Q2 2021 Earnings Call

Company Participants

- Marcos Antonio Molina dos Santos, Founder and Chairman
- Miguel Gularte, Chief Executive Officer
- Paulo Pianez, Director of Sustainability and Communication
- Tang David, Chief Financial & Investor Relations Officer
- Timothy Klein, Chief Executive Officer of North America Operations
- Unidentified Speaker

Other Participants

- Antonio Hernandez, Analyst
- Carlos Laboy, Analyst
- Robert Dickerson, Analyst

Presentation

Operator

Good morning everyone, and thank you for waiting. Welcome to Marfrig Global Foods S.A. Second Quarter Conference Call.

With us here today, we have Mr. Marcos Molina, Founder and Chairman; Tim Klein, Chief Executive Officer of North America Operations; Mr. Miguel Gularte, Chief Executive Officer of South America; Mr. Tang David, Chief Financial and Investor Relations Officer; Mr. Paulo Pianez, Sustainability and Communication Director; and Mr. Eduardo Puzziello, Investors Relations Director.

This event is being recorded. (Operator Instructions) This event is being recorded and all participants will be in a listen-only mode during the Company's presentation. After Marfrig remarks, there will be a question-and-answer session. At that time further instructions will be given. (Operator Instructions) This event is also being broadcast live via webcast and may be accessed through Marfrig website at https://ri.marfrig.com.br/, where the presentation is also available. Participants may view the slides in any order they wish. The replay will be available shortly after the event is conclude. Those following the presentation via webcast, may post their questions on our website. They will be answered by the IR team after the conference is finished.

Before proceeding, let me mention the forward statements are based on the beliefs and assumptions of Marfrig Global Foods SA management and our information currently available to the Company. They involve risks and uncertainties because they relate to future events and therefore depend on circumstances that may or may not occur. Investors and analysts should understand that conditions related to macroeconomic conditions, industry and other factors could also cause results to differ materially from those expressed in such forward-looking statements.

Now, I'll turn the conference over to Mr. Marcos Molina. Mr. Molina, you may begin your presentation.

Marcos Antonio Molina dos Santos {BIO 15363967 <GO>}

Before I talk about the second quarter results, I would like to thank and congratulate the whole team for one more set of record results. Our North American operations showed its best historical performance achieving over $720 million in EBITDA. In South America, even facing a scenario of cattle shortage and problems with shipping which affected our exports, we maintained our profitability and we made progress. So our programs of operational efficiency and our geographic diversification strategy. In the last 12 months, thanks to a disciplined financial management, we drastically reduced the cost of debt, and we lower our leveraging to its lowest historical levels.

We ended the second quarter with a leverage of 1.45 times in reals, and we also had the lowest interest expenditure in dollars. Strong cash generation allied to a lower financial cost allowed us to increase investments in organic growth in the Company. In the last 12 months more than BRL1.7 billion were invested in projects, that increased our capacity in process products. And in those of added value, we also made an important strategic investment with the acquisition of BRF shares. This stake aims at diversifying our investments in a segment that has a strong relation with Marfrig.

With the constant improvement in our production processes and the reduction of administrative and financial costs, and increased efficiency, we are on a virtuous cycle of value generation, which allows us to pay increasingly frequent dividends. Based on the strong results already achieved this year, we are proposing an early paying out of dividends of BRL958 million, and we also proposed a buyback program of over 26 million shares, and the canceling of another 20 million shares, that are already in our treasury. We will continue to generate value to our shareholders, fulfilling our role with society, being an innovative Company that is truly committed with sustainability and the best ESG practices.

I now turn it over to the CEO of the North American operations, Tim Klein.

Timothy Klein {BIO 16522695 <GO>}

Thank you, Marcos. Let's begin on Slide 4, where I will comment on the results for the second quarter. Starting on the left, sales volume in the quarter was 12.5% higher than the same quarter of last year. And then this we achieved our largest quarterly sales volume since 2012. As cyclically large fed cattle supplies were further enhanced by carryover from last year's coronavirus impacted slaughter reductions. Net revenue was 10.1% higher than the previous year, driven by continued high prices for beef and beef byproducts, and the improvement in sales volume.

Finally, we achieved a record EBITDA of BRL722 million, 13.8% higher than last year, with an EBITDA margin of 24.5%, another historical record. The key drivers of our performance were strong demand for U.S. beef, combined with ample availability of fed cattle. The continued renormalizing of the economy after the coronavirus pandemic, especially the foodservice sector supported exceptionally strong demand for beef.

Please move now to Slide 5, where I will talk about U.S. market data. In the quarter, the total U.S. kills increased more than 17% as cattle supplies and lot of (inaudible) to operate at full capacity. Cattle prices as reported by the USDA average $119.76 per hundredweight up 12% year-over-year, as industry kills return to normal seasonal levels. The USDA comprehensive cut-out the average $292.21 per hundredweight, steady with last year while the drop credit increased 64.4%, led by increases in hide and tallow bags. The cutout ratio was 2.45 versus 2.69 last year.

Higher cattle prices combined with steady box beef prices and higher drop credit values resulted in an 8.9% decline in per head gross margins. As we look forward to Q3 and the rest of 2021, industry fundamentals continue to be in our favor. The cattle supplies remain adequate, while beef demand is robust, both domestically and internationally. Margins for the industry should continue to be favorable.

Now, I'll pass to Miguel.

Miguel Gularte {BIO 20767495 <GO>}

Thank you very much, Tim. We will now move on to Slide number 7, where I will explain the performance of the South American operations in Q2 2021. As we can see on the left, comparing sales volume, there was a 5.5% retraction as compared to the same period last year going from 339,000 to 320,000 tons. This movement is explained by the strategy adopted by the management to preserve operating margins, considering the adjustments, our demand vis-a-vis the supply of animals.

In the central graph, showing net revenue. We can see that we achieved in this quarter BRL5 billion, 14% above the revenue in the same quarter in 2020. Here I should mention, the challenges that we faced in our exports. Despite a 12% increase in the average price as compared to Q2 2020, throughout this quarter we had significant logistics challenges in South America, with the unavailability of vessels and containers, which delayed shipping, impacting volume in 15% and sales in 4%, when compared to Q2 2020. The good news is that, these difficulties are being overcome, and this impact should be totally reverted throughout the second half of the year. On the other hand, in the domestic market, even with the stability in sales volume as compared to the same period in 2020, we were able to bring net revenue up in 53%, that is there was a 54% increase in the average sales price in the domestic market, resulting from a combination of a strategy to optimize our commercial channels, focusing on sales growth of branded products, and the beginning of the recovery of the local economy.

On the right, showing the EBITDA, we can see that we achieved in this quarter BRL181 million with the margin of 3.6%. The behavior of the margin is explained by the impact of the increased cost of cattle in Brazil and Argentina and the impact of logistics problems in our exports as I mentioned. These effects were partially offset by the operations in Uruguay. Just like with the growing share of industrialized products in our results exceeding 15% of the revenue in Q2 2021, as compared to 9% in the same period in 2020. Finally, I have to mention the new captures of the operating efficiency program that in this quarter reached BRL30 million when compared to the previous quarter.

Moving on to Slide number 8, I will speak about exports, and the operating efficiency program in Q2 2021. Our exports accounted for 58% of the total revenue this quarter as compared to 68% in the same period in 2020. Out of that, 62% were exports to Asia. Currently the market showing the best trade opportunities, especially China and Hong Kong.

I'd like to remind you that Marfrig is the company with the highest authorized capacity to export to China, are 13 certified plants in South America account for 70% of our production capacity. As I've been saying along the last calls, Marfrig has strived to implement operating improvements through efficiency programs in the operations in Brazil, Uruguay, Argentina and Chile.

Observing the chart on the right, we can see that through the implementation of these measures we were able to capture throughout this quarter, operating improvements that positively impacted our results in about BRL30 million, when compared to the previous quarter.

I will now pass it on to Tang, that we will speak about the consolidated results and the financial highlights of the operation.

Tang David {BIO 18672578 <GO>}

Thank you, Miguel. In the next slide, we will present the consolidated financial highlights of Marfrig's Q2 2021. Once again, the record performance of our North American operation which posted its best results ever, and the maintenance of the results of our South American operation which proved to be resilient, even in a very challenging quarter. Marfrig posted its highest quarterly profit, and the lowest leverage ratio in the Company's history.

Starting on Slide 9, on the left graph, in Q2 2021 we generated consolidated net revenue of BRL20.6 billion, a 9% growth compared to Q2 2020. Moving onto the second graph on the right, this quarter, we generated BRL3.9 billion in adjusted EBITDA, with a margin of 19%. Out of this total EBITDA, 96% was generated in North America. This growth as commented by our CEOs, Miguel and Tim, is explained by the record profitability of our North American operation, which offset the performance of the South American operation, that was impacted by the lower dollar level, and the logistics challenges in exports this quarter.

We now turn to Slide 10, financial results. Looking at the evolution of our financial results in the upper chart, we present financial expense in Q2 2021, amounting to BRL44 million, a

78% reduction in relation to Q1 2021. In the lower chart, we detail the interest provision in the quarter BRL321 million or $60 million, the lowest ever recorded at Marfrig.

I'd like to emphasize as well, the BRL228 million gain related to mark-to-market of the investment made in BRF shares. The exchange rate variation in Q2 2021 was positive and BRL96 million, explained by the difference between the final exchange rates of the periods, Q2 2021, BRL5 versus BRL5.70 in Q1 2021. Adding the three items together, the financial result is positive by BRL52 million.

On the next slide, number 11, the net results. The record operating performance added to the captures of the operating efficiency program, fixed cost control and the continuous reduction of our financial expenses resulted in the generation of net income of BRL1.7 billion in Q2 2021.

In this second graph below, we present the accumulated net income of BRL2 billion in the first six months of 2021, an increase of 38% compared to the same period of 2020. Based on this strong performance, the management is proposing the distribution of approximately BRL958 million in interim dividends. This amount is equivalent to a dividend yield of approximately 7%. Management is -- has also approved the share buyback program of approximately 26 million shares, and simultaneously the cancellation of 20 million shares held in treasury today.

On Slide 12, we generated in Q2 2021, more than BRL3 billion in operating cash flow, discounting the investments in CapEx and interest paid in the period. The free cash flow was BRL2.2 billion as shown in the graph above. In the graph below, we present the operating cash generation in the last 12 months, which was BRL7.5 billion. Here we highlight the investment of over BRL1.7 billion in CapEx, mainly in projects of organic growth, such as the expansion of the lines of processed products and of higher added-value, and the increase in productivity and efficiency. Free cash flow generation in the past 12 months was BRL4.3 billion.

On Slide 13, net debt and leverage. Net debt at the end of the second quarter totaled $2.8 billion, an 8% reduction as compared to Q1 2021. As a consequence of the strong cash generation in the period, our leverage reached the lowest historical level, both in reals 1.45 times and in dollars 1.55 times. In Q2 2021, approximately BRL517 million in dividends were paid. In that, BRL141 million paid to Marfrig shareholders, referring to the results of 2020, and the remainder to National Beef's minority shareholders. Observing the graphs on the right, 90% of our debt is indexed in dollars, which matches our EBITDA generation which is over 90%, and 73% of our debt is long-term.

On Slide 14, we present the details of our debt profile. Starting with the first graph on the left, the debt schedule. We ended Q2 2021 with cash of about $2.7 billion, enough to cover maturities until almost 2026. In the second graph on the right, we see the continuous decrease in the average cost of our debt. Debt at the end of the quarter stood at 5.09% per annum, 60 basis point lower than in Q4 2020. As a result of all of this process, we increased the average debt term from 3.4 years to 4.7 years.

We have just concluded in August 2021, the issuance of CRA with a volume of BRL1.2 billion in two series 7 and 10 years. Remunerating IPCA plus 4.5% per annum for the seven years use, and IPCA plus 4.60% per year. For the 10-year series which we have fully swapped for CDI plus 0.97% per annum, one of the Company's lowest cost operations.

I will now turn to Paulo Pianez who will comment on the sustainability highlights.

Paulo Pianez

Thank you, Tang. Historically, Marfrig has based its operations and actions that have had a positive impact on the development of low-carbon livestock farming, which combines production with the conservation of our biodiversity and that is productive, profitable and contributes to the social and economic development of the regions in which we operate.

Within it sustainability management platform, the main ongoing program is the Marfrig Verde+ plan launched in 2020, and conceived in partnership with IDH, initiative for sustainable trade. Aiming to ensure that 100% of the Company's production chain is traceable, sustainable, low-carbon and deforestation free.

During this year and more specifically in the second quarter, Marfrig intensify the process of implementing projects and initiatives planned for 2021. The first one has to do with the monitoring of the Cerrado an important Brazilian biome in terms of biodiversity, but also in terms of production. Marfrig has already concluded the implementation of satellite geo-monitoring of 100% of the properties that produce and display on, allowing for the identification and mitigation of social and environmental risks, and its supply chain. Another relevant initiative was the development of the risk mitigation map. A relevant initiative that allows us to prioritize areas of greater risk. A tool developed by Agroicone and that is now integrated to Marfrig's geo-monitoring system. It shows us the path we must follow to be more assertive in the implementation of our initiatives.

Another important initiative is the sustainable calf production program. It was also developed in partnership with IDH, Carrefour and Sao Marcelo farms, that has been implemented since 2018, and seeks to establish a new standard of sustainable production in the most critical phase, the breeding phase. The program has 150 producers and Marfrig is investing EUR1.8 million to double the number of producers benefited by this program.

Marfrig has also developed a protocol of good practices called Marfrig Club. This protocol was redesigned in light of the highest sustainability standards included in the main international indices and protocols, such as BB fall, CDP accountability framework initiative and IFC, always from the perspective of the producer. Another important tool, especially for the monitoring of indirect suppliers is called Conecta. That is based on blockchain technology, that was developed in partnership with Safe Trace, CPQD, The Nature Conservancy and Friends of the Earth.

To provide more security and transparency for traceability throughout the supply chain, the application of the tool is already being tested. Along the same lines, we've also been implementing Visipec, which is a joint effort between U.S.-based NGO, NWF and Friends of the Earth, based on a methodology developed by the University of Wisconsin. It is a traceability tool, complementary to the systems, that Marfrig already uses.

The first phase has already been concluded and we have already achieved 99.4% compliance in all our supply chain including indirect suppliers. Last, we've been implementing the cattle supplier protocol for the Amazon region, which was the partnership with the Public Federal Ministry. In the first phase of implementation, Marfrig already achieved excellent results in the first audit that took place in Q2, showing 100% compliance. These efforts and results show our commitment to increase positive impacts and thus contribute to social economic development, and to the maintenance and recovery of biodiversity in the territories where we operate.

I now turn it over to the operator, to begin our Q&A session.

Questions And Answers

Operator

Thank you. The floor is now open for questions. (Operator Instructions) Our first question comes from Mr. Antonio Hernandez with Barclays.

Q - Antonio Hernandez {BIO 19255349 <GO>}

Hi, good morning. Thanks for taking my question and congrats on the results. My question is regarding the (inaudible) where you couldn't quantify the impact from both the logistics exports challenges that you mentioned, that you've already overcome. But just to have more light, and what the specific impacts? And also what was the positive impact from the better sales mix? Thanks.

A - Marcos Antonio Molina dos Santos {BIO 15363967 <GO>}

Good morning, Antonio. Thank you for your question. This quarter we had a carryover stock of BRL750 million, which is roughly 2 EBITDA points. Point two, so our EBITDA was 3.6%, but it should have been 5.6%. So that would be the estimate for our inventory, it's roughly 15,000 tons, 16,000 tons of beef, that stayed back due to the impact on the shippings that we were expecting for this quarter. We believe this situation will become more stable in the third quarter, and that logistic bottleneck should ease throughout the semester.

Operator

Our next question comes from Mr. Rob Dickerson with Deutsche Bank (Sic - Jefferies).

Q - Robert Dickerson {BIO 17963496 <GO>}

Great. Thank you. I'm actually from Jefferies, but no problem. Just one question. It's for Tim. Obviously, profitability margin in North America was quite impressive in the quarter. I believe it's company high and realize the drivers of that margin just off of the essentially cattle supply relative to retail pricing demand. We've seen this kind of flow through over the past year or so. And it looks like the cutout spread is now reemerged to be somewhat attractive once again. So, I heard your comment in the prepared remarks say, you'd expect that level of profitability to remain elevated. So, the direct question is just how elevated, right, I'm assuming in the back half of this year it will be, what we saw in Q2. But at the same time, it sounds like it could be a bit higher than we even saw in the back half of the past two years. And that's it. Thank you. Thanks, Tim.

A - Timothy Klein {BIO 16522695 <GO>}

Sure. To answer your question, we do expect margins in the second half to be very, very good. They will be above last year's second half. And as we look forward into 2022, we still have the same cyclical -- the cattle supply that will be in our favor. And the real improvement has been on the demand picture with the foodservice industry, opening back up, demand has been very good. So, as we look down the road, we think 2022, although we don't expect it to be the same this year, in total, but should still be at the high end of the historical range.

Q - Robert Dickerson {BIO 17963496 <GO>}

Alright. Super. Thank you.

Operator

(Operator Instructions) Our next question comes from Mr. Rob Dickerson with Deutsche Bank (Sic - Jefferies).

Q - Robert Dickerson {BIO 17963496 <GO>}

Great. Super. Thanks again. And it's Jefferies again. I guess if there are no other questions in the queue, I will take the opportunity to just kind of ask about the investment in Brazil Foods, obviously somewhat of a material investment. I feel a lot of investor questions on it, since it's occurred -- since the announcement. So maybe just -- give you the opportunity to provide a bit more color as to why Brazil Foods, why now? What kind of -- how involved on the operating side, you might be going forward? Thanks.

A - Marcos Antonio Molina dos Santos {BIO 15363967 <GO>}

Hi. This is Marcos, I'll be taking the question. Buying the BRF shares as we've said in our announcement was a passive but strategic investment. They are our largest clients. But there is a lot we can do together that would be strategic for Marfrig. We bought the shares at -- what we thought to be very interesting prices, and we will be keeping the same strategic position with BRF. We have no intention at all to buy the rest of the shares, paying the 40% premium. So, we won't be doing that.

Q - Robert Dickerson {BIO 17963496 <GO>}

Okay. Thank you. That's it.

Operator

Our next question comes from Mr. Carlos Laboy with HSBC.

Q - Carlos Laboy {BIO 1506984 <GO>}

Yes. Thank you. The natural follow-up from the last question. You won't buy, but would you consider a merger still with BRF? And is -- or is that also off the table? The other question I had related to Visipec. There were some questions about the legality of Visipec early on. And it sounds like, a lot of those issues and questions have been addressed and answered. Do you see any legal issues with how you are now using Visipec? And how Visipec may remain a very viable component to cattle tracing in Brazil?

A - Marcos Antonio Molina dos Santos {BIO 15363967 <GO>}

I'll answer the question about the merger with the BRF first. These past two years, we looked into a merger, but we didn't go through with it. Now that we've bought the shares and we own 32% of BRF, we thought that would be the best way to invest in the company. So at the moment, the merger between the two companies is not on the table.

A - Unidentified Speaker

Hi, Carlos, Visipec has no legal issues at all, it complements the monitoring and tracing system here at Marfrig. It's been implemented and it had excellent results. So, we're actually enhancing the implementation. It's part of Marfrig's traceability platform. What happened in the past was that Visipec's databases were open. And you could have access to all sorts of information and that's no longer the case. But in terms of legality, there are no legal issues and we're still using it here at Marfrig.

Q - Carlos Laboy {BIO 1506984 <GO>}

That's great news. Thank you.

Operator

Excuse me. This concludes today's question-and-answer session. And this concludes Marfrig Global Foods S.A. Conference Call for today. Thank you very much for your participation and have a nice day.