MINERVA

3Q23 Preview: Just a scratch...

LatAm Meatpackers

Main takeaways:

(i) We expect a small increase in revenue, on a quarterly basis, given better volumes; **(ii)** Brazil should be the main positive highlight, due to the more favorable cattle cycle; **(iii)** Paraguay the main negative highlight, due to excessive rain hindering shipments; **(iv)** We remain optimistic about China's structural demand for beef in the long run, but in the short term we see a demand that should not sustain a high price level; **(v)** We believe that Paraguay should once again shine in the company's results if the climate problem ceases; **(vi)** We reiterate our **BUY rating**, but we have **revised our assumptions** to reflect working capital and leverage dynamics that are closer to the company's new reality following the acquisition of Marfrig's 16 plants, as well as lower short-term demand in China. In view of these changes, **we cut the 12M Target Price** to **R$14.00** (vs. R$17.00 previously), leaving the shares with an **upside** of **+73,91%**.

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Company

BEEF3 BZ Equity
Buy

Price: R$ 8.05 (06-Nov-2023)
Target Price 12M: R$ 14.00

Minerva will report its 3Q23 results on November 8th, and in this report we will present our expectations for the company's figures and compare them to market expectations. We expect a **reasonable** quarter in terms of **revenue**, with **improvements in the consolidated margin**. Compared to last quarter, we should see a **slightly growing top-line**, driven by an **acceleration of ~4% in volume**, but with **prices still stable**. Looking at margins, we should see a double-digit EBITDA margin, driven by the **positive cattle cycle in Brazil**. We expect Brazil to be the main positive highlight of the quarter.

On the other hand, we expect the **negative highlight** of 3Q23 to be **Paraguay**. Even with the positive cattle cycle, we observed the **occurrence of climatic events** that made it difficult the logistics of transporting live cargo to the cattle slaughter plants difficult. We therefore believe that the volume of shipments will be affected.

Valuation and rating. For the next few quarters, our expectation is that **(i)** the positive cattle cycle in Brazil will continue to favor margins; **(ii)** the company will once again benefit from the positive cycle in Paraguay, with the adverse weather conditions having normalized; and **(iii)** the volume of beef exports to the US will continue to grow. As we have said in other reports we have published, given the negative cattle cycle in the US that is expected to last until the middle of 2025, along with resilient demand, our analysis is that the US will continue to receive an increasing volume of shipments from other countries, such as Brazil and Uruguay. Considering that export volumes are still low given the situation, we see room for further improvement.

Looking more favorable than negative, we reiterate our **BUY rating** for the company's shares, but we have revised our estimates, especially with regard to leverage and working capital, and are **reducing our target price** to **R$14.00** (vs. R$17.00 previously). In 3Q23, we expect total revenues amounted in R$7.5bn Genial Est (-10.9% y/y). We project EBITDA of R$788mn Genial Est., down -2.3% y/y, but representing an expansion of +0.9 p.p. y/y in margin, which should reach 10.5%. For net income, our model reached R$218mn Genial Est (+54.1% y/y).

In relation to consensus. Our estimates are 5.1% below consensus in terms of revenue, and in line in terms of margin.

Continued good momentum in Brazil and improvement in Uruguay. On the positive side, we should have **(i)** the positive cattle cycle in Brazil, which should enable a double-digit EBITDA margin; **(ii)** Uruguay with a small increase in revenue, given the ~3% q/q acceleration in prices and volumes, despite the fact that we are still in a negative cattle cycle; **(iii)** Colombia having received authorization from health surveillance for shipments to China. Although Minerva has not yet obtained approval for the plants, we believe that it is now only a matter of time; **(iv)** a greater volume of exports to the USA, although not at a level that we can consider high.

Argentina and Paraguay as negative highlights. On the negative side, we expect **(i)** weak volumes in Argentina, due to local economic and political volatility, and stable in relation to 2Q23 and **(ii)** Paraguay with generally very weak figures, due to the climatic problems faced in the country in this period (excessive rain).

Chinese structural demand is at slow pace but remains incremental. Our perception is that, although we saw an increase in demand in July, we also noted a significant worsening in August. Along with the reduction in demand, there was a drop in export volumes, with a subsequent rebound in September. We see the RMB/USD exchange rate as one of the factors explaining this short-term volatility. When the exchange rate indicates a devaluation of the renminbi against the dollar, volumes fall, since beef is traded as a commodity in US$, and it becomes more expensive for China to import larger volumes.

Looking at a slightly longer time horizon, we remain bullish based on factors such as **(i)** the westernization of protein demand in China; **(ii)** the expansion of the Chinese middle class and **(iii)** beef consumption in China is still well below the world average (4kg per capita vs. ~15 OECD average). However, in the short term, we don't see demand being strong enough to sustain higher selling prices for beef. We therefore believe that in the coming quarters, even if Chinese demand contributes to sequentially higher export volumes, selling prices should remain stable.

Negative scenario in the US probably will continue to help. We believe that Minerva is already benefiting from the current scenario in the US, characterized by a negative cattle cycle, but with resilient demand for beef. As the company continues to drive more **(i)** exports' volume of commodity (processed) beef from Brazil to the US and **(ii)** exports of premium cuts from Uruguay also to US market. However, in our view, the volume of exports to the US should not yet be at a level that we can consider high.

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We also see an interesting upside if Paraguay is also authorized to export to the US. For this to happen, there is still a need for approval in a public consultation in the US, given that Paraguay has already been approved for exports from a sanitary point of view. We believe there is a chance of this happening in 2024. There was no progress on this issue in 3Q23. It is worth remembering that this possible approval could also be positive for Colombia, as the country could start serving clients in Chile who would no longer be served by Paraguayan production.

Table 1. Income Statement Minerva (3Q23 Genial Est.)

(R$ millions)	3Q23E Genial Est.	2Q23 Reported	% q/q	3Q22 Reported	% y/y
Net Revenue	**7.517**	**7.277**	**3,3%**	**8.438**	**-10,9%**
COGS	(6.057)	(5.765)	5,1%	(6.779)	-10,7%
Gross Profit	**1.460**	**1.512**	**-3,4%**	**1.659**	**-12,0%**
Gross Margin (%)	19,4%	20,8%	-1,36p.p	19,7%	-0,24p.p
EBITDA	**788**	**711**	**10,8%**	**806**	**-2,2%**
EBITDA Margin (%)	10,5%	9,8%	0,71p.p	9,6%	0,93p.p
Net Income	**218**	**121**	**80,2%**	**142**	**53,5%**
Net Margin (%)	2,9%	1,7%	1,24p.p	1,7%	1,22p.p

Soure: Minerva, Genial Investimentos

Our Take on Minerva

For the coming quarters, we expect revenue growth to be driven more by the volume variable, given that cattle sales prices should remain stable. The company's positive highlights should continue to come mainly from Brazil and, after the climatic problem of excessive rainfall in Paraguay, the country should once again shine in the company's results.

Recapping the latest events... At the end of August, Minerva's shares fell sharply after the conference call with analysts to announce the acquisition of 16 Marfrig plants for R$7.5bn. Although it had accumulated a performance less affected than its peers by the market bad mood since the beginning of the year, the announcement was undoubtedly a game changer for the stock's performance. However, most likely in a different way to what management had imagined it would be. The shares closed the trading session with a drop of -18% in a single day. The announcement has undoubtedly changed (for the worse) how a significant portion of investors view the company in the short term.

At that time, we saw a flow of investors leaving Minerva to structure a long position in Marfrig. According to some institutional investors we spoke to, one company's problem became the other's difficulty. Precisely because of this transfer of the issue of higher leverage from one investment thesis to another, some investors left their long positions in Minerva aside, exerting enormous selling pressure on the shares. Marfrig, on the other hand, rose +14% in that trading session, with the justification that the amount paid by Minerva for the acquisition would go into the company's cash flow, and Marfrig's leverage would fall to more reasonable levels. Although we understand the motivations of these investors, we see some irrational points in this sudden move.

We don't ignore the fact that Marfrig now has clear benefits from reducing its leverage and maintaining a smaller operation, focused on processed products (hamburgers and meatballs).

However, our estimates point to a reduction to 3.0x Net Debt/EBITDA vs. 4.1x (ex. BRF), already benefiting from a -0.5x reduction through the initial payment of R$1.5bn (20% of the total) in 2023, with -0.6x being reduced throughout 2024. Even so, 3x leverage is still high, and wouldn't justify getting too excited about Marfrig's performance, which is still exposed to fragile operational dynamics in the short term. This view was also proved to be right that even with this instant euphoric market reaction, the shares returned today, 2 months after the fact, to trade at exactly the same level of ~R$6.50 from which they jumped that day, giving back 100% of the gains.

Looking at Minerva, we now see an **increase in leverage to ~3.3x Net Debt/EBITDA 23E** vs. 2.5x in our estimates before the fact, given the debt issuances to structure the operation, such as the one made in September of US$1bn in external debt at a rate of 4.37%. We consider this new level to be high and it should contribute to a sharp reduction in the company's payout in 2024 (given that Minerva's dividend policy establishes a 50% payout only if leverage is equal to or less than 2.5x).

Marfrig's shares may have returned basically all their gains, but Minerva's didn't go back up. What ended up happening, in our view, was an opportunistic move by investors who saw that Marfrig's benefits were more evident than Minerva's, migrated from one stock to the other, and after some time, sold to pocket the gains. The vast majority didn't seem to want to take a long position in Marfrig in the medium term, and the move was much more speculative than rational.

But why didn't the buyer flow go back to Minerva then? To answer this question, we must assume that the initial reading was precisely irrational. There is evidence that Marfrig is not facing a favorable moment operationally and that the leverage, even cooling down, would still be hampering FCFE. So, it seems to us to be easier to identify that kind of dynamic than the recognition of the benefits of the acquisition in Minerva's figures in the medium term.

Although the assets, according to management, are in plug and play condition, requiring low working capital to start operations, investors seem to be wary of this condition. In fact, one of our Target Price cut adjustments came from more conservative working capital assumptions. In addition, the higher leverage, and therefore the reduced dividend payment, has scared away many investors who held long positions basically thinking about receiving proceeds. Investors seem to be looking more at short-term dynamics, and very concerned about the uncertainties that we recognize that still exist in relation to the acquisition.

Company's shares have fallen, but the investment thesis still stands. Although the shares have fallen and the flow of buyers has not yet returned, Minerva's momentum continues to be the best operationally among its peers. For us, this remains unchanged, with the favorable points in relation to our investment thesis in the company, including: **(i)** a positive cattle cycle in Brazil and Paraguay, and with a possible inflection of the cycle in Uruguay (which should occur at the end of 1H24); **(ii)** long-term structural demand from China, which should ensure growth in export volumes and **(iii)** a greater volume of exports to the US market.

It is worth noting that although we see Chinese demand as growing over a longer time horizon, in the short term we are not so optimistic. As a result, we have reduced our expectations for short time growth in volumes and, above all, for beef sales prices on the foreign market, one of the factors that contributed to our Target Price cut.

The acquisition still depends on approval by antitrust bodies in the countries where the assets are located. In Brazil, we expect CADE to approve it between the end of 2023 and the beginning of 2024. Therefore, Minerva should be able to take advantage of the positive cattle cycle in Brazil in 2024 to reduce its leverage. We emphasize that we see the cycle in Brazil reversing only in 2025, so there is plenty of time for the 11 plants acquired in Brazil (of the package of 16) to still benefit from the favorable movement. We believe this is one of the concerns investors have. Whether there would be enough time to absorb the synergies in order to generate cash flow from these assets while still taking advantage of the favorable moment in the Brazilian cattle cycle.

Just a scratch... The aspects mentioned above help us to remain bullish about Minerva. Furthermore, even though the acquisition has brought an additional dose of risk to the thesis, and there is still a certain lack of visibility regarding its effects, we believe that the market reaction has been exaggerated and that, at the current price level, there is an interesting asymmetry between the price and the fair value of the company's shares.

Certainly, there were doubts about working capital and the higher level of EBITDA generation, justified by Minerva's greater efficiency in managing the assets compared to the former operator. We don't deny that these doubts do interfere with the company's valuation, **which would justify our Target Price reduction of -R$3.00.** So we can't say that Minerva's short-term pricing has passed unscathed. There is some degree of reasoning behind the fall, but the brutality of it seems to us to have been exaggerated. We see it more as a scratch than a deep cut. We therefore reiterate our BUY rating, with a new **12M Target Price** of **R$14.00** (vs. R$17.00 previously).

Appendix: Minerva

Figure 1. Minerva – Income Statement in R$ Millions (Genial Est. 2023-2028)

Income Statement	2023E	2024E	2025E	2026E	2027E	2028E
Net Revenue	**28.110**	**29.841**	**32.303**	**33.112**	**34.244**	**35.986**
(-) COGS	(22.662)	(23.523)	(25.817)	(26.588)	(27.714)	(29.028)
Gross Profit	**5.447**	**6.318**	**6.487**	**6.525**	**6.530**	**6.958**
(-) Expenses	(2.794)	(2.995)	(3.245)	(3.258)	(3.380)	(3.576)
Adjusted EBITDA	**2.653**	**3.322**	**3.242**	**3.267**	**3.150**	**3.382**
(-) D&A	(537)	(458)	(494)	(509)	(515)	(517)
EBIT	**2.117**	**2.864**	**2.748**	**2.758**	**2.635**	**2.865**
(+/-) Financial Result	(1.445)	(1.649)	(1.299)	(1.126)	(1.418)	(1.331)
(-) Taxes	(94)	(199)	(237)	(267)	(199)	(251)
Net income	**578**	**1.017**	**1.212**	**1.365**	**1.018**	**1.283**
Profitability						
Net margin (%)	2,05%	3,41%	3,75%	4,12%	2,97%	3,57%

Figure 2. Minerva– Cash Flow in R$ Millions (Genial Est. 2023-2028)

Cash Flow (FCFF)	2023E	2024E	2025E	2026E	2027E	2028E
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(-) Taxes	(94)	(199)	(237)	(267)	(199)	(251)
(+) D&A	537	458	494	509	515	517
(+/-) Δ WK	2	(91)	7	(10)	(1)	(34)
(-) Capex	(1.356)	(1.139)	(741)	(610)	(566)	(517)
FCFF	**1.206**	**1.893**	**2.271**	**2.379**	**2.383**	**2.580**

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	Definition	Coverage
Buy	Expected return above +10% in relation to the Company's sector average	**49%**
Neutral	Expected return between +10% and -10% relative to the Company's industry average	**41%**
Sell	Expected return below -10% in relation to the Company's sector average	**5%**
under Review	Under review	**5%**

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