

Q1 2017 Earnings Call

Company Participants

- Guilherme Machado, Executive Investor Relations Manager
- José Cezário Menezes de Barros Sobrinho, Chief Financial & Investor Relations Officer

Other Participants

- Augusto Ensiki, Analyst
- Stephen Trent, Analyst
- Victor Mizusaki, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good afternoon, ladies and gentlemen. At this time, we would like to welcome everyone to Rumo's First Quarter of 2017 Results Conference Call. Today with us, we have Mr. Júlio Fontana, CEO; Mr. José Cezário, CFO and Investor Relations Officer; and Mr. Guilherme Machado, Investor Relations Manager.

We would like to inform you that this event is recorded, and all participants will be in a listen-only mode during the company's presentation. After Rumo's remarks, there will be a question-and-answer session for industry analysts. At that time, further instructions will be given. The audio and slideshow of this presentation are available for 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 1995 (01:15). 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're related 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. Guilherme Machado. Sir, you may begin your conference.

Guilherme Machado {BIO 17920567 <GO>}

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Good afternoon everyone, and thank you for participating in the first quarter 2017 conference call for Rumo SA. I would like to start reminding you that at the end of last year, 2016, we concluded the reverse merger process of Rumo Logística by Rumo SA which is the current denomination of América Latina Logística SA. Thus, we now present here Rumo SA pro forma results considering the accumulated results of Rumo Logística before the merging for comparison purpose. Okay?

So, this quarter, we record EBITDA growth mainly reflecting efficiency gains due to the implementation of our CapEx plan even though we have volumes in line with the first quarter of 2016. Then, let's start with chart number 3 with Rumo's consolidated results.

Our operating performance came in line for railway transportation despite the first Q 2016 strong base of comparison. Our total volume transported reached approximately 10 billion RTK due to the capacity increase generated for investments.

The first Q of 2016, as you may remember, was marked by an unusual demand for corn transportation early in the year due to a favorable crop in 2016, which extended exports to the following year. In addition, soybean shipments were concentrated in February and March in 2016, making us to operate within limited offer capacity.

Observing our volume in this quarter, first Q of 2017, we can see there was no similar demand for corn transportation due to the 2016 second corn shortfall. In addition, the scenario for soybean exports remaining regular (04:05) for the beginning of the year which mean a typical crop season with shipments taking place in the beginning of February.

Even so, our increased capacity allowed us to reach total volume growth (04:21) to the volume transported in the first quarter 2016. The volume of agriculture product decreased at 1.4% and volume of industrial products transported increased at 3.8% in the quarter benefited by the recovery of agricultural production causing higher demand for food transportation. Transportation average use (04:45) grew 2% either due to contractor adjustments and also as a reflect of product mix and growth.

It is important to mention that the increase in the average tariffs practice due to the accumulated effect, adjustment of - in GPM (05:03) index - the inflation index which was partly offset by the negative net effect of diesel price adjustments made by Petrobras between the quarters. The port load volume and terminals controlled by Rumo at Santos Port went down 12.4% in the first Q of 2017 because most of sugar crop was transported between the second and third quarters of 2016.

Moving on to chart number 4, let's talk about the consolidated financial performance of Rumo. Our financial performance was benefited by operating efficiency gains. Consolidated net revenues in the quarter was up 1% to BRL 1.2 billion due to higher port loading and transportation tariffs, which partially offset lower volumes for the future (06:04) products.

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EBITDA climbed 11% from 1Q 2016, reflecting efficiency gains achieved through our investments. Variable cost reduced mainly due to a high efficiency of the new asset and fixed cost and (06:26) and administrative expenses were up below inflation, which contributed to EBITDA margin increase, which reached 41% this quarter compared to 37.5% in the previous quarter. Our broad net debt came to BRL 9.1 billion in the first quarter of 2016, which maintained our leverage at the same level from December 2016 at 4.4 times the broad net debt to EBITDA.

So, moving on to chart 5, we can see our business units' performance, starting with the North Operation. Total volume transported by North Operation in the first quarter of 2017 was 1% higher than the first quarter of 2016, reaching 7.1 billion RTK, reflecting higher demand for industrial transportation and volume of agriculture products in line. Net revenue grew 2% to BRL 914 million in the first quarter of 2017, mainly due to higher average tariff practiced (07:40) combining FX from contractor adjustments with product mix and routes operated.

Thus, the North Operation EBITDA was up 6.2% to BRL 501 million in the first quarter of 2017. Higher operation efficiency generated through execution of our CapEx plan reduces in lower unit costs and a 2.2 percentage points margin increase despite the scenario that we had volumes in line with the first quarter of 2016.

So, moving on to the next chart, we can see how we improved our market share at Santos Port for grains. So, at chart number 6, we can realize how higher transportation capacity rate (08:35) in 2016 allowed us to increase our market share in grain transportation in Port of Santos. In January this year, grain exports maintained at the historical trend which is below the unusual volume seen at the beginning of 2016.

In February and March, grain exports were similar to previous years. Thus, with increased capacity, we managed to offset lower volumes in January and increase our market share in grains transportation in the Port of Santos from 42% in the first day of 2016 to 48% in the first Q of 2017.

So, let's move to chart number 7 which is talking about the South Operation performance. Total volume transported by South Operation in the first quarter of 2017 reached a 2.6 billion RTK. The 1% reduction year-on-year is mainly due to the first Q 2016 hard comp considering that demand for corn transportation was not similar in the first quarter of 2017 as previously mentioned.

However, industrial volumes were up 8% in the quarter mainly due to pulp supply made to Klabin in the state of Paraná. So, now revenues increased 5% to BRL 237 million in the first Q of 2017. Either by higher average tariffs due to contract adjustments and also by product mix transported into peer.

Thus, the South Operation EBITDA came to BRL 2 million in the first quarter of 2017, compared to a negative EBITDA in the semi-quarter of last year, a growth that is also justified by cost saving efforts.

Moving on the presentation, let's talk about the Container Operation performance. Total volume of containers transported in the first quarter of 2017 decreased at nearly 14% year-on-year due to the decision of not operating a non-profitable route in the Mercosur and the Rio Grande do Sul corridors, as well as due to lower demand for refrigerated products transportation.

Despite the remaining negative, the 26% improvement in EBITDA compared to first Q 2016 is mainly due to the rationalization of non-profitable routes and cost saving efforts.

On chart number 9, we can see the company's consolidated indebtedness position. Broad net debt increased 3% from BRL 8.9 billion in the fourth quarter of 2016 to BRL 9.1 billion in March 31, 2017. Broad net debt to EBITDA ratio of 4.4 times is almost the same leverage that we faced in the end of last year.

Such results reflected lower cash level chiefly due to the execution of the CapEx plan which is partially consumed (11:51) as cash in the period.

We also present here our debt amortization schedule already comes through (11:57) the \$750 million bond, the senior notes 2024 that we issued in February this year, which reinforced the long-term profile of our debt.

Moving on to chart number 10. Let's talk about financial results and cash flow. Financial result in the first Q 2017 was at 5% year-on-year, mainly due to higher gross debt charges after the debt restructuring process concluded in the second quarter of 2016. These effects were partially offset by lower expenses with leasing and real estate receivable certificate as a result of amortization of these instruments in the period.

Looking at the cash flow, we record a cash generation of approximately BRL 1.9 billion due to senior note 2024 issuance in February this year, as I have already mentioned. Excluding such effect of approximately BRL 2.4 billion, there was a cash consumption of approximately BRL 350 million as a function of the execution of our CapEx plan.

Moving to the next slide, next chart. We have the historical trends of our operation and financial performance indicators. Here we have two new indicators, the unitary variable cost and the unitary fixed cost plus SG&A expenses excluding depreciation for the rail operation only, which means that we excluded the port elevation service and also the sugar logistics solution. The unitary variable cost is the real operation cost per RTK produced. This ratio decreased 6%, reflecting higher efficiency of the company assets, especially lower fuel consumption of our locomotives.

Likewise, we present the fixed cost added to SG&A expenses excluding depreciation per RTK produced. Such ratio reduced 1% due to a reduction of costs and expenses during 2016, partially offset by inflation adjustments in the period. The operating ratio improved 3% in this quarter, mainly due to operation and efficiency gains and cost savings mentioned in the two indicators previously presented. Our diesel consumption measured in liters per GTK, which is the gross total including loading and wage, improved 4%, chiefly due to lower consumption of new locomotives as already mentioned.

Specifically referring to the North Operation, which is the grain transportation in the Rondonópolis-Santos route, we record a 7% reduction in the average car loads per day compared to the first Q of 2016, due to lower demand for corn in January, which was partially offset by higher soybean loading in February and March.

Here, it's important to mention that we are coming out of the fleet renewal as you already know. And as a consequence, we are replacing the 50 ton railcars by 90 ton railcars. As a function of this process, part of the average carload reduction can be explained by these effects. When we analyze the transit time in the first Q of 2017 compared to the first Q of 2016, we can see a 7% increase. Such a worsening indicator was due to scheduled interruptions in the rail line.

To execute the CapEx plan work since this is the period of lower volume in the year compared to the next quarters. The cycle time of railcars in Rondonópolis to Santos road in the first Q dropped at 5% year-on-year, and this improvement reflects the high operating efficiency at our terminals, not only in Santos but also in land terminals.

Now, referring to the South Operation indicators, the routes connecting the north of Paraná to the Port of Paranaguá, we have similar trend to the North Operation indicators. There was a reduction of 22% of carloads due to lower corn demand in January, a 17% increase in transit time due to scheduled works in line with our CapEx plan, and 9% improvement in cycle as a result of higher efficiency at terminals.

So, moving on, I would like to talk about our most recent market projection. On chart number 12, we have the most recent Agroconsult projections, the consultancy firm that we hire, for soybean and corn production in Brazil and in the state of Mato Grosso. As we already mentioned in the last earnings release, grain volumes accounts for approximately 70% of our total volume transported. Estimates remains very positive, soybean harvest already confirmed a substantial volume of product to be transported in 2017. And corn, second crop reveals favorable conditions for its productivity.

Thus, we estimate that 19% growth of soybean production in Brazil compared to previous year and the crop in the state of Mato Grosso, our main market, should grow 17%. When we look to the corn production, the Brazil growth was going to be approximately 35% and 42%, specifically in the state of Mato Grosso, which reveals very good conditions for our business in this year.

Now, moving on to the next slide, I would like to reinforce our guidance for 2017. So, chart number 13, market figures presented in the previous slide, added to the investments, which resulted in a higher capacity and operation efficiency that we're already facing makes us remain confident in increasing our results in line with our long-term business plan. Therefore, we reinforce our guidance for this year, with the EBITDA between BRL 2.6 billion to BRL 2.8 billion and the CapEx between BRL 2 billion to BRL 2.2 billion.

So, with this, I finish the presentation. I am here along with Mr. Júlio Fontana, Rumo's CEO and José Cezário, Rumo's CFO, as well as our financial team to clarify any questions

during the Q&A session. I sincerely would like to thank you all for participating in our conference call. Thank you.

Q&A

Operator

Thank you. We will now begin the question-and-answer for investors and analysts. Our first question comes from Victor Mizusaki with Bradesco BBI.

Q - Victor Mizusaki {BIO 4087162 <GO>}

Hi. I have two questions here. The first one, given that Rumo issued a bond back in February and as part of the strategy to - for liability management, the company has talked a lot about the BNDES. So, I don't know if you can give us any color on the current negotiations with BNDES to access the BRL 3.5 billion credit. And also, some color about the current situation for the contracts renewal.

And my last question, if you have any decision about the potential reverse merger with RLOG? Thank you.

A - Operator

Hi, Victor. Regarding the BNDES negotiation, it is going well as expected. Actually, we already discussed with them a timetable where we expect their final approval to happen at the end of June hopefully. And then with that, we are assuming that the disbursements will begin on July maximum August. That's what we expect according to the discussions that we are having with them so far. It is going well as I mentioned.

And it's not related to the Paulista renewals. There is no dependence on the renewals to get this new line as we already discuss it previously. As we are discussing with BNDES that we're going to invest in the Paulista network up to the end of next year will be the North Network concession that we have up to 2079. So, we are not mixing the renewals of the Paulista with the discussion with BNDES regarding the BRL 3.5 billion new line of credit. Okay.

And Victor, regarding RLOG, Cosan Logística process, it is - the shareholder structure is much more a discussion that is we think the board is not a management daily subject. And I think there is an intention to make the structure more straightforward, but the management has no view regarding that. So, I do not take any position on this as of now

Q - Victor Mizusaki {BIO 4087162 <GO>}

Okay. Thank you.

Operator

Our next question comes from Stephen Trent with Citi.

Q - Stephen Trent {BIO 5581382 <GO>}

Hi. Good afternoon, gentlemen, and thanks very much for taking my question. Just very quickly from me. When I think about your 2017 EBITDA guidance, can you just refresh my memory as to what is your underlying view on diesel prices for this year?

A - Operator

Stephen, actually, we do not have specifically a view on that aspect as it is not relevant for us according to our main contracts with trading companies. The price adjustment for good or for bad is best rule of our tariffs (24:37). So, it doesn't impact as much. There's a minor impact that tends to be positive if the diesel prices goes up, but it's not relevant at all. Did you get the (24:56)?

Q - Stephen Trent {BIO 5581382 <GO>}

Yes. Yes. Okay. That's very helpful. And just one on other very quick question. A couple of months ago, there had been at least some mild conversations about an eventual amending of your Southern concession, and just wanted to get your kick on that one as well. Thank you.

A - Operator

You're talking about the South, not network (25:26)?

Q - Stephen Trent {BIO 5581382 <GO>}

Yes.

A - Operator

Well, could you repeat again what is the point specifically?

Q - Stephen Trent {BIO 5581382 <GO>}

Yes, certainly. So, I know you guys are certainly in the process of amending the (25:44) concession. Medium to long term, do you see any potential to also make a list of somewhat similar kind of adjustment with the Southern concession given the Ministerial Provision 752 seems to have facilitated some of these?

A - Operator

You mean the possibility to renew the South Network, correct?

Q - Stephen Trent {BIO 5581382 <GO>}

Yes. That's right.

A - Operator

Yes. It is possible according to the new Provisional Measure that has been approved, and it's in the process to become a specific law in Brazil. It's depending on the approval by the

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president, which not happened yet, but it's going to happen in the next days or weeks. And it will allow us to getting to the process to renew also the South Network. It would be a possibility but, of course, the process has not started yet.

Q - Stephen Trent {BIO 5581382 <GO>}

Okay. Very helpful. I'll let someone else ask a question. Thanks very much.

A - Operator

You're welcome.

Our next question comes from Augusto Ensiki with HSBC.

Q - Augusto Ensiki {BIO 15988025 <GO>}

Hi, good afternoon, gentlemen. Thanks for the question. Just on the operational side, you're talking about the transit time and cycle time being a little bit impacted by this quarter's investments. When all is said and done, and the investments are at a more, I guess, They'll work at a dense stage. What can - what sort of improvement can we expect in the transit time and that cycle time? Like, where does this go, I guess, next year or the year after?

A - Guilherme Machado {BIO 17920567 <GO>}

Well, Augusto, this is Guilherme. Well, there is a significant improvement that we're going to face in the transit time and also cycle, as a function of the investments as we have been discussing with investors since we started the turnaround process. So, specifically, we're going to have improvements that will allow us to reduce transit time in the main route, which is Rondonópolis to Santos.

Below 80 hours or higher or a reduction higher than that, but it is a leading (28:34) process. As we add assets to our network and process the improvements in the rail structure, we're going to measure how efficient we are moving in the application of the CapEx. So, we have a long-term target, that is below 80 hours or more, but we're going to track this over time.

Q - Augusto Ensiki {BIO 15988025 <GO>}

So, that 80-hour target, where - when along would we be seeing that?

A - Guilherme Machado {BIO 17920567 <GO>}

Yeah. This is more towards the end of this five-year cycle plan, which is more towards 2020.

Q - Augusto Ensiki {BIO 15988025 <GO>}

Okay. So, then along - or from here until then, we see gradual improvement eventually getting to that target 80 hours or less?

A - Guilherme Machado {BIO 17920567 <GO>}

Absolutely. That's it.

Q - Augusto Ensiki {BIO 15988025 <GO>}

Great. Thank you very much, Guilherme.

A - Guilherme Machado {BIO 17920567 <GO>}

You're welcome.

Operator

Thank you. This concludes today's question-and-answer session for investors and analysts. I'd like to ask to Mr. José Cezário to proceed with his closing statements. Please go ahead, sir.

A - José Cezário Menezes de Barros Sobrinho

Okay. Thanks, all, for participating in our conference call. Our IR team area available in case you have any further questions or needs. Thank you very much. Bye-bye.

Operator

This concludes Rumo's audio conference for today. Thank you very much for your participation. You may have a good day. Thank you.

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