Q3 2014 Earnings Call

Company Participants

- André Nogueira de Souza
- Jeremiah Alphonsus O'Callaghan
- Wesley Mendonça Batista

Other Participants

- Alan Alanis
- Alexander Robarts
- Brett M. Hundley
- Carla M. Casella
- Daniel Sensel
- Jose J. Yordan
- Luca Cipiccia

MANAGEMENT DISCUSSION SECTION

Operator

Good morning, everyone, and welcome to JBS' Conference Call. During this call, we will present and analyze the results for the third quarter of 2014. As requested by JBS, this event is being recorded. The recording will be available to listeners this afternoon and can be accessed by following instructions posted on the company's website at jbs.com.br/ir.

Taking part on this call, we have Mr. Wesley Batista, Global CEO of JBS; Mr. André Nogueira, CEO of JBS USA; Mr. Gilberto Tomazoni, CEO of JBS Foods; and Mr. Jerry O'Callaghan, Investor Relations Officer.

Now, I will turn the conference over to Mr. Wesley Batista. Please go ahead, sir.

Wesley Mendonça Batista {BIO 15243148 <GO>}

Thank you. Good morning or good afternoon to you all that joined this call. This is our third quarter earnings call, so great to have you all in the call. So I will start talking about JBS at a glance. We estimate a revenue in 2014 of $50 billion. Our total cattle slaughtering capacity, it is today a 100,000 head of cattle per day. So we are running 73 beef slaughtering plants in seven different countries. In the hog segment, in the pork business, we are doing today 72,000 hogs per day in 11 production units between Brazil and the U.S. So we - in our chicken segment, we are processing today around 13 million birds in 57 production units in North America, Mexico, Puerto Rico and Brazil. Also in our hides and leather business, we are processing around 100,000 hides per day, so all of the hides that we - all of the cattle that we process, we process the hides in 31 production units spread between Brazil, Argentina, Uruguay, Paraguay and China and Vietnam. We go from raw hides to finished leather so it's a sizable segment inside of our portfolio.

We also are growing more in our packaged food business or in our further process business. So we are producing today around 80,000 tons per month or around 200 million pounds in packaged food products in our operations. So, it should be - we are 200,000 people who work in JBS together. So I'm referring to these numbers for us to - for you all to get a sense how our operation is structured today. So we - some points here that I would like to point out that we strongly believe that we built a very strong and a large production platform in countries that is very competitive to produce protein or in the countries that is the most competitive markets to produce pork for protein like U.S. and Canada and Mexico and Australia and South America so – and as well, our diversification between chicken, pork, beef, hides and leather and packaged food product. So we strongly believe that this has given JBS a pretty, pretty good diversification in terms of portfolio and as well in terms of geographic location where we operate our business.

So moving – I will refer to the page here, moving to the page 4. So today, we are present in more than 20 countries, operating in more than 20 countries. We export for more than 150 countries. We have a total of customer base of 300,000 customer and that explain all of the countries that we operate or we sell products.

So when look our revenues, we – 51% of revenue today is coming from North America, 17% is coming from South America and 32% is export. So, I'm referring to this number for analyze with you the diversification in terms of our sales that is dollar-denominated sales or real-denominated sales. So 84% of our revenues today is based in dollar. That the dollar getting stronger, this is a strong benefit for JBS having 84% of our revenues in dollar-denominated. So as the dollar is getting stronger, so we are going to see a big increase in revenues in reais terms, and as well our earnings of course will get the benefit as well as the dollar get strong as we generate more earnings in dollars terms.

So this is quite benefiting for us. And we believe that the internationalization that we did in these last seven years, then the globalization of our operation today is starting to pay – should pay off all these things that we did. So we became internationalized protein player globally, so this is a good thing in our view and we are very pleased where we are.

So moving to the page five, also good analysis here for us to see where we came from and how we are progressing our revenues and our EBITDA and as well our margin. So if we look in 2008, the year after we became a public company that we did the IPO in 2007. So in 2008, our revenues in reais term was BRL 30 billion. So when we are – our last 12 months is BRL 113 billion, so very strong growth in these last six year from – coming from BRL 30 billion to over BRL 110 billion, and a lot of this has relation to our internationalization and our diversification globally.

So right now, EBITDA from 2008 as well and the last 12 months – so in 2008, our EBITDA was BRL 1.1 billion and our LTM is BRL 9.6 billion. Margin EBITDA coming from 3.8%; our LTM, it is now 8.5%. So I mentioned this numbers to – from us to analyze here in this call that we have been able not only to expand our business, but as well expand margin and then improve our margins over time and since 2008. So we are satisfied where we are. We still think that we can keep improving our business. But we are pleased that we have been able to grow our business in a meaningful way, but as well improve our operation across the board and all the business that we operate.

So moving to more specific about it, quarter numbers. So in the page seven, our revenue in the third quarter, we did BRL 30.7 billion. There's 20. – 27% of growth quarter-on-quarter – this quarter compared to last year, the third quarter of last year. So it's still a strong growth in top line. Gross margin, we did BRL 5.5 million (sic) [BRL 5.5 billion] (10:03) in the third quarter, 18.1% gross margin coming from 12.9% last year or BRL 3 billion compared to the BRL 5 billion gross margin this quarter. So again, a strong gross margin expansion, 77% this quarter compared to last year.

So the EBITDA, we closed the third quarter with BRL 3.6 billion in EBITDA. That represents 11.8% margin EBITDA. Again, a good expansion this quarter compared to the second quarter this year as well compared to the third quarter last year.

So moving to net income, we closed the quarter with net income of BRL 1.1 billion that – this represents BRL 0.38 per share. And again, a good expansion as well in terms of net income and earnings per share. So we were able to have a very strong free cash flow and as well, operating cash flow with the BRL 3 billion in operating cash flow and BRL 2.1 billion in net free cash flow.

We closed the quarter also with a good reduction in leverage. So we reduced our leverage from 3.1 times through 2.5 times leverage. So since our last acquisition when we acquired Seara in Brazil, that was a BRL 6 billion acquisition that our leverage went up. And only to remind everybody, our leverage went up because we acquired the company for BRL 6 billion with no (12:10) results so – and I have been saying to all – to the market that we were very constant and committed in terms of deleveraging our balance sheet and we are seeing this and it is where we were looking and again, we keep looking to keep the leverage that we have. I'm confident that we will close this year below this 2.5 times leverage. So, probably more close to 2 times leverage or to some. But again, we will keep deleveraging our balance sheet.

So one thing that I'd like to mention is about our strategy in terms of policy exposure. So we consolidate our numbers in real and all of our debts. Not all of our debts; a big portion of our debt is dollar-denominated debt. So we have been carrying a fully hedged position for all of our exposure for many quarters. And of course, this was costing us. But we were very, very confident that it was not the best thing for JBS and for our shareholders to have exposure in dollars. And the real is getting weak. Not only the real; the dollar is getting stronger overall. And this quarter, for sure, our hedging strategy worked really well and we keep carrying this strategy. Actually, we closed the quarter, the real was BRL 2.45 and now is already BRL 2.57 so – but we still carry in our hedge position so this is for sure is working well on this strategy.

So moving to page eight, some business unit highlight. So JBS Foods, that is a business that is our chicken, pork and packaged food business in Brazil that we formed less a year after we acquired Seara, reached BRL 3.3 billion in revenue, 9.5% superior comparing to the second quarter in 2014 and EBITDA of BRL 576 million with EBITDA margin of 17%.

I will make a comment here. When we acquired Seara, Tomazoni and I, we were very confident, all of our team but Tomazoni and I. But we mentioned through the market that we were confident that we were going to be able to turn Seara around and definitely, we turned – we already turned Seara around two things to improve more. We are not where we want to be, but definitely Seara is running a much better structure today. They book margin, they book everything so we're very pleased where we are. And we are very disciplined to improve our business where we believe we can control and all the improvements that – the big portion of the improvements that we are seeing in our business is internal initiatives that we are doing.

So we get a lot of cost. We improved product mix, price, sales price and distribution structure. We put a lot of SG&A. So Tomazoni, I'm not sure – I think it was in the fourth quarter last year we gave to the market a guidance in terms of synergy that we were looking for BRL 1.2 billion in synergies. And actually, we are ahead of this number. We are already nine months so we already captured this BRL 1.2 billion. So we are going to close this year over our target.

So again, we keep looking to keep growing this business. After the Seara acquisition, we already did I think eight other acquisitions in Brazil. When we acquired Massa Leve (17:10) and all the regional businesses. So we're still looking to keep growing this business. We are very pleased with our management and look forward to keep a growing top line and expanding margin.

So our Mercosul business, we posted a net revenue of BRL 6.4 billion, 14.8% higher than the third quarter last year. With our EBITDA margin of BRL 555 million, that represents 8.6% margin EBITDA. So we saw a reduction in the margin in this segment. So we were running at around 10%, so the margin came off to 8.6%. Due to the cattle price that increased faster than we were able to pass price increase to offset the cattle price increase. So, we feel confident that this business will keep performing well. The exchange rate in Brazil, of course, will help and that the real getting weaker, this helps our export and our revenues in the export market.

So moving to the – our beef business in the U.S., that includes Australia and Canada and as well our lamb business in Australia. So we posted $5.8 billion in revenue, 24.7% higher than the third quarter last year. EBITDA was $500 million, with an EBITDA margin of 8.6%. So we – this margin came strong this quarter, several things that was part of this strong margin. Our Australian business is doing extremely well. Margin has been very, very strong in Australia. Our Canada business, I think, everybody remember, when we acquired XL in Canada, saw the company had a food safety problem so that was a turnaround acquisition because the food safety issue. We have been able to improve our Canadian operation in this quarter. Our Canadian operation run at much better than it was before, so this was another fact that was part of these good results in our beef business in the U.S.

Overall, we saw the industry adjusting capacity in these last 18 months, so for sure this is helping balance – help in balancing the supply in the (20:26) is also giving to the industry some margin improvement. So, we – overall, when we look our margin for the year, we are running our beef business at 3.6% margin EBITDA – 3.4% margin EBITDA. So, this is the number that we were expecting. Actually, we mentioned in the beginning or in the end of last year that we were looking for 4% margin EBITDA in our beef segment, EBITDA margin at 4% in this segment, so we are close to this margin.

So moving to pork, our pork business, a very stable pork business, we're well in pork business. We have been posting 9%, 10% margin. This quarter, we did 12% margin, almost $900 million in revenue and $113 million in EBITDA. So, we believe a strong – we have a very strong pork business than this business. We look forward to keep running this business very stable.

So, PPC, moving to Pilgrim's, already reported the numbers. We posted BRL 2.2 million, 5% over the same quarter last year. EBITDA was $435.4 million with a margin EBITDA – EBITDA margin of 19.2%, that also came very strong. And I think to mention about PPC, we have been -

Again, we are very pleased with our Pilgrim's Pride business since we acquired the business in – back in the end of 2009. So, we have been able to improve this business in relative terms when we compare ourselves with the industry. When we acquired the business back then, actually PPC was in the bottom of the industry margin in profitability.

So, we have been able – our team, they have been able to quarter-by-quarter improve this business regardless to market conditions. And we are very pleased to say that we are running our business inside of the softer, most profitable chicken companies in the U.S. So this is a very good thing and a very important thing for us because market condition will be for everybody. If the market is healthy or if happy, this (23:19) is in front of everybody so this is for everybody.

So a lot of to debate in U.S. about the industry getting the big benefit to increase production because the margins has been strong. A lot of question about that. Our view is that with the beef production forecast next year, the total – actually the total protein production in the U.S. is in chicken forecast is to grow – the chicken production is, in the forecast, is to grow 3%, around 3%. We believe that the market will absorb this 3% or 2%, 3% more chicken production due to the fact that beef will be produce less than the global market. We believe demand will keep growing and the U.S. economy, we believe, we are going to see – we already seen how our business – less availability in terms of labor, so the unemployment is reduced in U.S. So actually, we are very bullish about how we see the U.S. market. So, again, we don't see this increase put in margin and jeopardize in our U.S. business.

So moving to my last page here talking about export, we did $4.3 billion in export in our consolidated base comparing to $2.9 billion the same quarter last year. So the markets, Greater China represents 16.8% of our export, Mexico 11%, Japan 10.9%, South America 10% (25:21) So very strong export and we are optimistic that demand abroad will keep growing.

So, I will pass to Jerry O'Callaghan to go through the presentation here, and we will be here in the Q&A. So, Jerry?

Jeremiah Alphonsus O'Callaghan

Thank you, Wesley. Thank you, everybody. Thank you for being on the call. So I will go through the chapter on CapEx and cash and then briefly touch on each one of the business units before we open for Q&A. And again, just to remind everybody, we have a presentation available and I will make reference to the page numbers as we go through the presentation.

So I will take it from page 11 onwards of the presentation where we talk about CapEx. Our CapEx for the quarter was just under BRL 900 million – BRL 878 million, 20% of which was our acquisitions and the rest was basically expansion and modernization. That's pretty much in line with what our CapEx has been in previous quarters. I always mention that our CapEx is close to 2% of our revenues and again, that number is pretty close to 2% of our revenues.

Cash generation was really strong in this quarter. We had BRL 3 billion of operating cash and BRL 2.13 billion of free cash to CapEx, BRL 2.13 billion, which is a pretty strong number for the quarter.

Moving on to page 12 of the presentation, having a look at our debt profile a little bit more detail. Wesley mentioned already the fact that we're deleveraging quite substantially since we made the Seara acquisition about this time last year. So we've gone from 4 times leverage to just over 2.5 times leverage in this quarter. And basically, (27:21) to EBITDA and to cash generation both (27:26-27:31) again, as we mentioned, the deleveraging 2 times leverage is where we see that number going.

In terms of the breakdown of our debt by currency, by source and by company briefly at the bottom of page 12, we have three pizza pies. 80% of our debt is in U.S. dollars with an average cost of 5.71% so that's quite long-term debt. We've done a lot of liability management in the last year, year and a bit and so we've extended the maturity of our debt quite a bit. 20% is in reais in Brazil basically but that's pretty much balanced with our revenue base. As we mentioned earlier, 84% of our revenue is dollar-denominated and 16% is real-denominated.

Sources of our funding is 40% in the capital – in the debt capital markets basically and with quite a number of bonds out there as most of you know. And then the balance is basically with the commercial banks primarily in Brazil.

And the breakdown by company, we've got JBS SA, the parent company with 56%, JBS Foods with 13%, and other subsidiaries with 31%.

Moving on and having a look at the maturity on page 13. I will first read the balance of short and long-term debt remains pretty much close to where it was. 70% in the long-term, 30% in the short-term. Cash, almost BRL 12.6 billion in cash, which represents 110% of the short-term debt. On top of the cash, we've got $1.33 billion in fully available committed lines in the U.S. readily available, so we had our cash position plus the committed lines. That would represent 121% actually of short-term debt.

The maturity cost, we've got quite a bit of debt now maturing after 2018, in 2019, 2020, 2021 and then after 2021, we've got bonds maturing in 2023 and in 2024.

Now moving on to the business units and again following on in our presentation, speaking firstly about JBS Foods. Just a very brief description of JBS Foods, and Mr. Tomazoni, who is the President of this unit is with us here to take your questions later on.

Basically in Brazil, 5.1 million birds per day, 21,200 hogs per day and of production, 80,000 tons per month of prepared and value-added convenience products. 15 distribution centers in 12 states in Brazil. 55,000 employees. 29,000 (sic) [29] (30:27) slaughter and deboning facilities in the poultry sector, 8 in the pork sector, and 23 of these facilities do prepare for the product - for the processed products and as I mentioned, we have a total of 15 distribution centers.

If we look at the nine months up to third quarter, BRL 9.2 billion in sales and EBITDA of almost BRL 1.4 billion with an EBITDA margin of above 15% for the first nine months of 2014.

And then looking at the next page, looking at it on a quarter-by-quarter basis, we've seen revenue growth on a consistent basis in the last quarters, reaching BRL 3.4 billion in the third quarter, 9.5% up in relation to the previous quarter. We had substantial increase in domestic sales, up 16.8% and 2.9% increase in the sales of prepared products in the domestic market. Quite an increase in the volume of pork exports, 17.7% pork exports up in the quarter. And average export prices were up 6.4% in the quarter also.

Then EBITDA, it came from 7.9% in the fourth quarter of last year up to 17.1% in the third quarter, BRL 576 million. Wesley mentioned these numbers already. So we've seen the cost of goods sold reduced from 74.4% in the second quarter to 71.5% in the third quarter. And again, we've also seen a reduction, and this is a constant reduction in SG&A as a percentage of sales going from 15.2% of sales in the second quarter, down to 14.4% of sales in the third quarter.

In the Mercosul business, which is again just briefly to describe this business on page 19 of our presentation. This is our beef business in Brazil, in Uruguay, in Paraguay, and in Argentina but it's primarily Brazil. Capacity to process about 55,000 head of cattle per day and 90,000 hides per day. So a lot of our hides business is associated with this business unit. We have 43 distribution centers in Brazil; 11 of them are big central distribution centers and 32 of them are small regional distribution centers.

Again, the numbers here. 70,000 employees, 48 beef processing facilities, 6 feedlots, 29 tanneries doing our hide and leather production, and the 43 distribution centers.

We look at net revenue for the last 12 months up until the third quarter of 2014, BRL 27.8 billion and EBITDA for the same period of just under BRL 2.5 billion or the 10% average EBITDA margin over the last four quarters.

And then looking at page 20 with regard to this business unit, we've got again the historical revenue per quarter over the last five quarters. And again, an increase of 14.8% if we compare the last quarter to the third quarter 2014 against the third quarter of 2013. We've seen increase in sales prices in the export market, quite strong demand in the export market. And then, we've been launching convenient products and branded products in the domestic market, which has been expanding our presence onto the domestic market in Brazil on a consistent basis.

EBITDA, BRL 555 million with an EBITDA margin of 8.6%. Although, we've seen strong demand in the international market, we've seen some cattle price increases which compressed margin to some extent in the recent past. Although, we have not seen the advantage associated with the devaluation of the real in relation to exports because the majority of the devaluation of the real was at the end of the last quarter. So it's a benefit that will be affecting this business more in the fourth quarter of 2014 and in 2015.

Regarding our businesses in North America, again making a reference to our presentation again briefly, especially our beef business on page 22, we've got 9 nine beef processing facilities in the U.S., 11 feedlots, 1 tannery, and 6 trucking centers - 6 carrier centers.

And in Australia, we've got 13 processing facilities: 8 of them on beef, 5 of them lamb; 7 feedlots: 5 of which are beef, and 2 which are lamb; 1 tannery; 7 distribution centers; 3 case-ready facilities.

And in Canada, we've got one beef processing facility, one feedlot and a small trading office also in Canada, 30,000-plus employees in this business. And just to cover the net revenue for the last 12 months ending in the third quarter 2014, very strong revenue. BRL 20.5 billion – $20.5 billion, excuse me, in the last 12 months and an EBITDA of $705 million within the average EBITDA over the last 12 months – and average EBITDA margin, excuse me, of 3.4%.

Again on page 23, we've got historical numbers for the last five quarters just to demonstrate how revenues have increased quite substantially in the last couple of quarters from $4.5 billion to $5.3 billion to $5.8 billion over the last three quarters. We've seen obviously price increases in the period. And then when we look at the EBITDA curve. The first half of the year was more challenging, so we had flat EBITDA in the first quarter, $100 million in the second quarter and then $505 million within 8.6% EBITDA margin in that last quarter.

Moving on to our pork business in the U.S. Again, the pork business is three pork facilities in the U.S.; one in Iowa, one in Minnesota and the other one in Kentucky. And then our lamb facility in Colorado is also included here, as is two case-ready facilities which we have one in North Carolina and the other one in California. It's a 100% U.S. 51,300 hog per day. Capacity, 3,000 lambs per day. We've got more than 6,000 people team members at this business unit. Last 12-month revenue was just under $4 billion and EBITDA was just under $400 million with a 10.5% EBITDA margin in the last 12 months.

Again, looking at page 26 in our presentation, we can see that there's been quite constant revenue. The second quarter was quite strong. There's been a decrease in availability of hogs in the third quarter, which caused the decrease in revenues, but average prices have been up quite substantially. But if we look at the EBITDA of this business, it's gone from fourth quarter of last year, 9.5% up just over 12% with $113 million-plus in EBITDA in the third quarter at 12.1% EBITDA margin.

And then finally before we open for Q&A, just briefly to speak about our U.S. poultry business, which is Pilgrim's Pride Corporation, and as most of you probably know, a listed company in the U.S. and which has previously reported its numbers. But just to give an overall picture here, 7.5 million birds per day capacity, 6.5 million in U.S., 250,000 in Porto Rico, 800,000 birds in Mexico, 24 poultry processing facilities. There are 10 distribution centers located in Mexico and a total of 3,500 integrated contract growers, 36 hatcheries and 28 feed mills. Almost 40,000 employees in this business, 40,000 team members, so substantial job creator. Revenue over the last 12 months was $8.5 billion and EBITDA in the same period was $1.176 billion with a 13.8% average EBITDA margin in the last 12 months.

And just finally on page 29 of our presentation, just to look at those numbers on a quarter-by-quarter basis, you've seen revenues grow from $2 billion to $2.2 billion to $2.3 billion quarter-on-quarter in the period and make up the breakdown of sales domestically in the U.S. in this presentation and also in Mexico where revenues have increased by 15% in the quarter.

EBITDA, again, there's been a constant improvement in EBITDA over the last number of quarters culminating in an EBITDA of $435 million in the third quarter with a 19.2% EBITDA margin in the third quarter of 2014.

So I will leave it at this and we will open for Q&A. As I mentioned, Mr. Batista, our Global CEO is available; as is the President of our U.S. business, André Nogueira; and also Mr. Tomazoni, who is the President of the JBS Foods business.

So operator, if we could please open for questions-and-answers. Thank you.

Q&A

Operator

Ladies and gentlemen, we will now begin the question-and-answer session. Our first question comes from Mr. Alex Robarts with Citibank.

Q - Alexander Robarts {BIO 1499637 <GO>}

Hi, everybody. Thank you very much. I had two questions and I was hoping to, first of all, start with U.S.A. beef. I mean, this was extraordinary result frankly and I think impressive, particularly when we look at the quarter-to-quarter movement of four-fold increase in the margin.

You explained earlier in the Brazil call – in a Portuguese call about the trends that were going on in Canada and Australia as well and – but I was hoping that to take a specific kind of drill down into what was going on with your cost of sales quarter-on-quarter. I mean, it basically got 2% (42:07) in JBS USA, well, slower than the sales increase of 10%. And I'm hoping you could give us some color as to what was going on with your cattle prices and specifically talk about some of your strategies on the future side. To what extent was that a factor? And when we think about this level of margin coming into the seasonally weaker fourth quarter, do you think we should look at this as perhaps reverting more to a single-digit level in the fourth quarter for JBS beef? Or do you think it could be something perhaps more toward a lower single-digit level? So that's the first question, please. Thanks very much.

A - André Nogueira de Souza {BIO 20244486 <GO>}

Thank you, Alex. Well, Alex, this is André. First, when you look our cost of goods, we need to remind that part of this, you have Australia and you have the current effect. So cattle was not much cheaper in U.S. in the third quarter compared to second quarter. But you have the consequence of the effects from Australia that show cost of goods there.

Again, when you look at the quarter, it's a combination of important trends. One is the change in Canada. We talked in the previous quarter that issue on (43:44) Canada was a turnaround situation, that this was not performing well, and now it's improving. It's not in the level that should be but much better than the same quarter last year and much better than the previous quarter. So it was going in the right direction and was important to the contribution because it was negative before and now it's giving an important contribution.

As well, I would like to comment Australia's operation's performed extremely well. So it's a very important part, a very important contributor for the performance in the quarter as well as on operation.

And our U.S. operation, it has two things. The macro trend (44:22) in the quarter, but our operation is much better in the quarter. So we have the combination of these two things. And the fourth point was a comment in the previous quarter. That's two quarters: first and the second quarter. The way that we do hedge in the KRO, (44:37) the way that we contract KRO, (44:38) we have impact in the first and the second quarter that was negative. And you have to remember it was lower, number that we show was lower than the real. And now, in the third quarter, we did not have these negative impacts.

When you look in the last 12 months, the 3.4% margin is in line with what our expectation at this point last year. So we said last year that we expect around 4% and we strongly believe that we'll finish the year around 4%. So next year, our expectation with this combination of things, Australia, Canada, everything that we still have to do in U.S. continue to improve our performance internally in terms of (45:26) use and price and mix, we believe that next year can be better than this year, so that's our expectation.

Q - Alexander Robarts {BIO 1499637 <GO>}

Okay. Okay, fair enough. The second and last question is back on JBS Foods. I mean, what we saw in the quarter again Q-on-Q, 20% increase in your domestic processed sales, which was faster than we had expected. But what's interesting now is that it seems processed sales in JBS Foods, the domestic business is now about 60% as a percentage of your total sales. Where do you feel like you're getting the most traction as you roll out the pork and poultry processed products? Do you feel like the brand indicators are where you want them to be in terms of Seara and your regional brands? I know you have Wilson (46:35), you have (46:36). And where do you hope that the processed product as a percentage of your business in the domestic market reach? I mean, are we going to go higher or is it right now kind of more of a consolidate in these levels and just trying to work on brand equity? Thank you.

A - Jeremiah Alphonsus O'Callaghan

Okay, Alex. Thank you.

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

Look, Alex. This is Wesley. So since we acquired Seara, we have been improving our customer sales level. We went from serving 45,000, 50,000 customer and now we are serving 79,000 customers. So, we have been mentioning to everybody that our focus is not gain market share; our focus is to improve profitability to have Seara selling the product in their right point of sales in terms of price, and we are investing huge in quality, innovation and marketing. But this growth is coming from much better sales level, better quality, improving our distribution platform, serving more customer and having our products on the shelf. So, we are getting the benefit from our better service – our better serve that we are doing compared to before.

And again, to be honest as – even we are not focused on market share, we think that this will be natural, then this will happen. As we access more point of sales, as we have more products in the shelf and better quality. We are investing in marketing and innovation and as well in service. We believe we will keep growing our packaged food business in a percentage base compared to all of our domestic market.

Q - Alexander Robarts {BIO 1499637 <GO>}

Okay. Thank you very much.

A - Jeremiah Alphonsus O'Callaghan

Thank you, Alex.

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

Thank you, Alex.

Operator

Our next question comes from Carla Casella with JPMorgan.

Q - Carla M. Casella {BIO 2215113 <GO>}

Hi. You talked about your debt structure, which you've done a good job cleaning up over the last couple of years or I should say improving. Earlier in the day, you had mentioned doing some potential financings to pay down expensive debt. Can you say your preference of issuing new debt either at the U.S. LLC level versus issuing another entity level?

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

Look, Carla, I mentioned in the call, and I think André mentioned as well, we are always looking liability (49:36) management and this doesn't mean that we are already decided to lose something, but we are always looking - and as well, in terms of tax structure, well, it's better to put more of debt. And in reality is we are generating a very strong result in the U.S. So, yeah, the better place for us in terms of tax structure is to have - to put this. If we decide to do something, it's better to put more debt in the U.S. level and have less debt in Brazil and have more earnings in Brazil as we have a huge amount of goodwill in Brazil to be amortized.

Q - Carla M. Casella {BIO 2215113 <GO>}

Okay, great. Thank you.

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

Okay.

Operator

Our next question comes from Alan Alanis with UBS.

Q - Alan Alanis {BIO 15998010 <GO>}

Thank you so much for taking my question. And Wesley, Tomazoni, André and Jerry, congratulations on very, very impressive results.

I have two questions. The first one has to do with operations. Your beef operations in Brazil, JBS Mercosul is much larger than its competitors, the Marfrig and Minerva. Yet you had a lower EBITDA margin in the quarter than them. On the other side, JBS Foods is much smaller than BRF and you had a much better margin, EBITDA margin than JBS Foods. How would you reconcile this situation regarding relative scale and profitability of the beef and processed food business in Brazil? That'll be the first question.

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

Look, Alan, this is Wesley. Look, when I look our business not in only one quarter, our beef business has been performing - outperforming our competitors in Brazil and we still believe that our business is a very competitive business in Brazil. Of course, it's hard to analyze in one quarter in terms of cattle position or sales, export sales. So it's not an easy question because I don't know what our competitor is doing in each quarter.

In fact, overall, I can't see if there's any negative thing. And as well, Alan, you remember that we opened some plants in the last 18 months or 12 months and we're still ramping up some plants then getting these startups running a better land. (52:33). So this is about beef, about JBS Foods.

Alan, we - if you look, I think - if you're comparing apples and apples, I think our margin is almost the same as our main competitor who we can compare that has positive numbers. So when you exclude some of our competitors' business that should - for us to be able to compare apples and apples. And I think one thing that also the market needs to think about that we don't have hedge accounts. And remember that when you do hedge accounts, what you'll do, you defer the devaluation of the currency. So, your export revenue, you lock the dollar to not have the fluctuation and you put in the - not in the - you put in the - yeah, you put in the P&L the fluctuation.

So, I think what I can say, Alan, we are improving our business. We are closing price gaps. If you look our price, our average sales price in the domestic market last quarter, the difference was 15% and we closed the gap in the third quarter to 8.9% price gap.

So, I think the combination of this thing, and we are very optimistic about operation and I'd say, what, I don't see any reason why we - even we have a small operation, sometimes the big operation doesn't mean really big size plants in Brazil. Today, for example, there's more problem than benefit. We have a huge amount of labor issues, it's very hard to operate some really large facility in Brazil today, unemployment is very low. So, actually some small scale plants today in Brazil, you can do a better job than really big size. So, yeah, a combination, Alan.

Q - Alan Alanis {BIO 15998010 <GO>}

Got it. That's very useful, Wesley. Thank you. My second question has to do with the currency derivatives that you've established for Brazil. I mean, you mentioned 84% of your revenues are in U.S. dollars in a consolidated basis. More than 70% of your debt expires post 2018, so it's more than three years away. Could you explain to us what's the criteria? What are the principles? I mean, what makes you take one of these currency derivatives, increase it, decrease it? What's the kind of criteria that you take you to do that in light of the alternative of just saying, look, I'll wait for this debt to expire, I have a lot of revenues in U.S. dollars, and I have a match long-term of my revenues versus my U.S. dollars? What are the principles and criteria for taking this and what is the duration of these derivatives? Thank you.

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

Look, Alan, we have a very straightforward approach on this. So...

Q - Alan Alanis {BIO 15998010 <GO>}

Okay.

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

...we'll look everyday our exposure and how we measure our exposure. All of our debts that is dollar denominated minus all of our account receivables plus the sales order that is already confirmed that we have products in inventory, and we hedged the difference. And why we do difference? We don't believe in a natural hedge because our revenue, yes, is in dollar but this doesn't mean that you will keep the sales price in the same level that it is today.

For example, if we were 100% sure, for example, we are going to do from Brazil in export this year $6 billion. If we were 100% sure that the sales is still real, for example, let's say that the real tomorrow goes to BRL 3, you can't say that you need to hedge these because you have $6 billion in next quarter. Yes, but what's happened if the sales price dropped there, that this is very common to happen when you have a course devaluation (57:32) sales, sales price drop. So you cannot say that anyone has a natural hedge unless you lock the sales price.

So I - look, Alan, we have been carrying a fully hedged position and I think this is proving to be the right strategy this quarter. We were not impacted like a lot of Brazilian companies with a huge amount of impact in exchange rate. And again, I keep fully hedge the product - the real close at BRL 2.45 and it is now BRL 2.57 or BRL 2.56 or BRL 2.58 and I still fully hedge. And I say, what -JBS, we will not be exposed to the dollar. We think that dollar will keep middle term, keep this stronger. The U.S. economy is doing better. Commodity price is dropping, and this is our strategy.

And also, Alan, we don't see hedge accounts. I'm not criticizing who does, but we don't see hedging account's the best strategy. We see hedging account is like defer the problem. You are deferring the problem.

Q - Alan Alanis {BIO 15998010 <GO>}

Got it. Okay. That is so - thank you so much, Wesley. Again, congrats.

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

Thank you, Alan.

Q - Alan Alanis {BIO 15998010 <GO>}

Thank you.

Operator

Our next question comes from Daniel Sensel with JPMorgan.

Q - Daniel Sensel {BIO 16854713 <GO>}

Yes. Hi, good morning.

A - Jeremiah Alphonsus O'Callaghan

Hi, Daniel.

Q - Daniel Sensel {BIO 16854713 <GO>}

How are you, guys?

A - Jeremiah Alphonsus O'Callaghan

Great, Daniel.

Q - Daniel Sensel {BIO 16854713 <GO>}

Thank you. Just a quick follow-up on what Carla asked before. So basically, you're saying that in terms of capital structure that, one, that you have a bigger span is not the right one, right? The leverage is very low. In fact, this (59:32), you have a lot of cash. So, the question is basically you're planning maybe to lever up that entity in the future; question is what are you going to do with the cash that you're going to raise? Are you going to have dividend now and reduce that at the holding level and also pay some dividends to minority shareholders of Pilgrim's Pride or you will try to engage into another acquisition pretty similar to what you try to do with the Hillshire?

A - Jeremiah Alphonsus O'Callaghan

You just said Pilgrim's Pride level.

Q - Daniel Sensel {BIO 16854713 <GO>}

Yes.

A - Jeremiah Alphonsus O'Callaghan

You're trying the Pilgrim's?

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

So, Daniel, just to add. If you are referring in theory, look, simple. We have two option. We are building cash. We have a positive cash position in Pilgrim's. We keep building cash. So two things: the real and realist option. Or in some point, we are going to pay a dividend and send money back to shareholders or we are going to do acquisition. And all I can tell you, I think we proved our discipline on the Hillshire transaction. We are only going to do acquisition that is accretive. So, if we see an opportunity in any point that is accretive, we are going to be looking. But if not in some point, that the second option that we will ask to add (01:01:04) is to dividend, to send money back to shareholders. That's the two ways that you can do it. It's not three – it's not another option on top of these two.

Q - Daniel Sensel {BIO 16854713 <GO>}

Okay. Perfect then. And the other question that I have, you had an excellent quarter. So do you think that in terms of margins, you have reached a peak or you see that there's more room for improvement especially when taking into consideration some of the fundamental story of the cost side?

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

Daniel, look, we keep looking to expand our business in more value-added business in a more branded piece, and we think we have been able to expand in more higher margin segments. Though in middle term and long term, we believe we can keep growing and expand the margin. I will not mention short-term. I will not give any guidance. We never did in terms of next quarter or so. But again, we think we'll have great quarters going forward, but I will not – we don't give specific guidance in terms of margin. But again, overall, if you look at, yes, mid-term and long-term, look, we think we'll keep having a very strong top line growth and a good earnings coming from our business. If you look back seven years, we acquired sizeable business in markets that was in a situation that was attractive and we have been creating good value on these acquisitions and I think we will be able to keep doing so.

Q - Daniel Sensel {BIO 16854713 <GO>}

Perfect. Thank you.

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

Thank you.

Operator

Our next question comes from Brett Hundley with BB&T Capital Market.

Q - Brett M. Hundley {BIO 20873327 <GO>}

Hi. Good morning, gentlemen. Thank you so much for taking my question.

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

Hi, Brett.

Q - Brett M. Hundley {BIO 20873327 <GO>}

Good morning. So I had a question either André or Wesley. Your U.S.A. margins were excellent during the quarter both in beef and pork. And the question within beef, you talked about Australia and Canada. It sounds like you're very satisfied with the way that your U.S. business performed as well, U.S.-specific, but beef margins have become very difficult as we see them today. And I'm curious to get your near-term outlook; we've seen feedlots hanging on to cattle a little bit longer. It looks like there are some expansion plans underway and I'm curious if you believe if U.S. beef margins can reverse in coming months from where they're at today.

A - André Nogueira de Souza {BIO 20244486 <GO>}

I'll keep my position that I just comment before. We always have some seasonality in the fourth quarter. So if you look historically, the second and third quarter are better. The fourth quarter is a little bit weaker. I think that we're going to see a little bit of the same seasonality. When I look next year and I look the combination of our business, Australia, Canada and I look the improvement that they're doing inside of our business in U.S. and looking the rationalization that the industry did during this year has all the arguments, we believe that 2015 will be better than 2014.

You can have seasonality quarter-by-quarter, I don't think that this will change. But overall, at this point, the same thing that I said up is same time last year (01:05:20) in the same JBS Day and the look that they – we comment that – we believe that 2014 would be better and in reality, in 2014, we'll finish much better than 2013. Despite of the industry trend, we are sitting here now and believe the same thing about 2015. And you are right; we are seeing a very strong retention. So good signs for the – not for the short-term, but the near-term future of the industry in U.S.

Q - Brett M. Hundley {BIO 20873327 <GO>}

Okay. That's helpful. So am I understanding correctly that as we move into 2015, you feel good about your beef business being up year-on-year in the U.S. because improvement, strength in Australia and Canada can offset potential weakness in the U.S. market specifically? Or do you believe that you can drive improvements in the U.S. market alongside Australia and Canada?

A - André Nogueira de Souza {BIO 20244486 <GO>}

I think that you asked, has all the conditions should be there. Again, with the rationalization of the plant that we had and more improvement that we're doing inside of our business, I have no reason to think that our U.S. beef business will not be better 2015 than was in 2014.

Q - Brett M. Hundley {BIO 20873327 <GO>}

Okay. And then just my last question is we've seen some capacity – some processing capacity in the beef industry in United States come in relative to the supply level there. Is it your position there that further capacity needs to come in or be rationalized or do you believe that capacity can stay in place and match oncoming potential expansion on the cattle side?

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

I think that perhaps one plant that we opened that, to be honest, very marginal. I'm not sure if the location is the right location. I'm not sure if the asset is the right asset. Just that they are opened and shut so many times in the history that I don't think that, to be honest, it was very (01:07:40).

I think we have a good balance in most of the U.S. You have some areas in U.S., especially the cow (01:07:53) that's probably needs some more CapEx to come out consisting taxes in California. Fortunately, we don't have plants in these two areas that I believe that the two areas today in U.S. that has more pressure. And I think that's (01:08:11). If you want to be balanced, you need to have capacity to be shut there. Our plants are not there, our plants are more in the Bay Area (01:08:18) and I feel very, very comfortable with the supply in 2015 in our plant – for our plant.

Q - Brett M. Hundley {BIO 20873327 <GO>}

Very helpful. Thank you, sir.

Operator

Our next question comes from Luca Cipiccia with Goldman Sachs.

Q - Luca Cipiccia {BIO 6914452 <GO>}

Hi. Thank you. Good morning. Thanks for taking my questions. A follow-up on the acquisition front. First on Pilgrim's on the U.S., you said how you would still look for opportunities but want to stay disciplined. How realistic is it that you can find some attractive opportunities in the current market (01:08:59) where we are in the size and what type of prices may that imply? That's for the U.S.

But also in the JBS Food division, you've done a number of small acquisitions after Seara, and I would like to understand how do you see that progressing? Where do we stand in that process? Should we expect more and if so, is it on capacities, more on branded processed foods? Where do you stand in that? You have a critical mass now that you're satisfied with, do you think you could do more? Maybe if you can also comment on that will be great. Thank you.

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

Luca, basically – this is Wesley. So as of today, (01:09:46) we have – since we acquired Seara, we have been doing some small acquisition in our JBS Food business. And we keep looking opportunity in Brazil and I think we'll keep doing some regional acquisitions, but when we see opportunities. It's not because we will keep happening (01:10:10) I think that same kind of segment that we will keep (01:10:14) first to roll in the chicken segment, in the packaged food business and value-added type of business. So real risk in Brazil is what I think (01:10:23) that can be done.

Q - Luca Cipiccia {BIO 6914452 <GO>}

Okay.

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

But small and regional, yeah, is doable and is accretive. So I think this will keep happen. So in the U.S., it's hard to say if it's realistic to think about a sizeable acquisition because you never know how things progress. We keep looking two things. We keep looking to grow our business, to use cash to create value. So if we see opportunities, we will be interested. But we are not in the U.S. We don't – we are not engaging any discussion with anyone today. It's hard to answer your question if it's realistic or not. So I have to be looking – I have to keep looking and see.

Q - Luca Cipiccia {BIO 6914452 <GO>}

Okay, I understand. Thank you.

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

Thank you, Luca.

Operator

Our next question comes from Jose Yordan with Deutsche Bank.

Q - Jose J. Yordan {BIO 1496398 <GO>}

Hi. Good morning, everyone. My question is about this other income of BRL 240 million in the quarter, and I see in the notes that a lot of it is due to some political party donations and contributions or whatever. I mean, that obviously is likely to raise some eyebrows to say the least. So I'd just be interested in any color you can give us as to what the justification, how you justify that to the board and to the shareholders and whether – if you can put it in the historical context of what's been the level of political contributions in the past. And the last part of the question is, is it finished for now or should we expect more than in the fourth quarter?

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

Look, as you mentioned, the adjusted EBITDA portion of this is a contribution to the election in Brazil. As you know in Brazil, the election system is not public...

A - Jeremiah Alphonsus O'Callaghan

Publicly funded

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

...funded, so it's the private sector and the population funding the election in Brazil is common in Brazil. This is how Brazil works, and this is how the contribution is declared contribution. And a portion of - not all the number is election contribution, but a big chunk of the number, it is. And all that portion is restructuring charge that is one-off charge in these last acquisitions that we did like Massa Leve, like Belafoods and some other acquisitions that we did. But it is how the election system works in Brazil and our board - of course, this was approved by the board and the all the contribution. And again, the numbers looks bigger; it is big, of course. But today, we are the second largest Brazilian company, actually the largest private company in Brazil and we represent in Brazil what we are.

A - Jeremiah Alphonsus O'Callaghan

Just to add to that, Jose, we're also one of the largest employers in Brazil. We have operations in 21 Brazilian states. We're one of the two largest exporters out of Brazil. And we're very engaged in the communities where we are, our facilities wherever they are, and they're very relevant and regionally in the states where we are because lots of communities are dependent upon the business and we need to protect the business as much as we possibly can, thus protecting stakeholders and shareholders. And remember there are elections in Brazil every four years.

Q - Jose J. Yordan {BIO 1496398 <GO>}

Right, excellent. So I guess the last part of the question since the election was - took place during the fourth quarter, can you give us any color as to how much additional other - additional contributions to expect in the fourth quarter? And I'm assuming that in 2015, they drop off to close to zero.

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

2015, we're not going to have any or we're not going to have, yeah, any number in 2015. So in the fourth quarter, yeah, we will have some much more than there's now in the majority of the number was in the third quarter. I don't have the number top of my head but we'll have that incurred in the fourth quarter. But what I can tell you that majority was in the fourth quarter - in the third quarter, I'm sorry.

Q - Jose J. Yordan {BIO 1496398 <GO>}

Great, very clear. Thank you.

A - Jeremiah Alphonsus O'Callaghan

Thank you.

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

Thank you, Jose.

Operator

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

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

So, thank you all of you who have been in our third quarter earnings call. It is a very pleasure to discuss our results and have, everybody, a great day and look forward on the next quarter call. Thank you.

Operator

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