

Q2 2019 Earnings Call

Company Participants

- Marcelo Eduardo Martins, Chief Financial and Investors Relation Officer
- Ricardo Lewin, CFO & Director, Investor Relations
- Unidentified Speaker

Other Participants

- Analyst
- Josh Milberg
- Rogerio Araujo
- Stephen Trent

Presentation

Operator

Good afternoon, ladies and gentlemen. At this time, we would like to welcome everyone to Rumo's First Quarter 2019 results conference call, which will be led by Mr. Ricardo Lewin, Chief Financial and Investors Relations Officer. 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 investors and industry analysts conducted by Mr. Ricardo Lewin. (Operator Instructions).

The audio and slideshow 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 will turn the conference over to Mr. Ricardo Lewin. Mr. Lewin, you may begin.

Ricardo Lewin {BIO 20342706 <GO>}

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Good afternoon and thank you for joining us. I would like to take this opportunity to thank you for the recent recognition of Rumo on institutional investor ranking among the best companies in the transportation in Latin America mid-caps category. Another important milestone was Rumo being included on FTSE4Good Index Series for companies with strong ESG practices measured by global recognized standards. The first part of the presentation, it's important to highlight that 2018 results presented in our earnings release referred to the pro forma figures reflecting the impact of IFRS 16 to guarantee a fair comparison.

On page two of the release, the impact on each line item of our income statement is summarized. Let's begin our presentation on slide two. I start our presentation analyzing the market scenario this quarter, which was unusual. On one hand, soybean forecasts predicted high supply due to large inventories in the United States and strong crops in Brazil and Argentina, important exporting countries. On the other hand, estimates showed a contraction in China soybean import demand due to African swine fever. This scenario led to a decrease in international soybean prices. And producers prefer to stock unsold volumes instead of closing new sales at market price. As a result, for the second quarter, Brazil exports were hampered and Rumo soybean volumes were essentially limited to those previously contracted.

The current scenario should be the opposite. Forecasts point to record high domestic production this year, which combined with an equally favorable pricing scenario, a potential American crop disruption and domestic higher soybean inventories should boost Brazilian corn exports. This favorable combination could already be seen in the North Operation in June.

On the next slide, let's see the transported volumes. Volumes grew 7.1% in the second quarter '19. As mentioned in the previous slide, most of this growth happened in June, mainly on the back of corn inflows in the North Operation. Segment highlights include more than 3x fertilizer volume transported in the North Operation. Pulp volume grew by 28.6%, due to the annualization of last year's second half volumes. Container transport, that grew by 20%, having successful diversified cargoes, which now reaches over 70 different types, strengthening its business model and continuing to expand its network in the Southeast and Midwest regions of Brazil.

Please let's move to the next slide. Rumo's EBITDA rose 1.9% this quarter, compared to the same period last year and the consolidated margin stood at 53.4%. The 7% volume increase was satisfactory considering the unfavorable soybean market. We highlight North Operations that grew 14% on volumes this quarter. Tariffs dropped almost 4%, impacted by North Operations, mainly due to the single effect of higher volumes in June, when prices tend to be lower, early interest of corn in grain mix as corn has a lower tariff, exposure to lower spot prices in June when volume exceeded contractor levels and finally fertilizer volumes, which had a lower tariff when compared to the rates. Regarding costs, variable cost has positively contributed to the result as it grew less than volumes. Fixed costs rose 6.6% due to higher maintenance expenses in April and May, when compared to when idle, and the end of payroll exemption at Mato SG [ph] and Mato Sul. Therefore even with a lower margin due to lower yields, North Operation reported EBITDA growth. South Operation reduced its EBITDA and margin due to weaker soybean volumes.

Continued operation stood at the same level as the previous year and the second quarter '18 results were affected by the revenue from the selling of a business unit.

We will now take a look at the financial results and net income. The financial results decreased by 48.2%, compared to the second quarter '18, mainly due to a lower yield curve, lower growth debt and a drop of average cost of debt. Consequently, we had yet another quarter of net income, reversing the loss posted in the same quarter next year.

On the next slide, we will take a look at our debt. Rumo's indebtedness decreased to 2x net-debt-to-EBITDA compared to 2.1x in the first quarter '19. We emphasize our commitment with capital discipline, always trying to keep leverage at acceptable levels for the company.

On the next slide we have more information about the Norte-Sul Railway. On July 31st, we signed a concession agreement for Norte-Sul Railway, and we are now officially responsible for this new concession. It is still too early to set volume, price, EBITDA and CapEx commitment and they are contingent on the conclusion of pre-operating work and the start of negotiations for commercial agreements. However, I would like to share more details on the market dynamics. Norte-Sul Railway brings to Rumo access to various potential markets.

In addition to grains, we have great opportunities to transport fertilizers, bauxite -- bio fuels, byproducts and containers. We have already started to reach out clients and will pursue commercial agreements for the volumes as soon as the railway is ready. In the grain segment, we will enter two new markets, the State of Goias and Tocantins. In the case of other cargos, it is still too early to talk about future market share levels. But we can access the market's potential based on actual export data from 2018 and estimates from the Ministry of Agriculture.

In 2018, the two states exported approximately 13 million tons, which could reach up to 25 million tons in the next 10 years. This is a promising market for grains and other cargos that currently has no access to an efficient railway. As Rubens says, we are Brazil's -- we will do for Goias and Tocantins what we did for Mato Grosso and other states. We are now focused on making the network ready to run. Therefore, the required investments will be deployed without any change in our already released guidance of BRL13 billion to BRL15 billion. We re-enforce that we will remain committed with capital discipline and a constant seeking for efficiency. I conclude my presentation emphasizing our commitment to the company's business plan, increase capacity and improve efficiency, while putting safety first.

We plan to ramp up our business by connecting more producing regions in Brazil to foreign markets. Significantly contributing to domestic transportation with backhauling capacity, while reducing greenhouse gas emissions through energy efficiency and market share gains. All these coupled with the highest governance and sustainability standards committed to profitability and value generation to our shareholders.

I will remain at your disposal for the Q&A section.

Questions And Answers

Operator

(Question And Answer)

Thank you. We will now begin the Question and Answer sessions for investors and analysts. (Operator Instructions) Our first question comes from Mr. Chadwick -- from Credit Suisse.

Q - Analyst

Good after everyone, thank you for the question. My question is regarding the inventories of grains, stocked. We see that due to prices, a great part of the soy crop was not exported yet. So how do you compare the Current inventories of soy with last year? Any changes we could see part of this volume being transported by Rumo in the end of this year, already. Thank you.

A - Marcelo Eduardo Martins {BIO 16440115 <GO>}

Hi -- good to have you in the call. Thank you for the question. Well, last year, we did have a small, inventory during -- from December to January, okay, due to the high prices. This year it's a bit difficult to foresee, what will happen, okay? You know that what happened with the market this year. This is well explained in our material here, that the prices of soybean went down, -- went up. What we are seeing right now, is a complete different scenario for the second half of the year, due to several reasons among them, what's happening in the US? Okay. USDA announced recently didn't work for the -- is written in the US. So the soybean production will drop from 124 million tons to 100 million tons.

That can -- as a consequence of that, we already see prices starting to improve. So, what we see the inventories at the end of the year, depends on the prices and willingness of the farmers to trade their inventories. Okay? So it is difficult to foresee. What we see right now is that, we may have our good, if the prices continue to be in this level. We foresee a good trading in the last quarter. What can we do with inventory. So, it's difficult to foresee -- right now. We will see more to the end of the year.

Q - Analyst

That's great. Thank you very much.

Operator

Our next question comes from Josh Milberg, Morgan Stanley.

Q - Josh Milberg {BIO 19336060 <GO>}

Hey, everyone thank you for the call. My first question is if you could give us some perspective on the third quarter, volume outlook. We know that grain exports were strong in July and -- but just wanted to see if you could talk a little bit about the outlook for the

remaining months of the third quarter. And also just wanted to understand, if we need fear at all that with the anticipation of corn volumes in June. And what looks like it's going to be a very strong July, if we could then see a shortfall later in the year, that's my first question.

A - Unidentified Speaker

Hi, Josh, thank you for the question. The scenario, as it stands for corn is very positive, okay. We -- as you saw the volumes in our website we had anticipated an all-time high corn crop. So this year, crop is expected to be 102 million tons of production, okay. All time high. As you said, this already brought a strong growth in June. We for example the North Operation delivery already 27% growth as we published the volumes, okay.

Also how inventory results are using, coupled with a good trading due to the international prices for corn, okay and as I said, the crop disruption in the US. I said before about the soybean, but that will happen also with the corn. There's a drop from 366 million tons in 2018, to 353 million tons in 2019. So in our opinion, for this quarter we will have a very huge additional quantification pressure and that will bring us -- to our -- throughout all the second half of the year.

Q - Josh Milberg {BIO 19336060 <GO>}

Okay, --. That's -- good color. I presume that those strong volumes will translate into a better yield performance in the third quarter as well. Actually, if you wouldn't mind just touching on the yield outlook as well that would be good. And then and then I have a second question.

A - Unidentified Speaker

Yes, good. Well, let me give you some idea what happens in operation works plan. It's -- to reinforce here, the new -- lower than expected, but that happened because non recurring issues that affected the tariff. So, the first one is the seasonality among the month in the quarter. So volumes were lower than expected in April and in May, when the prices are higher, while we had good volume of corn in June, when the prices are lower, okay. In the second quarter, '19, also we had a significant amount of corn being transported. And remember that the corn yield is lower than the soy yield.

So that helped also to bring yields down. Also we have the RTK volumes, went up something around 27% growth in June and that was higher than clients expected and therefore, they started to pursue spot volumes on top of the commercial agreements in a moment where the spot prices were very low, okay. And finally, something that is happening recurrently, that's the volumes of fertilizers, that are growing fast as expected, this is good news for us. And although it will bring up the margins, the yields start to be reduced, while the backhaul freight something around 40% lower than the average, okay.

Now that was what happened in this quarter. Now analyzing these factors, okay that implies yields for the future for next half. Regarding the seasonality among months. It's not expected to have any huge influence in the second half of the year, compared to the

previous year, okay. Regarding the spot logistics, we'll have a strategic position to spot prices, okay. In the second half and our expectations of high volumes.

However, we already to see better yields in July and August that show The improvement of spot prices, they're getting better in the market, okay. But we cannot guarantee that these higher spot prices will remain until the end of the year. And regarding fertilizers, it will continue to grow at yields that are lower than the rest of our products. Regarding next year, it is still difficult to determine that okay, because we need to start negotiations for commercial agreements that will happen later, in this year.

Q - Josh Milberg {BIO 19336060 <GO>}

Okay, that's great, that's very helpful. I had one more question, but I'll do a follow-up at the end of the call and give somebody else a chance to ask a question, thank you.

A - Unidentified Speaker

Okay, thank you Josh.

Operator

Next question comes from Rogério Araújo, UBS

Q - Rogerio Araujo {BIO 17308156 <GO>}

Yes. Hi guys. Thanks for the opportunity. Have a group of questions. So first, a follow-up on Josh question on the tariffs. So, is there a way that you can provide an estimate of how tariff variation would look like in North operations? If we exclude the nonrecurring items, which is the corn mix and the lower volumes in April and May. And also the lower spot price in June. So in other words, if you get our contract on the average excluding those impacts, how much did the yield vary in this period ?

A - Unidentified Speaker

Rogério, -- very brief answer. There's no reason for orders not considering these nonrecurring issues. There is no reason for the difference from last year unless the volumes of fertilizers are going up. So there's no reason for being different.

Q - Rogerio Araujo {BIO 17308156 <GO>}

Okay. But what was it? So I just referred those impacts, was it above inflation and even fertilizers, or you are not passing through inflation in your contracts this year?

They do have inflation okay in our contracts so that there is an increase of inflation and of the fuel. However, when you consider the average yield, then don't forget to consider the fertilizer volume that as we said improve our margins, but reduce our tariffs.

Okay. Yes. It's a good color. So my second question is on Sorriso expansion. Is there any recent development in this project? And if you could provide a little bit more detail on

how the company expect to see this happening, it's through a contract arrangement? It's through a project that enables authorization for Rail in the Brazil. Or any other way you can do that, so if you could provide the recent developments on that project, it would be great. Thank you.

A - Unidentified Speaker

Regarding the expansion Rogério, remember that we -- the project is in different phases, okay in difference pieces, stages. So the first stage will be the road terminal, okay -- so sorry, the truck terminal in somewhere between -- in between Rondonopolis and Sorriso -- This project, we are already deploying some CapEx for studies. And we are also looking for the best place to buy land to do this terminal. Okay? Regarding the Sorriso project actually, to do the first stage, we need to -- the first phase of the project. We need to know where the railway will go through.

So we are deploying also some CapEx to make the analysis of the network. But this compared to the size of the entire project, this is still irrelevant. In a while, we will start to hear about the first stage that -- the truck terminal. Okay? So once we buy and we have the land and the beginning of the construction of the project, we will let the market know.

Q - Rogerio Araujo {BIO 17308156 <GO>}

Okay. What about government approvals? They're already asking for any? Or when do you plan to do that? And how hard do that?

A - Unidentified Speaker

For the first stage, it's not necessary to have ANTT approval, because this is a truck terminal okay? Regarding the second stage, that's the extension, for sorriso the railway we are waiting for their approval for Paulista renewal to restart the process.

Q - Rogerio Araujo {BIO 17308156 <GO>}

Okay. Thank you. If I may, you mentioned about malha paulista. So any news or expectations for timing on the conclusion of that? Thank you, that's it.

A - Unidentified Speaker

Regarding timing, Rogério, this is impossible to guess how much time it will take to the renewal. The last news that we have is their recommendation of TCU prosecutor, Julio Marcelo, for the non the nonrenewal of Malha Paulista that goes public in the beginning of July. This is far from being bad new for us because having this decision, at least we can move to the next stage of the process.

That means the process will go to TCU Minister Augusto Nardes. That's the rapporteur of the process. Recommendation and we also believe to TCU. And also bad news for us, that the recommendation for nonrenewal from Julio Marcelo because there are some cases, previous cases the rapporteur of the process, did not agree with the public TCU prosecutor.

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A very good example is that. So we know what are the next steps. For us, the TCU minister, in charge of the case. It has no -- deadline for approving it. But in our opinion, the process is very mature, the TCU minister in charge of the case is familiar with the process, because he has been following it since the beginning, many years ago. And in our opinion the decision is not supposed to take that long.

Q - Rogerio Araujo {BIO 17308156 <GO>}

Okay, great. Thanks so much. Have a good day at work.

A - Unidentified Speaker

Thank you very much.

Operator

Next question comes from Stephen Trent, Citi.

Q - Stephen Trent {BIO 5581382 <GO>}

Good afternoon, gentlemen, and thanks for taking my questions. I was curious, I know you've had this plan to start running 120 train cars per local, versus 80 on some of your network. And I'm wondering if you've made any adjustments to that plan, given what's happened with soy, if it's still intact and if so, approximately, what portion of your network would be impacted?

A - Unidentified Speaker

Hi, Stephen, good question. You know that this is a very strategic for us. We are investing since the merge between Rumo and ALL in the improvement of the capacity and as you've seen we have done up to now is to support the 120 railcars train. That means we will have a longer train, much more efficient and with an increased capacity. So this is not a project that will change due to very punctual changes in cropd, as happened in this year for soybeans.

This is a very strategic project that is foreseen to be a running between 2021, '22. So we had no changes in the plan. We keep doing our yards -- the crossing yards that will allow to handle 120 trains crossing. Okay? So we are very disciplined in this investment. That's very important for the company. And as I said the soybean reduction crop reduction of this year doesn't mean that we will have this for next year. So we continue to see a very huge potential for soybean in the next year as well as, increase of crop of corn and other products such as cotton for example.

Q - Stephen Trent {BIO 5581382 <GO>}

Great. Thanks very much Ricardo and just one very quick question aside from that. I mean kind of a follow-up on Josh and Rogério's question. When you look at the 2Q freight tariffs, how much of that -- the delta was related to lower sugar volumes?

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A - Unidentified Speaker

Back to your previous question, Stephen. Sorry, I was so excited to answer that I forgot to finish it. That -- after the increase in capacity is something around 70%, okay, that we foresee in North Operations before once we have the 120 railcar train. Regarding sugar, the trade of sugar has been very bad this year and last year, but that doesn't affect us at all, because actually we are using our capacity to transport much more profitable cargo that's sugar and -- sorry that's soybean and corn. So, the reduction of trading has not affected us at all.

Q - Stephen Trent {BIO 5581382 <GO>}

Okay. very helpful, that's it for me and thanks very much .

Operator

Next question comes from Victor Mizajaki --

Q - Analyst

Hi, thanks. I have two questions. The first one is a follow-up on Stephen's question. --, that you mentioned about capacity and given all this positive outlook for grain volumes in the second half. Can you comment a bit about your capacity utilization in the second half, especially in Q3. And if -- I mean we compare Q3 with the second quarter if you think about volumes, the second quarter the volume was concentrated in the North operation. So, if we can expect that maybe in Q3, that this volumes growth will be spread or split between the North operation and South operation.

A - Ricardo Lewin {BIO 20342706 <GO>}

Hey, Victor. -- the call. Let's start with the last one. The answer is yes. The volumes in the South were worst the second quarter because we didn't have anticipation of corn, okay? So we'll have increase of corn in the south so the volumes will go up and will be more spread the results, between North and South.

Regarding the third question. -- regarding the capacity, in the third quarter, will be very close to the full capacity. We can't say that in the second quarter, for example, in June that was a very big -- a very dense -- If we had more capacity, we could transport more. That means that we were full. So, we expect to be in the next months, with this size, the good size of corn crop, that we'll be at full every single month.

Q - Analyst

Okay. And my second question, I think about new investments. How do you start to invest in the North, South rail?

A - Ricardo Lewin {BIO 20342706 <GO>}

In the North, South, we have a very, very small, I would say, relevant investment in this year, That's basically on a study that we have to do this year. And next year, we will start to

have the big investment in Norte-Sul. Okay? Without --. The focus in the first year will be to prepare the network to operate. So, the required importance data, the required investments to do the network operator to be deployed without any change in the already released guidance of BRL 13 billion to BRL 15 billion from 2019 through 2023. So, 20,000 and 19 -- 6,023.

Q - Analyst

Okay. So, if you think about 2020, it makes sense that your CapEx, will go up versus 2019.

A - Unidentified Speaker

100%. --

Q - Analyst

Okay. Thank you.

A - Unidentified Speaker

Thank you.

Operator

(Operator Instructions) Thank you. That concludes the question and answer session for investors and analysts. Now, I'd like to turn the floor over to Mr. Ricardo Lewin for his final considerations.

A - Unidentified Speaker

I'd like to thank our investors and -- to participants of the call and talk to you the next quarter. Thank you.

Operator

That concludes Rumo's first quarter results conference call. Thank you.

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