Y 2019 Earnings Call

Company Participants

- Eduardo Miron, Chief Executive Officer
- Marco Antonio Spada, Chief Financial and Investor Relations Officer
- Marcos Molina, Founder and Chairman
- Unidentified Speaker

Other Participants

- Ben Theurer, Analyst
- Gustavo Gregori, Analyst
- Marcel Moraes, Analyst

Presentation

Operator

Good afternoon, ladies and gentlemen. At this time, we would like to welcome everyone to Marfrig Global Foods SA conference call to present and discuss its results for the fourth quarter 2019. 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. (Operator Instructions)

Before proceeding, let me mention that forward-looking statements are being made under 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 the 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 the 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 now begin the conference.

Marcos Molina {BIO 15363967 <GO>}

(Foreign Language) Good afternoon, everyone. Thanks for another call of results of Marfrig.

(Foreign Language) Thanks to a number of movements, very compatible with our strategy, we were able to firm up our position in the global beef position -- market, sorry.

(Foreign Language) We have made important and significant movements throughout the year. Between them, the acquisition of Quickfood, the owner of one of the -- or some of the most important brands in the Argentinian market.

(Foreign Language) Also, we returned to operate strongly in the processed foods, hamburgers for foodservice after five years of non-compete given the sale of Seara and after the acquisition of the Varzea Grande plant from BR Foods in Mato Grosso.

(Foreign Language) In addition to that, we have made important steps towards the plant-based protein. We made a partnership with the American company, ADM, for the production of the high-quality products in this area. Since then, Marfrig started producing in its factories -- facilities veggie burgers to meet the request or the needs of a number of foodservice chains. And also, we launched our own brand called Revolution, and this brand is now exported to other countries.

(Foreign Language) In 2020, our intent is to provide even more independence for this plant-based business with ADM in order to provide even more focus and lead this segment in the global market.

(Foreign Language) Now looking to these North American operations. I'd like to highlight the acquisition of an operator in Iowa and the increase of our participation in National Beef. All that was done without jeopardizing our commitment with the sustainable growth and the maintenance of a solid capital structure and cash generation. Those commitments, I'd like to renovate for 2020 and the future.

(Foreign Language) For 2020, we also have a lot of work to integrate the operations inside the South America, which includes Uruguay, Argentina, Chile and Brazil. Also, we need to do a better integration with our operation in the North America.

(Foreign Language) Regarding the operations, we intend to increase our production of processed, industrialized products based on beef. And our expectation for 2020, for both South America and North America is very, very positive. And we expect to generate, in these coming years, significant and historic marks.

(Foreign Language) After suffering for years with questions related to the quality, cost, the beef has adequate -- has adjusted its process regarding its norms and has consolidated itself as a go-to protein. So now it's a lot more secure and is, according to a number of communications, one of the key source for protein and health.

(Foreign Language) Back to Brazil, we have big challenges related to the provision of beef products in scale, especially because of the Amazon. I have spent a big deal of my time in order to develop a sustainable production in the country.

(Foreign Language) It is my vision that we have a great opportunity for all of us related to communication of our environmental assets as a great potential for the country, and we can produce a sustainable beef, grass-fed, and at the same time, preserve the Amazon forest.

(Foreign Language) Our duty is to help Brazil in improving its communication to the world, and be, the company, as we see, as a reference company and a leader in this sector, in this area.

(Foreign Language) To finish, I believe that we have done a lot of work throughout the year, that we are in the right -- we are inserting the right protein in the right momentum. I'd like to thank all our 30,000-plus employees and also the executive directory for the great job done in 2019.

(Foreign Language) I'd like to also thank our clients, suppliers and investors, and in special, the shareholders, for the partnership and trust in our management.

(Foreign Language) We will continue working extremely hard to do the right thing and to keep Marfrig ahead and be the reference in the global beef protein sector.

(Foreign Language) There's still a lot to do, and we come with help and the partnership of everyone. Thank you.

(Foreign Language) I I'd like to pass now the word to Mr. Miron.

Eduardo Miron

Thank you, Marcos. Good afternoon. I want to start by thanking everyone for participating in another earnings conference call of Marfrig Global Foods. Here with us today are our Global CFO, Marco Spada; and our CEOs, for the South America operation, Miguel Gularte; and Tim Klein, for all the North American operation.

Moving on to slide number 3, let's start by the quarter highlights. We, once again, posted a net income. This quarter, our net income was BRL27 million compared to a net loss of BRL1.3 billion in the same period of 2018.

Net revenue was BRL14.2 billion, a new record for the company, growing 23.5% compared to the same period of 2018. Adjusted EBITDA came to BRL1.6 billion, a record high for the company, up 70.5% from fourth quarter 2018, with margin of 11.4%.

An important highlight of the quarter was the cash flow generation. We generated BRL1.1 billion in free cash flow, which enabled us to begin the process of reducing working capital operations of the company. We reduced approximately BRL500 million in operations, aiming to decrease financial costs.

In operations, new plant authorizations in Brazil expanded export capacity to China significantly, giving us an important competitive advantage, considering the countries to which Marfrig already exports.

Another highlight was the launch of our new plant-based beef patty brand, Revolution Burger. The new product already has an important partner, Outback Steakhouse, which has launched its vegan beef patty with the Revolution seal. Soon, the brand will be sold to the end consumers in supermarkets.

In terms of capital structure, two important operations marked the quarter: the increase by 30.73% in the interest held in National Beef, with the acquisition of Jefferies interest amounting to 81.73% of the total interest and consolidating our footprint in the relevant US markets; and the primary offering of shares, which raised BRL900 million for the company, followed by a secondary offering, in which BNDES sold its total interest in the company. And as a result, our investor base and the volume traded in the stock exchange grew significantly, with floating increasing by 150%. These two operations resulted in more access and flexibility in US debt market, with lower interest rates via National Beef.

Increase in the flow of dividends for Marfrig, which will help reduce its debt more rapidly, puts an end to stand by on Marfrig shares, such as the put option related to non-controlling shareholders of National Beef and the imminent sale of BNDES interest.

Now over to Spada, who will provide some details on the operations.

Marco Antonio Spada {BIO 20767498 <GO>}

Thank you, Miron. On the following slides, I will comment on the operations results highlights. Going to page 5 and talk about the North American operation. You have to see the changes, the amounts reported here are in US dollars, and also consider the pro forma results in fourth quarter 2018, including the hamburger facility in Ohio and also Iowa Premium for comparative effects.

In the fourth quarter 2019, we posted growth in both volume and revenue, with revenue reaching $2.339 billion, an increase of 10.2% against the fourth quarter of 2018, due to the increase in average prices in domestic market and thanks to a solid and continuous growth in demand for beef protein in the United States.

Gross profit was $343 million, up $92 million from the fourth quarter 2018. This better performance is due to the increasing beef protein prices in the domestic market and also the decline in cost of cattle. The cutout ratio, which is the ratio between average beef price and average cost of cattle was 1.96 in the fourth quarter '19, and in comparison to 1.82 in the fourth quarter '18.

Starting this quarter, after the acquisition of additional interest in National Beef, we will also start to disclose EBITDA per operation. EBITDA for the North America operation was $290 million in the fourth quarter 2019, an increase of 32.8% from the same period of the previous year. Margin was 12.9%.

Moving to slide number 6, where I'll comment on the results of the South America operation. Net revenue from the South America operation increased 34.4% from fourth quarter 2018, reaching over BRL4.5 billion. The growth in exports, combined with higher average selling price, was the main driver of this growth. Revenues here are impacted, even though still partially, by the new facilities approvals to export to China in Brazil during the quarter, as mentioned by Miron.

Gross profit was BRL665 million, 91.5% higher than fourth quarter 2018 driven by the increase in export price and volume, and also the operational improvements we implemented throughout 2019, mainly the greater optimization of our production facilities, where we have closed three plants and increased the usage of other facilities with greater potential, such as Varzea Grande.

Moving on to slide number 8, we'll talk about the company's consolidated performance. We set a performance record in the quarter. Net revenue grew 23.5% to BRL14.2 billion, a record for the company. This performance is mainly caused by revenue growth at the South America operations, as explained earlier, and by the continuous strong demand in the North American market, apart from the exchange variation during the period.

Adjusted EBITDA was BRL1.6 billion, another record, and was 70.2% higher than fourth quarter 2018, with a margin of 11.4%. Another highlight was the profit for another quarter. In the fourth quarter 2019, we registered a profit of BRL27 million compared to a BRL1.3 billion loss in the fourth quarter 2018. Note that the quarterly result was impacted by plant closures and consequent asset write-offs. In the year, we registered net income of BRL218 million.

Moving on to next slide, where we talk about our cash flow. Operating cash flow reached BRL1.7 billion, reflecting the healthy moment in the operations. This enabled us to take a decision in the fourth quarter to reverse working capital operations in order to reduce our financial costs. With this, we see this account receivables totaling BRL531 million in South America. Here, in the presentation, we are making this adjustment, showing the situation before the decision when the operations generated free cash flow of BRL1.1 billion in the quarter, which helped us to achieve the target for the year.

As for CapEx, the funds allocated to recurring CapEx, that is those used for maintenance and small improvements, reached BRL323 million. This greater amount in the fourth quarter comes from the benefit of climate conditions in the United States, where National Beef took the advantage of the weather conditions to perform maintenance and improvements in the water treatment and reuse station, and also, the adjustment of slaughtering volume at Varzea Grande in Brazil, as mentioned earlier.

Interest expenses on debt totaled BRL301 million, impacted in this quarter by the additional cost related to the bridge loan for the acquisition of the additional shares in National Beef, and also by the higher exchange rate, which directly affects interest on our dollar debt. As such, free cash flow before M&A operations, payment of dividends to minorities and before the decision to reverse the working capital operations, was BRL1.1 billion.

Moving to the next slide, I will comment on the company's net debt and leverage. We started the quarter with $10.7 billion in net debt. The free cash flow generated in the quarter, the BRL1.1 billion presented today on the previous slide, was used to settle working capital transactions mentioned before, the BRL531 million, and also in the acquisition of the interest in National Beef.

In addition, we have paid dividends to non-controlling shareholders. Such dividend payments included Jefferies' dividends referring to the period they still have interest in National Beef also dividends to other non-controlling shareholders for the fourth quarter of 2019, and also an advance of discretionary dividends, which is the excess cash that would be distributed early in 2020. These payments were partially offset by funds raised in the primary offering of the shares.

Therefore, net debt ended the year at BRL13.3 billion or with a 2.77 times leverage ratio, very close to our expectations when the transaction was closed. Looking at the numbers in dollars, since 98% of our debt and 90% of our revenue are denominated in currencies other than Brazilian real, net debt ended the quarter at $3.3 billion and with a 2.74 times leverage ratio.

I'd like now to talk about the guidance we presented last year. Due to the primary offering of the shares, we had to officially change our guidance. However, we maintained our monitoring for management purpose, and I would like to share with you that we surpassed the maximum band of our guidance in terms of revenue, with a net revenue of BRL49.9 billion for the year. Likewise, we exceeded the maximum band for the EBITDA margin, closing the year at 9.6% margin. Finally, we also achieved the target of free cash flow generation, ending the year with a generation of BRL1.3 billion in the period.

Now over to Miron again for his closing remarks.

Eduardo Miron

Thank you, Spada. In the next slide, let's talk about the outlook for 2020. Our focus on value creation is based on three major fronts: beef processing, which accounts for approximately 9% of our businesses, processed foods, which account for approximately 10%, and the third front is represented by products we launched in 2019, our plant-based protein line.

Looking at our main front, beef processing, we have a very positive expectations for 2020. The US market in 2020, as you know, is election year and the economy should remain strong. In addition, the foundations of the business did not change, no increase in production and plentiful supply of raw materials.

In South America, we believe the foundations for export to China remain unchanged. The region will continue to play an important role in the international market, where demand remains high. We believe that the mass market will improve continuously, especially in Brazil. Combined with that, we have been working to improve our South America operations, making them more efficient and productive, and improvements made along

2019 will be fully utilized in 2020. In the processed foods front, we will continue to increase our production. For example, last year, we announced investments in the commercial [ph] plant, increasing our capacity in this front.

Finally, as to plant-based protein products, we will further improve our partnership with ADM and should launch new products this year, such as kibbeh meatballs and ground meat. We will continue focusing on reducing our financial costs now in a more positive environment.

2019 was certainly an extraordinary year for Marfrig, and everyone who participated in this journey should feel proud of the results. There's still a lot to be done, but I understand that the decision to have independent and oriented operational restructures was key to this success.

We should obviously consider that the timing of the industry was important and helped us. Growing economies and changing habits were important factors. Our agility, thanks to the simplicity applied to management, made a difference. Congratulations to everyone.

In closing, I invite you now to participate in our Q&A session.

Questions And Answers

Operator

(Operator Instructions) Our first comes from Ben Theurer, Barclays. You may proceed. please.

Q - Ben Theurer

Hey, good afternoon. Marcos, Eduardo, and Spada. Just two questions, and I apologize, I wasn't able to listen to the Brazilian call. So first, for your outlook for 2020, which you've just presented Eduardo, are you providing a range similar to what you've been doing for 2019 in terms of sales and EBITDA? Or is that something you're not guiding for? And then I have a follow-up question.

A - Eduardo Miron

Thanks for your question. Yeah, we are not planning to provide guidance this year. The reason why we provide 2019 was because we were in the middle of changing our strategy and we thought it would be important to provide some kind of direction, what we are trying to get. Having said that, we believe 2020 will be pretty similar to 2019. So therefore, although we are not providing any guidance, we believe that the fundamentals of the business will remain unchanged.

Q - Ben Theurer

Okay. Perfect. And then in the light of coronavirus, and it's something that's come up a lot. With logistical restrictions in China, basically disembarking ships, distributing product, is that something you have encountered as well, issues? How are you seeing currently demand for shipment, be it from South America or North America over to China? And how do you think this is going to evolve? Because clearly, one of the big advantages have been significant demand from China for your product.

A - Marcos Molina {BIO 15363967 <GO>}

Yeah, thanks again. I believe there is different ways to approach your question. So the first one is, we should expect a slow movement at the beginning of the year in China as a business as usual. So therefore, the events happen during a period where the operation is down, which I think helps somehow. We -- the way we see it, and we've been talking to our groups, and China certainly is -- has -- the impact of China is more on South America, where we export a lot to China than to any other place. We are seeing the movement coming back, especially this week. So there was a delay. There was a movement where the -- right, the holidays. So everything that are right, everybody knows. But we are seeing the movements -- the movement coming back.

From our planning, by the end of the year in 2019, we were already planning to reduce our exposure to this period of time to China. So therefore, our strategy worked pretty well for us because we -- and having sales anticipated throughout February, or we ended up selling to other destinations, so the impact for us has been, so far, not that important. Having said that, it's hard to predict the intensity of the situation, although we are pretty positive that it is more a question of time and not a question of directions. So directionally, things will remain exactly the same, very strong. And China will find its way to get the -- adjust the result and have the meats -- the beef delivered to their ports.

Q - Ben Theurer

Okay, perfect. Thank you very much for that clarification. I'll pass it on.

A - Eduardo Miron

Thanks.

Operator

Next question comes from Marcel Moraes with Santander.

Q - Marcel Moraes {BIO 6696122 <GO>}

Hi, good morning guys. Two questions here. The first one is Marfrig has become a single-protein business, and the financial average should be going down with the cash flow generation. So would it be feasible for us to think of M&A in 2020? And if so, would it be for diversifying the protein base or get into more processed food or even increase the exposure to other markets like Asia? So can we think of M&A in 2020? Thank you.

A - Eduardo Miron

Thanks, Marcel. I think you attended the Portuguese call, and Marcos, I think, was very, very clear that he wants to focus the company in beef, and he wants to turn this company as a leader and the best beef company in the globe. So having said that, I don't see any possibility to have any other protein in our portfolio. So in terms of M&A, it's not necessarily other proteins. I think we don't have anything in our pipeline, as we speak, which it doesn't mean that we will not see any specific opportunity. If it is a bolt-on for the current portfolio, it can help us to achieve our strategy.

Having said that, it's important to mention that we have diversified somehow having the plant-based, so it's part of our strategy to continue to develop and to grow on the plant-based business. And in order to do that, we expect to enhance the relationship with ADM and create even more independent type of business for the plant base in 2020.

Q - Marcel Moraes {BIO 6696122 <GO>}

Very clear, Miron. Thank you. And just a final question, if you allow me, it's about Uruguay. So we saw, in the fourth quarter, very solid margins for the South American business, the double-digit margin. And we understand -- well, I understand that Uruguay has been facing some issues with cattle availability. So I'd assume that the EBITDA margin in Uruguay is very low. If that is the case, can you give us some color about what is going on in the two main markets for South America, Uruguay and Brazil, in terms of EBITDA margins? Thank you.

A - Eduardo Miron

Sure. Although, as you know, we don't provide specifics in terms of margins. So we have already provided the EBITDA by operations, which I believe it is in the -- in line to the request from the markets, and -- but we are not expecting to provide by country.

Having said that, talking specifically about Uruguay and Brazil, I would step back and start saying that it's great to have South America operations with a diversified country base. So where we can benefit from in some countries, at the same time, it can compensate some challenges that we have in other places. Uruguay is a fantastic place, and it is a country that can sell to most of the best -- most destinations around the globe and to the best destinations. So it's a great place to be. Marfrig is the number one company in Uruguay.

The issue they have been facing is related to the cost of cattle, and this issue, which is happening or happened throughout 2019, is getting better and better. So whatever happened in 2019, for 2020, we should expect better margins and the business coming back to more normal margins. At the same time, I can tell you that, although the margin suffered because of the cattle, they continue to be very consistent. So although they were not as strong as in the past because of this whole issues of selling or the export of live cattle, the margins, they were consistent and now they are improving. Another key point about Uruguay, and is a strength for us, we have a very strong interaction with our North American operations, because of the organic, Japan, so there was a number of things that they share. They can work together. So although we may be facing some issues in some -- maybe on costs, we are doing a great improvements on sales. So one thing compensates the other.

In terms of Brazil, as you -- as what I may say is, certainly, it's the biggest animal around, right across all the geographies in Brazil, across the countries. It's the place where we have more opportunities in order to capture efficiencies. Miguel, as you know, has focus on this throughout the year, capture a bunch of positive results because of the work done on the efficiency. We should continue to capture -- to benefit from these efficiencies in 2020. Margin-wise, as you saw, we had 10%. And I think, for the year, it was 9.6% or something like that. Our range continues to be between 8.7% and 9.5%. I think, Brazil, because it's the main animal in this whole region, should be the driver for this margin.

So we are very positive because of the cycle and because of the improvements in the operations, not to mention that we are today a leader in the number of plants approved to export to China, which is something that we did not have in 2019. So we had a number of plants that were approved more towards the end of the year. Therefore, I think we have a number of positive things that can happen in 2020 that can benefit the results, especially Brazil.

Q - Marcel Moraes {BIO 6696122 <GO>}

Okay, that's quite clear. Thank you very much, Miron.

A - Eduardo Miron

You bet.

Operator

Next question comes from Gustavo Gregori, Bradesco BBI.

Q - Gustavo Gregori {BIO 16209398 <GO>}

Hi, good afternoon, everyone. Congratulations on the strong results. I have a quick question on the outlook for your debt. Obviously, the operational outlook is very strong, and your credit metrics have been improved a lot. In the Portuguese call, you did mention that one of the main focus is going to be to reduce debt costs. What I wanted to check with you is, if that would be an absolute priority? Or if you would perhaps consider taking on a slightly higher cost, if it also meant that you could increase the duration of the debt.

A - Marco Antonio Spada {BIO 20767498 <GO>}

Hi, Gustavo, this is Spada here speaking. In terms of duration, we are very comfortable with and very happy with what we have today. So definitely the -- our strong position and what we are really seeking here is the reduction of the cost.

Q - Gustavo Gregori {BIO 16209398 <GO>}

All right, perfect, very clear. Thank you.

A - Unidentified Speaker

Our next question comes from (inaudible) from the webcast. What is the expected net debt/EBITDA in 2020? And what are the strategies concerning additional liability management activities in the coming months?

A - Marco Antonio Spada {BIO 20767498 <GO>}

Well, we do not provide guidance for leverage. So not saying anything related to expectation in terms of leverage. What I can tell you is that we really -- we are really comfortable with the levels that we are and according to our plans in what we have, the idea is really to have the leverage to drop in 2020. So if everything go as planned, definitely, we should end 2020 with a lower leverage than it is today. Regarding the projection for liability management in the coming months, there's nothing really in the pipeline right now. Although, we are looking some good opportunities in the market, and of course, if there's a window, if there's an opportunity to do something, we'll be there.

A - Eduardo Miron

I'd like just to complement, so this is Miron. On the leverage, if you remember, we put as a target in 2018 to get to 2.5, went up with 2.4. For 2019, we ended up having an opportunity to acquire an additional stake in National Beef. Without that, our leveraging would be reduced, would be lower than what we had in 2018. So therefore, the direction for us is very clear. So we expect this number to continue to reduce and to continue can to pay -- to have a lower carrying cost. So there is no secret. So that's for us, is top priority.

Operator

Thank you. This concludes today's question-and-answer session. I would like to invite the company to proceed with its closing statements. Please go ahead.

A - Eduardo Miron

Well, again, I just would like to repeat that 2019 was an outstanding year for the company. I'd like to thank everyone for your support for the company, and see you in the next call for the first quarter 2020. Thanks.

Operator

That does conclude our Marfrig conference call. Thank you very much for your participation. Have a nice day.