Q2 2012 Earnings Call

Company Participants

- Eduardo Machado de Carvalho Pelleissone, Managing Director and Member of the Executive Board
- Rodrigo Barros de Moura Campos, Chief Financial Officer and Investor Relations Officer

Other Participants

- Mark Suarez

Presentation

Operator

Good morning, ladies and gentlemen. At this time, we would like to welcome everyone to ALL's Second Quarter 2012 Earnings Conference Call.

Today with us we have Eduardo Pelleissone, CEO; and Rodrigo Campos, CFO and IRO for ALL. We would like to inform you that this event is being recorded and all participants will be in a listen-only mode during the company's presentation.

After ALL's remarks are completed, there will be a question-and-answer section. At that time, further instruction will be given. [Operator Instructions]

We have a simultaneous webcast that may be accessed through ALL's IR website www.all-logistica.com/ir. The slide presentation may be downloaded from this website. Please feel free to flip through the slides during the conference call. There will be a replay facility for this call for one week.

Before proceeding, let me mention that forward-looking statements are based on the beliefs and assumption of ALL 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 condition, industry condition and other operating factors could also affect the future results of ALL and could cause results to differ materially from those expressed in such forward-looking statement.

Now I'll turn the conference over to Mr. Rodrigo Campos, CFO and IRO for the company for a brief explanation of how ALL's figures are presented. And then Mr. Eduardo

Pelleissone, CEO who will start the presentation. Mr. Campos, you may begin the conference.

Rodrigo Barros de Moura Campos {BIO 16203706 <GO>}

Good morning everyone. I would like to before Eduardo starts, I would like to make some comment about the numbers presented on the presentation here. So in order to better compare the results, the number we presented, will be presented in two different ways. First, consolidated numbers that the numbers of 2012 will be compared with results of 2011 exactly as reported on the financial statement.

But, when we consider results by business unit as we have created Brado in 1st April and created Ritmo in 1st July. In order to better compare result, you compared numbers of 2012 with pro forma numbers of 2011 as this Brado and Ritmo already existed in the first half of 2011.

With that, I would like to pass to Eduardo for his comments. Thank you.

Eduardo Machado de Carvalho Pelleissone {BIO 7120426 <GO>}

Thank you, Rodrigo. Good morning all. We will start with the second quarter and first semester highlights.

Our EBITDA, we were 2.3% in a quarter that we faced a very tough market. In our recruiter business as the first quarter grain production in ALL covered area was almost 60% lower in the first semester. Especially in the South, where the crop decreased 28% and the harvest happened between March and May and in the industrial business, the market environment was also challenging as the industrial production fell 4% in the first semester of 2012.

Our rail volumes increased 2.3% in Brazil pushed by 6.2% growth in agriculture segment. Our average yield decreased 2.7% pushed by the price in the stock market, mainly caused by the decrease of the first quarter as I mentioned.

Our rail operation's EBITDA margin remained stable in the second quarter, reflecting a very good quarter following that we have here in ALL.

Brado's EBITDA increased almost 15% in another good quarter and in Ritmo our volume increased almost 15% that will reflect the ramp up of the new intermodal volumes.

Going to the slide, talking about the ALL consolidated results, the slide number five, our EBITDA increased 2.2% in the second quarter, reaching almost R$500 million. Our net income decreased 17% in the second quarter to R$154 million, it's important to mention that -- the other creation non-cash gain of R$34 million in the second quarter of 2011. Our net income remained stable in the second quarter and in the first half of the year.

Going to the slide number six, talking about the Brazil rail road operation. The rail volume decreased 2.3% in the first quarter as has been said in a very tough market, pushed by a 6.2% growth in -- driven by market share gains. Our rail operation EBITDA margin increased 1.2%, again reflecting a very good cost performance.

Going to the slide number seven. Talking a little bit about the market. Well as the first crop decreased almost 16% in ALL region. The second corn crop which harvest again in the end of July should increase almost 70%. So we should face in the second semester a market pretty similar to the second semester of 2011, when we have more soybean and less corn, this semester we will have more corn and less soybean, pretty much the same volume that we faced in the second semester of 2011.

Going to the slide number eight, talking about our business unit, starting with commodities, in a very tough environment which forced us to use less productive terminals. We were able to grow 6.2% in the second quarter and 8% in the first half of the year.

Pushed by persistent gains without the addition of locomotive and rail market share gains in the port of Paranaguá, São Francisco, Rio Grande and Santos, we changed from 68% to 73%.

We introduced line number nine, even with a 6.2% volume growth and a 3.6% decrease in our yield, our EBITDA margin increased from 56.8% to 58.2% again reflecting a very good cost performance.

Going to slide number 10, talk about industrial projects, in the industrial segment, our volume decreased 8.4% stable in intermodal flows, with a volume drop in food project caused by our one month maintenance in -- facilities and in the food project the delay of the sugar cane harvest postponed the export of sack of bagged sugar in the second quarter.

In pure rail flows our volume decreased almost 15% in the second quarter, several -- volume drop in city construction, reflecting the redesign of the distribution strip that of an important client which eliminate one of our main transportation flows in the region of Paraná.

And in a few product segments where volumes were effected by our weakened general market. And our lower cost in recovery side, which reduced diesel consumption.

Going to the slide number 11, our net revenues went down almost 11% in the second quarter and our EBITDA decreased 9.6%, but our margin changed from 6.3% to 61.1% reflecting again our good cost performance.

Talking a little bit about Argentina in the slide number 12, our rail volumes decreased 9.3%, here it is important to mention that in Argentina where volume decreased 9.3% as well in Brazil the weather problem had severely affected the soybean and corn crop, soybean crop decreased almost 20%, the corn crop in Argentina decreased almost 25%.

And those are part of our main cargo in Argentina which reflects in our road rail volume. We increased our yield in almost 50% in the second quarter reflecting the inflation effect and 50% came from the exchange rate variation.

Going to the slide number 13, I will pass over to Rodrigo to explain Brado, Ritmo and our financial result.

Rodrigo Barros de Moura Campos {BIO 16203706 <GO>}

Thank you, Eduardo. Talking about Brado, the volumes of continuous -- has transported increased 18% in second Q 2012 and 17% in first half 2012.

When we break down this growth among the main corridors. We can see that we keep having a high growth rate on a wide gauge corridor and on a Rio Grande corridors which are the corridors we add assets, we add moving stock this year in Brado. So if you see in wide gauge, we increased volumes more than 50% is compared with the second Q last year and in Rio Grande corridor we more than doubled volumes as compared with last year. The corridor that had up, we had a weak performance in Mercosur corridor which goes from Sao Paulo to Buenos Aires, given all the customs restriction we faced in Argentina in the first half 2012 and volumes in Mercosur corridor went down like 25% in the second Q and Mercosur corridor is represented here, which represented like 30% of Brado volume last year.

So volume growth in Brado was good around 20% but it could be even better if it was not those problems we faced in Argentina.

When we go to slide 14, we see that Brado net revenues grew 17% in second Q and EBITDA increased 15% reaching R$10 million in second Q, in the first half revenues grew 17% and EBITDA also grew 16%.

Going to slide 15, in Ritmo, we see that the volumes in Ritmo increased 15% and it was pushed basically by the intermodal volumes. Remember that when we started Ritmo, the main opportunity that we used to see for this business was all this vast intermodal market around the rail network to connections, with certain connections to the rail road network that we would like to explore in a very asset light way.

And Ritmo is helping us in terms of volumes in the intermodal business. When we started this business there was no intermodal volumes in Ritmo.

And in the first Q Ritmo transported 2 million driven kilometers in the intermodal unit, in the second quarter it's increased to 4 million driven kilometers, so it more than doubled in the period, showing the -- how fast of the intermodal business.

In the opposite direction, we have the automotive segment, which had a very weak quarter. I mean volumes in the automotive segment went down 50% basically because of the customs restrictions in Argentina which affected the operations to the Mercosur which are the main, the most representative portion of the flows in the automotive segment and also because of the huge drop in demand for the automotive segment after the change in the user registration, it was new -- for the new trucks.

Going to slide 16, we see that net revenues of Ritmo grew 16.1% in the second Q and the EBITDA decreased 14% and here it's important to make a point, because the decrease in EBITDA is very linked to the automotive segment for the reduction as I explained.

The growth in the intermodal volumes, which was representative, was important but these few don't have a material margin in the intermodal business as we created the structured, the fixed cost structure to support and to growing this business, but as the business help us, the leverage should -- the operational leverage should play its role and the margin should start to grow and reach the level we expect.

When we go to page 17, we see the growth in consolidated net revenues, net revenues grew 10.4% in first half '12 as compared with first half '11, as was consolidated all the business, so as it was mentioned it is a result of growth in revenues in our rail road business, but also has other contributions of the other business of ALL.

Going to page 18, EBITDA grew like 4% and EBITDA margin decreased from 50% to 47%, important to mention that the reduction in EBITDA margin doesn't reflect the reduction in margins of each business, if you see on the rail road business the margin increased, in Brado business the margin was flat, but given the growth in this new business which have a margin that naturally is lower than the margin that we have in rail road, the average margins went down basically as a result of the new properties.

Going to page 19, the consolidated net income, we see that net income decreased from $186 million in the first half '11 to $152 million in first half '12, but when you exclude the extraordinary gain we have, when we created Brado in second Q '11 which was R$34 million, we had a net income which is exactly the same amount as last year.

Going to slide 19, we see the balance sheet. The leverage in our balance sheet in the end of first half '12, the leverage is a little bit higher than in the end of 2011 and that's exactly the construction of on the Rondonópolis, the CapEx that we are having with the project of building homes in Rondonópolis.

But it will be concluded at the end of this year and from the next year on. We start to reduce the company's leverage.

With that, I would like to pass to Eduardo Pelleissone to make some additional comments.

Eduardo Machado de Carvalho Pelleissone {BIO 7120426 <GO>}

Thank you, Rodrigo. Some additional comments. For the second semester of 2012, we might have not -- scenario as we faced in the first semester of the year in the states of Mato Grosso, São Paulo and Paraná.

Driving by the second con call, we -- where we said we expect it to grow 70% compared to the last year and the sugar cane harvest that should speed up and sugar exports are expecting to increase in the second semester.

Our spot prices should recover to the same level that we had last year driven by the improvement in transportation demand and diesel price that increases in July. We are very positive about our new business, and I told you about Brado, at end of the customs restrictions in the border of Brazil and Argentina. And the improvement in the transportation demand especially in the large gauge should speed up Brado's volume for the rest of the year. And Ritmo as we said, -- to support this intermodal volume growth.

I think that we advanced in the main -- got the approval of the deal, in port -- license that drilling works on the line started. And keep advancing governmental license and -- project.

Overall, it's well underway to be finished by the end of 2012. We know that it's very important that in order to become free cash flow positive in 2013.

That being said, I will open for questions.

Questions And Answers

Operator

Thank you. The floor is now open for questions. [Operator Instructions]. Please hold while we pull the question. Mark Suarez from Euro Pacific Capital is online. Please go ahead.

Q - Mark Suarez {BIO 16366613 <GO>}

Good morning everyone. I just have a question regarding volumes to start off, I know during the quarter industrial volumes reflected negative.

I mean just looking at my numbers this is the first time since the third quarter of 2010. And I am wondering do you expect to see more of the same for the second half, with growing still intermodal volume sort of offsetting some of the losses in fuel products as well as construction traffic.

A - Eduardo Machado de Carvalho Pelleissone {BIO 7120426 <GO>}

Mark, you're right. We face a very stiff scenario in industrial market and if we increase -- rate the very weaker -- in the industrial segment, industrial production went down like 4% as compared to the same period of last year, and also because of some problems in the specific segment.

For example, if you go to the fuel segment which represents like 35% of our volumes. The ethanol volume this year should be weak all over the year given that the sugarcane crop is being more used to produce sugar than to produce ethanol, given the price and given the profitability of those segments.

So I don't anticipate an improvement in terms of market for the industrial segment as a whole. But we keep trying to add projects in our intermodal business.

And I believe this will be natural growing segment of the company, we have that agreement that we signed, we have entered Brado for example which alone represents like 7% of all the industrial business that we expect to start to offering at the end of this year or beginning of next year which is a big agreement for the company and we have today around 20, 25 projects that we are discussing in our commercial areas with clients at different stage of maturities to add volumes in our intermodal business.

It's true that when the industrial production went down even the old projects that were -- are already in operation volumes also decreased, but the idea is exactly to add projects in order to offset part of the volume decrease in the market.

Q - Mark Suarez {BIO 16366613 <GO>}

Right, and having said that, would you expect let's say I think you reported that, sugarcane harvest is being delayed and as that improves and picks up can some of that go in to ethanol and improve your fuel product traffic in the second half or is that not really possibility at this point?

A - Eduardo Machado de Carvalho Pelleissone {BIO 7120426 <GO>}

I expect that this year sugarcane will be much more directed to sugar, where the profitability is better.

Q - Mark Suarez {BIO 16366613 <GO>}

Yeah.

A - Eduardo Machado de Carvalho Pelleissone {BIO 7120426 <GO>}

So we benefit from the sugar but we'll be affected on the ethanol.

Q - Mark Suarez {BIO 16366613 <GO>}

Got you. And now turning to Ritmo I know now this business has performed quite well over the past quarter. I know you reported weak automotive volumes during the quarter, what are your expect -- are your expectations therefore in rebound in automotive volumes for the second half of this year? I mean how you see that business progressing through the balance of the year? Just want to get the better sense of Ritmo.

A - Eduardo Machado de Carvalho Pelleissone {BIO 7120426 <GO>}

Yeah, we haven't seen that. I mean at this point. Remember that in the automotive segment of Ritmo we have basically volumes of trucks and our flows are between Brazil and Argentina. So I mean we're not seeing a recovery on the -- yet but hard to anticipate that. I mean it's possible that some recovery happens along the year but it's hard to anticipate

Q - Mark Suarez {BIO 16366613 <GO>}

Got it. And this is my final last question. I know margins improved despite the weak traffic. I think you've mentioned you've done a fairly good job in controlling cost. I believe you've seen some improvement in your consumption. I know we did last year. You also reported decrease in dredge and logistics cost. Will most of those cost can back as soon as volumes begin to accelerate again or do you think that some of those expense items can be sustained if not improved going forward.

A - Eduardo Machado de Carvalho Pelleissone {BIO 7120426 <GO>}

I mean as you mentioned part of the gain is related to diesel consumption and is a sustainable gain. We shouldn't see the consumption increase again. Those are the productivity gains that we are focusing. And in terms of other cost like fixed cost restructure that we also cut, it also is a permanent cut not a transitory effect

Q - Mark Suarez {BIO 16366613 <GO>}

Got it. Okay that's all I got for now. Thank you.

A - Eduardo Machado de Carvalho Pelleissone {BIO 7120426 <GO>}

Thank you.

Operator

[Operator Instructions]. There is no further question at this time I will turn the call over to Eduardo Pelleissone for final consideration. Mr Pelleissone? Can you give your final consideration.

A - Eduardo Machado de Carvalho Pelleissone {BIO 7120426 <GO>}

I would like to thank you all. I will wait for you guys in the next quarter with better results. Thank you.

Operator

Thank you. This concludes today's ALL's earnings conference call. You may disconnect your lines at this time.