Q2 2014 Earnings Call

Company Participants

- Edison Ticle, Chief Financial Officer
- Fernando Queiroz, Chief Executive Officer

Other Participants

- Eric Owen, Analyst
- Jose Yordan, Analyst
- Mauricio Martinez, Analyst
- Unidentified Participant

Presentation

Operator

Good day, ladies and gentlemen, and thank you for waiting. At this time, we would like to welcome everyone to Minerva's Second Quarter of 2014 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 would now like to turn the conference over to Mr. Fernando Queiroz, CEO, who will begin the presentation. Mr. Queiroz, you may start your presentation.

Fernando Queiroz {BIO 15387377 <GO>}

Thank you and good afternoon everyone. First, I'd like to thank you for participating in Minerva's conference call on the results of the second quarter of 2014. Let's move to slide 2 that will comment the highlights in the quarter. The company presented another quarter marked by solid results, both from the operating and financial fronts, as well as in the consolidation of the expansion cycle in which we have focused on the integration of the acquired plants, benchmarking units and maximizing operational efficiency.

In May, we began the operations at Frigorifico Carrasco in Uruguay. So, there was an additional two months of results, which had a very positive impact on the company's consolidated figures. I'd like to point out that the second quarter results do not include the Janauba plant, whose [ph] operations are expected to begin in the third quarter.

Also I'd like to say that although the acquisition of BRF plant is still under analysis of the Brazilian anti-trust agency, CADE, we've now signed a service agreement with BRF under this contract that became effective on July 15. We are providing cattle to BRF, which is proceeding with the service of slaughter, deboning and packaging. And Minerva distributes, based on its commercial strategy, both in the domestic and export markets.

Therefore, I reinforce that the second quarter results exclude both Janauba operation and the service agreement signed with BRF, and you can expect additional growth in the next quarters. Net revenue totaled R$1.7 billion representing a growth of 25% in relation to the second Q of 2013, driven by the beef and other divisions, in particularly the live cattle, leather and in other fine food segments.

EBITDA totaled R$178.7 million, 33% higher than in the second Q of 2013 with a margin of 10.8%. Excluding the reversal for fiscal provision, adjusted EBITDA was R$163.7 million, posting a significant increase of 22% over the same quarter in 2013 and the EBITDA margin remained close to 10%. The EBITDA growth was translated into an increase in the return on invested capital to 21%; 2.7 points higher than the figure reported in the second Q of 2013. Cash flow from operations in second Q of 2014 was R$101.3 million. If you adjust the non-recurring impact related to the biological assets that total R$88 million, cash flow would have been R$190 as we will detail during the presentation. As a result of its good performance in the quarter, the company recorded net income of R$18.5 million, thus reversing the result reported in the same period in 2013. We maintained strong liquidity with our cash totaling R$1.9 billion, enough to amortize our debt until 2022.

The company leverage, measured by the net debt-EBITDA ratio stood at 3.4 times. By excluding the perpetual bond issued from our debt, leverage would come down to 2.4 times. In line with our growth strategy, we expanded our distribution in Asuncion in Paraguay, aiming to capture the growing demand in that region. Lastly, I would like to stress that the results represented by the company this quarter reflected our focus on operational excellence, planning, risk control and financial management.

Now, move on to slide 3, we will talk about cattle supply in the second quarter. After our first quarter, we've got a basically similar atypical off-season due to the drought. In the second quarter, the rainfall in Brazil reached normal levels, especially in the North and Mid-West regions. The recovery of the pasture rather increased cattle supply over the North, thereby reducing the pressure seen at the end of the previous quarter.

Consequently, there was a reduction in cattle price over the second quarter as shown in the top right chart. For the second half of 2014, we expect a growth in feedlot operation, which should reduce cattle price volatility in the off-season.

Let's move on to slide 4 and we will analyze the performance of Brazilian exports. In the second Q of 2013 [ph], Brazilian exports of beef maintained the good pace with a 7% rise in export as compared to the second Q of 2013. It's worth noting that exports in 2013 reached record levels. So, the base for comparison is becoming higher and higher. The Brazilian exports are growing in each quarter, reflecting a change in the dynamics of the global beef floating market, where the key exporting markets are becoming importers and the only region that is able to fulfill this growing demand is South America, especially Brazil.

With regard to the sale mix, Russia and Hong Kong remained the main destination for exports, the more seasonal variation seen in relation to the second Q 2013 was Venezuela, which increased beef imports from 11% in the second Q of 2013 to 18% in the second Q of 2014.

Average beef prices in dollars also moved up, which can be explained about only by the sale mix, but also by the stronger pricing power the Brazilian producers tend to have in phase of the industry global scenario.

It should be noted that the Chinese market was reopened to the Brazilian beef after remember that less than one-and-a-half year. Even though we export directly to Hong Kong, the end [ph] of the environment is very positive since they allow direct access to the clients, and enable the opening of a few distribution channels in this important consuming market.

Now, let's move on to slide 5, which presents our performance in the domestic market. Sales to the domestic market remained strong in the second quarter. Besides Mother's Day, which is typically a period of high demand for beef, the FIFA World Cup in Brazil also had a positive impact on sales in June, especially in hosting series. Additionally, as the slide shows, the price of cattle posted a significant increased in the year-over-year comparison.

On slide 6, we'll discuss the industry in Paraguay. The performance of the Paraguayan operation was extremely positive in the second quarter of 2014. After a period of adjustment, slaughtering resumed to growth, reaching a level similar to the second Q 2013. Despite a gradual increase in slaughter, growth term [ph] market the rationality have been stabilized the average cattle price. Additionally, Paraguay has benefitted from the strong international demand for beef, thus achieving good pricing in the countries to where it exports.

As was the case in Brazil, Paraguayan beef exports to Hong Kong increased significantly accounting for 18% of total exports in the quarter, 700 bps up over the second Q of 2013. Other highlight in the quarter was the Chilean market, which significantly increased the beef imports from Paraguay in comparison with the second Q 2013. I'd like to highlight the possibility of the openings of Peru for Paraguayan beef, which has been closed since 2011 considering the reduced supply of beef in this region, a potential reopening would be extremely favorable for Paraguay.

Moving on to slide 7, we will discuss the industry in Uruguay. In the second Q of 2013, the Uruguayan industry consolidated its process of margin recovery that began at the end of 2013. The average cattle price has remained stable in 2014, reflecting the positive cycle that is beginning in the country producing high cattle availability. On the other hand, reduced supply of beef on the international market combined with the exceptional access of (inaudible) niche market has allowed for a good pricing of Uruguayan beef. As a result, revenue from export climbed by 32% in the second Q '14 in relation to the first Q '14.

In this context, I would like to emphasize that last May we began operation of Frigorifico Carrasco at an extremely favorable moment of the Uruguayan industry. Let's move to slide 8, which details of Minerva operating results. In the second Q of '14, the company's slaughter volume started rising, again due to the increase in cattle availability. As a result, our capacity utilization reached 75.8% in line with the company's historical average, remaining a reference in the industry. We continued to allocate a significant share of our production to the export market in order to profit from the favorable scenario from Brazilian beef exports. In the second quarter, there was a 9% increase in the volume exported in comparison with the first quarter.

Let's move on to slide 9, which presents the company's export strategy in detail. In the last 12 months ended in June 2014, Minerva remained the second largest beef exporter in Brazil. In Uruguay, considering the pro forma share of Carrasco, our market share in 12 months increased to 16%. As a result, we consolidated the company as the second largest exporter of that country.

In Paraguay, we are the largest exporter with 16% market share. This slide also shows Minerva's export trend. In the period on the analysis, we can see a more balanced distribution of the sales among the region and it will highlight that. Asia has been constantly increasing its share of exports, reflecting increased beef consumption in the region. In the period, sales mix increased from 10% to 13%. It's worth noting that in July, the Chinese market was reopened to Brazil beef after an embargo that's starting in December of 2012.

This is a very good news in view of the potential growth of the beef consumption in that region. The Commonwealth of Independent States, in particular, Russia represents the main destination of our exports. In the last 12 months, this region accounted for 19% in Minerva exports, lower than in the 12-month period ended in June 2013, partially explained by Russian embargo of some Brazil plants in the 4Q of 2013, which has already been suspended. You know that the company relocated part of its exports previously sold to Russia to markets with higher margins, especially the Middle East, contributing to a more balanced distribution of our exports.

As a result, Middle East share increased from 18% to 20% in the last 12 months, with the main destination being Israel, Iran and Lebanon for Brazilian exports and (inaudible) of Paraguayan exports. This increase is also explained by our focus on niche markets, which present higher profitability.

In the second quarter, our exports to Europe rose -- we reduced the supply of beef in Europe and an increase in demand for finer cuts, especially volumes has allowed for good pricing of South American beef in Europe. As a result, the share of Europe in Minerva sales mix increased from 9% to 12% in the last 12 months.

Moving on to slide 10, this is the revenue growth in Minerva main business unity. In the second Q '14, the company gross revenue increased by 26% in relation with second quarter of 2013. The beef division grew by 9% led by the sales in the domestic market, which climbed by 20% driven by the higher price of beef, which in turn is strongly correlated to the price of cattle.

The other divisions moved up 108%, driven by the live cattle, resale and leathers operations, as shown on the top right corner in this slide. I will now turn to Edison who will comment the financial highlights.

Edison Ticle {BIO 15435343 <GO>}

Thank you, Fernando, and good afternoon. Slide 11 presents our financial highlights. Net revenue reached R$1.7 billion in the second quarter '14, up 25% year-on-year. I like to remind you that these figures already include two months of Carrasco's operation, but excludes Janauba and the service agreement with BRF, as Fernando had already explained.

Second quarter EBITDA totaled R$179 million, up 33% in relation to second quarter '13 with a margin of 10.8%. By adjusting this figure to the reversal of 15 million provision for tax contingency, adjusted EBITDA was R$164 million, an expressive growth of 22% in relation to Q2 '13, reaching a margin of 9.9%. As a result, return on invested capital moved up to 21%, 2.7 points higher than in the second Q '13.

And I have got a leverage reported as net debt-to-EBITDA ratio stood at 3.4 times, lower than the level presented at the end of the first quarter.

Let's move to slide 12. Slide 12 shows in second quarter '14, the company had a net income of R$18.5 million, reversing the negative results reported in the second quarter of '13. Net margin reached 1.1% in this quarter.

Now, move to slide 13, where we are going to talk about cash flow generation. Cash flow from operations was positive R$101 million in the quarter. Working capital observed at R$4 million and was positively impacted by the suppliers line, that release of R$63 million to the bridge, partially reversing the impact on the first quarter related to the purchase of cattling cash.

On the other hand, the biological assets line observed R$88 million in the quarter, been experienced by three main factors. The first one, the acquisition of a portion of cattle owned by BRF, which has not been adjusted yet, that had a strong impact on working capital account. The second factor concerns the live cattle segment strategy. In the second quarter, the company focused on the purchase of dairy cattle to be exported to Asia, which demand high working capital, but has lesser profitability.

And the last, the company made some partnerships for the purchase of cattle to ensure supply of feedlot operations that will take place in the second half of the year. Excluding out these three factors, operating cash flow would stood at approximately R$190 million in the quarter. The purchase of cattle represented roughly R$58,000, which is about 2.5% of Minerva's annual slaughter and is around 5% of the second half total purchase of cattle in the half, in the semester.

Moving on to slide 14, let's talk about free cash flow generation in the quarter. Free cash flow after CapEx payment of cash financial expenses and working capital was negative by R$78 million. As mentioned in the previous slide, the main impact came from biological assets, that should be added to the payment of the first installment related to the acquisition of Carrasco in the amount of $17 million or R$38 million. If we exclude these two effect, free cash flow would have been at R$48 million positive in the quarter.

Moving to slide 15, let's take a look at company's capital structure. This quarter our cash position were included the proceeds from the perp bond issued at the end of March. As a result, the company's cash reached R$1.9 billion in order to pay down all debt until 2022 as you can see in the chart. Excluding the bonds repurchased in 2013 and in the first quarter of '14, our cash position would be at R$1.6 billion. Short-term debt represented 19% of the company's total debt, with approximately 73% of our debt exposed to foreign currency variation. The capital policy of keeping a natural hedge -- a natural hedge in relation to the breakdown of our revenues that was above 70% in the second quarter.

Let's move not to slide 16, where we present the figures of the company's leverage in view of the issue of the perpetual bonds. From an accounting standpoint, we booked 100% of the perp bond as debt. By doing that, the company's net leverage stood at 3.4 times, as we have already mentioned. However, if you consider the perp bonds never need to be redeemed, the net debt-to-EBITDA ratio would be 2.4 times. This reinforces what we have been discussing since the first quarter conference call that the flexibility that this type of financial (inaudible) the capital structure is something worth for the management of the company.

Moving on to the slide 17, we present the sensitivity analysis of Minerva's leverage considering the recent acquisitions. In the chart presented on this slide, we have four different scenarios of EBITDA margins for the clients acquired recently.

Since we began operations at Carrasco at the beginning of May, these results are already consolidated in Minerva's figures. So, considering the EBITDA margin scenarios that's ranged from 5% to 12.5% in the last 12 months, EBITDA that reached R$655 million reported by the company at the end of this quarter, Minerva's leverage would range from

3.12 times, if you consider a margin of 5 times, which is less likely to happen, to 2.6 times if you consider 12.5% margin in the plants acquired.

This is on the recent track record of the company that has been presenting 10% of EBITDA margin in the past 24 months. We believe this is the most likely scenario. In this 10% margin scenario, leverage would stood at 2.8 times net debt-to-EBITDA ratio. Note that these figures are based on assumptions announced to the market by means of notice and material facts related to the operations, related to the acquisition transaction. This analysis also shows the company's and the management's commitment to continue expanding footprint to continue increasing revenues, to continue generating more value, but keeping the financial discipline. Thank you very much and I'll turn you over to the operator to begin the Q&A session.

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 today from Mauricio Martinez with GBM.

Q - Mauricio Martinez {BIO 16363988 <GO>}

Hello everyone and thank you for taking my question and congratulations on the results. My question is regarding the beef exports volumes. As we have seen some decrease in the last quarters, I would like to know if you expect volumes to increase during the remaining of the year, and if you do, how much should be from the organic front?

And my second question is regarding the CADE's approval. If you have any updates for the BRF assets that will be great.

A - Fernando Queiroz {BIO 15387377 <GO>}

Great. Okay, Mauricio. First, relating to volume, as we explained, the volume is up close to 10% if you compared the first half of the year to the first half of the last year. But to give you an idea of the trend, we just received the release of the exports for the month of July from Brazilian authorities. Its (inaudible) records in 117 million kilos. So, this does show that the trend is very positive and like Brazil keeps occupying the position of being the leading country in beef exports.

Regarding BRF, the CADE theoretically has until the end of the year to give final replay, but we believe that this will happen in much shorter period of time, but unfortunately it does not depend on us, so we cannot predict and give you a precise data for it to happen. But in the meantime, as you know, as we announced, we are renting the plant so the plant is operating not will all the efficiency that we expect to get when the plant is operating by Minerva, but we are already identifying the points of improvement, the points of the benchmarks that we will apply once we have the final approval of the anti-trust.

Q - Mauricio Martinez {BIO 16363988 <GO>}

Okay, very clear. Thank you.

Operator

(Operator Instructions) Our next question comes from Eric Owen of Citi.

Q - Eric Owen {BIO 20236387 <GO>}

Yes, hi, good afternoon, everybody, and congratulations as well on the results. Could you just give us your views on the cattle cycle, just how much longer, I mean, it's been very favorable now for two years or so and expectations remain favorable in the 2015, but can you just give us maybe a little bit of your insights on when you -- how long you expect this favorable cycle to last and when do you expect to see it to turn? Thank you.

A - Fernando Queiroz {BIO 15387377 <GO>}

Brazil is in a very positive dynamics, even though that the cost prices is going up, there is some retention of cows. But on the other hand, this is being compensated by the higher productivity that they are delivering. The cost cut of 2013 was that all time high, so this cattle will be available in 2015 and 2016. But besides that, Eric, what's happening is that the productivity is going up. So, the cattle is being slaughtered, younger and healthier.

So, this shows that Brazil is not only increasing the size of their herds, but also is increasing the production of beef. So, there is retention, but this does not happen in United States and in other countries. The retention that reduced the number of (inaudible) being slaughtered is only generating a positive dynamics of producing more cost in the years to come. So, Brazil is definitely consolidating its position as a leader, beef producer and exporter.

Q - Eric Owen {BIO 20236387 <GO>}

Okay. So, you're favorable not just for 2015, but also it sounds like well into 2016?

A - Fernando Queiroz {BIO 15387377 <GO>}

(inaudible) we see the trend of the company. Sorry --

Q - Eric Owen {BIO 20236387 <GO>}

No, I said just to keep it in a relatively final time frame.

A - Fernando Queiroz {BIO 15387377 <GO>}

Especially, because we are seeing a downtrend in the competing countries, so if I leave South America, especially Brazil as the main source of protein [ph] so our growing demand is coming more from the Middle East, from Africa, from the Eastern Europe and especially from the Far East.

Q - Eric Owen {BIO 20236387 <GO>}

Okay, great. Thank you.

Operator

(Operator Instructions) We do have a question from (inaudible).

Q - Unidentified Participant

Hello, everybody and thank you for the call. I would like to know I think you have a cash position of 1.9 billion right now as (technical difficulty) your plans for the future, what is your minimum cash requirements?

A - Edison Ticle {BIO 15435343 <GO>}

We have a financial policy of keeping at least two much purchase of cattle. As you can see, the company is growing, we are integrating at least four more plants into the end of the year, including Carrasco that was already integrated. We have three more plants to integrate. So, the monthly cattle need will be around R$400 million to R$500 million, which will lead us to have a minimum cash policy of around R$1 billion.

Today we have 1.6 billion in cash because from the 1.9 billion is R$300 million of bonds that we bought back in open market purchase. So, we could not consider those bonds as free cash, as liquidity. Our goal is to keep our cash higher than 1 billion, 1.5 billion, 1.6 billion is something very, very comfortable especially when you look ahead, especially for 2015 and 2016, and we see lots of challenges not only in the world in terms of liquidity, but especially in the Brazilian economy due to the macroeconomic scenario.

Q - Unidentified Participant

Okay, thank you.

Operator

Our next question comes from Jose Yordan of Deutsche Bank.

Q - Jose Yordan {BIO 1496398 <GO>}

Hi, good afternoon, everyone. I had a quick question about Russia, there's been some concern from investors about obviously the problems that Russia is having with the international community and their potential ability to get their hands on dollars and euros in the future. Can you walk us through how you get paid for your Russian exports and what the risk is here in coming months as you see it, that will be great? Thanks.

A - Fernando Queiroz {BIO 15387377 <GO>}

Jose, if you look at in detail, the (inaudible) the restrictions are for machinery, for military equipment and for some technology. There is no restriction for food. We keep the same policy in Russia for receiving between 30% and 50% of the money in advance before producing, and the rest through line of credit or cash against documents depending on the client and the track record that we have.

In fact that we are seeing so far no decrease on Russian consumption. If you look at the number that I just said on the record exports in July, the bigger part was through Russia. So, Russia keeps a markets that are still demanding and demanding volume.

Q - Jose Yordan {BIO 1496398 <GO>}

And turning that on its head, is it possible that Russia might trade more with South America than with other countries as a result of this whole thing and do you see any increases in their demand for your beef in the recent weeks?

A - Fernando Queiroz {BIO 15387377 <GO>}

Definitely, Russia is an important country of food, of grain, of meat and they are building stronger bridges very fast for South America. I don't think that Brazil will necessarily follow all the measures that may come from United States and Europe again to Russia. So, I believe that we will be left with less competition over there, and that means -- that translates into better opportunities.

Q - Jose Yordan {BIO 1496398 <GO>}

Sounds good. Thanks.

Operator

(Operator Instructions) This concludes the question-and-answer section. At this time, I'd like to turn the floor back over to Mr. Fernando Queiroz for any closing remarks.

A - Fernando Queiroz {BIO 15387377 <GO>}

I'd like to thank you all for participating in this call. And to wrap up by saying that we remain extremely focused and committed with the integration of the acquired assets, benchmarking all our units, aiming to maximize synergies and operational efficiency. To conclude, we remain very optimistic about the industry outlook and the outstanding position that South America has acquired in the global floating sector. We appreciate your attention and remain at your disposal for any further question or necessary clarification. Thank you and have a nice day.

Operator

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