Q4 2018 Earnings Call

Company Participants

- Andre Nogueira de Souza, President & Chief Executive Officer
- Gilberto Tomazoni, Global Chief Executive Officer
- Guilherme Perboyre Cavalcanti, Chief Financial Officer & Investor Relations Officer
- Jeremiah Alphonsus O'Callaghan, Chairman
- [09PT62-E Jerry O'Callaghan]

Other Participants

- Barbara Halberstadt, Analyst
- Benjamin M. Theurer, Analyst
- Carlos Laboy, Analyst

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 fourth quarter and year of 2018. As requested by JBS, this event is being recorded. The recording will be available this afternoon and can be accessed by following the instructions posted on company's website at www.jbs.com.br/ir.

Taking part on this call we have Mr. Jerry O'Callaghan, Chairman of JBS; Gilberto Tomazoni, Global CEO of the company; Guilherme Cavalcanti, Global CFO; Andre Nogueira, President of International Operations; and Wesley Batista Filho, President of Operations in Brazil.

Now, I will turn the conference over to Mr. Jerry O'Callaghan. Please go ahead, sir.

[09PT62-E Jerry O'Callaghan]

Thank you. Thank you. Good morning, everybody. As I am exiting the Investor Relations role, just a quick word of introduction on this call. We're very pleased to be here, the whole team, to announce the fourth quarter and the 2018 numbers. And I would just like to extend firstly, a word of gratitude to the CEO of the company during the majority of 2018 and José Batista Sobrinho, the founder of the company. He had vacated that role in December and handed it over to Gilberto Tomazoni who was here and who will present the company's strategy this morning. I would also like to welcome to the JBS team, Guilherme Cavalcanti, who joined us in January of this year. So very pleased to have Guilherme on board as well.

And before I hand it over to Mr. Tomazoni, I would like just a quick word of gratitude to everybody at JBS across all the geographies that we operate in. We had a 2018 of which we are very proud, everybody is very proud of it. We came up with good results and so, the team members did a great job. They deserve all our praise and all our gratitude.

So with that, I'll hand you over to Mr. Tomazoni.

Gilberto Tomazoni {BIO 2090061 <GO>}

Thank you, Jerry. Good morning and welcome to our conference call. We are very glad to announce the result for 2018. It was a great year for JBS, a record EBITDA and free cash flow generation. We closed the year on high note and delivered everything we set out to do.

As I mentioned every quarter, nothing happen by chance, it was a result of the choices we make. We have a clear strategy focused on offering high quality products, actively manage products and their mix, and having a great discipline with cost and cash generation. The central part of our strategy, our people, our team, who has a deep knowledge on the sector and has been making a difference.

In addition, our results clearly show that the business model of JBS production platform diversified by region and protein types is practically impossible to replicate. It is our competitive advantage that makes it easy for the company to maximize opportunities in the local markets and globally.

Before going into more details of our financial results, I would like to highlight some sectors that are part of our priorities. First, operational excellence, for us it simply means being the best possible market operator. For that we compare each business unit with public information from our main direct competitors. We closed this year very satisfied with our results, the majority of our business units' performance better than our peers.

The second, the leverage. JBS used its strong cash generation to reduce debt. In 2018, gross debt was reduced by $2.7 billion and net debt by $1.5 billion. If you use the second quarter 2017 as a reference, until the end of 2018, gross debt decreased by $4.3 billion, reducing our leverage ratio to 3 times its EBITDA.

In addition, we made a relevant change in the profile of our debt. At the end of 2018, short-term debt decreased by representing from 25% (00:05:43) of total debt to only 5%. Moreover, total liquidity was BRL 16.3 billion, which is more than 5 times short-term debt.

Third, the cost of capital. In 2018, cost of capital decreased significantly by $240 million. However, there is another benefit yet to come which is an interest reduction. Our current cost of capital is not equivalent of our current financial metrics. This reduction will happen with time as we replace our current debt with cheaper lines. Consequently, this lower cost of capital will reduce our financial efforts to achieve future growth.

In terms of compliance and governance, we are very proud of our compliance program. Our initiatives have been presented to stakeholders during 2018 and we are very well recognized in Brazil and overseas. We end the year with over 112,000 team members trained in our Code of Conduct and Ethics in our anti-corruption programs.

Now, I would like to comment some of our main consolidated results. Net revenue reached BRL 182 billion, highest EBITDA in JBS history, BRL 14.8 billion. Operation cash flow was BRL 11.5 billion and the free cash flow was BRL 5.7 billion. Adjusted net income was BRL 1.6 billion.

To finalize this initial part of my comments, I want to emphasize two factors that have been very important for the growth of our revenue and margins. First, high value-added products, the relevance of these products has been increased significantly in our portfolio and now are focused in our future growth. The second, strong growth of protein consumption in Asia. JBS, thanks to its diversified production and distribution platform in Asia, has been increasing sales significantly and is firmly well-positioned to serve this growing demand.

Now, I would like to turn to the call to over Guilherme who will detail the results. Guilherme, please.

Guilherme Perboyre Cavalcanti {BIO 2181205 <GO>}

Thank you, Tomazoni. Thank you, Jerry. Now, please, let's move to page 4 where we'll talk about 2018 consolidated results. Net revenue grew at 11.3%, reaching BRL 181.7 billion. Gross profit and EBITDA, they grew at 10.8% and 10.7%, respectively, keeping constant margins. Net profit after adjustments had reached BRL 1.6 million.

Now moving to page 5, we had a significant increase in operational cash flow given the better working capital, mainly due to supplier days of payment improvement. This better working capital plus lower financial expense is partially offset by higher income tax due to the results improvement, led to more than double the free cash flow of the company, reaching BRL 5.7 billion or $1.5 billion.

Now moving to slide 6, we'll talk about fourth quarter 2018 consolidated results. So, net revenues grew 10.7% reaching BRL 47.3 billion. Gross profit and EBITDA, they grew lower then proportional to the net revenue, given the lower increase in gross profit and EBITDA of Pilgrim's Pride and Pork, when you compare the fourth quarter 2018 of these two divisions with fourth quarter 2017. However, poultry and pork prices already presented increases in 2018. We had a better net profit in the fourth quarter mainly due to financial expenses reductions.

Now, please let's move to page 7. We had 19.4% increase in operational cash flow, again this higher increase was due to working capital and better suppliers' terms of payment. Taking the divestment effect, free cash flow increased 41.3% due to the higher EBITDA and better working capital, partly offset by higher taxes due to the higher net profit.

Now, let's move to page 8 to talk about the debt profile. We ended up with our cash on the hands of BRL 8.9 billion and with almost $2 billion in revolving credit facilities, making a total liquidity of BRL 16.3 billion, more than 5 times our short-term debt that today is only 5% of the total debt. We also presented from the second quarter 2017 to the end of the year a reduction of $4.2 billion in gross debt.

Our net debt to EBITDA ratio decreased from the second quarter 2017, that it was at 4.07 to 3.01 at the end of 2018. It's worth mentioning that given 2019 positive free cash flow, the ratio of net debt to EBITDA tends to decrease for the year-end of 2019.

Now, let's talk about 2018 business unit performance, please. Let's start with Seara 2018 highlights. In 2018, Seara reported net revenues of BRL 17.7 billion, an increase of 1.1% when compared to 2017. Seara's EBITDA and EBITDA margin were BRL 1.5 billion and 8.7%, respectively. The results were impacted by the increase in raw material costs such as corn and soy milk and by the nationwide truck drivers' strike in Brazil, factors that are not expected for 2019.

During 2018, Seara's strategy was centered on strengthening its positioning to align with consumers preference by focusing on delivering excellence, quality and product innovation with national and international recognition. The company was able to increase household penetration to 77% in 2018 with a 75% repurchase rate at the same period. Strong international demand particularly from Asia positively contributed to Seara's product price and international market, with grain prices appear to moving forwards with the supply and demand balance.

Now let's move please to JBS Brazil. 2018 highlights was net revenues of BRL 27.6 billion and increasing 17.1% when compared to 2017. Substantial EBITDA growth of 3,129% from 2017 to 2018 with EBITDA margin of 4.5%. Focus in maximizing profitability through the improvement of products and channel mix and strengthening of partnerships with key clients understanding their needs and efficient and tailor-made solution. Development of special programs with cattle suppliers to ensure high quality standards.

It's also worth mentioning that fourth quarter 2018 margins presented a decrease in relation to the third quarter 2018 margins due to a lower exports that was upset by higher domestic sales and increase in the raw material price and the FX appreciation. Despite the pressure of the raw material, we expect a very good trend for the exports for 2019.

Now please, let's move to JBS USA Beef. The solid economic environment in North America, combined with solid industrial fundamentals, positively impacted cattle suppliers and beef producers, with a growing cattle availability and a stable slaughter capacity.

Record level in U.S. exports. JBS Beef invested in sales infrastructure in order to raise market share in exports and profitability, with an improved product mix. Growth in financial results from JBS Australia mainly due to increase in cattle availability and exports to China and Asia. Primo Foods restated to leadership position in Australia and New Zealand on prepared food segments.

Now please, let's move to JBS USA Pork. Increase in domestic pork supply contributed to a decrease in sales price, while the impact in margins was partly offset by the lower supply price. Pork USA segment exports presented a 4% increase in volume when compared to 2017.

Plumrose reported a record performance in 2018. The company continues to successfully execute their strategic plan, which is focused on incremental production, sale, and new product development. JBS closely monitors the events related to the African swine fever in Asia, due to its potential to cause significant change in the global trade and overall market environment.

Now Pilgrim's Pride, Pilgrim's Pride faced a challenging commodity environment along with a slower recovery from climate change in the U.S. These impacts were partly offset by a 15% increase in Prepared Foods sales. In Europe, even though Pilgrim's benefited from synergies, results were impacted by higher poultry feed costs due to drought in the region. Mexico's domestic market represented a significant 33% increase in Prepared Foods sales volume in 2018.

Now, I would like to begin the question-and-answer session, please.

Q&A

Operator

Ladies and gentlemen, we will now begin the question-and-answer session. Our first question comes from Barbara Halberstadt, Bank of America.

Q - Barbara Halberstadt {BIO 18022271 <GO>}

Hi, thank you. Thank you for the call. I have two questions, actually. The first one is regarding that exchange, there are some headlines (00:19:08) talking about that exchange that it would have mentioned that in the first call in Portuguese. So I just wanted to understand what are you thinking in terms of the debt allocation within the structure, that you're looking to doing a liability management this year?

And then, the second question is regarding the fact that you don't have any more the qualified opinion in your balance sheet is currently unqualified. If you feel that it's the order is being more comfortable with the provisions you made and if you can make any comments about that? Thank you.

A - Gilberto Tomazoni {BIO 2090061 <GO>}

Thank you, Barbara. I will ask Guilherme Cavalcanti to please answer this – your question.

A - Guilherme Perboyre Cavalcanti {BIO 2181205 <GO>}

Okay. Hi, Barbara. Regarding liability management, it's something that we will be doing going forward because we have an opportunity to decrease interest expenses of this company, given the solid credit metrics that we are presenting, more specifically at 3 times net debt to EBITDA. So going forward, we'll continue – we will be doing liability management and for that we'll be monitoring all the markets.

(00:20:13).

Yeah. And you're right. The unqualified opinion of the financial statements will reflect a higher comfort of the auditors regarding the provisions on our balance sheet.

Q - Barbara Halberstadt {BIO 18022271 <GO>}

Okay. Thank you. And just on a follow-up on the liability management, if I can ask, I understand you said you're going to look at the different markets and where there's an opportunity. But could we expect from the leverage metrics we see on the different subsidiaries any concentration in the U.S. versus Brazil, or also looking at where your operations are, would make more sense to increase leverage or concentrate it on where you have more operations currently?

A - Guilherme Perboyre Cavalcanti {BIO 2181205 <GO>}

Yeah. You're right. Today, 85% of our cash generation roughly is generated outside Brazil, they be U.S. And U.S. has only 65% of the debt. However, a better arrangement in a better allocation of the debt will be a result of Deloitte's work which already hired in order to do that. So today I can't say where – how we will structure to increase our efficiency in terms of assets and liabilities, but this is the result that Deloitte will present us after they finish their work.

Q - Barbara Halberstadt {BIO 18022271 <GO>}

Okay. Thank you so much and congratulations for the results.

Operator

Our next question comes from Benjamin Theurer, Barclays.

A - Jeremiah Alphonsus O'Callaghan {BIO 19817115 <GO>}

Hey, Ben.

Q - Benjamin M. Theurer {BIO 17248534 <GO>}

Hey. Good morning and well, Jerry, thank you very much for all the time and dedication over the last couple of years. So, good luck with the transition and your more expanded role as a Chairman, good luck first of all on that one.

Now, if I may, two, three questions, it's mainly in regards to the whole trade situation and the hold, disease outbreaks that are happening across the world. So, connecting two things here, so, obviously, you've mentioned in the press release and also now in your prepared remarks that you're continuously monitoring the ASF outbreak over in China and how that could impact. But there's an additional case with PD in Alberta, Canada, and I wanted to get your thoughts on how much of an implication or what you think implications could be for the U.S. pork industry, considering that there is a significant increase in capacity and none of the diseases have been breaking out in U.S., but we got a little bit of a short-term hiccup on lean hog short term. So, a little bit your short-term implication to you, but also medium-term opportunities you're thinking are going to be seen in the pork business first. That'll be my first question.

A - Gilberto Tomazoni {BIO 2090061 <GO>}

Andre, I think you can – can you answer this question?

A - Andre Nogueira de Souza {BIO 17758053 <GO>}

Okay, (00:23:39), I want to just want to make sure that I understood that question, I think that's the latest trade and the implication specially the hog or the pork and hog industry in U.S. So, Ben...

Q - Benjamin M. Theurer {BIO 17248534 <GO>}

Correct.

A - Andre Nogueira de Souza {BIO 17758053 <GO>}

...one important issue was solved that was the NAFTA, so Mexico and Canada two very important partners for U.S. in this pork and chicken and if that's behind now, we reduce a lot the questions and the stability of the market. China, they are going to import much more protein this year period.

The most that U.S. will grow is the high – is the question. That's not clear yet. The numbers each day grow but not clear yet. U.S. gets the benefit there, direct or indirect. If U.S. can and they reach a trade deal with China, and everything that (00:24:41) talk about that looks like that if the trade deal is achieved, it'll is very positive for the agriculture community in the U.S., it will be fantastic. So then you have direct access and the demand will be extremely strong, so the scenario will be one in the last time probably if that happen.

If that does not happen, so U.S. does not have a trade deal with China or achieve a trade deal later this year or next year, then U.S. gets the benefit indirect, but at the end of the day China will import much more anyway and import much more beef, pork and chicken, so U.S. will supply the market that's probably Europe, Canada and Brazil, Europe and for U.S. So, I comment in the previous call that just in the 11 weeks of this year compared to the same 11 weeks of last year, Australia export 100% more to China, beef. So that's going to Chinese, but less meat is coming to U.S. from Australia, less meat is going from Australia to Japan and Korea, and that's opened a huge opportunity for beef there.

Pork, the same scenario. If Europe starts to export much more to China and Canada starts to export much more to China, and Brazil starts to export much more to China, other traditional markets for U.S. will have a huge demand for the U.S. pork, that means Mexico, Japan, and Korea, and the new market that U.S. has opened like Colombia.

So the prospectus is all very positive. The industry is growing, hog production is growing. And your comment NAFTA has more pork capacity, but it is global demand, the way that's shaken up, the scenario is very positive.

Q - Benjamin M. Theurer {BIO 17248534 <GO>}

Okay. Perfect, Andre. Thank you very much. Very clear. And then just one question, there were some floodings in the U.S. and some of the cattle herd got impacted and we actually saw live prices going a level higher. Can you assess the impact and how much it has impacted short-term some of your sourcing in case of the cattle supply in the U.S.?

A - Andre Nogueira de Souza {BIO 17758053 <GO>}

So, cattle supply overall is very positive. USDA just released another Cattle on Feed report that shows that cattle on feed is even higher than it was last year. So continue to grow cattle production, right, and at low pace but continue to grow and cattle feed is very healthy.

We had a very harsh winter, very wet, and cattle and feedlot does not perform well in wet environments. So, cattle performance was very bad for the feedlot during this winter. With best cattle that should be prepared to be harvest in the first quarter, will be prepared to be harvest in the second quarter. So, we have a little bit of shortage compared to our expectation, all weather-related, all weather-related. The fundamentals and the supply in the industry is very positive, meaning that the (00:27:56) was not available and that's why you saw cattle price probably a little bit higher than our expectation, in the first part of the quarter – in the quarter, will be available in the second quarter and the third quarter.

Q - Benjamin M. Theurer {BIO 17248534 <GO>}

Okay. Perfect. Andre, I'll leave it here. Thank you very much and congratulation on the results.

A - Jeremiah Alphonsus O'Callaghan {BIO 19817115 <GO>}

Thank you, Ben.

Operator

Our next question comes from Carlos Laboy, HSBC.

A - Jeremiah Alphonsus O'Callaghan {BIO 19817115 <GO>}

Hey, Carlos.

Q - Carlos Laboy {BIO 1506984 <GO>}

Good morning, everyone. You have brought a fresh pair of eyes for the CFO function and you now had some time to gather some early impressions. Can you perhaps share with us what some of those early impressions are, some of the top priorities that you've had out of that function? And maybe you can share with us some of your initial thoughts on capital allocation discipline and on your capital market strategy going forward?

A - Jeremiah Alphonsus O'Callaghan {BIO 19817115 <GO>}

Carlos, your line is garbled. We could not get the question. I don't know perhaps...

Q - Carlos Laboy {BIO 1506984 <GO>}

Sure. Let me try get all those forward. I was saying that you have brought a fresh pair of eyes to the CFO function and you've now had some time to gather some early impressions and perhaps you can share with us what some of these early impressions are and some of your top priorities?

In addition to that, maybe you can share with us some of your initial thoughts on capital market strategy going forward and on the capital allocation discipline.

A - Guilherme Perboyre Cavalcanti {BIO 2181205 <GO>}

Okay. Thank you, Carlos. I will divide my first impressions in two sets. The first one, whatever I saw outside the company. So it was really an opportunity to unlock value given a cost of that that is not in line with the credit metrics. So, I think the financial performance of the company we had with that, we have an opportunity to decrease interest expenses. And of course, also the lower multiple, say, or our enterprise value will be back compared to our peers.

Now inside the company, I would like – I came here also to learn what was behind all the success stories of the company. Basically, Swift's turnaround, Pilgrim's turnaround, Cargill Pork turnaround and other successful purchases of the company. And what I can tell is that the JBS really puts the right person on the right place, the top management team, its excellence and the lower turnover of the top management team. And last but not least, a very strong commitment of all the employees of this company. So I think this probably – these are my first impressions that I have here in JBS.

Now moving to your question about capital market allocation, as I mentioned, I think we have a tremendous opportunity of decreasing the cost of capital and the cost of debt of the company. These two, the cost of debt decrease will be achieved with liability management, while showing – as the markets are more confident with our credit metrics, we'll be exchanging more expensive debt to cheaper debt, and at the same time expanding the maturities in a way that we would decrease significantly our refinancing risk. I think this will also show – will give more comfort to investors to invest in the company. And for that, I'm monitoring all markets, local markets, foreign markets, bilateral low ones. We will use all the instruments available to reach our goal of decreasing our interest expenses.

Thank you, Carlos.

Q - Carlos Laboy {BIO 1506984 <GO>}

Thank you.

Operator

This concludes today's question-and-answer session. I would like to invite Mr. Gilberto Tomazoni to proceed with his closing statement. Please go ahead, sir.

A - Gilberto Tomazoni {BIO 2090061 <GO>}

Thank you. I would like to highlight two important points. Please look the page 15, our priorities. We'll not change our priorities, we have the same priority focused on operational excellence, organic growth, investment, innovation and quality, focus on deleverage, in world-class global compliance programs. In page 16, I think this is important. Now, we are discussing to – this is (00:33:20). First, increase the consumption of Asia, it was natural to increase the consumption.

And now with the problem that China is facing with the disease in pork, I think this platform of JBS get to a strong competitive advantage, because we are very diversified in terms of regions, in terms of proteins and we are able to supply the demands in the market for different place even if the conditions improved in relation U.S. and China will be much better. But if they keep as is, we have a really strong conditions to supply this market, because if U.S. will be not able to reach directly China, the other parts of the world we are able to reach direct China, and we have great condition for U.S. to supply this market that we are not prioritizing for the other platforms.

And you see the page 17, our export, we are very strong today, where a great China represent 24% of export. We are well-positioned in the market and we are creating a distribution, we are investing in sales team and distribution platform in this market. And say, this is just to finalize now my final words. Thank you everyone for being part of this conference and have a good weekend.

Operator

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