Q3 2018 Earnings Call

Company Participants

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

Other Participants

- Alexander Robarts, Analyst
- Andrew De Luca, Analyst

Presentation

Operator

Good morning, ladies and gentlemen, and thank you for waiting. At this time, we would like to welcome everybody to Minerva's Third Quarter of 2018 Results Conference Call. Today, with us, we have Fernando Queiroz, Chief Executive Officer; Edison Ticle, Chief Financial Officer; and Eduardo Puzziello, Investor Relations Officer.

We wish to inform you that this event is being recorded, and all participants will be in listen-only mode during the Company's presentation. (Operator Instructions) The audio and slideshow of this presentation are available through a live webcast at www.minervafoods.com/ir and MVIQ platform. The slideshow can also be downloaded from the webcast platform in the Investor Relations section of this website.

Before proceeding, we wish to mention that forward-looking statements may be made during the presentation relating to Minerva's business prospects, operating and financial estimates and goals. They are based on the beliefs and assumptions of Company management and on information currently available. They involve risks, uncertainties and assumptions because they relate to future events, and therefore, depend on circumstances that may or may not occur in the future. Investors should understand that general economic conditions, industry conditions and other operating factors could also affect the future results of Minerva and could cause results to differ materially from those expressed in such forward-looking statements.

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

Fernando Galletti de Queiroz {BIO 15387377 <GO>}

Thank you very much. Good morning, everyone, and thank you for participating in Minerva's conference call on the results for the third quarter of 2018. We will begin the presentation talking about the highlights for the quarter.

Let's have a look on slide two, where you can see the main highlights. Minerva closed the third quarter of 2018 with positive operating cash flow of BRL406.5 million and a positive free cash flow to equity of BRL93.5 million. The Company consolidated gross revenues totaled BRL4.6 billion in the third quarter and BRL16.6 billion in the last 12 months, which was once again a record revenue for the Company. Therefore, the Company keeps achieving revenue records.

The breakdown of gross revenue by division shows that Brazilian Industry Division contributed around BRL2 billion, or 43% of the total gross revenue in the quarter, while Athena Foods, formerly the International Industry Division which corresponds to our operating in Argentina, Paraguay, Uruguay and Colombia. This division delivered BRL1.8 billion, or 40% of the total and the Trading Division contributed to BRL782 million, or 17% of the total.

Minerva consolidated exports, which accounted for 61% of revenues in the third Q of '18, recorded a revenue increase of 32.3% over the third quarter of the previous year and about 12% over the second Q '18.

Net revenues totaled BRL4.3 billion, moving up a substantial 27% over third Q '17. In the last 12 months ended September, net revenues coming -- came to 16 -- BRL15.6 million -- BRL15.6 billion, up 46% year-on-year.

Third quarter EBITDA reached BRL449 million, 44% more than the third Q of '17. The EBITDA margin stood at 10.4% in the quarter, in the last 12 months reached BRL1.5 billion, up 40% year-on-year with an EBITDA margin of 9.3%.

Regarding our capital structure, leverage measured by the net debt over LTM EBITDA ratio was below 5 times at the end of the quarter, despite the depreciation of the real in the period.

Our cash position came to BRL4.2 billion at the end of September. It's also important to mention, our cash policy of having an amount sufficient to buy raw material for the last -- for at least three months carries [ph] equivalent to BRL3 billion.

Last week, we announced a tender offer for our perpetual bonds, which are currently our most expensive debt at the annual coupon of 8.75%. This shows Minerva commitment to its strategy of accelerating deleveraging. Moreover, on September 30, the duration of our debt corresponded to an average of 5.4 years.

It's important to mention that we accounted for 21% of the South America beef exports in the last 12 months ended September. This result maintain our position as the leading beef exporter in South America. Considering the USDA latest beef exports estimated, which indicated the region [ph] is responsible for around 34% of global exports, Minerva accounts for around 7% of the total beef exported worldwide.

Finally, I would like to highlight that based on the results, we are maintaining our net revenues guidance for 2018 as between BRL15 million to BRL16 million.

We'll now move on to slide three, where we will talk about Minerva performance beginning with our exports. In Brazil, we accounted for 40% of exports in the third Q '18 and our exports revenue and volume climbing -- climbed 16.5% and 12.8% over second Q '18.

In the last 12 months ended September 30, revenues grew 13% and volumes increased 8% over the same period in 2017. In Paraguay, our market share was 42%, maintaining our position as the country's leading exporter. In Uruguay and Argentina, our share of beef stood at 17% and 18%, respectively. Finally, we were the leading beef exporter in Columbia with a market share of 82%.

As I said, when I was talking about the highlights in the last 12 months ended, Minerva maintained its position as the leading South American exporter with a market share of 21%.

Let's have a look on the slide four, where we talk about exports by division. Slide four. In the Brazilian Industry Division, Asia and the Middle East were the main destinations in the last 12 months ended September. Together, these two regions accounted for 54% of the divisions' exports in this period. This figure collaborate the recent estimates that growing demand for beef has been concentrated in these two regions. This increase in conception in Asia and Middle East is closely related to the utilization and development process, as well as the utilization of habits of consumption pattern. And this is fully aligned with our strategy of being present in the main markets of these regions.

At Athena Foods, former International Industry Division, the main exports in Asia was 34% of the total exports. In Americas, we were 22% with the highlights achieving. I also think it's important to mention, growth in the Commonwealth of Independent States, the CIS, which accounted for 80% of exports, 10% points are more than in the same period of 2017. The result is a clear reflection of the growing demand in Russia, which has been served by Athena Foods in December 2017.

Let's move on to the next slide to talk about the domestic market performance. Regarding our focus in the domestic market, we have been working to root our product search to more resilient clients, such as small and medium-sized retailers and mainly to the food service segment that comprise, snack bars, restaurants, buffets and steakhouses, which represents around 56% of the total domestic sales from January to September 2018 in the Brazilian Division. It also shows the segmentation in the spring of our sales in the domestic market.

As you can see, in the local sales from the Brazilian market, we gradually grew the beef premium sales, which are niche -- which are higher profitable. The resale of third-party represents 37% of the Brazilian domestic market in the year-to-date. The one-stop-shop strategy guaranteed to customers a wide option of products, such as frozen fish, vegetables, cheese, pork, lamb, among others.

Talking about Athena Foods, the domestic market positive performance during the nine months of 2018 was due to our strategy of repositioning the proceeds -- the products under the brand of Swift in Argentina. And also, through the sales of fresh beef to more than 60,000 points of sale, mailing in the physical distribution and in traditional retail. We also follow the same strategy in this division, focusing on the small and medium-sized retailers and food service all across South America.

I'll now give the floor to Edison, who will discuss Minerva financial and operating highlights.

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

Thank you, Fernando. We present now Minerva's financial and operating highlights, beginning on slide six. Gross revenue from the Brazilian Industry Division reached approximately BRL2 billion in the third quarter, a growth of 8% when compared to the third quarter of '17. Gross revenue from Athena Foods reached BRL1.8 billion, up 63% over third Q '17 as is shown in the chart in the top right corner.

Gross revenue from the Trading Division reached BRL782 million, 13% higher than the revenues in the same period of last year. As mentioned at the beginning of the presentation, breaking down the revenues, we can see that Brazilian Industry Division contributed for 43% of the Company's gross revenues in the quarter while Athena Foods and the trading division accounted for 40% and 17%, respectively.

Let's go to the next slide to talk about other financial results. So the Company's consolidated net revenue reached BRL4.3 billion in the third quarter '18, up 27% over the third quarter of last year. On the top right corner, we have -- we can see our third quarter EBITDA, which reached approximately BRL450 million, 44% growth when compared to the third Q of '17, with an EBITDA margin of 10.4%, up 130 basis points over 3Q '17.

Talking about the capacity utilization, in the third quarter '18, the Brazilian Industry Division operated with utilization rate of 78%, while Athena Foods reached a capacity utilization rate of around 82%, as a result of the Company's consolidated capacity utilization stood at around 80%, up almost 5 percentage points over the second Q of '18, and almost 3 percentage points more than when compared to the 3Q '17. These capacity utilization levels are considered ideal and have been gradually increasing since the acquisition of the plants in Paraguay, Argentina and Uruguay in July last year.

The net debt-to-EBITDA ratio in the last 12 months ended the quarter at 4.97 times, slightly decreased when compared to last quarter. It's important to highlight that the dollar appreciated more than $0.15 against the real, between the end of the second quarter and the third quarter. And this could have hampered our results, since 80% of our debt is dollar related. Nevertheless, leverage did not increase in the quarter due to the strong operational cash flow generation recorded in the quarter together with some measures that we took to hedge part of the long-term exposure.

Now, let's move to slide eight to discuss net result. In the quarter, Minerva had loss of BRL132 million. However, if we adjust this result for non-cash effect of the FX variation and for the hedge results, the Company would have posted a positive profit in the period of around BRL78 million.

Moving to next slide, let's talk about the operating cash flow. In the third quarter operating cash flow reached BRL406 million. Working capital variation was negative by BRL133 million, and this working capital conception was mainly caused by two factors. The first one was the receivables line that increased due to a higher volume sold in the exports, that have longer payment terms. And the second factor was the Suppliers' line. Having mind that in the quarter -- in the third quarter, we were still in the off-season, so marked by a little over cattle supply. So in order to keep the supply of cattle at reasonable level at -- and at reasonable prices, we used cash payment term in order to benefit for discounts and to increase the cattle supply during the off-season.

On the other hand, we had a positive result in the other payables lines in the Customer Advances account. As we have already explained, it in accordance with our credit policy, we require for -- from some customers and some countries to have advanced prepayments to start production of the product. So in this case, the advanced prepayment helps us to reduce the cash conversion cycle and allows us to reduce the working capital need.

In the last 12 months, operating cash flow was positive by around BRL844 million. And the working capital requirement were positive by BRL66 million.

Let's now move to slide 10 to discuss free cash flow. In the nine months of 2018, the EBITDA including non-recurring items reached BRL1.1 billion, BRL145 million was spent in CapEx, BRL644 million negative was the financial cash results and the working capital contributed positively to the operations with more than BRL100 million. So in the nine months ended in September, the Company was able to generate BRL389 million of free cash flow in the period. In the quarter, the Company generated BRL450 million of EBITDA and as a result, we generated a free cash flow of BRL94 million just in the third quarter.

Let's move now to slide 11 to talk about the Company's capital structure. So, as we have already mentioned, our leverage measured by the net debt-to-EBITDA ratio stood at approximately 5 times at the end of the quarter. It was pointing again that despite -- in spite of the appreciation of the dollar of more than 4% in the quarter, we are able to keep leverage virtually flat, thanks to cash generation, higher EBITDA and hedge strategy.

Our cash position in the quarter came to BRL4.2 billion in line with our policy of keeping an amount of cash -- in cash equivalent to at least three months of purchase of input, leaving us in a pretty comfortable situation to deal with volatile and adverse scenarios. Approximately, 86% of our debt was exposed to the exchange rate variation. However, 50% of our long-term net exposure is hedged, and the duration of our debt today is around 4.4 -- 5.4 years.

As Fernando mentioned in the beginning of the presentation, last week, we announced a tender offer to purchase -- repurchase our perpetual bond. Those bonds, they had 8.75% of annual interest payments and they are the most expensive bonds in our debt. So we decided to launch an offer to repurchase the bond using the proceeds of the capital increase that will be concluded next week. The current amount -- the current outstanding amount of the perpetual bonds is $291 million, and I expect to buyback all the bonds in the tender offer during November or if there are remaining outstanding bonds, we're going to call all of them in April for the perpetual notes, we'll be 100% call it until the beginning of April.

On next slide, let's discuss Athena Foods results. So as we announced in the second quarter of '18, we structured our wholly owned subsidiary called Athena Foods in Chile, and we're conducting this company's IPO on the Chilean market. I would like to remind you that Athena is equivalent to our former International Industry Division and covers our operating activities in Paraguay, Argentina, Uruguay, Colombia and our distribution activities in Chile.

We included Athena Foods income statement on this slide to give you a broader view of our operations in this Company. As you can see, we ended the third quarter with net income of approximately BRL118 million, and EBITDA of around BRL122 million with a margin of approximately 6.7% in the quarter.

In the first nine months of the year, net income reached BRL240 million, and net margin of around 5% and EBITDA reached BRL327 million with a margin of 6.7%. Please note that production units that make up Athena Foods were acquired in July 2017, and we're operating with narrow margins. So this result reflects the hard work of turnarounds that we have been doing in the past 12 months and the successful integration of those new units into our Company's framework.

Let's now move to the next slide, where we will briefly talk about net revenue guidance. Last quarter, we announced our net revenue guidance for 2018 between -- in a range between BRL15 billion and BRL16 billion. Using an exchange rate of BRL3.70 per dollar and ARS27 per dollar. In the last 12 months, our net revenue reached BRL15.6 billion, so yes, inside the range and that's why we are keeping this guidance for next quarter.

Now, let's move to the last slide of the presentation to talk about the current private capital increase transaction that we opened until November 14. So as we have already announced, the private capital increase was approved by the Extraordinary Shareholders' Meeting held on October 15, and the process was to get off on the following days. We decided to add this slide to have some investors understand the full process flow until it is concluded.

This slide is part of the subscription booklet that is available in our Investor Relations website and presents more detailed information, so I believe, it's worth reading material.

This slide shows an example of our shareholders who owned 100 shares in October 15. So on October 16, after -- immediately after the Extraordinary Shareholders' Meeting. This investor received 74 BEEF1, which are the subscription right. For the subscription rights, give this investor -- this shareholder the right to participate in the capital increase on a proportional basis. So as the capital increase, it will be carried out through the issue of up to 165 million shares, the amount of shares of each shareholder will correspond to around 74% of disposition on the day the capital increase was approved. The shareholders, who participate in the capital increase will receive 74 BEEF9, which has a subscription receipt, after the end of the subscription period.

As an additional advantage, I also explained the material fact dated September 12, for each subscriber's share. The shareholder will be granted with a subscription warrant, which will be traded on the stock exchange under the code of BEEF11. This subscription warrant is valid for three years, it can be converted into BEEF3 shares at any time during the maturity. So it behaves like an American call option. In approximately 10 days after the end of the subscription period, the BEEF -- the 74 BEEF9 receipts will be converted into 74 BEEF3 shares and the shareholder will be in their position with 174 BEEF3 shares and 74 BEEF11 subscription -- BEEF 11 warrant.

Lastly, and as this is the last slide from our presentation, I would like to take the opportunity to invite you all to participate in our annual public meeting, Minerva Day. In New York, Minerva Day will take place at Nash [ph] on November 19, and in Sao Paulo it will take place at Grand Hyatt Hotel on November 26. The IR department has already sent an invite through our distribution list and we will also make it available in our website with link to subscribe. So we look forward to seeing you all.

And now, let's begin the question-and-answer --

Fernando Galletti de Queiroz {BIO 15387377 <GO>}

Session. Thank you.

Questions And Answers

Operator

Thank you. We will now start the question-and-answer session for investors and analysts. (Operator Instructions) The first question is from Alex Robarts of Citi. Please go ahead.

Q - Alexander Robarts {BIO 1499637 <GO>}

Yes, hi. Good morning, everybody. Thanks for taking the question. Actually, I have two questions and they both relate to Brazil beef. The exports, very robust here in the quarter, better than most of our estimates on The Street. And you talk about incremental demand from Asia and the Americas. I guess those two regions together about 40% of your Brazilian beef exports. Could you comment on the quality of that incremental demand, is it seasonal? I mean, the Americas, really is because of Chile seems to have almost doubled, the importance in your mix and I'm wondering is that perhaps coming from the new distribution that the JBS assets had given you there. So if you could first of all, just give us a sense of the quality of this incremental demand in Asia and the Americas, is it sustainable in the short-term? Thanks very much.

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

What's the second question, Alex?

Q - Alexander Robarts {BIO 1499637 <GO>}

Okay. I was going to wait for the answer, but no, listen. I think in the annex, it's the cattle cost trend. We've been really seeing pretty favorable arroba prices as we come into the rainy season, we're well off the 2016, 155 peak levels. What is your view in the short-term for the cattle pricing in Brazil? That's the second one.

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

Right. So first on the sustainability of the growth that South America is having both on China -- the Southeast of Asia that's not only China, it's mainly derived by China and in Americas driven by Chile. I would add to that, the growth that the Middle East and North of Africa is having. So Middle East and North of Africa, it's also a growing area, where you have better distribution of income. There is no segmentation in the markets there, so it's very sustainable. This area and this part of the world are now healthy producers in volume and there is a growing demand. And the kind of product that they require, both on the premium products and on the commodity products, have South America as the main supplier. So we would first put highlight on Middle East and North of Africa.

Second, the biggest growth is coming from Asia -- Southeast of Asia, especially China, that they are changing their habits. The amount of fast food chains, the amount of their -- westernization of their habits is playing a very important role on the growth of the demand. So there, you want to see us well a premium market, a commodity market that will be used for further processing like burgers, sausages and these things. So this area, we are seeing a decrease in the size of the herd for there'll be more in products. Overall, the only place -- the only region in the world that is growing with supply, it's on South America. And there is a decrease in traditional suppliers like Europe and especially in Australia. Therefore, we are seeing a very sustainable demand for South America.

Talking about Chile is the last one, in South of Americas, in general. Chile has a very small size of the herd that they have important -- they are very important markets that they have the income -- the per capita income in the misconception start of the habits of the chicken. So it's driven also a very sustainable demand. We are supplying in all these countries, not only from one origin, but through all the origins that we can. Just like Chile is supplied by Brazil, by Argentina, by Paraguay, some things from Uruguay, Russia, that's some other market that's important. We also supplied by three or four countries that we are originating. So we see the growth of the demand and the bridges within South America and the important countries only being stronger. In fact, the countries are getting more specialized in what they produce and producing cattle is linked to the availability of water, that South America has plenty.

In terms of cattle cost, what we were seeing, we are in the low season, and therefore, the cattle traditionally goes up during this period of the year. What we are seeing is that, in the last five years, Brazil broke records on birth of calves. Therefore, the availability keeps increasing, but luckily and strategically, the demand keeps increasing as well. So we don't see any surprise for cattle price. We see that during the high season, that starts next -- early next year, the presence of the rain, it will be another very important and sustainable year for the production in Brazil and in South America in general.

Q - Alexander Robarts {BIO 1499637 <GO>}

Very helpful. Now that was clear. If I could just have the follow-up on Chile, sorry, and I know it's a relatively new market, with the Athena Foods and such. It was the one market that you didn't really show us the market share number, at least as I could on the press release. But could you comment a little bit about, are you gaining share in Chile? Is the market growing in Chile faster than other markets? And is it a fair assumption to have that you would be seeking to get perhaps some -- at least some double-digit share in that market? Thanks very much.

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

We are in double digits share, all the meat that is imported into Chile 40% is coming from Minerva or Athena operations. So we are by far the most relevant exporter in each of the Chilean market. What that -- you don't have that there because Chile is a consuming and distribution market, it's not a producing market. What we showed on our slide was the share that we have of exports out of the origins that we produce.

Q - Alexander Robarts {BIO 1499637 <GO>}

Got it. Thank you.

Operator

The next question is from Andrew De Luca of Barclays. Please go ahead.

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

Hi. Good morning. I wanted to go back to some comments you guys had in September when you mentioned the Mercosur assets were requiring more working capital than you expected. Can you just give us an update in terms of the additional working capital investments, if any, that are required for the Mercosur business? Thanks.

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

Mercosur business required more working capital just after the acquisition. So in the fourth quarter of last year, we invested almost BRL400 million -- more than BRL400 million in working capital. The majority was in the Mercosur asset. Since then, we have been in the process of integration, the process of turning around those operations. And for now, as you can see, the capacity utilization around 82%, we can see that the Mercosur assets are in a much more stable operation and we don't expect additional requirements of working capital in the short-term.

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

Great, thanks. And then my second question is, with regards also to working capital, and the (inaudible) in Russia, and now you being able to export from Brazil, how do you see that market evolving as a percentage of Brazilian revenues?

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

Well, as far as to predict, there are only few plants that approved that depends on if they are opening new plants to approve it. We hope it will, because Russia has always been a relevant market for Brazil. But to predict how much percent of the total Brazilian exports will go to Russia, it's practically impossible without knowing what -- what's the number of plants that will be approved.

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

Okay. Great. Thank you.

Operator

There are no additional questions at this time. 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 thank you for participating in our conference call about the outstanding results that we showed on the third Q. I'd like to highlight that this is a result of very detailed strategy and in a very efficient execution of the strategy of diversifying Minerva into South America. That is the area of the world that is occupying more space and more share in international trade.

So I would like to thank you all for supporting and for following [ph] us a new strategy. And finally, I would like to thank all the Minerva team for being aligned with the strategy and support in every day, in every hour, in every moment of the strategy that we have implemented. So thank you very much. We remain at your disposal for any further clarification or any further information that you may require. Thank you very much.

Operator

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