Q3 2016 Earnings Call

Company Participants

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

Other Participants

- Lauren Torres, Analyst
- Pedro Leduc, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

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

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

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

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

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

Now, I'll turn the conference over to Mr. Marcos Molina, Marfrig Global Foods' Chairman.

Please, Mr. Molina, you may now begin the conference.

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

Good morning, good afternoon, everyone. We are here today to present our third quarter results. It's been a very challenging year for Brazil. Throughout the last three years, the board has taken a very conservative strategy. Focus in cash flow generation. And maintenance of our investment. Limited at some extent by the R$350 of interest that has been due to MDS (03:14). And for the last, we are very confident on the fourth quarter as per the guidance we just released.

I will now pass the call to our CEO, Martin Secco.

Martin Secco Arias {BIO 18098476 <GO>}

Good morning. I want to start by thanking all of you to join us in another earnings conference call of Marfrig Global Foods. Today, we will comment on the result for the third quarter of 2016.

With me are the CEOs of the division Frank and Andrew. And our Global IRO and Global CFO of the company, Eduardo Miron and Roberta, our IR Director.

Please go to the slide number three to start our presentation. On this slide, I will comment on the revision of our guidance for 2016. I would like to remember that Marfrig is one of a few companies that give our guidance to the market since four years or five years ago.

In our last conference call, we commit to analyze during the third quarter, the guidance, given to market in favor, and to propose a revision, if we thought it will be necessary. We decided to revise it because of a new level of exchange rate, the lower level of the commodity prices in the international market, the contraction in beef spreads, and the maintenance of one plant in operation in Argentina. So, we revised net revenue to a range for R$19 billion to R$20 billion, compared to R$22 billion to R$24 as we said previously.

As the guidance for the adjusted EBITDA margin is now 8.5% to 9%. For CapEx, the new range is R$450 million to R$550 million which reflect the ongoing investment in maintenance and improving our existing assets. As well as the expansion project in Thailand which should start in the second half of 2017. Consequently, cash flow was revised to R$0 million to R$100 million which reflect our commitment to positive cash generation.

On slide four, you can see the performance of our main indicators in the nine months period of 2016. Consolidated net revenue for the first nine months was R$14 billion, the better average price in the Brazilian market and the average Brazilian real devaluation of

12.5% between the periods, offset the lower sales volume by division and the effect from lower commodity price on Keystone sale, which are highly indexed.

Adjusted EBITDA was R$1.2 billion with margin of 8.4% which is practically within our guidance. With this result benefiting from the better result of Keystone division, but adversely affected by the weaker result of Beef division. Meanwhile CapEx was R$344 million, as I mentioned before (07:40) was planning for the year an increase of in Britain (07:39) was expected in the second half of the year, given the investment by Keystone in Asia, such as building a new plant in Thailand and improvements in China, Malaysia and Australia on the ongoing investment in maintenance to ensure the efficiency of existing assets. In the nine-month, cash flow was negative R$29 million, but we expect a reversal into a positive by the end of the year. In the third quarter, cash flow was positive R$39 million. The highlight was another solid performance at Keystone and our working capital management, which helped to offset the result of the Beef division.

Before moving to the next slide, I will pass the call to Eduardo Miron, our CFO.

Eduardo Miron

Thank you, Martin. Let's go to slide five, where I will begin the presentation of the quarterly results, starting with net revenue. As you can see, Marfrig posted net revenue of R$4.5 billion in the quarter, down 13% year-over-year. The main factors in this performance were the 8.5% appreciation in the Brazilian real between the periods, the lower sales volume at the Beef division and the lower commodity prices in the international markets, which influenced Keystone's revenue. Keystone and Marfrig Beef International accounted for 65% of the total revenue up from 63% in the same period last year demonstrating the group international growing exposure.

With regard to our currency exposure, no debt in the quarter, 74% of revenue was bagged to currencies (09:38) other than the Brazilian real which is down 6% – six percentage points from the same quarter last year. This reduction reflects the strategy by the Beef division temporarily reduce its exports aiming for higher prices in the international markets that we expect to happen in the fourth quarter, as well as to redirect sales to the domestic market capturing good opportunities in the Brazilian market which although is still weak, has shown signs of recovery. The reduction in Argentina operations which last year had two operating assets also contributed to this performance.

Let's turn to a slide six, please. On slide six, I will comment on Marfrig's consolidated gross income and adjusted EBITDA. Gross income in the quarter was R$487 million, down 17% on the prior year period with gross margin falling 50 basis points to 10.9%. The main factors contributing to this performance were the stronger Brazilian real against US dollar, the lower sales volume in the Brazilian beef operation, the increase in cattle costs in Brazil up 6.8% which were partially offset by the continued margin expansion at Keystone.

SG&A as a ratio of net revenue were 5.8%, in line with the prior quarter and down R$15 million in absolute terms. Compared to the same period last year the increase of 130 basis points was made, due to lower revenue. As a result, adjusted EBITDA in the quarter was R$341 million, down 27% year-over-year, which - with margin of 7.7%.

Lastly, the chart on the lower right provides the breakdown of EBITDA in the quarter by division, with Keystone contributing 59% or 18 percentage points more than last year.

Turn to slide seven, you can see net income in the quarter and nine months, considering only the continued operations. In the year-to-date Marfrig posted a net loss of R$485 million, a significant improvement from the net loss of R$1.4 billion in the same nine months period last year. In the quarter, Marfrig posted a net loss of R$170 million which represents an improvement of about 80% from the same quarter last year. In both periods, the improvement is explained mainly by the continued solid performance at Keystone and the company's effort towards a simpler and more efficient business operation.

I would like now to pass the call to Frank Ravndal, CEO, of Keystone division. Frank?

Frank Ravndal {BIO 19230519 <GO>}

Thanks, Eduardo, and good morning, everyone. The third quarter was another strong quarter for Keystone Foods. The attractive commodity environment, a better product mix, and our ability to maintain strong volume across geographies were the main drivers to the positive quarter.

Let's review that performance in more detail on slide eight. And as a reminder, all financial data presented for Keystone is in US dollars. Starting with the graph on the upper left, net revenue in the third quarter of 2016 was similar to the year ago period. Though the overall net revenue was flat, there were a few important drivers during the quarter that worked to offset each other. Sales were positively impacted by the continued growth in key accounts in the US and double-digit growth across our business in both Australia and Malaysia. The main offsetting impact that kept revenue flat was the lower price of beef, mainly in the US.

You can see that key accounts as a percentage of sales increased from 26% to 31%. This expansion, primarily reflects a reduction in non-value added sales as we were able to turn investments made in the past year in fully cooked and par-fried capacity increases into additional higher margin key account opportunities with both existing and new customers.

In terms of volume, third quarter volume was up 2% from the same period in 2015 and 3% higher than the previous quarter. We continued delivering sustainable growth in the US helped by sales of No Antibiotics Ever products. In APMEA, performance remained very good with somewhat slower summer activity in China offset by double-digit growth in Australia and Malaysia.

Moving to the graph on the right side of the page, you can see the EBITDA and EBITDA margin for the third quarter. Keystone continued to deliver a consistent and solid financial performance. We generated adjusted EBITDA of $62 million in the third quarter of 2016, up from $53 million, an increase of 16% year-over-year.

Before going into more detail on this quarter's performance, I'd like to reflect back for a minute and note that Keystone has generated double-digit EBITDA growth every quarter this year against 2015 comparables. We had 17.5% growth in the first quarter, 24% in the second quarter and now 16% growth in the third quarter.

The third quarter performance was led by three main themes, the first of those was the strong growth in key accounts in the US with a solid contribution from No Antibiotics Ever products. Keystone remains well positioned to serve customer needs across a broad spectrum of requirements. The second driver was the recovery of led (15:53) quarter prices, as more markets opened for US exports leading to more than a 50% year-over-year increase. The third driver was the strong volume growth from our Australia and Malaysia operations driven by market share gains across the multiple markets served by those facilities. In summary, this was another strong quarter in what has been an outstanding year for Keystone.

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

Andrew Murchie {BIO 18098471 <GO>}

Thank you, Frank, and good morning, everyone. Now, on slide nine, I'll comment on the results of the Beef division, which if formed by Brazilian Beef operations and the international Beef operations.

The scenario in the third quarter remain challenging. The export spread in other words, the difference between our sales price and our capital cost, in both the Brazil and Uruguayan operations normaled (16:51) in this period. According to market data, for example, the export spread in Brazil decreased by 46% year-over-year, reflecting the high cost – the high capital cost and the lower average sales price in the international market.

Looking especially at Marfrig, and starting with the chart on the upper left. You can see that the net revenue on the Beef division was R$2.2 billion or 16% lower than in the third quarter last year. The main factor leading to these results were the lower export volumes. The lower volumes in Argentina due to the asset divestiture and the strong Brazilin real. With these factors partially offset by the strategy to optimize the sales mix via domestic market at more competitive prices.

On export, I have to go into more details to convey what was done this quarter. We work to reduce the pace of our exports aiming for higher prices which we believe was a successful strategy, given the price has responded late in the quarter and we are already seeing this improvement in the fourth quarter. The result of this strategy, a portion of our sales were not recognized in our third quarter results and consequently led to a temporarily buildup in inventory.

Meanwhile, together with the effort to negotiate better prices, and given, our commercial flexibility, we redirected a portion of volumes to Brazil domestic market which offered higher margins. In other words, despite its weakness the domestic market proved more profitable in specific cuts compared to certain export markets. And you can see the result of this effort in the stronger sales in the domestic market in this chart.

So, looking now at the volume chart, you can see the drop in the third quarter of 9% year-over-year, which is basically explained by the lower sales by the Brazilian operation due to the strategy I just motioned. It is worth mention that a 40% participation of Asia in our export sale it's aligned with our strategy of choosing the market with better profitability and growth potential.

Before moving to EBITDA, I want to note that the production side, our slaughter volume grew by 3.8% in our operations in Brazil and Uruguay. And our plants continue to operate at a high utilization rate with those in Brazil at over 80%. The chart on the top right shows adjusted EBITDA from the Beef division. Adjusted EBITDA in the third quarter was R$139 million with margin of 6.3% down significantly from the same period last year, basically due to the sharp contraction in export spreads, the stronger Brazilian real and the lower sales volume I just mentioned. With these factors partially offset by the recovery in prices in the domestic market.

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

Eduardo Miron

Thank you, Andrew. Going to slide 10, I'd like to show Marfrig's liquidity and debt maturity schedule. Net debt in US dollar, which is our main metric has remained stable at around $1.8 billion in the last four quarters, reflecting the stability of our cash flow in the year.

Going into a little bit more detail, as you can see on the chart on the upper right, on September 30, Marfrig held gross debt of R$11.6 billion which represents an increase of 6% from the prior quarter. The increase is only due to the receipt of the proceeds from the $250 million re-tap of the seven year bond, which were used in part to repurchase the 2017 bonds during the quarter.

With the remaining balance to be used to the payment of our 2016 bond that will be coming due November 2016, next week. We have decided to go for – we have decided to go for this – we decided not to go to this early settlement of this bond, due to the additional costs that it would incur. So, we will settle them now upon the maturity, meaning next week. The balance of cash and cash equivalents ended the quarter at R$5.7 billion, increasing 8% on the prior quarter, due to the same reason I just mentioned.

Still, on cash, I would like to comment that in addition to the payment of the 2016 bond of $141 million coming due now in November, we also have the last payment of the interest of the mandatory convertible debenture in January 2017 in the approximate amount of around R$350 million. As you can see on the indicators chart, Marfrig's leverage measured by the ratio of net debt to adjusted EBITDA in the last 12 months ended the quarter at 3.4 times which represents an increase of 0.3 times from ratio of 3.1 times in the prior quarter, reflecting the lower EBITDA in this quarter versus last year, as I mentioned earlier.

Lastly, I'd like to take the opportunity to comment that in October, S&P and Moody's published reports reaffirming our ratings with positive and stable outlook, respectively. And Fitch, in a report published on October 14 upgraded Marfrig's rating to BB minus with a stable outlook.

Let's go to the last slide please. In slide 11, I will comment on cash flow in the third quarter. Operating cash flow before interest and CapEx was R$537 million which was positively influenced by the solid operating result at Keystone and the optimization of our working capital in the period. On the other hand, our CapEx increased with investments in the quarter of R$175 million. And I had mentioned before, we would continue with our investment plans intact.

And we should expect a natural increase in our investment in the second half of the year. Interest expenses were R$292 million or 4% higher than in the prior quarter due to, basically, the increase in the gross debt that I mentioned a little bit earlier. Free cash flow from continuing operations totaled R$70 million, and given the negative results of R$31 million from the discontinued operations which involves the payment of adjustments related to asset divested. Consolidated cash flow was positive, R$39 million.

That concludes our presentation of the results of Marfrig Global Foods for the third quarter of 2016.

But before moving to the Q&A session I – and because this topic was brought during our Portuguese call this morning, I'd like to pass the call to Marcos Molina, the Chairman of the Company to provide an update on the debentures conversion. Marcos?

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

I confirm that the company doesn't have and won't have any negotiation in regards to the mandatory convertible debentures, repurchased. Next year, the annual interest payment of about R$350 million will come to an end totaling almost R$2 billion in interest paid during the debentures lifetime. This cash release will allow us to start 2017 in a much better shape.

I can also comment that we have been talking to (26:41) important shareholder. And I can guarantee, we're totally aligned in the following. The conversion will be completed on January 25, 2017.

You have the right (27:16) for a board member as per the current shareholders agreement. That said, (27:32) at any extent.

The participation held by (27:51) has a minority, a long-term and a non-executive profile. And lastly, that we are committed to continue to working together to create value for the company, its shareholders and stakeholders.

Thanks, everyone. Now, I'd like to pass to the Q&A session. Thank you.

Q&A

Operator

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

Q - Lauren Torres {BIO 7323680 <GO>}

Yes. Hi, good morning, everyone. My question is based on your revised guidance, I appreciate the clarity on the changes or why there was a change in guidance. I'm just curious though to get the weighting of these changes, meaning was it mostly related to the current fee that we saw the change in guidance as opposed to some of the other factors.

And I guess, as I look at these other factors into 2017, I know you're not providing 2017 guidance yet, but curious to get your perspective on trends, with respect to commodity prices and fee spreads. I guess, you did touch upon this already, but if you could talk a little bit more about expectations – for those two items that would be helpful? Thank you.

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

Before to give the word to Eduardo, of course, as you say the exchange rate was the most visible or important issue on our decision to change the guidance. As you remember we make – guided with the goal of 4.1 and the new one was 3.2, but the other point, we see better indication in the commodity prices for the next year and also a much better spread on our Beef business in Uruguay and also in Brazil. I don't know if you want to share something else.

A - Eduardo Miron

No, I think Martin you – I think you touched the main point. I think absolutely the exchange rate was the main driver, I mean, we had a important change over the year from 4.1 to around 3.5. Just, I'd like to highlight that for the fourth quarter we estimate a R$3.2 per dollar, but as you know, I mean, it's being very volatile lately. But, I mean all the other points Martin made are correct.

Q - Lauren Torres {BIO 7323680 <GO>}

Okay. And then I guess one other question. This is on one of your strategic point on organic growth. I think, we have some good clarity on improving sales mix at Keystone. But could you talk a little bit more about initiatives and where we see further upside about improving mix in the Beef division that would be great. Thank you.

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

Andrew, could you answer, please?

A - Andrew Murchie {BIO 18098471 <GO>}

I will ask please if you can repeat the question, I couldn't get it clearly?

Q - Lauren Torres {BIO 7323680 <GO>}

Sure. I was asking about your strategic initiative to improve sales mix at the Beef division. As far as initiatives in place to do that. Where you are, how much more opportunity there is on the mix side in beef?

A - Andrew Murchie {BIO 18098471 <GO>}

Okay. Great, great. Thanks for the question. Lauren, we have two scenarios, right. We have now by – for the end of the – on this full quarter, as we know, Brazil is coming very – with very good margins, and this will remain for November and December. Normally, the first quarter is much stronger domestically speaking.

So, we have as we call in Brazil the 13 Salary, which is half pay now in November. So, the expectation is that the increase in consumption will grow in Brazil between November and December. When we talk about expectations for next year, we have two scenarios that we have to consider. The first one is the position of Brazil as a producer. We do expect that the capital cycle is turning around in 2017 and 2018. This is basically due to the number of births of cows and prices of cows which are coming down. And also the other indicator is the number of cows available for slaughtering. Between these two indicators, we can see that next year, we should have more availability of animals.

If you consider also that the first quarter normally is a little bit more challenging because it's between the feedlot – ending of the feedlot of the first quarters and starting the natural breeding, January, February and March. We have seen that this year, because of the price of the corn, there was a expectation or speculation of how much animals will be closed in feedlots and how much will be not.

We understand that a part of these animals were not closed in feedlots and they've been raised in open posture with what we call supplementation. So, we reckon that some of these animals will not be ready by the end of this year and will go into January and February. So, we also expect to have a little bit more of availability of animals in Jan and Feb. If you put on top of that as well or is that we have for instance, in our new markets will be also a driver for next year.

We have the American market just open now. But only due to commercial issues and difference in prices, it hasn't been an active market for Brazil, but we do expect that next year, during the year we should see more action in terms of US demand which will fit perfectly with the other markets that we already have.

Very close to be happening as well during next year it should be Canada and Mexico which are being discussed already (34:27) agreements. China, we had a sort of a short demand, let's say during the third quarter which was basically as well based on commercial issues, prices. China is back in action, let's say on the fourth quarter, volumes have been coming back and we see China very stable as well, during the whole next year.

If we think about, let's say competition other countries which are – which can compete with Brazil in terms of beef, you look at Australia and you see Australia which is having a lower slaughtering this year and expected to be next year as well, they will be slaughtering less. Just as an indication, last month's 50% of the animals killed in Australia were cows.

So, they're going into the herd. And local market happened the same as in Brazil. Local market is increasing prices and exports are going down on prices. So they're producing less and whatever they produce will stay in Australia, the export will be very little. So, that will be another great opportunity for Brazil. So, with all of that together, we can consider that we have a positive scenario for Brazil exports and domestically 2017 and 2018.

Q - Lauren Torres {BIO 7323680 <GO>}

Thank you.

Operator

The next question comes from Diego Silva, Eden Park (35:53).

Hi. I have quite a few questions on both Keystone and Marfrig Beef. On Keystone, I wanted to ask, in terms of your Asian operation, could you please describe a bit more in detail what exactly happened in China? And what was the magnitude of that impact? It just seems that as you said, you had such a strong performance in Australia and Malaysia, that I would have not expected the volumes to be down in Asia overall?

And then, still in Keystone, could you also please clarify what's your current exposure to McDonald's? And my last question there, if you could just speak a bit about what you think are the biggest opportunities in both in the Asian part and in the US part? And maybe, last question – this one, and then I have just two questions on Marfrig Beef.

A - Frank Ravndal {BIO 19230519 <GO>}

Okay. Thank you. Yeah, sure. Let me address the Keystone question and thanks for asking those. So, I think the way we look at the APMEA volume over the last quarter, and as you mentioned sort of a strong double-digit in Australia and Malaysia, but offset with a more challenging environment over the quarter in China, it's gotten better through the quarter, but overall was down a bit. The overall scale of Australia and Malaysia relative to China, you have to keep in mind as well. And so, I think when we look at it and we see also just sort of a nine month, year-to-date versus last year as being up over last year and that last year was a tremendous growth across the region in several of the quarters up about 30% over the year earlier period. We are very pleased to see the maintenance of that strong volume over the region given that dramatic growth that happened for a number of the reasons that you may remember a few years ago.

So, the region stays very strong, a lot of good opportunities in various markets. We think China as well. So, I think, if you look at it, sort of over the course of the full year. We feel very good about being able to maintain what was such dramatic growth over the year before period.

The – I think the second question was around McDonald's. And we don't go into a lot of region specific breakdown, but overall McDonald's as a percentage of Keystones' overall sales, it's about 55% or so. So, that's down significantly from a few years ago as well as we built out a lot of the key account business.

And then, I think in terms of your third part of the question, I think for Keystone was around just opportunities in the US and APMEA and we're doing some interesting strategy work right now that we'll be able to cover early next year in the Marfrig Day but just looking at specific channels that we think provide the most interesting growth opportunity. And then, in the US, we're finding very good future growth still within a lot of the existing focus areas.

We see some more opportunity around fully cooked in the deli area. We still see more traction within the QSR space. And then in APMEA, I think, as we're looking to put the new plant in place in Thailand. We see opportunities to expand in the UK and Japan market, that we serve from Thailand, and we see continued growth opportunities across the rest of the region as well. So, we're feeling pretty good about the longer-term strategy and the opportunities out there.

Q - Operator

Thank you. And if I could just add two questions on the beef part. One of the things is, as I understand as the BRL (40:14) has moved a lot, exports have – on the balance, exports become less – the likely residue exports become less attractive versus domestic market because pricing gets worse. But, I wasn't expecting such a big switch from exports to domestic market and so I was just wondering, could you just please comment on, what was the overall performance of the exports market in dollar terms? And what were the main drivers of that performance and to the extent that it involves China, I would like you to elaborate a bit on that?

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

Andrew did you understand the question?

A - Andrew Murchie {BIO 18098471 <GO>}

Yes, Martin, yes. So, in lines of the export. What we have is that combined with a very strong and demanding domestic market on the end of the third quarter. Together with that, we also had places like Egypt, which since the beginning of the year was a very strong market. And if you follow the volumes that Brazil has done in Egypt in the beginning of the year, you will see there was quite significant, it was number two importing country of Brazil.

And because their internal – economical issue that they had in terms of buying US dollars in order to pay the export, they have basically come from number two in Brazil to number six or number seven. So, they stopped buying from Brazil. Also, who is not performing well and is showing some sort of a reaction now, but is not having performed well this year as well is, it's Russia and also Venezuela which were two very important markets for Brazil in the last year, and during 2016, they have not performed. So, I think that also has a lot to do with the volumes that has been diverted to Brazil.

Some market is still very strong as Iran, and even Chile and Europe, and of course, the most important one that we should be seeing now will be China. And it's quite normal that to see domestic market reacting as they did since the end of the third quarter and the fourth quarter. So, I think, it was very natural balance between options we had on export and Marfrig basically is very strong in domestic markets on food service and small retailers. So, we always had a sort of a good participation there. So, for us, it was a very sort of natural way, always aiming for profitability and then better returns.

Q - Operator

Understood. And just on the second question, Marfrig Beef, you mentioned the potential discussions with Canada and Mexico which should only bring quite big things for Brazil in general for Marfrig. Could you – is there kind of – any kind of more specific timeline or could you elaborate a bit more on that?

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

This is something that is out of our hands, it's in hands of the negotiator from the government. We know because we're watching (43:44) that are very important, but it's very difficult for us to make and announce of time. I want to make a complementation of the answer of Andrew regarding the export and the import. Try to remember that all the unit of Marfrig are allowed to export for all over the market and also make a production for the internal market. For that, our main target is the margin and we are always trying to combine the base margin between the export and the local market because we have the capability to do both. And this is something very important. We are not worried about how much we're in export and how much we're in import because we can go for both markets.

Q - Operator

Thank you very much.

The next question comes from Pedro Leduc, JPMorgan.

Q - Pedro Leduc {BIO 16665775 <GO>}

Hi, everyone, thank you for the question. Looking into next year, if you could help me reconcile the following, please. If I look at your net financial expenses on this quarter ex FX R$455 million, I'm assuming most of the low hanging fruits from debt liability management (45:15) R$60 million, R$70 million of quarterly interest from the MDS (45:23) we get to slightly over to R$15 million in that financial expenses. And there, if you could tell us how you expect us to evolve in the quarterly pace?

So, into next year's role, if you want to take advantage of the potential higher beef – cattle availability and grow volumes, you would require working capital, no? So, just help us understand a bit into next year if you'd likely to prioritize cash flow or try to get EBITDA up by increasing volumes and thereafter (45:57) during this financial expenses which seem to be suddenly high? Thank you.

A - Eduardo Miron

Thank you, Pedro. This is Miron. As you know, I mean, when we see all – the company as a whole, we have to look from both the operational and the financial part. So, we walk hand-to-hand. I think we shall expect a reduction in the financial expenses due to the two main factors that you – we have already shared and you guys have seen. So a reduction on the debentures expense and the reduction on the interest, given the liability management operations that we expect something around R$30 million from savings to get us on the spreads that we have. At the same time, I mean, the working capital operations. So, they are integrated part of our business. So, we tend to optimize this and we'll continue doing so next year.

Q - Pedro Leduc {BIO 16665775 <GO>}

Okay. So, a mix of both, next year. And then, I guess not a priority (47:06) net profit or cash flow, but if you were to choose one, which one would it be?

A - Eduardo Miron

No. I think, we have made a very clear option for positive cash flow. So, positive cash flow for us is absolutely our main target. And we will work together to achieve both. But, I'd like to just make sure that our financial discipline won't be put in a second position.

Q - Pedro Leduc {BIO 16665775 <GO>}

Thank you.

A - Eduardo Miron

You're welcome.

Operator

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

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

Thank you. The third quarter in particular for the beef division was today the most challenging one. The higher cattle prices in Brazil domestic market, combined with a rapid appreciation in the Brazilian real has a negative impact on the export of beef division. In the case of worldwide, the increase in the cattle price compared to the second quarter due to the seasonality, also had a impact on the third quarter result. The outlook for the future however, remained positive and encouraging. We expect a better fourth quarter than the third quarter. And the fundamental for 2017 are solid.

The limited supply of Australia Beef in the global markets as Andrew mentioned, due to the movement in the cycle of retained cows, the opening of the US market, Brazil for fresh beef imports. And the potential opening of new markets combined with a recovery in Brazil cattle cycle are factors that should support a recovery in the industry profitability.

At Keystone, the outlook remain positive. Our strategy to remain basic on the diversified sales to key account and on expanding existing market as well as on the company ability to make new demand and industry trend and to add value through the chain, through innovation and product and process.

Before I conclude, I want to take the opportunity to thank you all Marfrig team for overcoming the challenge we faced in the quarter. Thanks to you for joining us once again and have a good weekend.

Operator

Thank you. That does conclude our Marfrig's conference call. Thank you very much for your participation and have a nice day.