

Q2 2014 Earnings Call

Company Participants

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

Other Participants

- Alexandre P. Falcao, Analyst
- Paulo Valaci, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning, ladies and gentlemen, and thank you for waiting. At this time, we would like to welcome everyone to SLC Agrícola Second Quarter of 2014 Earnings Conference Call. Today with us, we have Mr. Aurélio Pavinato, CEO; Mr. Ivo Brum, CFO and Investor Relations Officer.

We would like to inform you this event is being recorded and 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. At this time, further instructions will be given.

Also, today's live webcast, both audio and slide show, may be accessed through SLC Agrícola's website at www.slcAgricola.com.br in the Investor Relations section by clicking on the banner, Webcast 2Q14. The following presentation is also available to download on the webcast platform. The following information is available in thousands of Brazilian reais and in IFRS, except when otherwise indicated.

Before proceeding, let me mention that forward-looking statements are based on the beliefs and assumptions of SLC Agrícola 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 the company and could cause results to differ materially from those expressed in such forward-looking statements.

Now, I'll turn the conference over to Mr. Aurélio Pavinato, CEO. Mr. Pavinato, you may proceed.

Aurélio Pavinato

Good morning and thank you all for participating at the SLC Agrícola earnings call for the second quarter of 2014. We may go please with slide three, where we bring a summary of the transactions that we announced Monday with Mitsui. As we've seen on the Material Fact, our company has contribute to the existing joint venture, the operation of Perdizes Farm that will also be part of SLC-MIT. As SLC Agrícola will be the leasing the land of Perdizes Farm to SLC-MIT, we will receive a leasing payment at the market prices. All is right for us (02:35).

We highlight that to maintain a steady stake (02:41) on the JV as part of the (02:44) transaction, Mitsui will acquire shares on the subsidiary from SLC Agrícola for R\$20.6 million besides doing a capital increase of R\$5 million. The management fee received on our company from SLC-MIT will be adjust proportionally to the increase in the planted area. Additionally, SLC will start leasing 4,426 (sic) [5,426] (03:14) hectares at the Maranhão State in a area that belongs to Mitsui. I would like to highlight that the joint venture between SLC Agrícola and Mitsui has been very promising, given the alignment in Q2 and vision of both companies in relation to the future of [ph] agriculture (03:41) what incentivized us to promote the growth of SLC-MIT.

Please we may now move on to slide six where we present the evolution of the international prices of our products for the quarter. Soybean prices traded in Chicago were down during the second quarter of 2014. This drop in prices relates mainly to the forecast of the high inventory (04:11) in the U.S. and globally. 2014/15 season, production in the United States should reach 103 million tons, growth of 15% in relation to the previous year. The developments of the 2014/2015 crop in the U.S. will be very important to define the direction of prices in the second semester of 2014 and beginning of 2015. Issues like lack of rainfall, high temperature during the summer and also the risk of frost in autumn may still reduce the size of the North America crops. It's important to highlight that for the year of 2015, we already have a heavy 26.5% of the soybean sold at the price of \$12.3 per bushel.

Corn is faced a similar scenario. In the U.S., the biggest corn producers despite the lower planted area, the increasing yields in the corn fields (05:25) will contribute to a production of 352 million tons, and increase ending stocks to 45.7 million tons against that 31.7 million tons on the previous crop. The USDA estimates that the global corn production at 2014/15 crop should reach 981 million tons, stable in relation to the 2013/2014 season. Global consumption is forecast to continue to increase in a pace of 2.6% in relation to the previous year. Ending stocks are forecasted at 188 million tons with a stock-to-use ratio of 19.5%, the highest in the three years.

In our case, however, despite the lower prices, due to our high yield geography (06:26) 118 bags per hectare in second crop corn, this crop generates contribution margins. Also in Mato Grosso (06:38) announced the minimum price guarantee program.

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As for the cotton market, the first semester of the year was marked by significant changes, while in China the government give signal of interrupting a cycle of three years of stocks buildup to let the market flow more freely. In other countries, the forecast point out to an increasing inventory for 2014/15 season. This combination of lower necessity of imports by China and the transition to a crop with bigger supply results in considerable reduction in future prices at ICE.

The announcement of the end of direct price support via cotton purchase in China results in significant drop in future cotton price at Chinese trading houses. This perception of lower price in the future should result reduction in planted areas of cotton in following years in China. The reduction should be higher in the Eastern region where up to now, there was no announcement of price subsidy to the producer. So they should migrate to other crops such as corn, soybean, other grains and fruits.

According to Cotton Outlook, the reduction in planted area for 2014/15 crop was 14.7%. Despite the negative scenario for the 2014/15 with the change in the Chinese policy and high inventories, pricing may find a floor (08:24) due to plant risks (08:25) from the El Niño phenomenon especially in India. In Australia, the USDA forecast reduction in planted area from 436,000 hectares to 275,000 hectares at the 2014/15 crop year, reduction of 37% due to the lack of rainfall and lack of water on - storage (08:53) water.

Another important factor is that lower prices will be naturally increase the demand of our cotton fiber and improve its competitiveness against synthetic fibers. The price of synthetic fibers currently in China is around \$0.6660 per pound.

For the year 2014, according to our hedging policy, we already have 91.5% of the cotton sold at the \$0.891 per pound. And for the year of 2015, 9.5% of cotton sold at the \$0.895 per pound, a level much higher than the current prices.

We may now please move to slide eight where we demonstrate the number relative to the performance of our fields at 2013/2014 crop compared to the previous year. During the second quarter, we've seen a larger - higher (10:13) soybean and corn first crop. And at the moment, we are in the harvesting process of cotton and corn second crop. This year, we are achieving much higher yields if you compare to the last year, with increase of 10.4% in soybean, 11.8% in corn first crop, 8.1% in cotton first crop, and 15.1% in cotton second crop what is contributing to the better financial results in 2014.

Now I will pass it over to the colleague, Ivo Brum, CFO and Investor Relation Officer, for the comments on the financial results for the period.

Ivo Marcon Brum {BIO 16639894 <GO>}

Thank you and good morning. Please we may move to slide 10. Our net revenue in the second quarter 2014 increased 24% over the second quarter 2013, mainly due to the increase in the soybean volumes between the periods. Even though partially offset by the reduction in the biological assets at the net revenue. However, it's important to highlight that biological assets does not consider hedging prices. When the products are invoiced

along the second semester, we will recognize the chip-ins (11:36) from the hedge price in the biological assets.

As already mentioned by Mr. Pavinato, we already have 91% of the cotton hedge at a price of \$0.89 per pound. The operational cash generation as measured by adjusted EBITDA in the second quarter 2014 was R\$88.1 million with margin of 24%, increase of 128% in relation to the previous year, what reflect is the margin improvement in the year of 2014. Net profit in the accumulated (12:17) of R\$50.2 million, and we have a good perspective for the second semester, this is on the increased volumes and the cotton price that we'll be invoiced in the second semester.

To conclude, you may now move to slide 11, where we present the breakdown of the net debt. Net debt closed in the quarter at R\$907 million, a low variation against this R\$977 million (sic) [R\$877 million] (12:50) of the first quarter of 2014. The main change occurred in the lines of working capital and trade financing in real, that increased due to the amortization of operations in Constitutional Funds and Trade Finance lines in dollars. The net debt to adjusted EBITDA ratio, however, closed the quarter with reduction in relation to the first quarter 2014 closed in the quarter at 3.3 times due to the improvement in the 12 months [ph] that will make the (13:24) EBITDA as already expected by the company.

Thank you. Now, we will open for questions.

Q&A

Operator

Ladies and gentlemen we will now initiate the question-and-answer session. Our first question is from Paulo Valaci of Brasil Plural. Please go ahead.

Q - Paulo Valaci {BIO 18268142 <GO>}

Good afternoon, gentlemen, thank you for the follow-up questions. My first question is about CapEx. And the current scenario for CapEx is, I was wondering how SLC's mindset with the investment plans have changed, and if you guys could share with us perhaps a guidance for this year and for 2015 that would be very helpful.

And then my second question is about freight rates in Brazil. When you look at what the company has been seeing this year, the question is how freight rates compared to last year and where do you expect them to grow in 2015? Those are the two questions. Thank you.

A - Aurélio Pavinato

Good morning, Paulo. Paulo about CapEx, this year, we are invest we can say in a normal base (14:59). So the total CapEx this year, if you consider the controller company will be between R\$150 million to R\$160 million. If you consider the consolidated number, including the JVs, because in the case of (15:20) JVs are investing, amount of money, especially on Pioneira Farm, the total maybe will be near R\$200 million this year.

For next year, we intend to reduce the CapEx. Probably something like 50% of the amount of this year because, as you know, the scenario of the commodity price for next year is not so good, so we are going to invest less and to focus on efficiency of the company. About the freight. The freight price came down this year compared to last year. Like if you compare like digit, (16:08) the longest freight we have is from middle market (16:12) Mato Grosso to serve (16:13) to Parnaguá.

Last year the prices went to up to R\$330 per ton. This year the freight came down to R\$230, R\$240, and is still at this price. Maybe a few months when the farms have already started (16:33) ship the corn production, the price can go up a little bit, but it's become much cheaper comparing to last year. For next year, probably, the freight price will at this level or maybe lower because if the commodity price will be lower probably the demand of our inputs will be a little lower and so the price - the freight price will be run, we can say, on a lower level compared with last year. Last year was the extreme year in terms of the cost of freight in Brazil. This year, it came back to a normal level, we can say. And next year, probably will be keeping (17:24) at the same level of this year.

Q - Paulo Valaci {BIO 18268142 <GO>}

All right very clear, thank you Aurélio.

Operator

Our next question is from Alexandre Falcao of HSBC. Please go ahead.

Q - Alexandre P. Falcao {BIO 5515455 <GO>}

Good afternoon, everyone. Thanks for the question. My question is regarding perspectives on and where do you guys see the upcoming crop? Do you guys, given the current prices and the current FX, do you see appetite for Brazilian farmers to plant more or at least to maintain it from planted area? And is that going to open some opportunities for growth, specifically for SLC going forward or it's still too early to tell? Thank you.

A - Aurélio Pavinato

Good morning, Falcao. The planted area for the next season 2014/2015 crop year, Brazil will increase the planted area because every (18:28) farmer, they bought fertilizers, they bought chemical, they bought seeds, so everything is ready to increase the planted area. So, (18:39) the growth on the planted area this year will be - will come from new lands and part will come from corn. So, corn is first crop we'll reduce, and soybean we will increase this year.

Because the price came down over the last two months. So, before that, the price was okay, you can say, for the farm. And the farmers in Brazil, they will not believe in that the price will come down, and this is one disadvantage, they just sold (19:15) the product for next year. So, we sold a big portion of our soybean.

But in the oil market (19:23) in Brazil, we are not happy, soybean is no more than 10% of the (19:29) no more than 15% of the total production. Is that - so (19:33) for the Brazilian

soybean business next year, we can say it will be thirsty year (19:39) because in our view, the price will definitely lag or may become (19:43) a little lower than the price for next year.

So next year, the farmers will not work and build (19:53) planted area and probably will reduce some amounts of marginal areas next year, the 2015/2016 crop year. This is our view about the growth in terms of crop areas in Brazil.

Q - Alexandre P. Falcao {BIO 5515455 <GO>}

So that does create opportunities for in terms of acquisitions?

A - Aurélio Pavinato

Okay, okay.

Q - Alexandre P. Falcao {BIO 5515455 <GO>}

And how you guys are positioning yourselves to take advantage of it. Thanks.

A - Aurélio Pavinato

They are. Yeah. So we think this is a large development for (20:29) market prices. As you probably know, we have some efficient farmers having a lower profitability but is having profitability like we are going to have next year. And some farmers in the breakeven and some farmers on the negative financial conditions you can say.

So probably, we are going to have some opportunities to take advantage, some leasing, some maybe - some land (20:59) to buy on a best deal in terms of pricing. So this is the reason, as we intend not to invest so much in terms of the CapEx on our operation, saving money you can say, and to be prepared to take some advantage of some opportunities. So we are going to go slowly in terms of developing (21:26) our land base. So going slowly not spend so much CapEx on that, and save the money to be prepared to take advantage of some opportunities.

Q - Alexandre P. Falcao {BIO 5515455 <GO>}

I'm sorry, Pavinato, just to clarify, do you guys need to give the preference to Landco in those acquisitions, so - and can we expect if there is a - it becomes again a buyer's market, we're going to see first, Landco going all the way up to their limit and then SLC being able to make these acquisitions, is that the case going forward?

A - Aurélio Pavinato

Will be opportunities for Landco or any other project (22:13) you can say.

Q - Alexandre P. Falcao {BIO 5515455 <GO>}

Okay, thank you.

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A - Aurélio Pavinato

Falcao. We believe - we know that the agri business, we have some yield with (22:31) lower price like we are expecting for next year. But we do believe that the following years, the price will go up again. Because the demand for corn, for soybean is growing at 3% a year. So if there is no expansion by the end of (22:48) next year, the demand will be higher than the production next year probably. And all the forecasts here (22:57) are considering a very, very good production this year in U.S. and they are considering as well abnormal (23:08) or a big production in South America, next crop. Because the next year it will be a El Niño year, with El Niño condition, normally, the production in Brazil and Argentina will be good. So this is the scenario for the production and some scenario for the market.

If you have any clients problem (23:27) in Argentina or in south of Brazil next year and no expansion in planted area, in the following year, the price will go up again to a normal level and the profitability will go back into our normal level. So this cycle of lower prices, in our view, is one year maybe two years, but probably if you have some web intervention (23:58), you can say, on production, maybe it will be just one year, if the weather would be wonderful, maybe it can be two years.

Q - Alexandre P. Falcao {BIO 5515455 <GO>}

Okay, perfect, thank you.

Operator

Thank you. This does conclude today's presentation. You may disconnect your line at this time and have a nice day.

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