Q3 2017 Earnings Call

Company Participants

- Eduardo Miron, Chief Financial and Adm. Officer and IRO
- Frank Ravndal, President & Chief Executive Officer
- Martin Secco Arias, Chief Executive Officer

Other Participants

- Botir Sharipov, Analyst
- Edward Santevecchi, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning and good afternoon, ladies and gentleman. At this time, we would like to welcome everyone to Marfrig Global Foods SA Conference Call to present and discuss its results for the third quarter of 2017.

The audio for this conference is being broadcast simultaneously through the Internet in the website, marfrig.com.br/ir. In that address, you can also find the slide show presentation available for download. We affirm (00:36) that all participants will 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.

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.

Now I'll turn the conference over to Mr. Martin Secco, Marfrig Global CEO. Please, Mr. Martin, you may now begin the conference.

Martin Secco Arias {BIO 18098476 <GO>}

Thank you. Good afternoon, ladies and gentlemen. I want to start by thanking everyone for participating in another Marfrig analyst presentation. Today, we will be commenting on the result of the third quarter of 2017. Today here with me Frank Ravndal, CEO of Keystone Foods; and Eduardo Miron, CFO Marfrig Global Foods and they will share with me the presentation. The presentation is the same we did on our private meeting this morning. However, in order to give you more time for the Q&A session, as well as not having such a long presentation for our call, I will be passing some of the slides that we did this morning.

Let's go to slide number 9 to start to talk about the Beef Division. Today, we are 18,000 employees. We are the second largest beef operation in Brazil, leader in beef production in Uruguay, and the largest beef importer of beef in Chile. 50% of our revenue coming from Beef Division. We have today under operation 19 slaughtering plants around Brazil, Uruguay and one factory in Chile.

As you remember, we decided to make a simplification of our structure with CEOs reporting directly to me. This division was made in April and we divide the company of the – the division of beef into division Brazil and international, International divided between Uruguay and Chile. And Brazil, we divided in the three segments that we'll comment you later.

This decision was made to give out more agility for decision-making, to have a better visibility of results, to have more focus and independence in management. These come to help in a very important moment of Marfrig and to help us with an excellent execution of better trio (04:49) of the company.

In Brazil, we divided company in three segment, meat packing plant which is responsible for the plant management, cattle procurement and sales, especially in the wholesale in Brazil and export channel. Food service and retail which is responsible for distribution and for serving value added channels. And Industrialized, which is responsible for processed products.

Please go to slide number 12. Between slide number 12, 13, 14 and 15, we want to give to you more details about the fundamental of our decision to reopen some factories here in Brazil. I want to remember to you the important of a agricultural business here in Brazil, the excellent sanitary conditions that we have. The production condition that we have, the improvement that we have in Brazil in the last year is about the genetics. And based on our projection, we have in page number 13 some information to share with you about Brazilian cattle herd projections, Brazilian beef consumption projections, Brazilian beef production projections and Brazilian beef export projections. All of them give us a very good information to make this decision.

In page 14, we have the relevant Brazilian stock around the world if you compare with other countries. And one very important indicator that is the productivity of our stock that today is 17%. This is a very good indication if we see how we improved in the last years.

The most important indication is the future that we have here in Brazil if we continue improving this indicator.

As you all know, the negative cattle cycle led us to take the decision in 2015 and 2016 to give temporary shut down some slaughtering plants in Brazil. The adversity faced by the industry on the first half of the year ended up presenting a new opportunity, which accelerated the expected improvement in the cattle cycle. Given this new scenario, we roughly adjust our primary processing capacity in Brazil, and early in June, we announced the expansion of reopening two new plants. As we expect, we'll reach at the end of the third quarter with the capacity to process 250,000 head per month.

Now we are in the middle of our second growth phase announced in August, that should lead us to the end of this year with processing capacity of around 300,000 heads per month. It is important to remember that newly reopened plants are located in a state that concentrate the higher supply beef cattle in the country, accounting over 70% of our country production.

Returning to Brazil operation on page 19. The two charts on the top of the slides show the evolution in our sales profile. As you can see, we adjust our sales mix to capture the best opportunity in the international market. Just an example, you can see our performance in Asia was 20% of our export in 2014 and today is 40% in the third quarter. We also improved in terms of our share Brazil, fresh export. As you can see on the chart of the bottom, in the third quarter we account 23% of the country's total export volume. As with export, we also improved our strategy for serving the Brazilian market with some recent action expected for the further strength of our position in the industry.

We are repositioning the brands Montana and Bassi. In the case of Montana, we have expanded production portfolio and create the new lines like Montana (10:03) and Montana premium beef. And to reinforce our one-stop shop concept in Brazil, we (10:13) meet our clients' needs. We recently began distribution product of Pagnifigue Uruguay, leader of frozen bread producer. And also we incorporate other new products on our portfolio.

On slide 21, I want to comment also some of our new development in industrialized segments that we create a new line of products. One, in a partnership with Nestle, we developed a new line of meat sauce that we are going to be launching in the export market as well over in the course of 2018.

Slide 22 shows the highlight of beef division in the third quarter of a year. After an adverse scenario in the first half of the year, the third quarter has began to reflect the industry positive fundamentals. The average cattle price stood at a BRL 134 per Aruba (11:27), down 12% year-over-year. The successful execution of the decision to reopen plants lead the division total sales volume of 301,000 tons, growing 22% on the same quarter over the last year.

Our sales revenue was BRL 2.6 billion in the quarter, a highlight was the recovering fresh beef export whose volumes grew by nearly 100% in the third quarter of 2016. The performance of export reflect the flexibility and capacity of the company to optimize its production base with volume from existing plan redirected to the export market, while volume from the recently opened plants which were pending authorization to export were redirected to Brazilian market.

Another important factor in the quarter was the decline in general and administration expense to BRL 195 million, a reduction of 4 percentage points from the same quarter over last year. As a result, this division posted adjusted EBITDA BRL 246 million, advancing 67% on the same quarter over the last year.

I will pass now the presentation to Frank Ravndal to share the Keystone performance.

Frank Ravndal {BIO 19230519 <GO>}

Thanks, Martin. We won't be able to go through the entire Keystone presentation but you have access to the information and can review it at your convenience. Before moving into the quarter results, I did want to spend a few minutes on our strategy, so let's jump ahead to slide 31.

In December 2016, we finalized our Strategy 2021 work. It was really an excellent process that included several consulting groups, one that helped us in the U.S. and China, and another that helped in other markets where they had greater market presence and expertise. So it was a good mix of internal know-how and experience with the right challenge and external dataset and objective perspective from outside of our walls.

The summary slide has five pillars. I think it's useful to think of the three on the left as the what, and the two on the right as the how of the strategy. So if we look through the three on the left that provide the direction and the what, it's really around continuing to develop and deepen and expand the relationships we have with really a phenomenal set of customers that are already in our portfolio. We certainly don't want to lose that focus. We believe there are many, many other opportunities to grow significantly with that existing incredible customer base.

The second is about continuing to expand and grow with new customers and to expand across a greater number of channels. And the third is really about moving towards a higher value product mix over time. In terms of the how, it's really one that's about unlocking that growth potential that we've identified with continuing to focus on commercial capabilities, and those commercial capabilities extend from having the right marketing and sales resources and skill sets inside Keystone, as well as around being increasingly in a lead position in terms of market and consumer insights to share with our strategic customers. And clearly, both of those are required to continue to fuel a strong innovation engine which will again continue to be very important for our growth objectives.

And the final pillar around the how is about a heavy investment plan. We will need to continue to invest in both capacity, as well as new capabilities to be a partner of choice with the customers that we've identified. A couple of important takeaways from the strategy, one is that we don't have to completely reinvent ourselves to continue to grow profitably.

We will continue to move into new customers, newer channels and adapt, but the core capabilities we have built will continue to provide competitive advantage. The second is that it's simple, our entire organization can understand it and rally around it and can understand how they fit. And the third is that though it's simple, there are detailed business plans by country behind this summary so a good roadmap exists for each year from now through 2021. We're already largely through the first year of that five-year strategy.

So let's jump to the earnings for the quarter. I'm really proud to announce that Keystone delivered another record quarter. Adjusted EBTIDA for the third quarter of 2017 was $77 million and the adjusted EBITDA margin was 10.8%. These results represent the strongest performance in Keystone's history.

Keystone continues to deliver on the objectives of our Strategy 2021 initiative, including growing volume of existing core customers, establishing Keystone as the partner of choice with new customers across multiple channels and driving towards a higher value product mix. During the quarter, we experienced strong volume growth with our core customers, particularly in the Food Service Channel in the U.S. and at APMEA.

Keystone has been working with these customers to support menu items that will drive store traffic and we've seen strong results during the quarter both on core menu items, as well as, promotional items . Keystone continues to establish itself as the partner of choice with new customers. In addition to the positive momentum with global QSR brands, we are growing with local QSRs and certain APMEA markets and continue to find attractive growth opportunities across Keystone in several newer channels including convenience and industrial.

Keystone is continuing to drive toward a higher value product mix across all channels. Higher value products include promotional products launched with support from Keystone innovation teams, as well as products based on unique needs and attributes such as no antibiotics ever. We continue to see healthy demand for these products. Customer demand continues to put pressure on very tight production capacity. Several projects that will expand capacity and extend capabilities have either just been completed or are about to begin full commercial operations.

Let's turn to the slide and take a look at the numbers. Please remember that all financial information that is presented by Keystone Foods is presented in U.S. dollars. First, in the upper left, Keystone's volume reached 286,000 metric tons in the third quarter. Although this represents a 1% increase on a consolidated basis when compared to the same period last year, our APMEA segment grew volume by 17%. This growth was driven by China and supplemented with increasing demand in the UK and the Middle East that was met through our export oriented facilities in Thailand and Malaysia.

In the U.S., the basis for year-over-year comparison is slightly skewed. During the third quarter, Keystone completed the transition from a relatively high volume but lower value customer that historically had seasonally high volume in the third quarter. This created a high basis for a year-over-year comparison with the third quarter of 2017.

Although this dampened volume growth during the period, other customers are absorbing the available capacity at a higher value to Keystone and with less seasonality, which is a positive development for the business. Keystone did experience strong volume growth in the food service channel in the U.S. during the quarter. This volume growth was offset by decreases in the industrial channel due to the customer transition that I just outlined.

On the lower left, the consolidated net revenue increased to $713 million during the third quarter which is a 4% increase over the same period last year. The stronger growth in revenue relative to volume growth is the result of, one, an ongoing effort to drive toward higher value product mix; and two, favorable pricing of dark meat byproducts of our poultry vertical integration in the U.S. Now moving to the right side of the page, you can see the record results for adjusted EBITDA and adjusted EBITDA margin of $77 million and 10.8% respectively. Keystone's adjusted EBITDA grew 25% relative to the same period in 2016.

As I've mentioned, the strong performance is the result of volume growth with the existing and new customers, as well as an ongoing product mix improvement toward higher value products. The strong customer demand and tight capacity I mentioned previously also pushes that limited capacity towards higher value products for our core customers. On the cost side, Keystone continues to benefit from a favorable environment for raw material costs including feed costs and outside meat purchases.

SG&A during the period was $18 million or 2.5% of net revenue, which is slightly above the same period last year but consistent with the historical range. In summary, the third quarter was excellent and contributed to a very strong overall 2017 year-to-date performance. We're excited about the capacity additions and capability extensions that we will bring to market in 2018 and beyond, and also excited by the commercial opportunities we see available across our global footprint.

And now I'll pass the call back to Eduardo.

Eduardo Miron

Thanks, Frank. I will begin on slide 35 with the consolidated results of Marfrig Global Foods. Both sales volume and net revenue posted double-digit growth rates, and this division's successful execution of its strategy was the main factor. However, it is worth to highlight Keystone's strong sales volume growth of 17% in the APMEA region, while the division's overall sales volume posted moderate growth.

Marfrig's consolidated adjusted EBITDA registered a strong growth of 40% year-over-year with double-digit margin, a level not seen since the fourth quarter of 2015. This performance is explained by the good results generated by both divisions, Keystone once again setting a new record and this division successfully capturing opportunities in domestic and international markets with the rapid adjustment of its production base in Brazil. So in my opinion, the third quarter represents a new level in the company's operational results.

Turning to the financial indicators on slide 36. Despite the quarter being marked by investment in the reopening of capacity in this division, we had a reduction in our leverage ratio, measured by net debt to last 12 months' EBITDA. As I commented in the earnings conference call for the second quarter, the growth in net debt due to the investments in reopening capacity should be offset by higher results, and that's exactly what happened. Our leverage fell from 4.55 times to 4.36 times.

However, I should note the new operational level that Marfrig has achieved after reopening capacity in this division. And in our opinion, the leverage ratio that best reflects this new scenario would be the one based on the annualized third quarter adjusted EBITDA, which considering the simple level of debt would generate a leverage ratio of 3.669 times, below 4.

We understand that this is a theoretical calculation, but it better reflects the current level of our operations and the downward trend in our leverage. Regarding that, at the bottom of the slide you can see that Marfrig's gross debt remained stable over the quarters, posting a moderate reduction.

The debt cost and average debt term also remains unchanged. Our cash position declined 13%, this reduction reflected the company's investments in the quarter, which were made using its own cash. And talking about cash, slide 37 shows our cash flow in the period. In the third quarter, the cash flow was negative BRL 621 million. As discussed in our previous earnings call and after announcing our decision to reopen capacity in Brazil, we did not expect a positive cash flow this quarter.

Operating cash flow was affected by the negative working capital variation influenced by both divisions, especially in the inventory and the clients' line. In this division, the higher production led to an increase in inventories, and the strong export volume in the quarter led to a decline in the advance from clients.

In Keystone division, we observed an increase in the inventories due to two main reasons. In the United States, the build in inventories due to the higher level of promotions and the higher demand for antibiotic free products. In Asia, the build in inventories was due to a scheduled shut down in one of our plants in China for cutback purposes. Another important (26:49) of cash flow was the ongoing investments in both divisions.

In this case of this division, the investments were related to the plant reopening, while in Keystone the investments were related to the 2021 strategic plan, which included CapEx expansion projects that were concluded in this third quarter. In Thailand, for example, the new chicken base process plants which represent an important expansion in our capacity in the region is currently in the ramp-up phase. And in Malaysia, we added a new production line.

Lastly, I want to call your attention to the interest line which was reduced once again. Compared to the second quarter it declined by 8% influenced by the exchange variation in the period. Compared to the third quarter of the last year, we registered an important reduction of BRL 100 million. That concludes this part of the presentation so let's go back to Martin for his closing remarks.

Martin Secco Arias {BIO 18098476 <GO>}

Thank you, Eduardo. Turning now to slide 39, I will comment briefly on our expectation for the closing months of the year and the scenario for 2018. For Beef Division, the full quarter is seasonally the strongest of the year. And from margin, the expectation is that they remain at healthy levels in line with our vision in which we expect improvements already in the second half of the year.

In the case of Keystone Division, we do not expect anything different from that we have been delivering and (28:44) for the result to remain robust in line with previous quarters. In term of leverage, despite our commitment to maintain our level of investment, we expect the downward trend of observed in the third quarter to continue.

For 2018, we also remain optimistic. The outlook for the global animal protein industry remain positive. In term of Beef, as I already shared with you the scenario remains positive with expectation of higher supply of cattle, supporting higher production with healthy margin for the industry. For Keystone, we expect a continued favorable global scenario to drive demand for the food service industry and for processed product, especially for chicken product who grows outperformance other proteins.

In this context, we expect a significant improvement in our operational cash flow for the company which in 2018 should be boosted by the ramp-up of the newly reopened plants in Brazil and Keystone capacity expansion project in Asia. For 2018, we will continue to focus on (30:12) the Keystone business – of the (30:14) Keystone business. It will give us a resource that will allow us to accelerate the reaching of our target leverage ratio of 2.5 times and to continue our levels of investing in organic growth projects.

During the earnings conference call in 2016, I mentioned that we will be sharing with you our strategic plan for 2021. However, due to our decision to carry out an IPO for the Keystone Division, we cannot, because of regulatory requirements, share any long-term numbers with you. But I can do before concluding today presentation is to share with you our vision of where we want to be in 2021 and to assume the commitment that another Marfrig Day, we will go into more detail in our plans and goal for the next five years.

Today, Marfrig is one of the world's leading animal protein, but in 2021, we want Marfrig to be recognized as well a global leader and the preferred partner in our market segment while becoming a leading creator of value of its shareholders.

I want to thank you everybody to share with you the presentation, and now we are open this space for the Q&A.

Q&A

Operator

Thank you. Ladies and gentlemen, we will now begin the Q&A session. Our first question comes from (32:22).

Hi. Thank you for the call. My first question is on the ramp up of production in Brazil. I'd like to listen (32:34) a bit better, when you're talking about – my understanding is that you've increased your foreign capacity to 250,000 heads per month as of September, and you're planning on increasing that to 300,000 heads per month. And I'd just like to understand, what was the – that increase was from how much before, and have you fully – I mean, did you want increase it to 250,000 by the end of September, or did you actually average the whole third quarter at 250,000? Hello?

A - Martin Secco Arias {BIO 18098476 <GO>}

Okay. Let's go again. As we announced, we want to reach 250,000 animals at the end of the third semester. Our slaughter in October was 267,000, for that we achieved the goals that we defined in June. And it's the same case of the fourth quarter that we announced our plan to achieve 300,000, and this is the number that we are planning to achieve at the end of the fourth quarter.

Q - Operator

Understood. But that was – if you then take that number and extrapolate it to 2018, assuming that you don't close back any capacity, that would mean you'll be basically running 2018 at 50% more production than you are running, let's say, up to June 2017. And then I guess my question there is are you going to then run at a level communication (34:51) or do you actually think you can put all that in your production into the markets without bringing prices down?

A - Martin Secco Arias {BIO 18098476 <GO>}

Okay. (35:22), the delay was noisy to understand you because we are in a huge room here and have a lot of noise. But our plan is to ramp up the new factories. As you know, the new factories started with very few habilitation (35:44) to export, for that we continue in the focus to improve our export for the previous plants and focus on the new ones in the local market. For that, this is a time that we expect that will take more or less four or six months average to reach the full habilitation (36:09) for these factors. For that we are going to continue in most markets, focusing both markets, as I comment very hard in the export. We are very hard today in China, Iran, Chile like our main markets.

We are a lot of expectation about the agreement between Mercosur and the economic community. And of course, we are working very hard on our Food Service segment here in

Brazil with a very strong campaign for our brands in the local market. For that we are planning to fulfill our capacity with the best mix between export and local market.

Q - Operator

Understood. And then my last question for you is just in terms of when I look at Keystone, and I see the much higher EBTIDA from (37:11) that you managed to do during this quarter, I'd just like to understand what explains - that there was a small increase in terms of tons but what explains that you're making so much more EBITDA per ton?

A - Frank Ravndal {BIO 19230519 <GO>}

Yeah. I think for the quarter there really are a lot of contributing, factors and I think we tried to cover some of those in the comments. But it's really one of - seeing some good activity around higher margin products, I mentioned a couple of those like some of the NAE products and continuing to be very well demanded by our customers. And then really a lot of other good supporting significant contributors as well. Around the cost side we had very low feed input costs which was certainly beneficial. We also had very attractive markets by and large for the outside meat purchases that we made, principally in chicken. As you know we're not a 100% vertically integrated in the U.S. so therefore we're a net buyer of breast meat, in particular, parts of the year.

And then also you had both of those on the cost input side, and then another one of the revenue drivers that was helpful was a very healthy market for the park sales of our dark meat byproducts in the U.S. So really, the combination of all of those being very attractive moments in their respective markets, and I would say in terms of the part sales, things having held up much more firmly than they normally would've been through the third quarter. And those have already adjusted as of October down to more seasonal normal levels, I would say. But so I think you had a number of different contributing factors, and it wasn't all dominated by one of those.

Q - Operator

Understood. Understood. And sorry, actually, I just have one last question which is in terms of the growth CapEx that you spend during the quarter, I assume there was still kind of a other tail of the plant that you were opening in Thailand, you mentioned as well the new production line in Malaysia. I mean, can you just give us a bit more of a sense on the growth component, how much - it seems still to be a very high number, and I only know about these two initiatives. Are there other initiatives that we should be aware of, was there - I guess, the plants in Brazil also contributed to that, but could you just give us a little bit of a sense of what made that growth CapEx?

A - Frank Ravndal {BIO 19230519 <GO>}

Yeah. So I can go into - definitely, there's a few other projects. I mean, what we mentioned specifically in terms of coming to completion in the last few months and about to become fully operational are really the addition of fully cooked capacity in Malaysia, and then the plant that you can see in our presentation that we didn't spend time on but which is about to become fully commercialized in Thailand, it's a significant expansion.

But in addition, we've had important projects like moving through the fresh beef in the U.S. And then we're also very far along on some of the investments that we're making across the U.S. chicken business to just increase capacity, where in particular at one of our vertically-integrated complexes that tends to focus on the slightly smaller bird, we're expanding there. And that is something that is really about an 18-month lead time before it starts to show up in terms of what we can turn around and sell.

So that's something that we've been working on for a while and we'll continue to work on and invest in all through 2018. And there's a number of other projects. So we have quite a few investment projects that we've been working on, but I don't believe we're breaking out or providing totals by company or by division. So I don't want to get into any more specifics relative to guidance, but just on the comments that I shared on our strategy is piece.

Q - Operator

Thank you very much.

A - Frank Ravndal {BIO 19230519 <GO>}

You're welcome.

Operator

The next question comes from Eddie Santevecchi, Nomura.

Q - Edward Santevecchi {BIO 5947871 <GO>}

Hi, guys. Thanks for the call. Just had a question around working capital. Can you give us an idea of what the incremental investment will need to be to go from the 250,000 heads at September to get you to that 300,000 figure?

A - Eduardo Miron

So if I got your question right, so you're asking about the size of the investment to get to the full reopening of the plants, correct?

Q - Edward Santevecchi {BIO 5947871 <GO>}

Correct. Yes.

A - Eduardo Miron

So, if that's correct. Without providing any guidance for the fourth quarter, we expect still an important expenditure in cash related to working capital and CapEx in the fourth quarter near to complete, not just the reopening of the plants but as you heard before we had one of the projects that are ongoing and we will continue. It's important to mention though that – yeah, sorry. Important to mention...

Q - Edward Santevecchi {BIO 5947871 <GO>}

Sorry. Continue.

A - Eduardo Miron

Yeah. Sorry. Important to mention though that all these are done in a very well disciplined process where our leverage is being absolutely very close controlled, and therefore, as I mentioned before in this level, we are below four. But even in the last 12 months, we see that the level would be more in a consistent level. So we are not concerned about this level of investments or the challenges that we have for reopening and for these investments for the fourth quarter or for the end of the year.

Q - Edward Santevecchi {BIO 5947871 <GO>}

And so just to be clear, after the fourth quarter you think the bulk of this investment in working capital and growth CapEx will be complete and then we can have a more normalized scenario for 2018?.

A - Eduardo Miron

Well, there is an absolutely spike because of the reopening of the plants in the case of Beef in the case of 2018, again, we have a five-year plan which as we mentioned before it is based on important investments. But I think it's too early for us to talk about 2018 apart of what has already mentioned by Martin, which is the outlooks is very, very promising.

Q - Edward Santevecchi {BIO 5947871 <GO>}

Okay. Anyway, and just on the outlook, you have obviously the plan here to continue ramping up production. Do you see more opportunities, I guess, to continue that, given that some of your peers in the space have pulled back. I mean, how do you factor that into your equation? Do you expect them to kind of come back and retake some of that market share, or do you think the levels where we are now is the right mix to think about this going forward?

A - Martin Secco Arias {BIO 18098476 <GO>}

The other plants that we mentioned about the 300,000 for the near future, and our strategy is not related about what is happening with the other peers. We have expectation in 2017 that the cycle is going to be more positive for us. The only thing is the timing was in a moment that we don't expect so early so that we accelerate a little bit our reopens of the factories. As you remember, we have a lot of events here in Brazil in April, but we are very comfortable with this level of activity for the near future.

Q - Edward Santevecchi {BIO 5947871 <GO>}

And just last question, I don't want to hog too much time here. But is there a level for cattle prices where if some of this increased production starts to shift the pricing that we're seeing now that maybe you would look to reduce some of this capacity that you put on? You said that 150, 160 (46:18) or maybe the changes or how are you thinking about that for the next year?

A - Martin Secco Arias {BIO 18098476 <GO>}

So we've got already a reduction of 12% year-over-year on the cattle price, and we see this price stable for the fuel for the next months. We are – at the beginning of the fourth quarter, we will be the ones – a little bit delay on the rainy season. But today, the situation is normal and we have a lot of expectation to have a good volume of cattle available in Brazil and also in Norway on the fourth quarter.

Q - Edward Santevecchi {BIO 5947871 <GO>}

Okay. But there's still a specific price that you're targeting at...

A - Martin Secco Arias {BIO 18098476 <GO>}

No.

Q - Edward Santevecchi {BIO 5947871 <GO>}

...that would also be planned?

A - Martin Secco Arias {BIO 18098476 <GO>}

No.

Q - Edward Santevecchi {BIO 5947871 <GO>}

Okay. Okay. Great guys. Thank you very much.

Operator

The next question comes from (47:25).

Hello. The first question is regarding your leverage target for 2018, you said 2.5. Does that include any proceeds from the Keystone IPO?

A - Eduardo Miron

Let's make sure I understand your question, this is Miron. Your question is what is the level of leverage for 2018?

Q - Operator

No. Well, you guided the leverage of 2.5 times for 2018, right?

A - Eduardo Miron

Right. It has not changed.

Q - Operator

Yes. Did that include the proceeds from the Keystone IPO?

A - Eduardo Miron

Yes. We always mention the 2.5 times would be achieved after a restructure transaction.

Q - Operator

Okay. And so in terms of the Keystone IPO, will all the proceeds be used for debt reduction or how should we be thinking about the Keystone IPO from a debt perspective?

A - Eduardo Miron

As we always convey, any proceeds for any structural transaction would be utilized due to leverage decoupling.

Q - Operator

Okay. Got it. And just one more thing from me, you've been talking about working capital, through the call. But just to be very clear, in terms of Q4, given the fact that you're ramping up capacity in Brazil, should we expect another outflow working capital in Q4?

A - Eduardo Miron

Sorry, I'm not sure I got your question. Could you repeat?

Q - Operator

Sure. Q4, shall we expect another outflow in working capital?

A - Eduardo Miron

Yeah. I think the – in terms of working capital, we'll continue pressure because of the reopening and we should expect similar levels of cash.

Q - Operator

Okay, understood. Thank you.

The next question comes from Botir Sharipov, HSBC.

Q - Botir Sharipov {BIO 16759043 <GO>}

Hi. And thank you for taking my questions. First one is on the Beef margins. You had a very challenging quarter in terms of industry events within cattle availability and cattle prices were pretty flat quarter-over-quarter and yet you guys were able to expand your margins from Q2 sequentially. So wanted to see if you could maybe give us some color until how you guys were able to do that, is that just the capacity utilization, because I understand that you had to hire maybe some more people when you reopen the plants so I just wanted to see where the improvements are coming from.

A - Martin Secco Arias {BIO 18098476 <GO>}

Could you repeat again the question?

Q - Botir Sharipov {BIO 16759043 <GO>}

Your Brazil Beef margins, EBITDA margin or gross margin improved from the second quarter to Q3 despite obviously some of the challenging stated cattle cycle in Brazil, and you also had a food deflation in the third quarter and yet your margins have expanded. So I just wanted to see what's driving that improvement in the margins in your Brazil Beef Division?

A - Martin Secco Arias {BIO 18098476 <GO>}

As you know, the margin of the Beef Division is very important the price of the cattle. But of course, it's the most important item in our costs, but it's not the only one. We have very important performance regarding the other costs at the slaughterhouses. We have a very good performance on export regarding very good prices. We have a good exchange rate also for this period. And all these factors mix it, they – the result of the improvement in our margin between the second and the third. But you need to forget that in the second maybe the price of the animals are very cheap or much cheaper than the third, but the performance of the industry in Brazil was very poor for the events that happened in April of beef week. For that, these variance costs are an important part of our margin in the second semester.

Q - Botir Sharipov {BIO 16759043 <GO>}

Okay. Perfect. Thank you. And on your capacity utilization, you mentioned that excluded 87% of your affected capacity utilization, was it the average for the third quarter or was it at the end of Q3, and what do you expect the capacity utilization to be at the end of the year?

A - Martin Secco Arias {BIO 18098476 <GO>}

What's the average of the utilization? It was a little bit less, maybe two points down than the previous quarter but the number is much better because we have the reopen in the factory. And as you know, we have the ramp up period of the factory and the first stage was very few activities because we are adjusting a lot of things. So that 87% was a very good figure for us in the third semester.

Q - Botir Sharipov {BIO 16759043 <GO>}

And that was the average, right?

A - Martin Secco Arias {BIO 18098476 <GO>}

Yes. And we expect to have this number or much greater for the fourth.

Okay. Thank you so much.

Operator

This concludes today's question-and-answer session. I would like to invite Mr. Martin Secco to proceed with his closing statement. Please go ahead, sir.

A - Martin Secco Arias {BIO 18098476 <GO>}

I would like to thank all of you to join us today for this call. We can continue on communication through other channels with our IR Department. For that, thank you again, and good afternoon for the everybody.

Operator

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