Q2 2019 Earnings Call

Company Participants

- Lorival Luz, Global CEO, Chief Financial and Investor Relations Officer Interim
- Patricio Rohner, International Markets Vice President
- Sidney Manzaro, Brazil Markets Vice President
- Unidentified Speaker

Other Participants

- Antonio Barreto
- Isabella Simonato
- Joao Soares
- Leandro Fontanesi
- Luca Cipiccia
- Lucas Ferreira
- Victor Saragiotto

Presentation

Operator

Good morning, ladies and gentlemen. Welcome to the Conference Call to release the Results of the Second Quarter of 2019 of BRF S.A. This conference call is being streamed on the internet at the address www.brf-br.com/ri, where you can find the presentation available in the webcast platform. All participants are connected in listen-only mode.

And after the speech, we are going to start a questions-and-answer session when instructions for you to participate will be provided. (Operator Instructions). The statements in this conference call relative to the company's business prospects, projections, results and the company's growth potential are assumptions and are based on the expectations of the management regarding the future of the company. These expectations are highly dependent on changes in the market, the overall economic performance of the country, the industry's performance in international markets and therefore are subject to change.

As a reminder, this conference call is being recorded. The conference is going to be presented by Mr.Lorival Luz, Global CEO; by Mr.Sidney Manzaro, Brazil Market VP; and Mr.Patricio Rohner, International Market Vice President. Now we give the floor to Mr.Lorival Luz, who's going to start the presentation. Please, Mr.Luz, you may start.

Lorival Luz {BIO 16180455 <GO>}

Good morning, everyone, and thank you all for joining us in this conference call to release BRF earnings regarding the second quarter of 2019. Before going into the results and the numbers, I would like to emphasize and to say again and express our recognition of the initiatives that have been implemented and the adjustments that started since the second quarter of 2018. And then undoubtedly with a highlight for the adjustments regarding the plants that we adapted back then in terms of the manufacturing processes, with repositioning announcements and decisions that we make at that difficult time regarding shutting down a few plants, others on collective vacation and the beginning of adaptation of our inventories and implementation of a management model with many tools. And we will be talking about that further on.

And also the approval of a strategic plan and also the organizational structure with a long-term vision, which we have been doing ever since. So, the results that we are presenting now and we are happy with our performance, and all of this is a result of consistent work that has been done by everyone in our organization, our more 85,000 employees, more than 12,000 partners that are very important in the company and a part of the essence of our business. All of this reinforces the vision that this management has regarding the objective and long-term management where initiatives and decisions made have the objective of providing the continuous growth of our profitability in an absolutely consistent manner as compared to our main long-term objective. And also respecting the features of our industry and our business, which is a long chain, a live chain with a lot of interdependencies that need to be adapted in the way it is managed.

So after this, I would like to go over the results with you, the second quarter of 2019, where we had an advance in our net revenue amounting to 18% year-on-year and also our volumes were up by 0.7% year-on-year. And this revenue came from price adaptations in many markets, in Brazil and international markets, and especially because of a growth in volume in international markets. Also there has been a continuous evolution of the gross margin of the company, reaching 25% in the second quarter and the result was an EBITDA reported of BRL1.5 billion and with an EBITDA margin of 18.6%. But as we said before in our report, in our management report, we had an adjustment of about BRL328 million positive result regarding ICMS that was a negative and a positive result, but the net was BRL328 million.

And in spite of this adjustment, we had robust EBITDA at BRL1.2 billion with an important adjusted EBITDA margin of 14.6%. We also recovered the losses that we had along 2018 with net income for our continued operations of BRL191 million. In the second slide, I would like to reinforce the discipline in the terms of cash generation that our company has had, its robust generation of BRL1.4 billion, even if we exclude the results of our divestments. And so in the quarter we received the funds coming from the sale of Europe and Thailand.

But even excluding those amounts, we had free cash generation that was positive in excess of BRL100 million. Another very important point is the closing of the quarter with absolutely robust cash of BRL7 billion, which allows us along the second half of this year to reduce the company's gross debt and also to work our liability management in an intense and strong way in order to have a longer debt profile for our company. So financially speaking, we will be working on these two fronts. As a consequence, we are reporting a significant drop in our leverage, in the company's net leverage more specifically reporting 3.74 times.

This is a significant drop as compared to 5.64 times that we had last quarter. And this gives us the conditions to reposition and to change the guidance. And we published a material fact today early in the morning where we are saying approximately 3.15 times for the end of 2019 and 2.65 times for the end of 2020. So this is the guidance for our net leverage and this is in line of the trajectory that we have defined for the company to have our management respecting the cycle of our industry and to manage the company in a way that is very deleveraged below 2 times in the long-term.

So we are following this track and this path of discipline and I think that our performance so far has been very fulfilling. But undoubtedly it's very important to say that we are in the middle of a journey and there is still a long way to go, a lot of things to do, many implementations that are going on and our commitment just reinforcing is the commitment with long-term initiatives that will bring results in due time. On the next slide, number 6 of our presentation, I would like to reinforce and highlight that regardless but together with the financial management and financial results that we are reporting, we are also working in a very consistent manner addressing other items that are absolutely important for the company. And so here I would like to mention some of those items.

So the first one is the evolution and increase of our marketing investment, which we have been making together with a launch of new products. And we would like to stress the importance of innovation, the launch of new products and the appropriate positioning of our brands in the market in order to support their strength, whether it is Sadia, Qualy, Perdigao or any other brand. So this, together with an improvement and work that we have been doing in customer service programs -- and we are going to give you more detail further ahead. Sidney and Patricio will be talking about that.

And this provides an effect and results in the mid and the long-term. So these are initiatives that we are implementing in a very consistent manner. Moreover, we are also working very intensely and I have invested a lot of time in engagement and culture initiatives to strengthen our fundamental commitments with safety, quality and integrity, and also to establish and build a strong culture, BRF culture, so that we effectively have a robust identity, getting closer to our roots, our essence of what our company is and we are doing this is a very consistent manner. Just as an example, in the past 45 days, I was in person visiting all our partners in Rio Grande do Sol, Parana, Santa Catarina, Minas Gerais, Mato Grosso, Goias; many Brazilian states.

And so effectively conveying and telling them about the importance and relevance of what we think that is important for the future of the company. We are also working on a front that is absolutely important and relevant, which is people management, talent management and to overcome succession. So these programs are happening, are going on so that we may have a succession in the future coming from within. So we want to have a strong culture, a BRF culture, intense training work, preparing our successors, the successors of our managers, C-level Vice Presidents and Directors; everyone coming from within.

Thereby assuring the continuity of our business without any changes in direction, but with consistency which assures our trajectory and continuity and consistency in the long-term for our company. On the next Slide number 7, I would just like to highlight the company's performance trend, so you can see our volumes growing 8% quarter-on-quarter. But it's important to highlight here that although there is an overall drop in volume in Brazil, we're repositioning. And Sidney is going to give you more details about that.

We have had an improvement in the product mix and in the quality of results, very much in line with the strategies and decisions that we have made. So there is a robust growth in our revenue in both of our geographies, Brazil and international markets, which provides better quality in our results. So if we look at the gross profit, we see and expansion of gross profit, a result of a better operational execution and also commercial performance in all markets. Just to give you an idea, you saw in our financials that our COGS per kilo has dropped by 4% in spite of an average price.

And you know how important grains are in our results, although grain prices have grown up from 2018 to 2019, if we take the same periods to comprise the cost of goods sold. So this is an important result that is very relevant in both dimensions, both commercially speaking in terms of revenue and also in terms of cost, which has led to a growing EBITDA. And it's also important to highlight with higher investment and more marketing expenses, because in fact we believe that it's very important to keep our brands strong with quality and appropriate positioning, thereby providing us a better profitability overall. In our next slide, just summing up our results where we have to point out that in this trajectory there is a consistent discipline and long-term vision which allowed us and it still allows us to keep going on our trajectory.

Implementing our management model which is based not only into the GDP tools, OBZ and some other management tools, but also in implementing SOE, which is our system of operational excellence which has been concluded in three units, our pilot project. And we are about to implement that in another 14 units and ideally we will be amounting 30 units of the company. Simultaneously we work on our business excellence with programs on sales logistics, which allows us to improve our and to reduce interruption. In a consistent way we are able with that to generate a better added value to our customers, serving a better product and delivering a good service.

With all of that, we feel very robust to keep going on our trajectory, all of that based on the GDP model where we keep all metrics, all companies' KPIs in a rather consistent and systematic way with lots of discipline. Moving to Slide number 9, now just a summary of where we are in terms of leverage. We have 3.74 leverage trajectory and we suggesting that we will be closer to 3.15 times by the end of the year, which is below our initial guidance which was 3.65 times. But above all our cash robustness, showing that we have enough cash flow to the next two years.

And let's make very clear that our EBITDA management or any other type of liquidity risk or refinancing in the short-run, showing that our company right now follows such a trajectory, there is no additional need of any cash for paying bills or for guidance of investments, which are part of our strategic planning. Briefly I would like to skip to Slide 11, addressing perspectives and how will that impact soybeans and corn price. I believe that we had shown this chart in the previous quarters. And taking a look at this chart in terms of soybeans and corn prices, we have an average price line for previous quarters in relation to the current reported quarter.

That is this is somehow an effect of the spot price over the cost sold the product at the company, where we see a growth of the price base which will impact the sale product cost in the second semester of 2019. And there is a growth in soybeans as well corn price growth, amounting 14% to 15%. And now what we have is stabilization somehow of prices. From now on, prices will become stable and there is trend for dropping prices, especially when we have a very favorable crop, not only in Brazil but also in Argentina.

We also have heard about availability and delays in corn crop in the United States caused short-term pressure. FDA will report soon on the status of this corn crop. We have to understand what this report will show us in terms of additional volatility. But yet companies, they deal with inputs in a way which is very much consistent as an input and not as a financial asset.

That is we are positioning ourselves in such a way to guarantee best cost and high storage levels to be able to keep up with our production. That has been done throughout the first semester, allowing us to feel safe and guaranteeing positive impacts by the first semester of this year in terms of cost per sold product. Cost of proteins, let's not forget that throughout 2018, prices, they were highly impacted by pressure due to some market closures, such as Russia, Europe for poultry and for swine as well. And that led to a price drop for proteins in the country.

And once inventories and productions became stable, prices also were recovered and repositioned throughout 2018 and first semester of 2019. So this effect that we see in Brazil is just a result of such a dynamic. And now we have to monitor that effect due to the African swine fever, which may represent some sort of impact by the second half of the year, African swine fever impact, which leads to significant animal herd reductions. We have here some data from the Chinese market and we have been reporting that so far where we see a reduced number of piglets, with a relevant drop.

And we see a Chinese reference market price since the second semester, where we see a rather relevant local market price increase. We obviously have to monitor all these trends. And there is another significant effect to be considered here, where part of imports being conducted by Asia as to swine is around 60% to 65% of all business, they originated from Europe. And in Europe we some cases of contamination, especially in the Eastern part of Europe and also in some countries in Western Europe.

Therefore, we have to be cautious about that and we have to follow closely any effects that we may see for the coming quarters. Here just somehow to show the effect of this market, this market price and volume price in the international markets that is still quite shy in the third quarter. Therefore, when we take a look at SECEX data and poultry in Japan in terms of volume that is in average with what we had last year, with some sort of price adjustments. Indeed, there is a greater increase by the end of the quarter, June 2019.

Indeed, we had some increase in swine imports to China and a final price adjustment by the end of the semester, with a not significant effect in the company's results and is expected to follow that scenario for the coming semesters. With that, I would like now to give the floor to Sidney, who will talk about the Brazilian market, Mr.Manzaro, and then I will go back to the questions. You have the floor, Mr.Manzaro.

Sidney Manzaro {BIO 17678250 <GO>}

Good morning.

I would like to thank you all for your presence and participation. I'd like to share now Brazilian results. Mr.Luz has just shared that BRF results were quite positive and I would like now to analyze Brazilian results in relation to BRF total scenario. Jumping now to Page 16, we had net revenue close to 18% in relation to the previous year that was the net revenue up, and a consistent gross margin reaching 24% and this 24% is the best result that we have in terms of margin since January 2018, showing a consistence in results recovery.

And such results, they were obtained by price, mix and operational efficiency. EBITDA and to concentrate our operational results, rolling out any other taxes effects, Brazil reached BRL462 million with a very significant margin of 11.3%. Since January 2018, this is the first time that we reached double-digit level, with a very consistent recovery and in comparison to the previous year, a gain of 153%, without letting aside what we believe which is long-lasting business. We kept all brands throughout the period and at the same very period we had 20% higher investment in relation to the previous, where at Sadia we had conducted a very focused campaign with the processed meats.

And now we had in the end of the second semester the wonderful Sadia Weekend where we emphasized hot dog, pizza and nuggets. We also had advertised a very robust campaign for Perdigao. Luciano Huck was invited to come and eat with us around the table. That was a wonderful campaign and Evaristo Costa finally was invited to come and taste our Qualy Vita products.

All of that fully aligned to our strategic planning, which is to keep and recover our brands' preference. Page 17, I also would like to highlight the efficiency in executing our business. We see growth in the mix of higher added value products for a positive result in Brazil, especially for cold cuts and margarines. But we also had expansion in the mix of higher added value channel in the small retailer and Food Services segments.

We keep on increasing operational efficiency in logistics and service level improvement. Our lean project which aims to turn our lean operations in a much higher level for efficiency and they are delivering very high results. And we have to improve our productivity and guarantee excellence of services. Services we increased eight points in relation to the previous year that is our level of services delivered to our customers.

They were not hindered by our production. On the contrary, we increased significantly our level of services and efficiency. And all of this is supported by a program which keeps the gains that we have attained, so more excellence plus excellence consolidates best practices and defines standards for efficiency and execution that we seek both in sales and logistics. It's 100% implemented in order to assure all gains and to seek best practices within our industry and out of our industry too.

And most importantly, our main challenge undoubtedly, engagement of our employees; I am increasingly prouder and prouder of the work that our people are doing, increasingly more in line with our strategic objectives and more engaged with our companies. Now going to numbers, if you look at Page 17, everything that I have said here is translated into numbers. It's a more graphic way to show it. So we had the impact of volume, because of the price issues that Lorival mentioned.

And it's important to qualify prices and volumes. So there was a 4% drop as compared to last year. This drop is much more intense in Natura segment where we dropped approximately 9%. In processed products, the drop was 2%.

But when we look at the short-term, in Natura products are still dropping as a result of price increases of almost 30% as a result of what was kind of held back in the past few years, because of the excess offer. So once supply and demand was equalized and this was adjusted, everything that was taken in was transferred for the whole industry, a 30% increase. There was an even larger drop in volume and so considering the 4% and 9% refers to in Natura and the other part is processed. So the drop was 2% as compared to last year.

In the last quarter, the growth was almost 5% in volumes in contrast with the first quarter. So considering the better commercial execution and the better follow ship of the competition, we could recover our volumes as compared to the first quarter. For this reason, our revenues have grown 11%. Also as compared to the first quarter, we have grown 4% and gross profit has grown 50% face value as compared to last year, in contrast with the first quarter of 17%.

But what is important, 24% margin, which is the best since January 2018. So if we take out tax effects, our EBITDA margin is 11.3%. So since January 2018, it's the first time we go to the double-digit level, in contrast with the Q1 is 23% growth and as compared to last year, 153% growth. So this demonstrates precisely what I have just said.

So this is a historical record and so we went from 20 to 24 in a consistent manner. So year-to-date from 19% to 22.7% and excluding the tax effects it's the first time we reached to the double-digit level since Q1 2018, reaching 11.3%, so excluding tax effects. So are going from 7% in Q1 2018 to 10.4% on average and the peak is 11.3%. So these are the results for Brazil.

I thank you very much for your attention. And now I give the floor to Patricio to continue our presentation, showing our very good performance in international markets.

Patricio Rohner {BIO 19686996 <GO>}

Hello. Good morning to everyone.

I'm very happy to be here to tell you a little bit about the international markets. And so you may go to Slide number 20 where you can see this separation between Halal and other regions, with a small change in terms of what we would be expecting and what is happening in different regions in the world. This shows that the Halal market is within expected and the other regions are growing a lot and focusing very much on mix, on channels and countries. And I'm going to give you more details.

When you see the net revenue, you can see the growth which is quite significant, both as compared to Q2 last to Q1 this year. And so we are talking about 24 -- 25% growth, which leads to an EBITDA of 85% in contrast with last quarter and almost 290% as compared to Q2 '18. Well, the drivers for this result is the Halal market, is the solidifying profitable growth through the expansion of the processed category. So here processed products, especially in the market in our Middle East factory, our plant in Turkey and complemented by processed products from Brazil to these markets.

In addition to good performance, we have reached a very similar result in other countries. And the second quarter is when we prepare Turkey. So in Turkey we are reaching very high EBITDAs as compared to the company's history. When we see other international markets, there is a lot of revenue growth and profitability, especially in Japan, South Korea, Mexico and Africa.

And then I'm going to give you some more details about them. Now going to Slide number 21, it's quite interesting to look at this page so that we may understand how the international market is behaving per geography. Halal accounts for almost 60%, non-Halal 40%. When we see per protein, the main protein, so it is 87% poultry and swine 8% and other 5%.

And the most interesting is when we see per family of products, we can see that it is very well balanced between whole poultry and poultry parts, 34% and 45%, swine 8%. What is interesting to note here is that when we talk about the whole poultry, it would be more commodity in international market. But in this case, it's the opposite. When you're talking about whole birds that go to the Middle East, the whole chicken with 800 to 1,400 grams for different consumers in different channels, in the retail and different types of food services.

Well, different customers prefer different sizes of birds. So in Turkey we have frozen product, so both in Turkey and in other markets, we are talking about the whole birds that are premium priced with brand and through our own distribution, as you know. And it is very efficient as compared to our local competitors. When we break down in terms of poultry parts, there are some markets in Mexico that prefer breast and some markets prefer leg.

So deboned leg is processed. But there are chicken cuts that have a lot of value added. So if we look at Africa, there are cheaper cuts and higher value-added cuts in Asia. But the growth is not just the Middle East because of the brand, but there is a lot of penetration of processed products in South America and in Central America.

Now going to Slide number 22, when you can see more details about the Halal market which accounts for almost 60% of our total, so we are talking about the growth in processed products that is significant from 12% to 14% overall, because of the large volume selling in the Halal market. Our growth in revenue is also significant, 15% for quarter-on-quarter, and 12% as compared to Q2 last year. And our adjusted EBITDA has also had significant growth, 30% quarter-on-quarter and more than 100% as compared to Q2 last year. So a part here is price, 11.6%, but it's also related to a better mix, as I said in the previous slide and also now mix of channels, products and also in our choice of countries, with significant gains of market share in the area of processed products.

And when we look at other international segments, you can also see a growth on non-Halal products, so there is a slight reduction in the overall share, although the volume has been growing in processed products too. Now, when we look the growth of net revenue, we are talking about 42% quarter-on-quarter and 46% as compared to Q2 last year. There is a combination of price and the adjusted EBITDA obviously in international markets, non-Halal market going from 7.6% to 20%. So 20% is even greater than the Halal growth where we have a more controlled distribution, because of the recovery of specific markets.

So we are talking about 43% price increase year-on-year with all the countries and higher market volume, almost 10% and the gross margin in the Asian market that has been growing. But the main thing, the main highlight is a very good commercial performance in Africa. We are much closer to our customers, because of the scenario and they need continuing supply and we are much closer than we used to be in the past. A very good performance in Americas, there's amazing work in South America, especially in our operations in Chile, where there has been a very significant improvement in the performance and obviously in Mexico, where we want to sell more volume.

And in closing, the African swine fever that has impacted prices in Asia at the end of Q2 '19, but we have more availability and production in terms of cuts, which have helped the price to consolidate, in addition to provided best of services to our customers, helping them to reach higher value-added channels. So I was very brief on closing because of time, but this is what I had to say. And this is our performance in international markets. Thank you very much.

(Question And Answer)

Operator

Ladies and gentlemen, we are now going to start our questions-and-answers session. (Operator Instructions). Our first question comes from Luca Cipiccia from Goldman Sachs.

Luca Cipiccia {BIO 6914452 <GO>}

Good morning to all of you.

As to the second quarter, I have two questions, one about Brazil, another one about the international markets. Starting with Brazil, you had mentioned about the trade-off dynamic between price and volumes, which is a very clear strategy and that shows a great level of evidence. But my question is, are there any additional indications for channels as well? And if you could elaborate a little bit more about routes, if there is any indication or any recommendation that we can take a look to better interpret what you expected to be the market development from now on, if volume maybe an issue, if we have a gradual consumption improvement. And about Brazil, if you can go into details a bit more.

Second part of my question as to international markets that's a rather general question. International images without Halal has two-fold, but such dynamics they seem to be exceptional with lots of disruption. But theoretically, disruption should just improve in the next quarters. Therefore, what are other factors that we should take into account so we can keep those levels at least in the next quarters? So this is a rather general question.

I hope you can help us in that sense. Thank you.

Lorival Luz {BIO 16180455 <GO>}

Thank you, Luca, for your question. Before giving the floor to Sidney to answer to that question, let me address a little bit more what we had stated about international markets.

In fact, data available and which will be presented in terms of Chinese production and how will that impact that are taking place, not only in Europe but in the eastern part of the continent as well that allows us to see our future scenario within a different perspective. I mean a perspective which is much closer to the one we had by the end of June, where we have an increase in volume according to SECEX information data, with a price that will meet last June's stability and depending on the effect of demand, we can also see some growth. So in general, line is considering available current data that represents a positive perspective in terms of results. In case you need additional information, I can get back to that.

And as to the Brazilian market, I would now give the floor to Mr.Manzaro. But not only as to everything else that we have been doing in the Brazilian markets, and once we have a demand growth in Brazil and considering any economic growth, we are fully prepared to capture gains in a rather consistent manner with a more appropriate commercial execution, fully aligned to our planning. And by that, I mean some growth in terms of volume, in the routes, in the small retailers. And now Mr.Manzaro can go into details about that issue.

Sidney Manzaro {BIO 17678250 <GO>}

I'll try to answer your question in two parts, as your question encompasses three different situations. First, we come up to the decision to become leaders. As we are leaders, we want to be in the front of prices. We were the first ones to pull the market until we have competition follow-ship, we are pressed.

We are pressed not only in terms of volume, but also in terms of business negotiations with our clients. Second, this is part of a process where by the end we adjust or we add benefits to the chain as a whole, not only to the industry but to the retail market as well. And we have a great acknowledgment by main retailers which highly understand the scenario. We had a lot of pressures by the chain in the past two years and we had narrow industry margins, which was not ideal to any sector, let alone to the retail.

And now the retail market fully understands that this has to be repositioned. And thanks to their support, we are able to do it. Now going back to your question and channels, we had different sort of behaviors. As to routes where we have small retailers in our business, it was a combination of execution, commitments and team's performance, where we suffered quite a little in terms of volume variation.

On the contrary, during this period of time, we saw some growth. There was no price impact, because there was growth. So route has suffered less in that moment. Food services migrated between industrial kitchens and small retailers, where we have some sort of contracts where we had just to sit down, negotiate, renegotiate them, which took some additional time, although time was not affected.

But it's still counting on our client's collaboration in understanding the current scenario. And last but not least important, where we have cash channels, national retailers, regional retail chains where competition level is much higher; we have greater with different sorts of impacts by each one of the industries in relation to their inventory. Some of them had a delay in the followship, whereas some others do not have. But anyhow, we had experienced some volume decrease in the past months where we have been discussing with our clients, with the followship by the competition right at the beginning 20%, 40%, 60%, even reaching 80% of followship.

Where we see that we are lagging behind, there is room for negotiation and now concentrating much more in activating new actions towards the retail markets recovery in this sector, which is key in our markets. Therefore, the hugest impact was in the self service, but a bit softer sort of speaking, then it was right in the beginning going back to the previous level. I do not know if I answered your question. Yes, well done.

That's very interesting. I guess that the answer to the small retail market, we may understand that has been a positive result, not only in terms of power but also in terms of elasticity, because the difference in the retails markets can be different. Elasticity is not an issue, as it may seem in terms of volume. Oh yes, elasticity is present.

But on the other hand, we have been performing hard work plus excellence. This is a project which tries to improve excellence to deliver a best service and somehow that we will collaborate to reduce that effect. And all of that improves the channel mix, category and regional mixes; leading to better profitability. Thank you.

Operator

The next question is from Isabella Simonato, Bank of America.

Isabella Simonato {BIO 16693071 <GO>}

Good morning, Lorival, Sidney and Patricio. Congratulations for your quarter. I have two questions.

First question, I think everybody became astonished about the level of price that you have been able to drive into the international market, showing that we have a very tight type of market right now. And facing this new positive cycle of proteins, due to swine flu, last quarter you stated that you would maybe benefit from higher protein prices without any major response from the offer side. With not major investments, are you still thinking alike or there any sort of investments to be done by side or by the industry to benefit from this high protein demand? That was my first question. Now my second question, after strong and solid results and a better balance sheet, what sort of liability management are you considering from now on? What sort of debt reduction are you considering for the next 12 months? Thank you.

Lorival Luz {BIO 16180455 <GO>}

Thank you, Isabella for your question. About investments, yes, we are fitting investments to our CapEx plan to guarantee our financial discipline as to deleverage. But indeed, we are performing some required investments to be able to meet such demand. And once again, let me emphasize how important it is to understand that this is not part of demand structural change.

What we have though right now is a rupture in the temporal offer and time is an issue. And we have to understand time concerns, once the African swine fever is solved or contained somehow. Therefore, expected investments or conducted investments, they are based over this new perspective to benefit from that rupture to supply market demands. And we are doing that.

We are supplying market's needs. But it's important to know that some time that scenario will be solved and we can no longer keep any over offer. Otherwise that will represent a negative effect, if we have too much offer. There are some investments being done, amounting BRL170 million.

We are assessing and considering new investments that can be done and they will be disclosed once additional analysis are carried out. As to liability management and considering that robust cash available and that trend for deleverage, the idea is to reduce our gross debt right now and to understand the local and international markets in a way that we can extend renegotiations in our indebtedness that can renegotiate that amount in debt. We'll be working strongly in liability management in the next six months there is in the second half in the year that will be and considering results, we'll see what sort of new cash. In fact, new cash is not required by the company, but the idea is to better manage an adequate gross debt and deadlines and costs.

Isabella Simonato {BIO 16693071 <GO>}

That's very clear. Thank you very much.

Lorival Luz {BIO 16180455 <GO>}

Thank you, Isabella.

Operator

Now we have Leandro Fontanesi from Bradesco BBI.

Leandro Fontanesi {BIO 20270610 <GO>}

Good morning. Congratulations on your performance. I have two questions. You mentioned in your press release that you used the grain scenario to change your strategy in terms of storage and pricing.

Could you give us more details about the changes? What changes are those? And the second point, a more basic question; could you explain the effect in cash generation of ICMS, the ICMS effect on cash generation? Lorival mentioned that. Could you explain that again, please? I would appreciate it. Thank you.

Unidentified Speaker

Thank you, Leandro for your question.

With regards to grain, what I would like to make it very clear is the way we see grain management here. And while that is an absolutely relevant input and we do not see it as. Can you hear me? Yes, I can hear you. And we do not address it or deal with it as an absolutely essential input, not as a financial asset to position ourselves or to make any sort of speculation.

So what we did was considering the timing and your house [ph] in the curves. We used at that time to buy the input or the supply and to assure the supply at very good conditions, but within the limit that we have and the management that we have, regarding that input and the price of risks associated to it. So we were managing and you using the interim crop to have enough more appropriate stock of that product. So this provides us security with regards to the coming quarter and also as compared -- and also for the first quarter of next year considering the transactions and what we have already bought.

And so, this is it. And as to ICMS, in fact, there were provision adjustments. Both the provision for the payment of the basic basket and in terms of fiscal fiends [ph] and our receivables. So it's important that regardless of the provisions that are non-cash provisions, the effective cash generation of the company was positive by the amount that we have reported of almost BRL1.4 billion.

But as we received, the proceeds from our sales in Europe and Thailand this quarter even taking that out, and we had a positive cash flow by about BRL100 million. And then in our administration report, you can see on page 17, all the cash generation with the non-cash effect of provisions. And even in the case of working capital, there is working capital investment with regards to the grains that we bought.

Leandro Fontanesi {BIO 20270610 <GO>}

Thank you.

It's very clear. Can may I ask an additional question as to the swine flu or fever? I know there was an effect in Japan and South Korea. And so there is -- or it's clear that there is a volume reallocation. So, how should we think in terms of protein replacement? So this drop in the production of pork and chicken has been the main replacement and will continue.

And also the effect on bovines, are you competing in this substitution and also with processed products? How could we see that?

Unidentified Speaker

Leandro, in fact, something that we need to bear in mind about that. Number one is consumer or consumption habits. In the case of European chicken with more white meat, and in Asia, they prefer red meat or darker meat. And so there is a trend for replacement, yes, there is.

And as a reminder, the protein that is immediately cheaper below pork is poultry or chicken more specifically. So there's a natural trend by the population considering income to migrate to the cheaper protein. Because the bovine protein is a much more expensive protein. The other thing is the cycle of increase of production, which is shorter for chicken and poultry, and longer in the case of cattle.

So obviously, we will need to monitor everything. That's why, we really need to follow up and pay attention to information. It doesn't happen at the same proportion. As you saw, there is a reduction in the herd of porks, which is larger than the increase in the import of protein.

So, yes, there is the replacement effect that will need to monitor. And in fact, it's not one-to-one. And then there is a trend for a migration to chicken considering price, and this has a consequence. And so, there will be a trend towards the balance between supply and demand in international market.

Thank you very much.

Operator

Our next question is from Antonio Barreto from Itau BBA.

Antonio Barreto {BIO 17449798 <GO>}

Thank you very much for your question. So my first question Lorival, if you could help us to estimate, what is the gain with the opening of the plants in China? Today, you are at the limit of production in terms of allocation to China on the main thinking of 4, 5 and leg.

[ph] So what will be the gain in volume or in rep percentage of the revenue once your plans are operational? And how does it impact prices on average allocations in China leverage prices? What we have been trying to estimate, what do you gain from opening the plants, imagine that there will be no price difference from year on?

Lorival Luz {BIO 16180455 <GO>}

Antonio, very good question. But unfortunately, I can't give you all the detail, telling you the price of each part. But what I can tell you is that we were working in China, but with the objective of making our plans operational to meet all the demand from different markets. The objective of the company is to infect -- meet the needs of those markets, serve the markets in Asia and in America's.

We have had a positive result in Mexico and in China and in other markets too. So the theme of when this will happen and when we're going -- when the factors are going to go live, this is going to come from the Chinese government whenever they find appropriate. And that should happen according to their understanding. To us, we need to have the appropriate production to me or rather in compliance with all requirements of the international market, and then we have those approvals.

For the different markets, the company will be able and ready to increase its exports of different cuts to different markets. And so -- I think you understand this, this is very strategic, I wouldn't be disclosing that level of detail to you as you have requested. But what I can assure you is that we are paying attention at that, and we want to meet all the requirements, so that we are prepared to serve all markets.

Antonio Barreto {BIO 17449798 <GO>}

Of course, Lorival, I understand.

If I may ask a second question, is production of pork. If I am doing the right math, you have increased a lot your volume of swine. And I was really surprised by the speed at which you were able to increase your swine production. And so we are not making more investments to increase production, but such a sharp production increase of more than 20% in the international market in sales volume with a more or less flat volume in the domestic market, it shows that you have increased the volume of swine in the short market.

Was this is came all from weight gain? How could you respond so rapidly to the volume of swine, to of volume increase in the pork market?

Lorival Luz {BIO 16180455 <GO>}

So in fact, there are two drivers that are important there. Number one, yes -- and there is a matter of weight. Remember last year, we had to do the opposite. When we closed Russia and we had to reduce the energy, we call it energy of the animals.

And then there is slaughter, that not at the optimal point, but at a lower weight because of excess supply that was present there and the impact. Of course, once we adapted that -- we adapted the optimal point of slaughter in terms of weight of the animal, which obviously provides us better yield and better volume too. Another factor, and I may have forgotten to mention it before. The moment we are now at the international and also Brazilian Market, our integration is very important.

So in the case of chicken, we are 100% integrated. And in swine, have more than 95% integration. This is absolutely paramount to our structure, which enables us too. For example, to meet these needs very fast, to go into the spot market and buy something of swine, which is very little and a very low volume as compared to the total, and which does not affect us as structurally speaking, which does not as affect our cost.

Because we have so much integration. So, yes, we can increase production as we did as you saw with increasing yield of the animal number one, two, we have the slaughter capacity. So we may go in and buy in the spot market, that affecting our cost structurally. Because remember, most of the processed products are made of swine or of pork.

So different from any other companies that are not fully integrated or not as fully integrated as we are. We are able to make those changes and not having impact of spot prices in the cost of our products, of our process products more specifically.

Antonio Barreto {BIO 17449798 <GO>}

This is very clear. Thank you very much.

Operator

Now, we have Lucas Ferreira from JP Morgan.

Lucas Ferreira {BIO 16552031 <GO>}

Hello, folks. Good morning. Thank you for allowing me to ask the questions, and congratulations on your results.

Lorival, on BRF Day last year, you defined a target for the company's strategy of getting to 2020 with EBITDA margins in line with historical margins of the company, which is about 12.5 and 13 if I'm not mistaken. Even if we adjust by the IFRS effect to this quarter, you were there already. So, you don't see impact of IFRS in your results. In in spite of your programs and your excellent plan, was that goal not aggressive enough or too conservative? Or do you see the company margins excluding positive effects from the market that will come? If it is already at a much more sustainable higher level, and you may get to the objective of the living your margin before scheduled.

And before my question, I have a question to Patricio, he made it very clear. The issue relating to commercial management international markets and mix -- everything is very clear to me. But could you say a little bit more about your day-to-day commercial negotiations? Even if you do not yet see such strong flows or not as strong as expected from China or China is trying to produce more chicken too, how does it impact at least in the feeling of customers? Are they willing to pay a little bit more, too have a stock and get rejected from being short stock? What is the feeling and how does ASF impact your negotiations in international and Halal markets? Thank you.

Lorival Luz {BIO 16180455 <GO>}

Thank you, Lucas.

I will answer first part of your question, and then I'll give the floor to Patricio. Our goal for this year was exactly to change results, and for the coming year reaching our targets. In our search, constant and intense search for what we are able to do or or to anticipate the better the merrier. So, I have to state that any sort of decisions that we make as to the consistent and a constant yield growth in a long run.

My commitment here is within a long run as well as the whole board of directors of the company and BRF as a whole. So let me make very clear that there is no short-term decision for anticipation meanings. Now, the whole decision is based on a longer run consistency. What is expected for the coming year is not quite conservative I would say, but quite a realistic.

To last year's scenarios considering a number of initiatives, that should be started. And what we have seen so far is that we have been quite successful in implementing on number of different initiatives. And as I said right in the beginning, we are quite happy with results that we see. And exactly for that, we adjusted our deleverage guidance for execution purpose.

And we acknowledge that the more we work to guarantee and implemented management module in all units corporation business units, that is a cyclical industry. And as we saw in the past to some negative results as well as positive. So depending on the cycle, depending on the season, we have to be ready and prepared to better capture positive of future gains. If we keep on working in that sense, being very, very humble right now to be able to continuous implementing everything else that we have been performing.

And to be able to make a proper decisions following rationale not being too excited about them, and to benefit as much as possible from this new time considering volatility and a market cycle. Having said that, now, I'd like to give the floor to Patrico. And if you still have any additional comments, we can go on.

Patricio Rohner {BIO 19686996 <GO>}

Good morning, Lucas.

Thank you for your question. I will try to be very brief, answering to your first part of the question at what extent is that feeling influence markets. My answer is just a little -- I had a chance to such a visit several markets, and I got even surprised with the little information that some countries have such as Africa and Japan about the general protein scenario. I know that to BRF had reduced products availability.

Due to previous problems, when you reduce a production in certain country, that will impact if you haven't got enough chicken breasts, maybe you don't have the chicken wings or the tides. And if you lose Russia in the case of pork, that will lead to the same type of effect. So none of the effects, BRF had reduced the offer. Several changes in the management just a little, and we had the to give a higher focus in some complexes markets such as Argentina with a very high time demand.

And we had advanced in centralized positions in the international market via Halal, especially in Europe, with a very large team based in Vienna working that external markets. What I did though was to raise the three larger teams, one to Asia where we have a great provider who is highly trained for that company. We have also have who is between Halal market distribution in Africa, Americas and China facing different changes with a focus in Chile and Mexico. I'm just explaining to you what we have in the background, which is we are much more closer to our clients, we are increasing our offer in added value products.

We are selling chicken breast in the Eastern countries, Mexico, Europe, but not in Brazil, and that allows more availability to interior back, tides, [ph] wings and breast. And we are cutting parts, we are calibrating that with some other investments such as as machine for calibration purposes. So what we have got today is a higher demand to our company, to guarantee a service, a differential for BRF. If you buy now in August, you'll see that you get the goods by September.

With that, you are able to plan in the industry as a whole bovine, swine poultry. They buy the goods and then that will be dispatched few months later. It's quite difficult to guarantee a distribution business. If you cannot guarantee a pipeline, and how you can recover your storage.

And in a short run what we did was to speed up added value products such as cold, processed foods, sausages and a vary -- and a third important variable is that markets such as Asia and Africa, which consume too much fish. And fish in the past few years became quite scarce, and then the demand now is going much more towards chicken than fisher proteins followed by swines. So what we did to summarize, we try to be much closer to the channel to our clients, and to the the market to help them to understand that new markets, what is a consumer trends. And with that, we can start with the products that they will look much more like future products than pasta products.

With that, we are developing products, we are benefiting from this new cycle which will take a few years. And with that, we will have a stronger partnerships as it became a more difficult to add value. And especially when you import raw material, it's much better to import a ready-made product than just the raw material, this is our strategy. I was quite a surprised with the lack of information, that some of our clients had in the international market about the current situation and future scenario for some proteins.

Therefore, we are reorganizing our commercial part, innovation and product. So when that demand becomes more, concrete will be offering a different type of mix with a different added value will be much closer to clients, channels and the markets.

Lucas Ferreira {BIO 16552031 <GO>}

That's very clear. Thank you so much for your answer.

Thank you.

Operator

Next question from Victor Saragiotto with Suisse.

Victor Saragiotto {BIO 19504427 <GO>}

Good morning, and congratulations to your results. I have two questions, first about the leverage guidance.

Before BRFS, we have different EBITDA, [ph] recurrent or non-recurrent. And depending on our calculation, we may reach an EBITDA which may drop it in the next two semesters. Could you clarify what sort of a methodology EBITDA are you considering? This is my first part of the question.

Unidentified Speaker

Good morning.

EBITDA, we'll not go down. And that is in this metric, as in the third and fourth semester, we'll have to consider some additional impact. But the metric is exactly the same one that we use to reach a 3.74x, there is the same adjusted EBITDA with the similar effects. Thank you.

Now a second question, please.

Victor Saragiotto {BIO 19504427 <GO>}

Lorival, how about process prices? We see that the company manage to -- surpass that to the Mexican markets, and we see some a dropper in the shares. And there is a new site where chicken prices are going down somehow. So, could you tell us about this dynamic? How about the prices for process made for the second semester? I would appreciate that.

And another point, costs cut or to reduce costs, you have been a comment -- mentioning that since last year. How about that cost cuts, how much can we still gain from now on, if you could go into that? Thank you.

Lorival Luz {BIO 16180455 <GO>}

Okay. I will answer your question about costs, and then I'll give the floor to Sydney to talk about prices, shares for processed foods.

As to costs, Victor, as I said, there are different ongoing initiatives today. We have a program of operational excellence which you are aware of, and that has been implemented in three pilot projects, fully implemented, a 100%. Of course, is that results, they would not yet capture as they were just recently implemented. And we are now expecting to deploy that to another 14 different units.

So, that has to be implemented the process by process, phase by phase throughout a certain period of time. Therefore, our goal though is that throughout the next year, we'll be able to have all units implemented and capturing these results. We are not expecting to anticipate anything or maybe to run a risk to move it towards something that may benefit a short run and maybe run a risk for middle to long term. Therefore, we still need to carry out some level of capture.

And let me tell you that what we have captured so far is not a lot, it's just a small share of water [ph] We can still capture considering the total cycle in each one of the units. And also the rollout to this project to all units, we still have a lot to do. That's why, our approach is to keep on implementing and to keep deploying the management model, that is crucial to all of us. So that is my answer to costs.

And now, Sydney can talk about processed meats.

Sidney Manzaro {BIO 17678250 <GO>}

This is an equation which is just replicate our chain as surprises and how will that impact over our business as a whole. This is an equation where we start monitoring in natura prices. We consider several indicators conducted by different research institutes and that supports in natura prices and also to make us understand the costs of prices or cost the trends.

So we keep looking to the grain sacked or in natura food, the live animals. With that, we can better monitor the market from a cost perspective. Conversely, we have some other institutes such as Nielsen institute, which uses this contract tool that allows to measure, not only price where we want to understand what is the relationship of prices to our main competitors. As well as turnover, we can understand how big is the elasticity effective.

So, Nielsen is one of the institutes that help us to understand how high is the elasticity and what is the relationship. And with that, we monitor the ideal point, and we have some other institutes such as and LCA, which measures future effects and elasticity of our products. This is an equation which inputs different information to be able to help us to reach the best decision for our business. Future scenarios, well, we are monitoring that, we are in a certain price level which we understand that based on current factors.

This is what we can keep up, sometimes carcass goes up or chicken goes down or maybe a breast price increases, weng [ph] decreases depending on the market to demand, but the price of point to so far, this is supposed to be the idea one as far as we understood, but we expect some additional points to impact to the market. Such as grain costs due to the report that is about to be published by the United States considering crops and that will directly impact to the Brazilian market depending on the news as well as the Chinese fact, which is still quite shy in Brazil. But we have to consider all these algorithm of information added two main trends. All of that is being monitored.

And once we find some room for that, we consider that costs will maybe affect our profitability, and that will require may be a deeper study for prices. But so far in the level, we are -- this is the prices that we consider to be ideal for the current scenario.

Victor Saragiotto {BIO 19504427 <GO>}

That is very clear. Thank you so much, and congratulations for your results.

Unidentified Speaker

Thank you, Victor.

Operator

Our next question comes from Joao Soares from Citibank.

Joao Soares {BIO 17386703 <GO>}

Good morning, everyone. Congratulations on your results.

I have a question. You have been indicating since the first quarter that you would place more focus on marketing and Sydney has mentioned some campaigns that you have ran along this year. But I would just like to understand better in terms of quantities, and how much that you have seen coming from the improvement in mix and the share of markets. Could you give us any examples of innovations that you have implemented?

Lorival Luz {BIO 16180455 <GO>}

Okay.

Thank, Joao. I'm going to turn it back over to Sydney, and he will tell you about some of the launches that we have had.

Sidney Manzaro {BIO 17678250 <GO>}

Well, thank you for your question. And the effects will be investments that are made, and the correlation between investment and brand.

The building of value added to the brands versus the times when there are price adjustments are not ideal. We need to be give NPS indicators when we talk to our consumers. Our campaigns are very well assessed by NPS, more than 8% which is superior -- to 8 points, which is greater than the historical average is that we have had from previous campaigns. The campaigns do not only add value, but more than that, they position the brands in the segments where we want them to operate.

Now, looking or rather I can't draw an immediate or direct correlation, also because we have suffered a strong impact of cost and price transferring that might distort any assessment that I could make. We need to wait a little bit longer, maybe next quarter or next conference call, where I can give you more detailed information. As to innovation, we have been working on that, we have a pipeline which is not immediate. We've been working on a quite robust pipeline for the second half of this year and next year.

We already have some innovations. And there's innovation within a model that of -- so a type of product, there's much more of an appetizer, and we are going to a segment that we find very attractive in terms of market size and market share. We also have chicken hamburger. In terms of high prices of bovine, a very interesting alternative for consumers.

And then we also have Qualy Vita. As we mentioned last quarter, we have broken the process with Bissell, or rather Bissell [ph] has a new partner in the market, and they reported that they will no longer stay with us. So we conducted a launch with Qualy Vita very successful, and we have advanced our participation very much. Or rather in market share, we have almost recovered Qualy Vita or lactose-free.

We have some novelties, but I could tell you that the pipeline for the future is very robust, and we have lots of novelties regarding innovation. As a reminder, in 2023, our goal is to get to 10% of revenue coming from innovation, and we are firmly committed to that.

Joao Soares {BIO 17386703 <GO>}

Perfect. Thank you very much.

Operator

We are now closing a questions-and-answer session. I would like to turn the floor to Mr.Lorival Luz for his closing remarks.

Lorival Luz {BIO 16180455 <GO>}

Well, I would like to thank everyone, and I would like to apologize that there were a few names in a list of questions. But as we are running late, we will get in touch with the people whose questions we could not answer here on the conference call, our Investor Relations team is going to get in in touch with you.

I would like to thank the whole company. I would like to thank our board of directors that are fully aligned with the company today with the guidelines that are being implemented. And I think that this full support that we have at all spheres and especially from our board of directors is absolutely fundamental for us to continue on this journey and to follow this path with this strategy, this positioning of making, and decisions looking in the long run of the company and in the future. And I would like to reassure everyone that this is a long journey that we are on, we are in the phase of implementing many activities, phases management models.

This is something that we want to continue doing in the company in order to strengthen more and more, the culture of recognizing the essence of our company and the legacy that we have in our company and the brands that are the most admired brands in our industry. So, I'd like to thank everyone again for your -- for the result that we are presenting. And I would like to close our conference call. Thank you all very much.

Operator

The conference call of BRF SA has now ended. We thank you for your participation, and have a good day.