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Q2 2018 Earnings Call

Company Participants

- Lorival Nogueira Luz Júnior, Global Chief Operating, Financial and Investor Relations Officer
- Pedro Pullen Parente, Chairman & Global Chief Executive Officer

Other Participants

- Antonio Barreto, Analyst
- Isabella K. Simonato, Analyst
- Leandro Fontanesi, Analyst
- Lucas Ferreira, Analyst
- Thiago Duarte, Analyst
- Victor Saragiotto, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning, ladies and gentlemen. Welcome to BRF SA Conference Call to discuss the results of the Second Quarter of 2018. This call is being broadcast via Internet at our website www.brf-br.com/ir where you will also find the company's presentation for download. At this time, all participants are in listen-only mode and after the company's presentation, there will be a Q&A session when further instructions will be given. We ask please, participants, to ask only one question.

Forward-looking statements about the company's business perspectives, projections, results, growth potential are assumptions based on the management's expectations regarding the future of the company. Assumptions are highly dependent on market changes on the country and industries economic conditions in our international markets, those are subject to changes.

As a reminder, this conference will be recorded. This conference will be presented by Mr. Pedro Parente, Global CEO; and Mr. Lorival Luz, Global VP, (sic) [COO] (00:01:34) CFO, and IR Officer. Now, I would like to turn the floor to Mr. Pedro Parente, who will start the presentation.

Pedro Pullen Parente {BIO 2058839 <GO>}

Good morning, everyone. So, let's start the presentation for the results of the second quarter of 2018. This is a quarter that has brought a very challenging environment for the company. But as you all know, it does not only for the company, but also for different industries in Brazil especially because of the truckers' strike.

Now about our company; this challenging environment also is a result of series of measures that have to do with protectionism starting in December of 2017 by the Russian Government measures banning imports of Brazil protein. After that, already in this quarter, the second quarter of 2018, there was another measure by the European Union de-listing 20 plants here in Brazil and these BRF plants. And in China, in June also in the same quarter, they have applied temporary anti-dumping tariffs over imports of Brazilian poultry meat. These protectionist measures do have an important impact in our operations.

In the domestic market, we then had an oversupply because of the banning of exports, especially banning coming from Europe and Russia. I have already mentioned the truckers' strike. We'll have more details about that later on. And also as we have informed, we have performed some adjustments in our production chains, so that we could adjust to the demand level and that has then caused some restructuring costs. And also as you know, there was an increase in grain costs that has also affected our gross margins.

But we do have here a scenario of opportunities to recover market and this is on the slide of the presentation. And you might experience some delay when we change the slides. So, please bear with us there. And this happens in this type of conference. So as I said, we have market recovery opportunities in Brazil. We may have a recovery of market prices of in natura and processed markets that will reflect these supply adjustments. Also, we had a market opening in South Korea. And also we have positive signs regarding the reopening of the Russian market to the Brazilian protein.

And now before turning to the main figures, and I think that in light of this challenging environment, one might ask if the goals that we have especially announced – especially the one regarding leveraging, those could be harmed vis-à-vis the figures that we're going to mention, and I would like to say that we are working on the company very much dedicated since starting May and June, and we'll have some special drivers to generate value in the short-term that will have a positive impact in our EBITDA, and that will be little bit over BRL 500 million for 2018, and over BRL 1.2 billion for the year of 2019. I will go into further details and also Lorival will talk more about those initiatives.

The plan of action that obviously we have seen that the results are way beyond of what we can deliver, but we are working exactly to make sure that our leverage goals that have been announced in the beginning of July and also our divestments program and that has been maintaining and the figures show an adjusted EBITDA for the second quarter of 2018 of BRL 373 million. A figure that is lower than the second quarter of 2017.

And we had non-adjusted EBITDA to the adjusted EBITDA, a difference non-recurring factors that caused an impact. We will go into the details of these figures, but we just want to mention that non-recurring factors and also regarding operation (00:07:40) and the hedging of our debt also direct impacts of the truckers' strike. The truckers' strike still has indirect impact over the year, but here we have direct impact from this quarter, and other factors that are less relevant.

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We have had a net loss of BRL 1.574 billion, that's negative. The same factors, the non-recurring factors regarding the EBITDA now can be applied to our net income. In addition to that, negative result of FX and the real depreciation, all these factors in addition to others also made us adjust our net income of by these non-recurring factors and also because of the FX variation and we will then have adjusted loss of not BRL 1.5 billion but rather BRL 340 million, still negative, if it were not by those non-recurring factors.

There is another positive figure, which is our free cash flow variation. We had in the second quarter of 2018, a free cash flow is still negative of BRL 63 million, but when compared to the second quarter of 2017, which was BRL 713 million negative, we have a positive variation in our free cash flow of over BRL 650 million is still more relevant is the free cash flow when we analyzed it in the first half of 2018 and in the first half of 2017. In the first half of 2018, we had a free cash flow negative of BRL 300 million, and when compared to the free cash flow negative of the first half of 2017, that shows a positive variation of over BRL 2 billion in our free cash flow generation.

The positive figures that we would like to mention are the number of active clients; we have a constant growth and this number of active clients. In the beginning of last year, we were at 163,000 clients. We have ended December of last year at 186,000, and we are already getting closer to 200,000 clients served. And we know, this is a very important figure, because it allows us to have a perspective of market share gain, and that's what we have been seeing in order to reach the total market share in Brazil of almost 47%, 46.8%. And another priority market for our company, which is that Halal market, we also have a growth in our market share and we have reached 43.6% in June and we were at 40.9% in May. Therefore, these are positive figures regarding the company's performance.

Now, to go back and talk about our main priorities, I would like to mention once again that the company's management is totally focused and totally dedicated to these drivers. We are working hard since June and these main drivers – and you may find them on the slide number 5 – the first of them, we have announced, which was the restructuring plan and our objective is to reach a monetization of at least BRL 5 billion and to bring down our leverage.

We are now announcing the second driver that we are calling the short-term levers or short-term drivers, we will have detailed information about that. And here, we have included the optimization of ag operations. Also, we want to improve price execution, reducing sales disruption. That is the demand that we have from our clients, we are able to meet and maintain those demanded products we want to have them in our stock. We also will improve our manufacturing excellence. And also we'll optimize our direct and indirect purchases process.

And I think it's important to draw your attention to this group of measures because they depend only on the company that is we do not have to count on the market or on the price drop of raw material; these are measures and to each of these measures, we do have a detailed action plan and they will be evaluated and followed within the methodology of the management system and I will talk about that later. As I said, these drivers of generating value in the short-term aim to cause positive impact in the EBITDA of BRL 500 million – or BRL 515 million still in 2018 and at least BRL 1.2 billion in 2019 once

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again. And that's going to be talked by Lorival shortly and we'll go into details about these measures.

We also mentioned operating and financial restructuring plan. We have a detailed strategic planning despite (00:14:35) of this plan and there are some important things that I would like to highlight when we speak about our management system. We will be completing this by September 2018 and we will probably have an Investors Day in the first 15 days of October, so that we can communicate our strategic planning to the market.

We also speak about our reorganizational structure. We have filled some important positions. These new people are coming to the company, but there are still two open positions, and we intend to inform the market in the coming weeks when these positions are filled. So, the organizational restructuring of the company is already functional according to what we think will be best for the company. And we have the BRF management system that will allow us to organize all of these initiatives and we'll give you more on that in a moment. Our goal is to achieve the results that are desirable for our company.

We'll go to page 6; here, we give you some details about these value creation levers or drivers for the short-term. For the benefit of time, I will not go into too many detail (00:16:19) all of them because Lorival will be doing this; he'll give you more detail. And here we present you the expected impact to be derived from these measures. Regarding strategic planning, once again, we highlight our major markets: Brazil, the Halal market, and Asia. And we clearly established our absolute commitment, more relativity here regarding safety, quality, FX, compliance. These are absolute commitments that the company takes on. They will be rigorously followed.

Regarding our BRF management system, what we seek with this management system is total integration between strategic planning, (00:17:24) annual plans, et cetera. So, these two will not be separate instruments; in practice, they will be one single instrument. Our strategic planning system will be a tool for strategy management, and we will detail the goals of our annual budget to the level of execution.

And this third point, which is absolutely fundamental, is that in the management system our goal is to ensure discipline and rigor in executing the annual plan. We all know that putting together a strategic plan is very relevant, and this is very good to have a solid strategic plan. But as important and certainly most difficult is to ensure discipline and rigor in executing this strategic planning. I would also like to draw your attention to the fact that the BRF management system will allow us to deepen the use of our zero base budget across the company, so that we can have permanent control of all of the costs that the company incurs.

These are my initial remarks, and I'll turn the floor to Lorival for him to continue with the presentation, showing details of our numbers and of the measures that I mentioned before.

Lorival Nogueira Luz Júnior

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Thank you, Pedro. Good day, everyone. I'm on slide 10. I will go over the results. You see that in this quarter we had a volume 4% higher year-on-year, driven by an increase in volume growth of more than 10% in natura. We had an impact on the average price of 2% (00:19:33) of the adjustment as Pedro mentioned. And there is an impact also regarding export restrictions imposed by the European Union, Russia, and the impact (00:19:45) extra tariff on our poultry meat in China.

Another important factor is that in this quarter we also have (00:19:58) reported regarding adjustments need related to the restructuring that we have announced an impact vis-à-vis the prior year considering an increased price of grains, (00:20:17) in the same period of last year. We had an increase of almost 50%, 5-0, if we consider the price of this year and the price of last year. Obviously, the impact on our cost is not that high. (00:20:38) production chain, but there is clearly an impact on our cost, cost pressures that are seen in our results and in the cost of our products.

Another important factor was the impact of the truckers' strike, and I will detail this more on the following slide. So, that impacted our net income BRL 1.574 billion of loss, but we had a positive impact regarding a better management of our cash flow. We highlight here that in this quarter we had another adjustment of the (00:21:31) total return. That impacted BRL 58 million negatively on our result. And also compared to 2017, in this quarter, we do not have assets related to (00:21:53) We have BRL 295 million compared to 2017 and that brings an impact when we look at our net income.

Moving on to the next slide, we talk about our adjusted EBITDA. And I would like to highlight in more detail the BRL 288 million, which is the impact of (00:22:21) operations. Within this BRL 288 million, we had inventory adjustment at market value about BRL 200 million. In addition to the inventory, (00:22:39) we had expenses related to consulting, lawsuits, procedures in (00:22:49) attorney's fees, et cetera, another BRL 40 million. And the impact of (00:22:59) is about BRL 40 million. The basis related to inventory adjustments, inventory of products, adjustments that we have to make.

Another relevant line item is debt designated as hedge accounting. (00:23:22) we have a debt in those and designated as hedge accounting in the past. While this quarter, the amount is higher, given the maturity of the bonds that matured and that were paid in the month of May, and that is why we have a higher amount here. This operation is fully positive for the company. This hedge accounting was designated back in 2011 and 2012 and that bring less volatility and less impact on our results around this quarter.

We also had an impact from the restructuring plans that we announced. We announced about 40 days ago, so BRL 144 million. About BRL 65 million were related to contract termination, many contracts that we terminated. And we also had the payment of damages to integrated partners, about BRL 30 million. (00:24:31) in the adjustment of materials, inventory raw materials, we closed down some production lines and that entailed some adjustments. (00:24:41) inventory adjustments, raw material adjustment, packaging that was not used, you will also have an adjustment here of about BRL 50 million. Altogether, BRL 144 million.

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And also regarding the truckers' strike, we had a negative impact of BRL 75 million. This was an impact on logistics about BRL 15 million (00:25:16) Related to the truckers' strike, we have some additional costs that we incurred during that period, about BRL 60 million. So, this impact will still be seen in the coming months, in the third quarter, related to the yield of our production. Because we have an impact in terms of the flow of food that was not ideal (00:25:49) during the truckers' strike. So the total – this is the total of non-recurring items, BRL 650 million.

Let's quickly mention and highlight the discipline in managing our cash. Free cash flow of the company, you can find it on slide 8, (sic) [12] (00:26:23) BRL 650 million in the quarter, BRL 2 billion for the half-year. And on the next slide, we talk about the debt of the company. We closed the second quarter with 5.69 times net debt of adjusted EBITDA. We of course have to manage the company and we communicated the plan of BRL 5 billion to bring the leverage down to 3 times in 2019. In the bottom chart, we show you the debt profile. In the bottom left, second quarter is what we have in the balance sheet, but we have the number for 2018.

There's BRL 2.5 billion in for 2019, BRL 1.8 billion. However, we renegotiated some of this debt along the month of June. So, here we put the pro forma maturity debt for 2019. As you can see we see a relevant reduction, BRL 1.8 billion for 2018, BRL 3.3 billion for 2019. So, that in the next 18 months we have exactly BRL 5 billion which is the amount that we expect can be covered with our cash generation. And now, we will start working on our debt profile for 2020-2021, trying to rollover this debt profile without having the risk of refinancing and having more liquidity for the short-term.

Now, highlighting a little bit Brazil; we had an excellent quarter regarding the commercial execution with a significant increase of our active client base reaching 195,000 active clients. And last year we had 171,000, so we are going towards our goal of 200,000 active clients. This is a relevant growth in in natura products and also processed foods. There was a growth in all the channels with a relevant market share of 46.8% and also a growth of almost 1 percentage point.

The average price year-on-year, that's where we have the impact and I refer you to the right chart, you have here the processed foods and in natura. In the past, we had 74% of processed foods and 26% of in natura, and now we have 30% and 70%. Therefore, we have an impact in the average price. But here I would like to highlight the growth and the price increase that we had in the first half for 2018 and this increase is of around 10%, when we compare the price increase at the closing of the first quarter in 2018 to the second quarter of 2018.

That shows a good discipline of the market and acknowledging the cost increase that we had, the cost transfer that we had, the logistics costs that we had that had to be transferred, and also the impact from the truckers' strike. This is an important factor here that we should mention. Now on the next page, I won't be repetitive. I just would like to highlight that these figures show our relativity and prices when we compare the processed foods to the second player. So, you see our share and share of processed foods and also this is the number of active clients to the bottom left chart.

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It's important to say that the company is already focusing on launching products. This is very important so that we continue positioning our brands correctly with the right value and with the right principles that they do have. So, we are launching the new line, Sadia Bio. This has zero antibiotics, zero performance improvers, and 100% vegetable food, and it has an innovation. Our clients will be able to follow the whole process and know who were the growers, we're the producers of that should that they're buying. So this is a new product. I think this is going (00:31:47) market range. We'll have the right pricing meeting a demand of the consumers that's more selective consumer that really looks for this type of product. So, this launching is going to happen very soon.

Now, talking about the Halal division, on the next slide, we also had a strong volume growth. Our market share also has increased, maintaining our leadership in this market. This market is very relevant. It's a priority market for BRF. It's important to have development share position. That growth, the results were very strong, BRL 186 million in EBITDA just in this market. In the past, this growth was of BRL 30 million. Now net of Banvit effect that is responsible for BRL 97 million in EBITDA. So this is very relevant and very strong result in this market and I think that brings relevant results to us.

In the International division, we see a greater impact of drop in volume, in general 13.7%. If we analyze specifically Europe and Russia market, we see a drop of 65% in new volume going from 90,000 tons to 36,000 tons. This is a very significant figure. And just in those market of Europe and Russia, there is an EBITDA drop of BRL 60 million (00:33:38) with the negative EBITDA of BRL 8 million. The EBITDA of that division closed at BRL 3 million. Also, adding the commercial dynamics that is very challenging in Japan as well, we have high inventory levels, 150,000 tons, and then the prices is of $1,800 per ton. So this is the main challenge that we have for the next quarter and also the challenge has been announced as one of the divestments in Europe and Thailand in the International market.

In the Southern Cone market, we still have our trajectory year-on-year that we had in the past quarters. I will go briefly through those data, because we have already started divesting the assets from Argentina. Now going back to something that Pedro mentioned is our main priorities and main priority areas. I will go into details about this plan of BRL 5 billion. We are working with Europe, Thailand, and Argentina divestments. Some mandates have been already executed with investment banks. Some investors have already received information last Friday. Europe and Thailand will be sent next week, that information, and we have scheduled in the classic process of M&A and we expect to conclude these transactions over the third quarter.

There are some stakeholders interested in the process that is very relevant and that really provides us a lot of confidence on those transactions. About non-operating assets, we are preparing an auction that should happen in the beginning of the third quarter as well. We have inventories of raw material frozen that's a relevant amount, and we are working with a lot of discipline to have a commercial execution in local and International markets in a productive fashion that's already providing us significant values in the cash of the company, and this will be reported over the third and fourth quarters of the year.

About the securitization average receivables, probably you would have seen we released (00:36:37) we have already authorized a mandate of a syndicate of banks to structure a

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FIDC in an initial amount of BRL 750 million and that should happen soon. About our industrial footprint, also we have had mandatory vacation leaves, layoffs, and also adjustments in the turkey production lines, the two points we already mentioned.

About the investments, I already mentioned, I talked about the extension of the debt and this is following the same lines. In the short-term drivers, as Pedro has mentioned, we are also working to identify item-by-item because there are too many details in agriculture, and we are focusing on our plan, on our execution so that we can have the best practices and also to adjust all our productive chain to the markets that we serve. Considering that we have the closing of some relevant markets, so we have to produce – or we do not have to have the production costs for those markets.

So we are adjusting ourselves that then – we then have to see what is the right cost of production to the market we serve, we cater to, and we are working on that. Also, we are working on the best practice of the price execution and the better management of our inventory chain, the production inventory, not only to decrease shrinkage and also to reduce cost. We are working in order to ensure manufacturing excellence. Vinícius just got to the company and I think he brings onboard a lot of experience and a lot of competence to work in this area in manufacturing and also to work with our supply team, aiming greater efficiency in our operations.

And also we have our strategic planning, as Pedro has mentioned. It has to do with the organizational structure. We have already disclosed it. We have here two positions, which I am so still in an acting position as a CFO and Pedro also is very much dedicated to the management strategy. And so, we have the team almost complete and these people do know the industry they work in the industry and they come to BRF with great expertise in their competence areas, but above all, there is an alignment among all of us in order to aim this common objective, which is to recover BRF.

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Therefore, having said that, I end my presentation. As I said before, we then turn to our Q&A session.

Q&A

Operator

Ladies and gentlemen, we will now start our Q&A session. The first question is from Isabella Simonato from Bank of America.

Q - Isabella K. Simonato {BIO 16693071 <GO>}

Good morning, everyone. Good morning, Pedro and Lorival. I have two questions. The first one is about the guidance of BRL 500 million in gains over the half of the year and how does that work with the EBITDA guidance, with the BRL 5 billion that you have announced in the restructuring plan? We could more or less understand the EBITDA for the year that is I want to understand that considering that you are maintaining that guidance (00:40:49)

I want to know, is BRL 500 million are above or what we already had in the EBITDA guidance, or if (00:41:01) to see a more complicated organic results and maybe even more in the International market than in Brazil considering the performance of the second quarter? And those BRL 500 million are now trying to offset that difficult organic performance maintaining the level of leverage at the end of the year stable or if – in fact the announced planned before already was contemplating that type of efficiency? That's my first question, and I'll ask the second one after your answer.

A - Pedro Pullen Parente {BIO 2058839 <GO>}

Thank you, Isabella. You know that we do not provide EBITDA guidance. I understand your numbers but as we have mentioned before, we are maintaining our leverage goal, as Lorival has mentioned. And these measures that we are announcing – that we are calling value generation drivers in the short-term make sure that the company is really taking seriously the commitment taken with this leverage level and that we will meet that target. Once again I do understand your figures but we do not have a guidance for EBITDA. But yes, it's important that you make sure that the company is really committed to meeting that leverage goal that we have established, okay.

Q - Isabella K. Simonato {BIO 16693071 <GO>}

Thank you. And my second question has to do with the performance in the International market. I think with the exception of Halal division, all of others had a negative EBIT. In other words the performance that's below the expectations and below recent quarters I think that European ban is difficult to reverse (00:43:04) the China issue. So, looking at the main regions, what kind of improvement can we expect along the second half of the year and full 2019?

A - Lorival Nogueira Luz Júnior

Isabella, hello. This is Lorival. Well, regarding international markets, indeed regarding Europe, it is difficult to reverse the ban in the short-term. We don't have any expectation that this will happen in the next quarter. As mentioned in the beginning of the presentation, we have heard that there is a possibility, there is some signaling of a resumption, this could be an upside, a positive expectation that we might have for the second half of the year.

The whole market is an important driver to us. And in this market, we have positive expectations. We already saw a very robust result in the second quarter, and we continue to be optimistic regarding that. And regarding the Brazilian market, we are focusing on a strong execution, extending our client base. And with the prices that we had in the second quarter as well as the discipline, all of that put together points to a positive outlook. So, we have a more positive expectation regarding Brazil. The Halal market and again the International market as a whole could bring us good news regarding the opening of Russia.

Operator

Thank you. Our next question comes from Leandro Fontanesi with Bradesco BBI.

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Q - Leandro Fontanesi {BIO 20270610 <GO>}

Hello. Thank you for the opportunity. Just a follow-up question. We understood that you committed with a leverage target. I just want to understand this BRL 500 million would be part of, what are you expecting for next year or is this additional? And the second question, in the domestic market, you gained market share and you had a price increase for processed foods. How does the market react to this price increase and is this market share continuing as a trend in June, do you expect that to be competitive, strong looking forward? Thank you.

A - Pedro Pullen Parente {BIO 2058839 <GO>}

Thank you. Let's go back to the previous topic; two observations regarding the debt. Firstly, we have a vision about the credibility process means promising and delivering to the promising. So for us, it is really important, we make clear that the promise made by management regarding leverage expected for year-end is maintained despite the results that we observed in the second quarter, which obviously fell way below the potential of the company.

We know and we are working to communicate our results, but also to communicate that we are working to adopt measures that will allow us to meet our leverage goal by year-end. Another point and I talked about this, these measures always depend on the company. We don't depend on third parties, we don't depend on market variable. It's just in the hands of the company, and that's why they are important to give peace of mind that by year-end we will be delivering this leverage goal once we go forward with our divestment program.

And as we mentioned in the beginning of July and now today in more details by Lorival. I'll mention that this plan is unfolding. Again, we don't give any EBITDA guidance because what really matters to us is that you all understand that we are working at full power and working hard so that the problems that we saw in the second quarter will not be repeated in the coming quarters. We are adopting measures across the company to deliver to the leverage promised for this year and for next year

As for the second question, I turn the floor to Lorival.

A - Lorival Nogueira Luz Júnior

Regarding your second question, we continue with very positive perspectives regarding market share. This has been quite consistent in recent quarters. And regarding price increases that I mentioned in the quarter-on-quarter comparison there are two factors that I would like to mention. First, like I said, it is important because we have an increase in the production costs for the whole industry. Given the price increase of grain (00:49:04) manufacturing costs, we'll have to adapt to increasing grain price and that will reflect on the price cost.

In addition, for that very same reason, the market reacted very positively because if you remember in the first quarter of 2018, there was a certain deflation compared to the prior year, a deflation of prices. So, the market reaction was extremely positive and even the

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reaction of the retail segment was positive. (00:49:50) has been maintained and this is the kind of gauge that we have also for the third quarter. So, we have a positive expectation regarding that. In terms of price adjustment, those will be maintained. The new prices will be maintained for the third quarter.

Q - Leandro Fontanesi {BIO 20270610 <GO>}

Thank you very much.

Operator

Our next question comes from Victor Saragiotto with Credit Suisse.

Q - Victor Saragiotto {BIO 19504427 <GO>}

Good day Pedro, Lorival. Thank you. My question (00:50:27) the company being able to grow volume year-on-year, and we talked about increasing the capacity and fixed costs. But when we look at (00:50:44) reduction of materials and inputs and when we divide by kilos sold excluding non-recurring items, we see a significant increase, even with this volume increase. So, does this pressure comes only from the grain increase in prices or is there anything else that we are not seeing? And how do you expect that this will behave in the future as grain price pressures are likely to continue along this year.

A - Lorival Nogueira Luz Júnior

Victor, thank you for the question. I think you are correct in your evaluation. I would just like to stress importance and relevance of this movement to adjusted price, to have more adequate price, because our manufacturing cost is strongly impacted by raw material price increases. Like as I said, the spot price year-over-year is almost 50% increase. This is a material increase, and that is why I think it is so important that we adjust our prices accordingly, after all raw materials are very important for manufacturing cost.

In addition, Victor, there is another important relationship that has to do with idle equipment. We see some markets closing, and we have a higher (00:52:22) and in our cost analysis, there's also an impact. This will be adjusted over time. We closed down some plants and some manufacturing lines, as we announced. We have the impact of the restructuring. And although we mentioned that there are BRL 70 million related to the truckers' strike resulting in an intrinsic cost in the operation that we cannot really highlight as connected to the strike. I'm going to give you some examples of that.

For the moment you have a limitation and have delay in the slaughtering of animals, you lose performance, and you miss the right moment and the right timing to slaughter. And this is normally included in the cost and it is difficult to break it down. And we cannot link that as an impact to the truckers' strike, but it did have an impact on yield, okay. Sometimes, if you take two or three more days to slaughter animals, there is an impact on weight, there is an impact on the commercial sales price. So yes, that happened in the second quarter. I just wanted to give you more color on that and to clarify. But above all, we are taking action, all of the necessary action for us to start capturing these BRL 500 million that we mentioned in the third and fourth quarters.

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Q - Victor Saragiotto {BIO 19504427 <GO>}

Thank you. Super clear. And if I may, I'd like to ask another question, could you quickly comment on the freight table of price list? (00:54:37) on refrigerated foods, I don't think that there's a lot of change, but for the grain market it seems that it's a little messy – the market is a little messy after the freight price list. Can you comment on how this can impact the company? Thank you.

A - Pedro Pullen Parente {BIO 2058839 <GO>}

This is Pedro speaking. Well, the freight price list, it is rather concerning to us. We have seen a lot of discussions about this across the country. This theme has been discussed at the Supreme Court as well. We are waiting to see if this discussion will lead to some change that will be favorable, but as the company depends into on-freight of course we are impacted. Like I said, we are waiting for the evolution of this topic so that we can, in due time, and depending on the results of these debates decide how we are going to react and what kind of measures the company will adopt, because it is important to clarify that we see this measure with concern because it will entail a general cost increase to the Brazilian economy.

Q - Victor Saragiotto {BIO 19504427 <GO>}

Thank you, Pedro and Lorival. Thank you very much.

Operator

Our next question comes from Lucas Ferreira with JPMorgan.

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Q - Lucas Ferreira {BIO 16552031 <GO>}

Pedro and Lorival, good morning. My first question has to do with Turkey operations. The Turkish lira depreciating approximately 40% this week, what do you expect in terms of business impact (00:56:34) Can you change your production mix to export more to offset that effect? And my second question, about prices in the second half in Brazil, is that that you had price adjustments to offset the cost increases in the second quarter, but my question is mostly specifically about, what you expect in terms of reducing inventories and improving working capital. Can this lead to additional promotions, price reductions, and any impact on pricing? Thank you.

A - Operator

Thank you, Lucas. And I will start by your second question. About the expectations, you said it well. These are positive expectations with the price adjustments for the second half of the year. Well, there is no negative expectation regarding that. Now, about the inventory levels reduction, as you said, we do have no price reduction effect in order for that to happen in those promotions either. This will come from a better commercial execution. It has been discussed in the last few months, and also it will depend on the expansion of our client base.

So, (00:58:01) exposure to our client base, better commercial execution, and also on the other side, a better management of our productive chain and our production itself avoiding discounts that we usually have on a yearly basis, and you know it well. So, we do not have an impact or do not forecast an impact regarding that.

And in Turkey, we do have an impact of that conversion because of the Turkish currency and that will open room for a different flow of exports now in this third quarter for the countries and the region. And when we do that, there is an impact in the local prices that also will help us. That's positive for us because we open an opportunity to export and when we did that, there is an impact in the local prices and that in turn will affect the whole industry. So I believe that we will have a positive perspective regarding exporting and a better adjustment to local prices in Turkey regarding our Banvit operation. Thank you.

Next question is from Luca from Goldman Sachs. (00:59:27)

Good morning and thank you for taking my question. I would like to better understand the possibility of having more significant impact of restructuring costs and adjustment costs for 2018 and 2019. We have seen that the second quarter obviously we did have nonrecurring events and the impact was very significant. And I would like to know if you can quantify or at least give us a direction if most of the restructuring costs have already been accounted for in the second quarter, will we see more of them? And also what about regarding operation (01:00:15) So anything else on this topic that would be interesting to better understand how much impact the second quarter had (01:00:31) of share of the costs.

Thank you very much, Lucas, for your question. Yes, most and I would say that most of that impact of restructuring has happened already in the second quarter, considering that the generating factors did happen in the second quarter as well. So, the laying off of people, the contract terminations, the closing of plants, so all of that did happen in the second quarter. We may have some remaining effect of the lower impact, considering as I said, the truckers' strike and others because then we have an yield impact – an industrial impact straight into production. So, we may have that, but I would say not as large as an impact that we had before, and these are the ones known so far. So, at this moment, we do not have any other factor that would be causing any extraordinary cost or expense. So, yes, most of those impacts have already been accounted for in the second quarter. Thank you.

Yes. And now just adding to this question, when we talk about the deleveraging goal for 2019 based on an adjusted EBITDA, I would imagine that the difference between the adjusted EBITDA and the EBITDA should you need to be looking at 2019; it shouldn't be as significant, right?

Yes. The trend and according to what we have in terms of visibility so far is that really this will be – those two figures will got closer.

Thank you.

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Next question is from Antonio Barreto, Itaú BBA.

Q - Antonio Barreto {BIO 17449798 <GO>}

Good morning, everyone. I have a question about the productive potential regarding biological assets. I know, it's very clear this restructuring plan focusing on the rationalization on the productive potential of the company you have announced. Closing plants and also rationalizing production to adjust your industrial footprint, but when we analyze the quarterly information, the number of mature companies is almost at 16%, very little in the second quarter and the number of immature breeders have grown. So, it makes us believe that the productive number of breeders in the next quarters will be even greater.

So my question is the productive potential in terms of biological assets shouldn't that be following the rationalization of the industrial production? How can we reconciliate that with your restructuring plan? Is this a matter that will be addressed later on and now we rather focused on the industrial production or if you have that understanding to recover the market, then you can maintain your productive potential in terms of biological assets.

A - Lorival Nogueira Luz Júnior

Well, Antonio, thank you for your question. You are right. We did have that in the quarterly information, but we are now managing a very long chain and the decisions made a lot of times will have an impact in the quarterly information, but they are regarding decisions made three years before. So what I can tell you is that the adjustments both in the cultural area, as well as in the industrial area. Yes, they are very much in line, but the timing that you will see them in the quarterly information, that timing may be in different moments. And that a lot of times will cause us to take a few actions or make a few decisions in terms of short-term adjustments that might refer to the sale of live animals or plants so that we can anticipate that adjustment. But what I wanted to assure you is that there is no mismatch between actions taken regarding biological assets and our industrial production. These actions are in line and the adjustments you will we see that in time, okay?

Q - Antonio Barreto {BIO 17449798 <GO>}

Thank you for your answer, Lorival. And my second question, if I may. We have increased the prices at the end of June of 10%. And when we look at the market variables, all of them have worsened a lot. When we look at prices of pork meat in the local market, they are down again after the truckers' strike. And could that somehow impact how much of this price increase will be accepted by the market.

A - Operator

I think it's important to analyze the seasonal dynamics. We also have in nature dynamics, we have dynamics for poultry, for swine, and they will have other impact, and also it has to do with the oversupply because of closing Russia market. And we will have another dynamics for processed foods and another one for the margarines market. So, these are different dynamics and what I can tell you is just a general overview.

In case of BRF, we do have sound brands, robust brands, and we have a distribution capacity that is very well – that has a great penetration. So, we have a strong price when compared to the first quarter. So it's important to look at that as a starting point. So, we did have a peak right after the truckers' strike and we went over 10%. Probably you have seen at some moments 30% to 40%. And then after that peak, we had a drop. So, that percentage of discounts and depending on where – on this curve you are analyzing but when we get the average price of the first quarter and the average price of the second quarter, yes, we do have that positive side to price increase. Thank you very much.

Next question is from Thiago Duarte, BTG Pactual.

Q - Thiago Duarte {BIO 16541921 <GO>}

Good morning everyone. Good morning, Pedro and Lorival. I have three quick questions. First, so talking about the price increase that just ended in the last question, is that price increase part of the plan of the short term initiatives to generate BRL 515 million more of EBITDA still in 2018. When we analyze those qualitative description of initiatives, most of them seem to be efficiency or cost initiatives, and I would like to understand if the price increase is part of that short-term driver in order to improve EBITDA generation?

And still on price increase, I would like to understand how much you believe that the trade down process of channels, brands, categories, how that has affected your business in the last two years (01:08:32) cash-and-carry, the loss of market share of Sadia, the change in category to – cheaper categories and how much access have you had? So we are going to look at the results of the third and fourth quarter results in like-for-like basis and we should see in the processed foods an increase of 10%. And do you think you still have room to amortize the price increase volume, migration of channels, categories, and brands? That's my first question.

My second question is on CapEx, also it has to do with the prior question. In the first half, you have a total investment of BRL 845 million, if I'm not mistaken, including that increase of 60% (01:09:17) investment in breeders. So, it looks like those investments in breeders will come down in the near future. But when you think about the CapEx of the company is below depreciation, so I would like to understand what would be the right figure for the next half of year or the next year? That would be interesting.

And my third question, if I may. It's about the Halal division, when we look at Banvit's contribution it was a little bit less than one-third of the revenue in the quarter and basically half of EBITDA. So, it looks like that the remaining parts of the business that is excluding Banvit is running really at lower margins than those 8.8% you have disclosed. And I would like to understand that when you change that Halal slaughter that has been demanded by Saudi Arabia, from what I understand, you have already adjusted yourselves to this change, but I understand this would cause a price increase.

And so, if you exclude Banvit, how the Halal division is running in terms of profitability today? It seems to be a little bit lower than this 8.8%, and I also want to understand the impact of those slaughtering change process – slaughtering process change. And I'm sorry for asking long questions.

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A - Lorival Nogueira Luz Júnior

Well, I apologize. I will be happy to talk to you later, because your questions are very broad and are many as well. But I'll try to be brief and address them quickly. Price increase within those BRL 500 million, we are not considering as drivers any price increase to reach those BRL 515 million, effectively basically all that we have already mentioned.

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About price increase and trade down and all of that, I think that we are with the right strategy, remember that we are expanding our client base and that will allow us to have the right opportunity as well. And we also have (01:11:33) positioning especially in the cash-and-carry market. So you will see the figures and details and we'll help you understand the impact of that trade down execution and what is really the impact (01:11:54)

About the CapEx, yes, it does have the depreciation and if we look at the last four or five years, what was invested in the company in terms of CapEx, you will see that was a relevant amount, very high. It is a very strong investment. And so now, yes, we do have the impact of the breeders, but also we need to optimize the capital that was invested. We need to invest on the plans and noted (01:12:31) to have the right return. So, we have to optimize those plans.

Yes, so you will see a better efficiency in the use with higher depreciation than the CapEx. And remember that part of the biological assets and most of them have come from also the impact of the price grain because when the grain price increases in our biological assets, which are our breeders, will also have an increase on the price of the asset itself. So, you cannot consider that as an increase of our CapEx, but rather that reflects the price increase on the basis of a biological asset that is live.

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With regards to Saudi Arabia, it is a positive effect indeed over there regarding sales and adjustment of the process. We already have a procedure to meet that demand, but I think it will be positive to continue to supply this market. And it involves not only benefit but also the fact that we are shipping more products in preparation, but this is a onetime-off effect in the case of that market. Later on, I can give you more in detail. Thank you.

Q - Thiago Duarte {BIO 16541921 <GO>}

Excellent. Thank you, Lorival.

Operator

Ladies and gentlemen, we're running out of time. So, we're now closing the question-and-answer session. I'd like to turn the floor back to Mr. Pedro Parente for his final statements.

A - Pedro Pullen Parente {BIO 2058839 <GO>}

Well, in the interest of time, I guess that all of the relevant messages have been conveyed and with this, I would like to thank you for joining us. Our Investor Relations department continues to be at your disposal if you have further questions and if your question was not answered during this webcast. Thank you very much, and enjoy the rest of the day.

Operator

BRF SA conference call is closed. We would like to thank all of you for participating and have a good day.

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