

JBS S.A.

Company Overview

JBS S.A., formerly Friboi Ltda, is a Brazil-based company involved in the food processing sector. The Company is primarily engaged in animal slaughtering, the cold storage of beef, the production and sale of meat, meat by-products and canned food. JBS S.A. divides its food processing business into three segments: Cattle Meat, Pork Meat and Chicken Meat. In addition, the Company and its subsidiaries are involved in the leather tanning; aluminium cans production, industrial waste management and plastic resin manufacturing; bar soap and soap production for its own brands of cleaning and hygiene products; production of biodiesel, glycerine and fatty acid; retail sale of meat and barbecue related items; production and distribution of electric power, among others.

In June 2014, its wholly-owned subsidiary, JBS Foods SA, announced initial and secondary public offering of ordinary shares. In June 2014, it acquired a 100% of Comercio e Industria de Massas Alimenticias Massa Leve Ltd. and properties. In 2015, JBS acquired Moy Park, one of Europe's leading prepared food products and poultry producers, with 13 food processing and manufacturing units in the UK, France, Holland and Ireland and over 12 thousand employees. The acquisition represented an important step towards JBS' expansion strategy in Europe with integrated production focused on innovation and powerful brands. In 2015, JBS also acquired Cargill's pork business in the US, the transaction added to JBS USA Pork two hog processing facilities, five feed mills, and four breeding units. With the acquisition, JBS became the second largest pork producer in the USA.

Financial Analysis:

Table 1: Income Statement

US\$M	2008	2009	2010	2011	2012	2013	2014	2015	Sep-16
Revenue	16,839.52	17,699.91	31,318.94	37,024.58	38,902.16	43,216.83	51,324.75	49,646.80	36,429.96
- Cost of Revenue	15,178.61	16,107.87	27,474.03	33,012.44	34,436.27	37,705.94	43,369.17	42,762.60	32,055.55
Gross Profit	1,660.91	1,592.04	3,844.91	4,012.14	4,465.89	5,510.89	7,955.58	6,884.20	4,374.41
+ Other Operating Revenue	-	97.93	31.76			39.12			39.52
- Operating Expenses	1,274.09	1,192.37	2,575.98	2,945.31	3,068.18	3,620.15	4,631.05	4,104.85	2,978.32
Operating Income	386.81	497.60	1,300.68	1,066.83	1,397.71	1,929.86	3,324.52	2,779.35	1,435.61
- Interest Expense	307.13	305.08	1,132.61	1,037.09	878.09	1,007.40	1,349.30	1,045.48	702.93
- Foreign Exchange Losses (Gains)	--	(433.36)	(163.72)	295.00	321.96	637.29	805.98	2,811.19	722.10
- Net Non-Operating Losses (Gains)	32.64	421.86	294.08	(127.39)	(512.73)	(540.52)	(616.64)	(3,478.28)	1,425.05
Pretax Income	47.04	204.02	37.72	(137.87)	710.39	825.70	1,785.88	2,400.96	10.56
- Income Tax Expense (Benefit)	34.53	92.39	187.89	55.59	318.32	305.47	760.65	838.05	(76.90)
Income Before XO Items	12.51	111.62	(150.18)	(193.45)	392.07	520.23	1,025.23	1,562.91	87.46
- Extraordinary Loss Net of Tax									
- Minority Interests	(1.89)	(0.30)	22.04	(148.09)	22.59	89.04	157.85	148.88	80.46
Net Income	14.40	111.92	(172.22)	(45.36)	369.48	431.18	867.38	1,414.03	87.46

Source: Bloomberg, JMMBIR

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JBS S.A. reported net earnings of US\$87.45M for the 9 months ended September 2016 relative to net earnings of US\$1,414.03M for the year ended December 2016. The reduction in revenue was accompanied by increases in cost of revenue and operating expenses, which led to a fall in operating income. Notwithstanding, the co-movement between interest expense, foreign exchange losses and non-operating loss has influenced the fall off in net earnings for the period ended September 2016.

Table 2: Balance Sheet

US\$M	2008	2009	2010	2011	2012	2013	2014	2015	Sep-16
Assets									
+ Cash & Near Cash Items	990	2,909	2,448	1,206	952	1,995	3,162	2,721	1,333
+ Short-Term Investments	0 --	--		1,632	1,676	1,820	2,472	2,037	919
+ Accounts & Notes Receivable	964	1,838	2,352	2,512	2,777	3,776	3,619	3,060	2,875
+ Inventories	1,102	1,996	2,839	2,901	2,530	2,923	3,718	3,530	3,958
+ Other Current Assets	513	1,153	1,241	1,373	1,528	1,725	1,214	1,228	1,138
Total Current Assets	3,569	7,896	8,880	9,623	9,462	12,239	14,184	12,576	10,223
+ LT Investments & LT Receivables	31	676	686	545	126	117	112	89	1,217
+ Net Fixed Assets	2,125	8,619	9,168	8,253	7,912	8,864	9,105	9,211	10,152
+ Gross Fixed Assets	2,574 --		10,936	10,264	10,179	12,100	12,796	13,454	15,276
- Accumulated Depreciation	449 --		1,768	2,010	2,267	3,236	3,691	4,243	5,124
+ Other Long-Term Assets	1,230	8,004	8,091	7,022	6,789	7,847	7,597	8,864	9,365
Total Long-Term Assets	3,385	17,300	17,945	15,821	14,827	16,829	16,813	18,164	20,734
Total Assets	6,955	25,195	26,825	25,445	24,289	29,068	30,997	30,739	30,957
Liabilities & Shareholders' Equity									
+ Accounts Payable	898	1,462	1,710	1,784	1,740	2,261	2,623	3,136	3,882
+ Short-Term Borrowings	957	2,941	3,127	2,866	2,977	3,992	5,171	5,278	5,411
+ Other Short-Term Liabilities	275	939	998	930	915	1,243	1,601	1,611	251
Total Current Liabilities	2,130	5,342	5,834	5,579	5,632	7,496	9,395	10,025	9,545
+ Long-Term Borrowings	1,470	7,328	8,335	7,263	7,025	9,876	9,971	11,355	11,898
+ Other Long-Term Liabilities	706	1,532	1,394	1,010	1,169	1,904	1,942	1,961	1,731
Total Long-Term Liabilities	2,175	8,860	9,728	8,273	8,194	11,780	11,914	13,317	13,629
Total Liabilities	4,305	14,202	15,563	13,853	13,826	19,276	21,309	23,342	23,174
+ Total Preferred Equity	0	0	0	0	0	0	0	0	
+ Minority Interest	-1	943	663	502	402	500	668	402	364
+ Share Capital & APIC	1,942	9,462	10,871	11,542	10,499	9,104	8,125	6,006	6,818
+ Retained Earnings & Other Equity	708	588	-272	-452	-437	189	895	990	601
Total Equity	2,649	10,993	11,262	11,592	10,463	9,792	9,688	7,398	7,783
Total Liabilities & Equity	6,955	25,195	26,825	25,445	24,289	29,068	30,997	30,739	30,957

Source: Bloomberg, JMMBIR

Influenced by decreases in current assets, the asset base of the company has remained virtually flat by moving to US\$30,957M in September 2016 relative to December 2015. On the other hand, total liabilities declined by 0.7% during the same period on account of decreases in current liabilities. Amidst increases in share capital, shareholders' equity increased by 5.2% to close at US\$7,783M as at September 2016.

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Table 3: Cash Flow Statement

US\$M	2008	2009	2010	2011	2012	2013	2014	2015	Sep-16
Cash From Operating Activities									
+ Net Income	14.40	111.92	(172.22)	(45.36)	369.48	431.18	867.38	1,414.03	87
+ Depreciation & Amortization	235.03	243.30	697.59	773.73	829.32	948.42	1,085.03	1,125.36	946.13
+ Other Non-Cash Adjustments	636.65	432.84	(304.85)	195.45	113.56	652.63	1,678.51	2,968.44	(300.02)
+ Changes in Non-Cash Capital	(352.38)	(10.43)	(1,063.27)	(560.44)	(555.74)	(850.18)	197.91	954.62	(433.72)
Cash From Operations	533.70	777.64	(842.75)	363.38	756.62	1,182.05	3,828.82	6,462.46	219.40
Cash From Investing Activities									
+ Disposal of Fixed Assets									
+ Capital Expenditures	(686.95)	(921.56)	(715.27)	(703.25)	(832.24)	(808.17)	(1,520.72)	(4,833.09)	(684.01)
+ Increase in Investments									
+ Decrease in Investments									
+ Other Investing Activities	(957.70)	(2,000.81)	(192.34)	281.24	(128.94)	(78.43)	(301.38)	(1,750.51)	(163.89)
Cash From Investing Activities	(1,644.66)	(2,922.37)	(907.61)	(422.01)	(961.18)	(886.60)	(1,822.10)	(6,583.59)	(847.90)
Cash from Financing Activities									
+ Dividends Paid	(28.38)	(62.35)				(79.27)	(93.68)	(706.36)	(477.14)
+ Increase in Long-Term Borrowings	2,005.98	2,325.38	8,076.35	10,504.53	7,269.90	10,095.96	10,504.18	14,306.35	
+ Decrease In Long-Term Borrowings	(2,179.03)	(1,611.42)	(7,659.78)	(9,721.39)	(7,078.41)	(8,760.82)	(10,012.55)	(12,427.91)	(10.19)
+ Increase in Capital Stocks	1,415.46	1,281.57	910.17						
+ Decrease in Capital Stocks		(38.72)	(121.58)	(75.12)	(1.21)	(1.10)	(27.37)	(436.29)	(211.06)
+ Other Financing Activities	401.94	1,657.87	(25.76)	77.73	63.05	138.41	135.16	584.08	(1,700.37)
Cash from Financing Activities	1,615.98	3,552.34	1,179.40	785.75	253.33	1,393.19	505.75	1,319.85	(2,398.76)
Net Changes in Cash	505.02	1,407.61	(570.96)	727.12	48.77	1,822.83	2,512.47	1,198.72	(3,027.26)

Source: Bloomberg, JMMBIR

Cash flow from operating activities seemed to have waned over the past 9 months ended September 2016. This deterioration followed 5 years of consistent growth in cash generated from operating activities. From this standpoint, the company scaled down on capital expenditure over the same period. Notwithstanding, free cash flow has turned negative for 2016.

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Table 5: Ratio Analysis

	2008	2009	2010	2011	2012	2013	2014	2015	Sep-16	
Debt Ratios	Total Debt/EBIT	8.06	18.23	8.32	10.60	7.53	7.90	5.14	7.22	8.84
	Net Debt/EBIT	4.77	13.07	6.54	7.63	5.55	5.72	3.23	5.16	7.69
	EBITDA to Interest Expense	2.02	2.43	1.76	1.77	2.54	2.86	3.27	3.73	3.15
	EBITDA-CapEx/Interest Expense	-0.21	-0.59	1.13	1.10	1.59	2.05	2.14	-0.89	2.15
	EBIT to Interest Expense	1.26	1.63	1.15	1.03	1.59	1.92	2.46	2.66	2.09
	Common Equity/Total Assets	38.11	39.89	39.51	43.58	41.42	31.97	29.10	22.76	24.0
	Long-Term Debt/Equity	55.48	66.66	74.01	62.66	67.14	100.85	102.92	153.49	152.9
	Long-Term Debt/Capital	28.95	34.47	36.68	33.44	34.33	41.74	40.16	47.25	47.4
	Long-Term Debt/Total Assets	21.13	29.09	31.07	28.55	28.92	33.97	32.17	36.94	38.4
	Total Debt/Equity	91.59	93.41	101.78	87.38	95.59	141.62	156.30	224.85	222.41
	Total Debt/Capital	47.81	48.30	50.44	46.63	48.87	58.61	60.98	69.22	68.98
	Total Debt/Total Assets	34.89	40.76	42.73	39.81	41.18	47.71	48.85	54.11	55.91
	Net Debt/Equity	54.22	66.95	80.04	62.90	70.48	102.66	98.15	160.53	193.47
Net Debt/Capital	28.30	34.62	39.67	33.57	36.03	42.49	38.30	49.42	65.93	
Liquidity	Cash Ratio	0.46	0.54	0.42	0.51	0.47	0.51	0.60	0.47	0.24
	Current Ratio	1.68	1.48	1.52	1.72	1.68	1.63	1.51	1.25	1.07
	Quick Ratio	0.92	0.89	0.82	0.96	0.96	1.01	0.98	0.78	0.54
	CFO/Avg Current Liab	0.22	0.22	-0.16	0.06	0.13	0.17	0.42	0.66	0.11
	CFO/Total Liabilities	9.65	6.20	-5.73	2.35	5.20	5.58	15.93	22.94	2.44
CFO/CapEx	0.78	0.84	-1.18	0.52	0.91	1.46	2.52	1.34	1.83	
Profitability	Return on Common Equity	0.56	1.87	-1.73	-0.40	3.48	4.36	8.89	17.99	-2.14
	Return on Assets	0.21	0.74	-0.68	-0.16	1.48	1.57	2.70	4.55	-0.53
	Return on Capital	1.83	2.25	-21.92		4.14	5.08	6.95	9.15	2.47
	Return on Invested Capital	2.00	2.20	-24.36		3.65	5.36	7.37	7.15	3.77
	Gross Margin	9.86	8.99	12.28	10.84	11.48	12.75	15.50	13.87	12.98
	EBITDA Margin	3.69	4.19	6.38	4.97	5.72	6.66	8.59	7.87	7.66
	Operating Margin	2.30	2.81	4.15	2.88	3.59	4.47	6.48	5.60	5.08
	Pretax Margin	2.28	6.23	6.48		6.76	8.30	13.26	3.10	1.76
	Income before XO Margin	0.28	1.15	0.12	-0.37	1.83	1.91	3.48	4.84	2.32
Net Income Margin	0.07	0.63	-0.48	-0.52	1.01	1.20	2.00	3.15	2.16	
Working Capital	Accounts Receivable Turnover	17.50	12.85	15.50	14.40	14.60	12.72	13.03	15.02	15.70
	Days Sales Outstanding	20.92	28.41	23.55	25.35	25.07	28.70	28.02	24.31	23.31
	Inventory Turnover	13.47	10.54	11.80	10.89	12.66	13.41	12.16	11.78	11.28
	Days Inventory Outstanding	27.18	34.62	30.94	33.51	28.92	27.21	30.02	30.98	32.46
	Accounts Payable Turnover	17.87	14.14	18.40	18.11	19.39	18.59	17.05	14.92	14.90
	Days Payables Outstanding	20.48	25.81	19.84	20.16	18.87	19.64	21.41	24.46	24.56
	Cash Conversion Cycle	27.61	37.22	34.66	38.71	35.11	36.27	36.64	30.83	31.21

Source: Bloomberg, JMMBIR

The level of indebtedness has remained elevated over the review period amidst expansion efforts. With the increase in debt, the company was able to maintain liquidity levels during the review period. Notwithstanding, there has been a slight deterioration in the liquidity level during 2016. Similarly, the profitability has waned somewhat. There have been some improvements in the cash conversion cycle, which indicates management's ability to effectively manage its working capital.

JBS S.A.

In December 2016 the Brazilian food maker JBS SA, the world's largest beef processor, announced plans to launch shares of its subsidiary JBS Foods International B.V. in the United States in the first half of 2017 as a part of a larger reorganization. Under the plan, the unit currently based in the Netherlands would be responsible for managing all of the company's international operations, with parent company JBS SA maintaining management of beef operations in Brazil.

Standard and Poor's Credit view on JBS S.A:

Standard and Poor's expects an improvement in JBS' consolidated margins and cash flows amid better conditions in the U.S. beef market and the group's resilient U.S. pork and poultry and its beef operations. Further, weaker global prices for meat prevent JBS's free operating cash flow (FOCF) from improving in 2016. Notwithstanding, the group could maintain consolidated margins above 7% in 2017 and improve its liquidity position with gradual incremental cash flows.

On Oct. 25, 2016, JBS' minority shareholder Banco Nacional de Desenvolvimento Economico (BNDES) vetoed the group's reorganization proposal. This action highlights the balance of power arrangement among JBS shareholders. Notwithstanding, the shareholders agreement will expire in 2019. From the viewpoint of Standard and Poor's, this event is credit neutral because the reorganization would not change asset or cash flow allocation.

Standard and Poor's expects JBS's operating efficiency to recover in 2017 against the background of a reduction in raw material prices (grain in Brazil, cattle in Brazil and the U.S., and hogs in the U.S.) as the grain harvest approaches and amid higher cattle availability, as well as the opening of new markets for Brazilian beef (China, Saudi Arabia, and more recently, the U.S.). However, the stagnant demand in Brazil and the appreciating Brazilian real would prevent the group's margins from rising above 8% (as previously seen in 2015).

Recommendation:

The 2016 financial year was a challenging year amidst weaker demand and reduced global prices for meat. Recovery is expected in 2017 against the background of lower grain prices as the grain harvest approaches and an increase in the number of cattle available. There is also the expectation of the opening of new markets for Brazilian beef (China, Saudi Arabia, and more recently, the U.S.). On the other hand, the revised structure of the initial public offering will provide liquidity to assist JBS S.A. in its expansion initiatives. The possibility of increased liquidity will be positive for existing bondholders from a repayment perspective. Therefore, JBS S.A. is recommended as a MARKETWEIGHT at this time.

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APPENDIX**IMPORTANT DISCLOSURES**

ABSTRACT— As a part of our new Portfolio Strategy we are recommending strict adherence to the following Portfolio Allocation DEFINITIONS/RECOMMENDATIONS.

PLEASE NOTE THAT NO INDIVIDUAL ASSET IN YOUR PORTFOLIO SHOULD HAVE A WEIGHTING GREATER THAN 5% UNLESS OTHERWISE RECOMMENDED BY YOUR PORTFOLIO MANAGER OR A SPECIFIC JMMB RESEARCH REPORT. CONSEQUENTLY THE FOLLOWING DEFINITIONS ARE PROVIDED FOR CLARITY.

UNDERWEIGHT—REDUCE EXPOSURE IN YOUR PORTFOLIO TO LESS THAN 5% FOR THIS PARTICULAR ASSET

SELL—REDUCE EXPOSURE IN YOUR PORTFOLIO TO ZERO.

HOLD/MARKETWEIGHT—EXPOSURE TO THE ASSET SHOULD BE EQUAL TO 5% OF YOUR TOTAL PORTFOLIO HELD AT JMMB.

OVERWEIGHT/BUY—EXPOSURE TO THIS ASSET SHOULD BE BETWEEN 5% AND 10% OF YOUR TOTAL PORTFOLIO HELD AT JMMB.

Source: JMMB Investment & Research, Bloomberg, Various Company Financial Statements, Standard & Poor's