Equity Research

Meatpackers

8 questions answered about the recent avian flu outbreak

LatAm Meatpackers

Main takeaways:

(i) In this report, we explain what bird flu is, how it was first found in dairy cows in USA and what the risks are for the companies we cover in the Meatpackers sector; **(ii)** We comment on how China often uses these types of cases to control prices; **(iii)** In the **"Our Take" section**, by end of the report, among Minerva, JBS, Marfrig and BRF, we assess **which companies would be most affected** and **which could take advantage of the situation and sell more**, depending on the strategy used by each in two scenarios: If the contamination reaches Brazil and if the contamination restricts the supply of cattle in North America even further.

What is avian flu? Avian flu is caused by the influenza A (H5N1) virus and is widely spread among wild birds, mainly waterfowl and birds of prey, but also in poultry. In the USA, since 2022, avian influenza has been detected in more than 9k wild birds and has affected more than 82mn farmed birds. The virus survives for long periods at low temperatures in equipment and can therefore pass from farm to farm.

What happened? This Monday, April 1st, a case of bird flu was detected in a human, specifically in Texas, USA, who had **contact with dairy cows**. This was the second human case of bird flu ever recorded in US history. The first occurrence was in 2022, in Colorado. However, this time, the virus spread to other mammals, including cows.

How did it get to the cows? The cows came into contact with the disease through pasture or water, both of which were infected by the birds through saliva or feces. In the case reported in Texas, humans contracted the disease through contact with a herd of cows.

What about commercialized milk? Does it pose a risk to consumers? The cases of contagion confirmed in females were tested through milk. The USDA (United States Department of Agriculture) has stated that the US national milk supply is safe, since the dairy's separation controls ensure that the product from infected cows is diverted or destroyed, thus preventing it from being sold. In addition, the pasteurization process, which eliminates bacteria and viruses such as influenza, is necessary for interstate trade, preventing yet another form of infection.

Where were the contaminations located? Cows from 13 dairy herds in 6 US states tested positive for H5N1. These states are Texas (7 herds), Kansas (2), Michigan (1), New Mexico (1) and Idaho (1), Ohio (1). Although no cases of infection have yet been identified in males or in cows destined for beef, which clears the situation of contamination in beef, the USDA has issued a statement saying that it remains vigilant.

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Company

BEEF3 BZ Equity
Buy

Price: R$ 6.71 (04-Apr-2024)
Target Price 12M: R$ 9.00

JBSS3 BZ Equity
Buy

Price: R$ 21.43 (04-Apr-2024)
Target Price 12M: R$ 30.00

MRFG3 BZ Equity
Neutral

Price: R$ 10.24 (04-Apr-2024)
Target Price 12M: R$ 10.00

BRFS3 BZ Equity
Neutral

Price: R$ 15.97 (04-Apr-2024)
Target Price 12M: R$ 17.00

Despite the fact that health and sanitary surveillance agencies indicate control over the creation, filtering and distribution of milk and affirm that the symptoms found in the case of human contamination by a citizen of Texas were mild, there is no way of predicting the actions to be taken by the Chinese.

What are the risks for Brazilian Meatpackers? If we look at cases of contamination, the biggest risk for protein companies is the restriction of shipments, especially to Asia. In December 2023, China blocked the export of chicken and eggs from various parts of the US to ensure public health. And it's worth remembering the suspension of Brazilian meat purchases in February last year, due to the Bovine Spongiform Encephalopathy (BSE) disease, popularly known as Mad Cow. Shipments in 2023 were suspended until March 23 (~30 days). In 2021, also due to an atypical case of Mad Cow, China restricted shipments for almost 4M, drastically affecting Minerva (more exposed to exports to Asia), and to a medium degree JBS and Marfrig (slightly less exposed than Minerva).

How China typically uses these cases as a way of controlling prices? We believe that, in addition to health concerns, China has already restricted the sale of Brazilian meat in the past in order to control prices, justifying its behavior with the Mad Cow disease. This is because shipments that have already been made remain in the country's cold chambers, but do not reach the consumer market. With the pressure to release shipments, the price could fall, which ended up happening at the time.

Our Take on Meatpackers

The truth is that **it is still too early to estimate the total impact of the situation** but given the history of restrictions to ensure the health of the population in various countries and the potential impact on price controls in China, we understand that **the risk** of a cut in demand exists **if the virus ended up being confirmed in male or female cattle destined for beef** (today confirmation is only in dairy cows in the USA).

Impacts of restrictions in Brazil. Although the **probability is lower**, if the disease reaches Brazil, contaminating cattle, among the companies potentially most affected, we believe that Minerva would suffer a stronger impact than JBS and Marfrig, as it is more exposed, with ~25% of total revenue tied to the Asian market (which would probably restrict Brazilian shipments), and 35% of the total volume of 2023 having been directed especially to China. JBS and Marfrig would not escape unscathed, but the percentage of penetration of the Asian market vs. total exports is lower compared to Minerva.

Impacts of restrictions in USA. However, if there are restrictions on sales within the North American market, which is **more likely**, both companies (JBS and Marfrig) would face broader consequences than Minerva, which exports only 10% of its shipments to the US market. In fact, this export penetration could rise if the Brazilian meat wasn't contaminated, and the US would have a tighter domestic consumer market and would need to import more meat from Brazil, benefiting Minerva. JBS and Marfrig have significant portions of their slaughter plant portfolios in the US market. In other words, they sell meat to the American market from local cattle.

In the case of JBS, the company reported 49% of its total net revenue coming from the US alone in 2023, while Marfrig reported 41% of its revenue coming from North America in 4Q23.

With regard to BRF, we would point out that the company has no operations in the US and does not export to the country. Its main exports are to the Halal market, including Gulf countries in addition to Turkey and Asia (China, South Korea, Singapore and Southeast Asia). Exports account for ~45% of its turnover, of which ~25% comes from Asia and Direct Exports, and ~20% from Halal. A possible Chinese blockade on chicken production in the USA could benefit BRF, since China could increase its purchases in South America to meet its domestic demand, which would enable BRF to sell more protein at higher prices. In Brazil, a Chinese trade blockade on chicken exports would only occur in the event of avian influenza being detected in commercial poultry. This could have a significant impact on BRF's performance.

What about the ratings?

Minerva. Despite the **weaker result in 4Q23** compared to what we expected, which was supposed to have gained advantages in price arbitrage in relation to situations of opposing vectors in the two geographies (Brazil vs. USA), we still prefer to give the company a vote of confidence. However, **our shipment volume expectations for 2024 have been reduced**. We may revise our bias for Minerva as uncertainties regarding the **delay in approval for the acquisition of Marfrig's 16 slaughter plants** squeeze the time window that the company will have to take advantage of the positive cycle in Brazil, before a turnaround between 2025/2026.

For now, we still have a **BUY rating**, but with a **cut** in the **12MTarget Price** to **R$9.00** (vs. R$14.00 previously), which provides an **upside of 34.13%**, due to the **reduced valuation levels.** Even though it is discounted, we don't see any short-term catalysts, with the market awaiting the approval and start-up of the slaughter plants to remove uncertainties.

JBS. We like the thesis for its **geographic diversification**, such as proteins, and **possible dual listing in the US** (expected for 2H24), since the company trades at multiples below comparable US players, such as Tyson Foods. We continue with our **BUY rating**, with a **12M Target Price** of **R$30.00**, allowing the shares to reach an **upside** of **+39.99%**. It is worth noting that we would also be willing to revise our rating in the event of an interruption in beef sales in the US due to avian flu.

Marfrig. Although the 4Q23 result was better, BRF was an important factor in the company's consolidated figures. Marfrig is BRF's parent company. Therefore, the improvement in the result did not come from the core business (meat sales), and the company continues to have pressured margins, considering **the tighter supply of cattle in North America putting pressure on costs**. We highlight the opposite dynamics of the cattle cycles in the US vs. Brazil. For this reason, we give a vote of confidence to Minerva, which is more exposed to the dynamics of the positive cattle cycle in Brazil, and on the other hand, we reiterate our **NEUTRAL rating** for **Marfrig**, which is more exposed to the negative cattle cycle in the US, with a **12M Target Price** of **R$10,00**, which represents a slight **downside of -2.34%**. The company seems to us to be trading today **without a margin vs. a fair price**.

BRF. We remain conservative, with our **NEUTRAL rating**, but we have **adjusted** our **12MTarget Price** to **R$17.00** (vs. R$14.00 previously), which represents a marginal **upside of +6.45%**. **We changed our volume and cost assumptions** to a slightly better outlook than we had previously in our model, due to a **strong 4Q23**, which surprised us and the consensus. This was due to **higher margin realization**, as the **drop in grain prices** had a broader effect than expected in 4Q23.

Even so, we don't have full visibility as to whether the favorable momentum will continue, mainly due to **uncertainty about the sustainability of operational improvements in the international segment**, where some regions still face **low sales prices**, and the **company's history of burning cash flow after fundraising**.

However, if we see **(i)** a continuation of the advance in sales prices on the international market, potentially driven by growing Chinese demand for the South American protein in the event of a **possible Chinese blockade of US chicken** due to avian flu and **(ii)** more efficient cash management, we could upgrade our rating.

Appendix: Minerva

Figure 1. Minerva – Income Statement in R$ Millions (Genial Est. 2024-2028)

Income Statement	2024E	2025E	2026E	2027E	2028E
Net Revenue	**31.500**	**33.679**	**37.308**	**39.134**	**41.920**
(-) COGS	(24.669)	(26.603)	(30.126)	(31.643)	(34.059)
Gross Profit	**6.832**	**7.077**	**7.182**	**7.491**	**7.861**
(-) Expenses	(3.674)	(3.766)	(4.107)	(3.979)	(4.589)
Adjusted EBITDA	**3.157**	**3.310**	**3.075**	**3.512**	**3.271**
(-) D&A	(445)	(469)	(474)	(474)	(474)
EBIT	**2.712**	**2.841**	**2.601**	**3.038**	**2.798**
(+/-) Financial Result	(1.305)	(1.655)	(1.203)	(1.364)	(1.251)
(-) Taxes	(478)	(403)	(475)	(569)	(526)
Net income	**929**	**783**	**923**	**1.105**	**1.021**
Profitability					
Net margin (%)	2,95%	2,32%	2,47%	2,82%	2,44%

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

Cash Flow (FCFF)	2024E	2025E	2026E	2027E	2028E
Net Revenue	**31.500**	**33.679**	**37.308**	**39.134**	**41.920**
(-) COGS	(24.669)	(26.603)	(30.126)	(31.643)	(34.059)
Adjusted EBITDA	**3.157**	**3.310**	**3.075**	**3.512**	**3.271**
EBIT	**2.712**	**2.841**	**2.601**	**3.038**	**2.798**
(-) Taxes	(478)	(403)	(475)	(569)	(526)
(+) D&A	445	469	474	474	474
(+/-) Δ WK	(95)	-68	(57)	(39)	(24)
(-) Capex	(890)	(563)	(474)	(474)	(474)
FCFF	**1.694**	**2.276**	**2.069**	**2.430**	**2.248**

Appendix: JBS

Figure 1. JBS – Income Statement in R$ Millions (Genial Est. 2024-2028)

Income Statement	2024E	2025E	2026E	2027E	2028E
Net Revenue	**364.480**	**384.310**	**443.792**	**451.498**	**468.352**
(-) COGS	(316.631)	(331.783)	(381.843)	(381.399)	(385.844)
Gross Profit	**47.849**	**52.527**	**61.949**	**70.100**	**82.508**
(-) Expenses	(28.158)	(32.328)	(39.534)	(43.696)	(44.230)
Adjusted EBITDA	**19.691**	**20.199**	**22.415**	**26.404**	**38.278**
(-) D&A	(10.007)	(8.005)	(6.754)	(2.502)	(2.502)
EBIT	**9.685**	**12.194**	**15.660**	**23.902**	**35.776**
(+/-) Financial Result	(4.917)	(4.858)	(2.864)	(2.916)	(2.893)
(-) Taxes	(1.621)	(2.494)	(4.351)	(7.135)	(11.180)
Net income	**3.147**	**4.842**	**8.445**	**13.851**	**21.703**
Profitability					
Net margin (%)	0,86%	1,26%	1,90%	3,07%	4,63%

Figure 2. JBS – Cash Flow in R$ Millions (Genial Est. 2024-2028)

Cash Flow (FCFF)	2024E	2025E	2026E	2027E	2028E
Net Revenue	**364.480**	**384.310**	**443.792**	**451.498**	**468.352**
(-) COGS	(316.631)	(331.783)	(381.843)	(381.399)	(385.844)
Adjusted EBITDA	**19.691**	**20.199**	**22.415**	**26.404**	**38.278**
EBIT	**9.685**	**12.194**	**15.660**	**23.902**	**35.776**
(-) Taxes	(1.621)	(2.494)	(4.351)	(7.135)	(11.180)
(+) D&A	10.007	8.005	6.754	2.502	2.502
(+/-) Δ WK	(1)	(4.655)	(2.757)	(385)	(829)
(-) Capex	(10.007)	(8.005)	(6.754)	(2.502)	(2.502)
FCFF	**8.062**	**5.045**	**8.553**	**16.382**	**23.767**

Appendix: Marfrig

Figure 1. Marfrig – Income Statement in R$ Millions (Genial Est. 2024-2028)

Income Statement	2024E	2025E	2026E	2027E	2028E
Net Revenue	**137.737**	**149.140**	**175.303**	**183.629**	**195.794**
(-) COGS	(123.278)	(133.356)	(141.945)	(153.105)	(164.682)
Gross Profit	**14.459**	**15.783**	**33.357**	**30.524**	**31.112**
(-) Expenses	(9.739)	(10.243)	(12.316)	(12.796)	(13.685)
Adjusted EBITDA	**4.720**	**5.541**	**21.042**	**17.728**	**17.427**
(-) D&A	(3.577)	(3.577)	(3.577)	(3.577)	(3.577)
EBIT	**1.144**	**1.964**	**17.465**	**14.151**	**13.850**
(+/-) Financial Result	(10.159)	(9.384)	(8.631)	(9.903)	(9.776)
(-) Taxes	5438	4476	(5.328)	(2.562)	(2.457)
Net income	**-3.578**	**-2.945**	**3.506**	**1.686**	**1.617**
Profitability					
Net margin (%)	-2,60%	-1,97%	2,00%	0,92%	0,83%

Figure 2. Marfrig – Cash Flow in R$ Millions (Genial Est. 2024-2028)

Cash Flow (FCFF)	2024E	2025E	2026E	2027E	2028E
Net Revenue	**137.737**	**149.140**	**175.303**	**183.629**	**195.794**
(-) COGS	(123.278)	(133.356)	(141.945)	(153.105)	(164.682)
Adjusted EBITDA	**4.720**	**5.541**	**21.042**	**17.728**	**17.427**
EBIT	**1.144**	**1.964**	**17.465**	**14.151**	**13.850**
(-) Taxes	5438	4476	(5.328)	(2.562)	(2.457)
(+) D&A	3.577	3.577	3.577	3.577	3.577
(+/-) Δ WK	3022	91	(169)	328	263
(-) Capex	(3.577)	(3.577)	(3.577)	(3.577)	(3.577)
FCFF	**9.603**	**6.531**	**11.968**	**11.916**	**11.656**

Appendix: BRF

Figure 1. BRF – Income Statement in R$ Millions (Genial Est. 2024-2028)

Income Statement	2024E	2025E	2026E	2027E	2028E
Net Revenue	**55.517**	**59.178**	**66.528**	**69.483**	**73.391**
(-) COGS	(45.071)	(47.500)	(50.230)	(53.807)	(57.281)
Gross Profit	**10.446**	**11.678**	**16.298**	**15.676**	**16.110**
(-) Expenses	(6.527)	(7.403)	(8.377)	(8.840)	(9.452)
Adjusted EBITDA	**3.919**	**4.275**	**7.921**	**6.836**	**6.658**
(-) D&A	(2.337)	(2.045)	(2.045)	(2.045)	(2.045)
EBIT	**1.581**	**2.229**	**5.876**	**4.791**	**4.612**
(+/-) Financial Result	(2.302)	(1.209)	(1.990)	(1.542)	(1.012)
(-) Taxes	245	(347)	(1.321)	(1.105)	(1.224)
Net income	**(476)**	**673**	**2.565**	**2.144**	**2.376**
Profitability					
Net margin (%)	-0,86%	1,14%	3,85%	3,09%	3,24%

Figure 2. BRF – Cash Flow in R$ Millions (Genial Est. 2024-2028)

Cash Flow (FCFF)	2024E	2025E	2026E	2027E	2028E
Net Revenue	**55.517**	**59.178**	**66.528**	**69.483**	**73.391**
(-) COGS	(45.071)	(47.500)	(50.230)	(53.807)	(57.281)
Adjusted EBITDA	**3.919**	**4.275**	**7.921**	**6.836**	**6.658**
EBIT	**1.581**	**2.229**	**5.876**	**4.791**	**4.612**
(-) Taxes	245	(347)	(1.321)	(1.105)	(1.224)
(+) D&A	2.337	2.045	2.045	2.045	2.045
(+/-) Δ WK	(230)	(102)	(232)	215	123
(-) Capex	(2.337)	(2.045)	(2.045)	(2.045)	(2.045)
FCFF	**1.597**	**1.781**	**4.323**	**3.901**	**3.512**

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