

Q3 2015 Earnings Call

Company Participants

- Guilherme Machado, IR Manager

Other Participants

- Mark Suarez, Analyst

Presentation

Operator

Good afternoon, ladies and gentlemen. At this time, we would like to welcome everyone to Rumo ALL Third Quarter of 2015 results conference call.

Today, with us, we have Mr. Julio Fontana CEO; Mr. Jose Cezario, CFO and Investor Relations Officer; and Mr. Guilherme Machado, Investor Relations Manager. We would like to inform you that this event is recorded. And all participants will be in a listen-only mode during the Company's presentation. After Rumo ALL's remarks, there will be a question-and-answer session for industry analysts. At that time further instructions will be given. (Operator Instructions)

The audio and slide show of this presentation are available through live webcast at ir.rumoall.com. These slides can also be downloaded from the webcast platform.

Before proceeding, let me mention that forward-looking statements will be made under the safe harbor of the Securities Litigation Reform Act of (1995). Forward-looking statements are based on the beliefs and assumptions of Rumo 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 conditions, industry conditions and other operating factors could also affect the future results of Rumo ALL. And could cause results to differ materially from those expressed in such forward-looking statements.

Now, I will turn the conference over to Mr. Guilherme Machado. You may begin your conference, sir.

Guilherme Machado {BIO 17920567 <GO>}

Good afternoon. Welcome to Rumo ALL's third Q 2015 earnings conference call. As announced in the second earnings release after the acquisition of ALL by Rumo, which

was formally approved on April 1, 2015, in this presentation, we will cover the consolidated results as well as our business earnings results, which are divided into North Operation, which accounts for the North Network, Paulista Network and the port terminals that we control in Santos Port in Sao Paulo. Also we have the South Operations, which includes the West Network and the South Network. And the Container Operations, which is the results of the container operations which includes Brado Logistica.

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So in line with the earnings release of the second Q 2015, in this presentation, we've also included the combined results for Rumo and ALL for previous years in order to have a better comparison of our performance, operational and financial performance.

So starting, I would like to move ahead with the consolidated results in this slide number 4. So we had a good operational performance in the quarter. So the total volume increased 6.3%, reaching 12.5 billion RTK in the quarter. And the growth was mainly driven by 14% increase in the total volume of the agricultural projects transported in the quarter, especially corn, in line with CONAB's outlook for a strong second corn production in the second half of 2015.

On the other hand, the volumes of the industrial products decreased 18%, mainly impacted by decrease in the fuel volumes as a result of the economic slowdown and also the interruption of some flows in the West Network as we have mentioned previously in the second Q 2015. And also a decrease in volumes in pulp and paper segment, both in the South and North operations as -- I'll explain this better as we move forward in the presentation.

So our consolidated average yield increased by 18.5%, reaching BRL90 per thousand RTK in third Q 2015 compared to BRL76 per thousand RTK in third Q 2014. The port elevation volumes at our terminal in Santos increased by 20%, reaching 3.8 million tons elevated in the quarter mainly due to the peak of the harvesting season of the sugar and an additional volume of corn which was a product that we haven't elevated in third Q of 2014.

So as we move forward to our financial performance on a consolidated basis in the slide number 5, we see that we have a very good performance in third Q 2015 compared to the previous quarter of last year. So consolidated net revenue increases by approximately 22%, reaching BRL1.4 billion mainly due to a combination of good operating performance as we saw very strong volumes in the agricultural products and in the port elevation products. And also an increase in the average yield of transportation. As a consequence, we have an increase in our EBITDA of 3%, reaching BRL552 million in the quarter, while our EBITDA margin decreased by 7.6percentage points. So in essence, this margin decrease was affected mainly due to increase in the maintenance costs in third Q 2015 in a total amount of approximately BRL92 million, in line with the new accounting procedures of the Company. So in third Q 2015, we registered a net loss of BRL43 million mainly due to higher costs, as I mentioned maintenance costs. And also financial expenses that I'll detail better moving forward in our presentation.

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So the net banking debt increased 3.5%, reaching BRL7.3 billion compared to BRL7.1 billion in second Q 2015. And our leverage moved from 4.97 times net banking debt to EBITDA to 4.85 times, mainly due to the improvement of our EBITDA of last 12 months, in line with the improvement of our operations and better performance in the overall business.

So I would like to move now to our business segments, starting with the North Operations and with a market overview. So North Operations delivered very solid results in the quarter, reflecting the operational gains from improvements not only in our rolling stock. But also in our improvements in the port and rail structure.

So there're some very important market data that I want to highlight that also contributed to our good performance. The grain production grew in absolute terms in a very good sense compared to (2013-2015) crop year. There was an increase of approximately 12% of soybean crops yield and also 13% in the second corn crop compared to the previous year. So this is mainly due to the productivity gains and expansion of the planted area in almost all producer states in Brazil, mainly in the Midwest region, center-south region and Parana, which is the state that we have our operations. So also in the Santos port, we saw an increase in grain exports of approximately 12%. And the spot market road freight, which means the freight in Rondonopolis to Santos stretch, which is a very important stretch to our operation, increased at roughly 17% in third Q 2015 compared to third Q 2014. So this information is just to give a highlight that all this very good performance of the agricultural products contributed to a good performance of operations. As you may know, 70% to 80% of our volumes are related to agricultural products.

So if you take a look to our volumes in agricultural products, we grew 40% in the corn volume transported mainly to a good pricing environment due to the devaluation of the real, which increased the demand of corn from Brazil. In the sugar, we saw a decrease of 15% in the total volume transported by the rail. So in the volume of industrial products, we saw a decrease of 73% in pulp and paper volumes, mainly due to two reasons. There was a very strong base of comparison in third Q 2014 in which we observed a very huge volume of pulp and paper of a client of the Company. And in this quarter, we have reduced the volume we serve at our plants, mainly to a decision of this important client to operate with trucks in Santos Port terminal. On the other hand, the fuel volumes increased mainly due to operation, the start-up of the operations of Raizen and Ipiranga in Rondonopolis terminal in Mato Grosso, which increased our industrial volumes as a whole.

So moving forward to the operational and financial performance of the North Operation, we saw an increase of approximately 16% of volumes transported, reaching 8.1 billion RTK, reflecting the very good volumes of agricultural products as I explained, especially corn. And also the operational gains that we saw in the quarter related to increased capacity due to a greater availability of our assets, locomotives and wagons. And also the improvements of the rail structure and port assets. So as the consequence, we saw 30% increase in our net revenues reaching BRL972 million in the quarter, driven by higher transportation volumes and approximately 21% increase in our yield, reaching roughly BRL91 per thousand RTK. So as a consequence, we saw an increase of approximately 18% in our EBITDA, reaching BRL490 million in third Q 2015. And our margin on the other

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hand decreased (5.5 basis points) to 50.4%, reflecting an increase in cost and expenses related to maintenance.

So moving to the South Operations and the market overview on chart number 8, here, as I explained in (inaudible) in North Operations, in Third Quarter of every year, we tend to see a very strong corn crop due to the seasonality of the (Q2). But in this quarter, we saw a different situation here in the South Operations. We saw a very strong crop season for soybeans, which increased 16% according to CONAB figures. And also we have the rainfall which delayed the soybean crop to the mid of the quarter. So as a consequence, we saw a 34% increase in the total volume transported of soybean, as a consequence of these two sectors that I just mentioned. And the beginning of the corn harvesting, which increased our volumes by 14%.

In the sugar, we saw a lower demand and lower transportation volumes mainly due to a very tough condition for pricing for producers which was trying to operate a better schedule for shipments of sugar due to these market conditions. In the fuels, we saw a lower demand of fuels mainly due to a result of the economic slowdown and also due to the interruption of fuel flows in the West Network since second Q of 2015. So in pulp and paper, we saw a reduction in volumes mainly due to a reduction of some flows of our clients, then also an interruption of a plant of an important client in the south region.

So moving to the financial and operational performance of the South Operations in the slide number 9, we saw a decrease of volumes of 7.6%, reaching 3.8 billion RTKs, as I mentioned, as a consequence of lower industrial volumes, particularly fuels and pulp and paper products. But we saw an increase in revenues of roughly 9.5%, reaching BRL318 million mainly due to the increase of our yields of approximately 18% in the quarter, reaching BRL83 per thousand RTK. EBITDA of South Operations reached BRL85 billion in the quarter. And we saw a decrease in our EBITDA margin that reached almost 27%, particularly due to higher maintenance costs, in line with the new accounting procedures adopted by the Company.

So moving forward, I would like to move to the Container Operations. In the Container Operations, we saw a reduction of approximately 7% in the total volume transported compared to the same period last year, mainly due to lower volumes transported in the Rio Grande do Sul and Mercosur corridors and also a loss of a very important client in the Container Operations. As a result of these lower volumes, EBITDA was negative in BRL24 million in third Q 2015. And also contributing to these negative results, we have fixed and variable costs higher than expected in this quarter.

So moving to the next slide, I would like to move back again to the consolidated view. So looking to our net banking debt in a consolidated view, it increased by 3% reaching BRL7.3 billion, equivalent to a leverage of 4.85 times net banking debt to EBITDA, which is approximately 2.5% reduction compared to the second Q 2015 as a result, that I just mentioned, of the improved last 12 months' EBITDA in line with the improvements of our operation and (inaudible).

The main movements in the quarter for our investments is BRL220 million from BNDES FINAME line, BRL200 million for banking credit note. And BRL72 million in 4131 loan. And also refinance of export credit note of BRL100 million. We have a total (amortization debt) of BRL384 million in several lines like FINEM, FINAME, debenture and other debt. It's important to mention that all our debt is hedged against variations of exchange in currency.

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Moving to our financial result and cash flow, I'd like to highlight that we have an increase of approximately 50% of our total financial expense compared to third Q 2014. This is mainly related to the increase of the average balance of our debt and also an increase of the interest rates in the period, mainly related to the increase of CDI. But it is important highlight another important factor. As I mentioned, we have debt denominated in foreign currencies, which all of them are headed against the exchange variation and they are protected. But also we have instruments that have transformed fixed interest rates to floating rates in some of our debt. And as you have followed, due to the increase of the future interest rates in the market, it impacted our financial expenses in a total amount of approximately BRL70 million, which is a non-cash expense. So if we were to exclude the effect of BRL70 million in our total financial expense, we should have reached BRL330 million in the quarter, which is an increase of approximately 24% compared to the third Q 2014.

Moving to our cash flow, the cash flow from operations reached BRL598 million in the quarter and the total investments in the period was approximately BRL388 million. And cash flow from financing approximately BRL136 million, which gives us a total cash generated in the quarter of approximately BRL74 million.

So moving to the operational improvements, which is a section that we're bringing in order to show how we're evolving with the investment plan, I would like to move to slide number 13 with the operational improvements in the North. So we registered record of shipments in Mato Grosso in August, totaling 1.5 million tons shipped in this quarter, which is equivalent of 587 freight cars a day, which is very expressive.

Following our fleet (renew), we received until September approximately 38 new AC44 locomotives from GE and 336 new HPT railcars. With these new assets, it was possible for us to negotiate new volumes to be transported in the second half of 2015. And also we follow a reduction in transit time between Rondonopolis in Mato Grosso to Santos Port in Sao Paulo by nearly 6%, also reducing the freight car cycle by approximately 17 hours.

So moving to chart number 14, we see the operational improvements in the South Operations. We received until now 86 HPE railcars, already in operation in our main corridor from north of Parana State to Paranagua Port. We follow the renovation of a very important bulk terminal in Port of Paranagua where we resumed operation in second Q 2015. And we expect to complete the renovation by the beginning of 2016. And we already started the tests of a new locomotive, Model ES43 from GE, which was a tailor-made design into our operation in the south region.

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So lastly, I'd like to move to our guidance on page 15. I'd like to reinforce the guidance that we've revised in the Second Quarter of the year. There is no change. So the ranges for EBITDA are BRL1.75 billion to BRL2 billion by December 2015. For total CapEx, the range is still the same, BRL1.7 billion to BRL1.9 billion. And divided by the recurring CapEx of BRL800 million to BRL900 million and the expansion CapEx in the range of BRL900 million to BRL1 billion.

Well with this, I conclude my presentation material that we have to share with you. So I'm here along with Julio Fontana our CEO. And Jose Cezario, our CFO and also our IR team and our financial team that would help us in any questions you may have in our figures in our presentation. So thank you, everyone.

Questions And Answers

Operator

We will now begin the question-and-answer session for investors and analysts. (Operator Instructions)

Mark Suarez, Pacific Capital.

Q - Mark Suarez {BIO 16366613 <GO>}

I guess my first question relates to the relationship between rail tariffs and trucking pricing, especially in the northern part of the country. I'm wondering do you feel that, given truck pricing as we see it today, rail pricing can continue to improve in the Fourth Quarter? And how do you see that tracking in the Fourth Quarter and as we go into 2016?

A - Guilherme Machado {BIO 17920567 <GO>}

So Mark, yes, we saw recently an increase in truck freights, especially in the corridor in the north operations. And well, what happened is that for the most part of our volumes, we have fixed contracts which establish fixed tariffs and we have a stake of our total volume, which is on the spot market. And in this stake of volumes, we have an opportunity to move tariffs in line with the tariffs in the truck freight market. And this is the opportunity that we have in this stake, which is approximately between 30% of our total volume that we transport.

Q - Mark Suarez {BIO 16366613 <GO>}

Okay, that's helpful. Then moving on to sugar volumes, I know you mentioned that sugar volumes were a bit more challenging because of the carryover effect. I'm wondering how much can they carry over, for how long can they carry over? I know that commodity prices have come down and they would like to see better pricing (tariff) sugar. Do you think that we might potentially see some of that sugar volume coming back in the Fourth Quarter, maybe potentially Q1 2016? How do you see that trending over the next six months?

A - Guilherme Machado {BIO 17920567 <GO>}

Well Mark, there is some flexibility in the producers in order to operate this carry-over shipments of the cargoes of sugar. But not that much. We think that for the last quarter of the year, a huge volume of sugar will be transported and exported through the main ports that we operate. So we have a view that huge volumes will be moved to Santos, mainly in Paranagua, by the end of the year, maybe beginning of next year. But not more than that. This is the maximum flexibility that we see in these overall cargoes.

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Q - Mark Suarez {BIO 16366613 <GO>}

Okay. And that's helpful. Then maybe moving on to your operation improvements, I see that you've done a lot of improvement as of late. You've added some locomotives. I'm wondering if you can give us an update on the Campinas-Santos stretch and the double track there, how's that's going. And if you see potential to adding maybe more double tracks, double stretch if you will, maybe some siding extensions in addition to the stuff that you've done so far?

A - Guilherme Machado {BIO 17920567 <GO>}

Well the plan is, moving forward -- we have implemented several initiatives that are already turning into more efficient operation in overall network as the beginning of the operations of the new locomotives, in line with the program to renew our fleet. Specifically with the duplication of the Campinas-Santos stretch, the huge gains of efficiency are already in play. There is almost no other initiatives to be done in this duplication. So it's almost in place, the efficiency we have to gain. And we imagine that until the end of the year, with these new rolling materials, we -- Cezario highlighted in the Portuguese call, we are operating approximately just (one quarter) with these new rolling materials. So there is more to come with these efficiencies, with these new equipment. And we imagine to continuously improve the operation with all the investment plan that we're doing.

Operator

(Operator Instructions) This concludes the question-and-answer session for investors and analysts for today.

A - Guilherme Machado {BIO 17920567 <GO>}

I'd like to thank you all for joining to our conference call for the Third Quarter of 2015 and thank you everyone.

Operator

That does conclude Rumo ALL audio conference for today. Thank you very much for your participation and have a good day.

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