Q1 2009 Earnings Call

Company Participants

- Antonio Augusto De Toni, Export Director
- Jose Antonio Fay, CEO
- Leopoldo Saboya, CFO & IR Director

Other Participants

- Marcelo Luna, Analyst
- Pedro Herrera, Analyst

Presentation

Operator

Good afternoon. Welcome to Perdigao SA's First Quarter conference call. The conference call and the presentation are simultaneously transmitted by a webcast on our website at www.perdigao.com.br/ir. At this time, all participants are in a listen-only mode and later we will conduct a question-and-answer session. Instructions will be given at that time.

We would appreciate if each participant made only one question.

(Operator Instructions)

Forward-looking statements relate to the Company's business 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. Those are subject to changes. As a reminder, this conference is being recorded. At this conference are Mr. Jose Antonio Fay, CEO, and Mr. Leopoldo Saboya, CFO and Investor Relations Officer.

I would now like to turn the call over to Mr. Fay. Please, Mr. Fay, you may proceed.

Jose Antonio Fay {BIO 15337837 <GO>}

Good afternoon. Thank you for everybody to be with us today. I will begin our conference call, talking firstly about that this is only a call regarding to First Quarter results and we will not comment about the rumors about the mergers and acquisitions and so on.

So our position, our public position regarding to that remains the same of our announcement on May 12th. So today we will talk about the quarter, the First Quarter of 2009, where we have, in spite of international prices, we have a growth in -- we grew in net sales 6%, which we consider it good, and we grew in volume, too. Even though we have 43% of our volumes in external markets -- that is, facing the crisis in biggest way.

In spite of, we have good sales, volume and net sales, we face difficulties regarding to expenses, mostly due to our partial shutdown of some units that we have to adjust our inventory levels, since we have some shortage in volumes in the last quarter of last year and the First Quarter of 2009. In order to adjust inventories, we had to stop partially some of our units and we pay the costs for in this quarter. Now Mr. Leopoldo will explain to you in details our quarter figures.

Leopoldo Saboya {BIO 16137418 <GO>}

Thank you. Good afternoon. So the idea here is to make a very brief presentation obtaining to the important points, so let's follow the presentation and now we can start on page four, page five, in fact, where we have the highlights of the results.

So first of all, a growth achieved in net sales, 6% growth, despite all of the odds we faced in the quarter, and 3% growth in volumes, so both volumes and revenues grew, which is very important to remark at this moment. Our gross margin was affected by all the difficulties faced, but especially regarding all types of granted (accounts) that were necessary to keep the flow of the exports and also some costs of (aided) capacity due to the technical shutdowns mentioned by Mr. Fay.

So all of those extraordinary losses we had in the quarter amounted something like BRL80 million in the quarter and on top of that we had also the effect of the fiscal loss recognition due to the Agroindustrial as a subsidiary incorporated as the Perdigao SA. So this was also an extraordinary result. That's why we considered the real bottom line of the Company the BRL94 million negative, these losses in the quarter.

The EBITDA margin, we reached 4.5%, which we know it's low, very low, in fact, in historical terms. And the EBITDA or (approximate) cash generation, BRL118 million. So some of the details on the next page that I already mentioned, the sharp decline in the export market price, with that movement of prices, made two main impacts. One was of course the marginal price of the next shipments, was done in much lower prices, but also this sharp decline in export prices demanded us discounts on the existing sales and booked sales. So that's why we had that extraordinary result during the quarter that we can say that was pretty much everything was we faced of difficulties to keep the flow of our exports.

So what I mean is that going forward we don't see these types of impacts of (granted) discounts keeping in our coming results. Of course, this movement of adjustments of inventories in Brazil leads to a redirection of volumes from the exports toward the domestic market, which also pressured the total domestic availability of meat in general and made our performance in meats in the domestic market tougher.

The cost of idle capacity, I've already mentioned, and of course we had also other collateral effects of this, of all of these that I've mentioned, that these reduced export flow. When we kind of lost track, we had an increase in our commercial expenses, which we think that when we're back to normal volumes and with the prices back into more (approachable) levels, we'll have this, such increase in investments that will dilute our commercial expenses to a more normal level.

Now, talking a little bit more about each business. Let's jump to the page eight. This is just a highlight of revenues. It's here I think it's important to mention that pretty much all the categories had presented growth, which we think it's very important in this context, so all the categories faced important growth in revenues.

Now, moving to the page nine, it's still to deconsolidate the level of protein prices and grains prices, but what we see nowadays is a much more predictable or at least better. We can better predict the market than we could have during the middle of the last quarter, so we are seeing now protein prices picking up.

The bottom of the market, we think it was February to March, from March on prices, it started to react, especially chicken. When you see grain prices, pretty much the same movement, and corn prices kind of stabilizing in the range of (3.50 to 4.00), and we think that these international prices will be sustained by reduction of US crops and a marginal increase in the consumption, especially for ethanol. In soybean, also, there is an upward trend, but not a (rally) in prices going forward. We think that this level of 10 or a little bit higher than that will be the trend.

In milk, as we can see here, after a lot of volatility in the past two years, we are now in a much more adequate and much more balanced market, which is good for us, and, as we will see, helped us to achieve very good performance in the dairy sector. The FX, after a big correction, it seems that it's trying to find a level near to 2.10. It was around 2.20, 2.30, and now the real has appreciated against the dollar and it's trading around 2.10. Of course, it will ask for more correction in international prices and if the real keeps strengthening, of course, it will make harder our recovery and profitability of the export market. So now let's straight jump to the page 11 and then it's needed, we're back to the page 10, where we have the breakdown of the mass-market sales.

So in the domestic market sales, I think that we had a good performance, not so good in volumes, but very good in revenues, and especially very good in profitability in the diary segment. We consider that pretty (on) nowadays has a very good breakdown of its domestic sales, a very strong presence in the processed meat products and also a very well-balanced and a very strong presence in the dairy segment, which makes our volatility lower.

So in the meat, we had lower volumes, and here the lower volumes in the mainstream category, which is elaborated in processed meats, it was due to the phase out of (Agipao) brand name, which we bought from Eleva and this phase out was a strategic movement in the middle of last year to (adequate) the portfolio of Eleva, and so that's why we had this drop in volumes. But of course, we had a very good performance in revenues and also a very good performance in terms of EBITDA margin for this segment. Of course, we had -- we needed to push a little bit volumes in the in natura or raw chicken and pork, because of the excess of products in the export market.

So that's why the overall performance of the meats in the domestic market was not that good. But dairy, on the other hand, we had a very good performance. So in volumes, 11% growth and revenues, 2.7% growth because we are living with raw milk prices much lower, approximately 17% lower than last year's prices.

As I said before, today this market is much more balanced and now is having good performance both in the food milk market, which means the UHT milk and pasteurized milk and also the processed products, where the Batavo brand name became 5% of growth in relative -- in the markets in these processed products markets in dairy.

So going forward, now I think we can go straight to the page 13, where we have the breakdown of the export sales. So the export sales, just a few words before we go into more details. During the quarter and, in fact, since November, we were in the middle of a big adjustment of the market, not only in Brazil, United States, but in all the world, we had a de-stocking process for the chain. We needed to adjust our production (lines). We also had disruptions in the logistic systems, so the majority of the impacts, not to say all the impacts, were concentrated in this quarter. And we are now much more positive going forward, although we recognize also that these (two) quarters, the Second Quarter, is going to be a transition quarter, powered more positive scenario in the second half.

I will explain why. So even though -- so on top of all of these difficulties, we grew volumes and revenues in the export market, so we think this is very good. And we had 5.1% growth in meats in general and a growth of 6.3% in revenues.

If we look on page 14, you can see that we had a sharp decline in our export prices in dollars, so 22% drop. This is just -- we cannot compare this pricing in dollar (form) with the real impact of prices in reals, because these price is in dollar form and it's just for meat. But this is just a reference to understand how big was the impact in the quarter. So the 22% drop, it was against the First Quarter last year and it was the same drop compared to the Fourth Quarter last year, which means that we faced a dramatic change in the market conditions.

But now, after February, the market has started to pick up and the de-stocking process, at least we think it's over. We have now in the world, and we can feel that the market, the supply-demand situation of leads, is much more balanced. We don't see a surplus of big inventories in the world, not in both producers and importers. When we look to the Brazil and United States, or the big chicken and pork exporters, we don't see big inventories, and also in the main markets we export, we are seeing markets now much more balanced, which makes us believe that we are in a period of stabilization of volumes and a continuity of price increase, which is not a -- it's going to not grow as fast as it has dropped. Thus it will keep increasing during the quarter and we believe that by the Second Quarter end, prices will be back to a more realistic level.

So the second half of the year will start with a more adequate profitability in the exports. Of course, all of this depends on the FX and the movement of other players in the market, in which we still see some opportunities and some irrational movements in the market. But it's much lower than it was during the last quarter.

So now talking a little bit by market, on page 15. So on page 15, starting from the middle, this is the region where we are seeing a real recovery, both in volumes and in prices, and prices are keeping in the upward trends. In the Far East, Japan is back into a more normalized slow in terms of volumes, inventories we consider that are normalized.

In Hong Kong and Singapore, a flat market, and a very tight increase of prices and the trend is to recover slowly. In Europe, it is the region where today we are still seeing more difficulties to be positive about the markets and if we split by turkey and chicken, in turkey the situation is tougher and for sure we don't see a solution for that in the short run. It will have a long-term solution for the turkey market there. Very high inventories built. In the chicken market, there is a recovery ongoing very slowly, but recovering and volumes much more stable right now.

In Eurasia, basically Russia here, volumes are showing slight recovery. Also, a recovery in prices and we believe that within three to four months, the situation there will be much more positive for the pork market. S now, going to the debt and investment, on page 17, we have the profile of our debt, where we can see the net debt, 3.6 billion. It is slightly over the figure of last year, Fourth Quarter last year. And of course, much higher than one year ago, but when we see the net debt to EBITDA position, of course, we are now at 3.3 times EBITDA, which we recognize that is not that comfortable and it's not the ideal threshold for us.

But on the other hand, we consider that on top of all the difficulties we face, the increase from one year ago, it is not dramatic. So only jumping from 2.6 to 3.3, but we think it's measurable. We keep our liquidity in a very high level, as you can see here in our cash position, total cash investments at BRL1.8 billion, which is the same amount of the current debt position, so all the liquidity ratios of our balance sheet is very good, so although we had a very poor quarter in terms of operational results, our financial statements are as strong as it was in the ending of last year.

In terms of investments, on page 18, the one -- approximately BRL120 million invested in the quarter is in line with our total CapEx for the year, which is planned to be BRL450 million and the split of the investment is shown below.

So on here, to finalize, on page 20, just a summary of what I said, this gradual recovery of exports, we -- although we are constructed not to say positive so far, with the market, we cannot assure that this recovery is sustainable and is consistent. We have very strong signals, but we are still under an adjustment process, much more slowly, much more smoothly than it was since the ending of last year, but there are other things to be addressed before we keep the confidence that we will have a very good coming results by year end.

So of course the improvement in economics in general, fundamentals of the world economics and Brazil economy, is helping the market. We think that we will also help our future results, our future performance. We keep the focus on profitability for sure. We need to enhance our operational performance, to (back) to Perdigao's historical levels of profitability. Also, another expectation for this year is the capture of synergies due to the integration of commercial and administrative process, and also because of the subsidiaries' incorporation. Now we have a much more clean and slim structure, where the Perdigao SA is the holding and the operational company.

And also, keep with our new commercial model called Go to Market, where we believe we will have a future results regarding the execution of sales. So by saying this, I thank you very much and also we now will start the Q&A session.

Questions And Answers

Operator

(Operator Instructions) Our first question comes from Mr. (Marcelo Luna with Money Securities).

Q - Marcelo Luna {BIO 15380566 <GO>}

Thank you. Good morning, gentleman. Can you hear me okay?

A - Jose Antonio Fay {BIO 15337837 <GO>}

Yes.

Q - Marcelo Luna {BIO 15380566 <GO>}

Thanks. I know we've discussed the export volume question before. I just wanted to follow-up on that and with regards to your comments, when you're saying that Europe, your export business to Europe is still looking very challenging during the First Quarter. I just wanted to have a better sense for how it is looking right now in April and May, because it sounds like we could still see volumes of your processed meats dropping in the Second Quarter, even dropping when compared to the First Quarter of 2009. So I just want to understand, when you say challenging, does it mean that volumes should continue to fall or you might see stable volumes in Europe compared to the First Quarter? That's -- I guess that's my question.

A - Leopoldo Saboya {BIO 16137418 <GO>}

Okay, Marcelo, we have here Mr. Antonio Augusto De Toni, or so-called (Guto), our Export Director, and he will be pleased to help you in your question.

Please, Guto.

A - Antonio Augusto De Toni {BIO 15337840 <GO>}

Hello, Marcelo. Again. Good morning. Well the volumes especially for the further processing of products, including April, is recovering a bit. But we believe we can achieve the normal levels by the second semester only. Because in the first semester, we have health restrictions, which is the quota, the quotas we get from the European Union and the (closes) we get, the (orders), in case we get from Brazil from the ministry. It is much more limited, or in lower volumes during the first semester.

For the second semester, we're going to get more volumes in quotas, and then we can achieve again the same levels of volumes that we have in second semester of 2008. This is one point. In the second point is that we decided to reduce a bit the volumes of (this) of the further processes, because of the profitability. We decided to renovate some projects and to impose some new prices to the customers and it was important for us that we have to reduce the volumes.

Now we are (associating) in renegotiating some new contracts and older contracts that we have with (importers), and then we can go to the normal levels again.

Q - Marcelo Luna {BIO 15380566 <GO>}

Excellent, thank you. And as far as the chicken and poultry exports, I don't think there is any reason to believe that volumes will remain (solid) in the Second Quarter, because obviously if there is oversupply in the First Quarter, so your volumes were up, so we should also see volumes of chicken in natura going -- falling, continue to fall, or weak volumes in the Second Quarter, right, compared to the First Quarter?

A - Leopoldo Saboya {BIO 16137418 <GO>}

No. The volumes. I can tell you the volumes for chicken now in this Second Quarter, and especially in the Third Quarter, it will go a little bit better, because normally -- in general, in the markets, we don't have any in stock, for example. I can give you one example. In Russia, for example, they will use it to work with three, four months of stocks and now, once they are short in finance, they are working with one or two months of stocks.

Now that prices are increasing a bit and those normal level of stocks in the global markets were lower, to recover the volumes from the export to Brazil. So now, I cant tell you, the First Quarter was very, very, very tough. The Second Quarter, it's improving a little bit, but it's still not a normal condition or the normal situation in the market.

We will come to the normal situation during the -- especially in the Third Quarter, when we have a good season because some of the markets, they are doing stocks for the Christmas, for the end of the year and this is a very god season for this, also for increasing prices and recovery volumes. Then we try, if we're going to try to keep the same volumes and prices for the last quarter of the year.

Q - Marcelo Luna {BIO 15380566 <GO>}

Okay. Great. Thank you, so much. And just a last quick question, Leopoldo, as far as your cost of grains now in April and May, would you say that they are probably at similar levels, maybe slightly higher, than your costs that were reflected in your COGS during the First

Quarter? So should we see higher cost of grains going through your COGS during the Second Quarter of 2009? Or just stable?

A - Leopoldo Saboya {BIO 16137418 <GO>}

They are pretty much stable.

Q - Marcelo Luna {BIO 15380566 <GO>}

Okay, good. That's very helpful. Thank you, so much.

A - Leopoldo Saboya {BIO 16137418 <GO>}

You're welcome.

Operator

Excuse me, our next question comes from Mr. Pedro Herrera with HSBC.

Q - Pedro Herrera {BIO 15159561 <GO>}

Hi, gentlemen. I just have a quick question, regarding in your exports, you mentioned that you were granted discounts to the importers, your clients. Could you elaborate some more and is this expected to continue into this quarter and next quarter towards the end of 2009?

A - Leopoldo Saboya {BIO 16137418 <GO>}

Okay, I already mentioned that the majority of the credit discounts, the impact was due to the First Quarter, but I will pass to Guto to put some more color on that.

A - Antonio Augusto De Toni {BIO 15337840 <GO>}

The granted (accounts) occurred mainly in two markets that we have, for example. one of the markets, it was the Eurasia, or mainly Russia, because of the devaluation of the ruble. The ruble was devaluated by 50% and then the customers, they ask us to help them because they have to buy in dollars and then to sell in rubles, and it's impossible to increase the prices in rubles by 50% from one moment to others. The other market that we had problems, it was in Middle East. It was not a problem of the currency, because the parities in the Middle East are fixed by the government, but we had for example customers working with Perdigao for 32 years. The oldest one we have there is 32 years working for Perdigao, and we have to help the guy to move the stocks and to reduce a little bit the losses in the market.

Also, because some of the players in Brazil, they started to reduce the prices. So it was this occurrence in the First Quarter, so we settled the situation First Quarter. In Second Quarter, we are finishing at all any problem of discounts of renegotiation of the prices and for the third and Fourth Quarter we don't believe we're going to face any kind of problem like this.

Q - Pedro Herrera {BIO 15159561 <GO>}

Okay. Thank you.

Operator

(Operator Instructions) This concludes today's question-and-answer session. I'd like to pass the floor to Mr. Saboya for his final statements. Please go ahead, sir.

A - Leopoldo Saboya {BIO 16137418 <GO>}

And I will pass to Mr. Fay that will make the final comments.

A - Jose Antonio Fay {BIO 15337837 <GO>}

Okay, just to summarize what we (start) before, we think that in domestic markets we will keep on looking for profitability even if we have some sacrifice in volume. In external markets, as we said, we have some -- we have weak performance for Russia and Europe, with some recovery. Far East and Middle East, good recovery, and good expectations for the future. And Americas and Africa, stable and good volumes, second half transition, and we are still positive for the second half, the Second Quarter transition, and we are still positive for the second half. The risk is the FX pressure that can jeopardize our international prices, but in general we have a good overview, a good time for the second half. Thank you, everybody, see you next call. Thank you.

Operator

That does conclude our Perdigao SA's conference call. Thank you very much for participation. Have a good day, and thank you for using Chorus Call.