Q3 2015 Earnings Call

Company Participants

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

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 Agricola Third Quarter of 2015 Earnings Conference Call. Today, we have with us Mr. Aurélio Pavinato, CEO; and Mr. Ivo Marcon Brum, CFO and Investor Relations Officer.

We would like to inform you, this event is being recorded and all participants will be in listen-only mode during the company's presentation. After the company's remarks are completed, there will be a question-and-answer session. At that time, further instructions will be given.

Also, today's live webcast, both audio and slideshow, may be accessed through SLC Agricola website at www.slcagricola.com.br in the Investor Relations section by clicking on the banner, Webcast 3Q15. The following presentation is also available to download on the webcast platform. The following information is available in thousands 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 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 for participating in SLC Agricola's earnings conference call for the third quarter of 2015. Let's turn to the slide 2, where we still start with the price scenario in the period of our main products. For another quarter, cotton continues to present low price volatility in the international market, remaining within a clear price range since the end of 2014 at around BRL 0.64 per pound.

Additionally, the market pays a premium for our Brazilian cotton, which today disclosed to 4%. Another premium is guaranteed relative to direct sales we make to Asian clients, which represents between 40% and 50% of its total sales where we are able to add this another 6% on international pricing as shown in our heavy position at the earnings release.

Each of all the (03:39) significant contraction of cotton plus the area in the 2015-2016 crop year of 7.7% according to the USDA support prices. On the other hand, the market has encountered resistance at the upper limit mainly due to the high Chinese stocks amidst all the recent years and global economical uncertainty that impact the cost of demands.

China is still a major driver of the cotton market. As we discussed in length in the past few months was the Chinese government's attempt to reduce its stock by selling cotton in the domestic market. Although it initially planned to sell 1 million tons, actually, sales came to only around 6% of this amount giving the products low quality and high price.

Despite China's high cotton stock, the 2015-2016 crop year should end the period of five consecutive years of inventory build. It's also important to point out that China's cotton stock are from previous seasons which allow us to infer that they are of low quality while the market has been demanding cotton (05:15) increasingly higher quality such as that produced in the United States, Australia and Brazil.

Soybean prices in Chicago are confirming the expected reduction toward the level of $9 per bushel. The decline is attribute to the consolidation of the full crop year in the United States which should lead to a more intensive restocking trend in the country.

Despite the higher stock in the United States, a more extensive rebuilding of the world's stocks in 2015 and 2016 will still be depending on the soybean crop in South America which is currently in the planting and initial development phase.

In Argentina, the last favorable exchange parity is discouraging the country's agricultural producers. For the planted area is expected to grow 1% – to reduce 1% from the previous year according to the Buenos Aires Cereal Exchange. In Brazil, CONAB estimates a slight expansion in the soybean planted for the 2015/2016 season to between 32.7 million to 33.7 million hectares for an average increase of 2.9%.

International prices for corn, on the other hand, have been (07:00) in the past several months despite the softer revision to the downside for global demand on the U.S. dairy price disclosed on Tuesday. (07:11) ratio will be practically unchanged between 2014/2015 and 2015/2016 seasons which gives some support to prices.

Additionally, we highlighted that the South America corn crop is still on the early planting phases, so it's still vulnerable to weather variations. Note out that like soybean and cotton, corn sales benefit significantly from the weaker Brazilian real which led to strong sales volume in recent months, especially in export markets where Brazil's competitiveness has increased substantially.

On the next slide 3, we present a simulation in order to illustrate the currency devaluation impact between 2014-2015 and 2015-2016 crop years on profit margins and on increase in production cost in reais. Considering that the gross margin for 2014-2015 is seasonal were of 120%, and that cost were 55% in dollar terms and 45% in reais, and considering an increase of 10% to order costs in reais due to inflation, and of 67% order cost in dollars based on (08:56) effect depreciation for the two crops from BRL 2.4 to BRL 4 per dollar. We could assume (09:08) margin expansion from 20% to 32% considering that 100% of the revenue are in dollars and which prices on similar levels compared to the last year.

Also, (09:28) of the first 2% on production cost, demanding automatically higher working capital. In the case of SLC Agricola, we negotiate reduction on input price in dollars and maximize efficiency on input allocation at the farmers through crop rotation, soil management by not expanding into new areas, and we see that our estimate increase in production cost was up only 17% and we can see on slide 4.

Let's move onto slide 5 which shows a table with the initial estimates for planted area in the 2015/2016 crop year. The initial estimate is of the planted area of 377,000 hectares or 1.9% more than the 370,000 hectares planted in 2014/2015. The increase will be led mainly by the area of corn as a second crop since no additional first crop areas are entering into production this year.

For soybean, we estimate a slight increase of 1.3% while for cotton we project a slightly contraction of 5% to 93,600 hectares, basically due to crop rotation which aims the maximum efficiency of the production season.

On slide 5, we present yields for this 2014/2015 crop year and the initial yield estimates for the new crop. For soybean, we project a yield increase of 4.2%. The average maturity of the field will be higher for the next crop year considering we don't add the new production areas which should lead to yields above those forecasts for the 2014-2016 crop year.

For cotton, compared to the 2014/2015 crop year, we project an increase in yields of 8.8% for the first crop and decrease in yields of 9.7% for the second crop. Sales in last year, (12:17) in April and May reduced the production in the first crop and benefit production in the second crop. We see the reason for our initial projection to call for a reversal of this trend in the new crop year. For corn second crop, we estimate a yield 2.4% below the level achieved in 2014-2015 in line with our historical figures.

By November 6, we have the (12:52) plant 38% of estimated area for soybean including super early and early variety cycles. We believe that's more certain with regard to the planting of the second crop in early January.

Please, let's move to slide 7 where we present a table with results for land appraisal in 2015. As disclosed to the market on August 25, the (13:30) of the hectares owned by the company was up 7% this year validating the thesis that even in various economic slowdown, price of land in Brazil tends to at least follow inflation. The IGP-DI inflation for the 12 months previous to the appraisal was of around 7.4%.

I will now hand the call over to my colleague, Ivo Brum, our CFO and IRO, who'll be commenting on our financial results in the period.

Ivo Marcon Brum {BIO 16639894 <GO>}

Good morning, everyone. Let's move to slide 8 which summarize our income statement. Our (14:20) for the year, EBITDA is BRL 187.9 million, down 17.1% from the same period in 2014. The main factor contributing to this variation was the low EBITDA from cotton prices due to the lower volumes and prices (14:41) in the comparison period.

However, a recovering margin is expected for the fourth quarter. As you can verify on the slide 9, volumes forecasted for the fourth quarter are up slightly 75,000 tons for cotton, 60,000 tons for soybean, and 160,000 tons for corn which had its price of around BRL 4,600 per ton on cotton, BRL 1,232 for soybean and BRL 400 for corn, so higher than the realized priced on this quarter.

Net profit for this first nine months in 2015 was BRL 85.8 million, 62% above the accumulated profit at the same period of the previous year due to the (15:46) recognition which reflected the expectation of the bad margins for the volumes to be delivered over the following months.

Let's move to slide 10 which shows a breakdown of our net debt. Our adjusted net debt increased 14.2% from the previous quarter, from BRL 1.08 billion to BRL 1.24 billion driven mainly by the effect from the exchange variation on the dollar-denominated debt. Therefore, the ratio of adjusted net is debt to adjusted EBITDA increased to 4.4 times in the quarter from 3.6 times in the previous quarter. However, with the expected increase in the next quarter, in the volume of the cotton (16:39) the net debt EBITDA rate of food returned to the levels between 3.8 and 3.9 times.

On slide 11, we demonstrated the main items that impacted the increase in the net debt since the end of 2014. The data shows that the (16:59) in an increase of BRL 200 million on the debt is included to the increase in the amount paid to the suppliers. (17:12) in dollar-denominated. However, it's important to highlight that the weaker real is favorable to our business as you demonstrated on the chart previously.

With that, we have one expectation of the better margins for the following years with consequent bad debt cash generation and reduction in the leverage.

Thank you. And we will now start the question-and-answer session.

Q&A

Operator

Seeing no questions, this concludes our presentation for today. I would like you for attending, and you may disconnect your line at this time. Have a nice day.