Q1 2018 Earnings Call

Company Participants

- Eduardo Pirani Puzziello, Investor Relations Officer
- Fernando Galletti de Queiroz, Chief Executive Officer

Other Participants

- Andrew De Luca, Analyst
- Lauren Torres, Analyst

Presentation

Operator

Good afternoon, ladies and gentlemen, and thank you for waiting. At this time, we would like to welcome everybody to Minerva's First Quarter of 2018 Results Conference Call. Today, with us, we have Fernando Queiroz, Chief Executive Officer; Eduardo Puzziello, Investor Relations Officer; Francisco Assis, Controller; and Nathan Freire, Treasury Director. We wish to inform you that this event is being recorded and all participants will be in listen-only mode during this company's presentations. (Operator Instructions)

The audio and slide show of this presentation are available through a live webcast at www.minervafoods.com/ir and MVIQ platform. This 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 during this presentation relating to Minerva's business prospects, operations and financial estimates and goals. They are based on 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 operational 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 afternoon, and thank you for participating in Minerva's conference call on the results for the first quarter of 2018. You must have noticed in our earnings release we made two restructuring. The first was related to the disclosure of our results from now on. We developed a new layout that will increase the transparency of our results and improve the understanding of the operational dynamics in the different regions that we operate.

We have then divided consolidated gross revenue into three divisions. First, the Brazilian industry division, the international industry division, second and the third, the trading division. In the Brazilian industry division, we will report the results of our Brazilian units comprising sales of fresh beef, processed foods such as those produced by Minerva Fine Foods, and slaughter byproducts such as leather, offal, among others.

The second one, the international industry division market have the same scope but with originating products from Paraguay, Uruguay, Argentina and Colombia. Finally, we have the trading division, which concentrates revenues from live cattle operations from the trading companies and the resale of third party products in our distributions among the world. We hope these results will help you understand deeply the particularities of the different regions where Minerva is currently operating.

The second restructuring process was in the organizational side. Nowadays, the footprint of the company is more diversified. Therefore, we have different dynamics, so we decided to implement a new management model that fit into this new reality in which has -- as main pillars the extraction of greater operational synergies to give more agility for the decision-make and with no doubt to carry out the activities applying the best practices. We will comment the new structure at the end of this presentation after Puzziello financial presentation.

Let's begin the earning conference call talking about the highlights for the quarter starting on slide two. The company consolidated gross revenues totaled BRL3.8 billion in the first quarter and 14.4 billion in the last 12 months. 63% of first quarter revenues came from the export market. Of the total, the Brazilian industry division accounted for 46% of the total gross revenues while international division represented 40% and the trading division accounting for the remaining 14.

Talking about that again, 46% of Minerva revenues comes from Brazil, 40% from the other countries in South America, ex-Brazil and 14% from trading operations among the world. First quarter net revenues reached 3.5 billion, 65% more than in the same period last year. In the last 12 months, net revenue including pro forma figures of Mercosur assets came to 14.5 billion, 45% more than in the same period of 2017.

In this contest, the accumulated net revenues is in line with the guidance for 12 months period between July 2017 and June 2018 that we informed to the market ranging from 13 billion to 14.4 billion. Based on the first quarter results, we are maintaining this guidance. Besides, yesterday, we disclosed our new guidance, but now for the period between January and December 2018 ranging from BRL14.5 billion to BRL15 billion.

First quarter adjusted EBITDA climbed 44% over the same period in 2017, totaling BRL285 million, with an adjusted margin of 8.1%. In the last 12 months, adjusted EBITDA reached 1.3 billion, up 39% year-on-year. The adjusted EBITDA margin for the period was 9%. Given

[ph] the operating results, we never recorded operating cash flow of a positive BRL187.6 million and free cash flow of a positive BRL51.6 million. In the first quarter of 2018 this was a achievement that is worth mentioning because it's normally the worst quarter of the year and this also shows our commitment with cash generation.

We closed the first quarter of 2018 with net loss of 114.7 million. In the last 12 months, we recorded a negative net result of BRL398 million, impacted by non-cash effect of foreign exchange variation. Just to emphasize, this was linked to the currency variation and have non-cash impact. On the capital structure front, we closed the quarter with a leverage measure by the net debt to adjusted EBITDA for the last 12 months of 4.5 times, 0.1 less than in the last quarter of 2017. This movement shows the beginning of our deleveraging process. We continue with a comfortable position in cash of 3.9 billion in the first quarter. The duration of our debt was around six years on March 31, 2018.

Minerva continue to account for 22% of South American exports and remained the largest beef exporter in the continent. This does reemphasize how strong South America became in the world market of beef. So Minerva is by far the largest and the most diversified producer in South America.

Talking about integration process, it's worth mentioning that we have concluded the period of setting the SAP, the basis platform for controlling and having all the same standards in all the countries and we will continue pursuing improvements in our operational and commercial efficiency programs through benchmarks, through best practices and through exchange of our positive experience. It's worth mentioning the positive outlook for the opening of new markets in the coming months. As we have already mentioned, we expect the Japanese market to open for Uruguay. The Indonesian market just finished (inaudible) into Brazilian plants and shall be open still in the first half of the year. And also, important to mention, the possible reopening of United States for Brazilian and for Argentinean beef.

Moving to slide three, we will talk about the sector and we will begin talking about the sector in Brazil where we have 45% of our capacity. The slaughter has grown 4% between first-Q '17 and first-Q '18. In first-Q '18, beef exports came to 319,000 tonnes, 21% more than in the same period of last year. Strong export demand came mainly from Asia, Chile and the North of Africa. Also, with Middle East we had an important -- it was an important destination for Brazil.

The domestic performance was in line with the seasonal trend for the period, characterized by more modest beef consumption. We also had the impact of the replacement of beef with other proteins and the calendar effect of the carnival and Easter that fell in the same quarter compromising the beef consumption in this period. Nevertheless, with that, Minerva had maintained stable share, a stable volume of product in the Brazilian local market.

We are now going to discuss Paraguay, which concentrates 20% of our production capacity. You can see details on the top right corner. Paraguayan slaughter fell 17% between first-Q '17 and first-Q '18. The decline was related to the rainy season which made the logistics much more complicated and reducing the availability of movement -- and reducing the availability of cattle. And therefore, there was a reduction of exports because of that.

Chile also had some suspensions during this period, but this already got back to normal. So, Chile, that important market is fully normalizing for Paraguay nowadays. The main destination of Paraguayan exports was Russia, which accounted for 44% of the country's total exports in the first-Q '18, 12 percentage points more than in the same period last year, driven mainly by the ban of the Brazilian beef to Russia. Therefore, Paraguay was able to occupy part of the space left by Brazil.

In Uruguay, where we have 12% of our operation, the slaughter volume was 8% higher than in first-Q '17 and 7% over 4Q of '17. The higher slaughter volume was due to the drop in the country caused by La Nina which encouraged cattle producers to bringing forward slaughter. In the first-Q '18, Uruguayan exports performed well, up 16% over first-Q '17. The main destination of Uruguayan exports were China and United States, which accounted for more than half of the country exports.

Finally, moving on to Argentina which represents around 19% of slaughter capacity, the slaughter volumes moved up 8% between first-Q '17 and first-Q '18. It's worth noting that like Uruguay, Argentina also went through a drought caused by La Nina. Argentina exports volume once again performed exceptionally, climbed 56% over first-Q '17. This was an outstanding performance showing that Argentina beef is back to the world market with a well recognized brand. China was the main destination of Argentina exports in the period and accounted for 35% of the total exports, followed by Russia and Chile.

I would like to draw your attention to the beauty of Minerva geographic diversification. For example, Russia closed its market for Brazilian beef. We use it and we increased our production in Argentina and Paraguay and also in Uruguay to fulfill the gap. Therefore, we were exporting as Minerva more than when Brazil was open. To create value, when Chile reduced its Paraguayan exports, Brazil replaced that origin, also helped by Argentina. So this arbitrage capability is one of the Minerva most competitive advantages.

Argentina domestic consumption was also strong in the first quarter, it's another point that is relevant to mention. The typical seasonal effect and demand in the quarter was barely affected by the seasonality. Again, I draw the attention that we have from time to time sanitary events, we have currency events, we have different events that allows Minerva with geographic diversification to mitigate the risks. There is no other tool that is as efficient as the one that we have to mitigate the risks on the beef sector.

Now, let's analyze Minerva performance beginning with exports on slide four. In the first quarter, Minerva continued to be one of the leading exporters in the country where we operate. In Brazil, we once again had a significant 19% market share of exports. In Paraguay, our market share of exports came to 40%, a total record that shall be broken again in the second-Q, all time highs consolidating our position as the largest exporter. So not only in the first quarter, but in the second quarter, we consolidated our position as the most important and the most relevant exporter out of Paraguay. Meanwhile, in Uruguay, our market share corresponded to 21% of the total exports in the first-Q. And in Argentina, we were responsible for 16%, with all the exports of the country. And finally, in Colombia, that is a small basis, we are responsible for 71% of the total country's exports.

Moving to slide five, we will show the breakdown of exports by region and by division. So to showing the different dynamics, we divided the results of exports between Brazil, the international division in two separate charts. In the Brazilian industrial division, the Middle East stood out in the last 12 months ended March, accounting for 31% of the total exports, 3 percentage points more than in the same period last year. The second most important destination was Asia, which accounted for one-fourth of the division exports in the last 12 months. So if you added Africa, that's mainly North of Africa, the Maghreb area, you see the importance of the Islamic slaughter for the company.

In the international industry division that includes all the South American countries, ex-Brazil, the main destination was Americas, followed by Asia, with 29% to Americas and 28% to Asia, 6 percent points more than in the last 12 months of first-Q '17. This proves what we have been showing to the market in the last few months, about the constant growth in demand from Asia and Middle East, and the fact that South American exporters are consistently better prepared to meet these demands.

I will now turn up to Eduardo, our Investor Relation Officer, who will present the company's financial and operating highlights. Puzziello?

Eduardo Pirani Puzziello {BIO 15044272 <GO>}

Thank you, Fernando. Good afternoon, everyone. We will present Minerva's financial and operating highlights as of slide number six. Fernando mentioned in the beginning of the presentation, starting this quarter, we are dividing gross revenue in three groups and we can see the evolution of each of these groups separately on this slide. Gross revenue from the Brazilian industry division came to BRL1.7 billion in the first quarter, around 22% higher than in the first-Q '17. Gross revenue from the international industry division reached BRL1.5 billion in the first-Q '18, around 165% more than in the first-Q '17 as shown in the graph on the top right corner.

In addition to the organic growth operation, this performance was related to the addition of these new assets as of last August. The capacity utilization rate of our Brazilian units stood at 80.1% in first-Q '18, more than 10% higher than in the first-Q '17 while the capacity utilization rate of our units in Paraguay, Uruguay, Argentina and Colombia stood at roughly 72%.

In the next slide, we will continue talking about the financial and operational performance of three divisions. But now we are talking -- we will talk about the trading division revenue, which stood around BRL513 million in the first quarter of 2018, around 70% above what we saw in the first-Q '17. This increase was driven by the improved performance of the live cattle segment combined with our strategy of re-selling third-party products in the domestic market and our protein trading operations in the export market.

In the bottom right graph, we also presented the share of each of the three divisions in the gross revenue breakdown showing the importance of each division that makes up our consolidated operation, as Fernando mentioned in the beginning of this conference. The Brazilian industry division accounted for 46% of the gross revenue, the international industry division represented 40% and the trading division accounted for the remaining 14% of the total gross revenue. Minerva's net revenue totaled BRL3.5 billion in the first-Q of 2018, 65% more than the same period of last year.

Adjusted EBITDA amounted to BRL285 million in the first quarter, also 33% higher than the EBITDA of the same period of last year and the EBITDA margin reached 8.1%.

So now turning to slide number eight, we are going to talk about the net results for the first quarter of 2018. As you can see in this slide, the company reached record net loss of BRL114 million after income and social contribution taxes in the first quarter of '18 and in the last 12 months ending March, company recorded a net loss of BRL398 million. As Fernando also mentioned at the beginning of the presentation, all related to the non-cash impact of the currency variation.

Moving to the next slide, we will talk about the cash flow, the operational cash flow of the company. In the first quarter of 2018, the operating cash flow was positive BRL187 million. Adjustments to the net income totaled BRL269.5 million, while the working capital variation was positive by roughly BRL33 million. In the first-Q of 2018, the positive working capital was a result of receivables line which returned approximately BRL331 million [ph] to our cash and also another positive contribution came from other payables line.

Please bear in mind that these lines reflect the company's credit policy and contains the prepayment from some clients according to their credit risk. On the other hand, the supplier line consumed BRL234 million, because the company paid cash for the purchase of more raw materials. In the last 12 months ending March, operating cash flow was positive by around BRL596 million. Adjustment to net income totaled approximately BRL1.5 billion, while the change in the working capital requirement was negative by BRL460 million.

Turning to slide number 10, we will now touch on the free cash flow for the first quarter of 2018. As you can see, the adjusted EBITDA reached BRL285 million while cash -- CapEx came to roughly for BRL48 million. The financial results with cash effect stood at around BRL218 million, while the variation in the working capital, as I just mentioned in the previous slide, reached BRL33 million. So as a result, the free cash flow was positive by BRL51.6 million in the first quarter of 2018.

Regarding the free cash flow of the last 12 months, the EBITDA reached BRL1.2 billion, excluding the pro forma figures of the Mercosur assets. Maintenance CapEx came to BRL258 million. Cash financial results for the last 12 months reached BRL795 million and the variation of the working capital requirement was negative by BRL416 million. So the results of the last 12 months free cash flow of the company was a negative BRL277 million.

Going now to slide number 11, we are going to talk about the capital structure of the company. Our leverage measured by the ratio net debt to EBITDA of the 12 months reached 4.5 times at the end of March, 0.1 times lower than the first-Q of '17. So as also mentioned by Fernando in the beginning of the presentation, it's the beginning of the deleveraging process of the company. Our cash position was BRL3.9 billion, sufficient to make us very comfortable to deal with the adverse scenario and settle out debt due in 2024. And at the close of the first quarter of 2018, roughly 80% of Minerva's debt was exposed due to the FX valuation with a duration of close to six years.

I will now return the floor over to Fernando who will talk about the new remuneration structure and also talk about the -- and then we're going to go to the Q&A.

Fernando Galletti de Queiroz {BIO 15387377 <GO>}

Thank you, Eduardo. As I previously mentioned today, Minerva is part of a new reality with a relevant, with a much more relevant geographic diversification. We are in a sector that is becoming more and more global. So we must be more apt to deal with the different dynamics and particularities of our company and on the locations and the geographic locations that we are, aiming to attract the best synergies from the unities.

To improve the integration between the management and to apply the best practice in the decision making, we re-adopt the company organizational structure. Thus, we started this new role of a Global Chief Operational Officer that is global, that will be played by our current COO, Mr. Iain Mars who many of you already met. Iain is with us for 10 years. He has participated in the growth plan and is fully aligned with Minerva dynamics and he share our business plan from the very beginning. He will coordinate the operational management team in Brazil, in Argentina, Paraguay, Uruguay, and Colombia and from the related business.

Another changing that we made was the restructuring of the financial department. Eduardo de Toledo left the company and we will have now three areas that are, first, risk and control under Francisco de Assis' supervision who is with us for seven years; Treasury with Nathan Freire, who is with us for eight years; and third, Investor Relation with Eduardo Puzziello here at my side, who has been in the company for eight years. These areas are 100% integrated and fully aligned with me and with the company strategy.

Once again, I would like to highlight that Minerva's main focus is the deleveraging process through the various traction from our unities and working capital management. During the integration process, I was focused on the operational side, and now with this step concluded, I will return to focus on the strategic level. This explained why we have decided to have a new structure to follow our principles, discipline, focus and consistency.

Finally, I'd like to mention that the achievements and the results from Minerva are due to the work of not only one person but more than 18,000 people. We emphasize their commitment and their search for a consistent improvement. I will now hand over it to the floor to start 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) Lauren Torres from UBS would like to make a question.

Q - Lauren Torres {BIO 7323680 <GO>}

Yes, hi. Thank you. Hi, everyone. Fernando, you were clear about the restructuring, but I'm just curious to get a bit more of your perspective on what changed in the last few months. We had the appointment of the CFO just a few months ago. So curious I understand the visibility, the clarity having executives at firm to fill these spots now, but I think with some nervousness in the market with management changes at the high level, curious to get your perspective on kind of what changed just in the few month time to do this restructuring now?

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

Well, there is not much that has changed, Lauren. Since we acquired the operations of Mercosur, they -- we've been preparing the company for restructure of having a COO, a global COO that would consolidate the operational part. So, that's what we shared with our Board, this has been discussed with our team. So, it was time to implement. What really was -- what is different that is happening at the same time that we had -- we had the no election of Eduardo de Toledo. Once you have a new -- even though you can make a good search and a new hiring, you got to know the person when it comes to the day to day. So there is always risks and uncertainties from both parts by having changing on the high level.

What we used was the common sense to recognize into change the structure with the team that we feel very comfortable that's the team that are with us for more than seven years and it's a very senior team that have been conducting the operations and have been conducting the strategy of the company for all this time. So it's not something that is -- it happened now, it's something that was planned and it was adjusted with this new senior team on the financial side.

Q - Lauren Torres {BIO 7323680 <GO>}

Okay. Right, that's helpful. And if I could just ask some questions on the results. Just curious on the margins. There were some items affecting margins in the quarter, but the integration now more or less done, curious to get your perspective on directionally where margins can go for the remainder of this year. And then also on leverage, I think you've given some general leverage target for us to think about in the next 12 months or so, can you talk about if we do have a leverage, a public leverage target?

A - Eduardo Pirani Puzziello {BIO 15044272 <GO>}

First, on the margins, the margins, normally the first quarter of the year, margins are lower. This is part of the seasonality. This year we had some good surprises and bad surprises. What was below our expectation was Brazil. The competition in Brazil was -- had increased, therefore, there was a compression in margins in Brazil. The positive surprise came mainly from Argentina, that outperformed what we expected. So -- but giving our view for the second-Q, we see Brazil normalizing, we see Paraguay also taking the new increase on volumes. What happened is that, in the first quarter, there was some retention of cattle due to the logistics, now it's normalized.

And Argentina keeps performing well, especially with the model that Minerva implemented by being focused on exports. So exports, especially now that the peso has devaluated make us even more competitive. Just to give you an idea, first-Q, if you analyze Argentina individually, first-Q '17 versus first-Q '18, the increase on exports out of Argentina were at 135%. So we don't give guidance of what would be the deleverage that we will reach by the end of the year, but definitely our focus is to decrease the deleverage. We have our internal goals, we have our internal measures that we are taking. That is leading to some small results on the first-Q and we shall continue on that path for now on.

Q - Lauren Torres {BIO 7323680 <GO>}

Okay. Thanks.

Operator

(Operator Instructions) This concludes the question-and-answer session. At this time, I'd like to turn the floor back --

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

Sorry, there is another question there that we have no problem of --

Operator

Mr. Andrew De Luca from Barclays would like to make a question.

Q - Andrew De Luca {BIO 18025129 <GO>}

Hi, yes. Thanks for the question. I just wanted to follow up on the prior question on the competitive environment in Brazil. Can you just give us sort of color on your outlook in terms of how you're expecting that margin to evolve? I mean, it sounds like obviously the Argentina side of the business is improving but what's your outlook for the competitive environment for Brazil for the rest of the year? Thank you.

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

What's happened in Brazil is that we are in a positive side of the cycle. The increase of supply, the increase of availability of cattle is shown and you can see in the prices that had go down. Not only that, but with the Brazilian currency devaluating, this you have a further impact in dollar terms for the cattle that we are purchasing. So this only consolidates South America, in Brazil, in Argentina, in Paraguay as the main, the most competitive supplier of beef worldwide. So we see the competitive environment more stable and more healthy for the rest of the year in Brazil, mainly because there is more cattle and there is more rationality.

Q - Andrew De Luca {BIO 18025129 <GO>}

Thanks. And on the back of the greater cattle availability and rationality, are there any concerns of additional capacity that's going to be coming online from JBS, for example? Thank you.

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

We are not seeing any move. This is something that we don't control what is happening to -- but -- in our competitors, but we don't see any major change on that.

Q - Andrew De Luca {BIO 18025129 <GO>}

Great, that's very helpful. Thank you.

Operator

This concludes the question-and-answer session. At this time, I would like to turn the floor back to Mr. Fernando Queiroz for any closing remarks.

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

I'd like to end this conference call, first, with saying that we are very confident with the changes that the company is going through. We believe that we will continue bringing positive results, and consolidating our position of being the leaders of exports out of South America. And I would like to thank once again Minerva entire team for doing the best for the company and for making us through their efforts and dedication the leader of South America. It's a multicultural company, it's a company that's diversified. And lastly, I would like to thank you all for the interest in the company and we remain at your disposal for any questions and clarifications. Thank you very much, and do not hesitate in contacting us.

Operator

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