Q2 2015 Earnings Call

Company Participants

- Edison Ticle de Andrade Melo e Souza Filho, Chief Financial Officer
- Fernando Galletti de Queiroz, Chief Executive Officer

Other Participants

- Andrew De Luca, Analyst
- Jeronimo De Guzman, Analyst
- Lauren Torres, Analyst
- Mauricio Martinez, Analyst

Presentation

Operator

Good morning, ladies and gentlemen and thank you for waiting. At this time, we would like to welcome everybody to Minerva's Second Quarter of 2015 Results Conference Call. Today with us we have Fernando Queiroz, Chief Executive Officer; Edison Ticle, Chief Financial Officer and Eduardo Puzziello, Investor Relations Officer.

We wish to inform you that this event is being recorded and all participants will be in a listen-only mode during the Company's presentation. (Operator Instructions) The audio and slide show of this presentation are available through a live webcast at www.minervafoods.com/ir. The slide show can also be downloaded from the webcast platform in the Investor Relations section of this website.

Before proceeding, we wish to mention that forward-looking statements may be made during this presentation, relating to Minerva's business prospects, operating and financial estimates and goals. They are based on the beliefs and assumptions of the Company management and on information currently available. They involve risks, uncertainties and assumptions because they relate to future events and therefore, depend on circumstances that may or may not occur in the future.

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

I will now turn the conference call over to Mr. Fernando Queiroz, CEO, who will begin the presentation. Mr. Queiroz, you may start the presentation, sir.

Fernando Galletti de Queiroz {BIO 15387377 <GO>}

Thank you very much. Good morning everyone and thank you for participating in Minerva's conference call on the results of the second quarter of 2015. Minerva is currently presenting results that demonstrates its capacity to quick anticipate different economic movements through focus on its consistent strategy and execution discipline as we will discuss from Slide 2.

Now, I'll look on Slide 2. In 2Q15, we had a record a gross revenue of R$2.4 billion, 34% higher than in the same period last year. Thanks to the combination between the healthy performance of the Beef division, especially on exports and the consolidation of recent acquisitions. As a result, export revenues grew 59% and domestic revenues moved up 32% in the Beef division. EBITDA totaled approximately R$217 million in the second Q of '15, 32% up on the second Q '14, with an EBITDA margin of 9.7%, 100 basis points higher than in the previous quarter.

This quarter net income stood at R$167 million, accompanied by a net margin of 7.5%, both figures substantially higher than in those on second Q of '14. Return on invested capital was once again a benchmark for the sector at 20%. This was yet another quarter in which Minerva was able to show its differentiated performance in the export market. While Brazil's export volumes fell 12% year-on-year, Minerva exports grew 22%, reaching our market share of one-fourth of the total Brazilian exports. This performance will be discussed in further details later on.

In the last 12 months, pro forma net revenues was close to R$8.6 billion, reaffirming our net revenue guidance for 2015 disclosed in March of between R$9.5 billion and R$10.5 million. The Company closed the quarter with a comfortable cash position of 2.7 billion, with 18% of its -- that in the short-term, stable average in our capital structure that leaves us prepared to face any macroeconomic scenario.

Finally, we highlight once more Minerva's main drivers. We will maintain our focus on the business sustainability, based on expansion and diversification of our operations in South America. We will prioritize the constant pursuit of efficiency in our production units, establishing benchmarks and capturing synergies from the recent acquisitions. At the beginning of the year, we divided the operations into Beef Brazil and Beef Minerva [ph]. And this has already impacted [ph] decision making. We will continue to be obsessive with cash margin, based on focused discipline and consistent execution, which have been the Company's main differential in the sector. We will continue working to reduce the Company leverage, growing consistently, but seeking opportunities that have a positive effect on deleveraging.

Let's move on to Slide 3 to discuss the industry overview in Brazil. Slide 3, in the first semester of 2015, the industry's slaughter volume fell 11% comparing to the same period of 2014. This movement was due to the industry's strong adjustment in response to the unfavorable macroeconomic factors that are affecting the country. We have also begun to feel the effects of the increased female retention confirmed by a recent data published by the Brazilian Institute of Geography and Statistics, IBGE, which indicate our 9%

reduction of cow slaughtering between first Q '14 and the first Q '15 compared with the same periods in 2013 and '14 respectively.

As you can see on the graph in the top right corner, cattle price remained stable in relation to the previous quarter, but increased more than 20% compared to the second quarter of 2014. It's worth noting that the cattle price began to fall in May and June and accelerated their decline in July, in response to the industry capacity adjustments.

We would also like to discuss some important issues that we have been monitoring and which may favor the industry in the second half. Firstly in the first half, there was a typical and a higher than usual rainfall for the off-season period and we expect the rain volume to continue favorably to agriculture in the second half, with more rain influenced by the El Nino. We also expect a declining grain prices due to the excellent harvest and second crop this year, which will favor feedlots activities.

We have also monitored the substantial increase in the use of technology by producers in regard to pasture supplementation and semi-confinement, which has led to younger and healthier animals for slaughter. This is confirmed by the latest data published by the IBGE, which indicates that the average rate of finished cattle in Brazil has already increased from 16 arroba per animal to 18 arroba per animal. Thanks to the combination of all these factors, we believe, will have a more generous supply of animal during this whole year, including, during the off-season with higher productivity gains for the producers and for the industry. Regarding Brazilian exports in the second quarter of 2015, we can see in the graph, at the bottom right that they have recovered in relation to the first quarter. Export volume climbed 11.5% over the previous quarter. However, compared to the second quarter of 2014, exports fell 12%. Firstly, the reduction is explained by the decline in the industry's slaughter volume, which is translated into lower beef availability for exports. There was also a decline in the volume exported to countries with critical political and economic situation, such as Russia and Venezuela.

Thirdly, as we're experiencing a more restrictive credit environment in Brazil, there is some difficulty in retaining working capital credits, which reduced the exports capacity of a number of industrial players. We emphasized that off the most that make up the second quarter, June presented a strong performance in terms of prices and export volumes. Thanks to the recovery of the Russian market, healthy imports from the Middle East and the beginning of shipments to Mainland China (inaudible). These factors influenced the average price in dollars, which increased from $4.11 per kilo in May to $4.40 per kilo in June.

Finally in this quarter, we continued to observe a slowdown in the domestic consumption due to adverse macroeconomic scenarios in Brazil, with price inflation and lower credit availability for consumers as we will discuss in further details later on.

Let's move to Slide 4, where we will discuss the expected scenario for the Brazilian exports. As most of you probably know, in this quarter, we learned that the United States have begun the process of opening its market to Brazilian beef imports. China has also revoked the ban of Brazilian beef imports and shipments beginning June. We would now present the Company expectation in light of this new scenario.

Firstly, global beef supply is still limited, mainly influenced by the competitive weaknesses of some countries, typically exporters such as Australia and United States. This scenario has helped South American producers to increase their share in the global market and consequently, their pricing power in international markets. This recovery witnessed [ph] when we see the upturn in the average price in dollars of South America beef. Also the strong dollar trends to boost export of countries that compete with the United States. This is combined with the average cattle price in dollars, which fell 4.5% between the first and the second quarter in Brazil and is currently half the price of the US cattle.

Talking specifically about Brazil exports to the United States, at first, Brazil will be part of the countries that will integrate what we call, 'all the others' quota, composed by countries that are not major beef producers, such as Chile, Costa Rica, El Salvador, Honduras, Nicaragua and the Dominican Republic. As a result, there is a great chance that Brazil will fill most of these quotas. Also the main US suppliers have not filled 100% of their captive quotas, leaving space for Brazilian producers to meet the United States beef consumption needs, in additional to the previously authorized quota.

However, it's important to emphasize that the major lobby by US producers to stop this opening, which is likely to cause this process to take longer than then was initially estimated. Regarding the reopening of Mainland China, we would like to remind you that the country had banned Brazilian exports in 2012 due to the prion case in Parana State. However, in May EBLEX and three companies that used to be certified to export to that country, were once again authorized to do the exports. The need for beef imports is constantly growing in China, accompanying the country's new consumption patterns in Brazil.

Shipments to Mainland China beginning June and there will be other group of sanitarians coming to the country to certify new plants. It's worth mentioning that Brazil currently obtained around 40% of the global demand. However with the opening of these two new markets, Brazil will obtain 60% of this demand. If due to the influence of the US opening new opportunities arise to access other potential markets such as Canada, Mexico, Japan, South Korea, which tends to follow the United States sanitary requirements standards, Brazil may obtain more than 80% of the global demand that is double of its current access to the global markets, which will significantly strength the Brazilian pricing power for the Brazilian producers and positively impacting the whole chain.

Finally, it's worth highlighting that the industry is expecting the reopening of our Saudi Arabia market. Groups of sanitarians have already been sent to Brazil and now the opening is just depending on some bureaucratic issues.

Now, let's move to Slide 5 where we will discuss the domestic market. As we have already mentioned, domestic demand was negatively impacted by the countries of diverse macroeconomic scenario in the second quarter. The combination of rising inflation, which affects the population real purchasing power, high interest rates, lower credit availability and lower household consumption intention has led consumers to opt for cheaper cuts such as forequarter cuts or other proteins, such as poultry and pork.

As you can see in the graphic on this slide, we have a real household income growth rate projections for the coming years. In 2015, the real household income is expected to decline 3.7%. In addition, as shown in the right graph, we can see the performance of the IPCA consumer price index and food price index, which show an upward trend. This scenario lead us to believe that the performance of the sector in the second half will continue to be influenced by macroeconomic indicators.

So let's move on to Slide 6 that will have an overview on Paraguay. In the second quarter of 2015, Paraguayan cattle producers maintained their animals on their farm for a longer period. As a result, have their animals were slaughtered in May and June, reducing the average price per animal by 9% compared to the same period of 2014. In total, 440,000 heads were slaughtered in the quarter, 7% higher than in the same period last year.

Regarding exports, the country recorded a 13% year-on-year decline in export volumes compared to the second Q of '14 due to lower demand from Russia, one of its main export destinations. On the other hand, the country reallocated part of its exports to Brazil and Chile, its main export destinations. We highlight that shipments to the European Union began this quarter. This market has opened to Paraguay exports in April and will probably increase export profitability.

Let's move to Slide 7, where we'll take a look on Uruguayan market. In the second quarter, 564,000 heads were slaughtered, 7% down year-on-year. Cattle price edged down by 3% from the first Q '15, but we're in line with second Q '14. Exports remained healthy at 67,000 tons. We highlight the strong upturn in exports to the United States, from 13% in the second Q of '14 to 22% in the second Q of '15 and China, from 20% to 39% in the same period. However, there was a decline in exports to Europe and Israel as you can see in the graph -- graphic in the bottom-left corner, which affected the average price in dollars with a 7% decline from the second Q '14.

We will now move on to Slide 8 to discuss Minerva results this quarter in further details beginning with exports. Slide 8, in the second Q '15, the Company remained one of the top beef exporters in the country where it operates. We once again highlight the performance of the Brazilian operations where the share of exports grew substantially as detailed in the following slide. In Uruguay, our market share increased from 16% in the first Q of '15 to 20% in second Q of '15. While in Paraguay, the Company's share of exports came to 19%, remaining flat in relation to the previous quarter, but increasing three percentage points over second Q of '14.

This slide also shows Minerva export mix by region. In recent quarters, Asia has been the highlight of the export growth. There is an increase in share from 12% in the last 12 months ended June '14 to 19% in the same period of 2015. If we add exports to China and Hong Kong, we will see that the two countries' imports have grown by more than 80%. It's important to bear in mind that we use it to send shipments to Mainland China only from our operations from Uruguay. But since June this year, one of our plants in Brazil has also been authorized to resume exports to that country.

In addition to China and Hong Kong, we are also very pleased with the increase in exports to South Korea, served by our Uruguayan unities and the upturn in the exports to Taiwan served by our Paraguayan unities and the strong demand in Singapore.

Another highlight has been the upturn in exports to the NAFTA, where the United States is the main destination. This region shares increased 2% in the last 12 months, accounting for 5% of the total in the same period. It's currently served by our plants in Uruguay and constant increase in exports to the region corroborates the current unlimited beef supply situation in the United States.

As we have already mentioned, there are great expectation that US sanitarians will be re-visiting Brazil as of the second half in order to certify Brazilian beef exporters as announced by the USDA from the Brazilian Ministry of Agriculture at the end of June. If the certifications are approved and a lobby of US producers doesn't represent a barrier, we believe NAFTA share of our exports will grow substantially with an impact not only on export volume, but also on the average price of our exports.

Let's move to Slide 9, where we'll discuss Minerva's performance in Brazil first semester of 2015. Slide 9, Minerva exports went once again up against the flow of the country exports. In the six months of 2015 compared with the same period of last year, Brazil total exports volume disclosed by Secex fell approximately 18%, while Minerva's exports increased 26% in the same period.

As a result, our share of the country's exports came to one-fourth of the country's total exports, exactly 24%. This performance was the result of the strategy adopted by the Company based on the combination of risk management instruments that indicate the best markets for placement of it products, together with an export platform, which allows rapid sales mix, adjustment to more profitable channels. Moreover, the plan certified and prepared to reach these markets give us more speed for obtaining the consumption of these new markets and adapt to the new scenario.

I'll turn now to Edison and he'll comment on the financial highlights.

Edison Ticle de Andrade Melo e Souza Filho {BIO 15435343 <GO>}

Thank you, Fernando. Good morning, everyone. So Slide 10 presents our financial highlights. As Fernando mentioned at the beginning of this presentation, net revenues came to a record of R$2.2 billion, 34% higher than in the second quarter of '14. In the last 12 months, considering the pro forma figures from the Mato Grosso plant, net revenues reached R$8.6 billion. Between domestic and export market sales, we maintained our focus on exports, which accounted for roughly two-thirds of total revenues this quarter.

EBITDA came to R$217 million, a substantial 32% increase when compared to the second quarter of '14. The EBITDA margin also reached 9.7%, higher than in the first -- 1% higher than in the first quarter of '15 and in line with second quarter of '14. We once more recorded a high return on invested capital of 20%, in line with the previous year, which maintained as a benchmark for the sector.

Let's move on to Slide 11 to present Company's capital structure. Minerva closed the quarter with a cash position of R$2.7 billion, roughly 2.5 times higher than short-term debt. Therefore, a very comfortable liquidity position. This position enabled Company to pay all its debt that is due until the end of 2022.

Excluding the repurchased bonds, which we will discuss later on this presentation, the Company's consolidated cash closed the quarter at R$2.1 billion. Short-term debt represented 18% of total debt and it's also worth noting that the Company has used some trade finance lines, short-term trade finance lines in order to reduce the cost of debt, while always respecting our financial policy of keeping not more than 20% of the total debt maturing in the short-term. Finally regarding the Company's liability structure, it is worth noting the comfortable situation of our maturities profile. At the end of the quarter, the debt duration was around 6.3 years.

Let's move now to Slide 12 to present Company's operational cash flow. In this quarter as we can see in the table of this slide, the operational cash flow was negative R$44 million. However, in the last 12 months, the flow was positive R$740 million. The quarterly result was due to the working capital performance. The Company's focus in the second quarter was to increase exports, that was the segment with greatest profitability. Given the positive momentum of the international markets, we recorded an impact in the receivables line, which requires longer payment terms.

Secondly, there was an impact in the suppliers' line as we decided to buy a larger amount of raw materials in cash by more capital in cash, with an attractive discount, which favored the operations' profitability and also due to the increase of the price of the cattle of 20% year-on-year. In the advance from customers' line of order accounts payable, there was 127 million reversal experienced by the seasonal change in clients profiles. And in this quarter, Minerva foreclosed on less risky markets and clients in terms of credit. So the change on the mix of safe [ph] index spot market had an important impact on this account.

Finally, we excluded from the working capital, the Carrasco installment payment that was made in shares, roughly R$23 million and the second Carrasco cash installment of around R$27 million, which was added to the investment line of the cash flow statement. In addition to the installment payments related to the acquisition of Carrasco, we also excluded the calculation, the equity evaluation adjustments and accumulated conversion amounts due to the impacts of FX variation on foreign assets, which represent around R$26 million this quarter. It's also important to highlight that in the fourth quarter '14 and in the first quarter '15, the Company posted positive free cash flow. However due to the comfortable cash position and leverage, Minerva have the flexibility to take strategical commercial decisions in order to enhance the profitability of our operations.

(Inaudible) second quarter results, was a non-recurring movement in terms of working capital needs. So we don't expect the same behavior for the working capital accounts in the second half of 2015 as we are very optimistic about the international demand.

Now moving to the Slide 13, we'll discuss the Company's net debt trends. When we look at the net debt bridge from the first to second quarter, we can see that net debt reached 3.6 billion at the end of June, representing a stable leverage of 4.4 times. And the dollar -- at the close -- the dollar at the close of this quarter was lower than the dollar at the close of the first quarter, the FX variation had a R$113 million positive impact on debt, reducing debt. It's important to remind you that the FX variation does not have a cash impact for Minerva. The free cash flow was approximately R$318 million negative, because of R$313 million negative impact coming from the working capital accounts, as we have already explained in the last slide.

So apart from the cash flow, there were other financial-wise increase, no-cash effect of approximately R$20 million. So adding everything, you reach at R$3.6 billion of net debt at the end of the quarter.

Let's move now to Slide 14 to present the net results. In this quarter, we recorded net income of approximately R$167 million, substantially higher than what was recorded in the second quarter of '14. Even excluding the effect of the FX variation, that have no cash effect and the impact of income tax and social contribution, the Company's adjusted net profit would be a positive R$53 million in the quarter and approximately R$243 million in the last 12 months.

Let's move now to Slide 15 to talk about the bonds, the buyback of the bonds made by the Company during the last 12 months. As we have spoken in our latest conference calls, we have bought back some of our bonds in the international market. So as a result of around R$575 million of our cash balance was invested in bonds issued by Minerva at the end of the second quarter of '15.

To conclude our presentation, let's analyze the effect of this buyback bonds in our capital structure on Slide 16. So, at the end of the quarter, our total debt was R$6.3 billion. As you can see in the table of this slide, if we exclude from the total debt, the bonds that were bought back of around R$575 million, the total gross debt ex the bond buyback would be R$5.7 billion and the cash position excluding those bonds, the net cash position would be around R$2.1 billion.

I will now turn back to the operator to begin our Q&A session. Thank you very much.

Questions And Answers

Operator

Thank you, sir. We will now start the question-and-answer session for investor and analysts. (Operator Instructions) The first question we have comes from Lauren Torres of UBS. Please go ahead.

Q - Lauren Torres {BIO 7323680 <GO>}

Yes, hi everyone. My first question is more of a clarification on a comment that you made with respect to working capital in the second half. Could you talk a little bit about what's the reversal, I mean, you well explained what the impact was on second quarter results, but what should change in the second half to help you get back to that positive cash flow on the working capital side?

And then my second question is just more of a general question on demand, domestic demand, there is caution here obviously with respect to the environment in Brazil. Just curious to get your perspective on the ability to grow there in light of the environment, where do you see opportunities, I'm not sure if there is much pricing opportunity, but if that's not the case, is the focus more on export. If that is the case and you're focusing more on exports, just curious to get your impression on, with the industry being soft, but your performance being quite strong, now how confident are you in your ability to be continue to maintain or grow market share, which has been quite impressive over the last couple of quarters? Thank you.

A - Fernando Galletti de Queiroz {BIO 15387377 <GO>}

Lauren, regarding working capital, as you can note, there was a big change on the mix of sales and there was a big growth on exports. So this required more working capital and it was concentrated in the pre-payments, in the advance payments that we received from more risky clients.

Looking to the second half of the year, we don't see this mix changing so much, improving so much, what will reduce even more the pre-payments from the clients. But we see an opposite move while we see markets like Russia and Venezuela coming back to the market, more risky markets where we will require more advance at prepayments that will help again reduce our working capital needs.

So looking through the prospects for the second half of the year, we are very confident to state that the working capital will improve, because the growth that we have been seeing in the exports and the change in the mix of sales -- in the mix of clients that we have been presented will not impact further in our working capital needs in the next two quarters. So I think, the second half was a big change on the working capital accounts because of the big change that we saw in the Company's market share and in the Company's mix of clients.

Looking further, we see this mix not changing so much. If there is a change, we'll be in the positive side when you look at the working capital needs.

Lauren, it's Fernando. Regarding your question about the Brazil demand, there are two things here. One is the macro scenario that we'll see consumption declining and/or trading down. So there is more demand for cheaper cuts and less demand for expensive cuts and we are seeing already this movement where the spread between expensive cuts and cheap cuts is narrowing. If we go to the Minerva strategy, taking out the macro scenario, we chose and we have a different strategy here, that is a strategy focused on the small-medium sized retailers and in the food service.

These segments, they are more inelastic, they are suffering less with the decrease of the demand. The sector that is more affected is the supermarkets and the hypermarkets segment, inside the retailers. Convenience stores and small-medium sized retailers, they are more agile, they are more flexible to adjust themselves. And this is exactly the market at Minerva is.

We know what we are doing inside Minerva, is that we are focusing on selling more the cheap cuts and also to have the mix of products adequate to the consumption. Remember that we are talking about proteins and proteins is part of the Brazilian local habits of consumption. So we are changing our mix of the one-stop shop for the distribution that we have inside Brazil that we are reaching, a 42,000 small and medium size -- we are reaching 42,000 clients in a weekly basis. So this gives us confidence that even if with the Brazilian market is slowing down, the macroeconomic is going down, Minerva will not suffer and we're so confident that we are reinforcing the guidance of -- that we gave in the beginning of the year, that is in the range of R$9.5 billion to R$10.5 billion of total revenues for Minerva by the end of 2015.

A - Edison Ticle de Andrade Melo e Souza Filho {BIO 15435343 <GO>}

Lauren, Edison again. Just adding to my answer, remember that the capital prices and capital is 80% of our cost, is also going down roughly 10% since the peak in the second quarter. So all of this, with this is 10% or roughly 10% reduction in cattle prices will also help working capital needs in the second half of the year.

Q - Lauren Torres {BIO 7323680 <GO>}

Okay, very helpful. And I guess the second part of my second question related to export demand. You had some great results relative to the industry. Just curious on your perspective on maintaining or improving that share over time?

A - Fernando Galletti de Queiroz {BIO 15387377 <GO>}

Well, this isn't an easy one, because what is happening is that there is a shortage of supply in the (inaudible) scenario and we mentioned during the call, they're coming back off markets, important markets like China, like Saudi. The perspectives that are positive about the NAFTA region especially from the US is starting buying from Brazil, but what we are really seeing is a decline of the availability from our competitors, especially Australia and United States. So the perspectives on exports, this is a very -- they are very favorable and this is one of the focuses that Minerva have given to its strategy.

Q - Lauren Torres {BIO 7323680 <GO>}

Very good. Thank you.

Operator

Next, we have Mauricio Martinez of GBM.

Q - Mauricio Martinez {BIO 16363988 <GO>}

Hello everyone and thank you for taking my question. I was wondering if you're aware of any hint of the willingness from Mexico kind of a -- to a ban to the Brazilian Beef?

A - Fernando Galletti de Queiroz {BIO 15387377 <GO>}

The countries of NAFTA, they have an agreement that they follow the same procedures, sanitary procedures. Then now you have local specifications about quotas and/or some other non-sanitary restrictions. What we are seeing is that South America is able to supply affordable protein and affordable beef for the world. So the tendency is that the countries that they started negotiating and now they've started to getting -- on the details of the agreements. For Canada and Mexico, United States is the most important agreement that has to be made for them to be spread to the other neighboring counters.

Q - Mauricio Martinez {BIO 16363988 <GO>}

But do you have any timelines, if there is any chance to return exporters to start -- shipments to these countries; to Canada and Mexico?

A - Fernando Galletti de Queiroz {BIO 15387377 <GO>}

Well, we believe that with the speed-- with the actual situation that we see in the market, it's hard to predict that, exactly date, but we can work in a scenario that is luckily that happens is still in the second half of this year. So before the end of the year, we shall start some shipments. We believe that there is a big chance to start some shipments to -- not only to US, but also to Canada and Mexico.

Q - Mauricio Martinez {BIO 16363988 <GO>}

Perfect. Thank you and congratulations on the report.

A - Fernando Galletti de Queiroz {BIO 15387377 <GO>}

Thank you.

Operator

Next, we have Andrew De Luca of Credit Suisse.

Q - Andrew De Luca {BIO 18025129 <GO>}

Hi, thank you for taking my question. Actually, I have two questions. The first one would be, the decline in SG&A expenses as a percentage of revenues. I wanted to know what should we expect as far as SG&A for the coming quarters? Should we expect that to kind of stay at this or should we expect it to increase? That's [ph] my first question.

A - Edison Ticle de Andrade Melo e Souza Filho {BIO 15435343 <GO>}

SG&A, we see that -- the Company is always after efficiency. We finished the integration process of some of the acquisitions that we made and this has a result -- a reduction on the SG&A. So, it's part of the Company's strategy to keep pursuing more efficiency and we shall -- whether we shall consider it as stable. Also we -- with the Brazilian situation, this is giving more negotiation power for us in the main accounts. One of them that we can highlight is the freight; both the external, the export freight and the internal freight. So, as always put in the market, I think, to be efficient in a commodity sector, you need to have scale and economy of scale, you need to have efficient logistics and distribution channels and you have to have risk management. So we are consistently working in the three pillars of being successful in commodities and now, if the situation of the slowing down economy, regain a bit more pricing power, negotiation power in some of these lines. So what you're seeing is -- that only shows that the company is doing its homework.

Q - Andrew De Luca {BIO 18025129 <GO>}

Okay, great. And then my second question would be on -- just touching on the comments you've made over some recent calls and specifically related to the lower domestic demand for beef and trading down to cheaper cuts and then also the limited working capital financing for the smaller exporters. It seems like some of these smaller exporters may be facing some increasingly challenging conditions going forward. So it would be interesting to get your take on consolidation opportunities in the domestic market.

A - Fernando Galletti de Queiroz {BIO 15387377 <GO>}

Well, as we see it from the basics, the market is really consolidated already, great companies are doing around 80% of the total exports. So there is always room, but there is a few room for consolidation. Definitely if the market scenario being much more instable, the financial lines for companies that have less track-record, less structure, it starts to be shortened. So this is only making the market further consolidated. So the answer for your question, yes, there is -- there may be some room for consolidation, but it's not big, it's not meaningful in the middle term. The players that are there are the ones that -- there are very few markets that are as consolidated as it is Beef in South America as we see nowadays.

Q - Andrew De Luca {BIO 18025129 <GO>}

Okay, great. Thank you.

Operator

Next, we have Jeronimo De Guzman of Morgan Stanley. Please go ahead.

Q - Jeronimo De Guzman {BIO 15888043 <GO>}

Hi, good morning. I wanted to ask a question on gross margin, wanted to get a sense of how much of the contraction came from the cattle price pressures versus how much came from the integration of the Mato Grosso and the Janauba plants. And also wanted to know if we should expect any further disruption from these plants now that you've concluded their integration?

A - Edison Ticle de Andrade Melo e Souza Filho {BIO 15435343 <GO>}

The decline on the gross margin was majority due to the increase in cattle prices. As you know, we are at the end part of the final integration of the plant that we acquired. And in the third quarter, as we are closing two of the plans in Brazil, there is a process of improving yields optimization and the rationalization, geographically speaking of our footprint in Brazil. So answer to your question, the majority of the impact, it came from the increase on cattle prices.

Q - Jeronimo De Guzman {BIO 15888043 <GO>}

Okay, thanks and on SG&A, wanted to ask again, I mean, just wanted to get a sense of how sustainable these are? I mean, was there anything non-recurring in terms of the SG&A savings that you may not see in the second half? I think in the Portuguese call, you mentioned something about live cattle exports going down in the quarter. So just kind of wanted to get a sense of, if that kind of normalizes, what that can mean for the SG&A in the second half?

A - Edison Ticle de Andrade Melo e Souza Filho {BIO 15435343 <GO>}

When live cattle -- if live cattle exports normalize in the third quarter, you can have as more pressure on SG&A on one side, but on the other side, the freight rate negotiations that we did during the quarter and during the year, gives plenty confidence to us to say that the SG&A will not be a problem. We'll continue printing good results and reducing the proportion of our expenses to the net revenues.

Q - Jeronimo De Guzman {BIO 15888043 <GO>}

Okay, thank you.

Operator

(Operator Instructions) Yeah, at this time, we are showing no further questions. This concludes the question-and-answer section. At this time, I would like to turn the floor back over to Mr. Fernando Queiroz for any closing remarks, sir?

A - Fernando Galletti de Queiroz {BIO 15387377 <GO>}

Thank you and thank you all for participating in this conference call. We remain at your disposal for any need or any clarification that you may want.

The last but not least, I would like to emphasize a very important point, which is a great value of our team in reaction, in timing, in adaptability to the new scenarios. In a new and volatile scenario, this makes all the difference, this team makes the difference for the Company. Thank you very much.

Operator

And we thank you, sir and to the rest of the management team for your time also today. We thank you all for attending today's presentation. At this time, you may disconnect your lines. Thank you and have a great day, everyone.