Q2 2015 Earnings Call

Company Participants

- André Nogueira de Souza
- Gilberto Tomazoni
- Jeremiah Alphonsus O'Callaghan
- Wesley Mendonça Batista

Other Participants

- Alexander Robarts
- Carla M. Casella
- David Cook
- Farha Aslam
- Jose J. Yordan
- Lauren Torres
- Luca Cipiccia

MANAGEMENT DISCUSSION SECTION

Operator

Good morning, everyone, and welcome to JBS Conference Call. During this call, we will present and analyze the results for the second quarter of 2015. As requested by JBS, this event is being recorded. The recording will be available to listeners this afternoon, and can be accessed by following the instructions posted on the company's website at www.jbs.com.br/ir.

Taking part in this call, we have Mr. Wesley Batista, Global CEO of JBS; Mr. Gilberto Tomazoni, CEO of JBS Foods; and Mr. Miguel Gularte, CEO of JBS Mercosur; Mr. André Nogueira, CEO of JBS USA; and Mr. Jerry O'Callaghan, Investor Relations Officer.

Now, I'll turn the conference over to Mr. Jerry O'Callaghan. Please go ahead, sir.

Jeremiah Alphonsus O'Callaghan {BIO 19817115 <GO>}

Thank you. Thank you very much. Good morning to you all. As we present these results this morning, we will go through our presentation, which is available on our website, and I will make mention to the page numbers as we talk about each item in the presentation.

Starting on page four of our presentation, looking at consolidated highlights for the second quarter of 2015. Firstly, with regard to net sales. We had a substantial increase in net sales when compared with the same quarter in 2014. We went from just under BRL 29 billion to almost to BRL 39 billion quarter-on-quarter, an increase of 34-plus percent in net sales.

In terms of EBITDA, EBITDA went from BRL 2.4 billion to practically BRL 3.6 billion with EBITDA margin going from 8.4% to 9.2%, an increase of 47% in EBITDA when comparing the quarters. And we can see that the EBITDA growth was substantially greater than the revenue growth in the period.

Moving on to page five in our presentation. Our consolidated net income was BRL 80 million in the quarter, BRL 0.03 per share as against BRL 254 million or BRL 0.09 per share in the previous quarter. The net income was affected by our FX hedging expenses in the quarter.

If you recall at the end of 2014, the real against the dollar was at BRL 2.60 to the dollar, that was at about BRL 3.20 by the end of the first quarter and back to about BRL 3.10 at the end of the second quarter. Today, that number is close to BRL 3.50. So we've had a consistent hedging policy around our dollar exposure in reais overall this period. And although we had some expenses and our net income was affected in the quarter as a result of that policy, we believe that the strategy continues to be effective through a longer period of time, when we see what is happening in emerging market currencies.

Generally speaking, when we see what's happening with commodities, hard and soft commodities, as we see the recovery of the economy in the U.S. and the strength of the U.S dollar, we are convinced that it is prudent to maintain this position and to know exactly what our risk is rather than to be exposed to the volatility associated with the Brazilian real and with emerging market currencies as a whole.

Cash generation in the second quarter was BRL 675 million as against BRL 147 million in the same period last year, 350-plus percent increase in cash generation in the period.

Moving on to page six in our presentation and looking at net debt and at leverage, very important, more and more we look at our net debt position in U.S. dollars and although, we made acquisitions and we paid for the acquisition we made in Mexico right at the end of the second quarter in 2015, our net debt in U.S. dollars remained the same at the end of the second quarter this year as compared to the end of the second quarter in 2014.

Leverage, we had a leverage of 3.2 times at the end of the second quarter in 2014 and that reduced to 2.4 times at the end of the second quarter this year. And if we take into account and do a pro forma addition of the EBITDA generated on an annualized basis of the acquisitions that we made over the last six months or just over six months, including the Tyson Brazil acquisition, the Tyson Mexico acquisition, the Big Frango acquisition, the Céu Azul acquisition, and also the Primo acquisition in Australia, which was finalized at the end of the first quarter of 2015, thus we've had only one quarter of results in these consolidated numbers we are presenting today. If we annualize the EBITDA associated with all those businesses, we're talking about an incremental EBITDA of about BRL 1 billion, more than $300 million, and that would reduce our leverage from 2.4 times at the end of the period to 2.3 times.

Moving on to page seven in our presentation and to talk a little bit about our exposure in terms of revenues by currency. If we look at today at the split between our revenues in reais and our revenues in dollar-associated currencies, we've got 84% of our revenues in U.S. dollars and 16% in reais, which is the portion of our revenue generated from sales in the domestic Brazilian market. And this is prior to the acquisition of Moy Park and of the Cargill pork business, which we announced at the end of the second quarter. So the position would be even more skewed towards U.S. dollars when those acquisitions are concluded.

On page eight of our presentation, a little bit about our historical performance. Firstly, if we look at our last 12 months' numbers, we had revenue of about BRL 130 billion and an EBITDA of BRL 13.2 billion in the period and that's equivalent to a 9.6% EBITDA margin for the last 12 months to the 30th of June this year. If we update these numbers with the exchange rate at the end of the second quarter and if we add the pro forma revenue associated with the acquisitions, which I just mentioned, we would have had an EBITDA LTM of (sic) BRL 15.2 billion and our revenues would have reached BRL 160 billion.

Also, on page eight, we've got numbers that stretch over a longer period of time from 2007 up until the LTM 2015. And I think it's important to point out the consistency with which we've grown our business and at the same time, we've grown the profitability of our business. We've gone from BRL 14 billion in 2007 to almost BRL 140 billion LTM. But more importantly, our EBITDA has grown greater than our revenues have grown. We've gone from a 4.3% EBITDA margin at the beginning of this period to an almost 10% EBITDA margin last 12 months.

Now to talk a little bit about our business units and starting with JBS Foods in Brazil, which is our poultry and pork and prepared foods business. We've had revenue increase again comparing the second quarter of 2014 with the second quarter of 2015 from BRL 3 billion to BRL 4.46 billion, an increase of almost 45% in revenues in the period. In light with those revenues, we've seen a greater increase in the performance of this business. We went from BRL 440 million in EBITDA the second quarter in 2014 to BRL 790 million in the second quarter of 2015, an increase of almost 80% year-on-year, with the EBITDA margin going from 14.3% in the second quarter last year to 17.7% in the second quarter of this year.

We've seen that this revenue growth strength coming from both organic and inorganic actions. We've seen revenue growths of practically 30% in the prepared products in the domestic market in Brazil. And we've also seen a continuous improvement in the quality indicators, level of service and execution associated with our business in Brazil, with our value-added branded business in Brazil.

We've seen a substantial enlargement of our customer base, particularly in the small and medium retail sector. Just to give you an idea of numbers, we've increased our customer base by 19,000 customers from the end of the second quarter of 2014 to the end of the second quarter in 2015. And we've seen successful strategy associated with our international business as well.

If we move to page 11 in our presentation, we can see some of the actions we've taken with the Seara brand outside of Brazil, where we are doing promotions at the point of sale and we are marking up products under our own brands worldwide in Brazil.

But also on page 11, we've got some numbers associated with the domestic market. So, we have the market divided into four different categories: frozen products, processed products, margarines and pizzas. And we can see the market share increase that JBS Foods has had in each one of these categories when comparing the 12-month period.

We've seen an increase in the size of the market of each one of these businesses, but more importantly, we've seen an increase in the market share of JBS Foods in each one of these categories. And in pizzas, a 9.7 percentage point increase; in margarines, 1.2%; in processed products at 2.3% point increase; and in frozen products, almost 11 percentage point increase of the increase in the market share of JBS Foods in each one of these categories.

We also had a substantial number of items launched. New SKUs launched, 46 new SKUs launched in the first half of this year and some examples of those are demonstrated on page 11, some of the new SKUs that we've been launching innovative products, convenient products in the domestic market.

Moving on to page 12 in our presentation and JBS Mercosul. We saw revenues increased by almost 15% from BRL 6.3 billion to BRL 7.2 billion in the comparable period. EBITDA down from BRL 634 million to BRL 377 million, down 40% in the period with an EBITDA margin declining almost in half from 10.1% to 5.2%. This margin compression was primarily due to tight cattle supply and relevant reduction in the Brazilian beef exports.

The highlights of the quarter were an increase in our participation in the industrialized further processed category, where we posted an increase in volume and prices both in the domestic Brazilian market and also in the external market associated with these products. We continue to invest in marketing and in product portfolio innovation in our beef business in Brazil.

And we are observing, as we enter the second half of 2015 an improved supply and demand balance and a recovery of exports to major markets, which in our view will improve and the performance of this business as we go into the second half of the year. A good example is the re-opening of the Chinese market for Brazilian beef, which we opened in June of this year. This is a relevant market and we've already seen a relevant demand coming out of this market at the beginning of the third quarter. 80% of the capacity in Brazil, which is approved for that market, is JBS capacity. So we will have a relevant participation in exports to the Chinese market.

We've also seen some other markets re-opening for Brazilian product, Saudi Arabia is on the verge of re-opening, and there is a perspective that the trade between Brazil and the U.S. will start in the not too distant future.

Moving on to page 13 in our presentation and to talk about our Beef business in the U.S., which includes Australia and Canada. These numbers are in U.S. dollars. We've seen revenue increase of 11.5% from $5.3 billion in the second quarter of 2014 to $5.95 billion in the second quarter of 2015. EBITDA increased from a $108 million to $228 million, a 110% increase in EBITDA. EBITDA margin went from 2% to 3.8% in the period.

We've seen volume and price improvement both in the domestic U.S. market and in exports. We consolidated the Primo numbers at the beginning of the second quarter of 2015. So this is the first quarter where we have those numbers presented to the public.

We've seen a resilient demand in the U.S. market for beef with growth in exports primarily from Australia. Basically, what we've seen is a decline in domestic production in the U.S. associated with herd retention and a corresponding increase in exports to compensate for the lack of cattle available in the U.S. market. So although prices have increased quite substantially, domestically in the U.S. market, consumption has not declined, imports compensating for the lack of domestic production.

We've seen Australian exports increase quite substantially in the first half of this year and particularly in the second quarter to the U.S. and elsewhere. The currency in Australia is favorable towards the export market and we particularly are very focused on increasing and diversifying our exports out of Australia.

And finally, on this point, we've seen a strong cow and heifer retention in the U.S., which is good news from medium and long-term for our business. We've seen cow numbers growing by 2.5% and heifer numbers growing by relevant 6.5%. These are the numbers that were presented recently by the USDA.

Moving on to page 14 in our presentation and our Pork business in the U.S. We've seen a decline of 22.7% in revenues associated with this business from $1.028 billion to $795 million, primarily because of the decline in the average price of products sold, which is associated with an increase in the number of animals that came to the market, number of hogs that came to the market in the quarter. EBITDA went from $113.8 million to $64.6 million, a decline of 43%, EBITDA margin from 11.1% to 8.1% in the period.

We did see quite a lot of demand coming out of the export market and we think that will increase in the second half of this year, particularly as a result of liquidation of sows in the Asian market. Our exports in the second quarter of 2015 were up about 35% when compared with the same period last year and we think we will continue to see strong demand in the export market. And also, in relation to this business, we've increased our participation in value-added products in the domestic market. We've got some examples of photographs on the slide on page 14. We've had quite a substantial increase in the sale of these value-added products domestically in the U.S. market, organic growth.

On our Chicken business in the U.S., JBS USA Chicken Pilgrim's Pride Corporation, they already published their numbers. So, those numbers have been available for the last couple of weeks. But just a quick synopsis here, sales were down 6.1% from $2.186 billion to $2.054 billion, primarily again as a result of the decrease in the average price of products sold. But EBITDA was up from $338.6 million to $425.8 million, an increase in EBITDA margin from 15.5% to 20.7%, an increase of 25.7% in EBITDA year-over-year basically as a result of our focus on operational excellence.

We have an effective strategy in product portfolio and management of sales channels, and a geographic and portfolio and sales channel diversification, meaning a good product mix which optimizes our risk management and the pricing of our products.

At the beginning of this third quarter, we had the integration of Tyson, Mexico operations and they're progressing according to plan and we will be reporting numbers as we finalize the third quarter of this year.

Moving on to talk briefly about exports. Our exports in the quarter were just under $4 billion, highlight for exports to Greater China. China and Hong Kong basically grouped together here. We had 14.7% of our sales to that destination. We should see an increase in that percentage now as we move into the second half of the year, and as Brazilian beef exports, which would have some quite relevant volume into that market.

Secondly, we've got very traditional markets. We have particularly for poultry products out of Brazil and also for our beef products out of South America, Africa and the Middle East are very consistent market for our products.

We're also increasing our sales around South America. 11.7% of our total exports went to countries in South America. And we export to South America, not only from Brazil, Paraguay, Uruguay, and Argentina, but also we export products out of Australia into South America and out of North America into South America.

Mexico is a very traditional market of ours as well. We have relevant distribution, as well as having operations. We have relevant distribution in the Mexican market.

And we have a strong presence also in the Japanese market as a result of our exports. Out of Australia and out of the U.S., Japan being quite import-dependent, particularly for high-quality value-added type beef cuts.

We also had relevant exports to the U.S. and that's primarily because of the Australian exports product into the U.S. to compensate for the reduction in production within the U.S. market.

Moving on to page 19 in our presentation to talk a little bit about our CapEx and about our cash generation. Our total CapEx in the second quarter of 2015 was just over BRL 2 billion, half of which approximately is associated with the acquisition of Tyson in Mexico.

The other half is associated with expansion and modernization of facilities, about 50% of it, and the other 50% is associated with maintenance.

Regarding cash generation, we generated net cash from operations of BRL 675 million in the quarter and free cash flow from – after CapEx was negative BRL 1.415 billion due primarily to the payment of the Tyson, Mexico operation at the end of the quarter, $400 million, which is about BRL 1.24 billion.

Our debt profile on page 20, a little bit about our debt profile. We already spoke about net leverage, which declined from 3.2 times to 2.4 times. And if we take into consideration the annualized EBITDA associated with the recent acquisitions, that would have been at 2.3 times at the end of the quarter with a net debt at BRL 34.8 billion.

When we look at net debt in U.S. dollars, as I mentioned and regardless of the acquisitions we made on the payment of the Tyson deal recently as well, net debt in U.S. dollars at the end of the second quarter of this year was almost exactly equal to what it was at the end of the second quarter last year.

The breakdown by currency, 87% of our debt today is in U.S. dollars and 13% in reais. And we've got the cost of debt under 5% in dollars and above 13% in reais, very much matching our revenue by currencies as well. The breakdown is just over 50% with commercial banks, with whom we have strong relationships around the world and 47% in the debt capital market. The breakdown by company almost 50% of our debt is a JBS S.A., 38% at JBS USA, and 13% JBS Foods.

Page 21 in our presentation, at the end of the quarter, we had just under BRL 14 billion in cash, equivalent to 87% of our short-term debt. And if we add on the committed lines we have in the U.S. of $1.6 billion, which are fully committed lines at the end of the quarter, the sum of our cash position in these fully committed lines would represent almost 120% of our short-term debt, which was 33% of our net debt at the end of the quarter.

Our debt maturity, again I think it's important to look at the amount of liability management we did over the last couple of years. We've extended the maturity quite substantially. We can see we've got no relevant maturities until 2020 and thereafter. BRL 8 billion in 2020, BRL 3.5 billion in 2021 and BRL 11.5 billion thereafter.

So with that, that concludes our presentation. I'd like to pass you on to Wesley Batista, our CEO for some comments before we open up for Q&A. Wesley?

Wesley Mendonça Batista {BIO 15243148 <GO>}

Very good, Jerry, and good morning all. I would like to talk about some highlights on the second quarter and summarize some performance of our second quarter, and as well to talk about where we see our business today and where we see our business going forward.

Some important highlights here. When we see our top line growth, we have been growing our business substantially and we keep growing our business of 34%, 35% growth quarter-on-quarter. But the good thing and more important than the top line growth is that we have been able to grow our operating performance greater than our sales growth. So, clearly, the EBITDA is growing a bit more than our revenue. So, our margin, our margin EBITDA...

Jeremiah Alphonsus O'Callaghan {BIO 19817115 <GO>}

EBITDA margin.

Wesley Mendonça Batista {BIO 15243148 <GO>}

...EBITDA margin is expanding, keep expanding. We have been able to keep expanding our EBITDA margin.

We have been saying this for quite a while, we believe JBS will built a unique protein platform globally, well diversified in terms of where we operate, in terms of the proteins that we are, and as well our product mix. And we see this very beneficial through this diversification in product portfolio in terms of geographic and as well in terms of different proteins. We have been labeled to stabilize and to our margins – and to have consistence in our margins, and we see this very beneficial because sometimes one protein is performing better, other protein is suffering. But when we consolidate our business, we see this very beneficial and this is a unique company in the sector that has this diversification.

So, obviously, this is great. We are expanding our value-added business. We are expanding our prepared food portfolio and we are investing our brands. We are very happy with the results that we are getting. So everyday more, and this is where we are keep going is to keep expanding our value-added portfolio and product mix that aggregates value through product innovation through our brands.

So, when we look inside of each business unit, so we are very happy where we are with our JBS Foods business unit. We are growing our business substantially in Brazil. We are investing in our brands, launching new products and we have been able to expand our market share. And the good thing as well is that the category is growing in Brazil, even though we are facing challenge in Brazil in terms of Brazilian economy. But the category, the frozen category, the other categories that we are is growing nicely in Brazil and we, on top of this nice growth, we have been able to even grow more than the market.

So, when we look our Beef business clearly has been the challenged business unit in the first quarter and the second quarter. So, margin declined. The good news on this business that we saw a big rebalance, industry rebalance in terms of capacity and supply kind of availability, and as well export has improved in Brazil. And with the opening of China and as well to the improvement in some key markets for Brazil. We have seen an improvement in the export for beef in Brazil.

We are already seeing much better margins in the business. Currently, as we speak, we had a great July. We are very confident we are going to see a good margin, margin expansion in the third quarter and going forward. So, we're very positive, even though we suffered in the first two quarters.

So, Chicken in U.S. is doing very well. We are very focused on excellence and execution and we are very satisfied with where we are. Our Australian business with the Primo acquisition is going well and is performing well. And as well our Beef business in North America is performing good comparing to the market.

So we are very positive that the Beef business in U.S., we pass the worst moments and we strongly believe that we are going to see going forward this coming quarters, 2016, 2017 improvement especially to the increasing cattle availability that we believe that this is going to happen. We have seen cattle retention in the U.S., and this is – we are going to collect fruits in the coming quarters and in the coming years.

Our Pork business continued performing well and we are very excited about the execution that we agree with Cargill. That is going to be very complementary to our Pork business in the U.S. So, overall, when we see our business, we are satisfied where we are. We are confident that due to the diversification that I mentioned before, portfolio diversification, platform and all these things, we strongly believe that we are going to deliver consistent margins going forward and we still believe that we can keep, even grow our margins more than our top line.

So talking about the net income, we were affected – our net income was affected this quarter by our hedging strategy. We remember that the real closed at BRL 3.10 in the end of the second quarter and now, the real is almost BRL 3.50. So just in 45 days, we saw a big devaluation in the real. So this is – our hedging strategy is going to be very, very effective and we strongly believe that this is the right thing to do.

When we see all the things that is going on globally, China, commodity price, the U.S. economy is doing better. So, we are going to see rate increase in U.S. The question is not if, it's when. And also the challenge on the Brazilian economy, we strongly believe that we need and should be hedged to not be exposed in real. We want to be fully hedged in dollar. And again, this quarter, we are – at this point, the benefit is far greater than the...

Jeremiah Alphonsus O'Callaghan {BIO 19817115 <GO>}

The cost.

Wesley Mendonça Batista {BIO 15243148 <GO>}

...the cost that we incurred in the second quarter. So, we still holding our hedging position and our strategy did not change and we are confident that this is the right thing to do.

We're hedging our exposure. We know how much this is going to cost to be exposed to the U.S. dollar. You don't know what's going to happen and you know how much can be the cost. So, we keep holding our hedging strategy.

So, with that, I will stop here and ask the operator, please open to Q&A. Operator, please. Thank you.

Q&A

Operator

Ladies and gentlemen, we will now begin the question-and-answer session. Our first question comes from Lauren Torres, UBS.

Q - Lauren Torres {BIO 7323680 <GO>}

Yes. Hi. Good morning, everyone.

A - Wesley Mendonça Batista {BIO 15243148 <GO>}

Hi, Lauren.

Q - Lauren Torres {BIO 7323680 <GO>}

Good morning. My question is directed to your Brazilian businesses. I guess first I'll ask the ever-popular question about how high is up on margin at JBS Foods. It seems like we're hitting another quarter of almost 18% margin. And you talked about organic and inorganic growth. So, just curious to get your perspective on when we look at organic growth, we look at synergies and cost reductions and kind of pull that together, how sustainable are these margins and how much of it is more onetime in nature because of the benefits that you're seeing flowing through?

And I guess, the second question is on Mercosul. And thanks for the description of a better second half, but I guess I'm just trying to get a bit more confident about why we should see margins actually turn positive as opposed to get less negative. If you could talk a little bit about the components of that. I know you mentioned a few factors, but I'm just trying to get a better sense of what's going to turn that around. Thank you.

A - Wesley Mendonça Batista {BIO 15243148 <GO>}

So Lauren, talking about first margin in JBS Foods, the sustainability. Actually, it's the other way around. It's not a onetime benefit. We have been incurring in costs due to the fact that we did several acquisitions in JBS Foods over this last 12 and more close over these last six months. Actually, it's the other way around.

If we normalize the margins in these companies or in these plants that we are acquired in these last 6 or 12 months, then the JBS Foods margin was going to be even higher. And now, our calculation, the impact on this is around 1%. So, if we normalize these companies and these plants in the same level that our current business is performing, our margin was going to be over where we are by 1%.

So, look, we see this sustainable. Actually, our business is even performing better as we speak. We are already in the mid of the third quarter. The business is even performing better than the second quarter. Brazil is benefiting in export, do some markets close to U.S., so volume is growing nicely in Brazil in chicken.

So, this is benefiting our Brazil Chicken business. And as well, the domestic market, we are growing and performing well. So, we are very, very confident. We don't see any reason that we cannot keep delivering this kind of margin and to be honest, we see even higher margin in this coming quarters.

So, about moving to the Beef business. So why I'm confident and I'm seeing already a good margin improvement is basically two things, Lauren. Export is much normal now in terms of volume. So Brazil got hurt by, in the first quarter and second quarter, by some markets that import a lot of volume from Brazil like Russia. So, we are seeing a good normalization in terms of volume. And as well, the opening of China is going to help quite a lot.

But also that is very important, the industry due to the decline in margin and we are part of the industry, the industry did equalization in terms of supply availability and as well the industry capacity. So, we are seeing – we saw and we are seeing a lot of beef plants closed in Brazil and this is putting much more balance in the industry comparing to the first and second quarters.

So, these two main things is the two key factors that we strongly believe we are going to see a good margin recover and improvement. And we are, as we speak, we are already – saw this in July and we are seeing this, as we speak. So we are very confident that margin in the beef sector in Brazil is going to recover and again, we are very, very confident that our JBS Foods business is going to keep delivering strong margin.

Q - Lauren Torres {BIO 7323680 <GO>}

Can I ask just as a quick follow-up, what are you seeing with respect to consumer demand for beef in Brazil on a sequential quarter-over-quarter basis?

A - Wesley Mendonça Batista {BIO 15243148 <GO>}

Even Brazil is facing some economic challenge, we are not seeing consumers decline or demand decline in Brazil. We saw big decline in exports. So in the first half of this year, export declined by 15%. So this is a big number. But in the domestic market, we are not seeing decline in consumers' demand.

And I tell you what, I can tell you, in all of our business, so in the dairy business that we run here in Brazil that JBS is still shareholder. We are not seeing decline in volume and also in JBS Foods, all the frozen and you can see in the graph, the frozen sector in Brazil went up – grew 7.5%, the category and as well processed products, 7.2%.

I think, Lauren, when you see some economics challenge in any country, the industry that suffer more is the industry that is in durable goods type of business, in the automobile industry, real estate and we are seeing these in Brazil. But food, people still buying and we are not seeing decline.

Q - Lauren Torres {BIO 7323680 <GO>}

Good to know. Thank you.

A - Wesley Mendonça Batista {BIO 15243148 <GO>}

Thank you.

Operator

Our next question comes from Farha Aslam, Stephens.

Q - Farha Aslam {BIO 6151888 <GO>}

Hi. Good morning.

A - Wesley Mendonça Batista {BIO 15243148 <GO>}

Hi, Farha. Good morning.

A - Jeremiah Alphonsus O'Callaghan {BIO 19817115 <GO>}

Hi, Farha.

Q - Farha Aslam {BIO 6151888 <GO>}

You're in the unique position in that you have slaughter operations both in North America, as well as Australia. And in your discussions, you highlighted the amount of imports into the U.S. of foreign beef. That's definitely keeping profitability in the North American beef sector a bit challenged. So for JBS USA, given your Australian assets, are you okay with that increase in the amount of beef coming into the U.S.? And some color would be really helpful in terms of how you expect your U.S. slaughter operations to perform over the next six months with that increased beef coming into the U.S.

A - Wesley Mendonça Batista {BIO 15243148 <GO>}

Okay. Great. André, I will ask André further. Please, can you...

A - André Nogueira de Souza {BIO 20244486 <GO>}

Hi, Farha.

Q - Farha Aslam {BIO 6151888 <GO>}

Hey.

A - André Nogueira de Souza {BIO 20244486 <GO>}

I'm not sure if the import in beef in U.S. has put any new challenge for the U.S. But the reality is the amount that we bought of lean beef was exact the amount in reduction of the lean production in U.S. so it's more related to the reduction, 27% reduction in the cow queue (44:47) in U.S. that was replaced by this amount of lean beef that came from outside of U.S.

Of course, we operate on this market (44:58). We bought a lot of this beef and it's beneficial for our operation in Australia, I'm not sure if this changed anything in regards of the cattle price in U.S. because of the availability and the price, the beef price in U.S. So I think that's the – the replacement was a very specific type of beef.

And I think that as U.S. come back next year and the following years to produce more, I think that the import will decline a little bit and U.S. will export more. And the profitability will be much more related with the price of cattle and price of beef in U.S. and outside of U.S.

Q - Farha Aslam {BIO 6151888 <GO>}

That's helpful. And then just as a follow-up, broadly, how are you seeing the M&A landscape around the world? Where are you seeing the best opportunities? And in particular, are there particular types of businesses that are more interesting for JBS in particular geographies you're targeting?

A - Wesley Mendonça Batista {BIO 15243148 <GO>}

We announced two acquisitions in this last quarter, the Cargill pork business in the U.S., and as well as the Moy Park business in the UK. So, we are not looking anything now. We are going to approve – we are going to wait the approval and close these transactions. We are very confident that we are going to generate strong amount of cash in these coming quarters. We strongly believe that our balance sheet will keep being very health and even with these acquisitions, we still believe that we can reduce leverage.

So, at this point, we are not looking. We are not active in M&A. But answering your question in terms of location, in terms of – I have been very clear with the market that we want to grow our business when it's the appropriated time for us in value-added products, in packaged food business, in North America, Australia. This is the regions, and JBS Foods. We have been growing our business and this is a business that in the right time, we want to keep growing this business.

In Europe, we did the Moy Park acquisition. We are going to learn and it's our first sizable investment in Europe, so we want to, first, get to know more the UK market and the European market before we decide that this is going to be nice strategic region for us. So at this point, North America and Australia and JBS Foods is the business and the regions that we have more interest. But again, after the two acquisitions that we did, we are very committed to close this transaction and to integrate this business and to generate cash to keep our leverage in a comfortable level. And so, this is where we are.

Q - Farha Aslam {BIO 6151888 <GO>}

That's helpful. Thank you very much.

A - Wesley Mendonça Batista {BIO 15243148 <GO>}

Thank you, Farha.

Operator

The next question comes from Alex Robarts, Citibank.

Q - Alexander Robarts {BIO 1499637 <GO>}

Yes. Hi everybody. Thanks very much.

A - Jeremiah Alphonsus O'Callaghan {BIO 19817115 <GO>}

Hi, Alex.

A - Wesley Mendonça Batista {BIO 15243148 <GO>}

Hi.

Q - Alexander Robarts {BIO 1499637 <GO>}

Hi. Two questions. First, going back to the JBS Foods business. Very interesting the revenue per kilo trends, and kind of the question relates to the process domestic revenue per kilo. I mean, it looks like from the first quarter to the second quarter in that key process category, you got about a 5% increase in terms of your average selling price.

Now, that's double the magnitude of your competitors' increase in the same period, but at the same time, you're also getting market share. And I guess it sounded also like you staggered a little bit the industry price increases or at least to the price increases that were being put through by the market leaders. So, I guess just thinking about that interesting revenue per kilo growth, is this coming from mix? If you could kind of help us understand, is it channel mix? Is it product mix that's giving you this lift on your selling prices year-to-date?

You talked about 19,000 points of sale coming on stream year-on-year in the domestic market, were these in point of sale that were helping to drive this revenue per kilo? And where might we think about your pricing in the domestic process in JBS Foods in the second half, given that I think we should all feel a little bit more pressured on the dollar packaging cost in such? So that's the first question. Thanks.

A - Gilberto Tomazoni {BIO 2090061 <GO>}

Hi, Alex. It's Gilberto Tomazoni. In reality, you mentioned all of the factors. It's a combination of increased number of clients. If you compare the quarter for the last year with this quarter, we increased 18,000 new clients, new customers.

A - Wesley Mendonça Batista {BIO 15243148 <GO>}

19,000.

A - Gilberto Tomazoni {BIO 2090061 <GO>}

19,000 new customers. And this is one thing, we are not present in this point of sale. We are increased. We have put our product there.

The second, in addition, when we increased this number of point of sales, we are able to assess up, let's say, it's in terms of margin, better channel. You'll go from the big one to the small one. This means you increase margin just because mix of channel.

Secondly, we improve our mix, even in all of the channels, even in the biggest one. And we launched new product. Since we start develop our brand, we launched a lot of new products. These new products came with high margin. The combination of channels, product mix in our advertising, because we are reposition our brand, we are making advertising.

The reason what we advertise in our products because we want to increase the value of the product. It's a combination of advertising mix of products and mix of channels is the result of this increase in terms of price. But we increased our volume in 2%. But even the promotion of Brazil, because we are focused on – we are not focused to gain market share. We are gaining market share because of this reason, but we are – our focus is to gain the preference of the consumers, and we are focused on that and we are focused to create value.

Q - Alexander Robarts {BIO 1499637 <GO>}

So, thank you. Now, that's helpful. So, in the second half, do you think you might look to take some prices tactically to offset some of the maybe dollar packaging pressure? Or would it just be a continuation perhaps of your positive mix that kind of can drive the revenue per kilo in the second half, you think.?

A - Gilberto Tomazoni {BIO 2090061 <GO>}

Our focus remain the same. But you'll never know how will be happen in the future because you have a competitor. We just finished July. In July, we keep the payment (54:10). And I don't know in the future, but I believe that some cost in terms of the grain, grain could be affect in terms of our margin. Then if the grain affects our margin, we are trying to put a part of the cost to the price. Could we say – it's very difficult to say, we remain confident that we can deliver for the next quarter, even higher margin when we had this quarter.

Q - Alexander Robarts {BIO 1499637 <GO>}

Okay. Okay. Thank you. And the second question just understanding a little bit more the thinking behind the share repurchase program. I mean it sounds like you said in your prepared comments, I mean you kind of confirmed the fact that there's no big debt maturities really over the next few years until 2021.

You're at the level of leverage that you've kind of guiding us to in the mid 2 times ranges. And so this almost BRL 2 billion in share repurchases over the next year, should we think about this as something that you plan to use tactically? Is it also perhaps signaling that maybe you're not out in the – looking at M&A targets for right now? Any comment about the thinking behind the share repurchase program would be helpful. Thanks very much.

A - Wesley Mendonça Batista {BIO 15243148 <GO>}

Alex, basically, look, we want to have the option. We approved in our board the share buyback program. We have been leaving our share buyback program open. We see this as a practical instrument. We believe that this should be open.

At this point, we don't intent to compromise any thinking in our leverage with the share buyback. We are going to use the share buyback option to be used, first of all, without compromising our leverage. Secondly, we are going to using this more tactical...

A - Jeremiah Alphonsus O'Callaghan {BIO 19817115 <GO>}

Strategy.

A - Wesley Mendonça Batista {BIO 15243148 <GO>}

...strategy.

Q - Alexander Robarts {BIO 1499637 <GO>}

Okay. Thanks very much.

A - Wesley Mendonça Batista {BIO 15243148 <GO>}

Thank you.

A - Jeremiah Alphonsus O'Callaghan {BIO 19817115 <GO>}

Thank you, Alex.

Operator

Our next question comes from Bryan Hunt, Wells Fargo.

Q - David Cook {BIO 17313467 <GO>}

Good morning. It's actually Dave Cook on for Bryan.

A - Wesley Mendonça Batista {BIO 15243148 <GO>}

Good morning, Dave.

Q - David Cook {BIO 17313467 <GO>}

Good morning. A couple from me. U.S. pork exports to China are down meaningfully for the year thus far, I think I've seen 40% decline cited. Can you talk about what you attribute that decline mostly to? Is it currency? Is it the shutdown in the West Coast ports? Or the U.S. use of ractopamine?

A - Wesley Mendonça Batista {BIO 15243148 <GO>}

André?

A - André Nogueira de Souza {BIO 20244486 <GO>}

Yeah. It's a combination of all the three factors and some liquidation that you saw in the sow herding in China that put more availability in domestic market. That what we expect that is changing now.

If you see the graph of hog cost in China in the last several weeks have been up very dramatically. So price of pork meat in China several weeks have been much higher. So we expect that this trend will change, but they have the limitation of free of ractopamine, so we need to export only products that fit that specification.

Q - David Cook {BIO 17313467 <GO>}

Is that something that the U.S. would ever move away from using in pork?

A - André Nogueira de Souza {BIO 20244486 <GO>}

I think that the market will define that. Again, pork from U.S. 30%, we will export, all right? And this is growing. So the pork industry and the hog industry in U.S. rely each day more in export. And because U.S. is so competitive, this will continue to grow.

I think that if demand globally change due to the fact the U.S. production. I think that we have today part of the production that is already ractopamine-free. I believe that this will grow as demand continue to grow for this specific type of product.

Q - David Cook {BIO 17313467 <GO>}

Okay. And given the recent devaluation in the Chinese currency, how do you think that impacts Chinese imports?

A - André Nogueira de Souza {BIO 20244486 <GO>}

I think that both direction is very small and is quite irrelevant, (59:50). 2% to 3% do not make any difference. You can see that the difference in cost of produced protein in China and the import protein because I think that this is absolutely relevant.

Q - David Cook {BIO 17313467 <GO>}

Okay. And on U.S. beef supply, when do you think you'd start seeing a meaningful increase in the supply of cattle?

A - André Nogueira de Souza {BIO 20244486 <GO>}

That's a little bit more challenging to say. I think that this is very related with the retention. If you see the retention to grow the herd continue to be strong and become even stronger a little bit more in the back of 2016, if the retention go more to the normal level, we will see some impact in the first part of 2016. I think that we will – I believe that we'd start to see in the first part of 2016.

Q - David Cook {BIO 17313467 <GO>}

Okay. And your Primo acquisition, you closed on that, how is that performing thus far relative to expectations?

A - André Nogueira de Souza {BIO 20244486 <GO>}

So, we have only three months with this acquisition. I think that it's not performing the level that we expect that this will perform that is over 15%. It's performed the same level that it was performing before. But in the last several weeks, we start to see a improvement on that. So, it's performed the way that was before, but the right point in the direction that we'll go to what we expect, that 15%.

The integration is doing very well. We have a new management team in place. So I'm very confident that we will deliver more than we expect originally.

Q - David Cook {BIO 17313467 <GO>}

Okay. And the last one for me. Pilgrim's Pride management has mentioned a couple of times zero-based budgeting. Is that an initiative you all are working on within the broader JBS organization? If so, can you discuss any progress or goals that you have for that?

A - Wesley Mendonça Batista {BIO 15243148 <GO>}

Yeah. This is Wesley. Yeah, we have been using zero-based budget for quite a while, for quite a long time. And now, our businesses start here in Brazil and we have the zero-based budget today across all of our business. And so, Pilgrim's Pride – so we implement and we are everyday implementing more and more in Pilgrim's Pride, but we have been using this for quite a while in all the part of our business.

Q - David Cook {BIO 17313467 <GO>}

Thank you.

A - Wesley Mendonça Batista {BIO 15243148 <GO>}

Thank you.

A - Jeremiah Alphonsus O'Callaghan {BIO 19817115 <GO>}

Thank you, Dave.

Operator

Our next question comes from Carla Casella, JPMorgan.

Q - Carla M. Casella {BIO 2215113 <GO>}

Hi. I may have missed it, but did you say the EBITDA contribution from Primo in the quarter and was that all included in JBS USA Beef?

A - Wesley Mendonça Batista {BIO 15243148 <GO>}

Yes, Carla. The Primo results is included, as Australia is included in the JBS USA Beef. Primo also is part of this, is included.

Q - Carla M. Casella {BIO 2215113 <GO>}

Did you say how much of the EBITDA increase in the quarter was related to Primo?

A - Wesley Mendonça Batista {BIO 15243148 <GO>}

No. We did not say that how much the EBITDA increase due to the fact that Primo is now included. And what André said is that the business is performing the same level that it was when we acquired. We are running the business just three months, and we expect that this business is going to deliver 15% type of margin, so this is what we said.

So the impact in the quarter inside of the business unit is not meaningful. So this is going to be more meaningful when we hit this level that we strongly believe we can deliver this kind of margin that I mentioned.

Q - Carla M. Casella {BIO 2215113 <GO>}

That's great. And then, also on the USA Beef side, did you provide the amount of hedging gain you had in the quarter?

A - Wesley Mendonça Batista {BIO 15243148 <GO>}

André?

A - André Nogueira de Souza {BIO 20244486 <GO>}

As I said in the previous quarter, since we start this year, we are – our MTM, our hedge gain, we are doing the MTM from our cash position, too. So, if I had a cash position cattle and I had this cattle (01:05:09), we are doing the mark-to-market in both positions. So, with that, we reduced a lot.

So, we just recognized that both when we queue the cattle (01:05:19) and month-by-month, we recognize the two valuations. So it's very small now that we have both with mark-to-market. It's not relevant anymore.

Q - Carla M. Casella {BIO 2215113 <GO>}

Okay. Great. Thank you so much.

A - Wesley Mendonça Batista {BIO 15243148 <GO>}

Thank you, Carla.

A - Jeremiah Alphonsus O'Callaghan {BIO 19817115 <GO>}

Thanks, Carla.

Operator

Our next question comes from Luca Cipiccia, Goldman Sachs.

Q - Luca Cipiccia {BIO 6914452 <GO>}

Yes. Good morning, everyone. Thanks for taking my question. Just a quick follow-up on some of the previous discussion. Firstly (65:48), on Brazil, on the point-of-sale expansion, you mentioned about 19,000, 20,000 incremental point of sales. Could you discuss how much more upside there is to that?

And also, how that grabbing more of this – how that process works? How you see that developing going forward? Maybe just an update on that as a follow-up to the previous discussion, that will be great.

A - Gilberto Tomazoni {BIO 2090061 <GO>}

Look, if you consider all of the customer we have now is around 1,200.

A - Jeremiah Alphonsus O'Callaghan {BIO 19817115 <GO>}

120,000.

A - Gilberto Tomazoni {BIO 2090061 <GO>}

120,000. But if our main competitor in the market say that they have above 2,000...

A - Jeremiah Alphonsus O'Callaghan {BIO 19817115 <GO>}

200,000.

A - Gilberto Tomazoni {BIO 2090061 <GO>}

200,000, I'm sorry.

Q - Luca Cipiccia {BIO 6914452 <GO>}

Yeah.

A - Gilberto Tomazoni {BIO 2090061 <GO>}

200,000, that means we are the same business. We are the same category. I believe that we can go with this number, too.

Q - Luca Cipiccia {BIO 6914452 <GO>}

Yeah.

A - Gilberto Tomazoni {BIO 2090061 <GO>}

But our strategy is to reach this level of customers if there is different go-to-markets because there is some parts of the country, it's not economic to go by itself, Maybe our own teams, own service teams and our own trucks to distribute. Then we are using – distribute to reach this point of sale.

We go in the ways it's productive to go there. We are not say, I want to increase. We are not at target for a number of clients. We open new route. We check if the route is profitable, we fix. And then we go to another route. We are looking in terms of how we can grow in a positive way.

Q - Luca Cipiccia {BIO 6914452 <GO>}

Yeah. Are there obvious areas where you are under-indexed, let's say? Is it more of a regional penetration? Is it more across the country, your intensity or the depth of your penetration could be great? And are there some obvious areas where the gap is, I wouldn't say, easier to close, but easy to identify at least?

A - Gilberto Tomazoni {BIO 2090061 <GO>}

For example, it's incredible but interior of São Paulo, we have a huge gap in terms of number of clients because they are traditional to buy for other brands, and then we are investing our brand to become more well known in the market and the people trying to eat our product and then we are now – before, we need to knock the door and ask I want to sell to you. Now, some clients call us, I want to have your product.

I'd say, we are not in the countryside on our main gap. Our main gap is in the big cities where it's easier to get there. But you need to get in a positive way. It's is very important. And just not to mention, a number of clients. We are managing for roughly (01:08:58) for each client, which is customer, sorry.

Q - Luca Cipiccia {BIO 6914452 <GO>}

Perfect. Thank you. Thank you very much. Very clear.

A - Wesley Mendonça Batista {BIO 15243148 <GO>}

Thank you.

A - Jeremiah Alphonsus O'Callaghan {BIO 19817115 <GO>}

Thank you.

Operator

The next question comes from Jose Yordan, Deutsche Bank.

A - Wesley Mendonça Batista {BIO 15243148 <GO>}

Jose.

Q - Jose J. Yordan {BIO 1496398 <GO>}

Hi, good morning everyone. Just a couple of questions.

A - Wesley Mendonça Batista {BIO 15243148 <GO>}

Good morning.

Q - Jose J. Yordan {BIO 1496398 <GO>}

The first one is on the whole beef capacity issue. Obviously, your competitors have been talking about how many plants they closed during the quarter, et cetera, and in general, it looks a like an industry-wide move.

I'd just be curious if you could give us some color as to what your role was on that. If you can remind us how many plants you opened over the last couple of years and did you close any in the second quarter. What was your variation in capacity contributing to the change in the industry?

A - Wesley Mendonça Batista {BIO 15243148 <GO>}

Yeah. Actually, not only the second quarter. So we started in the first quarter. In the first quarter and in the second quarter, we closed six plants in these two quarters. And as the market got much difficult in terms of exports and also the availability of cattle declined, so, yes, we are a part. So we are the leader in this market and we closed these plants as well.

Q - Jose J. Yordan {BIO 1496398 <GO>}

Great. And I guess maybe premature to think, but once the exports go back up in Russia in some places, if they do, and depending on how successful you are in China, in the U.S., et cetera, is it projected that some of these plants industry-wide will open within a couple of years? And are they ready to do so within a month or two notice if the demand warrants it?

A - Wesley Mendonça Batista {BIO 15243148 <GO>}

Yeah. Look, I think it's not only the demand. I think what's going to happen is if the demand get back and if the demand recover, and also if the industry starts to see a change in cycle and see more cattle available to be processed, so I think the industry can put some of these plants back. But for me, it's clear that now the industry is balanced in terms of cattle availability and also demand, and for me, it is clear that the industry is not going to put back any plants until the industry see a sustainable demand recover and as well cattle availability.

Q - Jose J. Yordan {BIO 1496398 <GO>}

Great. And if I can just have one more question on the two pending deals, I now realized there's a review period that has to be followed and you never know what's going to happen. But what's your advisors' latest estimate of when you can close on Moy Park and on Cargill? And specifically on the Cargill deal, given that it involves some integration, et cetera, unlike Moy Park, is there any sort of internal activity that you're doing to prepare for that, so that after the three, four months or whatever it takes, you can hit the ground running once the green light goes on?

A - Wesley Mendonça Batista {BIO 15243148 <GO>}

Yeah, sure. On Moy Park, what our legal advisors are telling us that we expect to get the approval in Europe sometime in the end of September and/or October. So, second half of September and to the end of October. So, this is what we are seeing now and our advisors are telling us.

About Cargill, we are working with the Department of Justice in the U.S. It's harder to predict. Our advisors, they are telling us that they believe we can close this deal this year, sometime this year. But we cannot guarantee if we are going to get the approval this year, but we see a good chance that we can get the approval during sometime in these coming months.

So, yes, we are active working. Our team in the U.S. are active in working with Cargill and planning everything, integration, everything. And as well Moy Park, we are going to be ready if we get the approval anytime from – in Moy Park from September 2015. We are going to be ready to close the deal. And with Cargill as well, we are working closely with them to be ready if we get approval anytime in these coming months.

Q - Jose J. Yordan {BIO 1496398 <GO>}

Super. Thanks a lot.

A - Wesley Mendonça Batista {BIO 15243148 <GO>}

Thank you.

A - Jeremiah Alphonsus O'Callaghan {BIO 19817115 <GO>}

Thank you, Jose.

Operator

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

A - Wesley Mendonça Batista {BIO 15243148 <GO>}

So, I'd like to thank you all again for being in the second quarter...

A - Jeremiah Alphonsus O'Callaghan {BIO 19817115 <GO>}

Earnings call.

A - Wesley Mendonça Batista {BIO 15243148 <GO>}

...earnings call with us this morning. And like I mentioned, we are confident that the company has a very strong global platform and we are very satisfied where we are and we think we can do more. And this is where we are going. We have been disciplined to execute our strategy and we are going to keep focused and committed with our targets. And we look forward for a great second half of 2015 and 2016 as well.

So, thank you all and have a good morning.

Operator

That does conclude JBS audio conference for today. Thank you very much for your participation. Have a good day and thank you for using Chorus Call.