genial | Equity Research

MARFRIG
3Q23 Review: A pleasant surprise

LatAm Meatpackers

Main takeaways:

(i) Results came in higher than expected; **(ii)** North America continued with weak numbers, with the negative cattle cycle putting pressure on margins; **(iii)** South America was the positive highlight, with the positive cattle cycle in Brazil enabling margin expansion in the region; **(iv)** Leverage continues to be a point of attention, although the sale of 16 plants to Minerva is a mitigating factor; **(v)** We reiterate our **Neutral rating** with a **12M Target Price** of **R$10.00,** giving the shares an **upside** of **+32,28%**.

Marfrig delivered a quarter of results above our expectations in terms of Revenue (+6.6% vs. Genial Est.), and with an EBITDA margin above our projections (+0.8p.p. vs. Genial Est.) and also +0.4p.p. above consensus.

On the negative side, as we expected, the North American segment suffered from high costs, with the low cattle supply scenario strongly damaging the operation's margins. On the positive side, we saw South America with the opposite, much more favorable scenario, with margins expanding due to the positive cattle cycle in Brazil. In addition, BRF also showed a small recovery in margins in a gradual movement, which is being driven by the fall in corn and soybean prices.

Valuation and rating. Although we have a good outlook for South America in the coming quarters, North America, a segment that represents ~40% of the company's revenues, should continue to have very compressed margins, pressured by the negative cattle cycle in the US. In addition, we are still cautious about BRF for the next few quarters and still closely monitoring the progress of the implementation of the BRF+ efficiency program and possible improvements in the international segment, which has been delivering figures well below those of the Brazilian business unit. North America together with BRF represents ~80% of Marfrig's turnover.

Looking at another point of criticism of ours, even though the company's leverage will be reduced to **3.0x Net Debt/EBITDA 24E** (vs. 3.9x in 3Q23), with the sale of 16 plants to Minerva, in our view, Marfrig's indebtedness is still an important point of attention for the thesis, and cash generation capacity will decrease drastically after the sale to cope with a leverage that will still be at this level. We therefore remain cautious and reiterate our **NEUTRAL rating** with a **12M Target Price** of **R$10.00**.

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Company

MRFG3 BZ Equity
Neutral

Price: R$ 7.56 (13-Nov-2023)
Target Price 12M: R$ 10.00

3Q23 Review

Considering the figures ex-BRF, net revenue was reported at R$21.8bn (-2.5% y/y; +7.7% vs. Genial Est.), and EBITDA clocked in at R$1.3bn (-44.3% y/y; +51.7% vs. Genial Est.). As a result, the company achieved an EBITDA margin of 6.2% (-4.6p.p. y/y; +1.8p.p. vs. Genial Est.), mainly reflecting the high costs of cattle in North America. Finally, net income clocked in at R$150mn, with a net margin of 0.7% (-0.6p.p. y/y; +1.3p.p. vs. Genial Est.).

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

(R$ millions)	3Q23 Reported	3Q23E Genial Est.	% R/E	2Q23 Reported	% q/q	3Q22 Reported	% y/y
Net Revenue	**21.844**	**20.282**	**7,7%**	**20.309**	**7,6%**	**22.414**	**-2,5%**
COGS	(19.837)	(18.719)	6,0%	(18.737)	5,9%	(19.630)	1,1%
Gross Profit	**2.007**	**1.563**	**28,4%**	**1.572**	**27,7%**	**2.784**	**-27,9%**
Gross Margin (%)	9,2%	7,7%	1,48p.p	7,7%	1,45p.p	12,4%	-3,23p.p
EBITDA	**1.356**	**894**	**51,7%**	**1.293**	**4,9%**	**2.433**	**-44,3%**
EBITDA Margin (%)	6,2%	4,4%	1,8p.p	6,4%	-0,16p.p	10,9%	-4,65p.p
Net Income	**150**	**-120**	**-225,0%**	**553**	**-72,9%**	**294**	**-49,0%**
Net Margin (%)	0,7%	-0,6%	1,28p.p	2,7%	-2,04p.p	1,3%	-0,62p.p

Soure: Marfrig, Genial Investimentos

North America: Resilience in demand, but costs remain high. In North America, we saw **(i)** demand for beef in the domestic market remaining resilient, driving **(ii)** volume's growth (+10.5% q/q; 6.9% y/y), which was also in an upward movement due to higher number of weeks in the quarter (14 weeks vs. 13 weeks in 3Q22). Additionally, **(iii)** the sales price accelerated on an annual basis (+12.9% y/y), a factor which, together with stronger volumes, contributed to growth in the business unit's net revenue, which reached R$3.4bn (+14.9% q/q; +18.6% y/y). Conversely, we observed **(iv)** costs also on the rise, with the low availability of cattle increasing the cost by +29.3% y/y, contributing to a still tight EBITDA margin of 4.4% (-0.8p.p. q/q; -7.4p.p. y/y).For 4Q23, we also expect weak margins for North America unit, due to the continuation of the negative cycle and seasonality typical of 4Qs, which in the US are weaker due to the winter season and reduced meat consumption. We also believe that 2024 will be a difficult year for the segment, due to the scenario of low cattle availability, which we estimate will continue until mid-2025.

South America: The opposite trend to North America in terms of costs. For South America, the scenario is quite the opposite of what we're seeing in North America. Guided by **(i)** a more favorable cattle cycle in Brazil, which enabled an expansion in the EBITDA margin, which ended the quarter at 11.6% (+1.6p.p. q/q; +2.1p.p. y/y); **(ii)** Cattle cycle in Uruguay showing signs of improvement, with an already significant drop in cost (-29.4% y/y) and **(iii)** the region is benefiting from the negative cycle in North America, and exporting a greater volume of beef to the US, both from Brazil (commodity processed meat) and Uruguay (premium cuts). We also come across with (**iv)** weakened sales prices to foreign markets, due to a downtrend in short-term Chinese demand, hurting revenues on an annual basis, which have reached R$377mn (+24.5% q/q; -1.6% y/y).

Looking ahead, we estimate even stronger margins, driven by the cattle cycle remaining at a favorable moment, considering the abundant availability of oxen in the slaughter phase, and the positive seasonality of the 4Qs, such as the start of summer in Brazil and other South American countries, together with the end-of-year festivities, where meat consumption rises. We also see a positive 2024, with the scenario of high cattle availability enabling good margins, a trend that we believe should continue until the beginning of 2025. However, we see weaker Chinese demand in the short term, which should contribute to an average selling price below that seen in 2022 (although we are bullish about it on the long run).

Our Take on Marfrig

The sale of 16 plants to Minerva is an important leverage reducer, but debt remains a point of caution. Marfrig's leverage ended 3Q23 at 3.9x Net Debt/EBITDA LTM. When the indicators are adjusted for the amount to be received when the sale of the Brazilian assets to Minerva is completed, leverage falls to 3.2x. We also see the company reaching, by the end of 2024, ~3.0x Net Debt/EBITDA, a level that is in fact healthier than the ~4.0x that Marfrig has been running, but still high.

If we consider that Minerva is taking the opposite path, raising its leverage, which was at a much lower level than Marfrig's, by the end of 2024 both companies will have close leverage, according to our calculation, with Minerva being only +0.3x higher than Marfrig, but with much more cash generation capacity due to the 16 assets that would have been transferred, 11 of which are in Brazil, and we hope that CADE will approve the operation in time for Minerva to operate with the cattle cycle in a favorable phase. Considering these dynamics, we believe it would be an irrational move for investors to switch their position from one company to another.

BRF as in 2Q23, did not squeezed the consolidated margin. In 3Q23, we saw BRF delivering an EBITDA margin of 8.7% (+0.5p.p. q/q; -1.0p.p. y/y), above the consolidated EBITDA margin delivered by Marfrig, which was 7.2% (+0.1p.p. q/q and -3.2p.p. y/y). This is due to **(i)** an operational worsening in Marfrig's North America segment, damaged by the negative cattle cycle in the US but with **(ii)** a slight improvement in BRF's performance, driven by the drop in grain prices (corn and soy) and efficiency improvements from the implementation of the BRF+ program.

A pleasant surprise. The quarter's figures were generally above our expectations and the consensus. Considering that most investors look at short-term dynamics, we believe that the **(i)** beating of the consensus, added to **(ii)** an improvement in BRF, which was seen in 3Q23, and which should continue for the next few quarters, as well as the **(iii)** sale of the 16 slaughter plants to Minerva as a trigger to cool leverage, can create a collection of reasons to attract buyer’s flow to the shares.

However... we remain skeptical, and reinforce that the move would not be rational. As we described above, even if leverage cools it off a bit, it will still be at high levels (~3.0x Net Debt/EBITDA 24E) and with less EBITDA generation to be able to lower leverage from that point on. Regarding beating the consensus estimates, this can indeed make an upturn in share prices, but again, although the quarter came in better than expected, it was still weak... With EBITDA ex. BRF of R$1.3bn, pulling out a drop of -44.3% y/y, with a margin compression of 6.2% (-4.6p.p. y/y). We don't classify the result as solid.

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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under Review	Under review	**5%**

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