

## Q4 2016 Earnings Call

### Company Participants

- Leonardo Almeida Byrro, Vice President and General Manager, Brazil, Planning and Distribution
- Pedro de Andrade Faria, Chief Executive Officer Global

### Other Participants

- Alexander Robarts, Analyst
- Lauren Torres, Analyst
- Luca Cipiccia, Analyst
- Pedro Leduc, Analyst
- Victor Saragiotto, Analyst

## MANAGEMENT DISCUSSION SECTION

### Operator

Good morning, ladies and gentlemen, and welcome to BRF SA Conference Call to discuss Fourth Quarter 2016 Earnings. This conference call is being transmitted via webcast in our website, [www.brf-br.com/ir](http://www.brf-br.com/ir). At this time, all participants are in a listen-only mode, and after the presentation, we'll 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. José Alexandre Carneiro Borges, 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 to all and thank you for being here. We closed another year at BRF, deeply disappointed with the result we present today. 2016 was a very difficult and a typical year

FINAL

Bloomberg Transcript

FINAL

as we have been saying given the grains, deep retraction of Brazilian economy, and despite this perfect storm, we managed to protect our margins at two-digit levels at much higher than historical parameters.

As Abilio mentioned today in the Portuguese call, we are proud with the work we have done in the past four years. We made improvements in various fronts. We also acknowledge that there were some mistakes along the way. As we approach the year end, we start to discuss at the board level how we could improve and revert our results. With that in mind, we went to 2017, 100% focus on reverting the current trends. We hired a well-known consultant company, BCG, to provide us an independent and deep diagnostic of the business.

So, yesterday, at our board meeting, we also approved the establishment of a steering committee, which will be led by our Chairman, Abilio Diniz, and this committee will be formed by Abilio, Walter Fontana and (00:02:45) who has more than 30 years of experience in the industry and has been working with us in the capacity of an independent consultant, (00:02:53) and by BCG, which have been supporting us in this process. This committee will meet at least once a week for at least 90 days to ensure that the initiatives will be implemented with excellence.

After the first diagnosis, I'd like to detail with you the three big agendas we would like to be engaged. First one, obviously, to recover our profitability in the short-term. The focus here is to increase cost competitiveness, both in the industrial and agro fronts. We have already improved quite a bit in a few indicators like our feed conversion and productivity use. But we see a lot of additional opportunities to tackle in areas such as procurement, specific opportunities in the footprint and also a different management model with our outgrowers and partners in the few.

In the search for synergies and efficiencies, we will also reorganize some corporate functions, focusing on what we think will optimize and bring a lot more agility to our decision process. And besides that, we are implementing yet another round of ZBB. This is our fourth year in a row implementing the methodology.

The second agenda is how we deliver our growth targets. And we'll spend a lot of time and energy in Brazil in OneFoods, as we see them as the main growth levers and avenues of today.

In Brazil, we already told you before, we have improved significantly our service level with the main national retailers. If we take a look only at the cash-and-carry channel, this evolution was stronger and already resulted in a positive outcome. For instance, in the second half of 2016, we delivered a 12.5% top line growth year-over-year in this channel.

The main strength of the company lies in the traditional trade channel, which has suffered more from the retraction in consumption and also from the down-trade trends that we verify. However, we've been implementing a new segmentation model that significantly improved our execution and service level, already showing positive signs. With that in place, we believe we'll have a much more granular understanding of each individual

point-of-sale getting to know them better and delivering products and offers that are much more customized and effective.

We are keeping our efforts in innovation as we did in 2016. And besides already substantial pipeline of high value added products, we also take a very important initiative in our base-load, high-volumetric products. With that, we'll be able to strengthen our position in the entry level segments and protect our core.

Besides that, with the end of restrictions from the antitrust authority in June 2017, our portfolio of brands and products can become wider and we'll be able to act in some entry level segment that today we're not present.

We are reshaping our marketing strategy, intensifying deeply the category management. The idea here is to enhance the connection of our consumers, reinforcing our brand strategy in each individual category, directing much more effectively our resources to better execution.

I'll give one specific example. In the first quarter of 2017, we see a positive seasonality for cold cuts, which is the most profitable category in our portfolio. And as such, this category now is our deep focus. We are investing a 360-degree activation campaign with above the level media, consumer campaign, trade marketing materials, more than 500 additional merchandisers working in the point of sale. So this mobilization concept brings the kind of execution that we do with Christmas products every end of the year.

In OneFoods, we have concluded successfully the carve-out of all the assets, therefore creating the largest Halal protein company in the world. We see significant growth potential in these markets. And as a first step, the acquisition of Banvit in Turkey has made us our first and most important player in the largest Halal food market. In the meantime, we're also working on a potential capitalization process to enhance and deepen our links to the region and accelerate even further this expansion.

Third and last agenda is building a model of integrated management. In that front, our main initiatives will focus on elevating core process of the company and how to evolve our supply chain planning process in a much more integrated and transversal one. When we split our international business in regions and even Brazilian in sub regions, we have become a lot closer to consumer and clients, but we created a bigger challenge to optimize our consolidated business. In many cases, our learning from past mistakes has shown that optimizing one specific part not necessarily brings the best for the overall company.

With that in mind, we are building a much more transversal concept of planning and management that will focus optimizing also our long and complex supply chain, understanding the needs of each market, but working in a much more balanced way in our pull versus push strategy.

I believe this is a very special moment of the company and it would be very important to be transparent and give visibility to all of you. Therefore, we are sharing some of those

initiatives we have put in place. I believe we are in the beginning of a new cycle in which I am very confident to prepare and to extract the best of what we have accomplished in the past four years and to achieve our long-term goals.

BRF now needs to change and adequate itself, but without changing the course of its long-term strategy. The Steering Committee, led by Abilio, will help us a lot in this journey and Abilio will play a key in this. And I would like to thank him for all the support in this process.

I finish now my comments and we can go deeper into our results of the fourth quarter in our Q&A session. Thank you very much for attending today's session.

## Q&A

### Operator

Ladies and gentlemen, we'll now begin the question-and-answer session. Each participant may ask only one question. Our first question comes from Lauren Torres, UBS.

#### Q - Lauren Torres {BIO 7323680 <GO>}

Yes. Hi. Good morning. Pedro, not to be too backward looking, but I think we need to be still seeing the results that came out of last year, but in your release, you highlighted internal execution challenges. So, I'm just curious to get a little bit more of your perspective or specifics on those challenges.

I know there were industry-driven challenges and competitive challenges within the industry. So, just curious what was – I don't know if I'd say self-inflicted or kind of out of your control that you felt were the biggest challenges of last year, and just thoughts on how easily can those be corrected as we think about your 2017 results. Thank you.

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

Lauren, thank you very much. This is a great question we had the chance to answer in the Portuguese call. I think the best way to simply my answer to you. In 2016, we have suffered from a big dislocation in markets, in parameters, in variables, which are critical to our business and that we don't totally have control.

What perhaps we did envisage back then, and I think it has given us the possibility to really understand, is that the way we were organized and the way we were trying to become ever closer to the market, we basically didn't cope well with second-order effects and third-order effects of the dislocations in the market.

What do I mean by that? We have a long and complex supply chain, okay, and we need the perfect and well-integrated expression of that. So, in a genuine attempt of maximizing our profit in all of the markets and business units that we operate, we lost a bit of sight

FINAL

and visibility and ability to react to challenges in the supply chain. So, today, we enter the year of 2017 and I think the fourth quarter results were very good testimony of that for us.

We're still taking some lagging effects of the crisis we've seen in 2016 in the form of inventories in some markets, in the form of some (12:12) in some of our factories, in the way we have to actively promote promotions in advanced shelf life products, so all of those they have really hurt our profitability as we reverse the original trends of the markets.

And that has given us a lot of visibility on how to correct what I'm calling a self-inflicted pain into a much more transversal way of operating the company, bringing core processes closer to the decision point. Also, instilling a much more granular view of the way we manage the company, being able to respond fast to the effect in the market, so that we don't need to take both reactions with kind of a lagging perspective and without having the visibility of the whole.

So, the Steering Committee and myself, we're fully committed in the past 12 weeks to understand how we best organize ourselves, how do we elevate some key process of the company like integrated planning, like our category management, to make sure that many of us have a good perspective into the whole of the company. I think this alone will help us accelerate our process of reversing the profitability trends of 2016.

## Operator

The next question comes from Victor Saragiotto, Credit Suisse.

### Q - Victor Saragiotto {BIO 19504427 <GO>}

Hi, Pedro. Thanks for taking my question. I just want to understand that it seems that in mid 2017, the restrictions on launching new brand imposed by Brazil's antitrust body will be lift, which should make more room for BRF to launch a new brand focused on low end customers. I just want to understand, if it is part of the discussions in the company or not. Thank you.

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

Yeah. I would like to ask Leo Byrro, who heads Brazil unit, to try and elaborate the answer.

### A - Leonardo Almeida Byrro {BIO 17581639 <GO>}

Hey, Victor. So thanks a lot of for your question. And yes, indeed, this is the one important milestone for us in 2017. We are working on our strategy to be able to entering some segments of the market that we do not play today, specifically in Brazil, in some regions and in some categories. Around 30% of the volume of our categories is played in a very low-priced segment that we do not have brands today. And we are working on our strategy.

FINAL

If you look at the innovation pillar, we have been working a lot on the value-added, more premium products that we launched in 2016. So we'll continue to do that looking into 2017, but we will also expand our innovation platform and new products for 2017 looking at this low value-added segment that we do not play today.

And we see that in a very complementary way of our strategy of having the B brands as you go into Sadia operating in Brazil more in the mainstream and premium segments, but now having also the possibility to work on that low value-added segment, which is very important in the traditional trade segment, where we have been suffering most of our down-trade and competition pressure.

This is where those brands can play a role in helping us have a more broader portfolio and spectrum of offer to our consumers in Brazil.

**Q - Victor Saragiotto** {BIO 19504427 <GO>}

Okay. Thank you.

## Operator

The next question comes from Alex Robarts, Citigroup.

**Q - Alexander Robarts** {BIO 1499637 <GO>}

Hi, everybody. Thank you. I guess, my one question is about the focus on the domestic market and the channel mix shift toward the traditional trade as the convenience premium and the economic recovery comes back into the Brazilian economy, which we all expect at some point this year. I guess, for us, it's really about a 2Q tipping point, from our point of view.

But the bottom cycle, it seems to me, in Brazil has been reached and I think the debate is the pace of the recovery this year of that Brazilian margin. So, here's the question. When I think about the - as I understand the strategy, that the beginning of the year is perhaps not to look for price increases in the Brazilian domestic market. We also have this statement that you want to bring in some regional brands or new brands in this Value B brand segment after July when your restrictions peel off, and the mix effect that that might have. How should we think about the revenue per kilo growth throughout this year?

And kind of connected to that, you've talked since BRF Day in New York in October about getting the traditional trade channel up to par. How are you in that process? Do you feel like it's still a work in progress, the segmentation and go-to-market to the traditional channel, or are we almost finished, and the benefits of that work should show itself in the first half? So, kind of a couple small bits around a larger domestic market margin recovery question. Thanks very much.

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

Alex, thank you so much, a great question. I think it really ties in with what has been enormous focus for us and we had the opportunity to discuss in New York. So I think the conscious strategy the company undertook, which gave us some pain in 2016, we really focus on improving our ROE or net revenue per kilo. And that was really a significant push that we did.

Unfortunately, we had to be more often than we should have with rounds of price increases. This always creates some level of conflict with the channels, et cetera. But the lesson that needed to be done was already done and that homework is behind us.

So as we look at the current stage of the company, I think we're much more comfortable in terms of where our contribution margin is in the vast majority of our categories. And we also need to focus now on really providing a much stronger volume output, which would then also have a very important impact in diluting cost and expenses.

So I think on that process, I think we're pretty much where we should be. And then on the overall journey of understanding each one of our more than 200,000 points of sales, as they were individual, having access to online real-time data, in terms of disaggregation, categories, channels, regions and also with a much stronger ability to influence what's going on in the field, I think what gives us is a perspective of being much more granular and laser focused on the actions, promotions that we do to be able to manage our business much more granularly.

I'd also like to ask Leonardo to jump in and to give you his own perspective. But I think the process in Brazil is slow, but sure progress, which I think we'll be able to harvest a lot of what we are planting now. And I agree with you, with Brazil reaching the bottom and clients feeling the effect of lower inflation, feeling the effect of having more disposable income, a lot of what has proven to be our biggest challenge even shown by our festivities campaign, which is a down-trade of consumers, this is the first year in the past 20 in which chicken consumption per capita in Brazil dropped. This is unheard of in the last 20 years, but I think as we hit the bottom and consumers start making choices, more oriented towards brands and value, I think we having occupied a whole new perspective in the point of sales will magnify the impact of that recovery.

#### **A - Leonardo Almeida Byrro** {BIO 17581639 <GO>}

Yeah. So, just jumping in here and trying to break down your question, Alex, and complementing Pedro here, so first on the pricing, we have increased the prices to the level we think we need in all the categories and in all the channels and regions in Brazil. So, our contribution margin per kilo is now, in beginning of 2017, at a level we want. Of course, we do not anticipate any other increases throughout the year, but we might do that, but we'll focus a lot on execution.

So, first thing is, our prices being there, once consumers come back with economy bounding back in Brazil, we think that the mix effect that you're mentioning will really help us get back on track in terms of the whole (21:45) per kilo you see on our P&L today. Second is, the B brand strategy, or entering in new categories, or new brands as you mentioned, will help us play in a new segment which will bring marginal volume to our

FINAL

supply chain, leveraging our supply chain and helping us to dilute costs, one thing that we were not able to respond fast over the past months in our business here.

And third, it will depend a lot on our execution on the right volume, on the right channel in a very granular way, as Pedro mentioned. Now that we have the contribution margin per kilo at the level we need, it's really the time for us to increase our volumes in a planned way, in an integrated way of managing our business to be able to really get the right focus and the right price without compromising our supply chain in our industry.

**Q - Alexander Robarts** {BIO 1499637 <GO>}

Thank you. That's helpful. Thank you very much.

## Operator

The next question comes from Luca Cipiccia, Goldman Sachs.

**Q - Luca Cipiccia** {BIO 6914452 <GO>}

Hi. Thank you. Good morning. Just a follow-up from the Portuguese call. Just wanted to understand the order of priorities for 2017, especially when it comes to the OneFoods project and potential IPO or other plans there. My question comes from the fact that, towards the end of last year, and even in the beginning of this year, it seems that (23:20) perceived it, that something along this line was somewhat imminent or in the short-term.

And I wonder now, with this sort of rethinking or period of assessment of the strategic model that you talked about, as well as the results, the profitability of the fourth quarter in the Middle East, how should we think about that project and that potential sort of value creation opportunity in the short- to medium-term? Is it something that I would assume stays on the table, but should we still consider it possible in the first half of 2017, let's say, or those plans have been put on hold for a while?

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

Yeah. Thank you, Luca, for your question. And I think you are also attending the Portuguese call. Actually, OneFoods is probably, and together with Brazil, one of our main focus and obsession of 2017 as it presents itself as our biggest growth avenue, okay. I think we were very successful in that project of doing perhaps the very complex part of it, which is a complete carve-out of all of the assets, figuring out how the interfaces with the mother company should be and how the current position gives us a lot of interesting opportunities to reorganize ourselves.

As you think about the evenness of impact, I have to say that this is a long-term project. I think a good and bold step we did in January was the acquisition of the leading company in Turkey, giving us already the leadership position in the largest market. And we intend to continue pursuing interesting alternatives to even create deeper links with the regions we want to service.

Bloomberg Transcript



You will probably figure out, today's world, you have a number of geopolitical sensitivities, et cetera, but we just feel that the reception of the concept of a company trying and dominating globally a segment is very much appealing to a lot of long-term investors out there. So, we continue to work, and the progress is very much alive, and it is indeed part of this three agenda topic that I mentioned for the Steering Committee.

**Q - Luca Cipiccia** {BIO 6914452 <GO>}

And, Pedro, opening the capital, say, in IPO scenario, do you think now it's more or less appealing as compared to strategic investors for this - to reach the same goal or there's no one in study (26:07), there's no decision on which alternatives gives that result better in relative to the other?

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

Yeah.

**Q - Luca Cipiccia** {BIO 6914452 <GO>}

I mean are you still considering the IPO? Yeah.

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

No, at this stage, we're considering all alternatives. We don't have a clear decision and we intend to continue following up on these and giving you full visibility as we go along.

**Q - Luca Cipiccia** {BIO 6914452 <GO>}

Okay. Thank you. Thanks.

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

Thank you, Luca.

**Operator**

Our next question comes from Pedro Leduc, JPMorgan.

**Q - Pedro Leduc** {BIO 16665775 <GO>}

Good morning, everybody. Thank you for taking my question. And comes in respect to Brazil, and the pricing environments and you mentioned you took additional pricing in December, you enter 2017 with a higher base, but at the same time, we're seeing production costs declining, and probably a lot of idle capacity in your lines as well as still a very stiff competition.

And question to you is, would it be possible that BRF potentially rolls back certainly price increases done in the last year, so which product often didn't get eroded by mix in order for you to stimulate the volumes or refilling of your plants? In other words, is it possible that you share a little bit of the lower grain costs with the end consumer, especially mid-

year when you can update us well on the probably new brand introduction or another alternative for the consumer? Thank you.

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

Pedro, this is a very good question. So, today, I believe the company has positioned itself for what we understand being the current scenario. Of course, your question depends on how low grain prices can go, okay. For what I think we're seeing today, I believe we have - and given a long and very difficult process. I think we've been able to realign the parameters of profitability already in a number of categories. This is not as clear for us still in the international markets where I still believe there will be some room for increasing prices globally. But very soon, and you know the dynamics of this market, we will see a lot of decompression of the pressure on our margins coming from our costs. And I agree with you, one of the main levers we have, as we've been exhaustively saying in this call, is to be able to have a better perspective of the chain, taking and minimizing, I think, very negative effects of idleness of the sub optimization of the value chain as a whole.

And therefore, we are working very hard on the integrated planning exactly to provide the ideal answer to the kind of challenges you are mentioning. But right now, I feel the company has entered 2017 on a much better footing in terms of where we see our prices today. And I think our need of giving back some of the territory we gained, at the end of the day, will be correlated to the factors we don't control, like the intensity and severity of the reversal of grain prices.

**Q - Pedro Leduc** {BIO 16665775 <GO>}

Great. And in terms of innovation of products in Brazil, can you mention a bit about the potential mid-year introduction of an alternative brand and how you're envisioning that? Is innovation going to more affordability this year or no change there? Thank you.

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

Yeah. So, Pedro, I think you're probably with us in our BRF Day. I think our innovation pipeline is very robust and it's significantly higher into - geared into bringing value-added products and moving our brands, but we are paying a lot of attention to the affordable and entry protein categories, okay. This is where a lot of our base load is, this is what I think optimizes our chain and our system, and therefore a number of that innovations we're working now, they're basically protecting our core, improving the way we formulate those products, making sure that we are also competitive.

As we go into the mid-year as you said, one of the main restrictions falls away and it gives us the possibility to create, I think, a more compelling brand architecture to meet all of the needs of the consumers. I think it will be interesting to listen to Leonardo's comments as well.

**A - Leonardo Almeida Byrro** {BIO 17581639 <GO>}

Yeah, Pedro. Just tying your two questions, yes, we're working on that front to start that mid of this year. So it will really expand our innovation platform here to bring more offers to consumer in this low value-added segment that we are not playing today. And

together, it will help us work on the better planning and reducing of the idle capacity you're mentioning in our business. So we have a double count benefit here by implementing that strategy.

So, we're at full speed working with the team on that. And just to give you some numbers in terms of better planning and idle capacity you mentioned, we are already reducing in the last quarter of last year, this year, around 30% our idleness in our results in Brazil, and also our need to give discounts of products with advanced value life really because of a better planning we're doing here in Brazil.

So, if we combine that, of course, the pricing issue you mentioned, if we'll be needing to reduce price or not, will depend on the relativity of prices to our competitors here in Brazil. What we expect is to have a followship, but, of course, it will depend -it will get to the levels we need and sustain the prices for the second semester. But the way we see ourselves putting investments to work is to build on the categories and really invest in strategies to move consumers to come back to our categories as we are doing, for instance, in cold cuts now in the first quarter. We are really using the price increases that we did to bring back some of that investments in activating promotions and POS activation for consumers here in Brazil.

So on one side, we'll protect the core with our innovations we have been doing and expand the platform to this low value-added segment starting July 2017.

**Q - Pedro Leduc** {BIO 16665775 <GO>}

Okay. Thank you very much. Have a good day. (32:47)

## **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>}

Well, with that, I'd like to conclude our today's session and conference call. As we said, we are very frustrated with the set of results we are presenting today. However, our confidence that we continue to work towards our long-term strategy and now with an intensified focus with the Steering Committee in bringing a very clearly defined agenda towards reverting the course of our profitability, accelerating our growth avenues in Brazil in OneFoods, and also creating processes in a much more integrated management will help us build a new chapter for 2017.

With that, I'd like to thank you very much for attending today's conference.

## **Operator**

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

FINAL

*This transcript may not be 100 percent accurate and may contain misspellings and other inaccuracies. This transcript is provided "as is", without express or implied warranties of any kind. Bloomberg retains all rights to this transcript and provides it solely for your personal, non-commercial use. Bloomberg, its suppliers and third-party agents shall have no liability for errors in this transcript or for lost profits, losses, or direct, indirect, incidental, consequential, special or punitive damages in connection with the furnishing, performance or use of such transcript. Neither the information nor any opinion expressed in this transcript constitutes a solicitation of the purchase or sale of securities or commodities. Any opinion expressed in the transcript does not necessarily reflect the views of Bloomberg LP. © COPYRIGHT 2022, BLOOMBERG LP. All rights reserved. Any reproduction, redistribution or retransmission is expressly prohibited.*

Bloomberg Transcript