

Y 2018 Earnings Call

Company Participants

- Julio Fontana Neto, Chief Executive Officer
- Ricardo Lewin, Chief Financial and Investor Relations Officer

Other Participants

- Alberto Valerio, Analyst
- Bruno Amorim, Analyst
- Lucas Barbosa, Analyst
- Pedro Bruno, Analyst
- Victor Mizusaki, Analyst

Presentation

Operator

Good afternoon, ladies and gentlemen. At this time, I would like to welcome everyone to Rumo's Fourth Quarter and 2018 Results Conference Call. Today, the conference call will be conducted by Mr. Ricardo Lewin, Chief Financial and Investor Relations Officer, with the initial statement of Julio Fontana, Rumo's CEO. 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. (Operator Instructions) The audio and slides show of this presentation are available through 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 1996. 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 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 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. Julio Fontana. Sir, you may begin your conference.

Julio Fontana Neto {BIO 3872510 <GO>}

Good afternoon, everyone. I'm Julio Fontana, CEO of Rumo. First, I would like to thank you for participating in Rumo's fourth quarter 2018 conference call. It's a pleasure to share our 2018 results review. Please let's start our presentation on Slide 3. This year was remarkable for Rumo. The results we delivered in 2018 consolidate a four-year turnaround and represent the achievement of the ambitious objectives defined when we merged with ALL in 2015. For the first time, Rumo posted significant net income and positive free cash flow, leaving behind periods of cash consumption while reaching a comfortable 2.2 times net debt/LTM EBITDA, ready to support future CapEx plan.

2018 was not easy. In May, the national truckers' strike compromised our terminals supply and resulted a loss of volume and EBITDA that quarter. At the same time, the corn crop, particularly in the South Region, fell short of expectations. Even so, we delivered results very close to the guidance ceiling on the back of a strong soybean crop, efficiency and capacity gains.

As for 2019, we maintain committed to delivering our long-term plan announced to the market three years ago. The year had a very positive start with a soybean harvest beginning in early January, which is normally expected at the end of the month. Prospects for the corn crop in the second half of the year are favorable as well. Our operations are ready to meet the growing demands of agribusiness and other sectors of Brazilian economy, which are expected to record growth in 2019.

I'm very pleased with our 2018 results as well as with the performance of the Rumo team, who executed the business plan with discipline. As a result, Rumo heads toward the end of the turnaround cycle to pursue a new one, the growth cycle. As announced, we started this succession process of the Executive Board, and we remain active at Rumo on a daily basis until November 2019. After this period, I will remain close that through this leadership of Rumo's operational (inaudible). In this new cycle, we will continue doing our best to pursue good projects and grow our business, while delivering robust return to our shareholders.

I will now pass over to Ricardo Lewin, Rumos's CFO, who will conduct our presentation. Thank you.

Ricardo Lewin {BIO 20342706 <GO>}

Thank you, Julio. 2018 proven to an outstanding year for Rumo. In a year that presented a numerous challenges, Rumo delivered results very close to its guidance ceiling, evidencing our deep commitments to maintaining operations at a high level. In this quarter, we booked the provision of BRL72.5 million due to the impairment in the West Network. That's not recurrent and has no cash effect, but led us to report an adjusted EBITDA according to Instruction CVM 527/2012.

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In the next few slides, we will be presenting number using the adjusted EBITDA. Due to the current public offering of local bonds, we will now disclosure our 2019 guidance. In addition, a long-term guidance that has already been announced is temporarily suspended. Please let's move to the next slide. Our transported volumes grew by 13% in 2018, mainly due to our record soybean crop that boosted grains performance. On top of the harvest, Rumo has shown its ability to deliver other initiatives to our (inaudible) volume growth.

Northern Operations recorded a 127% higher volumes in fertilizer transportation. New contracts boosted our pulp volumes by 83%, and we continued to develop our container operations factoring backhaul in the domestic market and imports.

On the next slide, I would like to share with you a relevant change in our pricing model. Over the last month, we have implemented change in our pricing system for the grain chain. Previously, our grain contracts were basis on a long-term three-year contract considering an annual growth with the change on the market chain dynamics mainly the relationship between farmers and tradings. Our clients realized that the high commitment and risk of this season could affect that.

To have a business scenario, we have agreed to reduce contract terms to enhance trading visibility towards competition, while raising the penalty for the fall of volumes contracted from 50% to 70% of the net revenue. Another relevant change implemented by this new model is that the take or pay is now monthly and collected on a quarterly basis, making volumes recovery not a possibility. This model represents a balance of pros and cons and has been well received. Above all, it will help us in our growth strategy.

Please let's move to Slide Number 7. In 2018, we achieved a very consistent EBITDA, which grew by 18% year-over-year. The EBITDA margin reached 49.2% reflecting our Company-wide effort to dilute fixed cost and improve locomotive efficiency decreasing fuel consumption. Analyzing our individual business units, the North Operations recorded continued high profitability. The South Operations, even though having faced constraints due to a reduced corn crop, continues evolving to deliver improved results, and the container operations delivered its first year of positive results by taking advantage of backhaul freight, increasing transportation volumes in the domestic market and import cargoes.

Moving to Slide Number 8, we will discuss our financial results and cash generation. As a result of 2018 efforts to cut that cost, Rumo decreased its financial expenses by 27.4% and a cost of its broad net debt by 29%. In the fourth quarter '18, we've been achieved from our yield curve growth, which resulted in a positive MTM effect of BRL129 million. Such financial result evolution, coupled with EBITDA performance, enabled Rumo to generate cash before amortizations and funding for the first time, leaving behind periods of cash consumption to make sure they deliver on our CapEx plan. In 2018, we also reported our net income of BRL273 million for the first time.

Let's move to the next slide to discuss our consolidated indebtedness position. As a result of our operational and financial deliveries this year, we ended 2018 with a leverage of 2.2

times net debt-to-EBITDA. This level is very close to the ideal net debt-to-EBITDA for Rumo, which enabled us to finance future projects and bring a higher return to shareholders. With this, I finish our presentation and remain at floor to provide any clarifications.

Before finishing, I'd like to reinforce that due to the current public offering of local bonds, we cannot answer any question related to future assumptions or any forecast. Thank you very much.

Questions And Answers

Operator

Thank you. We will now begin the question-and-answer session for investors and analysts. (Operator Instructions) Our first question comes from Pedro Bruno, Santander.

Q - Pedro Bruno {BIO 19082978 <GO>}

Hi, good afternoon. Julio and Lewin, thanks for taking the question. I have two questions actually. The first one is on the yield year-over-year variation, if you could help us understand that negative effect on the yield, I understand there is the fertilizer volume ramp-up, which I should explain part of it as you gained share -- gains share within the mix with a lower tariff as it, of course, occupies previously idle capacity in the backhauling, but if there is anything else that you can add to help us understand that movement. That would be the first one.

A - Ricardo Lewin {BIO 20342706 <GO>}

Hi, Pedro. Thank you for participating of the call. Let me give you a complete explanation about the yield. So it was clear for you and the market. Honestly, the explanation in two pieces, okay? The first one is planned in Northern Operations and second in the Southern Operations, okay? In Northern Operations, there is different mix with more pulp and fertilizer that brought both fourth quarter and 2018 average yield down. As long as the tariffs for those crops are lower, then they average for the ALL operation, okay? It is worth to mention that although it has lower tariffs, margins are higher. Also, due to their high volumes, we also served more volume in other terminals besides Rondonopolis which in turn had lower tariffs.

On top of that two reasons that I explained, we also have changed the way we priced range throughout the quarter. So in 2017, we basically had one price for soybeans in the first half and one price for corn in the second half. That's usually below the price of -- soybean prices, okay? In 2018, we decided to price differently by quarters. So there were two prices for soybean in the first quarter and two prices for corn in the second quarter, following international prices for commodities. For example, for corn, prices are typically higher in the third quarter than in the fourth quarter, while in the third quarter, we had beginning of the harvest; in the fourth, the end of the harvest, okay? So this change in the price methodology added to the reasons that I mentioned in the beginning caused a year-to-year growth in the tariffs, okay?

For the South Operations, the lower yields in the quarter were caused by a mix with less sugar, sugar that has higher tariffs for that quarter and also because due to lower cost of corn in Parana and State of Mato Grosso do Sul. In this sense, we served more volume in Brazil and Sul states, which typically had lower tariffs than Parana and Mato Grosso. But I would like to reinforce that although we have lower yield, the margins are much higher than we presented in last year.

Q - Pedro Bruno {BIO 19082978 <GO>}

That's perfect. Thank you very much, Lewin. My question would be potentially for Julio. More strategic one in the context of turning the page from being a turnaround story towards being a growth story as Julio mentioned, how do you see the North/South Network strategically within the context that should be coming to the market soon? That's the second one. Thank you very much.

A - Ricardo Lewin {BIO 20342706 <GO>}

Pedro, sorry for the question. This is Ricardo, okay? Julio is here, my side, but I will answer that, because unfortunately due to the local debenture issuance, which the (inaudible) posted to the Rumo's website, we are in the quiet period and we cannot commit to talk about future assumptions of the Company, give any guidance also to future projects of the Company. So we cannot disclose any additional information about this issue.

Q - Pedro Bruno {BIO 19082978 <GO>}

Understood. Thank you.

Operator

The next question comes from Bruno Amorim, Goldman Sachs.

Q - Bruno Amorim {BIO 17243832 <GO>}

Hi, good afternoon. Could you please provide us with an update on the take-or-pay contract that you have probably closed until December with your main clients. I understand you cannot provide guidance, but any color on the kind of agreements that you have closed could be helpful. Thank you very much.

A - Ricardo Lewin {BIO 20342706 <GO>}

Bruno, this is Ricardo. Thank you very much for the question. We gave in the call some explanation about the take-or-pay. I will talk a bit more about that. We just -- we are not disclosing how the process is going on, mainly because of this is commercially than strategic, okay? So just -- and I'm repeating here a bit about what we've told you in the presentation. Our previous grain concepts, they have basically three -- there were three-year land agreements that also we classed a high commitment with volume growth by both sides, okay? With the change in the market dynamics, and when I tell, this is mainly the relationship between the farmers and the tradings, our clients realize that on the top of the harvest-risk there had also a list of higher competition among the trading companies, which created additional margin pressure for them.

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So to address this scenario, we have been studying this new price system for -- over the last two years. We have our right to reduce contractual terms. So we enhanced the trading visibility towards the completion, while also raising the benefits for the contracts as we -- that went from 50% in the past to 70% in this new agreement, okay, 70% of the revenues. And about the relevant change that we can talk here that was implemented by the new model was, the take or pay is now monthly and collected on a quarterly basis, making the volumes recover not possible, and so make less volatile for us. This is what we can tell you by now about the take-or-pay contracts.

Q - Bruno Amorim {BIO 17243832 <GO>}

Okay. Thank you very much.

A - Ricardo Lewin {BIO 20342706 <GO>}

Thank you.

Operator

Our next question comes from Lucas Barbosa, Morgan Stanley.

Q - Lucas Barbosa {BIO 20835372 <GO>}

Good afternoon. Thank you for taking my question. In the release, you have mentioned that early exports of corn have given the -- you've mentioned early exports of corn given the anticipated soybean crop. I just wanted to hear your thoughts on how you see the grain inventory in the beginning of this year. If this corn export movement has triggered a large reduction in inventories for the beginning of the year, this is something that doesn't worry the Company? That's my question. Thank you.

A - Ricardo Lewin {BIO 20342706 <GO>}

Lucas, (inaudible). I'm sorry, I'm being bit boring about answering the questions. I wish to repeat that I cannot make any forecast in this call because the local debenture issuance, okay? The only thing that I can tell is about public information that we disclosed in the release. It's about that's according to Agroconsult estimates for '18-'19 crops. That indicates increased grain production in Brazil and Mato Grosso except for soybean crop in Brazil, which should decrease by 2% due to unfavorable planting conditions.

On other hand, the corn crop is expected to grow 18% in Brazil and 9% in State of Mato Grosso, which is the main region of origin for grains transported by the Company, okay.

Rumo continues increasing its capacity to meet a growing demand for this grain transportation by Brazilian ports.

Q - Lucas Barbosa {BIO 20835372 <GO>}

Okay. That's helpful. Thank you very much.

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Operator

The next question comes from Alberto Valerio, UBS.

Q - Alberto Valerio {BIO 20716048 <GO>}

Hi, Ricardo, thank you for taking my question. Just a quick note. I saw that there was a reduction in the finance expense for Rumo this quarter. I saw that there was a BRL1,209 million non-recurrence and I would like know, if you can take just this BRL1,209 million or is there the cost of debt to be back for 10% that we had in the previous quarter? Thank you.

A - Ricardo Lewin {BIO 20342706 <GO>}

Alberto, thank you very much for the question. I think that the good news about the financial expense reduction, not only about the last quarter, it was that when compared to 2017, the interest expenses was 29% [ph] lower what means BRL347 million we are saving every year, okay? Regarding the last quarter, the point here is that they were better due to they're more than the curve, okay, the CDI curve that went down. okay? So there are two effects here using the cost of debt and in the protection, we had protection that we have in the -- for the bonds, so -- in the end. So these were the two effects, okay, that we have -- that's in the -- this last quarter. Hopefully, this answer your question Alberto.

Q - Alberto Valerio {BIO 20716048 <GO>}

Yes. Thank you.

Operator

The next question comes from Victor Mizusaki, Bradesco BBI.

Q - Victor Mizusaki {BIO 4087162 <GO>}

Hi, thank you. I have two questions here. The first one will be, I don't know if you're going to confirm this, but based on what you've said about the new pricing model, given that you are reducing the volatility, can you mention that in end of the day we are in a situation where if you can increase your capacity without additional investments? And the second question, now that you have like 10% of your capacity in the spot market, can you comment how the minimal -- low freight prices are affecting the spot price?

A - Ricardo Lewin {BIO 20342706 <GO>}

Victor, sorry, but we are not listening very well your questions. Could you repeat? I don't know if you are too close to the phone.

Q - Victor Mizusaki {BIO 4087162 <GO>}

Yes, so the first one, how do you see that now that you have this monthly -- you track volumes on monthly basis, I mean, to take-or-pay contracts and the returning companies cannot move volumes from one month to the other. In end of the day, if you think about your numbers. Do you not see any, I mean, the business seasonality are like to reduce a

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lot. So in the end of the day -- can I mention that you can increase your capacity -- I mean, you increase your capacity without an additional investment, so returns could go up?

A - Ricardo Lewin {BIO 20342706 <GO>}

Well, okay, Victor, to give you a short question, the answer is yes. The less volatility we have is better for us, both for forecasting the volumes and they are -- in terms of planning, okay, and in terms of using better to capacity. So the answer is yes, you're right. And the second part?

Q - Victor Mizusaki {BIO 4087162 <GO>}

Yes, the second part is regards to your -- I mean your -- why do you take a look on that slide where you showed the new price model, apparently 10% of your capacity (inaudible) in the spot market? So I don't know if you can comment how do the minimal road freight prices affect the spot market, so if freight price could go up.

A - Ricardo Lewin {BIO 20342706 <GO>}

Victor, first is, I cannot tell that we're sitting right in the spot market. The point here is that we continue to focus in the take or pay and what we -- as we explained directly, the focus in take or pay is shorter term, okay. Whilst we do not close 100% of our capacity, then we will go through the spot market that in the past is what the market has been for you, but depend year-over-year what will happen with the crop situation, the price of the products of the grains, okay. So, it's difficult to forecast that.

Q - Victor Mizusaki {BIO 4087162 <GO>}

Okay. Thank you.

Operator

(Operator Instructions) Thank you. That concludes the question-and-answer session for investors and analysts. I would like to pass the floor over again.

A - Julio Fontana Neto {BIO 3872510 <GO>}

Thank you for your participation. We -- after the quiet period, we are here to clarifying some doubts.

A - Ricardo Lewin {BIO 20342706 <GO>}

Thank you very much. It was a pleasure to have all of you in the call.

Operator

That does concludes the Rumo/ALL [ph] conference for today. Thank you for participating. Have a nice day.

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