Q4 2015 Earnings Call

Company Participants

- Augusto Ribeiro
- José Alexandre Carneiro Borges
- Pedro de Andrade Faria

Other Participants

- Alexander Robarts
- Andrew Muench
- Jeronimo De Guzman
- Jose J. Yordan
- Lauren Torres
- Luca Cipiccia
- Pedro Leduc
- Thiago Kapulskis

MANAGEMENT DISCUSSION SECTION

Operator

Good morning ladies and gentlemen and welcome to BRF SA Conference Call to discuss Fourth Quarter 2015 Earnings. This conference call is being transmitted via webcast in our website www.brf-br.com/ir. At this time, all participants are in a listen-only mode and after the presentation 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.

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.

This conference will be presented by Mr. Pedro Faria, Chief Executive Officer; and Mr. Augusto Ribeiro Jr., Chief Financial and Investor Relations Officer.

We now hand the call over to Mr. Pedro Faria, who will begin the conference call. Mr. Pedro, you may begin.

Pedro de Andrade Faria {BIO 15115819 <GO>}

Good morning, ladies and gentlemen. Thanks for taking part in today's teleconference. I am very pleased with the results we're presenting for this quarter, particularly as far as our international regions are concerned. These were the results of our international expansion strategy, implemented over the last three years which was intensified during 2015 both in terms of acquisitions and improving our operation efficiency.

We had good results in 2015 with net revenues totaling R$32 billion, 11% higher on an annual comparison. Despite the fall of 4% in total volume year-over-year, we managed to improve our mix of products and markets. As a result, our total average price rose by more than 16%. For its part, our EBITDA came to R$5.738 billion in 2015. With a margin of 17.8%, our ROIC rose to 13.2% from 11.7% in 2014.

Another highlight in our results was the free cash flow generation that came to a total of R$3.4 billion. The strong operating cash generation in 2015 combined with the divestment of our dairy segment which brought R$2.1 billion easily financed our entire CapEx program of R$2.1 billion, a share buyback program amounting to R$3.7 billion, and acquisitions of around R$314 million.

Thanks to this, I am satisfied to announce that we have distributed over R$1 billion in dividends and interest on equity to our shareholders. Even then, our company ended the year with R$8.5 billion in cash and equivalents and a net debt of EBITDA ratio of 1.28 times.

The increasingly more global operation combined with a strong balance sheet ensured BRF to keep its BBB credit ratings, maintaining our investment grade. The fourth quarter was marked by one of the biggest inorganic growth movements the company has ever experienced. We announced three acquisitions in three different regions amounting to approximately $500 million. This shows that we are reinforcing our strategy of globalizing our operations and moving increasingly closer to the final consumer.

In Asia, we acquired Global Foods Siam (sic) [Golden Foods Siam] (04:12). This company is the third largest producer of cooked value added items in Thailand, which adds a higher added value portfolio to compliment BRF and reinforces our presence on important markets such as Japan and the UK

In the UK, we acquired Universal Meats, strengthening our distribution and presence in the food service segment. The Universal operation combined with Invicta, BRF and Golden Foods Siam operations put us in a heavyweight position on this market. We also signed a binding contract in Argentina to buy Campo Austral, a verticalized hog production company with strong brands in the cold meat category. These fit in perfectly with our processed product brand portfolio in Argentina.

In line with our global growth strategy, we moved ahead our organization model which is based on growing the centralization and presence in the region. It is against this backdrop that we made an announcement to the market yesterday on a change in our organizational model in which Africa, given its growth potential will become a region with the same autonomy and structure as others.

In another strategic movement, we aim to bring together in a single vice presidency, the processes of innovation and product positioning. Under this model, the former VPs of marketing, innovation and quality will become integrated. As a result, the strategic pillars of brands, quality and innovation will be interlinked within obligatory way under the leadership of Rodrigo Vieira. Besides this, we are continuing to invest in appreciating our main asset which is our people. We have thus chosen Alex Borges as our new VP of Finance after winning cycle in-charge of Latin America.

Given the importance and complexity of the Brazilian market, we are strengthening our team substantially. We are promoting Rafael Ivanisk who was our Commercial Executive Director to assume the position of General Manager of Sales and Marketing Brazil. At the same time, we're bringing Leonardo Byrro to assume the position of General Manager of Planning and Distribution.

Looking now at Brazil operations, we see that 2015 was marked by the return of Perdigão in two of the most iconic categories. This was a very important breakthrough for BRF as it gave us the opportunity to finally carryout in an integral way the position of Brazil's two leading food brands. Now, with an almost complete portfolio, we are strengthening our presence in the sales channels and to consumers which give us more resources and flexibility to better pass-through the moment of economic slowdown in the country, Brazil.

A look at the performance of the categories that have returned shows there has been a good increase in volume. The latest market survey figures show that for the second half of 2015, there was an increase of 18% in our total volume of cooked ham and 10% of smoked sausages product, compared with the first six months of the year. This growth reflects a gaining market share as these two categories grew only by 0.96% and 4.26% respectively in the same period. This highlights BRF's trends when it puts its two main grades forward.

Still on the market share from this management report on, we have decided to divide the presentation of processed products into chilled and filled items since they are different in terms of importance and strategy for us. As far as frozen products are concerned, we have decided to focus on readymade dishes, lasagna and branded items for instance, which are the most important products of the mix.

Considering this new way of looking our market share, the latest news and survey show that BRF market share was 63% in cold meat, 41% in field products, 64% in readymade dishes and 67% in margins. This shows that we are holding on to our undisputed leadership position in most of our relevant categories. I'd also like to say something interesting about the results of our commemorative campaign in 2015 which were very important for our results in the quarter. This led to an increase of around 5% in volumes and we won market share, even against the challenging economic backdrop. It was by far the best performance in the last three years.

This result only came about due to the following combination of factors; focus on execution, sense of urgency, optimization of sales management, strong connection between our brands and the consumers, all these elements are an inherent part of our company and contribute to BRF trends.

We should also highlight the progress we made with the sales team in the fourth quarter. We unified the sales force which now consists 100% of BRF sales people that sell everything that is in our portfolio. We also moved into the second stage of go-to-market that will now focus on segmentation and return. This initiative will help us reduce the cost of serving customers and increase the sales team productivity, allowing us to give the client an even higher level of service.

Looking at the international regions, we see that Middle East and Latin America were the highlights of the quarter. We harvested good results in Middle East in the fourth quarter 2015, thanks to our conscious efforts to make advances along the value chain, strengthening our structure in the region. As a result, even faced with worsening situation in Africa and in most of the RF world outside the Gulf, as a result of macroeconomic problems and liquidity shortage in the region, we managed to expand our EBIT margin by more than nine percentage points over the fourth quarter of 2014 (10:24).

The Latin American region was consistent in its strategy of recovering profitability and there was a 5.5 percentage increase in the EBITDA margin this quarter over the previous year. In Argentina, we worked hard the brand portfolio and products, successfully re-launched Paty, a brand that is synonymous with hamburger in Argentina improving the quality and the presentation of the product even further, consolidating our indisputable position as the market leader.

We also acquired in Molinos brand, such as GoodMark, Manty and Vieníssima. This started to appear in our results from December onwards. Still in Latin America, we are aiming to enter and develop new markets in the Americas. As a result, we're already seeing higher volumes and increasing growth trends in the Caribbean and Central American countries.

In Europe, we increased the margins, thanks to the better mix of products and channels. This was a result of the consolidation of Invicta in the UK and the greater customization of our portfolio. On the other hand, Eurasia continued to put negative pressure on the results, particularly our export of basic pork cuts due to the worsening of the macroeconomic situation in Russia.

In conclusion, let's have a look at Asia where we were impacted by higher inventories in some of the markets and the temporary interruption of imports from one of our plants. As a result, our volumes fell 7% in the quarter over the same period of last year. Nevertheless, we are making a number of strategic movements in order to reduce the volatility of the margins such as the acquisition of Golden Foods Siam in Thailand, expanding to new markets in Southeast Asia like Malaysia and Myanmar, and despite this our EBIT margins remain very solid and we're above 15%.

I will now hand over to Augusto Ribeiro who will talk about the financial highlights about fourth quarter 2015.

Augusto Ribeiro {BIO 18485971 <GO>}

Thanks Pedro, and thank you all for being with us this morning. As Pedro has already said, we are very pleased with the results we are presenting today. I'd like to reinforce some of the important financial figures in the fourth quarter of 2015. The consolidated net revenues in the fourth quarter of last year rose by 11% year-over-year and came to almost R$9 billion, boosted mainly by the prices that were 17% higher. The cost of goods sold came under pressure in the quarter, mainly as a result of the currency variation on prices of grains, packaging and input and expanded by around 16% over the previous year.

For its part, the gross income came to R$2.8 billion, 4.2% higher on an annual comparison. However, there was decline of 2.1 percentage points in the gross margin of the previous year as a result of these higher costs.

Operating expenses rose by 15.42% in the year, boosted mainly by higher fixed expenses such as trade and marketing in Brazil and commercial expenses from the incorporation of distributors in the Middle East region. The other operating results line showed a positive figure of R$226 million impacted by non-recurring revenues of R$309 million. These revenues rose mainly from the accounting reclassification of Minerva to a financial investment available for sale that no longer impacted the equity income line and graded again of a gain of R$126 million as asset was market-to-market. There were also gains in the recovery expenses of R$149 million mainly from the legal case over compulsory loans with Eletrobrás and the recovery of the PIS/COFINS tax on input.

EBIT in the quarter came to R$1.9 billion, 7% higher year-over-year boosting the EBITDA margin to 21% in the period. It is worth mentioning that if we had adjusted the EBITDA by the non-recurring events in the quarter, would have had an adjusted EBITDA margin of 17.6%. Net income came in strong at R$1.4 billion, 43% higher on an annual comparison. It was positively impacted by Income Tax and Social Contribution line that came to R$255 million positive, bringing the net margin of 15.8%.

In terms of our CapEx, we're continuing to invest in the Footprint and automation project and investment in the quarter. We're focused on expanding and optimizing our chicken plant in Argentina. Our investments in the fourth quarter came to R$740 million bringing the total for 2015 of R$2.084 billion. This was a little higher than our guidance of R$1.84 billion, and was due mainly to the currency valuations. We expect to maintain the same level of investment of around R$2 billion in 2016.

Our financial cycle for the period came to 34.3 days, a change of 2.6 days over the previous year due to the continued effort by management. BRF cash flow came to R$3.4 billion over the last 12 months, 19% lower than the previous year. This was due to the higher CapEx and the increased demand for working capital due to the growth of our operations. As a result, we ended the quarter with net debt of R$7.3 billion. And as Pedro has already said, a net debt to EBITDA ratio of 1.28.

That's the end of my speech in my last conference call at BRF. I would like to thank you all for your attention and the good relationship we had built up over all these quarters. I would also like to welcome Alex and wish him good luck. I'm sure he will continue this job he has got underway. Thank you.

José Alexandre Carneiro Borges

Thank you very much, Augusto. It's a pleasure to assume this new challenge. I feel that I can bring a real contribution to this new position after my experience in leading one of our markets which gave me an important experience in operation and clear understanding of the challenges and opportunities that we have to accelerate growth in our company.

With that, I pass back the word to Pedro. Thanks.

Pedro de Andrade Faria {BIO 15115819 <GO>}

First of all, I'd like to say a big thank you to Augusto for these – years of working alongside him and for his dedication to BRF. I am sure that the enviable position we have today financially has been achieved due to a great extent to his excellent work. I also wish Alex, who has been my long standing friend and colleague, even greater success as our new CFO than he has achieved running Lat-Am operations for BRF.

Before ending our earnings call, I would also like to share with you some prospects for the coming quarters. We are facing simultaneous problems on the Brazilian market as a result of the adverse macroeconomic conditions and a tougher competitive situation. During the first two months of 2016, we have successfully implemented a realignment of prices in all of our sales channels, which led to an average price increase of around 10% and corrected the relative distortions between channels.

Obviously, this situation means we face an initial challenge in terms of the performance of volume, which is being counterweighted by hard work in the execution in the field. At the same time, we face a challenging situation in the international markets in terms of international price in dollars, resulted from oversupply in some of our operating margins.

This impact of the situation on our margins has been stronger due to temporary rise in corn price in South and (18:46) Brazil. However, we reinforce our confidence in the structural improvement of our business model on the international market which although would not leave us immune from these effects, will ensure our margins have a much healthier performance compared with time and company space where we have been in comparable cycles.

I would like to finish by reinforcing our conviction in our strategy and commitment to long-term value creation for our shareholders. The three of us myself, Augusto and Alex are ready for your questions. Thank you.

FINAL

Q&A

Operator

Excuse me, ladies and gentlemen, we will now begin the question-and-answer session. Each participant may ask only one question. Our first question comes from the Lauren Torres, UBS.

Q - Lauren Torres {BIO 7323680 <GO>}

Yes. Hi. Good morning, everyone. Pedro, if I could ask just one question, I guess I'd ask a somewhat high level or general question on your outlook for this year. It seems like hearing a lot of companies that are reporting and talking about 2016, are talking more about focusing on what they can control and what they can't, considering the volatility in the market.

So I was just curious to get your perspective on, once again, focusing on what you can control, why you feel in light of this environment and particularly with Brazil getting weaker this year, that profitability is in front of you. Is it more about the strength of international offsetting domestic weakness or you feel there's leverage to pull domestically that you really haven't pulled before that can stimulate some better growth on a year-over-year basis this year in Brazil?

Once again, a general question, sorry for that but just trying to get your thoughts on kind of building a better business this year and improving profitability?

A - Pedro de Andrade Faria {BIO 15115819 <GO>}

Thank you, Lauren. It's a pretty broad question but very relevant one. So as we head into the year of 2016, as we've said we have the combination of a more adverse scenario internationally which is this essence of this cycle. You know we cannot revoke the law of gravity. We cannot revoke the law of cyclicality in some elements of our business. So of course this is playing out more in the first half than in the second half. We have to all understand those cycles in our industry, they are pretty short-lived, usually a couple of quarters. But as we enter 2016, there is a challenge there and also Brazil economic situation, right. So these are the two, I'd call it, headwinds that we are playing out.

So, you are right. We are focusing a lot on the levers we have, one of them which is still playing out is our portfolio, a better mix of products and markets. This continues to strengthen the overall platform as you saw in the fourth quarter in which we generally posted, I think, very solid profitability, able to defend our margin. And also focusing a lot on internal levers as I mentioned in the call in Portuguese, we have our ZBB in full force, guaranteeing that our expense platform stays in control. We also have implemented a number of changes in the model we go to market in Brazil. Right now we have 100% of our sales force the BRF guys which has led to dropping the cost to serve.

And we are focusing on our innovation platform. I think that the year of 2016 will be marked by one of the strongest innovation and pipeline activities that I've seen in the

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company, at least since 2010. So these are kinds of the levers that we control. What I would like to take advantage of your question to say that cycles; they tend to be very short-lived. We're starting to see some early elements of that cycle playing out more concentrated in the first half and then we should go into a much better second half. This is our expectation.

In the meantime, it's really a game of defending our profitability. We are full force in the implementation of realignment in prices in Brazil, prices going up more than 10% in the first quarter as we had said in the third quarter. So really defending the profitability, strengthening the pockets of growth in the portfolio through acquisitions as we said, we launched three acquisitions in the fourth quarter alone. And focusing on a few bets that seem to be going really well for the company internationally like South Cone and Argentina which I think we're doing much better there as well as the Middle East.

Q - Lauren Torres {BIO 7323680 <GO>}

Thank you. And also if could thank Augusto (23:56). Thank you.

A - Augusto Ribeiro {BIO 18485971 <GO>}

Thank you, Lauren.

Operator

Our next question comes from Luca Cipiccia, Goldman Sachs.

Q - Luca Cipiccia {BIO 6914452 <GO>}

Hi. Good morning. Good morning, Pedro, Augusto, Alexandre. Thanks for taking the question. I wanted to follow-up first on some comments on the earlier call on the price increases in Brazil. I think you said 10% since January. I wanted to get maybe a bit more direction on how we should model that considering the sequential change in mix relative to the fourth quarter with Christmas-related sales and all of that?

And to add as (24:32) the shift maybe it's also happening in the portfolio with Perdigão gaining or becoming more relevant part of the mix. When we talk about 10%, I assume that is on like-for-like price increases, but on aggregate what's the right way to think about the first quarter, that would the first?

And then very quickly the second, just on the international expansion. Last year was very active number of transactions. Where does inorganic growth, in international markets, stay today on the priority list? How should we think about that? And where are the gaps potentially where you think you could still do opportunities acquisitions? And also, do you think with all that's going on, with several of the challenges expansion has already occurred, you have the organizational platform and let's say management bench to continue expanding and handling more assets (25:30) in the international business for now at least? Many thanks.

A - Pedro de Andrade Faria {BIO 15115819 <GO>}

Luca, thanks for a very lengthy question.

Q - Luca Cipiccia {BIO 6914452 <GO>}

Sorry.

A - Pedro de Andrade Faria {BIO 15115819 <GO>}

I'll try to start from the very last to the one I can remember and then we try to go into the other elements of the question, okay. So, yes organizationally I feel very confident. We're just yet announcing a further decentralization of our model strengthening of our Africa platform. We see a lot of the effort we've done in the last three years in terms of building a strong bench and talented people, as well as the ability to extract highly seasoned talented people, as you know, only strengthening. So I think on that side, it gives me a very positive perspective. I've been closely in touch with the PMI, post-merger integration, of all of the acquisitions we launched in 2015. And I feel very confident of those. I feel like we are actually meeting or beating our original thesis going into the acquisition. So I've seen a lot of movement in Thailand, a lot of movement in Argentina, maybe Alex can comment.

Your other question about M&A pipeline, we come from the old saying of being more aggressive when others are fearsome and being more fearsome when others are aggressive, right. So, we really think that this cycle that the whole industry is going through is precisely the right moment in which a company like BRF holding a very strong balance sheet financial capability can take advantage and opportunity. Of course, we have our eyes into very specific markets, very focused few categories and also trying to professionally advance in the value chain and build a more sustainable mix. So I think there would be a number of interesting opportunities. I think we have been pretty active on that front. Having said that, we need to balance that against actually integrating and bringing Golden Foods Siam, our UK, and Argentina platforms into our business, so I think that's kind of the big perspective.

Q - Luca Cipiccia {BIO 6914452 <GO>}

Pedro if I can ask – sorry. If I can ask a quick one (27:51). So the priority is more on M&A, it's more geographic gaps now or rather product mix meaning the markets you're in, more brands was downstream or you still see geographic gaps in regions where you would want to scale up rather than changing the portfolio mix?

A - Pedro de Andrade Faria {BIO 15115819 <GO>}

A bit of both. When we talk about Southeast Asia, I think there are geographic gaps we want to cover. We've been having our eyes very focused on markets now with the platform of Thailand. So Malaysia, Myanmar, Philippines, Vietnam, these are all markets that we think are quite interesting.

In Latin America, obviously our first concentrated force came into Argentina, but with Argentina you have Uruguay, Paraguay and probably bigger markets like Chile, Peru, Colombia which are geographical gaps that at the right opportunity you would definitely like to pursue them. And of course, in what we call the halal-belt, the Muslim world which we have clearly established ourselves as the largest halal food player in the world, I think there are number of opportunities that we can continue to focus.

In terms of mix, I think again, even in Brazil, we are paying attention to opportunities in reaching our mix to get close and closer to real food, to healthier food, to a lot of the trends we've seen innovation. So of course we cannot concentrate everything on inorganic to build there, I think we have a very strong pipeline of innovation as I mentioned in the previous call, but this is – the overall trend is to advancing the value chain and get closer and closer to consumers.

Going back to your price increase question, if I remember that correctly, 10% is the best way we can guide in terms of what we are doing here. These are now contemplating all elements of the pricing. Of course, the best way to model that and maybe Augusto can help me here, is to actually try and extract the seasonality because you've been following the company long enough. You know that the fourth quarter will usually be strong one in terms of mix in terms of our campaign of festive and Christmas and seasoned products which as I said, this was probably the best campaign we had in three years, which tells a lot about our execution.

This is a time-sensitive operation in which all elements of execution must be aligned from marketing to trade marketing to sales execution to correct alignment and adherence between price to retail and price to consumer. And I think we came out of this campaign feeling very happy and that translated into, I think overall, even better profitability in Brazil than we were hoping before coming into the fourth quarter.

Maybe Augusto wants to talk about it, but I think I need to emphasize. If you look at that going forward, we will have a much more dynamic pricing. I think we are living in Brazil which has a much more inflationary inertia. So I would not expect us to do big shift, big movements like we did in January like double-digit plus, but to continuously assess the opportunity to price and to make sure we have the right portfolio and the right channel mix, right.

So please Augusto, can you compliment on how this model is going forward?

A - Augusto Ribeiro {BIO 18485971 <GO>}

Yes, just to reinforce as well what we've done in the fourth quarter. And there's going to be the tone as well throughout 2016. One important thing that we did, we started working with the relative prices between Perdigão and Sadia, for channel, per region within Brazil. We've been – I believe we're doing a very good job after six-month of launch of the brand. As Pedro had said, the pricing movement we did launch (31:44) now in January, a big move roughly 10% price increase – an average of 10% price increase. And going forward, those actions consider Perdigão relatively prices, Perdigão in the second branch my choice.

Strategic movement, we think each one of the regions of Brazil, those are going to be the main drivers when we are considering profitability. So at the end of the day, there might be price increases. We're going to do that if we have to, but a lot of strategic things we improved a lot, our knowledge of Brazilian market in the last year, given some investments that we did internally as well as the changes in structure environment that we did create for example the five regions within Brazil and with a qualification of our sales force as well.

Q - Luca Cipiccia {BIO 6914452 <GO>}

Perfect, great. Thank you. Thank you, Pedro. Thank you, Augusto and all the best for this future.

A - Pedro de Andrade Faria {BIO 15115819 <GO>}

Thank you.

A - Augusto Ribeiro {BIO 18485971 <GO>}

Thank you, Luca.

Operator

The next question comes from Andrew Muench, HSBC. Mr. Andrew, you can proceed.

Q - Andrew Muench {BIO 17481422 <GO>}

Hi. Thank you for taking the questions. So this one is on management here. I guess the changes that you've made – I'm trying to understand the differentiated sort of capabilities that these changes bring to the table? And then, sort of secondly, how important is the decentralization of the management team sort of, can you speak at a high level about these management changes and what they do for your organization? Thank you.

A - Pedro de Andrade Faria {BIO 15115819 <GO>}

Thank you, Andrew. So let me begin by what I think is perhaps the biggest change in terms of how we are organized, okay. So I think that having the adequate craft, integration and connectivity between marketing, innovation and quality is paramount to our business, okay. This is a very long value-chain, and we have all of the effect. They play a role into us bringing the highest quality product and also being able to have a fast time to market in innovation.

And of course, these are the two main pillars of our brand. So I think for the first year into my leadership, we felt we need to give a lot of emphasis on quality. By the way, I think all of the indicators on quality showed that yes we recover a lot of ground in having all the highest quality products as the overall function, but now I think that it will be very important that these functions are well integrated and connected. So this will be fundamentally the biggest impact on how we organize ourselves going forward.

The second one which is very important and of course, this coincides with the promotion of Rafael. We also bring in a very seasoned guy, ex-CEO of Cramer, did a beautiful job there to kind of take both of them on the role of pushing our Brazil forward. I think Flávia Prazeres did a beautiful job. She left a lot of good legacies here on many, many fronts. And we realized that we need to strengthen our regional functions in Brazil that play will be more into Rafael's role, but we also need to ensure coordination between all of the chain and the elements of we making sure that in terms of distribution and planning, we are functioning like clockwork. So I think these two guys, they strengthened the bench for Brazil. They built a lot more substance for our teams, and I think the internal reception we've got for that movement was really positive.

Thirdly, in terms of decentralization, which is I think the overall joining for organization, we see yet another example of that as we kind of emancipate Africa as we feel very confident and positive in our plans and growth projects there. So these are kind of the high level drivers of the change we're announcing. Of course, there's also the people element which I'd like to emphasize. I feel very positive to see that in the last three years we have substantially strengthened our internal bench. So a lot of those movements come actually with promotion, with people actually changing or switching roles inside the company, but giving them the perspective to grow in their careers in BRF, as well as we continue to be able to attract very solid balance, a lot of them not very new to the company since they've been in helping us in some shape or form in the course of the previous years, and of course underlying all of this, a very strong sense of (36:27), a strong sense of giving people the right opportunity.

So, of course, all of that maybe a lot to chew in one movement as a formality, but I'd like to say that internally the coherence of the movement feels very positive and we only got a very good reviews about that. Finally, just to take advantage and again thank Augusto here for the very good job he did as our key financial guy in the last few years driving this company to an enviable financial position.

Q - Andrew Muench {BIO 17481422 <GO>}

Great, thank you. And good luck, Augusto.

A - Augusto Ribeiro {BIO 18485971 <GO>}

Thank you.

Operator

Our next question comes from Jeronimo De Guzman, Morgan Stanley.

Q - Jeronimo De Guzman {BIO 15888043 <GO>}

Hi. Good morning. I wanted to go back to the Brazil margins and maybe it's basically two-part question. One is just kind of looking at the fourth quarter. One thing that was surprising was that you did see a big sequential improvement in the margin despite the fact that you didn't hit pricing. So if you look at the third quarter margin versus the fourth quarter, and you try to adjust for the non-recurring, (37:36) 500 basis points of margin expansion, so I just wanted to understand what helped drive some of that recovery?

And then looking forward, I also wanted to ask on the margin outlook from the perspective of whether that 10% price increase is really enough just because we've seen corn selling prices in reais increasing much higher than that. And inflation, obviously you have that inflationary pressure. So why not (38:03) more pricing going forward and what is earnings per margin?

A - Pedro de Andrade Faria {BIO 15115819 <GO>}

Well, Jeronimo, starting from the last part of your question. We think 10% felt right in January because there's also a very strong realignment of the channel relativity which was again a very important part of the exercise. Going forward, we still think we have more price action to do to recover to what we think is a sustainable profitability. And again, I'm very encouraged to see a competitive scenario which seems to be a lot more rational and should also help us. There's the inflation component, there's a spike in grain as I said so. The overall challenge for us and one is I feel very confident is to sequentially improve our profit margins into 2016, perhaps at the expense of volumes, but again creating a solid foundation for growth as we enter with a lot of the innovation.

And you are right. I think we are positively and happy with the strength of our Brazilian platform without a clear pricing being a drive in fourth quarter mix, and of course seasonality plays a big role in productivity (39:26). But the number of our levers starting to have an impact, for instance, lowering our cost to serve, for instance being more rational on the use of trade marketing and a number of other things that help us build profitability in Brazil which showed to the market a sequential improvement despite the absence of pricing which is coming like I said full-force first quarter.

I'd also like to ask Alex to share his thoughts on your question.

A - José Alexandre Carneiro Borges

And Jeronimo, just looking forward as you asked obviously we are facing a challenging scenario where pressure is lost due to the increased prices in grains in some of the international market where we are more exposed to the cycle also facing some pressure in terms of the margins, but I think this is the time just to really realize and execute a large transformation we have made on the company. Different structure, different product mix, different way we're getting our go-to-markets to our clients, number of examples in the Middle East, in South Cone and a number of other regions where we believe we can successfully go through this cycle.

So looking forward, yes, we are facing a challenging scenario, Brazil with economic challenges and with the grains putting pressure, but we're working a lot internally with the things on our hand to keep costs under control and to deliver, have profitability. We will look into increased prices when we make sense in an intelligent way maintaining our discipline, finance state, in light of the more challenging scenario. So looking forward, we're going to be very active in seeing what is the price position that makes sense to really have healthy margins throughout this cycle and really leveraging up what we have built in terms of brands and strategy to get to our clients.

Q - Jeronimo De Guzman {BIO 15888043 <GO>}

Thanks. Thank you very much.

Operator

Our next question comes from Thiago Kapulskis, Brasil Plural.

Q - Thiago Kapulskis {BIO 19187926 <GO>}

Good morning everyone. Thanks for the opportunity to ask. I just have a question about corn in Brazil. We're seeing actually prices going up a lot and you guys already discussed a little bit of this. But my question is the size actually passing through cost, what else could you guys do to make sure that these types of costs are not actually going to affect you? I mean in terms of even like hedging, I know you guys don't hedge commodity prices but is there anything else you guys are doing on that? And a follow-up on that would be, is there any kind of risk that you see a lack of corn in Brazil, not even saying about prices but a real lack of product that would actually disable your operations or hurt in terms of having to stop or halt operations or something like that? That would be my question. Thank you.

A - Pedro de Andrade Faria {BIO 15115819 <GO>}

Excellent. Again Thiago, this is Pedro trying to answer from the last part of your question. We don't see operational risks involved, and we effectively are sourcing grain in Brazil. You have to remember BRF has the fifth largest origination capability in the country after the big four trading companies that operate here and globally. We also are benefited in this scenario relative to the competition given our footprint, which is a lot more indexed into the center-west of Brazil, where for the more acute phase of this spiking grain prices, we continue to source effectively grain pricing on very competitive manner, okay.

So yes, it's not a risk that I see overall. You saw government also bringing some of the strategic stocks they hold to try and level the price action. So yes, it is an impact. We are not immune to that. Of course that translates into a margin compression which is very short-term lived. We have to remember that it also at the end of the day creates the trend of prices of chicken going up in the cycle. So the cycles tend to revert in a very fast way. But the grain price action is something that I feel no other company has the potential to mitigate the impact through the variables that we control. So, I'd like to mention that the strong effort our team is doing at live operations, bringing better yields, bringing yet better conversion rates, playing with all kinds of knowledge this company has to secure that, as part of this impact is mitigated.

Of course on the other variables of our cost breakdown, we are doing a strong effort. I think we are ever more productive on the label side. We are recording ever-low turnover ratios. We're also implementing a lot of new systems of attaching productivity to compensation in our facilities warmly received by our workforce. So, all of that plus our scale and advantage in procurement help us to mitigate to some extent this price increase. So, of course, sensitive. I think short-lived in terms of an impact and our team is working very hard to mitigate as much as they can.

Q - Thiago Kapulskis {BIO 19187926 <GO>}

Excellent. Just a quick follow-up. So if the government keeps doing public auctions specifically in the center-west where it seems that they have the largest stocks right now, would you then benefit from that rate given that you have a strong footprint there, right?

A - Pedro de Andrade Faria {BIO 15115819 <GO>}

Yes, I don't make a strong link of causation here because it's not the fact that the government sells and I'm able to buy. I'm able to buy because I have the largest infrastructure in the place to continue to originate and this is a long-term history for the company being able to have strong direct relationship with farmers and a number of capabilities that in this spike help us a lot.

The government coming into play is relevant because it's actually stabilizing the market in a way or not. Of course, all attentions to the Safrinha which used to the second harvest and now has become the first harvest. And in terms of hedging, I think in anticipation of that, we have built some level of hedging going into Safrinha second harvest which will also again mitigate a scenario in which prices don't converge as fast as it would probably have given historical seasonality patterns.

So, I think the overall message here Thiago is, this is not something new to BRF to see prices of grain going up and down. I think we believe we have the best infrastructure, resources and capability to play against that. Even if you know for a few months, that translates into some kind of margin compression, okay.

Q - Thiago Kapulskis {BIO 19187926 <GO>}

Okay, great. Thank you. Thanks a lot for your answer.

Operator

The next question comes from Jose Yordan, Deutsche Bank.

Q - Jose J. Yordan {BIO 1496398 <GO>}

Hi. Good morning everyone. Well, my main question was asked already. So I just want to – my second question was just a clarification. The R$309 million of non-recurring one-time items were all allocated to the Brazil segment, is that correct?

A - Pedro de Andrade Faria {BIO 15115819 <GO>}

No, that's not correct, Jose. We are exercising allocation based on the basically all of the markets. I think Augusto here, to my side, can help you understand the whole non-recurring and how it was actually allocated.

A - Augusto Ribeiro {BIO 18485971 <GO>}

Thanks for the question, Jose. The allocation basically follows the potential revenue, the size of each one of the business. All of the four main non-recurring events of the build which were, the majority were positive. They are basically a corporate one. They do not in principle apply to a single market. Therefore, we allocated a portion of it for each one of the market and it follows the size of that market in a quarter. So, for example, for Brazil, it's roughly 48% to 50% of that amount and then you have the follow-on on the other market.

A - Pedro de Andrade Faria {BIO 15115819 <GO>}

And Jose, this is Pedro. I'd just like to take advantage of your question to say that we believe we said in full transparency a pretty straightforward set of numbers here. We have one-off impact of Minerva which we've been pointing out in the previous quarters that it was, while understanding wrongly, having an impact in our operating margins, okay. So this was reversed as our decision to change our ruling the governments of the company. We also have a big one-off coming from it, a long-term fought war to recover some of those expenses which is actually a good positive and have the cash impact in the quarter. And finally, throughout the year, in our conservative approach, we've been building provisions, building things that at the end of the day looking against I think a good job that our legal team done.

Some of those provisions, they end up looking way too conservative, so some reversions which I think will be the normal course of our management here to always be conservative, build provisions ahead of events and then in the unfolding of those events, some of them coming back, but really a straightforward set of numbers to our opinion.

Q - Jose J. Yordan {BIO 1496398 <GO>}

Very clear. And if I can just follow-up real quickly, Augusto. I think in the Portuguese call in your remarks you mentioned your particular situation leaving the company and what your new opportunity was but I didn't quite get what that was. I mean I get that it all comes in the context of a bigger reorganization, but just curious if you can talk about what your new opportunity is or why you decided to leave at this point?

A - Augusto Ribeiro {BIO 18485971 <GO>}

Thank you, Jose.

Q - Jose J. Yordan {BIO 1496398 <GO>}

It's obviously like a very friendly departure or whatever given that not only you're on the call, but you've been showered with praise in both calls. And I would join that chorus as well but any comments would be useful.

A - Pedro de Andrade Faria {BIO 15115819 <GO>}

So Jose, before Augusto says, I'd just like to emphasize what you said. This is an extremely friendly process here, very smooth transition. Alex and Augusto are already part of the team here for a number of years. So, I think as far as our financial team is concerned and our ability to do what we've been doing, this is really a friendly process and smooth transition, you're right. Augusto?

A - Augusto Ribeiro {BIO 18485971 <GO>}

Thank you, Jose, for the question. At the end of the day, it is a personal decision, something that I've been discussing with Pedro (51:33) for some time. After almost nine years in the company, I started with Sadia and I started with the merge and then the expansion. It's a personal one actually. And there's lot of things complete. I'm not going to the competition or not move in, there is no such thing within our mindset.

It's actually really friendly. It's a personal decision. And given I concluded as I like to think actually, not to say, to think that I concluded a time within a company with a very well defined boundaries. There was a cash issue eight, nine years ago with this idea, then a merging issue with a lot of consultants, SAP, a lot of things between both companies. And then an expansion time here growing eight acquisitions last year, it was a very good year in organic growth for us. So it's a matter of personal decision. So I'm pretty happy actually with that. I'm 100% confident with Alex's capability. He's going to be the one actually going to relate with you from now on. And then, based on his experience, he's going to be very good for the company who has a bright future for the years to come. Thank you for the question.

Q - Jose J. Yordan {BIO 1496398 <GO>}

Thank you and good luck.

A - Augusto Ribeiro {BIO 18485971 <GO>}

Thank you.

Operator

The next question comes from Alex Robarts, Citigroup.

Q - Alexander Robarts {BIO 1499637 <GO>}

Thanks for taking my question. I just have one and it's something that didn't come up earlier in the Portuguese call. And it relates to your plant rationalization, automation of the Footprint project. 2015 did see incremental CapEx. Our numbers suggested about R$300 million into the plant rationalization project. Can you talk to us about – are you happy with what the project has been yielding so far? I guess we understand that this is a multiyear project. What kinds of benefits do think the cost structure will see this year from what you invested in last year? And what kind of projects do you feel are still on the board there to be implemented? So that's it for me.

A - Pedro de Andrade Faria {BIO 15115819 <GO>}

Thank you, Alex. Let me take the opportunity to say a few things about this. And here, I think Augusto and both Alex may want to join. So you are right to say this is a multiyear program, okay. This is a journey that the company embarked about a year and a half ago.

We're still in the pipeline. A lot of those projects are still being implemented as we speak. But we start to see early signs, very encouraging signs on all sides. On the quality, we see a sequential improvement. And also in terms of the cost structure, these are projects that they have usually very high rates of return. And of course they translate into, I think, a very different profitability that we are now showing for instance in our international markets. I've been closely following this company for as long as I don't know 2010, have seen myself a few very bad cycles.

I really like to say that even in our most basic offering of products – in our fleet of products (55:23) to market which are, quote unquote, more commoditized, our cycle has bettered this one, would have translated easily into negative margins across the board. This is not what we've seen. So a lot of the effort into automation, into Footprint, is playing out as we get our cyclicality low. So again, I'm very confident about this. I think we are more towards the end of this in terms of the program, we said it would be like a three-year program. So I think we are on-schedule. This has interestingly enough facilitated a few of our decisions in terms of moving from Brazil footprint to a global footprint.

Our automation learning curve in Brazil has enabled us to put in place and Alex can complement, perhaps the most competitive platform for exports currently which is Argentina, fully automated, bringing all of the innovation and processes and technology that we learn in this process. So, I think this is good. This is complimentary to the rest of the footprint. If you look at Thailand now, in which it's still essentially manually, and I think for that reason also highly flexible, able to create a lot of higher value added projects which complement our portfolio. But some of the key learnings of our automation and this journey are there, are translated into our numbers and will continue to help us in our journey forward.

A - José Alexandre Carneiro Borges

Alex, I would complement that investments in our plant and really revision of our plant industrial footprint has provided us with a lot of flexibility to play and to reach a number of different markets. We have seen announcements that we had made recently with habilitation and approvals to get license to export to different markets. I think this is a great advancement that we have done. We have been able to (57:23) in terms of where to export and sell our product.

And this is all (57:30) consequence and result of the investments, the revision of the industrial footprint that we have executed. So we are growing in the international production as well. We are starting to have some production outside of Brazil that diversifies risk and that puts us in a position again to optimize and to have access to different market, maximizing our price and our returns. This plays a very important role particularly in a challenging environment that we are growing right now. So we can be smart and just where to sell, how to position our products, not to base as much as downturn in terms of pricing and really optimize our results. So I think the investments that we have done and continue to do in our footprint, not only what Pedro said optimizing gain productivity and reducing costs, but also providing a lot of flexibility to play more smart in our international footprint – international markets.

Q - Alexander Robarts {BIO 1499637 <GO>}

Thank you for that. Well that's clear. The kind of tag on to that and you mentioned this in the last quarter call about the Lucas do Rio Verde plant vis-à-vis China. It seemed like that was a work in progress. You were organizing some total column measures and such. Has in fact Lucas do Rio Verde reopened for China, or is that still kind of work in progress?

A - Pedro de Andrade Faria {BIO 15115819 <GO>}

Okay. So thank you for your question, Alex. Coming towards the end of 2015, we were pleasantly surprised at the number of years working of having four new plants approved to China, okay. Lucas do Rio Verde itself is not approved okay, but that four plants being approved shown that actually the Chinese market will, I think, progressively become more important into our market.

And I think the fact that we got four plants approved show that in terms of the work we need to do both here in Brazil with our agricultural ministry as well as Chinese authorities for health and sanitation I think we know how to get there. And I think that you are right. The more plants we have opened to China, the better I think China is a market that we have a kind of a super cycle still for the foreseeable future, supply-demand in balance that leads to overall higher profitability than some of the other markets. So we continue to work very hard on that front.

Q - Alexander Robarts {BIO 1499637 <GO>}

Got it. Thank you.

Operator

Our next question comes from Pedro Leduc, JPMorgan.

Q - Pedro Leduc {BIO 16665775 <GO>}

Hi. Thank you for taking this question as well. So two quick ones, this Flávia, leave which was sort of non-compete clause, or it's free to move to anywhere she wants? Number one. And number two, your income taxes positive now for two quarters in a row. And I know we're seeing this Brazil looking for fiscal revenues. I'm wondering how you're managing this and if you're comfortable with it and what do you see going ahead? Thank you.

A - Pedro de Andrade Faria {BIO 15115819 <GO>}

Let me refer to Augusto for the tax question.

A - Augusto Ribeiro {BIO 18485971 <GO>}

Yeah. The one thing in the last two quarters they are basically following very strong currency valuation. Actually it's very simple in our case. We have a lot of results coming from outside of Brazil, some of them are – actually a big chunk of them are not – they do not sell for any kind of tax upon them. And a lot of issues and expenses that we have in Brazil, they are deductible from (01:01:41) tax perspective. So therefore, in the last two quarters, we have concentrated a lot of that issue in BRF. Looking forward, we don't see that happen again. I don't think that we're going to see a huge devaluation of the currency in 2016 at least not in the same size as we saw in 2015. So we should go back to our normal tax performance.

Q - Pedro Leduc {BIO 16665775 <GO>}

Okay. And just if you were to repatriate these profits with impaired taxes, is that right or no?

A - Augusto Ribeiro {BIO 18485971 <GO>}

Sorry.

Q - Pedro Leduc {BIO 16665775 <GO>}

If you were to repatriate and bring to Brazil these profits or send off from abroad then you would pay taxes but as long as it don't, you don't need to, is that a right reading?

A - Augusto Ribeiro {BIO 18485971 <GO>}

That's right. That's right. In a way we have a lot of investments outside of Brazil. Our M&A strategy is focused out of Brazil. So actually we're going to invest a lot of things outside of Brazil.

Q - Pedro Leduc {BIO 16665775 <GO>}

Thank you, Augusto.

A - Augusto Ribeiro {BIO 18485971 <GO>}

Thank you.

A - Pedro de Andrade Faria {BIO 15115819 <GO>}

And Pedro going back to your question on Flávia, the answer is twofold. First, our senior VPs and executives they are – we have a standard non-compete clause, okay. And finally, knowing Flávia very well, I really don't think and the way she is friendly leaving the company, I really don't believe she's going to competition in anyhow.

Q - Pedro Leduc {BIO 16665775 <GO>}

No, no, no. It's all right, thank you.

A - Pedro de Andrade Faria {BIO 15115819 <GO>}

Thank you very much.

Operator

This concludes today's question-and-answer session. I would like to pass the floor again to Mr. Pedro Faria.

A - Pedro de Andrade Faria {BIO 15115819 <GO>}

Yes. Again, thank you very much for joining this conference. Thank you for all the interesting point questions, reemphasizing our view for the next quarters. We are completely aware of challenging context that we are leading. However, on the international side as we said throughout the call, we continue to be upbeat on our ability because of our recent structural advancement to continue to defend our margins and profitability also knowing that cyclicality in our industry comes and go as we've seen every couple of years and so we think we have the tools to navigate that.

On the Brazil side, again more and more confident with the work they have done, the legacy that Flávia built as a team, so I think the movements here come as a natural continuity of the business, trying to defend our margins in that sense, very happy with the outcome of the fourth quarter and also knowing that the strength of our brands and the strength of our distribution will also help us. That coupled with innovation, we should see a very strong year for 2016.

I'd like to thank you all reinforce our discipline and our long-term commitment to shareholders' value creation. Thank you for attending this call. We look forward to see you in the next quarter.

Operator

That does conclude our BRF SA conference call. Thank you very much for your participation. Have a good day.