

Q2 2016 Earnings Call

Company Participants

- Aurélio Pavinato, Chief Executive Officer
- Ivo Marcon Brum, Chief Financial & Investor Relations Officer

Other Participants

- Márcio de Carvalho Montes, Analyst
- Vincenzo Paternostro, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Ladies and gentlemen, thank you for holding, and welcome to the Conference Call of the Second Quarter Review of SLC Agrícola. We would like to inform that all participants will be in a listen-only mode during the company's presentation. After the company's remarks are completed, there will be a question-and-answer session, and further instructions will be given.

Now, I would like to turn the floor over to Mr. Aurélio Pavinato. Please, Mr. Aurélio, you may proceed.

Aurélio Pavinato

Good morning and thank you for participating in SLC Agrícola's earnings conference call for the second quarter of 2016. Please go to slide three where we will begin with comments on the price variation of our main products in the past few months.

Cotton prices increased significantly in 2016 and already accumulated an increase of 120%. The lower price until the start of this year is still encouraged a reduction in planted area at the global level. After reaching a record of its 36 million hectares in 2011/2012, the cotton planted area is estimated at only 30 million hectares for 2016/2017.

Ending stocks, which stood at 112 million bales in 2014/2015, are expected to reach 91 million bales in the new crop year, which is too high, but it has already fallen back significantly due to the smaller planted area, the sale of Chinese government stocks, and the light recovery in projected consumption for the 2016/2017 crop year. The Chinese government is accelerating its strategy of selling (02:29) stocks, which has had a major impact on the market.

This year, as you can see on slide four, 1.7 million tons had already been sold of the total estimate stocks of 13 million tons in 2015/2016. China's domestic demand is taking the market by surprise leading to higher Chinese prices and consequently higher international prices as well.

Another fact that has been supporting prices in the short-term is a reduction of the quality of the U.S.A. crops this season as shown on slide five. In short, the (03:20) in world stock and great disparity regarding the allocation of the Chinese stocks had created an outlook for prices at the higher levels than last crop year.

In the case of soybean, as you can see on slide six, there was a strong upward move in price related to the shortfall in South America output in the 2015/2016 crop year, and to the higher probability of the La Niña by the end of this year which would increase the risks posed to yields in the United States and southern South America for 2016/2017 crop year.

Recently, however, the soybean market has suffered the correction mainly related to the favorable weather results to-date in the United States, as well as the lower probability of La Niña before year-end. Regardless, note that the U.S. soybean crop has yet to undergo its critical seed-filling phase, which is a period typically associated with higher market volatility and a factor that could be aggravated by the lower stocks and highly favorable demand as seen on slide seven, which shows the evolution in the world soybean demand and the recent drop on stock-to-use ratio.

Meanwhile, international corn prices presented on slide eight are reflecting the more comfortable supply demand scenario, which became clearer with the materialization (05:18) of the significant expansion in the corn planted area in the current U.S. crop. As a result, USD expects the counted (05:29) stocks to record to 52 million tons or 15% of the consumption expected for the year.

In the Brazilian market, however, the scenario is very different. We see high export volumes in 2015 and early 2016. The market suffered the shortage which even created the need to import corn from neighboring countries. Therefore, prices are currently at the import parity instead of export parity and therefore, are currently traded at a premium of up to \$3 per bushel on the price in Chicago.

This situation was further aggravated by the shortfall in the corn second crop, which has reached nearly 22% compared to initial estimates, which represents a decrease in output of 12 million tons. This situation normalize by only middle 2017 with the output from Brazil second crop. Until then, prices should remain high and extremely volatile in the domestic market.

Let's go now to slide 10 where we will comment on operating performance in the 2015/2016 crop year. As we have been saying since the start of the year, this crop year was heavily affected by the drought deficit, the entire Cerrado region, especially by year. The soybean yield has been finalized at 43 bags per hectare.

FINAL

In the case of coastal, however, the low rainfall in April, May and June further reduces the potential yield in relation to the forecast made in early May. As a result, we are revising downward our estimate for the first crop cotton lint yield to 1.25 tons per hectare from the 1.31 tons (08:00) projected in May. Second quarter, however, which accounts for 12% of the cotton planted area, should achieve the projected yield.

The yield of second crop corn planted in the Midwest and in the state of the Maranhão was also revised downwards to 5.4 tons per hectare from initial estimates of 6.42 tons per hectare, we've figured yield (08:35) revision due to the low rainfall in the second quarter of the year.

Precipitation chart showing the weather anomalies in this crop year can be found on slide five (sic) [11] (08:51) which is data for the Panorama Farm in Bahia and on slide 12, you can find data on the Paiguás Farm in Mato Grosso. [ph] This led the farm an (09:04) important area of corn second crop. In short, the second quarter rainfall was only 22% of normal in Bahia and 46% of normal in Mato Grosso.

I will now pass to the call over to my colleague, Ivo Brum, our CFO and Investor Relations Officer, who will comment on our financial results in the period.

Ivo Marcon Brum {BIO 16639894 <GO>}

Thank you, and good morning, everyone. Let's turn to slide 14. Net revenue in the first half of 2016 contracted 14.7% year-over-year, affected mainly by the difference in the allocation of Biological Assets. The lower mark-to-market adjustment of the Biological Assets reflects the expectation of lower margin for this crop year, using (09:59) the shortfall in the yields resulting from the low rainfall. However, note that the mark-to-market adjustments of the Biological Assets was mainly at the farms most affected by the drought.

Due to the early harvest, approximately 80% of Biological Assets were allocated from the farms in Bahia state, while in the case of the cotton cultivated in Maranhão state and the Midwest which will perform better, only 50% of the corresponding Biological Assets have been allocated.

EBITDA in the six months period was R\$65.2 million compared to R\$143.2 million in the first six months of 2015. The lower EBITDA mainly reflects the lower margin in 2015/2016 crop year. However, note that to-date, we have invoiced 100% of the soybean from Bahia and Piauí states, regions most affected by the drought. But there is still a balance of 2,000 tons of soybean output from Maranhão state to be invoiced as well as 96,000 tons of soybean output from the Midwest which will all have better margins.

The company posted a net loss of R\$77.2 million in the period compared to the net income of R\$76.3 million posted in the year-ago period. This loss should be reversed in the second half of the year with the mark-to-market adjustment of cotton Biological Assets from the better-performing farms and with the invoicing of the soybean from the better-performing farms too, as always, of the corn with high prices in domestic market.

FINAL

On slide 15, you can see a summary of our expectation for the second half. We expect to invoice 140,000 tons of cotton in 2016, which means 81,000 tons still to be invoiced in the second half of the year. For soybean, we estimated 550,000 tons, which means a thin (12:42) balance of 116,000 tons for the second half. In corn, we expect to invoice 350,000 tons which means a balance of 320,000 tons to be invoiced.

Another important factor is the exchange rate. As mentioned in the earnings release, the average exchange rate hedged for the first half was R\$2.91 per dollar, while the rate hedged for the second half is R\$3.92 per dollar. So the level of the current hedge was not captured by the allocation of Biological Assets, which considered market price and, therefore, will result in the market expansion in the second half of the year.

Let's move to slide 16 which details our net debt at the end of the second quarter. Net debt increased 6% on the first quarter to R\$1.1 billion. The net debt to EBITDA ratio increased from 3.26 times for 2.47 times (13:51). However, this ratio should end the year below 4 times, especially considering the recovery in the EBITDA is expected for the second half.

I will now pass the call back over to Pavinato for his comments on the next crop year.

Aurélio Pavinato

Thank you. Let's turn please to slide 18, please. The first aspect we want to highlight is the weather factor. The prospects for the upcoming crop year are excellent given the likelihood of the La Niña phenomenon occurring as of the end of the (14:33) year.

As you can see in this chart, historically, the La Niña phenomenon has brought good precipitation levels to the Cerrado region. Moreover, as you can see on slide 19, we have already made progress in our soybean and cotton hedging for 2017. And so far, we have managed to achieve a slight increase in dollar price in relation to 2016, which combined with the stronger Brazilian real hedge for next year leads us to expect improving after harvest 10% in the sales price in local currency.

Added to this is the fact that we are currently projecting a reduction in production cost per hectare in local currency, considering the lower price (15:37) of inputs in dollar terms and the lower exchange rate.

That said, we expect to take advantage of this favorable profitability conditions presented for Brazilian ag business over the next year and more completely for the next crop for which planting will begin next month.

Thank you. Let's now open the call for questions.

Q&A

Operator

Thank you. The floor is now open for questions. Mr. Vincenzo Paternostro of Credit Suisse Bank would like to make a question.

Q - Vincenzo Paternostro {BIO 17670256 <GO>}

Hello. Thanks for the questions. And sorry if my question was answered in the Portuguese call as I was not able to join the Portuguese call. My first question is I'd like to understand what's your view on corn price in the short term. I mean it seems that we had - I mean the second crop (17:07) is going to be quite poor in terms of the yield because of poor weather, right? So current corn price is extremely high. I'd like to understand whether this high corn price is sustainable during the second half of the year.

And what's your view and how this high corn price could impact the planted area for the summer crop, because it seems that we can have some areas shifted from soybean to corn. I'd like to hear your thoughts, to know your thoughts on that possibility? So that is my first question.

My second question, you mentioned that the outlook for the next crop is somehow positive for you, (18:00) is confirmed. So I'd like to understand whether you are back on that, whether you can increase your planted area based on this expectation of a much better weather condition for next year, because at the same time, we have somehow high debt, whether this - what's the strategy for next planting season? Thank you.

A - Aurélio Pavinato

(18:34) So about corn price, as we said the last quarter, our forecast that the corn price really stays all over the year at the import parity price. Usually, the corn price is specified by considering the export parity. So as you know, the corn logistic cost is high from the farm to the port compared to the - of the price. And so, the difference between the price, the parity, export and the import parity is a huge difference. And we are having Brazil this discrepancy between the export parity and import parity since the beginning of the year.

And why did it happen? It has happened because last year, Brazil exported too much corn, we can say. So the ending stocks of the year was too low, and the expectation was to recover this starting during this harvesting, this (19:55) harvesting. And as the yield has been much lower compared with the initial forecast, 22% lower, so it was not able to recover the stocks. So we are forecasting that the price will stay at this level, the import parity, we can say, sometimes is global price on the farming (20:21) compared with export parity like in Mato Grosso.

Export parity today is something like R\$17, R\$18 per bag. Import parity is something like R\$30, R\$33 per bag. So this is the difference in case of Maranhão. Export parity is R\$25 per bag. Import parity is R\$40, R\$43 per bag. So we are expecting to sell our stocks by import parity.

And it's going to last until the middle of next year, because during the summer, today, Brazil is planting 16.5 million hectares or 17 million hectares of corn. From these areas, only

FINAL

Bloomberg Transcript

5.2 million hectares is corn as a first crop and another 11 million hectares corn as a second crop and which region is planted corn as a first crop? Only Southern Brazil or mainly Southern Brazil. And the farms in the Southern Brazil are not shifting so much from soybean to corn. Why? Because the soybean price is good as well and the weather forecast of the La Niña for next year is not good for corn. If we are going to have a La Niña, the rainfall in Southern Brazil will not be good and corn suffers more than soybean.

So this is the reason the planted area in Southern Brazil is not going to increase so much. So I'm quite not sure agri consented (22:18) the planted area will increase only 200,000 hectares corn as a first crop, so not so much. So the stocks will recover only in the second semester which is (22:36) started to recover is the first crop.

In the Cerrado region, the production cost of corn as a first crop is so more expensive compared with the corn as a second crop, that is not interesting to plant the corn as a first crop instead of soybean and corn after (23:01) soybean. So we don't believe that many farms are going to do that.

About our planted area, next year, we are going to plant as much as possible cotton as a second crop instead of as a first crop. So in Mato Grosso, we are going to change 100% of our cotton as a second crop. We are going to start to plant the cotton as a second crop in Maranhão as well. So this change from first crop to second crop, automatically, will increase our soybean area, it's something like 10,000 hectares, and we are going to add in a new farm that we bought last year. Third farm in Mato Grosso, another 540,000 (23:56). And we are going to plant as much as possible corn as a second crop.

So this is the reason we're going to announce there the official planted area number on the October. But our feeling today is that we are going to increase our soybean area and corn area.

Q - Vincenzo Paternostro {BIO 17670256 <GO>}

Perfect. Thank you. If I may ask another question. I'd like to – I mean net debt to EBITDA is somehow high. I'd like to understand how comfortable you are with the indebtedness of the company. Are there – I mean are you expecting a much stronger cash flow to starting deleverage the company or do you have a plan to raise more capital to adjust the capital structure. How comfortable you are with the net debt to EBITDA of the company? Thank you.

A - Aurélio Pavinato

Ivo is going to answer your question, Vincenzo.

A - Ivo Marcon Brum {BIO 16639894 <GO>}

Hello, Vincenzo. So the net debt reached – (25:05) so if you see the net debt compared to the last quarter or at the beginning of the year, the level you can see is almost the same, okay. The ratio, yes, is high level, especially because we reduced our EBITDA, but in the second semester, when you have the cotton available to the delivery and you have

the soybean from the Midwest to be sold, our EBITDA will increase a lot and certain that the level will be lower than four times.

When we did the forecast, of course, we have considered that the full harvest was in our view. The leverage would be in low level nowadays (25:54) in the end of the year will be much lower, okay, but for at least the weather is our (26:00) risk. Okay. And this year we had - there's a strong problem in terms of the rainfall in the Bahia state, but next year, the forecast is much better and certain that you have much better use in the debt, because of that you can reduce our net debt.

Q - Vincenzo Paternostro {BIO 17670256 <GO>}

Perfect. Thank you.

A - Aurélio Pavinato

Yeah, just to add, Vincenzo, we are working to reduce our net debt to EBITDA ratio over the years. Unfortunately, this year, we suffered a strong drought and we lost too much production. This is the reason why we are going to stay at this level. We consider a good level for us, lower than 3 times. So we are going to - but for (26:49) this year, we're going to still be higher, but we are working to go to lower than 3 times over the next year.

Q - Vincenzo Paternostro {BIO 17670256 <GO>}

Perfect. So but just to make sure I understand, so the reduction in the investments should be based on the EBITDA increase, right, not on a potential divestment in land or something like that? Is that correct?

A - Aurélio Pavinato

Yeah. It is the more comfortable forecast. We can have something different, but we are forecasting to increase the EBITDA over the second semester and to reduce the ratio.

Q - Vincenzo Paternostro {BIO 17670256 <GO>}

Perfect. Thank you.

Operator

We have a question from the webcast from (27:45).

How do you see land prices regarding the drought and also the new land of that following (27:57) ownership?

A - Aurélio Pavinato

Mario (28:07), the land price in Brazil over the last year and this year increased a little bit in reais, so increased less than inflation. So we had a real reduction on the price, because the sector is suffering a credit and a cash flow crisis. If you see all the big producer in the Cerrado region, are suffering something like - some effects of the credit limitation and

many farmers where we see high debt in dollars, so when the exchange rate moved from R\$1.8 to more than R\$3, increased the debt.

And the drought added an additional reduction on the revenue. So currently, there is not so good liquidity on the land deals in Brazil. And this is the reason the price stays stable and this to go worse. When we see the profitability of the business today, it is better than it used to be one or two years ago before the real depreciation.

So considering that the land price is connected with the profitability of the business, so the land prices should go up. And if it didn't go up, it's because due to reason I said. So if you look for the future, next two years or three years or four years, and considering that the profitability of the business will be good, we do believe that the land price will continue going up as it has happened over the last 10 years.

Additionally, the legislature that is probably going to change will add, you can see, a stronger change on the market liquidity. So if foreign investors will be able to buy land in Brazil, in our view, the land price will go up faster than it will go with no foreign investors.

So another factor that the land as we are on the international business, are dollar-linked business, 100% of our revenue is linked with the international price, dollar price. Over - in a long term way, the land price is linked with the international land price and we see real depreciation. The land price in Brazil today is much cheaper than it used to be three years ago or two years ago. So this is another factor that will add the value to the land over the following years.

So considering these three factors, we have a potential in the medium term, not a short term, medium term, we have a potential to reach another level in terms of price of a land in Brazil compared the land price that we used to have two years ago.

So in summary, this is our view about the land price in Brazil and the future of the land business in Brazil.

Operator

Mr. Márcio Montes from Banco de Brasil would like to make a question.

Q - Márcio de Carvalho Montes

Pavinato, Ivo, thank you for the opportunity. I'd like to know about the invoiced products, if there was a strategy to the company to invoice the products with high cost of risk just at the movement of the quarter.

And second one, I'd like to know whether you think about the corn prices in international markets and also soybean ones the (33:15) tradition in the United States looks like to be very good price for this year.

A - Aurélio Pavinato

Good morning, Márcio. Márcio, could you repeat the first question, please?

Q - Márcio de Carvalho Montes

It's just to know if the invoiced products for the company during the quarter was a new strategy or was that an original one? Because you've invoiced products with high costs.

A - Aurélio Pavinato

Yeah. During the quarter, we invoiced soybean from Bahia, for example, Márcio, so the soybean from Bahia has yielded us (34:07). Normally, we sell our production (34:12). So we sell 60%, 70% of our production. In case of Bahia, as we locked 35% of the production, so beforehand, we still had probably 100% of our production. So when we harvest our soybean in Bahia, we invoiced everything during the harvest, because everything was sold. So the cost of production of the soybean was very high. So this is the reason why the prices are up, not so bad and...

A - Ivo Marcon Brum {BIO 16639894 <GO>}

But Márcio, that is - our strategy is, in the first quarter, we would sell the Midwest soybean. Second quarter, Northeast soybean. And you keep part of the production, around 40% of our production, you keep for the second half of the year when you have the best price, okay, which is really special (35:12). You follow to the strategy, but you sold 100% of the soybean in the Bahia state, because of the drought and because of the yields.

For the second semester, you keep our Midwest soybean, but we don't have to buy (35:30) soybean because you deliver 1%. This is a part of our strategy to do it.

A - Aurélio Pavinato

Yeah. So this year was a totally different year in terms of the evaluation between the farmers in terms of the amount that was invoiced. Normally so, the stock that we have today is the stock from (35:56) the yields were higher. So this soybean that we're going to ship invoiced over the second semester is the soybean that where the yields were high, where the production cost is lower per ton. So this is the reason (36:12) the second semester soybean that will be invoiced will be high and the price today is high as well.

The second question about the soybean and corn price on international market. So the corn U.S. planted the big corn area, the crop conditions in U.S. you can say is wonderful. So the yield will be very high. So the stocks in the international markets were high. So our view that the corn price will stay in a low level. Low level means between \$3.5 and \$4 per bushel.

Today, the (37:05). So today, it's really, really I can say in the lowest level. The U.S. farmers are not selling the corn by this price. So they are existing to sell the corn, so the base is U.S. went up, the base went up a lot. The base used to be \$0.50 per bushel and the base went \$1 per bushel because the price is too low. So it's a kind of a resistance to sell the

FINAL

Bloomberg Transcript

price by lower than \$4 per bushel in U.S. market, because as we know there, the production cost is something like that, something \$4 per bushel.

The soybean price, the stock is not as so high as corn. This is the reason we have a ratio between soybean and corn to be higher. And we are forecasting that the soybean price will stay at this level between \$10 and \$10.5 per bushel on international markets, so higher than last year, because last year was between \$9 and \$9.5, due to the strong demand and considering our normal production this year, the production will be a little lower than the consumption. So the consumption will move from 313 million tons, the consumption will move to 330 million tons. And the production this year - the consumption was 317 million tons, we moved to 330 million tons.

The production this year will go up, because there's very good crop in U.S. this year. It'll go up, but will still go up to 325 million tons or 326 million tons. So a little reduction on stocks again. So this year, we had a reduction in stocks, 4 million tons, and next year, we are forecast - or actually, USD is forecasting to have a small reduction.

So the soybean market is quite tight. If you have any problem in terms of weather in Brazil, in Southern Brazil, and Brazil lose something like 5 million tons, it's a reason to price the - to the price goes up. Like it happened last year, last year Brazil lost 6 million tons. Argentina lost 6 million tons. The pricing moved from \$9 to \$10.5 went to \$11 at that point (40:11) and then came back to \$10.5, \$10.3 that is today.

So the soybean market is more sensible of the supply. So for any reason, if you have suffered any loss on production and a loss on supply, the prices can go up. So it will be volatile, but can go between \$9.5 and \$10.5 per bushel over the following year.

So a little better compared to last year.

Q - Márcio de Carvalho Montes

Okay. Thank you very much.

Operator

This will be the last announcement. As there are no questions, we close now the question-and-answer section. Thank you. The conference call is finished. Have a nice day.

This transcript may not be 100 percent accurate and may contain misspellings and other inaccuracies. This transcript is provided "as is", without express or implied warranties of any kind. Bloomberg retains all rights to this transcript and provides it solely for your personal, non-commercial use. Bloomberg, its suppliers and third-party agents shall have no liability for errors in this transcript or for lost profits, losses, or direct, indirect, incidental, consequential, special or punitive damages in connection with the furnishing, performance or use of such transcript. Neither the information nor any

opinion expressed in this transcript constitutes a solicitation of the purchase or sale of securities or commodities. Any opinion expressed in the transcript does not necessarily reflect the views of Bloomberg LP. © COPYRIGHT 2022, BLOOMBERG LP. All rights reserved. Any reproduction, redistribution or retransmission is expressly prohibited.

FINAL

Bloomberg Transcript