Consumer Brands & Retail
Latin America – Food Products

HSBC Global Research

Commodities and Brazilian Proteins

US weather conditions affect grain prices, company margins should suffer

Brazil Proteins

Company	Ticker	Currency	Target price New	Target price Old	Rating
Brasil Foods	BRFS3	BRL	40.00	42.00	OW
Brasil Foods	BRFS	USD	20.00	23.00	OW
JBS	JBSS3	BRL	7.50	8.00	OW(V)
JBS	JBSAY	USD	7.50	8.00	OW(V)
Marfrig	MRFG3	BRL	10.50	11.00	N(V)
Marfrig	MRRTY	USD	5.00	5.50	N(V)
Minerva	BEEF3	BRL	9.50	9.50	OW
Minerva	MRVSY	USD	18.50	18.50	OW

HSBC ratings: OW = Overweight, N = Neutral, V = Volatile
Source: HSBC

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- **Corn, soybean, and wheat prices have soared 20-40% in one month as a result of severe weather conditions**
- **We expect fresh poultry margins to be most affected short-term, followed by US pork and beef margins medium-term**
- **Despite lower short-term margins, we see Brasil Foods as best-positioned to manage input cost pressures**

Weather issues drive grain prices near record levels. Drought conditions in the US Midwest led the USDA to reduce yield expectations substantially, by c12% for corn and 9% for soybeans. As the US is the world's largest producer of corn, 40% of the total, and soybeans, c35%, the effect on grain prices has been huge. With corn and soybean prices up 32% and 21% in one month, animal protein producers will be affected. The weather outlook remains negative, so drought conditions could worsen, adding further downside risks to US yields.

High input costs affect fresh meat producers, primarily poultry. Poultry has the higher exposure to grains, though US pork and beef producers also will be affected in the medium term. Hog prices have not increased materially but should see pressure if corn remains at current levels. US cattle prices should remain stable short-term as feedlots accelerate the sale of cattle to curtail losses from higher costs. This, however, would delay US herd rebuilding, auguring possible future shortages. Brazil beef should continue outperforming from its minimal exposure to grains, lower cattle prices, and the weak BRL.

Producers with large processed-products exposure are positioned better to manage input cost pressures; we prefer Brasil Foods. The BRF platform is 45% processed products and domestically dominant brands, with grains only 25% of COGS. Exports are recovering from normalizing prices in key markets, further benefited by a weak BRL. We expect short-term challenges as the company suspends brands, swaps assets with Marfrig, and aggressively introduces new products while targeting market share gains. The short-term focus on market share might limit BRF's willingness (rather than ability) to pass through higher costs aggressively, thus sacrificing short-term profitability. OW-rated BRF remains the stock to own in the industry, in our view. BRF trades at 7.5x 2013e EV/EBITDA, a significant discount to its historical multiples. We are buyers at these levels, as we see short-term challenges mostly priced in.

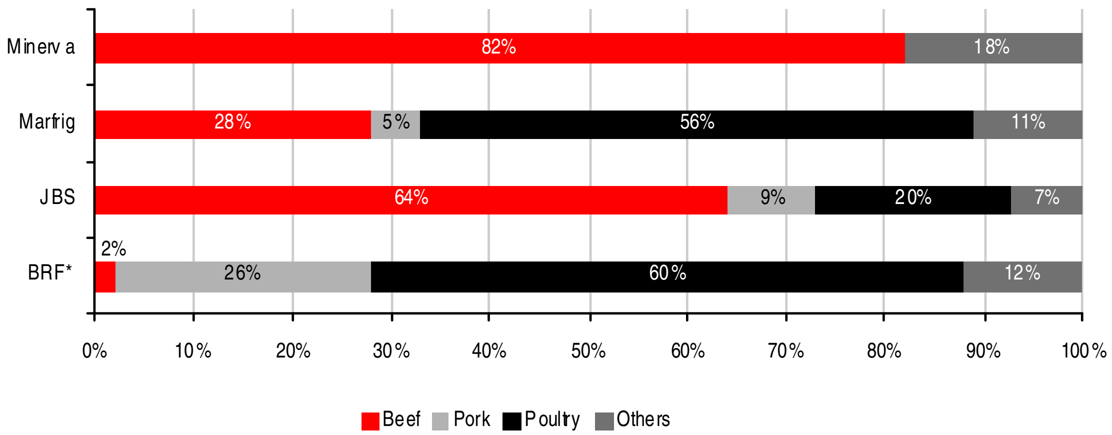
HSBC

1. Brazil protein companies: Valuation comparables

	Ticker	Price (BRL)	Target price (BRL)	Date TP set	Rating	EV/EBITDA 2012e	EV/EBITDA 2013e	EV/EBITDA 2014e	PE 2012e	PE 2013e	PE 2014e
Brasil Foods	BRFS3	29.65	40.00	23-Jul-12	Overweight	10.6	7.5	6.3	22.2	13.2	10.8
JBS	JBSS3	5.75	7.50	23-Jul-12	Overweight (V)	8.5	6.4	6.0	18.3	10.4	9.4
Marfrig	MRFG3	9.26	10.50	23-Jul-12	Neutral (V)	7.3	6.7	6.4	NM	NM	NM
Minerva	BEEF3	8.85	9.50	24-May-12	Overweight	5.3	4.6	4.4	12.0	6.2	5.2

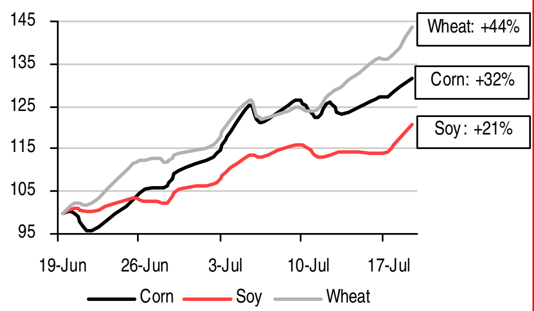
HSBC ratings: V = Volatile
Source: HSBC

2. Protein diversification by company



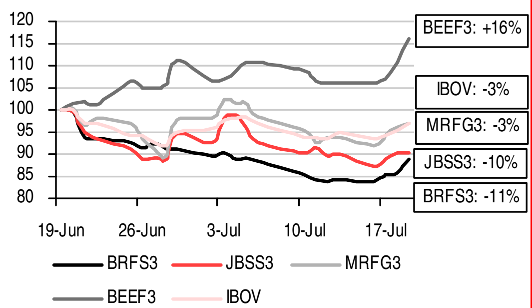
Source: Companies, HSBC estimates

3. Soaring grain prices, relative (past one month)



Source: Bloomberg, HSBC

4. Protein companies: Share price movements (past one-month prices, relative)



Source: Thomson, HSBC

Investment summary

Brasil Foods SA

BRF remains our favorite play in the industry, despite short-term weaknesses. The stock is down 19% YTD and trades at 7.5x 2013e EV/EBITDA. We continue to expect strong margin improvements from the international markets from a recovery in export prices and the weaker BRL. However, we expect challenges in the domestic markets from weaker-than-expected demand. In addition, BRF closed an asset swap with Marfrig in June 2012, and we expect BRF to focus aggressively on regaining lost market share from divestitures and suspension of brands. BRF's focus on regaining market share in the short term should limit its willingness (rather than ability) to pass higher costs through aggressively, we believe, thus sacrificing short-term profitability. However, in the medium term, we expect BRF to return to passing higher costs through successfully via pricing and to return to normalized profitability. It is important to note that grains account for only c25% of BRF's costs. The company has a solid 45% exposure to processed products, and its international expansion is geared toward further expanding the exposure of these higher-margin products. We reiterate our Overweight rating on the BRFS3 shares.

JBS SA

Increases in grain prices should affect earnings the most at JBS's US poultry platform, Pilgrim's Pride. The company is mostly hedged until 3Q, but we expect margins to be hurt thereafter. We expect US pork margins to return to longer-term normalized 6-7% levels. However, weakness in US poultry and pork should be offset by recovering US beef margins and solid Brazilian beef performance. Live-cattle prices in the US are stable to slightly lower, as higher corn prices force feedlots to accelerate cattle sales to curtail operating losses. We expect cattle prices to remain stable in 2H12, thus fostering a recovery in JBS's US beef margins. On the other hand, the Brazilian beef platform should continue to outperform due to lower cattle prices from the larger herd and the weaker BRL's boosting export profitability. JBS remains highly leveraged, yet has lowered its recurring financial expenses as a result of its 2011 debt restructuring. We reiterate our Overweight (V) rating on JBSS3 shares.

Marfrig SA

Marfrig will be affected by the recent spike in grain prices, as c67% of its revenues are derived from the poultry and pork segment. In addition, the company's hedges are limited: 45 days for corn and two months for soybean meal. We expect to see margin pressures from the higher input costs beginning as early as mid-3Q12. We view Marfrig's ability to pass higher grain prices through as relatively limited. In Brazil, the company will be integrating BRF assets and will focus on gaining market share in processed products, thus making it difficult to pass cost increases through. In Europe, economic conditions and competitive issues should make it difficult to implement price increases. Also, costs are exposed to wheat, the grain that has had the biggest price increase in the past month, +45%. Marfrig's beef platform should continue to outperform, however, driven by lower cattle prices in Brazil and the weaker BRL. We expect Marfrig will end 2012 with net debt-to-EBITDA of 4.3x, down from 5x at the end of 1Q12, though we still consider this to be high. We reiterate our Neutral (V) rating on MRFG3 shares.

Minerva SA

Minerva has almost no exposure to grains. About 97% of its consolidated revenues are derived from its beef platform in South America (mostly Brazil), and thus should be largely unaffected by the recent spike in commodity prices. We remain bullish on the Brazil beef platform, and we expect the country's cattle herd to continue growing steadily during the next couple of years as the record-high calf production of previous years matures. As Minerva is mostly a pure beef play and mainly exposed to Brazil, we continue to view the stock as an attractive investment opportunity. We rate Minerva shares Overweight.

Scorcher in US Midwest drives grain prices up

- Grain prices, key inputs for animal protein producers, have soared between 20-40% during the past month
- A severe drought in the US, potentially the worst since 1956, is to blame; weather forecasts point to persisting or worsening conditions, posing further potential downside risks to yields
- We see US and Brazil poultry as the most affected, followed by US pork and beef in the mid-term; Brazil beef should continue to outperform from lower cattle prices and no exposure to grains

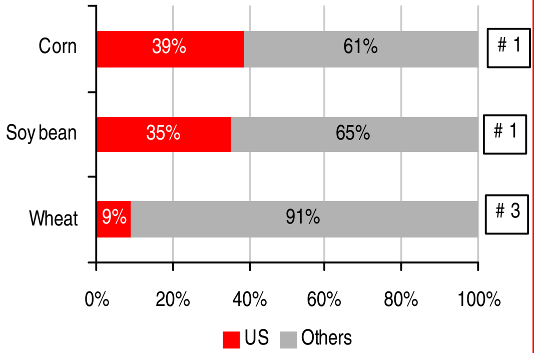
Summary

During the past month, the US has had abnormally dry weather conditions in the Midwest region. In its latest monthly update report, the US Department of Agriculture substantially reduced its yield expectations by c12% for corn to 146bu/acre and 9% for soybeans to 40.5bu/acre. The US is the world's largest producer of corn and soybeans, accounting for c40% and c35% of global production, respectively. Thus, drought conditions in the US have significant implications for global supply/demand dynamics. Grain prices spiked, with corn +32% in the past month and soybeans +c21%.

The weather outlook does not look promising, with drought conditions expected to persist or worsen in most of the Midwest. We see further downside risks to US yields that could further pressure commodity prices in the short term. In addition to rain, the only downside risk to corn prices at this time is a potential reduction in US ethanol blending requirements that would curtail a substantial portion of demand. For soybeans, a downside risk is record acreage and supplies from Brazil and Argentina substantially higher than USDA expectations.

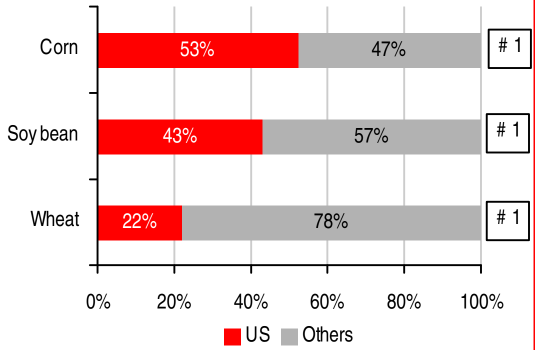
We believe that poultry is the most affected segment among the animal proteins, given the higher exposure of grains in costs. US pork and beef producers also will be affected by the higher grain prices, yet more in the medium term. Hog prices have not increased materially in response to the higher corn prices, yet we could see pressure over time if corn prices remain at current levels. Cattle prices should remain stable to lower in the short term as feedlots accelerate the sale of live cattle to curtail losses from higher corn prices. However, as a result of this, expansion of the US herd would be postponed, further accentuating the structural issues of a shrinking US herd. The

5. The US is the world's largest corn and soybean producer and third-largest wheat producer



Source: USDA, HSBC

6. The US is the world's largest exporter of corn, soybeans, and wheat



Source: USDA, HSBC

Brazilian beef segment is unaffected, as its exposure to grains is immaterial. We expect Brazilian beef producers to continue to outperform, given lower cattle prices and a weaker BRL.

US drought conditions

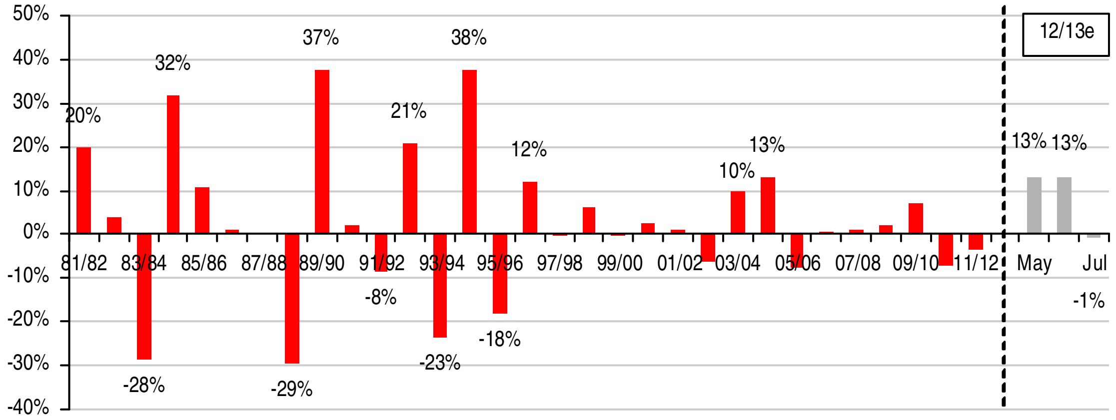
In the past month, the US Midwest has been facing abnormally dry weather conditions. See Charts 18 and 19. In the first chart, crop moisture from a month ago shows normal conditions in most parts of the country except the Southwest. However, the second chart with the latest crop moisture data shows deteriorating conditions in the Midwest, the most important agricultural region in the US and perhaps the world. Weekly temperatures have averaged at least 10 to 15 degrees above normal, and the lack of rainfall has severely affected crops during the critical pollination stage. In its latest monthly update, the USDA substantially reduced its corn and soybean yield expectations by c12% and 9%, respectively. See Charts 16 and 17 for the latest drought monitor and outlook for the next couple of months. The outlook does not look promising, with drought conditions expected to persist or worsen in most of the Midwest. We thus see potential additional downside risks to US crop yields that could further pressure grain prices.

The importance of the US in global agribusiness

Though acreage in the US has been relatively stable over many years, and agricultural production in other regions of the world such as Latin America and Australia has grown rapidly, the US remains one of the most important players in global agriculture. The US is the world's largest producer of corn and soybeans, accounting for c40% and c35% of global production, respectively. The US is also the world's third-largest wheat producer, after China and India. In terms of exports, the US is the leader in corn, soybeans, and wheat, responsible for more than half of the corn trade, 40-45% of soybean exports, and one-fifth of wheat trade globally (see Charts 5 and 6).

The Midwest is the most important agricultural region of the US, with 12 states accounting for as much as 85-90% of the country's corn and soybean production. This implies that the region produces as much as 30-35% of global corn and soybeans. The top five states – Iowa, Illinois, Minnesota, Nebraska, and Indiana – alone account for c65% of US corn and c55% of US soybean production. Thus, weather conditions in the US Midwest typically have substantial effects on global agricultural production and thus on prices.

7. US corn yields decline for three consecutive years (2010-11, 2011-12, and 2012-13e) for first time ever

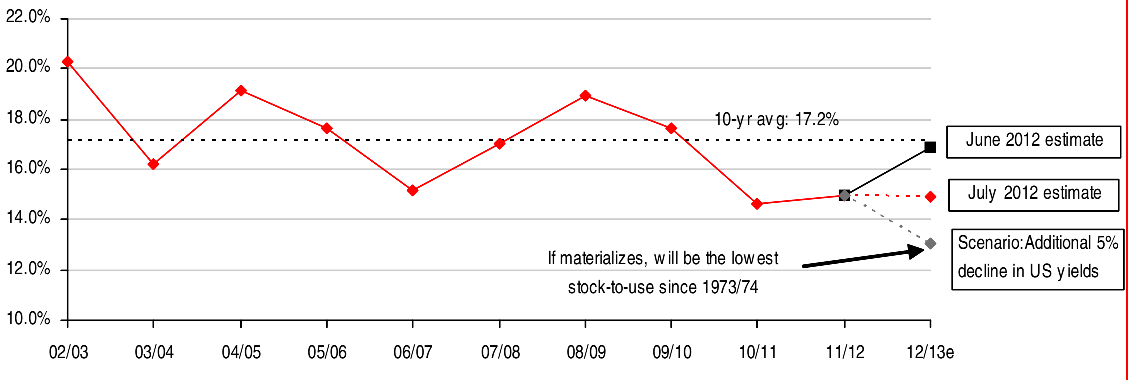


Source: USDA, HSBC

Corn

Corn is an important input for protein producers, and prices in the past month have climbed 32% to USD8.1/bu. Corn prices in 2011 were already high, averaging USD6.8/bu, +59% y-o-y. This was due to tight inventory levels, a 15% stock-to-use ratio, well below long-term averages. The 2011-12 crop year was the third consecutive year with a negligible surplus/deficit. However, in 1H12, corn prices fell to near USD6/bu as US farmers planted record corn acreage, the highest since 1937, and USDA expectations were for a solid 13% increase in yields. However, recent weather conditions have damped all hopes of a surplus in the near term. In its latest monthly update in July 2012, the USDA reduced its corn yield expectations by as much as 12% to 146bu/acre, sharply lower than the consensus expectation of 153bu/acre. This would mark be the first time that US corn yields declined for three consecutive years – at least since 1960 from when USDA data are available. (See Chart 7.) In its May and June forecasts, the USDA expected a solid recovery in yields for 2012-13 with a 13% increase y-o-y. However, as a result of the drought, it now expects a 1% decline in yields y-o-y, with a possibility of further downside risks. Note that these estimates are adjusted to reflect weather conditions up to the date of the USDA report (July 2012) and are not based on surveys. The USDA estimates in August 2012 will be the first to reflect farm surveys. Thus, we believe there are additional downside risks to yields once farm surveys are conducted.

8. Global corn stock-to-use



Source: USDA, HSBC

In its July 2012 report, the USDA lowered its 2012-13 global corn production estimates by 45m tons to 905m tons, now only +3.6% y-o-y, from a 12% cut to US production as a result of the drought. Global corn consumption estimates were lowered by 23m to 898m tons, +4% y-o-y, with most of the reduction coming from lower use of corn as feed, given the higher prices. This implies that 2012-13 will be another year of immaterial production surplus. The USDA expects a surplus of 7m tons, accounting for only 0.8% of consumption, and thus this would result in a fourth consecutive year in which the world has been unable to increase corn inventories. The USDA's ending inventory estimates for 2012-13 were lowered by 22m to 134m tons, with the stock-to-use ratio lowered to 14.9% from the c17% estimate in June 2012 and the 17.2% 10-year average.

From expectations of the global stock-to-use ratio's returning to average levels, the new USDA estimates indicate another year of very tight inventories. (See Chart 8.) If US yields were to deteriorate an additional 5%, the stock-to-use could fall to as low as 13.1%, the lowest since 1973-74.

With tight inventory levels as a result of lower US yields, we expect corn prices to remain high in the short term. Further upside from these levels will depend on weather conditions in the Midwest during the next couple of months. The outlook is not promising, with continued warm and dry weather conditions expected in the Midwest for the next few weeks. We thus anticipate additional downside to US corn yields that would push prices even higher than today's cUSD8/bu. Mitigating factors include a significant decline in overall demand from weak macroeconomic conditions, the high prices, or a reduction of the ethanol blend mandate in the US.

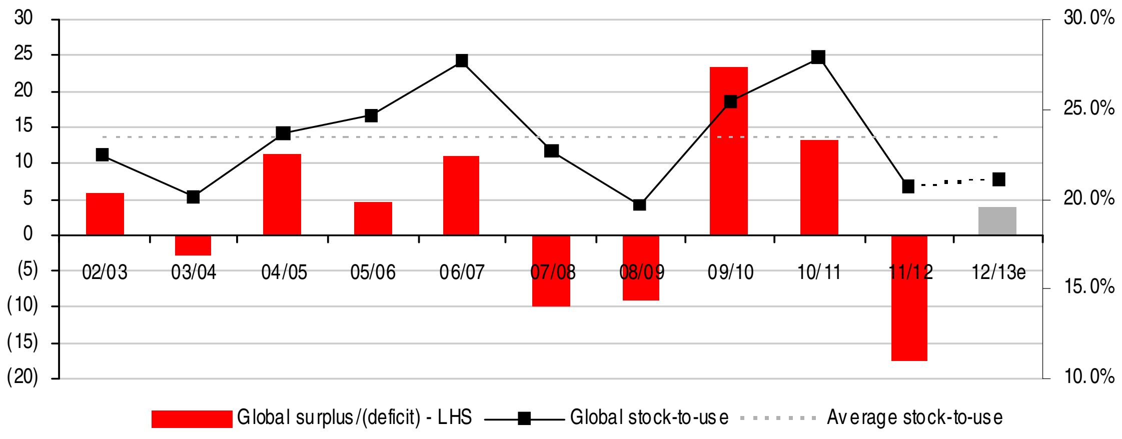
Soybeans

Soybean prices have risen c15% over the last month, driven by a lower stock-to-use ratio and a fall in US yields as a result of the drought. In the previous harvest year, a drought in Argentina and southern Brazil affected production and resulted in a large 17.5m ton deficit, or c7% of global consumption, the worst since 1976-77. As a result, the stock-to-use ratio fell to 20.7%from 27.9%, below its 23.5% 10-year average. (See Chart 9).

For the 2012-13 harvest year, initial USDA expectations were for a 6m ton global soybean surplus from record acreage in South America and a strong 6% improvement in US yields. However, in its latest monthly update, the USDA lowered its US yield expectation by as much as 8%, now 2.72tons/ha, -2.4% y-o-y. In the July update, the USDA lowered its global production estimates for 2012-13 by 4m to 267m tons, +13.3% y-o-y from the lower US supplies as a result of the drought. Global [soybean] consumption estimates were lowered by 2m tons to 263m tons, +3.8% y-o-y. The ending inventories now are estimated by the USDA at 56m tons, with the stock-to-use ratio at 21.2%, below the 23.5% 10-year average.

A key mitigating factor to higher soybean prices is record production from Brazil and Argentina. These two countries account for c50% of global production. The USDA expects solid acreage increases in both countries, +6% in Brazil to a record 26.5m hectares and +12.6% in Argentina to a record 19.7m hectares, driven by last year's higher prices. However, independent consulting companies in Brazil are pegging an even higher acreage number. For example, Agroconsult estimates that Brazilian acreage will increase as much as 11% and that this will result in Brazil's surpassing the US as the world's largest soybean producer.

9. Global soybean surplus/(deficit) in m tons and stock-to-use



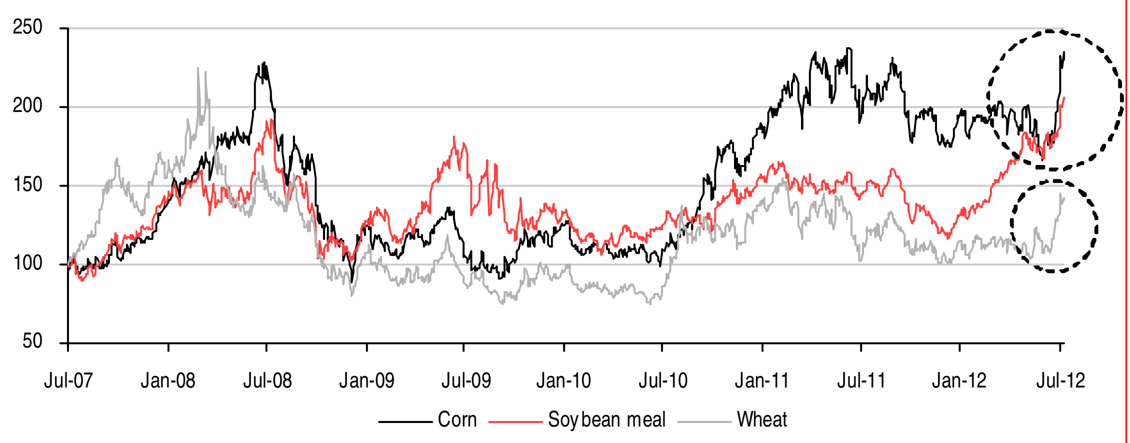
Source: USDA, HSBC

However, Conab, an agency of the Brazilian Ministry of Agriculture, will publish its first estimates of Brazilian production only in October 2012, as Brazil soybean planting begins in August and September. In addition, solid production numbers will depend on weather conditions in 4Q12 and 1H13. We thus expect higher soybean prices to persist at least for 2H12 until we see reliable estimates of the Brazilian and Argentine soybean harvest for 2012-13.

Wheat

Wheat prices have increased 45% in the past month, more than corn and soybeans. The increase in wheat prices was due to two factors, poor weather conditions in Russia and the Black Sea region, and the increase in corn prices. In its July 2012 report, the USDA lowered its global wheat production estimates for 2012-13 by 7m tons to 665m tons, -4.2% y-o-y (reduced by 13m tons over the past two months; the July reduction came primarily from Russia by 4m to 49m tons, Kazakhstan by 2m tons to 13m tons, and China by 2m tons to 118m tons, slightly offset by higher production in the European Union by 2m tons to 133m tons). The ending inventories estimates were lowered by 3m tons to 182m tons, with the stock-to-use ratio expected at 26.8%; the 10-year average is 26.1%.

10. Commodity prices, relative



Source: Bloomberg, HSBC

Russia and the Black sea region (the ex-Soviet Union) account for c17% of global production and, more important, about 25% of global wheat exports, with 85-90% of the region's production coming from Russia, Ukraine, and Kazakhstan. The USDA expects wheat production in the region to fall significantly this year due to severe weather conditions. The past few months have been excessively hot and dry, resulting in plummeting crop yields. The USDA expects wheat production to decline more than 40% in Ukraine and Kazakhstan, and c13% in Russia. Note that Russia and Ukraine limited grain exports in two of the past five years, and thus there is a risk that restrictions could be implemented if local supplies fall drastically.

Weather conditions have hampered production in other important exporting areas, including Australia, Turkey, and Central Europe. Note as well that a significant decline of 20% in planted area will limit exports from Argentina, the world's sixth-largest exporter; the USDA expects a 40% decline in wheat exports from Argentina. In addition, wheat prices are linked to corn, as wheat can be used as a substitute animal feed. As corn prices soared recently, this has driven some of the wheat price increases.

We thus expect higher wheat prices to continue in the short term. The stock-to-use ratio is expected by the USDA to decline this year to 26.8% from 28.6% in 2011-12 and remain only slightly above its 10-year average. In addition, lower corn supplies will pressure wheat prices, in our view.

Effects of higher commodity prices on protein producers

As most companies hedge input needs typically between 3-6 months, we expect the recent spike in commodity prices to affect earnings and margins toward the end of 4Q12 and into 2013. We regard US and Brazilian poultry and US pork as the proteins most affected. US beef should perform relatively well as the supply of cattle increases in the short term.

Poultry

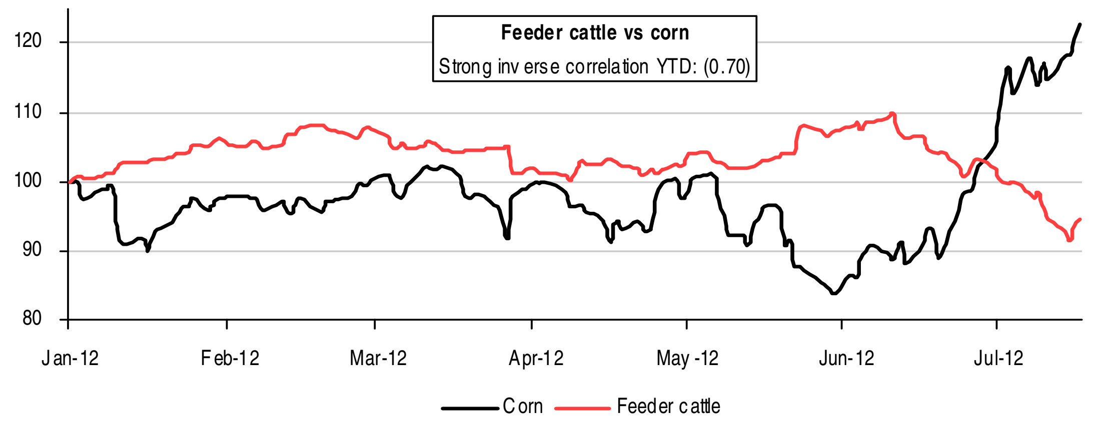
We view poultry as potentially the most affected among the animal proteins, given the higher exposure of grains in costs. The US poultry industry had just begun recovering from steep losses in 2011 and now will again be affected by the corn price appreciation. We do not expect producers to be largely hedged, as expectations from only a month back were for a record US corn crop. We believe that most producers will be hedged primarily until 3Q, with higher corn prices in 4Q12 and into 2013. As per JBS management, in US poultry, corn represents about 30% of costs. In addition, the US poultry industry is relatively fragmented, with the top four players controlling about 53% of the market, versus the top four's 74% for beef and the top five's 73% for pork (see Charts 12, 13, and 14). This industry structure makes it more difficult for poultry producers to pass price increases through.

Brazilian poultry producers will also be affected, as their main inputs are corn and soy meal. As a result of the BRF platform that consists of 45% processed products, grains account for only about 25% of costs. We expect Marfrig and JBS's Brazilian poultry platforms to be far more exposed to grains, as they are focused mostly on exports and on fresh products versus processed.

US pork

We expect US pork producers to be affected by higher grain prices over time. Margins have already returned to longer-term normalized levels of 6-8% from the solid 10-12% of the past couple of years. Over the medium term, we expect higher grain costs to be reflected in producer margins, yet depending on the success of potential price increases that can be implemented without materially curtailing demand. However, we expect

11. Feeder cattle vs corn



Source: Bloomberg, HSBC

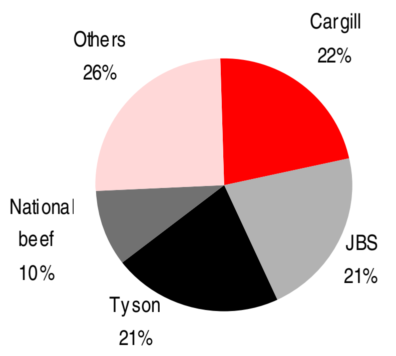
that an increase in pork demand from China due to the higher corn prices will provide some relief to pork producers.

US beef

US beef margins were weak in 1Q12, with cattle prices peaking at USD131/hundred lbs. We expect US beef margins to recover in 2H12 due to stable to lower cattle prices. As corn prices spiked and live cattle prices remained relatively stable, feeder cattle prices plummeted. We expect that due to the drought conditions, cattle ranchers are accelerating sales to feedlots. Higher corn prices give feedlots no incentives to increase purchases. In addition, feedlots should also be accelerating the sale of live cattle to curtail losses from higher grain prices. Thus, in the short term, we expect US beef margins to recover as cattle prices remain stable to slightly lower.

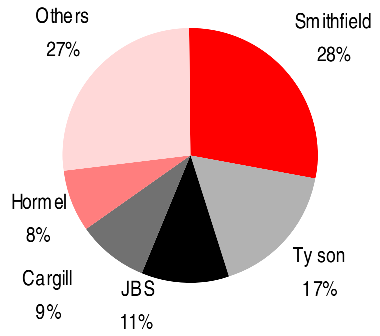
However, these current dynamics of accelerated slaughtering should delay any expansion of the US herd and accentuate the structural problem of a shrinking herd in the US. The herd already this year was at its lowest level since the 1952, and with the expected 2012 expansion delayed, the herd size could fall to yet another record low next year, resulting in record-high cattle prices at some stage. Margins at beef producers will depend on how much of those costs they can pass through without materially affecting demand.

12. US beef: Consolidated industry



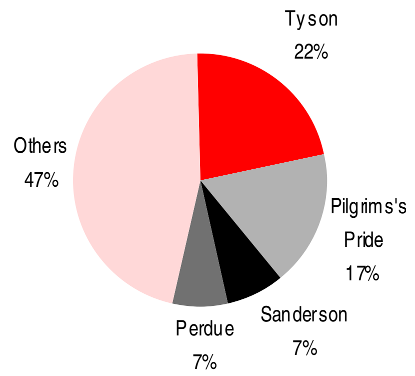
Source: Cattle Buyers Weekly (2010), Tyson

13. US pork: Consolidated industry



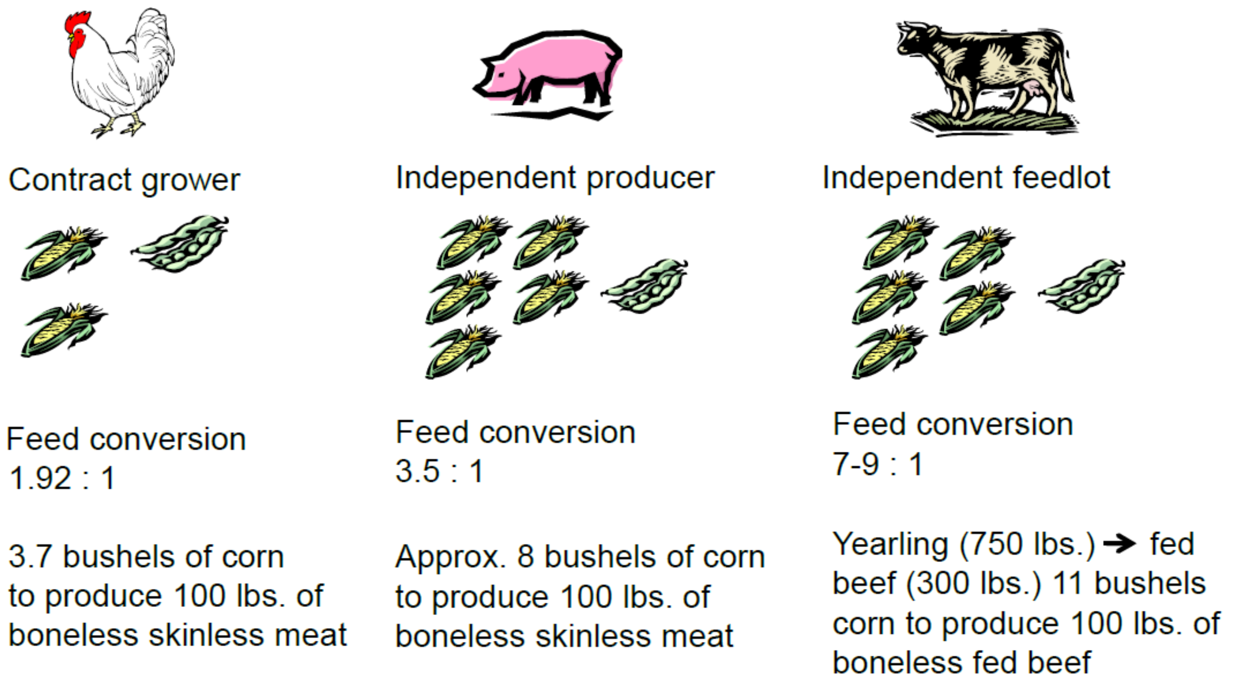
Source: National Pork Board (Spring 2009), Tyson

14. US poultry: Relatively fragmented industry



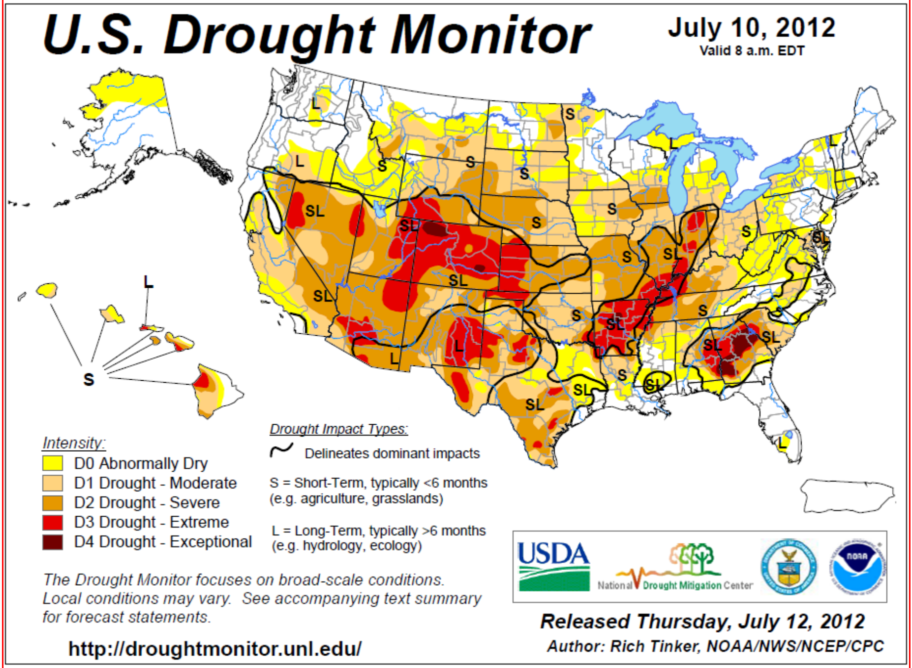
Source: Watt Poultry USA (February 2012), Tyson

15. Commodities and proteins



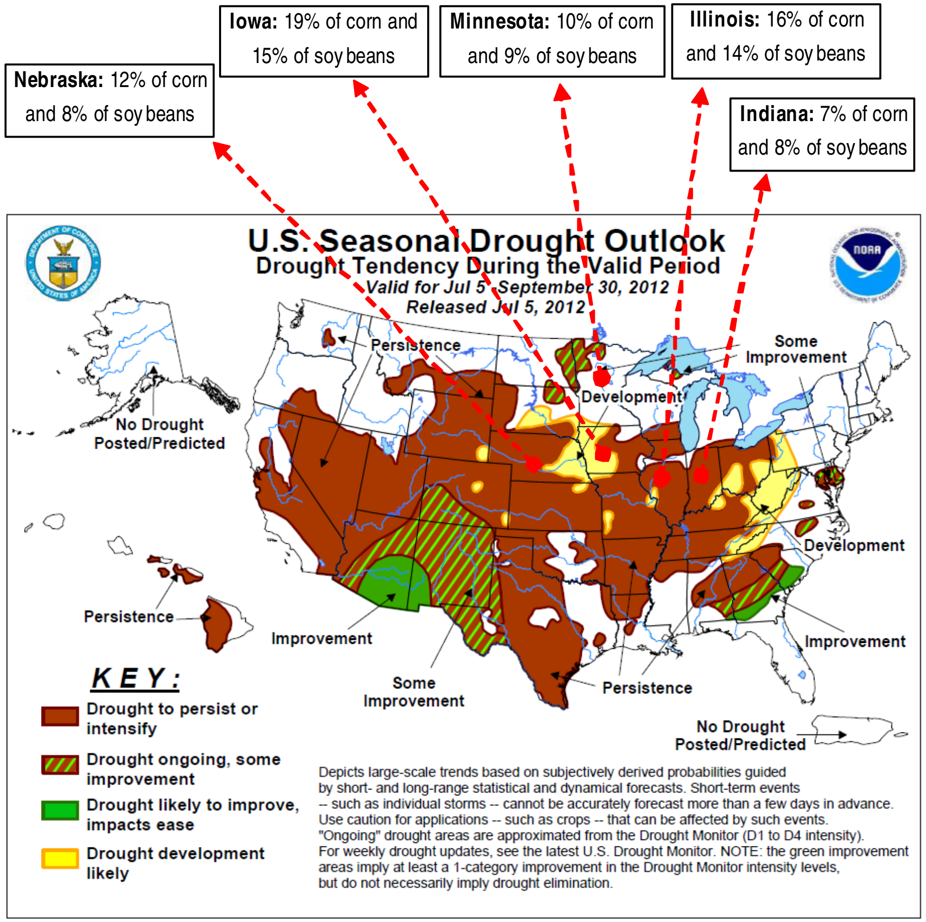
Source: Tyson

16. US drought monitor



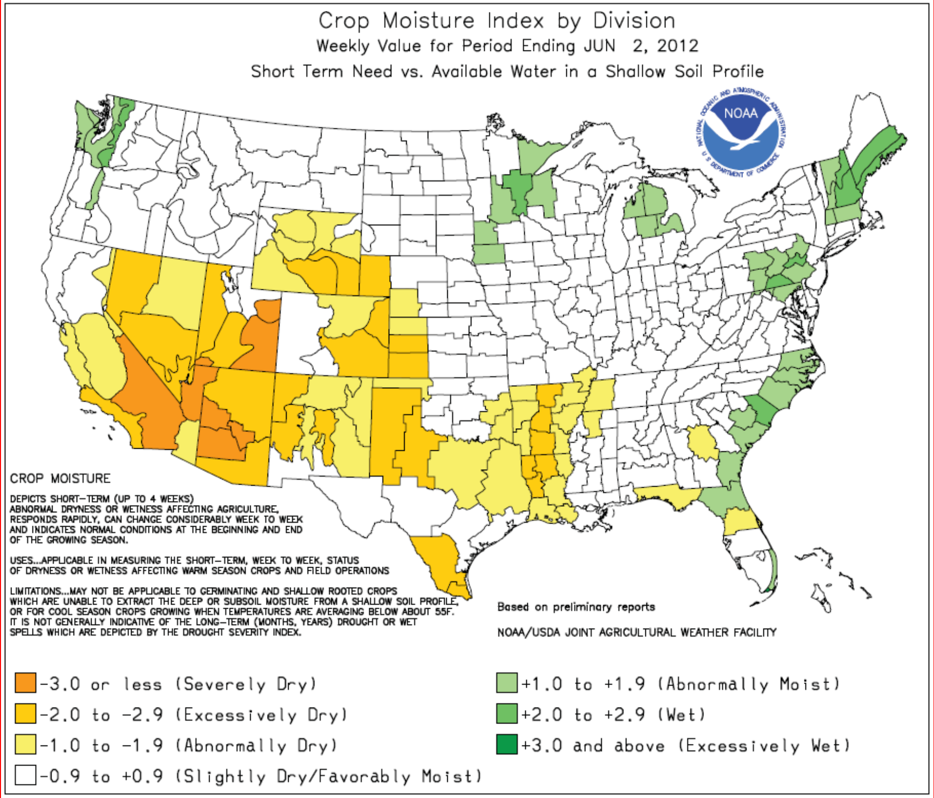
Source: USDA

17. US drought outlook: Five states account for c64% of US corn production and c54% of soybean output



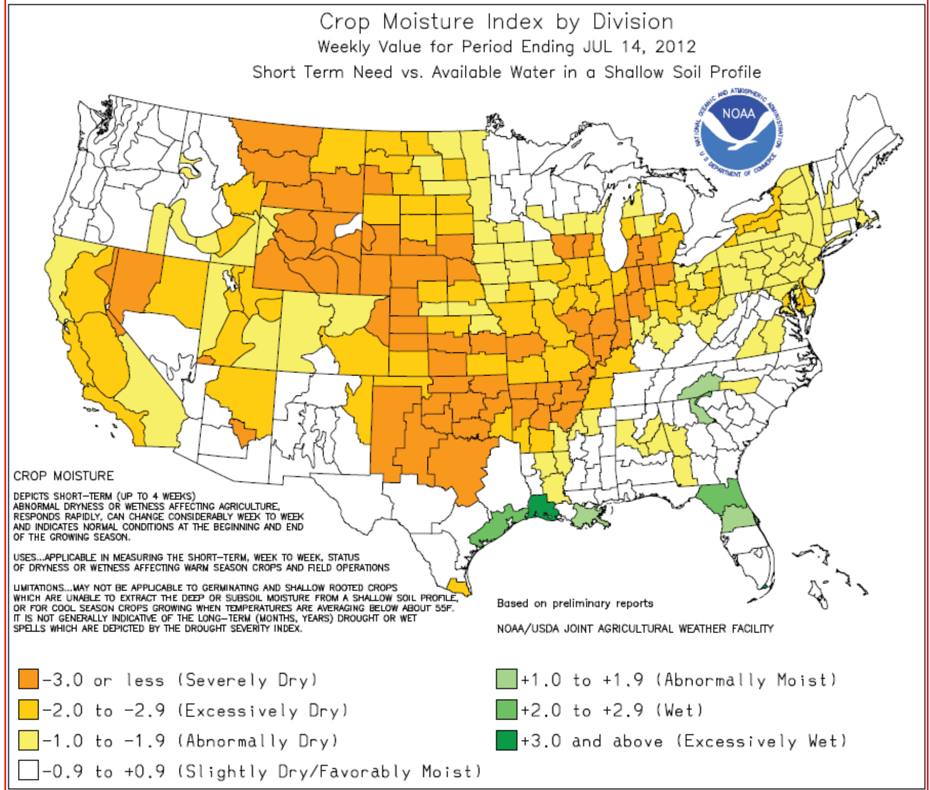
Source: USDA

18. Crop moisture at the beginning of June 2012



Source: USDA

19. Crop moisture in mid-July 2012



Source: USDA

Brasil Foods (BRFS3 BZ)

- BRF's processed products platform provides flexibility to pass higher grain prices through; we see softer margins short-term as the company focuses on market share versus profitability
- Export margins should recover strongly in 2H12 from normalized inventories and prices and from the weaker BRL
- We reiterate our Overweight rating on BRFS3 shares, on which we lower our target price to BRL40 from BRL42; our target price on BRFS ADRs falls to USD20 from USD23

Investment summary

BRF remains our favorite play in the industry, despite short-term weaknesses. The stock is down 19% YTD and trades at 7.5x 2013e EV/EBITDA and 13.2x 2013e PE. The stock declined 11% in the past month; we believe this reflected weaker short-term earnings expectations. Though we continue to expect strong margin improvements from the international markets, these should be offset by weaker domestic margins. International margins should benefit from a recovery in export prices and the weaker BRL. However, domestic markets have experienced weaker-than-expected demand, competition from pork products, and higher soy-meal prices. In addition, BRF closed an asset swap with Marfrig on 1 June 2012, and we expect BRF to focus aggressively on regaining lost market share from divestitures and suspension of brands. The company is launching new products with very competitive pricing and higher marketing expenses. BRF's focus on regaining market share in the short term should limit its willingness (rather than ability) to aggressively pass through higher costs, we believe, thus sacrificing short-term profitability.

However, in the medium term, we expect BRF to return to passing higher costs through successfully via pricing and to return to normalized profitability. It is important to note that grains account for only c25% of BRF's costs. The company has a solid 45% exposure to processed products, and its international expansion is geared toward further expanding the exposure of these higher-margin products.

Effects of higher grain prices on Brasil Foods

Ability to pass through? Yes

The effect of commodity prices is lower on companies such as Brasil Foods than its competitors due to the company's exposure to processed and branded products, as well as to its strong and, in some products, dominant market share. At the end of 2011, c45% of BRF's consolidated revenues stemmed from processed products. The company's growth strategy is to

expand over time its processed products business at its international operations, which today consists of 80% fresh products. The company is building a greenfield project in the Middle East, and it acquired two food companies in Argentina and completed the Marfrig asset swap, initiatives that increased BRF's processed products business overseas. Commodities represent only about 25% of total BRF costs (50% corn and 50% soybean meal). We view BRF as the best-positioned company among the Brazilian animal protein players to pass input cost pressures through due to the scale of its processed products business, its hefty c18% market share in global poultry exports, and domestic dominance.

Willingness? Not in the short term, we believe

In the short-term, however, we see Brasil Foods as unwilling to pass through fully or aggressively the majority of its higher input costs. Since BRF concluded its Marfrig asset swap on 1 June 2012, it has aggressively focused on regaining market share that it gave up from divestitures and the suspension of brands as mandated by CADE, the Brazilian antitrust authority. Thus, in the short term, we believe that the company will sacrifice profitability to regain market share. In the medium to longer term, however, we view BRF as the best-positioned company in the industry to pass higher costs through and thus return to normalized margin levels.

Short-term outlook

Domestic margin pressures

In the domestic market, we expect margins to be under pressure in the short term. We discuss the reasons as follows.

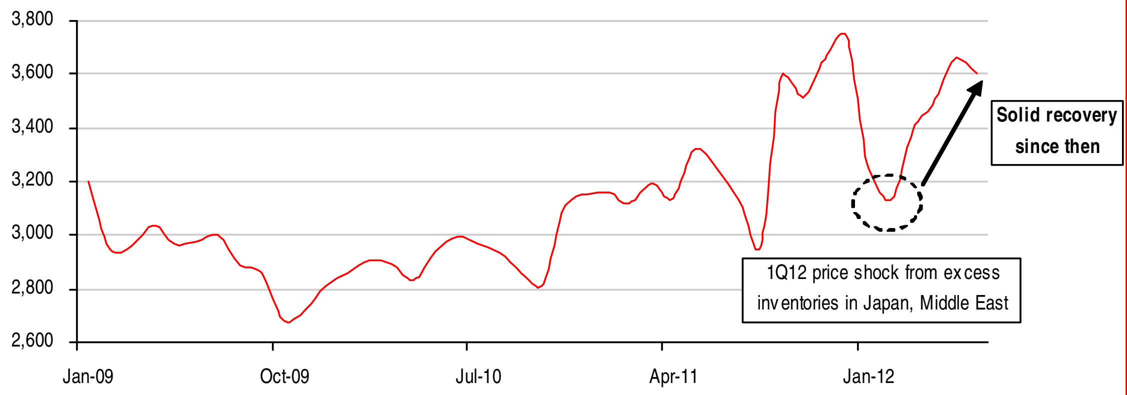
Weaker demand. Domestic market demand has been lower than market expectations due to weaker macroeconomic activity in Brazil. Despite lower unemployment levels, higher inflation and lower consumer confidence have affected overall demand, in our view.

Competition from pork. Domestic chicken products have been facing stiff though temporary competition from pork, as a Russian embargo on Brazil pork forced producers to divert pork products to the domestic market at very competitive prices.

Higher soy meal prices. Soy meal prices increased in 1H12, even before the recent run-up in commodity prices, as a result of low inventories due to drought in Argentina and Brazil in the previous year. Soybean production in 2011-12 fell short of demand by as much as 17.5m tons, or 7% of global demand, the most since 1976-77. By the end of 1Q12, soybean meal prices had increased to USD400/ton, up 30% from the end of 2011. With weaker demand and competition from pork, Brazil poultry producers have not been able to fully pass higher soybean meal prices through, in our opinion.

Divestitures and suspension of brands. BRF completed its asset swap with Marfrig and began divesting itself of assets as mandated by CADE, the Brazilian antitrust agency. The company also suspended some products under the Perdigão and Batavo brands beginning on 1 June 2012. BRF aims to focus on regaining this lost market share using existing brands, launching new products, and increasing expenditures on sales and marketing. At a time when BRF is market share-focused, we see its willingness to pass higher input costs through as rather limited. The company will sacrifice short-term profitability to regain market share, we believe. Thus, in the short term, we expect domestic margin pressures to persist.

20. Brazilian poultry export prices (BRL/ton)



Source: Secex, HSBC

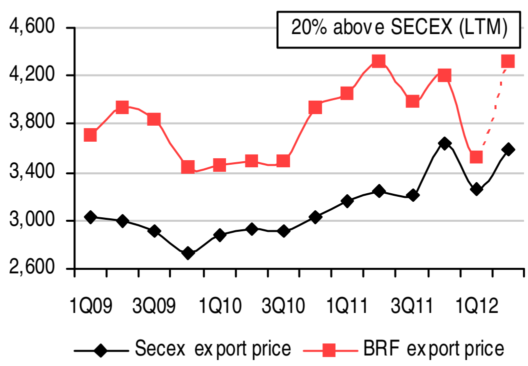
Improved international earnings

We expect domestic margin pressures to be partly offset by solid improvements in international margins, driven by two primary factors:

Normalization of inventories and export prices. We expect margin improvements in key markets, as Japan and the Middle East recover from excessive inventory levels. Export prices have recovered strongly since the drop in January 2012. (See Chart 20.) Export prices fell to BRL3,246/ton in January 2012, or 13.2% lower m-o-m as a result of higher inventories in Japan and the Middle East. However, since then, the recovery has been strong, with prices returning to BRL3,600/ton levels, or only BRL140/ton below the record level of BRL3,740/ton posted in December 2011. In addition, realized export prices for BRF are considerably higher than the averages reported by SECEX, the Brazilian Foreign Trade Secretariat. In the past 12 months, BRF prices were c20% higher than the SECEX average. (See Chart 21.) This was because BRF's exports to its subsidiaries abroad are done at intercompany prices (and not at prices charged to final consumers), the prices recorded by SECEX. In 2Q12, SECEX prices increased 10% to BRL3,600/ton. We expect BRF prices to reach levels closer to record levels near BRL4,000/ton.

The weaker BRL continues to help export profitability. The weaker BRL continues to benefit the export side of the equation. The BRL closed at BRL2.01/USD on 19 July 2012, or 29% weaker y-o-y. The weaker currency benefits BRF, as its USD-denominated revenues sizably exceed its USD costs. Of consolidated revenues, c40% are related to exports and mostly USD-denominated. Of total costs, grains, freight, and packaging are USD-denominated and represent close to 20-23% of costs. Thus BRF is about 17-20% long BRL.

21. BRF and SECEX poultry export prices (BRL/ton)



Source: Secex, BRF, HSBC

Expected BRF prices for 2Q12 are based on a 20% premium to SECEX

Preview of 2Q12 results

BRF is expected to report quarterly results on 13 August 2012. We estimate net sales at BRL6.9bn, up c10% y-o-y, mainly driven by a resilient

22. Brasil Foods: 2Q12 earnings preview

(BRLm)	Consensus	HSBC 2Q12e	2Q11	y-o-y
Net sales	6,907	6,948	6,294	10.4%
EBITDA	644	598	786	-23.9%
EBITDA margin	9.3%	8.6%	12.5%	(390bps)
Net income	188	100	498	-80.0%
EPS	0.31	0.11	0.57	-80.0%

Source: HSBC estimates, Bloomberg consensus

domestic market. We forecast domestic processed meat revenues will rise 15% y-o-y, primarily from price increases (+10% y-o-y) and a solid 12% increase in net revenues from food service. However, we are cautious about domestic fresh meats, given the higher supply of proteins as a result of the Russian embargo on Brazilian meat, as well as Argentine restrictions on Brazilian pork. Although we expect a 2% decline in fresh meat prices y-o-y, we would not be surprised by weaker figures.

From exports, we estimate revenues will increase c6% y-o-y, driven by an 8% volume increase. We forecast a 9% decline in fresh poultry export prices y-o-y (a 26% drop in USD terms) mitigated by the weaker BRL. We foresee a recovery for 2H12, supported by normalized inventories in key export markets and the continuing depreciation of the BRL.

We estimate EBITDA of BRL598m for the quarter, down c24% y-o-y and 7.1% below the consensus expectation. This is mainly explained by a combination of challenging export markets and higher grain prices versus the previous year. On a q-o-q basis, we expect a 12% improvement in EBITDA due to the recovering export margins (from -2.4% in 1Q12), as inventories in Japan and the Middle East normalize. On the other hand, domestic margins should deteriorate versus the previous quarter, reflecting increased grain cost pressures, especially in soybean meal, and expenses related to the closing of the asset swap with Marfrig. All in, we estimate a consolidated EBITDA margin of 8.6%, down 390bps y-o-y, and a marginal 20bp improvement from 1Q12.

BRF's net income line should reach BRL100m for the second quarter, a significant decline y-o-y explained by the weaker margins and higher financial expenses from a 62% increase in net debt and non-cash FX losses on the company's foreign currency-denominated debt as the BRL weakened during the quarter.

Estimate revisions

We are revising our estimates to reflect the dynamics discussed above. We do not make any changes to our revenue numbers except the new FX assumptions of the HSBC economics team. That team now expects a 10% weaker BRL with a 2013 average of BRL2.04/USD.

We are updating our costs and EBITDA assumptions to reflect current dynamics, ie weaker domestic margins from lower-than-expected demand, the company's focus on regaining market share versus profitability, and higher soy-meal prices. We now expect a 10.3% EBITDA margin for 2012 and a 12.8% margin for 2013, both 70bps lower than our previous estimates. The lower net income is driven by lower EBITDA.

Valuation and risks

We value BRF using an average of a DCF valuation and a target EV/EBITDA multiple. For our DCF metrics, we use a 10.2% cost of equity, a debt-to-equity ratio of 30:70, and a pretax cost of debt of 10%. This leads to a WACC of 9.5 %. We use a 3% terminal growth rate. Based on our DCF methodology, we arrive at a valuation of BRL46 per share. We use a 10x EV/EBITDA multiple to

our 12-month EBITDA to arrive at a value of BRL34 per share.

Using a 50-50 weighted average between the DCF valuation and the value derived using the EV/EBITDA multiple, we arrive at our new 12-month target price of BRL40 for BRFS3 shares, down from BRL42. Using the HSBC FX team's revised forecast of BRL2.05/USD for end-1H13, our BRFS ADR target price falls to USD20 from USD23.

Under our research model, for stocks without a volatility indicator, the Neutral band is 5ppt above and below our hurdle rate for Brazilian stocks of 11%. Our new BRL40 target price implies a potential return of 34.9%, which is above the Neutral band. We thus reiterate our Overweight rating on both Brasil Foods share classes. Potential return equals the percentage difference between the current share price and the target price, including the forecast dividend yield when indicated.

Risks

Downside risks, in our view, include competition from US poultry exports, higher grain prices from weaker production in South America due to weather issues, sanitary issues such as bird flu and foot-and-mouth disease (FMD), and potential restrictions in the global proteins trade from protective measures by governments protecting their domestic markets.

Catalysts

Catalysts that we see include the company's continuing its international expansion strategy in processed food products, lower or less-volatile grain prices, and faster-than-expected integration and synergies from Quickfoods, Avex, and Dánica in Argentina.

23. Brasil Foods: Changes to our estimates

(BRLm)	2012e	2013e	2014e
Net revenue			
Old estimate	27,474	30,440	33,547
New estimate	28,087	31,723	35,719
% change	2%	4%	6%
EBITDA			
Old estimate	3,013	4,098	4,690
New estimate	2,878	4,051	4,756
% change	-4%	-1%	1%
EBITDA margin			
Old estimate	11.0%	13.5%	14.0%
New estimate	10.2%	12.8%	13.3%
% change	-7%	-5%	-5%
HSBC net income			
Old estimate	1,287	2,042	2,431
New estimate	1,162	1,948	2,399
% change	-10%	-5%	-1%
HSBC EPS (BRL)			
Old estimate	1.48	2.35	2.79
New estimate	1.34	2.24	2.76
% change	-10%	-5%	-1%
FX average			
Old estimate	1.83	1.85	1.85
New estimate	1.93	2.04	2.15
% change	5%	10%	16%

Source: HSBC

HSBC

Financials & valuation: Brasil Foods SA

Overweight

Financial statements

Year to December	12/2011a	12/2012e	12/2013e	12/2014e
Profit & loss summary (BRLm)				
Revenue	25,706	28,087	31,723	35,719
EBITDA	3,245	2,878	4,051	4,756
Depreciation & amortisation	-886	-987	-1,083	-1,184
Operating profit/EBIT	2,359	1,891	2,968	3,572
Net interest	-354	-463	-503	-536
PBT	1,522	1,340	2,409	2,980
HSBC PBT	2,013	1,433	2,465	3,036
Taxation	-157	-270	-482	-596
Net profit	1,367	1,059	1,903	2,354
HSBC net profit	1,696	1,162	1,948	2,399
Cash flow summary (BRLm)				
Cash flow from operations	893	2,543	2,988	3,480
Capex	-1,676	-2,088	-2,147	-2,072
Cash flow from investment	-1,676	-2,088	-2,147	-2,072
Dividends	-340	-340	-371	-666
Change in net debt	1,510	590	-193	-465
FCF equity	-1,189	459	841	1,408
Balance sheet summary (BRLm)				
Intangible fixed assets	4,386	4,380	4,380	4,380
Tangible fixed assets	9,798	10,911	11,975	12,863
Current assets	11,277	12,285	13,319	14,929
Cash & others	2,893	2,987	3,458	4,201
Total assets	29,983	32,036	34,133	36,632
Operating liabilities	7,507	7,664	7,928	8,432
Gross debt	8,054	8,738	9,015	9,293
Net debt	5,161	5,751	5,557	5,092
Shareholders funds	14,070	15,579	17,111	18,799
Invested capital	15,061	16,924	18,287	19,540

Ratio, growth and per share analysis

Year to December	12/2011a	12/2012e	12/2013e	12/2014e
Y-o-y % change				
Revenue	13.3	9.3	12.9	12.6
EBITDA	23.1	-11.3	40.8	17.4
Operating profit	31.4	-19.8	57.0	20.3
PBT	51.9	-11.9	79.8	23.7
HSBC EPS	60.7	-31.5	67.6	23.2
Ratios (%)				
Revenue/IC (x)	1.8	1.8	1.8	1.9
ROIC	15.0	9.4	13.5	15.1
ROE	12.2	7.8	11.9	13.4
ROA	5.8	4.6	7.0	7.9
EBITDA margin	12.6	10.2	12.8	13.3
Operating profit margin	9.2	6.7	9.4	10.0
EBITDA/net interest (x)	9.2	6.2	8.0	8.9
Net debt/equity	36.6	36.8	32.3	26.9
Net debt/EBITDA (x)	1.6	2.0	1.4	1.1
CF from operations/net debt	17.3	44.2	53.8	68.3
Per share data (BRL)				
EPS Rep (fully diluted)	1.57	1.22	2.19	2.71
HSBC EPS (fully diluted)	1.95	1.34	2.24	2.76
DPS	0.39	0.43	0.77	0.95
Book value	16.17	17.90	19.66	21.60

Valuation data

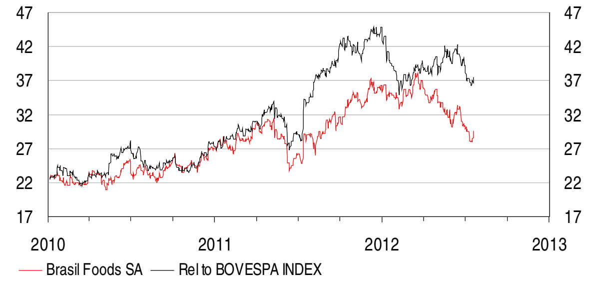
Year to December	12/2011a	12/2012e	12/2013e	12/2014e
EV/sales	1.2	1.1	1.0	0.8
EV/EBITDA	9.2	10.6	7.5	6.3
EV/IC	2.0	1.8	1.7	1.5
PE*	15.2	22.2	13.2	10.8
P/Book value	1.8	1.7	1.5	1.4
FCF yield (%)	-4.8	1.9	3.4	5.7
Dividend yield (%)	1.3	1.4	2.6	3.2

Note: * = Based on HSBC EPS (fully diluted)

Issuer information

Share price	(BRL)29.65	Target price	(BRL)40.00
Reuters (Equity)	BRFS3.SA	Bloomberg (Equity)	BRFS3 BZ
Market cap (USDm)	12,183	Market cap (BRLm)	24,681
Free float (%)	72	Enterprise value (BRLm)	30461
Country	Brazil	Sector	Food Products
Analyst	Pedro Herrera	Contact	+1 212 525 5126

Price relative



Source: HSBC

Note: price at close of 19 Jul 2012

JBS (JBSS3 BZ)

- Higher grain prices will affect US poultry margins the most but beginning 4Q12, in our view; US pork margins have returned to normalized levels
- We see a strong short-term recovery in US beef margins as feedlots accelerate sales; Brazilian beef is unaffected and should continue to outperform from lower cattle prices and a weaker BRL
- We reiterate our Overweight(V) rating; we lower our target prices on JBSS3 shares to BRL7.50 from BRL8 and on JBSAY ADRs to USD7.50 from USD8

Investment summary

Increases in grain prices should affect earnings the most at JBS's US poultry platform, Pilgrim's Pride. The company is mostly hedged until 3Q, but we expect margins to be hurt thereafter. Pilgrim's Pride has recovered well since its 2011 losses, posting a strong 5.3% margin for 1Q12. We expect good margins in the 5-6% range to continue in 2Q and 3Q and then deteriorating to about 3% in 4Q12. We are lowering our US pork margin expectations to longer-term normalized 6-7% levels due to higher hog costs, as we expect grain prices to affect hog prices over time, though mitigated possibly by increased demand from countries such as China.

Weakness in US poultry and pork was offset by recovering US beef margins and solid Brazilian beef performance. Live cattle prices in the US are stable to slightly lower, as higher corn prices force feedlots to accelerate cattle sales to curtail operating losses. We expect cattle prices to remain stable in 2H12, thus fostering a recovery in JBS's US beef margins. Short-term excess cattle supplies imply that the US herd expansion will be delayed yet again. Thus, we are trimming our 2013 US beef margin estimate to 3.8% from 4.2%. On the other hand, the Brazilian beef platform should continue to outperform due to lower cattle prices from the larger herd and the weaker BRL's boosting export profitability. The Brazilian beef cycle is peaking, and we expect to see benign cattle prices for the foreseeable future.

Overall, we believe that weakness in US poultry and a decline in pork margins will be mostly offset by solid Brazilian beef margins and a strong recovery in US beef. JBS's leverage remains high, however, although the company lowered its recurring financial expenses as a result of its 2011 debt restructuring.

We reiterate our Overweight (V) rating though we are lowering our target prices on JBSS3 shares to BRL7.50 from BRL8 and on JBSAY ADRs to

USD7.50 from USD8, the latter based on the HSBC FX team's forecast of BRL2.05/USD for end 1H13.

Pilgrim's Pride margins will be affected the most

JBS's US poultry platform will be affected the most by the higher grain prices. According to JBS, its corn exposure is hedged for only the next three months. Thus, we expect Pilgrim's Pride margins to be affected beginning in 4Q12. Margins in this business had recovered nicely from large EBITDA losses in 2011 (to 5-6% in 1Q12). We expect margins at these levels in 2Q as well as in 3Q12, with a potential steep margin decline in 4Q as current corn prices are reflected in earnings. We expect margins to decline to c3% unless higher poultry prices provide some relief.

US pork

US pork margins have fallen to more normalized levels near the 6-8% range from solid 10% EBITDA margins during the last couple of years. The 1Q12 decline in margins was a result of higher hog costs and weakness in some export markets such as China. Higher grain prices could further pressure margins, though this could also result in stronger international demand from countries like China. We expect margins near 6-7% in 2012, down from the 9.8% margin of 2011.

US beef

In 1Q12, US beef margins declined to negative territory, -1.1%, as a result of cattle prices reaching record highs: USD131 per hundred pounds on 1 March 2012, +18% y-o-y, before falling 10-15% to USD115-120 levels, where they had been in most of 2011. On the other hand, as expected, the US beef segment reported a 5% volume decline as higher beef prices hurt overall consumer demand. We expect 2Q12 to show a marginal improvement to near break-even levels, as weaker margins continued in April and May with June seeing a very strong rebound.

For 2H12, we expect strong improvements, with margins returning to normalized levels by 4Q as a result of increased supply of cattle, as feedlots accelerate sales to curtail losses from high corn prices. The higher cattle supply in the short term also implies that the US herd expansion will be delayed further. We thus are lowering our 2013 EBITDA estimate slightly to 3.8% from 4.2%.

The Brazilian beef platform remains solid

As we discussed in our 20 March 2012, *The Brazilian beef platform is regaining its luster*, the Brazilian beef cycle is peaking. With lower cattle prices from herd expansion, robust domestic demand, and a weak BRL helping exports, Brazilian beef producers should earn solid returns in the next 12-18 months at the least. We continue to expect solid revenue growth at JBS Mercosul from increases in capacity utilization and as a result of leasing four additional beef slaughtering plants that added c7% to the company's Brazil capacity. For the foreseeable future, cattle prices should remain benign and the weaker BRL should foster Brazilian export profitability.

Preview of 2Q12 results

JBS is expected to report quarterly results on 15 August 2012. We estimate JBS will post net sales of BRL17.4bn in 2Q12, +c19% y-o-y, primarily from positive effects of the weaker BRL on translation of the results of foreign subsidiaries. We estimate flat revenues y-o-y in USD terms for JBS USA beef and Pilgrim's Pride, USD3.9bn and USD1.9bn, respectively, while revenues from JBS USA pork should increase 2% y-o-y to USD865m from solid domestic pricing. On the other hand, we estimate a 17% increase in net revenues from Mercosul to BRL4.2bn, mainly due to a 17% increase in export prices from the weaker BRL (in USD terms, we

24. JBS: 2Q12 earnings preview

(BRLm)	Consensus	HSBC 2Q12e	2Q11	y-o-y
Net sales	17,691	17,444	14,622	19.3%
EBITDA	1,093	893	588	51.9%
EBITDA margin	6.2%	5.1%	4.0%	110bps
Net income*	290	154	(181)	NM
EPS	0.10	0.05	(0.07)	NM

Source: HSBC estimates, Bloomberg consensus. * Consensus net income estimate is based on four EPS estimates.

expect a 5% decline y-o-y) and robust domestic sales (up 14% y-o-y).

We estimate consolidated EBITDA of BRL893m, +52% y-o-y, for a 5.1% margin (up 110bps y-o-y). However, it is worth mentioning that the comparison base is very weak due to Pilgrim's operating losses in 2011. We expect PPC margins to recover to 6% versus negative 2.5% in 2Q11.We expect the US beef division to report near break-even EBITDA following 1Q12 operating losses, -1.1% margin, as average cattle prices have fallen from historical highs, down c6% q-o-q yet still up 6% y-o-y. In the US pork division, we expect lower margins y-o-y from weaker export markets (especially China), yet still strong at 6.5%, and at Mercosul, we expect solid margins to continue from lower cattle prices as the Brazilian herd expands (up 70bps y-o-y to a 12.5% margin).

We estimate net income of BRL154m, a substantial recovery from the year-earlier losses, as a result of the Pilgrim's Pride recovery and the strong performance at JBS Mercosul. In addition, higher net income also stems from lower financial expenses following the JBS debt restructuring concluded at the end of 2011.

We expect leverage metrics to deteriorate versus the previous quarter due to the recent spike in the BRL, which should affect JBS foreign currency-denominated debt. We expect the company to end 2Q12 near a 4.7x net debt-to-EBITDA ratio (including PPC debt) from 4.5x at the end of March.

Estimate revisions

We are revising our estimates based on the dynamics discussed above. We do not make any significant changes to our revenue expectations except those driven by the actual average FX rate in 2Q. However, we lower our estimates of EBITDA at Pilgrim's Pride and US pork. We expect a strong 9M12 EBITDA at Pilgrim's, partly offset by a weak 3% margin in 4Q12 for a 2012 average of 4.8%. For 2013, we reduce our expectation from a solid 7% margin to 4.3% to reflect the effect of higher grain prices. We also temper our US pork margin expectations to a normalized 6.5% for 2012 and 7.1% for 2013 versus the solid 10% margin levels of 2010 and 2011. In the US beef segment, we expect a strong recovery in 2H12, with a normalized margin of 4% returning by 4Q. For 2013, we are slightly reducing our margin estimate to 3.8% from 4.2%, given further shrinkage of the US herd. For Brazil beef, we increase our margin expectation to 12.9% for 2012 from 12.4%, driven by lower cattle prices and the continued weaker BRL.

Valuation and risks

We value the company using an average of a DCF methodology and a target EV/EBITDA multiple. For our DCF metrics, we use a 9.2% cost of equity (blended US and Brazil), a debt-to-equity ratio of 30:70, and a pretax cost of debt of 10%. This leads to a WACC of 8.6%. We use a terminal growth rate of 3%. Based on our DCF methodology, we arrive at a value of BRL9.10 per share. We use a 7x EV/EBITDA multiple to our 12-month EBITDA estimate and arrive at a BRL5.90 value per share.

Using a 50-50 weighted average of the DCF valuation and the value derived using the EV/EBITDA multiple, we arrive at our new 12-month target price of BRL7.50 on JBSS3 shares, down from BRL8. Using a BRL of BRL2.05/USD for the end of 1H13, our target price on JBSAY ADRs falls to USD7.50 from USD8.

Under our research model, for stocks with a volatility indicator, the Neutral band is 10ppt above and below our hurdle rate for Brazilian stocks of 11%. Our new BRL7.50 target price implies a potential return of 30.4%, which is above the Neutral band. We thus reiterate our Overweight (V) rating on both the JBS share classes. Potential return equals the percentage difference between the current share price and the target price, including the forecast dividend yield when indicated.

Downside risks

Downside risks, we believe, include volatility of the BRL and grain prices, weaker-than-expected beef margins in the US, propensity of the company to engage in large and risky acquisitions, and sanitary issues (bird flu, foot-and-mouth disease, and bovine spongiform encephalopathy, or BSE).

Catalysts

Catalysts that we see include a faster-than-expected recovery by weak US poultry operations, a focus of management on increasing free cash flows and on managing the business with no unexpected acquisitions, reduction of leverage, and lower grain and cattle prices resulting in margin expansion.

25. JBS: Changes to our estimates

(BRLm)	2012e	2013e	2014e
Net revenue			
Old estimate	71,293	79,248	85,863
New estimate	71,538	79,248	85,863
% change	0%	0%	0%
EBITDA			
Old estimate	4,250	5,771	6,275
New estimate	3,902	5,199	5,674
% change	-8%	-10%	-10%
EBITDA margin			
Old estimate	6.0%	7.3%	7.3%
New estimate	5.5%	6.6%	6.6%
% change	-8%	-10%	-10%
HSBC net income			
Old estimate	1,105	1,913	2,099
New estimate	929	1,639	1,818
% change	-16%	-14%	-13%
HSBC EPS (BRL)			
Old estimate	0.37	0.65	0.71
New estimate	0.31	0.55	0.61
% change	-16%	-14%	-13%
BRL/USD - average			
Old estimate	1.93	2.04	2.15
New estimate	1.93	2.04	2.15
% change	0%	0%	0%

Source: HSBC

Financials & valuation: JBS

Overweight (V)

Financial statements

Year to December	12/2011a	12/2012e	12/2013e	12/2014e
Profit & loss summary (BRLm)				
Revenue	61,797	71,538	79,248	85,863
EBITDA	3,151	3,902	5,199	5,674
Depreciation & amortisation	-1,291	-1,258	-1,409	-1,553
Operating profit/EBIT	1,860	2,644	3,789	4,121
Net interest	-2,011	-1,241	-1,452	-1,529
PBT	-230	1,389	2,337	2,592
HSBC PBT	-151	1,403	2,337	2,592
Taxation	-93	-399	-584	-648
Net profit	-76	921	1,639	1,818
HSBC net profit	-53	929	1,639	1,818
Cash flow summary (BRLm)				
Cash flow from operations	895	1,376	2,908	2,996
Capex	-1,174	-1,680	-2,060	-2,318
Cash flow from investment	-670	-1,680	-2,060	-2,318
Dividends	-125	0	-230	-410
Change in net debt	2,083	1,446	196	545
FCF equity	-1,400	-204	847	678
Balance sheet summary (BRLm)				
Intangible fixed assets	12,533	12,479	12,479	12,479
Tangible fixed assets	15,379	15,779	16,430	17,195
Current assets	17,931	19,542	20,958	21,983
Cash & others	5,288	5,102	5,719	5,987
Total assets	47,411	49,332	51,400	53,190
Operating liabilities	6,010	6,632	6,823	6,723
Gross debt	18,872	20,132	20,945	21,758
Net debt	13,584	15,030	15,226	15,771
Shareholders funds	20,664	20,619	21,569	22,520
Invested capital	34,545	36,065	37,326	38,947

Ratio, growth and per share analysis

Year to December	12/2011a	12/2012e	12/2013e	12/2014e
Y-o-y % change				
Revenue	12.2	15.8	10.8	8.3
EBITDA	-16.1	23.8	33.2	9.2
Operating profit	-26.5	42.2	43.3	8.8
PBT	-447.1		68.2	10.9
HSBC EPS			76.4	10.9
Ratios (%)				
Revenue/IC (x)	1.9	2.0	2.2	2.3
ROIC	4.3	5.3	7.7	8.1
ROE	-0.3	4.5	7.8	8.2
ROA	2.6	3.9	5.6	5.9
EBITDA margin	5.1	5.5	6.6	6.6
Operating profit margin	3.0	3.7	4.8	4.8
EBITDA/net interest (x)	1.6	3.1	3.6	3.7
Net debt/equity	62.9	69.3	66.9	66.2
Net debt/EBITDA (x)	4.3	3.9	2.9	2.8
CF from operations/net debt	6.6	9.2	19.1	19.0
Per share data (BRL)				
EPS Rep (fully diluted)	-0.03	0.31	0.55	0.61
HSBC EPS (fully diluted)	-0.02	0.31	0.55	0.61
DPS	0.00	0.00	0.08	0.14
Book value	6.97	6.96	7.28	7.60

Valuation data

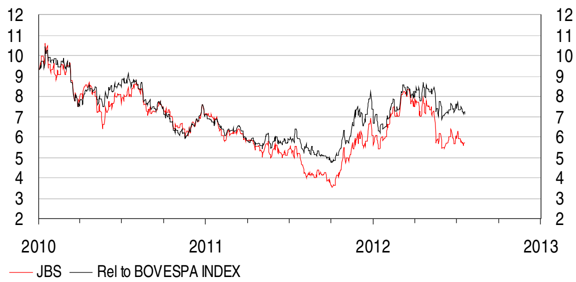
Year to December	12/2011a	12/2012e	12/2013e	12/2014e
EV/sales	0.5	0.5	0.4	0.4
EV/EBITDA	10.0	8.5	6.4	6.0
EV/IC	0.9	0.9	0.9	0.9
PE*		18.3	10.4	9.4
P/Book value	0.8	0.8	0.8	0.8
FCF yield (%)	-7.8	-1.1	4.6	3.7
Dividend yield (%)	0.0	0.0	1.4	2.4

Note: * = Based on HSBC EPS (fully diluted)

Issuer information

Share price	(BRL)5.75	Target price	(BRL)7.50
Reuters (Equity)	JBSS3.SA	Bloomberg (Equity)	JBSS3 BZ
Market cap (USDm)	8,413	Market cap (BRLm)	17,043
Free float (%)	44	Enterprise value (BRLm)	33152
Country	Brazil	Sector	Food Products
Analyst	Pedro Herrera	Contact	+1 212 525 5126

Price relative



Source: HSBC

Note: price at close of 19 Jul 2012

HSBC

Marfrig (MRFG3 BZ)

- Grain hedges in Marfrig's poultry segment are limited; the company could be the most affected by high prices; a focus on capturing Brazil market share should limit ability to pass on costs
- The beef segment should continue to outperform from solid Brazil dynamics, yet it represents only one-third of revenues; we expect end-2012 leverage to reach 4.3x, still high, in our view
- We reiterate our Neutral (V) rating on MRFG3 shares and lower our target price to BRL10.50 from BRL11; our MRRTY ADRs target price falls to USD5 from USD5.50

Investment summary

Marfrig will be affected by the recent spike in grain prices, as c67% of its revenues are derived from the poultry and pork segment. In addition, the company's hedges are limited: 45 days for corn and two months for soybean meal. We expect to see margin pressures from the higher input costs beginning as early as mid-3Q12. We view Marfrig's ability to pass through higher grain prices as relatively limited. In Brazil, the company will be integrating BRF assets and will focus on gaining market share in processed products, thus making it difficult to pass through cost increases. In Europe, economic conditions and competitive issues should make it difficult to implement price increases. Also, costs are exposed to wheat, the grain that has had the biggest price increase in the past month, +45%.

On the other hand, Marfrig's beef platform should continue to outperform, driven by lower cattle prices in Brazil. The weaker BRL will boost export profitability. In 1Q12, Marfrig reported a solid 11.5% EBITDA margin versus 9% for 2011. We expect double-digit margin levels to continue in 2012 and 2013, as the positive dynamics of the beef cycle should continue.

Marfrig's leverage will remain high and be a driver of its valuation. The company should, however, benefit from asset sales, such as the sale of Keystone's logistics assets to Martin-Brower. We expect Marfrig will end 2012 with a net debt-to-EBITDA of 4.3x, down from 5x at the end of 1Q12, though we still considered this to be high. Also, as a result of the leverage, we continue to expect negative operating free cash flows this year.

We reiterate our Neutral (V) rating and lower our target price on MRFG3 shares to BRL10.50 from BRL11. Our MRRTY ADRs target price falls to USD5 from USD5.50 based on the HSBC FX team's forecast of BRL2.05/USD for end-1H13.

Poultry affected by grain price increases

Marfrig's poultry segment, which generated c67% of consolidated sales for 2011, will be affected by high grain prices, in our view. According to the company, grains account for c65% of costs in the poultry segment. Of that, two-thirds is corn and one-third is soybean meal at the Seara (Brazil) and Keystone units. In Moy Park (European operations), two-thirds of the grain exposure is wheat and one-third is soybean meal. Marfrig hedged only 45 days for corn and c2 months for soybean meal. We expect poultry margins to begin to be affected as early as mid-3Q. In Brazil, c65-70% of current revenues are derived from fresh poultry and pork products, though this should fall to 45-50% over time as Marfrig incorporates the processed products business via the BRF asset swap. In the poultry and pork international segment, c80% of revenue is derived from processed products.

Overall, we view Marfrig's ability or willingness to pass higher grain prices through as limited. In Brazil, Marfrig is in the midst of ramping up operations at plants acquired from BRF and trying aggressively to capture market share, and thereby cannot or will not pass higher input costs through for competitive reasons. Marfrig's international poultry segment consists of two main operations, Moy Park in Europe and Keystone, which is primarily focused on the food service industry. In Europe, we expect competition to be intense and margins to be hurt. In addition, the European operations use wheat, the grain that has had the highest price increase in the past month, +45%. At Keystone, the company is structured to pass higher input costs on mostly via its "cost plus" contracts, yet we expect some margin pressure nonetheless as the business deals with large and powerful customers that might challenge some cost increases.

BRF asset swap

Marfrig began to implement the BRF asset swap agreement on 1 June 2012. Marfrig acquired shares of Athena Alimentos SA, the company to which BRF transferred all the mandated assets such as industrial plants, distribution centers, trademarks, and brands. On the other hand, Marfrig transferred its 91% stake in Quickfood Argentina to BRF. Both companies also signed an agreement for the transfer of BRL350m in cash to BRF from Marfrig under terms of the swap agreement, with BRL100m to be paid between June and October 2012 and the balance in 72 monthly installments along with interest at market rates.

Beef segment should remain solid

The Brazil beef segment will continue to outperform as a result of lower live-cattle prices. In addition, the weaker BRL is boosting export profitability. We expect lower double-digit EBITDA margins to continue for the next couple of years, as the cattle cycle is just beginning to peak. In 1Q12, Marfrig reported a solid 11.5% margin versus 9% in 2011 as a result of the lower costs and the weakening BRL, and we expect these positive dynamics to continue. Note however, that beef today accounts for only c33% of revenues.

Preview of 2Q12 results

On consolidated basis, we estimate net sales will increase c6% y-o-y to BRL5.6bn from a 13% average price increase offsetting 6% lower volumes. At Marfrig Beef (Brazil plus international), we estimate an 8% rise in revenues y-o-y to cBRL2bn, primarily from higher prices. From Brazil Beef, we expect flat revenues y-o-y, as price increases should be mostly offset by a 9% volume decline. At Seara Foods (poultry, pork, and processed products), we estimate a 5% increase in net revenues to cBRL3.6bn from solid

26. Marfrig: 2Q12 earnings preview

(BRLm)	Consensus	HSBC 2Q12e	2Q11	y-o-y
Net sales	5,897	5,644	5,322	6.1%
EBITDA	536	431	289	47.5%
EBITDA margin	9.1%	7.6%	5.4%	210bps
Net income	(253)	(32)	(91)	NM
EPS	(0.79)	(0.09)	(0.26)	NM

Source: HSBC estimates, Bloomberg consensus

results from the Brazilian domestic market. This stems mainly from a combination of price increases and an improved product mix, as Marfrig expands its presence in branded processed products. Revenues from international poultry and pork operations should be +2% y-o-y.

We estimate consolidated adjusted EBITDA of BRL431m for the second quarter, significantly higher y-o-y due to better margins in both divisions, yet c20% below the consensus expectation. Note that we exclude the one-time BRL318m gain from the sale of the Keystone Foods QSR operations, accounted for as other operating revenues in 2Q12 from our adjusted EBITDA calculations, given that it is nonrecurring.

We expect solid margins at the Marfrig Beef division to continue as Brazilian cattle prices continue to decline. We estimate a 10.5% margin for Marfrig Beef, +310bps y-o-y. For Seara Foods, we estimate 160bps margin increase y-o-y to 6% as the company expands in processed products. Note that the BRF asset swap should begin to be materially reflected in results beginning in 3Q12.

Despite the better operating performance, we still expect a net loss of BRL32m for the second quarter due to Marfrig's heavy debt burden and cBRL250m in noncash losses on the USD-denominated debt following the BRL spike. However, we estimate net debt-to-adjusted EBITDA ratio will improve to 4.4x (excluding the aforementioned BRL318m gain) from 5.0x at the end of March 2012.

Estimate revisions

We are not revising our revenue estimates, except for a minor change to FX to reflect the actual 2Q12 average BRL1.97/USD. We are adjusting our margin expectations to reflect higher grain prices, as discussed above. For the poultry segment, we are reducing our margin estimate to 6.6% from 7% for 2012, as grain costs will begin to be reflected as early as mid-3Q12, in our view. For 2013, we are reducing our poultry margin estimate to 7.1% from 7.4%. We are not changing our beef EBITDA margin estimate, and we continue to expect a solid 11% margin for 2012 and 2013. Net income should be hurt by the lower poultry margins, yet partly offset by lower interest rates in Brazil.

Valuation and risks

We value Marfrig using a combination of a DCF methodology and a target EV/EBITDA multiple. We are extending our DCF to end-June 2013. For our DCF metrics, we use an 11.2% cost of equity (blended Brazil, Latam, US, and Europe), a debt-to-equity ratio of 40:60, and a pretax cost of debt of 10%, leading to a WACC of 9.4%. We use a 3% terminal growth rate. Based on our DCF analysis, we arrive at a valuation of BRL13.70 per share.

In our computation of our target EV/EBITDA multiple, we take into account peer averages, Marfrig's historical multiples, and its high leverage, negative free cash flows, potential dilution from BNDES convertible debentures, and a delayed extraction of synergies. We apply a 6x EV/EBITDA multiple to our 12-month EBITDA estimate and arrive at a BRL7.30 value per share.

Using a 50-50 weighted average of our DCF valuation and the value derived using the target EV/EBITDA multiple, we arrive at our new target price on MRFG3 shares of BRL10.50, down from BRL11. Using the HSBC FX team's forecast of BRL2.05/USD for end-June 2013, our target price on MRRTY ADRs falls to USD5 from USD5.50.

Under our research model, for stocks with a volatility indicator, the Neutral band is 10ppt above and below our hurdle rate for Brazilian stocks of 11%. Our new BRL10.50 target price implies a potential return of 13.4%, which is within the Neutral band. We thus reiterate our Neutral (V) ratings on both Marfrig share classes. Potential return equals the percentage difference between the current share price and the target price, including the forecast dividend yield when indicated.

Risks

Upside risks, we believe, include large-scale deleveraging from asset disposals, a significant recovery in operating margins from lower input costs, higher-than-expected synergies from the swap of assets with BRF as well as from the new corporate structure, lower cattle prices in Brazil, and positive cash flows.

Downside risks, in our view, include integration of the assets from the BRF swap, logistics challenges in Brazil, weaker operating margins in the medium term, and any move to convert the BNDES debentures meant to relieve the interest burden resulting in considerable dilution to minority shareholders. BNDES is Brazil's national development bank.

27. Marfrig: Changes to our estimates

(BRLm)	2012e	2013e	2014e
Net revenue			
Old estimate	23,256	26,279	28,935
New estimate	23,318	26,279	28,935
% change	0%	0%	0%
EBITDA			
Old estimate	1,946	2,232	2,402
New estimate	1,879	2,190	2,402
% change	-3%	-2%	0%
EBITDA margin			
Old estimate	8.4%	8.5%	8.3%
New estimate	8.1%	8.3%	8.3%
% change	-4%	-2%	0%
HSBC net income			
Old estimate	(85)	22	43
New estimate	(125)	9	49
% change	-47%	-59%	12%
HSBC EPS (BRL)			
Old estimate	-0.25	0.06	0.13
New estimate	-0.36	0.03	0.14
% change	-47%	-59%	12%
FX average (BRL/USD)			
Old estimate	1.93	2.04	2.15
New estimate	1.93	2.04	2.15
% change	0%	0%	0%

Source: HSBC

Financials & valuation: Marfrig SA

Neutral (V)

Financial statements

Year to December	12/2011a	12/2012e	12/2013e	12/2014e
Profit & loss summary (BRLm)				
Revenue	21,885	23,318	26,279	28,935
EBITDA	1,600	1,879	2,190	2,402
Depreciation & amortisation	-742	-757	-785	-835
Operating profit/EBIT	858	1,122	1,406	1,567
Net interest	-1,528	-1,392	-1,396	-1,495
PBT	-1,277	-113	-179	-119
HSBC PBT	-670	-269	10	72
Taxation	530	84	61	41
Net profit	-746	-23	-116	-77
HSBC net profit	-345	-125	9	49
Cash flow summary (BRLm)				
Cash flow from operations	764	567	560	783
Capex	-913	-859	-972	-1,100
Cash flow from investment	-947	-469	-972	-1,100
Dividends	-62	-15	0	0
Change in net debt	2,375	337	885	793
FCF equity	-819	-476	-277	-188
Balance sheet summary (BRLm)				
Intangible fixed assets	4,355	4,103	3,845	3,587
Tangible fixed assets	7,095	7,246	7,692	8,214
Current assets	9,360	9,947	10,299	10,487
Cash & others	3,478	3,847	3,435	3,119
Total assets	23,823	24,447	25,185	25,815
Operating liabilities	7,592	7,755	8,397	8,891
Gross debt	11,197	11,903	12,376	12,852
Net debt	7,719	8,056	8,940	9,733
Shareholders funds	3,274	2,861	2,486	2,148
Invested capital	9,740	9,694	10,003	10,278

Ratio, growth and per share analysis

Year to December	12/2011a	12/2012e	12/2013e	12/2014e
Y-o-y % change				
Revenue	37.8	6.5	12.7	10.1
EBITDA	6.5	17.5	16.5	9.7
Operating profit	-2.0	30.8	25.2	11.5
PBT				
HSBC EPS	-738.8			445.3
Ratios (%)				
Revenue/IC (x)	2.4	2.4	2.7	2.9
ROIC	5.5	3.0	9.4	10.2
ROE	-9.7	-4.1	0.3	2.1
ROA	1.6	1.5	3.6	3.8
EBITDA margin	7.3	8.1	8.3	8.3
Operating profit margin	3.9	4.8	5.3	5.4
EBITDA/net interest (x)	1.0	1.4	1.6	1.6
Net debt/equity	224.5	267.2	338.9	423.4
Net debt/EBITDA (x)	4.8	4.3	4.1	4.1
CF from operations/net debt	9.9	7.0	6.3	8.0
Per share data (BRL)				
EPS Rep (fully diluted)	-2.15	-0.07	-0.33	-0.22
HSBC EPS (fully diluted)	-1.00	-0.36	0.03	0.14
DPS	0.04	0.00	0.00	0.00
Book value	9.44	8.25	7.17	6.20

Valuation data

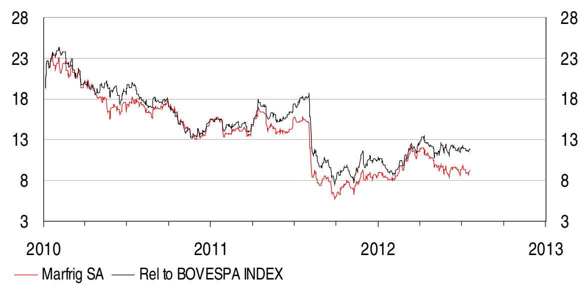
Year to December	12/2011a	12/2012e	12/2013e	12/2014e
EV/sales	0.6	0.6	0.6	0.5
EV/EBITDA	8.4	7.3	6.7	6.4
EV/IC	1.4	1.4	1.5	1.5
PE*			358.0	65.7
P/Book value	1.0	1.1	1.3	1.5
FCF yield (%)	-14.3	-8.3	-4.8	-3.3
Dividend yield (%)	0.5	0.0	0.0	0.0

Note: * = Based on HSBC EPS (fully diluted)

Issuer information

Share price	(BRL)9.26	Target price	(BRL)10.50
Reuters (Equity)	MRFG3.SA	Bloomberg (Equity)	MRFG3 BZ
Market cap (USDm)	1,544	Market cap (BRLm)	3,129
Free float (%)	57	Enterprise value (BRLm)	13786
Country	Brazil	Sector	Food Products
Analyst	Pedro Herrera	Contact	+1 212 525 5126

Price relative



Source: HSBC

Note: price at close of 19 Jul 2012

HSBC

Minerva (BEEF3 BZ)

- Minerva should be unaffected by the spike in grain prices, as it is primarily a beef company with operations mostly in Brazil
- We remain bullish on the Brazil beef platform, as cattle prices remain stable; the weaker BRL is a huge positive for Minerva, which derives 65% of revenues from exports
- We rate Minerva shares Overweight with target prices of BRL9.50 on BEEF3 and USD18.50 on the MRVSY ADRs

Investment summary

Minerva has almost no exposure to grains. About 97% of its consolidated revenues are derived from its beef platform in South America (mostly Brazil), and thus should be largely unaffected by the recent spike in commodity prices. We remain bullish on the Brazil beef platform, and we expect the country's cattle herd to continue growing steadily during the next couple of years as the record-high calf production of previous years matures. In addition, increased cow slaughtering should increase supply and benefit producers. At the same time, the industry today is much more consolidated than it was before the 2008 global financial crisis, and we see little need for irrational behavior from market players. As Minerva is mostly a pure beef play and mainly exposed to Brazil, we continue to view the stock as an attractive investment opportunity.

The weaker BRL should boost export profitability. Exports account for c65% of the company's consolidated revenues, with most of its costs BRL-denominated. Although 77% of gross debt is USD-denominated, we estimate that half of that is protected via FX hedges. Higher EBITDA margins and an efficient cash-cycle management should more than offset increased leverage metrics in the short term.

No effect from commodity prices

As Minerva is a mostly beef company with no exposure to grains, the recent spike in grain prices will have no impact on the company's margins. The only exposure that Minerva has to other proteins is via its processed-food joint venture, Minerva Dawn Farms (MDF). However, this entity represents as little as c3% of consolidated net revenues. In addition, the MDF products are mostly processed, with grains accounting for a small portion of costs (versus fresh poultry and pork) and thus easier to adjust prices to manage higher costs.

Brazil beef remains solid

Brazilian live-cattle prices remain stable to slightly lower. Since the last peak near cBRL110 per arroba in November 2011, prices have dropped c18%. The decline was due to market

28. Minerva: 2Q12 earnings preview

(BRLm)	Consensus	HSBC 2Q12e	2Q11	y-o-y
Net Sales	1,123	1,131	940	20.2%
EBITDA	101	108	80	35.1%
EBITDA margin	9.0%	9.5%	8.5%	100bps
Net Income	(45)	(90)	(2)	NM
EPS*	(0.44)	(0.87)	(0.01)	NM

Source: HSBC estimates, Bloomberg consensus. *EPS estimate based on consensus net income

expectations of stable and adequate supplies for at least the next couple of years, a reversal of the situation since the end of 2009.

These expectations are based on two factors. First, the record-high calf production of last year (almost 50m head in 2011) maturing, boosting the supply of animals by 5% in 2012. Second, increased cow slaughtering, as breeding costs (eg feed and leasing rates) have increased faster than calf prices, and thus farmers are profiting from selling females as feeder cattle. We believe there is strong evidence supporting a further and sustainable drop in cattle prices.

The industry is more consolidated today than it was in mid-2008, when several producers shut down operations due to the global financial crisis. We estimate that the three largest players now account for c30% of total slaughtering and c80% of Brazilian exports. In addition, most of industry's idle capacity (c30%) should not be back on line anytime soon due to lack of environmental and export licenses, scarce labor resources, and poor access to credit and working capital financing.

In addition, greenfield units usually take at least a couple of years to begin to operate efficiently. We regard the weakness in the BRL as a major positive factor, as it will accentuate Brazilian exporters' cost advantages over US beef producers, which have been struggling with a shrinking herd. We view Brazilian beef exporters as well-positioned to regain the market share they lost in the past few months.

The weak BRL is a huge positive

We expect the weaker BRL to extend Brazilian beef's cost advantages in export markets. HSBC's Latin America FX strategy team forecasts the currency rates for end-2012 and end-2013 at BRL2.00/USD and BRL2.10/USD, respectively. We believe this represents a major positive factor for Minerva as the bulk of its costs are denominated in BRL, while exports represent c65% of revenues. Although 77% of gross debt is USD-denominated, we estimate half of that to be protected via FX hedges. Higher EBITDA margins and efficient cash-cycle management should more than offset increased leverage metrics in the short term.

Preview of 2Q12 results

We expect Minerva to report 2Q12 results on 9 August 2012. We estimate net sales will rise 20% y-o-y to BRL1.13bn, reflecting a significant recovery in fresh beef exports in the quarter. We estimate y-o-y increases of 15% in volumes and 21% in average export prices, strictly due to the weaker currency (we estimate flat prices in USD terms). Moreover, we expect live cattle exports remained strong and will post a significant increase from year-earlier levels (yet almost flat with 1Q12). On the domestic front, we estimate a 12% drop in fresh beef volumes, as Minerva is switching to exports that are currently more profitable. However, domestic beef prices should increase 6% y-o-y.

We estimate EBITDA at BRL108m for 2Q12, a solid c35% increase y-o-y, reflecting the continuing declines in Brazilian cattle prices of 3% q-o-q and 7% from a year earlier, and increasing exports' profitability. We remind investors that Minerva is mostly a Brazilian beef producer and thus is the most leveraged to the positive equation of lower cattle prices and the weaker BRL; c65% of its revenues come from exports, and most of the costs are denominated in local currency. In addition, MDF operations continue to ramp up nicely, in our view, and are already adding to the company's consolidated margin. We estimate a 9.5% EBITDA margin for 2Q12, up 100bps y-o-y.

However, we forecast a net loss of BRL90m for the second quarter due to cBRL145m in noncash losses on Minerva's foreign currency-denominated debt (77% of the total). Excluding these, the bottom line would have shown an increase of cBRL8m, driven by the increased top line and better operating margins. We estimate that net debt-to-EBITDA in 2Q12 deteriorated slightly to 4.0x from 3.9x in the previous quarter, again due to translation impacts on the company's gross debt.

Valuation and risks

In this report, we are making no changes to our Minerva estimates, as we believe the company will be unaffected by the current commodity price environment.

We value the company using an average of a DCF methodology and a target EV/EBITDA multiple. We are extending our valuation to end-June 2013. For our DCF metrics, we use an 11% cost of equity, a debt-to-equity ratio of 40:60, and a pretax cost of debt of 12%. This leads to a WACC of 9.8%. We use a terminal growth rate of 3%. Based on our DCF methodology, we arrive at a value of BRL10.30 per share.

To arrive at an appropriate EV/EBITDA multiple for the company, we take into account peer averages and Minerva's historical multiples. The stock has traditionally traded at a significant discount to its peers primarily due to its limited geographic diversification, lower exposure to processed products, lack of protein diversification, and lower liquidity. We use a 5.5x EV/EBITDA multiple to our 12-month EBITDA estimate to arrive at a BRL8.70 value per share.

Using a 50-50 weighted average between the DCF valuation and the value derived using the EV/EBITDA multiple, we arrive at our unchanged target price on BEEF3 shares of BRL9.50. Based on the HSBC FX team's forecast of a BRL2.05/USD exchange rate at end-June 2013, we arrive at our target price on MRVSY ADRs of USD18.50, also unchanged.

Under our research model, for stocks without a volatility indicator, the Neutral band is 5ppt above and below our hurdle rate for Brazilian stocks of 11%. At the time we set our BRL9.50 target price, it implied a potential return that was above the Neutral band; thus, we have an Overweight rating. Potential return equals the percentage difference between the current share price and the target price, including the forecast dividend yield when indicated.

Downside risks

Downside risks, we believe, include a volatile BRL and higher live-cattle prices, global trade dynamics, sanitary issues (eg foot-and-mouth disease), market protectionist measures such as import quotas and tariffs, and potential dilution from the conversion of debentures.

HSBC

Financials & valuation: Minerva

Overweight

Financial statements

Year to December	12/2011a	12/2012e	12/2013e	12/2014e
Profit & loss summary (BRLm)				
Revenue	3,977	4,705	5,255	5,827
EBITDA	347	463	534	570
Depreciation & amortisation	-45	-51	-56	-63
Operating profit/EBIT	302	412	477	507
Net interest	-273	-332	-271	-262
PBT	-92	-77	125	162
HSBC PBT	29	80	206	245
Taxation	134	7	-31	-41
Net profit	46	-70	94	122
HSBC net profit	114	76	148	177
Cash flow summary (BRLm)				
Cash flow from operations	4	301	199	251
Capex	-161	-119	-131	-181
Cash flow from investment	-331	-143	-131	-181
Dividends	-7	-29	0	-23
Change in net debt	232	145	29	50
FCF equity	-52	117	70	66
Balance sheet summary (BRLm)				
Intangible fixed assets	340	340	340	340
Tangible fixed assets	1,115	1,183	1,258	1,375
Current assets	1,703	2,016	2,171	2,320
Cash & others	746	1,015	1,083	1,129
Total assets	3,527	3,930	4,163	4,426
Operating liabilities	695	769	811	879
Gross debt	2,036	2,449	2,546	2,643
Net debt	1,290	1,435	1,463	1,514
Shareholders funds	720	636	730	828
Invested capital	1,716	1,755	1,875	2,028

Ratio, growth and per share analysis

Year to December	12/2011a	12/2012e	12/2013e	12/2014e
Y-o-y % change				
Revenue	16.7	18.3	11.7	10.9
EBITDA	30.4	33.3	15.3	6.8
Operating profit	27.2	36.5	15.9	6.2
PBT				30.1
HSBC EPS	343.3	-33.7	94.6	19.3
Ratios (%)				
Revenue/IC (x)	2.5	2.7	2.9	3.0
ROIC	-8.6	21.5	19.7	19.5
ROE	18.6	11.2	21.7	22.7
ROA	-3.6	7.8	8.8	8.8
EBITDA margin	8.7	9.8	10.2	9.8
Operating profit margin	7.6	8.8	9.1	8.7
EBITDA/net interest (x)	1.3	1.4	2.0	2.2
Net debt/equity	161.9	201.6	181.7	167.4
Net debt/EBITDA (x)	3.7	3.1	2.7	2.7
CF from operations/net debt	0.3	21.0	13.6	16.6
Per share data (BRL)				
EPS Rep (fully diluted)	0.45	-0.68	0.91	1.18
HSBC EPS (fully diluted)	1.11	0.74	1.44	1.72
DPS	0.06	0.29	0.00	0.23
Book value	7.04	6.16	7.07	8.02

Valuation data

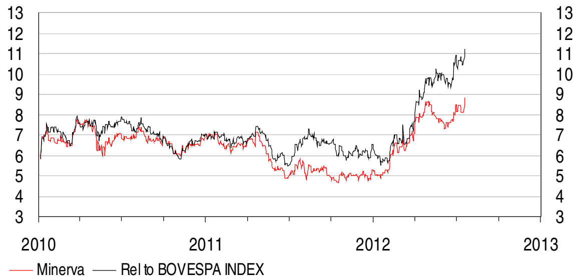
Year to December	12/2011a	12/2012e	12/2013e	12/2014e
EV/sales	0.6	0.5	0.5	0.4
EV/EBITDA	6.6	5.3	4.6	4.4
EV/IC	1.3	1.4	1.3	1.2
PE*	7.9	12.0	6.2	5.2
P/Book value	1.3	1.4	1.3	1.1
FCF yield (%)	-5.2	11.6	6.9	6.6
Dividend yield (%)	0.7	3.2	0.0	2.6

Note: * = Based on HSBC EPS (fully diluted)

Issuer information

Share price	(BRL)8.85	Target price	(BRL)9.50
Reuters (Equity)	BEEF3.SA	Bloomberg (Equity)	BEEF3 BZ
Market cap (USDm)	460	Market cap (BRLm)	932
Free float (%)	33	Enterprise value (BRLm)	2443
Country	Brazil	Sector	Food Products
Analyst	Pedro Herrera	Contact	+1 212 525 5126

Price relative



Source: HSBC

Note: price at close of 19 Jul 2012

Stated accounts as of 31 Dec 2010 are IFRS compliant

Disclosure appendix

Analyst Certification

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HSBC believes an investor's decision to buy or sell a stock should depend on individual circumstances such as the investor's existing holdings and other considerations. Different securities firms use a variety of ratings terms as well as different rating systems to describe their recommendations. Investors should carefully read the definitions of the ratings used in each research report. In addition, because research reports contain more complete information concerning the analysts' views, investors should carefully read the entire research report and should not infer its contents from the rating. In any case, ratings should not be used or relied on in isolation as investment advice.

Rating definitions for long-term investment opportunities

Stock ratings

HSBC assigns ratings to its stocks in this sector on the following basis:

For each stock we set a required rate of return calculated from the cost of equity for that stock's domestic or, as appropriate, regional market established by our strategy team. The price target for a stock represents the value the analyst expects the stock to reach over our performance horizon. The performance horizon is 12 months. For a stock to be classified as Overweight, the potential return, which equals the percentage difference between the current share price and the target price, including the forecast dividend yield when indicated, must exceed the required return by at least 5 percentage points over the next 12 months (or 10 percentage points for a stock classified as Volatile*). For a stock to be classified as Underweight, the stock must be

expected to underperform its required return by at least 5 percentage points over the next 12 months (or 10 percentage points for a stock classified as Volatile*). Stocks between these bands are classified as Neutral.

Our ratings are re-calibrated against these bands at the time of any 'material change' (initiation of coverage, change of volatility status or change in price target). Notwithstanding this, and although ratings are subject to ongoing management review, expected returns will be permitted to move outside the bands as a result of normal share price fluctuations without necessarily triggering a rating change.

*A stock will be classified as volatile if its historical volatility has exceeded 40%, if the stock has been listed for less than 12 months (unless it is in an industry or sector where volatility is low) or if the analyst expects significant volatility. However, stocks which we do not consider volatile may in fact also behave in such a way. Historical volatility is defined as the past month's average of the daily 365-day moving average volatilities. In order to avoid misleadingly frequent changes in rating, however, volatility has to move 2.5 percentage points past the 40% benchmark in either direction for a stock's status to change.

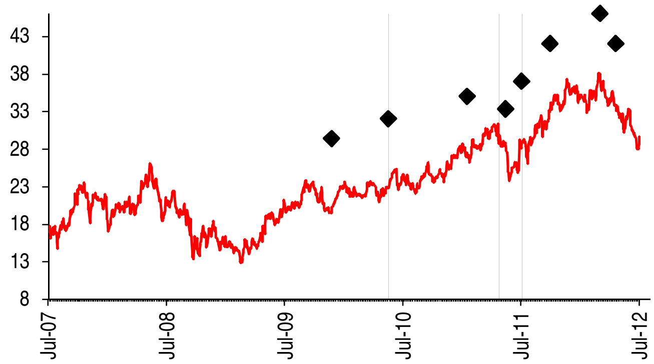
Rating distribution for long-term investment opportunities

As of 20 July 2012, the distribution of all ratings published is as follows:

Overweight (Buy)	50%	(27% of these provided with Investment Banking Services)
Neutral (Hold)	37%	(26% of these provided with Investment Banking Services)
Underweight (Sell)	13%	(18% of these provided with Investment Banking Services)

Share price and rating changes for long-term investment opportunities

Brasil Foods SA (BRFS3.SA) Share Price performance BRL Vs HSBC rating history



Source: HSBC

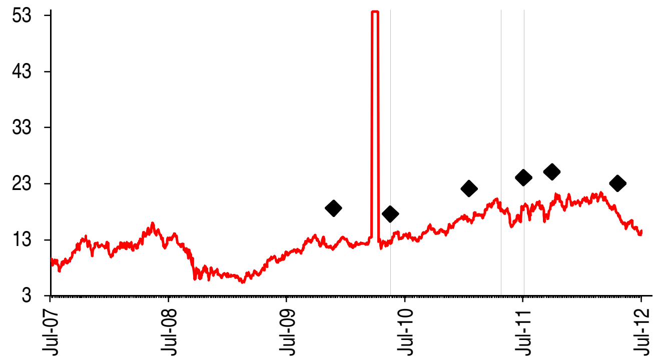
Recommendation & price target history

From	To	Date
Overweight (V)	Overweight	04 June 2010
Overweight	Neutral	11 May 2011
Neutral	Overweight	21 July 2011
Target Price	**Value**	**Date**
Price 1	29.37	11 December 2009
Price 2	32.00	04 June 2010
Price 3	35.00	03 February 2011
Price 4	33.30	01 June 2011
Price 5	37.00	21 July 2011
Price 6	42.00	17 October 2011
Price 7	46.00	20 March 2012
Price 8	42.00	07 May 2012

Source: HSBC

HSBC

Brasil Foods SA (BRFS.N) Share Price performance USD Vs HSBC rating history



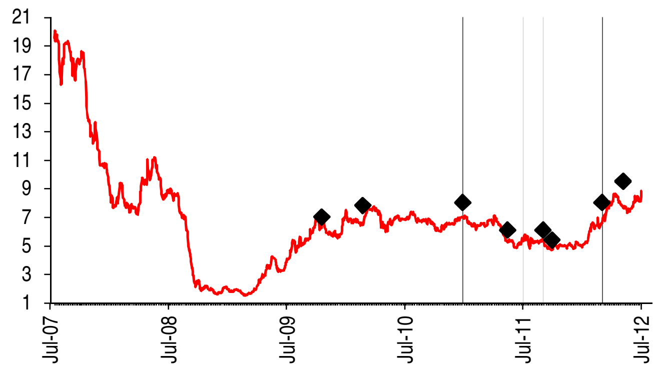
Source: HSBC

Recommendation & price target history

From	To	Date
Overweight (V)	Overweight	04 June 2010
Overweight	Neutral	11 May 2011
Neutral	Overweight	21 July 2011
Target Price	**Value**	**Date**
Price 1	18.56	11 December 2009
Price 2	17.50	04 June 2010
Price 3	22.00	03 February 2011
Price 4	24.00	21 July 2011
Price 5	25.00	17 October 2011
Price 6	23.00	07 May 2012

Source: HSBC

Minerva (BEEF3.SA) Share Price performance BRL Vs HSBC rating history



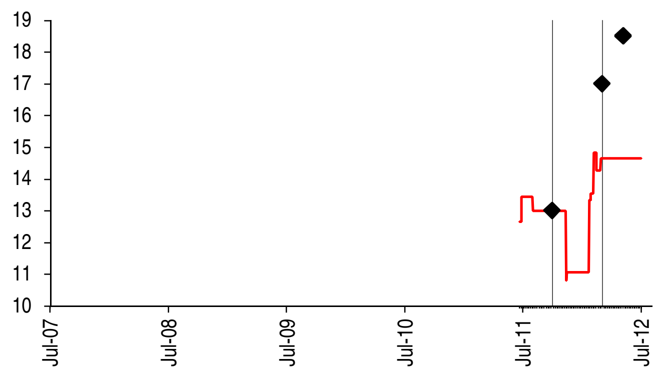
Source: HSBC

Recommendation & price target history

From	To	Date
Neutral (V)	Neutral	14 January 2011
Neutral	Restricted	19 July 2011
Restricted	Neutral	19 September 2011
Neutral	Overweight	20 March 2012
Target Price	**Value**	**Date**
Price 1	7.00	04 November 2009
Price 2	7.80	11 March 2010
Price 3	8.00	14 January 2011
Price 4	6.10	01 June 2011
Price 5	Restricted	19 July 2011
Price 6	6.10	19 September 2011
Price 7	5.40	17 October 2011
Price 8	8.00	20 March 2012
Price 9	9.50	24 May 2012

Source: HSBC

Minerva (MRVSY.PK) Share Price performance USD Vs HSBC rating history



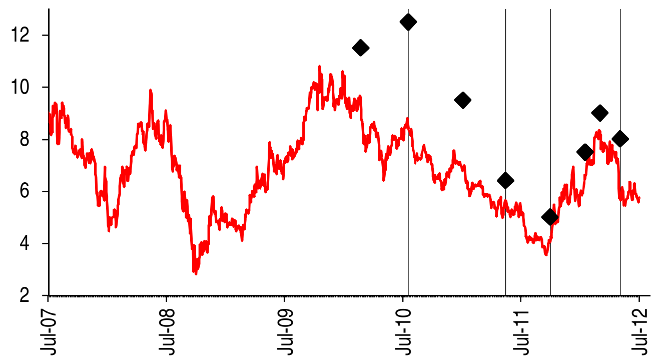
Source: HSBC

Recommendation & price target history

From	To	Date
N/A	Neutral	17 October 2011
Neutral	Overweight	20 March 2012
Target Price	**Value**	**Date**
Price 1	13.00	17 October 2011
Price 2	17.00	20 March 2012
Price 3	18.50	24 May 2012

Source: HSBC

JBS (JBSS3.SA) Share Price performance BRL Vs HSBC rating history



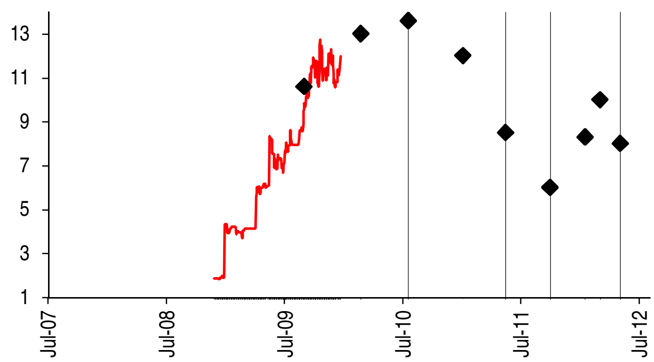
Source: HSBC

Recommendation & price target history

From	To	Date
Neutral (V)	Overweight (V)	05 August 2010
Overweight (V)	Neutral	01 June 2011
Neutral	Neutral (V)	17 October 2011
Neutral (V)	Overweight (V)	21 May 2012
Target Price	**Value**	**Date**
Price 1	11.50	11 March 2010
Price 2	12.50	05 August 2010
Price 3	9.50	21 January 2011
Price 4	6.40	01 June 2011
Price 5	5.00	17 October 2011
Price 6	7.50	02 February 2012
Price 7	9.00	20 March 2012
Price 8	8.00	21 May 2012

Source: HSBC

JBS (JBSAY.PK) Share Price performance USD Vs HSBC rating history



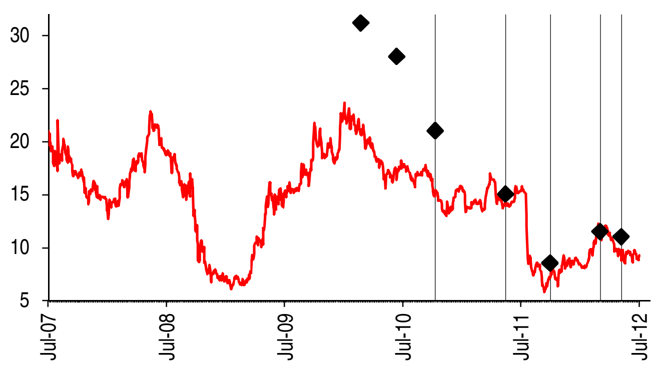
Source: HSBC

Recommendation & price target history

From	To	Date
Neutral (V)	Overweight (V)	05 August 2010
Overweight (V)	Neutral	01 June 2011
Neutral	Neutral (V)	17 October 2011
Neutral (V)	Overweight (V)	21 May 2012
Target Price	**Value**	**Date**
Price 1	10.60	17 September 2009
Price 2	13.00	11 March 2010
Price 3	13.60	05 August 2010
Price 4	12.00	21 January 2011
Price 5	8.50	01 June 2011
Price 6	6.00	17 October 2011
Price 7	8.30	02 February 2012
Price 8	10.00	20 March 2012
Price 9	8.00	21 May 2012

Source: HSBC

Marfrig SA (MRFG3.SA) Share Price performance BRL Vs HSBC rating history



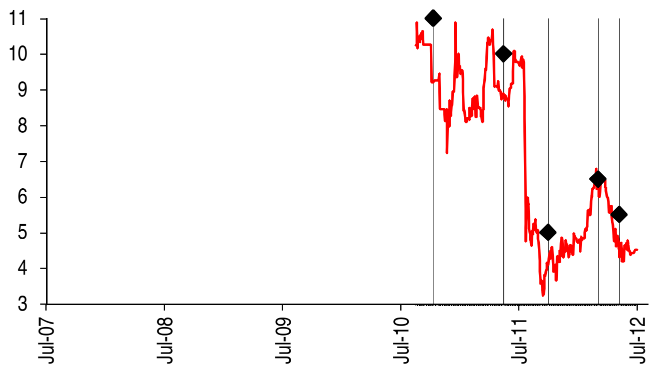
Source: HSBC

Recommendation & price target history

From	To	Date
Overweight (V)	Overweight	27 October 2010
Overweight	Underweight	01 June 2011
Underweight	Neutral (V)	17 October 2011
Neutral (V)	Underweight (V)	20 March 2012
Underweight (V)	Neutral (V)	24 May 2012
Target Price	**Value**	**Date**
Price 1	31.19	11 March 2010
Price 2	28.00	29 June 2010
Price 3	21.00	27 October 2010
Price 4	15.00	01 June 2011
Price 5	8.50	17 October 2011
Price 6	11.50	20 March 2012
Price 7	11.00	24 May 2012

Source: HSBC

Marfrig SA (MRRTY.PK) Share Price performance USD Vs HSBC rating history



Source: HSBC

Recommendation & price target history

From	To	Date
N/A	Overweight	27 October 2010
Overweight	Underweight	01 June 2011
Underweight	Neutral (V)	17 October 2011
Neutral (V)	Underweight (V)	20 March 2012
Underweight (V)	Neutral (V)	24 May 2012
Target Price	**Value**	**Date**
Price 1	11.00	27 October 2010
Price 2	10.00	01 June 2011
Price 3	5.00	17 October 2011
Price 4	6.50	20 March 2012
Price 5	5.50	24 May 2012

Source: HSBC

HSBC & Analyst disclosures

Disclosure checklist

Company	Ticker	Recent price	Price Date	Disclosure
BRASIL FOODS SA	BRFS3.SA	29.65	20-Jul-2012	1,2,4,5,6,7
JBS	JBSS3.SA	5.75	19-Jul-2012	7,11
MARFRIG	MRFG3.SA	9.26	20-Jul-2012	7,11
MINERVA	BEEF3.SA	8.85	20-Jul-2012	11

Source: HSBC

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