Y 2018 Earnings Call

Company Participants

- Elcio Ito, Chief Financial And Investor Relations Officer
- Leonardo Almeida Byrro, Executive Vice President, Planning
- Lorival Luz, Global Chief Operating Officer
- Patricio Santiago Rohner, Vice President of Halal Market
- Pedro Parente, Global Chief Executive Officer
- Sidney Manzaro, Vice President of Brazilian Market

Other Participants

- Alexander Robarts, Analyst
- Antonio Barreto, Analyst
- Leandro Fontanesi, Analyst
- Luca Cipiccia, Analyst
- Lucas Ferreira, Analyst
- Luciana Carvalho, Analyst
- Marcel Moraes, Analyst
- Thiago Duarte, Analyst

Presentation

Operator

Good morning, ladies and gentlemen. You're welcome to the Earnings Release, Q4 2018 of BRF S.A. We would like to let you know that this call is being broadcasted through the Internet on the Company's website at www.brf-br.com/ir, where the presentation is available at the webcast platform. Right now, all participants will be on listen-only mode, and after the Company's remarks are completed, there will be a Q&A section. We kindly request each participant to ask only one question. (Operator Instructions)

Before proceeding, let me clarify that any forward-looking statements made during this teleconference regarding business prospects, its forecast and operational financial targets are based on the management's expectations for the future of the company. These forward-looking statements are highly dependent on market conditions, overall economic situation in the country, the industry and international markets, and are subject to changes. I would like to remind you that this teleconference is being recorded.

This conference will be presented by Mr. Pedro Parente, Global CEO; by Lorival Luz, Global Deputy CEO; and by Elcio Ito, CFO and IR Director.

I would now like to turn the conference over to Mr. Pedro Parente, who will start the presentation. Mr. Parente, you may proceed.

(Technical Difficulty) Ladies and gentlemen, please wait. You may proceed.

Pedro Parente {BIO 2058839 <GO>}

I am going to restart since apparently, we had some sound problems. But I would like to start by once again, thank you all for your presence, and wish you a good day. Our executive committee is present here today, and I'm going to make this presentation. I'm Pedro Parente and Lorival, the whole executive committee will be available to answer eventual questions you may have, when we have our Q&A session.

Undoubtedly, this is one of the most relevant earnings release of BRF in the last few years. I would like to start by slide number 4, where you can see what the year of 2018 was like for BRF. Actually, we start in December 2017, with the closure of the Russian market, and we move on with the events of -- the events leading to 2019. But you can see that the red arrows demonstrate all of the events that caused a negative impact, which were relevant for the Company, and then the green arrows indicate all of the measures that were taken in starting in April last year when we had the election of the new Board of Directors. On benefit of time, I do not want to get into details of each one of them, but this only shows how challenging the year 2018 was for the company.

Of course, I should also mention that despite all of these events and all of the problems, we faced regarding the organization of the Company, and the need to have a very broad restructuring plan for the team with different process, different systems, which were emphasized as of the second half of the year. We concluded the year with a restructuring plan -- a financial restructuring plan. We met all of our objectives and reached 81%, of our goal according to our plan. We refinanced BRL6.3 billion in debts in 2018, closing 2018, with a strong cash of BRL6.9 billion, and because we did not comply with 100% of our goal, we revisited the financial leverage guidance for 2019, and went to approximately 3.65 times and as I mentioned, we concluded our organizational structure. We defined a team in our executive committee of a leader in animal protein worldwide. And therefore, we concluded our team by adding Mr. Ivan Monteiro as Chief Financial Officer and Investor Relations Officer. We also made an important change with the merger of our Vice Presidents including Patricio Rohner who is now our Deputy President for the International Market.

And now moving on to the next slide, please. I would like to give a look at 2018, under two different perspectives. One of them has to do with the results and net losses of our Company. But I would also like to analyze this from the point-of-view of generating future results for the Company. There is no doubt that when we show you a net loss of almost BRL4.5 billion, this figure is very expressive. But when we detail these figures, analyzing non-recurring events, actually the number that we would like to show as losses for 2018 would be around BRL939 million in losses and therefore it is a much lower than the BRL4.5 billion. Of course we also -- should also take into account that we have a Total Return Swap of about BRL214 million. And so what the number shows us from the point-of-view of adjustments is in the order of BRL4.5 billion. But from an operational point-of-view, what we see when we deduct this BRL214 million in swaps, the number is inferior to 2017. And what is more relevant in all of these adjustments in these non-recurring adjustments is the impairment, which takes into account the losses of operations in Argentina, Europe, Thailand and Varzea Grande, which results from the sales of the operations as extensively informed through out the second half of 2018, and the first month of 2019.

So the relevant question here is, is this -- is there a problem for our ability to generate future results? No, it is not. It actually improves. These operations, for example in Europe, there was a positive result in the first half. In Europe and Thailand, in Argentina, the results was approximately zero, and negative throughout most of the year. But in Thailand, as you all know, in the second half of the year, these numbers were very poor as well. And therefore by maintaining these operations with very low margins or negative margins, we are actually improving the ability to provide results for the company. And we should also take into account that we're going to concentrate precious resources in terms of energy, time and leadership, in the assets which are more strategic for BRF, including Brazil, ROLA, and Asia.

The other factors were observed throughout the year. I do not have to get into details here, but I thought it was important to make or to highlight this difference because, we had this adjustment in sales and operations, which were not profitable. But we're looking into the future with an improvement of our working capital and results for the Company, not only because of all of the sales, but because of the extensive restructuring we had in the Company.

A very important aspect to be mentioned here, is that we're still going to have an adjustment, which is related to the operations in Argentina, Europe and Thailand, the so-called CDA, in other words, the differences resulting from the tax -- I'm sorry, for the exchange rates with a loss of BRL800 million. However, we estimate that this impact will probably be offset by a difference in favor of the Company, because of the credits which are being discussed on some taxes such as PIS/COFINS and ICMS. We have recalculated these values in December and Lorival is going to talk about this later on.

We still have some issues, and actions or actually lawsuits, which are going to be decided in the near future. But just to make a brief note here, all of these effects will be offset and therefore, for the sake of transparency, I would like to mention that we still have this difference to be taken into account. And of course it's also important to highlight, as mentioned in our financial statements, the risks related to the Carne Fraca and Trapaca operations, and also the suits taken by investors in the US. And this cycle of very large adjustments resulting from everything that happened in the Company in the last few years, regarding to these extraordinary events in 2018.

In our opinion are concluded, except for the items I mentioned here. It's also worth mentioning that because once again, we recognize that this loss is really significant, but it's necessary for us to make these justifications to explain that from the operational viewpoint, our business today is much better than it was one year ago.

Moving to the next slide. You can see here some important indicators. Like for example, a very good improvement of our EBITDA margin. Throughout last year in Q2, we were at 4.6%, and we went up to 8.8% in Q4, and deleverage also decreased a lot. So we are perfectly aware this is always still a very high, but we are working very hard to reduce leverage, and to reduce from 6.35% in the second quarter of '18 to 5.75% in the last quarter of '18. This is our pro forma, because here we consider all the sales and the product of sales that have already been contracted, but not closed.

Now, moving to the next slide. You can see how our Monetization Plan was concluded, as I mentioned before, and some relevant data is on this slide. Our cash of BRL7 billion in December 2018, so did that -- is perfectly okay for 2019. And Lorival is going to show later that we are going to close 2019 with a good prospect. we have today the prospect that we are going to generate a free cash flow and it's going to be positive at the end of 2019. So, our net cash will be above what our Board defined for the year.

Another important impact on our results was the reduction of our stock of raw materials. Our inventory of raw materials was reduced in 60%. And when you reduce inventory at such a high level, then you just liquidate all the inventory with lower margins than what the business is used to. It's worth mentioning again that we have a whole set of measures in place which are not clear from our figures, but they are essential. As I said before, we have a new team of leaders, a new very excited and dedicated executive team, we have non-negotiable commitments now towards integrity and security, and we have a set of rules for management and operations, which are very solid. I am not going to go into details here, because I need to leave some time for Lorival to take the floor, and for the Q&A at the end.

So now, I give the floor to Lorival. And at the end, I am going to make a few more comments. Over to you Lorival, please.

Lorival Luz {BIO 16180455 <GO>}

Good morning, everyone. Now, moving to slide 9. What I'd like to say here is about the importance and consistency of our decisions, and actions taken throughout 2018, especially in terms of divestment of some of our assets. You can see the consolidated figures here as mentioned before by Pedro, you have operations that we continued, and those we discontinued on the right. So these were operations we sold like Argentina, Europe, and Thailand. So, we show here that the margin that we retained is above what was sold. So this shows our focus and this shows that the decision was made was towards seeking this profitability.

I'd like to show that from a BRL154 million that we had in 2018, about a BRL168 million come from the first half of the year, when our flows, in terms of sales to Europe generated these positive results. This shows that in the second half, we had a negative EBTIDA and we -- if we hadn't made these divestments then the negative results would go on in 2019. So we are focusing on the Brazilian market, the Halal market and Asia, and our management is geared now towards these markets. And we want to reduce the complexity in management of these markets that we want to be more effective and cut costs in 2019.

Now, moving to slide 10. You can see the whole quarter, and this reinforces our trends for 2019. The EBITDA was negative clearly in Q4 of 2018. It was minus BRL2 million, but if you look at the continued column, you're going to see that EBITDA is BRL840 million, 10% in margin. So it's just a reference that we make here to in the last quarter of 2017, when the EBITDA was BRL649 million, and a BRL190 million came from discontinued operations. And this includes the up -- the exports to Russia and to Europe. So, the continued operations, the operations we kept to have an EBITDA of BRL451 million. So under this column you have improved results of BRL450 million, and a margin of 10%, and BRL843 million in Q4. So it's important to emphasize, because our -- that because our consist -- we were consistent in our decisions.

Now, moving to slide 11. You can see the Brazilian market here. And I'd like to emphasize a few points, both for the last quarter and for the whole year in 2018. So during the year, we were impacted by the growth in grain prices, and I'm going to mention that later, this happened, especially in Q1 2018, and this of course then had an impact on our costs throughout the year.

And at the same time, we faced some market restrictions that impacted the Brazilian market as a whole and BRF in particular, and it affected our exports of poultry and pork. So we had this excess product here as a consequence, a reduction in prices, in the first half of 2018. So we had higher costs and lower prices to make demand and supply meet. But in the second half of the year, we started to recover very strongly price wise. And you can see that in the fourth quarter, -- in the second part of the fourth quarter, so, we expanded our margin in the second half of the -- of Q4.

We would like to mention two effects we had in Q4, especially. One of them was the benefit we had from BRL200 million coming from PIS/COFINS, Brazilian taxes, and they were a monthly cost we had, but this contingency was reversed. It's now positive, and the benefit means BRL200 million more. This is the result of the way we dealt with the inventory reduction and the reduction was 60% with very good effects in the last half, and with an impact on our negative EBITDA of BRL90 million. Once this process is concluded, once we complete the inventory revision, so now we are going into 2019 at a more adequate level. We don't need to make any adjustments for this year, we hope.

We had an expansion of 10% in our client base. We now have most 200,000 customers -- 194,000, actually now, and we also expect to improve our market share even with the higher prices we have now in place. So this is what I had to say about Brazil.

Now, let me talk about the Halal segment. The results in the Halal segment show clearly what our focus is and how much we want to expand in this market. Results have expanded in a robust way, both throughout the year and in Q4. This is the result of our adjustments, and how we made a more adequate distribution of volumes in -- volumes in more profitable countries, and we have a better mix of products in this market.

I'd like to reinforce here also that as to Saudi Arabia and what happened at the beginning of the year, our Company has plans listed and approved to sell in the Halal market in 2019. We are prepared to meet the demand we may have from this country, from Saudi Arabia, which is a very relevant market for us and our position there, our share there is really very significant for the whole region.

As to the International segment and you can see that on the slide 13. You can see very clearly here the impact we have coming from market restrictions. You can see that from 2017 to 2018, we've had some market effects coming from the closure of the Russian market for pork, and the closure of the market in Europe as a whole. So we had to face these restrictions. And in the second half of the year, we had to make a number of adjustments in our production, and the employees went on leave, on compulsory vacation, we had these layoffs in the Chapeco plant, especially we reduced our turkey slaughter in Mineiros and Beltrao. So we acted very promptly, but we had these impacts in the first semester, and we tried to adjust everything as quickly as possible in the second half. And we decided to divest also operations in Europe, which was announced early this year. So we reacted very quickly as I said before, and you can see that on the chart.

Last year, we had a lot of impact from all these reasons, and this is shown in our results. So EBITDA was BRL209 million in 2018, and from this BRL6 million, we still have a negative impact of minus BRL3 million from these discontinued operations.

On the next, I'll talk about the free cash flow. And I'd like to mention that from '17 to '18, in '17, we had a negative clash flow of BRL1.700 million, and in 2018, it's minus BRL664 million, it's not what we aim at, at the management, but this is based on our decisions to divest, to reduce the leverage of our debt. And you can see the facts of our assets that went into our cash in the first half. So we are going to have a positive EBTIDA of BRL1.3 million. And I'd like to reinforce that all cash generation is going to be used to reduce our indebtedness.

Throughout 2018, we had to adjust our management, we were very positive relating to our CapEx, but we of course went on investing on quality, improvement of processes in our Company and also on the improvement of all the regulations we needed to put in place. So we keep our focus on quality, our commitment towards integrity, and security of everybody working here. This is non-negotiable, and we've been very stricted -- strict as far as our CapEx is concerned.

On the next slide, on page 15, and it's important to highlight the deleveraging of the Company. We went from the Q3 reaching 6.12 including cash resulting from the sales of assets. The trend as disseminated. Previously, we have an expectation to reach the end of the year with a leverage of 3.65 times. So that the priority for 2019, when we are going to start the year with a very robust cash is the lengthening of this debt, cost reduction, we have restricted activities, and this is what we want to do. And when Ivan starts working on March 11, and we have been constantly discussing this with him, it is very well aligned. And is been given every information he might need, so that he can start working actively to start all of these initiatives as shown to you before.

In the next slide, you can clearly see, and I would like to reinforce here that the Company does not have and does not need to have any additional cash for 2019. And as you can see here in the construction, we're developing here, the Company basically closed the year with the BRL7 billion in cash, and we do have additional resources, which will come in, in the first half of the year, because of the decisions made and the divestment plan that was made. And with all of the cash events in the first half of the year, our cash will increase even further, including payments of debts and offsetting interest rates for 2019.

We also have refinancing activities, which have been taken into account and therefore we will pay 100% of our debt in 2019, and even so the Company will close the year with a positive cash of BRL5.4 billion, which is higher than our minimum cash. This reinforces our priority to work with, putting our debt forward with investments of BRL2.4 billion, and for 2021, BRL3 billion.

I would once again like to reinforce here that we do not need any additional cash, and also the consistency in our trust, in the plan and the execution of all of the initiatives related to cash efficiency, operational efficiency, which will help the Company deleverage by including its debt and operational cash to get the end of the year with BRL3.5 billion. And and then we will follow this in the next few years, the way we believe that we should do with about 1.5 or twofold leveraging.

In the next slide and it's actually my last slide, I would like to briefly summarize the year of 2019, and the outlook for the year actually. And so in 2018, as you can see, we have two graphs here, and they were based without including January 2018, regarding the price of soy and corn. And then regarding the price of chicken and bovine. And you can see -- i am sorry, the porcine [ph]. And you can see that in 2018, there was an increase of 20% in the price of soy and corn, while at the same time because of excess offers resulting from market closures, we had a significant price pressure on our proteins in the Brazilian market also with a decrease of about 20%. This trend was inverted in the half -- in the first half of the year, the prices of swine going up and we should also pass the costs on but the prices of chicken at a larger scale had a stronger recovery, and at the same time, we can see that there was a stabilization and some opportunities in terms of the causes of soy and corn for 2019. And therefore there is a trend towards the stability of the price for grains in 2019. At the same time, we have a price recovery for our products.

This we have a positive expectation regarding the economic scenario and growth in Brazil. In general and also with positive outlooks for the Asian market with increases in demand in China, which will have a positive impact on prices in Japan as well. And so this is the message we wanted to share with you. We will have a 2019, with the following trends as you can see on the slide.

And with that, I turn over to Pedro, once again.

Pedro Parente {BIO 2058839 <GO>}

Okay. So now we're going to start our Q&A session.

Questions And Answers

Operator

Ladies and gentlemen, we are now going to start our Q&A session. We kindly remind you that each participant is entitled to ask one question. (Operator Instructions) Our first question comes from Luca Cipiccia.

Q - Luca Cipiccia {BIO 6914452 <GO>}

Well, good morning, everyone. First of all, I'd like to ask you to better explain the message on the non-operational guidance? I think, that in the last few weeks and months, we had two important factors, which were not really demonstrated in the target -- BRL5 billion target, it was actually much lower than the estimates. And then we had a new adjustments on the write-offs and impairments. And if I remember properly, after Q3, the message was that the cleanup phase was over, so I think, that we're all aware of the challenges, the complications and the difficulties to sell assets in those markets. But anyways, I think, that a few months ago you informed us that the Company is -- was not in a position to be able to give a very clear guidance, but on the other hand for the variables that may be controlled by deleveraging and refractoring are not so clear?

A - Pedro Parente {BIO 2058839 <GO>}

(Foreign Language)

I thank you for your question. But I would like to record that I clearly remember that when we introduced the results for our divestment program about two or three weeks ago, we made it very clear that we would take losses resulting from the sales into account, and therefore I would totally separate the amounts that were appropriated throughout the year related to non-recurring events, specifically related to the Trapaca operation, the the closure of lines and plants resulting from what happened in 2018. And therefore this is absolutely consistent to what we said.

I need to double check the numbers whether they're really that inferior. But regarding these adjustments our vision was that we were going to close, but, in the presentation of the results we did inform that there would be losses. The number were not concluded then, because we still needed to have an external audit and therefore we could not share figures which had not been confirmed by the audit, just as we're now talking about future debt related to the translations of our operations. And so this has to do with the guidance we have given. And I would also like to mention this sales and mention that the problem was not the sales because that's what the market are available.

And the other remark I wanted to make is that the Company never -- was never guided by an internal assessment of costs. This was done by specialized advisors, who are totally reliable and tested by the market. As we announced, actually and therefore we did not make any communications and did not share results, which are not being based by external audits. Unfortunately, and we do regret that the results were not the ones we had expected, but when we have a BRL4.1 billion in a plan of BRL5 billion, I don't think the results were that negative, to be very honest.

I'm not happy because we did not reach the BRL5 million, but I should acknowledge that we met all of the guidelines of the plan. And so the results cannot be considered poor. They are not what we wanted, but they are not poor results. And therefore from a point-of-view of the information we are sharing with you, they are totally reliable and they are the best information we have available now. And they change on a day-to-day basis as you all know. This business has a -- a lot of external variables, which impact the Company, but the information we share are the best information we have available.

I would also like to remind you that Lorival mentioned, that the results for Q4, we have the impacts of our taxes including PIS/COFINS. But you should never expect that we will make promises that we cannot comply with. And that's why we're not sharing operational results until we're confident about the results of the measures we are implementing now. And so in this regards, I would like to mention to you that we're now in a much better position than we were sometime ago.

And the operational excellence measures we're implementing after a lot of effort made by the Company, I will share with you our results. And Lucas, thank you for your question. And you should, rest assured that there is no inconsistency in the information we're sharing with the market. Because our concern is exactly being very transparent with the best information.

Q - Lucas Ferreira {BIO 16552031 <GO>}

Well, thank you very much. I didn't want to imply that the guidance was not correct. What I'm trying to convey here and you actually answered it is, that I wanted to understand looking -- when looking at the future target if you're being conservative, taking into account the very high volatility level you have, as it was demonstrated for the other events. And so I think, that they're still very relevant. Thank you.

A - Pedro Parente {BIO 2058839 <GO>}

You're welcome, Lucas. I would just like to make a final reference, and you're totally sure there's a very high volatility. But what Lorival tried to share his last slide is that, if last year, the factors that influenced our results went against us, especially the price of raw materials, which are essential for us. In other words, the cost of soy and corn. And then on the other hand, the sales price of our products, which were affected by the difficulty to readjust the prices when we had a huge stock because of market closures, today, all of these factors, according to what we can see once again today, they seem to be working in favor of the Company.

And I would also like to share another factor with you. It's not a guidance by any means, but if any addition to what we see here, what the newspapers are publishing regarding an agreement between the US and China, where China will import soy from the US, as informed by them, however, this is a commodity market and I cannot guarantee that, but we can see the inverse effect of negative premium as opposed to a positive premium. So this is our vision, we're working strongly to try to change this.

Q - Lucas Ferreira {BIO 16552031 <GO>}

Thank you. Good luck to you all.

Operator

The next question is by Leandro Fontanesi from Bradesco BBI.

Q - Leandro Fontanesi {BIO 20270610 <GO>}

Good morning. Thank you for the opportunity to ask a question. I have actually three questions. The first is, as you said before, you've made many operational improvements. Margin has improved, and you've already completed your divestment plan. So can you please elaborate on what you have in mind about liability management? The equation is okay for 2019, but how are you feeling about longer maturity deadlines et cetera. What you have in mind for the business to be sound in 2020-2021 and so on without selling more assets?

The second question is that poultry and pork prices went up, margin is better, but what about the Sadia and Perdigao brands? What's the dynamics right now in this segment?

And last, in the segments you have a better margin, perhaps International segment is still lagging behind. So what's your expectation with this anti-dumping tariff, so perhaps this segment will go into a more positive trend from now on?

A - Pedro Parente {BIO 2058839 <GO>}

Good morning Leandro. Thank you for your question. First, I'd like to talk about our trust level in terms of liability management. Okay, so we don't need an additional cash, so there is no forecast for that in 2019, 2020 and 2021. So let me recap here. For 2019, we are fully okay with cash coming from divestment and other operations and transactions that have already been completed. As to 2020, and '21, we have about BRL3.5 billion -- BRL4 billion and plus BRL3 billion coming in. And I think, this is perfectly feasible, and we're going to have transactions throughout 2019, both in the domestic and international capital markets. So we plan to close transactions that are going to cover all the debt maturing in 2020 and 2021. So we're going to lengthen these maturity periods for the debt. And this is going to cover our obligations for 2020-'21.

In spite of that I'd like to reinforce that we have also rural transactions maturing. This is compulsory, because the banks force us. We make cash deposits, and we have to make these amounts available. So these are recurring operations normally around BRL500 million or BRL600 million or even more than that depending on our balances. So we are really fine and feeling very confident that with our results, we now have a positive cash generation, capital markets operations, both at domestic level and international level, plus the rural operations and financial transactions, so we won't need to make any equity or capital transactions to reinforce our cash. So this is what I'd like to make very clear to you all.

As to Brazil, more specifically, I'll say a few words and pass the floor to Sidney. So let me talk about Sadia and Perdigao, and after that then Patricio is going to add a few words on the prospects for the international market, because we are suffering this impact from sales and transactions.

As to Brazil, we have recovered prices since May, June last year, so we're going to have this happening both of -- with In Natura and processed products with Margarine and Cold Cuts, so we hope that we're going to have this increase that has been going on, without any relevant impact on market share. We are positive that as market leaders every time you make a move, you have an impact of one or two -- or two months until the market accommodates to your recent move. But I'm sure the market is going in this direction. And Sid can add to what I said, and talk about the positions of our brands.

A - Sidney Manzaro {BIO 17678250 <GO>}

Okay. Hello. As to processed products, Margarines, they are our priority in Brazil. In the second half and the last quarter, more specifically, we implemented a number of initiatives to structure these processes and to build the processes, and initiatives that are going to consolidate throughout 2019.

And also we don't have that much pressure coming from inventory reductions. So we could transfer prices because there was a lot of price pressure on us and we had to do that. We couldn't do that any earlier, because of our high inventory, but we managed to-date to do that. And the market was very receptive, and the strategy worked really well, and price transfers took place successfully. And we gained market share in spite of these operations in almost all segments, which is a proof that our execution was good, and that the market absorbed this process.

We gained market share in Frozen Products, Cold Cuts, Margarine, and with sausages et cetera, the market share increase was less marked. But we are going to recover this margins this year.

A - Patricio Santiago Rohner {BIO 19686996 <GO>}

Now, talking about China and international market, the analysis was positive for us. This additional tariffs were reduced, and our monthly earnings were good, above last year. So as regards to China, our view is very positive. There is going to be -- they're going to have an increase in demand due to the pork disease, and we're going to improve these volumes and prices in other markets to Japan, Korea, et cetera. So the prospect is that we'd like to have a much higher volume in China, but still we have positive results in other markets. So a brief summary would be that this is the current scenario for us.

Q - Leandro Fontanesi {BIO 20270610 <GO>}

Thank you very much for your answers.

Operator

Next question by Lucas Ferreira from JP Morgan.

Q - Lucas Ferreira {BIO 16552031 <GO>}

Good morning, everyone. I think, I'm addressing a question to Sidney because you talked a lot about the domestic market. So what's your prospect towards the supply of poultry this year? Raw materials went up from last -- at the end of last year to, today it's a bit seasonal, but do you think you can put prices up in the In Natura products, and what about the processed products, what's the market dynamics? Is the market more disciplined in this sense or can you still transfer a part of your prices, so can you talk about prices and prospects for the coming months in 2019, please?

A - Sidney Manzaro {BIO 17678250 <GO>}

Hello, Lucas. This is a very good question and it's a very broad question. When you talk about the domestic market, we are a very much connected with raw materials. We have indications coming from surveys that show that Brazil has exported poultry at a very high level. This helps us a lot, because this helps us decrease the supply in the domestic market. We've had problems with pork in China, but still this shows that we have a better market elsewhere. Prospects are positive, although we haven't felt all the positive results yet. But we are going to have less pressure on the domestic market, coming from the international market.

So again, prospects for price transfers are positive. And as I said, before, we worked hard on that. We went to about 90% of the price. This is not a negligible figure. This was more on the In Natura side, because we had this open window as we reduced inventory. And this is not a problem where -- we had all by itself, the whole industry had the same problem. And the scenario in the international market is positive. We are going to have better prices, but in processed products we have to monitor market share continuously. We have to check what's happening with our competitors and what they are doing. And I think, they are doing the same because all the chain was suffering from the same impacts.

What I notice in practice is that our competitors are doing exactly the same we are doing. So in order to give you an objective answer, we still very -- see there is some room for price transfers. Our industry as a whole is still under pressure, but the scenario for poultry and pork is more positive in the foreign market than it was last year.

A - Lorival Luz {BIO 16180455 <GO>}

So I'd like to add, I'm Lorival, here. Lucas, that it's important we start 2019, with a well-balanced ratio between supply and demand. And like what we had at the end of all the years when we had an imbalance, and the whole industry and BRF had to take care of this extra supply and all the inventories we had in 2018. So in 2019, we are at a better position.

Q - Lucas Ferreira {BIO 16552031 <GO>}

Thank you Lorival. Thank you Sidney.

Operator

Next question by Marcel Moraes from Santander.

Q - Marcel Moraes {BIO 6696122 <GO>}

Good morning, everyone. Can you please clarify something to us. How are the things happening in Asia, any good news on imports in China and at what point, are you going to recover really? And then what about the competitiveness of Brazilian products in Japan? I'm concerned about part of the market share there. Do you think you're going to recover this 80%, 70% market share you had in Japan for poultry for example, what are your views?

A - Patricio Santiago Rohner {BIO 19686996 <GO>}

Okay. Thank you, Marcel. Patricio here. So, very briefly mentioning Asia. Profitability as a whole is hugely affected by China. Their consumption is 52 million ton of pork. So -- and they have a lot available there. They are not in any shortage there. So the problem is in the medium-term and long-term. So we think we can be very positive from today and into the next two or three years. They have just giant consumption there as compared to other Asian countries.

So as to what goes from Brazil to Japan, we are moving some of those products to China, with similar products, very basic products around $300 total. And this helps us because, we wouldn't like to have the availability we need for China, but the difference in Japan is a vary market. If you compare with Thailand, this segment is totally different as compared to Brazil, with skin, bones, et cetera. So -- and we eat breast, et cetera like in Europe and Mexico, and we have more exports to the US also of breast, et cetera. And the US is also importing from Mexico and not from us. So Japan complements this demand.

And as to Thailand, this is for industrial kitchens, for factories, food services, delivery, et cetera. It's super-cooked. If you compare to In Natura products and the seasoned -- pre-seasoned products, they are not competitive. So we have this huge segment in Brazil, small in Thailand, but with good profitability. And we have other supplementary customers and channels. So I think that Brazil is going to recover this level of exports, perhaps not in the short-term. Perhaps not for Brazil as a whole, but there are other opportunities like China. But there is demand coming from Korea, the Philippines, et cetera, and they need suppliers, consistent supplies. And the only country positioned now to be competitive at a high quality level to offer that is Brazil. Brazil is still a reference for the exporting market all over the world.

Q - Marcel Moraes {BIO 6696122 <GO>}

Perfect. There is just one aspect here, because this China with -- this issue with China, do you know more or less how much gain per kilo you can have because you do not have these additional export tariffs?

A - Patricio Santiago Rohner {BIO 19686996 <GO>}

Well, this is very strategic and we don't really know exactly what the impact is. But everybody is aware of the prices and there is minimal prices announced. I would rather not give you exact numbers, but in China from February on we'll have monthly results.

Q - Marcel Moraes {BIO 6696122 <GO>}

Well, thank you very much.

Operator

The next question is from Thiago Duarte with BTG Pactual.

Q - Thiago Duarte {BIO 16541921 <GO>}

Well, good morning, everyone. I would like to start by asking you about the CapEx of the Company. We saw a CapEx in the order of BRL1.6 billion, last year. I would like to ask two questions regarding that. Do you consider this CapEx is sustainable in 2019? And also, I would like to understand why when we analyze the breakdown of the CapEx you show us, that we in fact see an increase in CapEx, and when we analyze the stocks of poultry of the Company, there was an increase in Q3 year-after-year. And then when we analyze it, different results, which were provided by the Brazilian industry in the metrics, we saw a decrease of 3%.

So there are two questions here, the level of CapEx for 2019. And I would also like to understand according to your opinion, why you think that you're going against the rest of the industry regarding the -- all of these major sales, and what this would -- or how this would impact BRF for 2019?

The second question has to do with the profitability level for the Halal segment. I would also like to take the opportunity of having Patricia here with us, for 2018, and especially when we think of the change, we had for Halal, we saw a margin of 9.6% of the adjusted EBITDA, and I would like to understand whether you consider this level to be normalized for the market as you see it today, taking into account the specific dynamics, especially in Saudi Arabia? And so it would be interesting to understand that.

And finally, and of course you're not providing an EBITDA to that guidance, you're just providing a leverage guidance for the end of the year. But when we analyze this pro forma debt level of BRL3.4 billion that you reported, it already includes all of the entries of resource disregarding the amortization plan. And this number seems to be very interesting in terms of EBITDA, and EBITDA free debt for 2019. And so when we analyze this based on that 3.6 times that you mentioned, we had BRL3.6 billion or BRL3.7 billion. Of course, you do not have an EBITDA guidance, but of course if you comment whether this makes any sense to you or not, I would. Thank you.

A - Pedro Parente {BIO 2058839 <GO>}

Well, thank you, Thiago for your questions. I will start with a few aspects, and then I will turn over to Patricia and Leonardo, so that they can provide further details. Regarding CapEx, we understand that one BRL1.6 billion is indeed sustainable. Of course, there will be variations to this number with the effects of the exchange rates and so on and so forth, but it is indeed sustainable.

And before I turn over to Leo further details regarding storage and everything, it's important to remind that what you see in the statements regarding biological assets, they are also impacted by exchange rates, and by the cost of grains, because at that time the price of grains was irrelevant. But as you have an increase in the price of grains in 2018, there was an if factor there for 2018, which is not reflected in financial values. Leonardo will get into the details, but I would like to comment -- your comments regarding the EBITDA guidance.

There are two factors of which you're well aware of, one of them is the EBITDA, which is expected throughout the year, and the other one is another component of the debt of what we're paying in terms of debt, but also we have the cash generation throughout the year, which will also be used to pay this debt. And so the rationale is, is actually the one you mentioned adding, that throughout 2019, we're going to have a positive cash generation. This is what the Company expects and what we're projecting.

Any other cash amounts will be used totally to reduce our debts and therefore we're going to work with the two aspects. One with the productivity in the gains we expect to have with the EBITDA gains as well as additional actions that will lead to a positive cash generation to reduce the Company's debts.

I will now turn over to Leandro, so he can talk about your first question.

A - Leonardo Almeida Byrro {BIO 17581639 <GO>}

Good morning Thiago, I hope all is well. We always try to be very strict when we analyze our own data to analyze the market, and therefore what we have projected for 2019 and 2020 is actually takes into account this balance in terms of what the market is offering and what we can do. We're being very strict in analyzing our stocks and how we can store animals. And of course, now that the market is heating up, we expect to be able to offer more to the market and leverage the growth of the Company. But the Company is being very transparent in terms of growth, and in terms of managing stocks, and also analyzing the market as it should as a very long chain that must be managed very carefully. So that we do not have any problems later on. We're analyzing the market, analyzing the demand for the next couple of years.

Q - Thiago Duarte {BIO 16541921 <GO>}

Well, I thank you. Regarding my previous comment and regarding Lorival's answer, at the end of Q4, you mentioned the BRL18.5 million, which represents a 4% growth; regarding last year now thinking about the number of -- it's all very clear now.

A - Patricio Santiago Rohner {BIO 19686996 <GO>}

Thiago, this is Patricio, and I will try to answer your questions about Saudi Arabia, and the Gulf. What we showed you was general results. I'm very optimistic regarding Saudi Arabia. The results we shared with you would be normal. I would like it to be better than that. And we are working in that direction. Everything that happened last year, our systems to kill our animals and the plans for Saudi Arabia and local production with the local producers is already on the table. But the country is changing very quickly, women and the labor work;

women can drive and they have an impact on consumption. And so the need to consume more products with added value is right there on the table.

Some years ago, some four years ago, women had a lot of time to cook and they had a lot of help at home. The costs have increased a lot for expatriates and also the internal the costs have increased, the domestic cost. And therefore consumption is changing and there is a higher trend for added value of products in which this is exactly where we are one step forward. And so, I'm very optimistic. And I think that if we have the ability to do that and if the Brazilians participate more, and not as we had in the past with the French and so on and so forth, but as our mix improves, we'll be one step forward to have a sustainable margin that will improve, taking into account the mix, the costs that have to do with volume and local management, and also because of consumption.

Q - Thiago Duarte {BIO 16541921 <GO>}

Do you think that this is possible, even with the local production reaching 50% of the offer?

A - Patricio Santiago Rohner {BIO 19686996 <GO>}

This is a discussion we had some years ago regarding the need to have local partners and also the whole foods, belief.

Q - Thiago Duarte {BIO 16541921 <GO>}

But you don't think that's necessary, the position of the business as it is today will have a sustainable margin?

A - Patricio Santiago Rohner {BIO 19686996 <GO>}

Well, I agree with what you mentioned. But when I talk about a mix of products, I'm talking about a local production in Abu Dhabi. And we have already expanded when which -- we expanded when we changed some lines, and we have a participation of 60%. And when you analyze our experience in Turkey, where we had one of the best companies in the sector, with an EBITDA of about 4% and for some years, we improved the situation. We can see that we have an ability to add value and because of our experience in Brazil.

When working overseas, in our experience in terms of costs, we know that producers are not good distributors, and they're not good businessmen in terms of working with brands and mix. And so, I do want to have a 60% share and I have told Lorival and Parente about this and they're asking me to travel there, the Company is working very closely with Saudi Arabia. And so, when I say 40%, I am being very cautious with the increase of mix and we will have a good business for those who come from outside, but for those who operate in both areas, with our mix and our brands, will have a better condition or better position actually.

Q - Thiago Duarte {BIO 16541921 <GO>}

Excellent. Thank you very much, Patricio.

Operator

Our next question comes from Antonio Barreto, Itau BBA.

Q - Antonio Barreto {BIO 17449798 <GO>}

Good morning. I thank you for your question. I just wanted to clarify a question regarding PIS/COFINS, and the gains obtained with these taxes. And when we analyze Brazil, it is very clear that you've commented that if it were not for the gains of PIS/COFINS, the adjustments of the debt would have been lower. It would have been BRL23 billion. What I wanted to understand it was not very clear, is whether those BRL800 million of adjusted EBITDA on the Company, I want to know if they include those gains or not with the PIS/COFINS?

A - Lorival Luz {BIO 16180455 <GO>}

Well, Antonio, good morning. The answer is yes, they do included in the Brazil paragraph. We make it very clear that it includes the BRL225 million or BRL226 million of PIS/COFINS. But also, it already includes the impacts of the last quarter, obtained with a stock to liquidation of around BRL90 million. So that even with these two effects, the operation of the Company when compared to Q4 in Brazil was superior, and was better than Q4 2017. And so if we analyze semester after semester, we can see a recovery of these margins moving from Q2 and Q3. It is always important to highlight that there was an impact of the mixes. When we did in fact have a decrease in Turkey in Chester, with a higher demand of swines and so, because we included it here in our discussion, the price of swine has not recovered as fast as the prices of poultry, and so we didn't have that impact. But despite all of these effects, if we take these two factors into account, the results of Q4 was superior and better when compared to 2017.

Q - Antonio Barreto {BIO 17449798 <GO>}

Thank you, very clear. My second is about something I'm not sure I understood correctly. I think, you said the sales of assets will lead to future expenses of BRL800 million. I haven't seen that in any of the section of the release. So when you talk about monetization, is this net of these expenses, and in your estimates for net debt at the end of 2018, have you also deduct these expenditures, so did I get this correctly?

A - Pedro Parente {BIO 2058839 <GO>}

Antonio, this is Pedro Parente, speaking. This translation effect due to foreign exchange adjustments. Let me just check back the figures here myself. Yes, about BRL800 million, this is just an accounting figure with no impact on the cash. So BRL4.1 billion is figure that's not affected by this BRL800 million. What I mentioned before on transparency is that we really wanted to consider this from the very start. We wanted to close this process. That was our goal. But unfortunately based on the rules we have to follow, this appropriation of foreign exchange differences can only be done at the closure of the process. So this is going to happen in the future.

We have chose -- just closed a cycle of adjustments that we made concerning on the problems we had last year and also the sales of our assets. I just chose not to make any surprises. I wanted to mention that adjustment in advance to you all. But even from the accounting view-pointing, we expect positive results, when we have the final judgments coming from courts concerning COFINS, PIS et cetera, and we believe that when we have this final orders, we are going to have this money contributing to a positive result. So from the accounting side, we have this negative impact of BRL800 million, of course, this depends on exchange rate at the closure, but this is the best estimate right now. But even from the accounting point-of-view, there is a high chance that we're going to have these COFINS and PIS procedures coming from a final court order, and this is going to set off the negative result.

Operator

The next question by Luciana Carvalho from Banco do Brasil.

Q - Luciana Carvalho {BIO 18724665 <GO>}

Good morning, everyone. Thank you for the opportunity to ask a question. And I'd like to ask about the working capital and improvement you disclosed in the second half, an improvement of BRL217 million, especially due to the changes in raw materials and finished products. So you went to 26% when the average was 34% in recent years. So in the release, you start say, -- say, you started 2019, that your inventories are balanced and that it's sustainable, so can you make a few comments on working capital, please?

A - Lorival Luz {BIO 16180455 <GO>}

Thank you, Luciano. First, I'd like to talk about two important effects on our working capital. One is the reduction in raw material inventories. It was very effective, a reduction of about 60%. And I can add that this is not only sustainable, but also we think we can reduce this even more from what we had in December to our goal. So we think there is some room for some additional reduction here. And the other effect is going to be detailed by Elcio, but our working capital is affected by receivables. Remember the FIDC transaction we mentioned, it's the receivable -- receivables fund.

A - Elcio Ito {BIO 18281069 <GO>}

So it's Elcio, here, Luciana, just elaborating one what was said, structurally speaking, we have a reduction of 60% in the inventory of raw materials as compared to beginning of last year. So it's a more -- better adjusted to our needs of raw materials, it's more balanced. We have the FIDC issue, so it's a structural reduction, because we are going to have the program going on in the coming semesters, and we have a reduction in finished products. And the control of finished products also makes a difference, not only on expenditures, but on operations too. So we had this reduction of BRL255 million, and this comes from the reduction in the receivables investment fund. So, partly it's structural and partly it comes from one-off operations with receivables.

Q - Luciana Carvalho {BIO 18724665 <GO>}

Thank you very much.

Operator

They last question comes from Alex Robert from Citigroup.

Q - Alexander Robarts {BIO 1499637 <GO>}

Good morning, and thank you. And I'd like to talk about the Halal segment, again. And I have two questions concerning this segment. You may have said something about that, but I missed the beginning of the call. So in Saudi Arabia, if we think about this year 2019, until now, what's the flow of exports you have going into this market? After this analysis, can you perhaps elaborate on the impact we can expect on volumes exported to Saudi Arabia, and the revenue you expect this quarter coming from this market, because you've closed plants and suspended some plants, and there are some news in the press about that?

And the second part of my question refers to Turkey. At Citi, we expected GDP, to be 4% to 5% lower in Turkey this year. So what's the scenario you see ahead of you, a challenging scenario, are you going to change the mix of products or lower prices so that you can sell more volume there? Can you say a few words about this scenario for 2019? Thank you very much.

A - Patricio Santiago Rohner {BIO 19686996 <GO>}

Okay. Thank you, Alex. Good morning. Regarding Saudi Arabia, you asked very specifically whether our volume of exports will be lower in Q1. We have our own distributors in Saudi Arabia, so since last year we have buffers stocks. So we have a higher volumes sold in Saudi Arabia, and I am talking about the last two months as compared to last year. And this has to do to more supply available there. We are buying from other people. We are producing much more in Abu Dhabi for Saudi Arabia, so our position is very comfortable as to sales in Saudi Arabia.

But in January, you had these changes in plants, and these plants that are listed have historically sold much more to Saudi Arabia than we are selling now. Because the production was local, they had those channels, et cetera. But we are comfortable about our volume and we have -- our volume is sufficient for Saudi Arabia until October 2019. So we are very optimistic. We are prepared to sell until October 2019, based on what we have now.

When I talk about the Abu Dhabi plant, I think you've visited the plant a few weeks ago, we have a very good mix there. We are supplying to global accounts to Sadia, one of our brands, et cetera. And we have access to raw materials ourselves, so we can increase the volume and we can enlarge the capacity of the plants with minimum levels of $100,000, et cetera to meet the demands of our food service. Our mix is very rich as I said. And for food services, we have expatriates. And this is the profile of labor we have at this type of channel. They are looking for higher value-added products. So we're going to have local partnerships to add value to our product and our services. And then we have all this conditions in place.

As to Turkey, last year, they had a very aggressive devaluation in foreign exchange, and we could transfer our prices until the cost was getting closer to our price positioning. But the small businesses suffered more. The small businesses are producing less because they cannot manage to pay in dollars. So we are at full capacity in this international market and our exports to the Gulf -- exports of value-added products, as we mentioned before, we are at historical record levels. So I'm very optimistic about our position in Turkey.

And as to improving the mix, as you mentioned, as Banvit was not supplying certain important customers like supermarkets, for example, but we decided to capitalize some other suppliers and now Banvit is selling up to 75% of our volumes. So we're improving our mix. We have a better access to different channels, different brands and we are at full capacity. And we are keeping that high level and we have a demand that is even higher then we are prepared to supply.

So I feel very comfortable about Turkey, even with the GDP decrease, red meat suffered, other products suffered last year, but they are migrating towards poultry.

Q - Alexander Robarts {BIO 1499637 <GO>}

Thank you. So in 2019, the domestic market in Turkey will not fall, it's not going to be weaker than last year, or is it still early to talk about the domestic market in Turkey?

A - Patricio Santiago Rohner {BIO 19686996 <GO>}

We don't expect it to fall. Our volume is very high at full capacity. We increased exports because of the dollar exchange rate. When I export, I have subsidies on what I import. So as we have platform for brands and a good mix in the whole region, we use exports to complement our portfolio outside Turkey. And then we have more dollars available for our own market. So the volume we are addressing to the domestic market, which is about 70% of the total, we had an improvement in this, in terms of channel, brand and mix. So I'm very comfortable about the way we are using our full capacity.

Q - Antonio Barreto {BIO 17449798 <GO>}

Okay. Thank you very much.

A - Patricio Santiago Rohner {BIO 19686996 <GO>}

Thank you.

Operator

We're now closing our Q&A session.

A - Pedro Parente {BIO 2058839 <GO>}

(Technical Difficulty) based on sustainable actions, and not on short-term actions, which in fact in the past proved to be measures that did not provide good results, and actually harmed the ability of the Company in this generation. And so we're very confident of what we're doing. We understand that we're talking about future results and the actions that we're taking now will definitely provide results in 2019. But according to sustainable actions and not measures that will initially provide immediate results. And in face of the nature of this business with a long chain that might be to the Company to having -- having to make reductions, which will further compromise our results.

I would like to thank you all for your presence. Our Investor Relations area will be available not only today, and definitely today because we are releasing our results. But our analysts and the banks, and if you want any further information, we'll be available to you. Thank you all very much.

Operator

BRF S.A. conference is now over. And we thank you all for your participation. I wish you a good day.