Q2 2014 Earnings Call

Company Participants

- Sergio Agapito Lires Rial, Chief Executive Officer & Director

Other Participants

- Alexander Robarts, Analyst
- Daniel Sensel, Analyst
- John Sykes, Analyst
- Jose J. Yordan, Analyst
- Lauren E. Torres, Analyst
- Shah Rishad Ahmed, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning, ladies and gentlemen. At this time, we'd like to welcome everyone to Marfrig Global Foods SA conference call to present and discuss the results for second quarter of 2014. The audio for this conference is being broadcast simultaneously through the Internet in the website, www.marfrig.com.br/ir.

In that address, you can also find the slideshow presentation available for download. We inform that all participants will only be able to listen to the conference call during the company's presentation. After the company's remarks are over, there will be a question-and-answer period. At that time, further instructions will be given.

Before proceeding, let me mention that forward-looking statements are being made under the Safe Harbor of the Securities Litigation Reform Act of 1996 (sic) [1995] (00:01:05). Forward-looking statements are based on the beliefs and assumptions of Marfrig's management and on information currently available to the company.

Forward-looking statements are not guarantee of performance. They involve risks, uncertainties and assumptions, because they relate to future events and, therefore, depend on circumstance that may or may not occur in the future. Investors should understand that general economic conditions, industry conditions and other operating factors could also affect the future results of Marfrig and could cause results to differ materially from those expressed in such forward-looking statements.

Now, I'll turn the conference over to Mr. Sergio Rial, Marfrig Group's CEO. Please go ahead, sir.

Sergio Agapito Lires Rial {BIO 1925337 <GO>}

A very good morning. I have here with me the Group CFO, Ricardo Florence, also present. I'd like to thank you all for attending this call.

Just in the spirit of moving forward, so let me start with the highlights of the second quarter. So we are pleased to report our second quarter of 2014. An important component of this quarter is our commitment to the guidance that we have put in place for 2014, not something very common in Brazil. But we are pleased to report that we are, if not meeting, very close to meet all indicators on that guidance as you're going to see in a couple of minutes.

So the performance has been in line with what we've told the market we would be executing, and the Focus to Win strategy has actually been paying off in terms of change in the culture of a company that will really become a lot more committed in focusing on the things we can control as opposed to the things we cannot control. So you will see that as we talk about the operating performance.

Sales, we've been fortunate to really post BRL 5.1 billion sales, a bit unusual for what historically is sort of a weak quarter, but it's explained partially by a very strong sales trajectory in Moy Park but also by Uruguay and a new plant in Argentina that is now operating closer to full capacity. Remember that we had closed a number of plants in Argentina in the second quarter of 2013. We only kept one plant operating and we re-opened a second plant in the first quarter of 2014, now taking - bringing it more into full speed in the second quarter of 2014.

Now, if you remember Marfrig back a number of years ago, we are very much close to the same turnover level, sales level, that we had back when we have Seara. We used to post, during the time of Seara, around BRL 5 billion, BRL 5 billion plus or slightly under, so - which used to be a BRL 20 billion company. So it's interesting to see that we've been able to recover most of our sales that we used to have in the past.

Margins are stable at levels above 7% across all businesses; more important than the number itself is the consistency and the new plateau where those margins are. This is the third quarter where we've been able to keep margins above 7%. We can't promise that, that's always going to be the case, but it is good to see a much more predictable and consistent performance coming from our company.

Net loss, a very significant reduction but still not yet into the profit terrain, which we are aiming to. But it's not immaterial in terms of reduction of 43% relative to the first quarter of 2014. Part of it is really explained by reduction of interest expense.

I mean, we've been telling the market that we would be working very hard in bringing the interest cost of the company down. We are pleased to say that we did. We brought the average cost of debt of Marfrig from 7.9% in the first quarter of 2014 to 7% in this quarter, allowing us to save BRL 26 million of interest expense in the second quarter, which absolutely explains why the net loss has been reduced.

Important to note that we have not been able to fully capture the interest expense in the second quarter, because the liability management exercise we conducted, actually, happened more towards May and June as opposed to April. So the quarter, we haven't really been able to fully capitalize on that interest expense reduction yet.

Another important piece is our liquidity position, so we absolutely strengthened from BRL 1.8 billion to BRL 2.6 billion, part of that has to do with the fact that we are no longer burning cash. Second, we certainly raised cash and we've been very prudent in the way we're managing our cash position, so as to allow us to continue remain stable and, balance sheet wise, unchanged company. Most balance sheet indicators, if not all, have been unchanged as you're going to see in a couple of minutes.

Going to guidance, so revenue is up almost BRL 10 billion, pretty much in line with what we said at the market we would doing, BRL 21 billion to BRL 23 billion, more on the low end of the range as opposed to the higher end of the range but important to note in the footnote of guidance, that when we put those numbers as our goals, we were counting on eventually an average exchange rate real-dollar of $2.40 which, of course, hasn't happened.

So despite the stronger real in the first half of 2014, we're still able to get to a BRL 10 billion mark in the first half. Margin, steady at 8.1%, more on the upper range. Our CapEx is slightly higher. We're totally committed to deliver the number you're seeing on the table, but this is pretty much spread across Marfrig Beef Brazil with roughly 70% of increase and the remainder of that increase being split between Moy Park and Keystone.

Free cash flow, close to breakeven, BRL 13 million, I will explain more the second quarter itself. But from where we were to where we are, I think we're pleased to see another quarter of consistent performance, and more importantly, a company that is able to manage its working capital.

There were always many questions around working capital delta, working capital variance related to Marfrig. And we are pleased to show that, I think we have got hold of most of the indicators in our items that basically impact us positively or negatively relative to working capital.

Net revenue mentioned, important to see the increase across all businesses. More important, increase on the Marfrig Beef from 18.2%, as you can see it on the slide, I don't need to read it for you. But on a consolidated basis, still a growth of almost 15% relative to the second quarter. So, it's not immaterial having a company growing organically, 15%. And even when you adjust to foreign exchange variation to Moy Park or to Keystone, but particularly Moy Park, we can clearly see a very important growth batted for Moy Park.

EBITDA margins, again, 7% across all business units. And if you look back 2013, again, an important change from a 5.9%, 5.3% type of range to consistent levels around 7% plus. Good performance – it's interesting to see the Moy Park and Keystone, alone, already account for 50% of Marfrig's EBITDA. And I personally believe we're very well positioned, geographically, with where we have our footprint. I think we're going to talk more about it.

I mean, being resilient, I remain extraordinarily bullish about Brazil, but I also recognize that in the coming years, the Brazilian consumer segment will certainly have, in my view, a different pattern, and I think we've seen it the last couple of years. We're going to talk more about that later.

Uruguay did post a very solid performance. It was one of the best performance of Uruguay for a long, long time. So those who have been following the story, we used to lose over $30 million in Uruguay a couple of years ago, between the beef side and the leather business that we have. We did sell the leather business. And we turned around the beef business, which now contributing significantly to our profitability. Uruguay accounts between 18% to 20% of Marfrig Beef South America only.

Balance sheet. Happy to deliver to the market what we said we would do. In the first quarter, we said we were looking at possibilities to conduct a number of liability management. We are the second Brazilian company that has been able to tap the U.K. market, the sterling market. So, we did issue seven-year bond from Moy Park at 6.25%. Only Petrobras was able to tap the sterling market from Brazil.

Then we also did another transaction of $850 million at 6.75% that allowed us to buyback the 2017 bonds at 9.875% and the 2021 bonds at 11.25%, helping us to reposition the cost of the company and helping us to get the 90 basis points from one quarter to the other.

Cash position, as I mentioned before, strengthened and more importantly, the leverage ratio very much unchanged at 4 times. Now remember, this is not where we want to see the company. I don't think 4 times is a number that we should necessarily accept easily. But it's also now a number a lot more in line with some of our peers, particularly in Brazil. So, I think both Minerva and JBS are in the range of 3.5 to 4 times. So, we're not anymore an outlier as far as leverage is concerned. But having said that, we still cannot believe (11:17) with the 4 times as it is. But pleased to see that it's stable, it's under control, and we can now manage the company a lot better.

Cash flow. Cash flow was negative BRL 29.7 million and that is explained by a couple of reasons. One, our own decision to have increased CapEx. We decided to put some more CapEx in this quarter, all related to farms in Moy Park, getting more chicken farms. Without chickens, we can't grow sales.

So, we have to get more farms. We had about 700 farms. To date, in U.K., only 10% of these farms are owned. Most of them are in England. So, I would say expansion in the supply chain from a poultry point of view. Some money also went into Keystone, combination of Asia, most of it, and some into Marfrig Beef. So, CapEx does explain – or the CapEx there does explain some of that.

Second piece, we have increased, on purpose, our export volume. Brazilian domestic margins for beef sales have been under pressure for certain cuts. I'm going to talk more about that later on. And the export cycle tends to be a longer cycle. It's more like a 60-day receivable term than it is on domestic sales, putting a little bit of an additional pressure.

Last, but not least, there were some payments around FIFA sponsorship that also, from a cash flow point of view, hit us in the quarter. Not overly material. We're talking about somewhere between $7 million to $10 million. But nevertheless, it's still healthy to bring it to BRL 29 million (12:58). For the semester, as we mentioned before, BRL 13 million negative.

Continuing – it's just worth mentioning that the working capital needs and the challenge around all this working capital are centered around beef in South America. Both Moy Park and Keystone were free-cash-flow-positive, so we don't see any issues there, whatsoever, and remaining, again, totally committed to deliver our 2014 guidance of neutral to positive cash flow this year already.

Estimates, they're pretty much in line. I think we certainly surprise the market on the net revenue side, perhaps a little bit more than people expected, but both EBITDA and adjusted EBITDA margins pretty much in line, which is more important is that the sales side, great relationship with the sell side. People are really following the story and believing in the story and more importantly, being able to actually do the forward-look of Marfrig and feeling comfortable to do so without being surprised negatively. So we see that as just another signal of us trying to be as consistent as we could possibly be.

For me, this chart is a reflection of how well are we doing in communicating our story. This is how we see it. So for me, it's a sort of a testimony that we're probably doing a reasonably good job in telling the market our story, so that the sell side can actually price us appropriately.

I did cover net revenue. I think it's just worth mentioning that Moy Park, in particular, comes a little bit over 18.2% growth when you look at back to the second quarter, but not a lot to offer. I always – I would like only to reemphasize that a weaker real, if that happens, assuming that the macro environment of Brazil deteriorates, it's actually very positive for Marfrig. We do get a negative impact from the debt, but we get a more than proportionate expansion of our margins on the operating level. So when you see 50% of the company's EBITDA, just based on the Moy Park. If I add Uruguay, that has been profitable, we're talking now almost 60% of the company's entire EBITDA totally outside of Brazil at this point in time.

Gross income, good progress, we are on track to post, eventually, BRL 2.5 billion of gross profit, an important one. And I mentioned that number because as long as we continue to reduce interest expense, that gross profit number is an important one. So BRL 2.5 billion is not an immaterial number. We have come very close to BRL 1.3 billion in the first half of 2014.

And the second half of the year tends to be a bit more active for the – in protein business, animal protein business just in general. No important shifts in the breakdown of businesses. As you can see, I would say Moy Park was a remarkable change from the second quarter. So posting a gross income growth of 43% when you compare it to last year, and that's not a small – even when you adjust it for exchange variation of 18%, it's an important growth trajectory.

We're very happy to be positioned in U.K., one of the solid growth stories of Europe, coupled with Germany. So we believe U.K. economy continues to grow steadily and we are very well positioned in an industry that is very much consolidated.

Slide of SG&A. We brought it down to 7.2%. Keystone has actually been the one helping us to bring the net debt average down. Work to be done in Moy Park and work to be done in Beef Brazil. I will talk more about that in a couple of minutes. But all in all, very positive for 7.2%. We'd like to see a number more under 7% consistently, but that's – it is a high order. Particularly when we are growing sales and we were growing organically. But we'll remain attentive on SG&A. Particularly Moy Park and Beef Brazil.

EBITDA, in line with the market. Solid margins at this point in time. I think beef, the increase of beef margin, it's true but, of course, we have to remember that the second quarter of 2013 is the quarter when we closed down a couple of branch in Argentina. So it does historically, the base of second quarter 2013, was really at the low end from a beef point of view. So when you see 150 basis points, I think more sort of a normalized, if we would probably have normalized debt to cost (17:34) associated with the Argentina shutdown.

But solid performance – for our beef business, very, very solid. We're very proud of what we're doing and, even more importantly, I think the international side as mentioned.

Net debt. Net debt came down from BRL 6.8 million to BRL 6.7 million, very much helped by a strong real, so that helps us on the debt side, the foreign exchange variation it is. But also and importantly helped by the fact that we're no longer burning cash. So I think the company has stabilized its position, as you can see, cash flow before CapEx around BRL 400 million.

That seems to be a pretty standard and good reliable number, and we made the decision to increase CapEx as mentioned before. And the provision for interest, now, in a lower level than it used to be. So the ground (18:25) rate of provision for interest is already coming much lower than used to be.

Balance sheet debt, worth noting on this slide is the reduction of short-term debt. We are now running 11% of our total debt, short term. Our short-term debt cost has moved from 6% to 4% and 4.5%, quite significant. So I think we probably can see – the 11% seems to be too much on the low end for me. I think around between 15% and 20%, within the total, seems to be more appropriate now as we have refinanced most of our short-term maturities. Leverage, pretty much unchanged no matter how we cut it and you see it. And a very solid cash position which I'm pretty pleased. I wanted to end an I will – and we will end the year with a solid cash position.

Maturity schedule. Please do pay attention to the first quarter 2014 and the second quarter 2014. I think, what's worth noting is the mountain, the 2017 bond, that was there in the first quarter of 2014 no longer exists in the second quarter. We did buy back significant amount, so BRL 1 billion is gone.

But importantly, the BRL 1 billion is gone is the BRL 1 billion at (19:39) type of range is gone. And on the 2012, although the bio (19:48) hasn't moved much, but the cost of that bio (19:51) has moved significantly as Ricardo has made that clear to me a couple of times and to investors here in Brazil as well. We have a new one, which is the 2019, which we have issued successfully at 6.75.

So, overall, good progress in an environment where I wouldn't call pro-Brazil. So, I don't think we have lived the first half 2014 within tailwinds on Brazil, more like happenings. So despite that, we've been able to successfully conclude, with the help of friendly banks, and more importantly, the fixed income community, who have made a very wise bet on Marfrig loans. And then hopefully we haven't disappointed them up to now and certainly not going forward.

Cash flow. Important to note on cash flow is our continued efforts around working capital. So, we've been able to extend, particularly, payment terms with suppliers, and that's pretty much scattered across four businesses: Moy Park, Keystone, Beef Brazil and Uruguay. Part of that is also related to our increased slaughter capacity both in Brazil and in Uruguay, where we have been able to buy cattle at longer terms than we were able to do in the past.

And in Moy Park and Keystone, there's a variety of components but it's important. Inventory is under control, an important component as before. It used to be a little bit of a wild card, so we keep paying quite a bit of attention to that. And so helping us to really come to what we consider to be a very close breakeven picture for first half.

A slide that shows the free cash flow of the company after CapEx and interest is always one of the best slides for me, because it basically brings to management the importance of free cash flow and how we wouldn't be able to even be in control of the future company if we wouldn't get that under control. So I think we're pleased to report a fourth quarter, where we've seen in the market quite, hopefully, clear evidence of working capital management taking place, under control and towards meeting our guidance.

Moy Park, pretty much helped by a couple of factors. One, increased demand or continued demand for poultry, that hasn't changed, helped by our position in the U.K. market, by the growth of the economy, but also by very high beef prices. So, poultry demand is annually growing around 1.6% in U.K. Don't see much of a change at this point in time. The market is consolidated, very different in U.S., so we have relatively few players in the poultry industry, which helps me to believe that I don't see important contraction or supply risk on the supply side.

Moy Park also will be benefiting from a much more benign and lower grain environment, price environment, than I think we have experienced. They are basically wheat focused as well as sowed and milled (23:07). And I think wheat prices have really reached relatively low levels. We've been hedged in a more significant manner up to September, so I think we should be able to see some of the new grain prices eventually filter in and helping margins in the fourth quarter.

Keystone, very much helped by Asia growth. Second quarter of 2013, there was an outbreak of AI in China, which basically damped sales of most of our customers, that has pretty much recovered. So we are seeing China, both China and Thailand, really at full capacity. We have two plants in China that are at full speed, 100%, seven days a week, just producing very, very steadily. We haven't seen really the U.S. side of Keystone moving faster. Most of our customers, particularly McDonald's, hasn't really had a very active agenda on promotions of poultry products. So promotions are very important in the U.S. to drive sales. So we haven't seen much of that.

In Keystone in the U.S., particularly, has been hit negatively by the meat – the chicken meat that it has to buy outside of what it's integrated. So Keystone in the U.S. has integrated 70%, being able to create its own chicken meat but still has to buy in the spot market 30%. So, with some customers, of course, we're not able to pass through necessarily all that increase.

I do believe in the second half of this year, we should see chicken prices a little bit more subdued than we've seen in the first half on the back of increased production. We're going to see probably more increased production coming through 2015 than actually 2014. But we're not seeing as much pressure as we've seen in the first half. Great job around SG&A, we're doing a very good job in that respect.

Marfrig Brazil. Marfrig Beef in Brazil, now, in particular. Brazil, we have seen, clearly, a compression of domestic margins in some of the cuts. The economy is slowing down or has already slowed down. Consumers becoming a lot more selective in what they're doing.

We've been able to increase volume. The World Cup has helped us to increase volume of certain cuts by almost 15%, and we have also increased volume in terms of sales. To give you a reference, in the second quarter of 2013, we sold domestically, in Brazil, BRL 950 million, and in the second quarter 2014, we sold BRL 1.1 billion, round numbers.

So, we have seen increasing volume, but we haven't seen the same sort of dynamic for margin. And what has helped the business is really the export flows. We have increased exports out of Brazil as well. Historically, Brazil beef would export 30% of its production, and we are now exporting over or slightly over 40% as we move forward, so a very important increase in the export.

Uruguay is doing very well. Marfrig has had a very, very solid performance in the first half. Argentina, we have, as I mentioned before, we initiated a second plant. These two plants are working on positive EBITDA margins. We have decided to offer one of the plants a collective package for voluntary active layoffs.

So, in the plant of Córdoba, we were able to reduce 217 employees, voluntarily, which is, again, helping us to reduce fixed costs in some of the plants that are closed temporarily. But Argentina can also be a positive signal if the government finally decides to lift export taxes and continue to leave the foreign exchange at 0.3, as it seems to be. But the lifting of export taxes would position our business to be a very important export machine.

Net income, a very important reduction of the net loss of 43%. You can see it for yourself on that slide. It's self-explanatory and very much helped by interest expense reduction, which was not surely captured in the second quarter, as mentioned before.

When we look at our growth performance, three specific things are moving, and as a reflection of a company, that is more predictable, that it's focusing on the operating side. But more importantly, I think, is the equity side of house, which we're pleased to see a number of new investors coming to Marfrig, people who have absolutely betted on a new story on management delivery, in what we said we would deliver on Focus to Win. Easy to say, it is now at first half, end of first half of 2014, but not so easy back when we have to make some important divestment and the company being very, very levered, but now in a more normalized level, level that we certainly want to bring down over the years to come.

Final remarks, the resources of beef in the world. So I think we remain very positive about beef prices. The fact that Russia has now finally embraced Brazil as its significant supplier of beef and chicken. But for us, beef is the important component. It's really positive. We have 11 units now licensed to export to Russia. Difficult to give you an idea how much would that impact business in the short run, but very, very comfortable to say that those are very important valves to keep domestic prices not falling too fast. Although, remember, some of the cuts that we sell domestically are not cuts that are exported. So, certain parts of the animal we do export and some parts of the animal there are no market outside of Brazil, so we ended up having to sell it domestically.

We think we will remain focus on the food service channel that has helped us to alleviate the pressure on margins in the wholesale segment, the largest of the markets. So much so that the World Cup, as mentioned before, helped us to increase volume by almost 15%. Some of that increase we'll actually recapture in the third quarter.

We initiated a very solid and important productivity agenda in Beef Brazil. We don't control the foreign exchange. We don't control what happens with the economy and what is clear, a deterioration of the consumer purchasing power in Brazil, but we do control our infrastructure. So we won't initiate a very solid and deep readjustment of our fixed cost structure in Brazil. We're aiming at reducing annually BRL 30 million. You're going to see some of that happening more towards end of the year and in 2015. We really have about $3 million of that after capturing the second quarter of costs and that will be a variety of issues.

We're going to be attacking – over time, we're going to be attacking vapor gas utilization, energy costs. We are bringing most of our plants to an 80% utilization capacity. We used to be sustaining (30:21). We have plants at 60%. We have plants at 82%. We have plants at 75%. So we want to bring most plants to a more common average across all variable and fixed cost components using the best plants that we have today and bring them all to that level. I do believe we're going to be able to do more than that. But let's focus on this one first, deliver and then we can talk more, but this is important.

We're going to pool a group, they'll be managing productivity, human capital productivity, in our consumer businesses. Commodity business needs to be run as a commodity business and we'll certainly do that in the beef side as a potential cushion towards the Brazil domestic market that can become a bit more challenging in the quarters to come.

There's plenty of supply of cattle. I don't see any problems there. But I also do not seek cattle prices going down. So we have - if you look at cattle prices in 2014 relative to 2013, we're talking increases over 20%. If you look at second quarter towards first quarter, you're talking about 3.4%.

So cattle hasn't abated because cattle ratios in Brazil are very capitalized. We are not under any pressure to sell cattle. We have seen the consolidation of very big players with very large number of cattle heads, 20,000 plus. We've seen cattle ranchers a lot more focused on future markets and understanding where export prices are. So, they can read the market as well as we can. So, I don't see, at this point in time, any leeway coming from significantly lower cattle prices on the back of domestic margins that make Brazil to be under pressure.

More important focus on three components. We are paying attention to - more attention to the profitability of our convenience business. That's a business that we have grown very fast over the last three years. We have leading positions in market share in U.K. But we don't have the set of margins that I think a convenience business should be triggering. We're running margins between 6% and 8% and we certainly want to see that business moving closer to a 10% margin than I think what it is (32:29) even to counterbalance what will be (32:33) point in time the readjustment and realignment of margins on the fresh poultry side.

On the Continental Europe, we've been able to move EBITDA margin from the negative territory to positive. The 1% increase on the current 4% EBITDA margin can be quite accretive to Moy Park. I mean, the food service channel, which is fundamentally France, accounts for 28% of Moy Park's today. So, if we can increase profitability by 1% there, it's an important piece. We will also make sure that we'll see ways to take advantage of a grain environment that is, certainly, structurally lower than we were - than what we saw back in the first half or even last year.

Keystone, no big change. I would say Asia continue to grow volume steadily. I would say China, Thailand and Malaysia being the important fillers. I'm seeing a lot of shifts from Japanese customers not buying from China anymore, trying to buy from other markets, in Thailand in particular. So we are well positioned in Thailand with two plants. We're over 100% capacity allocation at this point in time. So I would have to say that we're probably going to see increased volumes in Keystone coming out of Asia.

I'm not so sure we can keep margins as they are for Asia. As such, margins are between 8% and 10%, but volume was definitely increased. And no significant changes in U.S. as far as I can see with the exception that perhaps a more benign grain environment may relatively help Keystone margins in the U.S. towards the end of the year.

Strategy, stability, delivering what we said we would do and certainly close, if not meeting, most of our guidance levels. I'd like to remind the market that management compensation, variable compensation, is aligned to guidance, so variable compensation is totally aligned with shareholders in that respect. So everyone in the company, have as corporate goals, belongs in our, basically, scale out on guidance.

We don't see much change in beef. Much to the contrary, I see a lot of interest in the beef industry in South America both from customers, for reasons that we've seen and we heard, but also from investors. So it's interesting to see we ignited interest in beef as we have never seen on the back of shortage of beef worldwide.

I'm happy to report that I think we were able to get the Moy Park zone successfully placed, which actually helped Moy Park to tap and to enter the capital markets in U.K. I believe, at this point in time, the Moy Park, the pretty solid incredible story from an IPO point of view, we're not in a rush to do anything because we have no reason to do at this point in time. I think we feel the company is performing according to the plan. And as long we believe we'll continue to create value, time is in our favor to some degree, but I also understand - and I also want, and I speak for the management, to see a more accelerated path towards deleveraging the company.

So the dynamic here is ensuring that we continue to create value with international subsidiaries. And at the same time, continue with a pass-through performance, and at the same time, finding the right time and the right moment when we think we can do it and raise equity through the subs will be the right time to continue delevering the company.

With that, I stop for questions. I didn't want to - I already took 35 minutes so I think that's enough for a monologue. So we now - we're opening for questions.

Q&A

Operator

Our first question comes Lauren Torres with HSBC.

Q - Lauren E. Torres {BIO 7323680 <GO>}

Yes, hi, everyone. Sergio, I appreciate your comment on focusing on things that you can control rather than those you can't. But I was just curious if you could talk a little bit about the confidence you have in achieving your free cash flow target for the full year. It seems like the first thing you cite with respect to some of the weakness has to do with the consumer environment which doesn't seem to be improving. So I'm just trying to get a sense that there's kind of other levers to pull to achieve that? And then if the environment does get weaker, is that breakeven to positive free cash still achievable for the full year?

A - Sergio Agapito Lires Rial {BIO 1925337 <GO>}

Yes. So, the answer is unequivocal yes. I think if you look at the trajectory, for those who have been following the company, and there's a slide that shows you the evolution of free cash flow. I think having arrived at the end of first half with minus 13, with the voluntary decision of having increased CapEx, if we didn't have a - I mean we could have decided not to increase CapEx in the second quarter just for the sake of being very (37:59) driven in the first half. We will not compromise good growth just for the sake of one particular goal. But that goal is important because it triggers a very strong signal close the market of there is a way to de-lever the company over time organically.

So, management is absolutely committed. So what could happen – so, people say, I think here, some analysts and shareholders that now more confident that, one, they're in control of our working capital, which was something difficult to say last year. People didn't really have the confidence that we have the levers and we knew where to touch to manage working capital. So I think we have another quarter giving people at least that confidence.

Second, I don't see pressure for Keystone, on my part, from cash flow plus the cap rate. The two companies were free cash flow positive in the first half. And if we do have a lower grain environment, that will probably be positive. And I don't see margins dropping just because of lower grains at this point in time because we're fundamentally processed food company, so it takes a little bit longer.

In the case of fees, where we're going to see pressure is less on domestic margins but more on perhaps higher volumes for exports. So exports do take more time for you to collect the money. Marfrig is in a well – the good thing is that now we have sufficient bank lines to fund that asset. Because what you don't want to see is a big export push not having the appropriate working capital to back you up. And not only we have the lines, but we also have the lines at 4% and 4.5% costs as opposed to 6% to 7% in the past. So, I think we are in an environment that I feel very comfortable that we'll be in control of our working capital.

Now, on top of that, I believe the productivity agenda that I've just mentioned in Brazil will yield results, significant results, towards the end of the semester. Second halves are more active for animal protein business, traditionally. So, I mean, if you look back in any company, you will see that. So, all in all, I think we're moving towards a second half. And if – things that I can't control, if the real at 2.30 or weaker, very positive for us, both from our results point of view, but also from our working capital point of view.

Q - Lauren E. Torres {BIO 7323680 <GO>}

And just as a follow up then, on the investment for your export business in beef, is there any immediate need for greater investment to kind of keep up with the demand that we're seeing as exports are opening, or is this something that's already in your plans?

A - Sergio Agapito Lires Rial {BIO 1925337 <GO>}

Yeah. The investments – so, the answer is no towards exports. The answer is yes towards getting higher savings on productivity. So, for example, vapor, gas, steam (40:50), I mean, it's the cheapest energy for any plant in Brazil. So, we are trying to capture a lot more steam that we lose and wait in the plants today. We're probably going to be making some investments, energy utilization, our cold – the energy that we spend on cold storage in the plants. We have lots of storages that are losing energy by not being very well fueled. I mean, I'm getting through granularity. So, there's going to be some more money related to get higher efficiencies around the industrial side than related to export.

Q - Lauren E. Torres {BIO 7323680 <GO>}

Okay. Sounds good. Thank you.

Operator

Our next question comes from Daniel Sensel with JPMorgan.

Q - Daniel Sensel {BIO 16854713 <GO>}

Yeah. Hi. Good morning. A couple of questions regarding that. The first question is in terms of liability management. You were – you have been very active this year. Are you foreseeing to do anything similar during the second half of the year? And also, which one could be involved? And the second question is regarding how are you recording in your balance sheet the premium paid in these centers?

I'm just looking at the note that you have on the financial segments. And you have that for bonds, you have an amount outstanding of BRL 6.4 million. But then if I look at the amount outstanding of each of the dollar bonds and the Moy Park bonds, it gives me around BRL 6.8 million. So, is there any – are you deducting that premium from the amount that you record in the balance sheet? Thank you.

A - Sergio Agapito Lires Rial {BIO 1925337 <GO>}

So, the first question, the answer is no. We don't have any particular issue in mind. I realize the company doesn't have a 10-year benchmark. I realize that. So, at a given point in time, probably it will be appropriate to establish a long-term curve and shape of what market (43:04) it is, the long- term risk. No urge to do anything at this point in time. We're sitting on a good position at this point in time. So, the answer is no.

The second part of the question, I can answer part of it. And I think if you want to go through the reconciliation of the numbers, I would encourage you to call our IR for further details. Well we have the third, the premium pay on these bonds according to the standard of what that bond is, which is what the country rules allow us to do.

Important to mention that we actually paid a premium. I would encourage you to look at the sort of premium we paid for the 2017 and the 2021, actually averaged and lowered to the average of the marketplace of all the equivalent liability management exercises conducted by a number of issues in Brazil. As a matter of fact, on the new bond we issued, we actually had a negative new premium issue, which is something very, very unusual for a single view.

Q - Daniel Sensel {BIO 16854713 <GO>}

Okay. Yeah, I asked sequential, but if I do the math, I think that if we look at the dollars we have, you reported $200 million or $190 million less of debt, and if you translate that into leverage. We're talking about 0.3 times. And even it's not that big, when you have leverage around 4 times, you think it's an important number. But I will follow up with IR. Thank you.

A - Sergio Agapito Lires Rial {BIO 1925337 <GO>}

Thank you.

Operator

Excuse me. Our next question comes from Isabella Simonato from Merrill Lynch. Excuse me.

Our next question comes Alex Robarts with Citi.

Q - Alexander Robarts {BIO 1499637 <GO>}

Hi, everybody. Thanks. Yeah. I'd like to go back to the free cash flow trend, and I appreciate first half was down BRL 30 million, BRL 40 million, but the reality is that we have kind of reverted down to minus BRL 30 million in the second quarter after having that positive first quarter. And so kind of thinking now just in the third quarter, I guess, you seem to suggest - and in the earlier call, in Portuguese, you gave a few comments around this - but it seems to me that it's the beef business that's kind of been the relative drag versus Keystone and Moy Park.

So, when I think about the third quarter and the free cash flow generation issues, I mean, I guess I see a couple of things. It sounds like the beef purchases will continue to be there, at this kind of 20% higher cost level. It doesn't look like you'll get the strengthening of the real that kind of helped to a certain degree, right, during the second quarter. And I also kind of feel like the CapEx is on target. In other words, you're about half the way through your BRL 600 million target. What is the factor in the more short term, and I appreciate this is more of a short-term question. But in the third quarter, what would be the factor that could help improve the free cash flow generation potential in the third quarter given - I mean, yeah, so I'll stop there because I have a second question. Sorry, that'd be great.

A - Sergio Agapito Lires Rial {BIO 1925337 <GO>}

Okay. Everything you said is correct with the exception of one thing. I mean, the foreign exchange, the real didn't help the beef business in the second quarter. Actually, it did impact negatively to this business in the second quarter. Every time the real strengthens it's a negative force towards beef. Every time the real devalues, it's a positive.

So one of the things - if you believe - our guidance was predicated on a real-dollar $2.40, actually that hasn't happened in the first half. So despite not having the real at $2.40, we've been able to get very close or meet guidance including on sales. So that's one piece.

So if the real - if you believe the real - I don't control the real - but if you believe the real will be weaker going forward, that's very positive for beef, including from a cash flow point of view. Because the more exports we generate, the more dollar base we become as an organization. So if you add Uruguay, Moy Park, Keystone and a significant higher stake of exports to beef, you're talking of a company that is high in dollarized. So that will definitely help us. But then you say, Sergio, what could change going forward second half?

A couple of things, first of all, we said our guidance is breakeven to close 100, okay. So we are committed to that. We're not committed to anything different than that. We're committed to that. We are pretty close in first half, minus 13 to that guidance. It is not breakeven. I understand, but it's not a big variance in that respect. Second half of every year tends to be a lot more positive for animal protein business overall.

The fourth quarter tends to be the peak quarter for most of the business. So, I do expect higher volume - higher sales. I expect margins particularly for the international to remain equal or better, going forward and the opening of Russia, the opening of China are things that we cannot necessarily put a number right now. But those are all very positive in the structural changes that will benefit our beef business.

I also expect us to get the cost line of our Beef Brazil to a lower level, which will also, in parallel, be helping margins. So if I give you - and I did give, in the Portuguese call, elements - or if you take over time, for 19,000 people in Brazil where we spend over BRL 30 million annually. If we just cut by 20%, it's BRL 6 million right there that we don't have to pay. That's cash flow. That's real cash flow. And I'm just taking one item off the 19,000 people infrastructure that we have in the business.

So, just over time, if I can cut, for example, maintenance because there are different ways of going about it as opposed to have each brand running its own maintenance without a more structured approach towards how we are sourcing the spare parts, how we're going about teams. So there's a variety of where we'd say 8 to 10 very significant cost items in Beef Brazil if we cut between 5 and 10, resulting numbers from a cash flow that could be from BRL 5 million to BRL 20 million, very easily, very easily. And that's why this productivity agenda which is, call it, different than we have done in the first half, it's so important to ensure that we have a cushion - an additional cushion for us to meet the guidance of breakeven to close to 100.

Q - Alexander Robarts {BIO 1499637 <GO>}

Okay. Fair enough. And I appreciate that detail. My earlier reference to the stronger real in the second quarter, not necessarily related to the cash flow in beef but kind of on a consolidated level vis-à-vis your dollar interest expense and in your financial exposure there.

So, that was why I mentioned the stronger real. But fair enough. Kind of in the same line of second half free cash flow and capital structure, the second question I have then relates to Moy Park and your strategic alternatives. In May - I'm sorry, in March, after fourth quarter, that was when you first talked about potential IPOs of certain of your subsidiaries and such, commented earlier today as well after the first quarter.

And I'm just wondering. We've seen a lot of assets come to market, right? WH Group just came out. We have one coming in Brazil. And you commented on the interest just generally in protein and the supply picture globally being, at least in Latin America, improving.

Moy Park IPO, I mean, should it - I mean, maybe - could you comment on why that might not happen this year? And any of the kind of comments and feedback you have from some of your pilot efforts around that and any other strategic elements that we could kind of think about that would just raise capital and help the capital structure, that would be great. Thanks very much.

A - Sergio Agapito Lires Rial {BIO 1925337 <GO>}

Thanks, Alex. So, with that, what we said in the first part of the year is that we were exploring how to raise the equity through the subs. A couple of things we've done. One was, first, delever out Moy Park, which we did with a bond. So, we got the £200 million issued for seven years, which actually opened Moy Park to a number of UK investors, which pretty much did not know who Moy Park was. So, we're pleased to see that, that got done.

The second piece is that sales trajectory of Moy Park and the growth of Moy Park in the consolidated industry gives me, today, the confidence that it's certainly an IPO story.

The other side of this question is what we have seen is a couple of things. One, in a low interest rate environment and in a world where there is scarcity of food businesses, we've seen what happened to multiples, right? I mean, in January, nobody could see the Hillshire would be sold for the multiples that ended up being sold. And I think there's more to come. So, I do see pressure because of the scarcity of really good fundamental food businesses going forward.

So, on one side, I'd say we're not in a rush because the company is performing. We are creating value as we speak. On the other hand, of course, it will be nice to be able to find the right investor or the IPO story that will help us to delever Marfrig faster.

So, the only motivation would be very much on accelerating the deleverage story. We remain committed to delever Marfrig. I mean I want to make sure the market has absolutely no second thoughts about it. But I don't think we need to do it in a way that would sacrifice value if certain trends that we are seeing in the food space are becoming a little more concrete.

Again, it's very difficult to foresee the Hillshire or any other branded business in the U.S. would be seeing price at a multiple higher than 13 times. This feels like Asian businesses. We used to be in Hong Kong. So, that actually happened in U.S. So, I think we need to be prudent so that we - and I'm not saying that Moy Park or Keystone are branded business in the food space, but that's when the overall food platform has been related.

So, the answer is, on Moy Park, we're certainly prepared and preparing ourselves for it. We will certainly go for it if we feel confident that we will not sacrifice value and that's important for me, so that the market wouldn't be surprised if we decide to announce it. But we're not in a rush to do it, to comply with a particular time table. We don't have that.

Q - Alexander Robarts {BIO 1499637 <GO>}

Okay. Very clear. Thank you.

Operator

Excuse me. Our next question comes from Maurice Martinez with JBN (55:30)

Good morning, everyone. Thank you for taking my question and congratulations on the results. My question is regarding your raw materials, specifically in the Beef division, Keystone. As we have seen an increase in gross margin versus the first quarter, what are your expectations in raw materials and if you see an increasing gross margin at current levels for the remaining of the year?

A - Sergio Agapito Lires Rial {BIO 1925337 <GO>}

A very good question. You see, it's very much related to cattle prices. I mean cattle prices, if you compare 2014 to 2013, moved up in reais 20-plus percent. If you look at second quarter to first quarter, 3.4%. And why is that happening? First of all, there's plenty of supply in terms of cattle. So there isn't like, okay, the cycle has changed. It has not changed. What has happened is that we have very wise ranchers. I mean, the world – there's no really disintermediation. The ranchers in Brazil, cattle ranchers in Brazil, are very capitalized, they're not under pressure to sell cattle and they can understand and read what export process are. So, they take their time.

There was another element, which I think is worth mentioning, it was the drought. In some place, the drought – I mean, it hasn't had a very important effect, but it hasn't been good. So, depending on which states we're talking about, there has been lack of water. So it has only made some ranchers to be a bit more prudent and wait a little bit more, so that they could sell their cattle with better finishing, if you will, as opposed to sacrifice prices by selling relatively skinny animals. So, I don't see prices, cattle prices, moving much, much lower. I think we have seen – in the second half, normally, they would be lower. I mean there's a lot more supply coming in the second half than normally we'd see in the first half. So if I would have to make a bet to where they were to lower levels, but not much lower levels in that respect.

Q - Operator

Great. Very clear. Thank you.

Our next question comes from Jose Yordan of Deutsche Bank.

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

Hi. Good morning, Sergio. Just have a couple of follow-ups first on the Portuguese call. First on - you mentioned that fourth quarter much lower wheat cost in Moy Park, but it wasn't clear how far out you've hedged and how much of the cost savings versus your costs, let's say, so far this year in terms of beef cost in Moy Park?

And also I didn't fully get the comment on the leg quarters being exported from the U.S. to Russia and how much of an impact that had on your Keystone business? And then, well, I have a more general question but this - I'll ask it afterwards.

A - Sergio Agapito Lires Rial {BIO 1925337 <GO>}

Okay, so on Moy Park, most of our wheat hedges, not all of them, but a very large chunk, are basically to be rolled over in September. And wheat is a very important component of what we do in Moy Park as opposed to corn in Keystone. So, it's difficult - I can't just actually really give you a number, because with many customers, it depends on the customer side, because in some cases we pass through, in some cases we take the risk, but all in all, it's positive to hold (59:05) your business in general, particularly for sourcing and within proper risk management.

So rather than having hedge towards 2015, we, on purpose, decided to hedge towards the beginning of the second half, not because we had a crystal ball. We're happy that we did it, because in the beginning of the year, we have the Ukrainian event. That's a very significant supplier of wheat to Europe. But we're seeing out, as an example, record harvest in crops of wheat in Europe. We've seen Ukraine highly, highly motivated to sell wheat on the back of need to have dollars. So I'm very, in that respect, positive. I think it will be positive. I mean, I don't think - I don't expect a huge benefit but it will be positive.

You know, the leg quarter, somebody asked me, how would that impact the fact that Russia is banned in Europe, how would that impact Moy Park? And I said, hardly anything. I mean, Moy Park is not exporting leg quarters. But the U.S. companies do export leg quarters to Russia and Keystone does it a little bit.

So, it's totally immaterial. I mean, it takes away an optionality, so we will have an impact, for sure, on leg quarters from the U.S. will go down. But I was kidding that, you know, KFC will have the benefit of sourcing perhaps cheaper leg quarters going forward. But for the rest, I mean, I don't - it's not material for us. It's not material. I mean, we are more of a breast white-meat company than we are dark meat.

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

Sure, sure. Okay. So my more general question was, now that Minerva has taken over the operations of the BRF beef plants, are you guys seeing any visible change in the sort of rationality of the market there? I think that was one of the reasons they gave for potentially being able to manage those plants better, just managing the whole cattle processing cycle. And I was one. And two, if you had any update you could give us on the progress of the potential opening of the U.S. to Brazilian beef?

A - Sergio Agapito Lires Rial {BIO 1925337 <GO>}

Sure. I mean, on the U.S. side, I mean, the time table is that they would have to – not that they would have to, but there will be an expectation that U.S. would pronounce something towards the end of October. There are lines of thought that say that now that Russia has banned U.S., one way of U.S. to put a sort of an indirect sanction on Russia is to actually start sourcing beef from Brazil. So rather than keeping Brazil as a captive market from a supply standpoint to Russia, U.S. can also say, I'm also going to be grabbing some of that beef in my own market. So you're not necessarily the only one. That could be – it's an indirect possibility.

But I think we remain – I don't have any crystal ball. But I think U.S., looking at what's happening with beef prices at this point in time and capacity that hasn't really – although we've seen some more shutdowns of plants, I do see that opening happening definitely for 2015. And the good thing is that we've opened North America, not just U.S. I mean, Canada, Mexico will follow suit focusing in beef. That could be probably more material than actually China, as I see it.

Now, I can't comment on Minerva. I can only comment that if export is going to be a very important component of the industry? It's good to remind the market that 90% of the Brazilian exports are in the hands of three players, JBS, Marfrig and Minerva, accordingly.

So there's quite a bit of consolidation. So I would imagine people really going after the best possible returns as opposed to what happens in domestic market, where the three of us, we do not have more than 40%, which is a different dynamic where domestic prices can be more under pressure just because we have 40%.

Now, the fact that they would consolidate, would that help cattle farm (01:03:01)? I don't think so. I really don't. I mean, we have fairly large cattle ranchers with sufficient financial power to do whatever they want. So, I wouldn't buy that. It's interesting to see in the second quarter, and I'm not here to talk about Minerva but they – I mean our position from the cash flow was negative 29, part of that CapEx-related, and their position was roughly BRL 80 million to BRL 90 million, negative.

Also, of course, they did explain on the back of the number of things like buying more cattle from the (01:03:30) and all the rest. So, I think we're paying attention very – and we will remain, which is part of Alex's question, above cash flow, cash flow, cash flow. Don't expect to surprise (01:03:42) the market negatively.

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

All right. Sounds good. Thanks for the comment.

Operator

Excuse me. Our next question comes from John Sykes with Nomura.

Q - John Sykes {BIO 1533349 <GO>}

Yeah. Hi. Thank you. I appreciate you taking the call. Wanted to – with Moy Park, just based on a lot of what you're talking about it, you seem pretty positive about the second half. One thing I wanted to ask is the Boparan issue or just a publicity? I don't think it's a big issue being (01:04:20). Is that helping the Moy Park business at all?

A - Sergio Agapito Lires Rial {BIO 1925337 <GO>}

Yeah, it is. I mean, we have a very strong position in Ireland. The important thing is Ireland is not big. So, it's positive in terms of potentially enhanced margins thrust, but not necessarily market share. We are already a significant – we're one of the most important brands in Ireland. It's funny, but it's really as big as Coke. I mean, if you go to the Moy Park then, even the supermarkets, that point of view (01:04:53) is very well known. So it helps, it enhances, but doesn't really change materially the margin structure.

Q - John Sykes {BIO 1533349 <GO>}

Okay, so as you relatively positive with respect to the second half, from what part do you think margins will improve?

A - Sergio Agapito Lires Rial {BIO 1925337 <GO>}

As I mentioned before, I think what's favoring, what's coming, let's say, positive wins or positive trends is that I don't see change in terms of poultry demand. So that's positive. I see a more benign and probably more positive grain environment. That's positive. I also see a Moy Park that will be more committed to cut SG&A. I think that's positive for second half.

Negative, we've seen a number of changes in the supermarkets in the UK including CEOs change on the back of many of the supermarkets losing share to the more discount store models. It hadn't impacted yet, necessarily the poultry category. Remember, poultry is almost the only viable protein from an affordability point of view in U.K. at this point in time. The difference between poultry and beef is four times. So consumers are consuming poultry not because poultry taste better but it's more affordable. I don't see that changing necessarily.

I see Moy Park gaining market share and why is that? Number one, have to – was too busy (01:06:27) in a very significant integration of a margin position that they made. They own about 20% of market share in UK. We're basically running 25% and we continue to gain market share.

And last but not least, continue to improve the Continental Europe market. So we are 12%, we're working towards at least get that business to 6%.

Q - John Sykes {BIO 1533349 <GO>}

Okay, and then lastly, if you choose the IPO route for that business, would it be partial, or do you think there would be something changing control-wise?

A - Sergio Agapito Lires Rial {BIO 1925337 <GO>}

Yeah. I forgot to mention that, of course, Moy Park is also an important play in the turkey market, which brings a seasonality aspect to its business. So, November, December tends to be positively impacted by turkey sales. If we do IPO, we'll be very much in line what the market would be. In the case of U.K., you're talking about somewhere between 20% to 30%.

Q - John Sykes {BIO 1533349 <GO>}

Okay. Okay. All right. That's great. I appreciate it. Thank you.

A - Sergio Agapito Lires Rial {BIO 1925337 <GO>}

Okay. Thank you.

Operator

Our next question comes from the line of Rishad Ahmed with EMSO.

Q - Shah Rishad Ahmed

Hi, Sergio. Thanks a lot for the sort of presentation. I guess a few questions. One thing that we've sort of been hearing over the course of the last quarter is just some changes from China and Russia and opening up with - from China, Russia banning U.S. and European imports, and then China having that McDonald's food scandal as well, which should probably help Keystone.

I guess, do you foresee this opening up to have a material impact, like a positive impact for Marfrig Beef, and if so, when would you kind of expect that to start to trickle through, or is it not as material? That's kind of one thing.

And the second question is just - and I know you've spoken about cattle prices and how that's - you expect them to decrease over the second half of the year. I mean, how exactly is that going to happen, if let's say, you've had the drought, the cows are, let's say, coming in are thinner, and, I mean, what's the dynamic that's going to cause the cattle prices to move lower? Thanks.

A - Sergio Agapito Lires Rial {BIO 1925337 <GO>}

Shah, hi. Great questions. So, I will take a little bit of time because you're asking a very important question, really very important question. I want to make sure people hear me because I think a lot of people don't fully appreciate a couple of things. One, there is no beef in the world. So, there's a very significant disruption on the supply side. Where is the disruption? U.S.? I don't need to tell you, those who are in the U.S., how expensive are you paying for the beef? That's not going to change in the next 15 months.

It will change. Second disruption, Argentina. The export taxes that have been put on the Argentina beef industry actually puts Argentina out of the market, to a large degree, because they've been favoring domestic sales. Very significant disruptions, two very important dealers in terms of beef supply.

Now, if that wouldn't be enough, guess what's happening? We have a richer and wealthier China. China consumes 4.5 kilos per capita. And if you take - I don't know what their consumption is going to be. What I know is that they will consume more beef. I mean look at what happened to coffee, look what happened to wine.

Beef is correlated to a more affluent society. It's the desired protein. It's not poultry. It's beef. Now, who is basically supplying China today? India with buffalo meat that's cheap, low quality beef that goes into their food service industry which is that sort of beef as you find in the Chinese traditional dishes. But when you put the beef in your mouth, you actually know it's not good quality. It smells of fat. It doesn't taste anything. It's only the sauces that makes you eat that stuff, right?

Now, who is the credible supplier to China, Australia? They are making fortunes. The Australian industry is thriving as they have never thrived, but it's going to take them years to be able, if they can, the only supplier of China. So Brazil, at this point in time, is the game, in general. So China open to Brazil not because they have - they like Brazil. They have no other option. The impact will be unquestionable. It will not happen in 2014. It will eventually happen some of that in 2014. But the trajectory it has to be more like, if you look at all other commodities, Brazil pattern with China.

So, let's take Uruguay. China already accounts for almost 30% of all Uruguay exports. If I would have told you that two years ago, you'd say, you must be kidding. So China already accounts for 30% of Uruguay. If you go to Brazil, it's already the most important destination market of Brazilian beef exports. And meat being present in China with Keystone, we have the obligation to do that better than anybody else. So we're setting up a little team in (01:12:10). We are figuring out how we can get with some Chinese companies to figure out logistic. So we will put a lot of effort and money to make sure that we create a unique position and eventually bring stronghold position in China.

Conversely, we have never received more interest from Chinese customers and Chinese investors into the beef industry. I have received more Chinese over the last six months than I have over the last 10 years. So this is real. The other piece that I think is real is the opening of U.S. and even if it's on a quota system, what is important is the Brazilian beef starts accessing critical market they have never been able to access.

And when you look at on a 10-year trajectory, this can be really, really fundable for companies, beef companies. I can actually - we have dedicated plants for American food companies. We can actually have plants in Brazil that are doing nothing but processing hamburgers and food, beef-based products for the U.S. food companies, which they can't. So we can actually become a beef maquiladora, if you will, sitting in Brazil for the U.S. food industry. These things can happen.

Cattle prices, where the cattle prices are, I actually don't care. What I care is the margin between cattle prices and domestic products and exports. That's what I care. It's the spread, not necessarily what the cattle is. So, I do believe cattle prices will not necessarily decline significantly, but I don't see a lot of thrust to put pressure on prices higher for the second half on the back of a more supply of cattle. But what worries me is the gap between that cattle prices doesn't change and the Brazilian consumer that is trading down products, right?

So, it got to be - so that's why it's so important for us to say, you know what, we're going to control what we control, which is we're going to make our operation in Brazil leaner, anticipating eventually for a much more negative environment in terms of consumers in Brazil trading down in that product. It may not happen. I don't have any crystal ball, but I want to be on top of the market than be incredibly optimistic when I see that, at the consumer level, it's hard, 6% inflation is hard. We are not having challenge on volume. We increase volumes significantly.

Second quarter 2013 we sold in Brazil BRL 950 million, second quarter 2014 we sold in Brazil BRL 1.1 billion. So volume is not an issue, it's the mix.

Q - Shah Rishad Ahmed

But just on that point, I mean you're saying that if let's say exports are booming and Brazilian customers trade out, but there's some cuts of meat that can't be exported. I mean what could your export versus domestic sale mix for Marfrig Beef look like in another few years? Would that be kind of an 80/20 sort of mix or even higher?

A - Sergio Agapito Lires Rial {BIO 1925337 <GO>}

I mean what you don't see is the beef business that is only export oriented, that's very dangerous, because you can always be subject to lots of changes in international environment. Short-term, I don't see change happening. So, you really want to have a balanced domestic and export. The good thing about Marfrig and I'm perhaps being biased here, but I think you will appreciate what I'm going to tell you is that we are very well known by being good in the food service channel. That food service channel in Brazil is a lot less -- we thought more Brazilian from a margin point of view.

We have increased our sales of special cuts,15% during the World Cup. That's high margin, that's very solid double-digit margins for restaurants and steak houses in Brazil. It's not enough to counterbalance the sales that goes to large wholesales. But at least I have a significant - we have a significant food service channel and we'll continue to grow that channel.

Q - Shah Rishad Ahmed

All right. Thank you.

Operator

Our next question comes from Christina Ronec (01:16:35) with HSBC.

Hi. Good afternoon. Thank you for the call. I just want to get an update, if you wouldn't mind, Sergio, on the AR factoring. Did you do any in the second quarter, and if I remember correctly, I think you did about BRL 100 million in the first quarter? And if you could give us any guidance of what you expect to do for the rest of the year? Thank you.

A - Sergio Agapito Lires Rial {BIO 1925337 <GO>}

Christina, (01:16:59) can you repeat - the quality of the sound wasn't very good. Did you ask about AI?

Q - Operator

No. About the AR factoring. You sold some AR in the first quarter, BRL 100 million, but I don't know if you did any in the second quarter.

A - Sergio Agapito Lires Rial {BIO 1925337 <GO>}

Excellent. So, one of the things we did, I mean, it's not very common in Brazil that people really disclose - I mean, we disclose. We put a securitization vehicle that we call in Brazil, FIDC, some companies, some competitors have done that in the past, but they haven't necessarily disclosed. So we feel it's good that we disclose. We did that. What is the benefit of that? That's a vehicle. That's a conduit that allows Marfrig to sell domestic receivables only, so please, domestic receivables only, at a very competitive rate, no recourse.

So we actually get that out of the balance sheet and we actually get it better at a better cost than if we would have to finance in a straight bank line. Two things. In terms of - we've done pretty much the same. There have been a variance of about BRL 30 million first quarter to second quarter, Christina (01:18:08).

Q - Operator

So, repeat that please, the last quarter, is it second quarter you did about BRL 3-0 million?

A - Sergio Agapito Lires Rial {BIO 1925337 <GO>}

3-0, yes. So that being 3-0 in the second quarter delta.

Q - Operator

And can you give any outlook on what you feel to do for the second half?

A - Sergio Agapito Lires Rial {BIO 1925337 <GO>}

No, I don't expect a lot of change on that because, as I'm increasing more exports, I have fewer receivables, domestic receivables, remember? So it's a mix. So I'll have more export receivables, but I can't do much with the export receivables and I'll have fewer domestic receivables.

Q - Operator

Okay. Thank you for that.

This concludes today's question-and-answer session. I would like to invite Mr. Sergio Rial to proceed with his closing statements. Please go ahead, sir.

A - Sergio Agapito Lires Rial {BIO 1925337 <GO>}

Thank you, all. There are a number of you who are shareholders, a number of you who are bondholders. So, really, again, appreciating the world, there's so much to follow. I can only thank you on behalf of the management team that you're following us and that you're putting your money on us.

We're pleased to say and we're delivering the first half very different than what has been the history of Marfrig over the last two or three years. But not yet what it should be. So we are fully cognizant that there is a lot of work ahead of us. But at the same time, I think I hope the market would see that we're not surprising anyone. We're being a much more predictable company that our efforts in communicating our message is being reflected in how the shares are performing but also the bonds.

And I think there's more to come. There will be more to come. I'm absolutely – this is the unique food platform that has a lot of value that requires focus, hard work, and with that, I think having a Marfrig that is really moving to only in a world where we have solid 8-plus-percent margin. We're not there yet. Not even reached the target.

But our target, you've seen in the guidance. We're at 8.1% for the first half. But it's a massive – it's not an insignificant effort. We're happy to see us getting close, if not meeting, at least two out of the four right there on the guidance objectives in the first half.

So, thank you again, and please keep watching us. And we'll take it from there. Thank you for your support on behalf of the company. Thank you.

Operator

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