International Conference Call
JBS S/A
First Quarter 2019 Results
May 14th, 2019

Operator: Good morning everyone and welcome to JBS conference call. During this call, we will present and analyze the results for the First Quarter of 2019.

As requested by JBS, this event is being recorded. The recording will be available this afternoon and can be accessed by following the instructions posted on the company's website at: www.jbs.com.br/ir.

Taking part on this call we have Gilberto Tomazoni, JBS Global CEO, Guilherme Cavalcanti, Global CFO and Investor Relations Officer, Mr. André Nogueira, JBS USA CEO, and Wesley Batista Filho, President of JBS South America.

Now, I'll turn the conference over to Mr. Gilberto Tomazoni. Please, go ahead Sir.

Mr. Gilberto Tomazoni: Good morning everybody. Thank you for your presence in this conference call. I'm very happy to announce our results in this first quarter of 2019. The results show our discipline and commitment to our value creation strategy.

Going to the numbers, net revenue was R$44.4 billion, up 11.5%, and the consolidated Ebitda increased by 14.4% an increase in margin as well. Our leverage was in dollar 3.1 times and our reported net income was R$1.1 billion, an EPS was 0.41.

Before I pass to Guilherme, I wanted to emphasize some points: First, our financial position, leverage reduction, lower cost of debt, lower amount of interest paid, better debt profile, cash position, and cash generation; all of these efforts means that the company only needs to access the market in 2026.

In our commitment with transparency, we released our policy related to liquidity, indebtedness and dividend last night. Later Guilherme will explain a little bit more about these 2 policies.

Third, our good market conditions. We are in a favorable cycle of protein, favorable supply demand and a low cost of grains combined with the consumption of protein in Asia has been growing for some time, and in line with this, the company signed agreement of 3.5 billion in China (I think in the previous quarter), now with the African swine fever this demand is boosting. This is a point that I want to stress here.

The other point is the global footprint. I think JBS built a truly global footprint, which is practically impossible to replicate. We have operations in 4 continents, and we operate with 5 types of proteins. We have a strong management team. I just put this because if I sum this, our financial conditions, or favorable market conditions, our footprint, our strong management team, JBS is ready to accelerate goals inside the market opportunities.

To be listed in the US is a priority to unlock value and boost the growth.

I will now hand over the call to Guilherme, who will detail the results.

Mr. Guilherme Cavalcanti: Thank you Tomazoni. Before I start, I'd like to remember the disclaimer on page 2 about future events that are subject to risks and uncertainties, beyond our ability to control or predict.

Now, please let's move to page 4, where we show the evolution of our figures. Net revenue increasing 11.5% to R$44.4 billion, gross profit increasing 13.3% reaching R$5.8 billion and Ebitda increasing 14.4% to R$3.2 billion and Ebitda margin passing from 7 to 7.2%. Net profit of R$1.1 billion and earnings per share at R$0,41.

It is worth mentioning that this net profit was impacted by a deferred income tax that is generated because of the tax loss on the Brazilian operations. Due to the FX depreciation, becomes an asset that improves results. This accounting effects become the cash tax savings as it offsets future profits and decreases the usage of tax credits that can be used in the future. For the shareholders this means higher minimum dividend as Brazilian corporate law requires at least 25% of net profit and higher base accumulated profit for future dividends.

Now, please let's move to page 5, where we show that our operational cash flow increased to R$750 million given the higher Ebitda, as explained before, and free cash flow reached a negative R$712 million.

It's worth mentioning that the first quarter of the year is characterized by a seasonality effect of concentration of suppliers' payment and inventories recomposition, so every first quarter we have cash consumption, and in this quarter it was not different.

It is worth mentioning that in the first quarter 2018 we had R$110 million negative only because we had R$924 million of asset sales in the first quarter of 2018. So disregarding the divestments in the first quarter 2018, our cash consumption decreased almost by half in the first quarter even coming back to our normal level of capital expenditures of R$750 million because in the first quarter 18 we were contingent the Capex that was R$414 million, so we could increase our Capex to normal levels and at the same time decrease the cash consumption of the first quarter.

And also, it's worth mentioning that despite the cash consumption of the first quarter 2018, we generated R$5.7 billion in free cash flow, or US$1.5 billion.

Now moving to page 6, we see the evolution of our debt profile. Our gross debt decreasing to from US$17 billion to US$14 billion, our net debt in reais coming from R$45 billion to R$49 billion due to the FX depreciation on the debt when translated to reais. However, the strong free cash flow that the company presented last year despite this FX impact deleverage in reais decreased from 3.24 to 3.20. Leverage in dollars stayed at 3.1 times.

Now please let's move to page 7, where we will talk about the liability management that was done as a subsequent event of the quarter. This liability management took the average maturity from 4.3 years to 6 years. We had US$7.5 billion maturing until 2022. This number decreased to US$2.7 billion, of which 1.6 billion is loans with banks under the normalization agreement that we already started the process of renegotiation to extend maturities, decrease interest rates and release guarantees.

Cash on hands plus revolving lines cover maturities up to 2023. On the other hand, cash generation plus cash on hand cover maturities up to 2026. This means a very, very low refinancing risk.

This financial strength is already reflecting on the yields to maturity of our bonds negotiated on the secondary market. From the beginning of the year until today, our bonds are negotiated in yield to maturity around 1.5% lower. This means lower financial expenses for the future and consequently higher free cash flow to shareholders.

Another positive point of this liability management was a decrease on the gross debt, this liability management leverage-neutral, we increase the liquidity of our bonds and consequently the price discovery and we decrease our level of security debt in around US$2.4 billion from 6 billion, of security debt to US$3.5 billion of security debt. This gives the company another cushion given that you can use the guarantees to quickly raise debt if needed.

It's worth mentioning that yesterday, as Tomazoni said, we uploaded policies revised and approved by the Board of Directors. More specifically, a liquidity and indebtedness policy and a dividend policy.

The liquidity policy states that the leverage rate to be pursued in this long run is to be between 2 and 3 times net debt to Ebitda. Dividends are limited to 3.75 net debt to Ebitda, as the dividend policy. As to the indebtedness policy, mergers and acquisitions could be 2/4 over 3.75 as long as a contingency plan is presented to the finance committee.

This shows our commitment to the financial strength of the company and to higher governance and transparency.

To finish, it is worth mentioning that our leverage ratio finished the first quarter at 3.1 and the positive free cash flow will take us to the long-term target in the next quarters.

Now let's talk about the business units' performance. Please move to page 9, where we will talk about Seara.

Net revenue totaled R$4.2 billion, 5.6% higher than the first quarter 2018 essentially due to price increases of 13.9% and 18.4% in the domestic and export markets respectively. Total volumes were lower than the first quarter mainly in fresh chicken, partially as a result of deactivation of certain facilities to export to Saudi Arabia and the company's focus on price increases.

Domestic prepared foods volumes increased by 5.2%. Ebitda in the first quarter reached R$278 million with an Ebitda margin of 6.6% impacted by higher raw material costs, partially offset by higher sales price.

With continuous focus on innovation, Seara recently launched new products that have a healthy and convenience appeal; the Seara Nature line, which is made of natural ingredients, noble meats, without artificial food preservatives, reduced sodium and no lactose. Additionally, Seara Gourmet launched The Incredible Burger, an option for vegans with an unmistakable beef flavor, but with 100% vegetable ingredients, and also the long waited Seara Organic Chicken.

JBS Brazil on page 10, please. Net revenues of R$6.8 billion which corresponds to an increase of 7.4% over the first quarter 18 with the number of bovine processed growing 2.9% in the period. Ebitda for the quarter was R$195 million with a 2.9% margin, reverting the negative result posted in the same period last year. In the domestic market, net revenue was R$3.8 billion, a 2.7% increase when compared to 1Q18. A positive highlight was the 7.1% price increase in fresh beef.

In the export market, which represents 44% of these business unit sales, net revenue increased by 13.9% to R$3 billion with an increase of 8.8% in volume and 4.7% in average sales price.

Please let's move to page 11 for the JBS USA Beef. Net revenue increased by 1.4% excluding Five Rivers net revenue (sold at the end of the 1Q18), average sales prices for the quarter increased by 0.4%, annual production volume grew by 1.8% mainly due to the US. Exports increase both in volume and prices when compared to the first quarter 2018.

In the United States, this quarter results were affected by climate events that impacted the activities of delivering and slaughtering cattle in some of the company's facilities in the country. Nevertheless, cattle availability and demand for beef continue improving while the industry capacity remains stable, which indicates the continuation of a positive and growing margin scenario for upcoming quarters.

In Australia, results were higher than the same quarter last year with a significant growth in exports that posted an impressive growth with Asia, and notably China and South Korea being the main highlights.

Now please move to page 12 for JBS USA Pork. JBS USA pork net revenue was US$1.3 billion in the first quarter 19, an 8.9 decrease in relation to the first quarter 18. This result was mainly due to the 13% decrease in average sales price impacted by a 4% increase in pork production during the period.

Ebitda was US$105.4 million with a 7.9% Ebitda margin. The increase in pork supply in the US during the first quarter 2019 leaped the potential to reach a margin level comparable to the 1Q18 a while lower exports also pressured domestic prices. Additionally, although hog production in the US continues to grow, news about the evolution of the African swine fever in China and Europe contributed to an increase in this part of future prices of live hogs.

Management continues to closely monitor the events related to African swine fever in Asia and believes that the environment for global trade of pork and potentially other animal proteins may change with the magnitude of the impacts from the disease in the Chinese hog herd yet to be confirmed.

Plum Rose continues to accelerate the execution of its strategy to increase production capacity, grow its sales and develop branded products. Its performance for the quarter was one of the best since its acquisition in 2017.

Now please let's move to page 13 for Pilgrim's Pride. Net revenue from the US operation increased by 2.3% as a result of a 1.4% higher sales prices and 0.9% higher volumes. Still in the US, a more favorable environment was experienced during the first quarter 2019 with feature activities normalized to seasonal levels in retail and food service and the recovery in the commodity poultry prices.

In Mexico, net revenue was 9.7% lower in comparison to the same period last year mainly due to the 9.4% decrease in sales prices as a result of a softer demand for chicken combined with a more availability of imported pork from the US. Nevertheless, management believes chicken demand will continue to grow in line with historical rates in the long-term.

In Europe, net revenue decrease by 5.4% as a result of an unfavorable FX rate impact and 4.2% lower volume, which were partially compensated by 5.3% higher sales prices.

With that, I would like to turn over for the question and answer session, please.

Question-and-Answer Session

Operator: Ladies and gentlemen, we will now begin the question-and-answer session. If you have a question, please press the star key followed by the 1 key on your touchtone phone now.

If at any time you would like to remove yourself from the questioning queue, please press star 2.

Our first question comes from Alan Alanis, from UBS.

Mr. Alanis: Hello everyone, thank you for taking my question and congrats on the results. I mean, a lot of my questions were answered on the Portuguese call, but I do have a follow-up to that one, and it has to do with the benefit that you will get in margins on the US pork business.

I'm just trying to understand how the level of integration that you have in the US pork business should translate into margin expansion on the back of higher US pork prices. I don't know if you can elaborate on that and then I have a very brief follow-up on another topic, thank you.

Mr. Tomazoni: André, are you in the call?

Mr. André Nogueira: Yes Tomazoni, I am here.

Mr. Tomazoni: Please, could you answer? Because you answered in Portuguese and he's following the answer in Portuguese.

Mr. Nogueira: Okay, so Alan thank you for the question. The benefits are twofold: One is more [unintelligible] from the US, we are going to double exports direct to China, we opened a station now in the traditional US market [unintelligible] Japan, Korea, so you should see margin expansions in the profits inside.

And as we have 30-35% integrate, if hog prices are higher, we will get the benefits on the hog too. So, so we have high level of integration (around 30 to 35% integration) and I that we are going to see a wide profit in margins in the processed side just because we saw expansion in the US, we saw new plants come online, the hog production continues to grow in the US and we should see the remaining of this year and for next year better balance between supply of hogs and capacity in the industry. Considering even more how labor has been difficult in the US, so in the level of production I that we are going to keep a discipline on the labor side.

So I think that's twofold: The profit inside you should see expansion in margins and with our level of integration get the benefit of the hog side too.

Mr. Alanis: Got it. That's very clear. So for around 60 to 70% of your production in the US, I mean, some of that, since you are not integrated on that, the increase in prices should be shared, let's put it that way, with third-party suppliers of pork, correct?

Mr. Nogueira: No question. Hogs production in the US are having good margins now and they will continue to have good margins. No problems with that.

Mr. Alanis: [laughter] Okay, thank you so much!

And the second question is more on the consolidated level. If you could just explain a bit more what happened with the taxes with the negative effective tax rate that we saw in the 1Q, and what should be the effective tax rate that JBS consolidated we should be expecting for the full year 2019, please? Thank you so much.

Mr. Cavalcanti: Okay, thank you. Okay, the first let's explain what happened in the first quarter. The Brazilian company basically generated a loss, the parent company generated a loss given the FX depreciation on the dollar-denominated debt when translated to reais.

This loss becomes a credit because we can offset in future tax payments, so it becomes an asset that impacts positively the results. So that's what happened, and again, we can offset throughout the year as we generate profit depending on the FX, for example.

So it is difficult to say how much it is going to be effective tax rate for the 19 because depends on several factors that make the volatility very high, like the FX swings, for example.

What I can say it that currently the effective tax rate in the US is 9.1% and this is more predictable in some way.

For the long-term, the US operation is the main part of the results of the company, we have new tax law in new US which the income tax came to 21%. But again, it's difficult to predict what it's going to be the effective tax rate going forward.

Mr. Alanis: Got it.

Mr. Nogueira: Guilherme, just to add in your point about all the JBS outside of Brazil, what you should put in your model, Alan, is around 19% of its effective tax rate going forward. 19 is the right level.

Mr. Alanis: Yes, that makes sense. Okay, cool, thank you so much. I really appreciate it. Congratulations.

Mr. Cavalcanti: And it's also worth mentioning, Alan, that in Brazil we will probably not have cash taxes for a long period given the goodwill amortization, tax loss carryforwards and tax credits.

Mr. Alanis: Oh, that's important. Okay, that's important. So this level of taxation maybe slightly lower on a cash basis?

Mr. Cavalcanti: Yes.

Mr. Alanis: Got it. Really appreciate it. Thank you so much.

Operator: Our next question comes from Alessia Apostolatos, HSBC.

Ms. Apostolatos: Yes, hi, good morning. Thank you for taking my question. So you clearly outlined a lot of things you have already done on liability management; you pay down debt, you cut your cost of debt, released guarantees, lengthened securities, but it seems that the next thing you need to do, the next things you need to do, the real big ones require a US domicile, and in NY stock exchange listing you need for investment grade bonds new commercial credit lines in the US with lower rates and you can get in Brazil a lower cost of equity, a better governance platform for attracting cheaper capital.

So my question is: What else do you need to do for this listing and redomicile the next big step? And if so, when? Why not now, when the investors are focused on your industry more than ever before?

Mr. Cavalcanti: Okay, thank you Alessia. Let's first talk about what can be done going forward in terms of liability management and reducing interest rates. I think one of the first steps that we have to do is continue to show the investors the financial strength of the company, as we tried to demonstrate in this presentation. Because if you look at the average double B- industry in the US or even the average double B- food indice in the US, they all pay lower interest rates than us. So I we have still room to improve with the same rating peers.

However, going between 2 and 3 times net debt Ebitda is what rating agencies require you're a food industry to be investment grade. So I think we have also a second effect that would be ratings improvement.

And what you talked about the redomicile and the listing in the US for example, we are studying different structures, but the target is really to continue to decrease the cost of capital, and this, of course, can be reached from several ways: First of all, the Brazilian operations today embedded 35% of the total debt of the company, but only 18% of our free cash flow, and debt in Brazil, if you look at our bonds that are trade on the secondary market, it is around 1% still higher than our US bonds.

So I think there's also room that this part of the debt because it's the same risk, so I think the listing in the US will help to show that the risk is the same so we shouldn't have this spread. And of course, the listing in the US, as I mentioned before, we decrease in the cost of debt and the risk perception of the investors on the company we will consequently decrease the cost of capital, the cost of equity and the WAC.

So that's the listing… decreasing the average cost of capital it means higher multiples. So I think this will create some opportunity for us to have multiples more in line with our US peers.

It was mentioned that today if we have a record LTM Ebitda in reais of R$15.25 billion and if you look going forward the perspectives of the company and considering currently enterprise value of the company, we are still traded at lower than 6 times enterprise value to Ebitda, while our peers are trade at least at 8.5 or 10 times enterprise value to Ebitda. So I think that would be the opportunity.

And you are asking why we don't do this now; because we don't need to do. In the past we needed to list in the US to raise capital to pay down debt. We don't have this necessity anymore, so we can go deeply in different structures and to choose which one will be the best to maximize the value of the company. And, of course, if the perspectives of the next quarters are better, postponing the listing after these results appear in our results can mean a better pricing.

Ms. Apostolatos: Very clear Guilherme, thank you very much.

Mr. Cavalcanti: Thank you Alessia.

Operator: Our next question comes from Benjamin Theurer, Barclays.

Mr. Theurer: Hey, good morning. Can you hear me? Just to make sure because I'm on the cell phone.

Mr. Tomazoni: Yes, we can hear you very well. Go ahead.

Mr. Theurer: Perfect. So thank you very much for taking the question. So one question I had to start off, obviously with the whole trade dispute (and you've mentioned and you talked a little bit about it) between the United States and China we've seen input costs, particularly soy prices basically collapsing on the last couple of days, so just to understand, I mean, clearly it's going to be positive for your PPC operations in the US, but is there also something you believe is going to basically further allow attractive pricing on other things, such as cattle?

And is there some way that you can lock-in that price from chicken operations considering the significant sellout in debt? So what prospects for margins you might have just because of the input cost coming down? That would be my first question, if you could elaborate on that.

Mr. Tomazoni: André, please. Could you answer the question?

Mr. Nogueira: Yes Ben, you are right; if this trade dispute continues, we are going to see a grain price in the US a bit below the global grain price, and this will be positive directly for PPC and this will be positive for cattle producers, but [unintelligible - background noise] cattle producer and indirect benefits, then it will be positive for the hog producers and for the level of integration too.

So in the grain price it will be positive. On the other hand Ben, if you continue to raise [unintelligible] and the import is good, that can represent some pressure in costs in some of this material that we use at the plant level. Of course, it is much less relevant than the grain price, but we are going to see some pressure in packaging, in some other areas, in Capex, that partially offset the benefit.

Mr. Theurer: Okay, perfect. Very clear. And then you've mentioned, and you talked about obviously some of the cost pressure in Brazil, but could you elaborate what your expectation is for Seara going into the remainder of the year and what's your strategy is?

Because it sounds like you've been trying to be very proactive in terms of price increases, but you still had a lot of input cost pressure, roughly 170 basis points contraction on the margin in Seara. So, are there any initiatives you been doing, be it cost cutting, be it pricing in order to kind of get margins back on track? So what's the strategy for that? That would be great if you can elaborate on that.

Mr. Tomazoni: Ben, we are expecting to be in track margin in Seara in the next quarter because to explain the Seara weak results is simple, it's just 2 factors:

- One factor was related to Seara lost some permission for some plants to export to Saudi Arabia, but some are open, but before some plants were not dedicated to produce for Saudi Arabia and produce for other markets. Now with less plants allowed to export, they focused to push all the production from that plant for these specific plants that are allowed to export. That takes time because we need to organize your life operation because the size of the chicken is different, and you need to organize [unintelligible - background noise] as well. But this is already done. It is already done;

- The second we had 2 operational problems in 2 plants, just 2 plants. Remember Seara has 28 plants, and in 2 plants we have a problem, and the problem was fixed. We believe that in the coming months we are getting back on track again, Seara on the same track.

If you put all the impacts together, what is the size of the impact? It is around 2% of Ebitda. It's around 2% of Ebitda. And the cost of the grain decreased, the conditions of the crops in Brazil are going very well, I think is always in favor, we passed the cost to the price, the value of the brand increased, it increased in terms of preference of the consumer, we launched a new campaign. Everything is going well. We had 2 specific points and were fixed.

Mr. Theurer: Okay, perfect. And then just last but not least, we've all seen obviously the alternative meat, IPO beyond mid happening in the US with a lot of interest very strong, and you've mentioned actually in your prepared remarks that you’ve launched as well a vegan product and so on.

Could you elaborate a little bit of how you think you can basically position yourself and how you can develop product that is basically a meat alternative plant-based and what's your strategy on that in Brazil, in the US as an international company? Just to understand how you think of those alternative offerings more going forward.

Mr. Tomazoni: Ben, first, I'd like to say to you that maybe you are new here, but we are not disclosing our strategy on this part of the segment, but I can tell you what we are doing so far in terms of the market.

We have a global team for innovation based in Chicago. This team is tracking all of the consumers' trend in all of the world and we are putting together all of our team from different regions to accelerate the growth and innovation. We have innovation on one side of the country, from one country we can accelerate this innovation in other country. This is one thing. And we are looking for all of this trend that you mentioned before. And Seara launched last week a line of meatless product in Brazil, hamburger and other kinds of products meatless. It was launched I think 2-3 weeks ago.

This is what we're doing now, but we are really deep involved in understanding the market strengths about this.

Mr. Theurer: Okay, perfect. Thank you very much. And congratulations.

Operator: Our next question comes from Carla Casilla, JP Morgan.

Ms. Casilla: Hi. We've seen a couple of retailers bring more of their own production in-house. Can you just say if you see that trend continuing and/or if it's impacted any of your US beef or pork business?

Mr. Tomazoni: André, would you like to comment?

Mr. Nogueira: Yes, Carla. I don't think that this is a trend, Carla. We saw some movements; I think that's normal that retailers start to understand better each segment. What we saw until now is very, very small. One of the retailers that did that movement was a great impact to us, so we are going to help him as much as we can, we are going to continue to serve his business in a very strong way.

So I'm not really concerned with that at all. I don't think that's a trend, I think that's normal, we saw that in other parts of the globe, I just don't see that becoming a real big trend on that.

Ms. Casilla: Okay, great. And then on the ASF, is it more concerning that it has moved to Hong Kong from China? Does that make a big change in your… Can you talk about the risk of that crisis coming to the US or Brazil?

Mr. Nogueira: Of course the spread is pretty serious in Asia right now, it's in China, it's in Vietnam, it is in Hong Kong, is Cambodia. So it is spread in a very aggressive way. It is a concern that this can come to the US, I think that we are talking, the industries are talking with the government and taking all the measures that we can, and the government is taking all the measures they can try to prevent that.

I think that US has a very strong biosecurity. The disease has been in Europe now for many years, it has spread more in the wild hog, through the wild hog, that's not an issue that can really impact the US, there is no way that the wild hog can cross the ocean, but the countries that have good security in Europe, still are being able to protect and not be infected until now. You do not see this disease in Germany, in Netherlands.

So I think that is the risk that we need to the attention, it is a relevant risk, the industry is meeting about that, discussing about that with the government, we are taking the actions that we can take to protect the US from this infection.

And if it happens, all the way that the industry and the government will react to that. So I think that we have a plan to avoid and we have a plan on how we can contain that. I'm comfortable that we have good plans and the government is moving in the right direction to protect the border and, if it happens, how to act immediately to avoid a spread that can be an impact for the industry.

Ms. Casilla: Thanks a lot.

Operator: This concludes today's question-and-answer session. I'd like to invite Mr. Gilberto Tomazoni to proceed with his closing statements. Please, please, go ahead Sir.

Mr. Tomazoni: Finally, I'd like to emphasize: First, we are in a favorable market moment. JBS has really a global footprint, JBS has a strong financial position and proved management team. JBS is positioned to seize the growth opportunities.

I would like to thank all of our team members who have made a difference and thank you all of you for attending this conference call.

Operator: This concludes JBS audio conference for today. Thank you very much for your participation and have a good day.