Q4 2017 Earnings Call

Company Participants

- Abilio dos Santos Diniz, Chairman
- José Aurelio Drummond Jr., Group Chief Executive Officer and Director
- Lorival Nogueira Luz, Chief Financial Officer and Investor Relations Officer
- Unverified Participant

Other Participants

- Alexander Robarts, Analyst
- Antonio Barreto, Analyst
- Gabriel Lima, Analyst
- Isabella Simonato, Analyst
- Thiago Duarte, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning, ladies and gentlemen. Welcome to BRF SA Third Quarter 2017 Earnings Conference Call. This call is being broadcast via Internet at www.brf-br.com/ir where the corresponding slides will be downloaded. At this time, all participants are in a listen-only mode. After the company's presentation, there'll be a Q&A session where further instructions will be given. We kindly ask participants to ask only one question.

Forward-looking statements about the company's business, perspectives, projections, results and growth potential are assumptions based on the management's expectations regarding the future of the company. Assumptions are highly dependent on market changes, on the country and industry's economic conditions and in international markets. Therefore, they're subject to change. As a reminder, this conference is being recorded.

This conference will be presented by Mr. Abilio Diniz, Chairman of the Board of Directors of; BRF, Mr. José Drummond, Global CEO; and Mr. Lorival Luz, CFO and IR Officer.

Now, we'll hand the call over to Mr. Abilio Diniz. You may begin, sir.

Abilio dos Santos Diniz {BIO 1781457 <GO>}

Good morning, everyone. Thank you for joining us at this conference call. Thank you for listening to us and for giving us the opportunity and chance to talk to you. I consider this moment to be very important to the company. As a chairman of the board, I consider this to be very important to me and this will be reflected in my following message.

Yesterday, we had a meeting in our board of directors. We talked a lot and I took the message home, I thought a lot about it. And at the end of the day, I decided to do as I usually do. I said, Abilio open up, speak from the heart, look upwards, ask for some light and move forward. And that's my intention, that's what I intend to do with you right now.

I know you don't like so much this thing about having opening remarks, but sometimes there are models in which you have numbers, projections, and then you work on your evaluations. But it's also important for you to have some patience and bear with me because I believe my message is important.

I know that for four consecutive quarters, you've been surprised by the numbers projected and the results that are lower than expected. This is clear to us, but I'd like you to know that we have also been taken aback and this is something that I started doing since last year when we created the steering committee. The management is always eager to go for more. We want to have clear number, transparent information, so that we can all provide information that are really realistic with a lot of clarity in our projections.

As we speak, in addition to sharing numbers, figures and plans for the future, we have to recover our credibility. People have to trust the company, confidence in management, in myself in everything we'll be delivering. So, that's a critical moment and I want to recover this credibility starting today.

Since mid-2016, I've been having more a protagonist than a chairman should be or usually is. And there are some reasons behind it. I don't regret at all. I think it was important. It is the best I could have done to the company, being actively engaged. The second half of 2016 the company clearly showed that it was facing challenges and more challenges would come. High grain prices, international prices and commodity problems and also in-house problems. Our problems with our management.

In early 2017, I created a steering committee at the board level and we were more directly engaged with the management at that time, with Pedro and the managers were at the company at that time. And I guess the steering committee brought two important things. First, we improve the quality of our numbers, having more agile information. Agility is the name of the game. Today we have more concrete information, at that time not as we should. But we started working on it and now we have a centralized company again.

The company was decentralized. What is right or wrong? Should it be centralized, decentralized? There is no right nor wrong. The company had been too decentralized for a while. So, we had regions far from the control center and in this company we have to keep our eyes open in integrating (05:56) long chain. So once again, the company is centralized. I think it was absolutely key to the business which was started during early last year.

So, we were surprised and taken aback with an episode that I never imagined I would have in my life. Something that was really shocking. Operation Weak Flesh. You have no idea what it was about. You don't know what the impact was to this company and to other companies too. We had very serious problems, problems in the market closing the doors to us, 7 million broilers are slaughtered per day, not per year, but per day. Imagine when you break the chain, when you break such a long chain there is – things are interrupted (06:45). Think about the impact in ports, harbors, distribution centers, our raw materials, our products, our inventories.

We have some imbalance since late 2016. It's true. It has to be admitted. But Weak Flesh still requires some actions and we have been actively working on it as you see in our numbers today, but that was a terrible episode. The markets closed the doors and then started to renegotiate prices. And now conditions are more favorable to buyers and things are more challenging to us debtors (07:26). But we are overcoming step by step, but we still have plans that have not been fully released. So, this episode was really shocking, a huge impact, and most of the earnings last year were not only related to Weak Flesh but mostly related to it.

So in March and in April, we had the election of the new board, and one of the things that I clearly stated in the new board was this company has to be more focused on brands and on people. The big mistake in the previous administration was in terms of people management. So, I want a guy who is an expert on people, on brand, and our board members are interested (08:16) and very competent.

So, I'd like to tell you that we had an excellent choice, and that's where I met Drummond. I just knew him by name. I had never met him. So, I interviewed him. We had meetings and Drummond said these words the first moment we sat down to talk and it was a word that changed the game and that's how I started admiring him. He mentioned the word humility, and then we were talking very candidly. And we also have (08:52) to be the Head of the Marketing Committee, Flavia Almeida my partner at Peninsula to talk with human resources adequately. The most important thing at a company is people, have people at the right place, and then let them organize their own processes.

And we also have excellent Board Members like Francisco, Walter and they greatly contribute to improve our numbers, information, the audit committee. I guess, today we have a concrete block at the board focused on the best of the company.

But in the middle of the year, we clearly realized that something else had to be done we had to do an extra mile, go the extra mile, have a new management a new man in charge, a new CEO. I talked to Pedro who negotiated with the board and we decided to do it in a very organized manner. August 31, we announced that Pedro would leave us in December. And then we started searching for a new CEO in a very organized manner, led by the personnel committee and the board. Drummond was elected and chosen. He was chosen in November 22. And then he – after the appointment, he took office and he's here with us to talk to you for the first time.

I consider this to be a success. We were very well organized, and the outcome is here today. And what I really believe is that, well, it all boils down to people. Everything starts with people. And today, our BRF team, not only Drummond, but you from the market used to criticize, well, you don't have experienced people in the industry. But today, we have a human resource guy who has 20 years of experience at a global company and working in several parts of the world, experience from different countries, different peoples, totally different cultures. Lorival sitting next to me, I think you all know Lorival well. He was already here at the front interacting with you. He's a very seasoned guy.

In addition, I also have Alexandre Almeida who joined us. He was already heading consumption companies very successfully in the past. And together with these new people, we have a team that is really amazing, outstanding. Simon in charge of International operations, Patricio for 20 years in the Middle East knowing a lot in that market, vice president.

So, we are very confident of having the right people in the right place. I have (11:54) in front of me. We also have (11:56). So, many people. So, we have a team that was already here with a lot of experience and also Fabrício. So, we have a very consistent team, really, really consistent. And now with Drummond, we can take this company forward.

So, I'm really emphasizing this, but I think this is important right now. I'm confident to let you know that the company today is organized. It is a sound, solid company. So, we have some groundwork for the future. What about our future performance? Only the future will tell us. Well, we have to deliver. So, based on everything I've seen so far, I think we are on the right track for the future.

And what will happen? Well, only the future would tell us. But I want to assure you of is that today we have a foundation. We have a solid base today because I firmly believe everything starts with people. These people are working on processes, searching for fixing problems and weaknesses. They are actively engaged to deliver efficient figures, reliable figures, no surprises down the road, not having to wait for adverse events. So, we want to have this clarity and also convey this clarity to you. So this is BRF. This is a new company.

So, just to close, I would like to give you a message. Abilio, myself, I have been through very tough times and wonderful times as well, amazing moments, really great moments and also disastrous moments. Like the media said, I've been through good and bad times. In hard times, luckily, I managed to overcome difficulties and got even stronger than when I first started and this is also for the future.

The company has everything to overcome these problems, stronger and stronger. We have credibility problems now, but I'm confident the company has all conditions to get out of this much stronger than in the past. No doubt about it.

As to myself, for the last 18 months, well, I'm not going to be – to play a leading role because that's not what a chairman should do. The chairman has to work on governance, be a connection point between shareholders and management, get the board organized and also be the connection link between the board and management. However, it has to help strategy, make big decisions with the board and exercise its support.

So now, I'll be working more. I'll be wearing a chairman hat because I really trust people who are leading the company, Drummond. And, I think, this is a great moment. We got there. It was tough, but we got there. And let's move forward now.

Last point, a couple of words on Brazil, and this is in the interest of this company. I tend to say that I love crisis because I grow a lot. Companies perform much better when the economy is thriving. Nobody can deny we are about to have an economic upturn in Brazil. No doubt about it. The only doubt, well, economists are projecting whether we're going to grow 2.5%, 3% or 4% but there was no doubt growth will come.

Unemployment is not going to go down as dramatically as we want to but it's already going down. Inflation rates under control. So, consumer purchasing power will be great. And Brazil will perform better and will (16:32) drive our country. We have economic growth and we also have more political stability. Yes, look backwards, what the past has brought us. So, this is the time we have economic growth and we have also reasonable political stability.

So, elections this year. But my expectation is that Brazilian will vote better, will be calmer and not only to be too excited. They are going to be confident about their candidate and I believe we're going to better choose our governors and BRF is going to benefit domestically and also abroad. I think it's a good moment. It is great.

Drummond, you are our boss. So, now you have the board, all the support you need. Everybody is supporting. Everybody is standing by you. And then certainly that with this team, you have plenty of condition to take this company successfully into the future.

I know you want to talk about figures, but I have to say this, it's important for you to know where you've come from, where we are now, so you can better project our future, not only based on figures, but with what you trust. Thank you.

José Aurelio Drummond Jr.

Thank you very much for your kind words, Abilio. Thank you for your supporting message reflecting our board. We had a meeting yesterday and all this goes (18:14) in our team. So, I thank you very much and I'm really thankful to you. Me and Lorival will take this process forward, always ensuring the best and most transparent representation of our company. So, I thank you all for your participation on this call, which is my first earnings call for BRF.

As you have already read and seen in our financial statements, 2017 was a difficult year. It was below our expectations. It was a year where adjustments to the direction of the company were and as you (18:48) needed. And before we start looking ahead and looking to the future, I would like to comment that in the short time that I am a head at BRF, I was able to go deeper in some critical topics. And this initial study, which is not over yet, has shown the concrete and pragmatic actions.

As far as revenue, cost and capital, funds are needed and will be communicated and executed over time. I will come back after Lorival's presentation, he's going to tell you more about our results of 2017 and I'll bring you more details about these funds, (19:26) agenda and how I see the future, how our team sees the future. And the expectation that we have in these topics I just mentioned.

And I also would like to share with you what I believe to be my agenda and my overview to the company, which is not exhaustive. We will have a chance to talk also in the future and in our BRF Day.

But we'll – I'll go back after Lorival's presentation about our details. So, Lorival?

Lorival Nogueira Luz {BIO 16180455 <GO>}

Good morning everyone. Thank you very much for your participation. I will tell you more about some details on our financial statements and I will also make clear some important topics and relevant topics as well. So you can see that we are including also for our conference call material that you can follow on our website. So, now I am at the first page, page 5 where I will tell you more about the introduction and we used the concept that we are adjusting now – or using now which is the adjusted EBITDA.

As you know the adjusted EBITDA is in agreement with CVM Instruction 527/2012 and starting now on the fourth quarter of 2017 we are adding that information. So, you will still have as you have seen before not only in this material but also in our management report. You have the reported EBITDA and we are now adding this topic. The objective here is to provide more details on some impacts that will affect (21:06) our activities and that aim a better understanding of our operating performance. And that's the way we are following up our results within the company.

So, we are sharing with you the same way as we are analyzing and looking at these results in the companies. So, I do have a few considerations here that I would like to make them clear. So, I want to stress them. So, there is no republishing of such financial statements or balance sheet. That has never even discussed and considered. So, this does not exist, never existed and we never talked about it.

Also, important to say is that the company, at the end of 2016, within that cycle of changes in the auditing companies, we had Ernst & Young up to the end of 2016, that cycle ended. We closed the process and KPMG started the auditing process in January of 2017, the first, second, third and fourth quarter. So now, it's always KPMG. This is always very clear, that has not been during this process over the year. Any discussion, any consideration about changing auditing companies or anything that has been said in the market, I would like to stress, I'm repeating myself about that, there is no republishing of financial statements and no changes in auditing companies. So, we are really adding that information to you.

So, just to make it even more clear and you have seen that in the management report. You can see here in this presentation on the screen, we are describing all the lines that we consider to build our adjusted EBITDA. All these figures, all these lines have been identified. They are in the financial statements that are audited in a consistent fashion for all periods, regardless if the amounts of values are positive or negative. It also is important to make it clear that our external audits, as well as our statutory audit committee, our fiscal council and our board of directors have reviewed this concept and they are in agreement with that.

Now, going towards the figures. You'll see here the lines and the amounts that are being considered. So we have the first line for minority shareholders' stake. There is another line with a more relevant impact which is as Abilio has already mentioned that it's the direct impact from the Weak Flesh Operation that happened in 2017.

And then, we had BRL 14 million in the fourth quarter. Additionally, BRL 118 million in the second quarter of 2017 and now in the fourth quarter, we had an impact of BRL 206 million. This BRL 206 million, it's important to mention that it come from an adjustment to a realized value of inventories coming from a certain finished product that we had some destination to a final market but considering some embargoes that are – still existed over 2017. Those inventories ended up increasing, going up. And now, we are doing that, I just mentioned, to the realized value and we are using them as raw material. So this is an adjustment and value that has been done and that reflects the fair value of that inventory value.

And that has been done with all transparency possible. We discussed it into the details with the auditing companies and with the other members here. So this is a major effect (25:19) that has happened BRL 206 million. We are also adjusting other lines that have more accounting effects, not necessarily related to the business or to the cash generation of the business. And here, as an example, we had in 2016 some accounting gains coming from the process of the acquisition of a distributor in Kuwait, AKF, and we did have an accounting gain that year. And we also adjusted that.

Something else that always affects the company's results are tax recoveries, including their gains from successful lawsuits in the past and that has significant impact. So once again, we do have transparency here in the results. You can see that we did have significant amounts in 2016 and another amounts in 2017, including what we mentioned in the third quarter regarding (26:24), so this amount. We also have a positive impact in the company, but we take them away from the base.

And finally, we have an accounting effect from the hedge accounting of our debts because we have exports and we do have an accounting effect on that, and the settlement of those debt installments. And so in the accounting, we end up posting those impacts. And once again, it's transparent in a way that it is already rolled out in the company and we are sure that we are providing you more transparency and we are sharing as well the way we are managing the company.

Now, turning to the next page going into the results themselves, we have had a growth of 8.1% in the order and almost 5% in 2017, vis-à-vis 2016. That clearly is thanks to a better commercial execution in Brazil where we had a recovery of market share. We have followed that in the last quarters. And also we have a positive impact of the well succeeded consolidation of (27:43). So, that happened over the year.

Our revenue also grew in the quarter. And as price (27:52) dropped vis-à-vis the prior year, which was – in the full year and we also had a growth in all the regions. Obviously with the negative impact coming from the International market, especially in Europe. So, we do have that as well coming. Because of the Weak Flesh Operations, some of the markets were closed for a while. So, once again, we did have that impact.

And we ended the fourth quarter with a gross margin of 21% which is an advancement of 1.4 percentage points vis-à-vis the prior year, and a consistent improvement in all the regions as we have already mentioned. Once again, we did have some embargos and some impacts. And so, in International market, we did suffer a few impacts.

But now, it's important to say and we are looking at the numbers of the EBITDA and the net results. And here, we have the net loss that we've had in the quarter, BRL 784 million. It's important to comment. First, on that result, we already included and we already have it here the impact of the BRL 206 million that I explained about regarding the inventory reassessment. Additionally, we also have an impact on this quarter of BRL 164 million coming from revision, reinforcing of civil and labor issues in Brazil and in the Southern Cone, especially Argentina. That is included here.

In addition to that, we have the BRL 49 million coming from commercial adjustments in OneFoods also impacting the results of this quarter, and BRL 34 million in adjustments and provision for PP&E also that had an impact. And, remember, all these adjustments are of noncash nature. In a way that summing up all of that, we will have an impact in the EBITDA of BRL 430 million (30:15) in the quarter, which is extremely significant. We understand that this is not recurring. It's a onetime only that happened in this quarter.

So, now, going down to the net income, you know that in the provisions that impacted the EBITDA, you always have an EBITDA of the adjustment that's not going into the line of the EBITDA but rather in the financial expenses line. So, there is a counterpart here of other additional BRL 80 million, which also had a negative impact.

And you remember that in August of 2017, it had been announced that the Total Return Swap operation the company had at the time were shares held in treasury. And the realization and the marked-to-market of that operation in the quarter has generated a loss of BRL 121 million, which once again will impact on the financial line. So, we already had the BRL 80 million. Now, we have BRL 120 million (31:22). And that's not part of what we call the core of the operation itself.

And then adding in the income tax line in December, the government in Argentina changed the tax rate from 35% to 25% and that also had a negative impact for us. What we have there – we have there our assets. In terms of deferred taxes and considering the calculation that we have to do of those future credits realization, we have to post them as a negative impact as well and the results of around BRL 118 million and BRL 120 million.

And why am I going to all these details? These are impacts that happened in the quarter in terms of accounting provisions, adjustment and others. And the total in impacts of BRL 772 million in the net result of the company, that was a negative impact. So, it's important to highlight that. Also, relevant is that the nature of this adjustment is that we had no cash disbursement here. These (32:44) provisions that had happened. And you can see in our report that the net cash generation of the company, the free cash flow was of BRL 758 million, a robust result.

And you see the releases in that material that you have the highlight for Brazil, OneFoods, International and also the Southern Cone. Considering the time and because I do have to turn the floor to Drummond and open for the Q&A, I will turn to slide 11 because I have some important topics to stress.

So, as you can see, we had an operating cash flow already discounting a CapEx of BRL 310 million in the quarter, we had a generation of over BRL 700 million of operating cash. And maybe even more important is the free cash flow which was BRL 758 million as you probably have seen already.

And, what we are reporting for our adjusted EBITDA of BRL 645 million. This is a cash that is higher than the EBITDA and this is of course received and this is because of the nature of the provisions that we have, because they are really non-cash provision, therefore, we are confident about the perspective of the company and the cash generation which is robust, that cash generation that we had in the fourth quarter of last year.

We include here analyzing the debt profile. We end the year with a robust and sound cash of almost (34:37) BRL 7.4 billion, and additionally to that we still have BRL 3.3 billion and a revolving credit line that has not been used.is not being used. And we don't see right now the need of using that credit line, but we do have that available for us.

Our net debt has ended the year at BRL 13.3 billion with an average term 3.5 years. I would like to say that it's our objective to extend the profile of that debt. We are already working towards that. This is our objective over this year to expand it substantially, and as I said, we're already working on it. We are monitoring the market conditions both local and international. And this is an objective of the company to have an extended debt term. The leverage has ended the year at 4.46 times, which is below our objectives and below where we want to manage this company.

We do have our objective and it is one of our targets. So, all of us here in the company in 2018, this is a commitment that we have with the board of directors, which is by the end of this year, we'll be managing this company below 3 times. We understand that to manage this company at 2.5 times and 3 times is the right management for a company such as ours. And will allow us to have sustainable growth as well as a profitable one. That is clearly described in our internal goals and our commitment is to deleverage.

And to conclude, now about the CapEx, you can see that we have ended 2016 with BRL 5 billion in investments and that is BRL 2.6 billion of CapEx and BRL 2.5 billion of M&As. We have had more discipline over 2017, with BRL 2.3 billion and we are working now in order to look for a total investment this year that is below BRL 2 billion. And that was in operating performance and we are confident on that. And the right management of our working capital, we are confident that we will meet our targets regarding the deleveraging of the company.

Therefore, I conclude my presentation.

I just would like to highlight something else. When you look at the cash position where we are at, I want to stress and to make it very clear the company does not need capital increase. We are not working to do any follow-on or capital increase, that we have not even started that type of discussion. It has not been proposed by the CFO. This discussion just does not exist within the company. So, the company is not working – is not going to the market, it does not need equity, and is not working in any follow-ons. Right now, I just wanted to make that clear so that you understand it. So I end now my presentation

I'm sorry if I extended myself a little bit, and I'll return the floor back to Drummond and he will tell you more about the perspectives and his priorities in managing the company. Thank you.

José Aurelio Drummond Jr.

Thank you. Thank you, Lorival. Thank you, everyone. Slide number 3 (38:33) please. This slide depicts our agenda and the work architecture for the future, and it also helps explain why I joined the company. (38:46) very common between the company's values over 80 years of history and my beliefs. These are my personal beliefs that I have been using in my career over 35 years. So, based on this design, we have many points in common in terms of beliefs.

But I'd like to get started on this slide starting from the end. Lorival talked a lot about cash generation. I'd like to say that you hear us always talking about gross margin, cash generation, net income. Why am I telling you this? Lorival talked about CapEx. You have access to our figures. So, if I may, I would like to address a topic which includes both revenue stream, cost stream and capital stream. Our depreciation since 2014 increased BRL 700 million because we heavily invested in growth, growth that has not come as we expected.

That's why I firmly believe the company has full capacity to grow by at least 7% per year, both locally and globally, benefiting from previous investment, materializing those investments, but it doesn't mean we won't have growth and investments in the future. We'll certainly have and sometimes often to debottleneck some things. But we have the ability to grow, not only grow in volumes in Brazil and worldwide, but also to deliver our good performance in many regions in Brazil where we had a big drop. So, we have to recover our market share. Our growth share happened mid last year – or mid-2016 actually.

And today, we already have the best share position in six quarters and we have to continue our recovery process. In our viewpoint, when it comes to that value, we will recover at least 5% market share in total in Brazil. I believe this is doable. And the team's efforts in Brazil are being very well met, working on the foundations of market performance, in distributions, sales force, footprint, to the point of sale lineup (41:19), packaging, all fronts including prices. So we can have an adequate strategy to recover market share and manage our gross margin.

So, when it comes to revenues we believe we have plenty of conditions to grow continuously at least at 7%, including a significant share recovery in Brazil and working on our brand strategy globally. So, there's market share recovery, I underscore, it is important, if the market next (41:50)is weak or strong. Because that's a company strategy, we lost a lot of ground and now we have to recover. We have plenty of conditions to do that. We are working on it and making plans to raise the company for adequate share numbers to our company.

As to cost dimension and the cost stream, I have a lot of expectations. I hope we can have a coordinated multi annual effort to reduce at least BRL 300 million per cost at the company's operations as a whole, including initiatives for total spending management and acquisition, loss of waste, operating efficiency, automation, simplification of processes. If we put all these fronts altogether, and certainly we'll be greatly contributing with efforts coordinated and led by a very engaged action by our vice president, supervisors, at least BRL 300 million per year of cost reduction.

So, this also has to do with the capital stream or capital dimension. Like I said, we will keep on investing in the company. What we need to do today is to have a better use of previous investments. So, we should be able in future years to invest less than the run rate we had in previous years. Therefore, we're losing capital for several other functions of the company, including reduction of our leverage and indebtedness (43:33).

And the same goes for working capital, we believe the combination of these fronts, CapEx, working capital will give us an opportunity both to dispose some non-operating assets and therefore save for something about BRL 500 million per year of capital release.

So, when we work on these three fronts, cost reduction which we believe is doable in all fronts, with a broad (44:00) company of BRL 300 million or more year-on-year, capital release around BRL 500 million with more proper CapEx management. Not only with better use of our growth and investment in the past, but also being more efficient in terms of CapEx management, reducing working capital and some operating assets totaling BRL 500 million of capital release.

So, this driven by growth and the leverage in the future, we believe these are - it is a critical (44:32) for the company under my direction, under our management, and our daily, monthly care and attention on these work fronts, we are fully convinced that we can go for these targets and goals. You know we don't give guidance. This is not a guidance for result in earnings.

But now when we have very tough times, the running rate is okay. However, in the fourth quarter we had very poor net income in 2017. Si it's important to show what we are doing in order to make sure that 2018 and beyond, we'll have a recovery in gross margin cash generation starting 2018, and always underscoring net income generation. So, why is it so important?

I don't have anything against EBITDA, however, when we make this remark like I did about our depreciation, and then we measure EBITDA, this is not shown. Today, we have another BRL 700 million in our capacity to generate net income precisely due to the increase in our depreciation, which has not been materialized or visibly yet in our ability to grow as we should.

As to growth, there is an extra dimension. This company out of its nature, its launching, it needs to grow ongoing basis. The company should not change strategy quarter-on-quarter, correcting paths and tracks every quarter. It takes a long term strategy. And then, I ask your attention for this (46:11) about our fundamentals.

There are four important take-home messages. We don't have two strategies. We don't have a short term and a long-term strategy. Performance in the short term is to work daily on our long-term strategy, which is growing on and on, proper share management positioning with responsible cost of capital. We need information integration in our integration and we'd talk about this to have dedicated CapEx for the following years and a lot of economies will come. A quantum leap is required, so we can have better information management of the company.

Expansion and a(46:57) presence of our brands domestically and globally. This company has three big parts, agri business, industry and distribution. In agri business and distribution, we want to keep on building the equity of our brands, that's something imperative at the company. However, it is also linked to our ability to generate results that gives us the right to remain in the investment process, so we will never sacrifice our future just for the sake of a more beautiful quarter. We'll constantly be working to be sure we'll be working on a long-term strategy, but always be keeping an eye on our commitment to deliver our annual and quarterly promises. But always keeping an eye on the long-term strategy. Like I said, short term is only a fraction of long-term.

And most importantly of all these foundations, my first job and any leader's first job is to develop people better than himself or herself because that's how we can make sure the company longevity. Alexandre, Lorival and myself, we are a clear example because we came from the outside but this company needs to work to develop promote and give opportunities for in-house talents, particularly in leading positions. We have to work to have a succession pipeline to ensure the company's longevity and that's my personal commitment with the board and also share it (48:36) with you.

So, now those are the imperatives for sustainable operation, these are things that I've always believed throughout my career and has a lot to do with my trajectory, the company's history, the company always was in charge and consider this to be a priority. So, I'm very comfortable in being at this company where I can speak very comfortably about the importance of these imperatives. They are alive and kicking and all these topics on the screen, we address this every Monday in our staff meeting, the cost reduction, capital release, growth program. These are topics that will always be present in our management, in our daily agenda, weekly and I will always be personally involved.

So, this does not conclude our conversation. We know we have BRF Day. But today, we didn't only talk about our earnings for 2017. We would like to convey the message of how we envisage opportunities for the future, the major (49:42) about cost, capital, and share with you, I'm very confident. I know challenges are big but opportunities are much greater and always very welcome. And I feel very much supported by board members, the management. And I feel responsible for this, responsible for leading the company along this path, leading, protecting, helping shareholders, partners, everybody in the company.

So now, we would like to open the floor to questions, to talk and hear from you very openly, with transparency. Once again, our conversation does not end today. We have a lot of opportunities to interact in the future. But, please, bear this in mind, we will be working on our fundamentals in order to improve the company's performance and its structure, with (50:39) keeping an eye on performance in all the items on this slide. Thank you very much.

Q&A

Operator

Ladies and gentlemen, we're starting now the question-and-answer session. The first question is from Isabella Simonato, Bank of America Merrill Lynch.

Q - Isabella Simonato {BIO 16693071 <GO>}

Good morning, everyone. Drummond, my question is about Brazil's strategy. How do you see this market share recovery that we intend to see continuously in the future? And what about the mix? And what about the improved gross margin? I understand you have a cost reduction program, but what about the mix between Brazil and prices contribute to such margin recovery down the road, or is this more related to volume rather than a better mix or a price increase for consumers? That's my first question.

The second question, out of the BRL 300 million of cut down on costs, could you give us more color about the sources and origination of these cost cuts, and what are the most critical points?

A - José Aurelio Drummond Jr.

Thank you, Isabella. Answering the question about Brazil. I think it's important to clarify that we tend to have an antagonistic approach. It is either price or share. I don't believe such. Market share involves several fundamentals like I said in the beginning of my talk. And Brazilian's performance is very good. If we check our performance early last year, we had a mismatch in terms of the price move. We were too decoupled, a lot of share that continue with sequential share loss from 2016 and we were extremely decoupled.

And then we had several other actions, hiring salespeople, recovering the number of customers of the company , it was already 200,000 went down to 163,000. But now we recovered to 190,000 and we'll come back to 200,000 by the second half of the year. So, these fundamentals are critical to recover, both market share and price. Alexandre team's work has shown very good balance managing all these fronts.

Now, our strategy to recover share. If the market mix is bad, we're going to grow share. If the mix is good, we'll grow market share. We just have to make sure our cost is competitive to make sure share recovery is not going to impair our margin.

We all know that there is no rules and activities that involve a single dimension. We cannot only focus on share, price or cost alone. It takes a mix. And this execution - well, in some quarters, the composition of the products would be more favorable. In other quarters, composition would be less favorable. We're not going to change the strategy just for the sake of it. We're going to fix whatever has to be fixed. But I feel very comfortable with the path in Brazil.

The first signs since I joined the company, watching closely the performance last year, earlier this year, I have even a better feeling. But we had a trade down at the company - in the country, I mean, the company (54:35) only move away from a part of the market because there was a trade down and we don't want to change our price positioning. We always have to be in line with the signs of the market, recovering our market share and protecting and building an image design that is favorable.

What was your next question, please?

Q - Isabella Simonato {BIO 16693071 <GO>}

BRL 300 million cut down on costs.

A - José Aurelio Drummond Jr.

Obviously, I cannot disclose it. I cannot give you a lot of detail, but I can tell you the different fronts, at least one of the fronts. I can give you more color on this front. We have a very important procurement operation excluding grain, which is an operation which we believe is very well-managed. Very adequate management. And the same goes for our procurement. But the volume of sales is really big.

And I guess we can be even more efficient in our sourcing, dual sourcing strategy, electronic auctioning (55:45). Therefore, we can have unique performance with cost compared to our previous management. That's one front.

As for information integration, it may also have an impact on our capacity to improve the administration productivity of our corporate roles and also operations. We have the 70,000 to 80,000 people in our plants and certainly we can benefit from better information integration in our performance, and finally automation as well.

Automation is an interesting topic because if we only focus on our three-year horizon, nothing is going to be automated. But if you think about the next 30 years, there is a lot to be automated. So, that's the mindset for the future. I hope I've given you some color and maybe we can talk later in different circumstances. Thank you.

Q - Isabella Simonato {BIO 16693071 <GO>}

Thank you, Drummond.

Operator

Our next question is from Gabriel Lima, Bradesco.

Q - Gabriel Lima {BIO 16224058 <GO>}

Good morning, everyone. I have two questions, Drummond, and both of them are related to human resources which is a critical area for BRF.

The first question is regarding PLR. Last year, you had a loss and you don't have to pay PLR this year. But last year, you chose not to pay it and then you had problems with your people at the plant. So, I just would like to understand what you were going to do about that. You have 100,000 employees.

And also, I would like to understand about people, you just started a month-and-a-half ago, but you – but BRF had a lot of important people there in the past and so how do you see HR, not only profit sharing but also human resources. And I have a question after that.

A - José Aurelio Drummond Jr.

Thank you very much. Well, first, we have already decided and we have communicated that yesterday. We have approved it and the board, our employees would not have the right to the PLR by the rules, and we decided to have an extraordinary bonus to them, acknowledging their efforts.

And I believe there is an equation that we have to follow which involves efforts, results, acknowledgement, recognition and a reward. This year, we decided to reward the efforts, we did not have the results, and I think this is fair because it is right to compare the alignment of the expectations of ADP and officer (58:37) to the shareholders. But it is too far to have that expectation alignment and the influence in a shop floor employees (58:46) so compare that to shareholders that expect net income. So that's why we decided that. I think it was a right decision. The board has approved and it has been communicated to the company last night after we received the information.

About the second part of your question, I don't comment on my team and I will not tell you anything about that. But I will give you an overview about talent. Talent is never enough, you always like talent, I've never had a situation in my career where I had three talented people for one position, rather it was always the other way around. And we want always to bring more talent to the company, so that we can go through the difficult moments at any year or phase (59:40).

I believe that all these changes that we had over the time were not good because you end up losing continuity, you lose (59:50) the competition. But today, we have a leadership in the human resources area that is extremely experienced. I, myself, also have a great experience in the area as well. And our VPs are all motivated to walk that path, which is to develop people better than ourselves. That's part of our strategy and I'm sure that we are going to see that over time and adding (01:00:24) as I said, our VPs and our officers are not eligible to bonuses this year and this has been approved by the board yesterday as well and it has been communicated to the company.

And you said that you had another question?

Q - Gabriel Lima {BIO 16224058 <GO>}

Yes, Drummond. Thank you. It's interesting to hear your decisions. My other question was a little bit more difficult to you, but I think we need to understand a few things. This – everybody knows that you are in this position for a little bit over a month and you have Walter and Francisco representing Pedro and (01:01:09) that have not supported your nomination at the end of last year.

And for us that we are not in the company every day, that seems to be a lack of alignment within the board. It may be a disagreement between the board and the management. I know we are not in your day-to-day activities in the company, but I would like to hear it from you because that's what we receive on the other side and I would like to understand if you have had freedom to manage the company and even taking – considering the initial comments from Abilio that he should not be a protagonist anymore from now on.

A - José Aurelio Drummond Jr.

Well, let me address this question with a disclaimer. I cannot comment on the votes of the board members because the votes and you are aware (01:02:08) the votes are very personal. So but what I can tell you and I can assure you that these are two excellent colleagues. They contribute to the company since I (01:02:20) started in the board with them in the past, they are very constructive and our discussions are always aiming the best for the company.

Since my election, I have received the support from them and from all the other members, I have nothing else to say. And let me tell you, if I fail, this is my responsibility because I have received great support from the board members, from all the officers. I would humbly recommend you – and I don't spend one minute of my time thinking about that, and I would recommend that you shouldn't spend your time doing that either. Thank you.

Q - Gabriel Lima {BIO 16224058 <GO>}

Thank you very much, Drummond. Good luck on your management.

Operator

Our next question is from Thiago Duarte, BTG Pactual.

Q - Thiago Duarte {BIO 16541921 <GO>}

Good morning. Good morning, Drummond, Lorival and Abilio. I have two questions. The first is to better understand the figures about the future, and you also mentioned in the release and in your presentation as well, especially Lorival when you talked about the leverage from 2.5 times to 3 times. Can you elaborate a little bit more on that, how you are going to get to these figures? Do you believe that it's possible up to the end of this year just with the operating cash generation and the natural growth of the EBITDA year-on-year, or do you believe that there is room to have divestments or other companies or you have non-core assets? From the past years you already mentioned them. So, I would like to hear how you were coming to this 2.5 times, 3 times EBITDA.

And my second question and now is more a question for Drummond. And going back to the first question related to the non-dichotomy (01:04:19) volume price. But fact is that Drummond the average price in Brazil when we analyze (01:04:25) still very weak. When we analyze the recent (01:04:30) as you well said if the market is fading down, why would we have to follow it. But after that fourth quarter, do you already believe that in 2018 we'll see a reversion, a change in that promotional environment, or do you believe that consumer will be still cautious and that the market has a weaker mix than what you would like to see? I want to understand how you see that progress at the end.

A - Lorival Nogueira Luz {BIO 16180455 <GO>}

Thank you for your question. This is Lorival. I will turn to Drummond for the second question shortly. About the deleveraging, as you mentioned, you have all the components in which we believe that we are going to work on to come to this figure of lower than 3 times. So, as you know, we have that normalized base. And at the end of the fourth quarter, not considering those adjustments, we had a BRL 900 million EBITDA with a margin of 10%. So, I think, this is a significant and relevant figure that really makes us feel confident about the perspectives for 2018. So, this is part of the deleveraging process and it also includes an expansion of the EBITDA for 2018.

In addition to that, it's not only the EBITDA. We have also to generate cash. So, yes, we do have a commitment, a strong discipline in terms of the capital use whether in the investments and then both CapEx or any other acquisition. So, we will have over 2018 a discipline and severity very great in terms of capital expenditures, and that is going to be below of what we have had the last years.

And that also, with management in that line of working capital and the three main fronts which will give us a cash complement in a way that we can see and we have seen by the net cash generation in this last quarter higher than BRL 700 million. We feel confident about the cash generation for 2018. So, we do have the component, which is the cash generation that's going to be used to pay the debt, also investments and a better EBITDA.

About divestments, as you mentioned, that's not in our plans. So, we don't see the need to do any type of divestments or any type of sales of operations or businesses. That's not being discussed. This is what we are going to look at with a lot of discipline. And we will look at the non-operating assets or assets that are not strategic to us. We can always be analyzing them and in order to make a better use of the capital. That is our objective to have the better return on the capital. If we have an opportunity for some real estate to sell and other items and as Drummond has mentioned, we are already working along those lines.

So, this is the third component which also will give us more base for the deleveraging, so basically we have these three fronts that make us feel confident that we are going to be below the 3 times of leverage.

Now, Drummond is going to answer the second question.

A - José Aurelio Drummond Jr.

You probably have seen in the analysis and we also have carried out this internal analysis that our grain cost, they went up and then they came back down. But we did have a problem with other costs that have compromised the performance of our gross margin. That's why we have that important initiative of having a program for cost reduction in the company, which is not done in a week or one month. This is a recurring reduction. And we believe that we have the potential to contribute to that magnitude that I have mentioned before.

And especially because we wanted to have the foundation for a growth strategy and share recovery without compromising the value, and that's exactly what we imagined to execute and what we are doing in Brazil and we will continue executing that in Brazil. So that balance is - and that's something that we have to run on a daily basis, on a monthly basis if we have a sales mix that is at least in line with and not worse than the market and that allows us to compete with our cost structure.

And it's clear that we had an up and a down side to our direct cost. Then we lost intrinsic margin in the company, which we need to recover. And we do expect - we do have an expectation about the gross margin for the company as a whole in 2017. And we expect it to recover several points in the margin over this (01:10:36).

Q - Thiago Duarte {BIO 16541921 <GO>}

Thank you very much.

Operator

The next question is from Alex Robarts, Citigroup.

Q - Alexander Robarts {BIO 1499637 <GO>}

Good morning, everyone. Thank you for taking my question. In fact, what I really want to understand better, well, I'd like to understand more your vision about OneFoods. My question is twofold. In Q4, we (01:11:08) have seen a drop on margins, and you've explained the drivers to us. But I would like to better understand that BRL 49 million in the result. So, maybe that has to do with the commercial area. So, what was the driver? And do you think it might happen again this year?

The second part of my question has to do with your outlook and forecast for the margin this year to OneFoods. Could we assume that the margin could go back to a double-digit level like we saw over 2016? And in this case, what would the drivers be?

Do you think the macro scenario could be of help or be a challenge? What about inventory levels, do you think they will get back to normal? And perhaps, what about the current atmosphere in Saudi Arabia after the tax increase? Do you think this scenario is more normal now when it comes to local competition? Thank you very much.

A - José Aurelio Drummond Jr.

Let's do the following. I'll answer the end of the question and Lorival is going to answer the first part of the question. Without getting into details on the operations. Since I joined the company and now as we speak, as we all know in 2014 and 2015 we had amazing years in OneFoods. A very important combination of events and then things were normal and then we had a very complicated in 2017 with surplus inventory, so to speak contaminated stocks with higher costs and a drop in demand in these markets. Therefore, a very significant price pressure.

And we closed the year with the best price positions of the previous quarters. And OneFoods and ourselves had very different conditions to perform in 2018, which is part of our in-house plans and our confidence as well. As we performed over the year, we believe we have a chance to share good results with you. I believe we are redesigning our base line. So we can grow to increase our performance in the future. Lorival is going to talk now about the adjustment you asked.

A - Lorival Nogueira Luz {BIO 16180455 <GO>}

Good morning. Now, answering your question and giving you more color about the adjustments. So what happened, in reality, we have commercial agreements, trade agreements that we have over the year. And then we have to settle some accounts by year-end – at the end of the year, I mean.

So, this will no longer apply for next year. So, what happened was something very specific nonrecurring. These were agreements from year 2017, and at the end of the year, we have to make some adjustments. So, everything was very smooth. We were very confident and that's why we say these are nonrecurring items, and they will not apply to 2018. It was just something very specific nonrecurring.

Q - Alexander Robarts {BIO 1499637 <GO>}

Can you confirm that as we speak in the Middle East, inventory levels are normal or do we still see some kind of - or we still need more time until we get to a more normal level?

A - Operator

It is pretty normal and plenty of conditions to have the performance plan for the year. Just to clarify, inventory levels are low (01:16:06) normal and no commercial adjustments will be repeated. So, in 2018, we have a very favorable scenario.

Q - Alexander Robarts {BIO 1499637 <GO>}

Okay. Thank you very much.

A - Operator

Thank you.

The next question is from Antonio Barreto, Itaú BBA.

Q - Antonio Barreto {BIO 17449798 <GO>}

Good morning. Thank you for taking my question. I'd like to address other International market starting with Argentina and Iraq. In Argentina, we know it's a smaller market but when you check results they are behind our expectations. We understand there is the grain issue, inflation, costs, label, but if you think about other consumer goods companies like food and beverage, they are performing better in Argentina. Why is it so difficult to transfer margins are low (01:17:10) in Argentina? What about the mood for 2018? That's my first question.

A - Lorival Nogueira Luz {BIO 16180455 <GO>}

Lorival speaking. I'll be brief and then I'll turn it over to Drummond. It's important to clarify when it comes to Argentina that there are some events that occurred over the second half of the year. This is clearly shown in Q3 and they have an impact on our earnings. Over 2017 and in the last quarter, we did see an increase in volumes, an expansion in share gain, some products and brands, our leading brands in the segment. So, we did post growth in volume and growth in crisis.

On the other hand, you' are right. It was a significant impact on cost. However, once again this impact was nonrecurring. We had union and labor issues in Argentina and we revisited some topics in terms of labor contingencies, so we've had some adjustments in the last quarter and had a very strong impact on our EBITDA. And at the same time we all show up discussions involving one of our plant, the unions, an increase in personal expenses.

So, as we speak, we are focusing on these negotiations. So, that's (01:18:58) something timely about our good performance, our good commercial performance, something nonrecurring.

A - José Aurelio Drummond Jr.

May I just add, just to answer the question. We are working in-house and we'll be working in the following months revisiting our strategy for Argentina. I believe this will somehow allow us to put this plan into practice. Maybe in a couple of months. We have a chance to talk again about this.

Q - Antonio Barreto {BIO 17449798 <GO>}

Great. Thank you. Now, my second question about the International market, about Europe. We understand difficulties with fewer licensed plants (01:19:44) but based on what we know what about the exclusion of plants. It was something mandatory by the Ministry of Agriculture and the Brazilian industry. How do you see the outlook or the perspective to reopen your plant? And do you think that once it opens again – I'm trying to check the impact, the positive impact in the future.

Prices also increased a lot in Europe as far as I understand so there is some benefit in having several Brazilian plants not exporting to Europe right now. So, what about this equation in your mind? We can reopen more plants but are the Brazilian competitors can do the same, and then you have more volume, on the other hand lower prices. What about this equation in the future? Thank you.

A - Operator

Our Jataí (GO) (01:20:35) plant by the way was already authorized to export to Europe. We also have other plans about to be reconfirmed. So, we are confident that we are going to get a favorable position. Not necessarily opening our plant. Well, it doesn't mean that other players' plants will open too because that's a plant by plant decision. But even if other players' plants also reopen, we are confident in our ability to compete in the European market both in terms of quality and also costs.

So, you're absolutely right. We have been through a lot of pressure, difficulties, shutting down our units, but our International team, our operations team led by Fabricio (01:21:32) also managed to have outstanding performance, not only late last year, but also early this year. And we trust we'll have a positive outlook.

Q - Antonio Barreto {BIO 17449798 <GO>}

Just as a reminder, Drummond, how many plants do you have today which are not licensed or open to Europe? You mentioned Jataí (GO) (01:21:55), and is there any other that we should bear in mind?

A - José Aurelio Drummond Jr.

Only (01:22:00).

Q - Antonio Barreto {BIO 17449798 <GO>}

Thank you.

A - Operator

You're welcome.

The next question is from (01:22:22), HSBC.

Well, good morning, everyone and thank you for taking my questions. I have a couple as well. First on EBITDA margin in Q4. Obviously, you guys adjusted for some of the items but they were more than BRL 700 million of non-recurring items, I think, you mentioned in the press release. Have you calculated what the adjusted EBITDA margin would have been? Have those (01:22:49) have been adjusted for, I think you may have mentioned 10% and you also mentioned that you are looking to improve margins in 2018. Would 10% be the base level from which you're looking to improve the margin this year?

And my second question is on – and then also, the export outlook. I know you talked about the (01:23:09) OneFoods and that you're looking to favorable conditions in 2018. But OneFoods seem to have a challenging quarter in Q4. So, if you could maybe comment on OneFoods' performance in Q4 (01:23:21), what you're expecting in 2018, as well as what do you expect out of Asian markets this year? Thank you.

A - Lorival Nogueira Luz {BIO 16180455 <GO>}

Thank you for your question. First, I'm going to address the EBITDA margin and then Drummond is going to tell you more about market – expectations about the market. Naturally, I understand why you are asking this question and I guess you also understand my answer. I cannot give you the figure expected for 2018, but what I can tell and the exercise that we did and then you reflected very well in your question, qualifying the EBITDA margin at 10%. So, what we try to do was exactly to position and show where the company is and where we are.

So, we closed Q4 at a level of 10%. And this gives us a lot of confidence. We mentioned several times, different circumstances, for instance, OneFoods with a more proper inventory level. The commercial performance in Brazil is also more adequate, with significant market share recovery and also an increase in the base of point of sales and active customers and clients show (01:24:57) 10%.

Drummond talked about cost initiatives. So, I believe we'll start 2018 on a very positive tone, cleaner and ready to benefit not only from the market growth, but also from any possible opportunities in a very robust manner. So, this is the outlook. Well, Drummond was going to elaborate now about export outlook.

A - José Aurelio Drummond Jr.

I believe our OneFoods performance like we said before when we answered another question, it was very challenged over the year but we are confident that our performance will be in line with our plans, expectations. These are very good expectations and they are above our performance achieved last year, much higher and greater.

So once again, we cannot give any details on precise expectations, but we are fully convinced that as soon as we start reporting the earnings for 2018, everything will be materialized in a very effective manner.

Q - Operator

Thank you. And maybe on the Asian markets, obviously, there are high inventories there and the prices have come down I don't know if (01:26:33) you could comment on what your expectations in general are for the (01:26:36) in Japan and South Korea. Do you expect to see improvement there in 2018?

A - Unverified Participant

Thank you very much. Thank you very much. This Q&A is over. Thank you for your questions. So, we will keep on having a very visible, transparent conversation. We do everything we can in order to be as transparent as possible about the company's performance. And I hope to meet you in person in our BRF Day. Thank you very much.

Our expectations, our motivation goes for unique performance as a company over 2018 and beyond. We are very confident and assured of opportunities in the future. Thank you very much.

Operator

This concludes the BFR SA conference call. Thank you very much for joining us. Have a good day.