Q1 2014 Earnings Call

Company Participants

- Alexandre de Jesus Santoro
- Rodrigo Barros de Moura Campos

Other Participants

- Alexandre P. Falcão
- Kevin M. Kaznica
- Mark Suarez

MANAGEMENT DISCUSSION SECTION

Operator

Good morning, ladies and gentlemen. At this time, we would like to welcome everyone to América Latina Logística ALL First Quarter of 2014 Earnings Conference Call. Today, with us, we have Alexandre Santoro, CEO; Rodrigo Campos, CFO and IRO; and Pedro Albuquerque, IR Superintendent for ALL.

We would like to inform you that this event is being recorded and all participants will be in a listen-only mode during the conference presentation. After ALL's remarks are completed, there will be a question-and-answer session. At that time, further instructions will be given.

We have simultaneous webcast that may be accessed through ALL's IR Web site, www.all-logistica.com/ir. The slide presentation may be downloaded from this website. Please feel free to flip through the slides during the conference call. There will be a replay facility for this call for one week.

Before proceeding, let me mention that forward-looking statements are based on beliefs and assumptions of ALL 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 ALL and could cause results to differ materially from those expressed in such forward-looking statements.

Now, I will turn the conference over to Mr. Rodrigo Campos, CFO and IRO for the company, for a brief explanation of how ALL's figures are presented; and then, Mr.

Alexandre Santoro, CEO, will start the presentation.

Mr. Campos, you may begin the conference.

Rodrigo Barros de Moura Campos {BIO 16203706 <GO>}

Thank you for holding the conference of ALL. Just before I start, I'd like to make a brief comment about the numbers we'll be releasing in this presentation. As you know, we do not operate concessions in Argentina anymore since June last year. And since then, all the results coming from Argentina are in a separate line called results of discontinued operations.

But as in the 1Q 2013, we were still operating concessions there. The results which were released in the 1Q 2013 were consolidated. So, in the results we are showing now in 1Q 2014, we are comparing with results of 1Q 2013 already booked as discontinued operations, so with that - in order to have a comparable basis.

With that, I would like to pass the word to Alexandre Santoro.

Alexandre de Jesus Santoro {BIO 7120418 <GO>}

Thanks, Rodrigo, and good morning, everybody. This is Alex Santoro. To start our call, I would like to mention a few important highlights in this first quarter of our company, pointed in slide number 4. We reached a consolidated adjusted EBITDA growth of 11.5%, mainly through huge increases in our Rail Operations, as well contributions from Brado Logística. Our Rail Operations volumes increased 1.2% in this first quarter. Our volume performance in the Rail Operations was marked by a bad January when compared to last year, in which we benefited from an extraordinary amount of corn volume left from the second corn crop of 2012.

So, we decreased our volumes in January against last year. But during February and March, however, we performed much better and were able to increase volumes near to double digits. In addition, agricultural volume was also impacted by a worse mix of products, mainly in the Wide Gauge corridor, contributing to lower asset productivity.

We had a good quarter in terms of industrial volumes, as it increased more than 10% in the 1Q, mainly driven by our pulp and paper segment and by Brado's growth. Brado was able to grow in the main corridors that it operates, the Wide Gauge and Paraná corridors, but didn't perform so well in Rio Grande and Mercosur corridors.

This way, total volumes grew almost 8% year-over-year in the first quarter. Ritmo Logística didn't have a good quarter. The volumes decreased 16% in the first year, and the adjusted EBITDA dropped 24.6% to R$4.5 million, pressured by a volume decrease in both Intermodal Business Units and Dedicated Solutions Units.

An important step for us happened in March when we got the remaining necessary environmental license from IBAMA for our rail stretch duplication project from Campinas to Santos. This is a very important project for us and for the country as well, as it will structurally increase capacity in our Wide Gauge corridor, the most relevant corridor in terms of agricultural export in Brazil. Our Rondonópolis project, which is also a structure in terms of grain exportation, is operating at capacity now and is ready to hold volumes for the peak of the harvest.

Going to the consolidated results, you can see on slide number 5 that the adjusted EBITDA reached R$444 million and 11.5% growth in the 1Q against last year. Our Rail Operations contributed with 11.3% EBITDA growth.

In Brado, we posted an improvement of 41.4% year-over-year in this figure. While Ritmo Logística's EBITDA performance offset (06:59).

Our consolidated net profit was R$7.4 million in the 1Q, lower than the first quarter of last year. And we had higher financial expenses with increasing interest rates, almost 50% (07:17) inflation here in Brazil.

Now, I would like to pass to Rodrigo, who will discuss the results of our diesel units, as well as the financial consolidated highlights. Thank you.

Rodrigo Barros de Moura Campos {BIO 16203706 <GO>}

Thank you, Santoro. Starting from the Rail Operations business unit, we as Santoro said had volume increase 1.2% year-over-year in the 1Q 2014, mainly driven by an atypical 1Q 2003 (sic) [2013] (07:53), very strong. We know that the 1Q normally is the weakest quarter in terms of volumes and seasonality in the railroad. And last year, we had a strong 1Q because of the end of the – all the increase of corn – high volumes of inventory of corn at the end of year that pushed volumes on January. But we will talk a little bit more about that when we talk about agricultural commodities.

Our net revenues increased 10%. We have a good yield increase, average tariff increase of 8.7%, which basically reflects the inflation and diesel price increase in Brazil, the pass-through of diesel price increase.

And in terms of EBITDA, EBITDA increased 11.3% with an increase also in EBITDA margin from 53.7% to 54.3% in the 1Q as compared – 2014 as compared to 1Q 2013.

In page 7, we start to open the agricultural commodities business unit. We see that in agricultural commodities, volume decreased 1.7% and usually explained by the seasonal effect I mentioned. When we look at volume per month, we see that in January, that's typically the weakest month in the year, it went down 20% as compared with last year. Last year, we have strong volumes of corn in January, as Santoro mentioned. But the volume increased 8% in February as compared with last year and 8% in March, so recovering part of the drop we had in January 2004.

And also, we had an additional impact in terms of volumes in agricultural, which is related to the sugar transportation in the state of São Paulo in our Wide Gauge corridor. We increased almost 40% volumes of sugar there. And we know that sugar has a smaller average distance and lower productivity in terms of rail and port. So, at the end of the day, it reduced average productivity and impact volume growth also.

Going to slide 8, we start to look at the results in agricultural commodities. We see that revenue grew almost 10% despite of the 1.7% volume drop, and it's very related with the increase in the average yield, in the average tariff which reflects inflation and diesel price pass-through to our tariffs. In terms of EBITDA, EBITDA grew 10.2%, with a 0.3% increase in margins from 56.7% to 57%.

When we go to slide 9, we see that we had a good quarter in terms of industrial products business unit. Our volume grew 10%, pushed by intermodal flows, more specifically with wood and paper flows and with 18% increase in containers measured in RTK, so very good growth in wood and paper and containers. And in Pure Rail products, we increased volumes 1.7% basically because of the construction segment. When we go to the results of industrial products in slide number 10, we see that net revenues increased 11.2%, and I have reviewed (12:33) was more or less in line with last year, it increased 0.5%.

In terms of our agreements, commercial agreements, we passed through inflation in diesel as we did in agricultural, but I mean there was a very important mix effect in the industrial, with the increase in the containers, increase in wood and paper flows, and a decrease in volumes transportation which makes the mix – the average yield lower despite of inflation and diesel price pass-through.

In terms of EBITDA, I mean we have a material gain in Industrial business unit to increase almost 17%, EBITDA as compared with last year, with an important EBITDA margin increase from 42.2% to 44.3%.

When we go to Brado in slide 11, we see that volumes in Brado increased 8%, as measured in containers in 1Q 2014 as compared with the same quarter of last year. And the average distance grew a lot. Remember that when we're measuring RTKs, not only containers but implied (14:04) by the distance, the growth was 18% and was very concentrated in two corridors, which were the corridors we have prepared rather to grow. We have had rolling stocks for 2004 which were the Wide Gauge corridors, which links Mato Grosso and Santos, and on the Paraná state corridor which concentrates by the growth.

In terms of the EBITDA, Brado increased more than 40% with a meaningful margin gain from 15% to 21%, so a 6% increase in Brado margins, which reflects – increasing average distance also reflects beginning of Rondonópolis, a good quarter for Brado in the 1Q 2014.

Going to Ritmo in slide 12, Ritmo by the other hand had a tough quarter in terms of volumes. Volumes dropped 16% in 1Q compared to the same period of last year. Part of the volume drop was related to dedicated operations, and we leave some operations where we were not able to pass through to the carriers the cost increase we have. So at the end of the day, we'll leave some operations.

And intermodal flows, which are the segment that we have been growing in a very strong way. In the last two years, our volume dropped 20% because of a structural change in an operation of a client. So, we lost this operation. But even considering that, I believe we have a very big opportunity in intermodal operation in Ritmo, so we should be able to grow even in an environment like that. So, not a good commercial quarter for Ritmo, and Ritmo should start to capture the opportunities they have in intermodal to keep growing the range it was growing in the past.

In terms of adjusted EBITDA, EBITDA decreased 25%. Of course, I mean the company has a fixed cost structure. And with this reduction in volumes, you have an impact in EBITDA higher than the volume drop itself. So, margins went down from 10% to 8%, going down 2% in EBITDA, and ended the quarter with R$4.5 million.

Going to the financials, in page 13, we see our consolidated net revenues that we already mentioned at 8.1% in the quarter.

In slide 14, we see that our EBITDA increased 11.5% in a consolidated basis, and our margin increased from 48% to 49%.

In slide 15, we see that our net income decreased to R$7 million from R$34 million. And it's mainly driven by an increase in the interest expenses. You know that our EBITDA increased, operational results increased, but I mean the interest rates in Brazil increased 50% as compared to the same period of last year. Also, the inflation was higher, so the inflation then on mainly that (18:37) was also impacted by these trends. So at the end of the day, we had a drop in our net income pushed by interest expenses.

In page 16, we see our capital structure. We see that our net debt adjusted – net financial debt/adjusted EBITDA increased from 2.2 to 2.48. And I mean, the 1Q – usually in the 1Q the leverage increased, because I mean this is a low-season quarter, so we have less revenues which has to pay for the same fixed-cost structure. So of course, it's impacting the cash flow.

And by the other hand, you also have more CapEx because you are preparing the company for the crop season. And also, this is the period that you have more time to offer to make the works on the tracks, given the low volumes we have.

So we naturally intensify the CapEx during this period of the year. So with higher CapEx, we'll work operational cash generation, naturally, the leverage increases in the 1Q almost every year.

With that, I would like to pass the word to Santoro to give some additional comments.

Alexandre de Jesus Santoro {BIO 7120418 <GO>}

Thanks, Rodrigo. Just some quick additional comments on the quarter results and on our expectation for the next quarters. First, we expect to have a better operational condition from the 2Q onwards, as most of the problems at the ports have already been solved by the beginning of this year.

We have faced problems in the ports since the second quarter of last year, mainly in TGG and T-XXXIX terminals in the grain segments, as well as difficulties in the rail unloading structures in other segments.

The grain terminals are already operating regularly. Investments for the recovery and expansion of terminals are happening in the other segments. Rondonópolis is ready to load the major part of the agricultural commodities volumes that were loaded before at Alto Araguaia terminal, increasing average transported distance and putting the company to better haul volumes from the harvest peak in the 2Q and 3Q of 2014.

And as you already know, on April 15, our Board of Directors approved the proposals sent by Rumo aiming to merge the companies. The merger is conditional to the approval of ALL shareholders in an Extraordinary Shareholders Meeting to be held tomorrow here in our headquarters at 4:00 PM São Paulo time, and to the approvals of Brazilian Antitrust Authority, CADE, the National Land Transportation Agency, the ANTT, and also to other precedent conditions.

With this, I conclude our presentation and put ourselves available for clarifying any doubts you may have. Thank you.

Q&A

Operator

Thank you. Mr. Mark Suarez from Euro Pacific Capital, would you like to make question?

Q - Mark Suarez {BIO 16366613 <GO>}

Hi. Good morning. Just to go back on the rail duplication project you have from Campinas to the Port of Santos, how much real capacity do you expect to add after this is concluded and what sort of productivity gains do you expect to achieve? If you can give us some more color on your sort of what productivity gains you mean - you're talking about longer and heavier claims, sort of -- lastly, the locomotive, I'm wondering what sort of metric you're looking to achieve here?

A - Rodrigo Barros de Moura Campos {BIO 16203706 <GO>}

Okay, Mark. We - I mean, when you duplicate Campinas to Santos, we add a lot in terms of capacity, so we increased from our capacity of -- in part of train from 15 to 37, so you more than double the capacity in this from Campinas to Santos.

And also, as you know, today the train has to cross and this is the tracks where you have more density of trains. So, average speed was very low. After the duplication, the train goes and come back straight to the port, so a lot of gain in terms of transit time. So, of course, the potential increase in terms of volumes is huge. We will be able to haul much more sugar, also much more grains, than we hoped the day after the duplication.

In terms of productivity, it will depend a lot on the kind of route you are. On the sugar that are a more shorter distance route, the impact is -- it'll be very important because this segment represents almost all the extension of those routes. So the transit time would be reduced by half or better than that.

In terms of the longer routes that go to Mato Grosso, it would depend on the map, it would depend on the ports, but it can be reduced 15%, 20% in terms of the transit time.

Q - Mark Suarez {BIO 16366613 <GO>}

Got you. And then, and just to follow up on that, should we expect maybe the – I didn't know -- sugar volumes have actually trended very strongly in the first quarter. Should we expect maybe the sugar traffic to the terminals to maybe eat up some of that capacity or most of that capacity, including the duplication if and when the merger is approved? Should that be the trend that we should be looking forward to?

A - Rodrigo Barros de Moura Campos {BIO 16203706 <GO>}

Could you repeat, Mark? I couldn't hear you very well.

Q - Mark Suarez {BIO 16366613 <GO>}

Just on the sugar volumes that you talked about this quarter, I'm wondering if and when the merger is approved, obviously that is conditional on a number of factors, but should we expect greater sugar traffic to maybe eat up that new capacity once the duplication is concluded? How should we think about sugar volumes vis-à-vis the rest of the agricultural commodities?

A - Rodrigo Barros de Moura Campos {BIO 16203706 <GO>}

Mark, as you said, in order the deal be concluded, you need to have first the shareholder meetings approval which is tomorrow. So, we will see if it will approve or not. And after approving that, we need that CADE approval in this period, both companies will be managed completely – in a completely separate way. But in detriment of that, I mean, the duplication will completely change the productivity in terms of the railroad in sugar, in sugar routes, and also will create capacity to increase volumes in sugar and increase a lot also in the grains.

So, with the duplication, we would be able to accommodate all these contracted volumes that today we were not able to obtain. So duplication is important. Of course, it's not only a manner of the duplication. We need also the port capacity. Rumo is doing the investments on the ports. And today, we set the volumes we transported based on the port and loading capacity. But, I mean, 18 to 12 months ahead, which is the period we are talking here in order to conclude the duplication, probably the ports will be operating fully also and so all the completions will be there.

Q - Mark Suarez {BIO 16366613 <GO>}

Got you. And now when we talk about the terminals of the Port of Santos, is Rumo, as you mentioned, are making some investments right now, do you expect terminal capacity to maybe increase over the next 12 to 18 months, therefore making the logistical system more efficient as you increase your rail productivity, capacity, if you will?

A - Rodrigo Barros de Moura Campos {BIO 16203706 <GO>}

Yeah. I mean, when we speak in terms of this 12 period -- timeframe which is our forecast for completing and the duplication to Port of Santos, the plan of Rumo for sure is to have the terminal completed there. But I mean to have the exact timeframe of the works on the terminal, on the port, the best thing is to ask Rumo.

Q - Mark Suarez {BIO 16366613 <GO>}

Got you. Okay. I'll get back in the queue, guys. Thanks.

A - Rodrigo Barros de Moura Campos {BIO 16203706 <GO>}

Thank you, Mark.

Operator

Mr. Stephen Trent from Citigroup would like to make a question.

Q - Kevin M. Kaznica {BIO 17875244 <GO>}

Good morning. Can you hear me?

A - Rodrigo Barros de Moura Campos {BIO 16203706 <GO>}

Hi, Stephen. I can hear you very well.

Q - Kevin M. Kaznica {BIO 17875244 <GO>}

Oh, Okay. Yeah, this is Kevin Kaznica, just stepping in for Stephen for today. Just one quick question. Was the first quarter rail investment spend partially related to the shutdown or repair of the Wide Gauge corridor, and are you considering an investment of your plans on annual CapEx related to that?

A - Rodrigo Barros de Moura Campos {BIO 16203706 <GO>}

Stephen, if I hear you well, I understand that you are questioning about the increase in CapEx in the 1Q 2014 as compared to 1Q 2013. Am I right?

Q - Kevin M. Kaznica {BIO 17875244 <GO>}

Yes. We're just wondering if part of that was related to the shutdown or repair of your Wide Gauge corridor, or was that...

A - Rodrigo Barros de Moura Campos {BIO 16203706 <GO>}

Yes. Yes. I mean, there are two factors here, I mean. When you compare with last year, we take advantage of the lower volumes we had in January to increase, to concentrate more the CapEx in the 1Q, which is good because they depend less on the time between the trains to do the work that I need to intensify the maintenance and the CapEx we need for the crop season. This was one thing.

The other thing – you are right – was that we got the environmental licenses, so we start to do the CapEx there, we mobilize all the teams to start working there since the first day we got the license. So there was an additional CapEx related to the duplication of rail track from Campinas to Santos. Remember that today this is a part of contract with Rumo, but due to litigation, I mean, the cash flows are freezed. So we are doing that by our sales, because I mean the returns related to the duplication is undiscussable (32:02), I mean, are very huge. We wouldn't like to delay the CapEx spend because of the litigation.

Q - Kevin M. Kaznica {BIO 17875244 <GO>}

Understandable. So also a quick follow-up, are you considering an adjustment of your plans on annual CapEx, so just like the incremental, an addition, overall, or I guess is your CapEx guidance still holding for the rest of the year?

A - Rodrigo Barros de Moura Campos {BIO 16203706 <GO>}

Well, our guidance for CapEx is R$800 million. It's been the same. Of course, it does not comprise the duplication which is something that is inside our agreement with Rumo, and we expect to solve that in some way (32:53).

Q - Kevin M. Kaznica {BIO 17875244 <GO>}

Okay, very helpful. Thank you.

Operator

Mr. Mark Suarez from Euro Pacific Capital, would like to make a question?

Q - Mark Suarez {BIO 16366613 <GO>}

Hi, guys. Thanks for taking my call one more time. I just had a follow-up question on the CapEx here. You mentioned your funding for the rail duplication since you don't want to lose time. I mean, that's how I understand it. I'm wondering if and when the merger is approved, how is that going to change this? Are you going to be taking up the remaining balance of the projected CapEx and how are they going to fund it? Do you have any sort of – what are the detailed funding plans, if you will, if you have any at this point?

A - Rodrigo Barros de Moura Campos {BIO 16203706 <GO>}

I mean, Mark, I really cannot anticipate anything like that at this point I mean because, first, it must be approved tomorrow by the shareholders. After that, both companies, will be managed in a separate way. So until you have a CADE approval, it's hard – we cannot consolidate anything and we will not do that. So it's hard to answer that right now. So we don't have this visibility. At the end of the day, what I can tell you is that we will do the CapEx independent of any -- what will be the outcome of (34:57).

Q - Mark Suarez {BIO 16366613 <GO>}

Okay. And just one last thing on the potential merger here, assuming that everything goes according to plan and you got shareholders approval, what do you think the turnaround time for the two government agencies is to either approve or reject the merger? Are we talking about a matter of days, weeks or months? I'm just trying to get a timing on as to when potentially we could see this merger come to fruition.

A - Rodrigo Barros de Moura Campos {BIO 16203706 <GO>}

Yeah. I believe the biggest timeframe naturally comes from CADE, which have a legal timeframe of 330 days to decide, to approve or not approve or to have a final decision. Of course, this is the maximum and it could be that the decision of CADE could come in a much shorter time, but maximum timeframe is this 330 days.

Q - Mark Suarez {BIO 16366613 <GO>}

Okay. So, it wouldn't be out of the realm of possibility that this could only come into fruition by next year, or do you think that that's just too conservative and maybe we could see, again assuming everything comes into play, that this could be a second – a third quarter event?

A - Rodrigo Barros de Moura Campos {BIO 16203706 <GO>}

I believe that once the deal is approved, I mean, of course the best way – the best thing to do is to provide CADE all those information and help CADE to analyze as fast as possible because, of course, it's good for everybody. And for sure, CADE also will want to have the decision as fast as possible. So, of course, the idea is to accelerate that, to provide all information in order to accelerate that. But, I mean, it's difficult to anticipate. It can take 330 days. It can take three months, two months. It's hard to tell.

Q - Mark Suarez {BIO 16366613 <GO>}

Right. Okay. That's all I have for now. Thanks again for your time.

A - Alexandre de Jesus Santoro {BIO 7120418 <GO>}

Thank you.

Operator

Mr. Alexandre Falcão from HSBC would like to make a question.

Q - Alexandre P. Falcão {BIO 22205533 <GO>}

Hi. Good morning, everyone. Actually my question is regarding second and third Q where you're probably going to see a lot more of sugar volumes kicking in. I just wanted to pick your brains on in terms of where the yield – I'm sorry, where the volumes allocation are going to be between sugar and grains on the second and third Q.

And if you guys could explore a little bit in terms of growth of volumes from now to the end of the year. Is it feasible to assume a 10% increase in volumes even with very concerning data from the industrial front that we're seeing in the first quarter of the year? Thank you.

A - Rodrigo Barros de Moura Campos {BIO 16203706 <GO>}

Thank you, Alexandre. In terms of volume of sugar, what we have been doing is to hope based on port and loading capacity, so we'll keep doing that. Of course, as compared with last year, probably, we will have a meaningful growth, but it's hard to anticipate what the capacity will be at least from this point. So we will keep doing the same in the volumes of sugar. We will be – we will follow the same theme.

And I mean, in terms of industrial volumes, I believe we have been growing in the last quarters and even considering lower industrial (39:43), we keep seeing good source of growth from the new projects in the wood and paper segment, and also from Brado. So we should sustain the growth from industrial product.

Yeah. The 10% growth you mentioned in the consolidated basis, you know that we don't give annual guidance. But we prepare ourselves every year to grow low-single digits – high-single digits, low-double digits. But, I mean, of course the growth depends on several things. And we don't give annual guidance, more a long-term guidance. But, I mean, it makes sense when we look to long-term targets.

Q - Alexandre P. Falcão {BIO 22205533 <GO>}

Okay. Thank you.

Operator

Since there are no questions, I'll turn over to Mr. Alexandre Santoro for final considerations. Mr. Alexandre Santoro, you may give your final considerations.

A - Alexandre de Jesus Santoro {BIO 7120418 <GO>}

Well, thank you, everybody. Have a great day. We'll keep in touch to talk about the results of the shareholders meeting tomorrow. Thank you everybody.

Operator

Thank you. This concludes today's ALL's earnings conference call. You may disconnect your lines at this time.