Q1 2018 Earnings Call

Company Participants

- Ricardo Lewin, Unknown

Other Participants

- Augusto Akihito Ensiki, Latin America Analyst
- Bruno Amorim, Equity Analyst
- Unidentified Participant, Analyst
- Victor Mizusaki, Research Analyst

Presentation

Operator

Good afternoon, ladies and gentlemen. At this time, we would like to welcome everyone to Rumo's First Quarter of 2018 Results Conference Call. Today, the conference call will be conducted by Mr. Ricardo Lewin, Chief Financial and Investor Relations Officer.

We would like to inform you that this event is recorded. (Operator Instructions)

The audio and slide show of this presentation are available through live webcast at ir.rumolog.com. The slides can also be downloaded from the webcast platform.

Before proceeding, let me mention that forward-looking statements will be made under the safe harbor of the Securities Litigation Reform Act of 1996. Forward-looking statements are based on the beliefs and assumptions of Rumo's management and on information currently available to the company. 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 Rumo and could cause results to differ materially from those expressed in such forward-looking statements.

Now I'll turn the conference over to Mr. Ricardo Lewin. You may begin your conference.

Ricardo Lewin {BIO 20342706 <GO>}

Good afternoon, everyone. And thank you for participating in Rumo's First Quarter 2018 Conference Call. Let's start our presentation with Slide #3.

This quarter we posted substantial growth in transported volumes both of agricultural and industrial products when compared to the First Quarter 2017. Grain carryover inventories boosted volumes in January, typically a weak month. And higher capacity as generated by our CapEx plan increased volume in February and March. In addition, it's worth mentioning the growth of industrial products transportation, primarily via new pulp operation in North Operation and a higher volume of containers. Port loading volumes at Port of Santos decreased, driven by lower sugar exports in the quarter.

Let's now turn to Slide #4, where we can see Rumo's financial performance.

Higher volumes and higher average yield as a result of a better mix of transported products contributed to an almost 20% net revenue increase in the quarter. In addition, good operational performance and greater cost efficiency enabled EBITDA to reach BRL 650 million in the quarter, up 30% year-over-year. Once again, we evidenced our capacity to increase volumes without raising fixed costs. Variable costs lagged volume growth, mainly due to continued lower fuel consumptions, 5% less in liters per GTK. As a result, Rumo's EBITDA margin reached 47% in the First Quarter '18, growth of 6percentage points when compared to the First Quarter '17.

Moving to Slide 5. We can see the performance breakdown of our business units.

As explained in previous slides, soybean carryover inventory and increased capacity contributed to higher agricultural volumes in the North Operation. A new pulp operations benefited the industrial segment. With higher volumes and continued cost efficiency gains, the North Operation's EBITDA significantly increased. And its margin expanded.

On the next slide, let's look at our market share in the Port of Santos.

On Slide 6, we can see that in the First Quarter '18, Rumo maintained its 48 market share in grains transported to the Port of Santos, even with a significant increase in exports in the period. This stability evidences our capacity gains.

Moving to Slide #7, we look at South Operation's performance in the First Quarter.

Likewise North Operation, South Operation has delivered high-volume growth both in agribusiness and in industrial products. Cost efficiency also helped to bring a significant margin increase, up 11percentage points from 1% to 12% in the First Quarter '18.

Moving on to the next slide, we discuss our Container Operations performance.

The strategy of improvements in cargo assortment with higher average distances allowed increase in tariff and volume in RTK. This result, coupled with cost dilution, improved EBITDA and margin.

Let's move to Slide 9, where we present the company's consolidated indebtedness position.

Our leverage was in line at 2.6x broad net debt at EBITDA, an effect of higher net debt already expected for the First Quarter '18 and EBITDA growth.

Moving to Slide #10. We look at consolidated financial results and cash flow.

First quarter '18 financial results improved due to reduced cost of debt. The reduced cost of debt reflects the amortization of certain high-cost debts, their replacement with lower-cost debts and SELIC decrease.

Moving to the next slide. We present the most relevant operating and financial performance indicators.

From this quarter onwards, we will monitor new KPIs to gauge Rumo's operational development. We have introduced 2 safety KPIs: the rail accident index, which measures the number of accidents per million train kilometers; and the personal accident index. These are internationally renowned KPIs that evidence how we have been reducing the number of accidents through investment and several other initiatives, always pursuing the highest safety standard in our operations. As a result, rail accidents decreased 8% in the First Quarter '18 against the same period last year. In addition, concerning the number of personal accidents, Rumo already performs at international standards. Looking at year-over-year variation, we have seen a reduction of 44%. In addition, the transit time and railcars loaded per day indexes were discontinued since the most efficient way of measuring Rumo's productivity is in analyzing the cycle time of railcars and RTK's volumes.

Operating ratio was up 7% in the First Quarter '18 from First Quarter '17 as a result of Rumo's successful strategy to increase volume and cost dilution.

Diesel consumption, measured in liters per GTK, decreased 5% in the quarter from the First Quarter '17 due to higher operational efficiency, especially due to the upgrade of our locomotive fleet. The railcar cycle time both in the North and South Operations improved mainly due to greater operational efficiency at our terminals, gradually reducing railcars' loading and unloading times.

Moving to the next slide. We will discuss our most recent market projects.

Agroconsult reviewed (sic) (revised) upwards their figures for 2017-2018 soybean crop production in Brazil and the state of Mato Grosso, with growth of approximately 4% and 5% year-over-year, respectively, thereby benefiting volumes expected for the Second Quarter '18. In addition, the soybean trade and export environment remains favorable due to the crop failure in Argentina, which contributes to better international price levels.

Looking at the 2017-2018 corn crop production, we estimate a 13% decrease in Brazilian production and a 9% decrease in the state of the Mato Grosso. However, most corn carryover inventory is still stored. And this should contribute to additional corn volume destined to exports.

Now we will conclude with our guidance for 2018.

We are reaffirming the guidance for the year, maintaining the projections already disclosed.

With this, I finish our presentation. I'm here with our team. And we remain at your disposal for any clarifications. Thank you.

Questions And Answers

Operator

(Operator Instructions) Our first question comes from (Peter Grecino) with Barclays.

Q - Unidentified Participant

This is (Peter Goshenko) with Barclays. First, I wanted to get your sense on market dynamics that we're seeing with sugar prices significantly lower over last year. On the other hand, higher oil prices should translate into higher gasoline prices (still) pull ethanol prices up as well. This in theory shouldn't change incentive for the mills to produce more ethanol than sugar. So I'm wondering, what was be the impact on your business? And any color would be helpful.

A - Ricardo Lewin {BIO 20342706 <GO>}

Thank you very much for your question. Well regarding the dynamics, you're right. There's a -- the mills here in Brazil are turning to ethanol production. But it's important to understand that the sugar market is not that important for us, at least at this point of the -- of our business plan, okay. Our focus has been the grain market that's much more profitable for us, okay. Although with the increase of capacity, we have been transporting more sugar in -- at least in this First Quarter of the year, okay. So although what -- the dynamics is exactly what you said, sugar has a lower importance at this stage of the business plan.

Q - Unidentified Participant

Got it. Another question. On BRL devaluation that we've seen in the last couple weeks, can you elaborate on impacts on your operations on whether that in theory maybe makes more possible the operations for your customers, the exporter businesses? But I'm wondering if you guys are concerned. Are you seeing any impact in your business?

A - Ricardo Lewin {BIO 20342706 <GO>}

Yes. The impact should be positive because it increases the willingness of the producers, the growers, the grain growers to export, okay. So this much probably will be positive for us.

Q - Unidentified Participant

Okay. Another question. I was looking at your kind of breakdown of cash flows. You have this kind of noncash effect on EBITDA, which you still substract. And just the footnote is not as very clear. The BRL 336 million impact on this quarter, can you provide more color on what it was?

A - Ricardo Lewin {BIO 20342706 <GO>}

Okay. So we are talking a bit about the working capital, yes? The -- that's BRL 336 million that impacted the cash flow this quarter. This is -- first, it's important to understand that this working capital is completely in line with what we have budgeted this year in the company, okay. And the effects included in this business plan from this BRL 336 million, something around BRL 200 million comes from suppliers, okay. Half -- more than half of this BRL 200 million refers to CapEx that has been done or contracted in the last quarter of 2017. And disbursement happened in the beginning of 2018, okay. The other half is mainly result of OpEx, mainly due to (fuels) that -- what happened is a mismatch between the lower volumes in the First Quarter of 2018 when compared to the last quarter of 2017. So what we are doing now is paying fuels that we used in the -- in a period that is -- there's a lot of transportation, okay. Also included in this value, there is bonuses that had an impact in this First Quarter related to the last year. Last year, that was much better than the previous one. So we had higher bonuses in the company. The effect of this is something around -- the net effect is something around BRL 40 million. And the rest, you have other effects that are much lower than the ones that I told you. Just to reaffirm that in the next quarters the working -- this negative working capital should be reduced, okay. So it's not something that's recurring.

Q - Unidentified Participant

Okay. Yes. That's helpful. And last question, if I may. If you can provide any update on Paulista concession as well as any update on BNDES financing and if there have been some changes, that would be very helpful.

A - Ricardo Lewin {BIO 20342706 <GO>}

Yes, great. Regarding the Malha Paulista concession, the process has been evolving very well. Recently, ANTT, who is the regulator, hired Accenture to help them with the analysis. That has improved a lot the dynamic of the process. Also, ANTT has reaffirmed several times in conversations with us and with some investors that has been with them in (BrasÃ-lia) that they will be ready with their studies by June, okay, at least by the end of June. Then they are supposed to send their studies to TCU, okay. I cannot affirm you that this will be approved this year. However, what I can tell is there is a very good environmental -- environment for the approval of the renewal this year, okay. So it's doing very well the renewal process. Regarding BNDES, I -- when I'm asked about that, I always reaffirm that we are 100% funded to complete our business plan, okay. We don't need BNDES financing for the continuity of the investment plan. However, we are still discussing with them the possibility of approving a facility of BRL 2.7 billion for the South and North corridors. And we have been able to negotiate better conditions than we had in the past. The point here that we are still discussing -- it's not a difficult discussion because BNDES has been very flexible on that. The point here is that it's a bureaucratic discussion about some points that we're going to have in the contract with BNDES, not to hurt our current bondholders and other banks that give credit for us. So at least we want to have the BNDES facility in the same conditions we have with our bondholders.

Operator

Our next question comes from Bruno Amorim with Goldman Sachs.

Q - Bruno Amorim {BIO 21628005 <GO>}

So I have 2 questions. The first one is actual expense. Or could you please give us an idea of by how much will your capacity increase in the second half of the year on a year-on-year basis? As you have highlighted, volumes went up by 18% in the First Quarter not just because of the capacity increase but because of other factors. I guess in the second half of the year because you were operating close to 100% of your capacity in the second half of last year the volume growth in the second half of 2018 will be mainly driven by capacity additions. So any color that you could give us in that sense would be great. And second, with the depreciation of the currency, do you think that we could eventually see an anticipation of exports of grains in Brazil, which could boost volumes in the Second Quarter but eventually present a risk for the second half of the year or not?

A - Ricardo Lewin {BIO 20342706 <GO>}

Well regarding the first, roughly saying, we can -- you can consider a 10% increase in the capacity, okay. So we will be transporting 10% -- an additional 10% because we will be at full capacity. Regarding the second question, actually we are having a very strong soybean harvest, okay. It's difficult to anticipate the second half of the year because in the Second Quarter we will have a very strong transportation of soybeans. However, although we think that the currency change in the last days or months can improve the exports of grains. But it's difficult to have anticipation when you have such a strong soybean production.

Operator

Our next question comes from Augusto Ensiki with HSBC.

Q - Augusto Akihito Ensiki {BIO 15988025 <GO>}

Two for me. Firstly, can you comment a little bit on the fertilizer project? Has everything -- did it start operating? How -- if it has, how has it progressed? And when might we see the start to contribute to results? And secondly, on depreciation. At least for the quarter, it came down quite a bit sequentially. Is this kind of a rate that we can expect for the year? Or is there anything increasing going forward?

A - Ricardo Lewin {BIO 20342706 <GO>}

Well regarding the first question, the fertilizer project started to operate last month, in April. It has been -- actually, we have our first cargo, backhaul cargo, last month. And everything went very well. So we received the first cargo -- fertilizer cargo in a terminal called Termag in which we are partners. And this fertilizer cargo already arrived in RondonÃ³polis. So the first fleet was very successful. You'll be feeling the first results of this project this year, okay, because now we start to make the backhaul transportation. There is no surprise for that. So I reaffirm that in the first 12 months we will be transporting something around 1 million tons of fertilizer, okay. The second question about depreciation. The increase of depreciation regarding the First Quarter last year is a result of what we -- the investments that we have been done during the year. And this is the level of depreciation that you can reconsider. Yes, consider that you have additional CapEx that we'll be doing during the year. So remember that last year and this year are the peak of investments. We invested something around BRL 2 billion. So don't forget to add the depreciation of this new investment.

Operator

The next question comes from Victor Mizusaki, Bradesco BBI.

Q - Victor Mizusaki {BIO 4087162 <GO>}

I have 2 questions here. The first one. You have like BRL 1.7 billion of short-term debt. I'd like to know if you can talk about, I mean, how to expect to refinance these debts and if it's possible to reduce the average cost of debt. And the second one. If you can just confirm if your dollar-denominated debt is fully hedged.

A - Ricardo Lewin {BIO 20342706 <GO>}

First, answering the second question, 100% hedged, principal plus interest for the entire period of the debt. Regarding -- we have been -- we have gone through a liability management through all last year made up -- and the bond is one of the steps of this liability management. But I'll give you some numbers that may answer your question. If not, please, we can discuss a bit more. But in the First Quarter of 2018, we raised something around BRL 2.1 billion in new debts. From this BRL 2.1 billion, BRL 1.6 billion refers to the bonds, 2025. And BRL 0.5 billion on NCE that we raised with a bank. And we paid something around BRL 700 million of our expensive debt. I'll give an example. We have -- we have a debenture that the price was 13% per year. We had another debt that was CDI plus almost 5% a year. So we are paying the expensive debt. For the Second Quarter 2018, we intend to pay another BRL 1.7 billion. Mainly, that will refer to the 9 (edition) of the debentures of the North corridor that we have been promised to the market that we would be paying that for the last quarter. But what happened is that we have been a bit late in bringing the money from the bond because we were looking for the best structure to bring this cash. So we -- actually, we are going -- we have been through a liability management for all this last maybe year. And what you're asking is part of this liability management, that we are paying debt. And we are raising new debts with the market and private banks. I don't know if I answered your question. If you have some detail that you'd like to understand, let me know.

Operator

(Operator Instructions) That does conclude the question-and-answer session for investors and analysts. I'll turn the floor over to Mr. Ricardo Lewin.

A - Ricardo Lewin {BIO 20342706 <GO>}

I would like to thank all -- everybody that participated on the call. And if you have any additional questions, we are 100% available to answer them. Thank you very much. Bye-bye.

Operator

That does conclude Rumo's First Quarter of 2018 Results Conference Call. Thank you very much for your participation. And have a nice day.