

Q4 2015 Earnings Call

Company Participants

- Jose Cezario, CFO, IR Officer
- Julio Fontana, CEO

Presentation

Operator

Good afternoon, ladies and gentlemen. At this time we would like to welcome everyone to Rumo's Fourth Quarter of 2015 and the year of 2015 results conference call. Today with us we have Mr. Julio Fontana, CEO; Mr. Jose Cezario, CFO and Investor Relations Officer; and Mr. Guilherme Machado, Investor Relations Manager.

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 slide show of this presentation are available through live webcast at ir.rumoall.com. These 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 now begin your conference.

Julio Fontana {BIO 3872510 <GO>}

Good afternoon, everyone. And thank you for participating in the conference call to discuss the results of Fourth Quarter and the full year of 2015.

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Before we start the earnings presentation, I would like to share a few messages regarding this first year after the merger and all the transformations that we are implementing at Rumo.

2015 was a very challenging year. We faced political turmoil that in a way reflected on the economy, with a slowdown in economic activity, inflation on the rise, growing unemployment. And the weakening real. I was in the scenario that we started the Company's new management on April 2015.

It has been nine months of hard work with the principal initiatives of recovering growth in our operations. Several initiatives that we listed have already been reflected in the results.

Renewal of our fleet, with the acquisition of new locomotives and freight cars. And renovation of the existing fleet was the starting point of our investment. We achieved significant operating efficiency gains during this short period of time, which attests to the accuracy of our actions.

The transit time from our terminal in Rondonopolis to Port of Santos was reduced by approximately 14% in the year. And the average daily carload at Mato Grosso terminal also increased by nearly 16%, benefitting our cycle and increasing the availability of assets to acquire additional volume.

Several operating records were set during the period, particularly in October, when we shipped 1.3 million tons through our terminals in Santos and nearly 1.6 million tons through our terminal in Mato Grosso, while transporting 4.4 billion RTK in a single month.

We focused efforts on the operating process, which are being reviewed and which are critical in our activities. With this initiative, combined with fleet renovation, we managed to increase capacity beyond what we had planned. And our sales department was able to bring in more volume in the year.

We are reinforcing the message of compliance with the commitments undertake towards our stakeholders and especially our clients. We have a new commercial approach with the focus on the long term service level and client satisfaction.

Our employees also play a fundamental role in this entire transformation process. We invested in training, renovation of our facilities, especially overnight accommodations for our train drivers. And launched a zero accident campaign to reduce accident rates, which is the performance indicator for 100% of our employees.

We still have a lot of work ahead. This is only the beginning of our story of many challenges, hard work. And dedication to transform Rumo into a more efficient company and reach a higher standard of top quality. A big thank you to all the stakeholders and the (inaudible).

And I would now like to turn the floor over to Cezario, who will present our financial and operating performance.

Jose Cezario {BIO 19290961 <GO>}

Thanks, Julio. Good afternoon, everyone. And thank you once again for joining Rumo's conference call to discuss the earnings in the Fourth Quarter and full year of 2015.

In this call, we are going to cover the financial and operational performance of Rumo in a consolidated basis and also the results of our business units, which are divided into north operation, which includes North Network, Paulista Network and the terminals controlled by us in the Port of Santos; south operation, which includes the West Network and the South Network; and containers operation, which represent Brado's results and other results of our container operations.

As in previous quarters, we have included in this release the combined results of Rumo and ALL for the respective previous periods to enable the comparison of the operational performance. Since this is the earnings release for the full year of 2015, except when I specify otherwise, all my explanations will be related to the 12 months of the year ended on December 31st, 2015.

I wish to emphasize that this release includes the historical accounting information as well as the pro forma results of the year 2015 and the combined results of Rumo and ALL for the Fourth Quarter of 2014 and full year 2014 to enable better comparison of information.

With this, let's move to slide four with the consolidated results of Rumo. We registered a healthy operational performance, both during the quarter and the full year.

Railroad transportation volume reached nearly 45 billion RTKs in 2015, 6% higher than in 2014. This result reflects the 12% growth in volumes at the north operation, which was partially offset by the 7% drop in volumes transported by the south operation.

Additionally, the operational improvements and investments made in 2015 drove the growth in transport volume. Volume of agricultural products grew 10% due to the strong second corn crop, which lasted until the end of 2015 and contributed to the increase in total transported volume for the year.

On the other hand, industrial product volume decreased 13%, impacted by the increase in fuel transportation, reflecting the weaker economic activity and also the interruption of shipments in the west network since the Second Quarter 2015. And by the drop in transported volumes of paper and pulp by both the north and south operations.

The consolidated average transportation yield increased 11%, from BRL75 per RTK in 2014 to BRL83 per RTK in 2015. Port loading volume at the terminals controlled by Rumo at the Port of Santos increased 5% in 2015 compared to 2014, mainly due to the transportation of grain, approximately 1.9 million tons, which complemented sugar shipments in 2015.

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Now let's move to slide five that shows the consolidated financial performance of the Company. Financial performance also improved in 2015. Consolidated net revenue grew approximately 14% in 2015, reaching BRL4.8 billion due a better operational performance such as higher transported volume, especially agricultural products, increasing port loading volume. And increase in the average yield in railroad transportation.

EBITDA grew by approximately 14% from BRL1.5 billion in 2014 to BRL1.9 billion in 2015, while EBITDA margin reached 40% in 2015. EBITDA increased despite the allocation of high operating constant expenses totaling about BRL300 million in 2015, which were treated as CapEx in prior years and are now treated as OpEx, as per the new criteria adopted by Rumo since April 1st, 2015.

Our net banking debt reached BRL7.8 billion at the end of 2015 compared to BRL7.3 billion at the end of the Third Quarter 2015, representing a leverage, as measured by net bank debt per EBITDA, of 4.1 times. The 16% decline in leverage is basically due to EBITDA growth in the last 12 months reflecting the gains in operational efficiency and higher transported volumes.

Moving to slide six, let's make an analysis of our product mix and the routes we operate. As we have been emphasizing throughout the year and proved at the end of 2015, volume of agricultural products is the key growth driver of our operations.

There was a record of corn in the second crop production in Mato Grosso, the main state of our operations, which reached 20 million tons, approximately, in the 2014-2015 crop year according to Corn Update, due to improved productivity and expansion of planted areas.

Comparing 2015 and 2014, our volume of agricultural products transported grew 10%, which more than compensated the decline in volume of fuels, industrial products. And containers. The strong corn and soybean crops were reflected in the transportation of agricultural products, which accounted for approximately 80% of our total transported volume.

A combination of weaker Brazilian real, productivity growth by farmer producers. And increased areas of production, especially in Mato Grosso, boosted the demand for transport in these years.

Another highlight is the corridors we operate. Approximately 90% of our transported volume passes through the Rondonopolis-Santos corridor and the central corridor of Parana, which are the most efficient and were the main stretch that received investments in 2015. And which are now delivering important operating results.

Our market share in the ports where we operate reached 49% of all grains transported through the Port of Santos and 88% of all sugar exported through the Port of Paranagua, which proves our competitiveness in these ports for these commodities.

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Moving on to slide seven, we will go through our business units, starting with the performance of north operation. Total volume transported by the north operation in 2015 increased approximately 12% compared to 2014, reaching about 29 billion RTKs, reflecting the growth in the volume of agricultural products and operational gains.

Net revenue increased by about 19% to BRL3.4 billion in 2015 due to higher transport volumes and the increase of about 11% in the average yield, which reached BRL92 per RTK.

As a result, EBITDA from the north operation reached BRL1.7 billion in 2015, 43% higher than in 2014, while EBITDA margin increased from 43% in 2014 to 51% in 2015.

Moving to slide eight, we will look at the performance of south operation. Total volume transported by south operation declined by 7% in 2015 compared to 2014, impacted by the reduction in industrial product volumes, mainly due to the impact of rains in the Fourth Quarter as well as the drop in transported volume of pulp and paper and fuels, reflecting the weaker economic activity and also due to interruption of transport from the west network since the Second Quarter 2015, as we have previously mentioned.

Net revenue increased by 2%, reaching BRL1.1 billion in 2015, reflecting the 9% increase in the average yield in the period, which was BRL79 per RTK. With this, EBITDA from the south operation was BRL248 million in 2015, with margins of 22%, reflecting the declining volumes transported and increased costs, particularly due to higher maintenance costs due to the new criteria of accounting adopted by the Company.

At the end of 2015, we began a project to (inaudible) on the main efficiencies and productivity increase opportunities in south operation and launched several initiatives which are part of a major project to enhance productivity and to reduce costs at the main corridor of south operation, which connects the north of Parana to the Port of Paranagua. We expect this project to deliver important results during the course of 2016.

The next slide presents the performance of container operation. I'd like to start making a disclaimer here. In the container operation, we report the results not only of the subsidiary, Brado. But also including the costs incurred by Rumo to provide container transportation services.

Total volume of containers transported in 2015 increased 1% due to the higher volumes transported between Mato Grosso and Santos in the center of Parana, offsetting the decline in volume in the Rio Grande do Sul and especially in the Mercosur corridors. And the loss of volume of an important refrigerated cargo client.

EBITDA was a negative BRL53 million in 2015, mainly due to the increase in fixed costs, some nonrecurring expenses related to the exercise of the liquidity option of some non-controlling shareholders. And also due to variable costs and expenses in the period.

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Note that since the merger we have carried out important changes at Brado. We started a process of (inaudible) of the main drivers in opportunities of this business. We replaced the entire management team, which is already aware of this situation and is seeking alternatives to bring a balance to the operation in a sustainable manner, looking to future opportunities to enhance and to better perform into this market.

The next slide will provide information on the Company's consolidated debt. Net banking debt increased by 7% from BRL7.3 billion in September 2015 to BRL7.8 billion on December 31st, 2015. The net bank debt EBITDA ratio reached 4.1 times as of December 2015.

Leverage decreased in relation to the end of the previous quarter, mainly due to the improvement of the last 12 months' EBITDA. The increase in net debt is basically due to the execution of the CapEx plan, which has been progressing in accordance with the business plan.

The average cost of our bank debt as of December 2015 was lower than 100% of CDI already considering the portion denominated in foreign currency, which is fully hedged, as well as other swaps instruments used as strategies implemented to change fixed to floating rates in some indebtedness, as well as all TJLP debt from BNDES.

On the next slide, we will see the consolidated financial result and cash flow. The net financial expenses in 2015 increased by 14% compared to 2014 due to higher interest expenses on net debt due to the hike in CDI and TJLP rates over 2015. And the increase in the average debt balance in the year due to the investment program undergoing.

Returns from financial investments decreased also due to the reduction in the average cash balance despite the hike in the interest rate, as previously mentioned.

There was also the negative impact, actually a non-cash, of the swap of fixed to floating interest rate due to the rise in the CDI future curves.

Moving to the cash flow, we registered cash burn of approximately BRL1.2 billion over 2015, measured by operating cash flows less investment cash flow, as a result of implementing our investment plan, especially fleet renewal with the acquisition of new locomotives and freight cars.

The next slide will detail the operational improvements made during 2015. We ended up 2015 with a significant improvement in our key operating indicators, which improved significantly as a result of several improvements implemented in compliance with our investment plan.

Operating ratio declined by about 9%, which is a good trend. And is currently at 72% compared to 79% for 2014. This ratio measures the percentage of net revenue required to cover the Company's operating costs within the expenses, including depreciation, to arrive at a benchmark with other international railroads. We have cases like Canadian

Pacific, whose operating ratio is about 60%, while Union Pacific and CSX have operating ratios of 63% and 70% respectively.

Our diesel consumption, measured in liters per GTK, declined 4% due to the introduction of new locomotives and freight cars which have lower unit consumption. And the growth in volume on routes with lower average unit consumption.

Moreover, as we announced at the end of last year, we recovered 216 kilometers of rail structure, acquired 43 new locomotives and 732 freight cars. And recovered assets, all of which helped to reduce the backlog of our current fleet.

So let us move on the next slide for more improvements, especially at the north operation, which is our most relevant segment. From now on, we have selected some operating indicators to disclose in order to enable a better idea of some important improvements we have been implementing.

We registered a 16% increase in the daily loading of freight cars. This indicator represents the average number of freight cars loaded with grains per day at the Rondonopolis and Alto Araguaia terminals, which are the two most relevant for the north operation.

The improvements in Rondonopolis terminal and the revamp of the stretch that connects Mato Grosso to Santos Port were the main factors responsible for the increase.

We also registered a 7% decline in the transit time in 2015 compared to 2014, which came to 97 hours between Rondonopolis and the Port of Santos due to the new and more reliable assets brought to the operation, which enables greater use of same asset.

If we look at the comparison of the First Quarter 2015 versus the Fourth Quarter 2015, we have an even greater fall, 14%, as Julio mentioned in the opening of the call.

We reduced the cycle time of freight cars by 9% compared to 2014, totaling 252 hours for the freight cars to cover the distance between Rondonopolis and the Port of Santos due to the acquisition of new HPT freight cars which require lower time to load and unload, enabling us to load more volume in the same freight cars.

All these improvements helped us to achieve our results in 2015. So let's move to slide 14.

We are working today with three financial initiatives related to the improvement of Rumo's capital structure that we plan to implement simultaneously. As announced earlier, the capital increase is under process. We are discussing with the shareholders the structure and timetable, etc.

The debt re-profiling process, which enable a more uniform curve of amortizations and postponement of maturities, are also undergoing the discussions with the banks. And we

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are also discussing with BNDES opportunities and the possibilities of new credit lines to support our business plan and CapEx for the coming years.

So we will keep the market posted about all the initiatives. We are also refining our business plan now that we have almost a year of effective operation of the Company, revisiting the timing of some investments, taking into account market environment.

In this context, we are starting a reduction of approximately 30% in our investment plan in the next five years, which will have an estimated impact of 5% to 10% in the annual EBITDA forecasted maximum.

Let's move now to our final chart related to guidance. Still talking about 2015, in the case of EBITDA we have exceeded the midpoint of the guidance, having reached BRL1.9 billion in 2015.

In the case of CapEx, we have different situations. Recurring CapEx was within the range announced and in line with the revision of the Second Quarter of 2015, totaling BRL840 million in 2015.

In the case of expansion CapEx, investment was higher than planned by approximately BRL200 million due to an advance made to the supplier of locomotives for deliveries that will take place in 2016 and 2017 with 100% funding from BNDES, which enable us to lock the foreign exchange exposure in place in the price of these assets that we will be acquiring in the future.

We also take the opportunity to announce the guidance for the year, the current year, 2016. We have an EBITDA target of BRL2.3 billion and BRL2.5 billion, which represents 26% growth, taking into consideration the midpoint of the guidance compared to the reached EBITDA for 2015.

For the CapEx, we have a range of BRL1.8 billion to BRL2.1 billion for the current year. The recurring CapEx has a range of BRL700 million to BRL900 million. And the expansion CapEx has a range of BRL1.1 billion to BRL1.2 billion -- sorry, BRL1 billion to BRL1.2 billion.

As you can see, the 2016 CapEx already indicates around 30% reduction compared to the originally announced plan. In line with the previous chart that we mentioned, we are under analysis to postpone or to better get the business plan implemented.

With this, I now conclude my presentation and we can start the question and answer session. I am available together with Julio and Guilherme Machado, our Investor Relations Manager. And the finance team will assist us on specific issues that might require a more detailed explanation. Thank you.

Questions And Answers

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Operator

We will now begin the question and answer session for investors and analysts. (Operator instructions.)

That concludes the question and answer session for investors and analysts. It's now my pleasure to turn the floor back to Mr. Jose Cezario.

A - Jose Cezario {BIO 19290961 <GO>}

Thank you, all for participating in our conference call. See you soon.

Operator

This concludes Rumo audio conference for today. Thank you very much for your participation. And have a good day.

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