

# Classical Insights -- Emerging Markets

Global Investment Analysis Based on the Classical Economic Model

## Classical Insights Emerging Market Bullet Points April 23, 2009

### BEEF3 BS -- 2.49

all data in Brazilian reals

#### Sales and earnings

	2008	2009e	2010e	2011e
Sales (BRL mln)	2121	2503	2753	3028
Sales growth		18%	10%	10%
EPS	(2.87)	1.96	1.89	2.30
Cash flow	(2.58)	2.36	2.32	2.75
FCF	(7.26)	1.36	1.65	2.08
Cons. EPS		1.09	1.26	2.00

#### Target price & valuation data

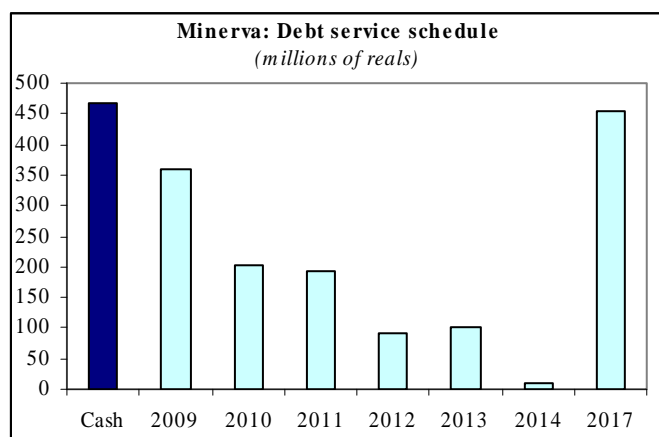
Our 12-mo. target	11.49	(based on 5x 2011 EPS)	
Upside to target	361%		
Mkt cap (BRL mln)	187	Enterprise value	1,130
P/sales (2009e)	0.07	EV/sales (2009e)	0.45
P/E (2009e)	1.3	EV/EBITDA (2009e)	3.3
P/E (2010e)	1.3	EV/EBITDA (2010e)	3.4
P/E (2011e)	1.1	EV/EBITDA (2011e)	3.1

cash flow defined simply as EPS + depreciation. FCF defined as cash flow - capex.

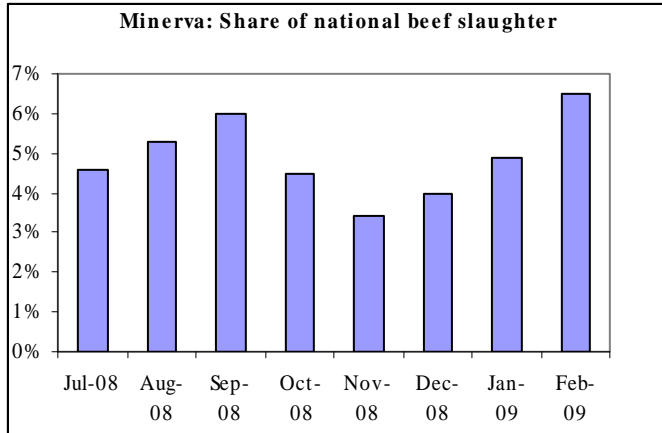
**Brazil's third-largest beef exporter, Minerva S.A., will sell \$1 billion of beef this year yet its market cap is just \$84 million.** Minerva is one of the cheapest stocks in Brazil on both a P/E and P/sales basis – chiefly because it is very highly levered. The firm took on 800 million reals in debt last year for acquisitions and expansion and then got whacked with huge forex losses when the real tumbled in Q4. (Operationally, however, the firm never went into the red.)

Now, though, things are looking up on a variety of fronts and Minerva shares appear very attractive. We will be adding BEEF3 BS to the EM portfolio. Points:

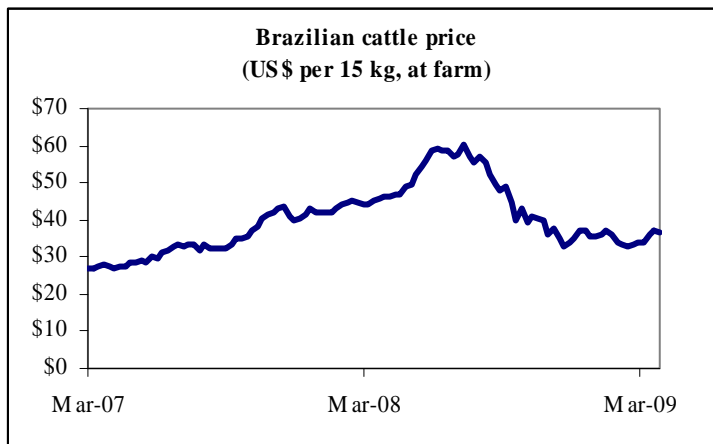
1) The debt is readily serviceable. Most of it is long term and Minerva has enough cash to cover the short-term portion. Management is in the process of restructuring the debt to push the maturities out some. Helping in this regard was last week's move by the Brazilian National Monetary Council to make available 10 billion reals of loans to the meat processing industry.



2) Business turned up sharply in March. Production rose 20% MoM to meet rising export demand, and capacity utilization is now back close to the historical norm of 80%. For the Brazilian beef industry as a whole, March export volumes rose 24% MoM. Minerva's share of the national slaughter rose back to 6.5% in February, according to the firm:



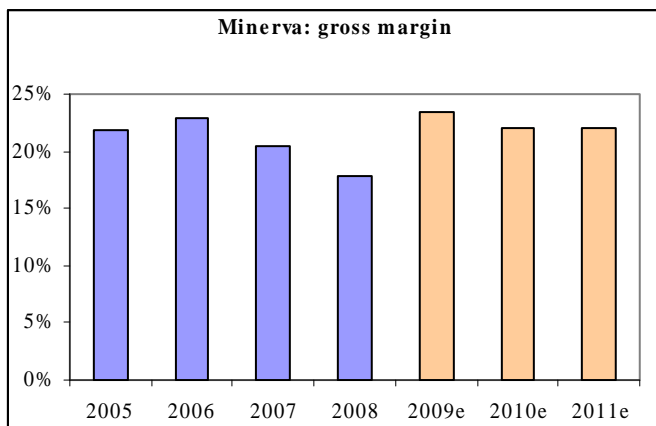
3) Input costs are down. The Brazilian cattle price (the cost for the processors to buy cattle) is down 40% from its peak last August in US\$ terms (and down 15% in BRL terms):



Source: Bloomberg, CEPEA

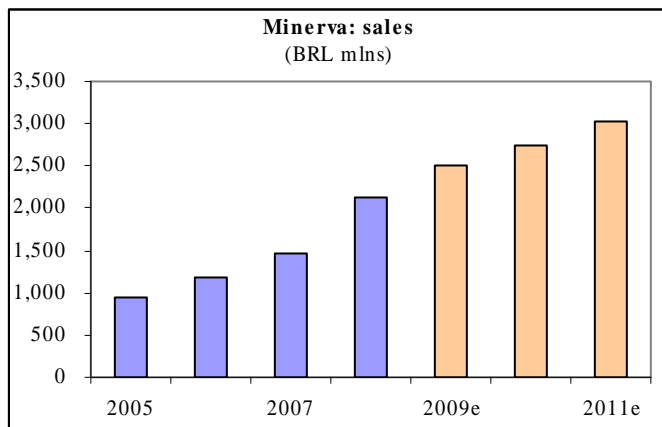
Another key point on pricing is that Brazilian cattle prices are now about 30% lower than US cattle prices now –roughly 3x the normal spread. This will help export margins (Minerva exports about 60% of its production).

4) Gross margins are almost surely expanding. This is the key to the story. We are modeling for a 23.5% gross margin this year, up from 17.9% in 2008, but only 2 points above the 2005-2007 average. For 2010 and 2011, we assume gross margin falls back to 22%, on higher cattle prices.

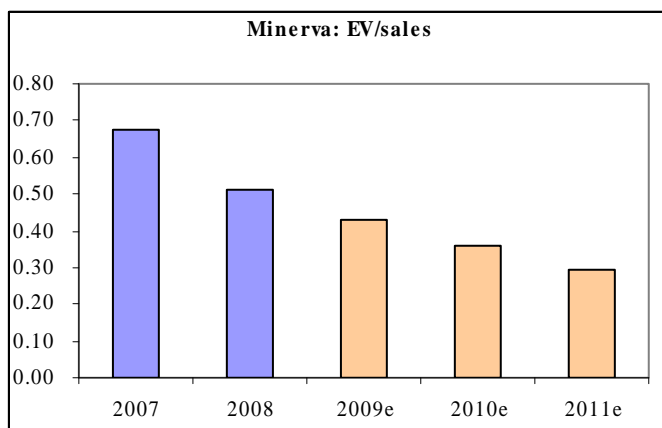


In reality, gross margins are very hard to forecast with any accuracy. It's conceivable that gross margin could be 25%+ given the plunge in domestic cattle prices in US\$ terms. One way to think of it is that higher margins are the flipside (or the consolation) for the big currency hit the firm took in Q4 2008.

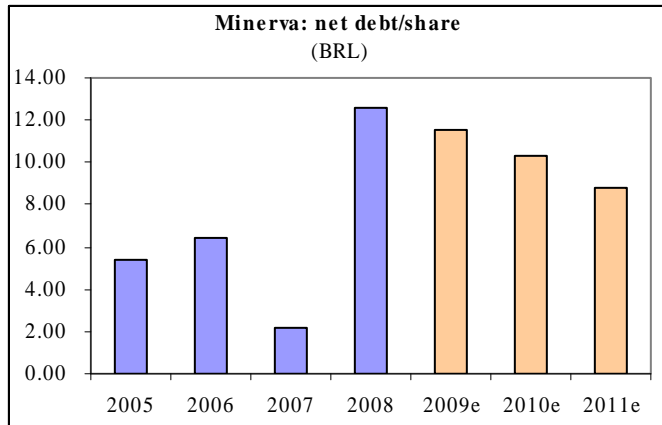
5) Sales are likely to keep climbing on acquisitions and organic growth. Last year, Minerva purchased Lord Meat and entered a joint venture to launch Dawn Minerva Farms. The Dawn Minerva plant was inaugurated in March of this year, and should boost company-wide production 20%. We are expecting 18% sales growth this year in BRL terms (with price weakness offsetting some of the volume gains) followed by 10% sales growth in 2010 and 2011 (as pricing rebounds a bit):



6) Minerva's EV/sales ratio has fallen with the share price – but it hasn't crashed (because the firm already had some net debt in 2007 and that net debt rose substantially in 2008). In our model, the EV/sales ratio falls to 0.36x in 2010 and 0.30x in 2011:



7) Minerva should be able to chip away at its debt in coming years, but we don't expect debt to plunge. Just *servicing* the debt is likely to eat up 25% of EBITDA, taxes will consume another 20%, and capex will take an additional 20% after that.



We've found that there is actually a silver lining to highly-indebted companies: You can be fairly sure of what they are going to do with their cash (pay down the debt). Minerva is likely to be disciplined in all aspects of its business until its balance sheet improves.

8) Valuation: We are setting a target price of 5x expected 2011 earnings, or 11.49 reals/share. Believe it or not, if Minerva shares were to rise to that level, the EV/sales ratio would still be just 0.72x. The leverage is so extreme on this company that even a quadrupling of the share price wouldn't change the overall enterprise value of the firm that much.

Risks: The top risk is the leverage. If the global economy were to fall into a double-dip recession and Minerva's EBITDA were to fail to recover, the firm might have trouble servicing its debt. Another issue is that earnings are very hard to predict with any accuracy. Minerva's price/sales ratio is lower than that of most *airlines* – and analysts routinely miss airline EPS estimates by \$5/share. Additionally, there is the ever-present risk that export markets could close to Brazilian beef due to health concerns.

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