Q3 2018 Earnings Call

Company Participants

- Aurelio Pavinato, Chief Executive Officer
- Ivo Marcon Brum, Chief Financial and Investor Relations Officer

Presentation

Operator

Good morning, ladies and gentlemen, and thank you for waiting. At this time, I would like to welcome everyone to SLC Agricola Third Quarter of 2018 Earnings Conference Call. Today we have with us Mr. Aurelio Pavinato, CEO; and Mr. Ivo Marcon Brum, CFO and Investor Relations Officer. We would like to inform you this event is being recorded. (Operator Instructions)

Also, today's live webcast, both audio and slide show, may be accessed through SLC Agricola website at slcagricola.com.br in the Investor Relations section by clicking on the banner Webcast 3Q '18. The slide presentation is also available to download on the webcast platform.

The following information is available in thousand of Brazilian reals 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 Agricola management and on information currently available to the company. They involve risks, uncertainties and assumptions because they relate to the 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. Aurelio Pavinato, CEO. Mr. Pavinato, you may proceed.

Aurelio Pavinato {BIO 16456795 <GO>}

Good morning, and thank you for participating in SLC Agricola's earnings conference call for the third quarter of 2018.

Let's go to slide three, please, which has a summary of our yields in the '17/18 crop year, whose harvest was complete in the -- in the year's third quarter. We update our estimate for our cotton linter yield to 1,810 kilograms per hectare, up 1.3% from the figure presented on the second quarter. The figure was also 8.3 above our initial forecast and 6% above the Brazilian average. For soybean, which harvest was completed in the second quarter, the average yield was 3,739 kilograms per hectare, 10.2% above the Brazilian average and 13.9% above the '16/17 crop year. The second straight year of yields well above the trend line is with current strategy of focusing on yield gains and on expanding our advance in relation to the average national yields. The main measures supporting these results were improvement in machinery -- machining (ph) per farm, growth focus on developed areas with a consequent increase in the average maturity of our fields and the investments in precision agriculture to ensure greater crop uniformity.

Let's turn to slide five, where we will begin our comments on the recent price variation in our main products and short term price outlook. Cotton prices are basically at the same level as the start of the year, given the recent declining, which was due to the uncertainties caused by the trade war between the United States and China. In the short term, however, the supply/demand balance for cotton remains favorable, with consumption following a solid upward path in recent years to new records and production growing more slowly which points to yet another year of drawdowns in global stocks. The USDA report on November 8th estimate world cotton consumption of 25.9 (ph) million tons and world cotton production 25.9 and consumption, 27.6 million tons.

In the United States, the world's largest cotton exporter, the USDA data points to production of 4 million tons, 12% lower than last crop year, mainly due to the severe drought in Texas, the country's main cotton-producing state. On top of that the hurricanes Florence and Michael not only caused additional losses in the volume produced estimates at up to 290,000 (ph) tons but they also affected the quality of the fiber produced. Since the Brazilian cotton is of high quality compared with that of the US and Australia, a production shortfall in the United States provided space for Brazil to expand its share of global trade.

In the case of soybean, price charts show -- so you can see on slide six, there was a reduction in prices over the year in Chicago basically due to the confirmation by China of a 25% duty on soybean imports from the United States, which is one of the developments of the trade war seen earlier. Soybean prices were further pressured by the good conditions at the US crop in '18/19 for which harvest is 83% concluded according to the USDA.

Despite the lower price in Chicago, the prices paid in Brazilian real to local producers remain above the level of the year ago, given the Brazilian real depreciation during the year and the premiums in US dollar, the so called (ph) basis currently in the Brazilian market as shown in the chart. Note that price -- currently price in Chicago are not attractive to the US producers, which have led the trade administration to announce a temporary financial aid package for farmers until trade discussion with China are not concluded.

Corn prices, which you can see on slide seven, are also near the levels at the start of the year despite the volatility during the period. In the global market, a second year of production deficit should support prices in the short and medium term. Despite the strong production in United States in the '18/19 crop year, shortfalls in second crop corn in Brazil and the corn crop in Argentina reduce supply during the year. The trade war between the United States and China has little impact on international corn prices since China is not a relevant corn importer. In domestic market, where prices are traded at a premium on Chicago prices, as you can see in the chart, being the shortfall in the second crop the main factor of the support. According to CONAB, corn production was 17% lower than in '16/17 crop year in Brazil.

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

Ivo Marcon Brum {BIO 16639894 <GO>}

Good morning, everyone.

Let's go to slide nine, which shows the highlights from our income statement for the period. Improvements on the operational front supported unprecedented financial results for the nine months period, with adjusted EBITDA of BRL397 million, up 26% year-over-year and net income of BRL373 million, up 60% year-over-year.

On the quarterly comparison, EBITDA and net income were lower. However, in our business quarterly analysis must take into account the context. The lower EBITDA is explained by the fact that the higher percentage of the soybean from the current (ph) crop was invoiced over the first semester as compared to 2017 and also by delays in the shipments, which were postponed to the fourth quarter given the (inaudible) rates. So our expectation for the fourth quarter of 2018 is to invoice approximately another 85,000 tons of cotton, 166,000 tons of the soybean and 130,000 tons of corn.

In the case of net income, the deduction between the third quarter of this year and the same quarter last year is due to the dynamics of appropriation (ph) of Biological Assets since the distribution of the net income among quarters was different in 2018 than in 2017. In 2018, a higher share of the net profit projected for the year was recognized in the first half, with a lower share left to be recognized in the third and fourth quarters.

Net debt (inaudible) increased during the year, but net debt to EBITDA ratio remain at a very comfortable level of 1.45 times. The higher debt balance is explained by the sharp expansion in the planted area for the new crop year, mainly due to the incorporation of a new production unit, Pantanal Farm, and by the significant expansion in the cotton planted area, which pressure working capital requirements.

I will now pass the call back over to Pavinato who will comment on the outlook for the next quarter.

Aurelio Pavinato {BIO 16456795 <GO>}

Thank you, Ivo.

Let's move to slide 12, which has an infographic with a summary of the production cycle. We are finalizing the planting of soybean which was already 8% completed as of November 9th, and are about to start planting cotton. To date, the crops are presenting excellent aspects, given the excellent execution of the planting operations by our teams, combined with good rainfall in distribution and intensity in all regions as you can see on the slides 13, 14, 15 and 16.

Let's go to slide 17 which shows our updated planted are forecasted for the '18/19 crop year. As you can see, due to the excellent conditions for planting soybean we expand the initially projected planted area for -- from 455,000 to 457,000 hectares which is 13% larger than in the previous crop year. Also note that in line with another pillar of our current strategy, which is growing our operations in higher value-crops, we are expanding our cotton planted area by 28% and as part of the continuous efforts to optimize asset utilization the company's total second crop planted area is expanding 18.7%.

On the slide 18, you can see details of the cost per hectare budgets for the '18/19 crop year. Mainly due to the reorganization over the year, the average cost increase in reals is estimated at 19.4% on the previous crop year, considering a budget effect rate of 3.8 for input costs. Note, however, that these effects will be offset proportionally by the increasing revenues given the company's hedging strategy, which has precisely this objective. Therefore, there should be no downward pressure on margins, as you can see on slide 19, which present the company's current value position for '18 and '19 showing good prices levels.

Lastly, given this combination of factors, namely the expansion in planted area, the alignment of costs and revenues and good yields expectation for '18/19 crop year are very positive, leave me to expect high profitability for the coming crop year.

Thank you. And now let's open the call for questions.

Questions And Answers

Operator

Ladies and gentlemen, we will now initiate the question-and-answer session. (Operator Instructions) Thank you. This concludes today's presentation. You may disconnect your line at this time and have a nice day.