

Q2 2020 Earnings Call

Company Participants

- Carlos Alberto Bezerra De Moura, Chief Financial And Investor Relations Officer
- Leonardo Campo Dallorto, Vice-President Of Integrated Planning And Logistics
- Lorival Luz, Global Chief Executive Officer
- Neil Hamilton Dos Guimaraes Peixoto, Vice-President Of Quality, R&D And Sustainability
- Patricio Rohner, Vice-President, International Markets
- Sidney Rogerio Manzano, Vice-President Of Commercial Brazil Market
- Unidentified Speaker
- Vinicius Guimaraes Barbosa, Vice-President Of Operations And Procurement

Other Participants

- Analyst
- Barbara Halberstadt
- Isabella Simonato
- Joao Soares
- Luca Cipiccia
- Lucas Ferreira
- Ricardo Alves
- Thiago Duarte

Presentation

Operator

Good morning, ladies and gentlemen. Welcome to BRF's Second Quarter of 2020 Results Conference Call. This conference call is being broadcast live at www.brf.br.com/ri where the presentation can also be downloaded. All attendees are connected in listen-only mode. After the company's presentation, we will open the floor for questions and further instructions will be provided. Each attendee will be allowed one question. (Operator Instructions).

Any forward-looking statements made during this call in respect to the company's business prospects, projections, results and the future growth of the company are based on assumptions and beliefs of the management as well as information currently available. These statements are highly dependent on the local market and on the overall economic performance of the country, the industry and international markets and therefore they are subject to change.

Please note that this conference call is being recorded. The call will be presented by Mr.Lorival Luz, the Global CEO of BRF and other VPs of the company are also present with us today.

Now I will turn over to Mr.Lorival Luz. Mr.Luz, you may proceed.

Lorival Luz {BIO 16180455 <GO>}

Thank you. First, I'd like to welcome all of you to our quarter 2 2020 results conference call. As you can see, for the first time, we are using video for this announcement. The purpose of the use of the video is to have a better interaction with all of you and to favor the discussion of our results.

I'd like to start by saying very proudly that I am very happy with the results that we are presenting to you today, particularly when we consider the current scenario of extreme adversity with the pandemic, which has been going on for six months already. This was a very difficult quarter, which demanded the best of each of us. We really had to work as a team And that is why I would like to start this call by thanking all our employees, everybody who is a part of our chain, of our production chain, all our partners who have spared no efforts to maintain our production and the supply to the population in such harsh times.

Also, I would like to say that we have built a very robust, solid and consistent result. Both from the financial standpoint and also in everything related with social responsibility and the care of our people. BRF is very proud to say that it was one of the companies who has invested the most in its people's health and also in the health of the communities where they operate. And we did this even in prejudice of any financial results or market share. This was not our primary concern because we in BRF, we truly believe that people's health and people's well-being is a top priority. The market share can be recover later, but lives cannot.

And that is why our top priority was to take care of the people. The results that we are going to present to you now also show the strength of our brands and how assertive our strategy was in expanding our products -- the portfolio of products with high value added. And I'm going to give you more details later. That is why I am totally confident that we have set the basis to advance with our strategy, seeking growth and generation of value to all our stakeholders.

So as for agenda for today, I will start with a brief 15-minute presentation, then we open the floor for questions, and we have all our VPs present with us today to help me answer your questions. But before I start my presentation, I ask you for a few minutes to pay tribute to our Board member, Walter Malieni, who left us last Friday in a very premature way. You all know that Walter has worked with us for the past 3 years, not just as a Board member but also a member of two very important committees and in the past 3 years, were a very turbulent period to the company but also vital for us to write our story.

FINAL

Bloomberg Transcript

FINAL

And Walter had a very active role, showed a lot of dedication. He was a unique human being, and you all know that. That is why on behalf of the entire company, I would like to pay tribute to Walter for his legacy, for his hard work, and our condolences to the family, to the wife, Luciana, and all family members and friends.

Now I will start my presentation. So let's go straight to Slide number 4. The second quarter was a quarter of investment, of taking good care of our people, of our communities and our business. We spent about BRL218 million in countless initiatives that we put in place during this period. We created internal and external campaigns, as you can see here, to show our solidarity, our social responsibility in our corporate citizenship and also always focusing on animal welfare.

The next chart shows the different initiatives that we have put in place. You can also read more about them in our management report. And I would like to highlight two points here: We work with prevention. We take care of our people. We proactively put on a leave more than 8,000 employees who were high risk for COVID-19. This includes older adults and other populations -- other vulnerable populations who were put on a leave, and we also hire another 7,000 employees temporarily. Of course, this had an impact on our operations and our productivity, but we know this was the right thing to do.

We were probably also one of the companies that test the most in Brazil, thousands of tests in more than 40 different sites to strengthen prevention so that we could take good care and preserve the lives of our people. The next chart also shows different initiatives in commercial and logistics, institutional relations and the BRF Institute.

In the beginning of the pandemic, we announced a donation of BRL150 million, and this money has benefited more than 180 entities around the world. On Page number 7, we show the impact of all this. We have more than 90,000 people working for us. And during the pandemic, we conducted a survey to try to understand what was their perception, how they were feeling. And we are very happy to know that according to our employees, we were doing the right thing. We were taking the right measures, and we were communicating well with our people with the right level of transparency. This shows that we have an engaged, united team working towards a common goal.

Now moving on to financials, I will not go into details here. This information is all in our management report, and we can also give you more details during the Q&A session. But on Page 9 of the presentation, I would like to stress how consistent our results are. And this consistency was maintained through the crisis, through the pandemic. And for fifth consecutive quarter, we are working with gross margins at the level of 24%, 25% and our EBITDA margin at 13%. Of course, this is for recurring operations and everything we do. We also had a focal impact here, both on cost and expenses as we reported in the results for this quarter, but it is worth noting that in addition to these identified costs, we also had further impacts.

We had impact relative to our productivity, relative to servicing certain markets and the supply of certain products. Because depending on the timing of -- some of our plants had to stop or reduce their production. So this could cause focal breakouts or short supplies in

some markets. And this is not quantified here. But everything that we have been doing in the past two years helped us bring to you consistent and sound results.

On Page number 10, we have a summary of Brazil and international results. And these are also very well detailed in our management report. And this shows how strong our portfolio and our brands are. Here, as I said, we've been working with EBITDA margins of about 14%. But let me focus on Page 11 in the part where we talk about our market share. Our market share for frozen meals and margarines for April and May show evolution and resumption, and this was a result of our commercial strategy and the launch of products and innovations always with the preferred brands of the market, which are always top of mind.

On the right side, we have new reading for May and June, both for sausages and in franks and cold cuts. And this precisely reflect the actions and decisions that we took and made over the course of quarter two, putting the lives of people as top priorities. For example, in Rio Verde, the region where we have our largest process foods plant in Brazil, we proactively and preventively interrupted our production. That's where we had the largest mass testing effort, we tested nearly 9,000 people with PCR test. We waited for the result and only after that, did we resume production.

Of course this had an impact. This had an impact in terms of supply and increased breakout and also an impact in the mix of products because in order to supply the market and avoid breakouts, we focused on the products with the highest volume, not necessarily the most profitable.

On Page 12, we see how strong our brands are and how assertive our strategy has been. This is a snapshot of what we are selling in Brazil based on our product portfolio. Here, we see two axes in this chart, the evolution and growth of the products over two years and the growth of our products over one year.

What's important to note here is that about 80% of our products are high margin, high value-added products, which build the strength of our brands. These are branded products with the best brands. If you think of any global trade or global positioning, you'll know that for these products and this type of operation, it usually has an EBITDA of 13, 14x. And only 20% of our portfolio is made up of in natura products with a lower added value, but still with positive margins. And these products are commoditize products which are traded at about 7x. So the direction, the strategy and everything that we're putting in place now has the purpose of growing the company more and more and growing these products in our portfolio more and more, as you can see here.

And in the next two slides, we show you how we have been doing this. We have numerous launches. For example, in Brazil, we have more than 56 new SKUs. You can see some of them here on this illustration. Also, Slide number 14 shows our international launches, about 57 new SKUs internationally.

On Slide 15, we see our capital structure, which continues to show this positive trend. We are seeking the ideal capital structure for the company. We went from 3.74x. Now we have

2.89x due to FX effect, and if we were to calculate our leverage in dollars to remove this FX effect, our leverage would be about 2.3%, which shows the current trend and our financial discipline. And this is also strength in as you can see here on Slide 16, by all of the operations and initiatives that we have taken on to expand the average debt term from 3.2 years to 4.2 years. And this already considers the operations that we made in July and August or the latest operations.

FINAL

Now let's talk about our outlook for the future. We have heard about the very good results that we had this quarter, but now we are working towards preparing the company for future growth. We have new licensed plants in different countries, as you can see here. And we also had -- at a final stage of conclusion, we have our new sausages and frank unit in Seropédica, Rio de Janeiro, which as of quarter 1 2021, will add an additional 30 kton per year of capacity to BRF. We also have the new plant in Dammam, Saudi Arabia, and we have already started our expansion process to start producing in Saudi Arabia and expanding the production of process products in Saudi Arabia with the highest added value.

Before my final considerations, I would like to call your attention to this overview about the protein supply and demand globally. This chart here shows a relevant drop in the production of animal protein around the world. And on the bottom of this slide, you see that there was an increase in trade globally, but there was a drop in per capita consumption. And this is a consequence of the growth of the population. So the population is growing, more people need to be fed. But at a same time, production is decreasing. So if we could go back to the per capita consumption of 2018, the world would have to be producing currently about 350 million tons.

And what I mean with all this is that the market will continue to demand more and more, and production is below expected to meet this demand. Before we have a list of initiatives. We are managing the company in a very focused manner, and with an eye at our responsibility with the environment, the community and our governance, which is a type of governance which ranks high across all aspects.

I'd like to call your attention now to the following. It's my final remarks, my conclusions and then we can move on to questions and answers. I'd like to once again call your attention to this quarter's results, a quarter where we traded above 1 million tons, even in a moment of pandemic. We had a gross income of BRL2 billion; EBITDA at BRL1 billion even with all the expenses and measures around COVID; an EBITDA margin at 14%, which shows the stability that we are enjoying.

We have reported even in the quarter an income of around BRL300 million. We continue to adjust our leverage and our capital structure at a leverage level of 2.89x and an average term of something close to five years. And more importantly and extremely strategic for the company, we have moved forward the products that carry our brands and which have a very high added value, which keeps increasing. That relevant growth in volume is our objective and our focus.

FINAL

In conclusion, now I'll move on to the next slide, my final slide. I'd like to call your attention to the following. I want to talk about the current moment we're going through, our moment and our feeling as a company. I'd like to say that in light of all the results of everything we have ahead of us, I have total confidence, not only in the present, but in the future of BRF, our company. I am totally convinced that we have an engaged team, which is committed around our purpose; a team that takes care of people; that does not do business at any cost; a team which is passionate for what they do and for the company. And we have increasingly strengthened our culture, that culture of commitment.

We have implemented a robust management system across all levels of the company. We are now coming to the close of the implementation phase of our efficiency process around commercial and operational areas.

Now on Slide number 21, just to be sure. And we are going through a reality where the world market is increasingly and consistently increasing demand for protein. And as we saw, production dropped in the past few years, which grants us a perspective of growth going forward for the next decades. So once again, demand is there, and the demand for protein is growing. We have the most admired brands in the market, and they keep growing in consumers' preferences. We are moving ahead in innovation. We are launching new products, and we are focusing once again on higher added-value products.

We have worked hard for the past two years, and you know that. You have witnessed our efforts for the past two years. So now we are poised to expand our business, expand our results and our returns with the best team, the best brands and the best products. And I tell you this with a lot of confidence because we have paved the way to get where we are and to have the foundations to start a new chapter, which will be quite successful in our journey here at BRF. Thank you very much.

Questions And Answers

Operator

(Question And Answer)

Thank you. Ladies and gentlemen, we will now start the Q&A session. (Operator Instructions) Our first question comes from Luca Cipiccia from Goldman Sachs.

Q - Luca Cipiccia {BIO 6914452 <GO>}

Good morning, Lorival, good morning everyone. Thank you. About the last operations, could you help us understand about margins around royal? Numbers for the second quarter were quite exceptional. I agree that the stability is there. But I'd like to understand what kind of legacy we will have going forward in the third quarter and also in the long run. Can we expect BRF to emerge lighter, more expedited? What kind of legacy are you expecting to have in terms of cost structure, which was impacted in the second quarter? So an outlook for the short, mid and short run, if you will.

FINAL

A - Lorival Luz {BIO 16180455 <GO>}

Thank you, Luca. We have my colleagues here with us. I'll start answering and our executives might feel free to jump in whenever they want. The trend for the next quarters concerning the impacts coming from COVID are smaller, both in terms of costs and in terms of expenses. Much of what had been done in the second quarter was one-off items, not recurring. Other expenses will become recurrent throughout some period until the pandemic plays out, but that will drop significantly along the next quarters. I'd like to ask Vinicius, our operational VP to complement and give some information about our productivity. Because in this period, we -- one-off preventive initiatives aiming at welfare for the animals and health for people, that included a reduction of some products in the availability, some product lines, but also as I said, a one-off decision, not recurring. Vinicius, please?

A - Vinicius Guimaraes Barbosa {BIO 17578795 <GO>}

What happened throughout this period in order to protect people, people who were moved away from operation, was significant. So we had high absenteeism, not because people didn't want to work. Some people said that happened in the U.S., but not here. Proactively, we decided to send those people home. And this is not around productivity. It was because we simply did not have people to produce all items across all lines, across all locations. So we had to adapt, not only to protect our employees' health, but also animal welfare.

We decided not to have sanitary slaughter throughout the period. So that forced us to work with a mix, as Lorival mentioned, slightly less profitable and with lower volumes. But that has improved already. We have a number of plants today where we run a very low risk of coming to a halt. So we are quite confident that in this quarter, our productivity level, our volume levels, we were very close -- will be very close to what we had planned earlier in the year.

Q - Luca Cipiccia {BIO 6914452 <GO>}

Thank you. The sound is very, very choppy. I apologize. The question is about the volatility of the market going forward. So an outlook for the remaining of the year is the bottom line of the question.

A - Lorival Luz {BIO 16180455 <GO>}

Patricio, can you address that? Patricio.

A - Patricio Rohner {BIO 19686996 <GO>}

Thank you Luca for the question. The Halal segment is one that suffered the brunt of the impact. Different things happened especially a lower level of lodging. As Vinicius mention, we were trying to preserve animal health and people's health. So what we did was to have a higher transference to DC. So we punished somewhat our revenue in terms of direct exports so that we can have an ideal stock for the second half of the year. During the pandemic, we had lockdown, tourism suffered, foodservice suffered, Gulf countries suffered because of transportation problems. Expatriate workers had to leave the country, but the main impact on our Halal line was -- came from Turkey because we have

FINAL

production there, and we had to put out people to protect the houses and so hire more people.

But we had inconsistency in exports to Iraq and the devaluation of the Turkish currency, the lira. So we're going now -- going through a transition. You know that Turkey has opened for tourism. They have a similar consumption to what they had last year. We have increased our market share up there. That was quite positive. We were very fast in guiding our volume towards retail and also to our distribution centers in the countryside. In the case of Gulf countries, there are the country speeding up their opening. Others are still in lockdown, and our prices are quite healthy in U.S. dollars. And our mix will be even more favorable as we conduct other adjustments.

So why do I say the mix is better? When you reduce production, that affects volume, but it affects the breakdown and the product mix. So the priority is to -- even if we lose opportunity to reap revenue in the quarter, we decided to do that so we will have a better second half. The third quarter will be a transition. And fourth quarter -- we expect for the fourth quarter a better performance so that we can start 2021 on the right foot.

Q - Luca Cipiccia {BIO 6914452 <GO>}

Thank you.

A - Lorival Luz {BIO 16180455 <GO>}

Thank you Patricio. Thank you.

Operator

The next question comes from Isabella Simonato from Bank of America.

Q - Isabella Simonato {BIO 16693071 <GO>}

Good morning, everyone. Good morning, Lorival. Thank you for the questions. My question is focus in natura poultry market. When we look at the data that you showed in terms of demand and supply globally, you get the conclusion that protein is lacking around the world. And that prices should be going up. We see that in terms of pork and beef, but not so much in poultry. What do you see in terms of supply adjustments to reach a balance within poultry, right, both internally and globally? And also, how do you see things in terms of exports? Are we going to be seeing different prices, higher volumes? So if we could have some color, please? What do you expect in terms of poultry prices, both domestically and abroad exports because the trend doesn't seem to be coherent when we look at the balance of supply and demand?

A - Lorival Luz {BIO 16180455 <GO>}

Thank you, Isabella. I'll start answering your question, and then I'll give the floor over to Patricio and then Sidney so they can comment -- complement on this dynamic of international markets. But again, the outlook going forward, and that's where we base our decisions is -- with that about, we're looking at the mid- to the long run because there are

one-off events that might take a month or a couple of weeks, but they are not recurring. The overall context is a context that we show where we have a lack of protein around the globe. So I give the floor over to Patricio, and he can talk about poultry and chicken specifically, specifically about Japan for a very specific reason. So please, Patricio, you have the floor.

A - Patricio Rohner {BIO 19686996 <GO>}

Thank you. As for chicken, poultry, just to give you an internal piece of data, we have a higher demand than we can meet. So overall, demand is very high. But because we do not have that availability, be it because of validations, be it for production issues, be it because of the COVID situation in the short run, you will remember that early on, when we talked about April, there were no containers to be filled.

Containers coming back from Asia were taking too long, especially in February when the COVID-19 reached its peak in Asia. So in the short run, this materialized in sales. So it's purely operational, if I may. But we have companies having to get ready to work throughout the COVID situation, social distancing inside the plant, speed of production lines, testing, moving people away from work. When you look at the mid run and even in the long run, those who were able to absorb that poultry in short run, they went for fish, which is also being pressured. So we see an opportunity for poultry to grow.

With one-off items, as Lorival said, we did not have higher consumption for chicken breast in Europe when compared to previous years, especially because in the second quarter is when clients and processing companies are getting ready for the summer. Today, Europe is receiving fewer people, fewer tourists, so that pressure was felt. So that's why I received a lot of pressure from the Middle East for poultry. Japan the same. Japan received many, many tourists in July and August. And they had planned on the Olympic Games. They had to cancel the games. So it was a one-off situation where they had a higher level of inventory, and that supply is being diverted to South Korea, for example. But the overall picture is the following: Poultry is the ideal protein to replace both pork and beef.

That's why we are quite confident that this demand is real, it's concrete. We can feel that coming from our clients and when we see countries opening up for tourism -- and Lorival just mentioned that, and also the number of new plants being planned, I have no doubt that demand will peak. But in the short run, we've seen a lot of volatility, both in demand and in supply production.

A - Sidney Rogerio Manzano {BIO 17678250 <GO>}

Isabella, this higher per capita consumption, the increase in per capita consumption of chicken also has a reflection in Brazil, of course. These two proteins, which grew in detriment of beef where: one was chicken of course, and of course, pork. And now with the more attractive prices when compared with beef, it will continue to grow, which is what we are seeing in Brazil.

The increase in the per capita consumption of chicken and the restriction of pork due to China's new requirement, poultry will be the ideal replacement for these other two types of protein to meet Brazilian demand. And you talked about prices as well. It's important that we put BRF in one segment. Yes, price did show a small decrease in April and May, but this was not followed by BRF. BRF has its brand, has its services and is very strong in innovation. As you heard from Lorival, 80% of our portfolio, including in natura products, are high added value. So we have not really been following these temporary oscillations.

We have consistent results. We already talk about the poultry crisis. We were able to maintain our profitability, the profitability that we defend under our strategic plan. So first, we do believe in an increase in the per capita consumption of chicken as we have been seeing. And second, we have been adding value and increasing our profitability through the strength of our brands, through our innovations and our strong distribution network. We have more than 1,000 clients spread throughout Brazil for in natura products. I hope I have answered your two questions, but I'm at your service if you have more questions.

Q - Isabella Simonato {BIO 16693071 <GO>}

That was very clear. Just a follow-up question. We know that the data is very volatile, not necessarily consistent with the price data. So how do you see the issue of supply in Brazil?

A - Lorival Luz {BIO 16180455 <GO>}

I will let Vinicius talk about housing. And if Leonardo wants to add more comments, we can talk about the other part of your question.

A - Vinicius Guimaraes Barbosa {BIO 17578795 <GO>}

Due to all these uncertainties, you know that once you decrease housing, it's very difficult to go back or correct that with stock. So right now, we're not taking on any drastic measures in terms of housing. This is something that we have been regularly discussing. Of course, during the pandemic, we did reduce some of the housing stocks, but these decreases when you think of the entire year, they are marginal. It's less than 1%. So we are paying close attention to this point that you raise, but in the short term, we don't have any plans of any dramatic changes compared with our initial plan. But we will keep an eye on that.

A - Leonardo Campo Dallorto {BIO 21111909 <GO>}

Isabella, of course, there was this decrease during the COVID crisis due to the current context but we should continue to see strong numbers for chicken in the second half of the year due to the protein -- animal protein deficit that we see around the world. So we truly believe in a resumption of production, and that we will be able to sell both in Brazil and internationally.

Q - Isabella Simonato {BIO 16693071 <GO>}

Thank you, Vinicius. Thank you, Leo.

Operator

The next question comes from Thiago Duarte, BTG Pactual.

Q - Thiago Duarte {BIO 16541921 <GO>}

Hello, good morning. Thank you for the opportunity. My first question is to Sidney and the second question to Patricio. Sidney, in Brazil, you brought some really nice data about the number of launches. It's very nice to see the company resuming its efforts and going back to launching products. I think that the quantification of the negative effects of the COVID crisis on costs was very clear, but I'm under the impression that there was also a positive effect from the standpoint of demand.

For example, the evolution of your market share in margarine. So could you please tell us what was this one-off positive effect? Because people were staying home, and I'm sure that contributed to the sales of some of your products. We heard that from other companies that sell consumer goods that some of their sales were boosted by the people staying home. And the second question to Patricio. Patricio, how do you see the margins in Asia? Because margins are still very high, but they have decreased this quarter compared with last quarter.

We know that stock data in Japan are a little worse than last year's lows. So how do you see this margin performing looking forward? You talked about the global animal protein production deficit, which is caused by the Asian swine fever, but part of this effect has already been incorporate into the price of products. So I'd like to hear your take on the Asian margins.

A - Sidney Rogerio Manzano {BIO 17678250 <GO>}

Thank you for the question and the positive comments. Let me try to explain. Certainly, when this crisis started, we saw a decrease in food service and an increase in retail. And of course, the company could benefit from that. We captured part of this move of the market, and the most symbolic example of that is margin. People were cooking more at home, so they started buying more margarine and also as a spread for their bread, right? But what we could capture was a part of that. According to what Lorival said, we also had an impact on our production chain.

Rio Verde is the largest plant in Brazil, and many items are produced there exclusively. And of course, there was -- that was reflected on the market share. Due to our strategy of consistent, profitable growth, innovation based and based on commercial execution, we saw these resumption of the market share in all product lines. And this was interrupted now due to the points that we raised, that we are not meeting the demand due to shorter supply, particularly in the plants that service Brazil. So yes, in the beginning, we were able to capture this higher consumption at home and BRF brands, which are very strong, had a very good appropriation of this market movement but only partially. Because there was another side to that with the restricted production, which hindered how much we could use of this market movement.

So now when things go back to normal gradually, we are going to recover this market share and go back to that growing market share that we had before. I don't know if I

answered your question, but I'm here if you need any more information.

A - Patricio Rohner {BIO 19686996 <GO>}

Now about Asia, in respect to Asia, we have different situations. Yes, we do sell more fresh or in natura products. Markets import more in natura products. For example, Japan, they import products in natura, and a good part is imported by local processing companies. And they process the product, they cook the product, they sell in local food services with what we call on the go. We have a lot of stores that sell products on the go, for example, in subway stations. So people are coming back from work.

They buy something in a subway station to prepare at home when they get home, the everyday menu that they consume in Japan, and it's cyclical. So when there's a high level of local production with low demand, either because of the lockdown and exports are still high, this is what happens in Japan.

In the past, it would actually happen once or twice a year. So what happened now during the past months is nearly normal to us because we monitor local stocks, we monitor local production. So we know what's happening. And that is why we were less affected because, of course, we had a decrease in production.

And also we had problems in June because of problems in Brazil. So what we expect for the future? We expect to offer and supply to rebalance themselves. And that the movement of lowering prices and still capture good margin is not happening right now. But when prices in Brazil start to increase, they will change their mix and sell the products in the internal market. And this is the normal, the regular dynamics.

So in Japan, we expect prices to improve, the current prices will improve. But of course, that depends on the behavior of Brazil and the comeback of Europe, particularly for chicken breast, because we know that this international mix, we have to balance this international mix between breast and legs. In China, pork prices are still very high, and that put more pressure on chicken. A good part of that was due to speculation due to the increased imports to the U.S., and they sell a mix with a low added value with very aggressive prices. And Brazil, in particular, has minimum prices according to the agreement between the countries.

And the third variable is the product mix. We sold more than half a month in griller for some governments, for example, Singapore. And part of this margin is also due to the product mix. So three variables: the normal market dynamics, the normal dynamics of the markets that we know and with which we work it in our everyday interactions with them; also the product mix, breast and legs and boneless products; and also the variable related with exports. When we reduce our production volume, griller tends to lose its ideal markets and look for alternative markets, both for volume and price. So they generate a lower margin compared to the previous mix that they sold in Asia. Do you have any more questions?

Operator

The next question comes from Lucas Ferreira, JPMorgan.

Q - Lucas Ferreira {BIO 16552031 <GO>}

Good morning. I have two questions. One for Sidney. Sidney, your sales channel, what was the behavior of your sales channel during the pandemic? And also I'd like to know about the price of processed products. Do you see any room for price adjustment considering that scenario that you described with the lower production? And if not, do you think you can use any discounts or change your sales mix so that you can increase your average sale price for the coming quarters? And the second question I think could be for Lorival or Vinicius. I heard that China detect the virus in chicken. It was not BRF chicken, but it's Brazilian chicken. So what types of control do you have in place? You talked about what you did for your employees. But what have you been doing to prevent any contamination of your products, your exported products?

A - Sidney Rogerio Manzano {BIO 17678250 <GO>}

So I'll go first, and then Lorival will answer your second question. Thank you for the questions. So you asked two questions. First, the channel mix. Well, initially, this consumption at home and reduction in food services of course caused a relevant decrease in our food service segment, close to 35%. But this was totally absorbed by the increase in retail consumption. Retail grew a lot and has a larger weight in our sales portfolio. So whatever we lost with food service was offset by the increase in retail. Even cash, which is a mixed channel, the larger presence of final consumers in our cash channel also help this channel grow in sales. So considering the equation of sales channels and the adjustment of our product portfolio and product categories, we were able to offset with the increase in retail, whatever loss we've had with food service.

What I can tell you about the short-term is that we see -- we already see recovering food service actually. It has been very positive, a positive surprise to us because initially, there was a 35% drop in food service, and now it's only one digit, so the decrease is only one digit currently. And with stores reopening, with businesses reopening, and considering the capillarity that we had in our very good capacity of distribution, this will help our volumes go back to pre-COVID volumes very fast. So food service is recovering. And consumption at home, we don't think that it will go back to pre-COVID levels. I think it is a new normal, either due to the macroeconomic reason, which is that people are more used to being at home, cooking at home, and because some people even experimented for the first time consuming at-home cooking. So we think that this will continue to be a trend.

We will continue to see higher in-home consumption. And since we have this very good capillarity in our distribution and very good quality of our brands and products, this will help us greatly. So we see this mix of channels very positively in the light of the recovery of food service and the residual permanence of this increasing in-home consumption.

In respect of prices, when we announced our previous results, we had already said that we had anticipated the price adjustment for Q1. Then in Q2, I'd say that the price still doesn't reflect the second price adjustment that we made in June. So it only partially reflects it. You will only see it fully in quarter three. So our price strategy is of course the pillar of profitability. Our contribution margins are defended and maintained and

whenever we are challenged from the grain, from the cereal perspective, we will revisit our margins based on our market positioning. So we had a new price adjustment that will be fully 100% reflected on Q3. I don't know if you have any more questions. I think you have a second question, that is going to be answered by Lorival.

A - Lorival Luz {BIO 16180455 <GO>}

Thank you, Sidney. I think that was a very relevant question considering the news that we heard today in the morning. So I would like to ask our Quality VP, Mr. Peixoto. Mr. Peixoto, can you answer his question, please?

A - Neil Hamilton Dos Guimaraes Peixoto {BIO 21479970 <GO>}

Yes. Thank you for the question. There are two relevant points here: First, the quality division is following very closely all scientific data related with COVID. And today, there is no scientific evidence that food or food packages are sources or routes of contamination for COVID-19. And this is not said by me. This is being said by the WHO; the Food and Drug Administration; and EFSA, the European food and safety association.

So this is the first point that we need to dis-mystify. And as I said, we are following the facts closely and trying to understand what happened in China. And the second point about our measures, the measures of the company, there's something really important here. We do not have any employees working our plants contaminated with COVID-19. And this is due to all the preventive measures that we took that were described by Lorival in the beginning of the presentation. We intensify the acts of control. We're testing people, we're measuring temperature.

We implemented social distancing and self-isolation measures. We intensified all the hygiene processes, and this includes production line hygiene, container hygiene for our exported products. And finally, PPEs. We have also implemented the use and the correct use of PPE in our sites. That's why I can reassure you that we are 100% sure that we are doing the right thing in respect to our products. Thank you for your question.

Operator

Our next question, Mr. Soares, Citibank.

Q - Joao Soares {BIO 17386703 <GO>}

Good morning, everyone. Thank you for taking my questions. Number one for Lorival and Sidney. When we look at the internal market, how do you see the corona voucher, as it's being called, the benefits coming from the government? Do you think that demand depends on those incentives or not and looking forward, how do you see possibility of a trend down and how do you position the company around that issue? And also the many things happening, I'd like to understand what you expect to see in terms of financial expenses, cash position, financial management going forward. And what other transactions could impact -- what kind of target you have in terms of cost reduction for the year also? Thank you.

A - Lorival Luz {BIO 16180455 <GO>}

Once again, making the most of our interaction. I'll give the floor over to Sidney to address the internal market and then Carlos will take on your second question, Carlos, our CFO, about liability management.

A - Sidney Rogerio Manzano {BIO 17678250 <GO>}

Thank you, Joao, for the questions. As for the corona voucher or the benefits, without a doubt, that was a positive measure in terms of consumption and, of course, food consumption. But as we see it, the food market is not very elastic, not very flexible. People might change income brackets, but consumption, especially if we look at the last crisis we've been through, consumption was quite resilient even with important drops in the economy. But when we look ahead, we see, of course, a change.

When we lose that benefit coming from the government, this will have effect. But on the other hand, when we look at the drop in revenue and an increase in unemployment, this will lead people to change consumption habits. And with this recent experience of cooking at home, this will help encourage that level of consumption, in-house consumption, which will benefit us because of our portfolio, our brands and more than that. It does have two aspects. We see Netflix taking off. We see 4G networks taking off as well, and that shows that people will be more at home than before, either because they're concerned about the COVID or because they found entertainment that fits their wallet.

So those two variables have a very positive impact on our business, either because it's due to entertainment or because of our higher added-value portfolio. People would be cooking at home more, as I said, and our portfolio is quite convenient, quite practical in that respect. So we understand that this market will continue to benefit from this new normal, as it's being said. That's how we see it even with a drop of incentives from the government.

Now as for the trade down, I think we do have a very important role to play here. Our company is a market leader. We have a good reputation in terms of market share and also in terms of preference for our brands. So what we have been doing in terms of increasing innovation, until recently, we were working at a level below 2%. Today, it's above 4%. This will meet demand coming from consumers who now want products that deliver to their desire. That includes practical items.

In that respect, we have a very important role of fostering the consumption of higher added-value products, and we're doing just that through our brands, into our brand communication. We continue to go preference and also through new products that meet new trends and also through the accessibility of our products that are now reaching more clients, that through different channels, digital channels, B2B, B2C. So that combination of factors places us in a very comfortable position in terms of meeting a higher demand for added-value products.

Lorival, back to you.

A - Carlos Alberto Bezerra De Moura {BIO 16675187 <GO>}

No, it's me. This is Sidney now. Our liability management processes have to combine prudence, financial discipline and economic efficiency. If you look at the last quarter, even with the effect of the foreign exchange variation on interest, which, of course, affects taxes, we had a drop in interest costs benefited by real-pegged debt. So we move towards a direction of having a higher portion of our debt pegged to the Brazilian BRL, 36% now; also maintaining a prudent level of a liquidity enough to support our business, around BRL11.5 billion, including our rotating credit lines.

The trend for the year is for us to be able to at least reduce at around BRL40 million in terms of financial expenses, given the new structure and also given the behavior of the CDI, as mention before.

Q - Joao Soares {BIO 17386703 <GO>}

If I can have a brief follow-up. Looking at nonrecurring financial gains. You had -- you saw an impact coming from a sale. I'm looking at the explanatory note here, but if you could give more detail about that, about this financial gain specifically. And looking forward, what can we expect along those lines?

A - Lorival Luz {BIO 16180455 <GO>}

Okay. I'll just explain the context and then its respective effect. It has to do with an acquisition contract, actually an option to acquire -- minority shareholders have in Turkey. Now that's a -- they have a put option against the company. And that's measured as a multiple of EBITDA, in EBITDA in Turkish lira, times, 6.1x, discounted the net debt of the Turkish operation.

They have a separate balance sheet. So we managed that, and Patricio, our Chairman of the Board there, and I sit on the Board with him. So we have this -- the measurement of that put option defined on a quarterly basis. What happened in this quarter specifically is that we had a different series of factors involved. Number one, the change in channels, the drop in demand, which generated a smaller EBITDA and also the depreciation of the Turkish lira, combined with the export issues with Iraq. That's why this option was reevaluated.

Last year, the company provision BRL203 million, so to consider that as a one-off issue is not correct. That is part of the business. It's seen as a financial result, even though it is connected to a contract, which is operational. But for accounting norms, we have to account for that this way with all the scrutiny from our auditors. But what we see looking forward is a stability trend as the business improves. The put option will probably improve as the business improves, and we provision for that until our minority shareholders decide on exercising that option. I hope I was clear enough.

Q - Joao Soares {BIO 17386703 <GO>}

No, it's clear. Thank you, Carlos, and thank you, Sidney for your answers. Thank you.

Operator

Our next question comes from Ricardo Alves from Morgan Stanley.

Q - Ricardo Alves {BIO 16840901 <GO>}

Good morning, Lorival. Thank you for the call. All my questions have been answered. The margin was quite impressive at 14%, and I'd like to have an outlook for the second half. You talked about processed products, which are coming on strong, you mentioned. And you have also pressure coming from the other side. So I would like to hear from you what you expect for the second half of the year. And what could affect the company's profitability? And I'm talking about the next half of the year, the next quarters and also if you could discuss in more detail, if you could recap your purchase policy or inventory levels in terms of grains and corn for the second half?

A - Lorival Luz {BIO 16180455 <GO>}

Thank you, Ricardo. As I said, we look at the impacts as a general thing in terms of production costs, operating performance, plant management and also the expenses concerning COVID. So we see a down trend of that impact across all issues or all fronts. Some expenses were one-off, one-timers. And so there is a trend of reduction for the second half in the second -- third quarter, which will become more relevant in the fourth quarter. As for the cost impact, I'll turn the floor over to our colleague because of the impact of the corn and then he'll complement my answer concerning second half, and he can also tackle other measures we are thinking about corn.

A - Unidentified Speaker

Thank you, Ricardo, for your question. We have been doing this for the past few years. Our input purchases for feed is not speculative. So we conduct a consistent study in the market. We've been doing this for a long time. We look at the short, mid and long run. Our main objective is to make sure we have enough supply to feed our animals. But we also -- we want to maintain our company's competitiveness. So for the last few years, we increased our storage capacity. We have more warehouses to have a higher storage capacity, and we use that according to our market view. We also have been using alternative materials.

Along with our nutrition team, we have increase the consumption of sorgho, for example. When we do that in Mato Grosso for the first time, we identify areas who were more prone to that crop. We worked with the partner growers, and then we have a better margins. Of course, our strategy in terms of storing more or less is strategic, as I said, I cannot tell you how much we store. But when you look at carryover stocks in Brazil and the U.S., we are in a safe position, and we make decisions based on the company's risk policies, not only at the short run, but looking at 2021. That's what makes us consistent in terms of decision-making. And that, of course, reflects on our results when we see the impact of grain costs on our performance when we compare to market. Thank you Ricardo for your question. I remain available.

Q - Ricardo Alves {BIO 16840901 <GO>}

Thank you, thank you very much.

Operator

Our next question from Barbara Halberstadt from JPMorgan.

Q - Barbara Halberstadt {BIO 18022271 <GO>}

Good morning. I have two questions. I like to have a follow-up about the liability management. What is your focus for the next 12, 18 months? Debt swap in the radar, what kind of strategy will you see going forward? And in terms of working capital, if you could give us some more color about how you've been managing working capital? And what do you expect to see for the remainder of the year?

A - Lorival Luz {BIO 16180455 <GO>}

Carlos, you have the floor.

A - Carlos Alberto Bezerra De Moura {BIO 16675187 <GO>}

As for liability management, our objective is to always have an extension, to have a comfortable profile for the company with the most efficient economic policy. Of course, we try to obtain more resources in BRLs reais, but we need to think that the depth of the capital market in BRLs is different from the depth of capital markets in strong currency abroad. So that's why we managed our hedge positions, so that they can come out neutral. In any event, the company is always ready and prepared to move depending on when market windows open so that we can explore opportunities just as we did at the recent tender offer. So we might extend terms, provide more comfort to our debt in terms of expense -- the expenses -- financial expenses load. And of course, we try as best as we can to increase the BRL portion of that.

As for the working capital, that's a very good question because it provides me with the opportunity to express the efforts we've been making to meet clients and suppliers with a series of efforts. Sidney has been leading that movement we have publicly announced to the market and in our communication materials as well. But we also made several internal efforts to support our client base, especially the small retail clients, so they will suffer the least with the pandemic. We manage to maintain default levels very low for clients.

And in terms of suppliers, we managed to meet their demands, we anticipated resources, and we also obtained extension of payment terms. And with that, we could provide a comfort level to our inventory. Lorival mentioned we're always trying to extend that so that we can have a cautious inventory to be able to meet our supply needs. So -- and we manage to do that quite efficiently. And in terms of other variations of working capitals, I'd like to highlight we managed to monetize our tax credits quite well, quite efficiently, especially those from the PIS and COFINS. And that has helped us out quite significantly in managing our working capital.

Q - Barbara Halberstadt {BIO 18022271 <GO>}

Thank you.

Operator

Next question from Felipe de Souza from (inaudible).

Q - Analyst

Good afternoon. Thank you for the question. Talking about strategy, BRF is coming from a period of restructuring of operations. And I'd like to know on top of reducing the leverage level, what other alternatives do you plan to follow with the business? Are you looking for M&A opportunities? Are you planning on concentrating or expanding your product portfolio? So my question is around strategy rather than a more focus approach on the current results. I understand your numbers will only improve after all we've seen today but in terms of the strategy going forward please. Thank you.

A - Lorival Luz {BIO 16180455 <GO>}

Thank you, Felipe. I'll all address that. You said it well. I think the company has been rebuilding. I have total -- we have paved the way and prepare the foundations of the company to face what's coming ahead. We have a better management system in place, better processes, more operating and commercial efficiency also personnel training, strengthening of our culture. In short, today, we have a very committed, align team with us. And all of us have a purpose in what direction are we going to follow now.

We're going to move towards what I've just shown you during the presentation. And we mentioned that in our last BRF day last year we're going to invest increasingly in innovation, product launches so that we will grow those -- 80% of our portfolio, which brings -- or which bring higher added value, higher margins and also to explore the strength of our brands. So the idea is to strengthen that strategy, to grow more towards that direction, once again, focused on higher added-value products, adding new lines, new products so that we can move, as I said and as we've done towards that direction. In other words, to migrate from a more volatile market, where we have more commodity-based products, to a product line, to a portfolio where we have more profit, more return and more stability in terms of result generation, in terms of cash generation. Of course, we are now going through a cycle where we are working on our strategic planning for the company. So for the next month, we'll be discussing along with our Board, discuss to align and define our next steps.

What I can tell you right now is that we are quite confident that we do have plenty of opportunities ahead of us. And as I said, our team is quite able, quite engaged, and we will step into this new normal, if I may, this new moment with all its energy focused on that. And this is about to start in the next coming months and then we'll be, as I said, in line with our communications during our BRF Day and communicating our strategy and our advances. But in short, we have paved the way for that. And we are now ready to try and capture more growth opportunities, margin opportunities with an eye at increasing the company's return and positioning the company where it belongs, including the multiples, of course, given the product base that we have.

Q - Analyst

Thank you. Just a short follow up, in terms of the process, the cost that you have today, I understand that the company is close to reaching long-term efficiency. Is that your understanding? Or do you still have a lot of efficiency gain before you can get there?

A - Lorival Luz {BIO 16180455 <GO>}

Well, things are being implemented now. So we are completing the implementation of these processes that we mentioned. Of course, that in the first half of the year, considering the crisis and the pandemic, it was difficult to keep up with the schedule, to keep the pace. So we have to adapt to current moment, but as I said, we have paved the way to all these initiatives, and some of them are already ongoing. Some are at its -- their final stages of implementation. Some of them are being completed. So there are still opportunities, there are still further gains that we can capture either in our plants, our sites or in logistics or in commercial efficiency.

Q - Analyst

Okay. Thank you.

Operator

We are now closing the question-and-answer session. Now I turn over back to Mr.Lorival Luz.

A - Lorival Luz {BIO 16180455 <GO>}

Well thank you all for attending. Thank you for being here with us today for this new format of our conference call. We try to make it more interactive, and I think that we could achieve that. We were successful achieving that. I'd like to take this chance to communicate for those who still don't know, and I'd like to recognize and thank our Investor Relations Director, Eduardo Takeiti. He made a decision to leave the company. He has new plans for his life, so he told us he would like to leave the company. He will still be with us for the next month, and he will be replaced by Gabriela Woogie [ph]. She will be with us for our next conference call.

So I take this chance to recognize all his hard work and dedication and everything he was able to achieve with the IR team in the nearly three years he was with us in the company. He was able to raise the bar. And I hope you also think so, but he raised the bar in terms of communication with our investors, with the analysts and all the interactions, the information provided, clarity of the information, the quality of the information. So I would like to express my gratitude and my recognition for Eduardo's work, his brilliant work, and I wish him lots of success in his new ventures in life. I'm sure that you will be brilliant in anything you do. I hope you can become an investor in the future Eduardo. Thank you all and have a great day.

Operator

FINAL

Bloomberg Transcript

Thank you. BRF's conference call is now closed. We would like to thank you all for attending, and we wish you a great day.

This transcript may not be 100 percent accurate and may contain misspellings and other inaccuracies. This transcript is provided "as is", without express or implied warranties of any kind. Bloomberg retains all rights to this transcript and provides it solely for your personal, non-commercial use. Bloomberg, its suppliers and third-party agents shall have no liability for errors in this transcript or for lost profits, losses, or direct, indirect, incidental, consequential, special or punitive damages in connection with the furnishing, performance or use of such transcript. Neither the information nor any opinion expressed in this transcript constitutes a solicitation of the purchase or sale of securities or commodities. Any opinion expressed in the transcript does not necessarily reflect the views of Bloomberg LP. © COPYRIGHT 2022, BLOOMBERG LP. All rights reserved. Any reproduction, redistribution or retransmission is expressly prohibited.

FINAL

Bloomberg Transcript