

Q3 2019 Earnings Call

Company Participants

- Ricardo Lewin, Chief Financial and Investor Relations Officer
- Unidentified Speaker

Other Participants

- Analyst
- Felipe Vinagre
- Rogerio Araujo
- Victor Mizusaki

Presentation

Operator

Good afternoon, ladies and gentlemen. At this time, we would like to welcome everyone to Rumo's Third Quarter 2019 Results Conference Call, which will be led by Mr. Ricardo Lewin, Chief Financial and Investor 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 the Mr. Ricardo Lewin. At that time, further instruction will be given. (Operator Instructions)

The audio and slide 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 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 the 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 the conference.

Ricardo Lewin {BIO 20342706 <GO>}

Good afternoon, everyone, and thank you for joining us.

I would like to point out that likewise previous quarters to facilitate the analysis, 2018 results presented in our earnings release refer to the pro forma figures reflecting the effect of IFRS 16 to guarantee a fair comparison.

On Page 2 of the release, the impact on each line of our income statement is summarized. That said, we will begin our presentation on Slide Number 2. This quarter, for the first time, we present our consolidated results, including the effects of Ferrovia Norte-Sul, North-South Railway, which we will name from now on Malha Central or Central Network.

We will not present a specific session for Central Network as it is at preoperational phase. The signature of the sub-concession contract on July 31 resulted in BRL2.9 billion referring to the auction value duly restated by contractual parameters and recorded as right-of-use, BRL220 million in the leasing account as concession fee payments, BRL75 million in the P&L.

To facilitate the analysis and comparison of results, we present the chart on Page 3, considering the third quarter '19 figures, but excluding the Central Network. However, it's worth noting that other sessions of the release report figures, including Central Network. On the next slide, I would like to remind you of the strategic relevance of the Central Network.

As we mentioned in our last call, the Central Network brings opportunities for Rumo related to transportation of diverse cargoes such as fertilizers, bauxite, biofuels, byproducts and containers. In addition, it expands our agricultural products area of operation to the state of Goias and Tocantins regions with a strong growth potential, which today do not have efficient access to railway.

Over the next months, our objective is to have this network fully operational. Therefore, we will make the necessary investments to achieve these railways potential, whose relevant results will be likely seen in 2022.

On the next slide, we will discuss our operational results in the third quarter '19. Volumes grew 7.7% in the third quarter '19 to 17.4 billion RTK, highlighting the operational performance in July, which allowed transportation to reach a record of 6.2 billion RTKs.

Segment highlights include fertilizer transported volume that grew by 42%, boosted by volumes in the North operation, grain volume that rose by 9%, highlighting corn transportation, which came in 24% higher than in third quarter '18 and container transport that grew by 12%.

Let's move to the next slide to discuss our financial performance. Rumo's EBITDA was BRL1.2 billion and rose 18.5% this quarter compared to the same period last year. And the

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consolidated margin stood at 58.6%, 4.4 percent points above third quarter '18, reflecting the company's excellent operational leverage.

We highlight the 4.6% yield increase mainly due to seasonality, which got back on track, yield increase from '18 to '19, lower impact of fertilizer volume on the average price since third quarter '18 already had a track record of volume. Variable costs increased less than volume growth, mainly reflecting improvements of 6.2% on energy efficiency.

Fixed costs increased by 4.3% due to payroll exemption in the West and South Networks and higher maintenance expenses in the North Operations. All operations recorded EBITDA growth with yield gains and positive performance of costs.

We will now take a look at the financial results and net income. The financial result came in line with third quarter '18 with a net expense of BRL300 million. The factors that positively contributed to such results are the decreasing gross debt and average cost of debt. On the other hand, there was a recognition of the Central Network contract that increased leasing charge due to the inclusion of interest on the concession installments. That said, we delivered a net income of BRL369 million in the quarter.

On the next slide, we will take a look at our debt. Rumo's indebtedness decreased to 1.8x broad net debt EBITDA, compared to 2.0x in the second quarter '19. We emphasize our commitment to capital discipline, always striving to keep leverage at acceptable levels for the company. On the next slide, I'd like to discuss the market dynamics foreseen for the fourth quarter referring to corn.

According to AgRural, corn record crop should result in record exports this year with 35.8 million tons. Even so, final inventory should increase to 18 million tons. Thus a positive corn availability if combined with positive price conditions may boost Rumo's volumes in fourth quarter '19, a period, which depends mostly on the market dynamics rather than in the company's capacity.

Regarding 2020, despite a preliminary estimate, we expect production should come in line with the record of 2019 with 101 million tons. We still do not have either data on Brazil's exports or exports by state.

Let's move to the next slide to discuss the soybean scenario for 2020.

Soybean projections for 2020 already consider planting preliminary data and indicate soybean record production in Brazil and in the state of Mato Grosso and expectations of soybean exports in line with 2019. This estimate takes into account the effects of African swine flu on consumption in China. But at the same time, it foresees that China will not reduce its inventories at the same proportion of 2019, thus opening room for imports increase.

Concerning uncertainties deriving from the trade war between China and the U.S, the soybean crop failure in the U.S should slow down the U.S inventories from 25 million tons

to 12.5 million tons, reducing the probability of the U.S. exports increasing even more.

As a consequence, we believe there is room to increase soybean volume transportation in 2020, especially in the first 3 months of the crop period when commodity price and demand for efficient logistics are higher.

This concludes my presentation. I remain at your disposal for the Q&A session. Thank you.

(Question And Answer)

Operator

Thank you. We will now begin the question-and-answer session for Investors and Analysts. (Operator Instructions) Our first question comes from Mr. Stephen Trent, Citi.

Analyst

Yes. Hi, thank you for taking my question. It's actually Brian Roberts on for Steve Trent.

How should we be thinking about the soybean volume growth in the northern networks versus the decline in southern network and then have you disclosed any potential margin or cost structure differences between the two networks? Thank you.

Ricardo Lewin {BIO 20342706 <GO>}

Hi, Steve.

Analyst

Brian.

Ricardo Lewin {BIO 20342706 <GO>}

It's Brian, sorry. I thought it's Steve there. Thank you for the question, but to giving you a very short answer. First, the north corridor, okay, the GTK is much higher in the north than in the south, okay? So that takes to a higher margin in the north compared to the south. In the south being smaller distance between the farms or the -- for the farms to the port, you have more competition from the truck market, okay? So that makes the margin -- it's offender of the margins. So, the margins are also smaller due to this reason, but basically this is the short answer. This is the huge difference between both.

Analyst

Great. Thank you.

Operator

Our next question comes from the Victor Mizusaki, Bradesco BBI.

Victor Mizusaki {BIO 4087162 <GO>}

Hi. Thank you. I have two questions here. The first one when we take a look on your container operation, we can see a very high volume growth, we talk about, like a 25% year-over-year. Can you give any breakdown in terms of how much of this growth is coming from your investments in the double stack and when do you expect to see these new volume or this new -- or the growth to stabilize and the second one if you can comment about your negotiations with the trading companies to set the new take or pay for next year?

Ricardo Lewin {BIO 20342706 <GO>}

Hi Victor. Thank you for your questions, but answer the first one about container, okay? Basically, the growth comes from the backhauling, the increase of backhauling, the increase of cargos, not necessary due to the double stack, okay? The double stack is very recent and you see improvement of margin, improvement of volumes in the double stack next year also, but basically the improvement of volumes comes from backhauling. Remember that you bring from very neutralized market that the market from Sao Paulo to the interior of the country, so Rondonopolis, Mato Grosso, you bring several different products. So, these are commercial efforts that we are -- that (inaudible) is doing to increase the backhauling in this direction and improving overall the margin of the business, okay?

The second question is about the take or pay, okay, that's right?

Well, regarding the negotiation, we have started negotiations, but we are far from the final figures we could be in 2020, okay? But as I have -- I think already said in the previous call, this is a very strategic information for us; and at this point, we cannot provide much information without compromising the agreement with the customers, okay? We are seeking to have as much take or pay as possible, but remember that this take or pay is subject to market conditions, okay? And that is it; thank you.

Victor Mizusaki {BIO 4087162 <GO>}

Okay. Thank you.

Operator

Our next question comes from Rogerio Araujo with UBS.

Rogerio Araujo {BIO 17308156 <GO>}

Yes. Hi, everyone. Thanks for the opportunity. I have couple questions here. First on Malha Norte-Sul, can you provide some details on how the investment plan is going? Also inefficiencies in CapEx, if there was any versus what was expected in the original plan and about timing as well. When this should begin generating revenues and when the major investment should be ready as well? So, it would be great to get some color here and then I will make my second question later. Thank you.

Ricardo Lewin {BIO 20342706 <GO>}

Hi, Rogerio. Thank you for the question, okay?

This first half of the year, we are starting to -- first half of the second half of the year in the third quarter, the first quarter with Norte-Sul or Central Network as we are calling (inaudible) and we are investing right now on the division of the network and also we are investing our time in starting to negotiate all the supply contracts, okay? So, the huge CapEx on Central Network will start from the next month and will take more or less two years to be operational, okay? For being operational, the first operation will start by the end of 2021, beginning of 2022.

Regarding efficiencies in CapEx, I think everything that we are seeing in the Central Network is being very positive. So, you saw that we provided some information about the market in the -- about the market in the way of the Central Network. So, you see that it's a very big market, larger than we expected. There is a lot of volumes that can be transported by containers also that by our less -- has been very positive, also better than we expected before and also the efficiency in CapEx you always have, because when you started (inaudible) and you go to the market to grow the CapEx, you obviously start to get improvement. So, it has been very positive.

We still cannot provide to the market any kind of number of CapEx, but a very positive thing that we can provide to the market is that including the Central Network, we are not changing our guidance in CapEx. That means that we will include the huge part of the CapEx in the North-South in our long-term CapEx guidance.

Rogério Araujo {BIO 17308156 <GO>}

Yes, perfect. Thank you and second question is regarding the accidents that happened in September that prevented room from transporting more volume. So, could you provide more details on what happened and if operations already normalized by October and also if there is any sign of capacity constraints and if this could happen again, so it would be great to get more color on what exactly happened and what to expect going forward. Thank you.

Ricardo Lewin {BIO 20342706 <GO>}

Well, let me start by the end; there is no capacity constraint right now at least and the operations are running okay. Basically what we had -- we had in September two derailments; one (inaudible) that together would total in 50 hours of operations

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interruptions okay, and we had one bunk that happened when I think truck crossed the tracks not respecting the sirens and was hit by our train. It also interrupted the operation for something around 15 hours, okay? So, these were the accidents, but we worked very quickly on that. The time that we lost are precious already, but we offer -- we act very -- we are ready to operate and after these operations are working perfectly well. Just so you can follow during this week, we will be presenting the -- to the market the fallings of October. You can see in our website I think on Wednesday.

Unidentified Speaker

Thursday.

Ricardo Lewin {BIO 20342706 <GO>}

Thursday, sorry.

Rogério Araujo {BIO 17308156 <GO>}

Perfect. Thank you very much.

Operator

Next question comes from Felipe Vinagre, Credit Suisse.

Felipe Vinagre {BIO 19282922 <GO>}

Hello. Thanks for taking my question. I have two questions. First a follow up on the guidance comments, when you said that the North-South CapEx already included in your long-term guidance. So, what's the -- so, could you quantify how much will be the CapEx just for North-South, and on the EBITDA side, does it mean the same that the EBITDA from the North-South is also included in your EBITDA guidance? That's the first question. The second, do you expect any impact from the completion of the pavement of the R163? I know the minister has been vocal about completing the thing that there's going to be some pricing pressure as a result of this completion. These are my questions. Thank you.

Ricardo Lewin {BIO 20342706 <GO>}

Hi, Vinagre. Thank you very much for the questions.

Well, regarding the guidance, it depends that we don't -- we are not changing the long-term guidance because of North-South at least by now. That means that by what you saw in the document of the auction, there was something around BRL3 billion to be invested in the North-South, BRL1 billion, what was the obligation that will be impaired in the network and BRL2 billion in rolling stock. The investments that we are doing in the next 3 years until 2023 three, four years, we are not increasing the guidance. That means we are doing the BRL1 billion in network and we are investing whatever we need in the rolling

stock, okay (inaudible) the volumes we have in Goias and Tocantins, okay, so, we are not increasing the CapEx.

On the other side, we are not changing EBITDA, but obviously the EBITDA generated by the North-South is not included in the guidance that we provided. Once we have we started to negotiate all the contracts for transportation and we have a better view on that, we will provide to the market, okay? So -- but, remember that these are pre operational railways that still need -- one year and half to two years to be ready so the commercial contracts will be decided earlier than that, okay?

Felipe Vinagre {BIO 19282922 <GO>}

Thank you.

Ricardo Lewin {BIO 20342706 <GO>}

The second one about the impact of 163, most probably you saw -- this question, because the volume that went up to the (inaudible) okay. Although we are following 163, it's a competition for our railway obviously, mainly once it's 100% paved.

Important things here that you remember that once the railway is paved, but for the government, it is high debt, so you have additional cost that's through 163. The other thing is that we lost total volumes to their ballpark and for R163, not because the competition of R163, but because the growth of CapEx that we have was lower than the growth of the market, okay? You have a huge concentration of export of corn in three months, so -- and this growth is much higher than the growth of our capacity and that was the main reason to lose capacity, our market share for the (inaudible) and that includes the 163. Important to say that it's huge investment, okay? It's huge investment; this investment, we feel, there is a test that will allow us to take part of the volumes of -- once we are more competitive than the other solutions.

Felipe Vinagre {BIO 19282922 <GO>}

Okay. 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.

Ricardo Lewin {BIO 20342706 <GO>}

Well, this is the last call of the year. So I'd like to thank you for our investors and for the sell side analysts for all the support you gave us during this year, and we hope to meet with you in the next year, okay?

Thank you very much. Bye, bye.

Operator

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

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