An Examination of the Resource-Based Horizontal Acquisition Strategy of JBS – the Biggest Meat Packer in the World

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ABSTRACT

This paper presents a longitudinal study of the resource-based horizontal acquisition strategy of JBS. This strategy transformed a relatively small business that was founded in 1953 (comprising a butcher shop and small slaughterhouse located in a small town in the interior of Brazil) into the world's biggest meat producer by 2010. However, the acquisition strategies of the company is not one dimensional, it changes with times and the maturity of the company. We further discuss the lessons learned from the growth strategies.

INTRODUCTION

This paper examines the successful resource-based horizontal acquisition strategy of JBS. This strategy transformed a business that was founded in 1953 by José Batista Sobrinho in a small town in the interior of Brazil (comprised of a butcher shop and small slaughterhouse) into the world's biggest meat producer by 2010.

The history of JBS can be divided into three periods: in the first period (1953–2006), JBS spurred its growth by horizontal acquisitions in Brazil, and first international horizontal acquisition in Argentina; in the second period (2007–2008), JBS became a public company with an initial public offering (IPO) of JBS and pursued aggressive international horizontal acquisitions that started with the acquisition of Swift in the U.S.; and finally, in the most recent third period (2009–2010), it merged with Bertin (the second largest meat producer in Brazil to JBS at that time) and diversified into the unrelated businesses of Bertin as well. In addition, with the acquisition of Pilgrim's Pride in the U.S., it also diversified into the poultry business. Finally, the paper evaluates the resource-based horizontal acquisition strategy of JBS and the role of the Brazilian Development Bank in financing the growth of JBS.

THE EARLY YEARS

In the early 1950s, José Batista Sobrinho started a small business purchasing cattle to resell to slaughterhouses in the city of Anápolis (the third largest city in the Brazilian state of Goías: with a population, at the time, of approximately 50,000 inhabitants). The business grew, and in 1953 Sobrinho opened—with his two brothers—a small butcher shop and slaughterhouse, which slaughtered five heads of cattle a day. The construction of Brasilia in 1956 (only 162 kilometers from Anápolis) promoted strong

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economic growth in the region during the 1960s. Sobrinho took advantage of this growth, and of the tax exemption offered to companies that were willing to invest in the new capital of Brazil, and his company, Friboi, made its first acquisition of an slaughterhouse in Planaltina (a satellite town of Brasilia) in 1968 (Bell & Ross, 2008; Salomão, 2009).

Brazil's strong economic growth in the 1960s and 1970s increased the country's beef consumption, and the business prospered. In 1970 Friboi acquired a new slaughterhouse in Luziânia (also in the state of Goiás). With this acquisition Friboi increased its slaughtering capacity to 500 heads of cattle a day. During the 1980s, Friboi invested to expand its processed beef production capacity, and in the 1990s and early 2000s the company began expanding aggressively, acquiring slaughterhouses and increasing its capacity for producing fresh, chilled, and processed beef in Brazil. Between 1993 and 2005, Friboi acquired twelve slaughterhouses and beef processing plants, and so became one of the largest beef producers in the country, with a slaughtering capacity of 5,800 heads of cattle a day.

Sobrinho's three sons (José Jr., Wesley, and Joesley) chose to work in the company rather than attend college. They started in the slaughterhouses, on the beef cutting room floor: however, from 2000 the sons took over the day-to-day management and high level strategic decisions, while their father (aged 80 in 2012) stepped back to play an advisory role (Bell & Ross, 2008). Today, Joesley serves as Chairman, Wesley as CEO, and José Jr. and the patriarch Sobrinho serve as board members.

The first international expansion by Friboi was made in 2005, with the acquisition of Swift, Argentina's largest beef producer and exporter, and was financed by the Brazilian Development Bank (BNDES). In the same year, Friboi was reorganized from a closed family business to a public company, and was renamed JBS SA, after the initials of the founder José Batista Sobrinho (JBS).In 2006, the newly renamed JBS increased its slaughter capacity to 22,600 head cattle a day (from the previous 5,800), by acquiring two additional slaughterhouses and beef processing plants in Argentina. With these two additional plants JBS had twenty-one beef processing plants in operation in Brazil and five in Argentina. The acquisitions in Argentina were probably motivated by the substantial strength that the Brazilian currency (the real) had against the U.S. dollar in 2006, making foreign acquisitions relatively inexpensive. This strength of the real, on the other hand, put Brazilian exporters in a disadvantage: it presented a challenge for JBS, who exported more than a third of its beef and generated sixty-one percent of its sales through exports to customers in 110 countries even through major international markets were closed to Brazilian beef, including the U.S., Canada, Mexico, and Korea (Bell & Ross, 2008).

IPO AND THE ACQUISITION OF SWIFT IN THE U.S.

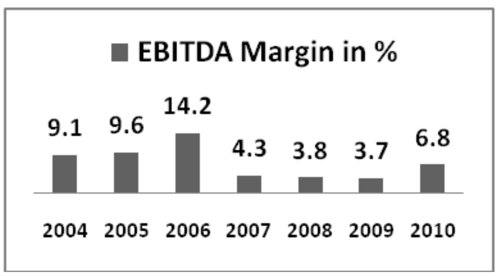
In March 2007, JBS became the first beef processing company to make an initial public offering (IPO) on the Brazilian stock exchange, raising almost US$800 million. In addition to acquisitions of both slaughterhouses and beef processing plants in Argentina and Brazil in the first half of 2007, in July of 2007 JBS surprised the market by acquiring Swift, with operations in the U.S. and Australia, for a total amount of US$1.46 bil. (Bell & Ross, 2008).

A substantial portion of the financing for the acquisition of Swift was obtained by JBS from a capital increase from the Brazilian Development Bank (BNDES) in exchange for a portion of the new common shares. Prior to the deal, JBS had a market capitalization of $4.2 bil. and sales of $2.1 bil.: almost five times less than Swift's sales of $9.5 bil. (Salomão, 2009).

Throughout the remainder of 2007, JBS made other major national and international acquisitions of slaughterhouses, beef packing plants, and industrial plants in the areas of the beef byproduct market segment and of packaging for JBS products. With these acquisitions, the total of the slaughter capacity of JBS rose in 2007 to 51,400 heads of cattle a day from 22,600 in 2006. The number of plants also increased from 26 in 2006 to 50 plants in operation at the end of 2007.

Prior to the acquisition of Swift, JBS had a stellar growth record, which helped promote the IPO and capital increase in 2007. From 2004 to 2006, sales rose by 21%, with net income increasing from $50.2 mil. to $84.3 mil. The ebitda of JBS, as a percentage of revenue, was: 9.1% in 2004, 9.6% in 2005, and 14.2% in 2006 (the year that the appreciation of the real against the dollar reduced exports of Brazilian beef)(see Table 1). These percentages were be far greater than those of other major players in the U.S. beef processing industry. On the other hand, JBS also held a high debt load ($956 million) at the end of 2006 (Bell & Ross, 2008).

TABLE 1: JBS Operational Performance



With the acquisition of Swift in the U.S., JBS became the third largest beef processor in the U.S. (behind Tyson and Cargill), and the largest worldwide, with holdings in the U.S., Australia, and Europe, as well as Brazil and Argentina. The rationale for the acquisition of Swift by JBS was the importance of establishing operations in other regions besides Latin America, as this allowed JBS to deal more effectively with the currency fluctuations, and to better manage sanitary restrictions and other trade barriers (Bell & Ross, 2008).

In December 2007, JBS announced the purchase (completed in 2008) of 50% of Inalca, the absolute leader in the Italian beef industry and one of the largest producers of beef products of the European market, with operations in Russia, Africa, and Europe. The acquisition, at a cost of Euros 225 million, represented a strategic alliance: this created important synergies between products and selling channels, introduced JBS products to key markets throughout Western Europe, and brought Inalca (now Inalca-

JBS) into closer contact with the world's main beef suppliers. For JBS, the acquisition represented an important initial step for the company's future growth in the European market.

RESTRUCTURING AND DIVERSIFICATION

In August 2009, JBS entered a new area with the creation of JBS Couros (Leather). The entry into leather was a logical step, since JBS was the largest producer of beef, and leather is a byproduct of this industry. By December, JBS also merged with Bertin, the second largest beef packer in Brazil and one of the largest beef exporters in Latin America. The merger with Bertin—besides reinforcing the market share of JBS in beef packing and leather—diversified the company into areas of prepared foods, pet foods, milk and dairy products, recycling, biodiesel fuels, petrochemical products, personal hygiene and beauty products, collagen, and canning, among others. With the merger, the slaughter capacity of JBS increased to 90,290 heads of cattle per day (from 65,700 in 2008). In addition, because Bertin was the largest Brazilian producer and exporter of leather, the merger the merger made JBS the largest leather producer and exporter in the world.

In the same month as the merger with Bertin, JBS made another diversification by acquiring 64% of Pilgrim's Pride Corporation (PPC) and thereby entering into the chicken-processing market. With this acquisition, JBS became the second largest poultry producer in the world, with operations in the United States, Mexico and Puerto Rico, and a daily slaughtering capacity of 7.6 million chickens. To finance the acquisition, JBS issued convertible debentures that were subscribed by the Brazilian Development Bank (BNDES). The same month also saw the company announced the acquisition of Tatiara Meat Company (TMC), located in South Australia. The completion of the acquisition occurred in February of 2010.

CONSOLIDATION PAINS OF JBS

During 2010, JBS made numerous efforts to resolve pending issues between the partners of Inalca-JBS, in which JBS had acquired a 50% interest in December 2007 for Euros 225 mil. Finally, a termination agreement to dissolve the partnership was signed: through this agreement the Cremonini group paid Euros 218.9 mil. euros to purchase the 50% interest of the company from JBS. Also in Italy, JBS acquired outright control over Rigamonti, in which it had held a 70% interest since December 2009.

The many acquisitions landed JBS with $6.9 bil. in debt, and some market analysts during 2010 expressed concern that the company was overreaching. The firm lost $160 mil. in 2010 on about $33 bil. in sales, mainly because of the cost of integrating Pilgrim's Pride and Bertin. As investors became worried, JBS' stock dropped by 30% during 2010. Other meat producers, including the main rival of JBS, Tyson Foods, also had income difficulties during 2010, mainly because of spikes in corn prices that increased the costs of raising cattle (Blankfeld, 2011).

In response, JBS management decided to postpone the initial public offering of its America subsidiary, JBS U.S., which was scheduled for December 2010 and already registered with the SEC. The initial public offering was required, because the indenture of the debentures issued in December

2009 and subscribed by the Brazilian Development Bank (BNDES) had the obligation to make them convertible into sponsored Brazilian Depository Receipts (BDRs) that were backed by US shares held by JBS. The deadline for this conversion was December 2010, and in the event of postponement, JBS had agreed to pay a premium of $300 mil. to the debenture holders as compensation, in accordance with the rules set in the indenture.

In December 2010, management decided that JBS would pay the premium and postpone the IPO to December 2011 (Economia, 2010). In April 2011, the management of JBS announced that they had cancelled the plans for the IPO of its American subsidiary JBS U.S., ignoring the obligation to its main debenture holder BNDES (Olivon, 2011). This decision was undoubtedly motivated by the poor performance of the company shares, which continued the downward trend that had commenced in 2010. In May 2011, the debenture holders, including BNDES, converted their debentures into JBS shares (Gradilone, 2011).

FINANCIAL PERFORMANCE OF JBS

The performance of JBS after the 2007 IPO never met shareholders' expectations, and this is reflected in the poor performance of the company shares. The prospectus for the IPO showed that its ebitda is about 14% of sales. To the disappointment of the investors, with the acquisition (in 2007) of Swift in the U.S, JBS had incurred a significant loss in the first year after the IPO, and its ebitda as a percentage of revenue never met shareholders expectations (see Table I above). As a result, JBS shares have underperformed ever since: from the IPO in 2007 to April 2012 the growth of JBS shares was only 4.75%, compared with the Brazilian stock exchange index's growth of 37.37% in the same period.

On the other hand, the status of JBS as a diversified global protein producer allowed the company to navigate the market in a way few others could. In 2008, for instance, when the European Union restricted sales of Brazilian meat (alleging that breeders weren't complying with the European Union traceability measures), JBS took advantage of its Australian subsidiary to export to Europe until Brazilian beef exports to the EU resumed in 2009. Similarly, although no Brazilian meat producer could export cuts to the U.S. because of restrictive U.S. safety rules, JBS was able to enter the market through its own U.S. subsidiary. Also, the production of three different proteins, namely beef, pork and chicken, allowed JBS to hedge against changes in meat consumption preferences (Blankfeld, 2011).

GROWTH FINANCING BY THE BRAZILIAN DEVELOPMENT BANK (BNDES)

In 2004, the Brazilian government adopted the Policy of Productive Development, with the purpose of developing specific sectors of the Brazilian economy (MDICE, 2012). One of the chosen sectors was the meat sector, which was selected to become the world leader in exports. Brazil, with one of the largest untapped agricultural land reserves in the world, was ideally suited to fill this demand. With the support of the government and financing from the Brazilian Development Bank (BNDES), the meat sector see rapid consolidation of some key players, and as a result of the successful policy Brazil became the world´s biggest exporter of animal protein (specifically, the number one exporter in the world of beef and of poultry, and the fourth largest exported of pork). Meat is currently the second largest agribusiness export market in Brazil after soybeans (Marques, 2010).

The management of JBS took full advantage of the support from the Brazilian Government, and used the resources offered by BNDES to finance its key acquisitions. In 2005, the first international acquisition of JBS of Swift Armur in Argentina was financed by BNDES; the acquisition in 2007 of Swift in the U.S. was financed by a capital increase in which BNDES subscribed a portion of the new common shares; the acquisition in 2009 of Pilgrim's Pride was financed by an issue of convertible debentures that were primarily subscribed by the BNDES. As a result, BNDES controlled about 31% of the company's outstanding shares according to JBS's annual report.

The financing of JBS growth by the BNDES generated some discontent from other meat packers in Brazil, who considered it unfair competition, and among cattle breeders, who were concerned that the concentration into a small number of meat packers would lead to fixing of cattle prices. There were also critics of the interference of the state into businesses like JBS, which they termed state capitalism. In response to these criticisms, an investigation was undertaken by Federal Public Persecutors in Brazil into the relationship between JBS and BNDES. However, BNDES was found to be acting according to the government's development policy (Agência Estado, 2011).

THE DYNAMIC FORCES OF CHANGE

The meat packing industry is a mature industry in Brazil, and similar to much of the rest of the world, it handles the entire process, from the slaughtering of animals (mainly cattle, pork, sheep, and poultry) in specialized slaughterhouses, to the subsequent cutting, packaging, and distribution of the meat.

Traditionally, cattle slaughterhouses in Brazil were small local operations that bought animals from independent ranchers, slaughtered the animals, cut the meat, and sold the cut meat to the local butcher shops: this is how José Batista Sobrinho started in 1953 in the small town of Anápolis. Three dynamic forces have changed the Brazilian beef business.

The first force that changed the beef business was the squeezing out of small ranchers by larger rancher operations. These moved further to the interior of Brazil where land was inexpensive and where breeding of thousands of heads of cattle was possible. This created the need to transport cattle from the open ranges to the slaughterhouses and to fatten them to gain weight before being slaughtered. These large-scale cattle breeders and the intermediaries that were in the cattle fattening business started to impose their prices on the local slaughterhouses.

The second force was the expansion of supermarket chains, which needed quality packaged beef to sell to their clients. These supermarket chains squeezed the traditional local butchers out of business, and these local butchers had been the main clients of the local slaughterhouses. In addition, the volume that these supermarket chains purchased, and their quality requirements, imposed changes to the traditional slaughterhouses: who had to aggregate meatpacking and implement a substantial number of sanitary and quality procedures. This increased the cost to the slaughterhouses, who were not compensated by the lower prices per unit that the supermarket chains were willing to pay based on their high volume requirements.

Squeezed between the large-scale ranchers and intermediaries on one side, and the supermarket chains on the other side, and with the higher cost of the operations, local slaughterhouses began to find themselves in financial difficulties. Taking advantage of the situation, JBS, along with some of the more effectively managed meatpackers, began to consolidate the industry by buying out those in trouble. The rationale for these horizontal acquisitions was a strategy to increase the capacity to slaughter cattle, in order to be able to build up a better bargaining position against the big ranchers and the cattle fattening intermediaries (on the supply side) and the supermarket chains (on the demand side). This is the reason that JBS (up until 2009) measured growth by the growth of its cattle slaughter capacity.

The third force that changed the beef business was the growing international demand for beef. The Brazilian government defined meat export as one of the priorities in their development policy. To access to the international beef market Brazil had to improve the entire beef supply chain. This requires investments by the Brazilian Development Bank in some key players (those that had the necessary scale and capacity to make the necessary changes to the supply chain to open the international markets for Brazilian beef): the most successful of these players was JBS.

THE ACQUISITION STRATEGY OF JBS

José Batista Sobrinho learned the business from the supply side in the 1950s by starting operation of purchase cattle to resell to slaughterhouses. In 1953, he learned to operate a small butcher shop and slaughterhouse, which he ran with his two brothers. The success of this venture motivated him to purchase an slaughterhouse in 1968 and another in 1970.

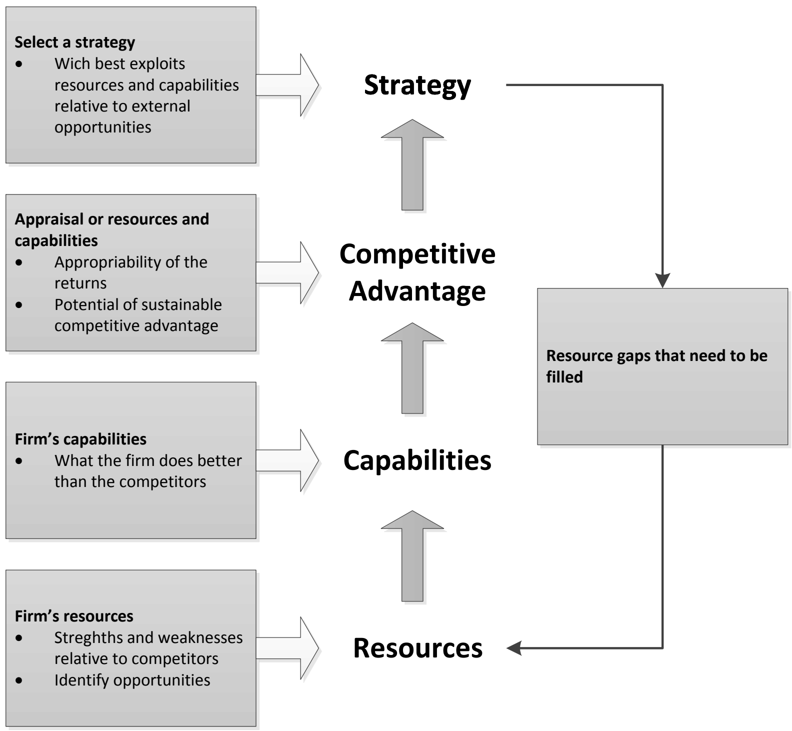
Sobrinho soon realized that he needed to increase his cattle slaughtering capacity to gain bargaining strength with the cattle breeders and the intermediaries who were fattening cattle to sell to slaughterhouses. He also realized that he needed to create a branded packaged beef to differentiate the beef he sold to supermarkets and to avoid commoditization. To achieve this he renamed the company Friboi, and encouraged customers to create demand for Friboi packaged beef in the supermarkets.

Sobrinho and his sons instinctively followed a resource-based competitive strategy in growing JBS (see Table 2). The key resource they used to build JBS was their slaughterhouses and the daily slaughter capacity of cattle which enabled them to gain bargaining power with suppliers. The capabilities they built up were the efficient operation of slaughterhouses, cost efficient processing and packaging beef, and the capability to market branded packaged beef to supermarkets (and so gain bargaining power with customers).

The acquisition strategy of JBS was a resource-based horizontal acquisition strategy up until the acquisition of Swift in the U.S. in 2007, the merger with Bertin in Brazil in 2009, and the acquisition of

Pilgrim's Pride (also in the U.S.) in 2009. The focus of the resource-based horizontal acquisition strategy was on acquiring beef slaughterhouses and packing plants to grow the cattle slaughter capacity.

TABLE 2: Resource-Based Competitive Strategy



Source: Adapted from Grant, 1991, p. 115

The acquisition of Swift in the U.S. in 2007 (with its slaughterhouses in the U.S. and Australia) was motivated by the possibility of increasing the cattle slaughter capacity and the need to establish operations in regions outside Latin America in order to deal more efficiently with currency fluctuations, sanitary restrictions, and other trade barriers. These issues were resource gaps (see Table II) that had to be filled for JBS to be a relevant actor in the world trade of beef. The acquisition, on the other hand, also included a concentric diversification into pork and lamb. This acquisition made JBS the third largest pork producer in the U.S. and with additional smaller acquisitions in Australia the world's leading lamb producer.

When JBS acquired Smithfield Beef in the U.S. in 2008, this consolidated its leadership as a beef producer. Together with the beef operations JBS, also acquired the largest cattle feeder in the U.S.: this was a major backward vertical diversification of JBS in the U.S.

The merger with Bertin in Brazil in 2009 was also motivated by growing JBS's cattle slaughter capacity; but it included a concentric diversification into leather. The merger consolidated the diversification that was started by JBS with the creation of JBS Couro (leather). With the merger, JBS became a global leader in leather tanning; but the merger also included some conglomerate type of diversification into dairy products and canned vegetables, such that JBS is currently the third largest dairy producer in Brazil.

The acquisition of Pilgrim's Pride in the US in 2009 was another concentric diversification into poultry. With this acquisition JBS became the world's second largest poultry producer behind another U.S. firm, Tyson.

Like most large companies, JBS also made some smaller vertical and concentric diversifications, which potentially occupy management time that could be better employed by concentrating on the core business: JBS today manufactures cans, produces collagen, casings, beef jerky's, energy, biodiesel, oleo-chemicals, has a trading company, a shipping company, a cattle confinement operation, and an agricultural supply and service company JBS, 2012).

CONCLUSION

JBS was very successful in the beef packing business, especially with its resource-based horizontal acquisition strategy. In addition, the company has been very politically savvy in adapting itself to Brazilian government policies as witnessed by its continuing financial backing by the Brazilian Development Bank (BNDES) to acquire slaughterhouses and beef packing plants in Brazil, Argentina, Uruguay, and Paraguay. When JBS realized that its Latin America export platform was vulnerable to currency fluctuations, sanitary restrictions, and other trade barriers, it used the financial backing of the BNDES to acquire Swift in the U.S. during 2007, and operations in the U.S. and Australia, Smithfield Beef in the U.S., and Tasman Group in Australia in 2008. In 2009 followed the merger with Bertin in Brazil and the acquisition of Pilgrim's Pride with the strong financial backing of the BNDES. These acquisitions diversified JBS into pork, lamb, and poultry (among other less synergic businesses).

The simple resource-based horizontal acquisition strategy in the beef industry that promoted JBS success was fuzzed (lost focus) by the need to learn to operate with pork, lamb, and poultry in foreign countries without a home-grown experience (such as the experience JBS had in beef). Also, JBS diversified into many new businesses, and some were completely new (such as dairy products, which came with the acquisitions and the merger with Bertin). All this was complicated by the many locations all over the world, and starting in 2007 this led to an enormous task of consolidation for JBS management. It is no wonder that JBS had consolidation pains and that the firm's performance reflects this.

Probably the only way for JBS to return to its past performance (that is, the performance achieved prior to the international acquisitions) is to concentrate on its core business and shed all the unrelated businesses that are distracting the management team. It seems that JBS management is starting to do this, by spinning off its dairy product division. The concentration on JBS core business would also realign the firm with the objectives of the Brazilian Government's Policy of Productive Development.

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