Q2 2013 Earnings Call

Company Participants

- Edison Ticle de Andrade Melo e Souza Filho, Chief Financial Officer and Member of the Executive Board
- Fernando Galletti de Queiroz, Chief Executive Officer and Member of the Executive Board

Other Participants

- Jose Yordan, Analyst
- Mike Holm, Analyst
- Wesley Brooks, Analyst

Presentation

Operator

Good morning, ladies and gentlemen, and thank you for waiting. At this time, I would like to welcome everybody to Minerva's Second Quarter 2013 Results Conference Call. Today, with us we have Fernando Galletti de Queiroz, Chief Executive Officer; Edison Ticle, Chief Financial Officer and Eduardo Puzziello, Investor Relations Officer.

I 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 slide show of this presentation are available through our live webcast at www.minervafoods.com/ir. The slide show can 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 this presentation relating to Minerva's business prospects, operating and financial estimates involved. They are based on the belief 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 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 that could cause results to differ materially from those expressed in such forward-looking statements.

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

Fernando Galletti de Queiroz {BIO 15387377 <GO>}

Thank you and welcome. It is with great satisfaction that I thank you for participating today in Minerva's conference call to discuss the results for the second quarter of 2013. Let's have a look on slide show, where we show the highlights of our results.

The second quarter was marked by a very positive results of Minerva, both in terms of operating performance and also in financial and risk management. The results also confirm our growth strategy based in South America. We closed this quarter with positive free cash flow of BLR52 million, highlighted by the working capital optimization, which also contributed to reduce our cash conversion cycle from 18 to 15 days.

Net revenues climbed at 23% year-on-year, while EBITDA came to BLR134 million, with a margin of 10.2%. Last twelve months EBITDA totaled BLR522 million, 36% higher than in June 2012. We increased our capacity utilization to 80.3%, reflecting the maturation of the investments made in recent years. Our leverage, measured by the net debt EBITDA ratio stood at 3.3 times impacted by the dollar appreciation on that with no cash effect. We've closed the quarter with a comfortable cash position, enough to amortize our debt through 2019. Return on invested capital stood at 18.3%, a 100 bps higher than in first Q '13.

Lastly, yesterday, our ADRs began trading on the OTCQX ensuring higher liquidity and new trading alternatives in the U.S. over-the-counter markets and reinforcing the company commitment to governance.

Let's move to slide three with our industry overview in South America. What are our competitive advantages? As shown in the graph on the top of the right-hand side, we noticed that the export volume grew in the world's main beef supplies. These data show that South American countries, especially, Brazil and Paraguay, are benefiting from the region's competitive advantages in cattle production. This advantage includes an abundance of natural resources, a significant improvement of sanitary conditions and lower dependence on grain, giving the South America capital is mostly related on pasture from open fields.

The (inaudible) farmers collaborate our assertive strategy, based on the expansion of our operations in South America and confirms our vision that in the coming years the region should become the world living beef export platform. In fact, South America already consolidated its position as the number one exporter in the world. So we expect this to grow even further and to have a even bigger share coming from this part of the world.

If you look at slide four on industry overview, how is the Brazil in cattle supply. Regarding cattle supply, the second quarter was once again marked by a higher slaughter volume in Brazil led by the high cattle supply, encouraged by our strong beef demand in the domestic and mainly on the export market. It's important to know that despite the significant increase in this slaughter volume, estimated at around 10% between January and June 2013, compared with the same period last year, the cattle price remained resilient. This confirms our perception that the current cattle cycle implies abundant cattle supply in Brazil.

Let's move to slide five on industry overview and exports. Brazilian beef exports extended by a significant 27% in the first half of 2013 over the same period last year. This performance is explained by a reduction in global beef supply due to the weakening of some producing countries, including United States, Europe and Argentina.

The strong demand from the developing countries, especially, Asia and Middle East also reinforce a positive scenario. This result also confirms permanent position that Brazilian beef has been gaining in the export market.

Let's go to slide six to you have an overview on the Brazilian domestic market. The Brazilian domestic market remains solid in the second quarter, supporting by prices -- supporting beef prices. It's worth noting that the cattle price variation trend remains aligned with the variation in beef prices as present in this chart, which shows the variation in capital versus carcass weight equivalent. The same trend observed in both variables explains a solid margin recorded by the company in the second Q of 2013.

Also this is right, I would like to highlight the performance of the small and medium retailers, in which, we never concentrated sales, in which had expanded at a faster rate than the supermarket and the hypermarket. We also observe fairly a healthy growth in the food service segment, not only in our internal distribution, but also on MDF processed products.

So this slide shows the strong correlation between the price in the internal market and the beef. If we expect the Brazilian competitiveness to grow with the dollar and the local market to remain stable, this stands true to benefit the export market. So this is the one thing that we foresee for the future.

Industry overview, going to slide seven in Paraguay and in Uruguay. The second quarter was also very favorable for beef producers in Paraguay with a lot volume remains solid, thanks to high cattle supply, which explained a stable capital price in the relation of the first Q of 2013. Added to this was a significant 34% increase in exports year-to-date compared to -- with 2012.

This performance was driven by the reopening of the Chilean market and the entry into a new market in the Middle East, Eastern Europe and Asia, which allow Paraguay to consolidate its position among the world's largest beef exporters. Also it's important to highlight that Paraguay has competitive advantages in terms of the input cost, labor, tax system, electricity makes Paraguay consolidate its position as one of the main destination for the future.

In Uruguay after first quarter characterized by high slaughter volume, some producer slowed down slaughtering in the second quarter. Year-to-date slaughter volume moved up by 7%, while cattle prices remained stable. We believe the market rational combined with the higher cattle supply will help boost beef production in Uruguay, leaving companies to increase capacity utilization and take advantage of (inaudible) export market.

We highlight Minerva's increasing focus on each markets and the process of integration between cattle suppliers and the company, guaranteeing relevant competitive advantage and higher margins compared to other players.

Uruguay is the case that we will see the margin expansion, because the market has been under pressure. And with the new volume, with more volume of cattle coming to the market, the percentage of (inaudible) in Uruguay is increasing. So this leaves Uruguay with a very positive scenario and a positive trend for the future.

In slide eight, South America export evolution. As you can see in the pie charts on the slide eight, Brazilian and Paraguay exports were more diversified, focus on their opening of the new markets and grow in regular markets. We would also like to emphasize the excellent performance of Asia, Middle East and Russia.

Let's go to slide nine and look at Minerva results from the exports. The solid performances in Brazil and Paraguay in the second quarter help us consolidate the Latin America as the major beef producing region in the world. Based on its risk management policies, Minerva adjusted its sales mix to follow and benefit from this trend.

In Brazil, we remain as the second largest beef exporter in addition to being among the country's third biggest exporters. In Paraguay, our share in exports grew to 17% after the acquisition of Frigomerc. In Uruguay, our share increased 300 bps over the second quarter of 2012 to 11%.

On the slide 10, you can have a look on the Minerva operating results. Minerva's slaughter volume remained strong in the second quarter resulting in expansion of our 5.5 percentage points. In capacity, utilization compared with 1Q of 2013 which stood at 80.3% above the historical average. This performance reflects the greater operating efficiency in our units and the maturation of the investment made in recent years. Driven by solid export performance, export accounted by two-thirds of our gross revenue in the second Q of 2013. This shows how Minerva have been growing and ramping up its operations. So you'll see that the capacity utilization, it's benchmark on the industry and we have further capacity to grow only organic.

On slide 11, the evolution of the gross revenue by segment. Minerva recorded a 24% increase in gross revenues in the first half compared to the same period of last year. This sales expanded 29% led by the substantial growth of 33% in exports. The company may export destination where Russia, Middle East and China. Domestic sales also performed well, increasing by 21% over the first half of 2012, partially led by the expansion of the small and medium retailers and the food service segment, in which the company concentrate its sales.

Gross revenues from the other divisions grew 8.4%, driven by the performance of leather [ph] and the MDF [ph] division, we delivered a record gross revenues in the quarter. This increase reflects the changing consumption behavior in Brazil in the recent years, driven by the expansion of major food and franchise chains. MDF key strategies should meet the demand from the food service segment. In this contest, it's (inaudible) to benefit from the strong growth expect in the domestic market.

Now I will turn over to Edison, who will comment on our financial highlights. Edison?

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

Thanks, Fernando. So, starting on slide 12, we'll take a look at our financial and operating highlights for the second quarter. The net revenue increased 23% over the second quarter of 2012, reaching BLR1.3 billion in this quarter.

EBITDA amounted to BLR134 million, almost 20% higher than in the second Q 2012, reaching a margin of 10.2% in the quarter. The company also again delivered a higher return of our capital, which stood at 18.3%, 2.6 percentage points higher than in the same period of 2012.

Our leverage measured by the net debt to EBITDA ratio reached 3.3 times at the end of the quarter, almost one time lower than in June 2012. This reflects the company's measures to adjust its capital structure, especially, in the last six months.

The increase of 0.2 times in the net debt to EBITDA ratio was due to the appreciation of 10% in the dollar against with the real that has a non-cash impact on the company's debt. It's also important to emphasize the company's export profile, where we try to keep the same breakdown of our revenues at the same breakdown of our debt. So today Minerva is exporting roughly 70% of its total revenues and we are keeping 70% of our debt exposure to the dollar, which brings a natural hedge to our exposure.

Moving to slide 13, an explanation about the net result. So, as I mentioned, dollar appreciation brought an impact of BLR215 million on the company's financial results, but if you exclude this impact, Minerva net income would have reached BLR18 million in the quarter.

Moving to slide 14 to discuss about our free cash flow in the second quarter. You can see that the free cash flow of the company after investments and financial expenses came through more than BLR52 million on the quarter. The most contributed to this positive result was working capital that released roughly BLR63 million to the operations. It's important to mention that part of this improvement in the working capital is due to the company's credit quality, especially in the export.

So for some countries and for some clients, the company normally requires prepayment when we close a sale, this prepayment could reach 30%, 35% in some case. So by increasing export and through the growth on exports the company is presenting, that South America is presenting and to the macro picture, where we see South America is the main supplier of beef in the world. All this scenario allowed the company to increase the prepayments against our clients and this brought a very important result in terms of generating free cash flow and improving our cash conversion cycle in the quarter. So this is part of our risk management policy. This is the part of the credit policy that the company has been improving for the past five years.

Moving to slide 15, a bit discussion about our capital structure. So the company ended the second quarter with BLR1.2 billion in cash, which is enough to pay down all the debt until 2019, and it represents more than three times the short-term debt of the company. 16% of our debt is during the short term, and also it's important to highlight again that our leverage stood at 3.3 times measured by the net debt to EBITDA ratio at the end of the second quarter.

So Minerva remains in a very positive profile in terms of debt maturities and in terms of cash and as most part of our debt is during the short term. Moving to the slide 16, you can see the performance of our share since January '12 and it's also important to highlight that yesterday the company's ADR program migrated from the OTC Pink to the OTCQX segment, the highest standard corporate governance trading segment in the United States OTC market. This initiative reinforces our commitment to increase the ADR liquidity and to provide investors with new trading alternatives in the U.S. OTC markets.

Now, I'll turn to Fernando, who'll comment on the outlook for Minerva for the second half of the 2013. Fernando?

Fernando Galletti de Queiroz {BIO 15387377 <GO>}

Thank you, Edison. On slide 17, we reinforce Minerva's strategy on the growth focus on beef and in South America. On to the demand [ph] side, focusing on the developing markets and using the opportunities and the competitive advantage that we have in this part of the world there to supply the rest of the globe.

On investment, we keep our expansion plans in South America, organic or through our analyzing acquisitions, expansion of our distribution, focus on the food services and focus on small and medium retailers, and also, on the strategy of increasing our further processed products through MDF, increase of our investments.

We saw that we are having the advantages of having a better -- higher margins and better profitability. Therefore, the dollar appreciation helps us to perform our strategy on export markets and we keep focus on improving our capital structure.

We remain committed to financial deleverage. However, we remain the outlook for the investments opportunities in South America with discipline to preserve the company's capital structure and seeking to maximize the return to our shareholders.

So, now, I'd like to open for Q&A to clarify any possible doubts that you may have. Thank you very much.

Questions And Answers

Operator

Thank you. We will now start the question-and-answer session for investors and analysts. (Operator Instructions) Our first question comes from Wesley Brooks, Morgan Stanley.

Q - Wesley Brooks {BIO 16407564 <GO>}

Hi, guys. So a couple of questions from me. Firstly, just can you give us some thoughts on margins in August? If we check the domestic margins, it looks like they're being weighed down quite significantly by the weak performance of fore quarter prices, then hind quarters have been really strong, exports are looking good. Can you give us some thoughts on where they are looking relative to, say, Q2 and the third quarter of last year in Q3 so far?

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

Well, we cannot comment on the results of July and August. But, what I can tell you is that the sample that we have, it's a positive and indicates an improvement. If you look at 2012, the second half of the year was much better than the first half of the year, it will be no surprise for us if we repeat this same behavior in the market this year.

Exports are one of the leading sectors of the increasing of the profitability, with the currency appreciating, if you look at today reaching about the five years high. So you see that this leaves us and leaves the other South American countries very competitive in exports and increasing the gap between United States cost and European cost. So we see as a positive scenario what we will face on the second half of the year.

Q - Wesley Brooks {BIO 16407564 <GO>}

Okay. Thank you. And then my other question just thinking about JBS and Marfrig's results, both were pretty weaker than expected partly due to Uruguay. So I'm wondering two questions around that, one is does that present some opportunities in Uruguay that maybe you didn't have a few months ago given that that's part of your investment plan? And then the second question is, is the difference between your good performance and theirs perhaps due to different regions like (inaudible) and Mato Grosso or something like that has actually benefited you?

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

Right. The first answering about Uruguay. Uruguay represents less than 5% of our total revenues and our operation in Uruguay is very focused on niche markets, but there are less subject to the market volatility. So our strategy in Uruguay goes down to the farmer where there is a big integration, as I just presented, so this allows us to defend ourselves even in moments that you'll have a reduction in margins like what happened in the first half. Regarding the the performance of Minerva in relation to the peers, we didn't have time to analyze JBS results. Marfrig for us, it was difficult to analyze, because there was the discontinuity of the Seara operation. But what I can tell you is that the qualities of our risk management that we never have the flexibility, they see that how we changed from the local markets and the export markets utilizing our channels allows us to increase the profitability. Also the channels that we have in the local market focus on the small and medium retailers and in the food service also helped us. On the top of that analyze that we are benchmarking capacity utilization, where we are above 80% of capacity utilization.

All these factors combine here, I don't think that there is one factor, but there is a combination of factors that all are very shallow analysis allows us to have the performance that we showed on these results today.

Q - Wesley Brooks {BIO 16407564 <GO>}

Okay, thanks very much.

Operator

(Operator Instructions) And our next question comes from Jose Yordan at Deutsche Bank.

Q - Jose Yordan {BIO 1496398 <GO>}

Hi, good morning, gentlemen. My question was also about Uruguay but I guess I just -- if you could give me your views as to when Uruguay will reach the peak availability i.e., where are they in relation to the cycle of Brazil? And if you could also add, what's your outlook for the -- for when the cycle will turn in Brazil, is it the end of '14, will it be 2015, any views you have on that? And where Uruguay and Paraguay stand in relation to the Brazilian cycle? I guess in order to get a sense of, do they work against each other, it's smoothing out the different effects of the cycle or do they work together?

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

Well, first talking about the cycles in Brazil and Uruguay, starting with Uruguay is having a record number of (inaudible) because profitability of farmers have been very positive. So this will turn into more availability in something around one to one and a half year. But, of course, the expectation of a farmer allows us to already have a cycle positive sooner than that. Besides that, as I answered in the next question, the focus that Minerva have on niches allows us to defend ourselves. And I believe that the industry had a more complicated first half with more pressure on the margins, but I believe in what we are seeing for the second half this shall improve.

Uruguay, the normal cycle in this, I would say, that's one and a half year behind Brazil on the cycle. In Brazil, the cycle remains positive. Farmers are gaining productivity. If you look at the results that we increased our slaughtered -- our total volumes slaughtered and the price didn't move up.

So that shows that the cycle keeps positive and Brazil had accumulated inventory results of views of cost and this shall keep coming in the market for 2014 and 2015. But the most important thing is not the price that we pay for the cattle, but is the difference between what you pay for the cattle and what we can sell.

And the pricing power that we are having on exports is increasing, because we are becoming more competitive with less competitors. So, we are becoming more competitive, because the currency is helping us and our competitors becoming less competitive. So all that helping us to increase our pricing power in a market that is much more consolidated and much healthier.

Q - Jose Yordan {BIO 1496398 <GO>}

Great, very helpful. Thanks.

Operator

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

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

There is one more question.

Operator

Yes, we now have the question from Mike Holm at EQS.

Q - Mike Holm {BIO 17572380 <GO>}

Fernando, thank you for taking my question. You mentioned in the comments that the benefits of the weaker currency had only been seen in the last month of the quarter. And I want to understand two things, is one, why is that the case is there a delay in the way the pricing happens relative to international markets? And the second, I'm just curious if you can give us some guidance, what the margin would have been in terms of EBITDA margin? Had you had the currency that you saw in June for all of that period, how significant would have been -- that change been? Thank you.

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

First, we had the dollar appreciation in the second month of the quarter. So, the sales as we kept strong position on our long and short, through our risk management policy, you saw some of these effects -- a part of this effect in less than one and half month. But, even though it was a half of the quarter, you can also see the results and you can see on the numbers, how they affected. This also shows how faster we are able to change and redirect our sales and our volume to the exports. Two-thirds of the total revenues of Minerva came from the export market. The same thing happened in other countries, so this flexibility makes a difference. What was the second question?

Q - Mike Holm {BIO 17572380 <GO>}

How your margins would have looked like if you'd had this currency that you saw in June for the whole of the quarter?

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

It's a good question, but I don't know how to answer, because again, I would have my pricing power increased. Most probably analyzing with logic, I would have slightly likely higher price on exports, because, as I said before, my pricing power is increasing, our pricing power is increasing. So I would have most probably a higher price and a bit less volume. So this would be my guess, but, of course, that is a hypothetical scenario.

Q - Mike Holm {BIO 17572380 <GO>}

Okay. Very good. Thank you.

Operator

(Operator Instructions) We show no further questions at this time. Mr. Galletti, would you like to make any closing remarks.

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

To conclude our presentation, I would like to affirm that we remain very optimistic about the outlook for the sector, supported by the strong demand for beef protein in the domestic and export market. We continue to weakening of the producing -- all the producing markets like United States, Argentina and Europe, the favorable cattle supply situation in Brazil and in the rest of South America as a result of the current status of the cattle cycle.

The recent depreciation of the real combined with our sales strategy will focus on exports will bring even better results to all Minerva investments. I'd like also to thank all of the Minerva team for the great work that they have been doing and how the year have been, helping and doing a job on increasing our margins and putting Minerva in a different position in the market. Thank you very much.

Operator

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