Q4 2013 Earnings Call

Company Participants

- Ricardo Florence, Group CFO
- Sergio Rial, CEO

Other Participants

- Alex Robarts, Analyst
- Gerardo Contreras, Analyst
- Giovana Araujo, Analyst
- Jose Yordan, Analyst

Presentation

Operator

Good morning, ladies and gentlemen. At this time, I would like to welcome everyone to Marfrig Global Foods SA conference call to present and discuss its results for Fourth Quarter of 2013 and for the year. The audio for the conference is being broadcast simultaneously through the internet on the website, www.marfrig.com.br/ir. In that address, you can also find the slide show presentation available for download.

We would like to inform you that all participants will only be able to listen to the conference call during the Company's presentation. After the conference remarks are over, there will be a Q&A period. At that time, further instructions will be given. (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 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're related to future events and therefore depend on circumstances that may or 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 results to differ materially from those expressed in such forward-looking statements.

Now I'll turn the conference over to Mr. Sergio Rial, Marfrig Global Foods' CEO. Please, Mr. Sergio, you may now begin the conference.

Sergio Rial {BIO 1925337 <GO>}

Thank you very much. So very good morning to those who are in our time zone. And to those who are not, in Europe. Good afternoon. And to those in Asia (eventually), good evening; they are really committed to stay in the call that late. I'm here with Ricardo Florence, the Group CFO, together with myself, plus the IR team also represented here in the same room.

So let's go to our Fourth Quarter. So first of all, to contextualize, this is the Second Quarter post divestiture of Seara, so it's what someone would call being the second clean quarter, not a lot of noise -- no noise whatsoever. And I think we are pleased to deliver the best quarter of the year, delivered a number of ratios, but also components of the performance of the Company significantly better than its recent past.

Let's go to slide two. On slide two, we basically, back in the Marfrig Day when we announced our five-year strategy, we shared with the market what we thought our 2013 would be, so more than sharing we actually anchored that as guidance for 2013 on two dimensions only -- revenues and EBITDA. On the revenue front, as you can see, we were able to beat our old target and our EBITDA margin. We are also happy to share with the market that we actually exceeded to 7.7%, relative to 7.5%, which was our self-imposed guidance and objective for 2013. Now, those numbers do not include in any way any non-recurring items, so this has nothing to do with any divestiture elements that we have seen in 2013.

On the next slide, slide three, that is not to be construed as guidance, but as our targets -- financial targets both for revenue and EBITDA that we have self-imposed to ourselves as business units during the Marfrig Day. So for Moy Park, a significant revenue growth of 15% and EBITDA margin of 6.2%, as you can see. For Keystone, 10% and 6.3%. And for our beef business in South America, 12% and 8.9%. So we're pleased to show and share with the market that all three businesses are performing well, steadily, and certainly above expectations with highlights being definitely devoted to both Moy Park and Marfrig Beef. Moy Park, we're going to explain more what's happening, that is has helped business to come to this level of performance. And of course, we're going to be talking about each and every business.

On slide four, it's just an attempt to share with the market what the Bloomberg Consensus was here in Brazil for our net revenues, our adjusted EBITDA and the margin. And as you can see, with the exception of net revenues, we have exceeded estimates from the market here. And this is a composite of a number of analysts covering the stock.

So increase of the net revenues, I'm going to talk more about it, but the year 2013 saw clearly the slowdown and what I would say the planned slowdown of our Argentina operation. We actually shut down two plants in the Second Quarter. We have pretty much left some in a more dormant stage. And we are operating at full speed and full capacity one plant very close to the Chilean border, where we have a unique presence as being the largest importer of beef into Chile. But EBITDA, we're glad to share with the market that this is our best gross margin for the yea; and as you're going to see also later on, best gross profit. So we are improving operationally, and that's what we are here to do.

On slide five, despite what I've called the macro environment from an emerging markets point of view, we have benefited quite interestingly to see how our bonds have rallied relative to this peer group that we have here assembled as JBS, Brazil Foods and Minerva. Again, they are not necessarily the only proxy to compare to, but they are also Brazil origin, Brazil-based groups, so I think this is a good basis to compare ourselves as opposed to peers or to competitors of Moy Park and Keystone.

So nothing more than just saying that the market -- the fixed income market is basically recognizing the improved performance, the improved capital structure, but more importantly I think also our undivided commitment to generate cash flow and continue to delever and strengthen the capital structure of the Group. It also denotes a great opportunity for us to continue decreasing our interest costs. So I think one of our biggest opportunities is to continue to see ways how we can actually bring the average cost of our total debt, which is today running pretty much unchanged at 8%, to lower levels.

Going to slide six. So what are the highlights of the quarter? The first highlight is that we are indeed paying attention to cash flow. So happy to share with the market that we are -- we have generated the highest cash flow before CapEx and interest expense for a long time, BRL368 million, over 50% relative to the Third Quarter, not enough yet to pay down CapEx, not enough to pay down interest expense, but in the direction to allow us to meet our guidance of 2014 of delivering (anilcrul) to a positive free cash flow in the year that we are living.

You're going to see that the quality of this cash flow is also not a one-off; it's predicated on the back of managing working capital. So as you can see on the second bullet point, we've been able to manage our inventory levels down, which has actually helped us, as you see here, support the reduction of -- a reduction of working capital of BRL62 million. That happened to be the case over the last couple of months as in the history of the Company. So working capital has always been sort of an unknown variable, and we are paying quite a bit of attention to (overall) value out of that so that we can move as fast as we can towards free cash flow.

If we take the BRL368 million and we would deduct CapEx, which was a little bit on the high side for the Fourth Quarter, we would have generated BRL(129 million), which is in itself another good signal. Not enough, and certainly not enough to celebrate anything, but enough to recognize that management is paying attention to performance, and performance is showing those signals.

The other highlight is reduction of gross debt. So gross debt has reduced from BRL9.1 billion to BRL8.9 billion, (not a) significant (indeed) for a Company that has always (at least) shown increased debt levels. We certainly have used some of our cash to pay down debt, but we have also, as you will see later on, reduced even further our exposure to short-term debt. Short-term debt today accounts for less than 13% of the total debt -- 12.6%. And when compared to the Third Quarter, we are over 16%. And I think we like it. We like to see our duration being extended, we like to see almost as much as possible -- we probably have reached the optimal frontier. I don't think we'll go much further than this, but I would imagine this is pretty comfortable relative to where we were a couple of years ago.

On slide seven, glad to share with the market all businesses have expanded their margin. This, the Focus to Win strategy, it's all about margin expansion. It's about organic growth. It's about paying attention to the variables we control.

Moy Park reported its highest EBITDA margin in the year, driven definitely by a profitable turkey operation. Turkey sales tend to get concentrated in one given month. You work the whole month to deliver results -- you work the whole year, I beg your pardon, to deliver the results in one given month. But also, their results have been benefitted by a number of other actions that I will share with you once we cover Moy Park.

Keystone benefitted from cheaper poultry prices in terms of raw material, but also saw some of their sales impacted by the same sort of event, lower chicken prices. But importantly to say that although we have not come back to the same level of sales in China prior to AI, we're seeing that Fourth Quarter sales have recovered from where we were -- I'm talking China, from where we were in Third Quarter. (We're quite) back to profitability.

We have announced repeatedly that we felt we were turning the corner with Uruguay and Uruguay business, which accounts for 18% to 20% of Marfrig beef business, has helped our beef operation to get to double-digit margin, which is quite a remarkable performance for a commodity business.

Adjusted EBITDA, highest in the year and showing 13% growth over Third Quarter. Again, not in a particularly conducive environment from a current point of view. The real was still under 2.3, so we're talking about a real at 2.28, 2.29. And I'll explain more what we have done particularly in beef. Net loss reduced over 50% when compared to the Third Quarter, but nothing to be proud of, but definitely going in the right direction.

On slide eight, which is unfortunately not enough to reflect all known financial wins that we have had over the last couple of quarters, but I think it's worth mentioning the Animal Welfare component of the pyramid you're seeing there. That's a report developed by NGOs internationally, most of them in Europe, that are basically paying attention to world farming, compassion in world farming and animal welfare, and that's how this group of NGOs classify or quality different players in the segment.

And we are pleased to see us being the only Brazilian Company referenced in this business benchmark study, and certainly have been moved from our Tier 4 position -- that's where we were back in 2012 -- to a Tier 2 position, which is -- not only it is a testimony and I think a positive signal to the folks of Moy Park and Keystone and Marfrig Beef, who take so seriously sustainability (in animal) welfare overall, but it's also a great proxy for us to position ourselves differently than some of the other companies with whom we compete.

So Marfrig's direct competitors are here in this pyramid. Unfortunately, we don't see our Brazilian competitors here; maybe one day we will see. But I think we do see a number of our direct competitors both from Keystone -- for Keystone and also Moy Park more than our Brazilian counterparts.

On slide nine, net revenue. Partially, the net revenue here hasn't grown more. I mentioned poultry prices in Keystone impacting AI still impacting sales in China for Keystone, so we haven't really recovered completely prior to AI. Moy Park probably leading the way from a sales growth point of view. And Marfrig Beef not having a greater impact on the back of us having planned to slow down our Argentina operation, which is -- yes, the negative impact is on sales, the positive impact has been on margin. So fewer losses that we were registering in the past.

Slide 10, highest gross profit at BRL660 million with the best margin of the year, gross margin of 13.3%. And interesting to see not much variance from a breakdown point of view. We are a lot more stable and predictable than we've been. Certainly for those of you who have been following the story from a long time, it's unthinkable to see that hardly the business has changed that much in terms of composition on the total pipe.

And I think the highlights for each business would be Marfrig Beef benefitted tremendously from our strategy and decision to increase our exports. We increased (technical difficulty) Brazil -- Marfrig Brazil Beef was exporting close to 40% in the Third Quarter; we moved to 44% in the Fourth Quarter -- 44%, taking advantage of strong international beef prices. Keystone has (started) showing some merits in their more active risk management, position management, so they were able to really capitalize lower grain prices. So you need to be able to be well positioned to do that.

And I think operationally both US and Asia, but particularly the US, has done a pretty sizeable job from increasing the size of the bird, which basically allows us to have higher level of efficiencies and productivity and margin on the same bird -- utilization of the same bird, but also keeping their costs pretty much tight and in control. Moy Park, phenomenal 19% growth -- gross profit. If you take out any exchange impact -- positive, in this case -- Moy Park still delivered something around 10% to 11%, so a pretty solid performance for Moy Park.

On slide 11, SG&A at 7.5%. This is an area where we still have opportunities. This is an area that I hope we're going to be sharing more with the market, particularly for -- not only, but particularly for the commodities side of the business, which is the Marfrig Beef operations in South America. We have just announced to move our entire beef operation to one place, one headquarters in the interior of Sao Paulo. Remember that a couple of quarters ago we had announced that we would all move to (Anhanguera).

In the meantime, of course, we did divestiture of Seara. That distribution center got sold, together with Seara, so we found another place, which is in Itupeva, where we're going to be consolidating all our beef operations in terms of supporting functions. And hopefully, that should yield significant savings for us in the year 2014.

Slide 12, financial performance. Solid margin, and again, increase in margin across all businesses, as you can see. Overall, 90 basis points expansion over Third Quarter. And that's not an insignificant, I think, accomplishment.

Slide 13, reduction in net loss in the right direction -- going in the right direction. (Well what to do). Nothing to celebrate, but definitely going in the right direction. This is partially explained by also a much more stable Company from a cash generation point of view. And some of the negative impact you see here, it is coming on the back of foreign exchange variation, which, for the quarter, was around BRL400 million plus.

On slide 15, we remain -- I think this is a good picture to show the evolution of gross debt, from BRL13 billion in the First Quarter of '13 to BRL8.9 billion in the Fourth Quarter. Again, not an insignificant accomplishment, particularly in the period in which we were able to do that. The darker blue shows our long-term (debtkeys), BRL7.8 billion, and (we saw) -- as you can see, we reduced our short-term debt from BRL1.4 billion, shown under Third Quarter '13, to BRL1.1 billion, shown under Fourth Quarter '13. So net debt of BRL7 billion, BRL7.1 billion, and gross debt reducing.

Some of the important indicators on the balance sheet. So if you take gross debt and just use the last 12 months for EBITDA, we have improved our leverage. If you take net debt, as opposed to gross debt, we are about -- we deteriorated a bit because of the use of -- yes, so the use of cash -- not the use of cash, just the net debt having increased a bit from Third Quarter, again, on the back of the exchange variation. Net debt, if we take the Fourth Quarter EBITDA and we annualize it, it also shows the better evolution. So no matter how you cut it, we have not only slightly improved or have stabilized and continue to have a Company that is a lot more stable than we used to be.

Solid current liquidity, we have extended duration, and the opportunity has to be on bringing that average cost of our total debt of 8% to a more palatable number of a group that has 50% of its business outside of Brazil. So that's not in line with the business models and the assets that we have and the businesses that we lead outside of Brazil, so this is where a big opportunity still exists, and it's already reflected in the way our bonds have rallied over the last couple of months despite the anti-emerging market sentiment.

On slide 16, we had shown you in Third Quarter -- in the Third Quarter a pro forma Fourth Quarter. Happy to deliver even a better picture of Fourth Quarter, with a reduced short-term debt of BRL1.1 billion, totally manageable, those are all great finance lines, which are basically used to support our increased export volume. Don't forget that we have increased significantly our export volume. I think in 2012 we were talking about roughly (30)% (diff); we're now, as I mentioned, 40%. So the shift of the export focus in our Marfrig Beef has not been small, has been pretty significant. So most of that is really aimed at our trade finance needs.

On slide 17, it's again -- it's a clear attempt to show you the evolution to where we were and to where we are; still a lot to do, but going in the right direction. And on slide 18, this is when we tried to show the market how do we come to that BRL368 million. And I'm going to give the word to Ricardo to walk you through, just to make sure we try to be as clear as possible on slide 18. Ricardo?

Ricardo Florence {BIO 20008948 <GO>}

Thank you, Sergio. In addition to the improvement that we had in operational performance across all the units, we also had a significant improvement in the performance in the working capital. The most part of them came through a reduction in inventories, where we basically had a reduction of five days in the total of the Company. In figures, this means BRL264 million, and this was not only in Beef Brazil, but also in Keystone Foods and in Moy Park.

As a consequence of the higher volume in exports mainly in Marfrig Beef in Brazil, we increased a little bit the receivables from clients. We understand that this is temporary. And also, we decreased a little bit the supplier's line. In total, we managed to decrease from 52 days to 49 days the working capital cycle in the total of the Company.

On top of this, we managed also to gain BRL32 million in the taxes line. The most part of it coming from the Company joining the (Refees) program, which is basically the use of the fiscal losses for payment of both interest and fees that we might have on this. As a consequence of this, we no longer have exposure for taxes prior to 2010. Altogether, this means BRL368 million in the operational cash flow before the CapEx, and this is after the CapEx we generated BRL129 million in the quarter, showing us a good direction to deliver our target in 2014.

Sergio Rial {BIO 1925337 <GO>}

Very good, Ricardo. I just want to add on to what Ricardo said, a couple of points. One, the number of days and the reduction in terms of days has happened despite the increase of exports. Remember, the export flow, it's a great venue to capture higher margins and definitely higher prices of beef, but, of course, does have an extended period relative to what you do domestically. So despite our increased exports, we were able to manage that.

Second point, on the tax piece that Ricardo mentioned, just in the interest to make it clear to those who are not living in Brazil, Refees is a program, that basically you sell as a Company all litigation that you eventually have at the federal level taxes. So it's basically saying no more disputes at the federal level taxes. We have agreed, and that seals any pending litigation that could go either way. It could go in our favor, but it could also go against us. So this is closing a very important door of potential surprises in the future, and I think it's not an immaterial thing.

So we have cleared all federal tax litigation that all companies in Brazil have -- you're always sometimes litigating and debating with the government, depending how they interpreted their own laws -- up to, if I'm not wrong, 2010. Is that correct? Or '09? '09, in 2009. I have the controller in the room nodding to me and saying it's 2009. So this has been cleared. And that's not a small thing.

Now moving to the business units. Moy Park. I'd like to absolutely congratulate the business in Europe, where everybody would say, "How could the business of Marfrig in Europe be the best performing -- one of the best performing, if not the best performing units?" The reason being very well positioned. The UK currently has grown very steadily, 1.7%, 1.8% last year. We are the second largest poultry operation in that country. The business has actually paid a lot of attention to its operations. How? Strong sales revenue, over 18%, and basically paying attention to the right set of customers, both on what we could call retail but also food service. We have benefitted from an increased demand on poultry. The UK has seen very high prices for beef, so we've seen some protein substitution into poultry. And we have increased, consequently, our fresh poultry sales not only with existing customers, but also securing new customers.

We have expanded our agricultural production over the last couple of quarter, which has allowed us to be in a position in the Fourth Quarter to capture. Our turkey business made profits in December for the first time. This was a small business that I think we got -- acquired two or three years ago and hasn't really delivered profits, and finally we're happy to share that they actually contributed to the quarter.

We also have done a number of important investments. We have increased two new lines -- two new cook lines in our site called (Grandham), which became sort of a super-sized (N4FP) for processed food. And we have closed down, consequently, a poultry factory in (Busebeg), and that impacts costs in the Fourth Quarter, but that will absolutely yield interesting returns for us in 2014.

Last but not least, the brand. We are today the leading brand in Ireland with Moy Park, touching over 50% of households in the entire country. And I think that is not going to change.

And the last point that I would also attribute to us is not dissimilar from what we've seen in Keystone, better management of our wheat supply. We have seen in the Fourth Quarter some benefits of lower wheat costs, which was a function of a much more active risk management position.

For this year, we're already covered until pretty much the beginning of the second half, and we are pleased to announce that because, of course, wheat prices have gone down dramatically in January and Feb, but nobody would expect the crisis in Ukraine. So people who would be short today in wheat are probably feeling uncomfortable, so I think we have a pretty good position to be able to benefit a potentially lower wheat prices towards the second half, but at least covered during the Ukraine crisis, as we have seen.

On slide 20, Keystone, solid performance. Asia, benefitting already from some promotions, but also not suffering, particularly China, as much as we had experienced in the Third Quarter with avian influenza. Our gross margin pretty much benefitted from lower grain prices, but an active management of lower grain prices. Lower grain prices do not necessarily equal higher margins; you've got to actively manage that to be able to capture that opportunity. So solid, solid performance with, I would say, an expansion in margin.

Marfrig Beef, we covered that, but I would say in a nutshell, despite high cattle prices in Brazil, Brazil is today the only significant player with surplus of beef in the market; the US isn't, with a herd of 90 million; Australia isn't; and Argentina is having its own problems, macroeconomically speaking. Uruguay is not big enough to be able to supply the world, so Brazil is in a neat position both in terms of cattle size and competitiveness to be able to continue being an important surplus.

Second point, for our operations in Uruguay, we are very big in Uruguay, we are the largest Company in Uruguay. It has already entered in a very positive cycle, which would help us throughout 2014. Third, we have increased our focus on exports, and I think that should not necessarily change in 2014 -- much to the contrary. We are seeing high and steady international beef price.

If China opens, which we believe will open to Brazil, I think Brazil will be the one that will benefit tremendously. So I do see the beef industry in Brazil benefitting tremendously from an opening of China. And we, with our presence of Keystone in China, have the obligation to position our product better, more efficiently, and hopefully with better prices.

In terms of share of the market, some synergies -- concrete synergies today, Keystone Asia buys 100% of its beef from our operation in Uruguay, and that is in context of beef is expensive, good to have assurance of a supply, and not have to be completely in the hands of the Australian beef packers.

The other piece for our beef operation that I remain very positive is the possibility still to cut costs. For a commodity business, I think we still have a significant opportunity to continue to bring costs down in both Brazil and Uruguay, and that should still help us to continue to keep margins at very, very good levels.

Next slide, this is just to remind you of our commitment in terms of guidance for 2014. It's worth sharing that this is predicated on an exchange rate of 2.40; we are under that at this point in time. But if indeed the real devalues beyond 2.40 on average for the rest of the year and we continue presenting the same sort of trend in terms of operating performance, there is a good chance we could deliver the upper range of that guidance. And if that happens, that will, at that point in time, already delever the Company to levels of leverage around mid threes -- (no), 3.5, 3.6. So we have stabilized the Company. We're giving signals of growing cash flow and paying attention to the capital structure, but underpinned by steady performance.

Final remarks, on slide 23, pleased to deliver a strong quarter. Not everything is perfect. We're not claiming that it's perfect, but on a relative basis, if we were sitting here on Fourth Quarter 2012, when the Company had had a significant burn cash -- burn in cash, I think it's a very different group than I think some investors had experienced back in 2012. So on a relative basis, I think we have certain things to celebrate and we shouldn't be shy about it, but it is -- this is not the group that (we'd like to have you owning it). So we've got to do better and we've got to improve our capital structure and continue to improve our performance.

Have no doubt, we are absolutely committed to creating value. I hope in a couple of years I will not be talking EBITDA with you; we're going to be talking (EVA). But we are not there yet. So there's still a long way, at least two years, for us to be able to really talk about EVA.

But once we start generating profit, the accumulated losses that we have will make us a very interesting story as we have a number of losses that will allow us to be profitable without having to pay (taxes) for potentially some time.

We actually acknowledge that improving the performance plus reducing debt and interest expense has a very direct impact to our share price. We know that, but again, all underpinned by performance. But we also understand the impact any change in the capital structure showing reduced interest costs could have to the equity side.

And we remain -- all businesses are performing, so we have no turnarounds. We certainly have what Focus to Win is all about, which is about expanding margin. I see no black clouds on the horizon for beef demand, and I already mentioned China. On slide 24, not inconceivable to see the US opening up to Brazil beef; if that happens, that will be another signal to the entire beef platform in South America. We're well positioned in Asia; we're happy with that. I did mention the point of the upper range of the guidance, that it's not inconceivable to see us (so much so there is there). And we believe we're a value story, with management totally committed to what shareholders are looking for.

Last but not least, one of the things we are also exploring, and it's really -- I'd like to reinforce the nature of its exploratory -- is the possibility of taking our subsidiaries abroad public, which could be one, two or none. And the reason is just very simple, with the -- we are going through a different cycle with emerging markets -- a significant pool of money leaving emerging markets, going back to mature markets.

And we are seeing very strong activity, both in London and New York, and clearly seeing also that the valuation of some of those companies are not in line with what we consider to be Marfrig. Today, (where value) -- enterprise value over EBITDA at 5.5, 5.7; just a straight beef Company would probably be higher than six times. We are absolutely convinced Moy Park and Keystone would be valued significantly more than I think the share price today.

But you know what? We're not here to define what the share price would be. We're here to deliver performance, but at the same time figure out are there ways to unlock additional value to Marfrig shareholders? This is not about a spin, but this is about the possibility and design of a potential listing, which could be, again, of one, of both, or of none. Could it happen in 2014? I don't know. We certainly would work towards that, in terms of if we feel the market is there, which is something not in our control. But this does not in any way replace the need to remain focused on what we control.

With that, I will end this presentation and open up for questions. Thank you.

Questions And Answers

Operator

Thank you. Ladies and gentlemen. we will now begin the question-and-answer session. (Operator Instructions) Our first question comes from Alex Robarts with Citigroup.

Q - Alex Robarts {BIO 1499637 <GO>}

Thanks very much. Hi, everybody. A couple of questions. And thanks again for the presentation. I guess we heard in the earlier Portuguese call that one of the interesting drivers at Moy Park in this quarter was food service. The asset beat our estimate and it was an interesting quarter. And just wondering about the sustainability of these margin levels, and to the extent we could see further upside as we look out into 2014 based on -- it sounds like there's a momentum with the food service business there in Moy Park. And kind of connected to that, how could you compare and contrast the food service trends that you're seeing in Keystone Asia and Keystone USA? So that's the first question.

And I guess maybe I could stop there because I have another one as well.

A - Sergio Rial {BIO 1925337 <GO>}

Thank you, Alex. Fourth quarter, without a doubt, it's a quarter that in the case of Moy Park was positively impacted by also turkey. So there is a turkey element that this year has been profitable, which wasn't in the last couple of years. But where should Moy Park -- how should you see Moy Park from a margin standpoint? I think Moy Park is absolutely a business between 7% and 8%. So we've seen margins of 8% in the past, 7.9%. We are seeing a relatively robust market for the Fourth Quarter.

So I see Moy Park -- remember, this is not yet even capturing the opportunity in Europe. What has Moy Park done for Marfrig? Back, I think, in the Second Quarter, I had announced that Moy Park would become our commercial platform. By announcing that, they've done a couple of things. They have reduced the beef inventory levels of Marfrig in Europe by just managing some of our beef sales better than we used to do directly from Brazil. Two, they have turned Keystone's negative margin business in France into a positive margin business.

Today, the food service accounts for roughly 15% of Moy Park. I believe the big push in growth of Moy Park has come on the back of retailers. So one of the things for us to ensure that we have more sustainability in Moy Park's ongoing profit margin has to be to increase our food service channel, to increase our brand awareness in Ireland, and to ensure that in the wholesale or retail supermarkets we are absolutely choosing the right ones, they are adding the sort of quality and allowing us to have the sort of margins that we have experienced in the Fourth Quarter. So it's possible, but it doesn't mean we don't have to tweak the model. Because we'll need to look at some other aspects here to ensure that the 7% -- between 7% and 8% remains an achievable target.

Q - Alex Robarts {BIO 1499637 <GO>}

Sorry. And just to contrast maybe the food service trends that you're seeing in Keystone Asia and the United States, how might they compare to what you're seeing in Moy Park in Europe?

A - Sergio Rial {BIO 1925337 <GO>}

Yes. Asia, I think in our case, we sell between -- something around $650 million. Thailand and China count for 80%. China is an important one with almost $400 million. So China has been impacted by AI in the Third Quarter, so poultry demand has actually declined in the Third Quarter quite significantly. It has recovered in the Fourth Quarter, but not to the levels where we were prior to AI. So I do see some -- Asia, from a growth perspective, Alex, at food service, is really all about selecting the right set of customers and having the industrial capacity, lines, to be able to serve those customers. I don't see a growth challenge; I see capacity to capture that challenge smarter -- no, smartly.

In the case of the US, we have not seen yet at the consumer level the sort of macro rebound. So I think there's still a disconnect between the macro rebound that we are seeing in the US economy towards the consumer spend. Definitely, the First Quarter -- the winter that I think we have experienced hasn't helped traffic in stores in general, and I think you have seen that in other publicly listed companies in the US.

So fundamentally, I think Keystone growth pattern, it's going to be more and more out of Asia as we continue to grow and expand our production. But not only -- but I do see Asia being the right lever to bring Keystone to a more rapid growth from a revenue point of view.

Q - Alex Robarts {BIO 1499637 <GO>}

Okay. Okay. And frankly, that's helpful. The second question relates to this potential capital markets transaction that you're, as you say, in exploratory phase. When I think about the last 12 to 18 months, capital markets transactions have been perhaps -- it's been part of the Marfrig story.

And as we think about the two key objectives that you state in the press release, meaning to accelerate growth in Keystone and/or Moy Park, as well as through reduced leverage, how should we think about this potential transaction? Is it really more about the accelerating of the growth, or is it more about the leverage, or is about both? And can we assume that the guidance is achievable? And I appreciate you talking about the guidance as dependent, to a certain degree, on the currency exchange rate, but can we kind of think about reaching this cash flow guidance that you laid out in January independent from a capital markets transaction?

A - Sergio Rial {BIO 1925337 <GO>}

Correct. So guidance -- 2014 guidance has nothing to do with what we just discussed on the exploratory phase or exploratory thoughts around potential listing. So we've got to have that very clearly separated.

Now, the risk of sharing what we just did is people not understanding why we're doing it, since it's exploratory. And I think this perhaps has a bit of a philosophical nature of the team in Marfrig. I think we don't like surprises and we don't like to surprise the market. This is not a target. We're not going to be having this as a goal. We are basically sharing and observing that today the activity around companies of a similar stature in terms of businesses that we have, of both Moy Park and Keystone.

Definitely, there is a significant interest in public markets for assets of this quality. We are obliged to look at it and say how would that one help us to grow faster as part of the Focus to Win? And if on top of that we can absolutely accelerate deleverage of the Group, we are, of course, I think, obliged to think, go through the math, and understand the implications of a potential dual listing.

What we know is that we will not do that just for the sake of deleveraging. We will do that for the sake of a growth story that, in the case of Moy Park -- just look at European -- look at Continental Europe. We haven't articulated strategy beyond the United Kingdom. Where would you take Moy Park? Which is part of your first question around how sustainable is that growth, Sergio, in the UK if you are not looking at perhaps some other markets?

Now, if that comes on the back of also having not only capital, but the right set of investors that really like the European story, one of the things that we have seen recently in our shareholder base, we have received a number of European investors buying Marfrig stock. Proportionately, we never saw, I think -- there are a couple of European investors holding almost more than 10% of the stock today. And those are three or four.

So we also see that sometimes there are a host of investors that would love to have a Moy Park stock and be willing to help that particular story that may not necessarily be, at this point in time, so interested in the beef side. The truth, Alex, is that however we cut it is that the stock price is impacted by the leverage and perhaps by the recent track record. So over time, this is all about figuring out, is there not more value for us to unlock? But again, never at the expense of operating performance. This is not a financial engineering group. We are here to run the business, but we have the obligation at least to share with the market at least how we see it, our thought process, which is not a goal. Okay? So guidance is the goal. So I want to make sure that the market sees '14 guidance as the goal, ex any capital market activity.

Q - Alex Robarts {BIO 1499637 <GO>}

Got it. Thank you. Very clear.

Operator

Our next question comes from Giovana Araujo with Itau BBA.

Q - Giovana Araujo {BIO 16356713 <GO>}

Hi. Good morning. Just a quick question. Sergio, if you have to choose two main initiatives to focus your efforts on operational improvements across all Marfrig divisions, which initiatives will you choose? Where do you see (technical difficulty) (more upside) in terms of value creation today?

A - Sergio Rial {BIO 1925337 <GO>}

Why did you make me this difficult question, Giovana? Very good question. Very good question. I think for Brazil beef it's continue on simplification and cost reduction, which hopefully is going to be an agenda topic for 2014. We've got to run a commodity business, and we are doing that. And the margins are what they are, but you start looking at your infrastructure when you don't need to look at your infrastructure. So it's time for us to ensure that we can keep these healthy margins for a long time.

For the international piece, let's say, both -- Keystone, I would say, is how do we capture the right growth, particularly in the US? In Asia, I think we are growing, (we're seen pretty well), particularly with the non-McDonald's accounts. We've got to choose correctly the customers. There are some food service names in the US who are having very strong growth, but we've got to make sure that we choose those names very smartly. For Moy Park, it's to ensure, which was Alex's point, that we were able to remain on a 7% range EBITDA margin for most of 2014. And that's the host of issues that I think we are looking at it.

So infrastructure in Marfrig beef, customer in Keystone in US -- customer selection, and in the case of Moy Park it's going to be a combination of increasing the food service channel as rapidly as we can, and making sure that we start figuring out in a more concrete basis how we're going to be capturing the European opportunity, and what would that opportunity be exactly, outside of the UK?

Q - Giovana Araujo {BIO 16356713 <GO>}

Okay, perfect. Thank you.

Operator

Our next question comes from Jose Yordan with Deutsche Bank.

Q - Jose Yordan {BIO 1496398 <GO>}

Hi. Good morning, Sergio and everyone. My question was, when was the follow-up to the whole IPO story, etc.? I think it would seem to me that before IPO-ing any of those you would have gone ahead already and put debt at those subsidiaries. So if you can give us any color as to what the first priority is, whether it's tackling the issue of moving the debt around to match the cash flows? Then, to explore the IPOs, how quickly we might expect that change in the debt structure to happen?

Then, my second question is just more technical. If Ricardo can remind us when the payments were on the BNDES converts -- on the mandatory converts last year, what the timing by quarter was? Because essentially I'm just trying to get to a more sort of normalized free cash flow, if you exclude the BNDES payments as well as using a more normalized CapEx for the Fourth Quarter, because it seems like you had some issues there -- some CapEx that is above the running rate that you are guiding to for 2014. So just trying to get a little clarity on those two as well. Thanks.

A - Ricardo Florence {BIO 20008948 <GO>}

Thank you, Jose, a very good question. And you certainly got that in your recent report, and many people did, which is we did pay the BNDES in November, so that actually happened, so we actually paid in advance six months. So in the Fourth Quarter there was sort of an impact of interest payment that would have occurred related to '14 in July, and we ended up paying it earlier, in November 2013. So you've got a very good point. And the CapEx, yes, we're still committed to the 600 million target. Of course, part of that CapEx went into Moy Park, farms and number of other things, but -- so, you've got the answer of your last question.

On the first one, you're absolutely right, one of the things we are looking at, sort of our analysis, is that Moy Park today, for example, is debt free, has zero debt. Keystone has 600 million facility, using about 400 million. So one of the things we could contemplate is to really bring both subs to a three times leverage, which would automatically help Marfrig overall to reduce -- not so much to reduce the debt, because from an amount point of view you're not changing that much, but you're changing the interest expense related to that.

So Moy Park has zero debt, so we could very well borrow at Moy Park level, ensure where we have the exposure at levels around 6%, if not lower. In Keystone, we already have LIBOR plus 2%, as opposed to the 9% and the 9.5% of our bonds. So that would be certainly the first step. Then overall, with the alignment with existing bondholders, that whatever we do is to always increase the creditworthiness of the Company. So this is always about whoever holds Marfrig bond, whatever action we take it will always be that that bond will value more than it is valued today.

So even if we bring debt to the sub, that could create some subordination in the eyes of many, but overall -- the overall impact and the final impact is actually of a much better group from a leverage point of view. So that's the summary.

So first debt, look at that, how we can bring debt into the subs, and that would be Moy Park, not so much Keystone. Then, in parallel, see what positive impact would a listing take -- have, both for organic growth and debt reduction at the corporate level.

Operator

Our next question comes from (Gerardo Contreras) with GBM.

Q - Gerardo Contreras

Hello. Congratulations on the Fourth Quarter results, on the operating efficiencies. And my questions -- I just have a couple of questions regarding the Keystone unit. The first one is, have chicken prices touched regular level, or do you expect them to decrease a little bit throughout the 2014 year? And the other question is, are you still expecting more benefits from the low grain levels registered in 2013? And how does your hedging politics work? Thank you.

A - Sergio Rial {BIO 1925337 <GO>}

Yes, can you repeat your first question? It didn't come out clearly. First question?

Q - Gerardo Contreras

Yes, sure. The first question is, do you think the chicken prices in the US have remained or have touched the -- its lowest levels, or do you think they may go --?

A - Sergio Rial {BIO 1925337 <GO>}

Yes.

Q - Gerardo Contreras

-- a little bit --?

A - Sergio Rial {BIO 1925337 <GO>}

Got it.

Q - Gerardo Contreras

-- lower?

A - Sergio Rial {BIO 1925337 <GO>}

Got it. Well the right answer is I don't know, right? I wish I had a crystal ball. But what I can tell you is what I see is you do have record high prices for beef, so I think you will continue seeing an important protein substitution into chicken in the US. And I don't think that's going to change; probably will increase as beef prices continue to rise. So I would see -- I would pay attention to beef prices, and that should explain where the bottom of chicken prices will be.

The other piece that I do not know, as you know, chicken industry tends to always build out new birds and normally going through cyclicality. So the cyclicality of lower prices may still stay here for a couple of quarters, but there is a good environment to see increased demand for chicken on the back of beef, but also on the back of the economy, and the traffic to food service increasing. Remember, we haven't really seen significant increase in traffic into many food service chains in the US economy.

In terms of grain prices, it's not about whether they are going to be low or high, it's about having the skills in the business to anticipate that. The CEO of Keystone, whom we hired about a year ago, it's a real fine risk manager, so I'm -- and it's not only him. We have made a number of very key hires. We hired two or three key individuals today that do not do anything but risk management.

And I think, for us, grain is key, but so is energy. And I think we haven't seen -- if you see what has happened to butane prices in the First Quarter in the US, it's just a small signal of if you're not having a very robust risk management culture you can really be in trouble. And I think we are building that culture. We are building a culture where people anticipate risks and are managing them appropriately.

So I don't know. But your question is, are you going to be able to repeat that sort of --? I have to believe that yes, I think we have the obligation to continue increasing our skills and hopefully showing to the marketplace that we are building that capability as part of our culture. So I have to say yes.

Q - Gerardo Contreras

Thank you.

Operator

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>}

I'd like to, first of all -- I always like to thank the foreigners -- foreign investors in general, both equity and debt, for sticking around, for staying with us, and for believing in what we say. Because rest assured that what we say is what we do. So I also want to make sure that the Fourth Quarter performance doesn't get overshadowed by eventually the listing. There's (no the) listing. Perhaps what there is is a desire from management to share with all of you our thought process and never, never catch you by surprise.

Third, to give you a very clear signal that we remain focused on the operation, but also we absolutely understand the value in improving the capital structure of the Company to the equity side. 2014 is the year of the equity side for us. We want to make sure that we pay attention to our shareholders, not that we haven't done in 2013. But 2013 was the year of the big delever, which hopefully we did; '14 is the year of performance, continuing to delever structurally, totally guided by our '14 goals, by our guidance. But if we find ways that are smart in terms of unlocking value to accelerate that path, we will, in a no-surprise basis, in a (no-cute) way.

So it's always going to be transparent and shared with all of you and, once again, have our story in front of you. We had a record number of participants in the local call today, over 400 people. We are seeing the Marfrig story being recognized as a classic value story where management is aligned with shareholders. And hopefully, we're going to be able to prove that to you, not in a quarter, not in two, but in subsequent years. So with that, thank you very much and keep paying attention to us. Thank you.

Operator

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