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Q4 2018 Earnings Call

Company Participants

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

Other Participants

- Julie G. Murphy, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good afternoon, ladies and gentlemen, and thank you for waiting. At this time, we would like to welcome everybody to Minerva's Fourth Quarter and the Year of 2018 Results Conference Call. Today with us we have Fernando Queiroz, Chief Executive Officer; and Edison Ticle, CFO and 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. The audio and slideshow of this presentation are available through the live webcast at www.minervafoods.com/IR in MVIQ platform. The slideshow also can be downloaded from the webcast platform in the Investor Relations section in this website.

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

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

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

Fernando Galletti de Queiroz {BIO 15387377 <GO>}

Good morning or good afternoon for everyone. Thank you for participating in Minerva's conference call on the results for the fourth quarter and the full year of 2018. 2018 was a year full of opportunities and we are able to harvest the fruits of our growth strategy through the geographical diversification of our operations according to the business plan that we shared with the market a few years ago.

We currently have one of the most modern industrial parks in the continent and we are the leading beef exporter in South America, with 21% of the region's total exports. It's worth mentioning that according to USDA, our latest estimates, South America was responsible for around 34% of the global exports in 2018. Therefore, Minerva account for around 7% of the global beef trade in the year.

As a result of our geographic diversification, which allow us to access better markets combined with our recognized operational excellence and supported by our business intelligent with our risk management tools, Minerva closed 2018 with a healthy operational performance, including record net revenues and most important, a strong cash flow generation. We will now begin our presentation and discuss the main highlights for the year. Let's start on slide 2.

Slide 2, Minerva shows that we closed 2018 with a free cash flow to equity of BRL 752 million, corresponding to our free cash flow yield of 40%. In the fourth quarter alone, Minerva recorded a free cash flow of BRL 363.3 million, with operational cash flow of BRL 340.1 million, underlining the positive moment of our operations.

In 2018, consolidated gross revenues totaled BRL 17.2 billion, a new record of revenues. In the fourth Q 2018, Minerva gross revenue totaled BRL 4.9 billion on the quarter. Analyzing the revenue's breakdown in the fourth Q 2018, 41% of the gross revenue came from the Brazilian Division, equivalent to BRL 2 billion. Athena Foods, our subsidiary that comprises operation in Paraguay, Argentina, Uruguay, Colombia, and Chile, also generated another BRL 2 billion in revenues, equivalent to another 41% of the consolidated revenues. This shows the balance between our operations in Brazil and the rest of South America.

Finally, the Trading Division accounted for the remaining 18%, contributing with BRL 866 million through the consolidated gross revenues. Minerva exports grew 24% in the fourth Q of 2018 over the 2017, accounting for 60% of the consolidated sales and moved up 40% in 2018 over 2017, accounting for 62% of the consolidated sales.

EBITDA totaled BRL 463 million in the fourth Q 2018, 27% more than in the fourth Q of 2017, accompanied by an EBITDA margin of 10%. In 2018, EBITDA came to BRL 1.6 billion, up 23% over 2017, with an EBITDA margin of 9.6%, 60 bps more than in 2017.

The pursuit of (00:05:49) more efficient capital structure continues to be the priority of Minerva. We closed 2018 with a leverage measured by the net debt/EBITDA ratio of 3.9 times, 1.1 time less than in the previous quarter, showing our commitment to the leverage.

In line with our debt reduction plan, Minerva completed a private capital increase totaling BRL 960 million (sic) [BRL 965 million] at the end of the 4Q 2018. It's worth noting that most of the proceeds of the operations were used to tender the largest share of our perpetual bonds, $225 million that was our most expensive debt.

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We will now move on to slide 3 where we will discuss our performance in 2018 in further details. We'll begin with our exports, always analyzing our revenue in market share. In 2018, our share of the Brazilian beef exports came to 18%, with a volume growth of 12% year-on-year. In Paraguay, driven by 34% growth in export volume, we reached a market share of 41%, consolidating our position as the country's main beef exporter.

In Uruguay, our share of exports came to 21%, 6% more than in 2017. In 2018, our share of beef exports came to 15% in Argentina and incredible 73% in Colombia. As I mentioned, Minerva has consolidated its position as the leading South American exporter, with a market share of 21%. Now moving to slide 4, we will take a look on exports by destination.

First, in the Brazilian Division, Asia and Middle East were the main markets in 2018. Together, these regions accounted for 52% of the exports in the period. As you all know, Asia and Middle East are recording a consistent increase in demand for beef. We can attribute this growth to the development and the urbanization of this region together with the changes in habits of consumption from the population.

Also, it's important to highlight two points: the spread of the African swine fever in China, impacting in a direct reduction of pork production. There was an article showing that it's already estimated in 15% the reduction in the total pork herd in China. Also, the natural problems that Australia is facing with droughts and floods that's also impacting the herd today but also compromises for the future and this is definitely an opportunity for South America.

Another highlight on the Brazilian Division was the increasing shares of Americas to 15% in 2018 versus 7% in 2017. The 7 percentage points growth was mainly represented by our increase in the Chilean market.

Now, talking about Athena Foods, Asia was also the main export destination, with 36% of the total, 10 percentage points more than in 2017. The reasons are the same ones that we mentioned before. The second main destination was the Commonwealth of Independent States, especially Russia, up 40% year-on-year. The result was intensified after Russia banned Brazilian beef imports, rerouting its demand to other export countries in South America, especially Paraguay, Argentina, and Uruguay and Colombia. Thus, it's very important to be geographically diversified and this allows us to take advantage of all market opportunities.

Our next slide will comment on our performance in the local markets. In 2018, we worked hard to optimize our domestic sales. We increased our capillarity while remaining focused on the more resilient markets such as more medium-sized retailers and foodservice, which comprises bars & snack bars, restaurants, catering and steakhouses. These are the clients that we are serving now through our distribution mainly and which accounted for 54% of the domestic sales from Brazilian Division, which shows the fragmentation and how spreaded we are in the capillarity that we have.

We still have third-party products, products that are not produced by Minerva operations, accounted for 38% of the domestic market in Brazil in 2018 and this is another special

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highlight. The one-stop shop strategy offer clients a wide range of products including fish, fruits and vegetables, cheese, pork, and lamb, among others. This shows that the distribution has the strength to sell not only Minerva products but also from other industry.

At Athena Foods, our strategy to reposition the processed foods under Swift brand in Argentina and the sales of fresh beef to our five distribution centers contributed to 67% increase in domestic sales in 2018. Minerva and Athena are focused on the more resilient markets, not depending on big retailers but also spreaded around the biggest growth that we see in the market and always searching for the highest profitability and consistency.

I will now – I will turn the floor to Edison who will discuss the main financial numbers.

Edison Ticle Melo e Souza Filho {BIO 20119771 <GO>}

Thank you, Fernando. I will now present Minerva's financial and operating highlights (00:11:52) slide 6. The gross revenue from the Brazilian Industry Division reached BRL 2 billion in the fourth quarter 2018, a growth of 2% when compared to the fourth quarter 2017. Athena Foods gross revenue also reached BRL 2 billion in the fourth quarter, a growth of 37% when compared to the same quarter last year.

The Trading Division reported gross revenue of BRL 866 million in the fourth quarter, a growth of 10% compared to 4Q 2017. It's important to highlight that the Trading Division comprises revenues from live cattle operations, Energy Trading and our protein trading business especially located in Australia.

As we mentioned at the beginning of the presentation, the revenue breakdown shows that each of our two industry divisions, the Brazilian Industry Division and Athena Foods, accounted for 41% of the company gross revenue, while the Trading Division was responsible for the remaining 18%.

Let's move on to the next slide to discuss more operational and financial highlights. The company's consolidated net revenue reached BRL 4.6 billion in the fourth quarter, up 16% over fourth quarter 2017. On the top right corner, we have our fourth quarter EBITDA that reached BRL 463 million, a 27% growth when compared to 4Q 2017, reaching an EBITDA margin of 10%, up 80 basis points year-on-year.

And now, talking about the company's capacity utilization rate, at the end of 2018, we kept the utilization rates around 80%, which we consider to be very close to what we would call ideal level. The Brazilian Industry Division operated at a utilization rate of 76% (sic) [79%], while Athena Foods ran at a capacity utilization of 79% (sic) [76%]. As a result the company's consolidated capacity utilization stood at around 77%, 2.2 percentage points lower at the end of 2017. Just a correction, Brazilian Industry was at 79% and Athena Foods was at 76% in the fourth quarter.

I would like also to emphasize that one of the highlights of our working capital management was a reduction in our inventory cycle, which came from 28 days to 20 days

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by the end of 2018. Our benchmark for the inventory cycle is around 18 days and we will pursue this target on the coming quarters.

Let's move now to the next slide to talk about the consolidated figures for 2018. In 2018, net revenues reached BRL 16.2 billion, with a CAGR rate of 19% in the last four years. As a result, we exceeded our net revenue guidance for 2018 in approximately 1%. The guidance was between BRL 15 billion and BRL 16 billion and we reached BRL 60.2 billion (sic) [BRL 16.2 billion] in the year. EBITDA reached around BRL 1.6 billion in 2018, a growth of 22% compared to 2017, reaching a margin of 9.6%, up 60 basis points comparing to fourth quarter 2017.

Return on invested capital came to 22% in 2018, up 4 percentage points over 2017. In the fourth quarter of 2017, just to remind you, we started the integration process of the operations that we acquired in South America in 2017, and the integration process had an impact on our return on invested capital level that was above 20%. In 2017, it reached 18% but during 2018, we were able to manage the integration successfully and it reached 22% during the year.

Finally, in the same slide, we can see the net debt/EBITDA ratio that ended the year at 3.9 times, a reduction of 1.1 times quarter-over-quarter and a reduction of 0.7 times year-on-year. It reaffirms our commitment to accelerating the company's financial deleveraging process.

Let's move now to slide 9 to discuss net result. We recorded a net loss of BRL 92 million in the fourth quarter after taxes. However, excluding the non-cash effects of impairment, monetary correction regarding our operations in Argentina and other non-recurring effects, especially in the financial result, the net result would turn into a positive of BRL 27.4 million before income taxes and social contribution. Let's move now to next slide to discuss the company's operating cash flow.

Operating cash flow reached BRL 340 million in the quarter. I think the improvement on working capital cycle this quarter was the main contributor to this result and was mainly due to the contribution of the customer advances line under the other payables that reached BRL 244 million in the quarter. We would like to point out once again that this line reflect our credit policy which requires certain foreign client to make advanced payment before getting our products.

Another positive contribution came to the line in inventories, as I have already mentioned, which returned BRL 187 million to our cash and reduced the average cycle of inventory to 20 days. We were also able to extend our suppliers' payment terms at the end of the year that had a small positive impact of BRL 80 million in the quarter. Let's move now to slide 11 to discuss free cash flow.

Fourth quarter EBITDA reached BRL 463 million while CapEx was BRL 43 million. The cash financial result was a loss of BRL 298 million and the working capital variation was positive by BRL 242 million, leaving us with a positive free cash flow of BRL 363 million just in the quarter, a meaningful result, especially when you compare to companies' actual market cap.

In 2018, adjusted EBITDA including non-recurring items reached BRL 1,550 million, CapEx was BRL 189 million, and financial result on a cash basis was a loss of BRL 953 million. The variation in working capital also gave a positive contribution of BRL 343 million in the year, so the free cash flow for the full year of 2018 was a meaningful BRL 752 million.

Useless to say that this good result on free cash flow is an important driver for our further debt reduction and deleveraging process that would take place during 2019. Let's move now to slide 12 to talk about our important steps that we are taking in order to accelerate the company's deleveraging process.

So just to remind you, last September, we presented two action plans to accelerate Minerva's deleveraging process: a private capital increase and the IPO of our international division, Athena Foods.

Well, talking about the capital increase, it was concluded last December with the participation of 91% of the shareholders' base, reaching a total capital increase of BRL 965 million.

As expected, given our focus on reducing leverage, the 100% of the proceeds of this operation were used in the tender offer of our perpetual bonds. We successfully tendered 75% of the bonds or $225 million of these bonds that were the most expensive debt instrument in our portfolio. Good to remind you that we're going to exercise the call option that matures in April to buy back the outstanding bonds, around BRL 70 million – $70 million, (00:21:07) par value in April in 2019. And it will allow us to continue reducing gross debt and also net debt by reducing further financial expenses.

Let's move now to next slide to talk about the Athena Foods IPO. So the second step on our deleveraging plan announced last September is the IPO of our international subsidiary, Athena Foods, on the Chilean Stock Exchange. We have already concluded a number of stages in the initial plan and in November, we made the first filing with the Chilean capital markets regulatory agency. We are now just waiting for CMF to give us the green light to announce the deal and start the road show probably in April. So if we get the green light by end of March beginning of April, we expect to have this IPO concluded until the end of May.

We also disclosed the Athena Foods income statement with quarterly and 2018 numbers. In 2018, Athena recorded a net revenue of BRL 7 billion, with an EBITDA of BRL 490 million, resulting in a margin of 7%. Important to highlight that Athena's leverage is very close to zero. So the net margin of this company is very close to the EBITDA margin. In 2018, the net result was BRL 290 million, more than 4% net margin.

Let's move now to slide 14 to talk about capital structure. As I have already mentioned, the leverage measured by the net debt/EBITDA ratio stood at around 3.9 times at the end of the year. We are moving forward with our plan to accelerate the deleveraging

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process and we also completed the offer to purchase our perpetual bonds, as I have already mentioned earlier.

Approximately 78% of our debt was exposed to FX variation in the fourth quarter with a duration of around five years. We will continue to focus on the deleveraging process by combining an efficient management of liabilities and free cash flow generation from operations in order to continue reducing our debt.

Let's move now to the next slide of this presentation to talk about the net revenue guidance. So in 2018, we had a guidance of BRL 15 billion to BRL 16 billion. As we mentioned earlier, we reached BRL 16.2 billion so we exceeded in less – in approximately 1% the guidance. So, it was achieved and for 2019, we are releasing a guidance of net revenue of – in a range of between BRL 16.5 billion to BRL 17.5 billion. This net revenue new guidance is based on an exchange rate of BRL 3.80 per $1.

And to conclude our presentation, I would like to thank Mr. Puzziello, that is no longer the Investor Relations Officer. After almost 10 years, he is leaving Minerva to lead our financial area in Athena Foods, our international subsidiary, becoming again my colleague in helping us with the important task of taking care of our new subsidiary in Chile. So thank you, Mr. Puzziello, and good luck in your new role.

So, let's begin now the Q&A session. Thank you very much.

Q&A

Operator

Thank you. We will now start the question-and-answer session for investors and analysts. We have a question from Mr. (sic) [Ms.] Julie Murphy from JPMorgan. Julie Murphy, you may proceed now.

Q - Julie G. Murphy {BIO 17715198 <GO>}

Good morning. Thank you for the question. I appreciate the comments about accelerating the deleveraging process and the next step of that plan being Athena. I'm wondering if there are leverage targets that you're currently contemplating. I think we talk about something like 3.5 times and what those targets would be with or without the IPO of Athena and perhaps the timelines. Thank you.

A - Edison Ticle Melo e Souza Filho {BIO 20119771 <GO>}

Well, hi. When we released the deleveraging plan in September, we also shared with the market some sensitivity analysis regarding the amount of the proceeds from the IPO and what would be our leverage in different scenarios of margin and the size of that deal.

If you go back through those scenarios, if we are able to have an IPO between BRL 1 billion and BRL 1.5 billion leverage at the end of 2019, according to these scenarios, would be in the range of 2.5 times and 2.9 times. So, we are not giving guidance regarding the leverage, but I think those exercise that we shared with the market are good – let's say a good GPS for what we are foreseeing in terms of leverage for the end of 2019.

Q - Julie G. Murphy {BIO 17715198 <GO>}

Okay. Thank you.

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Operator

And that concludes our question-and-answer session. At this time, I would like to turn the floor back to Mr. Fernando Queiroz for any closing remarks. Fernando Queiroz, you may proceed.

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

Thank you. I would like to finish this conference call emphasizing our commitment to create value for the shareholders by completing the financial deleveraging plan and cash generation through our operational and commercial efficiency and using our geographic diversification and risk management. I reemphasize the discipline, the focus and the commitment that we have.

Also would like to remind you that regarding the global trade, we will be always looking at the opportunities created by the imbalance between global beef supply and demand, which has consistently benefited South America players, consolidating our position and taking advantage of our region's higher spreads and cost of production.

We will continue focusing our efforts on consistently improving the execution of our business plan, seeking to increase our sales penetration in new domestic and foreign markets in addition to consolidating – continuous improvement in operational efficiency.

Last but not least, I would like to once again thank Minerva entire team for their efforts and dedication, especially Eduardo Puzziello, reiterating everything that Edison mentioned. Our team allowed the company to record a remarkable performance in 2018. I also thank you all for the interest in the company and we remain at your disposal for any question or clarification.

Thank you very much, everyone.

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Operator

And this concludes today presentation. You may disconnect your line at this time. Have a nice day.

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