01 Jul 2018 16:03:01 ET | 11 pages

Food Manufacturers
Latin America | Brazil

BRF (BRFS3.SA)

Forced Asset Sales Cut EBITDA ~10%; Lower Financial Leverage Implied (4.2x by YE), Senior Management Changes Continue

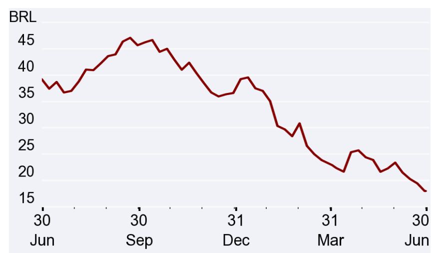
- Estimate Change
- Target Price Change

- Citi's Take: Since very high financial leverage is a key risk factor at BRF, lowering it with forced asset sales is a positive first step; however, the R$5.0 billion proceeds target appears aggressive (we use R$3.3 billion), and senior management changes continue. The asset sales set a quicker course to delever, but not as much as Marfrig's pending Keystone sale. The 2H18 time frame also appears aggressive based on recent deals. The production footprint restructuring will generate one-time 2Q18 expenses (and some in 3Q18), while the cost optimization initiative lacks details and leaves several C-level posts open including CFO (the 5th in 6 years). Last week, we lowered our earnings estimates from higher grains prices and longer than expected EU ban more than offsetting the positive effect of new weaker f/x forecasts on exports (see note). We also maintain our R$4.00/share corporate governance valuation discount to our target price. With lower EBITDA, but also lower financial risk, we lower our 12-month TP to R$20.50, implying a target EV/EBITDA of 8.0x (10% discount to 3-year historical), and keep our Neutral rating.

- **News: On June 29, after market, BRF conducted a call to detail its 3-step strategic plan that includes the expected sale of its European, Thailand, and Argentina assets by year-end (approx 10% of group EBITDA 2017).** BRF will continue to export to these markets. A smaller BRF will have assets only in Brazil, Middle East and Asia. The proceeds should mostly come from forced asset sales, but also from the securitization of receivables and working capital. A second step is to complete a production restructuring (started in March) that impacts 22 of the 35 Brazil plants and cuts the factory workforce by 5%. A third step is a cost optimization plan including the elimination of 4 of 14 C-level positions (internal and external searches are launched including for a CFO). Chairman and CEO Parente stated his CEO mandate is only for one year, and current CFO Lorival Luz will retain only his "COO" role. BRF also reiterated it will not offer new shares, and further details on the strategic plan will be given to the market at the end of August.

Neutral	**2**
Price (29 Jun 18 18:00)	R$18.00
Target price	R$20.50
from R$21.00	
Expected share price return	13.9%
Expected dividend yield	0.0%
Expected total return	**13.9%**
Market Cap	R$14,625M
	US$3,772M

Price Performance
(RIC: BRFS3.SA, BB: BRFS3 BZ)



Estimates	2017A	2018E	2019E	2020E	Q118A	Q218E	Q318E	Q418E
Sales (R$M)	33,469	33,265	33,904	35,857	8,203	7,397	8,479	9,186
EBITDA adj (R$M)	2,857	2,838	3,630	4,099	802	491	630	915
EBITDA margin adj (%)	8.5	8.5	10.7	11.4	9.8	6.6	7.4	10.0
Net income (R$M)	-1,126	-495	375	786	-124	-234	-193	56
EPS (R$)	-1.40	-0.61	0.46	0.97	-0.15	-0.29	-0.24	0.07

Valuation					Ratios	2017A	2018E
EV/EBITDA adj	9.8	10.0	7.5	6.5	ROE adj (%)	-9.8	-4.6
PE	-12.9	na	38.9	18.6	ROIC adj (%)	4.4	4.3
FCF (%)	-14.7	-3.2	2.0	3.3	Debt to Capital (%)	63.9	67.3

Source: Company Reports and dataCentral, Citi Research.

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BRFS3.SA: Fiscal year end 31-Dec — **Price: R$18.00; TP: R$20.50; Market Cap: R$14,625m; Recomm: Neutral**

Profit & Loss (R$m)	**2016**	**2017**	**2018E**	**2019E**	**2020E**
Sales revenue	33,733	33,469	33,265	33,904	35,857
Cost of sales	-26,206	-26,565	-26,730	-26,644	-27,936
Gross profit	7,526	6,904	6,535	7,261	7,921
Gross Margin (%)	22.3	20.6	19.6	21.4	22.1
EBITDA (Adj)	**2,938**	**2,857**	**2,838**	**3,630**	**4,099**
EBITDA Margin (Adj) (%)	8.7	8.5	8.5	10.7	11.4
Depreciation	-1,409	-1,670	-1,631	-1,637	-1,704
Amortisation	-194	-248	-226	-235	-249
EBIT (Adj)	**1,336**	**939**	**981**	**1,758**	**2,146**
EBIT Margin (Adj) (%)	4.0	2.8	2.9	5.2	6.0
Net interest	-1,524	-1,661	-1,573	-1,305	-1,132
Associates	29	22	31	31	33
Non-Op/Except/Other Adj	-159	-646	-73	-11	-43
Pre-tax profit	**-317**	**-1,346**	**-634**	**473**	**1,004**
Tax	-50	247	159	-95	-211
Extraord./Min.Int./Pref.div.	-5	-27	-19	-4	-7
Reported net profit	**-372**	**-1,126**	**-495**	**375**	**786**
Net Margin (%)	-1.1	-3.4	-1.5	1.1	2.2
Core NPAT	-372	-1,126	-495	375	786
Per share data	**2016**	**2017**	**2018E**	**2019E**	**2020E**
Reported EPS ($)	-0.46	-1.40	-0.61	0.46	0.97
Core EPS ($)	-0.46	-1.40	-0.61	0.46	0.97
DPS ($)	0.64	0	0	0.12	0.24
CFPS ($)	2.14	0.73	1.77	2.60	2.94
FCFPS ($)	-1.16	-2.64	-0.57	0.35	0.60
BVPS ($)	14.82	13.81	12.50	13.71	14.32
Wtd avg ord shares (m)	802	804	811	811	811
Wtd avg diluted shares (m)	801	805	811	811	811
Growth rates	**2016**	**2017**	**2018E**	**2019E**	**2020E**
Sales revenue (%)	4.8	-0.8	-0.6	1.9	5.8
EBIT (Adj) (%)	-68.3	-29.7	4.4	79.2	22.0
Core NPAT (%)	-111.9	-202.3	56.1	175.8	109.5
Core EPS (%)	-112.4	-200.7	56.4	175.8	109.5
Balance Sheet (R$m)	**2016**	**2017**	**2018E**	**2019E**	**2020E**
Cash & cash equiv.	7,395	6,458	9,395	9,588	9,879
Accounts receivables	3,085	3,919	3,543	3,634	3,941
Inventory	4,792	4,948	4,929	4,931	5,247
Net fixed & other tangibles	16,363	17,800	14,993	14,944	14,888
Goodwill & intangibles	6,673	7,198	7,198	7,198	7,198
Financial & other assets	4,637	4,906	4,937	4,968	5,001
Total assets	**42,945**	**45,229**	**44,994**	**45,263**	**46,155**
Accounts payable	5,840	6,445	6,005	5,876	6,047
Short-term debt	3,775	5,330	4,398	4,280	4,324
Long-term debt	15,717	15,413	17,593	17,119	17,297
Provisions & other liab	5,394	6,328	6,328	6,328	6,328
Total liabilities	**30,726**	**33,516**	**34,324**	**33,603**	**33,996**
Shareholders' equity	11,840	11,200	10,137	11,123	11,616
Minority interests	379	513	532	536	543
Total equity	**12,219**	**11,713**	**10,670**	**11,659**	**12,159**
Net debt (Adj)	**12,097**	**14,285**	**12,596**	**11,811**	**11,742**
Net debt to equity (Adj) (%)	99.0	122.0	118.1	101.3	96.6

Valuation ratios	**2016**	**2017**	**2018E**	**2019E**	**2020E**
PE (x)	-38.7	-12.9	-29.5	38.9	18.6
PB (x)	1.2	1.3	1.4	1.3	1.3
EV/EBITDA (x)	8.5	9.8	10.0	7.5	6.5
FCF yield (%)	-6.5	-14.7	-3.2	2.0	3.3
Dividend yield (%)	3.6	na	na	0.6	1.3
Payout ratio (%)	-138	0	0	25	25
ROE (%)	-2.9	-9.8	-4.6	3.5	6.9
Cashflow (R$m)	**2016**	**2017**	**2018E**	**2019E**	**2020E**
EBITDA	2,938	2,857	2,838	3,630	4,099
Working capital	568	-270	-45	-222	-453
Other	-1,793	-1,996	-1,356	-1,298	-1,260
Operating cashflow	**1,713**	**591**	**1,438**	**2,109**	**2,386**
Capex	-2,644	-2,720	-1,900	-1,822	-1,898
Net acq/disposals	-2,626	98	2,850	0	0
Other	0	0	0	0	0
Investing cashflow	**-5,270**	**-2,622**	**950**	**-1,822**	**-1,898**
Dividends paid	-1,713	0	0	-94	-196
Financing cashflow	**3,721**	**1,207**	**549**	**-94**	**-196**
Net change in cash	**-178**	**-937**	**2,937**	**193**	**291**
Free cashflow to s/holders	**-931**	**-2,129**	**-462**	**287**	**487**
Brazil Segment	**2016**	**2017**	**2018E**	**2019E**	**2020E**
Sales (R$ million)	14,808	15,189	16,042	17,243	18,675
Sales Growth (% YoY)	-2.9	2.6	5.6	7.5	8.3
EBITDA (R$ million)	1,546	1,887	1,488	1,983	2,241
EBITDA Margin (%)	10.4	12.4	9.3	11.5	12.0
Export Segment	**2016**	**2017**	**2018E**	**2019E**	**2020E**
Sales (R$ million)	17,598	17,465	16,371	15,755	16,216
Sales Growth (% YoY)	9.7	-0.8	-6.3	-3.8	2.9
EBITDA (R$ million)	1,658	1,145	1,547	1,680	1,866
EBITDA Margin (%)	9.4	6.6	9.4	10.7	11.5
Middle East	**2016**	**2017**	**2018E**	**2019E**	**2020E**
Sales (R$ million)	6,227	6,697	8,322	8,585	8,841
Sales Growth (% YoY)	-2.1	7.6	24.3	3.2	3.0
EBITDA (R$ million)	635	352	853	944	973
EBITDA Margin (%)	10.2	5.3	10.3	11.0	11.0
Asia	**2016**	**2017**	**2018E**	**2019E**	**2020E**
Sales (R$ million)	4,749	4,116	4,062	3,598	3,705
Sales Growth (% YoY)	44.3	-13.3	-1.3	-11.4	3.0
EBITDA (R$ million)	649	598	489	415	500
EBITDA Margin (%)	13.7	14.5	12.0	11.5	13.5
Europe & Eurasia	**2016**	**2017**	**2018E**	**2019E**	**2020E**
Sales (R$ million)	3,800	3,532	1,709	1,585	1,616
Sales Growth (% YoY)	4.4	-7.1	-51.6	-7.3	2.0
EBITDA (R$ million)	134	226	73	111	162
EBITDA Margin (%)	3.5	6.4	4.3	7.0	10.0

For definitions of the items in this table, please click here.

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Earnings Estimates Changes

Figure 1. BRF Changes in Earnings Estimates

	2018E			2019E		
	Old	New	Change	Old	New	Change
Sales	35,904	33,265	(7.3%)	37,740	33,904	(10.2%)
EBITDA	3,366	2,838	(15.7%)	4,031	3,630	(10.0%)
EBITDA Margin	9.4%	8.5%	-80bps	10.7%	10.7%	0bps
Net Income	140	(495)	NA	423	375	(11.4%)
EPS	0.17	(0.61)	NA	0.52	0.46	(11.4%)

Source: Citi Research

Bull/Bear: BRF (BRFS3.SA)

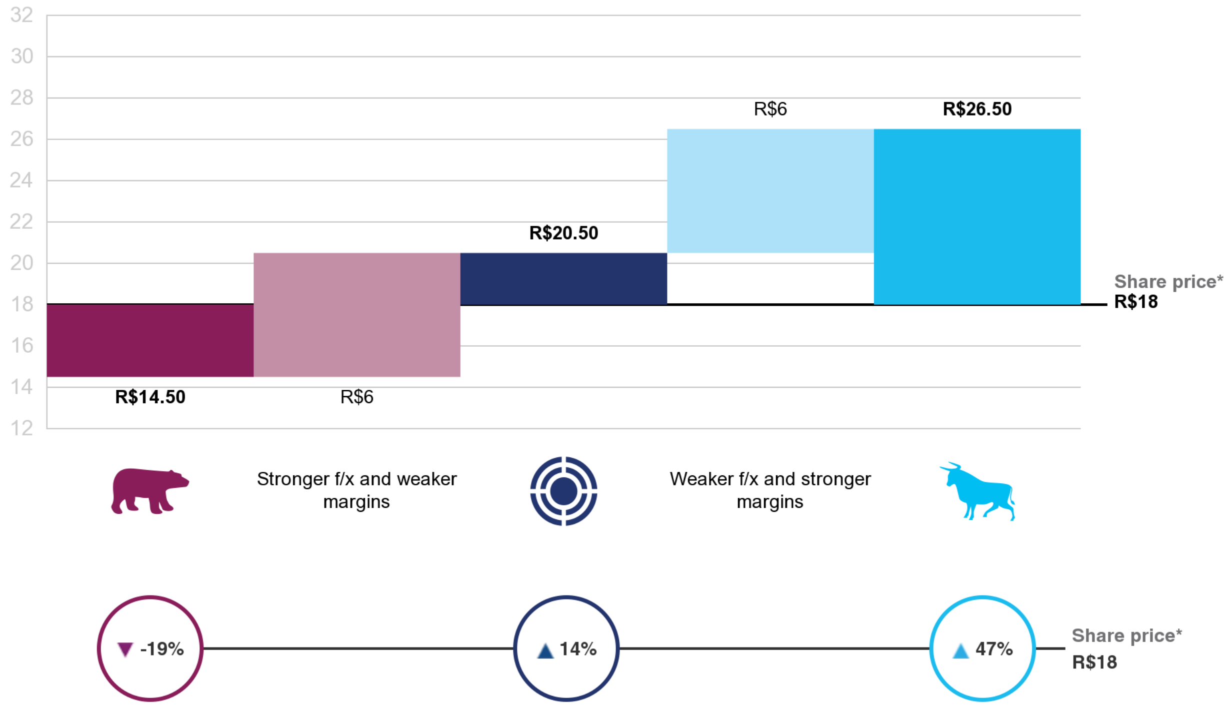
Bull/Bear: BRF (BRFS3.SA)

R$20.5 target price

14% expected share price return

Neutral rating

66pp Bull/Bear Spread



Source: Citi Research

***Share price as of 29 Jun 2018**

R$26.5

- Group EBITDA margin 30 bps higher
- Avg. f/x 5% higher in 2018E
- Target multiple 10% higher

R$20.5

- Avg. f/x of ~3.60 real/dollar in 2018E
- Target multiple of approx. 8.0x forward EV/EBITDA

R$14.5

- Group EBITDA margin 30 bps lower
- Avg. f/x 5% lower in 2018E
- Target multiple 10% lower

BRF

Company description

BRF is among the world's largest food companies, focusing on poultry, processed food and margarine products, under brands such as Perdigao, Sadia, and Qualy. BRF is among the world's largest exporters of poultry meat. The domestic segment is roughly 55% of group EBITDA, while exports represent 45%. The predecessor of the company was founded in 1934. Upon the merger between Perdigao and Sadia in 2009, the company was renamed BRF.

Investment strategy

Our Neutral rating for BRF is based on valuation and our view that export margins should recover slower than expected on higher inventories, stepped-up local competition, and less turkey sales in Europe.

Valuation

Our 12-month target price of R$20.50 per share is based on SOTP DCF and multiple analysis. At our target price, BRF would trade at approx. 8.0x forward EV/EBITDA, a discount to its 3-year historical average partly reflecting a corporate governance valuation discount.

Risks

Main risks to achievement of our target price include higher or lower-than-expected corn and soybean prices, soft dollar pricing in exports, higher or lower-than-expected f/x rates, and sanitary risks. Slower sales growth from trading down and more-than-expected competition with Seara are also key risks in the domestic market.

Appendix A-1

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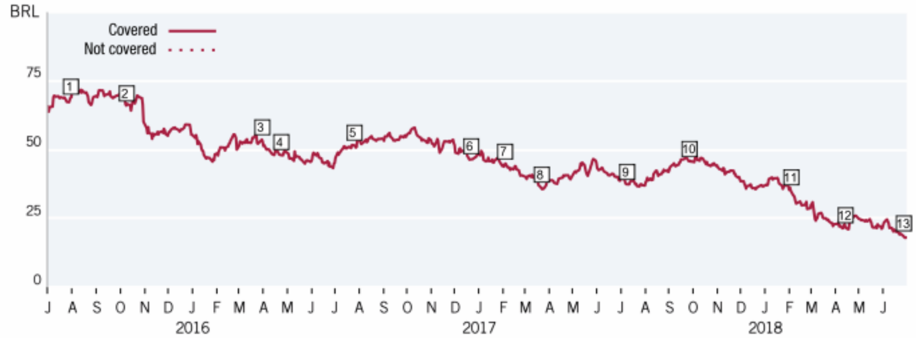
IMPORTANT DISCLOSURES

BRF (BRFS3.SA)

Ratings and Target Price History
Fundamental Research

Analyst: Alexander Robarts



	Date	Rating	Target Price	Closing Price
1	28-Jul-15 09:56:41	2	*74.00	68.20
2	08-Oct-15 00:01:41	*1	*83.00	66.00
3	28-Mar-16 17:21:49	1	*78.00	53.28
4	24-Apr-16 20:17:49	1	*74.00	48.00
5	25-Jul-16 03:39:18	1	*68.00	51.55
6	20-Dec-16 07:56:34	1	*70.00	46.40
7	02-Feb-17 15:25:29	1	*66.00	44.52
8	20-Mar-17 07:10:28	1	*50.50	36.30
9	09-Jul-17 19:00:00	*2	*42.00	37.42
10	26-Sep-17 18:58:52	2	*45.50	45.75
11	04-Feb-18 20:14:16	2	*40.00	35.06
12	13-Apr-18 08:10:06	2	*25.50	21.67
13	26-Jun-18 20:17:21	2	*21.00	18.50

*Indicates Change

Rating/target price changes above reflect Eastern Time

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	12 Month Rating			*Catalyst Watch*		
Data current as of 30 Jun 2018	**Buy**	**Hold**	**Sell**	**Buy**	**Hold**	**Sell**
Citi Research Global Fundamental Coverage	53%	36%	11%	5%	93%	2%
% of companies in each rating category that are investment banking clients	65%	64%	55%	64%	64%	66%

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