let's put this slide in the proper context. You're analyzing this shot, that's Brazilian Reais. If you turn it into dollars, you're going to see a different scenario. But what can explain the price rise in the Brazilian market is first the seasonality that we are in the peak of the off-season. And of course, that we are seeing a record number of slaughter. But what's important to mention is that despite of the record number of cattle slaughtered, the strong demand from the export market, the arroba price has moved quarter versus quarter, all the 6% in terms. And if you compare that into dollars, it's more competitive in dollars when you do this calculation.

Q - Celina Merrill {BIO 6748233 <GO>}

Okay. I see what you are saying. And then I guess, my follow-on question to that is, when I focus on the domestic market for you, do you expect to see as aggressive demand domestically in 2014, or given that corn and soy price are lower, is it possible you are going to get to see a little bit more replacement of demand from pork and poultry?

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

The spread between chicken, pork and beef in the local market shall remain stable. We don't see -- we don't expect to have this spread changing much from where it is. What we see is that for next year, Brazil will get more competitive on the export markets. So part of our business plan and part of our presentation where we are analyzing each of the main regions that we export to, is to prepare for the company to take stronger position on the export markets.

Q - Celina Merrill {BIO 6748233 <GO>}

Okay. Thank you very much.

Operator

(Operator Instructions) And next we have a follow-up from Celina Merrill of Credit Suisse.

Q - Celina Merrill {BIO 6748233 <GO>}

Hi. I just had a follow-up. Do you have a specific target for export. I guess percentage of volumes or percentage of revenues for 2014?

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

This analysis that we will do in a weekly basis on what are the markets that are providing better return for the company. The level shall be on the level that we are in this quarter or it's slightly higher on the average of the year. So it would be fair to expect three quarters of our revenues coming from exports.

Q - Celina Merrill {BIO 6748233 <GO>}

Okay, great. Thank you.

Operator

(Operator Instructions) Well, it appears that we have no further questions at this time, this concludes the question-and-answer session. At this time, I would like to turn the floor back to Mr. Fernando Galletti for any closing remarks. Sir?

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

Ladies and gentlemen, to conclude our presentation, we would like to address that we are very optimistic about the prospect for the sector. Thanks to the strong demand for beef dripping [ph] in the domestic and export markets, the continued weakening of the

Brazilian competitors and the favorable cattle supply situation in Brazil due to the currency status on the cattle cycle.

The recent depreciation of the real combined with our sales strategy, we focus on exports. We will ensure even better results for all of Minerva's investor. I would like to thank Minerva team for their commitment and dedication towards the continuous and sustainable growth of our company. And finally, I'll reaffirm that the partnership established with IFC and BRF makes us stronger for the challenges and opportunities that will emerge in the next years.

Also, I would like to invite all of you to take part on Minerva Day that will be hosted in the New York in November 21, where we can talk further about the cattle cycle, about the market (inaudible) Brazil, IFC will make a presentation, why the level of chosen to their investment in the sector, and the management team will further present the company. So if any doubt, please do not hesitate in contacting us and we remain at your disposal for any further question or clarification. Thank you very much all of you.

Operator

And we thank you, sir, and the rest of management for your time today. Thank you all for attending today's presentation. At this time, you may disconnect your lines. Thank you and have a great day everyone.