Q2 2016 Earnings Call

Company Participants

- Andrew Murchie, Chief Executive Officer
- Eduardo Miron, Chief Financial and Adm. Officer and IRO
- Frank Ravndal, President & Chief Executive Officer
- Marcos Antonio Molina dos Santos, Chairman
- Martin Secco Arias, Chief Executive Officer

Other Participants

- Andrew C De Luca, Analyst
- Isabella Simonato, Analyst
- Lauren Torres, Analyst
- Pedro Leduc, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning, ladies and gentlemen. At this time, we would like to welcome everyone to Marfrig Global Foods SA Conference Call to present and discuss its Results for the Second Quarter of 2016.

The audio for this conference is being broadcast simultaneously through the Internet in the website, www.marfrig.com.br/ir. In that address, you can also find the slideshow presentation available for download.

We inform that all participants will only be able to listen to the conference call during the company's presentation. After the company's remarks are over, there will be a Q&A session. At that time, further instructions will be given.

Before proceeding, let me mention that forward-looking statements are being made under the Safe Harbor of the Securities Litigation Reform Act of 1996. Forward-looking statements are based on the beliefs and assumptions of Marfrig's management and on the information currently available to the company.

Forward-looking statements are not guarantees of performance. They involve risks, uncertainties and assumptions because they relate to future events and therefore depend on circumstances that may or may not occur in the future. Investors should understand that general economic conditions, industry conditions, and other operating factors could also affect the future results of Marfrig and could cause results to differ materially from those expressed in such forward-looking statements.

Now, I'll turn the conference over to Mr. Marcos Molina, Marfrig Global Foods' Chairman. Please, Mr. Molina, you may now begin the conference.

Marcos Antonio Molina dos Santos {BIO 15363967 <GO>}

Good afternoon, everyone. I would like to take the opportunity to congratulate all Marfrig's team. During this quarter, we were able to achieve very important targets: positive operational cash flow and free cash flow, the lowest leverage from the last three years, and a record resulting EBITDA. And I'd would like to reaffirm my commitment and from the board to the financial discipline and that it will be something that we will continue as part of our day-to-day.

I would like to pass now the word to Mr. Martin Secco, CEO of Marfrig (3:42).

Martin Secco Arias {BIO 18098476 <GO>}

Thank you, Marcos. Good morning, ladies and gentlemen. I would like to start by thanking everyone for participating in another earnings conference call of Marfrig Global Foods. Today we will be commenting on the results of the second quarter of 2016.

With me are the CEOs of the business unit who will present the result of their respective units as well as Eduardo Miron, our Global CFO, IRO; and Roberta Varella, our Investor Relations Director.

Please go to the slide number three where we'll begin today's presentation. On this slide, I will comment on the evolution of the key indicators for our 2016 guidance. Marfrig consolidated net revenue was R$10 billion in the first six months of the year, growing by 8.7% on the same period over last year. Revenue growth is explained by the higher average sales price in the Brazilian market and by the average appreciation in the Brazilian real between the two periods.

Adjusted EBITDA was R$858 million with margin of 8.7%, which is in line with our guidance range for the year. CapEx amount was R$169 million, which was concentrated in maintenance at our existing operations. In the line with our planning for the year, we spent a higher amount of investment in the second half of the year due to the construction of the new Keystone plant in Thailand.

The scenario for the second quarter was remained very challenging, special for the beef operation due to the appreciation of the Brazilian real and higher raw material cost, but Marfrig was able to partially reduce the negative free cash flow of R$138 million in the first quarter to a negative free cash flow for R$69 million for the first half of the year 2016.

Regarding our guidance for the year, I would like to remind to you, when we give our guidance for the market at the time that we were reporting 2015 results, the market thought that we were very conservative. At the time, I responded that the figures were neither conservative or aggressive, but realistic for a business that involve multiple variables. Given the expectation of our better definition of the macroeconomic scenario in Brazil and the new exchange regulation that appear to be consolidating, we are analyzing the numbers and during the third quarter we will confirm if we maintain or revise our guidance 2016. But I would like to reaffirm however that we remain focused in our generation of positive cash flow.

I will let Eduardo to continue the presentation, especially regarding the financial figures.

Eduardo Miron

Thank you, Martin. Let's turn now to the slide number four where I'll give more details on the breakdown of our net revenue. As you can see, Marfrig's net revenue was R$4.8 billion in the second quarter of 2016, a small increase from the second quarter, but lower sales volume in the distribution and the lower revenues at Keystone influenced by lower commodity prices were offset by Brazilian real depreciation between these two periods.

Keystone and Beef International operations accounted for 63% of total revenue, up from 59% in the second quarter of last year, demonstrating the company's continued international expansion. With regard to our currency exposure, note that only 21% of our revenue was linked to the Brazilian real in the second quarter of 2016, which is down 1 percentage point from the second quarter of last year. This reflects Marfrig's important international presence with Keystone and Beef International operations as well as its continued success in seizing opportunities in the export channels in beef (9:08) Brazil operation.

Let's turn to the slide five. On this slide, I will comment on Marfrig's consolidated gross profit and adjusted EBITDA. Gross profit in the quarter was R$572 million, up 3.2% from the prior-year period with gross margin of 12%. The main factors contributing to this performance were the depreciation of the real against the U.S. dollar and the lower raw material costs in the international operations, which were partially offset by lower margins in the beef operations.

SG&A expense as a ratio of net revenues stood at 5.7%, 50 basis points higher than a year earlier. The FX conversion impacted (10:05) export logistics expenses in Brazil operations and on the SG&A of international operations, which were the two main drivers. In this context, adjusted EBITDA was R$414 million and margin of 8.7%, both figures in line with the second quarter of 2015.

Finally, on the graph on the lower right corner, we show the EBITDA breakdown by business, where Keystone represented 56% during the second quarter, a 16 percentage point increase from the same period of the last year.

On slide six, I will comment on net income in the quarter and year-to-date. In the first half of 2016, Marfrig posted a net loss of R$238 million, improving R$339 million or 60% from 2015.

During the second quarter, Marfrig posted a net loss of R$132 million, R$126 million lower when compared to the second quarter of 2015. Here we have two relevant impacts. First, in 2015 (11:40), the result was positively affected by a non-recurring gain on bargain purchase of the Mercormar asset. Second, in 2016, the result was negatively impacted by the increase in financial expense due to the liability management process, which means extraordinary expenses with the bonds repurchased and by the write-off of deferred expense from previous issues.

Before we move to the next slide, I will pass the call over to Frank Ravndal, CEO of Keystone.

Frank Ravndal {BIO 19230519 <GO>}

Thanks, Eduardo. Good afternoon, everyone. Keystone once again delivered excellent results for the quarter. Let's review that performance in more detail on slide seven. As a reminder, all financial data presented for Keystone is in U.S. dollars.

Starting with the graph on the upper left, the net revenue decreased by 4% compared to the same period of 2015, driven by lower commodity prices, mainly in the U.S. market. As you know, Keystone's business model includes pass-through arrangements for commodity prices and some commercial arrangements with several customers. Therefore, Keystone revenues link to meat and feed prices. The second quarter saw a continuation of the declining cost trend we experienced in the first quarter of 2016. In the U.S., for example, feed cost dropped by approximately 17%, and outside meat cost fell by approximately 15% from year ago levels.

You can see that key accounts as a percentage of sales increased to 28%. The higher percentage of key account sales to our total sales versus 2015 is a reflection of our ability to add new customers and build capabilities to expand our value-added sales, thereby improving our product mix. It's also important to highlight that our strong track record and reputation in the industry for innovation and for maintaining the highest levels of food safety continue to be recognized in the market and allows us to attract new customers.

Volume is up 1% from the same period in 2015 and was up 3.5% compared to the first quarter of 2016. Key accounts growth in the U.S. and an increase in the overall volume in APMEA were the main positive contributors to the small net volume increase. This partially offset the impact of a drop in volume in the U.S., largely driven by the decision to outsource of deboning work, which led to lower byproduct sales. Some of the key account growth in the U.S. did not impact volume as we converted some existing commodity sales, volumes and value added.

Moving to the graph on the right side of the page, you can see the EBITDA and EBITDA margin for the second quarter. Keystone set another record this quarter. We generated adjusted EBITDA of $67 million in the quarter, up from $54 million in the second quarter of 2015, an increase of 24% year-over-year.

This quarter's strong performance was (14:50) by three main themes. One was the better sales mix on strong sales volume in APMEA led by China, Malaysia and Australia out of an overall 8.6% volume increase from the second quarter of 2015 across the entire region. The second driver was a positive commodity market environment, which led to substantially lower fee and outside meat cost year-over-year. And the third main theme has helped to shape the strong quarter with further growth in key accounts with the solid contribution from introduction of some No Antibiotics Ever products in the U.S.

Consumer demand for poultry not treated with antibiotics important to human medicine or No Antibiotics Ever is increasing, and Keystone is positioned to serve its customers across a broad spectrum of consumer preferences, and we'll continue to adapt our practices and supply chain to meet their present and future requirements.

In summary, this was another great quarter for Keystone, and I'd like to take the opportunity to thank our Keystone Foods team around the world for the strong results.

I'd like to now pass the call to Andrew Murchie, CEO of Beef Brazil, to go over the second quarter results for that business. Andrew?

Andrew Murchie {BIO 18098471 <GO>}

Thank you, Frank. Good morning, everyone. On slide eight, I'll comment on the results of the Beef division, which includes the operations in Brazil and also in the international area. The scenario for the beef industry remained challenging under the business result reflected the challenge of sales (16:21). The main component of this scenario were the high prices of cattle and the limited supply for slaughtering due to the movement of the cattle cycle (16:31) in Brazil, and also the lower beef prices in the international market.

As you can see in the chart on the top left, net revenue was R$2.4 billion, down 6.4% on the prior year period. The lower sales volume affected by the appreciation of our industrial facilities and the cattle availability was partially offset by the higher average sales price, which benefited from the weaker Brazilian real. Our successful strategy of focusing on sales on the food service and small-retail channels, which accounted for 42% of sales in Brazil domestic market in the second quarter, up from 37% on the same period last year.

Also in the export market, our priority on improving the sales mix with Asia accounting for 34% of the export volume in the quarter, increasing 13 percentage points year-over-year. The chart on the top right shows adjusted EBITDA from the Beef division. Adjusted EBITDA in the quarter was R$180 million, down R$65 million from the same period last year with adjusted EBITDA margin of 7.5%. The result was due to the lower sales volume as already explained, the higher industrial fixed cost due to inflation between the periods, the lower spreads (18:15) both in Brazil and international operations, and also by the effect of exchange rate variation of the translation of international operations and logistic export expenses.

Before moving to the next slide, I will pass the call back over to Eduardo Miron.

Eduardo Miron

Thank you, Andrew. So let's go now to slide nine where I will comment on the international offering carried out in May and June of this year as part of our Liability Management process. In our opinion, despite the extremely challenging environment, we achieved the two main goals of our Liability Management, reducing costs and expanding terms.

In May, Marfrig was the first publicly held and private sector company to pass international best market, which had been close to Brazilian issuers since June 2015. Demand reached $2.5 billion, five times higher than the initial offering of $500 million. Because of the high demand for Marfrig securities, which reached $750 million, and also improved its pricing, which ended up at a final yield of 8.25% or 12.5 basis points below the initial guidance.

In June, due to the excellent performance of the 2023 bond in the secondary market and the window of opportunity that emerged for Latin America issuers following the United Kingdom's decision to leave the European Union. Marfrig once again was the first Brazilian company to re-tap the debt market. The additional offering of $250 million was re-tapped with a yield of 7.625% (20:08), a point below the original issue. The total proceeds from this new 2023 bond which amounted to $1 billion has been used to repurchase for expensive and short-term debt, effectively advancing the strategy of linking (20:32) the maturity profile and reduce the company's debt cost.

The table on the lower side of the slide shows the allocation of the proceeds based on face value. Initially, these resources were used to repurchase the bonds maturing in 2016, 2017, 2018 and 2020, whose face value amounted to $521 million. In July, the company announced the offer to repurchase the remaining 2017 bonds in the amount of $96 million, which closing date is today in fact. And finally, we have the 2016 bonds with an outstanding amount of $104 million maturing in November.

The chart on the top show our pro forma curve of the new maturity schedule of the bonds with an increasing average term from 2.7 years to 4.7 years.

Let's go now to the next slide please. Slide 10 shows Marfrig's liquidity and total debt maturity schedule. On June 30, the company gross debt was R$11 billion, down 6% and 8% from the end of first quarter 2016 and from second quarter of 2015 respectively. In U.S. dollars, gross debt was $3.4 billion, 4% higher than in the previous quarter, which reflects the portion of the new bonds that was not utilized.

The balance of cash and cash equivalents was R$5.2 billion or $1.6 billion, which are sufficient to cover practically all that payments through 2019. We understand our cash position is conservative, but we prefer to follow the strategy, given the still (22:40) adverse local and global scenario. In this context, Marfrig net debt was R$4.8 billion, decreasing 11% and 38% from first quarter 2016 and second quarter 2015 respectively. This is the lowest level since the first quarter of 2011.

In U.S. dollar, net debt was $1.8 billion, which is in line with the prior quarter and down 60% from a year ago. Marfrig's leverage measured by the ratio of net debt to adjusted EBITDA in the last 12 months excluding the positive effect from the capital gains from the asset divestment ended the quarter at 3.1 times, which represents an improvement of around 0.5 times from the ratio of 3.5 times of the previous quarter. The average cost of debt ended the quarter at 7.31%, down 33 basis points from the first quarter, reflecting the company's commitment to lower its cost of debt.

Let's now go to the last slide, please. On slide 11, I will comment on cash flow in the second quarter. Operating cash flow before interest and CapEx was BRL 338 million, advancing BRL 65 million from the first quarter of 2016, reflecting the good performance of our operations and the working capital management. CapEx which amounted to BRL 61 million in the quarter was spent primarily to maintenance of the existing operations. Interest expenses amounted to BRL 288 million – BRL 281 million, which benefited from the stronger Brazil real compared to the first quarter.

Another highlight in the quarter was the positive cash from discontinued operations, which contributed with BRL 73 million to the company's cash flow. As a result, consolidated free cash flow was positive BRL 69 million.

With that, we'll conclude our presentation. And now, we would like to start the Q&A session. Thanks, everyone.

Q&A

Operator

Thank you. Ladies and gentlemen, we will now begin the question-and-answer session. Our first question comes from Isabella Simonato with Bank of America Merrill Lynch.

Q - Isabella Simonato {BIO 16693071 <GO>}

Good morning, everyone. Thank you for the call. I have two questions. First on the beef side. First, when you look at the sales mix actually the relevance of exports in this quarter was lower compared to what we saw in Q1. I would like to understand the strategy behind the mix in this quarter, and also if you could give us an update on your view for cattle prices in the second half of 2016 and in 2017, and how do you see spreads in both domestic and exports market evolving going forward? Thank you.

A - Martin Secco Arias {BIO 18098476 <GO>}

Thank you. I would ask Andrew to complete your first question.

A - Andrew Murchie {BIO 18098471 <GO>}

Hello. And your first question is about the second domestic (26:40) a little bit to exports. As you know, our decision in terms of export to domestic market is on the basis of returns and in the profitability. What we have seen on the end of the second semester was exactly that in terms of the exchange was coming down and making the calculation and by the options that we have even in the domestic market was even of course better than export. That was the only reason that we have diverted some of the export into the domestic market. Profitability is the answer for that other one.

In terms of cattle cost, we don't see too much of a space for changes during this second semester. A lot of speculation about having less offers due to the grain prices because of the feedlot. We do believe there will be some smaller offer than the first semester. But we don't think that that will be too big. I think, professional farmers which confine animals every year, they will not stop just because of that maybe they will do a little bit less, but not stopping. It's their business, the cattle is on their farms, and they have to feed the animals.

We might have a little bit less, but not significant. So we see some steady offers by the end of this year. For 2017, yes, based on the last two years-and-a-half or two years of retention of cows in Brazil, and high prices of cows, we started to see that the price of cows are starting to drop a little bit, and that's the first reason that we might see more offers and less retention of cows by next year. So we do expect more offers of cattle in 2017.

Q - Isabella Simonato {BIO 16693071 <GO>}

Thank you.

A - Andrew Murchie {BIO 18098471 <GO>}

You're welcome.

Operator

Our next question comes from Lauren Torres with UBS.

Q - Lauren Torres {BIO 7323680 <GO>}

Yes. Hi everyone. Not to be too shortsighted in nature, but I'm just curious on you choosing not to update your full-year guidance at this stage of the game. I guess, particularly looking at your assumptions are based on currency of 4.1%, and seeing how the real has moved. Just curious once again to get the perspective on the puts and takes of how comfortable you are, so giving this guidance, and I guess keeping it unchanged at this point, and what could change I guess to kind of keep you within this range for the full year. And I guess, in particular, I'm curious to get your perspective on hitting your free cash flow full year numbers seeing where we are year-to-date? Thank you.

A - Martin Secco Arias {BIO 18098476 <GO>}

Thank you for the question. As I mentioned, we are analyzing during these days to inform the new guidance or maintain our guidance. As you know, we have a multiple variables affecting our guidance, but there are some of them that are very, very hard and especially the exchange rate, really we are assuming a newer scenario and we are making the calculation and we are informed to the market in the next weeks.

Q - Lauren Torres {BIO 7323680 <GO>}

Okay. And I guess, as the other part of my question. I mean, the comfort on the free cash flow guidance. I know, we came off a weaker first quarter, have seen a better second quarter. So what gives you the confidence as the things could change I guess on the full year number, but what gives you confidence on the second half of the year with respect to generating a better free cash flow?

A - Martin Secco Arias {BIO 18098476 <GO>}

Yes. We expect a better generation and as I mentioned, our main target will be positive cash flow.

Q - Lauren Torres {BIO 7323680 <GO>}

Okay. Thank you.

Operator

Next question Pedro Leduc, JPMorgan.

Q - Pedro Leduc {BIO 16665775 <GO>}

Thank you for the question for everyone. On Keystone, first a remarkable 9.9% EBITDA margins, nice, especially considering relevant cost (31:14) sales and this margin gain came entirely from the gross margin side versus the last year's 2Q at least. Could you guys talk a little bit more about what drove these gross margin gains, if it was purely, let's say, commodity cost driven or does it also have a more structural component to it, like the product mix, time (31:35), time efficiencies and also just help us understand how could it evolve going forward? Thank you.

A - Martin Secco Arias {BIO 18098476 <GO>}

Frank, could you answer this question for us.

A - Frank Ravndal {BIO 19230519 <GO>}

Sure. Hi, Pedro. Thanks. When you're talking about beef within Keystone. I'm just wondering where you were looking at that detail. I thought I heard you talk about beef margins in particular within Keystone. I just want to make sure I heard the question correctly.

Q - Pedro Leduc {BIO 16665775 <GO>}

No, just Keystone as a whole, of course.

A - Frank Ravndal {BIO 19230519 <GO>}

Okay.

Q - Pedro Leduc {BIO 16665775 <GO>}

On the margin gains that we saw, yes.

A - Frank Ravndal {BIO 19230519 <GO>}

Yeah. So, again, I think really just the different factors that I already mentioned. So you had a slight change of mix in the U.S. as we were able to take a little of bit what have been commodity sales and be able to turn those into value-added. And we did that specifically by being able to add some prior capacity of one location and some other capabilities that we're operating at another location. That allowed us to provide some existing customers and some new customers with a broader line of SKUs. So that was one attributed to some of the key account growth, which also then helped to drive additional margin and profitability for the quarter. That was one area.

The component around the cost structure from the commodities that you mentioned in your question is absolutely a driver as well in terms of the lower outside meat costs, as well as significantly lower feed cost during the quarter. And so I think, those were some of the main drivers that would repeat (33:20).

Q - Pedro Leduc {BIO 16665775 <GO>}

Okay. So, one of them is actually a business change or mix change as you guys (33:26) some is commodity. So at least one part we can imagine will prevail independent of commodity?

A - Frank Ravndal {BIO 19230519 <GO>}

That's right. That's right. I mean, I think a lot of the change if you can think about over the last couple of years in terms of the margin build up, it hasn't been volatile in terms of just being a commodity base. And so one of the driver in terms of EBIT change has been in that commodity that lower cost through. If you look at it over longer period of time, there's some things we've been able to do around, operating cost improvements, better pricing discipline and focus, improved mix and then sort of commodity risk management overall, raw material sourcing. So all of those components are, I think, stickier than just a moment in time. And you see that if you look back over our EBITDA for the last three years or four years.

Q - Pedro Leduc {BIO 16665775 <GO>}

Okay. Thank you. And then I have a second question for Miron on the company's cash position was pretty high at the end of the quarter, of course, you're doing some other tenderings, which haven't flown out of the cash yet, but still a little more than you would probably need, so wondering if you're thinking about any special deployment alternatives. And just on the recurring basis, you are deleveraging, but still not enough profit recurring level. So if there any more actions that you guys can see at least on the cash use side to lower interest expenses and thus bring the company to the current cost base (35:02)? Thank you.

A - Eduardo Miron

Thank you for the question. Yeah, as we mentioned before, we do recognize that we have a conservative position. We have now in this - today, in fact we are making the (35:18) payment and we have another in 2016 that is mature in November. And we continue to looking at opportunities to reduce our debt at the same time that we're keeping our eye on the overall situation and which - as we mentioned before also, so we still see as (35:38) situation in the local market and in the external market. So we're still having a conservative approach.

Q - Pedro Leduc {BIO 16665775 <GO>}

Thank you.

A - Eduardo Miron

You're welcome.

Operator

The next question comes from Stella Chen with Benchmark (35:57).

Hi, thank you very much for your results. I just wanted to ask, I guess some - ask Martin (36:05) a clarification regarding the BNDES mandatory convertibles. I know that you issued a statement clarifying that the news we got out was inaccurate and so I just, I guess I just want to know several parameters or so i.e., is Mr. Marcos comfortable with the convertible debentures being completely converted and/or what is an ideal scenario for Marcos in the past few days given the diventures? Thank you.

A - Martin Secco Arias {BIO 18098476 <GO>}

Thank you, Stella (36:44). And regarding this issue, we want to reaffirm our discipline - financial discipline. And early this morning, we make our formal communication for the company regarding the press release that we received yesterday and we are not going to make any comment or either speculation about this article.

Q - Operator

Some more direct question. Is it possible that you would be deploying any cash towards - maybe (37:30) the debentures early? Is that a possibility at all? Is there some kind of reassurance you can give us (37:35) lever up to resolve any of the issues surrounding the debentures?

A - Martin Secco Arias {BIO 18098476 <GO>}

Could you repeat again your question?

Q - Operator

So, I guess, a more direct question. Is there any possibility that you're willing to increase the leverage of the company to potentially prepay or pay part of the mandatory debentures down (38:07)?

A - Eduardo Miron

Hi, Stella (38:13). This is Eduardo Miron. As we are reassuring and we keep talking to the market, so our discipline in terms of the financials is absolutely key. So, our objective is to reduce leverage. It is not to increase the leverage. So, you can consider that any decision that the company makes has, as I would say, a condition direction towards leveraging and generating free cash flow. So that's what we can share with you at this point.

Q - Operator

Okay. That's exactly what I wanted (39:00) to hear. Thank you very much.

Our next question comes from (39:08)

Hello. Thanks very much for taking my question. I was actually also wanted to ask about the debentures and potential increase in leverage in that your (39:20) I wondered if you could also give me some information about opening up of the U.S. market to the exports from Brazil. I understand that there is some framework agreement has been put in place and these will start, but there's just some quota relating to this. So I just wondered if you have any feel for when the level of volume of exports might be reviewed.

A - Martin Secco Arias {BIO 18098476 <GO>}

Thank you for the question. As you know, because we were talking about that for other calls, it was very good news for Brazil for the whole agriculture industry, especially the beef industry in Brazil. We are in the middle of the Minister of Agriculture from Brazil make the instruction to the factories regarding to start to produce for the U.S. market.

Okay, as we comment in other calls, we are not expecting to increase our volume - physical volume of production, but this news make a very positive impact in our margin and our pricing of the product, as with other markets in the last six months like Arabia and China. But U.S. market has another significant importance for Brazil because there are so many countries that follow U.S. market instruction regarding the opening and open the market for Brazilian beef. I am referring Canada, Mexico, Caribbean region that all of them are very important players regarding the import of the beef around the world. So thus we are very, very happy about the news and we are thinking to start shipment maybe in 30 days or less than 30 days, will affect the last quarter of the company positively and it's a very, very long challenge that Brazil industry achieved in the last two weeks.

Q - Operator

Okay. And can you comment on how many of your plants are currently shut? Because I know that you're shutting plants to keep your utilization in the other plants up and I just wondered if those are still mothballed at the moment.

A - Martin Secco Arias {BIO 18098476 <GO>}

Just to confirm that I understand okay your question. You are asking about our capacity utilization or something like that.

Q - Operator

Yeah. I think you had some plants shut this year to make sure that your capacity utilization in existing plants is quite high. So I think you have maybe three plants shut at the end of the last year, beginning of this year, and I just wondered if they still remain shut or if all your plants are now open in Brazil.

A - Martin Secco Arias {BIO 18098476 <GO>}

Not for the moment. As I mentioned before, we don't have expectation to increase our volume, but we are going to work in some factory for Brazilian market and this will help not only on the price that we are going to achieve in U.S. but also will help in our strategy in other markets that we are going to operate with less volume.

Q - Operator

Okay. Thanks very much.

A - Martin Secco Arias {BIO 18098476 <GO>}

Welcome.

Operator

The next question comes from Andrew De Luca with Barclays.

Q - Andrew C De Luca {BIO 18025129 <GO>}

Hi. Thank you for taking my question. Martin or Eduardo, I wanted to go back on the comments on free cash flow and I know you can't provide a lot of color at the moment, but I was wondering if you could tell us what has specifically changed in the dynamics aside from the FX, because Andrew mentioned that the cattle prices are likely to remain stable in the second half. So I am guessing, is there something on the competition side that has changed that you weren't expecting at the beginning of the year.

A - Eduardo Miron

Hi. This is Eduardo Miron. So back to our commitment to free cash flow, we continue working extremely hard on the working capital. So we have specific actions in that direction. So we expect the result as we mentioned before related to the second half of the year. And on top of this, I believe we will see the benefits of reducing interest rate. So I think the combination of this should generate better cash flow in the second semester.

Q - Andrew C De Luca {BIO 18025129 <GO>}

Okay. But have you seen anything changing in the competitive environment? Just because your volumes declined in the low single-digit – sorry, around 13% and that's a little bit more than we saw for some of your competitors. So I wanted to see, are you seeing any sort of irrational (45:22) behavior from some of your competitors in the market?

A - Eduardo Miron

No. I don't think there is any different behaviors that we are facing versus with our competitors.

Q - Andrew C De Luca {BIO 18025129 <GO>}

Okay. Thank you.

A - Eduardo Miron

Welcome.

Operator

This concludes today's question-and-answer session. I'd like to invite Mr. Martin Secco to proceed with his closing statements. Please go ahead, sir.

A - Martin Secco Arias {BIO 18098476 <GO>}

Thank you. I want to remind everyone that the global outlook remains challenging. However, we expect a good performance of developed economies, especially in the U.S. In the specific case, our beef division will have a new challenge for the next quarter, that it will be the U.S. market open for Brazilian fresh beef. As I mentioned before, this is very potential to transform the industry and we expect also that after the U.S. market, other countries will follow this tendency like Canada and Mexico, there are very good potential customers for Brazilian beef.

With the consolidation of this scenario, Brazil expands its export possibilities, which will benefit the industry profitability in the medium and in the long term. At Keystone, our strategy is to remain focused on key account and our specific markets as well as the company's capacity to adapt to new market trend by offering higher value added and innovative and sustainable products.

Before I conclude today's call, I want to thank you Marfrig Global team for their commitment to delivering the results and to our ongoing liability management process during this period. Thank you, everyone. And until next earnings season, I hope to see you soon personally.

Operator

Thank you. This concludes Marfrig's conference call. Thank you very much for your participation, and have a nice day.