Q1 2014 Earnings Call

Company Participants

- Janet McCollum, Chief Executive Officer
- Ricardo Florence dos Santos, Chief Financial & Administrative Officer, IRO
- Sergio Agapito Lires Rial, Chief Executive Officer & Director

Other Participants

- Alexander Robarts, Analyst
- Jose J. Yordan, Analyst
- Pedro Leduc, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning, ladies and gentlemen. At this time, we'd like to welcome everyone to Marfrig Global Foods S.A. Conference Call to present and discuss its results of the first quarter of 2014.

The audio for this conference is being broadcast simultaneously through the Internet in the website, www.marfrig.com.br/ir. In that address, you can also find the slideshow presentation available for download. We inform that all participants will be in a – only – able to listen the conference call during the company's presentation. After the company's remarks are over, there would be a Q&A period. At that time, further instructions will be given.

Before proceeding, let me mention that forward-looking statements are being made under the Safe Harbor of the Securities Litigation Reform Act of 1996. Forward-looking statements are based on the beliefs and assumptions of Marfrig's management and on information currently available to the company.

Forward-looking statements are not guarantees of performance. They involve risk, uncertainties and assumptions, because they relate to future events and therefore depend on circumstances that may or may not occur in the future. Investor should understand that general economic conditions, industry conditions and other operating factors could also affect the results of Marfrig and could cause results to differ materially from those expressed in such forward-looking statements.

Now, I will turn the conference over to Mr. Sergio Rial. Please, Mr. Sergio, you may now begin the conference.

Sergio Agapito Lires Rial {BIO 1925337 <GO>}

Very good morning and good evening for those that are viewing us from Asia. I'm particularly pleased today to have with me the CEO of Moy Park, Janet McCollum. She has been with us since yesterday. She came over the weekend to be part of the Moy Park presentation piece. I also have Ricardo's CFO - Marfrig's CFO, Ricardo Florenc. So, the three of us, we're going to be walking you through the presentation today. So, again, thank you very much.

If we go to the first slide, which is the slide two, giving a little bit of summary, an elevated speech of where we stand as far as the first quarter performance of Marfrig. We're able to reach R$4.8 billion revenues - rias, those numbers are in reais. And we're also particularly pleased to have hit most of the targets laid down in our 2014 guidance. So, margin 8.4%, which sits reasonably well within our range 7.5% to 8.5% pretty much on the top of the range. CapEx of R$143 million, and for the first time after long, long time being able to generate free cash flow - positive free cash flow at the end R$16 million. We're going to talk more about that later during the presentation.

So, all-in-all, this is the third consecutive quarter that we do improve our rating performance in all businesses, in different degrees for sure. This is the first time, as I mentioned before, in the long time we're generating free cash flow. This is something that we as management we have committed to deliver to the marketplace. This was articulated back in October during the Marfrig Day.

This is also serving a much better quarter, first quarter 2014, when I remember having joined the company at that point in time, having to come with my first quarter, which was first quarter of 2013. A very different Marfrig today than what we were then. So, this is the quarter where we hopefully we're going to be able to articulate where we've been spending time on the operational front to improve the quality of our earnings.

On slide three, we share with the market some of the analysts' estimates. We basically do exceed in some way EBITDA and EBITDA margin. The market was not particularly, I guess, expecting that we will be able to hit free cash flow already in the first quarter, on the back of what I would say two reasons. One, the first quarter seasonally, historically and it's one of the weaker quarters from - due to its seasonality particularly after the fourth quarter. Second, high prices in cattle in Brazil, which did put quite a bit of pressure on the industry in Brazil as evidenced by some of our competitors' recent believes forced a number of us to really be very, very skewed on how to manage working capital. So, I guess many analysts and the market itself was not necessarily expecting that we were able to cover the positive number. And we'll explain more what did we do.

So, first quarter highlights a good performance across all businesses. It's a reflection of focus to win. We are really paying attention to improve our operational performance in many different fronts, but the important piece is reliability of having a third quarter that is predictable that it's within range and something not coming with any negative surprises. Pleased to - really pleased to deliver critical milestone, a company that has for a long, long time as mentioned used cash as opposed to really generate cash. So we have stabilized the capital structure of the company. So from here onwards, it's got to be about improving it, and whenever we have an opportunity, to deleverage as well.

We did mention our attention to working capital, and in the fourth quarter, we made a significant effort around the inventory angle of working capital. And this quarter was a combination of different fronts. Our inventory, we're not able to keep inventory levels at the same levels of the fourth quarter. One reason is increased beef prices. I mean we're sourcing cattle 12% more expensive than the fourth quarter of 2013, but we were able and we continue to do so to optimize our sales channels particularly in the beef operation in Brazil. We'll talk more about that, but we have overall for the group been able to manage and lower our DSO, days sales outstanding, in about five days. We certainly hit the high end of our margin goal with 8.4% and most of the balance sheet ratios have remained unchanged and some dimensions have actually improved as you'll see.

On slide five, both Moy Park and Keystone have delivered solid performance but with very different answers to the performance. Moy Park did report - did post the highest first quarter EBITDA margin of recent years for the first quarter. And Janet will expand a little bit more on that and (07:37) on the back of a number of things, but definitely on the back of a more - a better utilization of the animal carcass. She will talk more about that.

Keystone certainly did suffer with one of the most severe winters in the Northern Hemisphere and in U.S. in particular that basically did reduce traffic, but has also benefited from, what I'd call, a pickup in a more trend towards normalization in Asia where price has started really responding. We have also initiated and continue to do so increasing our key account segment expansion in Asia-Pacific. And we were able to also have some of all those negative headwinds offset by lower raw material costs, some of that we did also benefit from the mark-to-market position, which we basically reversed some of the gains that we had embedded. And - but overall, a lot of good marks on cost management, a lot of good marks in the way they are managing risk overall.

Marfrig Beef, I mentioned, impacted by the drought and certainly had and continued to have in certain parts of Brazil not all over Brazil, but in certain parts of Brazil, a pretty severe drought. And although the number and supply hasn't really been impacted, most producers have really held up their finished products, which has basically - which basically pushed up prices as I mentioned before, between 10% and 15% from compared fourth quarter to first quarter of 2014. Situation has stabilized. We've seen a different flow of animals in April and as well as in May.

It has certain impact on margins, but we'll be very fortunate in having our Uruguay operation performing very, very strong. So, Uruguay posted a very strong quarter, very strong cash flow generation also in the quarter. And that has helped the beef business to post a very high, too very solid and healthy margin EBITDA margin of 9.5%.

So, overall, an EBITDA of R$403 million, 9.4% over - when compared to the first quarter of 2013. And that's important to mention that in the first quarter of 2013, relative to the first quarter of 2014, our volume in beef in Brazil dropped 15% just on the back of that first quarter of 2013 very different than first quarter of 2014 on the back of the drought, and how beef cattle prices have responded.

We have also, I think it's worth mentioning that, Argentina having done what we did in the second quarter of 2013 is actually paying off. So we did reduce revenues in Argentina by almost half. So in the first quarter of 2013, our Argentina sales revenues were around R$200 million for the first quarter of 2013, while in the first quarter of 2014, those sales are under R$100 million, but now in a breakeven position as opposed to significant losses last year.

Slide six, it's our attempt to bring us back to the Marfrig Day, those who basically give us a pleasure to participate into that day in New York and in Sao Paulo. We articulated where we were as a group, where we are heading, and I think this is more of a score card of the market to let you know where we are and to also reaffirm our commitment to monitor what we say to all of you. So, I think overall, I think we're on new track. I think we are delivering all the statements and bullet points that we have articulated to all of you, in particular, let's say, earning instability, so results are in line over the last three quarters. So we are progressing quarter-after-quarter improving our operational performance. Operating cash flow of the company in the fourth quarter, which was very active quarter for protein businesses overall, we have printed R$368 million, we now will move it to over R$400 million in the seasonally weaker quarter, it's normally in the first quarter. So we are progressing quarter-after-quarter in a number of dimensions. You're going to see that also in terms of margin expansion.

So, on slide seven, mention the fourth part of the quarterly results, the net revenue. It is definitely impacted by the decrease in volume in beef. I mentioned that first quarter 2013, first quarter 2014 only beef in Brazil, it's a decline of 15%, as mentioned before that has an implication to the revenue line. Second, the reduced revenues in Argentina, as I mentioned we certainly reduced that level, but increased the profitability of the business.

Keystone, pretty much no growth, when you adjust the 14.7% to dollar real (12:52). In Moy Pork, a modest growth, but more importantly then a quarter-to-quarter solid direction in terms of trend. Slide eight, worth noting the participation of both Keystone and Moy Pork in the overall gross profit of the company. So Moy Pork moves from 17% to 23%, as you can see in the pie chart. And Keystone also moves 2%. And that is still against a relatively solid margin in the beef business. So I think the international side of the company is progressing well, which gives us confident that having divested and having reduced our exposure to the consumer market in Brazil, it was the right decision for Marfirg. Most of the other comments are self-explanatory.

On slide nine, here we have an opportunity. Janet will say more about its own G&A ratio, and the increase of 90 basis points, for Marfirg, there is definitely an interest to develop further our sales platform. But having said that we are today as we speak analyzing our fixed cost structure of Marfrig Beef in Brazil to see if we can come to the marketplace with more challenging target for hotels to reduce the infrastructure. So, we are working with a well-known consultancy firm in this country that has worked with them about for a number of years, and we plan to come with better results as far as both SG&A reduction going forward. For Keystone, Keystone has really, really delivered steadily very strong, very strong performance related to the way they manage their costs and their efficiency initiatives.

On slide 10, margin of 8.4% and I think what is important here is to show is more than 50% of EBITDA margin business of Marfrig sits and happens outside of South America. That's point number one. And point number two, although the exchange rate - although the dollar here - of the dollar real moved - relative - moved to became - the real became slightly weaker relative to the fourth quarter, our numbers in the guidance have all being predicated on a real dollar exchange rate of R$2.4, which hasn't really happened in the first quarter either. So there is really solid performance posted by both Moy Park and the margin posted - margin expansion by Keystone. So you can see at the bottom 120 basis points for Keystone, 130 basis points for Moy Park, and 110 basis points for beef since the first quarter of 2013.

Slide 11, on the back of heavy and more stable and positive cash flow generation, net debt has reduced from R$7.1 billion to R$6.8 billion. I recall - I remind you of the R$408 million of operating working capital, an increase of more than R$15 million relative to the fourth quarter, which is fundamentally where it all starts, this is where it all starts. So, it is on that column prior to CapEx - prior to anything we do. So, that's the operating performance signal.

I'll pass now the word to our CFO, Ricardo Florence, to take us through liquidity, debt, and some balance sheet considerations.

Ricardo Florence dos Santos {BIO 20008948 <GO>}

Thank you, Sergio. As you said, this first quarter represented - was an important milestone and achievement in a long-time the company (16:57), which was the achievement of free cash flow, upper CapEx after interest expenses. On the liquidity side and on the debt side, all the key indicators of the company remain practically stable when compared to the fourth quarter of the last year.

We continue to go-on on the process of lowering the interest expenses. This quarter, we had a decrease of 10 basis points, achieving 7.9% of average cost in total of our expenses on back of the reduction of the average cost that we have in our short-term debt mainly trade finance lines that we have. And this is also a consequence of the exports that we have done in the form of Marfrig Beef in Brazil.

To share with you a little bit of the magnitude (18:11) does, it will also decrease 2 percentage points that we have on this amount. And in fact, the total at this point, it was not there only because they represent in the short-term debt close to 13% of the debt of the company.

Solid cash position of R$2.4 billion. Going to the page 13, part of this cash, we have continued with the liability management operations that we have done. We have said to the market that we will be doing this. And we bought back bonds of the maturities that we have in 2017 and 2021, in the total $132 million. Pro forma of this you can see in the upper part of graph on page number 13. It feels very comfortable the level that the company has in the short term. And as I mentioned, we have done this with a much lower interest rate than we had in the last year.

Going to the cash flow piece, on the cash flow, I believe the most important piece here is that if you remember EBITDA that Sergio mentioned on page number 10, we were able to monetize all the EBITDA that we generated in this quarter, R$403 million is what we had in the EBITDA and R$408 million is what we have in the operational cash flow before investments. We did this on the improvement of the trade account receivables of the company, inventory day increase during this quarter has the consequence of increase of cattle price in Brazil, and trade account payable they have decreased on back of the decreased volume that we operated in Brazil.

CapEx, which was a very important piece, we (21:07) in the range of the guidance that we provided for the full year of the market in that R$143 million in the period and R$249 million in financial expenses leading to a free cash flow of R$16 million in the quarter.

I'll pass now to Sergio to (21:40).

Sergio Agapito Lires Rial {BIO 1925337 <GO>}

Well, thank you, Ricardo. I think this is to – what I think is important, what slide 15 tries to give you, this is the first time I think we are absolutely sharing our free cash flow positions and you will see a very clear inflection point as from the third quarter for reasons that I think you are very aware. One is when we start really – when we took and finalized the transaction to have exited Seara and from there on our efforts really bring the company to a positive cash flow position.

Now, this is not happening on the back of financial engineering. This has and it is happening on the back of operational performance. Point number one. The fact that we have expanded margins in all business, but in particular, both Keystone and Moy Park have now moved to a 7% (22:39) type of margin and there will be higher peaks in couple of quarters, that's one. Second, the fact that within beef in Brazil, undivided attention exists today to all dimensions within the working capital equation. So, in the fourth quarter, there was a very significant effort on inventory management which we certainly got a negative impact back in the first quarter of R$99 million as you saw on slide 14 from Ricardo, part of that was explained – mentioned before the higher beef prices, but don't expect these levers to be changing that much.

So, in the case of the receivable side what we've done was more and more trying to reduce our exposure to the most, call it, negative large super markets in Brazil, which basically demanded payment terms that are not in line with our commitment to generate free cash flow. So, there was – we have reduced our exposure to the most negative customers, whose names of course we will not going to be sharing, that basically demanded and it's still do pretty significant negative terms for us, and we're able to outgain most of that volume with other wholesale customers with whom we are building a much more solid long-term relationship on a different fronts but we're not opening up now exactly what. But I can share with you that, it's the whole portioning stake (24:18) in Brazil, it's a (24:19), which we do plan to take a leading position as much as we can especially with some of the large wholesale names in Brazil.

The other piece that we did also that's increasing our volume to slowly quarter-after-quarter to the smaller business segment and definitely to the food service segment, whether it's the receivable terms or something better at some of the large supermarkets. All in all, we're able to reduce by five days the DSO of beef as such. And we have also, on the back of retail, it was generating positive fragment value for us, which counted around R$100 million of some of those receivable, domestic receivables. So, the combination of optimizing sales in terms of channels, discounting some of those receivables that were still done at a cost level of the retail was accretive to managing our cash flow.

And the undivided attention of the business because remember, you just have to look at some of our competitors in the beef space and they have been the first and is the ones who basically mentioned as prices went up 12% to 15%, the need to buy cattle more on-demand, it was certainly significantly higher. Just to be able to secure the animal in a quarter where animals were not necessarily in quantity and it being offered as frequently as we had seen back in the fourth quarter. This situation has normalized already in April and in May.

So, all in all, we feel good job in terms of how we manage our working capital I mentioned in beef. And that's where really beef Brazil is the one that has the biggest weight on this dimension. And to counterbalance that, Uruguay continues to do a phenomenal job. They generated cash and Uruguay producer have been (26:22) already know that sales account between 18% and 20% of the total beef business of Marfrig.

Now, moving on Keystone , so the picture – the (26:33) you see here is one of our JV in China, SKCF. So here you're seeing a slaughter plant. There is a process plant along the lines of this plant. It's one of the fully integrated sites that we have in Asia, and this is done with a local partner that basically have 40% of this JV.

So, on slide 17, Keystone's strategy – strategic goals have changed in the Marfrig Day. Poultry remains the thrust of growth. Key accounts, not anyway determinant of our focus to McDonald's, but growing other businesses outside of McDonald's world remains important and we're going to share that with you.

Geographic expansion. We did announce before, Indonesia. We are now looking at exploring the Middle East to be able to come with some more complete brands going forward. So on slide 18 chicken already represent almost 80% of what we're doing in U.S. Very important. I mean, part of that is nothing more than substitution coming from beef, consumption per capita in beef is declining on the back price. I still believe beef is a more preferred protein than chicken, but with the current prices whether you are in U.S. or Europe, chicken has benefited tremendously from additional demand coming the other way.

And we also shared with you some fairness of customers in the food service segment in U.S., not everyone grows in the same way. There are different business models that are - have been more successful lately than others and we try to pay attention to this. This is for us a radar where we paid attention and try to understand what drives growth, and hopefully, as much as we can align our resources and strategies, footprint to those customers that are winning. So we do pay attention to a number of models. And this is more of an attempt to share with you more of our marketing developments, how we see it and how we position ourselves as we select other accounts going forward.

Slide 19, it's another reflection of that. So here we share with you our growth in the key account segment, showing both U.S. and the Middle East. We don't plan to show that every quarter. That's not the intention, but this is an attempt to give you at least some perspective and context what has happened in terms of CAGR for this segment over the last couple of years. Remember that I think five years ago - five years to six years ago, Keystone was 100% McDonald's. And this picture has changed quite dramatically. The opportunity here in this graph is actually Asia. As you can see, the green, the light blue, is Asia Pacific where we haven't really not necessarily grown our key accounts to its full potential. We are primarily and fundamentally McDonald's supplier in Asia which we are very proud and happy. But as long as we increase production, as we make investments in Asia-Pacific, you should expect that growth to also be expanded as far as key accounts. And some of which may at the bottom of the page they are real names. So those are customers that we're really truly value and have helped us over last couple of years to allow Keystone to be where we are at this point in time.

Slide 20, now more with the focus on Asia-Pacific, no particular concentration on a given market with the exception of China, where we certainly still have a big opportunity to grow further. But it's totally natural to see China taking a disproportionate share from the pie chart in Asia-Pacific. Actually I would say we're small in China. I would say there's more of an opportunity than an issue. I would like to see China not as a target per se, but relative to their size to some of the other markets and I wouldn't be surprised to see China representing 50% if not more in the years to come in Asia-Pacific.

When you see Japan here, for Japan it is coming from Chinese export from what we have in Chinese manufacturing plant into the Japanese market, and we do export out of Thailand to Japan as well. On the graph close to the pie chart to your right, this is our volume. So as you can see pounds, so I think we find this to be a good reflection of the previous - of the recent growth of Keystone in Asia-Pacific. So a lot more to happen in terms of growth?

So, to summarize, difficult quarter on the back of net revenues or actually net revenue remain unchanged to decline, but very solid performance from a margin point of view despite the extreme winter. And APMEA, Keystone has done a very good job in-sourcing lower cost meat and certainly lower feed cost in the last couple of months.

The situations will certainly change going forward. Poultry prices remain very high. It's not very different than the picture you've seen in 2013. So, the meat that we are sourcing from the third-party - it's certainly going to be a challenging task. We feel very fortunate having increased the size of our birds over the last couple of years that has actually allowed us to significantly reduce our exposure to third-party meat and helping us to capture the right in poultry price across U.S. So those are good to our operational and industrial leadership. We are really running lot works on a number of plants in Keystone U.S.

And in Asia, more specific, we've seen better response in terms of product mix and customer response both in Korea and Thailand. In Korea, we added a new line. That new line is not fully reflected in this quarter, but will be reflected in the quarters to come. Korea is a pretty important market.

And these last but not least is Keystone's leadership in managing the SG&A. They by far at this point in time the best in class. They realize they don't have a lot of room to get it wrong particularly when top-line in U.S. in particular hasn't nearly responded to the full potential and the full recovery of U.S. economy. We are not seeing that at the micro level yet with the exception of being fortunate to develop new relationships with new winning models in the QSR segment in U.S.

With that, we're going to be moving to Moy Park. So it's my pleasure to have Janet, the CEO of Moy Park here with me. She is going to walk us through Moy Park's first quarter and some of the developments in the business. Janet?

Janet McCollum {BIO 17090604 <GO>}

Good afternoon. Thank you, Sergio. I'd just like to take the opportunity today to briefly share with you some of the key highlights and strategic goals for Moy Park; concluding also with the summary of the business financial performance highlights in quarter one 2014.

Moy Park is, as many of you know, the European division of Marfrig Global Foods, and the company is well-established and in the business over 70 years with its – very much farming and headquartered in Northern Ireland. The company specializes in fresh, high quality and locally farmed poultry, and also convenient complementary food. And we have a strong presence throughout Europe in both retail and food service channel.

If I can step to slide 23, Moy Park is a positive growth story, and this is very much an exciting time for the business as we continue our journey to become a leading and highly regarded food company in Europe. Indeed, we take this further (34:44) strong growing and profitable organization at Moy Park is today. And there are four key strategic goals as reflected at the market day in October that underpins our opportunity for growth.

First of all, we'll have to continue to grow our core UK and Ireland retail, fresh poultry, and convenience food sales ahead of the market, principally in poultry. Secondly, we'll have to continue the expansion of our multi-protein retail sales in markets right across the UK, Ireland, and Continental Europe, recognizing that we have other proteins in terms of turkey, beef and pork within our protein portfolio.

Our third key strategic goal is to boost our presence in the food service distribution channels again across the UK, Ireland, and continental Europe leveraging our strong presence in food service in Europe. And fourthly to become market global distribution platform in Europe leveraging there the connectivity where it makes sense across the group and particular with Keystone in Asia.

If we move on to slide 24, here I would like to just reflect on some of the key highlights of Moy Park. Almost three quarters of our revenue is positioned in the UK Poultry market. And this slide highlights why poultry is fastest growing animal protein in the UK.

As you can, there is a significant price differential between poultry and beef. And today, poultry represents very much a healthy versatile and affordable protein for our consumers. Events in Europe have also heightened our customers' and our consumers' awareness to (36:55) demand for local production. And a recent survey suggests that eight out of ten shoppers would buy British when available increasing the demand for British production. Looking forward, market data also predicts that poultry is forecast to grow faster than all other proteins showing positive growth.

Moving on to the second point, we at Moy Park are very proud of our second position, number two in fresh poultry. We provide high quality fresh poultry offering to our customers, and this also provides us with efficiency and scale, and secures an integrated supply of locally-farmed fresh poultry into our convenience operations. But we have also really built a strong position in our other value convenience food category that's both in terms of our fresh coated and ready-to-eat poultry categories.

The market today continues to demonstrate positive growth, as consumers look for quick and easy and convenient meal provisions. We have a strong brand position in Ireland and we are very pleased that Moy Park is now Ireland's leading poultry brand and it's actually purchased by over 50% of Irish households today.

Turning then to point three, Moy Park have a strong and diversified customer portfolio servicing most of the major UK and Ireland retailers and European food service customers, which you can see details below in slide 24.

And with many of these customers we have established longstanding and valued relationship over time through our commitments to producing high quality product. And we try to exceed our customers' and our consumers' expectations.

As I move on to slide 25 and point 4. The first point really on slide 25 is to give you a sense of our growth trajectory. Moy Park is a positive growth story and you can see that we've achieved in GB pound sterling 14% sales CAGR since 2008. And this group combines relatively modest acquisitions and the infrastructure of Keystone Europe and Continental Europe. We do remain relatively confident of being a high single digit growth company. The business, as you can see, is also really focused on strong cash flow and management initiatives continue to focus on operating performance, driving our EBITDA cash generation and effective working capital management as we continue to grow the business along with very much considered control and prioritization of our capital investments.

Over the last five years we reinvested our operating cash flows into the business to provide modernized and well invested facility in order to facilitate and drive our future organic growth. In point five outlining our strategic growth initiative. We touched upon points one and two, but I thought I'd just highlight the third key initiative here, which is to drive our growth agenda for both customers and consumers and that is innovation and channel development.

More recently, as Sergio highlighted when looking at the SG&A, more recently we have invested in talent and capability to further enhance and deliver leading consumer insights to our customers. That reflects investments in chefs, in new personnel with capability and consumer insights and category marketing and the investment still support our customers' desire to drive the differentiation by delivering innovation and we've also brought new capability into the business to support or drive to support our customers in these market channels. And that represents channels such as online and convenience store channels, which are becoming more and more propaganda (41:57) within our customers' portfolio.

On point six, we're very proud of both our people at Moy Park and also our well invested farming and operational facility. Moy Park actually has a unique vertically integrated poultry platform in Europe where we have three generations of stock. Our grandparents stock, parents stock and our broilers and our locally farmed poultry production platform right across Northern Ireland and England does provide an integrated supply chain from farm to pork providing traceability to our customers. We are at Moy Park are proud of our well invested farming business and providing the highest standards of animal husbandry and welfare across our space.

If I can move on to slide 26, food service now represents 27% of total Moy Park revenues since we assumed the leadership of the Keystone infrastructure in Europe last year. And I'd also outline, one of our key strategic initiatives is to boost our presence in food service right across Europe leveraging our expertise in Keystone Europe. And the graph here actually highlights that both France and the UK markets are two of the largest European fast food markets. And the data also projects continued positive growth across both of the markets.

On the right hand side, you'll note also that poultry represents a high percentage of the total food menu within France and UK largest QSR operators. And we have (43:59) located principally in France, principally focused on food service and supporting our journey to increase our food service across Europe.

Moving on to slide 27, you'll see here that the business continues to deliver strong top line growth over the last three years and that is why at the same time expanding our EBITDA margins by 270 basis points. And as previously highlighted, we have strong presence in the fresh poultry, fresh coated and the ready-to-eat retail categories in the UK. And we very much strive to ensure that our product quality, our integrity, our people and food safety are the best in the industry.

If I can just close on slide 28 and briefly summarize the quarter one 2014 key financial highlights. You'll see here that net revenues have reached R$1.3 billion in Q1 and that reflects 27% growth largely impacted by the positive effect of the exchange variation in the period. We do; however, continue to see positive underlying growth, representing 1% to 2% and that reflects strong growth in both our other value retail convenience product and also growth in our food service market. And this strong growth momentum in these three areas have been offset by some value decline in fresh poultry.

Looking at the EBITDA, you can see that there is an increase of 55% up to R$95 million as compared to the previous year and that's improvement of 130 basis points. The margin expansion is positively impacted by a couple of key drivers. Firstly, by our improved revenue mix as we continue to focus on driving value in our added value products and also a clear management focus on carcass utilization endeavoring to ensure that we sell all types of the birds. We have also delivered improved factory operating performance with better capacity utilization in our French facilities coupled also with productivity improvement and yield improvement across our operations.

So all-in-all, a flawless first quarter in 2014 reflecting our focus to win and Moy Park management's continued to focus on our organic revenue growth and EBITDA margin expansion.

Thank you very much. And I'll now hand over now to Sergio to present the Marfrig Beef overview to you.

Sergio Agapito Lires Rial {BIO 1925337 <GO>}

Excellent, thank you Janet. So moving onto Marfrig Beef. So the highlights here you see on slide 30, these are the strategic goals of the business in South America, one was definitely improve cash conversion. And I think the first – particularly the last three quarters, it is a reflection that a lot of the improvement of the working capital that I mentioned is coming from this business.

Number two, top line profitable growth, so not so much looking only at the revenue, but definitely looking at profitability. And I think Argentina is a classic case where we reduced our sales, but improved our operating performance, Uruguay, we actually increased our sales and increased our operating performance from a profitability point of view. And in Brazil, as mentioned before, reducing our exposure to the wholesale segment, selecting better those large super markets with only -- who certainly want to have a long term strategic relationship and exiting as quickly as we can those that have more of a transactional nature and developing the other channels that would allow us to channel some of this excess volume to.

Leveraging our beef sourcing potential in South America to connectivity, going back to Janet's point, where it makes sense, it's already yielding results where Uruguay is supplying 100% of all Keystone beef purchases for China. So we're not going to do it for the sake of just synergies, we're going to make sure that wherever we can compete, whenever the businesses can connect with one another, not at the expense of creating internal monopoly, but basically trying to see where value can be created connecting the international line of Marfrig to the unique beef supply chain that Marfrig has in South America.

So on slide 31, first quarter normally a weak quarter for beef, but despite the environment where beef prices had gone up, as mentioned before, double digit, 12% to 13% relative to the fourth quarter, we were able to keep a very healthy margin at 9.5%, Uruguay did help tremendously this quarter, but so did Brazil. Brazil continues to have improvements in a number of KPIs. We have better deals in terms of carcass utilization. We have in first quarter 2014, a lower capacity utilization on the back of more difficulties in sourcing cattle when compared to the first quarter of 2013. But we have reduced a number of waste in dimensions like packaging and more importantly now we're also, as mentioned, prior during the call, working steadily in seeing areas where we will reduce the fixed cost infrastructure of the business in Brazil.

We have just moved the entire beef business out of São Paulo City, which is a very expensive place to carry beef business, so we are headquartered as the beef business in the interior São Paulo, about an hour from the City of São Paulo where the square meter, in terms of rental, is four times less expensive than what we were paying in the City of São Paulo. These are small, but not less significant steps for recognizing that in South America, not only but in everywhere, particularly in South America it's so important to manage our fixed cost structure.

I see no reasons to be less optimistic about Uruguay. In the month of April, Uruguay had a very high phenomenal performance double-digit margin growth and margin EBITDA that are same and that should not change in my view in the near future.

Moving on to slide 33, a reflection of what has happened to our bonds since December 2013, the cut date here is May 2nd. So first of all, thank you. I know there are number of bondholders listening to us, I'd like to particularly thank you for having trust of management that we would be doing the right thing and we'll continue to be paying attention to what matters to all of you, but it also the reflection of how much potential we still have in terms of where the yields of Marfrig should be. So this has been a phenomenal story. We have bought back around R$132 million to R$140 million of the 2017s and 2021s as Ricardo mentioned before, and we will continue managing that curve very actively in the second quarter and the third quarter, so expect more of that.

Slide 34, also equity, we're starting to see the equity side of our company responding to what's happening both from an operating performance, from stability, but also from what's happening in its cost of debt. We absolutely acknowledge there is a lot of work ahead of us. We're not necessarily – we're delivering part of the story. The delivery would have to be with real net profit and a discussion around dividend, and not necessarily around cash flow, but we're still moving from a situation where cash flow was not necessarily least perceived by the market as being a key capability of the company.

We are building with you the track record that we will continue to focus on a classic deleveraging story, which is Marfrig. The faster we deleverage, the more the equity side will respond. We're acutely aware of that. And hopefully, in the future – hopefully not too distant future, we're going to be able to be talking about, net profits and definitely, dividend payments.

Final remarks. A good quarter, especially in light of being seasonally weak, it's an important milestone for the company having free cash flow, it's been a long while we were able to produce that to you, and I think that slide shown you in 2013, hopefully it's a good signal, the delta, so it plans (53:34) about the 2016 is from where we are coming. So I think not recognizing that in three quarters, we were able to bring the company to a totally different plateau will be a disservice to 45,000 people working very hard to make that happen.

We are very, very really, reassured by the commitment both from Janet and Frank, in focusing on profitability and in sustaining as much as possible at our current margins. We have moved Moy Park and Keystone to a 7% plus margin plateau. It doesn't mean that the 8% posted by Keystone, it's the new paradigm, I don't think so necessarily, but I do think both businesses have phenomenal positive growth thrust behind them and led by extraordinary people. So I think we have one of the best European operations as a food company, really proud of it. And Keystone having shelved – having managed the 2008 economic crisis in U.S., having developed in such a relatively short period, a significant key account business, I think it is, it'll be a disservice to the team.

And let alone Asia, where I think we still have tons of opportunity, both from a growth point of view, but also from a capital efficiency point of view and the geographic expansion that we mentioned. These continue to strengthen its performance, solid margins, we've given some sentiments that we are on top of working capital, something not perfect. We're improving performance in a number of KPIs which were not necessarily shared with you, but I can tell you just on optimizing carcass normally as you know the pieces must be divided in the front part of the animal and the back part of the animal. We have seen really world class yield utilization in some of carcass, it has been around 80% and we're getting very close to that as world class.

So we're really paying attention and the business is paying attention to industrial KPIs. We're also looking at HR (55:45) turnover to be important piece, cattle and people make the biggest piece of the cost infrastructure for the beef business. And last but not least, it is the relationship with our cattle suppliers, their excellent customers, we've done a real good job, we're the second largest beef company in this country.

Situation in the world do (56:09) not changed. I made some comments on Keystone and Moy Park, I'll not repeat myself, it is self-explanatory. And the last is certainly, thank you all for supporting the company, for believing in management and for having helped us to come to the first quarter or the third good from an operating performance of the quarter. And I know there could be some questions around Moy Park and Keystone listing. We are still preparing both business to be in a position if we decide to do so to be listed, nothing to really report beyond that. We haven't seen the market environment outside of Brazil changing that much. I think there is still a relatively benign equity markets both in Europe and in U.S. So we'll continue keeping – we'll continue building the optionality and be ready for their optionality if the right moment comes and it makes sense for us as a group.

For the rest, thank you very much. And we open up for questions.

Q&A

Operator

Thank you. Ladies and gentlemen, we'll now begin the question-and-answer session. And now our first question comes from Alex Robarts with Citi.

Q - Alexander Robarts {BIO 1499637 <GO>}

Hi, everybody. Thank you. Two questions, and I guess, I might get start off with the working capital improvement. You came in better than what we were expecting and I know, I heard on the earlier call in Portuguese, you've talked about account receivable management as one of the factors. I mean, the question I get then becomes, could you talk a little bit more about the space to further improve the account receivables, a piece of the equation? And how much color could you give us from this kind of the short-term working capital outlook, thinking also about maybe some of your raw materials needs and such? That's the first question. Thanks very much.

A - Sergio Agapito Lires Rial {BIO 1925337 <GO>}

That's very good question, Alex. So, I'm going to try to be as specific as I can. So first - so how much more can we actually do on the accounts receivable and then I'll also go to some other dimensions in the working capital chain.

On the accounts receivable, we'll continue paying attention to this wholesale segment. That's where's the biggest negative impact comes for beef because you're talking with large supermarkets that are expect to pay you beyond 30 days, although they give you 30 days, but from a real technical and operational point of view, you get the money in 40 days or 45 days. So that's a segment where we really cut a segment and price accordingly when they want to do that. What goes to our favor now, Alex, is that I think I do believe my competitors are also paying [a lot of attention to profitability. So I don't think we have an environment in Brazil that people are trying just to gain market share. So I think the wholesale customers are figuring out that the world is short of beef. And if the world is short of beef, the beef suppliers in Brazil have channels to put that beef somewhere else. So that's one.

Second, of the small business, which is a segment where Marfrig hasn't really built over the last couple of years, we're now gaining some traction. One of the things we want to do is to introduce a card. We want to make an alliance with a bank or factoring company that basically gives credit to the small business and pays upfront and we're now with two proposals we're contemplating the cost of that model. So of course there is going to be a friction cost and we want to make sure that that friction cost more than compensate two risks; the credit risk, which we'll not be taking, so that will be for the account of the financial institution; and the second one the fact that we'll get the money faster. So those two together have to make sense on a net present value relative to do it ourselves. That's the second point on accounts receivables.

On the third, still on accounts receivables is being as smart as we can in figuring out good export markets. For example, Iran is the market that actually pays us in advance. There are certain markets where we have better payment terms than others. And then the trade-offs are margin versus time. So we're constantly managing that where we channel our export relative to how fast we get the money in the bank and the margins. So I'm giving you just three.

On the inventory level, there is a lot more to do. We slipped from fourth quarter to the first quarter by R$100 million, not necessarily acceptable. And I think whether it's – and there, I think, both Keystone and Moy Park can be more challenging and can challenge themselves more, part of their inventory book, it is the grow up, I mean, there is a big chunk of that. But whenever we can have an influence in making sure that the turnover of the inventory increases and improves, they will and they should. So we do expect continuous improvement on the inventory dimension going forward.

Last, but not least we are working on the possibility of setting up a fund, which is called in Brazil, FIDC, which is nothing more than a conduit through which we would put, when it would make sense, some local sales and that I think only one of our competitors has such an equivalent conduit and we are now looking to put it in place, so when we have the optionality, whenever it makes sense relative to cost to use that conduit going forward.

Q - Alexander Robarts {BIO 1499637 <GO>}

Very helpful and very clear. We could say that you are standing path through (01:02:37) the guidance that you have gave up to (01:02:39) R$100 million in free cash flow.

A - Sergio Agapito Lires Rial {BIO 1925337 <GO>}

Yeah. We are still – we are reunderwriting our guidance in the first quarter, but more important we're reunderwriting with numbers, right. I mean, because – yeah, and we are not necessarily giving any guidance around second quarter, but I do think from a beef standpoint of view the tough supply in the first quarter should not be there. I think, we're seeing that already in April and May. And there is another important phenomenon, which is although the World Cup will not necessarily increase Brazil's consumption better, but we do believe there'll be an increased demand for a special cup, particularly for barbeque during the World Cup, so we're preparing ourselves to be ready to supply those cups (01:03:28) during the World Cup where we do expect an important increase of demand.

Q - Alexander Robarts {BIO 1499637 <GO>}

Okay. Very clear. And I guess the second question, just to take advantage of Janet being on the call and such, when we think about in the UK the food service and retail (01:03:53), if you could comment a little bit about kind of how you're seeing the competitive dynamic there? And should we be thinking about grain cost in the second half of the year as a potential challenge as an opportunity if you could comment on the food grains in second half that would be great? Thanks very much.

A - Ricardo Florence dos Santos {BIO 20008948 <GO>}

Okay. I'm passing on to Janet. Janet?

A - Janet McCollum {BIO 17090604 <GO>}

Yes. Thank you, Alex. And just to comment first of all in your first part of the question in terms of the market. In food service we are seeing an opportunity with our operations in France to continue to grow our share within food service, and indeed within our fresh poultry categories where more and more we are servicing our business-to-business on food service customers.

In terms of the grain pricing, predominantly our grain price is focused on wheat and soya. And for our wheat pricing we are covered largely through September in terms of our cover for our wheat.

Q - Alexander Robarts {BIO 1499637 <GO>}

Okay. Thank you.

A - Ricardo Florence dos Santos {BIO 20008948 <GO>}

Thank you, Alex.

Operator

Excuse me. Our next question comes from Pedro Leduc with JPMorgan.

Q - Pedro Leduc {BIO 16665775 <GO>}

Hi, thank you very much for taking the question and it would be specifically for more part there for Janet, the release mentioned the actions that led to labor cost reductions that helped you improve gross margins by a great bit this quarter. And we were wondering if you could elaborate on those actions and how we could see them evolve going ahead? And on the same token, SG&A rose slightly fast, we understand that it's part of our strategy to invest a little bit. But we understand also that you want to expand margins further there this year. So how can we model SG&A expenses for Moy Park evolving throughout the rest of the year? Thank you.

A - Janet McCollum {BIO 17090604 <GO>}

Thank you, Pedro. If I just be careful on that question, first of all on SG&A, whatever reflect is that in the market price remains a hugely important factor in the market. But more and more our customers are looking for a differentiation to drive that innovation, particularly in the convenient food sectors. And there's two key areas where that differentiation is focused. Firstly, on the agriculture supply chain, focused on higher welfare (01:06:40) and secondly, on innovation through development and consumer insight. So what you've seen is that we have consciously made an investment in developing further our capability and talent in food development, consumer insight and innovation. And we are starting to gain some traction in terms of the investments we have made with some positive initial feedback, indeed, from our customers. And so we want to continue the momentum in partnership with our customers to deliver new ways and new innovative products to continue to grow the poultry categories and then take to win with our customers and our consumers. So what you're seeing is an investment today where we can see that investment have been made and we look to continue to grow organically our top-line revenue and our margins.

Q - Pedro Leduc {BIO 16665775 <GO>}

Okay, okay. All right. Thank you. And could you mention also a little bit, you mentioned a little bit of average price increase of 1% now this quarter there. Could you elaborate if that was more of a mix driven effect? I imagine so.

A - Janet McCollum {BIO 17090604 <GO>}

I think, it was predominantly a mix driven effect with the increase in our convenience added-value products in terms of growth.

Q - Pedro Leduc {BIO 16665775 <GO>}

Right, Janet. Thank you very much.

A - Sergio Agapito Lires Rial {BIO 1925337 <GO>}

(01:08:15)

Operator

Our next question comes from Jose Yordan with Deutsche Bank.

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

Hi, good morning, everyone. Well, Janet, I've a question for you and then one on the financials. But when you look at your wish list of CapEx every year with Sergio, I've been interested in more or less how much sort of unsatisfied demand there is at this point given the capital constraints (01:08:45). In any event, how many – in other words, how many positive net present value projects do you have right now that are in the backburner until later – until – or until potential IPO?

A - Janet McCollum {BIO 17090604 <GO>}

Thank you, Jose for that question. Well, in terms of our capital investment, I'll keep saying in the presentation over the last five years, we have invested a R$180 million into our facilities and that's driving modernization and efficiency and new technology giving up the capability to continue to grow organically. And our investment is ahead of our depreciation. So we continue to invest probably in the business, and we prioritize those capital expenditure every year driven by quick paybacks, efficiency, technology, and have some safety floor plan.

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

But I mean I guess – I was trying to get an idea of whether there were – what kind of backlog there was of additional things you can do to improve efficiency, et cetera or are we now in a stage of more harvesting these investments in a lower requirement, let's say, for non-maintenance CapEx?

A - Janet McCollum {BIO 17090604 <GO>}

We continue to harvest the benefit – the investments we've made over the last five years and we're not in a position to share what our future capital commitments might look like. But we continue to invest purposely in the business to grow the business in the future.

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

Okay. Great. Thank you. And Sergio in the Portuguese call, you were talking – there were two questions or three questions about the receivable – the recoverable taxes issue, the big decline during the quarter. And I wasn't 100% clear, number one, what happened, why that it go down by R$100 million-plus. And number two, can we see additional declines in that balance sheet line or was it a one-time issue?

A - Sergio Agapito Lires Rial {BIO 1925337 <GO>}

Well, Jose, thanks for being on the call. If I understand correctly, so what we talked was on the accounts receivable, not on tax. So what we said – I think when I was now was basically saying, how much of what you produce is one-off, that was the embedded question. How much is the one-off versus something that is more sustainable. So, on the accounts receivable front, and what we said is, we didn't have accounts receivable. I did mention about what we're doing, but we also did R$100 million type of discounting that makes sense for us at that point in time, it certainly helped. And then the second part was, how much is that already tied up to the fund you're planning to setup in the second quarter. And I said not at all, those are unrelated pieces, nothing to dissolve (01:11:59). There was nothing related to tax. Our tax position remains relatively unchanged. I think we grew about R$38 million, that's (01:121:10). So it's relatively immaterial, but nothing to do with that.

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

Okay. That's clear. Thank you.

Operator

Excuse me, our next question comes from (01:12:24).

Hey, guys. How are you? Just a quick question on – I was just wondering where you are in terms of raising debt through Moy Park. I mean, when you guys came with a new bond issue and tendered through existing bonds, you mentioned that you may use Moy Park, which is relatively unlevered (01:12:46) cheaper debt and potentially move debt around the group, so you can reduce your interest costs. I'm just wondering where you are in terms of that process?

A - Sergio Agapito Lires Rial {BIO 1925337 <GO>}

Oh, gosh (01:12:57), you sound like a bondholder. Thanks for your question. Now, I know you've been – first of all, thanks, you've been a long follower and investor in the story. Where we are, what we said is, we're preparing both businesses to eventually be floated in some sort of way. In the case of Moy Park, I did mention that Moy Park is pretty much unlevered at this point in time. We're looking at ways to position debt more smartly throughout Marfrig. It doesn't make sense today Moy Park – Moy Park is an interesting debt shield on the back of its very strong performance. We're carrying most of the debt now in the range of 7% to 8.5% at the holding level, but still in levels that are significantly higher than I think what Moy Park could actually borrow. So, there is a good chance that we may borrow at Moy Park level. And if we do that always in the context of absolutely creating a positive net price and NPV story on the interest side and – but not in any way to increase debt level.

So we'll continue to reduce whenever we have an opportunity – debt level. So, it could be just a simple switch from one to the other. But again every time we say that our long-term bonds just keep on appreciating, right. So it makes always the exercise more difficult for us, but just in this period of being completely transparent, which is my duty and Ricardo's duty. Yes, we are certainly contemplating doing that. But whether we will do it or not, we don't know. And if we do it, it would be a combination of a long dated bond, probably a bullet (01:14:50) for Moy Park with some floating components to the debt structure and in a way and size that would be commensurate with Moy Park's cash flow position.

Q - Operator

Okay. That's very clear. Thanks, Sergio.

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

A - Sergio Agapito Lires Rial {BIO 1925337 <GO>}

So, first of all, I mean, thank you very much. I understand a couple of things on the macro front. Brazil hasn't really necessarily being the darling of markets over the last couple of months. I also understand the exchange rate risk. Some of you do run as you bring your money into Brazil, so it's not so much only the underlying soft story, but it's also at which point do you come into the country from an exchange rate point of you. I and the rest of the managements do, we are a classic deleveraging story. We have the management here that it's committed as much as we can to deliver value to you.

This not a complete quarter. We're not posting a net profit. We are posting free cash flow, which is a massive milestone change from where we were, but it's not sufficient. I feel confident with the team that we have, I really do. And I think we have top management aligned with the story. Our compensation goals (01:16:24) including myself, are what you see on the Marfrig Day on the guidance. So, the four numbers on the 2014 guidance is what is guiding the Marfrig bonus component going forward, so we couldn't be more aligned with all of you.

We also realize that it's not sufficient, they were not debating how much dividends we'll be paying in terms of a dividend policy. I mean there's been a while the company has talked about dividend policy. But this is the story of the company that produces real stuff. We're not a story of PowerPoint presentations. This is the story of the company that it's a food company from China to Chile producing real quality food for a number of consumers. I also believe our deep position and our deep infrastructure, that has incredibly well-positioned in a world that has become tight, whether it's U.S. with 89 million herd or Australia now being bend technically from its point to Russia due to macro issues and geopolitical issues. Brazil continues to be an interesting place in terms of origin of future beef supplies. The Chinese realize that and some of the other destination markets to where we're exporting do realize that. The rest is management, transparency not surprise you and hopefully the markets to help us to refinance, to continue reduce our interest burden, which we have done on the short-term debt, but not enough to really cut our interest expense to a much lower level. So there is a lot of works to do ahead of us.

But thank you very much. Thank you for your support. And again, keep on paying attention to us. We will continue doing what we say, we will do. Thank you.

Operator

Thank you. That does conclude our Marfrig's conference call. Thank you very much for your participation, and have a nice day.