genial | Equity Research

MARFRIG

3Q23 Preview: Difficulties persist

LatAm Meatpackers

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Company

MRFG3 BZ Equity
Neutral

Price: R$ 7.50 (09-Nov-2023)
Target Price 12M: R$ 10.00

Main takeaways:

(i) We expect a weak consolidated result; **(ii)** North America should continue to be the negative highlight, with the unfavorable cattle cycle putting pressure on the segment's margins; **(iii)** South America, in the opposite scenario to North America, should be the positive highlight of 3Q23, with margin expansion made possible by the greater availability of cattle in the slaughter phase; **(iv)** Leverage continues to be a point of caution, although the sale of 16 plants to Minerva is mitigating part of it; **(v) Marfrig X Minerva**: Once the deal process is completed, we estimate that the companies will be with close leverages further down the line in 2024, however, Marfrig will be left with far fewer assets to generate operating cash and cool this remaining leverage going forward, losing a considerable amount of slaughter capacity; **(vi)** Trading at a **24E EV/EBITDA** of **7.8x** vs. a historical average of 6.2x, we see that the company's **current valuation is not discounted**. We reiterate our **NEUTRAL rating** with a **12M Target Price** of **R$10.00**, which gives the shares an **upside** of **+33.33%**.

Marfrig will release its 3Q23 results on November 13th, and in this report we will present our expectations for the company's figures and compare them to market expectations. We project a weak performance for Marfrig in this quarter, due to **still very high cattle costs in North America**, given the restricted supply of animals being slaughtered, which should continue to put significant pressure on margins.

As for the **South American** segment, we see an opposite, **more favorable scenario**, with a very **positive cattle cycle in Brazil**, and showing small signs of improvement in Uruguay. Finally, **for BRF**, we project a **sequentially better scenario**, with margins recovering mainly due to the fall in grain prices cooling the company's COGS.

Valuation and rating. However, although in South America and BRF we should see an expansion in margins, probably will not be enough to offset the negative impact we estimate at the North American operation, which represents ~40% of the company's revenue.

In addition, as we quoted in Minerva's preview, in the "Our Take" section, which follows attached (Minerva 3Q23 Preview: Just a scratch…), Marfrig's leverage will be reduced with the 16 plant's sale to Minerva. On the day of the announcement, according to our conversations with institutional investors, there was a transfer flow of long position from Minerva to Marfrig, exerting significant selling pressure on Minerva's shares. This resulted in a +14% increase in Marfrig's shares, as investors believed that the funds paid by Minerva for an acquisition would supplement Marfrig's cash flow and reduce its leverage levels.

In our model, Marfrig's leverage is projected to reduce from 4.1x to 3.0x Net Debt/EBITDA, reaping the benefits of a -0.5x decline through an initial payment of R$1.5bn in 2023, with -0.6x being reduced over 2024. However, the 3x leverage is still considered high by us, affecting our enthusiasm around Marfrig's performance. Despite the strong appreciation movement on the day of the announcement, the shares returned to their initial price of ~R$6.50 two months later, wiping out all the gains.

After the bad dynamics with Minerva's shares, mainly due to yesterday's result, echoing the 3Q23 release, we believe it's possible that part of the flow will end up going back to Marfrig once again. The stock has already returned to the ~R$7.50 level, mainly after the market priced in better results for BRF's 3Q23 last week, carrying a +17% upward movement in Marfrig's shares just between November 1st and 7th.

Minerva commented at the analysts' conference this morning that, considering the CADE process, everything leads one to believe that approval for the 11 plants that were acquired in Brazil (out of a total of 16) should only take place around June 2024. It is also worth mentioning that the CADE Court has only three of its seven members, which prevents the main cases from being considered. Minerva is working to speed up this timeframe, but we believe that there will be a few months of uncertainty until then.

In the meantime, our assessment is that investors will be much more attentive to the issue of the agreement for the acquisition, than necessarily to the operational dynamics of each of the two companies. Despite being extremely transformative for both, we believe that Minerva is experiencing a better moment operationally but has had more short positions formed as a result of the major fluctuations and uncertainties. Among them, we list investors' distrust of **(i)** the working capital required to operate these slaughter plants and **(ii)** the operating margin and EBITDA level of the 16 assets. In addition to these, another point that comes up in our conversations with investors frequently is **(iii)** when the plants are transferred to Minerva after CADE's approval, there will be considerable amount of available time for Minerva to take advantage of the positive cattle cycle in Brazil or not? We estimate that the turning point to a negative cycle will be in 2H25.

Within this dynamic, it seems difficult to say that there are no **speculative and irrational movements** in the transition of a flow of investors from one company to another. Even if, once the transaction is completed, Minerva's leverage rises to 3.3x Net Debt/EBITDA, Marfrig's leverage will fall to ~3.0x, which is not a low level. So, the difficulty with Marfrig's debt level is lessening, but it's not over. We therefore see the two companies ending the process with leverage levels that are close to each other, but **Marfrig will have far fewer assets to generate operating cash and cool this remaining leverage going forward**, losing a considerable amount of cash flow generation power.

We see Marfrig trading at a **24E EV/EBITDA** of **7.8x** vs. a historical average of 6.2x (well above) showing that the company is not discounted. Thus, we remain cautious and reiterate our **NEUTRAL rating** with a **12M Target Price** of **R$10.00**, which gives the shares an **upside** of **+33.33**%.

3Q23 Preview

For 3Q23, in relation to the company's performance ex-BRF, we estimate total revenues of R$20.2bn Genial Est (-9.5% y/y). We project an EBITDA of R$894mn Genial Est., down -63.3% y/y, representing a sharp compression of -6.5 p.p. y/y in the EBITDA margin, which should reach 4.4%. We also project a loss of R$120mn Genial Est (-140.8% y/y). Consolidating an operationally anemic figure.

In relation to consensus. Our estimates are -0.7% below consensus in terms of revenue and -0.5 p.p. below in terms of EBITDA margin.

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

(R$ millions)	3Q23E Genial Est.	2Q23 Reported	% q/q	3Q22 Reported	% y/y
Net Revenue	**20.282**	**20.309**	**-0,1%**	**22.414**	**-9,5%**
COGS	(18.719)	(18.737)	-0,1%	(19.630)	-4,6%
Gross Profit	**1.563**	**1.572**	**-0,6%**	**2.784**	**-43,9%**
Gross Margin (%)	7,7%	7,7%	-0,03p.p	12,4%	-4,71p.p
EBITDA	**894**	**1.293**	**-30,9%**	**2.433**	**-63,3%**
EBITDA Margin (%)	4,4%	6,4%	-1,96p.p	10,9%	-6,45p.p
Net Income	**(120)**	**553**	**-121,7%**	**294**	**-140,8%**
Net Margin (%)	-0,6%	2,7%	-3,31p.p	1,3%	-1,9p.p

Soure: Marfrig, Genial Investimentos

North America: Demand still resilient, but costs remain at high levels. In this region, we don't expect to see any major surprises. We are projecting a **(i)** resilient demand for beef in the domestic market; **(ii)** slightly higher volumes compared to 2Q23, driven by the aforementioned demand and the higher number of weeks in the quarter; **(iii)** a slight drop in the cutout price on a quarterly basis and **(iv)** high levels of costs, increasing marginally compared to 2Q23, due to the lower supply of cattle. This factor, together with the drop in cutout prices, should contribute to very tight margins.

Looking ahead, we see a weak 4Q23, given the continuation of the negative cattle cycle in the US and the poor seasonality at 4Qs. In addition, we believe that 2024 should be quite difficult, due to the scenario of low cattle availability, which should remain until mid-2025.

South America: Scenario in opposite trend to North America. We see a scenario opposite to that observed in North America, with **(i)** the positive cattle cycle in Brazil favoring an expansion of margins in the segment; **(ii)** the cattle cycle in Uruguay showing small signs of improvement; **(iii)** the region, especially Brazil, benefiting from the negative cattle cycle in North America by exporting a greater volume of beef to the US; and **(iv)** weaker beef sales prices on the foreign market, due to Chinese demand without much impetus in the short term, damaging the segment's top line.

For the coming quarters, we see a strong 4Q23, given the favorable cattle cycle and seasonality at 4Qa, and a positive 2024, with the scenario of greater availability of cattle enabling good margins. That painted picture should continue until the beginning of 2025. In addition, we see the average selling price of beef still below 2022, given weaker Chinese demand in the short term (although we are optimistic about it in the medium and long term). This is all considering that the company keeps its operations similar to the current ones.

If the slaughter plants are transferred to Minerva? In this case, these figures will undergo drastic changes, which are difficult to estimate at the moment. However, we are certain that EBITDA will be aimed down. In our current calculations, the drop is close to -40% vs. EBITDA 23E, considering BRF's improvement in this period, if not even greater.

Our Take on Marfrig

BRF is no longer a margin detractor for Marfrig. Just like last quarter, BRF should keep contributing positively to the consolidated margin. We are more optimistic about BRF for 3Q23, as we expect better margins. According to our projections, BRF's EBITDA margin within Marfrig's consolidated result should be 9.4% Genial Est. in 3Q23, well above the 4.4% Genial Est. margin of the Ex-BRF consolidated. This can be explained both by a considerable operational worsening in Marfrig's North America segment, due to the negative cattle cycle, and by an improvement in BRF, driven by the big drop in grain prices and efficiency improvements implemented by the company via the BRF+ program.

Difficulties persist. Looking ahead, we see Marfrig still facing headwinds such as **(i)** a negative cattle cycle in North America, contributing COGS at high levels for a while and, consequently, very compressed margins, and **(ii)** leverage still persistently high **(~3.0x Net Debt/EBITDA 2024E**), even with the sale of the 16 plants to Minerva. These two factors keep us cautious about the company's investment thesis.

Although the upside in relation to the current price is not quite low, we see almost none of short-term triggers to enable the shares to rise that are based on fundamentalist and rational terms, with the **volatility being attributed by us to speculative movements**. Trading at an **EV/EBITDA 24E** of **7.8x**, **above** the **historical average** of **6.2x**, we remain cautious and reiterate our **NEUTRAL rating** with a **12M Target Price** of **R$10.00**, which gives the shares an **upside** of **+33.33%**.

Appendix: Marfrig

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

Income Statement	2023E	2024E	2025E	2026E	2027E	2028E
Net Revenue	**133.777**	**138.765**	**150.217**	**176.439**	**184.868**	**197.129**
(-) COGS	(121.470)	(124.461)	(135.242)	(144.289)	(155.388)	(167.152)
Gross Profit	**12.307**	**14.303**	**14.975**	**32.151**	**29.479**	**29.977**
(-) Expenses	(5.844)	(7.662)	(8.168)	(9.573)	(9.571)	(10.466)
Adjusted EBITDA	**6.463**	**6.641**	**6.808**	**22.578**	**19.908**	**19.511**
(-) D&A	(6.134)	(3.925)	(3.925)	(3.925)	(3.925)	(3.925)
EBIT	**329**	**2.717**	**2.883**	**18.653**	**15.984**	**15.587**
(+/-) Financial Result	(6.371)	(10.516)	(9.134)	(7.790)	(10.059)	(9.833)
(-) Taxes	1096	2652	2125	(3.694)	(2.015)	(1.956)
Net income	**(4.946)**	**(5.148)**	**(4.126)**	**7.170**	**3.911**	**3.798**
Profitability						
Net margin (%)	-3,70%	-3,71%	-2,75%	4,06%	2,12%	1,93%

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

Cash Flow (FCFF)	2023E	2024E	2025E	2026E	2027E	2028E
Net Revenue	**133.777**	**138.765**	**150.217**	**176.439**	**184.868**	**197.129**
(-) COGS	(121.470)	(124.461)	(135.242)	(144.289)	(155.388)	(167.152)
Adjusted EBITDA	**6.463**	**6.641**	**6.808**	**22.578**	**19.908**	**19.511**
EBIT	**329**	**2.717**	**2.883**	**18.653**	**15.984**	**15.587**
(-) Taxes	1096	2652	2125	(3.694)	(2.015)	(1.956)
(+) D&A	6.134	3.925	3.925	3.925	3.925	3.925
(+/-) Δ WK	3513	61	157	(119)	358	305
(-) Capex	(4.139)	(3.925)	(3.925)	(3.925)	(3.925)	(3.925)
FCFF	**6.932**	**5.430**	**5.165**	**14.841**	**14.327**	**13.936**

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