FINAL

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Q1 2019 Earnings Call

Company Participants

- Barbara Halberstadt, Bank of America
- Marco Spada, CFO
- Marcos Molina, Chairman

Other Participants

- Analyst

Presentation

Operator

Good morning, ladies and gentlemen. At this time, we would like to welcome everyone to Marfrig Global Foods S.A. Conference Call to present and discuss its results for the first quarter of2019. 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 slide show presentation available for download. We inform that all participants will only be able to listen to the conference call during the company's presentation. After the company's remarks, are over there will be a Q&A period. At that time, further instructions will be given. (Operator Instructions) 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 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 Marfrig and could cause results to differ materially from those expressed in such forward-looking statements.

And now, a message from Mr.Marcos Molina, Founder and Marfrig Global Foods Chairman. Please, Mr.Molina, you may begin the conference.

Marcos Molina {BIO 15363967 <GO>}

Good afternoon everyone. I would like to thank you all for your interest in participating in Marfrig's Q1 2019 earnings release call. Before we start the presentation, I would like to extend my condolence to our CEO, Eduardo Miron, who is not here today because his father just passed away last night. My sincere respect with Eduardo and his family in this moment. Now and first of all, I would like to highlight the Q1 2019 Marfrig's performance. Which one was much better compared to Q1 '19 -- Q1 '18, on a pro forma basis. Also I would like to highlight the conclusion of Quickfood in Argentina and Varzea Grande transactions in

Brazil, which represents a relevant step forward. One of the pillars of our strategy to focus on value-added and industrialized beef products and strength our position as a global leader on beef patty production. So and also serving the major food service customers, demonstrating our relationship with this specific chain. And still talking about Quickfood, since we acquired the company, we reverted negative profitability to strength results in the first quarter 2019. These assets added to our current capacity in South America, put ourselves on an excellent position to capture the gains and the profitability of the new scenario for global proteins due to the events in China .

We foresee that the events in China, they are changing the global protein sector on a global basis and they will create significant opportunities for the company in the near future. For last but not least, I will comment about the robust results for North America operations.

Which demonstrate our a certain strategy to acquire the North American asset and maintaining the global presence of the company. Being a global company sustainable profitable and looking for cash flow generation. Thank you all and I will pass the word to Marco Spada, our CFO and Vice President of Financing. Thank you.

Marco Spada {BIO 19715083 <GO>}

Thank you, Marcos. Good afternoon, everyone. I want to start by thanking everyone for participating in another earnings conference call of Marfrig Global Foods. Today, we will comment on the results of the first quarter of 2019. Also present here on the call with me are Fabio Vasconcellos, our Vice President of Planning and Management. And also I'd like to introduce and welcome our new Investor Relations Director, Mr.Vitoccini.

On slide 3, I want to start with the highlights of the quarter and to comment on some points we consider important. Before starting the financial highlights, I would like to mention that from this quarter on, we will disclose the financial and operating information separately for North America and South America operations.

Turning to the financial highlights. In the first quarter 2019, we have generated more than BRL10 billion in revenue an increase of 8% over first quarter 2018, already adjusted on a pro forma basis, which means that it already includes the results of Quickfood international beef for the numbers used for comparison of first quarter 2018. The gross profit was BRL927 million and we have maintained the margin at the same levels of 2018 at around 9%. Even in a more challenging scenario, due to the most adverse weather conditions in both United States and South America we have increased our EBITDA by 16% compared to first quarter 2018, reaching BRL571 million. The margin was 5.7%, an increase of 0.4 percentage points compared to the first quarter of 2018. In this quarter, the net income was BRL4.3 million, which shows and confirms that our strategy adopted in 2018 were correct. A positive result in the first quarter, which is seasonally the worst one, leave us with a very positive scene for a great year of 2019 ahead of us. In order to further achieve the projections, and confident in our strategy given a positive momentum for the bovine cycle boosted by the new world protein scenario in the results of our operations, the company had disclosed the immaterial effect last night decided to provide our guidance for the year of 2019.

Commenting on the recent strategic moves. Late last year we had announced the acquisition of Quickfood in Argentina and also the acquisition of the asset in Varzea Grande in the Brazilian state of Mato Grosso, both from BRS Quickfood, was -- as we have already commented, has some of the most recognized brands in Argentina, including Paty, which is the synonymous of high-quality beef patties in Argentina. And also Vienissima! another well-known brand in sausage, among other products. We hired to serve as the CEO of this operation, Mr.Gustavo Kahl, who is an Argentinian and has over 29 years of experience in the industry including Minerva and Cargill. He knows very well the local market and will play a fundamental role in the success of our strategy actually, he is already managing to reverse the results of the operation in just one quarter.

In another move to boost our strategy of growing higher value products, we are assuming the processed product operations in Varzea Grande, Mato Grosso under a long-term contract with BRS in which we will supply beef patties, kibbehs and other products that they will sell under the Sadia and Perdigao brands. This operation will be further strengthened by our long-term partnership with McDonald's since the time of Keystone, which we have maintained this relationship at our beef patty plant in Ohio, which today is run by our National Beef in the North America division. This relationship with McDonald's is fundamental to our strategy of working with key clients in the food service channel in strengthening our position as one of the world's leading beef patty producers with production capacity of over 230,000 tons per year.

In corporate governance to increase transparency, we revalued our established, various compliance policies, which included the revision of anti-corruption policy and the establishment of the policies for conflict of interest, free competition, and relations and communications with government officials, which will reinforce our commitment to combine an ethical conduct In sustainability font which is a fundamental pillar of our strategy. We have created the sustainability committee, which is formed by prominent and highly respected professionals. We have also hired a sustainability officer Mr.Paulo Pianez Which is responsible for incorporating our -- in our routine activities the actions planned by the committee and for further improving the good practice that the company already has in place.

Moving to slide number 5. We would like -- here we will explain the highlights of the North America operation with further financial and operational details in this quarter. We had a very severe winter in North America, which affected our cattle fields and consequently reduced our sales volume. However, despite this scenario cattle prices were stable and demand remained solid reinforcing the favorable moment of the cycle in the United

States. The indicator for this is the cutout ratio, which is the USDA selling price over the carcass price, which is 1.74 or 3% higher than the first quarter of last year, reflecting a 3% increase in average sales price. Consequently, net revenue grew by 1% and gross revenue in dollars advanced 19%.

Let's move now to the South America division. In the South America division, we also had adverse weather that affected the supply of the cattle. For example, because of the prolonged rainy season, producers kept their cattle in pasture for longer, which pressured cattle prices and cattle availability. Uruguay also experienced adverse weather. And also with the sale of live cattle for export, the primary processing fell 5% on the prior year period, according to. These events had a negative effect on the mix of export destinations and directly impacted the volume of sales and justified the fall of 12% seen in the first chart on the left.

Revenue sales volume falling by 11%. Gross margin was 9%, reflecting the higher cattle prices in Brazil and Uruguay due to the reason I had just mentioned. An important highlight on this quarter is the turnaround margins at Quickfood, which were negative by the time we had acquired the asset. After adjustments to the operation to streamline the cost structure, we maximized the utilization and we strategically started to focus on exports. Now the asset is presenting very positive margins already in the first quarter.

Let's move now to slide number 8. On this slide, we comment on the consolidated performance of the company. And I would like to start with our positive results, a net profit of BRL4.3 million. Although the number is not big, we believe that the fact that it's a positive number in this first -- in a first quarter, which is seasonally the worst one, brings us a very positive message. The strategic moves made in 2018 were in the right direction. It's important to note that despite the lower sales volume due to the seasonal and weather factors I've mentioned earlier, the company was able to keep its gross margin stable and to expand its EBITDA margin. We have posted growth of 8% in net revenue, 7% in gross income and over 16% in EBITDA, which is explained by the margin improvement in North America division, recovering profitability in Argentina and also the depreciation in the Brazilian real against the U.S. dollar.

Moving to slide number 9. Here, I will comment on cash flow. We had our operating cash flow negative of BRL712 million, impacted mainly by two factors. The cash effect of results of the payment in 2018, specifically payment of income tax and bonus payment in the North America operation also, changes in working capital, mainly due to the increase in inventories. The payment of the bonus in the North America transaction is related to the excellent results generating the operation in 2018 and was paid in this first quarter of 2019. The variation of stocks is -- of inventory is justified by some factors. The addition of the Quickfood operation and its inventories in our balance sheet, the seasonal effect due to the use of our lamb slaughtering facility in Chile and also most important the affected inventory increase mainly in Brazil in preparation to face the new global scenario of proteins preparing us to export more since the end of March onwards.

The export-oriented position itself has the largest cycle, which automatically increases the inventories. This inventory buildup movement, in fact, has a negative cash impact in the first quarter that leaves us in a very good position to take advantage of the new global prices that are presented, especially for China. Not to mention here, the potential qualification of new plants for exports to this market. We also had the cash consumption of in the suppliers of BRL175 million, which was due to the revision in working capital operations, which also reflect the reduction in the other line of our financial expenses.

On the top of the operating cash flow, there were interest expenses and capital expenditures, which in this quarter has the impact of Quickfood and Varzea Grande acquisitions, leading to a free cash flow generation of negative BRL1.4 billion. And for illustrative purpose, if we exclude the non-recurring effects of the payments of bonuses and the acquisitions, the free cash flow will be negative BRL690 million instead of BRL1.4 billion. Moving to slide number 10, where we show our debt profile and leverage ratio. Marfrig ended the first quarter with a gross debt of $4.1 billion up 6% over the prior quarter, mainly due to the securing of new credit facilities to replace working capital operations and cash consumption, which allowed for reducing working capital operations that typically have a higher cost. The leverage ratio in Brazilian real stood at 2.76

times. It's important to note also the improvement in the debt maturity profile with the larger maturities coming due in the long-term.

In this sense, in early May, we issued a new US $1 billion bond maturing in 2026 with interest of 7% per year combined it with a tender offer for bonds maturing in 2021 and 2023, which pay interest of 11.25% and 8% per year respectively, which will further lengthen our maturity profile and reduce our cost of debt. The liability management effort is part of the company commitment to have a low financial leverage in an adequate debt structure.

Moving to slide number 11. This slide presents Marfrig's sales profile and exposure to countries. Today, 62% of the revenue comes from the United States and 12% from Brazil, which shows how our business is diversified in our exposure to the best destinations. China, in the first quarter, accounted for 6% of our revenue. And here, I should mention that in the new global scenario for animal protein due mainly to the African swine fever, sales share to China should increase. Japan accounts for 5% of revenue and also presents potential to be export given the recent authorization of exports from Uruguay. We are already taking advantage of the sales structure that National Beef had in Japan to sell products from Uruguay. This is a part of our map of opportunities and commercial actions that we leverage our sales to the best destinations by growing on our global coverage to drive our results.

I also should mention the various sales channels and client relations, such as the relationship of McDonald's, which National Beef did not have prior to the beef patty business in Ohio, which now the -- it's run by National Beef. In April, we began to produce and sell beef patties to McDonald's in Brazil as well through our new plants and project venture. We already sell to McDonald's in Uruguay. And also now in Argentina we are selling as well. Today, we have important clients, such as Sam's Club, Topco and a leading supermarket chains. All of this leaves Marfrig well-positioned to capture opportunities generated by this new global scenario. Moving to slide 13. On this slide, you can see the main action instruments in which we are focused in line with our strategic pillars and which will guide Marfrig on delivering the guidance that I will comment shortly. Our strategic direction and expectation for the year is to generate positive cash flow, to reduce our leverage compared to 2018 end and to continue our liability management actions to reduce our cost of debt and lengthen our maturity profile.

Another fundamental action is to conclude the acquisition that we made jointly with the other shareholders of National Beef in the State of Iowa. We will also advance in the synergies between North and South America operations. We will continue to implement the operational improvements and actions and KPIs in South America. I also highlight our actions in sustainability. Marfrig has always had a very strong bias in our culture and we will go deeper into this subject with the recent creation of the committee. The hire -- or the hiring of the Sustainability Director Mr.Paulo Pianez , the partnership with Embrapa the that this carbon issue regarding the low-carbon and neutral-carbon beef and many other projects which demonstrate our commitment to this thing.

Before proceeding with the presentation -- oh, sorry. Going to slide number 14, where I will talk about the our guidance for 2019. In order to provide more transparency and to further assist this -- the market projections and as we are confident in our strategy, leading a positive momentum for the North American operation that has already shown an improvement in the first quarter compared to 2018. There was already a very good result. It's important to mention that. And with a more favorable perspective for South America given the new global protein scenario, we are sharing, our more optimistic view for 2019 results.

As you can see in the table, we are projecting net revenue of BRL47 billion to BRL49 billion in 2019, also projecting an EBITDA margin of 8.7% to 9.7% -- 9.5%, and also a free cash flow before dividend to minority shareholders of about BRL1 billion, between BRL1 billion and BRL1.5 billion. Our projections are based on an exchange rate of BRL3.9 per $1. And in the results -- it started from the results reported in the first quarter. We reiterate our confidence in the timing of the cycle and believe in our strategy and the adequate footprint to capture the opportunities of this new global protein scenario that it-already represents. And always showing improvements since the end of March.

Finally, I would like to thank everyone for following our presentation and inviting you all for the question-and-answer session.

(Question And Answer)

Operator

Thank you. Ladies and gentlemen. We will now begin the question-and-answer session. (Operator Instructions) Our first question comes from Barbara Halberstadt, Bank of America.

Barbara Halberstadt {BIO 18022271 <GO>}

Hi. Thank you for taking my question and for the results for the quarter. I actually just have a very quick question. I wanted to understand a little bit better what we can expect for working capital for the upcoming quarters I understand, this one was atypical. So just wondering when we can see a more normalized level and what level would that be? Thank you.

Marco Spada {BIO 19715083 <GO>}

Hi, Barbara, thank you for your questions. Well, regarding the working capital going forward, I think we gave -- it's -- we have achieved a level for working capital usage. That is already considering the new export increase scenario, especially in Brazil. So we don't really expect an increase in terms of working capital utilization going forward or you should see a stability there in that sense that should be end of the year.

Barbara Halberstadt {BIO 18022271 <GO>}

Okay. Thank you. And just a follow up. Regarding I don't know if you mentioned this in the beginning of the call but, given the escalation of the trade wars between U.S. And China do you expect any negative impact for your U.S. operations for the portion that is exported?

Marco Spada {BIO 19715083 <GO>}

No. Well, China out of the United States does not represent a significant growth in terms of exports from -- for our America -- North American operation. So in that sense, we do not expect any impact of this trade war for our operation there.

And just going back to your first question. I reaffirm, what I've said in case there is no increase in terms of export volumes, okay? So, in that case there is new qualifications of our new plants in order to -- they are able to export to China for example, we might have a small impact in terms of the working capital a little bit more.

Barbara Halberstadt {BIO 18022271 <GO>}

Okay, understood. Thank you.

Operator

Our next question comes from Richard, Bradesco.

Analyst

Hi guys. Thanks for the call. Just a couple of quick questions. Can you give us a -- and I appreciate the guidance for fiscal '19 but, just an update on what you expect CapEx to be and also taxes. And if we should consider this level of the bonus payment something or at level that you'd expect to continue in the future?

Marco Spada {BIO 19715083 <GO>}

Hi, Richard , thank you for the question. Regarding CapEx, our expectation is to be around BRL1 billion for the year. So this will then include in the acquisitions that we had mentioned already in this first quarter. So that's basically the number. Regarding the -- the second question was regarding taxes. Well, the impact of taxes, we don't expect really to have a huge payment in terms of taxes as we do have some credits here in Brazil. The most that you can consider is around $30 million or $40 million. That's probably the total amount that we should spend in terms of cash for taxes in 2019.

Analyst

Okay. And just on the bonus payment, is that the BRL436 million? Is that a level that you would expect to remain fairly steady in '19 just as we try to model out free cash?

Marco Spada {BIO 19715083 <GO>}

I really hope that this -- that the number is going to be a repeated or even increased in 2020 actually. So that would mean that we'll never have a very big and huge results for the North American operations. So for 2019, that's the number that was paid . There's nothing else that should be paid this year. But as I mentioned, we really do expect and our intention is really to pay even more next year.

Analyst

Okay. And just one last question. You mentioned liability management efforts in the presentation. So should we expect that recur to your paydown of short-term bank debt? Or do you think you'd call the bonds? And just how should we think about your cash levels going forward with the liability management that's ongoing right now.

Marco Spada {BIO 19715083 <GO>}

Well, the -- our liability -- currently in our business we've done exercises that are still. I mean that our tender offer is two weeks to open. So, we won't have the final results for it yet. Understand that the -- or the settlement has already gone but it's still open. So after the conclusion of this we're going to analyze and see what are the debts we're going to be liquidating. Not sure yet if we're going to call the bonds. And I'm not going to state this at this moment, but it is a possibility.

Analyst

Thanks very much.

Marco Spada {BIO 19715083 <GO>}

Thank you.

Operator

(Operator Instructions) This concludes today's question-and-answer session. I would like to invite Mr.Marco Antonio Spada to proceed with his closing statements. Please go ahead sir.

Marco Spada {BIO 19715083 <GO>}

Thank you. First, I would like to thank all of our team here for their efforts and bringing this result of the first quarter. Also, I would just like to reinforce our commitment to our guidance, our confidence in our two operations. We will keep bringing some very good results, especially in this new global protein environment. Thank you all for the participation and we are available through our Investor Relations team here to assist you going forward. Thanks.

Operator

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