



## International Conference Call

Marfrig

3Q17 Earnings Results

November 14, 2017

31:52

### Q&A Session

**Operator:** Thank you. Ladies and gentlemen we will now begin the Q&A session. To pose a question please press the star key followed by the one key on your touchtone phone. To remove yourself from the questioning queue press star two.

Our first question comes from Diogo Silva.

**Ms. Diogo Silva:** hi thank you for the call. My first question is on the ramp-up of production in Brazil. I would like to understand a little bit better when you are talking about, my understand is that you have increased your slaughtering capacity to 250,000 heads per month as of then, as of September and you are planning on increasing that to 300,000.

I would just like to understand what was, that increase was from how much before? And have you fully... I mean do you want to increase it to 250,000 by the end of September or did you actually average the whole 3Q to 250,000?

**Mr. Secco:** okay let us go again. As we announced we wanted to reach 250 animals at the end of 3Q. Our slaughter in October was 267,000 and for that we achieved the goals we defined in June. And is same case of the 4<sup>th</sup> quarter that we announced our plan to achieve 300,000, and this is the number we are planning to achieve at the end of 4Q.

**Mr. Silva:** understood. If you do not take that number, if you do not take that number and extrapolate that to 2018 and assuming you do not pull back any capacity that would mean you would be basically running in 2018 at 50% more production than you are running let us say up to June 17.

And I guess my question there is are you going to then run at a lower utilization or do you actually think you can put all that new production into the market without bringing prices down?



**Mr. Secco:** Diogo the delay was not easy to understand you because we are in a huge room here and we 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 to export and for that we continue in the focus to improve our exports for the previous plants and focused on the new ones in the local market and for that this is a time that we expect we will take more or less four to six months average to reach the full habilitation for this factories.

For that we are going to continue in both markets, focused in both markets, as I commented very hard in exports. We are very hard today in China, in 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, and for that we are planning to fulfill our capacity with the best mix between exports and local market.

**Mr. Silva:** understood and then my last question please is in terms of when I look at Keystone and I see the much higher Ebitda per ton that you managed to do during this quarter I would just like to understand what explains it? There was a small increase in terms of tons; but what explains that you are making so much more Ebitda per ton?

**Mr. Ravndal:** I think... For the quarter there really are a lot of contributing factors and I think we try to cover some of those in the comments; but it is really one of seeing some good activity around higher-margin products, I've mentioned a couple of those like some NAE products that continue 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 buying large for the outside meat purchases that we made, principally in chicken. As you know we are not 100% vertically integrated in the US and therefore we are net buyers of breast meat in particular parts of the year.

And then also 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 part sales of our dark meat byproducts in the US.

So really the combination of all of those being at 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 normally they would have been through 3Q. And those have already adjusted as of October down to more seasonal, normal levels I would say; but I think you had a number of different contributing factors and it was not all dominated by one of those.

**Mr. Silva:** understood and then just I have one last question which is in terms of the Capex that of the growth Capex that you spent during the quarter I assume there was still a kind of

a tail of the plant that you were opening in Thailand, you mentioned as well the new production line in Malaysia.

Can you just give us a bit more of a sense on the growth components? 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? I guess the plants in Brazil also contributed to that; but could you just give us a bit of a sense what may to that growth Capex?

**Mr. Ravndal:** I can go into... Definitely there is a few other projects. What we mentioned specifically in terms of coming to completion in the last few months and about to become fully operational are really the additional fully-cooked capacity in relation and then the plant that you can see in the presentation that we did not spend time on, but which is about to become fully commercialized in Thailand and that is a significant expansion.

But in addition we have had important projects like moving through the fresh beef in the US, and we are also very far along in some of the investments we are making across the US; chicken business to just increase capacity, in particular one of our further vertically integrated complexes that tends to focus on slightly smaller bird, we are expanding there and that is something that is really about an 18 months lead time before it starts to show up in terms of what we can turn around and so. So that is something that we have been working on for a while and we will continue to work on and invest in all through 2018.

And there is a number of other projects. We have quite a few investment projects that we have been working on; but I don't believe we are breaking out or providing total spy by company or by division. So I do not want to get into any more specifics relative to guidance; but just some comments that I showed on our strategy piece.

**Mr. Silva:** thank you very much.

**Operator:** the next question comes from Ed Santevecchi, Nomura.

**Mr. Ed Santevecchi:** hi guys thanks for the call. I just had a question around working capital. Can you give us an idea what the incremental investment would need to be as you go from the 250,000 heads at September to, I think, 300,000?

**Mr. Eduardo Miron:** if I got your question right you are asking about the size of the investment to get to the full reopening of the plants correct?

**Mr. Santevecchi:** correct.

**Mr. Miron:** if that is correct without providing any guidance for 4Q we expect still an important expansion and cash relative to working capital and Capex and 4Q in order to

complete not just the reopening of the plants; but as you heard before we have important projects that are ongoing and we will continue.

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 new level we are below 4; 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 4Q or for the end of the year.

**Mr. Santevecchi:** and just to be clear after 4Q 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 18?

**Mr. Miron:** that is an absolutely spiked 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 is based on important investments - but I think it is too early for us to talk about 2018 apart from what has really been mentioned by Martin, which is the outlook is very promising.

**Mr. Santevecchi:** okay and just on the outlook you have the plan continue ramping up production; you are seeing more opportunities to continue that given that some of your peers in the States have pulled back? How do you factor that into your equation? Do you expect them to come back and retake some of their market share or do you think the levels where we are now is the right mix to think about going forward?

**Mr. Secco:** other plants that you mentioned about the 300,000 for the near future, our strategy is not related about what is happening with the other peers. We have an 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 do not expect so early and for that we accelerate a little bit our reopenings 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.

**Mr. Santevecchi:** and just last question, I do not want to talk too much time here; is there a level for cattle prices where if some of this increased production starts to shift the prices we are seeing now and maybe you would look to reduce some of this capacity you put on? 150, 160 where maybe this changes or how are you thinking about that for next year?

**Mr. Secco:** we will have already a reduction of 12% YoY on the cattle price and we see this price stable for the next months. We are at the beginning of 4Q, we will be... Was 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 Uruguay for 4Q.



**Mr. Santevecchi:** thank you, but there is not a specific price that you are targeting that would offset these plans?

**Mr. Secco:** no.

**Mr. Santevecchi:** okay great guys thank you very much.

**Operator:** the next question comes from Teo Lasarte, Insight Investments.

**Mr. Teo Lasarte:** hello. The first question is regarding a leverage target for 2018 and you said 2.5x. Does that include any proceeds from the Keystone IPO?

**Mr. Miron:** let us make sure I understand your question, this is Miron. Your question is what is the level of leverage for 2018?

**Mr. Lasarte:** No. Your guidance as leverage is 2.5x for 2018 right?

**Mr. Miron:** right that has not changed.

**Mr. Lasarte:** yes does that include the proceeds from the Keystone IPO?

**Mr. Miron:** yes. As we always mention the 2.5x would be achieved after they structured transaction.

**Mr. Lasarte:** okay and so 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?

**Mr. Miron:** as we always conveyed any proceeds from any structured transactions would be utilized to deleverage the company.

**Mr. Lasarte:** okay got it and just one more thing from me. You have been talking of working capital through the call; I just wanted to be very clear 4Q given the fact that you are ramping up capacity in Brazil should we expect another outflow of working capital in 4Q?

**Mr. Miron:** yes. I think in terms of working capital we will continue pressured because of the reopenings and we should expect similar levels of cash.

**Mr. Lasarte:** okay understood thank you.

**Operator:** the next question comes from Botir Sharipov, HSBC.

**Mr. Botir Sharipov:** hi and thank you for taking my questions. The first one is on the beef margins. You had a very challenging quarter in terms of some industries and cattle availability and cattle prices were pretty flat QoQ and yet you guys were able to expand your



margins from 2Q, sequentially. So could you maybe give us some color as to how you guys were able to do that? Is that just capacity utilization?

Because I understand you have to hire some more people when you reopen the plants. So I just wanted to see where the improvements are coming from.

**Mr. Secco:** as you know the margin of the beef division is very important the price of the cattle; but of course this is the most important item in our costs, but it is not the only one.

We have a very important performance regarding the other costs at the slaughterhouses. We have a very good performance on exports regarding very good prices; we have a good exchange rate also for this period; and all these factors mixed are the result of the improvement of our margin between 2Q and 3Q.

But you need not to forget that in 2Q mainly the prices of the animals are very cheap or much cheaper than 3Q; but the performance of the industry in Brazil was very poor for the event that happened in April of the weak flesh and for that this event cost an important part of our margin in 2H.

**Mr. Sharipov:** okay perfect thank you and on your capacity utilization you mentioned it stood at 87% of your effective capacity utilization; was it the average for 3Q or was it at the end of 3Q? And what do you expect the capacity utilization to be at the end of the year?

**Mr. Secco:** it was the average of the utilization. It was a little bit less, maybe 2 points than the previous quarter; but the number is much better because we have the reopening of the plants and as you know we have the ramp-up period of the plants and first stage it was very few activities because we are adjusting a lot of things and for that 87% it was a very good figure for us in 3Q.

**Mr. Sharipov:** and that was the average right?

**Mr. Secco:** yes and we expect to have this number or much better for 4Q.

**Mr. Sharipov:** perfect 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 statements. Please go answer.

**Mr. Secco:** I would like to thank all of you to join us today for this call. We can continue in communication for other channels with our IR Department. For that thank you again and good afternoon for everybody.

**Operator:** Thank you. That does conclude our Marfrig conference call.