Q3 2012 Earnings Call

Company Participants

- David Alan Palfenier, Chief Operating Officer
- James David Ramsay Cruden, Chief Operating Officer
- Ricardo Florence dos Santos, Chief of Corporate Strategy and Investor Relations Officer

Other Participants

- Analyst
- Christina Ronac
- Eric Ollom
- Ivan Fernandes
- Luciano Coster
- Wesley Brooks

Presentation

Operator

Good afternoon ladies and gentlemen. At this time, we would like to welcome everyone to Marfrig Alimentos SA Conference Call to discuss it's Results for the Third Quarter of 2012. 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 a slide show 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. [Operator Instructions].

Before proceeding, let me mention that forward-looking-statements are being made under the Safe Harbor of the Securities Litigation Reform Act 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 the 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 will turn the conference over to Mr. James Cruden, Marfrig Beef CEO Please Mr. Cruden you may now begin the conference.

James David Ramsay Cruden {BIO 15363978 <GO>}

Good afternoon. Thank you for attending our call to present our third quarter 2011 results. We recorded in this quarter our highest quarterly consolidated net operating revenue of 6.3 billion. The result is explained by the improvement in the product mix at Seara, by the incorporation of the new assets received from Brazil Foods which this quarter were only partially reflected in the results, by the good performance of the operations at Marfrig Beef which benefited from the improvement in cattle production cycle in Brazil and by the appreciation in the U.S. dollar against the Brazilian real in this period.

I'll now hand you over to Ricardo to make the presentation.

Ricardo Florence dos Santos {BIO 18071813 <GO>}

Thank you, James. Well, this quarter I would say it's roughly the result of the continuous work that they have done in improving the operations here in the integration of the assets that we brought on Board in the Seara division. We are presenting now the beginning of the results that we are sure that they will make in the future.

Regarding the results, for the total of the company, first I'd like to mention an improvement that we had in the gross profit comparing the third quarter of 2012 to the same period in the last year, we improved by 21% gross profit to R$990 million and at the same time we improved the gross margin by 100 basis points in the same period to 15.7%.

EBITDA margin. Total EBITDA was R$550 million, do not considering the other operational income and expenses, the adjusted EBITDA is R$514 million in the second quarter which is 19% higher than the EBITDA that represented adjusted in the same period in the last year. At the same time, the adjusted EBITDA margin was 40 basis points higher and we achieved 8.2% in the same period. We presented a net income of R$10 million improving the accumulated figures in the year to R$60 million or R$0.17 per share of Marfrig so far.

Operationally, the cash generation achieved R$132 million. This already excludes the discontinued operations of the asset sales that we did in the first quarter of the year. The leverage ratio, net debt to EBITDA in the third quarter was 3.93 times. This includes the pro forma of the previous marks in the acquired units, miles, the company that is sold in the same period. This is down from the 3.5 times in the prior quarter mainly because of the higher utilization of working capital because of the grain price increase, because of the inventory that we have at the end of the quarter, that's destinated to the Christmas season and also because of the new assets that we brought on Board in Seara and the working capital that is related to debt.

One of our goals it remains on target that is in the quarter, the participation of the value added products reached 45.6%. At the same time that we succeeded in the price increase to customers because of the grain price increase. We had an increase of 14% in the average price and specially in the value added products in that we reached at 24% increase, compared to the previous year.

Going to the page number three, the revenue by products. I would like to make some comments here mainly on the growth of processed products that reached 39% between the third quarter of 2011 and 2012 while the total revenues grew by 14%. Seara Foods grew by 22% while Marfrig Beef focus in the profitability, focus in margins was stable in revenues in the same period.

EBITDA margins I already did some comments on that on page number four. Adjusted EBITDA margin in the quarter was 8.2% higher by 40 basis points compared to the same period in the previous year and by 30 basis points compared to the previous quarter. And again, it was on a positive quarter that we had the chance to present. Regarding the capital structure management, the company was very focused in keeping the participation of the short-term debt in a total debt of the company and in the reduction of the average costs that we had. We achieved the goal. The short-term was kept at the level 26% same level that we had in the previous quarter, while we reduced in the same period the average cost of debt by 16 basis points to 7.82% between the end of the third and the end of the second quarter of 2012. We had also an increase in participation of the debt in the Brazilian currency by 1.2 percentage points on the total debt from 24.3% to 25.5%. This is a consequence of the reversion of the sleek interest rate in Brazil that's now at the level of 7.25%.

In total, we rolled over R$1.7 billion in the quarter, of which 100 billion of them were in Brazil and 700 million were in the units that we have abroad. We continue to be committed in the reduction -- long-term goal that we have is to be between 2 times and 2.5 times. And we remained committed with the continued reduction on this area despite of some seasonality that we may have depending on the quarters. In this quarter, and that represented a positive cash flow from operation -- for operational activities of R$132 million. The delaying in this quarter was the increase in the grain prices. In total in the working capital changes, it was negative by 355 million and also because of higher inventory that we had in the products that are being already prepared like the Turkey meat is one of the examples that are being prepared since the month of June to be sold only during the Christmas season and also the new units that are now operating in Seara.

Regarding the leverage of the company, EBITDA pro forma in the last 12 months was R$2.36 billion without considering the pro forma 2.25. The leverage grew to 3.93 times compared to 3.5 times that it was in the previous quarter. This is considering the LTM pro forma EBITDA.

Regarding the capital expenditures that we have in the period, we reduced a little bit investment in fixed assets compared to what we had in the previous month. But, one of the investments that I would point out in this quarter was investments in the new distribution center on -- in the São Paulo state that's very close to the São Paulo here, that I believe we will improve the logistic operations of the company together with the eight distribution centers that came with the asset swap that we did with the Brazil Foods.

We also had in the quarter R$89 million on investments in breeding stocks in addition to close to R$95 million that it is the payment of acquisitions that we did in the past like the 30 mid plant that we acquired from Doux Frangosul almost two years ago. The final payment was now and also the payment that we did to BRS in the quarter are some of the examples. And all this amounts comprised the total of R$301 million of net cash flow in this quarter.

I now will pass again to James to talk about the Marfrig Beef.

James David Ramsay Cruden {BIO 15363978 <GO>}

In the Beef division, our gross income grew 22.3% in third quarter 2011 to reach 432.2 million with gross margin expanding 420 base points to 22.1%. Our adjusted EBITDA of 236.8 million is up 28% from the third quarter 2011 with adjusted EBITDA margin expanding 270 base points to 12.1%. The Brazilian operations ended the quarter with capacity utilization at France in operation, of 74% and sales volume growth up 12.7% up on second quarter 2012 driven by slaughter volume growth of 9.7%. We had an increase of around 50% in the share of higher value products and the segment's totaled revenue compared to the same period last year. Average cattle price is down 22.6% in Brazil and 6.9% in Argentina and Uruguay on the third quarter of 2011.

Revenue by operation is relatively stable. Brazilian domestic market leads where our sales volume is highest and then followed by Brazilian export. On revenue, Brazilian Beef or Fresh Beef is around 60% on a regular basis, processed products around 20 and others at 20% as well. Export by destinations. The Europe is our main destination, around about 35%, followed by Asia, Middle East, Central and South America. For the third quarter of 2012, we maintained 11.4% of the Brazilian slaughter which was up against the same quarter of 2011. On exports, we've seen a slight reduction in our percentage from 16.4 in the same period of 2011 to 13.2 in the quarter. However that is compensated by an increased volume of sales on the local market. Our adjusted EBITDA margin is relatively static when compared with the second quarter of this year, up from 11.7% to 12.1%. The improvement in margin is reflected by the improvement in our operational performance.

I'll now pass to David to talk about the Seara Foods?

David Alan Palfenier {BIO 17536438 <GO>}

Good afternoon, everyone. Seara Foods also had a very good quarter, R$4.3 billion of revenue, up 22% versus prior year. It is driven both by mix as well as by pricing. As we've been talking to you over the months on our strategy, this is just the continuation of that direction. This drives adjusted EBITDA up nearly 13% first prior quarter despite the impact of the grains, we'll talk a little bit more about that later. And a slight gross margin expansion, 150 basis points over Q3 of last year 12'.

From the operating side, one of the drivers of the improvement in EBITDA and also in margin is the continuing increase of share of processed products. So it's 51%, 58% from the same quarter a year ago. Similarly, our average price is up in total 16.8%, but in the higher value added products up a full 24% versus prior year.

A dramatic increase in domestic volumes in Brazil, up 55%. This is some in due to the new efforts from BR Foods which is somewhat ramping up, but also just baseline organic growth of the base contribute to that as well. And one of the drivers of the organic growth is the fact that we've nearly now doubled our distribution versus Q1. We are now in 55,000 customers versus 28,000. So almost the 2x increase in distribution and that's obviously driving a lot of this volume growth as well.

Moving page 15, talking a little bit about the the breakdown of the top-line. First of all by operation, you will see that the dramatic increase in the internal market in Brazil, the domestic market. That again is partly in part the new acquisition of Seara Foods, but also for the organic growth that we were just discussing. By product line there you can see again the evolution of the further process business as we discussed before. And then in our exports market we continue to shift our volume out of Europe towards the Middle East and towards Asia, which records our faster growing markets and that's also the part of the strategy we have been discussing with you over the past several months. The top-line is in a lot of ways a reflection of the strategy we've been talking about over these last several months.

Moving to page 16 talking a bit about market share. So, as you can see from the graphics, what we've done is we've added the shares in case of the frozen meat products, June, July shares of the brands we've acquired with our own shares. And so that's explaining almost a seven point increase in market share on frozen meat. And then in the area of processed meats, same thing except the July, August report there. There are different timing showing a 3.3% growth on that same basis.

Speaking of share in the export markets, a bit of a different story, whereas shares are up and the internal market shares are down in exports for two reasons. The first reason and the primary reason is discipline. As you know, costs have gone up significantly higher than the prices have gone up for chicken and pork. Therefore, we've consciously then pulling back volume and obviously by these charts more than our rest of the Brazilian export is out. Same thing goes for pork and we're going to continue to be disciplined in the way we look at the export markets if pricing doesn't respond further and costs don't come down, we'll be content with the lower share but we're not going to chase bad volume.

And this is one of the several of the factors that affects on page 17 and the adjusted EBITDA numbers which by rights given the cost of grain ought to be down dramatically, but several factors in our favor I just mentioned the discipline in the export has been one driver. We've also got some currency help as you know more product business are based in non-real currencies. And so we've got some lift there. We also have pricing across many of the businesses. The process mix we talked about, the shift to the internal market we talked about. What we haven't mentioned are some significant cost reductions and operating improvements that are also helping us offset the increased of the grain costs. So several factors that have helped us balance P&L in tough times.

I'm now going to go to page 18 and just summarize overall Marfrig for you, and what our priorities for the balance of the year. In terms of our performance obviously very, very good scale gains at Marfrig Beef as we gradually increased our production capacity. Increasing the share of prepared and process products both in Beef as well as in Seara Foods specially with the Seara Foods' assets coming to Brazil continuing to grow significantly our business in Brazil and China. And then the other priorities obviously as you know we are committed to lowering our financial leverage, working to reduce working capital and capture synergies in Seara Foods and then improving the capital structure by reducing our indebtedness overall. So these are the priorities that we'll be looking at for the balance of the year and as we go into 2013.

With that we'd like to open it up for questions.

Questions And Answers

Operator

Excuse me, ladies and gentlemen, we will now begin the question--nd answer session. [Operator Instructions]. And our first question comes from Wesley Brooks with Morgan Stanley.

Q - Wesley Brooks {BIO 16407564 <GO>}

Afternoon guys

Couple of questions from me. The first one just around the integration of the Brazil Foods' assets and how far long that was during the quarter. I remember speaking with you guys and it sounded like there were some issues in the first part of the quarter, but you had really strong results. Can you give us some idea where you think you could have had your EBITDA, had you had those assets running flat out for the whole quarter, please?

A - James David Ramsay Cruden {BIO 15363978 <GO>}

Yes. So as you know we started integrating the first five facilities in the June and then we added two more in July and three more in August. So those plans obviously were not fully up and producing for all three months of the quarter. We're in a bit of a bind here with our trigger silence to give you a kind of projections of where things could be in the fourth quarter. Now there are things running but I would say probably, I would say another maybe 30% or 40% better than Q3, that's what we could expect out of the BR Foods assets. We will continue to ramp up through the quarter go not so much now driven by manufacturing facilities, but rather driven by logistics and increasing our distribution, that is now the ramp up. It's no longer operating ramp up from a manufacturing point of view.

Q - Wesley Brooks {BIO 16407564 <GO>}

Okay. Thank you. And my other question was around the equity offering that you've announced today. Do you have any thoughts on what the interest savings -- your net interest savings would be, following the deal and where your leverage would be?

A - Ricardo Florence dos Santos {BIO 18071813 <GO>}

Wesley, I'm afraid that we are a little bit risk frighted in making some comments on those. But I believe that the most part of the elements you have there to do the calculation by combining the material fact with the average costs that we have in our debt that by the way, as I mentioned during the presentation, we did a reduction on them again. Of course, it makes more sense always for the company to pay the most expensive debts. This means that this has been an effort. It would be a question to do the calculation in a potential reduction of the debt multiplied by interest rate of 8% or higher.

Q - Wesley Brooks {BIO 16407564 <GO>}

Okay. Thank you very much guys.

A - Ricardo Florence dos Santos {BIO 18071813 <GO>}

You're welcome.

Operator

Excuse me. Our next question comes from Eric Ollom with Citi.

Q - Eric Ollom {BIO 4374335 <GO>}

Yes. Hi. Good afternoon everybody. Could you just give us a little bit of color on the timing and the magnitude of the price increases to come in the fourth quarter? And could you just -- you talked about the debt repayment under this equity offering. It would all go to debt repayment or is there a portion that would just be held in cash or can you comment on that?

A - David Alan Palfenier {BIO 17536438 <GO>}

I think I'll take the first one and Ricardo can take the second one. So, I would say that the pricing that we are putting into the market on a list basis is, there is still a bit more that we're looking for, far more in export than in Brazil. However, not all the pricing that we have put into the market has actually taken hold yet. So, what you will see is a combination of the finishing off the list price increases plus the volumes sold at the new prices that we've already been getting in. So it's difficult to sort of call what that is in total, but it will be some combination of additional modest list pricing and then a fair a bit more as our current list prices get in. We have put in five or six list price increases in the last six months. So it's been -- there is a laddering effect of these they can take hold so that's so much difficult to project.

A - Ricardo Florence dos Santos {BIO 18071813 <GO>}

Eric, taking the second, you know that CPM Brazil has very stringent roles for the company to make any comments after filing that. But, just to bring you some color on that about what has been our strategy in the reduction of the debt, it has been almost always to be what is the short-term portion of the long-term debt. This usually is the one that has the highest interest rates and I believe that we can do better. This is what we have done in the strategy that we have had so far. By the way, I believe that this is the fifth consecutive quarter in that we've succeeded to decrease the average interest rate that we have in our debt. I'm sorry for do not giving you a more complete answer because of the restrictions that we have at this point.

Q - Eric Ollom {BIO 4374335 <GO>}

No, no that's fine. I understand. Thank you and good luck.

A - Ricardo Florence dos Santos {BIO 18071813 <GO>}

Okay. Thank you.

Operator

Excuse me, our next question comes from Luciano Coster with Credit Suisse.

Q - Luciano Coster {BIO 20318475 <GO>}

Hi. Good afternoon and thank you for the call. Most of my questions have been answered. I just wanted to ask, I'm sorry if I missed this earlier, I dropped off the line. Do you have any idea of what your CapEx will be going forward especially considering roll outs that you have in the Seara Foods business? Thanks.

A - Ricardo Florence dos Santos {BIO 18071813 <GO>}

I'll speak for Seara and then maybe, James, you can talk about what you guys want to be.

For us, we're going to have I'll say continuing CapEx for these biological assets that we have. We don't see anything materially changing there. On the infrastructure CapEx lever, we actually were hoping CapEx spend in the beginning of the year because we knew the brief results with assets were coming. Remember that these assets, these processed assets they are, we got more than assets than the volume of the brands we acquired because the -- agreement created extra capacity for us to be able to occupy the space of a couple of the BR Foods' brands that are being suspended for three years to five years.

So, one of the nice things about this asset swap is we actually got processed capacity in addition to the volume that we got from themselves, that in a way, balances out our, some of our growth CapEx needs so that we should be able to show the growth that's in our strategic plan without as much commensurate investment in CapEx.

A - James David Ramsay Cruden {BIO 15363978 <GO>}

On beef, Luciano, we don't have anything different from this year, which basically bows down to maintenance CapEx.

Q - Luciano Coster {BIO 20318475 <GO>}

All right. Thank you, guys.

Operator

Excuse me, our next question comes from -- with Blue Bay Asset management.

Q - Analyst

Hi. Good afternoon. Apologies if these questions are already been asked. But, just in terms of the rights issue, I mean, I am assuming it's not underwritten. Is that correct?

A - David Alan Palfenier {BIO 17536438 <GO>}

Say again please, if it's about the prospectus that we have filed this morning, we are restricted about doing comments.

Q - Analyst

Right. Okay. And the second question I had was just in terms of the -- in your statement you mentioned that the BNDS would look to convert some of its convertible debentures. I'm just wondering how that mechanism would work and what the potential dilution could be there?

A - David Alan Palfenier {BIO 17536438 <GO>}

Again, I'm sorry about answering in the same way. But, this information, please, for all of you that go to the web page of the company, it is included in the material fact. If you go to the prospectus there, that's a complete section about dilution and what could happen there. Please visit again for that.

Q - Analyst

Sure. And then the final question I had, are you still potentially looking to sell a minority stake in Seara or is that off the cards now?

A - David Alan Palfenier {BIO 17536438 <GO>}

We do not intend to sell any stake of any asset that's core for the company. What we might do at a certain point, it is to sale of a non-core asset which is the case for instance of the parts of the -- that was during the quarter this call, but that's it. No news about anything else with this.

Q - Analyst

Right. So you wouldn't be open to somebody buying like a 15% stake of Seara or something along...?

A - David Alan Palfenier {BIO 17536438 <GO>}

We do not have the any comments that, I'm sorry.

Q - Analyst

Okay. All right. Thanks a lot.

A - David Alan Palfenier {BIO 17536438 <GO>}

You're welcome.

Operator

Excuse me, our next question comes from Christina Ronac with Gleacher.

Q - Christina Ronac {BIO 6623815 <GO>}

Hi. Regarding the news on the accounting restatement I just noticed just on your leverage calculation you excluded to 2.5 billion convert, you exclude the leases note payable and you're also using the unadjusted EBITDA. So, I'm just wondering are you going to -- besides adding that convert as debt on your balance sheet, are there any other adjustments CVM is asking you to do, would be my first question.

And second question just giving the lag in grain and corn and soy, what kind of -- can you give us any idea of the headwinds you expect in fourth quarter due to that? Thank you.

A - Ricardo Florence dos Santos {BIO 18071813 <GO>}

Regarding to your first question, let me make the comment on that. The reclassification was only to bring from the reserve of capital into shareholders' equity to the non-current liabilities of the company. This is not debt and will never be debt. It's the nature of the instrument, only can be converted into common shares of the company under any circumstances. That's what we stated in a material fact. What we are following is based on the recommendation of CVM according to the CPC 39 in Brazil. This does not change the understanding of the company is that this do not -- can not be considered at any circumstance as debt in the company.

Christina if you could please just repeat your second question, please?

Q - Christina Ronac {BIO 6623815 <GO>}

Yes. Just given the nature of the input costs at corn and soy and given that it's a lag and you may have had corn running at the second quarter. Is there any headwind you see on that for fourth quarter?

A - James David Ramsay Cruden {BIO 15363978 <GO>}

Yeah. We, obviously, as the grain costs went up, we shortened significantly our position. We've gotten pretty low in terms of the days. So we're now converting corn to sales and corn and soy to sales in fewer than 60 days, 55 days. So the bulk of what we think is coming in the fourth quarter is pretty much already on hand. There could be a modest hit to the quarter, but I think the bulk of it we've already seen.

A - Ricardo Florence dos Santos {BIO 18071813 <GO>}

Yes. This is for Seara in Brazil and you've got only two component. The policy that we have had in the other countries and you have operations is to operate continuously with the hedge. For instance, just to give you an example, In U.S. we are hedged in 75% of our needs in corn for the next year 2013, 25% already for 2014. I mean, depending on the factors that we have in the operation and the -- on which is the area in that you have the operation for instance in the foodservice, this has been our policy. In other ways, in other countries like the UK, we operate more with the future contracts that also provides us very good coverage and to be protected against any fluctuations there.

Q - Christina Ronac {BIO 6623815 <GO>}

Thank you.

A - Ricardo Florence dos Santos {BIO 18071813 <GO>}

You are welcome.

Operator

Excuse me, our next question comes from Sam Ray with JP Morgan.

Q - Analyst

Hi. Good afternoon. Thank you for taking the question. This is Sam from Alan's team at JP Morgan. The question is like, could you please elaborate what led to the double-digit decline in Brazilian Beef volumes, and how are you seeing demand in the domestic and the exports market going forward for us to like share your outlook for beef volumes going ahead? Thank you.

A - James David Ramsay Cruden {BIO 15363978 <GO>}

Sam, the reception wasn't very good here but the question was about the beef, was it?

Q - Analyst

Yes. It's about beef volumes. What's your outlook going forward and growth in the domestic and the exports market in your views. And if you could also elaborate what led to the double-digit beef volume decline in the quarter for Marfrig?

A - Ricardo Florence dos Santos {BIO 18071813 <GO>}

Well, we, because of the origins of the company, we always tend to concentrate obviously first on where the greatest margins are. We are always very focused on local market, on the domestic market. We see with a lot of confidence, the domestic market and our domestic market isn't a business where we're dealing just with supermarkets and the larger retailers. We have an enormous distribution business which has added to it all the distribution assets that came with the offered swap. We -- the domestic market is strongest in the second six months of year rather than the first six months of the year. So at the moment we are in a particularly strong period, you will see that our export volumes reduced in the third quarter when our slaughter volume went up in the same quarter.

We see strong margins in the local -- market and we believe that we will continue on a more even way beginning of next year. Last year, or the beginning of this year, the end of last year was off to the start of, should we call it, the world financial crisis. So, there was a lot of concerns should we say from the consumers about where they were spending their money.

Now, we have a different panorama now. We believe that we need to concentrate on the domestic market to have a solid base for our business. What we are seeing is a cattle cycle where there is a steadily increasing availability of cattle and that's steadily. I'm not talking about something massive from one day to the next. But we would expect to see a further increase in our slaughtering in the last quarter of this year and exports will be relatively stable. I think it's the way we will put it and we could see the domestic market increase as a percentage yet again.

Q - Analyst

That's very clear. And if you were to give us a guideline with respect to if there was an export demand and you have to guess like from where it could be coming, which would be your top destination where you think that the incremental demand for beef would be coming in the next 12 months?

A - Ricardo Florence dos Santos {BIO 18071813 <GO>}

Well, we are seeing a stronger demand for the type of cuts that we export from Brazil, Argentina and Uruguay which is more expensive cuts to the EU. The EU for these kinds of products has a strong demand at the moment. The other markets, Russia -- Russia is Russia but it continues to buy beef and then we have all the North African countries and particularly at this moment, Egypt, are all strong buyers of beef.

Q - Analyst

Got it, that's pretty clear. Thank you so much for the answers. All the best.

A - Ricardo Florence dos Santos {BIO 18071813 <GO>}

Thanks Sam.

Operator

Excuse me, our next question comes from Ivan Fernandes with Barclays.

Q - Ivan Fernandes {BIO 22125325 <GO>}

Hi. Good afternoon guys. I have couple of questions. One is the follow-up to something that was to answer just given now, on the Portuguese call you guys mentioned that the grain cycle is about 15 days and just now you guys said 55 days to 60 days, so I wanted to confirm which one is it?

A - James David Ramsay Cruden {BIO 15363978 <GO>}

Yeah, sorry just to clarify, the grains themselves that we're carrying in stocks are running around 13 days to 15 days. The total cycle because that has been -- then we start feeding the broilers as another 40 days or so. So, you get that's total effect. The grains we have in stock plus the time in which the chicken ingredients, so that's the two numbers.

Q - Ivan Fernandes {BIO 22125325 <GO>}

So the number that shows up on the income statement is typically a 60 day lag from -- in terms of where the price was when you purchased it? Is that the way to interpret it?

A - Ricardo Florence dos Santos {BIO 18071813 <GO>}

Typically no, typically it would be larger than that. That is the effect now because we've worked to reduce the impact on working capital.

Q - Ivan Fernandes {BIO 22125325 <GO>}

Sure. Understood. And the second question I had is that if you could elaborate a little bit on the differences between the supply and demand condition in the domestic market versus the export market given that you've been able to put price increases through in the domestic market, but not so much in the export market?

A - David Alan Palfenier {BIO 17536438 <GO>}

Yeah. I think, I will start with the internal market here inside Brazil. What's happening is base consumption is still moving faster than GDP here by a fair amount and that's actually going to be typical of most of the emerging markets because, as people -- and I'm talking about the mass population. Therefore, pushing income ability increases. Food, especially protein is benefited more so we're seeing that in Brazil. Some of the syndicated data is actually showing a traction in consumption, but, that's really more the removal of the businesses, BR Foods that were suspended, industry has not been able to keep up with it but the fact that there is all that pent up demand that we're able to meet is why pricing is going through I think at the rate at which it is. So, there is both an underlying consumption driver, as well as just momentary gap in the market from the suspended brands.

In the export markets, quite honestly I just think we and the Brazilian chicken industry we're just not as disciplined as our friends in the United States. And we need to be more disciplined. And so when we're backing out and loosing market share in exports, we're trying to send a message that this is a better way to do business. It's been responsible for us having less of an impact of this whole grain issue in our own earnings. And I think others in the industry would do well to file a suite. But, until we all let inventory levels come down and start chickens out there, pricing is not going to move where each go happily.

Second quarter pricing was better than first quarter and third quarter pricing is better than second quarter. So I'm optimistic that maybe fourth quarter we'll start seeing some reasonable pricing there, but it's taken way longer than it should have. I don't know if that answers your question, but that's what I'm seeing.

Q - Ivan Fernandes {BIO 22125325 <GO>}

No, that's very good. Thank you. And then just want a follow-up to your first answer. So, if it takes about 60 days for the grains to flow through the income statement, then doesn't that mean that for most of July and August, you were working on grain prices that were basically purchased towards the end of the second quarter which was before the rising prices and that only September was really impacted by the higher grain prices. And therefore I would expect fourth quarter results to be weaker. Where am I wrong in that? Thank you.

A - Ricardo Florence dos Santos {BIO 18071813 <GO>}

Well, so the pace of the impact was actually little more aggressive than what you said, but it was a ramp up to your point that that's accurate. But pricing has also been ramping up in parallel. And that's really the secret here. It's the combination of what is happening to our costs, but what is happening to our pricing, and then what is happening to our continuing improvements in yield and conversion costs in the field and other initiatives that we've been developing which help explain why the impact isn't as severe as you might have expected it to be.

We've got significant gains in operations. Nothing different than that what we've been talking about in the past with you all on our various calls and meetings. I mean the strategies are coming to place and we're just seeing it with a little bit better ability to react to respond to the grain hits than we would have been, had we not made those operating improvements. So it's a series of factors that explain why the flow through hasn't, earnings hasn't been better. As you know, we are still trying to get pricing, we are still working on further operating costs. So that's why when we say that we think the bulk of it's behind us, we don't mean that there is not going to be some additional impact to Q4, but we will also have additional impact to pricing and our cost saving. So, that's I think the right prospective.

Q - Ivan Fernandes {BIO 22125325 <GO>}

Okay. Thank you very much.

Operator

Excuse me, our next question comes from Wesley Brooks with Morgan Stanley.

Q - Wesley Brooks {BIO 16407564 <GO>}

Hi, guys. Just a follow-up from me and I got cut off at some moments. I don't know if you might have answered this already but these payments for past acquisitions, can you just give us an idea of what the balance lift that needs to flow through the cash flow statement is of all of them combined, and when we should expect those to flow?

A - Ricardo Florence dos Santos {BIO 18071813 <GO>}

Regrading to the payments to Doux Frangosul, they ended. It was the last one. Regarding to the payments that we had for the contingent payment for the OSI Group related to the acquisition of Moy Park. There is only one more quarter, that's this one -- that's the last one and the payments for Brazil Foods, we still have a long road to go, I mean because the financials -- but that said, this is what we have certainly.

Q - Wesley Brooks {BIO 16407564 <GO>}

Perfect. Thank you very much.

A - Ricardo Florence dos Santos {BIO 18071813 <GO>}

You're welcome.

Operator

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

A - David Alan Palfenier {BIO 17536438 <GO>}

Well, would just like to say thank you to everyone who is on the call. Thanks for following us, especially those who follow us regularly. We ask for your understanding on some of the questions we were not able to answer given we're in a silence period here. Obviously these things will clarify in coming weeks.

So appreciate your patience on that and any follow-ups you have separately of course we're available for anything that we can do to help. So thank you very much. Have a good day.

Operator

That does conclude Marfrig's third quarter 2012 conference call. Thank you very much for your participation and have a nice afternoon.