Q1 2011 Earnings Call

Company Participants

- Leopoldo Viriato Saboya, CFO, IRO

Other Participants

- Alan Alanis, Analyst
- Daniela Bretthauer, Analyst
- Jeanine Thomson, Analyst
- Jose Yordan, Analyst
- Marcel Moraes, Analyst

Presentation

Operator

Good afternoon. Welcome to BRF Brasil Foods S.A. First Quarter 2011 Conference Call. This conference call and presentation are simultaneously transmitted via webcast on our website www.brasilfood.com/ir. At this time all participants are in a listen-only mode and later we will conduct a question-and-answer session. Instructions will be given at that time. We would appreciate if each participant made only one question. (Operator Instructions)

Forward Looking Statements are related to the Company's businesses, perspectives, projections, results and the Company's growth potential are provisions based on expectations of the management as to the future of the Company. These expectations are highly dependent on market chains, economic conditions of the country and the sector in international markets thus are subject to changes. As a reminder, this conference is being recorded. In this conference call is Mr. Leopoldo Saboya, Chief Financial Officer and Investor Relations Officer. I would now like to turn the call over to Mr. Saboya. Please sir you may now proceed.

Leopoldo Viriato Saboya {BIO 16137418 <GO>}

Thank you. Good afternoon everyone. So we are very pleased to be here presenting the First Quarter 2001 Results and very pleased because we are presenting very strong results in both top line and bottom line.

And it's due to several initiatives and a result of several measures. And the management is pretty satisfied overall with the results we achieved in this First Quarter despite all the challenges we have been facing regarding much higher cost environment and the appreciation of the real and some other head winds that we were able to manage and to have a quarter much better than last year.

So we will give all the details on the performance of the quarter. I would like first of all to emphasize as well that we had during this period a very, very, adequate strategy in procurement which helped us to smooth the impact of grains throughout several quarters so we could better manage other profitability and the impact on prices remarkably in the export market.

This vision that showed the overall better incremental margin gains compared to last year. And we keep on capturing synergies which is also another factor that helped to boost our margin. I would like as well to emphasize the investment grade conquest, this is a job that the management has been working for several months or even -- in fact much more than that more than years to reach that result by one agency. And we make a strong commitment with investment grade that we just achieved and to be followed by the other two agencies in the short terms.

Before we get into more details of the quarter's figures I would like to make first of all some clarifications or some -- or the Company position regarding the recent news on CADE process, the anti-trust body in Brazil. So initially I would like to remember you that we have been going through a very long process regarding this merger. Several steps we are at -- took successfully and we are now in what can be called the very last one which is the final CADE ruling. Of course we understand it's taking longer than expected and in fact longer than we wanted.

Also we must comment that these recent reports in fact these recent opinions by the Federal Attorney in charge of CADE processes is one more documentation to be added to the process and technically it brings no news in terms of the merits of the deal and actually doesn't considerate several analyses and documentation that were added to the process.

Remarkably economic and legal opinions made by (Ronomo's) people that work closely to anti-trust issues in Brazil like former CADE Presidents for instance that put a very remarkable opinion which added with it these other opinions from CADE as one more piece of the judgment.

We also wanted you to remember that the Company has always been keen on a negotiated solution. Into this that is considered to be an administrative sphere. So we strongly believe and want to have this solved into this sphere and we strongly believe it's fully possible.

So having said that I turn to the clarification of the results starting on page five where we have the highlights of our results. I think this chart is self-speaking that shows our enhancement of performance both gross profits and EBIT, EBITDA and net income. So we were able to grow, starting with the gross profit, we were able to grow 340 basis points our gross margins. Totally due to the point's I've just mentioned about our adequate strategy in the procurement of grains and other stuffs. And as well our capacity to timely pass on prices. This full inflation was based especially in export markets.

The EBIT we had an incremental of 450 basis points pretty much the same incremental of the EBITDA margin that jumped to 13.6% which is an outstanding margin for a First Quarter. And as we're going to see further on this was pretty much achieved the marginal contribution of the export activities the division that contributed more significantly to this turnaround. Net income reflects as well the good performance and shows that this performance is pure operational and there is no contribution from finance side as usual.

Going to next page we see more details the net income and the income statement sorry. First of all net sales grew 19% to BRL6 billion and this 19% is split by 20% growth in the domestic market and 18% growth in export markets but split differently among volumes and prices. For the domestic market we had approximately 13% volume increases and prices a little bit lower than 7%, the very same inflation faced in the last 12 months in Brazil.

In the exports it was somehow the other way around. It was 4% in volumes and 13% in prices being 23.4% in dollar terms and 7.5% of real appreciation that reduced to this 18% price -- this 13% prices in reals. We also emphasized in income statement our better performance in the gross margins that was reduced by 340 basis points and the SG&As that was reduced in 140 basis points to the net sales.

So all together helped us to really boost our both EBIT and EBITDA margins to this very good area of -- in terms of EBIT 8.7% and EBITDA to 13.6%. That compares to respectively 4.2% and 8.8% EBIT and EBITDA margin last year.

Let's move to the next page. This is exactly what I just said in terms of costs per net sales it was the explanation I gave in the very beginning which is a composition of several measures that was taken in order to smoothen the impact of costs of grains in our COGS. As well we also had the positive impact of the synergies which I will give more clarity on next page. That is reflected in this 340 basis points lower COGS per net sales.

In terms of SG&As this better performance was achieved for basically two reasons. First of all as we grew revenues in 20% area after several quarters not reaching a performance like that it helped a lot to dilute fixed costs. And on the other hand on the variable costs we had very big efficiencies.

For two reasons, first of all because we took advantage of the real appreciation in the costs that are related to dollars like sea freight costs and other expenses in our offices abroad. So the real appreciation that often hurts our top line in this case of expenses linked to US dollar is a benefit of course.

And on top of that we had a much better overall management of our value chain which are much more lean system running now in business as usual comparatively to last year where we faced still several problems, still collateral, bad reflections of the international crisis, meaning more inventories, inventories in the wrong place, more movement of products. So all of those operation expenses seem greater in periods where we don't have monthly operation, the one we had in during First Quarter. So that's why it helped us to achieve this very good SG&A per net sales expenses.

Next page, we can follow through the synergies capture. So we have here bottom line of BRL62 million of synergies after tax and pre-tax of BRL104 million which is the impact on EBIT or EBITDA. The synergies is being captured in pretty much the same space than last quarter and as long as we can foresee this is the pace we understand we can keep before getting the final CADE ruling. And they were captured in the areas where we are keen to go by procurement and areas of the export market.

On next page we brought, page nine, we brought this clarification here of EBIT and EBITDA breakdown. To be very very straightforward in the way we calculate and how we see and how we understand you guys must face or must translate our EBIT and EBITDA into a proxy of cash generation, operational cash generation. So first of all this EBIT here is exactly the way we calculated through the IFRS. So meaning that looking from top down on the income statement the EBIT is calculated after other results, other operational results.

And the EBITDA, how do we calculate it? We add back those other results and the depreciation and amortization as we have been calculating so far. So there is no changes in the way we calculate EBITDA although in the EBITs according to IFRS as I said before. Why we do that, first of all because in other results we understand that they are results not related to intrinsically to operational performance of the businesses of the Company. Or they are one shot expenses not recurring ones.

So that's why we put these BRL816 million in our vision is the best proxy for the performance the operational performance of the Company. And the 13.6% shows the margin, the best margin profile in EBITDA metric.

But here we clarify what is the non-cash and cash impact of these other results in order for you when you do the reconciliation of the cash flow statement you discount this BRL54 million cash out of the BRL816 million of EBITDA. So here is in order to completely separate what is concept of EBITDA and the concept what is goes to the cash flow statement.

And also with put here this BRL10 million in the D&A here but you are going to see that depreciation classified in other results in the financial statements. They add depreciation and amortization this amount is the depreciation and amortization in the free operating facilities.

Having said that we move to the page ten where we have the historical EBITDA margin levels which we can see that we are presenting historical high EBITDA margin for the reasons already mentioned. Moving forward as a consequence we have also achieved a better a marginal better leverage performance reaching 1.3 times net debt to EBITDA.

Next page, page 12, total investments, CapEx plus investment in breeder stocks and the (breeder) is roughly BRL280 million mainly in optimization, new projects and productivity. It's a blend that we'd like to see going further.

Let's now give some more visibility of the market performance per market. But before let's start with an overview of the price of the two main costs of our -- out of our COGS which is soybean and corn. As you can see on a quarter over quarter basis soybean increased 32% in reals in Brazil and corn increased almost 69%. So this is to show that on average, consider an average of 50% price increase of these two items.

It's relevant because although it's participates in the range of 23% to 25% of our COGS this very meaningful price spike is something relevant not only for us but for in a global basis creating a natural inflationary process for the value chain downstream which is meat and other related meat stuffs.

We consider that we ourselves we have been able to manage this very strong pressure in our costs in a very good way in both domestic market and the export market that resulted in better margins regardless this scenario of costs coming very strong on this quarter. But remember what we said last conference that our -- the impact the majority of impact of these skyrocketing scenario that is started by August last year we started to see the real impact in our costs in the Fourth Quarter.

We would see some more in the first and a further impact in the Second Quarter so next quarter. And we understand that the Second Quarter cost impact would be the peak of the so far increase on costs sustained. So going further on the net sales breakdown here represent no big changes with our last quarter figures, 40% exports and roughly 60% domestic market and in terms of breakdown per product there is no significant change.

Let's move to the next slide which is the export by region on slide 16 please. So on slide 16 you can see first of all that there is the main thing that calls our attention is the change of the First Quarter 2011 of the Middle East region that accounted for roughly 34% of our export net sales.

And basically what is in here is not a dramatic change in volumes although in value because in the First Quarter last year we had very depressed prices in the Middle-Eastern region and compared to very positive environment now-a-days. So it's basically the explanation why this region took participation.

We can see as well Eurasia reducing participation and other countries increasing in fact. So very in a nutshell what is going on in every market, in the Middle-East we are seeing local producers facing with this very big difficulties to keep on with the current production because of very high commodity costs. Now we are entering in the good period of demand the Ramadan that goes till August.

And we are harvesting the good strategy of having established our (all) distribution capability and sales in Saudi Arabia precisely that is helping us to better navigate in this moment of good inflation outside of Brazil. The Far East here first Japan. Japan is staying still very strong yen is positive as this maintains the purchasing power against Real and against our products, of course.

As we mentioned last call, the region was hit by last year's bird flu in south of the country and with the other tsunamis and the -- and other earthquakes that affected the region. Japan had to reduce production and is facing difficulties to maintain, especially with these very expensive seeds, nowadays, in the region. So demand is quite strong and we are seeing opportunities, punctual opportunities to move further prices accordingly.

The other part is region is not compared to Japan in terms of relevance. But in terms of perspective. We must comment, it is regarding China. We just had the new approval of a plant to pork meat to China. There's still, of course, no shipments. But we understand that within 60 days, we can have some and we don't expect to start that strong. But it's going to be a very, very positive trend for the industry, for the pork industry as a whole, open up the very good opportunities for us in the region that we are absolutely confident that China will become a big net importer of meat and remarkably from Brazil.

In terms of Eurasia, we are facing some difficulties in Russia, due to some lines that were cancelled, of Brazilian companies, like ourselves. But in terms of news, it's more to same of the Russian game, regarding the trading flow.

And other countries, here we have to emphasize the good performance of both Africa and Latin American markets. The regions where we are putting more focus and are already seeing good performance with the current measures that we did in order to better perform and have better growth in those regions, in terms of management, go-to-market strategy and mix of products of several initiatives that's now being matured.

So moving forward, on the analysis, of intermodal sales of our profitability and the core of the results, in the main categories we operate. So in the domestic market, we had this net sales growing in mid-27.5% and the volume growing roughly 11% and price and mix enhancing 15%.

Here's it's important to comment of -- that, first of all, here we had a better performance of the category called in natural, or raw, chicken and pork. Comparatively to last year, it was a much better performance, right before -- because last year, we had a lot of excess of meat in the Brazilian market and this year was a much tighter scenario and pulled by beef prices that were very expensive.

So these, although the raw meats in the domestic market is a small, comparatively, to processed, the contribution was positive for both prices and margins and helped to achieve this 16% in prices. In terms of dairy, although we were able to manage the increased net sales in 16%, the profitability of this segment maintained in the sidelines. But it's slightly better than First Quarter last year. Exports, the market where we saw most incremental changes compared to last year, it was almost 18% growth of net sales, being 4% volumes, 23.4% prices in dollar terms and being reduced by the 7.5% real appreciation.

So moving to the next page, now we can see the result of that in terms of margins. And here we are bringing forward, for the first time, the EBIT breakdown per market. So domestic market and export market evolution. So you can see what we said in the very beginning of the presentation, that the -- these outstanding results were pretty much built and based on export market recovery. So we recovered from a zero -- pretty much zero EBIT to an 8.3% or BRL200 million of margin or cash generation.

So it is, as I said, the sum of several issues. But I would emphasize our capacity to finally pass on prices, also to better control costs, to have an adequate go-to-market strategy in the main markets where we operate, starting to harvest the good of being closer to final clients in the main exporting markets like Middle East and Japan and also in Europe. So all of that, as a result, gave us this very outstanding First Quarter export market results.

Domestic markets also increased 180 basis points. And incremental margin was due to basically two factors. First of all, we think that processed foods, we had -- we observed up trading of the category. So people willing to buy more products with more convenience. And ultimately with a higher average price. And the beneficial effect of the already mentioned in Natura mix performing well in the First Quarter, different than what happened last year. So all of those impacts led us to increase our EBIT margins by 5 -- by 450 basis points.

Having said that, we move to the final part of the presentation, which is the performance in the capital markets. In terms of shareholders' composition, on page 20, we see no big changes in here. But the ADR growth to 10.5%, which is important to emphasize here, how pleased we are with the liquidity in our receipts in New York.

And of course, as well, the decrease we have been seeing in our shares, local shares. As shown in the very last chart on page 21 that shows our volume traded in the First Quarter '11. $62.3 million per day, which is 37% higher than First Quarter '010. Having said that, I thank you very much for your attention and turn it over the Operator for the Q&A session. Thank you.

Questions And Answers

Operator

(Operator Instructions) Our first question comes from Mr. Alan Alanis from JPMorgan.

Q - Alan Alanis {BIO 15998010 <GO>}

Thank you. So much. Hi, Leopoldo. Let me ask you, first, a very technical question regarding -- and thanks for opening the EBIT on the domestic and export basis. Is it fair to assume that the depreciation, if we wanted to calculate the EBITDA for the domestic and the export market, will also be proportional to that EBIT? And I have a second quick question also.

A - Leopoldo Viriato Saboya {BIO 16137418 <GO>}

Yes. You may consider so. But we can further help you to better calculate. I think your intention is to have a better in terms of EBITDA for market. But the -- it is not significantly different. You may assume that it's proportional.

Q - Alan Alanis {BIO 15998010 <GO>}

Got it. Okay. That helps. That will be useful. Now my question has to do with the use of cash. You've mentioned in previous conference calls that an ideal level of leverage for Brasil Foods would be around two times net debt to EBITDA.

And I think that giving the amount of cash flow generation you've had in the last 12 months, you're well -- way below that level.

What is the preferred use of cash going forward? And would you consider activating a share buy-back program, accelerating your dividend? And what's your latest thinking regarding the use of cash and the strategic priorities, especially regarding your international expansion, please?

A - Leopoldo Viriato Saboya {BIO 16137418 <GO>}

Thank you, Alan, for the question. You're right. Our long-term target for leverage is two times. We are way below that. But as long as we have a very clear plan, growth plan, for the next couple of years, this is a matter of execution of our plan and we don't have any specific plan of share buy-backs or accelerating, let's say, any type of pay -- dividend pay-outs or something the like.

Q - Alan Alanis {BIO 15998010 <GO>}

Yes.

A - Leopoldo Viriato Saboya {BIO 16137418 <GO>}

Of course, our CapEx program is behind the curve, first of all, for very, very known reasons. We are waiting for full visibility of CADE to speed up our expenses. So one of the cash -- the cash-outs will be for our program, CapEx for the next two years, 2011, '12. Which is important. And they are quite bigger than it was last year, as I do believe you are aware of. And we have explained, right?

And secondly, we are working on our non-organic movement, mostly international. And that main targets and regions we have been discussing. But to refresh, we are continuously looking to a further, let's say, move on the value chain in the main markets where we operate and to do that, we are analyzing both greenfield. But also acquisitions. It's selective acquisitions, the ones that really fit in our strategy and in our business profile.

So we have -- although we don't have, in the short -- the very short term, a clear destination for the cash, for the mid-term, it's clear that we have the use of those proceeds. Okay?

Q - Alan Alanis {BIO 15998010 <GO>}

Okay. Thank you. So much. That's useful.

Operator

Excuse me, our next question comes from Mr. Marcel Moraes from Credit Suisse.

Q - Marcel Moraes {BIO 6696122 <GO>}

Good afternoon, everyone. Leopoldo, my first question regards the gross margin. In the First Quarter, I know -- I understand that it -- the First Quarter does not fully incorporate the hike in the grain prices, right? So what would be the average grain cost that you have in your inventory in this First Quarter? And what -- is it correct to assume that you should be moving that number towards market levels? In terms of grain prices, in the Second Quarter or not?

A - Leopoldo Viriato Saboya {BIO 16137418 <GO>}

Let's say, on -- I don't have the precise average price of our costs. We do have the figure. But you cannot compare with a market price, especially because it's a compound of several regions, an average of several, several regions. But what I can tell you is that by the Second Quarter of this year, we will have this full impact and average of the former price increase so far.

Q - Marcel Moraes {BIO 6696122 <GO>}

Right. And are you seeing any -- or do you expect any further price increase in order to offset these higher costs in the Second Quarter? Or we should expect them to be flat?

A - Leopoldo Viriato Saboya {BIO 16137418 <GO>}

(Mostly), yes. Especially in the markets. I mentioned to you, where we still see opportunities in the Middle East, in the Middle Eastern market, in the Japanese market. And several others, we are still seeing opportunities to move gradually prices.

And also, now, the performance of reals back into above (BRL160) area, it is still above this. But this is -- it's important to emphasize here that in the Second Quarter, although we are seeing these important cost pressures, it is something non-dramatic or something that will jeopardize it, fully our position just achieved. So it's something that we can deal with. It's not fully during the quarter. We expected a trend won't change.

Q - Marcel Moraes {BIO 6696122 <GO>}

Perfect. Thank you. And the second question, it's on selling expenses. You mentioned in the report that trade costs had gone down. So how much -- and it was 140 bps. So how much of this is -- can be explained with the freight costs? And if we can assume that this impact -- that this positive savings is -- will be in place in upcoming quarters?

A - Leopoldo Viriato Saboya {BIO 16137418 <GO>}

Okay. I don't have it here and we don't split and -- that's (desperate) methods our variable costs. But the majority is -- has to do with freight costs of these 140 basis. But as I said, in the Portuguese conference call, we must put into balance that last quarter, last year, in the -- at the First Quarter last year, sorry, we were facing still several difficulties to -- regarding level of inventories, regarding further expenses due to our inefficient operation, in both exports and domestic markets. So it led us to a much higher level of variable expenses.

And now we are operating in a very smoothly way. So we are very optimized in terms of freight costs, in terms of efficiencies at the end of the day. So that's why the majority of the gains, they come from the variable costs.

Q - Marcel Moraes {BIO 6696122 <GO>}

Perfect. Is it true, for the next few quarters? Can you assume that your freight costs are going to go down in the second and in the third? Just because of this same issue?

A - Leopoldo Viriato Saboya {BIO 16137418 <GO>}

Comparatively to last year? Yes. But marginally, decreasing the gap.

Q - Marcel Moraes {BIO 6696122 <GO>}

Perfect. Thank you. And a final question on the synergies. You have shown in your presentation that synergies totaled BRL128 million. Is it correct? If we annualize that number, we will get somewhere around BRL600 million, BRL700 million, something like that. And I think the guidance was BRL500 million. Does that mean that there is some upside to those previous numbers?

A - Leopoldo Viriato Saboya {BIO 16137418 <GO>}

No. I think that there -- the -- what we can say, which is fair to raise from this release, synergies figures, is the net synergies, the net operational synergy, which is 104 on a quarter basis could be transformed if we assume it's going to be on a constant basis, which is not necessarily true. It is around BRL400 million. And these BRL400 million, it compares to our guidance of BRL250 million of this year, which is half of the full BRL500 million guidance of next year. 2012, for achievements.

Q - Marcel Moraes {BIO 6696122 <GO>}

Okay.

A - Leopoldo Viriato Saboya {BIO 16137418 <GO>}

Okay?

Q - Marcel Moraes {BIO 6696122 <GO>}

Okay. Perfect. Thank you.

A - Leopoldo Viriato Saboya {BIO 16137418 <GO>}

Okay.

Operator

Excuse me, our next question comes from Mr. Jose Yordan from Deutsche Bank Securities.

Q - Jose Yordan {BIO 1496398 <GO>}

Hi. Good morning, Leopoldo. My question is about just the export pricing. It's up over 20% in dollars over the last couple of quarters. And I just wonder when you're going to see some elasticity to this big price increase, especially with US potentially, with the US becoming much more competitive with Brazilian chicken at this point. Have you seen a big change in the sort of -- in the market share dynamics and the export trade so far? Or is that something that worries you? And if not, why not?

A - Leopoldo Viriato Saboya {BIO 16137418 <GO>}

Okay. Thank you for the question. Yes. This -- you -- you are right when considering such a huge increase of that amount could bring us some, let's say, cut-backs in volumes. Or so -- but so far, we have been able to sell everything we planned to sell. We are pretty much on track with our budget -- budgeting and also with our, let's say, planned capacity for export markets.

What is behind that is pretty much that this is an average increase of our products sold internationally. But if you look to several other main -- several other markets, the main consumer markets like Europe or Japan or even United States, you see the type of increase being maintained in meat prices, it's more than that.

So people are somehow trading down beef towards more chicken. And also, important regions, they are buying more imported meat and poultry is the one most benefit, because it's cheaper. So in the great majority of the countries, the imported frozen chicken is cheaper than the fresh, local ones.

In order to compensate or to mitigate food inflation locally, industries and governments, they are willing to buy more from outside and it remains Brazil. So so far, your theory would be correct, in terms of problems on the volume side. But it -- so far what we are seeing is there are other ways around. We have been able to maintain volumes with a continuously -- price increases.

And the second point regarding the market share dynamics against US, if we look to more -- a couple of years ago, if we looked to the market share trends among Brazil and the United States, there is no clear evidence that there is a change of market share among the two countries. If we try to look more closely to the last quarters or last months, it's the same thing.

Again, theoretically, we must expect that Americans would be selling to sell more internationally. But for them to put more value -- more volumes, for them to marginally increase their production, they cannot export 100% of incremental production. They must consider that a part of this production will remain, will stay in the local domestic market, which is not very good practice, as long as we know.

So this equation is not only thinking of -- that apparently good export markets for Americans. Because you need to see the whole equation to decide if you increase your supply to exports or not, at least this is the way we run our business.

Q - Jose Yordan {BIO 1496398 <GO>}

Right. Okay. Thanks. That was very helpful.

A - Leopoldo Viriato Saboya {BIO 16137418 <GO>}

Okay.

Operator

Excuse me, our next question comes from Ms. Jeanine Thomson from Oaktree Capital.

Q - Jeanine Thomson {BIO 3236221 <GO>}

I was just wondering if you could comment on the margin recovery that you've shown on the export market. How much would you attribute to it being driven by sustainable sectors, i.e. that we should be able to sustain in the coming periods of time, i.e. this year and next year?

A - Leopoldo Viriato Saboya {BIO 16137418 <GO>}

What we understand is it is sustainable for two main reasons. First of all, when we see quarter-over-quarter basis, incremental, it seems, not only seems but it's a lot. So 850 basis points, it's a lot. But we had a quarter -- on a quarter-to-quarter basis. So First Quarter 2010, second, third, fourth and now the first of '11. So five consecutively quarters, we had this better and better and better in margin profile.

So when we look to the incremental margins from the first to the Fourth Quarter last year, it was a marginal increase, right? So first of all, it's a result of several measures and several, also, better environments for exports, starting in a very depressed situation on year ago. This is the first important thing. So this is not only a big jump, within a couple of months ago, gradually being seen in our results.

So also, it has to do, still in the same first part of the answer, it has to do with the -- how well balanced is the supply-demand equation nowadays? So when you -- we have this well-balanced equation, coupled with our very strong position in the market, being a real price settler, we ended up being able to manage our margins and to really offset other headwinds, like FX or grain prices increase. So this is important to emphasize that this environment, it was supportive for all of that.

And the other things that we are -- in terms of more structural changes, we are starting to see the maturity of some measures took in the past, let's say, two years ago, or one year and a half ago, which is a better -- an adjustment of our go-to-market strategy in each market that we operate.

Secondly, we are somehow maturing the business model in key markets like Middle East, where we have our own distribution capabilities and our own sales forces selling straight to final clients, instead of having a former situation where we used to sell straight from Brazil to a wholesaler in the region and we managed that sort of sale to the retailers and so on.

So now we have a company established in the region, selling to the Arabs. So this situation helped us not only to boost our margins gradually. But as well, helped us -- has been helping us to do -- to navigate in a margin above previous margins in those specific margins -- markets.

So all of those aspects helped us to better perform in the international markets and we understand that, of course, some ups and downs are still to come in terms of some volatility because the market sales is being quite volatile, due to all those aspects that we mentioned of not only FX. But also other costs and other, let's say, volatility that we may see in the grains. But we understand that such margins can be a long term sustained. Okay?

Q - Jeanine Thomson {BIO 3236221 <GO>}

Thank you. Then just one final question. I was just wondering, I appreciate the comment you made regarding CADE at the beginning of the conference call. I was just wondering whether the internal general report surprised you in any way? And does that -- is there any inference to be taken, that we should expect a more restrictive to take place than maybe you would have thought a few months back, based on the release of that report?

A - Leopoldo Viriato Saboya {BIO 16137418 <GO>}

Our surprise is, if to say so, is the timing of that report. Not the content. It was -- it tends to be, in most of the cases, the final piece of the administrative judgment and not being thrown in the middle of the process. Just that. It doesn't change anything regarding our strategy or our communication or nothing.

Q - Jeanine Thomson {BIO 3236221 <GO>}

Okay. So it doesn't change your expectations with regarding the outcome of the CADE?

A - Leopoldo Viriato Saboya {BIO 16137418 <GO>}

No. Our expectation remains the same in terms of we are looking to have a negotiated solution. And this negotiated solution, for us, to expect something we need to hear from CADE what is -- what are the concerns. And so far, we haven't heard anything. So we cannot state that our taxation is better or worse, because based a report, we cannot, let's say, change or make any statements regarding what we expect.

Q - Jeanine Thomson {BIO 3236221 <GO>}

When you talk about the negotiated solution, that's what you're looking for, ideally. Is that -- would you be looking to negotiate a solution before CADE announced their ruling or would that come after the fact?

A - Leopoldo Viriato Saboya {BIO 16137418 <GO>}

The negotiation -- when we say negotiated solution, it is definitely within the CADE administrative judgment. It's a negotiation before it's being presented to the final voting process by the other councilors. That's the under -- the final understanding of what we mean by negotiate a solution which means that ourselves and the councilor in charge of the process, we've reached an agreement.

Q - Jeanine Thomson {BIO 3236221 <GO>}

Okay. And are those the discussions that are taking place at the moment?

A - Leopoldo Viriato Saboya {BIO 16137418 <GO>}

Excuse me?

Q - Jeanine Thomson {BIO 3236221 <GO>}

Are you having those discussions at the moment, regarding potential solutions?

A - Leopoldo Viriato Saboya {BIO 16137418 <GO>}

It's -- this is a continuous process of presenting arguments for a specific market, a specific situation. And of course we cannot anticipate anything on that sense. But there is no finding, no final presentation or nothing on the way, just the follow-through of the problems.

Q - Jeanine Thomson {BIO 3236221 <GO>}

Okay. Thank you very much.

A - Leopoldo Viriato Saboya {BIO 16137418 <GO>}

Okay?

Q - Jeanine Thomson {BIO 3236221 <GO>}

Thank you.

A - Leopoldo Viriato Saboya {BIO 16137418 <GO>}

You're welcome.

Operator

Excuse me, our next question come from Ms. Daniela Bretthauer from Raymond James.

Q - Daniela Bretthauer {BIO 13380169 <GO>}

Hi, Leopoldo. A quick question on your income rate paid in the quarter, it was 18%. Any specific reason as to the low rate? Any ForEx, foreign exchange gains or losses that impacted the income tax? Or should we expect around 18%, 20% for the rest of the year?

A - Leopoldo Viriato Saboya {BIO 16137418 <GO>}

No, nothing, let's say, nothing specific to this quarter. This is -- you may consider 18% to 20% as the normalized tax rate for the remaining of the year. Yes.

Q - Daniela Bretthauer {BIO 13380169 <GO>}

But for the following years, it goes up gradually, right? It's not going to stay around the 18%?

A - Leopoldo Viriato Saboya {BIO 16137418 <GO>}

Well if you look to the past, this is our effective tax rate. It always hangs around this area. 18%, 20%, sometimes a little lower than that. But 18% to 20%, you are on the safe side.

Q - Daniela Bretthauer {BIO 13380169 <GO>}

Okay. And just, sorry, to go back to CADE, I know it's a sensitive issue. But is the Company ready, let's say, to fight, do whatever it takes to get the merger approved or to keep CADE?

A - Leopoldo Viriato Saboya {BIO 16137418 <GO>}

Listen, Daniela, we are always ready to fight for shareholders' interests. We, let's say -- we don't believe this is going to be the case of turning to the court judgment. But we understand that we are under the administrative judgment and we understand there are many reasons to believe that we can reach a reasonable agreement for both of the parties within the administrative. But bear in mind that we are here to defend, ultimately, the interests of the shareholders and the value of these merged entities. So we don't think, from that, although we understand that this is a scenario that can be played.

Q - Daniela Bretthauer {BIO 13380169 <GO>}

Okay. Thank you.

A - Leopoldo Viriato Saboya {BIO 16137418 <GO>}

Okay?

Q - Daniela Bretthauer {BIO 13380169 <GO>}

Yes.

A - Leopoldo Viriato Saboya {BIO 16137418 <GO>}

You're welcome.

Operator

Excuse me, this concludes today's question-and-answer session. I would like to pass the floor over to Mr. Saboya for his final statements. Please, sir, go ahead.

A - Leopoldo Viriato Saboya {BIO 16137418 <GO>}

So ladies and gentlemen. thank you very much for attending our earnings conference. And we are really going to see you on our next quarter conference. So bye-bye and good afternoon.

Operator

That does conclude our BRF Brasil Foods SA's conference call for today. Thank you very much for your participation and have a good afternoon.