2Q19 Results
July 26, 2019

Operator:

Good afternoon, ladies and gentleman, and thank you for waiting. At this time, we would like to welcome everybody to Minerva's 2Q19 results conference call. Today, with us we have Fernando Queiroz, Chief Executive Officer; and Edison Ticle, Chief Financial and Investor Relations Officer.

We wish to inform you that this event is being recorded, and all participants will be in listen-only mode during the Company's presentation. If you need any assistance during the call, please press *0 to reach the operator.

The audio and slide show of this presentation are available through a live webcast at www.minervafoods.com/ir and MZiQ platform. The slide show can also be downloaded from the webcast platform in the Investor Relations section of this website.

Before proceeding, we wish to mention that forward-looking statements may be made during this presentation, relating to Minerva's business prospects, operating and financial estimates and goals. They are based on the beliefs and assumptions of Company's management and on information currently available.

They involve risks, uncertainties and assumptions because they relate to future events and therefore depend on circumstances that may or may not occur in the future. Investors should understand that general economic conditions, industry conditions and other operating factors could also affect the future results of Minerva and could cause results to differ materially from those expressed in such forward-looking statements.

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

Fernando Queiroz:

Good morning, everyone, and thank you for participating in Minerva's conference call on the results for the 2Q19.

I'd like to begin this conference with a brief discussion about our topic that has been widely discussed in the last few months: the African swine fever and the opportunities related to the outbreak.

Let's move on to slide 2. African swine fever is a disease that since the 2H18 has been decimating pig herds in Asia, particularly in China with a great impact on the animal protein market.

In the graph on the right, we see that pork accounts for a large share of the global meat diet, especially in China, where it represents almost 50% of the animal protein consumption, almost all of which is supplied by their domestic production. This means that as a direct effect of the ASF outbreak in China, we expect to see a substantial reduction in this production. Therefore, price is rising and consumption of pork is suffering with it.

According to the FAO, the ASF outbreak has reached 234 regions with confirmed cases, most of which in China and neighboring countries, such as Vietnam, Cambodia and also in Eastern Europe.

Containing the outbreak represents an enormous sanitary challenge. Since the disease is spread easily, it is highly lethal to the herds and does not have any control mechanism, such as preventive vaccines. As a result, some experts believe China pig herd will shrink by 30%, which would be a great impact on the entire animal protein chain. It's worth noting that China has approximately 50% of the global pig herd.

In the graph on the bottom left corner, we can see some interesting figures, such as the significant decline in pork production in China in 2019 and the prediction for 2020, a clear consequence of the recent and still present ASF outbreak in the country. There are some markets indicators supporting that this supply shock will be offset, albeit partially by consumption of other proteins such beef, thus creating a great opportunity to our industry.

As we can see in the information on the bottom right corner, due to the availability of a healthy herd and low production cost in South America players, we currently account for 70% of the Chinese beef imports, which have been increasing substantially in recent years, thanks to the higher income levels, urbanization and the Westernization of the consumption patterns in China.

This increased share of South American exporters also benefit from difficulties faced by other players, such as Australia, which has been increasingly facing tough climate conditions over the past few years, and the United States, which has export restrictions due to the utilization of hormones in the herd that is forbidden in China, and also the uncertainty related to the trade war.

I would like to highlight Athena Foods' exposure to the Chinese market mainly through our operations in Argentina. In 1H19, our Rosario plant was, on a global basis, the plant with the largest volume of beef exported to China among 100 other units worldwide.

In view of this good moment and in order to maximize the opportunity in the Chinese market, in June, we resumed our operations in Venado Tuerto unit, also in Argentina. Currently, this unit is in the ramp-up stage and will be at full operation by late August.

To conclude, we believe that African swine fever will further drive growth of beef consumption in China, indirectly benefiting beef producers in South America, the region that's best prepared to meet growing demands in Southeast Asia.

In this context, we believe that our footprint in South America, our expertise in the Chinese market and the first effects of the African swine fever outbreaks on animal protein consumption and its production chain will create great business opportunity in the upcoming quarters.

It's also worth to say that this impact is not only a temporary issue. It also has interesting long-term perspectives. As ASF outcome implies protein consumption changes, not only because of prices but also due to changes in population consumption habits.

Let's move to slide 3 to discuss the main highlights for the 2Q19. We will begin with operating cash flow, which totaled R$322 million in the 2Q19 and R$1.3 billion in the last 12 months.

Another cash indicator, the free cash flow was positive for the sixth consecutive quarter, totaling R$143 million in the 2Q19 and R$642 million in the last 12 months. Thanks to this strong operational performance, consolidated gross revenues totaled R$4.3 billion in the 2Q19, and in all-time highs, R$17.8 billion in the last 12 months ended in June.

Our revenues breakdown shows that 43% of gross revenues, or R$1.9 billion came from Athena Foods, our operation in South America ex-Brazil. The Brazilian Industry Division accounted for 42% of the total, or R$1.8 billion of consolidated revenues. Our Trading Division was responsible for the remaining 15%, with approximately R$630 million.

In the 2Q, Minerva exports once again stood out accounting for 67% of the gross revenue in the 2Q19, 41% higher than in the 2Q18. Consolidated net revenues reached R$4 billion in the 2Q19, 8% more than in the 2Q18, reaching R$16.7 billion in the last 12 months ended June.

EBITDA totaled R$364 million in the 2Q19, up 3% over the 2Q18, with an EBITDA margin of 9%, 20 bps higher than in the previous quarter. Adjusted EBITDA came to R$1.6 billion in the last 12 months, with an adjusted EBITDA margin of 9.6%.

The net result adjusted for the non-cash and non-recurring effect totaled approximately R$27 million in the quarter.

We closed the 2Q with leverage measured by net debt-to-LTM EBITDA ratio of 3.8x, in line with the 1Q19. Our debt duration remained at a very comfortable level at around 5 years. It's worth noting that in early April, we concluded the redemption of our perpetual bonds, our most expensive debt, reinforcing the Company's commitment to pursuing a more efficient capital structure.

Let's have a look on slide 4, where we'll talk briefly about Minerva's operating performance, beginning with our exports.

In the 2Q19, Minerva continued to be the main exporter in the countries where it operates. In Paraguay, we accounted for 47% of the beef exports, consolidating our position as the country's main exporter. In Uruguay, we had 20% market share of beef exports. In Argentina, our market share reached 70%, 6 p.p. more than in the previous quarter.

It's important to point out that we maintain our position as the leading South America beef exporter, with a 21% market share. And recalling that South America represents 35% of the global exports, Minerva's total exports represent approximately 7% of the worldwide exports of beef.

On the right side of the slide, we have a breakdown of exports by region. In the Brazilian Industry Division, the two main destinations were Asia and Middle East, which together accounted for more than half of the division. In Athena Foods exports, Asia was, once again, the main destination, accounting for 42% of exports, 11 p.p. more than in the same period last year.

I believe that it will be useful to talk about the increase in Athena exports growth to China, and particularly, as revenues from exports to this country grew 61% between 2Q18 and 2Q19. This means that in addition to the market share growth, we also had a significant increase in our volume of exports to Asia in the last 12 months.

I would now pass the floor to Edison that will discuss Minerva's main financial and operating highlights.

Edison Ticle:

Thank you, Fernando. Let's move to slide 5. Minerva gross revenue reached R$4.3 billion in the 2Q19, 80% more than in the 2Q18. In the last 12 months ended in June, gross revenue reached R$17.8 billion, an all-time high and 14% higher than in the LTM 2Q18.

The Brazilian Industry Division's capacity utilization rate declined to approximately 76.7%, falling 3.4 p.p. from the previous quarter. The decline was mostly due to the rainy season, which lasted a little longer than normal at the beginning of the quarter, and the 1-week suspension of exports to China.

At Athena Foods, the capacity utilization rate stood at 75.4% in the quarter, 3.9 p.p. higher than in the 1Q19. We were able to increase the capacity utilization rate, thanks to higher demand in China, and this increase was more noticeable in Argentina and partial normalization of Paraguay's slaughter volumes that were a little bit lower in the 1Q due to the rainfall.

Overall, the Company's consolidated installed capacity utilization rate was at 76% in the 2Q, in line with the 1Q. And we're seeing the 75-80% range that we considered to be ideal.

On the upper right corner, we have a breakdown of the Company's gross revenue by division. For the first time, Athena Foods division accounted for 43% and became bigger than the other divisions in Minerva. Brazilian Industry Division contributed 42%, and the Trading Division generated 15% of gross revenues in the 2Q19.

Finally, on the bottom right corner, we also again emphasized that the great exposure of Minerva's consolidated exports to regions with strong potential demand, such as Asia, especially China, that accounted for 37% of total exports in the quarter.

Let's move to slide 6 to continue discussing operating results. The Company's consolidated net revenue reached R$4 billion in the 2Q, 8% higher than in the same period last year. While in the last 12 months ending June, net revenues stood at R$16.7 billion, a growth of 12% year on year.

Also regarding our top line, exports accounted for around 67% of gross revenue in the Brazilian Industry Division and 77% in Athena Foods. EBITDA reached R$364 million in the quarter, 3% higher year on year and also a record for our 2Q, with an EBITDA margin of 9%.

In the last 12 months, adjusted EBITDA reached R$1.6 billion, with a margin of 9.6%. Finally, the net debt-to-EBITDA ratio stood at 3.8x in the quarter, practically in line with 4Q18 and 1Q19.

We will now move on to slide 7 to discuss net results and cash flow. Considering the net results before income and social contribution taxes and excluding the non-cash effects that impacted the result, such as FX variation, monetary correction in Argentina, FX hedge and exceptionally this quarter, the payment of the consent solicitation to our bondholders, the Company would have record net income before taxes of approximately R$27 million.

Bear in mind that the consent was a waiver signed in April to exclude Athena Foods from the guarantee structure of the bonds issued by Minerva.

In terms of cash, operating cash flow was R$322 million in the 2Q. Net income adjustments were R$336 million, while the working capital variation was a positive R$99 million.

Our working capital line was supported by the suppliers' line that contributed with R$46 million in cash in the quarter, and the other payables line, which includes the advances from clients that generated cash of around R$132 million. This line is a little bit volatile because it's correlated to our credit policy and to the destinations of our exports. The credit policy requires prepayments depending on the countries, depending on the client credit score. So, there is a great correlation between this account and the breakdown of our sales.

In the 1Q19, recurring free cash flow was R$143 million. We began the build-up with an EBITDA of R$364 million, CAPEX of R$68 million, a negative financial result of R$295 million and finally, a positive variation of working capital of R$99 million, which resulted in a positive free cash flow of approximately R$100 million.

However, with the adjustment for the non-recurring effect of R$43 million related to the consent solicitation, the recurring free cash flow in this quarter was R$143 million. It's important to highlight that this is the sixth consecutive quarter of positive free cash flow, which is a very important indicator for the industry, since we are in a commodity sector, so cash flow generation is pretty much volatile. This result reflects the Company's commitment to pursuing a more efficient operational and financial management for the long term.

Finally, recurring free cash flow reached a substantial R$642 million in the last 12 months. We started with an EBITDA of R$1.6 billion in the period, CAPEX of R$186 million, negative financial result of approximately R$1 billion and a positive variation in working capital of R$196 million, resulting in a positive free cash flow of approximately R$580 million.

Finally, adjusting for the non-recurring items in the period was around R$63 million. We have recurring free cash flow of R$642 million for the last 12 months.

Let's move to the last slide of the presentation to discuss capital structure. Our leverage, as we already mentioned, measured by the net debt-to-EBITDA ratio remained flat, at 3.8x at the end of June. The Company had a cash position of R$3.1 billion at the end of the quarter, and around 75% of our debt was exposed to the dollar variation.

Duration of our debt is approximately 5 years. And it's also worth noting the reduction of approximately R$750 million in our gross debt, showing our commitment to pursuing a more balanced capital structure in order to reduce the carrying cost of our cash and also reduce the financial expenses going further.

Still on the topic of liability management, in the 2Q, we issued R$400 million of local debenture at the rate of CDI + 180 bps. It's a 3-year debenture, and 100% of the proceeds were used to refinance short-term debt.

This concludes our presentation, and let's now begin the Q&A session. Thank you very much.

Luca Cipiccia, Goldman Sachs:

Hi. Good morning. Thanks for the question. I listened to the earlier call, so I only have maybe more of a general follow-up on capital structure. In the results today, and I think everything we keep hearing and seeing clearly shows that the environment, the outlook for the sector has improved.

The change is looking better, and especially compared to when you initially started to examine or looked into the Athena Foods transaction since then. So with that in mind, can you maybe walk us through this – is that still the only and preferred option? Or how fluid is that discussion in terms of other alternatives for deleveraging capital structures, especially considering what might be the optimal corporate structure in the medium term? Now that the urgency is still there from a balance sheet standpoint, but maybe it's a little less pressing, given how the sector and the outlook have evolved. Thanks.

Edison Ticle:

Hi, Luca. Just one thing: I think the IPO of Athena Foods has two important objectives for us. The first one obviously is to speed up the deleveraging process of our balance sheet. But I think there's another one, which is to unlock hidden value from our international operations.

So when we pursued the IPO of Athena Foods, we had these two main objectives in mind. We have been very careful in terms of valuation to do this IPO. We have the chance or the option to the IPO until April next year, but obviously, we're open to other opportunities, to other alternatives. But so far, we keep having the IPO of Athena Foods as our plan A.

Luca Cipiccia:

Right. And sorry, when you say hidden value, why would it be “hidden”? At the end of the day, you're in the same sector, you are listed in Brazil, which is arguably the most developed of the markets in LATAM and one where there's probably a greater awareness and understanding about the protein industry in general. I think you've mentioned the hidden value before, but like why would it be “hidden?” And why an IPO?

Edison Ticle:

Yes. It's a good question, Luca. Firstly, the multiples of the Companies in the sector in Brazil suffered a bit because of the high leverage of the sector. As you probably know, Athena Foods has practically no debt. So, this would imply a premium to Athena Foods compared to any other listed player in Brazil.

The second point is that 100% of the growth in Minerva will be done in Athena Foods. So when you see the growth in Minerva, it's diluted in our operations. When you focus only in Athena Foods, it tends to be an important growth company.

And third, Athena Foods has more access to market faster in the world like Asia, like China. It's much more exposed to those markets than Minerva as a whole. So, I think that there are a couple of reasons that would imply Athena Foods to have a better valuation than Minerva. I think I mentioned the three most important of them. But if you want, we can discuss further other reasons why we see Athena Foods at a higher valuation than Minerva.

Fernando Queiroz:

I would add to what Edison said, Luca, that our position as a leading exporter in all these countries in South America that we're in also brings a different value for being the number 1 or number 2 exporter in all these countries.

Luca Cipiccia:

That was very clear. Thanks for the clarification and the answers. Very interesting.

Tiago Mello, Bradesco BBI:

Hi, everyone. Thanks for the question. I'd like to ask a few questions on food service. In our view, the segment has become something of a trending topic and we see it gaining some investor attention. So, I would like to know if you have any updates on this segment in both terms of growth and profitability, especially now due to the ASF.

And also we have talked to some other protein companies, such as BRF, and they have mentioned interest in teaming up for possible food service partnership. So, I would like to know if that would be on the table for Minerva.

Fernando Queiroz:

Worldwide, we are present in three main segments: the retailers, the industries and the food service. There is a big growth and a lot of demand from the food services segment. That's why Minerva is specialized in working in niches. We are one of the biggest exporters of organic; we are one of the biggest exporters on special breeds, such as Hereford or Angus. So, things like that are part of our strategic plan.

The growth, especially in Southeast of Asia, is very focus on the food service where our presence is very strong and it keeps growing. We are world suppliers of food service chains. So, we are very close, and we are partnering with them, on their development, on the development of their products. And it's part of what's happening to the world, to be more and more segmented.

Tiago Mello:

OK. Just a quick follow-up: in terms of partnerships, would you see something possible due to–I don't know–protein portfolio diversification?

Fernando Queiroz:

No, we'll not go down in the chain. Our focus is to produce in the origins and have partnerships to deliver the products to our clients. We are not operators of food service chain; it's not our focus.

Tiago Mello:

OK. Thank you very much.

Fernando Queiroz:

I would like to end this conference call by emphasizing that we remain confident in our business model, in our team's hard work and in the combination of meritocracy, appropriate strategy, operational efficiency, capital discipline and commitment to the ethical and sustainable practices as the best way to create long-term value. I once again would like to thank all the Minerva team for its effort and dedication to reach the results we discussed today.

I'd like to thank you all for the interest in Minerva. And please feel free to contact us should you have any questions. Thank you very much.

Operator:

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