

12 September 2013 | 11 pages

Packaged Foods & Meats (GICS) | Food Manufacturers (Citi)
Latin America | Brazil

JBS (JBSS3.SA)

Higher Debt, Slower Beef Partly Offset Seara & Stronger Pilgrim's

- Estimate Change
- Target Price Change

■ **Our Takeaways:** Seara significantly increases JBS's financial leverage, but also sets the stage for attractive processed, branded meat growth over the medium term, in our view. Seara is in our model ([see related report](#)), but we increase our synergy estimate in 2014 and raise our Seara estimates accordingly. We also incorporate a better than expected 2Q13 result at Poultry USA. Partly offsetting these effects are: 1) higher financial risk as Seara's debt boosts JBS's net-debt/EBITDA to above 4.0x in 3Q13 from 3.3x in 2Q13, and 2) slower growth at Mercosul beef. **We raise our 2014 EBITDA estimate by 10% and target price to R\$8.00 based on our SOTP DCF, and maintain our Neutral rating (High Risk).**

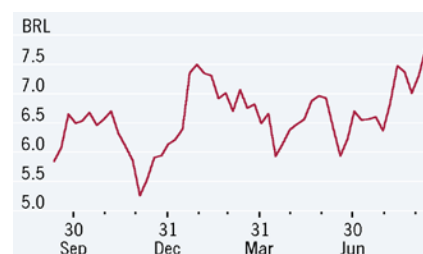
■ **News:** On September 12, Seara's sale was approved by the Brazilian anti-trust authority, allowing JBS to assume its assets and liabilities on September 30. Accounting for an estimated 10% of consolidated EBITDA, Seara's sales however will be consolidated in 4Q13. Its working capital and capex needs over the short term are expected to pressure free cash flow generation. Over the medium term, we expect double-digit margins can result from higher capacity utilization, shared expenses with JBS corporate and robust category growth. We raise our Seara EBITDA margin estimate but are more conservative than management's guidance, and assume a 10% EBITDA margin is reached in 2015.

■ **JBS Poultry USA (Pilgrim's Pride) is on track for a record year in terms of margin, but this appears priced-in, in our view.** Following a stronger 2Q13 and a better grain cost outlook (20% lower YoY in 2H13), we raise our 2013 Poultry USA EBITDA estimate by 19%. Additionally, a related positive currency translation effect on JBS's consolidated results is expected from the recent *real* depreciation.

■ **Finally, we lower our margin outlook at Mercosul beef (36% of consolidated EBITDA).** Higher YoY cattle prices in Brazil and Uruguay, weak wholesale Brazilian prices and Argentina offset stronger Brazilian exports. A similar YoY margin contraction trend in Mercosul beef was one of the reasons for our recent downgrade of Marfrig to Neutral High-Risk ([see Marfrig downgrade report](#)).

Neutral/High Risk	2H
Price (12 Sep 13)	R\$7.60
Target price	R\$8.00
	from R\$7.25
Expected share price return	5.3%
Expected dividend yield	1.7%
Expected total return	7.0%
Market Cap	R\$22,372M
	US\$9,824M

Price Performance
(RIC: JBSS3.SA, BB: JBSS3 BZ)



Estimates	2012A	2013E	2014E	2015E	Q113A	Q213A	Q313E	Q413E
Sales (R\$M)	75,697	91,899	110,294	119,506	19,528	21,931	22,917	27,523
EBITDA adj (R\$M)	4,410	6,239	7,855	7,935	879	1,668	1,657	2,035
EBITDA margin adj (%)	5.8	6.8	7.1	6.6	4.5	7.6	7.2	7.4
Net income (R\$M)	719	1,472	2,431	2,453	228	338	364	542
EPS (R\$)	0.25	0.51	0.85	0.86	0.08	0.11	0.13	0.19
Valuation					Ratios		2012A	2013E
EV/EBITDA adj	8.5	6.7	5.8	5.7	ROE adj (%)		3.5	7.1
PE	30.7	14.8	9.0	8.9	ROIC adj (%)		5.7	8.3
FCF (%)	-0.7	1.7	5.4	6.5	Debt to Capital (%)		48.9	56.1

Source: Company Reports and dataCentral, Citi Research.

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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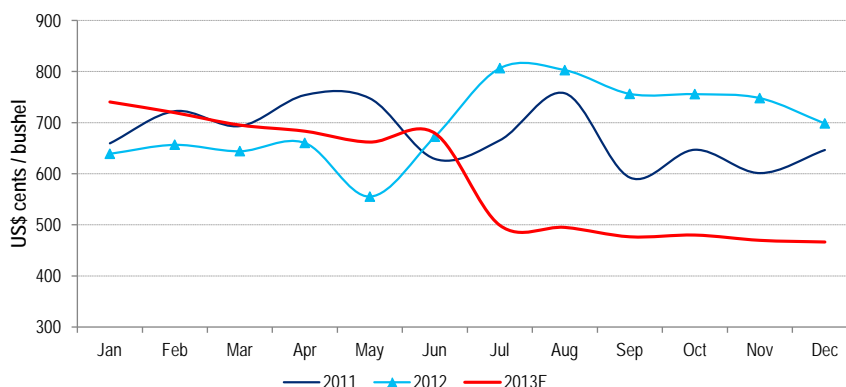
JBSS3.SA: Fiscal year end 31-Dec						Price: R\$7.60; TP: R\$8.00; Market Cap: R\$22,372m; Recomm: Neutral/High Risk					
Profit & Loss (R\$m)	2011	2012	2013E	2014E	2015E	Valuation ratios	2011	2012	2013E	2014E	2015E
Sales revenue	61,797	75,697	91,899	110,294	119,506	PE (x)	nm	30.7	14.8	9.0	8.9
Cost of sales	-55,100	-67,007	-80,241	-95,935	-104,523	PB (x)	1.1	1.0	1.0	1.0	0.9
Gross profit	6,697	8,690	11,658	14,359	14,983	EV/EBITDA (x)	11.3	8.5	6.7	5.8	5.7
Gross Margin (%)	10.8	11.5	12.7	13.0	12.5	FCF yield (%)	-2.7	-0.7	1.7	5.4	6.5
EBITDA (Adj)	3,151	4,410	6,239	7,855	7,935	Dividend yield (%)	0	0.8	1.7	2.8	2.8
EBITDA Margin (Adj) (%)	5.1	5.8	6.8	7.1	6.6	Payout ratio (%)	0	24	25	25	25
Depreciation	-1,198	-1,539	-1,829	-2,096	-2,211	ROE (%)	-0.4	3.5	7.1	11.2	10.3
{{001763}}	-93	-75	-78	-83	-84	Cashflow (R\$m)	2011	2012	2013E	2014E	2015E
EBIT (Adj)	1,860	2,797	4,332	5,677	5,641	EBITDA	3,151	4,410	6,239	7,855	7,935
EBIT Margin (Adj) (%)	3.0	3.7	4.7	5.1	4.7	Working capital	-1,873	-1,796	-1,883	-1,882	-1,587
Net interest	-1,380	-1,242	-1,511	-1,738	-1,719	Other	-671	-1,142	-2,059	-2,638	-2,602
Associates	0	1	24	0	0	Operating cashflow	607	1,472	2,297	3,335	3,747
Non-op/Except	-710	-173	-482	-175	-125	Capex	-1,174	-1,619	-1,930	-2,151	-2,330
Pre-tax profit	-230	1,382	2,364	3,763	3,797	Net acq/disposals	504	-212	0	0	0
Tax	-93	-619	-760	-1,204	-1,215	Other	-35	-39	-35	-35	-36
Extraord./Min.Int./Pref.div.	247	-44	-132	-128	-129	Investing cashflow	-704	-1,870	-1,965	-2,186	-2,366
Reported net profit	-76	719	1,472	2,431	2,453	Dividends paid	0	0	-368	-608	-613
Net Margin (%)	-0.1	0.9	1.6	2.2	2.1	Financing cashflow	1,181	361	-368	-608	-613
Core NPAT	-76	719	1,472	2,431	2,453	Net change in cash	1,214	95	-36	541	768
Per share data	2011	2012	2013E	2014E	2015E	Free cashflow to s/holders	-567	-147	367	1,184	1,417
Reported EPS (\$)	-0.03	0.25	0.51	0.85	0.86	Beef USA	2011	2012	2013E	2014E	2015E
Core EPS (\$)	-0.03	0.25	0.51	0.85	0.86	Sales (R\$ million)	28,040	34,651	41,031	46,088	49,125
DPS (\$)	0	0.06	0.13	0.21	0.21	Price (R\$ / kg)	6.00	7.40	8.75	9.77	10.21
CFPS (\$)	0.22	0.51	0.80	1.16	1.31	EBITDA (R\$ million)	1,225	473	1,246	1,844	1,818
FCFPS (\$)	-0.21	-0.05	0.13	0.41	0.49	EBITDA Margin (%)	4.4	1.4	3.0	4.0	3.7
BVPS (\$)	6.97	7.24	7.24	7.94	8.62	Pork USA	2011	2012	2013E	2014E	2015E
Wtd avg ord shares (m)	2,726	2,901	2,868	2,868	2,868	Sales (R\$ million)	5,913	6,931	7,903	8,902	9,434
Wtd avg diluted shares (m)	2,726	2,901	2,868	2,868	2,868	Price (R\$ / kg)	4.09	4.64	5.32	5.93	6.20
Growth rates	2011	2012	2013E	2014E	2015E	EBITDA (R\$ million)	566	366	429	507	377
Sales revenue (%)	12.9	22.5	21.4	20.0	8.4	EBITDA Margin (%)	9.6	5.3	5.4	5.7	4.0
EBIT (Adj) (%)	-27.1	50.4	54.9	31.0	-0.6	Poultry USA	2011	2012	2013E	2014E	2015E
Core NPAT (%)	74.1	nm	104.8	65.1	0.9	Sales (R\$ million)	12,917	16,102	19,205	21,458	22,760
Core EPS (%)	71.7	992.4	107.1	65.1	0.9	EBITDA (R\$ million)	-176	786	1,980	2,253	2,048
Balance Sheet (R\$m)	2011	2012	2013E	2014E	2015E	EBITDA Margin (%)	-1.4	4.9	10.3	10.5	9.0
Cash & cash equiv.	5,288	5,383	5,347	5,888	6,656	Mercosul	2011	2012	2013E	2014E	2015E
Accounts receivables	4,680	5,689	7,148	8,732	9,793	Sales (R\$ million)	14,927	18,013	23,760	21,994	25,325
Inventory	5,406	5,182	6,352	7,595	8,420	Price (R\$ / kg)	5.60	5.96	5.72	6.36	7.14
Net fixed & other tangibles	16,947	18,665	22,938	22,946	23,017	EBITDA (R\$ million)	1,598	2,469	2,447	2,243	2,406
Goodwill & intangibles	12,533	11,708	13,308	13,308	13,308	EBITDA Margin (%)	10.7	13.7	10.3	10.2	9.5
Financial & other assets	2,558	3,129	2,979	2,879	3,060	Poultry Brazil	2011	2012	2013E	2014E	2015E
Total assets	47,411	49,756	58,073	61,348	64,254	Sales (R\$ million)	na	na	na	11,853	12,862
Accounts payable	3,324	3,564	4,123	4,930	5,371	Price (R\$ / kg)	na	na	na	6.03	6.37
Short-term debt	5,339	6,099	8,324	8,324	8,324	EBITDA (R\$ million)	na	na	na	1,007	1,286
Long-term debt	13,533	14,390	19,422	19,422	19,422	EBITDA Margin (%)	na	na	na	8.5	10.0
Provisions & other liab	3,616	4,270	4,491	4,833	5,204	Total equity	21,599	21,433	21,713	23,839	25,933
Total liabilities	25,812	28,323	36,360	37,509	38,322	Net debt	13,584	15,106	22,398	21,857	21,090
Shareholders' equity	20,664	20,611	20,759	22,757	24,722	Net debt to equity (%)	62.9	70.5	103.2	91.7	81.3
Minority interests	935	823	954	1,082	1,211						

For further data queries on Citi's full coverage universe please contact Citi Research Data Services at CitiRsch.DataServices.Global@citi.com
For definitions of the items in this table, please click [here](#).

JBS Poultry USA

JBS Poultry USA (Pilgrim's Pride) is benefiting from a combination of lower grain prices (namely corn – See Figure 1) and productivity gains, and is on track to post 2013 and 2014 EBITDA margins above 10%. 2Q13 saw a record margin in part boosted by a surge in domestic demand in Mexico following a regional sanitary outbreak. Mexico currently accounts for approximately 10% of JBS Poultry USA sales. We expect a lower EBITDA margin in 3Q13 (QoQ) as the Mexico effect dissipates, and then a solid YoY 4Q13 margin expansion of over 500 bps YoY, helped by an easy base of comparison when we think corn costs have its biggest YoY decline of the year. Overall, we are increasing our segment EBITDA by 19% and 36% in 2013 and 2014.

Figure 1. Corn Price in the US (US\$ cents / bushel): 2011 – 2013E



Source: USDA, CME and Citi Research. As of September 12, 2013

Consolidating Seara

In Brazil, JBS will take over control of the Seara brand, as well as the regional brands acquired from Brasil Foods in 2012, and consolidate them with their Frangosul assets. Separate quarterly financial disclosure of operating results will begin in 1Q14. However in 4Q13, Seara Brasil will be incorporated as part of JBS Mercosul beef. On September 30 (3Q13), JBS will also consolidate an estimated total R\$4.9 billion in incremental debt (R\$1bn already incorporated). While JBS has negotiated lower debt cost since the Seara acquisition was first announced on June 10, we expect 3Q13 net debt/EBITDA to reach more than 4.0x, up from 3.3x in 2Q13. As such, 2H13 should see incremental pressure on cash flow generation. As Seara accounts for an estimated 10% of EBITDA, we do not believe the debt transfer from Marfrig to JBS will result in negative free cash flow at JBS, as it did at Marfrig (Seara accounted for approximately 20% of Marfrig's consolidated EBITDA).

Management expects gross synergies to reach R\$200 million with Seara, however, related costs and expenses have not been disclosed. We see JBS's challenge to reach a 10% EBITDA margin as threefold. First, as the third owner of Seara in four years, JBS will have to quickly salvage brand equity in processed meats category, and develop and execute a comprehensive branded portfolio strategy. Brazil is facing one of the most challenging consumer environments in years, and Brasil Foods has dominant market share in most of the related categories.

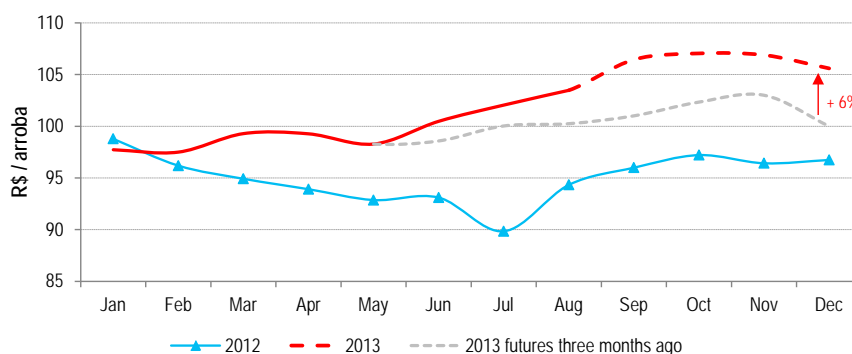
Second, increasing installed processed meat capacity and improving the distribution "fill rates" that Marfrig struggled with will also be a priority. Third, "right-sizing" its production footprint and distribution network, as well as building up grain inventories will require outsized management attention. While JBS has minimal experience in processed poultry and pork in Brazil, the segment's recently hired CEO, Gilberto Tomazoni does (from his 27 years at Sadia). As such, execution will partly depend in his ability to assemble and motivate the right team to carry out the transition.

Overall we prefer to be more conservative than management's guidance to reach 10% EBITDA in 2014 (Seara and Frangosul). We estimate that margin level to be surpassed in 2015. What remains unclear is if more than R\$60 million of the expected R\$200 million in gross synergies will be generated using the corporate cost structure of JBS. Assuming most of the synergies are achieved in 2014, we raise our 2014 EBITDA estimate for Seara (and Frangosul) by 23%.

Mercosul Beef

In Mercosul beef, cattle costs (approximately 80% of cost of sales), are beginning to "breakout" of the R\$90-R\$100 (per arroba) range seen over the past couple of years (see Figure 2). During 3Q13, they have increased 10%YoY and are likely to begin pressuring the segment's gross margin. Price controls in Argentina and higher cattle costs are other factors offsetting improved profitability growth from Brazilian exports. While we continue to expect a double digit EBITDA margin in this segment in 2H13, in line with management's guidance, we nonetheless adopt a more conservative outlook and reduce our full year 2013 margin estimate to 10.9% from 11.5%.

Figure 2. Cattle Price in Brazil (R\$ / arroba): 2012 – 2013E



Source: CEPEA/Esalq, BM&F Bovespa, Citi Research. As of September 12, 2013. 1 arroba = 14.7kg

Changes in Estimates

Figure 3. JBS Changes in Estimates (R\$ million, except EPS)

	2013			2014		
	Old	New	Change	Old	New	Change
Sales	90,183	91,899	1.9%	103,517	110,294	6.5%
EBITDA	5,919	6,239	5.4%	7,134	7,855	10.1%
EBITDA Margin	6.6%	6.8%	20 bps	6.9%	7.1%	20 bps
Net Income	1,350	1,472	9.0%	2,031	2,431	19.7%
EPS	0.47	0.51	9.0%	0.71	0.85	19.7%

Source: Citi Research

JBS

Company description

JBS competes globally in the fresh meat protein industry, where it is the largest in terms of revenues. Company is the world's leading producer of beef, lamb and chicken, and the 3rd US chicken producer. JBS has over 300 production units and employs 130,000 people worldwide. Its products reach more than 100 countries under brands such as Friboi, Swift and Pilgrim's. JBS has four main "reporting" divisions. Mercosul represents almost 55% of consolidated EBITDA, and comprises beef operations in Brazil, Argentina, Uruguay and Paraguay, and recently acquired Seara in Brazil. Beef USA is the largest division in terms of sales, but the second considering its EBITDA. The third division is Poultry USA, through the 75% stake JBS has in Pilgrim's Pride Corporation. Pork USA is the smallest segment, representing roughly 7% of EBITDA.

Investment strategy

Our Neutral/High Risk rating for JBS is based mainly on valuation. In our view, JBS Mercosul and Pilgrim's Pride assets are on track for a good year in terms of profitability this year. However, the combination of US beef industry pricing headwinds, spike in financial leverage from pending Seara acquisition and related capex / working capital requirements, and slight margin contraction at Mercosul make us more cautious. We believe the shares should continue to trade at its current discount to its historical average forward valuation multiples.

Valuation

We set a 12-month TP of R\$8.00 per share, based on SOTP DCF and integrated multiple analyses. In terms of valuation, relative to its protein peers in Brazil, Emerging Markets, Japan and the US, JBS is attractive on a growth adjusted basis. At our TP, the shares would trade at 6.0x EV/EBITDA, a 15% discount to its 3-year historical forward average multiple, in line with its current discount reflecting a cautious view on the outlook for the US beef industry, and material increase in financial leverage.

Risks

We rate JBS High risk. Main risks to achievement of our target price include higher-than-expected cattle, corn and soybean prices both in Brazil and in the United States. Sharper-than-expected fluctuations in the US dollar/Brazilian real exchange rate impact earnings. More-than-expected domestic competition in the fresh beef industry, mainly from Marfrig, may impact price flexibility. Sanitary risks include unexpected outbreaks of avian flu or mad cow disease in Brazil and in the United States.

Marfrig

(MRFG3.SA; R\$6.61; 2H)

Valuation

Our 12-month target price of R\$8.30 per share is based on our SOTP DCF and multiple analyses. At our TP, the implied forward EV/EBITDA multiple is 6.7x, offering a 7% discount to its 3-year historical average.

Risks

We rate Marfrig High Risk. Main risks for Marfrig in achieving our target price include higher-than-expected cattle, corn and soybean meal prices. Company could also be affected by slower-than-expected recovery in Europe. Sanitary risks include unexpected outbreaks of avian flu or mad cow disease in Brazil or in key export markets. If the impact on the company from any of these factors proves to be greater than we anticipate, the stock will likely have difficulty achieving our target price.

Valuation

Our 12-month target price of R\$8.30 per share is based on our SOTP DCF and multiple analyses. At our TP, the implied forward EV/EBITDA multiple is 6.7x, offering a 7% discount to its 3-year historical average.

Risks

We rate Marfrig High Risk. Main risks for Marfrig in achieving our target price include higher-than-expected cattle, corn and soybean meal prices. Company could also be affected by slower-than-expected recovery in Europe. Sanitary risks include unexpected outbreaks of avian flu or mad cow disease in Brazil or in key export markets. If the impact on the company from any of these factors proves to be greater than we anticipate, the stock will likely have difficulty achieving our target price.

Appendix A-1

Analyst Certification

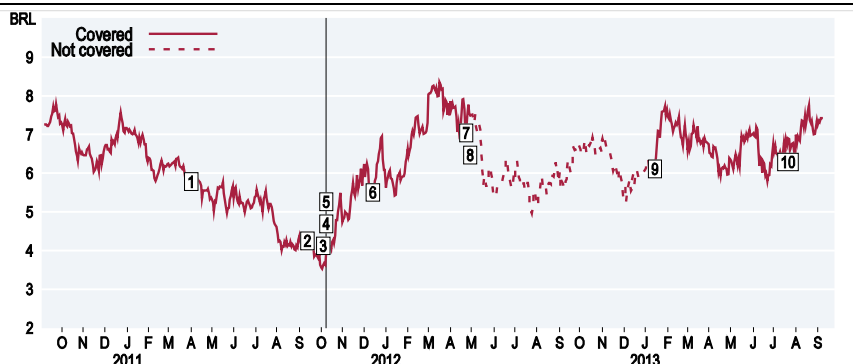
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IMPORTANT DISCLOSURES

JBS (JBSS3.SA)

Ratings and Target Price History Fundamental Research

Analyst: Alexander Roberts
Covered since January 15 2013



	Date	Rating	Target Price	Closing Price
1	1-Apr-11	*2S	*7.40	5.84
2	13-Sep-11	2S	*5.50	4.12
3	5-Oct-11	2S	*4.40	3.63
4	8-Oct-11	Stock rating system changed		

	Date	Rating	Target Price	Closing Price
5	8-Oct-11	*2H	4.40	3.63
6	14-Dec-11	*3H	*5.20	5.87
7	24-Apr-12	3H	*6.70	7.16
8	30-Apr-12	Coverage terminated		

	Date	Rating	Target Price	Closing Price
9	15-Jan-13	*2H	*7.50	6.25
10	21-Jul-13	2H	*7.25	6.75

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

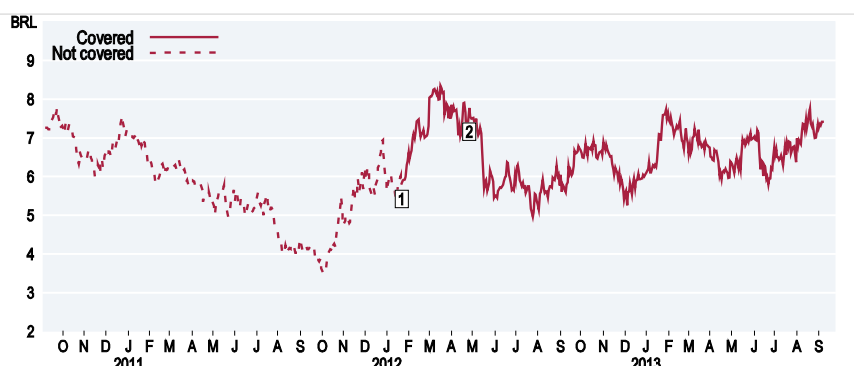
JBS (JBSS3.SA)

Ratings and Target Price History

Best Ideas Research

Relative Call (3 Month)

Analyst: Alexander Roberts
Covered since January 15 2013



	Date	Rating	Target Price	Closing Price
1	23-Jan-12	*ADD LP	-	5.82

* Indicates change

	Date	Rating	Target Price	Closing Price
2	28-Apr-12	*REM LP	-	7.77

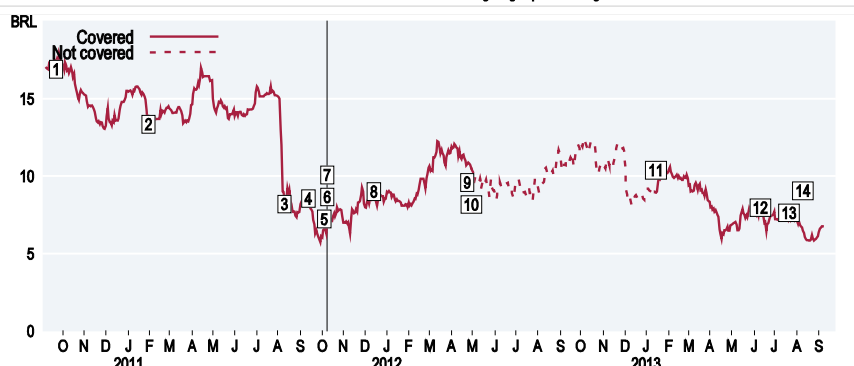
Rating/target price changes above reflect Eastern Standard Time

Marfrig (MRFG3.SA)

Ratings and Target Price History

Fundamental Research

Analyst: Alexander Roberts
Covered since January 15 2013



	Date	Rating	Target Price	Closing Price
1	22-Sep-10	*1S	*25.00	17.41
2	31-Jan-11	1S	*20.00	13.48
3	10-Aug-11	1S	*13.00	8.45
4	13-Sep-11	*2S	*11.00	8.40
5	5-Oct-11	2S	*7.90	6.62

* Indicates change

	Date	Rating	Target Price	Closing Price
6	8-Oct-11	Stock rating system changed		
7	8-Oct-11	*2H	7.90	6.30
8	14-Dec-11	2H	*9.40	9.00
9	24-Apr-12	2H	*11.30	10.80
10	30-Apr-12	Coverage terminated		

	Date	Rating	Target Price	Closing Price
11	15-Jan-13	*1H	*14.00	8.96
12	11-Jun-13	1H	*12.00	7.67
13	21-Jul-13	1H	*11.00	7.20
14	8-Aug-13	*2H	*8.30	6.47

Rating/target price changes above reflect Eastern Standard Time

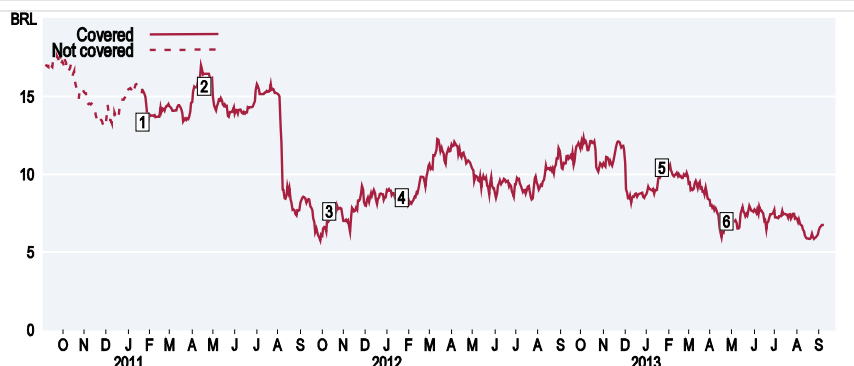
Marfrig (MRFG3.SA)

Ratings and Target Price History

Best Ideas Research

Relative Call (3 Month)

Analyst: Alexander Roberts
Covered since January 15 2013



	Date	Rating	Target Price	Closing Price
1	21-Jan-11	*ADD MP	-	15.40
2	19-Apr-11	*REM MP	-	16.45

* Indicates change

	Date	Rating	Target Price	Closing Price
3	12-Oct-11	*ADD LP	-	6.95
4	23-Jan-12	*REM LP	-	8.08

	Date	Rating	Target Price	Closing Price
5	23-Jan-13	*ADD MP	-	10.38
6	24-Apr-13	*REM MP	-	6.55

Rating/target price changes above reflect Eastern Standard Time

Citigroup Global Markets Inc. owns a position of 1 million USD or more in the debt securities of Marfrig Alimentos SA

Citigroup Global Markets Inc. or its affiliates has received compensation for investment banking services provided within the past 12 months from JBS.

Citigroup Global Markets Inc. or an affiliate received compensation for products and services other than investment banking services from JBS, Marfrig in the past 12 months.

Citigroup Global Markets Inc. currently has, or had within the past 12 months, the following as investment banking client(s): JBS.

Citigroup Global Markets Inc. currently has, or had within the past 12 months, the following as clients, and the services provided were non-investment-banking, securities-related: JBS, Marfrig.

Citigroup Global Markets Inc. currently has, or had within the past 12 months, the following as clients, and the services provided were non-investment-banking, non-securities-related: JBS, Marfrig.

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