Q4 2014 Earnings Call

Company Participants

- Aurélio Pavinato, Chief Executive Officer
- Ivo Marcon Brum, Chief Financial & Investor Relations Officer

Other Participants

- Rodrigo Mugaburu, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good evening, ladies and gentlemen, and thank you for waiting. At this time, we would like to welcome everyone to SLC Agrícola Fourth Quarter of 2014 Earnings Conference Call. Today, we have with us Mr. Aurélio Pavinato, CEO; and Mr. Ivo Marcon Brum, CFO and Investor Relations Officer.

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

Also, today's live webcast, both audio and slide show, may be accessed through SLC Agrícola's website at www.slcagricola.com.br in the Investor Relations section by clicking on the banner, Webcast 4Q14. The following presentation is also available to download on the webcast platform. The following information is available in thousand of Brazil reais and in IFRS, except when otherwise indicated.

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

Now, I'll turn the conference over to Mr. Aurélio Pavinato, CEO. Mr. Pavinato, you may proceed.

Aurélio Pavinato

Good morning. We thank you, you all for participating in our conference call for the fourth quarter year end 2014 results. You may please move to slide two, where I would like to begin with the highlights of the year. Our net revenue reached R$1.5 billion, a new record and an increase of 27% against the previous year, due to higher volumes and better sales prices for all crops.

Adjusted EBITDA closed 2014 at R$320 million, 37% higher than 2013. Besides the increase in volume and sales price, improvement in EBITDA occurred also due to better yields achieved in the 2013/2014 crop year, in comparison to the 2012/2013 season. Due to the increase in EBITDA, we also had improvement on our leverage indicators means the ratio between net debt and EBITDA reducing during the year, closing in three times.

In slide three, we show the evolution in the March price of our land portfolio. In 2014, we carried out the annual appraisal for this asset, which shows increase in the average hectare price of 17.4%, adding up to R$3.19 billion.

Slide four brings the summary of the advance we obtained in our two joint ventures. With Mitsui, we grew the joint venture by contributing the operating of Perdizes farming as per material factor dated, August 11. With that, the JV is now operating at total of 38,500 hectares. We also made a capital increase of R$30 million to the JV with Soares Penido, again contribution in the same amount from the other party. With the objective of (4:35) increase of 11,300 hectares of planted area accrued in the 2014/2015 crop year in this joint venture.

Moving on to slide five, we bring a few charts to demonstrate gains obtain relates to operational efficiency. By measuring the evolution in our general and administrative expenses per hectare, we observed a reduction of 30% over the last two years. And in the analysis of hectare planted per employee, we obtained a gain of 22% in a continuous process of scale gains and dilution of fixed cost.

In slide six, we demonstrate that at the 2014/2015 crop, we have performed precision agriculture technique in a total of 178,000 hectares aimed to optimize the use of inputs and improve the performance of the crops. Also over the previous years, we have been reducing horsepower per hectare in our tractor use, what demonstrates our efforts towards achieving better results with the same resource.

Now, I will pass it over to the colleague, Ivo Brum, for further details on the financial results of the period.

Ivo Marcon Brum {BIO 16639894 <GO>}

Good morning. Please, you can advance to slide seven, where we demonstrate a summary of our income statement. As already mentioned by Pavinato, we had significant increase in both our net revenue and EBITDA with growth of 26.9% and 37%, respectively, against 2013. Despite the growth in the (6:46), we had a reduction in net profit of 27.4%, closing the year with R$70.1 million. This was due to the increase in our financial expense, which occurred mainly due to FX valuation linked to our accounts payable (7:06) to the dollar. Such evaluation will be compensating 2015 because once we pay the suppliers; we'll use to sell the FX forward according to our hedge policy. And this way we guarantee the FX of this – the revenue will be in the same level of inputs.

Also, it is important to mention that net profit of 2014 did not include contribution from the government minimum price policy related to the crop of cotton and corn from 2013/2014 crop year. This value will be booked in 2015.

You may now move on to slide eight, where you can see the breakdown of our net debt. Gross debt increased 13.8% in 2014, closing it at R$1.3 billion. The main variation occurred in the lines of Constitutional Funds applied in the working capital, where we were able to secure higher finances volumes against last year, at favorable interest rate of 7.51% higher. We also have increased in the line of export financing, (8:23) negotiation of one loan in the amount of R$159 million in long-term. The rule was taking dollar, with swap R$2.

Despite increase in gross debt, we have a drop in the ratio of net debt to EBITDA as already mentioned by Pavinato, closing the year at three times, due to the increase of R$8 billion (8:51) in our EBITDA against 2014.

I will give it back to Pavinato for the comments on the market outlook.

Aurélio Pavinato

Thank you. And we can move on to slide nine. Cotton prices remained relatively stable during the second semester of 2014, after a correction that happened in the first month of the year. As already mentioned several times in our conference calls, the Chinese policy is the main factor impacted the cotton market including on the demand side, because after a cycle of year's building and (9:34) the Chinese government changed it strategy, what affects both the internal and external markets.

Internally, the government started to make direct subsidy payments to producers in (9:50) region, closing the cotton purchase program. Also, it is reducing inventories through our auctions to the local industry. The current level of cotton price is (10:06) per pound is the low cost of production for the majority of the producers, but it does not incentivize the planting.

In the United States, which is the world's largest cotton exporter, preliminary forecast for our 2015/2016 point outs to a reduction of a 15% planted area according to the National Cotton Council of America. In China, according to the China Cotton Association, area should drop 25% in comparison to the previous year, thus accumulating a reduction of 31% in two years. In India, which is the world's largest producer of cotton, a reduction is forecasted at 5% according to Cotton Outlook. And in Australia, the planted area, which has already suffered a severe reduction of 55% at 2014/2015 crop year due to water shortage, is expected to remain at the same low level for 2015/2016 crop year.

Beside this reduction in area, lower price of cotton should also increase its demand and its competitiveness against synthetic fibers. After five years of production surpluses, this first estimate is permitted to infer debt in 2015/2016 the trend start to change and cotton consumption maybe higher than production, which will bring support to prices.

The production of high quality cotton concentrates in Australia, in United States, in Brazil, will suffer a significant reduction in 2015/2016. With debt curve in supply, we expect an increase in the premium paid for this type of product.

Soy price in Chicago presents a downward trend along the year of 2014, (12:27) from $13 per bushel to the current level of $9.7 per bushel. This was reflects of the record crop in 2014/2015 in the United States and to the current estimates of a big crop in Brazil and Argentina.

This should increase global Indian tariffs of the commodity from 66 million tons to 89 million tons according to USDA. Despite the increase in Indian tariffs one factor that is supporting price is the Chinese demand, which keeps growing at a strong pace. According to the USDA, China will consume 86.2 million tons of soy, growth of 7.3% as higher than the growth of around 5% on the two previous years.

(13:28) had a similar dragger, showing decrease in price in 2014, also due to building up in global stocks. Because of that, (13:39) first crop in Brazil dropped 6.5%, for the second crop this scenario is also of reduction, (13:50) 2.5% drop.

Corn prices in reais however in Brazil had an important recovery this month to the tax depreciation. In relation to the U.S., the first estimate for (14:09) point out to a reduction in corn area from 90.6 million acres to 89 million acres.

You may please move on to slide 10, where we demonstrate numbers relative to the performance of our fields in 2014/2015 crop year. At the moment, we had approximately 30% of our soybean harvest and we validated initially estimated yields of 3.120 tons per hectare, an increase of 7.1% in relation to the previous crop is occurred mainly to the improvement in rainfall levels in the region by ENPOE (15:00) in 2015 in the comparison the last two years.

However, we made this estimate in the yields of the corn first crop, in relation to our initial forecast, giving the lack of rainfall in December and January. However, it's important to highlight that corn first crop yield (15:23) only 5.1000 hectares or 1.4% of the total planted area.

Crops of corn second crop in cotton first crop and cotton second crop in the other hands represent good development and we are confident to deliver yields according to the first estimate.

Finally, you can advance to slide 11, where we bring a table. We see our hedge position for 2015. Due to our hedging policy, which requires that sales prices start to be locked, when we start buying inputs, we were able to achieve the average of hedge prices at a level significantly higher than current market prices, exactly because we start to sell production at the first semester of 2014, when prices were higher.

Initial expectation was that 2015 would be a year of lower margins. However, Brazil's agriculture production is benefiting from the real depreciation, which began in the end of 2014. This is offsetting lower commodity prices in dollar, considering that part of our costs of productions is in reais and the 100% of the revenue are in dollars. That said, the current expectation is that we should randomize (16:56) similar or even better than 2014.

In summary, a change in FX level is very favorable for agri business in Brazil. Thank you. And now we open for questions.

Q&A

Operator

Ladies and gentlemen, we will now initiate the question-and-answer session. And our first question comes from Rodrigo Mugaburu with Morgan Stanley. Please go ahead.

Q - Rodrigo Mugaburu {BIO 20980025 <GO>}

Hi. Thanks. Looking at your hedge table, it shows you have nothing hedged for the 2015/2016, I'm talking about soybeans. If you can talk a little bit about the strategy, how do you see that evolving, are you going to wait and see if prices move up or as soon as you start hedging the costs, you're going to start selling some of that position? Thanks.

A - Aurélio Pavinato

Rodrigo, when we ever start to buy inputs, we tend to start to sell the production as well. According to our policy, our strategy and consider the pricing level today, with the exchange rate today, if you're going to buy inputs in reais, you are going to hedge a very good price in reais. If you buy the inputs in dollar, we will now (18:43) price in dollar. As we talked during the conference in Portuguese, our cost in dollar will reduce next crop year. So we are considering that if it is level price, we will be able to have a good margin starting in 2016.

Q - Rodrigo Mugaburu {BIO 20980025 <GO>}

Good. Thanks.

Operator

As we have no further questions, this concludes today's presentation. You may disconnect your line at this time and have a nice day.