Q2 2009 Earnings Call

Company Participants

- Leopoldo Saboya, Financial & IR Director

Other Participants

- Alan Alanis, Analyst
- Alex Robarts, Analyst
- Joao Carlos Santos, Analyst
- Marcel Moraes, Analyst
- Marcelo Luna, Analyst
- Paul Trejo, Analyst

Presentation

Operator

Good morning. Welcome to BRF Brasil Foods SA Second Quarter Conference Call.

This conference call and the presentation are simultaneously transmitted via webcast on our website, www.perdigao.com.br/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.

(Operator Instructions)

Forward-looking statements 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 changes, economic conditions of the country and the sector and international markets, thus are subject to changes.

As a reminder, this conference is being recorded.

I would now like to turn the conference over to Mr. Leopoldo Saboya, CFO and Investor Relations Officer.

Please, Mr. Saboya, you may proceed.

Leopoldo Saboya {BIO 16137418 <GO>}

Good morning, everyone. Thank you, very much for being present in our Second Quarter presentation. We want to make a very brief presentation of the Second Quarter and first half figures. Then we will move straight to the Q&A session.

So first of all, I would like to make some comments about our results, which we consider and we know that we had a weak operating result, although a very strong bottom line in this quarter. We are still suffering with the very tough conditions in the export market that affected all the businesses.

And also the very intense impact of the reduction of the production that we started to do last year impacted the results of the company and resulted in several unexpected expenses in this half as a whole, that I will give some more details of in terms of figures.

So we should start on page four, with the breakdown of net sales. This is to say that we have pretty much the same breakdown of sales last year, so the mix of product and product line is pretty much the same. So no changes in terms of comparison, basically. We also -- we had the same revenues, net revenues, of BRL5.3 billion in this -- in 2009 first half is the same amount of last year. So we didn't increase our revenues, although working with lower volumes.

And next page, the highlight of the results, in the quarter we had a net sales 5% lower last year and the gross profit, in terms of margins, pretty much in line with last year. But on the other hand, a very low EBIT and EBITDA margin as a consequence, due to much higher operating expenses. And I'll give details on that.

The net income, 70% higher than last year. We closed the quarter with BRL129 million against BRL76 million last year, the positive impact of the FX in the quarter, in our debt position, basically, and resulted in EBITDA margin of 4.9% against 8.2% of last year.

When we look on the consolidated first half and it's where I want to make more comments, because it's easier to analyze and to see all of the impact in one -- during one half. We see net sales exactly the same last year, as I told before, and gross margins a little lower than last year, basically 60 basis points lower and a much lower EBITDA margin. And the result of that is because of operating expenses. It is 330 basis points higher this year, this half, compared to last half.

And how can we see that if we break down what were the main facts of that? First of all, we need to consider that the company planned, last year, since August, September, growth for 2009 in the range of -- important growth, in the range of 10% to 13%, depending on the categories. And what we are seeing is that a lower -- is in fact volumes being lower than last year.

And on the other hand, we had the one shot costs for technical shutdowns of plants to reduce our production in light of all the difficulties faced in the -- especially in the export market after the crisis. So the figures of that is as following. Transaction costs, additional production costs, is due to those technical shutdowns of plants. They amounted, in the half, something like BRL70 million.

We faced also other variable expenses of BRL80 million, basically because of the FX impact because it impacted directly our costs. The majority of costs, of exports, they are denominated in dollars. And we have this impact in the expenses and didn't face a positive result in the top line because of the very dramatic reduction of international prices.

Also, very high inventories that we have been carrying since the ending of last year, so we have more cost of inventories.

And some other additional costs with handling.

Fixed expenses, fixed commercial expenses were -- it was something like BRL20 million higher than last year. So all of those -- if we sum up all of those extraordinary expenses, resulted in BRL170 million in the half, which is basically 320 basis points of expenses.

Then if we adjusted this to our EBITDA margins, we would be having the very same EBITDA margins of last year of 7.9% in the first-half last year. Which is not to say it's a good margin, although in the range of 8% it is considered to be a low margin, but remember that last year we were struggling against a very strong real and in the way of pass-through prices, all the impacts we faced on the cost side of our business, with also the FX impact last year.

So what I'm saying is that this impacted the results of the first half and we are seeing now, in the beginning of this Third Quarter, these costs, they are being back to a more normal. By the end of this quarter, we intend to have, compared to last year, operating expenses at a level much more in line, especially for the production costs and the majority of the variable expenses.

So moving forward, now looking to more -- a little more details on the businesses and domestic and export markets, let's now stop on page seven.

On this page, we can see the very high volatility we have been facing in very key prices and costs. So on the top left, the protein prices, we see that since the very dramatic drop of prices started back to September '08, prices of chicken, they have been steadily recovering in dollar terms, but not the same story for pork. Pork is a -- we have been facing a very negative scenario, where it seems to have an excess of supply abroad.

Prices, they didn't -- of course, they didn't return to previous level and we don't believe they will return. They were in September last year, they were in a very historically high levels. But they will keep increasing slightly and slowly in the coming months, especially for chicken, which is positive if we consider that cost is stable or a little lower for the coming months and expecting that FX won't move aggressively again.

On the cost side, here on the left and the bottom, we see that after a big correction of corn and soybean prices, now the prices are more -- it seems that they bottomed and they are showing in the half, a big decrease against last year. But when we see a quarter-over-quarter increase in dollar terms regarding Q2 through Q1 '09.

But even though, when you compare these impacts in reals, we see a little different because of the FX. So analyzing the first half, we have corn in reals, 17% lower than last year. And soyabean meal, 15% higher than last year, basically because of the FX.

So that's to say we are not having that different scenario for primary costs in our business. And looking forward, they tend to be even a little lower than actual costs.

For milk costs, the average price of state producers in Brazil, we see increase in the quarter over Q1. But this, in fact, as the market is much more balanced, we have been able to pass through prices, which means we are now getting a very good profitability in all the dairy business at Brasil Foods.

Dollar, also, this very volatile market. After depreciating a lot during -- since December, basically to April, the real started to strength against all of the currencies in the world, not only against dollar. The more dramatic impact of this occurred in the Second Quarter, with this appreciation, in that that more than offset all of the efforts to increase price in dollars.

And this next page is graphically how we can see this impact. So here in the blue lines, we see the prices in dollar terms. As I showed in the last page, price is increasing. This is the compound Brazil food prices in dollars, so including all types of products, right? So we are seeing prices going up. But -- and prices, and prices in real terms, they were increasing through April. They were following the same trend. But now with this very sudden real appreciation, they now are tracking to a much lower level. Which makes us -- we need more time to re-equate the price in dollars, to have a better, at least, graph profit in all the export business.

Just to give you an idea, of course, this very intense movement in red, the red lines, since -- from August to January, this is, I would say, unusual, because this is a movement that has the two main movements of prices in dollars and FX.

If we do not consider this period, we would say that if we link August '08 prices to January '09, it would be the twin for prices in reals. Which is being traded much lower than last year levels.

So now giving a little bit more details of our domestic sales, and then we go back to the export market in a little while.

And in the Second Quarter, we had lower volumes for elaborated and processed meats. It was 4.8% lower, but 4.8% higher revenues. So we had some 9% higher prices.

If we look at the same processed meats in the first half, we would have volumes dropping 5.9% and prices going up 13%. So here we had impact of several issues, but also the problem with Rio Verde plants also affected our performance in this half.

And also we, in that situation, we defended as much as we could prices in the domestic market. And it's also important to consider that this reduction of 5.9% in volumes in the first half, compared to last year, also includes the phase-out of (Asid Power) brand name.

Last year, we had processed products at above (an eighth) and now this year we shift -- we shifted completely these lines through our department name to produce other types of raw materials for other processed and other export products as well.

And the total domestic market performance, 14.5% lower volumes than last year in the quarter; and in the half, 6% lower. In terms of revenues, 3.8% lower revenue; and in the first half, 1.9% higher. So a slightly higher revenues in this year, year-to-date, compared to last year in our domestic market. Including dairy.

In the next page, it's pretty much what I said. We are seeing more demand for cheap products, which is also impacting our mix -- our portfolio of the domestic market. A strong pressure in the pork business, as we are seeing a very high supply of pork in general in the domestic market, pressuring all types of processed pork meat.

So in summary, we had slightly higher revenues with lower volumes, but operating results only a little below last year.

In the dairy, this is compounding all the first half, right? In the dairy business, as I said, the market was more balanced, a positive demand for our fluid milk and very good margins in the consolidated.

If we took all the domestic market together, meat and dairy, as I said, lower volumes, but good -- we are working with the very same profitability than last year. So the domestic market business is restored.

In the export market, here on page 11, we have the breakdown of volumes and sales. So total exports, we are just a little below last year, both in volumes and revenues. And if we consider the first half as a whole, it's even more closer to last year. Both volumes and revenues. We are -- we had in the half, in the first half, the very same revenues than last year.

So next page, on page 12, the first message is that during the Second Quarter, the real appreciation more than offset all the efforts to pass on prices during the Q2.

The higher expenses, and the cost of those technical shutdowns of plants, really squeezed our margins in the export market.

All the types of costs, as I said in the beginning of the presentation regarding variable costs, we're seeing a gradual slow recovery in prices.

And a tough market for pork and turkey remains. An improvement in the Middle East and Far East in chicken markets, we see as a positive equation for the second half this year.

Another message here is to say that, of course, our gross profit in the export market was damaged in this, both Second Quarter and first half. But I would say that the big issue in the export market were the operating expenses. Because as you work with lower volume, lower than planned volume, and you have all the variable costs, they are dollar linked.

We have a very big squeeze in our margins in this year. And this is a good part of the explanation why we are facing clearly weak operating results this year compared to last year.

Now looking to export by region, I've already mentioned that Middle East which is the main market is doing okay. Although, we are seeing now a little more pressure of volumes coming from United States companies and other exporters, other Brazilian exporters.

In the Far East market, basically in Japan, we are going through a tough August and September, tough negotiations. This is the time they start to prepare what's going to be the remaining of the year. And so it's pretty normal to have this little more tough market.

And in Europe, still having a lot of turkey in the market, very low turnover of the product, so we don't see Europe recovering. Although we start to see some signs of a recovery in the consumption of the market, as a whole, and the consumer confidence as well.

In Eurasia, the pork market is still difficult. Also, some signals of enhancement, but it's still weak demand. Actually now, we expect by the year-end for this market to be back to a more normalized, both volumes and prices.

This is, what I said before, in the Europe region. The consumer confidence backing -- returning to near to September, or at least November levels, but retail sales is still suffering.

Now talking about debt and investment, so our position of debt is not that different what it was in the last quarter. When I say last quarter, I'm talking the Q1 '09.

So I think it's better to analyze the situation now considering the net proceeds of the follow-on and coupled with Sadia's position, which is the next page.

In this page, we can see the consolidated figure after this receipt and after consolidating Sadia's figure. So on the extreme right, we see the bond offering situation, but with figures from the First Quarter.

If we consider the figures from the Second Quarter, and also we re-integrate both net debt and also the last 12 months EBITDA of both companies, instead of having 2.8 times EBITDA at our net debt, we would have 2.5 times regarding, as I said, the current Second Quarter figures of both companies.

And if we include the green shoe, 100% of the green shoe, this figure would be 2.2 times, which is a pretty more comfortable situation for Brasil Foods to keep all the business plans and working full capacity in the integration plan and the synergies capturing in 2010 on.

On next page, this is just a chart getting information from our accounting cash flow. That to show how different is this situation compared to last year Q1 and Q2, so the first half last year, with the first half this year.

So this year, in terms of net operating results, adding both quarters, we get a negative figure of negative BRL112 million. But on the other hand, we could face in the first half, BRL188 million in working capital.

So as we were in the middle of a very tough scenario, we made all the effort to save money in our balance sheet. It was completely different than it was last year. So that's why, although we had on our P&L, we are presenting a very strong balance sheet, even before the net proceeds of the follow-on.

In terms of investments, the majority of investments during the first half, it was to productivity and optimization. We don't have big greenfields or big projects going on.

So BRL295 million and we expect to have a CapEx year, for the total year, of BRL0.5 billion of CapEx for the year, plus BRL200 million for the breeding system. It was BRL94 million in the first half of the year.

This is shareholders composition. This is the ending of July figure. So after the two quarters of Sadia's control, controlling shareholders -- the foreign controlling shareholders of Sadia, and also the proceeds, only not including the green shoe and the remaining balance of Sadia, so this is the composition.

On page 21, we have the share performance and the volume traded. Of course, it's very high -- much higher volume during July when we issued the new shares. The 115 million new shares and the performance of PRGA3, a little higher than Ibovespa.

And on page 22, we see our market cap in broader terms, roughly flat, roughly $8 billion of Brasil Foods, much higher than any other competitors in the peer group.

Now by saying this, I'd like to thank you for your patience. And we now open to the Q&A session.

Questions And Answers

Operator

Ladies and gentlemen. we will now begin the question-and-answer session. Each participant may only ask one question.

(Operator Instructions)

Our first question comes from Mr. Marcelo Luna with Banif.

Q - Marcelo Luna {BIO 15380566 <GO>}

Thanks, hi. Good afternoon. Hi, Leopoldo, thanks for taking my question.

I guess, following the question in the morning or in the Portuguese conference call or focused more on the revenue side, I just wanted to talk a little bit about the cost side of the equation. And I would appreciate it if you could comment on the following.

We notice in the press release obviously that there was a significant reduction in production levels of meats, processed foods and then the food you were talking about the technical stoppages, et cetera.

So I was just assuming that we could see further technical stoppages during the Third Quarter. And obviously, we're already at the end of August. So it would be interesting if you could give us some color on how should the level of production in the Third Quarter look compared to the Second Quarter, and then also compared to normalized rates?

Then also if you could comment on the strength you have said here, how to estimate the cost of stoppages? So I'm not sure if you can give us any clarity on what would a technical stoppage cost, maybe per day, or per ton of a plant that you are stopping because of weak demand issues.

Because I'm assuming that we're going to continue to see weak demand during the Third Quarter, and then maybe recovering through Fourth Quarter.

Thank you.

A - Leopoldo Saboya {BIO 16137418 <GO>}

Okay, Marcelo, let me try to address your question.

So the cost of those -- first of all, we don't expect more stops or more technical shutdowns of plants during the second half. So this is the first thing.

The second thing is that what impacted our costs, due to those technical shutdowns, it's over, pretty much over. So the marginal impact in July-August is minimal. Okay? So all those BRL80 million, as I said before, it was, let's say, the costs for doing that; it's over. So there is nothing to be added in terms of cost of production and moving forward.

A good portion of the volume impact is in the dairy segment. But the dairy is a different story, where we can manage much more easily these increasing reductions of production. Especially in the fluid milk market where we need to analyze what is the real demand, and make the equation with prices and profitability, which in fact we did very well in the first half.

Q - Marcelo Luna {BIO 15380566 <GO>}

Okay, great, so can you give us a sense for where you are in terms of your production levels during the Third Quarter compared to the Second Quarter? Is it maybe 10%, 20% above the overall production levels that we saw in the Second Quarter? Can you tell us more or less where you are?

A - Leopoldo Saboya {BIO 16137418 <GO>}

Okay, in terms of capacity utilization for meat, I will focus on meat right? Just a warning, it's a little difficult to precise what is the real capacity utilization. Because it depends on a lot of assumptions in terms of feed and hours per day, things like that.

So if you consider the way we look at that, we are now working near to -- during the Third Quarter, we'll be aiming on near to the 90% of utilization which means it's pretty much back to what we consider to be full capacity.

(Pretty well), when you consider 95% is more than full capacity, because those 5% would be when you work with extra hours or weekends or things like that, which is not optimal as well, even in good periods of demand. So we are now backing to what we consider to be optimal utilization of our plants by the end of this quarter. Okay?

Q - Marcelo Luna {BIO 15380566 <GO>}

Okay, so that's 90% for processed foods.

A - Leopoldo Saboya {BIO 16137418 <GO>}

Yes, for meats in general. All processed and also meat for export.

Q - Marcelo Luna {BIO 15380566 <GO>}

But not slaughtering?

A - Leopoldo Saboya {BIO 16137418 <GO>}

Slaughtering, yes.

Q - Marcelo Luna {BIO 15380566 <GO>}

Okay, got it, thank you so much.

A - Leopoldo Saboya {BIO 16137418 <GO>}

Okay.

Operator

Excuse me. Our next question comes from Mr. Marcel Moraes with Credit Suisse.

Q - Marcel Moraes {BIO 6696122 <GO>}

Good morning, everyone, Leopoldo, I would like you to comment a little bit more on the continued increase in the EBITDA margin that is mentioned in the Portuguese conference call.

You said that we are likely to see the EBITDA margins back to double-digit levels by the year-end. If we exclude the non-recurring expenses that is mentioned in the first and Second Quarter, we would see, in the Second Quarter, a negative trend with regards to the EBITDA margin.

So I would like just to give you -- I'd like just you to give us a more color about where is this improvement coming from. If it's price adjustment, if it's volume, as you have mentioned, or it's reduced operating expenses.

What is the most relevant issue to drive the EBITDA margins back to those double-digit levels?

Thanks.

A - Leopoldo Saboya {BIO 16137418 <GO>}

Okay, just probably I just am missing this; or I or you misunderstood what is regarding the Second Quarter. But what I said in both Portuguese and English conferences, is that all the extraordinary expenses we faced during the first half would represent something like 320 basis points.

If we would add it back to our results in the half, it would represent something like 7.9 EBITDA margin. It would be exactly the same last year. We don't have this in a different trend from the first to the Second Quarter.

The difference of the second compared to the First Quarter of this year, is that as we work with lower than the First Quarter volumes, and of course revenues as well, impacted by the FX on top of that, when you look marginally, the second was more affected than the first. But this is not a trend.

Q - Marcel Moraes {BIO 6696122 <GO>}

Right.

A - Leopoldo Saboya {BIO 16137418 <GO>}

This is just a fact that occurred in the Second Quarter.

But now looking forward, in the majority of those extraordinary expenses, they are done especially in the production side and some variable costs. If we continue then we don't have those imbalances of FX and prices. Again, the trend is for a steady recovery of our operating margins.

We will end by getting back to the low two-digit margin by year-end. And the main drivers for that are as following, first of all, operating expenses, as I mentioned.

So they need to be back to the level below 20%. So when we're working on 19% -- 18.5% of our net sales in terms of total operating results, we are back into a good shape.

So this is, as we said in the Portuguese conference, we are having several, several plans and actions to be back involved with fixed costs, with variable costs, automizations, all the things -- everything you can imagine we are in place in a very aggressive plan to back to more competitive expenses as a whole.

This is one driver. The second driver is the continuity of the expected growth of international prices which we recognize has been tough because of the overall situation of each market. But we have been able to increase steadily international prices. Of course it will depend on international supply, and of course the FX volatility in the coming months. If the FX stabilizes as it is right now, of course this is what we expect, or what we hope, in fact, for us to plan better what is the right price in dollar we need to drive, these continued recovery of margins will happen.

So those are the main drivers for the results, and one that is intrinsically related to the others is volumes as a whole, so back into a higher revenue that will make our structure, will dilute our structure in a higher revenue.

Q - Marcel Moraes {BIO 6696122 <GO>}

Great, You believe that, even if you do not reach the same levels, I mean, volume levels to Europe and Japan, you would be able to be back to these double-digit levels, I mean probably adjusting the whole structure, right?

A - Leopoldo Saboya {BIO 16137418 <GO>}

Yes, that's it.

Q - Marcel Moraes {BIO 6696122 <GO>}

Okay. Thank you.

Operator

Excuse me, our next question comes from Mr. Alexandre Pizano with Banco Merrill Lynch

Q - Joao Carlos Santos {BIO 15122452 <GO>}

Hey. Good afternoon.

Actually, this is JC Santos once again, as in the Portuguese call.

So my question is, on the selling expenses, we've seen a spike on selling expenses, we've seen some one-off impacts here from the Rio Verde fire in the plant, and also additional marketing expenses due to the creation of Brasil Foods. So could you quantify to us how much would have been, as a percentage of revenues, or maybe in millions, the additional costs that you had from the selling expense? Because once again, you got back to the 20% of revenues in levels, which seems quite -- is quite high to the recent past, and if you see an improvement in this line for the second half of the year?

A - Leopoldo Saboya {BIO 16137418 <GO>}

Okay, the majority of those expenses in the domestic market, we didn't face that much difference of, especially commercial expenses as we did in the export market. Looking to the domestic market as a whole, as I said before, our profitability this year, our EBITDA margins for the total domestic market including dairy and meat, in the first half is pretty much in line with last year. So our, even with the lower volumes, we were able to readequate our commercial expenses to a scenario where we had lower volumes, but a little higher revenues.

Revenues in domestic markets it was 7.7% higher. Sorry, this was just for the processed food. If we had all the categories, just a second, all the categories together, all of the domestic market in the first half, it was slightly higher. It was 2% higher, all the domestic market, so it was not that much higher.

So we were able to readequate our equation in the domestic market, okay? Even though facing all of those things regarding Rio Verde, a little higher marketing expenses, as you mentioned.

The issue was in the export market, pretty much in there, where we had a very big impact of FX in our costs, because FX was 25% higher than last year, so costs much higher, and the majority of costs, they are denominated in dollars. But prices in dollars collapsed as you know. And we faced other extraordinary and one-shot expenses like costs for inventory, other costs to handling and things like that.

So now, looking forward of those costs, a good portion of the variable costs, and looking to excel now, they are a good portion, as I said, they are now in a more adequate level. So by the end of this quarter, we intend to be working below the 20%, of course, and be approaching the 19% of the company's total operating expenses, okay?

Q - Joao Carlos Santos {BIO 15122452 <GO>}

Okay, thanks, Leopoldo.

Operator

Our next question comes from Mr. Alan Alanis, JPMorgan.

Q - Alan Alanis {BIO 15998010 <GO>}

Hi, Leopoldo, good day. Just also following up on a comment made earlier on the Portuguese conference call. You mentioned that you will see a pickup, a stronger pickup in demand volumes from your external, from exports.

Number one, could you clarify, or could you expand on which regions, Europe and Japan, would you're likely to see this pickup in demand globally, number one. And number two, what kind of -- what are the dynamics, the competitive dynamics that you're seeing in this market from other players?

Thank you.

A - Leopoldo Saboya {BIO 16137418 <GO>}

Okay, where we expect a recovery is Eurasia, where the market is very weak right now, and although the economy is not showing good improvement over there, the pork market tend to recover from the very low volumes traded right now. So we expect by the end of this year, especially, and also considering that the Russians, they buy a lot of products exactly right now for the wintertime. So this is one of the regions where we expect more volume.

The other regions, they are not showing a big prospective or a very great prospective for increase of volume. But the total in the export market is not necessarily volumes, because we are working in a quantity where we consider is good, which is near 100,000 tons per month of export. Here, this is pretty much the average we had in the second -- both in the Second Quarter or the first half.

The issue is price. Because of this recent real appreciation, we need further increases of prices internationally, and that's where we are seeing a very slow movement. This is something that we cannot count on. We need to really struggle that day-by-day, to be able to pass through prices.

And looking at your second point, is, how is our competitors, and how is the market doing? This is also one of our main -- what we have been dealing with here at Brasil Foods is how other competitors are doing or are surviving in these environment, and this is, I would say to you, this is not an easy task or an easy answer.

We see that lots of small and medium players in Brazil are still suffering with the financial situation. The majority of players, especially the chicken players with a very dramatic financial situation against banks. Pork players, even tougher, so no good news here in Brazil for people to keep increasing volumes or being more competitive to export.

In the United States, maybe is the one that's now getting more good mood, especially because cost of production declined. Both corn and soybean as we have shown in the presentation. The dollar is weaker, right, against, not only to real, but other currencies as well, so they are being able to export more competitively. So this is the region, especially the United States where we expect enough positive competition. So these are the risk factors that we see in ourself for the price recovery in the second half.

Q - Alan Alanis {BIO 15998010 <GO>}

Good, that was very useful. Thank you, very much.

Operator

Excuse me, our next question comes from Mr. Paul Trejo with Blackrock.

Q - Paul Trejo {BIO 15398874 <GO>}

Hi, everyone.

Leopoldo, my question is with regards to the higher commercial expenses and other costs caused by the reallocation of products from Rio Verde. Have those problems all been adjusted, have inventories and production been adjusted so now we're back at a normal, or more normal level? And also, the costs associated with the Rio Verde fire, have you been remunerated by the insurance companies?

Thank you.

A - Leopoldo Saboya {BIO 16137418 <GO>}

Thank you for the question, Paul.

Yes, you are right that pretty much all the costs, all the one shots we faced pretty much in the Second Quarter. It's over, so now the production is everything is back, all the inventory positions, mix of products available in all our main distribution centers is back to our normalized portfolio in light of inventories, which means, we don't expect to lose sales, let's say, due to that reason. And also the expenses, the further expenses we paid to transport the -- for transport and for relocate productions is now solved. Okay?

Q - Paul Trejo {BIO 15398874 <GO>}

Thank you. And in terms of the payment from the insurance companies regarding the fire?

A - Leopoldo Saboya {BIO 16137418 <GO>}

Okay, in terms of the insurance, everything we had of extraordinary, it was already placed in our, as a provision to receive, and the cash flow effect is about to come. But everything was addressed, and everything is going okay. In summary, we don't expect losses with the balance between what we lost and what we will recover.

So there is no negative impact of this imbalancing in our results year-to-date. Okay?

Q - Paul Trejo {BIO 15398874 <GO>}

Thank you.

A - Leopoldo Saboya {BIO 16137418 <GO>}

You're welcome.

Operator

Our next question comes from Mr. Alex Robarts, with Santander.

Q - Alex Robarts {BIO 1499637 <GO>}

Hi, thanks, everybody.

You know, I want to go back to the volume issue, because I know earlier this morning, you talked about that as kind of a key driver into getting back into the double-digit margin zone and such later this year. And I guess I want to kind of take this from the angle of the domestic processed products. I mean clearly you have been getting well above inflation type of pricing. But when we look at the first half and we look at the Second Quarter you have been down in terms of that domestic processed volume.

You've talked about the (Avipal) adjustments and such on a year-on-year basis, but just, can you give us a sense of how you could perhaps look at the second half vis-a-vis the processed products volume? Should we see better growth? Do you plan to make some mix adjustments that will actually kind of stimulate growth, and what might that be? So that's kind of really the basic question.

Then the clarification that I had is, if I may, and I don't know if you're able to do this online, is, when you think about the BRL170 million in first half extraordinary expenses. You know, how much could we just allocate between the first and Second Quarters? Thank you.

A - Leopoldo Saboya {BIO 16137418 <GO>}

Okay. Thank you for the question.

An important driver is volumes for the second half, you are right. As I said, in the export market, it was what I explained, and for the domestic market, we do expect an enhancement in the processed as well, but it still will be lower than the budget, which means that we will have pretty much in line volume compared to last year, and not below, as we are facing year-to-date.

That is to say, we tend to compensate during the second half, what have we lost in terms of volume during the first half this year. But we won't be able to at least as far as we can see market conditions, in the domestic market, we won't see volumes closing the gap between the actual '09 sales, with the budget.

Okay, this is one important thing. The overall conditions for that is we are seeing the domestic consumption enhancing. In fact, the economy is doing well, the consumer confidence is better. The majority of the economic indicators, they are better right now. Inflation very low, real income not growing that much, but in the margin it is still higher than previous periods. So everything positive for us to believe in a good, or at least okay, '09 for the domestic market in terms of volumes, okay?

Now regarding your second question, with the split of the expenses. I don't have here the split, but it's important to understand that all those expenses, or extraordinary expenses, as we said, in the first half, the moment that they are accounted depend on the moment you sell. And sometimes they impact more, one or the other quarter, but they are a result that started in last year's decisions that we made this year. That's why we -- it's more accurate to give you a six-month position than a monthly or a quarter position.

And also, we need to understand that the Second Quarter had an additional impact, because of much lower volumes compared to the First Quarter, when we see on a year, two-year basis. So the important thing here, Alex, is to consider that, by the ending of last quarter, and the beginning -- I mean, right now, especially, the production costs, and a good portion, let's say 60% to 70% of the variable costs, they are now, they were already addressed. And with the plan we are doing, we'll be back to a more comparable operating expenses by the ending of this quarter, and beginning of the next one.

Q - Alex Robarts {BIO 1499637 <GO>}

Okay, that's helpful, thank you.

A - Leopoldo Saboya {BIO 16137418 <GO>}

You're welcome.

Operator

This concludes today's question-and-answer session. I would like to pass the floor to Mr. Saboya for his final statement.

Please go ahead, sir.

A - Leopoldo Saboya {BIO 16137418 <GO>}

Thank you, everyone again for being here with us. We will be here after the 21st of this month, and we will be back to our open period. We are now still in a quiet period because of the follow-on, as you know, and we'll be absolutely open and we'll enjoy to discuss with all of you our market conditions and our perspectives, and looking to more --

- to tell you everything, in order to make you comfortable with the company's projects and perspectives going forward.

And we will be, the one thing that is for sure, we'll be working very hard to capture the synergies, the remaining synergies with Eleva, and also to return the company to its normal profitability as it was. It was not different in tough periods we faced several times in our history. When it looked to Brasil Foods in the long term, that is the type of message we would like to leave with you. And to thank for your great confidence in our story. Thank you, very much.

Operator

That ends our BRF Brasil Foods conference call for today. Thank you, very much for your participation. Have a good day.