

Q3 2014 Earnings Call

Company Participants

- Alexandre De Jesus Santoro, Chief Executive Officer
- Rodrigo Barros de Moura Campos, Investor Relations Officer and Chief Financial Officer

Other Participants

- Mark Suarez, Analyst
- Ravi Jain, Analyst
- Stephen Trent, Analyst

Presentation

Operator

Good morning, ladies and gentlemen. At this time, we would like to welcome everyone to America Latina Logistica, ALL, Third Quarter of 2014 Earnings Conference Call. Today, with us we have Alexandre Santoro, our CEO; and Rodrigo Campos, CFO and IRO 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 company's presentation. After ALL's remarks are completed, there will be a question-and-answer section. (Operator Instructions)

We have simultaneous webcast that may be accessed through ALL's IR website, 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 the 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 condition, industry conditions and other operating factors could also affect the future of ALL and could cause results to differ materially from those expressed in such forward-looking statements.

Now, I'll turn the conference over to Mr. Alexandre Santoro, CEO, who will start the presentation. Mr. Alexandre, you may begin the conference.

Alexandre De Jesus Santoro {BIO 7120418 <GO>}

Good morning. This is Alex Santoro speaking. Thanks for joining us at this conference call. To start our presentation, I would like to mention a few important highlights in this third quarter for our company. The volume has improved 4.4% even in a tough demand scenario, reaching 12.5 billion RTKs, our record in a quarter.

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Yields grew 3.1% supported by the tariffs in our take-or-pay agreements, even in a depressed level at the spot market for its price. In terms of the merger with RUMO, today we have two new effects, the antitrust agency determine that the operation as complex in order to perform deepen analysis of the competitive conditions in the relative market and request some questions about the regulation in market data to the National Land Transportation Agency, the ANTT.

At the same time, the ANTT approved the merger today with large restrictions. This is a really good news and an important step to the conclusion of this merger.

Now going further in more detail. We can see on slide number three that in the third Q our rail operations volumes grew 4.4%, reaching 12.5 billion RTK.

Despite a better operational scenario at Port of Santos when compared to last year, we faced a very tough demand scenario in the great quarter, as the great corn production in United States reduced Brazilian exports and (inaudible) spot market freight price in the most important agricultural corridors that we operate.

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The rail operations average yield grew 3.1% in the third Q year-over-year supported by the tariffs set in our take-or-pay agreement, and partially offset by the depressed levels at the spot market freight price.

Spot market freight price decreased approximately 25% in the Wide Gauge Corridor from Mato Grosso to Santos and more than 13% in some origins in Parana corridor, which are the two most important corridors that we operate.

However, most of our volumes are take-or-pay contracts, we did not observe the drop in our consolidated rail yields.

The consolidated EBITDA reached more than R\$500 million, increasing almost 20% [ph] against the third Q of last year with a contribution of R\$583 million from the rail operation, almost 20 million from Brado's EBITDA and 5 million from Ritmo's -- from Ritmo.

Brado had another great quarter, continuing its operational ramp up in the period. Brado presented a volume growth of almost 18%, reaching 21,000 containers handled. This growth was driven by the augment in the wide gauge product in Parana where the company added growing stocks for 2014 and where major part of investments is concentrated.

Ritmo Logistica did not have a good quarter as volumes decreased 32% in third Q year-over-year and EBITDA dropped 28% to 5.3 million, pressured by both intermodal business unit and dedicated solutions unit.

Moving to the next slide, number four, we can see our consolidated results. Our net revenue has increased 5.2% when compared to the third Q, reaching almost R\$1 billion. In the first nine months of the year, the net revenues grew 5.7% and achieved R\$2.9 billion against -- during the first nine months of this year.

Our consolidated EBITDA reached R\$508 million, increasing almost 1% in the third Q, against the third Q of last year. Our rail operation contributed 0.6% EBITDA growth and Brado posted an improvement of 23.5% year-over-year, while Ritmo Logistica's EBITDA partially offset it. Our consolidated net income was 37.6 million in the third Q and with the nine months reached R\$138 million, against R\$44 million in the same period of last year.

Now, I would like to pass to Rodrigo, who will discuss the results from our business units Brado and Ritmo, as well as the financial consolidated highlights. Thank you.

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

Thank you, Santoro. Good morning. Starting from rail operations, as Santoro mentioned, volumes increased 4.4%. And when we breakdown in the main business units, agricultural commodities increased 5.2% in terms of volumes and in doing so far those volumes increased 2%.

When we look to net revenues, net revenues increased 8% and with average yield increase of 3%, which is below the inflation, but it's a positive number and it was supported basically by our take-or-pay agreement, as this spot market freight price in the quarter was below last year's freight prices.

In terms of EBITDA, EBITDA grew marginally from R\$480 million to some R\$483 million on the quarter and in the year EBITDA, in nine months has increased 3.3% as compared to the same period of last year.

Going into the agricultural commodity business in slide seven, we see that we have 5.2% of volumes even in a very weak demand scenario. And it was flat basically, market share gains in corn transportation, in exports, we know that the exports went down the deposits, so matured market share gains. Also the government did some auctions to increase price for exporters. It's like a -- they call that auctions PEPRO Auctions and it's a kind of export incentives, which avoid an even tougher demand scenario in the quarter.

Also, we increase the transport of soybean meal. Remember that the soybean crop this year was more -- the inventories were high and where you have more soybean crushed this year than if you compare with 2013. So we have all of these soybean meal volumes in the third Q and this is the volumes that we expect also to increase in the fourth Q.

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And finally, we have a quarter with a full contribution of Rondonopolis. If you go into last year in the same period, Rondonopolis was already operational, but was not operating at full capacity, but also a positive contribution.

When we go to slide eight, we see that agricultural commodity revenues, net revenues increased 8%, with an increasing, average yield of 2.6%, also below inflation, but much better than the scenario we saw in spot market freight prices and basically supported by our take-or-pay agreements.

The EBITDA increased 2% from R\$390 million to R\$397 million in the quarter and in nine months EBITDA increased 3.6% in 2014 as compared to 2013. When we go to industrial products business unit, volume increased 2%, mainly driven by a 9.5% growth in the intermodal unit.

And there were two segments which were the main drivers of this growth. The first is, wood products, which increased 14% and containers, which increased 21%. Those segments have been increasing at material rate along the year. If you see in the nine months, wood products increased more than 40% and containers increased more than 20% volume wise.

In Pure Rail flows, the volumes decreased in the quarter 4.2% and basically pushed by the ethanol exports in Brazil, which went down more than 70% in the quarter. It's also related with very big corn crop in United States, which increased also ethanol production in the country and impacted Brazilian ethanol exports at the end of the day. In the year, the Pure Rail flows are more or like in line with the same period of last year.

In terms of net revenues in slide 10, industrial products increased 2% in the quarter, with an average yield growth of 4.6%, a little bit better than agricultural commodity, but still below inflation. And EBITDA went down 5.2%. We had an increase in volumes, but I mean with an increasing yield below inflation and with a different mix of transported volumes, EBITDA had a more reduction as compared with last year.

If you take the nine months accumulated numbers, EBITDA is growing 1.8% as compared with the same period of last year. Brado volumes grew 24.5% if you measure in terms of number of containers transported, also more than 20% if you measure in terms of RTKs in the quarter saw material growth rate for Brado.

In the year, accumulated nine months, Brado also is growing very close to 20%, volume wise.

And the main corridors that Brado is growing are wide gauge corridor, which grew almost 45% during the quarter and Parana corridor where Brado grew 50% during the quarter. Those are the corridors where Brado added additional rolling stock also in two terminals, so those are the corridors where Brado concentrated its investments for 2014.

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And in terms of EBITDA, Brado grew 23% in EBITDA reaching R\$19 million on the quarter and reaching almost R\$50 million accumulated nine months 2014.

When we go to slide 12, we see that our subsidiary Ritmo had another tough quarter volume wise. Volume went down like 32% and it is a result of some -- the discontinuation of some operations in dedicated operation business unit given the new prices set on these units, we will prefer to discontinue those operations. And also because of the intermodal business unit, which are -- where the scenario were very similar, the scenario we mention here for agricultural commodity transportation. Lower volumes and also very pressured prices on the spot market.

So at the end of the day, volumes went down and it will face a difficult environment in terms of pricing as well. Ritmo's EBITDA decreased 28% in the third Q, as compared to third Q 2013 and even in nine months the reduction is 35% EBITDA as compared with last year.

Moving to page 13, we see that our revenues increased, the consolidated revenues increased 5.7%, EBITDA grew 3.5% with EBITDA margins going from 53% to 52%. The net income, consolidated net income increased from R\$44 million to R\$139 million, a material increase. But remember that the low base of comparison of 2013, because we had the discontinuation of ALL Argentina, which had an impact in 2013 results.

And when we go to the capital structure, net financial debt/EBITDA, we see that our net debt/EBITDA ratio increased from 2.2 to 2.45 in nine months 2014.

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

Thanks, Rodrigo. Just some quick additional comments on the quarterly growth and our expectation for the next quarters. For the fourth Q, it's still early to anticipate condition for commodities demand. We believe that the market which is similar to the third Q.

For industrial products, we expect a more heavier scenario of ethanol exports and a positive contributions of Brado and the total volumes. Our rail operations' CapEx will get over our original guidance of 800 million in 2014 and should be between 900 million and 950 million in this year, reflecting our extraordinary investments in addition to recurrent organic CapEx.

In terms of the merger of Rumo, we will continue contributing and working together to the antitrust agency aiming to obtaining approval for the measures of Rumo as soon as possible. And again, the approval from the National Land Transportation Agency is a very important step to conclude this measure process.

With this, I conclude our presentation and put ourselves available for clarifying any doubts that you may have, and thank you very much.

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Questions And Answers

Operator

Thank you. The floor is now open for questions. (Operator Instructions) Mr. Ravi Jain from HSBC would like to make a question.

Q - Ravi Jain {BIO 16135293 <GO>}

Hi, good morning. I had a quick question on the spot yields. How do you see the spot yields in 2015 given that they were pretty weak this year? And secondly, can you remind us approximately how much percentage of your revenues are spot versus the contracted yields, please?

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

Ravi, good morning. When we look to next year, our negotiation process with clients normally start -- normally around November and goes until February, which was the period where the crop, the planted area starts to be more clear here in Brazil. So that's the time of the year we start to negotiate prices for next year.

When we negotiate prices, we are of course looking forward, looking to the prices, to expected freight prices for the next year, which is always a function of the size of the crop and things like that.

When we look to 2014, it's true that spot prices were below our take-or-pay agreement, but if you come back to 2013, spot prices were higher than our take-or-pay agreements on average. So this is part of the game.

I believe that during -- when we start to negotiate next year, everybody will be looking to the next year and it's too early to make projections about crop in Brazil, crop in US, because at the end of the day it depends on planted area and climate.

But it's very hard to imagine an environment like you had this year with sizable crop, record crop (Technical Difficulty)

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

(Technical Difficulty) So I believe it's another discussion, another negotiation and every year or we are below the agreement or above the agreement, so it's part of the game.

Q - Ravi Jain {BIO 16135293 <GO>}

Perfect. Thank you. And my second question was on the storage capacity that the farmers are using right now to maintain their crops, and as you mentioned they could be pressured, first, to serious impact in terms of the farmers will be forced to do start selling up whatever they had stored for the current harvest year. Will that be by the first quarter of next year when you start harvesting the next crop?

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

Yes. I believe this year we should have a big end of the year inventories. I mean, once there is a big agricultural commodity inventories on the countryside today and you know that when the next harvest begins, the storage capacity should be prepared, should be open to receive this new storage.

So at the end of the day, at some points these volumes should be exported and probably we should have our first quarter next year with more volumes, which is not typical normally the first Q --

Q - Ravi Jain {BIO 16135293 <GO>}

Right.

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

Of low season quarter.

Q - Ravi Jain {BIO 16135293 <GO>}

Perfect. Thank you. Thank you for that.

Operator

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

Q - Mark Suarez {BIO 16366613 <GO>}

Hi. Good morning, Alex and Rodrigo. Just to go back to your comments on the agricultural volumes. Can you give us a sense as how those volumes are tracking right now into October? And how should we think about corn volumes and ethanol traffic as we head into Q4, as you have this lower export traffic coming out of Brazil, obviously due to the U.S. and Canada's corn crop?

And I'm just wondering if you expect those exporting centers by the government to continue and to may be partially offset some of that decrease, if you will?

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

Yes, actually there were some productions in the third Q that should support exports in the fourth Q, but the scenario until now it's very similar with the scenario we saw in the third Q. But at the end of the day, it's hard to anticipate the next two months of the quarter and also first Q next year because you have important inventories on the country side, you have some pressure to open the space for the new harvest. So the dynamics of exports is not easy to anticipate in the next four months, let's say that way. But some pressure in some point we would see, because surely you must have the country prepared to receive the new crop in the mid of February and the beginning of March.

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Q - Mark Suarez {BIO 16366613 <GO>}

Okay. And so with that do you think that may we should start thinking about pricing, tracking below the inflation target as we head into 2015, you think there is maybe a bigger risk that assuring you those contracts that you have less leverage to push up those prices to the level that we saw in 2013?

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

When we look fourth Q, the price -- the freight questionnaire didn't change at least until now. I mean it's a scenario similar to third Q. For the next year, it's a completely different environment we are looking forward. We're looking completely to 2015 and it will depend on expectations of the crop, the fact that we will have a higher inventory at the end of the year tends to be a positive pressure on prices at the end of the day. So it's a completely new discussion. I wouldn't say that I expect price below the inflation for next year, but I mean it's too early to talk.

Q - Mark Suarez {BIO 16366613 <GO>}

Okay. And then the third question on the CapEx that we can -- I noticed breakthrough of your guidance here, I'm wondering what the difference is toward those investments and going towards. And maybe -- you can maybe clarify what the difference between the new guidance and the previous 800 million level?

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

Actually, Mark, we took some investment decisions here of doing some extraordinary CapEx as compared with our original plan. Basically, three different things. One is some CapEx that we are doing within -- in Port of Santos. This year, Port of Santos is not too much pressured, it's not very pressured because of the low demand, but you know that we are duplicating the way from Campinas to Santos, and it should start to be operational in April next year.

So we expect a very different demand scenario, we have more capacity also, so at the end of the day we decided two facilities inside the Port of Santos in order to be better prepared to capture in the next year those additional volumes.

The second important investment plan was related with the urban areas, the rail networks which cross urban areas and we are doing some CapEx of improving the tracks on urban areas, we know that these areas are very sensitive in terms of safety, you are all the time crossing with people with cars in roads, in streets. And this is also important in order we could keep some good speed in urban areas. So this is a project for 2014 and there is a part for 2015 also.

And the third one is our complex in Rondonopolis, which we're also doing some improvements on the facilities, also looking forward for the Wide Gauge Corridor for the duplication, for the additional volumes that it should bring to the system when duplication is completed.

Q - Mark Suarez {BIO 16366613 <GO>}

Okay. So is the rail duplication investment including the new guidance here?

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

No, this is part of our agreement with Rumo. So it's in a separate way.

Q - Mark Suarez {BIO 16366613 <GO>}

Okay. And then finally, obviously you know you had the ANTT should you made a decision on the transaction, which was positive. And so, I'm wondering should we expect a faster turnaround now from CADE given the decision by ANTT or how should we think about the timeline with regards to the merger here?

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

I believe that, of course the ANTT is the regulator and if someone that CADE heard and has important weight on -- to understand the regulatory environment, the aspects of rail operation, but I mean the CADE by the end of the day is a separate process and we are keeping contributing with CADE with more information, more -- with all the information they ask, because we are pretty sure that, at the end of the day, this merger will create more capacity, will increase efficiencies and we will eliminate bottleneck for all users of the railroad. So this is what we are trying to show to CADE, which is what we believe at the end of the day.

Q - Mark Suarez {BIO 16366613 <GO>}

Okay. That's fair enough. That's what I have now, guys. Thanks for your time.

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

Thank you.

Operator

(Operator Instructions) Mr. Stephen Trent from Citi would like to make a question.

Q - Stephen Trent {BIO 5581382 <GO>}

Good morning, Santoro and Rodrigo. Thanks for taking my question. Just one or two from me. Looking at kind of a repeat of the question on yields looking into next year, has your thinking changed at all on yields with respect to the potential for Petrobras to increase diesel prices? And in your forecast, are you making any assumptions about Petrobras moving the needle on diesel price?

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

Stephen, normally what we do is we set prices or negotiate prices assuming the same price of the diesel and our contract has an automatic pass through of the diesel on 30% to 40% of the diesel price increase.

So if the diesel price increase more than inflation, it's additional tariff growth if it below the inflation, it push down. So at the end of the day normally our negotiations to next year prices consider the same price of diesel with an automatic pass through.

Q - Stephen Trent {BIO 5581382 <GO>}

Okay, Rodrigo. Thanks very much. That's very helpful. And just one more question. I couldn't hear you too well when you mentioned the fourth quarter, you said something about higher ethanol exports if I'm not mistaken. I'm wondering if I could trouble you to repeat that comment?

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

No, actually in terms of ethanol, I mean during this crop season I believe we have no change in scenario, more or less the same scenario, the same exports. And of course, for next year this is another thing, but for this year the ethanol export should be below 4Q last year.

Q - Stephen Trent {BIO 5581382 <GO>}

Okay. That's very helpful. That was all from me. Thanks very much.

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

Thank you, Stephen.

Operator

Mr. Ravi Jain from HSBC would like to make a question.

Q - Ravi Jain {BIO 16135293 <GO>}

Hi. Thank you for the follow-up. One last question I had was, once you complete the duplication between Campinas and the Port of Santos and your additional CapEx from Rondonopolis, so with the additional capacity do you think that could put a slight pressure on your huge negotiations, because if you wanted a higher volumes do you think that could put some slight pressure on the yields?

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

Actually, Ravi, when we look through 2013, which is a more cheaper than 2014, we -- all the time we faced excess demand, more demand that we could attain because of our capacity, because of Board capacity, because of several supply restrictions that avoid us to transport all the demand. So we had more demand on agreements than at the end of the day we could obtained.

And this was the case for the last three or four years. And last year was an exception -- sorry, this year is an exception with a very low demand. So in a more normal scenario, in a more -- and remember that the crop in Brazil was not bad, the crop in Brazil was a good crop. And when we go into next year, probably we should have a high-end of the year

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storages, inventories, we should have another crop and probably I cannot anticipate that. But the scenario of beet big crops in Brazil and US normally do not happen very frequently. So in a more normal scenario, I mean, we should start to see the same (inaudible) any problems that we always had, more demand than capacity.

So I believe that the price, the spot price -- the freight price negotiations will vary based on next year expectations and it's early to say because we don't have the planted area, we don't have too much information on that, we will have more on that in the next two months, but I mean the expectations to pass through inflation at this point, it's something like that.

Q - Ravi Jain {BIO 16135293 <GO>}

That's helpful. Thank you so much.

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

Thank you.

Operator

I will 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>}

Okay. I just want to thank you all for participating on this conference call, and wish you all a great day. Thank you very much. Bye.

Operator

Thank you. This concludes today's ALL's Earnings Conference Call. You may disconnect your line at this time.

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