genial Equity Research

JBS

3Q23 Review: Frozen margins, hot prospects

LatAm Meatpackers

Main takeaways:

(i) We saw a weak result; **(ii)** JBS Beef North America continued to have very compressed margins; **(iii)** JBS USA Pork surprised positively, driven by the normalization of the supply of hogs in the USA; **(iv)** JBS Australia and JBS Brazil showed a small sequential compression of margins; **(v)** The fall in grain prices has started to partially benefit JBS USA Pork and Seara; **(vi)** We expect a gradual recovery in margins over the next few quarters; **(vii)** We reiterate our **BUY rating** with a **12M Target Price** of **R$30.00**, given the shares **upside** of **+42.86%**.

JBS delivered a weak quarter, with some indicators below our expectations. Net revenue was R$91.4bn (-7.3% vs. Genial Est.), with an EBITDA margin slightly below our projections (-0.2 p.p. vs. Genial Est.). And, as we expected, we saw a quarter marked by mixed dynamics. On the negative side, we saw **(i)** little progress in terms of margins at JBS Beef North America, a segment that continues to suffer greatly from the negative cattle cycle in the US; **(ii)** margins below what we expected at JBS Australia, despite expansion on a year-on-year basis; **(iii)** lower beef and chicken prices on the international market hurting revenues and contributing to a sequential compression of margins at JBS Brazil and Seara and **(iv)** leverage rising to the high level of **4.8x Net Debt/EBITDA** (vs. 3.9x in 2Q23), as a result of the falling LTM EBITDA.

On the positive side, we observed **(i)** JBS USA Pork once again delivering an EBITDA margin in the high single-digit range, in line with its historical level of margins and with what we estimated for the operation; **(ii)** greater free cash flow (FCFE) generation, which reached R$3.4bn (+6.3% y/y), considering that the release of working capital more than offset the retraction in EBITDA and **(iii)** favorable prospects for the coming years in all the ex-JBS Beef North America segments.

Valuation and rating. It is worth noting that, in addition to our expectation of a gradual improvement in the figures for most of JBS's segments for 4Q23 and throughout 2024, we should also count on the approval and eventual completion of the dual listing process for the shares in the USA. In our view, this process could help unlock the company's value, given the discount that JBS has compared to its US peers. We believe that this will be a trigger for the appreciation of the shares, which despite having already risen +20% since the announcement of the viability process at the beginning of July, we believe that the movement has not been fully priced in by the market. Our belief is based, for example, on Tyson Foods trading at an EV/EBITDA 24E of 9.1x, with a large gap to JBS's trading range.

Along these lines, we see JBS trading at a multiple of **5.2x EV/EBITDA 24E**, not only below its American peers but also below its historical average of 5.5x. This, together with the positive outlook for the coming quarters and the eventual completion of the dual listing process, keeps us bullish on the stock.

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Company

JBSS3 BZ Equity
Buy

Price: R$ 21.00 (13-Nov-2023)
Target Price 12M: R$ 30.00

3Q23 Preview

JBS reported net revenue of R$91.4bn (-7.3% vs. Genial Est.), indicating a slowdown of -7.6% y/y. With costs squeezing the company figures more than we estimated, EBITDA fell to R$5.4bn (-10.7% vs. Genial Est.), marking a drop of -43.3% y/y. Therefore, JBS retracted its performance to an EBITDA margin of 5.9% (-1.0p.p. vs. Genial Est.), making up a drop of -3.7p.p. y/y.

Debt profile lengthening. It's worth noting that the increase in leverage is linked to the fall in LTM EBITDA, but there have also been important changes in the debt profile. In September, after managing its liabilities, JBS issued Senior Notes worth US$2.5bn. This issue was divided as follows: **(i)** US$1.6bn with an interest rate of 6.75% and maturity in 2034 and **(ii)** US$900mm with an interest rate of 7.25% and maturity in 2053. In addition, in October, JBS issued Agricultural Receivables Certificates (CRA) in the amount of R$1.7bn. With these measures, JBS lengthened its average debt term to 12 years (vs. 9 years in 2Q23).

Changes in the debt structure led to higher financial expenses. Even though the lengthening of the debt is a positive point, financial expenses suffered an impact in 3Q23, with part of the long-term funds raised having been used to pay off short-term debt, therefore lengthening the profile. As a result, we saw a greater discharge of financial expenses through the P&L. With EBITDA lower than our projections, the difference in the net profit line was even more elastic, with JBS reporting R$572mm (-65.4% vs. Genial Est.), a sharp retraction of -85.7% y/y. Finally, the net margin reached 0.6% (-1.0 p.p. vs. Genial), slowing down by -3.4 p.p y/y.

Table 1. Income Statement JBS (3Q23 vs. Genial Est.)

(R$ millions)	3Q23 Reported	3Q23E Genial Est.	% R/E	2Q23 Reported	% q/q	3Q22 Reported	% y/y
Net Revenue	**91.410**	**98.579**	**-7,3%**	**89.383**	**2,3%**	**98.928**	**-7,6%**
COGS	(80.357)	(86.434)	-7,0%	(79.496)	1,1%	(82.692)	-2,8%
Gross Profit	**11.053**	**12.145**	**-9,0%**	**9.887**	**11,8%**	**16.236**	**-31,9%**
Gross Margin (%)	12,1%	12,3%	-0,23p.p	11,1%	1,03p.p	16,4%	-4,32p.p
EBITDA	**5.409**	**6.057**	**-10,7%**	**4.470**	**21,0%**	**9.546**	**-43,3%**
EBITDA Margin (%)	5,9%	6,1%	-0,23p.p	5,0%	0,92p.p	9,6%	-3,73p.p
Net Income	**573**	**1.638**	**-65,0%**	**-264**	**-316,9%**	**4.014**	**-85,7%**
Net Margin (%)	0,6%	1,7%	-1,04p.p	-0,3%	0,92p.p	4,1%	-3,43p.p

Soure: JBS, Genial Investimentos

Beef North America continues to face a difficult scenario. With the supply of cattle remaining very tight in the US, even with resilient demand, the spread in 3Q23 exerted sequential pressure, causing the EBITDA margin (in USGAAP) to remain relatively apartment sequentially (+0.2 p.p. q/q; -5.7 p.p. y/y). During 3Q23, we saw the cutout price fall marginally, while the cost of cattle rose slightly, evidence of the critical moment in the current cattle cycle in the US.

However, this quarter, the company corrected some internal setbacks it had, both commercially and in relation to the White Bone plan (linked to initiatives to maximize cattle profitability), which partially offset the worsening in the industry and helped the EBITDA margin remain stable. We would like to point out that it could have been worse without these measures.

For the coming quarters, we estimate that cattle availability will remain low in the US, contributing to the segment's EBITDA margin remaining at a low single digit in 4Q23 and in 2024. We see a gradual recovery towards a greater supply of cattle in the country and, consequently, margins, only in mid-2025.

USA Pork returning to its historical level of margins. We saw **(i)** lower grain prices (-24.0% y/y), which benefited the segment this quarter, positively impacting the verticalized portion of the operation, although the impact of the drop in soybean and corn prices has not yet been fully realized given the delay in the composition of inventories and **(ii)** a drop in pork prices (-18.0% y/y), positively impacting the non-verticalized portion of the company.

Therefore, the segment once again delivered a high single-digit EBITDA margin (in USGAAP), ending 3Q23 at 9.4% (+7.9p.p. q/q; +5.0p.p. y/y), in line with the historical level presented by the operation (8% to 10%).

Looking ahead to the coming quarters, we are confident of more expanded margins for the segment, bringing interesting sequential progress, which could take the EBITDA margin to double digits in some quarters of 2024, with the operation ending 2024 with a margin level more in line with history, demonstrating the recovery of the segment to come.

For JBS Australia, we observed a sequential retraction in margins. With beef sales prices weakening on the international market, JBS reported net revenue in the segment was still weak (+4.4% q/q; -5.4% y/y), since ~66% of JBS Australia's beef production is destined for export. The EBITDA margin (in USGAAP), although expanding considerably year-on-year, shrank sequentially to 6.6% (-2.0 p.p. q/q; +3.0 p.p. y/y).

For 4Q23, we estimate a small sequential expansion in margins, and for 2024, we see EBITDA margins in the double digits, making the segment one of the company's best in terms of margins next year.

The positive livestock cycle in Brazil was not enough to offset other negative dynamics, as we had expected. Weakened sales prices on the international market hurt the segment's net revenue (+3.3% q/q; -11.1% y/y), and because the drop in prices was greater than the drop in the cost of cattle, margins were also negatively impacted. We also saw the leather business division with a lackluster performance, considering the lackluster automotive industry, and the Swift stores remaining margin detractors (several are still in the maturing stage and at breakeven in relation to EBITDA), factors which, together with weaker sales prices, meant that the operation ended 3Q23 with an EBITDA margin of 3.4% (-1.8 p.p. q/q; -1.7 p.p. y/y).

For 2024, we see the cattle cycle in Brazil remaining favorable, given the high supply of animals being slaughtered. If prices on the international market return to growth, and the USD/BRL exchange rate continues without major bumps (~5 BRL/USD), we believe that the EBITDA margin over the quarters should remain at mid to high single digit. If one of these two factors do not occur, we see the EBITDA margin remaining at mid-single digit. It is worth noting that we believe the operation will benefit from higher beef exports to the US, as long as the cycle remains negative there.

Lower chicken prices hamper margin expansion but a drop in grains helps Seara. We saw slightly weaker revenue sequentially (-1.0% q/q; -13.3% y/y), due to lower chicken sales prices on the international market. It should also be noted that, with lower demand from the foreign market, there was an expansion in the supply of chicken meat on the domestic market, also pushing down prices on the domestic market. On the positive side, the drop in corn and soybean prices partially benefited the segment this quarter. It is worth mentioning that the impact has not yet been complete due to hedging issues and the fact that Seara has a high average inventory cost. As a result, the EBITDA margin reached 5.5% (+1.4 p.p. q/q; -9.6 p.p. y/y).

Over the next few quarters, we expect further advances in profitability, as the company should see a gradual recovery in margins driven by the drop in grains, which should increasingly benefit Seara, until the operation returns to its historical EBITDA margin level (10 to 12%).

Our Take on JBS

Although we saw a weak quarter and, in general, less than we expected, with part of the segments facing challenges, we project sequential improvements for the coming quarters in all ex-JBS Beef North America operations, guided by **(i)** normalization of chicken supply and demand worldwide; **(ii)** maintenance of the downward trend in grains; **(iii)** normalization of pork supply in the USA; (iv) resilient demand for beef in the USA and **(v)** a favorable livestock cycle in Brazil and Australia.

Leverage rose to a high level, but the company improved its working capital and its free cash flow generation. Due to the sharp reduction in EBITDA, we saw JBS's leverage rise to the high level of 4.8x LTM Net Debt/EBITDA (vs. 3.9x in 2Q23 and 1.8x in 3Q22). However, on the positive side, the company freed up R$1.7bn in working capital, mainly due to the reduction in inventories and the improvement in accounts receivable, which generated R$3.4bn (+6.3% y/y) in free cash flow (FCFE).

Frozen margins, hot prospects. In addition, we believe that the process of dual listing of the company's shares will be interesting for unlocking the company's value in the medium and long term and, in our view, its approval could be a trigger for the shares to rise in the short term. We see the company trading at **5.2x EV/EBITDA 24E**, below the historical average, and we continue to see an attractive upside, based on a projected improvement as soon as 2024, in relation to the current low market valuation, due to very short-term dynamics. We therefore reiterate our **BUY rating** with a **12M Target Price** of **R$30.00**.

Appendix: JBS

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

Income Statement	2023E	2024E	2025E	2026E	2027E	2028E
Net Revenue	**366.791**	**374.002**	**394.316**	**455.465**	**463.609**	**481.169**
(-) COGS	(324.608)	(317.344)	(333.332)	(384.967)	(388.460)	(400.258)
Gross Profit	**42.183**	**56.658**	**60.984**	**70.498**	**75.149**	**80.911**
(-) Expenses	(22.197)	(29.491)	(33.647)	(41.007)	(46.155)	(45.672)
Adjusted EBITDA	**19.986**	**27.167**	**27.336**	**29.492**	**28.994**	**35.238**
(-) D&A	(10.817)	(9.770)	(7.816)	(6.595)	(2.443)	(2.443)
EBIT	**9.169**	**17.397**	**19.520**	**22.897**	**26.551**	**32.796**
(+/-) Financial Result	2.698	5.758	5.863	7.837	7.896	7.983
(-) Taxes	(4.160)	(7.873)	(8.630)	(10.450)	(11.712)	(13.865)
Net income	**7.708**	**15.282**	**16.753**	**20.284**	**22.735**	**26.914**
Profitability						
Net margin (%)	2,10%	4,09%	4,25%	4,45%	4,90%	5,59%

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

Cash Flow (FCFF)	2023E	2024E	2025E	2026E	2027E	2028E
Net Revenue	**366.791**	**374.002**	**394.316**	**455.465**	**463.609**	**481.169**
(-) COGS	(324.608)	(317.344)	(333.332)	(384.967)	(388.460)	(400.258)
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(-) Taxes	(4.160)	(7.873)	(8.630)	(10.450)	(11.712)	(13.865)
(+) D&A	10.817	9.770	7.816	6.595	2.443	2.443
(+/-) Δ WK	178	(418)	(2.200)	(2.657)	(363)	(794)
(-) Capex	(8.814)	(9.770)	(7.816)	(6.595)	(2.443)	(2.443)
FCFF	**7.190**	**9.106**	**8.690**	**9.790**	**14.476**	**18.137**

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Buy	Expected return above +10% in relation to the Company's sector average	**49%**
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Sell	Expected return below -10% in relation to the Company's sector average	**5%**
under Review	Under review	**5%**

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