

Food & Beverage

July 03, 2018

June: weaker figures in a tough 2Q; BRF announces a restructuring plan

Nome	Ticker	Price (BRL) June-18	Change (%)		
			Month	2018	LTM
Ambev	ABEV3	17.98	-7.4%	-14.5%	1.2%
BRF	BRFS3	18.00	-15.1%	-50.8%	-53.4%
JBS	JBSS3	9.30	1.8%	-4.7%	48.4%
M. Dias Branco	MDIA3	37.40	-11.0%	-28.2%	-22.8%
Marfrig	MRFG3	8.14	0.6%	11.2%	21.1%
Minerva	BEEF3	6.27	-14.0%	-41.1%	-48.2%
Ibovespa	IBOV	72,763	-4.4%	-4.8%	16.9%

Source: Economática and BB Investimentos

Food:

As expected, the interruptions in supply due to the truckers' strike had an adverse impact on BZ exports. According to the figures released by MDIC (Ministry of Development, Industry and Export), volumes of beef exports decreased significantly by 51% y/y in June, after two months of flat results. Therefore, revenue came in at USD 257 mn (-39% y/y), partially offset by the 24% y/y increase in average price. On the other hand, following the same path in terms of volumes, but with no price relief, poultry and pork recorded strongly lower revenues y/y. The volume of poultry exports shrunk by 42% y/y, while the reduction of 8% y/y in average prices contributed to a 47% y/y drop in revenue that totaled USD 299 mn. Pork, in turn, showed a decline of 52% y/y in volume and 24% y/y in average prices, leading revenue to a substantial decline of 64% y/y.

In addition to the lower volumes, we see higher costs pressuring margins in the sector in the 2Q18. Although the average cattle price showed a decrease of 1.5% m/m, reaching BRL 138.5/@ in June, it was 5% higher y/y. Following the same path, corn price decreased by 5% m/m, reaching the lowest level BRL 37/bag since February. As a result of the higher cost of freight and the unfeasibility to pass-through these costs, grain trade has stalled and inventories increased, pushing prices down. However, considering the entire 2Q, corn prices increased by 50% y/y on average compared to the 2Q17. Thus, we expect margins to come squeezed in the poultry and pork industry in the 2Q18, along with the challenging scenario for exports and the still weak demand in the domestic market.

In June, once again, most of the company's shares in the sector showed a performance below Ibovespa. **BRFS3** was the greatest fall, -15% m/m. In addition to the maintained restrictions imposed by Russia and Europe, the negative performance resulted also from the anti-dumping measure set out by China, that implemented an import tax of 23.5% on BRF's products. The second largest drop was **BEEF3**, which fell 14% m/m mostly due to the announcement in which BRF sold common shares issued by Minerva, reducing its percentage of capital held to 6.8% from ~12%. On the other hand, **MRFG3** has been benefited from the conclusion of the acquisition of 51% of National Beef, along with a positive expectation around the divestment (Keystone) that should promote a significant deleverage ahead.

Our thoughts on BRF's announcement of active measures to improve capital structure and reduce leverage:

Last Friday, June 29, BRF announced an aggressive, in our view, operational and financial restructuring plan. Facing a high leverage level and a challenging scenario, especially given the oversupply and lower volumes exported stemming from EU, Russia and China restrictions, the new management decided to focus on four main initiatives, as follows: (i) divestments of assets in Europe, Argentina and Thailand (which correspond to 10% of both the total volume and revenue in the consolidated); (ii) sale of non-strategic assets; (iii) improvements in working capital through an efficient inventory management of finished products and frozen raw material; and (iv) securitization of receivables. According to the management, these efforts should enable the company to capitalize around BRL 5.0 bn in 2018 leading leverage to a level of 4.35x in YE18 and 3.0x in YE19.

In our view, the delay in achieving the expected synergies through important acquisitions such as the Golden Foods Siam (GFS) in Thailand and Campo Austral in Argentina, contributed for the decision-making on divestments. Although we believe these measures are quite aggressive, since we consider six months a tight deadline to implement all of the initiatives, it is a first step for the so long-awaited restructuring process. In addition, we also expect that the company might gain efficiency due to further adjustments in production. In this sense, the company has reinforced that it is evaluating its assets in order to suitably balance supply and demand. According to the company, 22 plants (out of 35) in Brazil might undergo adjustments within the next 60 days, while the headcount has reduced by ~5% since March-18. Therefore, although we expect weak 2Q18 results as a result of the tough scenario aforementioned, we believe the initiatives announced and a better balance between supply and demand in the industry might lead BRF to a reasonably margin recovery and to deleverage in the medium term.

Sector Report

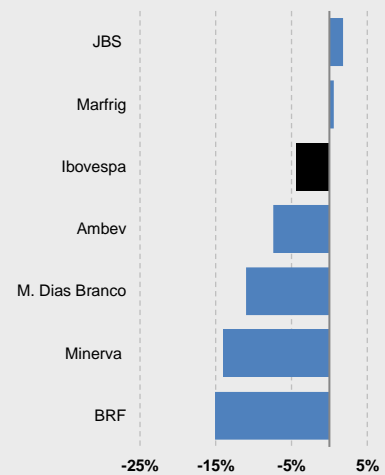
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Target Price (BRL)

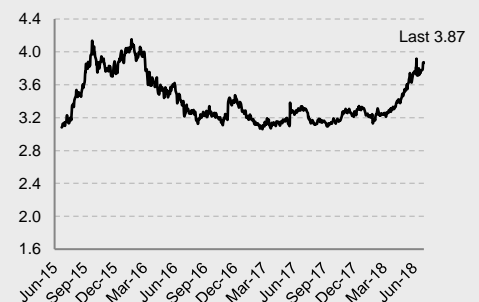
Ticker	TP	Upside(*)	Recommendation
ABEV3	24.0	33.5%	Outperform
BRFS3	35.0	94.4%	Outperform
JBSS3	10.5	12.9%	Market Perform
MDIA3	58.0	55.1%	Outperform
MRFG3	9.0	10.6%	Market Perform
BEEF3	15.0	139.2%	Outperform

Source: Bloomberg and BB Investimentos;
(*) As of 06/29

Food & Beverage - Monthly Change (%)



FX Variation (BRL/USD)



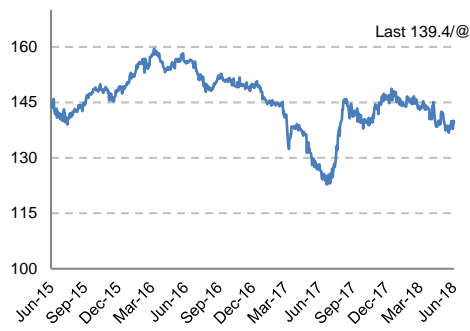
Source: Bloomberg and BB Investimentos

Beverage:

ABEV3 showed a negative performance as well, for the third consecutive month, and dropped 7.4% m/m in June. We point out some aspects that have been contributing to the down equity moves: (i) the still weak scenario for consumption in Brazil considering the still high unemployed rate (at 13.1% in March, according to IBGE) and lower disposable income; and (ii) the adverse effect in sales volume due to the truckers' strike. Moreover, on June 20, the Constitution, Justice and Citizen Commission (CCJ) in the Brazilian Congress approved two legislative decrees suspending the tax incentive reduction for producers of soft drinks in the Manaus Free Trade Zone. In this context, Ambev should be negatively impacted since the company has accumulated large amounts of tax credit that offset taxes charged on beers.

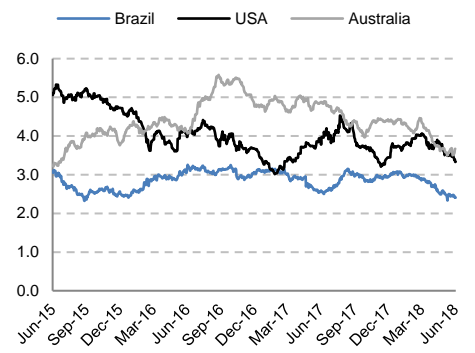
Cattle Prices in Brazil

BRL/15kg



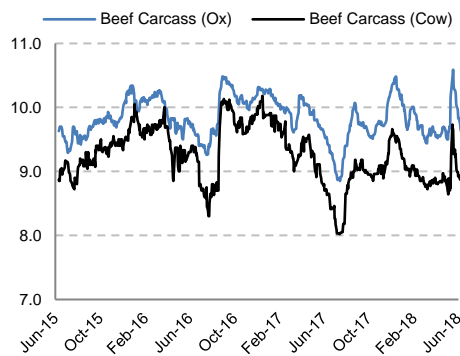
Cattle Prices in BZ x US x Aus

USD/kg

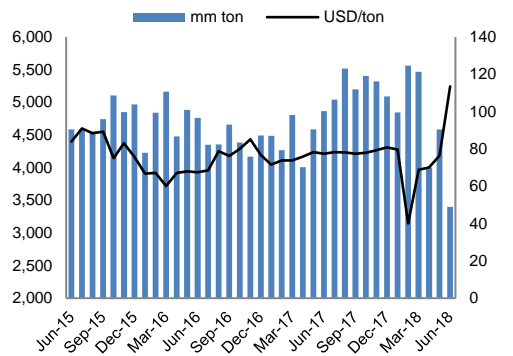


Beef Prices in Brazil

BRL/kg

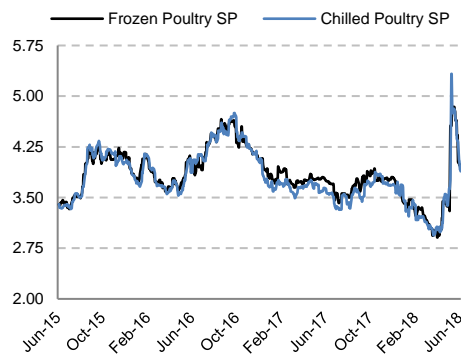


Beef Exports from Brazil

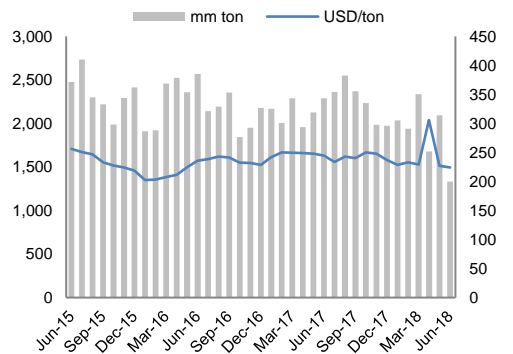


Poultry Prices in Brazil

BRL/kg

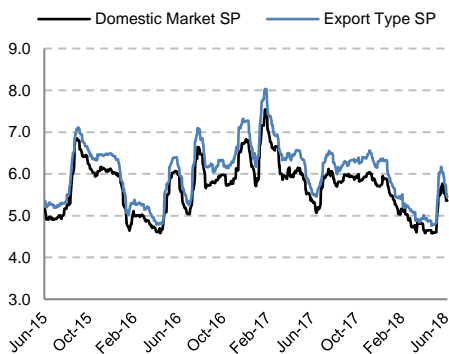


Poultry Exports from Brazil

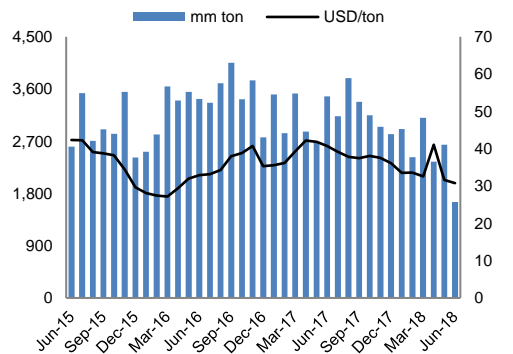


Pork Prices in Brazil

BRL/kg

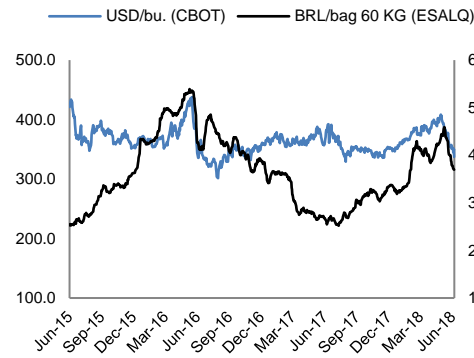


Pork Exports from Brazil

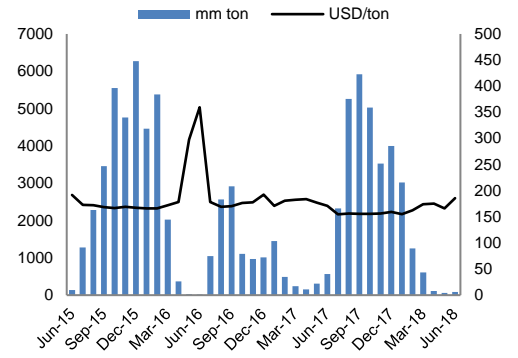


Source: Bloomberg, Secex and BB Investimentos

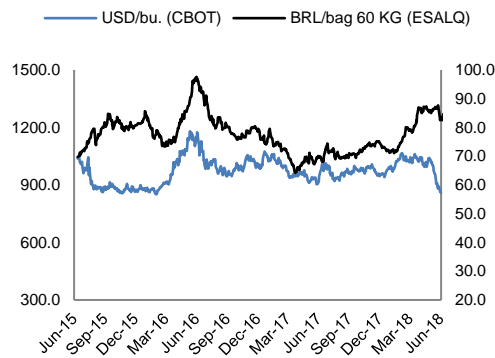
Corn Prices



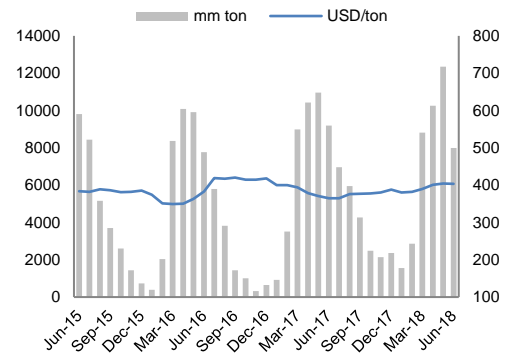
Corn Exports from Brazil



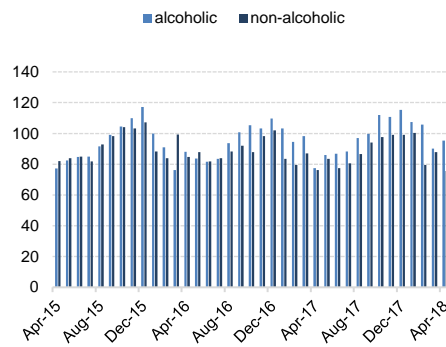
Soybean Prices



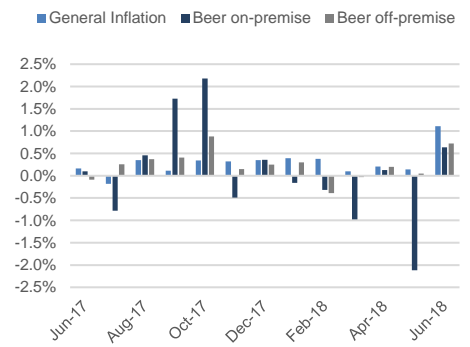
Soybean Exports from Brazil



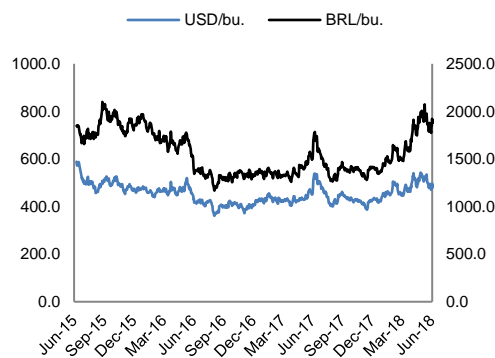
Beverage Production - Brazil



Beer Inflation - Brazil



Wheat Prices (CBOT)



Source: Bloomberg, Secex, IBGE and BB Investimentos

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