OUROFINO

EARNINGS

CONFERENCE CALL

2Q2019

08/08/2019

OPERATOR – Ladies and gentlemen, thank you for holding. At this moment we would like to welcome you to the Ourofino Saude Animal conference call for the 2Q2019. Today we have with us Mr. Kleber Gomes, CFO and investor relations officer. We would like to inform you that this event is being recorded and simultaneously translated. All participants will be in listen-only mode during the company presentation. And soon in this will be a question and answer section when further instructions will be given. Should any participant require assistance during this call, please press *0 to reach the operator. We have a simultaneous webcast at ir.ourofino.com. At this address you will find the banner Webcast 2Q2019 that will lead you to the presentation. Before proceeding we would like to mention that forward-looking statements made during this conference call referring to the beliefs and assumptions of Ourofino's management are assumptions of the company and are based on information currently available to the Company. They involve risks and uncertainties and assumptions as they relate at future events and therefore depend on circumstances that may or may not occur in the future. Investors should understand that general economic condition, industry conditions and other operating factors could also affect the future results of Ourofino and lead to results that differ materially from those expressed in such statements. I would now like to turn the floor over to Mr. Gomes. You may proceed sir.

KLEBER GOMES - Good afternoon to all of you. Thank you very much for participating in our earnings results for the 2Q2019. It is our understanding that the cattle breeding scenario in Brazil is beginning a more constructive phase driven by the opportunity to increase protein exports to Asia considering the sharp reduction in China swine breeding stock because of the African swine fever, and because of the macroeconomic fundamentals that should continue to evolve because of the likelihood of the structural reforms that Brazil requires. Therefore Brazilian produces may benefit from higher volumes and better profitability increasing investments and enhancing the adoption of technology, including medicine vaccines and other veterinary products. In this context the company expects a very positive cycle for its production and companion animals business and is ready to continue supporting producers in their continuous improvement of productivity and allow pet owners to offer the necessary care for their dogs and cats, therefore continuing to capture better results. However, it should be noted that the 1H of the year fell short of our expectations in the production animal segment with an increase of 7.0% in the quarter with a slight recovery for the semester. We had a slow buyer's market due to a moment in which we are waiting for a definition of the points mentioned formerly, especially macroeconomic points and part of this growth was due to higher sales of foot-and-mouth disease vaccines and the first campaign of the year, along with a higher idleness of the plant including the startup of the new vaccine plant with only initial sales volumes. This affected the segment gross margin, which was 45.0%. Despite all of this in consolidated terms 2Q presented a considerable increase, a net increase. They were 10.0% higher than the same period in the previous year, due to volume increases in companion animals and international operational segments with increases of 22.0% and 20.0% respectively. These segments had their margins affected because of the lower production volume reducing their historical profitability. The reduction of consolidated gross margin coupled with a recognition of R&D expenditures as expenses, which had already been foreseen in this project phase, led to a 6.0% reduction in the company's adjusted EBITDA. Generation of cash from operations increased 6x vis-à-vis the 2Q. As usual market seasonality always present a second half due to a higher concentration of trade fairs, a peak of cattle breeding period and favorable weather conditions along with excellent prospects for the cattle breeding scenario in Brazil as mentioned above. And because of this we believe that the potential increase in the volume of operations will result in a further dilution of costs and expenses. Consequently ending the year in line with our initial expectations. We continue reimagining animal health in the 2Q2019. We entered a partnership with AgTech Garage, a startup hub focusing on agribusiness development. This will allow us to have access to innovations aimed at increasing productivity and to facilitate the life of men in the countryside.

We now go on to our financial results and we will speak about the net revenues for the company. As mentioned, The net revenue was a BRL178.0 million with a growth of 10.0% vis-à-vis the same period 2018. In the semester net revenues were BRL269.0 million, a growth of 6.0%. The market had greater retraction as we had foreseen in animal production with net revenues of a BRL198.0 million in the 1Q and a growth of only 2.0% vis-à-vis 2018. In the 2Q2019 net revenue for the segment where a BRL139.0 million with the growth of 7.0%, already showing a recovery. Most of the growth presented was due to market opportunities with an increase in sale of foot-and-mouth disease. Companion animals have net revenue of BRL24.0 million in the 2Q2019, a growth of 22.0% vis-à-vis the 2Q2018. These volume increases enabled us to reach the higher historical quarterly volume and because of the sellout of distributors that is being expanded throughout the year. In the 1H2019 net revenues were BRL43.0 million for the companion animal segment, a growth of 13.0% when compared with the 1H2018. For international operations, net revenues reached BRL60.0 million in the 2Q, an increase of 20,0% when compared to the same period in 2018. If we exclude the foreign exchange impact the growth was 16.0% with volume increases with a highlight for Colombia. Net revenue for the segment was BRL27.0 million with a 31.0% growth. Regarding gross margin, the result was 50,0%, a decrease of 4.0p.p. vis-à-vis same period in 2018. Generally the margins were under pressure of the lower volumes reducing our historical profitability. Because of this the margin of the first semester was a BRL132.0 million, representing BRL49.0 million, a reduction of 6.0p.p. when compared to 2018. Companion animals segment had a gross margin of 71.0% in the 2Q, a decrease of 4.0.p.p. vis-à-vis the 2Q2018. This reduction reflects a lower volume of sales impacting the segment as a whole. In the 1Q2019 gross margin was 44.0% a reduction of 7.0p.p. vis-à-vis the same period in 2018. Once again because of the factors mentioned before and the shut down of the plant at the beginning of the year, the companion animal had a gross margin of 71.0% with the reduction of 4.0p.p. vis-à-vis the 2Q2018. Once again, this is due to the greater idleness of the plant impacting dilution, and of course increasing the cost of production. In the semester gross margin was 70.0% a reduction of 3.0p.p. compared to the same period in 2018. International operations had a gross margin of 58.0% with a decrease of 9.0p.p. when compared to the same period last year. Besides the lower production volume we had an impact in the product mix in Mexico and Colombia and the other countries that we export to. A gross margin there was 57.0%, a reduction is 8.0p.p.

We will now speak about SG&A and EBITDA. And we highlight the expenses for the 2Q that added up to BRL60.0 million, 34.0% net revenue. In the 1H2019 they stood at a BRL110.0 million, 41.0% over net revenue and a growth of 2.0p.p. compared to the same period in 2018. In the 2Q the growth of 2.0p.p. reflects a greater share of expenses in research and development compared to the allocation of [10:59] any and previous results. Once again, expenses allocated to R&D were BRL13.0 million in 2019 vis-à-vis BRL6.0 million in 2018. Once again, these results are now being launched into our figures due to accounting rules, just due to the reductions in margin and the change in the mix of expenses and R&D. The adjusted EBITDA was BRL35.0 million with a reduction of 6.0p.p. vis-à-vis the same period 2018. For the semester adjusted EBITDA stood at 13.0% a loss of 8.0 p.p.vis-à-vis 2018.

We will now speak about the net financial expenses, income tax and social contribution on net profit. Net financial expenses for the 2Q2019 amounted to BRL3.4 million, a reduction of 11.0% vis-à-vis to 2Q2018. While for the semester financial expenses were of BRL7.0 million a reduction of 4.0p.p. compared to the same period in 2018. Net debt stood at BRL217.0 million a reduction of 5.0% when compared to the same period last year. Income tax and social contributions for the 2Q were of BRL9.0 million with a tax rate of 37.8 for the semester. This stood at BRL7.0 million. Once again, the measurement of income tax and social contribution is done on fiscal basis and this is different from accounting results. Net profit for the 2Q was BRL15.0 million, below the BRL21.0 million observed in the 2Q2018. This is due to a drop in margin and the EBITDA. The net profit for the semester stood at BRL9.0, a reduction of 6.0p.p., vis-à-vis the 1H2018. In terms of indebtedness at the end of the 2Q2018 the net debt over EBITDA margin in the last 12 months was at 1.9. The increase is due to a reduction of EBITDA in the first semester this year. And there was a reduction of net debt of the company to BRL217.0 million, a 5.0% reduction. The average cost of the debt is close to 7.0% for the year in line with our background during the last year period. Once again, we would like to highlight our net debt profile that represents 2/3 of our long-term debt.

We will now speak about the cash generation for the company. For the consolidated amount of the semester it was debt amortization and payment of interest rate, totaling BRL58.0 million, CAPEX of BRL25.0 million and the payment of taxes of BRL9.0 million, offset by the cash generation of BRL67.0 million. This indicator grew a 131.0% vis-à-vis cash generation in the 1H2018. And the 2Q2019 cash generation was BRL25.0 million, a number 6x greater than in the same period 2018. Let's speak about our investments in research and development and launches in 2019. Our investments totaled BRL21.0 million in the consolidated figure in the 1H, equivalent to 8.0% of our net revenue for the period. This percentage is in line with the historical investments of the company and reinforces our guidance to have sustainable growth. This semester we also had the partnership with AgTech Garage. This is a start-up in agribusiness, a hub and it is deemed to be the greatest center of innovation in Latin America. With all of this and with the new innovative initiatives we contribute to our purpose of continuing to reimagine animal health. I would now like to return the floor to the operator to go on to the Q&A session.

OPERATOR – Thank you. We will now go on to the question-and-answer session. Should you have a question, please press *1.

Our first question comes from Olivia Petronilio from JP Morgan. You may proceed madam.

OLIVIA PETRONILIO - A good day and thank you for taking my question. In truth I have two questions. The first is about the plant. We see that you have had a margin pressure. What is happening with the ramp up at the plant and which should be the ramp up at the plant so that you will no longer have this pressure on margin? and in two or three years, which is the margin that we can imagine after the new products? The second question refers to the growth of production animals. During the first semester there was a decrease in revenue, now is this normal for the semester as a whole or should there be an improvement going forward?

KLEBER GOMES - Good afternoon Olivia and thank you very much for your questions. I'm going to begin with the second question, the growth of production animals. We highlighted that in the first quarter we had an impact. Once again, in the 2Q we had another impact and this impact was greater than the initial one and the growth figures of the production animals are the same. We would have had a greater growth if we had considered that of the 2Q. We ended up selling more foot-and-mouth disease and because of this we still continue our results to be somewhat below, while was imagined we felt that the market had a greater retraction and in our opinion, this is due to that holding of producers who are awaiting to see what will happen in Brazil, and we believe that in the second semester we will continue with this retraction. The second semester naturally tends to be much stronger. We have the trade fairs, we have the greatest fair of the year. We have the breeding, increase in production. Of course, this will bring in additional revenue. Additionally it is a period with greater rainfall and this once again will increase the purchase of our products and increase our results. Very generally our results are good. Although they are below what was expected. We hope that they will improve in the second semester considering the macro economic scenario and perhaps the push that we have had was the African swine fever that has been advancing significantly, and this will allow us to enter a very new and constructed cycle in coming years. When it comes to the plant of biologics, if we look at the pressure on our margin this is due to several factors. First of all, we're coming out of a period of lower sales. Our inventory was somewhat higher at the end of 2018 because of the market retraction. We had a consumption of inventory and less volume produced at the plant in general. This leads to a lower dilution of fixed costs and exerts pressure on margins. The greater impact once again is due to the lower volume throughout our plant and the biologic plant has already started operations, but only with initial volumes for the first vaccine that we have launched which is the Safesui circle virus vaccine and the volumes are still quite limited. The introduction of this vaccine and the market tends to be technical, it will take time and it will have a direct impact on the producers that oftentimes have already closed their purchases for the year. Now when it comes to the plant once again, we're still with the expectation that we will have a very complex production for swine as well ass for beef. We will have three or four years of launches looking forward.

OLIVIA PETRONILIO - Thank you. Thank you very much Kleber, that's excellent.

KLEBER GOMES - Thank you for your question, Olivia.

OPERATOR - Our next question comes from Caterine from Bank of Brazil. You may proceed with your question.

CATERINE - A good morning to all of you and congratulations for your results. I'm referring to your administrative costs and I have a question on this. There has been a great impact because of research and development on your revenues and if you could perhaps give us an outlook of your coming results, if there will be a reduction in your investments in research and development. And what is that we can expect as we returned from R&D, for EBITDA and your margin in general.

KLEBER GOMES - Thank you very much for your question Caterine. Well, let's begin with the expenses with research and development. We always underscore that R&D is important. Every year we carry out investments of 6.0-8.0% now the allocation of these amounts for the results relates directly to the phase of each of our projects that are underway in our product portfolio. And in fact the semester we had a somewhat greater concentration of expenses. Our outlook for the 2H is that we will have something very similar to what happened in the 2H2018. Year on year the level will be more similar to what we had in previous years and this should level out the distribution during the period. Now when it comes to our other expenditures, we do have a very high fixed component in our expenses, and with a performance that is somewhat more retracted than we had expected. And of course this is what led to a lower dilutions. But as we mentioned we are awaiting a market resumption. The market is going in that direction and what we have to do perhaps is change our mindset, stop this waiting that we are involved in and go back to our normal activities. Our expectation is to end the year as we had forecast because up to present we have been moving ahead quite slowly. Do you have any additional question Caterine?

CATERINE - If you could give us more results in terms of what you announced for the 2H in terms of SG&A and EBITDA?

KLEBER GOMES - What is it that we can expect? Well Ourofino has several initiatives in the field of innovation and we have one more at present. We began this partnership with AgTech Garage three years ago as part of a broader initiative that is called “A Round With Producers”. This is a startup that presents to us our project so that we can assess their stage of maturity and the potential for partnership. Three years ago we began this movement. We began with cattle breeders that would help us in deciding what to do with their startups. This is located in the Valley of Piracicaba, very similar to Silicon Valley. It is strong in business with very renowned institutions. And it is one of the greatest businesses in Brazil. And as part of the ecosystem of business it is one of the most important startups. When we began three years ago this was a very natural process. We were selected as their innovation partner and what we are expecting is to develop projects that are selected, work on them and bring them in house. We can not speak about percentages or the growth expected from these projects because everything will depend on the relationship. It is a *sine qua non* condition to have this company connected to all of our initiatives and we're working from the outside, inside. Once again, we're not going to be competing with the entire world. This is a process that goes from the outside to the inside and this is one more initiative among the multiple ones that we have.

CATERINE - Thank you very much for your responses Kleber.

OPERATOR - Our next question is from Pedro Ferroni from CPM investment. You may proceed sir.

PEDRO FERRONI - Good afternoon. And if we go back to the question that was already responded for Olivia, the renovation of your plant has given way to several costs. Are we going to continue to see this in the 2H as we saw in the 2Q and you're speaking about the change of mix in your International operations. What is this mix about? This is a curiosity that I have and a question in terms of Safesui, your circle virus vaccine. If we had swine fever in Brazil would we be prepared for this and if you have a survey development or if you have talked to the people in the market to understand which is the molecule that can be used in this case? Thank you.

KLEBER GOMES - Pedro good afternoon, and thank you very much for your questions. When we speak about the refurbishment of the plants that began at the beginning of this year, we have already remarked in the previous quarter that this was a one-time activity. Our plants are quite new, they are very streamlined. Nevertheless our main block was already 10 years old and we had to work with a retrofit in some sectors. This is an event that will not be repeated. We have already carried out the necessary maintenance and we are prepared for the rest of the year. Once again this began in the 1Q and with an increase in the volumes we do hope to dilute the loss of productivity that we had in the 2Q. Now when it comes to that mix in our international operation, we don't tend to speak about products here. It was once again a one-time event during the semester. We sold a bit more of less profitable products compared to the more profitable ones that we had. We had an increase in cost and an increase in prices in some products and some of these price increases will also be transferred in the 2H and all the production, even those that are exported and come out of our plant, and we because of the lower volumes we had the impact. It was a mix of these three factors that caused this problem.

Now when we speak about the African swine flu, we do not have any study focusing on this disease. Because we don't tend to work in those markets and therefore we don't have a research for these products. We do know that the market is working with a potential vaccine for the control of African swine fever or antivirals. There are very good people already researching them. When it comes to Brazil we have great confidence in our sanitary survey and that has always been very positive, we haven't had a single case. And once again, this is in the hands of the government and sanitary policies that we deem to be very robust. We don't think Brazil will be afflicted by this disease, the African swine fever.

PEDRO FERRONI - Thank you very much.

OPERATOR - We would like to remind you that should you wish to post more questions, please press *1.

Once again, should anybody wish to pose a question, please Press *1.

At this moment we would like to end the question and answer session. We will return the floor to Mr. Kleber Gomes for his closing remarks.

KLEBER GOMES - To conclude, once again I would like to thank you for the confidence that you have in our company. We continue forward with our purpose of trying to find solutions for the needs of our clients, and we hope to sustain the positive growth of Ourofino. We look forward to the second semester, and we hope that our expectations will be fully complied within the second semester. Once again, we would like to thank you and we are at your entire disposal.

OPERATOR - The conference call for the 2Q2019 ends here. We would like to thank all of you for your participation. Have a good afternoon.