Q2 2012 Earnings Call

Company Participants

- Corporate Participant
- James David Ramsay Cruden
- Ricardo Florence dos Santos, Chief of Corporate Strategy and Investor Relations Officer

Other Participants

- Analyst
- Denis Parisien
- Jose Yordan

Presentation

Corporate Participant

[Call Starts Abruptly]...assets in Brazil. We now have in the next... in the second half of this year to complete the integration of these assets. We at Marfrig are now in a position where our operations are well diversified throughout the world in different proteins. We will now... we'll just focus on the integration and the realization of the synergies that we have identified.

We believe that we faced a challenging scenario in the second six months of this year. But although the second six months may not necessarily be excellent, we do believe that it will be satisfactory. I'd now like to hand over to Ricardo for the rest of the presentation.

Ricardo Florence dos Santos {BIO 18071813 <GO>}

Thank you, James. Well I'd like to start with the financial highlights of the company. Net revenues they were record in the quarter and achieved R$5.8 billion, up 9.3% compared to what we did in the same quarter in the previous year and 11.2% more compared to the revenues of the first quarter.

Gross margin we had an expansion of 130 basis points compared to the previous year and a decrease of 70 basis points compared to the last quarter. We compensated this in the decrease of the SG&A and total EBITDA was also helped by the gain in the sales that we did in assets in the period, represented an EBITDA of R$768 million, an increase of 176% compared to the same period in the previous year. Do not considering the extraordinary gains, the adjusted EBITDA would have been R$460.8 million, 60% higher than in the same period in 2011.

Net profit reached the R$15.5 million in the quarter, compensating the loss that we had in the second quarter in 2011. Accumulated net profit is R$50 million in this year or R$0.14 per share. Regarding to the cash flow generation coming from operations, we had R$328 million in the quarter excluding the discontinued operations. A significant improvement compared to the consumption of cash that we had in the first quarter of R$90 million.

The leverage ratio decreased to 3.73 times down from 4.5 times in the first quarter of 2012. If you look at the pro-forma figures of the assets that come from the asset swap with Brazil Foods and exclude the EBITDA of the last 12 months of the logistics operations that we showed at also the Quickfood we would have achieved pro-forma leverage of 3.5 times.

We continue to be inline with the goals of increasing the participation of our value added products in our mix of sales. In this quarter we had 46.8% on order increase, compared to the previous quarters, this compares to 36% that we did in the same period in previous year.

And other highlights of course it is the beginning of the operation of the first plans that come from the asset swap with Brazil Foods as of June. We are completing now in the months of July and August. The integration of the assets that gained in the transaction.

On page number three, I would like to mention specifically two points here. First if you go in the first part of the slide, the revenues by products, the increase in sales of 9.3% was tremendously leveraged by the increase in the processed products, in value added products. That increased from R$1.96 billion in the same quarter in the previous year to R$2.72 billion in this quarter now, an increase of 38.8%. Going to the revenues by segment, the most part of increase in sales came from the Seara Foods that presented an increase of 13.3% in the same period.

Going to the values on the P&L we've presented an evolution in the margins of the company. The average price per kilo improved from R$4.49 per kilo to R$5.18 in this quarter outperforming the increase in cost in the same period. As a consequence of this, the margins increased by 130 basis points to 14.7%.

The profit per kilo increased from R$0.60 to R$0.76 per kilo in the period. The company has done also a big effort in controlling its expenses, fixed expenses they were exceeded in this quarter into higher sales and presented compared to the previous year. Selling expenses a decrease of 70 basis points and the G&A a decrease of 40 basis points in this period.

Total EBITDA of R$767 million, they were leveraged as I said by the gain in the sales of some assets. If we do not consider this, the adjusted EBITDA would have been R$460.8 million with an EBITDA margin of 7.9% inline with what we achieved in the first quarter in this year. And 250 basis points higher than in the same period in 2011.

For the bottom-line we've presented a net income in the quarter of 15.5 million, reaching a total net profit of 50 million in accumulated figures for the six months. And with the earnings per share accumulated of R$0.14 per share.

In the quarterly information to CVM we have also to present older informations do not considering the discontinued operations. What you have on page number six, is what is the effect in the first and in the second quarter of these operations that include the gains that we had in the sale of this company in the second quarter.

In the second quarter, we excluded if you do pro-forma without the discontinued operation R$130 million on the net revenues and a net income of 254.8 million that's the result of all those operations. The net income only from the continued operations would have been a loss in this case. But only affected by the effect non-cash of the appreciation of the US dollar compared to the Rial. And our net exposure in US dollars in our net indebtedness.

Going to the page number seven, we continue to work in our capital structure management. On the quarter we did some moves like for instance Moy Park to be added to the structure of Keystone Foods. By doing this we can use better the revolving credit facility that we have in Keystone Foods of $600 million in total.

[Technical Difficulty].

On the first quarter of 2012, we registered an increase in sales and prices of higher value productions in the domestic market and for the international operation we saw an increase in revenue. Average cattle prices in Brazil fell 21.9%, fell 10% in Europe while from the second quarter of 2011 and remained virtually stable in Argentina.

As far as the revenues were concerned, the Brazilian domestic operations accounted for 31%, pretty much inline with the same quarter in 2011 and the first quarter of this year. We saw an increase over the first quarter of this year for our export operations.

Uruguay and Argentina showed a small reduction on domestic operations and an increase in export operations. And by product we show a small reduction of beef over the same quarter of 2011 but pretty much inline with the first quarter of 2012.

This year we have seen an increase in our processed or value added items over our second quarter of 2011. Exports by destinations in Europe continues as our main market. Asia is important to us it's steadily growing. The figures in South America are bolstered by our increase in exports to Chile.

On the next page cattle slaughtering, Brazil has grown in this quarter, the second quarter of 2012, even against the second quarter of 2010 and an increase over the second quarter of 2011, we continue with the share of just over 10%. Market share of beef exports is down in the second quarter over the same quarter in 2011, by approximately 8%. Estimated beef consumption, we continue to believe there will be a steady increase of approximately 2.6% on a compound annual basis. And we also expect an increase in beef production in that period.

As regards to our margins. The gross margin is pretty much inline with the first quarter and substantially better than the same quarter in 2011. The cost of goods sold is inline with the first quarter of this year. And the average price also is inline with the first quarter of this year and through period of the second quarter of 2011.

On the breakdown of expenses, we had in the first quarter of 2012, 7.1% and in the second quarter of this year 6.8%, a small reduction. And on the G&A expenses pretty much inline with the first quarter of this year but slightly higher than the same quarter in 2011.

As a conclusion, what I would like to say is what we can see at the moment is a reduction in the cattle price principally in Brazil. We have seen an increase in our volumes in Brazil. We have seen a small -- in average prices both in Brazil and in dollar terms but we have seen a more favorable exchange rate meaning that in Rial terms we get more profit. And we have seen with the increased throughput and improvement in our productivity.

Now I'd like to hand you over to -- to comment on --.

Corporate Participant

Good morning everyone. Going to page 19 then. So revenue nearly R$4 billion up 13% versus Q2 of a year ago. Obviously some ForEx in there offsetting lower prices in export in dollar terms but with some nice pricing on our processed business, leading to adjusted EBITDA of R$239 million this is adjusted for the effect of the sale of the distribution assets of Keystone up 58% versus Q2 year ago and the average price of 16.6% versus Q2 year ago and 14.6% up first quarter this year.

As Ricardo mentioned earlier really, really good progress in Q2 on our continued move up the value chain which we've talked about before to now nearly 60% of our sales in further processed. I would remind everyone that while we have received manufacturing facilities from the BR Foods asset swap during Q2 we have not yet realized any sales, sales only begin in July so this move is the pre the integration of further processed volume from BR Foods.

Also as I mentioned we concluded the sale of the distribution assets to Martin-Brower during the quarter. And again as I just said we believe at the plans they have come, the first set of plans coming in from BR Foods.

Page 20, I'd like to describe three movements that are of a strategic nature in these pie charts. That the first and all these will be compared to Q2 of prior quarter these comments I am going to make. The first is you'll see that our Brazilian export business is a smaller share of our total revenues then it was the case in Q2 year ago. Why that's important is this is our highest percent of commodity volume as in our Brazilian export market so we are being less dependent on that is important with the upcoming grains issues that are going to be coming our way. Relatively our spike in our mix of further processed where we have some protection against commodities and also we obviously have higher margins. And then third from a export market point of view, I call out the drop in Europe again we've been trying to reduce a bit of our dependence on Europe both because it's a low growth market as well as the crisis that are happening in - it's good to see that we're able to redistribute our volume in some faster growth markets. So that's happening in Q2.

Page 21, talks a bit about our various markets in terms of volume and pricing and the most important thing for me here is as have been taking pricing at all of our markets. And so really good to see that we've been able to do that without giving up any volume. Some of the export businesses do have ports and there if you want to do the math about 11 points of -- from Q1 of this year to Q2 of this year in terms of barring internal port rates. So that gives an idea of the net pricing that's happened in these markets.

On page 22. This is lot of market shares. Obviously as you know we've been focusing in the frozen category where the pricing is best as well as margins are best there. And we've been continued to make good progress we had an outstanding advance in the April-May results that you just received up to nearly 10 points this is again pre Brazil Foods assets. If we transfer in their market share those brands market shares recent period. We would be already sneaking up on that 20% share market we expect as our five year target.

And processed meat of course is more about a bit more commodity in nature. Here we have been taking some pricing and so again it's good to see we have given after the volume share. And you can see that's also our place already had some significant market share gains with the Brazil Foods assets that will coming towards beginning next quarter.

In terms of our share of exports, Brazil exports in Poultry we have retreated a bit from the highs that we had in Q2 year ago. This is by design again as I mentioned earlier to given the low export pricing that is out there. But we saw them falling below our historical range of about 20% share of Brazil exports.

And imports similarly, we are in the range and where we've been historically 14%, 15%. Going then to slide 23, talk about our margins. You will see that that the pricing that we've gotten which we've been talking about however our cost has gone up slightly more than our pricing so versus a year ago.

We're given up above 0.6 in margin. So what are we going to do in addition to the pricing that we're continue to present in the market as you can we have been doing a good job of keeping our eye on our cost and tracking synergies.

So as both the case on our selling expenses as well as our G&A we're obviously also getting some revenue leverage over these fixed costs. But I think it's important to call out the fact that it's not just revenue leverage we have also been able to hold our fixed costs mix.

Slide 24 shows then the resulting EBITDA of this and...[Technical Difficulty] -- there was another logistics transactions which was canceled and that you were also pursuing the port terminal Itajaí for sale in addition to those there was also talk about more significant asset sale in the group if you could comment that will be great? Thank you.

Ricardo Florence dos Santos {BIO 18071813 <GO>}

Hi, good morning. Well I understand that even because it's interesting to avoid some science from the market because of this announcement, it's better to the current closer to the point and that we are achieving a final understanding. That's why we have not included anything else. And thus we are still working on several fronts. In other forms to increase and improve the cash balance of the company but I hope that you understand that we would be announcing them to the market only when they are closer to the point in that we can have the closing of the operations. But you can be sure that we are working very hard on field on this front.

Analyst

Okay, so you are still pursing the asset sales?

Ricardo Florence dos Santos {BIO 18071813 <GO>}

Yes it could make sense but only of something that's non-essential to the company.

Analyst

Okay. Thank you Ricardo. And then my second question would be regarding the covenants in your local debentures if you have renegotiated them?

Ricardo Florence dos Santos {BIO 18071813 <GO>}

Why we have no need to, they are covered by the EBITDA that has been produced by the company.

Analyst

Okay.

Ricardo Florence dos Santos {BIO 18071813 <GO>}

No first, maturity comes now in the first quarter of 2013 and we have done any renegotiation to extend the maturity if this was your point.

Analyst

Yeah. So you already did the rollover of the step coming out in the beginning of next year?

Ricardo Florence dos Santos {BIO 18071813 <GO>}

Yes, that's the first installment of this, it is divided in three installments, the payment and maturing in the first quarter of each one of the next three years that '13, '14, '15.

Analyst

And you don't foresee renegotiating the quotes that excludes the FX variation of the leverage covenant?

Ricardo Florence dos Santos {BIO 18071813 <GO>}

We don't see any for this with the EBITDA that we have achieved at least at this point we do not see any need.

Analyst

Okay that's great. Thank you so much Ricardo.

Ricardo Florence dos Santos {BIO 18071813 <GO>}

You are welcome.

Operator

Our next question comes from Mr. Denis Parisien, Deutsche Bank.

Denis Parisien {BIO 20333702 <GO>}

Good morning. Congratulations for the results. Thanks for the call. And I just would like to know if you can give us a little bit more color on capacity utilization in the different divisions. I believe that it was referred to a couple of times here and there, in diluting fixed cost and higher throughput. There is a 70% mentioned, I forget if that was overall in one of the divisions, it would be great if you could give us a bit of color in terms of capacity utilization by division particularly in Brazil Beef and Seara the second quarter 2012, compared to the first quarter 2012, and the second quarter of 2011?

And then my second question is all the pro-forma calculations that utilized the last 12 months, EBITDA of the acquired assets from Brazil Foods, this is looking backwards and assumes I guess that you would be able fully monetize those assets and maintain the market share that those assets had under Brazil Foods management going forward and I guess that would still to be something to be achieved and just assuming that the pro-forma calculations I guess if you can confirm that for me please?

Ricardo Florence dos Santos {BIO 18071813 <GO>}

Starting on the beef. We saw an increase in quarter one to the second quarter where in the second quarter we achieved 70% capacity utilization in beef. We will see an increase in our slaughter... a further increase in our slaughter in the third quarter. Both for increase in utilization of facilities that we were running in the second quarter but also we have a couple of facilities that we are not operating at the beginning of the year that are now operating. Obviously in the restart you started a lot of percentage of utilization.

We will see an increase in our throughput in the numbers of cattle slaughtered and we will see an increase in our utilization in the third quarter. The only comment on the third quarter is it's the sort of transition phase where we go from basically grass fed cattle into feedlot cattle and you can get a sort of blip in the middle of August for instance as the feedlot cattle become available in greater numbers.

What we haven't seen is any change in the cost of cattle force in this particular period. We are seeing a little bit tighter supply today should we say, but we expect supply to be normal from now virtually through until the end of the year.

If you want to know where we're trying to go, well we're trying to get our sales up to 75% capacity utilization in the second six months of this year.

Denis Parisien {BIO 20333702 <GO>}

And what was it in the... what was utilization in the first quarter and in the second quarter of last year if I could ask?

Ricardo Florence dos Santos {BIO 18071813 <GO>}

It was I think around the 65% to 66% level. Okay. January and February of this year were low for us and we increased I think 14% between the first quarter and the second quarter of this year.

Denis Parisien {BIO 20333702 <GO>}

Great.

Corporate Participant

Hey Denis for CR Foods then so to your question I think the base businesses capacity is sufficient for the growth target that we put out there in terms of how are we going to get as you say top-line leverage for the bottom-line. And this is doable with our normal growth CapEx that are in our CapEx plan. I would say the exception is the Brazil business where we are running at full capacity or have been running at full capacity for several months. What's happened there is when we realized that the Brazil Foods assets swap is going to happen we elected to put a hold on capacity investment because we knew so much capacity would be coming from them. So where we have been tight has been in primarily a process side of this Seara Brasil business. As Ricardo showed earlier on the slide there is a dramatic increase in capacity and about half of that capacity increase is needed for the assets that we acquired, the brands that we acquired. However the balance of it was designed to give us additional capacity to compete for the volume that is going to be available on the brands that BR Foods is suspending for three to five years. So we will have capacity to compete for that volume as well. So I'd say the big, big switch is going from having virtually no capacity at all for growth on our processed business in Brazil to having a significant amount of excess capacity now that we can go after.

I would highlight though that this capacity is going to be achieved only with satisfactory margins so I am not signing up for delivering all this capacity unless we can do it with appropriate margins. We're not just going to go built these plans up.

Denis Parisien {BIO 20333702 <GO>}

And how is the demand structure playing out. We know that the economy has been somewhat weak, domestic demand relatively weak in Brazil. How are you seeing it going from the first half to the second half in terms of the demand profile?

Corporate Participant

Yeah. We're going to have to see what happens as we all test the market with new pricing, ourselves included. I would say so far we do see some of the more commodity categories and what we call industrialized products here, I guess what called industrialize products they have been slowing down consumption. So in that space we are going to have to drive share. Several of the frozen -- where the biggest margins are, they are still showing some resilience. And so we're still expecting to see volume growth in some of those categories on the frozen side.

Denis Parisien {BIO 20333702 <GO>}

Good. And on the pro-forma, am I correct that you are using the EBITDA there is foods generated from those assets in the last 12 months?

Corporate Participant

Yeah we are just taking straight up what they published and sharing that with you. It's what they did in the last 12 months yeah.

Ricardo Florence dos Santos {BIO 18071813 <GO>}

Yeah, this is an official study. That it was executed by KPMG to their Board of Directors and is compliant to all the regulations to be used in those kind of pro-forma calculations.

Denis Parisien {BIO 20333702 <GO>}

Great. Thank you very much. I have another couple of questions. But I will get back into the queue, so other people can ask questions. Then I hope you feel better soon Ricardo.

Ricardo Florence dos Santos {BIO 18071813 <GO>}

You're welcome Denis. Take care.

Operator

Excuse me our next question comes from Mr. Jose Yordan with Deutsche Bank.

Jose Yordan {BIO 1496398 <GO>}

Hi, good morning everyone. David you were sounding like the grain costs were I think that only started on July 1st, am I right to assume that you guys had some interest... some hedging in your grain costs during the second quarter or perhaps that continued in the third quarter? Any color on that would be great. And then, you were just talking about the going after the suspended brand volumes is there any sort of early feedback you can give us on how you are doing versus Brazil Foods in terms of capturing that volume -- they mentioned in their call, about your new product launches. And you guys have done quite a few as well so any color on what... how the market share is of those expanded brands substitutes are panning out?

James David Ramsay Cruden {BIO 15363978 <GO>}

Hey good morning Jose, how are you doing?

Jose Yordan {BIO 1496398 <GO>}

Good.

James David Ramsay Cruden {BIO 15363978 <GO>}

So yes commodity costs so the answer is yes we have had a bit of impact of that already in these results however couple of things that we should discuss about this. First of all I want to speak at the market level we can take down the Seara Foods as well. But the nature of our business has some protection built into it already. So as you know much of our beef actually eats grass. So that it hasn't affected by the corn or soy prices, our Moy Park business is, we are feeding our animals there, wheat instead of corn, so there is a soy impact but as you know we haven't responded to the crisis anywhere near like corn has.

So that's protection. Much of our business in Keystone and Moy Park is also hedged with either financial instruments or other mechanisms which primarily leads Brazil as the place where you would expect to see some exposure. Because soy in Brazil is traded on the struggled border trade with some of those instruments are available to us and we have made use of those in the soy markets. And corn is the one thing, we have to watch out for and so if you were to look at our business and say where is Marfrig's overall exposure the primary exposure is on corn in Brazil. Are we getting more than that at this point would be speculative but that gives you sort of an idea of how to look at the risk profile of Marfrig.

Do you have any follow-up on that report or the other question?

Jose Yordan {BIO 1496398 <GO>}

No that's clear thanks.

James David Ramsay Cruden {BIO 15363978 <GO>}

Okay. So your other question was, how are we doing it at acquiring this volume and I can't tell you... I actually can't tell you here because most of our challenges so far are more on the internal side. So we have hired 600 new sales people to put in. We have got eight new warehouses going. 40,000 50,000 new customers to go see. So there is just growing pains of meeting these folks making the call getting the - all of that. They are far more an obstacle than what we are finding in the market. I would tell you in the market we are being well received by our customers. These big brands do have consumers that want them and so we are getting the brands in distribution they are turning just as well as they ever did.

And I think, also our just our speed of getting our internal machine up and running is going a little better than I had expected as well. And our systems are running, our laptops are also, we are running everything.

Everything seems to be moving pretty well. So I think it's going to be competitive out there but I do sense strength of the brands, I sense receptivity from customers and we are very quickly getting our internal act together. So I am reasonably optimistic that we can hit the numbers that we had shot that we are shooting for.

Jose Yordan {BIO 1496398 <GO>}

But just to be clear, I mean talking about the brands you acquired. I can see that they already had a following and a customer base et cetera. But the new brands and the new brands you have introduced the new SKUs you have introduced whatever how long have those been in the market for I mean is it just the few weeks or that way is it too early to tell or are you optimistic on the new launches as well?

James David Ramsay Cruden {BIO 15363978 <GO>}

Yeah. It is early to tell, but to be sure I get your question right, what we are doing with the new capacity that we were right we are actually expanding the capacity of SKUs that we've already been selling some of our best sellers in fact that were capacity constrained until these efforts came in and those are responding very quickly. So the Seara brand in particular is where you are seeing this capacity being utilized and we are getting significant uptakes in volume as you might expect from those some being able to release what was in effect pent-up demand on those lines.

Jose Yordan {BIO 1496398 <GO>}

Great. Thanks a lot.

James David Ramsay Cruden {BIO 15363978 <GO>}

Yeah.

Operator

Our next question comes from Mr. - with Deutsche Asset Management

Analyst

Hey guys can you hear me?

Ricardo Florence dos Santos {BIO 18071813 <GO>}

Yes. Good morning.

Analyst

Good morning. Just had one question... two actually. Are you still working on trying to get the convertible bond that you have with BNDES possibly to back load the coupon payment. Is that negotiation still ongoing? And secondarily just directionally speaking I would like to hear, as you're rolling out some of the export finance with the short-term debt. How much higher are you paying just ballpark marginally speaking as you rolling this cash down?

Ricardo Florence dos Santos {BIO 18071813 <GO>}

First regarding... starting from your last question. We have not had any increase in the interest rate that we are paying in the negotiations here for SECs in the order exactly, we have pulled it we have had even some decrease in the last interest rates. And regarding to your second point there is no negotiations at this point on any convertible bonds with BNDES or other players.

Analyst

Could you clarify I mean debenture that you have now a few months ago, there is ease out but all the terms and conditions remain as is right? And you paid a coupon, you paid the coupon on that the debenture but there were efforts to back load the coupon payment towards the end.

So not only you convert but on that existing debenture or the convertible bond are you... is that still an ongoing negotiation, can this be considered...?

James David Ramsay Cruden {BIO 15363978 <GO>}

No at this point there is no ongoing negotiation. The next payment of interest rates will be only in July in the next year. And we could continue to work in something else. But that at this point there is no ongoing negotiations with the BNDES.

Analyst

Okay. And this isn't anything to do with the conversion of -- bond what could be. I think you answered my questions. Well thank you very much. That's all I really had.

James David Ramsay Cruden {BIO 15363978 <GO>}

Okay. Thanks.

Operator

Excuse me our next question comes -- from Insight Investment --.

{Analyst:} Hi there. Couple of questions from me. I wondered if you could just basically give us some details on any maintenance covenants you have on your bank facilities. I know you mentioned that you have plenty of headroom or some headroom at the moment. But obviously this is in current convents on the bond debt. But just wondered how close you are on the any maintenance covenants if at all?

And the other question is really on your feedstock purchase now I know that you said that obviously with the beef there we can grow off anyway and then in Europe you are feeding the portray on soy, but in terms of corn et cetera, are you looking to pass-through...[Call Ends Abruptly].