Q2 2018 Earnings Call

Company Participants

- Eduardo de Oliveira Miron, Chief Financial and Administrative Officer & Investor Relations Officer
- Marcos Antonio Molina dos Santos, Chairman
- Martin Secco Arias, Chief Executive Officer
- Timothy M. Klein, President & Chief Executive Officer

Other Participants

- Autumn Graham, Analyst
- Isabella K. Simonato, Analyst
- Marcel Guimaraes de Moraes, Analyst
- Teo Lasarte, Analyst
- Thiago Duarte, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning, ladies and gentleman. At this time, we would like to welcome everyone to Marfrig Global Foods SA Conference Call to Present and Discuss its Results for the Second Quarter 2018. The audio for this conference is being broadcast simultaneously through the Internet in the website www.marfrig.com.br/ir. In that address, you can also find the slideshow presentation available for download.

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

Before proceeding, let me mention that forward-looking statements are being made under the safe harbor of Securities Litigation Reform Act of 1996. Forward-looking statements are based on the beliefs and assumptions of Marfrig's management and on information currently available to the company. Forward-looking statements are not guarantees of performance. They involve risks, uncertainties and assumptions because they relate to future events and therefore depend on circumstances that may or may not occur in the future.

Investors should understand that general economic conditions, industry conditions and other operating factors could also affect the future results of Marfrig and could cause results to differ materially from those expressed in such forward-looking statements.

Now, I will turn the conference over to Mr. Marcos Molina, Marfrig Global Foods' Chairman. Please, Mr. Molina, you may now begin the conference.

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

Good morning, everyone. Before I pass it over to Martin, I'd like to direct everyone from Marfrig for the (00:02:25) results in this quarter. This demonstrates and reinforce that our decision to focus in the beef protein and diversify from a geographic standpoint with our production base in the North America was absolutely correct. Not just the decision, but the timing of entering in the sector in U.S. was very positive, which, in our view, the long-term perspective continues to be very favorable for the beef protein.

Our shifting in our strategies includes the sale of Keystone. The same process continues to advance in new terms and we will continue to keep you (00:03:53) of the evolution of this. It's important to highlight that Keystone is an exceptional asset. Amidst this commodity crisis in the chicken business in U.S., its business model is differentiated itself from the competition.

I'd like to highlight that we will continue focusing our strategy and we will – and that our commitment to the financial discipline and deleverage continues to be in negotiable. The way we see is when the process, the sale process is finalized, Marfrig will be the sector company with the best leverage in this sector.

I'll now pass the word to Martin Secco (00:05:28) start the presentation of the quarter.

Martin Secco Arias {BIO 18098476 <GO>}

Thank you, Marcos. Good morning, everyone. Thank you for your interest in the company and for participating in yet another conference call of Marfrig Global Foods. In addition to presenting the results of the second quarter, we also give some comments about the transaction of the divest, Keystone Foods.

With me today are Eduardo Miron, our Global CFO; Tim Klein, the CEO of National Beef and responsible for the North America operation; and Roberta Varella, our IRO.

Please go to the slide number 3. In April this year, we announced a shift in the company growth strategy to focus on beef. And with the decision, we'll launch two major projects. The first, which we already have discussed extensively with you, was the acquisition of our controlling interest in National Beef, which we conclude in June.

And the second project is the sale of Keystone Foods. As we noticed on first half of July, we received the binding offer which were analyzed during the month and we are in the negotiation phase. I know you would like to see more detail, but unfortunately, that is what I can share information with you at the moment.

Regarding our operations, our exceptional operating results in the second quarter, which reflect our success (00:07:26) decision to expand geographically with a focus on beef protein. Marfrig pro forma adjusted EBITDA in the quarter was BRL 918 million, 87% higher year-over-year, driven mainly by the growth scenario in the U.S. market.

In the next slide, we'll provide a snapshot where Marfrig stand today. With our production platform concentrating in Americas and daily primary process capacity of 32,000 heads of cattle, Marfrig today is one of the global leader of beef supplier. Our geographic diversification enable us to serve the largest and the most important beef consumers around the world.

As you can see, the U.S. domestic market account for 62% of our revenue in the quarter. China, including Hong Kong, Japan, Europe combined accounts for 17% of our revenues. And Marfrig have a strong presence in South America, one of world's emerging regions, which accounts 15% of our revenue in the second quarter.

Now, I give the presentation to Eduardo that continue the presentation regarding the results.

Eduardo de Oliveira Miron {BIO 15427272 <GO>}

Yeah. Good morning, everyone. Would like to start on the slide number 5 where we – before we start commenting on the quarterly results, we would like to provide some guidance on how the numbers were for the quarter, how we (00:09:34) numbers in the following page. As you know, with the conclusion of the National Beef acquisition, we are presenting the key operating indicators on a pro forma basis. In other words, fully consolidating the company's results for the second quarters of both 2018 and 2017.

Continued operation in this presentation refers to the figures as reported in our financial statements, which includes National Beef only as of June 2018, which is the month in which the acquisition was concluded. As these figures do not consider any results to this – and this result do not consider any results from Keystone Foods. And since the first quarter of this year, it has been classified as an available for sale asset.

And lastly, although not material for the metrics, we reclassified Argentina business as a continued operation, given the sale process has already exceeded one year and to conform with the IFRS rules for assets held for sale.

So moving to the next slide, here is – we are going to talk about the revenue profile. So in addition to the beef production platform in South America, which in U.S. beef division before, there is – which is – as you know, the operations in Brazil, Uruguay, Chile and Argentina, now, after the recent strategic transactions, it also includes the beef operation in North America.

So to facilitate understanding of this recent dynamics, we are dividing our report into (00:11:35) which, in the quarter, accounted for 71% and 29%, respectively, of Marfrig consolidated pro forma revenue. As you can see on the right of this chart, on the pie chart, we try to list all the brands, and you see, we have a very diversified number of brands that cover different lines of products and different programs, integration with farmers and customers. That makes a big difference for us in terms of competition.

Now, moving to the next slide, we are going to talk about the pro forma revenues for the second quarter. As you can see in the graph, it shows the main driver that led to the changes in revenue, which is volume, price and the exchange variation. In the second quarter of 2018, Marfrig's net revenue was BRL 9.9 billion, representing a growth of 21% year-over-year, with higher sales volume which contributed to BRL 1.3 billion to the revenue growth, offsetted by the lower average price, which had a negative effect of BRL 478 million. The FX on the Brazilian real depreciation on the exports from Brazil landed to inflation of the revenues from our international operations, had a positive impact of BRL 929 million.

In the case of North America, the higher sales volume is explained by the strong demand of beef protein at global level, combined with the higher supply of cattle. U.S. industry harvest was around BRL 6.6 million hedged at (00:13:51) 4% compared to the second quarter of 2017. These factors offset the lower sales price which follow market dynamics.

In South America, for example, the strategy to reopen plants in Brazil to serve the great demand of beef offset the lower primary processing volume in Uruguay. So, we had a higher – an increase in Brazil and then a lower volume in Uruguay. In the Brazil operation, the contribution from the higher sales volume, around 53%, was partially offset by the lower average sales price compared to the second quarter of last year.

In the mass market, a higher supply of cattle and more intense competition amongst protein was observed. In the case of the external market, there was an increase in sales to countries that consume lower value products because the process of certifying our exports to more premium markets is still pending – is ongoing.

Even in this challenging scenario, we posted growth of BRL 58 million of revenue in our further processed products, which represents a growth of 4% versus 2017. It was pretty much driven by the sales of higher volumes to premium markets such as United Kingdom and United States, which, again, reinforces our positive – the positive market momentum of U.S. economy, which is what Marfrig believes.

Moving on to slide number 8, here is the pro forma indicators for the second quarter. This slide presents the key operating indicators, and the first one is the higher cattle supply. As you see, the higher cattle supply which supported growth in the primary processing, up 21% compared to the second quarter of last year, combined with a strong demand supported by margin expansion in the comparison period.

The margin gain is explained by higher margins in North America, reflecting the positive cattle cycle in the region and the continued good performance of the operation in the Southern Cone. This factor is offset by the lower margin in the Brazil operations, which, as you know, while it's affected by the lower average prices pretty much, given the higher cattle price the second quarter of the year, affected by the exogenous industry dynamics in the – one year ago.

In this context, Marfrig reported an adjusted EBITDA of BRL 918 million, up 87% on the same period of last year. And again, this is a pro forma. We are comparing apples-to-apples 2017 and 2018. So in both cases, we have the same components.

Moving on to the next slide, slide number 9, here, we are going to talk about our debt and leverage. The slide shows the indicators, but first, before we move to debt, I should mention that the reporting basis that includes, first of all, it includes the bridge loan for the National Beef acquisition and pro forma adjusted EBITDA in the last 12 months of this operation. The last 12 months result – and that of Keystone, which, since the first quarter of year, has been classified as available for sale. So, we have National Beef and we have Keystone Foods in this specific slide and for this specific calculation. And again, we added the results from our operation in Argentina.

So having said that, on June 30, Marfrig's net debt stood at BRL 16.3 billion, increasing BRL 3.7 billion from the end of the first quarter. This increase is mainly explained by, first, the sharp appreciation of 17% of the Brazilian real against U.S. dollar in the comparison period; two, the – by the adjustment of the debt of National Beef from $223 million to close to $400 million in the second quarter, which was due to unexpected dividend distribution prior to the sale. It is worth mentioning the long-term profile of our debt, with only 30% of maturity in the short term, even highlighting that the cost of this debt has been reduced to 6.6% per annum.

Another important reference to the debt is – and the cost indicators is that it's kind of fluid at this point since that we have the bridge loan of the acquisition and it doesn't necessarily include any positive impact of the inflow of Keystone sale. As a result, the company net debt is to (00:20:01) that in U.S. dollar terms, $4.2 billion, and in Brazil reals, net debt was BRL 16 billion.

As you can see in the table at the bottom of the slide, pro forma leverage is measured by net debt adjusted EBITDA ratio of the last 12 months closed the quarter at 4.2 times. It's important to note that this result was affected by the average exchange rate and the exchange rate appreciation at the end of the period of around 7%. If we exclude this difference from the analysis, the leverage would be below 4 times. This increase and relative to the (00:20:47) first quarter of 2018 is explained by the negative cash flow of the company this quarter, that we will discuss in the next slide.

Moving now to the cash flow slide, the cash flow – it shows our cash flow from the continuing operations in the quarter. Again, just a reminder, it includes just one month of the result of National Beef. And it does not include any cash flow from our Keystone operation. So, Marfrig registered operating cash flow negative of BRL 156 million, which is explained primarily by the inventory build and driven by basically the Brazil operation where the truck drivers' strike had a negative effect of around BRL 100 million.

The second block, which is CapEx, excluding the amount of the acquisition, was BRL 156 million, increasing on the prior quarter. So, the increase is explained by – as we have the strike, we end up accelerating certain maintenance costs that we had to take advantage of those stoppages. And the number two, the second event was the start of expenditures with modernization projects, such as the new freeze tunnel in our Promissão unit and other modernization in some of the plants.

The third block, which is interest expenses, they came at to BRL 255 million, increasing BRL 52 million from prior quarter. And the main factors were the, again, the sharp appreciation in U.S. dollar of 17% and the one-off increase in interest expenses due to the bridge loan for the acquisition that we have already mentioned when we talked about the debt. As a result, our free cash flow in the quarter stood at BRL 568 million.

So, I just would like to go back and just repeat. So in this case, we just had one month of the National Beef, and second, there is no cash flow from Keystone in this. So, pretty much this cash is driven by the Brazilian operation where we had some events and the fluid situation on the tax for the acquisition of National Beef.

With that, I conclude my (00:23:49). I'd like to invite Martin to continue the call.

Martin Secco Arias {BIO 18098476 <GO>}

Thank you, Eduardo. On next slide, I will comment briefly on the step of our short-term strategy. At National Beef, we plan to move forward now in the second half of the year with our integration plan. As of – I already mentioned, the acquisition complement very nicely our other operation. In other words, we do not expect any type of change to the structure. So, the integration will focus on (00:24:24), capturing opportunities and how will we move forward.

For example, we are in the process of implementing two global committees, one, on the food safety, and another, for sustainability and animal welfare, with the goal of guarantee the best practice in all our business. Also, in the issue of sustainability, a highlight of this quarter was the strategic partnership that Marfrig formed with Embrapa for the certification of carbon neutral beef. The partnership represents yet another advance in the industry value change and reinforce Marfrig's commitment to sustainable production system.

In terms of our commercial portfolio, we continue working to expand our portfolio of higher value products. In Brazil, we plan to start a construction of a new beef patty plant to serve the foodservice channel. For the investment of around BRL 80 million, the plant will have annual production capacity for 20,000 tons, and we start expectation for April 2019.

For our liability management, once the Keystone transaction is concluded, we will announce the next step in this process. And one – these steps are concluded, we will then focus on updating and restructuring the long-term strategic plan, which we hope to share with you in the medium term at another Marfrig Day event.

Next slide of the presentation. Marfrig expects to conclude, in a short period of time, another phase of this strategic (00:26:27) plan which will help its commitment of reducing its leverage and improve its capital structure. Today, with a business model, with a geographical diversified footprint in America and with access to our key consumer markets, Marfrig is consolidating its position in one of the world's large beef produce.

With an ample supply of cattle and driven by a strong demand in both the domestic and international market, the U.S. beef industry has delivered record results. In Brazil, the beef cattle cycle remained favorable and the country's importance as a platform for serving growing global demand is indisputable. Brazil, which is the world's largest exporter, was recognized by the OIE, the World Organisation of (sic) [for] (00:27:20) Animal Health, as free of foot-and-mouth disease with vaccination, with this certification further expanding of possibility of accessing our international market.

And in this entire process, what was not changed and what will not change at the company is non-negotiable goal of financial discipline.

Now, we are concluding our presentation and we invite you at the Q&A session. Thank you very much.

Q&A

Operator

Thank you. Ladies and gentlemen, we will now begin the question-and-answer session. Our first question comes from Isabella Simonato, Bank of America. Ms. Isabella, your line is open.

Q - Isabella K. Simonato {BIO 16693071 <GO>}

Hello. Do you hear me?

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

Yes.

Q - Isabella K. Simonato {BIO 16693071 <GO>}

Wow. No, thank you, Martin, for the call. When you published the pro forma numbers, including U.S. and Brazil, is there a way you could disclose to us, more or less, your share of profitability you saw in both divisions in terms of EBITDA margin? So, we can have a better understanding of how the strike impact Brazil and the main trends for both countries. That would be very helpful.

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

Yes, hello. Isabella, hi. Yeah, as you know, we are in this transition phase where we are working, assuming (00:29:32) what would be the best way for us to address this new platform according to this new certification model that we are creating. So if you remember, so even when we had the (00:29:48) split the numbers between the Cone – the Southern Right (00:29:55) Cone and Brazil. And now, I think we are just being consistent to the way we used to report. But I understand your point. I think we are trying – we will try to provide more direction so that you can work on your models. Certainly, the operations in the U.S., so they had a better performance than the operation in South America, but we certainly – we'll try to address your point, providing information there so you can do your models. So, we are not there yet but we will.

Q - Isabella K. Simonato {BIO 16693071 <GO>}

Great. Thank you. And regarding the Keystone sale, Martin, you mentioned that you cannot give a lot of disclosure right now. But I think there were some expectation that, so you could be concluded before the earnings, and also, there were several articles mentioning Tyson Foods in exclusive talks with you guys. Is there any expectation in terms of timing that you could be a little bit more precise when you're going to conclude the sale or no?

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

I think you know the answer, right? So, we absolutely cannot comment on rumors and we cannot comment on anything related to in negotiations of sale of a company. And so, therefore, I think I will frustrate you in terms of providing more detail. But I can tell you that one of the reasons why we are making or we are having this call out of U.S. is because we are very focused, and we believe that we are going to be able to move this process to the end soon.

Q - Isabella K. Simonato {BIO 16693071 <GO>}

Okay. Thank you very much.

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

You're welcome.

Operator

Our next question comes from Thiago Duarte, BTG Pactual.

Q - Thiago Duarte {BIO 16541921 <GO>}

Hi. Hello, everybody. I have a quick question. It's actually a follow-up. Just if you could provide us the breakdown when we look at the $4.22 billion net debt at the end of the quarter, just a breakdown between the different divisions. If I'm not mistaken, you mentioned something about it in your initial remarks but we couldn't get the figure. I'm particularly interested in how much of that is represented by National Beef's consolidated net debt at the end of June. That would be very helpful.

A - Eduardo de Oliveira Miron {BIO 15427272 <GO>}

Yeah. I think quickly mentioned that we – the number of National Beef, in terms of total debt, was around BRL 400 million (00:32:43), and it was pretty much part of the negotiation, a discussion that we had in the past. So, nothing has really changed from there. So, that's what I can provide. And you know that we had this bridge loan that is about $1 billion, which was utilized for the completion, right?

Q - Thiago Duarte {BIO 16541921 <GO>}

Yes. Yes. Yes. Okay. And the second question is related to the cash burn in the quarter. You mentioned the higher inventories that – the main responsible for the working capital drain in the quarter. You also mentioned the impact for the truck drivers' strike in Brazil, around BRL 80 million to BRL 100 million. So, just wondering if you have any visibility on the reversal of – at least a partial reversal of some of that working capital drain for the next two quarters. So, it would be helpful to get some granularity on that.

And particularly, on the working capital investment related to the North American operation for National Beef, why was that? How much your sales or your slaughtering (00:33:56) grew quarter-over-quarter or before and after you incorporated National Beef, just to see how much of that working capital drain we might see a reversal of that in the next few quarters? That would be helpful. Thank you.

A - Eduardo de Oliveira Miron {BIO 15427272 <GO>}

Yeah. (00:34:13). I'll now provide you a model right in this call. But I – what I can absolutely tell you is that I will not define this as a cash burn. I think we have specific examples of what happened this quarter. And I think we made a very intelligent decision to take advantage of the stoppage that we had in our plants to accelerate some of the maintenance that we had to do. So we try to do what was right to do and in spite of having to explain some negative cash or divisional cutbacks in this specific quarter.

I think we have to consider that we have this additional – as I mentioned during my presentation, we have the additional situation in terms of interest that we have this additional cost that we added to this, specifically on the working capital. Yeah. I think we had this situation. We expect cash flow to improve. I mean, in a – I don't know if you got that completely. But in this cash flow, we just have one month of National Beef, so it's not a pro forma. So, we are not putting all the cash flow from the business in this number. So, that's one of the reasons why we were a little bit careful before we start the presentation, trying to demonstrate the data that which the numbers were demonstrated. And again, it does not include any cash flow from Keystone Foods.

So it is, as I mentioned before, it's pretty much focused on the Brazil operation where we had a strike and we decided to make some additional investments in the CapEx, the maintenance CapEx. And I think until we have to say we are going to continue having some additional cost in the interest, as you may imagine.

Q - Thiago Duarte {BIO 16541921 <GO>}

Yeah. That's helpful. And then, one last question, just to give us your view on the Brazilian operation or the South American operation, you mentioned that margins in U.S. were higher than in South America. So, that's how you resulted in the 9 percentage EBITDA margin. But it looks like, looking at the market, talking to some of your competitors, it looks like the spreads in the Brazilian beef industry are improving or have been improving over the course of the last few months, considering the currency, considering the cattle cycle. So, just would be nice to hear your thoughts on where you see the profitability for the beef industry in Brazil going into the third quarter and the second half of the year. Thank you.

Operator

Our next question comes from Marcel Moraes, Santander.

Q - Marcel Guimaraes de Moraes {BIO 6696122 <GO>}

So Marcos, Martin, Miron, first, congratulations on the acquisition of National Beef. And I think Miron was discussing the very important aspect, which is the cash flow, and I understand that the exercise that we see in the presentation does not take into account National Beef, maybe three months of National Beef. But you probably have made an exercise, an internal exercise considering what if National was incorporated the full quarter, and if you exclude the, let's say, the negative impact from the truckers' strike, what do you think the cash flow would look like? So including National Beef, the three months, and excluding this impact from the truckers' strike in the Brazilian business, how much better you think the cash flow would be? This would be my first question. Thank you.

[Technical Difficulty] (00:38:46-00:40:53)

Operator

Mr. Marcel, could you please repeat your question?

Q - Marcel Guimaraes de Moraes {BIO 6696122 <GO>}

Yes. Okay. Hi. Good morning, everyone. Congratulations on the acquisition of National Beef, has shared some thoughts about the cash flow and it's quite clear for me that it does not incorporate National Beef during the three months of the second quarter. But is it possible to give us an idea of cash flow or what will the cash flow in case you include National Beef for the full quarter and if you exclude the negative impact from the truckers' strike in the Brazilian business? Is it possible to do the exercise to give us an idea of how much money you have made in such circumstances? Thank you.

A - Eduardo de Oliveira Miron {BIO 15427272 <GO>}

Yeah. So first of all, sorry for the technical issue that we had. So yeah, (00:41:54) had just one month. I believe, if we consider the overall results, I think we'd be more in a flat basis for the cash flow.

Q - Marcel Guimaraes de Moraes {BIO 6696122 <GO>}

Right. And so, I mean - do you mean a bit flat? Does it mean you're comparing to the BRL 156 million - not only the operating cash flow, you're talking about the free cash flow as a whole, so the BRL 568 million?

A - Eduardo de Oliveira Miron {BIO 15427272 <GO>}

Yes. Yeah, the whole free cash flow.

Q - Marcel Guimaraes de Moraes {BIO 6696122 <GO>}

Thank you, Miron. And additional question, it's about the working capital needs for National Beef. What should we expect? I mean, when you compare National Beef with the South American business, how do you compare the working capital needs? Of course, National Beef is much larger, but I'm not sure if (00:42:52) need more working capital than South America. Can you give us some color on that?

A - Eduardo de Oliveira Miron {BIO 15427272 <GO>}

Yeah. Again, Marcel, I think the way we started the call saying we're in the middle of this transition. So, I think we have to work a little bit more on the model with the analysts, so in order to help you to prepare your figures. So on our end, we are not expecting any major impact from National Beef. I think for this (00:43:26), we had a small increase in inventory in National Beef but that was something that was not necessarily expected, but there was a small increase that should be included in the number that you see in this one month that we - including in this cash flow. So, nothing major but we don't - for the whole part, we will have to provide a better perspective in terms of working capital for the future so then to help you to prepare your model.

Q - Marcel Guimaraes de Moraes {BIO 6696122 <GO>}

Sure. Thank you. And finally, with regards to the South American business, so you mentioned that profitability has gone down a little bit. And the question is, is it because of Uruguay or the Brazilian business is also - the margins are also going down in the Brazilian business?

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

Regarding the margin, we have a little down in Uruguay for the reason that we have a very good and strong activity at the beginning of the year for (00:44:49) season, and we'll reduce the production for the - in the second semester of the year. And as you know, it's a very, very small country that all these events make some significant movement in the volume of the activity, but we compensate during the year. We are going to achieve the same volume that we have planned in our batch.

Q - Marcel Guimaraes de Moraes {BIO 6696122 <GO>}

Thank you, Martin. But when you - just trying to understand if in the second quarter, the reduction in the profitability of the South American business, if it was kind of fully explained by Uruguay or in Brazil, there was also some, let's say, pressure because of the truckers' strike or just to understand what we're going to see next, if it's something more structural or something very (00:45:55) related to the truckers' strike affecting Brazil. And it may not be the case. It may be only because Uruguay is not running as fast as in the past.

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

Well, the other events that we have in the - affecting our result, as Eduardo commented before, is the event of the strike in Brazil. We lose at least 10 days of the operation in the whole Brazil because we - it's not possible to collect the animal for slaughter. We have very important problems on the exports. Also, that was very difficult time to collect the containment of the (00:46:47) and later on to put the containers on the basins (00:46:49). When (00:46:52) a little bit in the local market because we have problem on our (00:46:59) beef but we can share with the customers in this morning records, but of course, was a huge event in three months. We lose 10 of the operation, will have an important impact.

All the operation is already going to normal. We almost finished our problem with the export because, later on, we're going to have all the space that we need on the basin (00:47:34) because it was a national strike. A lot of product from the field are on the flow waiting for space. But we almost finished everything regarding the export sales.

Q - Marcel Guimaraes de Moraes {BIO 6696122 <GO>}

That's perfect. Thank you very much, and once again, congratulations on the acquisition of National Beef.

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

Thank you.

Operator

Our next question comes from Teo Lasarte, Insight.

Q - Teo Lasarte {BIO 15017626 <GO>}

Hi. Good afternoon. I was wondering if you can comment a bit on the pro forma adjusted EBITDA that you presented, so the BRL 918 million for the second quarter and you have BRL 490 million (00:48:21) in the second quarter of 2017. Now, looking at your results from last year, the beef operation had BRL 238 million of EBITDA. So, that seems to be a very small number for National Beef on these pro forma numbers. So can you comment, did anything happen in Q2 2017 for National Beef which resulted in very low earnings in this division?

A - Eduardo de Oliveira Miron {BIO 15427272 <GO>}

Yes. Hi, Teo. Yeah. So I think, I mean, we are trying to (00:49:03) put everything (00:49:05). Your question, I believe, is about the EBITDA. It's BRL 490 million (00:49:07) to BRL 918 million, correct? So the variation and the participation of the different business and it seems that National Beef is pretty small one year ago, correct?

Q - Teo Lasarte {BIO 15017626 <GO>}

Yes. I'm trying to understand why National Beef had such low earnings in Q2 2017.

A - Eduardo de Oliveira Miron {BIO 15427272 <GO>}

Yeah. So again, we won't go into the specifics, but I think the bottom line of the situation is we have two main drivers. So, one is the cattle cycle, and then, I think we are in a different momentum in terms of beef in U.S. And I think that's why we said that our decision to enter was timely and right and we believe that we did the right thing. And the second thing that you have to consider is you have the FX impact as well. So, it's the – we have here in – when you saw the (00:50:04) that we provided for the sale, you see that the FX is an important component over there, correct? So, there is the additional component in those numbers. So in terms of National Beef, I think the main driver was the cattle cycle during these two periods.

(00:50:26)

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

Just to complement the comment of Eduardo, we don't consider that Natural Beef result of last year was no good. It was very good, but this result was excellent. And for that, I will mention.

Q - Teo Lasarte {BIO 15017626 <GO>}

Okay. Because it seems some part of the National Beef in Q2 of 2017 had an EBITDA of roughly BRL 250 million, which is significantly below the EBITDA figure you gave for National Beef when you announced the acquisition. So, I think that's where I think we're all trying to understand why the EBITDA at National Beef is so low.

A - Eduardo de Oliveira Miron {BIO 15427272 <GO>}

Yes. And I'm sorry, we had Tim Klein in the line. So, he can provide some color about the (00:51:17) 2017 and the development in 2017 (00:51:20). So, I think it'll be great to have (00:51:23). Tim, are you there?

A - Timothy M. Klein {BIO 16522695 <GO>}

Yes. I'm here. To answer your question, first of all, the cattle cycle in the U.S. has continued to improve. So, the dynamics in place for 2018 were better than they were in 2017 for the – for each quarter of the year. In addition to that, this year, June was a five-week month. Last year, June was a four-week month. So, there's one extra week in this year's numbers.

Q - Teo Lasarte {BIO 15017626 <GO>}

Okay. Okay. Understood. Just one follow-up question then, so the BRL 490 million (00:52:09) from 2017, that's using last year's exchange rate, whereas obviously, this one, Q2 2018, is using the current exchange rate, and that also had a big impact on the reported EBITDA?

A - Eduardo de Oliveira Miron {BIO 15427272 <GO>}

Yes.

Q - Teo Lasarte {BIO 15017626 <GO>}

Correct?

A - Eduardo de Oliveira Miron {BIO 15427272 <GO>}

Yes.

Q - Teo Lasarte {BIO 15017626 <GO>}

Okay. Thank you.

Operator

Our next question comes from Autumn Graham, Schroders.

Q - Autumn Graham {BIO 16486290 <GO>}

Hi. Can you hear me?

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

Yes.

Q - Autumn Graham {BIO 16486290 <GO>}

Great. Hi. This is Autumn Graham from Schroders. I have two questions. The net debt-to-EBITDA figure cited at 4.2 times. Is it calculated in dollar terms or in BRL terms? So specifically, what FX rate are you using for the net debt figure and what FX rate are you using for the LTM EBITDA figure?

A - Eduardo de Oliveira Miron {BIO 15427272 <GO>}

Yeah. You are correct that we are calculating this in reals, right? So therefore, there is an impact of the FX. I think I try to address this when I said that this number has a negative impact of the difference of FX that we are utilizing between EBITDA and the FX for the end of the month, which is what we used for the debt. One additional information that we gave is if we normalize the FX, we will have a leverage ratio below 4 times. And we also provided (00:53:58) the P&L FX rate was BRL 3.61, and for the balance sheet was BRL 3.86.

Q - Autumn Graham {BIO 16486290 <GO>}

Okay. So, you're – okay, so you're using the average of the last quarter but not of the last 12 months for the P&L figure?

A - Eduardo de Oliveira Miron {BIO 15427272 <GO>}

Yes, several averages for the quarterly EBITDA.

Q - Autumn Graham {BIO 16486290 <GO>}

Okay. That's helpful. And secondly, certainly, it's very welcome to see this commitment to financial discipline as the company kind of think about its long-term strategies. Is there a way to quantify what financial discipline means and either quantify it or what does that really mean to the company?

A - Eduardo de Oliveira Miron {BIO 15427272 <GO>}

Yeah. Yeah. I think we've been – that's one recurring theme for us and we have to go over these products. So, the financial discipline is to have total leverage that is adequate for the sector. So, our decisions and strategic decisions really were 100% linked to our belief that we have to have a lot of leverage for the (00:55:24) of real. So, our target is 2.5 times. It's still our main target for the end of the year.

The additional about the financial discipline is it's related to our liability management process and this includes making sure that we have financial health that will allow us to reduce our churn (00:55:51) and reduce our cost, our carrying cost. And we believe that with the finalization of the second leg of the strategic move, which is the sale of Keystone, we'll be ready to another round in our liability management that will provide a benefit for our carrying cost.

Q - Autumn Graham {BIO 16486290 <GO>}

Okay. So yeah, the commitment to 2.5 times is very strong at the end of this year. Can we be confident that that will hold as the leverage target over the long term?

A - Eduardo de Oliveira Miron {BIO 15427272 <GO>}

Sorry. I was on mute. So yeah, our aspiration certainly is to be investment grade. So, we are going to continue working on this. We do it step by step. I think our products (00:56:59) that I just mentioned.

Q - Autumn Graham {BIO 16486290 <GO>}

Okay. Thank you.

A - Eduardo de Oliveira Miron {BIO 15427272 <GO>}

Thank you.

Operator

This concludes today's question-and-answer session. I would like to invite Mr. Martin Secco to proceed with his closing statement. Go ahead, sir.

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

Thank you very much. We would like to invite especially the attendants that have question already to follow us in the Portuguese call because we are just on time to be in the other call. Thank you very much and keep in touch.

Operator

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