Q2 2016 Earnings Call

Company Participants

- José Alexandre Carneiro Borges
- Pedro de Andrade Faria

Other Participants

- Alexander Robarts
- Antonio Barreto
- Jeronimo De Guzman
- Lauren Torres
- Luca Cipiccia

MANAGEMENT DISCUSSION SECTION

Operator

Good morning, ladies and gents, and welcome to BRF SA Conference Call to discuss Second Quarter 2016 Earnings. This conference call is being transmitted via webcast in our website, www.brf-br.com/ir. At this time, all participants are in a listen-only mode, and after the presentation, we will conduct a question-and-answer session. Instructions will be given at that time. We would appreciate if each participant made only one question.

Forward-looking statements related to the company's businesses, perspectives, projections, results, and the company's growth potential are provisions based on expectations of the management as to the future of the company. These expectations are highly dependent on market changes, economic conditions of the country and the sector and international markets, thus are subject to changes. As a reminder, this conference is being recorded.

This conference will be presented by Mr. Pedro Faria, Chief Executive Officer; and Mr. José Alexandre Carneiro Borges, Chief Financial and Investor Relations Officer.

We now hand the call over to Mr. Pedro Faria, who will begin the conference call. Mr. Pedro, you may begin.

Pedro de Andrade Faria {BIO 15115819 <GO>}

Good morning, ladies and gentlemen, and thanks for taking part in today's conference. I am very pleased to say that our expansion strategy and global transformation are ongoing at full steam and results are becoming more visible every day.

As we're reaching our results, our international operations are growing significantly, with volumes rising by 17% on an annual comparison. On top of that, we show remarkable resilience on the EBITDA margin and have remained at 13% even against the challenging and exceptional backdrop we have seen in the first half of the year. This was the quarter we partially consolidated the acquisitions of Calchaquí and Campo Austral in Argentina which combined brought more than BRL 50 million in revenues for the Latin America market.

We also concluded in a very satisfactory way our 100-day plan to integrate GFS, now known as BRF Thailand, in which we met the number of opportunities for synergies on the operating side as well as on the commercial side. This should continue to help boost the profitability of our operation in Asia.

One good example is the new branded line, the zinger (02:46), which is produced by BRF Thailand and will be launched in Middle East markets in the coming months under the Sadia brand. We have also announced the setting up of Sadia Halal, a BRF subsidiary that should be based in the Middle East and will be established as one of the biggest Halal food companies in the world with around $2 billion in net revenue.

We believe this is such an important step for the company in order to expand and consolidate its position in the Muslim markets. The creation of an independent company in the region will allow us to give much greater focus and accelerated expansion in a market where the population grows twice the global average.

Regarding the sector outlook, the chicken cycle in the second quarter was even more difficult compared to the first, basically with the three variables that directly impact our results and which are worth the commentary: the price of grains, international poultry price in dollars, and the exchange rate. What we saw in the second quarter is that these three variable elements moved in an important and synchronized way, creating a difficult and almost exceptional scenario for the segment.

In the quarter, corn prices have risen by more than 100% over the same period of 2015, increasing our cost metrics substantially. On the other hand, the production and supply of chicken continue to expand and squeeze prices in dollar terms which combined with a currency appreciation of around 10% over the previous quarter, pushing our price in reais to even lower levels.

However, when we look at some figures from the sector, we have the impression that the work is clearly behind us. Market figures showed a slowdown in production of one-day chick which points to a reduction in poultry production. Moreover, the entry of the second crop volume has already made a positive contribution to the decrease in corn prices as a result of greater availability of grains in the market between July and August. Even considering the current discussions of a potential crop shortfall, we should see healthier price in the coming quarters. Finally, we have begun to see a recovery in international dollar prices in markets that are critically important for BRF, such as the Middle East and Asia.

As we move to our Brazil operation, we continue to see demand shrinking. Nielsen figures show that the market for some important categories for BRF, such as ready-to-eat meals and cold cuts, have fallen by 10% and 60% respectively, compared to the beginning of the year.

At the same time, the pressure from costs during the quarter led us to make a new price increase of around 7% at the end of the month of May. Having done two successive price increases, we continue to see the competitive dynamic in the short term performing in line with expectations, competition holding back on raising prices in order to gain market share.

As a result, we are at loss around 2 points in terms of market share compared with the beginning of the year but continues to have a very solid leadership position with 57% total market share. We are following our strategy of improving the level of service for our clients through a number of initiatives to enhance execution and improve products such as the new version of the go-to-market which has provided a very satisfactory way of segmenting even further our client base. The goal of this improvement in execution in price increases is clearly to recover the profitability of our domestic operation.

Continually in Brazil, I am very pleased with the result of our innovation program which remained strong and focus on getting closer to the final consumer bringing new attributes for our clients, for our consumers in our categories. Besides the extreme success of our Salamitos snacks line, which had its production expanded by around 30% in May, market also proves to accept very well the launch of our new ready-to-eat meals line, resulting a gain of almost 4 percentage points in market share for that category.

In the second half of the year, we will launch new product lines focused on healthy meals. Moreover, we will introduce a new category of ready-to-cook meals. This category was created in partnership with the famous chef Jamie Oliver. The focus is to bring healthy products and move consumers closer to food, a campaign that Jamie has been pursuing worldwide.

In conclusion, we remain very confident in our financial position to navigate throughout this year of macroeconomic downturn in Brazil and sector challenges without deviating from our long-term strategy, continue with our short-term efforts to strengthen the initiative to reduce costs and expenses through our zero-based budget programs, and we have improved our commercial and logistical execution in our operations even further.

I will now hand over to Alex Borges, who will give you more financial details on second quarter results. Thank you very much.

José Alexandre Carneiro Borges

Thanks, Pedro. I would like to highlight some important financial figures from our second quarter results. Our net revenue increased by 7.6% year-over-year to BRL 8.5 billion. This result was due mainly to the strong growth in our international bonds, with the highlight to Asia and Europe.

We had a gross profit of BRL 1.9 billion, reaching a gross margin of 22.5%. This result was impacted by the challenges of the cycle due to a strong increase in chicken supply and increase in cost of grains, a lower chicken price in dollar terms, and a stronger real.

To give you an idea of the grain impact in our results, if we were to consider market price variation in the first half of the year and multiply this value by BRF's monthly consumption volume, we would reach an increase of approximately BRL 1.4 billion in costs year-over-year. This increase was BRL 936 million in the second quarter alone.

This should have been the impact on the gross profit from the grain alone, all other variables being constant. However, we managed to offset part of this impact through a number of initiatives such as an improved feed conversion ratio, a better nutrition formulation of the animal feed, a better execution of the purchase of grains, hedging, and other initiatives. The actual impact in our cost of the grains increase was around BRL 1 billion on the first half of 2016 and approximately BRL 600 million in the second quarter alone. In other words, we managed to offset the impact of the grains by around 30% so far this year.

We also managed to control our operational expense as well. We continue to focus on our zero budget – our zero-based budget program in a number of initiatives to offset the impact of the cycle. If we were to exclude the recent acquisitions, our SG&A would have increased by 4.5% year-over-year, well below currency impact or the Brazilian inflation in the period.

And despite of our efforts to offset the impact of the cycle, both in terms of costs and SG&A, our EBITDA margin declined by 6.3 percentage points year-over-year and reached 11.1% in the quarter. And the total EBITDA came to BRL 944 million.

It's worth mentioning that even though we are in the worst moment of this cycle, we had a consolidated EBITDA margins of 13.2% in our international markets which is over 10 percentage points higher if compared with the worst quarters of previous cycles. And this profitability results were achieved with interesting growth in many of the regions.

In another hand, we recognized the challenges of the Brazilian market. On top of the big increase in costs and the shrink in demand, we witnessed a reduction in volumes in our operational deleverage. All these factors together increase even more the challenges for this region. We are keeping our focus on recovering the profitability of the region and we raised prices again by approximately 7% last May. Considering the current outlook for costs, new increases in prices may be necessary.

In terms of our financial results, we had net a expenses of BRL 504 million in the quarter. This amount included a BRL 294 million in net interest, BRL 85 million in adjustments to present value, BRL 84 million in monetary correction and others, and BRL 39 million in foreign exchange variation. It's worth highlighting that we had an increase in net interest in the quarter of approximately BRL 34 million due to the increase of the net debt position in the period.

In order to provide more transparency to the market, we have revised our managerial cash flow session in our earnings release. Previously, we presented a simplified free cash flow version with EBITDA, changes in working capital and CapEx. Now, we are presenting the complete correct cash flow in a managerial format and we will upload in our Investor Relations' site other reconciliation line by line from the accounting cash flow statement to this managerial version.

Our operating cash flow duration came to BRL 908 million for the quarter which allowed for the financing of BRL 795 million in CapEx. There was also an impact for the payment of BRL 595 million in acquisitions in the quarter and the share buyback program of BRL 360 million. As a result, our net leverage for the quarter increased to 1.99. If we were to exclude the acquisitions and the share buyback in this quarter, our net leverage would have come to 1.82 times net debt-to-EBITDA.

The cash generation for the quarter already shows a significant improvement compared to the first quarter of 2016. And EBITDA to cash conversion of – was close to 100%.

With this, we'll finish our initial comments, and I would like to thank you all for your presence. And we are now ready to answer your questions. Thank you.

Q&A

Operator

Excuse me, ladies and gentlemen. We will now begin the question-and-answer session. Each participant may ask only one question. Our first question comes from Luca Cipiccia, Goldman Sachs.

Q - Luca Cipiccia {BIO 6914452 <GO>}

Hi. Good morning, Pedro. Good morning, Alex. Thank you for taking my question. I wanted to ask, just a follow-up on some of the discussion on the Portuguese call earlier about Brazil. Just to keep up – to pick it up from that thread, more on the visibility on rebuilding profitability in the second half. Maybe if you can give us more context on what you expect, how long do you think it will take before going back to double-digit margin, even assuming a better environment for corn in light of the change in mix and channel in branded products that you highlighted earlier, and as well some of the year-over-year effects that may facilitate that process? Third quarter last year, it was the Perdigão brand, and it was sort of the adjustment in prices and all of that. This year, I assume you may have some additional costs for the Olympics or some of these other items. There's a high seasonality as well in the second half.

So maybe if you can give us some visibility on the level of margins and the level of improvement that we should expect, considering maybe a better cost environment, but possibly as well, a more sticky mixed headwinds as we discussed – you discussed in the previous call from a channel and product perspective.

And then, if I may later, I would have just a quick one on Sadia Halal, but just in case there's time for that.

A - Pedro de Andrade Faria {BIO 15115819 <GO>}

Thank you, Luca, and good morning. First of all, my apologies for making switch from the Portuguese to English call. Thank you very much.

Q - Luca Cipiccia {BIO 6914452 <GO>}

No. Better for me.

A - Pedro de Andrade Faria {BIO 15115819 <GO>}

Okay. So when it comes to the domestic operations, Brazil operations, you are asking about double-digit EBIT margins, is that right?

Q - Luca Cipiccia {BIO 6914452 <GO>}

Yeah. I mean, just as you look into the second half, and you've been commenting about rebuilding profitability, sequentially, what do you think is related to expect (17:05) compared in the current market content?

A - Pedro de Andrade Faria {BIO 15115819 <GO>}

Okay. So, I'll start my answer to you by saying that we mentioned it in the Portuguese call, we have had sequentially better months throughout the second quarter. So, if I look just at the picture from June results, you already see us navigating double-digit EBIT margins, okay. This is when we get the full benefit of the price implementation. We get the full benefit from a level of price relativity across all categories and across all channels much more rational. So, I think we are really off of a gradual yet surely recovery of our Brazil operations.

What makes me confident about that is a number of initiatives are starting to pay off. Our GPM (17:56) was mentioned in the Portuguese call in which we are emphasizing a lot segmentation. We're seeing the early results in the sub-channels we have segmented and improved our level of services.

We are also seeing our (18:09), as we call it, coming down. We have a relationship program like Mercado which is also bringing the anticipated results. And we are starting to see – yet, when you look at the broader picture, we're starting to see stabilization in market share loss.

And in some categories, notably, we are gaining market share again. We are gaining market share in ready-to-eat meals, which is a strategically relevant category. And we see even on the processed categories in general, the high frequency ratings we get from Nielsen showing our stabilization of that market share trend.

So, I'm confident that we will see that. It's a big challenge because there's a number of variables which we don't control. We are hoping, of course, for a much better price environment for our input. We are almost – know that there is a communicating (19:05) place between chicken prices outside of Brazil and chicken prices in Brazil.

So, you should expect In Natura category in Brazil to have a quite positive price trend in the next few months. And I also expect that some of the innovation program that we bring are also happening to fight back the erosion in the mix, which I think was the main concern we have for the second quarter.

So, I expect the third quarter to be sequentially better than the first and the second, and I expect to have a nice fourth quarter, with a very well executed campaign around festivities. So, we can start the year of 2017 on a much higher and stronger note.

A - José Alexandre Carneiro Borges

Luca, if I may, I just want to add that you saw that the key drag on our results for Brazil in the second quarter was gross profit, right? We saw a decline of about 3.5 percentage points quarter-over-quarter. So, this is really hurting us. In one hand, it's COGS, as we mentioned, the cycle, grade, and everything else.

But on the other hand, it's a little bit of a loss of operational leverage because of having lower volumes, right? Especially, we are seeing a sequential improvement on the results, and that should come particularly from gross margins. We are looking to return or get back or continue to be in this trajectory of recovering the gross margins and getting back to levels that we have historically in this market.

And we're going to do that, not only benefiting from the cycle that's improving, but with the full impact from a price increase, improving the mix of channels and products that really hurt us in the second quarter, but also increasing volumes, which should help us to improve our operational leverage, reducing idle capacity costs related to this loss of volume. So, we are very confident that we're going to gradually continue to improve the business to recover the profitability in this region.

Q - Luca Cipiccia {BIO 6914452 <GO>}

Okay. Very clear. Can I ask quickly about Sadia Halal, quick one?

A - Pedro de Andrade Faria {BIO 15115819 <GO>}

Yes. Go ahead.

Q - Luca Cipiccia {BIO 6914452 <GO>}

My question was about – well, two things. One, if you could clarify what is going to go in there. I mean, should we think about the Middle East operation, is this more platform for a different kind of segmentation that, I mean, you're going to separate that or separate your division in a different way going forward? That's the first part.

And secondly, if you can talk around in the priority – the main rationale for doing this. I understand there's the operational flexibility, more consistency in strategy across the Sadia brand and the Muslim market, but how much – that is the driver, how much is the better relation, maybe platform in this market, how much could it be the idea of crystallizing some value? There were reports about potentially an IPO. I don't know if you can comment about that, but maybe give some context of why you're doing this between crystallizing financial value, operational flexibility, and domestic relationship. That would be useful.

A - Pedro de Andrade Faria {BIO 15115819 <GO>}

Thank you, Luca. I think the reasons why Sadia Halal – I think you are quite right to point a number of the reasons why, but I'd say that the overwhelming reason why is to accelerate growth. We truly believe we have a winning formula there. We truly believe we have the best brand in that market, and we also have execution capabilities which I think are second to none.

So, this entity will be growing. It's already one of the top, if not the largest, Halal food company in the world. And accelerate growth means extending the business model that we've successfully employed in the GCC in the fixed companies in the Gulf to other regions, Egypt, Jordan to markets which are deeply investigating, as well as some other opportunities in Southeast Asia and other bigger markets that we think that the reason for an independent management company is also again in the lines of our philosophic thinking of empowering people, giving them freedom to run the businesses. We have a platform, I think you will have the benefit of (24:14) which I think is quite substantial, good (24:17) in terms of talent.

So, I think unlike some other comments which may induce people to believe that we are trying to unlock value or monetizing the asset, we're truly thinking in terms of how we accelerate. In that sense, I think Sadia Halal brings us which is quite unique in that role because when you think about the perimeter of this entity, we are probably starting from farm to table. And the farm starts in probably the best production hub globally, which is different from other Halal food companies which don't benefit from a Brazil production platform which have (24:58) chicken production acquired into Halal standards in the last 30 years to 40 years.

We're also talking about our distribution model in the Middle East. We're talking about the (25:09) factory in Abu Dhabi. And of course, expansion of produce into Halal markets, Egypt, Malaysia, Turkey, Jordan. So, there's really a way to ignite the faster growth into what I think is one of the best hidden values in the BRF story, which is our Halal footprint.

A - José Alexandre Carneiro Borges

Pedro, if you allow me just to compliment. Luca, if you think about this, right, (25:38) export platform and the movement we made in the last few years where we accelerated over the last few years to become more of a local player, local distribution, the brand and commercial institution and so forth that you saw there and that we still have a lot of room to grow in three of our product mix to increase penetration, to increase the offering and so far supporting the plants in Abu Dhabi and so forth, this higher movement of becoming more of a local player has really picking up the results of this region.

If you think of where we were some five years ago in terms of EBITDA of this region, we were south of $100 million per year in terms of EBITDA in the region, and actually (26:31) record the number of its growth to 80 (26:33) if you reach back in 2012. And now working a particularly – and that was actually a good year at that high. If you think of what we did last year which was close to $450 million in EBITDA, this is multiplying the dividends by more than four just by the fact that we'd put a lot of emphasis, focus, execution, and the team there is really local and dealing this platform.

So what Pedro is saying, subsidiary growth is – I will take the next step to become even more of a local player to really capture the local opportunities (27:12) more independently managed and more focused team there to really accelerate what we think it's going to be, not only the GCC but upon Halal strategy. We see a lot of opportunities for growth in the regions. We have mentioned that over and over in our discussions that inhabited in a separate entity, dedicated, fully integrated. We are in a firm belief that we can really recognize (27:39) extraordinary solid growth and profitability of this business. This is the main reason behind it. You have mentioned a lot of other potential benefits, but this is what's really driving us to pursue these opportunities.

Q - Luca Cipiccia {BIO 6914452 <GO>}

That's very clear. Makes a lot of sense. The fact that it could be a public company, would it help anyhow or it's just a consideration that comes after?

A - Pedro de Andrade Faria {BIO 15115819 <GO>}

As we have answered to CVM's considerations and questions and stuff, this is one of the alternatives that we are analyzing. I mean, we may consider to the extent that it helps us to further accelerate growth. This is something that we are considering as well.

Q - Luca Cipiccia {BIO 6914452 <GO>}

Thank you very much. Thank you.

Operator

The next question comes from Lauren Torres, UBS.

Q - Lauren Torres {BIO 7323680 <GO>}

Yes. Hi. Good morning, everyone. My question or a follow-up, I guess, on your domestic business, you seem quite positive about some of the industry conditions turning in the second half of the year, but you put some good pricing already in place.

So, just curious about plans for the second half. You seem neither would like to take more pricing. I guess you mentioned that your competition is being somewhat irrational. With that said, if things get I guess more irrational in the second half, would that change your pricing stance?

And I guess in conjunction with that question, as you think about mix, value-added products I guess are not doing as well in modest (29:17) consumer, but how do you feel about that going forward? Is the incremental investments still going behind value-added brands, or if the consumer remains somewhat soft, the allocation spend, they shift? That's my question. Thanks.

A - Pedro de Andrade Faria {BIO 15115819 <GO>}

Thank you, Lauren. This is Pedro. I really believe, unfortunately, new wave of price increases is in due course, the most movement in our input cost such as grains have been really beyond anyone's expectation. But as we pointed out in the Portuguese call, these movements, they will be less intense, more granular and more focused in some categories that we still find room for price increases to take place.

As we move into the second half of the year, it's a busy part of the year for us. It's seasonally the stronger period of the year. We have festivities coming around the corner. So, I am truly hoping and I think I have reason to believe that competition that have maintained a big level of rationality as we move into this part of the year, if you continue to behave rationally, we are all being subject to the same level of increases in our input costs. And I think we'll finish the first half in a relativity, which I think brings back some level of equilibrium to the market.

So, I am hoping for a sequentially better second half of the year. It will be a gradual improvement, but I expect this to take place as the Brazilian economy also starts to recover and consumer sentiment improves somewhat.

When it comes to the mix, this is really the big priority we have. Consumers are making choices. Consumers are looking for value-for-money opportunities. But we continue to roll our innovation program in what I think is a very satisfactory way. We've had a big hit with Salamitos' next version, snacks is a very interesting high growth category because it brings both high value added for us, but also in terms of out of pocket and in terms of indulgence, I think it's a category that brings a lot in this moment of the Brazilian economy.

We took a challenge to reignite growth in revenues, and we're very happy to see – lasagna used to be the big item, and now it represents less than half of what we do, meaning, that all the categories inside that bucket are actually presenting very remarkable growth. We dropped 4 percentage points in market share in that category, and I think that's a more, I'd say, basic item in our portfolio that should be able to recuperate in terms of brand preference. Consumers who have migrated from Sadia to Perdigão, some of them will now hopefully migrate back to Sadia which gives us extra percentage guaranteed profit.

In terms of channel, I think as consumers become less constraining the budget, I think that gave rise to opportunities for convenience choice, for brand choices. So, I think this will be a gradual recovery. I don't expect one single thing to really ignite this, but I think we're just moving to a more positive tone here because we already see the early signs of our execution paying off and a better economic environment overall.

Q - Lauren Torres {BIO 7323680 <GO>}

Okay. Good to hear. Thank you.

Operator

The next question comes from Alex Robarts, Citigroup.

Q - Alexander Robarts {BIO 1499637 <GO>}

Hi, everybody, and thanks for taking my questions. I wanted to go back to the Halal project in the Middle East. I mean, it's pretty clear that your stated strategy is to accelerate growth with the Halal project overall.

And I guess in Dubai when we were at the (33:42) recently, kind of the markets seem to be very attractive, and nearby, as you said also today in your remarks, Egypt and Jordan. And Egypt particularly is my question. This is a market with 80 million people versus 50 million living in the Gulf. It's a significant market, and as I think about you throughout history for the last few years, it's been a dicey market for you, I think, at some point.

If I understand it, in 2014, you left Egypt, and it seems to me you've wanted to export more directly from Brazil, as you say in your press release. Can you tell us a little bit about kind of the growth potential in the Middle East vis-à-vis Egypt? Is the acquisition currency of a separately listed Halal entity necessary? Can you expand there?

It could be some without a potential IPO. And so, maybe if you can just speak to the potential of Egypt in the medium term and how might you think the Middle Eastern business can expand effectively in that rather sizable market. Thank you.

A - Pedro de Andrade Faria {BIO 15115819 <GO>}

Thank you, Alex. For sure, Egypt, Jordan, Turkey, Malaysia, Southeast Asia, eventually in the second round even Indonesia and other very important and large Halal markets that are in our radar screen of potential place for accelerate growth and opportunities to grow there. And as we grow in this expansion, to some extent, some of these markets represent a greater operational challenge given their scenarios, macroeconomics, political and so forth. And that's why it reinforces our view that we really need to become more locals and be pursued more as a local player than just what used to be historically an export platform out of Brazil.

Historically, we have - entering the countries, we're a very strong net importers. As we're moving along and growing, we have to do that. We need to strengthen our local position and relations with a lot of these markets.

We are analyzing if – how could an IPO help us and other alternatives as well could help us accelerate growth? Having local partners joining forces with us, how that could help us to accelerate potential acquisition opportunities? So that's – it's part of our study, as we think – as you are mentioning Egypt, for instance, what is the best approach not to be completely exposed to what is a challenging environment? We acknowledge that the whole region is challenging but it has – offers great opportunities, business and growth opportunities for us.

If you think about, it can range from capital structure discussion, access to funding, really partnering up with the local players, really getting closer to them, really being perceived more of a local entity rather than just a foreigner being there. That really opens room for us to continue to strengthen our people (37:56), and a number of other factors, operational, strategically and so forth.

So, we really think that – I mean you were there, right? You saw how much we have advanced (38:07) in some of the market, some of the markets where we had built a very, very solid leadership in branding, in market share, in price positioning. I think we've got – and we have built a very strong and winning model that we are looking for ways how to better replicate that in a faster way in time to market and so forth to some of these other markets that I mentioned. And I'm very excited about it, and I'm really working hard in this project how to really continue to accelerate growth in the region, very profitable and attractive results.

Q - Alexander Robarts {BIO 1499637 <GO>}

Okay. Thank you.

Operator

The next question comes from the Jeronimo De Guzman, Morgan Stanley.

Q - Jeronimo De Guzman {BIO 15888043 <GO>}

Hi. Good morning. I want to go back just what you mentioned you expect this recovery in trends particularly in volumes in Brazil going forward in the second half. I wanted to ask more specifically if you're already seeing any improvement in the trend in July so far, now that the price increases from May potentially have been absorbed.

And then, also kind of related to the volume question. You've mentioned that the competitive environment has remained rational. So, I just wanted to understand what is obviously driving the – (39:36) are being followed in pricing. So, I'm just wondering what is driving the share of losses. Is it just – you see it just as a timing issue, that you see you're just a price leader and now they probably got share or has there been something else that's been driving the losses?

And then, also related to the related to the volume question and the fact that you mentioned that the cash and carry format had been increasing, do you have any specific strategies related to this format to continue growing or to grow to be – or to have it be more profitable going forward?

A - Pedro de Andrade Faria {BIO 15115819 <GO>}

Thank you, Jeronimo. This is Pedro. So in terms of volume trends, we pointed out that we've seen even a 30-week trend (40:21) for the second quarter, the months which have – gradually and sequentially better, okay.

As we finished the second quarter, we have reasons to believe that we'll continue to see this gradual improvement in volume trend, July being better than June, August which is not a good month because of (40:40) calendar days being even better. So, I think that the overall trend is there.

We don't know how steep that recovery will be. But I have reason to believe that with most of the price realignment being done, with a lot of the equilibrium and relativity among channels, among capitals, among competitors, I think the market is at a much more favorable stance.

I think the reason for rationality is quite straightforward. We, the big leaders, we know probably the strongest balance sheet, we are suffering. A lot of our smaller competitors and regional players, they are also taking the pain. It's not more pain than we are. So, that I think is bringing a level of rationality which should even be perceived as we see the trends in production in Brazilian placements and so on and so forth.

When we think about market share, I will like to believe it's more of a timing issue, as we said. We have taken the burden of being the leaders in the categories and pushing them to a minimum level of profitability. And this also brings a lot of trends around how do the channels and the trade accepts those movements. There's some more price sensitive channels that we will fight hard not to lose whatever price or reference to. So, I think a lot of that is said and done.

We come to the end of the semester with strong relationships with the trade which have understood the necessity of those price increases. They've seen also competitive (42:26). So we're seeing emerging trends of stabilization in market share. I have pointed out to market share gains in some of the strategically relevant categories like to ready-to-eat meals. We've seen stabilization across the entire range of processed foods. So, I'm more positive on market share trends starting to reverse or even recover.

I think you have a second question, although I pretty much covered the entire question. Cash and carry. Yes. So, cash and carry, you are right. We have a team, a dedicated team now implementing a full-blown strategy with cash and carry. That involves a different level of service, more merchandise, more promotions. That involves a careful methodic study of the format. And as an opportunity, cash and carry is indexed to (43:25) into our portfolio.

It involves understanding the perfect mix and the perfect portfolio. We are re-launching same items we have discontinued because they have a strong acceptance in that trade. We are bringing new SKUs. We are playing a lot with the pack size, pack price, which is very relevant. So, I think we're already reaping the benefits of that initiative. This channel, for us, is one in which in the quarter we have grown compared to last year.

So, I think the trend is positive. We continue to try and perform our very best in this channel, which I think is here to stay. It is indeed what's fueling growth of mostly the big chains. It is indeed a very interesting format for consumers. Nearly half of the consumers there are actually – end consumers and not transformers, so there is interesting segmentation profitability. I think we're pleased with the initiatives we have for the format.

Q - Jeronimo De Guzman {BIO 15888043 <GO>}

Great. Thank you.

Operator

Our next question comes from Antonio Barreto, Itaú BBA.

Q - Antonio Barreto {BIO 18291497 <GO>}

Hi, everyone. Good morning. Thank you for taking my question. My first question is a follow-up to the comment that you guys made in the Portuguese call that you are able to buy grains at a 14% discount through June, and June was already lower than May. I just wanted to make sure I understood it correctly.

First, is it 100% until the end of the year (45:08) through the end of the year that it's bought? And if at that same price, there was a 14% discount through June? And you bought – fiscal inventories or contracts (45:20).

A - José Alexandre Carneiro Borges

Antonio, thank you very much for the question. The number that I was given was the purchase that we made in June versus May that was 5% lower on average. And that was a mix of buying on the spot, contracts that we have bought, and there is impacts of hedging contracts and other instruments. When I mentioned about July about 14% to 15% lower, it's in the same basis.

As you look forward to the remainder of the year, we have not bought 100% of our needs for grains. And I'm here more specifically on corn. We have bought a significant amount of our needs, and that is in physical contracts with producers mainly.

The curve of the price is going forward in our July (46:39), it's pretty much following the curve that you see on the market. The one that (46:48) you see what are the trading (46:52) versus the Chicago prices and so forth. There, you see the curve. And that's the curve, obviously, each one of our geographies has its own dynamics. Some of them more impacted by the second harvest, which are finalizing in the next month or so, but what we're seeing in terms of the dynamics is what you see in the screen in terms of the curve going forward. What I was saying is that the (47:29) the second harvest was lower than expected, and we're still seeing more exports from Brazil than expected. I think we will most likely as an industry, the whole industry, we need to import some corn in the second half. And the import of corn could also help to ease the pressure or the potential shortage of the grain because of excess exports that we are seeing.

So, we have seen the prices come down. It's about this 20% that I mentioned. We are seeing - but we're still seeing the dynamics under pressure. But even it's under pressure, given very much the comfort that the average costs levels that we were going to realize in the second half of the year, I'm going to be more competitive to what we have seen in the first half of 2016.

On the soybean, for instance, we're seeing an increase on the pricings in the more recent months. That is one of the grains that - one of the foods that we have, being able to manage our needs more effectively. We've been guiding a very tight position. So, we are more comfortable in that regard. But that's - the combination of these two is what's giving us the comfort that - are those too tight, but it's going to be a much better than this impact that we showed in our results in the first half of 2016.

A - Pedro de Andrade Faria {BIO 15115819 <GO>}

(49:22) to follow up, we (49:25) to go into more details if you want, but this is obviously it's an area that are - they're putting a lot of emphasis, a lot of focus there. And I think, from the results we just disclosed, we have achieved significant results.

If you think about competitors that do not and not be able to be as effective as we were, we are talking here of about 3.5 or 4 percentile points of lower margins or better margins that we gained because of our active management - managing through purchasing execution, hedging professions (50:07) of grains. So, I think it has been a source of competitive advantage for us. And we expect that continues to be the case going forward.

Q - Antonio Barreto {BIO 18291497 <GO>}

Okay. Thank you for that, José and Pedro. And my second and last question is about the line that you reported as other revenues. I could see on the financial report that you guys have a gain on a combination of business of BRL 58 billion on your AKF subsidiary (50:38). And I guess we'd like to know if this business are recurring daily (50:40) and if it's recurring or non-recurring, if it was allocated proportionally among the business segments.

A - Pedro de Andrade Faria {BIO 15115819 <GO>}

Yes. I can take this. This has to do with consolidation of our Oman operations, okay. So, this was in the Middle East. As we move from the 40% to 100% stake, this was the adjustments in the gains that we actually have built over the years and then we realize as we step off this on this quarter. So, it is we call - it's rather operational, but it's - the operational gain is not recurring. We're not going to have those going forward. That was because of their (51:38) operations, so therefore impacting the Middle East results.

Q - Antonio Barreto {BIO 18291497 <GO>}

Thank you. It's very clear. Thank you.

Operator

This concludes today's question-and-answer session. I would like to pass the floor again to Mr. Pedro Faria.

A - Pedro de Andrade Faria {BIO 15115819 <GO>}

Well, I'd like to wrap up this conference by thanking you very much for participating. As we finished the first half of 2016, it is no secret we have had one of the most challenging periods in the company, having very adverse effects coming from variables we cannot very much control. But I'd just like to state that I'm overall very satisfied to see that the company is still running very strong, still very much looking forward to its long-term strategy, seeing the benefit of a number of investments we have made in the last few years paying off, showing a lot more resilience in our international business, and also, in a more positive way, looking forward to a gradual Brazilian economy recovery, and of course a number of our initiatives starting to pay off.

I really believe this should be a year of first half, second half total different dynamic, still a lot of uncertainty around variables like corn prices, FX, trends, so on and so forth. But I think we are very, very confident on our ability to endure tough times as it was the case in the second quarter. And of course, be compensated by our efforts once the market become more favorable in terms of trend.

Thank you very much for taking this call, and I look forward to seeing you in the next conference call. Thank you.

Operator

That does conclude our BRF SA conference call. Thank you very much for your participation. Have a good day.