Q2 2014 Earnings Call

Company Participants

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

Other Participants

- Kevin Kazinski, Analyst
- Mark Suarez, Analyst
- Ravi Jain, Analyst

Presentation

Operator

Good morning, ladies and gentlemen. At this time, we would like to welcome everyone to our America Latina Logistica, ALL, second quarter of 2014 Earnings Conference Call. Today with us we have Alexandre Santoro, CEO and Rodrigo Campos, CFO and IRO for ALL. We would like to welcome 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. At that time, further instructions will be given. (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 the general economic conditions, industry conditions and other operating factors could also affect the future of ALL and could cause results to differ materially from those expected in such forward-looking statements.

Now I'll turn the conference over to Mr. Rodrigo Campos, CFO and IRO for the company for a brief explanation of how ALL figures are presented, and then Mr. Alexandre Santoro, CEO, who will start the presentation. Mr. Campos, you may begin the conference.

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

Thank you. Thank you, everyone for holding the ALL conference call. Just a brief comment before we start the presentation, just to remember that results from 2013 still have an effect from operations from -- of ALL Argentina and these results are showed in a separate line called results of discontinued operations, okay. So just with that I would like to transfer to Alexandre Santoro for segment results [ph].

Alexandre Santoro {BIO 7120418 <GO>}

Thanks, Rodrigo. This is Alex Santoro; our quarter could be summarized in four highlights. The first one is the volumes were weaker than expected in a top demand scenario, and interruptions in several rail segments due to excessive rainfalls. The yields was offset by depressed levels at spot market freight price. Some good news are that, it was our best half year in terms of operational safety and when I talk about the measure, with Rumo, the notification of the operation was filed in the Antitrust agency here in Brazil.

Go in more details, our rail operations results were weaker than initially expected, increasingly almost 1% against last year, mainly due to a very tough demand scenario in the quarter as China's reduces abruptly its grain import for Brazil, affecting transported volumes and yields throughout our rail network. In addition, excessive rain falls in June of 2014 interrupted several rail segments in the South Region of Brazil, which restrained operations to the Port of Sao Francisco and Paranagua and interrupted the route from Sao Paulo to Rio Grande do Sul for about 10 days.

In terms of the rail operations, average yield, it grew 4.4% in the second quarter, supported by the tariff set in our take-or-pay agreement and partially offset by the depressed levels export markets freight prices. Spot market freight price decreased approximately 13% in the Wide Gauge corridor from Mato Grosso to Santos and 21% in the Parana Corridor, which are the most, the two most important corridors that we operate. With prices in our contracts running above spot market prices, a large portion of our clients decided to operate on the inferior limits of our agreement, which usually represents 90% of contracted volumes.

The consolidated EBITDA grew 0.2%, reaching almost BRL580 million. As a result of a flat performance in our rail operations, an increase of 40% in Brado Logistica EBITDA and the decrease of 51% in Ritmo Logistica EBITDA. Brado continue its ramp up in the second quarter and presented a volume growth of 18%, reaching 18.6 thousand transported containers. This growth was mainly driven by the Wide Gauge and Parana Corridors, where the company added rolling stocks for 2014, and where the major part of investments are concentrated.

Ritmo Logistica had another tough quarter as volumes decreased 33% in the second quarter and EBITDA grew up 51% to BRL3.4 million, pushed by both Intermodal Business Units and Dedicated Solutions Unit.

Moving for the next slide, the slide number five; the net revenues increased 4%, 4.1% when compared to the second quarter, reaching BRL1,076 million. In the first half of the year, the net revenues grew almost 6% and achieved BRL1.9 billion in this first half. Our consolidated EBITDA reached BRL579 million, a flat growth in the second quarter against the second quarter of the last year.

Our Rail operations contributed with a 0.9% EBITDA growth and Brado posted an improvement of almost 40% year-over-year in this period, while Ritmo Logistica EBITDA partially offset it. Our consolidated net income was about BRL93.8 million in the second quarter, against a negative BRL74.4 million year-over-year.

Now I would like to pass over to Rodrigo, who will discuss the results on our business unit Brado and Ritmo, as well as the financial consolidated highlight. Thank you.

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

Thank you, Santoro. Moving to slide six, where we discuss results for Rail Operations. We see that volumes in the Q2 2014 increased 0.9% as compared to Q2 2013, mainly driven by an increase of 4.6% in industrial volumes, partially offset by a decrease of 0.1% in agricultural commodities. In the first half of 2014, volume grew 1% as compared to the same period of last year.

When we go to the net revenues, Net revenues increased 5.4% in the Q2 with a 4.4% yield growth in rail operation. Then EBITDA was mainly in line with the EBITDA we had in the Q2 '13, reaching BRL560 million.

When we go to agricultural commodities, as Santoro said, volumes were pretty much in line with the same period of last year, and of course we expected -- and we were prepared to grow more than that and we expected a better quarter in terms of volume growth. But the volumes in the Q2 were impacted by the China, the reduction from -- the import reduction from China. China, at the end of April cancelled some vessels, which were expected to dock in Port of Santos and Port of Paranagua in May and June. So China imports impacted exports in May and June, but actually in a way that affected transportation of agricultural commodity since April. So, it reduced the demand and also impacted spot market freight prices. When we look to the spot market price crisis in the Wide Gauge system which go from Mato Grosso to Santos, the prices were 13% below last year.

And when we look to the Parana Corridor from (inaudible) to Paranagua Port and to Sao Francisco the freight price went down like 21% as compared to the last year, so important price drop in our main corridors. With that the clients also went to the minimum volumes of the contract. They used the margins we have in our agreement, went to the minimum volumes of our take-or-pay agreements. So at the end of the day it also impacted our volumes.

And at the end in the south of Brazil we suffered also with a lot of rain in June, specifically, some cities in Rio Grande do Sul, Santa Catarina and Parana were impacted, were isolated for some period. And in terms of our rail operations, we faced several restrictions and in some point even some interruptions of our operations during June in the south of Brazil.

So at the end and going to slide eight, we see the covered net revenues grew 5.7% in agricultural commodities as compared with Q2 2013 and our EBITDA was basically in line, it increased to 0.4%, as compared to the Q2 2013, reaching BRL473 million and with our yield growth of 5.8% earlier due to lower than inflation in agricultural commodity.

When we go to industrial products, which are shown in slide nine; volumes increased 4.6% as I mentioned in Q2, basically in two segments; containers where our volumes increased 25% and it's very related to our Brado operations, and in wood and paper products where volumes grew 29%, so these are the segments which supports the volume growth in industrial segment.

When we go to page 10, we see that net revenues of industrial products increased 4% in Q2 '14 as compared to the same period of '13 with a huge decrease of 0.5%, which we explain basically by the change in mix of transported volumes with our increasing -- in Brado in containers, and an increase in wood and paper at the end of the day. And EBITDA marginally decreased as compared to the Q2 2013 from BRL89 million to BRL88 million EBITDA in the quarter.

Now we will go to Brado, Page 11, we see that Brado had a very good quarter in terms of volume growth. The number of containers transported increased 18%. When we consider RTKs, which consider also the distance transported, net volume, as I mentioned, increased 25%. So a good volume growth and these -- the volume growth are very concentrated in two corridors; Parana Corridor, where the volume grew 37%, and in the Wide Gauge Corridor from Mato Grosso to Santos where volumes increased 36%. And those are the corridors that Brado concentrated its investments.

In rolling stock, an additional rolling stock for this year and also in terms of terminals remember that in the Wide Gauge system, Brado have a new -- the new terminal in Rondonopolis, and also Brado has expanded the terminal Brado -- Brado have been in Cubatao, near to Santos and to put (inaudible).

And in the Parana Corridor, Brado also expanded the terminals in Cambe. So at the end of the day we are in line with Brado's plan when we see this year. And EBITDA grew 40% in the Q2 '14 from BRL11 million to BRL15.5 million. And if we take the whole year, the first half of 2014 Brado EBITDA is growing 40% as compared to the last year.

When we go to slide 12, which give the details of Ritmo Logistica results; we see that Ritmo didn't have a good quarter. It has a very tough quarter, explained by an important reduction in volumes, 34% reduction in volumes, which is part related to the Dedicated Solutions segment, where we have operations from mainly due to specific clients.

And here, we leave some operations given that those operations didn't reach our standards of return, and also that there was an important reduction in the volumes of Intermodal operations, very impacted by the reduction of demand we mentioned in the Q2 and also for the reduction in spot market prices and restricting businesses is a basis that margins are small and with these reductions in spot market prices, it has also impacted results [ph]. So at the end of the day, EBITDA of Ritmo decreased from 7.1 million in the Q2 '13 to 3.4 million in Q2 '14.

Moving to slide 13, we see that consolidated revenues increased 5.9% in the first-half 2014. EBITDA, which show -- consolidated EBITDA, which showed in slide 14, increased 4.8% in the first half, reaching BRL1.024 million with a margin of 52%, EBITDA margin.

And net income which is shown in the slide 15 increased from 40 million negative, to 100 million positive.

Remember that last year we had the impact of our -- of the operations of ALL Argentina, so which explains in large part this net income increase. And when we look the net debt-EBITDA ratio shown in the slide 16, we see that we ended the first half '14 with a net debt-EBITDA ratio of -- little bit under 2.4 times EBITDA.

With that I'd like to transfer the word [ph] to Alexandre Santoro.

Alexandre Santoro {BIO 7120418 <GO>}

Thanks Rodrigo; just some quick additional comments on the quarter results and on our expectations for the next quarters. The perspective should improve for the second half as the grain exports should recover to its normal course and sugar volumes are expected to increase throughout Paranagua Port. Moreover, we have a better operational scenario than we faced last year as the unloading restrictions we had at the main grain unloading terminals in (inaudible). They are already fixed and operating at capacity since the beginning of the year.

In spite of that, the second corn crop is expected to decrease its production area year-over-year. When we compare to the Q3, we now have the capacity to load the Rondonopolis, the major part of the agricultural commodity volume that we were loaded before at Alto Araguaia terminal, increasing average transported distance.

And as I said before, we had our best half of the year in terms of operational shift. And this is the most important operational CPI and show us that we are operationally ready to perform a better third quarter.

And the last thing, talking about the merger with Rumo, in April 15th [ph] and May 8th [ph] date, our Board of Directors and ALL shareholders approved respectively, the proposal sent by Rumo Logistica aiming to combine our operations with theirs, through the merger of ALL's shares into Rumo. The merger is still conditioned to previous approval of the Brazilian Antitrust Authority and the National Land Transportation Agency, as well as other precedent conditions. The notification of the operations in CADE, the antitrust agency was filed in July and now follows the usual procedures of approval. If all these conditions were achieved, ALL shareholders will own 63.5% of the new company shares after the completion of the merger.

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

Questions And Answers

Operator

Thank you. The floor is now open for questions. (Operator Instructions) Mr. Mark Suarez from Euro Pacific Capital would like to make a question.

Q - Mark Suarez {BIO 16366613 <GO>}

Yeah. Good morning guys, and thanks for taking my questions here. And just maybe to go back and talk about your volume mixture, looking forward and giving your announced merger with Rumo, should we start thinking about sugar volumes now becoming larger part of your business in terms of both revenues and railway capacity to the Port of Santos?

A - Alexandre Santoro {BIO 7120418 <GO>}

Mark, I believe that it's naturally to expect the sugar volume expanding, remember that we need that project with Rumo exactly extracting that. We have the duplication that will be completed in March, which will increase a large capacity of the system and specifically on this quarter, the mix of sugar and soybean increased a lot in favor of sugar, also because we didn't grew a regular grow as expected in soybean, and because of these problems, the demand problems we have. So, I would say that it's natural to expect growth in sugar, but also in soybean, and soybean and grains, specifically soybean and corn and specifically this quarter we didn't grow as expected in soybean and corn.

Q - Mark Suarez {BIO 16366613 <GO>}

And do you have like a target range of or an estimate of how much that will be as a proportion of total revenues; that is sugar, I mean?

A - Alexandre Santoro {BIO 7120418 <GO>}

No, actually, we have a big potential of growth of sugar in the state of Sao Paulo, there is big demand there, which they transported by trucks to the parts of the potential of growth in sugar and wheat [ph]. We have a much smaller market share in sugar if you compare with grains, certain important potential of growth is for -- it depends on quarter on the operational condition on rail and ports which will depend in a lot of things. On the long term, of course, we have a smaller market share in sugar than we have in the grains, but we still have a big potential in both segments.

Q - Mark Suarez {BIO 16366613 <GO>}

Okay. And you also mentioned and we know from past discussions that obviously sugar has a shorter haul. I would say, transportation and then soybean, for example, on average as you're going from Mato Grosso to the Port of Santos across to the inner Sao Paulo to the port. Can you give us a sense sort of the marginal, the margin difference between a car load of sugar, vis-a-vis that of soybeans, is there like a number you can sort of give us in terms of EBITDA, so that we have a better sense of what the margin difference are between those two commodities?

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

I don't have exact numbers here Mark, but there is a natural difference in margin always because of the distance. We have a higher distance in Mato Grosso than we have in the state of Sao Paulo. So probably a 5% to 10% difference depending on the region, depending on the route, more or less ranging from 5% to 10% margin --

Q - Mark Suarez {BIO 16366613 <GO>}

Okay. That's very helpful. And then finally on the agriculture volumes, now as we're going into the third quarter, you mentioned you expect to see an improvement. How shall we think about corn volumes and (inaudible)coming up, do you feel that maybe, those volumes to be stronger than what we typically see in a third quarter, over the past, let's say five, six years or what have you -- what you hear that could be stronger than seasonally normal this year vis-a-vis last year; what are your thoughts on that?

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

Mark, when we look to the corn crop, specifically, the second corn crop, we should have -- the last two years we have a very strong second corn crop, which was good and we still expect a very huge corn crop in the south of Brazil, in Parana -- main Parana. In Mato Grosso, we expect our second corn crop lower than last year, but still very good corn crop if you go historically. Also, I mean, we should have more soy meal throughout the year, because this year with all this points we mentioned about China and also because of the price of agriculture from other grains' internal market. The traders decided to crush much more soybean, then if you compare with last year, for example, so when we took to the mix of this year, we should see more export of soybean meal and less exports of soybean grain. So the mix should change which from some point of view, the soybean meal exports go throughout the year instead of have a peak on the harvest season, so it's a positive trend also.

Q - Mark Suarez {BIO 16366613 <GO>}

That's great. That's good for the agri, for the call that you provided here now. Just to follow up on that part of my last question, you talked about Ritmo, you talked about the Intermodal volumes going down because of agricultural -- the decrease in agricultural loan, should we expect then maybe a rebound in Ritmo in the third quarter, if we have a strong quarter volumes, or is that mostly correlated with soybean, if you were, what commodity sort of drives that out of that Ritmo business?

A - Alexandre Santoro {BIO 7120418 <GO>}

Yes. With the Intermodal segment, yes, I mean, once this spot market price recovered, once Intermodal market recover, we expect an improvement in Ritmo in the Intermodal segment. In the Dedicated Solutions segment we really lease some operations, of course, we are looking for another one, but we are very disciplined in our return targets to get new operations. So, in Dedicated Solutions you have really a reduction on volumes as compared to last year.

Q - Mark Suarez {BIO 16366613 <GO>}

Right. Okay. That's great. I'll get back in the queue guys. Thanks. Thanks for your comments.

Operator

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

Q - Kevin Kazinski

Hi. Good morning guys. Thanks for the time. This is Kevin Kazinski stepping in for Stephen Trent. And most of my questions were answered, but just I had a question, I don't know if you've mentioned during the call, but is there any update on when you expect the port operations to normalize following last year's accidents, fire; that they -- have they already normalized or do you expect them to normalize like 3Q, 4Q?

A - Alexandre Santoro {BIO 7120418 <GO>}

Kevin, we actually -- let's remember that in last year which we had some important problems on the grain terminal at the port. So TGG, which is the most important terminal for rail unloading, was partially non-operational because of a fire that you had last year. And also the terminal 39, which is the second most important, was affected by a ship which hit its ship loaders. So at the end of the day, when we compare this year with next year, the scenario -- the port scenario are much better, it improved a lot as compared with last year.

So we have all the grains terminals working at full capacity and I'm not sure if you are talking also about the fire in the sugar terminal, which happened recently in the Port of Santos, but it was a very small one. It affected more one terminal and more on the trucking operations, the unloading trucking operations. So it will not have any material impact in our operation. So the port scenario should be much better than the scenario we faced last year.

Q - Kevin Kazinski

Okay. Understood. Also I just wanted to confirm that, basically all the problems from last year have already kind of were still not (inaudible). Okay, and then just kind of, I guess, the big question is on the merger and Rodrigo gave us a pretty helpful update on that. I was just wondering, you have any kind of timeline and expectations for approval from CADE and the ANTT?

A - Alexandre Santoro {BIO 7120418 <GO>}

Yeah. We don't have a timeline, of course, we are doing everything which is possible to have which then sooner as possible at the end of the day. And what we did was to file the operation at CADE. CADE has a legal term that they can analyze the process, which is the legal limit is 330 days. But we are providing all the information, we have been very proactive giving CADE all the information in order CADE just could make its analysis at a much smaller time than that. So I cannot anticipate a time or I can, where I can tell you is that we are doing everything which are in our hands to have all the approvals done in the short term.

Q - Kevin Kazinski

Okay. Thank you. I mean, just so I guess you think it's the CADE is going to be the bottleneck, I guess, like their approval. You can think of --

A - Alexandre Santoro {BIO 7120418 <GO>}

Yeah. I believe so.

Q - Kevin Kazinski

Okay. Okay. Thank you very much.

A - Alexandre Santoro {BIO 7120418 <GO>}

Thank you.

Operator

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

Q - Ravi Jain {BIO 16135293 <GO>}

Hi. Good morning. I just wanted to kind of get a better idea of how you are seeing the spot freight prices now in July, and what is the expectation for the third and fourth quarter? Are you seeing clients getting more normalized from -- in their volumes instead of going for the minimum volume undertake in their agreements, or is it already got more normalized in the month of July?

And my second question is on CapEx, the first half has been pretty strong on the CapEx front, so what is your overall 2014 expectation now for CapEx this year?

A - Alexandre Santoro {BIO 7120418 <GO>}

Ravi, in terms of freight prices I would say that freight price recovered as compared to the Q2, but are still under our take-or-pay agreement more or less. In terms of CapEx, we still have the expectations of 800 million when we consider ALL of operations, of course, without considering on that the CapEx related to the duplication from Campinas to Santos, which is the tracks, which is related to our agreement with Rumo.

Q - Ravi Jain {BIO 16135293 <GO>}

Perfect. That's helpful. Thank you.

Operator

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

Q - Mark Suarez {BIO 16366613 <GO>}

Hi. Thanks for taking my questions again. I, Rodrigo, maybe we can, I don't know if you mentioned this in the call, I don't believe I heard it, in terms of the rail duplication, I know that you guys now have the operational license. When do you expect to complete the double track project and have your CapEx budget changed at all from last quarter?

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

Mark, we expect to have this duplication of operation in May next year.

Q - Mark Suarez {BIO 16366613 <GO>}

And is your CapEx budget towards that duplication is same as last quarter?

A - Alexandre Santoro {BIO 7120418 <GO>}

Oh! Yes.

Q - Mark Suarez {BIO 16366613 <GO>}

Okay. And then finally on the capacity expansions on the sugar terminals; I know, you've alluded to the fact that maybe that to be expanded. Is there any progress there, any updates you can give us from in that front?

A - Alexandre Santoro {BIO 7120418 <GO>}

Yeah. The operation at sugar (inaudible). Of course, the increase of volumes of sugar was like these improvements also.

Q - Mark Suarez {BIO 16366613 <GO>}

Okay. Great. That's all I have for now. Thanks. Thanks again.

Operator

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

Q - Ravi Jain {BIO 16135293 <GO>}

Hi. Thank you. I just have one final follow-up question. It's basically on the financial expenses line of your income statement. Of course, there has been an increase versus last year in the last few quarters. Is there any other reason apart from the higher interest rates and higher debt. I mean, I'm looking more particularly on, have there's been more or less expenses that you are paying to Rumo and now that litigation is ended, should we expect lower financial expenses or should it remain at these high levels in the next few quarters?

A - Alexandre Santoro {BIO 7120418 <GO>}

Yeah. Ravi, there was a part of this increase which related to interest expenses and part of this increase is compared with last quarter which related to Rumo operation. We have 30 million [ph] relate to -- of the increase, which is related to higher interest provisions related to Rumo operation. You remember that there is start of the Rumo -- the accounting of Rumo part goes on the course from length of rolling stock; part of the account is accounted like a financial means, which you increase your PPEs and you have a batch which pass through the interest expenses. So there was an increase related to these -- to the Rumo operations. Of course, we are on the crop season -- now in sugar, we reach the demand in the Q2 were higher than in the Q1. So we have more interest expenses.

And here we have the final CADE decision, both companies calculating a separate company, so the accounting of our interest will depend on the demand of sugar quarter by quarter by the end of the day. So you don't operate as a consolidated company until CADE approves.

Q - Ravi Jain {BIO 16135293 <GO>}

Got it. Thank you. That's helpful.

Operator

(Operator Instructions) I'll turn over to Mr. Alexandre Santoro for final considerations. Mr. Alexandre Santoro, you may give your final considerations.

A - Alexandre Santoro {BIO 7120418 <GO>}

Just want to thank you all for participating on this conference call and have a great day. Thank you.

Operator

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