Q1 2016 Earnings Call

Company Participants

- Edison Ticle de Andrade Melo e Souza Filho, Chief Financial Officer
- Fernando Galletti de Queiroz, Chief Executive Officer

Other Participants

- Andrew Muench, Analyst
- Mauricio Martinez, Analyst
- Nick Ivanov, Analyst

Presentation

Operator

Good morning, ladies and gentlemen, and thank you for waiting. At this time, we would like to welcome everyone to Minerva's First Quarter of 2016 Results Conference Call. Today with us we have Fernando Queiroz, Chief Executive Officer; Edison Ticle, Chief Financial Officer and Eduardo Puzziello, Investor Relations Officer. We wish to inform you that this event is being recorded and all participants will be in listen-only mode during the company's presentation. (Operator Instructions) The audio and slide show of this presentation are available through a live webcast at www.minervafoods.com/ir. The slide show can also be downloaded from the webcast platform in the Investor Relations section of this website.

Before proceeding, we wish to mention that forward-looking statements may be made during this presentation relating to Minerva's business prospects, operating and financial estimates and goals. They are based on the beliefs and assumptions of company management and on information currently available. They involve risks, uncertainties and assumptions because they relate to future events, and therefore, depend on circumstances that may or may not occur in the future.

Investors should understand that general economic conditions, industry conditions and other operating factors could also affect the future results of Minerva and could cause results to differ materially from those expressed in such forward-looking statements.

I will now turn the conference call over to Mr. Fernando Queiroz, CEO, who will begin the presentation. Mr. Queiroz, you may start the presentation.

Fernando Galletti de Queiroz {BIO 15387377 <GO>}

Good morning, everyone and thank you for participating in Minerva's conference call on the results of the first quarter of 2016. We will begin this presentation talking about the quarter's highlights, which are detailed in the slide two. Please have a look on slide two. Regarding the first quarter financial and operating results, I would like to highlight our free cash flow generation, which was positive by BRL40 million and was the result of the continuous execution of our operational and commercial strategies combined with us benefiting from the imbalance between beef supply and demand in the global market, being favorable for South America.

It's worth mention that if we adjust the free cash flow not considering the FX hedge impact, it would be of BRL173 million. These factors also allow us to increase the return on invested capital to almost 28% making Minerva the sector reference.

Net operating revenues reached BRL2.3 billion in the first Q of 2016, an 8.4% increase over the first quarter of 2015, a company record for the net operating revenues for first quarter. Normally the first quarter is the weakest quarter of the year, so this year was a record in all-time best results. Exports were approximately 70% of our total sales, followed by a favorable scenario, fresh beef exports revenue increased by 25% over the previous years.

An important -- as important as the revenue growth was the increase in the company's EBITDA, which registered the highest margin for our first quarter, since Minerva was listed, of 10.8%, 210 basis points up on the first Q of '15, thus EBITDA reached to BRL152 million corresponding to a 34% year-on-year expansion.

In our financial highlights, I believe that the most important achievement was our deleverage process measured by the net debt, the last 12 months EBITDA ratio, which was reduced from 4.1 times in the fourth Q of '15 to 2.9 times in the first Q '16. Thanks to the proceeds from the capital increase, the company closed the first quarter with a cash position of BRL3.4 billion, a figure that still leaves us in a very comfortable position to face a volatile macroeconomic scenario.

At the close of the first Q '16, 72% of Minerva debt was exposed to US dollar with duration currently at five years on average. It's also worth mentioning how the company is prepared to face the currently volatile macroeconomic scenario and extract value from commercial opportunities, making use of risk management tools as we have been doing in recent years.

Lastly, it's important to mention the ratification of the capital increase through which we issued 47.9 million new shares and allowed the participation of the Saudi Arabian Fund, SALIC in the company capital. I reiterate that through this deal we initiated a long-term strategic partnership in a region with a high growth potential, and where Minerva has already a relevant participation.

Let's move and have a look on the slide three to discuss the industry overview country by country. Slide three will talk about Brazil. The industry capacity adjustment to follow the reduction in Brazilian consumption continued in the first quarter of 2016. As a result, the sector total slaughter volume fell by 9% over first Q '15.

However, if we analyze the average capital price in the first Q '16, we can see that it increased by around 6% over the same period of 2015. This effect reflects the higher retention of animals in the pasture due to a favorable rain scenario, benefiting animal fattening and farmers' profitability. This movement opened a range of opportunities for basis arbitrage in the purchase of capital in different regions and benefited the company with better geographical diversification.

The rate of slaughtered animals also increased boosting productivity gains for the industry. In the Brazilian exports, we would like to highlight the strong growth in the fresh beef volume in the first Q of '16, 24% above the volume of the first Q '15 and the strong sales to the Far East, which accounted for 35% of the total Brazilian exports.

On the other hand the Brazilian domestic beef consumption was again impacted by the high inflation and unemployment. Retailers decided to work with lower inventories and consequently, demand a lower volume of beef implying a new adjustment to the industry capacity. We also experienced a reduction in the domestic supply of forequarter cuts, whose demand from countries in Asia, the Middle East and North Africa increased. These factors combined boosted the carcass average price positively affecting the industry average operational margins.

Let's move on the slide four, that we have an overview on the Paraguay. In Paraguay, the first quarter was a period of intense rain, hampering the farmer's farm to industry animal logistics. In addition to the month of February in the vaccination period, which combined with rainy season negatively affected the raw material supply. These two aspects benefited the companies using different origination strategies not only in the spot market.

This effect reduced the industry slaughter volume by 6% comparing to the first Q of '15. Despite this impact, the average cattle price remained stable over the fourth Q of '15 and fell by 22% compared to the same period of last year. In exports, the combination of the fact described and the reduction in sales to Russia reduced export volume by 20% over the first Q of '15. Nevertheless, it's important to mention the increasing demand from Chile, which accounted for 30% of the country exports, 600 basis points up on the first Q '15. As shown in the lower left chart of this slide, in addition to Chile, Brazil and Russia continue to be Paraguay's main export destination. In the first Q '16, Paraguay also benefit with the opening of the Iranian and Egyptian markets for beef exports.

Let's move to slide five, where we have a look on the Uruguayan scenario. The first quarter in Uruguay was challenging in addition to our highly irregular rain season with a drought in January and the intermittent rain in February and March, the industry faced isolated problems in exports. These effects influenced the average cattle price down by 7% year-on-year and the slaughter volume 5% down below when compared to the first Q of '15.

In export, despite of the 4% higher volume in the first Q '16 over first Q '15, revenues fell by 8% reflecting a reduction in average export prices due to the weaker sales to the US market. As shown in the lower left chart, the main export highlight was the China share up by 500 basis points compared to the first Q of '15, accounting for 31% of the total exports of Uruguay.

We will now move to slide six that will go into more details on the Minerva performance beginning with the exports. As demonstrated in the upper chart, we continue to be one of the main beef exporters in the country where we operate. Minerva share of Brazilian exports reached 20% remaining stable compared to 2015 average. In Paraguay, our performance also remained stable reaching 18% of the total exports, while in Uruguay our market share reached 15% of the total country's exports.

This slide also shows Minerva export mix by region. It's good to have a look. And the best performing in export market was Asia, whose share increased to 26% of the total exports in the last 12 months ended March 2016 versus 18% in the previous years -- in the previous year. China and Hong Kong together grew by 50% in the same period. Other important destination that have been consistently expanding are South Korea, Singapore and Malaysia.

Another highlight was the countries in the Middle East, which increased its stake from 14% in the last 12 months ended in the first Q '15 to 21% in 2016. The region's main growth highlights were Iran, Egypt and the United Arab Emirates. It's also worth mentioning that Saudi Arabia, an important market for this sector, resumed importing beef from Brazil in February. We believe that there is a huge growth potential for sales to that country. Even higher, if we consider our recent partnership with the Saudi Arabian Fund SALIC announced by the company.

I believe it's also worth talking about the reduction in the company exports to Russia and the CIS region, which is entirely related to the Russian economy. The chart show a 12% reduction in our exports to that region influenced by the foreign exchange depreciation and the reduction in the oil prices, which together negatively impacted the demand and the beef sales mix. I believe that the highlight was the agile commercial flexibility that the company demonstrated to adjust to this scenario and re-route part of its volume previously exported to that region to other more profitable destinations such as Asia and Middle East as you saw in the results, and I just mentioned.

I will now turn the floor to Edison, who will comment on the financial and operational highlights. Edison?

Edison Ticle de Andrade Melo e Souza Filho {BIO 15435343 <GO>}

Thank you, Fernando. Good morning, everyone. On slide seven, we will start presenting our financial operational highlight. As shown in the left upper corner of this slide in the first Q '16, the company posted net revenues of BRL2.3 billion, 8.4% higher than in the first Q of '15. In the last 12 months ended in March, net revenues reached BRL9.7 billion, 25% higher year-on-year, which is a new net revenue record for the company.

First quarter EBITDA as presented in the upper right chart reached BRL252 million, approximately 34% up on first Q '15 and with a margin of 10.8%, 210 basis points up on the previous year, and a record for our first quarter margin. Return on invested capital reached 28% in the first quarter of '16, 7.7 points higher than in the first quarter of '15. Once again, keeping the company as the sector reference.

Lastly, as shown in the lower-right corner, leverage measured by the net debt-to-EBITDA ratio reduced to 2.9 times at the end of the quarter. In addition to the proceeds from SALIC as mentioned in our last earnings release, and which entered in our cash balance in the -- during the first quarter. Another fact that contributed to the company's deleveraging process was the cash flow, the positive cash flow generation during the quarter. Thus leverage came to 2.9 times at the end of the quarter, 1.4 times lower when we compare to the first quarter of '15 net leverage.

Moving on to slide eight, let's talk about the net result. Minerva posted net income of BRL46.3 million in the first quarter of '16. It's worth mentioning that before tax, the net result of the quarter, the net income was BRL105 million. If we exclude the effects of this FX variation that reached to BRL298 million in the quarter and that has no cash effect.

And if you include the FX hedge result and exclude the impact of income and social contribution taxes, the company's adjusted result was positive BRL54 million in the first quarter. Making the same adjustments for the last 12 months, the net profit would have reached BRL210 million for the company.

Let's move now to slide nine to discuss operating cash flow. Operating cash flow reached BRL146 million in the quarter, working capital returned BRL181 million to the company's cash. The main impact came from the receivables line, which was positively impacted by the foreign exchange variation on receivables booked in dollars and also the reduced payment terms of certain clients.

In the last 12 months ended in the March, operating cash flow reached BRL977 million, affected by adjustments which includes the net income from operations of BRL1.1 billion and working capital positive in approximately BRL10 million. It's worth mentioning that the company grew around 30% in the last 12 months, but showing a huge capital discipline presented by the working capital variation in the last 12 months that was positive BRL10 million. So we are able to increase 30% revenues, 35% EBITDA with no impact on working capital needs.

Moving now to slide 10, we'll talk about free cash flow generation. Minerva recorded positive free cash flow of BRL40 million in the quarter. This cash flow results from first quarter EBITDA of BRL252 million, CapEx of BRL64 million, a positive working capital variation of BRL181 million and net financial result negative by BRL328 million, which around 145 million -- 195 million was related to financial expenses, to interest expenses and 133 million to the results of the hedge position.

It's worth mentioning that if we adjust the free cash flow, taking out of consideration the FX hedge impact, the free cash flow for the quarter would have been BRL173 million.

Making the same calculations for the last 12 months, CapEx with cash effect reached BRL251 million in the last 12 months. The working capital needs as we have already mentioned reached BRL10 million positive. EBITDA generation was around BRL1.1 billion in the last 12 months, and as a result the free cash flow generated by the company was BRL170 million in the last 12 months.

Moving on to slide 11, we will discuss the company's capital structure at the end of the quarter. So at the end of the first quarter of '16, as we have already mentioned, leverage reached 2.9 times at the end of the quarter, with the proceeds from SALIC, already recognized in our cash position, we ended the quarter with BRL3.4 billion in cash, around two times higher than all the short-term maturities, allowing the company to pay down all the debt that would -- that will mature in 2023, putting the company in an extremely comfortable position in terms of liquidity, especially in a scenario of great restriction and very high volatile -- a very high volatility in the economic scenario.

At the end of March, debt exposed to the FX variation was around 72% of the total debt, which allowed us to maintain our exports revenue natural hedge. So we were in compliance with our policy of keeping the exposure of the debt at the same breakdown of our revenues in foreign currency. At the end of the quarter, the duration of our debt was five years. And finally shareholders' equity reached positive BRL450 million -- BRL465 million at the end of the quarter.

I will now turn it over to the operator to begin our Q&A section. Thank you.

Questions And Answers

Operator

Thank you. We will now start the question-and-answer session for investors and analysts. (Operator Instructions) Our first question comes from Andrew Muench of HSBC. Please go ahead.

Q - Andrew Muench {BIO 17481422 <GO>}

Hi. Good afternoon guys. Thanks for taking the question. Just a very quick one on capacity expansion. So as we're looking ahead, sort of what sort of CapEx can we assume for the company, what about next year and perhaps the year after, how you're thinking about capacity expansion? Thank you.

A - Fernando Galletti de Queiroz {BIO 15387377 <GO>}

Well, the CapEx for the -- for 2016 would be maintenance CapEx, which is around BRL40 million per quarter. Expansion CapEx in terms of Colombia, we're going to have something around 10 million to 15 million until the end of the year, because the majority was concluded in the first quarter. Regarding acquisitions or new geographies like Argentina, there is a place that we were -- we will study. It's difficult to say what I can assure you is that we are not going to take any -- any expansion actions that we put in risk the deleveraging process of the company.

Q - Andrew Muench {BIO 17481422 <GO>}

Got you. Thank you. And then actually maybe just a quick follow-up, and unrelated to CapEx. But as we're looking at export -- export revenue as a percentage of total seems to be sort of structurally capped at 70 or at least the last few quarters we've been kind of stable at 70, is there room to expand that toward 80 or what's the structural impediment perhaps for expanding that further? Thank you.

A - Fernando Galletti de Queiroz {BIO 15387377 <GO>}

Yes. Theoretically there is room to expand to more than 70, but the local market also is an important market in a demanding market. The decision of in what market we place product is taken in a weekly basis based on the profitability that each market presents. So the ideal breakdown that we have today is reflected on our results and in the mix 70-30. But yes, theoretically it can go to 75 to 80 or even higher.

Q - Andrew Muench {BIO 17481422 <GO>}

Great. Thanks again.

Operator

(Operator Instructions) Our next question comes from Mauricio Martinez of GBM. Please go ahead.

Q - Mauricio Martinez {BIO 16363988 <GO>}

Hello, everyone. Thank you for taking my question, and congratulation on the result. I just want to know if you can share with us your expectations in margins for the rest of the year after today's strong margins and if you're seeing current margins are sustainable going forward? I don't know if you have discussed this before. Thank you.

A - Fernando Galletti de Queiroz {BIO 15387377 <GO>}

It's a good question. As I mentioned on the presentation, the first quarter is normally the weakest quarter of the year, seasonally speaking. This year it was a very good starting of the year. And the factors that are driving these margins is mainly the international supply-demand scenario, where there is a shortage of beef and where South America is able to price -- the pricing power that South America have has increased. So we are confident that we can keep the margins at double digit for the whole year of 2016.

Q - Mauricio Martinez {BIO 16363988 <GO>}

Great. Thank you. Congratulations again.

Operator

(Operator Instructions) Our next question comes from Nick Ivanov of Prudential. Please go ahead.

FINAL

Bloomberg Transcript

Q - Nick Ivanov {BIO 2459687 <GO>}

Yeah. Hi. Thanks. Can you please go over the -- again, your hedging policy and as of now have you change to FX hedges and not just FX hedges, but all hedging activities, if you could please?

A - Fernando Galletti de Queiroz {BIO 15387377 <GO>}

Well, the hedging policy that we have is divided into short-term and long term. The short term is the head of the flows is related to the operational margin that the company is getting on a daily basis. We have our daily meeting, the business meeting, where we analyze the scenarios, we analyze the margins that the main goal of the meeting is to lock up the margin. So we try to hedge all the risk factors, which are basically three; the price of cattle, the price of beef and the FX, if we are talking about exports that are the majority of our revenues.

So on a daily basis, every time that we -- we find good margins, we find good operational margins, we try to lock up the margins using all the hedging tools. For the long term, for the exposure of our balance sheet, which is basically the principal amount of our long-term debt and basically of our bonds. It's a decision that we discuss on a monthly basis with our Board. So every month, the CEO and the CFO comes to the Board, we make a presentation regarding the scenario, the volatility, the exposure of the company and what is our recommendations in terms of hedging or not hedging, the long-term exposure.

If you take a look in that during the first quarter we reduced a bit, the hedges that we built last year to protect the balance sheet against the FX depreciation on the debt side. Now we keep at the same hedging that we presented in the balance sheet at the end of the first quarter of '16. However, it's worth mentioning that the scenario that we are seeing in Brazil right now is highly, highly uncertain, is very, very volatile. And having this is mind, I think the best policy that we have to take and that we should recommend to our Board is to be more conservative on managing the risk of our operations.

So on the financial side, we will continue keeping high liquidity in order to deal with some more challenging credit scenario in Brazil. And on the financial and operational side, we'll try to -- to be more conservative on hedging our operations on the flow of the day-by-day, and also on the exposure of our long-term debt.

Q - Nick Ivanov {BIO 2459687 <GO>}

Yeah. Thank you. And the cash which is on the balance sheet, is there any percentage which is restricted due to the hedging?

A - Fernando Galletti de Queiroz {BIO 15387377 <GO>}

No. 0% restricted, what we do is we would try to keep between 30% and 40% of our cash in dollars, in foreign currency in order to have a better management of the exposure of our liquidity.

Q - Nick Ivanov {BIO 2459687 <GO>}

Thank you.

Operator

And our next question is a follow-up from Andrew Muench of HSBC. Please go ahead.

Q - Andrew Muench {BIO 17481422 <GO>}

Hi guys, thanks for the additional question here. I noticed back in Q4 '14, this is the first quarter where you had mentioned, have your animals. And then so I saw the slaughter volumes kind of trending down, however they look like volume was somewhat flat and has remained somewhat flat for the last, say, two years. Is this a structural change or you purchasing animals for the efficiency gains that simply are heavier, just in light of the current environment or is these heavier animals as a sort of a structural change that we can assume going forward in our models?

A - Fernando Galletti de Queiroz {BIO 15387377 <GO>}

Definitely that the Brazilian farmers are gaining productivity, they are putting more weight to the animal in less time, so there is an effect of more animal -- more weight by animal that we slaughter. This is not something for Minerva, is something for the whole industry. But on the top of that what you can see that our number of animals were down around 15% this quarter, and our beef production was practically stable, part is because of the animals are heavier, but also part because we also outsource carcass, especially to supply the Brazilian local market. So it's not only is slaughtering that makes our volume of production, is also made by outsourcing carcass of -- from other slaughter houses that accomplished, we find [ph] the quality standards that we have. So we buy cattle and we buy carcass.

Q - Andrew Muench {BIO 17481422 <GO>}

Got you. That's very helpful. Thank you.

Operator

(Operator Instructions) And this concludes our question-and-answer session. At this time, I would like to turn the floor back over to Mr. Fernando Queiroz for any closing remarks.

A - Fernando Galletti de Queiroz {BIO 15387377 <GO>}

Thank you very much. Once again, I would like to close this conference call. Thank you all Minerva team, due to their dedication and despite of the current adverse [ph] scenario that we are facing in our country, we posted such a strong result. Also, I would like to mention that such difficult scenario what leads Minerva to achieve such strong result, it's the focus on the strategy and the financial discipline. We consider the financial discipline and the focus of the strategy, the key factors for you to go through turbulent waters.

I'll also thank your interest in our company and we remain at your disposal for any necessary clarifications. Thank you very much and have a good day.

Operator

Thank you. This concludes today's presentation. You may disconnect your line at this time. Have a nice day.